Buffett's big bet: Trailing behind after lap one

The hedge funds - and Buffett's opponent - take an early lead as they trounce the S&P 500 in one of the worst markets on record. But there are nine years to go.

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(Fortune magazine) -- Remember "Buffett's Big Bet", in which the noted investor and CEO of Berkshire Hathaway maintained that an S&P 500 index fund would outperform five funds-of-hedge-funds over 10 years? Well, the results for the first lap, the agonizing year of 2008, are finally in, and the funds-of-funds soundly whipped the index. Vanguard's S&P 500 Admiral shares, the index fund "bought" by Buffett, were down 37%. On the average, and net of all fees, costs, and expenses, the five funds-of-funds backed by Buffett's opponent, Protégé Partners LLC, a New York money-management firm, delivered: -23.9%.

Considering that hedge funds can and do sell short, and that they are not limited to investing in stocks, Protégé's victory in a bear market year like 2008 was not surprising to anyone involved in the bet. Ted Seides, the Protégé partner who engineered the bet with Buffett, says that until September of that year the five funds-of-funds were in fact doing well enough that they still anticipated achieving the up year that hedge funds seek to deliver, even in difficult markets. "But when markets failed in the aftermath of the Lehman bankruptcy," says Seides, "the funds couldn't avoid the storm."

Which funds are these, you ask? The bet stipulates that their identities would not be disclosed. Buffett, however, knows their names and has seen their audited results. About his trailing position, he says, "I just hope that Aesop was right when he envisioned the tortoise overtaking the hare."

The reader will note that we said the results of the bet are "finally" in, and therein lies a little story. Originally, the thought was that an update on the bet would be announced each year at Berkshire's annual meeting, held in late spring. But the five funds-of-funds did not have audited financial
statements at that time, which made Buffett unwilling to announce results. Only in late October, when
the last of the five funds finally delivered its audited figures to Protégé, were complete results known.
They were very close to what Protégé had earlier estimated they would be, so it is likely that next year
Buffett will indeed announce 2009 "approximate" results at Berkshire's meeting in the spring.

The author of this article is both a friend of Buffett's and the editor of his chairman's letter in the
Berkshire Hathaway annual report.

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