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Opalesque Roundtable Series '14

AUSTRALIA

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Editor's Note

Why Qantas Super put over 30% in alternatives

Australia's superannuation system, established by the Keating government in 1992, has been a monumental success in Australia. With over $1.8 trillion in total AUM it is the fourth largest pension industry in the world.

Qantas Super, represented by CIO Andrew Spence, is one of Australia's leading corporate superannuation funds. Operating since 1939, the Super has 33,000+ members and assets of AUD 7 billion. Its Growth (Choice and default) option ranked number 1 out of 47 funds compared to peers on a risk adjusted basis for the year ending June 2014. Approximately 70% of the total investment program is now focused on alpha generating strategies and managers rather than low-cost beta.

To reduce the pension's dependency on the equity risk premium and to implement a highly cost-effective private markets program, Qantas Super invested over $2.2 billion, via aligned implementation models, across unlisted infrastructure and property, hedge funds, credit and private equity to deliver attractive risk adjusted returns, net of taxes and investment expenses, following a clear 'value for money' rather than a pure low-cost focus. This means the pension is willing to include strategies such as hedge funds or private equity, provided they offer an attractive net risk-adjusted return.

In addition to Andrew Spence, the following Sydney-based investment professions participated at the Roundtable:

1. Craig Stanford, Head of Alternatives, Ibbotson Associates (Australia)
2. John Shin, Portfolio Manager, Roberts Family Office
3. Stefano Cavaglia, Head of Funds of Funds, Philo Capital Advisers
4. Chris Thompson, Portfolio Manager, Advance Asset Management
5. Stephen Baldwin, COO, Regal
6. Jack Lowenstein, Joint CIO, Managing Director, Morphic Asset Management
7. Rob Lance, Head of Ascalon Capital Managers Australia
8. Damien Hatfield, Head of Sales, Australia, Ascalon Capital

The group also discussed:

- The need for tail risk protection: models and approaches. Why it won't help to "move the needle around the 50% mark"
- How does Qantas Super achieve an equity beta (S&P) of just 0.1 - 0.3?
- Should hedge funds investing globally engage in FX hedging? And how? How can a family office efficiently manage currency exposures?
- Why you should identify typical risk premia of managers and strategies
- Qantas Super's typical fee structure
- Is there still room for the traditional high beta, index benchmarked long only manager going forward?
- How has hedge fund replication changed over the last 15 years?
- Why is a lifecycle based approach of investing important for pensions?
- How do Australian hedge fund managers succeed and attract assets?

Enjoy!

Matthias Knab
Knab@Opalesque.com

Participant Profiles

(LEFT TO RIGHT)

Matthias Knab, Rob Lance, Craig Stanford, John Shin, Stephen Baldwin, Andrew Spence, Damien Hatfield, Stefano Cavaglia, Jack Lowenstein, Chris Thompson.

Introduction

Andrew Spence
Qantas Superannuation Limited

My name is Andrew Spence. In July 2008 I was appointed as the inaugural Chief Investment Officer for Qantas Superannuation Limited (Qantas Super). Qantas Super is one of Australia's leading corporate superannuation funds and is run for the benefit of members who are current and former employees of Qantas Airways Limited and its associated companies. Qantas Super has been operating since 1939 and has 33,000+ members and assets of AUD 7 billion.

Our Growth (Choice and default) option ranked number 1 out of 47 funds compared to our peers on a risk adjusted basis for the year ending June 2014. Our investment aim is to maximize long-term risk adjusted returns, net of taxes and expenses. This means we target to deliver strong investment returns for members while reducing the impact of downward movements as well.

Our strong risk-adjusted returns reflect the benefits of holding a portfolio of high quality, largely liquid investments that are appropriately diversified by strategy, geography and investment manager. Over the last five years, Qantas Super has been patiently and opportunistically building its exposure to a diversified mix of private market investments which offer an attractive long-term reward for the risk being taken. These investments now account for 35% of our Growth (Choice and default) option.

Rob Lance
Ascalon Capital Managers

My name is Rob Lance, I run Ascalon Capital Managers in Australia. I report to Chuak Chan, our CEO based in Hong Kong. We have offices both here in Sydney and Hong Kong which allows us to support partners throughout Asia Pacific

Ascalon is the boutique asset management arm of the BT Financial Group, so ultimately we are part of Westpac where we, along with Advance, BTIM and Hastings, operate in the funds management space.

We have a team now of 17 supporting our partners who are predominantly in the alternative / absolute return space. We invest in their underlying funds and inject working capital into their management company for our stake.

We have six partnerships at the moment, four are based in Australia - Morphic Asset Management, Regal Funds Management, ATI and Alleron Investments. In the wider Asia-Pac region we are partners with RV Capital based in Singapore and Athos Capital based in Hong Kong.

So that's where we are. We are certainly in growth mode and are looking at new relationships, new partnerships. The ability to do much of our work out of Hong Kong where Chuak, Andy Hutson, our head of investments, and Katarina Royds allows us to really reach out into Asia-Pacific while extending distribution and sales capability in Australia led by Damien Hatfield. Damien has been with us now for four months.

We get fantastic support from our sponsors and are mandated to add one to two managers a year over the next four years in order to build up a significant stable of best-of-breed managers across the cap structure in Asia Pac.

To that point, we are asset managers with the special focus to build a diversified spread across strategies and styles as the best way to de-correlate and de-volatize the portfolio without having to over-manage exposures.

Damien Hatfield
Ascalon Capital Managers

I am Damien Hatfield. I am Head of Distribution for Ascalon Capital Managers Australia and New Zealand. I have only recently joined Ascalon Capital. I originally had my own business which was a third-party marketing business, which I have merged into Ascalon Capital.

Our objective is to add a new stream of business, which is third-party marketing. I have a number of third-party marketing relationships and building on those relationships, Ascalon will then provide similar services to other fund managers that want to access the Australian marketplace. We may enter into some sort of partnership going forward, which could be, in some way, developing an Australian based business. And the Australian business will be more a full-blown distribution, where we would structure a product and we distribute that product through say dealer groups, up to private banks, through to the family office market, and into superannuation funds.

There are a number of groups like Ascalon in the Australian marketplace. I think our differentiation is the fact that we have dedicated marketing, administration and structuring teams, but we also have the capability of seeding new businesses in terms of the partnership as well. So we provide both seed capital and working capital to help a business get off the ground and to achieve a wider distribution.

Stephen Baldwin
Regal Funds Management

My name is Stephen Baldwin, I am the Chief Operating Officer for Regal Funds Management. We are a long/short equity hedge fund manager founded 10 years ago by two brothers, Andrew and Philip King. We have grown from a single desk to being 26 staff today; 20 of us based here in Sydney and another six in an office in Singapore.

As a firm, we are primarily fundamental bottom-up stock pickers. We have packaged that strategy in different ways with our flagship product being a market neutral fund with which we have had strong success.

We are running a little over a billion dollars in AUM today. About half of that is from Australian-based investors and the other half is from offshore investors.

Craig Stanford
Ibbotson Associates

My name is Craig Stanford. I am the Head of Alternative Investments for Ibbotson Associates. We are an active investor in many kinds of alternatives, but we have a focus on the more liquid sector, so we don't really do much in the private equity space.

We invest across all hedge fund strategies, most geographies, as well as some highly liquid diversified alternatives. What we are really trying to do is produce a return stream that is quite different to bonds and equities, so that our portfolios have shallow drawdowns, quicker recoveries and better risk adjustment returns.

John Shin
RF Capital

My name is John Shin. I work for a family office called RF Capital. The family office was established when Multiplex was sold in 2007 and since then we have been deploying the capital across real estate, hedge funds, and a number of other private equity investments.

Our interest in this space is twofold. One, we have an allocation to hedge funds across the world, and then as a further step along that journey we have now taken some of the strategies that we thought had sustainable alpha and have implemented them ourselves. SQF, launched 1 January 2014, is a event arbitrage fund that we manage internally. We have built a quant team and seeded it with $20 million of family office capital.

Chris Thompson
Advance Asset Management

I am Chris Thompson, Portfolio Manager for Alternatives within Advance Asset Management. We are the brothers to Ascalon in the sense that Advance Asset Management is the multi-manager division within BT Financial Group. In total we look after about A$26 billion in funds, which are mainly multi-asset portfolios, probably half of those are invested on behalf of retail and half on behalf of corporate superannuation investors.

My role is to look after the Advance Alternative Strategies Multi-Blend Fund, which is an allocation within our multi-asset funds, but is also available as a standalone fund to retail investors. The fund has grown to a size of A$2.9 billion Australian dollars of which A$100 million is from standalone retail investors.

Stefano Cavaglia
Philo Capital

I am Stefano Cavaglia. I am Italian but I have lived for a long time in South Side, Chicago. That is a segue to introducing Philo Capital, which can be described as a mean, lean, alpha machine.

Our client is Centric Wealth. This company primarily services high net-worth individuals, and we provide the investment advisory work to them. The house has currently 9 billion under management and may grow to 16 if one of the acquisitions goes through.

We do everything from soup to nuts in terms of investment advice. I head up the work that looks at fund of funds, long-only, long/short, multi-asset.

Our thumbprint is to identify where managers have skill and don't have skill. That means we spend a lot of time trying to understand the systematic bets that they make and what is leftover after you have identified the systematic bets. We do that currently for all long-only managers and we are looking to do that as well in the long/short space.

Additionally, we spend a lot of time thinking about downside risk, primarily because the type of problem that a high net-worth individual is really a multi-horizon problem, namely we are not looking at one time period, We want the best risk and return tradeoff over one time period and over a 25 year time period to attain my objective.

