Hedge fund manager Bill Ackman wiped out nearly $2 billion in a bet on Target’s stock. So why is he so sure he can fix his problems—and America’s?

Bill Ackman’s friends describe him in two ways. They offer the euphemism that the prominent hedge fund manager “does not suffer from low self-esteem.” Then they observe that he is optimistic—almost clinically so. A pop psychologist might diagnose Ackman with hypomaniac, a condition notable for persistently elevated moods but without the self-destructiveness of true mania. “He doesn’t register reversals and defeats and hard feelings the way other people do,” says David Klafter, a former colleague.

I ask Ackman about the condition while he is driving in a car with his family. He hasn’t heard of it, but says he is an “extremely resilient person.”

His 11-year-old daughter playfully chides from the backseat, “And you’re modest.”

Ackman is an activist investor, a respectable term for people who in the 1980s were known as corporate raiders. He buys big stakes in companies and then offers his opinions—loudly—on how to improve their operations. Often, Ackman has been a contrarian. He bought shares of Rockefeller Center when Manhattan real estate was on its back in the mid-1990s, and he launched an attack in 2002 on MBIA
In 2007, he sounded one of the most prescient warnings about the credit bubble and the leveraged complex of American finance.

William A. Ackman, who turns 43 this month, has had the seminal financial career of the past two decades, which is to say that he’s had the seminal American career of the era. Almost immediately after business school, he started a hedge fund to manage millions for wealthy people—with no investing track record. About a decade later, he was forced to shut down. He endured regulatory investigations played out in the klieg lights of the press. He relaunched and clawed his way back to respectability, becoming a member of a new generation of Wall Street wise men. No hedge fund manager or investment banker will be able to replicate his trajectory for at least a generation.

Now he’s gearing up for one of the biggest battles of his professional life. After losing nearly $2 billion in a calamitous bet on the retailer Target Corp.—almost all that investors had given him for the investment—he is waging a proxy fight against the company. He will have a tough sell in the leadup to the annual shareholder meeting in May. Taking on a company as big as Target is almost unheard of. Target decries the contest as "costly and disruptive."

Investors don’t want to hear much from hedge funds these days, and the tide may be turning against activism.

Panicked companies are focusing on their core business, not their capital structure.

At the same time, Ackman is talking about a much bigger turnaround situation: the United States. On a recent day in his glass-walled corner office in midtown Manhattan, he tells me with a smile, “I’m long America!” His tie is slightly loosened, and the sleeves on his blue shirt are rolled up. He is crafting a “plan to save the universe,” he says, with a slight glint that shows he is aware of the hyperbole. He recounts how he and Michael Porter, a Harvard Business School professor, recently had a “fantastic” meeting with Lawrence Summers, the director of President Barack Obama’s National Economic Council, to pitch their proposals for fixing the financial crisis and improving the market for mortgages.

“I’m long-term bullish on America but not on things turning around in the next few months, or even 12 months,” he says. “We’ve had the equivalent of a heart attack, but now we are in recovery, hopefully. It takes time to heal.”

These days, the public, enraged at the moneyed class of Wall Street operators, is in revolt over bonuses and rewards for failure, while Washington plans new regulations for hedge funds, and investors pull their money out of the industry. Ackman, who has been publicly vilified, can’t keep himself away from the spotlight. It’s almost in his nature to stand up and say that he has answers.

Overconfidence from financial types is what caused this grave economic crisis in the first place, of course. It can be a worrisome quality. But if you are Bill Ackman, you’re betting that confidence, correctly administered, might just get us out of it too.
Though often perceived as arrogant, Ackman up close might be the most winning salesman on Wall Street. Partly it’s because he explains each burst of an idea with overwhelming detail, lucidly laid out. But it also has to do with his boyish face—a rounded-off nose and high, rosy cheeks topped incongruously with a signature shock of gray hair that he’s had since high school. Going prematurely gray builds character, Ackman says.

“He’s gained a huge following of admirers, both male and female,” says Laurel Touby, founder of the internet company MediaBistro.com, which Ackman helped bankroll. “People fall in love with him. It’s almost like he’s the Bill Clinton of finance.”

