

OPALESQUE



# Opalesque Roundtable Series '17

# UK

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# Editor's Note

All asset classes today face questions, but the menu of choices for allocators has also never been richer. **Alternative risk premia** (ARP) have contributed a credible, liquid source of return distinct from equity beta and duration. For those who aren't able, or don't want to invest with hedge funds, it opens up a new strand of investment. For existing hedge fund investors it provides new lenses for appraising performance and decomposing risk. For some hedge funds it may be a death sentence, but for the best investors it's a new platform against which to demonstrate value creation. And so, **25% of institutions are using alternative risk premia today, while in the intermediary channel it's probably less than 5%** and has still great potential as well.

This rise of alternative risk premia strategies has created a lot more skepticism about the amount of value investors get from hedge funds, relative to the price they pay. Still, one of the main **misconceptions** is that hedge funds are no longer capable of adding value, while in fact allocators say they continue to find very interesting and consistent diversifying return streams from some high calibre managers. In this context, a new New SocGen study on managed futures fees has found that the majority of managers have justified "alpha" fees (page 11, 12).

**Alternative risk premia isn't a replacement for hedge funds either** (page 10,12). They can be used alongside, but there's a clear distinction between hedge fund strategies and risk premia strategies. ARP investing also requires a somewhat different mindset from investors (page 9). This huge **surge of interest in liquid diversifying strategies** — much of the allocation movement is largely being funded from equity allocations — is accompanied by a real **hunger for education and talent**. In fact a lot of organizations – distributors, intermediaries such as financial advisors or private banks and the like – have recently been hiring experienced people who used to work in the fund of hedge funds industry.

The Opalesque 2017 UK Roundtable, sponsored by Societe Generale and Eurex, took place in London with:

1. Andrew Dreaneen, [Head of Liquid Alternatives, Schroders](#)
2. Max Townshend, [Investment Director, Local Pensions Partnership](#)
3. John D Harrison, [Partner, Group CFO and COO, Amplitude Capital](#)
4. Dr Toby Goodworth, [Managing Director, Head of Risk & Diversifying Strategies, bfinance](#)
5. Markus-Alexander Flesch, [Head of Equity and Index Derivatives Sales, Eurex](#)
6. Jeremy Bruce, [Managing Director - Hedge Fund Sales, Societe Generale](#)
7. Duncan Crawford, [Hedge Fund Sales & Capital Introductions, Global Head Prime Services, Societe Generale](#)

The group also discussed:

- The four different types of investor that are interested in ARP (page 9)
- Which criteria are investors looking at when screening risk premia providers? (page 10)
- Value, Momentum, Carry, Low Risk, Quality: Eurex' new factor investment vehicles based on futures (page 11)
- Why UCITS hedge funds aren't really inferior to their offshore cousins (page 8, 20)
- What to do with the growing power of investment consultants? (page 9, 16)
- The two sides of pooling of managers and the return of hedge fund hotels (page 16, 17)
- Will fee calculations be based on beta-adjusted performance going forward? Is the newly discussed "1 or 30" model pointing into the right direction or potentially giving rise to moral hazard? What about extended crystallization points? Views on the CPPIB paper from 2008 (page 11 - 15)
- Darwinian pressure: Even mid-sized (\$500m) players consider consolidation (page 15)
- Changing investor preferences: Outflows from bigger and inflows to smaller managers (page 16)
- The come-back of funds of funds (page 17)
- Why the divestiture from hedge funds into private assets creates opportunities for liquid alternatives and ARP (page 18)
- Selection and onboarding process at the highly successful Schroder GAIA platform (page 21-20)
- UCITS or nothing: \$700 billion net new business for alternative UCITS expected (page 21)
- Why Amplitude is coming back to London despite [Brexit](#). Why Brexit could be a non-event for UCITS managers (page 22-23). Potential upsides (page 24)
- MiFID II: Nightmare meets opportunity (page 24 - 27)
- How EUREX leads the "OTC Metamorphosis", up to releasing the world's [first futures-based tradable hedge fund index](#) (page 26)
- Artificial Intelligence: The fight for talent (page 27)
- More internalization: a new paradigm for large institutional asset owners (page 28)

Enjoy!

Matthias Knab  
Knab@Opalesque.com

## Participant Profiles



(LEFT TO RIGHT):

Matthias Knab, Jeremy Bruce, Andrew Dreaneen, John Harrison, Markus-Alexander Flesch, Dr Toby Goodworth, Max Townshend, Duncan Crawford

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# Introduction

**Markus-Alexander Flesch**  
Eurex

My name Markus-Alexander Flesch, representing Eurex where I'm heading global sales for our equity and index products. What I'd like to add is that I always appreciate this Roundtable format to get in touch with all kind of end clients, like yourselves, to share ideas and also to talk about opportunities in the market.

**Duncan Crawford**  
Societe Generale

I'm Duncan Crawford. I head the Hedge Fund Sales team, which is the hedge fund facing part of prime services within Societe Generale, so this includes Prime Brokerage Sales, Capital Introductions and Alternative Investment Consulting.

Our clients are not only the hedge funds themselves, but approximately half of our business is servicing investors through managed accounts and various other different structures. Prime Brokerage Sales speaks for itself; a differentiating part of the Cap Intro and consulting team's offering is the database, indices and industry white papers we produce, making us a comprehensive information source or a marketplace of information and education between the managers and investors.

As a contrast to many other players in our space, we are in the slightly unusual situation that we have seen our prime brokerage business expand and grow substantially in the last couple of years, notably in the FX, Fixed Income and equity PB, although our core Futures clearing business has also grown along side.

**Andrew Dreaneen**  
Schroders

Head of Liquid Alternatives at Schroders and have been with the firm now for more than 16 years. Schroders has 35 different liquid alternative funds, 9 of which are managed externally on our GAIA platform, in total we have \$20 billion AUM across our liquid alternatives franchise.

These funds are typically in a UCITS structure, but we also have some Luxembourg domiciled non-UCITS funds for some alternative investment strategies which are more difficult to replicate in the UCITS structure. This includes things like distressed debt, private cat bonds, commodities and a few other alternative strategies.

**John Harrison**  
Amplitude Capital

I'm John Harrison and I'm a partner and Group CFO/COO at Amplitude Capital – a systematic CTA hedge fund. We launched our firm here in London back in 2004 and from very humble beginnings, we have grown our business to manage around \$1.6 billion across four main strategies. In December 2008, we relocated the investment advisory function away from London to Zug, Switzerland where we now employ circa 25 research, operations and IT staff. We retain a service company in the UK, a burgeoning IT hub in Prague and the Group investment management company in the Cayman Islands.

We are a research and technology driven business. Our success depends on maintaining a creative yet objective approach to research and from exploiting opportunities, as we identify them. Not always an easy task.

At today's roundtable, I guess I represent the manager's perspective. What are today's key issues and drivers of our business going forward? Clearly, growing assets under management is key to any manager. Fees and remuneration are also very hot topics and seemingly always on our radar. We are also devoting significant time and effort to develop our product offering and channels of distribution, whether it be UCITS, SICAVs, Fund of One, etc. Earlier this month, we opened an office in London to facilitate our marketing and investor relations drive. Given Brexit and the recent indecisive UK general election outcome, I would be interested to hear views across the table.

**Jeremy Bruce**  
Societe Generale

I'm Jeremy Bruce from Societe Generale, I basically run the hedge fund sales group within the execution side of the business across derivatives and equities, including all the usual channels, electronic programs and soon cash as well and all kinds of related activities, from long/short stock-picking research-intensive up to low latency co-located systematics.

I am also involved with the Security Trading Committee of AFMI which is the sell-side industry body, where we work a lot with the IA, AIMA and such organizations on regulatory and technical issues such as MiFID most recently. For example, I have done a good number of MiFID-focused presentations predominantly to hedge fund managers to help them to become better aware about the issues and challenges they will be facing.

**Max Townshend**  
Local Pensions Partnership (LPP)

I'm Max Townshend of the Local Pensions Partnership (LPP). LPP is a pension services business covering liability and risk management, investment management and pension administration.

On the pension administration side of the business, we provide pension administration services to some 1,000 employers with over 500,000 members. On the investment management side, we manage around £13 billion of client assets.

My role is to look after our "Total Return" strategy, a pool of investments that seeks reasonably liquid sources of return distinct from the equity risk premium. The importance of this allocation is underscored by the low returns currently expected from fixed income, which make it increasingly important to find other sources of diversification.

**Dr Toby Goodworth**  
bfinance

My name is Toby Goodworth and I'm Head of Diversifying Strategies at bfinance. bfinance is an investment consultancy that specializes in implementation, including manager selection and portfolio analysis. We were founded in 1999, have headquarters in London and offices throughout the world. Since 1999, we've helped about 350 clients on over 800 projects. We span all asset classes and investment styles, from traditional markets through private markets to Diversifying Strategies, which I head up. Diversifying Strategies covers hedge funds, fund of funds, the more unconstrained, liquid and non-traditional multi asset risk premia.

# 80

percent of all Beatles songs are about love.



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Matthias Knab

Max, in your introduction you mentioned you are investing in reasonably liquid sources of return distinct from the equity risk premium. Could we start with you explaining what you are looking at or what specifically interests you at the moment?

**Max Townshend:** With real interest rates low to negative across many currencies, the potential for duration to deliver the inflation-beating returns sought by institutional investors has never been more limited. This has impacted the utility of what has historically been the most prominent liquid diversifier of equity risk – aggregate fixed income – while simultaneously influencing all other asset class valuations.

As a result, investors continue to look for other places and ways to deploy capital. Real estate and infrastructure are two asset classes that provide attractive qualities, such as explicit inflation linkage and cash yield, but these investments are pro-cyclical and may only offer limited diversification.

It wouldn't be an alternatives panel if we didn't discuss **alternative risk premia**. This has provided a credible, liquid source of return distinct from equity beta and duration. For those who aren't able, or don't want to invest with hedge funds, it opens up a new strand of investment. For existing hedge fund investors it provides new lenses for appraising performance and decomposing risk. For some hedge funds it may be a death sentence, but for the best investors it's a new platform against which to demonstrate value creation.

We are trying to incorporate the elements and lessons of smart beta without getting caught out by the growing concerns about capacity and crowding of trades. We do have an allocation to trend-following, but as assets deployed in behavioral premia like trend and value increase there are legitimate concerns about their ability to generate the returns that they have done in the recent past, so we need to be cautious.

