



Opalesque Roundtable Series '15

NORDIC

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Editor's Note

Nordic hedge funds and CTAs an unabated success story since 1996

Since Brummer & Partners' decision to establish their first hedge fund in 1996 onshore in Sweden, the Nordics have been a centre of excellence in both active management and professional investing. The Swedish FSA has the reputation to actually know and understand hedge funds, and has provided an environment where retail investors, for instance, have been able to access hedge fund returns at a really early stage.

UCITS absolute return funds have grown nine times faster than offshore funds since 2009

This success story is continued with UCITS absolute return funds which have grown by around 47% since 2009, while the offshore fund market has grown by 5%. That is a fundamental change in the industry. Regulations have put more structure around hedge funds, so they are not as scary as they used to be perceived in the past, and regulators feel it is acceptable for someone in a private pension or individual portfolio to access that kind of diversification.

Alternative asset managers have a great opportunity to show the advantage of alternative investments in today's environment, where rates can't really go much lower and equity valuations may not be very attractive. Also more traditional institutions are adopting the alternative investment route. We see, for example, that an institutional investor such as the Church of England, which by the way runs a portfolio of £9 billion, has no issue with investing significantly in CTAs.

Crisis Alpha and Innovation in the CTA Space: Will they bounce back in the next quarter?

CTAs say that one of the most important benefits they provide to investors is "crisis alpha". These funds should give their strongest returns in times of market distress, and especially equity distress which is typically when irrationality dominates. Equity distress signals change in the macro-economic, political or psychological climate and is strongly linked to trending markets. That is when CTAs or momentum-based strategies have historically performed the best, and there are good reasons why they will continue to do that the next time the market tanks.

In light of the bad years (2011, 2012, 2013), most CTAs have put a lot of research effort into risk management and portfolio composition. They were forced to, because things suddenly were not as easy as in previous years. But these steps, or shifts in quality or ability, happen regularly. *As soon as the CTA industry is pronounced dead, which happened a year and a half ago, something happens in terms of development.* Possibly the most major development now is the CTA's improved ability to control downside risk.

The interplay between convergent and divergent trading styles seems to be very cyclical. Currently, the markets have reached a new low in terms of lack of divergence and lack of trends. RPM's proprietary aggregate measure of general trendiness or momentum across major futures markets is at a record low, they have not seen such a low reading and such subdued price moves since the 90s.

Have banking regulations gone too far? Unintended consequences of regulations created new major market risks:

Here is something that is starting to trouble regulators globally. Some of the larger banks no longer offer OTC clearing to their clients, but will only do it for their books. In essence, all investment banks seem to follow the same strategy nowadays, which is to just pursue the top 20 or the top 40 most profitable clients, and are happy with that. Major investment banks are saying now that they neither can nor want to offer clearing services to for example smaller clients, and in some cases even larger clients, like pension plans or insurance companies, as their business are unattractive from a capital adjusted perspective. Unless the client can offer interesting ancillary business, the return is just too small. This is a problem for the general real money industry and for the hedge fund industry, but the banks don't necessarily care.

Consequently the problem goes back to the regulators. The banks are going to say, "We are now so constrained by the regulatory requirements that we have limited balance sheet to offer and can't take any more business." These themes are actually picking up now, and the regulators have started to worry about these items such as clearing, market liquidity and the potential impact for retail clients.

The 2015 Opalesque Nordic Roundtable took place end of October at RPM's Stockholm office with:

1. Mikael Stenbom, [RPM](#)
2. Erik Eidolf, [Nordkinn](#)
3. Thomas Stridsman, [Alfakraft](#)
4. David Rindegren, [Carnegie Asset Management](#)
5. Mikael Spangberg, [Nektar](#)
6. Stefan Nydahl, [IPM](#)
7. Renaud Huck, [Eurex](#)

The group also discussed:

- What can systematic managers learn from Google, Netflix, Amazon, Facebook, and others?
- How the “not-invented-here” syndrome within the quant shops hurts performance and investors
- How are machine-learning and data science shaping the quant space? Will a systematic trading shop be “dead” in ten years if they don’t adopt those technologies?
- How to overcapitalise a hedge fund startup to ensure sustainability
- What is the “game plan and tagging” that has been developed at the Central Bank of Norway?
- How to create an investment process that is NOT very sensitive to changes in the general market environment
- How can funds survive the ever more often occurring black swan events?
- What is more important for systematic strategies: risk management or entry/exit strategies?
- What alternative investment managers can learn from behavioral finance.
- More and more assets are being concentrated to fewer and fewer players. What is really behind this investor behaviour?
- Are investors’ investment decisions driven by rationality in the first place, or *something else*?
- What are the appropriate criteria for investors and trustees to make responsible investment decisions?
- New products from Eurex: Mini-DAX® futures, spot FX trading
- How and why Eurex invests in start-up firms focusing on FinTech

Enjoy!

Matthias Knab
Knab@Opalesque.com

Participant Profiles



(LEFT TO RIGHT)

Matthias Knab, Mikael Stenbom, Stefan Nydahl, David Rindgren,
Thomas Stridsman, Renaud Huck, Erik Eidolf, Mikael Spångberg.

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Introduction

Mikael Stenbom
RPM

I am the CEO and principal owner of RPM. We have been active since 1994, specializing in multi-manager CTA funds and risk management for CTAs, CTA investors and hedge funds.

We offer today five different CTA-oriented funds, mainly in the European Union, and we have numerous customized mandates for larger investors and distributors.

Thomas Stridsman
ALFA Commodity Fund

I am the fund manager of ALFA Commodity Fund at Alfakraft AB. ALFA is a strictly systematic short term trend following CTA fund. We have about five years of track record so far, with an annual return of around 7%. I have been in the industry since early to mid 1990s in various positions such as editor for magazines, and as a researcher for larger CTAs, such as Rotella Capital Management.

Renaud Huck
Deutsche Börse

I am Renaud Huck and am responsible for buy side relations at Deutsche Börse. I work mostly for Eurex Exchange, the derivatives exchange of Deutsche Börse. We are the largest European derivatives market, and we offer listed instruments in various asset classes to the trading community.

My role within the company is to promote buy side entities and to give buy side entities a voice within the company – whether they are a hedge fund asset managers, pension funds, sovereign wealth funds, central banks – and also to work with them to explore new avenues, whether in terms of services or in terms of products that the company list.

Previously, I held a similar role at a North American exchange, and before that I worked for about 15 years as an investment banker and trader in the fixed income and equity derivatives space.

Erik Eidolf
Nordkinn Asset Management

I am CEO of Nordkinn Asset Management. We run a fixed income macro hedge fund. We are seven partners split in half between our Stockholm and Oslo offices. The fund is relatively young, having launched in July 2013.

We are somewhat different in the sense that we own the company equally across the seven partners, which allows us to run the fund in a different way than most peers. Because of our ownership structure, we feel that we are really in the same boat with our investors.

Before Nordkinn, I was running the Stockholm branch of Harcourt, a Swiss fund of funds manager, now part of the Vontobel Group, for 11 years. I started in the industry in 1998.

Mikael Spångberg
Nektar Asset Management

I am deputy CEO of Nektar Asset Management, which is part of Brummer & Partners Group here in Stockholm. Nektar is a fixed income relative value/ macro fund that has been running since 1998; it was one of the first hedge funds in the Nordics.

