OPALESQUE

Opalesque Round Table Series '09

HONG KONG

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Introduction

Dear Reader,
Welcome to new 2009 Opalesque Hong Kong Roundtable, which after Zurich and the 2009 Singapore Roundtable is our third Roundtable publication this year. How is the hedge fund industry changing? The Opalesque Roundtable Series is offering ongoing updates and intelligence.

The Hong Kong Roundtable took place on April 9th at the local office of Newedge Group, who also sponsored the event. I also want to thank Jennifer Carver from 3A Asia for helping me to put the following group together:

1. Tim Rainsford, Managing Director Asia Pacific, Man Investments
2. Craig James, Portfolio Manager, AM Investment Partners
3. Kirby Daley, Senior Strategist and Head of Capital Introductions Asia, Newedge Group
4. Andy Higgins, Co-Founder, Northwest funds
5. George Long, Founder, LIM Advisors
6. Chunli Hou, Co-founder and Principal of Andante Capital Management
7. Brian MacDougall, Executive Director, 3A Asia

Asian hedge fund veterans claim that looking back over the last 10 or 15 years, about all Asian investors at that time had absolutely no interest in hedge funds, in fact they thought they were ”very bad or illegal products”. Then the Asian financial crisis of 1997/98 made people realize that long-only leveraged equities or property were not necessarily the best asset classes, so they started to be interested in structured products or hedged vehicles. For many years, there was no interest in Asian-based hedge funds. If they were interested investing in a hedge fund product, they would go into a New York or London managed product.

However, the dynamics are changing. This Opalesque Roundtable gives more insights:

- Which strategies run by Asian hedge funds experience inflows?
- What are Asian hedge fund investors looking for after the crisis?
- How has the strategy break-down of Asian hedge fund start-ups changed, and why is it now more interesting than in the past?
- What are the opportunities Asian hedge fund managers are pursuing at the moment?
- What does the ”reverse brain drain” from New York and London to the Asian financial centers like Hong Kong mean for global hedge fund investors?
- Will the trend towards ”institutionalization” slow down and boutiques reign going forward?
- Is it true that most investors have traditionally invested based on these three crutches; size, track record, and quality of other investors? What instead should investors be looking for?
- What is some of the latest research or innovation in finance coming out of Asia?
- How does the licensing process work in Hong Kong? What are benefits for hedge funds to set up an office or run Asian strategies out of Hong Kong?
- What structural deficits remain within the Asian financial infrastructure?
- and much more... 25 pages full of actionable intelligence!

Enjoy ”listening in” to the 2009 Opalesque Hong Kong Roundtable!

Matthias Knab
Director Opalesque Ltd.
Knab@opalesque.com

Cover Photo: Hong Kong Skyline and Victoria Harbor

Participant Profiles

(LEFT TO RIGHT)

Matthias Knab, Craig James, Brian MacDougall, Tim Rainsford, Andrew Higgins, George Long, Chunli Hou, Kirby Daley

Introduction

Brian MacDougall
3A SA

My name is Brian MacDougall, I am an Executive Director with 3A Asia. 3A is part of Banque SYZ in Switzerland. We are a fully licensed Swiss private bank, with three different areas - alternatives, long-only, and private banking. We now manage about $2.8 billion in fund of funds products, and as a bank we manage about $16 billion. We do not engage in any commercial credit or mortgages so our credit rating remains quite high.

We offer an Asian fund of funds; a commodity fund of funds which did very well last year - up 8.6% and already up about 6% through April. We also have CTA, multi-strategy, multi-arbitrage, and equity long/short funds of funds.

While 2008 was a difficult year, this year looks much better - most of our funds are up, which is quite promising.

Tim Rainsford
Man Investments

My name is Tim Rainsford, I am Managing Director of Man Investments for the Asia-Pacific region and I am based here in Hong Kong. Man Investments is the world's largest listed fund of hedge funds business. We currently manage around US$48 billion for both institutional and high net-worth private investors. We are listed on the London Stock Exchange and are a member of the FTSE 100 Index.

We have 15 offices worldwide and have 1,800 people on staff globally. In Asia, we are headquartered here in Hong Kong and have offices in Singapore, Japan, and Australia. We provide off-the-shelf and bespoke solutions for institutions using our different investment platforms: our fund of hedge funds business - which is primarily located in the U.S. and in Switzerland, and our very strong managed futures fund, AHL, which is located in London and has produced solid double digits returns year on year.

Craig James
AM Investment Partners

My name is Craig James, I run the Asia Volatility Fund for AM Investment Partners. AM Investment Partners is headquartered in New York and has assets under management of approximately USD$1billion. AM was founded in 2001 by Adam Stern and Mark Friedman. The fund has three main tenants to the strategy - volatility arbitrage, which is the strategy that we employ here in Asia; merger arbitrage, and convertible arbitrage.

The fund, since inception, has generated double-digit returns. Last year was a strong year for us, commensurate with the volatility that was experienced in 2008. The Asia fund was up approx 30% in 2008.

As we are coming into 2009, I think it's an interesting backdrop for volatility funds. We have seen a re-risking in all asset classes for the first quarter. Maybe the good times are back, but I think everybody that lived through 2008 can certainly understand that having an allocation to non-correlated volatility strategies probably makes sense going forward. So we hope there is an audience for the kind of product that we are provide here in Asia.

Kirby Daley
Newedge Group

I am Kirby Daley, Senior Strategist and Head of Capital Introductions - Asia for the Prime Brokerage Group at Newedge. We are a full-service, hedge fund prime broker, covering all strategies of hedge funds, with a special focus on derivative-based trading strategies, such as Managed Futures, Global Macro, FX, Commodity, and Volatility managers.

