



Opalesque Round Table Series '13 UK

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Editor's Note

Breaking models and innovation in asset management

Since the financial crisis, investment risks have been completely transformed. Correlations have changed altogether, and many asset managers experience the break down of most of their macro models. Fund managers and investors globally struggle with the interventionist environment. At the same time, some say the world has rarely been more predictable than it is now with the politicians and regulators setting the destination.

Hedge funds respond well to these challenges and do it through innovation. Through their expertise in areas like arbitrage, execution and risk, investor groups from the private wealth and high net worth communities can access benefits and strategies that were previously only available in the institutional space.

Funds of hedge funds have also innovated over the last five years, for example by running much more concentrated portfolios and offering specialized products, whether it be macro, fixed income, emerging managers, emerging market products, or by building a UCITS platform. Some funds of funds have **full in-house trading capabilities** and offer not only heightened transparency but they also actively manage risk at the FoF level through managing the strategy exposures or implementing thematic views. Investors who previously went directly to hedge funds are now starting to realize that they don't have the resource to maintain the monitoring and active management they require. They are starting to look at using fund of fund managers and fund of hedge funds products again. This is also because they want real diversification benefits, which they may not really get by just allocating to large brand name hedge funds.

Investors want a pan-alternatives approach

A new trend within institutional investors is the move towards pan-alternatives portfolios. Those investors are not just talking about hedge funds or about private equity, but want to apply a much broader view and blend both liquid and illiquid types of exposures. Combinations of real assets, private equity and hedge funds are viewed as all part of a continuum for an overall alternatives exposure within portfolios.

The Opalesque 2013 U.K. Roundtable, sponsored by FFastFill, Eurex and Taussig Capital, took place in London on May 14th with:

1. Dr. Ana Cukic Armstrong, **Chief Executive Officer, Armstrong Investment Managers**
2. Andrew McCaffery, **Global Head of Hedge Funds, Aberdeen Asset Management**
3. Hamish Purdue, **President, FFastFill**
4. Joe Taussig, **Founder, Taussig Capital**
5. Nicolai Borchers Hansen, **Partner, Fund Manager, Aros Capital Partners**
6. Martin Armitage-Smith, **Portfolio Manager, Visible Earth**
7. Pierre Crama, **Principal, Signet Capital Management**
8. Renaud Huck, **Head of UK Institutional Investor Relations, Eurex**
9. Scott Gibb, **Partner & Fund Manager, Cube Capital**

The group also discussed:

- **Opportunities:** U.S. financials, Asia, Africa, global macro and emerging market debt. Are Basel III and Solvency II among the greatest opportunities of our lifetime?
- Will the “**futurization**” of the financial markets result in more safety and activity? How to deal the big elephant in the room called EMIR?
- How much can you rely on standard **risk management** solutions provided by firms like Albourne with OPERA or RiskMetrics? What other approaches are available?
- **Multi Strat Re:** A low cost approach for hedge fund managers to tap assets from private equity, mutual funds, retail investors, financial institutions, pension funds, ERISA plans, and endowments. While they wouldn't invest in a hedge fund, many will invest in a reinsurance company, which has its assets managed by a hedge fund manager.
- To what extent have **UCITS** become a new home for most hedge funds?

Enjoy!

Matthias Knab
Knab@opalesque.com

Cover Photo: **The Shard**, also referred to as the Shard of Glass, Shard London Bridge and formerly London Bridge Tower, is a 72-storey skyscraper in London.

Participant Profiles



(LEFT TO RIGHT)

Pierre Crama, Matthias Knab, Martin Armitage-Smith, Andrew McCaffery, Renaud Huck, Joe Taussig, Scott Gibb
Nicolai Borchers Hansen, Dr. Ana Cukic Armstrong, Hamish Purdey

Introduction

Dr. Ana Cukic Armstrong
Armstrong Investment Managers

My name is Dr. Ana Cukic Armstrong, CEO of Armstrong Investment Managers. Originally I am from Belgrade. In '94 I moved to London to do my MBA and PhD at Imperial College in Quantitative Finance. I then joined UBS where I was head of portfolio construction, overseeing around 5bn Euros in assets under management. After UBS I moved to Insight Investment. My company, Armstrong Investment Managers, emerged in 2009. And we are macro investors, and our flagship fund Diversified Dynamic Solution now has full three years of track record.

Scott Gibb
Cube Capital

I am Scott Gibb, from Cube Capital. I am Partner and Portfolio Manager at Cube. I am originally from Zimbabwe, and studied at the University of Cape Town majoring in economics and econometrics. Post graduation I returned to London where I continued to work in the finance industry in various analytical and portfolio management roles. I have 13 years of experience in the industry.

Cube Capital is an alternative asset management business with AuM of \$1.3bn. We have three main functional lines with the oldest and largest (~\$800m) being the fund of fund business, which was inceptioned in 2003. We also have a liquid hedge fund offering and a separate illiquid real estate business focusing on direct ownership and development in specific deals (as opposed to the fund format of the liquid strategies). My focus is on the fund of fund business.

Pierre Crama
Signet Group

My name is Pierre Crama. I am a Principal and Head of Operational Due Diligence at Signet Group. We are a fund of hedge fund specialized in fixed income. Recently, we have decided to extend our investors' offerings with a UCITS platform of long only absolute return mandates. We have also launched a wealth management practice in Geneva. Today I am representing the fund of hedge funds practice. I spent the last 10 years in the fund of hedge funds space in London. Before joining Signet, I was a partner at Fairway Capital Partners UK LLP in charge of due diligence and managers selection. Prior to this, I was responsible for operational due diligence, valuation, currency hedging and cash management at La Fayette. I am a French national, educated in Paris, and I moved to the UK in 1999.

Martin Armitage-Smith
Visible Earth

My name is Martin Armitage-Smith. I am a British national and graduated at Cambridge University. I am a Partner and a Portfolio Manager at Visible Earth. Visible Earth is an Africa-focused business which manages investments in real assets and their related businesses as well as funds which invest in the public markets that are rapidly evolving in line with strong developmental themes in the region. We are initially launching funds which invest in agriculture and African local currency debt markets.

Andrew McCaffery
Aberdeen Asset Management

My name is Andrew McCaffery from Aberdeen Asset Management. I am the Global Head of Hedge Funds in the Aberdeen Solutions Division.

Aberdeen Asset Management is a \$320bn asset manager, and the Solutions Division manages around \$40bn. I am here in my role representing the fund of funds business. We invest into hedge funds, private equity, and across a range of UCITS, long-only funds and other alternatives as well.

My career has primarily been in investment banking, including proprietary trading, interest rate derivatives sales and management, and always a focus on hedge fund activity and strategies. I have been at Aberdeen for the last two years; prior to that I was a partner at BlueCrest, with most of my career having been in the investment banking trading and sales activities at SBC/UBS.

Renaud Huck
Eurex Group

My name is Renaud Huck. I am Senior Vice President for Eurex Group, which is the largest derivatives exchange and clearing house in Europe.

As the Head of the Buy-Side Department, my role is to engage with the buy-side: hedge funds, asset managers, pension funds, sovereign wealth funds, central banks, and to develop our

relationship with them, whether on the trading or on the clearing side. I am also in charge of promoting exchange listed and OTC cleared initiatives and offerings.

Previously I had a similar role for a competitive North American exchange, and before that I worked for about 15 years as an investment banker and trader in the fixed income and equity derivatives space.

Nicolai Borchers Hansen
Aros Capital Partners

I am Nicolai Hansen. I am one of the Founding Partners and CIO of Aros Capital Partners. I left one of the largest Danish hedge funds, where we managed \$4bn billion, to form Aros Capital in 2009. We now manage \$550m million, so quite a bit of difference from the previous book, but it is growing steadily.

We are managing a number of specialist institutional mandates within the equity and fixed income space, and we also run the macro fund, Aros Paradigm Fund. We are currently in the process of launching two new vehicles; one is a covered bond hedge fund and the other is a fixed income UCITS fund. Recently we also extended our offering into the private wealth space where we aim to bring the benefits of hedge fund strategies to private wealth clients.

