

# Opalesque Roundtable Series '15

# CANADA

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# Editor's Note

## Success with an alternative investment program is not a sure thing for anyone

The large Canadian Pension funds like Ontario Teachers' Pension Plan (OTPP) have an excellent track record (average annual return of 10.2% since inception) and reputation as astute and very sophisticated investors. OTPP was one of the first institutions to use derivatives in 1990 and made its first investment in hedge funds already in early 1995. OTPP's strong focus on innovation, which is continued until today, was born of a simple lack of diversity in the assets: When the fund was started on Jan 1st 1990, it had billions of dollars in Ontario debentures that were not tradable, and therefore intelligent and meaningful diversification was recognised as an immediate and vital necessity.

OTPP's success is attributed to its governance and very specific objectives that were laid out at the fund's inception. What stands out in OTPP's governance is a strong board of largely independent professional members, who give large amounts of delegated authority to the group of professional investors and remunerate them in a way that's linked to their performance. The success of Ontario Teachers' Pension Plan has been noticed, not only globally, but also within Canada, and that has created the path for other large Canadian institutions, including corporate pensions. With OTPP, CPPIB, OMERS, Caisse dépôt, PSP, Alberta Teachers, and others, it can be said that Canada is today known, talent wise, for ice hockey and for its institutional investors.

## The Role of Governance and Alpha

Interestingly, there are marked differences between the Canadian institutional investors and the ones based in the US and Europe. As mentioned, governance in Canada has many consequences, and one of them is the pension's ability hire and pay competitively, something that is much restricted in the US. Europe has similar freedom to attract talent, but European institutions are so heavily regulated that these very smart, talented people are prevented from doing very often what they would like to do. Somehow Canada shares with Europe the ability to pay for talent and intelligence and also enjoys the freedom that North American regulation gives their investors. That makes Canada very special.

About 8.5% of OTPP's \$154.5 billion CAD assets (as of Dec. 2014) are externally managed, and Jonathan Hausman's group makes up the majority of that. In this Roundtable, Jonathan discusses the role of alternatives for OTPP, how OTPP invests into alternatives, and why OTPP is actually growing their risk budgets towards alternative investments. Jonathan also expressed that his group feels *"very strongly that there is such thing as alpha"*. While other investors believe that there is no replicable process that one can identify, *"we believe that there is, and which is why we think that some managers are really the ones worthy to identify and find, and cultivate and develop partnerships with."* Hausman also believes that higher levels of alpha come with managers at earlier stages of their development.

However, success with an alternative investment program is not a sure thing for anyone. Over the years there were also failures, in Canada and elsewhere. Institutions with significant assets and the objective to manage them using alternatives and be progressive failed in the end with their attempt. When you take a deeper look at those, participants of this Roundtable believe those schemes did not work where the governance and the specific objectives weren't working in the first place.

## Information management and systems: The Investor's GPS

OTPP, like other very large, sophisticated investors, have recognised the importance of having quality, real time information about markets and their investments, and have therefore made significant efforts to build cutting-edge infrastructures around information management. *When information is provided to you faster and more efficiently, people and institutions become better investors.* Risks decrease because you are surrounded by and have access to a superior informational system. It's like having a GPS to better navigate through markets and investments: It allows you to drive more often. It allows you to go to places you never dared to go, you can see exactly where you are and where you are going.

This Roundtable, sponsored by Sigma Analysis & Management, took place April 2015 at the Sigma office in Toronto with:

1. Ela Karahasanoglu, **Principal and Senior Manager Research Consultant, Mercer**
2. Jonathan Hausman, **Vice President of Alternative Investments and Fixed Income Emerging Markets, Ontario Teachers' Pension Plan**
3. Claude Robillard, **Managing Director, Investor Relations, West Face Capital**
4. Michael Beaton, **Head of Direct Trading, Carlyle Liquid Market Solutions / DGAM**
5. Luis Seco, **President and CEO, Sigma Analysis & Management**
6. Ranjan Bhaduri, **Chief Research Officer, Sigma Analysis & Management**
7. Tim Pickering, **CIO and Co-Founder, Auspice Capital Advisors**



The group also discussed:

- Why it is important to separate, not just psychologically, but also operationally, long-term alternatives from short-term alternatives
- How does OTPP identify external managers? What are the selection criteria? What does the relationship with external managers look like?
- Why OTPP thinks managed accounts are a much better way to build the relationship with external managers
- What is the concept of “*tacticality*” that OTPP is trying to increase now?
- Could Toronto be the “Hollywood” of the hedge fund industry?
- Why there is a receptive global audience for Canadian investment ideas
- Update on Liquid Alternatives, Currencies, Multi-Asset Strategies, Energy
- New hedge fund fee models based on volatility
- When do investors and consultants rate a manager positively even in absence of a longer term track record?
- Mercer has widened the manager base they are covering by including smaller and emerging managers. How can funds get onto their radar?

Enjoy!

Matthias Knab  
Knab@Opalesque.com

## Participant Profiles



(LEFT TO RIGHT)

Matthias Knab, Michael Beaton, Luis Seco, Ranjan Bhaduri, Jonathan Hausman.  
Claude Robillard, Ela Karahasanoglu, Tim Pickering

# Introduction

**Ranjan Bhaduri**

Sigma Analysis & Management.

My name is Ranjan Bhaduri. I am the Chief Research Officer at Sigma Analysis & Management. My duties include helping to service our clients with regards to structural alpha and hedge fund manager research.

**Michael Beaton**

Carlyle Liquid Market Solutions.

I am Michael Beaton. I am the Head of Direct Trading at Carlyle Liquid Market Solutions. Carlyle Liquid Market Solutions grew out of Carlyle's acquisition of Diversified Global Asset Management and was created to deliver hedge fund and liquid alternative products to its investors.

I am the portfolio manager of two funds, the Carlyle Trend Following Fund and the Carlyle Liquid Tactical Fund. Both funds were launched last year and have posted strong performance.

The Carlyle Trend Following Fund, CTFF, was launched in May 2014 and seeks to deliver strong risk adjusted returns by extracting value from the persistence of price momentum in liquid asset classes. CTFF trades across equities, currencies, fixed income, and commodities, taking both long and short positions in each of these markets.

The Carlyle Liquid Tactical Fund, CLTF, was launched in August 2014 and is a systematic fund that aims to generate strong risk adjusted returns by tactically investing across a diversified set of global liquid risk premia spanning equities, fixed income /credit, commodity and other inflation-sensitive assets as well as alternatives. The fund is tactical and responsive, and aims to provide strong risk adjusted returns by responding to varying market conditions.

**Claude Robillard**

West Face Capital.

My name is Claude Robillard from West Face Capital. We are a multi-strategy alternative asset manager. We express our portfolio through a variety of approaches including opportunistic investments, rescue financings, equity positions of influence and distressed investments. We also manage an active co-investment platform to address opportunities that may otherwise be outsized for our Funds. I oversee IR for our firm and manage our global relationships.

**Tim Pickering**

Auspice Capital Advisors.

Tim Pickering. I am one of the PMs, CIO, and co-founder of Auspice Capital Advisors. We are a Calgary-based non-correlated alternative manager, registered as a CTA, however we don't like to be shoved in that box exclusively.

We have a product suite that ranges from trend following, quantitative rules-based strategies to enhanced beta or smart beta strategies in the CTA and commodity space. We also offer commodity beta products.

We offer a range of different vehicles for different investors, like funds, ETFs, '40 Act funds both in Canada and the US for retail and institutional clientele.

**Luis Seco**

Sigma Analysis & Management.

My name is Luis Seco. I am the President and CEO of Sigma Analysis & Management. I am also a Professor at the University of Toronto and the Director of the RiskLab and the Mathematical Finance Program there. I am also a part-time barista and cook.

**Ela Karahasanoglu**  
Mercer's Alternatives Boutique

My name is Ela Karahasanoglu. I am a Principal and a Senior Manager Research Consultant in Mercer's Alternatives Boutique, based in Toronto. Prior to Mercer I worked as the manager of research and trading for a quantitative global macro CTA based in the New York area. At Mercer I am responsible for researching North American hedge fund strategies with specific focus on currency, global macro, CTA/managed futures, commodities, multi-strategy and multi-asset strategies. I produce white papers for Mercer and help with asset allocation for Mercer clients. I am also the designated currency and hedge fund specialist for Mercer Investment's Canadian business and sit on our International Fixed Income Manager Ratings Review Committee. I am an avid cook as well!

**Jonathan Hausman**  
Ontario Teachers'

My name is Jonathan Hausman. I am the Vice President of Alternative Investments and Fixed Income Emerging Markets at Ontario Teachers'. There I manage both an internal and external investment program.

