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Opalesque Roundtable Series '14

ZURICH

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Editor's Note

Equity investors have been dancing on thin ice and it's difficult to say how long the ice holds. Alexander Ineichen says he is certain that at one stage the hedged approach will reveal itself again as more intelligent than a long-only approach: "To stick with the metaphor: A long-only investment style is like dancing on thin ice, while a long-short investment style is like dancing on thin ice wearing swimmies: it might look odd at times but it's safer."

Despite rallying equity markets, these are not times to be either "all-in or a contrarian". Some hedge fund managers have started to call themselves "reluctant bulls" because of these market dynamics. Still, for the majority of investors, the most important question is what to do with their bond exposure. The debt issue has not gone away. While in the late 1990s and early 2000s we saw a move from equities to alternatives, at the moment assets are moving from bonds to alternatives.

We shouldn't forget that $100 invested in the S&P 500 Total Returns Index in January 2000 grew to only $148 by September 2013. The same $100 invested in the average hedge fund portfolio grew to $218. People tend to forget that halving your wealth-- which stocks did twice in the last decade-- is not good for your long-term financial health.

Therefore, for a number of reasons, investors express enormous appetite for alternative fixed income strategies, absolute return or unconstrained approaches. The search is on for less conventional products and strategies based on select risk premia that offer maximum diversification, like catastrophe bond funds, volatility products, equity long/short, event driven, mergers & acquisitions, credit and corporate loans.

This Opalesque Roundtable, sponsored by Eurex, IDS and Taussig Capital, took place in December 2013 in Zurich with:

1. Alexander Ineichen, Founder, Ineichen Research and Management
2. Daniel Durrer, Head of Institutional & Fund Distribution (Continental Europe), GAM
3. Hansjoerg Borutta, Group CIO, Marcuard Heritage
4. Ian Hamilton, Founder, IDS
5. Joe Taussig, Founder, Taussig Capital
6. Markus-Alexander Flesch, Head Sales and Marketing, Eurex Zurich
7. Phoebus Theologites, CIO, SteppenWolf Capital

The group also discussed:

- **UCITS:** For many European managers, UCITS funds have been the fastest growing product segment over the last two years. UCITS has become something close to a 'must-have' label for many providers. But not each UCITS is a mega seller. What is essential to succeed in this space?
- **AIFM versus UCITS:** As costs and paperwork are onerous for smaller managers to operate under AIFMD, managers go with the fund format rather than the licensing under AIFMD.
- Global regulations cause a **"train wreck in slow motion"**: Most US managers are not aware they will need a person on the ground in Europe. Meanwhile in Europe, the end of the "one man shop" asset managers is near.
- How the **Scotstone Group** offers an AIFM umbrella for smaller managers
- **Consolidation as a win-win:** Why Arkos Capital is happy GAM acquired them
- **Small is beautiful, or getting comfort in great numbers?** How family offices decide if they should invest in an emerging or established hedge fund manager?
- Why you should **not be bothered when hedge funds "lag the stock market"**
- Why **Eurex Clearing's Prisma** is unique in the exchange world
- How managers from $10m to $1bn can benefit from **brand building and product extensions**

Enjoy!

Matthias Knab
Knab@Opalesque.com

Participant Profiles

(LEFT TO RIGHT)

Joe Taussig, Markus-Alexander Flesch, Ian Hamilton, Matthias Knab.

Hansjoerg Borutta, Daniel Durrer, Alexander Ineichen, Phoebus Theologites.

Introduction

Phoebus Theologites
SteppenWolf Capital

I am Phoebus Theologites, CIO of SteppenWolf Capital. We have been managing a German global-macro UCITS since May 2013, and are awaiting BaFin approval for a seeded fixed-income UCITS in early 2014. We also expect to launch two further German UCITS – an equity and fixed-income Mischfonds, and a high-conviction, concentrated cross-asset fund – in the first half of 2014. Our 8-person (soon to be 11-person) investment team comprises at least two specialists in every region, asset, style and/or instrument we trade, so as to both enhance team-wide interaction and mitigate key-person risk. We are headquartered in Luzern, but our team is also dispersed across London, Dubai and Tokyo to afford us both local-market and 'round-the-clock coverage.

Alexander Ineichen
Ineichen Research & Management AG

My name is Alexander Ineichen. I entered the financial industry in 1988, working mainly in derivatives research and research on what some people still call "alternatives". In 2009, I founded my own research firm. We offer two types of research: absolute returns research and risk management research. The former is for investors who outsource certain risk management tasks to third parties. The latter is targeted at risk takers and decision makers, that is, investors who have internalized risk management.

Daniel Durrer
GAM

My name is Daniel Durrer and I am responsible for Continental European distribution at GAM. I have been with GAM for 11 years now. I started my career at Swiss Bank Corporation where I worked in long-only funds distribution for around ten years. I then moved to the Cayman Islands where I broadened my experience in the hedge funds and private equity industry.

Let me give you a bit of background on GAM: The company was founded 30 years ago with the aim to provide private clients with Absolute Return oriented mandates, which included a large allocation to hedge funds. We started as a very small boutique which was first acquired by UBS, then by Julius Baer. Our offering traditionally was predominantly in private client mandates and funds of hedge funds. But over the last five years, we have successfully transformed our business model and overcome our private banking heritage. Today, our offering consists primarily in a fast-growing range of single manager funds managed in-house as well as external, and we work mainly with institutional investors or financial intermediaries.

In addition, we are now part of an independent, pure-play asset management group – GAM Holding AG, which was formed after the separation from Julius Baer's private banking business. The GAM Holding Group includes also the bank's former asset management business, now re-named Swiss & Global Asset Management and retains the exclusive license for the Julius Baer funds.

Hansjoerg Borutta
Marcuard Heritage

My name is Hansjoerg Borutta. I am Group CIO of Marcuard Heritage. We are a wealth management service provider located in Zurich. Our group was founded in 2003 and we run various offices globally, e.g. in Switzerland, Cyprus and Singapore.

I started as an economist and econometrician in 1987 and moved into banking in 1994, focusing on asset allocation, product development, and quantitative research. As Global Head of hedge funds for UBS Wealth Management I built up and ran a $60bn platform in the 2000s. In 2010, I joined Marcuard Heritage, which I enjoy very much. Our focus is on wealth preservation which leads to a strong affinity with absolute return investment approaches. Within our client portfolios we invest a significant share in hedge funds.

Markus-Alexander Flesch
Eurex

My name is Markus Flesch. I am heading the Eurex office here in Switzerland as well as in Italy for now 10 years. Before joining Eurex I was for for almost 10 years trading fixed income derivatives, as well as Equity Derivatives at Citigroup.

Joe Taussig
Taussig Capital

My name is Joe Taussig. We partner with hedge fund managers and family offices to create or acquire insurers, reinsurers, and banks where our partner gets to manage all of the Investable assets. Our most visible success is Greenlight Capital Re, which has $2bn in assets and is publicly traded on NASDAQ.

Two other companies like this have gone public and listed on the NYSE in 2013. One is Third Point Re, which went public in August has about $2bn in assets, and the other one is called Blue Capital Reinsurance Holdings. The asset manager receives management and performance fees for running the assets, and investors are invested in such vehicles because they almost certainty outperform the managers' funds and they get better liquidity than a fund once the company is publicly traded. When I checked about a week ago, Greenlight Re and Third Point Re traded at more than a 20% premium to book value.

Managers who can offer investors such vehicles also find that they can collect assets from sources they otherwise can't access. For example, Third Point Re. received $390 million from private equity firms that otherwise would never have invested in Third Point's hedge fund. In addition the hedge fund manager gains AUM from the premiums, which Warren Buffett calls “The Float”. Lastly, public shareholders include mutual funds and many institutions that have investment, tax or regulatory restrictions on investing in a typical hedge fund, but not in a reinsurer. Additionally, all of these assets are permanent capital.

Ian Hamilton
IDS

My name is Ian Hamilton from IDS. We started off in South Africa doing hedge fund administration, basically starting the industry there which has grown substantially. IDS also offers administration in Malta and Mauritius. In addition, I set up a Malta based company called Scotstone to help emerging or non-EU domiciled fund managers getting, through various platforms, access to the European market. About 30 minutes ago I got the news that we now also have our own AIFMD-approved fund manager license in Malta; but let me tell you that this is not something you can get overnight, it takes some time.