Joe Taussig
Taussig Capital

My name is Joe Taussig of Taussig Capital. We create startup banks, reinsurers, and insurers or acquire existing ones. We do this in partnership with asset managers, whereby the asset manager manages all the investable assets. Our banks, reinsurers, and insurers have brought billions of dollars of new assets to our partners that would not otherwise be available.

This model was pioneered by Warren Buffett. Recently, it has been copied by Greenlight, Third Point, SAC, AQR, and Paulson. We have identified at least a dozen reinsurers that have been launched by other well-known managers and we know of at least two dozen other managers who are seriously looking at it.

These reinsurers are virtually certain to outperform the manager's funds. Greenlight trades on NASDAQ at a premium to book, provides liquidity of \$3m a day, and has a tertiary benefit of not causing annual taxes on its earnings and providing capital gains treatment instead of ordinary income treatment in the UK, Canada, Australia, and the U.S. when its shares are sold. Its NASDAQ symbol is GLRE.

Asset manager sponsored reinsurers that have successfully launched had to divert significant internal resources for 18 months to two years and required a high capital target (\$200m or more), substantial compensation guarantees (up to \$25m), and personal investments of \$50m or more in order to attract the reinsurance teams they needed to raise additional capital. All of these greatly increased the execution risk.

Furthermore, the startup costs for these reinsurers have run from \$1m to \$5m and fixed costs of operations can be \$3 to \$10m per year. As such, many, many, many more hedge fund managers have tried and failed than have succeeded, but you never read about the failures in Opalesque.

We have just launched Multi-Strat Re to allow virtually any manager to do this in 90 to 120 days (vs. 18 months to two years) without having to divert internal resources from the existing fund management business, provided that he or she can seed the reinsurer with \$1m or more and generate more than 3% returns net of fees and expenses over any five year rolling period of time.

The startup costs are \$100,000 (rather than \$1 to \$5m), fixed costs are roughly \$100,000 per year (vs \$3 to \$10m), there are no compensation guarantees (instead of up to \$25m), the manager only needs to commit \$1m (instead of \$50m or more), and all other compensation for the Multi-Strat Re ecosystem is performance based tied to generating new investors and "float" (as Buffett calls it), and not having reinsurance that blows up.

It is totally turnkey. We run the reinsurance business, which is a shared resource for each Participating Reinsurer, and each Participating Reinsurer's assets are managed by its Sponsor.

Since each reinsurer is a standalone entity, bad performance by one manager does not affect the other reinsurers.

Instead of having to figure it all out beforehand (with big consequences if the asset manager doesn't), he or she can learn by doing. When the reinsurer is large enough and the asset manager is comfortable enough to go to the next level, the reinsurer can hire full-time staff, raise additional capital in the capital markets (within a year of startup in many cases) via a 144A offering or an IPO, become independent of Multi-Strat Re, and be like Berkshire or Greenlight Re.

We have four managers who have executed agreements with us and we expect to raise between \$200-500m for them in the next year.

Hamish Purdey
FFastFill PLC

My name is Hamish Purdey. I am Australian by background and my undergraduate and postgraduate law degrees in technology study were done in Australia. I currently serve as Chief Executive of FFastFill PLC. We are a software-as-a-service company that provides execution, clearing and settlement services into the listed and increasingly OTC derivatives community.

We are based here in London and have got over 200 staff. As a software-as-a-service player, we have all of the necessary infrastructure hosted. We sell to both the sell-side and the buy-side to which we provide market connectivity.



Eurex Exchange's new trading architecture: More choices, greater performance, Eurex reliability.

Eurex technology sets global industry standards in speed, innovation and reliability.

This year we will introduce a new trading architecture for Eurex Exchange that will revolutionize how market participants access market opportunities.

Designed in partnership with exchange participants, the new trading architecture aims to enhance performance across the board, including reduced latency and increased throughput.

The architecture also features innovations to the all-important “back end” of capital market technology, including:

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- Improved functionality, including enhanced calendar spreads and user-defined strategies.
- High performance messaging architecture for minimum latency, high-speed communications and reliable database systems.

All this means a more dynamic and responsive platform for trading more than 1,700 products from around the globe – including futures and options on benchmark indexes, leading fixed income derivatives and access to one of the world's most attractive markets.

Technology that delivers a world of opportunity.

Discover more from Eurex Exchange.

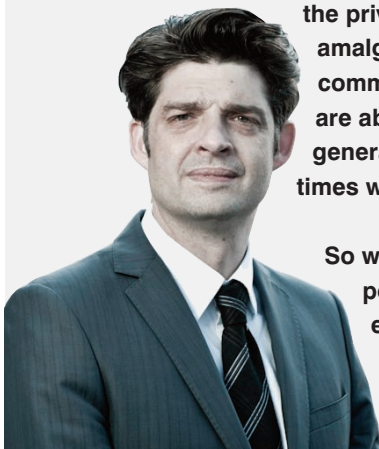
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Matthias Knab

A great definition a fund of funds manager gave at one of our Roundtables in Canada was that the hedge fund industry is actually the domain within finance where innovation happens. Hedge funds are the innovation in asset management. Quite a few of you mentioned you are expanding your services to include more private wealth clients. Please tell us more about the innovations that you are now extending to private wealth clients.

Nicolai Borchers Hansen: I believe that hedge fund managers can bring focus on risk and execution to the benefit of the private wealth community. Private wealth management may once have been an amalgamated service which encompassed multiple elements, however with yields so low, the community is in fact shifting the focus towards absolute returns. As hedge fund managers we are able to bring the shrewdness of trading to the market. For example, we are able to generate return by arbitrage in the market, or merely by having a more efficient execution. At times with record low yields this focus is something you don't really see in the private space.



So what we do is move the high net worth client from a private bank solution, as far as possible, into the institutional space. That is an innovation, certainly from the client experience. When yields are where they are, we believe that you need to extract every single basis point, and that means that you need to play the investment and execution game differently today than a couple of years ago.

Pierre Crama: One way the fund of hedge fund space has innovated over the last five years is by running much more concentrated portfolios. Instead of building a diversified fixed income portfolio, we have reduced the number of underlying positions and allocated with our high conviction managers to meet our cost of capital.

Another way to differentiate ourselves and keep a competitive edge consists of allocating to emerging managers. Investing early, effectively allow us to build long term relationship with our managers, access the founding share class (fees discount) and receive updates from the key decisions makers (PM and COO) during our future onsite monitoring reviews. It also means that we are invested in smaller, more opportune portfolios rather than larger and less focused ones.

Prior to 2008, we were working with managers running both illiquid and credit related strategies. Over the last 18 months, we have decided to move for our European investor base into more liquid credit strategies, because that's where the demand is in continental Europe. Unfortunately, we are missing some part of the liquidity premium that is available in distressed, CLO and private lending, because our historical client base was not welcoming this type of liquidity. Given that we want to make sure our liquidity profile is aligned, we have moved to the more liquid part of the credit spectrum. Conversely, our US client base is very interested in capturing liquidity premia.

After taking feedbacks from our client base over the last two years, we were led to launch a series of high yielding, quite short maturity, low fee, well researched and geographically diversified hedge fund 'lite' bond portfolios on our UCITS platform which can be expected to provide security, transparency, liquidity, yield, low cost and geographic spread. By leveraging on our selection of first class fixed income managers for our fund of hedge fund business, we have therefore appointed four sub advisers located in different time zones to run a long-only high yield absolute return products. We will extend our UCITS offering with other strategies in due course.



For our UCITS products, we charge a flat management fee with no performance fees and we share the economics with the managers. The liquidity is weekly.

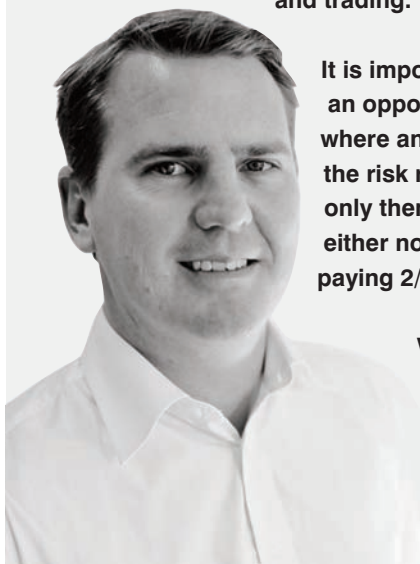
While we are building this UCITS platform, we also believe there is an appetite for a floating rate product. We are consequently in the process of white labeling a leveraged loan portfolio with one of our underlying managers to provide investors with a high yielding, short duration senior secured debt portfolio. The fund may utilize leverage of up to three times and seeks to generate net returns of 12–15% over a full credit cycle.

