OPALESQUE

Opalesque Round Table Series '11

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Editor's Note

Do you know....

• **... that a new "risk-based capitalization" model originating from Connecticut is now competing with traditional seed arrangements for emerging managers? Why is it so attractive for new or emerging managers, as well for investors?**

• **... the two main reasons why the large multi-strategy hedge funds are the winners in the current market environment?**

• **... which strategies work in FX? That a new model categorizing Forex managers into 14 different style buckets allows for unprecedented insights into sources of alpha and sustainability of alpha?**

• **... why Asian investors are still very slow in returning to the hedge fund industry after 2008, and what strategies are in demand from those who reinvest?**

The 2011 Opalesque Connecticut Roundtable is a solid 26 page document full of new insights and important background information. The Roundtable discussion took place in Stamford, CT in Septber 2011 with:

1. **Edward Massaro,** Chief Operating Officer, Knighthead Capital
2. **Bryan Borgia,** Principal, Topwater Capital Partners
3. **Virginia Parker,** Chief Executive Officer and Chief Investment Officer, Parker Global Strategies
4. **Joe Taussig,** Founder, Taussig Capital AG
5. **Scott Price,** Vice President, Custom House Fund Services

In addition, this Roundtable discusses:

- **Is the industry going towards the $100 million seed deal?**
- **What are the three business lines many fund of hedge funds find themselves after 2008?**
- **What are the ten focus areas within operational due diligence where investors hold hedge funds to a higher standard now?**
- **Why do many emerging managers still struggle with the proverbial elevator pitch, and what to do about it?**
- **What are the opportunities in stressed and distressed debt?**
- **Why international investors discover now the appeal of U.S. Energy Master Limited Partnerships (MLPs)?**
- **Why more hedge funds leave New York for Connecticut, and that even Malta (offering U.S. managers a corporate income tax of 5% via a new ratified tax treaty) may be a destination?**

The Roundtable was sponsored by Custom House Group and Taussig Capital.

Enjoy "listening in" to the 2011 Opalesque Connecticut Roundtable!

Matthias Knab
Director Opalesque Ltd.

Knab@opalesque.com

Cover Photo: Hartford Skyline from Charter Oak Landing

Participant Profiles

(LEFT TO RIGHT)

Matthias Knab, Scott Price, Edward Massaro, Virginia Parker, Bryan Borgia, Joe Taussig.

Introduction

Virginia Parker
Parker Global Strategies

I am Virginia Parker and started Parker Global Strategies ("PGS") almost 16 years ago to specialize in alternative investment strategies for institutional clients. We first started out in the multimanager FX business where we had mandates from large banks and public pensions. We built managed account platforms for several banks and designed and managed portable alpha strategies for pensions.

In 1998 we moved into the fund of hedge fund business, where we have customized over 30 mandates, many of which were linked to structured products. In 2005 we started to build expertise in a broad spectrum of energy and global natural resource investing. Earlier this year, we decided to focus exclusively on our FX/Macro and Energy businesses and exit the fund of hedge fund business. We employ 23 people and are headquartered here, in Stamford, CT. Our back office and fund services team is based in Denver, Colorado. Our Denver operation is becoming a third business line for PGS.

In the FX area, we have worked closely with dbSelect for many years. We have recently announced initiatives with CitiAcess® who have licensed two of our investable FX indices and Morgan Stanley with whom we are a product partner for their FX Gateway platform. On the energy side, we are launching a UCITS compliant fund focused on US energy infrastructure and exploring a market neutral version of our flagship strategy.

Edward Massaro
Knighthead Capital Management

I am the Chief Operating Officer of Knighthead Capital Management. We are a long-short credit investment firm specializing in event driven, distressed credit and other special situations across a broad array of industry sectors.

We launched the Knighthead Master Fund in June 2008 with approximately $400 million under management and currently manage $2.5 billion. Knighthead was founded by Ara Cohen and Tom Wagner. Prior to starting the firm, Ara spent 17 years as an investor with Brown Brothers Harriman, King Street Capital Management and lastly with Redwood Capital. Ara was the first investment professional hired at Redwood and he helped build the firm from a small start up to a $2.7 billion fund with average yearly 20% plus returns. Tom Wagner was a Managing Director at Goldman Sachs where he served as head of trading in distressed and high yield debt, as well as co-head of trading in special situation equities, busted convertibles and investment grade crossover. Tom managed a team of 22 traders with aggregate balance sheet risk of over $4 billion.

I am responsible for business development investor relations, marketing and operations. I also am a member of our valuation committee. Prior to joining Knighthead I spent 22 years in leveraged finance and capital markets roles, including Global Head of Leveraged Finance at UBS, Head of Loan and High Yield Capital Markets at RBS Greenwich and most recently Leveraged and Acquisition Finance at HSBC.

Bryan Borgia
Topwater Investment Management

My name is Bryan Borgia, I co-founded Topwater Investment Management with Travis Taylor in 2002. We are in Norwalk and specialize in creating customized managed accounts programs for large investors. Our most well known product, which we have been running since 2002, operates in a very similar way to a multi-strategy hedge fund. We farm out capital to traders or hedge fund managers, whatever they want to call themselves at that point in time in their careers, and they run their strategies for us in managed accounts under unique deal terms. We pay our managers a premium payout versus what they would get paid in a traditional hedge fund structure, but we do require all the managers to bring risk capital to the account.

Joe Taussig
Taussig Capital AG

We partner with hedge fund managers to create insurance companies and banks where the manager runs all of the investible assets of the entity as permanent capital. These companies are similar to Greenlight Capital Re, which is publicly traded, and Third Point Re, which was announced last week.