We also service a broad range of family offices in Switzerland who are investing into a number of our funds that we have on the various platforms. Over the course of the next six months we aim to open up the entire South African hedge fund market, which is a well-run industry, to international investors. South African hedge fund managers have been performing well and consistently over many years now, but so far it is still quite difficult for them access international capital. We will again do this through Malta, following our vision to provide many interesting investment opportunities for family offices and institutional investors.


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Matthias Knab As 2013 ends and we are looking into 2014, what are the things you are focusing on?

Hansjoerg Borutta: When a year with good market performance comes to an end, every investor's number one goal is to protect the gains made. In fact, the market performance this year was better than anticipated. 2012 was a pretty worrisome year with a lot of tail risks. 2013 was easier, but not really easy. As we are wealth preservation oriented, we did not invest at full throttle in the markets. Our asset allocation varied through the year and we took some money off the table when we achieved certain performance goals or we felt that it was necessary. It is no secret that there are still a lot of issues with respect to the real economy and the financial markets. So we are not following the current equity rally happily and blindly. We are cautious, but given QE and the zero interest-rate policies, a lot of money flows into equity and real assets, which we cannot ignore either.

We shifted our investment focus recently more back to Europe, thinking that the U.S. has run its course quite well for the time being (but there is surely more to come for the U.S. in the future). At the same token, we still see some risks in Europe. We have built up an exposure to event driven and mergers & acquisition funds, as there are many cash rich companies around that will probably start putting their cash to work in Europe. We have also reduced the long only exposure in favor of equity long short.

Because we have foremost wealth preservation in mind, we are always eager to be prepared for the worst case. Fortunately, we do not think that most of the tail risks we can think of are imminent at present.

Regarding out fixed income investments, it is fair to say that we have been on the short end of duration for the last two years. We moved also into the credit and corporate loans space that went very well for us. We are aware that these areas have become somewhat rich as well. However, as long as the default rates stay as low as they currently are, we are not overly concerned.

Daniel Durrer: We also see a certain degree of upside potential for European equities, and it is quite easy to understand why. There is also a lot of appetite for alternative fixed income strategies, including absolute return or unconstrained approaches or less conventional products like our catastrophe bond fund. The UCITS version of the latter was launched two years ago – the demand for it currently by far exceeds the capacity of our strategy which is why we have an impressive waiting list for the fund.

We continue to see strong interest for alternative UCITS, which has been our fastest growing product segment over the last two years. This reflects on one side the shift in demand from offshore to onshore funds – both private and institutional investors increasingly see UCITS as their preferred way to access sophisticated alternative strategies, because of the liquidity, higher level of investor protection and transparency offered by this fund format. For European investors, these products are tax transparent, and this opened up a new market for us. While in Switzerland hedge funds never carried a tax disadvantages and could be distributed to qualified investors under private placement rules, the UCITS regulation allows us to market our funds across Europe – and to a broad range of investors, not least because of the transparency available with UCITS funds.

UCITS has become something close to a ‘must-have’ label for many providers. Still, a

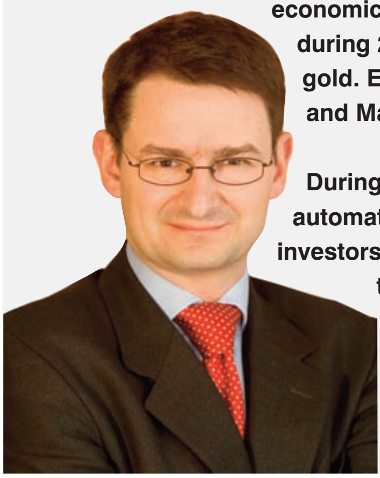
credible track record of proven investment expertise, sound investment management processes, a robust infrastructure, responsive client service and transparent reporting are essential to succeed in this space. Investors have a broad range of choices when it comes to the actual investment strategy – hence the UCITS label does not replace proper analysis on whether a product is suited to fulfil certain investment targets or represents the appropriate building block in an investor's portfolio.

The interest in alternatives shows that there is great demand for non-correlated strategies, despite rallying equity markets, and as an alternative to the large allocations many still have to traditional fixed income. This also explains the interest we have seen in our market-neutral equity strategies, managed by a Lugano-based team we acquired in 2012, formerly Arkos Capital.

Within 12 months of the acquisition, we have been able to double the assets in their low-volatility strategies, which are strong performers. One of their long-short strategies focusing on European stocks, was capped last summer at around EUR 1bn, to preserve its integrity. The emerging markets equity long-short strategy is gaining traction – and capacity will not be unlimited. The team also manages a convertible bond product and another long-short equity product focusing on the financial sector – a very interesting proposition.

Matthias Knab Are you affected by the restrictions of the UCITS' framework for certain strategies or instruments?

Daniel Durrer We carefully consider this question before launching a UCITS version of an alternative fund: is the format really suited to allow the strategy to unfold its potential? For instance, strategies that capture some sort of liquidity premia are typically not.



Alexander Ineichen: Over the past couple of years we have been applying a momentum approach to "things economic" in our subscription-based risk management research. This has worked reasonably well during 2013; being long in equities and avoiding many bond markets, emerging markets and gold. Everyone agrees that markets are not markets anymore. Markets are being manipulated and Martin Zweig's "Don't fight the Fed" applies.

During 2013 I was also reminded of Gil Atkinson (1827-1905), businessman and inventor of the automatic sprinkler: "If you're already walking on thin ice, you might as well dance." Equity investors have been dancing on thin ice and might continue to do so. It's difficult to say how long the ice holds. I'm quite certain though, that at one stage a hedged approach will reveal itself as more intelligent than a long-only approach. Again. To stick with the metaphor: A long-only investment style is like dancing on thin ice ignorantly while a long-short investment style is like dancing on thin ice wearing swimmies: it might look odd at times but it's safer.

Phoebus Theologites: I would like to add a few comments on market outlook. Let me start with the average SPX investor. In constant 1990 dollars, he is flat relative to 14 years ago. So when investors talk about capital preservation or high management fees, they should bear in mind that a passive investment in the SPX has returned nothing over 14 years in terms of additional purchasing power. In view of this, our goal is to generate real above-inflation returns, over an entire business cycle and beyond, and strictly within our VaR limits, which are set out in our regulatory authorization and monitored daily, both internally and externally.

Let me now come to Europe, where the average Euro Stoxx 50 (SX5E) investor has been hearing from the sell-side the same SX5E-SPX 'catch-up'/'convergence' stories for four years running. It remains to be seen whether this will occur at

all, given the Euro-zone's ingrained structural deficiencies and position further back on the cyclical clock, relative to the U.S. In the meantime, said investor is flat relative to four years ago, and down 30% since the pre-GFC highs. Every year, people like to rekindle their hope that 'this year is different' – and yet, only an active manager could have helped such investors make money in Europe over the last five years.

We position via a mix of cash/delta-1 and options. Since we do not like paying theta, except in rare instances and for very cheap options, most of our option-based positions are self-financing spreads. This means that we run some tail risk – but for now, we are comfortable with it, since the financial repression is continuing. Our practice has served us well, especially in skittish markets such as the Nikkei 225 (NKY), where our rolled 1x2 call spreads, given the upside skew, have allowed us to participate in the rallies, but also to escape 5-7% down days unscathed. We do not foresee such days in the SPX and the SX5E anytime soon, so to the extent that the outer strikes of our broken-wing butterflies and condors are far away, we are happy to use them to pay for our central strikes, around which we may also overlay more active delta-1 trading.

These are not times to be either all-in or a contrarian, and I very much agree with Hansjoerg's point: if your primary concern is capital preservation, you have to draw the line somewhere in terms of leverage and VaR, and be content with a stable, pragmatic, even high-single-digit return with bond-like volatility, despite unavoidable comparisons to indices which are up 20% or 30% for the year. So, while you have to participate in the markets and play the rallies, you have to do it responsibly, controllably, and without greed.

We are cautiously, almost reluctantly, bullish equities (in different degrees across the U.S., the EU and Japan), bullish USD, bearish rates (but long immunized corporate high-yielders), and long-term bullish on bullion (which we have called very successfully since inception). We are fully aware of the state of the U.S., EU and Japanese economies just below the surface, the persistence of anemic aggregate demand, and the secular stagnation which threatens to set in, but we have also never made the mistake of fighting the Fed, the herd, the tape or the algos. Our team members have 20 years in the markets on average, and in our brave new world, people our age have to adapt – or retire.