Scott Gibb: The fund of fund space has seen significant changes since the financial crisis – some of the less value-added methods of managing money have been under severe pressure and are in fact disappearing – most significantly the so-called “concierge” model whereby the fund of funds simply provided access to hedge funds. This model has been disintermediated by investment consultants to a large degree – they do research on large, brand name managers and make recommendations to large allocators as to which one to invest with, charging a small fee for the advice. This is rational as the “concierge” fund of funds typically underperformed given their high and undeserved fees.

Models that have survived and continue to thrive take several forms. The very large FoF have continued to attract assets, offering lower fees for highly diversified, low volatility products and often managed accounts/funds for larger clients. Some FoF are also offering specialized products whether it be macro, fixed income or emerging market products. They typically offer slightly differentiated access to the “concierge” model, and offer value in other forms such as heightened transparency, extensive due diligence and monitoring, complex risk management etc.

On the other end of the scale are the more active managers – those that may be more concentrated, macro/top-down driven. They actively manage risk at the FoF level through managing the strategy exposures, perhaps implementing thematic views. Cube’s FoF product fits into the latter camp. In addition to actively managing risk through strategy and manager selection we have an active overlay function which is used to manage the marginal beta of our FoF portfolio, and for which we have a full in-house trading function.

This overlay is instrumental in how we manage the risk and generate returns for the fund. We have been actively managing the overlay since 2007 and it has added significant value to what we do – however it has been necessary to develop the resources in order for this to be effective. Additionally, since the financial crisis and the regulatory change which has led to the marginalization of proprietary trading desks, we have also developed the ability to take some direct credit and equity exposures. Again this is only possible given the resources we have to do non-fund diligence and trading.



It is important to note that we don’t necessarily “need” to have direct exposures here, this is an opportunistic element to what we do. We focus on dislocated or orphan assets, situations where an event has disrupted the natural investor base. In these situations, where we can see the risk reward as significantly in our favour with a high probability of a positive outcome, only then will we apply resources to participate. We would pursue those situations if we are either not covered by managers in our portfolio to sufficient size or if we think it is not worth paying 2/20 for simply being a liquidity provider.

While the exposures tend to be small for both the overlay and the direct, the benefit is significant in both contribution to performance and the lower fees associated with only a single layer of fees being charged on these exposures and returns. The nature of the contributions to risk and return for each individual position is relatively small with 5-10bps downside but with anywhere between 25-100bps upside contribution should they perform to expectations.

Scott Gibb

Obviously the most important part of what we do, 85%, is still finding hedge fund managers to express our investment views. Because we tend to work with smaller managers we have a very focused and intense investment and operational due diligence process to identify, understand and manage the risks of any fund that we may want to invest in. In this regard we have few conventional constraints such as size and track record. Instead, we take a holistic approach to the risks, identifying, analyzing and, where possible, mitigating or eliminating them. For us there is no cookie-cutter approach to manager selection and due diligence, but rather a process which seeks to highlight the risks so we can actively assess and manage them.

Dr. Ana Cukic Armstrong: In our industry to a certain extent you also see innovation when it comes to fund structures and jurisdictions, and in fact I have a question about this. Over the last few years many European investors have a clear preference for UCITS structures. One of our flagship funds is a qualified investor fund, Dublin registered, but the whole UCITS reference goes to the point that some of the investors are seeding a UCITS mirror version of our Qualified Investor Fund in Switzerland.

A few years ago we were talking whether UCITS is only a passing fad, and now the question is, to what extent has that structure actually become a new home for most hedge funds? Are you fund of hedge funds investors thinking this will continue in that direction?



Andrew McCaffery: When we look at investing into any strategy, we don't really differentiate it in respect to being offshore or onshore. We do look though at the quality of the structures, the payoff between liquidity and the strategy capability, the potential return, and what are we compromising and paying for in that process. I believe that now we are dealing with much more of a continuous spectrum than before when the whole distinction offshore versus onshore framework.

Now, we look at managed accounts, UCITS funds, and offshore funds all in the same portfolio, and how we structure holdings in our portfolios depends on what we are trying to achieve. Obviously, a great deal of this is driven by the individual objectives. The fact appears to be to us that investor demand is consistently evolving, and we are seeing this process move from prescribed objectives to client's defining objectives in more detail, and looking to achieve defined outcomes that they require, therefore the customization profile continues to grow. This can lead to a 'fund of one', or a segregated portfolio for the client, rather than utilising a funds of funds in the traditional sense.

With respect to the UCITS question, the balancing out of regulatory developments, investor demands for liquidity and the differing strategy demands for investors without offshore hedge fund access, it would suggest UCITS will see further growth. As a replacement for offshore? I would not expect that, I would see it as a growing universe that develops in addition to the offshore activity, but we could see pockets of demand, eg. liquid macro or efficient credit biased strategies, that generate strong interest in a UCITS format as investors need this type of onshore, regulated vehicle.

To a degree, this also comes down to the point of active management that has already been raised by Scott and Pierre. At times, you want to take very distinct tactical views, and UCITS is actually a very good vehicle to achieve that in a fund of funds portfolio.

Unfortunately, the underlying managers aren't always very comfortable with that approach, if they see such movements of capital. So that could be a conversation that is good to have upfront, so that the manager understands an idea of how you will work with them. You may not be invested every day of the next five to 10 years, but you will have a relationship with them and be invested at times during



those five to 10 years, depending on what strategy or style of their exposures are, and your ongoing needs and views to be reflected in a portfolio.

This is one part where we see UCITS as a value proposition, and where some of the demand will be driven by such liquidity considerations and tactical opportunities.

A further observation I wanted to share is that the discussion with many institutional investors is moving much more towards pan alternatives needs and portfolios. So they are not just talking about hedge funds or about private equity, but they go into a whole range of things they want to consider in their alternative allocations and how to blend them for their portfolio objectives.

There are two things that really strike me that are happening at the investor level from this; one is the way in which they are becoming much more aware of the opportunities to embed strategies into their overall asset allocation, and the way they can influence the nature of the payoffs in equities or bonds, as much as in their overall portfolio, rather than just from a part of the portfolio being allocated separately into 'alternatives'.

And secondly, you have a greater depth of discussion about what are the different types of strategy opportunities they can access, by tapping into both liquid and illiquid types of underlying exposures.

These are some of the core reasons why we see combinations of real assets, private equity and hedge funds being considered together and viewed as all part of a continuum for an overall alternatives exposure within portfolios.

That may be partly a U.K. or European phenomenon from our experience to date, but it certainly is a developing trend that we see gaining some momentum. The role for us is to be able to seamlessly bring all those different levels of expertise into one portfolio and one reporting profile.

Joe Taussig: Copying Buffett forty some years after the fact may not seem like innovation, but in comparison to delivering an asset manager's unique talents to investors through offshore funds, UCITS or managed accounts, you could well say that moving into the reinsurance business is a major innovation.

Our reinsurance companies are a virtual certainty to outperform the manager's funds. Secondly, they generate permanent capital. Thirdly, they raise a significant amount of assets from sources managers couldn't otherwise access.

New assets come through what Buffett calls "the float", which become full fee assets that the manager gets to manage. New assets also come by way of equity capital from new investors. Third Point Re raised \$390m from private equity funds that would never have invested in a hedge fund, but will invest in a reinsurance company, which has its assets managed by a hedge fund manager.

Mutual funds, retail investors, and certain institutions, pensions, and endowments have investment restrictions relative to hedge funds. In addition, pensions and endowments can lose their tax exemption if they invest in a domestic hedge fund, and ERISA plans cause lots of problems for an offshore fund if it isn't big enough. However, each of these types of investors has bought Greenlight Re's shares on NASDAQ, because it is a publicly traded stock.