Chunli Hou
Andante Capital Management Ltd.

I am Chunli Hou; I am Co-founder and Principal of Andante Capital Management.

We are a relatively young firm to participate at this Roundtable. We started the firm in June last year. Andante was founded by three mathematicians and one computer scientist. Our goal is to offer regional investors a high-quality quantitative investment shop here in Hong Kong, with high transparency and accessibility.

We build mathematical and statistical models that trade in G10 currencies, options, and futures. Our approach is to follow more statistical techniques, that is statistical arbitrage and relative value, instead of trend following.

Since inception of the fund (nine months), we have achieved about 18% annualized return with 9% standard deviation and virtually no correlation to S&P and other major CTA managers.

Andrew Higgins
Investment Management

I am Andy Higgins from the Northwest funds. We are based here in Hong Kong and in London where we just opened a new office after splitting the firm from RAB Capital. We began about 10 years ago as Northwest, then RAB got on board as shareholder, and now we are back as Northwest.

We have three funds: a Pan-Asian market neutral fund, a China opportunities fund, and a high-leveraged warrant fund, which did very well last year.

We have approximately $400 million under management and about 15 staff - four in Hong Kong, and the balance in London. I have been with the company for 9 years, actually all of our traders and portfolio managers have been with the company at least 9 years.

George Long
LIM Advisors

My name is George Long; I run a business called LIM Advisors. We are headquartered here in Hong Kong and also have small offices in Tokyo and Beijing. We are basically a multi-strategy investment firm running convertible bond arbitrage, busted high-yield convertible bonds, high-yield debt, and merger arbitrage, and relative value types of trades. We offer our strategies through different funds. The business is 14-years-old; I set it up here in Hong Kong at that time.

Matthias Knab **What is your outlook, how do you expect your strategies to do this year or mid-term?**

Tim Rainsford For Man Investments, as a large allocator to single hedge fund managers, we invest across the hedge fund universe, but let me point to the managed futures sector, certainly for the current environment. As we all know, managed futures had an outstanding year last year. Man Investments have always been a strong supporter of including managed futures in well-diversified portfolios. We have always tended to overweight to this hedge fund style relative to the indices, particularly within our diversified fund of hedge funds.

I believe managed futures have proven what they can do in terms of providing some insulation to portfolios. They can deliver in difficult markets and display uncorrelated characteristics to not only traditional assets but also to other hedge fund strategies. We expect, obviously, the volatility to continue in markets, and therefore expect that managed futures will continue to perform. We are still seeing good inflows into our managed futures programs.

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In addition to that, we like global macro and long-short strategies more from the directional perspective, but we are certainly seeing good interest from our investors, particularly institutions at the moment into a combination of either managed futures and global macro, or combination of managed futures and long/short.

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So at the moment, in terms of strategies that we like, those are the three; but we continue to invest across the universe. We certainly haven't dropped any particular strategies completely as a result of the recent events.

Kirby Daley Last year at this Roundtable I mentioned that from a capital introduction perspective, speaking to investors across the board, institutional, private banks, funds of funds etc., that there was a strong interest in volatility. We noted this interest both from our London office but especially here in Asia. Asian volatility was a sector where investors really wanted more information. They wanted to know more about the opportunities and how to get exposure. In the year since then, we have seen a number of volatility managers starting up, some with great success.

This year, we have seen another shift in investor interest into managed futures, global macro, currency, in addition to volatility. These are basically the main uncorrelated strategies. At Newedge, we have been following these strategies for years, because these trading funds are our bread and butter clients, but we often didn't get the full attention of investors, especially in the last three or four years of the equity bull market.

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Many investors would listen, and understand the benefits of uncorrelated strategies, but it would still only be a 5%-10% part of their portfolio, at most. After the events of the fall of 2008, we received numerous calls and inquiries from investors across the board saying, “Can you send us that information on uncorrelated strategies again and tell us again where we can find that research?”.

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George Long

Looking at our space, which is multi-strategy, high-yield is very exciting. There are tremendous spreads right now in Asia, although they have contracted a bit from the blowouts of last October and November. The spreads are still very rich: you can get 15%, 18%, 20%-type returns quite easily out of high-yield bonds, and 25% or 30% if you want to push it.

There is still a lot of opportunities in the busted convert space, this is a subset of our overall high-yield and another exciting area. There is not too much in the straight convertible bond arbitrage area right now, because most of the convertibles don’t have any equity. They are way out of the money, so there are not very many delta opportunities.

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George Long

We also see selective private deals exciting, but narrow opportunities and merger arbitrage and relative value trades, particularly in merger arbitrage there is a rich spread, but there are not that many mergers going on right now.

I think there are plenty of exciting opportunities post last year's corrections and in the convertibles space where we operate. We don't do the typical convertible arbitrage trade.

George was talking about the yields on some of these instruments. There are a lot of negative basis trades out there at the moment, which isn't what we typically do, but it offers interesting opportunities for locked-up money. And I see that this is something that everybody is chasing at the moment; everybody is trying to get some secure money over a two or three year period. While you could say that there are plenty of opportunities out there, the ones we are pursuing are rather uncorrelated trades in areas our competitors do not operate. In the event of another selloff or another round of serious redemptions, we are not going to be at the mercy of somebody else's trade.

Andrew Higgins

Andrew Higgins In the current environment, I don't believe that it is necessary to operate with a high leverage. I think there are plenty of exciting opportunities post last year's corrections and in the convertibles space where we operate. We don't do the typical convertible arbitrage trade.