Scott Price
Custom House Global Fund Services

My name is Scott Price and I head the Chicago operation with the Custom House Global Fund Services where we have about 60 staff administering approximately 200 hedge funds. Globally, Custom House has about $55 billion under administration and in total we work with about 240 investor management companies operating out of numerous different jurisdictions. We offer fund formation, corporate secretarial, fund administration, transfer agency work, as well as shadow accounting services. We also work with many other investment vehicles such as managed accounts, family offices, and multi-manager funds, but our bread and butter business is valuing funds.

Matthias Knab **Virginia, you are very well known for your pioneering work as a multimanager in Forex, then you evolved to a full fund of fund and now you focus again on FX, global macro and energy. Why those three particular areas?**

Virginia Parker We have been very active in the FX and macro area for a number of years, and wanted to focus where we are seeing the greatest client demand for our services.

We started our energy strategy in 2008 and now have a strong three year plus record. We are focused on a specific niche of U.S. energy infrastructure which is often not understood and also not terribly overcrowded, like many other strategies have become. The energy infrastructure niche is very important, has the wind at its back and provides us with an area where we can really help offshore investors looking for this exposure.

If one considers the fund of hedge fund business today, one recognizes important and significant changes since 2008. We performed a strategic review of our position in the market and our opportunities for growth. Despite relatively strong performance in 2007 and 2008, and a policy of transparency and strong communication with our fund of hedge fund clients, we have found the market tough for raising new fund of hedge fund assets, as a smaller player in the field.

We have always had a strategy of being a niche player, and since the start we focused on transparency, risk measurement and management oversight and a number of managed accounts with hedge funds. Where that was rather unique in 1997 when we won our first fund of hedge fund mandate, it is less so today. In FX/macro and Energy, our value proposition is clear. We have a great team and a great focus. This is a business where evolution is key.

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Scott Price What specific factors do you think contributed to the contraction of the fund of funds industry or your fund of funds business?

Virginia Parker Historically, we have had the majority of our assets from Asia and a large percentage from Japanese banks and insurance companies. Speaking about Japanese institutions generally, not our clients, it is interesting to note the progression of events. When Basel II came along, the Japanese banks were the first to comply. Many banks decided to exit their hedge fund investments entirely, until they had a better understanding of the implications of Basel II. Fortunately, with our transparency to the position level, we were able to provide helpful information, and Basel II reporting where needed. As the financial crisis of 2008 unfolded, many Japanese institutions were already out of their hedge fund investments. Some institutions with direct investments with hedge funds had stop losses set at 10%, so they were out before the fall of 2008.

There was plenty of pain felt in the Japanese market, as there was across the entire world. Many Japanese investors spent about one year trying to figure out where they were positioned with their portfolios, and then during the second year, a lot of time was spent figuring out where they wanted to go. By the third year, at the beginning of 2011, still not a lot of activity was taking place. However, some of the institutions that were able to move quickly did come back right after the financial crisis in early 2009 and went into areas like distressed credit, because they understood the opportunity to be bottom feeders.

But generally, the institutions in Asia have been very slow with investing into our industry again. After 2008, a lot of institutions globally no longer liked fund of hedge funds - it did not matter if a fund of hedge funds were among the many who actually did a good job during the crisis. The sheer magnitude of unexpected losses and the whole Madoff debacle tainted the fund of hedge funds area. Guilt by association.

We find that particularly in Europe, there is a dislike of the fund of hedge funds. When we meet with European based fund of hedge funds, so many explain to us that they are now in multiple businesses. Again, the importance of evolution. They would start their introduction: "let us tell you about our business... we are in three businesses: we are in a fund of hedge fund business; we are in the advisory business" - and most of them had a third business going which might be seeding or a hedge fund manager platform. Of course, this is only anecdotal incidence, but this has happened in a number of meetings and continues happening. There is certainly a trend here that speaks about the funds of hedge fund business.

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Matthias Knab **What is the demand now on the multimanager products – FX, global macro and energy – you are offering at the moment?**

Virginia Parker A lot of new investor groups seem to be looking, or re-looking, at FX and macro. We see keen interest from Japanese investors. Apart from distressed, FX/Macro was one of the areas these investors went in again after 2008, often in CTA strategies where liquidity and transparency are available and little concern over the risk of gates or side-pockets.

Scott Price At Custom House, we have seen more inflows into CTAs and more funds set up to trade commodities than any other investment group since 2008. I believe that one of the primary reasons for this is the liquidity terms that these sorts of funds offer. More funds are moving from monthly to weekly and even daily liquidity. While this sort of liquidity can't be offered with all strategies, it appears that managers recognize that these terms are attractive to investors. Luckily for us, we specialize in daily valuations, so we have seen a lot of inquiries from funds who are considering better liquidity terms.

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Scott Price

Bryan Borgia

Certainly liquidity is at a premium in the allocation space and I would agree that CTAs are in vogue for this reason.

In general, liquidity should always be managed according to the strategy, because eventually things always will swing back the other way. If you run a distressed fund or any other relatively illiquid strategy, you have to match the liquidity terms of your hedge fund vehicle with the underlying instruments. Otherwise you are frankly doing your investors a disservice and will run into the same problem as in 2008 when there was a run on funds and managers did not have the liquidity to redeem investors.

I agree with Virginia that in general large institutions take their time figuring out where they are, how to get over the storm and then planning what comes next. You are really looking at a three to four year time period before these investors react and shift capital resources, they move very slowly.

Scott Price

When it comes to operational due diligence, what are some of the things investors like to see today? What kind of pressure do they put on you to lift your standards?

Edward Massaro

The "pressure" or standards that investors hold us to is extremely high. The operational due diligence is as important as investment team diligence. The focus areas that I see from our investors and their consultants include: Corporate and governance structure, operating model, regulation, compliance and audit, risk management, investment implementation and controls, and human capital. We will become a registered investment advisor in the first quarter of 2012.