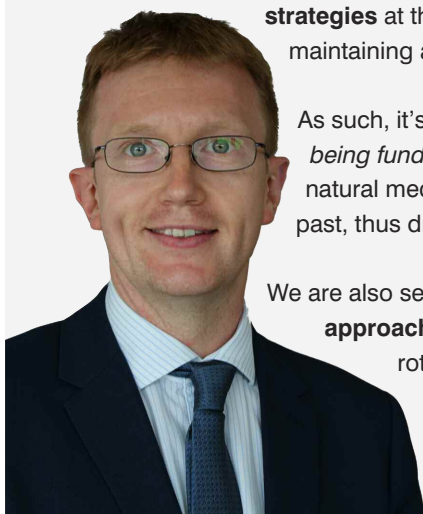
Nonetheless, we are grateful to have these new building blocks when considering portfolio construction. *All asset classes today face questions, but the menu of choices for allocators has never been richer.*



**Dr Toby Goodworth:** I would agree with Max. We work with a wide variety of clients, not just in the UK, but across Europe, North America, Middle East and Australia, and we are seeing a **surge of interest in liquid diversifying strategies** at the moment. In most cases the aim is to control equity risk within the portfolio whilst maintaining a good rate of return, as well as introducing more diversification into the portfolio.

As such, it's no surprise that much of the *allocation movement we are seeing at the moment is largely being funded from equity allocations*. There's a big drive to reduce or control equity beta and the natural mechanism of rotating into fixed income is potentially less effective now than it has been in the past, thus driving interest in other forms of liquid diversification.

We are also seeing significant interest in more traditional but **highly unconstrained multi-asset approaches** as well. I think that's a general recognition amongst asset owners that asset class rotation has become more challenging, and needs to be done on a more dynamic, and perhaps more frequent, basis than what has been seen previously. The belief here is that multi-asset managers are able to react faster to changing market environments than many asset owners' allocation processes allow.





**Andrew Dreaneen:** I would like to provide some perspective on the intermediary channel (e.g. private banks and independent asset managers) - we see similar challenges as it relates to asset allocation and portfolio construction. What is encouraging is that we see **more willingness to embrace alternatives** as a great diversifying tool, not only within the institutional channels but also very much in the intermediary channels.

There is also a real **hunger for education**. A recent trend is that a lot of organisations – distributors, intermediaries such as financial advisors or private banks and the like – have been hiring people who used to work in the fund of hedge funds industry. Many funds of funds have shrunk significantly and have had to redefine their business models, so some of the very experienced people from their fund selection teams can now be found within some of these more main stream distribution platforms. They now help those platforms grapple with all the different types of investment strategies that are available, as they keep coming from the hedge fund world now to the liquid alternatives side.

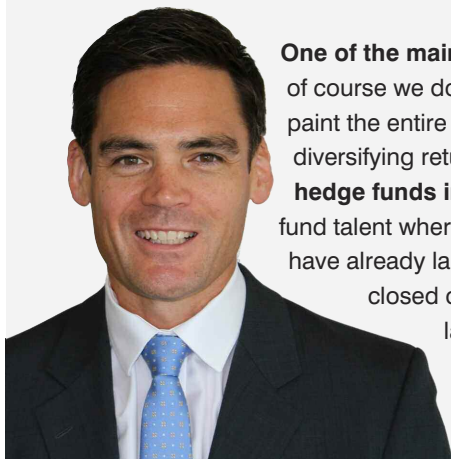
Just in general, liquid alternatives have grown a lot, and whether it's about diversifying into systematic strategies or risk premia or where cost is the main driver, in general many of those developments first happen in the US and then over time have translated to Europe as well, typically starting in the institutional channel before the intermediary channels too. **25% of institutions are using alternative risk premia today**, while in the intermediary channel it's probably less than 5%. Many of our conversations are therefore about education on alternative risk premia and how to include these strategies into a portfolio. A main driver for this conversation has been pricing, especially in light of mediocre hedge fund returns over the past few years. *This rise of alternative risk premia strategies has created a lot more scepticism about the amount of value investors get from hedge funds, relative to the price they pay.* Ultimately this creates a much more competitive environment and the winners will be those asset managers who consistently deliver unique sources of return and value for money.



**Matthias Knab**

Andrew, you mentioned education is relevant, what are some of the most frequent misconceptions or issues you are addressing when educating investors on alternative investments?

**Andrew Dreaneen:** I would say that many investors have been investing in alternatives for a long time, so the conversation can be very specific to new and innovative investment strategies. We also have some investors who are relatively new to hedge funds, and are therefore keen to understand what the entire hedge fund menu looks like, in terms of different strategies and how to think about these from a portfolio construction standpoint.



**One of the main misconceptions is that hedge funds are no longer capable of adding value** - which of course we do not agree with. It is clear many hedge funds are not adding value but we prefer not to paint the entire industry with the same brush, and continue to find very interesting and consistent diversifying return streams from some high calibre managers. Some investors are quite sceptical about **hedge funds in a UCITS format**. We often hear people say it is not possible to find genuine hedge fund talent whereas in our estimation 75% of the largest hedge fund managers headquartered in the UK have already launched a UCITS – and most of the managers in the remaining 25% are either hard closed or their strategy doesn't lend itself well to UCITS. We have also seen a pick up in the largest US headquartered managers up from c. 21% a year ago to just under 30% today now running UCITS funds. Another commonly held misconception is UCITS hedge funds are inferior to their offshore cousins – however if you do your homework you will



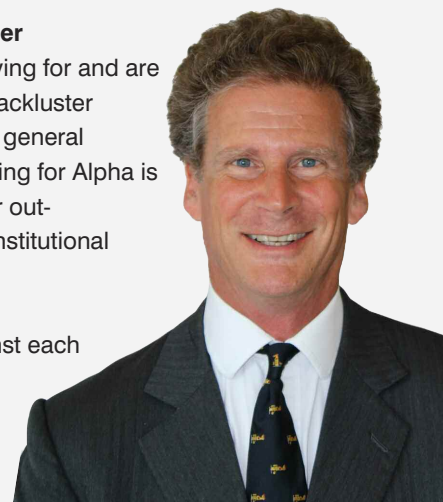
find there are a number of managers offering either pari passu products or products that are differentiated but still very attractive on a standalone basis when compared to other offerings within the UCITS market.

**John Harrison:** Our client base is virtually entirely comprised of very significant institutional investors, including sovereign wealth funds and large pension and endowment funds. As a general rule, I'd say HNW investors make up a relatively small percentage of our AUM. With this as a backdrop, we have certainly observed a trend towards the **growing power of investment consultants** and their influence over allocations into our sector.

As one might reasonably expect, the experience and expertise of consultants across the full spectrum of CTA strategies varies significantly. At Amplitude we have devoted material resource towards working with consultants to educate and inform, and one hopes, provide greater clarity on the systematic approaches we pursue. One should not forget that until quite recently, a lot of the quants and systematic traders were lumped together and labelled "Black Box" investments. Our job is to re-emphasize what distinguishes one strategy from another, the investment objective and provide consultants with the tools to observe the marked differences between strategies commonly termed Black Box.

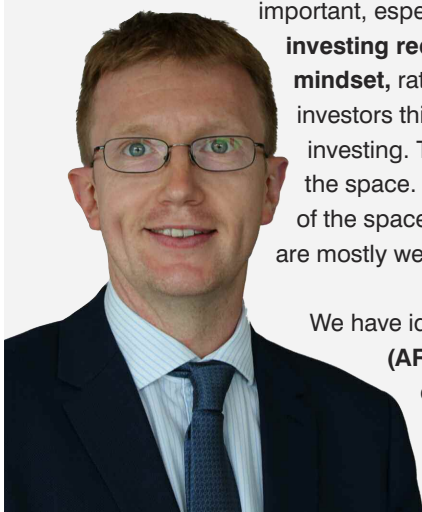
The other hot topic we are witnessing is, of course, around the issue of **fees and manager compensation**. Allocators are increasingly much more cautious about what they are paying for and are sensitive as to the dollar fees paid to managers. What has driven this? Probably some lackluster performance over recent years could be partially responsible for this, though I suspect a general maturing and increased sophistication of market participants has also played a role. Paying for Alpha is the in-vogue catch-phrase. Most allocators would appear to have no objection paying for out-performance, though historic compensation schemes are increasingly under review by institutional allocators.

Another trend we are seeing is the **pooling of managers**, where returns are off-set against each other – compensation being paid on the net returns of the pool. We have taken a pessimistic view on this approach, though it has seen some traction in certain geographical regions.



**Dr Toby Goodworth:** I just wanted to pick up on a couple of points. Andrew, you mentioned education. I think that's incredibly important, especially when it comes to the topic of risk premia investing. **Alternative risk premia investing requires a somewhat different mindset; it's not the conventional strategy allocation mindset**, rather a risk factor framework which crosses multiple asset classes in one style. For a lot of investors this is a new concept which is often, incorrectly, associated with pure 'black box' quant investing. Therefore, I agree that there is a lot of education required to get people comfortable with the space. The first aim is to dispel that myth that all risk premia investing is 'black box'. In fact, much of the space is academically well established. And those premia that are less established academically are mostly well understood empirically: 'practitioner premia,' in effect, tried and tested over many years.

We have identified **four different types of investor that are interested in alternative risk premia (ARP)**, and each approach the space from a different perspective. As such the areas of focus can vary considerably. The four types of risk premia investors are:



**1.) Risk premia as a complement to a broader hedge fund portfolio**, often in a core satellite arrangement. Generally, the drive here is often cost reduction. An alternative risk premia allocation is seen as an effective way to reduce the cost without destroying the return profile. However, care must be taken here; risk premia are not a replacement for hedge funds. They can be used alongside, but there's a clear distinction between hedge fund strategies and risk premia strategies.

**2.) Investors who are not allowed to invest in hedge funds**, perhaps due to investment mandate restrictions. Previously, if an investor couldn't invest in hedge funds, there were few other options. Today, the menus are much richer; apart from hedge funds there are a wide variety of other liquid diversifiers that can check boxes 'traditional' hedge funds may not be able to in terms of transparency, liquidity, or cost.

**3.) We are also seeing alternative risk premia compete alongside more traditional multi-asset investments**, often as a complement to more directional traditional multi-asset funds, or as an alternative to more diversified unconstrained multi-asset managers.

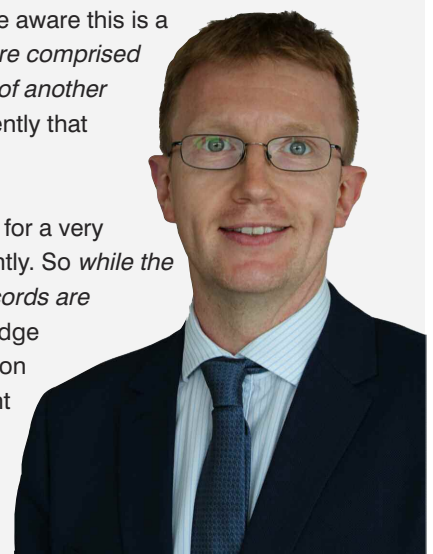
**4.) Finally, we also see ARP strategies being accessed by investors looking to extend an existing smart beta allocation**, perhaps into asset classes other than just equities, as well as adding a broader range of premia types. Here the focus is often on the academically well-understood premia that are widely available in a directional manner through smart beta strategies, but can now be accessed in a more market neutral fashion through ARP approaches.

**Duncan Crawford**

Do you see investors looking for the same track record and assets under management criteria from risk premia providers as they do from hedge funds?

