

Opalesque Roundtable Series '15 WEST COAST

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Editor's Note

Will we see Unicorns dying, or are we still in the early stages of a technology boom?

Record figures in Silicon Valley: \$ 9.3 billion went to Silicon Valley based start-ups just in the last quarter. 74 start-ups are valued at over one billion dollars (and called "unicorns"); Uber, for example, is now valued at \$50bn. Private investors are lining up to hand out checks, while the companies – contrary to the dotcom era – opt to stay private, enjoying less regulation and more freedom.

But pessimists fear a scenario where dying unicorns could tear holes in the balance sheets of venture capital companies, causing a chain reaction. VC firms' yield will go down, affecting their ability to raise money, and start-ups may end up falling like dominoes once the assets aren't going any more their way.

Along with the tremendous wealth creation in the Bay area, there has also been a boom in West Coast wealth managers that have concentrated their client base in the tech industry, and also concentrated their clients' assets in the tech industry, potentially putting their clients at a higher risk. But even skeptics of the current boom say that the situation is different from 2000 when many companies were already public and the collapse hurt a plethora of small investors and pension funds. This time, a large proportion of highly rated U.S. companies are not public. A potential setback would therefore hit start-up employees and a limited number of investors.

Meanwhile, James Alpha Management believes we are still in the early stages of a technology boom comparable to the late 1990s which they believe will peak by 2020, but you are also *advised to be invested in technology now* to be able to ride the wave. Early stage venture capital would also reward investors handsomely between now and 2020, but if you wait another year or two, you could be too late. The tough part of this proposition is that it is very difficult to predict which apps and which companies will win or lose, so you have to find a manager who is both astute and has exposure which is diversified enough to benefit, but not so diversified that returns suffer and just mirror the indices.

The Opalesque 2015 West Coast Roundtable, sponsored by Arthur Bell CPAs, took place July 2015 in San Francisco with:

1. Chris Winiarz, [Investment Officer, University of California](#)
2. Brian Lahart, [Head of Alternative Investment Research, Abbot Downing](#)
3. Alan 'Butch' Andreini, [Senior Vice President, James Alpha Management](#)
4. Nadine Terman, [CEO and Co-Founder, Solstein Capital](#)
5. Jason Gerlach, [CEO and Managing Partner, Sunrise Capital Partners](#)
6. Mike Furlong, [Co-Founder, Sliced Investing](#)
7. Corey McLaughlin, [Member, Arthur Bell CPAs](#)

The group also discussed:

- What are the criteria and process of the University of California, a \$95bn institution, to select external managers?
- Given the levels of the equity markets, are investors dialing up alternatives in 2015, including tail risk strategies?
- How does James Alpha Management, a single family office specializing in seeding and growing alternative investment managers, identify start up managers to work with?
- What are the benefits of being based in the San Francisco Bay area?
- What are the best ways to compound capital today?
- How does a CTA with a 36 year track record navigate and succeed in today's environment?
- Has a manager's size become a proxy for quality, safety, and skill? Rightly so? Is the investor base bifurcating with only a minority allocating to smaller managers?
- What are the risks of co-investments that sometimes investors tend to overlook?
- How are managers and investors keeping up with a constantly changing world? How to best identify and profit from mega trends.
- How can FinTech help alternative investment managers and investors? Sunrise Capital's success story with Sliced Investing. Benefits and limits of automation.

Enjoy!

Matthias Knab
Knab@Opalesque.com

Participant Profiles



(LEFT TO RIGHT)

Matthias Knab, Corey McLaughlin, Alan 'Butch' Andreini, Chris Winiarz, Nadine Terman, Jason Gerlach, Brian Lahart, Mike Furlong.

Opalesque 2015 West Coast Roundtable Sponsor



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Introduction

Nadine Terman
Solstein Capital

I am Nadine Terman, the CEO and Co-Founder of Solstein Capital. At Solstein, our investment team concentrates capital in ten to fifteen high conviction investments around the globe, predominantly in developed and some emerging markets. We employ a fundamental value investment strategy and seek to compound capital for clients over a multi-year investment horizon while tightly managing risk.

Brian Lahart
Abbot Downing

I am Brian Lahart and I am a Managing Director at Abbot Downing. Abbot Downing is a boutique business within Wells Fargo that delivers an exceptional client experience and world-class solutions to ultra-high-net-worth individuals and families. We provide wealth management solutions that address the full impact of unique wealth, which reaches far beyond money management. We also provide wealth management solutions to foundations and endowments.

I have been with the firm for over eight years and lead our Manager Research Group which is responsible for sourcing and vetting both alternative and traditional investment strategies for use in our clients' portfolios.

Alan 'Butch' Andreini
James Alpha Management

My name is Butch Andreini. I work for James Alpha Management which is a New York-based single family office. We are a broadly diversified asset management firm specializing in identifying and growing alternative investments for institutional and individual investors. Our objectives are to identify outstanding early-stage alternative investment managers, contribute strategic capital, and provide the ongoing operational, management, and sales support necessary to grow their assets under management and bottom-line profits.

Christopher Winiarz
University of California

My Name is Chris Winiarz from the University of California's Investment Office. I joined UC about three years ago to lead the opportunistic equity portfolio, where we focus on identifying inefficient markets globally and take concentrated risks in our highest conviction ideas. We use a combination of external management and internal management.

Mike Furlong
Sliced Investing

I am Mike Furlong. I am the Founder of a company called Sliced Investing. We are an online platform for independent investment advisors and family offices to access non-traditional financial products and services. We've built the technical infrastructure that automates the entire investing process, making investing in a hedge fund as easy as investing in a stock through E*TRADE. We offer access to top alternative investments, centralized reporting, integrations with administrators, custodians, other service providers, and more. Our goal is to empower independent advisors with the same investment management and operations capabilities they would have at a bank or wire house.

Corey McLaughlin
Arthur Bell CPAs

My name is Corey McLaughlin. I am with Arthur Bell CPAs, a firm dedicated to protecting the best interests of clients and investors in the alternative investment industry for over 40 years. We provide a wide range of services, from traditional audit and tax services to highly specialized advisory services and family office services, as well as performance analysis work.

I have been with the firm for about 17 years. I manage the audit and advisory practice and have had the pleasure of working with a large range of clients, anywhere from startups all the way to managers with hundreds of billions of dollars.

Jason Gerlach
Sunrise Capital Partners

My name is Jason Gerlach, and I am the CEO and Managing Partner of Sunrise Capital Partners. Sunrise is a pioneering alternative asset management firm that is now in its 36th year of investing in San Diego.

Founded in 1980, Sunrise has generated over \$1 billion in wealth for its investors since inception, and today, we continue to offer a range of diversifying quantitative macro, equity, and equity and bond investment programs for individual and institutional investors alike. Note for the record that thanks to a dynamic strategic partnership we recently entered into with one of the world's largest and most prestigious alternative asset management firms, Sunrise is closed to new outside investment until January 1, 2019. However, we remain open to dialogues with investors and others regarding what we do and the alternative investment industry generally.

In addition to my role at Sunrise, I am a co-founder and the current President of the California Hedge Fund Association ("CHFA"). CHFA currently has over 1,000 members statewide and beyond, and since our 2010 founding, we have annually put on about a dozen educational and networking events throughout California. We additionally host an annual event in Las Vegas and are exploring the launch of an event in Arizona in 2016 as well.

70

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Eurex Exchange – the home to the euro yield curve.



Matthias Knab

We are now mid-2015 and have had a bull-run for quite some time. Some people are looking to protect capital and implement a downside protection. How are you dealing with the situation? Are you still bullish or have alternative investments with one of their original aims to provide a hedge become more important for you lately?

Brian Lahart: It's the right question to be asking today. To start with, at Abbot Downing we believe that it is important to have a diversified portfolio across four asset classes – Fixed Income, Equities, Alternative Investments, and Real Assets. While we are not market timers, we do actively manage our clients' portfolios to take advantage of shifts in valuations and emerging new investment themes. Therefore, we spend a lot of time researching new themes that could lead to compelling investment opportunities. These can be longer-term structural themes or shorter-term tactical themes. As it relates to your question, one of the themes that we are working on today is a concern we have that investment risk in the market may be underappreciated and possibly mispriced in some cases. With extremely low interest rates in most of the developed world, there has been an increased focus to find higher yielding and higher returning investments, while paying less attention to the risk required to generate such returns. There seems to be a growing attitude among investors that a 5% return is better than a 4% return, *even if it comes with twice the risk.*

Since 2008 we have had a zero interest rate policy in the U.S. which has been an incredible tailwind for many asset classes. It's not exactly known how all of these asset classes will perform once interest rates begin to normalize. This is not to suggest that one should liquidate all of their risky assets and shift to cash. Rather, we think investors should consider increasing allocations to strategies that are structured to navigate or exploit a more volatile environment such as certain hedge fund strategies and certain private debt strategies.

There has been a lot of press and media coverage around a possible liquidity problem in some bond markets, yet yields remain low and volatility generally subdued. Alternative strategies that have a decent short exposure in certain fixed income instruments – where prices are stretched and do not provide much more upside – could be compelling. We also like alternative strategies that can profit from an increase in market volatility. And while these strategies can be a drag to performance during a more benign environment, many offer such a compelling risk-reward tradeoff that they are worth considering.

So while equity markets may certainly be higher at the end of the year than they are today, the risk of achieving that return appears to be more elevated and investors should adjust their portfolio allocations accordingly.



Matthias Knab

Are you dialing up alternatives or are you also looking at tail risk strategies?



Brian Lahart: We looked at dedicated tail risk hedged strategies a few years ago and felt that there were better ways to manage risk in a portfolio. Maintaining a diversified portfolio, across the four asset classes I mentioned, while rebalancing to take advantage of changes in asset prices and investable themes, seems more prudent than buying a tail risk strategy and hoping it works when you need it.

