Was Raj Rajaratnam's Conviction Bullish for Gold

and the End Times for Hedge Funds?

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he conviction of Raj Rajaratnam on 14 counts of insider trading is a very serious event that may prove to be the final straw that breaks the camel's back. It will prove to be yet another factor that justifies the long-term bull market in gold. It may set off a stampede to move funds management from the United States to just about anywhere but USA/New York. Yes, the jury was instructed to find him guilty and did. However, there is just so much more behind this case that the vast majority do not understand and only those who have traded serious money honestly comprehend. But this case also demonstrates to the world that the NY Investment Bankers are exempt from the law when they could have been prosecuted on solid evidence. Raj Rajaratnam's defense has been belittled by the **London FT** on Thursday, May 12th, 2011 in "**Rajaratnam's guilt and market justice**" showing just how there are grave misconceptions lingering about the financial industry. The **FT** wrote:

> ***"True, the case against Mr Rajaratnam was damning. Once the prosecution secured the judge's permission to use wire-tap evidence, it was able to produce powerful proof in support of its contention that the hedge fund trader made $63m by learning secrets about earnings announcements and deals before they were announced. … This did not stop Mr Rajaratnam from mounting a rearguard defence, contending that the nuggets he gathered were not insider tips in their own right but part of a sort of broader mosaic of information that any enterprising investor would seek to construct to back their trades. The jury rightly saw this for the chaff it was." Id./p8***

While the **FT** called for the indictment of Rajat Gupta, the former McKinsey head and elite Goldman Sachs' board member, there is a striking absence of investigative analysis on the part of the press to actually dive into the case and explore the true ramifications of the allegations. There is an assumption here that the $63 million **WOULD NOT** have been made **BUT FOR** the so called inside information. This is simply not true. The government had to reduce the charges from 23 to 14 counts because their theories are simply bogus. Insider trading is nowhere close to what it was supposed to be about. The theory of insider trading today actually being **UNFAIR** or **HARMFUL** to the market is simply absurd for there is **no empirical evidence** that such information produces 100% winning trades. The original theory emerged from the Great Depression where a director, knowing the company was bankrupt, withheld that info so he could sell his stock. After his personal sale, then he would announce the company was bankrupt. That was **REAL** fraud based upon insider info. Today, ANY information is actionable and you don't even have to make a profit. In the case of Galleon, the hedge fund was destroyed for claiming $63 million out of more than $1 billion was based upon insider info. That is less than 10% of the fund and has traditionally been regarded as ***de minimis*** and not a crime. Justice Alito previously held the allegation must be more that 10% of transactions to be material for fraud. He wrote: the ***"'rule of thumb' of 5-10 percent of net income is widely used as general materiality criteria in fraud cases."*** In re Westingtonhouse Securities Litigation, 90 F3d 696, 714 n.14 (3rd Cir 1996)(J.Alito). The SEC itself in its own rules acknowledged that ***"the misstatement or omission of an item that falls under a 5% threshold is not material in in the absence of particularly egregious circumstances."*** **SEC Staff Accounting Bulletin No. 99, 1999 WL 1123073 (SEC Release No SAB-99)**. You can have a hedge fund with $1 trillion, yet a single transaction amounting to just 1% today is grounds to seize the entire fund and destroy it. I myself was held in contempt for $1.3 million out of $3 billion they claimed they could not find. So, unlike Madoff where the entire thing is a fraud, just a single transaction is grounds to destroy your company in America. The SEC does not follow Alito or its own rules. They love to say Rajaratnam is a billionaire, insinuating everything is somehow illegal gains, yet the allegation concerned just $63 million that was not even personal.

Then there was the Supreme Court decision in **DURA PHARMACEUTICALS, INC., et al. *v.* BROUDO**, 544 U.S. 336 (2005) that dealt with the sloppiness in the allegations of security fraud also ignored. It established that the so called misrepresentation had to directly be the "***loss causation***" to establish a fraud. In other words, there is a loss, but to create the crime, they were saying the misrepresentation was unrelated, but as long as SOMETHING was false, a crime took place. So a fund manager could solicit money, and a loss takes place, and then they say he lied about his age and therefore the victim would never had given him the money if he thought he was 2 years younger than he was. What is happening in America is any loose connection the government can concoct with hindsight, could land you in jail for 20 yrs. There is no rule of law and everything is the discretion of the judge denying equal justice for all.