I have been with Nektar for three years and a quarter, and prior to that I was on the banking side, primarily within SEB, for many years. I joined the market in 2000.

Stefan Nydahl
Informed Portfolio Management

I am the CEO of IPM, Informed Portfolio Management, here in Stockholm. IPM was started in 1998 with the ambition of serving institutional clients with their allocations and portfolio needs, and developing products to diversify their portfolios. We have developed into a fully fledged asset manager and run roughly 5\$ USD billion today; around \$3.6 billion in long-only equity strategies, and around \$1.4 billion in global macro strategies. All our strategies are systematic.

Before IPM, I was with Brummer & Partners for nine years, as the CEO and CIO of one of their fund management companies. Before that, I worked in the US for quite a few years, also running quantitative equity market neutral hedge funds. I started in the hedge fund business in 1998.

David Rindegren
Carnegie Asset Management

I work at Carnegie Asset Management, in Copenhagen, Denmark. I started out on the quantitative side in the US at a firm called Ned Davis Research Group when I was at university. Then I was at Brummer & Partners for five-and-a-half years, managing a long/short equity, global market neutral TMT fund. I then headed for the long side at Handelsbanken here in Stockholm, and managed concentrated long portfolios for three years as Chief Portfolio Manager of a group of four PMs, with €1.4 billion in AUM.

Now I am managing €70 million in a global long/short fund and I was hired a year-and-a-half ago to and to tweak the strategy, improve the risk management process, build on the short book and increase AUM.

70

percent of the world's surface is covered by water.



Eurex Exchange turns figures into opportunities. About 70 percent of all listed and centrally cleared euro interest rate derivatives are traded on Eurex Exchange, making us the home to the euro yield curve.

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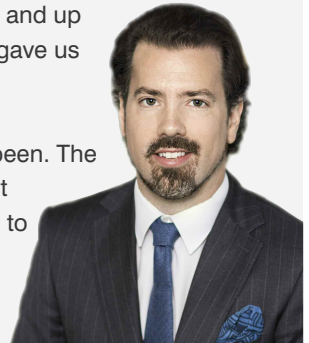
Eurex Exchange – the home to the euro yield curve.



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David Rindegren: I was managing a market neutral strategy back in 2008 and 2009; I was flat in 2008 and up 27% in 2009. 2009 was my second best year; but I always say that 2008 was my best year because it gave us the opportunity to profit in 2009.

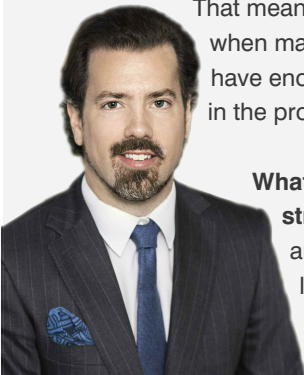
This year is probably my third best year, being up 8% year to date, given how volatile the market has been. The returns are partly due to the changes we are making in the fund that are starting to pay off as well. Last year we were up 16.5% and no one paid attention, and this year we are up 8% and people are starting to pay attention. So I would say that this year is one of the more interesting years, and being up 8% feels like a home run.



David Rindegren: I brought along some of the risk management techniques from Ned Davis Research Group into Carnegie Asset Management, which manages \$14 billion, 98% of which is long-only money.

That means we are a small hedge fund tucked into a group of long managers. What long managers tend to do when managing long/short strategies is to be positioned rather net long over longer periods of time, and not have enough of a focus on medium term risk management or on shorting stocks. So, since I have arrived, I am in the process of improving the fund in those areas.

What they really have succeeded at over time at Carnegie Asset Management is having a very strong alpha in their global long fund, 5% annually over 25 years. I am leveraging on their long skill and combining that with more active risk management. We have now had two strong years in the long/short fund and we managed through Q3 to be down only 50 basis points when the market was down 10%.



Stefan Nydahl: Yes, around 8%.

For us, 2015 has been an opportunity to prove that our **investment process is not very sensitive to changes in the general market environment**. Most of what we do is relative positions, so we do not depend on lower interest rates or such trends. It is a pretty robust process in that regard.

To some extent it has been good that these more volatile and erratic markets have arrived, because it is now even easier to show what we can do. What's also interesting is that we made money in most of our subcategories; in bonds, equities and in currencies. So far 2015 has been an interesting year, and if these markets are here to stay, it will become more interesting still.



Stefan Nydahl: As I said, we do not depend on any trends in the market, it is all relative.



Our investment process is basically based on two pillars. One is more generic, with value and risk premium signals.

The other is based on forward looking factors, an even purer form of alpha. We look at a broad set of macroeconomic indicators trying to predict potential market adjustments arising from macroeconomic shifts in local and global activity. That part of our strategy has performed well this year.

Mikael Spangberg: We are up around 4% so far this year. Given our mandate for uncorrelated return and market neutrality, this return is acceptable both from a standalone perspective and compared to our peers.

We have made money in various markets and asset classes. Domestic markets and particularly Sweden has been a pretty solid theme for us this year. We have also banked solid returns in Asian markets, e.g. from actively trading the Chinese currency.

Our portfolio is typically very diversified across many small more or less independent positions.

We categorize our trades into macro or RV (relative value) and so far this year macro trades have been profitable. The European fixed income market has been challenging but we have been able to make some returns. On the other hand, in the medium to long-term, we foresee very compelling opportunities in that market, but not so far this year.



Mikael Spangberg: Yes, many big, well-known macro names have struggled this year.

If you just look back a year or so, we have had several market events which may be defined as “black swans”. Perhaps we shouldn’t call them black swans anymore? We had the US Treasuries event in October 2014; the Swiss Franc float in January 2015; in April, we had extreme movements in the German Bund market; in August and September, China led an equity meltdown, etc.



What has helped us, compared to some of our peers, is that we have run a very balanced portfolio and spend a lot of time on portfolio construction.

One needs to be aware that we are in a new regime where events like the above mentioned can happen. Liquidity has dried up in many areas which causes volatility to change and markets to behave a lot differently, e.g. with correlation breakdowns.

We construct a lot of our trades with a defined downside profile, a less linear, convex type of risk, as we try to ensure that the real portfolio is truly diversified. Generally we like to be long event risk and long volatility, and that has paid off a bit more in 2015 compared to last year.

We also try to be more focused on being tactical, rather than betting on high conviction themes. One should be careful of running high conviction macro themes and bet with or against the market because in these times, a lot of things can change very fast.

Liquidity has changed to the worse, especially in some OTC markets, since the banking community is not as active as a financial risk intermediary as it used to be. Consequently the market can react very quickly amid thin liquidity, for example when the CTA community adjusts their positions. There are no middlemen left who could buffer such events.

Erik Eidolf: We are also up this year; plus 2% year-to-date. We are not necessarily pleased with 2%, yet the markets have indeed been quite challenging over the past year, with the black swans Mikael has mentioned, and so on.

At Nordkinn, five of the seven partners are part of the investment team. Out of those five, four are PMs/risk takers and one purely focuses on risks. We try to monetize on their individual edges by combining their skill-sets in a consensus environment. We run five sub-portfolios, with the main portfolio being our group consensus portfolio. What holds everything together is what we call the “game plan and tagging concept,” which was developed by two of our partners when they ran the FX reserves for the Central Bank of Norway prior to Nordkinn.

