



Opalesque Roundtable Series '17

ZURICH

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Editor's Note

Alpha is like Schrödinger's cat

Swiss investors and banks have been early adopters of hedge funds and alternative investments, and many, such as UBS, still back hedge funds strongly with allocations of 10% to 18% in many discretionary mandates (page 6). But this doesn't mean things are not changing. Until recently, a hedge fund's total return was understood as beta plus alpha, but now actually part of the alpha can be described as alternative beta – market neutral factors that you can create in a systematic fashion. *So now we have beta plus alternative beta (or alternative risk premia) plus alpha (page 8).*

The proliferation of these risk premia strategies over the past couple of years has led to a commoditization of the space, and access to these return sources for institutional investors has much improved. Leading Swiss players such as Vontobel and Swisscanto Invest, the asset management arm of Zurich Kantonalbank and the 3rd largest asset manager in Switzerland, are offering investment solutions that simplify access to those risk premia indices or include them in balanced, diversified products (page 6-7).

But alpha remains the trickier part and appears to be just like Schrödinger's cat: when we could not measure it, it was very much alive, but now with better tools and academic framework to measure and analyze it, alpha appears to be dying. However, veteran investors believe that there will be a **turnaround in active management and sophisticated risk-managed strategies**, which are actually seen compatible and complimentary to risk premia and alternative beta investments.

The following speakers participated at the 2017 Opalesque Zurich Roundtable which was sponsored by Eurex:

1. Enzo Zinnà, [Eurex](#)
2. Karsten Schroeder, [Amplitude Capital](#)
3. Gregory Hung, [Zürcher Kantonalbank](#)
4. Daniele Scilingo, [Nanos / Crossbow](#)
5. Michael Appenzeller, [Fundbase](#)
6. Jerome Morin, [Vontobel](#)
7. Filippo Montalbano, [Sussex Partners](#)

The group also discussed:

- How to combine true alpha strategies and alternative beta strategies (page 7)
- Are smaller institutional investors overwhelmed by that approach? (page 9)
- What are the right fees for true alpha? (page 9-10, 16, 18)
- How investors get stuck in "the conundrum" by demanding niche strategies and idiosyncratic returns, but on the other hand wanting big brand name manager with a lot of size. But these two things often don't go together (page 9)
- How FinTechs like Fundbase want to reduce the total fees and costs to access alpha (page 10-11, 14-15, 18)
- What contributes to the concentration in the hedge fund and funds of hedge funds industry? (page 15)
- How has investing in hedge funds changed for smaller and mid-sized investors? (page 12-13)
- How do investors perform strategy due diligence? (page 14)
- How the hedge fund industry is forced to mature (page 16, 18). Where long/short investments beat the index by a long shot (page 16)
- An alternative method to invest in commodities (page 17)
- Collateralization of actively managed certificates: An alternative to fund structures (page 17)
- Quant 3.0: How big data, machine learning / artificial intelligence are entering asset management (page 19)
- Are there risks in risk premia? (page 20-21)
- Investment opportunities (page 22-25)

Enjoy!

Matthias Knab
Knab@Opalesque.com

Participant Profiles



(LEFT TO RIGHT):

Enzo Zinnà, Tomas Hricko, Jerome Morin, Daniele Scilingo, Matthias Knab
Filippo Montalbano, Gregory Hung, Karsten Schroeder, Michael Appenzeller

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Introduction

Tomas Hricko
UBS

I am Tomas Hricko. I work for UBS where I am the head of hedge fund specialists and distribution team for our wealth management unit outside of the US.

Jerome Morin
Vontobel AG

I am Jerome Morin, I work at Bank Vontobel AG on an innovative open platform of Risk Premia indices.

Daniele Scilingo
Nanos / Crossbow

I am Daniele Scilingo. I created the brand nanos investment 14 months ago. Before that I worked at Pictet as a fund manager for 14 years and joined Crossbow Partners which is a hedge fund advisor where I am responsible to create a unit that focuses on sophisticated long-only, so long-only with the possibility to hedge market exposure.

Enzo Zinnà
Eurex

I am Enzo Zinnà and I work for Eurex where I am responsible for Italian and Swiss buy-side-clients (asset managers, pension funds, insurances, etc.) and Italian banks.

Filippo Montalbano
Sussex Partners

I'm Filippo Montalbano and I am the head of Sussex Partners Switzerland. Sussex Partners was founded in 2003; we are FCA & FINMA regulated, and all we do is hedge fund selection and advisory on alternative investments. Our headquarters are in London and we also have an office here in Zurich and dedicated staff in New York and Tokyo. Our client base is institutional.

Gregory Hung
Zürcher Kantonalbank

My name is Gregory Hung. I am a portfolio manager at Swissscanto Invest which is the asset management arm of Zurich Kantonalbank. We are the 3rd largest asset manager in Switzerland. I joined Swissscanto in 2011 from UBS Global Asset Management, and I am responsible for fund of hedge funds and alternative risk premia solutions.

Karsten Schroeder
Amplitude Capital

I am Karsten Schroeder, I run Amplitude Capital. It's a short term systematic specialist. We have four programs out now. Dynamic and Klassik are our two flagship programs. We launched two other programs last year, Adagio and Vivace, one of them is a cash equity program. We manage in total \$1.5 billion and have 32 people on staff.

Michael Appenzeller
Fundbase

I am Michael Appenzeller. I am the Co-Founder of Nectar Financial and Fundbase.com. Nectar Financial is a wealth management FinTech platform which combines the operations and digital wealth management chain for the wealth management industry. This company employs around 60 people. Fundbase.com is the leading FinTech platform for the liquid alternatives space, so hedge funds and about 20 other asset classes. That company employs about 25 people and currently has a total of 10,000 managers on the platform which can be researched and accessed.

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planets are visible to the naked eye:
Mercury, Venus, Mars, Jupiter, and Saturn.



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Matthias Knab

Swiss investors and banks have been early adopters of hedge funds and alternative investments. What are some of the most current trends and developments you are seeing both from the product development and the demand side?

Tomas Hricko: UBS has been backing hedge funds strongly. In many of our discretionary mandates we have an **allocation of 10% to 18% in hedge funds**, so obviously we as a firm believe in the space and in alternatives, and many of our clients are following suit in that they like to have an allocation in advisory mandates too.

Of course some investors were also obviously disappointed by the hedge fund performance of the last few years, but it seems that things are though beginning to turn visibly as we see better, increased performance in all of the main products, and therefore we also see some renewed interest from investors. So in aggregate, our business with hedge funds and alternatives is actually growing.



Jerome Morin: We've experienced an increase in the number of liquid alternative offerings from investment banks over the last years in the form of risk premia indices. Vontobel is also very active in this space where it is developing investment solutions that aim at simplifying access to those risk premia indices.

What we identified as an issue with those exciting new alternatives, and we're aiming at solving this, is how to make risk premia indices more accessible, as today access to those cheap liquid alternative is really difficult. We see that as an exciting opportunity, where Vontobel's DNA in derivative platforms and efficiency could be truly leveraged.



Matthias Knab

More, specifically how do you do it?

Jerome Morin: Well, first, it's about having the set up to access all those liquid alternatives, across all asset classes, and at last count, we identified about 700 of them. Then it's about providing a platform with all the relevant services and tools to help investors get access and use them in the best possible way. This means providing investors with of all kind of analytics to help in their selection process and in the construction of portfolio of risk premia indices, as well as providing all the relevant wrapping, reporting, rebalancing to properly manage such portfolio etc. As I said, Vontobel is a leader in platform technology, and this is not a first for us.



Gregory Hung: On the subject of alternative risk premia, we have also seen demand from our clients for liquid, transparent and cheap alternatives. It can be a challenge to satisfy all of those needs and generate an attractive rate of return but alternative risk premia can contribute to finding new interesting solutions. The **proliferation of risk premia strategies** over the past couple of years has led to a commoditization of the space, and access to these return sources for institutional investors is much improved these days. Basically every large investment bank on the street now has an offering of risk premia across asset classes, and while the devil's in the detail there's principally no magic behind this.

It's really about factors such as value, carry, volatility carry and momentum which you can harvest across asset classes in a market neutral way, i.e. without much of the respective market betas. By accessing them through swaps you can create something that is fairly low cost, diversified and daily liquid.

As a response to this demand and also given that the classic fund of hedge funds model has come out of favor, we have put together a balanced diversified risk premia product in the form of a certificate and are now in the process of launching a Luxembourg UCITS fund. So we are analyzing all the different platforms and premia that have been created by the banks based on academic and empirical research, and may at times also influence the design of these strategies. If, for instance, there are certain things that we would do differently in the construction process such as the algorithm and other rules, we can work with the banks and do that. The reason why we access these strategies through the banks is because of breadth and cost efficiencies.

