OPALESQUE

Opalesque Round Table Series '10

TEXAS

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Editors' Note

Dear Reader,

Flying into Dallas from Sao Paulo (where I produced the Opalesque Brazil Roundtable available in our archive), the contrast struck me hard and unexpectedly. When jogging around Dallas, I saw that every second shop on Commerce, Main, or Elm Street was closed and empty – Dallas seems to have that feel of a hard recession. There were even empty parking spaces on all streets at all hours - unthinkable in buzzing Brazil, which is cranking to be the fifth largest economy in ten or fifteen years.

Enter Kyle Bass, who basically says this is just the beginning. Bass is one of the handful money managers on the planet, who correctly identified the subprime meltdown, who set up the right trades and made a fortune for himself and his investors. (For a splendid recount on this feat, follow this link.)

In this Roundtable, Bass adds a lot of scary details and color to his current investment thesis of a the Keynesian end that awaits Greece, Japan and the "Club Med" (Italy, Spain), with the U.S. not be far behind. Bass says he is "not contrarian for contrarian sake" and he "can't wait to be long" - after this secular crisis has been overcome through debt restructures.

Bass says politicians have front row seats to observe and reflect on Japan, which is "the best opportunity I have ever seen in my life. It is the most convex opportunity I have ever seen. If you take the time to look at the numbers, you realize why they have had seven finance ministers in three years, five in the last year-and-a-half. The whole scenario is playing out exactly as you would expect it to play out, right under everyone's nose, and no one says a word about it...."

This Roundtable is a thrilling discussion between (global) macro scenarios and equities-centric investment approaches that may leave countless investors with bloodless net returns, deceived by "attractive valuations" while real assets could end up ruling supreme.

But what is a real asset? How safe is your Gold ETF or futures and futures options on precious metals really, when you compare open interest against the registered and eligible inventories behind those instruments?

This Roundtable further covers:

- Overview on the Texas hedge fund industry: inflows, structure, upcoming managers
- Texas is different: Why emerging hedge fund managers can get meetings with Texas billionaires
- Quantitative, qualitative, or the "blink"-effect? How Texas investors and family offices select managers
- Why do so few investors have permanent allocations to CTAs and managed futures, and what is the price for that?
- With no state income tax and relatively healthy state finances (unlike any other state, Texas is blessed with a $9 billion slush fund), local managers expect an influx of colleagues from other states where top marginal rates may get close to 60%.

This inaugural Opalesque Texas Roundtable was sponsored by the CME Group. We also thank our 2010 Roundtable Series Sponsors Custom House Group and Taussig Capital, as well as Akin Gump for providing the meeting venue for our team:

- **Kyle Bass, Managing Partner, Hayman Capital**
- **Don Hodges, Founder, Hodges Capital Management**
- **Shaun Jordan, Director, Abraham Trading Company**
- **Craig Caudle, CEO and Principal, Liberty Funds Group**
- **Terry Beneke, CIO, Antares Capital Partners**
- **Guilllermo de León, Manager of Investments, Salient Partners**
- **Barry Greenberg, Executive Director Texas Hedge Fund Association, Partner, Akin Gump**
- **Rick Redding, Managing Director, CME Group**

Enjoy the read
Matthias Knab
Director Opalesque Ltd.
knab@opalesque.com

Cover Photo: Downtown Dallas, Texas. Photo: Matthias Knab

Participant Profiles

(LEFT TO RIGHT)
Standing: Matthias Knab, Rick Redding, Barry Greenberg, Shaun Jordan, Guilllermo de León
Seated: Don Hodges, Kyle Bass, Craig Caudle, Terry Beneke

Opalesque Texas Roundtable Sponsor

CME Group

Introduction

Rick Redding
CME Group

I am Rick Redding the Managing Director at CME Group. CME Group is the largest global derivatives exchange. It is the combination of the CME, CBOT, NYMEX, and COMEX Exchanges. We have global benchmark futures products on every asset class, in every time zone.

Barry Greenberg
Texas Hedge Fund Association

I am Barry Greenberg and today I represent the Texas Hedge Fund Association, a regional trade association based in Texas with approximately 200 members ranging from investment managers to service providers, as well as academics and students. I am also a partner at the law firm Akin Gump, Strauss Hauer & Feld where in the investment funds group I represent hedge funds, private equity funds, mutual funds, and investment advisors in regulatory and compliance matters.

Kyle Bass
Hayman Capital

I am Kyle Bass. I am the Managing Partner at Hayman Capital here in Dallas. We manage about $530 million, mostly global macro-focused.

Shaun Jordan
Abraham Trading Company

My name is Shaun Jordan. I am the Marketing Director for Abraham Trading Company. We are a multi-strategy systematic shop, trading futures contracts globally. This is our 23rd year of trading as Abraham Trading Company.

Don Hodges
Hodges Capital Management

I am Don Hodges representing Hodges Capital Management. We have five mutual funds. We only had one multi-cap fund for most of our history, but a recent outgrowth of that is a Blue Chip 25, an equity income fund, a small-cap fund, and a pure contrarian fund.

Craig Caudle
Liberty Funds Group

I am Craig Caudle. I am the CEO and Principal of Liberty Funds Group. We are a commodity trading advisor and a commodity pool operator. We are the trading advisor on approximately $35million and we advise institutional clients on CTA selection on approximately $65million. So, I have a dual role in the industry, one as a trader and then also as an evaluator of traders and trader strategies.

Terry Beneke
Antares Capital Partners

I am Terry Beneke. I am CIO of Antares Capital Partners, which is a single family office based here in Dallas. The majority of the family's liquid net worth is invested in hedge funds. We are currently invested in about 20 different managers. Investing in hedge funds is the focal point of the work that I do and where the family invests.

Guillllermo de León
Salient Partners

I am Guillermo de León. I am Manager of Investments at Salient Partners, LP, an alternative investments firm with $8 billion in assets under management based in Houston. Our flagship fund has approximately $5 billion in assets under management and invests across hedge funds, private equity, real estate and natural resources to provide clients with 'university endowment' style investment program exposure. We co-manage the fund with our long-time partners at Morgan Creek Capital.

Matthias Knab **What opportunities are you pursuing at the moment, where are you trying to make money? I just flew into Dallas from Sao Paulo, and the contrast struck me hard and unexpectedly. When jogging around Dallas, I see that every second shop on Commerce, Main, or Elm Street is closed and empty – Dallas seems to have that feel of a hard recession. There are even empty parking spaces on all streets at all hours - unthinkable in buzzing Brazil, which is cranking to be the fifth largest economy in ten or fifteen years. Now, as Texas-based managers, how do you make money these days?**

Craig Caudle As a CTA, we have a little bit of a different approach, and part of that is the result of not really having the benefit that other money managers enjoy in terms of relative performance. If you think back on the 2008/2009 time frame, the problem a lot of financial planners ran into is that asset diversification did not work.

