

OPALESQUE



Opalesque Round Table Series '09

CANADA

Editors' Note

Dear Reader,

I have the pleasure to present you the inaugural Opalesque Canada Roundtable.

While 50% of the world's mining companies are listed in Canada, you will soon see that Canada is much more than resources. In the last 6 months, the make-up of the Canadian hedge fund industry and the AUM distribution per strategy has markedly changed. Un-levered AUM allocated to fixed income is probably touching 40%, and still increasing.

But even within the resource sector, there are still abundant and unique opportunities. If you look at the balance sheets of virtually every mining company, there is essentially no or very low debt. Combine that with the fact that the same company has a very low credit rating (as rating agencies focus on historical volatility of commodity prices), you have a fine environment for a range of different strategies.

You will read about the maturation of the Canadian marketplace, as well as:

- **Who are the new players and strategies coming out of Canada?**
- **Opportunities in commodities, credit and energy trusts**
- **How to capture alpha from the resource markets – going beyond commodity beta**
- **Why large global investors have started to think more thematically and tactically – what are some of the emerging new investment structures?**
- **Lessons from 2008 and strategies to understand uncompensated investment risks**
- **A discussion of the validity of both the single manager and the multi-strategy hedge fund approach**

This Roundtable was sponsored by TD Securities and took place in their Toronto office on October 1st with:

- **Abdalla Ruken, Chief Risk Officer, [Polar Securities](#)**
- **Aleksander F. Weiler, CFA, External Portfolio Management, [Canada Pension Plan Investment Board \(CPPIB\)](#)**
- **Barry Allan, President, [Marret Asset Management](#)**
- **Brian Trenholm, CFA, Managing Director, [Salida Capital](#)**
- **Gary K. Ostoich, CAIA, President, [Spartan Fund Management and AIMA Canada Chairman](#)**
- **George I. Main, CEO, [Diversified Global Asset Management \(DGAM\)](#)**
- **Jason Marks, CEO and CIO, [GMP Investment Management](#)**
- **Lionel deMercado, Managing Director, Global Head of Equity Finance, [TD Securities](#)**

Enjoy "listening in" to the new Opalesque Canada Roundtable!

Matthias Knab
Director Opalesque Ltd.
knab@opalesque.com

Participant Profiles



(LEFT TO RIGHT)

Aleks Weiler, Gary Ostoich, Lionel deMercado, Jason Marks, Abdalla Ruken, Matthias Knab, George Main, Brian Trenholm, Barry Allan.

Introduction

Lionel deMercado
TD Securities

I am Lionel deMercado and I head up the prime brokerage and securities lending businesses for TD Securities. We are part of TD Bank Financial Group, one of the top 10 largest financial institutions in North America and one of a few banks in the world rated Aaa by Moody's. TD Securities provides prime brokerage services to both alternative investment funds in Canada and off-shore managers with a Canadian component to their portfolio, across a wide range of strategies.

Jason Marks
GMP Investment Management

My name is Jason Marks, I am the CEO and Chief Investment Officer of GMP Investment Management. We launched our flagship multi-strategy fund, the GMP Diversified Alpha Fund, in April 2008. The Fund currently has in excess of \$220 million in assets under management. The investment objective of our fund is to generate superior, risk-adjusted investment returns in the range of 1%-3% per month with minimal volatility. The Fund achieves this objective by utilizing the partners' diverse investing backgrounds in conjunction with proprietary real-time risk management tools and a sophisticated capital allocation process.

Barry Allan
Marret Asset Management

I am Barry Allan, I am the founder of Marret Asset Management. We are a North American-focused credit firm. We have roughly \$3.4 billion in assets currently and have recently launched an investment grade fund that hopefully will take us closer to \$4 billion.

We run three products at this time: high yield credit products that are long/short and long-only. We also have a long/short resource-yield product which is designed specifically for Canadian energy and mining companies. The emphasis there is on income trusts, royalty trusts, and energy and mining companies or senior secured debt with equity warrants. We also have an investment grade business that we run in the long/short and long-only format. This investment grade business is completely focused on Canadian companies.

Abdalla Ruken
Polar Securities

I am the Chief Risk Officer of Polar Securities. Established in 1991, Polar manages roughly \$ 870 million for mostly non Canadian institutions from the US, Europe and Japan. We employ 27 people of which 13 are investment managers and the rest are dedicated risk, operations and business management staff.

We offer two funds, both Offshore and Onshore: North Pole, with an 18 year track record, is a Canadian equity and equity derivatives multi-strategy fund that executes more than a dozen strategies across the Canadian capital markets in mostly event driven and arbitrage strategies; and Altairis, which is a US focused equity long short fund, with a 12 year track record.

In keeping with the firm's risk appetite, our funds deliver mid teen returns with single digit volatilities.

Gary Ostoich
AIMA Canada and Spartan Fund
Management

I am Gary Ostoich, Chair of the Canadian Chapter of the Alternative Investment Management Association and President of Toronto based hedge fund manager Spartan Fund Management.

I started my career in the Canadian hedge fund industry at its infancy in the early 90's while a partner within the Toronto office of a major Toronto law firm, McMillan LLP, where I headed up its

hedge fund practice and sat on the firm's management committee. I have appeared before various regulatory bodies and task forces in Canada with respect to the hedge fund industry and testified before the Senate Banking Committee in Canada with respect to hedge fund regulation. I left McMillan in 2004 and crossed the street to join a hedge fund as president.

In 2003, along with Jim McGovern and David Jarvis (two veterans within the Canadian hedge fund industry) - I helped establish the Canadian Chapter of the Alternative Investment Management Association. As Chair of AIMA Canada, my mandate includes working closely with regulators within Canada, focusing on investor education and promoting sound practices within the Canadian hedge fund industry.

AIMA is based in the U.K. and has over 1,100 corporate members worldwide. AIMA Canada is one of the largest chapters with approximately 75 corporate members.