The external program is comprised of what we call both short-term alternatives, better known as hedge fund strategies, and long-term alternatives, which are various long-term lending-related strategies.

My internal program is a macro desk in emerging market rates, credits, and currencies.

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**Jonathan Hausman:** Well, I think that like other investors around the world, there is always an element of serendipity that produces others people's positive perceptions. Obviously, we are all trying to do much the same things.

I do think however that a lot of what you have called the "Canadian way" in the end comes back to governance and very specific objectives that were laid out for pensions like Ontario Teachers' in its modern incarnation in 1990, which of course, like many significant policy changes, occurred in the wake of government fiscal considerations as well as other factors.

Out of a very difficult situation in Canada in the '90s, there was a great need to increase the certainty around the actuarial goals of our key constituents in the province of Ontario, like the teachers. That was really how the institution was born.

When I say governance, what I am referring to specifically in our case is a strong board of largely independent professional members, who give large amounts of delegated authority to the group of professional investors and remunerate them in a way that's linked to their performance.

This is a defined benefit program, and while I will not debate the merits of this approach in this forum, I would certainly say that it provides a low-cost alternative to the constituents, to our fiduciaries – so in a way it's a great deal for everyone.

When you have this level of delegated authority together with that level of professionalism and an independent identity, then you can start to do the work of investing, focused primarily on performance and on innovation.

Innovation, in our case, was born of a simple lack of diversity in the assets that we started with -- billions of dollars in Ontario debentures that were not tradable. So one of the things we did in the 1990s was to enter the world of derivatives to gain more diversity in our strategy, in fixed income, for example. That created a need for diversity in other derivative strategies, including equities. As a result, we were one of the first institutions to use derivatives regularly, but again, it was borne out of necessity.

As time went on, in 1994, that spark of culture around innovation led us to the world of alternative investments. When our present CIO, Neil Petroff, used to attend hedge fund conferences in 1994 and 1995, he was practically the only institutional investor there; certainly the only Canadian one, along with family offices, which at that time largely made up the investor base of hedge funds.

I think we made the first investment in hedge funds in early 1995, and this has grown since then through various stages. But each time always driven by a need for returns that have little correlation to broad markets, a steady cash flow, and the need for the best and brightest managers, whose activities were largely outside of the scope and scale of what we did internally at Ontario Teachers'.

I can't speak for all Canadian pension investors, although I think they have largely benefited from the same basic model as Ontario Teachers' and have done very well in their own right, but let me point out again that the kernel of the DNA, if you will, of the organization was born in those years, in the early 1990s.



**Luis Seco:** There are marked differences between the Canadian institutional investors and the ones that I see in the US and Europe. As Jonathan stated, governance in Canada has many consequences, and one of them is the pension's ability hire and pay competitively, something that is much restricted in the US.



Europe has similar freedom to attract talent, but European institutions are so heavily regulated that these very smart, talented people are prevented from doing very often what they would like to do. Somehow Canada shares with Europe the ability to pay for talent and intelligence and also enjoys the freedom that North American regulation gives their investors. That makes Canada very special.

**Ranjan Bhaduri:** The success that the pioneers like Ontario Teachers' Pension Plan has been noticed, not only globally, but also within Canada, and that has created the path for other large Canadian institutions to try to build their own programs within their own identity, but still use innovation and embrace governance and diversification in their portfolios.

In Canada, with CPPIB, OMERS, Caisse dépôt, PSP, Alberta Teachers, and others - it really had become very much a situation where Canada is known, talent wise, for ice hockey and for its institutional investors. I think that Canada is truly world-class in institutional investing, and that Ontario Teachers' Pension Plan deserves a lot of credit for the success that Canada has had in this arena.



**Michael Beaton:** Maybe this is my investing bias, but I think empiricism matters. It is one thing to reason out how certain approaches and governance structures should drive superior investment performance, but is another thing to actually see it play out in practice. Canadian investors have had the luxury of seeing big plans like Ontario Teacher's and CPP realize great success right in their own backyard. I think this makes it a lot easier for other Canadian investors to adopt similar practices and innovate a little faster than those further removed from that experience. I see this willingness and desire to innovate not just across our public pensions but also across many Canadian *corporate pensions* as well.



**Tim Pickering:** I will be the first one to give a punch, and while I am not referring to anybody in this forum, but related to something that Jonathan said in terms of the primordial role of governance and the specific objectives being the key drivers of the success at Ontario Teachers'.

I am pointing to those key aspects, because over the years I have also not only witnessed successes with those *but also failures*, not in Ontario, but at other organizations, where there was a pile of money, where there was an objective to manage it using alternatives and be progressive, but in the end they failed. That was within Canada, and I won't mention any names.

So when you take a deeper look at those, I think what you can see is that it didn't work where the governance and the specific objectives weren't working. To tell you the truth, that concept would also have been a concept lost on me 15 years ago when I left institutional trading. But having had so much interaction with institutions since then, I now completely understand and respect that.



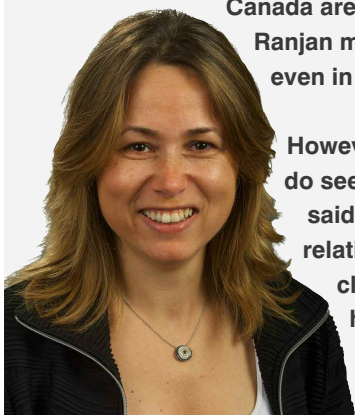


My point here is that success with an alternative investment program is not a sure thing for anyone. There haven't been just success stories, and for some the road has been a bit bumpier, within the Canadian context and probably also abroad

When we're looking at the Western provinces of Canada, the only comment I would add is that we are definitely seeing more activity from there. Groups like Alberta Teachers' have also been adding absolute return strategies over the last two years. You are starting to see that in organizations in British Columbia, but they are definitely a little bit slower to adopt. There is absolutely no doubt in my mind that Ontario Teachers' have been the leaders and made a significant impact for all of us.

**Ela Karahasanoglu:** I do agree with you. The very large sophisticated institutional plans don't tend to be Mercer clients in Canada as they usually have sufficient internal governance and resources to run their plans, so they do not rely on us as much. We are mostly working with the next tier of investors, those who may not have such deep internal resources, and often will need consulting advice, sometimes to the extent of delegated solutions.

Jonathan talked about the importance and the role of innovation. Let me add that the sophisticated investors in Canada are often quite progressive. Investors such as Ontario Teachers', OMERS, and the ones that Ranjan mentioned earlier have launched their own strategies that we don't really see elsewhere, not even in some of the other progressive locations globally.



However, that has taken some while to permeate to the smaller pension plans. In that sense we do see a trend towards increased allocation to alternatives within the Canadian landscape. That said, when you look at the allocation to absolute return strategies, they still seem to be relatively small in Canada versus some of the other regions where Mercer services institutional clients. Therefore while, as we said, the larger institutional plans have taken the lead and have been very instrumental in permeating these ideas into the smaller plans, it seems to be taking somewhat longer than in other regions.

**Matthias Knab**

Jonathan, you gave us a short overview of the historic evolution of Teachers' starting with derivatives, then in 1995 the first hedge fund investments. Obviously, since the 90's a lot has changed, and I am wondering, what is the role of alternatives for OTPP today? And second, how do you currently invest into alternatives?

**Jonathan Hausman:** I would say that the role that alternatives play is structurally the same. Alternative investment is a pure value-add activity, which means that it is solely for the purposes of increasing the alpha of the fund. That is not any different from what it was before. Alternatives are essentially a way of increasing our return-driven investing returns so that we may better achieve our goal of maintaining the actuarial stability through the long-term.

In respect of your second question, as things change, we have always tried to be as reflective as possible on what is the best way to achieve the highest risk-free rate of return from our investment activities. I would cite three different examples of how we have tried to evolve along with the changing landscape of the environment.



The first has been the increased use of managed accounts. In our short-term alternatives, so in the hedge fund strategy investments, to be specific, we have over the last six years in fact transferred our investments from funds to managed accounts.

Let me add here that this was not solely or even primarily done to address some of the grotesque examples of operational risk that existed during the 2008 crisis, although that is certainly a plus, but really to use in our view a better way to invest. Already two years before the crisis, we had already experimented with and piloted substantially managed accounts. So that was the direction we were going in anyway, and we accelerated that transformation post-crisis.

