OPALESQUE

# Opalesque Roundtable Series '14

# GENEVA

Opalesque Roundtable Series Sponsor:

eurex

opalesque.com

# Editor's Note

Did hedge funds have a good year in terms of performance in 2013 in the end?

It really depends on the strategy and the context, according to the participants at the latest Opalesque Geneva Roundtable. An absolute return strategy with LIBOR + 400bps and 2.5 Sharpe Ratio objectives may have had a fantastic year achieving 600 points and an equity manager who returned 20% might have had a terrible year.

Most hedge funders agree that overall, the performance of hedge funds has been pretty good, especially that of long/short, distressed and credit funds – and especially compared to the assessed equity risk of the portfolio. However, there may still be a problem with certain defensive or tactical trading strategies. Some also observe a wide diversity in manager performance in 2013, of which several look very interesting.

The top echelon of Geneva's fund of hedge funds power houses have used the post crisis years to work on an impressive product innovation and client-centric offerings.

In this Roundtable, the participants furthermore discuss **new products and services based on thorough innovation**, hedge funds fees, especially the new rules around fees that apply to institutions (including the TER), and the way U.S. pension funds (that tend to go direct now) treat fees compared to their European counterparts.

They ask how much of the TER would one want to use in order to achieve performance, and explain why, when it comes to fees, investing in hedge funds could be compared to investing in a pair of shoes.

The timely topic of **bond investing** was also on the table, their substitutes (such as some UCITS); as well as that of the **supposed asset outflows from Switzerland**.

The group also discussed:
• What some of the **Geneva-based fund of hedge funds houses** such as UBP, Unigestion and Mirabaud are up to these days, and what the "new name of the game" is for their group;
• **Emerging manager** Martek's new long-term value public equities fund;
• The decline of hedge fund investments from **European clients** and what needs to be done to regain their interests;
• Why **funds of funds in America** get the bigger mandates;
• Why one of the next biggest opportunities for the hedge fund industry will come with the **fixed income bear market**;
• What IDS is doing to counteract the **squeeze from "fortress Europe"**;
• What may happen to and around **long term interest rates**;
• The **different sub-markets** for different kinds of clients;
• The current **tail risks**;
• The risks of private equities and latest developments within **private equity** funds;
• And why insurance, reinsurance, and banking are **attractive sources of funding**.

The **2014 Opalesque Geneva Roundtable** took place in December 2013 at the sophisticated offices of Mirabaud Asset Management. It was sponsored by the IDS Group, Taussig Capital and the Eurex Exchange Group.

The Roundtable's esteemed guests were:

• **Arié Assayag,** Global CEO of UBP Alternative Investments
• **Patrick Fenal,** Deputy Chairman, Unigestion
• **Marc-Henri Barrail,** Head of Advisory Hedge Fund Services, Mirabaud Asset Management
• **Ian Hamilton,** Founder and Head of IDS Group
• **Jacques Bally,** Founder and Head of Bally Capital Advisors
• **Joe Taussig,** Founder and Head of Taussig Capital
• **Kevin Martelli,** Founder and Head of Martek Partners

Enjoy "listening in"this most insightful Roundtable!

Matthias Knab
Director – Opalesque
knab@opalesque.com

Cover Photo: Chillon Castle and the Dents du Midi on Lake Geneva

# Participant Profiles

(LEFT TO RIGHT)

Standing: Marc Henri Barreil, Arié Assayag, Olivier Marion, Patrick Fenal, Kevin Martelli, Matthias Knab

Joe Taussig, Jacques Bally, Ian Hamilton

# Introduction

**Patrick Fenal**
Unigestion

Patrick Fenal, Deputy Chairman of Unigestion, a boutique asset manager with almost USD 15 billion in AUM, focused on institutional clients with a strong tradition of investing in alternatives.

**Ian Hamilton**
IDS Group

Ian Hamilton, Head of IDS Group, but also head of Scotstone Investments, which is based out of Malta and consists of various investment platforms and a whole suite of hedge funds managers; we also have an AIFMD approved asset management license.

**Jacques Bally**
BALLY CAPITAL ADVISORS

I am Jacques Bally, an independent asset manager from Saint-Sulpice, close to Lausanne. Our company BALLY CAPITAL ADVISORS SA was founded in 2003. Our primary concern when it comes to Asset Management is the safeguard of our customer's capital and the control of risks. We are also active in the mining arena, we strongly believe that the increase in volatility that we foresee for 2014 will favorably impact the price of precious metals and consider that the present low prices will offer a good buying opportunity during the first half of 2014.

**Joe Taussig**
Taussig Capital

I am Joe Taussig from Taussig Capital. We partner with asset managers, mostly the hedge fund managers, to create banks, insurance companies, and reinsurers where the asset manager manages all the assets. It's basically what Buffett already did many years ago; some 90 some percent of his alpha comes from such a structure rather than from his stock picking, and we help other managers do the same. So the most recent high visibility manager to set up a reinsurer and run its assets has been Dan Loeb. Third Point Re listed on the New York Stock Exchange after only 18 months of operation and has about $2bn of assets now.

**Arié Assayag**
Union Bancaire Privée Alternative Investments

Arié Assayag, Global CEO of Union Bancaire Privée Alternative Investments.

**Marc-Henri Barrail**
Mirabaud Asset Management

I am Marc-Henri Barrail, Head of Advisory Hedge Fund Services at Mirabaud Asset Management. We are very pleased to welcome you today in our Geneva headquarters.

**Kevin Martelli**
Martek Partners

Kevin Martelli, I am the Founder of Martek Partners, which is the investment advisory company advising on a value investment fund that invests globally with no specific sector or geographical preference.


Eurex.
An Exchange
for the better.
When you're on Eurex Exchange, you're in a one-stop-shop with more than 2,000 products to trade.
Here you'll find one of the world's most active markets in euro-based fixed income and equity index derivatives, including sector derivatives. Plus a broad offering in single equity products.
And there's more. We have a growing range of alternative asset classes as well as commodity derivatives including immediate access to Europe's most dynamic energy market.
On Eurex Exchange, you can enter off-order book transactions through our EurexOTC services – giving you opportunities to trade large volume without execution risk.
Our growing global partnerships create opportunities to trade partner products like KOSPI 200, the world's most heavily traded options contract, and SENSEX derivatives on Eurex Exchange's T7.
Eurex Exchange participants make up a global distribution network of more than 8,000 traders from 30+ countries trading about 7.0 million contracts every day.
And each of these trades is handled through Eurex Clearing – one of the world's leading clearing houses and an innovator in risk management.
Diversity, flexibility, global coverage.
Discover more on Eurex Exchange.
www.eurexchange.com
eurex
The information published in this publication is for general information purposes only. It is not intended to constitute investment advice nor is it intended for solicitation purposes. Eurex is not responsible for any errors or omissions contained in this publication. Before trading, persons should consider the risks involved and the legal requirements of the relevant jurisdiction. Not all products mentioned in this publication are currently available for offer or sale to, or trading by, United States persons. Korea Exchange, KRX, KOSPI and KOSPI 200 are registered trademarks of Korea Exchange Inc. BSE and SENSEX are trademarks/service marks of Bombay Stock Exchange (BSE).