**Dr Toby Goodworth:** That's another important education point, Duncan. Most investors are aware this is a new area, but what they are potentially less aware of is the fact that *many ARP strategies are comprised of systematic models that have been running for many years, even decades, often as part of another strategy, or a screening filter within a discretionary strategy perhaps*. However it's only recently that these models have been brought together and offered in aggregate as an ARP strategy.

Let's take momentum or trend following, for example, these strategies have been out there for a very long time. It's just they haven't been accessible in a standalone, low cost format until recently. So *while the respective approaches may have been around for a while, the combined strategy track records are relatively short*. Some investors are able to look through these shorter track records and judge strategies on existing, and representative, carve-out track records, whereas others are still on the sidelines with a 'let's wait and see' attitude. I respect both opinions, and there is no right or wrong here ultimately.



**Duncan Crawford:** There has been a drive to push hedge fund fees lower for a few years now, and I suspect you'll all have read Albourne Partner's recently published white paper on the '**1 or 30 fee structure**' put forward by Texas Teachers' pension fund. That drove us to take a bit of a closer look at some of the data that we have.



We receive data on about 4,000 distinct hedge fund strategies, the most comprehensive being in the managed futures space. We chose 70 discrete trend following managed futures managers and added them to a classic 60-40 portfolio using a 10:90 weighting. Then compared that to the same 60-40 with the SG Trend Indicator, again with a 10:90 weighting, as the beta. I should add that we adjusted each manager's management fees to 1%. *If we assume that managers are able to charge an incentive fee the moment they beat the beta portfolio, 60% of managers could charge an incentive fee, 40% having a marginal incentive fee of over 20% and for 20% an investor would be better off paying an 80% incentive fee than allocating to the SG Trend Indicator with a 1% flat management fee.*

Encouraging findings for the industry, both managers and investors. The full white paper will be published in the coming weeks.

**Markus-Alexander Flesch:** From the perspective of an exchange and market infrastructure provider like Eurex, I found your comments on risk premia and factor investing very interesting. However, I definitely agree with Toby's statements that while these are new products, the actual strategy or idea behind these new funds is a fairly old topic. Being more precise, the French-Fama model is now almost 20 years old, so you could argue what we see now is nothing but a **marketing hype**, but a quite powerful one if you look at the momentum around ETFs and ETNs that are now coming out.

Andrew mentioned that many things happening in the US over time translate to Europe as well, but in the case of ARP let me point out that this is not so straight forward as we have a different market structure, different market players and also regulations. But still, smart beta and factor investor are becoming quite relevant, and so also from our side we have expanded our equity portfolio with a breed of new products. Jointly with our index provider STOXX we were able to come up with almost **six different factor investment vehicles based on futures**. These new instruments on **Value, Momentum, Carry, Low Risk, Quality, Size** have met with good demand, particularly from some leading German asset managers, and so we believe the momentum will keep growing, which was confirmed through further engagement from two French Asset Managers recently. Remember, we as an exchange are almost the last in the chain of such a trend, and therefore I'm convinced that this trend will continue and that it is actually more than marketing hype. Beside the argument of the increasing interest, I believe that also from a fee perspective – tying back to Duncan's earlier comments – an exchange can offer really competitive and interesting products like this.

At this point I won't be starting the critical discussion around the relevance of passive investment and active management because this industry topic has being discussed controversial for a good reason. But again, also from the exchange perspective I believe that this particular trend in terms of risk premia investing is absolutely relevant and I foresee further growth in that particular segment even on the listed side.





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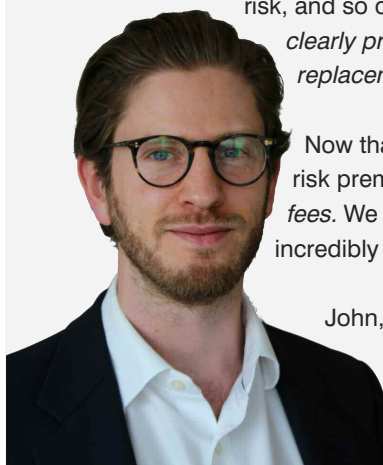


**Max Townshend:** Going back to what Duncan said about new fee models, we did a similar analysis across the CTA universe when making a trend-following allocation and agree that **many managers have justified “alpha” fees**. But one of the key distinctions of the new fee model argued for by Albourne is the **charging of fees on beta-adjusted performance**. With trend-following strategies as an example, prior to alternative beta there wasn't a transparent, low cost way of accessing that risk factor. *Now that there are cheap alternatives, the yardstick against which the performance of active managers is measured should logically change.*

We ran an exercise with medium-term CTAs, adjusting for beta exposure to a low cost, implementable trend following benchmark. For the leading trend followers, a 20% performance fee against cash equated to them taking 50% to 55% of the alpha. Most were taking much more, some upwards of 80-90% of alpha. So long as alpha is positive you could argue that when a manager takes 90% the investor still gets 10%, but when asset owners are taking significant capital risk on the tracking error, that might not be an attractive bet ex ante. Today the industry question is “**what is a fair split**”? It seems to be that 30% of alpha is where the industry is heading, but this may change in the coming years.

*Many managers however are unwilling to discuss using anything other than cash as a benchmark.* The unfortunate irony is that, should trend following – or any other alternative beta – underperform in the coming years, high beta CTAs who refuse to acknowledge their beta exposure will be unable to earn performance fees regardless of the relative alpha they generate.

Going back to a comment Toby made that risk premia is not a replacement for hedge funds, this is very true for us as well. We believe that some alternative risk premia require a lot of scrutiny, particularly in the case of momentum and value strategies where there isn't an obvious risk transfer. Carry strategies are typically co-skewed with equities, limiting their ability to diversify risk, and so our use of alternative risk premia needs to be carefully considered. *Risk premia strategies clearly provide useful investment building blocks, but we see these as a compliment to, not a replacement for, hedge funds.*

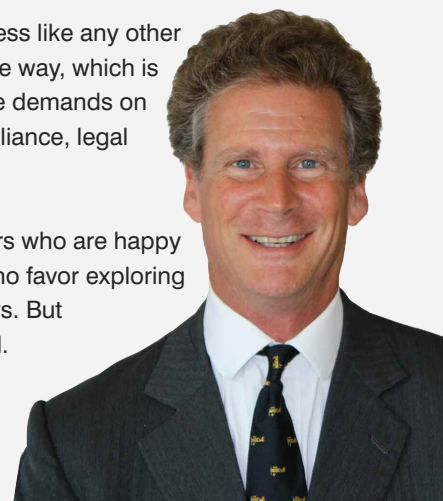


Now that we have these very well-costed benchmarks and alternative low-cost solutions in alternative risk premia, there are *specific funds where it has never been easier to justify why we are paying higher fees*. We have a platform to demonstrate that what they're doing is unique and differentiated, which is incredibly valuable.

John, I wonder whether this has extensions for firms like yours, which have historically been uncorrelated with other CTAs and risk premia - are you starting to see clients come with more positivity about your fee rates, understanding why they are justified?

**John Harrison:** This is quite a topical question. When it comes to fees, we have a business like any other business. We need fee income to pay for our costs, which unfortunately is only going one way, which is up. It quite simply has become more expensive to do what we do, for many reasons. The demands on managers for transparency, tailored reporting, research, operational development, compliance, legal etc. have all added to core costs of managers.

Our own institutional investor base is very diverse in this regard. There are those investors who are happy to maintain a straightforward and transparent fee structure. There are others however, who favor exploring more complex and sophisticated fee structures which apply benchmarks in different ways. But generally, for managers relying on a 2/20 model as a default, this would seem a hard sell. Circumstances do differ of course, and strategies that have a unique flavor, excellent risk/return characteristic or are say, capacity constrained may yet be able to command a premium.



There are fee related trends which can put managers under significant pressure and these often relate to ideas on **reference benchmarks**, what these should be and at what level – an example might be the use of hurdle rates. Determining appropriate levels are difficult. Some allocators argue that the allocators cost of capital is appropriate, perhaps using CAPM as a valuation tool, some simply a % over LIBOR, but ultimately, it is a commercial agreement between allocator and manager and another mechanism for establishing a fair price for the investment service/product being considered.

Normally we have three paragraphs to describe our performance fee calculations. It is very standard and straightforward, along the lines you have all seen. But we also have experience with methodologies that occupy over 17 pages of an IMA where performance fee calculations may be multiples based on defined performance criteria and/or benchmarks.

Ultimately, as a CTA we seek to provide a diversifying component to an allocator's portfolio. It aims to add significant value due to low or uncorrelated return streams. This can be different to an absolute return target, though that premise is being questioned all the time. If, for example, we don't deliver when the market is down, that's a problem for us that we must always look to address.

As a manager, it is critical that we are adequately rewarded for doing what we say we are going to do. CTAs like us operate on the concept of a partnership. It's really a partnership over time. It is in the interest of both parties to find a satisfactory balance. It is rarely a short term perspective as investors understand that they are not going to get what they want every year. But on a medium time frame, the value of a CTA to a portfolio becomes much more evident.

**Dr Toby Goodworth:** Fees are one of two topics that investors always want to discuss. The other one is liquidity. On the diversifying strategies side currently it's all about seeking portfolio diversification in as liquid a manner as possible with an appropriate cost framework. I agree with John that the industry has moved on from the classic 2 and 20 headline fees in many ways, but there is no 'one size fits all' solution within the hedge fund and liquid alternatives industry.

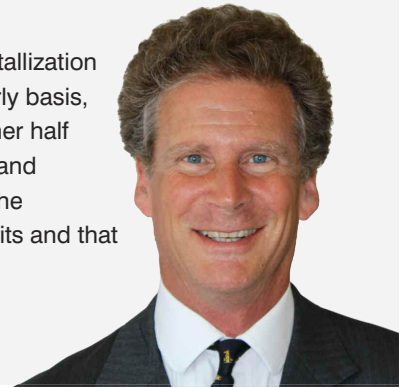


There are some areas where 2 and 20 may still be well deserved for a particular type of product, either because of low capacity or particularly high levels of alpha. In other cases, a flat fee option may ultimately be more desirable for investors. As we see it, fee evolution has been somewhat Darwinian. There has been good competition brought to the market, in some higher capacity or more beta-driven areas in particular.

Outside of the lower cost flat fee model, performance fees have an important role in aligning managers with their investors, and I'm in favor of such alignment. Certainly this 1 or 30 model, with an alpha share consideration, is in the right direction, as long as both manager and investor agree the terms are fair. If you squeeze too much towards performance fee only, that drives obvious risks.

**John Harrison:** I agree. If you are loading your fees aggressively on a performance base only, perhaps with a 0 or 30 or even 0 or 35 fee scale, I would see this as probably sub-optimal and with a big question mark on whether it is sustainable in the medium term. It could be argued that such arrangements may create a form of **moral hazard**. I don't have the empirical evidence to support this notion, but I suspect that managers may be tempted to take on slightly more aggressive bets in such scenarios. So the fee structure is important for a number of reasons.

