



# Opalesque Roundtable Series '18

# CO-INVESTMENT

Opalesque Roundtable Series Sponsor:



# Editor's Note

## Co- and direct investments is where the puck is going in a big way

Co-Investments are equity, debt or other exposures offered by fund managers to their investors directly in the portfolio companies, project or trade in which they invest. They can offer **access to high-conviction ideas and differentiated return streams with lower fees and potentially enhanced returns**. Co-investments also allow investors to better manage and add concentration in their portfolio and can therefore be an attractive complement to fund investing.

**The number of co-investments in private equity has grown 20 fold over the last 17 years with about 90% of private equity fund managers offering co-investment opportunities.** Co-investment and direct deals have been gaining significant momentum for hedge funds and real estate funds as well.

A recent Forbes article pointed out that private investors with a net worth of \$500 million or more are using a significant and increasing part of their wealth to acquire a stake in or whole businesses throughout the world, typically through a **direct investment** via their single-family offices. For example, many of Pierre duPont's clients don't want to invest in a fund because they recognize that the best way to protect and grow their wealth is to own a substantial chunk of a successful and growing business which ideally is in line with their own operational and entrepreneurial expertise.

Still, a large range of investors are receptive to co-investments via an asset manager because the trades are typically complicated and often a host of legal structures are involved. Investors also appreciate and seek the flexibility co-investments are offering, as they can be structured in a wide variety of ways – e.g. segregated portfolio company (SPC), a fund-of-one or a separately managed account (SMA) to meet the needs and preferences of the investor surrounding issues such as custody, investment discretion and confidentiality of their involvement.

While we know that the fees and investment returns look good, but the lack of process, organizational structure and difficulties around manager selection are blocking points for many investors. Timing can also be an issue regarding the timely execution of a co-investment, but this can be addressed upfront with prearranged fees and prearranged structures (page 7, 21).

This Roundtable, sponsored by Lyxor Asset Management, took place in New York City with:

1. David Dunn, **Co-Managing Partner and Co-CIO, Cross Sound Management**
2. Jason Hubschman, **Head of Financial Engineering and Product Development, Lyxor Asset Management Inc.**
3. Jean-Francois Tormo, **U.S. Head of Global Portfolio Solutions and Senior Portfolio Manager, Lyxor Asset Management Inc.**
4. Jim Mitarotonda, **CEO and Chief Investment Officer, Barington Capital Group**
5. Kieran Cavanna, **CIO, Old Farm Partners**
6. Marco Lukesch, **Portfolio Manager, Emso Asset Management**
7. Pierre duPont, **Partner, HPM Partners**

The group also discussed:

- Which are the three main reasons or motivations for a co- or direct investment? (page 6, 7). **Why almost all activist managers offer co-investments** (page 7). Shifting from credit towards more equity-related types of co-investments (page 10)
- **Liquidity considerations** for co-investments (page 8). **Typical fee arrangements** for co-investments (page 9, 24-25)
- Due diligence and questions to ask when reviewing a co-investment (page 18). How to deal with the potentially higher volatility of co-investments (page 9, 11). Portfolio construction with co-investments (page 19). What can go wrong and lessons learned. Risk in co-investments and how to mitigate it (page 22-25)
- The role of **manager selection** (page 12, 15). What is **the ideal co-investor** (co-investment partner selection)? (page 12, 13, 18). **Sourcing of co-investments** (page 14, 15)

- Allocators often develop teams for co-investments. How do managers view their expertise? (page 11). Why **family offices and high net-worth investors** are welcome co-investors (page 17)
- **Governance and best practices** in co-investments (page 13-15 ). Process and infrastructure considerations for co-investments (page 14, 21)
- **Co-investment funds of funds**: Why commingling co-investments can ultimately be attractive. The opt-in structure (page 19-22)

Enjoy!

Matthias Knab  
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## Participant Profiles



(LEFT TO RIGHT):

Kieran Cavanna, David Dunn, James Mitarotonda, Marco Lukesch, Jean-Francois Tormo, Pierre duPont, Jason Hubschman, Matthias Knab



# Introduction

**Jason Hubschman**  
Lyxor Asset Management

I am Jason Hubschman. I am the Head of Financial Engineering and Product Development at Lyxor Asset Management Inc. I am responsible for structuring bespoke investment solutions for institutional clients.

My main focus is matching up and meeting the needs of our investor base with the underlying hedge fund managers and optimizing solutions based upon the needs of both parties.

Lyxor has extensive structuring expertise that we put to work for our clients. We launched the industry's first hedge fund managed account platform 20 years ago, and have continued to develop our platform and capabilities in the space. We currently have approximately \$16 billion in hedge fund managed accounts, including dedicated managed accounts customized for specific institutional investors, as well as commingled managed accounts that offer risk managed access to leading hedge funds. We believe that combining structuring and investment expertise can lead to more efficient implementation methods and results when allocating to alternatives.

**Jean-Francois Tormo**  
Lyxor Asset Management

I am Jean-Francois Tormo, U.S. Head of Global Portfolio Solutions and Senior Portfolio Manager at Lyxor Asset Management Inc. I am also a member of the firm's Investment Committee, for fund-of-funds and multi-asset products. I am in charge of the fund-of-funds and advisory mandates which are managed out of the Lyxor New York office. This includes fund-of-funds for which we have full discretion where we can go direct or invest in other investment vehicles, such as managed accounts, and a number of advisory relationships that we have with U.S. institutions.

Altogether Lyxor advises and manages approximately \$15 billion globally in multi-manager alternative investment mandates, including for some of the world's largest institutional investors. Our investment team incorporates all aspects of alternatives investing, including manager research, operational due diligence, risk management and sophisticated portfolio construction.

**Kieran Cavanna**  
Old Farm Partners

I am Kieran Cavanna, CIO of Old Farm Partners. We are a fund of hedge funds and co-investment firm. We have about \$220 million in our fund strategy and in addition we have four advisory relationships. Prior to founding Old Farm, I led the External Manager Team at Soros Fund Management.

**David Dunn**  
Cross Sound Management

I am David Dunn, Co-Managing Partner and Co-CIO of Cross Sound Management. My partner, Arif Gangat, and I launched Cross Sound in early 2016 having previously spent five years working together in the U.S. distressed investing group at Arrowgrass Capital where we developed a successful investment approach that utilized our complementary skills, including fundamental and legal/restructuring analysis.

Cross Sound is an event-driven fund emphasizing a catalyst focused approach to identify non-correlated distressed investments in North America. Currently, we offer three alternative investment solutions across the distressed complex: 1.) an event-focused, distressed strategy which invests across the capital structure 2.) an event-focused, senior secured strategy investing in stressed and distressed corporate loans and bonds and 3.) deal specific or thematic co-investment opportunities.

Our strategies are managed a bit differently than some of our distressed peers; we're not "buy-and-hold passive investors" and we place a great deal of emphasis on the restructuring process, the upcoming events in the process and how those events will impact securities prices. Also, we are not shy to roll up our sleeves and drive the process via committee participation, board participation or quiet activism with management and the Board. We employ a concentrated approach that focuses on our best ideas which naturally provide strong co-investment opportunities for our co-investment partners. Over the last two plus years, we have

shared roughly 20 co-investments to a limited subset of co-investment partners.

**James Mitarotonda**  
Barington Capital Group

I am Jim Mitarotonda, the CEO and Chief Investment Officer of Barington Capital Group, L.P., an activist investment firm that I founded in January 2000. Barington specializes in investing in undervalued small to mid-cap publicly traded companies, typically with a market capitalization from \$500 million to a few billion, although we will invest in both larger and smaller companies when we see compelling value. The largest company we have invested in to date was Darden Restaurants, which had a market capitalization in excess of \$6 billion at the time of our investment.

Our strategy is to take sizeable stakes in publicly traded companies that we believe are fundamentally undervalued and can appreciate significantly when improvements are made to their operations, corporate strategy, corporate governance and capital allocation. We develop detailed plans to improve the long-term performance of these companies and then seek to collaborate with their boards of directors and management teams to implement our recommended initiatives.