**Matthias Knab** Please share with us more details about the strategies you focus on and the opportunities you see.

**Jacques Bally:** As independent asset managers we work on a tailor-made basis for our customers. Usually we do quite simple investments, i.e. cash bonds and direct investments in equities. Of course, for some customers we also use alternative investments. We have been investing in hedge funds for the last 20 years; some funds we are invested for already 15 years. 2013 was a very good year to us, particularly in the direct investment accounts. The performance of our European equity accounts for direct investment with clients has been of 37.3%. The advantage of such portfolios is that the customer can at any time consult his portfolio and see what are the positions.

**Kevin Martelli:** I have just set up my fund, which currently manages less than EUR 10m, so we are still very small. I set up the fund in Luxembourg. I come from an investment banking and private equity background, so managing such a small amount of money means that I needed to find the right structure in order to keep administrative costs down.

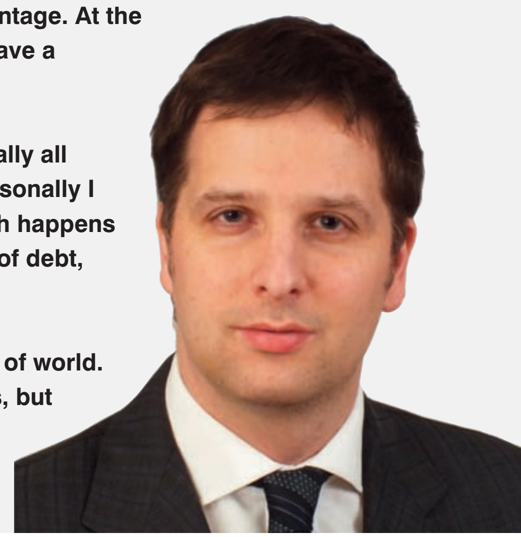
We follow a long-term value approach. It is quite peculiar in the sense that the fund can invest in any type of assets, from equity, to bonds, to derivatives, anywhere in the world, but with very strict value investing principles. Another specific feature of the fund is that investors have a three year commitment despite the fact that the fund invests in public securities, and this is in order to ensure a long-term approach in assessing investments, rather than having to focus on short-term performance.

I started the fund in April, in a relatively challenging environment, because assets are very highly priced and it is difficult to find assets which provide the right margin of safety. Right now we have more than 70% of the fund's asset in cash.

In terms of investment approach the fund uses a bottom up, research-driven approach in order to select businesses, which show superior returns on capital and a sustainable competitive advantage. At the same time we try to be conservative also in terms of valuation in order to have a sufficient margin of safety.

As I previously mentioned, we invest globally, that means we consider literally all countries, including emerging as well as frontier markets. For example, personally I think one of the best opportunities available today is the Iraqi market, which happens to be one of the cheapest and highest growth markets with very low levels of debt, unlike developed countries.

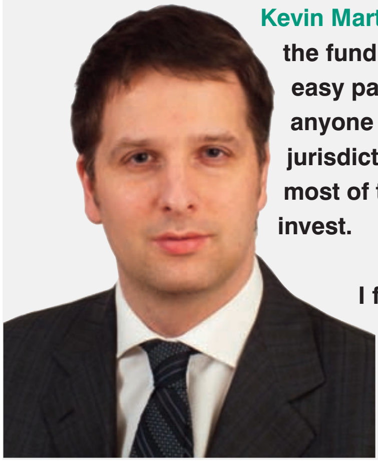
It is not easy to access this market, which is kind of insulated from the rest of world. My fund in fact had to invest in another fund to get exposure to Iraqi stocks, but that also tells a bit about the challenging environment we are in, I believe asset managers need to be very selective at this time.



**Joe Taussig** I happen to know about your background, which I believe is very interesting. Could you please share with us more about that?

**Kevin Martelli** Sure, I started my career in two investment banks; Rothschild and Credit Suisse where I worked mainly in Mergers & Acquisitions. From there I moved to Exor, which is an Italian listed holding company with a diverse asset base. There I was in charge of sourcing and evaluating investment ideas as well as monitoring some of the assets of the holding company. As part of a JV between Exor, Rothschild and Jardine, I also worked on small private equity investments in Asia, in particular China and India.

Over time I developed a passion for value investing, Warren Buffett's approach, and that was also how I got to know Joseph. I also found a like-minded investor with whom I am sharing offices in Lausanne; that was also one of the reasons why I decided to move to Switzerland.



**Kevin Martelli: It took me around one year from the time I had the initial idea to the structuring of the fund, but that had nothing to do with the raising of capital. I actually found out that was the easy part in a way, because unless people knew me, there was no sense to market the fund to anyone else at such an early stage. The difficult part was rather how to find a legal structure and jurisdiction that were cost-effective for a fund below EUR 10m within Europe, because of course most of the investors are from Europe, so I needed to find a suitable fund structure for them to invest.**

**I finally managed to find the perfect structure with ADEPA, which is an asset management company based in Luxembourg. My fund is a segregated and independent sub-fund within a SICAV SIF umbrella structure where ADEPA is the asset management company and I act as an investment advisor to my SIF fund.**

**Matthias Knab** We will later talk about how emerging managers can get started today in greater detail. Jacques mentioned he had a very good year in some of his strategies, who else has had a good year?

