



Opalesque Round Table Series '10 SINGAPORE

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Editors' Note

Dear Reader,

Welcome to 2010 Opalesque Singapore Roundtable, part of our Opalesque Roundtable Series which offers ongoing updates and intelligence on the hedge fund industry.

Singapore is the second destination choice for hedge funds after Hong Kong. Start-ups are reportedly on the rise this year, especially after the central bank approved new rules exempting most funds from obtaining a Capital Market Services licence.

According to the Monetary Authority of Singapore (MAS), the Singapore hedge fund industry has weathered the crisis reasonably well in 2009 despite the general downward trend globally. Notwithstanding the year-on-year decline in the number of hedge fund managers from 350 to 320 as at end-2009, the AuM of the Singapore hedge fund industry held steady at S\$59 billion (approximately US\$42 billion) as at end-2009. The profiles of hedge fund managers and their strategies remained highly varied. This diversification has helped to sustain the industry during the difficult period.

The island country, already a key financial centre, is noticeably making sure that it stays that way through friendly regulations, ongoing training, good infrastructure, and, apparently, frequent airplane flights.

The roundtable participants discussed the opportunities that can be found in the region, their outlooks, and focused especially on risks and risk management.

This Roundtable covers:

- What the region offer in terms of opportunities
- The role of commodities in the Asian markets and in portfolios
- The outlook for Asia and for various strategies
- The risks and challenges in the market
- How are the risks managed? Is VaR an effective risk management tool?
- What due diligence should really be about
- Various ways to evaluate a manager
- Why would one want to set up a hedge fund in Singapore?

The Singapore Roundtable took place on September 21st, 2010, at the local offices of Custom House and included the following experts:

- **Mark Wightman, SunGard (Asia-Pacific)**
- **Adam Fiore, Chief Operating Officer, Flowering Tree Investment Management**
- **Randall Kahn, Director of Investments, APS Investment Management**
- **Dermot Butler, Chairman, Custom House Group**
- **Benedict Yap, Senior Researcher, Mercer Investment Consulting (Singapore)**
- **Lionel Semonin, Managing Director, Four Elements Capital**
- **Stephane Pizzo, Managing Partner, Lotus Peak Capital**
- **Lampros Vassiliou, Managing Partner, Teak Capital Partners**

We thank our 2010 Roundtable Series sponsors Custom House Group and Taussig Capital, as well as SunGard, our Singapore Roundtable sponsor, for their support.

Enjoy "listening in" to the 2010 Opalesque Singapore Roundtable!

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

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Participant Profiles



(LEFT TO RIGHT)

Standing: Benedict Yap, Dermot Butler, Ralph Chicktong, Mark Wightman, Stephane Pizzo, Lionel Semonin, Benedicte Gravrand
Seated: Randall Kahn, Lampros Vassiliou, Adam Fiore

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SUNGARD®

Introduction

Mark Wightman
SunGard

I look after the strategy for SunGard in Asia-Pacific. I have been active in the alternatives space for over 15 years, and covering Asia since 1994. The role we play as a technology vendor includes providing portfolio management and risk solutions, decision support tools, and fund accounting packages across the whole alternative spectrum from hedge funds to private equity and fund of funds.

Adam Fiore
Flowering Tree Investment
Management

I am the Chief Operating Officer and head of the Risk Management Committee for Flowering Tree Investment Management based in Singapore. We are an Asia ex-Japan equities hedge fund manager that launched our investment funds in May 2009. Our primary exposures are in Greater China and India. Our focus is company specific, we look for structural growth stories with high returns of capital employed on the long side and bad businesses with low returns on capital and specific catalysts on the short side. We do not have a macro overlay, but, rather, have a risk management plan to deal with the significant downward volatility that occurs from time to time in our markets.

Randall Kahn
APS Investment Management

I am the Director of Investments at APS Investment Management, among the first Singapore investment firms focused on Asia. We have 15 years of experience, \$1.9 billion of assets and several offices in the region: the head-quarters are in Singapore, we have three offices in China (Beijing, Shenzhen and Shanghai) and one in Tokyo. Our three core products are managed by the Asia, China and Japan teams. Performance has been Best in Class and we have won several awards in the last couple of years. We do both long-only and long-short, and we are bottom-up fundamental, long-term investors with low turnover. Our Asia-Pacific hedge fund is up over 25% year-to-date net and the Greater China long-short is up about 14% net.

Dermot Butler
Custom House Group

I am the Chairman of the Custom House Group. We are a global fund administrator. The head office is in Malta and the subsidiary companies in Dublin, Chicago, Singapore, Luxembourg, Netherlands, and Guernsey, which hosts half a person. We specialize in alternative investment across the range of CTAs, hedge funds, funds of funds, including sub-funds, managed accounts, managed account platforms.

We have also won a couple of awards. We have two separate awards for Best Client Service. And we also had one about 18 months ago for Best Small Hedge Fund Administrator. And I query journalists' punctuation as to whether that is the Best "Small Hedge Fund" Administrator or the Best "Small" Hedge Fund Administrator." And we believe they are talking about the Best Administrator of Small Hedge Funds.

Benedict Yap
Mercer Investment Consulting

I am a Senior Researcher with Mercer Investment Consulting in Singapore. We have been in the global investment consulting business for more than 35 years, and are present in more than 55 locations worldwide. Our clientele is very much institutional, and includes the likes of retirement schemes, government agencies, sovereign and national funds, endowments, charities and private banks, amongst others. On a global basis, our assets under advisement amount to some US\$3.7 trillion. We are 160-strong in the Asia Pacific and we have been in Singapore since 1995. As a manager researcher, I am responsible for conducting research on traditional Asia equities and bonds managers, as well as Asian hedge fund managers. Prior to Mercer, I was a hedge fund analyst with a Swiss-based fund-of-hedge funds.

