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Opalesque Round Table Series '10

HONG KONG

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Editors' Note

Dear Reader,

Welcome to 2010 Opalesque Hong Kong Roundtable, which after Zurich and the UK, is our eleventh Roundtable publication this year. The Opalesque Roundtable Series offers ongoing updates and intelligence on the hedge fund industry.

The Hong Kong hedge fund industry now contains a more experienced crowd of managers, but also more emerging managers, who use a greater variety of strategies and instruments. As one of Asia's main financial hubs, Hong Kong is also seeing a renewal of interests from Western allocators, who are setting up shop there in droves.

The territory does not just present a stable regulatory environment, low taxes, and more local money to court; it also supports the great Greater China story.

This Roundtable also covers:

- What strategies are being launched in Hong Kong?
- What kind of emerging managers are there in Hong Kong?
- What are the investment opportunities and the macro prospects in China?
- Why was the China hedge fund industry called the grey market? Where is it heading now?
- What Asian markets are currently attractive?
- What are the challenges and key investment risks? Will Western regulation affect the industry? Is the investment space being over-crowded? Is non-risk taking such a high risk on the industry?
- How difficult is the current fund raising environment? What deals are managers cutting to attract capital?
- Is the UCITS structure likely to work in Asia?

The Hong Kong Roundtable took place on September 16th, 2010, at the local offices of Bingham McCutchen, who also sponsored the event, and included the following experts:

1. Daniel Ghirardi, Chief Executive Officer, SYZ & CO
2. Vincent Duhamel, Chief Executive Officer, SAIL Advisors
3. Denise Hu, Chief Investment Officer of Archer Asia
4. Frank Brochin, Chief Investment Officer, StoneWater Capital
5. Tobias Bland, Chief Executive Officer, Enhanced Investment Products (EIP)
6. Andy Mantel, Founder and Managing Director, Pacific Sun Investment Management
7. Anne-Marie Godfrey, Partner, Bingham McCutchen's Investment Management Practice Group
8. Matthew Puhar, Partner in the Corporate M&A Securities Practice Group at Bingham McCutchen

We also thank our 2010 Roundtable Series sponsors Custom House Group and Taussig Capital for their support.

Enjoy "listening in" to the 2010 Opalesque Hong Kong Roundtable!

Benedicte Gravrand
Senior News Editor - Opalesque Ltd.
gravrand@opalesque.com

Cover Photo: Nan Lian Garden, Hong Kong | Photo by: Anita Ritenour

Participant Profiles

STANDING (LEFT TO RIGHT)

Benedicte Gravrand, Anne-Marie Godfrey, Tobias Bland, Frank Brochin and Matthew Puhar

SITTING (LEFT TO RIGHT)

Denise Hu, Andy Mantel, Daniel Ghirardi and Vincent Duhamel.

Introduction

Anne-Marie Godfrey
Bingham McCutchen

I am the Partner responsible for the Investment Management Practice Group at Bingham here in Hong Kong. Bingham is a US law firm headquartered in Boston, which acts for many financial services' organizations and investment funds. We have 300 lawyers in our Financial Services Area.

Vincent Duhamel
SAIL Advisors

I am the CEO of SAIL Advisors, an alternative investment management and research firm investing approximately $2 billion in hedge funds, from our offices in Hong Kong and New York.

Daniel Ghirardi
SYZ & CO

I am the CEO of SYZ & CO in Asia. We are part of the SYZ & CO group of companies, a Swiss based asset manager and private bank. 3A, the alternative investments arm, advises and manages funds of hedge funds for institutional clients worldwide. We have a dedicated research team based in Hong Kong.

Andy Mantel
Pacific Sun Investment Management

I am the Founder and CEO of Pacific Sun Investment Management (HK) Ltd, an investment advisory specialist in Greater China. We run a long-short fund called The China Mantou Fund and we plan to launch a long-only Greater China value fund in the near future. We also plan to raise a China pre-IPO fund that will be co-invested with some successful mainland Chinese entrepreneurs.

Denise Hu
Archer Asia

I am the Chief Investment Officer of Archer Asia. We are an Asian-focused investment management and research firm. We specialize in constructing portfolios of hedge funds for institutional and private investors. At the moment, we manage mostly the private capital of Rockhampton Management Group in our flagship product, Archer Asia Fund, which is a diversified Asian-focused fund of hedge funds.

Frank Brochin
StoneWater Capital

I am the Chief Investment Officer at StoneWater Capital. Our firm is based in New York and manages three funds of funds focused solely on emerging markets, in particular Asia. Over the past six years, we have been investing in Asia through long-term, fundamental equity managers and offer two single strategy, multi-manager funds focused on Asia ex-Japan and Greater China. In May of this year, we launched a multi-strategy fund of funds that covers global emerging markets.