We feel that managed accounts are a better way to invest because it places us, the investor, at the center of the investment process, and not the manager. This is in no way a criticism of the managers, but we think managers are best suited to be focused on their trading strategies, while we as the asset owners can be more focused on the structure that allows us to invest with greater levels of control, transparency, which is extremely important to us, and assuring that the liquidity of the underlying asset matches the legal structure. Managed accounts were clearly the better way to invest considering these different dimensions.

The second development I would refer to is that of recognition of the importance of separating, not just psychologically, but also operationally, what we call long-term alternatives from short-term alternatives.

I would make the simple observation that in the 2008 crisis one of the problems that many hedge funds – although certainly not all – encountered was a mingling of assets that were really private equity-related strategies with more liquid strategies, and when it came time for redemptions to be paid, that sometimes created a problem.

What we like to do is we think of ourselves as the fund of fund manager ourselves, and we are very clear about the different liquidity profiles of what we do and make sure that they are duly understood and risk-managed appropriately.

The third thing that I think is very important is to recognize the changing landscape of where alpha is generated. We feel very strongly that there is such thing as alpha; some don't. Some believe that there is no replicable process that one can identify; we believe that there is, and which is why we think that some managers are really the ones worthy to identify and find, and cultivate and develop partnerships with.

So this third, important development is about the process of identifying the talent and building relationships with managers. Let me add here that we are to a certain extent convinced of the higher levels of alpha come with managers at earlier stages of their development, which is not to say that those alphas would necessarily diminish with greater size, but being cognizant of the appropriate size of certain strategies, particularly in the increasingly illiquid trading environments and almost all assets.

**Matthias Knab**

What is the current percentage of alternatives within the overall portfolio? And has it gone up or down over time??



**Jonathan Hausman:** If you look at our annual report, about 8.5% of our assets are externally managed. My group makes up the majority of that. But the direction of the alternatives, or external managers we call them, is perhaps towards growing our risk budgets in that area. We feel that over all those years we have established a reasonable track record and have reasonable experience and so the direction would be on the margin to grow that activity

**Matthias Knab**

I think a lot of people are delighted to hear that your institution believes in alpha and that you are actively looking for it. Can you explain to us more about your process how you are doing that? How do you identify your external managers? What are your criteria?

Also, how would you further characterize the relationship? You already referred to it more as a partnership, could you give us a bit more color?

**Jonathan Hausman:** Like any business relationship, everybody has to win here. When it comes to our relationships with managers, let me start to say that also we don't have too many of them. We believe it's important to have a relatively manageable number of managers, otherwise you can't have really strong relationships.

We have an AI team of ten or twelve people and then an operational team on top, of whose time we benefit from greatly. If you think about that and how many managers can the individual team member really have real relationship with, you get a sense of the relatively small number of managers that we would engage.

The second observation I would like to share is that initially managed accounts were viewed with some suspicion by some, but not all, established hedge fund managers, which I guess was understandable given some of the operational work that had to be done. But maybe also it was because of the fact that a managed account obviously gives a greater level of control to the investor, or as the prime brokers call it now, the asset owners.

We actually take a kind of contrarian view, which many managers today also share, which is that having a managed account is a much better way to build the relationship with the management. Let me explain to you why. In the old model, the investor received transparency only through a call or through a monthly or even quarterly letter. All you can do is to assume that things are not going well because you don't know, you are missing the information. And then when you see a certain number popping up, it can be very troubling for investors in that way.

But if you can see that information everyday, you can observe how the positions evolve and understand that they indeed exactly mirror the strategy and the discussions you had with the manager, then you can focus with the manager on things that are exceptional as opposed to things that are normal or should be normal. That creates a much more productive relationship.

Let me also tell you that we invest a lot of time to find managers, and to on-board them. So we are loath to give them up. We take all the time we need to make sure they are the right people because once they are in, they are in, with all the usual caveats. They then also know that we understand their strategy and can obviously see what they do and monitor how it conforms to our understanding.

In that respect it is also very important to point out that we are open to understanding that sometimes certain management strategies are not in vogue at certain times. It doesn't mean you have to fire the manager then, rather it just means that you understand that this respective portion of the portfolio construction is doing what it's supposed to do.

Our emphasis is not really on managing managers, but managing the portfolio construction, and that's what managed accounts really do best in the sense that they allow you to maintain what you want and also to maintain relationships so that you are never surprised.



**Jonathan Hausman:** We are obviously looking for performance, but that only takes you so far. Of course, a track record is critically important, but we are also looking for process.

We have an extensive due diligence process, which is really there to see the greatest possible engagement and understanding with the manager before even we have hired them. Our due diligence can go on for a little while, and to ensure that we really do understand what's going on, and, secondly and most importantly, *they* know exactly what's going on inside their funds, i.e. their research and investment process, position and risk management, and so on



I am very pleased to say that the managers that we have, have reached a level of process, be it around risk management or human capital management, that we find really quite excellent. But they have to reach that standard, for sure.

I do think that there is a greater awareness of these things today, and we find that people are very happy to engage us on the requirements that we have.

**Jonathan Hausman:** The main area of innovation or progress for us is to really get to a relationship with the manager that goes beyond the broad conventions. I am not speaking only of fees here, although that is obviously part of it too, but it's really about the *tacticality*, which is probably not a word, but nonetheless, let me express it that way that we are trying to increase tacticality.

What does that mean? It means that post-crisis we live in a different world in terms of where and how dislocations occur. Opportunities come and opportunities go, and dislocations come and dislocations go. You can't necessarily have an all-weather portfolio for all possible circumstances, because the truth is all the circumstances happen, but they happen at different times and in different places

That tactical element I am describing here isn't just with our hedge fund strategies per se, but also with what we call long-term alternatives. We want to have dry powder with a number of different players in different spaces that don't necessarily have an offering all the time. Specifically, we want to be able to have special accounts; meaning, managed accounts, with managers that when they see opportunities, they can act on them with us immediately. We have done all the work and preparation, so all the agreements, structures and procedures are in place.

This goes beyond the idea of just investing in a series of funds that sort of go on with their normal strategies. But more importantly, we think that it's important to have that capacity to act on certain things when they happen. That is really the focus and the essence that I described as wanting more tacticality, because we don't believe really in maintaining a static portfolio.







**Ranjan Bhaduri:** I think Jonathan brings up an excellent topic with regards to managed accounts. Done properly, utilizing managed accounts empowers the institutional investor. Not only from a risk management and risk monitoring way to help protect against strategy drift, style drift, concentration risk, and fraud, but also from a portfolio construction purpose. As Jonathan stated, managed accounts allows the institutional investor to tactically adjust and adapt in a superior way.

**Michael Beaton:** I agree completely that the desire to become more tactical is one of, if not the theme of the last decade amongst investors. This theme has been echoing and reverberating since 2008, when many determined that static or buy-and-hold portfolios led to outcomes that exceeded their risk tolerance.

The desire to be tactical is very natural and sounds great, but when push comes to shove, actually implementing a process that allows you to act tactically in a meaningful way poses several meaningful challenges to investors.

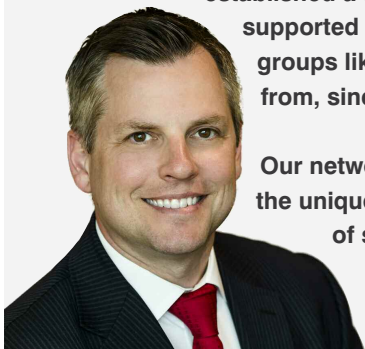
I think there are three key challenges that investors must address to truly be able to take advantage of tactical opportunities.

First, you need to be able to access a multitude of distinct asset classes and strategies. To really be able to take advantage of the potential of tactical investing you need to have capabilities across a large investment universe. If the best investment opportunities arise in an area where you cannot deploy risk, you're left with a sub-optimal investment process.

Second, you must develop an investment process that accepts market-timing. This is somewhat anti-thetical to many but fundamentally, tactical investing is about deploying capital into the right opportunity at the right time. Building a concrete framework to instill discipline around measuring opportunities across multiple asset classes and quantifying the magnitude of these opportunities over time is key. This is not a trivial task.

Finally, I think a competency in the use of derivatives is also important to tactical investing. The ability to move capital quickly is crucial. In many cases, derivative markets allow for a faster redeployment of capital with less market impact.

Internally, we launched the Carlyle Liquid Tactical Fund last year which we believe addresses these challenges I mentioned and offers a fairly innovative approach to investing across a full range of liquid markets.



**Claude Robillard:** First of all, I would like to acknowledge that groups like Ontario Teachers' Pension Plan that have established a strong global leadership position in investing in alternatives have without a doubt supported the awareness of Canadian capabilities in this space, which has created a halo effect for groups like ours. In our travels, the conversation quickly turns to what we do versus where we're from, since Canada is already on the map.