Christopher Winiarz: I think our institution might be a little different. We have endowment assets, defined benefit pension, defined contribution, and working capital. In total it's about \$95 billion in assets, so we're not as nimble as others might be. However, with over 50 investment professionals in every asset class we can be opportunistic. We also have the luxury of being long-term, which gives us the flexibility to be patient and wait for an opportunity.

I think our goal is not necessarily to dial up or down risk, but to better understand our risks and take more educated bets. Our strategy could be described as rolling up our sleeves and diving into specific risks where we have a differentiated view, more domain expertise, or where there is something about our size, scale, or geographic location that gives us some additional advantage compared to others.

So when we step back and think about it, being located here in the Bay Area is a pretty unique opportunity. How would we compare our skill set versus a sovereign wealth fund in Asia or a family office in the middle of Germany? What can they bring to the table that we can't, and what value-add do we bring relative to them? From that perspective I think it's not about dialing up or down certain assets or strategies, but really trying to better understand our risks and emphasize our competitive advantages.

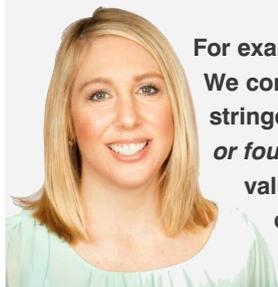


Matthias Knab

Nadine, is this also something that you as a deep value investor have been thinking about?

Nadine Terman: Our team at Solstein absolutely is focused on risk management and capital preservation. That said, we endeavor to understand and then differentiate between business, or cash flow, risk versus security price risk, mapped over the lifespan of an investment. This work influences investment entries and exits, position sizing, ongoing due diligence initiatives, as well as hedges. At Solstein, we can think about risk and capital allocation a little bit differently than other managers who might have daily, monthly, or quarterly liquidity terms.

It's simple math, but one of the best ways to compound capital with a concentrated strategy is to limit losses in number and dollar. The winners, then, take care of the rest. We are fortunate at Solstein to have a number of risk management levers at our disposal. Our limited partner base affords us a multi-year runway, an ability to concentrate capital, and the flexibility to be tactical within an opportunistic mandate.



For example, Solstein's longer runway provides our team the luxury to be patient on investment entries. We continually maintain a number of potential investments on deck, yet every position must meet a stringent set of criteria before it enters the portfolio, which includes valuation. *We might only make two or four new investments a year*, so the deployment of capital in long positions may be slower when valuations are high in target industries and geographies, as we wait for more attractive entry opportunities.

Matthias Knab

To what extent do you care about downside protection?

Nadine Terman: Regardless of the buoyancy of the financial markets, we actively try to understand what risks exist and what risks may not be priced into a security. Similar to Brian, we are not market timers, and we are not macro managers. We must have an informed view on what risks we are taking, though, at any given time.

As an example, in the first quarter, we had communicated to our limited partners that our team was prepared for a potentially meaningful market dislocation. We heightened our focus on managing both position and portfolio risk, and the end result was the complete exit of a core position, plus the trimming of three additional large core positions. We wanted to ensure that our portfolio companies and their underlying cash flows were insulated, to the extent possible, against outsized externalities, and that the portfolio consisted of high quality, diversified cash flows with uncorrelated drivers.

At the same time, our target list of short positions started to grow. To be clear, *our short positions at Solstein are done for alpha generative purposes*, not for portfolio downside protection. That said, they may also act as a natural hedge to certain business or security drivers of one or more long positions, thus providing a type of downside protection.



Matthias Knab

Jason, is your strategy doing better with increasing volatility?

Jason Gerlach: Our flagship macro strategy, Sunrise Evolution, is not one that is long volatility per se but rather, an “all-weather” investment strategy designed to provide investors with compelling, long term, risk-adjusted returns that have a low correlation to traditional asset classes and investment strategies. Rather than simply thriving on “volatility” in the generic sense, Sunrise Evolution thrives in the presence of certain patterns of volatility which are sometimes prevalent and sometimes not.

This year so far, our net return on an absolute basis has been slightly positive through the end of June, but on a relative basis, particularly vis-à-vis other quantitative macro strategies, it has been quite strong given the indecision global markets have demonstrated since January. And looking at a broader sample size, our net performance number, since the current version of our flagship investment program began investing on January 1, 2013, has returned north of 30% on a net cumulative basis, a number that we and our investors are quite satisfied with in both absolute and relative terms.

Generally speaking, we like to see markets that are moving somewhere as opposed to bouncing around aimlessly in a relatively tight range – though we do utilize some models that are aimed at capturing return in certain range-bound scenarios. A theme of the last couple years is that finally, after several years of heavy-handed government intervention that in many cases constrained markets’ free movement, more free-flowing, directional price action has returned. This has certainly been a positive for us. Of course, there are always some notable exceptions to any pattern such as the Swiss Monetary Authority’s intervention in their currency earlier this year and, obviously, what we are seeing in China in recent months as the government there tries desperately to prop up a sagging domestic equity market.

As a result, both the Swiss franc and the Chinese equity markets have presented some unique challenges this year.

However, the key to our 36 years of successful investing has been not becoming unduly focused on the particular market moves of a given day, week, month, or even a year but rather, building and continually enhancing investment models that over the long haul will deliver value to our investors. Our investment approach is agnostic to any particular investment environment and is instead focused on finding particular, reoccurring, statistical inefficiencies that pervade global stock, bond, currency, and commodity markets.



These inefficiencies can arise in bull environments, they can arise in bear environments, or they can arise in something in between, and that's ultimately why our return profile often bears little resemblance to most other investment strategies and thereby offers investors a compelling diversification play in addition to compelling risk-adjusted returns.

Our goal really at the end of the day is simple: we want to deliver our investors an acceptable risk-adjusted return that makes them comfortable and keeps them comfortable. That is what has kept us going for 36 years; that is what our clients are looking for from us going forward. We don't want to give them too many "white-knuckle" moments in bad times, and we want to give them plenty of enjoyable moments in good times so that they will continue to feel comfortable investing with Sunrise for the long term. Given that many of our investors have been with us for a decade or more, we believe we have achieved this goal historically, and we remain vigilant in trying to achieve it going forward.

Corey McLaughlin: We have been on a long bull market run. When you kind of reflect back on history and see how things had played out the last time, we could be in a similar run as leading into 2008, and at some point every good market, unfortunately, comes to a downturn.

One of the areas that did really well during that time in 2008 was the CTA space. And if you look at the numbers recently, the CTA space is starting to see a little bit of an uptick in terms of capital-raising. So it will be interesting to see if investors continue to focus their attention on diversification of assets as a way to kind of protect things if markets end up sliding downward a bit. CTAs tend to be a good diversification tool, and they can produce returns in markets that aren't going upwards.

An area in which we have seen a lot of activity, and I think we will continue to see activity, is the private equity space. Private equity, along with venture capital, has been very, very hot. Also, we are seeing more of an interest, particularly from the younger generation, in impact investing and really investing in companies that can make a better change for the world.

While I risk sounding a bit like Michael Jackson's "We Are the World", we do see a deep interest there. For example, there are companies that can drive positive changes in the energy markets and other areas that people are passionate about, and those sectors have a lot of upside and also can be very rewarding for people to be a part of and get involved.

Direct lending is another hot area where we have seen a lot of activity. So not being an investor, but being a service provider that hears information from being in the industry and fielding a lot of calls and talking to a lot of people, those are some of the areas that we really see moving.



Matthias Knab

Butch, your firm must be going through many proposals each year. I wonder, what are the new managers doing? What are some of the strategies that people are setting up?

Alan 'Butch' Andreini: Yes, quite a few. Over the last five years there has been on average 1,000 new launches a year with many of those falling into the "emerging" category. Since there are very few firms like James Alpha that allocate to and partner with institutional quality early-stage managers, this naturally results in our benefiting from a constant stream of new and interesting opportunities to consider. At the same time, roughly 800 funds close a year, the majority of which opened their doors just a few years before, so we end up having to be very patient when it comes to finding what we view to be a good opportunity.

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We are going to be invested in and partnered with these managers for what we expect will be an extended period of time, so we take a very long-term view when evaluating a manager. As a family office, first and foremost, we are investors putting our own capital at risk, so we look for managers that have a well-defined, repeatable, and sustainable edge, and our experience has shown us that these are most often found in under covered segments of the market that are tailor-made for smaller, nimbler managers to execute on. And because these opportunities are difficult for larger managers to access, we find that they tend to persist longer. So generally speaking, we are looking for strategies that have staying-power. For us, today, that means partnering with managers that are tapping into areas of the market where we expect to see long-term and sustained growth as well and managers that have identified new forms of opportunity inside of changing market dynamics brought on by recent regulatory developments such as Basel III and Dodd Frank.

Matthias Knab And how long is your partnership horizon when working with a manager, five years?

Alan 'Butch' Andreini: Hopefully much longer. For example, on the equity side, we are working with managers that give us exposure to what we believe will be extended growth opportunities in technology, healthcare, and energy infrastructure here in the United States. The new forms of opportunity I mentioned are showing up in credit markets as well where we see post-crisis regulation changing the behavior of markets and their participants.

Again, for example, we are working with a direct lending manager that is taking advantage of the fact that banks have backed away from middle market lending which in turn has created a sizable and growing opportunity for managers with the expertise necessary to access this segment of the market. We've also partnered with a credit manager that utilizes a highly liquid corporate credit strategy that we believe is well positioned to take advantage of a growing lack of liquidity that's been brought on by the combination of record issuance and banks' newfound inability to maintain large inventories of corporate credit bonds. Hopefully these examples provide you with a good sense of what I mean when I use the phrase "staying power."



