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Opalesque Roundtable Series '16

GENEVA

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Editor’s Note

Destroying Alpha: Everyone, even pensions, has become much more short-term, and it’s a problem

Markets and investors themselves are starting to suffer from the proliferation of short-term strategies which are more and more demanded even from traditionally long-term investors. Regulatory elements might play a role in that evolution. For example, pension schemes have theoretically a much longer-term investment horizon, but they are not really long-term today. There are obviously many baby boomers about to retire which probably shrinks a bit the duration of investments, but foremost pensions are subjected to regulatory constraints, with yearly assessment of their financial health, and this in a way is making them short-term investors. *Maybe sovereign wealth funds and some long-established family offices are the only real long-term investors left?*

When investor demand and behaviour actually destroy Alpha

Investors have also become less and less patient, expecting positive performances every month from their managers. *This behaviour typically destroys alpha as active managers have now to manage those expectations, often by limiting the risk taken.* Overall, investors have unrealistic expectations as they want – though not necessarily need – liquidity, they want less risk but at the same time expect their managers to create alpha. Lots of investors today are expecting higher returns than what the liquid markets can offer them, with a lower volatility. Investing in very liquid markets - where you do not have the illiquidity premium anymore - and expecting double-digit returns is not possible anymore. In conclusion, investors have to readjust their expectations for the foreseeable future as expected returns have decreased substantially in all asset classes, driven by the drop of the risk free rate along with the fact that alpha generation from hedge funds is utterly difficult in liquid markets.

People are also noticing a certain level of crowding in these short-term, technical and often relatively simple strategies. This can also be an opportunity for active managers if they are able to adapt their style. We have seen recently that the best performing managers are those who are willing to withstand high volatility, who are willing to be wrong in the exact timing, simply because they have longer term views, which are ultimately rewarded. And managers who do that are providing liquidity to the market, which is can be seen as one of the social roles of hedge funds, for which they should be rewarded. This Roundtable also discusses investments that can still offer yield despite of the regime change that has happened in 2016 (*and which we predicted in 2015*), where it’s really about about capital preservation.

Intermediaries face more challenges but can also offer real value-add

Active management is under massive challenges. But, the more passive a market is, the more opportunities there are for active managers, and vice versa. Intermediaries can actually help investors to deal with such questions and challenges. Probably the greatest mistake in fund manager selection is based on the exact same behavioural bias, which is also rooted in short-termism: **Buying a manager at the peak and sell him/her in the trough, and keep on doing that all the time because you can't withstand periods of under-performance.** Intermediaries can provide investors a diversified portfolio of managers and actually deal with these periods of under-performance. Of course, intermediaries can also destroy value – fees to high, or insufficient quality of product and/or service, etc. – though end-investors now have the tools to measure their performance.

The Opalesque 2016 Geneva Roundtable, sponsored by IDS and Eurex, took place at the end of 2015 with:

1. Ian Hamilton, Founder, IDS
2. Frédéric P. Lebel, CFA, Co-CEO and CIO at OFI MGA
3. Michaël Malquarti, Head of Manager Research & Alternative Investments, SYZ Asset Management
4. Julien Tizot, Inpact Partners, Head of Investment Research
5. Gregoire Haenni, Ph.D., CIO CPEG (pension fund of the state of Geneva)
6. Ewan Graves-Tamvakis, Risk Manager, LCJ Investments

The group also discussed:

- How do investors deal with a manager who is producing red numbers month after month? (pages 16-18)
  How do they react when a manager loses key staff? (pages 17-19)
- Why do many fund of hedge funds portfolios invest in a lot (75%) of the same funds? (pages 19-21)
- Why are some hedge funds able to keep their pricing power and charge higher fees? (page 8)
  Do high fee hedge funds provider better returns? (page 9)
- How investors globally benefit from the fusion that is happening between traditional and alternative investments (page 9)
- Are sovereign wealth funds creating a huge overhang on the market? (pages 12-13)
  What is the so-called unconstrained money doing? (pages 24-25)
- How do investors deal with the fact that the business of managing hedge funds has become much more fragile? (page 15)
- What should be the number one discipline of a good hedge fund manager? (page 15)
- What is Peter Drucker's explanation of investor herding? (page 21)
- How do pensions deal with negative interest rates? What else is worrying pensions today? (pages 21-23)
- Is risk really necessarily linked to volatility? (page 23)

Enjoy!

Matthias Knab
Knab@Opalesque.com

Participant Profiles

(LEFT TO RIGHT)

Michaël Malquarti, Ian Hamilton, Ewan Graves-Tamvakis, Julien Tizot, Gregoire Haenni, Frédéric Lebel, Matthias Knab.

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IDS GROUP

Introduction

Ewan Graves-Tamvakis
LCJ Investments

My name is Ewan Graves-Tamvakis. I am the Risk Manager for LCJ Investments, which manages the LCJ FX Strategy, a fundamental and discretionary global macro strategy expressed through currencies.

LCJ launched here in Geneva in 2007, and as our long term track record demonstrates, we are focused on producing consistent absolute returns over the long term with low correlation to our peers and a conservative risk profile.

One of ways we seek to achieve this is by avoiding short term noise in the FX space, with an investment horizon typically between 3 to 12 months, and by our use of options to limit our downside risk.

I started my career as a project manager in electronic trading and risk management systems in London, and moved into the alternatives sector in 2006, before joining LCJ in 2011 where I have developed our operational systems and communications to meet the evolving needs of our institutional investor base.

Ian Hamilton
IDS

My name is Ian Hamilton. I am one of the granddaddies of the industry, given that I have been about 40 years in the investment industry. We have a hedge fund administration specialist administration company called IDS, but that actually isn't my passion. My passion is another group that I have set up called Scotstone, which offers plug and play hosting solutions to help develop new hedge fund managers who are really struggling to get their foot into the market. However, we don't do any capital raising. We are based in Malta, but also work with Cayman funds.

I do have a concern that with all the regulations and legislation we are killing off future managers who just can't get on to the ladder.

Michaël Malquarti
SYZ Asset Management SA

My name is Michaël Malquarti. My background is a bit unusual in the sense that I studied physics and I carried out for a few years research in the field of theoretical cosmology.

Eventually, after my PhD I moved back to Geneva. I looked for work in other sectors, and you could say that I ended up in the only one that wanted me, which was finance.

[laughter]

I joined Group SYZ a bit more than ten years ago, first as a Quantitative Analyst, and then I moved to become Head of Risk for the Alternative unit, right in the middle of the summer of 2008, where I had the pleasure to put in place new risk systems and processes, whilst supporting my colleagues in managing the on-going situation. I then moved towards more portfolio construction issues and eventually became a Senior Portfolio Manager and a Fund Analyst in the team.

At the end of 2012, I took responsibility with another colleague of mine as Co-Head for the Alternative Investments team and carried out a relatively deep and eventually successful restructuring. In October 2015, I was appointed Head of Manager Research and Alternative Investments, a function which covers all our fund research activities, long-only and alternative, for Group SYZ, with three different business lines. One of them is discretionary portfolio management, so funds of fund and bespoke mandates for institutions. The other one is advisory. The last one is a fund distribution platform, so externally managed funds, which we then distribute.

Gregoire Haenni
CPEG

My name is Gregoire Haenni. I am the CIO of the Pension Fund of the State of Geneva. Prior to that I was the CIO of the CERN Pension Fund, and before that I was a fund manager for Pictet & Cie.

The Pension Fund of the State of Geneva has currently CHF 11.5 billion under management. This pension fund was newly formed in January 2014, and is the merger of two big public pension fund; namely the CIA and CEH. Just a little disclaimer, I am here on a personal basis, and my views and opinion do not engage the pension fund.