Just look at the number – and prominence – of managers who have exited the industry over the last 12 months. Erstwhile giants have found it impossible to adapt. This is a psychological issue. It has nothing to do with analysis, whether it's top-down or bottom-up. It has to do with one's ability to swallow one's pride and/or obstinacy, and realize that the old tricks of 20 years ago have been side-lined by massive monetarist intervention. Whether this leads to trouble later (as I believe it will) is a different story, which I am not going to go into now. I will finish with my third comment on the markets, before I move on to discuss UCITS.

One of the first things we discussed upon launch was that Japan was the latest newcomer to the central bank intervention game. On this basis, we sold substantial Nikkei downside, and used the proceeds to finance options positions in other markets. We are still long January NKY to 16000 (which is the outer strike of our 1x2 call spread), but we are also short the NKY/TPX ratio, and long a zero-cost downside condor, as crash protection. We like to position ambi-directionally (sometimes via calendar spreads) and trade the resulting range, taking profit opportunistically. In the NKY, which has the riskiest profile of the three main indices we trade, this is a necessity, not a luxury, due to the uncertainty surrounding Abe's 'third arrow'.

Coming back to UCITS now, the reasons we decided to go down this path, and specifically so in Germany, were: (a) investor preferences, (b) BaFin's reputation as a strict regulator, and (c) the availability of top-notch service providers. I agree with Daniel: if there is one space that is currently growing in Europe, it is UCITS, because going forward it will be harder for smaller managers to operate under AIFMD (the costs and paperwork are onerous), and also institutional investors themselves will mostly be unable to invest in anything but UCITS, due to their own internal guidelines (rather than due to regulatory or legal restrictions). The safety and transparency of UCITS are far superior to those of off-shore funds, so it is not surprising that total UCITS AUM are growing monotonically and rapidly.

Markus-Alexander Flesch: By talking to my clients and by assessing the trading volumes on derivatives exchanges in Europe and the U.S., I can confirm that there is a lot of flow and activity into the U.S. as opposed to Europe. There might be several reasons. Phoebus talked about AIFMD and the regulatory pressures in Europe which include the coming changes in the OTC arena. Also from my perspective, investors seem to perceive that the U.S. is offering them a more favorable climate than Europe, so that could be one reason.

Another reason is that irrespective of say the political situation, it seems to be that the U.S. is much more calculable for investors than Europe. As I had mentioned before, these things can also be seen in the mere reported volume figures. Irrespective of the economic environment in the U.S., which seems to be ahead of Europe any way, the perception of the client is that the U.S. is more let's say trustworthy than the fragmented area here in Europe. That leads to bigger inflows into U.S., even in 2014.

Matthias Knab Ian, can you comment please from your perspective about the prohibitive costs for managers to get an AIFMD license?

Ian Hamilton: It is interesting looking as to what is happening in Europe, and particularly with AIFMD, and again in Switzerland here as well, because I don't think this is just a problem of AIFMD – I am coming across Swiss managers who operate entirely below the radar, who are fighting about the fact that fund managers have to be registered or licensed now.

I, personally, am in favor of the licensing of fund managers, because it is for investor protection. And, gentlemen, we talk about swallowing pride, I think a lot of people are going to have to swallow their pride and not operate as one-man shows, and have to form proper groups for investor protection. It's interesting to see a lot of nodding heads around the table.

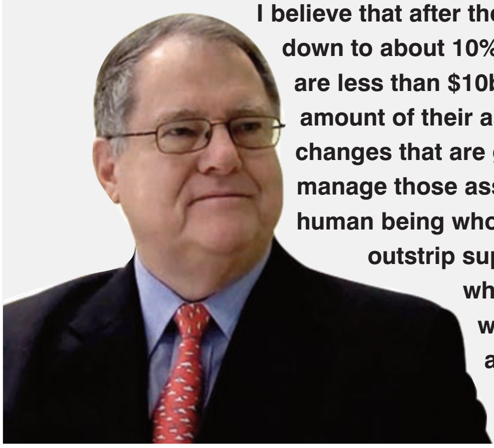
Given this, I look at it as an opportunity for the Scotstone Group, we have set set up our own asset manager which acts as the host for some of the smaller people. Standalone is expensive and I would hate to see increasing costs and regulation result in the ladder being pulled up for the future and the smaller fund managers.

Again, from my experience, we are seeing a lot of the smaller fund managers that left institutions in the past five years are now running fast growing fund management houses, and one wouldn't like to see that everybody is forced to remain in institutions.

But the one rule that I have is that we will not entertain people who are not licensed, whether it's in Switzerland or anywhere else. And it has been interesting during my short trip here as to how many people are complaining and not wanting to do anything. There is going to be an AIFMD and licensing storm in Switzerland, like in many other countries. I wonder how people feel about that...

Joe Taussig: Prior to the crisis, 20-30% of all global hedge fund assets came from Switzerland, and there was no restriction to doing business here for any manager. Your fund didn't have to be registered and the manager didn't have to be registered, as long as the buyer was not a resident of Switzerland. The managers could fly into Switzerland

and see the private banks who had assets from clients who were not residents of Switzerland, and could market their products.



I believe that after the crisis that Switzerland's market share of global hedge fund assets has gone down to about 10%, maybe even less. I believe one of the big private banks had $60bn and they are less than $10bn now. However, every manager I know in America still has a fairly significant amount of their assets from Switzerland, and I don't think that they have a clue about the changes that are going to come. At some point in the future, they will no longer be able to manage those assets unless they have a physical presence here. They will have to have a human being who is dedicated to their business, and the demand for these people will far outstrip supply. Every time I raise that issue with American managers, they are astounded when I tell them what's ahead of them. We are talking about very big managers with $5bn or $10bn and up, so if you just use the 10% metric I mentioned, we are talking about $500m or $1bn of assets, and they are absolutely clueless about the coming restrictions. Does anybody disagree with me?

Phoebus Theologites: I fully agree with Joe that it's almost like watching a train wreck in slow motion. Why? Because FINMA never made a secret of the future changes in Swiss investment law. On the contrary, they have been very open about it, and there have been numerous seminars, organized by banks and service providers, informing and warning managers about the changes – yet few managers have started preparing their FINMA regulatory applications so far.

I would also like to go back to what Ian very aptly brought up – which is why I was nodding when he was saying it: the time for one-man shows is over. The typical example here is that of a former private-banker-cum-asset-manager, who left the bank many years ago to go independent, taking a few clients with him, and whose performance may or may not have been good in the meantime, but that's beside the point. The point is that such operations no longer fulfil the audit-trail and record-keeping requirements of the regulator(s), and there is a growing tendency on the part of the latter to view this hitherto-unregulated sector as a bit shady, and in need of a shake-up or shake-down, as the case may be.

If you engage a prominent Swiss law firm to help with your FINMA application, you are looking at CHF 50-100K+ in fees, depending on complexity, including compliance and other necessary manuals in addition to the application itself. Why? Because the process takes months, not weeks, and the per-hour fees accumulate. In Germany, it has been our experience with BaFin that you can get a fund approved in just a few weeks, if they already know you from previous funds and if your administrator, custodian and auditor are top-notch like ours are. In Switzerland, on the other hand, FINMA is going to be swamped, since the country is small and FINMA's staff is correspondingly small. Here you are looking at six to nine months for approval – and you need to show substance, too.

A one-man show can no longer manage the substance required by the regulator, so the old private banker running CHF 100M at less than 1% management fee, and no performance fee, suddenly finds he needs at least an assistant asset manager by his side (to mitigate key man risk), as well as a compliance officer and a risk manager. And, to the extent he doesn't want to pay market salaries to the latter, these functions have to be outsourced – so add another CHF 50K or so a year for such service providers to come in, either for few hours a month, or for a day every quarter, to do and sign off the blotters and books. When you work out how many basis points your cost base will become, going forward, it is not surprising that managers are fighting the implementation of FINMA's proposals.

Who we are and what we do?

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

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Whether you're looking to launch a new fund, make a transition to a new administrator or simply wish to outsource some of your processes, we have a solution to suit your needs.