I recently joined Spartan Fund Management, a multi-strategy hedge fund manager based in Toronto, as President. My role within Spartan primarily involves four areas: overseeing existing business lines/infrastructure, new product development, legal input on structured trades and being part of the business development team that interacts with our high net worth and institutional investors. Spartan's edge involves uniting successful floor traders, market makers and bank prop traders in the Canadian market into an investment fund structure. This edge is best exemplified by our CIO, Rob Celej, who has over 25 years experience in the Canadian capital markets, 7 of which involved working on the floor as an options market maker for a major Canadian bank. Spartan has particular expertise in option and volatility based strategies within the Canadian marketplace and currently advises a domestic fund, an offshore fund and managed accounts.

George Main
Diversified Global Asset
Management

I am George Main, CEO and CIO of Diversified Global Asset Management Corporation. We run fund-of-funds products and a hedge fund out of our offices in Toronto and New York, with a combined AUM of approximately \$3 billion.

Our direct trading hedge fund is a global multi-strategy fund that trades about 50 books across five broader strategies, including global macro, credit, equity hedge, equity market neutral and relative value/event.

Our fund-of-funds strategies are comprised of traditional allocations, but also exposures to commodities and what are now referred to as alternative alternatives. Investments falling into the latter group include music & film rights, drug-royalty businesses, litigation-led investing, all machinations of alternative energy, and so on. One of my partners also serves as the Global Chairman of AIMA.

Aleks Weiler
Canada Pension Plan Investment
Board

My name is Aleksander Weiler, I am one of the Portfolio Managers at the Canada Pension Plan (CPP) Investment Board, and my group's focus is on our external manager relationships in public markets.

We are the investment manager of the Canada Pension Plan which has assets of \$116 billion; the province of Quebec has its own scheme which is managed by the Caisse de d'pUt et placement. The CPP Investment Board participates in most strategies, in most markets globally through a combination of internal active teams and external manager relationships. We are a very alpha focused organization with an investment-only mandate to generate the highest returns, subject to not taking undue risk of loss.

Brian Trenholm
Salida Capital

I am Brian Trenholm, one of the Portfolio Managers at Salida Capital in Toronto. Salida was founded eight years ago and currently manages about \$500 million through private funds and separately managed accounts. We are the exclusive advisor to four funds, two offshore and two onshore, and will soon be launching a fifth, more conservative fund.

All of our funds use a top-down bottom-up approach to investing. Macro views will determine sector and strategy selection, combined with bottom up fundamental analysis to determine security selection. Our investment team consists of former resource-focused, sell-side analysts, each with more than a decade of capital markets experience. These individuals bring a unique wealth of specialized knowledge and contacts particularly in the energy, mining, and related fields – areas that we believe hold the greatest potential for the coming years. This can be seen through our current macro theme for our funds: a long-bias in precious metals and natural resource equities, with particular sectors of focus being gold and other precious metals, energy, base metals, and agriculture.

Over the past year and a half Salida, has focused on being a leader in communication, transparency and education not only with investors but with prospective investors as well. We believe that for investor confidence to be restored to the industry, disclosure and communication are vital – investors want to know how their money is being invested and need to be comfortable that risks are both understood and contained. Through a number of new and ongoing initiatives we have aimed to be a leader in these three areas - communication, transparency and education.

Abdalla Ruken

When it comes to opportunities, I like to quote Henry Singleton, the CEO of Teledyne in the 60s and 80s. In a similar market scenario when asked about opportunities, his response was “The best plan is no plan.” The best plan for him was to remain opportunist and flexible. I find that a very interesting answer because it echoes the Polar approach. This is how we acted in 2008 and how we continue to act.

We continue to be paid well in the Canadian capital markets right now acting as liquidity providers. There are a lot of opportunities we are realizing at the moment in areas like balance sheet repair, arbitrage, mis-priced assets and so on. Canada has reasonably developed and regulated capital markets for a hedge fund to operate, and particularly as a multi-strategy firm we can act effectively on these opportunities.

Barry Allan

We are a specialty credit manager and we believe that there will be significant opportunities in the credit markets over the next four or five years. I expect credit spreads to have a much higher volatility in the next five years than we had in the last five years, which for some people might be difficult to imagine since credit spreads were at their most volatile time in 2008, but I think that we will see several periods of widening spreads and rapid spread declines over the next several years.

In Canada two areas stand out as particularly interesting, as they enable us to directionally trade credit spreads. One is in the investment grade space and the other field is in the resource sector of the high yield space.

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There are significant long/short opportunities - being long industrial credits and short financials. I think it will take a while for that to play out, but I believe that the beta of financial spreads in

Canada are dramatically higher than industrial corporates, and if they are trading at record tight levels and the betas are twice as big, I really like being long industrials and short financials.

The other interesting sector in Canada is the resource sector, which presents itself in two forms. First is within the energy trust area. As trusts are forced to convert to taxable corporations, they will be spitting the trust into debt and equity pieces. How will the debt component be priced? We believe it will be relatively cheap. The conversions will create a lot of opportunities.

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Another really interesting sector is the whole mining sector. 50% of the world's mining companies are listed in Canada, and if you look at the balance sheets of virtually every mining company, there is essentially no or very low debt. That means the same company has no or extremely low debt, and very low credit ratings at the same time. This is because the rating agencies focus on historical volatility of the commodity prices.

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It can be very profitable to provide debt to the mining sector, which is not served by the banking industry at the moment. We are talking here about providing debt to a company that may be 80% equity financed and earn very high coupons, plus benefitting from equity kickers for warrants.

These are examples of how the opportunities exist to really fulfill what is our hedge fund mantra: providing equity-like returns with debt-like risk.

Gary Ostoich

The opportunities that we see at Spartan are from an emerging manager's perspective – emerging from the point of view of a relatively small investor base that needs to be rebuilt, but with a 3+ year track record. Spartan is a boutique manager that has particular expertise in options and volatility related strategies, which is quite unique within the Canadian marketplace. We focus on volatility related inefficiencies by positioning the portfolio to take advantage of these opportunities. Given the trader's experience on prop desks and as former floor traders, we approach each day with a tight risk budget and measure our success day-to-day, not month-to-month.