**Arié Assayag: I think we first should look at the definition of performance. "Having a good year" really depends on your strategy. For instance, an equity manager who generated 20% in 2013 will have had a terrible year, especially if he is managing U.S. stocks. On the other hand, an absolute return strategy with LIBOR + 400bps and 2.5 Sharpe Ratio objectives may have a fantastic year achieving 600 points. So the definition of performance is very much linked to the strategy and how it is used, the objective, the fee structure, the liquidity, and the dependence of the return profile with equities and bonds.**

**At UBP we have organized our platform to allocate money to external hedge funds, and this has been the core and the very long history of our firm. From our perspective there has been a wide diversity in manager performance, and some of them are very interesting.**

**On top of it, we have developed unique proprietary functions that allow us to reduce risk that we do not want to keep in the portfolio. This is done via overlays where we use options and volatility instruments in a quite opportunistic way. But reducing all risks is not optimal. What can make us different is not so much the ability to reduce risk, but to actually take risk. We have decades of investment experience with hedge funds, and while, as I explained, hedge fund investments can include risks that we don't want, in many cases there are risks that we feel an investor should gain exposure to. For those reasons we have developed a program where basically we are adding or reducing exposure to a specific macro theme or risk.**

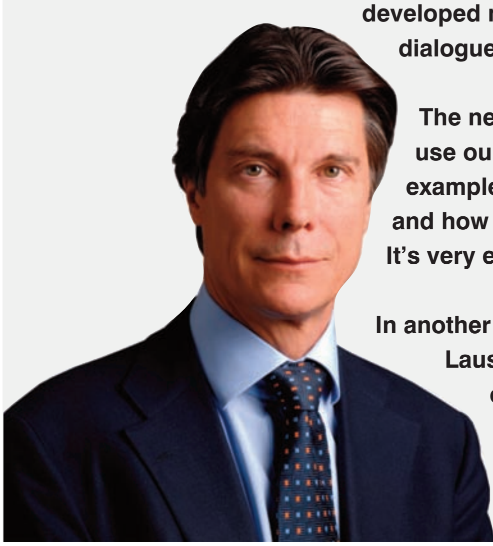
Looking at funds of hedge funds, our performances range from 6% annualized for our absolute return program to 18% for the less liquid directional return program. In terms of our risk hedging, we have been able to generate about 500 points above the underlying risk that we were looking to hedge - for example the S&P 500. Our macro hedging modules have worked very well. This is a program that takes on positions through the combination of five or six directional themes; this strategy has offered a 35% performance in 2013, with a limited volatility.

**Patrick Fenal:** First, I fully agree with Arié's comments on performance, I think even sometimes 0% might be classified as a pretty good performance, it all depends on the context, the strategy and the markets.

Today, Unigestion currently manages USD 15bn, of which around 40% is in “alternative” assets, split between hedge funds in the form of funds of hedge funds, as well as private equity. Over 90% of our assets are managed on behalf institutional clients, and from that side particularly we have a very high demand, for pure mandates or dedicated solutions for institutions.

For many of our clients in these dedicated mandates we have been able to leverage our proprietary research capabilities to help clients to understand and actually mix the different risks of private equity and hedge funds.

The new name of the game is obviously to be more flexible and provide flexible solutions for everyone. While UBP has developed new products and approaches, and we at Unigestion are engaging in in-depth dialogues to construct and deliver solutions which really reflect what our clients need.



The new kinds of questions from clients are very interesting and allow us to really use our research and innovative capacities to deliver new kinds of solutions. For example, an insurance company who asks us about the best use of its equity beta, and how to combine and use that beta best between private equity and hedge funds. It’s very exciting.

In another example, our research team, together with some academics from HEC Lausanne have produced a great paper about a new way to measure risk in private equity. Everyone is talking about volatility, but there are other types of risk obviously, which are more appropriate for private equity, than to study the volatility of private equity.

**Matthias Knab** Can you explain some of the other risk dimensions?

**Patrick Fenal:** Yes of course, but I still recommend you to read the paper, it's an easy and interesting read. One of the main risks of private equities is that your investment is not delivering soon enough, which then means that you cannot reinvest the money, and so on. It's a bit like the restaurant owner's challenge: your first customer needs to eat fast, because if he is not eating fast enough, you cannot sell the table a few times during the night, and that is really more important than volatility.

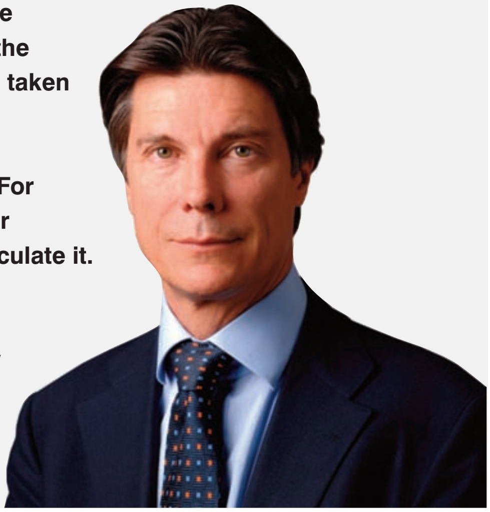
We see a strong demand for private equity, in Europe that demand outstrips the demand for hedge funds. I think we all know that there is clearly a dichotomy between the way hedge funds are viewed by Americans, or at least North American institutions versus the European ones, and the demand in Europe is clearly going down.

The main reason will not be the 2013 performance, because whatever the mainstream media may be saying, the performance of hedge funds that year has been pretty good. But I will also add that investors should also assess a fund's performance versus its equity beta, because that has really been a significant driver of the performance.

In our view, particularly long-short, distressed and credit managers were able to achieve a pretty good return compared to the assessed equity risk of the portfolio. In our analysis, those managers do provide alpha. To be precise, since about one year ago, we see active managers producing interesting performance and bringing alpha, and I think that's a plus and very good news for the industry.

However, we may still have a problem with certain defensive strategies or tactical trading strategies. These can be very interesting in terms of asset allocation, probably even more interesting than long-short, because long-short are basically equity related, but in some cases the fee structures are clearly not in line anymore with the expectation of the clients.

I mean, we all run or have allocated to products that are working defensively this year. Some of those probably yield around 0, or maybe 1%, or 2%. So here we are talking about real absolute return performance with a low equity beta, probably lower than 10%. The issue is that the majority of the gross performance would be probably be around 6% or 7%, but the majority of that performance has been eaten by the fees of the manager. Therefore, your client feels that it's not a good relationship, because the way the performance is split is unfair to the clients: while the client makes only 2%, for the manager it's probably 4%. So a lot of clients generally feel that the way fees are taken in this field is a bit unfair.



And by the way, most of the institutions are affected by new rules around fees. For example, Switzerland has made the TER, the Total Expense Ratio, mandatory for pension funds, so still we have to find a uniform and comprehensive way to calculate it. We also now have tough rules for private equity.

Fees is of course, one of the big issues, amongst other things, that the industry still has to address, but again, in general 2013 has been a good year for the industry, and I hope it will give investors more appetite, because in the recent past many tended to neglect the asset class.

**Marc-Henri Barrail:** I agree with Patrick, it has been a very good year overall for the industry as a whole, and it has also been a good year for Mirabaud Alternative investments. For instance, our flagship fund Haussmann Holdings celebrated its 40th anniversary and ended the year up 19%. This good result and outperformance is the result of different factors: at the beginning of 2013, we made the strategic decision to beef up the risk, and we also exited some strategies. For instance, we exited all quantitative strategies at the beginning of 2013, because we believed that this type of environment was not favorable for them. This active implementation of our views and convictions is, of course, part of our job as an active manager.

