



Opalesque Round Table Series '11 NEW ZEALAND

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Editor's Note

Dear Reader,

Three weeks after the 6.3 earthquake that struck Christchurch, I flew to Auckland on the North Island of New Zealand for our Opalesque 2011 New Zealand Roundtable. Four of the participants joined the Roundtable from Christchurch on the Southern Island. One of them was still affected from an injury, while another one was currently living with his family in a tent in his garden.

However, the spirit at our reunion was up-beat, as a lot of fund managers have done extremely well in New Zealand and were able to outperform the majority of their global peers, including investment legend Warren Buffett, over the last 12 months.

Independent thinking has always been a strength of the Kiwis. Being in New Zealand allows those managers to make “very good, very dispassionate decisions” and offer both domestic and international investors attractive options. With a return of over 16.5% per annum since inception after fees, the Ernst and Young NZARA Absolute Return Index has outperformed the HFRX Global Hedge Fund Index, the Newedge CTA Index, MSCI World and the NZX 50 Gross by a wide margin.

Pointing to the extreme volatility in the markets, Charles Drace from Socrates Funds Management warns that “volatility does not suit traditional strategies but rather alternative strategies”, and that “most of the people in the alternative market in New Zealand are probably better able to cope with that volatility than Wall Street or London type managers.”

New Zealand based managers benefit from a highly skilled workforce with very low levels of staff turnover. An extremely low cost base allows them to start out and maintain their business also with little AUM. But the country, the government and some entrepreneurs have also higher aspirations to establish New Zealand as a back/middle office infrastructure provider to some parts of the financial services industry. More, consultancy firm Oliver Wyman suggested in a report to the government to develop the framework for a true Asian funds domicile, as at this point “Asian” funds are really domiciled in Luxembourg, Dublin, Cayman Islands or other similar domiciles outside of the region.

The government has already put a very tax efficient and cost effective New Zealand Limited Partnership structure in place that can be used for non-New Zealand investors investing outside of New Zealand as a pass-through entity. Such a LP can be registered for \$250 only which allows launching a structure quickly with a relatively small capacity, whereas “with a Cayman fund you do not get any change out of \$50,000”, says Kenji Steven from NZ Capital Strategies.

In this Roundtable, you will further read about:

- **What hedge funds are NZ based investors interested in?**
- **How do local managers tackle the challenge of raising capital?**
- **A breakthrough in mathematics of complex systems: Are the markets electrical in nature?**

The Opalesque 2011 New Zealand Roundtable was sponsored by the New Zealand Absolute Return Association (NZARA) and took place March 2011 in Auckland with:

Anthony Limbrick, Portfolio Manager, 36 South Capital Advisors

Branton Kenton-Dau, Founder, Markets DNA

Charles Drace, Founder, Socrates Funds Management

David Copley, Managing Director and Chief Investment Officer, Trafalgar Copley

George Bayley, Founder, TGN Funds

Jeremy Muir, Partner, Minter Ellison Rudd Watts

Kenji Steven, Founder, NZ Capital Strategies

Mark Houghton, Founder, Saxe Coburg

Mark Sleeman, Founder, MS Capital Management

Mike Gibbs-Harris, Founder, MGH Asset Management

We also thank the 2011 Roundtable Series sponsor Custom House Group for their support. Enjoy “listening in” to the Opalesque 2011 New Zealand Roundtable!

Matthias Knab

Director Opalesque Ltd.

Knab@opalesque.com

Cover Photo: Queenstown and Lake Wakatipu, South Island, New Zealand

Participant Profiles



(LEFT TO RIGHT, STANDING FIRST)

Jeremy Muir, Mark Sleeman, Branton Kenton-Dau, Kenji Steven, George Bayley, Matthias Knab

Mark Houghton, Mike Gibbs-Harris, Charles Drace, David Copley

(Absent: Anthony Limbrick)

Opalesque New Zealand Roundtable Sponsor

NZARA

New Zealand Absolute Return Association

Introduction

Mike Gibbs-Harris
MGH Asset Management

I am Mike Gibbs-Harris, Director of MGH Asset Management. We are a US SEC registered investment management firm that runs the MGH Investment Fund, a Dublin listed fund. We invest globally in international equities and since the Fund's inception at 1/1/03 it has compounded at +13.3%.

George Bayley
TGN Fund Distributors and
Developers

My name is George Bayley. I run a company called TGN Fund Distributors and Developers. We work with New Zealand-based, absolute return managers regarding their strategy and development of a domestic investor base. I have been working for the last three years closely with a number of NZARA (New Zealand Absolute Return Association) managers.

Jeremy Muir
Minter Ellison Rudd Watts

My name is Jeremy Muir and I am a partner in the Banking and Financial Services Team at Minter Ellison Rudd Watts. We are a part of the Minter Ellison Legal Group, based in Australasia and with international offices in Hong Kong, Shanghai, Beijing, and London. I work in the fields of funds management and financial services regulation, both in establishing funds and in advising funds with respect to ongoing issues and advising international financial service providers in relation to doing business in New Zealand. Before I came back to New Zealand in 2005, I worked offshore in Guernsey, Channel Islands, and the Cayman Islands.

Kenji Steven
Capital Strategies

I am a Director at Capital Strategies. We are a boutique investment management firm running private equity/venture funds, hedge fund of funds, and a variety of specialist mandates for predominantly offshore clients. A key focus is to facilitate offshore investors who want to allocate to the eclectic and interesting strategies that can be found in New Zealand by providing local due diligence, structuring and allocation via an experienced local co-investment partner. We also provide fund design and establishment, asset management, and full suite operational management oversight for seamless domestic/international solutions.