Despite a three-and-a-half year track record with strong returns, including positive returns in 2008, we were hit with large redemptions from institutional investors who needed liquidity in Q4 of 2008 – the good news is that we were easily able to provide the liquidity and remain profitable in 2008. Our opportunity is one of selectively rebuilding our investor base by getting our message out to let investors know what our edge is in the Canadian marketplace, and how we have performed.

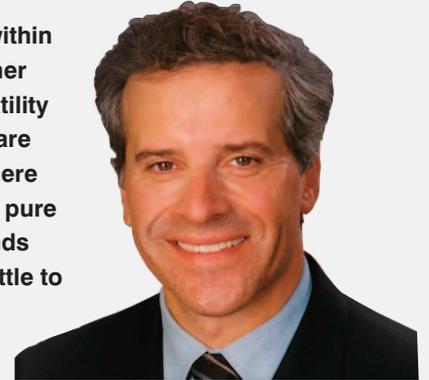
From a larger Canadian industry perspective, I think we are seeing a shift in terms of what investors based outside of Canada are looking at when deciding about making an allocation to managers located in Canada. In the past, many of the largest inflows in Canada were going almost

exclusively to long biased resource centric equity managers, and this was reflected in the AUM of the Canadian industry.

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We are now seeing a broader allocation of investor funds to a variety of strategies within the Canadian marketplace – long beta managers will still receive allocations, but other strategies within Canada, whether they are market neutral, credit, distressed or volatility related strategies, are definitely receiving more attention. In other words, investors are starting to realize that although resource related stocks dominate our exchanges, there are a variety of approaches to exploit inefficiencies in our resource markets beyond pure beta exposure. Many of the funds around this table are good examples of hedge funds within Canada that exploit opportunities in the Canadian capital markets that have little to do with direct beta exposure.

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George Main

The world has passed through an inflection point, and we could certainly talk about how the subsequent opportunity set is unfolding – this discussion would include themes such as the provision of liquidity, congestion on balance sheets across industries, and how that congestion is to be alleviated. I believe it is an interesting conversation to have, but the more provocative discussion may be one about how the world perceives these risks and is reorganizing as a result.

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Perhaps investors are ready to transcend the current legal taxonomy, where hedge funds, private equity and long-only vehicles are distinct legal entities and thus worlds apart. Maybe now people want to think thematically and tactically. In my view we have evolved from the passive world that peaked in the 80s to 90s, and evolved into a world where investors follow their thematic interests.

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Perhaps investors are ready to transcend the current legal taxonomy, where hedge funds, private equity and long-only vehicles are distinct legal entities and thus worlds apart. Maybe now people want to think thematically and tactically. In my view we have evolved from the passive world that

peaked in the 80s to 90s, and evolved into a world where investors follow their thematic interests.

I live in Canada and my firm is based here, but to be honest I invest little in this country and most of our clients are domiciled abroad. Obviously, the dominant themes in Canadian investing are related to commodities and the strength of our banking system. Safe banks, while perhaps good investments, evoke little interest from us. However, playing commodities without being constrained to a long only bias is certainly an attractive proposition.

What I want to address again is how firms effectively present themselves to investors who are looking to capture those themes. This includes figuring out how to organize the business, having the right governance structures, and how to think about strategies and their respective life cycles.

The time factor is critical. There are a great number of strategies that have had their time in the sun, but no longer suffice as a base for a successful business. Perhaps the most notable is convertible bond arbitrage. Converts are no longer a business in and of themselves, and only find a place in portfolios as a trade that is episodically attractive.

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George Main



Broadly speaking, our approach at DGAM is twofold. We aim to be tactical with fleeting risk premia (and do so through our liquid, multi-strategy hedge fund), and strategic with structural opportunities where conditions allow us to hold positions for longer periods. Examples of such structural themes would include capitalizing on a weakening US dollar, or playing the global commodity theme, which may simply be the other side of the same coin. There is also an attractive emerging markets theme. From our perspective, we are trying to think sensibly about how to participate and benefit from structural transformations of the global economic system.

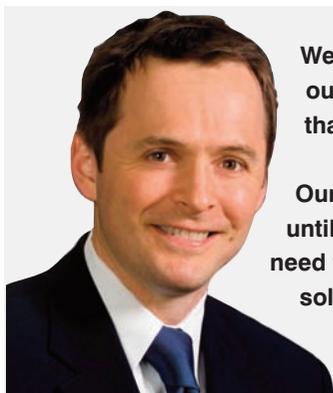
Aleks Weiler

As an organization, we have internal active teams which focus on real estate, private markets – including private equity, private debt and infrastructure – and public capital markets. Our internal active teams do security selection, market timing, and strategic capital provision to companies. We also hire external managers to execute some of the same strategies. In some cases, the two sides overlap, and sometimes we work with external managers who we think has a certain strategic or structural advantage.

The decision to add active management is five years old, and we continue to expand our roster of quality partners.

George Main

You are active in the hedge fund arena as well, right?



We do have a lot of discussions with managers about appropriate structures for investors like ourselves that have longer time horizons. We also provide opportunistic capital in situations that are interesting.

Our asset base stood at \$115 billion at the end of June. Inflows should exceed benefit payments until roughly 2019. The plan is sustainable through the 75 year actuarial horizon. As such, we need to be global investors as, over this period, interesting investment opportunities will not exist solely within Canada's borders.

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Yes, correct. You referred to different time horizons of different opportunities earlier. We do have a lot of discussions with managers about appropriate structures for investors like ourselves that have longer time horizons. We also provide opportunistic capital in situations that are interesting.