Corey McLaughlin Chris, do you consider private equity investment at all, or are you purely liquid?

Christopher Winiarz: Yes, we do. Across our institution we do have a separate private equity team, real assets, real estate, and cross-asset class teams. Even though I am a member of the public equity team, within our mandate we have the ability to invest up to 35% in nonpublic equity.

We ask ourselves: "Am I going to be compensated well in excess of the risks I am taking and relative to our public equity benchmark?" Secondly, we ask: "Why is that the right risk for public equity to take instead of a different asset class?"

Let's take biotechnology for an example. *Can we get the same return with a different level of risk by investing in the public market space versus private equity?* Those are the discussions we are trying to have across asset classes, and sometimes we do make those investments in the public space and work across asset classes to analyze those risks.



Just today I've been working with our real assets and private markets team to help analyze a publicly listed security, but has real assets type risk. Ultimately we are trying to work across asset classes with a focus on always understanding what are the risks and returns.

Corey McLaughlin

One of the reasons why I asked that question is that we are seeing a lot of co-investment opportunities. Some of those can offer attractive advantages in terms of fee structures and the returns they can produce. However, sometimes you may also be limited on the type of control you have.

Nadine Terman: With regards to the points made by Chris and Corey, we are definitely seeing greater interest in partnership opportunities from the family office space. Once they have built trust with a manager, they want to leverage their due diligence they have already done, and they recognize their own strategic advantages. Family offices often can entertain a longer-term view, while at the same time they can be more opportunistic and flexible with their capital.

In our case at Solstein, we leverage an activist tool set outside of the US, which can lead to investment opportunities in both liquid and illiquid securities that are of interest to these family offices. While the majority of our team worked together at a large activist firm prior to founding Solstein, we intentionally altered the playbook to accommodate the nuances of investing overseas, as well as the risks embedded in illiquidity or a lack of control. By taking a more constructive, quiet, and long-term approach with boards and management teams, we are viewed as a desirable partner when investment opportunities arise. Family offices are interested in this differentiated sourcing, and the strategic advantages of their capital base make them a great partner.

Moreover, our constructive approach provides an additional level of comfort to our limited partner base. Oftentimes there are large family ownership stakes in the businesses in which we invest, and it is more fruitful to develop a positive dialogue with the families to understand country-specific risks and opportunities, such as governmental or regulatory changes that are coming down the pike.

So you are right, once allocators have built that trust, they may decide they don't want to go out and find another private equity shop doing similar types of deals. Instead, they may prefer to allocate additional capital to an existing manager.



Christopher Winiarz: Nadine makes a great point. We are seeing more and more of that, but not just from the private equity space, but from public equity as well. In particular where there are large clients globally that need to put sizable capital to work. While we have made some co-investments, I would say that was the first iteration.

Our second iteration is trying to move forward and think of them as a broader relationship and true partnership. In our case, we want to let our partners know that we have a \$95 billion balance sheet, and we can help them if they find the right opportunity.

So we are taking the partnership a step further from co-investment. *If you think of our balance sheet as an extension of yours, what types of opportunities does that open to you? Within the context of a true partnership, how does the University of California's network help a manager out?*



Corey McLaughlin

How are you building this relationship?

Christopher Winiarz

It's tough. It's time-intensive. It's traveling the globe, learning, and listening. As an example we will be in Tokyo next week meeting with asset allocators, portfolio companies, and macro and policy advisors. We try to build that network and find other like-minded partners.

Matthias Knab

We also know that a lot of family offices are very active and look for opportunities with direct investments. However, we should also keep in mind that direct investments come with their challenges. You have to have the right resources and the right process set up to evaluate a direct deal or a co-investment deal. There is always the risk that even accomplished hedge fund researchers or hedge fund allocators will invest in deals without doing the proper diligence or the proper underwriting on an individual company. They are good at underwriting managers and the process and the people, but they might not have the expertise to really underwrite a business or to fully go through their cash flows. So, I think people need to be careful about how to underwrite and how to get comfortable with that investment.

Alan 'Butch' Andreini: We believe that one of the keys to our success is precisely building long-lasting, trust-based relationships with our managers. We view ourselves as partners where we seek to absorb as much of the administrative and sales and marketing role as possible so that our managers can focus on what they do best which is generate alpha.

We also believe in finding managers with “deep domain expertise,” meaning they have been investing successfully in the same strategy in the same manner for 15 or 20 or more years. For diversification we can look to the broader equity and fixed income markets and all sorts of passive strategies, *but for alternatives we are really looking for “deep domain expertise” and where they have seen multiple market cycles and multiple economic cycles, they know all of the relevant securities and companies involved, all of which provides a real “edge” when it comes to investing.*

In our experience there are truly only a handful of money managers who have a distinctive edge and combine it with high integrity and a true alignment of interests. When you do find these managers, seek to stick with them for the long haul. Do your homework, decide to invest based upon high and strict standards, and then once you do invest, truly become their trusted partner. What we do is not easy and requires a lot of effort, but we believe it is well worth the effort.



Matthias Knab

Markets and opportunities do change over time, trends can fade or continue. How are you as managers and investors keeping up with a constantly changing world?

Brian Lahart: Sometimes we find that themes can evolve and morph into new themes that are related. For example, several years ago we spent some time exploring alternative energy and uncovered ways to profit from that growing trend. As we continued to study the energy complex, we noticed a new paradigm forming as a result of technological advancements in traditional energy (primarily oil and natural gas) extraction. With the progress of fracking technology, a new energy manufacturing renaissance grew in the United States with tremendous opportunities for new capital investments. This new theme (as documented in our white paper *The Changing Energy Environment*) was the foundation of a whole new set of private and public investment opportunities for our clients.



Nadine Terman: Brian makes a great point. At Solstein, we typically have three to five research themes the team is analyzing. *It's not the theme itself that is usually the point of differentiation. Instead, it's what your team does with that theme.* Our thematic work often points to potential times or areas of dislocation in an industry or an ecosystem. It is much easier to be opportunistic when you have the vast majority of your work completed, and you are simply waiting for time to pass and data to reveal itself. When a dislocation arises, the incremental work to gain conviction around an investment opportunity is much less, and conviction is much quicker to gain. *Moreover, the team has no capital at risk in this waiting period, so the cost is minimal.*

For example, we are interested in the November elections in Spain. There may be greater instability in its financial markets, due to political changes or even just potential political changes. There may be buying opportunities in businesses that would be immune to political changes, yet would be lumped in with other businesses that could be at risk, due to regulatory changes or other key business risks. If you do your work ahead of time and have that kind of cookie-cutter approach to thinking through potential messes in the future, you can have a menu of those on deck. All that remains is collecting that incremental data and waiting to see if those events you envisioned are coming to pass.



Alan 'Butch' Andreini: In general, we expect our managers to be thinking about those macro trends, and we certainly share our views with them. But the macro trends also influence the managers that we invest with. For example, several years ago we concluded that a zero interest rate, low growth environment would cause investors to place a premium on both income and growth. As a result, we have been invested for some time in a REIT manager and an MLP manager as well as with a couple of technology focused managers.

More recently, we have invested with a direct lender focused on high growth technology companies. And in the credit space, we have invested with a team with an outstanding 25-year track record who decided to get back into the game as a group three years ago and has put up great numbers. But we like them primarily because, in addition to world class credit research, they are very trading oriented, use very little leverage, manage risks tightly, and have excelled in prior rising interest rate environments. We fundamentally believe that in fixed income, as well as equity markets, buy and hold strategies will suffer and more nimble strategies will prevail these days due to the rapid fund flows and instant trading that move markets, increasing risks in the system, and the uncertainties surrounding whether the Fed will raise rates and/or when the next overleveraged government entity will face problems. High asset valuations also mean it is a good time to be liquid and nimble. *When asset prices collapse, it will be a good time to buy and hold again. Just not now.*

We have also taken advantage of specialized opportunities such as in maritime finance which was the last asset class to recover from the 2008 crisis. As a result, we exploited specialized investment opportunities in 2012 which have provided multiples on our capital greater than the tripling of the stock market since March 2009 and in a much shorter period of time. These opportunities do present themselves, and when they do, you need to be prepared to pounce.

Going forward, we think there are three major opportunities. Briefly, for many reasons – we can go into in a lot of detail at another time – *we believe we are still in the early stages of a technology boom comparable to the late 1990s which we believe will peak by 2020*, but you need to be invested in technology now to be able to ride the wave. Early stage venture capital will also reward investors handsomely between now and 2020, but if you wait another year or two, you will be too late. The tough part of this proposition is that it is very difficult to predict which apps and which companies will win or lose, so you have to find a manager who is both astute and has exposure which is diversified enough to benefit, but not so diversified that returns suffer and just mirror the indices.



With the amount of unallocated private equity real estate funds now at record levels, higher even than in 2006/07, real estate is set to go into bubble territory over the next two years just as it did in 2008. As in 2008, the winners will be publicly-traded REITs, and the losers will be those private equity real estate funds. Buy now and prepare to exit in about two years.

Last but not least, MLPs have recently declined from a peak in mid-2014 to almost 50% lower back to 2011 valuation levels. This makes infrastructure MLPs very attractive as their fundamentals are certainly a lot more attractive than in 2011. E&P MLPs clearly have problems, and our manager has not been invested in them for some time, but pipelines and midstream firms as well as certain suppliers do not suffer from lower oil prices, but their stock prices have traded down in tandem with E&P MLPs. Lower oil and natural gas prices actually mean more consumption of both which means more, not less, infrastructure is required. And the U.S. energy boom continues and the need for energy infrastructure here remains substantial. So you have terrific long-term growth trends, strong and improving fundamentals, and prices that are 50% lower. While the current downturn inevitably will have a bit further to go, the result is a wonderful buying opportunity.