Our network appreciates that we often present ideas through a Canadian lens and, correspondingly, the unique exposures we generate. That said, we do express ourselves outside of Canada in areas of sector expertise where we feel we have an edge.

To your earlier question, we work on identifying a finite number of catalysts to surface value in our investments where we feel we can either manifest or accelerate a desired outcome. We view success in an investment as a product of factors versus a sum of factors - you need to consider joint probabilities because if any one of your ideas doesn't quite work within a thesis, it can substantially impact an outcome.

Each of our investments is idiosyncratic and differs from what you will typically find in event-driven portfolios. Our names rarely cross-correlate or cross-pollinate with other global fund managers. We run a slightly concentrated book, but at the same time we focus on structural resiliency within the portfolio in that the factors that surface value in each of our names are independent. We also focus on the optimal approach to exiting an investment, expressing ourselves through private or public market channels. Finally, we like volatility because it creates opportunities.

Summing up, we are seeing a receptive audience for Canadian ideas. The global investment community is looking for "new and different", and is anticipating greater dispersion of returns between markets and between asset classes near term. We find investors in this environment are keen to explore strategies and groups like ours.

**Matthias Knab**

Luis, you and your group are also pushing the frontier in innovation. Can you talk to us in more detail what are you doing, what role does innovation play, and how you help investors do a better job?

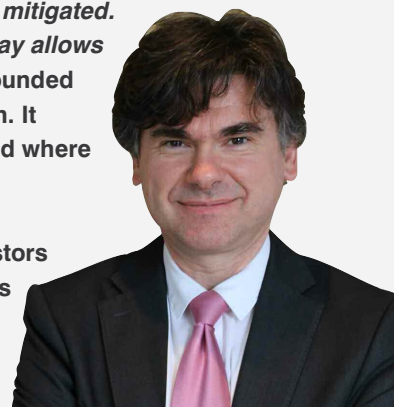
**Luis Seco:** 2,500 years ago Heraclitus said that nothing stands still, everything changes. Bob Dylan said it too. It continues to be true today, but today things are changing in a very particular manner: *change is driven by information*. When it comes to investing, we as managed accounts providers working for investors, we can clearly see a new appetite for information, which is new from the content perspective as well as from the form perspective; information needs to be delivered to empower investors, particularly when it comes to making decisions. This is very different from, for example, providing information for purely regulatory purposes.

Jonathan has used the term "tacticality" earlier, and in my view that term will become an actual word, because there are some real consequences to thinking like that. *When information is provided to you faster and more efficiently, people and institutions become better investors.*

I will give you an example. I lived in New Jersey for four years, many many years ago. Back then, the worst thing you could do in New Jersey was to take the wrong exit on a highway, which can easily render you lost, or worse. So driving to any new destination in New Jersey in 1985 was a very risky proposition, especially for someone from Spain, who has never driven on those highways.

*Fast forward to today: You put the GPS on, and suddenly you are empowered, risks are mitigated. You see, the fact that you have the relevant information given to you in a manageable way allows you to do something that looked risky earlier on. Risks decrease because you are surrounded by and have access to a superior informational system. It allows you to drive more often. It allows you to go to places you never dared to go, you can see exactly where you are and where you are going.*

For example, investing in emerging managers. With a better informational system, investors really know what's going on without a manager track record. Investors cross boundaries that in the past they were afraid of crossing.



**Ela Karahasanoglu:** The landscape has been shifting and we are very cognizant of it. Mercer has been carefully listening to what our clients are saying, what the institutional world is talking about and where the industry is heading. For instance we are now focusing more on emerging and niche managers.

In the institutional consulting world sometimes it is challenging to look at the smaller managers, even if they perform better, partially because they potentially pose higher operational risk. But we have been taking that into account and have started marking and monitoring such managers in our universes for investors who actually have the required governance to be able to potentially invest and allocate to such strategies. We believe these allocations are suitable for what we call is the “opportunistic bucket”.

I think this clearly illustrates the direction the market is taking. Performance and alpha is sought after in different locations rather than, say, in mega managers who have traditionally tended to gather a lot of the institutional assets.

The other thing that we have been observing on our end is the increased demand for liquid alternatives, which is very much of a debated subject these days. We do have some investors who are very interested in having some form of liquid alternatives in their portfolio – in the form of a ‘40 Act, UCITS or the like.

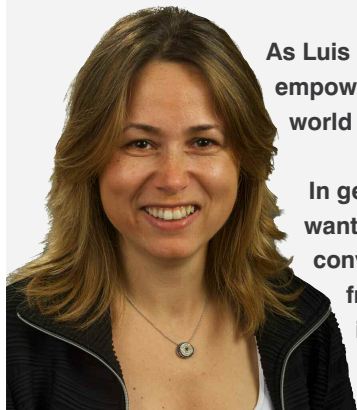
We have now created a separate universe for such strategies and have been expanding it alongside our other manager universes. Some institutional investors are interested in such cheaper, but maybe more beta-like type of investments, and we feel some of the regular hedge fund strategies could still be effective in a liquid alts format and we welcome this approach, on a case by case basis. That is another change in the landscape and we are actively searching for more such managers who can actually deliver these types of products.

So, today, it’s not just about the trading strategy or the fees, but also about the type of offering or the product. Portfolio construction, risk management, idea generation are still very important, but I think the different fee levels that can go with different types of offerings are an important part of the consideration for many of clients.

Generally, we don’t want to see managers who are charging exorbitantly high fees for the risk-adjusted returns they are delivering. In certain instances higher fees could perhaps be justified, but typically we continue to look for managers who charge in line with the performance and volatility they deliver.

We also recognize every client portfolio is slightly different. Some actually need more liquid products versus others, and some might need more equities than others, but at the end of the day we like to track what the real demand is in the market environment and how that translates into the universes we cover. In other words we would focus on newer demand areas that might also be more progressive.

For instance, one of the things that has been up and coming has been multi-asset strategies. Multi-asset is a sort of a blurry type of universe including various type core and idiosyncratic strategies, but interestingly, so far most of the demand appears to come from the US and the UK, but not much from Canada. Based on my observations multi-asset is not as much known in Canada yet. We have been introducing this concept to the marketplace and talking to our clients more about it. This is a good example of the advantage of being global; the demand we see in one location helps us drive our efforts in other regions.



As Luis mentioned earlier in his GPS metaphor, the clients have been more educated and empowered, also thanks to, again, the pension plans like Teachers’, OMERS, and CPPIBs of this world who have been giving more GPS directions to investors.

In general, we find that investors today have a better idea about where they stand, what they want, and how to get it. Indeed, we don’t simply give advice; we have very productive conversations with our investors who come to us with their own questions. Now more frequently investors approach us and say “we already understand various sleeves, and here is what we need and want in our portfolio. How should we go about it?” and that’s where try to help them create the structure to help them achieve their goals.

On a separate but related subject, I was looking at the results of our Canadian institutional allocation survey a couple of weeks ago. It seems that the alternative allocations have been increasing in an average Canadian pension portfolio, but the exposure to hedge funds is still relatively small say compared to the US, UK or Australia.

I think alternatives and particularly hedge funds are still up and coming here in Canada, and there is a lot to be done on the educational side. We explain to investors that don't view hedge funds as an asset class but rather as a collection of different types of strategies and different risk premia. In that sense, we do not believe all types of hedge funds would be suitable for any investor, but they need to be diligently picked, sized, structured and diversified based on every client's specific needs.

Another progressive asset class, which in fact has been around for a very long time but has gone quite unnoticed until recently, is currencies. In the Canadian landscape, especially dynamic currency hedging, has become quite topical given the significant move in the Canadian dollar against major currencies over the last period. It has been quite evident that sometimes "sit and forget" may not work for well for pension plans with large foreign exposures.

**Jonathan Hausman**

At OTPP we are always neutralizing our US dollar exposure, so it hasn't really played much of a role in our portfolio construction.

**Matthias Knab**

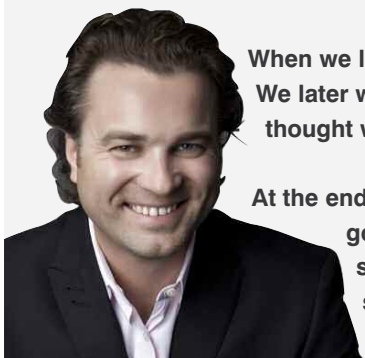
Does your institution integrate what's nowadays called "smart beta" approaches?

