



Opalesque Round Table Series '10 ZURICH

Opalesque 2010 Roundtable Series Sponsor:



Editors' Note

Dear Reader,

Welcome to the Opalesque 2010 Zurich Roundtable! It is estimated that around one third of all global hedge fund assets are allocated through Switzerland – the country is home to some of the most experienced and largest investors into hedge funds.

“Relocating to Switzerland”: Experiences of New York and London hedge funds who moved here

Recently, an increasing number of hedge fund managers have either launched funds from Switzerland or moved their whole operation into the country. They benefit from the presence of those end-investors: not only represent the Swiss pension fund and insurance industries a lot of capital, but more importantly, this group has endorsed hedge funds relatively early on, and are now increasing their engagement in this alternative asset class.

Swiss fund of hedge funds say the quality of hedge fund managers based in Switzerland is good compared to other locations, with one Roundtable participant having 15% to 20% of assets allocated to Swiss or partially Swiss-based managers – quite substantial given the moderate share of Swiss based single hedge compared to the US or UK. As a special in this Opalesque Roundtable, hear from London and New York hedge fund managers why they moved to the Zurich area, and what this experience was like.

Small is beautiful: Why some Swiss investors prefer small managers – why asset concentration to large managers can be dangerous

93% of the net inflows in the second quarter of 2010 went into hedge funds managing more than \$5 billion. That group of funds collectively manages about 60% of total industry assets. What is behind this trend? And what are some of the problems the industry will face if this massive asset concentration continues? Are smaller funds the way to go?

New Paradigm in Hedge Fund Technology emerges

Financial markets and hedge fund strategies change all the time. Apart from investment risk, hedge funds today need to cope with an increased visibility of reputational and counterparty risk. Investor due diligence demands have grown – taking time away from managing a fund. Across the board, hedge funds are forced to review their processes and capabilities. This new operational paradigm created more demands on the middle and back office to act as profit centers within the organization. What tools are now available to fit a fund manager's applications to new internal needs, and enhance workflow capability internally and with the outside world?

In addition, this Roundtable covers:

- **How to save gated asset-based lending funds:** A new bank plans to provide liquidity to up to 200 asset-based lending funds with aggregate \$100 to \$200 billion locked up in gates
- **How do you know your NAV is right?** How some hedge funds improve their NAV up to 25bps by checking their independent fund administrator's work
- **A small country:** what limitations or challenges hedge funds face when coming to Switzerland
- **How Swiss hedge fund managers achieve better alignment between managers and investors**
- **Update from the world of futures and CTAs:** how to best invest in systematic strategies
- The UCITS discussion: what works and what not – will UCITS still be around in ten years?

The 2010 Opalesque Zurich Roundtable was sponsored by Advent Software and took place September 7th with the following experts:

- Alexis Dawance, **Co-Founder Global-Cap**
- Chris Manser, **Global Head of Hedge Funds, AXA Investment Managers**
- Frederick Barnard, **Partner, Limmat Capital Alternative Investments**
- Gregor Etzweiler, **Partner, 47 Degrees North**
- Guy Spier, **Founder, Aquamarine Capital**
- Joseph (Joe) Taussig, **Founder, Taussig Capital**
- Karsten Schroeder, **Head of Research and Chairman, Amplitude Capital**
- Tom Zdon, **Vice President of Business Development and Solution Consulting, Advent Software**

We also thank the Opalesque 2010 Roundtable Series Sponsors Custom House Group and Taussig Capital for their support.

Matthias Knab
Director Opalesque Ltd.
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Cover Photo: River Limat, Zurich

Participant Profiles



(LEFT TO RIGHT)

Matthias Knab, Alexis Dawance, Chris Manser, Karsten Schroeder, Joe Taussig, Tom Zdon, Guy Spier, Gregor Etzweiler, Frederick Barnard

Opalesque Zurich Roundtable Sponsor



Introduction

Karsten Schroeder
Amplitude Capital

My name is Karsten Schroeder, I am the Head of Research and Chairman of Amplitude Capital, a \$1 billion CTA. We run a short-term program and a medium-term program, as well as a blended version. The firm was set-up in 2004 in London and we moved to Zug in Switzerland in December 2008.

Chris Manser
AXA Investment Managers

My name Chris Manser. I am responsible for the fund of hedge fund business at AXA Investment Managers. We currently run \$5 billion in commingled multi management products as well as customized multi-manager mandates with a team of roughly 40 people, which are mostly based in London.

Gregor Etzweiler
47 Degrees North

My name is Gregor Etzweiler. I am a partner at 47 Degrees North and responsible for manager screening and analysis. We are a Swiss based fund of funds managing \$250 million and have three strategic partners: CalPERS, Iveagh - the Guinness family office, and the founder of HedgeServ, a new Administrator. We consider ourselves a specialist alternative investment firm offering institutional investors access to early-stage managers, innovative strategies and thematic hedge fund investments, as well as a new UCITS fund of hedge funds.

Tom Zdon
Advent Software

My name is Tom Zdon. I am the Vice President of Business Development and Solution Consulting globally for Advent Software in the Geneva product line. Geneva is used by alternative hedge funds and broadly in the fund administration / prime brokerage space, covering the middle to back office needs of our clients. We are currently in use by over 180 hedge funds globally, as well as fund administrators and primes. We assist hedge funds by providing an operationally efficient platform that crosses all asset classes helping firms to meet the needs of investor due diligence, decision support, and to verify results from Fund Administrators.

Frederick Barnard
Limmat Capital Alternative Investments

My name is Frederick Barnard. I am a partner at Limmat Capital Alternative Investments here in Zurich. Limmat Capital was formed in 2005. Our flagship fund is the LC Equity Fund an active directional long-short fund focused on short-term trading, with some longer-term investing in European equities and interest rates. The fund has 140 million under management and a 5 year track record with annualized return of 20% and standard deviation of around 6%. We have had no down year since inception and the lifetime Sharpe ratio of the fund is 2.8.