You had multiple asset classes moving in similar directions at the same time and subsequently people were looking for true style diversification. The only style among all the alternative classes that made money in 2008 was CTAs. Our deal is not about whether the recession is over, still coming, double dip or not. Our function and the only way we can survive is to continue to develop strategies that can make money in growing economies as well as contracting economies. We get hired and fired based on absolute return.

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While investors look at us and agree that we constitute a non-correlated performance stream, for some reasons we are always the first to get fired. A great example is, I saw a reference this morning in Opalesque where it was reported that a certain, large CTA had a good year in 2008, but a terrible year in 2009. If I look at a systemic manager like Abraham Trading who made something like 30% and was down 5% 2009, there is not one equity manager on the planet that would have had a ratio making six times more in 2009 than they lost in 2008. Yet, as a CTA we are judged as having had a terrible year in 2009.

Our strategies sometimes get placed in the global macro category but are, for the most part, quantitative and agnostic in their approach. We feel that we have an advantage and that the opportunity is great, because the capital flows - in and out, driven by fear and greed - are still alive and well.

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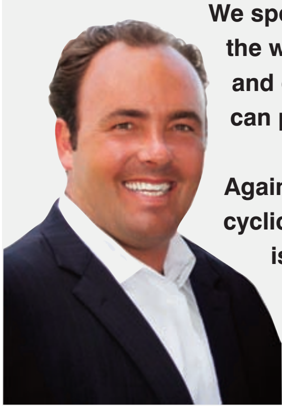
You could say that we see opportunities in the rubble of the $1.8 trillion hedge fund industry. The CTAs are only about $220 billion. I saw that AQR, a $23 billion fund is moving into the managed futures space. That firm alone would represent 10% of our business.

Our strategies sometimes get placed in the global macro category but are, for the most part, quantitative and agnostic in their approach. We feel that we have an advantage and that the opportunity is great, because the capital flows - in and out, driven by fear and greed - are still alive and well. Quantitative strategies are able to capitalize on those flows from traditional and other money managers and able to capture short- and long-term moves that basically are identifiable only by using quantitative tools.

Kyle Bass: Craig, I appreciate what you are saying, but just off the top of my head, there is an equity manager that made up six times his losses from 2008 by his gains in 2009 – that is David Tepper who is trading equity in Dallas, and that is just off the top of my head and not looking into databases or other statistics.

We think there is a lot of opportunity at the moment. However, for cyclical, or long-only investors, the next five years are going to be very different. When you look through periods of time in history, if you have done a lot of reading with regard to history, it becomes obvious that there is a Keynesian end, and this Keynesian end is going to show itself in Greece, in Japan, and in what is called the "Club Med" (Greece, Italy, Spain) - these countries will end up having to restructure debt.

I also believe that the capital asset pricing model - which some believe works, some believe does not work – shows that the risk-free rate is not, in effect, the risk-free rate. We believe the markets offer an enormous opportunity right now, which we try to capitalize on in our fund.



We spend probably 80% of our time on Japan these days. Japan is one of the most convex situations in the world at the moment. In our main fund, we currently make money nominally, in distressed debt and event driven situations. However, on top of that we spend a lot of our time in the tails, where you can put together enormous asymmetric positions in rates and currencies in Japan.

Again, I believe there is a lot of opportunity out there; however those people who believe we are in a cyclical move are going to realize in the next few years that we have a secular problem. These kinds of issues can't be continuously put off to a later date - I believe the later date is approaching, and that we are going to capitalize on those moves in the next two years.

Kyle Bass

Matthias Knab **Would you like to elaborate more about the kind of opportunities you see in Japan?**

Kyle Bass: Japan, as an economy, has never admitted its mistakes. 20 years ago they transferred the bad private assets to the public balance sheet, while nominal GDP has gone nowhere for 20 years. It is where it was 20 years ago. That is what happens when big government shows up to make up for the deficits of private spending.

Studying Japan - I know a lot of people have looked at it for a long time – some people may think that Japan is the US's glide path and that we can, at least, go to safety and a have nominal GDP stay flat, and grow our sovereign obligations over the next 20 years to 230% of GDP. However, that is where we, or the government, wants to go.

If you look at why things are happening in Japan, the way they are developing, one factor is of course, the declining population, combined with their attitude toward immigration. Japan is in a secular population decline. Their population peaked in 2004, but their working age population peaked last year. How much longer can a country then keep its social benefits schemes up? I am going to put words in everybody's mouth here, but I think we would all agree that we cannot pay for Medicare parts A through D and social security in the future. It is not going to happen, right?

The unfunded, discounted present value of those five things today is more than $100 trillion. With a $14 trillion GDP, there is simply no way to pay for it. What will happen is that we put it off until the time comes where we can't do that anymore, and then finally we cut benefits, right? Europe cannot pay for their social benefit schemes, we can't pay for ours either, but our population is still growing, so there is that window to put things off to another day. But, as Madoff showed you, when you have more exits than entrances in any scheme like that, the rubber finally meets the road and you have to deal with the problem.

In Japan, the rubber met the road in mid-2009. They had more people leaving the workforce than entering it.

Most people are now aware that the Japanese actually sell almost all of their sovereign bonds to their own people - 94% of Japanese debt is sold to the Japanese.

Now, what do you think happens when the entire buying base turns into sellers? Well, let's see; one finance minister died, the next politician that gets the job quits four months later after ratifying the 2010 budget, and then for some reason you decide to double the deposit guarantee on the one bank that buys the most JGBs. If you follow the news - that is what just had happened.

Let's look at their budget now. They may have ¥42 trillion of receipts but spend ¥96 trillion a year -- more than twice what they make. Their debt service is ¥20 trillion. Every 1% move in their cost of capital moves their expense up ¥11 trillion, and a 3% move in their cost of capital puts them out of business, if you like. The real Keynesian end is when debt service exceeds revenues right? Then you are in a spiral you cannot ever come out of.

The market is going to see it way before that happens. However, when you look at the way options in Japan are priced today, they are of course priced on historical volatilities of this asset - the government bond - which is close to zero, while at the same time the risk in that asset class is enormous. Throughout the history of our firm, we have sought to find massively mispriced risk with asymmetric returns, and take significant positions while limiting capital at risk. If you do the right research, you can purchase almost $30 billion worth of risk for say $30 million. If we are right, which is a question of time in my opinion, we will have a pretty good asymmetric return. And if, over the course of the next two years, we are wrong and nothing is happening – yet – we will burn roughly 2% of our capital a year in pursuing this strategy.

I do not anticipate being wrong, and while there is no way to tell any exact timing, there are signs that show up along the way. For example, the largest buyers of their bonds are saying, “We have to sell from now on.” The largest pension fund in the world said it last June, and Japan Post said it a few weeks ago: “we have to diversify.”

If 90% of your assets are in Japanese government bonds and you were to “diversify,” you either a) do not buy anymore or b) sell some. When your biggest holders turn into sellers overnight, what do you do? You have to finance yourself at G7 rates and borrow maybe where Germany borrows – and that is giving them the benefit of the doubt - but if they borrow where Germany borrows at a bit over 3%, they are out of business.