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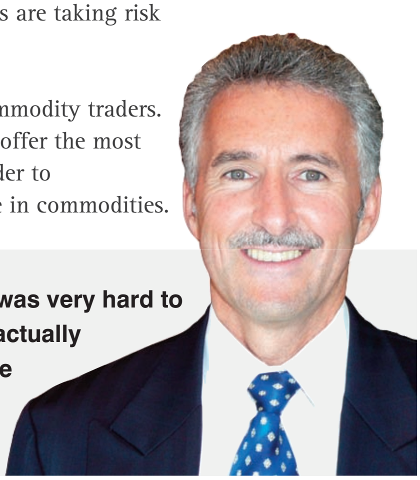
Brian MacDougall The only thing we are absolutely sure about this year is that volatility will remain with us, so we must choose our investments accordingly.

In the different areas we look at, Asia is very exciting for us now. Before this crisis, it was very hard to tell who was adding value in Asia. Who was riding the great beta run, and who could actually add alpha to their portfolios. Since this crisis, we can easily separate the best from the rest. We have also seen some very good managers opening up their funds again to new investors.

The other real change we have seen is that Asian managers are taking risk management more seriously now.

The other area that we like very much is relative value commodity traders. We believe that in the macro space, commodity managers offer the most value. You need to have vast amounts of experience in order to successfully trade commodities or do any type of arbitrage in commodities.



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Since many speculators got out of the commodity market back in July and August last year, there are great opportunities for the fundamentalists to make money. And at some point, when the markets turn around, they will be able to benefit from the upside as well.

We have also been watching the credit space very closely. While many people have been talking about the vast opportunities in the credit space for almost a year, we have not jumped in, but have lined up a group of managers that we think will do very well when the timing is right.

What makes them special is that they of course know the credit market very well and secondly they have marked to market. There are still some credit funds out there that have not. You must know them very well.

Craig James

I do think that the year 2008 marked a climate change in Asia. From 2002-2007, Asia was fertile ground for long/short managers that were principally just long, and it was difficult to distinguish between sharp managers and participants that just were benefiting from the tide. 2008 was certainly a paradigm shift - people got reacquainted with the concept of downside risk. There was a confluence of retail structured products that added to the volatility to the downside: different retail oriented products here had actually short puts embedded in their composition. There was a tremendous amount of wealth destruction by selling sophisticated products that actually exacerbated the downside moves to high net worth individuals.

Going forward, I believe there's going to be a deeper appreciation for the downside that's been largely absent the last half of the decade. At our group, we aim to offer investors the convexity that will protect their portfolios during turbulent periods.

As investors re-enter the market place, we believe investing a certain proportion of their portfolios into non-correlated, positive convexity strategies make a lot of sense.

Chunli Hou

The consensus here seems to be that volatility is going to remain high for the foreseeable future. We are trading mostly short- and medium-term high liquid instruments. We still see a lot of opportunity in this space and believe that this strategy will continue to perform well.

Matthias Knab

Chunli, you are a new quantitative manager here in Hong Kong. Can you tell us more about your approach and the type of innovation that you are creating?

Chunli Hou

You are correct, we may be a bit different from other funds or start-ups.

First, we believe that the quantitative strategy can be built and operated pretty much everywhere in the world. We chose to be in HK to serve the investors in this region so that they can monitor and come to see us much easier than going to New York or London. We also believe that Asia has a larger pool of quantitative talents we can recruit and integrate going forward due to the effects of the global financial crisis and regional power shifts. There are many talented and experienced fund managers and analysts who will come back to Asia. We are trying to utilize these opportunities and to replicate the New York quant fund business model substituted with Asian talents.

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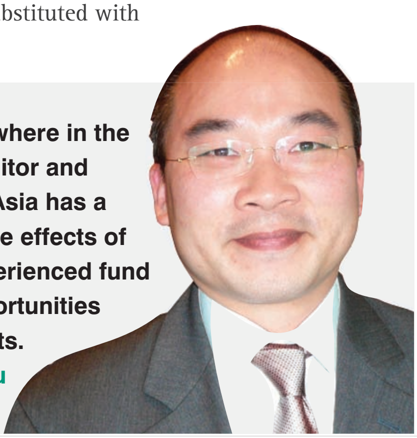

Secondly, in terms of our investment approach, since our scientists have worked and are trained in traditional statistical arbitrage shops, the analytical tools we utilize are largely based on statistical arbitrage and relative-value techniques. However, the asset classes we focus on are currencies, options and futures, which are quite different from what other stat arb people do, but quite similar to managed futures/CTA. I believe that by doing so we are getting many more opportunities and extract more alpha from time to time.

We represent new approaches, new strategies in Asia, and I believe that going forward more different kinds of managers will emerge in Asia, whereas before it used to be mostly just long/short and distressed managers. Hong Kong has been a very good place for new managers. The regulation is comprehensive and it also has a very economical environment to set up a new firm.

Start up hedge funds are fewer this year and also smaller in size. The typical launch size of a new fund right now in Asia seems to be between $5m and $15m.

The strategy breakdown of the Asian startups, however, has been far more interesting than in past years. Our prime brokerage division has taken on about half-a-dozen discretionary Asia macro and quantitative funds. One of the consequences of the present environment is that these new hedge fund managers must look harder for assets.

There are vast and deep markets in Asia that can be exploited in different ways than just playing equity-long with a little bit of short. Those are being discovered and the interest from investors to watch these start-up managers from early-on has been very intense as well, even if an investment is not immediately forthcoming.

