



Opalesque Roundtable Series '15

INVESTOR ROUNDTABLE

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Editor's Note

How investors transform their alternative investment portfolios in an alpha-challenged environment:

Investors in alternative investment asset classes are diversifying more than ever in today's markets, and are starting to find far more creative opportunities than ever in the past. With bond yields producing very little income and fee pressure on alternative asset managers due to performance concerns and a perceived lack of alpha, managers, investors, and specialized service providers alike are all taking part in a massive transformation in alternative investing.

Nearly 70% of the total hedge fund industry's AUM is managed by a small group of large managers. While this group makes up less than 10% of the total number of funds in the industry, 75% of hedge funds manage less than \$500M in AUM. This is the segment a number of investors focus on to get access to talented, smaller, more nimble firms who can still outperform and deliver alpha.

Wealthy families in particular are looking for diversified alternative income investments as a way to replace bond income, which has traditionally supported their lifestyle. Their problem is that things like yachts, private planes, art, and expensive overall lifestyles have much higher inflation rates of 12 to 15% compared to the lifestyle inflation of 1 to 2% for the average U.S. citizen. For family offices, alternative income investments are a way to replace bond income without taking on the risks of the bond market. But are they going more for the smaller or the larger managers?

Find out more about what investors are looking for in their alternative portfolios, and how managers can adjust to attract more capital.

The Opalesque 2015 Investor Roundtable, sponsored by Arthur Bell CPAs, took place October 2015 in Connecticut with:

1. Carol Pepper, [CEO and Founder, Pepper International](#)
2. Kim Waldman, [Director of Business Development, Arthur Bell CPAs](#)
3. Brian Lasher, [Principal, Portfolio Manager, Federal Street Partners](#)
4. Greg Moroney, [Principal, Operational Due Diligence Analyst, ABS Investment Management](#)
5. Chip Perkins, [Principal, Perkins Fund Marketing](#)
6. Michael Swackhamer, [Principal, Generation Equity Capital](#)
7. Gregory de Spoelberch, [Opalesque \(moderator\)](#)

The group also discussed investor perspectives on:

- The appeal of a Founder's Class and Founder's Fees for early stage investors into hedge funds
- The growing momentum of seed and accelerator capital for smaller AUM managers
- When should a manager give up ownership percentage of their fund to get to the next level?
- Why the millennial generation, female investors, and foundations are driving Impact and ESG Investing. What is "Just" Investing?
- What kind of opportunities do family offices look for in co-investment and direct investing? The psychological components of investing in hedge funds and private equity, particularly for family offices.
- A unique private equity co-investment model for family offices to get deal-exposure
- Details on due diligence and investment process of a fund of funds in selecting top hedge fund managers
- How can managers successfully market their firm and appeal to investors?

Enjoy!

Matthias Knab
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Participant Profiles



(LEFT TO RIGHT)

Gregory de Spoelberch, Brian Lasher, Kim Waldman, Michael Swackhamer, Carol Pepper, Chip Perkins, Greg Moroney.

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Introduction

Kim Waldman
Arthur Bell CPAs

My name is Kim Waldman, and I am with Arthur Bell CPAs. We are a specialist accounting, tax, and advisory firm, focusing exclusively on the alternative investment industry. By serving a wide range of individuals and firms within the alternative investment community, we see, hear, and understand different perspectives of what is going on in the industry from both investors and managers.

As many of you know, our firm started in this industry over 40 years ago, working mostly with Commodity Trading Advisors (CTAs) and Commodity Pool Operators (CPOs). Over the years we've expanded our client base, working extensively with hedge and private equity funds, venture capital groups, real estate funds, broker-dealers, institutional investors, family offices, and high net worth individuals. Our services include tax and audit at the fund level, and more strategic services including tax and advisory, estates and trusts, and consulting at the management company and General Partner level. Our offering is also inclusive of a fully functional concierge Family Office Services team.

Carol Pepper
Pepper International

I am Carol Pepper, the CEO and Founder of Pepper International, an award winning consulting firm and family office based in New York City that I founded in 2001. I was very honored to be named as one of the 50 Most Influential Women in Private Wealth by Private Asset Management in 2015.

I help families all over the globe to set up family offices, most of whom are billionaire-plus net worth families in Asia, Latin America, the United States, Europe, and the Bahamas. I also act as the External Chief Investment Officer to several significant single-family offices, and help them pick all of their investments, including their alternative allocations.

Brian Lasher
Federal Street Partners

My name is Brian Lasher. I am a Principal and Portfolio Manager at Federal Street Partners, which is a small fund of hedge funds based in Stamford, Connecticut. I have been at Federal Street for eight years and investing in hedge funds for over 17 years.

The principals of Federal Street Partners established the firm in 2000 to manage their own assets, and then began taking outside capital in 2002. They have been involved as fiduciaries and managed multi-manager investment programs since 1979. Today Federal Street offers two funds of funds, one of which focuses on global equities and another which is focused on Asia and the Emerging Markets. The types of sub-funds that we favor and invest in are smaller, newer and more entrepreneurial firms, and are usually lift-outs. What is most important for us is to find teams who have proven histories of success.

Greg Moroney
ABS Investment Management

I am Greg Moroney, a Principal and Operational Due Diligence Analyst at ABS Investment Management. ABS is an independent fund of hedge funds manager specializing in the management of equity long/short strategies.

The firm began operations in the fall of 2002 with the goal of becoming one of the highest quality franchises in equity long/short investing by generating excellent risk/reward returns for our clients. The three managing members have worked together since 1994. Today, we manage approximately US\$5 billion of hedge fund assets across 74 managers primarily utilizing equity long/short strategies.

Personally, I have been at ABS since 2006 and work on the operational due diligence team. As part of the investment process, our responsibilities include an off-site review of all legal and financial documentation, background checks, references, and service provider confirmations among others. Additionally, an on-site visit is done to analyze the full operations of the fund along with the middle and back office personnel.

Chip Perkins
Perkins Fund Marketing, LLC

My name is Chip Perkins. I am the Principal of Perkins Fund Marketing, LLC (PFM). PFM is a global placement agent which works exclusively with five to seven hedge funds (of non-competing strategies) at any given time. We occasionally take on private equity assignments, but our primary focus is on finding talented hedge fund managers and helping them strategically raise assets. Over the past 18 years we have raised over \$5.7 billion for our clients.

We are based in Southport, Connecticut, and our 12-person team brings an extraordinary level of experience and maturity to each marketing and sales assignment we take on in the alternative investment arena. We continue to grow our network of funds and fund managers, all the while increasing and deepening our relationships with our investor clients which include family offices, fund of funds, consultants, pensions, and endowments/foundations. This ongoing growth and strength of our investor relationships is a key component to our fundraising success.

We are registered with the Financial Industry Regulatory Authority (FINRA), the Connecticut State Banking Commission, the Municipal Securities Rulemaking Board (MSRB), and the Securities Investor Protection Corporation (SIPC).