Ackman thinks that the financial rescue of the banks, a plan which has been carried over from the Bush administration, is wrongheaded. And months before his meeting with Summers, that began to concern him. “I always thought the country would survive Washington. Now I feel like I have a civic duty if I have a decent idea for how to solve a financial problem,” he tells me.

A few weeks later, we speak again. “I’m so busy it’s driving me crazy,” he says. “Every day I don’t get this plan out, I feel the country is going to ruin.” In unguarded moments, he has a tendency to become grandiose. In public settings, he’s learned to restrain himself, speaking in interviews with a curious calm.

Ackman believes that the financial-system bailout has been flawed. The government has put taxpayer money into financial institutions at the wrong time and in the wrong place within their capital structures. So far, we’ve aimlessly given billions to banks. That money could wind up going toward bonuses, dividends, or interest payments on debt, merely delaying the inevitable failure of the insolvent ones. Many economists argue for more aggressive nationalization of insolvent banks, but policymakers have been reluctant to take that route, wary of harming bondholders. Ackman wants these creditors turned into the equity holders of insolvent banks, through carefully adjudicated reorganization processes, before the government ponies up more money.

Ackman and Porter also worry that Treasury Secretary Tim Geithner’s rescue plan is overly focused on shoring up the securities and derivatives tied to mortgages. Instead, the duo would target the mortgages themselves in a way that they contend would be cheaper than the government’s approach. Ackman likens the situation to a $100,000 house with a million-dollar insurance policy. When the house burns down, rather than paying off the policy, the house should just be rebuilt. Ackman’s idea is to have the government offer to buy defaulting mortgages for 50 cents on the dollar. Such a guarantee would put a floor under the market and induce the owners, most of which are mortgage-servicing companies, to sell to the government if they can’t find better deals elsewhere. If values in the mortgage market stabilize, the result will be a beneficial cascade through the value of all those securities and derivatives. Leverage got us into this mess; Ackman wants to reverse it to get us out.

Even as the hedge fund business implodes from its own hubris, Ackman’s three main funds, which are...
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In 1994, Gotham bought shares in a real estate investment trust poised to take control of Rockefeller Center, effectively becoming the largest holder of the real estate complex. At the time, the New York commercial real estate market was in a devastating slump. Thrusting himself into a highly publicized takeover battle, Ackman scored huge returns on his investment when the REIT was bought. He was on the map.

Over the next three years, his fund averaged returns of 40 percent annually after fees. Gotham hardly ever shorted or bet against
companies. But one day in early 2002, Whitney Tilson, a friend of Ackman’s since their days at Harvard College, called him at home to recommend that he buy a stake in a company called Farmer Mac, the Fannie Mae of farm mortgages. Ackman printed the annual report and started reading it around 9 that night. Riveted, he continued past midnight. He called Tilson first thing the next morning, excited. Farmer Mac was indeed an opportunity, but Tilson had it wrong. Ackman didn’t want to buy the stock; he wanted to short it.

Gotham placed its bearish bets. Then Ackman confronted a problem—how to get his negative message out. He began by talking to a reporter at the New York Times but didn’t think the resulting story made the case strongly enough, so he set up a website for the express purpose of displaying a report he wrote, with disclosures that his fund was short Farmer Mac’s stock. Going public on a short is an invitation to be attacked by companies and investors.

Ackman relished the frenzy that ensued. He’s still proud of the report’s title, “Buying the Farm.” And he profited spectacularly from the results: By fall, Farmer Mac’s stock had collapsed.

Fresh from the Farmer Mac success, Ackman launched an audacious assault on MBIA, a company at the center of both Wall Street and state and local finance across the country. This move would prove remarkably insightful once the financial crisis hit, but vindication would be years in coming. First, Ackman was forced to undergo a remarkable battle with the company and its regulators.