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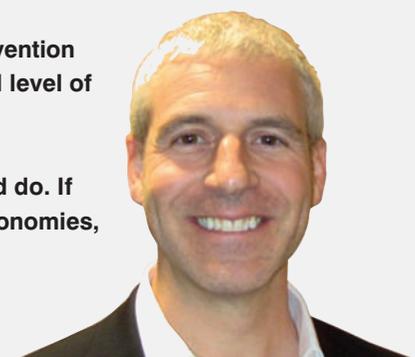
Brian Trenholm

Let me come back to the opportunities for a moment. Today's world features an unprecedented level of government and central bank intervention into global economies. In my opinion, this pretty much guarantees an unprecedented level of waste of scarce resources.

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As mentioned, our investment team at Salida consists of former sell-side analysts in the resource sector, and consequently all of our funds have had triple digits returns year-to-date due to our ability to capitalize from opportunities in the natural resource and precious metals space. But we don't just expect investors to have that "trust us" mentality, which is why we publish numerous monthly reports, one focused on our macro themes and world markets, one focused specifically on the global energy sector, and one special report of which past topics have included crude, gold, natural gas, copper, inflation, and China.

Jason Marks

Based on my experience in managing a number of diverse businesses through different market cycles while at TD Securities and as the Chief Market Risk Officer and the Chief Credit Officer at TD Bank, I have made a number of key observations regarding the performance of trading and investing strategies.

Firstly, most managers will seek to add capital for their strategy regardless of the risk return characteristics for that strategy at the time. In general, investors and managers do not scale the amount of capital assigned to a specific strategy based on the size of the opportunity. My observation is that depending on where one is in the market cycle, different strategies offer better risk reward characteristics. As a result, it is easy to see how investors and managers can easily sub optimally allocate their capital.

My second related observation is that it is rare, even on the precipice of a severe correction, to materially reduce one's exposure. For example, you can be the best convertible arbitrage manager and convince yourself and others that "I can grow my portfolio, but I will be able to reduce my portfolio in the event of a large correction, so it won't be so bad" – however, you never get out. For most managers, the odds that one gets out in time are extremely small.

Credit markets provide an excellent example of how managers can act irrationally when it comes

to risk and return. Banks have a history of shrinking their loan books at times when credit spreads are at their widest. This is the worst time in the cycle to be reducing exposure. Then again, the same bank will increase its risk to credit markets when credit spreads are at their narrowest. Once again, the worse time to be increasing exposure. This leads to excess liquidity when returns are the slimmest and greatly reduced liquidity when spreads are at their widest. In fact, this is when banks should be growing their credit business. This is why: when marginal liquidity is disappearing, there is a window where credit is the best asset class in which to invest. This fact has been reinforced through the recent credit crisis and subsequent recovery.

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Jason Marks

As credit spreads narrow, the relative superiority of this asset class will be reduced. As this happens, an investor should be migrating to other asset classes that offer relatively more favorable returns such as quantitative or equity strategies.

Our idea at GMP Investment Management was to create a fund where we are able to dynamically deploy capital on a real-time basis. We have built proprietary systems to monitor risk and reward in various markets. As a result, we are capable of moving and shifting capital from one market to another as the risk premium dictates. We have created a risk management system that attempts to limit personal biases from the capital allocation decision making process.

Matthias Knab

Jason, your points are actually a plea for multi-strategy funds, right?

Jason Marks

Yes. You need the capabilities a multi-strategy provides in order to address the fact that a single strategy won't work all the time. In order to produce stable returns through a cycle, one needs the freedom to move capital to the optimal mix of strategies given where one is in the market cycle.

Matthias Knab

Who else has a view on this question? We may get into a fundamental or philosophical discussion here, since of course there are also hedge fund investors who use funds as building blocks for their portfolios and asset weightings and for them it may be relevant that a commodity fund remains a commodity fund, otherwise they'll call it a style drift....

Abdalla Ruken

I would second Jason that the ability of a multi-strat to deploy capital efficiently as strategies become more or less favorable in different economic environments works particularly well in Canada given the limited breadth and depth of its capital markets as compared to larger markets like the U.S. Moreover, Canada offers some very specific Canada centric investment opportunities which we at Polar trade.

It is not just the commodity theme that is working well here. There is room for hedge funds as liquidity providers across a wide range of asset classes. If you are good with your risk management and a good portfolio manager, you can allocate your capital well and make money.

I kind of half agree and half disagree with Jason's points. I do agree that you do have to manage risk and you have to allocate capital, but I don't agree that you have to have a multi strategy fund to do that. If you have the ability to go long and short, you can allocate to the long side and you can allocate to the short side and stay within the expertise that you have.

If you look at the 2008 returns for example, most of the multi-strategy funds underperformed in fact, because they did capital allocation poorly, or they didn't have the right risk management or the right signals, or they had too many people disagreeing.



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The general principles of allocating capital applying proper risk management etc. are universal, but I don't really see that you have to be a multi strategy fund.

Abdalla Ruken

I also see Barry's point. In our case, equity long/short is a single strategy fund with a market neutral mandate. It's not net long or short any one sector in any material way and it keeps concentrations managed. Through good portfolio and risk management it was able to generate positive returns in 2008. So it goes beyond the multi-strat platform, but I think the ability to deploy capital efficiently is easier for the multi-strat in Canada.

Jason Marks

My only rebuttal to Barry is that if you gave yourself more degrees of freedom when it comes to capital allocation, then you have the opportunity to better stack the odds in your favour.

There are two reasons why a multi strategy fund would not outperform a single strategy fund through the cycle. Firstly, if the single strategy manager was superior to the multi-strategy manager in a given strategy, a single strategy manager could outperform. Secondly, if there was a flaw in a fund's capital allocation strategy, it could underperform a single strategy. Aside from those two factors, a multi strategy fund has the capacity to outperform.

George Main

I agree with what Jason is saying, but I'm also very empathetic to Barry's point. These are different people in different business set ups, and in my case, I wear both hats. I run a multi-strategy fund that has established a priori systematized filters that create trades within 50 or so strategies. From that perspective, I completely agree that in some of those plays you have to be in and out quickly. The inflection points are fleeting, and the gamma you short is massive. If you aren't sufficiently nimble you risk looking foolish.

