
Josh Ritchie for The Wall Street Journal

Nick Krsnich closed his fund and handed money back to investors.

That is the unusual step Nick Krsnich, a mortgage-focused hedge-fund investor who previously was Countrywide Financial Corp.'s chief investment officer, took last month after he concluded that mortgage bonds and other investments were on thin ice.

"The opportunity wasn't there anymore," Mr. Krsnich says. "I just couldn't invest money for people at 4% or 5% yields" on mortgage-backed bonds.

So far, Mr. Krsnich's move looks prescient. Since he closed his $36 million JMN Structured Strategies Fund on June 7, mortgage-securities prices have tumbled, lifting yields above 6%. Mr. Krsnich predicts market prices will continue to slump as the Federal Reserve becomes less active as a bond buyer, a view at the center of the debt-market selloff of the past month.

Nonetheless, Mr. Krsnich's decision carries potential peril. If the market strengthens, his move will look like folly. And some investors say that whatever happens, Mr. Krsnich may be jeopardizing any chance of raising money again.

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"He's taking short-term career risk," says Andrew Martzloff of Bitteroot Capital Advisors, a firm in Bozeman, Mont., that invests in investment firms for wealthy individuals. "It may be too much of a challenge to restart the firm" if new opportunities arise.

Some billionaires, such as George Soros and Stanley Druckenmiller, have returned outsider money to invest for themselves. But because fundraising is so unpredictable, less prominent managers such as Mr. Krsnich usually prefer to search for new investment opportunities while clinging to cash and continuing to charge clients hefty management fees, rather than hand money back to investors.

"In my 25 years in the business I've never had a manager sell everything, send it back and say the opportunities are over—it just doesn't happen," says Jay Krieger, a principal at Fundamental Capital Management in Pasadena, Calif., which invests in hedge funds. "Usually managers say they've found new, clever things to do, even if they haven't."

Mr. Krsnich knows those risks better than most. He ran a $200 million fund for Colchis Capital Management, LLC, in early 2011, when he became worried about the market's outlook, sold his investments and closed that fund. Mr. Krsnich avoided losses when the market subsequently weakened, but some investors were upset that he decided to return cash, rather than search for bargains elsewhere in the market. He was able to raise just 15% of the earlier sum for the JMN Structured fund.

Mr. Krsnich says he is well aware that his recent move could have been a career killer.

"People say I'm crazy," Mr. Krsnich says. "But they told me when I left Countrywide I was nuts.

"I don't like to be seen as a quitter but I didn't like what was going on in the market then and I don't now," he says.

Mr. Krsnich's background is as unusual as his recent decision. Two of his uncles played in the major leagues and Mr. Krsnich had his own promising career as a pitcher in the farm system of the Detroit Tigers. He struck out Kirk Gibson in spring training one year, though he also served up a barrage of long homers to the slugger.

"I think one of his home runs is still in orbit," he says.

Mr. Krsnich's career ended when he slipped on wet infield grass and tore up his knee.

Joining the mortgage business, Mr. Krsnich rose within Countrywide. At one point he was responsible for bundling home loans into about $400 billion of bonds a year, or about 20% of the entire market.

Mr. Krsnich became an outspoken critic of Countrywide's push for market share and what he thought was an unhealthy embrace of risk. He left the company, which was sold to Bank of America Corp. BAC -1.18%in 2008, before the housing collapse.

Mr. Krsnich developed a model for valuing mortgage bonds, became excited about beaten-down mortgage bonds and hung his shingle in San Francisco in September 2008. That month, Lehman Brothers Holdings Inc. collapsed and markets imploded, resulting in an immediate loss of nearly 11% for his fund that year. Mr. Krsnich's distressed fund rebounded, scoring gains of 34% in 2009 and nearly 16% in 2010.

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Mr. Krsnich struck out Kirk Gibson.

Part of the gains came from buying pay-option mortgages, or those that allow homeowners to miss a mortgage payment while adding that sum to the interest-accruing balance. Mr. Krsnich took his daughter to visit homes backed by these mortgages, determined that many were of high quality, and started buying.

But Mr. Krsnich worried that mortgage prices had gotten too high in 2011, and shut down his fund early that year, returning investor cash.

Mr. Krsnich's new fund, based in Palm Beach Gardens, Fla., gained 21.5% last year and was up 5% this year, before his latest decision to close. The gains compared favorably with many mortgage investors, especially those like Mr. Krsnich who don't use much leverage.

Explaining why he pulled the plug, Mr. Krsnich says his concerns stretch beyond mortgage and debt investments.

The U.S. "has been throwing more debt at a debt problem," he says. "I came out of Countrywide and if you give more debt to a person who hasn't proven they can pay back the loan, it's usually a situation that doesn't work out well."

Some investors in Mr. Krsnich's fund applaud how he avoided the market's recent losses, but they now have to redeploy funds at a time when interest rates remain low and the investing climate is unsettled. Others are troubled by his decision to step back from the market because they continue to invest in other hedge funds.

"I'm happy with what he did," Mr. Krieger says, "but I don't want to hear it because I have exposure elsewhere."

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