Frédéric Lebel
OFI MGA

My name is Frédéric Lebel. I represent OFI MGA, which is a subsidiary 80% owned by OFI Group based in Paris, and 20% of Man Group from London. I act as a Co-CEO and CIO of this structure.

I have been involved in the hedge fund business for the past 20 years, notably at Lombard Odier, where I worked for 12 years.

OFI MGA invests across all strategies and geographies in hedge funds. We also have been quite involved in managed account solutions. We run both individual portfolios for institutions as well as fund of funds.

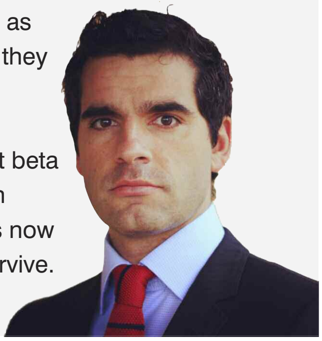
Julien Tizot
InPact Advisory

My name is Julien Tizot. I am a Partner and Head of Investment Research at InPact Advisory, a newly founded advisory company here in Geneva. I used to be the Head of Alternative Investment at AG2R La Mondiale, a EUR 100bn+ pension fund and insurance company based out of Paris.

InPact Advisory advises large institutions: family offices, pension funds, and insurance companies throughout Europe on their private market investments. We are currently active in several strategies and advise clients across Europe. Our philosophy is based on sourcing investment managers with a value-add approach that can deliver performance for our investors. We then create the best possible structure for the managers to achieve the target returns, with no liquidity mismatch, and a solid investor base. Finally, by pooling the investments of our clients, we are also capable of substantially reducing fees without removing the managers' incentives.

Matthias Knab When you look at the public discussion in the US, there were recently very negative articles about hedge funds to the point that public pensions would be getting ripped off by hedge funds. I wonder what is your view on this?

Julien Tizot: Spending almost a decade as an institutional investor, I would like to add to this discussion that investors have clearly improved in their global knowledge. They used to not really know what they were investing in – partially due to the lack of transparency – nor they were capable of truly understanding the performance drivers of their investments. All of that has changed now. Not only they have much more transparency, but also a much better understanding of those performance drivers. Sophisticated investors are now able to differentiate performance sources such as beta, risk premia and real alpha. The consequence is that investors are capable of reducing the fees they pay to managers if only beta and/or risk premia are the drivers of the performance.



By running this type of analysis on the hedge fund industry as a whole, it is unfortunate to realize that beta and risk premia are the overwhelming factors explaining the performance, and alpha has come down dramatically in recent years, reaching negative territories in most of the strategies. And as institutions now have this knowledge, fees will continue to drop, making it more difficult for mediocre managers to survive.

Frédéric Lebel: In the past few years, there have been some significant changes as regards fees. We have seen many providers trying to bring cheaper products to the market. There are also more strategies that can be replicated with a lower cost base. So there is a clear trend towards creating cheaper alternative than the standard 2/20 model.

But there are also some important segments of the business, which are very much performance-driven and performance-focused. A great deal of groups manage to keep their pricing power. It has generally been harder though for intermediaries to maintain their pricing power.

Matthias Knab Why do you think this is the case?

Frédéric Lebel Because these managers are in high demand and area attractive to clients who believe in their unique skills and expertise. These clients want to access these managers and their fairly limited capacity. So that capacity is then priced not towards the many but the few who can, and I guess anecdotal evidence proves that these fund managers succeed in sustaining their fee level.

Matthias Knab Julian mentioned before that it is important to do your work and do the analysis to find out if the fees a manager charges are worth what you are getting in return as an investor. So, I wonder, if certain groups are able to maintain a higher fee level, does this then also imply you'll get the better returns with them as an investor?

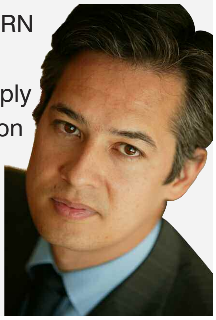
Frédéric Lebel: Well, of course it is easier to say this after the act than before the act. I guess most people who look at fees cannot make a decision on an attractive fee level by looking at the fees alone, they have to look at other considerations such as the investment strategy and the team, the fund structure and various other differentiating factors. So it is not because something is cheaper, that it is better.

What I guess the clients have done, and which was pointed out by Julien as well, is taking the fee consideration to a much keener level and basically allocate their fee budget with more attention that in the past. They are generally more careful, as we are to only spend that budget with the structures and funds that really provide exceptional value. There is less capital to be allocated to the average structures and clearly a concentration among the top players.

The other point is, as I mentioned earlier, that we have now more capabilities to invest in factor models, which replicate a significant part of the alternative betas. Clients want to pay for truly outstanding performance and value-added. They are much less ready than before to basically agree to the same fee for all proposals.

Gregoire Haenni: I think we are experiencing a very interesting moment because of the **fusion that is happening more and more between the traditional and the alternative world.** And what is interesting for institutional investors is that we benefit from the best of both worlds. For example, we like transparency, we like liquidity, we like the low fees on one end, and then on the other end we like agility and the ability of the manager to preserve capital, or to deploy a strategy that delivers alpha over long run.

And of course, fees are an important part of the equation. But, to give you concrete example, while I was at CERN we identified managers that could deliver alpha over long run and we asked them to adapt their alternative strategy towards a long-only strategy. So the long book was managed pari-passu, and the short book was simply replaced with an index. In addition to that they had to imply analytical filters – no gaming, no weapons and so on – and the fees were reduced significantly.



Those strategies worked extremely well, and that is why I believe that the two worlds will merge and that we are at an interesting moment for pension funds.

Ian Hamilton: I think really what we are experiencing in the hedge fund industry is what the long-only went through when indexation and core-satellite proposals were developed. The investor was prepared to pay a higher fee for out performing funds. It was a specialist's skills that achieved that out performance, the so-called Alpha, Now investors are looking at the hedge fund managers in the same light. It is often the smaller boutiques who are going to outperform because they are on the move, they have new strategies, and one should pay more for them.

In Swiss terms, the superior hedge fund manager can be compared to a Lindt, for which you'll pay more than you would be for Cadburys. You can have Cadburys, and for the same price you will have double the chocolate, but not of good quality. But, if you want to have a superior chocolate, you would go for Lindt and pay more for it.

Who we are and what we do?

The IDS Group is an independent fund administration group which was founded in 2002. We specialize in providing back office services to alternative asset managers including hedge funds, funds of hedge funds, private equity and property funds. We are the largest fund administrator in Africa with assets under administration of approximately $6bn and international offices in London, Malta and Mauritius. Our clients trade all investment strategies and we pride ourselves on providing a tailored solution to meet their differing requirements.

What sets us apart?
Understanding your business is our business. Our clients vary in terms of size, location and complexity but we treat every client as an important client. One size does not fit all. Our experienced team works with our clients to ensure complete understanding of their requirements and provide detailed and bespoke solutions as well as ongoing advice, assistance and support. We continually review our processes and integrated range of products and services to ensure we maintain the high service levels that our clients expect from IDS.

When should you consider using IDS Group services?
Whether you're looking to launch a new fund, make a transition to a new administrator or simply wish to outsource some of your processes, we have a solution to suit your needs.

Michaël Malquarti: I think an interesting aspect about our industry is that I believe we are the only sector whereby **pricing is intertwined with value.** If you buy any other product, once it is manufactured its quality remains the same, whatever the price. Even if priced much higher, the product will remain the same, or possibly, typically for luxury products, selling it a higher price might actually even add value to it. But when we manage money, everything else being equal, the higher you price your service, the more you reduce value. This is an element which is quite interesting. It doesn't mean however that cheaper products have a higher value, but that pricing is part of the value.

