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Small Gold Trader Makes Big Splash

Daniel Shak's Aggressive Bet Grabbed Sizable Chunk of Contracts, But Prices Fell and Wager Went Bad

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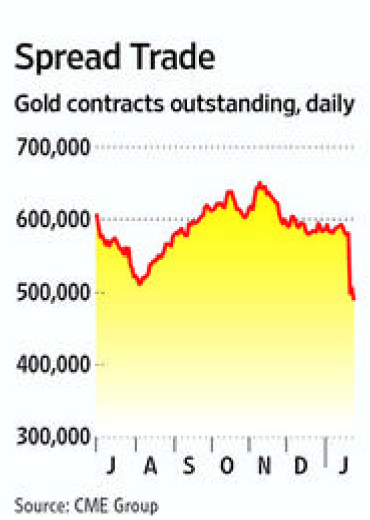
A huge trade by a tiny hedge fund has sent shudders through the gold market.

Thanks to the nature of futures trading, Daniel Shak's $10 million hedge fund held gold contracts valued at more than $850 million, more than 10% of the main U.S. futures market, and the equivalent of South Africa's annual gold production.

But as gold prices started falling this year, the trade, which was a combination of being long and short gold contracts—bets that prices will both rise and fall—started going bad. Monday, he liquidated his position, and is returning money to clients.

As a result, the number of gold contracts on CME Group Inc.'s Comex division plunged more than 81,000, to about 500,000, the biggest single reduction ever. While his trade didn't account for all of the contracts, an average daily move is about 3,000 to 5,000 contracts.



That Mr. Shak and his firm, SHK Asset Management, could control one of the largest positions in the gold market underscores how leverage can enable investors to control huge positions in many commodity markets.

"Yeah, that was just me liquidating my spread position," Mr. Shak, 51 years old, said in an interview. "I had a significant, fully margined position. The dollar amount of the gold liquidation was very small, it was just a lot of contracts."

Mr. Shak said he quit the trade when he was 70% down. People close to the firm confirmed the loss was about $7 million.

Just over a week ago, he put his apartment on Manhattan's Fifth Avenue up for sale with a price tag of $7.5 million. He said the sale wasn't related to his losses.

While the drop in contracts didn't appear to hurt gold prices, it caused some panic in the market. Brokers said they fielded calls from clients worried that a big trader may be dumping holdings. Monday, gold futures rose slightly to $1,344.50 a troy ounce and settled at $1,318.40 Thursday. The front-month contract is down 7.3% from its record close on Jan. 3.

Gold has been one of the hottest trades of the past few years, attracting big hedge-fund managers such as John Paulson and George Soros. Since the metal shot up 30% last year to records, some investors have become concerned that some large holders could sell, triggering an exodus.

Many are buying gold futures, which trade on the exchange and enable investors to buy the metal at a fixed price before a fixed date, and others are plowing money into exchange-traded funds, which are backed by the physical bullion.

What Mr. Shak took on was a "spread trade," in which he was long and short gold contracts of various maturities.

It isn't an outright bet on gold prices, but rather on the degree of movement among different contracts. The fact that the sale came from a spread trader, rather than a gold holder, could put some investors' minds at ease.

Spread trading often flies under the radar of regulators and exchanges, as it is regarded as involving little risk. Therefore, traders are able to use high leverage to command a big number of contracts with only little capital.

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"I just chose to close,' said Daniel Shak (with eyesglasses). 'I wasn't forced.' Here, Mr. Shak, a competitive poker player, at the World Series of Poker Ante Up for Africa tournament in 2007.

For example, with as little as $135, a trader can control a spread trade, which is nominally valued at more than $260,000 at today's price.

In comparison, traders need to put up $6,751 to invest in one futures contract. Mr. Shak's positions were extended as far as December 2015, according to exchange data.

"He just had too much position on," said a person who is familiar with his trades. "He didn't think he was flying naked the whole way."

A CME spokesman said he couldn't comment on specific trades.

Mr. Shak said the trade had been profitable for him for years, but it stopped working and the exchange kept raising his margin requirements, forcing him to put up more money. Mr. Shak said that when the exchange raised it by 25% Monday, he decided to cut his losses and end the trade.

Some Wall Street banks and gold producers were on the other side of the trade, according to people close to the matter.

"It was David against Goliath," Mr. Shak said, referring to his position in the market in relation to banks and the commodity exchange. "I just decided to get out; down 70% is better than down 100%."

He had worked as a floor trader at Comex for years before he set up his own fund in 2002. The firm suffered losses of about 12% in 2008, before rising 20% in 2009 and 100% last year, Mr. Shak said.

Mr. Shak, who lives in Las Vegas and also owns a home in the Hamptons on New York's Long Island, also is a competitive poker player and says he has won more than $2 million, including a $1 million win at the Aussie Millions in Melbourne, Australia, last year.

Discussing his business before the poker tournament, he told an Australian newspaper that he trades with the biggest gold and metal producers.

"I am one of the very few people willing to sit down and make a market in any spread transaction. It's a niche market, but it's my niche," he said.

Mr. Shak said his decision to close his position wasn't related to the faulty trade, but rather was a "lifestyle decision."

"I just chose to close, I didn't like my positions so I chose to liquidate, I wasn't forced," he said. "I was in the process of closing anyway."

Mr. Shak said he will return to trading in a few weeks, though perhaps not manage money for others.

"This is not career ending," he said. "I'm not stopping trading."