



# Opalesque Roundtable Series '15

# BALTIMORE

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# Editor's Note

Maryland is one of the smallest in terms of area but one of the most densely populated states of the United States. It has the highest median household income, making it the wealthiest state in the country. The state's largest city is Baltimore, named after George Calvert, the first Lord Baltimore and the first English proprietor of the then-Maryland colonial grant in 1632.

In 2014, Maryland was ranked first in "Entrepreneurship and Innovation" by the U.S. Department of Commerce for the third year in a row. It is also number one in university R&D dollar spend and ranks first for concentration of businesses and jobs in science, technology, engineering, and mathematics.

## Cyber alley in Baltimore

Information technology, telecommunications, and aerospace and defense are leading forces behind Maryland's economic growth. In the biotechnology area, Maryland is a noted leader and is at the center in the mapping of the human genome and commercial applications that result from its research. It is also a significant research and development hub for healthcare and healthcare IT.

Within information technology, one of Maryland's strongest sectors is cyber security. This is aided by the nearby presence of the NSA and the Department of Defense. Both organizations have an enormous amount of brain power and resources, and actively fund research and development. The Maryland cyber security ecosystem is further aided by a number of recent large scale exits.

A community of local venture and private equity companies are active in seed, early, and late stage financing. There are also a number of technology councils, incubators, and accelerators that help young entrepreneurs and start-up companies. If you look at who is funding innovation, it is increasingly venture capital firms as opposed to large corporations. Apart from these VC and PE sectors, this Roundtable also discusses opportunities in local real estate, liquid alternatives, structured note investing, and showcases how local multi-family offices achieve yields for the clients and avoid going into "returnless risk."

This Opalesque Roundtable, sponsored by Arthur Bell CPAs, took place in June 2015 in Baltimore with:

1. John Avirett, [Greenspring Associates](#)
2. Arthur Bell, [Arthur Bell CPAs](#)
3. Tom Biddison, [Cornerstone Advisory](#)
4. Katy Kaminski, [Campbell & Company](#)
5. Pace Kessenich, [WMS Partners](#)
6. Corey McLaughlin, [Arthur Bell CPAs](#)
7. Gene Parker, [Continental Realty Corporation](#)
8. Jason Tagler, [Camden Partners](#)

The group also discussed:

- \* How to create income strategies with discounted cash flows and structured notes
- \* Update on the 40 Act space and liquid alternatives:
  - Issues sponsors should be careful about
  - How 40 Acts differ from traditional funds
  - Why more institutional investors invest in 40 Acts
  - Minimums for starting 40 Act funds
- \* How to get 12 - 15 IRR in real estate
- \* Are the FASB valuation rules still an issue today?
- \* What's really required to "institutionalize" a hedge fund or CTA?
- \* What investors are looking for when choosing alternative investments
- \* Investor perspectives on the active-passive discussion
- \* What characteristics are seeders looking for in an entrepreneur?
- \* Alternatives coming of age: How founders can best transition out and ensure continuity of their business.

Enjoy!

Matthias Knab  
Knab@Opalesque.com

# Participant Profiles



(LEFT TO RIGHT)

Matthias Knab, Corey McLaughlin, Jason Tagler, Gene Parker, Pace Kessenich, Tom Biddison, John Avirett.  
Katy Kaminski, Arthur Bell, Tina Lewandowski.

## Opalesque Baltimore Roundtable Sponsor



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# Introduction

**Katy Kaminski**  
Campbell & Company

My name is Katy Kaminski from Campbell & Company. I am new to the Baltimore area. I moved from Sweden to join Campbell & Company as the Director of Investment Strategies. Campbell is a CTA with over 40 years of experience focused on systematic quant strategies in the futures space. I am a part of our research team and primarily focused on portfolio construction and risk management.

I was originally an academic and have done a lot of research on trend following and systematic strategies. I was also an allocator in Europe, and I am excited to be in Baltimore.

**Corey McLaughlin**  
Arthur Bell CPAs

My name is Corey McLaughlin. I have been with Arthur Bell CPAs since August of 1998, and I head up the audit and consulting group.

We are a firm that's focused solely on the alternative investment industry. We have tremendous experience—over 40 years in the industry—which has earned us an excellent reputation within the alternative investment community. We service a large breadth of clients, anywhere from start-ups to the mega hedge funds. As a result, we have expertise with many different entity structures and a wide variety of strategies, including long-short equity, fixed income, commodities, structured notes, and private equity. Through our work with clients and our involvement in the industry, we quickly gain an understanding of the hot topics affecting funds and asset managers in today's environment.

Arthur Bell CPAs performs specialized advisory and operations consulting in addition to the traditional audit, tax, performance reporting, and family office services.

**Tom Biddison**  
Cornerstone Advisory

My name is Tom Biddison. I am a Principal with Cornerstone Advisory. Cornerstone Advisory is a boutique wealth management firm based in downtown Baltimore.

We began in 2007 as a result of a breakaway from a broker-dealer. We recently launched a private placement, The Outcome Driven Fund, around our specialty in creating institutional structured note strategies. We have had tremendous success with this strategy in our private wealth practice over the past eight years and believe there is an opportunity in the marketplace for this type of investment. We are using both original issue strategies as well as secondary offerings in the fund.

**John Avirett**  
Greenspring Associates

My name is John Avirett, and I am an Investment Partner at Greenspring Associates. Greenspring is a \$3.4 billion venture capital platform located in Owings Mills, Maryland.

We focus on three different investment strategies within venture. The first is fund investing, where we typically target early stage IT focused managers. The second is direct investing, where we deploy capital in growth stage companies usually a few financing rounds prior to an exit. Finally, we also invest in both direct and fund secondaries.

As it relates to sector allocation, we tend to focus predominantly on both fund and direct investments in the information technology space. To a lesser extent, we will allocate capital to communication and healthcare focused funds and companies.

We are excited to help finance innovation and believe that now is a tremendous time for start-ups to reach scale quickly, create enduring new markets, and drive efficiencies for enterprises and consumers.

**Arthur Bell**  
Arthur Bell CPAs

My name is Arthur Bell, the Founder of Arthur Bell CPAs. I started life many, many years ago as a trader and chief financial officer. Then someone told me that they needed my CPA expertise much more than they needed me as a CTA, so that is how I got into this business.

We are very excited to be part of the alternative investment industry and are deeply involved with it, not only on the client service side, but by participating in organizations that aim to improve the circumstances of the industry. We have been very active on different boards, and are actively involved with the Managed Funds Association along with regional societies like the Mid-Atlantic Hedge Fund Association, the New York Hedge Fund Roundtable, and the California Hedge Fund Association.

**Pace Kessenich**  
WMS Partners

My name is Pace Kessenich. I am a Partner at WMS Partners. We are a multi-family office located in Towson, Maryland. We have approximately \$2.8 billion of assets under management. We are an advocate for our clients regarding all aspects of their financial situation. This includes asset management, risk management, estate planning, or helping with tax or insurance planning. Yet, we don't draft a will, and we don't fill out a tax form, but we are there as advocates in all those aspects.

My particular role is Director of Alternative Investments. We classify 28% of our assets as alternative investments, which we think is fairly high for a multi-family office.

We break alternative investments into four basic categories: hedge funds, real estate, private equity, and discounted cash flow investments, which we consider unique to us. Under discounted cash flow investments we make investments in secondary market lotteries, structured settlements, and other cash flowing assets.

**Gene Parker**  
Continental Realty Corp

My name is Gene Parker. I work for Continental Realty Corp right here in Baltimore where I am the President. I have been at the firm for about 22 years.

We are an owner-operator of commercial real estate, primarily in the shopping center and apartment areas. We have done lots of things, but that is our most recent focus.

The company has been around for 55 years. For the first 50 we were a family business, we basically invested and operated using family equity. In the last five years we have gone to more of a private equity model, and that has led to significant growth, both in terms of the size of the portfolio, and the pace of our growth, and all the challenges that come with that. But it has been a lot of fun and rewarding for us and our limited partners. Our portfolio is in the Mid-Atlantic and Southeast U.S.

**Jason Tagler**  
Camden Partners

I am Jason Tagler with Camden Partners. Camden is a growth equity firm. Primarily, we partner with management teams and help them grow their businesses. Three main sector areas where we are active include healthcare, education, and business services.

We are a little later stage than venture capital, but not doing leverage buyouts. So we are sort of in \$10m-\$20m revenue range where we help growing businesses from that stage to \$100m or \$200m in revenues.

My background is all in software services. I was a software developer about 15 plus years ago. At Camden I invest in software companies and also do some growth buyouts as well.

We have a couple of other product lines which are a little smaller in size, but our primary focus is on our growth equity funds.

