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THE BLOW-UP ARTIST

Can Victor Niederhoffer survive another market crisis?

by John Cassidy October 15, 2007



Niederhoffer's approach is eclectic. His funds, a friend says, appeal "to people like him: self-made people who have a maverick streak."

On a wall opposite Victor Niederhoffer's desk is a large painting of the *Essex*, a Nantucket whaling ship that sank in the South Pacific in 1820, after being attacked by a giant sperm whale, and that later served as the inspiration for "Moby-Dick." The *Essex*'s captain, George Pollard, Jr., survived, and persuaded his financial backers to give him another ship, but he sailed it for little more than a year before it foundered on a coral reef. Pollard was ruined, and he ended his days as a night watchman. The painting, which Niederhoffer, a sixty-three-year-old hedge-fund manager, acquired after losing all his clients' money—and a good deal of his own—in the Thai stock market crash of 1997, serves as an admonition against the incaution to which he, a notorious risktaker, is prone, and as a reminder of the precariousness of his success.

Niederhoffer has been a professional investor for nearly three decades, during which he has made and lost several fortunes—typically by relying on methods that other traders consider reckless or unorthodox or both. In the nineteen-seventies, he wrote one of the first software programs to identify profitable trades. In the early eighties, he went into business with George Soros, then arguably the world's most successful investor. A few years later, when prominent money managers were based almost exclusively in Manhattan, Niederhoffer moved his home and his trading room to Connecticut, to a twenty-thousand-square-foot neo-Tudor mansion crammed with books, manuscripts, silver jewelry, art work, and a collection of seashells. The walls of his vast living room, which has a ceiling about thirty feet high, are covered with more than two dozen paintings, many depicting

industrial landscapes or Western shoot-'em-ups, and the floor is occupied by, among other objects, a large painted pony, a black-spotted wooden hound carrying three quail on its back, a seated pig, and two miniature black bears. Niederhoffer's home is also frequently occupied by various of his children. (He has six daughters and an infant son, from two marriages and an extramarital relationship.)

After the 1997 Asian financial crisis, Niederhoffer was forced out of business for several years. Then, in his late fifties, he made a dramatic recovery. He founded three new hedge funds and launched a Web site, DailySpeculations.com, where he posts his idiosyncratic insights into the stock market—"What can we learn from shelled species about the markets?" he wrote in May—as well as opinions about sports, politics, and culture (" 'The Fantasticks,' currently running as a revival on Broadway, is the perfect musical"). He has mentored dozens of successful traders, many of whom regard him as a guru. "Before I joined Victor, I used to trade for a Wall Street firm," James Lackey, a self-employed Florida investor who placed trades for Niederhoffer from 2002 to 2006, told me. "But I quickly realized that I didn't know very much. What he taught me was how to approach the market as a whole, and how to analyze it scientifically. He was just amazing at seeing what was happening and showing us how to make money."

Niederhoffer, a former national squash champion who is considered one of the most talented Americans to have played the game, relishes the acclaim, but he knows that in his field circumstances can change quickly. By the end of August, his funds were in trouble, and on Wall Street rumors circulated that he would soon be out of business again. Niederhoffer had been worried all summer, but he tried to project a wry, self-deprecating humor. "If an event like 1997 occurred again, my dependents would be up the creek, and I would be a night watchman somewhere, just like Captain Pollard," he said to me when I visited him at his home one morning in June. "In America, they give you a second chance but not a third."

Tall and trim (he still looks like an athlete), with closely cropped white hair, olive skin, and a long, expressive face, Niederhoffer speaks softly, with a strong Brooklyn accent. He was wearing a yellow shirt, pink trousers, and white socks, but no shoes—he maintains a "no shoes" rule in the office, to reduce noise—and was sitting behind his desk, which is dominated by two Bloomberg screens, in a large room over the garage which he shares with his partner, Steve Wisdom, and several members of his company, Manchester Trading. (The trading operation fits into two rooms; the other one is over the kitchen.) In one hand, he was holding a telephone receiver, and his light-blue eyes were fixed on the computer screens. "The market's way down today," he said by way of greeting. Turning back to the telephone and addressing his broker at the Chicago Mercantile Exchange, he asked, "Can you repeat those quotes, please?" After a few seconds, he said, "I'll sell two hundred red March at five hundred and ten. I'll sell two hundred blue March at eleven ten."

The Chicago Merc is a futures market, where people trade contracts that give them the right to purchase a particular commodity at a specified date in the future. Originally, the items traded on the exchange were physical commodities, such as eggs, butter, and pigs, and its main customers were farmers and food companies. In recent decades, futures trading has become more abstract; professional speculators now use the exchange to place bets on the prices of financial securities, such as stocks, bonds, and currencies—a development that Niederhoffer, a former math prodigy who has a Ph.D. in economics, has exploited. He likes to be at his desk well before the Chicago market opens, especially on days when he has big positions riding overnight. He is mainly a short-term operator—he bets on how prices will move in the subsequent few minutes, hours, or days—and most of his knowledge of current events comes from Bloomberg. (He doesn't read newspapers or watch television.) When he

arrives at his office, he turns on his computer and reads about developments in the Asian and European markets, which often foreshadow the day's action in the United States.

At the end of the previous week, the yield on ten-year Treasury bonds had surged to almost five per cent, prompting Niederhoffer to turn uncharacteristically bearish on stocks. Once the bond yield reached five per cent, he had reasoned, some investors would move their money from stocks to bonds, which would depress stock prices. Accordingly, he had sold short more than a billion dollars' worth of stock futures. (Selling short, a common tactic among speculators, involves selling something you don't own with the intention of buying it back later, at a cheaper price. If the price of the security falls while you are "short," you make a profit; if the price rises, you lose money.)

Even by Niederhoffer's generous standards, going short a billion dollars of stock futures was a large bet, but it worked out well. Not long after the markets reopened on Monday, the bond yield climbed to five per cent, and stocks and stock futures tumbled. On Wednesday, the morning of my visit, shortly after the opening bell sounded on Wall Street, Niederhoffer repurchased the futures he had sold, making more than five million dollars.

He didn't look pleased, though. During the morning, stocks had continued to fall, and he knew that if he had waited he could have made an even bigger profit. He says that in twenty-eight years as a professional investor he hasn't had a single truly satisfactory trading day. At eleven o'clock, the Dow Jones Industrial Average had slipped about a hundred points and the S. & P. 500 Index was down about thirteen points. Niederhoffer stared morosely at his Bloomberg screens. "The score doesn't look good," he muttered. The screens were tracking the movements of various stock-market indices in Europe and Latin America, but I noticed that they weren't displaying any American prices. Niederhoffer used to invest heavily overseas, but since his 1997 misadventure in Thai stocks he has confined his trading to the United States. He explained that when the U.S. market was falling he preferred to track the DAX, a German stock index that generally moves in synch with the American market. "You can see how much you are losing, but it doesn't hurt as much as watching the S. & P.," he said.

