Introduction

Hedging In and Out

Perhaps J. P. Morgan did as a child have very severe feelings of inadequacy; perhaps his father did believe that he would not amount to anything; perhaps this did affect in him an inordinate drive for power for power's sake. But all this would be quite irrelevant had he been living in a peasant village in India in 1890. If we would understand the very rich, we must first understand the economic and political structure of the nation in which they become the very rich.

C. WRIGHT MILLS (1956), *The Power Elite*

A greedy fraudster or a visionary entrepreneur. These two tropes dominate media portrayals of hedge fund managers. I would venture a guess that these caricatures frame your own idea of a hedge fund manager, too. But behind the tales of designer suits, helicopter commutes, and illicit pursuits is the less sensational story of Craig,[1] who met me for coffee one morning at a busy Starbucks near New York City's Grand Central Station. Every day, he commuted into the city by train from the New Jersey suburb where he lived with his wife and two children. On that day, Craig had primped because he met me only a few hours before a job interview—a sign of the ease with which he job hunted. A forty-something white[2] man, Craig wore a pressed gray suit and had freshly trimmed his gray-speckled beard, a contrast with his usual wardrobe (sneakers and a t-shirt) as a trader at a midsize hedge fund with a nerdy startup culture and $2 billion in assets under management. When the markets went in his favor, Craig could earn several million dollars a year, easy.

While Craig's trades in the stock market and the resulting riches might appear to be the result of well-earned, individual success, Craig's high earnings capture a broader social problem facing the United States. Income inequality has skyrocketed. In the forty years since the Carter administration removed a cap on interest rates charged by banks, signaling a new era of financial deregulation, the richest 1 percent have doubled their share of the nation's earnings.[3] Wall Street became riskier, more complex, and obscenely lucrative.[4]

Today, the hedge fund industry drives the divide between the richest and the rest. In the United States, where the median household income is roughly $51,000, hedge fund portfolio managers, on average, bring home $1.4 million each year.[5] Even entry-level analysts collect nearly $680,000.[6] These salaries have launched many hedge fund workers into the top 1 percent of households (which, on average, bring in $845,000 per year).[7] Which is to say, where most research on inequality focuses on the poor and working class, this book sheds light on the growth and persistence of inequality by studying the prosperous—the "haves" rather than the "have-nots"—especially the elite white men who garner most of this industry's astronomical payouts.

As in other high-paying economic sectors (for instance, technology and law), women of all racial groups and racial minority men are drastically underrepresented in the hedge fund industry. Firms run entirely by white men manage 97 percent of all hedge fund investments.[8] Across an industry employing some 55,000 Americans, women are outnumbered more than four to one (holding approximately 19 percent of all positions); in senior positions, that rises to about nine to one. These numbers are in keeping with the demographics of the 1 percent: women, who account for about half of the nation's labor force, comprise only about 16 percent of the 1 percent, and some 90 percent of the heads of families in the top 10 percent of earners are white.[9] *Why* people of color and white women are underrepresented both among top earners and on Wall Street begs examination. What are the deep mechanisms of inequality that prevent all but white men from equal access to an industry that controls so much wealth?

Put differently, the forces preventing women and racial minority men from becoming top earners are well documented,[10] but that's different from understanding *why* elite white men garner such high compensation at hedge funds (more so than in other eras and contexts where white men control the upper echelons). Glimpses into the social worlds of these power holders can help us see how race, gender, and social class, as systems of inequality, work together to create and insulate outsized salaries, bonuses, and other compensation—in and beyond hedge funds.

As hedge funds amass riches, most American workers accrue debts. The United States has an uneven, hourglass economy: a few in the upper class, most in the lower, and a squeezed and shrinking middle class between them.[11] Since the 1970s, working-class wages have declined 5 percent (adjusted for inflation), middle-class wages have stalled, and top earners' income has skyrocketed. These trends are the product of a whole host of government policies: tax cuts for the wealthy, deregulation of financial services, scaled-back protections for workers, and welfare "reform" for the poor.[12] The resulting inequality is a pressing social problem, threatening everything from personal well-being to education rates, social unrest, and even our democracy.[13] Using hedge funds as a case study, I explain how this vast inequality was created and what can be done to change it.