So also for us, alternative risk premia is a big theme that we continue to work on. It falls into a framework within the alternatives and hedge fund world where we see **true alpha strategies on one side and alternative beta strategies on the other**.

Classic beta strategies in the alternatives space are for example insurance-linked securities or long-only commodities which provide you with beta to alternative markets. We call these **alternative asset classes**, and they are typically long-only and directional. **Alternative risk premia** (also known as alternative beta or structural alpha, depending on who you talk to) are based on factors and are market neutral. Part of the return which was previously coined as alpha can now be identified as alternative risk premia. They are part of our beta offering in the alternatives space and as such priced at a cheaper price point.

That said, we still believe in the value of hedge funds even though industry performance over the past few years has been disappointing for many reasons we can discuss. Like Tomas we also think that there will be a turnaround in active management and sophisticated risk-managed strategies.



Daniele Scilingo: The trends that you are describing is showing that the industry has lost faith in alpha generation and all that you are doing is just replicate in a less expensive way what the managers are producing and maybe claiming 2 and 20 for the performance labelled as "pure alpha". As I see it, you guys from the quant side are now stepping in and trying to mimic some of their strategies and arbitrage away the opportunity.





Jerome Morin: I don't think that alpha is disappearing. To some extent, it's like Schrödinger's cat: when we could not measure it, it was very much alive but now we have better tools and academic framework to measure and analyse it, then it's dying. What I am trying to say is that there has been great development in risk measurement and portfolio construction, and with today's need for transparency and clear accountability, it's no surprise that a **risk based approach is taking over**, so I would not really put this in terms of alpha dying but more like in terms of risk management taking over.

It does not mean that our offering is incompatible with active management, quite the contrary. With risk premia indices and portfolio construction like ours, investors can actually better focus on what makes them special by outsourcing some systematic strategies through risk premia indices, with clear, identifiable and measurable risks and then retain the tactical allocation, but with a degree of information and access to relevant analytics, to help them in their decision making. A bit like a plane, we keep the pilot, but we provide him with more assistance and relevant measures to control ever more complex planes.

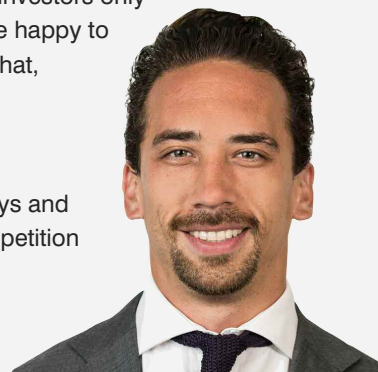
Gregory Hung: I agree that it is complementary to active management. In a discussion like this, I always start with the understanding of the total return. While before total return was just understood as beta plus alpha, now actually part of the alpha can be described as alternative beta – market neutral factors that you can create in a systematic fashion. So now you have **beta plus alternative beta (or alternative risk premia) plus alpha**.

For example, if you invest into value equities by simply going long a basket of cheap stocks according to some fundamentally sound valuation metrics and short overvalued names in a market neutral and sector neutral way, you've created a raw and fairly pure systematic equity value factor that can be rebalanced on a regular basis. *That's an alternative beta factor and not alpha*. If a manager can add value on top of this through stock selection, market timing, execution or more sophisticated portfolio construction with a robust and repeatable investment process then that's alpha worth paying for.

Again, part of the alpha has now become alternative beta and the price tag for that alternative beta has come down as well. But that doesn't mean you shouldn't have it. Similar to the trend of investors going more passive and investing in index funds, you could say part of what used to be alpha is now available as alternative beta at a cheaper price point.

We believe that **only true alpha is worth paying a higher price for**. The alpha in the market is scarce and limited and only a small fraction of all hedge funds out there are able to deliver it. Those that do deserve to get paid well by all means. But there also needs to be a discussion about the shape of fees as one size does not fit all. While some investors only want to pay for pure alpha as measured by an agreed upon customized benchmark, others are happy to delegate the risk taking and management to a hedge fund entirely and pay a standard fee for that, perhaps adjusted for a longer lock-up. But the distribution of profits should be fair and needs reconsideration in many instances.

At any rate, the closet beta players are having a more difficult time charging 2 and 20 these days and have already started to come down in fees a while ago. And I think that's fine, right? More competition should eventually also lead to better results for investors..



Karsten Schroeder: At the end of the day I would say you get what you pay for. When you have a simple strategy that you can access through replication which is what investment banks are offering: of course, you can build or replicate a hedge fund portfolio to a certain extent. But we also shouldn't forget that from an investor's perspective this loads a little bit more responsibilities on them because they have to call the shots to do the allocations, to time certain asset classes to do all of that.

Now, putting yourself in the shoe of a smaller pension fund, this is exactly what they *don't* want to do. And often they don't have the resources, so yes, the products are out there, but often on the end investors' side you just do not have the necessary teams, and they are not designed for that type of investing and actually they are not supposed to do that.

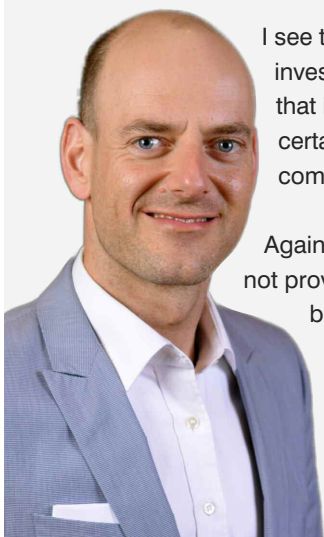
I totally agree that some alternative beta products can have a huge capacity and also that some firms have become more asset collectors than trying to develop maybe niche strategies that provide you with a lot of idiosyncratic risk so that some of the fees are probably not justified. On the other hand, managers have also proactively come down and cut fees.

But we also need to remind ourselves that there are a lot of requirements from the investor side as to how they expect the business to be run. I am just touching on compliance, on risk management, on cyber-security, you name it. I still remember to 2008-2009, and certainly a lot of investors are very uncomfortable with counter-party risk. I remember when we got calls from big bank brand names asking us if we had any exposure to that other big brand bank, and asked us to just cut it, right?

I don't think that these type of concerns will now suddenly be going completely away. Do you want to be exposed via some sort of vehicle to a counter-party? No, you don't want to. So I don't think it's that easy.

And as far as the fee discussion goes, yes, I think you have to provide something to the client in order to justify fees. However we should also factor in that the operation of a hedge fund has become more-and-more complex and more-and-more expensive along the lines that I have mentioned and also in research costs, data costs, and so forth.

This trend certainly poses a challenge for the managers, but it will ultimately also pose a challenge for the investor, because if investors continue to push fees beyond reason then it will eventually backfire. I have to say that investors are all aware of that issue, and also aware of what I "**the conundrum**": *They want niche strategies and idiosyncratic returns, but on the other hand they want the big brand name manager with a lot of size*, but these two things often don't go together. The two sides are actually a contradiction in themselves, and I think that's really the issue they face. So investors don't want you to become too big to dilute their strategies too much, but then they also want to squeeze the fees, but that in a way forces the managers to collect assets.



I see this as a very tricky situation at the moment, not only for us as a manager but also from the investors' side because they get challenged on all the fees they pay by their committees. We also know that in some regions, for example in Australia, you have fee caps on your total expense ratios, and that is certainly also a factor in Europe and in US. So I think it's more a question of finding a healthy compromise there.

Again, I agree that if a manager provides a simple strategy that is highly correlated to a replica and does not provide an excess Sharpe over such an index, well, then he has a problem. But I would assume that the better managers do provide a lot beyond that. Also we as a mid-sized shop look for the smartest talent, we employ a range of PhDs, and we are not paying them to play computer games. So if you have a business strategy just constructing some sort of simple trading strategy, with all due respect, this is not going to be as good, and that just coming back to my point you will eventually get what you pay for.

Michael Appenzeller: With our Nectar business we service wealth managers, family offices, multi-family offices with a total of 35 billion of assets. Around 60% of those clients invest in hedge funds, private equity, and all kinds of things. I can confirm that the performance problem we talked about is there.

Then the other company, Fundbase, which is separate from Nectar, started to create the marketplace for liquid alternatives where we offer our users – investors – data and certain investment procedures to access the funds and managers.

I would guess most of the companies here have some form of employees who have looked at that platform and have used it in one way or another. There are users who have created short lists, long lists, and there are people who actually invest in funds they find.

What we did when we reached a critical mass of users was looking at our own data generated from these activities, and we saw the people discovered and did quite beautiful things with our platform. They actually found good investments and started to create good portfolios. For example, I discussed with an user about his portfolio, with relatively little effort he was able to build a portfolio for his clients that returned between 7-8% made out of these so-called expensive, non-alpha producing managers.