**Tina Lewandowski**  
Arthur Bell CPAs

I am Tina Lewandowski, the Marketing Director for Arthur Bell CPAs, a firm with headquarters just outside of Baltimore that is dedicated to the alternative investment industry. I am pleased that our firm could bring this Roundtable to Baltimore to showcase the breadth and depth of the alternative investment community right here in our backyard. As the event coordinator, I look forward to more opportunities in the future that bring the hedge fund, CTA, private equity, real estate, and venture capital networks together.

# 70

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Let's look at the different opportunity sets that each of you address, either through a product or from the investor perspective. We can also talk about the products you are launching and the opportunity sets you are targeting with them. Tom, you mentioned your new structured products fund, can you tell us more about that?

**Tom Biddison:** Let me start with a little bit of background. Until the year 2007 we were basically a traditional asset allocating firm using primarily mutual funds. We started to shift from active management towards passive strategies in the more efficient markets, but we were seeking something unique to enhance our client experience.

Through one of the major investment banks, we were introduced to the idea of these structured note strategies, and we invested some of our own money to see the end results. Ultimately we started to see success, and began to gradually implement these strategies into client portfolios; at the time predominantly around growth-oriented strategies.

Let me give you a quick Reader's Digest version of how these strategies work. Over the past eight years, we have developed relationships with ten major investment banks. Through those relationships with the investment banks, we are able to create a scenario around whatever financial experience we are looking to track. So that could be real estate, that could be a particular commodity, it could be an equity index or a single stock, whatever the case may be.

In the initial stages it was all about growth; how can we create leverage, how can we create some embedded downside protection so everything is not a linear return path?

For example, we created scenarios where we could, for lack of a better word, sell away greed, buy fear protection, and then create attractive leverage in the middle so that we are able to create a higher probability of a reasonable return, but manage downside risk along the way.

That evolved into then creating income strategies, which is probably our most relevant offering right now. Everyone is looking for a way to create income with low interest rate risk, with shorter durations, and with less volatility. We use the same "outcome driven" packaging to create these income strategies that pay an attractive contingent coupon with between 20 and 30 percent embedded downside protection.

So we break it out into two scenarios. One is the income paying period and one is the payment at maturity. Let's assume that we create a two year note with an 8% annual yield (paid monthly) linked to the S&P 500 with a 25% coupon barrier and 25% embedded protection. During the payment period if the S&P 500 does not drop 25% from trade date levels, we are going to receive the 8% coupon all along the way.

If it were to happen to drop below that 25% mark during the life of the note, we just don't collect the coupon during that period of time when it's below that threshold.

And then at maturity, the focus is on preservation of principal. Generally we protect that full 25%, so if the index was down 26% over the 2 year note term, our investment would lose 1% on principal at maturity.

The general theme, and why we think it's relevant now and moving forward, is that these strategies tend to work best when interest rates are reasonable, because they are basically a combination of a zero coupon bond and derivative strategies to create the return package. We will have more coupon to purchase the associated options.

These strategies also tend to work better in more volatile environments, because we will be selling volatility, which gives us more dollars to, again, create better economics of the investment.

From a portfolio construction perspective, we have been allocating this in our client portfolios. We have had a couple of registered investment advisory firms express interest and utilize it in their portfolios as well, generally putting it into an alternative or low



correlated class, because it is a nonlinear investment. It's not directly tracking equities, commodities, or interest rates.

So this is something we launched in November 2014. We currently have just under \$22 million in the fund, and we are looking to grow that to about 50 million. It's a 3(c)(1) fund so we will cap out at 99 investors, and eventually look to show a solid track record so that we can then market it to the endowments and the pensions.

**Katy Kaminski:** For us at Campbell, the most exciting area has been the liquid alternatives area. The 40 Act space has become so popular in the United States. We have already worked with Equinox to launch the Equinox Campbell Strategy Fund in 2013. In December of last year we also launched another fund ourselves, and we are planning to launch another mutual fund in the near future.

We were able to raise over \$1.1 billion in two years in the Equinox Campbell Strategy Fund. That offering has been extremely successful. We see that many people are interested in liquid alts, they are interested in finding easy and secure access points to hedge funds.

For me, this is kind of an exciting thing to see. Having gone from Europe to the States, the way that we access hedge funds is so different here than it is in Europe.

I was personally invested in hedge funds as a retail client in Europe in my private pension. Here in the US, the only way that we could do that was if you are a qualified investor. And now with the liquid alts movement we are seeing a huge amount of interest. But with that interest there's also a lot of challenges and education, et cetera.

But we are definitely seeing that liquid alts is a totally new investor base, and it's the same with the European UCITS funds. As a result, there are now a lot of different access points for our strategies that we didn't have before. We are working on a new fund and we have several different funds that have already been quite successful in the last two years.



I don't know if any of you are also in the liquid alts space – it's very good for futures trading, because everything we trade is highly liquid. This is a bit harder in venture capital and other less liquid strategies perhaps.

**Corey McLaughlin:** Also, on our end, we have seen a lot of activity in the liquid alts space. If you look at the total numbers in terms of investments that are going into liquid alts, it's pretty substantial.

I think Katy made a really good point that liquid alts fit certain types of strategies very well. For instance, commodities and other strategies that are exchange-traded and very liquid are easier to value on a daily basis and therefore fit well into the liquid alts space. Investors as well as the traders can come in and out easily without hurting the portfolio because of liquidity constraints that some of the other strategies may have. It's fundamental for managers to look closely at the liquidity requirements that liquid alts are subject to and that the SEC requires.

We should also note a business issue that we discuss with clients launching liquid alts products. *The sponsor needs to be careful about what the liquid alts product offers in terms of alpha versus what maybe the private offerings offer.* This is important because the fee structures are different for a liquid alts product versus a private offering. For example, in liquid alts there could be limitations on certain types of fees that you see in private offerings.



Therefore, if a firm offers the same kind of trading style in a liquid alts product as in their private offering, and the fees are less substantial in the liquid alts product, clients in their private offering may wake up one day and say, “What’s going on here? Why am I in this versus that?” So, again, that is something to think about.

**Matthias Knab**

Corey, so I wonder what is really driving the rise of liquid alts if in effect a hedge fund or CTA may have to give up their two and twenty fee model?

**Corey McLaughlin:** That’s a great question. I think capital raising is a big part of the answer. Firms want greater exposure to different investor bases for more opportunities to generate capital. So I think managers are willing to give up some of their fees in return for more of a fixed fee environment with a larger capital base and greater diversification of their client base.

We mentioned CTAs as a good fit for liquid alts. The CTA space, somewhat unfairly, has experienced some challenges since 2008. In the financial crisis, many CTAs performed strongly, and that performance helped a lot of investors through a difficult time. Sometimes in bull markets investors forget what CTAs can offer to help diversify their assets.

Even though many CTAs did well during 2008, unfortunately, they were also liquid. Therefore, investors that had assets in illiquid products needed money to fund different capital call requirements, so they pulled out of CTAs. This was unfortunate as many of those CTAs had been doing quite well.



In general CTAs tend to do really well in periods with a lot of volatility. Therefore, performance broadly across that sector has lacked for some years, but most recently it has started to improve. I would encourage people to keep in mind and remember that CTAs are an important part of larger portfolios.

But let me also point to an article I happened to read today where Kara Stein, the SEC Commissioner, said that the SEC will put some scrutiny on liquid alts products, claiming that it wasn’t the SEC’s intention to have retail investors exposed to these alternative products. The SEC will be taking a closer look and keeping their eye on the liquid alts space. It will be interesting to see how this plays out and how this might affect the liquid alts market.

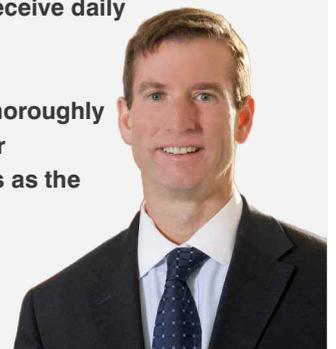
**Matthias Knab**

In general, do you see more transparency on liquid alts?

**Corey McLaughlin:** Yes, absolutely! There are very specific reporting requirements for 40 Act Funds, and so if you look at their schedule of investments, it’s extremely detailed, with a lot of transparency information. Obviously they have daily NAV reporting. While there are some hedge funds that provide that as well, you do not receive daily reporting from most hedge funds.

They are also different in terms of governance structure. You need a Board of Directors that thoroughly controls everything about a 40 Act Fund. The Board makes all the decisions about who is your accountant and who is your attorney, so those decisions are now somewhat out of your hands as the actual manager.

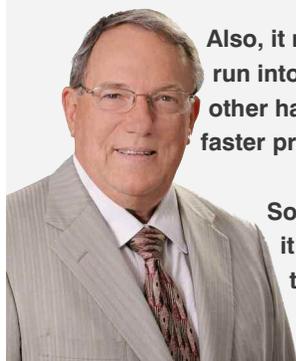
The Board is really diligent. They have heavy fiduciary responsibility, and so they will also be monitoring the manager about what the manager is doing from a trading perspective,



and more. The structure is very different from the private fund world.

