

# TRADER

MONTHLY

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## THE TOP TRADES OF THE YEAR!

THE BEST, WORST AND MOST AUDACIOUS TRADING FEATS OF 2005

T. BOONE PICKENS REVEALS HIS SECRETS

A KILLING IN HONG KONG

THE RETURN OF A HEDGE-FUND HELL-RAISER

30 HOLIDAY GIFTS THAT KEEP GIVING — To You!

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- ⌘ HAWAIIAN GOLF
- ⌘ ULTRALIGHT JETS
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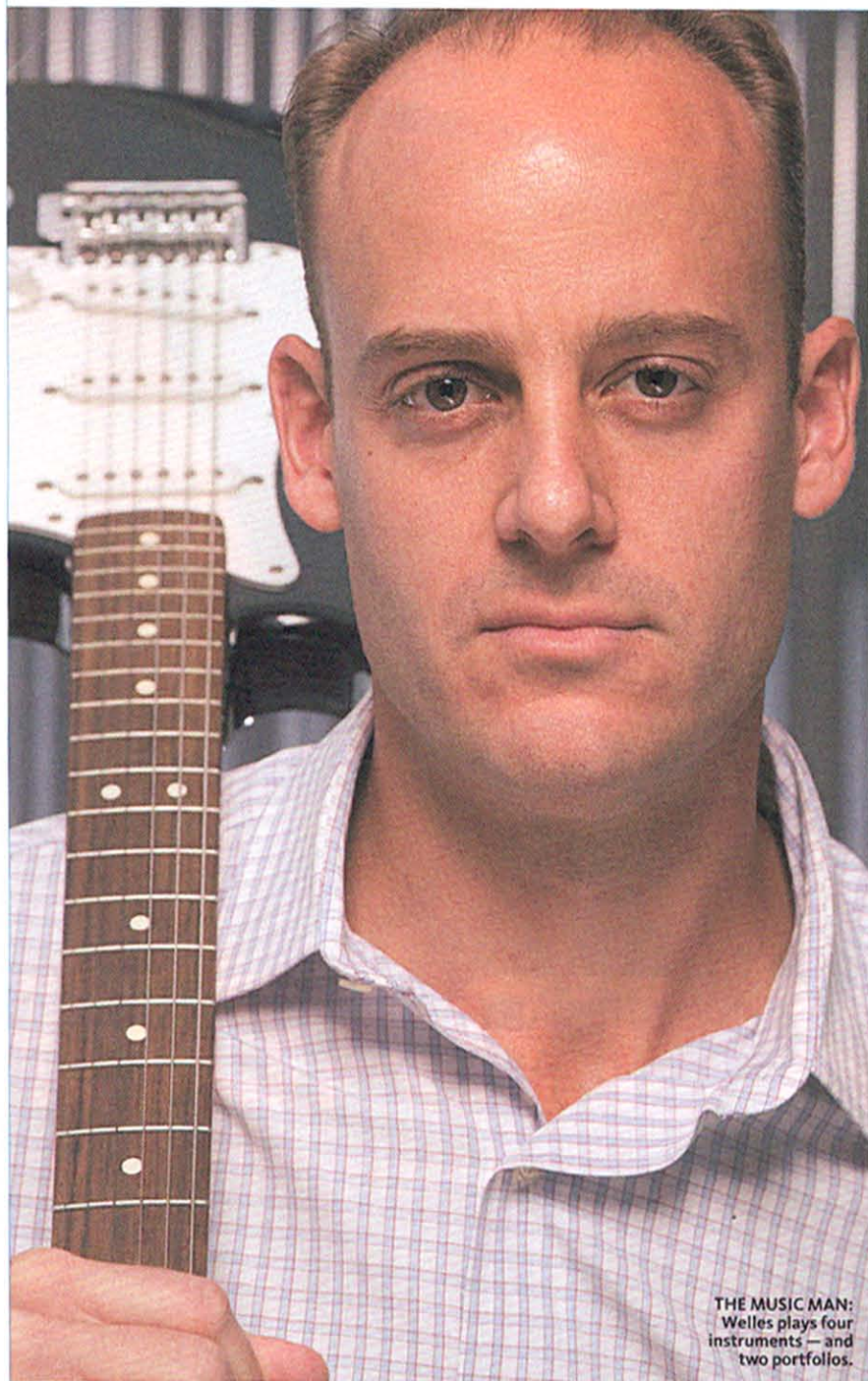
DIRECTIONS

CLOSE

INSIDE: THE PIT BULL HONORED, MULLING BAYDOL'S DEBACLE, THE OTHER BLACK GOLD

“The market is like music. Orchestrating it while keeping the beat — that’s the challenge.”