The whole dilemma ideologically goes back to the zero interest rate policy. Zero interest rate policies are a runaway truck ramp for a government that has finally put their economy in a place from which they cannot emerge from. Unfortunately, this is exactly where we are.

Most of the developed world is at a zero interest rate policy. If you reset all of your borrowing expectations close to zero and move bad private assets to a public balance sheet, you cannot ever move again. This is ideologically our belief, once you trod down that route, the longer you are there, the less chance you have of leaving.

Japan is the best opportunity I have ever seen in my life. It is the most convex opportunity I have ever seen in my life. If you take the time to look at the numbers, you realize why they have had seven finance ministers in three years, five in the last year-and-a-half. The whole scenario is playing out exactly as you would expect it to play out, right under everyone's nose, and no one says a word about it. It is shocking, actually.

Rick Redding Are you even more concerned about the carry trade unwinding? Could that escalate the problem even faster?

Kyle Bass: No, I am not concerned about an unwinding carry trade where people borrow in yen and they invest abroad. An unwinding carry trade strengthens the yen. I believe that is why you have seen yen strengthening all along.

I just put on the carry trade on – right here on my house in Dallas. I got my bank to lend me in yen for my mortgage. I did not have a mortgage, but I decided to put one on the house, because I believe the yen is going to get destroyed and until that happens I can borrow at Japanese rates for five years. When you can borrow at 2% for five years in yen, why would not you do it? You will be able to pay your loan off in cheaper yen.

We spent a lot of time on this investment case. We have met with the ministry of finance, and multiple market participants from different sectors and we also retain advisors with close relationships to policy makers so we know the way they are thinking about this. You find that the officials have a sense of fatalism there, which again, is just shocking. They do not argue with you saying "you are wrong because of xyz", they say "it is just not going to happen now. We realize you are right ultimately, it is just going to happen later, maybe when we are not here."

Kyle Bass

Guilllermo de León Do you think the fact that many investors have lost a lot of capital investing in Japan after its bubble burst is the reason why no one is focusing on these opportunities today?

Kyle Bass: Possibly – it is a fact that most people just miss this opportunity these days. Actually, for the last 20 years the big global macro players called this specific opportunity the widow maker, because when Japanese rates hit 3%, they said "My God they cannot go any lower", and they shorted a ton of Japanese bonds. Then the rates went to 2, and they said, "we have got to double up now". Then they went to 1, and later even into basis points for a while in the ten-year bond.

Therefore, a lot of people are dismissive of the strategy because in the past it has not worked. What these guys missed was that in the past the Japanese population was still growing. The population peaked at 127.8 million people four years ago, and now they are at a 127.3 million people. Japan has a net negative birthrate and it is accelerating. The National Institute of Population and Social Security Research is forecasting their population to be just above 100 million people by 2040 - think about that.

How do you keep together any kind of social benefit scheme or even deficit finance mechanism for your country if you do not have population or economic growth? If in fact, you cannot continue to pay your bills? When you look at receipts versus expenditures you cannot even believe how things look if you take the time to analyze the numbers.

Over the past few months, I have spoken at a couple of big, well-known universities. I asked them to tell me how much the U.S. government revenues are – the money the government brings in, I am not referring to the GDP here. Nobody knows, no one is paying attention. They know what the deficit or GDP is because it is published every day. Very few people know the number - it is $2.2 trillion. We spend $3.7 trillion, which makes a $1.5 trillion deficit.

Well, in Japan, it is worse. They have ¥42 trillion of government revenue and ¥96 trillion of expenses.

The Prime Minister confirmed our numbers by saying, "For the first time since World War II, we will issue more bonds than we have in revenue." That is a nice way of saying "we are going to spend twice what we make". Here is a

suggestion, if you look at this and take the time to dissect the income statement and balance sheet of a country - and pretend you are the Finance Minister - now try to figure out what you can do to make this work. Try to find a solution, only to find that you cannot do it.

Guillermo de León And immigration into Japan isn't a viable solution.

Kyle Bass: That is it. They are an insular society, hostile to immigration. They only have a couple of million non-Japanese people in the country out 127 million people. Those are mainly the Brazilians [of Japanese descent] and Koreans that helped rebuild Japan after World War II, and they are throwing them out now because they are afraid a foreigner could be getting a Japanese job, because there are not very many jobs available in Japan at the moment. Will they open the border to China? They hate the Chinese. Even if they encourage families to have more children there is at least an 18-year duration mismatch, they will still be 20 years away from entering the workforce. What I am telling you is: no matter how you draw this up, there is not an answer for Japan.

Matthias Knab **Kyle, thank you for laying out this great macro play. Global macro has certainly grown again as a category investors allocate to. We have some allocators at this Rountable, and I know Shaun is curious to ask them if they are using the recent events in the markets as an opportunity to make permanent allocations to CTAs and managed futures?**

Terry Beneke Do we take permanent positions in CTAs? The answer is we probably should, but we have not yet. While we were down in 2008, we did survive in part to managers like Kyle and John Paulson who made us money in the time when a lot of people did not.

Looking at CTAs, I have always been intrigued by the lack of correlation and the generation of profits when most other strategies did not perform. We have been spending some time this year looking at them, but have not pulled the trigger yet. I feel like I should be doing something, but I have not done it yet because this market is still running away.

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Most of our long/short managers are doing pretty well. The ones that are still carrying big short positions are struggling. I understand why they are short; I have some patience for that. Everyone says we are in an environment where stock pickers are going to do well, but the truth is that crappy companies are still running pretty strongly. My pessimism is also tempered by hearing things like "it does seem like things are getting better". Just today I was on a call with a manager who said they are long just about every company in their portfolio, as they see signs of growth.

Terry Beneke

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Shaun Jordan

But on the other side, could it be that managers like Craig or us are the solution and slice and dice through the muddy picture you just mentioned through our diversified portfolios and diversification benefits?

Craig Caudle

There are examples of investors using CTAs for all kinds of strategies, including macro. Our largest client recently told us "we are concerned about the mini-Japan, which is us, the United States. How can we run record budget deficits for unpredictable long periods?"

As a way of background, the Fed was formed in 1913 with a mission statement that says "we are going to continue to grow credit aggregates". Now, about 100 years later, inflation basically has devalued the dollar by a factor of 20 in the last 100 years, and by half in the last 15.

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The problem that exists for quantitative traders is that most investors think in fundamental economic terms. For example, everybody gets passionate about Kyle's fundamental breakdown of a problem and people can relate to his explanation. You can take the story to the owner of a family office, who made his money manufacturing widgets and they get it.

On the other hand, our solution is quantitative. We said we can create a strategy that will act like a positive carry option defending the purchasing power of the dollar. We incorporate our mechanical programs and embed a negative dollar bias, a negative interest rate bias, and a positive commodity bias. In the short-term we could be wrong in any one of those sectors timing wise but we are down there under the hood with the chisel trying to make money with these diverse strategies. It's seems to work better if our client has a theme to hold on to when they are having their review with Terry or another financial consultant.

