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Bruce Berkowitz: The megamind of Miami

Posted by [Scott Cendrowski](#), reporter
 December 10, 2010 3:00 am

He may be the most driven investor on earth. And now the founder of the \$17 billion Fairholme Fund is making the boldest bet of his career.

Bruce Berkowitz is starting to sweat. It's just after 5 a.m. on a Thursday, and the man who is arguably the top mutual fund manager on the planet is briskly walking his usual morning route on the mansion-lined streets of his gated neighborhood in Coral Gables, Fla., just outside Miami. Alongside him is his investing partner, right-hand man, and next-door neighbor, Charlie Fernandez, who is furiously scrolling through e-mails on his BlackBerry as the two bat around ideas for the portfolio of Fairholme, (FAIRX) the \$17 billion fund Berkowitz started 11 years ago. "Out here you can actually think," says Berkowitz, explaining the appeal of an hour of daily pre-dawn speed-walking to a visitor hustling to keep pace.



PHOTO: JEFFERY SALTER
 Berkowitz in his home office in Coral Gables, Fla., with his beloved poodle, Jazz. He struggles to sustain interest in anything besides investing. "You do what you enjoy," he says.

As he charges through the darkness in shorts, running shoes, and a black University of Miami zip-up hoodie, Berkowitz bounces from topic to topic in his typical scattershot way. He and Fernandez have just returned from an eight-day fact-finding trip to China -- he's bullish but wishes he'd gotten in 10 years ago -- packed so full of meetings that, Berkowitz says, they slept a mere 24 hours total. Next he jumps to the bold investments that he and Fernandez have made -- hedge-fund-like maneuvers involving both equity and debt -- in subprime lender AmeriCredit and then-bankrupt mall owner General Growth Properties (GGP), moves that have netted his fund a profit of \$2 billion.

Finally, on the fourth or fifth pass down his block, Berkowitz, 52, gets around to the biggest and most public wager of his life: his \$5 billion bet on the resurgence of Wall Street. Fairholme is now the largest shareholder of AIG (AIG) after the U.S. government, with a \$1.5 billion position in the insurance giant. And Berkowitz has also taken huge stakes in Citigroup (C), Goldman Sachs (GS), Morgan Stanley (MS), and Bank of America (BAC). "We're going to make more on these names than we have on anything," he declares, as the sun begins rising behind the palm trees.

Berkowitz may not be a household name to most investors, but he should be. During the past decade, Fairholme has produced an annualized return of 11.6% over a span in which the S&P 500 (SPX) has risen a paltry 0.7% a year on average. Since the fund launched in 1999, Berkowitz has beaten the market every year except one (when Fairholme was up 24%, vs. the S&P's 29% rise in 2003), and he's on track (up 17% through early December) to easily beat it again in 2010. "The highest compliment I can give," says hedge fund billionaire Leon Cooperman, who got to know Berkowitz when they both invested in telecom stocks earlier this decade, "is if he called me up to recommend a stock, I would pay attention."

The fund's outstanding returns -- along with Berkowitz's being crowned U.S. stock manager of the decade this year by investment research firm Morningstar -- have attracted a flood of new money to Fairholme. Investors have poured in more than \$4 billion over the past year. And they've added \$330 million more to his Fairholme Focused Income Fund, which launched in January. He plans to open a third fund, one that focuses on smaller opportunities, early in 2011.

Berkowitz welcomes the influx of money. (He says his target is for Fairholme to reach \$25 billion in assets.) For now, though, much of the new cash remains just that -- cash. Rather than put it all to work in active investments, Berkowitz has an unusually high 25% of Fairholme's portfolio in cash or short-term debt. It's a huge reserve of liquid funds, and Berkowitz wants it for a couple of reasons, both of which suggest that he sees a rocky road ahead for the U.S. economy. First, if a falling market scares his investors into withdrawing funds, the extra money means that he won't be

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Scott Cendrowski is a reporter at *Fortune*, where he writes about finance and investing. Before joining the magazine in 2008, he was a Pulliam Fellow at *The Arizona Republic* and an intern for *Bloomberg News*. A Detroit native, he has a B.A. in public policy from Michigan State University.