Investors today are doing what they should be doing. In some cases they will spend multiple days with us focusing on operational diligence. This is a positive development for our industry, but it also raises the bar for startup funds.

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I am the one that handles the selection of managers for our managed account programs. I spend most of my day talking with managers about their strategies, anywhere between 20 and 30 managers a week. They can range in size going from zero AUM to 2BN in AUM, with the vast majority being below 250MM.

The heightened emphasis on operational due diligence is very intensive and often times the operational due diligence manager has the trump card. That means if a manager does not pass operational due diligence, regardless of whether you like the strategy and you think that particular manager creates alpha or takes money out of the market or whatever you want to call it, the investor will not invest.

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Scott Price How can emerging managers be successful in such an environment?

Bryan Borgia It is difficult, they face a massive headwind, and it is hurting them. This is coupled with the additional burden of SEC registration and taking on a CCO. Managers are going to need to get to critical mass quickly in order to support the infrastructure that is needed.

Edward Massaro It is still doable and economically viable, which is why you see the growth of the fund seeding business. If you have a good pedigree and a seed investor, endowments, foundations and family offices will come in next; that is how we started.

Investors like transparency, they like to see and understand what you own and why you own it. There are no surprises at the end of the month for our investors, they appreciate that. If you stick to your stated strategy and do a reasonable job with your investments, investors will stay with you.

Virginia Parker The energy fund that we are running is focused on the MLP space, which is a fairly small sector within the energy space. We started running this about three years ago and we were very fortunate. We already had the infrastructure and the people around, and having run a number of managed accounts over the years helped us a lot. We already worked with an independent back office group, so we did not have to make a huge new investment in the fund set-up and infrastructure. And then it was also helpful that the strategy has done quite well over the past three years and we believe there are good reasons the area will continue to perform well going forward.

Scott Price We work with five or six relatively large multimanager platforms and I was always impressed with the very extensive technical infrastructure they have in place.

Bryan Borgia It does take a significant amount of infrastructure; the risk room for one of our programs runs 32 CPUs & 72 screens to monitor all of the accounts and positions. This is what we need to do for our business at our current size...I can only imagine the systems in place for some of the really large firms.

Matthias Knab **Coming back to the emerging manager question and how much more difficult it has become to start out – Edward, your fund had a fairly good launch with $400 million given that it was 2008 when you launched. How did you pull that of?**

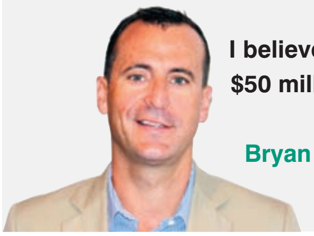
Edward Massaro We were fortunate to have a strategic investor with a long lockup that allowed us to build the business during a very volatile time. We launched shortly after Bear Stearns was acquired by JP Morgan. In fact pre Bear Stearns troubles we had commitments approaching $1 billion; that all changed rather quickly.

Joe Taussig

We were working very closely with a key employee with a hedge fund manager on one of our transactions, and he left mid deal which caused us a little problem. It turned out that Blackstone seeded him with $100 million, so again the $100 million was the number and actually the number he had in mind that he felt he needed to be competitive and viable in the marketplace.

Bryan Borgia

That resonates with what I have been seeing, I believe that going forward the industry is going towards the $100 million seed versus doing say two $50 million seeds.



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Matthias Knab

Virginia, you said before your clients have great interest and demand for FX managers and to some extent that makes sense - I believe that going forward, FX is an area that investors need to understand and also develop views. Developing views on FX and how FX will influence portfolios will become more important than ever before. The world order in FX may be turned upside down with the continued rise of Asia and the issues we have around the Western currencies like the Dollar and the EURO.

You have researched FX for decades now and developed the pioneering Parker FX Index. What did you find over the years, can investors really get alpha from FX? At Opalesque, we do get the index performance each month, and it seems like many have a challenge to perform consistently.

Virginia Parker

Let me give you a little history of our work in the FX space. We created the Parker FX Index in 1992 to help banks to evaluate whether or not their own internal proprietary traders were doing a good job. They wanted to compare them with is happening on the outside. We started collecting the performance of the currency managers and created an equally-weighted performance index, because we did not want the large currency managers to swing the performance.

About seven years ago we decided to do much deeper research in order to better understand the performance of the FX managers. We broke them down into categories and came up with our first investible index.

We then decided to find out which FX managers really performed, because a number of them do not. About four years ago we started a second round of deep dive research and came up with new ways of bucketing the managers according to their risk factors. We looked at how their sensitivity to different risk factors changes over time, and by going through this mapping process we were finally able to recognize the patterns of various managers. For example, we could clearly recognize a manager with a long bias to carry versus a manager who goes long and short carry.

Some of them, especially short-term traders, were sometimes short carry or neutral to short. We looked at the same information for momentum, trend following, breakout, valuation and volatility and developed a unique mapping system with about 14 different style buckets for managers. We recognized that we had mapped several previously unrecognized styles. Our maps are very visual. We provoke interesting reactions from FX managers when we share what we see about their styles.

A quick answer to your question about a sustainable alpha, I believe that there are probably not more than a couple of handfuls of managers out of at least 100 currently available who we believe can truly

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A quick answer to your question about a sustainable alpha, I believe that there are probably not more than a couple of handfuls of managers out of at least 100 currently available who we believe can truly add value over time. FX is a very tough area. I have said for 15 years that in my view, FX is probably the hardest place to make money consistently. I think it has become increasingly more difficult over the past years. There are correlation issues throughout the global markets and a constant risk on, risk off, that makes FX investing so difficult, just as in the traditional markets.

So, what works in FX? One area is very short term algo trading. It is hard to get this strategy right, but the few managers that get it right are able to show fairly consistent profits, unless there are huge intraday moves, or gaps, like with the Swiss franc recently.