We are just in the process of opening up the Aoraki Absolute Return Fund to international investors. Aoraki (named after our tallest mountain) allocates to the best Kiwi alternative managers, several of whom are here today combining local due diligence, oversight and monitoring. The underlying strategy performance is based on the NZARA Absolute Return Index which has been recorded and compiled by Ernst & Young since July 2007, and has compounded in the mid-teens since then with strong performance right through the global financial crisis.

Branton Kenton-Dau
MarketsDNA

My name is Branton Kenton-Dau. I run a company called MarketsDNA. We trade funds based on our understanding of the mathematics of human intention in the marketplace. We believe that markets are electrical in nature, conforming to the laws of electrical plasma. We have just launched a long-term systemic fund called PaceMaker, which is currently trading a long/short strategy, using SPY the US Tracker Fund for the S&P 500.

Mark Houghton
Saxe-Coburg Limited

My name is Mark Houghton. I am a Director of Saxe-Coburg Limited, we manage private client portfolios here in New Zealand mostly for domestic investors. I set up Saxe-Coburg in 1991. We are totally independent; I manage 70 portfolios and each of them is unique. Our clients come from all walks of life, ranging from small retail investors to larger wholesale investors. Because we use a custodian and have total discretion, we are able to provide small investors with the high quality of service normally only associated with high net worth investors.

Mark Sleeman
MS Capital Management Limited

My name is Mark Sleeman. I am the director of MS Capital Management Limited, which is a CTA based here in Auckland. MS uses a systematic quantitative investment strategy across a diverse portfolio of exchange traded futures markets, with a 65/35 relative weighting split between commodities and financials.

Overall MS' strategy is long-term, with an average holding period of 100 days. Within that there is a wide dispersion of time frames, from medium to extremely long-term, with some strategies occasionally holding positions for several years. MS has a proprietary track record dating back to 1997, with a compounded rate of return of +14% after pro-forma fees. MS has enjoyed particularly strong performance over the past 3 years. Its 2010 client performance is +23%.

Charles Drace
Socrates Funds Management

My name is Charles Drace and I am from Socrates Funds Management. Socrates is a member of NZARA, the New Zealand Absolute Return Association. We base our strategies on long wave theory, which basically says that markets go up and down in long cycles, which can be 16- or 18-year long cycles. The long-term downward cycle in the share market started in 2000. There is a reverse correlation between the share market and commodities market so the commodities market has been in a long-term, up cycle since 2001. We have been focusing on the commodities and will continue to do so until the cycles change again.

David Copley
Trafalgar Copley

I am David Copley, the Managing Director and CIO of Trafalgar Copley. Trafalgar Copley is a Cayman Island-based fund, which we launched in April 2007, so we have been in business about four years. We are a long/short equity and credit strategy focusing on the Australia and New Zealand markets. We have offices in Auckland and Sydney.

Anthony Limbrick
36 South Capital Advisors LLP

I am Anthony Limbrick. Previously I was a participant in the Opalesque Roundtables under the Pure Capital banner, but as of March 1, the Pure Capital team has moved to a 100% focus on London-based 36 South Capital Advisors LLP – a macro-volatility and tail risk manager based in London. The Pure Capital principals are still based in New Zealand but I now spend almost half the year in London. Effectively we have been fully integrated into the investment team there and I am one of a four-person executive team and I am also a portfolio manager. I have been on the 36 South investment committee since early 2006, so this was a natural progression for our business. We will still run Pure Capital's firm capital in the targeted non-correlation strategy, but from the end of March it is no longer available to outside investors and 36 South will be our principal client. 36 South is a New Zealand success story – with a 9-year track record of approximately +15% per annum in the Kohinoor strategy.

Mark Houghton

In 2007 the tax laws changed in New Zealand and that has allowed us to seek out great managers globally, and we have found these particularly in the absolute return area. We feel that it is here where the greatest depth of talent lies. The most important thing to private clients is preservation of capital, because most of them made their money either through a business or selling a farm or other property investment, or they may have received a marriage settlement or an inheritance. Whatever it is, they are generally not in a position to start again. Absolute return managers really help us to meet all of our clients' needs.

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We invest in both New Zealand and offshore-based, absolute return managers. Interestingly, most New Zealand equity managers outperform the New Zealand market, which is very unusual, as most long only equity managers elsewhere generally underperform their market. In the past we used to favor international managers because we were influenced by the very low representation of both the NZ and Australian markets in terms of global equity markets. However, given the emergence of some very good managers in this part of the world and their clear local advantage, I am willing to invest larger sums with local managers, just because I think they have this strong local advantage. All of our local managers are long/short equity. For macro and trading strategies we look globally, and we also of course look for international long/short equity exposure offshore.

Mark Houghton

Our client's portfolios range from growth only to income only, with the bulk being a balanced combination of the two. For income, we focus on the NZ market, particularly bonds and listed property. We also own a couple of local monopolies like Auckland Airport, which pay a reasonable dividend. When we look at the growth side, we are particularly focused on managers who will protect capital while providing outperformance of traditional markets and long only strategies.

I personally believe that the market is one of the most risky places that you can be. Unlike a lot of institutions and academics that believe the market is the zero risk place to be and any departure from that is taking on risk, I think the truth is nearer to the reverse of this assumption.

We look particularly for absolute return managers who provide bond-like volatility with equity-like returns. Absolute return managers are basically the only place we look for growth. Depending on the mandate, absolute return managers can be 100% of a mandate set up for pure growth, while for the average client the proportion would be somewhere around 40-60%.

