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For Sale: Illiquid Assets, Hard to Value

Side pockets might as well be a curse word for hedge fund investors.

During the financial crisis, when hedge funds became an A.T.M. for anxious investors, managers used side pockets, or segregated accounts, to stow away such illiquid investments as risky loans that they did not want to unload in a fire sale.

To the frustration of investors, a lot of those assets sit there still.

A recent supply list from Shelley Capital Advisors, an outfit that advises buyers and sellers of hedge fund assets on the secondary market, is a reminder of just how pervasive the practice was during the financial crisis.

While nobody seems to have an exact figure for how much illiquid assets have been put into side pockets, analysts estimate it ranges from $50 billion to $200 billion. Many of these assets are likely to be sold at a steep discount.

Names familiar and foreign abound. The big winner, at least on this list, appears to be Philip Falcone's Harbinger Capital Partners. Investors trying to shed their stakes in the various side pockets have put about $71 million worth of assets on the block. Investors in D.E. Shaw, the multibillion-dollar hedge fund, also make a strong showing on the list, looking to sell about $17 million.

A number of investors in SAC Capital Advisors, the mighty hedge fund run by the billionaire Steven A. Cohen, are also listing their side pocket stakes with Shelley Capital. More than two dozen stakes are listed on the sheet, with prices varying from $100,000 to $3.5 million.

A spokesman for SAC Capital declined to comment. Spokesmen for D.E. Shaw and Harbinger did not immediately respond to inquiries seeking comment.

All told, Shelley Capital's list included about a half-billion dollars in illiquid assets and side pockets for sale. The list does not include the holdings they sell as entire portfolios, according to Shelley Capital's co-founder, John Seilern, who declined to comment on the specifics of the list. Including the list, sent to DealBook by a hedge fund investor who did not want to be identified, Shelley Capital has about $960 million in illiquid assets and side pockets for sale.

While some of the investments were sold off as the credit markets and economy recovered, others are still waiting for the right buyer to make an offer. In the meantime, investors are going it alone, trying to hawk their wares through secondary providers like Hedgebay and Shelley.

The business of selling side pockets has picked up since 2008, when the financial crisis prompted hedge fund managers to use them. While some managers have liquidated their holdings and returned money to investors, many have not. For those investors looking to cash out, the secondary market is really their only option.

Since the firm started last June, Shelley Capital has seen about $1.5 billion in side pockets cross its desk, though that is not the amount of business it has done.

Mr. Seilern, who declined to say how many sales the firm has completed, said only that matching sellers and buyers can be a challenge.

"Our challenge is not finding supply and finding demand — both of them are at our beck and call," Mr. Seilern said. "It's matching the expectation of the buyer and the seller."

Side pockets are partly loathed for their opaqueness. As an investor, it can be tough to know what is in them, which makes selling it to someone else a tricky proposition.

Hedgebay, one of the biggest market makers in the business, does about $1 billion a year in side pocket transactions, officials there say. Last month, the average stake sold for about 50 percent what was paid for it, and one particularly unlucky seller sold its stake for 10 cents on the dollar, according to Hedgebay data.

The discounts are not necessarily a reflection of the asset quality, experts say. Sometimes, investors just do not have the estimated two to five years to wait it out for the asset value to recover.

"It's not just because some of those assets are not that exciting," Hedgebay's co-founder, Jared Herman, explained. "Regardless of how exciting they are, it's going to take a long, long time to appreciate."

As for buyers, those in the secondary market say they are often large institutions, like bulge-bracket banks and even hedge funds.

Link: http://dealbook.nytimes.com/2011/03/28/for-sale-illiquid-assets-hard-to-value/