



WHEN HARRY RESEARCHED BERNIE

Three weeks ago I had not heard of Harry Markopolos and Bernie Madoff. I think most people have now heard of Bernie Madoff but not as many people are probably aware of Harry Markopolos so I am writing this to spread his name a bit further.

Like most people I was surprised when the news broke about Bernie Madoff's alleged "ponzi" scheme but the more I thought about it the more I thought that I should have heard about this guy. In particular the claims he had made about the returns he had been generating over many years made me surprised that I had never heard about him. I thought that somebody who claimed to generate a return of over 10% per annum without a down year would have received far more attention in the investment world. I would have thought that I would have read headlines like "Madoff does it again!" in the FT or on Bloomberg. I would have thought that CNBC would have had him on as a guest host to hear the wisdom of this investment guru. I thought he would have been compared to a George Soros or a Warren Buffett.



It was only after I had started reading about Madoff that I came across the name Harry Markopolos. In fact it was on an email from my professional body the CFA Institute (Chartered Financial Analysts) that I read the following:

A CFA Charterholder Who Did Not Give Up

Harry Markopolos, CFA, a longstanding member of the Boston Security Analysts Society, has been in the news this week for his role in reporting the allegations that Bernard Madoff was running a Ponzi scheme. Over the past eight years, Harry has steadfastly informed the U.S. SEC that Madoff's strategies could not possibly yield the high returns he reported. Despite many ups and downs in his investigation, he did not give up. We send our congratulations to Harry for his continued efforts to eliminate professional misconduct and protect the interests of investors.

Having read the above I decided to do a Google search on Harry Markopolos and Bernie Madoff. I was surprised to find a whole series of links to a document written by Harry

Markopolos where he basically outlined his concerns about Madoff. You can read the document yourself at the link below:

http://online.wsj.com/documents/Madoff_SECdocs_20081217.pdf

I want to highlight a couple of things that jumped out of this document for me: First of all he highlighted exactly the first issue that occurred to me, namely why was this guy not world famous:

Red Flag # 3: *Why the need for such secrecy?* *If I was the world's largest hedge fund and had great returns, I'd want all the publicity I could garner and would want to appear as the world's largest hedge fund in all of the industry rankings. Name one mutual fund company, Venture Capital firm, or LBO firm which doesn't brag about the size of their largest funds' assets under management. Then ask yourself, why would the world's largest hedge fund manager be so secretive that he didn't even want his investors to know he was managing their money? Or is it that BM doesn't want the SEC and FSA to know that he exists?*

Secondly I think he really highlights a concern about funds of hedge funds:

Red Flag # 17: *Madoff does not allow outside performance audits. One London based hedge fund, fund of funds, representing Arab money, asked to send in a team of Big 4 accountants to conduct a performance audit during their planned due diligence. They were told "No, only Madoff's brother-in-law who owns his own accounting firm is allowed to audit performance for reasons of secrecy in order to keep Madoff's proprietary trading strategy secret so that nobody can copy it. Amazingly, this fund of funds then agreed to invest \$200 million of their client's money anyway, because the low volatility of returns was so attractive!! Let's see, how many hedge funds have faked an audited performance history?? Wood River is the latest that comes to mind as does the Manhattan Fund but the number of bogus hedge funds that have relied upon fake audits has got to number in the dozens.*

In Opinion Piece 6 I wrote the following:

So let this be a warning to naïve investors, be careful when somebody recommends a hedge fund and personally I would be more inclined to warn people against funds of hedge funds.

I think funds of funds should come with major warnings attached.

If I had the time to do a PhD or had the inclination to become an academic I would love to do enough research to back up my hunch that the average fund of funds will underperform the average fund because of the additional charges involved.

Harry Markopolos has shown that investment professionals need to stand up for what they believe and I genuinely believe that fund of funds should be researched to a far greater extent.

I have mentioned two out of the twenty nine warnings / red flags in the Markopolos document.

The document was written in 2006 but Markopolos had first made his concerns known as far back as 1999.

This is such a well written document outlining why there had to be something wrong with the returns generated by Madoff that I was then really disappointed to hear that Madoff had been investigated by the SEC (Securities and Exchange Commission – the US regulator) and had managed to get off with a relatively minor warning. I do not want to jump to conclusions about the SEC but in the light of the news this week about our own regulator in the Sean Fitzpatrick / Anglo Irish bank affair I have to say that regulators appear to be providing taxpayers with bad value for money.

As I said this is not intended to be an attack on regulators. It is primarily meant to be in praise of Harry Markopolos so I just want to mention some of the other things I found out about him from my Google search.

I took the following from Yahoo:

But people who know or worked with Markopolos say it wasn't prescience that helped him foresee the collapse of Madoff's alleged \$50 billion fraud. Instead, they say diligence and a strong moral sense drove his quixotic, nine-year quest to alert regulators about Madoff. "He followed through on everything he ever did. He never let up," said his mother, Georgia Markopolos, in an interview Thursday. "Some kids just let it go if it's too hard, but he wouldn't do that." "He feels very sorry for these people that got taken," she added. "It wouldn't have happened if they would have listened to him long ago."

If only the world had a few more people like Harry Markopolos.....



Harry Markopolos