All our products did well in 2013. For instance, even our fund of funds dedicated to emerging markets, which was a very difficult market, outperformed the MSCI Emerging Markets by 6.4% last year and returned 1.4% for the year. I agree with Patrick, there still are many very good and talented managers available who are able to extract performance and alpha from various markets.

When it comes to certain changes or evolutions in the alternative investment industry, we cannot ignore the challenges surrounding the traditional fund of funds model. While many investors remain satisfied with this approach, we also see an increasing demand from larger clients with existing portfolios for specific advisory services. These large clients typically come to us seeking greater flexibility and a tailor-made approach to their investments. I think that, as an industry as a whole, this is where we must come up with more innovative solutions.

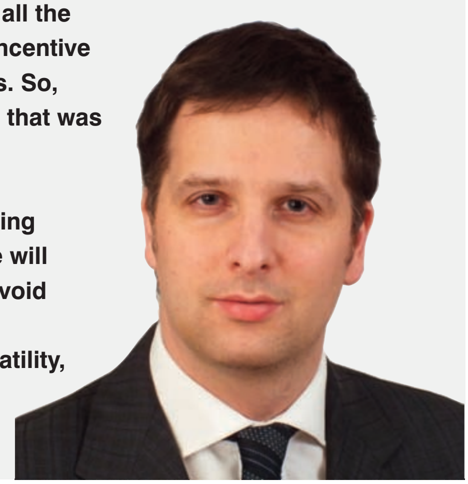
We also need to keep a keen eye on the markets. While some may talk about a "new normality" of the markets, others are actually questioning the current very low volatility regime. Hedge Funds appear to be a convincing solution to current markets conditions, where managers will take active risks in areas where there are opportunities, while simultaneously buying protections on mispriced risks.

**Matthias Knab** How do you do that?

**Marc-Henri Barrail** Hedge funds are flexible and active by nature and offer a unique range of strategies, approaches and themes in their portfolio. If you have the appropriate experience and knowhow, they can be blended in order to come up with the desired risk/return profile.

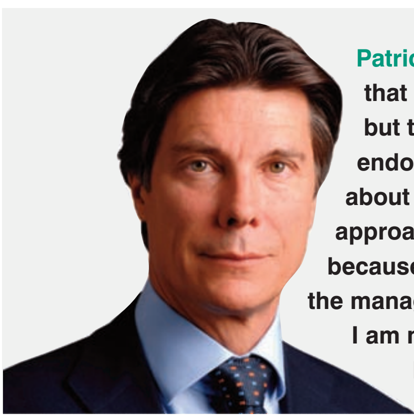
**Kevin Martelli:** Patrick pointed out that new rules or sensitivities around TER, volatility and the incentive system in general are affecting the clients and the industry as a whole. So even in our case when together with ADEPA we structured this relatively small fund, we thought about keeping costs low, and as a result we decided to cap TER at 1.5%.

An additional key feature of the incentive system was to have a hurdle rate net of all the expenses at 6%. Only after that we can apply performance fees. That means the incentive structure of our fund has been somewhat inspired by the first Buffett partnerships. So, sometimes one does not have "to reinvent the wheel", and looking back to a fund that was created back in the 1950s can be useful.



We also apply a high watermark, which pushes us to focus our attention on avoiding permanent loss of capital. So regardless of volatility, we believe that over time we will achieve a good track record by investing in great businesses at low prices, and avoid permanent losses of capitals by good risk management and monitoring of your investments. Those are essentially the mistakes one needs to avoid, and then volatility, at least from my perspective, plays a secondary role and it is more of an opportunity.

**Matthias Knab** That is an interesting approach how you have structured and organized your fund and fees in order to provide an attractive total expense ratio. Are there any other thoughts on this issue?



**Patrick Fenal:** I think one of the underlying issues we are encountering here is not the fact that the managers do not understand this issue, because it's really a very simple issue, but that the industry is facing this significant demand from mostly U.S. pension funds or endowments that are going direct. Those institutions basically seem not to care so much about the fees as European institutions do. This creates a mismatch, because when you approach a manager to discuss the fee issue, they are not that open to the discussion because they have other clients accepting the actual fees. That of course makes sense from the manager's perspective, but we are dealing with two different sets of minds. And to be frank, I am not pessimistic here but I do have the impression that European investors are losing a little bit of ground against the Americans these days.

**Still, like Kevin, we see some managers who are able to come up with fee structures that are mutually beneficially for both parties by, for example, starting to take fees only after a decent threshold, which, by the way, is the way it works in private equity. But most hedge funds have no reason to follow the same model.**

**Ian Hamilton** I just wanted to follow on the comment that the American investors are not that concerned about the cost and TER, etcetera. I can confirm the worst clients and investors that we have into our funds happen to be the Swiss family offices who try and rip every cost apart and try and get it as cheap as possible. I hate to say that in Switzerland, but that is where it's coming from...

**Arié Assayag: I think that all issues raised so far are very important issues. It is clear that hedge funds investment around Europe has been declining for a lot of reasons, and we do not see that happening in the U.S.**

**UBP manages around $11bn of alternatives for a quite large pool of clients, and we see mainly two groups of investors: (i) those who have kept the confidence in the asset class, clearly benefiting from long-term value creation through various crises and cycles; and (ii) those more recent investors who did not benefit from this long term value creation cycle. The latter category is typical of many institutional investors in Europe with shorter hedge fund experience, who in addition to that are increasingly constrained by regulators, their board or their risk department. An important part of our work is thus to educate our investors about hedge funds and alternatives and to work with their investment board and risk department.**

**The huge work done by UBP over the last months has been to offer an investment comfort to investors, by focusing on transparency, control of assets, a responsible fee structure, aggregate risk reports delivered on a daily basis and the ability to plug in new regulatory frameworks and models like Basel III or Solvency II. To develop such an offering, we have partnered with Guggenheim Fund Solutions, with the objective to propose an investment solution that is built on superior transparency and governance.**

**With that, I am quite optimistic that we will be able to revive a lot of the European private and institutional clients' interest for alternative investments, and in fact we are already starting to see that happening. Although fundamental, high performance and lower fees are no longer sufficient... You need to gain investors' interest and trust by resolving a lot of their issues and problems.**

**In the fund of funds industry, the core business relies upon the selection of the most talented hedge fund managers. We all know that. But what the industry players have been figuring out over the last couple of years is that it is no longer enough from an investor standpoint. Fund of funds managers now need to go beyond that, for instance by convincing a manager to evolve under a UCITS format or by being responsible vis-à-vis the fee structure. On this last point, I must stress that I believe that the 2 and 20 structure, especially in Europe, is no longer acceptable.**

**Now, let me take a moment to talk a bit about the other type of clients, the group that has not lost confidence in hedge funds. The relationship of those investors to hedge funds, especially in the U.S., is very much servicing driven. The investors need the managers for something they cannot do themselves. And over there the compression of fees is quite dramatic. All of these evolutions explain the drastic concentration that you see in the U.S., with fund of funds companies being able to win important mandates.**

**One final word on the investment side and its evolution. In the past, we used to build absolute return portfolios by mixing different strategies, with the aim that they would balance each other. Now we aim to work with individual strategies where each of them is capable to deliver an absolute return.**

If you look again from the investors' side, we believe there is a huge opportunity for solutions to diversify the fixed income part of their portfolios, especially due to the current rising rates environment and the negative correlation between bonds and equities being challenged. We are already getting a very good traction for those absolute return products we have developed, as investors have started to include them into their core strategy.