In my view a discussion around hedge fund fees is the wrong one. I always say, if you don't pay a Formula 1 World-Champion millions, he doesn't go to a race. If you don't pay the best a good salary, they don't race. But I do think that the industry does have a real issue when it comes to the **total** fees and costs to access alpha, and that's why we created Fundbase: to make it extremely cheap to access alpha.

Before this platform was around, it was all manual search and processes, all very time consuming. What we have discovered that actually there is some **systematic way of accessing these talents**, and based on that we have developed some algorithms which we are now testing which systematically access new funds that we see. These could be funds that just came onto the platform and which could be useful for a portfolio. So, apart from merely listing the funds, we are also systematizing the search for these managers.

And I think that aspect is really key as I believe that the people and processes which are traditionally used to access the alternative investment class are in sum just are too expensive, i.e. people are too expensive.

What we have discussed regarding the beta-related forms of investing via risk premia and factors is certainly a good and important development as well, but what we are trying to create is a systematic way to capture alpha and try to go away from say how funds of funds have done this in the past: A bunch of people looking for funds, going to conferences, often a very social process, and then trying to call the shots on what is a good hedge fund strategy under Trump or whatever. I personally don't see this is a value of generating activity, and I am saying that for a reason, because when I look at our clients on the wealth management side via Nectar, I see that they are all doing this and they are not getting anywhere. These investors end up being in the same funds, the big names we all know.

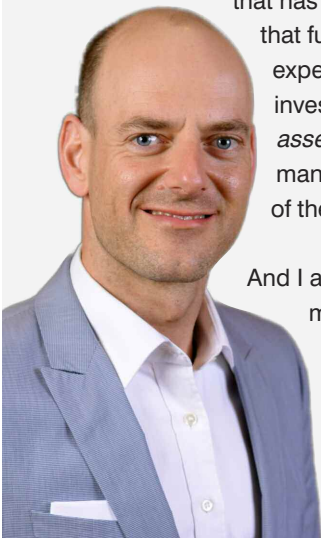
Around 80% of investors just go into big managers which to my understanding correlate heavily with what we called beta before. So they go into the guys that don't perform anymore and then add a lot of fees and cost on top because all of that is a very manual process, and usually these organizations that provide services are really expensive. At some point, every industry will have to face and question how they are operating and try to rationalize the whole approach to doing things. In my view investors can only lose in my opinion with the old process, and we have to think how to rationalize the process of selection and how to access the alternative asset class.

For example, we entered into a joint venture with a University, it's not public yet, but there we introduce algorithms for different important aspects like fraud detection and systematically introduce technology into the selection process with the aim of cutting the cost of selection and hopefully be much more successful in finding alpha-producing managers.



Karsten Schroeder: I am think that it's unfortunately not that simple and straight forward. For example, a rich individual has a completely different utility function than an institutional investor, and we all know that the hedge fund space is dominated by institutional investors. That was very different 10 years ago, but our industry has become much more driven by institutions and the large investors.

So, when someone looks at the managers on your platform, they obviously see the performance data of that manager and very little about things like quality of compliance, how they handle things like their cyber-security, corporate governance and so on. If you put yourself in the shoe of let's say a committee member at a pension fund, if they would allocate to a manager that has awesome performance, great strategy, but say something screws up say on the shareholder level of that fund manager, this guy is going to lose his job. Therefore I don't think he has interest in making these experiments. He knows the big firms, they are very well-organized, they are very well-governed, so the investor acts in accordance of his responsibility for the assets. *The mandate of a large hedge fund or asset manager is not to provide crazy returns but foremost to protect the downside.* It's a lot about risk management. I am not just talking about risk management on the strategy, but about risk management of the business.



And I agree, the fund of fund model has failed. We know how many assets went to fraudulent fund managers in 2008 and so institutions got paranoid about it. Hence, everything that addresses these issues is taken extremely seriously, and this of course creates costs on a manager level but it also makes hopefully sure that something like that doesn't happen. I think that's the big difference compared to an individual selecting a fund on a platform, because if he makes a wrong decision it's something else than for a large pension or fiduciary assets.

Michael Appenzeller: Of course, we are not proposing that you can have an algorithm but then you find a good looking manager sticking out from the crowd and then you invest, that's not where we are. We obviously have an investment team, we have a CIO with like three decades in the industry, analysts, and we outsource due diligence, I just want to correct that. But our machine is like a pearl hunter, he brings a pearl, like a dog or finds a truffle, and then he brings it to humans and the humans look at what exactly you mentioned. But, yes, institutional investors have to cover their back, I agree and we know that.



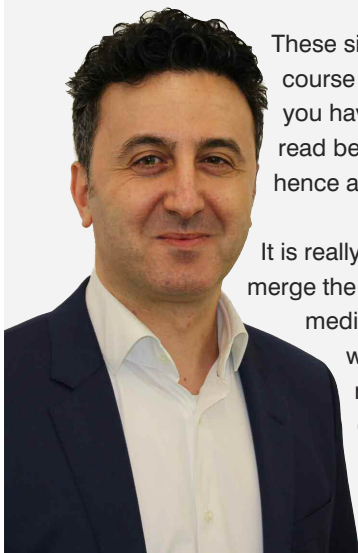
Filippo Montalbano: Let me use a metaphor. Assume that I am a doctor - but an old style doctor, one of the last millennium ... so a really, really old style one. If you came to me for a visit and entered my surgery, I would be watching you already while you were still walking along the corridor. I would observe how you walk, would look at your face and read your body language ... and I would take the TIME for you. Today, modern doctors don't even look at the patient anymore when they enter their rooms. The majority are sitting behind their desks and looking at screens or print outs, or are busy typing into their computers. They don't look at the patient directly anymore and don't take adequate time – they don't try to read between the lines.

In that sense, I would disagree with Michael. I don't think that you can find the pearls by screening databases. You need to find them when they are still a grain of sand. For this reason, experience and an interdisciplinary network are essential. Of course, you can use a database, but only as a support tool; it cannot be the driving force of any selection and is far from a qualitative quality stamp - unless you only want to focus on the very established, big funds.

I'll give you another example to underline what I mean with the new vs. the old style of doctors. Databases are a collection of data. Today everything you read online or in the newspapers seems to be about big data & algorithms. Also, hedge funds are constantly re-inventing themselves, evolving and digging into this field, like CTAs by the way have now done successfully for many, many years.

But just having that data doesn't help. On the contrary, it can be a mine field, and can lead to wrong conclusions. Example: managers accustomed to price-earnings ratios are struggling to interpret new-media data. Chipotle Mexican Grill Inc. was rocked by waves of customers with foodborne illnesses and some hedge funds misread the impact on sales. They for example relied heavily on foot traffic from location apps that showed a dramatic decline while overlooking credit card transactions that revealed customers had meals delivered during the colder months – in conclusion, they were wrongly positioned.

It is only a simple example, but it tells you more. It tells you that **data scientists** should be accorded much more weight and importance. A lot of firms treat data quants as back-office employees unworthy of making investment calls. The opposite should be correct: they need more influence, even a seat on the management committee.



These simple examples show you that data and databases alone cannot be the solution. You have of course to clean the data (there are thousands of fake Twitter accounts which can affect stock prices) but you have to be able to interpret: $1 + 1$ could at one point also be 3 and not only 2. You have to be able to read between the lines, and yes, artificial intelligence will help. But in order to do so, you need time, hence an old fashion type of doctor.

It is really what we do with our clients at Sussex Partners – we take time, listen, try to understand, filter and merge the information given by our clients in order to come back with a tailor made “medicine”. The type of medicine which you could get in the past when you were going to the pharmacy and the pharmacist was telling you: “Please come back in a few hours, I will prepare it in the meantime ...”. This does require time, but then getting something tailored for you will take some time. It also gives you the opportunity to look beyond your own nose and to check if the new solutions would also fit the overall allocation goals.

Tomas Hricko: Karsten has already alluded to how the industry has gone a long way over the last 10-15 years. The assets have tripled, so it went from roughly 1 trillion to 3 trillion. The assets in the industry are again at an all-time high, and I can only echo that real alpha, real talent is most likely scarce.

I was the COO of a multi-strategy fund in the US for the last four years before joining UBS, so I got some insights from that perspective as well. When we look at the really good firms, I think that with the institutionalization of the industry and the related inflows from large institutional investors, the hurdles for investors to access really good talent have also gone up. They have not gone down, they have gone up, because the institutional ticket now is 100 to 200 million.

To get access at a competitive price investors need to invest significant, institutional level amounts. Personal relationships only or investing at the minimum amounts of some



managers (which often equal to a few million USD) does not provide access anymore at institutional levels due to the dominant positions of large pensions funds and other institutional investors unless it's a niche strategy. The hurdles for the investment managers and competition have also have increased strongly. This leads to a disadvantage for smaller funds in accessing capital. Doing some desk research, by the proverbial three guys with a Bloomberg in a garage is for most investors not going to be appealing anymore.