Years ago, we actually set up one reinsurer for a pension fund that could not invest less than a \$100m. The hedge fund manager ran \$2bn, but offshore only \$100m. That meant the investor couldn't go into the offshore fund because of the ERISA restrictions that would be placed on the offshore fund. However, the ERISA plan could invest in a reinsurance company even though it was the only investor and



still access the manager.

There is substantial interest in this subject from European managers, because this is the easiest way for them to raise assets in the U.S. Despite the fact that the U.S. accounts for 60% of all assets in the alternative space, most European managers find it too daunting to even try and most manage no U.S. assets at all.

There are literally no regulatory considerations for raising capital for a reinsurer other than those governing Reg 'D', 144A, or Initial Public Offerings of shares. You are simply selling stock in a reinsurance company and since it is offshore, it does not need to have its investment manager regulated in the U.S.

Martin Armitage-Smith: We are providing a conduit to invest into Africa. There is quite a buzz going around for the last couple of years about the fact that African demographics are very strong, that 15% of the world's population in Africa generates 3% of the world's GDP. So Africa is really a neglected investment destination, but it's not the easiest place to approach, and as a consequence you need to be innovative.

So one of the things we have created is the Visible Earth African High Yield Index. The fund that I am running is based around this index that includes eight Sub-Saharan African countries that are evaluated according to several different criteria.

When talking about Africa, you also have to talk about liquidity. Yes, Africa is certainly pretty illiquid, but we feel that investors are actually compensated for the illiquidity. Therefore, our first fund has a one year lock up. We feel that this is the gentle route in and that we are not asking investors to take an awful lot of risk with that.

Other people have already experimented through the JP Morgan Emerging Bond index with longer term bonds in Nigeria.

We are very interested in exploring the SME opportunities, which again is very much a neglected area capturing investor interest at the moment, but again, how is it to be done? Visible Earth will probably start to offer some specialized SME finance through its African agribusiness and afterwards a dedicated group will broaden that experience. It's crucial to execute well. We have a lot of connections on the ground and contact with Africa in our business. And we have a lot to talk to investors about in terms of our expertise in executing the strategies which we manage. For us that's the key thing, how do you execute.



Renaud Huck: I would summarize innovation for Eurex Group under four chapters. The first one is on the listed product side. This year and last, we added to our suite of products, both in the fixed income and indices offerings. This will help the trading community greatly in terms of hedging and risk management.

On the OTC side, as you know the big elephant in the room is called EMIR, and the European regulators such as ESMA are quite keen on seeing this regulation going forward in parallel with what is currently taking place in the United States with Dodd-Frank. In response, Eurex Clearing is launching an entire suite of OTC IRS clearing products and services.

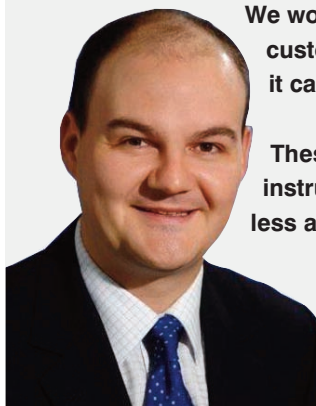
The third element is our innovative trading architecture. As an electronic trading exchange, this is hugely important to us. Hence, we recently launched our New



Trading Architecture (NTA). Designed in partnership with exchange participants, the architecture aims to enhance performance across the board, including reduced latency and increased throughput. It is a new generation of a trading platform.

And the fourth chapter is to enhance our risk methodology. As the largest clearing house in Europe we're moving towards a new regulatory environment. We will have ETD and OTC products under the same roof. So in order to be able to put together ETD and OTC products and to combine the benefit of both trading venues, we've enhanced and reengineered our risk methodology to allow people to have a portfolio view of their risk positions. This will of course mean portfolio margining efficiencies, too.

Hamish Purdey: From our perspective we see the need for innovation around the data flows in the processes of trading, clearing and settlement. We are one of the only vendors in our space I think who really understands that problem and helping the sell-side and buy-side intrinsically to reduce some of the operational risk resulting in executing these trades.



We work very closely with Eurex and with other markets to make sure that the risk that our customers' experience and our customers' customers' experience is actually quantifiable and that it can be judged in real-time. We have done a lot of work in order to be able to do this.

These issues also become increasingly important in the OTC world as well where some of the instruments are less liquid and some of the margining methods are less able to be predicted and less able to be known in advance.

This is where we are focusing our innovative efforts. We sometimes find that a number of our customers don't have a full understanding of how problematic some of their operational processes are, so a lot of our work also involves a consulting and educational component.

Matthias Knab

Hamish brought up a good subject, which is risk management. From your perspective as industry practitioners, how has risk management improved or changed, and what remains still open?

Andrew McCaffery: Appropriate risk management is always a challenge for investors and managers. I won't necessarily touch on aspects around implementations, but when we step back and think about the risk environment and also what markets are pricing, it's still very interesting to try to understand the different risk dimensions you now need to contemplate. We all are dealing with economic risks - I am sure Ana can give a great deal of thought and input around that as well - and then another large aspect is the political risk.

We have to realize that we all living in an interventionist society. Who would have thought that the U.S. and U.K. would intervene more than the Chinese seem to be doing this year? We are living in a world where the political framework has changed enormously. I also believe there is still more risk ahead which is not potentially reflected in the markets. Just consider the low pricing of volatility and the sort of relative complacency this implies in many markets. Is that telling a story that intervention is working and politics can roll on endlessly, and that we are in this muddle-through environment for a lot longer than people envisage, or are we reaching an unsustainable point where a change will be an eruption?



There are also other factors that are really very difficult to identify, like the tariffs around regulation. What are the true consequences of Dodd-Frank? One thing that is sure is that the cost of regulation has increased a lot – in the U.S. it has gone up 10 times from pre 2009 to where we are today. What will be the regulatory changes and implementation requirements here in Europe over the next two or three years? Things like the financial transaction tax - what does that mean for our industry and how we will be transacting in markets? What costs will investors have to bear, and will they pay to maintain strategies as they are today?

Or think about what will happen to corporate taxation? That is the last great coffer governments haven't attacked yet. The rhetoric is building over 'avoidance' and 'global taxation'. Corporate profits as a percentage of GDP are as high as we have never seen in many countries, and they tend to be mean reverting through time, is this time going to be different? That is something we may be quite relaxed about today but is a growing threat.

Other risk dimensions are things like counterparty risk and liquidity. Collateral plays a central role here, and if you look at the Fed's latest report, they talk about a huge gap that is measured in trillions between collateral that is available and the collateral that may be needed in a stress situation.

Andrew McCaffery

Other questions to consider and answer. What happened to Cyprus? What is the real counterparty risk we face as investors in a 're-structuring' sovereign world? Market liquidity; is high frequency trading providing a transitory form of liquidity for equities, rather than something more structurally supportive? I think there are a number of things that are still real risks to investor's future returns, but today I admit I am not sure how we can manage them truly effectively. From a risk management perspective you have to think about these issues, try to identify the real risks, and then think about avoiding what could create permanent loss of capital. This is the key issue and we should always be trying to avoid, minimize, or take some sort of true protection against the risk of this occurring.



Dr. Ana Cukic Armstrong: Political and economic risks have been around for a while and still are significant sources of risks. What investors seem to be assuming though is that no matter what kind of risk is going to hit Cyprus or Italy, or a property bubble in China or any other problem, somehow politicians manage to pull some magic and to stop markets from a big selloff. Somehow, investors seem to remain confident that some kind of solution will be found.

That confidence is clearly in the crisis of equity markets. A lot of politicians went into extensive QE and money printing, and still we ended up in deflationary environments over the last few months. The question is whether eventually we will emerge with some sort of inflationary risk and what will happen with that huge amount of money that is being printed. And secondly, whether the governments that are sitting on those huge amounts of debts actually see the deflation risk as a solution to their problem?