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Ian Hamilton: I gather that the Swiss authorities have hired additional 15 lawyers who are sitting and doing nothing, because nobody is putting in their applications. So I have seen this all before in other jurisdictions where fund managers actually bury their heads in the sand and hope that it is not going to happen or that it is going to go away.

There are solutions. For example, I can point to a similar South African experience, where we went through a comparable process, and a company like ours actually engaged lawyers to do this work on behalf of all our clients. We were able to cut time and a lot of costs for the clients. If you look at the legal work, a lawyer may just do one application and then try to replicate as much as he can for every subsequent one, but he charges everybody the same as what he did for the first one. I think there is quite a bit of scope for organizations to come forward here in Switzerland and help bringing more efficiency into this process. Where one starts in Switzerland, I don't know; I have been involved with these things for the last ten years in other countries.

Malta is also a very interesting case, because we have followed the same strategy as before in South Africa. We have engaged the lawyers and we are able to get our applications through, because the lawyers know their authorities, they know their way around. You don't want to go and take somebody who doesn't have that kind of experience.

I remember that last year at the Roundtable in Geneva we talked about similar things, and it appears that one-year later not much has happened. I was wondering if people are talking to the administrators of their funds and ask them for advice? My own view of an administrator that he should not just provide the administration side to a fund manager, but also should be partnering with fund managers and help prepare for regulation, as it will also have impact on the administration.

Matthias Knab How do these structural issues in the financial industry in Switzerland affect the family office community?

Hansjoerg Borutta: Obviously, we observe the situation very carefully and try to be prepared for any regulatory development that may affect us directly and also indirectly. But sometimes you can be well advised to take your time as well. At the time when new rules are being drafted, it is very easy to jump to conclusions and do your thing, only to find later on that you have to adapt again,

You can have very different approaches about how and when to react to regulatory changes, and it is very difficult to say which one is right or wrong. In the fund management industry we see both approaches, i.e. managers who try to be pro-active and others who behave more like the proverbial frog in the slowly boiling water, which does not realize what it is going on until it is too late...

The same is happening on the asset manager side, the so-called "Vermoegensverwalter" in German. I believe for the Swiss asset managers 2016 will be important as new regulation will most likely be introduced, if not earlier. They will have to adapt to higher standards with respect to critical mass requirements regarding compliance and risk management. If you run a one-man show with, say, $100m under management, I guess it will get tight to make a living out of that if you are required to expand your costs in order to be compliant.

Markus-Alexander Flesch: Regulations are of course the big topic. From our view, I would say that EMIR and Dodd-Frank are sort of well-established regulations in the U.S. as well as here in Europe. Unfortunately, and this has been mentioned today, the Swiss regulator FINMA is lagging behind, representing a big burden and threat for the Swiss financial industry.

Hansjoerg spoke about the asset managers' regulations, but also on the OTC side, FINMA has already delayed FinfraG – the Swiss EMIR – until mid 2015. In preparation to FinfraG there have been some sort of market consultation on some essential topics included in this new regulation so that it has a "Swiss market flavor". But as it turns out now, that parts of it will be only a "copy-paste" and therefore will be very similar to Europe legislation. Knowing this, it becomes odd and questionable why the Swiss market needs to be in a "pending state" for another at least 18 months. This puts the majority of the Swiss players in a very awkward situation, as most of the companies affected are not just Swiss Franc based, meaning that these banks need to be compliant with EMIR at a much earlier stage, while not having a reliable home market regulation. This represents another uncertainty to all market players, which will eventually lead assets to leave to jurisdictions with a more reliable legal background. And we all know what will be consequence of leaving assets: reduced market attractiveness, reduced international competition, hence a further reduction in employment. Therefore a further delay of any regulation in comparison to other regulated markets is really a pitfall for Swiss institutional clients.

Alexander Ineichen: Please let me add a general but related comment. Many non-professional and non-finance literate people think financial professionals are quite stupid. My wife is not alone in this regard. Most people don't consider someone as very smart if that person makes the same mistake over and over again. As Albert Einstein put it: "Insanity is doing the same thing over and over again and expecting different results." Many regulatory bodies are doing exactly that: not learning from past mistakes.

What has happened in the hedge fund industry just happened in the banking industry some time ago. This is what regulation does: it makes a market more homogenous. However, a healthy market is the opposite, that is, heterogeneous. Biodiversity adds to the robustness of the system while increased complexity reduces the robustness of the system. (Dodd-Frank is 848 pages and all politicians queried on the subject admit not having read the tomb.) Right now this is happening in alternatives. Biodiversity is reduced as it favors not the strong, productive and innovative, but the larger organizations. Complexity is increased which adds unnecessary costs, again favoring savvy lawyers and tax advisors; rather than savvy investors. Financial engineering gimmickry blossoms again, replacing hands-on investing based on sound investment management principles.

Daniel Durrer: Both the costs and the pace of local regulatory developments across the world are a big challenge, especially for smaller managers. If this all leads to end-investors having less choice, that would be highly counterproductive in my view, and ultimately it cannot be what regulators had in mind either.

For groups like ours the regulatory burden for smaller boutiques lead to some attractive opportunities. We have quite a strong culture of independence – our in-house managers run their strategies independently from a house view, and we have always worked with external managers running strategies under the GAM brand. Regulatory developments can lead also to acquisitions like the one I mentioned before, of Arkos Capital. Their co-founder has remained on board as CIO of the team and he recently told me that before becoming part of GAM, he was spending half of his time dealing with regulation, audits and compliance, and how much he enjoys the fact that now he is back at what he does best: managing assets for his clients. The combination of our size and culture makes us an attractive partner for such a boutique, allowing them to preserve the integrity of their investment approach and enabling them to grow.

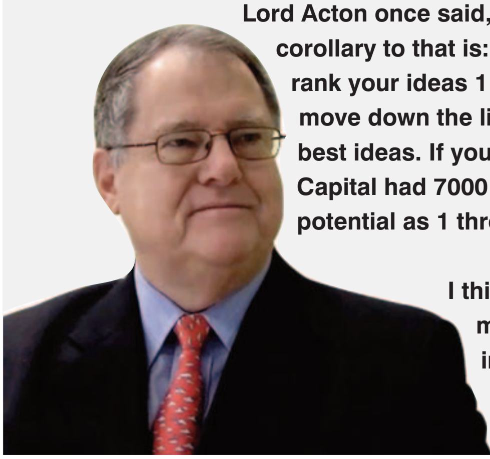
Regulatory efforts are focused on avoiding mistakes made in the past and stronger investor protection, and while they may lead to a certain industry consolidation, I think it is important to preserve the breadth and diversity of offering and investment ideas. Choice is very much in the best interest of end-investors.

Ian Hamilton: I welcome what GAM is doing, and I wonder what is the size a manager would have to be? You probably won't be looking at the one-man shows or the smaller guys who contribute tremendously to the hedge fund industry and the financial markets by cleaning up inefficiencies. Given their small size, they may go for very small issues or opportunities, which the bigger hedge fund managers can't be doing because of their size.

I completely agree with Alexander because I am seeing that happening in other jurisdictions as well: the regulators are not recognizing what has happened in the banking sector. I think all of them it should be compulsory for them to read 'Too Big to Fail', because they are pushing the hedge fund industry into the same situation, which is probably not always in the interest of the investor: usually, the bigger you get, the more towards average is your performance.

All these things may lead to a difficult situation going forward, and markets actually can become grossly inefficient by just having big players.

Joe Taussig: I vehemently disagree with you, when you say that the bigger you get, that you tend more towards average. I think you tend toward below average.



Lord Acton once said, “Power corrupts, and absolute power corrupts absolutely”. The hedge fund corollary to that is: “Size kills and absolute size kills absolutely.” If you're a manager and you rank your ideas 1 through n, your best idea should have the highest risk reward, and then you move down the list. If you have more ideas than the capital, you are going to allocate to the best ideas. If you have more capital than ideas, the situation becomes different. Long Term Capital had 7000 trades on, and you can't tell me trades number 6991 to 7000 had the same potential as 1 through 10.

I think there are enough studies now that are pretty convincing that small, newer managers will generally outperform, and I agree that it's not good for the investor community to have these guys marginalized when the cost of entry puts them out of business.