Tobias Bland
Enhanced Investment Products (EIP)

I came from Jardine Fleming where I ran the proprietary trading desk from 1996 to 2001. We started EIP in 2002, which is a quantitative asset management firm. We run three alpha or non-correlated products and eight long-only Enhanced Index funds. EIP has 14 employees. I spend my time between the investment management side and running the business. The three funds we have on the absolute return side are: a volatility fund, an arbitrage fund, and a fixed income fund.

Matthew Puhar
Bingham McCutchen

I am Matthew Puhar, Partner in the Corporate M&A Securities Practice Group at Bingham McCutchen. Our practice also touches the investment management side in terms of m&a work and the downstream funds investing activity particularly for p/e funds and larger hedge funds.

Benedict Gravrand **What opportunities is your firm currently pursuing in this environment? What are your best ideas?**

Tobias Bland At the moment we have a view that this range trading environment is going to continue. Strategy-wise, EIP has a Mean reverting style of investment and therefore we expect reasonably low returns over the next couple of years. The firm has recently been looking more at the volatility space. Volatility is very low across the region, so we have some spread trades on between developed market volatility and Asian volatility.

The fixed income space has been very kind to most people in the last six to seven months. We have been long of high yield instruments across the region, and hedging with some Philippines CDS. This CDS is at its tightest ever.

EIP has got two ideas in the building phase. One is to benefit from the Yen through long call options in Japan and a range of knockout options. Secondly, we are long on Nifty volatility; Nifty is realizing around 12% to 15% at the moment. You can buy Nifty vols on the short date at around 13% or 14%; Volatility is at an all time low and India has the ability to surprise on policy.

Frank Brochin Our clients are investors who want to take advantage of the long-term Asian growth trends which we believe represent the single most attractive investment opportunity today.

If you look around the US or Europe, you will find over-leveraged societies with indebted governments and consumers, and a generally unhealthy financial system. While governments are piling up debt, consumers are busy de-leveraging; growth is anemic. So you really have strong headwinds with respect to the economy and investments.

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If you look at emerging markets in general and Asia in particular, you find economies that will continue to grow rapidly over at least the next decade. The attractive point is that the drivers of this growth are secular in nature, namely the rise of a new middle class and a resulting increase in domestic consumption, coupled with significant infrastructure investments. This growth will take place in a very sound financial context, as Asia is under-leveraged at the country, corporate and household levels.

Our managers on the ground are investing in companies that participate in this growth and will thrive for many years to come, in particular those companies that provide goods and services to households with rising disposable income, and those that participate in the development of the region's infrastructure.

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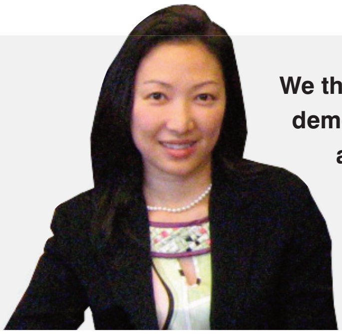
We believe that the best way to capture this opportunity is through equity long-only or long-biased managers with a bottom-up, fundamental approach and a long-term investment horizon. We know that this strategy will generate volatile returns but we feel that it is bound to be the most rewarding over time.

Denise Hu

We think the best ideas are in Asia. Apart from the strong economic fundamentals and demographic trends, what is interesting about Asia for hedge fund managers is the information asymmetry and inefficiencies in the markets. Different Asian countries are going through different economic cycles, as well as changing regulations at the moment. This creates attractive opportunities for hedge fund managers experienced in trading the Asian markets.

In our portfolio, we follow a core and satellite investment approach. The core bucket consists of managers that are well established blue-chip funds. We combine these with opportunities from the satellite bucket which includes niche and emerging managers.

After 2008, we saw a slew of second and third generation managers' launch in Asia. This is very exciting for us, because in the past new managers usually came from long-only backgrounds or the prop trading desks. Now they spin out from established hedge funds, and they bring with them the track record, know-how and hands on experience to run hedge fund strategies in Asia.



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Denise Hu

Even though their initial fund size is usually very small, they are more willing to invest in the risk system, operations and human capital than they were before 2008. People always say that 'big is beautiful'; but we see a lot of advantages in the smaller managers that are at their 'sweet spot', especially in Asia.

Also, in the past 18 months we have seen a growing diversification of strategies in Asian hedge funds, with more event-driven, credit and macro funds launching. This is a very healthy development for the industry.

Summing up, Asia and emerging managers in Asia are our best ideas.

Andy Mantel

As a specialist in Greater China equities, we find that one of the opportunities lies in the increasing number of investment choices. According to our analysis, there are now about 5,500 companies that are considered Greater China equities listed worldwide. We forecast this to grow by about 27% to around 7,000 companies three years from now.

Aside from our current long-short fund, The China Mantou Fund, we are looking to launch a new value fund that will play off our long side attribution and also previous long side track records. Our current niche is cheap companies that are typically small and mid cap companies, which trade at single digit forward earnings.