Before long, Niederhoffer cheered up a bit. "There have been three big down opens in a row, which is unusual," he said. "The market doesn't like to do the same things repeatedly." He turned to Alex Castaldo, a thin, bespectacled fifty-three-year-old Italian who has a degree in electrical engineering from M.I.T. and a Ph.D. in finance from CUNY, and asked him to compile some data. "Doc," he said to Castaldo, "what does the market do when it opens down a lot three days in a row?" A few minutes later, Castaldo handed Niederhoffer a computer printout, which showed that since the start of 2003 there had been just ten occasions on which, for three consecutive days, the S. & P. 500 had fallen sharply in the first hour and a half of trading. On eight of those occasions, stocks had bounced back, with the average market rise by the end of the following trading day amounting to three tenths of one per cent. For a trader like Niederhoffer, who uses leverage—borrowed money—to scale up his bets, the ability to predict even relatively small changes in the market can pay off handsomely.

The software that Niederhoffer uses to identify stock-price patterns is a version of the code that he wrote thirty years ago. Many hedge funds and Wall Street banks now rely on such programs to spot potentially lucrative market fluctuations and place orders automatically—a practice known as "black box" investing—but Niederhoffer is scornful of this method. Although markets sometimes move in predictable ways, he says, the patterns change constantly, and reliance on mathematical algorithms can be disastrous. At Manchester Trading, Niederhoffer or Wisdom reviews each trade before it is placed.

In this instance, Niederhoffer expected the market to rebound, but he decided to hold off on buying. Morgan Stanley had just issued a notice advising its clients to reduce their stock holdings. "Plus, the Fed has been making

bearish noises,” Niederhoffer said. A few minutes earlier, the Dow had dropped below thirteen thousand five hundred. Castaldo went over to Niederhoffer’s Bloomberg and called up some U.S. stock charts. Niederhoffer, looking at the falling lines, announced, “It’s gone down two per cent—that’s enough.” Then he turned to Owen Wilson, a young Englishman who has worked for him for a couple of years. Holding a phone to his ear, Wilson shouted out quotes from the Chicago Merc. “Buy a hundred and fifty at eighteen seventy-five,” Niederhoffer said. Wilson placed the trades and called out more numbers. Again, Niederhoffer told him to buy. Within a few minutes, Wilson had purchased tens of millions of dollars’ worth of stock futures.

Niederhoffer received his first lessons in finance as a child growing up in Brighton Beach. He learned to bet on stoopball, paddleball, and checkers, which he played with other local kids, and with adults who went by nicknames such as Bitter Irving, Bookie, and Nervous Phil. His father, Artie, a New York City cop who spent twenty years on the force before becoming a professor of sociology at John Jay College of Criminal Justice, tried unsuccessfully to dissuade him from gambling. “Everything was a money game,” Niederhoffer told me. “My father hated it, but I loved to win a nickel or a dime.” With the encouragement of his uncle Howie, who was in high school, he also placed wagers on professional sports. In October, 1951, on Yom Kippur, Howie and Victor, who was eight, sneaked out of synagogue and bet eight hundred dollars on the Brooklyn Dodgers, who were playing the New York Giants in a pennant-decider. When Bobby Thomson hit his famous home run, defeating the Dodgers, Howie and Victor were devastated. (The knowledge that only two of the lost dollars were Niederhoffer’s did little to console him.)

Niederhoffer says that as far back as the Middle Ages his ancestors were money changers. At the end of the nineteenth century, his paternal great-grandparents moved from Austria to the Lower East Side, where several of their seven sons sold fruit from a horse and cart. Niederhoffer’s grandfather Martie, who had a good head for figures, became an accountant. In the boom years of the nineteen-twenties, Martie borrowed money and invested it in real estate and stocks, assembling a portfolio that made him nearly a millionaire. The stock-market crash of October, 1929, destroyed most of his wealth; two years later, the market dived again, wiping out what he had left.

Martie, who spoke Yiddish and pidgin Spanish, got a job as a translator in a Brooklyn courthouse. But he retained an interest in the stock market, and in 1954 he financed Victor’s first equity investment: a hundred shares of the Benguet Mining Company, which was trading at fifty cents. For several years, the stock hardly moved. Then, in just a few months, it doubled in value. On Martie’s advice, Victor sold his shares, and made a profit of fifty dollars. During the next thirty-six months, the stock’s value increased to thirty dollars a share. “I have repeated the mistake of grabbing at small profits and selling at a targeted round number over and over in my speculative career,” he wrote in “The Education of a Speculator,” a memoir that he published in 1997. “I believe many others make this same error.”

At the age of six, Niederhoffer says, he was such an accomplished paddle-tennis player that he had to spot his opponents fifteen points a game. At thirteen, he defeated a seventeen-year-old to win the New York City junior singles tennis championship. (In school, his competitiveness elicited mixed reactions. At the end of his last year at P.S. 225, his sixth-grade teacher wrote, “Although a little trying at times, you were the spark the class needed this year. You have a keen mind; learn to curb your inclinations to demonstrate superiority.”) At Abraham Lincoln High School on Ocean Parkway, Niederhoffer was the president of his class, the captain of the tennis team, the star of the math team, a pianist in the orchestra, a clarinetist in the band, the sports editor of the newspaper, and a frequent contributor to *Vanguard*, the school magazine. In an article that appeared in the June,

1958, issue, Niederhoffer warned that automation “will require a complete reorientation” in the attitudes of trade unions. Five months later, displaying a view of government intervention that he would later renounce, he argued that “federal aid to education is imperative if equality of educational opportunity in our democracy is to have real meaning.”

Niederhoffer’s father, whom he idolized, encouraged his athletic and intellectual pursuits, and his mother, Elaine, who was descended from a long line of rabbis, pressed him and his younger brother and sister—now, respectively, a commodity-fund adviser and a psychiatric social worker—to succeed. “My mother was never content,” Niederhoffer told me. “She pushed us to be No. 1.” In January, 1960, at his mother’s urging, he applied to Harvard. In a letter of recommendation, his academic adviser and tennis coach, Milton Hecht, wrote, “Victor ranks among the first in intellectual achievement and promise in comparison with the thousands of students I have taught in the last thirty years.” Harvard awarded him a partial scholarship, as did Columbia and the University of Pennsylvania. Niederhoffer chose Harvard, where he majored in economics.

Niederhoffer spent less time in the classroom than he did on the squash court. Until he moved to Cambridge, he had never played squash—or squash racquets, as it was then called—but the physical demands of the game appealed to him. He borrowed every book on squash at the Widener Library, and took some with him to the practice court, where he opened them on the floor and repeatedly copied the moves they described. In 1962, as an eighteen-year-old sophomore, Niederhoffer won the junior championship of the National Intercollegiate Squash Racquets Association. A year later, he won the Harry Cowles tournament, a prestigious competition for amateurs. “He has good size, quickness, and a skillful touch,” his Harvard coach, Jack Barnaby, told the *News and Views of Harvard Sports*, a campus publication, in January, 1963. “But a lot of players have those attributes. What he has beyond that is one of the most competitive characters I’ve ever seen. He makes you feel like you are watching a person of Ty Cobb’s cut in action again.”

