Situational Awareness: A cautionary tale

Situational Awareness wasn't just another fund blow up; Leopold Aschenbrenner's meltdown is a warning about high valuations and risk, punctuated by Citadel having quickly unloaded SA assets it had recently purchased on the cheap. It also emphasizes the importance of finding managers with proven long-term track records of successfully navigating turbulence and highlights the risk of working with unproven emerging managers. Experience matters.

In the movie, Shakespeare in Love, whenever somebody suggested a compelling handle to one of the Bard's plays, William often responded, "Good Title."

That certainly applies to the name of Leopold Aschenbrenner's hedge fund when he launched it several years ago, propelled by the response he received to his treatise about the future of AI. His words clearly had traction with many investors itching to hitch their fortunes with the next great visionary, even one barely in his 20s.

Turns out there may never have been a greater misnamed hedge fund.

The manager's high-octane approach to investing contrasts somewhat with the PM's early assertion that, "Obviously, not blowing up is task No. 1 and 2."

Kind of recalls the words of Secretary of Defense Donald Rumsfeld after the US invasion of Iraq in 2003 went sideways: "Stuff happens."

With lawyers having not yet rushed in to claw back investor losses, and with some LPs already ponying up additional capital to the fund's latest investment, it may be a safe assumption that the youthful manager did nothing nefarious in having sunk his fund's fortunes virtually overnight.

Though we haven't seen any fund documents, a fair guess is its presentation, DDQ, and prospectus spelled out the fund's basic risks of applying leverage to highly valued public equities coupled with its exposure to less liquid, harder to value private investments.

Can't imagine investors not having paid any attention to these details, especially with $25 million investment minimums and some tickets written with long lock-up periods. Still, it seems investors went in with Eyes Wide Shut.

According to The Wall Street Journal, some of those investors included top AI executives at Meta, Jane Street Capital (whose traders reportedly lost $15 billion in July), and Patrick and John Collison, the brothers who co-founded the payments firm Stripe.



Good bet that many hadn't personally experienced the Tech Wreck a quarter a century ago.

Unbridled by sound investment principles, Aschenbrenner's saga makes the hedge fund industry look rather silly.

While Bloomberg reports the fund was still up 80% for the year through July, investors who came in more recently got hammered.

Even more disconcerting, as Bloomberg pointed out, Wall Street banks were the source of Aschenbrenner's leverage.

Even though these institutions apparently escaped unscathed, it makes one wonder if Goldman Sachs, JPMorgan, Citigroup and Bank of America, which the Journal identified as the fund's prime brokers, conducted any serious due diligence.

According to several CIOs I've interviewed who use leverage, they believe PBs' main concerns are not whether extending leverage makes sense but if they can trigger collateral asset sales quickly enough to get their money back.

JPMorgan subsequently has terminated it prime brokerage relationship with the fund. Aschenbrenner has established a prime broker deal with the boutique shop Clear Street. And the PM has now begun to use "flex options" to gain embedded leverage exposure.

This focus on Situational Awareness is not schadenfreude. Rather, it's a useful contrast with my firm's annual global hedge fund survey, now in its 23rd year, that highlights the few managers that have consistently delivered on the promise of long-term active management.

Situational Awarenes is a cautionary tale about investing in the age of the Mag 7 and irrational exuberance over all things AI and risks involving emerging managers with limited track records. The average age of the Top 50 funds in our survey is over 16 years.

The initial screen that whittles down the 1000s of funds in the universe to a few dozen starts by looking at only broad strategy managers with a minimum of five years of returns that have met annual hurdle rates.

While high volatility isn't disqualifying, it's rare to see it in this survey because it isn't often associated with long-term consistency.

Eric Uhlfelder

Eric Uhlfelder has managed hedge fund surveys for the Financial Times, The Wall Street Journal, Barron's, Institutional Investor, and SALT. His signature annual Global Hedge Fund Survey is a highly regarded industry benchmark of the world's most consistently performing asset managers.

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