Generally, you could say that China's capital markets have been an experiment since day one – the Chinese have been listing companies on markets all over the world. We basically look at the whole universe of Greater China stocks, and we do see tremendous opportunities searching for companies we feel are not on the radar screen of global investors yet. For example, a company we hold is called China Green, listed here in Hong Kong. We were a major investor of the company at the IPO in January 2004 at HK$1.26 a share and also during their secondary placement shortly thereafter. The share price did not move for a couple of years, but we kept our focus on the company, met the management every month when no one else was covering the firm. Once there was coverage - around ten brokers started to cover it in just six months – and the stock went from HK$1.26 to over HK$10 by May 2008 at which time we sold some of its shares. We ended buying some back between HK$4-5 in late 2008 when markets crashed. We like to get in early in stocks and we have had many successful investments over the years.

Daniel Ghirardi

As a fund of hedge funds manager, we try to find the new gems among Asian hedge fund managers. Denise has pretty much covered it up, but we also realize that compared to Europe and the US, we have to be a little more flexible and faster on our due diligence and risk management procedures. For example, if we apply the same size and track record's guidelines to the managers in Asia than the ones in Europe or the US, we will be left with very little choice to run an attractive portfolio.

We are now moving away from long-short equity towards much more interesting and less crowded strategies. In regard to our Asian managers, we aim to be much more flexible so that we can turn around portfolios much faster than the ones with more European or U.S. managers. We are very excited by the opportunities in the region as we are back to the roots by selecting real talents and applying tactical portfolio management techniques. Something that became impossible with US and European based managers.

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Daniel Ghirardi

We at Banque Syz also focus on bringing some of our expertise to Asia, for example, we were among the first managers to start a UCITS fund of funds. It seems that Asia is going through a regulatory spree and we have the tools to create products that will be much more regulated. However at the moment, there are not that many Asian managers with a UCITS fund, it is a bit of a challenge to find good managers that have a UCITS structure.

We also launched a commodity fund in Asia five years ago that does pretty well. At the moment, we are looking at currency funds.

Asia is not only interesting from the perspective of finding good managers – there is a second dynamic which involves more and more investors, especially institutional investors, coming into the game and allocating to alternatives. This process will take a few years, you can compare the situation to Europe about ten years ago, which was a green field too at that time. A lot of education is being done here in Asia.

One of our two key focus areas revolves around emerging managers. As a consequence of all the regulatory changes in Europe and in the US, a lot talent is being spun off either from the prop desk or from funds. Those newcomers need seeding or early stage investments. We do see a lot of opportunities here in Asia, in the US and in Europe.

The other key focus involves the less liquid hedge funds. After the crisis of 2008, there has been an enormous demand for anything that is extremely liquid. Our view is that liquidity was always an asset-liability mismatch between the investor and the funds, depending on the funds, of course. The story here is that there are opportunities for longer term stable capital, at higher risk premium, to invest in less liquid strategies - not private equity liquidity type, but probably with a two or three year horizon.

Vincent Duhamel

Vincent Duhamel We continue to be cautiously positioned as we expect more market volatility ahead. While economic data continues to be weak, particularly in the US, the potential for QE2 is driving the price of risk assets higher, while interest rates remain low and the US dollar weakens. In this environment that is so heavily driven by government policy actions, it is difficult to have strong macro views one way or the other. We expect that by early 2011 that we will have a better sense of whether there is a sustainable economic recovery in the US and the world. We continue to focus on trading-oriented managers and long-short strategies in both credit and equities and have built in hedges into the portfolio to protect against the potential for a crisis

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Benedict Gravrand **Some of you mentioned emerging managers. More than half of the new Asia hedge funds this year so far have been launched in Hong Kong. Why and what kind of managers do you see? Are managers leaving the long-short equity arena?**

Vincent Duhamel I do not think fund managers will be leaving the long-short equity area. It continues and will for long time, be an important source of alpha in the capital market structure. For investors, it is a transparent and liquid area to invest. The new managers that we are seeing are emerging from a number of larger funds that have decided to start on their own, or prop desks that have become much more aggressive at spinning themselves off.

The opportunities arising in China have been making it, so far, one of the most exciting markets for hedge fund talent development. This is one of the reasons why we are not going to find a lot of macro or credit strategies there. Rather, it is the natural space for long-short equity, probably because of the still underdeveloped nature but increasing in pace with the rise of the Chinese capital markets.

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Vincent Duhamel

Daniel Ghirardi I agree with Vincent. China is interesting, although the markets are not that developed, as you do not have the flexibility to do much there from a capital and financial markets perspective. But we are seeing some special situations that do well. As for emerging managers, a lot of new people have spun off from larger funds or prop desks - because all the prop desks are going to be disseminated within the next few years - and we try to spot these talents.

Denise Hu Some existing hedge funds which had problems in 2008, such as suspension or gating, still face high watermark issues and have found it hard to retain talent. As a consequence we see the portfolio manager’s right hand man, or the fund’s star analyst, set up their own fund.

