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Opalesque Round Table Series '12

FRANKFURT

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Editor's Note

German institutions reveal high demand for absolute return

While some German high net-worth and family office clients are reducing exposure to absolute return strategies due to disappointing returns in the past few years, for institutions it's the opposite. Participants at the 2012 Opalesque Frankfurt Roundtable report a markedly increased demand for absolute return strategies from institutions, paired with an unprecedented appetite for new approaches in the market and preference for boutiques over very large asset management companies.

"We find ourselves talking to investors who we honestly would not have dared to approach two years ago. We see investors coming into asset classes like infrastructure and some very conservative German insurance companies looking at hedge funds and absolute return funds for the first time. Summing up, I see a lot of new sources of capital for our products", says Christian von Strachwitz from Questa Capital.

Rolf Dreiseidler from Man Group added: "Pension funds and insurance companies invest in our products that only two or three years back would not even have considered our solutions. This is the highest demand for absolute return that I have experienced so far. What we have also observed is a shift in interest away from fund of hedge funds, with the exception of customized solutions based on managed accounts, into single manager absolute return content within a UCITS format."

The Opalesque 2012 Frankfurt Roundtable was sponsored by Eurex and took place at the Deutsche Borse in Frankfurt on June 14th 2012 with:

- **Christian von Strachwitz,** CIO and Board Member, Quaesta Capital AG
- **David Zimmer,** Chief Executive Officer, Altira Group
- **Erik Crawford,** Family Office Investor
- **Dr. Randolf Roth,** Head of Market Structure, Eurex
- **Rolf Dreiseidler,** Head of Institutional Clients Germany, Man Investments
- **Sy Schlueter,** Portfolio Manager, Montan Alternative Investment

The group also discussed in detail:

- **The asset allocation of German high net worth and family office clients**
- **Strategies in demand in Germany**
- **Opportunities in:**
- **German Residential Real Estate**
- **German "Mittelstand": Rewards of the Buy and Build Strategy**
- **Trading and hedging of country specific government bond futures contracts in Europe**
- **Asset protection solutions and Managed Futures**
- **Renewable Energy and Infrastructure**
- **Second wave of internet e-commerce: how will it transform finance and real estate?**

Finally, we cannot have a Roundtable discussion in the heart of Europe without getting involved in the politically motivated discussion around high frequency trading and the introduction of a financial transaction tax. Read in this Roundtable about the amusing if not silly proposals to "slow down the market", and why a financial transaction tax would kill the markets.

Enjoy the read!

Matthias Knab
knab@opalesque.com

Cover Photo: Frankfurt skyline

Participant Profiles

(LEFT TO RIGHT)

Sy Schlueter, David Zimmer, Rolf Dreiseidler, Dr. Randolf Roth, Christian von Strachwitz, Erik Crawford, Matthias Knab

Introduction

Rolf Dreiseidler
Man

My name is Rolf Dreiseidler and I head up the Institutional Clients team for Germany at Man. We are a leading provider in alternative investment solutions with USD 59 billion under management and 1,400 employees worldwide.

Man has been around for over 225 years and has a quite an astonishing history. The founding father of the company, James Man, was a barrel maker in London who at one point discovered that the content of the barrel was more profitable than the barrel itself. As such, he ventured into commodity trading, at that time mostly into sugar trading. Later on, he discovered that a derivative of sugar, alcohol, was even more profitable.

Consequently, in 1784, James Man secured the contract to supply the Royal Navy with the rum for its daily "rum tot," a tradition under which all sailors were allocated a daily ration of rum – apparently for disinfection, although I'm not sure if this is the true reason! Anyway, this tradition continued until 1970, with Man holding the contract throughout the entire period.

As an active trader in physical commodity markets, effective hedging of price risks became a critical success factor for James Man. Fast forward a few decades, and Man became one of the world's leading commodity futures brokers.

Fast forward again to the mid-80s: to diversify its business from pure brokerage, Man founded an asset management arm called Man Investments. Having a deep experience in futures brokerage, the natural evolvement was to get involved in Managed Futures, which eventually led to the acquisition of AHL, today, one of the world's leading CTAs.

Since 2000 the group built a presence in hedge fund of funds and is a recognized provider of alternative investment solutions to institutional and private investors, mainly through advisory mandates, pooled investments and managed accounts. For more than 14 years, our expertise in utilizing managed accounts has formed an essential component of our success. We have also just announced the intended acquisition of FRM. Man and FRM's combined multi-manager business will have total funds under management of approximately $19 billion, making it the largest independent non-US based fund of hedge funds. We will bring clients the fullest array of hedge fund investment offerings, strategies and services, strengthening our value as a partner that can help with all aspects and stages of hedge fund investing programs, from participation in early stage hedge fund seeding to diversified and thematic funds of funds and customized solutions offering a high level of transparency and liquidity.

Another key milestone for the firm was the acquisition of GLG Partners in 2010, another leading alternative and long only investment manager, operating purely on a discretionary basis and providing great diversification benefits to the systematic trading style of AHL.

Man also runs a unit called Man Systematic Strategies (MSS), which provides innovative solutions in systematically managed commodity-, active ETF- and Tail Protect-solutions. Finally, Man has a deep expertise in long-only convertibles, - as well as in insurance-linked securities-management.

Dr. Randolf Roth
Eurex Exchange

I am Executive Director, Head of Market Structure at Eurex Exchange, which belongs to Eurex Group. Eurex Exchange is the largest derivatives exchange in Europe and among the top 3 in the world. Our head office is based in Frankfurt, but we are having representative offices around the globe.

Christian von Strachwitz
Quaesta Capital

I am Christian von Strachwitz, founding partner of Quaesta Capital; an Alternative Investment Manager with focus on institutional clients -- we are based in Frankfurt as well as in Pfäffikon, Switzerland. We have been around for seven years now and are very active in the fields of FX, Macro, Fixed Income, and Renewable Energy Investments. Furthermore, we offer Risk Management as well as Tail Hedge strategies to our clients.

David Zimmer
Altira Group

I am David Zimmer, CEO of Altira Group. We are an asset management company focusing on alternative investment strategies for institutional and private investors and active in three different fields: Renewable Energies & Natural Resources, Africa and what is called the German Mittelstand & Restructuring. We also seed new teams internationally who have interesting investment topics and help them raising funds.

Sy Schlueter
Copernicus Fund

I am Sy Schlueter, the fund manager of the Copernicus Fund which I started in 1994 as an European equity long/short strategy with an overlay of macro themes. In 2005 we started a German residential real estate fund and in 2009, we have added another business segment investing in distressed ships. We are not based in Frankfurt but in Hamburg, a city with a lot of expertise around shipping.

We are generally driven by providing products which generate total returns to investors. It is therefore no surprise that over the last couple of years our firm expanded into real assets as a natural addition to our long/short strategies. We see this as a general change in the global fund management industry as the search for absolute returns is ever increasing.