Another trend we are seeing is that large institutional investors are pushing for extended crystallization periods. So, whilst in the past, virtually all investors in the CTA space crystallized on a quarterly basis, the reality is now that more and more assets are on different cycles where fees crystallize either half yearly or even on a yearly basis. But if you look at a strategy such as ours, with liquid assets and holding periods of one to two days or one week up to six weeks depending on the strategy, the investment cycle is pretty well complete, there is an argument to say that you've realized profits and that profits should be subject to performance fees.



**Dr Toby Goodworth:** We also see strong pricing competition from managers in the form of **fee tiering**, with reduced fees as assets grow. So whilst a given headline fee might appear high, often institutional ticket sizes will benefit from significant reductions for scale, or for longer term commitments. It's also worth noting that fees in certain areas have come down very significantly in the past few years according to a recently published study that we conducted, particularly for fund of hedge funds.

**John Harrison**

When it comes to lock-ups, I was on a panel two days ago and we were talking about this, and one of the large institutional investors in the UK market was actually quite keen on the idea of lock-up in return for favorable terms. So, certain investors would appear to be willing to be locked up in return for an adjustment on fees.

Do you have any view on it?

**Max Townshend**

Was that investor looking at a product of scarcity, or were there some supposed long term alpha opportunities?

**John Harrison**

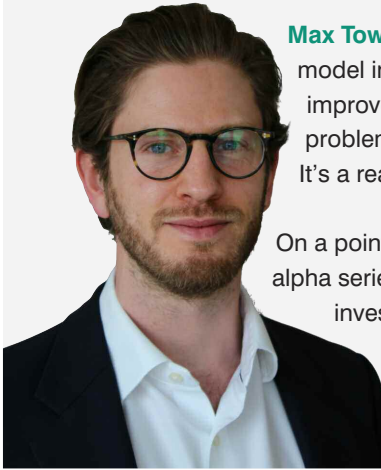
Like all investors, seeking alpha was key. Scarcity was indeed a factor here, I believe.

**Max Townshend:** Going back to your earlier point about fee hazard; with one sided performance fees essentially an option on future returns, increasing the segmentation of sources of return can create expensive and risky portfolios of short options positions for asset owners. When locks are added in, you start paying fees on performance that cannot be realized, and you are ultimately unable to rebalance. Diversifiers are worth very little if you can't actually derive any utility from that diversification. So it's a surprising trend.



## John Harrison

Right, and this surprised me too. While it gives the manager the option to plan a bit further ahead, I don't view this as a trend that rewards the investor correctly for the exposures that he is taking on. I take a view that his hands are tied, which at some point he may not like.



**Max Townshend:** Have you guys all read the [CPPIB paper from 2008](#)? It offers a very sensible fee model incorporating risk adjustment to return and looks to compensate skill not luck, hoping in turn to improve long term alignment. If this is applied on a beta adjusted basis you can eliminate most of the problems with crystallization, and for good investment managers there's no loss of earning potential. It's a really sensible approach.

On a point you made John, I'm sympathetic to managers when investors ask for hurdle rates. If it's an alpha series, is it coherent to apply a hurdle? We have the hurdles in private equity and credit investments because they contain a lot of beta that should be rewarded. So the hurdle is a proxy for a beta benchmark. But if the return driver is pure alpha, the same argument clearly doesn't apply.

**Dr Toby Goodworth:** Given the current strong focus on liquid implementations of alternative solutions, we don't see a great deal of investor interest in longer locks for reduced fees.

In all this fee discussion, we also shouldn't forget the effectiveness of straight-up competition for assets. A customized RFP process where managers don't know who they are in competition with can only encourage competitive pricing for the investor as a search process proceeds.



## Matthias Knab

John, in your introduction you mentioned many challenges that asset managers have today. We talked about some of them, are there others we haven't talked about so far?



**John Harrison:** I feel there are a lot of challenges left. Talking again from our perspective as a mid-sized managed futures hedge fund, pricing and fees are, I would say across the sector, a very significant challenge today. Another challenge relates to asset raising. **Even for mid-sized companies with sizeable assets and solid track record, we do see a certain pressure to consolidate as a result of a relatively static AUM growth** which, when confronted by ever increasing cost base, can cause issues. That is a business risk some managers have to look into at the moment. *The problem is particularly acute for those running assets below \$500m or so.* The break-even point for managers continues to increase. The irony is that Amplitude came exactly from this fertile ground of small energetic managers. We grew our business from almost nothing to a position where we are today. The question we should ask is, would a similar business starting up today in London/New York be able to get through?



My fear is that they won't because the barriers of entry today have increased so dramatically. What happens to the future generation of managers? This, by the way, is also a discussion for allocators. If you value what managers are providing by way of diversity of investment opportunity, then there has to be a way of paying for that, otherwise eventually these firms will amalgamate and become parts of large distribution groups. The result will probably end with a whole different return stream.

Another new reality firms have to adapt to is having to align ourselves with consultants. I already mentioned that there is now a whole other group of industry participants we have to educate about what we do, and of course some of them already have a fairly good understanding of systematic investments, but not all.

Then we are all facing regulatory challenges, which is a completely different question, I am sure we are going to talk more about the issue of regulation.

I am curious to hear from Duncan about the number of small managers coming through who have a realistic chance of actually making it. When we started live trading in 2005, we had \$5 million AUM and you, SocGen, very kindly took us on-board. I am not sure if you would have the same appetite for that again in today's market.

**Duncan Crawford:** Yes, sadly, it is a very different story now. Bringing on managers like yourselves when they are small and helping them grow and develop was part of how we built our business, it was part of our DNA. For some time now there haven't been so many managers launching even at the \$20m, \$30m, or \$50m level, and as you say, there are managers with a few hundred million in assets that are looking to join up with other managers. Many haven't received performance fees for a number of years while the cost of running their business has increased with the increased regulation.

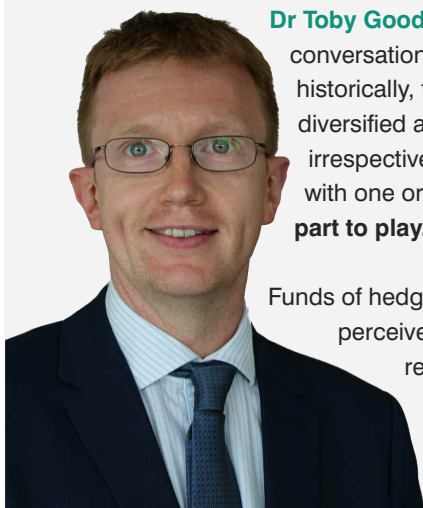
*So fund managers are looking for ways to stay afloat and rationalize their business, for example by mutualizing their often significant infrastructure, or looking at different ways of servicing other managers while avoiding any contagion of IP.* Mid sized or larger managers develop models to potentially give these smaller managers a better support and help to get them going, obviously for a fee or fee share of some kind. The platforms or the so-called **hedge fund hotels** are starting to get more interest and are no longer seen as inferior to doing it alone. These multi-single manager platforms tended to have struggled over the years, it has seemed to have been difficult for them to develop and really grow. There has been the odd outlier, where one manager here or there managed to raise significant assets within such a platform, but historically they haven't done that well, however that seems to be changing and we are seeing them starting to do that much better.

Here is another interesting trend I would like to comment on. Since 2008 there has been a huge shift in hedge fund investors from family offices and fund of funds to institutional investors. The fund of funds have largely been bypassed with institutions going directly to hedge funds, and most of the flows were allocated to the biggest funds for a number of reasons, one of them certainly because that had the least job risk for the decision maker.

Since 2008, hedge fund assets have increased from \$2.3 trillion in January '08 to about \$3.2 trillion assets now, but much of that has gone to the bigger managers. However this year, there have been **small outflows from the bigger managers but actually inflows to the smaller managers.**

Institutions are clearly more comfortable with smaller hedge funds than they were when they started allocating directly. I think they have always realized that they are more likely to get higher volatility, more alpha and more diversified returns if they go for smaller managers, and perhaps, we are finally seeing that happening. I mean, it's certainly seen in the numbers at the moment. While this doesn't take us back to the days when Amplitude started, it's certainly helpful.





**Dr Toby Goodworth:** We are also seeing an increase in the number of fund of funds mandate conversations we are having with investors. Although absolute levels of interest are lower today than historically, there's been a noticeable uptick in activity recently for smaller sized investments seeking diversified alternatives exposure. It's a recognition that investors want alternatives in their portfolio irrespective of their size. For some a direct program is appropriate; for others it might be that going with one or two broad spectrum single managers is suitable. **Funds of hedge funds have a strong part to play.**

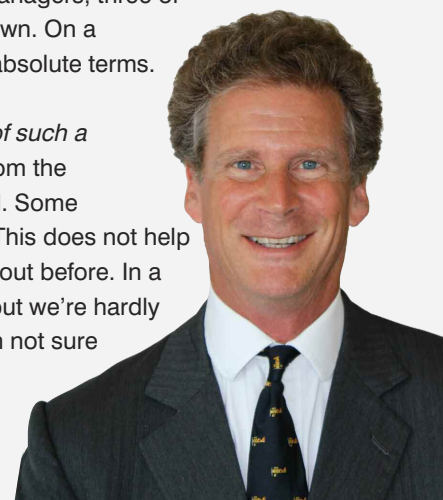
Funds of hedge funds have also been addressing what many see as one of their biggest hurdles – the perceived cost, and especially the dual layer of fees. There has certainly been some innovation recently to address this factor, which historically has been prohibitive for some investors, such as the introduction of fund of sub-advisor models.

**John Harrison:** I can think of two aspects where platforms can make quite an important contribution. As we have said, there is a case for smaller managers that can offer a diversified return stream, however the reality is that the allocators are looking at big tickets. There are quite a lot of allocators, even from large pension funds, who might wish to allocate to extremely interesting new smaller managers, but they simply can't. First, there is the issue of the due diligence and monitoring the fund and all the onerous work this involves. But foremost, putting a \$150m or \$200m allocation into a manager who currently may have \$150-200m under management, is impossible.

The result is that those larger allocators can really only look at a limited pool of managers. **Platforms could play a role here.** By careful selection and cherry-picking, a platform may be able to build diverse risk adjusted pools with idiosyncratic characteristics, with sufficient capacity to attract large allocators. In this vision, a platform goes beyond simply providing access to these managers. You want a platform that's actually sat down and has done all the due diligence on the managers and individuals, so that they are able to say categorically that "these are the people."

Platforms have also been instrumental in some cases, in **pooling managers** and their programs for a fee paid on aggregate performance. This is a discussion we have witnessed. From the investor perspective, the structure is seemingly understandably attractive. An example might be where an allocator has exposure to 5 managers, three of which are down over a period, and two are up, yet the overall return of the portfolio is down. On a standalone basis, performance fees have been paid, yet the overall portfolio is down in absolute terms.

