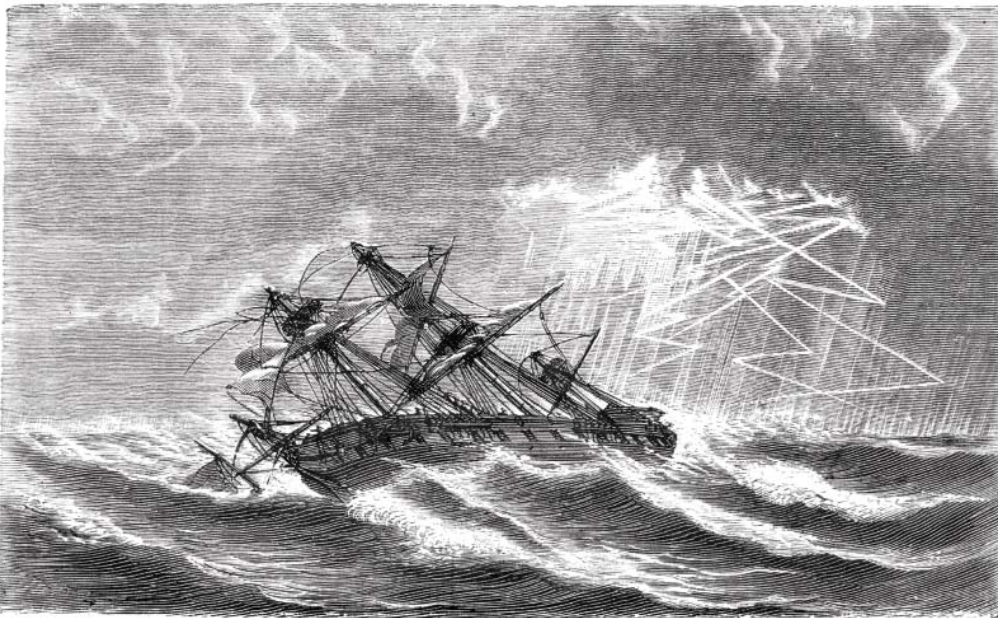


The Collapse of Ballamor Capital Management
Lessons for High-Net-Worth Investors



This White Paper is intended to be an aid in understanding certain challenges faced by high-net-worth investors, using facts available in the public-record about the recent troubles of Ballamor Capital Management of Radnor, PA. Throughout, we use material developed by professional journalists, in particular by Harold Brubaker of the *Philadelphia Inquirer* and by reporters at the *Florida Sun Sentinel*, *Palm Beach Post* and *Broward/Palm Beach New Times*. This publication is not intended to be a comprehensive analysis of the investment strategies of Ballamor Capital Management or of the portfolio of any individual Ballamor client.

At a Las Vegas investment conference on May 15 2009, Barry Bekkedam, founder of Radnor Pennsylvania investment firm Ballamor Capital Management, appeared before an audience of public pension fund managers to brag about his firm's latest cutting-edge investment opportunity:

"We negotiated the first \$100 million of outside money to go in. We're getting a 15 percent current cash return, and a clawback and personal guaranty on the part of the general partner who has half