**Marc-Henri Barrail:** I agree that maybe one of the next biggest opportunities for the hedge fund industry will come with the fixed income bear market. A huge amount of money is at stake here, and hedge funds active in this space will have a role to play.

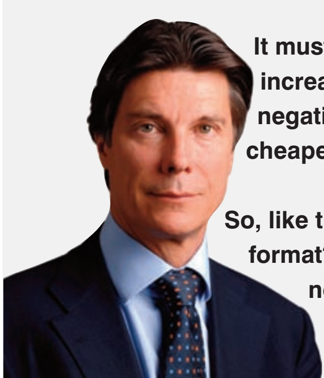
For the time being, the market seems to be on Prozac, but the day everyone wakes up, many will get hurt. In my view, this is probably the next opportunity for hedge funds. They have to come up with a range of solutions in order to provide some form of protection against rising interest rates, widening spreads while capturing the prices 'dislocations. This will allow investors to substitute parts of their fixed income allocation with a hedge fund and absolute return allocation.

The discussion about hedge funds and fees has been going on for a very long time with some people complaining that hedge funds are "expensive". For us, investing in hedge funds is akin to investing in a pair of shoes: if you buy bad ones, they may be cheaper, but they will hurt your feet for a year, make you look badly dressed and you will end up throwing them away 12 months later. A good pair, on the other hand, will last you longer and ends up being cheaper than buying bad shoes every year. The one difference with hedge funds is that the good hedge funds are not necessarily more expensive than the bad ones. As you're paying roughly the same amount, you might as well pay it where it makes sense, if you can find and access the good ones. Also, I personally do not mind paying a performance fee to a manager who can return performance and that is what it boils down to: what is left after the fees? If that performance is interesting, the fees are cheap for the quality, if it isn't, it's expensive. The funds who are unable to produce interesting returns generally do not survive for long anyway.

**Ian Hamilton:** The long-only industry has been a sector where fund managers get their fees regardless of whether they lose your money or not, so I don't think we should flagellate ourselves in the hedge fund industry for the fees we charge...

**Matthias Knab** Coming back to the theme of bond exposure and fixed income replacements, what can we as an industry do? What else are you seeing or doing in that respect?

**Patrick Fenal:** I believe that a possible fixed income substitute must be in a type of UCITs (long/short duration product) or similar format that regulates the liquidity.



It must be said that the line between hedge fund managers and UCITs managers has become increasingly blurred. Some long-only managers in fixed income have started to offer products with negative duration or positive duration, very much like a macro or some forex managers, but at a cheaper price.

So, like the industry, Unigestion has been evaluating what strategies can be brought to the UCITS format? We are known as the kind of grandfather of the minimum variance technique, and we have now also added an absolute return UCITS product to this range. As an absolute return product we see a requirement of not exceeding 10% of equity beta. As UCITS, the fund is very liquid, and for the year of 2013 it has gone up 14% with very low volatility up to date.

## Who we are and what we do?

The IDS Group is an independent fund administration group which was founded in 2002. We specialize in providing back office services to alternative asset managers including hedge funds, funds of hedge funds, private equity and property funds. We are the largest fund administrator in Africa with assets under administration of approximately $6bn and international offices in London, Malta and Mauritius. Our clients trade all investment strategies and we pride ourselves on providing a tailored solution to meet their differing requirements.

### What sets us apart?

Understanding your business is our business. Our clients vary in terms of size, location and complexity but we treat every client as an important client. One size does not fit all. Our experienced team works with our clients to ensure complete understanding of their requirements and provide detailed and bespoke solutions as well as ongoing advice, assistance and support. We continually review our processes and integrated range of products and services to ensure we maintain the high service levels that our clients expect from IDS.

### When should you consider using IDS Group services?

Whether you're looking to launch a new fund, make a transition to a new administrator or simply wish to outsource some of your processes, we have a solution to suit your needs.

**Joe Taussig** My perception is that there has been a massive outflow of assets from Switzerland over the last five years, is that correct?

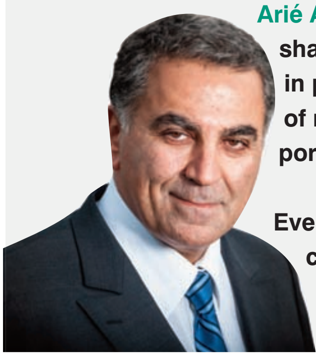
**Arié Assayag** Yes.

**Joe Taussig** I am not talking about performance here, I was wondering how much of it is due to the retrocession changes and the changes around bank secrecy? I was in Singapore last month, Credit Suisse alone has 5,000 employees there. It seems that a lot of assets are moving from Switzerland.

**Arié Assayag: I will restrict my comments on hedge funds assets, because that is what we are talking about here. In that respect, the outflow of hedge fund assets from Switzerland are not very much different to what you have seen in other countries. If you look at hedge fund assets in France, Italy, or Spain, the industry in those countries has probably shrank more than what we have seen here in Switzerland. A lot of that is due to risk aversion, and also to greater regulatory constraints.**

**The other factor is that the equity market, which is a competitor in terms of risky asset investments, has been doing very well.**

**Joe Taussig** You are of course right in that. Still, my perception is that the outflows in Switzerland have reached something like 50% since 2008, while the size of the global hedge fund industry appears to be back to pre-2008 levels.