Lionel Semonin
Four Elements Capital

I am the Managing Director at Four Elements Capital, which was founded almost 2 years ago by a team of ex-BNP Paribas and ex-JP Morgan commodity specialists, who had been working together for about 5 years. We focused on commodity and quantitative analysis and developed strategies. Four Elements is a specialized commodity asset manager focused on absolute returns from a quantitative, systematic, fundamental analysis approach. Our team of 9 members is concentrated on commodity research. We now trade 30 commodities, and are about to increase that to 35 commodities. Our flagship fund, the Earth Element Fund, will be 2 years old at the end December.

Stephane Pizzo
Lotus Peak Capital

I am the Managing Partner of Lotus Peak Capital in Singapore. I have been a hedge fund analyst since 1994 in Switzerland, the U.S and now in Asia for the past four years. Lotus Peak Capital is active in two main fields: we manage an Asian fund of funds, focusing on non-beta strategies. We focus on macro, CTAs, commodity trading, volatility trading, arbitrage, ie strategies that benefit from Asian volatility and market inefficiencies without having a large exposure to market beta. In addition, we act as a consultant for a small number of European investors who wish to access on the ground expertise in the Asian hedge fund selection.

Lampros Vassiliou
Teak Capital Partners

I am the Managing Partner of Teak Capital Partners. We set up in Singapore in 2007-2008. We are a specialist in special situations investments with a focus on private debt opportunities in either distressed or event driven situations. Southeast Asia is our primary focus, but we have an Asia-Pacific brief including Australia. We also look to structure investments, by operating on a capital partnership basis, where we can combine with a capital partner; we have a number of strong capital partnerships with other investment groups and high net worth investors. We originate and structure the investments and then look to take down a portion of the deal in conjunction with a capital partner who will take down the balance. We also provide what we call special asset management services, where we assist other funds or investors extract value from their troubled investments.

Lampros Vassiliou

The outlook is strong, particularly in Australia, where there were a number of special situation opportunities, and also in Indonesia and in Thailand. Although the market for a fund like ours exists in good and bad times, there are numerous opportunities at present – the opportunities are largely a function of the state of the global economy and tightness in credit at a particular time. The outlook tends to hop around from market to market.

Our key investment approach involves providing capital to companies through a well covered debt instrument combined with equity or other upside, at a time where the company is about to collapse or facing a major event including an inability to refinance maturing debt, rescue the company from the edge of the cliff, recapitalize and restructure it both financially and operationally, positioning it for growth, and then moving forward with it, capturing follow on growth investment opportunities thereafter.

Stephane Pizzo

The opportunities for fund of funds are in the opportunities of the underlying managers. The reason we are based in Asia is because we think the region offers, from a global standpoint, the best opportunities in terms of volatility inefficiencies and diversity in the various markets and instruments. Obviously in this space talent is rare, so the challenge is to find the right manager for what we are trying to achieve. But we think Asia is probably the best region to try to extract positive returns going forward.

Lionel Semonin

Our flagship product extracts fundamental discrepancy in a really systematic way, and produces transparent diversified commodity long-short portfolio. The Asia opportunity does not only reside in Palm Oil and Rubber (traded in Kuala Lumpur and in Tokyo respectively) but also in understanding the driving factors of commodity consumption in Asia which is becoming more and more important in the global commodity trading landscape.

Within emerging markets, one has to differentiate between net importers versus net exporters of commodities. In Asia, a strong fraction of the commodities are net importers and will continue to create further imbalances impacting prices going forward. We also believe that the commodity market is now in the second phase of a long term Bull Run, where price should be impacted differently representing increasing constraint to produce certain commodities.

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Four Elements Capital specializes in looking at these differences in a quantitative manner in order to invest on those which are likely to be the most supplied constraints.

Benedict Yap

With our clients, we typically establish a long-term strategic allocation program for their portfolios. On the back of this, we then seek to add value in the short term opportunistically, via a disciplined dynamic asset allocation process, which seeks to exploit deviations from long term averages and so generate improved returns amidst reduced risks.

With regard to hedge fund strategies, we started the year seeing the hedge fund universe deliver its best return in a decade, on the back of distressed markets normalising and technical factors

correcting. Some managers have come through more strongly than others, with the overall universe of managers also being significantly smaller now than it was two years ago.

Going forward, we don't expect the same strength in returns as we have seen in 2009, because markets have returned much closer to normal. This said, we still believe that current market conditions do provide some attractive opportunities for active management. Hedge funds also face far less competition, both from within their own industry and also from the investment banks.

We expect the recovery in US corporate profits and the strength of the emerging eastern economies to lead most major global markets towards recovery.

However there are also some significant risks – over the short-term, we believe that the rally we've experienced in the third quarter thus far have resulted in certain markets running a little ahead of their improvements in fundamentals, and we are also concerned that smaller companies globally are more vulnerable to hiccoughs in the recovery. While this makes us cautious about managers with significant beta exposure, the dispersion of returns within the markets suggests that there are some great opportunities for equity long-short managers that can add value on both the long and short sides of their books.

Trading-oriented strategies (Global Macro, Managed Futures/CTAs and commodities) had a relatively disappointing year in 2009 following strong 2008 returns. While the last 3-6 months seem to point to a possible turning point for these managers, we are wary that many of the headwinds that they have faced recently (including a lack of clear trends) may continue. Until there is a clear outlook for inflation and/or the major central banks start the process of increasing interest rates, the main opportunities appear to be in intra-country, picking up the strengths of different economies, and how these countries are dealing with them. This may favor short term strategies as well as fundamental approaches. We also believe that speculation around the role of the USD as an anchor currency will persist and managers who anticipate correctly changes in sentiment on that front will do well. While we think that there will be challenges as well as opportunities for trading strategies for the rest of this year and going into 2011, we still believe that trading strategies have an important role to play in a portfolio context.



Interestingly a number of fund-of-hedge funds have recently started adding exposures to commodity hedge funds. We started advocating these strategies to clients in 2008, because they provide an attractive alpha source that is lowly correlated to other mandates. We have recently been implementing a number of new fund-of-commodity hedge fund mandates for clients.