On a holistic basis, the question is really how do you address that? Of course, *the idea of such a pooled environment is great, but there are also some problems.* I think the main issue from the perspective of a manager is that it has no control on the other managers joining the pool. Some managers may consistently perform but there could be others who consistently do not. This does not help create that equilibrium between managers, and managers and investors we've talked about before. In a situation like this, the best managers will eventually say, "Hey, we performed really well but we're hardly being paid, so we're jumping off." This is the hazard I see in pooling managers, and I am not sure what the answer is yet.



**Andrew Dreaneen:** One major trend we haven't yet commented on is this kind of **divestiture from hedge funds broadly into private assets** over the last couple of years. The frustration of returns is surely a factor in this. I am aware of institutions in Asia which might have had 2% hedge funds, but it's gone to 1%, and the other 1% has gone to private assets, which maybe were 8% and now 9%. Considering the overall size, this can be quite large sums of money.

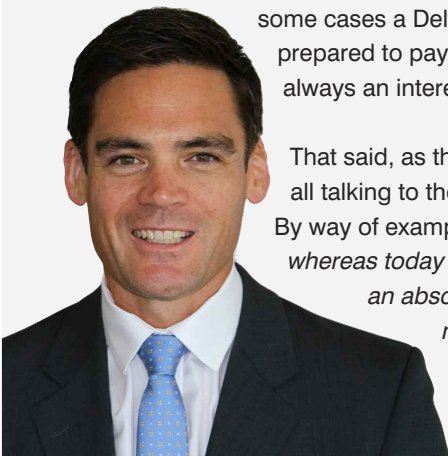
But on the other side of the coin, if investors are moving heavily towards the illiquid side, that is in a way *also very beneficial for liquid alternatives and alternative risk premia*, which obviously tend to be very liquid as well. A lot of private assets firms are raising record levels of AUM, however we still see a desire from investors to retain some level of liquidity in their portfolios. So whilst on the margin some hedge funds may be seeing outflows, I think the trend actually bodes well for liquid alternatives and all alternative risk premia. By way of example, we saw approximately \$100bn redemptions from hedge funds in 2016 and more than \$30bn of net inflows into UCITS hedge fund.

Another trend we are seeing in the liquid alternatives space is growth from a broad range of investors - the initial wave of growth came immediately following the financial crisis which involved predominantly experienced hedge fund buyers from asset managers and wealth managers moving away from offshore hedge funds into UCITS and US 40 Act funds. I believe this trend will continue to grow and these investors will remain the biggest segment of the market. But looking outside of that, I think *the real opportunity is the group of investors that have never meaningfully invested in hedge funds before*, but are now grappling with how to best diversify their long only portfolios after a prolonged bull run.

This bodes well for the growth of liquid alternatives moving forward. However, the investors who have never bought hedge funds before may be struggling with the concept of performance fees, and some may opt to go through these alternative risk premia managers or through traditional asset managers who also have a liquid alternatives line up, but are often priced more keenly.

Still, the growth will continue, and we see that in our offering at Schroders as well. We have \$20 billion in 35 funds, and 23 of those have launched since the financial crisis. 9 of those are managed externally, but the balance is managed internally. We have made a really big effort into growing our liquid alternatives capabilities. When we look at potentially on-boarding a new strategy, we are very mindful of the pricing of those strategies and what clients are prepared to pay in the channels which perhaps are less familiar with hedge funds and generally very focused on fees, especially when there is transparency around those fees. A lot of the allocators are managing funds of funds or other portfolios where their fees are fully disclosed to clients, along with the underlying component parts.

As a result, there is a focus in getting fees down to 50 or 60 basis points, this is commonly a number that's mentioned to us, but at the same time the investors want to buy liquid hedge fund strategies managed by some of the best hedge fund managers in the world, which are in some cases very closely linked to their flagship hedge funds, and in some cases a Delta One product. This means that really a gap opens up between what people are prepared to pay and what some of the more experienced hedge fund managers are charging, which is always an interesting conversation.



That said, as the long only and alternative asset management worlds have converged and we are now all talking to the same clients I would say this **increased competition is beneficial for end investors**. By way of example, *before we were selling a fund of hedge funds against another fund of hedge funds; whereas today a fund of hedge fund is competing against flat fee funds of managed accounts, against an absolute return multi asset fund run by traditional asset managers, against a discretionary macro fund that's run by either a traditional or a hedge fund manager, against a multi-strategy single or multi manager and then you have all of the various systematic managers in quant macro and multi strategy/ multi asset absolute return.*

When you consider all of these types of offerings in the liquid alternatives space, with the benefit of the UCITS passport, they are all effectively competing for the same dollar at the end of the day and in some cases are priced north of 2/20 and in other cases less than 50bps flat. It is going to be very interesting to see where investors make allocations in the future with more choice than ever before - thus far we have seen success from some of the big brand name hedge funds or traditional asset managers, managers with typical hedge fund fees and some of the lower cost more scalable alts too, but everything in between has been a bit more mixed in terms of success.

Unfortunately, when fees are the primary determinant, you end up with a more limited toolkit to work with - we have heard about allocators selling out of the higher priced managers specifically because of price, while at the same time some of these managers have consistently been the best performing fund in their peer groups by a long way. But I understand that many people do put price first and so it is important to have different strategies at various pricing points and different risk return characteristics to cater for demand.

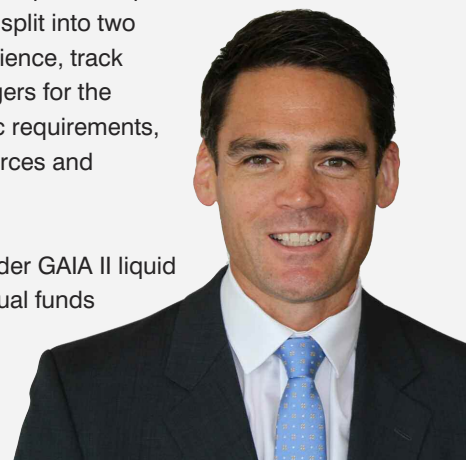
**Matthias Knab**

Andrew, can you share with us more details how you select managers and your onboarding process at your GAIA platform?

**Andrew Dreaneen:** Our goal at Schroders is to offer high quality and innovative investment solutions to our clients. In true pioneering spirit we set up Schroder GAIA in 2009 as one of the first alternative UCITS platforms. Schroders has extensive experience in hedge fund manager selection and investment dating back to 2000 and has built up a proprietary hedge fund database with over 10,000 funds. We are continuously on the look out for interesting managers with differentiated return streams and tend to focus on strategies where there is strong demand from our clients.

We are selective in terms of who we are prepared to work with and place considerable importance on identifying high *pedigree managers with demonstrable proven track records. Our goal is to partner with a small select group of leading managers as opposed to setting up an access platform for a broad range of managers.* In order to find credible partners, we perform both detailed quantitative and qualitative investment analysis, including in-depth interviews and due diligence. The quantitative analysis examines, among other things, performance, correlation, beta, drawdown, up capture and down capture versus both the benchmark and peers. In terms of the qualitative investment analysis, emphasis is placed on different criteria for different strategies. However, broadly speaking, the criteria can be split into two categories. Firstly, manager selection from an investment perspective looking at experience, track record and skill, investment process, risk management and integrity. Secondly, managers for the Schroder GAIA platform are evaluated using additional key commercial/UCITS specific requirements, such as fit with UCITS constraints, capacity, manager size, manager operational resources and manager reputation.

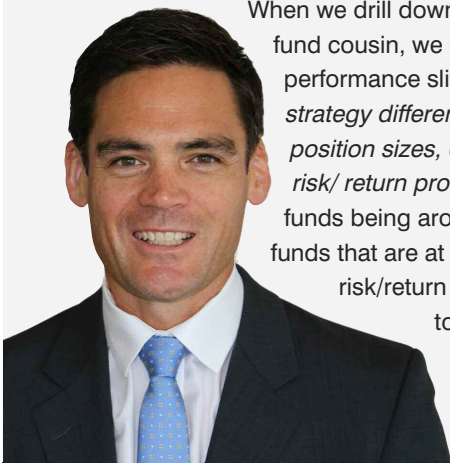
Last year in March 2016 we launched the first Liquid Distressed strategy on our Schroder GAIA II liquid alternatives AIF platform. It ended up being one of the best performing alternative mutual funds last year and was up 23.4% (according to Kepler 5/383 funds). We pride ourselves on being early movers and continue to seek opportunities to innovate.





**Andrew Dreaneen:** Yes fund size is important – the average fund size in our liquid alternatives range is \$600m, however we see a lot of sub scale UCITS funds in the market, some of the managers out there may need to subsidise the funds to keep the administrative fees in check.

We have run a number of comparisons between the admin fees on UCITS funds and Cayman hedge funds. What we have seen in the aggregate for a \$500 million UCITS hedge fund in Luxembourg versus the same \$500 million hedge fund strategy in Cayman, the difference purely on the administrative fee side is around 15-20 basis points. It could be a lot less if the UCITS is not widely distributed and the costs can vary depending on the strategy and it may change again when the fund reaches say \$1 billion.



When we drill down into the potential sources of tracking error between a UCITS and its offshore hedge fund cousin, we often haven't have found the administrative fees to be the sole or largest contributor of performance slippage. *The main contributors to performance difference in our findings are investment strategy differences, things like excluding different trading strategies or individual positions, changing position sizes, or perhaps running different gross and net exposure profiles and targeting a different risk/ return profile.* People always talk about the average give up of a UCITS versus offshore hedge funds being around the 1-2% range, but that includes some funds where it's 6% or more, and some funds that are at just 10 basis points. Most of the funds which deliberately target a substantially similar risk/return profile and where everything they do in offshore can be replicated in UCITS are more towards 10 basis points and other funds where it is more difficult to replicate the offshore hedge fund, like event driven credit, the performance difference naturally tends to be more meaningful.

**John Harrison:** We are a CTA of course, and coincidentally we are looking at UCITS at the moment. When we looked at UCITS III some years ago, we saw some issues around concentration and aggregation, and also the issue of commodities and how we get around that with synthetic swaps and total return swaps. UCITS kept evolving and we are now at UCITS V and we are relooking at it at the moment.

There seems to be significant appetite, even within our CTA world. I mean, in the end we are very liquid, we generally show low or uncorrelated returns, have a very transparent approach. All of which are key UCITS traits. We follow a prescribed set of investment rules given our systematic nature, so you know pretty well what you are buying into. UCITS still poses some problems however, as we can't access certain markets with our strategy that we would rather like to.

An additional concern for Cayman domiciled investment managers are the regulatory hurdles and the additional cost layers this can create. Just looking at MiFID or the AIFMD, these two regimes require us to locate our IM within the European Union, and here we haven't quite worked out a cost-effective solution yet.





**Dr Toby Goodworth:** From our view point, we see a drive for UCITS which is certainly not slowing down. **In certain regions, it's now essentially UCITS or nothing.** In other regions there may be a preference for UCITS versus offshore, and in others it's offshore as usual. What has changed over time is that many investors are looking at UCITS right away rather than looking offshore and then moving to UCITS.