In that context downside risk is very important, because in these types of problems we often talk about, for instance, the value of compounding. And the merits of compounding go to zero if you have been hit by some downside event. This cancels any chance of accumulating wealth and hence you never reach your goal. That's why from an investment perspective, any investment in long/short or long-only is very, very much skewed to strategies that provide that downside protection.

Jack Lowenstein
Morphic Asset Management Pty Ltd

I am Jack Lowenstein. I think I am the minnow in the menu. We have about $100 million, including the Ascalon commitment. We are Ascalon's most recent acquisition, or investment I should say. Ascalon owns 35% of our business. We are a global long/short equity fund, with a very structured risk management framework, and we use a multi-asset class approach to hedge the risk in the portfolio.

Our main point of distinction is that we have a style-agnostic approach to stock picking. We don't think it's good for investors to be too style-boxed through the cycle; we believe there are different points in the cycle when different styles work best.

We have been going for about two-and-a-half years, and at this stage we have an investment team of seven. Our background as a group is that the two founders, myself and Chad Slater, came from Hunter Hall which was until we left one of the larger Australian based global equity long-only managers. I left there three years ago and the doors opened for our new business about two-and-a-half years ago.

Matthias Knab As volatility comes back to the markets, downside protection is becoming even more important. Stefano, can you elaborate how you are taking care of this at your firm?

Stefano Cavaglia: From an analytical perspective, all we do is identify typical risk premia that managers or strategies are exposed to, and then we analyze those risk premia in terms of the environment. That means we have some idea how in certain environments some risk premia have positive payoffs, and negative payoffs in other environments. That is how we get comfortable with what managers do.

So once we have identified their style, then hopefully we are able to identify also their idiosyncratic skill and how that also behaves under different environments. I always say our work is part science and part kind of thumb in the air, because you have to take all of those numbers with a grain of salt.

But we have taken it to a point where we are quite comfortable that at least from a day-to-day perspective it gives us some comfort for identifying whether the managers are doing what they claim to be doing. In fact, one manager we recently dealt with claimed to be a value small cap manager. We then saw, for instance, that there was a period of time when small cap value was really roaring and this manager should have had a phenomenal performance, but in fact he was going exactly the opposite way. So it just didn't make sense. We said, at the very least you should be earning some money from this tailwind, at the very minimum.

So we went to talk to the manager and we asked about some of his latest trades? And he says, "oh, I bought Google, and then I sold it when prices weren't moving my way..." A value manager who has got a long horizon who sells his position after a month may give you some comfort in terms of how you want to manage that relationship on behalf of your clients. And again, is the manager doing what you expect him to do?

It's a tug of war really, how far do you take this, but it really does help you get some comfort around expectations. Now, that's on the day-to-day level of what we do.

I think in terms of products, we have been looking very, very hard recently at tail management protection. One of the things we like to do is get a feedback between the manager and ourselves. It's a long story, but I will tell it, if you don't mind.

One of our managers, a global equity manager based in Perth, has a 25 year track record, and what they excel at is being in and out of the market when there are difficult periods. The track record is phenomenal because they timed '87, they timed '02, and they timed '08. So you can only imagine what that track record looks like, returns of something like 16% per annum for 25 years, it's really stunning.

Now, that manager went to China, comes back, and it's the China story that we have all heard. But he says I am tilting everything in my portfolio away from China. I can't completely tilt away from it, but I am going to really skew all of the positions away. So, that's one part.

But then you have a client base that has long-only portfolios and long-only holdings that are very much, call it 40%, 50% Australian equities. Now, you can have all these dynamic asset allocations, blah, blah, blah, that everybody loves to call, but in reality they don't do anything. All they do is they move the needle a little bit around the 50% allocation, let's be frank about it.

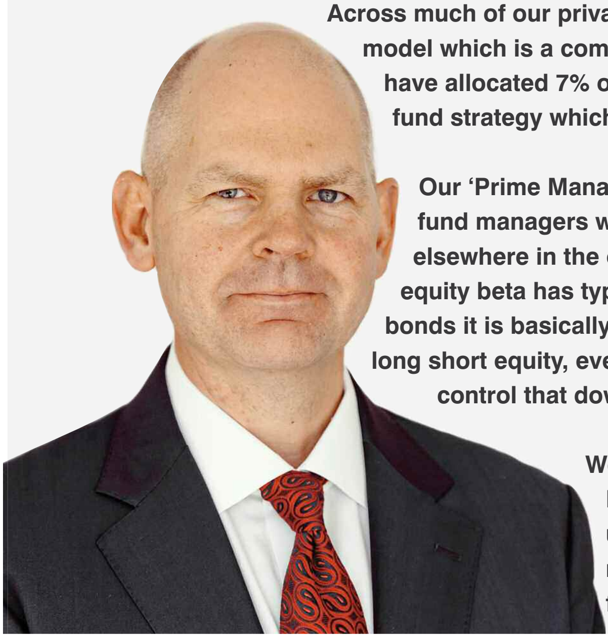
So what's going to happen is that you hear people saying, "yeah, we are going to go underweight, we are going to go to 40." But if you have an event and if you have a China collapse, as this manager is suggesting, then you might want to do more than just move the needle around the 50% mark.

So we have been looking at tail management strategies. But what happens is when you go to U.S.-based managers, they tell you they all have their tail management strategies. But are they in any way tailored to this particular Australian market phenomenon? No. So then you can say, all right, is there a way to build it? So we are working with a number of managers to build a focused tail strategy for that event.

Matthias Knab The other investors, how are you dealing with this downside risk?

Andrew Spence: Over the last six years, Qantas Super has built a robust and contemporary investment platform that aims to prudently deliver a smoother glide path of returns to our members in a post-GFC world. We articulate this as 'attractive absolute returns in rising markets and superior capital preservation in down markets'. This approach recognizes the asymmetric risks associated with market volatility that our members (particularly default members) typically face in building towards a comfortable level of income in retirement.

Our focus has been on lowering the portfolio's dependency on the equity risk premium and implementing a highly cost-effective private markets program, totaling $2.2 billion, via aligned implementation models. This program is now well-seasoned and invested across unlisted infrastructure and property, hedge funds, credit and private equity to deliver attractive risk adjusted returns, net of taxes and investment expenses.



Across much of our private markets program we operate what we call a 'Prime Manager' model which is a combination of an adviser and an implementer in one. For example, we have allocated 7% of our Growth (Choice and default) option to a highly tailored hedge fund strategy which we call "Diversity".

Our 'Prime Manager' in Diversity typically holds between 15 and 20 individual hedge fund managers which in combination help to diversify the factor risks we hold elsewhere in the overall portfolio. Over the last five years our correlation to the S&P equity beta has typically ranged between 0.1 and 0.3, so it is relatively low, and to bonds it is basically sub 0.1. We include a broad range of strategies like global macro, long short equity, event driven, insurance-linked, and commodities to help us better control that downside risk.

We use a holdings-based risk platform called RiskMetrics, which our Diversity manager also uses, to deliver risk transparency. That gives us a very tailored and focused approach to better control downside risks. Diversification and a clear understanding of our portfolio's risk factors are fundamental to the way we invest.

Damien Hatfield: Just taking on that theme, I would like to introduce something I have thought about over the years, and that is FX hedging. The reason why I want to raise that issue is downside risk, given that the Australian dollar has had quite a significant move recently.

When I started my career in alternatives back at Deutsche Bank in the '90s, I built a CTA book which ended up being quite a large amount of money. Very early on I happened to notice that the U.S. and European-based CTAs used to provide their positive performance in U.S. dollars, but the Europeans were investing in their local currency being Swiss francs or whatever it might have been. And if you took the currency into consideration, the European investors were negative even though the USD performance was nicely positive.

Later I moved into funds management, where I started to find a lot of fund managers in Australia didn't hedge the currency. That means if they are running U.S. dollar assets, they were happy to leave the assets in whatever the asset currency might be.

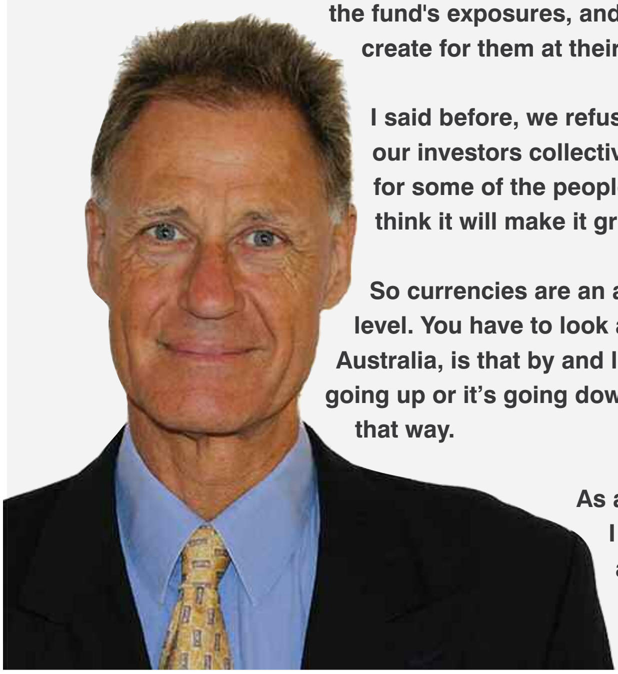
When I ran my book in the '90s, I had raised the assets in A$ but even if the performance of the managers was good, but because the U.S. dollar moved against us, I would still have to go back to the client and explain why his portfolio had a loss. Of course I wanted to avoid that, so I was always fully hedged (for A$ investors in A$ performance).

