Paulson Confronts Goldman Fallout

Hedge Fund Allays Investors’ Concern; ‘I Felt Reassured’

BY GREGORY ZUCKERMAN AND JENNY STRASBURG

John Paulson hasn’t been accused of any wrongdoing. But the hedge-fund billionaire has gone on the offensive to reassure investors that his huge fund will emerge unscathed from a case that has drawn him into a political and legal vortex.

The steps, including a conference call with about 100 investors late Monday, come amid indications from some clients that they might withdraw money from his firm after a lawsuit brought by the government against Goldman Sachs Group Inc. related to an investment created at his firm’s request.

Investors have indicated they are concerned that scrutiny over the firm’s deals may spread, including to overseas regulators. They said they wanted to protect themselves in case new information emerges that could damage the hedge fund, they say. Another issue, they say: The legal case could simply prove a distraction for Mr. Paulson.

“Some of the callers asked pointed questions, almost like a court inquisition, but most people were supportive,” said Brad Alford, who runs Alpha Capital Management. “I felt reassured that he did nothing wrong.”

“It’s not a rush for the doors,” said another investor in Paulson & Co., who has communicated with larger Paulson investors since Friday, when the government unveiled its Goldman case.

Mr. Paulson sent a letter to investors Tuesday night saying that in 2007 his firm wasn’t seen as an experienced mortgage investor and that “many of the most sophisticated investors in the world” were “more than willing to bet against us.”

Mr. Paulson’s firm focuses on largely liquid investments, those relatively easy to sell without pushing prices much lower. Even if a number of investors ask out, the firm likely will be able to sell investments without crippling their holdings, investors say.

Some traders have been examining Mr. Paulson’s top holdings and positions in which filings in...
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The lawsuit broke on Friday, some of these stocks, including Conseco Inc., Cheniere Energy Inc. and Anglogold Ashanti Ltd., fell sharply.

The case has delayed the initial public offering of a Canadian investment fund, Propel Multi-Strategy Fund, formed to give investors exposure to two funds advised by Paulson, according to people familiar with the offering. Propel didn’t respond to requests for comment.

On the Monday night conference call, some investors asked if Mr. Paulson or anyone at the firm had received a government notice of potential civil charges, called a Wells notice, according to people familiar with the call.

Mr. Paulson said no. Mr. Paulson said the case wasn’t a distraction that was affecting the firm’s investments, and that he was confident the public glare would abate.

On the conference call, Mr. Paulson calmly explained the trade with Goldman, which involved a “short” bet on mortgage bonds. He said that the very nature of the transaction required both a “long” and “short” investor, suggesting that investors knew that a bearish investor had bet against the deal.

Mr. Paulson suggested to clients that the large investors who purchased the Goldman deal and others relied on rating firms, and didn’t do enough of their homework, investors say.

The hedge-fund firm has a deadline next Friday for investors who want to withdraw money on June 30. Paulson allows most investors to pull out four times a year, but they need to give at least 60 days notice. Investors can cancel redemptions before the end of June.

Magnetar Capital LLC, another hedge-fund firm that, like Paulson, was heavily invested in collateralized debt obligations in 2007, also has been working to reassure investors that it believes its mortgage-linked investment strategy was sound and can withstand regulatory scrutiny.

Investors in Magnetar, which oversees some $7 billion in assets, also have a deadline next week to request June withdrawals of money. The Evanston, Ill.-based firm sent an 11-page letter to investors on Monday saying that it didn’t control which individual assets went into CDO deals in which it invested.

It isn’t clear whether scrutiny of Magnetar will rattle its investors, who have known some details of the firm’s strategy for several years. An article this month in news outlet ProPublica was the latest to assert that Magnetar designed deals built to fail that caused cascading losses for investors on the other side of the trades. The hedge fund’s strategy was the subject of a Jan. 2008 Wall Street Journal article.

Magnetar told investors this week that it based its mortgage- CDO strategy on statistical models, not a fundamental belief that the housing market would slide.

A Magnetar spokesman said, “Our communications with investors have been very positive and supportive.”

