



Opalesque Round Table Series '13 AUSTRALIA

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Editor's Note

Australian hedge funds blessed with healthy retail inflows

The Australian hedge fund industry is enjoying renewed interest from international investors and healthy inflows from retail, which in Australia includes high net worth and self-managed superannuations, the fastest growing part of the Australian financial market. Based on a historically strong equity culture, the self-managed superannuation investor takes personally charge managing his pension assets, mainly because he or she is unhappy with the advice they got or the offerings of the institutional super funds.

Superannuation assets set to double in seven years to \$3tn

According to Deloitte, over the last six to 12 months retail investors have expressed more interest in hedge funds than in the previous five years combined. With compulsory superannuation of all employee salaries set to increase from 9% to 12% by 2019, Deloitte forecasts that these uplifts will increase the superannuation industry from \$1.6tn today to over \$3tn already by 2020. There are even calls for further increases as high as 15%. As a consequence, this towering pool of pension assets has also attracted interest from U.K. and U.S. Fund managers looking to establish businesses in Australia.

Australia is a center of excellence for funds management. In the last three to four years, five times more funds were established in Australia than shut down. Overall 23.5% of Australian hedge funds - nearly one in four - had positive returns in 2008. John Corr's fund for instance didn't have a negative month in 2008.

What also helped the industry gather assets is the fact that Australian interest rates have come down. The Australian commercial banks have basically re-capitalized, and rates on term deposits that were 4.5% through to 6% are now yielding only around 2.5% to 4%, and investors have started to look for low risk alternatives, including hedge funds and alternative investments.

The Opalesque 2013 Australia Roundtable was sponsored by Eurex and Australian Fund Monitors and took place May 2nd 2013 with:

1. Robert Graham-Smith, **Portfolio Manager, Perpetual Investments**
2. Chris Gosselin, **CEO, Australian Fund Monitors**
3. Declan O'Callaghan, **Partner, Deloitte**
4. John Corr, **CIO, Aurora Fortitude**
5. Monik Kotecha, **CIO & CEO, Insync Funds Managers**
6. Simon Shields, **Joint MD, Monash Investors**
7. Russel Pillemer, **CEO, Pengana**

The group discussion explored the following themes:

- **Why do Australian managers outperform?**
- **Using retail financial advisors and dealer groups to place hedge funds**
- **The attractiveness and how to approach the Australian high net worth sector**
- **Opportunities:**
 - **Secondary placements and IPOs are picking up in the Australian market**
 - **Listed hybrids and global resources equities**
 - **Event-driven strategies and special situations such as spin-offs, divestitures and corporate reorganizations as well as some activist driven strategies**
 - **Opportunities created by banks retreating from traditional activities**
- **How demographics influence investor behavior**
- **Unorthodox capital sources for Australian start-up managers**
- **Should investors insist on daily liquidity?**

Enjoy the read!

Matthias Knab
knab@opalesque.com

Cover Photo: Sydney Opera House

Participant Profiles



(LEFT TO RIGHT)

Monik Kotecha, Simon Shields, Robert Graham-Smith, Declan O'Callaghan, Matthias Knab
Chris Gosselin, Russel Pillemer, John Corr

Introduction

Russel Pillemer
Pengana Capital

I am Russel Pillemer. I am CEO of Pengana Capital. We run five distinct strategies focused on equities in the Asia-Pacific region with offices in Sydney, Melbourne, and Singapore.

In detail, the strategies we run are Asian special events, Global resources long/short equities, Australian equities absolute return, Australian equities market neutral and Australian small caps. Our total funds under management are in excess of \$1bn.

Simon Shields
Monash Investors

I am Simon Shields, a Principal at Monash Investors. We are an equity investment manager with an absolute focus and have been operating for ten months. We run an equity hedge fund called the Monash Absolute Investment Fund which is long biased. Our aim is to reliably grow investor wealth using the share market as a source of specific opportunities. We mostly invest in Australian equities. The fund has started well, being over 18% after fees since it began.

Chris Gosselin
Australian Fund Monitors

My name is Chris Gosselin from Australian Fund Monitors. We were established in 2006 to provide information and consulting services to offshore investors looking at Australian funds. The business now has an online database (www.fundmonitors.com) and research on over 300 funds that are managed from or available in Australia.

Monik Kotecha
Insync Funds Management

My name is Monik Kotecha. I am from Insync Funds Management. We launched about three and a half years ago in September 2009. I manage the Insync Global Titans Fund which is focused on building a portfolio of 15 to 25 exceptional global companies from around the world. On top of the stock picking, we have added a deep layer of risk management. That means we manage the currency risk and downside risk. Currently, we manage and advise on about a \$150m.

Robert Graham-Smith
Perpetual Investments

I am Rob Graham-Smith and I work as a portfolio manager in the multi-manager team at Perpetual Investments, which is a listed financial services company in Australia. My team runs several diversified alternative funds with allocations to hedge funds, private equity, infrastructure, opportunistic credit, and opportunistic real estate, as well as more conventional diversified portfolios which include allocations to traditional asset classes.

Our investor base predominantly comprises high net worth individuals, endowments and charitable organizations as well as Perpetual staff. Our flexible alternative investment mandates allow us to invest across both a variety of alternative asset classes but also a variety of liquidity spectrums – i.e. the opportunity to invest in more liquid or less liquid opportunities as they arise.