We believe that by the end of 2009, we will see the beginning of a reshaped Asian hedge fund industry with a different strategy breakdown.

The global industry will look much more like it did if you go back to the early 90s, when the strategy pie chart showed the majority of hedge fund assets in global macro or managed futures strategies and about 25-30% in all other strategies combined.

I also see a trend towards the really skilled managers, moving away from the institutional managers. The wave toward institutionalization seems to be over, as the pendulum seems to be swinging back the other way to more boutique-type managers. Individual boutiques may be bigger, on average, in 2010 than they were in 2000, but they will still be boutique. I believe boutique hedge fund managers will rule the industry far more than institutionalized hedge fund managers, and we are seeing that wave start in Asia as well.

Kirby Daley

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There are vast and deep markets in Asia that can be exploited in different ways than just playing equity-long with a little bit of short. Those are being discovered and the interest from investors to watch these start-up managers from early-on has been very intense as well, even if an investment is not immediately forthcoming.

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Matthias Knab **What will the industry look like?**

Kirby Daley

In my view, the global industry will look much more like it did if you go back to the early 90s, when the strategy pie chart showed the majority of hedge fund assets in global macro or managed futures strategies and about 25-30% in all other strategies combined. At the moment, we may only have global macro and managed futures adding up to approximately 20-25%, if that. If you look at what is being discussed by regulators in the U.S. and around the world regarding more permanent short-selling rules and restrictions, for example, this may contribute to the trend of shifting strategies from equity long/short to managed futures and global macro.

We will see other strategies start to fill the space as well, but as I mentioned, the easy money and beta plays are gone, so we will go back to the golden age of true hedge funds. Investors will likely be more concerned about an uncorrelated return stream that fits their portfolio in a particular way, rather than balancing strategies and being worried about having too much of a particular strategy in their portfolio. I would say that going forward this probably will not to matter as much, as long as the return stream is uncorrelated and is in line with what they are targeting.

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To a certain extent I disagree with Kirby on the question of the future of the hedge fund landscape. I believe it will be considerably more difficult for smaller hedge funds or for hedge fund start-ups, because capital is hard to get hold of, and investors are much more rigorous in their due diligence and more demanding when it comes to the risk management of the single managers. The operational due diligence in particular, and the demand for managed accounts, will continue.

Newer managers have to build a solid infrastructure before they start to receive new capital. We are seeing a movement of capital into larger managers.

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Newer managers have to build a solid infrastructure before they start to receive new capital. We are seeing a movement of capital into larger managers. I would not call this necessarily an institutionalization, but investors are looking for scale, they want to know that there is longevity, they want to know that those managers will be able to ride through the cycles. Therefore, managers with a billion dollars or more are attracting more capital, while those that are smaller are increasingly finding it more difficult, as the demands that are being placed on the managers is now more than just delivering performance.

The parameters now seem to be not only performance but also having the risk management embedded into the business structure, the demand for managed accounts and increased transparency, and finally liquidity, not only of the manager's strategies but also of the fund itself.

George Long

I see actually quite contradictory trends, so I agree and disagree with all these comments about the industry. As we have all witnessed, a very large fund manager has actually blown-up, so the fact that you are large doesn't mean anything, that is what I hear now from people.

On the other hand, I agree with you about the requirements regarding systems and risk management. So there are these quite contradictory trends where large allocators out there all wanted to have very strong platforms, and yet these very same platforms actually became asset gatherers and basically didn't produce great returns and lost all control of risk.

There were all kinds winners and losers. Some very large, big brand name single manager hedge funds failed because they just didn't get it. I guess we will see some boutiques become really premier boutiques to stay in the range of $2bln to $5bln, and you will see guys that want to be big players but will not make it because they don't have the structure, or the infrastructure etc.

I see actually quite contradictory trends, so I agree and disagree with all these comments about the industry. As we have all witnessed, a very large fund manager has actually blown-up, so the fact that you are large doesn't mean anything, that is what I hear now from people.

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George Long

So I think we will see quite a lot of cross trends and currents over the next three or four years, there will be shake-outs.

Matthias Knab

So George, what does it take to be a winner? What do the winners do differently?

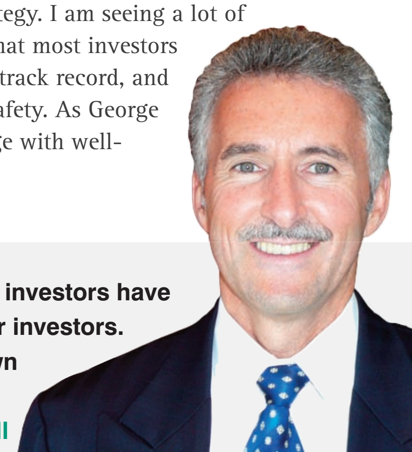
George Long

Well, I think in order to be a winner you have to find the right client base to match what you are doing and how you can make money. In the past we could witness a huge mismatch in liquidity expectations between allocators and their funds, the strategies they ended up investing in. This is now forcing a lot of strategies to become more and more liquid.

I think Kirby is right in the sense that people who want liquidity are going to force money into managed futures, CTAs or big-cap, long-short, quant strategies or whatever can absorb liquidity and pull it out very quickly. However, you can't do high-yield or busted converts with weekly or monthly liquidity. Money will also go into very niche strategies.

Brian MacDougall

I agree, you have to find the investors who suit your strategy. I am seeing a lot of confusion among investors right now. I have often said that most investors have traditionally invested based on three crutches; size, track record, and quality of other investors. None of these provide actual safety. As George pointed out, the funds that have blown up have been large with well-known investors.