Our strategy lends itself extremely well to offering co-investment opportunities, and we have a long history of successfully partnering with co-investors in our activist investments.

**Marco Lukesch**  
Emso Asset Management

My name is Marco Lukesch. I work for Emso Asset Management which is an 18 year old emerging markets fixed income asset manager. We have a variety of different products and I co-run our distressed and illiquid business, focusing on distressed and illiquid credit investments in the emerging markets.

Over the last few years, Emso has done several co-investments on the liquid macro side.

**Pierre duPont**  
HPM Partners

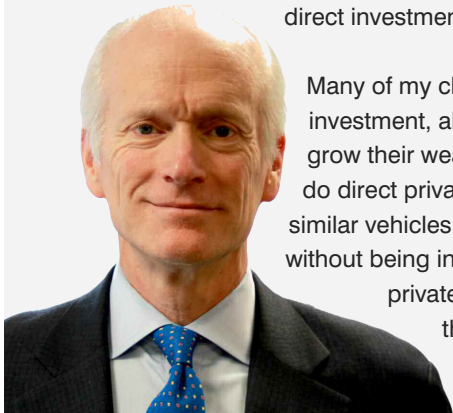
I am Pierre duPont from HPM Partners. We are a registered investment advisor and manage about \$10 billion for more than a thousand people nationwide, including a number of very large family offices and private business owners, and successful private equity or hedge fund founders.

We do global asset allocation and portfolio management, estate planning, tax, and a full suite of family office services, plus we provide a variety of services for businesses and fund GPs such as 401k, deferred comp, and executive financial counseling. We are a private partnership and have a staff of about 110 people in six offices nationwide. And we are fanatical about our fiduciary obligations to our clients and thus are only ever paid directly by our clients, never taking success fees or fee-shares from the funds we allocate to or from the other advisors we bring into a situation.

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**Pierre duPont:** Regarding co-investments (or as I mean the word, direct-private investments next to or independently of a fund's investment), I take a different view than anyone else in this room. My particular focus and expertise regarding investments is on multi-gen inheritors and business owners. I work with some family offices and successful business owners to help them build and manage and grow (and even exit parts of) portfolios of private-direct investments.



Many of my clients don't want to be invested in a fund at all because they have expertise to add to an investment, along with their money. Most importantly they recognize that the best way to protect and grow their wealth is to own a substantial chunk of a successful and growing business, so they want to do direct private investments. Occasionally, they have invested in some private equity funds or a similar vehicles and received co-investment rights, which is good, and occasionally they may co-invest without being in the fund because of their additional value-add. But mostly my clients like to do direct private Investments on their own or in collaboration with other individuals who are a bit like themselves.

**Marco Lukesch:** Pierre, I think you made a valid point. When you think about the types of co-investments or direct private investments, I think that in general we can say that **there are mostly likely three reasons or motivations for a co- or direct investment:**

*First, it's a liquid investment and you have too much of it in your fund. Second, it's an illiquid investment and should not go into the fund because the capital structure of your fund is daily, monthly, quarterly, or maybe even annual liquidity. Third, you cannot do the transaction without co-investors, because the required deal size is likely too large for one investor.*

To me, the first and the third one are traditional co-investments where you are co-investing with the fund. The second, illiquid one I would call direct investments. Investors seem receptive to that.



**Pierre duPont:**

You are exactly right. I think one reason that family offices or wealthy individuals participate in that is because they don't have the expertise to do the analysis, let alone the finding of the deals that you bring to the table, and so that does make sense.

**Marco Lukesch:**

Correct, and so we are finding that people have been receptive to co-investments offered to them via an asset manager because the trades are typically complicated and also typically a host of legal structures are involved.

**James Mitarotonda:** We have also seen significant receptivity to co-investments, particularly from family offices, high net-worth individuals and even the institutional market.

Co-investments are, of course, a custom affair, and this contributes to their attractiveness. We can structure a co-investment in a wide variety of ways to meet the needs of our co-investors and their preferences surrounding issues such as custody, investment discretion and confidentiality of their involvement. Investment options include direct private investments, special purpose vehicles, management account arrangements and funds-of-one.

Let me tell you how we go about co-investments. After signing a **confidentiality agreement** with us, the investor gets an opportunity to review our investment presentation and have a meeting with us where we will have a detailed discussion about the company and our plan to improve its long-term performance. This is different from investing in a fund where you do not have that kind of visibility regarding individual investments, at least until after they are made public.

At Barington, we have a two to five year investment time horizon. So our approach is closer to private equity than your traditional long/short hedge fund, as it takes some time for a company to implement the measures we recommend to improve long-term value for shareholders.



*When excess capacity is available, we believe it is beneficial to permit others to co-invest with our clients, as co-investors increase the size of our collective investment in a company. A larger investment can increase our influence as an activist investor, as well as lessen the expense burden on our ongoing clients, as co-investors bear a pro-rata portion of expenses. Co-investors may also provide additional benefits to the group, if they bring, for example, industry knowledge or operating insight regarding an investment.*

Co-investors typically do not get to see our smaller investment opportunities, where capacity is limited, and when we do offer co-investments, we'll give preference to our existing clients. While the minimum size of a co-investment tends to be higher than a fund investment, fees are usually lower.

**David Dunn:** I would echo the points that you made previously and just add that from our perspective the traditional definition of co-investing doesn't necessarily matter.

*What I mean is that we don't see LPs say, "I am going to come in for X% and your fund is going to invest Y% in the deal and that's what I am looking for." In fact, in many cases, our co-invest partners don't require that our flagship strategy or another commingled fund invest alongside. Rather, we notice that they really want access to interesting ideas, the opportunity to invest and the ability to put their money to work.*

Our approach has been to establish a true partnership with our co-investors by identifying a series of trades within a certain sector or of a certain nature, and then pursuing those trades collectively to their benefit.

From a structuring perspective, we have seen LPs being most amenable to structuring a single co-investment opportunity via a segregated portfolio company ('SPC'), a fund-of-one or a separately managed account ('SMA'). Additionally, we have also witnessed amenability to co-invest facilities which permits an investor to pursue a particular series of trades within a committed facility – subject to parameters around security type, duration, size, target returns/IRRs and sector.





**Marco Lukesch:** I agree, and we have also seen cases where investors have set up a fund-of-one that basically mirrors the main vehicle or the main fund, and then they have a separate box for co-investment or direct investment that is created specifically on day zero to make these types of investments to speed things along down the road. With that you typically have prearranged fees, a prearranged structure, and then you can bring them the trade, and if they like the trade, you can potentially execute it very quickly because all of this has been thought through on day zero already.

**James Mitarotonda:**

We are seeing dedicated teams at some of these institutions such as endowment and sovereign wealth funds that are focused primarily on co-investments.

**Jason Hubschman:** Many of our clients have established a dedicated platform consisting of a series of funds-of-one, *so while the underlying investment funds may have a somewhat frequent liquidity, the investor is actually making long-term investments.* They are de facto giving up liquidity by setting up multiple fund-of-ones already for their balance sheet, and now they are looking at ways to better monetize that set up – the long-term commitment – and co-investments are a natural fit.

We are seeing investor interest in establishing captive co-investment facilities where managers can sign on very quickly for co-investments, either directly in the investor's own vehicle or using LPs from manager set-ups, like Marco had mentioned.



**Jean-Francois Tormo:** Just to add to Jason's comment, we are seeing the same type of appetite from investors in single co-investment ideas, even though we are going one step further, which is to potentially **create a fund-of-funds dedicated to co-investment for our clients**, where we can have a series of idiosyncratic opportunities in a fund structure.

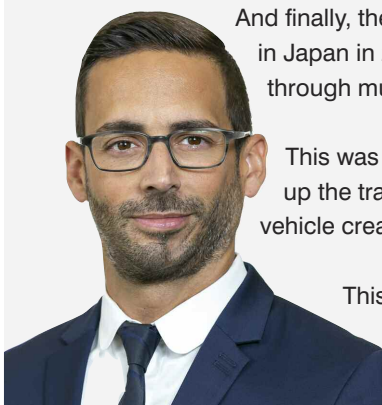
I think in this audience, we have a good representation of every co-investment type. At Lyxor, we have four broad categories of co-investments.