The other aspect which often is totally overlooked when we talk about fees, especially when it comes to hedge funds, is that you pay fees to access the balance sheet of a fund, and that balance can greatly vary in size and overall risk from one fund to another. This element is in a way quite clear when dealing with CTAs, where you can often have several leveraged versions of the same strategy, which are obviously priced proportionally to the volatility level. Similarly you have very different levels of active risk-taking within the overall fund industry, and therefore different fee levels. Typically, for hedge funds, it ranges from very low-volatility funds, especially in Europe, to very high-volatility funds perhaps more in the US or in Asia. Therefore, I think we have to bring back the fee level to the active risk being taken by the manager. The lower the volatility, the less you should pay in general. And in that respect, the most expensive manager is not always the one that has the highest fees.

But let's also look at a maybe a more general reason why hedge funds are sometimes criticized. We already discussed fees, which is one issue, but it's fair to say that there are also doubts about the fact that they can deliver anything interesting at all, and this is even a wider issue regarding active management. Over the last 10 or 15 years we have seen a dramatic growth in passive investment, both for traditional beta and now also for alternative beta. I was recently at a conference where some of the largest allocators in Europe were present, they were all allocating to smart beta as well.

The crucial point is that in any case, you will always have a balance between markets which are in a way driven by passive investments and markets which are driven by active investments. And **the more passive a market is, the more opportunities there are for active managers, and vice versa.** So the pendulum might now have shifted towards active management.

What has even more changed over the years is the investment style of many market participants in the sense that **everyone now has become much more short-term.** This is quite striking and in a way also worrying that almost all investors now follow, at least for some part of their portfolio, a very short-term trading style. This can be actively done as part of the way they invest, either by directly implementing short-term trading strategies or by allocating to managers doing it for them. However, it can also be done by merely trying to time investment decisions, always attempting to find the very right moment to buy and sell on purely technical grounds.

Regulatory elements might play a role in that evolution. For example, pension schemes have theoretically a much longer-term investment horizon, but they are not really long-term today. There are obviously many baby boomers about to retire which probably shrinks a bit the duration of investments, but foremost **pensions are subjected to regulatory constraints, with yearly assessment of their financial health, and this in a way is making them short-term investors.** I was talking about this with other asset managers, and to them probably the only real long-term investors left are some sovereign wealth funds and some long-established family offices.

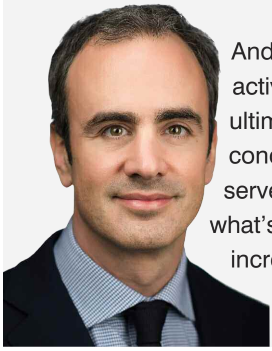
So there might be some **crowding** out there for these short-term, technical and often relatively simple strategies. This to me is an opportunity for active managers if they are able to adapt their style. We have seen recently that the best performing managers are those who are willing to withstand high volatility, who are willing to be wrong in the exact timing, simply because they have longer term views, which are ultimately rewarded. And managers who do that are providing liquidity to the market, which is basically, if I may say, the social role of hedge funds, for which they should be rewarded.

So these are some of the major paradigm shifts I see taking place in the markets: the growth of passive investment, including alternative beta, and the proliferation of short-term strategies driven by demand from traditionally long-term investors. I think hedge funds have to adapt to that and become more long term now, more ready to withstand volatility, and through that more able to justify their fees.

Ewan Graves-Tamvakis: When the financial crisis hit, there was a regulatory divide between traditional long-only and hedge funds, which required hedge funds to avoid publicity in order to remain exempt from regulation, and as a consequence they were seen as opaque and the public relations capacity was perhaps underdeveloped.

Times have changed, but if you think back to the period immediately post-crisis when the public criticism started, there was a need starting then for better communication from the hedge fund industry to respond to these negative articles and explain its value to the public at large, and unfortunately ground was lost very quickly at an early stage with hedge funds facing some criticism that they were not able to respond to at the time, and some of that ground is still being made up.

Communications have improved dramatically since then, with the assistance of groups like Opalesque, AIMA, and others providing those information channels between managers, regulators and the public. As a result also of regulatory and market developments, hedge funds have become better understood and more transparent, and there is a more open dialogue on terms such as fees; and naturally the traditional long-only sector has adapted as well. We are seeing these changes, but it has taken time.

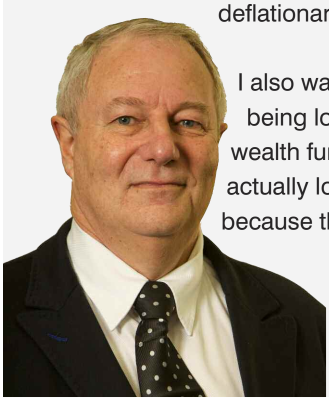


And yes, there remain important discussions around fees and the overall value of alternative investments and active management in general, also in the mainstream media, but the fact is that fees and allocations are ultimately determined by market forces, and alternative assets have recovered and even grown, so one conclusion is that there must still be a significant need out there for alternative sources of return that is being served by the hedge fund industry. This suggests that there could still be a bit of a disconnect in between what's reflected in the media and the underlying situation. Therefore, the communication process remains incredibly important to explain the value in alternative investments that is meeting this demand.

Gregoire Haenni: I think that amongst institutional investors there is also a big disappointment with alternative strategies; and the reason for that is if you take a simple passive 60/40 approach, and you look at it for the last 20 years, you would outperform any other strategy. The essence of those 60/40 approaches is that bonds negatively correlate to equities, and the reality is that you made money on both sides.

Looking at 2008, despite the fact that our portfolios were down a lot, they recouped the losses within 18 months; whereas the alternative industry had gates, side-pockets, liquidity issues, and it took them years to recover. So I think this has to be taken into account in the discussion.

Ian Hamilton: I think you are wrong to look at the past when it comes to hedge funds, and hedge funds are here for the future. We had long bull markets, we had inflation, but now we are in a totally different scenario, we are in a **period of actual capital preservation** which the long market is not going to necessarily provide investors. Long only is going to struggle in deflationary and basically zero inflation in places like Europe.



I also wanted to challenge something else that Michael mentioned before about sovereign wealth funds being long-term investors. I fear a huge overhang on the market as the oil price comes down. Sovereign wealth funds are going to have to divest their liquid investments. I would think that any smart hedge fund is actually looking at all those portfolios and will start shorting, if they do their work and dig deep enough because there is no ways any of SWF are not going to be looking at their portfolios and liquidate.

You've seen Russia eventually annihilating its sovereign wealth fund, Norway is restricting and the Middle-East funds are definitely starting to disinvest in the marketplace.

Gregoire Haenni Ian, let me just clarify that I was not expressing a view on the future, I was just explaining why for the last 20 years and up until now institutional investors are not so excited about alternative investments.

Michaël Malquarti: I don't know sovereign wealth funds that well, and actually your point is totally fair. But apart from the current market pressure, my previous point was that they don't have the constraints that a lot of other investors have in principle as far as that time horizon is concerned, and that includes pensions as well. Obviously, SWFs are also managed by humans with their own agenda, which is another issue altogether.

You are certainly right that for the last 20 years or actually even the last 30 years we have lived in a rather extraordinary world due to the dramatic collapse of rates all along the yield curve which was of course a consequence of the rise in rates that happened 10 or 15 years prior to 1985.

And this means that pretty much every investor now, every person managing money except maybe those who were managing money in the early 1980s, which are very few, as well as everyone doing any kind of backtest has in mind a norm that was set during a rather extraordinary period which is characterized by a collapse of the yield curve.