Erik Crawford

I have worked in fund selection for a multi-family office and as an investment consultant for institutional investors. In both roles I advised on or invested in both traditional, long only asset classes (equities, fixed income, real estate and commodities) long/short and absolute return funds, and fund of funds. The family office accessed hedge funds through a fund of fund approach based on a managed account platform and accessed private equity primarily through fund of funds.

Both the family office and institutional clients were quite large and sophisticated, though the allocation to alternatives differed between the two groups. No institutional investors had more than 10% allocated to hedge funds and private equity, whereas the family office clients usually had target allocations exceeding 30%, some up to 50%.


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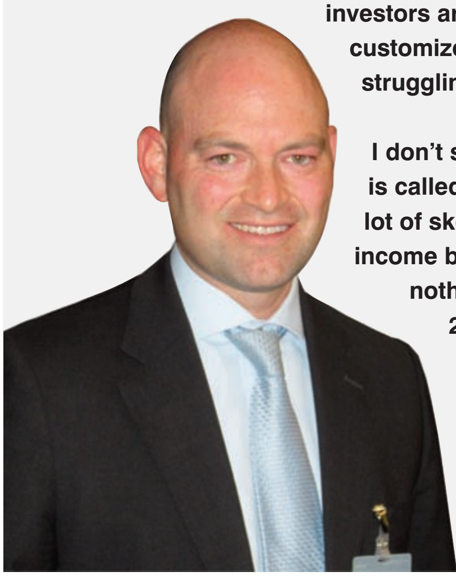
Matthias Knab **What is the level of understanding and the demand for absolute return products and what is the dynamic and the developments that you see around that here in Germany among the different investor communities like retail, high net worth, family office and institutional?**

Erik Crawford: **I represent the investors here, and I would say German high net worth clients have 10-12%, on average, allocation to absolute return, and institutional investors have 2-3% on average. Demand is weak because absolute return strategies have delivered disappointing returns in the past few years. In some cases allocations are being reduced.**

Most investors consider absolute return as a distinct asset class, but at the family office we mixed absolute return strategies into our long-only allocations to smooth returns. And we did in fact reduce volatility, but the return results were mixed.

From what I am hearing from other people, there has just been a general disappointment with absolute returns, maybe because expectations were too high. I think we had realistic expectations, but even then returns were disappointing. The hedge fund of funds were particularly disappointing. The double layer of fees certainly doesn't help and I think investors are moving away from these structures to cut out the second layer and get a more customized, focused allocation. And media reports talk about shrinking assets and struggling firms within the fund of fund space.

I don't see a tremendous amount of demand out there for absolute return, especially if it is called hedge fund. If you call it absolute return, that helps a little bit, but still there is a lot of skepticism in these Cash Plus strategies that you see that are macro based, fixed income based. They have also struggled a lot. With Cash Plus - if cash is bringing you nothing, then the plus has really got to do something. If the plus is just bringing 1% or 2% too, then, yeah, okay, it is better than a money market fund, but it is still not giving you what you want, and you still have the risk of maybe getting -2%, which some of them have done. But those are strategies that tend to be more applicable and digestible for the institutional community, so some demand will continue.



Erik Crawford

Matthias Knab **Where are you putting the 90% of assets?**

Erik Crawford The family office clients have a big allocation to private equity; for matured clients it is about 30%, then maybe 15% in real estate, including REITs, pooled funds and direct holdings; 10% in commodities; and 15-20% in equities and convertible bonds; 15-20% in fixed income including investment grade governments/corporates, high yield and emerging market debt.

For commodity exposure they use long-only futures-based funds that try and match the Dow Jones Index plus a few percent. There was a market neutral fund in the mix, tone of the examples that did reduce volatility, but after a year-and-a-half of zero return we had to get rid of it.

Rolf Dreiseidler Erik, given the disappointment that you expressed I was wondering why you didn't bring the allocation down to zero? What made you stick to 10%? Do you see some opportunities or improvements in the absolute return sector?

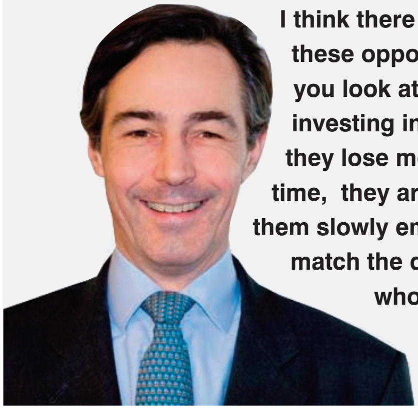
Erik Crawford: I think we still believed in absolute return, but we reduced our return expectation that flows into our strategic asset allocation model, where you have your risk and return assumptions, your correlation assumptions, just like a lot of institutional investors. So the model naturally allocates less to hedge funds when you put in worse return expectation, and maybe a little higher correlation expectation, since experience has shown that these hedge funds, as an asset class of fund of funds or multi-strategy funds, are higher correlated to risk markets, to credit markets, to equity markets than they were supposed to be. So that leads to a lower allocation. Plus, the investment committee decided tactically to reduce the allocation given the currently low risk-free rate. But there is no complete rejection of absolute return.

One more thing – for the family office clients, the investments within the hedge fund allocation were driven in the past by risk factor and sector allocation, but in the future more emphasis will be given to manager selection.

Erik Crawford

Sy Schlueter: From our perspective, there is actually always demand for absolute return because everybody wants to make money. As we know, there have been times when people thought having exposure to equities means making money like in the 80s and 90s, but the experience of the the last 12 years have taught people that owning equities does not automatically generate an absolute return.

I think that ultimately everybody is looking for absolute return and people try to get it by having exposure to a certain asset classes. However generally you could say that probably 50% of the time you make money by having an exposure to a certain asset class, and 50% of the time you do not. For a number of years now equities have not delivered, and I think that for the next 20 years bonds will not be able to deliver positive return. People scramble for asset classes which can make them money, and that goes from retail investors to the big pension funds. Particularly the Western world is increasingly dependent on generating absolute returns; their pension funds and insurance companies have certain liabilities and they need to have investments with a certain yield to match these liabilities.



I think there are plenty of opportunities out there, but too few managers who are able to exploit these opportunities because most of them aren't trained to see and extract value from them. If you look at the asset management industry in general, we still have this massive long-only world investing in equities and bonds and pride themselves when they beat the benchmark even when they lose money. In my view, with the challenging markets, which we will be in for quite some time, they are an endangered species. We need a different quality of asset managers and we see them slowly emerging in the hedge fund industry. One reason why it so difficult at this stage to match the demand for yields and fulfill investor expectations is that there are too few managers who can deliver.

Sy Schlueter

Christian von Strachwitz: We only manage assets from institutional investors like pension funds, insurance companies and family offices, we are not dealing with retail clients. Our experience with institutions has been totally opposite to what Erik sharing as a family office investor. We do see a markedly increased demand for absolute return strategies from institutions. A lot of institutional investors are starting for the first time to seriously look at alternative investments. They are just now starting to gather more experience and become more knowledgeable in this asset class.

Our company is clearly benefitting from this increased interest which as Sy has said is also driven by the fact that the traditional asset classes or means of investment are just not delivering. All firms or institutions with defined liability aspects are facing big trouble and are pressed to find or generate alpha in their investments.