This is an insular industry, and few scholars have had the access needed to investigate its inner workings.[14] After working at that Seattle hedge fund, I returned to the industry as a sociologist. Drawing from my six years of interviews, observations, and analysis, I present an insider's look at the industry to explain why it has generated extreme wealth, why mostly white men like Craig benefit, and how it can be reformed to create a more equal society.

What Is a Hedge Fund?

By now, I suspect, you might be wondering, *what is a hedge fund?* A hedge fund is a private financial firm that pools large sums of money from wealthy people and large institutions to invest in the stock market. The high volumes mean hedge fund investments can bring enormous profits, but only to those who qualify to invest in the first place. The US Securities and Exchange Commission (SEC) requires that each hedge fund investor have a minimum net worth of $1 million (excluding a primary residence) and a minimum annual income of $200,000. Less than 13 percent of Americans qualify on their own, and yet the industry invests money for a wide segment of society. Pensions, governments, universities, and other nonprofit endowments comprise nearly 60 percent of hedge funds' client investments.[15] Hedge fund investments affect states, businesses, and workers worldwide.

Hedge funds use a variety of investment strategies, from algorithmic trading to leveraging debt to event-driven investing in response to corporate and geopolitical events.[16] The inner workings are purposefully opaque—in the name of protecting proprietary trade secrets—and often convoluted. That means hedge funds are difficult to understand and scrutinize, which makes them risky but can also confer advantage (the opacity can be a source of competitor confusion, boosting profits). This is just one of several ways that hedge funds differ from investment banks. Hedge funds, with their exclusive clientele, can charge higher fees and thus generate higher profits while employing fewer people to share in the pot. Further, because the fees charged by hedge funds are taxed as capital gains, rather than income, their tax bills are comparatively low.[17] This allows for extremely high earnings, especially for those at the top.

The industry invests money for a wide segment of US society and for people and governments around the globe. As I mentioned, institutions comprise the majority of their investors who foot the bill for the high fees.[18] In fact, Harvard University's endowment fund is involved in such risky investments—about one-third in hedge funds—that the *Wall Street Journal* labeled the Ivy "a hedge fund that has a university."[19] The investments made by hedge funds influence the salaries and pensions of most people who work for colleges and universities, public schools, city services, government agencies, and large nonprofits. Even though you may not yet fully understand hedge funds, it is likely that their work affects your life in some way.

With respect to the money flowing out, hedge funds generally invest in land, real estate, stocks, bonds, debt, currencies, and derivatives.[20] The astronomical size of these investments means that their impact is felt far and wide. Hedge funds have collapsed currencies and sparked recessions around the globe, spurred the privatization of US schools, slashed and burned newspapers, and suppressed workers' bargaining power, contributing to the stagnation of middle- and working-class wages.[21] Thus, it is not only the high compensation meted out to hedge fund workers that widens inequality but also the investments themselves. Again, the work of financial investors affects, well, everyone else.

In 2020, the global hedge fund industry managed $3.7 trillion in assets—an all-time high—through over 16,000 firms employing 390,000 people, including outsourced labor (the average hedge fund employs only twenty people).[22] US-based hedge funds alone manage assets totaling 12 percent of the country's GDP. For reference, in its 1950s heyday, General Motors' revenues accounted for roughly 3 percent of US GDP, with $806 million (which would be nearly $8 billion in today's dollars) in net profits shared among nearly 600,000 workers.[23]