Scott Gibb: We very much agree with what Andrew said. The risks have been completely transformed. Looking at economic risk is fine, but we are now living in an environment where we have compressed every risk model given central banks behaviors, which has led to dramatic falls in volatility, and perhaps too sanguine a view of potential downside risks if policy-errors occur. From our perspective we believe that this necessitates a move from primarily focusing on economic risks to looking more centrally at political risks and decisions as well as the way the people and markets start to adapt and respond to these. A key problem today in many developed markets is that there are no "strong leaders" who have the fortitude to take tough decisions and to guide their people and nations through tough decisions. Currently quite a populist agenda is followed by all as they are governed by their fear of re-election. In many cases strong voting constituencies in aging economies are leading to sub par solutions being enacted. Things probably have to get worse for this to change, but we are seeing some



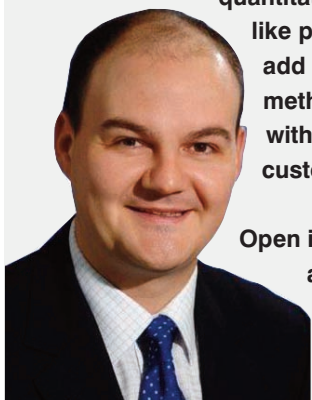
signs of tensions building today.

Central bankers today have made it clear that their strategy has been to boost asset process in an effort to kick-start the economies, trying to ignite the “animal spirits”. So far asset prices have risen, but growth and unemployment remain sluggish and high respectively. The policies have led to greater disparity between the asset rich and those that are not. While there has been some erosion of middle classes net financial position, it has not been pronounced, but if that intensifies it can lead to real political issues. It is not necessarily our base case that these issues will come to pass, but if they do it is likely that they will take time to manifest and materialize. We believe that it is important to be on top of these issues and thinking about some serious repercussions.

Scott Gibb

That is not to say that we are not focused on the everyday risks of our investments, this is key, and we manage these very closely by trying to limit overlapping strategies/asset classes so that when we need to make adjustments we can be precise in doing so. We actively use quantitative risk management tools. However, given our top down approach we put more reliance on our proprietary forward looking risk tool which we use not only to identify outcomes. We also incorporate the information that we gather from our investment managers on how they may behave in various outcomes/scenarios to allow us to map a clear understanding of our “expected beta” going forward (to a variety of risk factors).

Hamish Purdey: Our firm deals a lot with data and we generate many numbers and risk parameters that are part of a quantitative risk management approach. While it is very hard for us to obviously look at sort of things like political risk and that sort of risk, we do believe that the type of the information we provide can add real insights and value for the users, particularly the ability to replicate exchange margin methodology in real time. But interestingly we also find that lot of the numbers we produce - along with a lot of the data made available - isn't being used by our customers or our customers' customers. I am talking here about things like concentration risk and open interest, for example.



Open interest is a key metrics in our industry, but we find that not enough of our customers use that as a key measure of their entire customers' risk. Being long 500 futures in one contract where the total open interest is 10 million contracts, versus being long 500 where the total open interest is 501 contracts is a very, very different model of risk.

Hamish Purdey

So I am taking a bit of the other side here, and point to the fact that there could also be a kind of risk if the users are not actually embracing the data that is available. At FFastFill we try to do our best to make sure such risk data is available to our customers in a user-friendly, real time and easy way through our deep back-end infrastructure.

Martin Armitage-Smith

If you go to universities, you will find that a huge fragmentation towards more and more specialization is taking place, and this has been the trend for the last 20, 30 years. While collectively we know a lot, we don't necessarily join all that together. There is a realization that not only is the world becoming more complex it is highly interconnected. We have all these systems, whether it's finance or other vital systems like healthcare, food production, resources, water and earth, and so on, and in fact, all these systems are under massive stress.

With the world population still growing, this stress will get only worse. In my view we need to step up and acknowledge and find new ways to deal with the complexity and the links that exist between all these systems.

Pierre Crama: Leaving this macro discussion for a moment, as allocators to hedge funds, risk takes different shapes and forms, and some depend foremost on whether we are talking to an emerging manager or an established manager. With established managers we would like to visualize and understand very carefully their risk management frameworks, how risk is perceived at different levels of the organization, whether it is market risk or business risk related.

Andrew mentioned different types of macro risks, but the core issue for emerging managers is how long they can survive below their break-even point given the scarcity of capital post 2008. Assessing the scalability of their infrastructure at an early stage is also important to avoid wasting time and monies.

We also have to look at some of the unintended consequences of the global regulatory actions. It is clear that an over-regulated environment affects a lot of small businesses by setting higher barriers to entry. As a consequence one can wonder if some managers will be relocating somewhere else in light of the new regulatory environment we are moving into.

There has been a lot of talk about firms moving to Switzerland in the recent years, but jurisdictions like Malta have gained interest for managers who are looking for ways to cope with over-compliance and over-tax burden environment. These are the types of factors you also need to assess for different types of managers.

Coming back to the way we are managing risk at Signet, we are looking at risk with a forward looking approach. That means that when we see managers, we want to evaluate on a proactive basis what kind of market exposure we can expect to receive in the next quarter.

We tend to be careful when it comes to the more standard solutions that are provided by firms like Albourne with OPERA or RiskMetrics, but rather aim to be forward looking.



Renaud Huck: As far as the risk theme is concerned, it is fair to say that from a regulator's point of view, the world of tomorrow is going to a more cleared environment than an uncleared one. From a clearing house perspective, our role is risk mitigation - that's our job on a daily basis. So how do we look at the new world to come and how can we bring the right solutions to the marketplace, especially considering the fact that we have to navigate in very curtailed waters and given different regulatory legal frameworks on either side of the pond?

More specifically, if you take collaterals, going forward when the regulators push OTC trades to a clearing house, how do you make sure from a clearing house perspective that the collaterals which are posted are protected, i.e. segregated?



So we have to come up with segregation solutions. But I think that when you look at the big picture, with so many different CCPs, you have different forms of segregations. So what is sometimes commonly called segregation is not really a proper segregation model - i.e. what is inside the tin is not what is written on it. Therefore, I would definitely advise clients to make sure that they have a full understanding of what people claim to be segregation.

In the case of a default, if your "segregation" is purely to receive back a cash equivalent, this is not segregation because you lose one of the core elements of your investments, which are your collaterals. So I think that it is important that proper (and real) solutions are given to the industry. In the Client Asset Protection initiative that Eurex Clearing has launched since November, we fully segregate the collaterals as well as the positions, i.e. nothing is liquidated if a dealer and a clearing member was to default. This is really important to differentiate.

Renaud Huck

In my view these are the kind of solutions going forward that will be important for the industry. However, there is yet to be a figure put on the amount of collateral which is going to be required worldwide. Are there going to be enough collaterals? I think it's a big question that a lot of the buy side would like to have answered, because it's very difficult to know.

Nicolai Borchers Hansen: I think risk right now is extremely fascinating in the sense that most of us who are managing money have experienced most of our macro models breaking down. That means that after building these for 10, 15 years, we need to start from scratch with a different conceptual risk and investment approach.

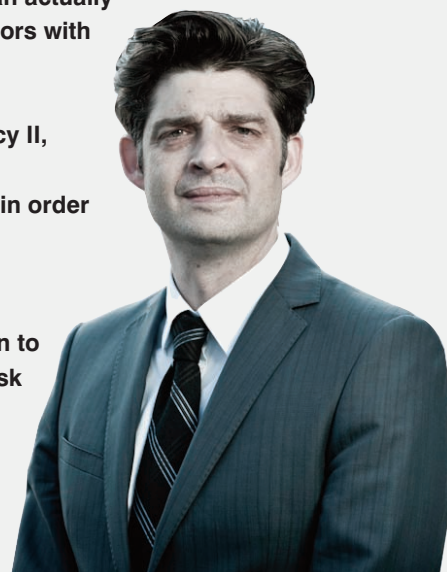
I used to teach risk management at a Danish university a couple of years ago, and I can say most of the theory and model doesn't apply today. Personally, I find it captivating to redefine these things and that is in fact what we must do.

We can also sit here and just whine about all the problems with regulatory risk. We now tend to spend half our conversations with institutional investors on things like if we are AIFMD compliant, and so on.