We have always aimed to deliver absolute return through FX, Fixed Income and Global Macro. We are only one firm and perhaps our perception is a bit biased, but we found over the last few months that institutions we never thought that they might even consider to invest in strategies like global macro are coming to us and start investing. Just one thing, you shouldn't call your product a hedge fund – if you do that, you are out of the game as nobody here in this country will invest in a hedge fund. The way out is that even as a UCITS you can now implement to a certain extent hedge fund strategies.

Christian von Strachwitz

Rolf Dreiseidler: I totally agree with Christian, we now have pension funds and insurance companies investing in our products that only two or three years back would not even have considered our solutions. This is the highest demand for absolute return that I have experienced so far. What we have also observed is a shift in interest away from fund of hedge funds, with the exception of customized solutions based on managed accounts, into single manager absolute return content within a UCITS format.

What has changed dramatically is the level of discussions we have nowadays. Whereas in the past the word hedge fund ended any discussion before it had even started, today investors are open to objectively investigate and assess the benefits and risks of a certain strategy. They still might come to the same conclusion that it is not for them, but this is not derived from prejudice but from objective assessment. However, far more often than not, investors come to the conclusion that absolute return strategies are highly beneficial to their portfolios.

I'm confident that this trend is going to continue for various reasons. First of all, and contrary to common opinion, pressure on institutional investors in Germany is not that high yet. Reason being is that insurance companies and pension funds locked in attractive yields in earlier years and given the long duration of these assets they can easily sit out 3-5 years of low interest rates without compromising their return targets too much. However, as we move on in time, and given how the low interest rate environment persists, institutional investors are increasingly looking at absolute return strategies to provide their yield requirements.

Another reason for growth in demand for absolute return solutions can be found when assessing the current geopolitical and macro economic picture. Given all the challenges that we face in light of the debt crisis, only one thing seems to be clear to me and that is that the next ten years are not going to be more stable or offer more growth potential than the previous ten years have. Already in these past ten years we had two serious equity market crisis and most equity investors got lucky if they did not lose anything over that time period.

Rolf Dreiseidler

Compare that with a reasonable equity market neutral manager who made a decent return for their investors over the same time period and you can see why interest in these strategies is currently picking up.

In fact, most institutional investors hedged their active equity mandates with a futures overlay as they did not have the risk budgets to cope with large drawdowns. The residual exposure of an active long only equity fund, and the respective short equity future, is more or less equivalent with a market-neutral fund. It is therefore not a quantum leap for investors to look for specialised equity market neutral managers with a proven edge and an explicit mandate for capital growth and capital protection.

Fundamentally, equities are still a good asset class to be in, but only without the beta...at least for the unstable times that it looks likely we will experience over the next years.

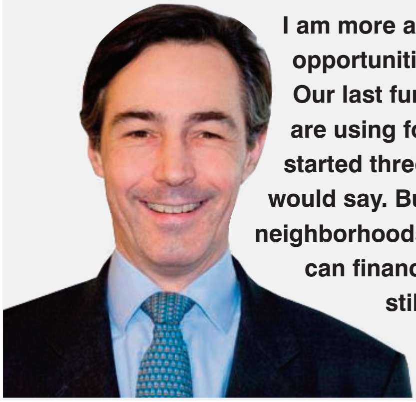
David Zimmer: Two observations on investor's erratic behavior. Currently we do see a lot of investors jumping on the flavor of the day – themes that can change every one, two, three years – which we find quite remarkable. It is surprising because if you look at the totality of their assets and their asset allocation, you would assume that they think in ten or twenty year terms, but nevertheless they do have a lot of interest in new topics. That is in fact very positive for us, because we do have a new topic that goes for the next decades. One of our core themes is investing in sub-Saharan Africa, specifically into banks, and we found that a lot of investors like that idea, especially because Africa is the last frontier market - and we discovered this theme early enough to deliver a first mover advantage.

Our second observation relates to the renewable energies sector that saw a lot of interest over the last two years. Now, when the subsidies were cut unexpectedly in Germany, everybody immediately stays off. It is still a highly attractive asset class, especially for institutional investors such as insurances who need long-term predictable and stable cash flows – but nevertheless, a few headlines in newspapers are enough to scare people and keep them away. I find that quite remarkable too. There is obviously a high uncertainty and willingness for new approaches in the market.

Matthias Knab I travel a lot and I know that a lot of international investors are interested in the German real estate market. Sy, your firm manages such a fund, can you tell us more about this market and the opportunities?

Sy Schlueter: As funny as it sounds, I have been for 25 years in equities as analyst, strategist, investment manager, but I must say that German residential real estate is still my best idea.

I am not too optimistic on equity markets and not optimistic at all on government bonds, not even the so-called safe haven government bonds. For long-term investors, real estate is an asset class one should consider in general, but we all know that many markets bubbled in the last ten or fifteen years. In fact, there are only few real estate markets that have not seen a bubble and in my view only two markets worldwide can be considered substantially undervalued, and these are the German and the Japanese residential real estate market. Finding such an opportunity at our doorsteps, it was obvious that we entered it.



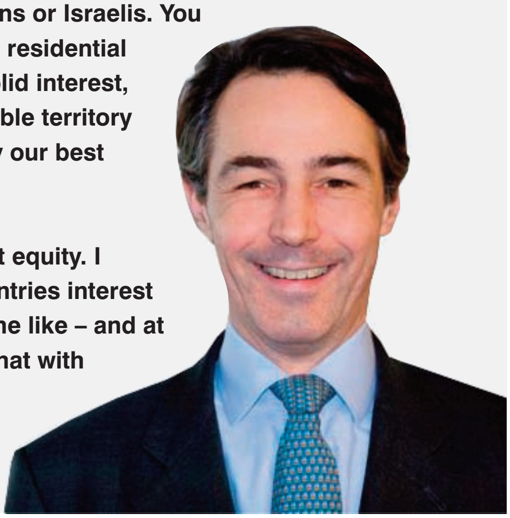
I am more a stock picker than a house picker, so we built up a good team exploiting these opportunities. With interest rates where they are, this asset class is pretty much a no-brainer. Our last fund focused on Berlin residential buildings - Zinshaus or "yieldhouses" is the term we are using for it, which you can buy with a yield of 7.5% or 6.5%, maybe even less now. Since we started three years ago to solely invest in Berlin, I think the multiples have gone up by, 20% I would say. But it is still possible to buy century-old buildings of high quality in decent neighborhoods at around and below 15 times multiples, which is giving you a yield of 7.5%. If you can finance a great deal of this at say 2.5-3%, your yield is almost 5%. After fees the investor still gets a payout of 4-5% per year.

Sy Schlueter

I personally expect that we are going to experience a real estate bubble in Germany, because our interest rates in Germany are generally too low for the economic environment, similar to what it was for example in Spain or other Southern European countries ten years ago. We also see it anecdotally in Berlin where not only the proverbial German dentist is buying residential real estate, but you see Greeks, Spaniards, Italians or Israelis. You do not see that many U.S. investors as they find some excitement in their own residential real estate market. But probably from everywhere else in the world there is solid interest, and institutions are about to come in. As I said, I think we will enter some bubble territory in a few years time. For the time being, German residential real estate is really our best idea.