**Arthur Bell:** The allure of 40 Act Funds is very nice. Some people have tried to get in, but you have to remember it takes a lot to be successful. If you have a bad track record to start with, it's still going to be a bad track record in a mutual fund.

**40 Act Funds have a high front-end expense.** If you can't afford that, you have a problem, especially since you will generally earn lower fees in a mutual fund format.



Also, it may be rather easy for investors to get into a 40 Act Fund, but it's a two-way street. Should you run into a downturn, you have to worry about retail clients making a quick exodus from the fund. On the other hand, if you have a really good record, there could also be a line waiting to get in, which is also a faster process than in the private fund world.

Some people that have gone into the 40 Act space are now realizing it isn't quite what they thought it would be. They were not prepared for the extra marketing effort or are not happy with some of the relationships.

**Jason Tagler**

Can this work at \$25 million? Or do you need \$100 million or \$500 million instead?

**Arthur Bell:** I would say \$25 million is really at the bottom end of it, particularly if that's all that your firm has. I mean, there is a difference between managing \$200 million and then starting this fund with \$25 million, or having a total of \$25 million AUM that you are putting all into this fund. Plus, you will not have the two and twenty fee structure to carry you that way.

On a liquid alts panel at our Industry Update last year, the clients who have gone through the start-up process said you shouldn't even think about it if you are under \$50 million. I would say a minimum of \$50 million to \$100 million is more viable.



**Tina Lewandowski**

Katy, what are your minimums for starting one of the funds?

**Katy Kaminski**

That's not really my area of focus at Campbell but I know that we determine the minimum to start a fund based on several factors including the characteristics of the markets being traded, the expected turnover rate of positions in a strategy, seed investor interest, and many other variables. So for us the minimum could be different for each fund.

**Corey McLaughlin:** There are a couple of other things that you have to consider as well. To start, a turnkey option for mutual funds or liquid alts products is a Series Trust.

A Series Trust is already established. Somebody has set it up, and different series come in, which are basically different advisors. The Board and structure are already established, so there may be some efficiencies that help you with start-up costs. But then you don't control the whole structure as you would in a standalone product.

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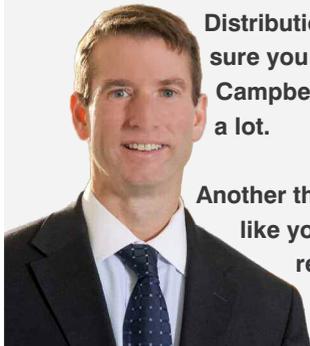
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We have seen some clients jump into this with a belief that they are going to open a liquid alts product and then money is just going to flow in the door. It doesn't work that way. You have to beat the streets, like you do to raise capital in a private fund, although in a different way. So there's a learning curve that usually happens with how to effectively raise capital in a liquid alts product.



Distribution channels are extremely important. When launching a liquid alts product, you need to make sure you have the right relationships and the right people who will sell your product for you. I think Campbell has a long history of building the right systems with the right people, and so that helped them a lot.

Another thing is if you want your returns published on a recognized database like Morningstar, it's not like you operate for one month and that return will show up in those databases. Depending on their requirements, you may need a track record for a number of years before that fund even shows up there.

**Katy Kaminski:** I will just add one point to that. I have been out meeting with a lot of investors, and we are actually seeing a lot of demand from institutional investors on the 40 Act space, which is something that was kind of interesting. I was expecting 40 Act structures to be primarily a retail product, but honestly we are seeing a lot of institutional investors that are looking into them, possibly because they are looking for a low fee version, something that's easy to access, something that has operational due diligence boxes checked. So that's one thing that's been kind of an interesting development for me is that I am actually talking to fund of funds and institutional clients about these types of products.



**Tina Lewandowski** It's less paperwork, right?

**Katy Kaminski** Yes, I think so.

**Matthias Knab** Jason, please tell us more about your work?

**Jason Tagler:** We're beginning to work on a totally different strategy relevant to Maryland. We are going to focus on seed-stage investments after angel, but before you really reach that Series A, B, C level.



I do a little angel investing on the side, in addition to what I do at Camden, and it's clear there's a lack of seed-stage funding. We see an opportunity that addresses a gap in the market. There's sort of a chasm that a lot of the companies can't seem to get over. What's really interesting is when you take this opportunity and look at it from Maryland's perspective; a couple of other things come into play that makes it even more important here in Maryland.

Maryland is number one in university R&D dollar spend, and number two in R&D intensity, which is the ratio of R&D spent relative to Maryland's GDP. So there is a severe disparity between how much early stage research is done here versus how much of that we commercialize as a state.

**Pace Kessenich** Of the research activities that you mentioned, what percentage do you think is healthcare versus IT?

**Jason Tagler** I am not personally spending a lot of time on this strategy, so I haven't been deep into it, but Johns Hopkins University leads the nation in R&D spend.

**John Avirett:** Within Maryland, I would say that the most significant research and development hubs within the healthcare sector are Johns Hopkins, the National Institute of Health, and the University of Maryland. These Maryland-based organizations receive some of the highest levels of federal funding in the United States.

Another area that is emerging within Maryland is healthcare IT. DreamIt Health in particular is a strong resource that collaborates with important institutions in the area such as Johns Hopkins, University of Maryland, and Northrop Grumman.

Within information technology, one of Maryland's strongest sectors is cyber security. This is aided by the nearby presence of the NSA and the Department of Defense. Both organizations have an enormous amount of brain power and resources, and actively fund research and development. The Maryland cyber security ecosystem is further aided by a number of large scale exits, most notably Cisco's acquisition of Sourcefire for \$2.7 billion in 2013.

The amount of talent and research happening within the sector locally presents a really interesting opportunity for seed-stage managers. In general, the majority of venture investors based in Maryland such as JMI Equity, ABS Capital Partners, Camden Partners, and Greenspring Associates focus on later stage financing rounds. So, it is exciting to hear that Camden Partners will now help bridge the gap for these businesses to reach the scale required for the downstream partners that I just mentioned.



**Arthur Bell** Does R&D include the Johns Hopkins University Applied Physics Laboratory?

**John Avirett** Yes, Johns Hopkins Applied Physics Lab has been a strong contributor in research and development helping to support national security needs.

**Arthur Bell** Applied Physics Lab itself is a massive operation.

**Jason Tagler** What we are focusing on is cybersecurity, healthcare IT, and any tech transfer that is coming out of any universities. We also will get involved in the process and try to help facilitating how that transfer happens. That's the goal of this strategy.

**Tina Lewandowski** Are you also working with some of the local technology councils and incubators to identify these opportunities?

**Jason Tagler** Yes, we do. There's a lot of deal flow relative to healthcare and cybersecurity.

It's the commercialization of that; that's where the big gap is. There's a lot of R&D spend, but there's not a lot of commercialization in helping to close that with - it's not just dollars, but growth expertise in that space.

**Jason Tagler:** I always talk about our area as cyber alley. If you think about where all the cybersecurity is happening, there are a lot of people working for the government under different contracts. They spin out and start their own companies and have an incredible amount of entrepreneurial capability that can be applied to other government ideas. You can then take those government companies and commercialize them.



But I think we have a great community overall, particularly in Baltimore. I lived through the tech bubble bursting from 1998 to 2003 in Silicon Valley, and I still go out there quite a bit, but one thing that's exciting about Baltimore are places like Betamore and the Emerging Technology Center (ETC). I just learned about Fastforward, a Johns Hopkins University accelerator in Remington.

The growth curve of technology and entrepreneurship in Baltimore is very steep right now, so it's pretty exciting. There's a lot of excitement in the community, and a number of people are volunteering their time and putting their own dollars to work in that area. I think there are good things to come in that space.

**John Avirett:** When you think about the opportunities out there, one of the things that gets venture capitalists excited on both ends of the spectrum, seed and growth, is the fact that major technology trends like cloud computing, healthcare IT, cybersecurity, enterprise IT, mobile, and others, are still relatively nascent from an adoption perspective. We think that these overarching themes have the ability to continue to create massive markets in the future. And, if you look at who is funding innovation, it is increasingly venture capital firms as opposed to large corporations. This creates huge opportunities for founders and private investors to monetize technology around these trends. Additionally, it positions venture-backed companies as critically important forms of outsourced research and development for large companies that need to find ways of continuing to fuel growth.

In fact, we have seen this a lot where the larger incumbents have not effectively been able to take new products from concept to fully formed business unit. So, increasingly these groups have turned to venture-backed companies to fuel innovation gaps. This combined with the sheer size of the current market opportunities leads us to believe that we are in the midst of a particularly fertile environment for new innovative companies.



**Jason Tagler**

I see the same thing. The bigger companies are not innovating, and they are just acquiring for growth, particularly in software IT and technology right now. I would definitely echo that. It's a pretty big trend and similar to what we have seen in pharma and biotech for a long time.