**Jonathan Hausman:** We are always open to the simple proposition that managers have to be judged based on their performance against what otherwise one can buy in an off-the-shelf product. So we certainly view having a facility with alternative beta products as being primary to our process, because otherwise we would not be judging the actual alpha being produced by managers that we pay for. It's a very important ingredient in what we do.



**Tim Pickering:** When it comes to innovation, those of you who know me will understand that I almost have to jump out of my chair when this topic comes up, because at the end of the day, this is kind of what gets me up in the morning.

I started my career here in Toronto at TD; a very discipline-based trading organization, and then went on to trade for Shell. When I left Shell to start Auspice, it was all based on taking that discipline and doing some innovative things with it. What happened at that time was that we immediately got shoved in the category of a CTA, and frankly back then I didn't even know what a CTA was.



When we launched the diversified program, our flagship program, that made sense to a lot of people. We later we launched a natural gas ETF based on an index we published with the TSX, people thought we were out of our minds, and I am just going to tell a quick story of that progression.

At the end of the day, what we wanted to learn was how to deliver the right product, with the right goals, at the right price, for the right investor. We didn't identify CTA or any particular strategy fitting in any box, but the question was, where did it fit on the alpha to beta spectrum?



So typically you would look at a product, look at its attributes, look at the level of transparency, match that up to the investor, put the right cost on it, price on it, set the right goals for performance, and ultimately create a product suite. But that really hadn't been done in the CTA space. I mean, CTA was kind of a fairly traditional space, as I could see it.

When we took that step to take a CTA strategy, so taking one of our own strategies, and publish it third party as an index, people still struggle with that idea. And I am going to tie this back to information and Luis' comments here in terms of an index.

As a rules-based manager, you have a distinct advantage, and that is, if you have a repeatable process around what you do, you can make active feel passive. So the question is where do you want that strategy to fit on that spectrum of alpha to beta? You can make active more efficient, and if you make it more efficient, you can offer transparency, you can offer an index, and thus fit it into a different delivery mechanism like an ETF.

So still to this day people will say, "okay, about your Managed Futures Index strategy that's published on NYC, what's the index?" Well, the index is us. The index is taking a rules-based strategy, lifting the kimono, and actually having somebody publish those weightings third party on a moment-to-moment basis.

So where does that fit and why would a manager do that? That fits into the spectrum between beta and alpha. Whether you call it smart beta or enhanced beta or whatever you want to call it, it's defining a product in its level of transparency, and its cost, and its performance, and finding that right combination and pricing it as such for the right client.

Once we decided we were going to publish that index, I had a fairly famous CTA manager call me up and wanted to sit down and talk to me. He said, "So what are you going to do and how does this work, what's the strategy?" I said, "Here it is," and I outlined it for him.

And he said, "Okay, very interesting, and what are you going to charge for that strategy?" I said, "We are going to launch an ETF at 95 BPS, and we call it an enhanced beta strategy to managed futures."

He said, "Well, you are out of your mind. He said that's very similar to our strategy. We charge two and twenty for that type of a strategy!". I said to that manager, "*Look, in two years from now you are not going to be charging two and twenty.*"

This comes down to information, and this is the point that was last made by Luis, and *that is, things that are unknown become known, the black box gets broken, for lack of a better term, and the right price needs to be paid as the market evolves*, and you can either accept that and get on that train or not.

I am going to tie this to one last point, and Ela has heard me talk about this. We at Auspice believe in a concept called Core Satellite. That's nothing crazy and new. Most of you have heard of that. But maybe in the context of CTA we haven't heard it as much.

At the core, how are you getting that tail risk protection, that trend following exposure, and are you paying an appropriate price for that core trend following approach with a certain level of transparency, in a certain package? And then perhaps "satelliting" that with strategies more niche, tilted to alpha, stuff that is less transparent than the managers learned along the way.

And so we believe in that this Core Satellite approach is also helping us with our transition from being a smaller boutique manager to hopefully more institutional accounts.

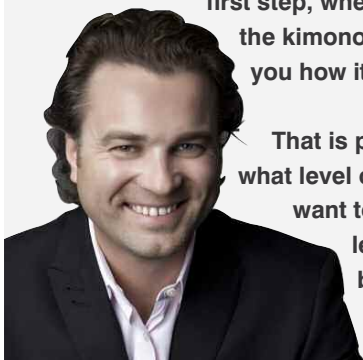
So those are some of the innovations I see specifically in our area; Core Satellite, active and passive and enhanced beta, smart beta concepts, and it really comes down to information and accepting that information changes everything.

**Michael Beaton:** I'd also like to add that transparency takes on a different meaning in the context of more active strategies. Even more than position level transparency, investors should really be focused on transparency of the investment process. They need transparency on the design of the strategy in a way that enables them to understand prospectively how the strategy will perform given certain market conditions. This is easier for some more traditional strategies. Many investors have a good sense of how a typical equity long short manager will do in bull and bear markets. But in strategies like trend following for example, prospective performance is more nuanced.

The strategy is really interesting in this context. We often hear from trend following investors that they love the tail hedging properties of these types of programs. I am always quick to point out that while the principles and dynamics embedded in the strategy support this tail behavior, at the end of the day, the strategy is not an explicit hedge. We spend a lot of time making sure all our cards are on the table so to speak and our investors have a reasonable sense of what to expect in specific market regimes. This is a constant dialogue.



**Tim Pickering:** Regarding your point about transparency and knowing what you get, I agree that this is an important first step, whether it's a CTA strategy or any other strategy. What we have decided to do is a full lifting of the kimono, if you will. If you give us enough money, we will give you the construction rules and show you how it works.



That is part of the process where we try to define what the investor needs. What do they want? And what level of transparency do they want? Do they want to see the weightings as an index? Do they want to see them from the ETF company that reports the weightings of the strategy at the retail level? Or are you a managed account institution who not only gets to see the weightings but actually asks for the construction rules for the strategy? And so, it's just again matching up that need.

**Michael Beaton**

Investors must find a level of transparency that is meaningful and functional for them. This may vary both by investor and the strategies that they pursue. But ultimately getting that right is a key to making an investment a successful endeavor for both sides.

**Ela Karahasanoglu**

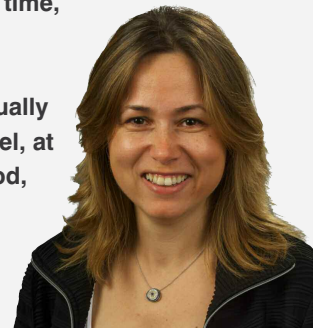
This is an important point. So for us, in general, before we give the assets or the rating, we would want to see the portfolio construction details. We would need that before the assets are flowing, not after. And this goes for anyone, including you, Tim!

**Tim Pickering**

Sure! You just have to sign a big document to get it.

**Ela Karahasanoglu:** This just gives you an idea as to how the industry has moved forward over time, which is something I would like to focus on for a moment now.

If we'd go five years back and look at the due diligence that was done back then, we would actually see that a lot of the information either remained proprietary, or was shared only at a certain level, at a certain depth. Overall it was more difficult to conduct due diligence. But after the recent period, particularly post the Global Financial Crisis, where some absolute return strategies, such as managed futures and macro etc., have gone through rough periods, managers have become more forthcoming, and this works to our and investors' benefit.



One vital piece of information in there is understanding exactly where the performance is coming from, what are its exact drivers. Rather than just looking at the absolute levels, it's all about how and why that return stream is produced.

Increased information shared by managers has been beneficial to some of the smaller managers. As long as we can understand the returns in a detailed manner and get a good idea as to what's going on at different levels, we may not need the entire track record per se, particularly for managers with very limited track records. *This could allow us to rate a manager positively even in the absence of a longer term return stream.*

As a result of increased education and sharing of knowledge and evolution, I think there is increased interest in some of the so-called “black box” strategies because now investors have seen how they can perform in various market environments, and now they want to understand how they work, and we as researchers can facilitate that.

And exactly for that reason, the due diligence process has become really crucial and is at the top of many institutional clients' and pension plans' agenda. These include analysis like, *“Is this strategy beta-driven? Are there a number of underlying risk premiums that drive the performance or is there some alpha embedded in there? And if so, is this alpha worth paying for?”*.

There is also some progress regarding the way hedge funds are defined. The whole gamut of hedge funds is now divided into different bits and pieces and market players recognize that each piece serves a different role.

