

Investors Take a Pass on Goldman

By Tom Taulli June 19, 2007

1 Recommendation

With some of the smartest minds on Wall Street, it seems natural that **Goldman Sachs** (NYSE: [GS](#)) would be top-notch in the hedge fund world. But over the past few months, scuttlebutt has circulated that things may not be so golden. The latest negative story came this week from the Financial News Online, which said that second-quarter inflows into Goldman's alternative investments were nil.

A [hedge fund](#) tries to achieve positive returns despite market conditions. This often requires complex strategies like merger arbitrage, short selling, and currency bets. With a 20% fee on the profits, a fund manager can get rich quick if the returns are strong.

But according to a recent report on Bloomberg.com, Goldman's \$10 billion Global Alpha fund has been ailing. For the first four months of 2006, it lost 3.4%. If you take a look at the past two years, the fund has posted a chilling 12% decline.

"I have read that Global Alpha targets annual returns of 20%," said Steven Sheldon, the founder of SMS Capital Management, in a recent Fool interview. "That is a pretty high target that requires concentrated big bets to achieve unless the overall market achieves similar returns. Sometimes managers, keenly aware of their subpar performance, may start taking additional risks to make up for lost ground. Obviously, that could lead to even further problems." (You can read the full [interview](#) on my CAPS blog).

But doesn't Goldman have lots of credibility, and shouldn't investors keep a long-term perspective? Didn't Global Alpha generate a hefty 40% return in 2005?

All true, but the hedge fund industry is intensely competitive. Rivals like **Merrill Lynch** (NYSE: [MER](#)), **Morgan Stanley** (NYSE: [MS](#)), and **Lehman** (NYSE: [LEH](#)) are beefing up their hedge-fund businesses.

The underperformance also left its mark on Goldman's fiscal Q2 financials, as the firm's incentive fees fell 87% to \$110 million.

Even for a company the size of Goldman, this is a big deal. And as alternative investments continue to boom, the firm is missing a key opportunity. Goldman needs to act fast to turn Global Alpha around, because it already seems like investors are losing patience.

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Fool contributor [Tom Taulli](#), author of The Complete M&A Handbook, does not own shares mentioned in this article. He is ranked 1,831 out of 30,414 rated investors in [Motley Fool CAPS](#).

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