For every single position we take (a position can be combinations of trades), we have a clearly defined stop-loss as well as profit-target. As we apply that concept time and again, we have consistently shown a clear asymmetry in our profile of profits and losses. So it is not surprising that our track record, which is only 27-month long now, has had constant low correlation and high Sharpe-ratio. It is simply the result of our “game plan and tagging concept” approach. And the more it proves to work, the more convinced we get that this concept is optimal for us in our quest to generate stable risk-adjusted absolute returns to our investors.

During many of the black swan events, which Mikael talked about, such as the SNB Swiss Franc situation in February 2015, or the Flash Crash in US treasuries in October 2014, our game plan tagging concept supported us strongly. Since we adhere to strict stop-losses, we tend not to burn the house down when we are wrong. Instead, we have in such events been able to contain our P&L against the downside and then actively trade around the positions in our portfolio to gradually get back the upside. Benefits of strict stop-losses is very intuitive for all investors, however we believe that it is equally important to respect profit-targets and thereby not take profits too soon.



Matthias Knab

Renaud, how has Eurex, as an exchange, dealt with the recent market dynamics?

Renaud Huck: We have tried to grow our business. We took a look at our product range and identified what was missing and then at the market conditions, which allowed us to grow organically and consolidate our product range.

For example, on the fixed income side, our analysis allowed us to grow our Italian bond futures suite, as we realized there were some curve discrepancies between core Europe (Germany, France, etc.) versus the periphery of Europe,

such as Italy and Spain. In fact, as of 26 October, we introduced Euro-BONO-futures – Spanish 10-year bond futures – in order to offer the marketplace the possibility to do even more relative value trades between core Europe and periphery Europe. This is exactly what many relative value fixed income hedge funds try to capture, whether on the bond side, or on the listed derivative side, and this is where we saw an opportunity to bring something of interest to the marketplace.

Eurex is the exchange with the broadest offering of equity index derivatives globally. Over time, we have grown our suite of MSCI equity index futures. Now we have over 40 index futures, MSCI benchmarked, and around 20 options, and these products are growing steadily. Many investment firms who don't necessarily want to use the cash equity market to replicate or capture the performance of indices will also use listed derivatives like ours, provided they have reached the thresholds of liquidity which allows those firms to integrate them in their investment strategy. We have now reached that level for a few of the MSCI Blue Chip indices that we have listed at Eurex, which is very promising going forward.



We have also been launching a Mini-DAX® Futures contract, where we see demand, particularly from the CFD (contract for differences) oriented trading community. Many people are looking to get fractional performance from very small denominated equity index products, as we see in Asia with the KOSPI, and with similar instruments.

Matthias Knab

What will be the contract size of the Mini-DAX®?

Renaud Huck: The contract size is 5 euros. It is quite small because the existing DAX Futures contracts have a very high nominal value compared to other European indices or even to our own Blue Chip equity index, the EURO STOXX 50 Index Futures, which is much lower. The new denomination will allow people to trade the market with a different type of instrument.

I have highlighted these examples of organic growth for us but equally, as an exchange we observe how the marketplace is developing and historically have always been rather active in taking equity shares in other venues as well. We recently bought a spot FX trading platform called 360T, with the objective of integrating more spot FX trading within the value chain of the exchange.

People may say that we are a traditional financial exchange that is converting into a hybrid structure, where cash and listed derivatives are going to be listed together. We already have Eurex Repo, Eurex Bonds, and now we have a spot FX trading platform. This platform will also enable us to run in tandem the FX futures that we already list on the exchange, and now spot FX.

Technology is another important aspect of our developments. As an exchange, we are both a trading platform and a software developer, where we integrate new trading products and processes for the benefit of the trading community.

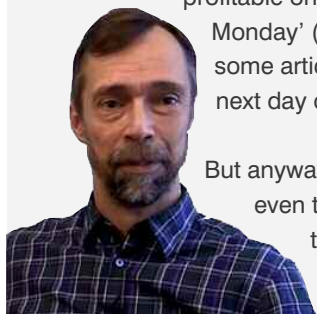


Matthias Knab

Thomas, how has the Alfa Commodity Fund done so far this year?

Thomas Stridsman: I am down about 3% at this point, but still very proud of it. To explain that, I need to take a longer perspective view of things.

I am a trend following CTA, and there really haven't been many trends this year. Of course, there have been a couple of really profitable ones, like the downtrend we had in oil and energy a couple of months ago, or what happened on 'Black Monday' (24th August 2015). I was extremely well-positioned then and made 9%; there was a big hoopla, and some articles were written about me, which I think is silly because I know that I am going to give it back the next day or the coming days. For that reason, I am actually more proud of the 4% return for that week.



But anyway, I am happy with having returned 7% annually, as that outperforms most of my competitors and even the larger players in this segment. And also, 3% down at this point of the year is still within breakeven territory; within one month or two, we could still turn it into a good year.

Matthias Knab

Mikael, how have you done at RPM?

Mikael Stenbom: We are mostly up a little bit, in the majority of our funds.

I ran into two Swedish traders one day, late January this year. One was a long/short equity trader and the other one was a CTA. The long/short equity trader was depressed. He said it was impossible to make money in these markets, because they just kept on going without any fundamental reasons. The CTA trader, on the other hand, was happy. He said that these were the best markets he had seen since 2008. Now, at this point in the year, I think these perspectives have been interchanged. The long/short equity trader – or the convergence trader – may have reasons to be quite happy, if he is skillful. While the CTA trader may find the world quite difficult.

So we have seen a shift over the year, from divergent markets, where markets just keep on going, into more directionless markets, where convergent strategies have a better chance to profit.

However, at RPM we are not traders ourselves; we review and allocate money to CTAs. So we try to have a different perspective.

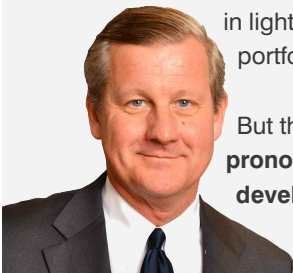
Most CTAs are down on the year. One of the major Swedish ones is down close to 10%. That is probably true for most larger CTAs and trend following CTAs in the world. But there are some exceptions. You can also occasionally find short-term traders that have enjoyed exceptional performance. We have one of them in our funds: QIM is up 30% this year.

The interplay between convergent and divergent trading styles seems to be very cyclical. Given our perspective, we try to measure the degree of general divergence in the marketplace, and see to what extent the financial and commodity markets in general are suitable for convergent or divergent trading styles. Currently, we can see that we have reached a new low in terms of lack of divergence, lack of trends, in financial markets. We have in fact not seen such a low reading, such subdued price moves since the 90s. Given those circumstances, I think it is amazing that CTAs are not down even more. Being down about 3%, as Thomas is, is excellent in this environment.