Matthias mentioned style drift. In all honesty it isn't really about style drift, but rather what you hire people to do. If you want someone to be in credit, you should absolutely hire a credit expert. Be that as it may, it is still advisable to understand where spreads are. I believe it is critical to have a view of your own so you can effectively monitor the relative attractiveness of the space, as well as the actions of the underlying manager.

Jason brought forth the fundamental criticism that very few managers are able to turn their trades quickly, but instead tend to throw more money at existing allocations. I also ask myself if people are simply momentum junkies; unable to go short, and only willing to take long positions. As spreads narrow, too many fund managers simply lever into them because they would rather have the natural yield they can see than bet on the inflection point. It can be tough to make the decision to stand in front of the market's momentum, but it is in doing so that genuine skill is demonstrated and outsized returns can be earned.

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George Main

At DGAM, we bet on the inflection in IG Credit in 2007, and were up several hundred percent on those positions in 2008 as a result. In order to reap the benefit of our insight, we had to hold our resolve through almost two years during which spreads continued to tighten beyond what we thought was rational or sustainable.

Turning our attention back to Canadian capital markets, there are unquestionably some great people and attractive investment opportunities in this country. I also like the direction regulation is going, and hope current efforts to establish a single national regulator are successful. This should ultimately make Canada a cheaper and more transparent place to transact.

My main concern with the current regime is related to the questionable ability of smaller players to act on an equal footing with the Chartered Banks. In retrospect, an oligopolistic banking regime has clearly been a good thing from a global stability perspective – Canada's financial institutions didn't have to reach into more complex businesses to the same degree, or lever themselves as greatly to preserve and grow their EBITDA. However, a negative side effect of this market structure is that when you come to do business in our capital markets, it is not as clear that you have informational equality; a lynch pin of efficient and mature markets. While I highlight this as a detriment to our financial landscape, it is also a point that creates a strong case for entering Canadian markets with a local partner as a guide

Gary Ostoich

With respect to the Canadian regulatory system, we have had a very strong regulatory framework for decades which is applicable to a full range of participants in the Canadian capital market including hedge fund managers and prime brokers. I think the strength of our regulatory system was in part responsible for the ability of our prime brokers/banks to weather the storms of 2008 and 2009. Accordingly, I believe that the Canadian system has enough "teeth" for regulatory enforcement. I think 2008 was a test, in just about every G8 country, of the adequacy of everyone's legal and regulatory regimes.

The other part of regulation relates to self-regulation. Sound practices are an important component of this – AIMA has always promoted sound practices and have produced various guidelines for hedge funds and other participants. To the extent that investors and "gate keepers" such as prime brokers insist on adequate due diligence of hedge funds to comply with appropriate governance models, which includes a separation of duties within fund managers, the more likely

investors will avoid operational problems with individual managers. I think when you look through the failures of funds in the hedge fund industry in various countries, many of them could have been detected through some basic due diligence by investors. The due diligence would have uncovered, at a minimum, the compliance culture of a firm.

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From AIMA Canada's perspective, we constantly see new entrants into the hedge fund landscape. Some of these entrants include very prominent individuals within our capital markets and this bodes well for the future of the Canadian industry. Many of these entrants are focusing on strategies other than equity long/short. As well, we see very successful managers in Canada that are not even trading Canadian markets, but they are Canadian firms. For example, one of the top 10 short term trading CTA managers (by AUM) is located in Canada. Apart from those who focus on the local opportunities, an increasing number of talented managers trade globally.



Gary Ostoich

Accordingly, the Canadian hedge fund industry will continue to grow, mature and diversify and the current rules that we have are adequate to allow the industry to grow.

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Lionel deMercado

As a prime broker providing services for a significant number of the managers in Canada, we could observe that over the last six to nine months a significant amount of risk has been taken off the table. There is less leverage being used, and we have also seen a substantial improvement in the liquidity of the funds on our platform.

We have seen a significant shift away from resource-type into credit-type funds. There was probably a five-fold increase in AUM allocated to that strategy since the beginning of the year, and the trend continues. We also have a substantial pipeline of very senior industry people who are in the process of launching new funds in the credit space.

Un-levered AUM allocated to fixed income is probably touching 40%, which as I said is a significant change from where it was a year ago, and we see that growing. While the average fund size in Canada is significantly smaller than in other major alternative investment centers globally, we do see the fund size going up. For example, some of the fixed income funds on our platform have an un-levered AUM anywhere from a couple of \$100 million up to \$700 million and growing.

In Canadian terms, this is a pretty significant fund size. Over the last three to four months, fund sizes and allocations also to non-fixed income funds are increasing.

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We are getting a lot more inquires about fund formations. Some of these new managers come from existing firms - buy and sell side - who are leaving to start their own shop.

So I agree with Gary's point that the industry here is getting more diversified, Canada is not only that resource-based market any more as it may have been a few years ago.

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Abdalla Ruken

I would definitely encourage investors and due diligence teams to come here and visit us in Toronto. A favourable new development is the recent revamping of the Toronto Island Downtown Commuter Airport. From Chicago or New York, you can fly into the Toronto Island Airport in a very comfortable, nice airline from where it is a very short distance to downtown.

Barry Allan

I suggest to step back for a moment and look at what Canada is. Canada really is an emerging market. It is a bigger and more regulatory friendly emerging market than Brazil, China or India, but Canada is not New York or London. That being said, I think we are in a very attractive time to invest in Canada. The TSX has beaten the S&P 500 by 800 to a 1000 basis points for the last ten years, and I think it'll beat it again for the next ten years, mainly because I think the S&P will probably be negative. It's an attractive place, and if you are deploying capital on large scale, diversified around the world, you may look at putting five to ten percent into Canada. Of course, you won't put 80% of your assets in Canada. We run the largest credit operation in this

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Of course, you won't put 80% of your assets in Canada. We run the largest credit operation in this country, and we are a four billion dollars operation.