Matthias Knab

Chris, you said you manage internally and you use external managers. What's your framework for that? Also, when you work with external managers, what are your selection criteria?

Christopher Winiarz: The allocation, whether it's internal or external, is partly dependent on the asset class. We have different skill sets, and we are set up in a certain way to achieve our objectives.

While our fixed income team manages the majority of their assets internally, our public equity team manages the majority externally. We start out with understanding our skill set and allocating time and resources on bottom up ideas.

My point here is that regardless of the structure – whether it's external through a manager, a co-investment, an individual idea sourced through our proprietary network, or whether we have partnered with another strategic relationship – the process is always to analyze based on risk and return across all asset classes.

Regarding the second part of your question on our selection criteria, our process is driven by internal staff. We conduct all the research in-house and make decisions internally.

Our manager research philosophy has two tenants. First, we search for the best manager and won't settle for "good enough" or top quartile. There can be large dispersions between top quartile and top decile, let alone top percentile. *And to make a proper judgement on who the best manager might be, we need to understand every manager in that space, so we cast an extremely wide net and have some proprietary methods to find managers. Ultimately we review every manager A to Z and don't rank, screen, or sort based on a database.* We turn over a lot of rocks and kiss a lot of frogs. It's not easy. Our second tenant is to look for inefficient areas where active management may have a greater probability of success. If we put a dollar of risk capital to work, we prefer it in an area where there is some structural inefficiency that makes it easier for active managers to outperform.

The process itself has three steps. We learn what the manager does and what they believe. We need to understand these so we can quantitatively or qualitatively prove the way in which they added value was consistent with their objective. Lastly, we make that subjective decision if past performance is likely to continue and what our expected returns may be. However, the process is not as linear as it sounds.

We don't limit ourselves to any set criteria and try to remain unbiased, but for us, *there are a few things that typically resonate. One of which is passion, it typically sets apart the good from the great. A manager could be so passionate about investing that it's all they do, they don't have*



other hobbies, they fall asleep with 10Ks and 10Qs on their chest, and they don't take vacations. Obviously, this is very difficult to measure, so our process does take a lot of time.

Matthias Knab Is size for you a criterion?

Christopher Winiarz Size is not a criterion. We work with some of the smallest managers to the largest ones. We see a lot of new or emerging managers, and we discuss seeding firms and strategies.

Corey McLaughlin: It's interesting you mention the importance of a manager's or a managerial team's motivation. From our side, over the last few years, we have observed that when investors look at managers, they have a real concern about motivation, particularly as managers get bigger. *How do managers stay motivated; how do they transition the firm; what's the succession plan for the firm so that the founders or key personnel are well backed up?*



Making sure that once a manager gets to a certain level they don't lose that drive, that desire, that hunger, is something we have seen a lot of people looking at now, whereas ten years ago this was not so much of a consideration. Today, there is much more emphasis placed on the talent pool and how the larger firms transition once the key people attain a certain wealth, and how they transition that wealth to the next generation in a good way to make sure the firm can continue in perpetuity.

Nadine Terman I have a question for Mike. When you work with the underlying managers on your platform, how are the asset flows directed? Is it determined by the capital that is flowing into your platform, or is the allocation more about what you want in a portfolio?

Mike Furlong: That's a good question. We primarily make the investment decision, though often it is based on what investors have indicated they want. Once we decide we like a manager, we outsource the investment diligence to a third party consultant.

We do a decent amount of thinking in-house about the way we want to structure the platform and what our investors are looking for. We really have a broad range of clients, from individuals to family offices. We also have our own themes, developed internally, which tend to guide our decisions on what funds we onboard.

Bank disintermediation, for example, is a theme we like to make investable through Sliced. Funds that are taking advantage of the regulatory implications of Basel III and Dodd-Frank – whether it's in life insurance, peer-to-peer lending, or direct lending.



Jason Gerlach: For the record everyone, Sunrise is a big fan of Sliced and the broader concept of using technology to increase accessibility to alternative investments. In fact, until our recent closure to new outside investment, our flagship fund was on the Sliced platform, and in the short time we have known them, they have proved to be one of *the most efficient sources of new capital we have ever worked with.*

It's a small sample size so far, but the rate at which Sliced was able to introduce us to new investors who we otherwise couldn't find and who had not previously heard of Sunrise was quite impressive, and I believe that's a consequence of Sliced's success in leveraging technology in a way that no one in the hedge fund space has been able to do previously.

So we are true believers in Sliced and the concept of leveraging technology to increase access to alternative managers, and I think that they have a chance to be very, very successful because like it or not, there is an entire generation of investors coming into their prime investing years who will approach alternatives in a different way than our clients historically have. This new generation likes the speed, convenience, and anonymity of doing things on their mobile device, even hedge fund investing, and I think Sliced recognizes this trend and is building a business that has the potential to successfully capitalize on this trend.



Going forward, I'm certain we are going to see a lot of innovation in the way people consume investment products, alternative and otherwise, and the best managers will find a way to tap into these new methodologies and thrive as a result.

Matthias Knab

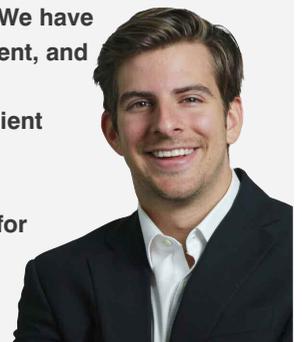
In the last three or four years I have seen a whole wave of platforms such as yours coming up. I have actually started a file where I keep the names of them, just out of personal and business interest, in order to keep the oversight. By now I must have several dozens of names in it. So far from my perspective, there hasn't been a big winner yet, so the race is still on. How do you differentiate from the other platforms out there?

Mike Furlong: There are a number of other platforms that have been started within the last five years; we are only about a year old, so we are pretty young.

I think that we are really one of the few companies that are founded by technology entrepreneurs, entrepreneurs that have backgrounds in technology as opposed to finance. And I think that what we have seen is that although there is a ton of value added from expertise in finance, access to certain products is more or less becoming commoditized. We have access to some of the best private investments in the world through our platform, but so do others. We see user experience and infrastructure as being the keys to unlocking capital opportunities for individuals or investment advisors.

We feel we differentiate ourselves significantly from a technology and data science perspective. We have built the tools and portfolio analytics to help advisors understand how to make a private investment, and how it fits into the overall context of their portfolio. We integrate in with custodians and get transparency into clients' portfolios, such that we have the ability to recommend (on a specific client basis) which products make the most sense for their portfolio based on certain objectives.

Our platform is also flexible – we allow someone to upload funds they are currently investing in, for example. So if a family office is currently investing in funds, we allow them to upload it to the platform, and then we do online documents, sign for them, and other procedures; we make it



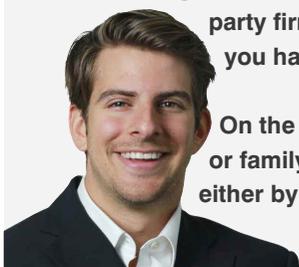
really easy to remove or manage all that back office work. Our platform can be used as software as well as an engine to access investments, and it can be completely branded for partner firms.

We are not just a marketplace that has a list of funds, click on, get some information, read, and then express interest, and set up a call with the manager. We automate from start to finish the entire investment process, and we've established integrations with many third parties such as administrators, custodians, and reporting services.

Christopher Winiarz

What type of due diligence do you complete and what does that entail?

Mike Furlong: We work in partnership with other firms that source us the managers, and then we have another third party firm that comes on and does the diligence on the funds. That firm is called Atrato; I am not sure if you have ever heard of them, but they will do investment and operational diligence on all the funds.



On the sourcing side, we've partnered with a firm called Krusen Capital and a few other funds of funds or family offices that will opportunistically source us funds that we will then raise capital, alongside, either by way of like a feeder fund structure or direct opportunities if the minimums are under a million.

Alan 'Butch' Andreini

Raising capital has become very competitive so I understand why managers are going to want to work with Sliced. You have had some success attracting investors to the platform. What do you think they find most attractive? What's really driving them?

Mike Furlong: I think that there are a few things that drive investors to the platform. There is the efficiency piece, and there is the access piece. If you go independent as an advisor, you don't have that whole bank infrastructure, that product team, that operations team, someone like Brian Lahart there sourcing and doing due diligence of the funds for you. Most of the 10,000+ independent advisors out there are primarily concerned with growing their business as opposed to vetting individual hedge fund managers. They lack the infrastructure to allocate efficiently to products not easily exchanged at a custodian.

With that said, it's extremely important for an advisor to be able to distinguish themselves and offer their clients the full spectrum of financial products out there. Especially products that are going to offer asymmetric returns during market cycles.

The feedback we've gotten is that our platform helps advisors garner more assets because they now have a unique product set in their back pocket.

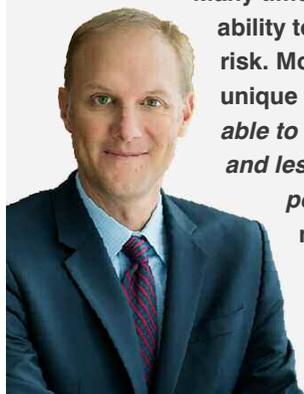


Matthias Knab

Brian, what are the criteria that you use to source and vet managers?

Brian Lahart: There are several important criteria we consider. Initially I always like to hear the portfolio manager articulate their investment philosophy – in their own words – as it relates to their strategy and why they believe that they are qualified to identify mispriced opportunities. I like managers who know who they are and, importantly, know who they are not. I tend to find that managers who are clear thinkers, and who can articulate their philosophy and strategy in a clear and concise manner, are a good place to start.