Michael Swackhamer
Generation Equity Capital

My name is Michael Swackhamer with Generation Equity Capital, a Boston-based private equity firm. We have a very particular focus in working with privately held companies in the North American small business market, typically investing in businesses with up to \$50M in revenue. To be clear, we are not doing venture stage investing nor do we consider those companies that we partner with "early." Rather, the companies that we find most attractive are businesses that are cash-flow positive, have a strong level of operating history, are potentially innovative leaders in a niche market with some category leadership, and exude some defensibility to their story. So these are "good" companies, and it's our job to discover them in a very proprietary way, and through a partnership focus, build a great business ultimately driving returns for our limited partners. As operationally focused investors, what we also find compelling are those businesses that provide us with an opportunity to leverage the skill-set and experience of our operating partners as we have a very seasoned team in place with a variety of skill-sets across a number of industry verticals. Through our experience, we are careful not to distract a management team but rather to add the right level of strategic support where the business may need it most.

I should also note that we have a strong-preference to be the first institutional capital in a business and so the concept of a partnership for many of the business owners that we are interested in getting to know is new and a bit daunting. It's therefore our job to be patient, educate them on the value of working with GEC, and carefully articulate to them what the process pre-close and post-close will be like. We welcome this process of "getting to know each other" over a longer period of time as it provides the collective opportunity to lay out expectations and align on the forward vision, both near-term and in out-years which is critical based on the active nature through which we are investing. This ultimately creates a strong and cohesive relationship post-close.

70

percent of the world's surface is covered by water.



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Carol Pepper: In terms of alternatives, I have recently been looking at impact investment funds for clients that are interested in Environmental, Social, and Governance (ESG) concerns. There is a lot of traction in that space among family offices. I have also been looking at biotechnology and life sciences projects, and in some Asian-focused funds with very niche strategies.

I have been looking at impact investing because both female and Millennial clients are focused on impact investing. A 2015 study put out by The Morgan Stanley Sustainable Institute found that 84% of Millennials and 76% of women are interested in impact investments, or investments that both make a financial return and have positive impact.

I am looking for niche strategies to generate portfolio alpha. A growing number of investments today are just generating beta, with very little alpha. Asia offers great long term prospects, so I am looking at a Chinese incubator of social impact companies; the ideas coming out of that space are exciting. There are great regional Asian plays that are developing. For example, the governments of China and Korea just recently met to promote more cooperation and entrepreneurial development between the two countries.

In general, I and a lot of family offices that I know have been somewhat turned off by hedge funds over the last few years. I think that basic equity long-short trading strategies and equity market beta can be purchased more cheaply these days through Exchange Traded Funds (ETFs) than they can in hedge funds, and like many family offices we object to the 2% management and 20% incentive fee structure unless those fees are really justified by outsized performance.

When Julian Robertson was running Tiger Management, an investor could justify the 2 and 20 structure because you are earning over 30% a year. If you are earning only 5 or 6% a year with an alternative product, 2 and 20 feels awfully expensive. Even Julian actually only charged 1 and 20, I believe. Family offices and the people that I work with are feeling that most fund products are too expensive for the returns that they are delivering. They are also still feeling residual disappointment and anger from 2008 and 2009 when so many funds blew up and investor portfolios were hit hard.

As a result of this sentiment, family offices are looking more frequently at co-investment situations and direct deals. Those opportunities are more exciting these days than funds, because the feeling is that the fees which managers charge are simply not justified. That may or may not be true. Many investors do not appreciate all of the resources that fund managers bring to the table, but having said that, this is the direction that families are taking these days. As a final note, although they have interest in going direct, many family offices are actually ill-equipped to do the required work to properly manage an individual investment and or company, so this is something they have to address internally before investing.



Kim Waldman: We have also observed the diversification that Carol touched on among investors who are not necessarily looking for a traditional commingled or typical hedge fund investment. That diversification could include direct or co-investment opportunities. It could include peer-to-peer lending, which is gaining momentum, along with a broad range of non-traditional opportunities. Family offices in particular tend to be leading the charge in terms of that diversification and moving away from the traditional investments and structures.



Concerning co-investment opportunities and direct lending deals, we hear different perspectives from our range of clients, along both the management and end investor spectrums. Some investors look to take equity ownership in whatever management vehicle is created. Some are looking for a type of revenue share in the returns. What is it about those types of investment opportunities that is particularly interesting to investors and what are you seeing in terms of deal structuring?

Carol Pepper: One of the biggest challenges for family offices today is the reality that their bonds are no longer producing income. *Yachts, private planes, art, and expensive lifestyles have much higher inflation rates. Lifestyle inflation for these families is more like 12 to 15%, as opposed to lifestyle inflation of 1 to 2% for the average US citizen.* There has accordingly been a continual growth of the expenses that families need to cover, while concurrently their traditional source of bond income to cover those expenses has been going down. While we wait for interest rates to start rising, *one thing that we are looking for from these alternative income investments is a way to replace bond income without taking on the risks of the bond market.*

To give you an example, I looked at a solar fund which produces an 8% federal tax-free return at a fixed rate for the next 10 years called Clean Energy Advisors. I liked it so much, I decided to join the Advisory Board of the fund, which is a first for me. Many investors would find a federal tax free 8% fixed rate return attractive. There is no public market risk, and this type of fund is completely uncorrelated to the markets. Those are the kind of dynamic opportunities that we are looking for, which provide a fixed income replacement.

On the equity side, many families are most comfortable when they are in control. Philosophically, families prefer to have a controlling interest. If they are going to be a minority partner with another family, usually this would only occur with another party that they know well, particularly if it is their first deal. Once they get comfortable, however, sometimes families will take the minority position if they feel strongly that the other party has more industry expertise in the area of the investment.

What we are seeing more frequently these days is that the lead investor tends to be someone with deep industry expertise and knowledge in the particular area of the company under consideration, and that the co-investors either are close friends or people that are willing to trust that party's expertise.



Michael Swackhamer: To address a few of Kim's comments and back to Greg's question, we are seeing some great opportunities right now in the small business segment of the private market. As we know, there is some real overhang in the broader private markets today which is driving up purchase price multiples as a lot of capital is chasing deals. When you couple this with the increased regulatory requirements seen in the market today and the resulting costs to comply, it's getting even harder for firms to continue to drive meaningful alpha. So we continue to find value in the small-cap end of the private market which can at times be uncorrelated to the current state of the debt and equity markets.

Where we are spending time is in a massively inefficient market and one that is relatively underserved – though we are starting to see some lower-middle market intermediaries entering the small-cap space. Within this environment, we aim to stay patient, and opportunistically pay valuations that are commensurate with the quality of underlying company, given the size of the market opportunity and the risks to plan – rather than, for instance, focusing on where public comps are trading, even with a 30% private market illiquidity discount.

To some of the last few points that Carol made, yes, the HNW individuals and family offices that we work with are very interested in going direct. The challenge however is in the execution; as many of these groups admittedly lack the sourcing capabilities and the sophistication around due diligence. Also what I find that tends to go undiscussed is the deal-structuring element. For instance, owning a preferred security, that sits senior in the capital structure with some preference on liquidation and that comes with a participating feature and an accruing dividend, is dramatically different than being a common shareholder in a business – it's an entirely different investment altogether. And it's hard to appreciate the value in the protection of a deeply negotiated security until you need it and have been through the process before.

So we have built our investment effort with a focus on co-investment where folks can come directly into the operating company alongside us – and see what protections we build around our investment, how we put boards in place and add strategic value to our businesses. This naturally has a way of dramatically reducing the expense ratio and potentially provides an investor who is looking to eventually go direct with an opportunity to see how the deal-process works.