But at the same time I believe this environment generates a lot of great opportunities. In our view rarely has the world actually been more predictable than it is now. The route being paved means we can actually see the industry is currently heading because it's driven by politicians and regulators with a very explicit destination.

Specifically, a lot of the risk-weighted assets that are affected by Basel III, Solvency II, ALM etc. all create a lot of investment opportunities. For example instruments like subordinated debt, which are not Basel III compliant are being called or tendered in order to comply with the new framework.

Additionally with the strong market we have had in 2012 and so far in 2013 buying insurance is fairly cheap due to volatility being low. That means that in comparison to many other times, now we do have the opportunity to buy some fairly cheap tail risk hedging, while adding risk to these macro/micro themes.



Dr. Ana Cukic Armstrong: This is a very interesting discussion. We have talked about the portfolio risk similar challenge a couple of years ago, and the correlations have completely changed; gold was more correlated to equities, and equity volatility with the silver, and that's changed over the last 18 months. Silver became more investment-driven and so on.

All capital market correlations have changed. Gold was very much driven by the size of the Fed balance sheet until maybe 12 months ago, and that's changed completely. Prices of commodities completely broke correlation with QE and inflationary expectations. So while on one side it is becoming easier for macro funds - as long as macro factors are rightly anticipated into the portfolio construction process - the correlations in the financial industry are somehow broken, and have to be revisited pretty much constantly. So one cannot really just adapt the models to the new macro environment, but we are facing constant challenges as they arise. We as managers need to look and analyze each day the sources of risk in a portfolio context.



Joe Taussig: Nicolai brought up a very interesting point. We look at Basel III and Solvency II as two of the greatest opportunities of our lifetime. That may seem counterintuitive. If you look at market valuations in the insurance business, the S&P insurance index is down 50% while Greenlight Re is up 30% since it went public in 2007.

We believe that the big banks and insurance companies are going to be forced to de-lever en masse, and they will do it rather stupidly. Executive compensation will drive it. They will try to be in as many businesses as they can, regardless of profitability, in order to use the complexity to justify their compensation as long as a line of business is not capital charge heavy.

Meanwhile, they will get rid of things that are capital charge heavy, regardless of profitability. Capital charge heavy is good business if you can deliver investment returns on assets in excess of 3% per year over any five year rolling period of time. Our partners back their conviction that they can beat this bogey with their own money.

Our banks and our insurance companies do not lever very much, so Basel III and Solvency II are non-events for them. By comparison, Swiss Re is levered six times. Generali is levered 40 times. Our typical company in the insurance business is levered one-half to one time, two times max.

Banks like HSBC or Bank of America were levered 60, 80, 100 times before the crisis; our banks lever four to five times, 10 times max. To move into our type of investing, the traditional reinsurers and banks would have to let 80% to 90% of their staff go and that would have a serious effect on executive compensation. Ain't gonna happen.



Joe Taussig

Our partners and we do not worry about capital charges but about profitability and ROEs, since capital charges are largely a function of leverage and we do not lever very much. Even with low levels of leverage, ROEs in our companies tend to be between 15% and 30%, and they achieve it without taking home run (or here in London, what you would call "going for six") types of risks.

Matthias Knab

What other opportunities do you see?

Scott Gibb

In the current environment where Central Banks are doing everything in their power to orchestrate a recovery, there are some distortions and some potentially heightened risks, but we definitely see a lot of attractive opportunities as well. One of the most broad and prevalent themes around which numerous opportunities have arisen since the financial crisis has been that of regulatory change. There has been a proliferation of legislation mandating deep and wide changes to the way regulated entities can do business, from Dodd-Frank and the Volcker Rule to Basel III and Solvency II. This has created opportunities in strategies from structured credit to closed end funds and bank capital, as well as statistical arbitrage and other event driven strategies. There are a variety of reasons for this from restrictions on proprietary trading to capital charges for various securities and many more.

Scott Gibb: One of the ongoing and most interesting opportunities we see today is in the financials space in the U.S. The U.S. is most interesting because the banks have made the most significant progress in cleaning up their balance sheets, getting rid of hybrid capital and getting to equity capital ratios around 8-10%. Whilst healthy, there are pressures from the bottom up, regulatory costs have escalated meaning that many subscale banks will have to close or merge. At the same time banks are suffering in a low loan growth environment, with zero interest rates meaning they can earn almost nothing from their net interest margin. This situation has happened in the past, and it usually leads to a significant increase in consolidation as banks seek to gain scale and profitability.

Since the crisis there has been almost no merger activity in the financials space, mostly for the obvious reasons, however now the banks have largely tidied up and there is a massive need to consolidate the almost 6,500 banks in the US.

Also, we have been doing a lot of investing in Africa for the last two years. Asia has heavily engaged with the continent given its significant resources, and not only have infrastructure development projects helped many of these economies, but the impact of the financing and capital that were provided through less conventional methods have in many ways filtered through the economies helping develop an emerging middle class and consumer base. Add to this that over the past 10 years or more the proportion of what could be classed as democracies – although perhaps weak democracies – has increased from about 40% to 60% to 70%. This has facilitated better corporate governance, with highly educated business, political and central bank leaders expected to continue further improvements, bringing down inflation and improving management of government finances.

The majority of the continent has a very attractive demographic profile, which should support growth. Growth has, indeed, been significant, with many African countries populating the list of the top 50 countries by GDP growth. This makes it a compelling place to invest, with the majority of the potential coming not in the resource sector, but from consumer growth, technology leapfrogging etc. We have recently noted a significant increase in interest in the continent from institutional investors and expect that over the next decade we could see a transformation similar to what we have seen over the last 10 years in Asia.



Martin Armitage-Smith

Martin Armitage-Smith: You may have heard the statistic that for every 10% the broadband coverage increases across the African continent, GDP goes up by 1%. Visible Earth recognizes the critical role of innovation in Africa's economy. We think Africa can side-step the low value-added, assembly-line model in China with its focus on high tech-led industry. The rate of technological absorption in Africa is astounding.

Scott Gibb

That is right. Now, obviously with all the talk of opportunity in Africa one has to mention the risks. It is obvious that today there are liquidity risks especially if you are looking to take advantage of the most pronounced Africa bargains. There can be no question about that which means transparency and sizing are so important. By sizing correctly you should be able to hold on through very tough times to very attractive companies, which grew at 30% despite the crisis in the global economy and sustain (and have done so for a very long time) very high dividends, and where you can hope to add as crisis fades.

Scott Gibb: One final opportunity I wanted to mention will be that of the yield curve and rate normalization which can be expected should the U.S. continue to make progress and start to grow – this will be massive. However it will likely bring with it significant volatility and losses for various strategies, which is very exciting.



Pierre Crama: We also observe a number of opportunities in Asia where we are engaged with a number of managers either playing Macro or emerging market debt. Asian economies are more sound than in Europe. You could even argue Indonesia compared to Spain or Italy is definitely in a better shape. More and more Asian economies will become investment grade, and if you look at the debt to GDP and the competitiveness and the productivity out there, there is definitely a certain return to be made.



As an allocator to hedge funds, we see that the level of dispersion of returns between different managers within the same strategy is extraordinary. So as the markets become less correlated, allocators have to be careful when you select one manager. That is also a reason why we never invest in an index or replicators of a specific strategy, because we feel that managers do have a unique ability to provide returns.

Another theme I like to mention is shadow banking. If you look at the economy in Europe versus U.S., the financing is different. Taking for instance Europe, it used to be that about 50% was financed by the banking sectors and going forward more will be financed by the bond market. With the deleveraging and the disintermediation of the banking sector, the loan market is also expanding, both into U.S. and in Europe, and we see this as a recurrent theme to play out in the foreseeable future.

Renaud Huck: I think that in terms of opportunities, it's fair to say that with incoming regulations, the marketplace is going to be quite different. And I think that there is a theme which has appeared in the past couple of years, and never been mentioned before, which is the "futurization" of the industry.

And I think that with EMIR in Europe and similarly with Dodd-Frank in the United States, second and third tier buy-side and equally sell-side participants will exit the OTC space. I think that it will become too expensive and structurally challenging for them to continue trading in the OTC space.