Today I am still absolutely staggered to see that Australian fund managers don't hedge the currency and leave the assets in multiple currencies. In fact, I also know a number of managers that have received awards as "manager of the year", but it wasn't their performance that got them there, but the currency contribution. What's your view on that?

Jack Lowenstein: We are managing global assets for a primarily Australian investor base. Our take is that we have to have a view on the currency. When I was at Hunter Hall, Chad, my current partner, and I managed the currency exposure and we made hedging decisions on a case-by-case basis.

So for example, during 2010 we made quite a lot of money going long Swiss francs and short euro, because we were very concerned at that point about the outlook for the euro.

So the answer to your question, Damien, we feel we have to manage the currency as part of what we do. The problem we have as a fund manager as opposed to an allocator is that we have to manage risks regarding the fund's exposures, and we have to leave it to the allocators to manage the risk that we create for them at their level.

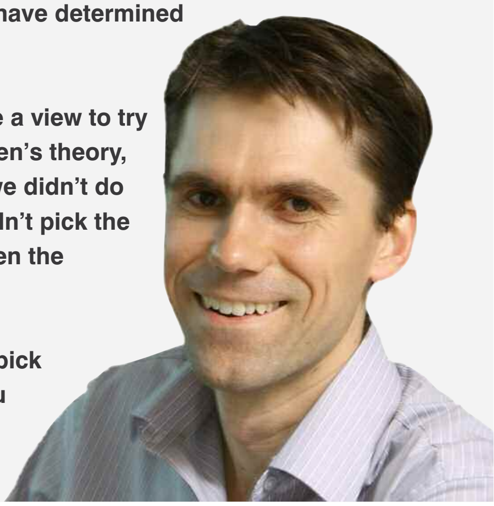


I said before, we refuse to be style-boxed. We don't think that's the best thing to do for our investors collectively through the cycle. We do realize it makes things a little difficult for some of the people, and it probably makes our business grow more slowly, but we think it will make it grow more steadily.

So currencies are an asset class, but you can't avoid taking responsibility for at the fund level. You have to look at it. I guess the lucky thing you have as an global investor based in Australia, is that by and large, the Australian dollar tends to move on long sweeps. It's either going up or it's going down. You get a bit of volatility within that, but it does in my view move that way.

As a final note, I have been investing in global equities for 15 years and I would say at least 10 of those years have been what you might call a bear market from an Australian investor perspective. Because not only was the Australian dollar steadily appreciating for most of that period, but Australian shares were outpacing global shares.

Stephen Baldwin: We take a little bit of a different approach than Jack, and are more in line with Damien. Our view is you need to know what you are good at and what you are not good at, and we have determined that we don't think we can add value in FX.

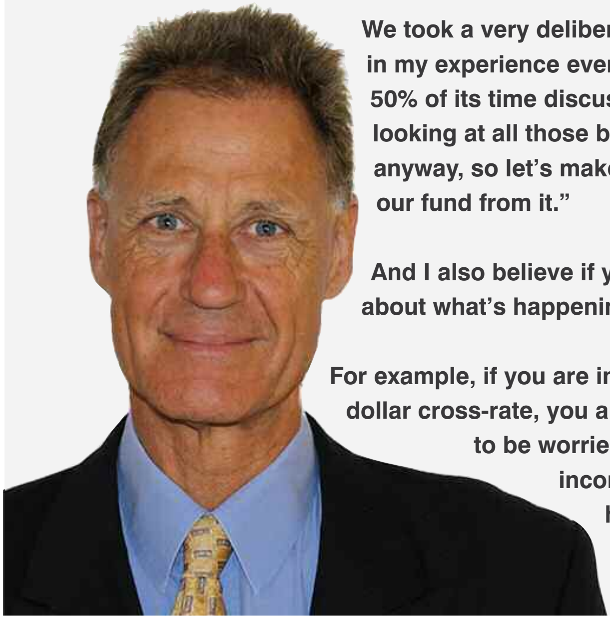


We do think we are good fundamental bottom-up stock pickers, and so we take a view to try and naturally hedge the currency as much as possible. Again in line with Damien's theory, we want to look at the returns at the end of the month and say, we did well or we didn't do well. If our returns are negative, I want to be able to tell you it's because we didn't pick the right stocks. Not that we had a great month and we got everything right, but then the Australian dollar is down 10 percent so you've still lost money.

We will tell you what we think we are good at. You are with us because we will pick the best stocks for you and not because we are FX experts, and that's what you will see in your return profile.

Rob Lance Jack, your partner Chad Slater, wasn't he Chief Economist at Treasury?

Jack Lowenstein: No, not quite, but he is an economist and worked at the Commonwealth Treasury, then at BT Funds Management and after that he joined Hunter Hall where one of his jobs with us was specifically to manage this currency aspect.



We took a very deliberate decision to be both a top-down and a bottom-up house, because in my experience every fund management investment team meeting ends up spending 50% of its time discussing the state of the markets or the state of the economy, so we are looking at all those broader aspects. Therefore we said, "well, we are going to do that anyway, so let's make sure we actually build it into our process – and generate value for our fund from it."

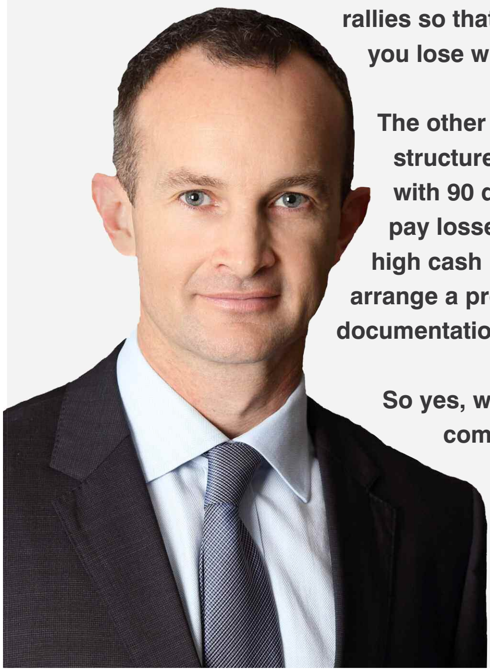
And I also believe if you are investing in global equities, you are going to be thinking about what's happening in cross-currency pairs all the time.

For example, if you are investing in Japan, irrespective of your view about the Yen-Australian dollar cross-rate, you are going to be worried about the Yen-Won cross rate, you are going to be worried about the Yen-US dollar cross rate. So you absolutely have to incorporate your view on currencies into your stock picking. So if you have taken it to that level, you are also looking at the final steps to say, how is it going to affect my Australian dollar return?

Chris Thompson: Within our Alternative Strategies Fund, which is a standalone fund, we think it's quite important to hedge out the currency and not to leave it exposed to foreign currencies. This actually goes back to risk management, how to manage the downside. We are trying to expose our investors to as many small bets as possible, and certainly if we left that unhedged, as Damien said quite rightly, the overall performance would be completely swamped by the direction of the A$. So for that reason we want to make sure that we have got smallish bets in lots of currencies, in fact we don't want a big bet on anything in the portfolio; the same applies to equities, bonds and everything else; sort of a little bit similar to what Andrew was saying on that side.

Within our diversified multi-asset funds, I think it is a little bit different because they tend to be dominated by equity risk. Leaving some offshore assets unhedged and therefore leaving offshore currency exposure in your portfolio can be a good diversifier in the raw portfolio. And certainly there you are going to make sure you have got a view on the currency and what you are doing.

Craig Stanford: Our underlying investments are mainly US$-denominated and we fully currency-hedge those at the moment, but I don't necessarily think that this is always the best idea – it depends on the product and your skill in forecasting FX. We hedge the currency because our fund is a low beta, low return target product and we don't think we are particularly skilled at forecasting FX. The main outcome for us is that we don't want FX to dominate the returns.



As an alternative you could take the view that during stress periods the U.S. dollar typically rallies so that you would get more protection from being unhedged, but the flipside is that you lose when the U.S. dollar falls, so it really depends on what you are trying to achieve.

The other thing to bear in mind is that hedging introduces quite a lot of complexity to the structure because you have assets which are maybe only liquid on a quarterly basis with 90 days' notice but you have got currency forwards, which you are going to have to pay losses on every day. So how do you fund those losses? One option would be to run high cash levels, but then you are always underinvested. Another option would be to arrange a provisional leverage commitment but to organize that involves a whole lot more documentation and having quite a big structure around it.

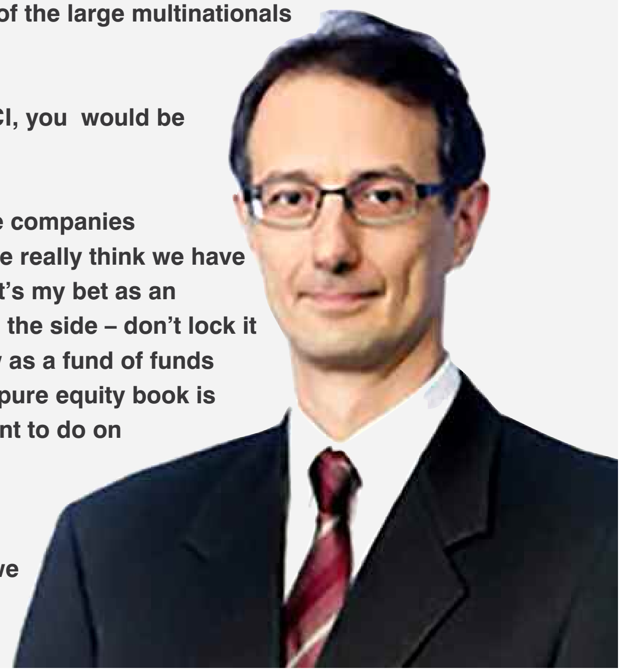
So yes, we do it for our hedge fund portfolio, but it introduces a fair amount of complexity. For our other investments, we separate the decision to invest from the decision to hedge the currency. We invest in the underlying asset and its base currency, and then we look at the portfolio level exposure on our multi-manager trusts and decide whether we want to run the FX exposure there, but that's not how we do it with hedge funds.