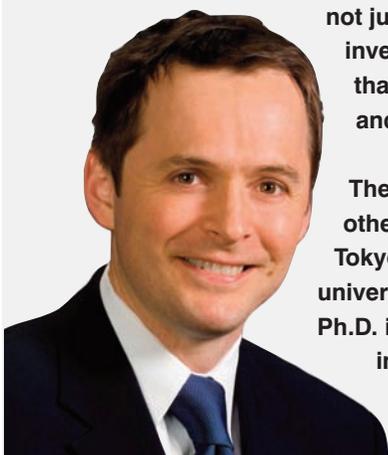
Barry Allan

country, and we are a four billion dollars operation. I know of people in London and New York that run \$50-60 billion operations. Our hedge fund is under a billion dollars. Maybe it could grow to four or five billion dollars, but it can't be \$30 or \$40 billion dollars. You can't deploy capital like that, it is more an emerging market play. I think Canada is an extremely attractive place to put our capital to work but certainly not as a core investment strategy.

Aleks Weiler

It takes two things to generate attractive risk adjusted return: good investors and good opportunities. I think you get a combination of both in Canada. The bar may even be a little higher here in the sense that a lot of the high net worth and institutional investors are very sophisticated and look at global comparables. To succeed, it's not just a matter of being locally excellent; you need to be globally excellent to attract that investor base. And then secondly, in terms of people, if Canada has one successful export that doesn't really get captured much in the official numbers, it is the incredibly educated and hardworking people here.

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The number of Canadians that show up as key professionals as a proportion compared to other nations amazes us every time we visit investment firms abroad in New York, London, Tokyo, Hong Kong or other cities. We use to joke that if you graduate from a top-notch university, earned your MBA from a brand-name school, added a CFA and then completed a Ph.D. in a sort of nuclear finance, then you are ready for an entry level job in Toronto, whereas in most other places, this would be considered a fairly advanced set of qualifications.

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So in both of those aspects, Canada is actually a fairly good place to invest. It is a place that you can put a lot of money? Probably not - in terms of global equity capitalization, Canada only accounts for just over 3 percent.

Brian Trenholm

Some comments here today have downplayed somewhat the importance of resources, but there are other elements to Canada's resources sector that are important to recognize. It's not just about the world-class deposits in the oil sands or in certain metals-rich regions. A very important element on top of this is the technology that gets developed in Canada related to both energy and mining. Beyond the mammoth deposits, there are a lot of marginal deposits in very adverse climatic and geological conditions. The technology to extract oil, gas and metals is vital and gets exported around the world. This is an element of Canada that cannot be ignored.

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Aleks Weiler

In addition, a lot of different businesses operate in an ecosystem like mining. It reaches from the pure exploration and technology behind discovering an actual resource to all the activities around financing the development of it. A number of activities start to enfold, like equipment rentals, capital market activities up and down the capital structure of companies. Canadian financial institutions are fairly good at identifying and servicing this sector.

The small cap Canadian resource stock isn't the only story, there could be an interesting commodity bond story or even convertible story, or bonds with warrants. At certain times, these may offer a much more attractive risk reward proposition, or within the financing some of the mining equipment, or into forest plantations, or receivables financing within that.

There are various opportunities both in the public and the private sector. We haven't talked much about the private side, but there is a fairly healthy private placement market that exists for a number of these opportunities that don't necessarily show up for everyone, as by nature it's private.

George Main

On the global regulatory side, Canada is active in both the G8 and the G20, and will host next year's G20 meeting in Huntsville, just two hours north of Toronto. We have also been involved in the regulatory scene vis-à-vis hedge funds for a long time.

Personally, I am on the Investors' Committee of the U.S. President's Working Group on Financial Markets. Through this mechanism, we have some visibility to what may be coming down the road. There is a consensus forming in terms of best practices and a movement toward more investor-friendly terms, greater transparency, the mandated use of administrators, etc.

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In Canada, we have organized ourselves to address this through AIMA, but perhaps we should consider creating a hedge funds standard board type entity of our own.

George Main

I think that we should all laud these developments. It is the right thing for good companies to support improved regulation insofar as it is geared toward making the business more institutional. In Canada, we have organized ourselves to address this through AIMA, but perhaps we should consider creating a hedge funds standard board type entity of our own. We have a developed regulatory foundation, but room for growth and improvement remains.

Gary Ostoich

I agree with a number of things George just touched on. From a regulatory point of view, Canada's regulatory framework is closer to the U.K. than it is to the U.S. If you manage money in Canada - whether you are a hedge fund or any other type of money manager - you need to be registered with a Canadian securities regulator. It doesn't even matter if you have no Canadian clients or if all your clients are Canadian clients - if you are located in Canada, you need to be registered and are then subject to range of regulatory requirements including the need for insurance, capital requirements, compliance manuals, personal trading policies and are subject to compliance audits by regulatory bodies.

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Gary Ostoich



We just had another regulatory rule introduced that came into force on September 28 of this year. This new rule attempts to harmonize and streamline the registration of advisors and dealers across Canada. The new rule also introduces a new registration category that applies to entities involved in the creation, operation or sponsorship of investment products.

The new registration category called "investment fund manager" means that there is another level of registration that will apply to most money managers - including hedge fund managers - located in Canada who organize or operate pooled funds, as the establishment and management of the pooled fund will trigger another registration requirement. Accordingly, even though a hedge fund manager in Canada would have been registered as an advisor in the past, he or she now will likely need to be registered as an investment fund manager as well.

When discussing regulations both globally and domestically, people should be aware about the depth of regulations already in place - I don't believe we need further regulation in Canada. Current regulations are more than adequate to support a strong hedge fund industry.