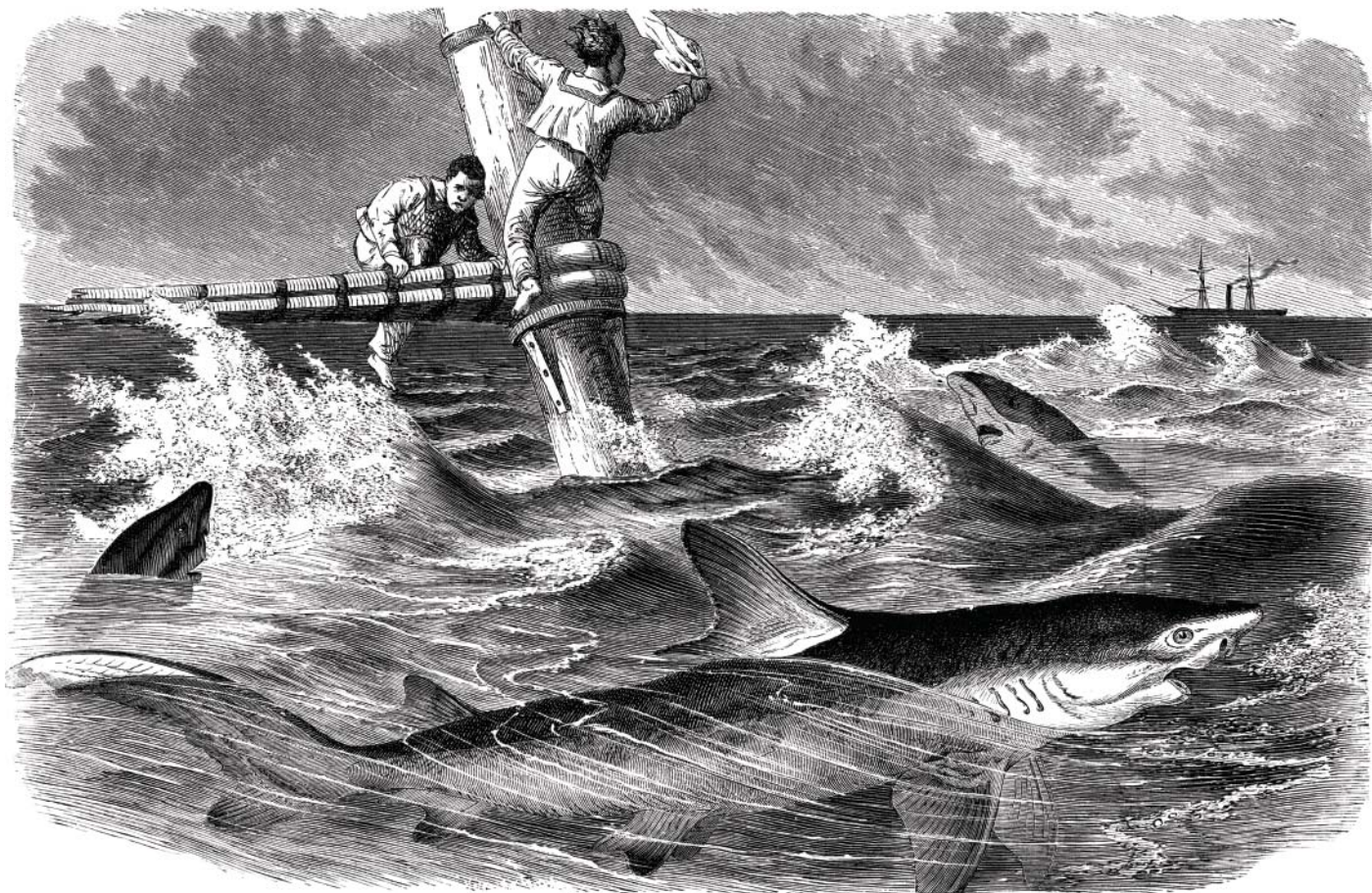
a billion of his own money in the fund. How's that possible? How can you get that return? Literally, he didn't know the fund structure was out there. We put him in the fund business, basically."

What was this new fund that Ballamor helped to create? How did Bekkedam and his clients get a 15% return in a world of money-market yields below 1% and Treasury bond returns under 4%?

The Banyon Income Fund was a limited partnership, organized by Fort Lau-

derdale, Florida investor George G. Levin with Bekkedam's help, created to purchase lawsuit structured settlements at substantial discounts. Some of the largest investments in Banyon were actively solicited by Bekkedam.

Unfortunately for Ballamor's clients, the Banyon Income Fund was feeding money to Fort Lauderdale attorney Scott Rothstein, who turned out to be running a pyramid investment fraud, usually termed a "Ponzi scheme" after early-20th-century fraudster Carlo Ponzi. Within five months of Bekkedam's Las Vegas speech, and after Bal-



lamor's clients had already invested \$30 million, Rothstein's fraud was exposed and he fled to Morocco on a chartered private jet.

The timing of the discovery of Rothstein's fraud probably saved Bekkedam's clients much larger losses. It appears that Ballamor Capital Management's clients had invested only \$30 million out of the promised opportunity to invest \$100 million. After a week in Morocco contemplating suicide, Rothstein decided to return to Florida, where he now resides in the Federal Correctional Facility in Miami, awaiting sentencing on multiple counts of fraud. According to *The Broward/Palm Beach New Times*, on Rothstein's return from Morocco, Bekkedam was at the airport to meet him, and screamed, "Where's the money?"¹

Florida has long been fertile ground for investment scams. When Bekkedam helped organize a new fund to invest in what was actually a \$1.2 billion fraud, it was less than a year after Bernie Madoff's much-larger Ponzi