The first is in public equities, where we can co-invest with activist managers. Second, includes legally-driven types of opportunities that can be in emerging markets, which are not only exploited by managers, such as Emso, but can also be in the U.S. through Chapter 11. The third is what we call “market-induced dislocations.” For example, in 2008, we saw large dislocations in the credit market, with a number of assets, in particular structured, corporate, stressed and distressed credit, which were trading materially below fair value. These were great opportunities for co-investments as they subsequently recovered with high IRR. Another example was in 2016, where we saw some technical dislocation in CLOs as a number of banks and funds had to sell CLO assets. This co-investment was shorter as those assets recovered in a short period of time.

And finally, the last one is the “macro-induced opportunities.” An example of this would be what happened in Japan in 2013, where one could have benefitted from the reform program under Prime Minister Abe through multiple assets, such as equities, foreign exchange and fixed income.

This was a very important macro theme in a number of global macro funds which were not able to size up the trade in their fund due to diversification constraints, and a result of a separate co-investment vehicle creation. More recently, we saw similar macro opportunities in India.

This highlights how different idiosyncratic co-investment opportunities can be grouped into a single fund structure that can produce a high IRR, and a very low correlation to traditional assets.





**Kieran Cavanna:** There is so much activity like this that Jean-Francois has described going on right now. I have been doing co-investments for about five years now and I really do think this is where the puck is going in a big way.

For us at Old Farm, this means a liquid-only, best ideas approach to co-investing. Regarding the type of managers we work with, we have to have high conviction in their ability and judgement before engaging on an idea. We love it when they bring us one or two ideas a year, and a common mistake we see out there are hedge fund managers bringing too many co-investment ideas to market. Volume does not breed confidence.

We also need to mention fees, which are of course another attractive factor. **A zero percent management and ten percent performance fee is typical** for a co-investment, and investors appreciate the fee savings. This fee savings is particularly important for those investing for some sort of constituency; whether an investment committee or on behalf of a family. Endowment boards I know, and really investors in general, continue to have a strong appetite for saving on fees. The impulse to break down the one-and-a-half and 20 standard hedge fund fee without sacrificing returns is quite strong.

But to sure, it's not just about saving fees. If co-investments are properly sourced and underwritten, a co-investment program can also make good risk-adjusted returns and add to the risk/return profile of a larger hedge fund allocation program.

As a co-investor, I am seeing just a ton of activity across strategies and different manager types. For instance, in the realm of activism – a popular domain for co-investments but I am not too active in this space – I see co-investment pitches come across my desk on a weekly basis. Another example, one of the world's largest macro firms in London is rolling out three big trades in separate funds with very good fee structures right now. Another, I have a short-only co-investment that we have done with a really great short seller.

**The variety is out there, and it is not just long things or adding to beta.** So, as an investor, I see that the opportunities in co-investments are really broad-based and the ideas are vibrant. It is a very interesting area and I think anyone allocating to hedge funds has to have some sort of strategy to address co-investing.



**Jean-Francois Tormo:**

I was wondering, how are you able to combine these different opportunities, which are idiosyncratic, uncorrelated, and where the typical portfolio construction techniques do not necessary apply. In this scenario, how do you approach portfolio construction?

**Kieran Cavanna:** You are right, co-investments can be much more volatile, and so at Old Farm we combine hedge funds with co-investments. One rough rule of thumb is that if we do a 5-6% allocation to a hedge fund, we may do 1.5% as co-investment. Sizing is so important; just this year, one of our co-investments is up 80% and one is down 25%.

*Generally co-investing is not a pursuit for investors looking for lower volatility, but given the position sizing, I think it's reasonable for most investors to engage on.*

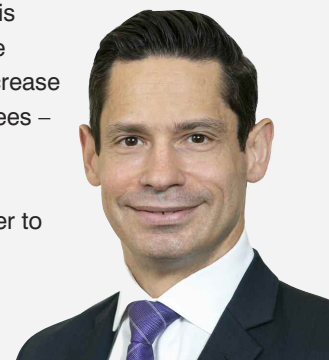
Right now we have 13 co-investments allocated across 20% of our portfolios, and are quite punchy but small positions.

What is interesting is examining the fee savings on that 20% of our portfolio in aggregate. It is extraordinary how depressing that 20% is on the overall fees we pay in aggregate to hedge funds. Yet so far we have not sacrificed good returns for lower fees.



**Jason Hubschman:** Just another quick point on the fee savings, which as you mentioned, Kieran, is relevant for anyone who has to report to their constituents. From the investors' perspective, they are already long a manager due to a traditional investment into the strategy, so they would prefer to increase the allocation via a co-investment for two reasons – access to the “best ideas,” and to drive down fees – because those are very tangible from a reporting standpoint.

The fee savings are realizable very quickly. Obviously, the co-investment itself is going to take longer to materialize and monetize, but cost savings can be shown pretty quickly up to a reporting board.



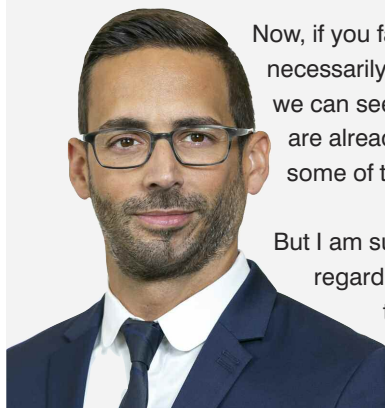
**Kieran Cavanna:**

Imagine you are on an investment board and that you may not have that much good news to deliver, but you could say, “*by the way, we just saved \$5 million in management fees by doing some interesting things that are fairly unique to us*”, and I think that’s exactly what is happening out there and is one of the main motivations behind having a comprehensive co-investment program.

**Matthias Knab**

What other trends or developments do you see around co-investments?

**Jean-Francois Tormo:** One thing that comes to mind is that there is some degree of cyclical in co-investments. The financial crisis in 2008 was a credit-induced crisis; therefore, a lot of the opportunities were in credit. As a result, we saw double-digit or higher IRRs.



Now, if you fast forward to today, what can investors expect in some of these opportunities? Well, not necessarily the same type of potential IRR because those trades have been done already. This is where we can see a bit of a **shift towards more equity-related types of co-investments** simply because we are already that far in the credit cycle. There is a degree of cyclical in the potential IRR in some of those opportunities.

But I am sure you as managers and investors in some of the securities can share more insights regarding the next trends or the current opportunities, or some of your recent projects around this topic.

**David Dunn:** I would summarize my thoughts by saying that co-investments are potentially attractive for allocators as they offer access to high-conviction ideas with lower fees and potentially enhanced returns. Also, we are very transparent with our co-invest partners and are willing to share our research and models with them to augment any independent diligence they'll execute on the opportunity.

Fees certainly play a big part as co-investments can help lower the cost of a hedge fund program, but then there is also a strong focus on finding differentiated return streams. The demand for credit co-investments is also a byproduct of the global hunt for yield driven by the later innings of the current credit cycle. We believe finding investments that are uncorrelated to the market and to other hedge fund holdings is an attractive proposal for our co-invest partners.

*Jim mentioned earlier that dedicated teams are being developed within the allocator community to pursue co-investments. We have seen that as well, but we have also experienced a lot of multi-tasking, so to speak. People that wear allocator hats are also wearing co-investment hats, and depending on which co-investment partner we are speaking to, the ability to actually execute on a co-investment varies pretty significantly from institution to institution.*

That being said, over the last 18 to 24 months, hedge fund allocators have built out dedicated teams, consisting of team members with tenured capital markets experience, who are focused 100% on co-investment opportunities. This in turn can lead to an improved probability of execution and a nimble institutionalized process around identifying, diligencing and ultimately executing on co-investments.



**James Mitarotonda:** I want to come back to Kieran's point of having one co-investment up 80% and another one down 25%.