**Tina Lewandowski**

We are very proud of that entrepreneurial and innovative spirit in Baltimore. At the same time, I often talk to people about how hard it is for smaller, innovative companies to emerge past the start-up phase; they feel like they have to sell their business. We want those businesses and jobs to start and thrive here in Baltimore.

What do you think of Baltimore as a marketplace that can help these thriving and growing businesses stay here and fuel the economy?

**Jason Tagler:** Well, there are people who are trying to improve what we have in the local technology ecosystem. There's a group called youngStartup that's taking top people from universities and providing a two-year internship with startup companies here in Baltimore and other second tier cities.

The whole purpose of the program is to bring those really creative people who are entrepreneurs into our cities, give them an opportunity using the "Teach For America" concept, and hope they develop a great network and start businesses. As they grow, they will ultimately create more jobs and more opportunities.

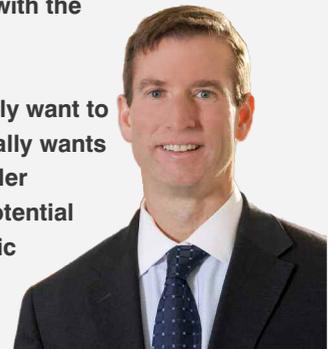


We are just trying to provide more fuel and resources to these companies and there are several ways people are doing it. Greg Cangialosi with Betamore, the ETC, and other accelerators, combined with these initiatives, creates this ecosystem and everything feeds on itself.

I personally think, even relative to Silicon Valley, we are growing faster in terms of the IT growth innovation curve. If you look at where we were ten years ago when I came to Baltimore and where we are now, the curve is actually very steep. We are much smaller than the total ecosystem in Silicon Valley, but I would say the growth rate of our technology ecosystem is a lot steeper, particularly if you consider the cybersecurity industry.

**Corey McLaughlin:** I have lived in Baltimore my whole life. I was born and raised here. It has been a lot of fun to be in the area. Also from my perspective as a local resident, I see a lot of opportunities for Baltimore. One of the trends we see is impact investing. If we couple that with some of the things that you were talking about with the R&D opportunities in organizations like Hopkins, it just seems to be a good match.

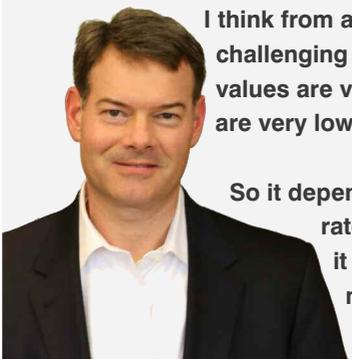
I also like to point out that there is a great amount of civic pride in Baltimore. People here really want to make Baltimore be the best it can be. That also applies to the technology sector. Baltimore really wants to make a name for itself and to foster further investments and growth in the startup and smaller companies sector. Looking into the future, I think this opportunity will continue with a lot of potential for the city. There is a real hunger and desire here to have Baltimore be an influential economic center.



**Matthias Knab**

Thank you, Corey, let's turn from the venture side to real estate now.

**Gene Parker:** It's hard to follow up an innovation conversation with real estate, but I will try. We just raised a \$164 million private equity fund to go out and buy real estate assets in the Mid-Atlantic and Southeast. Clearly, we are from Baltimore, we have been here 55 years, and we would love to spend that money in this market if we could.



I think from a commercial real estate standpoint what makes Baltimore a good market also makes it a challenging market. There are fairly high barriers to entry. There's not a lot of undeveloped land. The values are very high, because incomes are high, job security, those types of things, and so cap rates are very low, it's a very competitive market.

So it depends on what you are looking for. If you have a portfolio of assets, then it's great. There are rate increases and there's low vacancy, but when you are trying to place money in that market, it can be a challenge. There are a lot of people that look at Baltimore and Washington as one market, first of all. And second, there's a lot of capital from all over the world chasing opportunities.

I think from the strategy standpoint what we have to look at is not trying to compete with all the larger firms, the REITs and the large international companies, but out-competing the smaller companies. So we like to try to be the largest company competing for the asset we are trying to acquire, maybe under the REITs, but certainly above the small guys.

I think as a practical matter, probably 20%, 25% of our money gets invested in Baltimore, because it's such a challenge. It's very difficult to find upside in this area, but that indicates the strength of the market.

This area tends to not be overbuilt, like the Carolinas or Florida, particularly Florida. There are certainly ups and downs in those markets. There's overbuilding and then there's distress selling, so you can get in to buy some of the distress and then resell toward the top again.

The ups and downs lead to a lot of opportunity, but you have a lot of available land down there. There are no barriers to entry. You can build a shopping center at every corner, and there's always a new corner. A lot of that is because of the amount of growth. People are moving down south. So that's where some of our money will be focused.

I think it's an interesting way to look at Baltimore, where what really makes it a great market makes it also a challenge to find investments. Most of our products are value-add products, meaning we have to go out and then buy something at a five or six cap and figure out, how do you turn that into a 12, 13 or 15 IRR over a 10, 12-year whole period. That's a challenge if you can't find real value-add opportunity.

So in this market, if you are looking for consistent yield, stability, low coupon, there's plenty of that around. There are plenty of stabilized assets. There's one right across the street; Hunt Valley Town Center. The challenge is how do you find those opportunities that have a lot of upside in a market that's very strong, where people are all looking for the same thing?

**John Avirett**

Are there any particular areas within the Baltimore Metro that have more upside than maybe others?

**Gene Parker:** I think it's probably mostly out toward the counties in terms of where to look for the upside.

We look at an area like White Marsh. It's a terrific area with everything that's happening up that way. In White Marsh, you actually can tap into a little bit of Delaware, a little bit of Southern Pennsylvania, Cecil County, and Aberdeen. Certainly, Northern Virginia is another area with growth which is appealing.

They talk about real estate being really location, location. It really is. So while we tend to look at broad markets, within a broad market there are a lot of great opportunities and a lot of terrible opportunities, and it's many times block by block. You can literally have a great investment on one side of the street and a bad one on the other.

Sometimes it's about demographics and incomes, but a lot of times it's about the quality of the asset, functional obsolescence, the quality of the retailers, traffic patterns, visibility, a lot of those types of things. It really is down to sometimes block by block.

That makes it a challenge. In order to buy 12 properties for our last fund of about \$250 million of total assets, we had to look at about 2,000 properties.

Now, when you say, all right, we have a fund, it's maybe 60%, 70% larger. How do you do that? You don't want to look at 4,000 deals for 24. You want to try to find a way so that out of the 2,000, with the same team you have in place, you can be much more efficient about trying to find value-add opportunities in these very competitive markets.



They always say in our business, it's ten year cycles and five year memories, right? And right, you have some of that. So it's very interesting.

**Tom Biddison**

Can you talk a little bit about the financing you are seeing revolving around those new purchases of the properties?

**Gene Parker:** Sure, the financing breaks down a couple of different ways. One is for multi-family where the biggest lenders, by far, and the most competitive, are Fannie Mae and Freddie Mac. Most of what we do is Fannie Mae financing. It's fairly straightforward and largely non-negotiable. So what makes this really work is that you can put long-term debt on properties while interest market rates are low.



On the commercial side there is a larger range of lenders out there like commercial banks and life insurance companies. But also here, rates are really competitive. One thing we tend to look for is a few years of interest-only payments. This helps in a fund model when you are maximizing cash flow to investors.

There are a lot of real estate investors out there that are using floating rate debt, and it's pretty attractive. But the way we look at it is that downside protection is everything. Sure, we are paid to figure out the upside, the value-add strategy. We could do a lot better from a return standpoint with floating rate debt, but it's also scary.

**Tom Biddison**

How long are your locks?

**Gene Parker:** The locks are generally 10-15 years. That said, our current fund is really a 10-year fund. So as a practical matter we are only going out 10 years, but we have other legacy assets in the family business that may go out to 15. We actually also have some going out to 25 years.



**Tom Biddison**

Is the demand for your fund affected by that at the moment, because you are steering mostly away from the floating rate?

**Gene Parker:** That's a great question, because obviously the debt has positives and negatives. The downside is that upon loan maturity if cap rates go up, values go down, so your equity gets squeezed and it may be harder to refinance, and also your cash flow may be reduced by higher interest rates.



The way we look at it is that we take very long-term debt. We also try to price in or essentially purchase the rights to prepay the loans. We might, for example, have on a 10-year loan the ability to prepay it in the last four or five years. We may pay 10-12 extra basis points for that, but to have that flexibility when the time is right, either the real estate market is right, or the debt market is right.

We also look at it and say, if we can get the 10-year financing, and in some cases 12, because really our fund is a 10-year term, but with a couple of extensions. If we can get that 10 or 12-year financing, then it might be very accretive to a buyer if the interest rates go up. So we have the flexibility to sell with in-place debt, as opposed to defeasing the loan to sell.