So what will happen next? Will this continue, as it did for a couple of years in 2011, 2012 and 2013, interrupted by some brief periods of divergence? Or have we moved back into a more cyclicity in the marketplace? I believe that we are probably close to a shift. I say that, not based on any macroeconomic analysis, but simply on the basis of how markets have behaved in the past. We have developed an aggregate measure of general trendiness or momentum across major futures markets. It shows a daily correlation of .76 to the Newedge CTA Index – which is somewhat fascinating. Today's reading is quite low, which historically has signaled good returns over the next quarter or so.



What you said about convergent and divergent cycles is very interesting, Mikael. You also said that it is a wonder that most CTAs are keeping up relatively well. Why do you think that is? You have been working with CTAs since 1993, so what innovative steps have you witnessed?



Mikael Stenbom: There have been many steps taken by the CTAs over the years. In general terms, most CTAs, in light of the bad years (2011, 2012, 2013), have put a lot of research effort into risk management and portfolio composition. They were forced to, because things suddenly were not as easy as in previous years.

But these steps, or shifts in quality or ability, happen regularly. **As soon as the CTA industry is pronounced dead, which happened a year and a half ago, something happens in terms of development.** I think the most major development now is CTAs' ability to control downside risk.

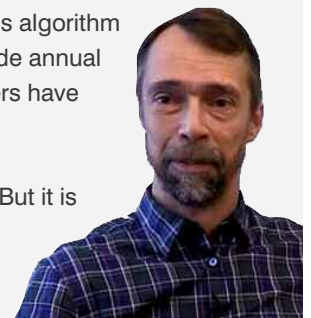
Thomas Stridsman: I have to agree with Mikael. And let me tell you a story of how I went about it a few years ago. I took a break from my usual markets research of analyzing strategies directly in the market, and I started to actually research the disclosure documents and the performance profiles of the players that were around back in those years, 2005 and 2006.

What I found was that many CTAs had a good performance during the entire 1990s, but at the turn of the millennium, performance of many went down to a much slower pace, with much higher volatility. But a few of them in 2005, Transtrend in the Netherlands for example, and also Eckhardt in America and a few others, had a sustained performance through the 90s and into the 2000s.

So I started to research these guys and their performance, I read their disclosure documents back and forth, trying to figure out what they were doing. I put my research against various regression analysis and tried to find connections between macro variables and their performance.

Eventually, I think I made a discovery and based my risk management and money management on this algorithm that I put together based on the research. That algorithm has saved me during these years. I have made annual returns of 7%, and I am ahead of most larger quant manager, because my risk management parameters have saved me.

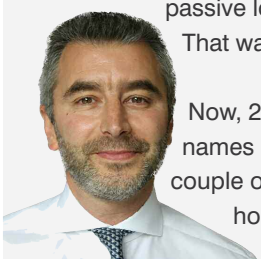
My strategies for entry and exit are as simple as they can be. Anybody can pick them up in any book. But it is the risk management that has been the key for me. So I think you are 100% right there, Mikael.



Renaud Huck: CTA funds have suffered over the past five years. They actually had a pretty amazing performance after Lehman, which in fact comforted the investment community from an institutional investor standpoint. They thought the processes that the CTA industry had been implementing for the past 15, 20 years were going in the right direction. Their returns validated what they had been preaching in the desert for many years, when a lot of investors were purely looking at passive long-only funds and not looking closely enough at what the CTA community was bringing to the table.

That was a credit to the work that the CTA industry has accomplished globally.

Now, 2015 turned out to be another very difficult year for the CTA and the hedge fund industry. A lot of the big names have closed some of their funds or some of the asset class strategies that they had started in the past couple of years, on the commodity or the cash equity side. It is not necessarily good news when you have household names closing down funds and giving back money to their investors.



But nevertheless, when you look at the AUM figures in the industry, you see it is still growing. So there might have been some redemptions and fund closures, but the global AUM of the hedge fund industry is close to a historical peak.

This means that if you look at it from an investor perspective, you say to yourself, “What horse shall I bet on? Shall I go for a traditional asset manager, for the traditional buy-and-hold on the bond or on the equity side? Shall I explore the alternative investment industry, i.e. things like CTAs, global macro?”

We look at it from an exchange perspective; we see the profiles of the different users of our instruments, and consequently get an education from those actors in financial markets who are progressively adopting new investment instruments, and new investment strategies such as hedge funds. What we can observe is that a **number of traditional institutions are now adopting the alternative investment route**, which for me is a good indicator.

We see, for example, that an institutional investor such as the **Church of England** – which by the way runs a portfolio of £9 billion, so we are talking of a decent player in investment space – has no issue with investing significantly in CTAs. This means that they have made their own due diligence, they have gone through their own education on this hedge fund segment in order to understand what value it brings to an investor.

There is a natural progression of investors using different types of investments and becoming better educated. So hopefully, in spite of a difficult year and the recent difficult years, this trend will continue.

Mikael Stenbom: You made an interesting comment, Renaud, about the assets in the alternative investment industries being close to new highs, while we constantly read about players or managers closing down their funds.

This is a very disturbing trend, and possibly quite distressing for the alternative investment industry as a whole, because **what really happens is that more and more assets are being concentrated to fewer and fewer players**. This means that the diversity and the barriers of entry for new managers are becoming higher and more adverse.

This lack of diversity means increased risk for the alternative investment industry as a whole. And unfortunately we also see this trend in other industries as well, where the number of significant players is being reduced, such as in the banking industry, the telecom industry, the pharmaceutical industry.

In our industry, this is partly driven by regulation, but it is also, to a larger extent perhaps, driven by investor behavior. Personally, I am distressed to conclude that investment decisions on the part of some of the larger investors are heavily influenced by political considerations, and not based on rationality, that is: *“who will have the largest probability of achieving a decent risk adjusted rate of returns?” I fear that instead an increasing number of institutional investors look around their shoulder and say, “What are my peers doing? They are investing in Winton, or they are investing in some other well-known hedge funds, so let’s do the same, because then it seems too risky go with Nordkinn or with Alfakraft.”*



Erik Eidolf: Very interesting comment, Mikael. I agree, but I also disagree on the regulation point.



When you look at it from the Nordic perspective, I believe that the regulatory aspect of the Nordics has always been very good. If we go back to Brummer & Partners' decision to establish their first hedge fund in 1996 onshore, it had tremendous effect on the local industry as all other hedge funds being launched in Sweden thereafter followed their suit and became onshore as well.

At Nordkinn, we respect the challenge to get investor's confidence, which pushed us to always consider the investor perspective and put ourselves in the shoes of our investors. Therefore, we deliberately decided to be onshore in Sweden because we believe that the Swedish FSA (Financial Supervisory Authority) is not only very strict, but also very experienced having regulated hedge funds since 1996. Their hard requirements on us as a fund company falls in line with our institutional ambitions and most importantly these hard requirements are defined with the quest to protect investors, which we appreciate.

If you compare it to other regulators, such as the Norwegian FSA, the Finnish FSA or the Danish FSA, we didn't think they had the same level of experience like the Swedish FSA. So, with the EU's AIFM Directive coming into play in 2014, we decided to work under the Swedish FSA supervision, and then of course also gain the benefits of the harmonization AIFMD provides across Europe.

So the good thing about regulation is that it increases the requirements on hedge funds, but I agree with Mikael about the pitfall related to the number of new funds being launched locally has been limited. The strict local regulation prohibits launching smaller funds, which over time poses risks for the industry as a whole since the barriers to entry are so high.