¹ Where did Rothstein stash the missing \$1.2 billion? Nowhere. The money is gone, and in a sense largely never existed. It was the sum of the investors' actual contributions and Rothstein's calculations of the compounding effect of his claimed 15% to 210% returns. What a Ponzi scheme does is raise and distribute funds, while the operator skims enough to support his lavish lifestyle, which in Rothstein's case included a private jet, eleven exotic sports cars, an 87-foot yacht and massive contributions to political candidates from both parties.

scheme was revealed. Many of Madoff's victims were located in Palm Beach, just a few miles down Interstate 95 from Bekkedam's Florida home near Jupiter, and only half an hour north of Scott Rothstein's principal law office in Fort Lauderdale. It seems never to have occurred to Bekkedam that Rothstein's high returns might be an indication of a similar fraud.

It still isn't clear whether Banyon's General Partner George Levin was another victim of Rothstein's Ponzi scheme or an insider. He was clearly close to Bekkedam. Levin invested \$5 million in Nova Bank, one of Ballamor's private deals, an additional \$1 million directly into Ballamor Capital Management, and had promised to extend a personal loan to Bekkedam himself².

The failure of Banyon Income Fund helped to precipitate the sudden collapse of what had been one of the Philadelphia Main Line's more prominent investment firms. Founded in 1997, Ballamor Capital peaked at over \$2.5 billion of assets under management. Bekkedam's success financed a spectacular lifestyle, with a Main Line mansion, a Florida home north of Palm Beach, a stable of exotic auto-

² Banyon Income Fund, LP prospectus page 18. The Banyon prospectus raises questions about Bekkedam's judgment, but it also supports his honesty. If he wasn't honest, he would not have disclosed that he was hoping for a personal loan from Levin, and if he was in on the scam he would surely not have needed the loan.

mobiles and trips on chartered jets to meet clients driving Bentleys.

As of early 2010 the firm claimed assets of \$1.7 million, though the value of the firm's various private transactions was unclear. As of late April, Bekkedam was attempting to sell the remainder of Ballamor's client list to a Massachusetts wealth-management firm with a similarly exclusive clientele.

What brought Bekkedam crashing back to earth? Several issues seem to have tripped up the high-living wealth manager. One was a lack of effective due diligence. Banyon Income Fund was not the only problematic investment Ballamor Capital made. Bekkedam had a taste for investing in troubled firms, including \$150 million in debt and equity invested in Stokes Land Group and \$10 million invested in Rockbridge Commercial Bank³.

How do we understand the spectacular success and equally spectacular failure of Barry Bekkedam? We recently met in our office with Charles de Vault, one of the Partners at International Value Associates, and Morningstar's *International Co-Manager of the Year* in 2001. In a conversation unrelated to Ballamor, de Vault made an interesting comment: "There are two types of people in the wealth-man-

³ Harold Brubaker. "Rise and Fall of a Main Line Investment Advisor." *Philadelphia Inquirer*. April 25, 2010.

agement business: asset gatherers and real investors.”

Bekkedam was apparently the former, an asset gatherer of formidable charm, ambition and success. His limitations as an investor can perhaps be inferred from a review of Ballamor’s own marketing materials, which bragged about the firm’s unconventional investment approach:

*“The hallmark of Ballamor’s investment philosophy is to seek the lowest risk approach to providing consistent positive returns under normal inflationary conditions. In an attempt to achieve these results, we construct portfolios that are diversified among multiple asset classes, unlike a traditional portfolio consisting of only stocks and bonds.”*⁴

Given the inherent variability of the returns of publicly-traded securities like stocks and bonds, how did Ballamor expect to deliver “consistently positive returns?”⁵ Mostly, it appears, through private deals. The same marketing

⁴ Ballamor’s decision to organize a limited partnership so that its clients could invest \$100 million in a Ponzi scheme was certainly “unlike a traditional portfolio.”

⁵ Investors want to earn high returns without volatility. The ability to earn 8% to 12% annual returns with no down years was one of the primary selling points of the Madoff Ponzi scheme. In the real world, where market returns vary wildly from one year to the next, and returns are negative an average of one year out of three, the fantasy of “consistently positive returns” is dangerous nonsense.

“There are two types of people in the wealth-management business: asset gatherers and real investors.”