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Charles Drace

I would like to add that Mark - together with the other members of the New Zealand Absolute Return Association - is an exception in New Zealand with this commitment to absolute return. Most money in New Zealand is invested with the big local fund managers here which all tend to follow the same strategies, what you might call typical Wall Street strategies with little if any commitment to protecting investor's money. Unfortunately, these Wall Street strategies are often not suitable for volatile or falling markets.

The alternatives follow a strategy that can provide negative correlation which is actually very difficult to get these days when property, shares, bonds, and everything else follows the same dynamics. Alternatives have an important role to play to provide that negative correlation and actually give investors access to a number of strategies that in my view are more suitable for the situation that we find ourselves in at the moment.

Mike Gibbs-Harris

On the positive side, I believe the large government funds like the Cullen Fund have adopted the Yale approach with reasonable percentages to alternatives, but I suspect they tend to use the larger offshore managers.

Matthias Knab

What is your situation at the moment as New Zealand based absolute return managers?

Mark Sleeman

I don't think there is any doubt that as a New Zealand based manager it is always challenging raising assets from overseas. However I think it is particularly difficult at present, at least from an emerging CTA perspective.

The combination of tough economic conditions and the hangover from Madoff means the investor pool is small and very risk averse. On the other side of the coin there are a large number of CTAs out there looking to raise money. The investors are in a buyer's market and they are reacting accordingly by being extremely selective. It seems that they are only comfortable allocating to the very largest managers or those that have a unique story. Investors at present seem far more concerned about risk (both performance and operational) than return.

As traders we are used to seeing cycles in the markets, and I believe we are seeing a down cycle in the business of raising money. MS' advantage is that it manages a significant proportion of proprietary assets. This takes some pressure off the asset raising process, as we simply can wait out these periods. It also allows us to concentrate on maintaining a robust investment process, rather than feeling pressure to tinker with our strategy just to suit prevailing investor sentiment.

With central banks being so quick to supply liquidity to the system, I believe one of the big risks for investors is inflation. We already see significant price increases in commodities across the board. The problem with being extremely risk averse in an inflationary environment is that if you are simply preserving your capital, you are actually losing purchasing power. You need to be generating significant returns just to keep standing still.

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Mike Gibbs-Harris

I agree, people are still risk-averse and certainly risk-averse to going all the way down to this part of the world. Some of our clients in Europe have been using third party due diligence firms, and these firms have been concentrating on places closer to London and the U.S. rather than coming all the way down to New Zealand. On the other hand, once people come they usually find what they want, that is, solid managers offering uncorrelated strategies and returns.

As Mark said, in order to outperform inflation some risk taking is required. Last year we were up about 16%. Annualized over the last three years we were actually up 3%. While at first I thought "well, that is not very good", it is actually better than the inflation in US Dollar terms, which is how we are measured.

The very fact that inflation has been so low over the last few years has meant that low nominal returns have managed to produce positive real returns.

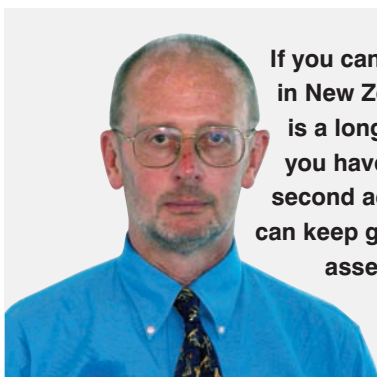
Matthias Knab

You have an SEC registered entity and you have clients in the U.S. and in Europe – that means you travel a lot and while your firm and/or funds are registered and regulated overseas, you don't have an office there. Do you recommend this set up to other managers?

Mike Gibbs-Harris

If you can afford an office offshore it probably is worth it. For me one of the big pluses about being in New Zealand is that it allows you to make very good, very dispassionate decisions. Everything is a long way away and most of the news happens at night, so you can come in the morning and you have a few hours to properly analyze and contemplate how you to react to the events. The second advantage of being in New Zealand is that it is a very inexpensive place to be based. You can keep going and build your track record without even having \$50 million or \$100 million of assets.

The downside is definitely marketing and growing your assets. Oftentimes, nobody believes you can do it from New Zealand, and secondly you are not that easily on anyone's radar screen.



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Mike Gibbs-Harris

David Copley

We are a New Zealand domiciled manager and focus on local markets to exploit the inefficiencies here, but we also have a global partner that provides infrastructure and also helps us to raise global

capital. Having Trafalgar as our offshore partner with offices in London and Hong Kong works well. The due diligence is done on and through them, which makes it very easy for our offshore institutional clients. We use independent fund administrators and other reputable service providers, and in many cases investors have already done due diligence on Trafalgar.

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This set up allows us to enjoy the best of both worlds, and we also found that offshore clients are comfortable with this set up. They do like having the niche of managers in smaller markets, but they also want the comfort of dealing with due diligence process, service providers, administrators, counterparties and risk management disciplines that they used to.

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Matthias Knab

How is this relationship set up? Are the two firms interrelated or is it purely a marketing agreement?

David Copley

It is a joint venture between myself and Trafalgar. The two things we really do is run the portfolio and liaise with investors, including capital raising and marketing, and the Trafalgar operation does basically everything else for us.

As we discussed there are pluses and minuses in operating out of New Zealand – we can exploit the inefficiencies in the capital markets in Australia and New Zealand, we make use of the human capital with high skill sets, and we are slightly out of the noise. This helps keep our heads a little clearer, particularly on the bad days. And as for the negatives, our business set up helps us overcoming some of those hurdles.

