



# Opalesque Round Table Series '10 CONNECTICUT

Opalesque 2010 Roundtable Series Sponsor:



# Editors' Note

Dear Reader,

About one third of the global hedge fund assets are managed from Connecticut. For the second time, I have come to Greenwich to hold an Opalesque Roundtable there. The Roundtable took place in October 2010 with the following experts:

- Ajay Jani, **Managing Director, Emerging Markets Portfolio Management, Gramercy**
- Donald Brownstein, **Chief Executive Officer, Chief Investment Officer, Structured Portfolio Management**
- Joe Taussig, **Founder, Taussig Capital AG**
- Jonathan Litt, **Founder and Chief Executive Officer, Land and Buildings**
- Kevin Schweitzer, **General Partner, Chief Investment Officer, RockView Capital**
- Marco Bianchi, **Head of US Business Development, NYSE Liffe**
- Pamela M. Lawrence, **Co-founder and Managing Principal, Restoration Capital**
- Theresa Patti, **Managing Director, Senior Portfolio Strategist, QFS Asset Management, L.P.**
- Walter Raquet, **Chairman, WR Managed Account Services**
- Bill Ferrell, **President & Chief Investment Officer, Ferrell Capital Management**

This 28 page Roundtable includes several in-depth discussions on fundamental developments. Today, asset/liability management has forced investors to become much more focused on absolute return. However, not only has the focus changed, but also the way investors invest. **The pronounced shift from mere asset allocation to risk allocation will favor hedge funds, as investors are forced to analyze what part of their portfolio really drives performance.**

A second major trend is **the evolution of risk measurement into real risk management**. "Going forward, it will not be enough just to get risk reports and find out what your risks are in the portfolios, and then at some point later learning that while you were measuring risk, you really did not have any way to apply a protection plan in case the risk went up above your policy limits", says Bill Ferrell.

Hear about the latest trends, technological advances and examples of **how to aggregate risk on portfolio levels in order to create efficient portfolio hedges on time and deal** with tail risk events ahead.

In addition, this Roundtable discusses:

- **Details on the significant spike in interest from very large hedge fund investors in managed accounts**
- **Opportunities in distressed, real estate, emerging markets and global macro**
- **Is regulation changing or threatening the hedge fund business?**
- **What will be the two phases of the coming "Bernanke Moment"?**
- **Will interest rates go up? Will foreigners stop buying U.S. bonds? Will inflation heat up and the U.S. pay back bonds with inflated dollars? Will there be an abnormality in asset prices as a consequence?**
- **New equity index futures and innovative clearing model from NYSE Liffe U.S.**
- **What could the next stress tests deal with, what could happen now, instead of merely looking backwards?**

The Roundtable was sponsored by NYSE Liffe U.S. Opalesque also thanks the 2010 Roundtable Series sponsors Custom House Group and Taussig Capital for their support.

Enjoy "listening in" to the 2010 Opalesque Connecticut Roundtable!

Matthias Knab  
Director Opalesque Ltd.

Knab@opalesque.com



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# Participant Profiles



(LEFT TO RIGHT)

Matthias Knab, Marco Bianchi, Bill Ferrell, Joe Taussig, Ajay Jani, Pamela Lawrence, Kevin Schweitzer, Walter Raquet, Theresa Patti, Donald Brownstein, Jonathan Litt

## Opalesque Connecticut Roundtable Sponsor





# Introduction

**Theresa Patti**  
QFS Asset Management, L.P.

I am Theresa Patti from QFS Asset Management, a quantitative global macro investment firm. QFS was founded in 1988 by a former professor of economics and quantitative finance named Sandy Grossman. I have been with the firm since 2001 and as Managing Director & Senior Portfolio Strategist work closely with the research team on evaluating our existing strategies, managing customized mandates, and working on new product development.

We have been running the QFS Currency Program since 1993. We also operate the more diversified QFS Global Macro Program that has been running since 1998. In 2005, we launched a stand-alone fixed income program that trades global yield curves long and short. Our models incorporate a combination of proprietary long long-term macroeconomic/fundamental econometric models together with some trend and technical indicators in a systematic approach to trading global currency, equity index, yield curve and commodity markets in a risk-controlled manner.

Our AUM is currently about \$1.5 billion. We are based in Greenwich and employ 32 people in total.

**Bill Ferrell**  
Ferrell Capital Management

My name is Bill Ferrell from Ferrell Capital Management. I founded the firm 22 years ago after a career on Wall Street. I worked for Citibank in the capital markets group for 11 years and then spent five years at Kidder Peabody where I ran the municipal business. I was a member of their Board of Directors and the Management Committee of the firm.

I founded Ferrell Capital with the idea to take risk management from the trading desks to the buy side. Interestingly, now after 22 years, I am finding that I have a shot at being an overnight success. Traditionally, our clients have been money center banks. They have been extremely interested in having us help them allocate capital and help with regulatory issues. Now, all of a sudden, the institutional market is approaching us for risk management, and we are delighted to help them.

**Kevin Schweitzer**  
RockView Capital

My name is Kevin Schweitzer. I am the General Partner and Chief Investment Officer of RockView Capital. I founded RockView Capital in 2004. We are a fundamental credit manager with two investment strategies: a long/short credit strategy that we've been running since 2004 and a short-biased credit strategy that we started at our client's request in 2008. I started my career in the early 90's and traded credit for Paloma from 1995-1998, did a stint with CoMac and Stanfield in the earlier part of this decade and was incubated in 2003 prior to launching RockView in 2004.

We run two funds; our flagship is more market neutral from a credit perspective, and we have a dedicated short credit vehicle. The differences between the two funds are pretty significant. Our short-biased strategy can be as much as 500% net short, while our flagship credit fund is roughly plus or minus 25% net long or short. The flagship fund is up around 13% for the year, and the short-biased credit strategy is up about 5%. That strategy made most of its profits for the year in May and August. We have 10 employees and manage about \$150 million.

Our approach is based on fundamental analysis. We think of ourselves as credit migration experts. We look for directional long securities that will migrate upwards in credit quality, and for those we believe will degrade in credit quality and widen on a curve. Our longs are typically built bottom-up, using fundamental analysis. Additionally, when we're in convertibles, we're typically looking

for smaller, less followed credits that have high Gamma and low Delta. Our shorts are a source of profits for us and are more theme-based on secular trends in the economy. After we identify the trend, we identify what industries and those underlying companies may be subject to credit deterioration. Typically, we have 8-10 themes on the short side. We're generally long high yield and crossover names and short investment grade.

**Joe Taussig**  
Taussig Capital

My name is Joe Taussig, I am one of the sponsors of this Roundtable. We work with fund managers and help them create insurance companies and banks in partnership with them. We have done more than two dozen of such vehicles. The motivation for the manager is to raise assets which they come to manage, and those assets are permanent capital.