In the 1963-64 season, Niederhoffer, now a senior, was captain of the Harvard squash team, which went undefeated. He also won the individual national collegiate title, and his aggressive playing style attracted the attention of a reporter at *Sports Illustrated*, who wrote, “Niederhoffer thinks he is unbeatable and clamors loudly for justice when his shots go awry. Consequently, on those rare occasions when he loses a tournament, squash lovers are delighted.” The reporter quoted Niederhoffer’s freshman coach, Corey Wynn, who recalled his former student’s penchant for “handballing it”—physically blocking his opponents from reaching the ball, a tactic that was frowned upon in New England. Niederhoffer’s mother read the article and consulted a Fifth Avenue law firm, Cohn & Glickstein, about suing *Sports Illustrated* for libel. (On the firm’s advice, she decided not to file a suit.)

In February, 1966, Niederhoffer won the U.S. national amateur championship, the culmination of a series of important victories. *Sports Illustrated* and *Time* sent reporters to these events, and Niederhoffer wasn’t pleased with the coverage. First, he wrote to *Time*, denying its claim that during the national championship he had offered odds of two-to-one against himself. An editor replied, defending the magazine’s reporting as having been based on “reliable sources.” Unsatisfied, Niederhoffer wrote another letter, to a senior executive at Time-Life, the parent company of both *Time* and *Sports Illustrated*, complaining that the articles had “created the impression that I was a poor boy from Brooklyn who had adjusted badly to the rigors of a social sport.”

An aura of class and ethnic prejudice pervaded press accounts of Niederhoffer’s achievements; he was widely viewed as an ill-mannered upstart from the wrong side of the East River. The *Times Magazine* noted that he was “built wrong for a squash player: not lithe and wiry, or even tall and gracefully powerful. He is shaped

rather like a block—fairly broad in the shoulders, no waist, thick shapeless legs—and his color is sallow, the deep oyster sallow of a New York street creature.” In Chicago, where Niederhoffer moved in 1964, to attend graduate school, he couldn’t find a squash club that would admit him. He was so offended that for several years he gave up the game.

After he returned to the court, in 1972, he won the national amateur championship four years running, an unprecedented feat. In January, 1975, in Mexico City, he won the North American Open, a major professional tournament, defeating the legendary Pakistani player Sharif Khan in four games. Afterward, Niederhoffer wasn’t very gracious. “Khan had a fatal plan—a lack of real toughness,” he told *Sports Illustrated*. “He’s been winning so long he doesn’t know anymore what it is to play a battle to the death.”

Shortly after noon, a housekeeper’s voice announced over an intercom, “Victor’s lunch is ready. Does he want it?” “No,” Niederhoffer replied. “I can’t eat lunch with the market like this.” He looked at his screens. “Europe got killed,” he said to nobody in particular. He was still irked by Morgan Stanley’s bearish notice to clients. “If the big brokerage houses are going to make money from commissions, they have to get people selling as well as buying,” he said dismissively. Unlike most Wall Street firms, Manchester Trading doesn’t have a television in its trading room, partly because Niederhoffer doesn’t want to be distracted but also because he can’t abide doom-mongering market commentators, like Alan Abelson, a columnist for *Barron’s*, the financial weekly, and Robert Prechter, Jr., the publisher of the *Elliot Wave Theorist*. “These people have been bearish since Dow 700,” Niederhoffer said angrily. “When the market is going up, they can’t get a hearing. But when the market falls they get invited back on. They say it’s like 1997, or 1987, or 2002. How about 1907? That was a bad year. Interest rates went up; the market went down by nearly fifty per cent.”

Just after one o’clock, the market hit a new low for the day, with the Dow down about a hundred and twenty-five points, and the S. & P. 500 down about fourteen points. It is a strange feature of financial markets that time occasionally seems to speed up. On quiet days, when prices aren’t moving much, traders monitor their positions, read the papers, and chat with each other, and it can seem as though an eternity passes before the closing bell sounds. But when the market becomes volatile every move brings with it a fresh opportunity for profit or loss, and each minute can fly by. The mathematician Benoît Mandelbrot, who pioneered the application of chaos theory to financial markets, refers to this phenomenon as the “multifractal nature of trading time.”

Niederhoffer turned to Castaldo. “This day is far from over,” he said. “Doc, what happens when the market is down twelve points at one o’clock and it has been down significantly the previous two days?” A few minutes later, Castaldo handed him another computer printout. “Most of the time, these computer analyses don’t work, but it gives you an anchor,” Niederhoffer said as he scanned the sheet. “My checkers teacher said even a bad system is better than no system at all.” The data showed that the last time trading seemed to follow the current pattern was between November, 2000, and September, 2002, when there had been eight such three-day periods. In most of these instances, the market had rebounded strongly during the subsequent seventy-two hours. Niederhoffer looked at Owen Wilson. “I’ll buy another fifty at eleven-fifty,” he said.

Niederhoffer’s investment philosophy is based on a belief that over the long term the market goes up, but over the short term it constantly reverses itself. In his books—his second, “Practical Speculation,” was published in 2003—he compares the behavior of investors to that of herds of rampaging elephants that retrace their steps over and over. He refers to this pattern as a “LoBagola,” after Bata LoBagola, the author of “LoBagola: An African Savage’s Own Story,” a book published in 1930 describing the customs and wildlife of West Africa. After the book appeared, LoBagola was revealed to be an African-American vaudeville entertainer from

Baltimore, the son of a former slave. In a 2004 post on DailySpeculations.com, Niederhoffer wrote, “Regrettably LoBagola was an American con man. . . . Nevertheless, I claim that despite his imposture, the moves back and forth in big markets often follow a LoBagola, and even though, nay especially because, LoBagola was an impostor his name should be given to major moves which would seem to follow a symmetry up and down.”

Niederhoffer doesn’t claim to be able to say what the Dow or the S. & P. 500 will do next week or next month, but he believes that over shorter periods—hours or days—there are sometimes predictable patterns that can be exploited. In “The Education of a Speculator,” he devotes an entire chapter to this notion, comparing the market’s movements to some of his favorite pieces of classical music, and juxtaposing pages of sheet music with stock charts. “When the markets are moving in my favor in a nice, gentle way—never below my initial price—I often think of the ‘Trout Quintet,’ ” he writes. “Another frequent work I hear in the market is Haydn’s Symphony No. 94. . . . Right after lunch, or before a holiday, the markets have a tendency to meander up and down in a five-point range above and below the opening. The pattern is similar to the twinkling C-major fifths of Haydn’s symphony.”

In the early eighties, when he was making a presentation to potential clients, Niederhoffer sometimes took along Robert Schrade, a friend who was a classical pianist. After Niederhoffer talked about his methods, Schrade would demonstrate the rhythms of the market on the piano. This double act didn’t always impress investors. “CalPERS”—the California Public Employees’ Retirement System—“is not going to be interested in investing with Victor, nor is the Harvard endowment,” Paul DeRosa, a partner at the hedge fund Mt. Lucas who has known Niederhoffer since the late seventies, said to me. “Your basic, buttoned-down endowment, advised by professional consultants, wouldn’t touch him with a ten-foot pole. His is a fund that is going to appeal to people like him: self-made people who have a maverick streak.”