Anthony Limbrick

One of the principal reasons that Pure Capital decided to focus on 36 South was the difficulty we have found in running a targeted, non-correlation investment management business out of New Zealand. Our strategy is very “niche” with challenging performance dynamics as a result of client portfolio customization and embedded, structural, non-correlation in most of the portfolio solutions.

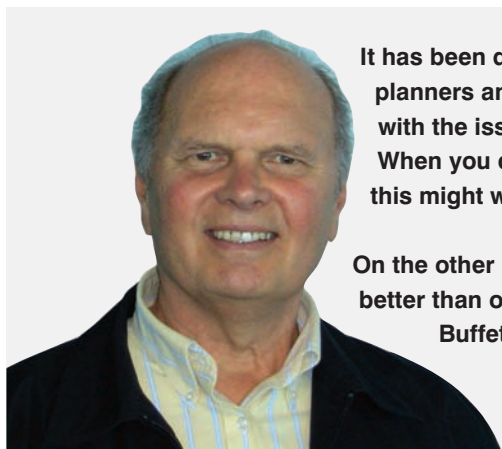
After being up very strongly in 2007 and 2008, we were slightly up in 2009 and down in 2010. With performance numbers such as we have had over the last two years, we need clients who understand the long-term benefits of our targeted non-correlation approach and investors are more difficult to land and to keep when one is based in New Zealand, a small and distant market with a largely unsophisticated investor-base.

36 South, with a performance profile highly-correlated to Pure’s, moved to London in early 2009 and success has been such that the firm now has USD \$250 million in assets under management and continues to see a surge in interest. This is proof of the difference between raising assets in a major financial centre and trying to do so from New Zealand. We are very excited about being fully-focused on a business we know well, which appears to have substantial growth prospects and has a long track record of success.

Charles Drace

It has been difficult to raise assets under management. It seems like investors, financial planners and other advisors had basically gone into hibernation, choosing not to deal with the issues out there but rather to just stick with what they have done in the past. When you come in with an alternative strategy, it is quite difficult to convince them that this might work or even be better for the current situation - they just do not want to know.

On the other hand, a lot of fund managers have done extremely well in New Zealand and better than others. Our February figures show that in the last 12 months we beat Warren Buffett, and we're certainly not the only ones in NZARA who have done so.



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Charles Drace

Kenji Steven

You have really got to look at the geographical situation of New Zealand and the mentality and mindsets of the big institutional allocators. After Madoff, a lot more due diligence is required, but New Zealand is nine to ten hours away at best, possibly twice that for many of the institutions, and that is really why we are largely off the radar screen. It is very, very difficult, I think, to get these parties out here.

But having said that, we have in the past seen senior people from Europe make the long trips to New Zealand and those relationships have worked very well as they recognized the benefits of operating from NZ, in particular the highly skilled workforce with very low levels of staff turnover. However, despite having previously run a big, global fund of funds mainly catering to institutional clients, at our more boutique business today we deliberately choose to not deal with them. Instead of targeting those institutions that have very long and complex decision-making processes, we focus more on the high net-worth/family office end of the market where decision cycles tend to be shorter.

For this sector, it is less necessary to carry out on site due diligence and relationships are more relevant, and while the allocations can be a bit smaller, the money tends to be stickier. We did see a great deal of interest in investing in New Zealand over the last 12 months. Some of the more traditional investment markets like the U.S. and Europe have certainly had their fair share of problems as a result of the financial crisis, and the prudent long-term allocators have really been considering where the gaps in their portfolio are.

They are looking for sources of non-correlated performance and are interested in markets like New Zealand. We are bullish on the opportunities here and find that people are very interested in New Zealand, but there is just a lack of awareness and understanding of what goes on here. Therefore undertaking an education process is very important.

Having run offices in New York, London and Zurich, these places are very expensive. As Mike mentioned, the costs here are not high and therefore running a successful and profitable business does not require the same level of assets. This also allows us to exploit capacity constrained strategies that for other managers may be uneconomic.

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Kenji Steven



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These services include the full range of operational functions that one might incur, including fund design, set-up, compliance, execution and governance, really everything from the very pointy end of the investment management side. I suppose something very similar to what I used to run in my previous firm where you keep the non-client facing functions here in New Zealand and the other matters are done in some of the offshore markets.

Jeremy Muir

At the moment, there is support from the government in New Zealand to establish New Zealand as a funds hub for the Asia-Pacific or, at least, a place where some aspects of the fund administration or domicile process may be located, even if the fund manager is not located here. I think there is great scope for that.

We have a very educated professional class that can certainly provide NAV calculation and other services for funds. There are also other proposals that are going through at the moment to allow the creation of a tax-efficient fund vehicle in New Zealand which can then be used for international investment funds.

The government set up the International Fund Services Development Group last year, which then in turn contracted the international consultancy firm Oliver Wyman to do a report on the options for New Zealand. That report basically concluded that there was currently no clear funds domicile in the Asia-Pacific. Whether you agree with that or not, they were making the obvious point that many "Asian" funds are domiciled in Luxembourg, Dublin, Cayman Islands, or other similar domiciles, outside Asia, and it was considered that there is scope for New Zealand to provide similar services from within the Asia-Pacific.



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Jeremy Muir

As a firm, we have been involved in submissions to the Inland Revenue Department here on these proposals. Fundamentally, for the fund vehicle, what is proposed is an extension of New Zealand’s Portfolio Investment Entity or “PIE” regime. The PIE regime is a tax treatment – a PIE could be a unit trust or a company. The new proposals would allow the creation of two new types of PIE: a “Foreign Investor Zero Rate PIE” or a “Foreign Investor Variable Rate PIE”.