**Arié Assayag: I believe it can be misleading to say that the hedge fund industry is now in the same shape as it was in 2008. If you look at the global asset classes, and in particular their weightings in percentages in the investors' portfolios, you will notice that traditional assets have raised a lot of money because of their performance, at the expense of hedge funds whose assets in portfolios has probably been divided by at least 3 or 4.**

**Even in the U.S., where we see quite a lot of momentum on the hedge fund side, this percentage compared to overall assets has not gone up either, and there has been quite a lot of rotation between commingled fund of funds into advisory or direct hedge fund investment.**

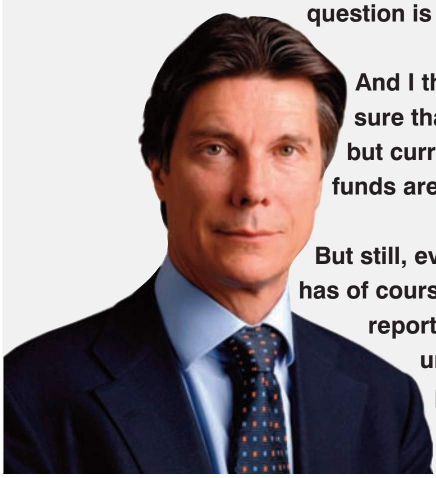
**Ian Hamilton: In that context, if over the last three years I was running a family office, I would not have wanted to have my allocation going into hedge funds while we have had a bull market in equity and a bull market in fixed interest. You are allocating those assets to different types of managers, so you are going to be on a hiding for nothing if you are going to allocate it all to hedge funds.**

**That for me is also part of the explanation. The hedge fund market has been stale, because there have been boom markets in other markets. But the question I want to ask is: *Has the time come that those family offices and institutions should consider a reallocation to hedge funds?***

**Patrick Fenal: I can only talk for the institutional side where indeed it is very clear that the percentage allocated to hedge funds has probably been divided by 2 over the last five or six years. I also agree that this is at the same time an opportunity. However, to a certain extent we also face a reputation issue, so for some investors there is still a reputation risk, and then we have the fee discussion. The fee pressure on the pension's side is huge. You have to be clear as nowadays pension funds have to report the TER. To give you an idea about what kind of numbers we are**

talking about, a typical TER may be 0.8.

What this means is that if the pension has a 10% position in hedge funds, that 10% position will probably count for 0.4 of all their expenses. So 50% of the total fee allocation would be eaten by just by their hedge fund allocation. The question is how much of the TER do you want to use in order to achieve performance?



And I think performance is clearly the key message. With rising performance, I am pretty sure that most people would be ready to spend some of the TER basically in hedge funds, but currently the percentage of hedge fund allocations we are seeing in most of the pension funds are tiny numbers, between 0 to 5%.

But still, even a pension that manages between just say 0.5% - 5% of assets in hedge funds has of course to deal with all issues related to hedge funds, including the fees, and you have to report to your board the performance and other data which are not always that easy to understand. There is a huge pressure on pension fund managers. During that same period of time equities are buoyant and way easier to explain; even private equity is easier to explain than most hedge fund strategies.

**Jacques Bally:** I find that it's exactly the same challenge if you deal with private investors. It's very easy to explain to a customer that you have purchased Roche or Nestlé and to see a very nice performance on the stock chart, but it's a bit more complicated to explain that you invested in a fund of funds that has so many positions, that has a monthly liquidity, and when you redeem you have to wait another month until the funds are deposited in the account, and so on. So it's very easy to defend a direct investment against an alternative investment today.

**Ian Hamilton:** Still, we have to try to convey the full picture to the investor, both institutional or high net worth. Usually investors are looking for investments that are currently undervalued. We have seen massive performances in the long equities and the bond sectors, so I strongly feel that this should be the time that we start marketing hedge funds as the next sector investors should be considering, and given that it has underperformed for a certain period now, hedge funds may be a good investment for a number of years going forward.

**Matthias Knab** We already spoke a bit about new products and innovation, do you want to add what you or your firm are doing?

**Ian Hamilton:** One development that not only myself but all here at this table and many others in the industry are facing is what I call "Fortress Europe". Switzerland sits in the middle of Fortress Europe, and with all the regulations coming out of the E.U., AIFMD, etc., Switzerland is in a squeeze.

I was listening how Kevin set up his fund in Luxembourg. I have established a comparable solution in Malta where we set up an AIFMD fund manager and are able to create EU onshore platforms and also Cayman and other jurisdictions. I chose Malta as a jurisdiction rather than Luxembourg because of the cost advantage Malta is offering, which I can pass through to the managers.

I am looking at the hedge fund managers of the future, people like yourselves, and unfortunately you are being squeezed out of the market. I personally and probably many others of us gray-haired around the table and elsewhere don't agree with this situation. Where can the future guys start out today? It was easier for us to leave institutions and start our own funds in our days, but that process has become more and more difficult. To me, that's not good for the industry, we are not nurturing talent for the future.

So providing help and a platform is one of the things I am doing privately through the Scotstone Group. We have some Swiss managers starting to show interest, and we have a large number of South African managers who are setting up and getting distribution through us. The situation is a considerable challenge for people from outside of what I call "Fortress Europe", because unless you have a compliant set up, you will be squeezed out and not able to sell your products to the wider market that you need here.

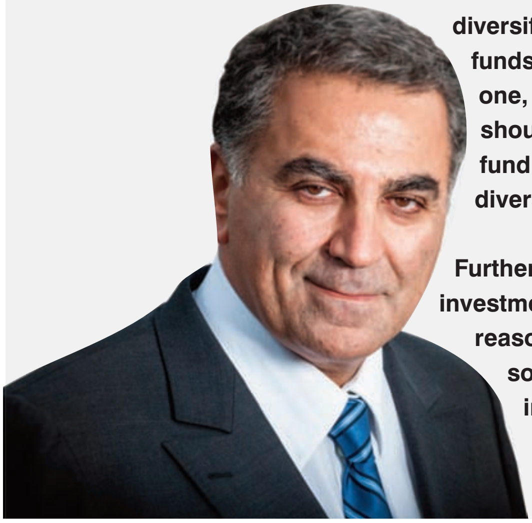
**Arié Assayag:** To some degree, a lot of the fund of fund players or hedge fund investors have been exposed to similar pressures. What we have done here in Europe after the crisis was to focus on improvements of the model. We improved the risk side, reduced the over-diversification and developed more concentrated portfolios, and started more customized advisories. We did that with the assumption that those improvements of the model, along with the performance, would be enough to convince investors to come back into hedge fund products.

About two years ago we came to the conclusion that of course the first category of investors I was talking about – the U.S. type of investor or long term investor who kept confidence into the product – has started to either invest directly into hedge funds or use the advisory mandate, because they usually tend to have a large size, no matter if it's a pension fund or a family office.

Now, when it comes to the other category – those who have lost confidence – I don't think it is a matter of innovation in the sense of bringing a new idea or concept to them. For us, what we felt that the situation required, was to reinvent the hedge fund investment format in a way that will take into account all the sorts of issues we mentioned earlier.