Looking at other asset classes, of course, I am glad we are running long/short equity. I believe that for some time things will remain very difficult. In a number of countries interest rates are already going up – ten year bond yields in Greece, Italy, Spain and the like – and at one point they will go up in Germany and the U.S. and we know from history that with rising rates it is not likely to make money with equities, because you have pressure on multiples.

Sy Schlueter



As much as managers have prided themselves in the '80s and '90s of how great corporate managers they are, they mostly have seen their share price going up because bond yields went down, hence equity multiples went up and hence share prices went up. And the opposite is true - if bond yields are going up they won't see their share price appreciating. They can work as hard as they want, it is going to be very difficult.

Besides that, I also believe most analysts' corporate earnings estimates are too high, maybe because the economic growth scenarios or the margin expectations are too high. For the next nine months, I do believe we will have some fun on the short side. We are not bond investors, but I think there are some opportunities on the short side of these safe havens too.

I can't say much about commodities other than I see a risk that in the short term commodities will have a hard time to perform, therefore our next product is likely to be another Berlin fund.

When it comes to Germany, where for political reasons we can't call hedge funds hedge funds, I was saying more than ten years ago that we need two crashes to develop this field So when the tech bubble burst, suddenly everybody came along and said, "gee, how did you make money in 2000 and 2001?" Even some corporates turned up to see what is the secret about this long/short thing? Unfortunately, after the crash the next five years went way too smooth and everybody forgot about it. And then we had the second crash in 2008, and I believe by now they all are awake. Either you exit equities altogether now, which they probably have or continue to do and go into market neutral strategies, or they need to find a manager who is able to make money in any equity environment, i.e. long/short strategies.

Sy Schlueter

Another area is Foreign Exchange, which looks to me like an asset class in the making. I mean, to a certain extent FX has always been an asset class, but it has not had the perception of an asset class. FX is a liquid market and is therefore of interest as investors looking for alternatives often want monthly liquidity as well. Christian, do you want to share with us how investors start to use FX funds and what you see happening in that space?

Christian von Strachwitz: Is FX an asset class? That is a very academic and very disputed question. To be honest, I do not think so. It is not an asset class, it does not carry inherent reward or premium if you invest into it, if you look at it from a purely academic perspective. The only inherent premium or reward you get by investing it is the money market rate, so that is the base return of FX.

Is it nevertheless an interesting area? Yes, definitely. The point is that this space has been dominated by carry strategies. The problem with carry is that they work in a wonderful and splendid manner, until you have a problem on the global economical level, and then things usually become extremely difficult and painful.

Of course, there are a couple of managers trying to learn the lesson out of that and use different strategies and ways to make money. For example, over the last couple of years you could see a more pronounced trend where currencies are again, considered as a tool to modify and enhance the economic situation of a country. Unfortunately, that is certainly one of the major instruments which Greece misses.

As with all investments, using FX or FX oriented strategies makes sense if you know what you are doing. What you can definitely expect from a good FX strategy are the three characteristics which have become again more top of mind with the financial crisis: liquidity, diversification and transparency. Even in the midst of the crisis in late 2008, FX managers have never had a problem to serve their clients with redemptions orders. The market is the most liquid in the world and has well proven that status throughout the financial crisis. Diversification wise, both 2008 and also in 2010 – two very challenging years for the financial markets – currency managers have been performing very well, hence have confirmed their substantial diversification benefits. Last but not least, transparency has become top of the agenda lately – within the area of institutional currency management it has already been for many years an absolute standard to accept managed account solutions for large investors.

Christian von Strachwitz

Lately we have observed a push by banks to offer liquid investment structures via managed account platforms. The pioneer in that field was Deutsche Bank with its DB Select managed account platform. Citibank and Morgan Stanley have recently launched their own platforms with slightly different approaches. Within the Citibank Access platform thematic multi-manager style indices are offered.

Quaesta Capital has been selected by Citibank as the index sponsor which selects the composition of the index and who is responsible for the ongoing monitoring and due diligence activity of the underlying FX managers. The use of those style indices allows the sophisticated institutional investor to even better reach for the specific characteristics he aims for with an investment in the currency market. However, sustained alpha from FX is challenging.

Christian von Strachwitz

Rolf Dreiseidler

I had the same experience personally in my previous role as a fund of hedge fund manager and it's the same for Man's fund of hedge fund business. You hardly find any FX manager delivering sustainable alpha - and with that I do not mean returns from carry trades which certainly don't qualify as alpha - through various economic environments.

Dr. Randolf Roth: From an exchange point of view, we see continued growth in volatility products. They are used by many equity investors and fund managers to hedge the tail risk of a fast retreating market, as we experienced it a few times in the last three years.

Two months ago, we had one of the most successful product launches; the futures on the outstanding French sovereign debt securities, the so called Euro-OAT Futures. While we would rather have a healthy Europe, than profiting in terms of new successful products from a worsening of the sovereign debt crisis, the market reality is different: The credit spreads between the different Eurozone sovereign debt securities widen, and there is accordingly a need for country specific government bond futures contracts. The times when the Euro-Bund derivatives were used to manage sovereign debt interest rate risk across the Eurozone are gone. Eurex Exchange has responded first with a portfolio of derivatives on the outstanding Italian sovereign debt securities (Euro-BTP Futures) and now the first Euro-OAT Futures.

Dr. Randolf Roth

Christian von Strachwitz I share Sy's view regarding real estate in Germany but not the doom outlook regarding fixed income and equity space. Erik was so kind to share with us some insight in his asset allocation. The point is that where investors put their money is a question of choice, and the choices are extremely limited. Nobody is going to put all his money into real estate, even if it is Berlin and even if it is managed by Sy. Therefore, people have to allocate into different fields.

I am not so pessimistic about equity because with the current low interest rate environment we might face inflation. People will then start to look for an inflation hedge, and equities might be considered appropriate for this.

I do agree with David's observation that institutional investors display an increased willingness to try different things like his sub-Saharan financial institution fund. Obviously, you have to demonstrate a clear edge when going into such a niche, specifically if you are targeting German institutions. We see exactly the same with a number of developments around tail hedge and other completely different areas like natural resources, renewable energy and so forth. We find ourselves talking to investors which we honestly would not have dared to approach two years ago.

While institutions certainly display more openness and willingness to test and to try new things, obviously the magnitude of the investments is still going to be pretty small and the majority of their money will still be in fixed income and equity. Even with the additional solutions from Rolf here...

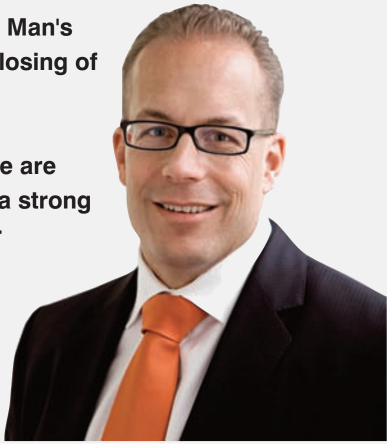
Christian von Strachwitz

Rolf Dreiseidler Thanks Christian, I'm happy to share my view regarding demand and opportunities.