On top of existing regulation, we have the self-regulation and self-policing of the industry that I referred to earlier, where for example the prime brokers and other service providers play an important role through their due diligence up front on managers as well as ongoing monitoring in the case of prime brokers. In many ways, the self-regulation by managers and their investors is one of the most important components. The more demanding investors are regarding a range of topics including governance and transparency, the faster the industry will change and I believe we are seeing that change.

Brian Trenholm

If you want to be successful in marketing hedge funds in 2009 and beyond, you have to have greater transparency and more investor communication. There is no other way. You will not attract funds otherwise. This speaks to Gary's point of self-regulation - in order to succeed and to be viable, you have to communicate and be transparent, and that is without regulation requiring it. The market realizes it is necessary in order to succeed.

At Salida, we have built a back office and operational infrastructure that we believe to be world class, and we have chosen partners who are global financial leaders. We have made it a priority to increase communications to both current and prospective investors, not because there's regulation requiring it, but because investors demand it in today's market.

Abdalla Ruken

The question of regulation was triggered largely by two events. One of them is of course Madoff. Madoff in the end was so simple to pick out; a proper due diligence would have brought it up. Therefore, Madoff was a case of failed due diligence. The case is very well documented. The legal structure of that firm was very convoluted, the access to things onsite was very restricted, there was no independent administration, and so on.

The other event relates to liquidations of certain very large hedge funds. People were concerned about the systemic risk stemming from the liquidation of large funds, which in 1998 led to a great debate the result of which was recommendations for indirect regulation of hedge funds through banks, counterparties and investors. I think that this indirect regulation route is in fact the better route.

Barry Allan

Corporate governance in general in Canada can be improved, but I would say regulation of investor funds and particularly hedge funds is as good as anywhere in the world.

While we can talk about fraud, regulations and transparency as much as we want, but let me tell you that last year many hundreds of thousands of times more money has been lost through through ridiculous degrees of leverage than through fraud.

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While we can talk about fraud, regulations and transparency as much as we want, but let me tell you that last year many hundreds of thousands of times more money has been lost through through ridiculous degrees of leverage than through fraud.

Every investor and every due diligence has to understand three dimensions: transparency, the integrity of the manager and the leverage deployed. Transparency could be defined as a function of leverage too. So if you will you can boil things down to purely integrity and leverage, which includes understanding volatility characteristics of the real leverage that is inherent in their fund. If you understand those things, I think you will make pretty good decisions.

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Jason Marks

My experience on both the risk taking and the risk management aspects of trading and money management provides me with a unique perspective on the effectiveness of regulatory regimes. The biggest problem with regulation is that it tends to only address a particular risk after an “accident” has occurred. The typical response to a risk problem is to impose bureaucracy and infrastructure around that particular problem. The unintended consequence of increased bureaucracy is that it results in regulators and firms over focusing on the last problem rather than attempting to identify future problems.

A second reason the regulation tends to focus on past problems rather than identifying future issues is the reluctance of management and regulators to impose tight controls and regulation on business that have been historically profitable. The rationale behind this behavior is that investors and regulators get a false sense of security from a strong track record. In fact, the better the track record, the more potential concern interested parties should have. Also, the balance of power tends

to shift to managers with better track records. Thus they are able to easily raise money and can refuse to deal with investors who require too much information. This is exactly what happened with Madoff.

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One can address these complex issues by having access to detailed information on a fund and by having the capability to understand in detail all the risk associated with a manager’s positions. One cannot rely on any simple standard tests, metrics or ratings. These metrics may provide comfort, but will not protect investors from the next “accident”.

Jason Marks

Regulators, investors and risk managers have always had a hard time addressing this behavior. One can address these complex issues by having access to detailed information on a fund and by having the capability to understand, in detail, all the risk associated with a manager’s positions. One cannot rely on any simple standard tests, metrics or ratings. These metrics may provide comfort, but will not protect investors from the next “accident”.

Thus regulators will always be in the tough position of finding a balance between investors’ requirement for effective regulation and the limited resources that are available to them.

Lionel Demercado

It is correct that prime brokers and banks use these self-regulatory processes much more and look a lot closer at what the funds are doing and have a lot more dialog with them.

In our case, we stress test all our accounts and risk score the funds of all of our managers. If something looks outside of the norm, we are very quick to have discussions with managers asking if anything has changed.

Abdalla Ruken

Let it not be said that the crisis was all bad, because there are certain stress tests that have been presented to the hedge fund model globally that have good benefits going forward.

Something also happened on the investor side. When we talk to investors post 2008, we feel that they have all been seasoned by it; they are all 2008-veterans now. So everybody learned a lot.

Managers who had one or two primes - especially if those primes were from parent companies that had no balance sheet left - faced difficulties. Some were forced to liquidate. Those who did not have internal systems learned a lot when things were going at a very high velocity.

We see this differentiated perspective in the behavior of investors and in the questions they are asking. Are you multi-primed? Do you have the internal systems? Do you have the internal controls? Do you have independent administration? How do you manage your liquidity? Did you gate?

I used to be on the allocator side, and pre-2008 had seen investors who just put all sorts of hedge funds into one bucket and called alternative investment. Now, investors increasingly see hedge funds as sets of strategies executed across asset classes and how these fit within their portfolios.

I also see that the core of hedge fund investors, especially institutional investors, remain committed to hedge funds and they see that going forward the hedge fund model will continue to work.



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Abdalla Ruken

Barry Allan

Maybe I will take a little bit different track about the lessons we learned in 2008. Keep in mind that we are credit managers, and credit was at the center of the storm. The two biggest lessons we learned about markets we already knew anyway - they just got enormously magnified - is the dangers of excess leverage, and the differentiation between managers generating returns from skill versus managers that generate returns purely through leverage.

When credit spreads are 240 basis points and you are eight times leveraged making 8%, there is a huge disconnect between eight times leverage and producing an 8% return in a market that would produce you a 3-4% unleveraged. Making two times the return with eight times the risk is a really bad idea, and some people learned it the hard way.