A few months ago, after visiting a Redwood forest in Northern California, Niederhoffer became fascinated by the ecology of trees. He bought several books on the subject and posted an article on his Web site applying what he had learned about trees to the stock market:

Lesson Two: The forest thrives and benefits after many seemingly disastrous events. Fires clear the underbrush. Dead trees still standing provide cover for much flora and fauna. Trees contain so much water that there is still much biomass left when they die, and they contain the nutrients and moisture that other plants or fungi need for survival. This situation is called a biological legacy by the scientists, but is just known as a gift by the laymen.

The number of, the amount of time in between, and the extent of watershed declines that the market has witnessed in the last year, as well as the resilience of the market to these declines, is a good measure of the health of a system. It is often good for future growth, to see decimated parts of the market landscape, such as the U.S. real-estate sector, which has currently taken it on the chin, or the Saudi Arabian market, which is down 75%.

After he wrote the article, Niederhoffer gave the books he had read to one of his employees, Charles Pennington, a former professor of physics, and asked him to develop precise numerical analogies between the life cycles of forests and those of corporations, in the hope that the exercise might suggest some profitable investments. Niederhoffer’s employees are used to such requests. “Things sometimes work that you wouldn’t believe, and things don’t work that you would expect to work,” Steve Wisdom said to me after we had left Niederhoffer at his desk and gone downstairs to eat lunch in his formal dining room. (The dining room is next to the library, where Niederhoffer keeps his collection of rare books and manuscripts, including a first edition of Adam Smith’s “Wealth of Nations” and a copy of David Ricardo’s “Principles of Political Economy and Taxation” which has margin notes by Thomas Malthus.)

Wisdom, a clean-cut man of forty-six, met Niederhoffer twenty-five years ago, in New York City, when Wisdom was a philosophy major at Harvard and the chairman of the university's Libertarian Club. "We hit it off, and that was that," Wisdom recalled. After graduating, in 1983, Wisdom worked for Niederhoffer for fourteen years, until Niederhoffer's business collapsed, in 1997. He returned in 2003, largely, he told me, because of Niederhoffer's willingness to try new ideas. "Everyone has computers; everyone has Ukrainian math Ph.D.s," Wisdom said. "There are people chopping at the data every which way. Making money is not easy, and it requires a lot of creativity. Victor always says, 'Suppose I didn't know anything. Suppose I'd never traded this instrument before. What would I think?'"

Manchester Trading's three hedge funds are relatively small by current standards. At the end of June, the funds' collective value was about three hundred and fifty million dollars, of which about half belonged to Niederhoffer and Wisdom. In 2003 and 2004, the funds increased in value by more than forty per cent each year, and in 2005 the value of the largest fund, Matador, rose fifty-six per cent—a performance that earned Niederhoffer an industry award. Last year, his funds were flat. But in the first six months of 2007 they were up again, by between thirty and forty per cent.

Niederhoffer acknowledges that his aggressive investing style and his reliance on borrowed money increase the volatility of his returns and the likelihood that he will suffer a calamity. In May, 2006, Matador lost about thirty per cent of its value, and in February of this year it suffered another big fall. Many hedge funds claim that they can generate high returns with little risk. Niederhoffer tells friends who want to invest money with him that it is too risky. (Most of his clients are multimillionaires and financial institutions.) "The idea that you can make a lot of wealth in a steady, unspectacular fashion, with no great gyrations, is a canard," he said to me. "If you are going to try and make forty or fifty per cent a year, tremendous variations are inevitable."

At three o'clock, when Wisdom and I went back upstairs, Niederhoffer was outside playing tennis with one of his traders, Duncan Coker. Soon, however, he returned, sitting down at his desk in a T-shirt, tennis shorts, and sneakers, ignoring the no-shoes rule. "The market's supposed to go up from three until the close," he said. "Let's see if it does." While Wisdom and I were having lunch, the Dow had stabilized and Niederhoffer had sold some of the stock futures he had purchased earlier in the day. "The worst mistake in this business is to be in over your head," he said. "I was long about seventy-five million dollars. In addition to that, I had my regular option position. So I took the opportunity to reduce my exposure."

In addition to speculating on short-term market movements, Niederhoffer frequently sells financial contracts, called "put options," which, in the event of a steep fall in the market, would oblige him to pay out large sums of money. The buyers of these options are usually other investors seeking to hedge their positions, and in a sense Niederhoffer acts like an insurance company: in return for a premium—the price of the option—he agrees to bear the risk of a market crash. Often, this is a good business; but whenever the market enters a volatile period he is in peril. ("He is his own worst enemy," Nassim Taleb, the author and derivatives trader, says of Niederhoffer. "One of the most brilliant men I have ever met, and he wastes his time selling options—something nobody can have any skill in—and it leaves him vulnerable to blowing up.")

As 4 P.M.—the close of trading—approached, the Dow was again down, by about a hundred and twenty points. Niederhoffer didn't seem particularly discouraged, though. He thought that he discerned a LoBagola pattern. "It's going to be very bullish for tomorrow," he said. "It will be the first one-hundred-point drop in sixteen hundred points. I'm going to buy some more futures."

Niederhoffer's theories about market behavior date to his college years. In 1964, when he was a senior at Harvard, he wrote a thesis on stock-market patterns. At the time, the so-called "efficient market hypothesis," which states that stock prices move randomly and therefore can't be predicted, was coming into vogue. Niederhoffer, citing data on trading volumes and subsequent price movements, claimed to have found evidence that contradicted the random model. His argument didn't fully convince his adviser, the economist Robert Dorfman, but it helped earn him admission to the University of Chicago Graduate School of Business, where he enrolled in September, 1964.

At Chicago, Niederhoffer wrote several research papers arguing that it was possible to detect predictable movements in the stock market. He uncovered evidence, for example, that the market tended to do worse on Mondays than on Fridays. Several members of the faculty had helped to develop the efficient market hypothesis, and Niederhoffer's relationships with his professors were often contentious. At one seminar, he later recalled, "I criticized all those who had concluded that markets were random, including most of the professors in the room, as being too heavy-handed in their testing methods to uncover the structure of price variations. Further, I cautioned them that their failure to disprove a hypothesis that no structure existed was methodologically inadequate to support a conclusion that prices were random. When I put it in the vernacular, 'You can't prove a negative,' pandemonium broke loose."

Niederhoffer was an early proponent of what is now called behavioral economics, and his unorthodox theories made him something of an academic celebrity. In 1969, he was hired at Berkeley as an assistant professor, and several hundred students signed up for his course on finance. Three years later, enrollment had dropped precipitately. "I wasn't too good at it, frankly," he told me. "I was not a very good teacher, and I had my own ideas about things. I was earning nine thousand dollars a year. I was playing squash, doing research, dabbling in business. It was all too much."