So in order to build the systems you need – not only for compliance or regulatory reasons but also from an investment strategy point of view – significant assets to support an asset management business today. Everything which is more or less technology-based needs tremendous resources in order gain an advantage and compete successfully. There is a hedge fund in Chicago which deploys so significant resources in technology that it would be ranked as one of the top computing centers in the world. Some of the most successful hedge fund firms today resemble more tech company than an investment firm.

Coming back to alpha and beta, I agree that there is this bifurcation between alternative beta and alpha. Real alpha is scarce and there are significant barriers to entry. There are not that many really differentiated and good firms out there.

Karsten Schroeder: I can only agree with your comments, Tomas, in particular regarding the barriers to entry. You also see that from the **recruiting perspective**. In the old days you were talking to the top guys and they would consider going to an investment bank or to a trading house or to a hedge fund. But nowadays we are competing with the likes of Google, it's completely different.

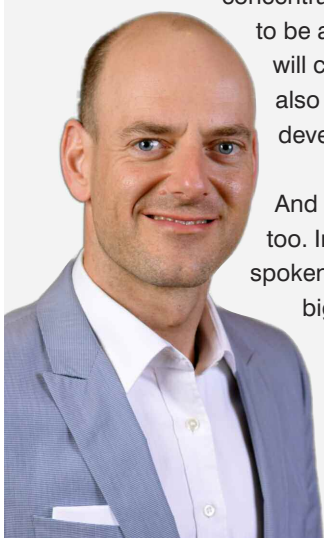
We are going through a transformation and almost turning the firm into a tech unit. Of course, being a systematic manager is still an extreme specialization, but there are now also there generic tasks like collecting data, identifying the right data, and then a lot is cleaning data. Filippo referred to that as well, it's a lot of work because you get the data from different providers, in different formats, in different frequencies, and so you need to bring all of this together.

With all of that the demand for computing power goes up tremendously. The models you build are more complex, you also deal with unstructured data, you include multiple data streams, so also from a hardware and processing perspective, significantly more investments are required.

And not everything people think they found can be implemented. For example, we get a fair amount of trading ideas. So a team might say, "We have developed this idea and done this back test," and what sometimes goes missing is the **practical knowledge** to think about how to turn that into reality. We here on this table all know that if a strategy has a high concentrations in small titles, you might be able to trade with say \$5 million but that's about it. It's never going to be a relevant size, and aspects like shorting availability, slippage cost, robustness, and things like that will change a lot. That is why it is so important not to just have the tech savviness and capabilities, but also the real world investment experience. You need to have people that understand all of this when you develop strategies.

And Tomas is also absolutely right also as far as the parameters in the institutional game have gone up too. In the old days, you could command certain conditions and fees with a \$50 million ticket. I have spoken to a lot of medium-sized clients who now find it pretty hard to negotiate fees with some of the bigger shops because they only have a \$100 million allocation when other investors have a \$500 million allocation. So, with a 100 million ticket you can't really move much.

I think fees have to be fair but it's not an evenly distributed situation here. Depending on who you are, you can negotiate a lot, but if you are not part of that big, institutional bucket, you could find it actually quite difficult.



And coming back to the point of how to access this business in a cheap and efficient way, it affects the smaller and individual investors in the same way. Because of your smaller size, you will not be able to access things in a comparable cheap and effective way, and also because it's not in the interests of the manager either. We need to run a massive size of assets to support our organizations. A million or a \$10 million ticket is not going to cut it for us.

Michael Appenzeller

Tomas, can I ask you a question? How many hedge fund analysts work for UBS?

Tomas Hricko

On the hedge fund platform UBS manages around \$34 billion to and the number of analysts will be at almost 100 people globally in various hedge fund related investment and research functions. All over in hedge funds, the resources are much larger if you include non-research and investment staff.

Michael Appenzeller: This was probably an unfair question, given that I now will be saying that we don't employ but do have about 4,000 analysts on our platform – that's our user base which can work day and night for other users and themselves on the platform, so that's sort of the breadth of crowds that we access and generates data in doing that.

So we don't see ourselves as a database, but more as a community that creates data. That's our main difference to the commercial hedge fund databases out there. And this community lives, every day new managers come onto the platform. Most of them are not good as we discussed, but if you have maybe 100 new managers per half year, you might find one. In any portfolio, it's usually two to three positions which make a difference, so you only need to find those.



Karsten Schroeder: Let me ask you a question. When I deal with a new investor and they perform **strategy due diligence** on us, they show up with four or five people and that's probably meeting number ten. So the team shows up in our office and I spend six hours with them. All of these guys on the other side of the table have a pretty decent degree as well and a couple of years of experience, and we really drill through our strategy because they have to get the head around it to see if it does or doesn't make any sense to them.

I mean, with all due respect, but you can have 10,000 users and none of them would understand remotely what we are doing and being able to make a call on it.

Michael Appenzeller

Yes, of course not, but if those guys find your fund on the platform and they like it, they will shortlist your fund, and that's all I say.

Karsten Schroeder

The risk that I see here is that people will just be **chasing performance**, because that's the only information they have, whereas the more informed "old school" investors are potentially able to make better strategy calls.

Tomas Hricko

I think we're dealing here with asymmetrical information. The wisdom of the crowd can be problematic. There is something to it, but the question is then really how many users – and many of them uninformed – does it take to really uncover the good thing?

Michael Appenzeller

I think we could say that any fund analysts is also uninformed until he drills down. I am not saying we should take the fund analysis and strategy due diligence off the shelf. The drill down, you have to do it, I don't deny that. But once you start, you are in a sea of unknown, and then you have to find an efficient way to find that stuff.

Tomas Hricko: There is clearly efficiency of scale. Why is there concentration in the hedge fund industry or in the fund of funds industry? Because there is efficiency of scale!

With the same analysis that we would need to do to deploy 20 million, we can deploy 200 million, 300 million, and more. There is massive efficiency of scale in finance like in IT, and that's why there is concentration in the industry because it's a scale game after all. A part it is an art, doing a good portfolio, calling the shots, doing innovative data science, but there is efficiency of scale and therefore concentration. That's why we can have the large analyst team that can drill down and do the research.



Matthias Knab

FinTechs like Michael's Fundbase are trying to bring scale to a range of function and processes in finance and asset management, and we all know there are parts of the whole infrastructure that can be optimized, if not disrupted. It will be interesting to see how things will play out over the longer term.



Daniele Scilingo: We discussed the massive growth in the hedge fund industry. I am a fundamental stock picker, so if I'd look the hedge fund industry as a single company, it would be characterized by a very high profitability that attracts a lot of new participants and plenty of competition. Additionally, the threat of substitution with other products that have better value to cost ratio is omnipresent. The rule of thumb that 20% of those players are good, and 80% are just there because of the attractiveness of the industry most probably applies to the alternative industry as well.

Now we have achieved a certain industry maturity and simultaneously aggregate performances have disappointed. Surprise! Surprise! The industry attracted so many "talents", *and of course*

everyone in the hedge fund space is a Formula One driver, even if he drives just a Mazda.

Interest rates are at zero, so you don't have the risk free rate of 5% that you can cash in every year. Now people see that performance is not double digit, what it used to be, and alpha is scarce. But again, as per definition, alpha has always been scarce and talent is always rare, independent of the industry. So now we are at the point with three trillion assets in hedge funds that the investor asks, "Why should I pay for so-called alpha if I can replicate it with 10 basis points as a risk premia strategy?"

The active long-only industry where I spent my last 15 years already went through this transformation over the last 10 or 15 years with the passive ETFs ballooning. Now **hedge funds enter the same cycle** where everything that can be replicated cheaply will be wrapped in a inexpensive alternative. Here as well, taking the three trillion or whatever the number may be in the future, after a certain time of transition, a sizable part the assets will be in some risk premia ETFs or whatever it will be, but for the remaining smaller part of the pie, *the clients will really compete to get in, because if a manager has real skill and alpha generation capacity, he has the whole world of hedge fund investors that tries to get part of his capacity.*

So if you have skill, your fees will stay high and may go even higher, as Renaissance Technologies has proven for example. I think clients are more than ready to pay for skilled investment professionals if they realise that it cannot be replicated by risk premia strategies.

Filippo Montalbano: What often occurs to me in these type of discussions is that it appears most people just think the whole global investment landscape breathes and acts like the US, the most transparent and liquid one. What we at Sussex Partners do is to see which strategies can be run where.