We also see strong demand for asset protection solutions. The concepts that we offer at Man's Systematic Strategies unit have been so successful that we are going to announce the closing of these strategies due to capacity constraints shortly.

However, asset protection is not only delivered by so called "black swan" products. There are other strategies for an investor to consider as well. For example, managed futures have a strong track-record of adding value in times of equity market crisis. I also see opportunities for discretionary global macro managers that can position themselves to profit from market disruptions. Also, we already spoke about the advantages and opportunities for equity market neutral strategies which offer strong capital protection.

Rolf Dreiseidler



Apart from that, no matter who I speak to on the institutional investor side, everybody is either looking at infrastructure and/or renewable energies or has just initiated a first investment there. Unfortunately, Man is not providing any products in these areas yet, but I clearly see the benefits that infrastructure and renewable energies potentially can provide. I also believe these areas should become an integral part of our social responsibility. If we talk about exiting nuclear energy, we need to have and support alternatives. Also, as the current European government debt crisis demonstrates, we all know that governments are not going to be able to sustain our infrastructure going forward. Therefore I think it is crucial to bring providers in that space together with institutional investors to the benefit of both as well as society itself.

Erik Crawford: I think the problem in all of this is, and this is the way it has always been, and it will probably always be this way: investors tend to be looking at stuff that worked well recently and they wish they would have had it, so that is why they are doing it now, tail risk hedging is a classic example. At the family office we just determined that it is too expensive and does not make sense.

Erik Crawford

And where they are able to, and as long as they can communicate it to the clients, the family offices takes a long-term perspective. They try and bring absolute return through a classical asset allocation, in its totality, giving the clients a return that is attractive, what they want, but it takes years to get there, and it is not going to be that way every year.

Another problem is capacity constraints: if everyone starts going after certain absolute return strategies and if huge tidal waves of funds are flowing into strategies that are capacity constrained and do not work if too many people are trying to trade the same stuff, then it is not going to work either. And so I think there is going to be disappointment in that respect too, if the amount of funds allocated to absolute return strategies increases.

We saw in the last decade as funds under management and the hedge fund industry went up, returns went down. There has been a shakeout for the last few years, but we could see the same dynamic happening again.

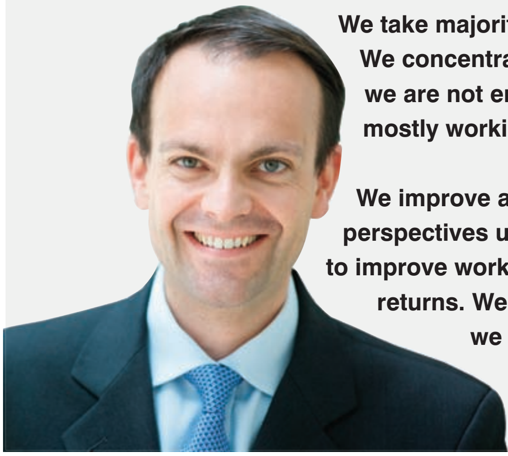
Erik Crawford

David Zimmer: I have a similar view like Rolf and see infrastructure and energy investments as very attractive, also because they help you to stay secured against recession. Usually, energy prices will rise during a recession, and on top we are moving from a subsidy-only energy policy in the renewables now into a market priced energy solution; we are very close to it.

For example, production costs of creating energy from wind are comparable to a coal power. The large energy institutions do a very good job telling the public that atomic power plants produce cheap energy, but this is completely wrong. Ask people who do these kinds of investments. I recently discussed it with Chinese energy experts, and they said this is the most expensive way of producing energy. They are building them just because they are technically capable to do it and because they need any source of energy.

Furthermore, I believe in the German Mittelstand. These small and mid-sized firms are a huge force in Germany with lots of potential. That market is, from our point of view, extremely attractive, because the successful private equity funds grow very fast, and as soon as they grow, they have larger equity tickets, they need to invest. Often, they need to change their strategy, and move in the next market and therefor the small and mid-cap market constantly offers great

opportunities for us.



We take majority positions in unlisted companies following the concept of "buy and build". We concentrate on asset-light companies, less on production-heavy companies, because we are not engineers or technicians. We need to understand what we invest in, so we are mostly working with service companies.

We improve and support their management – most of them are at least in certain perspectives under-managed. We bring in new managers where appropriate and help them to improve working capital. A successful buy and build strategy brings you outstanding returns. We worked with this strategy successfully in emerging markets until we realized we can get the same returns in Germany with a much lower country risk.

David Zimmer

German Mittelstand is a very interesting space to invest in, and we see that not many others are aware of this – which makes this segment less competitive. But these kind of investments only can be done with a team on the ground. The same goes for our Africa investment team - 90% of our people are located in Africa. You have to be locally present and linked with the market.

Once we developed the firm further, we mostly sell our stake to strategic buyers, for example another large company. For example, we select a company making EUR 20 or 30 million revenues and we make it grow organically – additionally we buy some competitors if appropriate. As soon as they hit 50 million to 100 million in revenues, they become interesting targets for the larger strategic buyers, which do not have the capabilities to execute the buy and build strategy on their own.

Dr. Randolf Roth

As I am also a Supervisory Board Member of the European Energy Exchange, I am happy to hear that investing in renewable energy is of interest to most of you. In my view, there are two key challenges around power in Germany but also other countries.

Firstly, substantial investments into the network, the grid, are necessary. This seems difficult to achieve because the enormous risk related to this kind of large infrastructure investments and in addition, there is resistance on the local level whenever it comes to building new lines, adding execution and timing related risks.

The second issue is storage. Of course, it's a nice thing that renewable energies have grown so much that they occasionally produce 100% of the power we need in Germany. However, we need power constantly addressing the fluctuating demand, which requires more sources of steerable supply and the ability to store more power, which is difficult. Do any of you also invest in those two sectors, storage and network capacity?

David Zimmer

We look at it very closely. But first of all, there are solutions where the grid is not actually the issue. For example when it comes to solar energy, 80% of the installed capacity is roof top installations on houses, so you do not need any larger lines here.

But there are other challenges such as development costs for additional asset classes like geothermal. Geothermal is not at all developed in Germany and we have great resources of this type of energy. With geothermal you can produce base load energy and heat at a very attractive price. The challenge with geothermal is the high risk when you start out – in drilling. Drilling a hole can cost you EUR 1 to 3 million, and the result will be binary. Either you hit it, or not – it is one or zero. And there are no investors yet in the market who are willing to take that risk. But we are absolutely sure, these funding sources will come, and we will have a new and relatively stable source to produce renewable energy.