I also like to hear the portfolio manager articulate the objective which they are trying to achieve in their fund. Some express the objective merely in terms of return potential. Others discuss both risk and return potential. Some are unable to articulate their fund’s objective at all and immediately want to discuss their favorite stocks. Again, I am attracted to managers that have a realistic perspective of what they can and can’t achieve. With just a couple short questions I can usually determine whether I am speaking to simply a good stock picker or a great portfolio manager.



Many times the difference between a good hedge fund manager and a great hedge fund manager is their ability to manage risk. Great portfolio managers understand this and have a sincere appreciation for risk. Most are excellent at picking stocks, but managing risk, especially in a difficult environment, is a unique skill. Therefore you will see that *many are good at making money in a bull market but not all are able to retain those gains during a bear market. In the last 6.5 years risk management has been less and less important given the run we have seen in the equity markets. This makes sourcing great portfolio managers, with good risk discipline, even more difficult.* Sometimes one has to look at a manager’s track record from a previous firm to find an environment that was more challenging.

Finally we want a good partner for Abbot Downing. We want a firm that cannot only deliver an outstanding risk-adjusted return, but also be a good partner to us and our clients.

Corey McLaughlin

Brian, I am curious how important the operational side is to you from a due diligence perspective. Is that a primary or secondary thing that you look at? And how does that compare to maybe five, ten years ago in terms of how you look at and how you consider managers?

Brian Lahart: Operational risk is extremely important, but it's never the first thing we address. Our primary concern is determining whether the manager can deliver attractive risk-adjusted returns. If we don't have confidence that they can, then there is no need to assess their operational controls and infrastructure.

If we do get excited about the return potential of a particular fund, then we will embark on a full and comprehensive review, including operational due diligence. I have a strong appreciation and respect for operational risk. Before I joined Abbot Downing, I was Head of Risk Management at a hedge fund of funds shop responsible for conducting all of the operational due diligence. This component has always been important and a key component to our process. We have always felt that it is critical to review and assess a manager’s valuation policies, their cash disbursement procedures, and their compliance program. The past episodes of fraud (such as Madoff) that have come to light haven’t changed the value we place on these areas since we have always considered them very real risks.

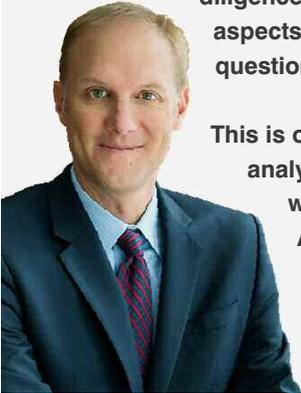


Mike Furlong

When you guys are thinking about diligence, how much of it would you break down as qualitative versus quantitative, and then how much of it is manual versus automated – or potentially automated?

Brian Lahart: Due diligence is an extremely inefficient process. There are no short cuts.

How much is quantitative versus qualitative? There is no good answer. I will say this: if the return potential is not attractive, then it doesn't matter how much you like the people or the process. That said, when conducting diligence on a manager, I think the qualitative aspects are often more valuable than the quantitative aspects. It requires hours and hours of meetings, conversations, visits, questions, and follow-up questions.



This is one of the reasons why diligence is a very inefficient process. It also requires experience. The analyst must have the experience, confidence, and credibility to ask the tough questions, reconcile with other sources of information, and come to a conclusion – all with imperfect information. At Abbot Downing we like to do a lot of reference checking on a prospective manager using our own network of industry professionals. Fortunately, being part of Wells Fargo, it is not difficult to find someone who has worked with / worked for / invested in / interacted with a manager that we are evaluating.

Christopher Winiarz: Our process is a mix of quantitative and qualitative, but we tend to agree with Brian. We probably spend more time qualitatively than we do quantitatively as we need to understand an investment before making a quantitative judgement.

Regarding the automation aspect you asked about, there are absolutely many things which could be automated, but it's still going to require a lot of manual oversight and qualitative judgment and assessment.

One aspect that comes to mind is a potential automation of attribution analysis. It's possible to do, but you will have to take a deeper look at the parameters used. Instead of just spitting out country attribution, maybe you should be looking at attribution based on market cap or PEG ratio quintile. Having that manual oversight is probably needed in a lot of instances.



Alan 'Butch' Andreini: Brian makes several good points and touches on something that's very important to us at James Alpha. I completely agree that there's no one right way to choose a manager, and while we do our fair share of general quantitative, qualitative, and operational due diligence, on the qualitative side of things, we are particularly concerned with the people running the business.

Earlier Chris mentioned the importance of passion, and we couldn't agree more. We want to work with people that eat, sleep, and breathe their chosen investment strategy. Whatever it is they do, they should love doing it. If they love doing it, then it's likely they've developed the deep domain expertise necessary to carve out a repeatable edge that is then sustained by their passion. It's a virtuous cycle that starts and ends with a person's passion for investing.

On the operational due diligence side, we do all of this work ourselves. Our due diligence goes well beyond any due diligence we have seen from any investor in our funds. Our philosophy is to believe nothing that we hear and only half of what we see, and verify everything.

To give just one example, a manager will give us their performance figures. We ask them to put us in touch with their prime broker who can provide us with their brokerage statements directly. We then reconstruct their performance figures. If the performance they provide to us does not match the performance we construct from the brokerage statements, then we are not likely to be interested. We will probably give them a chance to explain the differences, but it is obviously a red flag.



As another example, if they say “call Sue Jones at Goldman Sachs to get the brokerage statements,” we will actually first call Goldman to see if Sue actually works there and in the role we have been told.

From these two examples, you probably get the picture as to how thorough we are with our due diligence. Because we intend to have long-term relationships with relatively few managers, we perform what we refer to as “acquisition level” due diligence which is the sort of due diligence you would do if you wanted to own the manager’s business.

What we have learned through this process is that the managers essentially self-select. The best ones who are really on top of their games appreciate and welcome the effort we put in. Those managers who are not as professional resist the scrutiny and usually end up being ones we choose not to invest with.

We have a systematic checklist of items we are performing due diligence on, but we are not just checking boxes, we are probing, digging, and thinking hard about what we are learning.

And it is the senior partners who perform our due diligence, not a junior, or even, senior analyst. Not surprisingly, with this level of due diligence, we have turned up actual frauds, so not much surprises us at this point.

Last but not least, we usually end up with a number of recommendations as to how to improve their internal operations, streamline processes, or tighten up certain procedures from a compliance or security perspective.

As you can see, we view due diligence as a critical component of our investment process, and we regularly review operations after we have invested as well.

Nadine Terman: From a manager’s point of view, we actually prefer working with educated, analytical allocators.

If you take our strategy for example, it took us a year to deploy our cash and build a portfolio. So the net returns in that year were, as you can probably guess, minimal and not meaningful. Following our stringent process, it just takes time to build positions. But since that time, the portfolio has been compounding. The underlying cash flows of the businesses in which we invested are driving value for our limited partners. So, if an allocator doesn’t take the time to actually look at how the portfolio was built, the risk in those positions, and the cash flow of the underlying businesses that we are investing in, they are not going to understand how we delivered our returns.

This year, our team garnered considerable publicity because of a recent award that took into account both risk and return. If you looked at our numbers last year, they were very good, yet on a risk-adjusted basis much better. We would not have been able to beat a supercharged biotech manager last year on pure return numbers alone, but if you actually take risk into account, then it’s a totally different analytical framework.

Therefore we prefer investors who understand what we are doing and why we are doing it, otherwise I would say that maybe you would get the top quartile this year and then the bottom quartile next year and then middle of the road the following year, because you are not really understanding what you are getting if you are just looking at the numbers from a one, three, five-year perspective.

Understanding a fund and its returns really comes down to fully understanding the strategy. If you don’t have the time to look at the manager as well at the strategy, you probably shouldn’t be in the business. Having that understanding of what a manager is really doing isn’t probably something that can be automated or achieved by quickly browsing a pitch book and then summing it up with a statement like, “gosh, those returns are good!”

As others have explained, it is paramount to understand a manager’s investment process and investment strategy, what exactly he or she is doing, because sometimes people say they are



doing one thing, but actually they are doing something a little bit different, which doesn't mean that they are not a good manager, but you as the investor need to really understand what you are getting when you partner with a manager.

Christopher Winiarz: I agree 100%. The challenge for us is how to step away from simply automating things, and actually make an assessment. We can gather facts, but ultimately we have to make that analysis and judgment.

Let me give you an example of how we actually do that. We could screen a database for top quartile performing managers, which could easily be automated. But it would be backward looking. In sticking to our principles of hiring the best manager, we need to analyze the entire universe, not just top quartile.

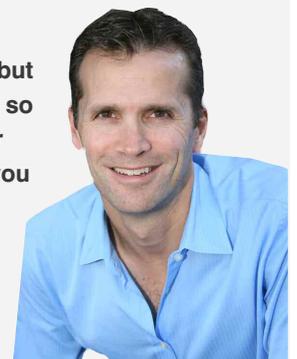


We have an investment with a biotechnology manager who is not listed in any database. To uncover this great investment team, we needed to meet with 113 biotech managers. Many in the space tell me there aren't 113 managers with biotech expertise, and I respond that "there are, we've met with them and have the list." So as much as we want to automate this process using some metric, the qualitative aspect remains the most important. Additionally, assessing the risk-reward tradeoff is probably best done qualitatively as well.

Jason Gerlach: It's always interesting to me to hear and observe how different people make investment decisions when considering alternatives. Our firm has been around long enough to have seen the days where due diligence was solely a round of golf and a handshake. Since those days, I think the pendulum has swung all the way over to what in many instances is an absurd level of due diligence which has in many cases led to nothing short of "analysis paralysis." Oftentimes it feels like we're simply being asked questions for the sake of being asked questions, and that there are people on the other side of the table from us simply looking to justify their job and find a path to "no" so that they clear their desk. In these instances, we find ourselves asking, ourselves: "Why on earth does this matter at all and how is this helping end investors," and as one can imagine, the asset raising process becomes very, very frustrating.