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Some of the most attractive opportunities this year have been in the event-driven space. On the mergers side, companies have stored up significant cash reserves over 2009, and with little prospect of organic growth in the short-term, mergers and acquisitions have been abundant and are likely to continue increasing as companies seek to consolidate. This space is particularly attractive now that the hedge fund industry has shrunk. The weight of assets targeting potential deals is also much lower than it has been for a number of years, as hedge fund assets alone in this space are back to 2005 levels, which is almost half their peak at the end of 2007; deal spreads are wide, which in turn provides good opportunities for returns. On the distressed side, while the compression in credit spreads has reduced some of the beta opportunities, we still believe that there are good security specific opportunities available in the markets.

The broad range of opportunities that we saw in the relative value space at the start of 2009 has narrowed significantly, with some managers making strong gains through last year. Convertible bond arbitrage managers have clearly rebounded strongly and opportunities going forward appear to be more security specific. Volatility arbitrage managers suffered last year with the significant decline in expected volatility but a number of fund-of-hedge fund managers we rate highly are once again seeing small allocations to such managers as a good insurance premium given the potential risks through the next 6-12 months.

Overall we believe that hedge funds in aggregate should deliver strong returns in the short-medium term, but we caution that investors should not expect the same strength that we have seen in 2009.

Dermot Butler

We are administrators, so we look at where the market is in the funds or accounts which we can provide our services to. We have seen some huge disruptions: \$100 million three years ago was petty cash, but today it is an ambitious target for a startup manager.

The likelihood that a company like Custom House managing to get one of the \$5, \$10, \$15 billion accounts today is slim. We think we can increase that opportunity by boosting our services. For example, real time pricing is necessary.

As far as the actual targets, today's fashionable move is the UCITS funds. There is an awful lot of talk about UCITS and I think it is probably a lot of wasted air; people are going to buy UCITS for the wrong reason; they believe that because they are regulated and therefore safe. However, four UCITS funds in Europe went under because they were invested in Madoff. Regulation isn't going to stop a crook. It is also dangerous because some investors are liable to tick the due diligence box because UCITS funds are regulated. UCITS does nothing to preclude an incompetent manager, so due diligence is still incredibly important.

Many hedge fund strategies just cannot use the UCITS format; or they may have to go through some rather complex form of derivative structure in order to get the long-short aspect, which is expensive and adds complexity. The anecdotal evidence of the number of UCITS funds that started and got nowhere is quite strong.

If a big name manager or an institution comes along and says "I only invest in UCITS, but I like your strategy, so I'll give you a \$100 million if you add UCITS," then you would be a fool not to open a UCITS fund. But the average manager must heed the cost, has got to explain why their UCITS fund is under-performing their Cayman fund, and must find some form of distribution.

And I have this image of the poster of Ben-Hur, the movie, which had "Ben" going up with a small b and a bigger E and a very big N and then the "Hur" having a big H, small U and a very small R at the bottom, and Charlton Heston in the chariot. It is exactly the same poster for the UCITS fund. The difference is that, at the back above, is Charlton Heston wearing his other costume as Moses, holding out an arm with a tablet that says 130/30. The 130/30 fund were a huge story and I don't know one person who actually managed to raise much money there.

So that is one of the problems of trying to identify where the market is. We are not doing much as far as UCITS go, but we are doing a lot with managed accounts and managed account platforms.

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Dermot Butler



And fund of funds; a lot of them are liable to go the managed account route because most of the investors we talk to now require matched liquidity; which is easier to achieve in a managed account. These are the strategies we are looking at.

Randall Kahn

We should use more of those types of cinematic allegories in finance, and your point about 130/30s is well taken.

At APS, we are a deep fundamental bottom-up value-bias investor. We do both long and long-short. Our hallmark is primary research, and we don't rely upon street research. We like to be contrarian; we got out of the market in 2007, which helped us in 2008, and we got back into the market and that helped us in 2009. These decisions were based on market valuations at the time. We have 11 investment staff in China, 15 in Singapore, 4 in Japan.

We also use third party consultants; when you invest in Asia, it is like getting married, you must know who you are going to be spending your life with. So, we do background checks on management. For example, the market was really excited about a food company that was the caterer for the Olympics in China. They raised a lot of money for capital expenditures (capex) and state-of-the-art production facility. So we went out and visited it in China and found that the equipment was old and second class; the money was not being used. The company later went bankrupt when it was discovered that the head of the company used the money for his own personal expenditures.

There are opportunities to be found in Asia; it's just not efficient, and we find that to be a wonderful stomping ground.

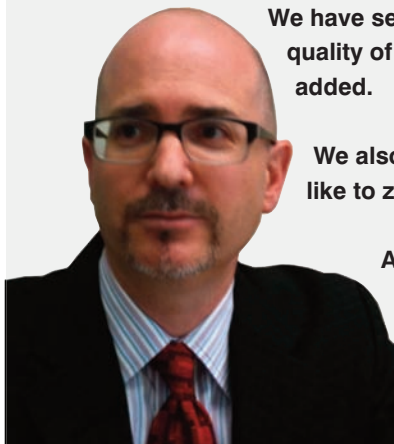
We have seen a lot of analysts on the Street who have migrated to the hedge fund world, so the quality of research has degraded; that means that our own research is that much more value added.

We also find that there is definitely a lot of group-think in Asia; so when people are zigging, we like to zag; we want to see what is different from the market consensus.

And then there are 1800 companies listed in China, of which 400 to 500 have research from the street; that means that there are a lot of great companies where you can generate alpha; we have people on the ground kicking the tires, speaking, reading, writing Chinese, talking to management, reading the local press, chatting with the locals in the region. This is our kind of market.

As for our best idea; Melfas is a Korean make of chip modules used for touch panels, for the likes of Samsung and LG's touch panel phones. It is interesting because the market is booming; Samsung and LG are expanding their product offerings and, with only four players, there is an oligopoly.

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Randall Kahn

Melfas is gaining market share because they have lower costs of production, since they use fewer layers of film during manufacturing. They are integrated, and when 4G comes out, they will be able to bring out their product much faster than their competitors, benefiting their clients such as Samsung.