Erik Crawford

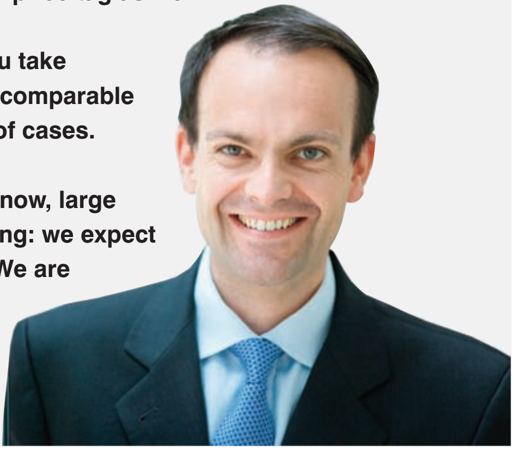
I think the danger with infrastructure or renewable energy is the same as with absolute return and tail risk hedging or timber, which was a super hot topic in the last decade, because everyone looked at the Yale example and says, oh, and so what happens when the whole world tries to make timber investments? Prices got way too high and it was not attractive anymore.

On the solar topic, I am wondering if renewable energy is a good investment, or it is attractive because of the emotional social responsibility story and the subsidies?

David Zimmer: The price decrease in solar for example has happened much faster than any expert anticipated in advance. Five years ago everybody said prices would go down by around 5% per year, whereas over the last three years alone prices fell by 50%. We are at a point where in countries like Greece, Southern Italy or in Spain you are able to produce energy with solar power at the same price than traditional power plants. This makes sense economically, particularly as you are not producing any CO2, for which you have to put on a price tag as well.

We mentioned that wind is already competitive to coal, and furthermore, if you take countries like India or Africa where you do not have a good grid, it is already comparable to their typical energy prices today, because they use diesel engines in a lot of cases.

Regarding renewable energies you need to look at the country specifics. For now, large solar plants don't make sense economically in Germany, but it will not take long: we expect in another two to three years, large installations will be economically viable. We are also convinced that the investments over the last ten years of course made sense in order to bring us to the point where solar energy is today.



David Zimmer

Matthias Knab Turning to another topic, politicians here in Germany and other parts of Europe are not really defending high frequency trading (HFT) but publicly demand curbing or slowing it down. I just came back from Asia, and also at our Hong Kong Roundtable we discussed HFT as the Hong Kong regulators are also scrutinizing it. Where is this discussion heading, what do you see coming and how would it affect you?

Dr. Randolf Roth: You could almost have the impression high-frequency trading has become a public enemy, not just in Germany but also in France and other European countries. As a result, in Germany and beyond the concept of "slowing down the market" has become very popular. It is reflected within the proposal of several measures.

One proposal is to prohibit market places to provide direct electronic access for non-members. That obviously would include the buy side. Another proposal is to require anybody using electronic algorithms to execute their trading strategies, to become a market maker. Again, that would include buy side firms. Finally, I would like to mention the proposal of introducing a minimum order resting time in regulated markets. This would have a significant negative effect on the liquidity and efficiency of markets. All this is part of the MiFID review.

As there is the widespread doubt about the need for the necessity to respond in milliseconds, I would like to address this by explaining the reasons for the importance of speed and related to that the negative consequences of a minimum resting order time.

All successful market places require a variety of players implementing liquidity provision strategies. In some products, those players become official market makers in other products such as futures, there is no formal requirement, tile or benefit for the liquidity providers. In all cases, they are necessary.

Liquidity providers enter quotes which are based on a certain set of information. If the information changes, this implies new prices and quotes. In such a situation the liquidity provider needs to update its quotes in the market as quickly as possible. If he is unable to do so, others will take advantage of its prices.

Over the last decade liquidity providers were able to act faster which leads has improved the provided liquidity. This is reflected in shrinking market impact costs for the buy side.

If there is a minimum resting period, the liquidity provider would be forced to leave an outdated quote in the market. As a consequence, even with a tiny minimum order resting time of 10 milliseconds, there would be an opportunity for others taking advantage of the outdated resting quotes. This would cause losses for liquidity providers. As a result, either the liquidity provider will leave or the market will move to a different jurisdiction.

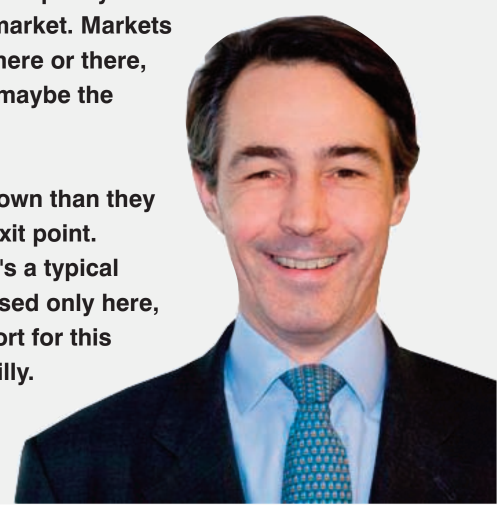
Dr. Randolf Roth

Sy Schlueter: As a long time user of the financial markets I have seen such discussions coming up all the time. I can faintly recall people had the same concerns and arguments when electronic trading was introduced. I am not sure, maybe these are the same people who want to go back to floor trading... well, I am kidding, but really I have no idea whose interests these people think they are protecting. Liquidity distinguishes effective from ineffective markets and every effort should me made not to restrain it.

Another such discussion is around banning short sales. All these things reduce liquidity. The truth is that every participant you are taking out of a market is actually bad for that market. Markets have always been volatile for many reasons, and if HFT adds a bit of volatility here or there, people have to deal with it any way. There are many reasons for volatility, and maybe the positions should not be as large if someone cannot deal with the volatility.

Volatility also provides opportunities as an investor. Prices can come further down than they would otherwise, and so the smart investor has a lower entry or, conversely, exit point. Therefore, I really do not understand the discussion and I am tempted to say it's a typical German discussion of the uninformed, but it is not as these themes are discussed only here, even in the U.S they have this discussion. That shows me that the public support for this industry is kind of going down the drain, for me those suggestions are really silly.

Sy Schlueter



Rolf Dreiseidler

Given our large stake in algorithmic trading, as represented by our $20+ billion AHL funds, Man would be affected to some extent by these suggestions. However, I would like to point out that we are not, and have never been, engaged in high frequency trading. In fact, we have systems in place that are designed to detect high frequency trading by using algorithms that look into the order books to identify respective patterns. If these systems identify high frequency trading activities, AHL stops its own trading activities until those patterns disappear. This is for protection purposes as we don't want our investors to be those paying the high frequency traders.

Dr. Randolf Roth

You say that in AHL you are looking for the presence of HFT in certain products and avoid the product if there is too much HFT presence. As all liquid, electronically traded products have a substantial HFT presence all the time and AHL is actively using those products, I presume that you are looking for a relevant presence of certain strategy types such as liquidity detection strategies, rather than the presence of HFT in general, when deciding whether you stop trading.

Could you shed some light on what kind of strategies you look for or what is it that makes you avoid markets?

Rolf Dreiseidler

We are certainly not worried about a market maker providing offer prices. What we are worried about are market participants that put certain prices in the order book but with no intention to trade at this price just to take them out again the next millisecond. What these players are after is to provoke false impressions on demand and supply of certain financial instruments and capitalise on those. This sort of behaviour is what our models try to detect.