Guy Spier
Aquamarine Fund

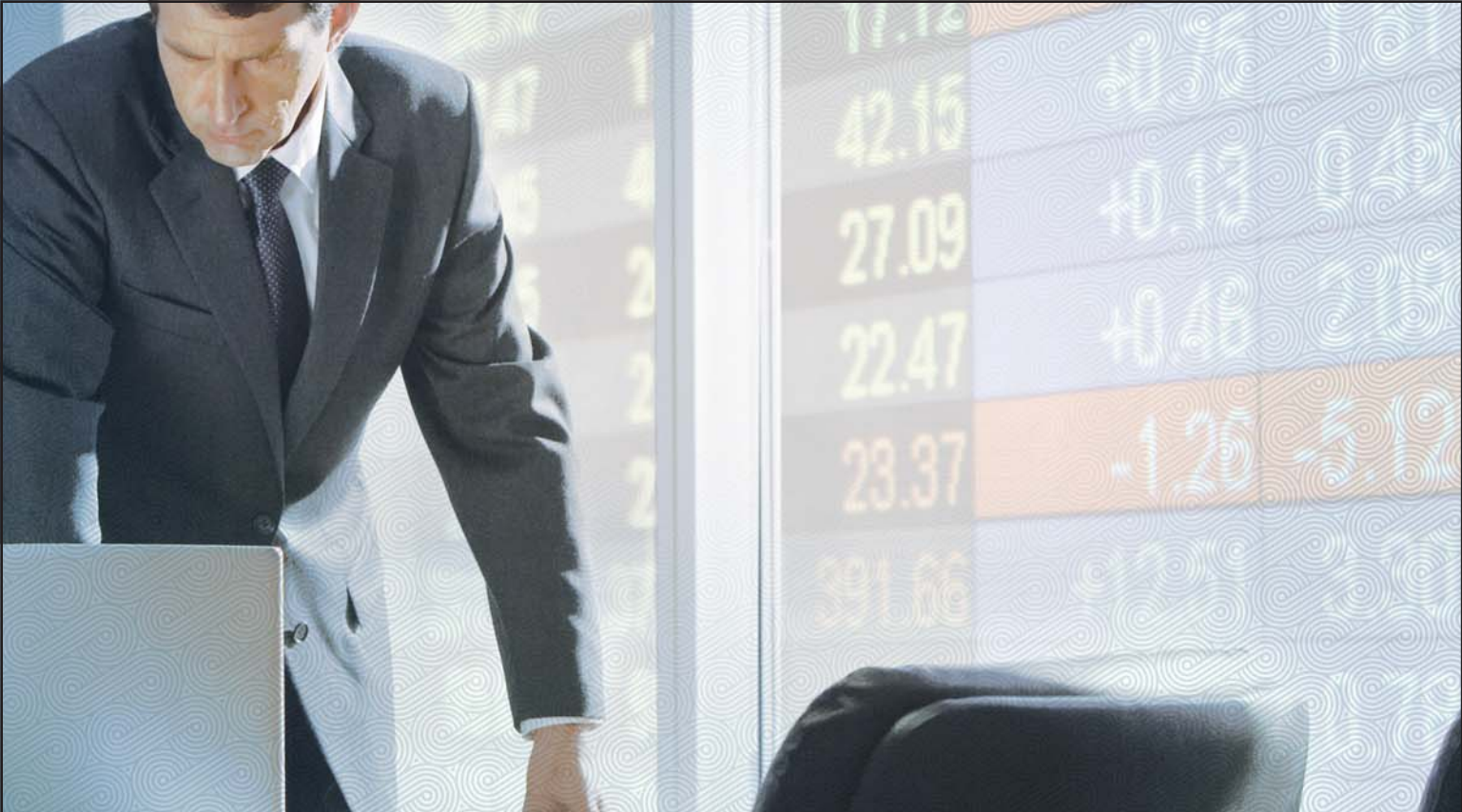
My name is Guy Spier, I run Aquamarine Fund, an investment partnership focused on global long-only deep value investing. We have been running the fund for about 12 years at about 7 percentage points better than the S&P. The fund has 80 million in assets under management. I was running it out of New York until a year ago, when I moved with my family to Zurich for better quality of life.

Joseph Taussig
Taussig Capital

My name is Joe Taussig. We partner with hedge fund managers who are looking to raise lots of assets and permanent capital. For example, by creating banks and insurance companies, we have raised billions of dollars for different hedge fund managers who have partnered with us over the years.

Alexis Dawance
Global-Cap

My name is Alexis Dawance. I am the co-founder of Global-Cap. Global-Cap was founded in 2006. We are a hedge fund company managing two hedge funds. Our GMC fund is a global long short thematic fund that outperformed significantly the MSCI World and the HFRX Equity Hedge index each year since inception.



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Please share with us some of the opportunities you pursue at this moment. What is going on at your company or in your fund? Is there something you are excited about right now?

Guy Spier

A thought that kind of moved me the most over the last year-and-a-half was expressed by John Burbank of Passport Capital when he said to “go long what China is short.” I just came back from China, and in my view the people who herald the collapse of a bubble in China are pretty much on the wrong side. There are many far-reaching developments in the natural resource markets that show the emerging presence of China in the world.

A thought that kind of moved me the most over the last year-and-a-half was expressed by John Burbank of Passport Capital when he said to “go long what China is short.” I just came back from China, and in my view the people who herald the collapse of a bubble in China are pretty much on the wrong side. There are many far-reaching developments in the natural resource markets that show the emerging presence of China in the world.

For example, when China changes from being a net exporter of coal to being an importer of coal, this is a profound change with many ripple effects. Just think of the number of dry cargo ships dedicated to sending coal to China, how this affects coal handling facilities at ports etc. At the moment, this is one of the themes is that some large companies are now cottoning on to: BHP Billiton is trying to buy Potash, and China, or some Chinese company will probably counter bid. These kind of opportunities are no longer within large cap companies, where much of this is already priced in, which means that you have to look harder to find them.

Another of these remarkable changes can be seen in the emerging presence of China in Africa. Africa is one of the few places where the Chinese can still gain access, if not control of natural resources, which results in a profound transformation of Africa that in fact very few people realize.

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Another of these remarkable changes can be seen in the emerging presence of China in Africa. Africa is one of the few places where the Chinese can still gain access, if not control of natural resources, which results in a profound transformation of Africa that in fact very few people realize. One of the effects of this will be the emergence of the African consumer as a real economic force over the next 5-10 years, there are very interesting opportunities there.

Summing up, I do believe there is phenomenal opportunity in the area I am active, which is fundamental value.

Karsten Schroeder

I believe that compared to other funds at this Roundtable, our strategy at Amplitude Capital is rather at the other end of the spectrum of strategies represented here. What we do has not much in common with the fundamental world. This year, statistically, is not different from the other years we may be looking at, as we aim to create returns in different market environments.

However, 2010 so far does offer good opportunities for us, potentially more than what we had seen last year. What has been very hurtful in the recent past for short-term, systematic traders were government interventions which especially affected the fixed income side. For short term traders, 2010 so far has not been as dramatic from that point as it was 2009.

2010 so far does offer good opportunities for us, potentially more than what we had seen last year. What has been very hurtful in the recent past for short-term, systematic traders were government interventions which especially affected the fixed income side.

We also find that the market liquidity is normal, there were no liquidity issues so far this year. In terms of regulatory impact, I am always surprised when we as a managed futures fund are asked about regulations, because with what has been discussed on the government level, the managed futures industry is going to be the last sector affected by any regulation they could potentially implement. This is why I personally am pretty relaxed about regulations.



There have been no issues in the worlds of futures and CTAs. Do not forget that futures exchanges are an absolutely crucial component of an economy, and if you restrict those markets, your smallest problem is going to be the hedge fund world. You will rather have massive issues in your overall economy, because you could shut down liquidity, which then will be a big problem. So, I do not see any stress on that level, we do not have any counterparty risk - we are trading standardized and fully collateralized products as a future contract, so there are no problems there.

Karsten Schroeder

These things look a little bit different for the medium to long-term range. Equity markets in particular have not really provided medium to long-term traders with a lot of opportunities, because the market was pretty trendless. I have always said that the recovery that we have seen on the equity market was not supported by any fundamentals, but driven by a massive cash injection. As a consequence, we see the equity markets hovering around for the last 12 months, which is not a great environment for systematic traders.

Hence, trend-following strategies have not made much money in the equity markets, but things worked out very good on the fixed income side this year. Many investors and systematic traders with long bonds had a strong August performance, that is where the vast majority of the money was made on the systematic side.

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In terms of the outlook going forward, we probably all agree that the world is anything but stable for the time being. There are a set of people who argue for an inflationary environment, and of course there are those who argue for a deflationary environment in the US and the western world in general.

To be quite honest, we do not care which way it plays out. It will lead to interesting movements on the bond and also on the currency side, and such movement is basically all we need. I do think that eventually the equity markets will need a bit of a correction, because we have had a very high share of government spending that has offset the consumer demand drop, and I think they can't continue to do this much longer, so eventually this will filter through.