Niederhoffer had also married—Gail Herman, a graduate of Bryn Mawr whom he met at the wedding of a Harvard friend, the economist Richard Zeckhauser. In the early seventies, Gail and Niederhoffer, who had decided to leave academe, moved to New York, where he started an investment-banking firm that sought out small, family-owned companies and helped sell them to bigger, public companies. The venture proved so successful that before long Niederhoffer and a partner, Dan Grossman, started buying and operating businesses themselves. Among the firms they acquired were American Almond, a Brooklyn company that provided almond paste to bakeries, and Tech Com Inc., a Florida defense contractor that built navigation equipment for planes and ships. "I would run the companies. Victor would visit them every two years or so, and cause havoc," Grossman, a lawyer by training, recalled recently. "He'd say something like 'What this company needs is sales. No more research, no more secretarial duties—I want you all out there selling things.' Then he'd leave, and I'd say, 'Don't take any notice of what he said. That's just Victor being Victor.' "

By the late seventies, Niederhoffer and Gail had two daughters: Galt, who was named after Francis Galton, the Victorian polymath who helped to develop regression analysis and coined the term "eugenics"; and Katie. In 1981, Niederhoffer and Gail separated, and he began dating his assistant, Susan Cole, whom he married in 1991. They have four daughters: Rand, Victoria, Artemis, and Kira. The mother of Niederhoffer's son, Aubrey, who is one and a half, is Laurel Kenner, a former editor at Bloomberg whom he met in 1999. "My personal life is more complicated than Rupert Murdoch's," Niederhoffer joked to me. (Murdoch has six children from three marriages.)

Niederhoffer began investing seriously in the stock market when Galt and Katie were young. In 1979, using money he had saved, he started trading more or less full time and opened an office in midtown. "I got lucky," he told me. "In eighteen months, I ran fifty thousand dollars up to twenty million dollars. I had an idea that there was going to be inflation, so I kept selling Treasury bonds and buying gold and silver. For a long time, it worked very well. Then one day I was playing racquetball in Staten Island with a guy who subsequently became the U.S. champion. After the first game, I called the office to see where the market was. The price of gold had fallen from eight hundred and fifty dollars to six hundred dollars in an hour. My net worth had gone down to ten million dollars.

"That was where my Brighton Beach training came in," Niederhoffer went on. "I'd seen a lot of gamblers die broke. My father used to say I'd end up on the Bowery, like the other gamblers. I'd say, 'Dad, I've got a system.' He'd say, 'Baloney. Those guys on the Bowery had more statistics and systems than you've got.' I took what he said seriously. I told my assistant, who later became my second wife, 'If I ever lose more than half my stake, close out all my positions. Don't let me trade anymore.' I went back to my match. During the second game, she sold everything. By then, my ten million dollars had dwindled to five million, but at least I got out with that much."

Wall Street in the late seventies was much less technologically sophisticated than it is today. "If you could solve two equations in two unknowns, you were a high-tech person," Paul DeRosa recalled. "Someone with Victor's quantitative skills was a rare bird. In the early years, that gave him a big advantage." In 1981, George Soros, who was by then a wealthy investor but who was having a bad year, heard about Niederhoffer's reputed ability to predict short-term market movements and arranged to meet him at his office. Soros left the meeting impressed, and gave Niederhoffer some money to manage. The men shared an intellectual fascination with markets, and they became close, talking on the phone nearly every day, and playing tennis or chess several times a week. "My father had just passed away," Niederhoffer recalled. "George was struggling. He needed a ledge to give him some purchase. I provided that."

By the mid-eighties, Niederhoffer was managing many of Soros's investments in bonds and commodities, which were worth hundreds of millions of dollars. On Tuesday, October 20, 1987, a day after the Dow dropped five hundred and eight points, Niederhoffer and Soros played tennis, as usual. Both men had lost a lot of money in the crash, and Niederhoffer had trouble concentrating; Soros, however, was calm. Don't worry, he told Niederhoffer, the market will reopen tomorrow, and there will be plenty of opportunities to make back our losses.

Over the next several years, Niederhoffer's funds yielded an annual average return of about thirty per cent, which put them near the top of the industry. In 1994, *Business Week* named him the best commodities-fund manager in the country. A year later, he started two new hedge funds: Niederhoffer Investments and Niederhoffer International Markets. For a while, he hardly slept. During the day, he traded stocks and currencies in Europe and the United States, and at night he bought and sold Japanese yen. He also invested in emerging markets, making successful plays in Turkish bonds and Mexican stocks.

Toward the end of 1996, another profitable year for him, Niederhoffer decided that he wanted to invest in Southeast Asia, which was widely seen as a growing market. He dispatched an old friend, Steven (Bo) Keeley, to the region. Keeley, a veterinarian who spent six months of the year living in the California desert without a telephone or electric power, had trekked in dozens of countries. On one trip, while paddling down the Amazon, he had contracted malaria, briefly gone blind, and been comatose for a week. Keeley believed that assessing a

developing country's economic prospects involved not only meeting with the C.E.O.s of leading companies but studying the lengths of discarded cigarettes—the theory being that the wealthier people are, the longer their butts—and the state of the brothels. After a couple of months in Asia, he reported to Niederhoffer that the brothels in Bangkok had recently become much cleaner and safer, and that Thailand was an excellent place to invest. During the previous decade, the Thai economy had grown at an annual rate of almost ten per cent; its interest rates were among the lowest of any country in the region; and its stocks were cheap because they had fallen sharply earlier in the year. In the spring of 1997, Niederhoffer invested several hundred million dollars in Thailand. Instead of buying stocks in some of the country's biggest companies, he entered into complicated deals with Wall Street firms to buy futures contracts that were tied to the value of Thai stocks. The margin requirements for futures purchases are much lower than those for stock purchases, so he was able to put up a relatively modest amount of cash, while using borrowed money to accumulate substantial holdings.

His timing was atrocious. In May and June, a wave of selling swept through the Asian financial markets, and Thailand was especially hard hit. Many overseas investors tried to repatriate their money, and the Thai government started to run out of foreign-exchange reserves. On July 2nd, it was forced to abandon what amounted to a fixed exchange rate between the baht and the dollar, which had been in place for more than a decade. The Thai currency collapsed, and so did the stock market. The value of many of Niederhoffer's Thai holdings dropped by more than ninety per cent. His lenders demanded that he put up more collateral. In order to meet their demands, he was forced to sell many of his profitable investments, which left his funds severely depleted. "We were like someone who is immune-deficient," Steve Wisdom recalled. "We had lost so much money that we had no resistance left to other maladies."

Apart from his Thai holdings, Niederhoffer's most substantial investments were in the American futures markets. At first, the U.S. market weathered the Asian crisis pretty well, but in the fall of 1997 it became more volatile. On October 27, 1997, the Dow fell by more than five hundred points, and, for the first time in recent history, the market closed early. Amid widespread panic, Niederhoffer fielded calls from lenders. Some, including Refco, a large commodities broker, demanded that he give them more money to support his options positions. Niederhoffer was unable to come up with the cash, and the next morning Refco liquidated his portfolio.