Another area where we see managers succeed is a style that we refer to as quantitative multi-strategy. They seem to have developed what you can call a reversal system for nine different factors we have identified. They also seem to deploy some very short term trading which they combine with some longer term trading. There are few managers that are quite good in that category.

And then there are a handful of managers who emerge from what we call the quantitative fundamental side. They really look at what is going on in the world, but with a rules-based system. Some have done a pretty good job.

What does not work in FX is the old fashion technical trend following. It is very hard. Even the medium term trend following is a very tough way for managers to make money consistently. What you often see in this kind of trend following is that they get it right occasionally, so maybe they may be up eight months, but it is not unusual that that same manager may later be down for eight months.

As you said, all investors who invest globally have to figure what happens with currencies. Also, we are in an interest rate environment where it is much less expensive to hedge.

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As you said, all investors who invest globally have to figure what happens with currencies. Also, we are in an interest rate environment where it is much less expensive to hedge. It is now possible to be hedged across many currencies. Historically, when rates were lot higher, hedging was very expensive in certain currency pairs.

We had Japanese clients who always had to be hedged even when the rate differential was 7% or 8%. We often thought the client would be spending too much, and at peak times we sometimes suggested a dynamic or 50% hedge instead. But that was not permitted in their policy guidelines. Currency is a very important piece of their overall return which in fact can also be used as an enhancement.

One approach that we have come up with after several years of research was to add gold as a currency. We believe this is an important development. We are only doing it from the long side right now, but potentially it could be short also. Most reserve banks in fact use gold as a reserve currency, and we believe gold can be used for the same purposes by investors as well.

Matthias Knab **Bryan, you are an allocator and you deal with many hedge fund managers. What is your own procedure here, what trends do you see and which sectors are hot right now from your perspective?**

Bryan Borgia Correct, I speak with a lot of new or emerging or experienced managers that decided to go on their own. First stop with Topwater is a 15-30 minute phone call with myself, discussing the manager's firm and strategy. One common theme I see is that many managers still struggle with the proverbial elevator pitch. Managers should be able to break down into one paragraph what exactly sets them apart from other managers, and many cannot, or at least don't do a good job communicating it. This includes to clearly define what classifies as a potential edge. For example, if you are a long/short manager and you believe your edge is being plus or minus 20 net, that is not an edge - that is portfolio construction.

I have always been a big believer in active due diligence vs. the more common due diligence centered around a PowerPoint presentation or due diligence document. When we started Topwater in 2002 we were honest with ourselves that we needed to do something different, something that was out of the box and more in line with our core belief of active due diligence. Therefore we took an approach where both the manager and our firm put real money in our managed accounts. That gives us full transparency and alignment of interest. The managers can run their strategies and we can monitor closely and determine which managers truly take money out of the market. One thing has been consistent over the last 10 years, it is more difficult than you think to try and figure out who is the real deal and who isn't.

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Once we have identified a truly capable manager, our edge is to help the manager ramp up his business and grow and allocate more of our capital to that manager. Regarding your question as to which sectors would be hot, we actually don't do any top down asset allocation or strategy mix between the different trading styles on a tactical basis. Instead of moving assets towards say high frequency, relative value or distressed etc., we look at every manager that comes through the door and try to find out if he truly has an edge in his particular space.

That said, I would prefer to invest with managers that have some form of specialization. For example, I would much rather hear from a new manager "listen, my universe of names is 30 names and I live in North Carolina and I try to invest in companies that I can drive to and talk to management." That strikes to me as a potentially an edge versus another manager that says "I screen a thousand names through my database and then we end up with this list of 200 names" It's harder for me personally to wrap my head around that as a sustainable edge.

Let me add that if I were a traditional allocator and not a managed account program investor, I would be investing in the large multi-strats as I think this market place favors the large multi-strats. It is increasingly difficult to successfully start a hedge fund, and that adds to the talent pool for multi-strats. I believe this trend will continue, so for the foreseeable future those firms will continue to pick up impressive trading teams, because those trading teams realize it is more difficult now to launch a fund...and the prop exodus just further increases the pool of talent for them.

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That said, I would prefer to invest with managers that have some form of specialization. For example, I would much rather hear from a new manager "listen, my universe of names is 30 names and I live in North Carolina and I try to invest in companies that I can drive to and talk to management." That strikes to me as a potentially an edge versus another manager that says "I screen a thousand names through my database and then we end up with this list of 200 names" It's harder for me personally to wrap my head around that as a sustainable edge.

Let me add that if I were a traditional allocator and not a managed account program investor, I would be investing in the large multi-strats as I think this market place favors the large multi-strats. It is increasingly difficult to successfully start a hedge fund, and that adds to the talent pool for multi-strats. I believe this trend will continue, so for the foreseeable future those firms will continue to pick up impressive trading teams, because those trading teams realize it is more difficult now to launch a fund...and the prop exodus just further increases the pool of talent for them.

This new reality has been a benefit to us as well. We were able to allocate money to a lot of very talented people through our managed accounts. Of course, as Ed mentioned it is not what things used to be in 2006 or 2007 where you had more free capital, the leverage of the fund of funds and therefore larger fund launches...the game has changed and I do not see it going back to a 2007 type environment for some time, if ever.

Matthias Knab **What is the split on your platform between the more established and emerging managers?**

Bryan Borgia That depends what you consider emerging. I never really loved that term. I do not consider a group spinning out of one of the big named funds with ten years experience managing a large pool of capital as emerging. You can call them emerging because now instead of maybe having $500m in their book they are out on their own with maybe only $25 million of their own capital. I am not sure if emerging is the right term, I am kind of still looking for the right one...possibly a simple "new" is a better label. We have 3,500 managers in our database, and I have pretty much spoken with all of them. 95% of them fall into what is deemed emerging in this industry, which is sub-2 billion AUM. The industry is definitely top heavy as it relates to AUM, but that is not necessarily a bad thing.

