



# Opalesque Round Table Series '11

# AUSTRALIA

Opalesque 2011 Roundtable Series Sponsor:



# Editor's Note

The Australian hedge fund community is a sophisticated marketplace with tremendous talent. Many of these managers are ex-pats who have worked overseas in New York, London or Asia and have come back home for lifestyle or family reasons. At the moment, around 90 Australian hedge fund managers offer over 240 funds, and 2010 was a good year for them, returning on average 10% against a flat ASX200. Because they are overlooked, sometimes even by the local investors, there are some good opportunities. These funds would certainly be able to raise substantial amounts of assets in the U.S. or Europe with the same quality individuals.

Recently, both international investors and local Australian investors like the large “super funds” have begun to allocate more to Australian hedge funds. This is seen as a major shift and stamp of approval for Aussie managers, given that historically most of the allocations from the larger supers have gone offshore. In addition, Australian high net worth individuals and family offices are starting as well to include more domestic hedge funds in their asset mix.

By now, Australian hedge funds deploy a large range of strategies. Out of the seven hedge funds set up in 2010, only one of them was Australian equity long/short and the others were all either merger arb, global macro or had an Asia-Pacific focus.

## Some Australian Superannuation funds shift assets from “mega” hedge funds

The Australian superannuation sector is the fourth largest and fastest growing global pool of pension assets. Employers have to contribute 9% of all wages, salaries, or earned income by law into a registered superannuation fund. Some of the super funds have up to 10% of their assets in hedge funds, and have started to use them to run more of their equity bucket in the hedged format, which could be a trend with large implications going forward.

Some superannuation funds have started shifting assets from large “mega” hedge funds into smaller and emerging managers. And not all of them request a five year track record. For example, the Sunsuper funds was a **third month investor in a New York based credit fund and even seeded another credit fund**. As a consequence, superfunds report a heavy **traffic from offshore hedge funds coming to Australia for marketing over the last 18 months**. This Roundtable offers invaluable insights what the “supers” are looking for.

One-third (by value) of all superannuation money is now self managed and held in what is called a **Self Managed SuperFund** or SMSF. The high net-worth and educated investors want to manage their retirement funds themselves, this pool of money that constitutes an unique opportunity for money raising for Australian hedge funds. With the right set up and distribution, hedge funds can also market to Australian **retail** through financial planners, which can be “at least as good (educated) as the best people from offshore fund of funds”.

The 2011 Opalesque Australia Roundtable was sponsored by Australian Fund Monitors and took place March 2011 in their Sydney office with:

**Bruce Tomlinson, Portfolio Manager, Sunsuper Superannuation Fund**

**Chris Gosselin, Founder, Australian Fund Monitors**

**John Corr, Chief Investment Officer, Aurora Funds Management & Founder, Fortitude Capital**

**Dereke Seeto, Managing Director, Credit Suisse**

**Phil Carden, Portfolio Manager, Supervised High Yield Fund**

The Roundtable discussion also highlights:

- **How to crack the Australian institutional market**
- **Asset allocation, manager selection process of a leading superannuation fund and what hedge fund strategy the institution is interested in**
- **How important is “marketing” for a hedge fund? What is the “right” kind of marketing? Investors warn what types of marketing is a red flag for them.**
- **How Australian hedge fund managers overcome the “tyranny of distance”**
- **Why investors in the Supervised High Yield Fund count amongst the most financially literate in all of Australia**
- **“My bills cannot wait for the market to rally”: why alternatives and hedge funds should be in every portfolio**
- **Regulatory Update**

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

Matthias Knab  
Director Opalesque Ltd.  
Knab@opalesque.com

Cover Photo: Ayers Rock, Northern Territory, central Australia.



# Participant Profiles



(LEFT TO RIGHT)

Matthias Knab, Bruce Tomlinson, Dereke Seeto, Philip Carden, John Corr, Chris Gosselin

## Opalesque Australia Roundtable Sponsor



# Introduction

## **Chris Gosselin**

Australian Fund Monitors (AFM)

Chris Gosselin from Australian Fund Monitors (AFM). We provide information, research and consultancy services on the Australian absolute return and hedge fund sector. We monitor over 240 funds that are either managed from or available in Australia. This accounts for 90-95% of the total absolute return funds operating here, managed by over 90 managers, ranging from the largest with close to \$20 billion in funds under management to small emerging or start-up funds with less than \$10 million.

## **Dereke Seeto**

Credit Suisse

I am Dereke Seeto from Credit Suisse. I run the Prime Services team in Australia. Credit Suisse is one of the world's leading financial services providers. As an integrated bank, Credit Suisse offers clients its combined expertise in the areas of Private Banking, Investment Banking and Asset Management. Credit Suisse provides advisory services, comprehensive solutions and innovative products to companies, institutional clients and high-net-worth private clients globally, as well as to retail clients in Switzerland. Credit Suisse operates in over 50 countries worldwide.

In Australia, Credit Suisse has been active for almost 40 years and provides a broad range of services across all of its business Divisions. Within the equities business, Prime Services has been in Australia servicing both offshore and onshore clients since 1997. Prime Services globally is built around helping facilitate three key priorities of investment managers: generating alpha, accessing financing, and building capital.

Credit Suisse Prime Services is an integrated business across asset classes. Prime Services offers a core prime brokerage relationship, securities lending, delta one products such as index swaps, Exchange Traded Funds alongside structured products and a listed derivative brokering execution and clearing service. Prime Services offers stable access to asset-based lending balance sheet and a state of the art swaps platform on long and short assets. Our prime solutions business offers innovative structuring and financing of illiquid and esoteric assets whilst our dedicated team of risk managers provides customized approaches to margining and best practices to our partners. Prime Services also provides a dedicated capital services team to assist our partners build a optimal investment base over their lifecycle whilst our Prime consulting team assists clients through all stages of their lifecycle offering front to end business and technology solutions and advice.