David Zimmer

Our firm is not affected by this discussion, However, I do think these issues are perceived and discussed very emotionally, often by people who do not know much about it – which is quite similar with the discussion around the hedge funds..

Matthias Knab

Randolf, how is France discussing these issues around high frequency trading?

Dr. Randolf Roth: France goes into the same direction. France and Germany are the two big proponents of a slowdown of markets, a regulation hindering high frequency trading and a financial transaction tax specifically hitting speed sensitive strategies.

France has already decided on a financial transaction tax, to be introduced in August, specifically hitting on high frequency firms. We can expect something similar in relation to the upcoming German election next year as 80 percent of the Germans support a financial transaction tax. This results from the populist view that the current difficulties in the euro zone issue from the financial crisis, and therefore the financial industry needs to pay. This view is actively promoted across different parties.

It is incorrect in at least two ways: Firstly, the financial transaction tax hits precisely those parts of the financial industry which had nothing to do with the causes of the financial crisis. Secondly, and maybe more importantly, what we currently witness in Europe is a sovereign debt crisis, resulting from structural weaknesses in different countries. For only a few countries, e.g. Ireland, it could be argued that the financial crisis is the main source for the country's difficulties. In all other countries the financial crisis was simply the catalyst and magnifying glass for the unsustainability of the current economic policy. To mention just a few things: Except for one, none of the EU countries fulfilled the Maastricht stability criteria and there is little hope that this will become better in the future. There is also the question, why countries became members of the Eurozone for political reasons, when they did not fulfill the admission criteria.

Of course, for the political parties it is much more convenient to put the blame on the financial industry rather than have a public discussion on the points I just raised.

I believe that one of the biggest misconceptions with the Financial Transaction Tax is that the policy makers have the impression that there will be some manageable extra costs for retail, institutional customers and of course banks and HFTs. The debate is about the question, to what extent the broker can pass on the "tiny" cost.

At least for derivatives, that is not true. The costs are so high, that markets will move elsewhere.

I will give you a concrete example. With the EU Commission proposal but also apparently with the currently discussed German proposal, the tax for derivatives would be 0.0001, i.e. 1 basis point. In the case of DAX-Futures

Dr. Randolf Roth

that would be a tax of 15 euro per side and per contract. In contrast, our fees are at EUR 0.30, while a typical broker commission would be at EUR 1.5. The average profit of a prop trading firm providing liquidity in this product is about EUR 0.50-1.5. per contract. In other words, sometimes they win and sometimes they lose, and in total they make a profit of EUR 0.50 to EUR 1.50 per contract. From the EUR 0.5-1.5 they need to pay all costs related to their business, e.g. their infrastructure, the staff, connectivity fees, rents etc.

Comparing the revenues per contract of the liquidity provider with the tax rate of EUR 15 shows that with the proposal, markets will stop operating as we know them. There are three different possibilities: Firstly the market will either move OTC, secondly it will move to a different country or will have sort of break down as the liquidity providers simply will leave the market. So the real question is not whether and how much do retail investors pay on the trade in tax, but rather: Do markets still exist in the taxed countries and if so, by how much will the liquidity and therefore the implicit transaction cost worsen?

Sy Schlueter But ultimately, it is like the stamp duty similar to the UK, is it not?

Dr. Randolf Roth: I know three different concepts. There is a stamp duty in the UK. It is on UK shares with plenty of exemptions for market makers, banks and certain UK institutions. Effectively, the tax is paid mainly by foreign institutional investors and retail investors. Investors have found ways to deal with it, including moving business OTC to CFD products, which are not taxed.

Then there is the French tax, to be introduced in August, which is focusing on French equities, EU sovereign bonds and certain CDS, and has an additional surcharge for French HFT firms. So it is similar to the UK stamp duty and does also provide a number of exemptions for certain players e.g. banks.

The EU Commission proposal has a much further reach as it seeks to include all products and does grant almost no exemptions. The EU Commission tried to get all the EU countries behind it, however Sweden and the UK did not agree, and it ultimately fell apart.

There is no clarity yet on the German proposal, except that it should be very broad. There are also further proposals in the pipeline as Germany and France still seek to get a group of European countries to team up and introduce a tax.

I believe, any tax attempt should be profit rather than turnover-based. Otherwise there are either major disruptions or the flaw in the design needs to be corrected by a large number of exemptions.

Dr. Randolf Roth

Erik Crawford I think ultimately the asset owner is going to be paying the tax. The banks are just doing transactions, is that not the case?

Dr. Randolf Roth Yes.

Erik Crawford So the general population is for this tax, because everyone believes banks and hedge funds are greedy trouble-makers, but it is they themselves, the general population as mutual fund owners and pension fund and insurance beneficiaries that are going to be shouldering the tax.

Christian von Strachwitz Theoretically yes, practically no.

I think that there are lot of strategies which are not profitable anymore if you impose such a tax fee on them. That means the whole investment landscape will totally change with whole strategy sectors and funds not able to survive in such an environment. This can include exchange segments like equity index and bond futures, many markets can suffer substantially and the financial landscape as a whole will be much more inefficient in the end than now.

I don't think people are aware what environment they will be creating – if the ultimate goal is to have only long-term investors acting in an illiquid environment with extreme bid-offer offer spreads, will that be the goal? Is this about shooting everybody who is doing more active investing and just keep the long-term buy and hold investor? If this is the end-game, we will see fundamental changes in the financial industry here in Europe, which will then of course reverberate through all other industries and sectors.

Christian von Strachwitz

Rolf Dreiseidler: I recently came across an academic paper about the impact of transaction taxes that was quite worrisome. The paper concluded that a transaction tax would cause bid-ask spreads to increase, resulting in lower liquidity. As markets nowadays are very sensitive to illiquidity this would result into a penalty discount. For a 25 basis point transaction tax the researchers estimated a negative impact of 10% on affected equity markets - per annum!

Rolf Dreiseidler

Of course, one could question the results of the study and other researchers could certainly come up with different numbers, but I believe there is a point to be made that a tax that many would initially judge as a minor issue might end up compounding and affecting the overall market or market structure.

David Zimmer

What scares me most is that if you actually talk to the people who are making those decisions you find most of the time that their knowledge of the markets is very limited. That means they really make their decisions based on sentiment and public opinion. I think we all should get engaged here and give them as much information, background and education as we can, so they can take a wise decision based on professional knowledge and not just build their policy on what they read in the newspaper headlines.

Matthias Knab

This is something where the German Alternative Investment Association, the BAI, is involved in this as well?

Rolf Dreiseidler

Absolutely, the BAI spends a tremendous amount of time and effort to provide factual information and education to all sorts of market participants including investors, regulators, politicians as well as the press. The idea is to help them form an educated and well founded opinion about alternative investments.

Certainly, one of the biggest challenges is the press as there is some sort of intrinsic incentive here for negative headlines. It is quite convenient to point at hedge funds as being the reason for anything ugly that is happening in the world. At the same time, independent studies from renowned organisations proving the opposite hardly find their way into the headlines. And this pattern keeps repeating over and over again and certainly has its impact on the perception of some decision makers.