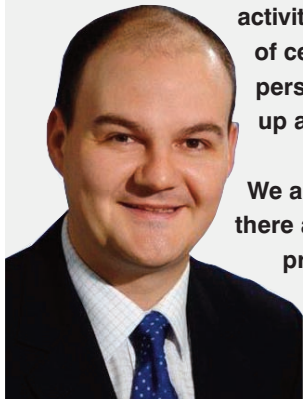
So the opportunity for us as an exchange and a clearing house is to list OTC proxy futures instruments, such as swap futures, inflation futures, to name a couple, and I think this is what will help the industry. I think that those products are the result of I would say the unintended side-effects of the new regulation. The regulators didn't think that by implementing these regulations, the way the marketplace was going to operate will change dramatically, but that's going to be the case.

One of the worries as a buy-side entity is to see the limitation of the strong relationship which exists between the financial service providers, such as prime dealers, the PBs and the banks, due to CRD4 and some of the capital charges they are going to face. There is no doubt that they are going to have to cherry-pick their clients.

This means that with a reduced balance sheet, they are not going to be able to extend the credit lines as they used to. So if you are on the receiving end or on the other end of that situation as a medium-sized buy-side entity, you are facing crucial questions to answer. How are you going to access the same asset class tomorrow, is it going to be through the OTC space but with dramatic limitation and at a significant cost, or is it going to be through a more listed format?



Hamish Purdey: We are very happy with what Renaud is saying – this "futurization" in the end brings more safety and activity into our core market. And certainly we have in some respects backed the right horse in terms of central counterparty clearing instruments and central counterparty cleared markets. So from our perspective we are excited by that and by the fact that with software-as-a-service we have the set-up and the market connectivity ready to go for when the markets expand into these new areas.



We also see Asia as a big opportunity. But Asia is also a difficult place - it's easy to spend money there and more difficult to earn revenue. There is a definite price differential between what people are prepared to pay for the same service in Europe or the U.S. versus Asia. The regulatory changes and consolidations we have seen in the U.S. and in Europe will also expand at some point into Asia, where the landscape is of course still very fractured. That will be another big opportunity going forward.

Nicolai Borchers Hansen: Hedge fund managers can thank the regulators for providing us with greater opportunities by decimating the bank prop trading desks. This means that we are able to navigate and expand into more spaces to fill the void, for example in the credit market. This is more of a telephone market, and you see the spreads widening. While we remain very fundamentally focused, we are actually entering into arbitrage within this market.

The current low interest yields leave institutional investors like pension funds and insurance companies craving for yield. We, as a fundamental driven shop, have the expertise to get involved in some of the more complex structures in the debt market. This may be in emerging markets or in financial issues in the developed market.



Nicolai Borchers Hansen

So if you are fairly nimble and able to read both the political landscape and your history books, there is actually a lot of money to be made also in the future, at least as long as the market is driven by political statements and central banks.

Renaud Huck

Do you think that the situation in emerging market debt is a temporary one or maybe a longer trend?

Nicolai Borchers Hansen

Well, I think if we can assume one thing it's that everything is temporary, so I believe this will also be temporary, but I do believe the opportunity will be there for quite some time. It is interesting because really we don't have much growth anywhere besides Africa. We all know that global markets right now are fueled by liquidity, but it's running to the wrong places. Entities like us hedge funds can get leverage, while small and medium size companies have problems getting it.

Matthias Knab

Who of you is working on new products we haven't mentioned yet?



Nicolai Borchers Hansen: We are working on two new fund launches in the fixed income space. One being a hedge fund and the other an unlevered UCITS fund.

The hedge fund is called **Aros Bond Strategies** and is a fixed income hedge fund seeking to extract Alpha opportunities in primarily European AAA rated covered bond markets. There is a target annual return of 12% and volatility of 9%.

Aros Cash Alternative is a fund investing primarily in the highest quality AAA covered bonds. In our experience, investors will get a better yield than most cash products and deposit arrangements reducing the counterparty risk without the need to tie up for any length of time. Target annual return is 3.5% with volatility at 2.5%.

Martin Armitage-Smith: I mentioned earlier the Visible Earth African High Yield Index we have launched, and there is actually a fund which goes with it. Again, it's not just an Africa story, it's equally about what Africa is not. Africa certainly isn't a low growth zone with massive embedded expectations about what the state can deliver. While you can't really say that Africa is starting off with a clean slate, my point here is that expectations from the governments is rather low, so it's the people and the private sector that will contribute to the strong growth.

So you get a running yield on this fund of about 7.5%, and we embed in it a passive hedge, which is there to mitigate the systemic risk, which is an ever present factor. Let's say every two and a half to three years one has to be prepared for an "event" in the market, so we have that hedge built in to the portfolio. And that passive hedge can also flip to be a dynamic overlay as well. So that's quite a nice product.



We are also preparing an SME product within our private equity division, where the yields will be higher, probably 20-25% for Sub Saharan Africa, that's for later in the year.

Pierre Crama: We saw a convergence between long-only absolute return managers and hedge fund managers, and that is why we have decided to seed some of the managers in the long only high yield space for an absolute return mandate where they can still benefit on the high yield side from the carry. The capital appreciation remains limited, but we still believe selecting securities, even driven type of situations with managers who have been running hedge fund strategy in the past is a right move for us. We want to offer this type of quality managers to our investors.



We have seen a lot of traction since the last six months. We have launched the Asian Income Fund and the U.S. High Yield Income Fund back in December, with two respective underlying managers. We are going to launch the Russian High Yield Income Fund and the European High Yield Income Fund in the next couple of weeks. We are excited about this platform. We still see the issuance in the high yield space remains at an all-time high in Europe and the U.S.

Andrew McCaffery: Ana asked earlier about UCITS funds, and we were also active in this area launching a UCITS fund of funds directed at the wealth management and smaller institutional investor space. This is where we see demand for such funds that come with good liquidity terms.

I had also mentioned the theme of the pan alternatives style mandates. This is something that in a fund structure may still be on the drawing board and it is open how such an approach can be realized in the European environment, but it has very interesting potential.

But certainly in the U.S. we do observe the push to access the retail investor base through 40 Act mutual fund structures, which I believe are gaining a great deal of interest as seed demand is starting to pick up. I don't know if it's going to be the next 130/30 or if it's going to be 'the real thing', but I think there is enough trust and demand at present, that if a manager has the infrastructure to deliver a diverse portfolio and reasonable returns, then they will see more and more demand.



Joe Taussig

As I mentioned before, SkyBridge has such a vehicle and inflows are \$100 to \$200m per month now.

Andrew McCaffery

Well, that tells its own story, doesn't it?

Renaud Huck: In terms of new products, we recently launched new indices by extending our partnership with MSCI - the large index provider. We launched broad indices: MSCI World, MSCI Europe, MSCI Frontier Markets, and also will soon launch some single-country indices across the world. They will give investors access to markets where it is sometimes difficult to access the cash equity market. In this case they will have access to some specific country indices.



In the fixed income space, as I mentioned earlier we offer inflation futures and swap futures. There is a big demand from institutional investors to have access to those products.

And also I think that it is fair to say that though for the time being regulators are less focused on the FX space - they are pretty soft and not too heavy handed. I am not sure that they won't be tempted at some stage to extend their net on this asset class. So this is definitely an area where currency futures are of interest and something that we are having a look at. So watch this space!

Joe Taussig: We have been doing these reinsurers and banks for about 20 years now. We have generally set up or acquired one a year. While we are known for the ones that launched, we have had many, many, many more projects and many, many, many more man months devoted to ones that did not launch than have launched.

I can give you three examples of ones that did not work, because they are no longer in business. Pequot and we spent more than a year trying to buy a bank and they were going to put \$1bn into it. They went out of business in the middle of the deal. Another time, we bought a Swiss bank with Fairfield Greenwich Group three months before Madoff happened.

We had many meetings with Tiger, but they had other priorities and never pulled the trigger. I will bet that we have also had more than one meeting, meaning the manager liked the concept enough to have at least a second meeting, with more than 200 managers that each managed more than \$100m and were economically viable when we met. Unfortunately, permanent capital was never an important enough priority to pursue it, and they, too, are no longer in business.