The seeding business is blossoming these days because the deals and terms seeders can secure are much more advantageous than those of 2005, 2006, and 2007. In the past, seeders had to have capital locked-up for at least two years and in exchange hedge funds would typically give away equity stakes and other economic benefits. But now there are several new launches that have initial seed capital with no lock-up. Seeders receive a fee discount and a lot of other perks including liquidity benefits. While this is attractive for seeders, dependency of the hedge fund on a cornerstone investor which can pull out any time creates business sustainability concerns for other new investors.

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Benedict Gravrand **What are the challenges in the market right now, and what are the key risks?**

Frank Brochin We see two potential risks in the market today. The first is related to what's happening in China right now. As you know, the Chinese authorities have put in place a very large economic stimulus program over the past two years; by some accounts, they injected the equivalent of 20% of the country's GDP into the economy in 2009 and probably about 10% this year. The challenge, now, is to progressively remove this stimulus without crashing the economy. We believe that the risks of policy mistakes are somewhat high, and if the Chinese economy were to miss its soft landing somehow, it would affect the entire region.

In my mind, those are the two main potential issues on the horizon today – the phasing out of China's stimulus, and financial developments in the Western world, in particular Europe.

Frank Brochin

The second potential risk facing Asia is related to what's happening in Europe and the United States. Our financial systems and economies are still very fragile, and any negative development would quickly prompt investors to take risk off the table, as we saw earlier this year when Greece nearly defaulted. While this would have a limited impact on Asian economies, it would have an immediate impact on risk appetite and by extension, on Asian markets. Volatility in Europe would result in significant volatility in Asia.

In my mind, those are the two main potential issues on the horizon today – the phasing out of China's stimulus, and financial developments in the Western world, in particular Europe.

Andy Mantel Although my general economic outlook is quite optimistic, a risk for investors is the occasional fraud stock, which does happen from time to time whether in Hong Kong, in Singapore or in the US.

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There are a lot of reverse mergers in the US, and probably 700 listed companies there which are considered China plays. But in my experience, it is sometimes very difficult get transparency with these companies and often there is a conflict of interest that exists between the investor relations company and the reverse merger listed company.

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The positive aspect of these potential and real fraud cases is that valuations are kept low across the board. There are a lot of hidden opportunities for those who do their homework on companies; so we often verify company information and forecasts of our top positions. Fraud is a major risk for investors but also presents excellent opportunities.

Matthew Puhar In your experience, which markets are best at weeding out the bad ones in terms of listing diligence, etc.?

Andy Mantel Hong Kong clearly is the best. In the domestic markets of Shanghai and Shenzhen, there are a lot of frauds going on, but they do not come to light.

The reverse merger space in the US is precarious. We did one small Private Investment in Public Equity (PIPE) deal, in part as an experiment. We found out the promoter of this PIPE deal had been involved in many other bad investment deals. So we definitely want to be careful in that area, but it does present some good shorting opportunities too.

One aspect of the problem in this area is in the lack of US and Chinese regulations. There are boutique investment companies in the States acquiring shell companies, and then injecting Chinese assets into and listing them, and then putting out super-aggressive projections. From our experience we have learned to avoid PIPE deals, and if we really feel strongly about it, we may actually short some of these companies.

Singapore has a lot of bad apples as well, and Hong Kong has its share, but not as many.

Vincent Duhamel The risk lies in that investors are not taking any.

Indeed, institutional investors and large funds are all going into the very low risk type of investments. This lack of risk taking is becoming the largest risk for the capital markets, which are not currently well-balanced, and could potentially create the next bubble.

Investors either pile up in investment grade, in totally large secure real estate markets, with large funds, large hedge funds, large fund of funds, large well-known brand names, without focusing on performance and on intelligent and aggressive risk taking.

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Vincent Duhamel

We have built too much focus on portfolio conditions and financial regulations and when the pendulum swings back towards the middle, it will create some potential risks for a lot of investors, globally.

There is certainly a big risk in correlation at the moment. Correlation in asset classes has gone from around 45 to 82 in the last five years. It is actually dangerous to park your money in fixed income, commodities and equities, as they are all moving together, which is unhealthy and making your hedging process correlated. The search is for non correlated assets!

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The Japanese Government Bonds (JGBs) market will probably be very prevalent to that: people have been buying JGBs hedge consistently on this idea and they have done very well with the Yen appreciation. If the treasury market comes back off, then it will bring systematic risk back into Asia.

Denise Hu

As a hedge fund allocator in Asia, one of the challenges that we are seeing this year is that fund raising has been very difficult - not only in Asia, but around the world.

However in Asia, because there are so many new launches competing for assets, managers are willing to do side deals with investors just to get that initial capital. For example, one hedge fund might tell an investor: "if you invest $10 million in the fund before we reach $100 million, we will give you 25% discount of all fees" As a result, the lack of uniformity in fee structure and liquidity terms is moving the industry backwards. We promote transparency and fairness to all investors, but in this environment we are seeing a lot more 'deals'.

