



# Opalesque Round Table Series '13 FLORIDA

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# Editor's Note

## The Tyranny of the short term

Many investment strategies make sense only if they are held over a full investment cycle, but the challenge professional asset managers have is that psychology often weakens the investors' conviction when volatility kicks in.

Drawdowns have become the single biggest risk parameter investors for investors, rather than Sharpe ratio. Investors look at their mark-to-market gains and any loss from the peak turns into pain. This peak to trough drawdown versus annualized returns is also called the pain indicator. If that drawdown is vastly more than the annualized returns, investors lose their confidence in the strategy. If after a deep loss the strategy bounces back, a lot of people will miss the rally because they threw in the towel and walked away before that. This happens not just with alternative investments, but also the long only space.

This Roundtable discusses two factors that exacerbate this problem. First, investors today tend to succumb to a constant overload of the “wrong” information. Many of those media the investors use talk about trading on a day by day basis, and professional investment managers believe investors shouldn't be focusing on this type of information at all, because the incessant inflow of short term information usually carries investors away from looking at the long term perspective.

## Why 80% of investors ask the wrong questions when evaluating a manager

The other fundamental problem comes from the fact that most people managing vast pension assets as well as their advisors and consultants have never traded, certainly not alternative investment strategies. This can also distort a proper evaluation of certain investment styles and trades, and deeply affects how certain institutions and their consultants screen, evaluate and invest in external investment managers.

Daniel Ades believes that 80% of investors he meets ask the wrong questions when evaluating a manager. This Roundtable highlights why this is the case, what would be some of the “right” questions, and also critically examines the role of consultants and their dismal lack of actual trading experience, particularly in alternative strategies.

The Roundtable took place on December 14th 2012 at Wells Fargo Miami office with:

- **Julie Neitzel, President, GenSpring Family Office**
- **Daniel Ades, Partner, Kawa Capital Management**
- **Marc Lehmann, General Partner, Riverloft Capital**
- **Maxime Dupont, Founder, Chairman and Chief Executive Officer, Quantam Group**
- **Michael Levas, Founder, Chief Investment Officer, & Senior Managing Principal, Olympian Capital Management**
- **Monty Agarwal, Managing Partner, Chief Investment Officer, MA Capital Management**
- **Paul Grassi, Wells Fargo Insurance Services, Vice President/Hedge Fund Practice Leader**
- **Pratik Sharma, Managing Director, Atyant Capital**

and offers interesting insights about:

- **How to evaluate correctly an investment manager**
- **Strategies to enable investors to handle the information overload**
- **Why real estate investors are typically a different breed**
- **The three basic dimensions of risk, and how they are interlinked**
- **Are most investors really in an unintended risk on environment?**
- **How sovereign wealth funds and other sophisticated investors benefit from short term volatility**
- **How complex, dynamic hedging applications can bridge the gap between algorithmic techniques and traditional long term investment**
- **The “huge” arbitrage between private and public assets and other investment opportunities on which Florida based hedge funds focus**
- **The benefits of running a hedge fund from Florida**
- **How to access Florida's high net worth communities most effectively**
- **How GenSpring multi family office screens and selects external managers**

Enjoy the read!

Matthias Knab

Director Opalesque Ltd.

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# Participant Profiles



(LEFT TO RIGHT)

Marc Lehmann, Daniel Ades, Monty Agarwal, Paul Grassi, Michael Levas, Julie Neitzel, Pratik Sharma, Maxime Dupont, Matthias Knab



# Introduction

## **Julie Neitzel**

GenSpring's Miami family office

I am Julie Neitzel, President of GenSpring's Miami family office. I have been in the family office space for about 15 years. We typically work with families with higher levels of wealth, which we would define as having an investable asset base in excess of \$25m. I very much enjoy working in this sector, because there is such an array of different aspects and complexity involved in the decision making process of how to choose investments, how to create portfolios based on what the client is trying to accomplish, and then holistically integrate tax, estate planning, and other considerations around it. That has been my personal focus as a professional, and that has been the focus of GenSpring Family Offices for the last 23 years.

## **Marc Lehmann**

Riverloft Capital

My name is Marc Lehmann. I am the Founder and the Managing Partner at Riverloft Capital based in Miami Beach. We focus on event-driven investments, up and down the capital structure. We have been around for about 19 months. Previously, I was the Partner and Head of Research at JANA Partners. Prior to JANA, I was an analyst at Appaloosa.

## **Daniel Ades**

Kawa Capital

My name is Daniel Ades. I am the Managing Partner and Founder of Kawa Capital, an asset management firm that is now almost six years old. Before that, I was a Partner in an investment advisory business called Horn Eichenwald Investments based in Miami as well.

Kawa Capital is an alternative asset manager. Our main fund is a multi-strategy hedge fund that for the last four years has mainly invested in event-driven and credit trades. We also have a private equity and real estate and energy side of our business.

Our interest is always to look for good risk/reward investments regardless of where they are. So we run three different funds but also create different alternative special purpose entities for different themes that we like. About half of our assets is in the multi-strategy hedge fund. I am the main portfolio manager of that fund, and also run the business side of Kawa. The other areas of our firm are run by different people.

## **Monty Agarwal**

MA Capital Management

I am Monty Agarwal, Managing Partner of MA Capital Management. I have over 17 years of experience at some of the largest banks in the world trading bonds, currencies and commodities. I have lived in India, Japan, Hong Kong and Singapore. In Singapore I was the Head of Trading for BNP Paribas Asia.

I launched my first hedge fund Predator Global Master Fund in (2004). The fund was nominated as the Best New Asian Hedge Fund and Best Asian Relative Value Hedge Fund, (2005) by Eurekahedge and Terrapinn and had been profitable every single year before it was sold in September (2006).

I am also the author of The Future of Hedge Fund Investing (Wiley, 09). Due to its global popularity the book has also been translated into Chinese.

MA Capital Management provides services for accredited institutional investors, ranging from advisory to creating multi-manager portfolios of either long only or alternative managers. We also offer a multi-strategy systematic managed futures product. In 2013 we will launch a retail product offering alternatives to non-accredited investors as well.

## **Michael Levas**

Olympian Group of Investment  
Management

Michael Levas, I am the Founder and Senior Managing Principal of the Olympian Group of Investment Management Companies. I founded the company in 2003 after a very long career at some of the most prestigious firms on Wall Street, Lehman Brothers, Bear Stearns, Paine Webber, SG Cowen, and DLJ.

There are two aspects to my business. One is the hedge fund which is a multi-strat global macro fund and where we try to take advantage of certain inconsistencies in the market that exist and use, for example, arbitrage, event- or news or momentum-driven strategies.

And we also have an asset management business which is primarily long only. Here we are primarily servicing high net worth, ultra high net worth clients and institutions. I also speak at a number of conferences all over the world on various aspects of our industry like market structure, regulation, institutional trading, etcetera. And finally, I am also a consultant to a number of hedge funds and asset management firms on issues like regulation, compliance or market structure themes.

We will be launching a new long only strategy which I have developed. I am very excited about that product, which we will also be offering through a 1940 Act fund.

**Maxime Dupont**  
Quantam Group

I am Maxime Dupont, Founder and CEO of Quantam Group of Companies. We are based in Luxembourg but also have an office here in the U.S. For the first part of the decade, Quantam was very successful as a CTA with assets peaking at \$1.5bn in a systematic strategy. We progressively transformed the company to utilize our knowledge in alpha creation for proprietary investments only, mainly in high frequency strategies like arbitrage and market making, which are less suitable to external investors due to capacity, exchange memberships and complexity. We still have a customer business where we do tailor made structured product solutions, hedging overlay solutions for long only investors or other groups of asset managers who are looking for a let's call it airbag against drawdowns using futures and options.

**Pratik Sharma**  
Atyant Capital

My name is Pratik Sharma, I am the Managing Director at Atyant Capital. We manage two strategies; one is a value investing strategy focused on Indian equities and the other strategy is a hedge fund strategy focused on precious metals and precious metals mining companies. Our India strategy is bottom up and relies on our India based team to conduct deep fundamental research. We launched our firm in 2005 and work with high net worth individuals and institutions.