Coming back to the US: I guess it's fair to say that it makes sense to also invest into quantitative and more systematic strategies. You have the data points to do that. But if we look at **Japan**, which is still the third biggest market globally (approx \$4.4 trillion) after the US and China, you'll find that out of the 3,500 listed companies only 30% are covered by analysts, leaving 70% of listed companies with little to no coverage. This has far reaching consequences.

If you wanted to have exposure to Japan, over the last 10 or 15 years you would have been off much better if you had invested into a long/short equity Japan manager instead of a long-only. If you look at the period between 2000 - 2014/15, the Eurekahedge Japan Hedge Fund Index has been able to generate annualized returns of approx. 6.5% since January 2000, while the Nikkei 225 and TOPIX Indexes have had annualized returns of about -0.5% and 1.3% respectively for the same period. You can exploit the inefficiencies here better via a simple long short equity stock picking approach.

I also agree with Daniele about capacity. If you are trading small or mid caps in Japan, you have for example only \$300 million capacity for your fund and then you simply have to close your product. It isn't possible to have a multi-billion Millennium type of company in this space.

If you go to China, the situation is actually the same. In India, it is difficult to short, and Korea has one of the highest shorting costs, which can go up to 8%.

What does this mean? You have to differentiate where to allocate long only active or passive and where long/short works; where do I allocate to replication strategies, smart beta etc.? It depends on the geography and also the development of the local markets (liquidity, derivatives, and so on).

Another example: the other week, I met a pension fund which would like to invest into commodities. I actually started in late 2015 proposing commodities and even within our own



company, some people were looking at me and saying: “Filippo, commodities ... are you sure ...?”

But it is not a question of timing! You have to find the right approach – the correct strategy and implementation. In our case, it's a long short approach, only futures based (no equities at all), with highly specialized trading teams/managers. One trades just cocoa, another one natural gas, the other crude oil, and so on. All trading strategies are then aggregated into a portfolio. You can see that these single commodities are pretty de-correlated to each other and offer a good value add and de-correlation to equities and bonds. Exactly what you are looking for these days.

These are examples of different perspectives which the client should get, he shouldn't just get just numbers or one single correlation number.

Daniele Scilingo

But then such an investor doesn't invest in commodities; he invests in the skillset of someone that trades in commodities which is completely different than investing in commodities.

Filippo Montalbano

Correct, trading in commodities is very, very skill driven, they are also very capacity constrained and the people we look for are often coming from the physical side, from the big houses.

Jerome Morin

To Filippo's earlier point, I agree that there is value in active management for emerging markets, for instance.

Enzo Zinnà

When I look at our MSCI products, there is a lot of liquidity in the MSCI Europe and MSCI World, and since 2016 and this year too, MSCI Japan and MSCI Emerging Market futures have a lot of liquidity. MSCI Emerging Market Asia this year even had more volume than the MSCI World

Jerome Morin

From a risk perspective, you cannot really find an alternative to hedge funds without risks. Even a simple certificate has credit risks.

Though, If I am right, SIX Swiss Exchange is now or very soon launching some collateralized instrument that help in mitigating that risk.

Daniele Scilingo: If I can add to it, certificates that collateralize exist already, the COSI collateralization that EUREX offers. Additionally the Swiss Stock Exchange does also collateralization of actively managed certificates, that is very efficient and very attractively priced. And it **completely eliminates the credit risk of the issuer.**

At nanos investment we launched the first actively managed certificate that was collateralized by the Swiss Stock Exchange. With a few basis point of costs we eliminate not only a lot of discussions, but also the balance sheet risk of the issuer.

But what I wanted to add also to Filippo's comment about the US being the most liquid and transparent market, and some people think that in such markets it's not worthwhile having an



alpha strategy. The reality is that the best alpha generators actually are in the US. And a lot of them invest in large caps as well, because they have the DNA, they know what they look for, they have a long-term time horizon that in the high frequency world typically nobody has the luxury to afford anymore. This means they can time-arbitrage investment ideas, identify the stocks that will perform over a longer term, and add value by compounding

So there are *opportunities that can be exploited with specific skill sets, with a different time horizon, with a different or contrarian, fundamental way*. But you need to know what you do and stick to what you do best. I think that *nowadays there are too many strategies that just chase short-term performance* – I speak now for fund managers and investors – and the skill set and the DNA has become less relevant.

If your business case is to offer nicely wrapped risk premia in a 2 and 20 vessel, then you will be replicated away and you will disappear from the industry.

If on the other side you have a skill set, a DNA or a specific way to analyze fundamentally some things, you have a chance to survive and to command the fees that help you finance the needed infrastructure.

Jerome Morin

I have a question for you, Michael, regarding data or big data. I tend to think that the real issue is getting data rather than processing it, so I would like to know if you could share with us how you actually bring value to all that data?

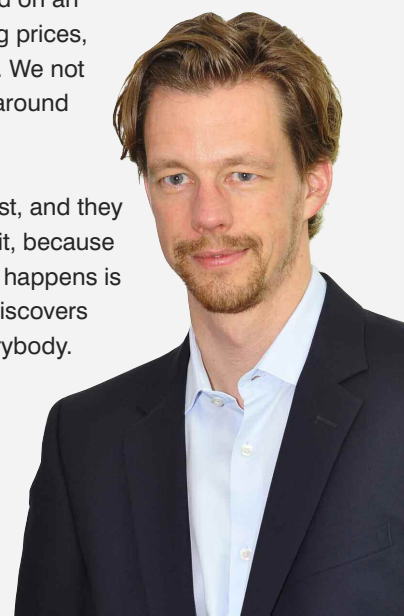
Michael Appenzeller: At our firm we found that process relatively simple. What we did for years was building a platform that provides value as a very simple tool. When we set up, we started out with investors and not with anything else.

I mean, people seem to forget, **this industry is still awful on the operations side**. If you get any kind of monthly statement from a bank, most likely your performance is wrong because there is some old or stale hedge fund price in there.

In so many ways the industry is just behind the curve, for example too much data is collected on an estimate basis. Not many people really understand this. So we started out with just collecting prices, and then we started to collect documents and then even more information on the managers. We not only collect just price data, we collect manager information around it like social information around the people and the manager, so we enlarge the value we bring to professional investors.

What happened next was that those users brought their portfolios, their long list, their shortlist, and they work with the tool. The idea is obviously not to look into a person's portfolio and try to copy it, because then you have the performance everybody else has, which is not so good. But what actually happens is that *we increased the chance of seeing in every corner of the market*. If there is a guy that discovers something here or there, we just increase the probability of seeing interesting things for everybody.

So we enlarge the dataset all the time, and with the computing power available there is no problem in that. We have been testing for months algorithms that identify things, and now, slowly but surely this algorithm starts to automatically bring what a person used to do. It's just AI which for me is just a fancy term for trying to mirror a person.



I don't believe the dystopia that machines will take over the world, you just try to mirror what the person does and then maybe down the road you get better. But what I do is *using computing power, which is almost free – it sounds a bit brutal – to replace people flying around the world to conferences, calling their prime brokers or networking with their peers or whatever*. So it's just a machine bringing me those investments. But there's no magic to it, I don't think there's a lot of magic to this industry.

You just have to democratize the access to these say 250 managers that you should look at. Sure, that basket of the 250 may be changing, but it is mainly about making access to that alpha pool cheap for investment professionals. I don't believe in having retail investors on our platform really. They should have at least 15-20 positions.

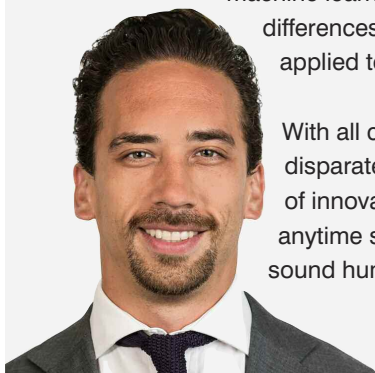
But one thing we haven't talked about here is the **situation of the pensioner**, the beneficiary or end user of all the pension money. That person is really the client, and we all know in what situation they are in with interest rates being depressed for such a long time. So when you ask your banker or your pension manager, "What can we do about this? I mean, we are not earning money, should we just cancel your contract as an investment manager?", you usually don't get any answers. You get answers like compliance and UCITS and so on, but the real issue is that they don't have access to a good, well-diversified, low cost basket of assets that produce real returns. It's just not happening, I see it in our portfolios at Nectar. But we really have to solve this problem.

Gregory Hung: Coming back to Jerome's question, I think the field of **big data and machine learning or artificial intelligence** more broadly is very exciting and will continue to bring innovation to the financial industry in the search for alpha.