John Corr
Aurora Funds Management Group

John Corr from Aurora Funds Management Group where I manage the Aurora Fortitude Absolutely Return Fund, the Aurora group is a merged group of three funds management groups. The Fortitude Fund has a eight year track record delivering absolute returns from Australian equities. We manage approximately \$95m in this strategy, Half of that is coming from industry super funds and half retail. The group as a whole manages approximately \$500m which is across three major funds and some retail distribution funds.

Declan O'Callaghan
Deloitte

Declan O'Callaghan, audit partner from Deloitte, focused on the funds management industry. I am the national leader of the Deloitte's hedge fund practice and I am a member of Deloitte's global hedge fund executive. I also am a member of the compliance committee of AIMA. Deloitte is one of the world's leading professional services firms in the financial services sector. In Australia, over 400 dedicated industry professionals in our Financial Services Industry Group provide services to all of the major banks, five of the eight largest insurance companies and seven of the top 10 wealth managers. The capabilities available to our clients extend from core Audit to include Actuarial, Taxation, Forensic, Risk, Internal Audit, Regulatory Compliance, Corporate Finance, Human Capital and Consulting amongst others.

Deloitte provides services to a wide spectrum of fund managers from the well established businesses right through to supporting new start-ups. We provide services to approx. 40% of the fund managers in Australia.



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John Corr: One important development and good piece of news is that the industry continues to see retail inflows. In some of our previous discussions we have talked about how in the past retail investors have looked at absolute return differently. They are concerned about different things. Probably in the last 12 months some investors that historically have been early adopters of hedge funds here may have gotten burnt by issues like Basis and Hedge Funds Australia. They are now reconsidering hedge funds, they know they should be doing it, but they have been scared. The fact that we continue to do what we do – running alternative investment strategies - still continues to gain recognition

What also helped the industry build FUM is the fact that Australian interest rates have come down. The Australian commercial banks have basically re-capitalized, and they are dropping the margins on the deposit rates. Term deposits that have been sort of 4.5% through to 6% from a few years back and they are now yielding only around 2.5% to 4%, and investors have started to look for low risk alternatives.

The implied volatility of Australian equities has come down dramatically. Despite headlines in the media trying to beat up a bit of excitement, the market is exhibiting very low volatility for the last few years, actually going back to the volatility levels we saw in 2006 levels and possibly lower at times in the last few months. While that may sound very dull, we find that exciting.

We believe that means there will be more opportunities, so we have lifted our gross exposure.

There have been some event deals and pre-event deals that failed fairly spectacularly in Australia in the last 12 months. Those events have received some international headlines, and I believe as a consequence a number of Asian funds have pulled out of that type of trading in Australia. That means funds like us are seeing some wider margins there.

The other area I want to talk about is a rather dull strategy, that we as professional investors are very excited about, are some of the hybrid issues that are now approaching their maturity. The issues I am referring to are listed hybrids issued by Australian domestic banks with very attractive buyer terms, and retail investors are selling in the short term to fund some new issues that we think are less attractive. So we believe we are in a good spot, we are seeing inflows and we are excited about higher returns.



Simon Shields

As I said we are the startup phase, and our inflows are predominantly from high net worth individuals at this stage. We are now just beginning to speak to family offices and institutions who have shown early interest in us.

Simon Shields: I am very excited about the opportunities in the market at the moment. We are stockpickers, and right now there are a number of specific things happening in different industries and stocks, as well as an increase in corporate activity. For example, secondary placements are picking up in the Australian market, and that is always good for professional investors. IPOs are picking up as well. There have been a couple out of New Zealand recently and here in Australia we have had a few more.



Russel Pillemer: Over the last 12 months, we have also found pretty good inflows into our strategies across the board, not only from Australian retail and high net worth investors, but also from global hedge fund investors. After 2008, there was a real absence of offshore investors interested in investing into Australian hedge funds. However, over the past year, we have seen increased interest from these investors with many of them looking to once again invest in our managers.

Another trend post 2008 was that many investors were only interested in investing it with the mega funds. However, this trend has also appeared to have turned with recognition among investors that many mega-funds are not performing as well as some of the smaller funds, and that capacity is an issue. We have recently experienced a good increase in interest from those investors who for a number of years would not have considered smaller managers.

If you are an international investor looking to invest in Asia, there are two choices; either you can invest into managers who are based in the Asian region, or you can invest in the New York or London-based managers who invest (from afar) into Asia. Whilst a couple of years ago, the initial trend was to invest in big global managers we now see more interest in investing in the local managers.

We have also seen positive inflows from some of the platforms offshore, especially from Europe. We are anticipating substantial growth from these sources.

In terms of our strategies, we are finding particularly strong demand for returns that are uncorrelated with equities such as our Asian special events fund and Australian market neutral fund.

Another strategy that appears to be gaining traction is global resources equities. These companies have been absolutely hammered and are now being valued at the same levels last seen in 2008.

Whilst it is unclear whether this sector has truly bottomed, we are finding that some investors (who are considered to be particularly savvy) have started to invest.



Robert Graham-Smith: Over the last two to three years, the relatively high level of interest rates in Australia was a source of frustration for many investment managers here. The structure of the banking system and scarcity of funding for local banks meant that retail investors could earn returns on bank term deposits 2% or more higher than the official cash rate – a very attractive yield for them, effectively risk free as in some cases as these deposits were also government guaranteed. As recently as 12 months ago, retail investors could earn around 6% in a 12-month term deposit with one of the local banks. As domestic interest rates together with Australian bond yields have come down finally, this should support more inflows into the fund management industry.