**Paul Grassi**  
Wells Fargo Insurance

My name is Paul Grassi. I run the Hedge Fund Practice for Wells Fargo Insurance out of Tampa and New York City.



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**Marc Lehmann:** We focus on special situations and events, and what excites us at the moment is that we see a lot of companies taking action to extract value for their shareholders. We, as investors, prosper through such events. We have seen a good number of companies converting to REITs and push down some of their assets into MLP structures. We have also seen many companies trying to take advantage of the current tax code in order to distribute dividends.

Since the crisis of 2008-2009, we have noticed companies regaining their confidence and beginning to take corporate actions, which is great for our strategy. On the negative side, we can also see that many companies still have been delaying taking the proper actions, whether that's selling a business or making acquisitions. As companies take additional actions it will create many more opportunities for us to profit from these events.



We also focus on industries that go through structural changes due to consolidation, regulatory changes or technology shifts. Consolidating industries include areas like auto rental companies and containerboard manufacturers. Financials and healthcare companies are being altered by massive regulatory changes. Energy production in the United States is being impacted by improved drilling technology that is affecting oil and gas prices, and also impacting chemical producers in North America. All of these shifts, and others we have identified, create winners and losers that we focus on capturing through our research.

**Daniel Ades:** The crisis of 2008-09 was not really a credit crisis but more a liquidity crisis. At that time, not a lot of companies were bankrupt, so there wasn't that much to do in distressed. Also right now, there is still too much easy money, so a lot of bad companies still manage to avoid going through the painful process of restructuring. I believe going forward we will see more bankruptcies that allow the system to flush through these problems, to restructure and be productive again. That is exciting, because it presents lots of opportunities for our main fund along the way.

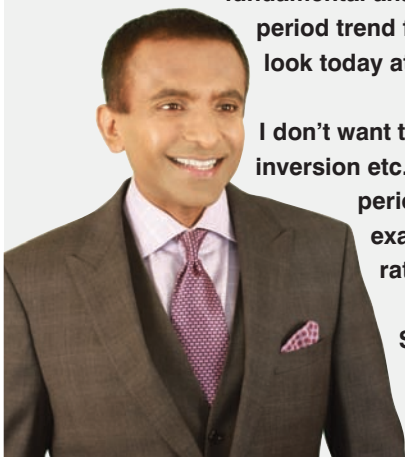
But we also see a tremendous amount of opportunities outside of our main hedge fund. In our view, there is huge arbitrage between private and public assets. There is certainly a financial inflation in the world where anything that's listed, be it a bond or an equity, has become very expensive. So for the last two or three years we were also busy finding ways to do something on the private side. For example, we are just launching a private equity real estate fund. In the private sector you can buy at significant discounts compared with where public securities trade. The big arb here is eventually flipping these assets into public vehicles at some point in the future. So, on the private side we are active in the alternative energy space, solar, and now also real estate where we create assets that generate significant amounts of cash flows. For us this is a massive opportunity, a great arbitrage between publicly listed and private assets. You can get the same type of risks, but with very different yield profiles.



**Monty Agarwal:** I was at a conference in August in China speaking at a hedge fund conference and had an opportunity to speak with close to 200 different institutional investors. One common theme we are hearing is that a lot of the institutional investors are becoming sort of disillusioned with the hedge fund industry. They look at what happened in 2008/2009 and that over the last three years the returns haven't been that good as well. Their sense is that many hedge

funds have morphed into a beta play.

One of the areas they are moving into is systematic strategies with a short holding period which do not rely on fundamental analysis or human discretion. Historically, systematic strategies were mostly long holding period trend following strategies that were very prevalent back in the 80s and the 90s. But if you look today at a managed futures index, those haven't done well recently either.



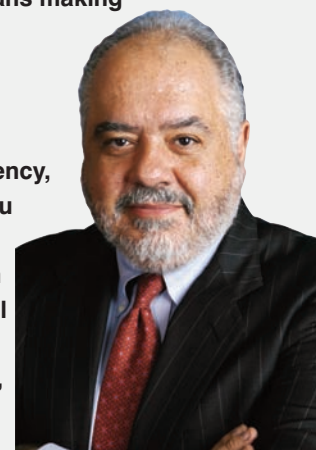
I don't want to get too much into a deeper analysis that will point to factors like volatility curve inversion etc., but the bottom line is that investors have become interested in short term holding periods. By that we don't necessarily mean high frequency, but strategies based for example on pattern recognition or volatility arbitrage with holding periods of a few days rather than months.

Short holding period strategies are among the strategies that we are finding significant demand for, at least from large institutional investors outside of the U.S. like sovereign wealth funds.

Therefore, we are very excited about developing our in-house systematic strategies as well as sourcing outside managers in the short holding period space.

**Michael Levas:** I am going to take it from a different point of view. In my view, we did experience quite a bit of volatility in the markets. Just think about the number of central bank interventions globally and politicians making statements that have had an incredibly adverse effect on our business of investing overall.

I also don't believe all investors are interested in the short term, and that is also one of the premises for our new strategy we will be launching. I believe that here in the United States, a number of investors are looking for the slow and steady growth as opposed to the high frequency, momentum or the short-term trading. If you look at Buffett or Tiger or Baupost in Boston, if you listen to some of these gentlemen who have been in the business for many, many years, I believe there is value in these types of more longer term strategies. Investors, especially from the family office space, are looking for consistency of their investments overall, and in general they aim to decouple themselves from volatility and what's going on around the world. We have set up our new strategy in both an institutional as well as in a '40 Act mutual fund format, and are very excited about this new product.



**Maxime Dupont:** I think it's probably difficult to say what kind of strategy is currently in demand, whether it's high frequency or long-term fundamental strategies or fundamental rights system. I believe there is room for a lot of different strategies and what is in demand depends only on the type of investors, and their specific and different needs.

Secondly, I believe it is also important to point out that short term strategies cover a wide range of things. It includes high frequency like arbitrage or market making, which are very specific strategies and to the most part extremely algorithmic based, but short term can also include strategies that are just intra-day or with holding periods of up to around three days.



The longer term fundamentally based strategies have of course a lot of benefits, but also high frequency is interesting for some investors because the strategy in general has less instant risk, as the time in a position is very short. The idea is usually to grab some small profits in the market and take advantage of some market behavioral patterns that usually subside quickly. Therefore, the trades and strategies need to be renewed continuously.



I believe that high frequency trading is a more suitable approach for prop trading, because the techniques involved are extremely complex and for obvious reasons algorithms are not fully disclosed. Therefore, even if investors see an attractive and extended track record, they are reluctant to invest in these strategies as the number one criteria for many investors is understanding what they are investing in.

The type of high frequency trading I am talking about here usually comes with a reduced capacity, because as I said, the strategy is mostly about grabbing a small arbitrage opportunity. And finally, because the markets change all the time, you have to renew your strategies constantly. This means that your track record is more reflective of your capabilities to design strategies rather than the strategies themselves. It is quite an interesting question to reflect about how important is your track record of five years ago within today's environment. Other strategies may have a greater consistency in this respect.

In my view, all these aspects in a way disqualify high frequencies to be part of the pure asset management world. While the opportunities in high frequency need to be more exploited, this will probably happen more in prop trading activities, be it with banks or specialized prop firms.

On the other hand of the spectrum, long term quantitative or fundamental strategies may be more suitable for investments. Over time, they have demonstrated a sustainable alpha, and there are premia in investing in various assets. While at the moment the pace of these strategies has slowed down a bit, they are easy to understand for investors, and also benefit from active beta management when executing them.

**Maxime Dupont:** One thought of ours is to bridge the gap between the two camps of the algorithmic techniques and the long term investment. Today, investors tend to be rather risk averse, so while they are interested in say emerging markets or in bonds but with a long term approach, they don't want to see a -40%, -50% or -60% drawdown anymore, because it's just too harmful. They have been hit in 2008 and in the last 15 or 20 years they have been hit three or four more times like this, and therefore they shy away from suffering such a kind of drawdown again.