Tom Zdon

For Advent, we see increased demand for breadth of application functionality into the middle office, as well as a heightened need for collaborative workflows across the hedge fund ecology. 2009 increased the visibility of reputational risk, counterparty risk, and investment risk, causing hedge funds to review their processes and capabilities across the board.

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The increase in counterparties created more demands on the middle and back office to act as profit centers within the organization. Investor due diligence demands have increased – taking time away from managing a fund. On the other hand, the outsourcing of various functions has led to its own set of challenges. As a result, our focus has been on providing our clients with enhanced workflow capability internally and with the outside world. Hedge fund strategies change, as it was noted by all the participants. Therefore, what is key from for Advent is to provide a rich set of data consolidated in one platform with tools that enable an organization to fit the application to their internal needs.

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Frederick Barnard

Looking at the markets, what has really surprised us recently is that on an individual equity basis the intra-portfolio correlations are extremely high, especially over the past three to six months. We find this surprising, taking into account the current market. If we were in a really stressful environment, you would expect to see high correlation, but I would not expect it in the current environment, where equity markets have been of recent directionless. There are some possible explanations; currently we are witnessing a binary world where we see either risk on or off. Second the increase in ETF investing and trading has increased correlations.

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We also are currently witnessing an exit of certain players from the market. For a CTA trading futures the situation may be different - I can imagine that there is still liquidity here – but on the individual stock level we don't have the liquidity or depth that we had before the crisis, and we expect this situation to probably continue for the future.

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With regards to the high correlation in the market, it means that at the moment it is difficult to extract alpha from stock picking and that we have to attempt in addition to stock picking to make money out of beta or directional bets.

Chris Manser

With the asset allocator hat on, I think we have to bear in mind that at the moment the risk of being wrong is quite high, from a directional perspective. As a result, whether we take a long or short view, our aim is to try to limit the beta in our portfolio.

There is nothing wrong with having a small (positive) beta in the portfolio, but generally we try to make money from alpha. I agree with Frederick that alpha opportunities that we have been finding have been less on the long-short equity side. This is mostly because of the high inter- and intra-sector correlations. However, we have found good alpha in relative value strategies where of course there are significantly fewer market participants. This is why some arbitrage possibilities still exist even after having had a good run over the last twelve months.

But by and large, I believe the easy money (i.e. from beta) that the industry was making over the last year or so is over, and has been over already for the majority of 2010. It has become much tougher to make money, which makes it all the more interesting for us as an allocator. In our case, we have been focusing much more on the liquid, trading oriented managers and trying to extract that alpha, rather than taking a very long-term directional approach.

Gregor Etzweiler

The challenge at the moment is that the macro picture switches regularly between inflation and deflation. Some managers even speak about the potential of a stagflation. On the other hand, emerging markets growth looks solid so the term "de-coupling" pops up again. Corporate balance sheets also look healthy. So there are quite a few forces that pull in different directions. Markets and to some extent also hedge fund managers, are confused by these frequent changes of the macro outlook. Therefore, it is certainly true to say that there is not a lot of directionality and also lower levels of risk in the books of hedge funds at the moment.

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On the other hand, as a fund of hedge funds, we must make the best out of this situation, i.e. take a certain view but still protect our investors' capital. At 47N, we do not give the double dip scenario a high probability. We currently rather believe in a slow growth scenario.

However, as long as the probability of a double dip recession cannot be ruled out, we prefer to position ourselves in the short-duration and liquid part of the high yield universe. With respect to the liquidity argument, our focus on early stage managers is an advantage as the hedge funds we invest in tend to have comparatively small assets under management, which implies that their positions are relatively small. We have seen in 2008 that these smaller positions are easier and faster to liquidate if required.

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We have also seen a pick-up in the merger-arb space over the last couple of months. This is not so surprising given that corporate profits are good, cash levels and free cash flows are at historical highs and funding costs low. Looking at the level in the equity markets, I disagree with Karsten, as I do not think that valuations are very stretched. With a sluggish growth picture, buying extra sales rather than growing organically is easier.

M&A spreads look more attractive now as they increased over the last couple of months from 6% to around 10-11% currently. Companies are still cautious - no one wants to be the next Fred Goodwin.

We may increase our exposure to these strategies, but overall I agree with Chris that you do not want to take too many directional bets with all these uncertainties still circling around.

Alexis Dawance

I think there is too much debt in this world, we are not out of it, the markets are still in the de-leveraging mode. I met so many fund of hedge funds in the last two weeks, and no one invests or is doing anything. I think you can really feel this de-leveraging process within the financial industry. The financial industry is also probably in the secular decline.

The industry has been ultra profitable during the last ten years, but for a reason, which was leverage. Wall Street was extremely profitable because of leverage. When you leverage your balance sheet 35 times, it is pretty easy to deliver a good return on the equity.

The problem is where do we go from here? We think that the US household has to save more. Gregor alluded to the fact that corporate free cash flow reached an all time high. We agree, however let me also point out that most of these companies are facing extremely low taxes - until now. Given the fact that many governments are almost bankrupt, you can imagine that taxes might raise producing some stress on P/Es because the "E" of P/Es are, of course, after-tax.

Therefore, we would be very cautious about that consensus, or consensus in general. We do see some risks in the markets, for example all the pension funds are long commodities, because Wall Street told them four years ago that it was a new asset class, everybody is short the US dollar, everybody is long gold, everybody is long emerging markets, etc. Each time you see the same trade, and I think a reverse of this trade could be very dangerous.

Finally, on a ten year basis, we believe there is much more value in equity than there is in bonds. I believe you really have to be extremely courageous to buy bonds at these levels, especially after the inflows in emerging market bonds and U.S. Treasury for the last six months. A short-term play might work on a two to three year horizon in Treasuries, but I think on a ten-year horizon with the current 2.5% yield, you are barely being paid for inflation. In my view this very dangerous, and you have a huge credit risk on top.

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As we mentioned, the environment for finding opportunities in this world is tough and difficult. Still, we do have a slight long bias at the moment. We are short some domestic Chinese names, but mainly based on valuations, because generally we believe in the long-term Chinese story. But when you see retailers who are trading at 2 times sales, 10 times book, names like Li Ning, the Chinese Nike - every Chinese has to buy three pair of shoes during the next three years to justify such a valuation now.



Therefore, we do believe in a secular growth, but you have to pay attention to valuations as well. We are a macro fund, so sometimes we also look at what is close to us where at times you can find some nice opportunities. For example, we put on a rather large trade where we bought cheap Spanish stocks. The idea was to buy what is cheap and what is good in the PIGS countries. You can find some very interesting franchises there like Telefonica, Iberdrola etc. - these are companies trading at 8.5 times earnings having more than 50% of their sales outside Spain, often with a huge exposure to Brazil, meaning that we got a cheap BRIC exposure just by thinking a bit out of the box.

Alexis Dawance

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We will probably see governments putting higher taxes on luxury goods, which won't be a good

thing as people don't really want to pay 20% more for their Hermes tie.

We are also long the Chinese car industry, where we buy auto parts manufacturers. They trade at cheap valuations and come with huge growth. The number of cars are almost doubling every year for the last three or even five years. We also like the European solar industry, which is also very non consensus. This is to give you some idea of what we do on the long and short side.

Joseph Taussig

Matthias asked what do we find exciting? We actually think lending is pretty exciting, but commercial lending, I do not mean real estate but to the small and medium-sized business. You have your lowest loan-to-values and your highest spreads almost through business history right now.

