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JAKE DEAN

LESSONS LEARNED: Charles Norton watched a New York City hedge fund collapse after betting heavily against tech stocks in 1998. Today, risk management is a prime focus of his company, GNI Capital.

SAVVY SOLUTIONS

GNI Capital co-founder says he learned valuable lessons about running his business by witnessing poor decisions made by a former employer

Better mousetrap

HEDGE-ING: *More opportunity*

BY CHAD ERIC WATT / STAFF WRITER

Witnessing the destruction of a hedge fund helped shape the investment philosophy of GNI Capital Inc.

In 1998 Charles Norton worked as an analyst for the now-defunct New York hedge fund. His future partner Allen Gillespie had been brought in to offer independent advice.

From the same trading desk, they watched as the fund's manager continued to bet against technology stocks.

The manager insisted he was right and the markets were wrong.

"It's not often you witness that firsthand," Norton said. "Risk management is a big part of what we do."

From the ashes of that operation, Norton joined Gillespie in his still-standing company, bringing over separate accounts he had managed for the hedge fund to create GNI Capital.

The investment advisory firm has taken that experience, and a focus on market research, to build its business, from \$5 million in assets under management to \$45 million today. Its revenue has tracked closely with that growth rate.

Research focus

GNI Capital began with managing separate accounts for high net worth individuals. Separate accounts are professionally-managed investment accounts that are held in the client's name. Unlike mutual funds, separate account investors own stocks in their individual account rather than a share of the whole pool.

Also unlike mutual funds, GNI adjusts its investment styles based on its research, rather than sticking with a particular technique.

Norton is not particularly sanguine on

stock markets as a whole.

"In the next 10 years, we'll be about where we are today," he said.

In the interim, investors will see some upward and downward movement, but GNI's long term outlook is sideways.

Taking advantage of that movement is what will yield good returns.

"That's the whole secret — being able to use those as opportunities," Norton said.

Lance Alston, vice president of advisory firm JWA Financial Group Inc. prefers a different approach.

"We want to be as diversified as possible," Alston said.

Among the universe of investment options, chances are good that some are growing in value and the cost of missing out is too great.

"There is a constant regular repeating opportunity to be invested in the market," Alston said.

To the contrary, Norton said GNI doesn't feel the need to be constantly invested in the market. Based on its research, the firm will instead keep cash positions in the name of risk management.

Short component

GNI also has its own hedge fund that trades S&P 500 vehicles both long and short. That provides an option to its investors not typically found with many conventional investment managers.

From that experience on the short side — betting stocks or indices will lose value — GNI has developed a separate account investment style incorporating a short component.

In the separate account style, GNI deals in exchange-traded funds — investment vehicles built to match the performance of different stock market indices. That approach limits the risk that comes with shorting individual stocks, Norton said.

Through the end of 2004, GNI's All-Cap

LONG AND SHORT

NAME: GNI Capital Inc.

BUSINESS: Investment Management

HEADQUARTERS: Addison and Greenville, S.C.

LOCAL ADDRESS: 15455 Dallas Parkway Addison 75001

OWNERSHIP: Privately held

TOP EXECUTIVE: Charles Norton and Allen Gillespie

EMPLOYEES: 2

LOCATIONS: 2

ASSETS UNDER MANAGEMENT: \$45 million

PHONE: 972-764-5222

WEB: www.gnicapital.com

Hedge Portfolio produced a five-year annualized return of 9.4% after fees. That compares with a -1.1% return for the S&P 1500 index for the same period.

GNI operates on a management fee basis. That helps keep its interests aligned with its clients, Norton said.

The performance of its investments led GNI to land business from institutional investors — professional investment pools with deeper pockets and keen demands — within a year of starting work together.

"If we built the right product and had good performance, we would get our first institutional clients," Norton said.

Now GNI also applies its research as a sub-adviser to other investment firms. Through a fee-sharing arrangement, GNI manages the money of other advisers' clients.

This spring, it also launched a subscription-based newsletter.

"Being a research-driven firm, we could share our thoughts with a wider audience," Norton said.

Plus, it provides an additional way for GNI investors to gain insight into how the firm makes its decisions.

Investors with GNI often liked hearing its rationale for its choices.

"We think that's appropriate," Norton said. "After all, it is their money."

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