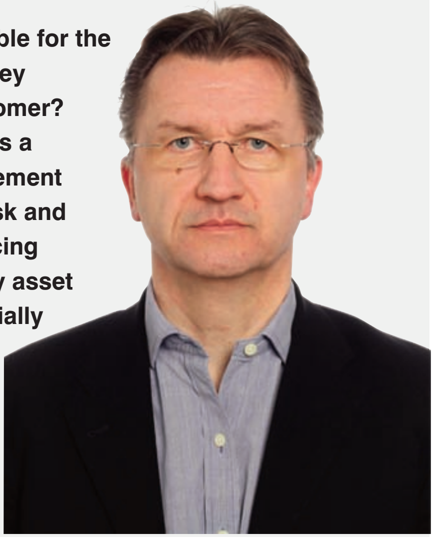
Hansjoerg Borutta: I guess it's a long debate, and in my experience and of what we see and what we saw, I think the truth is somewhere in between. Personally, I believe that the mindset of the manager is key. We look for managers who take preserving money as important a task as making money. Taking risks need to be combined with strong risk management skills paired with some sort of constructive paranoia to be eager to make another dollar while not to lose some of the dollars already earned. If you invest with managers with that mindset, you should have the chance to have less sleepless nights, as these fund managers will rather have them.

The search for the right mindset is a strong filter. It will reduce the theoretical number of 10'000 available funds to maybe a couple of hundreds.

So I think it's a mixed bag. I would not subscribe to say, the small ones are by definition good because they are fresh, and I would not reverse the argument. I think that makes actually due diligence so necessary and exciting, because you have to look to the core and analyze the essence. And as it is a people's business, due diligence is an ongoing process with regular monitoring to check if the fund manager is still in line with our understanding.

To the other points, which were made before, I think there are two other elements which I find quite worrisome. The one is that regulation seems to prefer always the protection of the investors who want to redeem at the cost of the investors who want to stay in the chosen strategy. Particularly, the quest for liquidity has become something like a golden calf independent of the individual investment rationale. For long-term investors this can be very painful and costly as they might forego good investment opportunities.

Another worrisome development is in the making regarding the role of custodian versus the asset managers and their customers. Maybe it is a post Madoff trauma and an unclear situation what the true responsibilities of the custody business are. But are custodians really also responsible for the risk profile of the customers instead of the asset managers who advice them? Are they responsible with respect to the selected products by the asset manager for the customer? There is evidence that such interventions become more current practice. This creates a problem for asset managers which run for instance, a discretionary portfolio management service for customers with different custodians. The latter might develop different risk and approval standards which may lead to varying degrees of intervention into the servicing between the asset managers and their customers. This is a serious challenge for any asset manager as he faces the additional challenge to get his investment decisions potentially also approved by the possibly multiple custodian relationships of the customer. Imagine the situation that every custodian would define what the true risk profile of your customer is and what this customer would only be allowed to invest in according to the custodian's definition of approved investment products.



Ian Hamilton: You have raised very interesting points about the role of the custodian, and again, what I have come across working in various jurisdictions is that there is a lot of confusion around the roles of the custodian, a trustee and the role of the directors. In fact, I haven't come across any regulator that actually clearly understands the distinction between and the obligations between those. And because their lack of understanding you often get a finger-pointing as to who is ultimately responsible.

That is something that I think is going to be also one of the bumps that we have going ahead. And particularly where you don't have a trustee, which roles are then added to the directors', and how responsible must those directors be? It's very difficult nowadays to get good directors who are prepared to take the responsibility. Again, that's an extra cost that is coming.

If you want to have good directors, you have to pay for them, and a good director is one who is going to limit the amount of funds that he is going to be on, so he wants to be paid more. And I think these are all time bombs that we have ahead in the industry whether it's in Europe, whether it's in America or wherever.

Matthias Knab We discussed how important it is that emerging managers are supported because they bring the innovation to the industry and focus on niches that the larger players neglect or can't play because of their size. Phoebus, you are an emerging manager who set up in Switzerland. How has Switzerland served you as a place to start your business, what is your experience?

Phoebus Theologites: Switzerland has so far served us very well, as we have not exceeded the AUM mark of CHF 100M. As long as our fund(s) are regulated by BaFin in Germany, we as investment advisors do not need to be regulated in Switzerland. However, as we launch more funds and our AUM grow, we will fall under the remit of FINMA. Alternatively, we can go to the FCA in the UK, since part of our investment team is there, which will allow us to passport ourselves to the rest of the EU. Without an EU passport, our ability to promote and place our fund(s) across the EU ourselves is severely restricted, since we are Swiss. At best, we can only market the advisory services of our Swiss entity – which is totally distinct from advising on or arranging investments – to qualified investors only, and on a one-to-one basis only, without breaking any regulatory guidelines. This means that we can only point out the existence of our Swiss entity to qualified investors, without advising, promoting or distributing anything, leaving it up to them to pro-actively make unsolicited inquiries and decide for themselves.

Matthias Knab No matter where I go to conduct our Opalesque Roundtables globally, regulations are always a big concern, if not a worry. Let me ask you what else is moving you? What other trends and development around alternative investments or finance do you think are relevant right now?

Alexander Ineichen: Investors currently face various challenges. Capitalism is on a sabbatical. The misallocation of capital continues. Repressionomics reigns. Debt levels are rising. Demographics are not helping. Governmental intervention into free markets is rising continuously. Many industrial economies have been robbing Peter to help Paul. But now they need to rob Tom, Dick, and Harry to help Peter. If something cannot go on forever, it won't. Herbert Stein's Law applies. The uncertainty with regards to the timing of the homecoming chicken to be roosted is a challenge for all investors.

Modern Portfolio Theory suggests there is such a thing as an "efficient frontier" where the trade-off between expected risk and expected return can be "optimized." However, there are many constraints that make asset allocation using a two-dimensional model an almost comical endeavor. Many viable investments for the flexible and sophisticated investor simply do not fit into a two-dimensional grid. The ideal portfolio is a well-balanced portfolio that is regularly rebalanced and reasonably well understood by all who carry responsibility. Continuous learning as well as continuous search for new sources of returns is part of the response to the challenges investors face today.

'Risk' as well as 'risk management' are terms that are not clearly defined. The ambiguity of terms is arguably a challenge for the fiduciary. The regulatory and accounting standards might be out of synch with good practice thereby distorting incentives for the various investment management and governance bodies. Potentially, it's a balancing act between doing what is rightful and what is right.

The investment landscape has opened to all kind of asset classes and investment forms. Savvy, flexible, sophisticated, intellectually-open minded, well-staffed, well-connected, and well-advised investors will be picking up liquidity and complexity premiums along the way. Bureaucratized, regulatory-burdened, liability-benchmark hugging, and mean-variance-optimizer-worshiping investors won't.

Institutional investors' current affinity with liability benchmarks has a very strong resemblance with investors hugging asset benchmarks towards the end of the prolonged equity bull market at the end of the 1990s. The period of disinflation of the 1980s and mainly the 1990s together with some other factors gave rise to the cult of equities. Reforms and a changed perception allowed some investors larger allocations to equities, essentially to take more risk. The common wisdom prior and at the peak was that "equities are for the long-run" and that they outperform bonds in the long run. As long-term investor, one could therefore have a large equity allocation because one could sit through large drawdowns. Many non-English-speaking Continental European institutional investors, for example, started to move away from their traditional bond-heavy portfolios and piled into equities close to the peak. So when we hear more and more institutional investors claiming that asset-liability management, ALM for short, is the pinnacle of institutional investor's wisdom, it somehow has a déja vu ring to it. We've seen an institutional infatuation with benchmarks before. (And, somewhat akin to musical chairs, it can be embarrassing for slowpokes.)

I think the most important thing is what to do with the bond exposure at the moment. The debt issue has not gone away. We have financial repression, and whether it will lead to more expropriation or really much nastier stuff, we don't know. I think the relationship between bonds and alternative investments is that history is repeating itself. In the late 1990s and early 2000s it was a move from equities to alternatives; now it's a move from bonds to alternatives. Overvalued equity markets put hedge funds on the map of the institutional investor 12-14 years ago. Currently it is overvalued bond markets that can explain the search for alternatives.

Matthias Knab Well, are there views on this bond theme and the big rotation that maybe coming or has started?