For instance, you may not bundle managed futures with all the other hedge fund strategies because managed futures/macro might have a certain role that is different than a long/short equity strategy for example. Ranjan and Tim have heard me talk about this before, but this managed futures/macro duo might serve a specific role in the portfolio during equity down markets. And maybe at the left hand of the portfolio during periods of strong spikes in volatility you might even consider tail risk strategies, which is another way of potentially protecting the downside. The crucial question here is how they actually fit into a portfolio, and we increasingly get a lot of questions on *“Okay, what do we do when the equity markets turn down? What do we do when the bonds yields start increasing? How do we protect our growth portfolio? How do we ride a liquidity situation?”* I think that is what has really brought on the whole innovation in the market place, the move forward and the structuring of different strategies and types of products.

**Ranjan Bhaduri:** This is a great discussion that underpins the need for education, and hopefully this Roundtable publication will contribute to that.

Ela mentioned how investors are now really focused to find out what is alpha and what are the right fees for it, and I am in a way happy that we at Sigma are able to contribute to those questions through our managed account solutions and ongoing research on structural alpha. Over the years, we have done a lot of work on different kind of hedge fund fee methodologies, some very detailed analysis and studies, and are able to provide some pretty good insights.



Our research efforts on those issues are continuing, and let me also share two ideas or project we are looking at, probably more for 2016. Anybody who is familiar with research knows that not all ideas go from concept to product, so this may or may not occur. I'm actually going to now be in prints saying these ideas, so hopefully that will increase the probability that they occur...

One is an emerging manager product. Sigma has done a very extensive research and it seems we almost continuously travel around the world meeting with hedge fund managers. One of the results of this has been a lot of knowledge on the emerging manager and micro emerging manager space.

The second is a hedge fund manager content database at an enterprise level. a centralized type of database that's user-friendly that can allow you to sort of search for different strategies and different styles of hedge funds, so either by geography

or by assets under management or by the type of strategy or style that hedge fund manager is doing, I think it would be of tremendous value. It will contain content such as newsletters, presentations, DDQ, research pieces, and multi-media content.

**Matthias Knab**

What is your definition of an emerging manager?

**Ranjan Bhaduri**

Here I'm talking about more the liquid alpha space of CTAs as well as certain types of equity managers, both systematic and discretionary. Really, it's either less than a three-year track record or less than a \$150 million from assets or program assets. We are working on certain algorithms to try to create a very unique systematic product, but it's probably better for me to leave it at this stage.

**Michael Beaton:** Allow me to come back once more to the higher transparency requirements we have discussed before. That's a very common theme we all have heard a lot of, and it's often positioned as something that is a one sided battle between investors and managers. But I think this dynamic provides opportunities to managers that are willing to embrace it.

For example I think what Tim did is really interesting in terms of innovation. By taking his strategy, constructing an index and converting it into an ETF, he created an opportunity for himself from investor's need for higher transparency.

Similarly, at our firm we were able to launch the Carlyle Liquid Tactical Fund in August 2014 prior to having a track record. I don't think this would have been possible had our seed investor not had the sophistication and capability of thoroughly vetting our highly systematic and quantitative investment process. I have no doubt that their capabilities in this arena arose out of their decision to partner in a more collaborative way with their managers.



**Claude Robillard:** It's worth mentioning that *transparency can be addressed through qualitative means as well*. Given our fundamental bias, we provide ex-ante and ex-post analyses of the anticipated or resulting impact of our investment in our quarterly letters, and other forms of investor communication, versus providing lists of positions that, on their own, don't paint a full picture.

We are seeing increased demand for customized analytics. We're being queried on sector weightings, exposure levels, that sort of thing, so that LPs can conduct in-house sensitivity analyses. But that's more a function of an investor's desire to understand how their exposures intersect, versus the need to track individual manager positions.

Transparency as it relates to our investment approach gives people comfort that they know they are compensating us for something that they couldn't readily do themselves. Investors can self-medicate beta efficiently through the use of ETFs, we want to focus on opportunities unrelated to broad market exposure. We want to isolate the alpha we produce, and clearly communicate that to our LPs.

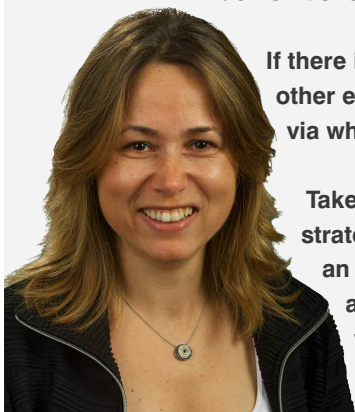




**Ela Karahasanoglu:** Let's clarify in that respect where beta fits into the whole spectrum. Neither we at Mercer, nor our clients say that we don't want beta, that we just want alpha. We understand that some form of beta cannot really be excluded; it could or even in some cases should be part of the whole performance profile.

I also would like to point out that some betas cannot be implemented that easily. Take momentum or trend following beta for instance. As much as people would like to think, *"Oh, we can just take moving averages and with some crossovers we are just going to produce those trend following returns!"*, it's not as simple as that. There's a caveat to it, such as risk management, implementation or transaction costs, and a number of other important issues.

In that sense, we would expect some types of beta to be embedded into certain types of manager strategies or performance, but of course we would like to understand what type of beta we are talking about, how much of the returns is from that beta, how much of it is alpha, what is really driving the performance? And In that instance, how much of it should go into the client portfolio, or should it go into the client portfolio at all?



If there is an existing exposure to x number of betas - such as size, turnover, momentum or some other exotic beta or however you would define it - should you have that beta in the portfolio, and via which vehicles?

Take carry, for example. Carry is a known phenomenon and we would expect it to be in some strategies. But if a manager's returns are driven solely by carry, should they be really charging an active fee? Probably not. But would we expect it to be part of the return profile? Most likely as it could be value adding and it may not be employed easily by an institutional investor who may not have the structure to implement something like that on their own.

**Matthias Knab**

Ela, you mentioned earlier how Mercer has widened the manager base you are looking at by including smaller and emerging managers. I think this is a message many people in the industry are delighted to hear.

I have heard from a hedge fund that has been around since 2000 and has over \$1bn assets how difficult it was even for a firm like this to get the attention of the consultants, who for many institutions act like the gate keeper. I won't mention the name here, but he said that one of your competitors in the consulting field apparently said a number of years ago that at any point in time they would have the capability to look at only 45 hedge fund managers, which is of course a very limited universe and leaves out a lot of alpha-producing managers.

So I wonder, how do you think compares Mercer's capabilities to that? How many managers do you follow?

**Ela Karahasanoglu:** Let me start with the cue that sometimes such a comment might be the view of an individual rather than that of their firm, but I hear you.

So let me take a step back and maybe look at that question from a broader consulting perspective. First of all, our definition of emerging managers is in line with what Ranjan referred to earlier; managers with less than couple years of track record and/or assets less than 100 or 150 million, but this is a rough definition and I am generalizing here. There might be exceptions to this definition.

It's clear that those managers have not been exactly at the core of what institutional investors have been looking at, and for the obvious reasons.



The reason often is that the operational infrastructure or business management for emerging managers might not always be as sound as a manager who has a longer track record with more resources and assets. Track records might be easier to analyze when they're longer just by the nature of them and it might require a little bit more due diligence when you don't have the performance or the assets to see exactly how things have played out in various market environments. So you need to take the next step, which means going above and beyond the track record or the assets.

We do however believe there is some alpha embedded in emerging managers, and as long as they are marked appropriately, meaning as a niche or emerging manager, these managers could also be considered in an investor portfolio assuming that the investor has the necessary governance in place. Now having said that, as you said earlier, we are in the business of limited resources and the demand is pretty much unlimited, particularly from managers.

Just to give you an idea, if you look at my Inbox, it's pretty scary. It's got a life of its own and I sometimes feel it is going to come alive and attack me one day. This is because of the information overload we get from managers; there are many out there and it is not as simple as reading every email and finding the right manager amongst hundreds.

However finding such strategies is doable, but is a matter of approach. We don't have to go and talk to everybody. We just need to find out who is really investable out there and it does require a lot of reading, networking and investigating. It does require resources as well of course and I believe we are equipped quite strongly on that front.

Mercer's Global Manager Research has 120-plus people, one of the largest in the industry, and that is across four boutiques - equity, fixed income, real estate and alternatives. In alternatives we are roughly 50 people, including the infrastructure, private equity and hedge funds team. In hedge funds - give or take a couple people - we are around 25 people and we are all out there looking for the good managers, so we do have serious resources dedicated to this effort, and more importantly, we do it collectively. In other words, we don't sit in our little worlds and do our own work. We communicate and share the relevant information across the team.