And so on the face of it, the problem with CTAs is that we are not thematic. We are grinders. For example, did you really understand how that orthopedic surgeon put your knee back together or did you hire him based on his track record. Track record, you could see what he was going to do but how did he do it? Well, I get just as excited about our option strategy which takes millions and millions of bits of data where we have a couple of edges.

Craig Caudle

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And so on the face of it, the problem with CTAs is that we are not thematic. We are grinders. For example, did you really understand how that orthopedic surgeon put your knee back together or did you hire him based on his track record. Track record, you could see what he was going to do but how did he do it? Well, I get just as excited about our option strategy which takes millions and millions of bits of data where we have a couple of edges. I have got this edge in my favor every time I play. Or the advantage we have when looking at a distribution of short-term tick data, and what that might tell us about short-term trading opportunities. But the people across the table from us cannot get excited about that the way they can get excited about the scenario that Kyle outlined. Japan's got fewer people, no more coming in, they will not let them in, their revenues are, you know, half of their expenses – I mean I want to put that trade on, but if I told the same story about the logic behind our approach they just are not equipped to judge its merit. So I think that is the issue on thematic versus quantitative investing.

Terry Beneke

Craig made some great points. As an allocator, the problem that I have with quantitative strategies is that I am never quite sure exactly what is under the hood. Craig talks about buying track record - certainly track records are an important part of the process, but if I do not understand what generated that positive track record, I will certainly not be able to understand what happens when this fund hits the rough storm. As an allocator, the challenge with CTAs is to clearly understand the source of return, or to put it differently, it is the challenge CTAs have to better articulate the engine that drives your performance. It is not enough saying we just data-mine 2000 bits of information and base our strategies on that.

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In addition, I need to understand – and again, you guys need to explain – what was going on when things did not work out for your strategy. That is required for me before doing an investment; otherwise I cannot pull the trigger and put my money in.

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Guilllermo de León

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Let me also be a little self critical from an asset allocator’s perspective. I believe there is a tendency among asset allocators and market professionals to think that we can occasionally (and sometimes more frequently), correctly time the entry of our investments into the market. So why invest in CTA strategies when they are in a drawdown if we believe we can correctly identify a better entry point?

This dynamic occurs frequently across most asset classes despite the fact that we have all read research that refutes any claim that investors can accurately and consistently time the market.

Salient, as a firm, has had more consistent and meaningful exposure to CTAs over time. My personal experience with high net worth clients, however, has been that they typically allocate much lesser amounts to CTAs and managed futures.

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We know that if we run any correlation analysis, CTAs demonstrate an attractive diversification profile. But, as Terry stated, part of the problem is the complexity of quantitative strategies and the reality that a lot of CTA and managed futures funds are not particularly inclined to help clients understand what is under the hood. This is a key requirement for most advisors. When a strategy works, we typically do not have to explain a lot to our clients, but when the strategy does not perform well, we often do not have sufficient information from the underlying managers to communicate results effectively and in the proper context.

Matthias Knab

In 2009 we had an Opalesque Managed Futures Roundtable in Chicago. One of the outcomes there was that you have to put on the managed futures when you don't need them, so that you'll have them when you need them – like a hedge basically.

It seems one of the topics that crystalizes at this Texas Roundtable is how to be a contrarian. Don, you mentioned before your firm runs a contrarian portfolio or contrarian fund. Would you like to tell us more about your approach?

Don Hodges We are a bottom-up equity house doing research on common stocks. I won't say that the companies are the only thing we pay attention to, but it gets about 98% of our focus. You could argue that we live in a very simple world that is just looking at common stocks. However, over the last ten years our capture rate is about $18,900 when the market is up $10,000, and when the market tanks $10,000 we are down about $13,000.

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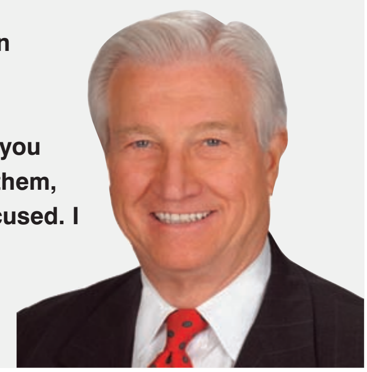
Right now, you can buy the big blue chips at 13x, 14x, 15x earnings, when in 1999 some of them traded 40x earnings, and some of them are paying as much as 4% dividends right now. I believe there is great opportunity in really high quality domestic equities over the next four to five years.

The fund that is just an absolute delight to manage is our contrarian fund, which is even deeper than deep value. We are buying things that nobody likes. We started the fund on September 10th, and as of yesterday we are up 25%. We bought the newspaper stocks, airlines, we bought one or two trucking companies, retailers – stocks the market does not like. There is always great opportunity in contrarian stocks, they always exist in any kind of market.

One of the convictions I have is that if you stay focused on one area, you learn every time you go through a cycle. If you go through a cycle where equities are not good and you desert them, you miss a great learning opportunity, because you are being constantly forced to stay focused. I think that with this focus we learn more about equities than somebody that is moving from area to area.

Don Hodges



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The thing I find the most fun is the contrarian approach, through our pure contrarian fund. During the 18 year lifetime of our multi-cap fund we invested in contrarian, we bought growth, we did super growth, we did small, medium, and large cap, a little bit of everything. As one result of that we discovered that our small-cap stocks outperformed the rest of the portfolio, so logically we started a small-cap fund, and with the changes that have taken place in 2008 and 2009 we decided there was a place for a Blue Chip fund with 25 stocks. We also saw great opportunity in income equities as opposed to bonds. So, we started an equity income fund where the average income from 48 or 50 stocks is about 4.5%.

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One of my favorite sayings is: it's important what you buy, but it is also important when you buy it, and where you buy it makes all the difference in world. I could have two identical portfolios, but one I bought using proper time and one I bought when the market was high. Therefore, we believe that by staying focused on equities we can do better than the person who does equity in certain cycles but exiting them when the market is out of favor.

Kyle Bass: Can I ask Don a kind of personal question? How much of your personal net worth is invested in your fund complex and how are you personally allocating your assets outside of your funds, just in percentages

Don Hodges

About 50% of my personal net worth is in my mutual funds, and I invest money in them every month. The rest is in real estate, some art, I own a couple of farms, some oil income – you could say it is spread out over a number of different things. However, let me point out that I have made more money by being in the market than I have in any other sectors.

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We have benefited a lot from our approach. We bought newspaper stocks when they were cheap. We bought Gannett as low as $5.5, it is $18 now. We bought the Dallas Morning news at $1.09, it's $7.75 now. We bought Continental Airlines at $8, it's $22 now.

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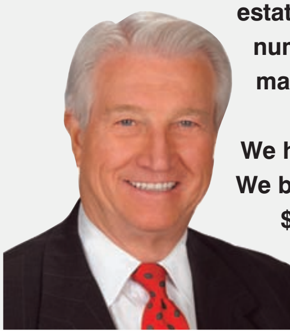

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Kyle Bass: The number one performing equity market in the last 10 years has been Zimbabwe. So the point I am trying to make is that if you are focused and you are a great stock picker, but paid no attention to what the government was doing, which means in this example that in nominal terms your stock portfolio makes good money - but then when you went to redeem a quadrillion Zimbabwe dollars, you could go buy an egg with it.