MBIA dominated a sleepy, safe, and wonderful business: insuring municipal bonds from default. Since muni bonds almost never defaulted, MBIA almost never had to pay off the insurance. But when Ackman surveyed the company’s filings, he realized that MBIA had, to a degree utterly unrecognized by Wall Street, shifted into the business of insuring a vast array of much more dangerous paper: collateralized-debt obligations, or CDOs, which were constructed by the big banks to combine the bonds of multiple companies.

Expecting MBIA to default, Gotham began buying credit-default swaps, a form of short-selling in the unregulated derivatives market. If other investors became worried that MBIA would default, Ackman could sell the credit-default swaps for a gain; if MBIA actually did default, he would make a king’s ransom.

MBIA got wind of Ackman’s research and asked to meet with him. On November 21, 2002, Gotham representatives sat down with top MBIA executives. As people who were there recall the meeting, Jay Brown, the CEO of MBIA, began by saying how long he had been in the insurance business. “No one has ever questioned my reputation or my company’s,” he said. “You are using an unregulated market to manipulate a regulated market,” referring to MBIA’s insurance business. “You’re a young guy. It’s early in your career. You want to think very hard before you release that report,” Brown said, pointing out that MBIA was the largest guarantor of municipal bonds in New York State and the country.

“Is there anything you disagree with or that’s factually inaccurate?” Ackman asked.

“This is not about the facts,” Brown replied. “Let’s put it this way: We have friends in high places.” (An MBIA
spokesperson says that the purpose of the meeting was to learn Ackman’s intentions and to request an early copy of his report to be able to point out any inaccuracies.)

The tense encounter lasted less than a half-hour. As they walked out, Ackman’s analyst shook Brown’s hand. Ackman then held his hand out to the CEO. Brown looked at it, lifted his arm up, and said, “I don’t think so.”

The hedge fund young turks walked away feeling threatened, thinking that MBIA would sue them. Ackman, though, was also exhilarated. On December 9, 2002, Gotham put out a devastating 66-page summation of the company’s precarious financial position called “Is MBIA Triple A?”

Nothing much happened. The stock actually went up that day.

The months that followed probably mark the period during which Ackman’s optimism-to-reality ratio hit a peak. As the case against MBIA was building, Gotham was falling down. Ackman and Berkowitz’s performance had been lackluster for several years running. Gotham had made several investments in privately held companies, and like many hedge funds in 2008, it found itself stuck with these illiquid assets as some investors were asking for their money back. Ackman and Berkowitz decided they had to wind Gotham down.

Things got worse. In January 2003, the office of then New York State Attorney General Eliot Spitzer subpoenaed Ackman. The Securities and Exchange Commission began an informal inquiry a few weeks later. At first glance, Gotham’s MBIA report looked as if it might be a case of a hedge fund trying to generate a huge amount of negative attention for a stock and then profit from the fear—a “short and distort” campaign. Gotham was pilloried in the press.

A dual investigation is almost every hedge fund manager’s nightmare. Not Ackman’s. “Now I’m going to be able to sit across from Eliot Spitzer and explain to him my concerns!” he told his skeptical Gotham colleagues.

Between March and June, the attorney general’s investigators hauled him in for six grueling days of testimony. Aaron Marcu, Ackman’s lawyer, tried to rein him in and keep him from saying anything that might later be used against him. Once, he interrupted Ackman to tell him he had already answered a question.

“Leave me alone,” Ackman snapped. “I’m not finished yet.” With that, he rose, unbidden, to a large pad perched on an easel and started diagramming MBIA’s serpentine financial structure. He expected to flip the AG’s team against MBIA.

Remarkably, he succeeded.
After a nearly four-year-long investigation, MBIA agreed to settle civil securities-fraud cases with the SEC and the attorney general’s office, paying $75 million in fines and restating seven years of earnings. David Klafter, who was then working as Gotham’s general counsel, says, “How often does a complaint go to a regulator and it boomerangs and the complainant ends up getting sanctioned? Not often, right? It happened to Bill.”

By January 2004, Ackman was back in the investment business, launching his current hedge fund, Pershing Square Capital Management. Over the next few years, he honed his approach to shareholder activism, scoring big investment wins with Wendy’s and McDonald’s.