It's very dramatic in the US dollar zone where we went from 15% to 2% and less dramatic here in Switzerland, but nonetheless the case is the same. And this not only boosted bond returns but also equities returns, as P/Es went up massively, as they should, and any other cashflow-generating asset. The expected return for the balanced portfolio might actually over the long-term be much, much lower than we have got used to, not only in nominal terms – that's what everyone expects given the low inflation environment – but also in real terms.

Therefore, from now on, active management and the production of alpha, how little one might think it is, is actually very valuable to an investor.

Matthias Knab So given those dynamics, where do you see active management heading, when at the same time there is also so much money going into passive investments?

Ewan Graves-Tamvakis: I would maybe answer that question with another question or a hypothesis: if it's only the active managers who are paying for research and actively trying to generate alpha, which creates market efficiency, what would happen if the proportion of active managers became very low, would we expect increasing inefficiency and volatility? Perhaps this is a relevant factor in current markets. Also, since active managers pay for this price discovery, are active managers providing a public service to markets and the passive indices that rely on these price signals, which maybe isn't correctly priced or valued when making a simple comparison between active and passive?

Ian Hamilton: There was in the 1980s and 1970s a great efficient market hypothesis everybody talked about, and to be honest, it was the biggest rubbish. I have worked in institutions and I have seen how they create inefficiencies in markets, and it's the smaller guys, the boutiques et cetera that **bring the efficiencies back into markets,** so I believe we will always have to have active fund managers.

What I would do in an investment house is having a passive core and then look for fund managers and specialists to add active satellites to that. We were doing that already in the 1990s.

Frédéric Lebel: Indeed active management is under massive challenges. When you think about somebody trying to outperform a benchmark these days or manage with a relatively low tracking error at standard fees, that is a really difficult task.

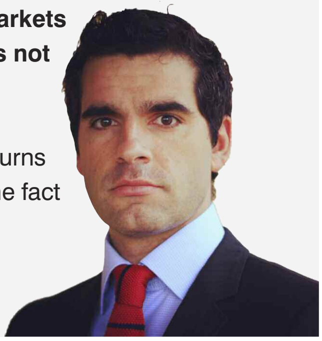
When in turn you think about hedge funds, a large array of possibilities are open to them. It can be multi-class, variable in terms of exposure and quite free in terms of mandates or restrictions. So for such fund managers, there is a lot more to do.

To Gregoire's point, the active investment management industry has been somewhat disappointing during the period described. Conversely, it proved to be relatively favorable for the passive risk asset portfolio. The question really is about trying to address the future, as Ian has also pointed out. The future might not be as easy as the past for the passive risk portfolio. It may have a lot more to do with selecting the proper risks, selecting the proper sizes of trades and asset allocations, and at times even constructing assets.

Therefore I would say that the future for the hedge fund business might be very different from the past, because, to your very point, Gregoire, the passive risk asset portfolio's future might be very different as well.

Julien Tizot: Michael mentioned backtesting, and I agree on the fact that backtesting any type of investments often consists in fooling the investor. Even relying on historical returns is difficult today as we have entered unchartered territories with a negative risk free rate in some regions. **Investors have also become less and less patient, expecting positive performances every month from their managers. This behavior typically destroys alpha as active managers have now to manage those expectations, often by limiting the risk taken.**

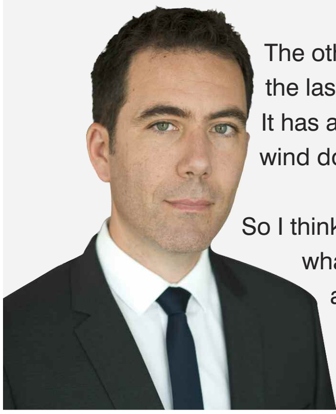
Overall, investors have unrealistic expectations as they want – though not necessarily need – liquidity, they want less risk *but at the same time expect their managers to create alpha*. Lots of investors today are expecting higher returns than what the liquid markets can offer them, with a lower volatility. To me, **investing in very liquid markets - where you do not have the illiquidity premium anymore - and expecting double-digit returns is not possible anymore.**



In conclusion, investors have to readjust their expectations for the foreseeable future as expected returns have decreased substantially in all asset classes, driven by the drop of the risk free rate along with the fact that alpha generation from hedge funds is utterly difficult in liquid markets and has been foremost disappointing.

Michaël Malquarti: I totally agree with that, and I think that's where intermediaries can actually help investors to deal with such questions and challenges. **Probably the greatest mistake in fund manager selection is based on the exact same behavioral bias: buying a manager at the peak and sell him/her in the trough, and keep on doing that all the time because you can't withstand periods of under-performance.**

So our approach is to provide investors with a diversified portfolio of managers where we actually deal with these periods of under-performance. This requires discipline obviously. For example, today I was looking at year-to-date numbers from the underlying managers of a portfolio, and they range from something like +30% to -20%. So, for the reason I mentioned before, we pick conviction managers who tend to take more risk, like for example volatility risk, but not only. Then it's about making sure that at the portfolio level the overall risk is well contained because the portfolio is properly diversified in its sources of returns. This means that a single manager's underperformance has a minimal impact on the overall portfolio. Therefore it makes it easier to keep the position. And if we do that as an intermediary, either in the format of a fund-of-funds or as a bespoke solution, I believe we can add a lot of value to many investors in that respect.



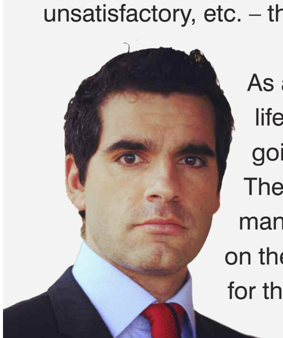
The other consequence of the development Julian had described, which I believe has got a lot worse in the last few years, is that **the business of managing hedge funds has become much more fragile.** It has always been fragile, very insecure, but recently we witnessed some very high profile funds having to wind down after sometimes only 12 months of underperformance.

So I think it's true: investors are becoming in a way impatient and unrealistic about their assumptions about what can be achieved by even a very good organization. This is something we also have to take into account when selecting a manager: business sustainability, which is a function of many factors, including the investor base.

Ian Hamilton: Being many years in the industry, I have seen some of the failures. The number one discipline of a good hedge fund manager is knowing and **limiting the assets** they are going to take on. Very few hedge fund managers want to turn away money. The incredibly successful managers I have seen have often closed to new investors, and they deliver. It's very nice to get huge amounts of assets, but then cut your cloth and your mandate accordingly. The way institutions are going into mega sized hedge funds is wrong. When they experience the poor performance often associated with size, they will then blame it on hedge funds in general.

Whereas, a lot of boutique houses have not only survived but in fact have done very well by sticking to their knitting and not growing too big. I have seen those hedge fund managers who are very happy and are rewarded, and so are the investors.

Julien Tizot: I completely agree with Ian here. I also wanted to go back to Michael's point about intermediaries. It is very important to measure what intermediaries bring to the table. Some of them can destroy value – fees to high, quality of service unsatisfactory, etc. – though end-investors now have the tools to measure their performance.