Our most visible vehicle was created with David Einhorn's Greenlight; it is called Greenlight Capital Re. It is a publicly traded company, GLRE, and David has about a \$1.3 billion of permanent assets he would not have otherwise had. Greenlight Capital Re. has outperformed his funds by 7.5% since inception, has about \$3.5 million a day of daily liquidity, and for U.S. investors there are no K1s.

**Marco Bianchi**  
NYSE Liffe

My name is Marco Bianchi, I am the Head of Business Development for NYSE Liffe U.S., the U.S. Futures Exchange of NYSE Euronext and a sponsor of this Roundtable. My background is in listed derivatives. I started in the derivatives industry in London, working for the Liffe Exchange at a time when futures and options were traded on an open outcry trading floor. I am now based in the U.S. where I have spent the last several years building and establishing a significant client business for NYSE Liffe.

About three years ago, Euronext merged with the New York Stock Exchange, and while retaining my responsibilities for the US client business of NYSE Liffe I joined a new team focused on building a new U.S. futures platform for the New York Stock Exchange that is very much focused on innovation and market structure as core themes. We believe that there is a tangible opportunity to bring a more balanced and a more competitive structure to the U.S. futures market which will be beneficial to a wide range of market participants.

As an Exchange, we are specifically focusing on capital efficiencies. We aim to offer innovative and more capital efficient opportunities to users of US interest rate derivatives, as I will explain more fully during our discussion.

**Walter Raquet**  
WR Managed Account Services

My name is Walter Raquet. I am the chairman of WR Managed Account Services. We are providers of managed account services and daily risk analysis, daily trading guidelines for institutional investors. Before that, I founded a firm called Knight Trading in 1995. WR Managed Account Services is located in Stanford where we have 30 professionals on staff.

**Pamela Lawrence**  
Restoration Capital Management

I am Pam Lawrence. I am the co-founder of Restoration Capital Management. My partner Ivona Smith and I started Restoration in 2001 with seed capital from the Ed Bass Organization in Fort Worth, Texas. Our investment focus is on the distressed and stressed credit markets; in particular, we focus on investing in the small-to-mid sized companies, those with \$2 billion of total enterprise value or less. We are fundamentally driven investors with a focus on capital preservation. We invest in the senior part of the capital structure which includes senior bonds and bank debt.

**Donald Brownstein**  
Structured Portfolio Management

I'm Don Brownstein. I am the founder and CEO of Structured Portfolio Management which is headquartered in Stamford, CT. I started SPM in 1997. We currently have about \$1.8 billion under management. Our strategies are always narrowly defined and most of them have been successful in exploiting anomalies within the markets for residential mortgage-backed securities. Our longest running fund—the \$1 billion SSH fund—has been doing that since 1998. We currently have two funds open, the SPM Core and SPM Opportunity Funds. SPM Core invests solely in mortgage-backed securities utilizing various tactics that reflect our experience as analytical & statistical experts in this area. SPM Opportunity invests not only in mortgage-backed securities but in other fixed income and event driven strategies as well. Our funds have consistently won awards from the HF investment community and have been named in the top 10 of the Bloomberg Top 100 Hedge Funds

**Ajay Jani**  
Gramercy

My name is Ajay Jani. I am with Gramercy, an emerging markets focused asset management business. We manage about \$2.5 billion, roughly 80% of that is in alternative strategies and the rest is in long-only. Gramercy was founded in 1998 and we have about 62 employees worldwide. Our headquarters is here in Greenwich and we also have offices in London, Bulgaria, and Mexico City. We offer roughly a dozen funds focused on different strategies, so clients can pick and choose what type of strategies they want, instead of investing in a multi-strategy product.

My responsibilities at Gramercy are managing the macro business as well as developing improved hedges for our credit books. As part of this business we have just launched an Emerging Market Macro Fund.

**Jonathan Litt**  
Land and Buildings

My name is Jon Litt. I founded Land and Buildings during the summer of 2008. We invest in global real estate and real estate related equity securities. Prior to that, I was a sell-side analyst for 14 years, covering U.S. publicly listed real estate companies. During that period, I was ranked the #1 All American REIT Analyst for 8 years, as reported by Institutional Investor Magazine, and ranked in the top 5 for 13 years. Most recently, I was at Citigroup for 10 years and also headed their Global Property Strategy. Prior to my sell-side experience, I was on the buy-side investing in the same securities, and before that I was buying shopping centers for a group out of New York.

Our principle strategy at Land and Buildings is a directional long-short fund. Over the years we have found that best-in-class companies outperform worst in class and this is the basis for the composition of our long and short positions.

**Kevin Schweitzer**

We've been receiving a lot of attention from investors that believe investing in RockView is timely. They're looking for credit managers that can deliver returns in idiosyncratic credits, have credit identification skills, have name-specific, alpha-generating trades on the short side, and appreciate our dedication to avoiding high 'flow' credits. We've also been approached by a distribution partner to be the sub-advisor for a short credit UCITSIII fund, as well as sub-advising an alternative mutual fund too.

**Walter Raquet**

In our space - managed accounts - we see a significant spike in interest from very large hedge fund investors. I believe we are currently talking to about to 15 institutions with about \$3-\$25 billion in hedge fund assets. They all have an incredibly keen interest in receiving daily risk reports, daily trading guidelines, and all of the other information that we can provide.



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**Theresa Patti**

We have been seeing increased demand for managed accounts from clients over the last couple of years, following the financial crisis and Madoff. The clients want increased liquidity and transparency into the holdings of the portfolio, and to know that the assets are safe. We have accommodated those requests where the account size would be sufficient to justify opening a managed account - but there is a lot of work involved, both for the manager and the client. Thus, for smaller clients who want managed accounts, we think platforms such as Walter's WR Group can make a lot of sense, and we have been increasingly listing our strategies on platforms like his.

Another major impact on QFS has been that since 2007, the global macro trading environment has improved significantly. Following what we saw as an abnormal period of synchronized global economic growth and very low volatility in the mid-2000's, the environment rapidly changed in 2007 as the housing bubble in the U.S. burst and the U.S. went into recession and was followed by some, but not all, major economies. As investors began to shift investments from one country to another, one asset class to another, volatility increased. This new environment (which we see as the more normal state of the world) is much better for macro trading, because we earn our returns from differences in global business cycles. As a result, our returns improved and investor interest in our strategies increased.

We are seeing lot of very interesting and unusual central bank behaviors lately among countries. The whole situation with China (the U.S. putting pressure on the Chinese to let the Yuan appreciate) and the U.S. quantitative easing (which is now very successfully depreciating the U.S. dollar), creates very good opportunities. Some emerging market countries are getting a lot of inflows and are trying to limit this to slow down the appreciation of their currencies. The Japanese Central Bank has indicated it will undertake a series of asset purchases like we are seeing in the U.S. in an unsterilized fashion, and they may basically attempt to depreciate the Yen in that fashion instead of doing direct interventions, such as their recent interventions in September which turned out to be completely ineffective.