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Brian MacDougall

Matthias Knab **This was the Madoff effect. As nobody was really doing due diligence, most people actually invested looking at the list of everybody else who was already invested.**

Brian MacDougall The track record as the last crutch has been no guarantee of success either. All or much of the criteria that was used so far to select investments hasn't worked. And still, you can see that a lot of investors out there are still hanging on to that.

Some investors are trying to come up with new criteria which, in the best case, will make them fail-proof against the last crisis, and managed accounts is one these. Yes, there has been a big rush towards managed accounts, and that may protect them from the crisis we have just gone through, but people have to consider that the next crisis will be coming anyway; investing will never be fool-proof.

The track record as the last crutch has been no guarantee of success either. All or much of the criteria that was used so far to select investments hasn't worked. And still, you can see that a lot of investors out there are still hanging on to that.

Today, investors should be looking at partnerships, not just managed accounts. Managed accounts are only a part of the solution. The other part of the solution could be a real partnership, for example with a fund of funds. We are out there in field, we know and monitor thousands of funds, we are constantly doing due diligence, there is a real opportunity to build real solutions. But that means investors actually have to open up. This would mean spending time to actually dig in to what exactly is important to the investor, what exactly are the specific parameters and aims within their portfolios, what are they trying to achieve - and then to work with say a fund of funds to build those products. This may be the more effective approach than just inviting some product providers in, checking out what they are offering that day, but staying very closed.

Brian MacDougall

As a product manager or fund manager we need to very much decide, "who are we?" - and then go out and present that to investors. I have been presenting a new product just the last few days to institutions, and some are saying "great, I want it," and others say "absolutely not." There is no continuity at all among investors at this time.

Matthias Knab **Instead of the three crutches you have mentioned, what could be some other new criteria for investors to use in deciding on allocations? What else should they be looking for?**

Brian MacDougall Today, investors should be looking at partnerships, not just managed accounts. Managed accounts are only a part of the solution. The other part of the solution could be a real partnership, for example with a fund of funds. We are out there in field, we know and monitor thousands of funds, we are constantly doing due diligence, there is a real opportunity to build real solutions. But that means investors actually have to open up. This would mean spending time to actually dig in to what exactly is important to the investor, what exactly are the specific parameters and aims within their portfolios, what are they trying to achieve - and then to work with say a fund of funds to build those products. This may be the more effective approach than just inviting some product providers in, checking out what they are offering that day, but staying very closed.

Craig James There is one point I think will become even more important going forward and will be demanded by investors. We have all seen the blowups - Brian had mentioned Amaranth - you think you are investing in a certain strategy, and then suddenly you find yourself long a giant natural gas play, I don't think anybody wants to see that again.

Going forward, if the due diligence is going to occur on a strategy level, investors are going to demand that you stay disciplined to whatever strategy you are proposing. I believe that to some degree the hedge fund industry suffered from style drift as managers morphed into areas they had less expertise in.

In almost all meetings the questions are always: "What exactly are you doing for us? We want to understand the strategy down to what are the limits, what kind of scenarios would make money, what kind of scenarios would be difficult?"

This kind of transparency is demanded and ultimately it has to be offered by the by the industry, otherwise the product goes away; the confidence won't be there any more.

To give a different perspective on the managed account issue: it's very real. It is not just being talked about. 50% of our revenue has always been driven by managed accounts, but right now, we are seeing an absolute surge in interest in managed accounts from investors, including sovereign wealth funds, institutions and family offices. These are the types of investors who always listened to us in the past, but didn't really embrace the idea, as they were not convinced of the benefits versus the costs. Clearly, this is a post-Madoff reaction, but I believe this is not just a flavor of the day.

Being equipped to accept managed accounts is actually one way that a startup hedge fund manager can add to their AUM.

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Being equipped to accept managed accounts is actually one way that a startup hedge fund manager can add to their AUM. As Tim explained before, start-up managers are confronted with more issues and demands now than before, and growing assets is a challenge. Having the infrastructure for managed accounts can be one way that a manager can overcome some of these hurdles. For an investor, investing through a managed account is also a common way to test a new manager. Unfortunately, a lot of the smaller managers don't have the infrastructure to handle them, so this may be something to think about when you are setting up a hedge fund. Having the ability to take managed accounts is a substantial advantage, if you can do it credibly.

Chunli Hou

I can confirm this, also in our case as a new manager, we experience an increased interest for managed accounts. So even in the startup space, we do see that people are very interested in opening managed accounts with us. They want transparency and they are checking how managers handle the transparency and also the trades. Once they are comfortable with what you are doing and believe that you have the abilities, then - at least in our case - size is not really an obstacle for an investment.

Andrew Higgins

Talking about style drift, I think that is a very important subject. It can be like a compulsion to start chasing whatever is the hottest, newest product, but from an investor's point of view it is important to know exactly where you are and stick with what you know and not try and veer too far away from that.

From a due diligence or the compliance point of view, it is very important that there are no surprises for the investors. From a regulatory perspective, I believe all funds managed out of Hong Kong use third party administration and auditing, as opposed to maybe the US where this is not so much of an issue. Obviously, all the blowup issues have really been out of the US, and I assume the lack of third-party auditing has been a major reason for this.

I also believe that a lot of the problems from last year were driven by greed, with people literally just interested in building up their assets under management as high as possible.

Whoever comes out at the end of this current consolidation period will come out a lot stronger and probably with a lot of lessons to operate their business on a better basis.

I would like to add something a bit contrarian here regarding style drift. We are all trying to come up with hard and fast rules that will protect us from the next crisis but we need to be careful that we don't lose our ability to be flexible.