Therefore it may be an interesting approach within modern asset management trying to cross the skills of long term investors and efficient stock pickers with the more algorithmic techniques and add an effective risk management overlay, which together can be very beneficial for the investor. That would be my idea for the investment industry and the investor communities today.

We have started to apply this idea this year, and we are currently operating dynamic hedging strategies as an overlay, for example on top of a "long term" emerging market fund which was launched in July and raised over \$100m almost immediately. Institutional investors are willing to invest in an alpha engine that they understand (discretionary & fundamental stock picking) while being protected with a higher frequency systematic beta management, similar to a private structured product, able to cut exposure quickly to avoid big drawdowns.



**Pratik Sharma:** We've touched on general investor appetite, which seems pretty apathetic. People have a visceral reaction to words like risk and volatility. In order to succeed in the investment business, you have to be a contrarian.

At a time where everybody is apathetic and everybody is afraid of risk and of volatility, those who embrace risk and embrace volatility and take a different outlook are in a position to do quite well.

The main focus of our firm is Indian equities, and India is probably one of the ultimate risk-on,

risk-off asset classes out there. When risk is on, people love Indian stocks and the idea that Indians are going to rule the world in 50 years becomes en vogue. When the risk is off, India goes from being the best to the worst investment ever. For us, India is a great barometer for general investor risk appetite. Our barometer, as we approach the end of 2012, tells us that investor appetite towards risk assets is relatively low right now.

But when you look at what is actually happening on the ground on a fundamental basis, it is actually quite exciting. India has three key advantages, something which I refer to as the three Ds: Demographics, domestic demand, and depth of markets.

Regarding demographics, it is well-known and anybody who has read any report knows that half of Indians are under the age of 25, 85% are under the age of 45. It is also becoming better known that the majority of Indian GDP is domestic demand driven. From a depth of markets perspective, India has 100% electronic markets with over 6000 listed companies. Regulation is based off of the Anglo-Saxon model and all companies are required to report quarterly and annual financial reports.

Now, some people get concerned if they look at some other macro statistics on India and point to widening trade deficits, a weakening currency and declining exports. One can look at it that way or dig a little deeper and see that imports are strong which reflects that domestic demand remains robust in India. Declining exports say more about the demand situation in the rest of the world than they do about the Indian economy.

I've mentioned that domestic demand in India remains robust, which is a secular trend I see every time I visit a village or a factory in a remote part of the country. This demand is an ongoing reality mostly driven by rising incomes in the hinterland.

Coming back to the imperative of being a contrarian, when I look at those core fundamentals that exists over there and couple that with investor apathy, aversion to risk, and a visceral response to the notion of volatility, I think anybody who is taking the other side of that trade is in a good position and will do well over a decent time horizon.

**Julie Neitzel:** I think there are a couple of reasons why there is that apathy. Most people, individuals or institutions, believe that they are long term investors until the unanticipated results start making them nervous (due to drawdown periods). This is the investor psychology coming into play, and I believe that institutional investors behave not that differently from individual investors.

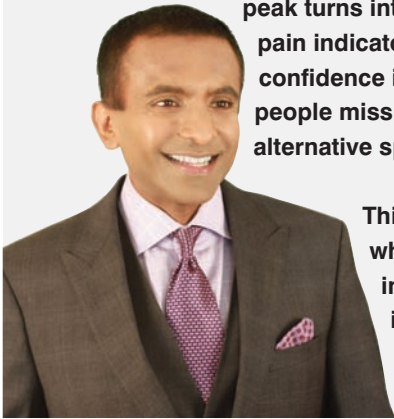
If we look at the hedge fund area as an asset class or strategy, aggregate returns were negative in 2011, and by end of 2012, a lot of the strategies were delivering low single digit returns. Well, that's not very interesting for most investors, particularly with the recent returns of traditional asset classes. Yet, if you look at research – I was just looking at a report analyzing hedge funds as an asset class and strategy compared to stocks and bonds from 1994 through the end of 2011 – hedge funds still outperformed on a risk adjusted basis.

The challenge is really getting investors to stick with their allocations for the long term. Let me share an anecdotal case to make that point. We had allocated client capital to a long/short manager with a good track record. He started his fund in about 2005, and in 2011 he had eight successive months of negative returns (as his short positions continued to lose). The manager never had that succession of negative returns ever in his strategy, and it continued on for almost up to 12 months. The clients became nervous and opted to redeem from this strategy as they were uncomfortable with the 25% drawdown at mid-year 2011. However, as fate would have it, this manager finished 2011 with double digit performance while peer managers finished with low single digit returns. Had the investors been willing to endure the volatility, they would have benefited from the return outcome.

I commonly mention that an investment strategy can make sense over the investment cycle, but the challenge many times is not allowing investor psychology to weaken one's conviction when volatility kicks in.



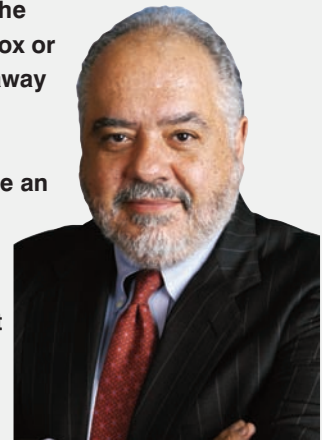
**Monty Agarwal:** Drawdowns are by far the single biggest risk parameter investors are affected by. It's not Sharpe ratio. Investors look at their mark-to-market gains and assume that it is money in their pockets. Therefore, any loss from the peak turns into pain. This peak to trough drawdown versus annualized returns is also called the pain indicator. And if that drawdown is vastly more than the annualized returns, investors lose their confidence in the strategy. So, after a deep loss, even if the strategy does bounce back a lot of people miss the rally because they throw in the towel and walk away. This not just happens in the alternative space, but also the long only space.



This ratio is the reason why a lot of people missed the 2009 rally as well as the 2012 rally where the S&P is up over 15% already. But to them, the pain ratio doesn't justify staying in that asset. So that is in fact one of the most important risk parameters for the investors. Sharpe is in my opinion completely useless, especially when it comes to alternative strategies, it's the RMD ratio (Annualized Returns / Maximum Loss).

**Michael Levas:** In my view, one of the problems that we all, and particularly investors, face is the constant information overload. People continuously watch CNBC, they listen to Bloomberg, Fox or CNN - I mean it's unbelievable... That incessant inflow of short term information carries them away from looking at the long term perspective.

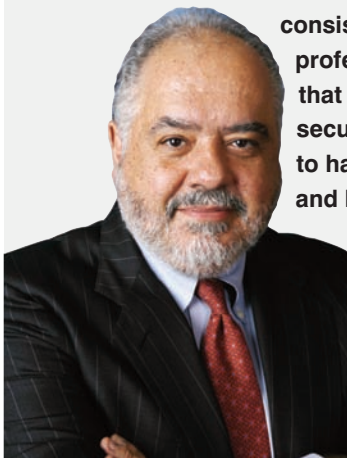
For instance, I had an ultra high net worth client from the middle 1990s to last year, he could be an institution in himself. But, with the volatility we experienced in the summer of 2011, he just bloomed away. When I would call him, I heard CNBC blasting in the background. That is a serious problem. It really is, because not only is it information overload, but also mostly the wrong information. Many of those media the investors consume talk about the trading day, but the investor shouldn't be focusing on this type of information at all. But they do, and I believe this also influences our business as professional investors in a very negative way.



**Matthias Knab**

What would be the right way to go about this problem of information overload that seems to make investors focus on the wrong things? What would you like to teach those people instead?