For everyone's sake in our industry, I am hoping that there is a middle ground somewhere between the relatively limited due diligence of the past and the typical overkill of the present. I completely understand that for anyone on the allocation side, they have to please their constituencies and do the diligence that their investors demand, but at some point they are doing *disservice to their investors by utilizing a process that results in only a handful of massive managers getting all of the assets*. Indeed, the statistics reported by groups such as Prequin show that nearly all the money allocated to hedge funds and other alternatives in the last five years to aggregate amongst the top 30 or so managers in the world. I believe that in 2014, something like 90% of all asset flows into hedge funds went to firms of a billion plus or higher in assets under management. This is a problem on many levels and not a good long term development for investors as innovation is stymied, pricing power is concentrated, and huge "point of failure risk" has emerged.

And while I hear a lot of investors saying: "We love small managers, we really think they produce alpha," the statistics don't lie. Who is raising the most money? Not small and medium managers but rather, the Bridgewater, Och-Ziffs, and BlackRocks of the world, which is great for them, but not so great for managers under the threshold of one billion and, I believe, not great for investors or our industry overall. Imagine a scenario where a firm like Bridgewater failed for some reason? Can you imagine the tremendous implications that would have on investors and the industry in general? I shudder at the thought and hope it never happens.



It appears to me that size has become in some people's eyes a proxy for quality, a proxy for

safety, a proxy for skill and a lot of other factors when in fact, it's not clear to me that there's any correlation between size and those other factors, let alone any causal relationship. Just because a firm is strong at raising assets and the sales and marketing processes that drive asset raising, it does not logically follow that that firm is strong in the area of investing, compliance, or the other important attributes that make for a great asset management firm.

In our case, over the last several years we have had many people look at our track record and say: "You're a great firm, why don't you guys have more money under management?" And the best answer we have been able to come up with in the post-2008 environment has been to say that "we don't have more money under management because we don't have more money under management." This is an absurd response in many respects, but it's the unfortunate truth and, for all of us at Sunrise and similarly situated firms I imagine, a very frustrating "chicken and egg" scenario that is hard to escape.

It's not all gloom and doom for smaller managers however. As noted, after years of effort, we at Sunrise just finalized a strategic partnership that will bring us some significant allocations that will potentially bring us back to the "magic billion mark" in the next 12 to 24 months. Moreover I am excited to hear some of the concepts that have come out of the conversation today and thrilled that there are platforms like Sliced that are out there that seem to be agnostic towards size and are more focused on quality and other important attributes to alternative investment success.

Ultimately, I think the best alternative investment industry is one where there are more small and medium sized managers and fewer mega firms. Hopefully, a trend toward that outcome will start to develop soon.

Alan 'Butch' Andreini

A statistic I've come across a few times is that two-thirds of industry assets are in the hands of some 200 managers. There's no question that's a significant source of inefficiency that is ripe with opportunity for anyone willing and able to go after it. This is exactly what we are focused on and why we get excited about working with talented early-stage managers who are still nimble enough to access that opportunity.

Christopher Winiarz: I think we like to be agnostic to size. We have invested with managers below \$200 million, yet our average ticket size is about \$500 million, so that can be substantial for boutique managers.



On the other hand, we have invested with the largest managers out there where the offering is differentiated and unique.

We look at manager's size several ways. *Does the operational infrastructure match the need of the investment team? How does size impact the investment opportunity?* Generally we want to ensure that the investment team doesn't outpace the back office, which can present challenges and risks.

Nadine Terman: These industry trends are a hot topic right now. I am participating on a panel at the Wharton Investment Conference in a couple of days, and it is one of the questions that is teed up. I think everyone agrees that there is a barbell effect, with a lot of small managers on one end, versus a handful of the big guys on the other. People are interested in finding solutions, though. Also, I see parallels with a video Matthias recently did with Meredith Jones about women in the hedge fund industry. Women manage roughly 1 or 2 percent of hedge fund assets. There have to be a few more talented women out there worthy of backing, right?

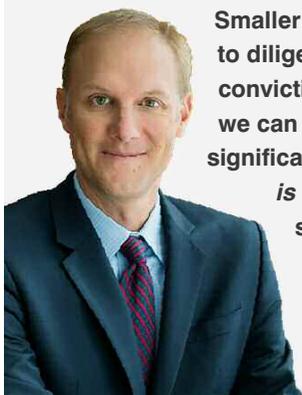


There may be structural or other reasons for that, but the reality is that if an investor is going to spend the time researching one or a number of managers, it's a lot easier if they deal with a manager who is also capable of taking a bigger ticket, and that just gives them a certain comfort level. Oftentimes they don't think about a *separate account*, which hopefully should reduce any kind of risk of being in a commingled fund, but unfortunately many investors just don't get away from that set up. Plus, I don't see that trend changing, so I see this barbell effect only continuing and strengthening.

But I think that ultimately we will see a bit of a bifurcation of the allocator landscape, with people who write those big tickets continuing to allocate to the larger managers, or hiring more staff to be able to look at those 100 biotech funds like Chris has done. You have examples with the Canadian pensions, and CalPERS seems to be focused on growing its internal resources to invest directly or to review certain types of managers with better results.

Then, we will have firms like Sliced or James Alpha capitalizing on that opposite end of the barbell. The data shows that their target managers generate greater, differentiated returns, so these allocators will be successful from taking a different approach. Therefore, I do believe we may end up with those two distinct pockets of capital.

Brian Lahart: We are pretty agnostic when it comes to the size of a manager. We don't want to be more than 10-15% of their assets, but other than that we do not have any hard rules when it comes to size. We have invested in both large and small funds. In fact today we have just as many hedge funds approved with less than \$500m of assets as we do with funds over \$5bn of assets.



Smaller funds may have a shorter track record or fewer people and therefore can be more challenging to diligence. However, that is often a source of strong, differentiated returns. If we can develop conviction in a smaller manager, and get comfortable with the business and operational aspects, then we can often secure better terms, capacity, and rapport with the manager than we could have with a significantly larger manager. *Sometimes it's not long before you shift from a concern that the asset base is too small to a concern that the asset base might be too large.* More often than not, when we source a manager with a low asset base, their AUM does not stay low for long. Other investors will discover them and the asset base will grow with their success. However, the benefits that our clients accrue from investing early in a manager's lifecycle are huge. Managers appreciate the confidence you show them in the early years of their lifecycle and will remember that.

Mike Furlong

I agree with Brian, Jason, and others, and I think that through the lifecycle, your risk switches from being that startup to ultimately how to stay motivated. I think that's a critical thing that the industry needs to continue to support, because from my perspective, the fun and excitement of being part of this industry has been the innovation and the entrepreneurial spirit.

I think it's going to be very relevant that as an industry we continue to take a look at startup managers that are really providing those new ideas for alpha and who are innovative.

Jason Gerlach: We at Sunrise have thought long and hard as to how our industry has evolved since 2008, and we have a theory that the institutionalization of hedge funds and the push of pensions and the more traditional large-scale allocators into alternatives during this time frame has led to a lot of the problems facing the industry today. Historically, pensions and other institutions were very vanilla in how they invested: conservative, long-only stocks and bonds for the most part. And they gravitated toward the Fidelitys and the Vanguards of the world – big, relatively straight-forward, very traditional asset management firms that looked a certain way and acted a certain way.

When pensions and other institutions started pivoting toward hedge funds and other alternatives in the early and mid-2000's, and more significantly, in the post-2008 environment at the recommendation of their consultants, they naturally gravitated toward and sought out the managers that looked the most like those firms they were comfortable investing in – that is large, relatively low volatility type managers. This in turn pushed alternative managers who wanted to attract institutional money to aggregate assets, de-volatize their strategies, and take other steps to essentially look less like hedge funds and more like the Vanguard-type firms of the world. This in turn led to a dampening of the return potential of many firms in the hedge fund space and to some extent, an extinguishing of the entrepreneurial, risk-taking spirit that made the hedge fund industry what it was in the first place. So in some respects, one could argue that the institutions have significantly changed the hedge fund industry and essentially caused the ascension of a few uber-managers at the expense of hundreds of very good medium-sized and smaller managers.

The irony is that now we're starting to see some performance-based backlash against hedge funds in recent years – arguments pointing out that hedge funds have failed to beat the S&P 500 over the last three or five year stretch and comments like: "Well, my 60/40 portfolio would have done better in this portfolio of hedge funds, so what's wrong with you guys? I thought you guys were supposed to be about big returns?" And part of the answer to this question is really something along the lines of "Hedge funds were doing just fine and delivering "big" returns until you and all of the institutions poured 100's of billions into them, asked them to look and feel more like Vanguard, and removed their incentive and ability to act like true hedge funds."

Add to all of this the fact that as hedge funds accrete billions and billions of dollars, it becomes much harder for them to find or trade the niche investment opportunities they often thrive upon, because at their bloated size, they flood out the inefficiency or the arbitrage or whatever they are looking for. This is yet another way that "institutionalization" has perhaps caused more problems for hedge funds than it has solved.

So overall, it's an interesting cycle that we are in – *the bigger the industry gets, the worse it seems to be doing in many ways.* I don't necessarily think we should go back to the days where there was no institutional money in hedge funds, but part of that scenario is kind of appealing, because I think it would allow for a more competitive landscape in our business. I don't know if there have been any empirical studies that would support this idea, but it seems to us to be strangely coincidental that in the post-2008 environment, the once-thriving and competitive hedge fund industry has become in some respects an underperforming oligopoly as institutional money has poured into hedge funds, and continues to do so.