Matthias Knab So what are the share classes that you directly offer?

Craig Stanford We can offer share classes in almost any currency, but at the moment the investors are in the Aussie dollar share class and 70% of the underlying investments are U.S. dollar denominated.

Stefano Cavaglia: Prior to coming to Australia I ran a global long/short for about eight years at O'Connor in Chicago, so I want to concur. I chose the positioning that what we were good at was stock picking. We were investing in 22 countries and would hedge out all of the currencies, and it was relatively easy. You basically do it through your funding. Any long position is funded through a borrower de facto, and it's relatively seamless from an operational perspective actually. So it's a question of where you want to stack your bets at the end of the day as a manager.

I am not trying to pick on what you said, but I think when you start hedging out those currency exposures, it's not crystal clear what numbers you look at. You have got exposures to companies. I have actually written the book on this, because that was one of the things that we did at UBS, so I wrote some papers with Brinson, Diermeier and Solnik on this topic. We documented how much of the foreign sales activities of the large multinationals was accounted for stuff outside of their own home market.



And that figure is pretty large and pretty chunky – if you look at MSCI, you would be looking at a very large chunk of that world index.

In addition, and this is where it gets really, really messy, you find the companies themselves are hedging out their currency exposure, right? So do we really think we have a handle on what number we should try to hedge? My bet is no. That's my bet as an empiricist. I would say if you want to do currency plays, just do it on the side – don't lock it up in the underlying book, but keep them separate. Because if I now as a fund of funds manager want to know what you are doing, I want to know what the pure equity book is doing, no currency messing around, and then whatever bets you want to do on currencies is a separate book.

But very few managers tell you this. They just lump them in one and good luck to you to figure it out. That's why we get paid the wages we get, to figure those things out.

Jack Lowenstein: I agree, that is an issue. What we as a single product, global equity manager are trying to do is to provide a diversification opportunity for Australian investors – in our case mostly retail investors – from their overweight portfolio of Australian equities and their Australian dollar cash.

So our default position I should say is to be unhedged, and we manage hedges selectively within that. I mean, in some cases we manage hedges between two cross-currencies, not back into the Australian dollar, but our default position is to be unhedged. And we believe that most people here are investing in global equities funds with at least in part the aim of getting exposure to a non-Australian dollar asset class. So I have no shame in what we do.

Stefano Cavaglia: I respect that. But as the French would say "J'accuse!", the whole issue boils down to an unhedged exposure. If you are going to Joe taxi driver and you try to explain to him why he should go into global equities, it's not a currency story you are telling him, it's an equity story. It will be about growth opportunities, or industries that we don't have here domestically, like IT, right? That's what you are telling him. You are not telling him go there because you could play with currencies.

Let me translate this. The appropriate benchmark to me in the global equity world is a hedge benchmark. And the onus is on the consultants of the world to Tell the Qantas Super's of the world that they should be using a hedge benchmark. Yet that doesn't happen and maybe you can tell me that I am missing the point.

John Shin: We come from a very different approach because we are unconstrained. That means we think about currency as a currency allocation all by itself. For example, we run bands of different currencies and then we hedge everything outside of them. We would say we are going to have X percent in home currency, Y percent in euro, Z percent in US$, and if we are outside of those boundaries, then we will hedge. But if we are inside those boundaries, then we will let each currency run its own course.

We have also looked at Global Macro Managers, for example, Discovery out of Connecticut that uses emerging equities as a conduit to express their global macro views, and they have additional alpha on top of their global macro themes by picking individual stocks well. My guess is if you decompose their returns, a lot of it will come from the global macro bet, but they are putting it on via equities rather than the other way around.

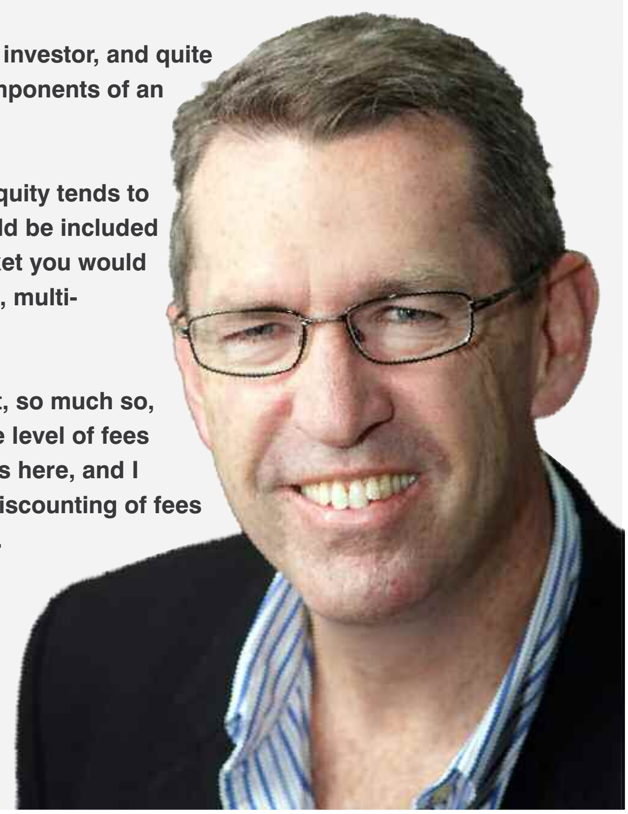
Damien Hatfield: Thank you for your views here on foreign exchange, I believe we have heard some pretty good exchanges on this. I wanted to turn our discussion to our pension funds, the superannuation fund industry which with $1.8 trillion in total AUM it is the fourth largest pension industry in the world. The sector here is divided into four major sectors; there are the industry superannuation funds, retail funds management, self-managed super and corporate funds.

In essence, the superannuation fund industry is a very experienced investor, and quite innovative in that they embraced alternative assets early as key components of an investment portfolio.

We are also a little bit different here in Australia in that long/short equity tends to be included in the equity asset allocation and long/short credit would be included in the fixed income asset allocation, whereas in the alternative bucket you would find the more non-correlated strategies such as macro hedge funds, multi-strategy hedge funds, etc.

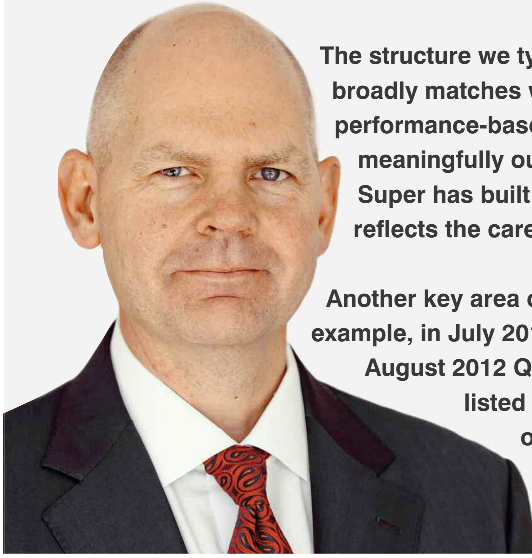
We do know that the Australian industry is very fee-sensitive. In fact, so much so, that some of our superannuation funds are very tough regarding the level of fees that they will accept from managers. We have a number of managers here, and I would like to get their views on their fees or their attitude towards discounting of fees or the fee environment in Australia. That would be my first question.

The second question is about the relationship between the asset consultants in Australia and superannuation funds and whether or not we have a different dynamic here compared to pension funds globally. I would guess that Andrew would probably be the best person to address that one.



Andrew Spence: APRA, the regulator for Australian superannuation funds, has a clearly stated view that fee levels across the industry are too high and need to come down. This is driving consolidation across much of the industry, with funds leveraging their scale to squeeze investment manager fees and, in an increasing number of cases, internalizing investment management capabilities. One question to consider is whether the opportunity cost of the industry's pursuit of ever-reducing fees is potentially lower alpha generation and lower portfolio diversification.

Qantas Super has adopted a clear 'value for money' focus rather than a pure low-cost focus. This means we are willing to include strategies such as hedge funds or private equity, which are typically regarded as more expensive asset classes, provided we can get an attractive net risk-adjusted return. I think one of the key issues regarding fees is getting the right alignment of interests between Qantas Super, the asset owner, and our investment managers so that alpha generation, rather than beta outcomes, is appropriately rewarded over a suitable timeframe.



The structure we typically use is a low dollar-based fee, rather than a basis point fee, which broadly matches what you'd expect to pay for beta management. And then we put in place a performance-based fee which appropriately rewards an investment manager when they meaningfully outperform their benchmark after the base fee has been recovered. Qantas Super has built a well-aligned and very cost-effective investment platform which largely reflects the careful way we have crafted our investment partnerships.

Another key area of focus has been on enhancing our implementation efficiency. For example, in July 2011 we formally moved to an agency FX model for transactional currency. In August 2012 Qantas Super moved to a single, 'whole of Plan' trade execution model in listed equities which is helping to reduce duplication, brokerage, stamp duty and other taxation imposts. These initiatives are delivering significant net benefits to our members, equivalent to 38.3 basis points per annum for our Growth (Choice and default) option.

