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# Deutsche Bank Fallen Trader Left Behind $1.8 Billion Hole



By SCOTT PATTERSON and SERENA NG

The fall of Boaz Weinstein, once one of Wall Street's hottest traders, speaks volumes about why financial firms still are reeling from the shattered global markets.

BOAZ WEINSTEIN

As a chess master, poker and blackjack devotee and top trader at Deutsche Bank AG, Mr. Weinstein made big bets using complex financial instruments, generating large returns for the bank and about $40 million in annual pay for himself. But in 2008 the group he ran saddled the bank with $1.8 billion in losses, erasing more than two years of trading gains.

On Thursday, the German banking giant reported a 2008 loss of $5 billion (€3.9 billion), its first one-year loss in over five decades and a reminder that financial firms are not out of the woods. In an earnings conference call, Chairman Josef Ackermann described the market environment as a "series of earthquakes with constantly changing epicenters."

The losses are the latest reminder of the challenges faced in the new financial order. Wall Street firms long relied for much of their profit on massive risk-taking by aggressive traders deploying the firms' own money; with that game over, firms are struggling to find fresh sources of revenue.

But first they must stabilize their institutions after the holes dug by former Masters of the Universe. Last month, Deutsche Bank shut down Mr. Weinstein's operation and wound down many of his positions. He left the bank this week, with plans to start a hedge fund.

Mr. Weinstein, 35 years old, was at the vanguard of explosive growth of "proprietary" trading, in which banks gambled with large chunks of their own capital. Complex instruments let them augment their bets with borrowed money, multiplying profits when things went right but magnifying losses during bad times.

Mr. Ackermann, speaking to analysts on Thursday, said that to earn a $1.5 billion profit from proprietary trading the bank needed to risk several times that amount in capital. "You can easily lose two to three billion. That's what we have seen in 2008 and something we don't want to see again," he said.

Reuters

Deutsche Bank Chairman Josef Ackermann at a news conference in Frankfurt Wednesday announcing that the German bank had a $5 billion loss last year, $1.8

The cerebral Mr. Weinstein used to play down the complexity of his trading, saying he used common sense and simple mathematics. He sometimes would quip, deliberately conflating two clichés: "It's not rocket surgery." But he has also boasted that people viewed him as the "best credit trader in the world."

And he still has his fans. Prominent investors who've worked with Mr. Weinstein expect him to rebound from his big losses in 2008. "If he made a mistake he'll learn a ton from it," said William Ackman, manager of New York hedge



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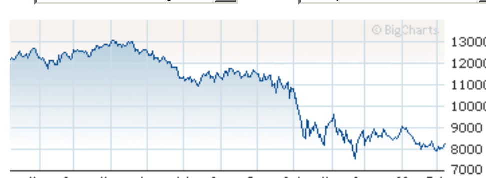


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According to an account provided by a number of current and former Deutsche Bank traders, Mr. Weinstein surged to the top of the bank's credit trading desk using tactics involving credit-default swaps, a form of insurance against bond defaults.

His group -- which he named "Saba," Hebrew for grandfatherly wisdom -- generated estimated profits of $900 million in 2006 and $600 million in 2007. Over seven years, the group had trading losses in just four quarters, someone familiar with the matter says.

Mr. Weinstein brought in traders who shared his interest in gambling. An early hire was Bing Wang, who finished in 34th in the World Series of Poker in 2005. On Fridays after the closing bell, Saba traders, often including Mr. Weinstein, would gather for poker in a room off the trading floor, with a $100 "buy-in" to sit at the table.

In 2005, Mr. Weinstein won a Maserati in a poker tournament sponsored by a unit of Warren Buffett's Berkshire Hathaway Inc. And a few times a year, Mr. Weinstein joined several Deutsche Bank traders -- members of a secretive blackjack team who'd attended Massachusetts Institute of Technology -- to hit the blackjack tables in Las Vegas.

In the office, Mr. Weinstein's signature trade was a strategy called "capital structure arbitrage," based on gaps in pricing between various securities of a single company. For instance, if he thought its bonds were undervalued relative to its stock, he might take bullish positions on the bonds and simultaneously bet against the stock, waiting for the disparity to shrink or vanish.

In 2005, Mr. Weinstein used swaps to bet on a rise in the value of General Motors Corp. debt. He also shorted, or bet against, GM's stock, which was trading at about $30 a share.


Then disaster struck. In May 2005, billionaire Kirk Kerkorian made a tender offer for GM shares, sending them higher. Days later, credit-rating firms downgraded GM debt. Suddenly, both sides of the trade were going against Mr. Weinstein.

He huddled with his lieutenants at the New York apartment of a trader. One option was to try to minimize losses by paring the securities positions. Mr. Wang, the poker expert, argued for adding to them, say traders who were present. If the rise in the stock and drop in the debt proved temporary, huge profits could be made. "Load the boat," Mr. Wang recommended, says a person who attended the meeting. Mr. Wang, no longer at the bank, couldn't be reached for comment.

Over the following months, Mr. Weinstein's group added to its bullish bond position, through more credit-default swaps. Within about a year, the bet paid off handsomely, as GM's stock price declined and its bonds stabilized.

Colleagues say Mr. Weinstein believed his chess skills gave him an ability to see several moves ahead in trading. One day in 2005, a Russian employee on the trading desk challenged Mr. Weinstein to a "blindfold" chess match, in which Mr. Weinstein would play with his back to the board. With more than 100 employees watching, some placing bets, Mr. Weinstein won in about two hours.