**Michael Levas:** I think the investor should select their advisor carefully, and then work within a relationship that is based on trust. I believe trust is a key issue, and it must be regained. If an investor has been having a trusted relationship with an advisor or a manager where for many years he saw and benefited from consistent returns, then there is a good base to keep that trust factor. Of course, each professional will have a bad month and even bad years, but again, it is the longer term results that count, and investors should come back to a position where they feel comfortable and secure to rely on their advisor and their relationship. We, the professional managers, are happy to have a more consultative relationship, we love to talk about markets anyway, their direction and how we are positioned to take advantage of certain things. So instead of just looking at "what are my returns today? What did I make this month?", we should be talking about the investment thesis and try to see the full picture and think long term.



Maybe age and experience helps as well, I might be the oldest person in this room. But, as I expressed before, the more I listen to people like Julian Robertson from Tiger, Buffett and others like them and analyze their thinking and their approach and how they are



actually doing over all these years and decades - following a more long term approach and sticking to a defined investment view makes sense to me.

In business we carefully select our partners and ideally we do have trusted and long term relationships with for example our accountant or attorney, so when it comes to investments, it will be beneficial to come back to the same principles.

**Daniel Ades:** Trust is an important factor. When I started my firm six years ago, we wanted to follow what we call a 1980s style hedge fund. What we mean by that is that we explore an incredibly broad mandate. We want to be able to invest in anything we believe is a good risk/reward. The investors get full transparency; they can see everything that we do. So we communicate openly what we are doing, how we are doing it, and why we are making the investments we make. And at the end of the day if the investor still doesn't like what he/she sees, they can always redeem. So the core principle in terms of running our firm is to look for good risk/rewards regardless of a specific mandate.

The problem with that is that the institutional market seems to hate it, because they can't put me into a box. So for me, the issue is a bit different. We have our trusted relationships with family offices and high net worth individuals, and with now six years of a pretty good track record with a couple of hundred million dollars, we have all the compliance and SEC procedures, but still have an incredibly hard time getting institutions look at us because we don't fit in any one single style box.

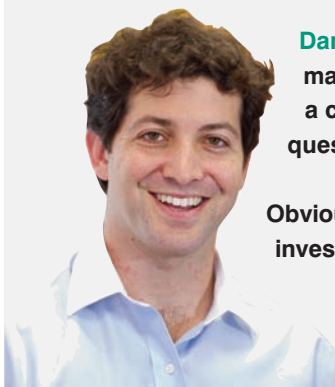
The conflict is obvious. For the decision maker on behalf of the institution, even if he likes what we do, his career risk is just too high: if we do well, his boss will think he is doing his job; if we do poorly, he will lose his job since he invested outside of the "boxes". So instead of evaluating the risk/reward of the investment, it becomes a decision what is the best risk/reward regarding the decision maker's job security.

That is a huge challenge I often think large institutions and pension funds face when they are investing. In my mind, people should look at investments and managers trying to find out if what the guy says makes sense. Do I agree with the actual investments? Then, they should come back a year later and actually find out and verify what happened to the manager's investments: did his views work out, was he right, or was he wrong? And over time, the investor will get a good idea of how managers think, how do they look at risk, how do they look at opportunities and then make an appropriate decision and manage their position.

But unfortunately, that's not usually what people do. We really strive for and want that our investors know us in depth, as well as we want to know our investors. We have over 170 investors in our different funds, and I don't think there is an investor in one of our funds that we don't know. Sometimes people see our returns and say, "these are great returns, I am going to invest, those guys aren't going to lose money". But this is not true, at some point we are going to lose money. People have to be prepared that we are going to make mistakes because we are humans like everyone else, and beyond that it is really about educating investors about what they should look for, because the fact sheet only tells you so much of the story.

Understanding the investment approach and rationale has become even more important as the increasing intermediation via advisors, private banks, multi-family offices or fund of funds has added up to three or four layers between the actual saver and investor and the individual investment manager who executes a strategy or trade. And again, most people that are in the middle of the process are not necessarily focused on what are the best risk reward trades, but more on how do I maintain my job, or how do I grow my AUM? And I think that's very unfortunate.





**Daniel Ades:** Right, but also the investor has to make the effort to really understand the manager. People shouldn't invest because of a specific track record. Analyzing a track record is a component of what you should do, and beyond that you as the investor have to ask the right questions.

Obviously we do have an investor relations team, but I as the founder and one of the PMs meet investors all the time. And my point here is that about 80% of the investors I meet ask the wrong questions. Of course, I make an effort to answer their questions, but each time I am thinking if I would be the allocator, I would want to know different things from the manager.

**Daniel Ades:** Walk me through your best trade, walk me through a recent trade, walk me through your worst trade. How do you really manage risk? When do you take action, and how?

People generally ask "what are your risk management tools?" But a tool doesn't mean anything! The right question should really be "tell me an instance where you were taking too much risk, and then you took risk off. Why did you take that decision? What was a trade where you should have taken risk off but didn't? Why did you not? What specifically triggers if you take an action based on a risk observation? Did your action manage to protect your portfolio in a significant way?"

You see what I mean? I can spend an hour telling about all these controls and beautiful things and bells and whistles we have in our fund. Systematic strategies are different, but in most human based investment strategies, what really matters is if the person who is taking risk in the portfolio is really making good risk/reward decisions? And that is exactly what people should be able to gauge. You really want to understand not what the manager did, but what is he going to do? If a year from now the manager will confront a particular risk/reward decision, are they going to make the right decision or the wrong decision?



**Monty Agarwal:** I wrote a book, '*The Future of Hedge Fund Investing*' back in 2009 that addressed this very problem with so-called institutional investors Daniel talks about. I believe there is a basic, fundamental reason for this phenomenon. If you think about it, at the end of the day, hedge fund strategies are basically strategies that mimic what prop traders have been doing on trading desks for years and years. All these strategies are run by traders. So who can best assess hedge fund strategies? It is people who have run trading desks and who have managed traders.



Now, have you ever looked at the resumés of the people running pension funds or the consultants of these pension funds? None of them has worked for a day trading even a penny. They are lawyers, accountants, relationship managers whatever have you. They have no trading expertise. And that is exactly why they have adopted a beta approach to the hedge fund industry. This whole bucketing concept is in the end a beta concept. Which geography do I put you in, which asset class do I put you in? That is not what alternatives or hedge funds are about – it is not about geography or a bucket, but

rather what is the strategy and what is the specific risk profile of that strategy? That would be a better way to bucket it.

However, this fundamental problem comes from the fact that the people who are managing these vast assets and people advising these pension funds have never traded in the alternative space. How will they be able to come up with the right questions?

Similar to Daniel, that was my frustration as well when I started my hedge fund back in 2003. You walk into a meeting and how many times do you hear the wrong questions, even if they come right out of the AIMA document. And quite a few times we ended up receiving an allocation from the investor, even though we knew they had not really understood our strategy. This is a good discussion and I hope we are helping investors ask the right questions, because, these issues have in the end led to the whole Madoff crisis and a lot of similar problems.

**Marc Lehmann:** Michael talked about the problem of noise that investors are facing today. We try to be a medium and long term investor, and we feel that we actually benefit from such noises in the markets. For example, some people use statistical trading platforms that occasionally end up feeding on themselves. They may have signed onto these electronic platforms because they took a one day “trading” class or read a book, and they may start shorting a stock because it broke some line. They don't understand the fundamentals of what they are investing in or trading, and are creating price distortions. For us, these distortions represent great opportunities.

I also agree with the issues around institutions not really understanding a hedge fund strategy as Daniel and Monty have described them, and it is a huge problem. We are lucky in that respect because the majority of our investor base have worked in the business; he or she is either currently or previously at a hedge fund, an investment bank or a high net worth advisor. They usually trade a part of their own money, so we typically don't have that problem with our current investors. But, we have met with some investors that sometimes can display cognitive dissonance.



Some time back we met a Miami based real estate investor, and he told us that he doesn't like the markets because he doesn't like volatility. When I asked him how he has dealt with the volatility of his real estate portfolio, he said “well, I get cash flow, so it doesn't matter.”