The rapid surge of entrepreneurial based technology startups coupled with significant advancements in computational power and cloud computing has created a number of data vendors which are converting big unstructured data into machine-readable formats that can be processed systematically. This data, which can be quite expensive to obtain, includes satellite imagery and pattern analysis, corporate transaction data, crowd-sourced data, news and investor sentiment, company call transcripts, social media data and many more. These new types of data sets can bring additional investment insights and potentially drive alpha for those players who can best manage and manipulate them. Big hedge funds and asset managers are pouring money into technology and data management and scooping up computer scientists like no tomorrow to help them build and develop next-generation investment systems. Even if a lot of it doesn't work, some of it may create profound changes to our industry.

Some people call this **Quant 3.0**. While Quant 1.0 can be characterized by simple models like pair trading and mean reversion with limited computer power in the 80s and 90s, Quant 2.0 saw a proliferation of more sophisticated rule-based models with information more plentiful and increasingly available. In Quant 3.0, computer power and data storage are commoditized and machine learning tools enable deep analysis of enormous volumes of data. One of the fundamental differences in Quant 3.0 is that here data drives models whereas in Quant 2.0 specific models were applied to specific data.

With all caveats in mind, machine learning algorithms can capture the inherent characteristics of disparate big data and identify hidden relationships among observed variables, potentially driving a lot of innovation in the quant finance space. And while the machines are unlikely to take over the world anytime soon, success will be driven by the ability to adopt these new tools and combine them with sound human common sense.



Filippo Montalbano

I have a question for Jerome and for Greg. If you would put together a portfolio, mean reversion strategy etc. with options, would **herding** be a problem? I am just thinking back to August 2007 when this happened. How would a situation like this affect a portfolio which would be constructed by you?

Jerome Morin

It's a very good question. The only way to truly reduce risk is by first understanding it. This is the reason why we always try to deconstruct each and every strategy we have to better stress test our portfolio.

Gregory Hung: I agree with that. The process always starts with the fundamental understanding and intuition about the strategies. *You have to know why value works or why we have a size factor, why we have carry, and you need to understand how they behave in different market environments and when they out- and underperform.*

And so from that understanding you need to create a robust portfolio of strategies with different characteristics. For example, among other things it makes sense to blend more pro-cyclical risk premia such as volatility carry with risk premia that exhibit more defensive behaviors such as momentum or quality equity.

And remember, you can create all these factors in a market neutral way to extract the pure factor. From there, to get a diversified portfolio, you could apply e.g. equal risk contribution to the balanced selection of strategies. But you absolutely must monitor correlations over time, and Jerome already mentioned that. This is important because what can happen is, as we have seen, the equity momentum factor all of a sudden becomes highly correlated with the low beta equity factor, and therefore you need to monitor those developments closely and take appropriate action.

In general, you can't just blindly invest into a number of seemingly different single risk premia, but you need to bundle them together in a robust fashion based on a sound fundamental understanding of their behavior and construction.

Crowding is a concern. Certainly, many of these factors are deep and liquid, but some of them can sell off in tandem because there's liquidation pressure and correlations increase as we've seen in the past and will see in the future again. But based on your understanding of these factors and their correlations with each other, *your portfolio needs to encompass strategies that can do well when others don't do well. That's the trick.*

The idea of factor investing is not to always have positive returns in every factor, but to harvest their positive expected return **over a cycle** and to include risk premia that zig when others zag. For example, when the market sells off you want your short volatility strategy to be negative, because otherwise there is really something wrong. So that's part of our approach to managing tail risks and crowding.



Jerome Morin: This is open to debate, but typically **crowding brings its own opportunity**. If you look at what happened to commodity ETFs and their known rolling schedules and so on, well, they created other opportunities through pre-rolling strategies. Liquidity or passive liquidity always brings other opportunities.

And that brings us to a very interesting aspect. If you are trying to get a risk premia index to access some market arbitrage, well you would rightly worry that if everyone were to do the same, then it would disappear away. But, I would say it's not always that simple, as there are always different ways

of implementing that same strategy, and some are more successful than others. This is the reason why even in the passive, systematic approach there will always be innovation. *As soon as the implementation of a strategy becomes too successful, another one will take advantage on it*, it is a very fluid environment. Key is therefore having access to as many provider of risk premia indices as possible. This is what our platform offers.

When people address that aspect of liquidity or crowding, and ask “Will it disappear?” - I usually say, “Yes, maybe, but there’s another one that will come up.” That is why I am confident about the future of risk premia indices.

Enzo Zinnà: Greg and Jerome, you spoke about hedging and volatility, so my question would be, do you have some volatility-positions?

Do you for example have a look at the **VSTOXX for the French election**? Now the first month is at 16, the second (April) due to French election is traded at 25% and May is at 22%, are you able to invest in volatility in situation like this and do you do it?



Jerome Morin

There is an upside in volatility indeed linked to the outcome of the election.

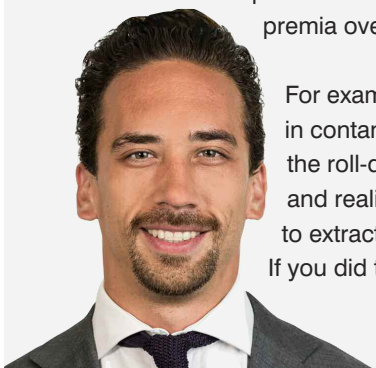
Enzo Zinnà

But do you invest in this, do you take the risk?

Jerome Morin

We don’t on our side. Everything that we do is systematic. This is a tactical play.

Gregory Hung: This is a perfect example of an active strategy. You need a discretionary manager to look at this and take a view on the French election and potential outcomes and then maybe trade this with a butterfly or some other active implementation. The idea of risk premia investing is not about tactical trading but about harvesting risk premia over time.



For example, in the volatility space you can harvest the risk premium in the VIX curve, which is usually in contango, by buying VIX put options on a daily basis with a diversified profile of strikes to profit from the roll-down. The classic textbook risk premia in volatility is exploiting the difference between implied and realized volatility by e.g. selling delta-hedged straddles on a daily basis. But all these strategies aim to extract that risk premium over time and you don’t care so much about an upcoming French election. If you did then you’re moving into the realm of tactically timing risk premia which is a different story.

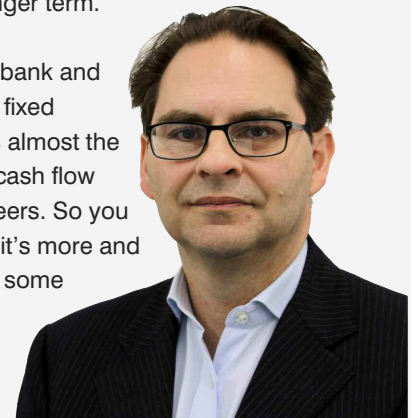
Matthias Knab

This brings the discussion back to active management, and I want to tie this up with Michael's earlier comment about the end investor or pensioner not really getting a lot of return these days.

Where do you see opportunities for return? We talked about systematically harvesting risk premia, we mentioned emerging markets, and Daniele talked about making money by following a certain DNA in active management. Could you maybe tell us a bit more about your own strategy? We recently have done [a video about you and your strategy](#), so I know you create a very attractive return and outperformance over your benchmark index...

Daniele Scilingo: My strategy is pretty simple. I try to bring back the investor to what investing actually is. Pick a few stocks with very good cash flow generation, hold it for the long-term, and the yield is not the dividend yield, but it's the ability of these stocks to compound their high returns over 10, 20 years. So investors that decide to join me in the journey of compounding – with a certificate listed on the Swiss Stock Exchange collateralized by the Swiss Stock Exchange, or via managed accounts – they bet on my ability to identify and pick 10-15 **compounders in Switzerland**: their quality, the ability of their management to grow long-term and to allocate capital wisely, I think, that yields the best results, over the longer term.

There is yield around, but it's not in fixed income where you cut your coupon, bring it to the bank and cash in a yearly interest payment. Yield today is offered in other investments. If you invest in fixed income, the higher the risk, the higher the yield. In equities, it seems counterintuitive, but it's almost the opposite. You go into high quality, well-run companies, their returns are actually higher, the cash flow generation they have is higher, and their ability to grow their dividends is higher than their peers. So you go up the quality scale and you gain by better compounding. Meanwhile in the bond space it's more and more risky, you have to go down the quality or liquidity dimensions to be able to get at least some yield.



Gregory Hung: We think a big opportunity has opened up over the last couple of years because of Dodd-Frank. Investment banks having exited the prop trading and risk warehousing business has opened up a lot of interesting areas for hedge funds to jump in and provide liquidity to markets. These **market-making operations and former prop trading strategies** such as fixed income arbitrage and merger arbitrage can be very interesting for hedge funds that run multi-PM, multi-strategy platforms with strong access to investment bank balance sheets, the necessary trading infrastructure and robust risk management processes in place.