Greg de Spoelberch

Chip, to Carol and Michael's point, do you offer co-investment or direct investing opportunities to investors? Who are most of the investors that you work with and that you actively interact with? Are they primarily institutions or does it range across the board to include family offices and ultra-high net worth?

Chip Perkins

We work with investors of all classes. We work with high net worth individuals, family offices, and institutional investors. We hear about direct investing by families more often these days, but we do not bring those kinds of deals to the market. Families do not know how to perform the due diligence, and also we as a broker dealer will not perform the due diligence or take the liability on direct deals because it is not our specialty. We know how to analyze hedge funds and private equity funds, but to take the time and effort to analyze individual opportunities does not make sense for us, so we leave that kind of deal to experts like Michael and Carol.

I will re-emphasize that direct investing is definitely a prominent buzz word right now, and is taking a lot of capital that ordinarily might go into other alternatives.

Greg, what do you think? Are investors trying to invest directly into your world of hedge funds?

Greg Moroney: That theme has become very common. End investors now want to invest directly in hedge funds versus using a fund of funds because of the perceived added layers of fees. I say perceived because we frequently use our size and expertise to negotiate fee breaks with the underlying managers.

Back to Chip's point, investors have to ask themselves, *"What is our expertise in the hedge fund world? is our ongoing due diligence?"* You can always find a manager's track record and decide to place capital with either the manager with the largest AUM or the best track record. But what about monitoring going forward? Not to mention the operational due diligence performed in mitigating non-investment risk.



Greg de Spoelberch

Greg, I know you are an Operational Due Diligence specialist and are not on the marketing side, but can you shed some light as to what went into the decision to promote ABS's strategy as an equity replacement rather than a traditional fund of funds? Can you also talk about your due diligence process in this ongoing monitoring of your global equity long-short managers?

Greg Moroney: We are a traditional fund of funds in the sense of our structure and products, but the thought of equity replacement comes from our investment philosophy. ABS has always focused toward equity long-short strategies because regulated equity markets provide transparency along with easy, independent valuation. You can clearly identify managers from the qualitative side, and then back up your selections on the quantitative and operational side. It makes the investment process much cleaner. Instead of trying to invest directly in equities, let us find the most talented equity investors around the globe.

Regarding our process, due diligence should incorporate independent, bottom up, qualitative, quantitative, and operational analysis. Our first step is to identify the managers we like. The qualitative side goes through their process to find talented managers. Then, we move to the quantitative process, and our risk analysts vet a manager thoroughly to assess that what they are saying is accurate. Finally, the operational due diligence team evaluates that all elements of the business are legitimate from an operational and compliance perspective.



This is obviously a very simplistic description of what we do, but this three-pronged process allows us to give the talent that we find, those gifted portfolio managers, the flexibility to focus only on investing. Just as important though is establishing a systematic monitoring process at each level. The on-going monitoring is as important as the initial due diligence.

Kim Waldman: Greg and Carol both touched on a key theme that is very important. Investors are much more focused on operational due diligence than they used to be. Regulatory issues, compliance, risk mitigation, and cyber-security are all of paramount concern. Investors are no longer merely looking at whether or not you have a Business Continuity Plan (BCP Plan). They want to know if you have a dedicated Chief Compliance Officer and want to see the credentials of the individual and the team.

With all of the due diligence requirements and oversight that Greg and Carol mentioned, the cost of managing money is going up, while investors are simultaneously becoming increasingly apprehensive about fee levels. *Managers are being squeezed from both ends, by operational costs from third parties to meet regulatory and investor demands, and the downward fee pressure from the end investors. Both managers and investors are questioning the layers of fees and whether those fees are justified.* If we are talking about the alternative investment industry, we can't ignore the most critical traditional element of alternative asset management, and that is generating alpha. Alpha comes at a higher cost for both investors and managers in this new regulatory and due diligence environment.

It is up to both the investment consultants as well as the operational due diligence professionals to mitigate risk, and to find the best places for investment. Yet, these consultants are often the entities and individuals who are now bearing personal risk as fiduciaries on behalf of the investors. I am really interested in hearing this group's opinions on where the burden of risk is placed now as a result of the driver of downward fees, upward cost of operation, and the fact that alpha, frankly, just costs more.



Chip Perkins: I have been expecting a lot more fee pressure than I have seen. Most of the managers that we work with have a 1.5% management fee, and a few are at the traditional 2 and 20 levels. Some of our managers have hurdle rates and some don't, but what the investment decision really does come down to is whether or not the strategy fits into the allocator's portfolio, and if the net return that the investor is getting satisfies his or her expectations. I have a quantitative fund which is charging 2 and 25 with their leveraged fund, but they have been returning over 20% net for the last five years, so allocators are happy with their net returns.

No one is averse to paying fees if the strategy is meeting their return expectations. What is interesting is that now for managers with an AUM of little less than a \$100 million, you often have a Founder's Class, where fees would be at a lower level. Managers lower them to whatever is necessary to get the first bite of the apple from an investor. *Fee structures vary a lot,* and we are seeing a lot of creative structuring for smaller managers looking to get early stage capital. Kim's point about the extraordinary operational costs that Congress has added to this industry and the financial industry across the board is absolutely true. It is a challenging environment.



The risk is all on the manager now. They have added a lot of people to their operational structure, including Chief Compliance Officers, Chief Financial Officers, additional accountants, and outsourced third parties to comply with risk control protocols. All of those operational components are common now. As a result, the industry as a whole has gotten much more expensive for the manager, and added significant compliance and potential regulatory risk with the SEC or with FINRA.

The game has certainly changed, and the fees that might have seemed outrageous in 2005 at 2 and 20, now aren't as extraordinary, because the increased costs for funds are so significant.

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Brian Lasher: Notwithstanding costs, fees, and additional regulation, I think it is actually a very exciting time for the alternatives industry as a whole. I say that because investors are going to need the flexibility and the ability to find interesting opportunities like the solar or small cap opportunities that Carol and Michael described. A couple of data points came across my desk lately that really honed me in to focus on this search for new and dynamic alternative opportunities.

Recently, Grantham, Mayo & Van Otterloo (GMO) put out its annual update of its real return forecasts for the next 7 years. Over the years, GMO has been highly respected for their ability to get the general direction of the markets right. Looking across equities, only emerging markets had a positive return. Returns for everything else, including U.S. large caps, U.S. small caps, and international, were negative. Across bonds, it was only Emerging Market debt that performed positively. For Emerging Market equities and bonds, the returns although positive were in the low single digits.

To the extent that hedge funds can help overcome a pretty unexciting outlook for the indices by finding opportunities in less efficient markets outside the U.S. or in certain niches that only alternatives can access, those investor concerns about fees, regulations, and costs will probably go by the wayside and become less important. Investors will need those better returns that alternatives can provide, whether it is an endowment to satisfy a spend rate or a family to satisfy its lifestyle needs.

Recently, I also took note of a presentation slide showing the forecasted 10 year real returns of a typical 60%/40% U.S stock and bond index portfolio from five large investment organizations. Neuberger Berman reportedly projected a return of 3.8%, and Bridgewater projected a 0.9% return for that traditional 60-40 portfolio. The average projection was about 1.7%. If lifestyle inflation truly is 12%, like Carol said, mainstream asset classes are not going to be able to deliver sufficient returns, and investors are going to need to focus more on alternative investments.



