Game Theory

Peter Thiel bases his hedge fund's strategies on some dark predictions

BY ERIC J. SAVITZ

For Peter Thiel, the next move for the economy could be a deflationary swoon with a devastating impact on employment. That's led him to make some highly contrary investment bets.

Thiel: He's a dot-com millionaire. In 1996, after leaving Credit Suisse, he moved back to California and set up a small fund called Thiel Capital, starting with $1 million in friends-and-family money. Among other things, it invested in a start-up company working on encryption technology that evolved into PayPal, the online payment company. In 1999, the company made Thiel its CEO. Over the next four years, PayPal turned into a huge success. In March 2000, days before the Nasdaq began to crumble, it raised $180 million in venture capital. PayPal went public with a $1 billion market capitalization in February 2002, and five months later was acquired for $1.5 billion by eBay. For his approximate 4% stake in PayPal, he got about $60 million in eBay shares.

That gave Thiel the grutakate to get back in the investment business. Initially, he considered starting both a hedge fund and a venture fund— and, in fact, he has $70 million of his own money invested in start-ups. After some analysis, he decided the risks of starting a big venture fund were too great. "The whole venture industry is facing low returns for many years to come," he says. "There's an $80 billion overhang in the venture business," he contends. "At a reasonable pace, the industry could invest $8 billion to $10 billion for the next five years. Realistically, they will invest it faster, and end up with low, if not negative, returns. It's the worst time ever to be a venture capitalist. But it's a great time to be an entrepreneur—it's a seller's market to a degree that's never been seen before."

That said, Thiel has made significant bets on a number of start-ups, using his own capital. The list includes Friendster, an online networking and dating site that subsequently received venture funding from Kleiner Perkins and Sequoia Capital, and American Thunder, a magazine for Nascar fans.

Thiel thinks the hedge-fund arena is getting overpopulated as well. "There are an awful lot of funds pursuing disturbingly similar strategies," he says. He avoids the crowds by making some highly contrary bets. "We aren't living in ordinary times. We went through the largest financial bubble in the history of the world, which created an incredibly distorted context on many levels. Our mission is to make sense of the crazy world...and to understand where there are great opportunities for mispricing."

Which questions? "Questions about what globalization means (for the U.S. and other developed countries)," he says, "QUESTIONS ABOUT WHAT SECTORS OF THE ECONOMY WERE MASSIVELY UNDERINVESTED IN OVER THE PAST 20 YEARS. THE WORLD IS MUCH DIFFERENT THAN IN THE 20TH CENTURY. THERE IS A SINGLE WORLDWIDE ECONOMY, BUT MORE THAN 200 COUNTRIES, FAR MORE THAN IN 1945. THE TRENDS IS TOWARD UNTY IN AN ECONOMIC LEVEL, MORE SEGMENTATION ON A POLITICAL LEVEL. THE CENTRAL QUESTION IS THE ROLE OF THE U.S. IN THAT." The fund manager favors weakening changes in real estate and financial services. "Real estate is considerably more expensive than it was four years ago," he says, owing to an explosion in consumer leverage. "People are borrowing more, and saving less. The savings rate is barely above zero percent. That makes that not just extreme, but insane, is that we're talking about 40-some-
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