Slimmer staffing helps to explain the high incomes, at least at the upper levels of hedge fund hierarchies. In 2010, just after the Great Recession, the world's largest hedge fund, Bridgewater Associates, posted annual investment returns of $15 billion—more than the *combined* profits of Google, eBay, Yahoo, and Amazon. Yet, Bridgewater had 1,200 employees; in 2010, Amazon had 100,000. Additionally, those lower in the hedge funds' hierarchies earn salaries near the national median (base salaries for administrative and recruiting roles fall around $50,000—similar to what I earned), but members of the investment team *start* at upwards of half a million in total compensation. Senior managers and other leaders can command base salaries of a million dollars annually, plus a cash and stock bonus that may double or triple their take-home pay. Bridgewater's founder, Ray Dalio, earned *$3.1 billion* in 2010. Personally.[24]

These extremely high profits are possible because many hedge funds can bypass regulatory scrutiny, avoid taxes, and even undermine governments. Only hedge funds that manage over $100 million in assets, for instance, must register with the SEC. And the hedge funds that do register encounter less regulatory oversight than investment banks because the SEC considers their high-net-worth-investors to be less risky, more sophisticated, and in need of less legal protection than the average consumer. The lax scrutiny allows hedge funds to pursue risky investments and take big swings. To exploit loopholes in transnational regulatory and tax structures allowing for lesser oversight and greater profits still, most US-based hedge funds use a blended "offshore/onshore" investment structure.[25] In this way, hedge funds behave like the private wealth managers studied by sociologist Brooke Harrington: they undermine state authority in ways that give elites special privileges that ensure inequality persists from one generation to the next.[26] Operating with relative autonomy, mobility, and secrecy, hedge funds are unfettered by any given sovereignty. Their accumulation of wealth can go relatively unchecked.

Hedge funds have profited beyond other financial firms in recent decades because they encounter fewer regulations, charge higher fees, pay lower taxes, and employ fewer people. They are relatively small and nimble, with big pools of cash to insulate risk and big pools of profit to show for their efforts. The firm's few employees share in these benefits because their bonuses come from the fund's profits as well as their own personally held fund equity, but the bulk of the take goes to those at the top—the elite group of predominantly white men known almost innocuously as hedge fund managers.

A New Gilded Age?

Today's extreme inequality can be a bit harder to spot than in previous eras, if only because of the day-to-day work of elites. These high earners act and look very different from the robber barons of our imagination. Craig didn't don the trappings of a millionaire: he's got a no-frills mentality, straightforward demeanor, and only arrived at our first meeting in a bespoke suit because he had a job interview later that day. And if you passed him on the street, you'd never think he belonged among the hedonists on, for instance, the high-finance television drama *Billions*. These aren't the Gilded Age elites who lived lavishly off of their inherited wealth, as the economist Thorstein Veblen wrote of the leisure class in 1899, and conveyed their class status through conspicuous consumption in a leisurely lifestyle. Hedge fund workers are all but defined by an absolute preoccupation with the work of accumulation.

This gives us a clue as to how and why the financial sector has become a primary driver of inequality over the past forty years. Economist Thomas Piketty's 2013 book *Capital in the Twenty-First Century* was tremendously popular and raised awareness about the proliferation of profits going to the top 1 percent. Piketty's research made it plain that, unlike twentieth-century top earners who relied on passive forms of income to preserve existing wealth, today's elites actively work for their earrings. The working rich, not the leisure class, are the economic and politically powerful elite of the twenty-first century.[27]

In many ways, the ranks of the working rich are more open than the leisure class of the past. The civil rights movement, women's rights movements, and others have helped to diversify the membership of elite institutions. Still, inequality has increased. This is because, as sociologist Shamus Khan has established, new entrants can climb up the rungs, where the old elite held more firmly fixed class positions. It's just that not everyone has equal access to the next rung on the class ladder. The cumulative advantages of an elite upbringing—such as private tutoring, family libraries, music lessons, extracurricular coaching, and elite connections—ease advancement.[28] Meanwhile, new entrants to elite occupations encounter what the sociologists Sam Friedman and Daniel Laurison call a "class ceiling," preventing the working and middle class from achieving upward mobility.[29] As a result, the new elite do not necessarily make it to the seats of power.

