

LTCM case

**FIN 319
Winter 2001**

**University of Michigan
Business School**

Maximum score for each question is in brackets. Please, make your answers as short as you can: you save time on writing, and I – on grading. Also, when you have to be short, you have to think very clearly. It helps when the questions are complex.

Maximum total score is 100. The maximum score for each question is in brackets.

Question 1 [30] Please, read the article:

“Winding up LTCM's positions threatens market's morals,” South China Morning Post, Hong Kong, Oct 18, 1998.

It could be downloaded from URL:

<http://www.citi.umich.edu/u/galka/319/SouthCh98.txt>

Answer the following questions:

1.1 [10] What do you think about the author's perspective: is it correct or incorrect, and

1.2 [10] Whether the issues that are raised in the article are serious (i.e. they have the potential of causing a damaging effect on financial system)

1.3 [10] Comment why the author has chosen this specific publication.

Question 2. [24] Please, read the article

"Long-Term Capital Chief Acknowledges Flawed Tactics,"
Wall Street Journal, August 21, 2000, from URL

<http://www.citi.umich.edu/u/galka/319/Meriwether2000.txt>.

Also, you might be interested to read the article

"Manager of Hedge Fund Fiasco Seeks to Repair His Reputation,"
Wall Street Journal, August 22, 2000, from URL

<http://www.citi.umich.edu/u/galka/319/aboutMeri2000.txt>.

2.1 [8] Comment on the reasons for the Meriwether's "change of mind".

2.2 [8] What do you think Meriwether's real beliefs are?

2.3 [8] Do you believe that Meriwether really changed his mind? Why or why not?

Question 3. [15]

3.1 [5] Do you think that Federal Reserve orchestrated bailout of LTCM was due:

a. too big to fail

b. too important people to bear the losses

c. care about avoiding of the financial crises

Write to 1 - 2 sentences to support your point about each item a. – c.

3.2 [5] Do you think that the considerations a. or b. were essential in how the bailout was orchestrated?

3.3 [5] If Central Bank would have been able to see into the future: would you think they would have repeated their bailout?

You might find it useful to read the article

“Long-Term Capital's Partners Got Big Loans to Invest in Fund,” Wall Street Journal, October 6, 1998, from URL:
<http://www.citi.umich.edu/u/galka/319/bailout98.txt>

Question 4. [9]

Present a short list of errors that you have noticed in the Nova documentary *Trillion Dollar Bet* (2000).

Question 5. [15]

Use the papers (were distributed and discussed in class)

Scholes, Myron, 2000, "Crisis and Risk Management", *The American Economic Review*, Vol. 90, No. 2, pp. 17-21. [The near crash 1998]
and

Kho, Bong-Chan, Lee, Dong and Stulz, Rene, 2000, *The American Economic Review*, Vol. 90, No. 2, pp. 28-37. [The near crash 1998]

5.1 [6] Was Prof. Scholes paper biased (in a sense of the favorable presentation of the LTCM fund strategy / actions)?

5.2 [6] How (if it was) his analysis was influenced by the fact that he was an 'insider'?

5.3 [6] What are the relevant issues that are overlooked in the second paper?
[Hint: See Michael Lewis article

"*Winding up LTCM's positions threatens market's morals,*" South China Morning Post, Hong Kong, Oct 18, 1998.

Also, think whether FED had the incentives to keep the banks participating in the bailout 'happy'.]