Rajaratnam would **NEVER** have been convicted in Britain or any other country where there is a real rule of law. This is one **PRIMARY**

reason why every hedge fund manager who remains in the USA after this case, is sublimely optimistic, or brain-dead. You will see more and more now leave America for it is too damn risky to do business here anymore. It is true that in both the US and Europe, prosecutors must show the alleged insider trading was "**on the basis of**" the inside information. Such cases do not fly in Europe because they actually have to prove something links. In America, the connection is loose. The judges allow presumptions that are highly dangerous. The defendant is presumed to have acted on inside information in their possession where it may not have been the **ONLY** or most important factor influencing the decision to trade.

How many times do earnings come out that are positive, and yet the stock goes down and the media explain the reaction as not being good enough. The best news will be ignored in a bear market. They may also be simply the subject of market "rumor" that drives the price contrary to earnings reports. Any investment professional worth his weight in any commodity, would NEVER make a decision on a single factor in shares no less earnings. Our own model correlated everything globally. There was NEVER a single fundamental that one hangs your entire life on. For the **FT** comment that the jury rightly ignored Rajaratnam's defense on this issue was justified, is plain wrong. He was found guilty because of a presumption that any single piece of news justifies a decision.

INSIDER TRADING under this basis exists **SOLELY** in SEC rules. It does not apply in commodities, bonds, futures, or currencies. The Rajaratnam case has demonstrated to the world that Goldman Sachs could be destroyed in the blink of an eye, but for their political contacts. Clearly, with this type of presumption, there is **NOBODY** on Wall Street in equity who cannot be convicted. Hedge fund managers are not subject to insider trading theories in anything except stocks. Thus, the ethics are not the same depending upon the trade.

In the Galleon case, some of the links between Rajaratnam and the ultimate source of the information were at best tenuous. His fund management business was based on research and analysis that more often than not provided the significant support for the trading decisions. But trading huge chunks of money is substantially different than trading your personal portfolio. When you are in the billions, it is **MORE** than just the buy or sell decision. It is **HOW** you get in and out of that instrument that is also critical in addition to the overall tone of the marketplace. Ignored in the Galleon case was **HOW** do you decide on **HOW** much to invest into a single stock? Unless you have traded such vast amounts of money, you will not appreciate that you have to consider the market size, normal volume to be able to facilitate the trade, and expectation of profit compared to other investments. It is nice that you can claim insider info enabled the defendant to make 25% on his money on a particular stock, but if that took 1 year when he doubled his funds rolling over trades in other instruments on a comparative basis, it was not such a good deal.

It is one thing when the info concerns a takeover where there will be a guaranteed price that is perhaps double current market value. It is another thing to WITHHOLD info so you can sell your position and you are a director. But info related to earnings just does not cut it. There is no direct guaranteed link. Even Buffett lending Goldman Sachs $5 billion by no means was a guarantee it would work in the middle of

a global economic meltdown. If Goldman were in trouble by itself, that is DIFFERENT than the facts in this case. There was NO guarantee that Buffett putting in $5 billion would have saved Goldman. It was far more important that they had Paulson in the Treasury than Buffett with spare cash. Prosecutors and courts make no distinction between the type of so called inside info and this leaves the law far too ambiguous. The original definition of a director withholding information for personal gain is certainly a justified crime. The Michael Milken definition of insider trading was bogus then. If person A and B are going to buy a company, person C is defrauded out of an opportunity to make the same money is highly debatable. A director telling someone the company is being bought is different. That's a guaranteed trade.