Matthias Knab

There is also the risk that the term "institutional quality" gets overused a bit. To Jason's point, possibly some people have started to equate that with a nice marble conference room table on Park Avenue, with an army of accountants, marketers, a polished pitch book, and a huge infrastructure.

However, there is probably a fine line. You certainly want some institutionalization. You do want robust policies and processes, solid accounting and operations, but I've also heard views that the term gets overused to the point of sometimes passing on some good up and coming managers.

Jason Gerlach: The upshot of the discussion we've been having is that I believe we may all have something to worry about in terms of the direction we are heading with respect to innovation. Again, if you think about it, fearless risk-taking, entrepreneurship, and innovation is what really made this industry what it was in the first place – it's certainly what was at the genesis of Sunrise Capital Partners when it emerged in the 1970's. Yet today, it is harder than ever for someone to start a hedge fund or other alternative asset management business.

In my role at CHFA and in industry conversations, generally I often hear comments like: *“Who in their right mind will launch a hedge fund today?”* This is not a good thing.

The challenge for those wanting to get a foothold in the industry is that the threshold for success, let alone survival has become a lot higher. You need millions in AUM and fairly robust infrastructure in place before you can even open your doors, and this means that you have got to either raise a ton of money prior to launch, which is not easy to do, or come into the business with a bunch of your own money, which obviously is a rarity. Therefore a lot of great investment ideas will never see the light of day, because the holders of those ideas can't even get a business off the ground to start.

At the California Hedge Fund Association, one of the things we are really trying to achieve is to help make sure that California is always a place with pathways for people who have innovative financial ideas to launch asset management firms. *The barriers to launching one's own asset management firm should not become so prohibitive that talented entrepreneurs are forced to raise a white flag and just go to a firm like PIMCO and work there.*

This is not to say there is anything wrong with working at PIMCO, I am sure they have some great jobs; they might even have a job for me someday if I can't keep Sunrise going. However, there is something to be said about startups; and certainly California's Bay Area understands that better than anything. You want 100 people to go out and start things, not because all 100 of them are going to succeed, but because three or four of them are probably going to do something innovative that the world has never seen and in the process create the PIMCOs of the future. *And if those 100 suddenly become 10 instead of the 100, your chances of finding that next great project or idea will be greatly reduced, and you may just be stuck with what's out there: with PIMCO, Vanguard, or with Fidelity, which is not necessarily a good thing for investors.*



At CHFA, we think that all of us here in the State should band together to create some kind of “California Way” to the investment management business that will encourage innovation. That's something that we are trying to foster, through roundtable discussions like this and the many events and programs we do aimed at emerging managers. It's important to us, because I don't think our industry is better off if there are just four big managers in California and everyone works for them. I think competition breeds excellence, and you need to foster it.

Nadine Terman: Per Jason's points, we received some very interesting feedback from allocators at a conference that I co-manage here on the West Coast. Many of the allocators in attendance were from the East Coast, and they represented some of the largest, blue chip organizations. The managers in attendance had headquarters from Chicago to the West, and they were predominantly emerging managers. The allocators consistently remarked on how many great managers they had met, that they had never met before. They said, “We just never get out here.”

Sometimes people aren't doing the work, because they don't have to do the work. It is clear that there are enough managers who reside in New York or Boston, so they don't have to go searching for that differentiated or smaller manager in Chicago, Ohio, or California even. One would think that it's kind of a no-brainer, that when they occasionally visit California and meet with some bigger funds, that they also extend their trip and meet with the emerging managers. It's harder to find differentiation when you look in the same place all the time.

Moreover, I considered their feedback a really interesting data point – especially if your business is to meet the next generation of managers, California doesn't seem that far of a plane ride away.



Jason Gerlach: We have heard hundreds of anecdotes to that effect, even the large allocator who is now partnering with us had told us: "We've never heard of you guys, where have you been?" I said: "Well, we have been doing this for 36 years and have been marketing like crazy over the last several years but unfortunately, to relatively little avail versus the mega-firms."



San Diego, where we are based, is not viewed as a financial services center, and it's not typically a place where allocators go to look for managers. Yet ultimately, I think if you are truly doing your job as a consultant or as a CIO, you shouldn't be geographically bound in your search for managers. I suppose it's more convenient to just go up into Connecticut if you are in New York City and find a couple of managers there, but if they are not truly the best, then I think you are selling your clients short for the sake of convenience.

Nadine Terman: Also when it comes to the so-called second or third generation of hedge fund managers, I think it's important to find out if a manager is just another spin out or blue print from the same shop, or is it going to be something really different? An allocator or a consultant should understand what positions a manager owns and why. That is how to determine if a manager is really differentiated from what is already in their portfolio. A manager might provide differentiated alpha for one allocator but not for another, so it is important to do the work.

I also understand the headcount dilemma, in conjunction with the constraints on dollars to put to work, but that's why I think we are going to see this bifurcation I talked about. At Solstein, we are considering giving capacity rights to allocators that plan to back us in size earlier on. Over time, they get to grow with us. They won't be shut out. When an investor is spending a lot of time understanding what you do, and if at some point they feel comfortable to invest, that in turn also gives you as the manager a lot more comfort and flexibility that you are partnering with the right kind of people. Just like we concentrate in securities, we appreciate those investors that concentrate their capital in managers and create a partnership.



Matthias Knab

Jason talked about the "California Way" in professional finance and asset management, and that the entrepreneurs may need more support so that they can really grow and contribute. He also talked a bit about the challenges and advantages of being based on the West Coast, let's take a closer look at those?

Jason Gerlach: Once again putting on my CHFA hat as opposed to just my Sunrise hat, I'd note that the CHFA was founded by Sunrise and a few other managers in Southern California, back in 2010. We all lamented the fact that we were always getting on a plane and going to New York or Connecticut or London for meetings and that all the big industry conferences were in Florida, and we are just saying to ourselves, "Why is that?" California is not exactly the boondocks, it's the largest state in the union; it's the largest economy of all states in the U.S. and larger than most countries, for heaven's sake...



We knew that there were great managers out here. We knew that there were many great service providers out here – sophisticated accounting firms and law firms, etc. And of course we knew that there was also a lot of money invested with alternatives out here, a lot of private wealth, and some of the biggest institutional asset holders in the world. And given all of this, we asked ourselves: "Why is California so relatively obscure in the hedge fund scene and alternative investment industry generally?"

We didn't really know the answer, but we wanted to see if we could address what we viewed to be a significant inefficiency in the marketplace, and hence CHFA was born, and we set out to first galvanize everyone in the industry across California; whether they are Southern or Northern, San Francisco, San Diego, Los Angeles, Orange County, or otherwise, and then to try and talk to them and figure out what they needed and wanted from us, and then hopefully deliver those things with CHFA.

And looking back over CHFA's first 5 years, that's what we have done. We have over 1,000 members now. We have done over a dozen events per year over the last several years, and overall we at CHFA think we have brought the hedge fund and alternative asset management game to California in a more robust way than it ever has been before in addition to enhancing the events and activities that were already happening in California.

For example, we are co-presenting the AlphaHedge Conference here in San Francisco in late September. This event has been happening for years, but now we're trying to make it even more relevant and topical for emerging managers, and we're trying to address some of the issues that touch precisely on what's happening here in California such as FinTech, for example. Butch and I are both involved in the conference planning and organization, and we welcome others to get involved as well. Northern California should be a hedge fund and alternative investment incubator and hotbed, and hopefully AlphaHedge and CHFA's other efforts will make that a reality.

As another example of what CHFA is about, in March 2015 we helped organize the first alternatives-only event ever held in L.A. This event, known as ALTS LA, was attended by over 500 people, and we were so thrilled by the outcome that we're going to repeat it on March 10, 2016 at the Hyatt in Century City.

In addition, in recent years CHFA has formed a strategic partnership with Context Summits, a firm that has emerged as the leading cap intro event organizer in the world. Their events have a strict focus on manager-investor meetings; there are no panels; there is no education; there are no razzle-dazzle, SALT Conference type activities. It's about managers sitting down for 20 minute intervals with allocators and working to address one of their biggest challenges head on – asset raising. An efficient manager can go to a Context event and in over two days have 10, 20, even 30 meetings with real allocators who are actively looking to place money. Context did their first California event last year in Orange County in partnership with CHFA, and they are stepping it up even more in 2015 with two events – one focused on hedge funds and one focused on liquid alternatives. Both events will be in Orange County in September, and CHFA members get a nice discount if they sign up for either or both. You can learn more about both events at www.calhedgefund.org.

Summing up, CHFA is doing its very best to provide as many opportunities as we can here in California for managers to connect with investors and for investors to come out and vet new managers. This effort will only be as good and successful as the managers, investors, and service providers who participate, so we urge everyone in the alternative asset management business here in California and beyond to get involved in CHFA.

Christopher Winiarz

I guess other than giving more money to California hedge funds, what can we do as allocators to help out with that goal?

Jason Gerlach: Giving more money to California managers is certainly number one because assets ultimately are the lifeblood of a firm and as discussed, asset raising is the largest challenge facing emerging managers here in California and elsewhere.

But beyond that, there is indeed more allocators can do. For starters, I think the fact that we are having this kind of conversation is great, and we very much appreciate your willingness to engage. Please keep doing this because the whole industry learns the more you share about your process, what you look for in managers, etc.



Please make sure your staff is getting to events and being transparent and explaining the rules of the road, explaining what your criteria are, and doing all they can to educate California's managers as to what it takes to get an allocation from you, particularly some of the smaller or medium-sized managers in California.

And beyond that, maybe you and other institutional allocators can set up some kind of program where people from your team can come into emerging and other small or medium asset management firms and help them sharpen their games and figure out what parts of their business maybe aren't working as well as they should.