Fixed income arbitrage specifically used to be an area where the prop desks were very active. Basically you are trying to arbitrage the basis spreads of a number of different instruments that converge at maturity which are held and traded by a diverse set of investors with different motivations. These strategies have had really good returns. We particularly like portfolio implementations that are mindful of the risk embedded in the strategy and carry long swap spread positions to hedge for these vicious dislocations that happen from time to time. I think the outlook is still very interesting, also because there are structural changes in the market such as the aforementioned balance sheet scarcity at banks for fixed income operations as a result of regulatory reasons.



Another example is the dislocation in the repo markets. German general collateral has been extremely scarce as a result of QE by the ECB and as a consequence has seen massive dislocations that have created interesting trading opportunities. Furthermore, basis spreads are attractive due to large portfolio flows in combination with increased realized and expected volatility in government yield curves.

Announced merger arbitrage has been very interesting as well. Risk-adjusted spreads are quite high and there is a flurry of M&A going on around the globe. Spreads have been attractive for a number of many reasons: there have been anti-trust issues, there is limited capital to chase the opportunity, and there have also been a lot of mega cross-border deals that are riskier. A lot of these factors have led to healthy and juicy spreads resulting in an attractive yield you can extract from those deals. So that's another strategy that we like.

While a lot of people are saying global macro is dead, and indeed traditional discretionary macro traders have had lackluster and disappointing performances in some instances, I believe we are now in an environment that is really interesting because of macroeconomic, policy and political divergences that should provide for a fruitful ground for macro traders going forward. Basically the Fed is in a hiking cycle while the ECB and the BOJ are still in QE mode. Monetary policy is more and more handing the baton over to fiscal policy as a source of stimulus. Growth and inflation are picking up. This is happening in an environment of big political uncertainty around the globe, and populism is on the rise. However, volatilities are at a record low, so there is a huge discrepancy there and something has got to give. The combination of these aspects will give rise to a number of tradable trends for discretionary managers in my opinion.

Daniele Scilingo: I agree that with the continued regulation and the polarization of the capital needs, huge opportunities are opened up. Private debt has also been a booming asset class as the banks have now stricter capital regulations and are therefore restrained regarding credit.

Trade finance is also attractive. The financing can be very short-term and with very low risk, but you can get nice returns. Some insurance companies that have to get rid of some of their policies that have already been closed, so you make money by waiting for the runoff. Because the insurer want to optimise its use of capital on the balance sheet, they are keen to had it over to less regulated investors. Hedge funds, private investors or family offices can pick up these assets. They can just run down the book and with a little bit of leverage get very nice returns.



Jerome Morin

Dodd-Frank and other regulations impacted what banks can retain on their balance sheet. So indeed, lending your balance sheet to a bank could be a good way to get some yield, however, you would be amazed how little is the yield on such trades.

Gregory Hung: Actually the point you are raising there is very interesting. In Asia for instance you have **massive structured product issuance** which continues to create an oversupply of volatility when dealers offload their risk into the market which can push down implied volatility below realized at various points during the year. That's interesting because it sometimes allows you to earn back your premium while actually being long volatility.

Being long volatility is particularly compelling in terms of diversification given the negative correlation to hedge funds and risk assets in general. Of course, it has been a widow-maker trade but it's a great source of diversification and tail hedging in this environment. There are some volatility specialists with a long volatility profile that are adept at gamma trading and trading spreads to recover a large portion of the premiums spent which reduces the inherent bleed of this strategy.



I think there's an opportunity in volatility going forward, because the hunt for yield has compressed literally everything, akin to a tightly wound spring that needs to release at some point. The consensus seems to be that the second half of 2017 might be more rocky while the first half will be more or less smooth sailing, because economic indicators, sentiment and flows are pointing up. However, complacency as indicated by the levels of volatility is massive. Therefore long vol can be an interesting diversifying strategy for most portfolios.

Daniele Scilingo

Every time volatility spikes you have so much short volatility capital around that your spike gets dampened within days. You are right that a lot of positions will lose significant money some day, but then short-term the effects will be dampened so that maybe you run out of cash before your payday happens.

Enzo Zinnà: This is a good point. I remember trading the SMI in 1991, as the volatility in the SMI options we traded always was at around 18%, and it went down to 15%. Then on our trading desk we said, "Okay, let's buy volatility." Then it went down to 12% and then we said, "Oh, now it is really cheap, let's buy more volatility now!", and then it went down to 9%. So you never know when volatility is low, but you know that for example a yearly volatility of 12% corresponds to an expected daily change of the underlying of 0.75%

So Daniele is absolutely right when he's thinking about going long volatility. I wonder, Gregory, when you spoke about the implied volatility going below realized, do you trade variance swaps? As you surely know we have a Variance Future.



Gregory Hung

We take advantage of these opportunities through our hedge fund managers. We don't trade it ourselves.



Jerome Morin: I have created a few risk premia indices that provide access to the implied-realized. I would not know how to play this strategy other than systematically and as part of a broader allocation. It may sound stupid, but the only tactical play I could see for this type of strategies would be to get in just after a market crash and to get out just before the next... So bottom line, as for most risk premia indices, it's about understanding their risks to better control and diversify them.

Now, I understand it can be a bit difficult to understand those risks, what is a "Vega profile" how is a Delta hedge implemented, and so on and this is another reason why we are bringing our platform.

So yes, there are a lot of strategies that can provide you decent carry provided you can understand and measure their risks in the first place. Also, it's interesting to note that investment banks have learnt and invested a lot in research to develop better indices since 2008. It used to be that you could only harvest implied realized in equity, but now you can do that as well in credit, on rates, on FX, really across a lot of asset classes.

Matthias Knab

Greg mentioned the consensus that maybe the first half of 2017 is smooth sailing, but things could get rocky at some point. At the same time there would be a complacency in the market. How do the consultants and advisors here address this? Do you see risk increasing?

Karsten Schroeder: We do not try to time the markets, or incorporate price targets or actually any non-price data into the signal generation for any of our programs' strategies, but I personally tend to agree, that from a macro, fundamental, so valuation perspective, equity markets do not look terribly cheap.

Add a bit of geopolitical worries into the mix, and there could be potential for markets to correct at some stage in 2017 or later. That correction can be an opportunity for our programs to deliver diversifying returns. Generating strong returns in those sort of markets is part of our programs' target function.



Michael Appenzeller: Not that I am in a position to answer that, I hope you guys will be, but I think the only thing you can do is proper diversification of instruments, managers, strategies and underlying factors. So I think it is necessary to have a discussion like we are having it here. Different strategies may or may not be good in the future, and this is why investors need to have a basket and not just of pure hedge funds.

The industry has moved on, next to hedge funds you want to have other well diversified strategies in your alternative basket, including some of our systematics also, but then just make sure to check on their beta as well.

I think that's the only thing you can do. Do you want to guess where the markets go again? I mean, that doesn't work.

Daniele Scilingo: Interestingly, one of the risks we experienced over the last five years was actually **not** being invested or being too cautious. Some investors were and are extremely risk-averse and they staid out of the market due to increased uncertainties. As a result a lot of assets underperformed massively because they had little market exposure with disappointing alpha generation. I think now we are coming into a phase where markets continue to go up, we entering the most positive months of the positive seasonality – I am actually a big fan of the seasonality charts – and people are still too nervous and defensive.

Sure, at some point we'll experience again a correction, crash or even a melt down with a real dislocation of the markets. How I try to address this is with some simple put strategies, but if I looked at fund structures, I want to make sure that **leverage** is under control. There are highly leveraged strategies in so-called liquid markets, but we all know that during dislocations liquidity disappears very quickly, and so I want to understand and see that a certain strategy stays liquid also in really difficult situations.

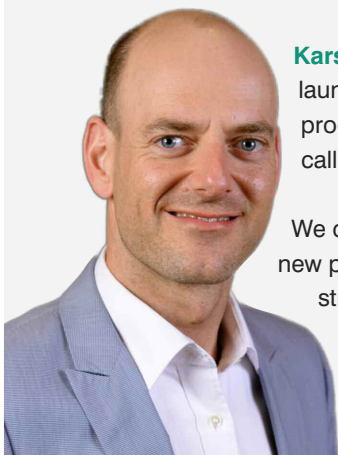
We applauded at very good fixed income arbitrage managers in the mortgage-backed securities space, where they were exploiting minimal spreads with a leverage of 100x. And then when we had a few weeks of dismal liquidity, the spreads went up and they went out of business.

When you are looking how to position your portfolio so that it can weather a storm, then low leverage strategies that can withstand a period of low liquidity can make great sense for investors.



Matthias Knab

We had a great discussion, are there any other final comments before we end? Is anyone working on new products?



Karsten Schroeder: Our research team has been extremely busy and productive, and we have launched two programs recently, one in 2015, our first foray into short-term quant equity trading with a program called Vivace, and at the end of last year we launched a low fee medium-term CTA strategy called Adagio.