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And of course there are reasons for that. If a large allocator would be deciding to reduce a 18% allocation to mutual funds or long U.S. equity to 15% and put those 3% as their first move into "alternatives", my guess would be their investment committee would sit down and say something like "okay, who are we going with, will we be going with Brevan Howard, Och Ziff, Bridgewater", or any other big brand hedge fund? Very rarely would you hear "I ran across this great emerging manager who runs $75 million, I believe he delivers superior returns and is able to take money out of the market"

I am specialized in this niche, so I know that there are still plenty of two, six, 10 man shops out there that very successfully trade at least for the moment smaller pools of capital and really take money out of the market. Therefore, I am fine that the large allocators collectively putting their capital to the biggest funds,I completely understand why they do that.

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Matthias Knab **Bryan, you set up your firm in 2002 and allocate to this segment of smaller and emerging managers. Who is backing you, who is your investor?**

Bryan Borgia Bryan Borgia: Our largest investor is Freestone Capital, which is a $2.5 billion firm located in Seattle. The firm has been a significant investor of ours since 2004. In 2009 we did a joint venture with them because they wanted increased capacity to our main program.

Matthias Knab **Ed, what opportunities do you see for your fund strategy at the moment? What is going on in credit?**

Edward Massaro We are very bullish on the stressed and distressed debt currently. We are investing debt instruments at the top of the capital structure and seeing returns in the 18-22% range. In addition the companies we have chosen to invest in are in very defensive industries: food, power, health care. Here are a few figures that will help define the size of the market: In February 2011 the amount distressed debt outstanding was $140 billion in, today that amount stands at $500 billion.

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The first quarter was a 13-15% type of environment based on the opportunity set in distressed, stressed, and performing credit. If we take, say, September 1st and ask what will be the opportunities over the next 12 months, we believe we could achieve high-teens, up to low 20% in credit. Let me point out that this includes buying senior, top of the capital structure loans and bonds; we are not talking about subordinated debt or equities

During periods of stress, you cannot buy the overall credit market via an index. In 2009 you could literally buy a high yield fund index and you would have been just fine. Today, you really need to differentiate between credits.

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Matthias Knab **Virginia, can you tell us more about your energy fund and the opportunities you see within the energy sector?**

Virginia Parker In July 2008 we raised $525 million for a multimanager MLP fund, and as the client needed to have a lot of liquidity in the fund, we thought that rather than seeing the liquidity constrained by external managers or possibly see their returns affected by the restricted liquidity, we suggested that our firm will run the very liquid part of the portfolio in order to satisfy the client's liquidity requirements.

I used to manage equity portfolios earlier in my career, so we developed a concentrated best ideas strategy in a core portfolio. We then have a satellite portfolio that is more event-driven. One of our ways of controlling risk is moving our allocations between our core portfolio adjusting the exposures between core and satellite. For example, when the market cratered in 2008 the larger, liquid MLPs held up a lot better than some of the smaller MLPs. We also tend to be very thematic, and there are some very interesting themes that are going on in that specific energy market.

Fast forward, we outperformed all the other mangers over the past three years and though we love this sector, we decided not to offer it in the U.S. and compete with the other MLP mangers there, but rather bring this opportunity to other parts of the world where we can also educate people about the MLP market.

The MLP structure was created back in 1986 by Congress to encourage investment in US energy infrastructure like pipelines, storage tanks, basically the transportation network throughout the United States to move crude oil and natural gas liquids. Today, the publicly traded MLPs' market cap is around three hundred billion dollars.

Since 2008, the daily trading volume grew from $300 million to about $800 million. These companies trade just like equities on the New York Stock Exchange and on the NASDAQ, but they are different from traditional corporations. Like REITs, there is no corporate tax. If you look at the history of the build-out of the infrastructure in the US, this investment structure has really worked.

Historically, MLPs have grown distributions at about 6.5% per annum, on average, over many years. They currently yield about 7%. You have a security that is liquid, high yielding, and the yields grow.

You also have a really interesting story for what is happening in this space in the US. I think one of the most important themes is natural gas, the price is very low right now, but because of that very low price of natural gas we are starting to see more of a shift. For example, for trucks moving from diesel to natural gas can actually get a tax credit for doing this.

Natural gas is about 30% cleaner than crude oil. Using more natural gas is an important first step as the U.S. is continuing to move to other types of alternative energy. Natural gas is scalable and provides a transition towards cleaner alternative fuels that are not yet scalable.

I am sure you are aware of the horizontal drilling that has been done now into the shale gas. It has been estimated that the US has over 100 years' worth of energy supply. This really exciting. We have these huge shale formations all over the country. There is the Marcellus in New York State and Pennsylvania. There is another huge one in Ohio and Michigan called the Utica. These places are in the Rust Belt, where unemployment has been high for years, as factories have moved abroad. Suddenly these regions are being revitalized job are being created. In fact, there are not enough people to fill the demand for employment.

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New pipelines are planned to be built out all over the US. There is a major one that was just finished about a year-and-a-half ago called the Rocky Express, originally designed to move product from the Rockies to the East Coast. What is interesting is that the dynamic has reversed, and the product is now coming from the East Coast back to the Rockies, thus reversing the direction of the pipes. There are some amazing things going on.

But you don't just need the pipelines, there is a whole sector called gathering and processing. These are companies that gather the product and process and break it into its component parts. For example, liquid natural gas is broken down into its hydrocarbon components and sold on to the market. This is a growing industry. A lot of the pipelines are being leased by the large integrated oil companies. These are typically very credit worthy counterparties for the pipelines companies that increasingly enter into long term contracts. The mechanism is that the MLPs build new pipelines, they contract the customer for all the volume, often via "take or pay." If the customer goes away, the customer still has to pay for the use of the pipeline.