So we are very sensitive, and I think frankly our investors are as well. They want us to make our money through operations and a good value-add strategy rather than just through financial engineering. We just have to be careful.

**Tom Biddison** How long have you had this sort of strategy?

**Gene Parker:** For 50 years we were a buy and hold company, and that's what we did. And so some of the questions when we got into the fund model were, I thought you guys held forever. What's going on? Why the change of focus? To some extent the answer is that our investors look for a liquidity event, and they look for an IRR. While we can obviously deliver our IRR through long-term holds, the investors really do want liquidity events.

One of the challenges of raising a fund like ours is when people say, tell me about liquidity during the ten years? There isn't any, in the sense of, hey, I want my money back. As a practical matter we have 6% distributions, return on equity, largely tax-free in the initial years. We have sales from time to time that return, hopefully not only the principal, but some excess. But it's really an illiquid investment.

But it's interesting. I would tell you that we are considering in the next fund, three to four to five years from now, using more of an Evergreen model, with the idea that we are going to buy these properties probably with larger groups of investors and hold the properties in perpetuity.

We will need to figure out liquidity events to make that work. We have three or four years between now and when this fund is fully invested to figure that out. But we are continuing to take a look at two things. One is what are the requirements of the investors? What are they looking for in terms of the length of the investment? But also, what business do we want to be in?



**Jason Tagler**

It sounds like the investment strategy has stayed the same for a long time. I am kind of curious, since you have a unique perspective and a really long history with the same investment strategy, what's the band of returns when you look back, has it varied a lot?

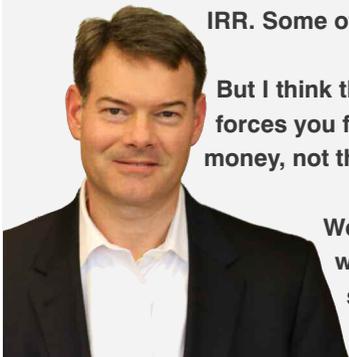
I am sure interest rates have had an impact and it sounds like competition has increased over the last 50 years.

**Gene Parker:** From an investment strategy standpoint, for a long time when it's a family business, families like the ones that I work for essentially just buy and hold, and to a larger extent they are not terribly concerned with return analysis and IRR, because frankly, nobody is asking the question. Things are pretty good so you move on.

Looking at our properties purchased since about 1990, I would say that the overall portfolio has seen about a low 20s IRR. Some of that is cap rates and obviously some of it is cash flow and property appreciation.

But I think that going forward – given where cap rates are, and where they are likely to go – that really forces you from an execution strategy and investment strategy to figure out how you are going to make money, not through cap rate compression, but through profitable operations and true value-add.

We spend a lot of time saying, if we have to stand in front of a group of investors and say, are we being good stewards of that money, what does that look like? What's the value-add strategy? How has it changed?



The market has become very competitive. You could do a lot of off-market deals. There were a lot of them around. Now, the Internet, for example, has made things so competitive. You put a property on the Internet and you get bids from all over the world. Now there are 30, 40, 50 investors for every deal, and half of them you have never heard of. They are from around the world.

**Corey McLaughlin**

Do you rely on tax credits in any way?

**Gene Parker**

We don't rely on tax credits. It's really all a private equity model for the equity side and then financing is Fannie Mae and Freddie Mac, life insurance companies, and commercial banks, and that's a total capital stack.

**Matthias Knab**

Let's move to the private wealth side. I am curious to hear from Pace a little more about your work with alternative investments. You mentioned before you have 28% allocated to alternatives. Is this part of the portfolio something that you build up, that you maybe had to fight for, or was it already like this for some time? Will it remain at that level, or will you be taking it up or down? And what in general is the role of alternatives in your institution?

**Pace Kessenich:** When we take on a new client, we typically tell them, "You have made your money, you have in a way won the war, so now you don't really need to fight the battle." What we mean by that is that we are always looking for investments that take the client off the roller coaster of the stock market. We look for investments that provide cash flow along the way, because if you have cash flow along the way, then you can ride the roller coaster or simply get on with your life better. Therefore, we tell the client, what you really want to have are investments that are not correlated to the market. This is how we got involved with cash flow investing.

I have been with WMS Partners for eight years, and they were doing alternatives probably for eight years before that. It started with the discounted cash flows, which is where we have carved out a niche for ourselves.

An example of that would be buying state lotteries on the secondary market. For example, a lottery winner may get \$50,000 a year for 20 years, according to the game, rather than the \$1million payout. Sometimes the winner says, "Well, that's nice, but I need cash now," so they have a mismatch in cash needs. We on our side have intermediaries that find these people, and then we will be the funding source for them and buy out that winner. That gives us essentially a guaranteed return with extremely low risk that the payment will be missed.

We have never had a payment missed. For the lottery commissions of the states that play these games, it's the golden goose. Lotteries are the fourth leading revenue generator for the State of New Jersey; it's third in Maryland. State lottery winnings were our first investment in discounted cash flows over 15 years ago.

We have expanded from there, and we have added other types of discounted cash flows. For example, we buy structured settlements, which are annuities from insurance companies. We have been pooling the annuity cash streams together to diversify the pools against insurance company risk.

To date, we have purchased approximately \$700 million in payments. I don't know what the current NAV is today, because they are a self-liquidating asset. They are illiquid, so they could run 10, 15, 20 years out, but if you lock in a 7.5%, 8.5%, 9% return, it's quite attractive from an investment perspective. Over the history of our buying these discounted cash flows, our average yield on the overall portfolio has been just shy of 8.5%. It's taxed as ordinary income, so we try to invest in tax advantaged accounts.



We are always looking at various alternative investments, so we have invested in all the strategies represented today at this Roundtable. However, the characteristic that we generally find most attractive with any investment is that we are getting cash back quickly.

For example, when I talked to John's firm, Greenspring Associates, he has three product offerings. There is one product that we really like, and another product that we would probably not do, and that's because there will be too long of a time period when we would not receive cash flow.

So in essence we are *cash flow private equity investors*, whether that is private equity in the form of purchasing real estate or whether it's in the form of purchasing companies or other assets. Current cash flow is what we really look for.

Some other investments we have made include an investment in a drug royalty fund (intellectual property), utility assessments on development property in the state of Maryland, legal settlements, senior living facilities, and multi-family garden style apartments.

Investing in utility assessments was a unique situation that we were able to take advantage of in 2008 and 2009. We purchased utility assessments from developers which gave our investors cash flow that was senior to everything except property tax liens. We were able to buy these streams at 11% return, with loan to value in the 1-2% range. Think about that...your mortgage is at 5%, 6%, 7%, and you can own the rights to a stream of payments that is senior to your mortgage at 11%. That's a pretty good risk reward.

We have purchased legal settlements. This is created when there is a case where the two sides in a lawsuit already have a legal agreement made on what the payout is going to be, but before the payout can happen, there might have been a death or a child involved and the case needs to go before a judge. So there's a period of time where the settlement has been made, but the payout will not be paid for a period of time and the litigator needs the cash to run his business. Therefore, the litigator is willing to sell a portion of his future income stream at a discount.

We have purchased senior living facilities. We believe the decision for people to move into senior living facilities is not dependent upon the economy but rather the individual's health and their social situation. We feel we have demographics at our back at this time.

We have also made investments in Continental Realty's funds to get exposure to multi-family garden style apartments. We believe that occupancy in apartments is somewhat negatively correlated to the economy versus office space which is cyclical in nature.

We like Jason's fund (Camden Partners), because it's very good at getting cash back fairly quickly compared to most private equity funds.

**Matthias Knab**

Let's further look into the broader investor demand, Pace already explained a bit what he is looking for, so I wonder how things are going for the product providers in this group when it comes to fundraising and marketing, both within the US and globally?

**Pace Kessenich:** I can start with that question, because when Continental came out with their fund, I knew they would be oversubscribed as soon as they came out with it. Asset allocators like us are looking for yield right now. The bond market is overpriced. We call it "*returnless risk*."



So if the bond market is over-valued today, anything that is a quasi-replacement for a yield bearing investment is going to be interesting to our clients. Anything that's giving an investor yield right now is very interesting from an asset allocator's standpoint, because we are really not crazy about a 2% return on a 10-year treasury. With rates where they are today, they can either stay flat and you get 2%, or rates will rise and your bond goes down in value.

**Tina Lewandowski**

Pace, you clearly expressed what you are doing and looking for today. I was wondering, do you put that message out in forums like this, so that when people are coming to you, they know how to approach you?

**Pace Kessenich**

Yes, we are putting that message out, probably even more so over the last 18 months or so. We are putting our stake in the ground that we're looking for such types of investments. Just today, before this Roundtable meeting, a manager visited from New York. He runs a fund that invests in different cash flowing ideas; music royalty rights, movie royalty rights, credit card receivables, aircraft leasing – anything that has a cash or a factoring component to it. We will do further due diligence on this fund.