However this does not discourage us, we will try even harder. One action we have taken very recently is that we hired a PR-Agency to support our efforts here.

To adequately address regulators and political decision makers, we also hired a managing director a few years ago who used to work for the German supervisory authorities. He does a tremendous job and spends a lot of time in Brussels and Berlin speaking to politicians and other public decision makers, providing profound insights into alternative investments. Going forward, we will seek even closer cooperation with other relevant associations to strengthen our political impact.

Another measure worth mentioning in this regard is the ”BAI Scientific Award”. Here the idea is to provide a monetary and reputational incentive for students and academics to conduct profound research into alternative investments, focusing on the practical relevance and benefit for institutional investors. The effect of this is twofold: first of all there is more research available to support the decision making of institutional investors; Secondly, these young academics may at some point take their knowledge of alternative investments into careers where they end up working for a regulator, the press or for an institutional investor.

To extend our academic reach to the benefit of institutional investors, we are currently in discussions to establish a BAI endowed professorship in alternative investments. Also, we are planning to extend our extra-occupational course of studies offerings into infrastructure and renewable energies as well.

I guess I could keep going on for ages on what the BAI is doing, but in the interest of time, I will leave it there.

David Zimmer: There is one other point we have not touched yet, which is the impact of the internet. I believe that we are in the second wave of internet e-commerce already, which will completely change the retail landscape including the offline stores with the potential of affecting many other sectors. For example if you look at the real estate markets, right now 90-95% of the sales are still offline but the online part grows faster than any expert assumed in the past.

Just compare the internet start up Zalando which engages in the online retail of apparel and shoes and is based in Berlin. The firm was set up in 2008, having EUR 1 billion in revenues and a positive cash flow within three years - challenging the leading German shoe retail chain Deichmann which was established in 1913 already and has EUR 3 billion in revenues. We will see similar stories in other fields as well.

Looking at the financial service industry, I am wondering what you expect to be the next changes the internet will be bringing to us. If you think about the reach and potential of Facebook and other kind of social platforms, also our industry might change dramatically in the short future. What are your views on that?

David Zimmer

Dr. Randolf Roth

Exchanges are driven by network economics. We used to be among the biggest players enjoying the benefits of network economics. Through the internet, much larger networks have been built, e.g. social networks like Facebook or market places like Ebay.

This could be an opportunity for us in terms of collaborations but also a threat in terms of those large networks developing their own market places competing with us.

Sy Schlueter

I believe in the end it boils down to transparency. The internet makes the transaction itself easier and faster, but transparency will have the biggest impact. And I think the financial service industry has probably been one of the worst performing industries in that respect, I can imagine that the Internet does help to show who is doing a good job and who is not. This combined with the challenging environment we are in now will speed up the structural change process in the financial service provider industry and may be causing trouble for the established players who have dominated the market for decades on a national and international level.

You can see this effect already in retail and private banking where the average or half educated investor does not rely anymore on his bank to sell him a fund, he will rather go and search the Internet as he may be searching for new shoes or buy his books on Amazon. The internet will certainly be a force in all sectors towards the better players, lower prices, and faster transactions.

Rolf Dreiseidler A question from my side would be where do you currently see risks, challenges and opportunities on a broader level - especially from an investor's perspective?

Erik Crawford Well, I think a risk we all face is business risk, which is big right now. One challenge many institutional investors have is convincing their clients about what the future is going to be like, and managing expectations, and having return goals that are realistic. Betas are going to be different going forward and alpha is scarce. If investors are not successful in doing that, then they will have unhappy clients.

As far as investment risk and opportunities go, you can try to reinvent the wheel or come up with a whole new paradigm or way of investing. But there has been turbulence in the past as well. An asset allocation will generally not yield much more than the market return return over time, and the market return depends a whole lot on the valuations at the point of investment.

But even if investors are successful, more often that not, at picking the right markets at the right time, it's hard to imagine returns in the next 10-20 years being what they have been in the last 20-30 years. At least without taking a lot of concentrated risk, which most people don't want. Therefore, risk and return expectations must be managed.

Christian von Strachwitz: Let me turn to the opportunities again – we already mentioned the new sources of liquidity coming into alternative investments. You see very conservative family offices investing in internet startups, and old-commerce type companies like Otto Group seeding startups. We see investors coming into asset classes like infrastructure and some very conservative German insurance companies looking at hedge funds and absolute return funds for the first time. Summing up, I see a lot of new sources of capital for our products.

The extent of uncertainty and the lack of steady growth and conviction of all market participants in the current environment is certainly very helpful from a alpha provider perspective. Frankly, we like the current market environment.

On the other hand, we see that the current set of alternatives regarding investment choice has opened up a lot of opportunities. Investors are willing to look at totally different things and do business with or invest through relatively young firms.

The perception from the investor side, how they view, screen and evaluate product providers, has certainly changed, both on the retail and institutional level. They made their experiences with a couple of very large asset management companies, and those experiences are telling them perhaps they should be a bit more adventurous and go into some of the more unexploited niches.

Christian von Strachwitz

Dr. Randolf Roth Upcoming regulatory changes require a large part of the currently OTC traded business to be served by central infrastructures such as clearing houses and trading platforms. As OTC products are often very similar to our products, this generates opportunities for us. We address this to major initiatives as e.g. securities lending, OTC clearing and new risk methodology (Prisma).

Sy Schlueter: I am convinced about the future of our industry and see great opportunities in the alternative investment area. As I expressed before, I believe we have a huge structural change process going on because the old long-only world is not delivering, there is a clear need for alternative investment strategies.

However, we as providers have to go with the same structural change. Seventeen years ago I started out in the markets in a boutique format, and at that time setting up was an easier process than today. As alternatives are moving more into the focus of the mainstream investor, being boutique also has some disadvantages. We need to adapt and grow to meet the institutional investors' demands. We do that by expanding and adding new teams to our platform, maybe merging with other boutiques, possibly even from other continents, etc.

Sy Schlueter

The demands from the institutions go beyond the absolute return generation and your risk management process into fields like your counterparty risk, the overall size of your organization, demonstrating you have a compliance officer and a money laundry officer, and so on. Therefore, in order for us to benefit from the institutional interest, we have to be more institutional as well, which for some of us means to grow or team up with others while maintaining your edge in the investment niche you are focusing on.

Erik Crawford: I also want to contribute to the opportunities side and not just provide the cold shower over and over. I think Africa was mentioned once or twice, that is region with great growth potential and valuations with many healthy, growing, profitable firms. In general investors need to really look global now with their investments and broaden their horizons.

And also, in a very difficult macro environment going forward, even though I have said alpha is scarce, it is still worth pursuing. The ETF industry has grown tremendously in the past few years, but I would really look for good active managers who can find quality investments at a good price and just buy and hold those for a long time and let the volatility come and go, and ultimately, if you can afford mentally, to ride the volatility waves that will come, you will be much better than taking ETFs or something like that.

Erik Crawford