Michael Swackhamer: I think that's very well said. The key is, how do we find those high quality investment opportunities as managers? I think you have to think outside of the box a little bit and find your own path – though as you are doing so, stay disciplined and be careful not to style drift. You also see some managers eager to drive that small extra incremental return taking on an incommensurate level of risk to do so. That can be a dangerous game to play. Opportunities could come simply in taking more of an opportunistic and multi-channel approach to sourcing leads – something we have focused on to a great extent as we have built out the proprietary sourcing platform at Generation Equity Capital.



What I also think is uniquely valuable and a concept that I employ at GEC is the concept of partnering smaller businesses together with seasoned operating veterans who are a part of the Generation Equity Capital platform and who have 20+ years of experience in a specific industry or sector that is relevant to the company. There often winds up being a number of areas of relative inefficiency in smaller, less sophisticated businesses that are not obvious to the entrepreneur, but that present areas of great opportunity that we often see either immediately or over time, post-close. So this combination of putting together seasoned industry veterans with smaller businesses can have the potential to drive powerful results. It allows us to expand margins and also widen the spread between entry level multiples and where we will wind up exiting, ultimately creating opportunities for outsized returns.

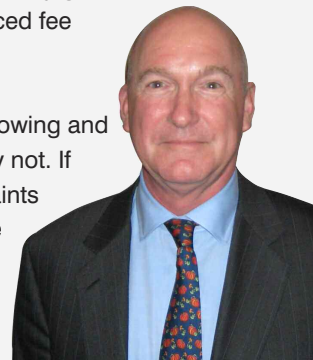
Greg de Spoelberch

Chip, what else are you doing to bridge the gap between your investor and manager clients? What are the investors looking for?

Chip Perkins: We have two sets of clients. We have the managers that pay us to market for them, and we have the investors who provide capital to the managers. When we are working with the manager, we have to figure out what is affordable for them to launch with, because often we work with funds that are \$100 or \$150 million in AUM who are emerging managers. Our rule is that they have to have enough capital and their own resources to run their business for three years, or we will not take them on as clients because it puts business, their investors, and us at risk.

I mentioned a Founder's Class and Founder's Fees earlier. Those are critical these days to incentivize investors and get managers to the \$100 million mark. Whatever the structure or whatever those fees are, they will remain in place for the investor client. If an investor puts \$10 million into the Founder's Class, when the fund surpasses the \$100 million mark in AUM and the investor wants to put another \$30 million in, the investor usually has those same fees locked in. It is a very good deal for the investor, and when they are looking at emerging managers, they are looking at this reduced fee structure as almost a requirement. The fee pressure is much less at 1 and 10, for example.

Although that is prevalent these days, if one of my managers gets to that \$100 million mark and is growing and expanding, I thought I would be receiving more downward fee pressure from investors, and I'm really not. If there is a strategy that fits into their portfolio and the returns are solid, I am not hearing many complaints about fees. If an allocator is writing a \$500 million check, on the other hand, there would definitely be investor objections to full fees. If an investor is writing a \$10 or \$15 million check and likes the manager and the returns that they are getting, we are rarely hearing complaints about fees.



Kim Waldman: I agree with you, Chip. A small to mid-sized family office or sophisticated high-net worth allocator will often have strong relationships and very well-defined investment parameters. This might also apply to some of the small Taft-Hartley plans with sophisticated consultants. Carol mentioned many of these investors are averse to fees, but if there is a compelling need in the portfolio and they like the manager and strategy, I do not think fees are the biggest issue.

When I said I am seeing fee pressure, if we look at the 80-20 rule, we are seeing the vast majority of massive inflows into alternatives coming from the large institutional pension plans, both public and private. These plans are driving the market, and at times they are coming in with \$200 to \$500 million investments that can move the needle in their considerable portfolios. These are material investments, and they will most likely come in with a side letter request. Every significant institutional investor that I have worked with has a side letter in place for specific fee arrangements or has a Most Favored Nation clause (MFN). Most of these larger investors are not even willing to invest in a commingled fund anymore.



Regarding Chip's point about the concept of a Founder's Class and similar early stage investing trends, I am frequently hearing that all types of investors and even managers are establishing entire platforms for the purpose of facilitating more creative early stage investments. I would be curious about what investors are thinking as they continue to diversify and look for the returns that they are no longer getting from the traditional investments.

Chip Perkins: On the hedge fund side, there are a lot of firms that are starting seeding platforms. I am involved with a group that is doing that, and you can get an additional kick in your return because you are taking 25% ownership of the revenue stream from the fund.

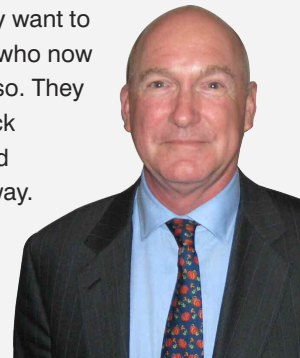
But I think you also have to question the thinking of any manager that takes less than \$100 million to give up 25% of their business, because to me that is a bad decision. However, if you have a \$30 million AUM fund and you can get a \$100 million accelerator investment, then that can really put you in the bigger game. In that scenario for a small manager, it is worth taking that capital and giving up a piece of your business.

That seeder or accelerator model is gaining momentum and becoming more frequent. My view is that the terms of a lot of these deals are onerous. It means that as a manager you will pay out 25% of everything you make forever. As long as you are in this business you are going to pay the investor 25% a year.

A good deal in the case of an accelerator or seeding deal would be a revenue share of 25% or less, a check that would get the manager over the \$100 million mark and a sunset on the payout.

The decision to take that kind of accelerator capital can help the manager reach AUM level where they want to be, but there are certainly long-term consequences that they need to consider. I hear from managers who now have \$600 or \$700 million and want to buy out the early stage investors, but they cannot afford to do so. They have made solid returns for the last seven years for whoever seeded them, and they are basically stuck because they are still paying out that 25% and they cannot expand their business. They cannot reward employees as well as they would like to, or should, because they have given part of their company away.

This is sort of a Catch-22 for emerging managers, because it provides a way to get over the \$100 million mark, but there are long-term consequences.



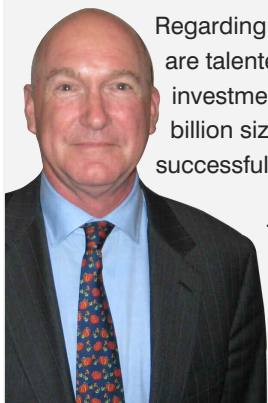
Kim Waldman

You make a strong argument for managers to consider before giving up a percentage of their General Partner (GP). I often see founders, angel investors, or seed investors come in for a certain period of time and receive a revenue share over a hurdle, as opposed to investing directly in the GP. This also happens in the institutional space, where pension plans are not able to invest in a vehicle where they may have an equity interest in the GP.

What else are you seeing as far as investor trends and creativity in structuring arrangements with managers?

Chip Perkins: There is certainly a tremendous amount of creativity going on in the hedge fund business, and we are seeing a myriad of new things happening. Managers and investors are looking at hurdle rates, and they are looking at when the investors should pay the incentive fee. Both sides are considering what expenses are being paid against the management fee, or are alternatively getting turned back into the fund. There is a lot of inventiveness going on and a lot of flexibility to make the investor feel more comfortable, but there are also manager considerations to keep in mind, because they need a certain amount of revenue to keep their team together.