When we look at the benefits and the negatives of co-investing, you could say such a potential range of outcomes is a negative compared to a fund investment, where our investors gain exposure to a dozen or so positions. I would add, however, that when our clients invest in more than one co-investment, we net the returns, which protects our clients to the extent that there are both winners and losers. Even if a client were to invest in just one co-investment with no netting, the lower fees that we typically charge on co-investments may offset this potential negative.

We are currently discussing with co-investors a couple of companies that we have been working on. One is an aerospace company that has underperformed the overall market for a number of years. As most aerospace companies have done quite well in the recent past, we believe it is an attractive investment opportunity.



**Jason Hubschman:** Many investors that we talk to are interested in co-investing from a fee and an investment perspective, but then from a process point of view and a structuring point of view, they have impediments.

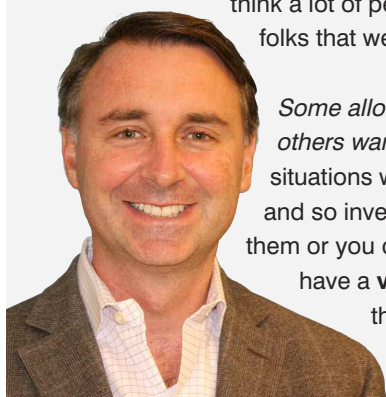
Our approach is to be a solutions provider around structure and process so investors can efficiently allocate to opportunities. We act as a fiduciary to our clients and serve as an extension of staff – in this case, the focus is on a fiduciary process as a specialty office for investors who want to allocate to co-investment opportunities, but have not built out internal teams focused solely upon co-investments.

*We know the fees look good and that the investment returns look good, but it's the lack of process and organizational structure that is a blocking point for many. What in your experience are the other things that are really preventing some allocators from putting more money into the co-investment space?*



**Kieran Cavanna:** Well, I think it's a few things. **Manager selection is critical**, we haven't really discussed that part. I mean, what hedge fund doesn't have a liquid idea out? They all do. You can still come across instances where managers or allocators thought a certain trade was like getting free money, and what happens next is that you often see that big trade blowing up. Like, Puerto Rico last year was a one, and Argentina so far this year.

Another example from a long time ago was when a big activist investor raised capital to engage a large department store chain, and because that was an early version of a co-investment and because it did not work out, it was a very negative experience for some. Just like with many other things, **it matters who you are dealing with and not just the idea**, I think a lot of people don't want to engage with people they don't know. I know we don't want to engage with folks that we don't have a good context around.



*Some allocators want to process everything internally and re-underwrite every trade completely while others want to focus on certain types of co-investments*, in one case a group I know really focuses on situations where the manager is in control. Jim also pointed to the fact that there is a lot more volatility, and so investors have to have a portfolio approach to these things because you can get lucky on one of them or you could also get really unlucky on a single idea. In my mind, as a co-investor you really have to have a **very clear policy** on what you are doing, and right now a lot of groups are figuring out what their policies will be.

**David Dunn:** Kieran mentioned manager selection and how important it is from his perspective. Similarly, **co-investment partner selection is equally important for us as managers**. When establishing these relationships, we believe it's important to know your clients' co-investment needs extraordinarily well from the start.

To Jason's question around the process perspective, *we seek to establish the appropriate infrastructure well in advance of our first co-investment transaction with each of our partners.*

*For example, we'll have a formal non-disclosure agreement in place, agree loosely on fee terms and fully understand our partners' preferred ticket size, duration, types of securities and internal controls. All of these factors permit us to be highly targeted when sharing ideas with our partners. We can also establish a standing implementation vehicle – SMA or fund-of-one – for our partners to the extent that they want to do one or more trade(s) in the future.*







**James Mitarotonda:** *I think it's important to have a plan up front on how to build a position, so all group members understand at what prices purchases will be made, in what amounts, and how the purchases will be allocated among existing investors and co-investors.*

As a registered investment advisor, we are committed to making sure that **all our group members are treated in a fair and equitable manner**. For example, it is important to us that all group members executing trades get the same execution and purchases and sales are allocated on pro-rata manner, so nobody is advantaged or disadvantaged. We therefore have trading processes that we put in place to make sure that is the case.

**Marco Lukesch:**

Just to add to our discussion on internal/external process management, one corporate form that can be used in the Cayman Islands is a segregated portfolio company. Each trade could be a segregated portfolio of the segregated portfolio company. You could even have share classes within the segregated portfolio for one investor with different trades, so it is an immensely flexible structure.

**Matthias Knab**

Let's further look into best practices, governance regarding co-investment and how to address potential conflicts of interests.

**Marco Lukesch:** Right, these are very important aspects also in co-investing. For example, **one key question is who gets to see what?** I think the easy answer here is transparency. One way to address this is to be very explicit that investors who come into the commingled fund for X amount have the right to be on the co-invest list; whether they want to be on that list or not, it's up to them obviously.

*But let me also take a step back in this discussion by saying that you actually need a commingled fund to find ideas to be able to show investors to co-invest or direct invest. I believe that first of all you need to be constantly in the market and that you need to have some level of credibility in the market.*



**James Mitarotonda:** Given the nature of our type of investing, the most important step to start the process is the signing of a confidentiality agreement with a strict "no-trade" provision.

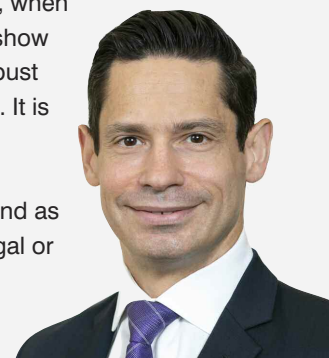
It typically takes us 6-9 months to identify an investment idea and develop a plan to improve a company's financial and share price performance. We will then put together a detailed investment presentation that could be 50 to 80 pages in length. *So, of course, we want to make sure that our work is protected and that no outsider front-runs our investment group.* We take this process quite seriously, and have worked with the government in the past to help prosecute a potential investor that violated the terms of our confidentiality agreement.



We touched upon the importance of working with established investors. I think it is always a good idea for co-investors to work with registered investment advisers that have an **established infrastructure** in place – including legal, compliance, accounting and other back office functions – as well as experience working with co-investors.

**Jason Hubschman:** I think one of the things that we keep coming back to is process. For example, when looking at how co-investment opportunities are allocated to clients, the only real way to be able to show that you have been "fair and equitable" in all instances is to be able to show – and rely upon – a robust process. Merely looking at who saw the opportunity and who decided to invest will not be sufficient. It is really a process-driven issue, more so than a results-based issue.

By relying upon a process that is clearly set out at the beginning, you can avoid upsetting clients, and as long as your process is sound, you will be able stand on it if someone comes in with any type of legal or regulatory scrutiny.

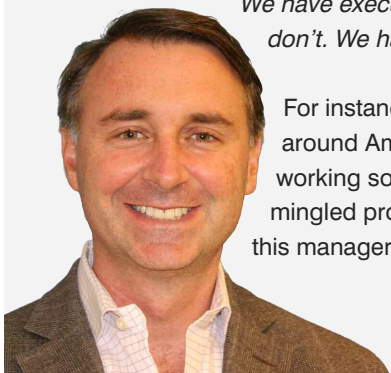


**Matthias Knab**

Kieran, do you want to add something regarding process and best practices?

**Kieran Cavanna:** We are fund of hedge fund investor, so for us like any other investor the **sourcing is critical**.

*We have executed co-investments with managers we have money within their funds and others that we don't. We have also invested with managers who don't have a fund but they have a good idea.*



For instance, we have a manager with a short-only theme who has a \$70 million co-investment structure around Amazon displacing B2B distribution businesses which is a super interesting trade but not working so well so far this year. This manager is a retired hedge fund manager, and does not have a co-mingled product outside of this one theme fund. We love the idea and look forward to it working out, and this manager has demonstrated in the past that they can find great short thematic ideas.