Charles de Vault
Partner, International Value
Associates & Morningstar
International Co-Manager
of the year 2001

piece offered an unusual perspective on the risks of different asset classes. For example, real estate subordinated debt and senior secured mortgages were represented as being the safest of all assets, *safer even than cash*, and private corporate equity as being safer than publicly-traded stocks!

The idea that mortgage debt of any kind is safer than cash is obvious lunacy. In fairness to Ballamor, a similar careless confidence in the security of mortgages was the central fact behind the sub-prime debacle of 2008, the failure of Lehman Brothers and Bear Stearns, the near-failure of Citigroup, Merrill Lynch and AIG, and the resulting worldwide market collapse.

Clearly private transactions in regional real estate developers or troubled banks, not to mention an actual Ponzi scheme, were in every meaningful respect riskier than more-conventional

assets like investment-grade corporate bonds or the publicly-traded securities of large American corporations. Bekkedam does not seem to see it that way. He suggested in an interview with the Philadelphia Inquirer that the failure of several important transactions was a result of an unprecedented real estate collapse: *“In this environment. . . there’s nothing you could have done. When prices drop 50 percent, what can you do? There’s no metric to have planned for that.”*⁶

How might one have planned for a 50% drop in Florida real estate markets? The housing bubble of the 2000s was the best-documented and most-discussed investment bubble in human history. To reference only a few sources out of hundreds of articles in both the business press and among academic economists, one might have read front-cover articles in *Fortune* (September 2004) or *The Economist* (June 2005)⁷, paid attention to the insights of local economist Mark Zandi at *Moody’s economy.com*, or simply studied the history of the first great Florida real estate boom of the 1920s, which ended with mass bankruptcies and tens of thousands of abandoned homes in all stages of construction⁸. Surely when someone starts

⁶ Harold Brubaker. “Rise and Fall of a Main Line Investment Advisor.” *Philadelphia Inquirer*. April 25, 2010.

⁷ “The worldwide rise in house prices is the biggest bubble in history.” *The Economist*, June 16, 2005.

⁸ In 1928, Henry S. Villard described a trip

a website called *www.condoflip.com*, an experienced investor should be thinking “bubble.”

Of course, firms much larger and more prominent than Ballamor Capital Management also lost big in the real estate collapse. Real estate and private equity deals of even top-drawer firms like Carlyle and Goldman Sachs crashed and burned. At the end of the real estate bubble, Wall Street was systematically underestimating risk by an order of magnitude. (Two orders of magnitude in the case of AIG’s renegade credit default swaps unit in London.)

More from the marketing brochure:

“Ballamor’s sophisticated approach to asset management offers our clients access to investment opportunities that provide uncorrelated returns with acceptable levels of risk... Ballamor’s primary role is to design and construct portfolios, in addition to providing due diligence and manager selection.”

Two key words here are “access” and “sophisticated.” The promise of private

to Miami for *The Nation*: “Dead subdivisions line the highway, their pompous names half-obliterated on crumbling stucco gates. Lonely, white-way lights stand guard over miles of cement sidewalks, where grass and palmetto take the place of homes that were to be... Whole sections of outlying subdivisions are composed of unoccupied houses, through which one speeds on broad thoroughfares as if traversing a city in the grip of death.” (*American Heritage* magazine, August 1965.)

deals is that they provide the wealthy with an inside track to the good stuff – exclusive investment opportunities superior to those available to the common folk. Far too often, the results of such deals are, as they were in the case of the Banyon Income Fund, painful losses.

Even investors who lost serious money with Bekkedam appear still to believe in his honesty and good intentions. As one said, “I don’t think Barry is dishonest in the least. He got ahead of himself.” If it wasn’t dishonesty that brought down Ballamor, what was it? The answer appears to be simple, and not unusual.

It was over-confidence. This is not a failing unique to Ballamor and Barry Bekkedam. Indeed, according to research in behavioral finance it is one of the most essential aspects of the human condition. *Almost everyone is over-confident about almost everything, almost all the time – just like Barry Bekkedam.*

It seems evident that Bekkedam believed his own representations about the risk of his various private deals. It appears never to have occurred to him that he was being offered investments with unusually-high returns because the underlying businesses were in trouble. Either Bekkedam and his clients underestimated the risk of his various individual deals, or they failed to understand the forbidding math of total losses.