**Tom Biddison**

Do you find that it can be challenging from an allocation perspective to work with some of these private investments?

**Pace Kessenich:** While we probably all have our standard model that we work off of, every client in the end is different depending on what their net worth is. A \$5 million client has a different liquidity profile than a \$50 million client. I have some clients that have 50% of their portfolio in discounted cash flows because they use this annuity stream just like a pension. They will know the cash flow they will receive over the next upcoming years. This may allow them to take more illiquidity risk in the rest of their portfolio because they know what cash they will be getting from their discounted cash flow investments.

I have other clients that only have 5% or 10% in discounted cash flow investments, but that will then correspond to their specific liquidity needs. We are not afraid to be investing in illiquid investments if we know they will be getting cash flow along the way.



**Gene Parker:** I'll follow up on what Pace said about the fundraising. We have kind of a mixed experience. In our first real estate fund, which is our third overall fund, we raised about \$96 million. It took us maybe 12 to 18 months to raise that equity. This fund, we raised a \$164 million in four months, and the reality is we turned down a lot of investors. It's a nice problem to have, and we struggle a lot with saying to ourselves, "All right, are you're raising money for money's sake or can you actually put this stuff to work," right? Our track record really isn't about raising money, it's really about delivering results. So one of the things we look at are what is the right amount of money to raise and what's the right pace of growth?

We turned down a \$25 million overseas investor. We actually turned down some other overseas opportunities because we haven't figured out how to set up sort of an overseas network yet, but it can certainly be done. We need to think about those things going forward, because there's clearly a demand there. It's more about trying to make sure that you're putting some limits on yourself because we can raise \$300 million in the next 12 months, but I'm not sure we can invest it. So we just have to think through, to go from 12 properties on our fund in the past three years to 20+ in the next, that's a lot of growth, and so, we just needed to be careful. But I'd love to figure out the overseas model, how to raise a \$100 million overseas, but we're just not there yet. I think it's back to one of the questions asked earlier, which is, what size do you need your overseas investors to be before you invest in the required infrastructure?



**Tom Biddison:** I also wanted to echo what Pace said from a private wealth perspective. Not only as a firm, but also from the individual investors that you speak with, there's a huge thirst for yield, but not at the expense of liquidity in a large percentage of the portfolio. It is important to avoid going well down the credit spectrum, otherwise you've traded one risk for another. From a fundraising perspective, our initial goal was really to raise \$25 million for this fund. Right now we are half-subscribed, and we have \$22 million.

So, from a fundraising perspective, we'll exceed our initial goals, and we think probably double that. Our experience says, if you're telling a story that you can generate anywhere from 8% to 12% yields with low interest rate risk and embedded capital protection, that's a story that people are interested in hearing right now. It just happens to be that the way we're doing it is very unique and customized, and it's creating the return through a variety of different experiences.

The structure is manufactured by each respective investment bank that we utilize. Each investment is different in the component parts that are making it up. At the end of the day, the responsibility lies with the issuer to deliver on the payout parameters. So in many instances, they're really able to hedge away the lion's share of the risk through derivatives and the purchase in some instance of the actual security. In other instances, they're using Monte Carlo analysis to minimize their risk. It's not a strategy where the investment bank is generally betting for or against us. It's a profit center for the investment banker charging a nominal fee for the manufacturer, and they're collecting dollars to deploy into their operations. It's a fee business for them, and they're collecting capital through their bond distributing, no different than they would but through traditional issuance.



**Jason Tagler**

So if I invest in that through you, I will have some counterparty risk to whatever investment banks put the product together?

**Tom Biddison:** That is correct, and actually the core risk of this investment is the credit risk of the associated counterparties. That is why, after having started with one in 2007, we now have 10 counterparties. Our idea is clearly to diversify across the sector. The likelihood of JPMorgan, Goldman Sachs, HSBC, Credit Suisse, and all of the component players going out of business is probably low, but you bring up an excellent point.



This core risk is something that we've worked very, very hard over the past couple of years to address by developing these investment banking relationships. It also allows us to have the banks compete for the business. If we're going to go out and we want to do a deal; one bank could very well, depending on their fundraising needs and their capital deployment. The duration or the strategies we've used vary between 13 and 36 months. So we're trying to keep these short. In many instances, the call periods are even shorter than that.

**Jason Tagler**

Are there institutions buying them, or who do you mainly target? My impression is that this product is probably hard to explain to a high-net-worth. Sometimes I hear people say "I can't explain private equity," but what you are doing is probably harder than that.

**Tom Biddison**

You're right, it's been a long eight years...

**Jason Tagler**

During which you probably will have created some amazing slides...

[laughter]

**Tom Biddison:** Correct, I'm still not convinced that once you explain it that everyone actually completely understands it. But that's probably the case in many areas of the financial industry.

In our case, we actually use SEC-registered documents, where we aim to clearly illustrate those "if this, then that" sort of scenarios. That means people know there is a range or there is an expectation of particular scenarios that can occur. And at its core, these are investment contracts. "This is a contract that Goldman Sachs says they will pay you X if this occurs."

We can explain to the client all the component parts of what's happening here, but at the end of the day, the specific scenario is really the most important piece of the puzzle.

At this point in time, the investors we have in the fund are established relationships that we have reached out to personally. There is also one other registered investment advisory firm with whom we have a relationship – they recognized the strategy and its application on their portfolios, and they have taken a significant sleeve of their assets and deployed it into the fund.

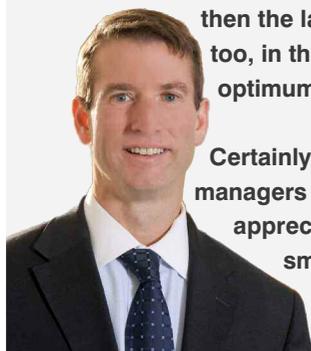
Our current fund won't be the end solution, but the right vehicle to do a great job and deliver a great return for 99 investors. We want to create and audit the track record and then be able to move the strategy on to the institutional space where, as Art pointed out earlier, you need those three years for a three year track record. Even though we have \$100 million in separately managed accounts that we have been running for seven years, I can't check that audited three year return box.



**Corey McLaughlin:** I want to comment about capital raising from a slightly different angle, and see what the managers around the table think.

We have been hearing a lot from our clients and prospects that returns are a factor that gets you to the table, but it's not the only area of focus for investors. In fact, they are becoming increasingly focused on things like depth of talent, succession, systems, controls, etc. We are seeing requests for Service Organization Control (SOC) reports on the internal control structure of an adviser becoming more prevalent. In addition, investors increasingly want to know about the adviser's service providers. In particular they want know who they are, what their experience is, and how much expertise they have. The managers also report that it has become difficult and burdensome to manage through the due diligence process.

I think that is also what has caused some asset concentration. We hear frustration that the due diligence requirements from institutional investors favor the larger managers that can afford to build a highly sophisticated infrastructure, so then the larger managers continue to grow and increase their assets. But that is in a way a conundrum, too, in the sense that those same investors worry about whether some of the large funds will exceed optimum asset levels.



Certainly the larger managers are critical to the industry. It's also nice to have a steady flow of newer managers to continue to evolve the industry. In my view, having been in the industry for 17 years now, I appreciate how the entrepreneurial angle and the start-up phases really drive the industry because the smaller or newer managers are constantly developing new ways to create alpha. They come up with new ideas and thoughts that allow them to deliver attractive returns for their investors.

**Katy Kaminski:** We've been getting a lot more answers to phone calls and emails, I guess. This is because in our space, we've had a lot of challenges with performance over the last couple of years – not particularly for us, but the CTA space had its challenges as a whole. It's also common for different types of hedge fund strategies to go in and out of favor every few years. CTAs have recently gone from out of favor to being quite in favor.

So one of the things that we are definitely seeing is that people are asking more questions. We need to provide more education, and that's one of the main reasons I joined Campbell. My background is rooted in academia and investor education, and we're seeing the benefit of that perspective. Explaining quantitative strategies is never easy. That's even more challenging with systematic, quantitative strategies that have automated algorithmic trading, and things like this that are foreign to many investors. So this is definitely an interesting area to be focused.

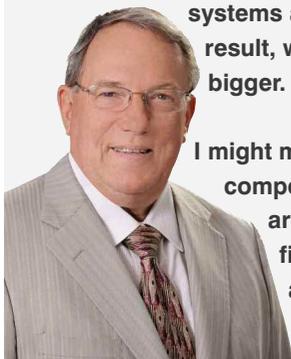
We're seeing that we're getting more of a partnership with investors, where just like you said, they really need us to partner with them on educating their investment committees, pension boards, clients, and any number of different audiences. They love to have a relationship with us where we can help them to understand what kind of exposures they have, so that they can understand how to use investments and their portfolios a little bit more effectively.