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In contrast to those places, there are countries like Australia that actually never entered recession throughout the global financial crisis. There, the Central Bank is really more concerned about inflation as opposed to deflation, which is the concern everywhere else. All of these developments and forces are very good for us in the currency world, because currency is always a relative value trade that reflects the differences between the economies involved. We see a lot of differences in growth and interest rates, and in the direction of interest rates; we see a lot of differences in monetary policy behavior which, in sum, create huge opportunities for exchange rate changes. For us, currency has been our most profitable space over the last year-and-a-half or so, and we expect it to be an important driver of P&L both in the currency program and our more diversified macro program going forward.

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#### Ajay Jani

From Gramercy's perspective, two things particularly are interesting right now. Having been involved in emerging markets for almost 20 years, we went through every crisis. While formerly most of the crises were originating in the emerging markets themselves, we are starting to see, for the first time in my career, that most of the recent and foreseeable crises are starting to come out of the development world - the G10 or G20.

The second observation is related to our investors. Roughly two-thirds of our investors are long-term investors, like pension funds or endowments. On average, those investors have about 5% in EM. I do not know what the right amount is, they do not know what the right amount is, but in their mind they think the right amount is higher. So, there seems to be a tendency where some investors started to throw money at EM almost without care.

Liquidity is still lower in emerging markets compared to G-10 markets, and the big risks are that a lot of these countries are not necessarily prepared to take that money as quickly as it is coming in. You saw Brazil last week double the inflow tax from 2% to 4% (since increased to 6%). Korea is now starting to audit the money that is coming in and making noises on implementing taxes or capital controls. There are a lot of countries that are weary of taking in this fast money. They have been burnt in the past by portfolio investment, and more importantly they do not necessarily want their currencies to strengthen as rapidly as the market is pushing them to.

Under such circumstances, someone could end up trapped or positioned wrong in the short-term.

However, when central banks have decided they want less dollars, EM currencies and EM exposure is certainly an option to help diversify their reserves.

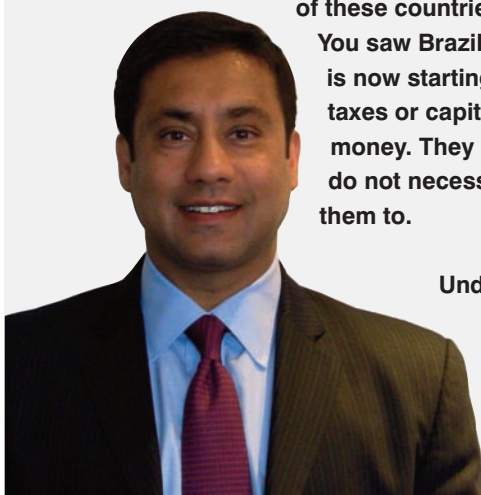
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Ajay Jani



#### Jonathan Litt

Before setting up Land and Buildings. I was on the sell-side, and my clients were amongst the largest equity investors generally and in publicly traded real estate stocks specifically. On the buy-side, we have been talking with institutions that have big allocations to private real estate. The theory behind these private real estate investments is that they are not correlated with stocks or bonds. During the recent financial crisis those investments were not only highly correlated with stocks, but they have proven to be very illiquid, and over-levered with few options for recapitalizing. These institutions did not really understand the risks of being in private real estate.

Increasingly we are hearing these institutions talking about increasing their allocation to public real estate from private real estate. Firms like ours will be well positioned to help these institutions implement their public real estate investing strategy.

#### Bill Ferrell

There are three macro trends going on in the industry that are really important and are going to fuel very strong growth in the hedge fund space in 2011. And the first trend is the fact that asset/liability management has forced investors to become much more focused on absolute return. In 2008, every pension fund and endowment found out the hard way that relying on benchmarks was simply not a very prudent strategy when they compared the benchmark performance to their liability structure. When benchmarks behave badly, they tear-up portfolios and create major losses.

When you look at the volatility of volatility, for example in the VIX contract, you will remember that back in 1998 volatility in the equity and foreign exchange markets actually reached the 40s. That was considered to be a horrifying event then. When we went from 40s to 50s to 60s and up to 70 on the VIX in 2008, it was not only horrifying, but it really gave a new reality to the fact that people are a lot less likely to applaud performances that beats an Index if the Index is doing really badly.

**The second main theme is that people are now shifting from asset allocation to risk allocation. They are looking at the asset mix of their portfolios a lot differently, and this is also going to favor hedge funds. Investors will start analyzing and scrutinizing those factors in the portfolio that really drive their performance.**

**The third big picture strategic trend I see happening is that risk measurement will evolve into risk management. Going forward, it will not be enough just to get risk reports and find out what your risks are in the portfolios.**

**You must be able to apply a protection plan in case risks exceed your policy limits.**

**Bill Ferrell**



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The third big picture strategic trend I see happening is that risk measurement will evolve into risk management. Going forward, it will not be enough just to get risk reports and find out what your risks are in portfolios.

You must be able to apply a protection plan in case risks exceed your policy limits.

What we at Ferrell Capital provide is the opportunity for institutional investors to set policy limits as to how much risk they want to take, (the band of outcome that makes them comfortable they can still meet their liabilities), and add active management where we actively hedge when those risks bands are violated.

**Matthias Knab**

**Going from risk measurement to risk management will be a large step for many investors, who often still have a benchmark orientation, as we said. Walter, can you comment from your experience on this trend? Have your clients started to turn the risk management reports you produce as a starting point for active risk management?**

**Walter Raquet**

We have a large client that has a portfolio of about 20 hedge funds. We do give him information on the aggregate risk and he actually puts on daily hedges to take down some of the risk where he feels uncomfortable. The key is having all that information on a portfolio view. When you look at just one hedge fund it is hard to hedge, but when you look at say 20 together it is much easier and more economic to put on hedge.



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As a way of illustration, in summer of 2008 there were 28 managers in a certain portfolio, and we realized our oil exposure was out of line. We put a hedge on it and then oil went from \$140 down to about \$80, which obviously helped us a lot. If you looked at an individual manager, the effect was maybe not that much, but in the whole group the oil exposure was at an uncomfortable level. This is really one of the big benefits of having such a risk aggregation, and I think the pensions are realizing that now.

## **Donald Brownstein**

This is an interesting question. For SPM, every strategy we employ has to be well-defined and that means identifying the portfolio of risks the strategy will encounter. So risk management provides the very context in which we invest.