Daniel Durrer: We see investors re-thinking their allocations. There was that wake-up call in May/June 2013, but everybody probably knows that more will happen, in the markets, and more needs to be done in investor's portfolios. The big question is how to reposition the current allocations. I agree with Alex that this will be the big challenge, and I also would argue that generally most investors are not really ready for that to happen.

Like Hansjoerg, we view short duration fixed income as one option to limit the potential downside in the current environment – other options are the alternative strategies I mentioned before. Some asset classes that have enjoyed strong flows up until recently look much less appealing now – for instance high-yield fixed income or commodities. Just consider the drawdowns experienced by gold in 2013. I believe all of this makes investors more willing to look at – and allocate to – a broad spectrum of traditional and alternative asset classes. This can maximize an investor's opportunity set, ensuring he can access multiple sources of returns regardless of the market environment, ideally with a positive absolute return profile and a low correlation to traditional asset classes. The key is to select risk premia that offer maximum diversification, as well as the optimum level of return for the risk being taken. We have developed an innovative UCITS product that constructs portfolios of traditional and alternative risk premia that we have found of particular interest to institutional investors.

Markus-Alexander Flesch: From the exchange perspective, I know that most of our institutional clients are short duration. Trading volumes and figures are confirming this perception, as the long end prices are pretty stable and oscillating in a pretty fixed low yield corridor. So, judging from this perspective, most of the clients seem to be sidelined with suppressed activity. This is a trend I don't foresee to be changed, as long as the central banks are holding on to their "easing" programs.

In opposite to that, there is pronounced activity in trading treasuries in the U.S., showing that U.S. players seem to be less influenced by central bank policy than their European counterparts. However, I have had various conversations with European asset managers expressing the necessity to kind of swallow their pride and get active in the markets, irrespective of their personal belief, meaning you have to go with the flow…

The point is that 2013 has been a year with extremely low volatility across all major markets, be it in Asia, Europe, or in the U.S. However, volatility nevertheless, at least from our perspective, remains a topic, and we have decided to build out the volatility segment within Eurex. So we will hopefully at some point be able to produce more products like our VSTOXX, which is doing very well. The volumes have picked up significantly over the last 14 months.

Also the VIX in the U.S. has been doing very well, which is of course also due to the fact that this instrument was created at least two and a half year earlier, and that the activity and composition of the U.S. market in terms of institutional activity is more developed than Europe. However, I believe Europe will catch up significantly over the next eight to 12 months. At that time any European investor will hopefully have access to a very robust and liquid European-driven volatility product. So we will strengthen the volatility products around the VSTOXX, but also expand into the sort of OTC markets by offering eventually variance products to complement our VSTOXX offerings.

Apart from volatility, our dividend products have also experienced tremendous growth and development as more investors and institutions have started to generate alpha by implementing dividend strategies, and managers launching dedicated dividend funds. That sector is also poised to grow substantially in 2014.

Ian Hamilton: I was just going to actually comment on the flows and the size of the hedge fund industry, which is now being reported as having reached new record levels. I believe we have to look at those flows and size also relative to the long only product as well – then you will find that hedge funds actually grew very slowly versus long only over the last two or three years.

That means the hedge fund industry is actually lagging behind on a worldwide basis. But possibly, some of the investors that do go into hedge funds now are contrarians, saying that while hedge funds have underperformed in 2013, maybe they will be outperforming in the coming years.

Hansjoerg Borutta: What is kind of funny and sad at the same time is to read in the media "look, hedge funds are lagging the stock market!" But, at least in my understanding, isn't that the job of a hedge fund in a bull market? A hedge fund has to hedge, the manager has to manage the risk, so there are embedded costs for that, and this risk management is an important component of the alpha part.

For me as a wealth manager and hopefully wealth preserver, I want managers who run steadily, I want to harvest positive compound returns over time, and that needs to happen in a controlled risk frame. My investors still want to make money, but they are always very conscious about not losing money. That is how I need to operate.

So I shouldn't care about what the press writes about underperformance and benchmarks, but of course a client may read those papers, even the reputable ones, that completely leave the risk management dimension out of the picture. Asset managers and clients shouldn't care about such "whatever is best performing" benchmarks, because they know their targets and how to achieve them, choosing the appropriate instruments at the right time. It really puzzles me that the hedge fund industry is not able to get rid of that image that they have to compete and beat whatever performs well at the moment. They cannot be Jack of all trades under any condition, in any market. This industry should really have other goals...

Alexander Ineichen: I completely agree, Hansjoerg. I believe rationally we and many absolute return investors agree this is how it should be, but at the same time we also know what the reality is. I am in no way trying to make fun of investors, but it's a fact of life or maybe part of human nature that when things go up, we want the outperformance, and when things go down, we want to be hedged. Quite often, it's a balancing act between these two. Hedge funds shouldn't be compared to long-only equities, but fact is that a lot of people do make the comparison, which you may say also proves that the collective memory of many investors, including institutional investors, is not 10 years but probably much shorter than that, possibly just around two or three years.

We shouldn't forget that $100 invested in the S&P 500 Total Returns Index in January 2000 grew only to $148 by September 2013. The same $100 invested in the average hedge funds portfolio grew to $218. Some people tend to forget that halving your wealth, which stocks did twice in the last decade, is not good for your long-term financial health.

Ian Hamilton: We talk about investors having a very short term outlook, that is of course a concern. Another area I am always concerned about is the miss-selling of hedge fund products particularly when it comes to the retail market. I prefer to deal with the institutional market. Typically it takes them more time to make up their minds, but when they invest, they usually fully understand and tend to take a longer time to exit. But when it comes to chasing the retail market, maybe not all providers have not looked at the lesson the Italian hedge fund industry had in 2008 when it went from billions to almost zero overnight, because it was mostly retail money.

Another rather amusing aspect about hedge funds is that many people think hedge funds allow them to make an enormous amount of money, because they see the gross lifestyle of high profile hedge fund managers with enormous amounts of money, and therefore investors should also make enormous amount of money investing in hedge funds.

Matthias Knab The hedge fund industry thrives on innovation. Can you share with us which innovations are you involved with or do you observe in the industry?

Joe Taussig: We are looking right now at an area I am going to call brand building and product extensions. If you go to an American drug store and look for Crest toothpaste, you will see that Procter & Gamble has all kinds of different variations of the same product. They are simply segmenting the market in different ways. A parallel occurred to me recently when I studied the success of the Third Point Reinsurance IPO on the New York Stock exchange.
If you look at Dan Loeb, he offers essentially three different products: he has a closed end fund in London with about $800m, he has the reinsurance company with about $2bn, and he has the open ended funds. The more I thought about this, I found that he has tremendous economies of scale, but he has also segmented his investors who have different appetites for specific investment structures. From his perspective, it doesn't cost that much to extend his

product range. The same is true for managers launching a UCITS fund. That is also another way to tap another investor where the marginal cost of the next increment, as long as you already have your fund strategy and team in place, is pretty minimal.

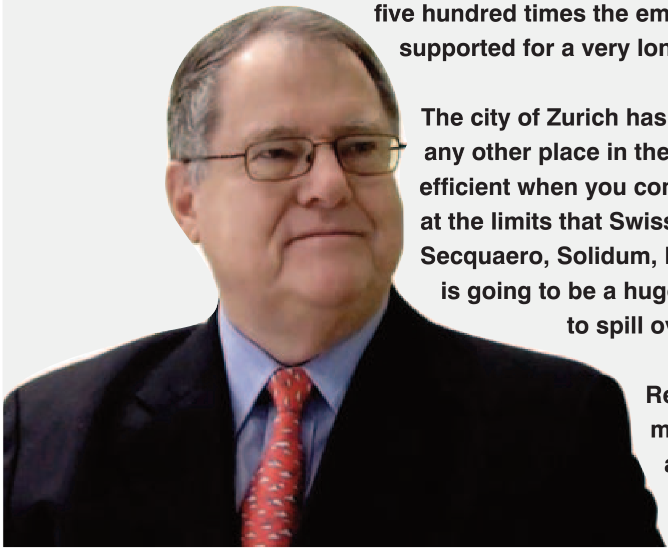
The same thing is happening in the U.S. again, and I should have seen this sooner. 40-Act Funds are taking off dramatically. A 40-Act fund is the U.S. equivalent of UCITS, and basically sold to retail through brokerage firms. One of our clients, SkyBridge Capital, has raised $2.5bn in 2013 with a 40-Act Fund. I know Deutsche Bank is having a huge amount of in-flows through its 40-Act funds.