Additionally, if you vet a manager and opt not to invest, please make sure you don't just say "no" but instead, provide a "no because" type answer that details steps a manager can take to get on a path to "yes." You need to understand that an educational "no" from an organization like yours can be almost as powerful as a "yes," because it can provide a blueprint for that manager to improve, grow, and succeed in the future.

I offer this last suggestion from personal experience as we used the power of the "educational no" to significantly enhance our business and get it to the explosive growth point at which we find ourselves today. In our case, we are a second generation firm, and after we took over from the original ownership group, my two partners and I needed to do extensive upgrading and modernization to bring our firm up to a 21st century standard. To hone this process and ensure that we were focusing on the right things, we met with a lot of top, very large institutional allocators who we knew would likely say "no," simply so we could leverage their process and knowledge and use their suggestions in our re-building blueprint. And believe me, we got our share of "no" answers over the last few years....

Matthias Knab Because of that transition?

Jason Gerlach: Yes! And as a result we had to tune our business accordingly and really sharpen Sunrise's game.



There were things we weren't doing as well as investors like Chris or Brian expected, and over the last half decade we have addressed each of those things, and it has paid off in the form of the very large allocation I mentioned earlier today. It's extremely rewarding to have a situation where an investor says, "We asked you to fix that four years ago and wow, you have, and now we'd love to invest, so here's a check" That's meaningful. And we only achieved outcomes like this because we were able to interface with institutional investors and really get honest and objective feedback.

Corey McLaughlin

I will try to offer a different perspective. Arthur Bell CPAs, having started on the East Coast, but being solely focused on the alternative investment industry, sees a lot of activity in and around our industry. That passion and that entrepreneurial spirit and innovation we talked about earlier really does come through on the West Coast. I think people on the East Coast are standing up and really taking notice, and if nothing else, we want to be here more and get out of the humidity and enjoy the nice weather here.

We and, it seems, everyone can see a lot of successful startups and entrepreneurial managers in Northern and Southern California. We are excited to be a part of it. We are also glad we can be involved with the California Hedge Fund Association – thank you, Jason, for engaging us with them. We see the sky is the limit for all of you here in California.

Alan 'Butch' Andreini

It's possible I'm being overly optimistic, but I like to think that the efficiency and transparency that is being made available by FinTech is slowly starting to address some of the issues being touched on here.

Mike Furlong: I think there is a long way to go, but I also believe that this thesis is correct. I think the operational issues we discussed are very significant and very real.

It reminds me of the fund of funds, Lighthouse. It's a large fund, but they have a pretty innovative approach to the way that they allocate. They use managed accounts to allocate to emerging managers, basically because they have realized those are a great way to deal with operational risk. In their case, it's the fund of funds that sits on the top of the managed accounts and removes the operational risk because they are taking care of all those aspects. That model, I feel, is particularly transferable to a platform. That's a bit like the Holy Grail, because you remove the operational risk and can capitalize on the alpha the emerging managers can produce.



Nadine Terman: As a contrarian manager, I am trained to look for potential areas of dislocation and confusion. Per the comments by Corey and Butch, there may be an interesting development in financial services on the West Coast when the next tech crash happens. In the past several years, there has been a boom in West Coast wealth managers that have concentrated their client base in the tech industry, and that have concentrated their clients' assets in the tech industry. To provide a contrast, while I am not a client of Brian's at Abbot Downing, I would venture to guess that the client base and its asset allocation are very different there.



Moreover, while there is a lot of wealth here in Silicon Valley, it is quite different in terms of the appetite (and perhaps understanding and appreciation) of risk. There is a strong interest in angel investing, which enables people to go on the boards of private companies and work with them. There is significantly less interest in backing emerging hedge fund managers. Maybe Sliced is going to be a platform that speaks to some of these people today, or perhaps a transition will have to occur when the start-up party ends.

Alan 'Butch' Andreini

Another thing I think worth mentioning is how our proximity to Asia appears to be allowing the West Coast to harness a lot of the energy being generated by investors looking to gain access to the fastest growing regions in the world, namely China. I'm curious whether others agree?

Christopher Winiarz: Yes, absolutely! I don't know if proximity alone makes it more interesting. It's roughly the same plane flight from here to Asia as it would be to London, so pick and choose where you want to go. And from my perspective the opportunities are a lot greater in Asia right now.

When people talk about Asia being the second largest economy, they are typically referencing China, which is also the second largest securities market in the world. As of right now, foreign investors have limited access to mainland China A-shares, unless you have a QFII quota. But that will change.

Fast forward 10 to 15 years, China is very likely the largest financial services market in the world. And the interesting part is that their history looks very similar to the U.S. asset management community 30 years ago. It was very wealth management driven with one-on-one personal service. Fast forward to today, you have a lot of independent asset managers, and it's an actual industry in and of itself. You see that in your leadership role in the CHFA.

But in China, there are about 1,000 independent asset managers and only about 15 have more than a billion dollars of assets under management.

Think of that stat for a second. It's really staggering that there are only 15 asset managers with over a billion dollars in assets in the second largest financial market in the world. It's important to meet with many of those players and understand that their financial market is going to be liberated



soon. I don't know if it's one year, three years, or five years, but in very short order they are going to have the same opportunity to do things that we have here in the U.S.

Now, my point here is that many of those firms are actually coming to the U.S., and their first stop is in California. We are seeing many looking to understand what are we doing from an asset management industry perspective in order to learn how to grow their business. It's a big difference if a CIO who runs a portfolio has the foresight to add a CEO to manage the business. It's a different skill set than simply picking a security. And many of them are trying to understand how they can grow in the next five or ten years and how they become the T. Rowe, BlackRock, or Wellington of China. Having been to Asia about five or ten times in the past year or so, we have built many meaningful relationships. And now we are actually seeing a lot of reverse inquiries as well.

Brian Lahart

I have been to Asia twice in the last five years – visiting Singapore, Hong Kong, Malaysia, Thailand, and Indonesia. In addition, Wells Fargo has manager research analysts on the ground in Hong Kong providing great local knowledge. We like to visit Asia not only to source new managers but to also experience firsthand some of the massive changes taking place in the world's most populous continent.

Some of our longer term investment themes are based on dynamics largely taking place in emerging economies within Asia. As an example, our white paper "The Wealth of Nations" focuses on the growth of the middle class and the rise of the global consumer. As a global investor it's important to understand and take advantage of these trends that often exist outside of the U.S.

Corey McLaughlin

Speaking with one of the family office allocators regarding G2 and G3, for example, there was a message that I am hearing among those younger generations around impact investing and environmental, social, and governance (ESG) types of philosophies.

I am just wondering if you have any thoughts about the allocators' interest in ESG? Is the family wealth doing that? Are the managers concerned with impact investing at all? As an investor, as a public plan with fiduciary responsibilities and such, are there plans in place, are there metrics that you look at, or are there other considerations? Where does this discussion fall in the West Coast world?

Brian Lahart: You are correct – there is interest from clients – particularly from second and third generation family members – around impact investing. Fortunately, we have been very involved in this space. Over the past decade Abbot Downing has sponsored impact investment conferences as well as sourced impact investment funds focused on areas such as clean energy and micro-finance. In fact, just last year our clients invested in a venture capital fund that we sourced which invests in companies that strive to improve both their financial bottom line and have a positive social impact – their second bottom line.



We are also fortunate to have a partner within the Wells Fargo organization who is considered one of the premier thought leaders in the space. Nelson Capital, a wholly owned registered investment advisor within Wells Fargo, advises clients on how to integrate impact into their portfolios. We partner with them on many Abbot Downing relationships where we feel we can leverage their expertise.

Matthias Knab

Do you still do these events on impact investing and who did you address with them?

Brian Lahart

These events are for Abbot Downing clients and prospects. In fact our Family Dynamics group works directly with clients helping them determine the impact they want their wealth to have on their community and the world, of which impact investing can play a key role. Our annual Abbot Downing Family Forum event is another example of our firm taking a lead role in bringing together thought leaders to discuss important issues for multi-generational families such as impact investing.

Mike Furlong

Although we aren't really a family office ourselves, I think that we as a company know that environmental considerations are some of the biggest issues in the world right now for our generation. And I think this is actually one of the more interesting areas because LPs are uniquely positioned – structurally – to profit from making certain sustainable investments.

You see this in the lending space and the credit space with these peer-to-peer lending companies. I believe hedge funds as a vehicle are actually operationally efficient to be able to provide capital sourcing for a company who doesn't want to balance sheet finance their loans they're making to African villages for solar panels, for example. Maybe loans in Africa offer great returns, but there is little data surrounding it, and it would be difficult to get a loan from a bank.

Christopher Winiarz: Given that the University of California is a public institution and an educational institution, we have many different constituents thinking about impact investing, SRI, or ESG. To the credit of our new CIO who has been a visionary, we now think about these themes as risks, and we incorporate it into our practices.

One of the things he has put in place is a framework to think about these aspects. ESG are actually just several of many risks that we should be thinking about when we make an investment. By having a framework in place to assess those risks we can better manage it relative to others.

We have already seen some initial changes just in his first year, where we have committed to allocate \$1 billion to climate initiatives as part of the White House's Clean Energy Investment Initiative. We have also developed a plan to promote entrepreneurship and innovation for a low carbon future through our UC Ventures program.

Even on the corporate governance side, we have increased the amount of engagement, by doing simple things such as meeting with Japanese corporate management teams to discuss their capital allocation policies and understanding the Japanese Stewardship Code and Corporate Governance Code.

All these things are just a few examples of our new framework and the lens we are applying here. So impact investing for us isn't necessarily about investment or divestment, it's a framework to analyze risks.



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