Throughout that time, though, MBIA’s stock held strong. Employees at Pershing Square “thought I had gone off the deep end. And there were investors who did not invest in Pershing Square because they thought I had just lost it on this MBIA thing,” Ackman says. As time went on, he couldn’t stop thinking about the company. “I have trouble saying ‘MBA’ without saying ‘MBIA,’” he tells me. Once he was walking down a street on Manhattan’s Upper West Side, and he saw a woman wearing a sweatshirt with MBIA on it. Was it some kind of division of the company that he didn’t know about, he wondered? He repeated the word on the sweatshirt out loud to himself: “Co-loo-M-B-I-A, Co-loo-M-B-I-A.” Suddenly, he realized he was looking at a woman dressed in Columbia University garb.

In his office one recent late afternoon, he beckoned me over to his computer, with a look of pride. He launched a video of two young girls performing a catchy, singsongy tune. A few years ago, his two daughters had composed this song-and-dance routine as a present for their father:

**MBIA is a bad company**

They make people promises
  they don’t keep
**MBIA is a bad company**

**MBIA is a bad company**

They lie to people and the
government and do bad things
**MBIA is a bad company**

**MBIA is a bad company**

Yes it is. Yes it is. Yes it is.

Ackman’s MBIA investment led him to a conclusion that proved pivotal in light of the coming credit crisis. In the spring of 2007, when the Dow was over 13,000 and the world was awash in money, he began giving a speech to investors called “Who’s Holding the Bag?”

The talk began with a warning that a virtuous credit cycle works viciously in reverse. It discussed the risks in mortgage-backed collateralized-debt obligations, corporate lending, and commercial real estate markets. He raised alarms about the credit-rating agencies’ conflicts of interest in the structured-finance market. He concluded that since the most highly rated paper, the triple-A portion, was more vulnerable than anyone realized because of poor lending, bond insurers like MBIA were in deep trouble. And if they were in trouble, all
the parties that thought they were insured would also be in trouble. "When the losses hit, these guarantees will have no value, and counterparties are left holding the bag," he said.

Few investors bought it at the time, but that's exactly what happened over the next two years. It became clear that bond insurers wouldn't be able to make good on their insurance, so banks—the bond insurers' customers—were forced to take hundreds of billions of dollars in losses. MBIA reported $1.9 billion in losses in 2007 and an additional $2.7 billion in 2008. When Ackman started giving his talk, MBIA's stock was in the upper $60s per share, close to an all-time high. By early March, MBIA was trading at approximately $3 a share. “The original thesis [about the company] was very much incorrect," says Kevin Brown, MBIA's spokesman. “I'm not going to deny his call on the mortgage market was correct.”

Late last year, Ackman closed out his MBIA positions. Overall, after six years of battle, his MBIA investments returned about $1.1 billion in profit. He has pledged all his personal proceeds to charity. He's already donated about $50 million to his Pershing Square Foundation and to education causes and still owes about $100 million to make good on his promise.

Perhaps more surprising, Ackman managed to turn Spitzer into one of his defenders. While Spitzer was governor of New York, they met to discuss mortgage insurers, including MBIA. Today, Spitzer says of short-sellers, “In terms of contribution to the marketplace, they are critically important and unpopular because of it. We know there's bias in favor of affirmative analytical work." The former governor also tells me, “Bill is extremely smart," adding that “he is obviously a guy who understands finance.”

When I ask Ackman how he feels now that this epic Wall Street battle is over, he pauses maybe for the first time that I've heard since we've met. He laughs uncomfortably. “I don't feel like it's over because MBIA still exists," he says finally.

Despite his insight about the precariousness of the financial system, Ackman puzzlingly didn’t follow through to anticipate the pain of the American consumer. That led to a series of mistaken investments in retail. His Target investment has been the worst of all.

In 2007, he set up a special fund to invest in a single stock in a highly leveraged way. In a sign of how frothy the markets were, he raised $2 billion from start to finish in a week, about two-thirds of which came from other hedge funds. Investors knew the outlines of the investment but not that it would be in Target.

