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Texas Teacher Pension Buys Bridgewater Stake

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Scott Eells/Bloomberg NewsA pension is betting on the long-term outlook for Bridgewater Associates, founded by Ray Dalio.

The Teacher Retirement System of Texas just went from hedge fund investor to hedge fund owner.

Last month, the Texas pension took a $250 million stake in Bridgewater Associates, the giant money manager. Now, rather than plowing money into specific portfolios, it can claim a piece of the whole operation.

It is an unusual move for a pension. By investing directly in Bridgewater, the Teacher Retirement System of Texas can share in the upside return without paying the high costs. But the large state pension is also betting on the long-term viability of a firm whose fortunes are associated with a single enigmatic founder, Ray Dalio.

"They are essentially making a double bet in this particular firm," said Elizabeth B. Nesvold, managing partner at Silver Lane, an investment banking adviser that specializes in asset managers. "When you think about the downside, you get a double whammy."

Unlike many businesses, hedge funds are often closely linked to one person who has driven their success. SAC Capital has Steven A. Cohen; Pershing Square Capital Management, William A. Ackman.

But as the largest hedge funds mature, many founders want to sell stakes in the businesses they have built. In the last year, firms like Millennium Management, started by Israel Englander, and the Rock Creek Group have sought outside investors.

In addition to handsome paydays, hedge funds want to diversify their ownership base, in part to find a more stable supply of capital.

Since last year, Bridgewater has been negotiating partnerships with the Texas pension and two unnamed parties. The firm told fund investors in a letter last month that the stake sales were part of a "10-year plan to transition Bridgewater from being run by Ray, to being independent of Ray." Bridgewater said it planned to keep Mr. Dalio's stake between 10 and 20 percent.

"There's a saying in the hedge fund industry that goes your assets go up and down in the elevator every day," said Yasho Lahiri, a partner at the law firm Baker Botts. "The institutional investor is taking a bet that what you have built is really a self-replicating business."

It can be a good deal for hedge funds. In Bridgewater's case, the partnerships offer a partial exit for Mr. Dalio, who is 62 and has spent 30 years building the firm. He is transferring some shares to the Texas pension.

For the pension, the fate of the investment will depend largely on Bridgewater's performance. As a longtime investor, the Teacher Retirement System of Texas has been participating for years in the gains of the hedge funds. In the last 20 years, Bridgewater has made an average of 14.7 percent a year.

Now, the pension will also stand to benefit from fees that Bridgewater collects. The firm, which has roughly $120 billion in assets, makes about 2 to 3 percent a year in management fees on the money invested in its hedge funds.

The Teacher Retirement System of Texas said in a statement that it "believes this is one of the best investment opportunities of its kind." The pension, which manages about $108 billion for 1.3 million employees and retirees, has been an aggressive investor in the so-called alternatives space. It recently committed $3 billion each to the private equity firms Kohlberg Kravis Roberts and Apollo Global Management for a break in fees.

If Bridgewater's assets, and returns, continue to soar, the pension could do quite well. But if it has a string of bad years and investors withdraw their money, inflows could suffer.

"The investor has huge market risk," said George J. Mazin, a partner at Dechert, a global law firm. "There have been a number of deals where investors bought high at the top of the market and in the next couple of years there was no growth and an attrition in assets."

Such investments have been a mixed bag over the years.

Goldman Sachs, which started an in-house group to buy hedge fund stakes, has made some smart bets. Goldman's Petershill fund bought a piece of Winton Capital in 2007 when the firm had less than $10 billion under management. Since then, its assets have swelled to nearly $29 billion, and performance has been strong, including a 6 percent return in 2011.

But Goldman has also had prominent losses. The Petershill fund bought a stake in Shumway Capital Partners not long before the firm's founder decided to shut it down and return capital to investors. Another holding, Level Global Investors, was swept up in an insider trading investigation and decided to close shortly thereafter. Goldman lost big on its investment.

Morgan Stanley offers another cautionary tale. In 2006, it bought FrontPoint Partners, a hedge fund firm with $5.5 billion in assets. But soon, top managers started to leave. The relationship worsened when a FrontPoint manager was accused of insider trading in 2010.

In 2010, Morgan Stanley took a $193 million impairment charge related to FrontPoint. The bank sold its stake back to FrontPoint last year.

The deals can also prove treacherous for the hedge funds, as they try to navigate the relationships with their partners and their investors. An owner, like the Texas pension, may want fund assets to grow, because it means more money in hand. But an investor in the fund may want to keep a lid on the size, fearful that if the fund gets too large it will hurt performance.