The funds which we have been running the longest have produced what we believe are the best returns overall in the history of residential mortgage-backed security investing. The way we have accomplished this has been by building individual risk management “cages” specifically tailored to our strategies and within which our portfolio managers run those strategies. Risk management becomes, metaphorically, the bars of the cage. Our investors have access to all of our risk reports and we tell them - in often excruciating detail - what risks they currently have. They can also check this by looking at the daily risk reports we make available to them. We also design custom reports when investors request them. Of course, we continuously adjust our hedges to stay within the “cages.”

The underlying philosophy and approach here is based on the idea that hedge fund management should be transparent to our limited partners. This way, investors know what risks they are taking. So, instead of merely defining what asset classes they are exposed to, our investors - in choosing an investment vehicle - get to choose which risks they want to take. The large majorities of our investors are institutional and have the horsepower to work through the details of our strategies.

As 2008 has taught everyone, different asset classes can embed the same risks. What's more, the presence of certain risks may not always be apparent. So having multiple approaches to both measuring and managing risk is crucial to us. Finally, because we can't expect to be omniscient we always hold a lot of cash and have a proverbial “Plan B.”

## **Kevin Schweitzer**

A lot of our investors are looking at hedging their portfolios and creating a sort of tail-risk scenario. This brings it back to a risk conversation in terms of looking at their portfolio overall. They're wondering how to hedge out some of their exposures they have overall to credit, whether it is in distressed, high-yield managers, even investment grade; especially with the large run-up that we've had in the high yield investment class over the past two years. People do not necessarily want to get out of that, or those funds overall, they are just looking in terms of how to hedge that, or, possibly, being able to take advantage of any downward movement, too.

So, one of the things that we have been doing is having conversations with our clients and prospective investors who ask “how do I short credit and get properly positioned for this trade?” To my knowledge there are only about eight hedge funds that are running dedicated short portfolios in credit. So, it is interesting as to how various people approach it whether it is 100% short or variable exposures with some short-dated longs to offset the cost of carry, such as RockView's approach. There appears to be building demand for short managers or people with short experience on the fixed income side and it's nice to be one of those proven strategies because we think about fixed income a little bit different than the equity side. Of course, on the fixed income side you know where your risk is, when you put on a trade you have a limited upside on a fixed income bond when you own it. You have a proportionally unlimited downside, so you are reversing that trade - thereby, capturing the optionality to the downside, if you will.

So, what we do is create a portfolio where we have a slightly positive carry, but still achieve

negative correlation for our investors. In fact our short-biased strategy has a negative correlation of about (.70) to high yield yet still has positive performance.

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**Kevin Schweitzer**



**Pamela Lawrence**

Similar to what Kevin was saying, I believe that institutions with distressed exposure in 2008 found that if they were invested with a number of larger distressed managers, there was a decent amount of overlap in those managers' portfolios. GM, Chrysler, Delphi were some of the typical investments. This was not the case for us and we are getting a very positive response from some of these investors about that.



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**When we talk to them about companies we are invested in, they often say "I have never heard of this company before."**

**Pamela Lawrence**

When we talk to them about companies we are invested in, they often say "I have never heard of this company before." An example of this is Mega Brands. Mega Brands designs, manufactures and markets toys and stationery products. Mega Brands made an expensive acquisition in 2005 and added a significant amount of debt to its balance sheet. The combination of increased legal fees from numerous recalls and litigations regarding certain key products, declining revenues from the economic downturn and a levered capital structure, reduced the likelihood of refinancing its debt. The Company's \$350 million of outstanding bank debt traded down significantly. Upon the Company's announcement to offer to exchange its existing bank debt for 60 cents in cash, plus equity in the restructured company we built a position in the bank debt. Three months later, Mega Brands paid the bank debt holders 60 cents plus accrued interest from the last coupon payment. This was equivalent to our cost basis and we created 10 cents of equity for free. We exited the position for a realized gain of approximately 15% and IRR of approximately 80%. With \$350 million dollars of outstanding debt not many firms could have made a position in Mega Brands a meaningful position in their portfolio. As a firm under a billion dollars, we were able to capitalize on this opportunity.

Our focus on smaller companies diversifies their distressed allocation in a market that really has a lot of volatility lately.

**Marco Bianchi**

Many of the themes we are discussing such as transparency, risk management, as well as the globalization of investment flows and the importance of regulation certainly resonate with us at NYSE Euronext. When you go back to just a couple of years ago market participants identified the New York Stock Exchange as the place for U.S. cash equity trading and listings, essentially a traditional stock exchange. Well, when you look at the combination of market venues, products and asset classes that are now under the umbrella of the NYSE Euronext Group, you are looking at a much more diversified platform. Our standardized, electronically traded and globally distributed derivatives products provide for a lot of the risk management applications that global hedge funds, investment managers, buy-side and sell-side clients are looking for.

When we discuss new and innovative product ideas, it is actually a very fruitful dialogue that we have with our clients, because they define very precisely some of the risks that they need to hedge and some of the benefits that they are looking for in an exchange. We are trying to listen and deliver the products, services and market structure that our global clients are looking for.

For our new U.S. futures exchange, NYSE Liffe U.S., we have formed a partnership with three buy-side and three sell-side equity investors who are already very established clients of ours across the many other markets that are part of the NYSE Euronext family.

We have partnered with our clients and are focused on building a multi-asset class platform. We have products that range from precious metals – like gold and silver futures and options which offer very useful investment and risk managements opportunities given the still unstable and uncertain times in the global investment markets. We offer a wide range of futures based on MSCI international equity indices covering emerging markets as well as established US and European underlyings, and we plan to list interest rate products in Q1 2011.

**Theresa Patti**

Are you doing anything in the currency space?

**Marco Bianchi**

We have not announced any specific plans in the currency space, our focus up until now has been mostly on commodities, precious metals, interest rates, as well as on the equity indices.

**Matthias Knab**

**Marco has mentioned one of the buzz words - regulation. Is regulation changing or threatening your business?**

**Kevin Schweitzer**

We are relatively active in the credit default swap market for both funds; however, we're predominantly on the long side as we are buying credit default swaps.

One of the things that we are pleased about in terms of the regulation is that the collateral that you post will be relatively consistent amongst counterparties; hopefully the developments will lead to an exchange at some point in time. Other effects are probably a bit more transparent in terms of pricing of the credit default swaps contracts themselves, and in addition it will probably lead to tightening of spreads amongst the securities.

I believe that the regulatory trend is beneficial overall for users of credit default swaps. On the other side, of course, are the banks that will be impacted in terms of commissions and the free capital they've been using on their collateral postings from their clients.

**Marco Bianchi**

Currently global currency markets are open 24/7 with various liquidity pools available around the clock. From your perspective, are there certain things when you are trying to source liquidity, or you are trying to access certain particular markets that are not optimal, is there something that you wish would be different?

