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WEEKDAY TRADER EXTRA

Kyle Bass' Comeback Plan: Oil, Argentina and Patents

By Jim McTague August 13, 2015

Not very long ago, J. Kyle Bass was one of the hottest brands in the $3.1 trillion global hedge fund industry. Bass anticipated the disintegration of the nation's housing market in 2008, Greece's economic demise in 2012, and the massive bond-buying program by the Bank of Japan that began in 2013. Investments based on these insights made a mint both for him and for clients of his $2 billion asset Hayman Capital Management, headquartered in Dallas. Bass' track record of identifying global imbalances and profiting from them catapulted the unflappable former bond salesman to stardom.

This is an edited version of a story written for InsideSources. Jim McTague was formerly *Barron's* Washington bureau chief.

The investment community viewed him as a visionary who had a clear-headed plan for investing in a world where economies have been wildly distorted by artificially low interest rates. Bass' spot-on insights also turned him into one of the investment-conference circuit's most powerful draws, and his guest appearances were coveted by business-network show hosts because their audiences hung on every word uttered by the brashly confident asset manager.

Alas, Bass has had a dismal time of it recently in the land of investment. Suddenly, the former luminary can't seem to get anything right. His massive investment in General Motors' stock bombed when news broke about the deadly problem with the ignition key switches on some of Chevrolet's Cruze models. Bass, a Texan with no relation to the Bass family of oil tycoons, has also made a huge bet on an oil-price rebound, arguably a mite too early.

It's difficult to know exactly how Bass' funds are doing because he keeps his fund's actual performance metrics close to the vest. Bass declines to reveal returns for the past five years. And Bass will not discuss his average long positions versus his average short positions -- two measures frequently employed to compare fund performance.

Hayman's setbacks come as the industry's top performers have been putting up great numbers. (Consider, for example, that LTE Hedge Fund, managed by

Melkonian Capital Management, was up 34% in 2014, according to an LTE performance letter to clients obtained by Bloomberg.) And by Bass' own admission in a recent interview with InsideSources, things aren't looking all that good in 2015. "It's been a tough year," he acknowledged. "It's nice to win all of the time. When you are not winning and everyone else is, it makes life difficult."

And yet, like a gambler doubling down, Bass maintains enthusiasm for some of his more unorthodox bets. His rebound plan has two key elements — oil and Argentina -- both of which are plays being avoided as too risky by the conventional investment crowd. He's certain that it will work because Bass, who has a mathematician's appreciation for precision, has arrived at it after careful research and logical deduction. But others see a huge gamble, even by the freewheeling standards of the financial industry.

Bass' oil argument is intriguing, if unconvincing to others. Even as crude prices drop, he argues, the current global glut in oil will rapidly give way to a supply squeeze over the next 12 months. Here's his reasoning: Declining prices are going to push a lot of thinly capitalized players to dismantle their drilling rigs. That, in turn, will reduce supply and create opportunities for the remaining drillers. And so, naturally, he's investing robustly in oil drillers. "The supply glut is going to swing to a pretty severe supply deficit in the next 12 to 18 months," he predicts.

It's audacious, especially at a time when there's a widely held belief that a nuclear deal with Iran -- assuming it squeaks by Congress -- will enable the cash-starved country to dump more low-priced oil on the market. That, in turn, would depress prices even further. But Bass says he does not expect any significant Iranian oil production until sometime in 2016, for a couple of reasons. First, he notes that Iran's oil reservoirs have been closed for a very long time, meaning they will need time to ramp up. Second, he says, it will take anywhere from four to six months -- in his estimation -- for the treaty to be implemented and sanctions relief to kick in.

On Argentina, he is bullish where others are heading for the exits. He says he has invested in Argentine equities, another bold move considering that the country has one of the world's worst economies, characterized by government debt, corruption, high taxes, currency controls, and rampant inflation. Last year, Argentina defaulted on its debt for the second time in 13 years. Bass points out that the leading candidates in the presidential contest, which will be decided in October, all pledge to end the economic policies of President Cristina Fernandez de Kirchner. "There's going to be a sea change in the manner in which that country is governed," Bass says, arguing that the country, which is rich in natural resources, will attract huge amounts of foreign investment in the next five to seven years. But that, of course, remains to be seen.

Finally, Bass is courting controversy with a new investment tactic recently adopted by his fund. He teamed up with Erich Spangenberg, CEO of IPNav, to challenge what they argue are questionable patents held by pharmaceutical companies to stifle competition from the generic marketplace. (It's worth noting that Bass' new partner, Spangenberg, has been described as the world's most notorious patent troll. IPNav says it has generated over half a billion dollars in licensing revenue in patent-infringement penalties for its clients, which include individual investors, corporations, and universities.)

Bass will not discuss this investment because it has become a hot-button issue in Washington, D.C. Members in both the House and the Senate are in the process of changing the law on patent challenges to exclude persons who actively short the target company's shares.

Indeed, just the news that Bass and Spangenberg have filed a patent challenge at the U.S. Patent and Trademark Office is enough to send a stock tumbling, and drug makers contend this will hurt their companies and raise the cost of new medicines. Consider that shares of Acorda Therapeutics, maker of Ampyra, a multiple sclerosis drug, fell almost 10% in February when Bass filed a challenge that claimed its patent on the drug should have expired years ago. But Bass contends that about 1% of branded pharmaceutical companies have gamed the patent system in order to keep charging top dollar for medicines that rightly should be available in generic form for more patients.

The political winds may be blowing against Bass, with the pharmaceutical industry pushing to narrow the universe of persons who have standing to file a patent challenge for review by a panel appointed by the Patent Office. A bill easily passed the House Judiciary Committee in June and awaits a floor vote. A related bill has cleared the Senate Judiciary Committee. The pharmaceutical industry is hoping for passage in both chambers in August. The change would cut the legs from under this particular Bass strategy.

A recent blog by a lawyer at the white-shoe firm of Steptoe & Johnson seemed to capture the growing consensus in Washington on the Bass strategy, when the blog described it as "the dawn of reverse monetization, in which a party may extract value by eroding another party's patent rights."

But Bass, the man who gained acclaim playing long odds (he would say making calculated risks), seems unlikely to fold his cards any time soon.

Editor's Note: *This story has been edited to remove a reference to press reports of Hayman's 2014 performance.*

Comments? E-mail us at editors@barrons.com