I personally was aware that Republic National Bank was cleaning itself up about 9 months in advance, which is the sign that it was preparing to be sold after it took a huge loss in Russia with Long-Term Capital Management. Edmond Safra wanted to sell the bank after it covered-up a loss of over $300 million by offsetting it against profits it had unreported in Russia. The chairman of HSBC then visited me at our London Office about 5 months later to ask my advice on buying Republic. I knew Republic would be sold, but the HSBC meeting, who was a client, merely confirmed who would be the buyer. We could never buy or sell stocks because if such contacts and there would be no way to argue well the stock was bought first on a hunch. There was no way I could ever buy stock because there was no way after the Milken case to ensure there would never be any crime. The Galleon case may also now change the entire industry.

Under a real impartial court, there could have been no crime without specific notice as to what insider trading really is rather than this make-it-up-as-you-go shit. Under 15 USC §78ff, the law states "no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation." When you keep changing the definition of what is insider trading, there is no prior notice. The trading in the Galleon case was (1) not proved to be the **SOLE** source of the trading decision, (2) was ***de minimis*** relative to the entire business, and (3) wiretapping had **NEVER** been carried out in such a case ever before.

These types of aggressive prosecutions are undermining the economy and have been shifting the financial capital of the world out of the USA. NO other nation turns against its own people to further the careers of lawyers. You will NEVER see criminal charges filed in Europe on such a case nor in Japan. Indeed, the prosecution was proud to announce to the press:

> ***"The message today is clear – there are rules and there are laws, and they apply to everyone, no matter who you are or how much money you have."***

Even the **FT** has called for the Indictment of the Goldman Sachs director. Since this is the criteria that companies can be destroyed under securities law in America, it begs the question why has there been not a single prosecution of any New York investment banker that was involved in creating the $700 billion crisis? Those in the financial industry at senior levels who really know what is going on but do not speak out, recognize that this Galleon case was all about show. It prosecuted nobody that was connected with the destruction in the mortgage market. It was nothing more than a substitute

for what everyone sees as real justice and simply a distraction.

There is no intent to criminally prosecute any of the Investment Bankers that have wiped out everyone's pension, destroyed the real estate market so that almost 30% of all mortgages are more than what the home is worth, and manipulated Congress to bail them out again at taxpayer's expense. This has eliminated the retirement of so many people wiping out their future entirely. People can be paying their mortgage for another decade and get absolutely nothing in return. But what the hell; prosecuting outsiders who dare to muscle into the New York crowd and $63 million in alleged profits on insider info is far more important to the nation than prosecuting those who have destroyed our future and got $700 billion in a taxpayer bailout. I think the math is 0.00009%. Did this help the markets? Or was it a warning to get the hell out of town before it is too late? They prosecute drug dealers that have no real effect on the nation as whole. They did not rob every one of their retirement. Who caused more damage to the average man; the drug dealer or the Investment Banker who created the CDOs?

ANY hedge fund that is still in the USA has got to be nuts. They are targets as substitutes for the real culprits so those in power can pretend to be doing something. So the message is clear. It does matter who you are, for it is purely the discretion of government **WHO** to prosecute; not the people. Those who even invest in hedge funds should start to look at investing with those funds that are actually outside the USA. The mere threat of an investigation can cause a hedge fund to collapse even when there is no wrong doing and investors can get killed on a stampede to get out.

The conviction of Raj Rajaratnam, relied heavily on the use of wiretaps. This has now raised the question about are there any rights left? His lawyers will appeal primarily on this ground, and the Second Circuit court of appeals will uphold the conviction as always because they let the prosecutors dictate the real meaning of the constitution on a case by case basis.

To get this conviction, the **Fourth Amendment** has been gutted entirely and that means your home is by no means your castle anymore. There is always banter on phones among professionals as there are a flood of jokes that are not always for public consumption. The case relied upon these widespread communications that can be turned into inside information by presuming a decision is solely based upon this conversation.