Had Pequot completed, the Swiss bank had happened a year earlier, or Tiger and the others prioritized permanent capital, I believe that Pequot, Fairfield Greenwich Group, Tiger, and many of the others would still be in business.

Think about it. Pequot and Tiger each held the title of largest hedge fund in the world. Gone. No one in the hedge fund industry is "Too Big to Fail". He who ignores the lessons of history is doomed to repeat them.

We have talked about innovation and new products. On the Multi-Strat Re platform, we can get a fund manager into the reinsurance business in 90 to 120 days, and with just \$2m of capital the investment in the reinsurer should be worth more than a similar investment in the manager's fund in less than a year.

We have also set up the mechanisms to raise a lot more capital for these reinsurers from investors that would not likely invest in the manager's funds. With Multi-Strat Re, a manager is in a much different position than Einhorn, Cohen, or Loeb who had to personally invest between \$75m-\$250m, divert internal resources for 18 months to two years, and be exposed to a lot of execution risk. So far, we have signed up one manager per month, and next year it could be up to two to four per month.



Joe Taussig

Multi-Strat Re will allow most managers to essentially do what Buffett did. Buffett was the hedge fund manager for 13 years, but most people don't know that. He quit cold turkey to go into reinsurance and banking, because they are much more stable platforms and much more likely to deliver better risk-adjusted returns. While we do not advocate the exit from the hedge fund business, no manager should be without this weapon in his or her arsenal.

Hamish Purdey

We are working on a lot of new products at the moment; especially in the allocation space. We see the allocation process as being one that needs improvement, especially where hedge funds are using multiple brokers for their trading, their clearing and their settlement, and then being able to provide solutions, both for the sell-side and for the buy-side to be able to manage some of that message inflow.

We see that being dovetailed back into real-time risk. We see it dovetails back into clearing and settlement processes, but we really do see the processes being partly broken, and especially with our software-as-a-service platform, we have got a lot of the solutions in place.

We spend £2.5m pounds a year on development that goes into our own book. So we do a huge amount of internal development, some of which we don't talk about, because not all of it makes it to market, but most of it does, thankfully. So again, we do a huge amount of new product development, and we support Renaud's view Renaud that a lot will be going on-exchange.

Matthias Knab

For a long time the markets and investors were in this risk on, risk off mode. Has this changed now, are investors coming back?



Joe Taussig: We are trying to bring new investors to alternative and hedge fund managers through structural innovation, and we do see that both old and new investor groups have been becoming more active. For example, Third Point was 50 % funded by three private equity funds. They would no more invest in a hedge fund than fly to the moon, but they invested in a reinsurance company that has its asset managed by a hedge fund manager. Greenlight has mutual funds, retail investors, financial institutions, pension funds, ERISA plans, and endowments as shareholders that would not likely have invested in David's hedge funds.

Joe Taussig

Again, Buffett defined the model. If you read the AQR paper that *'The Economist'* reported on, the key to Buffett is the "float", rather than his stock picking -- he has talked about the value of float openly for 40 odd years, but people are just starting to pick up on it.

Matthias Knab

Is there a lot of retail participation in those public reinsurers run by hedge fund managers?

Joe Taussig

Only when it goes public. Greenlight runs about \$7bn and roughly \$1.2bn is in the reinsurance company. I would say that \$1bn of that is net new money that David wouldn't have had otherwise. When Greenlight Re went public, retail investors bought it because it's a stock and are likely a significant component of its public ownership in terms of numbers of investors.

Andrew McCaffery: One of the key things that we haven't touched on, despite all of us going around the world, is Japan. One of the most interesting items we have seen recently has actually been the events in Japan, and the developing change of risk appetite. Investors, both in the country and with reverberations out from Japan to others, have reacted very quickly and powerfully to the behavior of the new government and BoJ policy expectations, and actual changes made thus far. It may be another 'liquidity rush' and the structural changes prove more uncertain, but the perception has been changing and creating a new found interest to review risk actively.

We are seeing a very distinct increase in interest from that part of the world, which historically has been very slow and deliberate in nature since the global financial crisis hit. It is quite a notable, positive change.

There has been a level of inertia in the institutional space for a while now, but also here people have started to look more actively at ideas and redeploy allocations. We are also seeing a more encouraging trend on the wealth management platforms, where allocations to fund of funds and hedge funds have been weak, but they are starting to finally come back.



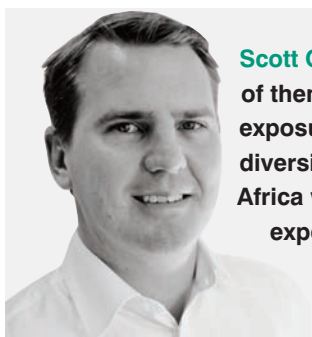
Another development that was really striking to us, which has only happened in the last three to six months, is that some of those investors who went direct to hedge funds are now starting to realize that they don't have the resource to maintain the monitoring and active management they require. They are starting to look at using fund of fund managers and fund of hedge funds products again, and that is an interesting change in both psyche and the asset flows which could prove constructive for the fund of hedge fund business compared to the last four to five years.

Andrew McCaffery

At this time it is still open if the majority of those assets will flow into fund products or into more customized solutions. I think we will see a combination, at one level a process of benchmarking by using a diversified FOHF product is possible once more, but also helping with all aspects of the allocation process for an investor's dedicated portfolio, rather than necessarily all coming back into a fund of fund vehicle.

Scott Gibb

I believe we have reached turnaround in flows into funds. We find Europe is still very slow, although it is starting to heat up. People are actually starting to allocate. I am also not sure if Asia has any interest in fund of funds or hedge funds at the moment. The U.S. however has been a relatively fruitful place for us. People there also invest into fund of funds.



Scott Gibb: I agree with Andrew's observation on the people who went direct into hedge funds. Some of them decided to go with one or two big brand name funds that give them the same sort of exposures they may already have. Now they have actually started to realize that if they want some diversification benefits, they need to go with smaller managers or invest with managers in places like Africa where the other guys won't go. That is where they can turn to groups like us who have the experience and skill to be an active manager giving them exposures that they don't have elsewhere.

Dr. Ana Cukic Armstrong: Traditionally, pension fund consultants have usually worked with a very concentrated number of funds they have been recommending. Since the last six to 12 months they are looking to expand the universe towards smaller and more nimble macro funds.

When it comes to investor behavior, we also saw that many insurance companies, especially in Europe (for example in Ireland), have been sitting on structured products and the cash deposits as certain countries were offering cash flows just to keep money within the country.

Another trend we saw emerging is North American pension funds accessing European managers through Dublin; that is a new trend. They are looking to deploy capital and going to invest in the macro opportunities Nicolai has mentioned. I will just quickly add that apart from credit, there are huge opportunities in commodities markets, because there was a big selloff within copper, gold, zinc. Gold volatility spiked incredibly and allows for some very interesting strategies.

We also see interesting opportunities in the equity markets as well. Global growth is 3.5%, and 80% of that growth is coming from emerging markets. Well-positioned portfolios will profit from that growth.





Pierre Crama: Talking to prime brokers, endowments, foundations, and pension funds are putting together emerging managers programs to get access to alpha at a discounted fees via investing in the founding share class. That's what is going to differentiate the established model with the new generation of managers coming into force.

What also I would like to touch base very quickly on is consolidation. I don't think we are over with the consolidation trend in the fund of hedge fund space. Even ourselves, we are close to announcing a deal in the next coming month, by forming a joint venture with a large U.S. group on the East Coast (1). Forming one group with different alternative solutions (hedge funds, PE, co-investments) is the way forward.

Renaud Huck

What we see from a client and an end client buy-side point of view is the willingness to get a better understanding of the changing regulatory landscape. For a long time the more invisible buy-side clients such as pension funds and institutional investors relied on the service and expertise that their sell-side prime dealers and prime brokers were giving them. Now they themselves are definitely more engaged and aware about the entire situation.

The future will hold significant changes for them and going forward they will have to interact very differently with the marketplace, purely because the rules of engagement are about to change forever, whether you are on the buy-side or the sell-side.

(1) It was later announced that [Morgan Creek Capital Management will acquire Signet Capital Management](#).

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