—Stephen Grocer and Ben Dumett contributed to this article.
Goldman Profits Soar 91% in Period To $3.46 Billion

BY SUSANNE CRAIG AND DAN FITZPATRICK

What if you made $3.46 billion and no one cared? Goldman Sachs Group Inc. found itself in that awkward position Tuesday as it reported the second-highest quarterly profit in the company's 141-year history. The 91% surge was powered by the strongest net revenue ever in Goldman's fixed-income, currency and commodities operation, which makes trades for clients and the firm.

But reaction to the results was drowned out by questions about the fraud lawsuit filed against Goldman last week by the Securities and Exchange Commission. In a conference call, analysts pressed company executives more than 40 times in a relentless effort to learn more about the controversial financial instrument created for hedge-fund firm Paulson & Co.

In contrast, there were fewer than 30 questions about the first-quarter results and other nonlegal matters, including the $5.49 billion Goldman set aside for compensation and benefits, up 17% from last year's first quarter.

Goldman's co-general counsel, Gregory Palm, in his first-ever appearance on a Goldman earnings conference call, repeatedly denied that the firm did anything wrong, using details that show how the company is likely to shape its defense strategy as the lawsuit proceeds through a federal court in New York.

"We would never intentionally mislead anyone, certainly not our clients or counterparty," Mr. Palm said, "We are very dis...

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Still Rolling
Quarterly net income at Goldman Sachs, in billions

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Source: the company
Profit Surge Doesn’t Change the Subject

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appointed that the SEC would bring this action, which related to a single synthetic CDO transaction involving two professional institutional investors, in the face of extensive record we believe establishes that the allegations are unfounded.”

Mr. Palm stressed that all three parties to the synthetic collateralized-debt obligation called Abacus 2007-AC1 had a hand in selecting the mortgages they subsequently bet on. Goldman added that it wasn’t required to disclose who provided input into the mortgage-selection process for the deal or what views their clients were taking on the portfolio.

Goldman said on Tuesday that it suffered more than $100 million in losses on the deal, including an $83 million hit from a chunk of the transaction that it wasn’t able to sell to investors. Goldman had previously said that its losses were about $90 million.

Some analysts expressed frustration with Goldman’s determination to do whatever it takes to fend off the SEC’s accusations. “Why not just work with the SEC?” asked Michael Mayo, an analyst at Calyon Securities. “When you fight City Hall, some bad things happen.”

“It is very early on, and we will see how it unfolds,” responded Goldman Chief Financial Officer David Viniar. He said customers, clients and trading partners are standing by the company. “I think you can see from our results last quarter that our clients still support us,” he said.

The lawsuit “is not an immediate concern,” said Sid Sczygeliski, chief financial officer of Aspirus Inc., a Wausau, Wis., hospital system that raised more than $200 million through refinancings and bond issues handled by Goldman. Still, faced with a new bond issue planned for October 2011, the legal mess at Goldman “is something we are continuing to watch and monitor.”

Patrick O’Meara, president of financial-advisory firm O’Meara, Ferguson, Whelan & Conway, which works with 42 Catholic dioceses in the U.S., said none of them “is currently rethinking their relationships with Goldman Sachs.” Mr. O’Meara was at the Vatican on Friday when the suit was filed, triggering a discussion among U.S. church officials.

“There is a great deal of suspicion with the manner in which the charges were filed and the timing of the charges,” he said.

John Kallinunas, president and chief operating officer of Regal Financial Group, a Kentwood, Mich., investment adviser, said he has received two calls from clients asking “if Goldman was going to be another Enron.”

“If they have clouded their judgment, we will have to use somebody else for advice,” added Mr. Kallinunas, whose firm relies on Goldman for research and asset management.

Goldman’s earnings jumped to $3.46 billion, or $5.59 a share, from the year-earlier $1.81 billion, or $3.39 a share. Revenue was 36% to $12.78 billion. Analysts surveyed by Thomson Reuters expected earnings of about $4.01 a share on $11.07 billion in revenue.

Goldman shares declined 2.1%, or $3.34, to $159.96 in New York Stock Exchange composite trading at 4 p.m.