John Corr

In my view these government-guaranteed retail term deposits in Australia were the best risk-adjusted asset class globally in the last two years,

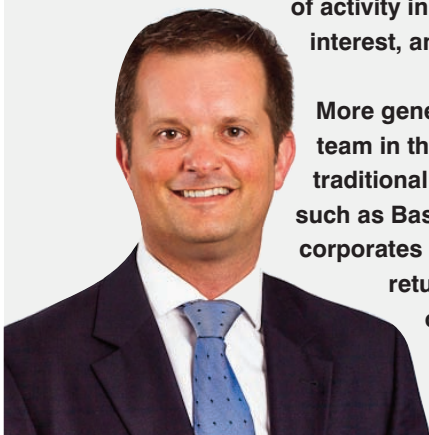
Robert Graham-Smith

The decline in interest rates is generally supportive of retail flows. Certainly our investor base recognizes the benefits of diversification a range of alternative investments including hedge funds offers.

Robert Graham-Smith: We have a fairly constructive outlook regarding event-driven strategies this year; not necessarily just M&A activity which continues to be rather subdued although picking up globally, but I am referring here more to special situations such as spin-offs, divestitures and corporate reorganizations as well as some activist event-driven strategies. A lot of companies globally are very cashed up with strong balance sheets, and they are now being pushed by shareholders to create value or do something with the cash. This could involve paying dividends,

buying back shares, or in some cases acquiring other companies. I think that will result in a pretty fruitful hunting ground for some event driven hedge fund strategies.

In our hedge fund book we have had a fair amount of credit exposure which has done well in the last couple of years, but we have become more wary of credit generally as yields continue to be compressed. Non-agency residential mortgage backed securities in the US have continued to do very well. But we have already started to see a migration of activity in that space into different areas of structured credit, so we are monitoring that with interest, and at some stage we are likely to adapt our exposure accordingly.



More generally, within broader alternatives and particularly private markets, the focus of our team in the last six to 12 months has been the opportunity created by banks retreating from traditional activities in Europe in particular. A lot of this is being driven by regulatory changes such as Basel III where traditional lenders are not providing finance to strong middle market corporates in some cases. We are seeing the opportunity to achieve up to low double digit returns through managers lending money to corporates. Although these are less liquid opportunities, earning a strong contractual return while focusing on strong companies and remaining high up in the capital structure we believe is a very attractive proposition versus more liquid bond markets.

Monik Kotecha: I agree it is clearly noticeable that the larger funds are actually not performing particularly well now, particularly against the benchmarks. We launched just over three years ago and focused on building a track record. In the last six months we have been more actively meeting potential investors, and started to pick up very strong flows domestically. So I agree investors are now more open also to smaller funds.

We are also getting some calls coming from overseas. These are investor groups who are now looking globally for managers who they think will be able to generate good returns. So, rather than saying, “well, we’re based in New York and we’re just looking for New York-based funds, or maybe in Europe”, these groups are recognizing that they, as investors, also operate in a global environment. They know that there might be some very good fund managers in places that historically may not have been considered a natural market, and they are looking for the hidden gems out there also in other places.

The other relevant consideration for those investors is the capacity issue. If you look at the research, it's quite clear that fund managers who have smaller capacity are more likely to outperform for lots of different reasons than the larger managers. Once a fund has reached a certain size, then the focus changes towards the retention of funds, and you lose the cutting edge in a sense.



Declan O’Callaghan: With compulsory superannuation set to increase from 9% to 12% by 2019, we have seen a noticeable increase in interest from U.K. and U.S. Fund managers looking to establish businesses in Australia. This ranges from small distribution offices to fund offshore product through to establishing houses here and issuing local product.



In recent months, we are also seeing some interest in the Super Funds taking parts of asset management back in-house. We have also seen the regulator (ASIC) issue guidance on what disclosures must be given to retail clients investing in hedge funds. Whilst this will increase the regulatory compliance burden on fund managers, it is designed to give those investors increased confidence in investing with Australian managed funds. The other noticeable change I have seen is the increased interest from Deloitte’s private client network on understanding hedge funds and seeking to diversify their investment portfolios.



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Key Statistics	Kardinia	ASX 200 Acc
May-13	0.40	-4.50
Annualised Return	14.35	3.57
Latest 3 Months	3.19	-2.43
Latest 6 Months	9.12	11.52
Latest 12 Months	18.48	26.41
Latest 24 Months (p.a)	8.20	7.26
Latest 36 Months (p.a)	12.28	8.44
Latest 60 Months (p.a)	10.77	1.82
% Positive Months	74.12	58.82
Best Month	8.72	7.98
Worst Month	-4.38	-12.61
Largest Drawdown	-6.02	-47.19
Average +ve Return	2.08	3.38
Average -ve Return	-1.51	-3.88
Annualised Standard Deviation	8.00	14.96
Downside Deviation (Since Inception)	4.02	11.72
Sharpe Ratio (Since Inception)	1.13	0.00
Sortino Ratio	2.18	-0.10

*Statistics for the ASX are adjusted to the fund's start date

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Australian Fund Monitors

Your "eyes and ears" in Australia.

