Derivatives Could Hedge Career Growth

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Staff Reporter of THE WALL STREET JOURNAL

NEW YORK—The derivatives debacles of 1994 continue to reverberate throughout the investment community.

Institutional investors, grilled by directors and pension-fund trustees about their use of derivatives, remain wary of the complex instruments. These investors recall the fate of managers such as Orange County, Calif.'s Robert Citron, whose use of these instruments brought his career to an untimely end.

"After the big derivatives blowups of the last year or two, you don't want to find yourself in a boardroom explaining why you've bought some kind of oddball product," says John Carroll, manager of GTE Corp.'s $12 billion pension fund, a veteran investor who acknowledges his reluctance to be a pioneer in the use of derivatives. "If you made the right call and used derivatives, you might get a small additional return. But if you make the wrong call, you could wind up unemployed, with a big dent in your credibility as an investor."

Fear of Embarrassment

The dread of professional humiliation is as powerful a motivation as fear of being fired, says Andrew Turner, director of research at Frank Russell & Co., an investment-advisory firm.

"If you're a treasurer or chief executive, the incentive to just put the lid on all this derivatives stuff is going to be pretty strong," he adds. "Even if you keep your job, you don't want to get labeled as [someone] who got snookered by an investment bank."

Eastman Kodak Co. recently axed its pioneering $300 million investment in managed futures and decided to severely limit the use of derivatives in its pension fund. Just a few weeks ago, **Federal Express** Corp. followed suit, yanking $25 million allocated to managed futures strategies under the aegis of **Mount Lucas Management** Corp., of Princeton, N.J.

Mount Lucas, which also ran the Kodak portfolio, says both investments were profitable, and the Federal Express investment represented one of that company's top-performing assets last year. The decisions, says Mark Stratton, senior vice-president of Mount Lucas, appear to be linked to changes in senior financial personnel at the two companies and to changes in the composition of investment committees.

Mirroring Kodak, Federal Express

Decisions like those by Kodak and Federal Express are just the tip of the iceberg. Similar policies are being adopted quietly by other companies, says one New York banker specializing in risk management, who asked not to be named.

"Trustees have said we shouldn't be investing in derivatives at all," says Russell Meekins, director of finance at the University of South Carolina Educational Foundation, which manages about $50 million. Trustees fearful of offending donors have banned direct investments in even "plain vanilla" products such as exchange-traded futures contracts, Mr. Meekins says. A donor, he adds, doesn't want to read in the newspaper that the university has lost part of its endowment through the use of derivatives.

Furthermore, "career-risk" considerations surface at all levels. For instance, in California and Ohio, where public funds and municipalities suffered large derivatives-related losses, legislators worried about appearing too lax are responding to public outrage by debating new laws that would ban, or at least limit, this kind of fund's usage of products deemed to be more risky.

Jeremy Grantham, a partner at Grantham Mayo Van Otterloo & Co., a Boston investment management firm, says the misadventures of high-profile investors such as Orange County have rendered even plain derivative products unpalatable.

"If you buy comfortable-looking, well-known, stable stocks like drug companies, or Coca-Cola, you're taking very little career risk because clients will blame a stupid market if things go wrong," Mr. Grantham says. "But if you buy something more risky or unconventional and fail, the response is going to be: 'How could you be so stupid?' "

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