I don't want to criticize your approach of being singularly focused on the area you are good at, however in my view of the world you are in essence assuming or relying that our governments are getting it right. That they are going to get the money supply right, they are not going to spend more than they make, they will fix the budget, and all those issues.

You said you would not be a cyclical equity investor, and when I go to the bottom of our different positions here, I believe this is where we have the disagreement. I don't believe that we are in a cyclical move, because the issues at stake are a secular problem.

There will be a point in time when the governments get it wrong – if you look through history, the government gets it wrong about every 75 years. Within our lifetime, we have not had to deal with such a situation. It is fine to remain singularly focused on one asset class if we stay within this 75 year window, but if we cross that international dateline and enter a period in which people and systems heavily restructure, it will be the wrong approach to remain focused on the wrong thing right, namely focused on nominal returns and not real returns.

Obama created trillions in 14 months. We had $800 billion of base money in the beginning of 2008. We more than

doubled the base money supply, and they are spending almost twice as much what they have made. Your recent purchases would not have gone well if the government did not literally create money out of thin air.

The reason I asked you about your personal asset allocation is that if I am right and the government really screws this up, you will still be personally okay because of your diversification, however the people that have financial assets in your fund will suffer.

Don, excuse me for singling you out here in this discussion to make my point that there is always a difference between non-real and real returns. Again, my point is that real returns are going to matter very soon. But the truth is that no one is thinking about real returns these days.

Kyle Bass

Rick Redding

It is interesting hearing the perceived difference between where Kyle is coming from and Don. Don said, he's just an equities guy, but there is actually some commonality when you started asking about the personal portfolio. A good portion of your personal wealth is really a macro play on either sovereign risk or what you think inflation is going to do. The futures markets are a lot broader than just financial assets and allow investors to allocate or hedge exposure to commodities or real assets.

It is interesting hearing the perceived difference between where Kyle is coming from and Don. Don said, he's just an equities guy, but there is actually some commonality when you started asking about the personal portfolio. A good portion of your personal wealth is really a macro play on either sovereign risk or what you think inflation is going to do. The futures markets are a lot broader than just financial assets and allow investors to allocate or hedge exposure to commodities or real assets.

If you look recently at what firms are trading now in the futures and options products, the growth areas have been in three places: currencies, energy/commodities/metals, and then the back-end of the curve is in the rates complex, because they are taking a view on what government policy is going to be. It is all one big macro trade.

Individual investors do not think enough about looking at the opportunity set. Most investors are so focused on equities or fixed income that they are not seeing how markets are connected. There are a lot of people now focusing on those alternative areas where the macro funds and the CTAs have been expressing their views. This is the right time for people to get educated on how to use all asset classes directly through the futures market or indirectly through hedge funds or CTAs.

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Individual investors do not think enough about looking at the opportunity set. Most investors are so focused on equities or fixed income that they are not seeing how markets are connected. There are a lot of people now focusing on those alternative areas where the macro funds and the CTAs have been expressing their views. This is the right time for people to get educated on how to use all asset classes directly through the futures market or indirectly through hedge funds or CTAs.

The question Kyle raises is important and that is, "is this a secular or cyclical issue?" Many of the dislocations in our lifetimes have been short lived, cyclical events. Well, if you go back to 1870s or 1930s there were actually multi-year, structural events. I think that question is what a lot of people are trying to figure out now, and you see it reflected on our volumes.

Shaun Jordan

A researcher from our group has created a scenario walking through how a true currency devaluation would actually play out, say a 60% plummet of the U.S. dollar in four weeks. Kyle, how do you see the Japanese scenario coming through then, or what are the five canaries to look out for? Where is the point we can all say "damn, now this is bad". I know this is an impossible question, but still I'd like to hear your thoughts.

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Shaun Jordan

Kyle Bass: **It is not impossible, it's actually is easy to answer. Imagine if Geithner woke up one day and had taken his own life, and then the next guy that we put in the job quits four months later and checks himself into the hospital, after ratifying a budget for the next year, and quits.**

Say Citigroup was the biggest buyer of U.S. Treasuries putting 90% of their assets in Treasuries, while the rest of the banks put 20% of their assets in Treasuries. Now imagine the government came out one day and said "hey, let's double the deposit guarantee at Citigroup. Let us take it from 250 to 500 and let's leave it to 250 in every other bank."

Why would you ever do that as a government? Because you are desperate. Why would you ever cannibalize your whole banking system? You see these things happening day after day, they are so obvious, and all is happening right in front of us.

Kyle Bass

Matthias Knab — **Kyle, I know that some people are wondering Why then are their bonds cheaper than Greece?**

Kyle Bass: **They sell it to their own people. The Japanese government convinces their people.... 94% of all Japanese Government Bonds are sold to domestic investors.**

Matthias Knab — **In addition, the Japanese own $750 billion of U.S debt, right behind China?**

Kyle Bass: **No, they are number one now, as China just let some mature.**

Most importantly, our deal with China and Japan, where we run big trade deficits with them, and they turn around with their dollars and buy our debt, as Craig said before, this whole game let the dollar devalue. When Bush took office he said "I have a strong dollar policy", and eight years later the dollar had depreciated 43% - imagine where would be if we had a weak dollar policy.

Our game as a country is to borrow from everybody else and devalue our dollar. But now that is the game of Japan and the game of Europe. We are right in the second proverbial race to the bottom.

Shaun Jordan Do you have the classic debt issue and no one's there to buy it?

Kyle Bass: Correct, that is the case. It really comes down to a simple calculation.

For the last five years, the G20 has issued $1.4 trillion worth of incremental debt every year against a $60 trillion total G20 debt number. What is the level of inflation that we target: 3%, right? What is $1.4 trillion divided by 60? It is pretty close, right?

Last year we printed $4.5 trillion just to plug deficits in G20. This year its $4.6 trillion - where is it going to come from? We are going to print it or are we going to crowd something else out? Well, I guess what we are going to print it, no?

So, we have this scenario where money is growing on trees and it comes out of nowhere just like it did in the last 14 months, and we sit around this table and we feel great about it. I mean, things feel good, everybody is feeling pretty good about themselves right now, but this is exactly how the big bang happens each time. If you study history, the history of the big devaluations of developed nations in the world, this is how it happens, every time. There is this period in time called the "golden period". Right after the big print, for the next 12 to 18 months things feel great, and then it really gets bad.

Believe me, I am not a pessimist by nature. I am looking for numbers that would plausibly show me another scenario, but I cannot come up with those.

Don Hodges What you are saying basically, is that we are using the model that got us in trouble, we are buying a house we cannot afford.

Kyle Bass: Exactly, that is it, plain and simple. When you spend 3.6 and you make 2.2, it does not work for very long.