The heavy reliance upon the extensive use of evidence obtained by wiretaps was simply both unprecedented and controversial. In Britain, telephone communications may **ONLY** be intercepted under a warrant issued exclusively by the Home Secretary. Only authorities such as the police and the intelligence services may obtain interception warrants. The SEC counterpart in Britain, the FSA, has no such power. Furthermore, any such material obtained under one of these warrants may only be used for background intelligence and is not admissible in court proceedings. Rajaratnam's conviction would not have taken place in London. It is true that recorded conversations concerning trade execution are required by law in Britain and such tapes may be admissible in court proceedings in the UK. But this is true in the USA and is different than wiretaps installed covertly.

Now that telephones can be wiretapped for just about any excuse, people can be stripped of lawyers, thrown in prison on civil contempt and coerced without end on the pretense that a corporate officer does not have the same rights as an individual thanks to **O'Melveny & Myers, LLP** who I believe did more to destroy corporate rights than any law firm in American history. In Europe, they will not play games and pretend that it is not you personally they are imprisoning until you die, but the corporate officer as **O'Melveny & Myers** argued. The risks of being in the USA just far outnumber the rewards especially when the USA has conspiracy and Europe and Asia do not. You actually have to commit a crime or attempt to do so. In Europe, they actually have to prove you relied on insider info in order to be charged rather than the USA loose insinuations and presumptions used to charge Galleon.

Even in the USA, the admission of wiretap evidence in court proceedings is not supposed to be a given. But most judges would never deny the government such wiretaps when it knows without them there is no case at all. So there are no strict procedures that apply to any wiretap interception. They vacuum in emails under the Patriot Act without warrants today. Any such evidence is routinely admitted in court proceedings in the USA. Rajaratnam's counsel has already announced an intention to appeal the convictions on the grounds that the wiretap evidence should not have been put before the jury. The likely victory – the virtual 99% conviction speaks volumes.

Those who might say I am just being unpatriotic should look at Dick Cheny's firm, Hallibuton, who moved to Dubai abandoning its American citizenship and this was **THE** firm who made the big bucks in Iraq and the Vice President had been its chairman. If such a well-connected firm abandoned the USA, you have to ask why? No doubt their lawyers told them to abandon ship. **WHY?** US conspiracy theories being allowed in court is a disaster. Yet criticize the government, and they call you a conspiracy theorist when in fact that is how they prosecute all crimes federally.

This entire inside trading issue is far too vague and really needs clear delineation if it is to provide any real deterrence. It must be limited to what it was arising out of the Great Depression or inside info regarding takeovers. The government gave Treasurer Hank Paulson a waiver to help Goldman Sachs when he was still a shareholder. Was that inside trading based on info?

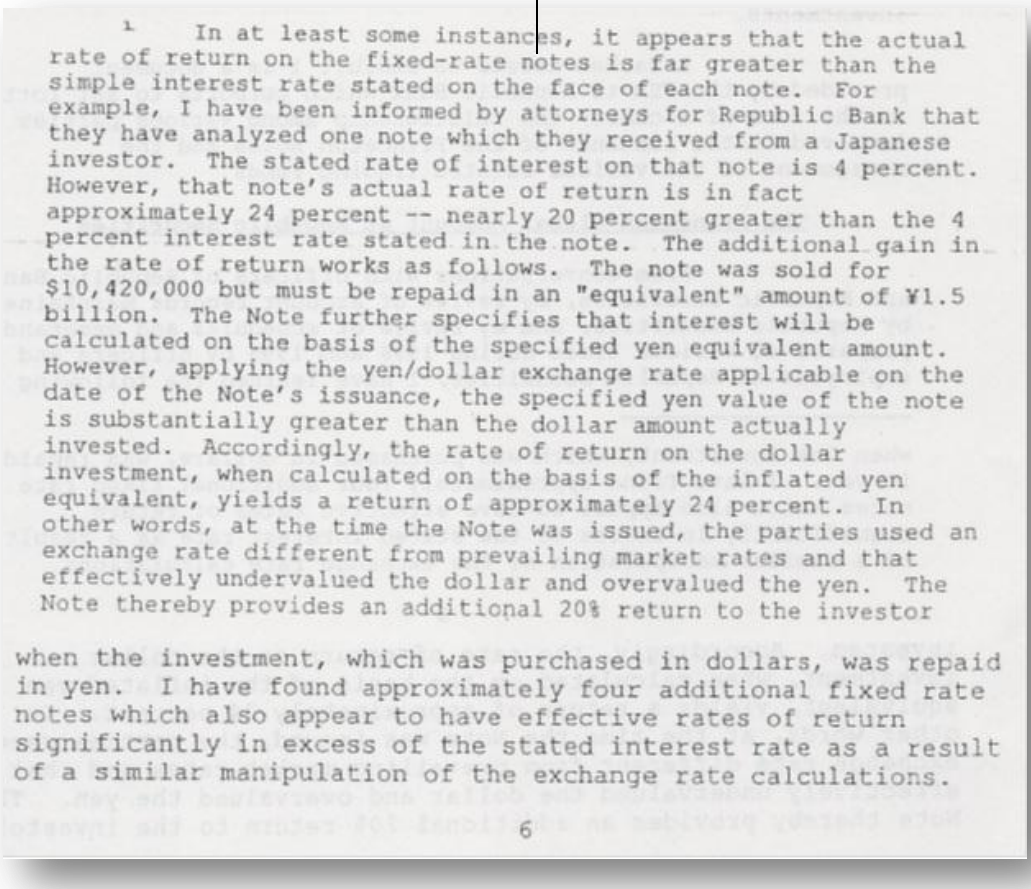
Inside Trading minus takeovers or directors acting on their personal portfolios withholding information are justified. Other areas are simply too tenuous and there is no empirical evidence that proves that such info is a 100% guarantee of profit. As it stands, the current vague frontiers are far to elastic and this will drive more capital offshore. The AIG trading operation was in London in part for this very reason.