Adam Fiore

With regards to the market outlook, the investment team at Flowering Tree is quite excited at the company level; they see opportunities to invest in industry leading companies run by strong management teams growing at 20-25 percent plus at reasonable prices. We like the consumer theme in China and to a degree in ASEAN. The financial and industrial sectors provide opportunities both on the long and short sides.

Like Randall, we think the way to make money is to be independent and right and ahead of the Street or contrary to the Street. Each of our 5 senior investment team members focuses on a limited number of companies both long and short that they know well, only about 40 to 50 companies. We think our focus helps us get an edge in understanding the direction and inflections in companies' fundamentals before they are apparent to others and develop the higher conviction levels needed to ride winners.

Mark Wightman

At SunGard, we are most interested in terms of what strategies clients want to run right now. Start ups in Asia have traditionally been long-short strategies but a lot of startups at the moment are looking at global macro and other liquid strategies, and there are definitely a number of players either specializing in FX or in interest rates.



Start ups in Asia have traditionally been long-short strategies but a lot of startups at the moment are looking at global macro and other liquid strategies, and there are definitely a number of players either specializing in FX or in interest rates.

There are a couple of very interesting startups that will be coming out of prop desks in the next six months, which ties in with what is happening in the U.S., where a lot of prop desks are being spun off. Also echoing Dermot's point about due diligence, we all know it is taking longer for the startups to raise money, and investors are increasingly looking for an institutional systems infrastructure; the days of 2 men and a spreadsheet are gone.

Mark Wightman

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off. Also echoing Dermot's point about due diligence, we all know it is taking longer for the startups to raise money, and investors are increasingly looking for an institutional systems infrastructure; the days of 2 men and a spreadsheet are gone.

There is no doubt that technology is definitely part of the due diligence process now. One area I would flag which some of the prime brokers have picked up on is that it has almost got the point that it has become a box ticking exercise. Some of the funds are just looking to buy the cheapest system they can find, whether or not it is actually useful. I hope that investors are going to be aware of this and actually drill into it. There is no point just having something to tick a box, it has got to be of sufficient value and actually fit for purpose.

Adam Fiore

Going back to the outlook question, from an individual public company perspective it is quite positive in many cases.

But when one looks at the markets as a whole we think the challenge is that while in the medium and certainly the long term the fundamentals are going to drive returns, in the short and medium term there can be significant disconnects. We spend a lot of time thinking about those issues and are layering in, not a macro view, but risk management techniques to deal with things like the MSCI AC Asia ex- Japan index (MXASJ) being down 50+%, which has happened three times in the last about 15 years.

Adam Fiore



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Given this, your base case has to be that the same thing is likely to happen again in the next five years. We work on a plan to manage that risk; it is complex analysis and specific to the circumstances at the time of the drawdown.

If that's not enough you also have to grapple with a fundamental problem with risk management, which is that the main data you have is historical data. As we have learned repeatedly, the past in the markets (however useful) is not always the future. You have to use the data and apply it to the present situation which may be unprecedented. That is the challenge of the risk manager.

Benedicte Gravrand

I want continue on what Mark and Adam have just talked about. What risks and challenges do you see in the market at the moment and how do you manage them?

Lionel Semonin

We are fully systematic, so we did our due diligence and looked at available system in the market that could satisfy both our operational and risk management need. Unfortunately due to the peculiar nature of our strategy and the high demand we have from our systematic approach we could not find any available system that would satisfy our need. We found it hard to move from a bank-supported infrastructure to our own self-developed one. This development remains one of our biggest investments.

We have now a fully fledged front to back, integrated automatic order trading to processing system. Given the number of contracts we trade we have between 60 and 90 trades a day which are traded either through order generated or by electronic trading. Our risk management consists in reducing the risk between the theoretical strategy versus our traded strategy. The theoretical

allocation is part of our investment process and insures in any moment in time a diversified long short commodity exposure across all commodity sectors.

Randall Kahn

Both Adam and Lionel hit the nail on the head. At APS we have an independent risk management team which is run by our COO; we use a real time system that looks at how the portfolio is constructed, where we are making money, where we are losing money, and it shows the liquidity, etc. So the idea is to keep our finger on the pulse; looking at what is happening, at odd stock movements, and at liquidity not only at the stock level, but at the portfolio and the firm levels as well. That said, the biggest variable driving our risk controls is stock selection; the best way to not get in a crash is to avoid in the first place. So, know what you own.



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Randall Kahn

We can spend up to six months looking at a stock idea. We looked at green energy because of the strong growth in that area. We looked at those large scale windmills, brought in an expert, found out that there's a lot of value added in these offshore windmills. They are very difficult to construct. Unfortunately, after all our work, we discovered that there are basically no Asian players. We saw no way to make money, and moved on. You just have to spend a lot time getting to know what you own.

Asia is still cheap; its PEG Ratio is less than one. If the U.S avoids double dip recession, it would be a huge upside for Asia. Everybody is talking about domestic demand in Asia. But the opportunities for Asian stocks are huge and if we think too much about these macro issues, we might miss that; we should just focus on the companies which are building products, selling them, making more money.

Mark Wightman

A couple of years ago, a lot of hedge funds lived in a single-prime world and the prime brokers provided a lot of infrastructure and reporting, particularly risk. Obviously today we are very much part of a multi-prime world due to counterparty risk concerns and a lot of funds say "Risk is a big issue, bigger than ever before, but because we're multi-prime, we don't have one high tech prime broker to provide a consolidated risk platform." On one level, there is demand to see more infrastructure coming out of the administrator, but equally from our vendor world, it is a standard request

We ask a lot of hedge funds what risk really means to them. It can mean many things to many people and - going back to our box ticking due diligence - it is often a value at risk (VaR) number, because investors like VaR (despite the numbers not necessarily being comparable due to definition differences). But how many managers actually look at VaR on a day-to-day basis?