What you have to really study when talking about this phenomenon is the difference between nominal amounts of currency in the system and what it buys, because that relationship is non-linear. If you had $100 in the system and you print $10, you did not devalue the dollar by 10%, you devalued more because inflation expectations can take hold. This is that qualitative slip that is already beginning to happen...

One of the questions I have for Rick and the CME is really interesting. We study the COMEX and the NYMEX rate very carefully and very closely. When you look at the total open interest in futures and futures options in say a precious metal like gold, the number is currently around $140 billion. This stands against the registered and eligible inventory which totals approximately $12 billion. Eligible inventories are things people have bought and taken delivery of, but still remain in the COMEX warehouse. Registered is what is available for delivery, which is around $3 billion.

So you got $140 billion of open interest and $3 billion of deliverables. When we spoke to the head of your team handling deliveries their response was "Well, less than 1% takes delivery every time, so it is not a problem." And we said, "Well, what if it is a problem," and his answer to us was, "Price solves everything."

And we said well, "What if does not solve everything?" People talk about gold being a, is it a crowed trade. Let us see. It is a zero sum game, there is $140 billion long, $140 billion short and there is $3 billion of gold out there for immediate delivery. Where is the crowd? The crowd is on the short side, right? So, how do you guys think through a big delivery problem?

Rick Redding We had seen various times in history that you have someone that takes a big delivery or tries to force a big delivery.

Kyle Bass: That is a good point, but that was one person. This time, it could be the whole market place.

Rick Redding You have very little physical gold on a relative basis sitting behind governments or what governments claim they have. If there would be a systemic group of people asking for delivery, you would likely see a supply from government stock piles at that point. The answer, "price solves everything", has been accurate to date. There are a series of regulatory safeguards such as position limits that would alleviate substantial congestion of positions at expiration. But you know in the case of gold, or in the commodities, price will bring gold out of storage and available for delivery.

Shaun Jordan Let's think this through, if investors assume things could get really ugly, so they are badmouthing fiat currencies and then go and buy fiat gold. They buy the ETF, the futures contract etc., but those are the first things that a government would liquidate in a scenario like we are talking about. They would say here are your printed dollars, and you are going to give us that at this exchange rate. Those instruments would be the first accounts to get liquidated by a Federal Government with a precious metal shortage, I believe.

Rick Redding You brought up a couple of countries that have probably sold a significant amount of gold over time, without much attention paid to it.

Kyle Bass: Let me clarify that I am not proclaiming some sort of "end of the world". What I am talking about is a complete change in the wealth of people in different nations. Everyone will get up and go to work the next day, we will just be poorer.

But certain things will be over then by that time, like the U.S. living with this dissonance believing we can import deflation and cheap goods from China, Japan and anywhere else, and that we do not have to take the bad with the good. We believe we do not have to take their wages or their living conditions.

Unfortunately, in free trade there is the phenomenon of entropy. Entropy leads in the end to a normalization of both living conditions and wages, which is what we are seeing in the U.S. The jobs we lost are not coming back. They left and they are not coming back. The only way we can get them back is if to build up the walls, but when we throw up the walls, then all hell breaks loose.

That is basically the reason why we need to have a great restructuring. Once we restructure our interest expenses and large parts of our revenues, then we will be able to grow again.

But what does this restructure mean, what are the consequences? People with financial assets are going to lose purchasing power, and people with real assets are going to maintain purchasing power, that is it. Whether it will be common stocks today or tomorrow or real estate today or tomorrow, it is going to happen in the next three to five years.

But the silver lining, the dynamics I have been pointing out here is that our politicians here have front row seats and will be able to observe and reflect on what is going happen in Japan. We are about to see what a Keynesian end looks like. I hope it does not pull us in with it. I don't think it will, I think the events will run on us actually. But maybe that is what will change the Barney Franks and Pelosis of the world's opinion as to how to run massive deficits and just keep them running.

Kyle Bass

Matthias Knab For a while now, we have a kind of meta theme crystallizing here in this discussion, which is "how to be a contrarian". We touched it when we talked about investing in CTAs, Kyle was a contrarian already in 2006 when he was one of the few who foresaw the subprime meltdown, and now again with your Japan thesis. Kyle, what does it take to be a true contrarian?

Kyle Bass: First, I'm not contrarian for contrarian sake. If, in fact things were in order and I could see them working, I cannot wait to be long. I am tired of being short, but I cannot go long until there is a restructuring.

What does it take to be a contrarian? You have to start with your own analysis, with your own thinking. We sit in rooms like this and we talk as a firm, and we do not take outside influences when we define and formulate our views. Then we go meet with the outside, we like to hear the way they think about things.

The reason we open source our strategy is to get constructive feedback. We ask people to tell us where and how we are wrong, why we may not be thinking about something right. When we open sourced the Japan thesis, we have not had really any significant push-back, not even from Japan's Ministry of Finance. The main feedback we get is "yeah we agree with you, we just hope it is not right around the corner."

Matthias Knab Do you see the influx of people putting money on your trade?

Kyle Bass: Yeah, we are raising good amounts of capital. If you are someone managing say $8 billion dollars and you think, I have just a 10% probability of being right, you'll have to be a fool not to invest with me or someone like me, when you do the math.

Matthias Knab Let us look at Texas now, as this is our Texas Roundtable. Barry, you head the Texas Hedge Fund Association, what is going on here on the ground, any new funds being formed, for example?

Barry Greenberg We have seen certainly an upswing in activity of startups that are entering the market. In 2008, Texas was affected just like the rest of the country. But before that, Texas had been for a long time a healthy place for alternative managers to be in business - not just in Dallas, but in Houston and other parts of the state as well.

We are starting to see new entrants coming back into the market. Some of this is certainly driven by performance, as 2009 was a good year for a lot of managers. Having that positive track record as a tailwind is helping some managers who have decided that now is the time to hang up their shingle and venture out on their own.

Capital raising is still very tough. The time between when someone has an initial interest in potentially starting a fund and actually launching is much longer than it used to be. One of the reasons for this trend is that managers are now more cautious. They want to make sure the assets are really there before they actually launch. To get from the point where people say they have an interest, to reaching the finish line is often more difficult than people anticipated.

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Summing up, we do see signs of recovery and new interest, but it has been a slow go for many. Also, the size of the startups that we are seeing are smaller than they were in the past. Today, a $25 million startup is a good number, where in the past that might have been considered small.

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Rick Redding

We have dealt with hedge funds in Texas for a number of years and one of the things that is unique in Texas is the amount of energy funds, including many energy-only funds. In other states you may see that energy is just a piece of the fund, but here in Texas you have several dedicated experts in energy.

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Rick Redding

Guilllermo de León

I've lived in Texas for three years so I don't have a tremendous amount of context on this topic. I have seen, however, significant intellectual capital in energy investing and energy trading in Houston. More can definitely be done to raise the state's profile as an attractive place to launch or relocate a hedge fund, and as a key destination for funds to visit when raising capital.