Australian Fund Monitors provides **data, research, analysis, investment opportunities, due diligence** and **consultancy** on the absolute return and hedge fund industry in Australia. With over 280 funds either managed from or domiciled in Australia, we have the most extensive database available, covering strategy, performance and risk analysis.

However, data alone is only part of the story.

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Whether you're familiar with Australia, already on the ground here, or a newcomer looking for opportunities, Australian Fund Monitors are ready to help.

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John, you mentioned before how retail investors are changing their investments because interest rates are coming down. How do the other investors in Australia, the institutions, superannuations and the self-directed superannuations, family offices and high net-worth handle the situation? What are they changing in their portfolios?

John Corr: Self-managed superannuation is a big area in Australia and it is generally considered retail. It is a big growth area. Pre 2008 a lot of these investors thought they can do everything themselves, but then they learnt that there are some risks that hadn't taken into account, but that being said there is a strong mistrust of fund managers and strong desire to own shares directly.

But in the superannuation fund area, the industry super funds and the large super funds, I think there's still a capacity problem that these firms want to invest hundreds of millions if not billions of dollars and at the same time not want to be major part of the fund. So that is a problem where again in marketing to that, we really need to pitch to the smaller funds. We have done a little bit of that and found that there is interest. But, as a rule, they are a little bit suspicious still.

We have had discussions with a couple of other institutional investors. They want to get more into the low-beta or no-beta yield plays. They want to deal with lower fees - surprise, surprise! But yes, they are definitely looking at the area, trying to understand it. I must say that the level of sophistication at some of them is relatively low, the systems in place are not set up to deal a lot with derivative products or any sort of corporate issues. So, their risk systems are not what you might think they would be from what we have seen. So, in sum, we need to overcome those issues: the sophistication level, that general suspicion versus hedge funds and alternative investment managers, and the capacity issue.



Simon Shields: I think that's right, particularly for self-managed super funds - a lot of people do want to invest in shares themselves, but they can't really be a hedge fund. Particularly shorting with derivatives, they just can't do it because they don't have access to the markets or instruments, they are not professionals and they can't control properly for risk. So in my view there is certainly a place for hedge funds within self-managed super funds.

Monik Kotecha: In terms of what's driving the retail investor, I think one of the key drivers both here and overseas are demographics, and that factor is sometimes overlooked. A change in a country's demographics changes the investor behavior in terms of what they are looking for in an investment.

Someone in his 20s and 30s tends to be more comfortable with a great amount of risk as they look for capital growth. As they get older, they start looking for income characteristics. If someone had say \$1m in their super fund, as long as they could get 6.5% or 7% in term deposits, it was quite a struggle to get them into any other asset class. The investor would get \$70,000 a year in income with relatively low risk, but now as the term deposit rates have fallen to 4.5% or below, they face a \$30,000 gap on their income needs. So those investors are now striving to see where they can generate that incremental return, and I think that challenge is not just specific to Australia.

The other day I was looking at an offer from Bank of America. If you were a premium customer with Bank of America, and you wanted to invest in a premium deposit



account going out 10 years, you get half a per cent. That's it – you have been a diligent saver, and you're only getting a half a per cent return.

So, coming back to the demographics, as every year goes by, the average age in Australia is getting older, but it's not from 30 to 35, but from 50 to 55 to 60, and that is a really powerful trend with forceful effects on our market. The search for yield is on not just because of the low interest rates, but also because of the powerful secular shift in demographics.

What's interesting is that when you look at the global economy, we do have some confidence in corporate balance sheets around the world because they are the strongest they have been for 30, 40 or even 50 years. A good number of companies are now starting to significantly ramp up the payout ratios and the dividends. Companies that actually do that successfully will actually turn out to be the more rewarding investments over time. This, again, is not just an Australian trend, it's happening and relevant for all developed markets.

Declan O'Callaghan

I agree with Monik here. The investors we are seeing through the Deloitte Private network is in that 50-60 demographic and they are interested in yield but never at the expense of capital preservation. So with yield more difficult to find and with hedge funds proving less volatile than the ASX, then investors are telling us that hedge funds need to form part of their diversified portfolios.

Russel Pillemer: A meaningful amount of our distribution efforts are focused on the Australian retail market where we work with financial advisors and direct high net worth individuals and family offices.

We spend a lot of time with retail financial advisors and dealer groups, and we find them to be a really good source of money and an excellent segment to interact with. The smart financial advisors out there have recognized for a number of years now that they need better solutions for their clients. They need less volatility in their portfolios and they are looking for more sophisticated portfolios that are able to withstand market shocks.

Accessing the Australian institutional/ superannuation end of the market is difficult for hedge fund managers for a number of reasons. This market is almost entirely run by the asset consultants resulting in the need to market to the asset consultants, not the underlying investors.



In general, the asset consultants have not been particularly keen to support the local hedge funds. Several reasons are given for this including small fund sizes, lack of capacity and high fees. The local hedge funds have tried to counter these arguments by pointing to their strong investment returns. However, they have failed to get significant traction.

In addition, there is unfortunately a bit of a tendency amongst Australian institutions to think that if something is made locally, it's actually not good enough for them. That mindset unfortunately does exist, and while not everybody in the industry thinks that way, certainly a meaningful segment of the institutional market does. The Australian hedge fund managers need to work towards getting the superannuation funds to appreciate the opportunities available to them locally so that they become active supporters.