My manager coverage is not really capped by a number. Of course, there is client demand which directs our due diligence efforts, we write research pieces and give out ratings, and that can only be so many. But this doesn't prevent me or my colleagues from going out to events and talking to managers in the meantime. To give you an example, I think I broke a record couple of months ago at the Managed Futures Event in Miami. I met with over 20 managers in two and-a-half days. It's a lot of managers to talk to, but was very helpful. Out of that lot there were some which I thought were quite interesting, including some niche/emerging managers, and I shared that information with the team. We then collectively decided to further look into some of those in various locations. So we're out there trying to see who's up and coming as well as who's no longer cutting edge. Simply because we like a manager doesn't mean that we will continue liking them forever, they still need to make their case.

In that sense, the number of managers that I might be looking at could be over a hundred, maybe more, but I may not be actively rating them. What I am trying to underline here is that we are trying to identifying the new talent through our network, events etc. That is not to say we don't have a constraint on our time and resources. If there's some client work that needs to be done now, the rating may come later but we would make sure that that manager is known in our database, GIMD, which is available to those investors who have subscribed to it.

**Ranjan Bhaduri:** I think looking at and investing into emerging managers or managers that are not as well-known makes a lot of sense. And nobody actually needs a consultant to point them to a manager that already has 50 billion in assets.



We had discussed so far how managed accounts clearly help increase the opportunity set for institutional investors. What I am going to say may refer more to the liquid alpha space. Often, a smaller or emerging manager may not yet have the operational infrastructure or the tier 1 counterparties that might be required by a certain institutional investor.

But if they invoke managed accounts, they may be able to access these kind of resources and service providers, and if done correctly, they may even be able to save on certain other parts of expenses.

**Matthias Knab**

Ranjan mentioned expenses, which can be overwhelming for a smaller manager. So they need more income. On the other hand, investors press for lower fees. What are your comments regarding this conundrum?

**Ela Karahasanoglu:** Regarding the industry trend in fees; I've seen different numbers in different publications by different providers, but the general consensus seems to be they have come down slightly. More importantly though they are not just going down but in general are becoming more flexible. When I say flexible, I mean that all sorts of structures are coming into play. For instance some managers may charge a flat management fee as an alternative to management/performance fee combo or might offer a performance fee only option. We also see volatility-based management fees, which we didn't see as much previously.

With a higher performance fee, the risk adjusted returns won't really change, but if you're looking at the management fee for a manager that delivers a volatility of 5% versus 10%, that same management fee is going to have a very different impact on your risk-adjusted returns.

We hear a lot of managers talking about different fee structures for different volatility levels. Once or if their volatility is lower, they are willing to give more concessions on that front to keep their investors interested as investors now think about how much they want to pay per unit of volatility, because that does make a difference. We also do see a lot of flat fee structures in the liquid alternatives side.

One interesting point though is I notice some institutional investors tend to go for flat fees rather than performance fees. I find this quite intriguing because I would expect a preference for performance fee only rather than management fee only structure, but I guess there is the element of knowing what you're going to pay going forward rather than that "high" percentage that needs to be shared away from the returns. In the future I would expect to see investors demand more of the "only performance fee" structures rather than flat management fees simply because as an investor you just share in when the manager is performing and you don't really have to pay when they are not. I believe this is more relevant for managers who are already above a certain AUM level and are breaking even. Performance fee only may not really be a strong proposition for the smaller managers who rely on management fees to survive.



**Ranjan Bhaduri:** There is fee compression going on across the entire hedge fund industry that in some ways it sort of feels a bit like everybody is pulling on the blanket. There are probably a variety of reasons for this. Generally the last few years have been a more difficult environment for some hedge funds to raise capital. For a number of investors, the hedge fund industry may not have fully met investor expectations over this time period.



There are also many new types of products coming onto the market, some with new fee methodologies, and they are giving investors more choice. Some of the new fee models have borrowed ideas from the private prop trading world or from the private equity world.

Also we at Sigma spend a lot of time on those new fee models. For a South American family office client we were able to negotiate a very fair and simple type of fee structure that the client was very pleased with and even the manager was very receptive to.

Let me also make the point to new hedge fund managers coming out that they are somewhat delusional if they think they can get 2 and 20, and they are going to put themselves offsite in terms of trying to raise capital. It really even hurts their history of returns. By setting a lower fee, you might actually get more revenue because you are able to raise more capital. Also, what investors often look at are the net returns, and so your table of monthly returns actually improves if you have lower fees, and that can create a positive feedback loop.

I think that it's safe to say that hedge funds that don't adapt to this, that don't adapt to lower fees and transparency and so forth, are going to be challenged over the medium to long run, in my view.

**Claude Robillard**

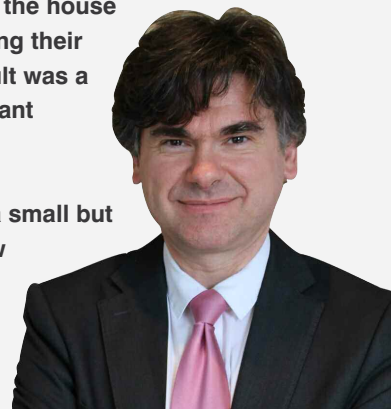
I think these are solid observations. I also believe that managers are showing flexibility to adjust to the current market environment and investor fee expectations. Having said that, I think it's important to note that, paradoxically, fixed overhead costs and the cost of addressing an evolving regulatory environment have gone up exponentially. That means it may be doubly difficult for new entrants to establish a solid footing.

**Luis Seco:** The underlying theme here is leadership, which I want to explain with my next example.

After I lived in New Jersey I moved to California, to Pasadena, not far from Hollywood, the capital of the movie industry, which has a very interesting history. The movie industry is a capital intensive one, and the money was in New York, which is too noisy and a weather profile not adequate for filming outdoor all year round, like California. And they chose a location called Hollywood, at that time a very conservative community, very inadequate for a group of artists who were out to challenge the status quo, which however offered them weather and tranquility to develop the industry.

They had a vision, they created the Academy Awards, an event where this group of people said to each other, "Oh, you're great!" "Yes thanks, but you're great too. Here is an award to you!" "Oh, an award for me? Here is one for you, too!". At the outset, the rule in Hollywood for actors and actresses was when they open the house door, even to pick up the newspaper or to pick up a bottle of milk, they should be wearing their suit with a tie, full makeup, just in case the media will catch a glimpse of them. The result was a public for which films are like a new religion, and their choice of location was an important factor in that.

Sometimes I feel Toronto could be the Hollywood of the hedge fund industry. We have a small but vibrant hedge fund community, we all know each other although we tend to meet in New York or Dubai. We have some of the world's smartest investors such as Jonathan who joined us today, who manage to attract many of their peers to come to Toronto for inspiration.



**Tim Pickering:** Well, there is something to that, and for sure we could think of ways to strengthen us. Our own home base and the industry all together. There is a certain irony to the fact that many of us here at this Roundtable tend to meet and run into us more in the US, Dubai or other places, than we're actually meeting here in Canada. We are running all over the world looking for relationships and assets, and while you are that there is some incredible talent here right at home, it's also only so much. I know, because I have pushed and tried very hard, but there are not 25 or 50 Ontario Teachers.





**Luis Seco:** You are right, but if we focus on investors worldwide, given the strong presence of sophisticated investors here, we could become Hollywood, or the Milan of the hedge fund fashion industry. If we could develop here a community that would make others fly in to find out what we are thinking about or what is the next gadget we are working on, that would lead to leadership.



**Ela Karahasanoglu**

I used to work at a CTA, a quantitative global macro shop. The headquarters were in New York but I was part of the Toronto office. You know what happened? We could not grow the assets, so I had to move back to New York.

I agree that we have a lot of talent here in Canada. The industry is also really close, pretty much everybody knows everybody else, and generally it's very progressive. But I also believe that we have somewhat of a regulatory hurdle here which is relatively high for launching or running a hedge fund strategy. I don't believe it is as friendly an environment as in the US.

**Tim Pickering**

I agree with you 100%.

**Ela Karahasanoglu**

Of course, there is a caveat to that. In the US, the regulatory landscape has been changing as well and so it is becoming increasingly more difficult there as well.

Interestingly I am covering hedge funds out of Canada, but this is simply because I wanted to come back and live in Toronto. Otherwise, my position would have been hired in Chicago and in that case I wouldn't be sitting here with you right now.

The choice for hiring in the US is understandable. It is likely the result of the fact that Toronto is not really the hedge fund hub from the global perspective. To that point, my coverage is in the US and I don't cover a large number of managers here because we don't have a lot of hedge funds here - it is only a handful. Couple larger manages and some smaller CTAs who have been battling to survive. I think there is the necessary level of institutional assets, and there is the required level of understanding, so I do not view these as the main issues. Perhaps it is the institutional landscape where some players are more conservative than for instance in the US. I'm not necessarily referring to the very large plans, but more the average institutional plans who prefer to have real assets over hedge funds in their alternatives bucket. That said, as I said earlier I think this is changing, they are coming along, which is great news. Yet the regulatory hurdle is still not helping.