One of the managers we were invested with in 2006 was an M&A manager, and all of a sudden they were talking to us about credit. We thought style drift, this is ridiculous, what do these folks now know about credit? So we were thinking of redeeming from them, but first we visited them to see exactly what they were up to. We spent a couple of months going through their strategy and scenario. What happened in the end was that we decided to put them in all of our portfolios, and that fund turned out to be Paulson.

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Matthias Knab

Over lunch we talked about how the mechanics of the investment industry, some parameters on product design, product creation, or distribution channels and the role of intermediaries are changing. In this group now, can we elaborate again about this? Behind the scenes, structural changes happen for example by the increased use of managed accounts, and changes within the private banking world.

Kirby Daley

We have seen interest in our full-service prime broking offering increase substantially in the last year from family offices. Many of these organizations used to be very large private banking clients for their trading and investing needs. The private banking industry is obviously still a vibrant and viable industry, however we are noticing that some of these clients are also looking to do more on their own. There is an increased demand from this side for managed accounts as well as hedge fund manager research, data on managers and introductions so that they can choose some of their external investments themselves. At Newedge Prime Brokerage Group, we are able to package such services together.

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I don't know if that's a whole industry shift, but the reason we are noticing this is because we put together a family office team about three years ago to comprehensively service the business of family offices that trade for themselves and invest in external managers via managed accounts. Interestingly, when we started this we thought that it would get a lot of interest right away, but for two years, the activities here were rather slow.

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Tim Rainsford

I agree with that. From the distribution side, which includes private banks, we observe how the private banks are becoming much more rigorous in the due diligence on their single managers that they introduce to their platforms and on their fund of funds. There is no demand for leverage. Throughout the bull market, there was certainly a growing demand for leverage to be embedded within products which now certainly has left. We also see an increase in demand for products that are structured much more simply, which can be more easily explained to their investors. Even the sophisticated investors don't want to see these complicated structured products presented to them. Often they are also looking for investments which include some form of protection, either capital guarantees or a managed downside protection.

I believe the move from the banks is back to more basic products; products that are more simple, which can be explained and certainly with less leverage.

Brian MacDougall

There seems to be a divide within private banking since the crisis. Some investment banks were using their private banking brand as a way of selling their own structured products and after the recent events, a lot of those private banks are hurting, and particularly their clients are suffering. There is not a lot of business coming from these banks right now. On the other hand, the old style private bank still seems to be doing quite well and is interested in finding new products that suit present conditions They are in a much different position.

Matthias Knab

Let's look briefly at how has the Asian investor changed or how is he emerging? What do you see, what are the trends here, what are they buying?

George Long

If you look back over the last 10 or 15 years, I would say that all Asian investors at that time had absolutely no interest in hedge funds, in fact they thought they were very bad or illegal products. Then the Asian financial crisis of 1997/98 made people realize that long-only leveraged equities or property were not necessarily the best asset classes, so they started to be interested in structured products or hedged vehicles.

For many years, there was no interest in Asian-based hedge funds. If they were interested investing in a hedge fund product, they would go into a New York or London managed product or maybe a Man Group product for example.

During the last bull market years - 2004 to 2007 - a lot of money was raised locally, and not as

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During the last bull market years - 2004 to 2007 - a lot of money was raised locally, and not as much internationally. The big question for the Asian hedge fund industry is whether it will be locally supported. I know in my own business, and I believe most of my friends when I talk to them, still don't have a large, local client base in Asia.

George Long

much internationally. The big question for the Asian hedge fund industry is whether it will be locally supported. I know in my own business, and I believe most of my friends when I talk to them, still don’t have a large, local client base in Asia.

The local pension funds in Asia have not been big supporters of Asian hedge funds, and also the sovereign wealth funds in Asia have not invested much in Asian-based products. For the large sovereign wealth funds that are newly established, their first port of call is New York or London.

This means that for an Asian manager, there still is very little local support when it comes to investments, but also I have to say that it is better now than it was. Still, it is easier to get money overseas than from local investors. This is at least my experience and I understand that from friends of mine who run funds they experience the same.

There is very little Hong Kong pension fund money flowing into Asian managers. It is going in either pure index products or into balanced portfolio-type products. The real question is if the local asset owners, the Hong Kong Monetary Authority, invest with local managers?

I want to point to one interesting trend: the reverse brain-drain from the West back to Asia. Andante Capital is a good example of this, with the principals being Asian and having all lived and worked in the alternatives industry in New York for a number of years before returning to Asia to set up shop together, on their own. They are one of our prime brokerage clients, and we see interest in them from Asian-based investors, even though they trade a global product from Hong Kong.

There are a few other examples like them. My feeling is that over the next five to ten years, we will see that Asian investors who have typically gone to London or New York for the bulk of their global hedge fund investments may start feeling more comfortable with the caliber of managers available in Asia, and have the added comfort of dealing with a manager with similar background, culture, and language. Through managers like Andante, Asian investors can get global market exposure through a local fund. Due to the proximity, Asian investors can visit their office without having to take a 15-hour flight to do so, where often they will be jet lagged and get very little time from the manager, relative to effort getting there.

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Brian MacDougall

A lot of this discussion so far has been focusing on the institutional investor so let me also include here some dynamics from the retail side, what happened at some of the smaller private banks or financial advisors etc. We have noticed that through the years, a lot of them were buying last year's returns. Based on past returns, they bought the best funds that came to see them. They had no international expertise, no people to go out and do due diligence globally and therefore took quite a bit of risk and got hurt badly in the last year.