Stephen Baldwin: Australia is often talked about as a low-fee type of environment, and while we have experienced that from time to time here as well, I don't think it's fair to say that all of Australia is in that bucket. Particularly if we look outside the institutional space at dealer groups or high net-worth individuals which are certainly more focused on after fee returns. Our own focus has always been on the net return after fees to investors.

One of the things I dislike in Australia is people publishing their pre-fee returns, because I think it's very misleading. The pre-fee returns are academic, the only thing that matters at the end of day is how much did I give back to you after fees. That is why we always talk about after fee returns. And if our after fee returns don't stack up, then you really shouldn't be with us.

We have certainly had challenges in Australia when we have talked to some of the large Super funds, not to your own group, Andrew, but other groups with the belief that managers are simply getting paid too much. We have also heard the comment, "we fundamentally don't believe in performance fees". We don't think that's right. We do think that a performance fee can be appropriate as part of the alignment with managers and investors, but that is not shared by the whole market.

Given those difficulties, our approach in the institutional space has been to give up and to look for other segments of the market. So as a firm, we haven't done a lot of work in the superannuation fund industry in Australia for a long time, because that issue has just been too difficult for us to overcome. We also acknowledge we have limited capacity in our strategy and that can be a challenge if you are someone like Australian Super and you need to be able to allocate a billion dollars to a strategy, you can't do that with us.

Our flagship market neutral strategy has around a billion dollars capacity all up, so we can't take enormous tickets at this stage. So for us, we have tended to focus on other areas of the market, both offshore investors local groups like family offices and dealer groups.

Matthias Knab You understand fees are a global discussion now, particularly in the U.S...

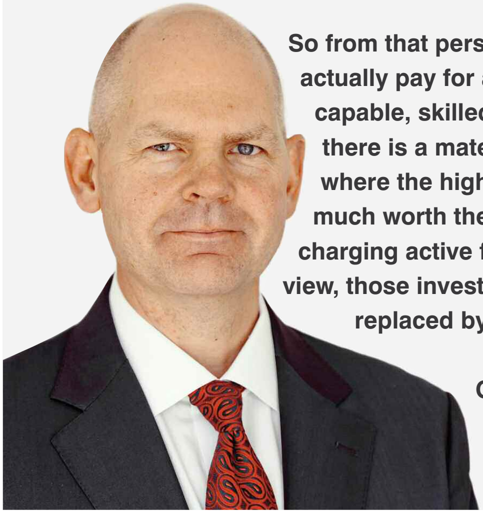
John Shin: As a family office I think I can safely say we have invested with some the funds that have the highest management fees and performance fees around the world, but we are always and absolutely focused on net return and the right alignment of interests. For example, we are very, very focused on how much capital a manager has invested in the fund themselves so that there's not just a one-way call option on the performance fee...

The other thing we think is really relevant is making sure that the period or window of calculation of the fees for liquid and illiquid strategies makes sense as well.

Rob Lance: It seems to me that differentiating beta based strategies from alternative and absolute return type strategies should be reflected in the fees. So from a more traditional portfolio management stance rather than a portfolio of funds perspective, for diversification, where possible – anything non-correlated to any movement in the underlying market – is where we will pay rack rate because that is part of how we manage risk.

With bigger expectations that the market has for alpha as well, I wonder if the whole space is changing for the active long fund manager? The market tried to distinguish real alpha in the '80s, the 90's were all about portable alpha, and now it's smart beta. Apart from coming up with more interesting names for it, I wonder if is there is still room for the traditional high beta, index benchmarked long only manager going forward?

Andrew Spence: To answer this from a Qantas Super perspective, approximately 70% of our total investment program is now focused on alpha generating strategies and managers rather than low-cost beta. The last three to four years have been characterized by 'trending' markets as quantitative easing has forced yields lower and led risk assets, such as listed equities, to rally significantly. This stage of the market cycle could well be nearing a conclusion and there is clearly an opportunity for high quality active managers to add value in an environment where there is likely to be increasing dispersion in corporate earnings.



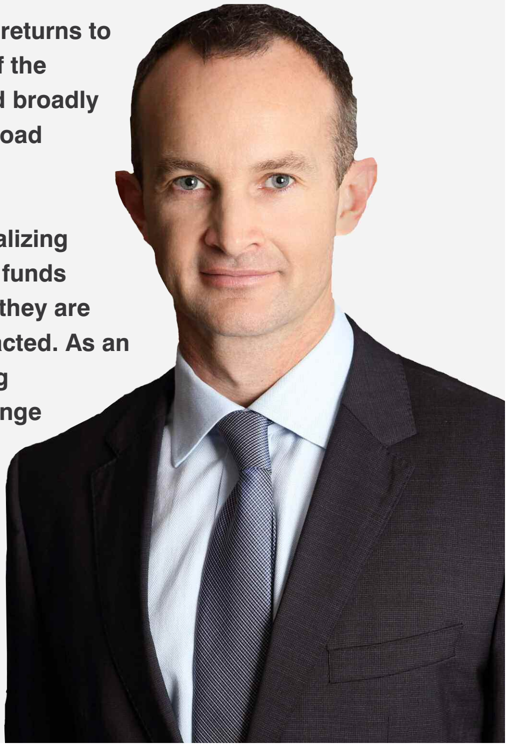
So from that perspective, alpha comes very much to the fore. The question is what price you actually pay for alpha, because as we all know, alpha is very scarce. There are very few truly capable, skilled managers that can add value on a consistent basis. Given that, I also believe there is a material cross-subsidization going on across the funds management industry, where the highly capable active fund managers that can consistently deliver alpha are very much worth the money we pay them. But there is also a vast array of managers that are charging active fees for delivering beta-like returns. This is clearly unsustainable and, in my view, those investment firms will be forced out of business over the medium to long-term and replaced by either smart beta or market cap passive strategies.

Going back to the topic of investment fees, one of the unintended consequences of the industry's singular focus on low cost is that Australia is getting a reputation for being 'cheap'.

Some asset owners are trying to access high quality managers and strategies at unrealistic fee levels. In a post-GFC world where Australia is no longer the marginal supplier of investment capital, high quality managers could well look to deploy their limited capacity in markets that are willing to more appropriately reward their alpha generating capabilities.

That is a regrettable position for a country like Australia which has a large pool of retirement savings to invest. Despite that, Qantas Super continues to strive to meet high quality offshore managers to ensure we get good access to the best ideas.

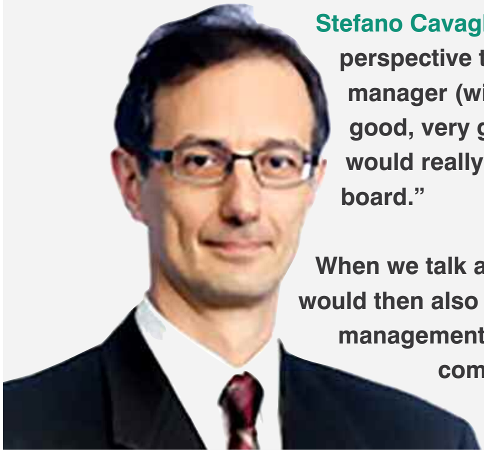
Craig Stanford: **I agree that only net returns after fees are relevant, because that is the performance you are getting, after all. The best fund we ever invested with ended up with fees of four-and-forty four, and it still annualized at around 35% net per annum for over a decade. You wouldn't have received those returns if you had just looked at the fees.**



In my mind, the real problem beneath that fee discussion is that over time the returns to hedge fund investors versus the return to managers have been less in favor of the investor and more in favor of the manager. The reason is that fees have stayed broadly constant, but the net returns have been trending down, if you look at it on a broad industry basis.

Following up what Andrew was saying about the shift to lower fees and internalizing everything, I think there is a real risk coming out of that with "cheaper" hedge funds coming to the market and institutions then allocating money to them because they are cheaper without thinking about how their performance outcomes may be impacted. As an example, you may find that the cheaper funds have less sophisticated shorting programs, less sophisticated hedging, and maybe aren't able to use the full range of assets that are open to unconstrained and better equipped managers.

The performance outcomes in this case could be that those funds have higher beta, more downside risk, and greater drawdowns so that perhaps during the next market sell-off they don't provide the same level of protection and investors may conclude that "hedge funds failed", while in fact it was the investor's implementation that was flawed. But the investors won't see it that way.



Stefano Cavaglia: **I want to commend Andrew for having taken the route from his fund's perspective to endorse performance fees and so on. I will tell a contrasting story of one manager (with a Scottish accent) I heard saying, " I have this manager and he is making good, very good returns. But his performance fee as a result is going up and up, and I would really like him to lose money, because that way I will look better in front of the board."**

When we talk about some pensions' efforts to internalize all of their equity management, I would then also hope that the regulators would start demanding that all results of internal management will also be openly presented to the end client, how much of the returns are coming from internalized management net of costs, and how much of it is coming from the external managers net of fees.

Chris Thompson: On the fees issue - I think there are two different angles, and we have probably covered both angles in discussion, but it's important to differentiate the two.

The issues are definitely growing. There is an escalating "political" view in this country that fees are bad and we have got to get fees lower and that this can be done without impacting ultimate performance. For example, the Grattan Institute has jumped on the band wagon, implying that if we could take fees out of the system, members would be better off by the amount of fee saving. Given super has become so important, it has become a natural target for politicians to get fees down in super at all costs. And that plays through in different ways.