If I look at the number of mandates for UCITS versus offshore searches we have conducted, UCITS is dominating at the moment.

**Andrew Dreaneen:** One interesting dynamic for liquid alternative investors is how the supply side of the equation is continuing to improve especially from large US based managers. Investors are still looking for blue chip, well-established hedge fund managers offering strategies in UCITS, and those managers that do come on board, where there is a great degree of product integrity, tend to raise money very quickly and can get to capacity in relatively short time.

So let's just address this opportunity set from the perspective of managers. There are 34,000 UCITS funds, \$9 trillion in assets. Today the subset of alternative UCITS is, depending on the database, roughly 800-1200 funds and \$300-400 billion which only equates to approximately 3% of total assets. Looking out 5 years there are numerous studies predicting this will grow to 10% of total assets. What is exciting is that will represents around **\$700 billion of net new business into alternative UCITS over the next several years**, which will likely go to some of the world's largest managers that come to the market, but there will also be a lot of opportunity for mid sized managers too. Whilst some of the fund of hedge funds, seeding platforms and family offices are dedicated to seeding new managers, the mainstream allocators such as private banks and asset managers are still very much focused on brands. They would like to have managers that are widely recognised and have long-term track records on their shelves for their end clients.



**Matthias Knab**

Typically, what exactly would those mainstream allocators look for in a brand managers, like how old and what type of size would they like to see?



**Andrew Dreaneen:** If we look at the 20 largest alternative UCITS funds in the market, the vast majority, 15 to 18 of those are run by traditional asset managers, however the segment of the market that has also been growing strongly is funds run by more established hedge fund managers with \$5bn firm AUM or more. For a number of these funds the UCITS capacity is capped at say \$1bn AUM so they often don't show in the top 20, but appear slightly outside. Some of these firms offer just the one strategy, but a number of the systematic hedge fund firms now offer numerous strategies in UCITS given the greater flexibility to customise and offer different risk return profiles.

In the fundamental long/short equity space, because it's generally quite easy to replicate the strategy in UCITS, most of the managers are offering a version of their flagship at the same price. Many managers with \$5 or \$10 billion in the offshore format have raised a billion or more in the UCITS format as well.

**John Harrison:** Let me start off by saying that I am generally an optimistic person, and I see that the position of the City of London is not as dark as some political commentators may suggest. That said, there is an uncomfortable level of uncertainty at present, I think further fueled by the recent UK general election and the less-than-desirable result.

As you mentioned, Amplitude started its business in London. Why? Because businesses like ours need to be where everybody is, and those allocating or interested in the European hedge fund business are largely in or pass through London. That historically has been the case, and it still remains the case.

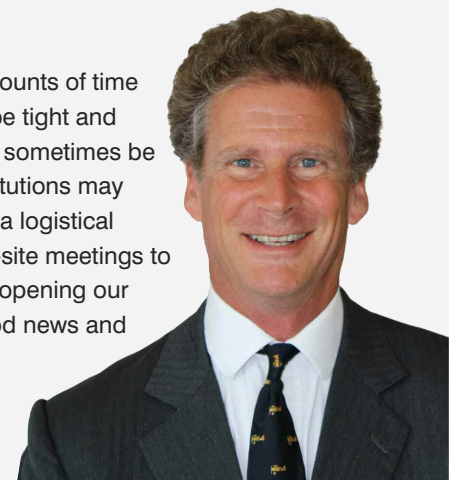
We made a choice to move to Zug, Switzerland back in 2008 based not necessarily on issues like taxation, which tend to get a lot of coverage; but on general lifestyle choices and excellent supply of technical universities. When we made the decision to move, the firm had reached a profitable status and we felt able to undertake the issues presented by relocation. From that perspective, it has been a huge success and the relocation, from a business perspective, has proven to be positive. It's an excellent place to be based.

Nevertheless, three key considerations always remain. Firstly, can we operate our business successfully outside a financial hub? The answer to this has been yes. From an operational perspective, technological advancements mean that the physical location is rather less relevant than was once the case. As long as the IT infrastructure is in place, a good supply of technical expertise and a business friendly environment exists, then location outside a hub remains an option.

Secondly, with an Investment Advisor now located outside the EU in Switzerland, the issue of domestic regulation has always been important. Unlike the sophisticated and internationally recognized regulatory regime of the UK (the FCA), Switzerland does not have a comparable body to regulate the hedge fund sector – though FINMA has gained more traction over recent years. The degree of regulatory oversight remains of key importance to our institutional investors, so considerable effort is made to maintain our SEC, NFA and CFTC regulated status.

And then there's **the issue of through traffic**. *This is the single biggest reason why we have invested recently in a London office.* It is probably fair to say that we slightly under-estimated how important it was to have a physical location where people pass through. People come to London not only to meet managers, but are here also to meet brokers, lawyers, accountants, exchanges and attend industry functions, to conduct due diligence. As a business which requires time in-front of clients, being in London makes a lot of sense. Our offices are based just off St. James' and so much of this activity takes place within a 3 mile radius. Already we are seeing fruits of this investment.

Large institutional investors and those driving investment decisions have very limited amounts of time available to cover their portfolio managers and see new ones. Travel schedules tend to be tight and rather inflexible. They will come to the main hubs, including London of course, but it can sometimes be difficult for these institutions to justify extending trips to other locations. Whilst these institutions may have had our firm on their radar for some time and may be keen to progress, having extra logistical issues can make a difference. We have found that the conversion rate between good off-site meetings to on-site meetings is impacted by location. As mentioned before, within very short time of opening our London office, we have already seen increased traffic coming through, which is very good news and confirms our decision. It is maybe too early to say this categorically, but so far, so good.



Regarding the longer term issues facing the City, **Brexit** dominates. There are important outstanding questions for the industry. Just take UCITS as an example, and passporting, or AIFMD. How will a London manager market into the European Union going forward? MiFID II could be potentially problematic, though this will not happen for another two years or so after which, Brexit really becomes Brexit, and by then we'll have a much clearer idea. By that stage, managers will be MiFID compliant as the MiFID provisions will already be part of the UK legislative agenda also. Optimistically, I would hope that given the equal regulatory regimes inside the UK and in the EU, agreement should be relatively achievable.

Another question: *what will happen to my UCITS if I am London based?* The ground has moved around me. I used to be in the European Union, now I am not. Therefore, my product can no longer be a UCITS? One assumes that such managers will need to absorb additional costs of infrastructure or substance within the European Union.

While I am optimistic in general, I also do see some danger zones around Brexit. There are a few more clouds, and to be honest, we are maintaining flexibility and options in case things really go wrong. From a business risk perspective, we must consider the downside as well, and there could be a perfect storm with not just Brexit going pear-shaped, but also the UK electing a government that is not aligned at all with the interest of the City that we all share. That would be a rather difficult environment.

The fear that I see is not 'death from a sudden chop'; it's dying by a thousand little cuts. Brexit raises fundamental issues about the soft influence of the UK in the international stage over time. How quickly can it adapt to a more independent trading status and exploit the opportunities this presents is key. There is a lot of vested interest at chipping away at the UK's dominance in financial services and this is a dangerous situation. If regulation is used as a tool to repatriate key activities outside the City to say, other EU locations, this gradual drain could have a long lasting impact on the City. The concern would be the ripple effects on other activity such as financing, M&A, trading and the impact on the professions that support these activities – lawyers, accountants, service providers, etc. This may be alarmist, however, uncertainty breeds fear and managing this over the Brexit transitional period will be important.

#### Matthias Knab

We will have to wait and see whether or not there is a bilateral agreement between the UK and the rest of the EU around passporting UK funds to Europe and vice versa. But in the extent that that doesn't happen, I think a lot of people are taking some precautions. Many of the traditional asset managers already had a UK fund range sold to UK clients with a UK ManCo, and then also a Luxembourg or Dublin ManCo fund range sold more globally and also into the UK. So I think some of *the larger players are well-placed already for such an eventuality*.

And what is the situation of the smaller managers? UCITS is really a global product and has a lot of complexities around how you distribute that, and so many firms who decided to set up UCITS and then also wanting to limit their cost and efforts to one domicile, the jurisdiction of choice has probably been already Luxembourg or Dublin rather than the UK.

*For that reason I am not sure that Brexit at least relating to the passporting of funds is going to have a massive impact.* Of course, I still hope the process is managed and done in a very sensible way, because as John said it's probably much more about the asset management firms, where the people are based and the whole supporting mechanisms and infrastructure we have in place.



**John Harrison:** You are pointing rightly here to the issue of the delegation of responsibility. Certainly Dublin and Luxembourg have grabbed a high market share of the more operational functions, but in the end the investment management decision is always done out of London. I suspect one of the little screws that could be twisted is the tightening up on the rules on delegation of those particular activities, which could sting a little bit. I don't know what the answer to that is.

The other point which I have been quite intrigued by is the **potential flexibility** that Brexit, once it's done and dusted, may bring. I think it's fair to say that we are not going to simply be able to say that, going forward, all of the regulations coming out of the EU can be ignored. To be honest, most London managers are already compliant with EU law, and in fact, the United Kingdom has driven quite a lot of the provisions of the AIFMD which at that time nobody liked – example the compensation caps. But now we find ourselves dealing with the regulations pretty well, and so going forward, we are unlikely to be abandoning these provisions.



The one thing that might happen, which I have heard mentioned, is that we add more flexibility to the degree regulation impacts or applies to managers choosing to be based in the UK. For example, there could be managers who have no interest in marketing into Europe; a bit like Guernsey or Jersey, there is already a very well-established regulatory regime that operates well. How those jurisdictions interact with the European Union is quite interesting, because those who wish to market into the EU will opt-in and subscribe to all the European Union type of regulation. Those who just want to be based in London or Jersey or wherever, but have no interest in marketing at into the EU at all because say, they look to Latin America, Asia, North America or somewhere else, can benefit from a lighter level of regulation. That may be an interesting path for UK regulation to differentiate itself. This optionality is of course, not possible within the EU. Whether that's possible and whether that's feasible, and whether that will happen, I don't know, but it could be an option.

**Jeremy Bruce:** You are right, John, it's very hard to say anything about those aspects with certainty. We mentioned **MiFID II** which goes live January 3 2018, and it's well worth remembering, even if you are an asset manager or running UCITS that large parts of MiFID are going to apply to you one way or another, also if you are in the business of managed accounts. Managing third party money is a MiFID activity. Many other things you do you may well be brought into the MiFID regime, for example just by virtue of the fact that you use a broker and you are doing certain activities can bring you into MiFID.

Brexit is obviously a tricky issue for investment managers regulation, but there is a lot of discussion around equivalence. It's almost certain that the UK regulatory regime would meet the criteria of equivalence. I think we can say that with almost certainty, because a large amount of MiFID II is in fact drafted by the UK.