In his main funds, Ackman buys big positions in a few stocks. He maintains little leverage to reduce the risks inherent in this concentrated investing style. But he gets his risk jones on with single-stock funds. They are at once flying-too-close-to-the-sun ventures and deeply savvy moves. Even if the ideas flop, he is still in business.
Ackman urged Target’s management to sell its credit-card business to get rid of consumer-credit exposure and use the proceeds to buy back stock. He also wanted the company to realize the underlying value of its vast real estate holdings. Target bought back stock, but so far that has been a poor use of money. The company also moved partly on his credit-card suggestion but hasn’t heeded his real estate advice.

By the fall of last year, Ackman was getting into a bad spot. Some of his long-dated options were set to expire at the beginning of 2009. He couldn’t renegotiate them in the middle of the market panic.

On October 29, Ackman rented a giant theater in the Equitable Building in midtown Manhattan. He presented to hundreds of investors and reporters his plan for Target to spin off its real estate into an innovative real estate investment trust. The lengthy, complicated presentation of roughly 150 slides took about an hour and a half, with an extra 15 minutes for questions.

Ackman wasn’t the only one under strain. Target’s sales in stores open a year or more were falling. In December, Gregg Steinhafel, the retailer’s CEO, came to New York to meet with some investors. He panned the REIT idea and said Ackman was simply buried in his position and trying to jack up the shares to get out. In a sign of frayed nerves, he also attacked customers of Kohl’s, one of Target’s competitors, as having “low IQs.” Target smacked Ackman down twice, rejecting the proposal.

Target’s stock was tumbling; Ackman’s leveraged fund was doing much worse. By early March, as Target’s stock continued to fall, Ackman’s Target fund was down 93 percent.

The broken investment led to at least one strained friendship. Hedge fund manager Dan Loeb had put money into the Target fund and had been bombarding Ackman with emails, demanding that he let him out of his investment or wind down the fund. Loeb essentially ran an activist campaign against him, prompting Ackman to reorganize the fund: He waived management and incentive fees for investors in it, put $25 million of his own money in, and finally succeeded in extending the options. But he’s had enough of the excitement and leverage of a single-stock fund. “I think I may never do it again,” he says, chastened.

In early March, Ackman had another run-in with a New York State attorney general. Andrew Cuomo called him about the Target fund situation. “It’s kind of a scary way to begin a conversation with the AG!” Ackman says.

But Cuomo was calling to compliment him on how he treated his investors in revamping the fund and waiving his fees, saying that is what the hedge fund business needs. “How cool is that?” asks Ackman, excited as a boy.

Some investors think Ackman doesn’t understand the subtleties of retailing. “Activists may have been well intentioned, but many have seriously hurt many retailers by urging them to buy back shares and to increase debt,” says David Berman, a retail investment specialist who runs the hedge fund Durbin Capital. “Businesses were made unhealthy in front of our eyes, and management
and boards were fooled by smooth-talking activists and bankers alike who misguided them.” Ackman counters
that his advice has never saddled a company with too much debt.

By March, Ackman owned stock and controlled options in Target worth about 7 percent of the company. And
he was gearing up for the big fight to get board seats. At Target’s annual meeting in May, Ackman is running
for a position on the company’s board. He has recruited four other candidates who have specialized in real
estate, credit cards, and retailing to serve on his slate. “It’s going to be very high-minded,” he says of his
campaign. But he is also evincing the old stubbornness. “The only Stalinesque election process in America is
the election for directors of American corporations,” he tells me. “And I just think that’s wrong.”

Maybe because Ackman has lost so much money with Target, he’s been more reflective lately. “The
investment business is about being confident enough to know that you’re right and everyone else is wrong.
Yet you have to be humble enough that you recognize when you’ve made a mistake,” he says. “Earlier in my
career, I think I had the confidence part pretty solid. But the humbleness part I had to learn.”

While he concedes that the Target investment was structured badly at first, he won’t back down on it. It’s up
more than 40 percent since he injected his own cash: “I continue to believe that the investment in Target is
not a mistake.”

Bill Ackman remains optimistic.