We're pleased to note that Credit Suisse Prime Services was voted the number one prime broker globally, and number one in Australia by our global client base in the 2010 Global Custodian Survey.

## **Philip Carden**

Supervised Investments Australia  
Limited

I am Phil Carden from Supervised Investments Australia Limited. We are a fund manager formed late in 2007. We manage two funds, a global equities fund and a debt securities fund. I am manager of the debt securities fund. It has currently \$12 million under management and our equities fund has \$18 million under management.

The debt securities fund is targeted to be a low volatility, high-yield fund and our management philosophy there is to only invest in assets that will essentially guarantee our principle and interest payments whilst trying to select those with the highest yield.

We have done that now quite successfully for over two years. In 2010, our fund returned 15.90% after all fees. The Supervised High Yield Fund has been trading for over two years, and the equities fund for over three years. The equities fund has returned 15.10% in 2009/10 financial year versus the MSCI Global Index hedged in AUD at 7.99%.

Our view is that after the extreme volatility in equity markets over the past four years, some investors

will be attracted to investments that display characteristics of low volatility and consistent returns above the bank deposit rate. We have identified that this style of investment is available through the asset backed debt securities market rather than from equities. We also think the demand for low volatility high yield investment will grow over the years ahead.

**Bruce Tomlinson**  
Sunsuper

My name is Bruce Tomlinson. I am a portfolio manager at Sunsuper, an Australian pension fund. It is a pleasure to be back on this Roundtable, I participated at the last one about a year ago. Our fund has grown substantially in the past year and we are approaching \$18 billion. I continue to look after the hedge fund portfolio and have also recently been given the responsibility for our long-only Australian equity portfolio.

The hedge fund portfolio is about \$1.1 billion and the Aussie equities portfolio is about \$4.5 billion, so there is a fair amount of capital there. It is all outsourced to specialist fund managers. In addition to the internal investment team of 12, we use Aksia for hedge fund due diligence and for Aussie equities we use Mercer Investment Consulting. We have full control and discretion over the manager selection and the strategy allocation within those portfolios.

Last year our hedge fund portfolio returned 12% in A\$ (net of fees), which was our best absolute year since we started to invest in hedge funds in mid 2007. Arguably though our best relative result was only losing 5% in 2008 (-1% A\$). We are very pleased with last year's result, but continue to strive to compound steady absolute returns over the long term.

Our portfolio is targeting market neutral type of returns. We really do not want equity market risk, we don't want to pay hedge fund fees for that. As a pension fund we already have large amounts in long-only equity, so we avoid having more of the same risk in our hedge fund portfolios. Our structure is to have a core position of circa 40-50% in macro strategies (both discretionary and systematic) with a generally low correlation to equities, and around that we are more opportunistic with the rest of our portfolio.

We have a lot of money in credit at the moment, around 30%, while we are actually under 10% in equity long/short, which may be somewhat unusual, certainly if you compare it to a typical fund to funds. I will go into some of the reasons for this allocation later. We actually would like some more equity long short exposure. We round out the portfolio with some event-driven multi-strategy type funds.

Summing up, we expect our hedge fund portfolio to continue doing well and give us great diversification and solid absolute returns.

**John Corr**  
Aurora Funds Management

I am John Corr from Aurora Funds Management. Aurora is a domestic asset manager that we created during the middle of last calendar year through the merger of three different groups: Fortitude Capital - which I have led for seven years; Aurora Funds - a distributing group, and Sandringham Capital - also an asset manager. I am the Chief Investment Officer of the group. In total, we manage about \$550 million.

Our absolute return fund strategy is now the Aurora Fortitude Absolute Return Fund, a market neutral Australian equity fund with about \$60 million. Our multi-strategy approach with a long gamma overlay has produced very consistent returns, our long-term average of the public fund is just short of 10% annualized with standard deviation of just over 3%. Over the 72-odd months we had been running the strategy we had just about half a dozen down months. So we really offer that much sought low volatility, we love to think that we are true to that label.

Our fund has a market neutral bias, and in addition we protect the portfolio from sharp market movements by a 'long gamma' overlay. The use of equity derivatives enables us to hedge market and stock specific risk through volatility strategies, which therefore we view as an alpha producer. Obviously, this overlay has been a cost to the fund during the last few years, but in 2008, when we needed it protect us very well, as it will when it is needed again.



# AUSTRALIAN FUND MONITORS

## Targeting Absolute Returns

### Australia – a land of opportunities:

Australia has long been known as a land of opportunity, particularly when it comes to its abundance of natural resources.

Australia's A\$4.2 trillion Financial Services sector, which is underwritten by one of the largest compulsory superannuation (pension) schemes in the world, sound corporate governance, and efficient financial markets, also provides abundant opportunities.

Total pooled investment fund assets under management in Australia exceed US\$1 trillion, the largest in Asia, and the fourth largest globally.

There are over 200 Hedge Funds in Australia, providing investors with both returns and opportunities through the market's ups and downs:

- Almost 25% achieved a positive return in 2008, and
- Over 90% outperformed the ASX200 during the GFC.
- From January 2003 to December 2009, AFM's index of hedge funds (excluding Fund of Funds) provided an annualized return of over 19%.

Opportunities worth sharing in....

[www.fundmonitors.com](http://www.fundmonitors.com)

### Your "eyes and ears" in Australia.

Australian Fund Monitors provides data, research, analysis, due diligence and consultancy on the absolute return and hedge fund industry in Australia. With over 200 funds either managed from or domiciled in Australia, we have the most extensive database available, covering strategy, performance and risk analysis.