Let me also share a reflection on the situation in fixed income and the risk of changing interest rates. I do not really think the long-term rates will go up rapidly, but what will happen is that the stress and the tension will increase.

Why do I say that? Let's look at the long-term rates first. In Japan they are 0.6%; in the U.S. the ten years is at around 2.7%, and the Bund in Europe is around 1.7%. But the one thing that is probably most scary for investors is that all monetary policies aimed at reviving the economy are actually also trying to bring inflation up.



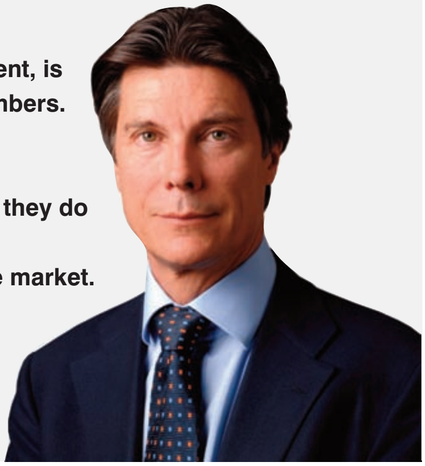
I think this discomfort is going to lead to diversification, and when you look at the diversification, it is not the benchmark, it is not the HFR or a traditional fund of funds portfolio; the benchmark is the absolute return funds. If we take the largest one, which is PIMCO Total Return Fund, that alone has like $240bn. But people should be aware that these products are correlated to fixed income. 75% of that fund is in investment grade. That means they are not going to be a great diversification.

Further, I am not going to discount the need of diversification on an equity investment. As equity goes up, the risk also builds up, and I would say that any reasonable investor will know that from a certain point onward they need to do something. In this context, asymmetric returns are getting more and more interesting, and more importantly traditional hedge fund strategies like long/short equity, event driven, or activists, which are great generators of performance.

**Matthias Knab** Apart from the interest change risk that we have discussed, any other observations on risk?

**Patrick Fenal:** I guess tail risk is always there, but now probably more than ever, and of course we all need to be careful that we are not caught out by another bubble in the markets. Normally in such a market there are no cheap assets, but with volatility currently looking very inexpensive, it would be easy to get caught out.

But in general, let me add that I don't want to give the impression we are negative. At this Roundtable, we have exchanged views and ideas why we have seen a slow down in demands generally for hedge funds. However, I am a strong believer in hedge funds and I do enjoy having the opportunity to work with highly talented people, but if there is one reservation, it would be that the capacity of all these people is limited.



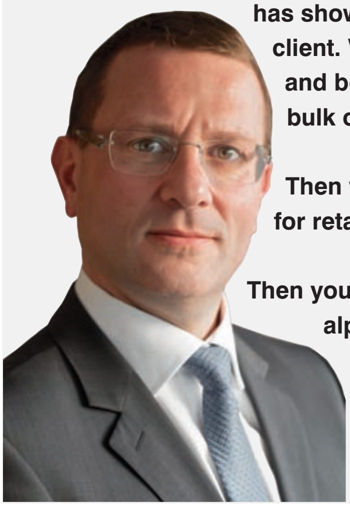
So one aspect of the challenge we have been discussing, the fixed income replacement, is that we are talking about a huge shift in the market, we are talking about gigantic numbers. And certainly those amounts of assets will not be able to fit easily into anything.

Arié mentioned PIMCO – we have seen the long only guys coming to the market, and they do have some points going for them. I do agree that they are correlated and have other restrictions, but they know the market pretty well, and to a certain extent, they are the market.

Back to true alternatives, our task is obviously to find clever ways to get some return, but also to get some capacity, because the name of the game would always be the capacity. We are talking about replacing huge numbers.

**Marc-Henri Barrail:** One challenge that investors will face in the future is that the historical diversification will not hold anymore for any extended period of time. If we start to see re-pricing of risk premia, it will be across all asset classes. So a traditional investor simply investing across different asset classes will not get the protection he expects. This is where hedge funds can add value; investors will have to switch from passive diversification to active risk management.

Arié explained how he sees two distinct, large groups of investors with their differing needs and wants. In that respect I believe that many solutions have been developed by the industry in order to answer the different investors' particular needs, address the client segmentation and how clients actually approach the hedge fund industry today. Experience has shown me that in the current environment, there is a different sub-market for every type of client. We continue to have traditional clients who want to have access to offshore hedge funds and believe this is the best way to achieve the best performance, and this remains true for the bulk of the allocation.



Then we have the new regulations, UCITS for instance. This is especially true in Europe, not only for retail clients, but also for certain institutional clients, such as insurance companies.

Then you have other sub-markets such as the managed account platforms, the risk replicators, the alpha replicators, to name but a few. Investors that are concerned by certain aspects of hedge funds can today find ways to access a hedge fund type of investment with specific features. Today, investors can find access for the specific markets that suit their specific needs. The industry has matured.

# INNOVATIVE BUSINESS MODEL

## Hedge Fund Due Diligence Exchange

Forensic-style due diligence at large discounts by matching clients

Exchange Platform
Explore the marketplace and add your indication of interest

Cost Sharing
Matched clients save half or more providing great value


**Decades of Experience: Highly experienced senior team, with operational, buy & sell side, quantitative, qualitative, and legal experience in hedge funds, funds of funds, commodity pools, and traditional assets.**

HFDDX

www.HFDDX.com

**Arié Assayag:** Let me share a view on tail risk. If we look at the equity market, the great quote from Templeton comes to my mind, 'bull markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria."

With that in mind, I do think that we are in fact very far away from optimism on the equity market. We usually hear things like, "well, it's not going to go much higher, and the economy is bad, people don't understand why it's going up." It's certainly true that the tail risk is going be very interesting when you go into optimism.

In addition, I don't know if a lot of people realize that, we are now in an environment where hedging is very costly. When you short the Eurostoxx market, you get the risk free rate, 0%, minus the dividend, so it will cost you almost 4% to be short. At the same time, the one-year 25-delta put is going to cost you less than 4%. So we are in the situation where the tail is much cheaper than hedging.

So I believe investors really do have interesting options today. If someone prefers to be long the market, say long 100% or even 200% the S&P, he can have 5% or 10% invested in the tail risk. In our view, the tail is going to become more and more attractive going forward, and we are doing a number of such constructions, especially with the way the long-term volatility is priced. At the moment, volatility is below almost everything and therefore is offering an attractive discount. At the same time, there is still a huge problem to be resolved; I am referring to the global debt problem here. While the issued debt is reviving global growth, many countries are not in phase, but in different points in the cycle. In my view, the tail offers tremendous opportunities.