The prosecution case must have been faced with great uncertainty. Without wiretaps, there would have been no case to begin with! The damage to the economy and the financial industry far outweighs and possible benefit for instead of being a deterrent, it warns those who really understand that anything can be used against you no matter how subtle it may appear. They will presume you acted FOR that reason and deny you the right to a trial of your peers who understand the industry nuances.

Unfortunately, lawyers do not really understand the industry and its complexity just as they say you have to be a trained lawyer to understand the law. In my own case, the lack of understanding of international cross currency trading is self-evident in the allegations that were initially filed. They could not understand why the Japanese did not complain and there were no defaults because they saw the world ONLY through the eyes of the dollar.

If you borrow money in any currency, your obligation is to repay the loan. If you borrow dollars and repay dollars, the bank does not come back and say because the dollar declined against the euro you now owe more in dollars than the contract stated. Yet the government did not understand international currency transactions and recalculated yen transactions into dollars and then did not understand when the Japanese did not see that they lost money. The yen between 1995 and 1998 declined from about 75 to 147 to the dollar. So repaying a loan in yen was fine, but recalculating that in dollars they did not understand how about half the dollar amount was repaid and the noteholder was happy. They then also claimed some were paid 20% returns instead of 4% because they did not understand currency.

Just because the government files allegations, it does not mean they really understand what the hell they are doing. It is one thing to allege a plain vanilla Madoff case. When you get into international finance, they are certainly beyond the plain vanilla world. When it comes to the mortgage debacle, this was even far clearly that any insider trading case.



1 In at least some instances, it appears that the actual rate of return on the fixed-rate notes is far greater than the simple interest rate stated on the face of each note. For example, I have been informed by attorneys for Republic Bank that they have analyzed one note which they received from a Japanese investor. The stated rate of interest on that note is 4 percent. However, that note's actual rate of return is in fact approximately 24 percent -- nearly 20 percent greater than the 4 percent interest rate stated in the note. The additional gain in the rate of return works as follows. The note was sold for $10,420,000 but must be repaid in an "equivalent" amount of ¥1.5 billion. The Note further specifies that interest will be calculated on the basis of the specified yen equivalent amount. However, applying the yen/dollar exchange rate applicable on the date of the Note's issuance, the specified yen value of the note is substantially greater than the dollar amount actually invested. Accordingly, the rate of return on the dollar investment, when calculated on the basis of the inflated yen equivalent, yields a return of approximately 24 percent. In other words, at the time the Note was issued, the parties used an exchange rate different from prevailing market rates and that effectively undervalued the dollar and overvalued the yen. The Note thereby provides an additional 20% return to the investor when the investment, which was purchased in dollars, was repaid in yen. I have found approximately four additional fixed rate notes which also appear to have effective rates of return significantly in excess of the stated interest rate as a result of a similar manipulation of the exchange rate calculations.