However, data alone is only part of the story.

Like anywhere in the world, local knowledge is invaluable to success. And with Australia either in a different time zone, or a long-haul flight away, reliable local knowledge of the industry – whether of Managers, Investors, distribution trends or regulations - is not always easy to find.

Whether you're familiar with Australia, already on the ground here, or a newcomer looking for opportunities, Australian Fund Monitors are ready to help.

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**Chris Gosselin**

2010 was a good year for hedge funds in Australia: On average hedge funds returned 10% for the year against a flat ASX200. Across the market various sectors performed particularly well, carried by some outstanding performances by some funds, particularly those exposed to the material and resources sectors which were strong on the back of Asian and specifically Chinese demand. Many of the concentrated (often boutique) funds were able to benefit from the small resources sector which rallied particularly strongly.



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**Chris Gosselin**

After the drop in new fund launches in 2008/09, we saw a number of them during 2010. Although some funds did start out in 2008 and 2009, it was certainly a difficult time, not only from the market perspective, but also because generating investor interest was extremely difficult, especially after issues like Madoff.

Investors are starting to return to the sector. There is a better perception around hedge funds, including finally some positive comments in the media.

**Chris Gosselin**

Both international investors and local Australian investors are coming back to allocate to Australian hedge funds. Australia has a hurdle to jump with international investors known locally as the “tyranny of distance”. It is a ten hour flight from Hong Kong, eight hours from Singapore. I recently met an investor who was visiting from Toronto, and he was saying that 24 hours travel is a big barrier, although Australian travelers tend to think of it as just an overnight flight.

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## Dereke Seeto

During 2010 we saw the start of a sentiment shift from the Australian domestic investors towards hedge funds; they are now taking the Australian managers a lot more seriously than in the past.

From the offshore perspective, the Asia-Pacific angle, we would say that investment flows to Asian Hedge funds as a whole are lower compared to what they should be given Asia's weight in the MSCI Global Index. Eurekahedge estimates that 9% of global hedge fund assets are in the Asia Pacific region versus the MSCI free float of more than 23%. However we definitely begin to see a change in that bias towards trying to catch-up or add to those investments. Presently, we are finding that hedge funds are migrating to the APAC region in a measured manner (which is a very different approach to 2005). The firms are much more thought-out in their attempts at building a presence, selective about the people they employ and cognisant of "preserving the culture" of their parent firm when expanding in the region.

In Australia for onshore funds we estimate seven hedge funds started up in 2010. This is below the peak numbers we had around 2005 and 2006, where you had double digit figures in domestic hedge fund launches.



**A new trend is that a lot more of the larger institutions are considering rolling out some of their own business lines or units as alternative investment products, as opposed to investing direct into third party external funds or into funds of funds. Investors seem to have a preference for direct investments and are bypassing the funds of funds. We see the same dynamics being considered within the superfunds, slowly building out teams from their investment committees with the aim of investing direct.**

**Another change here is that the superfunds are now also allocating to local hedge funds, which is a major shift given that historically most of the allocations from the larger supers have gone offshore.**

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Another change here is that the superfunds are now also allocating to local hedge funds, which is a major shift given that historically most of the allocations from the larger supers have gone offshore.

We still have to deal with the situation that the average Australian hedge fund is relatively small, particularly compared to those being run out of places like the U.S. or some parts in Europe. Given the costs now associated with assessing an overall fund, overseas investors tend to not come to Australia if the fund's size is restrictive or does not correspond to their institutional requirements.

## Matthias Knab

**Where do you see now the critical mass in assets to be considered institutional?**

## Dereke Seeto

Bruce is probably the best bet to indicate where he considers is the starting level in terms of assets, but from our perspective as a service provider we would put it at around \$100 million to fully engage from a capital services perspective, which includes certain marketing activities and real support to institutionalize the overall business. For us, you need a critical mass of \$100 million.



Such a size actually allows us to get a seat at the meeting table with a lot of institutions. On the other end of the spectrum, at least at this time we do not see that much capital investments into start-up or smaller Australian funds.

**Chris Gosselin**

Regarding the threshold for an “institutional” hedge fund, it is certainly increasing. Five or six years ago the critical mass used to be \$50 million, it then became \$100 million and for the big offshore investors the number is now well beyond that. Large investors want to write a minimum ticket size of say \$50 million, and at the same time many don’t want to be more than 10% of a manager’s funds under management; Immediately they are limited to managers or funds with at least \$500m.

**Bruce Tomlinson**

Absolutely.

**Chris Gosselin**

The critical mass may be closer to \$500m for the larger institution. Smaller managers really have to be aware of the dynamics, so there is probably no point marketing to big investors because they probably won’t allocate until the manager is much larger. The manager may get on investors’ radar, but until they have the critical mass and the processes and systems that are now being required by the institutions and the consultants, it will be very difficult to get much traction. Managers need to understand that they have to pitch their product to those investors who actually have the potential and ability to invest in them.

**Dereke Seeto**

I agree the smaller Australian funds have to start to pitch their products at a different level of investor. The good news is that a lot of Australian high net worth individuals and family offices are starting to allocate to domestic hedge funds. From an investment perspective this has probably been the biggest change in 2010.

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A lot of the resources that were being put to work in fund of funds are now working at some of the family offices. We are definitely starting to see more and more of these family offices wanting to allocate specifically to domestic funds, and I think that is something as a trend that will continue.

Particularly those family offices that are now moving to second and third generation wealth - they are looking to diversify their own underlying asset bases and invest direct into hedge funds. Allocating to the Australian domestic funds allows them to get a seat at the asset manager’s table and then hear and actually see what they are doing.