I found it outrageous how some investors are in fact able to cope with a decline of real estate prices of 40% or 50%, but do not want to deal with the volatility of the stock market or with hedge fund investing. There is a certain level of resiliency towards volatility, but when it comes to hedge funds and the stock market, they feel different. Somehow they feel empowered by price quotes on Yahoo Finance or whatever platforms they use to look at price history and make judgment without proper fundamental analyses. That can create a bias against hedge funds, but that can also add to behavioral issues in the market that can create more opportunities for professional investors.

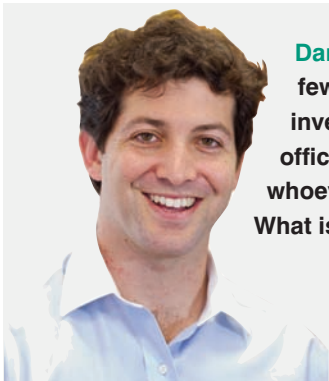
In regards our earlier discussion about how to deal with drawdowns, I will quote the great philosopher Mike Tyson, who said “Everyone has got a plan until they get punched in the mouth”. That is what seems to happen, investors talk about a long term plan and then they get punched in the face but they somehow forget about it. The “punch in the mouth” taken by many investors over the last decade has pushed many to make decision in conflict with their own best interests.

**Julie Neitzel:** Marc spoke about real estate investors, and throughout my career I have worked with them on and off for the last 20 years. Typically they are barbell investors, meaning that they hold cash and real estate and rarely other types of investments. You can try to convince them about different types of strategies and the benefits of



diversification, but good luck with that! So Marc, what you experienced with that real estate investor is not unusual.

The other thought that I wanted to share with you following Daniel's and Monty's observations on the challenges when trying to bring across your strategies and ideas to institutional or different types of investors. I think it is important, and this would be my recommendation, to make sure you make an effort to really understand your investor in terms of how they approach an investment. It is correct that particularly in the institutional space, investors tend to be more process driven or more formulaic in terms of how they are going to allocate their capital. If you don't understand their procedure to analyze possible investment strategies, it may feel like they are trying to put you in a box somewhere, but that is their defined process which you need to follow for consideration of your strategy.



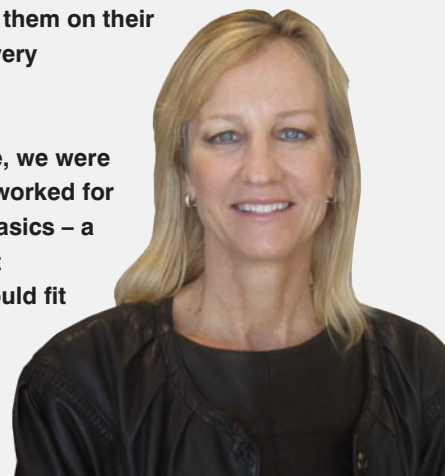
**Daniel Ades:** I absolutely understand that a process is involved, I just tend to think that quite a few of those investors do have an inefficient or in fact the wrong process when analyzing an investment. On the other hand, we actually have a tremendous amount of success with family offices because they generally have more discretion, especially when the owner of the money or whoever is the ultimate decision maker is looking at us and decides this makes sense to him. What is really challenging or introduces some inefficiency in the process is if this relationship gets more distanced. So, the more intermediation, the more people in between and the greater the distance between the end investor and the manager, the harder it is to make an investment decision based on the right reasons.

**Julie Neitzel:** You are right in that respect, it's like the game of telephone. If I say something to Marc, and he passes it on around the table, by the time it gets to Matthias, it will probably be totally diluted or different in terms of whatever the original thought was. But having said that, I do think managers need to make the effort to understand prospective investors very well in terms of how they approach and integrate them into their investment plan.

For example, individuals or families generally have two investing buckets, one is for lifestyle and then the other one is more growth oriented, and if there is an investment that you want to present to an individual it is important to note if they have capacity in their growth bucket, because their lifestyle bucket is meant to fund their ongoing lifestyle expenses, and many types of strategies might not be appropriate in that context.

I agree with you that most consultants that are advising their institutional investors on making these investment decisions have never spent five minutes either on a prop desk or let alone managed a strategy or capital. So again, it is a language or communication issue. You have to try to reach them on their communication basis or speak their language to get your point across. I know it's very frustrating, but that's just the reality.

By way of example, I worked in the private equity arena for three years. At that time, we were raising a new fund and when I was presenting our strategy to the consultants that worked for endowments and foundations, I found out very quickly that I had to start with the basics – a primer 101 about what is private equity and the merits of this asset class. After that discussion I could take them through the specific strategy of the firm and how it could fit into their asset allocation. I found that frustrating as well, but nonetheless, these were the people that were going to make the decision, and it was in our best interest to do all we could to educate them, so that maybe they could get to the point of understanding the value of investing with us.



**Daniel Ades:** I talked a lot about risk/reward, but we haven't talked that much about the risk dimension, which is fundamental as well. People have different perceptions of risk, and I believe it is helpful that investors are really aware and conscious about which of the three basic types of risk they are taking. These basic risk dimensions are duration - how long you are going to hold the investment, liquidity - how liquid is it, and credit risk, which is how likely is a permanent loss of capital.



All investments include a particular equation between these three different forces, so each investment includes different nuances of these risks. And if an investor is going further along the risk curve, they are taking more risk, also in the other two types of risk. So for us, the other area of friction when talking to prospective investors is often around risk. We sometimes see that investors don't realize the risk they are taking in the other two areas of risk, because they have a simplified, one dimensional perspective on risk. We really try hard to educate and to explain, but sometimes you can get a bit discouraged, and then I am grateful of the fact that our fund has now become large enough and we ourselves own 25% of its assets because we reinvested our returns and performance fees. That makes life more comfortable, and in the end investors are welcome to invest with us as well as they are welcome not to invest.

**Pratik Sharma:** We have discussed how some investors have a structured process to evaluate a hedge fund manager or a hedge fund strategy. We like to flip that around and evaluate our clients using a comparable level of due diligence. As managers, having investors who don't share your investment philosophy or time horizon can be a major challenge.

So for us managers, there is a non market risk that we take, which is a redemption risk. Our firm runs concentrated portfolios. In a market that can be volatile and where liquidity waxes and wanes, redemptions at the wrong time can be detrimental to the business.

Therefore, the onus is on us to be as diligent when we are evaluating potential partners as investors are, or should be, when they evaluate potential investment managers.



**Julie Neitzel**

I also want to comment on the impact of the increasing regulatory requirements on the hedge fund industry. Also, in their due diligence process, investors want to see state of the art operations and execution of the strategies, which in my estimation will continue to add higher costs to operating your businesses. I am curious about your views and experiences here and how do you address these issues in running your business model?



**Michael Levas:** I serve on the Regulatory and Government Committee of the Hedge Fund Association. You are right, there are a number of issues we have to deal with on behalf of the association and hedge fund managers. For example, legislation like Dodd-Frank is not complete, and this will continue to exacerbate cost in many areas: trading costs will go up, risk management, legal and compliance, even in research and development. For example, the regulators will want to be looking at your algorithms. You and the firm you represent will have to explain what this algorithm does that you are using, and if you are unable to explain what it does, then there is going to be an issue with that from the regulator's point of view. I just continue to see this without question as an example of one of the many issues to deal with, and of course this will be impacting the business in many different ways.

**Julie Neitzel**

What is your perspective on hedge fund inflows? I saw a statistic recently that hedge fund inflows until the end of the third quarter of 2012 has been the lowest inflow since 2009.

What is your view on that? Are investors holding off allocations to hedge funds because of the negative returns in 2011 and low returns in 2012? And how do the smaller funds cope with this situation?

**Marc Lehmann:** The procedures that many investors follow since the 2008 crisis make it difficult for smaller managers to start and to grow. The safe decision is to go with a larger fund, and that is the decision people typically make. This happens not just in our business but in every business despite multiple studies that consistently say that smaller managers tend to outperform larger managers.