Robert Graham-Smith

The majority of the institutional investment industry in Australia is exceptionally peer relative in the way that it thinks and moves and acts. That may change over time, and I agree with Russel that it's very consultant driven.

Robert Graham-Smith: One thing that has always confounded me about the retail investment market is an almost unhealthy obsession with daily liquidity which is a challenge for certain alternative investment strategies. That means if you will only invest in products that do have daily liquidity, you are potentially precluding a whole lot of really valuable diversifiers from your portfolio.

I understand that people change their minds about investments and that some investors were burned in 2008, but I also believe that investors need to realize that not everything they invest in must have daily liquidity.

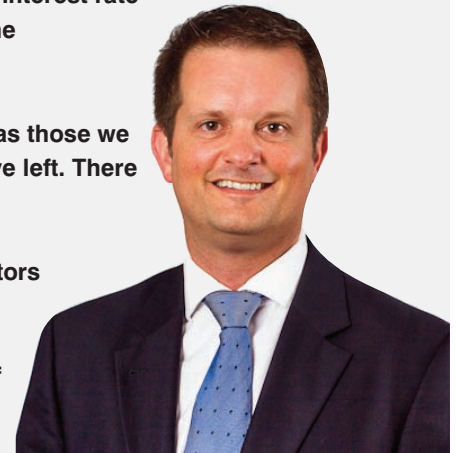
You asked how Australian institutions are reacting to the changing interest rate environment? This is of course a global phenomenon, and in some ways we are lucky in Australia in that we are late to the game, so the hunt for yield is only really just starting to seriously happen here.

If you look in the U.S. in particular but also Europe, it's really tough for any investors to get the 6% or 7% desired return per annum from their portfolios. The yields in fixed interest markets are not there anymore, and while equity markets have been doing well recently and many people have smiles on their faces, those markets are obviously pretty volatile.

I believe there are some big dangers out there moving forward, as essentially zero interest rate policy, which has been in place for over five years in the U.S. now, has caused some fundamental changes on the way that people and markets behave.

As a consequence, I believe people are exploring different sources of return such as those we are pursuing in direct lending where we replace or step into the void the banks have left. There are also still great opportunities in private equity and private markets.

You have a multitude of styles of investments in the hedge fund industry and investors can engage in areas that have the ability to generate decent returns. While most of those strategies are not completely non-correlated, they offer the investor a good chance to get their 6% or 7% return, which I believe is quite attractive particularly if you compare it with the yield on most government bonds.



John Corr: It's probably worth highlighting something like 44% of the ASX 200 are finance companies, and Telstra is probably another, adding another 6% or 7%. So our stock market has a heavy concentration on finance, and this whole low interest rate has led to more money going to the banks,.

In terms of yields on the index, the Australian market looks very attractive, but again, we have mentioned a few times how much retail investors own their own shares. Indirectly they hold more banks and Telstra than the institutions. So they really are overweighting the sector and again they are starting to realize that they are heavily exposed to it and looking for alternatives as interest rates come down.

It is kind of ironic to think that the retail investors are probably ahead of the institutions in that regard that they know or feel the risk, while the institutions for gatekeeper reasons and all sorts of other reasons seem to be somewhat insulated to it. Moms and dads feel that pain and feel the excitement of dividends going up. I also believe that it is important for international investors to notice how large the whole banking and finance sector is in Australia.



Chris Gosselin: Compared to countries in Europe and Asia, Australia has a very high proportion of retail share ownership ratio. That has come through privatization of firms like Telstra, Commonwealth Bank, Qantas and others. That means that retail investors have become accustomed to the volatility associated with equities. I am not sure that this makes it easier to market a managed product to these investors or more difficult. In any event many retail investors think they can manage their own portfolio, and then when a 2008 type market event occurs they realize it's not quite as easy as it seems.



Chris Gosselin

When marketing hedge funds to the industry superannuation funds, size is a key issue as there aren't many local funds that can take single institutional inflows of the \$200 or \$250m allocations which institutions prefer to make.



Chris Gosselin: Russel talked about the high net worth sector and mentioned it is difficult to identify these investors, but this sector probably offers the greatest opportunity for Australia's absolute return sector. What is required from the local industry is to put more focus on educating investors. I believe that high net worth investors have a number of attractions: the total investment size is bigger; the investors are more educated; they are more decisive; less fee focused; and very value focused. They are happy to pay fees if they get good performance while both the retail and the institutional sector are incredibly fee focused.

The average fee structure (not weighted) of Australian hedge funds in our database is a management fee of 1.33%, with a 13% performance fee. However, the media still talks about "two and twenty", while in reality fees are effectively 30% lower than that. So fees really can't be the issue any more, they are not significantly higher than some of the long only type products.

Monik Kotecha: I just came back from the U.K. and one thing I noted with interest is that some of the advisors there have now started to remove the long only funds from their approved funds list for retail investors and included more hedge funds and absolute return funds in the mix. That for me is a logical step as we face increasing volatility and lower returns.

Russel already talked about the need for more education around the Australian hedge fund and alternative investment industry, and in that context the other aspect that needs to get more recognition particularly from overseas is the fact that Australia is definitely a center of excellence for funds management. Julian Robertson also made that point, and Matthias had included his statements in last year's Roundtable. We do have a massive talent pool, and the history of that is actually going back some 20 or 30 years.