**Theresa Patti**

We have always traded currencies OTC directly with counterparties and not traded in the futures



markets in currencies, because the OTC markets are just much more liquid. OTC has always been our preferred means of putting trades on.

**Through the global financial crisis we were trading with various banks and we were worried about how much credit exposure we had to these banks. We had to look at their CDS spreads and news on them every day and were on the phone with them constantly. So yes, we are taking counterparty exposure, although we generally minimize that by use of bilateral margining. That means that every day either we post margin to them or they post margin to us, which minimizes our risk to basically one day's P&L. But certainly, throughout the financial crisis this setup created a lot of work, and going forward the idea of doing more on the futures exchanges with a central clearing house could alleviate some of that additional work, if the currency futures markets became more liquid as a result of regulation.**

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**Ajay Jani**

Regarding emerging market currencies, many of them are still non-deliverable, so the capital accounts are not fully open. The way to access those markets then is through a non-deliverable forward. With the exception of Brazil, which trades to a standardized date every month, normally the protocol for an NDF is to ask for a one-month price or a three-month price and then, obviously, as the position ages, if you need to unwind it becomes an off market date and a bit less liquid.

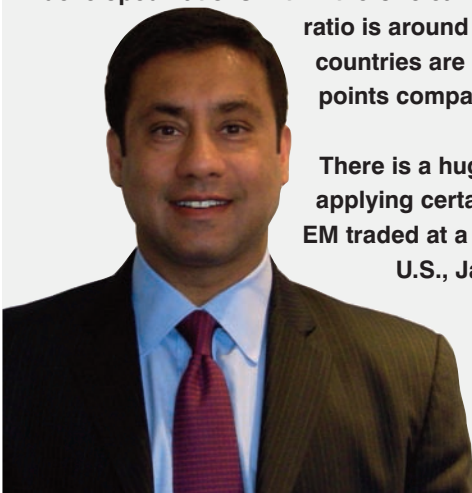
If somehow somebody could organize the NDF market to sort of replicate what Brazil has done – creating a very liquid NDF market simply through a standardized date, that would be immensely useful for the marketplace.

**Coming back to opportunities around emerging markets, just this morning I looked at some data – at the moment the developed nations within the G20 carry a debt load that is about 87% of GDP, on average, while for EM countries the ratio is around 37%. Yet, the developed countries are rated AA+ on average and the EM countries are rated BBB. The credit spreads in EM for those countries are about 165 basis points compared to about 65 basis points for the developed world.**

**There is a huge inertia on the part of the rating agencies and the investors in terms of applying certain ratings for a certain category of countries versus the other. It used to be that EM traded at a spread compared to “the anchors”. The anchors were France, Germany, the U.S., Japan, and then maybe peripheral Europe.**

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Over the last 20 years, most emerging markets have actually worked off their debt at a time when the G-7 or the G-10 have levered up. There is really a mis-rating between EM credit spreads and G-7. Let's take Argentina, for example. Gramercy was very involved in the Argentina restructuring. Argentina five year CDS (credit default swaps) trades around +700 - compare that to Italy at +182, Argentina is still very, very mis-priced. That is just one of the many interesting specific opportunities we see in emerging markets.

### **Marco Bianchi**

When we talk to our buy-side clients on the equity side, emerging markets frequently come up as a very important theme. A variety of portfolio managers who for a long time have been primarily focused on US domestic investing and index replication are looking more and more towards exposures to emerging markets as well established markets outside of the United States.

As such, two products that we picked for our equity index futures portfolio are based on the benchmark MSCI Emerging Markets, and MSCI EAFE indices. These products are developing very good liquidity, confirming the market need for access to simple, transparent and centrally cleared investment tools.

### **Bill Ferrell**

I would just like to comment on a few things that have been discussed. First of all, Jean-Claude Trichet yesterday at the Economic Club Luncheon must have mentioned at least five times that one of his biggest concerns is the potential for regulatory arbitrage. Regulatory arbitrage could provide fantastic opportunities for hedge funds to make money, because there are differences in the way the Fed is participating in the markets and how the European Central Bank operates. These differences will result in price anomalies and will take some time to pan out.

Theresa was mentioning before the counterparty risk and how her firm goes about managing it. One of our important clients has been JP Morgan; they were probably the first financial institution to realize they had more counterparty exposure in their global trading floors than they did in all of their credit risk in their loan portfolios. They were among the first to take risk management very seriously, and to this day it seems to be doing well for them.

There are really two ways of looking at the business of managing risk. We believe it is fundamental to recognize the difference between strategic allocation and tactical management. Why is that? On a strategic level, pension funds, endowments and foundations allocate risk to different asset classes and different strategies, based on their expectations for future growth and diversification.

They must additionally realize that from a strategic level they could be investing in things that have a lot of diversification value on day one, but the volatilities and the correlations of those investments can be changing a lot faster than their ability to deal with them. This is why on a tactical basis they protect portfolios when the markets become volatile, and when the correlations change dramatically.

### **Donald Brownstein**

The question of regulatory arbitrage is an important one: I think it is going to be very significant for investing as we go forward. In fact, I believe that the United States is about to enter a distinctive moment in the history of our central bank's management of monetary policy. For those of you who are old enough to remember 30 years ago (and I am in that group), the US economy underwent a generational change when Paul Volcker was Chairman of the Fed and had

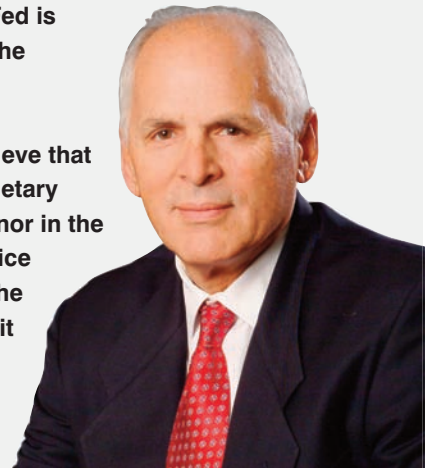
what I refer to it as “The Volcker Moment.” Through a dramatic monetary policy move the Fed was able to transform the macro-economic climate. The accomplishment was to re-tether inflationary expectations for the United States. The consequences have endured for decades.

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**Well, 30 years later, instead of inflationary expectations the current Chairman of the Fed is worrying about deflationary expectations and I believe we are about to experience “The Bernanke Moment.”**

**Just as “The “Volcker Moment” had both short- and long-term consequences, we believe that “The Bernanke Moment” will have two phases. First, an early phase in which the monetary aggregates (and, hence, inflation) grow-- but are not fully expressed in price indices nor in the yield curve. Second, a longer-term phase at the beginning of which both rates and price indices move significantly upward to reflect these inflationary policies. At that point the Fed will become less accommodative and, we believe, may adopt some sort of explicit price stability target.**

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### **Jonathan Litt**

During my career, I have spent many years working at large financial institutions. My sense is if there are bad apples, no regulatory structure whatsoever will prevent bad things from happening.