**Bruce Tomlinson**

From an allocator’s view, single country equity long/short is not for everybody, so there are some obvious reasons why there is not a truckload of offshore money invested in Aussie equity long/short. Large investors may either have a standalone hedge fund portfolio or might add long/short to the broader long-only equity portfolio. Where you make the allocation from is different for each superfund.

We have got a foot in both camps, so for about four years we have run our dedicated hedge fund portfolio. With myself taking on the Aussie equity portfolio as well, we have actually moved two Aussie equity long/short managers into the Aussie equity portfolio. The idea is to build a non-benchmark driven satellite portfolio, and I know that a few other investors around town are starting to do the same and include long/short in their large long-only equity portfolio.

When it comes to a fund’s size, we won’t bother with a fund if they cannot accommodate an initial investment of \$25-\$50m that we can grow to \$75-100m. We may build our position to be 20% or 25% of a manager’s capital in some cases, however if we can only put say \$10m or \$15m into a fund,

it is not worth our time. We do invest early, but a fund's size has to reach \$250m-\$500m eventually from our perspective.

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**Bruce Tomlinson**

#### **John Corr**

**Coming back to the discussion about investors, we are seeing unprompted offshore enquiries for the first time in two or three years. All these inquiries are coming from direct investors, not from fund of funds. Mostly pension funds see the low volatility and consistency of our returns and want to know more about it. Those funds are mostly from the U.S. whereas before our institutional investors were mostly coming from Asia. Some of these pension funds ask us for advice on who else they can see here in Australia, because they do not want to make the trip for just one fund.**

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**I mentioned before that we merged three firms into one, which means that we are also able to target the local markets. We have actually had our first retail inflows as our fund is now also available on some bank and broker platforms, and we also see interest from there.**

**It has been a new experience for me to talk to research houses that focus on the retail end and to financial planners, and I was pleased to find that a large percentage of them are quite well educated. In fact, the best of the financial planners are at least as good as the best people from offshore fund of funds that visited us in the past.**

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It has been a new experience for me to talk to research houses that focus on the retail end and to financial planners, and I was pleased to find that a large percentage of them are quite well educated. In fact, the best of the financial planners are at least as good as the best people from offshore funds of funds that visited us in the past. They understand the process, benefits and risks of our equity neutral hedge fund strategy. Interestingly, some of those retail investors and distributors have been burnt in some other products that offered to do the same thing as our hedge fund, but ended up not delivering what they promised in 2008.

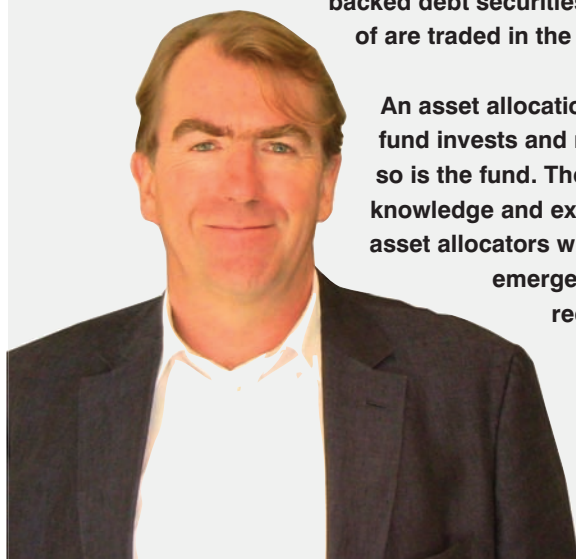
From the institutional side, we are at the fourth of the five-stage due diligence with a local superfund, so we hope to get our first direct superfund allocation shortly. We have also been approved by a large institution for an investment that would double our funds under management. Some institutions are comfortable with concentrated exposures that we can offer.

### **Phil Carden**

We are a new fund just over two years old, our customers have come from the high net worth or self-managed superannuation fund sector. Interestingly, most of the people who are invested in The Supervised High Yield Fund are amongst the most financially literate in all of Australia. We have ex-bond dealers, ex-money brokers, ex-stock brokers and CFOs of large investment banks and multinational companies, people who intimately understand how capital markets work. They chose to invest with us.

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**I think we will see a change in terms of asset allocation towards secure interest bearing securities. Also, asset backed debt securities are liquid securities. These mezzanine mortgage backed debts I speak of are traded in the billions of dollars daily by the worlds' biggest investment banks.**



**An asset allocation model should look at the depth and size of the market in which the fund invests and not only at the depth and size of the fund. If the funds assets are liquid, so is the fund. The model should assess the managers' integrity, expertise, ability knowledge and experience in addition to the age of the fund. Following such an approach, asset allocators will become nimble and able to allocate into new opportunities as they emerge, rather than waiting for three or four years for the fund to create a track record and required size.**

**Are we not better to invest with a small experienced manager operating in a large, liquid market than a large experienced manager operating in a relatively smaller market?**

**Phil Carden**

I think it is worth mentioning that as a result of the global financial crisis a number of opportunities exist now which are very much ignored. Particularly in Australia, there are opportunities offering high levels of security, low levels of volatility and consistent, above average returns. These are mainly mezzanine investments in asset backed securities such as residential mortgage backed securities. This is where we are investing. We have noticed that there are very few funds investing in this mezzanine asset backed sector. There is one industry superannuation fund in Melbourne doing this and they

have got most of the market to themselves; then other than us and a small high net worth fund in Melbourne I am unaware of any other investors.

We know the government has got \$20 billion they are investing in senior debt, top grade residential mortgage securities to help that market along so that it recovers from the global financial crisis and will be able to compete with the banks. We know that the issuers will invest at the capital level, which is the bottom level, but there is really nobody investing at the mezzanine level, and none of this market can progress without those mezzanine investments. So the risk is low, well secured and the returns are high around 7% over the bank deposit rate!