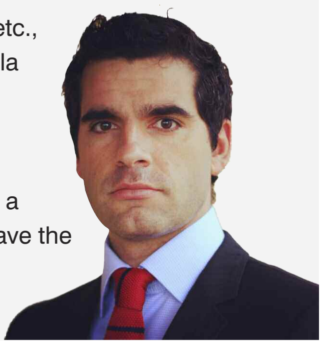


As an anecdote, I was talking to a retail investor interested in investing into the general account of a French life insurance to take advantage of tax break on profits. But here is the reality: that investor's money will be going to a life insurance company, which is going to charge both acquisition fees and management fees. The company is then going to invest into the market as well as a variety of funds, paying brokers, advisors, managers, etc., pilling up several layers of fees before making one single investment. And with 0% returns on the risk free rate, risky markets will have to be very favorable and/or lots of alpha will have to be created for the investor to just break-even.

Therefore, looping back to my previous comments, I believe investors must understand the true value created at both the investment and non-investment level.

Matthias Knab So here is a question to all of you, following to what Julien said earlier about investors having become too impatient. How do you then deal with a manager who is sending you those red numbers month after month?

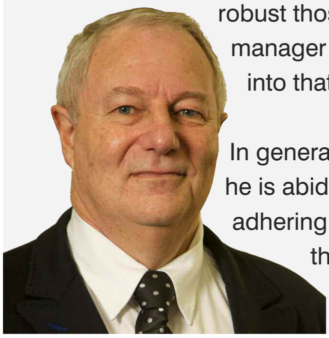
Julien Tizot: Based on my experience as an institutional investor combined with my academic research, I really believe **private markets offer tremendous opportunities to managers to unlock the illiquidity premium and generate alpha,** and so we have been exclusively focused on illiquid niche products since we launched the firm.



Our investors have typically invested in strategies such as private debt, real estate, distressed debt, etc., with a very long-term horizon. Yet, within those strategies, we avoided crowded sectors such as vanilla SME loans and focused more on a value-add approach such as specialty finance for example.

It is very important to have investors who do understand what the manager is trying to achieve and carefully explain to them the risk they are taking as this illiquidity premium should be associated with a certain level of risk. But if you have investors who understand the strategy well and managers who have the right structure to be able to harvest premia, then I believe you have the right recipe to perform well.

Ian Hamilton: I think the issue really lies in what type of strategies the investor is choosing, and to really understand how robust those strategies are. And, depending on the strategy, if you are now going to measure your fund manager on a very short-term horizon, you could actually look at yourself and ask if you should have gone into that strategy?



In general, in times of underperformance, you have to be very close to the fund manager. You have to see if he is abiding by his strategy and if there is something that is going wrong. But if you find that the manager is adhering to his mandate and performing in terms of that mandate, if there is no performance in real terms in the short term, then in fact you have made the wrong decision, not that fund manager.

Michaël Malquarti: Still, and we already mentioned that, it's a hard to stay in a losing investment in general, and it's even harder to stay with a manager who is losing money, because it's someone else who is losing money for you. And the truth is, you never know exactly what is going on in the mind of the person managing the money. So I think there are several elements that can help. In our case we only run multi-strategy mandates, so the impact of a losing manager is small on the portfolio. As a consequence, we can withstand that for longer period of time.

Another thing that we do in our role as an intermediary is to educate managers, especially managers who have launched recently or who are still in the early stages of building their company. We talked about investors sometimes having unrealistic expectations about future returns, and we find that managers too can be unrealistic in what they can provide.

So one question we discuss more and more with managers is “what will happen when you are not just a few months down, but a year down?” Or, “At which depth in a drawdown are you going to start pro-actively calling investors to tell them what is happening?” The crucial point here is to really know what type of investors the manager has and what his/her risk-tolerance is, which then helps assessing the plausibility of reaching the stated expected return over the long term (including good and bad years).

Investors like us can withstand drawdowns. We may not always want the managers to engage into some sort of “risk management procedure” which often just means cutting losses in the trough. If your investors are for example high net worth individuals who might only have a couple of hedge funds in their portfolio, they might want you to do that. So the **managers have in the end to decide who they are catering for,** and that’s something we stress a lot, also by selecting the right managers for us or our type of investing.

Now the only thing where bad performance can be a problem is that it can also trigger asset losses, as I mentioned before, or the manager losing confidence, et cetera, et cetera. So unfortunately, sometimes performance is also an indicator of future returns in the sense that badly managed periods of under-performance can impair future returns. But if you do the right job at the beginning, which means talking to the managers and envisaging the fact that they might do much worse than they have done since they have started managing money, and which also means trying to understand how they will react if this occurs, then it is much easier to deal with drawdowns or disappointing returns. As a consequence, it helps in avoiding destroying value by over-reacting to short-term performance.

Ian Hamilton I just have one question that I want to ask: What happens if you invest in a manager and he loses key staff, what’s your reaction then?

Ewan Graves-Tamvakis: In terms of timeframe I would add an observation from a manager’s perspective.

Ours is a fundamental and discretionary strategy, and looking at FX, which is our market, we saw the effects of the huge wall of liquidity arising from central bank policies globally, which suppressed divergence between currencies on the basis of fundamentals. You will remember that back in 2014, we’d had a few years of that environment at the time, with highly correlated risk on/risk off moves. Now that’s clearly a challenging environment if you are an active manager and use fundamentals to generate returns. However it is also extremely hard to predict when this will change, so it is important for both managers and investors to be consistent, so long as the strategy is performing as expected for the environment, and when there is significant advantage expected in having exposure to that strategy when the environment changes.

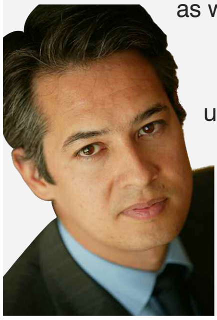
Throughout that period we remained consistent in our strategy, and fortunately for us the environment changed in summer 2014 and due to that consistency the strategy was very well placed to profit. The majority of our investors have been with us for a long period of time, some going back now over eight years, and they benefitted. At that same time, whilst we had over the previous couple of years seen a significant growth in assets, we observed that is was the more recent investors that were less able to sustain their investment through that period of uncertainty, despite us performing in line with expectations, and consequently they missed a period of exceptional returns, so on reflection it is important for both managers and investors to be consistent and have a multi-year timeframe.

Frédéric Lebel: To your question on what we ought to be doing following several consecutive down months for a certain strategy, it depends whether a lot on whether the fund follows a discretionary or systematic strategy. For a discretionary manager, Michael's point might apply with investors interpreting something is broken and basically starting to get their assets back fairly quickly. In a systematic strategy you would tend to own more and more the same portfolio at a cheaper level, with the result that you might actually become even more of a contrarian investor and expecting reversion to the mean.

What we have all learned from the crisis in 2008 is that losses do have an impact on the viability and the potential of a fund manager's business. We thus have to take that into account and **avoid being the last in line** by trying to preempt bad things that can happen.

So that is also one reason why this business has become much more short-term oriented, as we discussed before. I would echo Julien's comment about longevity: The best way to stay five years in a fund may indeed be to lock yourself right from the start. This is however hardly what we wish for. We are however looking at strategies where you can extract liquidity premia and also add these liquidity premia one on top of the other in order to generate long-term, consistent returns.

Gregoire Haenni: **When I invest with a manager, I always ask him at what point I should pull the plug and at what point are he starts to worry about his own performance?** In other words at what point he think something is broken with the investment strategy? And then when we reach that level, it's a stop loss for us. But let me also add that in the past I have redeemed managers more after operational issues or a spiral of redemptions or a key person leaving, that's a red flag for me as well, rather than an underperformance.