We actually think lending is pretty exciting, but commercial lending, I do not mean real estate but to the small and medium-sized business. You have your lowest loan-to-values and your highest spreads almost through business history right now.

We have been working with several of the asset-based lending funds to convert themselves from funds to banks as a way to access cheap capital, and frankly to modestly leverage the spreads. We are working to create another bank right now which will provide liquidity to the 100 or 200 asset-based lending funds that have in aggregate about \$100 to \$200 billion locked up in gates right now, so that they can pay back and redeem their investors, continue to earn fees on the loans, and then re-lend once loans have been repaid. All of this has been a real problem in an industry that we think has a lot of good operators, but they are still suffering from the liquidity crisis.

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On top, there is no securitization market, no commercial paper. The wholesale banks are withdrawing, because the capital charges are too high. We do think this represents an incredible opportunity, almost once in a lifetime.

Gregor Etzweiler

Joe, would you say that lending is a suitable strategy for hedge funds?

Joseph Taussig

First of all, I do not like the hedge fund structure in general. The whole industry is an asset liability mismatch, particularly the asset-based lending funds that were offering monthly and quarterly liquidity and lending out three to five years in some cases. These funds should have had a permanent capital base. A bank actually is the right structure to do the business, also compared to the private equity model, as the bank just stays to fundamental banking, which is take deposits and make loans. I mean, if you look at somebody like HSBC or BofA and study all the different lines of business they are in, you will see why they are virtually unmanageable as a company.

On the other hand, if you just stick to the fundamental banking business, you can get deposits right now at 3% or 4% which you can lend out in the low teens, net of all expenses, net of all defaults, recoveries etc. You leverage the balance sheet only four times – and not the 60 or 80 times like HSBC and BofA, and with that you have a nice 30 ROE.



I do not like the hedge fund structure in general. The whole industry is an asset liability mismatch, particularly the asset-based lending funds that were offering monthly and quarterly liquidity and lending out three to five years in some cases. These funds should have had a permanent capital base. A bank actually is the right structure to do the business, also compared to the private equity model, as the bank just stays to fundamental banking, which is take deposits and make loans. I mean, if you look at somebody like HSBC or BofA and study all the different lines of business they are in, you will see why they are virtually unmanageable as a company.

Joseph Taussig

Guy Spier

Joe, obviously, the interest of the people who license banks is to keep the spreads wide for the existing bank, so they can rebuild their balance sheets after the financial crises. Maybe you can share with us how you go about getting a new bank licensed given that the existing banks do not want anybody new licensed, because it is such an extraordinary opportunity.

Joseph Taussig

Let me tell you the saga, or part of it. We tried to set up two banks here in Switzerland and correct, we completely failed. We tried to set up in the US and failed even worse. We did set two banks up in Malta and have two more going right now. Malta had no bank failures, the World Economic Forum rates it the strongest banking system in the EU in terms of all the ratios. Well, Malta is obviously a small country, but they looked at the current situation as an opportunity to compete and offer a fast track licensing scheme right now. They have a corporate tax rate of 2.5% - you get to keep more of what you make in the deal, and you can passport everything throughout the EU.

Guy Spier

Any other jurisdictions that you operate in?

Joseph Taussig

We'll probably do a Swiss bank, but generally, we do not like buying banks or insurance companies, because we do not trust the balance sheets because of the legacy issues. If you start a bank from scratch, there are no legacy issues and you do not pay a premium for the book value. Every dollar that you pay on a premium to book value could be used for signing bonuses to bring good people in to your to start-up, so it is just a philosophical position. Ultimately, we will probably end up doing more in Switzerland than any place else, but certainly not in the next year.

Matthias Knab

All of you are Swiss managers or managers based in Switzerland and you run your funds out of Switzerland. How is Switzerland for you as a base?

Karsten Schroeder

I would say we are pretty happy with Switzerland on multiple levels. We moved over from the UK two years ago for a range of reasons; predominantly for quality of life aspects. The financial world is pretty mobile in terms of people and assets compared to a lot of other industries, because you do not have factories or anything like that.

This means more and more financial centers around the world have to realize this... we all know London has not necessarily become the more attractive place in the last couple of years, which creates an opportunity for a country like Switzerland to provide an alternative for people who seek to move away from the more traditional centers. Switzerland has a good infrastructure, it is a good source for human resources, you get very well educated people here and on top you have very good access to investors.

A huge share of the assets invested in the hedge fund industry actually comes from Switzerland and even investors based outside of Switzerland will pass through the country when they travel through Europe. For example, someone may go to London, Paris and Zurich, so the place is definitely not off the beaten track. However, if you would base your fund in a place like Malta for example, unless you have a very prominent name, you will probably have difficulties raising assets just because it is not on the normal travel routes for the people doing onsite visits.

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Apart from that, I am a bit concerned about the discussions I am hearing in Switzerland about a further EU integration. I can see the reasoning from a general economical point of view, but I am reserved to the idea when it comes to the financial industry because the extent of the harmonization that would need to happen. As we all know, continental Europe is anything but supportive of the finance industry and financial markets in general, with rather left wing governments in France and even in Germany, despite the fact that they call themselves conservatives.

Let me add to this discussion that other financial centers like Singapore will have a validity going forward. We do monitor the developments here in Europe and Switzerland, and Singapore could actually be a potential exit option. I mean, no one knows what is going on here five years down the line. Therefore, in my view it would be important for Switzerland to prevail and to keep its neutral position to a certain extent while continuing to improve say on the regulatory front. I have been mentioning this a couple of times that Switzerland lacks the regulatory environment for hedge funds as we have it for example in the UK.

Karsten Schroeder



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Despite all the negative things I could probably say about London, we do have a very good

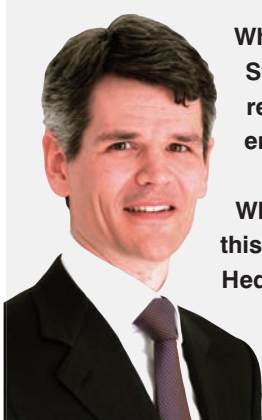
working relationship with the U.K. FSA . When it comes to hedge fund regulation, I actually think the FSA has done probably the best job in the world comparing it to all the other regulators.

I know they have failed on the banking side, but in terms of hedge fund regulations it is a very good agency. This is an area where Switzerland can improve and it is important that they build up a proper regulatory framework, so that we get a wider recognition worldwide and do not have to go through all sorts of structures like UCITS or some sort of other wrappers. Then, also pension funds and other jurisdictions will be able to easily invest in funds that are advised out of Switzerland.

Chris Manser

I think Karsten is right with his comments on the regulatory side. There is some homework that the Swiss government and regulator have to do with respect to alternative investment managers including hedge funds. As part of the discussions around the European Alternative Fund Managers Directive efforts are being made to address those issues.

In general there are currently two ways to become a regulated asset manager in Switzerland, either by becoming a “Fondsleitung” or to get the “Effektenhaendler” status.



What is important and maybe different to other places is that there are a lot of end-investors here in Switzerland. If you look at the pension fund industry as well as the insurance industry, they represent a lot of capital and even more importantly, they represent an investor base that has endorsed hedge funds relatively early on.

While some of them may have been disappointed over the results achieved during the credit crisis, this is a sophisticated group of investors that understands the benefits from investing in Funds of Hedge Funds. We can see that activity is picking up at the moment as some investors are looking to replace some of their existing managers.