Assume that 30% of your investment net worth is in private transactions, with \$1 million each in three separate deals. One, the Banyon Income Fund, is a total write-off. A second, Stokes Land, hopes to return fifty cents on the dollar in five years. Even if the third deal returns 10% per year over five years, you will still have lost almost one-third of the money committed to private deals. (And is that 10% assumption really realistic in a world of 4% Treasury bond yields?)⁹

So far we’ve focused on the problems of Ballamor Capital and its high-profile founder Barry Bekkedam. But every seller needs a buyer. Ballamor’s problems are in many ways representative of larger issues in the high-net-worth marketplace. This brings us to the question...

⁹ This illustration is not intended to represent the actual portfolio of any Ballamor client. It is an exercise to help investors understand the impact of the total loss of even a small part of a large portfolio on the ability to earn acceptable economic returns.

What makes the wealthy so vulnerable to scams and risky investments?

In large part, it is misplaced priorities. A recent *Luxury Institute*¹⁰ survey of ultra-high-net-worth investors asked them to rate various boutique wealth management firms on multiple criteria, including whether the firms:

- Enhanced their social status
- Were unique and exclusive
- Made them feel special

Were these folks choosing a financial advisor or a country club? (It appears that investment performance did not even make the list of questions.)

“As Americans, we believe in upward mobility. To have upward mobility, you need downward mobility. How do you get downward mobility if you are rich? *Alternative investments.*”

¹⁰ *The Luxury Institute* styles itself, “the trusted and respected voice of the high net-worth consumer”. Among the categories of goods and services it rates for its wealthy target market, besides wealth management services, are handbags, bath fixtures and skin care products.

The *Luxury Institute* survey demonstrates one of the sad truths of financial management. Most investors, especially wealthy investors, make decisions about financial advice almost entirely based on subjective criteria unrelated to economic considerations. Did the guy go to the same college I did? Does he dress the right way? What kind of car does he drive? Are we in the same country club? Does he vote for the right party and donate to the right charities? *None of these criteria correlate with actual investment skill.*¹¹

Ignoring investment results in favor of look-and-feel issues might be all right if you are so rich, and have such modest consumption needs in relation to your wealth, that real-world investment returns are irrelevant to you. (Think deci-billionaire Warren Buffett living in a fifty-year-old Omaha split-level home.) But the evidence from the Ballamor collapse points very much in the opposite direction. Investors turned to Bekkedam to help them earn higher-than-market returns, because they needed massive cash flow to sustain their expensive upper-class lifestyles.

Years ago one of my finance professors said, half in jest, “As Americans,

¹¹ One of the most capable investment managers I know, who runs a \$3 billion portfolio and chairs the Investment Committee of the best college in Pennsylvania, drives a Toyota Camry and wears Rockport shoes to work.

“If you are rich, you are not economic royalty, you are a *target.*”

we believe in upward mobility. To have upward mobility, you need downward mobility. How do you get downward mobility if you are rich? Alternative investments.” He believed that the underlying cause of losing wealth was over-spending. The pursuit of higher-than-market returns using alternatives, which resulted in losses that could not be recovered, was the symptom not the cause.

The great drivers behind most investment debacles are greed and self-deception — the desire to earn returns higher than those available in the financial markets, often to support an unaffordable lifestyle, and a willful blindness to both warning signs and the counsels of prudence.

Protecting your wealth

Knowledge is your best defense. To avoid becoming a victim of the next Scott Rothstein, Bernard Madoff, Carlo Ponzi, Manhattan Fund or Bayou Partners (the last two are famous hedge-fund frauds), you should understand the following facts:

You can't earn equity returns without equity risk. The central appeal of Rothstein's scheme was the chance to earn returns that simply weren't available in the public markets. Rothstein's investors, and his enablers like Bekkedam, simply believed what they wanted to believe — that they could earn junk bond returns on secure investments backed by cash flow from major corporations — equity returns combined with Treasury bill risk.

The rich do not enjoy preferred access to superior investment opportunities. The conviction that they belong to a privileged class, with access to superior merchandise unavailable to the common public, is one of the enduring fantasies of the wealthy. In fact, the most conspicuous frauds of the last half-century have usually targeted the wealthy. (As Willie Sutton said of banks, "That is where the money is.") Many of these frauds have compiled impressive client lists of the rich and trusting, including Fortune 500 CEOs and Main Line old money. *The only privileged access the rich enjoy is better dressed and more persuasive salesmen, not economically superior investment opportunities.*

Private deals are dangerous. One of the most dangerous aspects of private investment transactions is that you can't know the value of what you own or the real economic risk of your holdings. By contrast, if you own assets in a brokerage account or with a mutual fund, your balances are available online at any time. Speaking of brokerage accounts...