Generally, managers say: "We need a VaR number to keep investors happy; maybe I'll use it to understand risk concentration. At the end of the day, I'm managing my risk based on stress testing, real time Greeks, scenario analysis and the like."

There's definitely a theme emerging in the institutional space, with a move towards the use of factor-based models, which are not so much about stocks and bonds, but about exposure and risk budgeting. It is no good saying, "I have bought Alcan, and I have an aluminum exposure." You have also got exposure to certain currencies, to aluminum, to rates (as the company has debt) and so on.

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Mark Wightman



Through our APT business, we are now seeing quite a lot of hedge funds taking a factor-based view of the world as it helps them better understand the risks they are taking. Equally this factor based world view better enables managers to take a more holistic risk view across equities, bonds, commodities and alternatives.

Adam Fiore

We don't use VaR as a risk management tool and don't provide it in our reporting to investors. When marketing, we think that it is a good to best practice to only present some of the portfolio metrics to our investors that we actually use in looking at risk internally. VaR often goes up as stocks go down, if we hold a name and then it goes 20% cheaper on no news, we say you should like the stock even more or you should not have been in it in the first place.



The fundamentals and the markets in Asia get disconnected from each other, which, depending on the circumstances can be one or both of an investment opportunity or situation to apply risk management techniques.

Adam Fiore

This doesn't mean we don't take risk management deadly seriously. The fundamentals and the markets in Asia get disconnected from each other, which, depending on the circumstances can be one or both of an investment opportunity or situation to apply risk management techniques.

Benedict Yap

From a market perspective, there are perhaps a few areas of concern, with the biggest probably being the specter of a double dip recession. But a couple of the most well regarded investors in the market have come out to say that this is not likely to happen, so at least there's some silver lining on this front.

On the macro front, an area which might pose challenges to managers would be the increasing frequency of government/central bank intervention in the global markets, as exemplified by the rather common displays of loud sabre rattling and growing talks of a “currency war”. Take for instance the mid-September intervention by the Bank of Japan to sell the Yen for the first time since 2004. While I know of a number of Macro and CTA managers who profited from this trade, I also know that some were caught off guard. For those on the wrong side of the trade, instances like these can turn a positive month into a loss making one.

And there's also the risk inherent in the unabated rise of the emerging markets. Emerging markets have had a good year thus far, and the IMF forecasts growth in these markets to outpace that of the developed markets. Closer to home, strategies focused on ASEAN and Asia small cap equities

for instance have generated strong performances year-to-date and have attracted a lot of demand. But have investors, who have simply been jumping on the bandwagon, forgotten the downside risks embedded in these markets in the event that hot money decides to exit overnight? Particularly for long/short trades in such markets, are there sufficient shorting facilities available? How much of a danger will basis risk pose? While one can certainly ride the beta on the upside in such markets, how much real protection can one expect from the short side? I'm reminded of the Japan equity market in the years leading up to 2006 and 2007, when small caps were the darlings of many a Japan long/short manager; many were simply long small caps and short large caps. Then in 2006 and 2007, as the small caps got sold off, these managers were taught a hard lesson on the concept of basis risk. Similarly, if foreign institutional investors in the emerging markets decide to unwind their positions over night, we could well see another accident waiting to happen.

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Benedict Yap



At the manager level, business risk appears to be taking centre stage, post 2008. We are particularly concerned that hedge funds which have not reached their 2008 high watermarks by December this year will face difficult decisions because many high watermarks reset at year-end. It's been reported that at the end of 2Q-2010, 30-40% of hedge funds in the industry were at high watermark. For the rest who remain below high watermark, how long can they continue to exist? For managers who are under their high watermarks and still decide to remain in business, we believe they will have a more difficult time retaining talent for two reasons: employees have not been compensated in line with competitors for a few years and the more stable hedge funds have started hiring again.

Interestingly enough, the flipside of this business risk scenario which I've just touched on, poses another source of risk too. It's also been reported that approximately 60% of industry assets are now controlled by blue-chip hedge fund managers (i.e. those with more than US\$5 billion in AUM). This in itself is creating another vicious cycle of investor concentration risk in the industry's top 5% of managers (by size). While the fallout in 2008 has to a certain extent helped to separate the wheat from the chaff, I typically get somewhat wary when investors start engaging in overcrowded trades by putting all their money in the same basket of managers.

Lampros Vassiliou

I don't know if that's right in the sense of the good guys standing and the bad guys being washed away when you apply that concept beyond fund managers to the corporate world. .

We have not really had any improvement in the way in which corporates and their directors are held responsible for what they do in this region.

In the fund world, one example is that a lot of people tick boxes on counter-party assessment and don't really know the counter-party. Usually it is particularly important to understand how your counterparty will react in the worst of circumstances and to understand what is fundamentally important to them so that you can pull it back or threaten it when required.



More generally, the way in which the world responded to the '97 Asian financial crisis and the global financial crisis (GFC) in '08 was not a reaction in which we fundamentally changed the way we do things. There is still a hole in the fundamental structure of the economy globally and in Asia. What happened in Asia in '97 was that the hole or the bubble in the real estate and the corporate sectors moved to the banking sector and then was taken by over the government through asset management companies (AMCs) into the sovereign sector and then pushed back through the structure of NPL sale programs and bond issues that funded the AMCs. The '08 experience globally similar in that the hole quickly moved from real estate to the financial sector, then was grabbed and moved into the sovereign sector, and now we're seeing it being pushed back to the corporate sector.

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The hole is still there, it has never been filled with anything real. Some large firms like Lehman's disappeared and some of the froth of private equity investment may have bubbled away, but we have not seen true sovereign balance sheet restructuring, true financial restructuring of corporates fictionally rescheduled debts, nor fundamental improvement in legislation with regards to the key aspects of the investment environment, particularly in Southeast Asia. These are just examples and I am combining many thoughts here, but in short, things haven't got real yet.