Paul MacGregor

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Guy Spier

Generally, I am, by and large ecstatic to be here and operating in the Swiss environment, except for stamp tax, which is the most outmoded pain for any investor here, requiring us to do inane contortion. As Karsten said, money is flexible, it can go anywhere. And the global capital markets have no interest in paying some local stamp tax, but it hits you as the guy running the money out of Switzerland, rather than somewhere else.

A conversation that I have had with a local broker was: “broker, you are going to have to eat the stamp tax duty, because otherwise I will place the trade with somebody in Singapore” – it is as simple as that. I understand the stamp tax duty raises about 300 million Swiss Francs, which is something I would argue that the Swiss banking industry should take on in some other way, it is completely anachronistic.

If you are a slightly larger organization, you just reorganize yourself so that the key trades that would attract the stamp tax duty are placed outside of Switzerland. The real downside to that is that Switzerland does not get smaller managers who may have higher expenses to follow the same

strategy. This is really something that needs to be fixed sooner rather than later.

Gregor Etzweiler

One thing we have not mentioned yet is that generally the quality of the hedge fund managers that are based in Switzerland is good compared to other locations. Raising money in Switzerland is probably more difficult than for example in London. You need to have a special edge to be recognized by investors if you are based in Switzerland. There are not many “walk-in” clients.

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We have between 15% and 20% of our assets allocated to Swiss or partially Swiss-based managers, which is quite substantial given the moderate share of Swiss based single hedge compared to the US or UK.

Let me also address Karsten's comment regarding his satisfaction of working with the FSA, which I think is an important point. We should remember that hedge funds initially emerged as an unregulated investment vehicle. This was actually one of the main characteristics of hedge funds as it allowed them to explore investment strategies that were not available to the traditional asset management industry.

However, the lack of regulation soon turned into a double-edged sword as the investor community did not feel comfortable without any oversight. The FSA made a good job as they managed to align the interests of investors and hedge fund managers. Being regulated by the FSA is now actually looked at as an advantage by hedge fund managers themselves and not only by investors. At the same time, the FSA rules do not constrain the managers to such an extent which would make it impossible to run their strategy. Some managers even argue that the FSA is one reason that holds them from moving away from London to Switzerland as Switzerland is somewhat behind the FSA on the regulation side.



Gregor Etzweiler

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I was surprised by the level of interest by the press around this whole relocation topic, citing an “exodus” from UK based manager. I remember an article by Kinetics published at the beginning of this year which read that they expected 150 UK-based managers to relocate to Switzerland within the next two years. I do not really see this happening yet and I am curious what the other people here at this Roundtable think about it. Sure, some large funds like Brevan Howard, BlueCrest, Moore Capital etc. shipped over a handful of people, but I do not really see the huge trend the press was proclaiming.

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Chris Manser

I think we have to be realistic when talking about this whole relocation topic. This will not happen from one day to another. One reason why the activity might have been lower than anticipated is that the European Alternative Investment Fund Managers Directive has created a lot of uncertainty. This uncertainty might have kept managers away from moving for the moment.

On the other hand, if you for example look at what is going on the regulatory (CRD 3) and tax front in the U.K., the pressure is clearly increasing. I could well imagine that as soon as the regulatory framework is a bit clearer, more managers will be moving.

Karsten Schroeder

Clearly, the press has overplayed the relocation story of managers leaving London and coming here. The industry went through a combination of the financial meltdown, firms disappeared etc. We have probably had literally every newspaper and television studio calling our office for an interview. However, the truth is that there are also larger firms moving into Switzerland, and they are not just moving a handful of people, but moving completely. Of course this will not end up in a total exodus out of London, but we see a slow and continued process.

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I think it is not to be neglected that at the end of the day the big cities are not necessarily a great place to live. A lot of people move to these places because of work opportunities. When these opportunities come down, then obviously less people will move to the big cities. As Chris said, this is a slow process, you are not going to turn things completely in one year. But still, from London's perspective it would be wrong to simply close the eyes and say, "yeah, it is an insignificant number of funds leaving." In fact, I do not think that London closes the eyes.

They are very well aware of what is going on. People need to make sure that you keep the attractiveness of their cities and jurisdictions.



As I mentioned before, I believe the only major room for improvement Switzerland has to go through is on the regulatory front. I think a complete misconception that is also being played out by the press is the notion that hedge funds are kind of like an unregulated, crazy playing field - it is not. Being unregulated is not in the interest of the hedge fund industry. The reality is that we as hedge fund managers want to have a good and a proper regulation. It is funny, every journalist is totally surprised when you say this, and ask perplexed "well, why do you want to be regulated?" The reason is of course that we do not want fraud cases, we do not want the blow-ups, we do not want the black sheep. Hedge fund managers, at least here in Europe, do want free markets, but we don't want to operate in an unregulated environment like we currently have in the U.S., where you can administrate your assets yourself, and manipulate your prices.

Karsten Schroeder

On the other hand, there are strategies where you probably would have to base yourself in London, for example if you rely on the fundamental market gossip, it is a bit hard to do that out of Zug, right? But, if you have strategies that can operate more independently, where you do not necessarily have to rely on the big banking sector being present at your doorstep, you can pretty

much move anywhere you want. Switzerland provides a very good combination of business aspects and quality of life aspects.

And I think it is not to be neglected that at the end of the day the big cities are not necessarily a great place to live. A lot of people move to these places because of work opportunities. When these opportunities come down, then obviously less people will move to the big cities. As Chris said, this is a slow process, you are not going to turn things completely in one year. But still, from London's perspective it would be wrong to simply close the eyes and say, "yeah, it is an insignificant number of funds leaving." In fact, I do not think that London closes the eyes. They are very well aware of what is going on. People need to make sure that you keep the attractiveness of their cities and jurisdictions.

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Matthias Knab

Tom, Advent is obviously a leading global player when it comes to fund administration and operational solutions. What is your experience when you compare the U.S. with other places, say Europe, as far as standards and procedures related to fund administration?

Tom Zdon

Well I have heard this discussion comparing standards in the U.S. and Europe before. The majority of our clients have always been administered or had a separate fund administrator where they themselves do not own that fund administrator regardless of their geographic location. Where we see the most differences are factors unrelated to geography and more related to the firms' strategy and the types of investors they have. Granted, regulations in the US have differed, but in reviewing our clients we find the majority use external fund administration. And we count 17 of the top 20 fund administrators by AUA as our clients.

In regard to NAV production, we are linked to the success of our fund administration clients and fully support independent valuations of NAVs, as it also helps the hedge fund industry avoid reputational risk and allows for more investors to access the market.

Our hedge fund clients fall into two categories. Those who relegate NAV production and numerous middle office functions to the fund administrator, and those that relegate, but verify. We have a number of hedge fund clients who shadow their administrators and have found errors where it comes to complex investment tracking, fees, or valuations. By having systems that allow them to see information in the same manner as the fund admin, they have been able to better communicate and work with the service provider.

In some cases this meant an improvement in their NAV of up to 25bps. In other cases, some hedge funds with the increased information have been able to renegotiate contracts with fund administrators for lower fees. Shadowing of NAV becomes a philosophical conversation as a hedge fund gains in size or number of institutional investors, as well as a philosophical approach of trust but verify.

As for trends, we see increased demands internationally for middle office functionality, workflow development, reconciliation requirements to ease the heightened demands created by the increase in counterparties, and new capabilities around explaining returns relative to both the mandate and

the markets. From an asset class perspective, we see trends towards SMA, fund of funds, and private equity style structures. And lastly we see convergence in regulatory requirements. Whether located in the US or Europe, where regulation does not drive homogenization of practice, investor demands do.