Barry Greenberg

How do the other participants here see the regulations playing out? It seems clear that Congress is going to do something that will require many hedge funds to be registered with the SEC as investment advisers, and even those that are not registered will likely be required to report some information about their business and positions to the SEC to analyze macro risk. Also, there is discussion that the CFTC may potentially put limitations on trading. What impact will these changes have on startups as well as existing managers?

Craig Caudle

I represent CTA's and CPA's on the National Futures Association Board of Directors. While I was really excited to do that, right after I became a Director I started getting annual audits instead just one every three year audits or so..., probably a pure coincidence... But, anyway, the NFA can walk into a shop and can pretty quickly establish if you are trying to follow the rules. They probably will always find something that you need to address, but then you correct it and move on.

That said, from the CTA side, you do not hear as much uproar about SEC registration because of what most of us do and how we are set up. CTAs, for the most part, have had to be more transparent. Otherwise we would not have any institutional clients. Issues like transparency, liquidity, are the kind of things that a lot of hedge funds strategies cannot really deal with effectively. This is a reason many are opposed to federal registration. CTAs have already had to deal with transparency, liquidity, and valuation issues. We may have to double our compliance to satisfy both CFTC and SEC guidelines, but generally you do not hear as much of an uproar from the CTA related to that issue.

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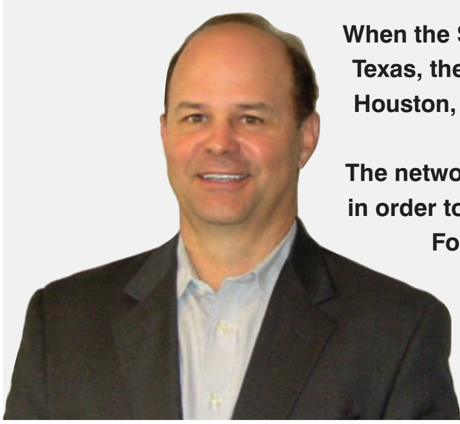
At this Texas Roundtable, let me also mention how running a hedge fund or CTA here is different from other parts of the country. Most people who set up a shop here have launched in a community that can be considered outside of Wall Street. Most managers here would not have come out of an arb desk on Wall Street and after passing the hat around launched with a couple of hundred million dollars. The unique part of the Texas community is the pockets of super high net worth individuals and families throughout the state, and they all know each other.



When the Street comes up with a product or a new manager, they make a circle through Texas, they come to the Crescent here in Dallas, downtown Ft Worth, hop down to Houston, and then they might slide out west to Midland.

The network can quickly vet a new product or manager. There is a high trust level involved in order to get funding here, a lot depends who you are, who you have worked with, etc. A Forbes 400 billionaire may take a meeting from a startup, which you might not see happening that often in other parts of the country.

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Shaun Jordan

The community here is remarkably cooperative too, people communicate here, ask for references and give recommendations.

When I started as the Marketing Director for Abraham Trading Company, one of the things I did was to call anybody who I thought might talk to me. I started locally within the high net worth realm, and it's a fact that there is a tremendous amount of family office impact. Even in Austin, Texas you can find some family offices that can have high impact on your funds. For example, in 2008 we raised money exclusively from the state of Texas.

Kyle Bass

There is one more thing that people are not talking about with regard to the states, and it is not because we live here that I bring this up. When you look at the fiscal balances of the states that really had problems in the real estate markets, you see 20% fiscal deficits in California, you see 15%'s in New Jersey and New York or more. What do you think will happen once the November elections are behind us? We all know taxes are going up, right? The federal rate is going to go up, there will probably be a kind of VAT applied, but most importantly the state and local taxes in the coastal states will go up even higher.

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One of the results of this dynamic is net migration to Texas. We do not have a state income tax, and I believe the Governor today really understands that he cannot go out and unreasonably spend the state's money. We have a $9 billion slush fund unlike any other state in the union. We did not go out to spend more that we made - we might run a small deficit, but nothing like the other states.

I am very bullish on Texas over the next 10 years and believe that for the next decade we will see an influx of good businesses and good people here, which is going to be very beneficial for commerce, our industry as well as other industries.

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I am very bullish on Texas over the next 10 years and believe that for the next decade we will see an influx of good businesses and good people here, which is going to be very beneficial for commerce, our industry as well as other industries.

Terry Beneke

I have actually encouraged some managers in the northeast to consider coming down here, because it is such a friendly environment without a state income tax. I have read several times now that top marginal rates in the northeast may start to get close to 60%. In fact, I am surprised that more people have not come down here already.

As Shaun pointed out, Texas is a very collegial community. When I worked in prime brokerage for a couple of years, it was amazing how easy it was to talk with people and to get people to come together and share ideas, or routinely get together with a number of family officers in this area. You can easily establish a very open dialogue where people are happy to trade ideas and give great color on managers and ideas. That is certainly uncommon compared to other parts of the country.

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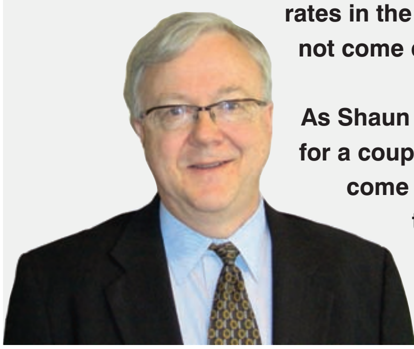

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Terry Beneke

Matthias Knab **Terry, how do you select hedge fund managers, what are you looking for? Also, do you do seeding or go into emerging managers?**

Terry Beneke Generally, I agree with Barry that it has been a more difficult environment for both investors and hedge fund managers. When it comes to seeding, there are some families here in town and across the state that are doing more seeding, but it does tends to be all the small side, and probably we are not that different than any other of those places.

2008 was an awesome and awful laboratory experiment; so one of things I am looking for is, how did someone navigate during that period of time? If the startup was formed post 2008, I want to know what role did the manager play in the previous fund, and how did that fund do? Obviously, not that many funds did that well. If the manager comes out of a shop that was down -30% or -40% in 2008 that does not put any wind at his back.

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I am also concerned about startups where someone gathers a group of people who have never worked together before. I could see great launches with pedigrees that are amazing, but if it is not a team that has ever worked together before I am reluctant to be an early investor in such a group. A good friend of mine started a fund a few years back which did not work out, and his comment was "I brought together all these smart people, I felt somewhat obligated to listen to them", all because he had not previously worked with these people in that sort of environment.

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As investors today, we are trying to be contrarian, but I am not sure what that word means anymore. We do feel that for the immediate future the growth in the world is not going to be in the Western World, so we have been spending time looking at managers who invest in countries outside of Europe and the U.S.

We jumped into the distressed trade in 2009, but that worked so fast that we are a bit concerned about our exposure there. Distressed for us is more of a manager-specific trade than a thematic trade, and we probably will not increase our allocation there.

A little under 15% of our portfolio is gold exposure, which was an interesting investment to put on and certainly aggressive at that time, but taking into account some of the dynamics and risks we had been discussing today you could also wonder if 15% would be enough of an exposure. So these are the questions we wrestle with all the time.