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forced to sell stocks he believes in.

Second, stockpiling cash is in keeping with Berkowitz's plan to evolve Fairholme from a regular, stocks-only mutual fund into a more versatile distressed-asset investment vehicle, and to profit from the coming wave of corporate restructurings he anticipates. He believes that dozens of overleveraged companies will need to fix their balance sheets in the next couple of years -- commercial real estate is one industry ripe for it, he says -- and he wants Fairholme to be ready to step in as a Warren Buffett-style lender of last resort, with highly favorable terms for his investors, of course. As Berkowitz puts it, "There aren't many people in the world you can call who can write a check for \$1 billion today."

Wall Street's history is filled with stories of money managers who have become superstars after a spectacular run, only to struggle once investors flocked to their funds. Bill Miller famously guided his Legg Mason Value Trust (**LMVTX**) to a 15-year winning streak over the S&P 500 before going into a deep slump beginning in 2007. Ken Heebner of the CGM Focus Fund (**CGMFX**) was riding high in 2008 (when his success earned him a cover story in this publication) but has since struggled mightily.

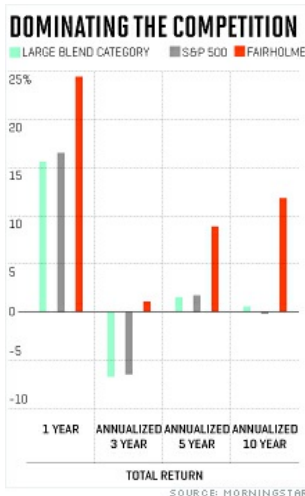
Can Berkowitz continue to beat the odds? Can a single investor, even one with singular focus and discipline, successfully manage a portfolio the size of Fairholme? "It's a challenge for any manager to take in that kind of inflow and repeat," says a large Fairholme investor. Says another: "You hope that when you buy a manager, it's a seasoned team. Having a one-man band can be risky."

Berkowitz acknowledges the concerns with his usual candor. "Right now," he says matter-of-factly, "we're at an interesting junction point where people can't decide whether we're about to blow up."

Getting away from Wall Street

For its first six years Fairholme was run from an office in Short Hills, N.J. Then, in 2006, Berkowitz uprooted the firm and his family to move to Miami. The warm weather in southern Florida was certainly a factor in the decision, as was the absence of a state income tax. But Berkowitz says the biggest reason was that he wanted to put some space between himself and Wall Street. In Short Hills, his office was in a building with several other money-management firms. And no matter where he went in town, he was in danger of running into know-it-all investors who might pollute his thinking. "I had to get away," he says.

Fairholme's Miami offices occupy a single floor in a nondescript office building. There are 20 or so full-time employees to handle compliance, investor relations, and trading. But there are no teams of research analysts. And most of the time there is no Berkowitz either.



That's because he spends almost all his time working at home. Berkowitz bought his current 14,500-square-foot mansion for \$14 million in 2008. He and his wife, Tracey, gutted it -- he says it was filled with gaudy marble and chandeliers -- and remodeled in a low-key modern style. Berkowitz's spacious office has dark wood floors and Barcelona chairs. Massive windows offer a perfect view of the Atlantic Ocean. On his desk is a blanket for his beloved 12-year-old white poodle, Jazz.

Berkowitz is about 6 feet tall and lanky, and looks young for his age. He keeps his dark hair brushed back and usually wears blue oxfords with loose slacks or jeans. Despite his obvious wealth, Berkowitz doesn't have a fancy-car fetish. Unless he has to take the highway, his vehicle of choice is a tiny Mercedes-Benz Smart Car.

At Tracey's urging, Berkowitz has been attempting to acquire a hobby for years. A few years ago he tried golf but gave it up. ("I just couldn't hit the ball straight," he says.) He talks

excitedly about scuba diving but admits he's been only twice. Next to the door of his office are two guitars, a Fender Stratocaster and a vintage Rickenbacker. Berkowitz says he tried to learn the instrument last year but couldn't stick with it.