Going forward, I believe we may also see the retail side demanding from the intermediaries to do a lot more due diligence than they did before, and hopefully buying more secure products than just chasing the last year's returns.

Matthias Knab

Craig, your Hong Kong unit is part of a larger U.S. based organization. Can you tell us a bit more about your experience? What is it like to run your fund out of Hong Kong within such a set-up?

Craig James

AM Investment partners originated out of New York City and was founded by two managers who both had a convertibles backgrounds. One of them actually had Asian experience back in the early 90s, and obviously the idea was that Asia represents a fertile ground for a volatility fund. You can see dramatic movements in the region - generally they are priced in, in terms of the volatility landscape - and we had also seen others doing very well in this region.

We also believe that there is an audience for such a product. Asian investors typically are very savvy in respect to structured products, there is a long standing record of Asian investors embracing derivatives.

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Setting up a fund is not without its challenges. Even $100 million of initial commitments does not necessarily open every door, and certainly we had to fulfill all the technical and formal requirements like setting up an office, getting a license from the SFC and fulfilling all the technical requirements that come along with that, like hiring the responsible officers for example.

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In our case, all of our compliance and administrative technology functions still emanate out of the US. We keep a global CFO and a global COO. At some point, when we get big enough here in the region, it will probably be required to have a local CFO and COO, but so far, we do benefit from this global transference of functions and information.

We are tightly tied into our U.S. operations. Although we are separate and distinct in the legal entity form, I don't leave at night until I have had a conference call with the colleagues there coming in for the morning and vice versa. So there is always a continuous information exchange where everyone benefits.

Matthias Knab **Let us look now at the evolution of Hong Kong as a marketplace. George, you founded the company here and expanded then from Hong Kong into other areas and regions. How has Hong Kong served you as home base, and what is your experience, also as an entrepreneur?**

George Long I set the business up in 1995 and I can actually tell you there was a period of time for about three or four years where Hong Kong was a very, very bad base. It was quite a serious issue back then; in 1997 the Hong Kong government tried to settle hedge funds down through tax investigations.

Things changed when Singapore started soliciting hedge funds. Singapore realized that actually hedge funds are not at an anomaly or a one or two man band operating out of Bermuda. Realizing that hedge funds are actually the mainstream product, Singapore started attracting hedge funds, which finally brought the Hong Kong government to realize that it was actually quite foolish to try to shut down the hedge fund industry here.

Today, Hong Kong is a pretty good base to operate from; in fact the SFC is now actually quite advanced in their thinking about hedge fund regulations. Hong Kong is a good regional base, it is a lot better than Tokyo, which is a very narrow place to be in. In Japan, you can't really trade anything else outside the country, and you can't even trade in Japan without serious tax issues. Therefore, Japan has kind of forced everyone out of Japan basically because of what is called their permanent establishment tax issue, and looking into the broader region, Singapore is not a bad base either.

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George Long

I just happened to be in Hong Kong when I set up the business, I was running the office for another firm then. Singapore is a good base too for covering South Asia, and maybe Australia from a distance point of view. From an entrepreneurial point of view, when you are starting a hedge fund, I think you have to be either here in Hong Kong or in Singapore. Sydney for example is more a local, Australian market. You have to be in a major money center. If you go set your fund in Thailand or Korea, you really are just off the beaten path. The hedge fund conferences are Hong Kong, Singapore, and there may be cap intro conference in Shanghai or Tokyo, but this is not happening in Bangkok or Bali or somewhere else.

Therefore, Hong Kong is a great place in that sense. There is a very good infrastructure here and by and large a pretty good tax system. The investment industry regulation on the whole is very good. There is one exception, which is Responsible Officers or RO system, and the restrictions on who qualifies as an RO. The SFC requires an RO to have 5 years of portfolio management experience. When I was chairman of the AIMA Chapter here I had many, many conversations with the SFC and told them that the 5-year portfolio management experience requirement is totally self-defeating, it does not really accomplish anything. For example, we can't get our Chief Operating Officer licensed as a RO because he does not have five years trading experience even though he has more responsibility for managing the business.

But overall, Hong Kong is a pretty good center now, and I think it will probably get stronger because you have all the capital in China, the 2 trillion of reserves that is going to eventually to find its way around the world, some of that would go through Hong Kong.

I actually think Hong Kong is not doing enough to actually solicit or present itself as a gateway for outbound money. We have an office in Beijing, and when I meet with the government in China, mostly they are just going direct, they are going straight to New York or London and Hong Kong has no part of that.

From a policy point of view, Hong Kong may be more active to position itself as the outbound gateway to the rest of the world for China, but they have not really thought of it that way. They have thought of themselves as a listing place for H-shares or maybe a Gold exchange or those types of things. But they are not really thinking about how to help bring Chinese money through here and take a haircut from it.

At our firm we have been through the set up and licensing process twice in the last couple of years. I would say that about two years ago, Hong Kong was probably a less amenable place to set up, whereas Singapore was probably easier and faster. As George mentioned, since Singapore then started a bit of a march on Hong Kong and Hong Kong has changed the policies, it has become a lot more amenable. We got our licenses through in about seven weeks from start to finish - obviously we were already established, but then under a different business, but we got things done a lot quicker than we expected. I think they are maturing, that is probably a good word for it.

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Matthias Knab

A big theme for our industry globally is the tightening of regulations and possibly taxation, particularly from the U.S. and Europe. How do you think will this affect Asia - negatively or will there be some positive side effects? What will the Asian hedge fund industry look like in a couple of years?