Also, the economy in this region has been driven by Chinese and Indian growth, and while I believe in the long-term Asia story, and believe it will be achieved over the longer term, for the moment we must focus on the way in which it reacts to jolts and the truth there is that it is incredibly fragile. There is significant fragility in the markets. Also, the key risk of fraud causing complete disappearance of value is the fundamental risk that hasn't really been addressed yet in this region.

Benedict Yap

Just to address Lampros' initial point about the good guys left standing and bad guys being washed away, post-2008. Yes, we should never assume that those who have survived 2008 are indeed the good managers. In fact, if anything, more work needs to be done on these managers to ensure that it was skill, coupled with a robust risk management process and sound operational systems, that had enabled them to navigate successfully through the crisis, and not luck. Hence I had said that while 2008 had helped separate the wheat from the chaff in the hedge fund world, this was only to a certain extent.

Randall Kahn

Doing due diligence on fund managers is very much akin to the due diligence that we do on companies. I agree with Lampros in that it is not about checking the boxes. For example, we once were looking at two companies which both looked great on paper; we visited the first company and sat down in a beautiful office, with beautiful art on the wall; we commented on it and the chairman said he was really into art, that he was spending his time with his wife building out this big art gallery.

In the second company, the secretary was wearing ear plugs because in the little bit of space next to her desk there was a machine manufacturing widgets; the office was very barren, with machines

going everywhere. The man we were to meet was quite busy but made time for us. We asked about what this machine was doing by the secretary and he said “We had space, I figured let’s manufacture more widgets.” We invested in that company.

So here is a case where none of those observations would be on those “check the boxes” form, but you know from meeting with the company which is the better investment.

Stephane Pizzo

The risks and challenges for us, a fund of funds, are similar. Indeed, investing in managers is like investing in companies for you: we invest in people and we have to be aware of the risk of fraud. Now, after the fraud of '08, we all well understand what needs to be checked during due diligence, which boxes need to be ticked and what questions need to be asked. We need to have onsite meetings. The key is what to do with the information. Because different investors have different minimum requirements; there is some leeway in terms of deciding to go ahead with investments. What is acceptable for one investor is a veto for another investor.

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Another risk involves understanding the manager’s motivation: are you first and foremost managing your own money i.e. are you managing your portfolio first and having a few investors participating in this portfolio or are you in this business to raise assets, gather assets and make your living off of the management fees?

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The industry is in a sense evolving into two camps; the big large multi billion funds, where by and large, the portfolios are being managed taking the minimum risk to generate the minimum return acceptable for investors not to leave. And on the other hand you have the smaller, hungrier managers who invest their own assets and who are in for the performance. Going forward it is possible to imagine that the industry, which is starting to bifurcate between those two pools of managers, is actually going back to basics in the second camp.

Another risk for me is correlation in the market, and correlation between managers. I have 12 names in my portfolio. This year there were times when 11 of them were either up or down; it shouldn’t be that way, but unfortunately when you decide on a manager, it is a medium to long term investment, generally at least 18 to 24 months. It’s very difficult to change course in the middle. As for correlation between markets, I need to plan 18 months in advance, so I need to have a macro view that is fed from the people I allocate money to, among others, to navigate those waters without too much variation and without going straight into a brick wall.

Randall Kahn

I will ask a question which might be a little sensitive. When making investments, we spend a lot of time doing due diligence; what’s interesting is that in 18 to 24 months, you might not necessarily see the performance coming from the fundamentals, there can exogenous factors. So I am curious as to how much due diligence can you really do on fund managers if your investment horizon is that long?

Stephane Pizzo

You don’t start with the idea that in 24 months the relationship with the invested manager will be over; hopefully the relation can last 10 years or even 20 years. The turnover comes from our

experience: we have been running only for one year and we got rid of one manager who closed down due to low returns.

There are probably two extreme ways to do it, one way is to stick to the same manager for the long-term, and spend a large amount of money on due diligence, therefore delegating to the manager the responsibility to position his/her portfolio according to his/her views. The other way is to say “we have a large macro overlay in our fund of funds and we decide to switch from one strategy to the next. We move the equity exposure up and down, adding this or that at a rather rapid pace.”

Benedict Yap

I'll have to back Stephane's point that as asset allocators and advisors who conduct due diligence on managers, we don't typically begin looking at a manager with a stipulated timeframe in mind and know exactly when to invest or for how long should an investment last before terminating it. If we accept that genuine alpha generation is for all seasons, as a colleague of mine likes to say, then it does investors no good if a manager can only add value within a stipulated window of time and does nothing otherwise. Yes, we recognize that certain strategies tend to do well at certain market inflection points, like convertible bond arbitrage over the last 18 or so months, but we believe it is necessary for a manager to demonstrate the ability to generate consistent returns over time, as opposed to being up X% in one year and down the same amount in the following. I think we all know that by virtue of the law of compounding, such a manager is likely to generate negative returns in the long run.

In Mercer, when we evaluate a manager, we seek to ascertain if the manager is best of breed, mediocre or below average. And when we rate a manager, our view of the manager spans across the market cycle; we look at how the manager performs or behaves across the cycle, whether actions taken (risk taking or risk cutting) are in line with what the manager has told us, whether our understanding of the manager is corroborated, etc. Within the timeframe mentioned by Randall, i.e. 18 to 24 months, you can to a certain extent actually tell whether or not a manager is really doing what he/she is saying. This differs somewhat from the fundamental company research which Randall speaks of, wherein actions taken by a company's management may indeed take a protracted period of time to be implemented due to external factors which management has little or no control over.

Dermot Butler

My only impression of the reaction to the VaR is that people have attended in the past years VaR on its own and that is rather like having one leg on a stool. I just don't understand

Adam Fiore

Another factor is if you are going to publish VaR you should really explain in detail how you are calculating “your” VaR, different calculation methodologies lead to different results and the reader should have the relevant information.

Dermot Butler

Years ago I used to be an option trader and I remember when they introduced the Black-Scholes model. What I invested in, either smelt good or didn't, and that was my due diligence. And in options, there were certainly ways to value investments, by looking at their prices. I have never used the Black-Scholes model; apparently, you take your volatility number and then you run all these other figures and formulae; I asked how they got the volatility number. For example, Adam's is going to be different to Lionel's, which means you could actually tailor Black-Scholes to prove that whatever you are going to pay is correct - by manipulating the volatility number.