For example, if a manager has a bad year, there are ways to take smaller incentive fees and to crawl it back over time so that they can keep the team together. Greg, Brian, and I put significant time and resources into performing the due diligence and making the decision to invest with or work with a manager. I do not want to run away after six months if there is a little hiccup in performance, because we all have a great deal of time and energy invested in them. We support our managers, and can find creative ways to help them operate because we believe in these individuals and in our investment decisions.



Regarding large institutions that want to inject very large allocations, there are simply not that many managers that are talented enough, if they are at \$500 million AUM for example, to take a couple of \$200 to \$500 million investments. There are not that many managers who are good enough to be successful at the \$2 billion or \$2.5 billion size. There are only so many Paul Jones or Richard Chilton type managers in this universe that have been successful with that kind of money and who can successfully operate at that size.

That is why investors need to look at these newer funds that do not necessarily have the track record, and where investors can get the fee breaks when the funds are starting out. It does put pressure on specialists like some of the experts at this table, but it is vital for investors to get access to these newer and better performing managers.

From a conceptual standpoint, I do not necessarily view individual investors who go in early as seeders.

I think of them as very savvy and strategic investors, because a great many of the smaller managers perform better over the first three or four years of their existence. If those managers never get to too large a size, they can continue to have success and perform well. If managers do the math, they realize that they can make more money with an \$800 million AUM fund that is performing well, and can keep their investors happier than they can with a \$3 billion fund where they cannot perform as well and receive only a 2% management fee every year.

Brian Lasher: About 50% of our investments into hedge funds have been made within the first two years of a fund's life. We have invested today roughly a similar percentage into funds that are at \$500 million AUM or less, so we focus primarily on smaller and emerging managers.

Regarding early-stage investing and the questions of structuring and creativity, we have never seeded. We have been day one investors, and have been investors in Founder's Share classes. We have also negotiated fees and have encouraged managers to redesign their structures before they launched based on their particular investment strategy. In all cases, we have been focused on after-fee returns.

We are very familiar with seeding because we invest early on, but we do not utilize that model because we do not want to be "married" to a manager, and must maintain a certain level of flexibility for our portfolios.

At the end of the day, for fund of funds to survive, investors do not need us to "round up the usual suspects" or provide "the flavor of the day" hedge funds. They need us to find managers who are differentiated and who will outperform.



Carol Pepper: Regarding the theme of smaller managers, from my experience *the more established family offices that are not from financial services backgrounds tend to shy away from smaller funds*. I certainly do avoid investing in them, because we want long-term established track records. We want to see a team that has been together for 10 years or so. If it is a lift-out, we may consider that group because that is different from a new team that is starting out together and unproven.

We also want to see sufficient assets under management, usually at least a billion dollars or more, so that we know that they can pay the bills and keep the team together. We also want to see true alpha. If there is no alpha, then we would rather buy ETFs than buy a hedge fund. Alpha really means that there is a return above the market. Many hedge funds in August and September of 2015 were disappointing performers relative to their claims that they could be absolute return vehicles. They simply have not been able to perform as well as they claim that they can. Therefore, I think that hedge funds have to set return expectations that they can actually deliver.



I will reiterate that family offices with a hedge fund or private equity background that have had financial services success are perfect candidates to be seeding funds or early stage investors. If you are an investor who is not financially sophisticated, then you are better off looking for longer track records. You may give up some of the performance that a smaller fund could return, but a lot of small funds blow up, which is the last thing you want to live through.

Greg de Spoelberch

I would like to transition to Greg here. We talked a little bit about due diligence, but can you give some more insight as far as emerging managers? What are you looking for and what are the red flags?

Greg Moroney: I am going to agree with Brian and Chip. We come with a different outlook and with a different mandate than Carol does, and have the capability to look closely at emerging managers and newly launched funds. Almost 50% of our investments go into funds that are within the first 12 months of their launch. Even with our \$5 billion in AUM, those kind of small and emerging funds are definitely still an area of focus, because we believe that small and new managers are hungrier, more motivated to prove themselves.

Here are some interesting stats: Nearly 70% of the total hedge fund industry AUM is managed by a small group of large managers, which comprise less than 10% of the total number of funds that are in our world. **75% of hedge funds manage less than \$500M in AUM.** Both Brian's firm and ABS specialize in weeding through the entire hedge fund universe, and where appropriate, allocating to those talented, smaller managers.

The industry has really changed a lot in the past 8 years. You are seeing emerging managers launch with full operational support in-house or at the very least with outsourced support depending on their resources. Emerging managers today are far more prepared for the enhanced scrutiny from investors, because the lack of operational support or the proper service providers in place would be red flags.



Greg de Spoelberch

I didn't realize that both of the fund of funds represented here invested early so frequently with managers so close to launch or before their launch. I remember one of ABS's Founders, Alain de Coster, saying that *past performance is gone, it is not as important as finding the firms who will perform this year and in the coming years*. This would be counterintuitive to the point Carol made about needing a long track record.

Greg Moroney

There is a reason "past performance is not indicative of future results" is a disclaimer in every marketing document. I do agree with Carol in that there is definitely an element of safety in looking only at established managers. It is inevitable that some funds will shut down early on.

Greg de Spoelberch

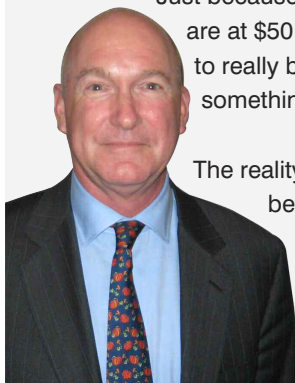
I have read studies done in the industry that indicate that if a firm does not get to a \$100 million AUM in the first year or 18 months, there is an overwhelmingly high likelihood that they will never get there. Do you think that is still accurate? Can a manager survive with less than \$100 million in AUM?

Chip Perkins: I have some managers that are small, and they have performed really well. Sometimes investors like the returns, but they do not like the space, or they like the returns but are not comfortable with the person running the portfolio. *People often overlook the fact that if a manager keeps his firm small and does well, he can still make a good living.*

Just because a firm stays relatively small, it does not mean that they cannot survive. After four or five years, if they are at \$50 or \$60 million, will they get to a billion dollars in AUM? It is highly unlikely, unless they get somebody to really believe in them, and in that case it would probably be through a \$150 million Special Purpose Vehicle or something along those lines which could reignite the growth potential.

The reality is that it is very difficult to get to that high AUM level if you are at less than \$100 million. You have to be very careful in your expense control and really outperform.

I wanted to ask a question of Carol. When you said that you wanted a 10 year track record and over a billion dollars AUM in a hedge fund manager, how many of those funds do you think are out there that meet those requirements?



Carol Pepper: I do not have those specific statistics, but family offices are far more likely to invest in the largest hedge funds, like firms led by a Paul Tudor Jones or a Louis Bacon of the world, because those are more institutional in nature and considered safer. Renaissance Technology, which fluctuates between \$10 and \$30 billion dollars, is another example.