In the first case, a Foreign Investor Zero Rate PIE would have both New Zealand and non-resident investors but the fund would invest only outside of New Zealand and therefore only derive foreign-sourced income – a very standard international offshore fund model. In the second case, a Foreign Investor Variable Rate PIE would also allow you to mix New Zealand investors with international investors but could derive both foreign-sourced and New Zealand-sourced income. In either case, foreign investors would not be taxed in New Zealand on foreign-sourced income.

Matthias Knab

You talked about a PIE already out here, what has been the progress in the last year?

Jeremy Muir

There has been definite progress and we are told that the proposals will be included in a tax bill later this year and expect there will be an announcement in the next Government Budget, which will be announced on 19 May. What we are hearing from Inland Revenue is that the Foreign Investor Variable Rate PIE, which allows New Zealanders and foreign investors to derive foreign-sourced and New Zealand-sourced income will be in effect from April 1, 2012. The Foreign Investor Zero Rate PIE, the model without New Zealand sourced income, may be able to be used from the date the new Tax Bill receives Royal Assent, which may be before the election this year, which is November 26th, so not too far away. This is all still to be confirmed but we have seen draft proposals from Inland Revenue, so it is a real idea that is coming to fruition.

Matthias Knab

Do you think that can compete versus Dublin UCITS, Cayman, BVI?

Jeremy Muir

Well, this is only part of the story. For a start, these reforms are not about creating something like UCITS, in the sense that it does not represent a fund vehicle which can automatically be marketed in other jurisdictions. There is more work to be done in that direction, around the creation of fund “passports” in the Asian-Pacific.

On the other hand, New Zealand funds already have the benefit of Trans-Tasman Mutual Recognition. You can create a New Zealand fund with New Zealand-law offer documents, and extend the same offer of securities into Australia with very minimal extra regulation and no new documentation. I think the proposed changes to the PIE rules are a part of the story only and will complement other vehicles available already in New Zealand, such as our limited partnerships, which we have talked about in previous roundtables.

A number of people are perhaps skeptical as to whether we are suddenly going to compete at the same

level as some of the more established offshore centers, but we have heard a lot of interest, particularly around use of the New Zealand Foreign Investor Zero Rate PIE as an investment vehicle for Australian investors. We know that some major financial institutions have indicated that they are seriously considering this.

Mike Gibbs-Harris

Over the last 12 months there was a fundamental change in the way New Zealand fund managers are regulated. Before, if you sold funds in New Zealand you had to register the prospectus, but fund managers did not have to be registered. Whereas now, operating in New Zealand requires registration.

This means that hopefully at some point New Zealand based managers will enjoy reciprocity with the rest of the world. For example, Australia and Hong Kong have reciprocity, but New Zealand and Hong Kong do not have reciprocity - it is just going to take some time. The fund that we manage is actually registered in Dublin, and the reason for that is it is then subject to an EU regulator. By means of this regulation we can access a broad range of investors, and lastly certain institutional investors in Europe can only invest in funds that are subject to an EU regulator.

Kenji Steven

Apart from the new vehicles the government is working on, the New Zealand Limited Partnership structure is already in place and can be used for non-New Zealand investors investing outside of New Zealand as a pass-through entity.

Apart from the new vehicles the government is working on, the New Zealand Limited Partnership structure is already in place and can be used for non-New Zealand investors investing outside of New Zealand as a pass-through entity. There is no tax drag here in NZ and it is indeed a very cost effective structure. You have all the beneficial tax treatment of an LP, but without the prohibitive establishment and ongoing costs that you incur when you want to register a structure in a place like Cayman. Here, you pay about \$250 to register an LP and above and beyond that it is just the cost of your legal documentation. I have worked with all kinds of jurisdictions and certainly from an international point of view, the caliber of work that we get done here in New Zealand is very high and the fees the lawyers charge are very reasonable. As a business we have found this gives us a great degree of flexibility to tailor structures and solutions that may otherwise perhaps be an uneconomical mandate.

For example, if you want to launch a structure quickly with a relatively small capacity, using the LP structure allows a very cost efficient launch. On the other hand, with a Cayman fund you do not get any change out of \$50,000. Here you can set-up an LP for probably 10% of that.

I don't know if the government is on the right track in the long run when trying to establish New Zealand domiciled funds, but clearly if you look at the expertise we have here, as a back/middle office center the country does become very interesting. I remember a conversation with the Head of Securitization of one of the major European banks several years ago when structured credit was still a fun thing to be doing. As we were running a global player, structured credit business from Christchurch, he said to me "why are you guys down here, you are in the middle of nowhere? It just does not make any sense at all."

As the days went by in New Zealand, he gradually started to see the light and said "you know what, it is absolutely brilliant what you guys are doing down here!" Because he learned that we had staff turnover of approximately 5% per annum of mainly junior staff, and his figures on an annual basis were almost ten times that. Our running costs were a fraction of what his were and the capability of the team here was world class.

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The economic cost drag and the time delays in projects that you suffer from with high staff turnover can be significant. Whereas here in New Zealand we have a highly skilled, educated workforce, trained in New York, Hong Kong and London who come back for lifestyle reasons and are very glad to be doing work that they have done offshore, so they tend not to change jobs.

Jeremy Muir

Kenji mentioned the New Zealand Limited Partnership structure, which is indeed a very useful vehicle and possibly not as frequently used as it could be. I was involved with a lot of the original discussions through the New Zealand Private Equity and Venture Capital Association and other bodies - it was designed quite carefully and came into effect quite recently in 2008. The legislator looked at the Delaware, Guernsey, and Cayman models for limited partnerships and really tried to distill a solution that was straightforward and had nothing that would be regarded as unusual or off-putting for an international investor. It is a very easy to understand and easy to administer vehicle, and offers the flow through tax treatment that is going to be of interest to international investors.