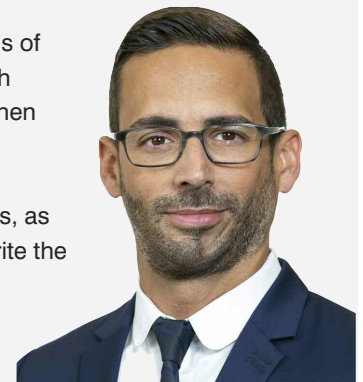
I agree that it's key to have to have these protocols in place. We rely in the first place on our **manager underwriting** as a very important component; this is really at the core of what we do. We are not portfolio managers ourselves trading stocks, and hard for us to second guess a portfolio manager too much in their area of expertise. Rather, we like to establish a co-investment with someone who is good at something and keep within that domain of expertise. For example, I know Jim has a very good reputation in retail and consumer stocks for instance, and if he was bringing up retail name, I take that seriously. If he is bringing a biotechnology name, I probably would pass. So, at least for us, we rely much more on manager underwriting and invest in that regard rather than sort of reinventing the primary research ourselves on the idea. We do some vetting of the idea, but don't fool ourselves into thinking we are experts because of it. I tried the approach of fully re-underwriting at one stage and we ended up not getting great outcomes.

*And Jason, coming back to the protocols, here is an interesting situation. I just came from a fund that has a 20% position in stock. They have a \$400 million fund and they have a \$100 million co-investment. Now if he needs to trim it, who goes first, right? You have to have some sort of protocols on how you manage things like trade allocation. And at the heart of it, you can't hurt or disadvantage the fund, you can't hurt the fund investors. We pay attention to this sort of protocol. By staying in liquid things though, we avoid a lot of potential issues in my view.*

And also, let me use this forum to make an appeal to all managers who set up and do these co-investments: **Make sure it really is your best idea.** There are few things that can kill a relationship quicker than getting pitched an idea and watching that stock drop significantly because something completely aberrant happens. I said this already, everybody has a liquid idea out there, so everybody has something that they can put more money into, no doubt, and so being super-choosy is really important for the manager and for the investors.

**Jean-Francois Tormo:** If I may add, it's really an extension of what we have already done in terms of manager selection. Our manager selection team, which is organized by strategies, is working with managers that they have known very well, and is trying to understand these specific trades and then decide whether it makes sense to size up via co-investment structure.

The additional work includes understanding the securities, the thematic, the monetization process, as well as what can go wrong and how to react. This means, you are somewhat trying to re-underwrite the trade. This is where the job is slightly different from traditional manager selection.



**Marco Lukesch:** Right, but I also get Kieran's point and I believe this brings up an interesting question like, **"Where is the underwriting line?"**

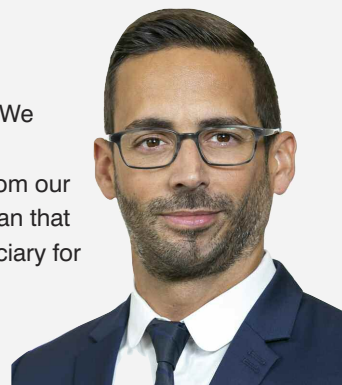
In emerging markets, it's not just credit risk in a transaction, there is also legal risk, there is also some form of jurisdictional risk, there is FX risk typically, so the question is how far does the allocator want to staff up to be able to underwrite a trade in this domain? Do they want to have a team of transactional lawyers looking at individual deal docs? That's often expensive and a lot of work.

The decision needs to be made how far do you want to go down the line in terms of underwriting these transactions and then staffing up appropriately and you need to have the clear strategy around it.



**Jean-Francois Tormo:** It is clear that these aspects and questions need to be defined well.

I don't think we are disagreeing here, underwriting the trade starts with underwriting the manager. We know that you have the teams, the research capabilities, the way to structure the trade, the local contacts, and the infrastructure. A sector like yours – emerging markets – is very specific. Then, from our perspective, we seek to get a clear understanding of the trade itself, which obviously does not mean that we are trying to challenge you, but having the right understanding is what we have to do as a fiduciary for our investors.



**David Dunn:** I would say from a manager's perspective it also requires a bit of a paradigm shift from how you might interact with a co-investor versus a limited partner who is invested in a co-mingled fund and someone you talk to once or twice a quarter or once every six months.

As it relates to co-investments, you have a **whole other form of communication** with your partners, starting with the diligence process of any potential co-invest and then very succinctly identifying entry and exit points, size and duration and event path. And then, once the trade is executed, really sort of re-underwriting that trade on a daily, weekly, monthly basis and communicating that to the co-invest partner, which may be more information than they want but at least, you are giving them that opportunity.

To add some finer points around my comments, in our experience, **the co-investment underwriting and monitoring process generally occurs in five broad stages:**

First, we share a 'co-investment teaser' which addresses, at a high level, our investment thesis, background on the company, a summary of historical and forecasted financials, key risks and the required due diligence timeline. Should our partner be interested in learning more, we'll move on to stage two, which is when we'll share Cross Sound's full due diligence information, including models, memos and presentations, on the investment. During this stage, which can be as short as a few days or as long as a few weeks, we'll communicate frequently with our partner to answer any questions that arise as they complete their own independent due diligence.

Once our partner has wrapped up their diligence, stage three begins and they'll seek approval from their investment committee for the investment and allocation size. Once approved, step four is executing the trade. We have partners that prefer us to do the execution on their behalf and other partners with the capabilities to execute on their own. The final stage is the ongoing qualitative and quantitative monitoring, by us and our partner, until the investment is monetized. In the event there is a significant deviation to the initial thesis/event path, we will immediately discuss with our partner to keep them informed and devise an appropriate response. We've instituted a servicing model where we prefer to over-communicate and be fully transparent with our partners.

Additionally, through this process, we've found that an engaged co-investor can be a value-add to us, as well. I can think of one particular institution that we do business with that does add value to a lot of our trades and we actually derive benefit from having their team join us at a meeting or on a conference call because they have differentiated ideas. This is an unexpected, but certainly welcomed benefit of the co-investment construct that we are seeing.



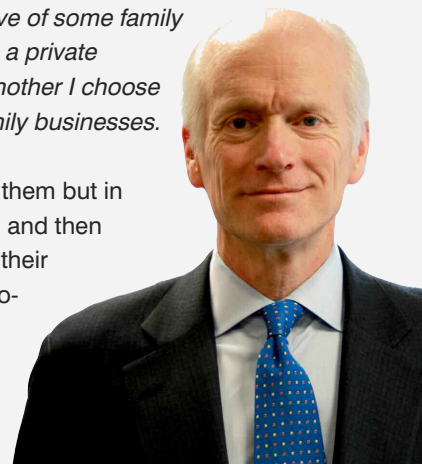


**Pierre duPont:** David, you used that word “value-add” for the first time in our conversation today, and I had been waiting for that, hoping someone would say it at some point, because, again, I am in a different business.

The family offices I deal with in general don't have the billion-dollar institutional magnitude you are referring to, and for them, it can be completely about the value-add that they themselves can bring to the board of a company – it's their expertise in a particular sector, or their decades of experience building businesses that is the value-add. And in many cases (true, not in all cases), they would be looking at a private company and a very long term hold – we are not talking 3-5 years as PE funds usually limit themselves to, instead we are talking forever in some cases.

*Forcing an artificial exit just because the fund is approaching its end after three to five years is in some cases not the best thing for a private company and its long-term success. So that's the perspective of some family offices and private investors, and I share that perspective: that has been my experience as a private business builder earlier in my career (in one case I took PE to build my business, and in another I choose not to take PE) and in both my mother's and father's families regarding their respective family businesses.*

A family office's ability to find a peer, someone a bit like them or maybe a bit different from them but in either case someone who can speak and think wisely regarding business, and understand and then contribute value-add to a \$100 million company – that “value-add” is usually at the core of their investment thesis. So when a family office or a ultra-high net-worth investor talks about a co-investment, it's usually with someone a bit like them, a peer, maybe a similarly-sized family office or another UHNW.



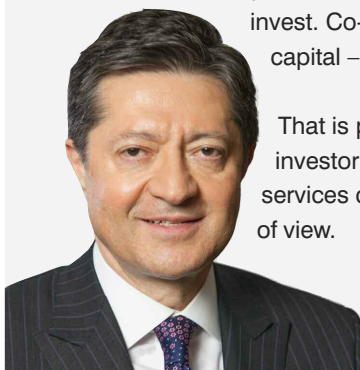
**James Mitarotonda:**

I would like to add to Pierre's point that there are a large number of family offices that didn't generate their wealth by investing in the financial markets. They made their money by building a company.