I am in the real estate business, and whether it is the direct business or in public markets, the fundamental driver of real estate is supply and demand. It is supply and demand in capital, and supply and demand of the actual building or space.

From an investor’s perspective, as we look around the world today, we ask ourselves where is the best demand? The best demand is in the emerging markets. And where is the least supply? In the Hong Kong office market for example, there is virtually no new space being built, vacancy rates are 1%, and there is an outsized demand; even if China GDP slows it will still be growing. As such, there is a sustained demand for office space, and rents are growing 20% or 25% and the public companies are trading at 15% discounts to private valuations. We like that equation.

Brazil has two square feet per person of retail space, while the U.S. has 20 square feet per person. Average incomes of Brazilian households are going up quickly—they can spend, they can shop. We believe there is another opportunity in Brazilian regional mall and retail real estate space.



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Let's now turn to inflation. Some of you invest in fixed income, and given the declining rate environment this has been a good place to be. The income characteristics of real estate, that is the attractive yield, puts public real estate somewhere between fixed income and equities. Further, when inflation heats up, real estate will prove to be a great store of wealth, particularly against a backdrop of limited supply.



We like markets such as Midtown Manhattan offices and apartments in the northeast where it is hard to build. No one wants an apartment complex built in Greenwich. If you can own a Greenwich apartment complex, you are going to see good rent growth. Demand in the middle of the country is weak, so we do not see a lot of opportunities there. We also believe Europe is going to be quite problematic in terms of the ability to drive demand given austerity plans.

Overall, our view is that real-estate is undervalued, and the more interest rates go down, the cheaper it gets. If you can buy real estate at an 8.5% yield and the 10-year is at 2.46%, that is an arbitrage that is going to go away.

**Jonathan Litt**

If you look at the U.S., there is almost no new supply. If you go around the country today, you will see very few office buildings, shopping centers, warehouses being built. Any incremental demand should drop to the bottom line in these companies in the form of increased occupancy and rents.

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Matthias Knab

Jonathan, sometimes I hear people referring to the risks in commercial real estate, where in a couple of years large chunks of loans that have been securitized come up for renewal. Whereas a mall owner who has financed his project say with a local bank can go back to the bank and negotiate terms, the guys who just sit on a securitized paper really have no one to go to, as no bank out there will be willing to add his debt again to their balance sheets. Some people say that is a time bomb waiting to come down on us, what is your view here?

Jonathan Litt

We were certainly asked that question about a potential bust in commercial real estate a lot last year and spent a lot of time thinking about it. We were quite short during the downturn because of concerns about these issues. However, as we entered the fall of last year and really dissected the outstanding commercial real-estate debt and maturities, we found in our universe of companies most of the debt coming due between 2010 and 2013 is in the money. There might not be as much equity as one would like, but chances are the real estate is worth more than the loan amount, because those loans were made in the 2000-2003 period.

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**The real problem loans are the CMBS loans that were made during the 2005-2007 period which puts maturities in the 2015-2017 timeframe. Those are underwater. The only thing that is saving them is that interest rates are so low, they can service the debt.**

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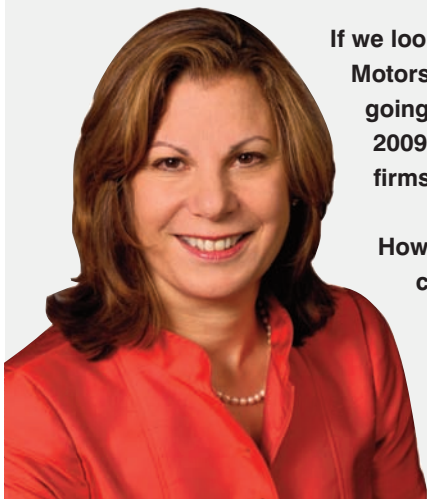
The real problem loans are the CMBS loans that were made during the 2005-2007 period which puts maturities in the 2015-2017 timeframe. Those are underwater. The only thing that is saving them is that interest rates are so low, they can service the debt. We anticipate there will be restructurings and workouts. The question is will they be at fire sale prices, which could depress real estate values, or will we see orderly liquidations and restructurings?

Given the amount of capital that wants yield and wants to participate in the improved underlying fundamentals of real-estate, we do not anticipate significant distressed sales of traditional core assets.

Pamela Lawrence

If we look at the distressed market, there are no longer big bankruptcies – the General Motors and the Chryslers of our world are all over. Lehman still exists but that situation is going to be a slow liquidation. The default rate has come down pretty dramatically since 2009 and continues to decrease. Free cash continues to flow into the market, allowing firms to generally refinance their debt.

However, in the next four years over \$600 billion of debt will mature. Some of those companies will be able to refinance, some will do exchange offers and extend their debt, but not all of them will accomplish this feat. There will be companies that default. We expect these opportunities to increase in the next two to five years, particularly smaller companies that tend not to have access to the capital markets.



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**Pamela Lawrence**

I am not predicting a default rate that goes back to 10-12%, but it is not going to stay at the 3-4% level. And that assumes the economy stays the same and that everything is the same in the credit markets.

Currently, we are pursuing opportunities in smaller companies that are stressed. We look for companies where we can buy secured debt, where we are not overly levered through our investment, and there is a catalyst in the next year that will cause some event, usually a maturity, allowing us to realize value. The opportunities provide great returns while protecting the downside in this volatile market.

**Theresa Patti**

While we are on the topic of yields, one of the big looming dangers that we see as part of our macro view is that the U.S. is obviously following this very stimulative monetary policy. Essentially, the dollar now is falling significantly as the U.S. adds sizable yearly deficits on top of its nearly \$14 trillion worth of debt. Because of the current account deficit, the country is issuing anywhere from \$30-50 billion a month in new debt, which is held by foreigners. Most of that debt is held in short maturities, which means that the U.S. has to continue to roll over all of this debt.

In our view, it seems unsustainable for the U.S. to continue issuing these huge amounts of debt at what are essentially risk-free interest rates as its fiscal position deteriorates. One of the big opportunities we see on the horizon – and it is hard to say how far away the horizon is – is the marked potential for long-term interest rates to rise very sharply. I am curious of what you think about sort of the impact on your strategies if that does come to fruition.

**Jonathan Litt**

The question, are rates going to up, is interesting. We see two scenarios. One is technical: foreigners stop buying our bonds. The second, is inflation heating up? At the moment, it appears inflation is not heating up and it may not for quite a while. So, what would cause the Japanese, the Chinese, or other foreign central bank to boycott buying the dollar? Maybe it is the assurance of mutual destruction of both economies.