These investments have proven to be an inflation hedge over the years and can offer high yields to investors. During the financial crisis the underlying fundamentals of the companies remained sound, and after the financial crises they just continued increasing their distribution and generating attractive earnings.

As I mentioned before, this area is not really known outside of the U.S. and in times like these we believe that this interesting niche strategy has appeal for many investors, as it involves transparency and a very strong liquidity. In addition, this is a part of the energy sector that generally does not have a high exposure to the volatility of commodity prices.

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Matthias Knab **Bryan, coming back to your work with emerging managers. Can you tell us more about the type of deals you have with them, what does a typical arrangement look like?**

Bryan Borgia We make direct hedge fund investments into managers, but the far larger business is providing managers with capital via managed accounts, where we require them to put up risk capital. Obviously, if we are requiring them to put up risk capital there needs to be an incentive to do that. We do that by paying them performance fees that are well above the market normal for a typical hedge fund investment.

Because of that very high performance fee we have been able to attract talent. Ultimately a hedge fund manager or a trader with a high conviction in his ability to take money out of the market will want to go where he gets the highest payout possible. And certainly nobody puts up risk capital to lose it, so that is how we have structured allocations for our main program, and it certainly streamlines and enhances the interview process.

Every time a manager says "I am willing to put up risk capital, whether it is my own or me and my partner", I know we are getting a manager who is confident in his ability and his strategy, and we from our side are willing to pay him a higher percentage of the profits which they would not get anywhere else.

We believe our firm is different from other firms in the sense that we allow managers latitude to run their fund, other managed accounts, and the track record is theirs...we do not have claws in them. I have taken a very different approach because I am convinced that in the end most managers want to put their own name on the door. Ultimately, they wanted to put XYZ capital on the door in Pound Ridge, Greenwich or Norwalk. We provide a very turn-key solution for these types of managers.

A core focus of our business is making it very easy to do business with us. So, my team needs to know everything to do with execution and the logistics of setting up the accounts. Managers who set up with us are able to operate the capital just as they would with their fund, so we are integrated with prime brokers like Deutsche Bank, Goldman, Jefferies, BTIG, etc. and across all the various trading software solutions EMS/OMS, etc.

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In essence, we deal with different buckets of managers. There are the emerging managers that need AUM, so we help them building up their AUM in order to become more institutionally viable. In addition, it is a nice monthly revenue stream as we usually pay out monthly; this helps them to support their staff and their business.

Another group of managers come to us because they want to run a second strategy. As we all know, once the prospectus leaves the building, the manager will have to stick to that strategy and limitations, and in most cases it would take a certain time to roll out a second strategy. Therefore, plenty of managers come to us and open a managed account very quickly because they want to seize a unique opportunity that is present in the market.

A third group of managers are purely looking at it from an economic standpoint saying "I get paid 15%, 20% or 25% of my P&L at this shop, where ever it is, but you guys give me a much higher payout..." But as I explained, the payout also comes with a different dynamic as the manager puts up risk capital for the account. There is a Ying and Yang to our account, it is certainly not fit for everybody, but certainly it is a great way to evaluate talent.

Bryan Borgia

A true managed account - not a commingled vehicle or swap like a managed account platform - requires man hours to set up. In order to get quality managers to run capital for us in managed accounts, we need to bare the brunt of those man hours.... if an investor would come to a manager and ask to run money in a managed account, and if the manager turns around and says, "I trade on Bloomberg AIM, with these 4 away brokers, and I have one trade who likes to use REDI as a backup system" and if the investor then says "well, what are those?", the manager probably is rolling his eyes and saying this is going to be a nightmare to integrate this account into our daily routine. We step in here with a turnkey solution for both the investor and the manager. In that respect, we actually help the investor to get the managers he wants. With us, a manager won't say "I really can't take your managed account as I know this will be just a drag on my time and on our systems", because we would handle all of this.

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Matthias Knab **How many managers do you have on the platform?**

Bryan Borgia 35ish right now.

Matthias Knab **And where are they from? How do you find them or how do they find you?**

Bryan Borgia We have been doing this for ten years, so actually a lot of traders find me. We have 13 different brokerage relationships, we get referrals from cap intro, legal counsels, administrators and brokers we do business with. We have taken a very slow approach and built this business relatively under the radar screen until the CBS Marketwatch article.

So typically somebody tells me, "I know this great manager, he is spinning out of xyz Group. He is launching in with $20 million of his own capital and he has got a $15 million commitment from another institution. He wants to launch with $100 million..." - and I might be the other $65 million to back him.

Matthias Knab **Bryan, as you have been doing this for some time now, can you share with us a typical success story of a manager who came out big after you took him on?**

Bryan Borgia Sure, I will just give you the most recent one as an example of how we progress with a manager. Roughly two years ago we took a PM who had left Third Point, a healthcare long/short manager. In their case, they were not interested in a typical seed deal. A seed deal has a very different dynamic, this manager was not interested in taking on a seeder but still looked for ways to build their track record. We funded them with a $25m managed account to start, and ramped it up over the course of two years.

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We watched, or performed what we call active due diligence…we thought the portfolio manager was smart, obviously we watched how they traded in and out of names. Now, with a manager who performs really well, the smarter move is not to continue to pay them out as much as we do, but to allocate capital to them at the normal payout. We were able to secure additional funds from Freestone's fund of fund for the manager. That was the first allocation the manager received into their fund.

It makes sense --- identify talent, back talent, confirm, and then begin to allocate additional capital to the managers that are good. Other investors will eventually take notice of this manager, or at least they should give them a look.

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It makes sense --- identify talent, back talent, confirm, and then begin to allocate additional capital to the managers that are good. Other investors will eventually take notice of this manager, or at least they should give them a look.