**Pierre duPont:**

Correct, going long on one company may very clearly be the source of almost all wealth in this country.

**James Mitarotonda:** Right, one company, and that's usually the company they built and ran and that became successful. They therefore may have significant operating experience as well as industry expertise in sectors where we invest. Co-investors with this type of background can bring tremendous value – in addition to adding capital – by way of assisting us in assessing businesses and our value-creation plans.



That is part of the reason why family offices understand and appreciate what we are doing as an activist investor and enjoy working with us. We invest in consumer, retail, industrial, chemical and business services companies. These are sectors that family offices typically know well and can add a valuable point of view.

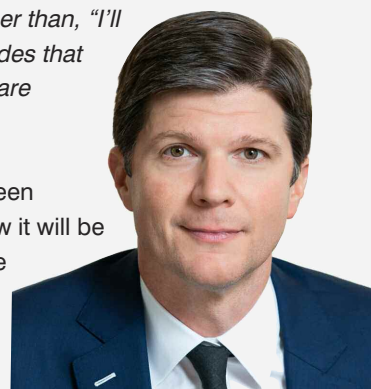
## Matthias Knab

We had already made a point that there is a wide spectrum of behavior and of skills between your co-investors. I was wondering, from your point of view as a manager, is there something like an ideal co-investor? We also spoke about process, what other recommendations that you have for an end investor to execute co-investment in a seasoned way?

**David Dunn:** I wouldn't say we have an 'ideal' co-investor. We are open to partnering with institutions, family offices and high net-worth individuals.

*Back to my value-add point – we look for investors who can bring something else to the table. For example, it can be an institution that has research capabilities away from their investment arm that then allows us to work with experts that they know in the field and can be relied upon. For us, this is a true optimal partnership rather than, “I’ll show you an idea, you give me that allocation and I’ll go invest it”. This is especially true for trades that are longer in duration and more illiquid, which is generally the types of co-investments that we are looking at.*

Transparency around understanding each other's process is also a key attribute required between managers and co-investors. In our case, when we go to our partners with an idea, we know how it will be processed and reviewed within their organization. By having this bi-directional transparency, we believe the chances of execution are significantly higher.



**Kieran Cavanna:** As an allocator, one thing we look for or try to understand is **why we are being given this opportunity?**

That's an important early question for us to have answered. And sometimes these can be very subtle reasons like an idea that slips between two sub-sectors of healthcare, thus has little sell-side coverage and limited buy-side sponsorship because of how larger asset managers are organized. There are these opportunities out there and as a matter of fact that proposal for this odd ball healthcare name made a lot of sense to me because we knew that this manager was really good at finding these kinds of things and actually has a 12-year history of finding one or two big hits like this a year. I have invested with him since 2009 and it helps to know a manager's history and strengths when assessing a co-investment.

In addition, the question of “why have I been given this opportunity?” is also important because there is so many co-investments out there that I think aren't all that great for investors. In fact some of the largest co-investments I have looked at are coming from larger asset managers and I find little attractive about these ideas frankly. Some of them are very large market cap activist campaigns. To lock-up money for up to three years in what is a very liquid stock, in what would be a very tough activist campaign – well, when you ask, “why I am being given this opportunity?”, I don't know how you would answer that succinctly to your investors. *I find the best activist situations occur in the small and mid-cap space, and not all of these managers are in the press all the time.* With the managers we deal with, they typically have some expertise and we try to prove that that expertise has some persistent pattern, quantitatively and qualitatively.



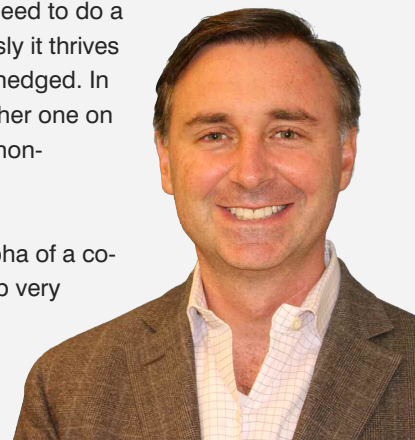
**Jean-Francois Tormo:**

From your perspective as an allocator, I wanted to come back to the portfolio construction aspect – how do you go about mixing these ideas together? Are you agnostic toward the type of trade, securities, or themes?

**Kieran Cavanna:** That is a great question. I think that we are *constantly cognizant about not doubling up on too many things or risks*.

For example, we have two great Internet names that have done extremely well and I don't need to do a third. We had the short only trade I mentioned, so we have oversized that, because obviously it thrives more in down market, and most of our other co-investments are going long something, unhedged. In addition, we have done two macro trades, one is focused on Iceland and Ireland, and another one on Saudi Arabia being included in global indices. While both long things, we look at those as non-correlated.

We are trying to diversify while keeping the quality high. The theory is of course that the alpha of a co-investment should be so targeted on specific stock so that you can potentially add these up very nicely and have a diversified book that doesn't depend on something happening in the market. But I wonder, do you have any thoughts on that yourself?



**Jean-Francois Tormo:** I would say the same, all of these trades or thematic are so idiosyncratic that the level of correlation between those trades is naturally quite low. Some of the things that you can do is to cap the exposure to a single idea, such that you end up with 15-20 securities or thematic and achieve your diversification.

Conversely, when you invest in hedge funds, you can do a lot more from a portfolio construction perspective, as you can aggregate exposure by asset class, sector, geographies, etc.

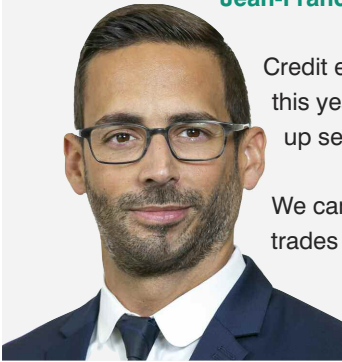


**Marco Lukesch:** I am wondering, when you are building up your risk models and you have a concentrated position in some US credit or say something in Colombia, what do you do? Do you try to overlay a benchmark that you think is close enough?

Presumably you are building some risk metrics around your portfolio of liquid stocks and other assets with CUSIPs that is model-able, and then you have some illiquid credit that isn't in Bloomberg and has no price history. How and what do you allocate to that from a risk management perspective? How do you think about it within your framework?



**Jean-Francois Tormo:** We are not really trying to add any type of overlay on top of that.



Credit emerging market exposure tends to be uncorrelated by nature, but you have seen what happened this year in emerging markets. It was idiosyncratic in Argentina, very idiosyncratic in Turkey, and you end up seeing a global sell-off in emerging markets.

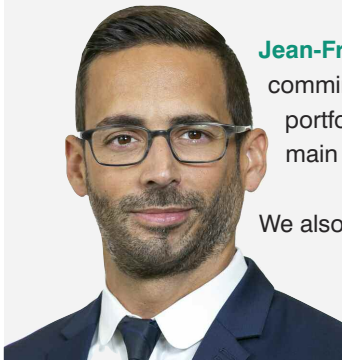
We can conclude that you can't really hedge against that risk when it comes down to these types of trades and thematic.

**Jason Hubschman:** As Jean-Francois points out, with these types of investments it's more about a prospective risk analysis and assessment, understanding the scenarios that could play out. This is of course a different prism for an investor to evaluate risk where they may have a portfolio of hedge fund managed accounts, where they may be looking day-to-day at the underlying exposures and may make some allocation decisions based upon that, or at least know how markets impact their overall portfolio. They are able to be much more proactive with the information, simply because of the nature of the investments.

But with the type of illiquid investments we are discussing here, there is an information set available and you need to understand different scenarios on a prospective basis. However, as conditions change, the investor is often locked into the trade, so it's about understanding and being comfortable with the trade upfront, because your ability to act is so constrained once you put it on.