His office shelves are filled with some 2,000 vinyl records that he bought in bulk a year and a half ago. When asked for a favorite, though, he struggles to come up with a name. He has to remind himself to use his \$80,000 McIntosh sound system. "I get really upset when I don't put it on for a week or two," he says. "It's something I'm trying to do for 15 to 20 minutes a day to relax." In truth, he doesn't think he's missing out on much. "People do what they enjoy," he says. For him, it's investing.

Early to rise, early to bed

Berkowitz works seven days a week and often starts sending e-mails before 4 a.m. After his power walk with Fernandez each morning, Berkowitz works out in his basement gym with a personal trainer and is at his desk by 8:15. When the market closes, he meets again with Charlie for an hour, then spends an hour or two with his family. (He has three children, the youngest a senior in high school.) He's usually in bed by 9 p.m., reading annual reports or other filings. Once his eyes get tired, he puts on Bowers & Wilkins headphones to listen to conference calls. "They pick up voices really well," he says, before pausing. "This is really sick, isn't it?" (Berkowitz says he listened to Bank of America's recent earnings call over and over -- nine or 10 times -- to



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While he may not employ a full-time team of analysts, Berkowitz often hires experts to challenge his ideas. When researching defense stocks a few years ago, he hired a retired two-star general and a retired admiral to advise him. More recently he's used a Washington lobbyist to help him track changes in financial-reform legislation. When asked about the SEC's investigation of "expert networks" in relation to insider trading, Berkowitz says that he has never employed any of the firms implicated, and that the consultants he does use don't provide company-specific information.

Most mutual fund managers practice diversification -- they buy 50 or more stocks and thus spread the risk. But since his early days managing money in the 1980s, Berkowitz has run concentrated portfolios. Currently the Fairholme Fund holds only 25 stocks, and 38% of the money is in the top five names. When asked why, Berkowitz responds by echoing Berkshire Hathaway's Charlie Munger: "Why would you want to put money into your 35th-best idea?" He then pulls a book from his shelf: *The Science of Hitting* by Ted Williams. On page 37 there's a graphic showing the strike zone sections where Williams hit for his highest averages. "We're operating in our sweet spot," says Berkowitz with a smile.

That sweet spot is financial stocks.

Berkowitz has always specialized in understanding banks and other financial companies -- and has often made huge returns in them. In the early 1990s, for example, he purchased beaten-down shares of Wells Fargo when short-sellers were arguing that commercial real estate loans would cripple the bank, and watched the stock rise ninefold over the next nine years.

Berkowitz's bet on banks now comes down to this: He's convinced that the worst is over. And his certainty is all the more compelling because he sensed disaster coming early. In 2006, Berkowitz sold his stakes in mortgage lenders Countrywide Financial and Freddie Mac after he noticed a proliferation of overleveraged balance sheets, aggressive lending, and exotic mortgage securities in the financial sector. "Worldwide, financial institutions may ultimately write off hundreds of billions and are being forced to raise equity to survive -- if they can," he wrote in Fairholme's 2007 letter to investors. Shortly after, he put much of the fund's money in defensive stocks like Boeing (BA) and Pfizer (PFE).

When the markets subsequently collapsed in 2008, Berkowitz saw it as a once-in-a-generation opportunity. The one mistake he didn't want to make was to plunge in too early. Cultivating a healthy paranoia is a hallmark of his investing approach. As he is fond of saying, "The first rule is: Don't lose money. The second rule is: Follow the first rule." So, he says, he spent nearly every day of 2008 and 2009 studying the banks. He combed through congressional testimony from Wall Street executives. He studied TARP filings and loan data from the Federal Reserve. All the while he monitored balance sheets. And only when he was convinced that it was impossible to lose money did he plunge in.



PHOTO: JEFFERY SALTER
Berkowitz moved to Miami from New Jersey to isolate himself from other investors who might pollute his thinking.

Fairholme's \$450 million investment in Citigroup in the fourth quarter of 2009 was his first sizable bet. Citi lost almost \$30 billion in 2008 alone, and its shares fell more than 90% during the credit crisis. But by the fall of 2009, Berkowitz could see that good, conservative loans were replacing bad ones in Citi's lending businesses -- and even its so-called toxic assets were yielding more than 5%. "You have to normalize the environment -- that's the arbitrage," he says. "Are they going to make it through the tough times? And what are they going to look like in more normal times?" So far in 2010, Citi shares are up 34%, and Berkowitz believes they could easily double from here.