Add to that the increased capital adequacy for mortgages bought by the Bank of International Settlements and the increased amount of mezzanine debt that is demanded by ratings agencies and you end up with a very big opportunity.

The market size in Australian residential mortgage backed securities is \$110 billion down from a pre-crisis high of \$215 billion. Just doing a simple calculation where approximately \$20-30 billion of the \$110 billion is in mezzanine debt, based upon the pre-crisis market levels that number can double. Therefore there is plenty of room for growth. This is a large amount of money that will easily return 700 basis points over LIBOR or BBSW. This is a very good return on securities that have residential property as collateral and very little downside.

If you look at the sort of event that has to occur to lose your money in the Residential Mortgage Backed Securities sector, you are looking at 50% of the population defaulting on their mortgages, and then the properties that underlie those mortgages being sold for 50% of their historical market valuations. That is the kind of event that would in fact cause massive trouble in the banking system, but here in these mortgage backed securities you will get all your interest and all your principle back.

Now, why is there not more money chasing these assets? Because there is no fund or no expert with two or three billion under management. Very few managers know how to concentrate and asset allocate in this sector, that's why. You can get into a lot of trouble investing in structured asset backed securities such as Residential Mortgage Backed Securities, look what happened in the United States... However, there is also a very large amount of paper available that is worthy of investment, if you know how to analyze and where to find it. For instance, unlike the United States, in the Australian market there has never been a default in residential mortgage backed securities.

That sort of data is just totally ignored, mainly because of the mess in the U.S. mortgage market. Like John, I also believe Challenger's marketing message is quite right: who knows where the stock market is going to be when we retire? Nobody knows, it might be up 50% or it might be like December 2008 where it was down 50%. The benefit of investing in interest bearing securities like RMBS is that you know where your portfolio is going to be when you retire.

I think we will see a change in terms of asset allocation towards secure interest bearing securities. Also, asset backed debt securities are liquid securities. These mezzanine mortgage backed debts I speak of are traded in the billions of dollars daily by the worlds' biggest investment banks.

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Are we not better to invest with a small, experienced manager operating in a large, liquid market than a large, experienced manager operating in a relatively smaller market?

## **Dereke Seeto**

By now, Australian hedge funds deploy a large range of strategies, it isn't really that long/short is the only option available. For example, when I look at the seven hedge funds that were set up in 2010, only one of them was Australian equity long/short, and the others were all either merger arb, global macro or had an Asia-Pacific focus.



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Another interesting trend is that we have also started to see a lot of successful long-only managers considering launching products. The firms involved here are successful long-only managers with good performance and track records, and institutional quality infrastructures that add some additional strategies around their already strong long-only underlying portfolio.

Dereke Seeto



Another interesting trend is that we have also started to see a lot of successful long-only managers considering launching products. The firms involved here are successful long-only managers with good performance and track records, and institutional quality infrastructures that add some additional strategies around their already strong long-only underlying portfolio.

If you look at start ups, they really have to cope with two things. One, how to attract the right talent and two, regulation. While there is talent in Australia, finding the right talent can be a time consuming process – so we advise our funds to plan early. Building a firm culture can help, though ultimately the long term success and viability of the fund will be key to attracting talent. The second biggest issue we have seen in Australia, particularly over the last three years, has been local regulatory issues.

Some of these factors also contribute to why statistically you could observe more hedge funds starting up in Hong Kong versus Australia. Approximately 55% of manager start ups in 2009/10 were in Hong Kong. Clearly investor base considerations and proximity to the markets traded are key, but regulation is another factor that should be factored in.

John Corr

You are probably right – we set up our firm around seven years ago, and certainly if we were doing it now we may not chose Sydney, but rather Singapore or somewhere else.

Matthias Knab

Why exactly? What has changed, what would deter you?

John Corr

Well, you have to deal with things like the whole uncertainty of tax and offshore investors, increased regulation, as much as having been through the whole crises and raise money from offshore, putting up with that distance which is a problem in getting offshore investors... And on top you have the challenges in raising domestic assets that confronts you with the dominant role of asset consultants and researchers in Australia. As we had mentioned, in my view this group is just ridiculously powerful given the fact that the very same people have probably not done their job in the past.

Chris Gosselin

Cracking the Australian institutional market is particularly difficult. The only way start-ups here can succeed is with their own capital, plus friends', ex-colleagues' and family's. From there it is a long process building critical mass in the business at the same time as producing attractive returns with low risk. Once that is done, the emerging manager can start to attract high net worth clients and some of the smaller family offices. Reaching that institutional threshold is probably at least 3 years down the track, and they can't raise retail assets at that stage because of the barriers and structures in place such as getting on approved product lists and platforms, plus the distribution costs

There are a lot of funds that have done a great job over many years, whether it is a low volatility fund like John's Fortitude. Which has consistently performed, or funds with higher volatility. But raising capital is still the greatest problem for a fund manager after performance.



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In fact, sometimes when you look at some of the funds that do make it onto recommended lists, structure and compliance seems far more important than performance. We see plenty of large funds with institutional grade systems and support, but with very average performance over two, three, and four years.

Of course since 2008 investors have become more focused on operational issues, and I am not criticizing that, but some have forgotten that having poor performance and good compliance is not looking after the end investor.

**John Corr**

The number one paradigm that affects all Australian investors is the cult around equities here in Australia. There is this belief at all levels of society that equities are going to be the prime asset class. And of course, there are 20 to 30 years of historical reasons for that like the demographic shifts through the baby boom and immigration, then we had deregulation and after that the mining boom. The situation peaked in 2005 and 2006, but not much has changed really. If a manager does not beat the market, people think you are not good enough. When you point out that your strategy is set up to outperforming when markets fall, people say we do not believe it. And when their equities have fallen, they think "oh well, it is going to recover."