Unfortunately, investment costs get caught up. The consequence of this is that capacity constrained skill based alpha will become unaffordable to default super options. I think this is to the detriment of the returns and risk of these funds because we would all agree that alpha is a diversifier to the equity that dominates most so-called "balanced" portfolios.

The fee debate also plays out through competition between the retail funds and against the industry funds. Also, I am guessing if I am a CEO of a smaller super fund, I am feeling I have got to get my costs done, otherwise I am going to lose my job. So there's a political will to get fees down, and the problem is investment fees, not surprisingly, get caught up in every other efficiency that can be gained.

Certainly then, I am sure you have got plenty of asset owners in this country who desperately want to optimize "net of fee" outcomes to investors, but are just not in a position to do that because they effectively have to work within a risk budget that not only shuts out plenty of alternative investments but also the better active managers who may be running smaller amounts of money or having less capacity, because they are so good that they are in demand from other investors around the world.

Certainly there are also people who look after hedge funds and super funds in the country who are absolutely adamant hedge funds are the way to go as for allocation in a portfolio, but they are getting sidelined.

However, like I said, there are two sides to the debate on fees. I think the days of just paying fees for the sake of it are over. It used to be the case that if someone called themselves a hedge fund then they automatically demanded two-and-twenty. The good news is that, and this is definitely global as well, that investors, (certainly institutional investors) have wised up to that.

And so, as Stefano mentioned in what he does, I think a lot more scrutiny of returns is required. And investors are being a little bit more careful in saying, I really want to allocate where I really think there is skill or something idiosyncratic, and I am prepared to pay for that. Particularly because I can see either through a track record or through research that this investment is going to return sufficiently after the fees are taken off. But there are all sorts of other returns that hedge funds have given us over the years that actually can be accessed more cheaply and probably in more liquid form as well, which is the other side of things.

Certainly, that is we are doing within our funds at Advance by saying "look, a lot of the returns can be accessed in a more efficient way". These returns have become known as alternative betas or smart betas. But then importantly, what we are doing is still accessing idiosyncratic alpha through hedge fund managers where we believe these returns are valuable to the portfolio and can't be accessed any other way.

Damien Hatfield: So this discussion actually started to go towards a government-mandated scenario, which a lot of offshore participants in the hedge fund industry would not really be aware of. This government-mandated situation is effectively a new product and was introduced after the Global Financial Crisis and they now call this product MySuper. It's a default option and most of the assets are indexed type products in MySuper portfolio.

A retirement planner can take this default option, it has a very low fee option which covers a series of asset classes. And the asset classes tend to be more beta-oriented, because they are going to be index products, low fee, daily liquidity, and that's what's going to fit into this component called MySuper.

Chris offers a MySuper alternative product, which is a replication strategy, a hedge fund replication-type asset, and I want to talk a little bit about that.

I first came across replication back in the early 2000s, when it started to develop as an industry segment. I can remember looking at it thinking, what is this? This is obviously a passing phase. I thought the whole thing would die a quick death and we would never hear of it again, because I couldn't understand the hedge fund industry had gone from an industry where I had met some of the smartest stock pickers, some of the smartest fixed income traders who were all benchmark unaware, and now we are going to develop a product which was hedge fund benchmark aware, low fee, daily liquidity – that to me was just totally the opposite to what I had come to love and know as the hedge fund industry.

But replication has a place and it definitely has a place in the MySuper product. But also we are seeing within the superannuation funds, RFPs for the cash component of a hedge fund product. The reason why you have got cash in the hedge fund portfolios is the rebalancing of new fund flows, which can't be invested immediately.

What happens is that we are now seeing demand in Australia for replication to soak up the cash component, because that cash component is giving somewhere between 2.5% and 3%. And if they can get a hedge fund style return stream in an index, then that's attractive to superannuation funds, and it fits very, very well in the MySuper.

Let me throw this out, probably to Chris to make a comment about that, because he actually has a product in the market which is tailored to replication.

Chris Thompson: This sector has certainly changed since 15 years ago when the investment banks were launching their first replication products. Certainly, I would have shared exactly your feelings for those products in those days, where you were trying to replicate an index which had, as we knew, quite a lot of equity beta and then hopefully had a lot of alpha, and obviously some fees coming off, but net of fees alpha.

It didn't seem to make a lot of sense trying to get something that was going to be correlated to that index, because probably what you were picking up was probably the stuff you didn't want. So certainly those products didn't seem to make a lot of sense.

But when you start unpacking things and going bottom-up and looking at what makes sense to try to replicate – because the other problem with the index is there are all sorts of strategies in there – so if you try and replicate the index, you will not be able to replicate certain aspects and with others you get better results at replicating.

But if you start doing things a little bit from the bottom-up, getting for example carry-like returns or short volatility returns in some ways into your portfolio directly, I think you have more of a chance.

Also, what we do in our product is actually isolate a set of 30-40 managers, where we can look at their returns, particularly in aggregate, and show that we can replicate their returns, mainly because these aren't the fast-moving CTA's, global macro managers, or people doing things like distressed debt or structured credit, where really it's an idiosyncratic skill-based return that you are getting. Rather, we are more looking at the long/short or the event-driven guys, where I think you certainly have a better chance.

One needs to remember that you are never going to get the alpha through a replication, so certainly with all these products you need to know what you are investing in. You are not trying to get alpha at the end of the day, but like you said, unfortunately in a world where you have got a fee budget and you can't necessarily completely look at net of fee returns, I think it's a viable alternative.

Plus, the other thing apart from fees that we shouldn't forget in this discussion is the liquidity aspect. And certainly we went down this route, partly because our retail product demanded after 2008 a daily unit price and sufficient liquidity. But I think it's an important tool within the way we construct the portfolio as well. It also allows a more dynamic approach in risk-managing the portfolios compared to a typical hedge fund of funds.

Matthias Knab What's the type of return that you are achieving with the replication?

Chris Thompson: I think the best way to look at that is in terms of our tracking error against underlying managers that we are trying to replicate which has been about 1.5% pa below the managers' returns.

So you are giving something up, but like I said, what you are getting back for it is the liquidity. If you would be invested through a traditional fund of funds with maybe 30 or 40 funds, you as investor will be stuck in there, particularly when in a GFC type of environment.

John Shin Are you targeting any Information Ratio, Sharpe Ratio or anything like that?

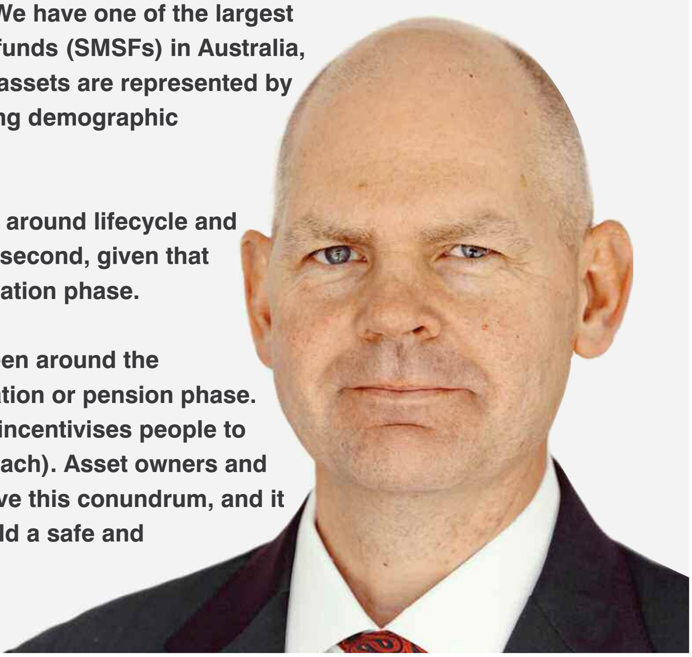
Chris Thompson We see the hedge fund replication in context and as a building block with the rest of our portfolio. And yes, we have been targeting a Sharpe Ratio of 1 for the whole portfolio.

John Shin That is interesting because we have come up with the same approach, but implemented it slightly differently. In our case we have built out a substantial quant research team, their focus is to identify factors or alpha sources that are sustainable. We then test those strategies against a transaction cost model and risk model – which significantly reduces the list of feasible investment strategies.

Matthias Knab Who else is working on a new product or a new approach to investing?

Andrew Spence: I can't say that it's new or original but when we look at our default members, we recognize that members in their 50s are particularly exposed to a number of different risks at a critical point in their retirement planning. Typically members are disengaged, meaning that they are not focused or involved with contemplating sequencing risk, investment risk, or anything along those lines. We have taken the view that a lifecycle type of approach is one way to try and manage those risks. We are not saying it's a perfect solution, but we think it's a better solution than perhaps having just one default option for our members.

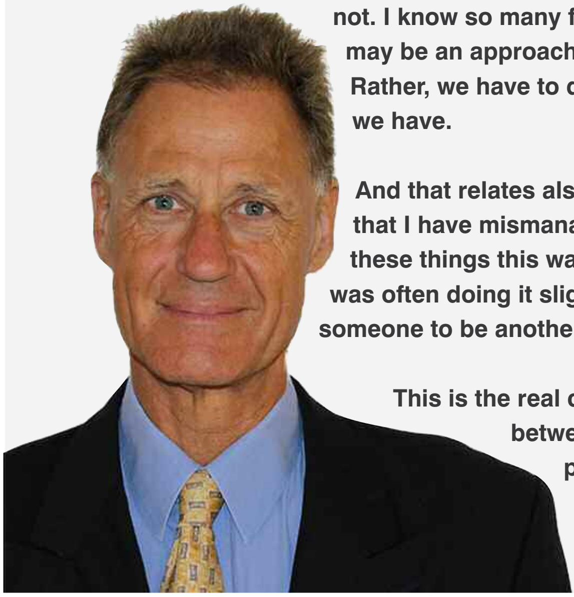
What we did was a lot of modeling around our member data. We have one of the largest average balance of any fund outside the self-managed super funds (SMSFs) in Australia, at about $180,000 per member. About 50% of Qantas Super's assets are represented by people in their 50s or older. That on its own is a very interesting demographic situation.