Joe Taussig So let me just double check if I got the full picture, Bryan. Freestone was an investor in your business, but separately they also invested in that manager directly through their fund of funds. With your firm putting the first capital into the manager, Freestone already had interest through you, and then they sort of topped up directly, right?

Bryan Borgia Correct. They had exposure through our managed account program, and got additional exposure with a direct investment into the managers fund.

Joe Taussig Does she run the fund pari-passu?

Bryan Borgia In this case she does, it is not required that a manager runs his fund pari-passu with our account – a lot of managers use our accounts to run side strategies, build track records around new strategies, best ideas strategies, etc.

Joe Taussig How large are your managed accounts, say what is the smallest and what is the largest?

Bryan Borgia The largest is 100 million, and we will do accounts as small as 5. As you are aware, a key component when you offer managed accounts is the ongoing monitoring and risk management. We have a lot of software to insure that -- if you came to me and you would run a stat-arb book with a maximum of 2% position on every name, if you would deviate from that it will be flagged and you will blink in the risk room if something is outside the lines of what is deemed appropriate for the account.

I will spare you war stories, but everybody who has ever allocated to a hedge fund knows that usually he is somewhat blind to how that rate of return was created. The classic would be just shorting volatility, which can create this up 1%, up 1%, up 1%, up 1%, down 40% rate of return.

To a certain extent, a long/short manager, any manager is exposed to the same risks, no? Therefore, until you have full transparency, you will be in the dark not only in respect of the risks but also regarding the source of the returns. If a manager reported you up 2%, you would not know if that was because he was positive on 22 of his 40 names or if one got taken over and the manager just got lucky once or twice. On the other side, through my managed account I am able to discern the difference between a manager who I truly think is taking money out of the market consistently, or whether it was just a good time for that one trade or if he was just long biased in an upwardly moving market.

Now, an interesting question is how long it takes me to be able to evaluate a trader. That also depends on the strategy – for example, if the manager puts on nine value-based investments and he moves his names every seven months, well, how many seven month periods would it take to get an idea about the manager? A manager with higher turnarounds – it does not necessarily have to be ultra high frequency – can be evaluated quicker.

Joe Taussig Have managers also left your shop? What does that process look like?

Bryan Borgia In general, a manager is closed out when their risk capital is gone. We do not rotate in and out of a manager, unless that happens. I like to give my managers a long lifecycle to trade, because nobody makes money every single month or every quarter or every year. In fact, we have had managers that have been under water for years - meaning he still has to work his way from loss to profit – but until he has burned through his total risk capital, he can still trade.

Joe Taussig So just to use some numbers here, if you put a 100 dollars into a manager and the manager puts in $10, those will be his risk capital and if he loses those $10, you close him out, right?

Bryan Borgia Correct, the risk capital is first. Once he burns that through, we close the account. When we take on a manager, we will ask him if over a series in time he will be up 20% before he will be down 10%, based on his track record and the economics of his strategy. If he says no to that question, I will not introduce my structure, in fact my first response would rather be why an investor would ever pay 2 and 20 to be in his fund?

Joe Taussig This is more than interesting. Generally speaking, managed account platforms significantly underperform for most strategies, because the manager cannot execute on his best ideas if he has to worry about redemptions of an immediate nature. Global macro is an exception that comes to mind, but most for most others, underperformance will increase with the lack of natural liquidity (think asset based lending funds or activist investing). Since the manager has the most skin in the game, I can see that your model and your math might work.

Bryan Borgia We look for somebody who believes he has an asymmetric risk/reward profile for which I am willing to pay very handsome sums, but at the same time we want a level or condition in which they participate or put up risk capital for it.

Matthias Knab **You are all having your business here in Connecticut, are you still happy with the region? Has Connecticut's attraction for hedge funds increased or decreased lately?**

Ed Massaro As our current lease expires in New York and we looked around the Connecticut marketplace, we found some very compelling locations. We believe that CT provides the same or better infrastructure and talent that the city provides. We are going to miss New York, but we found a good spot in Greenwich. Another factor is as our staff gets more experienced – which in this case is just a euphemism for getting older – there is a natural tendency to move and start families outside of Manhattan in places like Fairfield and Westchester counties.

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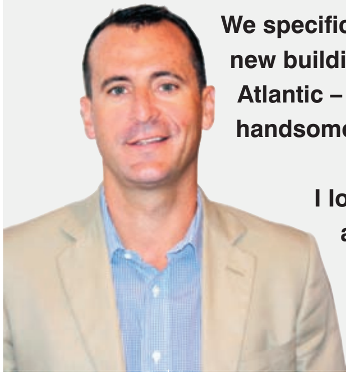
Ed Massaro

Bryan Borgia We have always been in Connecticut, primarily out of selfish reasons because I live here with my wife and three kids and so does my partner Travis. Three of our employees do the reverse commute. One is a bit extreme, he actually drives in from Long Island, the two others are on the opposite direction on the train. For the first three years of the business it was primarily me and my partner, but now we are ten and therefore we do have now a bit more sensitivity to the talent pool. As we know, the job market right now is very much in favor of anybody who can put out an open job posting. In addition, I am in New York probably at least one day a week.

We specifically did not go inland in Connecticut, we are in South Norwalk on the train line in one of the new buildings next to the Maritime Center which houses ourselves, one private equity firm - Virgin Atlantic – an American Airlines division, and Kayak.com. We have a very nice office with a very handsome build out, and I have no problems disclosing we pay $31 a square foot for it.



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I love Connecticut and I always have, and I believe we are close enough to New York. There is a fine line there when it comes to location. Suppose you are set up in Ridgefield, you would be requiring a visitor to take the Metro North and then hop in a car and drive.