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Denise Hu

The other challenge stems from those investors that are willing to put $30 million or $50 million in a hedge fund, however with no lock-up. Those very investors may just pull out capital very suddenly, as the fund, to them, is just used as a cash management tool. A consequence of this is that managers which have a concentrated investor base may suddenly find their business is no longer viable. In short, there are a lot of new launches in Asia, but finding one that is investible requires careful consideration.

Anne-Marie Godfrey

Our clients are seeing this demand for side letter arrangements as well. Regulators, including the SFC continue to frown on these kinds of arrangements and they clearly create difficulties for other investors as well.

Our hedge fund clients are facing regulatory challenges due to the uncertainty that proposed legislation like the European AIFM directive is causing in terms of new product set-ups.

For managers, there is also the challenge of increasing due diligence demands from investors and there is pressure on fees in addition to demands for preferential arrangements.

Benedicte Gravrand **Following on what Denise has just said, what has asset raising been like over the last 12 months?**

Tobias Bland We have been lucky enough to have received two new investments in the last 18 months, which are both relationship deals. One was for the volatility fund, for which we managed to raise $20 million. The other one was for our convertible bond fund. The terms negotiated for the CB Fund were practical given the 2008 circumstances for hedge funds; the manager gets paid at the same time as the investors. I think that is how hedge fund managers and investors should align themselves on fees going forward, instead of charging annual performance fees with no recourse.

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Tobias Bland

Our third launch was in the fixed income space. Here, the capital came in smaller parcels from lots of high net worth individuals. EIP managed to achieve the launch with the help of the promoter and 180 IFAs in a network around the world. The fund is a UCITS structure.

Any big capital raising for debt is being placed at the moment and the market seems toppy. Last month, there was $8 billion worth of Asian debt issued, which is the largest by far. If the Philippines can issue $2.25 billion worth of government debt internationally at 150bps over, then we are definitely in a bubble.

Andy Mantel I found out a few months ago that some of the people in Europe and in the US we had been talking to many times in the past were either not there anymore, or had shifted their strategies around and did not want to focus on Greater China long/short any more. But I think that focus should come back.

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Andy Mantel

My partner in Nanjing and I plan to raise assets from rich entrepreneurs in China as he has a very good network of friends/entrepreneurs that have listed their businesses. These entrepreneurs invest in Renminbi and then, when their companies list and they cash out in a global currency. These people are extremely rich, have excess cash, and are looking for places to put their money. I expect by early next year, Pacific Sun will have successfully raised funds from some of these new market participants.

Vincent Duhamel Redemptions have now stopped and we are starting to see some new assets trickling through. Q1 this year was relatively good in this respect but when volatility came back in Q2, capital completely stopped coming.

But we also found some geographical differences. Fund raising in Asia has been very minimal as the syndrome of dealing with larger names or brand names is still very important for some very large investors.

In the US, there seems to be a lot more activity. Significant numbers of institutions still have a strategic allocation to the alternative space over the long-term, and they also realize the type of returns that they need to match their future liabilities and long passive fixed income exposure is just not enough.

Europe continues to be challenging for a number of reasons. The regulatory environment is still evolving, and somewhat opaque, if you think of AIMF directives or Solvency II for insurance companies. Additionally, a proportionally larger number of funds of funds in Europe were involved in very public and embarrassing hedge funds scandals that have now made European investors very reluctant to invest in the alternative space.

Benedicte Gravrand **Anne-Marie, you were talking about regulations in US and Europe and how they will affect the Hong Kong hedge fund industry. Can you tell us more on that?**

Anne-Marie Godfrey Probably as much as 50% of the money that is raised for funds managed in Asia is raised in Europe. The Alternative Investment Fund Managers (AIFM) directive is clearly going to have an impact on third country managers and on European managers who are delegating to Asia-based managers. This has already happened a lot for funds with Asian strategies for which it is necessary to have a manager here on the ground. It is also going to impact on the domiciles of funds that are going to be marketed in Europe going forward.

The Belgium Presidency of the European Union has produced yet another draft of the AIFM directive. There are also a Council of Ministers' Draft and a European Parliament Draft. It is anticipated that there will be a vote in October or November to finalize the directive. At the moment it is very difficult to advise on the impact for third country managers, because there are so many drafts out there and a lot is going on behind the scenes.

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Anne-Marie Godfrey

I think the US position is a lot clearer since the US Financial Reform Act was signed into law. There are a lot of Asian managers raising money in the US, who previously qualified for an exemption from the requirement to register with the SEC, who will not qualify for an exemption under the new regime. This means that by July 2011 they will have to register with the SEC.

The documentation that will be necessary to file with the SEC has become more extensive. Part 2 of the Form ADV has been amended and is now in narrative format, which makes it more difficult for managers to complete. We are still awaiting SEC guidance on some of the information and documentation that will have to be submitted.

As a consequence, the compliance cost for Asian managers is certainly going up, notwithstanding that this legislation and these regulations are not emanating from Asia.