I personally have seen in the last 10 years that the sophistication of the questions and the granularity of detail required by investors has increased substantially. Meaning that, originally, it was more ideological, "what are you investing in and why?" And now, it's actually down to "I need to understand exactly why these notional exposures are like this, and I need to be able to report these in our US Sarbanes-Oxley compliant reporting, and then we're going to look at this or that." And then we've got European investors. We're looking at solvency issues and other issues and your UCITS like, "how are you going to wrap your UCITS? Is it going to be with a swap or are you going to carve out this, etc." It's getting really complicated, and their investors are expected to understand what they are doing at a much more granular level than what I would say, five or ten years ago, and I'm sure Matthias would agree with me on this, with a lot of the different products.

So I would say that we're definitely seeing that, and I have seen that personally, the granularity of the information and the relationship that supports that dialogue with investors is becoming more-and-more important on our side with all the regulation and these advances in the hedge fund and mainstream investors.



**Arthur Bell:** I think the word for it is "institutionalization." Firms need defined processes and a sophisticated infrastructure for compliance, accounting, and technology, along with business continuity and succession plans because investors are checking on those. Investors want to know what your structure is; what your backup systems are; what your IT and security looks like. These things now have a much greater priority. As a result, we are seeing more clients trying to institutionalize and structure their operations as they get bigger.



I might mention, there are other trends, too. Managers are increasingly focusing on their core competencies and outsourcing as much as they can. The more they can outsource, the happier they are. They are looking at systems outsourcing, not trading systems, but operational systems or financial systems. The internal audit is being outsourced where that's possible, even the risk analysis. Outsourcing these areas can be less costly overall and a lot easier to manage, so we are seeing more-and-more of that as a trend.

**Tom Biddison:** When we as an investor look at external investments, performance is certainly important, but there are also a lot of other criteria, like if it is a repeatable process? For us consistency is a very important component when we vet asset management firms.

So again, is it a repeatable process, or is it an investment with maybe high leverage risk in one particular area where you will either strike out or hit a home-run? That is generally not a type of strategy that we would seek for our clients, even if the track record was spectacular, simply because of the damage such an investment could potentially do to a portfolio. There certainly could be certain small slivers where you might reach a little bit further, but I think that trading exclusively on performance, without the other component parts becomes somewhat shortsighted.



**John Avirett:** Since we started Greenspring Associates some 15 years ago, we set out to treat our clients as partners. One of the key reasons for this is the fact that venture capital is a highly specialized portion of the broader alternative asset class that requires a distinct skill set, network, and set of resources to effectively navigate. Additionally, it often makes up a relatively modest portion of a client's portfolio, whether it is a high-net-worth individual or a large sovereign wealth fund.

Keys to effectively managing a venture capital portfolio are access to best-of-breed managers and companies, significant allocation to these investments, and an ability to structure the portfolio in a way that leverages synergies.

Along the way at Greenspring, we built a team of close to 35 people to be able to accomplish those goals in addition to expanded client services.



We have found that each client is different and a true value proposition lies in our ability to act as a trusted advisor to them for the entirety of their venture capital strategy. Some clients want the ability to invest in companies, funds, or secondaries alongside of us while other may prefer access to advice and resources. In all cases, our expanded team and capabilities have enabled us to preserve and expand relationships over the long term.

We found that by adding these internal resources and focusing on a partnership type of approach, we have been able to grow the platform through the ups and downs of the market.

**Tom Biddison:** Pace, I'd be curious if you are seeing this as well from your side, I think one of the trends that we're seeing overall is a decreasing of interest in the typical stock-picker. Even here at this Roundtable, we don't have anyone reporting the benefits of stock-picking, but also on a larger scale we have generally noticed a significant shift away from stock-picking active management strategies towards more passive ETF or index-driven strategies.

You are even seeing that some of the institutional sales departments of some of these major funds are getting smaller, because those companies aren't interested in supporting the associated costs with those types of departments. Is that something you are seeing as well?



**Pace Kessenich:** We have divided the active-passive question according to geography or asset class. In other words, if we are going to be picking a US large cap manager, we will mostly be using a passive approach. However, our research has shown that if you are looking for an emerging market manager, because that market is not as efficient as the US, some active managers actually do create alpha. So for us the passive/active decision really depends on the asset class. Certainly in the US and other efficient markets, we are predominantly passive right now. I am sure that over time as a country like China becomes more developed, then we will be probably become more passive in China.

Also, not everyone is aware that not all indexed ETFs are the same flavor, particularly in the emerging markets. Some ETFs include South Korea in their emerging market fund, while others won't. That could be a matter of having 12% Korean assets in one ETF, and zero in the other. So, again, one index or ETF is not the same as the other. Many ETFs are cap-weighted, which could mean that a large allocation within the ETF could be invested in Chinese mobile carriers or the Chinese banks. Currently, we are not looking for exposure to Chinese mobile carriers and Chinese banks. We really want exposure to the emerging market consumer.



Some passive ETFs in the emerging markets include only companies domiciled in the emerging markets. We like some active managers that do not care where the company is domiciled, but rather does the company have exposure to the emerging market consumer?

**Matthias Knab**

So, Pace, as someone who has done research into these questions, isn't it also the case that ETFs are much more tax-efficient putting aside the actual fee difference?

**Pace Kessenich**

Yes, we track the tax efficiency of funds. And yes, an active fund would most likely be less tax efficient than a passive fund.

**Jason Tagler**

There are whole groups that market themselves as passive tax-sensitive strategy.

**Matthias Knab**

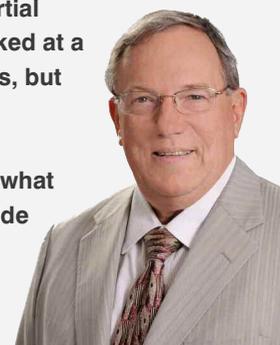
What other trends or changes in the industry are you observing?

**Arthur Bell:** One of the things that has happened with the aging of the industry is that some of the founders are now transitioning out.

Over last few years we have had a number of clients where the founder has transitioned out. This also is, by the way, an important due diligence question: what is the succession plan? Who's going to be running the business?

So we are seeing different types of buyouts. There are internal buyouts, external buyouts, and partial buyouts for outside investors who are allowed to come in and partially redeem shares. We've looked at a few other options, such as ESOPs. So far, we haven't seen one that really meets our clients' needs, but we are always looking for alternatives.

Do you actually have an inside team that can buy you out? If you haven't built up that core talent, what are your other options? Are there outside investors, and who are the outside investors? The outside investors could be institutional investors or foreign investors. It's a little tricky to get the foreign investors in depending on the structure of your company because they generally enter through a domestic entity.

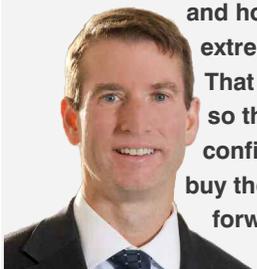


Depending on the type of entity you're operating, it's much harder to get certain types of investors in because there are restrictions on access.

So that is a development that is happening right now, and actually happening much faster and much more frequently now. There's more talk about it, either because the people that founded these firms are getting up in age or they may have come to a point where they have created a fortune and want to retire as the next step.

But again, doing that transition right is quite a process, and unless you have worked through some of those, most people don't realize that it's not as simple as it might sound..

**Corey McLaughlin:** Part of the challenge within a transition is how do you solicit the next generation of firm leaders and how do you keep them engaged? How do you allow them the opportunity to buy pieces of an extremely valuable firm and get them the wealth they need in order to accomplish a complete buy-out? That is not an easy challenge for most firms. You also don't want to give them too much wealth overnight so that your team stays focused and motivated. Investors really want to see a motivated group and have confidence in them and that process. The trick is to enable your team to build that wealth so they can buy the shares over time, commit long-term to the firm, and make sure that it's in good hands as it moves forward.



**Gene Parker:** Also at our firm we have thought through these transition questions. Obviously, with a family business, you go through transitions of generations, and you have to figure how to retain the staff that can take you to the next level. And then additionally, who of the family can also be there with you. Tenure is also important. I believe it is important to our investors, that our team has been with us for a long time. I would be curious to also hear Pace's standpoint, because he is someone who would be doing the due diligence on a firm like us.

But the question of what do investors look for, one of the things we found that investors look out for is if we are financially participating with our investors, like putting up 10% or of our own principals' cash into the deal. That really creates an alignment of interest. In addition, the employees also have an alignment of interest because their long-term wealth creation and compensation will be coming from the success of the fund.



**Pace Kessenich:** We absolutely buy into the "Skin in the Game" concept. We want to be a "partner," not a "bank." We are looking that the company's or their principals' money is on the same terms that we are. In private equity you could have different share classes like Series A, B, C, common stock, and an option pool. They all could have different incentives on a transaction at the time of exit. So whatever class that we are invested in, we want to make sure that management has invested under the same terms so that we have the same financial incentive. Aligned incentives are on our checklist, and we are not going to invest unless we are on the same terms. I have experience when this was not the case. We became a "bank," but not a partner, and ended up negotiating across the table from the sponsor of the deal.