Assets and advice should live in different places.¹² An investment advisor should be in the business of giving advice, not of holding securities or cash. Insist on a third-party custodian that is a member of SIPC (the Securities Investor Protection Corporation). Many well-capitalized firms provide custodian services for independent Registered Investment Advisors, from Charles Schwab to Pershing to Raymond James.

Economic diversification is essential. Some wealthy investors had all or most of their money with Scott Rothstein.¹³ They had no overall portfolio design. They paid no attention to any principles of diversification. They were, even

¹² In the cases of both Bernard Madoff and Kenneth Starr (who defrauded Hollywood celebrities like Sylvester Stallone of tens of millions), the "advisor" held assets at his own captive brokerage firm.

¹³ Unfortunately, it was not just the wealthy, who at least voluntarily sent their money to Rothstein to "invest." He also raided his law firm's trust accounts, so middle-class families who had their life's savings in escrow waiting to close on a new home also lost everything.

if they did not realize it, betting everything on red, hoping the ball would fall their way. Instead they were stunned when the roulette wheel came up 00 and all their money went away.

The government can't (or won't) protect you. As early as 2000 money-manager and investment investigator Harry Markopoulos told the Securities & Exchange Commission (SEC) that Bernie Madoff was running a Ponzi scheme. The SEC did nothing for almost a decade. Many private transactions, like the Banyon Income Fund, are structured under rules that allow them to avoid registration with the Securities and Exchange Commission. The SEC has been given a much larger enforcement budget. It remains to be seen if the agency will now prove more effective. *We believe the most effective investor protection remains your own common sense.*

It is not who you know, it is what you know (and be darn sure you check it out). Wealthy investors, like all human beings, take comfort in being part of the herd. 'If my friends have invested with Scott Rothstein, I should too.' One of the largest investors in Rothstein's scheme committed \$100 million after having dinner on his yacht with Barry Bekkedam. *This is not effective due diligence.*

Strategies

How can you protect yourself?

Detach your self-esteem from your pocketbook. Don't make choices about investments or advisors based on look-and-feel factors, make them on objective financial criteria. In a rational investment world, the charms of exclusivity and prestige should always take a back seat to transparency, liquidity, low costs and documented investment performance.

Recognize the limits of your own ability. Research in behavioral finance suggests that most individuals are innately poor investors. One of the characteristics of most successful individuals – self-confidence – can be a powerful driver of bad investment results. Because of over-confidence and a high need for control, ultra-high-net-worth investors are among the *least* successful long-term.

Keep your expectations reasonable. We live today in a world of half-percent money-market funds, 2% stock dividends and Treasury note yields of less than 4%. And those returns are all *before* taxes and inflation. In this context, thinking there are 15% returns going begging is simply not rational. During episodes of disordered markets, there may be the opportunity to earn higher returns by buying economically valuable assets when they are temporarily at a discount due to an irrational marketplace. (Warren Buffett excels at making

those kinds of transactions. He has made a career of buying economically valuable assets at deeply discounted prices in disordered markets, when panicked investors are selling.)

Know your sustainable distribution rate.¹⁴ This is the percentage cash flow you can withdraw from your portfolio each year with adequate confidence that you will never run out of money. (This number is almost certainly much, much lower than the returns that Bekkedam's clients expected and "needed".)

Keep it simple. Ironically, the Philadelphia area is also home to another prominent investment firm. That firm was founded by John Bogle in 1974. Today Vanguard Investments manages \$1.2 trillion, about 400 times what Ballamor managed at its peak. Vanguard offers low costs, full disclosure, daily pricing and a broad array of investment options. What it does *not* offer is the cachet of exclusivity. (You can open a Vanguard account for as little as \$3,000.)

¹⁴ At TGS Financial Advisors, we use a combination of linear cash flow analysis and Monte Carlo analysis to calculate sustainable distribution rates. Our methodology differs from that of most firms in that we use forward-looking financial market assumptions instead of historical data sets to model portfolio returns, in order to resolve the end-of-period bias issues that plague most financial modeling. Our goal is to provide clear guidance to each client, while building in a margin of safety. *We would rather lose a potential new client than provide an artificially-high estimate of sustainable cash flow that causes a client to run out of capital years down the road.*

Recognize the limits of due diligence. Barry Bekkedam was duped by Scott Rothstein, and it destroyed his business. French nobleman and hedge-fund manager Rene-Thierry Magon de la Villehuchet lost \$1.4 billion of client funds with Bernie Madoff, and committed suicide when he learned that Madoff's fund was a fraud. The head of Merrill Lynch lost millions of his own money when hedge fund Long Term Capital Management collapsed in 1998. *All of these men were well-connected investment insiders who made life-changing mistakes in pursuit of high returns, because they simply did not understand the actual economic risks of complicated (or fraudulent) non-public investments.* Given the limits of due diligence, we suggest that most investors simply...