"It was a very poor decision on my part to invest in Thailand," Niederhoffer told me. "I had no scientific basis for investing there. In the U.S. market, there is evidence that it is a good time to invest after a big fall. In Thailand, there was no such statistical evidence. It was purely a qualitative idea. I'd seen Soros do that a lot of times and make a lot of money, but it didn't work for me. Previously, I had had two or three qualitative ideas that made money—Turkish bonds, Mexican stocks—and it lured me into a false sense of security."

We were sitting on a bench outside a building in the East Fifties, where Laurel Kenner lives and Niederhoffer stays when he visits. He was drinking a bottle of organic lemonade. I asked him whether hubris had contributed to his downfall. "Yeah, I'd say," he replied. "In those days, we always wanted to be No. 1 in the ratings. There was a Canadian firm, Friedberg—they were having a good year, and we wanted to keep up with them. It was always nip and tuck between us and them." Niederhoffer was silent for a moment. Then he spoke quickly: "You asked for reasons—I could name another ten. We had no stops. We picked the wrong country to invest in. We were too illiquid. We had too big a percentage of the market, and we didn't have the ability to get out of our positions. We were too financially vulnerable to the brokers. I didn't take account of the fact that I could be squeezed and that customers could withdraw their money. But mainly I didn't have a proper foundation

for my investment there. I had no knowledge of the country. I'd never even visited the country. All I had done was finance a trip by Bo Keeley to the brothels there."

After his funds folded, Niederhoffer fell into a deep depression. His eldest daughter, Galt, a film producer and novelist who is thirty-one and lives in Manhattan, recalls coaxing him to Long Island for a walk on a beach, where he knelt on the sand like a zombie. "It wasn't just depression," she said. "It was self-hatred and hopelessness. He felt like he had let people down. It was so shameful. This was a guy who grew up in a modest house, the son of a cop. Imagine what it would be like to create all of those things for your family and then to lose them."

Niederhoffer had managed to retain some of his assets. He mortgaged his house in Connecticut and sold a collection of trophy and presentation silver and some of his rare books, which enabled him to pay off his creditors. He used this period of enforced inactivity to reconsider his approach to investing and to retool his pattern-recognition software. After about six months, using several hundred thousand dollars of his own money, he started trading again. "I had no brokerage account—no broker would do business with me under ordinary terms," he said. "No customers would open a new account with me." In 1999 and 2000 he did well, and in 2002 he started Matador, an offshore hedge fund. Its biggest investor was Octane, a hedge fund based in Switzerland, whose chief investment officer, Mustafa Zaidi, is an old friend of Niederhoffer's.

At the beginning, Matador had less than ten million dollars to invest. In its second year, the fund had a return of forty-one per cent, and Niederhoffer's renewed success helped him attract more money, including some from former clients who had lost their investments in 1997. (For these investors, he waived the hefty fees that hedge funds normally charge.) Eventually, he had enough cash to open two more funds. In February, 2003, Niederhoffer published "Practical Speculation," a manual for serious investors, which he co-wrote with Laurel Kenner, whom he had been dating for several years. That year, he separated from his wife, Susan, and in 2004 he and Kenner launched DailySpeculations.com, which they dedicated to "the scientific method, free markets, deflating ballyhoo, creating value, and laughter."

The Web site has since evolved into an informal social-networking site for speculators and aspiring speculators. "I met a lot of my friends through the site," James Lackey, the trader who once worked with Niederhoffer and who posts regularly on the site, said. "Victor is like the hub where the wheels of speculation turn. He's the center of so many of our relationships—we call him the Chairman. He's the guy who keeps everyone in line."

In April, 2006, Niederhoffer attended a dinner at the St. Regis Hotel, where MARHedge, a company that published a newsletter for the hedge-fund industry, presented him with an award as the top manager in the commodity-fund category. "What I'm proudest of is that we've made several hundred million dollars after fees," Niederhoffer said to me in July. "We've returned a lot more money to our investors than they have invested."

As Niederhoffer and his funds prospered, it appeared to many of his old friends and colleagues that he had finally become a master speculator. "It is impossible to go through what Victor went through without it altering what you do," Paul DeRosa told me in July. "It made him more conscious of risk, more attuned to it. It was an expensive education, but the important thing is that it wasn't wasted." Irving Redel, a former gold and silver trader and chairman of the New York Commodities Exchange, who was a mentor to Niederhoffer in his Wall Street days, said, "To be a great trader you need discipline. You have to have certain strategies that you follow, but you also have to have the flexibility to know when it is going wrong. And you have to know to never go

beyond what you can afford to lose.” I asked Redel whether Niederhoffer has these qualities. He replied, “He does now.”

On the first Thursday of every month, Niederhoffer hosts a meeting of libertarians at the General Society of Mechanics and Tradesmen, on West Forty-fourth Street. One Thursday evening in early June, about seventy people were gathered in the society’s library, listening to an elderly woman in a white hat, who stood at a lectern talking enthusiastically about Christopher Hitchens’s book “God Is Not Great.” A middle-aged man with a beard spoke next, urging the others to accompany him on a walking tour he hosted called Ayn Rand’s New York, in which he visited local buildings where Rand had lived and held objectivist salons, as well as sites—the Waldorf-Astoria, Grand Central Terminal—that served as inspirations for places in her novel “Atlas Shrugged.”

The meetings are open to the public, and Niederhoffer, who was sitting on a table at the back of the room, swinging his legs, encourages each person to speak. He calls these sessions the New York City Junto, after the discussion group that Benjamin Franklin founded in Philadelphia in 1727, which held meetings for thirty years and eventually became the American Philosophical Society. Niederhoffer’s Junto is more casual, but he takes libertarianism seriously, considering it to be a natural complement to speculating. As a statement on his Web site puts it, “Victor Niederhoffer believes the purpose of life is the pursuit of happiness and achievement, and that the voluntary transactions that flow naturally out of an enterprise system are the key to material and personal freedom, and peace.” In an op-ed article that he published in the *Wall Street Journal* in 1989, he argued that speculators serve several important economic functions. When a good becomes scarce, he said, speculators bid up prices, which encourages firms to produce more and consumers to buy less, and helps to restore balance to the market. “I am proud to be a speculator,” Niederhoffer wrote. “I am proud that my humble attempts to predict Tuesday’s prices on Monday are an indispensable component of our society. By buying low and selling high, I create harmony and freedom.”

The guest speaker at the meeting was Thomas DiLorenzo, an economics professor at Loyola College, in Maryland, and the author of fourteen books, including “How Capitalism Saved America: The Untold History of Our Country from the Pilgrims to the Present.” DiLorenzo’s subject was the filmmaker and liberal gadfly Michael Moore. Not having seen Moore’s latest movie, “Sicko,” DiLorenzo was at something of a disadvantage, but he expressed outrage at Moore’s failure, in his previous films, to recognize the importance of competition, the virtues of sweatshops, and the depredations of socialism. At one point, Niederhoffer interrupted him and asked, “What are the general principles?” DiLorenzo replied, “Markets work and government-run monopolies don’t.”

