I'm far from a sophisticated investor, although I guess I am an accredited investor because of my networth. As I have [written before,](#) I'm a big believer that whenever you do a business deal with people you don't know, particularly buying and selling stocks, you always look for the sucker. If you don't see the sucker, then you are the sucker.

I have found myself on both sides of trades. I've been the sucker, buying stock in companies that turned out to be far from what they said they were, or even who the principles said they were. I've watched in amazement as the internet bubble went to the moon with the entire world ignoring the history of technology stocks. Anyone who tells you they have never made a mistake in the market is either lying to you or never traded in the market.

Today's boom stocks are hedge funds that are going public. Fortress could be the netscape of the boom with Blackstone and many others to follow. Would I buy ? No. I personally would never buy stock in a public hedge/private equity fund. Ever. My position is based on basic common sense and a rudimentary understanding of the hedge fund business. Here is the logic:

When you are an investor directly into a hedge fund you have 1 single element of leverage on the hedge fund , and that is the ability, often with very stringent limitations, to pull your money from the hedge fund. That is it.

That leverage is mighty however, particularly for the bigger investors in the hedge fund. Why ? Because when an investor pulls a significant amount of money from the fund, it creates a cascading series of problems.

It may cause the fund to have to sell securities in order to pay back the investor while still retaining their required or chosen cash levels.

The more leverage the fund uses, the more the cash problem is leveraged as well.

A fund's "scoreboard" is their return and their amount of assets. Its also their marketing pitch. If they perform, they can draw more money into the fund if its open, or to their next fund if its closed. If they don't outperform, they can usually forget about growing or their next fund. Its unfortunate, but you rarely if ever hear about the hedge funds that closed unless they were absolutely huge.

Hedge funds obviously don't want their big investors to withdraw, so they work incredibly hard to make sure they outperform their peers. As the number of funds has grown, so has the difficulty to outperform. There are so many funds chasing the same deals in every area of specialty that the funds keep on investing in riskier and riskier deals. All in hopes of keeping their "money happy"

Bottomline is that hedge funds scramble hard each and every day to make their big investors, some of which can leave on the drop of the hat, happy.

Appeasing hedge fund investors is a very, very different business than making shareholders happy.

If a shareholder sells their share of stock, the hedge fund wont really care. Sure, they want the stock price to go up. They own shares of stock in the fund, and as the stock price goes, so goes some percentage of their networth. That should be enough for them to do whatever it takes to increase the stock price, right ? Maybe

Increasing the price of a share of stock is as much marketing to create demand for the stock as it is earnings of the fund.We also call this increasing the P/E of a stock. There are dozens of ways to increase the PE of a stock that is showing a profit. Hedge fund investors care about 1 thing. Cash. Money that is returned to them. Shareholders care about the price of the stock. One is capital returns, the other is capital appreciation.

That difference is just common sense, but its significant.

Which makes me wonder why those who put money into these hedge funds are letting them take the fund public. It will certainly change how the fund invests and manages its assets, even if the fund says it wont.

They can't be responsive to shareholders and investors with the same story

Hedge funds are known for laying it all out on the line and doing the big deals. Often ones considered to be crazy by outsiders, but smart by insiders. They are the ones buying the lousy or stagnant public companies and taking them private, remastering them, only to reissue them to the stock buying public investor a couple years later at multiples of their investment.

How many public companies do you know that are known for their risktaking ? That gladly take outsized risks that some consider crazy,and do they do it on an ongoing basis ? How many public companies do you know that aren't focused on hitting "the number" to keep shareholders happy ?

The hedge funds that are staying private have to be licking their chops. Competing against public hedge funds that have to deal with reporting and disclosure requirements is a lot easier than competing with a company that is stealth in their actions. They also know that despite proclamations to the contrary, the public funds will certainly change how they approach investing to make the market happy. The earnings of public funds impact the brand of the fund. If earnings are good, its business as usual. If earnings are bad, and / or the stock underperforms, then the public fund's brand , and their ability to raise money is diminished.

Finally, the IPO also seems to put public shareholders on the opposite side of the ledger of those that have invested in the fund directly. Shareholders participate with management in the earnings of the fund, while those who put cash into the fund participate in the returns of the investments of the fund. Of course, the higher the return on investments, the greater the income of the fund itself and the numbers allocated to public shareholders. But fund investors returns are also a function of how much or how little management takes off the top. This isnt a problem when things are going great, but its always a problem when things aren't going great.

This post isn't expert commentary. Its just a friendly heads up based on what I see.

If you are looking at investing in any hedge fund stock, take a long, hard look at the business,IN PARTICULAR, the tax consequences of the investment and your place as a shareholder before you buy. If you are looking at just getting in and hoping it goes up because its the hot company in a hot industry… Welcome to 1999