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Tom Zdon



Geographically we see plays in Ireland, Luxembourg, and Malta towards for offshore funds – while seeing repatriation of funds from the Caymans. And the increased accessibility of UCITS has many managers introducing products within that umbrella.

Our job as a software provider is to make it cost effective by providing a hedge fund with the broadest possible scope of features and information without adding to the operational overhead to get there. Whether that means providing the ability to reconcile NAVs with the fund administrator, or simply providing decision level support and quality information, the total inputs should be the same.

Frederick Barnard

I agree with Karsten that regulation is coming, it is just a question of when it comes and in what format it comes. I don't think anyone who is trying to build a business in the hedge fund industry is against regulation, as long as it is not too onerous and too much of a cost hurdle.



With regards to hedge funds relocating to Switzerland, I think the country is really an ideal place to operate from. It is a small country, so there are some limitations or challenges for foreigners who come here in terms of access to housing and schooling etc., particularly in certain areas like Geneva. This is an issue the Cantons will have to address if they are looking to attract more hedge fund companies and people here. Another challenge can be getting work permits for non-EU personnel in Switzerland - it is not the easiest process to go through and there are also some hurdles there.

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Alexis Dawance

I think Geneva was probably the first choice of many of these U.K. fund managers, because they used to go to Vernier for the weekend and to land in Geneva, however they speak French there and the food is probably different...

It is very difficult to find large office spaces in Geneva today, and the flat situation is very tight - you have maybe 1% of free flats in Geneva, which makes things very difficult. I think Zurich has a card to play there, because there is a lot of office space coming in during the next two to three years, all very nice and brand new, and the real estate market and school situation is probably a bit better too. Zurich might be the more attractive place in the future for hedge funds.

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Matthias Knab

Gregor, your company focuses on emerging managers. Please tell us some of the things you observe in this sector. What are some of the new funds and new companies that are set up, and where are they set up? Which strategies do they run?

Gregor Etzweiler

Structure-wise, we observe a trend towards European structures. While Cayman is still popular, we do see more and more hedge funds starting up in Malta or Luxembourg or moving away from the Caymans to one of the European jurisdictions. UCITS is typically not the first choice for early stage managers because of the high set-up costs, in particular legal costs involved in launching a UCITS fund and having a European-based management company. Therefore, early stage managers typically start with an offshore fund.

From a strategy point of view, 2010 so far is an exceptional year in the sense that no hedge fund strategy has done particularly well with relative value being the slight outperformer. All other strategies, i.e. long/short equity, event driven, CTAs and most disappointingly discretionary macro are flat for the year. Therefore, at least for the last 2 quarters, I did not see a dominating trend towards certain strategies that are pushed ahead versus other strategies. Before that, there was a strong trend towards more liquid strategies but I would argue that this trend has peaked in Q1 2010. These days, the picture is pretty mixed due to the uniformly moderate performance numbers across the industry.

Activity is still moderate on the "Innovation" side which is the other area we focus on. With our Innovation Fund we invest in hedge funds which are utilising innovative or niche strategies in new alternative investment fields including electricity trading, insurance-linked securities, alternative energy, shipping, water and structured credit. We also invest in established strategies in new markets such as relative value strategies in Asia or event driven in Latin America. The number of launches in this universe has decreased substantially. In times of uncertainty, people prefer to invest in what they are more familiar with. However, this also opens up new opportunities as less

money chases these assets. Mortgage-backed securities related strategies did very well for us for example.

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Gregor Etzweiler

Geographically, we still see the majority of funds to be set up in the US, and I would expect more to come from there, especially with the implementation of the Volker Rule. It is unclear as of when all these traders will leave the prop desks, but eventually they will leave. So there is a lot of talent being freed up especially in the US which will presumably result in a substantial number of new launches.

Chris Manser

I agree that we should be seeing quite a bit of activity from the Volker Rule. It will be quite interesting to follow those start-up hedge funds over the next 12 to 18 months. Over the last 12 months, there was no clear trend in the industry in terms of strategy or geography. We have seen start-ups in the US, in Europe, and Asia alike.

This is not an easy fund raising environment for start-up managers - a lot of money is going to the large managers and the smaller ones tend to get left behind. Startup managers have to come with a well sized team and good infrastructure - otherwise fundraising will be very difficult - and of course with an excellent pedigree. But if a firm is able to deliver all of this, it can be achieved as shown by some very successful startups over the last 12 months.

Gregor Etzweiler

Through our focus on the early stage managers, we see a lot of managers who run between USD \$50 million and USD \$200 million assets under management. These guys are having a very tough time to grow their assets base these days. As Chris correctly pointed out, most of the flows are absorbed by the large institutions. I am somewhat disappointed that the crisis in 2008 did not result in a change of this “herd-mentality”.

2008 outlined that large funds did not perform any better than the small ones - I would even say the opposite is true because as a matter of fact it is easier to sell a USD \$5 million convertible bonds position than to sell a USD \$100 million position. I am therefore a bit surprised that most of the inflows recently went into the more established funds. It has not been long since Stanley Druckenmiller shut down his fund because of lagging performance. Druckenmiller claimed the enormous amount of capital he was managing as having had a major negative impact on his ability to perform.

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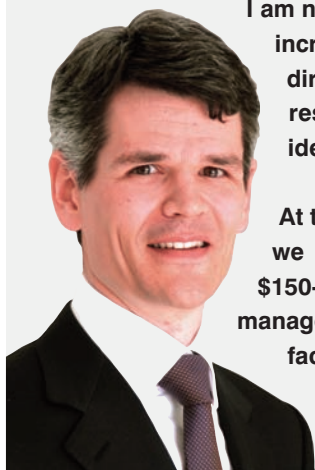
Chris Manser

I am not that surprised about this, because I think one of the major trends we have seen is an increase in direct investment activity by institutional investors. Just put yourself in the shoes of a direct investor, like a pension fund that needs to deploy capital with a limited number of resources, You will not be allocating to small managers. because first, they are difficult to identify, and secondly you have to write big tickets, and you do not do that with small managers.

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At the same time, I am not saying that a focus on large managers is the right thing. On our part, we want to be as flexible as possible and have made investments in managers that were running \$150-200 million at the time of our first investment as well as making investments in large managers. Our goal is to find the best managers and size will always be one factor among several factors determining our choice of manager.

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Coming back to the trend towards direct investing into hedge funds, I think that an institutional investor with a certain size can do it themselves, as long as they are able and willing to commit the resources necessary to do a proper job. However, I think that it is generally quite difficult for insurance companies or pension funds to hire a team of 5 or 10 qualified people to do a proper job and if they can't they should instead farm the money out to a professional fund of hedge funds provider.

Karsten Schroeder

There are a couple of factors that drive the quality of the return. The more assets you have, the more budget you have for research which is good, so that will enhance your returns. But we also

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There are a couple of factors that drive the quality of the return. The more assets you have, the more budget you have for research which is good, so that will enhance your returns. But we also know that every additional dollar you put on your strategy will dilute the returns.

Therefore, somewhere between these two factors will lay a sweet spot, which makes it a commercial decision of the manager. This is one of the vital issues that an investor has to try to figure out. A fund may be way past that sweet spot where even additional budget to research will offset the dilution of the quality of the returns that comes along when you load-up additional assets to that strategy.