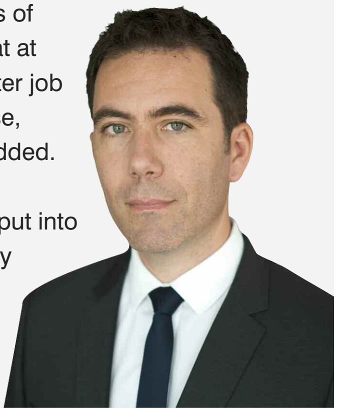


But coming back to the situation of institutional investors, you have to bear in mind that when the fund is underperforming and you pay such high fees – on a compound effect they are huge – and when the manager keeps on underperforming, it's not easy to explain why you stick with your position. But we can agree what has been said: when you have decided to invest with a manager you should have a time horizon greater than 12 months. But unfortunately, it has become a fact that investors today focus on months-to-date and year-to-date returns.

Michaël Malquarti: Something which is linked to your questions, but also to this kind of short-termism and to the faults of some the intermediaries, is the fact that this industry grew dramatically within the ten years prior to the crisis. It is very difficult for such a specialized industry as ours to grow so fast without hiring sometimes less competent and less experienced people, or at the very least people who don't have the maturity to deal with the issues and complexities that characterize manager selection.

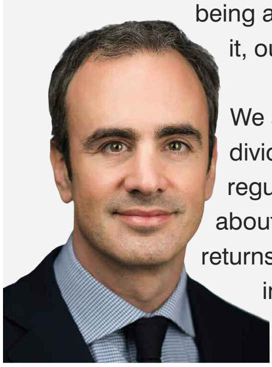
So now we are seeing a consolidation of that industry, and possibly the quality of what is being done in that respect has improved. What's interesting is that so far in 2015, if you look at HFRI indices, the funds of hedge funds index performs better than the average hedge fund index, which seems to indicate that at least either in terms of portfolio construction or in terms of selection, funds of funds has done a better job than the random hedge fund investor. Obviously, I say that with all the caveats warranted in this case, since these indices are subjected to very well-known biases. Still, the arrow points towards value-added.

My perspective on the question of key people departures is that it is a corollary of reacting to the input into performance generation (rather than the performance itself). And obviously the key people are a key element for that input. So, more often than not, a key person's departure is a trigger to redeem the fund.



Ian Hamilton I often use the following simple analogy comparing long-only managers and hedge fund managers. If your long-only manager gets run over by bus, you must be going to get better performance because he was probably justifying his salary there and fiddling around, as he is often basically managing a passive index fund. But, when your hedge fund manager gets run over by bus, you close the fund and liquidate..!

Ewan Graves-Tamvakis: For us, investor communication is certainly a two way process. So it's not just a question of being asked questions but also it's very much on us to inform and educate investors that come to see us. This includes not just being as transparent as possible but also finding ways of explaining in a very clear way, what we do, why we do it, our philosophy, and how we stick to our philosophy.

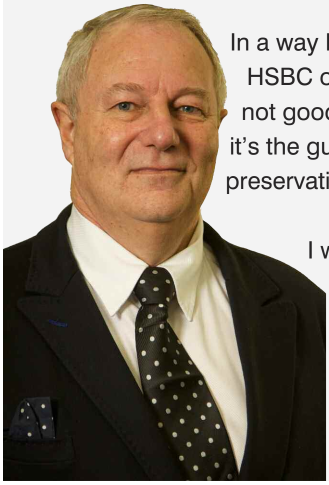


We see that communicative aspect as an increasingly important part of what we do, but there is also a dividend on that, because investors then much better understand what is going on. We communicate as regularly as they need, so they know exactly what's going on. So we help them get a better understanding about what's happening in our market so that they can also have an anticipation of how that will affect our returns. This then means any surprise gap is minimized, and that has certainly helped us in terms of our own investor relations.

Gregoire Haenni: I have also a question for the group. I've recently went through a lot of fund of fund portfolios, and when I say "a lot", I mean really quite a few. What really surprises me is to see that the bulk of the composition is made of the usual suspects, the multi-billion hedge funds, the companies with a 20-year track and so on. I didn't see many of newcomers. I have seen a lot of prop desk carve outs or spinoffs, but for some reason many of them don't survive. I think the barriers of entries are much higher today than they were a couple of decades ago.

I can see that investors like to see a track, but what are the reasons that they limit themselves so much? I would love to see a new Tudor or a new Millennium, and so on. This is a big question mark for me why people stick with the usual suspects rather than finding new talented managers and new setups?

Ian Hamilton: There is safety in numbers. People succumb to the herding instinct, and that's what you see happening here. There is also the issue that these analysts or people recommending the selection having to please their masters above them which are either a pension fund or an institution. if you don't do a good or a safe selection, you're going to be hammered.



In a way I note the same in my own business. When there is a choice in the international market between HSBC or IDS for fund administration, the large fund managers will go for HSBC, even though the service is not good, because if the choice is wrong, i.e. if HSBC messes something up, it's HSBC. If IDS messes, then it's the guy who selected us who is on the line. So that's why you get the herding instinct. It is self-preservation in institutions.

I write a column for the Opalesque New Managers magazine, and in one contribution I made the suggestion that we need to have fund of funds that actually look for the neglected funds. The guys who've got good performance don't know how to market it, et cetera. The problem is that institutional advisors are lazy and not prepared to do extra research and rely upon the herd to protect them.

Gregoire Haenni But that's my question, I also don't see those newcomers being taken up...

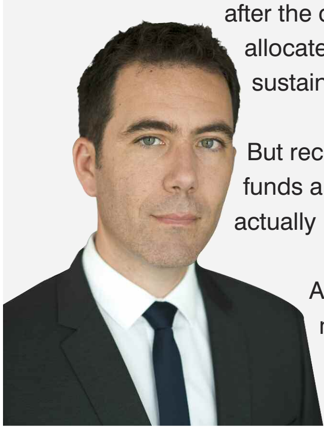
Frédéric Lebel: I am happy to answer this one. There is a big difference between before the 2008 crisis and after, which has to do with simply how funds of funds are being run, how funds are being selected and how large a portion of a fund's assets can be held by one management group. In the past, typically some private banks here in Geneva would spot a fund manager early and, after thorough due diligence, have no issue with owning a large share of the fund.

Now, you have to think about what percentage you will represent in any one fund, and if the fund is, let's say, $50 million, you might think about it, but if it is much below this level, let's say, $10 million, you might not, because it may prove to be a waste of time. Our average allocation is $10-15 million, and we cannot own such a large share of a fund, so it just doesn't make sense. So today this let's call it "fairly favorable capital" is not there anymore, because the rule applies pretty much everywhere that an institution cannot have a stake larger than 10% in a fund. And the unintended consequence is that the young sprouts do not come as easily come to light because of this.

Michaël Malquarti: To me, there are three elements to your question. The first one is the agency problem, which Julien already talked about, which exists not only for hedge funds investor, but for any type of agent or intermediary.

The second problem is the one Gregoire mentioned, which is the concentration of assets in the largest funds of funds or fund allocators, which led to a concentration of assets in the largest hedge funds as well.

To some extent, this is also justified in the sense that through those larger funds you can access people who have the capacity, have the infrastructure, have the experience to actually carry out the best strategies. And if you look at the numbers, some of the largest hedge funds have also been among the good performing funds. So there was some level of justification after the crisis when these large institutions or large multi-manager platforms had actually capacity to allocate, also because after the crisis the smaller funds were more unstable in terms of business sustainability.

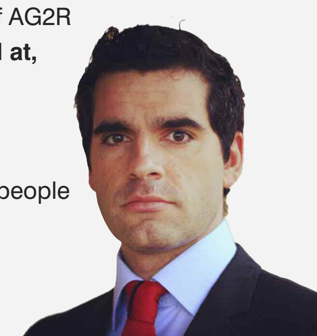


But recently, say in the last 12 months, we may have reached a bit of a transition, where a lot of the larger funds are closed or about to stop accepting new money. So now there is indeed more added value to actually look at smaller managers.