When credit spreads are 240 basis points and you are eight times leveraged making 8%, there is a huge disconnect between eight times leverage and producing an 8% return in a market that would produce you a 3-4% unleveraged. Making two times the return with eight times the risk is a really bad idea, and some people learned it the hard way.

This is something we understood at the beginning, because we never actually used leverage. The actual impacts of inappropriate leverage in 2008 is probably the biggest lesson.

The second thing we learned centered around liquidity.

So we learned about liquidity of our portfolios. We had a liquidity scoring system set up to protect us in our investments, and that allowed us to do that. I don't know how many phone calls we got saying "congratulations, you are the highest performing credit fund, here is our redemption notice." And we gave it to them, even though some people advised us that we were stupid for not putting up gates.



Barry Allan

This is something we understood at the beginning, because we never actually used leverage. The actual impacts of inappropriate leverage in 2008 is probably the biggest lesson.

The second thing we learned centered around liquidity. We had a lot of European fund-of-funds clients that were selling hedge fund-of-funds investments to corporates as corporate cash

management with a target return of LIBOR +1%. They invested 12 times leveraged structured credit funds with a bunch of slices of CLOs and CDOs, and LIBOR +1 turned into LIBOR -25 and when they asked for their money back, the gates went up.

So we learned about liquidity of our portfolios. We had a liquidity scoring system set up to protect us in our investments, and that allowed us to do that. I don't know how many phone calls we got saying "congratulations, you are the highest performing credit fund, here is our redemption notice." And we gave it to them, even though some people advised us that we were stupid for not putting up gates, that we are being penalized for doing our jobs, and so on. We simply responded that we have a contract with all of our clients that says that we will produce these returns with this amount of risk, the liquidity terms are x, and when you want your money back you give us a short notice, and we give you your money back. So we stood by our contracts.

The third lesson was a bit of a surprise to me - counter-party risk. We had a bulk of our short positions in CDX index swaps with three counter parties, and two of them pretty much ceased to trade them on any reasonable price levels. If we had been able to execute our macro view and would have been able to put a lot more short positions in index swaps, we probably could have made a lot of money. In the end, we just broke even.

This inability to execute with large U.S. financial institutions was a big surprise, and we learned a lot about that. We have since then changed the way we are working with the various counter-parties. Unfortunately, none of the Canadian banks were actually trading any of these index swaps. If they had, I believe we would have been a lot better off then.

Aleks Weiler

For us, the source and quality of returns that a manager produces does matter.

Don Raymond, who heads public markets for us, presented a paper at a CFA Institute conference on our proprietary fee structure. In it he highlighted a bit from the classic Grinhold and Kahn text "Active Portfolio Management" where they state that the fundamental goal of performance analysis is to separate luck from skill. They facetiously divided managers into four quadrants based on one axis being skill and the other being luck. The "blessed" managers are of course those with positive luck and skill. The unskilled managers who have bad luck are called "doomed". Unskilled managers who are simply lucky are labeled "insufferable". The skilled but unlucky are deemed "forlorn".

One of the lessons we are seeing as an institutional investor coming out of 2008 is that all is not necessarily lost for the "forlorn" as investors like us are constantly on the hunt for skill plus it is easier to have discussions with them around the appropriate alignment of interests as compared to having the same conversation with the "blessed."

Generically, we think of four sources of alpha: better information, better processing of that information, better access to investment opportunities, and better influence on the investment's outcome. There is no right answer as to which source is better than others. Certain activities have a higher breadth than others. Market timing would classically be a lower breadth activity, however this is balanced by the return you can make. When you are right, it is much larger. We spend a lot of time understanding the alpha, and certainly last year forced us to do this even more. Our diligence has always been tough but it's become increasingly so as we move on.

Not every investment turns out of course, sometimes the odds are against you. Investment risk is assumed to be a compensated risk, because you expect to earn something for it over time.

We spend a lot of time trying to understand the uncompensated risks in each investment. Roughly speaking, there are four of those:

1. The debt and equity capital risk: Do the manager's leverage providers continue to provide them leverage or funding or roll-over structures? Is there an inherent asset liability mismatch within a fund? Obviously, the less leverage required for a strategy, generically the better in that case.

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2. The business sustainability and operational insufficiencies risk: operations need to be matched to the investment process. A statistical arbitrage manager doing north of 10,000 trades a day needs to have a highly automated back office as it is physically impossible to manually process all of these tickets. Contrast this with one investing in bank loans which can require weeks or months and plenty of lawyers to settle trades. The management fees earned are paid to cover these costs so it is unjustifiable not have solid operations.

3. You also deal with fraud risk, which is a harder one to ascertain. Fraud risk is always a wrong way risk - people rarely restate things downward to pay less performance fees.

4. And finally, tail risk does matter, and again there are probably three or four different reasons for it. Each manager is going to be a little different in respect to tail risk.

Some managers have tail risk because they trade in instruments that in regular times are relatively liquid, whereas in bad times they become a "trade by appointment only".

Aleks Weiler



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Some managers have tail risk because they trade in instruments that in regular times are relatively liquid, whereas in bad times they become a "trade by appointment only".

Running investments has always been about hard work and understanding why somebody has made money, and then even more importantly, trying to estimate the sustainability. We discussed it here and we are probably not too far apart that there is a life cycle not only to a manager but also to an investment opportunity.

For example, convertible arbitrage was a pure alpha activity in 1970s, but over time as it has become widely understood and practiced, it has become more of a "hedge fund beta." You now see firms launching retail mutual funds. This is a good sign that those activities are more of a beta type of activity than an alpha one, but that doesn't mean it's not attractive at certain points in the cycle.

Abdalla Ruken

Even though we did well in 2008, the year has reinforced our habit being hedged at all times. We are not betting on macro factors like commodity prices or interest rates etc. We constantly tease these exposures out of our portfolio. We mostly hedge through buying puts so we are always paying a premium for our hedges. And here comes 2008 as one those years where all that premium we had been paying and paying suddenly did its job.

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