At least one member of the audience, a gray-haired man, seemed to think that this was going a bit too far. He cited the Federal Home Loan Banks, an agency that makes mortgages more readily available, and the National Park Service. Don’t you agree that the government does some things well? the man asked. “No,” DiLorenzo replied. “The government has screwed up the national parks. I think capitalism would do a much better job with land.”

Shortly after ten o’clock, Niederhoffer ended the meeting. I was eager to speak to him about the stock market, which had fallen by almost two hundred points that day. “I can’t talk about it,” he said when I approached him. “It’s too painful. I might be able to review it in a few days.” He walked across the room to greet Kenner and Aubrey. He put his son on his shoulders and disappeared onto Forty-fourth Street.

On May 3, 2006, the day that Aubrey was born, Niederhoffer’s wife, Susan, filed for divorce. As his spouse and the legal owner of many of his assets, which he had transferred to her in 1997, she had claim to much of his

fortune. For months, the couple's lawyers argued. Then, in February, Niederhoffer persuaded Susan to drop the divorce proceedings. In return, he agreed to leave Kenner at the end of 2007 and return to her. Then he informed Kenner of the plan.

For now, Niederhoffer shuttles between the women. From Sunday to Tuesday, he and Susan share the house in Connecticut. (Three of their four daughters have left home; the youngest, Kira, attends boarding school.) He spends the rest of the week in Manhattan, with Kenner and Aubrey. "He's emotionally involved with both of those women right now," Galt said to me. "He never really leaves women. Wives become extended-family members, like in-laws, or honorary members of the harem. They tolerate it because he's a flawed genius and a man. They take the good with the bad. It's all I've ever known. All I've ever known is we are weird."

I was having lunch with Galt at a French restaurant near her apartment in Chelsea. Although Aubrey's birth had been a shock to the family, she went on, her father sees his other children regularly, and he is on good terms with his first wife, Gail—Galt's mother—who divides her time between New York and Texas. "We've become kind of like this very functional dysfunctional family," Galt said. "To most people, it is completely abnormal, and yet we've come to have this somewhat wholesome, happy dynamic. All of the girls are close. My mother and Susan have grown very close." Recently, Galt added, she, Gail, Susan, and all her sisters except Artemis, who was away, got together to celebrate the third birthday of her daughter, Magnolia. Laurel was not at the party. "Laurel is another story," Galt said. "Susan and Laurel are not close. There's nothing happy about that."

Last year, Galt published a novel, "A Taxonomy of Barnacles," which she described to me as "an effort to exorcise my demons about living in a family that was different from everybody else's." The novel features an eccentric and domineering businessman who has six daughters and desperately wants a male heir. Eventually, he acquires one in surprising circumstances. Shortly after the book came out, Niederhoffer took Galt to lunch at the Four Seasons and told her that her book had been prescient. "Oh, my God, you have a love child!" Galt blurted out. "No," Niederhoffer said. "I have a son." A few months later, Aubrey was born.

Kenner, who is fifty-three, told me that she is unhappy about Niederhoffer's arrangement with her. "Obviously, there is a lot of anger there," she said. "But it is not just me. There is a baby involved." I expressed surprise that her relationship with Niederhoffer remained cordial. "We had eight great years," she replied. "He gave me so much. I am immeasurably better off on so many levels through meeting Victor. He was the best lover I ever had—not just in sexual terms. We wrote a book together. He is a great, romantic, gentle person."

Niederhoffer declined to discuss his relationship with Susan. As for Kenner, he said, "We've had a very fine collaboration and had much pleasure and happiness together, and we have a wonderful son. We're parents, and we still have mutual respect and admiration for each other." He went on, "We didn't have in mind the ultimate outcome, but we created a fantastic legacy—the baby, the books, and the articles."

On Tuesday, July 17th, the Dow rose above fourteen thousand for the first time. The economy was growing, the long-term interest rate had dropped back to five per cent, and the volatile trading days of early summer seemed largely to have been forgotten. After the market closed, however, Bear Stearns announced that two of its hedge funds, which had investments in securities tied to subprime mortgages, had lost almost all their value. Problems in the subprime market spilled into money markets that banks and other financial institutions rely on to finance their daily activities; several more hedge funds went under; and commentators began to speak of a looming "credit crunch." Stock markets around the world experienced wild fluctuations.

On Tuesday, July 24th, the Dow fell two hundred and twenty-six points. Two days later, it dropped three hundred and eleven points. Commentators on CNBC were making ominous pronouncements. I sent Niederhoffer

an e-mail, saying that I hoped he had been well positioned for the market's correction. He replied in three words: "I was not." On Friday, July 27th, the Dow fell another two hundred points, closing four per cent down for the week. The markets were still volatile a week later, when Niederhoffer came into Manhattan for his monthly libertarian meeting. After it ended, we went across the street to a restaurant, where he ordered a cappuccino. He looked pale and haggard, and years older. For several minutes, we sat in silence. Then, in a low voice, he said, "Things have changed totally since we last spoke. The situation is fundamentally different. It is critical." Kenner and Aubrey joined us, but Niederhoffer hardly seemed to notice them. "We are fighting for survival night and day," he said when I pressed him for details. "I was caught wrong-footed in the market turbulence. I'm not as smart as I thought I was."

The previous week, the Chicago Mercantile Exchange, in response to the turmoil in the market, had raised its margin requirements on futures traders, a move that was potentially devastating for Niederhoffer, who had hundreds of millions of dollars in options. He had more money in reserve than he had had in 1997, but he was worried. "It's a matter of redeploying resources," he said. "Also, in trying to be courageous in response to the crisis, I put up a lot of my own capital. You remember the story of the Essex and Captain Pollard? We are like a tiny fishing boat off the coast of Alaska that has been caught in the biggest waves in a hundred years."

Talking about his predicament seemed to improve Niederhoffer's mood a little. He ate some sorbet and played with Aubrey. Then he said, "Now I have to go home and work." Kenner got up to leave, straightening her dress and inadvertently exposing a thigh. "Do that again," Niederhoffer commanded. "Do what?" Kenner asked. "Lift it up," he said. "It can keep a man afloat." They both laughed.

During the next two weeks, I tried repeatedly to talk to Niederhoffer. Part of the reason for his reticence was that he feared a leak. Hedge funds depend on access to borrowed money. If lenders learn that a fund is in trouble, they might decide to stop giving it money—which can have disastrous consequences for the fund. On July 30th, Sowood Capital Management, a Boston-based fund, announced that the assets under its management had lost more than fifty per cent of their value in a few weeks, and the fund closed shortly afterward. By mid-August, two funds operated by Goldman Sachs had lost about a third of the value they'd had at the beginning of the year. Goldman decided to invest two billion dollars of its own money in one of the funds, Global Equity Opportunities, and it persuaded several wealthy investors to put up another billion dollars on favorable terms.

