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PROFILE

Dancing with Stars

Talking With Rick Lake, Co-Founder, Lake Partners

By J.R. BRANDSTRADER

July Hedge Funds: Best, Worst, Biggest

RICK LAKE KNOWS THAT IT TAKES MORE than fancy footwork to be a winner on the dance floor; it also takes a talented partner.

Lake is a money manager and avid competitive dancer. One of his regular mambo partners, Anya Garnis, was a recent finalist on *So You Think You Can Dance*, the hit TV show in which contestants vie for $100,000, a new car, and a professional dancing contract.

Similarly, when it comes to investing, Lake Partners, the Greenwich, Conn., investment-advisory firm run by Lake and his brother, Ron, depends on veteran investment pros with winning long-term records and a knack for navigating through tough markets.

"I like experience," Lake says, speaking from the expanded Victorian building that houses the company's office. The structure is also the home of Aptons of Greenwich, an old-school haberdashery run by a man named David Proudfit. "He's conservative and good," Lake says of the aptly named Proudfit. "He'd be glad to customize whatever you buy."

Much the same could be said of the separately managed accounts that Lake Partners offers, which have had excellent results over the past decade.

Rick and Ron both went to Harvard where their mother, Cis, was among the first women in the business school. Mom may have given him a taste for business, but their dad, Herman, an engineer, taught him to appreciate math, which Lake says helps his dancing and his investing.

Lake Partners, which was founded in 1989, offers consulting services to funds of funds, endowments and professional and private investors that, combined, have $6 billion in assets.

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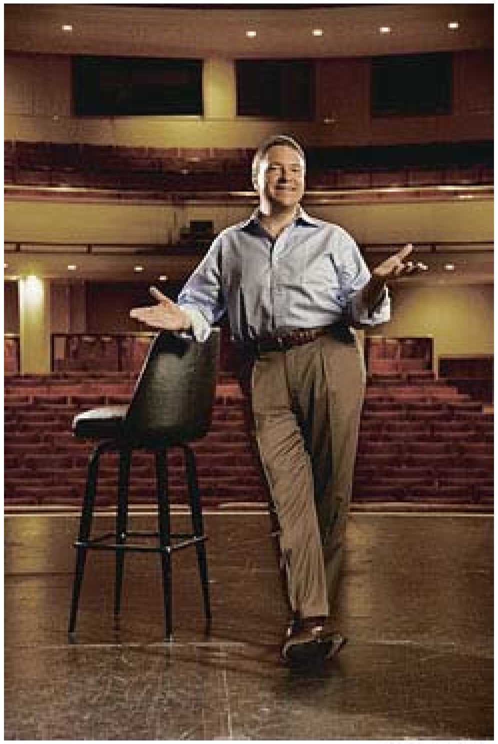
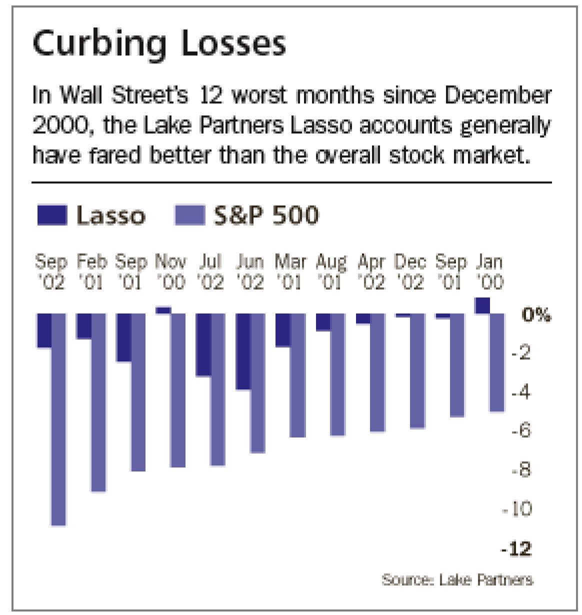