The due diligence point that was made is very valid. It was interesting and rather a sad reflection on the industry when we found out who didn't invest in Madoff or didn't have anything to do with Madoff. Deutsche Bank would not lend money to anybody who invested in Madoff, and Caceis would not take a fund that had investment in Madoff.

From my point of view, risk is not just going to be portfolio risk, there are other risks. And you should not use an administrator who does not have a SAS 70, indeed, it is rapidly becoming the case that you should not invest with a manager who does not have a SAS 70, because that's one of the boxes people tick.

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We have to carry out certain risk management procedures, and one of which is due diligence on managers and their shareholders. Some of the services you have to use, such as World-Check, can provide good information but can also certainly dumb information down because it's just a selection of websites, one of which might be a political website which may damn somebody for a good reason or for no good reason.

For example, Custom House's new Chariot Dealing Platform (which stands for Custom House Accessible Reporting In Open Technology) is a platform that reduces a lot of risk by reducing errors.

Randall Kahn

There are also the issues of Singapore, and domicile. Thanks to the Monetary Authority of Singapore (MAS) the regulatory environment here is quite robust.

Lionel Semonin

We look at risk very differently because we are systematic. When listening to lot of people especially Randall and Adam, it is quite interesting that they have moved from risk management to be an integral part of their investment process. We also strongly believe in that. Looking at the VaR is is one value that we find backward looking, indeed "you don't drive a car looking at the rear mirror". From a systematic perfective we build our portfolio integrating the expected return, volatility and correlation. We believe that just looking at volatility and correlation could strongly impede your returns without protecting you for big 'tail risks' that occurs infrequently. We are thus not really keen on mean-variance optimization at a portfolio level. Doing that completely discounts for the particular risk approach that you may have.

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Lionel Semonin

As for tail risk, over the last 2 years you had a good ability to test your model to the extremes. In the commodity space, we have seen daily, weekly moves that we had not seen before. If you had any risk management system which was looking only at historical VaR without stressed scenario,

you would have been crucified. Our risk management approach is based on forecasting and stress-testing more than historical analysis although we do look at it in our analysis.

Benedict Yap

I agree fully with Lionel's point about not driving by looking at the rear view mirror. However, I would like to add that there is merit to reviewing past performance and behavior. One of the key factors that we look out for in a manager is his/her ability to learn from past mistakes and make the necessary improvements. So yes, it would be challenging for one to move forward by looking at the rear view mirror, in fact it is dangerous. But it is important for a manager to know where he/she has gone wrong and be proactive in overcoming those weaknesses.

Mark Wightman

Adam mentioned that VaR is particularly backward-looking which we all know; but as Mark Twain said "history does not repeat itself, but it often rhymes." People tend to spend too much time talking about VaR and don't necessarily look at the whole risk spectrum. VaR is one crutch to lean on but if you are a manager and you are only relying on VaR, you are certainly missing something.



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Mark Wightman

From the software provider's role we have to supply everything that people ask for; generally it is driven by a quorum within the market. Most hedge fund managers would look at real time Greeks and some form of stress testing whereas their risk team may look at historical scenarios, VaR and concentration risk, factor models, counterparty risk and some simple form of liquidity risk.

For most of our clients, VaR will always be there in the form of standard historical or Monte Carlo VaR along with the ability to allow for fat tails. Scenario analysis is data hungry but allows a manager to re-run either pre-canned or user specified events such as 9/11, global financial crisis etc and see the effect on the fund's portfolio.

For investors it is about understanding the whole risk process and valuation policies. Not that there is one Holy Grail, a be-all-end-all solution, but you should be looking at risk in a number of different ways. Obviously the duty of the vendor is to provide a number of different methodologies, and it's up to the risk managers of the funds to choose which are most applicable to their own particular world.

Dermot Butler

Stephane mentioned fraud. Post Madoff and Petters, which were both major frauds, the problem with them and the potential problem with any private equity or any illiquid asset including OTC transactions, is verifying that actual assets exist. Up till Madoff, people thought that verification of the assets was something that the auditors would have checked. Quite inexplicably, auditors have managed to deny that responsibility, although that is their basic skill. Now administrators are going to be required to verify the assets and we are doing it for some people. This isn't a particularly difficult job; it is just onerous and time-consuming. It is a matter of putting a forensic accountant on the case.

The attitude to fraud has grown more prevalent, but it will disappear, people will forget about it and the old days will come back.

Stephane Pizzo

In my experience of this industry in Europe, in the U.S. and Asia, what I find very refreshing with Asia-based managers is their openness and willingness to show what they're doing, disclose how

they work. There are no legal issues where nobody wants to talk or put anything in writing. Checking background information is possible and so is talking to administrators.

Benedicte Gravrand

More hedge funds are being launched in Singapore each year. This is attributed to the pull back factor in investment banking, to friendly local regulations or to the lifestyle. Why would you want to set up a hedge fund here in Singapore, even though the asset raising environment is quite challenging.

Lampros Vassiliou

It is a combination of those things. A big factor is the weather and the lifestyle in comparison to Hong Kong. It is ultimately the choice of people whether to have a base in Hong Kong or in Singapore. Increasingly people do not want to be in Hong Kong because of the pollution and other issues. The legislative environment works because you are not really talking about it; regulation works best when it is in the shadows, ready to fall upon you with great weight when it needs to - that is the way it works in Singapore.

Also geographically Singapore is very well positioned for running a regional strategy and that is what many of the funds here are doing. And I see the industry continuing to grow here. Of course let's not forget Changi airport and our wonderful Singapore Airlines.

Dermot Butler

Hong Kong is probably still the center of the hedge fund business particularly in terms of China. Singapore was picking up lots of funds at the expense of Hong Kong last year, if they weren't pure Chinese plays.