As far as our firm is concerned, you can find some of the usual suspects in our list, but many of our managers are also smaller managers. This is also the case because we are not one of these very large behemoths, so we will not run into the capacity issues that the largest players have.

Julien Tizot: Gregoire, that's a great question, and in fact, when I took over the hedge fund book of AG2R La Mondiale in 2009, I did the same analysis that you are doing now. **In all funds of funds I looked at, more than 75% of the underlying funds were the same.** So again, I wondered about the true importance and value-add of those intermediaries.

And I am with Ian here, in those days of 2008 and 2009, there was a lot of blood in the streets, and people were not willing to take any risk as most of the executives and board members switched to a "job preservation" philosophy.



Another factor is that large investors have constraints that often steer them towards larger funds. But here again, I believe larger end-investors really have to question themselves if they get value from an intermediary and also, if they themselves already know all the potential funds. They have the team to do a due diligence, the size to negotiate fees, the capacity to get the transparency. So, are they actually getting the value they pay to the funds of funds or the advisors?

So this is what we actually try to achieve at InPact. I used to sit on the other side of the table and that question was key to us. So, as an advisor of those large institutions, we have the philosophy to unlock value along the process from finding the right strategy to setting up the proper structure for managers to actually deliver true performance.

We, at InPact, only focus on a small number of funds, and see the relationship as a partnership between the manager and our investors with interests aligned, risk understood and expectations realistic.

Matthias Knab

I have got an interesting insight to share from our recent Opalesque 2015 Nordic Roundtable that I recommend people download and study. We had some of the smartest people from the Nordic region participate.

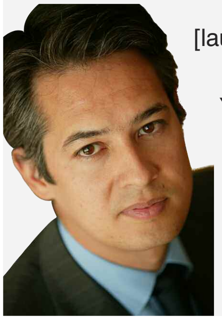
Mikael Stenbom from RPM, a veteran investor and the most senior investor in that group, shared the following anecdote, particularly to Gregoire's question. He said that in a previous life he was a management consultant, and in order to do his job he had to review all the current management literature and the management gurus out there. And the guy that he found the most effective, the most insightful and significant was Peter Drucker.

And Stenbom said that one of the things that Peter Drucker all the time was repeating and trying to make people understand is that **in corporations the decision process is not driven by rationality, but really by what are the peers are doing.** Therefore, it's a fallacy to believe that corporations, including CEO and the Board of large corporations, make independent decisions solely based on analysis and rationality, because things are typically far too complicated. Looking what the peers are doing, and doing the same, is in our nature. So that just keeps spiraling and puts more and more assets into the same funds.

Frédéric Lebel

I have another question. Since we all deal with institutional investors and as we are in Switzerland, where about 50% of all bonds are yielding negative returns, I was wondering, Gregoire, how institutions such as yours responded to the challenge of holding so many negative yielding assets compared to possibly expensively priced hedge funds but promising a positive outcome?

Gregoire Haenni: Thank you, Frédéric, for the hot potato.



[laughter]

Yes, there are for sure big concerns about the bond portfolio. Most of the portfolios yield a negative return – so after the currency hedges, it's either low or negative. The big question mark is if we trim the exposure, we will have to reinvest it elsewhere.

So I think the first objective is to beef up the real estate portfolio. At the CPEG, we invest locally in Switzerland,

and we know the real estate market is constrained. The second objective is to increase equities, but we then also increase the risk of the portfolio, and valuations are quite high. Cash is not king, and there are no safe havens. So yes, it is a big challenge.

We have had interesting discussions with a few managers, and I think the takeaway is that we are in a cycle where we have to get used to negative yields. Probably we will have to buy some Bunds yielding a negative return of -0.5%, and we may be even happy with that.

I always say, there are three ways to provide returns. The first one is capital appreciation. The second one is to invest in financial instruments with a yield; dividends, coupons. And then third one is what I call talent and agility.

Most pension funds are very active with the first two axis, namely capital appreciation and investing in yielding instruments. But yields are low and the upside for capital appreciation is limited. So we have to play with the third dimension. And I think a good way to solve the problem with bonds is to find something similar that has the same behavior as bonds used to have. So that is one direction that I think is interesting for institutional investors.

Matthias Knab Can you specify what you are looking at?

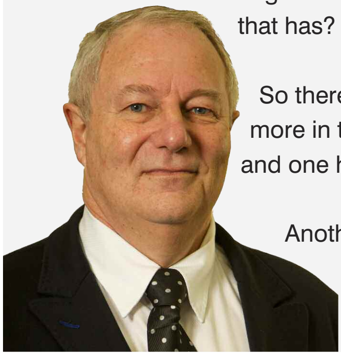
Gregoire Haenni: To answer your first question, what worries me going forward is that all the investors are going in the same direction. They are giving up on liquidity. They are going down the credit quality. Everybody is doing that. But you can do only it up to a certain point.

Another major risk that we have with the credit market is that there is no liquidity. So if for some reason a market participant wants to exit the strategy, the door would be very, very small. So there are not really a lot of solutions in this environment.

The other aspect is that many managers or alternative managers have all lowered the target returns. I think we are in a cycle of low returns, low yield with big risks, lower liquidity and higher levels of volatility.

Ian Hamilton: We had a similar discussion at the Zurich Roundtable as well where people were still talking about 6%, 8% returns. My view is similar to Gregoire's in the sense that we need to accept that **the best we can do in these kind of markets is capital preservation.**

We talked about inflation, negative inflation, et cetera – we don't quite know when that cycle is going to end. Oil prices have still got to feed through, now they are talking about a $20 oil price. Can you imagine what deflationary effect that has?



So there might be some deflationary effects, but at the same time, in other areas, consumers have got more in their pockets. Petrol prices have come down, food prices can fall down, so consumers have more, and one has got to look to see where they are going to be spending.

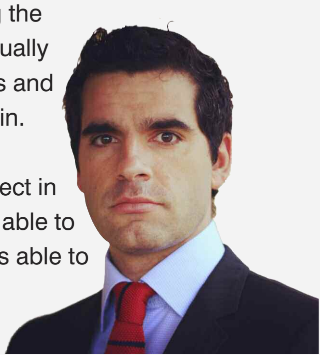
Another sector that could be interesting, maybe not so much in Switzerland but in many other places, is infrastructure funds. This is really the time that countries with deflationary expectations should be launching infrastructure funds to be able to finance and build for the future.

Julien Tizot: I am glad to see that investors are lowering their expectations.

After the crisis, a lot of investors went into liquid funds and liquid products, which was a normal response after the numerous gates and side pockets, though sometimes exaggerated as portfolio durations are still extremely long in some cases. So now, some of our investors at least are **realizing that they do not need 100% of their portfolio in liquid assets,** and that there is a lot value in less liquid strategies. For example, private debt has been a big theme for several years, especially in Europe as the sector profits from a macro tailwind with banks having to sell their risk-weighted assets.

But this strong flow has lowered the spreads while companies bear more leverage. We have done a lot of work on this private debt segment, and we think **corporate loans to SMEs or real estate deals is not worth the risk anymore.** I think the expected risk return is not in tune with the risk investors are taking. We have therefore decided to focus on **specialty finance projects** with a manager who can actually deliver strong performances in those niche strategies.

Gregoire, you mentioned real estate. We have done a lot of work on the Spanish residential real estate market. Prior to the crisis Spain was in a lot of trouble, but the country has been pro-active in making changes, including the creation of SAREB, the bad bank of Spain. We have been working with a manager who is able to actually source good deals there. He can buy distressed debt from banks, from SAREB, and from developers and continues to buy and purchase lands, develop them and then sell the units in prime locations of Spain.