Tobias Bland We have just filled in our ADV 1s and 2s, but we have been registered with the SEC since 2005. They have actually set up a help desk, and they have electronic formatted documents and are very helpful. You could say that the whole procedure is focused at smaller managers in the US therefore needs to be straight forward.

Benedicte Gravrand **Coming back to investments, please tell me more about the Asian countries and markets that you find attractive at the moment.**

Frank Brochin We have been progressively increasing our allocation to India since the beginning of the year. In our mind, India has always been one of the most attractive investment destinations in Asia from a long-term perspective; the country has an excellent macro-economic outlook with the same secular growth factors as in China, namely the rise of an urban middle-class, an increase in domestic consumption, and significant infrastructure investments. In fact, the demographics are actually better than in China: the population is young and growing and most importantly, the working-age population is increasing.

On the other hand, a lot of issues have been causing concerns for foreign investors over the past several years: inflation, the lack of infrastructure, and very large fiscal deficits at the government and state levels.

We think that over the next couple of years, India will find itself in a very sweet spot from a macro-economic perspective, which should provide significant support to the domestically-focused companies in which we invest.

Frank Brochin

What prompted us to increase our allocation is that over the past year India has become much more successful at addressing these issues, and things have started to change for the better. The government is reducing the country's deficits through the elimination of some subsidies, asset sales and changes in the tax system; it is also engaging the private sector to participate in the build up of the country's infrastructure; and it is raising interest rates to address inflationary pressures.

For these reasons, we think that over the next couple of years, India will find itself in a very sweet spot from a macro-economic perspective, which should provide significant support to the domestically-focused companies in which we invest.

Tobias Bland Our market view is contrarian as we like Japan. This is because its exports of domestic brand names to China and India have expanded, as they are attracting the emerging consumer middle classes.

There are some very bad demographic problems in Japan, but it is now at an apex where things have to be changed in order for the government and the economy to turn around deflation.

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India has been, for us, an enigma due to its volatility. It was easily the most volatile market in Asia only one year ago, and now it is the least volatile market. The Nikkei is much more volatile than the Nifty, there has to be a trade there, it's just a matter of timing.

EIP also thinks the South Asia economy is expanding on liquidity from developed markets "blanket EM investing", and this is causing another bubble. These market moves normally correct within 24 months to real growth rates. Asian currency appreciation may take the shine off results in the coming quarters.

Andy Mantel I think Taiwan is looking more interesting right now. I lived there in the early nineties; when I left, around 200 companies were listed, but now there are more than 1,200. The Taiwan

Taiwan is also one of the highest dividend paying markets in Asia, if not the world. And the Taiwan-mainland relationship is having a very strong effect on developments; individual mainland Chinese travelers will be able to go to Taiwan on an individual visa – all this shows lot of promise.

Andy Mantel

Depository Receipts (TDR) is an interesting development for the market and offers opportunities for companies to list. In a recent listing, a company called Yangzijiang Shipping that is already listed in Singapore issued TDRs in Taiwan, and the share price in Singapore went up about 40%. There has been around one TDR a month since last May and the procedure will get fast-tracked now. There will be a lot of opportunities there, putting more light on the Taiwan market.

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Benedicte Gravrand **With regards to UCITS-compliant funds, what you have seen in Hong Kong? Could it work here?**

Daniel Ghirardi From what I saw in Europe, where we were among the first to launch a UCITS fund of funds; everybody said they wanted to have something much more regulated, transparent and liquid, but the reality is that very few people have actually invested in this area. There are two reasons for that. First, UCITS are not more secure than any other investment, and second, the choice of managers is restricted, and the structure limits the strategies.

But we are seeing more so-called Newcits - single managers, single strategies with a UCITS wrapper - which have more traction than UCITS fund of funds. It is maybe the way to go, but so far it has not really taken off. There is much noise, but not much action going on.

Anne-Marie Godfrey I agree with Daniel. There are certainly a lot of inquiries about establishing UCITS structures from Asian hedge fund managers, and their proposed purpose for establishing UCITS funds seems to be to market to institutional investors in Europe, as opposed to going to the retail public in Europe or Hong Kong. The inquiries do tend to be about the Newcits variety of UCITS funds, and about UCITS funds that will use financial derivative instruments for other than efficient portfolio management purposes.

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Anne-Marie Godfrey

There is a lot of talk and a lot of inquiries in this area, but some managers are surprised when they realize what is involved in running a UCITS fund, particularly in terms of the compliance and the liquidity requirements. Some of their strategies are just very difficult to adapt to make them fit within the UCITS requirements in terms of levels of diversification, liquidity, etc. There is a lot of interest but I do not see a lot of managers pushing the button on it yet.

Benedicte Gravrand **A lot of western financial institutions are setting up shop in Hong Kong. Do you think they have the right expectations? Why are they coming here?**

Vincent Duhamel Asia is primarily the only area is still growing and whenever you have a number of fund closures or changes in the regulatory environment in New York or London, the region becomes more attractive as a result. It is questionable whether some of these Western institutions are going to be around for the long term. We have seen this numerous times, a cycle of come and go on the part of Western financial institutions. On the first speed bump, they will either close down or scale down their activities.