Bryan Borgia

I love Connecticut and I always have, and I believe we are close enough to New York. There is a fine line there when it comes to location. Suppose you are set up in Ridgefield, you would be requiring a visitor to take the Metro North and then hop in a car and drive. I am not saying that this will adversely affect your ability to raise assets, but I do think you need to be sensitive to the fact most people come into town saying "I am going to be in the New York/ Connecticut area", and my response is that I'll will meet them in either spot, because it is really only a 50 minute train run.

Virginia Parker

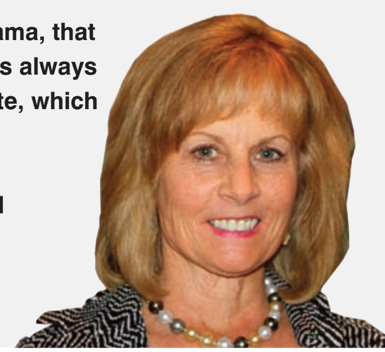
We have been here since the beginning, which is 16 years ago. Before setting up Parker Global Strategies I was working for a firm in Greenwich. When setting up PGS, I found that the rents in Stamford were about one half of those in Greenwich. My view back then was that if UBS is moving here, we can move here too. Stamford has ended up being a great spot with UBS, RBS and so many hedge funds in the area, there is a great talent pool.

Connecticut is a great place to be. It is fairly convenient, because most investors doing due diligence will be going to New York and usually come out this way as well. We are in midtown Stamford, which is about half the price of downtown but only about a six block walk away, so we definitely get value. We have also been fortunate at times when renegotiating our lease, this often seemed to happen when we were exactly at the bottom of the market when the landlord comes in begging...

I am very worried about the taxes here though, and it seems the state believes, like Obama, that the country can be saved only by taxing rich hedge fund managers. Fairfield County was always seen as the affluent part of Connecticut and had therefore to support the rest of the state, which does not tend to have so much industry anymore.

We have had fairly significant budget shortfalls in the state, and for the City of Stamford hearing things like UBS might move away is very scary. So, I do have concerns.

Virginia Parker



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Ed Massaro

When we were thinking about moving to Connecticut, I called the Governor's office and, she, at the time, responded very quickly. There is a team in place that basically helps businesses moving to Connecticut. They will also give certain incentives when firms hire new staff and jobs to Connecticut.

Virginia Parker

But you know the catch, you have to be a C corp, you cannot be an LLC to qualify for those.

Ed Massaro Yes, that is right.

Bryan Borgia I know multiple hedge fund managers that are entertaining now or did entertain the idea of going to the U.S. Virgin Islands, because if you go there and employ ten people, you can lock in some massive incentives.

Joe Taussig Not too long ago, some 100 hedge fund managers had actually moved there, because you could get your personal income tax rate to 3.8%, but over time the U.S. government shifted the goal post a couple of times.

The government set up the regime so that the companies there would grow and employ locals. However, as it was U.S. territory, people with a U.S. passport did not need a work permit. So, the companies started to import people which then started pushing locals out of housing causing even more problems. By the way, Zug in Switzerland is having the same problem now.

Some guys stayed there because they had large, legitimate operations and infrastructure there, for example James River. The rules were then changed so that you were not allowed to do business locally, but you had to spend a 183 days in the USVI physically. That of course is a non starter: you cannot do local business, so that means you need to be on the road to get business but then you are in peril not to be on the island long enough. That is when a lot of people bailed.

Recognizing the problem with that, they changed the rules again. A lot of the guys had their office, homes, wives, kids on the continent and were just nominally on the USVI. The final rule then was that they said you cannot spend more than 90 days physically in the continental United States, nor can you have your true family residence there, and economically you cannot be more connected to some other place, it basically had to be on the island.

Bryan Borgia Coming back to Virginia's point that she starts to get worried about Connecticut taxes. It is true that we have a financial services bias in our state, so we just run the numbers, it is a basic exercise for us. And if for some reason people get incentivized to leave, they will end up leaving, so hopefully that does not happen.

By the way, what is the straight-up tax difference between New York and Connecticut?

Edward Massaro The two major differences I am aware of are the 4% UBT tax you pay in New York, and approximately 2% savings on state income tax if you live and work in CT.

Joe Taussig Let me tell you that this issue also frequently comes up at Opalesque Roundtables from some of the other places like London, Switzerland or Malta, they are quite worth a read. For example, I cited David Butler from Kinetic Partners before who told me close to 100 managers have moved now from London to Switzerland. If you are a U.S. citizen, that will not make a big difference as you are taxed by the U.S. on your worldwide income. But others can actually go to Switzerland and negotiate a tax rate with the Canton in Switzerland. For example, Alan Howard of Brevan Howard physically moved, and a lot of them have done the same.

Now, if you do not want to physically move to Switzerland, you can put your business or parts thereof to Malta. In other words, if you employ married people and both of a couple are professionals, it may be hard to move the second person, and maybe the kids are in certain schools or you live in that grand old house you don't want to give up, so what they are doing is moving the business itself in to Malta. We dealt with this at the Opalesque Malta Roundtables. Right now there may be like 400 or 500 funds domiciled there and at least 100 hedge fund managers.

Malta has a tax treaty signed with the U.S. last year, and really I would be dumbfounded if you U.S. guys won't set up more things and benefit from a corporate income tax of 5%.

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Joe Taussig

Scott Price

We at Custom House have been setting up a lot of Malta domiciled funds for our clients. We're a little more familiar with Malta than most as we have had a long history of working with Malta as a jurisdiction. Several years ago we worked with a large Canadian bank to establish a multi-manager fund domiciled in Malta. From there we have established numerous other funds in Malta and eventually moved Custom House's corporate headquarters to Malta. We expect Malta to increase in importance as a jurisdiction.

Edward Massaro

I am happy to be in Greenwich if you guys are moving to Malta.