Gary Spector

Rick Lake

The firm directly manages an additional $543 million for private clients, foundations, endowments, retirement plans and insurers. Among its varied offerings are separate accounts and a fund that follows its Long and Short Strategic Opportunities strategy, known as Lasso. Since the strategies' inception in December 1998 through the end of this year's first half, these investments were up 78.5%, net of fees, handily beating the S&P's 500's 40% gain over that stretch -- which includes the brutal three-year bear market that began in the spring of 2000. The key to success for these investments has been the strategy's ability to work in both up and down markets, with the help of hedging aimed at minimizing risk. There are $103 million in assets in the Lasso separate accounts, which require a $250,000 minimum initial investment. But accounts that are part of a retirement plan can include a Lasso fund. One benefit: The fund, which has $17 million in assets, imposes no minimum-investment requirement if it is held in a qualified retirement plan.

Neither the fund nor the separate accounts themselves are registered with the Securities and Exchange Commission. But all of their holdings are hedged mutual funds that are SEC-registered.

Steve Deutsch, an analyst with Morningstar, the Chicago-based investment-research outfit, calls Lasso "a hedge fund-like investment strategy for Main Street investors."



For Lasso separate accounts, Lake charges a management fee equal to 1% of assets, and the average weighted expense ratio of the funds in its portfolios is 1.6%. The firm gets no incentive fee; hedge funds typically take 20% of any profits a client's holdings produce.

Overall, Lake Partners tries to protect its clients against big drops in the market, while generating "alpha," a long-term return higher than that of the overall market.

Narayan Naik, a professor at the London Business School, says that "portfolios that deliver alpha and have lower exposure to systematic risks than typical long-only funds have a better chance of preserving value" during periods of market turmoil, such as the past few weeks.

Naik adds that his research shows that hedged mutual funds run by managers with experience of implementing hedge-fund-like strategies significantly outpace those run by managers without such experience.

That's where market veterans, such as Mario Gabelli (a *Barron's* Roundtable member), Fred Green and David Winters come in.

TO TAP THE MERGER-AND-ACQUISITIONS market, which was extremely hot until the credit market tightened up on concerns about the subprime-mortgage debacle, Lake Partners uses the Gabelli ABC Fund (ticker: GABCX). "If the world is riskier, spreads are opening up, so somebody doing merger arbitrage for existing transactions is making more money," Rick Lake says. He also likes the fact that "Gabelli ABC has never lost money in any full calendar year since its 1993 inception."

Lake also is putting some money into the Merger Fund (MERFX), whose manager, Fred Green, has extensive experience at evaluating deals, in markets lovely and lousy. That fund has "been adding opportunistically to positions in announced deals that [its] research shows have secure financing and agreements with few escape hatches for the parties involved," says Morningstar analyst Dan Culloton.

At the same time, Lake thinks that the recent market woes have provided some great opportunities for investors like David Winters, who travels far and wide to find promising situations for his Wintergreen Fund (WGRNX). "He is a stockpicker picking stocks on the long and short side and when markets become disruptive, it creates opportunities to buy stuff cheap and you have a catalyst to actually do some short-selling," says Lake, who calls Winters "a value guy who just can't wait to buy stocks cheap."

Morningstar analyst Bridget B. Hughes notes that Winters has displayed an admirable trait: an ability to stanch his fund's losses in down markets. "That has helped Winters' [fund] hold up well during tough times, such as the bear market that began in March 2000," she says.

Using such funds has helped Lake Partners curb its clients' losses when the bears take over (see chart).

Other funds that Rick Lake favors include Janus Adviser Long/Short (JALSX) and ProFunds Short Real Estate Investor (SRPIX).

The Janus fund, run by portfolio manager David Decker, "uses return on invested capital to identify long and short opportunities worldwide, which has really paid off lately," Lake says.

And while the ProFunds offering, like most real-estate funds, has taken its lumps lately, Lake says it offers excellent opportunities to patient investors: "The yields on REITs [real-estate investment trusts fell] below 10-year Treasuries' [recently]... an ... anomaly not likely to persist," he predicts.

That said, Lake points out that he never invests more than 2% to 5% in volatile or specialized situations, regardless of how tempting they appear. As in competitive dancing, the aim is to produce impressive lifts while avoiding embarrassing drops.

J.R. BRANDSTRADER, a free-lancer based near New York City, is a frequent contributor to *Barron's*.

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