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**The equity market in Australia is going to go through an incredibly flat period at some point, and I think that there is a travesty that serious alternatives - and how you define those is another interesting question - but serious alternatives have to be provided to Australian investors. I do not think it is being done, because this cult of equities is being institutionalized in Australia, and as we have this aging demographic, people are approaching their retirement age and face the prospect of falling asset price and a low yielding portfolio.**

**I am not a Challenger [an Australia annuity provider] fan, but I like the ads they are putting up now saying "my bills cannot wait for the market to rally". The excuses people are given for the underperformance of their assets is ridiculous. We have been talking about all the hurdles for hedge funds in Australia, yet some large institutions get away with what at times is close to criminal, I believe.**

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### Chris Gosselin

The financial industry as a whole really has an obligation to develop a serious alternative investment sector. The media so far has not been very helpful, we really have to communicate with and educate all sorts of people, including the ones in investment committees, research groups and even in some respects some of the asset consultants.



**Education is incredibly important. If you look at the article on hedge funds in today's “The Australian” newspaper, it had a positive tone, however, they just focused on upside performance. They did not cover drawdowns or volatility. It's a problem when they only show headlines that say “up 60% or 50%”, because a lot of the funds that deliver that were the ones down 30%, 40%, or 50% in 2008, so that sends the wrong signal.**

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Greed and fear work well at every level within society. Would you invest in a fund that makes 10% or would you rather in a fund that is making 60%? Well, of course people go for 60%, and particularly the retail investor who is not told about the volatility or the risk factor involved. Few investors understand that the best hedge funds produce good returns with very low risk and a strong emphasis on capital preservation.

I was interested in Bruce's comments that they have started to move some long/short funds into the equity bucket rather than alternatives. I think that is very sensible as many of hedge funds in Australia are essentially active equity managers, so why wouldn't they be classified as such?

### Bruce Tomlinson

It was a bit opportunistic to move those long/short funds into our Aussie equity sector. This transition effectively freed up some capital for me to do more in global hedge funds.

Let me add to our discussion around regulation, and say that I am actually a bit concerned about what may come out of the current initiative called the Cooper Review. The review may eventually have some wide ranging ramifications, and while I'll try not to be too negative about it, I suspect if the recommendations are adopted they may result in poor outcomes for superfund members in the long run.

Things may end up with a lowest common denominator type of approach, and there may be a drive for low fee or passive investment strategies and a herding of funds around a common asset allocation, which unfortunately will just reinforce the equities risk we have been talking about.

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**I think the review may put pressure on funds like ourselves to have less in alternatives not more, which is not a good thing. The larger pension funds or superfunds in Australia are looking at the alternatives universe. You have a small group of funds like ourselves that already put 7-10% in hedge funds, but many more are at zero or just above that, so the average or median investment of superfunds here into hedge funds is just three or four percent.**

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**Matthias Knab**

**We mentioned the importance of education – could more education help?**

**Bruce Tomlinson**

Investment consultant influence on asset allocation is very strong, and the accepted framework seems to be that you cannot spend too much (on active investment management) and you cannot be too far away from your peers (on asset allocation).

This really puts up big constraints on your investment choices. If you look at the smart endowments or smart family offices, they all try to do smart things and don't care much about peer groups and fees, but focus on risk-adjusted net returns.

**Chris Gosselin**

Some of the larger family offices are using the same consultants now. They have arrived at the stage where many think they need consultants. They end up focusing on fees the same thing "what about fees, the fees are too high", rather than looking at that the net performance.

As Bruce said, The influence of the asset consultants is complete - and they are also becoming dominant in the retail sector where you find that funds wanting to be on an approved list have to spend \$40,000 or \$50,000 for two so called "independent" research reports, whether they are worth reading or not.

Regarding the peer pressure around "average" hedge fund allocations, if you look at different sectors or countries, Bruce, I am sure there are institutions that have double your allocation in hedge funds.



As I mentioned, last year was a good year for us. In spite of having a lot of money in macro it did reasonably well for us; our best and worst performing managers were macro managers. Our portfolio did about 12%, and we were pleased with that.

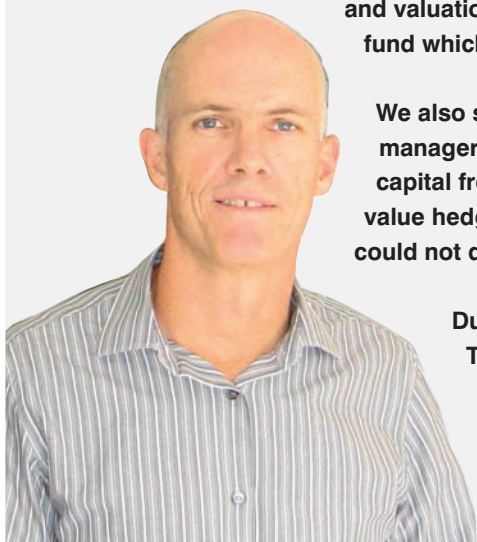
Rather than going along with our peers, we really try to be different and use a different portfolio construction approach in order to outperform them. Last year we rebalanced our portfolio away from some of the large and mega managers in order to add a few small or emerging funds.

As I said before, we are not afraid to go early into a manager, and we are happy to take a little bit more idiosyncratic (manager) risk from a business perspective. Of course we demand segregated assets, independent administrators and valuation, etc. For example, we were a third month investor in a New York based credit fund which came via our advisor Aksia.