And so there are two products that we are focusing on: one is around lifecycle and a 'whole of life' solution to their accumulation phase. And the second, given that demographic, is to have a retirement solution for the decumulation phase.

Australia's system is quite unusual in that all the focus has been around the accumulation phase and almost nothing around the decumulation or pension phase. At this stage there is no government regulation that basically incentivises people to take an annuity (which is very different to the European approach). Asset owners and managers around the world are trying to find ways how to solve this conundrum, and it is also very important for us to take a close look at how to build a safe and sustainable retirement solution for our members.

Jack Lowenstein: I guess the real problem is that for a fund manager, as opposed to the asset owner, it is very important to stay focused on what we as managers want to do, and let everybody else choose whether they'll like it or not. I know so many fund managers try to build a product to a perceived market, and that may be an approach that can work in other industries, but I don't think this works in ours. Rather, we have to do what we think is our way of making money for investors with the team we have.



And that relates also how you work and interact with others in your team as well. I know that I have mismanaged one or two portfolio managers by telling them, "I want you to do these things this way," but their natural way, where their skills achieved their best returns, was often doing it slightly differently. You can actually ruin a career when you try to force someone to be another manager than he or she is in fact.

This is the real challenge because we are in a complex industry with many levels between the end-consumers, say the pensioner, and the ultimate product produced by a manager like me. Sometimes it felt like I almost had to shut my ears and say, "I'm going to do it this way because I think this way will work best for my average investor and for the cycle..."

Stefano Cavaglia: Like Andrew, we are also working on these lifecycle type of products throughout the accumulation phase. We design tools that can help us have a communication with the members, also the so-called disengaged members to get them to respond because in the end, what really matters is more the amount of contributions that they are making over time and not so much the returns that they are gaining on those contributions. And getting them to contribute the right amount to reach a particular goal is probably the more critical question and the one that they would probably relate to more. On the decumulation phase we are working with an insurance company that could potentially provide those annuity products.

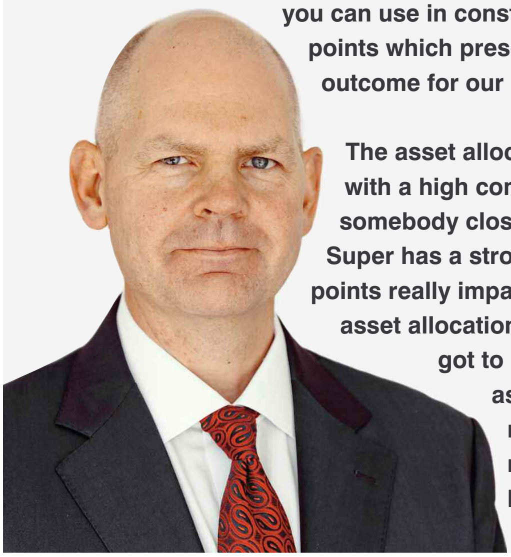
Related to this is also the hedge fund component and what role it can have? We have been talking to a number of fund of funds because quite frankly, we don't have the required bandwidth. So we are looking at joint ventures with some fund of funds, and we are currently exploring their views on what they can provide in the liquid hedge fund space.

We divided liquid hedge funds into two sections. One is called by some people hedge fund replication. But I don't like to call it that. I prefer to put the focus on the different risk premium that hedge funds are exposed to. And then there's another part which is strategies that can live and continue to exist as daily or weekly liquidity strategies, and thus you have the 40Act funds that have now surfaced in the U.S.

It's very interesting to see how some of the fund of funds are saying, "What's the difference in the expected returns between these two strategies?" The consensus is that there is no consensus, quite frankly. And it's very much biased to who has a 40Act fund and who doesn't. Also, as Andrew referred to earlier, we may be in for some surprises in the next cycle that will also have an impact on the daily liquidity funds. I believe the markets will then soon find out which ones were properly designed and which ones weren't, so caveat emptor for those of us who work in that space. We have to be very careful about what is being pitched to us and find out what is really inside of that shiny kimono. We do a lot of that work, especially because I am Italian. We like to look under the kimono.

[Laughter]

Andrew Spence: In Australia we have a peculiar situation regarding the design of a lifecycle solution for superannuation members because APRA (the regulator) basically prescribes the maximum number of price points that you can use in constructing a lifecycle strategy. As I understand it, we can only use four price points which presents us with some challenges in constructing the most investment efficient outcome for our members.



The asset allocation you want to use for a 20-year-old is obviously an aggressive strategy with a high component of equities because you can ride through the market volatility, while somebody close to retirement age will obviously hold a more defensive portfolio. Qantas Super has a strong 'user pays' philosophy and APRA's restriction on the number of price points really impacts our ability to optimize the trade-off between the step-down function in asset allocation for dealing with sequencing risk and the pricing of the assets that you've got to actually help you deal with that. So that is proving to be quite an issue for us, as I am sure it is for the rest of the industry. It did start off at one price point, now it's gone to four. I think that hopefully in time, the regulator will take a much more pragmatic approach and leave it to the funds to justify the fee levels they have chosen for their lifecycle solution.

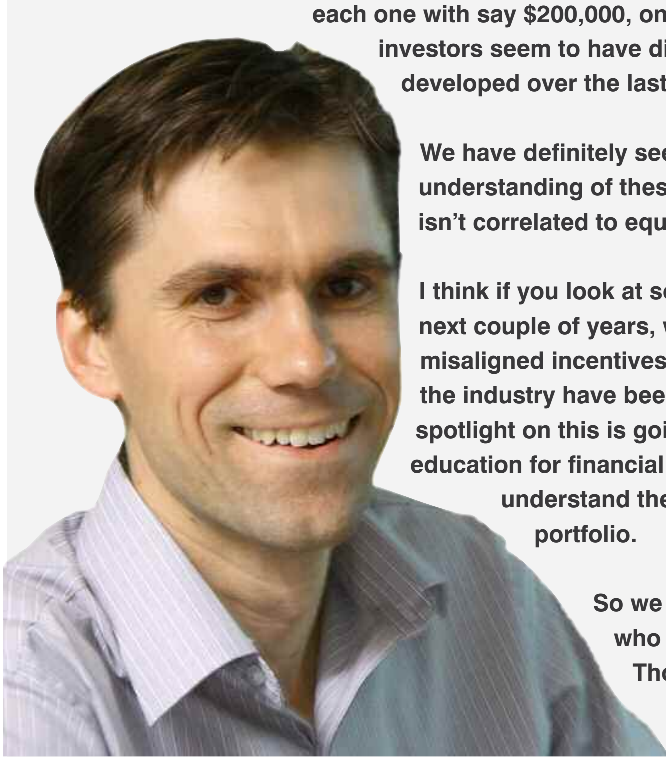
Damien Hatfield: Today we have a hedge fund manager who has about $1.2 billion in AUM and you started in 2004. We have a hedge fund manager over here in Morphic who have nearly $100 million in AUM, and you've been going for two years. There are real challenges, so I'd like to have a look at the Australian hedge fund industry just from a couple of perspectives. And of course, I should include John as well because he just got seeded by the Roberts family to start a quantitative hedge fund.

So, I would like the group to talk a little bit about the challenges in the local industry in trying to attract assets. When I was marketing Australian single managers, the biggest investors were global fund of funds, but those flows stopped around 2008-2009. Some managers closed as a result of redemptions, others continued on significantly reduced AUM. So that certainly was a big challenge to the industry.

Stephen Baldwin: Looking back to when we launched in 2004, we initially found it very, very hard to raise money in Australia. For a long time the only money from Australian investors was our own or from friends and related parties. So in 2005, pretty soon after the business started, we launched an offshore fund, and by 2007 or 2008 we found that 80% to 90% of our money was raised offshore.

Then following the global financial crisis we experienced a difficult time. We had a lot of withdrawals, particularly from global fund of hedge funds. As we didn't gate and offered monthly liquidity, we saw some pretty big outflows and lost more than 75% of our AUM over a period of just six months. Luckily for us, the investor flows quickly rebounded and we did get inflows again.

What I can also say is that over the last three years I feel that we have had genuine success raising money in Australia. The vast majority of that has been from dealer groups, private banks or non-aligned high net worth individuals. The private banks particularly have become a helpful conduit for us. They aggregate 10 or 50 investors, each one with say $200,000, onto a single platform. Our main product is market neutral, and investors seem to have discovered an appetite for it now. But as I said, this only developed over the last three years.



We have definitely seen a changing of attitude and across the market a better understanding of these products and why you'd want something in your portfolio that isn't correlated to equities.

I think if you look at some of the changes in financial planning coming up over the next couple of years, what we have seen across the industry has been a lot of misaligned incentives, and while there are good financial advisers out there, parts of the industry have been chronically undereducated for a long time. I think a lot of the spotlight on this is going to change those types of things. I believe increasing education for financial advisers will be really good for strategies like ours because I understand they are a more complex proposition than a 40 stock long only portfolio.

So we need an adviser who can understand what we are talking about, who understands the concepts of beta and alpha and correlation. Those are the kind of advisers who would allocate to products like ours.