What is special about this investment is that it is not the typical income producing asset that you expect in real estate with limited room for alpha generation. It is a very specific strategy, where the manager is able to actually perform. So that is again an example of our approach looking for spaces where somebody is able to demonstrate a true value-add approach through good sourcing and creation of barriers to entry.

Michaël Malquarti: Gregoire mentioned that we may be in a cycle of low returns, low yield with big risk and big volatility. I have a thought to offer here, because I see that a lot of people are linking risk and volatility. This also leads me back to one of my earlier comments that unfortunately many investors have become like prop desks traders: looking at daily volatility, or even weekly or monthly is actually relatively short-term. **Risk is not necessarily linked to volatility.**

Perhaps I am wrong, but my impression is that the linkage volatility = risk created a lot of biases in the way people build portfolios. For example, **a less liquid instrument might be as risky as a liquid one, but you won't see it in the volatility.**

Second, even if you consider only liquid instruments, it's very difficult to think that today a 10-year Swiss bond will end up in 10 years' time bringing you more return than buying equities, whatever happens along the path. With a diversified set of equities you also get some dividends, which over 10 years, even if the dividends are cut down say by half on average, still provide quite a bit of a buffer. We don't know if we'll have capital appreciation, but it's difficult to assume that in 10 years, equities will be cheaper than today. So if you close your eyes for 10 years (which you do when you invest in low volatility illiquid assets), equities are less risky than bonds, if your risk is to miss your long-term positive return.

So the issue of time horizon is important. What is the risk that in 10 years' time a pension fund, for example, will not meet its liabilities? This is also a risk-related question that short-term volatility measures don't address.

I am not blaming anyone here, there are regulatory constraints, as we mentioned, and there are agency aspects in it as well, which force people into those directions. But my point here is that a lot of investors will have to **think more long-term** and focus on the proper risks, which is, "where am I in 10 or 15 years' time?".

Another thing, and let's see if everyone agrees on that, is that we are living a very difficult period. I actually believe we are going now through a political and possibly institutional crisis, it's not an economic crisis only.

So I believe the solutions to what we are going through at the moment will have to be political, and I think governments and parliaments have not realized that yet. In my opinion this is creating a lot of social instability and possibly geopolitical instabilities. Parliaments and governments will eventually need to address that.

For example, when it comes to infrastructure, also here in Switzerland we have needs. Everyone knows about the needs we have in terms of road or rail infrastructure, for example, but somehow we seem to have neither the political will nor the institutional framework to get that done. Meanwhile, investors are throwing money at the Swiss Confederation by buying government bonds at negative yields. We know that there are valuable long-term projects, but we are kind of locked into a system where on the one hand you have money that wants to be invested and you have the demand for capital, but on the other hand we don't find a way to make that happen at the political and institutional level.

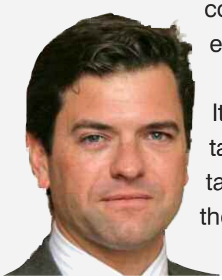
Gregoire Haenni: I just want to clarify something. When I was saying risk and a lot of volatility, I was not saying that volatility is a risk; I was trying to say that the stimulus programs applied by Central Banks have dampened volatility to extreme low levels, and I think that this is coming to an end in certain regions of this world. Just look at what happened during the summer 2015 and the rebound in October. We had yearly returns in a couple of days, so this is what I call volatility.

Investors believe their risky assets are negatively correlated with their bond portfolios, but in reality they are carrying a lot of risk on both sides. Therefore, in effect, you don't have any rationale for holding such a big position.

Also, bear in mind that a lot of institutional pension funds are underfunded and therefore the tolerance for risk is very low. We therefore need to find other solutions.

Frédéric Lebel: It is always interesting to observe what so-called unconstrained money is doing, and I would like to make two short remarks. What I have seen these people that have plenty of cash and availability of advise are doing is building up their own assets these days. So rather than doing asset management, they are creating and then managing assets, their assets.

The second comment is really related to what you might call managing investors, where their expectations really is a key component. I guess that each investor rightly feels somewhat different, do not we all do? It is thus about understanding investors and finding the right outcome for them. It goes to building towards that very outcome a strategy that then takes into consideration different aspects, usually related to liquidity, volatility, types of assets, currency management, etc.



It allows us to come up with rather than one solution a package of well thought out proposals. We also have to take regulation very much into account, and that is clearly a constraint for our investors' base. We also have to take into account their preferences. This leads to an outcome-based solution, which, I would assume, is where the industry will ultimately be heading to.

Matthias Knab Just a follow-up question, when you say those unconstrained investors create their assets, can you give examples? Like do they run rather than invest in corporations?

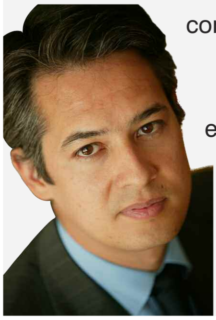
Frédéric Lebel Yes, corporations could be an example. But an even easier example would be found in large European cities, where family offices for instance buy real estate, and turn it into an operation, a hotel usually. They then sell it a few years later when it has a track-record as a cash-flow generating assets.

Ian Hamilton: I want to give Gregoire some support. I believe one of the elephants in the room is **underfunding of pension funds** right across the world. And we talk about managing expectations of investors; in a pension fund you are managing the expectations of pensioners. There has been a total global mismatch of raising the expectations of what the pensioner is going to get and what actually can be delivered. And it has now been left to the managers of the *investments* to deliver and try and close that gap.

In many instances this is going to be impossible. You only have to look at a company like British Airways, which has the most overpaid, over-rewarded staff. It's a bankrupt airline, sooner or later it's going to have to go. And there are many governments that are the same. This will at some point lead to social unrest. Take for example Greece

Gregoire Haenni: It is true that there is a lot of pressure on the return of the portfolio to deliver and live up to the pensioner's expectations. I also believe longevity is understated going forward, and also from that side the pressure is just going to increase.

What worries me is that we have two scenarios going forward: the first scenario is that we have a big market shock like 2008, and following that we will rebuild our portfolios, and then we have another cycle of assets appreciating.

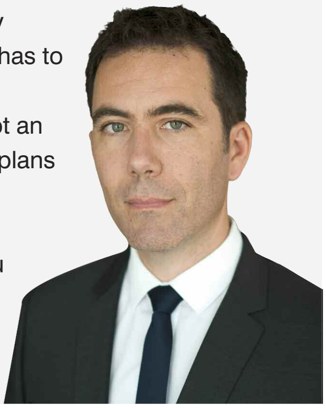


In the second scenario we assume that the current situation continues for a while. If this low return environment continues, then we have a very big issues with our return objectives.

So yes, we are in a cycle where it's going to be tough and challenging, but on the other hand, we are experiencing I believe an optimistic situation as we could see another industrial revolution which might increase the profitability of companies, bringing back the industrialization in our developed countries.

I am optimistic on the mid-term to long-term view, and a bit worried on the short-term point-of-view.

Michaël Malquarti: I think we can all agree that the people who manage pension assets have a very difficult job. But as I mentioned, I think we are going through a political and institutional crisis which has to be solved. To Ian's point, I agree that the problem of pension schemes is to some extent not about managing assets, but basically about managing the liabilities. And this is a political challenge, it's not an investment challenge. It's a very tough political challenge. Obviously, in Switzerland there are some plans to address that, but probably those will come short of addressing it entirely.



There could certainly be some positive scenarios as well, but I don't know how much probability you want to give to that. Over time, the underfunding will become clearer and along with that, how pensions will address the situation, and what role alternative investments will play.