Pratik brought up the importance of being a contrarian, and from that perspective you could say since that money has slowed down we are at, or close to, an inflection point. It has been a difficult decade not just for hedge funds but for markets in general, and once that turns around, a lot of opportunities will be created. There will be fewer people competing for those opportunities.

The allure of fixed income has also been so great that people might have already taken it to the extreme. While it has obviously been a great asset class over the last few years relative to equity, I wonder what investors will now view as their alternative to fixed income with the 10 year below 2 percent. People with outsized fixed income allocations will ultimately have to start looking in other buckets for returns.

So while we are not happy with the challenge in raising assets, we are excited about the opportunities the markets present us, and as over time we take advantage of them, our strategy will resonate with investors.



**Pratik Sharma**

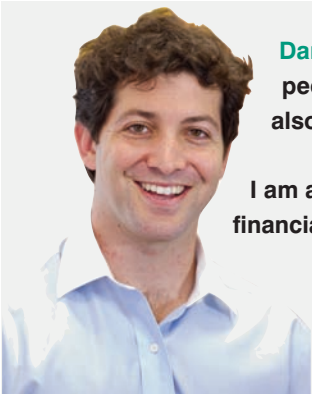
With 10 year US Government debt yielding less than 2%, you're essentially talking about return free risk. Low interest rates were something we also witnessed at the beginning of the 21st century. Policymakers' objective was, and is, to induce people to take risk. It's not totally working as planned in this instance, but if we see a repeat of the early 2000s, then the type of environment where two guys with a Bloomberg terminal can raise half a billion dollars and be up and running in six months could return.

However, I don't necessarily see it, because what the investment communities witnessed in the first decade of the 21st century has really scarred a lot of people for life. You are seeing it in the velocity of money data and how transactions are just not clearing. Things seem to take much longer and the animal spirits from the early days have definitely been dampened.

I scratch my head thinking about what could rekindle those animal spirits, but it's a Catch 22 because in terms of allocating capital we are seeing many attractive opportunities. But the forces that result in these opportunities being available also make this a less hospitable environment to raise capital.

**Daniel Ades:** I actually disagree with that people are not taking risk right now. I actually think people are taking a tremendous amount of risk, but we are not getting rewarded for it, and people also don't realize it.

I am also taking the opposite view saying that I don't think things are attractively priced. I believe financial assets are in general very expensive. My biggest challenge is investing money because there is more money than good ideas out there where to put capital. In my view, we are actually in a massive risk on environment. Maybe it's an unintended risk on environment. Let me give you an example. When you could buy a bond and get 7% and you make a mistake, the interest that you were getting would compensate for your mistakes.





But in this environment where the five year treasuries are at 70 basis points, you will only make 3.5% total return for five years. And if with one investment you make a small mistake and lose 3.5% of your money, it would have wiped out your entire return.

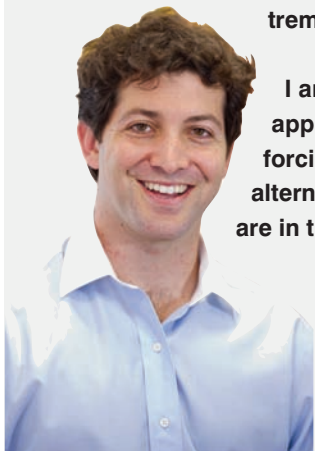
**Marc Lehmann:** In the realm of corporate credits, I agree with Dan that things are getting expensive. Nevertheless, there is an interesting bifurcation between opportunities in fixed income and those in equity. We often see situations on the equity side, with companies trading at three and a half or four times EBITDA with a high free cash flow yield, while we find high yield comps that may or may not have public equity, but they have five times debt to EBITDA, yielding mid-to-high single digits. In one particular case we know, the company is sitting on a net cash of \$3 a share and trading at \$10, or a three times EBITDA and high teen free cash flow yield, while one of its competitors has five times debt to EBITDA, and the bond is traded by 8.5%.



So I guess it depends on where you are looking. There has certainly been a massive rush into high yield, with high yield absolute spreads at the lowest level ever and bankruptcies pretty much at the lowest level ever. So to your point, people are buying into high yield at 600 basis points or wherever it is today, and you can argue they are not getting compensated enough.

**Monty Agarwal**

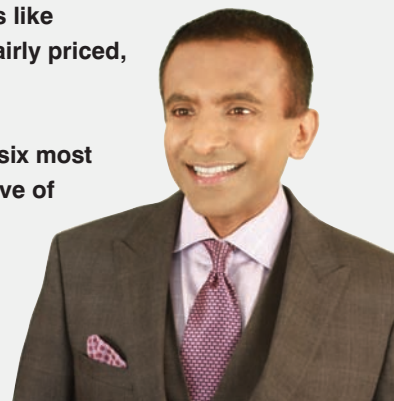
**Daniel Ades:** Credit is definitely the most outrageously expensive space, but I don't think it's the only one. Regarding equities, my view is they are correctly priced. Given the uncertainties the world is facing, I believe that equities in general are reflective of those uncertainties. Our fund had 20-30% in equities and we have almost nothing right now, but I can totally see why someone would buy event driven equities, we know you guys that are good and you did a tremendous job there.



I am sure there are outliers out there, but in general I think most asset classes are either appropriately priced or very expensive. And with the zero interest rate policy, governments are forcing people to make bad investment decisions because they don't have options. It is the lack of alternatives that cause people to make irrational risk decisions, however we need to remember we are in the business of managing risk. So in my analysis, the average investor, the average pension fund or insurance company is making very poor risk/reward decisions on the capital that they are allocating without the benefit of a certain base yield to protect losses. So again, I disagree with the statement that we are in a risk off environment, and I actually think people are taking tremendous amount of risk, it is just a matter of them being aware of the risk they are taking or not.

**Monty Agarwal:** To Julie's point about the low level of inflows into hedge funds, yes there is a lot of money sitting on the sidelines, and Daniel is right too saying that by putting money in bonds at 1.7%, they are actually taking the wrong kind of risk. But I also believe that a number of sophisticated investors like sovereign wealth funds realize those things, they realize a lot of the asset classes are fairly priced, so they are looking for opportunity elsewhere.

For example, let's look at short term volatility for a moment. We created an index of the six most commonly traded commodities of most managed futures strategies. The cumulative move of that index in the short term like i.e. daily holding period, weekly and monthly has increased year after year. The annual moves have not moved much since 1990, but the shorter term moves have increased. That for example is an area where those investors see the value – capturing short term volatility through smart algorithmic strategies with short term holding periods.



The daily move in our proprietary volatility index is 195% over the course of a year, so a smarter strategy would be trying to capture that 195% return in a year. Compare that now to traditional buy and hold investing where the annual move is in the 15% to 20% range. The opportunity set is clearly greater as you move down the holding period curve.

These are some of the shifts I am seeing, that some investors are going from traditional investing like “do we buy this equity sector, do we buy this bond sector or this set of commodities?” into pure short term trading strategies.

**Maxime Dupont:** Julie asked about inflows and the inflows that were slowing down. For me, there is only one explanation, which is that the investors don't find the products that they want. Some will have found that the product they used to invest in was more risky than what they thought, so they may have switched to something that may bring them more comfort.

In order to propose investment schemes that appeal to investors under such circumstances, we don't have too many choices. One way is to complicate things and make them much more complex and sophisticated. But then we may run into the problems Daniel has described, that not all investors can really follow what you are doing. So if things get too sophisticated and trading gets too advanced, then investors or not all type of investors will step into it, or they are not in a position to catch all the subtleties of what is being done on the risk management side. But you as the manager, this is how you need to do things because it gives you the best reward and risk return.



I very well understand Daniel's position when he says he and his team are happy to own a quarter of the assets of his fund, and if investors want to join, they are welcome, and if not, then it's fine as well. We have made similar experiences and found we would raise much less assets than before when we were running simpler products that were just based on trend following and easier to understand. And when we started to do things that were more sophisticated, we then paradoxically started to step out of the investors' radar. And the only way we found to reap the benefit of our strategies was to start trading for our own prop account. That means if we wanted go into what we believe is the the right direction and develop what we think are really cutting edge strategies, we had to become a prop trading firm.