**Kevin Martelli:** On one side a lot of people are talking about tail risk following what has happened in 2008 and 2009. On the other hand, global debt, both public and private, is probably the highest level ever, while at the same time interest rates are probably at the lowest level ever. That combined with the fact that equity markets are relatively expensive (for example, the S&P 500 is trading at around 25x on a Shiller P / E basis, one of the highest levels over the last few decades) means that capital markets are going through a peculiar and potentially risky juncture. All of this is probably the result of central banks engaging in quite unprecedented actions that make the whole system quite fragile and exposed to potential significant market corrections.

I agree that buying hedges is quite expensive. It is very difficult to find assets which are not overpriced, whether it is fixed income or in equity, and that is why I believe flexibility is needed in order to sometimes just remain in cash if you do not have better options. But that means underperforming is inevitable on the short-term in order to be able to exploit opportunities when market corrections do eventually take place.

We are in a world where every month many of us are in some way benchmarked, and I think that probably increases the risk of the system because it can kind of force people to take risk just because of this short-term benchmarking. It will be interesting to see what this dynamic will lead to. Overall I am a bit skeptical on artificial manipulation of pricing of assets.

**Ian Hamilton:** It's a simple correlation. If interest rates are so low, debt is going to be at an all-time high, because people are just going to borrow. What is the point of putting money away into cash in such an environment? At the recent Zurich Roundtable we heard similar comments where managers called themselves "reluctant bulls" because they participated in the markets in order to maintain some performance. I do believe it's good to be brave and go against the herd.

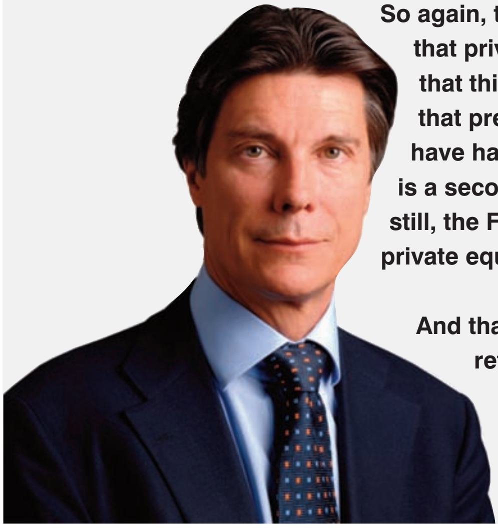
**Matthias Knab** Patrick, I wanted to round up this discussion with a few observations from the private equity world. Could you please share with us some updates of what you are seeing?

**Patrick Fenal:** The first observation is that contrary to hedge funds, the demand for private equity has remained more or less stable, maybe even slightly increased over time, so there is demand.

Today we have discussed why hedge fund demand in Continental Europe was going down, and I believe one reason is also because of the sub-par performance. We could now have a deeper discussion about how to assess and calculate performance in private equity, but my point here that we have generally had pretty happy private equity investors over the last five years, even if you include 2008.

The fees are what they are, and they are accepted by most players in the market. Of course, everyone complains about fees at all times, but they are pretty decent for the return. The way private equity fees are taken is probably more in line with the interest of the clients.

There is one development in private equity where, similar to what you see in hedge funds: the very sophisticated investors have begun to go direct and invest on their own, obviously being helped by consultants. This gives specialists like Unigestion new ways and new opportunities to work with clients. In particular, to expand from private equity to private assets; and also to have maybe a broader range of products on offer and build solutions across the private assets spectrum. So we have expanded our research interests to aspects like how to combine private assets intelligently in order to achieve specific objectives. It's very exciting.



So again, the demand for private equity looks pretty solid so far. What is clear to all is that private equity obviously needs a good equity market, nobody is fooled by the fact that this is a fundamental driver. But again, the demand is solid, even from countries that previously took some time to warm up to private equity, for example France. We have had some decent demand for our secondary offering from French institutions. It is a secondary, so probably the industry has seen better times in terms of discount, but still, the French institutions are attracted to the smoother J-curve that secondaries in private equity can offer.

And that is something new as well in private equity. People want faster and easier returns. In fact, they are ready to give away some return at the end in order to get it faster – I find that interesting. Summing up, private equity is offering a healthy story in general, but also, like in hedge funds, the challenge also is that you have to renew yourself, work harder, and be innovative.

**Joe Taussig:** We talked a lot about the changed needs, preferences and demands from the investor side. Retail, high net worth and pensions are immensely significant sources of funding. Our team also specifically looks at insurance, reinsurance, and banking as attractive sources of funding. We find that those sources are relatively cheap and relatively stable. The way how we tap that market for our clients, i.e. the hedge fund managers, is that we are able to attract those funds into permanent capital vehicles.

The two largest reinsurers that we have been involved with are David Einhorn's Greenlight Capital Re and Dan Loeb's Third Point Re. They both have about $2bn assets, and all of it is permanent capital. Greenlight is about nine years old and it has outperformed David's funds by about 4% since inception.

Third Point Re is about two years old, so still kind of in its early days, but it has also outperformed Dan's funds pretty well. Both companies offer daily liquidity for investors and their premium to book value is at about 20%.

Reinsurance is also very tax efficient for Americans, Canadians, Brits, and Australians. We think it's a pretty good trade. Historically we have set up one or two reinsurers for hedge fund managers per year. In 2013 we have started five, and we will probably do one to two a month in 2014, helped by the dedicated platform we have put together. On that platform, we are running the reinsurance business for the asset manager, and all they have to do is focus on running the money for the shareholders.

And then, when the new reinsurer gets to critical mass, we have a couple of investment bankers coming down to Bermuda who know and like the model, and we work on an IPO.

Earlier this month a company called Blue Capital Reinsurance Holdings went public on the NYSE. It's a startup that raised $175m with a one and a half and twenty fee structure, and basically has only one permanent employee.

The assets of this company are similar to those in an ILS fund. A lot of cat bond funds operate out of Zurich, and I have talked to people in Zurich about converting some of those funds into a proper reinsurance business. The demand for those instruments, particularly in the U.S., is outstripping supply. These types of funds offer investors a range of attractive non-correlated yield trades. Americans are taxed every year on their gains, and for them, investing in a fund is pretty punitive. But if they are invested in a reinsurance company as opposed to a fund, there is no annual taxation, and they still get capital gains at the end.

Blue Capital Re has a very interesting concept, and it wouldn't surprise me to see some of the other managers in Zurich do a similar type of structure. I am referring here to firms like Twelve Capital, LGT, Sequaero, or Solidum. At the moment, there are already about $20bn being managed out of Zurich now in these types of structures that can get converted, it's not trivial.