Avoid non-public investment transactions. Once upon a time, there may have been a return premium to be earned for investing in private equity or other non-liquid transactions. That was before hundreds of billions of dollars began chasing a finite number of attractive deals. In recent years, firms like Carlyle, with worldwide reputations and billions under management, have seen some of their deals become entirely worthless. Some great deals are only available in private form. So are many, many lousy deals. *If you can't reliably tell the good from the bad, just don't play.*

As a client or potential client of TGS Financial Advisors, how can you be sure that we will not steal or squander your wealth?

We are not a broker-dealer. We do not stash client funds or securities in drawers in our office. All of our clients' dollars and securities are held by third parties; they are invested through large, well-capitalized, fully-regulated financial institutions like Raymond James Financial, Vanguard Funds or Capital Research Associates.

We provide real-time access to all of your account information. If you wish, you can check your account online ten times a day. (Though, in the interests of both prudent time-management and emotional stability, we don't suggest it.)

We only buy publicly-traded securities. We only buy securities that are priced daily (in the case of mutual funds or bonds) or even minute-by-minute (common stocks, closed-end funds and exchange-traded funds).

We don't buy private deals. We don't own hedge funds, credit default swaps, private equity funds, equity-indexed annuities or unlisted stocks.

We don't operate a black box. While the specific databases and algorithms we use to vary our allocations to asset classes are proprietary, both our percentage targets and our actual

dollar commitments are disclosed every time we re-balance a client account. My quarterly newsletter *Navigator* column, titled "Inside the Black Box," is specifically designed to de-mystify our investment process and keep clients informed about our economic perspective.

We don't leverage. Leverage drove much of the financial meltdown of 2008-2009. During the good times, using leverage (often euphemistically titled OPM – "other people's money") can multiply your returns, but during bad times it can just as surely magnify losses. We manage money for over 260 client households, and only two of those have securities subject to margin loans. (In both cases this is for personal economic reasons, and not as an element of their investment strategy.) Absent leverage, our clients possess a precious strength – staying power.

We have never claimed to be able to deliver acceptable long term investment returns without market risk. Indeed, one of our central messages to investors has always been the necessity of understanding and accepting the inherent volatility of common stocks in all their forms, in order to reap the historic benefits of ownership of stocks over the long term.

A final point. Clients of TGS Financial Advisors experience volatility in their portfolios every single day that the markets are open. Compare this with (for example) Bernard Madoff.

Madoff's "investors" experienced no volatility in their "portfolios" for years – until the scam was discovered and all of their wealth was revealed to be a fiction. In our commitment to transparency, full disclosure, and prudent management of real and volatile assets, we like to think of TGS Financial Advisors as the "un-Madoff."

Please remember to contact TGS Financial Advisors if there are any changes in your personal or financial situation, or investment objectives for the purpose of reviewing, evaluating and revising our previous recommendations and/or services. Please also advise us if you would like to impose, add, or to amend any reasonable restrictions to our investment advisory services. A copy of our current written disclosure statement discussing our advisory services and fees continues to remain available for your review upon request.

ABOUT THE AUTHOR



James S. Hemphill, CFP® ChFC CIMA
Chief Investment Strategist
Managing Director

Jim has been managing individual client portfolios since 1978. He holds the Certified Financial Planner™ (CFP®), Chartered Life Underwriter (CLU), Chartered Financial Consultant (ChFC), Certified Investment Management Analyst (CIMA) and Chartered Advisor for Senior Living (CASL) designations. He added the Investment Strategist Certificate in October of 2005.

Jim's practice focuses on planning for the transition to a successful retirement. Jim is married to Amy. They have two sons, Jack and Alex, and a daughter Katharine.

TGS Financial Advisors is a wealth management practice located in Radnor, PA. Since 1990, we have helped successful families to build, maintain and preserve life-time wealth.