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Vincent Duhamel

This is a very interesting dynamic which adds a lot of expertise and a lot of depth to the capital market structure of Asia, but the commitment is still something that remains to be seen.

Tobias Bland In one of our associated business that focuses on the recruitment side is seeing a lot of new openings in Hong Kong. A lot of people come into town and settle in very fast. Taxes are one primary attraction.

However, the only story in town is Asia, which could be dangerous. The amount of money that is coming with these people is huge relative to the amount of deals around town and in relation to the amount of (ex-Japan) strategies available in Asia. We will be getting a flattening of returns as a result of too much money, and then a wave of incomings followed by a wave of outgoings. A herd mentality is driving a lot of shops here at the same time.

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Tobias Bland

Denise Hu Allocators in Europe who previously invested in Asia tell us that it is very hard for them to invest in Asia now. They come here only once or twice a year and each time they are overwhelmed by the pace of change and increasingly appreciate the importance of being 'on the ground in Asia' to select and monitor Asian managers.

On the hedge fund side, larger global managers have set up office in Asia just to have better access to the investor base here. They are proactively seeking capital here, particularly from sovereign wealth funds, to diversify their investor base.

Frank Brochin We believe that it is very important for the front-line investment teams, the people who actually select Asian securities, stocks, and bonds, to be based here in Asia. They must be familiar with the local cultures and industry practices; they have to know the management teams of the companies in which they invest; they have to understand the business and political context of what they do; and they need a sense of the local markets. Being on the ground is really the only way to pick securities in Asia.

As a fund of funds manager, our job is to pick such Asian-based managers. Over the past six years, we have reviewed more than 1,200 funds in Asia, and feel that we are extremely close to all of the players here. To the extent that we can continue to meet them regularly, and have a very close relationship with them, we can do a good job serving our clients.

Daniel Ghirardi

We came to Asia for all the reasons that have been mentioned; here we have a local research team and manager selection team – which is especially good for spotting the managers early.

At the moment, Europe is dead and the US, although still growing in terms of assets, is very US-centric. Asia, on the other hand, is the last El Dorado for people trying to raise money, although there is also a lot of noise. Of course, the big sovereign funds are allocating, but it is still a long way to go till Asian institutions really go full speed in allocating to alternatives.

On the other hand, I also see a lot of interest in private equity. This will probably be interesting going forward.

Vincent Duhamel

We were founded in Asia, but during the crisis, we took the opportunity of lower rents and available talent to open up in New York and perform more analysis there; the reality is that 70% of all the hedge funds that are being created or that exist are sitting in the New York and Connecticut area. The available talent adds value there.

We continue to have a strong base here because this is our home, but as most of our investments are in the US, we need to have a presence over there.

Benedicte Gravrand

Do you think China is facing a real estate bubble and that banks are facing loan losses?

Tobias Bland

The capital raising going on in China is very simply humongous. There is $100 billion worth of IPOs, and the secondaries coming before year end. This is going to cap the China and Hong Kong markets. There has to be a tipping point on capital raising and EIP believes that point is coming sooner rather than later resulting in less issuance.

Frank Brochin

It was clear a few months ago that in some cities, say Shanghai, Shenzhen or Beijing, real estate prices had gone up too much, in particular at the high end of the property market. This was unsustainable and becoming a political issue - at some point the government had to do something about it.

Now, when people think of a real estate bubble, they think of what happened in the United States. They think of Florida condos and the subsequent subprime and financial meltdown.

For a number of reasons, that is not likely to happen in China. First, there is real demand for housing: the urbanization rate in China is growing at 1% per year, and the demand for new apartments or houses is solid. We are talking about some four to five million units a year - this is real demand.

Second, away from the coast and Beijing, incomes have been rising in line with real estate prices. So, overall, on a country-wide basis and outside of the bubble areas, real estate remains affordable.

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Finally, the main reason why we think there is not going to be a real estate burst like we had in the US and in some areas in Europe is that there is very little leverage in the system. Chinese people actually put a lot of money down when they buy a house or an apartment and own significant equity in their properties. As for banks, the total mortgage debt outstanding for China is only 14% of GDP, which is much lower than the equivalent numbers in the US or Europe. With such a low level of leverage, it is very unlikely that we could have a mortgage bust affecting banks here in China the way it happened in the United States or Europe.

Andy Mantel

Obviously, the demographics are very compelling and penetration rates are very low. China will probably match the US by 2020 in terms of global consumption - at 20% each.

We are focused on the Chinese consumer. What we see when go to some second and third tier cities is quite amazing. There is a place called Zhaoqing, an hour from Guangzhou that I visited recently for the weekend. It has over 5 million people and I was the only foreigner. There is no four or five star hotel yet and business is flourishing. It is selling athletic shoes and telecom products at very high prices. Street markets, which are not taken into account in the official economic numbers, are also flourishing. This place is only a few hours from Hong Kong and a lot of my friends have never heard of it.