Berkowitz on AIG: Treasury will profit big

His boldest, least understood investment by far is his huge position in AIG -- the single largest holding in his fund. Conventional wisdom on Wall Street said AIG would never repay the government the \$180 billion in bailout money it was extended after its London-based credit derivatives group posted billions in losses on bad mortgage bets. Institutional investors have shunned the insurer, and last year more than one Wall Street analyst wondered whether the stock was worthless. By early 2010, it was down 98% from its pre-crash level.

But when Berkowitz dissected AIG's businesses, including its core property and casualty insurance arms in the U.S. and its Asian life insurance unit, he found that cash flows were positive, even as mark-to-market losses in other parts of the company continued to cause billions in losses. "All of my most intelligent friends in the insurance world think I'm an idiot," he says of his AIG stake. "These are CEOs of insurance companies. But it's just right there."

After restructuring charges, the giant lost \$11 billion in 2009, but "at its core, their intact franchises make money," says Berkowitz. It's those core businesses that Berkowitz is betting on. After sketching the value of its operations, some of which would be sold off to pay back the government, Berkowitz predicts that U.S. taxpayers will eventually get repaid, although he admits that is still a ways off.

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Berkowitz started buying AIG bonds and preferred stock as well as common equity in February. Since then the stock has risen more than 75%. "The good thing about AIG is that it's just so complex," he says. "For a mere mortal with an average intelligence, it takes a long time to try to put all the pieces together. It's all there to be put together, it's just that you need to have no social life and not too many investments."

An early lesson in odds making

Berkowitz grew up in Chelsea, Mass., a gritty suburb of Boston. His father Barney was a part-time taxi driver who ran a bookmaking operation out of his corner convenience store, and his mother, Hennie, was a homemaker. When Bruce was 15, his father had a heart attack. Berkowitz quit high school for two months to take over the bookmaking operation while his dad recovered.

Creating betting lines for horse races and baseball games gave him his first lessons in odds -- and how most people don't understand them. "I learned hope and dreams and the perverse psychology that makes people make stupid decisions," he says.

An indifferent student, Berkowitz managed to get into the University of Massachusetts Amherst despite mediocre high school grades, becoming the first in his family to attend college. Once on campus, he found his motivation -- not to end up a taxi driver like his dad, he says -- and discovered he had a talent for math. He also met Tracey, who was a year older and living in the same dorm. They got married the week he graduated.

Berkowitz and his wife both found jobs with the Strategic Planning Institute in Cambridge, Mass. An offshoot of General Electric, the consulting group analyzed data for **Fortune 500** companies to give them insight into what drove profitability. The couple was transferred to the group's office in Manchester, England, in 1981, but Berkowitz soon found the job boring. In his spare time he began trading stocks through the local Merrill Lynch office. He ended up joining Merrill's London brokerage office in 1983.

Berkowitz quickly emerged as the office's top salesman in fixed income, which was in a raging bull market. He bought *BusinessWeek's* international subscription list from McGraw-Hill and spent Sunday afternoons stuffing envelopes with letters of introduction to potential customers. American banks were new to England, and people were interested.

"Clients just loved him," says former partner Pascal Besman. "He had a great personality, and he was brilliant. He devoted all his time to work. We would work 14 hours a day, then we'd hang out another three or four."

Berkowitz became a hot commodity. By 1987 he had a core group of 200 wealthy clients, and Lehman Brothers recruited him to start its new high-net-worth office in London. He moved back to the U.S. with Lehman in 1989, then was recruited to Salomon Smith Barney in 1993 -- always retaining his core group of clients.