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**We also seeded another credit fund, also in New York, with a very large established manager. Basically we told them that we wanted this strategy. We were reinvesting capital from a long-only high yield managed account and wanted to switch to a relative value hedged approach. This is a large asset manager but for various legal reasons we could not do a managed account, so they started a dedicated new fund for us.**

**During the last year we also put money into our second Aussie equity hedge fund. That one is also a relatively small fund with just over \$200m. We still have a lot of money with the large managers in our fund, so we are continuing to look for more balance.**

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We want to do more long/short equity this year, and we are watching to see what the fallout from the expert network scandal might be, and will there be some opportunities there.

We have been researching Asian event equity for a while but struggle to find capacity with good managers that don't take too much equity beta, which is always hard. We continue to go to Singapore and Hong Kong to look for managers. We continue to be opportunistic and will hopefully find something there before long.

**Matthias Knab**

**Can you explain to us your motivation why you are pulling out from the large mega managers?**

**Bruce Tomlinson**

Again, it gets back to being different from the others. A lot of the newer pension money from U.S. and Australia is going to the mega funds, but I personally am happy to take money off them. I don't see how a multi-strategy fund with \$25 billion or \$35 billion can continue to add sufficient alpha. At such a size their business issues become dominant, there is staff turnover, the overall alignment with investors is not as good.

Also, as one of 500 investors in a fund, you do not get a lot of contact or transparency. It is just not the same as being 10% or 15% of a manager's capital, where you get excellent interaction.

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**Thirdly, many of those mega funds were established 15 or 20 years ago and have or are starting to have generational change issues, and that is often a time of stress. From our perspective I think it is prudent to invest with a range of managers and not just have it all with the mega funds.**

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Of course, we follow a structured and responsible approach. We do a lot of our own research, we travel a lot and use specialist advisors so we feel comfortable taking on some of those small and medium sized managers. On the other hand, I could see how institutions that do not travel that much or do not do much direct research will be more risk averse and prefer a larger manager.

**Matthias Knab**

**What are some of the opportunities for Australian hedge funds, where is the industry going?**

**Dereke Seeto**

From an asset raising perspective, one unique opportunity Australian hedge funds can tap into is the universe self-managed superfunds while they continue to build up the required asset base and

institutional quality to then finally garner the domestic institutional flow.

I think that is definitely a fantastic opportunity and they should be focusing to get into that niche. As the self-managed superfunds start to get more educated, we will definitely see more investments into alternatives.

#### Chris Gosselin

The Australian superannuation sector is obviously very large. By law, employers have to contribute 9% of all employees wages, salaries, or earned income into a registered superannuation fund. That 9% may effectively be viewed as an employment tax the government is planning to increase this to 12%.



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**One-third (by value) of all commercial or industry money is now self managed and held in what is called a Self Managed SuperFund or SMSF. This trend must be a real problem for the pension industry. The high net-worth and educated investors want to manage their retirement funds themselves, partly because the returns they have been getting from some superannuation funds have not been attractive. It is this pool of SMSF investors that constitutes an unique opportunity for capital raising for Australian hedge funds, as Dereke pointed out.**

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For the balance, the majority of employees do not actually follow or check on their superfund's returns, because they don't have to contribute any of their own money. It is all paid for by their employer.

As a consequence, I don't think they really worry about their Superannuation savings the way they would if they were contributing their own money.

#### Matthias Knab

#### What is your recommendation here?

#### Chris Gosselin

My recommendation is never going to be accepted, because it is politically unacceptable. The concept of the superannuation levy is sound and sensible, as it reduces the government's obligations to fund the ageing populations retirement. However it should be based on a co-contribution. If you want to get the average employee interested in their superannuation and retirement savings, then every dollar the employer pays in superannuation tax should be matched by the employee.

The people who run their own superfunds are interested in their retirement savings. They actually pay for the set up and administration of the fund. They are legally responsible for the compliance and administration, even if it is outsourced. The current trend of dumbing everything down to the lowest common denominator with a low fee model will cost the country dramatically going forward.

## Bruce Tomlinson

The Australian hedge fund community is a sophisticated marketplace with tremendous talent. Many of these managers are ex-pats who have worked overseas in New York, London or Asia and have come back home for lifestyle or family reasons. It is true that because we are below the radar and far away from most allocators, the local funds do not get as much airtime as they deserve. These funds would certainly be able to raise a lot more capital in Asia or the States with the same quality individuals.

It is worth some of these large offshore funds coming down here and spending a week seeing a couple of funds in Sydney and Melbourne. There are good funds here and because they are overlooked, sometimes even by the local investors, there are some good opportunities. So I encourage the offshore investors to come down under. Another good sign is that specialist advisors like Aksia and Albourne are slowly increasing their coverage of the funds in Australia.

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## Chris Gosselin

To tap into offshore investors, some local funds have opened offices abroad. There are some funds with a Singapore as well as an Australian office. If funds really want to get serious about attracting offshore investors, it will be necessary to be very active in their offshore marketing.

Back in 2004 to 2006 it was not unusual for Australian managers to make an offshore marketing trip two, three or four times a year. That has not tended to happen as much since 2008, but it is starting to come back as it is completely necessary. Managers cannot wait for investors to come and see them in Australia; they have got to go overseas to visit investors if they are to compete for allocations.

## Dereke Seeto

There is also traffic in the other direction - we also see offshore managers coming to Australia to market their funds, trying to get the domestic investors and pensions interested. In the same way, Australian managers need to get out of Australia and do some marketing overseas.

## Matthias Knab

**Bruce, do you have a lot of offshore managers knocking at your door, what is your experience and advice?**

## Bruce Tomlinson

Yes, the traffic we see from offshore hedge funds coming to Australia for marketing has been very strong over the last 18 months. To be honest, I suspect there will be a lot of disappointed investor relations people, because as we have explained it before, the Australian market is consultant driven and it will be quite a while before most funds gear up.