There might be small real estate bubbles in major cities, even though we have been net short properties in the last year and made some money. But, right now, this sector it is probably more of the neutral stance, because there are some opportunities on the long-side as well. It is definitely a 10 or 20-year story.

Benedicte Gravrand

What about the evolution of the China hedge fund industry; where do you think it is heading?

Vincent Duhamel

The China hedge fund industry has existed for quite a while; it was called the grey market for a long period of time, and now it is slowly coming to light. The regulatory environment has finally started to allow some players in; E Fund being the first one.

E Fund, which was one of the stars at the beginning of 2000, runs fund management companies in China with Bosera and China Southern. China Southern is the second player to launch a hedge fund. These hedge funds are not without some qualifications. They probably do not use the same tools or all of the tools that the typical hedge funds, for example in Hong

We still have the problem with onshore and offshore structures - what will be allowed for foreigners and what will be allowed for mainland Chinese - but it is just a question of time before this restriction also disappears.

The offshore market in Hong Kong has been much more efficient. A number of talented managers in China have done very well over the last few years, despite the difficult capital market environment that we have seen in the country.

The whole capital market structure in China is still very young, and evolving. This creates opportunities for hedge funds, as China does not have the same depth and breadth as other capital markets, thus creating inefficiencies and opportunities.

Vincent Duhamel

Kong, would be allowed to use, but there are a lot of similarities like the two and twenty fees. This is the start of what should be a very fast growing industry in China.

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Andy Mantel

I think the onshore hedge fund industry in China will develop very slowly due to China's ambition to control development. In fact, the Qualified Foreign Institutional Investor program (QFII) has progressed extremely slowly on the mainland. I was involved in Taiwan's QFII back in 1991 and that was very fast; and our firm had opened around ten accounts opened within one year.

And as far as hedging goes in China, this is a grey area; the industry can charge high fees, but shorting is very difficult. Therefore talents will continue to migrate from the mainland into Hong Kong in order to try to launch some type of domiciled fund here, both to operate efficiently and also to avoid unwanted attention in Beijing.

Anne-Marie Godfrey

The regulatory position relating to hedge funds in China does seem to be developing, albeit slowly.

China is no longer a long-only market. Rules were recently changed to allow trading of stock index futures, securities lending and margin trading on the Chinese Financial Futures Exchange, albeit not yet for QFII licence holders. There is a lot of excitement over "mini QFII" but nobody is quite sure how it is going to pan out and whether renminbi deposits in Hong Kong could be used to invest directly in Chinese equities without a QFII license. There have been some backward steps as well, with respect to SAFE's ban since October 2009 on the renting of QFII license quotas.

What is really amazing is not so much the growth of the number of hedge funds and their assets, but really the evolution of their strategies. Six or seven years ago, most of the managers we came across were using long-only or long-short strategies. Today, you have an increasing number of equity, bond and derivative securities tradable across Asia; liquidity has increased; and managers have the opportunity to go into different asset classes and trade different strategies efficiently.

Frank Brochin

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That evolution has been very helpful for building a fund of funds, as it is now possible to combine different strategies together and target not only the long-term growth opportunities, but also the mispricing inefficiencies still prevalent in Asian markets. That is why we recently launched a multi-strategy fund of funds.

Benedicte Gravrand **What else is new in Hong Kong?**

Tobias Bland We are about to launch into the ETF world. There are two views: one is that the Asian population has always liked to pick stocks and they will not stop doing that. Therefore mutual funds or ETFs will not take off in Asia the way it has in Europe and the US. EIP believes that the simplistic nature of ETFs means they will be adopted by retail over and above equity and mutual funds in the coming years.

ETFs are probably the newest and biggest wave of product that is going through Asia at the moment.

Vincent Duhamel The only major change from a regulatory standpoint is the code of conduct about selling derivatives or defining and adhering to suitability criteria when you sell to investors. In comparison to the policy changes in Europe and US, this is probably the only intelligent policy response that we have seen globally.

Anne-Marie Godfrey The only other changes that come to mind are that the SFC is introducing another type of license, a Type 10 license for credit rating agencies, and the disclosure rules relating to short selling will also change soon. Overall, the regulatory position is relatively stable.

We are seeing growing diversification amongst hedge funds in Asia. Not just in terms of strategy and country funds, but also the emergence of Asian sector funds in areas such as technology, real estate or commodities. This is a pleasant surprise as sector funds have been common in US or Europe, but still nascent in Asia.

Denise Hu

Denise Hu Looking at the broad trends in the Asian hedge fund industry, not just in Hong Kong but around the region, we are still in a phase of adjustment after 2008. We expect to see more closures of smaller funds and more consolidation ahead.

On the other hand, we are seeing growing diversification amongst hedge funds in Asia. Not just in terms of strategy and country funds, but also the emergence of Asian sector funds in areas such as technology, real estate or commodities. This is a pleasant surprise as sector funds have been common in US or Europe, but still nascent in Asia.

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