The spectacle of one of Wall Street's most profitable firms being forced to shore up one of its flagship funds suggested some of the pressures that Niederhoffer was confronting. In today's interconnected financial markets, there is no such thing as an isolated incident. When a dramatic event occurs in one sector, the effects are felt in others. The Goldman funds were computer-driven funds, and their software programs had failed to predict the size and speed of movements in the stock market. Prices had got "way out of whack," David Viniar, Goldman's chief financial officer, complained. "We were seeing things that were twenty-five standard-deviation moves several days in a row."

Like Niederhoffer's funds, the Goldman funds were heavily leveraged. For every hundred dollars of capital that the Global Equity Opportunities fund owned, it had borrowed about six hundred dollars. When a fund is leveraged six to one, a five-per-cent fall in the value of its portfolio becomes a thirty-per-cent loss in capital. "Leverage is a double-edged sword," Richard Bernstein, an analyst at Merrill Lynch, wrote in a note to clients a few days before Goldman announced its efforts to prop up the Global Opportunities fund. "It enhances returns on the upside, but also makes underperformance more rapid and severe."

Of course, Niederhoffer was aware of these dangers. But, between the middle of 2003 and the start of this year, the financial markets had been mostly calm. Stock prices had gone up, and, atypically, they had done so in a fairly straight line, with only two significant reversals, in May, 2006, and in February, 2007. From Niederhoffer's perspective, the decline in market volatility was a welcome development, because it made his options trading much less risky. With prices steady or rising, he was less likely to be caught on the wrong end of a big market move. As the quiet times continued, many investors were lulled into believing that a less volatile era had begun. Alan Greenspan, who was the chairman of the Fed until February, 2006, helped to feed this illusion by talking about how financial innovations, such as the development of asset-backed securities, had spread risks more widely, making the market less vulnerable to shocks.

The crisis in the subprime-mortgage market changed all this. In the stock market, volatility was more pronounced than it had been for years. Even on days when the Dow closed just a few points down, prices lurched around. On Friday, August 10th, the Dow fell more than two hundred points before recovering at the close. On Thursday, August 16th, it fell almost three hundred and fifty points before closing down just fourteen points. A measure of market turbulence which many traders watch closely is the Chicago Board Options Exchange Volatility Index, known as the VIX. Between January, 2003, and January, 2007, the VIX fell from more than thirty to about ten. By the end of July, it had surged above twenty, and on August 16th, the day before the Fed cut the discount rate, it hit thirty-seven.

The surge in volatility prompted the Chicago Merc to raise its margin requirements for options on S. & P. 500 Index futures twice, first from two per cent to three per cent, and then from three per cent to four per cent. Niederhoffer was asked to double the amount of capital supporting his positions, and he found it difficult to raise the necessary cash. Some of his investments had lost a lot of their value, and the value of others was difficult to determine. There were so many moving parts in his portfolio that he wasn't sure where he stood. When a trader can't meet his margin requirements, he is at the mercy of his creditors. As Niederhoffer's financial situation deteriorated, ADM Investor Services, a Chicago-based brokerage firm that caters to futures traders, ordered him to liquidate some of his options positions. Working late into the night, Niederhoffer berated himself for leaving himself so exposed. Referring to the margin calls, he said to one acquaintance, "I shouldn't have been in the position where it could have had such an impact." Despite the lessons of 1997, and the precautions he had taken, he was again in over his head.

Every August, Niederhoffer throws a big party in New York City, to which he invites dozens of regular contributors to his Web site as well as some of his friends. This year, there were about seventy-five guests. Most were New Yorkers, but some had come from as far away as England. For three days, Niederhoffer entertained them at his expense. On Friday, he organized a trip to the New York Botanical Garden and to a Mets game. On Saturday, he hosted a beach outing at Coney Island and a dinner at Delmonico's, near Wall Street. On Sunday, he provided a picnic brunch in Central Park's Conservatory Garden.

As the crisis in the market spread, Niederhoffer had briefly considered cancelling the party, but he decided that to do so would have alerted people to his troubles. At three o'clock on Saturday afternoon, I saw him in the crowd on the boardwalk at Coney Island, across from the Cyclone roller coaster. As usual, he wasn't difficult to spot: he was wearing yellow trousers and a yellow T-shirt that said "Chief Speculator" on the back. On the beach, his staff had set up a blue canopy, and about a dozen people had gathered underneath it, taking shelter from the sun.

Niederhoffer had Aubrey on his shoulders, and he seemed to be in a better mood than when I had last seen him. He makes frequent visits to Coney Island and Brighton Beach; the house he lived in as a boy was about half a mile east of where we were standing. “We are going on the Wonder Wheel,” Niederhoffer said, gesturing over his shoulder at the slowly turning Ferris wheel, which dates to 1920. While he was gone, I spoke with two of his guests, a young Liberian M.B.A. student who said that he had recently posted an article on DailySpeculations.com about gambling on thoroughbred racing, and an older Frenchman who traded stocks at a Wall Street firm. The atmosphere was friendly and relaxed. None of the guests mentioned Niederhoffer’s financial predicament.

At 6 P.M., the party reconvened at Delmonico’s, which Niederhoffer had reserved for the evening. After cocktails in the dark-panelled bar, his guests entered the ornate dining room, where a Broadway tap dancer and a family of Hawaiian singers performed. I was seated next to Laurel Kenner and Aubrey, but didn’t see much of Niederhoffer, who was wearing a lilac jacket and spent most of the evening table-hopping. After dessert was served, he stood up to speak.

“This is a historic gathering,” he said, swaying slowly back and forth. “We are here in the middle of one of the greatest turmoils in Wall Street history. I am sure that many of you are keen to know how we are doing. Well, I can tell you that it has been very difficult. The battle has been joined, and it is still to be determined who the victor is. I always say that when you are in the middle of one of these situations it is better to say nothing. If you say you are doing badly, it gives ammunition to your enemies. If you say you are doing well, you are tempting fate. . . . We will see what happens and who wins the final point.”

Later in August, after the Federal Reserve cut the discount rate—the rate at which it lends to banks—the markets calmed down; but Niederhoffer’s woes continued. In September, he was forced to close two of his funds, including his flagship, Matador, which had declined in value by more than seventy-five per cent. After cashing out many of his investments, Niederhoffer repaid his lenders and returned what money was leftover to his clients. He laid off several employees and consulted with his lawyers. Meanwhile, rumors circulated on the Internet that, for the second time in a decade, his funds had “blown up.”

Had he been able to wait a little longer before liquidating his trades, his funds might have recouped most of the losses. After the Federal Reserve cut interest rates again, on September 18th, the stock market rallied further and volatility decreased. Still, Niederhoffer sounded philosophical. “The market was not as liquid as I anticipated,” he said. “The movements in volatility were greater than I had anticipated. We were prepared for many different contingencies, but this kind of one we were not prepared for.” Niederhoffer was still trading for his own account, and for some remaining clients. “My basic ideas about the creative power of the market, buying in panics, buying on weakness—I don’t think what has happened has anything to do with that stuff,” he said. “I am going to keep going, for better or worse.” ♦

ILLUSTRATION: PHILIP BURKE