Renaud Huck: Just to add to what Mikael said, it is true that currently most of the new money is being invested or concentrated in a limited number of funds, let's say, the top 20 global funds. This means that the second-tier and third-tier asset managers only have 15%-20% of what remains to share among themselves. This also means that if you are a hedge fund start-up, it is going to be quite challenging to raise funds; so that is one element of the situation.

The other aspect relates to the concentration of risk. If you look at the banking sector, you also come to the conclusion that there are less and less banking entities that are strong enough to take on a lot of business. We have observed, from a Clearing House's perspective with the upcoming EMIR Regulation on OTC clearing that the number of global clearers who are willing to undertake clearing are becoming fewer and fewer. **Many of the big names have said they will no longer offer OTC clearing to their clients, but will only do it for their books** and so consequently clients will have to look for Global Clearing Members (GCM) who will be willing to do OTC clearing.

The industry doesn't actually want such a high concentration of risk on the clearing side held only within a limited number of hands. Equally, buy-side clients do not want to face the same entities on the banking side all the time because they will all end up running the same or similar counter-party risks with the same names. Eurex Clearing, our associated Clearing House, will also have a concentration of volume within a limited number of names.

It is, sadly, an unintended consequence of the regulation. The regulators may not have foreseen that potentially some banking entities would decide to discontinue OTC clearing. They assumed that everybody would adopt OTC clearing and would offer it to their buy-side clients. One of the first elements where this became visible was around the reporting requirements - the banks decided to no longer offer reporting to the buy-side clients, and this was a clear indicator that on the OTC IRS clearing side there would only be a few candidates in that space.

Global banks have reached their capacity limits. They are saying, "we have oversold our balance sheet, we can't take any more clients onboard." What does this mean? It means that in the context of a regulation like EMIR, the regulators are saying to the buy-side industry that, going forward, they will not be in a position to have their OTC IRS trades on the balance sheets of the banks, but they will have to post them to a clearing house. At the same time, the sell-side, the banks, are saying they can't take anymore of those trades on their balance sheet.

As a consequence, a **lot of the second-tier, third-tier, smaller buy-side entities, whether they be smaller asset management firms, smaller hedge funds, smaller pension funds, will have to exit the OTC space forever and use listed derivatives going forward.** Imagine a small Swedish pension fund doing one swap on a weekly or bi-monthly basis. It is not going to be possible for any of the banks to have those kind of trades on their balance sheet, as it will not prove profitable enough for them.



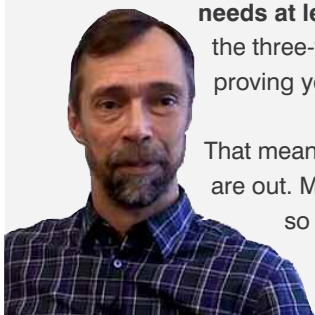
When we made this analysis across Europe, we realized that there was going to be a need for proxy fixed income OTC listed products, such as swap futures, repo futures and so we launched those products. For the time being, they haven't grown tremendously, since the mandate for OTC clearing has not been kicked off by ESMA, the European regulators. However, we are convinced that going forward, during 2016, this process is going to accelerate, as those smaller buy-side entities will have to find a place to warehouse and post their OTC trades. **In the future, there will be more futures-type instruments than OTC instruments**, and this is where we see some of the growth coming from the fixed income space on a Pan-European basis.

If we look at another asset class, like the equity space, we know that for equity total return swaps, the regulators will come to the same conclusion as they did with OTC IRS, which is *how do you circumvent the counterparty risk between two bilateral trades?* It is by posting the trade on an exchange, on a clearing house. With this in mind, **equity total return swaps** will most likely follow the same path as OTC IRS products. They will be posted, and there will be a post-trade clearing process through a clearing house. This is also going to change fundamentally the rules of engagement within the industry. OTC is going to be more commoditized, and is going to be more on exchange.

Thomas Stridsman: Erik and I are in the same boat in that we are fairly new in the market and also still relatively small, with not too much money under management. For a new company trying to make an inroad in this industry, the avalanche of new rulings, compliance requirements and regulations coming at you all the time, has made it incredibly expensive. Therefore, relatively speaking the overhead costs also are much larger for a firm like me or Nordkinn than for a bigger player. The costs are basically eating up all the money my company is making at the moment from fees, and so on.

New players need to have very strong backers, or a lot of money behind them when they start their business, to invest in their actual business, not in the strategies, just to survive a couple of years and to cover the regulation costs.

Another consequence of all this is an investor who would like to invest in your fund will now hold back and wait – **he needs at least to see a track record of five to six years these days. It used to be three years:** if you passed the three-year threshold, you were one of the guys. But not anymore. You need at least five to six years of proving your worth and staying power, before most investors will even start to consider you.



That means you will remain a small player for much longer time, and if you don't have the staying power, you are out. Meanwhile, money will find its way to the biggest managers, the likes of Lynx, Winton, Transtrend and so on. It is very hard these days, because of the avalanche of regulation and investor behavior, to even get a business up and running.

Erik Eidolf: I agree with Thomas. We had to meet the challenges of the huge regulatory costs just to get our onshore structure in place.

Swedish onshore funds are not allowed to charge any other fees than the management and the performance fees, so all other costs have to be paid by the company. Further, we run a master-feeder structure. This combined, is something we at Nordkinn find hugely attractive: our investors can see our gross performance vs. net performance and they thereby get full insights regarding the cost structure. It is only fair that the fund company uses the management and performance fees to pay for audit, administration, marketing costs etc.

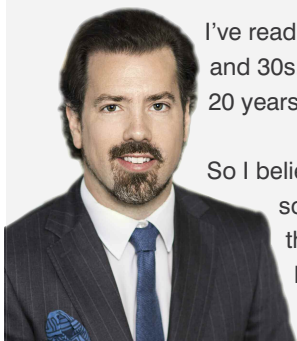
When we started in July 2013, seven institutions entrusted us with their assets and today we have 32 institutions. Expressed in assets we have grown from \$50 million to roughly \$470 million over the past 27 months. We believe that having breathing room to build Nordkinn properly has been an important factor to get these investors' confidence in us.



When we started the business, we sold-off a portion of the fund company to five hedge fund industry veterans to intentionally overcapitalize our fund company. This secures the financial longevity to continue to build our firm brick-by-brick without panic. At launch, this also enabled us to finance the relatively large cost for the onshore structure, which is critical given that these set-up costs may not be charged and amortized to the fund.

David Rindgren: I happen to also be running one of the smaller funds here, with €70 million, but the fund is also in the decent position of being embedded within a larger fund house that has €14 billion in AUM. There are a couple of lawyers available for me, for example, as we are hundred people strong, so I am in a way insulated from the regulatory side of the business.

With regards to the AUM being concentrated in some of the biggest funds, my view is that most of these things are also cyclical, so also here we are looking at a long-term trend that will turn the other way at some point. There may be some big funds closing down and that money has to go somewhere. And there are investors looking for smaller managers. That said, the break-even point has probably gone up in the last couple of years. But cyclicity also probably applies to regulations; if we over-regulate this industry, that could also bounce back at some point.