Matthias Knab

Branton, you were raised in the U.K. where you were a successful business consultant before moving to New Zealand. Why did you come here? I also understand you have been researching your unique investment approach for about ten years now, please also tell us more about what you are doing.

Branton Kenton-Dau

I have always admired the Kiwis' ability to think for themselves, that was really one of the main reasons I came to New Zealand initially, I came from the U.K. where as soon as someone opened their mouth, I could tell what their opinions were on pretty much anything, it is all based on how they were educated.

I, and my team, have been studying human intention in the financial markets for ten years. I was a management consultant before, and back in 2002 we discovered that mathematics or complex systems governs the way companies perform, to the extent that we could determine which companies would be successful or not. We published research papers on that.

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Based on those initial discoveries, we have now been able to discern specific patterns that operate within the markets. Drawing from a lot of different disciplines, we have actually come to understand financial systems as intentional systems. People buy and sell with the intention of profit, whether that is speculative or commercial, those movements are controlled by laws, to be more precise, those laws are actually electrical laws. We actually believe that the mathematics that governs electrical plasma (ionized matter with electrical properties) also governs the way the financial markets perform.

The primary research has been conducted by myself and by our mathematical genius Martin Burley who has been our Head of Research now for seven years. We started out by quantitatively validating research out of Stanford University called "Built to Last," which is a book that claimed that companies with very strong cultures perform better than the companies with weak cultures.



We built a qualitative model that analyzed the annual reports and the websites of the entire S&P 500, the ASX 200, FTSE 100, and NASDAQ. So over three years, we looked at a thousand companies altogether. It was very laborious, but in the end we validated that thesis: companies with strong cultures perform better. Why is that?

The interesting part of this is that it actually confirms the mathematics of complex systems. There is a mathematical basis to human systems – listed companies organize themselves in the same way that a hurricane organizes itself. If you pull out the plug of your bath, it forms that spiral. It is the same mathematics.

Back then we discovered we could predict the patterns how individual companies perform. We even predicted the collapse of AIG. We then asked if we could see similar patterns in whole markets, as these are also systems from our perspective. Dealing with a whole market was more difficult; it has taken us a long time. I mean - ten years is ten years.

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Finally we have been very heartened by the ability to apply that model to the markets which has put us on a very exciting journey. In 2007 we developed a trading strategy called PaceMaker based upon our findings. We paper-traded it over the last three years with very good returns. Interestingly, in times of very high volatility you can see those patterns more clearly. This supports our belief that the markets are electrical in nature.

We started live trading in December 2010. As we have done our original research mostly on the S&P 500, we have started to trade SPY and are currently trading a private managed account. I am very grateful to be able the newest member of NZARA here today.

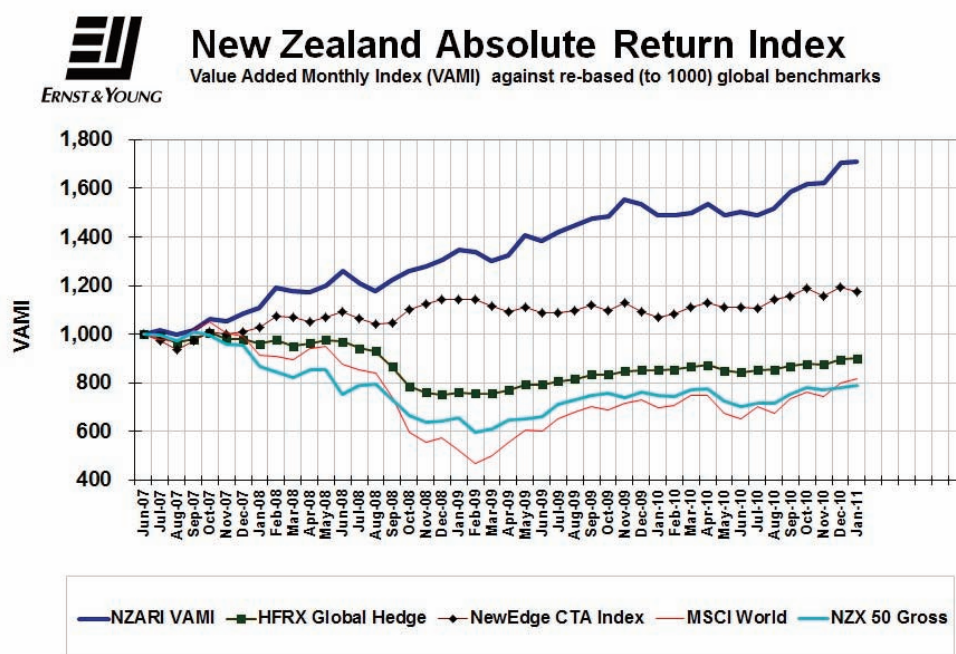
Matthias Knab

George, with your company TGN you work closely with NZARA, the New Zealand Absolute Return Association. What is new there?

George Bayley

In 2007 I set up TGN out of my own investment company as a fund origination and distribution company. Our focus is purely on the New Zealand marketplace, helping alternative strategies run by New Zealand managers to be accepted by New Zealand investors. Although, in the future, we are keen to work with overseas partners in the origination and distribution of NZ unique brand of alternatives managers.

Our mission thus far has been to educate the marketplace here. Together with our other colleagues within NZARA we have found that the market did not understand or appreciate alternatives – it is still mostly about relative returns.