**Jean-Francois Tormo:** Like Kieran, we underwrite the managers first, because we invest in their commingled funds, so we know what their processes are. We understand their process when it comes to portfolio construction, valuation and when things need to be changed and how this all plays out in their main fund.



We also understand their monetization process and how they react when things go wrong.

**Matthias Knab**

You mentioned a funds of co-investments that you are planning to launch or may have already started to work on. Can you tell us more about it?

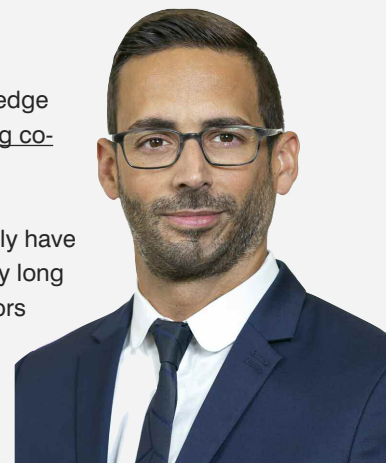


**Jean-Francois Tormo:** We are seeing a lot of opportunities in the space, just like all of you. Regarding a potential **funds of co-investments**, we are in the process of building that capability.

We have a large pool of assets in hedge funds. We see the appetite for the types of opportunities that co-investments can offer, and to Jason's point earlier, *the institutions we work with don't necessarily require the liquidity when they invest in hedge funds. This is where we see an opportunity that lies between hedge funds and private equity.* This is really where we are trying to focus our efforts.

We also see an opportunity just from our own business perspective at Lyxor, so continuing to leverage on what we do, which is to invest in hedge funds, to build portfolios, to underwrite hedge funds and to create appropriate solutions for our clients. At Lyxor, we believe that commingling co-investments can ultimately be an attractive building block for investors.

There are a number of investors who want to pursue co-investments, but they don't necessarily have the capabilities to go and underwrite the trade and/or the managers. As we know, this is a very long process and takes a lot of resources and knowledge. Therefore, the idea is to offer the investors one single structure where they can have access to a number of different opportunities.

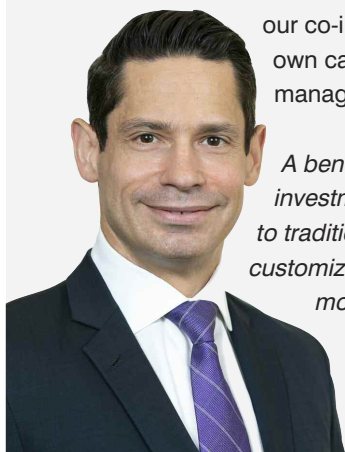


**Jason Hubschman:** We are seeing interest for co-investments in almost every conversation we have. We are engaged in discussions with both existing relationships and prospective ones. For example, prospective clients are asking to set up the sidecar, and the co-investment vehicle upfront because they see the investment opportunities.

We are also seeing it with other investors where we are advising on investment in a single hedge fund and in the diligence process, the investors have identified specific trades that work very well for their overall book and want to work with us and the manager to try to develop that in a specific vehicle.

As Jean-Francois said, our approach is to have a flexible offering that allows us to directly invest and manage our co-investment vehicles, to the extent that they exist, but then also many of our clients will want their own captive platform, their own Cayman SPC type structure that is very easy and flexible to on board managers.

*A benefit of co-investments from an operational standpoint is due to the concentrated nature of the investments, the lead time to onboarding and launching a manager in a SPC is shorter when compared to traditional strategies. The time-to-market can be very short and something that can be done even in a customized vehicle, which is very different from the normal fund-of-one process which could take six months when you are dealing with a full, broad mandate with a full slate of counterparty relationships where you may also bring in the client's SRI requirements or your specific risk analytics – a lot of those things drop away because of the nature of the co-investments.*



**David Dunn:**

This question is for the Lyxor team. Do you anticipate offering your clients the ability to opt-in / opt-out to single co-investments within your program? If so, how do you envision structuring this?

**Jason Hubschman:** Yes, we are seeing more interest, obviously from our larger clients, for the **opt-in type structure**. I think it's a process framework to allow for free flow of information up to their investment teams that they are going to require. Because the opt-in structures will require a higher level of interactions – both from a data flow and time perspective – the management of that process will be the key to remain efficient.

Let me add that we will have to limit the number of investors that we are going to seek out for such an opt-in co-investment fund, maybe five to seven could even be too big initially. However, when you look at a fully discretionary co-investment fund, you can see a very wide investor base and that is where we would ultimately like to be.

**Matthias Knab**

Before we close I wanted to make sure we covered the fee theme around co-investments. Let me know if you have anything to add there.

And secondly, what other lessons have you learned in doing co-investments, in the sense of what can go wrong? What are some of the potential pitfalls, what should people be aware of? We already spoke about the need for procedures, let me know if also on that side there is something to add.

**Kieran Cavanna:** In general – and I am trying not to be too negative – but I think there is a lot of mediocrity out there in the co-investment space that is being offered to investors. I think there are a lot of things to be avoided. This is critical because the volatility in co-investing is so much higher. I mean, who doesn't have a liquid idea, and everyone is greedy. So, again, you have to really be careful in your manager selection.

And the other thing I have seen is that how quickly some of these things can go wrong, so this aspect is also often under-appreciated and I have learned this myself the hard way. For example, I looked very carefully at an emerging market airline and we didn't really discuss the direction of the dollar and oil only to some degree as given the sector and that it's an airline. I didn't invest, but I watched as the stock got hit by 40% or so in a week, which was beyond what I thought was the downside. And mind you, nothing went wrong at the company. I mean there wasn't a bad earning or anything like that, but was driven by oil and the dollar.



*So I think we can all naturally underestimate ancillary risks that then can hit you big time, because we get so focused on a great story. That is why diversifying and having a portfolio approach is so important.*

I had mentioned Argentina before because I'm just shocked Argentina is down as much as it is in 2018. And Brazil was down 28% in the second quarter on a currency-adjusted basis. We need to invest professionally and carefully, so *when it sounds like a great idea, at the end of the day we still must go with managers who are good risk managers first, who have good experience and can succinctly answer why were are getting this great opportunity.*

**Jean-Francois Tormo:**

Risk in co-investments, particularly in long-only type of situations, tends not to be hedged. In a situation similar to this emerging market airline company that you had mentioned, were you thinking of hedging some of the currency or commodity risk when putting up such a trade as a co-investment?

**Kieran Cavanna:** This a fundamental question and I decided not to get active on that level. Not only is it beyond what I want to do, I also want to avoid introducing any other unintended risks in the portfolio like being short oil in a good oil environment.

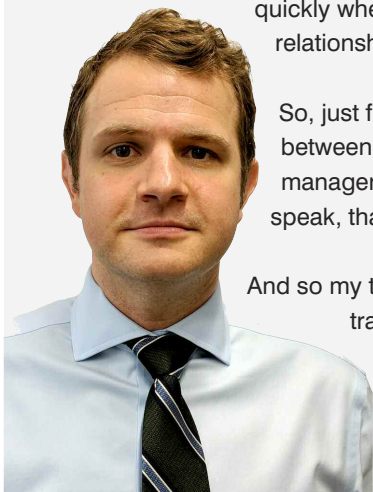
And so, what do I do? I frankly just **size these co-investments appropriately**. If it's a phase II biotech company, its size in my portfolio is 50 basis points because it could double or it could be cut half. While we tend to avoid binary things generally, if we do engage on something like this we would just size it and look to diversify our other bets.



**Marco Lukesch:** Kieran, you talked about mediocrity in the co-investment space, the abundance of liquid ideas and that a lot of things should be avoided. I also understand that an investor's relationship with a manager can go sour very quickly when you get pitched something which then went south, even if you may have had a long-standing relationship with a manager.

So, just from a manager's perspective, in most cases there is just say an arm's length transaction between two people that have known each other for a very long time and they understand that the manager is adding risk to the relationship in some ways, but also, amongst consenting adults, so to speak, that's very much the goal of their relationship.

And so my take here is that it is sometimes worth having the conversation upfront that by entering in this transaction, we are increasing the risk of our relationship. We are going in with open eyes, and if this goes wrong, let's try to avoid this destroying our relationship or at stay focused on understanding what went wrong.