We currently plan on launching a UCITS version for our flagship program Klassik. Although this is not a new program per se, we are quite excited about it, because there is quite a gap in the universe of UCITS strategies. There is hardly any short-term CTA available in UCITS form, and now there will finally be one soon.



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What happened in Week 3?

Hedge fund manager A has produced a custom video with Opalesque.TV and it has been online for a few weeks. As with manager A, we sometimes notice that the weekly views of a video can jump several hundred percent from one week to the other.

Weekly video views	Week 1	Week 2	Week 3
of Manager A:	110	101	376



There are a range of different reasons for such a sudden jump in views, for example manager A could have:

- won a prestigious award or was nominated to it
- been included in some industry ranking
- been written up in the press / hedge fund media
- just launched a new fund that gained a lot of attention
- posted a (very) good month or year
- etc.

It is safe to assume that on any given day, someone or many will google any hedge fund manager's name, fund name, or company name. Good for those who have a custom made, targeted video online that investors can access any time, and at their time.



Unexpected long-term effect

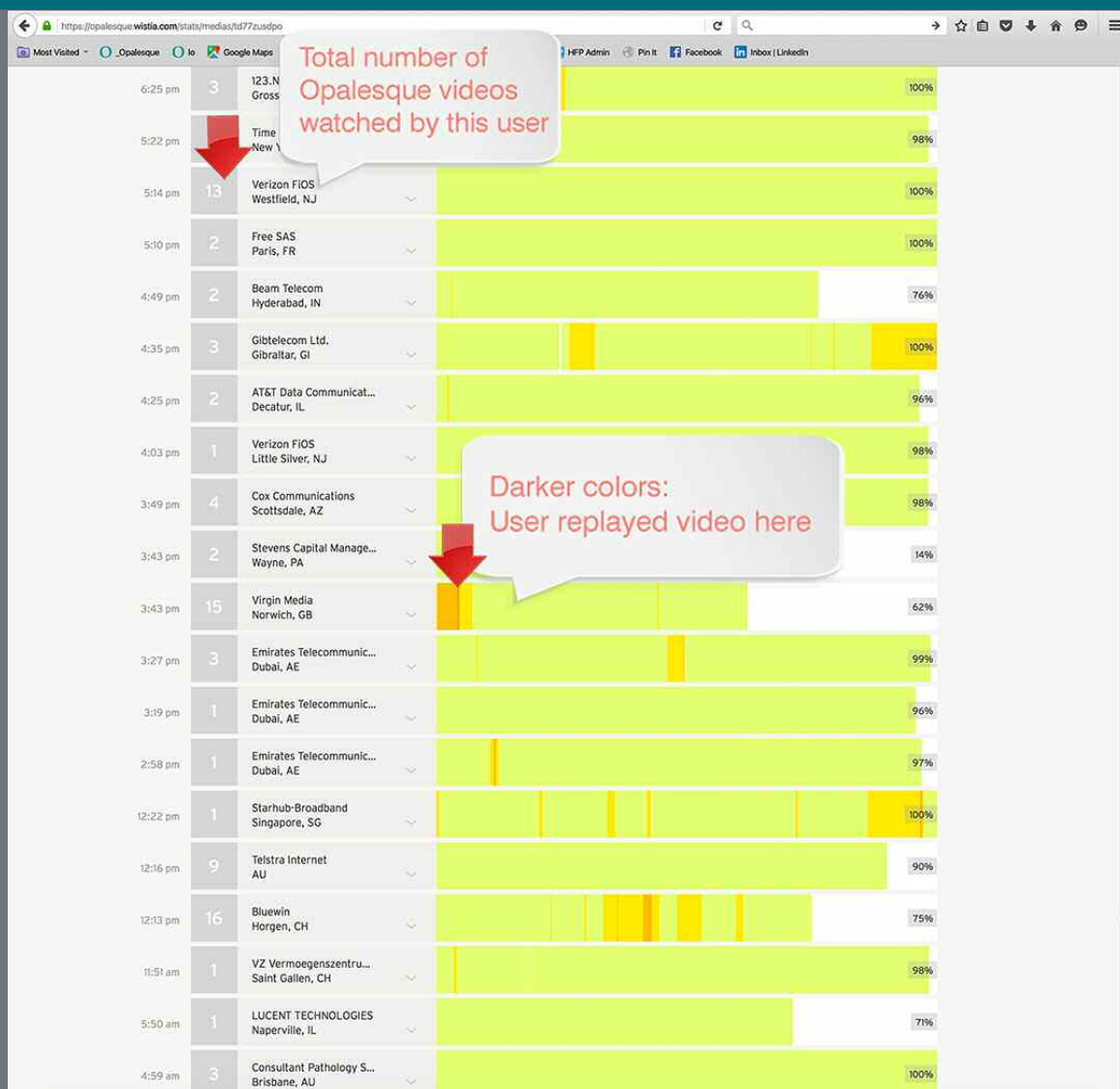
Opalesque has detailed viewer stats on 280+ videos since 2009. What's most interesting is that **video views do not drop significantly over time**, no matter how long the video has been online.

Taking Meetings over Christmas and while you're sleeping

Opalesque.TV videos are designed to simulate a first time meeting with a prospective investor. Many of these allocators will watch a video when they see that there's one available on the manager they are researching (like the viewers of manager A). All 280+ managers who have produced a custom Opalesque.TV video can therefore actually make business (or "have a meeting") while sleeping. Or when it's Christmas.

This video was watched 104 times over the 2016 Christmas holidays:
<http://www.opalesque.tv/hedge-fund-videos/patrick-stutz/1>

Take a look at the next graphic, especially at the hours (which are Central European), the locations, and the completion (how many viewers watched the video until the end):



We therefore believe there are real **opportunity costs** for managers who do not use videos to explain what they do.

Save up to 50% in travel costs by making your first meeting the second one

Have you ever spent time and money to take a trip to present your fund, only to hear, *"Thank you for coming to our office, and please keep sending me your reports ..."*?

What if you had known before that the investor is looking for something else?

By sending their video to prospects **before the meeting**, the manager wins twice. Should the investor be looking for something else, the manager can focus his efforts on those investors who watched the video **and liked** what they saw.

In these cases, managers tell us that the first real meeting becomes more like a 2nd meeting (the 1st one being the video) as the groundwork has been laid and the meeting will be much more successful and achieve much more compared to a regular first meeting. By better **qualifying your leads**, you can basically halve your travel budget and raise more assets quicker.

Compliant

- Opalesque.TV videos are produced to comply with your regulatory requirements
- Allow for true reverse solicitation

You're in control

When you're doing a custom Opalesque.TV video, you have full control about any aspect of your message. This is not a given in any other regular media coverage.

A manager portrait on Opalesque.TV is generally designed to simulate a first time meeting with a prospective investor, meaning that questions like the following will be discussed:

- Please introduce yourself and your firm
- What is special about your strategy?
- How are you different from your competitors?
- What else is important regarding the asset class?
- Opportunities you focus on

Working with a trusted partner

Over 1.2 million people have watched one or more Opalesque.TV videos, which means that the people you may be targeting will already be familiar with Opalesque.TV videos.

Managers like **Julian Robertson, Izzy Englander, Jim Chanos, Jeffrey Ubben, Elena Ambrosiadou, Anthony Scaramucci**, and many others have done Opalesque videos, as well as institutions like **Morgan Stanley, State Street Global Advisors, M&G Investments**.

Broad distribution

You can either produce a private video with us, which will only be hosted on the non-public part of your website, or we can offer you the broadest possible multi-channel distribution on Opalesque.TV and our partners like Reuters and other leading platforms. Contact us to discuss your custom distribution package.

Managers have **quadrupled assets** thanks to our video (\$700m to \$2.4bn in 1 year) and also received a book contract or **invitation to speak at the World Economic Forum or at TED** through our video:

- View count: Over 1.2 million views (hundreds of thousands of people)
- Thousands of investors will view your presentations
- Longterm effect: views do not drop significantly over time
- Without investing a single additional minute of your time – time required to record a video is approximately 90 minutes.

Costs

For a 10 minute video the all-inclusive package price is US\$4000 which includes: travel (Europe and NY tristate), full production at your office, multiple edits (cuts), provision of the final video file, and a global, multi channel distribution package. A 15 minute video is \$5000, so \$1000 will be billed for each additional 5 minute segment above 10 minutes. The client determines the final length of the video.

Links

Opalesque.TV video which got 104 views over 2016 Christmas:

<http://www.opalesque.tv/hedge-fund-videos/patrick-stutz/>

Opalesque.TV videos sorted by number of views:

<http://www.opalesque.tv/most-viewed-hedge-fund-videos/>

Opalesque.TV videos sorted by number of social media shares:

<http://www.opalesque.tv/most-shared-hedge-fund-videos/>

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