I remember when I joined Bankers Trust in the mid-90s, it was considered to be one of the pre-eminent funds management businesses globally, and out of that evolved groups such as Platinum, which is a global hedge fund managed out of Australia and one of the great success stories, and there have been others since then. Australia is a global center of excellence for lots of different reasons, We have good regulations, but foremost the intellectual capital in our industry here is enormous and still unrecognized.



Monik Kotecha

It is ironic, but I think that will change as well, that the domestic superannuation funds tend to go overseas thinking that's where the talent is, Whereas the overseas investors are now slowly starting again to look at Australian based global funds. For me the key thing is coordination in terms of collective education; I am not talking about marketing but real education, and through education you build the trust.

Declan O'Callaghan: As mentioned previously, our private client network is demanding more education on hedge funds. In the last six to 12 months, I have seen more interest than the previous five years combined. They are starting to open the door to alternatives, whereas before they wouldn't have considered them.

So along with that increased appetite, I agree with Chris, now is a good time to focus on educating that high net-worth market around what alternatives and in particular hedge funds can positively contribute to their portfolio construction.





John Corr: The press in Australia have been damning of alternative managers as a whole. In reality, if you look at it, the issue at the root of this is the collapse of Basis Capital. Basis was a problem, but they were also kind of just ahead of the curve. Soon after Basis hedge funds globally and all other professional investors were challenged, particularly the leveraged asset class, because of leverage and beta.

During the crisis of 2008, the Australian alternative managers as a whole did dramatically better than both the domestic long only and the global hedge funds, but the press for some reason thought it wasn't worth a story. I have had interviews with a local influential paper where the reporter told me in the face that sure this would be a positive story, but his editor won't publish it, because they don't want to do positive stories on hedge funds.

Chris Gosselin

That may not be specific for our industry, the media thrives on negative stories.

John Corr: I understand that, but I also have a suspicion that another factor is the concentration of banks in the traditional Australian funds management area. This group is spending lots of advertisement dollars with the press. Nobody one has ever told me that, but that's the only reason I can think why the press won't be more positive or why they will not go out of their way not to publish positive stories about the domestic hedge funds when they deserve it.



Chris Gosselin: I noted that just this weekend we did actually see a positive story in the Australian Financial Review about hedge funds. It is a fact that the performance of Australian funds has been much better, not only then the traditional domestic market, but also funds globally, particularly in 2008.

Overall 23.5% of Australian hedge funds - nearly one in four - had positive returns in 2008. I believe that's the most positive story you can possibly have. John's fund for instance didn't have a negative month in 2008 and I don't think there are many equity long/short funds around the world that achieved 12 positive months in 2008. I think it's an extraordinary performance.

Monik Kotecha: I think we are facing the issue of the gatekeepers again when we look at the funds platforms the advisors use. The question is who ultimately advises the advisor? The RIAs or financial advisors can't actually move until the gatekeepers give the funds a tick of approval. In Australia, the gatekeepers have a very pivotal role in determining who goes into the portfolio and who doesn't.

On the institutional side, the investors are more progressive and they are using alternative funds. The challenge here is to recognize that Australian-based funds are world-class, and they can actually also talk to the fund manager at any time. But still, some rather opt to go with someone they can only speak once every year, but that doesn't make any sense to me at all.



Monik Kotecha

I already mentioned that the retail side can evolve and take a step ahead embracing alternative investments. I used the U.K. example where I was very pleased to see this adoption of alternative strategy really happening. Even my mother's portfolio of investments actually has two absolute return funds. I think this is just extraordinary and the way it should be. If you believe that we are in

a volatile environment and returns are hard to get, then at some point gatekeepers will come under enormous pressure from the very clients that they advise. They will say “hold on here, we are paying you x dollars to give us advice and you keep on generating negative returns for your clients, it's not good enough...”



Monik Kotecha: And yes we had a good six month period, but if the uncertainty continues to persist, then I think the pressure will start to increase. I also believe that the rise in the Self-Managed Super Funds, which are the fastest growing part of the Australian financial market, is directly correlated with that. These investors are unhappy with the advice they are getting. It is not that the advisors are bad, but the advisors have to rely on the gatekeepers to give them a new roadmap and options that are a lot better than the roadmap they had in the past. Obviously if the markets are always rising, then there is no risk, but now things have become a bit more challenging and I believe everyone has to work a bit harder going forward.

Chris Gosselin: Hedge funds are important for risk mitigation and diversification. I agree with Monik, but I would also like to point out that in general the situation is much more positive than it was 12 months ago. The Australian equity market has risen over 20% in the past 12 months and although 50% of this has come from just eight stocks, the sentiment is much better now.

So most importantly, the sentiment is better, and I think that is reflected in the fact that new funds that are starting up like Simon's fund, Monik's and other emerging funds that started out over the last 12-24 months. That's a really positive sign. You don't get that kind of growth unless there are inflows. Even though the inflows to new managers might seem slow initially, the main thing is that the inflows are sufficient, and will increase over time.



Russel Pillema

I was just going to say, Simon, you are a brave man, starting off new in this sort of environment. When we started off in this business in 2002, it was a very, very different world, and it was much easier for small guys to get up and running.

Matthias Knab

I agree, can you share with us who is financing or seeding your fund?