We are talking about innovation, and surely as new investment vehicles and structures become available, managers can now expand their ways to deliver his or her skills and appeal to various segments of the market. The COO of Greenlight tells me that David Einhorn spends about 5% to 10% of his time on the reinsurance company, while the unit represents somewhere on the order 25% of his total assets. That is because David is chairman of the publicly traded company, so that takes some amount of time that has actually nothing to do with asset management. Loeb, in contrast, isn't even on the board of Third Point Re, much less than being the chairman.

The reason why I said I should have seen this before is because I was studying Buffett, and saw the same thing: he was a hedge fund manager for 13 years and he quit to go into insurance, reinsurance and banking. At the time, I didn't realize there are nuances. Everything was in the Berkshire Hathaway pot, and I could almost argue that he would have been better if each of these were standalone businesses, because the way we look at insurance or reinsurance, it's just a source of funding like bank deposits are. It all comes down to the cost of funding, and as long as you can put the funds to work at a better rate of return than your cost of funding, you are going to have better returns of the fund.

I have been doing this activity for 20 years. Our managers have always outperformed their flagship open ended funds, as long as the manager's fund performs at least 5% per year compounded on a five year rolling period of time. I also know from experience that there are certain investors who are very uncomfortable with the reinsurance business, but very comfortable with banking in the sense of creating income streams. And there are others who are very uncomfortable with banking, but very comfortable with insurance and particularly when you mention cat bonds.

If you look at Blue Capital Reinsurance Holdings that just went public on the NYSE, what you'll see is basically a virtual company. It has a part time CEOs who happens to be a very close personal friend of mine, and an interim CFO. They are going to hire full time CFO to talk to the market. This company raised $175m as a startup. What do they do? Well, they are a catastrophe bond fund, but with a slight variation. Let me explain. One of the problems with the UCITS format for cat bond funds is that you can't use derivatives. So if you are going to into that asset class, you also have to do something called collateralized reinsurance. This is a highly attractive sector that in my view is poised for huge growth going forward, because these new players bring tremendous efficiencies to the market. While a firm like Swiss Re has thirty to forty times the capital of Greenlight Re or Third Point Re, Swiss Re also has five hundred times the employees. I am not that sure that such discrepancies can be supported for a very long time.



The city of Zurich has probably more ILS (insurance linked securities) players than any other place in the world. If I look at these ILS players, I know they are more efficient when you compare them limit to limit, not premium to premium. If you look at the limits that Swiss Re has and compare with the limits of say Twelve Capital, Secquaero, Solidum, LGT, or Credit Suisse, all these are much more efficient, so that is going to be a huge sea change in just one industry, and I expect this revolution to spill over several others.

Reinsurance is different than insurance. I also believe this new model will also revolutionize banking, I really do. Remember that all these strategies employ equity capital on top of which they create operating profits.

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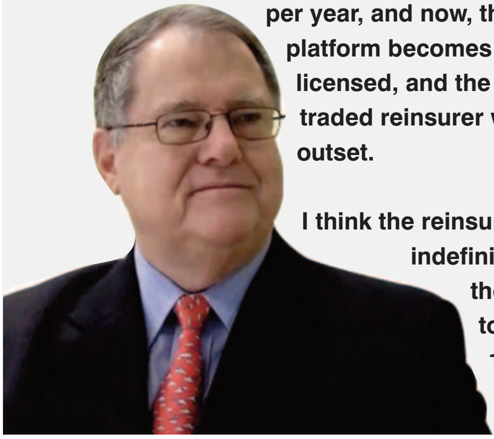
Phoebus Theologites: I agree with your thoughts here, which also bring to mind war stories from when I used to work at Gen Re Financial Products. In the wake of the Enron disaster, Warren Buffet came out calling derivatives “weapons of financial mass destruction”. Internally, we had the reinsurer on the one hand and the financial products market-maker on the other, and risk was supposed to be transferred between the two – except that Enron resulted in things going awry. This, I believe, is the model you have in mind, and which is coming back in fashion. I understand exactly what you are saying: earning an actively-managed return on cheap ‘float’ results in enhanced net interest – and other – income.

Joe Taussig: I talked about Third Point Re and Greenlight Re, but I haven't talked about S.A.C. Re, which we also advised on. All those projects took at least two years and there are a lot of things that can go wrong. For example, due to Steve Cohen’s SEC problems, the ownership of S.A.C. Re is changing, as is the asset manager. We were also doing one with Pequot when they went out of business.

To simplify the startup process, our firm put a platform together targeted at managers from $10m to $1bn. We have already set up five reinsurers for hedge fund managers in 2013. Historically, we may have aimed at two per year, and now, thanks to this platform, we’ll probably do one to two a month during 2014. Our platform becomes a shared resource and each manager has his own company, which is fully licensed, and the idea is to transition from an incubated type entity to a fully staffed and publicly traded reinsurer without having to have the capital to fund a fully staffed reinsurer from the outset.



I think the reinsurance industry has got to change, the cost structure can't be carried forward indefinitely. It breaks my heart because insurance and reinsurance are important to the city of Zurich, and I have lived here for over 10 years. But every industry has to adapt to change, and it will suffer if it doesn't innovate. If you review the past 10 years, between UBS, Credit Suisse, Swiss Re, and Zurich a lot of wealth has been destroyed.

Markus-Alexander Flesch: Hopefully we are able to increase the wealth as opposed to destroying it.

For a derivatives exchange like Eurex, when it comes to innovation we are also contingent upon request of our clients. From a structural and technical point of view, some of our innovations, especially on the technical side have been driven by clients being active in high frequency trading, since such a business model requires low latency. In order to respond adequately, Eurex is striving to be the leading exchange and therefore is committed to technical innovation. However such a commitment is as well dependent from external factors, like regulation.

More recently our technical innovation has been affected by the German high frequency directive, which definitely has hit some clients operating high frequency trading models. Therefore technical innovation can only represent a fraction of our efforts to be the leading derivative exchange and it is therefore logical that innovation encompasses other fields as well, like risk or better risk control.

As trading means managing risk, Eurex always offered risk tools. Our most recent example is Eurex Clearing’s Prisma, which is absolutely unique in the exchange world. In a nutshell, Prisma is stepping away from a more simple way of measuring derivative risk to a state of the art capturing of “portfolio risk”, therefore enabling clients to combine their OTC business with the listed world.

Such an innovation is adding value to the complex world of derivative trading. Prisma unifies two affiliated worlds, it decreases complexity and increases efficiency. The increase of efficiency is achieved by a reduction of required collateral by offering crossmargining between both trading worlds. With decreased funding Prisma increases transparency and capital efficiency measured by Basel III. Such in increase in transparency has as well positive effects not just on the prime brokers balance sheet, but as well as for the client's portfolio. So therefore, our innovation very much helps our clients to have a better access towards their portfolio in various asset classes.

Daniel Durrer: Personally, I think that despite the increasing sophistication of risk management and portfolio construction methods, investors continue to struggle with their two most basic objectives: to earn a return that reflects the level of risk they are prepared to take, and to have effective protection in place in case of tail risk events. With their 30 years' experience of investing into hedge funds, our alternative investments solutions team has developed a new approach that seeks to address exactly these two challenges.

It goes back to the risk premia I mentioned before: we analyze a wide range of sources of risk and return using a proprietary clustering tool. With our Cluster Map Analysis we identify and combine what we believe are the most attractive ones based on their correlation to traditional assets and to one another.

As we plot a range of investments on the map, related risks tend to be physically clustered together. It also shows that asset allocations that are typically used as diversifiers, such as commodities, high-yield credit and emerging markets, may not be very diversifying at all. While this is something that many investors are aware of, they do find it difficult to find truly liquid alternatives.

Our starting point is always that risk premia must be liquid and they should persist over portions of the market cycle. Alternative premia fulfil these criteria, as they often consist of low-correlation return streams that active investors have taken advantage of in the past. A few examples are the risk arbitrage spread from M&A events, FX carry spread between high-yielding and low-yielding currencies, or equity option premium.