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The other person who is probably on the hit list of Goldman Sachs is none other than **Matt Taibbi** of the Rolling Stone. His latest article on May 11th is again spot on. It further illustrates that there is no equal justice for all, because it is all about who you are, that justifies action. **Taibbi** wrote:

"Thanks to an extraordinary investigative effort by a Senate subcommittee that unilaterally decided to take up the burden the criminal justice system has repeatedly refused to shoulder, we now know exactly what Goldman Sachs executives like Lloyd Blankfein and Daniel Sparks lied about. We know exactly how they and other top Goldman executives, including David Viniar and Thomas Montag, defrauded their clients. America has been waiting for a case to bring against Wall Street. Here it is, and the evidence has been gift-wrapped and left at the doorstep of federal prosecutors, evidence that doesn't leave much doubt: Goldman Sachs should stand trial."

There is little doubt that **Taibbi's** latest piece should be taken seriously. There is simply a great distinction between insider trading that was alleged in the Galleon case that was just not even close to being within the historical sense that truly causes harm to the marketplace, and the organized short-term manipulations of the markets. There will be the usual claims oh Armstrong is nuts or something else to distract the attention of the people. But keep in mind that (1) Buffett took the Chairmanship of Solomon Brothers **AFTER** they were caught manipulating the US Treasury Bond auctions, and (2) Eric Holder has announced the Justice Department will investigate the organized manipulation of oil prices. Thus, manipulating markets is not a conspiracy theory nut job!

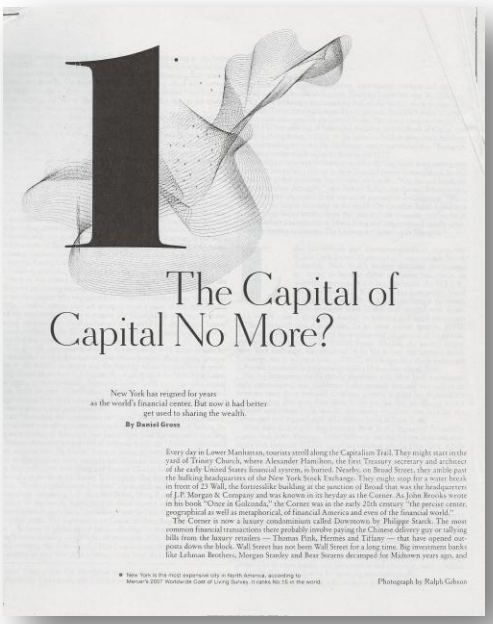
The record stands for itself. Alan Cohen, Goldman Sach's head of global compliance, was appointed by the court to run Princeton Economics as the receiver. He seized all evidence and prevented a lawsuit being filed against Republic National Bank for such manipulations and parking trades in Princeton's accounts removing them as errors after the weekend. The evidence collected included tapes that would have exposed a lot more than Galleon. Why did the government never use them? It was said in open court on Feb, 7, 2000:

"The … tapes… we made as a journalist, so to speak. I did a number of pieces and monitored a significant effort by a number of investment banks and fund managers who attempt to organize together in manipulating markets. I wrote extensively about several cases on that, and I made tapes to back up myself in support of that.

These are tapes that are, again, I do not see where they are particularly relevant to this particular case, your Honor. They have significant implications for a number of well known players and investment banks on the street that probably do reveal criminal behavior, but that does not necessarily involve this case. They are things that I wrote about. It is well documented that I was exposing the silver manipulations that were – went by a number of firms including Republic Bank. The CFTC even contacted me personally for information in that investigation and as well as that led to the Bank of England getting involved into the investigation."

