Short’s Story
Money Manager Stan Druckenmiller Is Still Bearish

STANLEY F. DRUCKENMILLER isn’t a stereotypical bear. The last great bull market, he says, now was fun. Indeed, despite a puckish sense of humor, Stan takes no obvious pleasure in watching stocks go down in flames. What he does like to watch, however, is the value of the portfolio he manages for Dreyfus Corp. Corp. And, if it takes shorting stocks—or implementing exotic bearish strategies in futures—well, so be it (at least in the funds whose charters give him that freedom).

Stan, a self-described bull fellow who spent two semesters at the University of Michigan pursuing a Ph.D. in economics before he wound up on that he didn’t want to teach, got his start as a securities analyst in Pittsburgh. Only 18 months later, in mid-’78, Pittsburgh National made him director of its equity and fixed-income research. In 1981, Stan started his own money-management firm, Duquesne Capital Management, Dreyfus hired him as a consultant in 1985, and a year later, Stan made it to the Big Apple. He joined the money management giant full-time, to run its Dreyfus fund and its Leveraged fund, and to start up three new funds, all with “Strategic” in their names. The latter funds, in particular, give Stan a lot more investing latitude than most other mutual fund managers enjoy. These days, as infamous, Stan is shorter more than he’s buying. We got him talking last week—on one of the days when the market wasn’t tanking. The following Q&A details why he’s currently bearish and what he’s doing about it.

—Kathryn M. Wellm

BARRON’S: Stan, what is your point of view from other mutual fund managers?

DRUCKENMILLER: We all gamble with other people’s money and charge them a fee. But three of the funds I run are creatures called the Strategic funds—all of which have the ability to go net short. The idea, and it was really Howard Stein’s, in setting them up last year, was that we had been in a bull market for 12 years at that point, but that some day, it was going to end. And we were starting to see a heavy inflow of dollars into equity funds, just as the mutual fund industry did in 68. We thought it’d be nice to have vehicles in place where possibly we could make money in a down market. Or at least, protect people’s capital. Certainly, a year isn’t enough of a history to say they work. But we are not short about the start. We designed the Strategic funds so that they can employ very aggressive asset allocation, and it’s not just in the prospectus. We actually do it. Two of them, Strategic World and Strategic Aggressive, are particularly interesting because they’re limited partnerships.

Q: Why’s that interesting?

DRUCKENMILLER: They look and act just like mutual funds, but because of their limited partnership status, they aren’t restricted by the 90-day rule.

Q: Which ones?

DRUCKENMILLER: Only 30% of a mutual fund’s gains can be generated in trading under 90 days. Because they don’t operate under that restriction, the two limited partnerships have all the derivative markets, as well as the more conventional markets, at their disposal. And the derivatives can be very useful in trading the swings in this volatile market.

Q: Some folks blame index futures and the other derivatives for a large part of that volatility. And say that they almost caused the world to end in October.

DRUCKENMILLER: We don’t like to think that the kinds of things we do with derivatives caused the end of the world. We don’t do things called portfolio insurance. In fact, I’ve never quite understood why it was supposed to work. Apparently, with portfolio insurance, as the market goes down, you sell more. As the market goes up, you buy more.

Q: That’s the theory.

DRUCKENMILLER: As Growing up in mid-America, I was always taught—I’m not saying I always do— to buy low and sell high. Our participation in the derivative markets—and we’re not claiming to be world savers, but we tend to trade against whatever the daily trend of the market might be, rather than with it. So often, we find ourselves on the other side of portfolio insurance. When prices are plunging, rather than sell, we prefer to buy, and vice versa.

Q: Is trading index futures a large part of what you do?

DRUCKENMILLER: No, not really. The use of derivatives by the funds has been overrecessed. In the near future, the funds are unlike conventional funds because, if we don’t like the market, we don’t just go to 20% cash; we might actually go net short. And the derivatives just gained status at certain times, be a convenient way of doing that. But when you are trading against the market, you are going to make, or lose, money for shareholders is with the decision to be in or out of the market. That’s the big decision, not daily trading in derivatives or some fancy insurance spread.

Q: You almost sound old-fashioned.

DRUCKENMILLER: A: What we do is old-fashioned. Actually, all the derivatives do is greatly increase the speed at which we can move, should we have to.

Q: So are you in or out of the market today?

DRUCKENMILLER: A: Let’s put it this way. The Aggressive fund is net short. Investing is about 7% net long. And World is 50% net long. But it’s short Japan and the U.S. It’s long mainly Continental Europe. So all three funds are, at least in conventional terms, very defensive here. Our mandate, as we look at it, is to make money on an absolute basis, not to protect our shareholders in declines and try and make money in any environment. You can’t really compare us with people whose charters are to be fully invested, no matter what.

Q: How much more defensive could you get?

DRUCKENMILLER: A: I could go to net short in all three funds, and the net short position in Aggressive, which is currently marginal, could become quite a bit shorter. Right now, it’s under 20% and it could go as high as 60%-70%.

Q: Would you call that aggressively bearish?

DRUCKENMILLER: A: That’s not really that

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Q: What do you keep in the front of your mind?
A: You keep in the front of your mind the fact that, at the beginning of the year, things were looking good. The economy was strong, and there was a lot of optimism. However, as the year progressed, the economic outlook gradually deteriorated. By the end of the year, the economy was once again facing significant challenges.

Q: What do you keep in the back of your mind?
A: The back of your mind is where you keep the reality of the economic situation. You know that the economy is not as strong as it was at the beginning of the year, and you are always aware of the potential risks that could arise.

Q: Why is this important?
A: It is important because you need to be aware of both the optimistic and pessimistic scenarios. This allows you to make well-informed decisions and to be prepared for any eventuality.

Q: How do you stay focused on these things?
A: I stay focused by regularly reviewing economic data and by keeping up to date with the latest news and developments. I also engage in discussions with other experts in the field to gain a broader perspective.

Q: What does all this tell you about the economy?
A: It tells you that the economy is facing significant challenges and that there is a lot of uncertainty. However, it also suggests that there is room for improvement, and that with the right policies, the economy can rebound.

Q: What are the implications of this for investors?
A: Investors need to be cautious and to avoid taking on unnecessary risks. They should diversify their investments and be prepared for a range of outcomes. At the same time, they should not be overly pessimistic, and should be ready to take advantage of opportunities as they arise.

Q: What advice would you give to investors?
A: My advice to investors would be to stay informed, to be patient, and to be willing to take calculated risks. They should also be prepared to adapt their strategies as the economic situation evolves.

Q: How do you keep your focus on these things?
A: I keep my focus by regularly reviewing my notes and by thinking about the implications of the economic situation. I also engage in discussions with other experts in the field to gain a broader perspective.

Q: What do you think the future holds for the economy?
A: It is difficult to say for certain, as there are many variables at play. However, I believe that there is a real possibility for improvement, and that with the right policies, the economy can return to a more sustainable path.

Q: What are the biggest risks to the economy?
A: The biggest risks to the economy are related to the availability of credit and the potential for a real estate bubble. If these issues are not addressed, it could lead to a significant downturn in the economy.

Q: What are the biggest opportunities for investors?
A: The biggest opportunities for investors are in sectors that are not overvalued and are not dependent on credit. This includes sectors such as technology and healthcare, which are likely to continue to perform well in the future.

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