Whether or not equivalence is designated on day one of Brexit, who knows. The UK will be in an unusual situation compared to many other countries, like Japan, the US and so on, which have equivalence under MiFID I, but may not have day one equivalence of MiFID II. We obviously will be in the European Union when MiFID II gets effective, and leaving later for the purposes of Brexit. So we will certainly have an equivalent regime, but whether we'll have that designation day one or x years down the line from the point of Brexit is hard to say.

The other thing – and this is kind of all crystal ball stuff – but if we did have equivalence, which is possible, what that would then mean for MiFID II passporting is hard to say. This is because MiFID equivalence doesn't necessarily – or haven't for MiFID I – got even to the MiFID II passporting scheme in order to say, "as long as you are regulated by one of the regulators of the European Union, you are free to market your products and services without Europe." That's another unknown.



But to your point about positivity, there are some positives. So there's a lot of stuff in MiFID II, much of which is still only really people are getting to grips with, which is incredibly unpleasant.

Just by way of example, if you are a hedge fund in fact in Europe and say you trade Samsung by a Korean broker. The very fact there is a dual listing of Samsung inside the European Union means that are potentially you are liable to be doing trade reports within one minute of execution, which will be a real challenge.

Clearly it's possible in the future that that kind of thing could be removed by an equivalent UK regime, but not putting those dual listing stipulations on. So that's probably raised more questions than answers, but to the degree that helps, who knows?

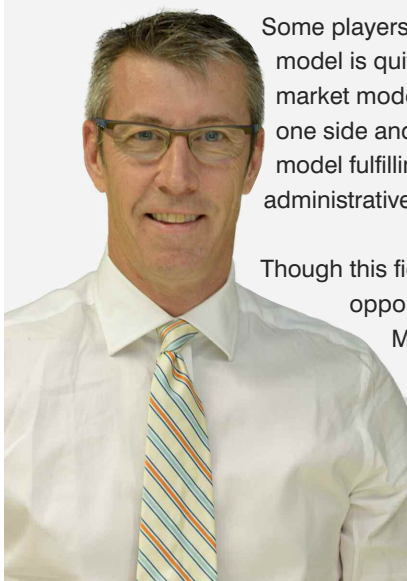
But whatever happens MiFID II, January 3, most people, whether or not you think you are a MiFID manager, many of those regulations also apply to things like managed accounts, gold-plating or from the fact that your activity, the brokers you use, will bring you into the MiFID regime as it applies to the activity, that's probably the first hurdle to get over.

What happens after that, equivalence, MiFID II passport for marketing, or whether the UK can then kind of have the advantages of equivalence, but avoid some of these horrible things of MiFID II, as it stands today, who really knows?

**Markus-Alexander Flesch:** I agree with Jeremy that there are lots of unknowns in the whole field of regulation of MiFID II. Deutsche Börse or Eurex is – as much as you are – a victim of that regulation, and as Jeremy pointed out the whole trade reporting complex turns out to be a burden to the market, with still some left uncertainties on 3rd country equivalence, affecting countries like Switzerland or US, both core markets for Deutsche Boerse.

With only six months to go, it still seems to be a sort of moving target, and unfortunately, nobody knows or has really clarity how it will work, and whether the rule which has been described by Jeremy will really be applied or whether the equivalence regime will deliver some simplicity or even softening some of the detailed directives.

But to be fair, **MiFID II also offers opportunities** and it has been designed, as you all know, to increase the transparency for the final investor, which is something Eurex regards as our main mandate and duty: create and operate liquid and transparent markets and products.



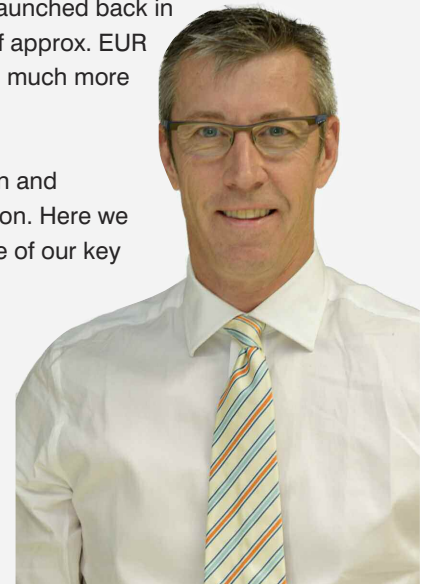
Some players have voiced concerns that the influence of the regulator even in the already existing market model is quite dramatic. Eurex is a strong believer of constructive dialogues, and we think that the market model needs to be adopted in a consultative and cooperative manner between the regulator on one side and the market, i.e. buy side and sell side on the other side. This way we can develop a market model fulfilling the principle of best execution and on the other hand does not increase the cost and administrative burden.

Though this fiction has still a long way to go, there are other developments where regulations opens opportunities for market structure providers like us. For instance with the regulation of "Bilateral Margin rule" or "OTC2CCP" Eurex is able to create **new listed products and solutions** for trades that previously have been purely OTC. Meaning opaque and merely non-transparent. With clients requiring transparent and fair price discovery, I believe MIFIDII will partially help to develop the market like this. However, six months is not a lot of time to overcome market models that have been routed fairly robust for more than 20 years.

**Markus-Alexander Flesch:** Well, I have already referred to the big trend of futurization or OTC products being brought to the on-exchange order book which has been a big driver for the expansion of our equity index portfolio over the last 3 years. Though Eurex has already started this “**OTC Metamorphosis**” back in 2008 with our most successful EuroSTOXX Dividend Future (FEXD), many products have followed this strategy, which was initiated and of course supported by asset managers and many hedge funds. Even CTAs have been early adopters of that Dividend Future product and helped making it a great success. However many further products followed: e.g. our Variance Future EVAR or our most recent “futurized” product the EuroStoxxTotal Return Index Future (TESX), which has been established and successfully launched back in December 2016. With partners like BNP we were able to exceed on open interest by now of approx. EUR 3.5bn, which I feel is only a start and with the engagement of more asset managers there is much more in this product segment to capture relieving banks from their capital constraints.

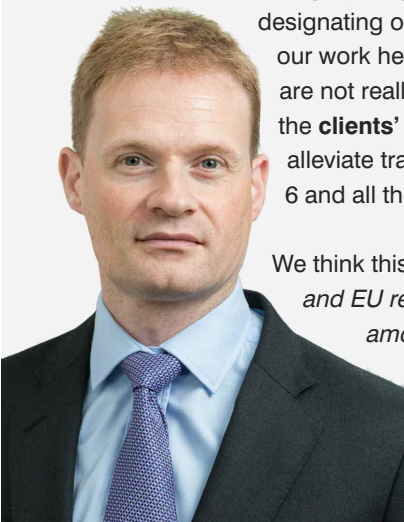
We also intending to expanded our volatility portfolio with derivatives focusing on dispersion and correlation, taking advantage of a low volatility environment and a pronounced sector rotation. Here we keep evolving beyond the plain vanilla products. Just from the first conversations with some of our key clients and buy side managers, this trend seems to be quite relevant for the market, as well promising good returns and diversification to the end client.

Another product we are excited about and will hopefully launch within the next six months is a future on the **Hedge Fund Research Index**. This index is not investable yet, but is another good example how we try to increase diversity and offer value through a variety of different derivative products.



**Jeremy Bruce:** Innovation is also a gradual or continuous exercise, so a lot of what my team is doing is designing or redesigning many things we are doing and how we do it, be it smart order routers, be it the way we organize our trading or accessing liquidity, be it micro options or new crossing mechanisms or whatever. I won't go too far into it, but designating ourselves into the Systematic Internaliser Regime and such sorts of different things. Most of our work here is actually geared towards helping our clients. So, compliance-wise, many things we do are not really implemented to meet our own regulatory requirements, but rather facilitate and help with the **clients' regulatory burden** and new obligations which will come up with MiFID II. This includes to alleviate trade reporting requirements, or to make sure that they are in a certain category vis-à-vis RTS 6 and all these requirements.

We think this is important because with *MiFID II*, if we go all the way back regulatory-wise to all other UK and EU regulations for the last 20 years, this regulatory framework for the first time put an enormous amount on the buy side to comply with, be it commission, be it transaction reporting, trade reporting, be it transparency on who your brokers are, on how much you are spending on research, on time-stamping every single transaction down to the millisecond, huge amounts of things that the buy side have just never really had to think about before.



And so we are trying to help do things. The regulatory obligation will always be on the buy side, it cannot be delegated, but the more as a bank and prime broker can do, and the way we can organize ourselves to make that as light as possible for our clients, the better. In some ways it's almost a defensive effort as well, to be honest. We invest and do all this so that our clients have the certainty we're doing all we can to make things as least bad as possible in a way. From that perspective, then it's almost an opportunity.

**John Harrison:** **Aggregation limits** are one of those big industry issues now. It's a problem not just for the manager, but also for the allocators now, because exchanges are placing aggregations limits no longer per manager, but on an aggregate basis. For example, if a large allocator is invested in many hedge funds, there's a drive now to understand what the total aggregation risk for that one allocator is within the market, and that requires a lot of activity and monitoring from the allocator to ensure that the managers they have engaged are also totally on top of the exposure that they are creating for them. And when they rebalance portfolios, that has an implication all around, because some, such as ourselves, we cannot change the hardwired basis in which we allocate to markets. So there are issues there, but I can also add that we're making progress here.

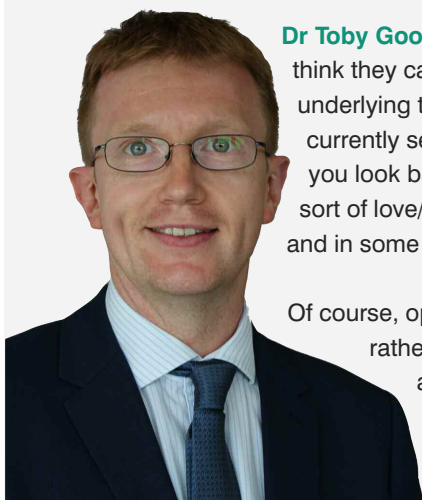
If there is one other topic I definitely do want to raise at this Roundtable is AI - **Artificial Intelligence**. This has become a big debate now in our industry which we clearly can't ignore. Also at Amplitude, there is a push to examine the extent to which we can utilize AI as a means of enhancing what we already do and also explore new ways.

The pool of talent is limited in its availability and becoming highly desirable. The art here from a business perspective is to enter the fray at the optimal time. AI projects will have a lead time before results can be determined, but managers must not ignore the subject. Some managers are actually making remarkable progress in this area, and if you get left behind, there's always a danger that you are left holding the Nokia mobile telephone, when iPhones are coming out, and nobody really wants to be in that spot.



**Dr Toby Goodworth:** AI and machine learning are certainly the buzzwords, together with big data. I think they can be interpreted at many, many different levels and, while there is an element of hype, the underlying technology is undoubtedly there and is going to grow. On that note more generally, we are currently seeing **a much broader acceptance of quant strategies** from investors than in the past. If you look back on much longer cycles, specifically within the alternatives industry, you can identify a sort of love/hate quant meta-cycle, and we are now at a period where quant strategies are accepted, and in some cases even significantly preferred.