**Luis Seco**

I think the regulatory framework is a victim of the lack of leadership. I think that with good leadership, education and transparency regulators will benefit greatly and their job will be easier. I think we have something very interesting going on in Toronto. I'm not afraid of a strict regulatory landscape. We just need to focus on excellence, which we have, and move on.

**Tim Pickering:** : I think those are great ideas and I think you should be the ambassador for that.



While we have been in business for a while now, we still see ourselves as emerging in many respects. We found it quite a challenge to be an emerging manager in Canada, and there have been mistakes along the way in growing the business. Probably the biggest and the first mistake was staying focused on Canada for the first few years. I should have pushed out of Canada quicker. Not having done that has in a way hurt us, there were certainly opportunity costs.

Don't get me wrong, I am as patriotic as the next person beside me, and I believe, as we have expressed in the talent within Canada. But now, we seem to be in the funny situation that Auspice getting recognized outside of Canada, but we still have a weaker recognition in Canada, which we find humorous.

**Luis Seco**

Leadership must look beyond that. Hollywood's movies were about New York City. They did Miracle on 34th Street, they did not do Miracle in Beverly Hills.

I'll give another example. Several years ago I was hired to deliver a hedge fund course in several parts of the world. When I gave my course in New York, there were New Yorkers in my course. When I gave my course in Chicago, there were Chicagoans. When I gave my course in Toronto, I had people from Saudi Arabia in my course.

**Tim Pickering**

Right! It's true. When we visited the Middle East we could see that there is a very complete recognition for talent and the opportunity of schooling in Canada.

**Luis Seco**

Exactly. We will continue to meet each other at airports and in New York, but I think we have to put some focus on the cathedral, where that act of highness happens, and it could be here.

**Claude Robillard:** There's been a strong evolution in the alternative investment industry in Canada over the last 15 years. It has been a natural transformation that began with a reduction in principal trading activities within the banks, where portfolio managers, analysts and traders branched out to create a series of independent operators. Today we have both large and small players, and while I think there is a lot of thought leadership in Canada, I also agree with Tim and Luis that we can do a better job co-opting and promoting Canadian talent and investment opportunities.

In order to connect with domestic and international audiences, you have to nurture this process and invest time, effort and airmiles in developing your network. I have seasoned relationships from 15 years ago and newly-minted ones from three months ago, both here and abroad. Canadian ideas are generally under-represented in global investor portfolios compared to our global peers, the more we get in front of people, the more we'll cure that delta.

We need to reinforce the idea that Canada is an incredibly fertile ground in which to operate. The world is listening – I've covered about 20,000 miles in the last three weeks. Now, sometimes, a new relationship looks across the boardroom table and says, "Right, Canada, okay. I'm a bit concerned with certain factors in the Canadian market right now: a potential real estate correction, the collapse in energy prices..." To which we say, well, let's take a look at this from an entirely different angle. We think therein lies the opportunity. A distressed energy market is potentially very interesting environment in which to operate. There are opportunities in deep value, M&A, capital structure optimization that are the result of the volatility that emanates from that space.

Perhaps I can bring this full circle. Leadership in the alternative investment industry is also a function of providing capital where it otherwise wouldn't be present. It's worth highlighting that our industry supports productive economic activity. Specifically, we are seeing a supply/demand imbalance in the availability of capital in Canada right now. There has been less activity in non-traditional bank financing and lower levels of FDI. Small and mid-cap issuers have had difficulty raising equity and debt in this environment.

That means there is a vacuum here which needs to be filled. And frankly, the cost of capital is somewhat elevated, in other words, strong risk/return profiles are on offer when you're looking at today's landscape.



Specifically, if you look at the energy space today, clearly it's feeling some pain. But it's important to analyze the field in segments. At these prices there are permanently impaired companies, there are temporarily impaired companies, and there are strong companies. So you can't paint the sector with one brush. For example, energy companies in Canada that have completed major CAPEX initiatives and that are solely focused on OPEX can be successful at \$20 oil, \$40 oil, \$60 oil, \$80 oil, and so forth, which may not seem obvious at first.

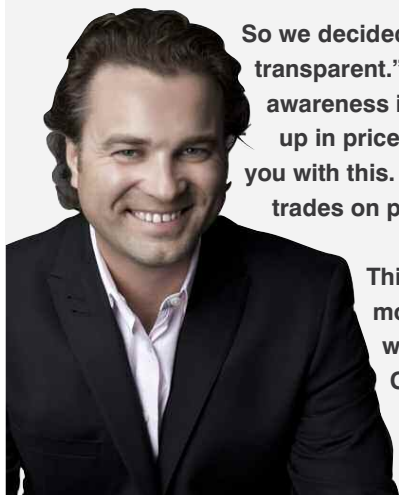
Our local presence and experience assist us in filtering good from bad investment candidates in terms of where and how to make money. In-depth knowledge of management teams, for instance, is imperative. We often know teams from a multi-generational perspective. And it's as important to identify high-calibre operators as it is to identify suboptimal management teams and absentee boards. Support the former and, at times, supplant the latter. Finally, local presence assists us in monetizing our investments as we can turn to strategic and financial buyers in our network in lieu of a focusing solely on a market exit.

So all of this is to say we can make a very strong case for investing in Canada, with Canadians. Canada is a terrific investment destination, but at the same time it's really up to all of us to ensure we're noticed. And I think that market factors may accelerate inbound flows. Investors are carefully monitoring an aging bull market, a low interest rate environment, arguably crowded trades, single factor input markets, and the hunt for yield. All of these inputs may continue unabated, or they may be reaching an inflection point. Either way, Canada deserves consideration for your next investable dollar.

**Tim Pickering:** It's good that we're also touching energy at this Canada Roundtable. Actually, most Canadians and much less anyone else knows that we are the third largest reserve and seventh largest producer of oil in the world.

Now, if you ask most Canadians, "Well, what's the benchmark for Canadian crude oil?" They wouldn't know what it is. It's not the WTI and it's surely not Brent. So Auspice launched the Canadian Crude Index last summer, but we kept that very quiet. We are just going to start talking about it here shortly, because there's got to be a better way of describing what Canadian Oil. This isn't to pitch any of you on the concept, but we don't think that Canadian crude or Canadian energy gets held back because of pipeline constraints exclusively, and that gets focused on in the media. That's just one component.

The reality is any market to be successful in long-term needs participants of various drivers. Speculation is obviously a key part of that; 80% of liquidity comes from that. What we haven't had in Canadian crude or Canadian energy trading are non-wholesale market participants in general. When we talk about Canadian crude, nobody knows really what it is. The WCS (Western Canadian Select) illustrated there's a basis to WTI. But it's a bizarre concept, esoteric. It's a spread that only Shell and BP traders understand.



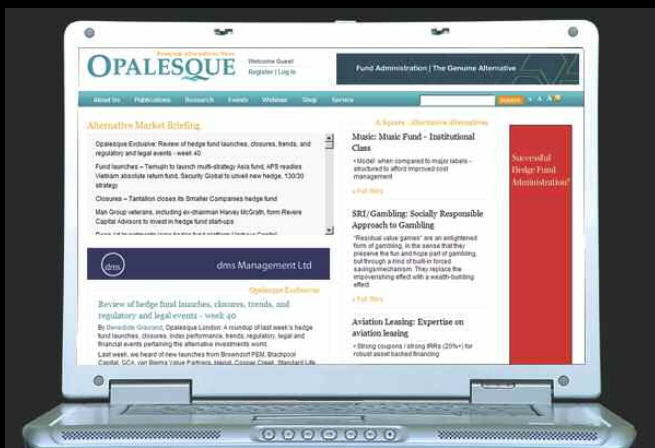
So we decided, "Let's create an index called CCI or Canadian Crude Index to make that more transparent." It's not just for creating an ETF product at the end of the day, but let's create awareness in Canada for what is Canadian energy, because if there's going to be a Canadian bump up in prices, it's not just going to be from putting a pipeline down south, trust me, and I'll leave you with this. Mayan crude, Mayan Mexican crude is the heavy-sour crude, very similar to WCS that trades on par or at premium to WTI. That's just not a pipeline issue.

This in a way also ties back to expressing what we have in Canada and making people more aware of it, and whether I make money as a product publishing index doing an ETF, who knows. But part of my driver is transparency awareness for what we have here in Canada.

# accurate

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