This concept is particularly important in private investments because you can't "divorce" from your partner the next day like you can in a mutual fund. It is very important that the people that you are working with are scrutinized, and you feel that they are your true partner.



We have had some clients bring in some legacy private assets that turned out to be very challenging, and it takes a long time to get out of a private asset. Being in an investment with a questionable partner can create reputational damage for yourself and takes up time and resources to rectify the situation. In private investments, it's definitely a partnership. It could be as long as 10 years. It is very important to know the people you are investing with and have your economic interests aligned.

**Tina Lewandowski** I wonder, you work with a lot of families, are you seeing a difference in any of the generations regarding their investment interests?

**Pace Kessenich** The one I see the most now is impact investing.

**Tina Lewandowski** That's what I expected.

**Pace Kessenich** The next generation right now has a little bit more of an appeal to have a social cause to their investments versus generation I.

**Jason Tagler:** Pace's previous comment about the people side really resonates with me as well. For Camden, we are directly investing in companies where either we, with another similar fund, control the company or Camden alone controls the company. Ten years ago I actually did a little bit of mutual fund and hedge fund investing before I came to Camden. I remember talking to David, who co-founded Camden, about what you were saying, but not having enough experience to understand that. Looking back on it, it's all about partnering with the management team because you're spending an enormous amount of time with that CEO or that CFO to help build that team. One thing is for sure when it comes to direct investing, you're always going to hit speed bumps and find yourself turning in different directions. It's never a smooth ride, and you have to be able to ride that out with people you really trust.

So what Pace is talking about when he looks at investing in a company like Camden is just as true, if not amplified, when I look to invest in a company. I would say over 50% of what I'm investing is actually being invested in the CEO of the team.

Over the past few holidays, I was on the phone with a CEO, every day, including weekends. We're truly partnering with those CEOs and if they're experiencing a difficult crisis, and it happens to be the weekend, I'm actively involved in that crisis with them. That's the one thing I wanted to echo which is magnified even more in my world.



**Matthias Knab**

What are you looking for in an entrepreneur? What are your criteria?



**Jason Tagler:** I think the first thing we look at is obviously experience. The entrepreneur needs to have some experience in what they are doing. Does he or she have real domain expertise? I mean, the same really applies to us because we believe that our domain expertise, in the areas we invest in, is one of the differentiators. Trust is really the biggest factor, because you have to feel really comfortable that this person is going to be a good steward of our capital, right? My approach is that I get up in the morning, and I'm investing a state's pension plan money, someone's endowment, or someone's retirement fund, so I feel that sense of fiduciary and I really look for those criteria.

I would also look for things like is he or she a good listener - the kinds of things that you would think about in terms of having to be in that partnership. You can't divorce the asset class, and I can't divorce this company. Whether they're going to be successful or not, we're going to just have to work through it. These are things you should really consider when it comes to the partnership.

**Pace Kessenich:** One of the things that we find attractive about private investments is the principal-agent alignment. Many times in private equity, the fund will have a preferred return before the sponsor is allowed to share in the profits of the fund. From a monetary perspective, this preferred return is a lot different than the public markets.

With a preferred return structure, the sponsor of the fund/investment does not get to share in the profits until the investor gets their original capital back and a preferred return. Can you imagine if the CEO of a publicly traded company had that incentive instead? Fund managers can also control whatever leverage they need to control at their portfolio company to drive value. This may be different than just stock price. A private sponsor has a lot more control over the principal agent relationship than in the public markets. So, that principal-agent in the private markets is certainly very important to us, that we're aligned and that the incentives are there.

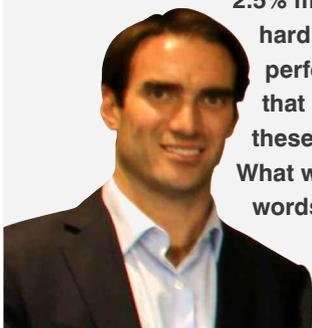
We have a hedge fund manager that we're invested in who is sharing in the profits of the fund only when they beat the healthcare index. So if the healthcare index is up 10% and the fund is up 12%, they are not getting their share of the profits on the 12% they have increased, but only on the 2% above the index. Their view is that if they can't outperform a passive index, they should not get compensated. We feel aligned with management in this structure.



**Jason Tagler**

You basically have to outperform a long-term return of the stock market, so it's very much geared towards performance. If you're not in big funds, you have to perform in order to create wealth for their principals. You have to beat the S&P at a minimum before you get to get into the carry range. Some funds don't in our space... I mean, you invest in a lot of other funds, you're at both sides of the table -- some have it, some don't. It's completely different.

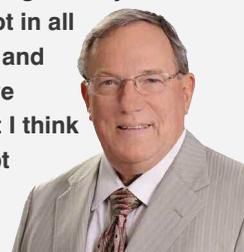
**John Avirett:** Interestingly, on the fund-of-funds side of our business, we invest in funds that have, believe it or not, 2.5% management fee and 25% carried interest. At first glance, these terms can look onerous and hard to stomach, but a key point of our due diligence is to understand and project future performance net of these fees and expenses. Our overall goal, especially when it comes to funds that charge premium economics, is to ensure alignment of interest. We often ask ourselves "do these managers through prior and projected performance truly warrant the terms that they market?" What we have seen and what we often lobby for is hurdle rates for premium economics. In other words, venture investors should only benefit from increased carried interest when their funds produce outsized returns, which in the end produces the right sort of alignment between the General and Limited Partner.



**Pace Kessenich**

I have a question for Art and Cory about the FASB rules around the changes of valuing assets or the mark-to-market rules. Is this still a big issue today for your clients? Those valuation changes may have exacerbated a lot of the redemptions and margin calls in 2008/2009.

**Arthur Bell:** Corey can answer in more detail, but for sure there have been a number of changes in the generally accepted accounting principles that are counterintuitive, or they work good at some situations but not in all situations that have caused the problems. For example, the layering of risks and the layering of debt and liabilities are all things that caused consternation. But for the most part, that settled down. There have been a couple of years where there has been a lot of dialogue about it, a lot of gnashing of teeth. But I think the valuation of level one to level three assets has become much easier in a sense that people accept what it is.



**Corey McLaughlin:** I agree, there was a good bit of consternation at the time when the standard came out. There were some political aspects involved as well. I personally think this standard is a good standard. Of course you could say that I am a geeky accountant in that way, but I do think it's a great way for investors to really take a look and understand what their exposures are in a particular fund. Questions like, *"Where am I at? How liquid am I? Do I have a lock up or not? And if I don't have a lock up, but there are 60% in level three assets, how does that work, and how am I ever going to be able to get access to my money if there's no lock up, and there are all these level three assets? In addition, if there is no lock up and people are getting in and out and these level three assets are subject to variability in terms of value because it's an estimate, am I being affected in some way, positively or negatively? How is that working out?"*.



I will add that valuation continues to be a focus area and hot button with the SEC. We press the issue all the time with our clients and try to instill upon them the importance of having good policies and procedures in place. Particularly, if you have hard-to-value assets, you can't just say, "Well, this is what I feel like the fair value is today." You need to have some hard documentation that really supports those values, and then make sure you also have independent evidence to support it.

**Arthur Bell**

Sometimes a manager may think or say, "Well, we're going to undervalue it, to be safe. So that should work in favor of the investors." But, that is still not the fair value.

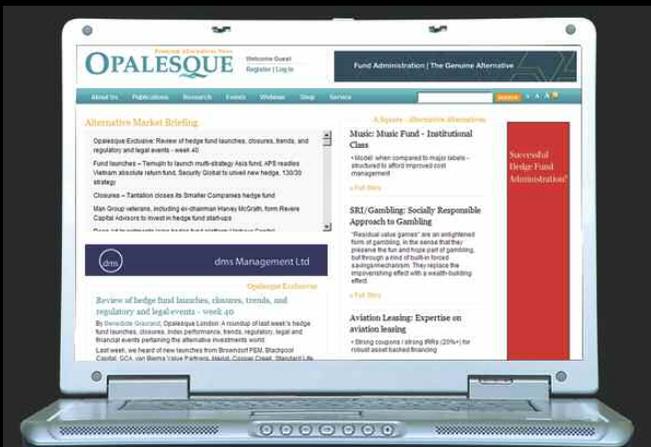
**Corey McLaughlin**

A downside of these fair value rules in the investment industry could be situations where, for example, a real estate fund has a long-term lock up, so ownership is not really changing. And still, you need to get an auditor to go through this valuation process. Maybe that doesn't really add a lot of value to the investor, so there could be some downsides from that perspective. But overall, I think the concern about the value standard has calmed down at this point.

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