

We got a copy of billionaire hedge fund manager Seth Klarman's letter to investors — here are his 5 biggest warnings about the economy

Seth Klarman, president and CEO of the The Baupost Group. [Getty Images/ Scott Olson](#)

- Billionaire Seth Klarman's annual letter to investors said that the spike in sovereign debt levels in countries like the United States, France, Canada, Italy and others "may well be" the seeds of the next financial crisis.
 - Klarman blamed technology, President Donald Trump and the "modern-day media and the internet" for the "growing divide" in the US.
 - Klarman's roughly \$32 billion hedge fund "returned between roughly breakeven and a decline of less than one percent for the year," the letter said.
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Similar to his billionaire hedge fund [counterpart](#) Ray Dalio, Baupost Group CEO Seth Klarman is concerned about an incoming financial crisis as well as political and social tension in the US.

In his annual letter to investors this week which was viewed by Business Insider, Klarman laid out his biggest concerns about the economy, democracy and society, as the one-time mega-donor to the GOP has been outspoken against President Donald Trump.

For the year, the \$32 billion hedge fund returned between "roughly breakeven and a decline of less than one percent," the letter said.

Here are the five biggest areas to watch in 2019, according to Klarman.

Private equity was "most overextended class" of 2018

Klarman wrote in his 22-page letter that the conditions that set record-setting fundraising amounts in the private equity field, which he attributed to expensive public markets and low yields, "will almost certainly not prevail forever."

Thanks to a growing economy and low rates, private equity investors "had the wind at their backs for a decade," Klarman writes

With rates hiked four times last year, Klarman said that private equity may be the most "overextended asset class in 2018" as investors flocked there for a chance at double-digit returns.

Global leadership is "up for grabs"

Klarman is a known Trump critic, and his letter to investors did not hold back in questioning the President's choices in foreign affairs. Because of the United States' "desire to withdraw from its long-prized role as a champion of liberty and democracy across the globe," Klarman wrote, last year was "a banner year for strongmen."

He cites the lack of consequences experienced by Russian President Vladimir Putin after the attempted murder of a former spy on British soil and continued expansion into the Ukraine and Crimea, along with the election of far-right Brazilian politician Jair Bolsonaro as president in October.

"The bottom line is that leadership matters. The growing turmoil in Washington and other world capitals is taking a toll on the country," Klarman wrote, saying it would be challenge for investors to "simply hunker down and keep their focus on markets."

Sovereign debt might be the "seeds" for the next financial crisis

Putting the blame on politicians who "borrow rather than pursue a responsible fiscal course," Klarman identified the growing debt of countries like the United States, Italy, France and Canada as the next potential cause of a financial crisis.

Debt eclipsed annual GDP in the United States in 2017, Klarman wrote, and "there is no way to know how much debt is too much."

"America will inevitably reach an inflection point whereupon a suddenly more skeptical debt market will refuse to continue to lend to us at rates we can afford. By the time such a crisis hits, it will likely be too late to get our house in order."

The dangers of the "post-truth" era

Klarman lays the blame for the current hyper-partisan divide in the country at the feet of several people and entities: Trump, the media, technology, Putin and social media, among other factors.

Regardless of the person or tool that is most to blame for lack of shared facts, Klarman writes, "deliberate ignorance and denial of facts and truth are disturbing phenomena" that ultimately impacts the country's claim of being a democracy — a trend investors must be concerned with.

"Businesses need a long-term horizon to plan, and social unrest makes planning more difficult. It can't be business as usual amidst constant protests, riots, shutdowns, and escalating social tensions," the letter said.

"It is not hard to imagine worsening social unrest among a generation that is falling behind economically and feels betrayed by a massive national debt that was incurred without any obvious benefit to them."

Algorithmic trading's impact on the markets

While Klarman did not take as strong a stance against quant investing models as [his contemporaries like Leon Cooperman and Stanley Druckenmiller have](#), he was concerned that "no one knows might respond to" the next major market sell-off.

"We simply cannot know how those algorithms might respond to new and unexpected conditions," he wrote.

Because of the growth of passive funds and quant models, markets feel "strange and enigmatic," though Baupost "will not complain about this."

"The recent selloff likely presented a buying opportunity - you can go years without seeing such valuations - but not across the board and not one for the faint of heart."

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