He began to chafe, however, at the oversight of working inside big firms. His bosses criticized him for running highly concentrated portfolios, even though, Berkowitz says, his returns regularly trounced the market. In 1994, for instance, he owned only two stocks: Berkshire Hathaway (**BRKA**) and the Fireman's Fund Insurance Co. "I was bumping up against constraints," he says. He also liked the idea of having a public record of his stock picking. So in 1997 he departed with all 200 of his original clients and about \$400 million in separate accounts, and opened his own firm. He recruited two stock pickers -- a star Paine Webber broker named Larry Pitkowsky and a value investor named Keith Trauner -- to help generate ideas. Fairholme, named for the street where Berkowitz lived in London, launched in December 1999.

His biggest project so far

Over lunch at a small Italian restaurant in Coral Gables in November, Berkowitz takes a call from activist hedge fund manager Bill Ackman of Pershing Square Capital in New York City. Ackman is congratulating Berkowitz on the day's news: General Growth Properties, the country's second-biggest mall owner, has officially emerged from bankruptcy after a year and a half under court supervision.

The call lasts only a minute, and afterward Berkowitz asks Fernandez how much Fairholme shareholders are making from their investment in GGP. Fernandez quickly responds: \$1.4 billion. It's a huge return, and, as Berkowitz quickly says, it wouldn't be possible without Fernandez.



Fernandez, 48, joined Fairholme in 2007, shortly after marrying Berkowitz's cousin. To outsiders it smelled of nepotism, but Berkowitz says he had been looking for someone like Fernandez for a long time. Even though Fairholme posted 20% annualized gains in its first five years, by 2005, with the fund at \$1.5 billion in assets, Berkowitz thought it needed a change. He wanted someone with the right experience to help him branch into opportunities outside public securities. Fernandez was a restructuring whiz who had worked at companies controlled by pharmaceutical billionaire Phillip Frost. Soon after Fernandez's arrival, Pitkowsky and Trauner left Fairholme. Berkowitz then changed Fairholme's charter to allow the fund to invest in debt for the first time



PHOTO: JEFFERY SALTER
Berkowitz runs Fairholme with Charlie Fernandez, his right-hand man and next-door neighbor, seen here on a sofa in Berkowitz's home office.

and take larger stakes in companies. Shortly thereafter Berkowitz insisted that Fernandez move into the house next door to his, the better to work on deals.

Their biggest project so far has been General Growth Properties, and it's a good example of the types of transactions Berkowitz wants to do more of. Soon after the largest real estate bankruptcy in history made headlines in April 2009, Berkowitz and Fernandez began reading through the court filings. Aided by a veteran bankruptcy lawyer in New York, they determined that some of the company's battered debt could be paid off with the rent checks still coming in. Fernandez called more than 100 holders of GGP bonds and made bids over the phone. After six weeks he had accumulated bonds with a face value of \$1.8 billion.

At that point Ackman, who had acquired a huge equity position in GGP, and property owner Brookfield Asset Management invited Fairholme to join them in recapitalizing the company's stock. "We set it up so there was room for others, and Bruce was my first call," says Ackman, who made a huge return when the stock rose from 50¢ to more than \$15. "The guy is the most stand-up investor I've ever worked with."

Why not move to hedge funds?

Not all of Berkowitz's interactions with the hedge fund world have been quite so favorable. In October he and noted short-seller David Einhorn faced off in the media over St. Joe, a Florida real estate developer that has been battered by falling land prices. Berkowitz, with a nearly 30% stake, is the largest shareholder in the company. After Einhorn, who is short the stock, gave a negative presentation at an investor's conference, driving down the price, Berkowitz thanked him for raising the company's profile. "I want to send him a box of chocolates," he told Reuters. He says he's confident he'll make a bundle on St. Joe eventually.

As Berkowitz moves more and more into these types of distressed investments, a natural question arises: Why not become a hedge fund manager himself, and take a hedge-fund-size cut for his services? For one thing, says Berkowitz, he isn't eager to deal with high-maintenance hedge fund investors. But more important, he doesn't view himself as the fast-money type.

As he nears the end of his morning walk, Berkowitz begins musing on his aversion to losing money. He is not, he insists, interested in taking risks. His contrarian investments may look perilous to outsiders, but to him they are the safest opportunities he can find. He stops and shuffles to the dotted yellow line in the center of the street and points down: "This is where we can make our shareholders plenty of money." For Berkowitz, out of the ordinary is middle-of-the-road.

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