**James Mitarotonda:** Coming back to Matthias' question, again, I think it's important to **know your customer**. While we make sure that we have a confidentiality agreement in place each and every time, it is still very important to know who you are dealing with. Look at some of the issues that are going on with that [Malaysia sovereign wealth fund and Goldman Sachs](#).

It's always nice to raise additional capital, but you still have to know who the investor is, and ensure that they are buttoned up and will follow your compliance procedures.

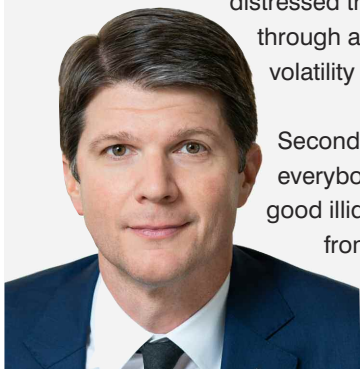


**David Dunn:** From a **pitfall** perspective, a few ideas have popped in my mind.

*First, as managers, we need to be very upfront with the folks we show a potential trade to, particularly with respect to the required amount of time necessary to diligence an opportunity. While this can be perceived as being a little pushy, we don't want to run into a situation where we weren't clear enough about the timeframe upfront and diligence began and more diligence begets more diligence and ultimately, we didn't get to the execution stage since the opportunity traded away from us and our partner. We manage an event-driven distressed strategy, and many of the investments that we are looking at certainly have an event component to it and a finite duration.*

*That's the reason, to one of my earlier points, why it's crucial to know your partner extraordinarily well, to understand their internal processes, the structure within their firm to diligence and approve investments, their level of capital markets knowledge, their sensitivity around trade volatility, and the types of instruments and what types of trades they would ultimately be comfortable with as part of their program.*

A manager may get a great initial reaction to a deal, from the co-invest partner, but if at the same time it's a legally intensive, distressed trade that ultimately could go through a number of appeals, the appellate process or could go through an in-court process, the partner must be cognizant of the trade evolution and be okay with volatility throughout the lifecycle of the trade.



Second, as managers, we have to be careful of not commoditizing our ideas. Kieran, to your point that everybody has a good liquid idea, I agree, and would add that everyone certainly in our space has a good illiquid idea, too. Being very selective, creative and truly identifying ideas that cannot be sourced from another manager or certainly not many managers is crucial. We view this as a key differentiator as to why investors choose to partner with Cross Sound.

**Matthias Knab**

Let's not forget to talk about fees just one more time.

**Kieran Cavanna:**

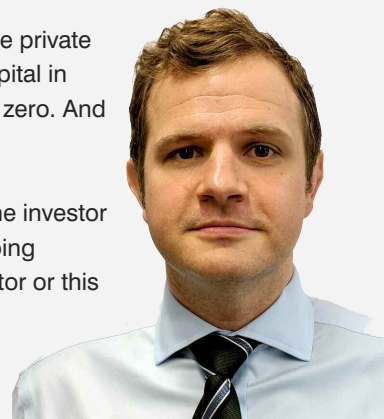
Zero and ten is where I start, but I understand that sometimes you have to do workout, sometimes you have to hire lawyers, etc., so when we speak and negotiate, all I ask all these managers is to be fair and transparent. Also, it's of course not a fund investment, it's a single idea. So the volatility will be high, will generally not be traded, so I think lower fees are the way to go.



**Marco Lukesch:** When we started the conversation I mentioned that in my mind, there are typically three types of co- or direct investments, the liquid one where you have it in your fund and you want to do more of it. You have the illiquid one that doesn't fit in your fund and then you have the "we can only do the transaction if we are part of a larger group," right?

Each of those three different types of transactions are different. The last of the three is more the private equity model. If they are going to buy a \$10 billion company, they typically need a lot more capital in those types of transactions, and the fees paid by the co-investors can be very low, sometimes zero. And the argument is that, "You, Mr. Private Equity, GP can't do this trade without me."

So, with the liquid one, it's already in the fund, you are already getting compensated for it. If the investor wants to do more, the manager should get paid, but arguably not as much as the manager doing transaction type number two, where he is doing the trade explicitly and solely for this co-investor or this group of co-investors.



**James Mitarotonda:** Our management fees range from zero to one percent. We typically request a modest management fee given the nature of our investment strategy and the large amount of work that other activist investors typically outsource but we handle internally. Our incentive fees range from 10-16%, depending on if there is a management fee or not.

We allocate whatever third-party expenses we might incur to all group members on a pro-rata basis, and here I mean direct expenses relating to an activist investment – for example legal, due diligence and proxy solicitation expenses. We are able to manage our third-party expenses quite well, because we have a strong in-house team that can do a large part of the heavy lifting and their work is not charged to our clients or co-investors.



**David Dunn:** In our case, our co-investment opportunities are not solely focused on management fees but on properly aligned incentive fees. As such, this allows the manager to propose more creative fee solutions that also aligns LP incentives around the trade. Similarly, we have discussed with some of our partners stratified returns based on how well the trade performs. When the trade does better than expected, it's a "win-win" situation for both the manager and co-investment partner.

This question is for the Lyxor team. Based on your experience, where are your existing and/or prospective investors allocating to co-investments within their broadly diversified portfolios? Is it within their private equity or hedge fund sleeves, in a separate 'opportunistic' allocation or somewhere else?



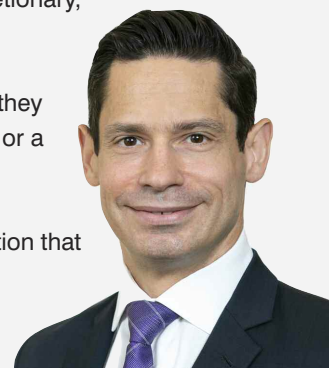


**Jean-Francois Tormo:** We have seen allocations to co-investments from a number of groups within their asset teams. Depending on the type of trade, we have seen co-investments being done from the equity bucket, especially activist and equity only positions. In a number of cases, it is an opportunistic bucket (distressed, dislocated credit). We have also seen the opportunistic bucket being set up as a sub-category of the alternatives bucket. In essence, the allocations depend on the organization, their structure and comfort level of funding as it relates to these types of trades. Essentially, there is no one answer.

**Jason Hubschman:** We've found that investment/mandate structuring will likely drive where the investment will sit within the overall client portfolio – that is, is it a full discretionary mandate on our end or is it an opt-in opt-out structure? Since an opt-in opt-out structure will need to have direct discussion with the specific asset class teams who are going to make the investment decision, it is probably going to be more directly attributable to their asset class bucket. If it's discretionary, then it may be something more in the private equity space or a special co-investment sleeve.

Again, a big driver here can also be how the client is internally organized, the types of investments they can easily make within their mandate and if they have a preference to a direct advisory relationship or a fund investment structure.

We are comfortable working with clients to consider these factors and structure an investment solution that is optimal to their constraints.





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– Bob Wies / President MV Digital

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– Marketing Sherpa

## **And more cost effective:**

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– Diode Digital

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– *Forrester Research*

Video content can increase the chances of front page Google ranking by 53 times

– *Cisco*

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– *Simply Measured*

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Opalesque videos are regularly featured among the best in any top 10 or top 20 hedge fund / investor video ranking, such as this one which lists 4 Opalesque videos out of a total recommended of 19 videos.

Opalesque started shooting manager videos in 2009 – you will probably know that **Julian Robertson, Izzy Englander, Jim Chanos, Jeffrey Ubben, Danny Yong, Elena Ambrosiadou**, and **many other hedge fund legends** have produced videos with Opalesque. We have also produced videos for some of the **biggest institutions** as well, such as **Morgan Stanley, State Street Global Advisors, M&G Investments.**



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- 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 1.3 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**.

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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 1.3 million views (hundreds of thousands of people)
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- Longterm effect: Views do not drop significantly over time
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## Costs

For a 10 minute video the all-inclusive package price is US\$10,000 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 \$15,000, so \$1,000 will be billed for each additional minute 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/>

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