In early 2007, as it grew clear that lending excesses afflicted markets such as housing, Mr. Weinstein bet that short-term interest rates would fall quickly once the credit bubble popped and the Federal Reserve eased monetary policy, a former trader recalls. Mr. Weinstein bought instruments that would profit if the gap between long-term rates and short-term rates widened. The trade paid off when the Fed began cutting short-term rates in September 2007.

By early 2008, Mr. Weinstein was at the top of his game. He, along with a colleague in London, was overseeing global credit trading for all of Deutsche Bank. His own trading group, Saba, had grown greatly, to roughly $30 billion of positions and $10 billion in capital. And his control also extended to the bank's trading for customers.

Wall Street traders were optimistic in early 2008 that the mortgage crisis was contained, though there were some strains in short-term lending markets, causing corporate-bond prices to decline. On several businesses, such as Ford Motor Co., Lyondell Chemical Co. and General Electric Capital Corp., Mr. Weinstein bought corporate bonds or loans as well as credit-default swaps.

The swaps would pay off if the debt defaulted. And the cost of this protection was less than the


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income produced by the bonds. Mr. Weinstein believed the debt was cheap relative to the cost of protecting it with swaps.

Corporate bond prices soon rallied, leading to a tidy profit for Mr. Weinstein's group, after the Fed's brokering of a deal for reeling Bear Stearns Cos. stabilized the credit markets. Emboldened, Mr. Weinstein added to his positions in succeeding months. His group entered September in the black for the year, expecting to tack on more gains.

But the simmering financial crisis finally boiled over. The government said early in September that it would take over mortgage giants Freddie Mac and Fannie Mae. And Lehman Brothers Holdings Inc. was teetering. Traders worried about losses they might incur if Lehman failed.

On the night of Sept. 13, a Saturday, Mr. Weinstein joined other big banks' credit-trading chiefs at a New York Fed meeting in lower Manhattan. A rival executive says Mr. Weinstein seemed poker-faced and relaxed.

The next day it became clear Lehman would fail, and a struggling Merrill Lynch & Co. agreed to sell itself to Bank of America Corp. Within days, the government bailed out another big player in credit derivatives, American International Group Inc.

Brooding in his office overlooking Wall Street, Mr. Weinstein remained outwardly calm as markets went haywire, traders say. The value of his group's holdings of corporate bonds and loans began to slide as other investors, needing to raise money, sold such securities.

At the same time, trading in credit-default swaps was curtailed because market players were concerned about entering trades with banks that potentially could collapse. This left Mr. Weinstein's group increasingly unprotected against losses in corporate bonds and loans, because it used swaps to hedge those positions.

Mr. Weinstein wasn't alone. Similar positions held by banks and hedge funds across Wall Street fell apart amid the seismic dislocations after the Lehman collapse.

As prices of corporate bonds and loans slumped to new lows and stocks plunged too, Mr. Weinstein wanted to buy more swaps to protect his positions, traders say. He told traders that in such a trading environment, "the primary objective is to get as flat as possible to the market" -- not betting on either a rise or a fall -- according to a person familiar with the conversation.

But in contentious conference calls, risk managers at Deutsche Bank told Mr. Weinstein to scale back positions or sell them entirely, traders say. Mr. Weinstein's stock-trading desk was instructed to sell nearly every holding, effectively shutting it down.

A frustrated Mr. Weinstein pleaded for more freedom, arguing that he long had been given wide latitude to set his trading strategies, traders say. Deutsche Bank, seeking to contain the damage, said no.

In his office, adorned with a picture of him with Mr. Buffett, Mr. Weinstein often huddled with associates, trying to figure out a way to stop the bleeding. But losses worsened, continuing into early October. Mr. Weinstein would hole up in his office for long stretches, staring at multiple trading screens on his desk, say associates.

Among his traders, the flow of information ground to a halt. Typically, junior traders with group's various desks distributed daily emails showing their profits and losses. These stopped circulating. Among Saba traders who weren't privy to the losing positions, rumors of huge losses began to swirl.

Traders, called to meetings in Mr. Weinstein's office, returned tight-lipped. Some tried gallows humor to break the tension. In late November, a trader was conducting a tour of Mr. Weinstein's operation for visitors. "If you come back two weeks from now, this space will be empty," the trader said, according to someone who heard the remark.

By the end of the year, the group's losses totaled $1.8 billion. Deutsche Bank said it lost €4.8 billion ($6.2 billion) in the fourth quarter alone, hurt by a €1 billion loss in credit-market proprietary trading. It also recorded losses from its exposure to troubled bond insurers and mortgage-backed securities that fell in value. The bank said it has scaled back risk-taking in its trading operations and pared its holdings of illiquid assets, and expects to perform better in 2009. Its shares fell 3.4% Thursday on the New York Stock Exchange.

Some positions the bank held onto rebounded by about $600 million in January as credit markets eased, traders say. But Mr. Weinstein announced early in the month that he would be leaving the bank to launch a hedge fund, a move he had been contemplating for at least a year.

He is now looking for investors, and several have committed to his fund. He expects it to start trading in the summer.

People familiar with the fund say it is likely to be called Saba.

BACK TO TOP

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