Coming back to Chris' point about inflows going mostly into the larger funds, that is actually my criticism on the whole industry. For a big investor, it is very, very difficult to make, let us say a brave, more entrepreneurial investment, because he has to go through this massively expensive due diligence process. And just economically, if you spend \$0.5m on due diligence you cannot make \$2 million or \$5 million allocation to a small or start up manager. Then you have all your admin and monitoring costs on top, but my point here is that a lot of this due diligence is completely repetitive.

I am running through a meeting with pension fund A, and I am running through the same set of meeting with pensions fund B, C and D, and they are asking exactly the same questions. The whole procedure is completely repetitive. If there was a way to take that work away through an agency, say a government agency or whatever, the investor would only have to do the strategy due diligence part.

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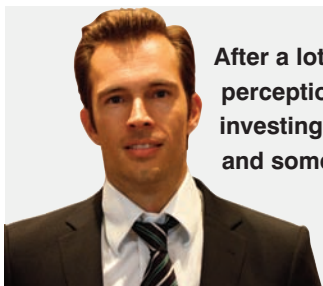
I am running through a meeting with pension fund A, and I am running through the same set of meeting with pensions fund B, C and D, and they are asking exactly the same questions. The whole procedure is completely repetitive. If there was a way to take that work away through an agency, say a government agency or whatever, the investor would only have to do the strategy due diligence part.

Such a solution would make it much easier for investors to efficiently allocate capital, also from diversification aspects. They could do something like trial investment with smaller tickets much easier or earlier. Also with 10 or 20 million tickets they will be able to capture more of the outperformance and interesting return streams that a smaller or more innovative manager may be able to offer for a period of time – until of course the question of the sweet spot will come up again at a later point, where they have to proof they are able to handle the growth.

For all those reasons I plead for a more of standardized due diligence process. Things will be easier for the manager, because he is not running this through a gazillion identical due diligence meetings, and it would be easier for the investor as well because he could make more entrepreneurial, flexible and diversified investments, which will be beneficial for both sides.

Frederick Barnard

After a lot of investors got burnt in some single funds, particularly in the last crisis, there is a perception that bigger is less risky and therefore they are not going to be “fined” or penalized for investing in a large fund, even if the returns may be sub-par. Whereas, if they invest in a smaller fund and something goes wrong, their neck is on the line.



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There is also a certain operational hurdle coming into play, which may put smaller funds more at risk. These operational aspects can be driven by regulation or the due diligence process, which is much more intense these days. The barrier to entry level has definitely increased. As a consequence, the operational platform of a fund is a lot more scrutinized. For people to get up to a best practice levels involves significant investments, which for some smaller managers can be quite burdensome. All these issues contribute that money is going to the larger managers.

Guy Spier

We are a smaller manager, and 95% of the money that I have is from individuals and small family offices. The vast majority of institutional money that I did have left me in 2008 and one of the results of that was that I have completely reoriented my business to not even try and go after any kind of institutional money. For me personally, I found that small is beautiful. I am a much happier person and believe I am a much better investor for it.

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Let me also add this is not a unique experience just of me. A friend of mine, Zeke Ashton from Centaur Capital was running about \$150 million. He had one institutional account leaving him, and as a result of that he went below \$100 million. He then actually shut down a part of his operation, however his returns were still amazing, he has never had a down year with annualized returns in the mid-teens through the last decade or so, and he only goes after individual investors. There seems to be a certain bifurcation in the market – not all people are willing to invest and make it into the call it big leagues. Of course, some people may view this as “asset gathering”



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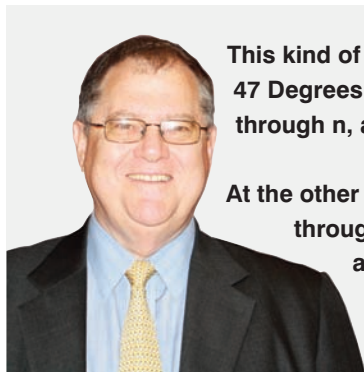
From my experience, there is a whole pool of people, some of them extremely talented, who for one reason or another have not crossed the bridge into the institutional side of the business, maybe they are able to bridge this gap in the future.

Alexis Dawance

I think the problem is also risk taking. Currently, in this industry, people are focusing on their jobs. They will not lose their jobs recommending the top five hedge funds. But, to speak in an analogy, if we take a big clients to the small shop, to the small restaurant down the corner, you would probably have much better service, food, and in the financial world even transparency and access to the fund manager.

Joseph Taussig

This kind of debate of small and large is universal in the industry. I have always liked this strategy that 47 Degrees North has pursued. You have more ideas than capital, so you will rank your ideas 1 through n, and you will focus the capital on the best ideas.



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At the other extreme, if you are Long-Term Capital, you have 7,000 trades on and you rank them through 7,000, you cannot tell me that 6,991 through 7,000 would be as likely to have risk adjusted returns as 1 through 10 or whatever the opportunities are.

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At the other extreme, if you are Long-Term Capital, you have 7,000 trades on and you rank them through 7,000, you cannot tell me that 6,991 through 7,000 would be as likely to have risk adjusted returns as 1 through 10 or whatever the opportunities are. Lord Acton once said that power corrupts and absolute power corrupts absolutely and I would say the corollary of that is that size kills, and absolute size kills absolutely. If you look at some of the funds that have gotten very big over time, you can just see the diminishing returns.

Gregor Etzweiler

The beauty about investing in smaller or early stage managers is also that there is more room to negotiate favorable terms for our investors.

Coming back to Chris' point earlier that they are constraint investing in smaller managers because they do not want to be more than x% of the Manager's assets, I would argue that there are ways around that. If we invest in a fund where we would be say 50% of the fund's assets, if the fund has a liquid strategy I do not see a huge problem. We sometimes negotiate side letters that allow us to exit immediately in case assets fall below a certain threshold. Also, we try to eliminate any risks and costs associated with the liquidation of a hedge fund. There are ways you can secure or save your capital if a larger investor pulls out of a smaller fund.

Like some of the other participants at this Roundtable, I am concerned with the concentration of assets into the large funds. It is certainly not healthy for our pension system if all pension funds invest in the same hedge funds.

But we can not simply blame the pensions and insurances for allocating mainly to the big funds. A lot of fund of hedge funds had done the same – and probably still do – and charge their normal fees for this. I seriously question the value added to investors if a fund of funds invests a majority of its assets in the top 20 hedge funds. Larger pension funds nowadays do have the in-house skills to cover these investments themselves. And it is cheaper if they do it themselves. Pensions should

invest in fund of funds which give them access to areas which are outside their scope and experience.

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I read recently that 93% of the net inflow in the second quarter of 2010 went into hedge funds managing more than \$5 billion. That group of funds collectively manages about 60% of total industry assets. Therefore, if you look on a 5-year horizon we may be dealing with \$40 billion+ hedge funds, which will result in two problems.

I read recently that 93% of the net inflow in the second quarter of 2010 went into hedge funds managing more than \$5 billion. That group of funds collectively manages about 60% of total industry assets. Therefore, if you look on a 5-year horizon we may be dealing with \$40 billion+ hedge funds, which will result in two problems.

First is we said that it is very difficult to perform when a fund is that large. The second issue are incentives. Do you really want to perform when you make so much money with the management fee? You could state that a consequence of these pension funds invested directly in the very large funds probably will lower the returns of the whole industry.

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Karsten Schroeder

It is not always necessarily the case that a bigger fund would perform worse than a small one, because a lot of strategies are very liquid. There are still no issues in taking and managing also very large positions.