If you are a very sophisticated financial investor and you are comfortable with black boxes and products like that, there is a far greater likelihood that those kind of families are comfortable in the hedge fund space and in looking to smaller, emerging managers.

Some of these larger hedge funds are technically closed to outside investment, but there are groups like Crystal Capital Partners which is based out of Florida and can provide allocations to the largest players for as little as \$100,000, because they have been invested with those blue chip hedge funds for over 20 years. Groups like that allow family offices to get smaller allocations for things like their children's trusts.

Those types of feeder mechanisms can be helpful by allowing family offices to get access to the big names. I am not talking about feeder funds, which exist for the sole purpose of feeding one fund, like the Madoff feeders were. I am talking about a company that has allocations into those big hedge funds. They will have a \$20 to \$50 million allocation and then create sub-sells underneath it.

Truth be told, if you are a well-known family office and you call a big name shop, they will let you invest. From my experience, it is actually a myth that these large shops are completely closed. They are not closed to family names that they like, so you can get access if you are a big family office.



Kim Waldman

It is interesting to look at the difference between investor classes. There is no one-size-fits-all among these different classes, and even within them, and there is clearly a great deal of customization and innovation happening. Alternative investing is to some degree a science and to some degree an art, but to a large percentage of investors, there is also an emotional and a psychological component.

Where does the industry go from here? How can or will alternative investments continue to evolve and provide value for investors?

Chip Perkins: Regarding the psychological component of investing that you mentioned, *the thing that differentiates the hedge fund business from a lot of investment opportunities is that it is still very personal. You sit down with the portfolio manager. You have access to the whole team. You talk to them. You look them in the eye. You decide, do I trust this person? Do I like this person? Do I want this person to handle my money? I think that will always be the case.*

As an investor, you do not have to like a manager personally if you believe they will be successful, but it does help if you are able to develop a good rapport and a relationship with them.

Alternatively, if you are sending your money to Fidelity, for example, you do not know if the same Harvard graduate who managed a mutual fund last year is managing the fund this year. You never meet or even speak to these people. You see their ads and their marketing presentations on television, but you never have any direct interaction with them on a one on one level.

Ours is an industry that is still very personal, and I think that whether that means private equity funds, hedge funds, 40 Act funds, etc., an investor can still "reach out and touch it," so to speak. These investment vehicles are more tangible and more accessible. That access can help alleviate investor concerns, because unlike other more traditional investments, they are not able to sit down with the Chairman of Volkswagen or with a mutual fund manager.



Carol Pepper: Impact investing is one class of alternative asset management that is growing by leaps and bound. There are over \$20 billion of impact investments in Europe. There are billions of dollars in that asset class in the United States. There has been a compounded growth rate of 13% per annum over the last ten years in impact investment funds.

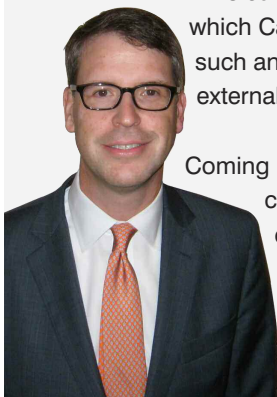
What is driving this movement is the Millennials who are now coming into their adulthood, and many are demanding social impact in the investments that they make. There is also an interesting investor base growing for this asset class in the female demographic, because women who are about to inherit trillions of dollars as their husbands pass away are often focused on impact investing.

There is a very senior person who left Pequot Capital Management recently to start a real asset sustainable investment fund called Ultra Capital, which invests in water and infrastructure products. That illustrates the example of a model that I personally like; where hedge fund professionals can take their incredible ability to analyze and make great investment decisions and put their knowledge to work not only for the good of the investors, but for the good of the planet. That is an exciting development.



Brian Lasher: In our industry, you can understand the firms in which you invest in a way that is different and more dynamic than simply picking stocks, like a Volkswagen, or putting your money into a mutual fund. The culture of a firm is critical to me when I am making an investment decision, and factors into that likeability factor that Chip mentioned and other qualitative characteristics.

A firm's culture often impacts investors more than the processes. It really dictates the motivation of the players, which Carol was talking about, and what they are trying to accomplish within their portfolios. To a certain degree, such an industrial psychology leads to successful trading decisions, effective relationships internally and externally, and a positive return outcomes.



Coming back to a point that both Greg and I talked about, lift-out teams have already established some form of culture among themselves regarding the interaction of their team. They also have a well-practiced decision-making process, and if they disagree, they have strong relationships in place to come to productive resolutions. The ability to observe a firm's culture and the intimacy you get with hedge funds are important aspects of evaluating these investments. You have greater confidence by identifying positive cultural traits in your hedge fund investments versus other types of asset classes.

Michael Swackhamer: I can identify with Kim's point about the emotional or psychological element around investing. Our investor base today is made up of a number of HNWI individuals and family offices.

Because our aim is to be the first institutional capital in a business, we end up connecting with many family-owned companies. Therefore, there winds up being an emotional connection between much of our investor base and the very companies in which their capital will be put to work. They like the concept, because there is a sense of familiarity with entities that we are getting to know, and our investors recognize both the challenges and opportunities these family owned businesses might experience.



Greg Moroney

Referring to Carol's point about impact investing, Michael, do you consider what you do in helping families and small businesses to be a form of impact investing? It does create socially beneficial results in a lot of cases. Alternatively and hypothetically of course, would you invest with a cigarette, marijuana, or the gun companies if you found value in them?

Michael Swackhamer

I would say - not quite - not in the way the term "impact investing" is being used today. Although in many cases helping families diversify their wealth and grow their companies does create some level of social good. And we are not spending time in those areas today.

I think Carol probably has the most impact investing experience here.

Kim Waldman: We often hear about the investor's connection to the underlying investment opportunities, so the whole like-minded synergistic theme definitely strikes a chord with family offices that we work with. I would like to point out that there is a big difference between a socially conscious investor and impact investing, because ESG and sustainable investing constitute their own asset class now.

Regarding the socially responsible investing, there are well known investors who are looking closely at that space. Paul Tudor Jones, his family office, and The Robin Hood Foundation, over which he has tremendous influence, have embraced this concept of Just Companies. This is also true of multiple foundations and endowments, particularly those who are philanthropic and utilize the grant-making model. Are companies good to their employees? Do they treat them well, providing vacation, flu shots, other benefits, and sufficient health coverage? Do they use solar panels or some kind of alternative energy to heat their buildings? These investors use an entire program scale of metrics to determine how "Just" a company is. They use that program in determining whether or not they will actually make an investment into the company.



I heard Paul Tudor Jones speak in April of this year. I believe there is a Dow 100 now, but they are moving toward a Dow 500, comprising the top 500 stocks that meet these Just Company metrics. He has teams of people looking at this. It is fascinating, and although slightly different, the concept is very much in line with what Carol was saying about the demands of the Millennials, the G2, and the G3s, for sustainable investments.

Carol Pepper: There are also a number of rating agencies that are coming into play in these areas. For example, MSCI rates hundreds and thousands of U.S. and international companies on many variables of Environmental, Sustainable, and Governance factors. In the past, foundations like the Gates Foundation, for example, are typically focused to producing income with 95% of the Foundation's money and giving 5% away to the cause. They are now saying that the 95% of invested capital must also reflect impact investment goals.