The hedge fund workers I interviewed predominantly framed their upbringings as solidly middle class, though in reality, they were nearly all from upper-middle-class/affluent families and were very well educated (our friend Craig held a PhD in biology). Their embrace of a rags-to-riches discourse of bootstrapping and meritocracy, which US society views as more admirable than coming from a well-to-do family, fit well with other elites' tendencies.[30] Expressions of extravagance and entitlement are no longer elite status markers, sociologist Rachel Sherman shows, but symbols of the ease of privilege and reminders, by comparison, of the morality of productivity.[31] My interviewees commonly presented themselves as outsiders and underdogs; a little probing revealed that their parents included the dean of a business school, the chief executive officer of a Fortune

500 company, and the chief financial officer at an investment bank. Concealing those indicators of generational privilege reinforced the assumption of their own individual merit—the idea that they alone were responsible for (and, perhaps, deserving of) their professional and financial success.[32]

The tendency to present oneself as "self-made" stems, in part, from a heightened perception of insecurity on Wall Street.[33] When the stock market fails, traders suggest it takes fortitude, resilience, and commitment to bounce back. Craig planned ahead for periods of unemployment, like the one he was facing when we met (his recently restructured firm had given him a nudge to move on before he was let go). Craig's experiences reflect a more widespread culture of risk and insecurity in the United States,[34] which sociologist Marianne Cooper argues instills a sense of emotional vulnerability even among the affluent. Managing that unease motivates people like Craig to work harder and, thus, fuels inequality. The intensification and fetishization of work are a product of job precarity even among the country's top earners.[35]

Exacerbating this tendency, as their jobs become less predictable, people feel compelled to protect their monopoly on resources and opportunities by working harder—or at least building strong reputations as tireless workers. The escalating incomes driving economic inequality aren't, as dominant explanations would have it, the result of technological advancements increasing efficiency and allowing higher profits to flow upward.[36] Scholars aiming to debunk this explanation point out, for instance, that the top earners in financial services out-earn their peers in sectors like technology and medicine, which have seen similar advancements.[37]

Wall Street differs from those other industries because it has been purposefully deregulated; neoliberalism, in other words, has paved the way for the explosive growth of the hedge fund industry. Since the 1970s, neoliberal policy, based in the belief that markets should be allowed to function with minimal government intervention, has scaled back worker protections and financial regulations. As a result, the financial sector's share of US corporate profits tripled in half a century, even as its share of US employment remained nearly stagnant (rising only 3 points, from about 4 percent in 1950 to just over 7 percent in 2001).[38] In the past, if the manufacturing sector saw robust, steady growth, we could expect fairly strong wages for even low-level workers coupled with an expansion of their ranks (regardless of many technological advancements, though not all). That's not true for the financial sector, which shares its profits with a vanishingly small number of people. Additionally, financial actors, with their elite networks and resources, are uniquely able to influence politics to favor deregulation, leverage bargaining power within the industry, and stimulate market demand for their products, like convincing friends in high places to invest in their hedge funds.[39]

Economists broadly attribute earnings to human capital, specifically how workers themselves factor into the supply side of the classic supply-and-demand equation for wages.[40] Wall Street, following suit, rationalizes high incomes by pointing to the supposedly unique skill sets and talents of hotshot traders. A quick glance at Forbes' annual list of top incomes, however, reveals the massive flaw in this logic. The *lowest* annual income reported among the twenty-five highest-paid hedge fund managers was $225 million in 2018, a notoriously bad year for the financial industry. The top four took home over $1 billion each, with James Simons of Renaissance Technologies claiming $1.7 billion that year alone.[41] No amount of human capital can explain these earnings. These admittedly extreme cases show that the money being made in hedge funds defies any rational calculation of supply and demand. Moreover, because men out-earn women who have comparable levels of human capital and work in similar financial-sector jobs,[42] it is plain that human capital cannot, in and of itself, account for these astronomical, unequal earnings.