There is a trend in the industry, and I think this is a very good direction, towards a better alignment between the manager and the investor. For example, we are always offered to trade off performance fee against management fee, meaning that we basically provide a very low and even up to zero management fee. Of course, with the higher performance both the investor and the managers share the benefits, and therefore we as a fund continue to take risk on board.

I would argue that even very large funds will be willing to negotiate things like that. If you are a \$5 billion fund and you negotiate a \$300 million ticket, this is still a sizeable investment. Clearly, what we as hedge funds all want to concentrate on is managing our assets. Not all of us want to deal with hundreds of underlying clients. In our case, we prefer a more concentrated, planned portfolio where we know that the few clients are 100% educated and they know what they get themselves into. This is a vital insight I figured out through 2008 – contrary to Guy's experience, we saw the more retail investor or fund of funds type of investor pulling out, but none of our institutional clients pulled out, they did not even reduce their exposure.

In our case, the fund was hard closed, and therefore investors know they can get out but they cannot get back in, but we mainly found the real issue is how well educated the client is, how well they understand the performance, how comfortable they are etc., which I believe we can only do with a limited amount of underlying clients, and not with hundreds of say retail type of investors.

That is why we are more geared towards an institutional client that also has an expert team in certain areas. If you run a \$100 million family office and you need to invest into emerging markets, relative value, CTAs, private equity, real estate, and God knows what, it becomes actually very difficult to become an expert investor in all these different areas. Unless you use external sources you will probably find it very difficult to make a balanced and professional decision in terms of investing well in all these difference strategies.

Whereas, when you have an institutional client with say five people dedicated to quant strategies, and these people have spent a couple of years doing this, from my perspective as a manager, we have a different kind of conversation because I do not really have to start from the very basics. They know what I am talking about, they know all the advantages and disadvantages, the drivers and the markets, and this is a real benefit to us.

Therefore, if they invest in our fund, they really know who we are, what we do and what they will get, and they have good reason for their investment. It is not like “Oh! I liked the last year's performance, let's make a little bit of an investment here” type of decision.

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Guy Spier

I instituted a share class in 2008 which charged zero management fee and just a performance fee. In our case, there is no negotiation with investors but they can select either a more classic management plus performance fee or just a performance fee. It is very interesting how each model attracts a different type of investor. Often it is the institutional family office or the individual entrepreneur who goes for the zero percent management fee. In general, I have found those are high quality investors who think about their investment very differently.



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Guy Spier

Matthias Knab

What other developments are relevant to you or your investors? Is anybody doing UCITS funds for example?

Alexis Dawance

We recently got the FINMA approval and will launch a UCITS III fund soon. We believe it is not the optimal wrapper, but it is what people want – maybe not the perfect choice, but I think it UCITS are a good choice also in the light that the industry is getting much more regulated, and we have to face those choices to go forward. We do have distributors for our product, which will be mainly private banks.

Frederick Barnard

To what degree do you think the UCITS fund structure is going to impact your performance? I have seen a lot of studies done on the operational and the due diligence process, but not really any studies on how UCITS fund restrictions impact managers’ performance.

Alexis Dawance

I think the main issue is going to be on shorting smaller companies. If you want to short a company between two and three billion in market cap or even less, it is going to be much more difficult. You have to use derivatives or you can even use single futures, but this market is still quite limited and illiquid. However, if you are going to trade only large cap, that impact should not be that strong.

Frederick Barnard

For certain strategies the UCITS will not be an appropriate investment.

Alexis Dawance

I think for many strategies the UCITS III will not be appropriate. Or people may just run any strategy and use a bank to do a big swap. But at the end of the day, such a fund is no longer a real UCITS III, I think.

Joseph Taussig

I think you have a couple of other issues with UCITS structures. The structures themselves are relatively expensive and that comes right out of the investors' returns. I also believe UCITS hobbles the truly gifted managers an awful lot. I have seen this in the managed account platforms. Think about it as a manager: if you have to look over your shoulder at liquidity every step of the way and your next best idea has something that is a little bit illiquid, you won't be putting your best idea forward.

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The managed account platforms basically underperform by 3% or 4% a year just because managers cannot put their best ideas forward. I see a similar problem with the UCITS strategies and, God forbid, anybody goes into a closed end fund upfront. Going forward, I believe it is virtually a certainty that some will trade at a discount to NAV. This will be interesting. I am very skeptical of it and tend to doubt they will be successful 10 years from now.

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Gregor Etzweiler

We launched a UCITS fund of UCITS hedge funds with our London based partner Iveagh on June 1. We did a detailed study of the total expense ratios as we previously had the same opinion as you, Joe. We also believed that the structures would be more expensive for investors but to our surprise this turned out not to be the case. They are, though, more expensive for the sponsor or manager of a fund.

Management and performance fees are in line with offshore structures. Most of the UCITS funds so far were launched by relatively established managers with a strong capital base who charged the company for the setup cost rather than the fund. Also, if the manager decides to launch the UCITS fund on one of the UCITS platforms, he basically gives up part of his management fee for the benefit of the platform provider, meaning there is zero additional cost to the investor.

The one issue that we put a lot of emphasis on is whether the strategy in question really fits into the UCITS framework. This goes one step further than just to analyze whether the fund in question

fulfills all the UCITS rules. You can wrap almost everything in a UCITS structure. I have seen things such as UCITS compliant structured credit funds which in my opinion is not a strategy that fits a UCITS structure.

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A lot of investors buying these products believe that their capital is fully protected when investing via UCITS. Well, it's not. For example, UCITS does not prevent a fund from instituting a gate. So investors could theoretically end up in a similar situation as we went through after 2008 in the offshore world. It is our job as a fund of funds to make sure that this is not happening and that we only pick managers which are really suitable for UCITS.

UCITS will come at the cost of lower returns. I expect UCITS funds to underperform offshore funds on average by 2-3% per annum which is basically the price you pay for the better liquidity.

Gregor Etzweiler

Drilling down on the strategy and keeping in mind what UCITS stands for is important when selling UCITS products. A lot of investors buying these products believe that their capital is fully protected when investing via UCITS. Well, it's not. For example, UCITS does not prevent a fund from instituting a gate. So investors could theoretically end up in a similar situation as we went through after 2008 in the offshore world. It is our job as a fund of funds to make sure that this is not happening and that we only pick managers which are really suitable for UCITS.

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Joe Taussig

How big is your UCITS fund?

Gregor Etzweiler

The fund is still small. We launched with approximately USD \$5.5 million and it has grown to USD \$7.5 million. We have another USD \$15 million committed by now.

Joe Taussig

And what happens if everybody hits the exit button at the same time?

Gregor Etzweiler

Well, first of all, in the UCITS world, you tend to have more investors. So, we are dealing with a broad investor base on our side. Additionally, we are only a small share in each of the underlying funds. Remember, we have a fund of UCITS funds. Even if we have to redeem 100% tomorrow, it

will take probably take one week to liquidate 90% and two weeks to liquidate everything.

Chris Manser

For us, the UCITS III is another tool you can offer to your client base, and is increasing the choice for investors, which is good. UCITS III has advantages and disadvantages which different investors will weigh differently. Hence while it will be the way to go for some investors, others will continue to stick to the traditional unregulated fund of hedge fund.

We expect that volatility will be a bit higher, because the beta component is higher and because UCITS tend to be focused on more directional strategies like CTAs or long-short equity.

We at AXA Investment Managers are expecting to launch one UCITS fund of hedge fund in due course as well.

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