The Rockefeller Brothers Fund has also decided to divest itself of all fossil fuels, which is interesting considering that the Rockefeller fortune was founded from the Standard Oil empire. That decision was driven by the millennial generation, which has come onto the board of the Foundation and has driven a major change in the policy.

So the movement is coming along, and I think it is a great area of opportunity that should be on the mind of hedge fund managers. It would be interesting to see a strategy that would short-sell companies that are not impactful, and invested long in companies that are impactful. I would be curious to see how that strategy does when you back test the approach?





Chip Perkins: That is an interesting thought, but one of the problems with that approach is that if they short so-called socially irresponsible companies and the companies no longer exist, how are people going to fill up their car or heat their house? There is only so much impactful investing you can do to a point where the ramifications do not become disruptive to the economy. I understand the benefits of a lot of these initiatives, but take solar energy for example. There is no transmission to where most of the solar energy is produced. It could be said that investing in sustainable companies is not a sustainable strategy to produce income for investors.

Kim Waldman

Do you see large investor inflows from sovereign wealth funds and large pension plans who have to move the needle paying more attention to sustainable investing and more socially conscientious investment philosophies?

Carol Pepper: Yes, I was just in Montreux, Switzerland, at a conference. A member of the Norwegian Ministry of Finance was there. He explained that the Norwegian Sovereign Wealth Fund pays attention to impact issues in all of their investments. That fund is making a conscientious effort to invest responsibly.

Companies who pay attention to governance and the environmental effects are actually outperforming in general. Companies that are not impactful or do not think about these issues may pay a price in the future.

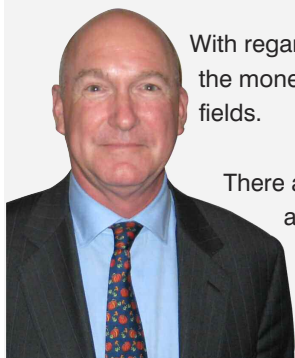
An example of a successful initiative is the creation of plastic bags that can dissolve, and so those will not fill up landfills. That is happening today. People are innovating and creating new products with social and environmental impact in mind. What is most important to me philosophically is that they are trying to move forward and make positive change.



Greg de Spaelberch

Chip, in your experience speaking with institutional investors, are our pensions, foundations, and endowments here in the U.S. setting mandates for this type of investment?

Chip Perkins: In my experience, yes, they do want to have a more diversified portfolio with impact investments. *But they also want to have minority managers and female managers*, so there is a lot of pressure on institutional investors to pursue these mandates whether it is with a state pension plan, a private pension plan, an endowment, or a foundation. Everyone wants to diversify not only their portfolio of investments, but diversify the people that manage those investments. So there is a tremendous amount of new investment vehicles being added across the board, and it is challenging for investors to meet these mandates.



With regard to Carol's comment on the Norwegian Minister, I was also going to mention Norway, and where did the money come from that created the Norwegian Sovereign Wealth Fund? It came from the North Sea oil fields.

There are indeed funds where you can focus solely on new areas of alternative energy. The foundations are driving those types of investments because they can, it is their money and their prerogative. However, historically most of those funds have not fared well. Some do, but on a little capital base for the most part, and generally there aren't that many companies in that area. It is a very concentrated portfolio of companies that are doing well in that space.

Greg Moroney

I do not think that anyone is going to argue against any of the merits of ESG. First and foremost though, you have to look at your particular mandate and establish a portfolio that carries out your fiduciary duties to that mandate. If the mandate then allows to take consideration for social and environmental issues, then all the better. I polled all of our managers specifically addressing ESG, and while they do not tend to specifically address the topic within their stated mandate, they can think about the topics within their investment philosophy.

Greg de Spoelberch

I want to go back to perspectives on the investing side. Specifically, what are red flags for you, Greg? When you are putting together your approved list or when a manager gets to you as the final tier of approval, what would cause you to veto them?

Greg Moroney: We do have full veto power as the third prong in our investment process. We touched on this before, but I try not to use red flags or to veto a manager outright. These days, a red flag would obviously refer to things like a self-administered fund, which do not really exist anymore. NAV-lite or a one man audit firm are clearly unacceptable. Or any conflict of interest with a broker dealer or within the fund management structure would also be examples of potential red flags. We do not see those deficiencies often post-Madoff. You cannot raise a dime from an institutional investor with any of those factors coming into play.

So we utilize yellow flags. This is often because you will have a very smart individual focused solely on the investment element of running a fund. Frequently, they forget about putting the back office support system in place, so deficiencies in those areas would cause us to yellow flag them. If we accumulate enough yellow flags together on a certain manager, the result becomes what we call an operations hold.

I like to think about acting as a true limited partner. *We obviously want to work with the managers that we are high on, and so if necessary we will sit with them through several months of straightening out their operational and compliance procedures and getting their back office in line.* We often suggest outsourced Chief Financial Officers when managers do not have one internally or have had turnover. We take any and all steps to become comfortable enough to know that we are only taking investment risk, and so we will work with them in that capacity to get them to that point.



Brian Lasher

Are there any new areas of concern when doing operational due diligence recently? For example in the past, Fin 48 was a focus.

Greg Moroney

Cyber-security is the one making all the headlines. Tax issues are always big because they are ever-changing. I am not a tax specialist, but a firm like Arthur Bell would be the best firm to ask on specific issues like FIN 48. That brings me back to the importance of service providers. You must have the proper service providers in place, so that you get the right advice and you know how to maneuver.

Kim Waldman: Managers are spending so many basis points above what they used to spend, and those fund expenses hit the performance of the fund. When the performance is not there, investors like Carol will not invest any of their family office capital because funds are not outperforming the traditional 60/40 portfolios. The result is that there is no remaining alpha. It really is a vicious cycle for emerging managers. A lot of the top marketers like Chip will not even look at funds unless they are a certain size or if they meet specific criteria, so it is a very challenging business for the smaller managers.



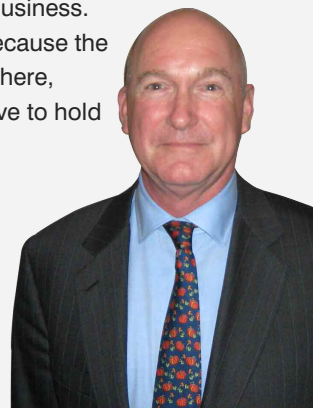
Chip, when your clients invest, you come in with a revenue sharing agreement, which means that you are not giving the manager operating capital to implement these systems or back office components. How do you convince managers to cover the service provider fees and operational due diligence expenses? How does the manager feel about spending this money, and how do you convince them to implement these changes and services?

Chip Perkins: It is quite simply the cost of doing business. Managers really have no choice these days but to put those support systems in place. Would the manager want to keep all the money being generated by their returns? Yes. Do they have to spend capital to get more capital? Yes.

With the seeding model, certain agreements may be helpful to them. Most seeders pay full fees when they invest with a fund, so that seeded capital is being used for the purpose of covering operational costs. If you are a fund with a 2 and 20 fee structure, and I as an investor have taken 25% of your firm by giving you \$100 million, you are charging me 2 and 20 on my capital, and I am going to usually share revenues on everything above my investment. So I give the manager some stability, because he is getting \$2 million a year on the management fee of my capital and also their share of the incentive. That can help to fund operational expenses.