I've read that in the 50s, there was a shortage of stockbrokers because they all got wiped out in the late 20s and 30s. So who knows. If there is an over-supply of stockbrokers today, we might be under-supplied in 10 or 20 years' time.

So I believe that this **longer-term cyclicity** applies to everything, including regulation, and that cycle could at some future point save the smaller, more entrepreneurial funds. The problem is one has to survive up to the point when regulation eases. But with regulations, it always feels like it is darkest before that happens.

Mikael Spangberg: I agree that barriers to entry have definitely gone up significantly, partly due to regulation applicable to the investment manager, but also due to regulation of the banking industry. For example, Renaud said that the banks are not strong enough. I would rather say that the banks are not willing to bank or finance some clients. Because of regulation, they have a limited balance sheet. **All investment banks seem to follow the same strategy nowadays, which is to pursue the top 20 or the top 40 most profitable clients.** This behavior is quite expected.

At Nektar, we have around 25 banking relationships globally, we trade globally, we clear globally and we are a pretty sizeable shop. We see this game being played by all banks. It is sad for the industry as a whole because, as Mikael said, there are fewer and fewer players and more concentration on the larger investment managers.

On the topic of banking regulation, perhaps a lot of people would agree that it has gone too far. Whatever your view is on this, it is definitely affecting markets and people's ability to engage in markets.

I know, from speaking to major investment banks that they neither can nor want to offer clearing services to for example smaller clients. In some cases even larger clients, like pension plans or insurance companies, as their business are unattractive from a capital adjusted perspective. Unless the client can offer interesting ancillary business, the return is just too small.

Some of the investment banks are not offering any more mandates to certain clients, because they already have the most profitable ones and are happy with that. That is a problem for the general real money industry and for the hedge fund industry, but the banks don't necessarily care.



Consequently the problem goes back to the regulators. The banks are going to say: *“we are now so constrained by the regulatory requirements that we have limited balance sheet to offer and can’t take any more business.”* And that is what the regulator is now concerned about. These themes are actually picking up now. The financial industry has changed and is changing in so many different ways that the regulators are now worried about several items such as clearing, market liquidity and the potential impact for retail clients.

Mikael Stenbom: I hear David's point about cyclicalities, but, to be honest, I am very pessimistic about these developments. I don't think there is much one can do.

I was a management consultant running a strategy consultancy firm in my previous life, and in order to do that I had to re-read a lot of the books written by popular management consultants. One that really stands out is Peter Drucker, an Austrian-born American management consultant, who was active until he passed away in 2005, age 94. One of the last pictures of him was with the management board of General Electric, sitting in his very modest home in California, on the floor, in his living room, listening to this man and asking questions.

So Drucker said that it is really a fallacy to believe that corporations make independent decisions solely based on analysis and rationality, because it is far too complicated. Instead, **corporate leaders make decisions based upon what their peers are doing.** What Drucker really said is that this is in our nature; any of the big management trends like outsourcing, in-sourcing, M&A, etc. - these are all trends that are ***not necessarily*** driven by rationality.

I think the same goes for the investment industry; trends are born and solidified by group behavior. Maybe David is right that at some point the cyclicalities will return and regulation will become more efficient. Or maybe there will be a trend when investors will say, *“No, we can’t invest with the big ones now, because the bell cow investors are now focusing on the smaller or the newer guys.”* Maybe that will happen.

But if one were to give any advice to investors, it would be the same advice that we always give: *Look at what your responsibilities are, who owns the capital, the pension fund? Who are the pensioners? And what is my task as an investor on their behalf?* The task is to maximize their risk-adjusted rate of returns, or something similar. That should be the focus, and nothing else. And then you should work hard, do your analysis, and do whatever is necessary in order to fulfill your task. That rational approach should hold for any business or any activity.



But I suspect that today too many, unfortunately, are considering lots of other factors when making their decisions on who to invest with; political risk being one; the media risk being another one; career risk being a third one, etc. This has always been the case through history, to a greater or lesser extent. I think this is cyclical. What is new now is that people are relatively open about it. If you have made a decision based on other reasons than maximizing the benefits of your investors, you would have kept quiet about it and felt bad about it.

Stefan Nydahl: As Mikael pointed out, the task for us as managers, as well as for investors, is to maximizing the risk-adjusted returns for the whole portfolio. We, as alternative asset managers, have a great opportunity to show the advantage of alternative investments in today's environment, where rates can't really go much lower and equity valuations may not be very attractive.

That is also where the herding behavior poses a risk. Investors should really look for the investment managers that can diversify their portfolio. Investors will probably suffer if they just follow the herd, especially in this environment.



Mikael Spangberg: I represent a large fund in this group, but I agree with Mikael and Stefan. Investors are more constrained for a number of reasons; just think how a life insurance company will be constrained by Solvency II. If I would be working for a smaller fund, I would focus on raising money from investors that are as unconstrained as possible.

The whole idea behind the hedge fund industry is to be unconstrained so that you can go long or short and act beyond benchmarks etc. One should also apply that thinking to asset raising. Several of these large institutions that have big pockets of money are unfortunately also very constrained. In the last few years, they have for example been depending on operational due diligence consultants which have extensive requirements on the investment managers. Hence for a start-up firm, it might sometimes be impossible to comply with all their so-called best practice requirements.



If I were working with a smaller firm, I would not spend too much time on those investors. I would instead focus on investors that are still unconstrained and can take more or less rational decisions. In Sweden, for example, we have a great segment, namely corporate pension funds, which are relatively unconstrained, especially from a regulatory perspective, but perhaps also from a “career risk” perspective.

Stefan Nydahl: I would like to add one thing about the regulatory environment here in Sweden – which as David pointed out was created partly thanks to Brummer & Partners. We have an FSA that actually knows hedge funds and has provided an environment where retail investors, for instance, have been able to access hedge fund returns at a really early stage.

Now, in the US we have the ‘40 Act funds, and in Europe we have the UCITS. Thanks to those regulatory changes there are also new opportunities for managers to reach out to a segment that previously couldn’t invest in hedge funds at all. This is actually a good thing that came out of regulations.

We launched a UCITS fund in August for which we have already raised around \$130 million. So we have been following that market quite closely. **UCITS absolute return funds have grown by around 47% since 2009, while the offshore fund market has grown by 5%.** That is a fundamental change in the industry.

Regulations have put more structure around hedge funds, so they are not as scary as they used to be perceived in the past, and regulators feel it is acceptable for someone in a private pension or individual portfolio to access that kind of diversification.



Matthias Knab

Stefan, you mentioned before that your investment models are not just about trend following, but also include some predictive work. What technology are you using, and how do you do the prediction?

The reason I ask is that I often have a discussion where the trend followers say they don’t predict the markets, they only go with the trend.

Stefan Nydahl: We are systematic, but what we do is fundamentally based. It is very transparent in that sense.



We follow roughly 50 underlying indicators, and some of those are more predictive by nature, like macro-economic factors for instance. What is quite unique, from a systematic manager point of view, is that we try to model everything on the basis of an underlying economic idea.

To predict currencies, for instance, we look at macroeconomic indicators such as terms of trade. We always try to put a relationship in place ex ante. We don’t let loose a machine learning algorithm and just let it find the best fit.

Everything should and is in fact based on an underlying economic fundamental idea.