Of course, opinion here varies by investor, and we are not saying quant is better than discretionary, rather just that we are currently seeing investors lean that way. The other big trend, as I've already mentioned, is a strong focus on liquid strategies too. This often goes hand in hand with quantitative strategies.

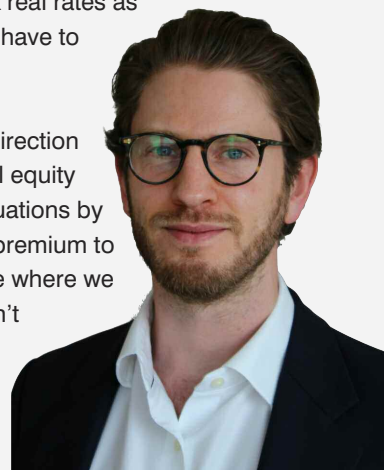




**Max Townshend:** Building on Toby's consulting lens, I think that in the UK we will also start to see **more internalisation by asset owners**, a growing trend in Canada and Australia. In 2014 our team began managing an internal fundamental equity program, which now accounts for about 40% of our long only equity exposure. In due course, with the advent of alternative risk premia investing, some of the lower turnover futures based and single stock long/short equity factors are potential candidates for us to research and manage internally.

With a strategic lens, we're always interested in trying to find areas where our risks align differently to large parts of the market. An example of a risk that is structurally against us is Sterling real rates, where many corporates and pensions in the UK are forced buyers of protection. There's far greater demand for linkers than issuance by the DMO, and as a consequence the premium to hedge inflation is high. If we didn't have a Sterling liability, one might see short UK real rates as an appealing trade for the next 20 years, but we have significant real rates risk and our clients have to consider paying a premium to hedge.

But there may be other risks that markets want underwritten which are actually in contrast to direction of risk in our assets and liabilities. An example is the Sterling insurance market; through global equity exposure we invest in a lot of overseas assets, and Sterling weakness increases our asset valuations by more than we expect cost input inflation to increase our liabilities. The options market pays a premium to hedge Sterling downside, a risk which creates positive outcomes for us. This is a rare example where we can be on the other side of a market, earning carry to hedge a risk. That particular example isn't something we would necessarily implement, but trying to be more thoughtful in matching investments to our circumstances is of growing importance.





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## What happened in Week 3?

Hedge fund manager A has produced a custom video with Opalesque.TV and it has been online for a few weeks. As with manager A, we sometimes notice that the weekly views of a video can jump several hundred percent from one week to the other.

Weekly video views	Week 1	Week 2	Week 3
of Manager A:	110	101	376



There are a range of different reasons for such a sudden jump in views, for example manager A could have:

- won a prestigious award or was nominated to it
- been included in some industry ranking
- been written up in the press / hedge fund media
- just launched a new fund that gained a lot of attention
- posted a (very) good month or year
- etc.

It is safe to assume that on any given day, someone or many will google any hedge fund manager's name, fund name, or company name. Good for those who have a custom made, targeted video online that investors can access any time, and at their time.



### Unexpected long-term effect

Opalesque has detailed viewer stats on 280+ videos since 2009. What's most interesting is that **video views do not drop significantly over time**, no matter how long the video has been online.

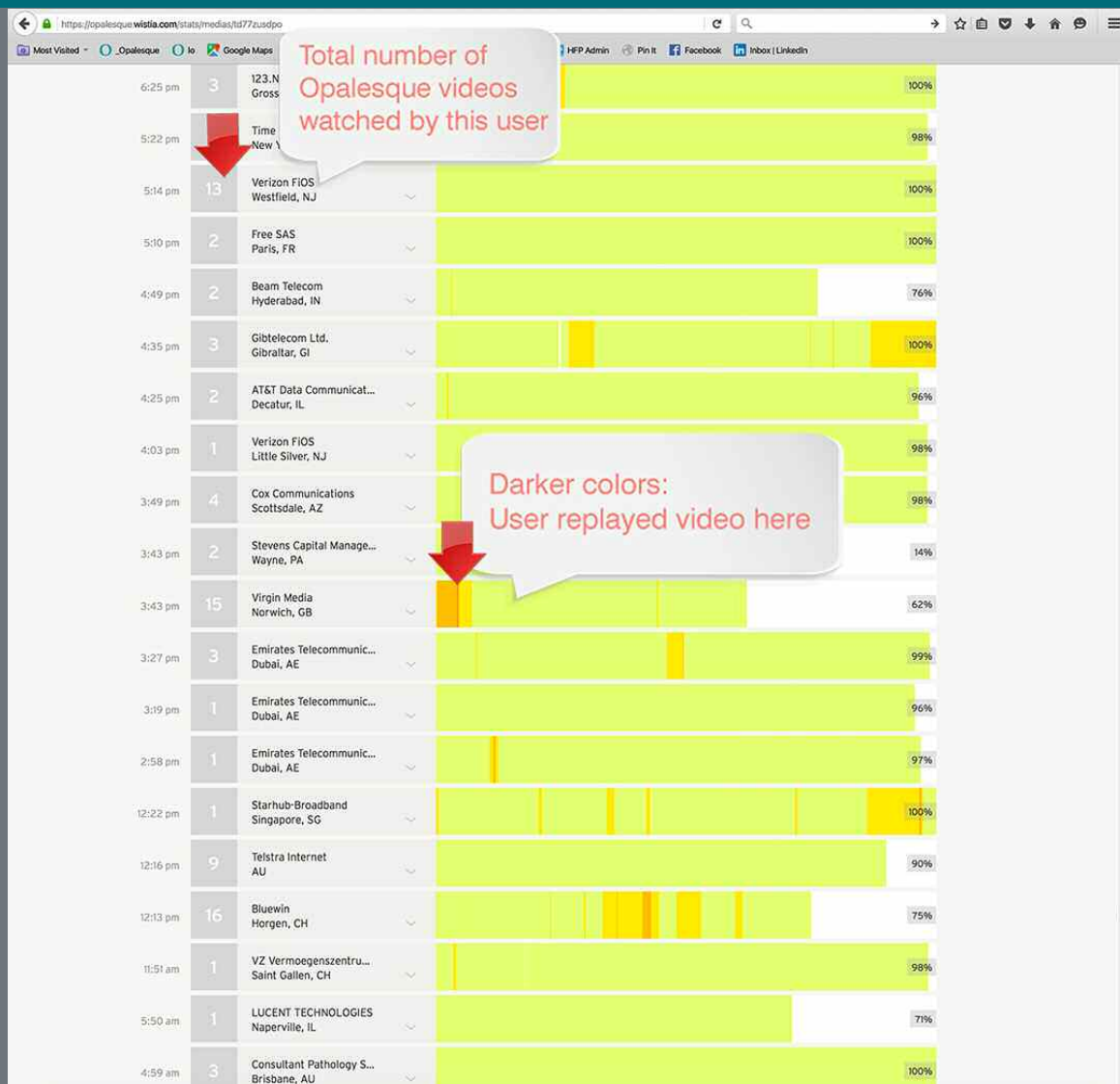
# Taking Meetings over Christmas and while you're sleeping

Opalesque.TV videos are designed to simulate a first time meeting with a prospective investor. Many of these allocators will watch a video when they see that there's one available on the manager they are researching (like the viewers of manager A). All 280+ managers who have produced a custom Opalesque.TV video can therefore actually make business (or "have a meeting") while sleeping. Or when it's Christmas.

This video was watched 104 times over the 2016 Christmas holidays:

<http://www.opalesque.tv/hedge-fund-videos/patrick-stutz/1>

Take a look at the next graphic, especially at the hours (which are Central European), the locations, and the completion (how many viewers watched the video until the end):



We therefore believe there are real **opportunity costs** for managers who do not use videos to explain what they do.



## Save up to 50% in travel costs by making your first meeting the second one

Have you ever spent time and money to take a trip to present your fund, only to hear, *"Thank you for coming to our office, and please keep sending me your reports ..."*?

What if you had known before that the investor is looking for something else?

By sending their video to prospects **before the meeting**, the manager wins twice. Should the investor be looking for something else, the manager can focus his efforts on those investors who watched the video **and liked** what they saw.

In these cases, managers tell us that the first real meeting becomes more like a 2nd meeting (the 1st one being the video) as the groundwork has been laid and the meeting will be much more successful and achieve much more compared to a regular first meeting. By better **qualifying your leads**, you can basically halve your travel budget and raise more assets quicker.

## Compliant

- Opalesque.TV videos are produced to comply with your regulatory requirements
- Allow for true reverse solicitation

## You're in control

When you're doing a custom Opalesque.TV video, you have full control about any aspect of your message. This is not a given in any other regular media coverage.

A manager portrait on Opalesque.TV is generally designed to simulate a first time meeting with a prospective investor, meaning that questions like the following will be discussed:

- Please introduce yourself and your firm
- What is special about your strategy?
- How are you different from your competitors?
- What else is important regarding the asset class?
- Opportunities you focus on

## Working with a trusted partner

Over 1.2 million people have watched one or more Opalesque.TV videos, which means that the people you may be targeting will already be familiar with Opalesque.TV videos.

Managers like **Julian Robertson, Izzy Englander, Jim Chanos, Jeffrey Ubben, Elena Ambrosiadou, Anthony Scaramucci**, and many others have done Opalesque videos, as well as institutions like **Morgan Stanley, State Street Global Advisors, M&G Investments**.

## Broad distribution

You can either produce a private video with us, which will only be hosted on the non-public part of your website, or we can offer you the broadest possible multi-channel distribution on Opalesque.TV and our partners like Reuters and other leading platforms. Contact us to discuss your custom distribution package.

Managers have **quadrupled assets** thanks to our video (\$700m to \$2.4bn in 1 year) and also received a book contract or **invitation to speak at the World Economic Forum or at TED** through our video:

- View count: Over 1.2 million views (hundreds of thousands of people)
- Thousands of investors will view your presentations
- Longterm effect: views do not drop significantly over time
- Without investing a single additional minute of your time – time required to record a video is approximately 90 minutes.

## Costs

For a 10 minute video the all-inclusive package price is US\$4000 which includes: travel (Europe and NY tristate), full production at your office, multiple edits (cuts), provision of the final video file, and a global, multi channel distribution package. A 15 minute video is \$5000, so \$1000 will be billed for each additional 5 minute segment above 10 minutes. The client determines the final length of the video.

## Links

Opalesque.TV video which got 104 views over 2016 Christmas:

<http://www.opalesque.tv/hedge-fund-videos/patrick-stutz/>

Opalesque.TV videos sorted by number of views:

<http://www.opalesque.tv/most-viewed-hedge-fund-videos/>

Opalesque.TV videos sorted by number of social media shares:

<http://www.opalesque.tv/most-shared-hedge-fund-videos/>

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