A successful hedge fund manager's wife will want to be in Connecticut, Fulham or in Singapore, which is a slightly less expensive lifestyle, it is definitely a much better lifestyle and everybody says it is safe; that is a huge plus as if you happen to be wealthy, you get worried about kidnaps.

The regulator here is friendlier. We tried in Hong Kong beforehand and went to speak to the regulator, they weren't aggressive or anything, they just didn't want to talk to us; whereas over here they welcomed us with open arms, they asked what we were doing and they helped us. The other place that helps you more is Malta, but that's a different story.

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There has been an influx of Japanese managers because of the adverse tax structure in Japan; and Singapore is picking up quite a few managers who worked in regions out of the UK, the USA and Europe.

In the UK, managers are moving in fact largely to Switzerland or Malta because of the tax structure, or for regulatory reasons. And they moved here because this is probably going to be the great market. America has been the "great" market for hedge funds for years, but we're going through a period where that is changing in almost everything and Asia is going to be the "great" market in the future.

Dermot Butler



In the UK, managers are moving in fact largely to Switzerland or Malta because of the tax structure, or for regulatory reasons. And they moved here because this is probably going to be the great market. America has been the "great" market for hedge funds for years, but we're going through a period where that is changing in almost everything and Asia is going to be the "great" market in the future.

There was a period of about six months where certain managers said that they were going to go to Hong Kong because the regulator here had not said what he was going to do, just that he was going to do something. It was very myopic decision making; they should just look at Europe, where we've had since April 2009 the AIFM directive in drafts and they still haven't agreed, we don't know what's going to happen. And if/when anything does happen, it won't be before 2013. A lot of people have done things like relocating or creating UCITS, as they think it might solve the problem.

On the other hand, six-month decision making with some consultation is remarkable for a regulator and it should be plus points for Singapore.

Mark Wightman

On the regulatory point we did see a slowdown during a six month period, just because people were unsure of what was going to happen. Once the regulators actually came out with the guidelines and made clear what they were looking for, managers then felt confident. So Singapore is very much back on the radar.

We definitely see so many managers coming here particularly those with kids because of the lifestyle, but one of the things that Singapore does particularly well is that the government is looking at the industry in terms of what resources we actually need.



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The government has the only actual official education program I've seen anywhere in Asia Pacific in fund administration. You can do a certificate and even a diploma (a nine-month diploma in fund administration) because the government thinks this is the industry Singapore wants to be in. With a government which is looking to provide the skills locally, Singapore is an obvious environment to consider setting up in.

Lampros Vassiliou

It is important to remember what a true hedge fund is and stay true to that, and not allow the various things we've been discussing which are important, like risk management, transparency, the prevention of fraud, and regulations, make us forget the essence of the a fund. All these factors are hugely important, but we can't allow them to undermine the true essence of why there are hedge funds, as a vehicle for sophisticated investors who are willing to take the risk of losing their money to generate returns, and that is a very fundamental point that we just forget sometimes.

We need to create the right environment to foster innovation and risk taking and stay true to why this industry has developed.

Lionel Semonin

I would agree with everything except for one point on the curve side. Before we moved here (we all moved from London to Singapore as a team), we did business plans for different countries and the cost was a big issue for us, because the infrastructure building on the systematic front is huge, what with the IT and the developers. The cost here compared to US or Europe is much, much cheaper. Hong Kong is good also, but Singapore is more of a community player and gives more access to the infrastructure.

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Benedict Yap

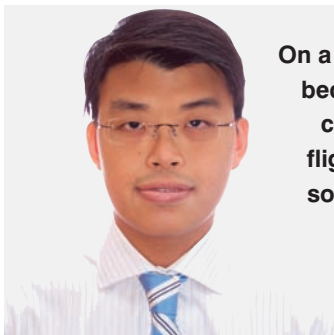
Pardon my need for facts and figures; occupational hazard of my job as a manager researcher. So just for the record, according to the 2009 Singapore Asset Management Industry Survey conducted by the Monetary Authority of Singapore, there were 320 hedge fund managers managing more than US\$40 billion at the end of 2009. These figures are certainly noteworthy, considering that there were just more than 100 hedge fund managers in Singapore, managing in excess of US\$10 billion back in 2005.

I have to agree with the comments raised thus far, particularly the point about clarity and transparency. These are definitely factors that managers, who are considering setting up in Asia, would place a lot of emphasis on. In hedge fund speak, it is very much akin to dealing with a black box – just like how investors are often wary of black boxes, so too are managers of regulatory or tax regimes which are neither clear nor transparent. Imagine being hauled up for infringements not related to poor investment process or operational structure, but because of changing policies!

I remember visiting a neighboring asset management hub in 2007 to look at an interesting Asian equity long-short manager, who had been managing money there for a couple of years. The manager's investment capabilities were pretty impressive, and we proceeded to do more work on the manager. A highlight of the operational due diligence exercise was when we found out that the manager was not even sure if he had been operating with the proper license over the last two years! After much thought, we decided to walk away from the manager.

On a different note, with regard to the point made about managers being attracted to Singapore because of lifestyle reasons, anecdotally, I understand that factors as basic as good air connectivity and an ample availability of flights at most hours of the day, including red-eye flights, are good enough reasons for one to set up in Singapore! So it does indeed appear that softer factors may actually carry more weight in the decision making process these days.

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Dermot Butler

There is also the issue of web transparency. Transparency is more important in terms of transparency of procedures than transparency of a portfolio because if you are running a proper hedge fund, you are going to get crucified if you supply full transparency, including short positions.

Although you get it in a managed account, the primary danger of transparency from an investor's point of view is assuming a risk; if investors have transparency, they are obliged to understand investments and quite often they don't.

A lot of banks have opened up private banking and wealth management units in Singapore because of the pressures on those businesses in Europe and the States. Singapore is going to be a center for wealth management. Coming back to Lampros, the private entrepreneurial family office-like investor has been out of the market and they will come back in, as they see the hedge fund market making money; they will eventually support the startups.

Dermot Butler



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