What is important is that risk premia, both traditional and alternative, do not typically stay static on the map: they migrate relative to each other throughout the asset class cycle. That's why an active selection, deselection, sizing and management of this premia on behalf of our clients is key to maximize the breadth of sources of returns and the level of expected returns for the risks taken.

One of the most interesting aspects of the new GAM approach is in regards to sizing positions and portfolio construction. Portfolio construction is driven by GAM's Expected Drawdown Parity approach, which is very different, in theory and practice, from traditional, backward-looking risk parity approaches. Classic risk parity sizes positions inversely to volatility, which penalises position sizes for upside volatility just as much as downside volatility. Conventional risk parity approaches end up with the largest long positions in markets with the lowest historical volatility, namely government bonds. However, our approach focuses instead on expected drawdowns which can sometimes come to the opposite conclusion. Taking bonds as an example, earlier last year analysis suggested upside of 1.7% but a potential drawdown of 15%. The conclusion was to go short of bonds, using one of the Barclays indices. Whilst other risk parity funds incurred losses from frequently heavy weightings in fixed income, the GAM fund took the opposite approach and profited.

GAM uses the skills and expertise of the Alternative Investment Solutions team to take both straightforward directional positions on asset classes, such as the bond short, and to take positions in alternative risk premia such as currency carry trades, merger arbitrage, trend-following strategies or volatility. The fund targets LIBOR +4 to 6%, with volatility 3 to 5%, but the low cash usage of the strategy and the nature of the portfolio construction techniques allows the manager to expand or reduce the amount of risk premia exposure dependent on the client's requirement. As a result it can be suitably tailored to a client's requirements, and we have found this to be of significant interest for institutional clients.

As mentioned before it can be accessed through a daily dealing UCITS fund, but we offer it also in the form of customized portfolio mandates. We have only recently started to market it, and feedback from clients is extremely positive. In third quarter, we have won a very sizeable allocation from a U.S. institution for instance.

Phoebus Theologites: The way we do it is by being fully and truly transparent. Not only do we send out daily to all our investors our full list of marked-to-market positions, but we also apprise them of our intended positioning in advance, and of our execution fills in real time. This continual, intraday information flow ensures that our investors are aware at all times of our deliberations, decisions, execution and performance, and this in turn allows them to increase or exit their investment at will, since we are daily-liquid, without any notice or lock-up periods.

Matthias Knab Given your investor base, that is also quite innovative, no?

Phoebus Theologites: I believe so. Our minimum investment is just €100, so we cater to the entire investor spectrum, from institutions to 'widows and orphans'. One might think that providing trading information and market views continually during the day is ope onerous – or clogs up our investors' inboxes. Here technology plays a big role. Our streaming market commentary is time-stamped and archived in a database which is accessible over the internet by investors, if they so wish, and thanks to the state-of-the-art systems of our administrator and custodian, we are able to generate 100-page reports daily, which slice and dice our portfolio in a vast number of ways, at the press of a button. Good service providers and good technology afford our investors full transparency and real-time information, without taxing our internal resources unduly.

Matthias Knab Looking for a moment at the global investment outlook, any thoughts or concerns you want to share what may be coming in 2014?

Hansjoerg Borutta: Alex published recently a simple but interesting chart of the U.S. 10 year treasury bill yield from the 1980s to today. The story is simple. The yields were on a downward slide over 30 years which coincides with our working life. We might be at a turning point now as we enter possibly the right side of a "V" shaped development of this yield as rates will rise further. The implications could be huge and one question is in as much we are able to adapt our past experience that we gathered in a regime of falling interest rates to the new paradigm. Obviously, the pattern will not necessarily unfold in a symmetrical way. What I would like to hear from the industry is ideas how to shape up for that?

Source: Ineichen Research and Management AG

Joe Taussig

To me that chart also looks like the Swiss Franc. The first time I came to Switzerland I think the rate was 2.85 Swiss Francs to the dollar. Today it is 90 Swiss Rappen to the dollar and I don't see it going the other way, because one of the things I like about Switzerland is that governments do not waste money like every other place I have ever lived.

Phoebus Theologites: I would like to comment in response to Hansjoerg and on how to position. Interest-rate implied volatilities are still cheap, as EUREX can tell you. I have been writing to our investors and to those fellow asset managers who receive our streaming commentary daily that everything from U.S. 3x10s to mid-curve EURIBOR options is still cheap, urging them to take advantage of the lull before the storm by immunizing in advance their fixed-income portfolios over the medium and long term, and sitting on the carry. Investors have not woken up to the steepening and yield creep yet, otherwise you would have seen significantly increased volume and short open interest, in Bobl and Bund futures for instance, but it's just not there. Fixed-income investors are sleepwalking into a potentially disastrous scenario, which will probably have become reality two years from now.
It takes time for natural processes to reach implosion or explosion, but when they go parabolic or, even worse, exponential, they become unsustainable – at least as far as natural analogies are concerned. There have been increasing costs and declining returns on the repetitive bouts of easing and intervention by central banks over the last 5 years. The BoJ is a relative newcomer to monetization and the concomitant support of asset prices, and we have traded accordingly and successfully, but look at the Fed and the ECB.

We are on record saying that the Fed was not going to taper in September, and that the ECB would cut the refi rate, and we have been vindicated. We are now on record saying that the Fed will taper by 10 billion in December (2013), and that the ECB will muster consensus for a conditional LTRO in 2014, since European banks are still zombies, and could not hope to survive without an injection of liquidity, especially since they are now paying back LTRO2. The ECB

could even take us a step closer to 'Japanification' by cutting the depo rate to negative. This is not to be ruled out.

So what does one do with all this? Volatility, as I said, is still cheap after years of financial repression – but it will not stay cheap forever, and thus one should take advantage of it. Look at what the big banks are doing in the U.S., positioning in huge size across Greens and Blues – which fits my own timing of when things will start getting nasty in late-2015 / early-2016. Why do I say this? Because I am on record since 2010 saying that the next big cathartic event will occur "around the middle of the decade but not sooner". This is why I call myself a reluctant bull, having survived the post-GFC monotonic markets without blowing up – not because I think they intrinsically or fundamentally deserve to be up here, but because I am pragmatic, and I accept that monetization and financial repression will continue to sustain the markets for quite a while yet, and certainly for longer than the erstwhile bears would have us believe, via both behavioral distortions and numeraire effects.

Eventually, we will have an environment where the front end is 2.0-2.5% and the back end is above 5%, but earnings yields will not have kept pace, and equities will thus lose their appeal quickly. This will happen not only because of higher valuations to come, but also because of reduced margins due to higher financing costs, coupled with persistently subdued aggregate demand compared to its pre-GFC credit-fuelled heyday. Ignore the perennially over-optimistic forward-looking earnings estimates published by the sell-side: if you plot earnings revisions over time, you can see they are almost invariably downward-sloping, i.e. forecasts are almost invariably revised downwards relative to initial estimates, in classic 'pump-'n'-dump' fashion – and yet there are investors who still swear by such 'research'.

We are in a situation where global demand remains anemic, as reflected inter alia by commodity prices, and central banks need to print to sustain asset prices. No-one is spending much, so sooner or later this will be reflected in earnings. Sure, there is an arbitrary multiple expansion going on, so we are trading at 1800 in the SPX and above 3000 on the SX5E. That's great – but it's also sentiment-driven and divorced from fundamentals: stocks are now money-base numeraires.

So my guess is that, a couple of years from now, the front end will be significantly higher and, to come back to my previous point, who do you think is massively positioned around this? Precisely those U.S. investment banks which serve as the right and left hand of the Fed: they know what's coming, since they 'are' the Fed. When you look at the flows, you realize that something is shaping up for late-2015 onwards, because the DV01 these guys are running is humongous. I have never seen it in my 20 years in the markets – and that's just on the strip, not to mention bond options and swaptions. Yet few investors have woken up to this.

So, one potential response to Hansjoerg's query is "buy volatility while it's cheap" and the other is "immunize via short futures, and lock in spreads down the credit echelon". One final point: Bunds are currently too expensive for what they are, i.e. a 'safe investment'. I'd rather be in U.S. Treasuries. The 1% yield spread is one of the reasons why you will see more 'fresh' money going into USTs over time, helping to rein in the pace of steepening, and strengthening the USD.