It is better understood now that investing for the shorter term has less risk, and that is why it is flourishing. Your holding periods are shorter, you may not hold positions overnight and so you can escape faster if there is trouble.

There comes an interesting dynamic into play when you manage your own money via prop trading. I believe you probably dedicate 90% of your research on beta management and risk, because the risk of drawdown has another quality then. That risk can be more acceptable for an investor who is allocating to you within the diversification of his investments, but when you have most of your assets in your prop strategy, you are not looking at a risk of drawdown, because it has become a risk of ruin now. So you avoid any extreme concentrations and in general develop very advanced techniques.

So again, coming back to Julie's question about the reduced inflows into hedge funds, maybe it is because investors don't find a classical product that feels comfortable to them, along with an acceptable level of risk. But the paradox is that if we provide to them something which is less risky, it needs to be more sophisticated, however then they may not understand it, so they won't invest in it.

Again, the solution we follow at Quantam in serving external investors is to leave the alpha drivers relatively simple to understand (like medium/long term fundamental trades), and on top of that add a layer of fast beta management systematic strategies to drastically mitigate drawdowns. Complex

hedge fund alpha engines should stay at the prop trading level, or for very specific investors only, who understand well what it is about. But this type of trading may not be suitable for asset management anyway - due to capacity limitations.

### Matthias Knab

You are all based in Florida and run your business and your operations here. How is being based in Florida serving you?

**Julie Neitzel:** I am going to speak about South Florida specifically, because Florida is a very diverse state from the West Coast to North Florida which is like a totally different state. And North Floridians feel Miami is like a different country. From the outside you wouldn't think so, but Florida is very diverse.

Miami is almost a world on its own, it is a very global market. Being a gateway city, we have a very big Latin American influence here. There is a lot of inflow and outflow from Latin America, whether it be funds or fund managers.



### Julie Neitzel

A couple of months back I was on a panel at a Latin American real estate conference, and it was amazing how many fund managers from Brazil, Chile, Argentina, and Mexico attended and how much interplay there is between Miami and really the rest of Latin America. But Miami is also a gateway to Europe, there are many Europeans here as well as Canadians, particularly up in Broward County. Also, when you look at everybody sitting around the table here today, this is a reflection as well of the diversity of the South Florida market.



**Pratik Sharma:** There has been a number of high profile hedge fund managers who have now relocated to Florida. I am a recent transplant to Miami myself, and there are a quite a few others who are well known but prefer to maintain a low profile. I see a good number of firms setting up operations down here. Miami is hard to beat when you combine lifestyle with the cost of living. People may not actually think that living in South Beach is cheap, but compared with Manhattan, it's dirt cheap.

### Pratik Sharma

I like the networking aspects that happen in any hub like Miami in our case. None of us has really ever met one another, so this Roundtable is also a great networking opportunity. Over time, a good working ecosystem can get established with a growing talent base. The venture industry has been doing that for the last 15 years with the Annual Venture Conference they host not only in Miami but in Palm Beach and other parts of the state. Over time, that has grown into a sizable ecosystem, and I believe the hedge fund industry has the same opportunity with its tremendous talent pool that is dispersed across the state.

**Maxime Dupont:** I totally agree with you, and that is why our firm has joined an initiative called Traders Alliance. We rented and set up a nice office in the center of Brickell for 20 or 25 spots, extendable. The idea is to create a kind of a village of prop trading groups that can unite their forces to share costs like rent and the redundant fiber optic internet access they need to have in order to operate properly.

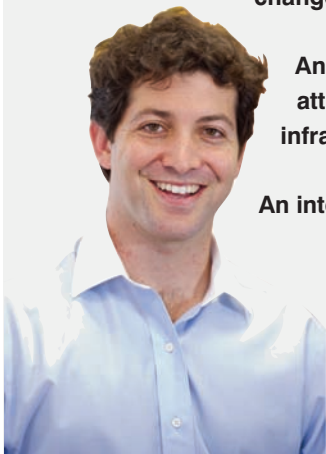
The stability of your operations is put to test with each due diligence visit of prospective investors, so it is helpful for all of us to do these things right. We started the project in this year (2012) leveraging on exactly the conviction that Miami is a great place to live and to trade. And there is still enough to offer for other industry members to come and to settle here easily and at reasonable cost, either to establish headquarters or a simple satellite desk. So, we hope that the industry continues to grow and more firms, traders and also emerging managers make Miami a real trading place, which it deserves.





**Daniel Ades:** I enjoy living here and it has been great for us as a firm. We can see the difference from 10 years ago to today, especially when we hire analysts and build up your staff. Even compared to five or six years ago we see a major difference. If you are a manager, Miami was always attractive because you pay fewer taxes and enjoy a great quality of life. However back then when we wanted to hire a junior analyst or even a top talent, it wasn't that easy because they prefer to be around the ecosystem of other analysts. But now, the community has developed and that makes it easier for hiring.

We have also a number of very good industry and investor conferences around here and Palm Beach, some major events are taking place in South Florida. Over the last 10 years, Miami and South Florida in general has really changed, I can really see that as I have been here for a long time.



And as taxes go up in the US, which they inevitably will, that makes Florida an even more attractive space for managers to be in. In the past, another big downside used to be infrastructure.

An interesting tale on this: about one year ago we got featured in 'The Wall Street Journal' and following that we received a call from a friend who was excited about it because for once a Florida hedge fund hit a major newspaper and it wasn't because of fraud! Over the years, Florida has had a number of frauds, and that's very unfortunate in terms of reputation. So, the more we have real managers doing real things and actually generating good risk rewards, we can all work together to dispel that image. And I think that you can visibly feel that shift over the last 10 years.

**Marc Lehmann:** I have been here for about two and a half years, and we launched Riverloft Capital 19 months ago, and we continue to see people migrating down here. Some time back, just a few of us started to organize quarterly dinners just to get people together, and I have been surprised at every dinner by new people showing up. Sometimes the folks you meet are kind of semi-retired trading their own accounts, but more and more we are seeing people launching new funds. For example, one of the people I know will be launching a healthcare fund down here any day now, and around Palm Beach you have another community forming.

There are also other strong industry dynamics working here in South Florida. I am not sure people around the country and around the world appreciate that there are a good number of market leading private equity shops down here that are active in the middle market segment, and many of them deliver some of the best returns in that sector globally. These are firms like HIG, Sun Capital, Trivest, and then there are other offshoots like Brockway Moran, ComVest, and Platinum.

We do a lot of fundamental research and we know the guys at most of these shops, so we get a lot of value having relationships with them. The other factor is that in South Florida you have an impressive number of individuals who own mid-size to very large family businesses and are either semi-retired, retired or they may have chosen to live and work here for the quality of life and tax advantages. Obviously some of those people are only here seasonally and they are a bit fragmented all over South Florida. But then again, South Miami to Palm Beach is only a two and a half hour drive, and more importantly, it is in a way a more relaxed and easier environment to meet people than in places like New York, for example. There, people tend to be more guarded, whereas here you can meet someone over some Mojitos -- it is a much easier place to meet and build relationships.

In that respect, South Florida is a tremendous resource for knowledge and talent. People may believe we are tanning or swimming in South Beach, but the reality is very different, if you think of all the businesses and money that flow through here. That is certainly the reason why all the big banks have sent armies of high net worth

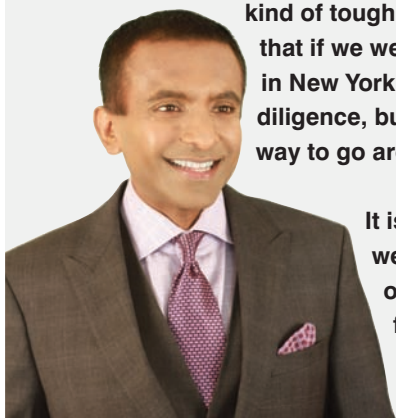


advisors and professionals down to South Florida to capture that money which ultimately came from the talents, the knowledge and the businesses that those people have started. We have been able to expand our network that was pretty standard and based on lots of New York-centric relationships and given it a new dimension by growing it locally. It has been very helpful in our research process.