Simon Shields

Let me address two parts of your question. Why now? I believe the opportunities in terms of valuations are there. Even if the world is not doing so well, there are always some businesses that are growing reliably which creates an interesting situation when everything just gets smashed down together in a crisis.



Simon Shields: At the end of 2007 the Australian market had gone up 22% per annum for four years in a row and I was thinking the party has to stop some time, and of course it stopped quicker than we thought it would, and a lot harder.

The opportunity in Australia now is that the market is trading close to where it first got to seven years ago. But now the earnings are higher and the interest rates are lower and inflation is lower, and there are record piles of cash sitting on the sidelines, because everybody is still quite timid. The market should continue to be supported as investors take time to realize that the world is not going to fall apart.

One of the reasons why we are seeing inflows, and why I think they are going to get stronger over the next couple of years is because people looked at the 25%

or 30% recent increase in the market, and now they fear they are missing out. Up until now they have been on the sidelines. They may have lost a bit of money before, but for a while now they have felt protected. They have probably saved a bit of money by not being in, but now the amount of money they saved is evaporating compared to the profits they are missing because the market is going back up.

And even though hedge funds like equity long/short provide lower risk and lower volatility, the perception is that they are more risky and for the more sophisticated investors. Ironically this helps us at a time where people become more confident to invest and take on risk. This is not only happening in retail, but we also see this switch in family offices and institutions. They are looking to come back and engage more in the markets, and they are prepared to move up that sophistication scale and to get their exposure.

Simon Shields

The second aspect of your question was “where is the money coming from”, or where can a start up manager go to raise assets? Of course, as Russel already hinted at, the environment for capital raising for start up managers is pretty tough. Everything has got to come together, and you have got to have a convincing track record. My history is in long only, where I was managing large amounts of money for very big fund managers over a long period of time.

To start a new fund, you need to know where you will get equity capital. Either, you have made that capital yourself over the course of your career; or you have got somebody who wants to back you, or it's a combination of the two, but also then in most cases you will need to find seed money for your fund as well.

The banks are closing or at least reducing their prop trading, and so we will continue to see a lot of those guys setting up their own firms and that for quite some time we would see more funds that start up than close.

I personally was lucky because my ex-employer was prepared to come in and provide seed capital. Other people that I have seen starting up were backed by a family office.

Russel Pillemer

You did well. I am aware of multiple situations where managers have left their employers to set up a new long/short strategy and have approached their old clients to invest, only to be told “we would like to invest but unfortunately, our consultants won't sign off on it”.

Simon Shields

You are right; many long only clients will not invest with a start up. They want to see a track record and so they will favor more established hedge funds over a startup hedge fund.

Declan O’Callaghan: Based on our client base in hedge funds, it is interesting to note that over the last three to four years, the number of new funds we have supported through the establishment phase is a multiple of five times the number of funds which has closed its doors in that same period, so there are definitely some very good examples of newly established fund managers who have made a success of it. The ones that have been most successful are the ones that have been set up by notable fund managers who have long track records of making consistently good returns for the major superannuation funds.



Chris Gosselin: I think there are number of capital sources for Australian start-up managers. One is family office backing - we have seen a number of funds have been very successful with a family office backing, and some family offices have backed multiple funds over the years. Then there are high net worth individuals who are probably not really comfortable with investing in mainstream, large long only, index-type managers. Many of these investors may have previously been in the financial services industry, and so understand the benefits and the risks.



Some recent fund start ups were formed with the backing of an institution or an advisory group, so having a readymade distribution through a high net-worth dealer group, who have an existing client base is a great way to launch a fund.

Other new funds have launched with the backing of the traditional “friends & family” network, trying to get maybe \$5m or \$10m to develop a track record. In my view, that is a much harder option. If you can find the backing of two or three high net worth individuals or a family office, then although you give away some upside and maybe some equity there’s a more solid base to start on. We have observed a shift towards new launches with family offices or advisor group backing.

Chris Gosselin

Of course you also have to have the right structure to attract overseas money. You need a Cayman based or similar fund, but the issue around the Australian withholding tax for foreign investors is still to be resolved.

Russel Pillemer

The Australian hedge fund industry should be receiving much greater support from government. At the moment it seems pretty obvious that we are going to have a change in government in a few months. We should start planning an approach to the new government.

John Corr: In my view, also here the problem is that the government tends to take all their advice from the banks. I mean, that’s who is going to influence policy. So even if a particular initiative makes sense, if they see that as even a small burden to their mammoth businesses, they will stop it. The policy influences are coming not from this room, and I am not saying they should be, but influence on policy comes back to an industry group that can influence policy.



Monik Kotecha

We have started exploring the different vehicles that are available to tap the international investor markets like Cayman or maybe the more strict European regimes out of Ireland or Luxembourg.

I think the demand for excellence in fund management is global, and with publications like Opalesque or the global hedge fund databases investors today have the means to identify and monitor fund managers that may be sitting in a place like here, Australia based global fund managers are capable of delivering very attractive risk adjusted and absolute returns. I am quite optimistic that this trend will accelerate which will help the industry to become even more international, with the searches becoming even more global where investors are looking for those unique pockets of alpha.