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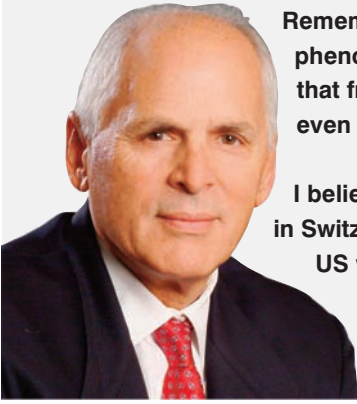


**Donald Brownstein**

Remember what Milton Friedman said: “Inflation is always and everywhere a monetary phenomenon.” If the Fed buys \$5 trillion of 5 and 10 year notes and borrows the money to do that

from the Treasury, they are increasing the money supply and rates do not have to move even 1 basis point upward.

I believe we are getting ready to monetize the debt that China created for us. I remember being in Switzerland about two years ago and was asked by a large investor whether we thought that the US would pay China back and my response was, "Would you?" Well, we'll pay them back all right, but with inflated dollars.



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**Donald Brownstein**

Of course Chairman Bernanke is fully aware of this, as is everybody else on the Fed. We basically owe a bunch of money to people who took Treasury securities and dollar reserves rather than taking payment. For China to hold dollar reserves is equivalent to lending us money since they cannot spend those dollars in China. While they hold them we can print more dollars. So, they basically gave us a 30% discount by manipulating their currency and keeping the payment in dollars. Now we are going to pay them back with devalued currency.

So a substantial part of the pain associated with quantitative easing is going to be felt offshore. Because of the privileged position of the dollar and the heavy dependence of export driven economies on the U.S., this is a particularly opportune time for the Fed to take the action that it is going to take. I suggest reading Reinhart and Rogoff's book "This Time Is Different" if you want to familiarize yourselves with the long and repetitive history of sovereign debt being repaid with debased currency.

#### **Ajay Jani**

I have read that book you are referring to and the prognosis for some of the countries in Western Europe and the U.S. in terms of the debt levels we have built up is very frightening. I am skeptical that the economies will succeed in generating any meaningful inflation to help bail out creditors, whether it is indebted consumers or companies or states in the short run.

Over the last 30 years, we have basically added about 3 billion people to the global work force, which is depressing wages. You see it everywhere. Returns on equity are up, profit margins are up, and unless the U.S. decides to close completely, so that foreign produced goods cannot come in, there is always a place cheaper than the U.S. to produce the goods that already come in. No matter how much you raise the price of gasoline, transport etc., these measures will just affect the consumers' ability to spend on the something else.

The explicit assumption behind "QE2" is that it will cause higher inflation. The implicit assumption is that higher inflation will lead to higher wages, which will reduce the real value of debt, and this is where I am more skeptical. Global markets mean that overseas labor can be used to fill domestic demand, keeping a lid on wage pressures. Absent measures to keep out imports (Smoot Hawley II) or a substantial debasement of the U.S. dollar to make domestic manufacturing much more competitive, this global pool of labor will thwart upward wage pressure in the tradable sector of the economy. If we get higher prices without higher wages, then in fact QE2 will actually make debtors even worse off.



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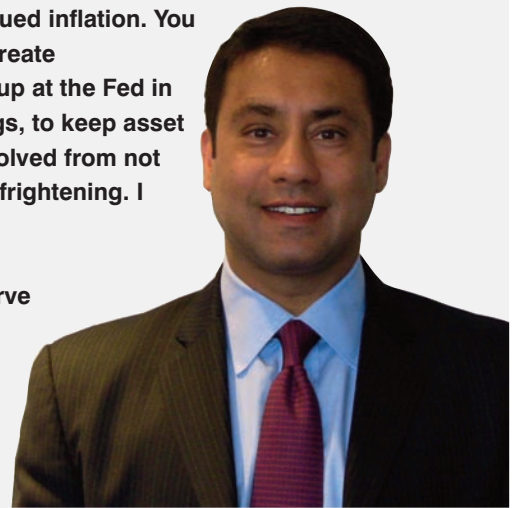
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**So prices may change relative to each other, but until the U.S. de-levers at the consumer and at the state government level, it will be pretty difficult to generate meaningful continued inflation. You might have a burst of six or eight months, but really what it is going to do is create abnormalities in asset prices. We recently heard the head of the markets group at the Fed in his speech two weekends ago saying Fed policies will aim, among other things, to keep asset prices higher than they might otherwise be. We have in fact a Fed that has evolved from not being able to see bubbles, to actively trying to create them, and that is pretty frightening. I have seen such efforts in emerging markets many times, and it never works.**

**The United States appears to be taking the dollar's status as the world's reserve currency for granted, but currencies can and have lost this status in the past. Just ask Spain, Holland, or the U.K. It's been said that the French Revolution was a period of quantitative easing, followed shortly thereafter by the guillotine.**

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#### **Donald Brownstein**

I have got to disagree with that. Because of, among other things the Volcker Moment thirty years ago, the U.S. is in a privileged position.

People around the world believe in the dollar and will continue to believe in the dollar. If the Fed were to overshoot its target, which is apparently somewhere between 1.75-2.5% inflation, if they were to overshoot that by, say, a factor of 2, so what? Would you care to invest in Brazilian currency denominated debt instead of the dollar? That is a rhetorical question.

**Joe Taussig** Swiss Franc.

**Donald Brownstein** There are not enough of them.

**Joe Taussig** Cannot argue with that.

**Marco Bianchi** I thought that it was an extremely interesting discussion and I will not express any views on rates per se. I do not know what is going to happen with U.S. interest rates, but I do know by talking to a lot of our fixed income clients that a lot of investors are looking for as much liquidity and capital efficiencies as possible to manage their capital exposure to US interest rates.

At NYSE Liffe U.S. when we looked at the U.S. interest rate futures and options space, we realized that currently there is only one marketplace for Treasury and Eurodollar futures and options – this market is the CME and all of their products are concentrated in a single clearinghouse in Chicago. The monopolistic nature of the current market model inspired us to seek an innovative solution that offers clients unique capital efficiencies beyond the status quo when they are looking at managing or hedging their US interest rate portfolios.