Tim Rainsford

I do not think that we can fool ourselves with regards to regulations. The regulations will become tighter and we as an industry have to navigate these new regulations in terms of how we do business, where we do it, how we sell our funds, and how we raise money?

I spend a lot of time with the regulators around the region and they certainly aren't giving me any indication that they intend to lighten up on rules or registration requirements or anything like that. In doing so, the local Asian regulators are studying hard what it is that global regulators are planning to do about tightening rules around hedge funds.

Craig James

I think we are living through interesting times - the line between public and private money has never been more muddled with the PPIP and unprecedented government intervention. It is really difficult to understand who is private and who is public anymore. And along with that, I would agree that regulation will increase and become more and more a part of our business.

Another area of concern is the lack of a listed marketplace, particularly in derivatives. 95% of our exposure for example is over-the-counter. We deal with individual counter-parties, and relative to the US and Europe, this is a tremendous amount. I believe investors are increasingly nervous about that, having watched the collapse of both Lehman and Bear. We spend a lot of time explaining to our investors our due diligence process and our ability to handle another default. What would make investors increasingly comfortable is if Asia had an entity such as the Options and Clearing Corporation that acts as the clearinghouse for derivatives. There is an ongoing initiative to get these OTC derivatives on exchange, but it is a work in process.

If you are going to do business in Asia, particularly in derivatives, the liquidity for single stock listed options just isn't there yet. I think the Hong Kong stock exchange is going to have to stand up and take notice. If there is this initiative by U.S. or other governments to bring CDS or other derivatives trades on-exchange, Asia and Hong Kong in particular should respond to this. It is something all the major broker dealers here in the region understand and are trying to address, but again there are legacy issues, bandwidth and technology issues and things like that. It is a structural challenge as well as a regulatory issue going forward.

George Long

Going back to your question how will Asia develop, will it benefit from current trends and issues? I think Asia definitely benefits because we did not experience a systematic collapse of the Asian financial system as we have it in the US and the UK, and the reason for that is that we had one here in 1997-1998. Not in Hong Kong, but then the Korean and Thai banks collapsed, the Malaysian banks almost collapsed, and the Indonesian banks got totally blown away. The Chinese banks did not collapse, but they had NPLs of 30% in 1989-1990.

Over the last 10 years, Asia underwent a huge restructuring of the banking system, so Asia is actually quite strong at the moment and will to some extent benefit from the financial crisis in other part so of the world. Asia still has large surpluses, even under the collapse in the export sectors right now. Asia has built up very substantial surpluses and savings, which at some point will get channeled back through Hong Kong and Singapore and other financial centers. I actually believe that Asia will grow and become an even stronger financial center.

The challenge for Hong Kong and the rest of the Asia is whether there is enough leadership to address the structural issue as Craig has mentioned, like building Pan-Asian exchange linkages or derivatives clearing. This type of infrastructure has been built in the US and to some extent Europe, Asia is still too divided into lots of small countries and then two big countries like India and China; or you have countries like Japan that want to provide leadership and no one else in Asia wants it. The extent of this kind of fragmentation could be the reason why Asia may not really benefit as much as it could out of this crisis.

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Andrew Higgins

I would add to that list that generally, the overall capital markets are still underdeveloped in Asia. A lot remains to be done, for example in China. But this obviously presents opportunities and will attract global capital, as those markets develop.

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Andrew Higgins

Matthias Knab

So part from these things that remain to be done, what innovation, new products, or new approaches are coming out of Asia at this time?

Brian MacDougall

We have done some research I would like to mention. We talked a bit about correlations, and certainly last year we could see so many correlations go to one. Yet correlations of managed futures to other strategies has remained negative in many cases.

In a crisis, you are forced to sell into dropping markets, or at least you must mark to market. But in CTAs/managed futures, you don't have liquidity problems: you are sitting on as much as 85% cash.

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We discovered in our research that the correlations between the different styles of CTAs stayed consistent throughout the years and different market conditions, which is quite interesting. If the different strategies were negatively correlated last year, then they were negative correlated the year before, and the year before.

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That means, if you chose your strategies correctly, you can retain the good returns with much lower volatility. We were doing this research just for our own portfolios, but found this fact so relevant that we have launched a very exciting fund of fund product of CTAs, which combines different trading styles.

Talking about correlation, this is probably one of the biggest takeaways of 2008 apart from the immense volatility that was there. Whether it was FX correlations or equity correlations, really across all asset classes, the moves were dramatic. A lot of it was related to inventory, and when the deleveraging was occurring, there was just one-way trading.

Hopefully we don't, but whether we see that kind of liquidity event again or not, I think the important takeaway is that some portion of your portfolio should be invested in non-correlated assets and set up to benefit from volatility.

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George Long

We are in one of the greatest economic recessions or restructurings, which has not yet fully played out, so it is going to be very exciting over next couple of years. We may not have seen yet the lows in the equity markets. We are still living through the default cycle and the whole balance of payments restructuring. For us as a hedge fund manager, for the next couple of years we are very excited about the opportunities as we all go through this financial restructuring.

I have heard two things over the past few months from people: "hedge funds are done" and "Asia is done" - essentially being worded in different ways, but it is my belief that this type of sentiment will be very short-lived.

George pointed out the advantages that Asia has right now to come out of the current economic crisis stronger and probably earlier than the rest of the world even without the hyper-consumption that drove growth for the past few years. And what may happen with hedge funds - while the term hedge fund may disappear, the demand for the types of returns that hedge fund managers produce will be stronger than ever in the coming environment. Pension funds, insurance companies, and many other investor types rely on the kind of risk-adjusted returns that only hedge fund managers are able to produce.

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