Robert Graham-Smith: Quite a few Australian hedge fund managers have demonstrated really solid and reliable track records, in some cases for more than a decade. Compared to the global opportunity set I am looking at, some Australian managers are able to present some very compelling numbers. I am interested to get the thoughts from Monik, Simon, and John – the hedge fund managers at this Roundtable – what are the drivers behind this?

Robert Graham-Smith

Obviously you will all say it’s because you are really smart and that’s the reason [laughter], but is it because markets are less efficient here, or something else that helps some Australian long/short equity managers to generate those sort of returns over a long period of time?

Monik Kotecha: One aspect is certainly that we are a center of excellence for funds management here in Australia. I can't say that enough times, but Australia doesn't sell itself hard enough. We have world class fund managers sitting in Sydney and other places in Australia, so anything the government can do to promote this sector will be of real benefit to Australia over the medium to long-term.

Our outperformance has also partly to do with what's called the Omaha effect. Some times you do better if you are further away. I worked in New York in the late 90s and everyday there would be a new company walking through the door and making their case. You would spend the whole day watching this revolving door of ideas and brokers, and it is a real challenge to sit down and actually think about what is happening in the world. Also, once those folks leave your office, they will be talking and presenting to your local peers, so there is a lot of herding and group thinking.



Monik Kotecha

There may be a benefit in being a bit removed from this herd. Also from Australia we also have even access to company management. We just had a conference call on Monday with a top 100 firm from the U.K., and as soon as we finished the call they said "next time you are in London you are more than welcome to come and see the CEO and CFO." Today, you can get any information you want on a company anywhere in the world today, so information isn't a barrier to what we do. But at the heart of the matter is not the information, but the insights that you develop. I believe that distance creates a competitive advantage; it's not a disadvantage. And I think the smart money gets that.

Our country has a very strong capital market structure and over an extended period of time has put a lot of thought, education and resources into the financial sector. You find a good number of Australians either as founders or in key positions at many leading global hedge funds or financial powerhouses. That tells you a lot about our industry.

Declan O'Callaghan

I agree with the comment regarding Australia being a center of excellence – we have high quality fund managers and a developed infrastructure to support significant growth in the industry.

Monik also brought up our geographical location. Given the well documented shift of power from west to east and given our proximity to Asia, what are your thoughts about how we as the Australian hedge fund community take most advantage of that? Whilst I believe the new Significant Investor Visa (SIV) scheme is a positive step by the Government to entice high net worth individuals (and associated capital flows) into Australia, there is further significant work to be done for Australian fund managers to make the most of this situation.

Robert Graham-Smith

If you think about the transfer of private wealth management from the traditional places like Switzerland to places like Singapore, I agree we are facing a huge opportunity, assuming Asia doesn't come off the rails in the interim.

John Corr

If we go back five or seven years ago, about 80% of our assets was offshore money, all Asian fund of funds which were basically joint ventures between American or European groups and Asian managers. Also, pre 2008, travel expenses were irrelevant, they were considered an expense you couldn't do business without. Then we are ignoring the elephant in the room so to speak is the whole tax regime. I mean the excuses or reasons we continue to hear will remain the same but for international investors the whole tax situation has to become much more certain.

Declan O'Callaghan: The Investor Manager Regime (IMR) is designed to provide foreign managed funds and their investors with greater certainty regarding the tax treatment of certain income of the foreign fund. IMR1 and IMR2 have been implemented but in our view needs refinement and IMR3 is currently in consultation stage which needs refinement also. It remains to be seen just how much the Treasury adopts the recommendations we and other industry

bodies have put forward to the Treasury but early signs are encouraging and will if adopted meet its original objective of providing that tax certainty which we have been starved off and has contributed to reduced international capital flows in recent years.



Moving away from IMR, we have already highlighted large superannuation mandates are difficult to access through the asset consultants. It is already a fact that the compulsory savings ratio will go up from 9% to 12%, and there are even calls for further increases as high as 15%. Deloitte forecasts that these uplifts will increase the size of the Superannuation industry from \$1.6tn today to over \$3tn already by 2020.

So, we need to ask ourselves how do we as a community engage with the asset consultants in order to manage a small slice of that significantly increasing pie.

Chris Gosselin: John brought up a really good point that the client base pre 2008 was almost entirely offshore investors but that all flowed out in '08 or '09. However since then it has largely been replaced. One of the healthy aspects is that local managers have had to refocus on the local investor, whereas in 2003, 2004 and 2005 you started a fund with \$50m or a \$100m from an investment bank. The fact is, we've got a much stronger industry as a result of having to survive on local investment.



Chris Gosselin

That's good for the industry, and if it can develop the offshore market and investor that's just going to add extra power to the industry. 2008 showed managers can't rely just on offshore investors, because they are more likely to withdraw their investment for reasons other than performance. We hope there won't be another 2008 for a few years, but the industry is much more robust now than it was.

John Corr

But I think we certainly looked at the numbers like last year, and we realized how much the business has changed. But also back then, not all offshore investors invested with us, we would also hear from them "we would love to invest with you, but the distance is too far." So we go and market also to our local investors, and they agree that in their case, distance isn't a problem. But then, distance may come into our way from the other side: as most domestic institutional investors are already pretty exposed to Australian equities and Australian assets, they may prefer an international manager who on top will give them the opportunity for a yearly trip offshore...

Chris Gosselin

That is correct and you can see the same dynamics with local asset consultants who see one of their strengths as being able to introduce investors to global managers, in New York or Zurich.

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