Also within our investment research process, when our research team is looking into a new idea, they have to first and foremost formulate the idea; “what am I expecting, what is the underlying economic argument for it?” And then they can start to test the idea and see if they are right. This is a robust approach. We also have a category of indicators to cover what we call market dynamics, which is more about looking at how we think markets are functioning. For example, how capital flows will affect an exchange rate.

We certainly have, and make heavy use of, statistical and mathematical expertise at IPM. However what I really like, and what I am proud of, is that everything is fundamentally based.

Finally, we have no explicit momentum factors at play at all. We don't look at the price trends and all we do is relatively based, i.e. we invest in one market versus another.

Matthias Knab

We are actually talking here about innovation. We already covered innovation when we spoke about risk management and how the CTAs have changed and improved. What examples of innovation have you experienced in terms of products, methodologies and strategies?

Thomas Stridsman: This is something I have been thinking about a lot lately. For those of us who are building mechanical strategies or systematic algorithms, the industry is in a way moving more and more towards how the IT industry functions.

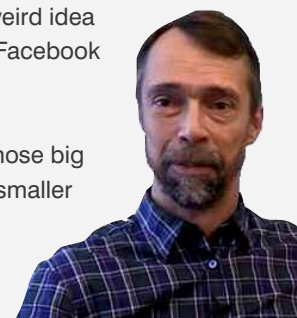
Google uses various machine learning algorithms to calculate page hits, Amazon is using state-of-the-art neural networks and machine learning techniques to suggest your next purchase, or what other people like you have just bought. Netflix can have you rank or review a movie without actually seeing that movie, because they can calculate it from who you are, relative to what other people like you around the world are watching.

Our industry is moving towards using of those same tools, called machine learning or data science – those are the buzzwords today. So I am trying to do exactly the same as what the Google engineers are doing. I am looking into the exact same platforms, the same Python or programming codes, and techniques to build machine learning trading algorithms. **With the same tools as Google and Amazon, I aim to solve a different problem.**

But contrary to what IT firms like Google, Facebook, Amazon etc. are doing by acquiring small start up companies and integrating their products and models into their own business, the big players in our industry seem to be rather afraid of taking on smaller companies. I haven't seen a lot of those deals where a larger CTA or quant shop has bought up a smaller shop and integrated them into their business. I believe what's behind this is a huge “**not invented here**” problem in our industry. If I am allowed to speculate, I could possibly present the best idea in the world to Winton and the likes, but they are not going to go with it because it was not invented there.

While in the IT industry, Google is not afraid of paying big bucks for a bunch of engineers with some weird idea that you actually don't know where it is going to go, and integrate them in the business. Amazon and Facebook are just the same.

If our industry is moving towards concentrating the asset under management with a few big players, those big players also need to start to rethink how they are running their business. They should start buying up smaller companies, possibly like mine, or like maybe Erik's.



David, you are maybe already in a situation like that; you are a smaller shop within a much larger one, but we need to see more of that. It is the responsibility of the larger players. In order to generate better returns, steady returns, they need to not be so afraid of the “not invented here” syndrome, and they need to understand that this is not such a unique industry anymore. We are doing exactly the same thing as Google or Amazon, we just apply it to a different problem. I do hope that is something we will see more of. In essence, the large management firms themselves need to start doing what some fund-of-funds are trying to do today when they pool together smaller, innovative managers.

Renaud Huck: In the field of innovation, there is a lot to be done. As an exchange, we came to a similar conclusion by observing the industry: we have to step up to the plate and look at what can be done on a broad basis, in the industry and for the industry.

Here at Eurex, we have set up an innovation department, which is mainly involved in FinTech. It is a bit like a private equity structure, where as a company we invest in small startups in the FinTech industry, mainly around trading technology, financial software, where we think that going forward there is the possibility that it could be integrated at our exchange.

We invest in the future of those small entities but we do not only act as a private equity manager, we also do matchmaking. We are part of a London-based broad industry structure which is called Level39, which is Europe's largest technology accelerator for finance, FinTech, retail, cyber-security and future cities technology companies. As a seeder, we sometimes also give advice to small entities towards other entities which are potentially in the same field that are working on something similar, and where together they could breakthrough with better chances.

Many of the banks, for example in London's Canary Wharf, have such innovation/seeding structures that help small entities to grow, and startups to come up with and develop ideas. And also there we help them, and point them in the right direction where they will find the right partners.

Sometimes, some of the applications are very interesting for what we do, and sometimes they are interesting for us as an investor, even though they would not help our business. So we either act as an investor, or as a business which in the future might integrate some of those applications.



There is quite a lot happening in this area. Happily, a lot of young startups are coming up with very innovative ideas, which is very refreshing to see. Although sometimes it may require a lot of capital to come up with a good idea, the ingenuity of the human brain makes the difference, and a very good idea will break through.

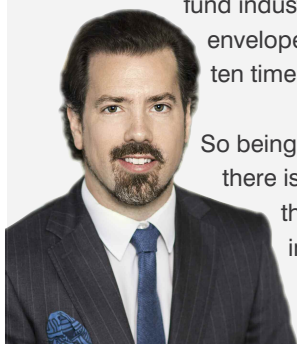
Mikael Stenbom: There is an increasing, though not dominant, trend among CTAs and other alternative investment managers who are inspired by **behavioral finance**. They are trying to pick up ideas that might profit from concepts like herding and confirmation bias, etc., which I find very interesting.

What we also see are managers that are looking into endogeneity within the larger fund houses. We are all brought up with the idea that the market out there is an entity that is exogenous from any single individual or any single firm. However, anecdotal evidence and some hard evidence suggests that what very large managers devote most of their research effort into is how to minimize the impact they make in the markets and avoid feedback loops that will impact your own systems if you are a systematic trader.

Smaller and emerging managers are of course realizing this and it is perhaps a way for them to outperform the larger managers, by creating technologies and methods that detect and profit from the larger managers' endogeneity and market impact.



David Rindregen: I am going to take a very local perspective on this. I am a Swede working out of Copenhagen, and if I look at the hedge fund market in the two countries, Denmark and Sweden, I say they are very different. The last numbers I saw on hedge fund industry assets was \$42 billion in Sweden and \$3 billion in Denmark. Our own assets are partly Swedish and partly Danish, but the big opportunity is certainly outside those countries. However, given the small size of the Danish hedge fund industry's AUM, it can certainly grow three or four times. And the Swedish economy, this is a back of an envelope calculation, is not even twice as big as the Danish one, yet Swedish hedge funds' AUM are more than ten times the Danish size.



So being part of a market that is ten years behind the Swedish market, at least on the long/short equity side, there is certainly a growth opportunity for me. There are a lot of great managers in Copenhagen, especially on the fixed income side, but there aren't that many long/short funds there yet. And the Danish retail investors aren't as used to hedge funds as the Swedish ones are, given that they have had Bummer & Partners in Stockholm since 1996.

Erik Eidolf: In Sweden, there is a saying that the shoemaker should continue to make shoes. That is a very important principle at Nordkinn; the idea is that every partner at Nordkinn should do what he has been doing over the past 15-20 years and everything we do is built bottom-up using the seven partners as building blocks. That is how we ended up in the fixed income macro space and how we ended up with the "game plan and tagging concept."