Mead Welles is a guitarist, drummer and pianist — and also a hotshot trader whose note-perfect emerging-market plays keep his two hedge funds in tune. As for the returns he generates? They’re music to his ears. See “Scaling Profits,” page 52



**THE MUSIC MAN:**  
Welles plays four  
instruments — and  
two portfolios.

## SCALING PROFITS

PERFORMANCE

Mead Welles drums up success for his two Octave hedge funds by applying theories he learned as a musician  
BY IMOGEN ROSE-SMITH

**SHELTER ISLAND**, New York, late afternoon on the last Saturday before Labor Day: Roughly 50 people gather at a tony country club to check out a Wall Street-centric band called, appropriately, the Subscribers. Pounding the drums is Mead Welles, manager of two hedge funds, Octave-1 and Octave Entertainment, who sets the beat for the band's bluesy, throwback rock n' roll.

Back at the Manhattan office of Octagon Asset Management, where the conference room often doubles as a practice studio for the band, the percussionist trader describes how his musical abilities influence how he approaches the world of trading and structured finance. "With music, there's a finite framework within which to operate," says Welles, 38, who in addition to the skins plays guitar, bass and a little piano. "But within that framework are an infinite number of combinations." The same holds true for the markets. There might be only a limited number of ways in which a transaction — a securitized loan to a small Third World company, say — can be structured. But within those limited variables, like the eight notes in an octave, are limitless possibilities.

Large banks, which tend to overlook the type of obscure deals through which Welles's funds prosper, think only in scales. A nimble, innovative fund manager with a good ear, he says, can make money by viewing the capital markets as no less a space for innovation than the recording studio. Thus, for Welles, Octave isn't just a cool-sounding name chosen to reflect his appreciation for music. It underlines his belief that the funds, which between them have attracted more than \$300 million, can create opportunity within structural limits.

Welles's specialty is emerging-market corporate financing. For example, imagine that a small company in Venezuela is seeking to raise short-term operating capital. For credit-risk reasons, major lenders won't touch it with a 10-foot drumstick. Even if a bank were willing to make a loan, it would come with a crippling premium.

Banks are not thinking outside the box. They're looking skeptically at the limited options available, the ways in which a loan

can be provided. Here's where Welles makes his beautiful noise. Octave will package the deal in such a way as to effectively mitigate both the credit and the cross-border risk yet still earn a very attractive yield. It might mix credit types, or secure a loan in a way that makes it less vulnerable to the risks generally associated with a small company in a country under authoritarian rule. But Octave will come up with the cash at a premium that isn't ear-splitting.

And the beat goes on, because Octave can turn around and sell the deal, at a profit, to the banks that were unwilling to lend in the first place.

"There are opportunities to approach the marketplace and extract value or create arbitrage through structured finance solutions," says Welles, whose soft-spoken style belies the fact that he rides to work atop a yellow BMW motorcycle. "Most money managers focus on exchanges and traditional markets, not on the OTC structured-product markets."

Welles takes the risk for them, prepackaging offerings for the secondary market, albeit at a premium.

At any time, Octave-1, which has averaged an 11.5 percent annual return since inception, might hold securities linked to 30 such emerging-market financings in its portfolio. Its success depends not just on the individ-

A native of Lake Forest, Illinois, Welles went to Middlesex, a prestigious boarding school in Concord, Massachusetts, outside of Boston, where "our music program was just phenomenal," he says. A strong music program was also a guiding factor behind his decision to attend Bates College, a liberal-arts mecca in Lewiston, Maine, although he majored in economics. "I wanted to make money," he says.

"Mead is a true Renaissance man," says Chris Heasman, a director at Lazard Asset Management and a guitarist/vocalist in the Subscribers. Welles got his start in finance in 1989, working as a research analyst for Shearson Lehman in Chicago. He began trading in the asset-management arm of Cargill and later moved to the emerging-markets division, focusing on Russian and Brazilian paper. In 1996, after being stiffed on his bonus despite having had one of his best years at Cargill, Welles split to launch his own funds.

Two years later, his divergent interests merged when he began to work on deals similar to "Bowie Bonds" — securities tied to royalties of future sales of David Bowie's album catalog — and launched the Octave Entertainment Fund with the idea of securitizing entertainment-royalty streams. Currently, he is close to completing a deal

## "MUSIC, LIKE TRADING, HAS A FINITE FRAMEWORK WITHIN WHICH ARE INFINITE COMBINATIONS."

ual transaction, but on how it works in a risk-diversified portfolio. "Playing the drums is the ultimate in multitasking," Welles argues. "You have all these different components, so your brain has to compartmentalize what is happening." Similarly, a portfolio is a series of compartmentalized transactions. The key is being able to make the components work together. "Breaking it up and at the same time orchestrating it, all while keeping the beat — that's the challenge," he says.

to securitize ticket sales for the Rolling Stones' tour in Germany.

Meanwhile, the Subscribers are set to release *Clarksdale 9*, their first album of all original songs, with proceeds going to a charity called A Leg to Stand On, which provides artificial limbs to Third World amputees. It has oversubscribed. Says Welles, "We've already received orders for 1,000 copies, and it hasn't even been released." Pretty good arb, if you ask us. ■