Matthias Knab Andrew, Damien had that question for you regarding smaller managers...

Andrew Spence: We basically have $700 million in hedge funds; they are largely global rather than Australian-based firms.

We have backed two local managers. One is Jason Halliwell at GMO. The other is a downside risk protection hedge fund strategy with SouthPeak Investment Management to which we awarded a relatively large individual mandate tailored for our specific needs. We have invested with them for almost 18 months now, so you also see that we are not overly concerned with being a relatively early adopter when we see skill and a strategy that really suits our needs. Interestingly, the principals of SouthPeak on the trading side have just relocated to Greenwich, Connecticut to be closer to the time zone for the hedging strategies they have in place.

I think it's one of the ironies of the hedge fund industry that the strategies which are typically most attractive are the ones that are massively capital-constrained. This means you have to be an early adopter rather than being a 'Johnny-come-lately' deploying very large amounts of capital into hedge funds.

This is actually true for the whole industry. I believe there is a massive asymmetry with the large asset owners getting bigger and bigger. Just take a look at the sovereign wealth funds and the amount of capital they are looking to deploy. I believe that half of total sovereign wealth funds' capital has been garnered within the last ten years, which is an expression of this bifurcation in markets, certainly also around real assets, where we are seeing a massive disconnect between the large asset owners deploying very large sums of money in bidding for trophy assets, and then there is the small or mid-market segment where a lot of our alpha strategies are focused. Those remain significantly less contested at this stage.

Qantas Super has been able to generate attractive returns via its Prime Managers in infrastructure because these assets are relatively small with an equity check of around $200 million to $300 million. The big asset owners just can't get their investment allocations filled, as they would need to acquire ten to 15 or more of them, while we just need a handful.

That is a very interesting dynamic in the marketplace. You have to look at the payoff or the yields on some of these assets. You can see large sovereign wealth funds bidding for London property assets, and the yield is down at 2%. We have bought a small local port in the Australian state of Victoria and paid well under ten times while other larger 'trophy' assets in Australia were just recently sold for somewhere between 25 and 28 times. In my view assets bought for less than ten times will most likely outperform 'trophy' assets bought for 25 times – time will tell.

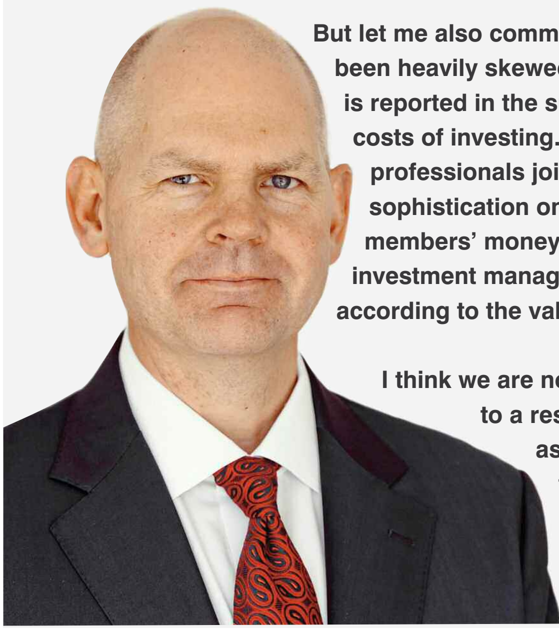
Chris Thompson You are right, the larger funds, pensions and SWFs are just getting larger, for different reasons. I always thought that it must be extremely difficult to add value, to create a sensible return for such large funds. Can you share some more reflections and thoughts about this issue?

Andrew Spence: I think there are some very smart people running the investment programs of the sovereign wealth funds, but with that size comes a massive challenge of scale. Most of our comments today focused on our approach to understanding our key comparative advantages, whether as an asset owner or an investment manager or an adviser, and the need to strategize on how we can maximize our strengths and basically backfill our weaknesses.

But the large sovereign wealth funds have the additional challenge of how to rationally deploy very large sums of money. The difficulty in that area in particular is that it is very hard to pursue an alpha-driven strategy when we know alpha is scarce.

I do believe that Qantas Super, as a corporate superannuation fund that is dedicated solely to our members' best interests, is in a sort of sweet spot with our current AUD 7 billion in capital. This is sufficient for us to get exposure to complex and sophisticated assets using high quality investment partners, but our asset size doesn't preclude us from gaining a meaningful exposure to those alpha strategies which represent approximately 70% of our investment platform.

If we were managing $30 or $50 billion then we would need to adopt a very different investment approach in order to take advantage of the landscape that we would then face. Again, it's about understanding what our comparative advantages are, and maximizing them. I am very comfortable managing the size of fund that we have. I think it's a comfortable position, if such a thing exists.



But let me also comment on another development in our industry. Until now our industry has been heavily skewed towards the way investment managers work; for example, performance is reported in the surveys on a gross of fees and tax basis whereas the investor bears these costs of investing. However, we are seeing an increasing number of talented investment professionals joining superannuation funds, and this move is boosting the level of sophistication on the asset owner side of things. The asset owners represent the members' money. So first and foremost, the asset owners control the money, not the investment managers. Investment managers are an agent and they should be rewarded according to the value that they create.

I think we are now seeing a secular shift that will continue over the next ten to 15 years to a restacking of the industry away from investment managers and towards asset owners who are driving a clearer pricing of alpha relative to beta. I do think that those managers with real skill will continue to thrive. They'll make large sums of money from their rare investment skills, and so they should. But there is also a vast array of managers that don't fall into that camp, and they are going to get severely squeezed, in my view.

Stefano Cavaglia: We discussed a bit how has investing changed or how is it changing, but I wanted to extend that a bit into how business in general has changed. Allow me to paraphrase the words of one of my mentor who said, "If we as investment managers understand how businesses are run and how they are changing their business, we can then understand how we, as investment managers, should structure our business accordingly".

It was such a fundamental question for me when we were dealing with this – his was at UBS asset management where my team did work on the importance of industries as a driver of stock returns, and the whole firm went from a very regional national centric approach to managing global equities to a very industry-centric approach. This was 10-15 years ago, so it's kind of an ancient history but anyway...

The concept is still valid, let me give you some thoughts because as I go talking to managers, I always have this in the back of my head. For example, we have invested in a growth manager who mentioned the following, "What was striking about Apple was the way they, in a very, very short period of time, in four or five quarters, were able to print sales like no firm had ever printed sales in the entire planet before." The manager added that this was beyond what they expected and beyond what anybody could have expected. So what is it? What is this firm doing? Apple was actually exploiting a channel of distribution, exploiting the internet, which is now certainly more mature than it was call it 10, 15 years ago.

This whole notion of exploiting the distribution channel is something that I see time and time again in firms that succeeded, and firms that then print money for us as managers.

This then ultimately also means that I as a fund of funds manager, what I look for is firms that are aware of these distribution channels and firms that have management that is particularly flexible and adaptive to changing conditions, and then will respond.

***It's not that investing has changed*. It is what do and what we look for in terms of how an investment manager thinks.**

Matthias Knab That is certainly very interesting to look at managers also from that perspective, checking their flexibility and innovation.

As I came all the way down under, one last thing we should address as well is what's going on with regulations here?

Andrew Spence: There have been an enormous number of regulatory changes in the last few years and these are having a profound impact on the way members and asset owners tackle that landscape. However, there is a real risk that if regulatory reform continues apace then members' confidence in Australia's superannuation system established by the Keating government in 1992, which has been a monumental success in Australia, could be undermined. The fact that we are the fourth largest pool of superannuation savings in the world tells you everything, given that the capitalization of our stock market represents just 1.4% of the world's market cap.

Damien Hatfield: One area that really concerns me, and it's something which has really started to escalate and is becoming ever increasingly more difficult, is to market into the United States and to Europe.

I was speaking to product developers here in Australia and even throughout Asia: if you want to develop your product now – it can be an alternative asset product, it could be a traditional product, might even be infrastructure private equity style products – for managers here it started to become quite impossible to actually market into the regulatory environment of the U.S. and Europe.

This actually creates two issues. The first issue is going to be that product producers here are going to really focus their distribution into Asia because we're on the same time zone, and the Asian markets are starting to increase in terms of wealth. They have pension funds and wealth managers, so the logical extension from Australian manager is to more directed distribution into Asia. But the bigger issue, I think, is that European and American investors are not going to get the benefit of return streams outside their country that they could have got. They won't have access to Australian assets, for example.

I think that's going to be a real big issue and will degrade returns or retirement return streams in those countries as time goes by. These ever increasing regulations are possibly getting to a ridiculous level. There is a case which you could probably elaborate on, Rob, which is about a manager sitting in Hong Kong with a website that is now being prosecuted by U.S. authorities.

Rob Lance It's actually by the Hong Kong authorities.

Damien Hatfield As agent on behalf of the U.S. because of U.S. investors accessing a website of a Hong Kong-based manager. This is getting out of control.

Matthias Knab The same issues are raised also when we do these Roundtables in Europe. We also have sometimes regulators participate, for example at our France Roundtables usually the head of the AMF. The regulators there obviously don't want to shut down anyone, but they make their point that they want to regulate the industry according to their own understanding and procedures.

In Europe, the regulators have created UCITS funds, and if the strategy is not "UCITS-able", then you also have the vehicle of the Alternative Investment Fund (AIF), etc. In addition, there are many platform providers in Europe that offer a manager, also international managers, a regulatory umbrella. So there are solution available, but of course they add costs and complexity. However, once you have gone through all the hoops, you generally can passport your fund to all E.U. countries and market there.