That is our strength. We simply remain true to what we are. Within that, we are innovative to a degree, but at the same time avoid doing things we haven't done before. That said, we welcome new products in markets where we are specialized. We have been pushing, for instance, Norges Bank (the central bank of Norway) for NOBA-futures (i.e. futures based on Norges Bank policy rate). In Sweden we are actively trading RIBA-futures (i.e. futures based on Riksbanken policy rate) and our PMs were very early to trade these when they came to the market. Yet, the overarching idea is that our PMs should do what they have always been doing, which is an important element to gain investor confidence. The best feedback we can get from investors is when they say that Nordkinn seems to be very well thought through. If they get that impression, then they hopefully also understand us.

So when it comes to attracting investors, we strive to be very pedagogical and explaining how we do things. Therefore, we believe that being transparent is actually in our interest.



Mikael Spangberg: Erik, I agree with your strategy. We apply the same at Nektar. We have been managing money since 1998 and during these 17 years, we have only created one product alongside the Nektar fund. That was the Nektar Special Opportunity Fund, which was launched after the financial crisis and capitalized successfully on extreme dislocations for two years. Then we closed it and returned the money to investors. Our efforts are totally dedicated to running the Nektar fund, not launching any new product.



We don't want to be diluted and launch new products and try to please everyone. We stick to the core. Over the years, of course, you have to adapt to new markets, new volatility regimes, recruit new PMs or quants and you have to apply new methods and grow organically. But sticking to your core is the basis. The foundation of Nektar lies with our culture and investment philosophy which has been unchanged since the beginning.

Stefan Nydahl: It is really important to stay true to your core. That is why investors put their trust in you in the first place. If it is not broken, don't fix it.

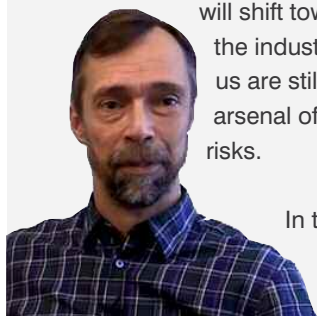
In IPM's case, it is about keep on doing what we have done for quite a few years now, generating an average return of 10% with slightly higher volatility. What we have done is launching new vehicles but with the same strategy. Our core strategy is still the same. But we now provide the new vehicles to the types of investors that might be too constrained to invest with us otherwise.

UCITs is a typical example. In some countries in Europe now many institutional investors will not invest with you if you are not providing a UCITS format. As you grow your business, you accept that there are some constraints out there, and create different types of vehicles to facilitate the interested investor.



Thomas Stridsman: In terms of strategy, I will definitely stick to what I am doing, which is systematic trend following over certain timeframes, which are rather short-term. That said, **the systematic mechanical part of the industry, of which I am a part of, will move more and more towards machine learning-type tools and data science**, as I already mentioned.

So I will not deviate from my strategy as a base. But the way of doing research, and eventually implementing my strategies, will shift towards machine learning-type tools. I think we will be forced to go there, at least within my segment of the industry. If we continue to do things the old school way, as we were taught in the 90s or 80s – and many of us are still doing it – we will be run over by the new guys, the young guys who will come with a totally new arsenal of tools, and who will simply start to produce better returns, steadier returns – higher reward at lower risks.



In terms of the technology that the industry is using, we are in a big shift at the moment. Over the next ten years or so, if you have not moved with the shift, you are basically out.

Matthias Knab

That is a strong prediction. Do you have any further comments regarding the technology shift? Do you see it as a threat, is it something that you are monitoring, or do you see it already happening in the market?

Renaud Huck: As an exchange, we understand electronic trading and the sophisticated trading possibilities with HFT (high frequency trading). We invest massively in co-location in order to offer the closest proximity of routers to the matching engine of the exchange, if that is the type of strategy that the portfolio manager will entertain, with the appropriate electronic trading tools. We monitor everything in order to avoid trading pollution and abnormal levels of trade-per-second messaging to ensure that there is a level playing field for everyone.

There is a place for everybody who wants to express their views, whether you want to go fully automated, or whether you want to remain a click-trader.

The most important point is what you want to do with the technology that you have and what view you want to express. Some prefer to be very short term, consume a lot of market data and send multiple messaging to the exchange within the same second whereas some prefer to be a more medium to long-term view-taker and express different views.



Stefan Nydahl: With regards to Thomas' comment about machine learning tools, I think it is very interesting. It is something that we have seen recently in the high frequency trading space in the sense that it has become an arms race, where it is all about getting close to the exchange, programming on the actual chip, etc. That can definitely affect short-term prices.

However, if you look at the example of Google, Amazon, etc., over the last couple of years, it has been my personal observation that I have been getting the same type of ads from both vendors. This means they are all using similar algorithms. What kind of impact will that have on the market? There may also be another arms race about who has the sharper algorithm, who becomes slightly faster and gets there in time.

As a fundamentally-based manager, I am not too concerned about that. That is fine if you get more efficient pricing in the short run, and it will not be so relevant for the longer-term positions where we try to benefit from a slightly longer horizon than most of the other investors. We have an average holding period of 9 to 12 months.



We certainly have the statistical knowledge and the computer power to do many of these algorithms, and they are good tools to have. But I think it really depends on what space you are in. I still believe that fundamental will prevail over the long run, as an investment approach.

Thomas Stridsman: I agree with you, Stefan. Fundamental trading or investing will prevail and high-frequency trading is not the only way to go if you are doing systematic trading. I still think that systematic trading can work over any timeframe, but if you have, as I have, decided to be a systematic trader, you need to start using machine learning tools. Otherwise you are dead.

It doesn't matter what timeframe you are focusing on, what you think your expertise is, or what you want to be. If you will not take the machine learning route, young guys coming directly from the university will come and kick your butt in a couple of years.



Stefan Nydahl: Maybe it is a matter of approach rather than time horizons.

We are a systematic manager, and we are fundamentally based. I have been in this industry long enough to see a few of these trends before. In the mid-90s, when I started looking at quant strategies as a PhD student, it was already believed that machine learning and genetic algorithms would handle everything. It is interesting to see that, over time, while certainly having had a big impact it is more as another set of tools in the statistical toolbox. There are still a lot of systematic strategies that you can do without machine learning, and as with any tool you can use machine learning in both productive and non-productive ways. In the end it depends on how you approach things.



I think it is very important to keep focused on the underlying idea. Even if you use machine learning algorithms or some version of it, underlying economics are driving markets in the longer run. However, we certainly have to have respect for the timeframe. As John Maynard Keynes, the English economist, said, markets can stay irrational longer than you can stay solvent.

Mikael Stenbom: In our business at RPM, the most important thing that we provide to our investors is what we call Crisis Alpha. Our funds should give their strongest returns in times of market distress, and especially equity distress – that is typically when irrationality dominates. Equity distress signals change in the macro-economic, political or psychological climate and is strongly linked to trending markets. That is when CTAs or momentum-based strategies have historically performed the best. And there are good reasons why they will continue to do that the next time the market tanks. We have seen it through history and it has even been simulated back to the 1500s.

Momentum-based strategies are at their best in times of change. And we work hard to avoid losses in between. That is our mission.



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