We have a very difficult time marketing the smaller fund managers. They must be really unique or doing something that is very outside the box. I will give you an example; I have a manager right now who is in the direct lending business. He is only going to raise \$100 million, and can only enact his strategy in Australia and in England, because the laws there are different. It would be considered Private Investment in Public Equity (PIPEs) investing here, but in those jurisdictions you can be given stock and you can immediately sell it. Here you would have to hold onto it.

Out of these niche strategies that are being created all over the world, we can find really interesting approaches that appeal to investors, but a lot of these strategies cannot take a great deal of money. Therefore, I cannot bring them to a lot of the investors at this table and in my rolodex, because the capacity is too small. Greg, what is the smallest investment that you would make?



Greg Moroney

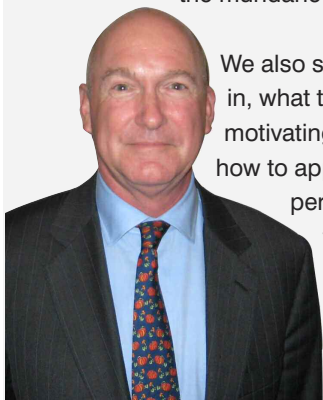
Although we are a \$5 billion fund of funds, we just invested in a hard close of a small fund of a couple hundred million, and we put in \$50 million. We supported the final close, because that was the capacity for the strategy.

Brian Lasher

Chip, what wisdom do you impart or advice do you give to the managers that you onboard, specifically regarding engagement with potential investors?

Chip Perkins: There are a number of things we do. We try to find individuals with not only personality, but with passion for what they do. They need to love the game they are playing. We spend a lot of time working with the manager on their presentation skills and how they should act in a meeting to communicate the critical messages to investors. They must impress and engage the potential customer. We also work on all of their marketing materials and due diligence questionnaires, and update everything constantly.

We send out the monthly information with a consistent, polished process. It is as though I am the Vice President of Marketing and Sales, and my team is their sales force and support organization. Because we perform those functions, we take a lot of the mundane marketing functions off of their plate.

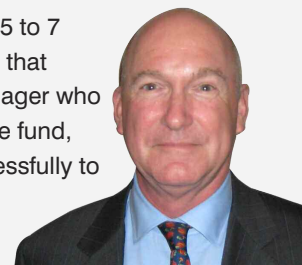


We also spend time with managers before their meetings going over who the potential client is that is coming in, what the client's hot button issues are, and getting the manager excited for the meeting. It is almost like motivating a fighter in the locker room before he goes out to the ring, telling them what to watch out for and how to approach the fight. We try and do the same thing with the manager, because managers cannot perform well every single day. They may have had a hard trading day that day, or the day before, and their energy level or attitude may not be optimal. You have to wake them up and remind them that they have to be excited about what they do. *Every meeting is a big meeting.* You only have one opportunity. That meeting could lead to months of due diligence or to five more meetings, but you have to treat every investor that comes in your door as an opportunity.

Brian Lasher

How often have you decided to pass on a manager who is a perfectly good investor and probably would be successful, but did not have the love of the game or presentation skills that you are looking for?

Chip Perkins: It undoubtedly happens. I talk to or meet with 150 managers a year, and we only carry 5 to 7 managers with non-competing strategies at any time. There are certainly a number that would fall into that category. They have talent, but for one reason or another, we did not onboard them. We had one manager who was a fabulous investor and performed very well. It took us a very long time to get \$300 million into the fund, because although they had the passion, they did not exhibit the passion or convey that passion successfully to investors, which is a big difference.

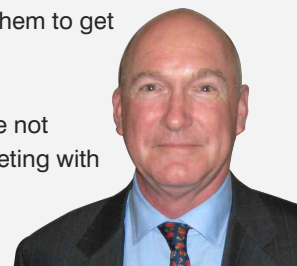


Michael Swackhamer: Building off of what Chip said, pre-marketing and getting your materials together is also massively important. It is always a challenge for a manager who goes live with a fundraise and who does not have the preliminary work completed that investors will ask for. The process of compiling materials in the middle of a raise will be a distraction, and a resulting loss in momentum could become a reality.

Pre-marketing, preparing all materials, and anticipating what investors are going to ask you in advance before you go to market is critical to running an efficient and well-structured fundraise.

Chip Perkins: Pre-marketing is massively important. What we do is *create a 30-second pitch, a 3-minute pitch, and a 30-minute pitch for each manager*. The reason we do this is for the voicemail message, for the “hook them to get a call,” and for the instructional 30 minutes on the fund.

We do this because we will not waste our manager’s time with a meeting that is ill prepared. If we have not prepared the potential investor on an initial background call before we have a conference call or a meeting with the fund manager, it is a waste of everybody’s time.



Greg Moroney

I agree. We are in an amazingly competitive industry. If that first meeting goes wrong, a manager could have the structure, support, competitiveness, drive, and performance, but if they cannot convey their strategy well, they can talk themselves out of consideration for an investment.

Greg de Spoelberch

Carol, regarding presentation, is there anything else that you can add as far as what comes across well or might deter you from considering investing with a manager?

Carol Pepper: For me it comes down to a sense of integrity. *Human beings know things before they know the rational conscious reasons why they know them, and we all size each other within 5 to 10 seconds. If there is a feeling or some concern about a person’s integrity, especially in the post-Madoff world, then they are out of consideration. If you Google them and find something disconcerting online, then they are out of consideration.* It is critical to make sure that you Google and research every single person on the team, to make sure that there is not a police charge or multiple charges because that will turn investors off immediately.

I was just recently warned off of a fund by a potential investor because there was an article about a manager that said he had received both his Undergraduate and Master’s Degree at a certain school, when upon checking with the school it appeared that he had only earned his Undergraduate degree from that university. That discrepancy turned off the investment staff of a family office, and they were not going to look any further at the fund he managed. They also told others, like me, about their concern. Family offices share their opinions about funds they are considering much more freely with each other than they did in the past, not wanting to repeat another Madoff situation.

Family offices are highly suspicious these days. They have been fooled, have been burned, and have lost money. Anyone who in any way is not completely straightforward is out of consideration.



Family offices are to this day still very angry about Madoff and also about the failure of Long Term Capital Management. They have long memories, and still remember that failure, because a lot of them lost money when LTCM blew up.

You have to perform a thorough background check on every single person involved with the fund, to make sure that they are really clean. The family offices will hire a private investigator or security firm, and will completely reject that investable opportunity if they are not completely beyond reproach.

Chip Perkins: When we look at managers, we also perform background checks. We do Google searches. We ask for references. We talk to colleagues that knew them in other jobs, which are often people that we have known well from our years of experience in the alternative investment industry.

Professionals will sometimes say that they attended a Graduate or Business School. If they only took a handful of classes and there is no record of that, I do not know why they would put that on their resume, but some do, and equate the attendance of a higher institution with graduation and earning a degree. Things like that create a lot of smoke around the fund, which is a red flag for me and for investors. You have to be confident with using your own resources and due diligence process when you are considering all of the different elements of a fund manager and their staff, because if there are a lot of erroneous claims made by managers it can quickly become slanderous.

I agree with Carol, in that integrity and ethics are vital. Managers need to be as direct and forthcoming as possible to create trust between themselves and investors from Day 1.



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