Being here also allows you to think independently, you don't get overwhelmed by the chatter of traders that all crowd up in New York. Though we do get a 90 day period where a majority of the investment conferences are held in South Florida. Some of them have started already in December, but usually in January, February, and March, you see the invasion of investment banks and others with their conferences in South Beach and Boca Raton.

We also have mega events like the boat show and Art Basel. There are periods during the year where you can see a good number of individual investors and institutions. Of course, if you live in New York the visitor flow is more consistent and throughout the year, and here it is a bit more concentrated during this four or five month period of the year. In any case, in our experience, almost everyone makes it through South Florida at least once a year; it's a great place to be.

**Monty Agarwal:** We started the first hedge fund in 2004, and we have been in Palm Beach Gardens for about 10 years now. And yes, institutional investors may come here and often in that period from November to March, but it is still kind of tough. They tell you "okay, we have you on our list, we will come down", but it is just clear that if we were in say New York or Chicago, it would be much easier. We do have a marketing office in New York and there are certain things you can do in order to accelerate the process of due diligence, but being based down here, it definitely takes time, and for the large investors there is no way to go around it.



It is also correct that a lot of high net worth individuals are in Florida, and for that reason we also have a lot of wealth managers, asset managers, and advisors. Florida is probably one of the best places in the world to capture high net worth investors and probably family offices, but less the institutional market. But that plays very well with products that are retail oriented or target these intermediaries for the high net worth industry.

There are a lot of high net worth investors here, but one of the challenges with the HNWI market is that there isn't an easy way to find these individuals. It's not as if one can look them up in the phone book.

**Monty Agarwal**

That is why you need to go through the intermediaries like wealth managers, advisors, or family offices, and there is a huge concentration down here.

**Pratik Sharma**

But aren't we then back to the issues we discussed before that the intermediaries or gatekeepers tend to go with the larger funds?

**Matthias Knab**

Let's ask Julie, how does your family office screen and select external managers?

**Julie Neitzel:** GenSpring has a centralized investment group that screens managers, travels and meets with them. Then once a manager is deemed appropriate for client portfolios, then they monitor the fund performance/activity monthly.

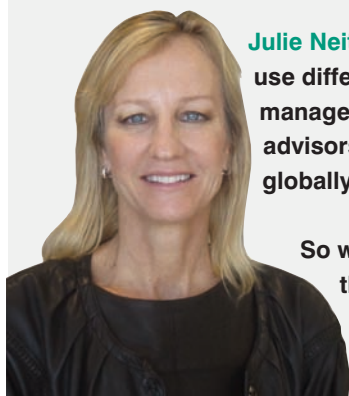
The investment team has very specific processes for their sourcing, due diligence and monitoring work. As one might expect, there is not a day where our firm is not contacted by a manager, a strategy, a fund, because a multi-family office like ours represents many investors, and so it is a logical place for fund managers to come to.



As you know, there are so many managers out there so that you can't do an in-depth analysis of all of them. You have got to kind of pick your places that make most sense for your investors and define the areas of your investment platform that you want to populate.

Matthias Knab

How many managers are on your approved list?



**Julie Neitzel:** We cover about 200 managers in every strategy, from fixed income to alternatives. We use different tools for our screening process to go through the data of as many as 20,000 fund managers. I do believe it is a challenge for a smaller family office, institutions as well as for advisors to properly manage this flow of possible managers and solutions that are available globally.

So when you are knocking on the door of family offices or registered investment advisory firms, that is a situation they are challenged with. They simply do not have the time to speak to every manager. It is important to have a relationship or find some other way to get attention on your investment strategy.

Matthias Knab

Do you have typical requirements like size or a minimum track record?

**Julie Neitzel:** We do have certain criteria, however we are not solely looking for three or five years of audited statements, which is typically what you would find with an investment consultant. For example, we have funded managers when they left an institutional employer and wanted to take the next step and set up their own shop because they felt constrained and not able to best execute their strategy. We have seeded some of those managers, or asked managers to build solutions we felt were specific for our clients.

We tend to remain open about how we approach the managers, but there is process around it. Clients are looking for sustainable investment solutions. That is also why on the level of the manager having a process and having some repeatability in what you are doing is really important. Having a few lucky trades is not a sustainable strategy. For that reason investors that come from the advisory and fiduciary side of the business are so keen on your process and procedures, which can feel at times like you are being boxed in.



Matthias Knab

Paul, you have been offering insurance to hedge fund managers since 2000. What are some of the changes that you have seen over this time? I also understand that insurance for hedge fund managers is driven by institutional investors, right?

**Paul Grassi:** If you go to Europe, probably 80-90% of the managers there have what we call the E&O / D&O Insurance. It is very prevalent there, whereas here, not as much. When I started in this sector 12 years ago, very few managers were insured, particularly emerging managers. Also, the larger funds at that time were not quite as large as they are today, and the investor base leaned much more heavily to high net worth individuals rather than institutions.

Today, you find that box in any due diligence questionnaire that asks “are you insured?” But it should be more than



**that: what are you insured for? Who are the carriers? And with the Wells Fargo name on that certificate you will have more sway than through a smaller broker, and carriers such as: Travelers, Chartis or CNA will have more sway than smaller carriers. Also, what are the limits? Does the manager have adequate insurance limits?**

**We are covering a broader array of exposures. Cyber and privacy issues as well as employee fidelity, ERISA, etc. With Dodd-Frank, more and more managers are getting registered providing more and more interest in professional liability. I think that trend will continue. That trend also reveals that while more managers are getting coverage, existing managers are also increasing their coverage. As such we build coverage towers or silos where large limits are provided by multiple carriers. These silos are scalable to increase along with the manager's asset base.**



**Our clients are hedge fund managers, fund of hedge funds and advisors that typically run between \$15mm and \$15bn. Working with our clients, we aim to create what I call a three-legged stool model between the carrier, the client, and ourselves. What I believe we bring to our client base is very high level access not just to the carriers but to the most senior underwriters within the carrier's financial institutions' group. For example, we can work with our clients and their lawyers to help create or manuscript the appropriate policy language. With such a broad base of clients, we truly understand "market pricing" at any point throughout the year. As a result, we are in effect, continuously negotiating terms and conditions for all of our clients throughout the year.**

Smaller insurance brokers simply do not have as much leverage and consequently do not have access to the right people to make that happen. Still other insurance brokers run almost like a high frequency shop in how they work. The model is to attend a lot of conferences, get a bunch of business cards and try to send an avalanche of ill-prepared submissions to multiple carriers hoping for a success rate of about 20%.

Our model is completely different. We do virtually no outbound marketing and few sell side events unless our clients request our attendance. Our prospects are typically introduced to us by their trusted advisors and other clients. We do really well at qualifying risks both at the client level as well as the carrier level. Let me explain. After detailed consultations with our prospects, sometimes for as much as a year or perhaps more, we present a very detailed submission to the right carriers with an appetite for their particular strategy, performance or AUM level. This provides targeted carriers with highly qualified, highly motivated buyers. As a result both the prospects and the carriers are very engaged (again the three legged stool approach) and put together a deal that works all around. We much prefer to deploy our considerable resources effectively to maintain relationships with clients and carriers than use a shotgun approach to growth.

Having Wells Fargo Bank as a sponsor is of great value because we have an amazing resource base of professionals, claims advocates, staff lawyers, expert networks and things like that. We can also make introductions to our broker dealer, fund administrator, treasury, custody, asset management groups and more. With that we are able to bring a lot more value for the same commission that you would also pay the guy down the street.

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# Helping asset managers minimize risk



The management and professional services liability exposures for alternative investment managers may continue to increase in response to the ever changing and challenging regulatory environment.

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