If we add up our hard asset exposure - gold, energy, some of the industrial commodities, we are still adding on exposure, we do have a fairly decent hedge against inflation. However with the printing presses in different parts of the world just continuing to run as fast as they are, I do worry do we have enough?

Despite all of that, we will still look at the classic long/short U.S. equity managers. It is hard to define what makes somebody standout – certainly if a manager demonstrates to add real value on the short side, that is of great interest to us. Running a short book can have been painful for managers in 2009 and for the start of 2010, I think ultimately that is going to prove to be very valuable to us as allocators.

Guilllermo de León Personally, I would love to do more seed investments. I believe this is a great time for a seed capital business, both from a talent availability perspective and also from the realization that modest amounts of capital can have a meaningful impact right now.

Strategies that we are currently exploring or are interested in include distressed, macro opportunities and asymmetric macro trades.

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Guilllermo de León

Kyle Bass When you are looking at a manager in Asia for example, how do you do due diligence the manager's background? How do you conduct a robust background check on that person?

Terry Beneke We made a conscious decision to only look at managers who are domiciled in the U.S. or in the U.K. I do not have the bandwidth to do the sort of work that needs to be done if we were to invest in managers in other jurisdictions.

Guilllermo de León Manager sourcing is a continuing effort and challenge. We travel to Asia, Europe, and Latin America to discover talent and conduct ongoing due diligence, but the success of this effort depends on the strength of our network of references and contacts, the depth of local investment talent and viability of local market and regulatory infrastructures.

Craig Caudle My contention is that a market generally goes where it can hurt the most people. In other words its movement will correct an imbalance of investors' positions. I also believe that the big collapse in 2008 was customer driven. We can blame it on mortgages, but, someone demanded and bought those products, the Street would not have sold it to them if there wasn't a huge demand. This is leading to my question related to quantitative performance measures where in the same way Sharpe led the most sophisticated investors of all into that trap. For a long period of time the Sharpe ratio holds up – you can look at convert arb, relative or stat arb, mortgage pools, or whatever. And see a great Sharpe ratio. When push comes to shove, a high Sharpe ratio in many of those strategies resulted from the leveraging of a strategy that without leverage would not have been as appealing. What do you use to avoid pitfalls like that? What performance measurements do you use when you gauge managers?

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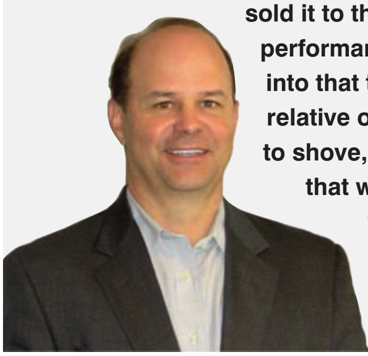

Craig Caudle

Terry Beneke That is the right question to ask and the hard question to answer, because the more time I spend in this business the less I believe that metrics are the way that you want to make those decisions.

Sharpe ratio was something that I used to pay more attention to, but in strategies where prices are level two price quotes, it is easy to smooth out returns". Then those Sharpe ratios can look awfully good when they aren't really that good". Therefore, we look at all sorts of things like exposure levels, draw downs, and attribution - we try to be as granular as we can on attribution information. Some strategies are amenable to leverage and for others leverage means throwing more kerosene on the fire. We try to understand those strategies with their interdependencies.

For us as investors, I also want to understand where the strategy goes wrong. We do a fair amount of such qualitative work and try to get a full picture of a manager and the strategy, while others may do a more robust statistical review.

Shaun Jordan Does [Malcom Gladwell's] "Blink Factor" play any role here when you look at a manager and really try to understand them and their strategies?

Terry Beneke I think there is some good truth to that Shaun. As investors, we meet with hundreds, if not more managers, and over time through countless meetings you can develop a sort of sense when meeting a manager, that this firm really gets it and knows what they are doing. Assuming that the terms of the partnership are reasonable - obviously that differs from investor to investor – and if we like his investment proposition and can live with the terms, there could be a good chance that we will make the allocation.

But let me also tell you that in my former life, when I was on your side of the table and represented funds to investors, I can also remember meetings where you'd think to have witnessed that "Blink" factor, and three months later you'll call them up and they do not remember who you are.

Guilllermo de León We could spend several hours debating the merits of statistics and their relevance to the manager selection process, but we would still conclude that there is no single perfect metric that incorporates all relevant aspects. Personally, I tend to use the Sortino ratio as one of the measures to consider during this process, and typically review it in conjunction with measures such as gain and loss deviation, length and severity of drawdowns, skewness and kurtosis, and other measures of consistency.

Of course, outside of statistical measures, understanding the leverage and liquidity characteristics of each fund under review continues to be critical in manager selection.

Matthias Knab **Terry, how do you select hedge fund managers, what are you looking for? Also, do you do seeding or go into emerging managers?**

Craig Caudle There are 1,041 CTAs strategies in the Barclay Database that we follow. The fastest way to filter through that universe is looking at upside deviation, downside deviation, consistency of returns etc. We then group the CTAs by different styles, exposure and timeframe into a three dimensional grid, where we identify about 150 viable managers. From there we do the qualitative assessment. The only reason we use the quantitative as a selection is just for the screening, which gets a fund into round two where the qualitative research begins.

Don Hodges I saw a quote the other day from Wilbur Ross saying, "Information has zero value today, because everybody gets the same information". So it's real value is reduced to zero, and he said it is the interpretation, or taking it one step further, that really makes the difference and I think it is hard to quantify consistently based on information.

Rick Redding Don, as an equity player, what kind of flows do you see now in your funds?

Don Hodges It is a simple cycle: when the market is bad you have outflows, and when the market is good you start having inflows. We are having inflows now, and you could say that this is one of those things that go hand-in-hand with the market itself and can almost be viewed as a contrarian indicator, at least in our case as mutual fund providers. In 2005, we had $100 million in our portfolio, a year later we had $500 million and that was when the market was great. We went up to about $750 million and we are back now the $435 or $400 million in our main fund. The flows are going to be determined by what is going on in the market.

Terry Beneke Don, you had the advantage of being able to put out your advertisements to the public, and personally, I think they come across pretty well. You got that great tone of voice and give people a lot of comfort. That is something that a lot of the managers in this room do not have that benefit.

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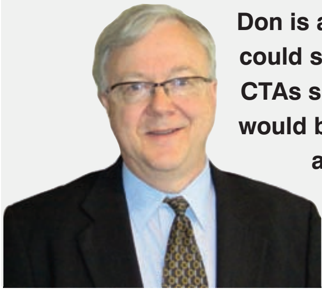
Terry Beneke

Shaun Jordan You mean the tone and the confidence, right? (laughter)

Terry Beneke No, seriously – Don is a public figure, he is well regarded and can give advice publicly to people. I like his ads. We could set up a separate roundtable and do some work on this, discussing whether hedge funds and CTAs should get the same opportunity to tell their story – if they wish to - and what industry changes would be required to accomplish this. I personally think we probably should as an industry, but we are not there yet.



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