Hedge funds left reeling as VW races on
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Volkswagen's soaring share price seems certain to have inflicted heavy damage on some hedge funds and banks. Rough calculations suggest losses as of last night could be as high as €30bn ($38bn).

But the list of losers could extend far beyond the unlucky investors who bet wrongly on VW's share price falling. One hedge fund manager caught in the crossfire says: "This thing will leave no winners."

The comment reflects the reality that hedge funds are first up in the losers' list. "I have hedge fund managers literally in tears on the phone," says one London-based car analyst.

Many hedge funds, particularly those seeking to arbitrage between related securities, have taken positions in VW. According to some industry insiders, more than a hundred hedge funds have sold VW shares short -where they bet on the stock price falling. Data Explorers, a research company, shows that about 13 per cent of VW's shares were lent out for short-selling, the highest proportion among large German companies.

One of the common trades in VW was to short ordinary shares and buy preference shares. The bet was made because, at the start of the year, the former were trading at a 50 per cent premium to the latter and the expectation was that the spread between the two would close. Instead, the ordinary shares have soared while the preference shares fell.

"It is the worst investment in the history of financial markets," says one fund manager. When Porsche revealed at the weekend that it had lifted its stake in VW from 42.6 per cent to almost 75 per cent using derivatives hedge funds panicked as it effectively cut the free float to only 5.8 per cent from 45 per cent.

Speculation also mounted yesterday over the exposure of banks to VW. It is assumed that many banks acted as counterparties to Porsche and have thus lost money. Unsubstantiated rumours led shares in France's Societe Generate to drop 17.5 per cent at one point with Morgan Stanley down 11 per cent and Goldman Sachs off as much as 8 per cent.

But many investors suggested there could be a bigger loser: the entire German capital markets. Shareholders are angry at how Porsche could amass such a high stake in derivatives without disclosing them. Klaus Kaldemorgen, the head of Germany's largest fund manager, DWS, said it risked having systemic issues for the country: "It cannot be that a share in a prestigious index like the Dax can rise by more than 100 per cent in one day because of the small free float."

Deutsche Börse, the organiser of the Dax-30, said its management board was monitoring the situation closely. But an official said suggestions by one investor that VW's ordinary shares would be forced out of the Dax on Friday - to be replaced, ironically enough, by its preference shares -were "likely to be wrong".

Further questions have been raised about Bafin, the German financial regulator. It says it is continuing to monitor the situation but hasn't started a formal investigation.

Bafin insists Germany's rules on the disclosure of derivatives are similar to other European countries.

Some bitter investors suggested yesterday that Porsche could also run out a loser. It is unclear how much of its 31.5 per cent stake in VW held through derivatives it will be able to convert into shares as they could be too expensive and the market too tight. It also faces some unintended consequences such as triggering an automatic bid for Scania, the Swedish truckmaker in which VW has a two-thirds stake, if it lifts its equity stake in VW above 50 per cent. Porsche did not return repeated calls for comment.

One of the few winners in the whole saga could be the government of Lower Saxony, VW's home state, which holds a 20.1 per cent in Europe's largest carmaker. That holding was worth €47bn yesterday.

Fonte: Financial Times, London, October 29 2008, Companies & Markets, p. 16.