**Our strategy is focused around a new clearinghouse that we are building with DTCC, called New York Portfolio Clearing. In an environment where capital is very scarce and expensive, NYPC will offer cross-margining of cash bonds and interest rate futures together. Those are natural complements and frequently two sides of a hedging transaction, but at the moment every investor is being double-margined because funds are collected separately against futures and underlying cash positions. To the degree we can put futures and cash together at the clearing level, we will be able to release a significant amount of trapped capital back to the market and we hope that will be the reason for liquidity to build on our new platform. This is a very exciting project with potential benefits available to a significant number of institutional and sell-side market participants. We are working very hard towards a “go-live” of our innovative clearing house NYPC and the interest rate futures product suite on NYSE Liffe U.S. in Q1 2011**



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**Kevin Schweitzer** Generally you can say that absolute levels in the high yield and investment grade in credit have never been lower. High yield is about 7.5%, and the investment grade is incredibly low.

We believe being short corporate credit at these levels can be very attractive. We have also looked at creating a basket of relatively high dividend yielding stocks. You can find investment grade stocks, companies that have continued to generate increased earnings with a high dividend yield of

5% and higher, and you can actually buy credit default swaps against them that are yielding 80, 100 basis points.

That means you can pick up about 400 basis points by trading down in the capital structure of a company that the bond market has deemed worthy of a yield under 2% - while still enjoying the potential of unlimited upside that an equity security affords. A dividend yield that high, typically signals a company whose dividend is in jeopardy, but we've been able to screen for companies with these high dividend yields and yet extremely low bond yields (which implies steady cash flow) to get the best of both worlds.

Today, I look at corporate spreads and wonder if the levels where they are today accurately reflect the risks that are in the marketplace versus the potential reward. There is really a limited reward, and we think corporate credit is a very attractive asymmetrical trade we can capture for our clients.

**Jonathan Litt**

I am curious about your comment on corporate credit. Why do you think corporate credit rates are going to go up or spreads are going to widen?

**Kevin Schweitzer**

We are not focused on the macro side, but look for individual company shorts: individual companies encountering some event risk. We are not making a macro call in terms of the market place being wider, whether inflation picks up or not. We are looking for companies that encounter some difficulties, stress or distress to encounter.

**Bill Ferrell**

We started to discuss what will happen when the Dollar gets diluted. This reminds me of two events that I was involved in. One was being berated by Swiss institutional investors in Zurich back in 1986 about the fact they had bought US stock market heavily and while they were making money in US stocks, they were losing their shirts on the Dollar. And of course, they accused me of personally not caring about the Dollar. All I wanted to do is get out of Zurich alive.

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**The other episode happened when the Japanese pulled a "no show" on a US Treasury Auction back in April, 1987. Subsequently we saw a huge spike in rates, because we have been accustomed to selling most of our debt to them while no U.S. financial institution had any interest at that time to buy US Treasuries because the yields versus the cost of money did not cover perceived risks.**

**Instead of wasting time on stress tests that have centered around things that actually happened in the past, I think there are some very good points we brought up at this Roundtable today about what the next stress tests are going to be, about what could happen now. If I would be in the real estate or the corporate distressed market, the question I would ask myself would be about the impacts on these kinds of spreads, if in fact the U.S. takes a path where they will not be able to distribute securities overseas?**

**People working in Treasury have told me their biggest fear is indeed that folks won't show up for a Treasury Auction - we have not seen this for quite some time, but it has happened before.**

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**Donald Brownstein**

The issue then was inflationary expectations becoming un-tethered, but we are at the opposite pole now. The whole point of the Fed buying Treasury Notes is to force other investors out of that market and into risky assets. This crowding out is what they refer to as “portfolio rebalancing.” So, if the Fed comes to own the 5 and 10 year Note market for awhile, so what?

**Theresa Patti**

Debt then becomes an inter-generational transfer: the Treasury issues the debt and the Fed buys the debt, but eventually the debt has to be paid off. It won’t be us – it will be our children or even grandchildren maybe, but eventually the debt will have to be paid off but, as discussed, perhaps in significantly devalued real terms.

**Jonathan Litt**

Japan has been doing this for 20 years and nobody has paid it off yet. In theory, Bernanke may be hoping inflation will pay it off as opposed to actually having to pay debt back in current dollars. For a remarkably long time, Japan has been able to survive at very high debt levels and low inflation, or in fact, with deflation.

**Donald Brownstein**

Japan had deflated about 70%.

**Jonathan Litt**

That is right, probably 80% is the number; but it also started at a much higher level than where we started.

**Joe Taussig**

Before we finish, let me ask you about the controversy played out in the media about the State of Connecticut and the State of New York kind of competing for hearts and minds in the hedge fund industry, how do you see this discussion, and how do things pan out?

**Ajay Jani**

I work in Connecticut but am a resident of New York City. The Governor of Connecticut basically made an open invitation for city based investors and hedge funds to relocate here to Connecticut. We spoke earlier about regulatory arbitrage, and similarly she is offering tax arbitrage. As a resident of the New York City, I hope she goes even further than she has gone already, because it just pins down what could potentially happen in New York State.

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**Joe Taussig**

Also in Switzerland where I live, tax competition is looked at as healthy. Cantons and towns compete, so that is why you have clusters like Zug or Pfäffikon ending up with all kinds of hedge fund managers who have moved or set up there, because they can negotiate their tax rate when they come in.

One of my favorite is a small Swiss canton called Appenzell. You can rent a car anywhere in Switzerland, including Geneva, you will see your license plate is AI, which is Appenzell. This canton has staked out the rental car business as their fiefdom, they have the lowest taxes on cars, and so every rental car is registered there.

**Matthias Knab**

**Let me ask you, did managers come from New York, what is the trend?**

**Ajay Jani**

Gramercy started in New York and we moved to Greenwich about 10 years ago.

**Jonathan Litt**

There is a no doubt, I moved to Connecticut because it's a more preferential environment. When I had the chance to locate my business, I chose Connecticut because of the tax advantages.

However, when I actually look around and see what is happening in New York and New Jersey metro area, including Connecticut, I believe the region is losing its competitiveness. Connecticut became a hub through the tax environment, and I think going forward there will be other states which are going to try to draw us in. They might not be as centrally located as Greenwich, but I think that Connecticut is going to run-up against some competition over the next several years.

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**Another positive about Greenwich and probably Stamford as well, is there is no competitive disadvantage from a geographical perspective. You won't hear potential investors say, "Oh, you are in Greenwich, forget it." They come to our office building which houses a number of hedge funds on Greenwich Avenue. Also, company managements come through town regularly. The flow is maybe somewhat less than if I was in midtown Manhattan, but not materially. Connecticut has become a location where investors and corporations need to visit.**

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**Theresa Patti**

We have also not had a problem in getting employees doing the reverse commute from New York to Connecticut. People have recognized that Greenwich is a hedge fund hub. That there are a lot of us here, and we are staying. I do not think we feel any temptation to move in to the city at all, for tax reasons as well as employee and investor reasons. I do not see Greenwich really losing its luster, and even if the tax situation in Connecticut were to become less attractive, I believe the tax situation in New York would still be worse. So, I do not see the situation changing.

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