TGN markets to the major investment pools in New Zealand, including the pension funds, private banks, and high net worth investors. After three years of doing this, we finally feel we are getting some good traction.

Some of the managers may not be based here anymore, because they have moved offshore to Switzerland or might be based over in Australia, have offices in Switzerland and London, et cetera. But I still believe we can raise really quite decent tranches of assets in the New Zealand marketplace.

We believe New Zealand absolute return managers can offer both domestic as well as international investors attractive options. Proof of this can be seen from the NZARA Absolute Return Index set up in July 2007 in conjunction with Ernst and Young, with a return of over 16.5% per annum since inception after fees.

In our business, the number one thing you need in order to market a fund is credibility. The second thing you need is performance. If you are missing either of those two, then you might as well stay home. The Ernst & Young index proves that the absolute return industry in New Zealand is delivering both on credibility and good solid performance, and we look forward to growing this sector of the investment universe here in NZ over the coming years.

Over the next 12 months, TGN, in conjunction with NZARA, will be seeking to launch a NZ-based Unit Trust to allow local investors to access these exceptionally talented managers. We would also be interested to discuss with overseas distributors and fund originators ways in which they might like to access this group of 'away from the herd' alternatives managers.

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Charles Drace

Talking about overseas trade and relations, New Zealand has in fact, a free trade agreement with China.

Matthias Knab

Is New Zealand the only OECD country with a free trade agreement with China?

Kenji Steven

I think we are the first. There is quite a good rapport between the two countries. New Zealand economically and from a population point of view does not really register for the Chinese, but from a goodwill and strong relationship point of view the countries maintain a very good relationship. New Zealand has been quite supportive of Chinese aspirations and the governmental and non-governmental organizations around the world.

George Bayley

The other aspect about which some people I am involved with got very excited about was the time zone. It is completely opposite to Europe, which means you can do the back office here overnight. This is pretty much a no-brainer, and in fact such a set up does not work so well out of the States...

Matthias Knab

What else can you share with us?

David Copley

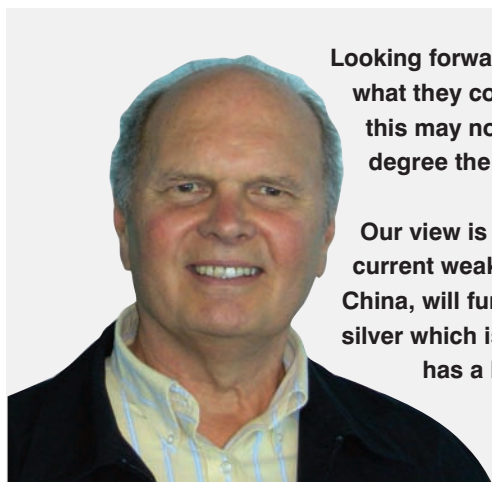
We only focus on the New Zealand and Australian markets, and as far as an outlook is concerned we probably see a few headwinds coming their way. One is that European credit issues are not great for the cost of landed credit in this part of the world. Both countries have relatively high interest rates which means cash here is an attractive alternative to equities, which is a much different situation than in the U.S. where obviously the low interest rates drive money into stocks. We do not have that dynamic.

Then the third thing is everyone will have their own China view, and ours is a rather restrained view that does not make us that constructive about China. We also share some concerns on the Australian house price situation and believe that these will be some headwind for the Australian consumer. So net-net we see Australasian equities underperforming global markets.

Charles Drace

We base our strategy on what is called "Long Wave Theory" - markets have 16 to 18-year up cycles and 16 to 18-year down cycles, and the commodity market is inversely related to traditional share markets. As a result, we are invested in commodities, and the commodity market treated us well last year. We feel comfortable being in that market, and we got into it early. With this fund we got into commodities in 2006 and before that, in 2002, I had another structure in place, and I believe we were one of the earliest managers in New Zealand going into commodities at that time.

There is probably another eight or ten years in this commodity market, so we'll concentrate on that. According to the Long Wave Theory, eventually that will change and the markets will reverse, which means at that point we will be concentrating on share markets again.



Looking forward, one of the biggest problem we see is volatility that is driving investors into what they consider to be safe investments. At the moment - I say at the moment because this may not be true tomorrow - it is U.S. bonds, U.S. share markets, and to a lesser degree the U.S. Dollar.

Our view is that this volatility, that is already in the market, together with the inherent current weaknesses of particularly the major economies of America, Europe, Japan and China, will further perpetuate flows into commodities for safety, particularly into gold and silver which is our specialty. We run the only gold fund in New Zealand and think that fund has a huge possibility going forward.

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Mark Sleeman

In terms of the markets we are seeing two main themes: a major bull market in commodities, and huge volatility spikes. The bull market in commodities is significant, with most markets heading up and

many at multi-year highs. The volatility spikes are something else again, usually with extremely sharp reversals occurring across many markets simultaneously. I think the two are linked, with the volatility feeding off the large bull moves. I suspect that the bull moves themselves are feeding off the liquidity that central banks have been pumping into the system. History and common sense indicates that the risk of supplying so much liquidity is inflation, and this looks to be what is happening.

Being long term, MS' strategies generally perform well during periods of extended market moves, whether they are up or down. However, if we are in an inflationary bull market it is likely we will see more of the extreme volatility periods that we are getting used to. MS' job, as a manager, is to stick to our robust investment strategy during these periods, while paying extra attention to our market and execution risk. It is our experience that if we follow this, the returns take care of themselves.