(Tr; 2/7/00, p4-5)

The Galleon case is ***more-likely-than-not*** going to escalate the migration of capital out of the USA depressing the dollar exporting financial chaos to Europe. These things are interconnected. A rising Euro will soften economic growth. NY already lost its status as IPO leader of the world. Foreign companies no longer want to be listed in NYC thanks to regulation and prosecution. Unless Congress acts soon, they may not be able to sell their debt as everyone is bailing out. So you see, the Galleon prosecution is another straw that is building to break the camel's back. Once London lost its status of financial capital of the world to NY, the game was over. We are doing the same stupid thing in America. Good night. It is getting close to the time to turn out the lights.



The Capital of Capital No More?

New York has reigned for years as the world's financial center. But now it had better get used to sharing the wealth.

By Daniel Gross

Every day in Lower Manhattan, tourists stroll along the Capitalism Trail. They might start in the yard of Trinity Church, where Alexander Hamilton, the first Treasury secretary and architect of the early United States financial system, is buried. Nearby, on Broad Street, they amble past the bustling headquarters of the New York Stock Exchange. They might stop for a water break in front of 23 Wall, the fortresslike building at the junction of Broad that was the headquarters of J.P. Morgan & Company and was known in its heyday as the Corner. As John Brooks wrote in his book "Once in Golconda," the Corner was in the early 20th century "the precise center, geographical as well as metaphorical, of financial America and even of the financial world."

The Corner is now a luxury condominium called Downtown by Philippe Starck. The most common financial transactions there probably involve paying the Chinese delivery guy or tallying bills from the luxury retailers — Thomas Pink, Hermès and Tiffany — that have opened outposts down the block. Wall Street has not been Wall Street for a long time. Big investment banks like Lehman Brothers, Morgan Stanley and Bear Stearns decamped for Midtown years ago, and

New York is the most expensive city in North America, according to Mercer's 2007 Worldwide Cost of Living Survey. It ranks No. 15 in the world.

Photograph by Ralph Gibson

The **New York Times Magazine** published a piece written by **Daniel Gross** in October 2007 reported that in November 2006, testimony took place before the Committee on Capital Markets Regulation reviewed this migration of capital and still nothing has been done to prevent the Decline and Fall of the United States. Gross reported testimony:

"***Evidence presented here suggest that the United States is losing its leading competitive position as compared to stock markets and financial centers abroad***." Id/ p64. Indeed, Gross reported the findings that in 2000, the United States possessed 50 percent of the global IPO market. By 2005, it was just 5%.

This was caused by over-regulation and aggressive prosecutions of firms other than those in New York City. You might think that there is not enough regulation. To the contrary, we do not really regulate the Investment Bankers like Goldman Sachs. The overregulation has to do with the knee jerk reaction after ENRON and the enactment of **Sarbanes–Oxley Act of 2002** (Pub.L. 107-204, 116 Stat. 745, July 30th, 2002), that placed the burden so high on corporate officers, foreign companies who once found it prestigious to be listed on the NYSE, withdrew the listings and fled.

This **'Public Company Accounting Reform and Investor Protection Act'** (in the Senate) and **'Corporate and Auditing Accountability and Responsibility Act'** (in the House), now commonly called **Sarbanes–Oxley**, set in motion the *Decline and Fall of the United States* as the Financial Capital of the World.

Paul Sarbanes – Michael G. Oxley

Senator Paul Sarbanes (D-MD) and U.S. Representative Michael G. Oxley (R-OH) did more damage to the United States than perhaps any other regulation in history. For once the Financial Capital of the World status is lost, the *Decline and Fall* of the nation is not far behind. Now we have the **Dodd-Frank Bill** making matters even much worse. The downside of democracy is the idea that politicians have to enact something with each crisis, when in fact, they lack the experience to comprehend the global ramification of their actions.

With each aggressive prosecution, personal careers are advanced thanks to the press, but the subtle implications are ignored. Without a COMPLETE revision of law and prosecutorial decisions, the USA is doomed once it has to beg for money overseas.