Also, for many institutions seeing a portfolio manager or investment professional out marketing is a red flag. Instead of managing their book they travel the world marketing? That is not a good sign for me.





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**Bruce Tomlinson**

**Chris Gosselin**

I understand the conflict here, but on the other hand the investors really don't want to meet with a marketer, they want to see the portfolio manager eye to eye. They want to get to know the person who is running the strategy.

**Dereke Seeto**

This is correct, at some point yes, but for initial dialogues it should be the marketer, it cannot be the portfolio manager that is out there spending three or four trips a year for overseas marketing.

I think that is one of the areas where the Australian funds have lacked a little bit in terms of their global peers. In order to build an institutional network, you have to hire a marketer who travels and spends that time marketing. Then at the relevant point it will be the PM who meets with the investors.

**Chris Gosselin**

I have spoken with a hedge fund with just under \$100 million in assets. When I asked them what their marketing budget was, they said "we don't have a marketing budget."

It sometimes seems as if this is the only industry in the world where smart people actually put significant resources into establishing a business, then then say "good luck" when it comes to marketing. They just sit there and expect assets to grow. The most successful funds all have active professional marketing, which they see as an essential resource.

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**Chris Gosselin**



**Dereke Seeto**

It is only one half of the overall game plan, but a very, very important part.

**John Corr**

When a manager sets up a fund or a boutique investment manager, we are generally trying to get away from the bureaucracy. This industry is supposed to be a meritocracy where the best rewards are returned. Unfortunately from my own experience I know that is an idealist view, but I still believe that at some point the numbers should sell and not the people.

**Chris Gosselin**

If you never put a brand on a BMW or a Mercedes, and never advertised it, if it was completely unbranded, the car would not sell the way it does.

While there are always concerns about the quality of some marketers within the funds management industry, the reality is that marketing is an essential part of every business enterprise. Investor relations and communication are incredibly important. Fund managers have to communicate regularly and in the right way with investors if you want to find them, or retain them. They cannot just rely to be found among 15,000 funds globally somewhere on a database.



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**Chris Gosselin**

**Phil Carden**

Just on the other side, what is the point of someone who is less than \$150 million hiring someone to go and talk to people who will not talk to him? I could probably throw \$5 million at marketing into our little \$12 million debt securities fund. We have got great returns, good track record, but will it make a difference?

**Chris Gosselin**

Of course each fund has to take into account where they are, their size and their target investor. Funds need to plan their marketing strategy based on the type of investor who is likely to be interested.

**Dereke Seeto**

At any size or phase of your development, you should also think about how to enter the next one. So even if it may be too early for an institutional investment, at some point you should strive to be on their radar and start that process of dialogue with them.

The investment cycle from institutions will always take longer than you'd like: there will be the initial meetings, the monitoring, the follow-up meetings, the many stages of due diligence etc. You cannot assume that once you reach that critical mass of \$100 million then finally you'll go out, talk to the institutions and collect your investments, because it is a very slow process in the end.

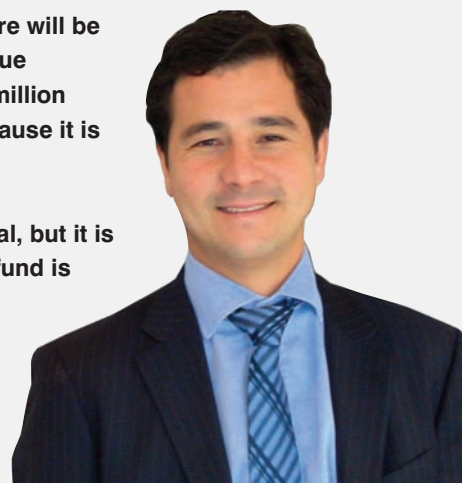
A lot of smaller managers think that performance alone is enough for their survival, but it is not. A lot revolves about education and creating the understanding of what your fund is offering investors outside of the market norm. This is where an investor relations resource is invaluable to you, because we have heard it from the horse's mouth when Bruce said if it is the PM that is actually marketing to them, they can become concerned about who is making the returns.

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**Dereke Seeto**



And things are not done with just one meeting, you need somebody who keeps up a regular dialogue. Most managers also tend to oversee the competition they are in. Because there are so many funds out there, investors have lots of choices. You need to make sure you are on the top of things when the time has come for your strategy, or the investor reshuffles or grows his portfolio for whatever reasons.

**Matthias Knab**

## **How diverse is the Australian hedge fund community really?**

**Dereke Seeto**

Let me first give you some statistics on Asia-Pacific, which I will later drill down to Australia. 71% of Asia-Pacific hedge fund assets are in equity, and the rest are split between multi-strategy, macro, Asia fixed-income, distressed, and a little bit of event-driven.

If we further break down equity funds according to invested region, around \$24 billion is Asia including Japan market neutral, around \$22 billion is Asia ex-Japan, \$21 billion is Japan long/short, some global equity around \$15 billion, \$6 billion is Australian equity, and Chinese equity is \$9 billion.

If we then turn around and look at where each of those underlying managers are geographically located, around 22% of all assets under management are managed out of Australia, approximately \$33 billion. Now, if we exclude one very large institution, that number drops down to around 12% of the total Asia-Pacific assets under management based here in Australia. That's approximately \$17.5 billion.

The natural strength of Australian hedge funds is of course within equity long/short. There are some very strong Australian long/short managers here and there should be, but offshore investors may want to be aware that beyond the long/short category approximately 8% is in Japan focused funds and an additional 10% focused in global macro - very good global macro with strong performance. Overall allocation to global equities is approximately 33% of Australia based managers, and much of the growth within Australian funds over 2010 came in the commodities focused funds.

# accurate

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