Anthony Limbrick

It is our view that financial markets now have to live with an ongoing feedback process - where any financial stress will be met with quicker, knee-jerk monetary stimulus...the QE phenomenon. We believe there is no free lunch and as a result of the moral hazard being built into the system, the Western economy will become more fragile, more inefficient...and will struggle to keep up with what will be a surge in the value of real assets against fiat currency. As a result we believe that any asset with a price linked to real assets and life's necessities such as food will continue to see higher highs - even if we end up with minor deflationary interludes.

At 36 South we have a specific inflation-targeting product, the Cullinan strategy. Our Kohinoor strategy is also set up for this as well, principally through a substantial exposure to long currency volatility.

We often get asked about our long-term view on volatility, as we are a volatility manager. With volatility now just under long-run averages, we believe this down-cycle in volatility is probably not finished and may well have more to run - to the point where volatility and tail-risk becomes an unpopular strategy again. At that point we will likely end up with a re-run of the 2007-2009 debacle. There may be multi-month volatility surges within that secular down-trend though. We will have to navigate our way through this. We have a proven track record in doing so.

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Mark Houghton

One of the things you have to accept if you are going to invest with absolute return managers is that you will be uncorrelated to the markets, and that can be good and it can be bad. This means there are periods where you can end up with significant underperformance of benchmarks. This does not really cause us to change our strategy, but it can be difficult for clients who often compare their returns to what they could get in the bank. Unfortunately, many "forget" that unlike many other investors we largely preserved capital in 2008 and had a reasonable 2009, but this year we are probably going to be around flat to 5%.

At the moment I am looking at new managers that will meet my return expectation profile. For example, in long/short equities I want a manager to capture a fair bit of upside markets, to considerably outperform in flat markets and to protect capital in a down market.



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Mark Houghton

Jeremy Muir

Let me make a final comment from a legal perspective. Over the last 12 months we had been very busy as New Zealand is in a time of real change in terms of its financial services regulation. We have adopted new laws in relation to how we regulate financial advisors, which not only affects our domestic market, but also anyone internationally who deals with New Zealand clients, although the obligations can be very limited if you are an offshore provider who deals only with wholesale clients.

We have also adopted a law that requires all financial service providers with a place of business here (or carrying on certain other regulated businesses) to be registered on a new electronic register of financial service providers. If anyone internationally is looking at doing due diligence on New Zealand fund managers or institutions, the new register will be a useful source of basic information.

There are also further major changes in the pipeline for our securities laws, which will affect international funds who want to raise money in New Zealand, and how New Zealand funds raise money as well.

It has been a very busy period and it shows no sign of abating. From the perspective of the alternative funds markets, it will also help to credentialize some of the New Zealand fund managers when they are perhaps looking to raise money overseas. We are moving towards a more regulated environment.

Charles Drace

I do not want to be sounding like a predictor or anything like that, but let me also dwell a bit on the recent earthquakes we have witnessed in Christchurch in February and the Chinese and Japanese earthquakes in March and the continued earthquakes in the midwest of the United States.

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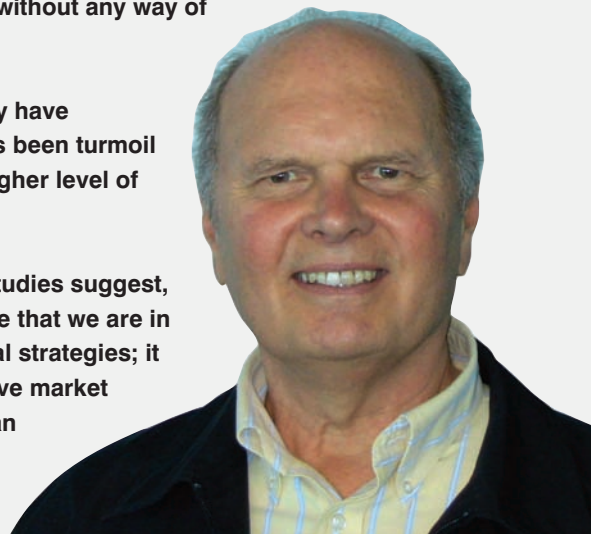
I remember having read a book some years ago called “Ubiquity” by Mark Buchanan. He studied the mathematical repetitions and cycles of not only share markets, but also earthquakes, economic cycles, social cycles, etc, including sand slides.

Drawing a parallel with the markets and with what Branton was saying about the mathematical nature of markets, it prompts me to give some thought to these environmental cycles too, without any way of actually coming up with any conclusions.

Is it a coincidence that the six biggest earthquakes recorded in history have happened in the last five or six years, while at the same time there has been turmoil in virtually all markets during the same period of time? And a much higher level of volatility than we have seen in a long time.

Whether there is a direct relationship as Ubiquity or socioeconomic studies suggest, whether one is reacting to the other or not, I think it is vital to be aware that we are in an extremely volatile period now. And volatility does not suit traditional strategies; it suits alternative strategies. Most of the people that are in the alternative market in New Zealand are probably better able to cope with that volatility than Wall Street or London type managers.

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Matthias Knab

Why do you think New Zealand based managers will cope better than Wall Street or London?

Charles Drace

We are more eclectic; we are more open-minded. We have mentioned before that we have the ability to have a more dispassionate view, because we are not in the middle of the noise and we are in a slightly different time frame. Though quite a number of our fund managers have a lot of experience overseas, I suspect that their views have been more free since they have been back in New Zealand and less influenced by the fund management industry overseas.

For me personally, if I read something that comes out of Wall Street, I automatically assume the opposite is the truth. I think you would not keep your job very long in Wall Street if you took this approach all the time. So I do believe we can cope better, and I think investors, both institutional and private, will have to reflect very seriously about investing in traditional ways in a period of high and potentially worse volatility, both environmental and market related.

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