



Opalesque Round Table Series '12

GENEVA

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Editor's Note

Geneva is described by some as the place where the godfathers of the funds of hedge funds industry can be found. And interestingly, this has not changed.

The city's hedge fund industry is still recovering from '08, though. There has been a slight increase of funds (to around 130) and of assets under management (to around \$20bn+) this year in Switzerland since last year, but for Geneva, 2011 was quiet. It was a good time for funds of hedge funds to sharpen their *raison d'être*, for hedge funds to focus on performance, innovative products, and new selling angles, and for consultants and marketers to follow the flow of shifting demands from investors. All of this and more was discussed during our 2012 Geneva Roundtable, around Caliburn Partners' famous red table:

- **Funds of funds** must justify their existence as there is huge pressure on fees, on research efforts, on alpha generation. Being contrarian is one way to succeed, through showing high conviction in their managers, investing in managers when those are down, in niche or small managers, etc. The question of whether only local underlying managers should be used was raised. And it was also said that the model of using hedge funds right across the portfolio is now a model of the past.
- **Investors** still want some liquidity in their portfolios but are now also looking at illiquids too, such as niche strategies. Some are seeking newer and emerging managers. Many are simply not moving their capital at the moment, and sticking with their funds if they are already invested. Others are hunting for non-financial products (art, real estate, etc.)
- **Hedge funds trends:**
 - What kind of year has 2011 been for global macro and equity long/short strategies? The new way European investors are qualifying their investments in equity long/short funds.
 - Are hedge funds reducing their exposure, their leverage, increasing their cash levels? How do they prepare for the unexpected?
 - Some have observed that hedge funds are now trading more, doing less fundamental analysis, and that more tail-risk funds are coming out.

The participants:

1. Katherine Hill, **Managing Director, Palladio Alternative Research S.A.,**
2. Cédric Kohler, **Head of Advisory, Fundana S.A.,**
3. Simon Collard, **CEO and Founder, Collard Capital S.A.,**
4. Tony Morrongiello, **Managing Partner, Caliburn Capital Partners S.A., (host)**
5. Anne-Cathrine Frogg Spadola, **First Vice-President, Mirabaud & Cie,**
6. Cyrus Fazel, **Hedge Fund Advisor, Aramis Capital S.A.,**
7. Philippe Bonnefoy, **Chairman, Cedar Partners, Eleuthera Capital, Newscape Capital Group**

also talked about:

- **New products:** Mirabaud's innovative emerging market fund (in collaboration with Interpeace) and Eleuthera's new currency funds;
- Mixed feelings about upcoming worldwide **regulations** and the way FINMA, the Swiss financial supervisor, is trying to adapt to them;
- How fund managers and investors in hedge funds are positioning themselves with regards to the current **uncertainties in Europe**;
- Why **Greater China, Japan** are some of the favourite picks. What about emerging markets in general?
- Why 2012 could be an interesting **stock picking** environment;
- Why is **due diligence** always necessary, whatever the format of the fund – even for UCITS-compliant funds?
- The advent of bank platforms and seeding **platforms**;
- The role that **ETFs** can have in portfolios;
- Where are **asset flows** in Geneva coming from?

The 2012 Opalesque Geneva Roundtable took place in December 2011 at the offices of Caliburn Capital Partners.

We want to thank the 2011 Roundtable Series sponsors Taussig Capital and Custom House for their support.

Enjoy “listening in!”

Benedicte Gravrand
Senior News Editor
Gravrand@opalesque.com

Cover Photo: Mont-Blanc seen from the Swiss Jurassic coast of Lake Geneva

Participant Profiles



(LEFT TO RIGHT)

Cyrus Fazel, Anne-Cathrine Frogg Spadola, Cédric Kohler, Tony Morrongiello, Benedicte Gravrand
Katherine Hill, Simon Collard, Philippe Bonnefoy

Introduction

Philippe Bonnefoy

Cedar Partners

I am Philippe Bonnefoy, the founder of Cedar Partners which has an office in Geneva. I am also the founder of Eleuthera Capital, based outside of Zurich, which operates a systematic currency trading business, and I am Chairman of Newscape Capital Group in London, which provides discretionary fund management services and is manager to an Irish UCITS platform.

Simon Collard

Collard Capital

I am Simon Collard and I founded Collard Capital, a Geneva-based investment manager, which manages the Collard Global Macro Fund, a Cayman-domiciled fund that was launched in September 2010. We have a track record verified by PricewaterhouseCoopers that goes back to September 2007. The business' setup uses AIMA best practices as a standard and we have got top quality partners and service providers such as PWC as auditor and Apex Fund Services, Ireland, as fund administrator.

I am the portfolio manager of the fund and I have over 24 years of experience, including at Merrill Lynch and Dresdner Kleinwort Benson. I have spent the past 16 years running my own trading business. We set up the business from scratch in Geneva, and we like it here because it has a cluster of hedge funds, and it has lower costs than London although that has been eroded a bit by the strength of the Swiss franc. Switzerland has fantastic political stability which has proved to be a very important point.

Katherine Hill

Palladio Alternative Research

My name is Katherine Hill, and I work for Palladio Alternative Research. We are a Geneva-based hedge fund due diligence, research and advisory firm. We plan to expand and open offices in Asia and the US as well.

Tony Morrongiello

Caliburn Capital

I am Tony Morrongiello, one of the founding partners of Caliburn Capital. We are a fund of funds manager, mainly focusing on select emerging markets, the commodities complex and inefficient niches. We primarily manage money for institutional investors with UK pension funds accounting for the largest proportion of our assets.

Anne-Cathrine Frogg Spadola

Mirabaud

My name is Anne-Cathrine Frogg Spadola and I represent Mirabaud, a private bank based in Geneva and founded in 1819. The bank has been actively allocating to hedge funds since the early 70s, making it an integral part of the way money is managed. We run multi-manager portfolios, offer advisory services and customized accounts.

Cédric Kohler

Fundana

My name is Cédric Kohler. I am the head of the advisory group at Fundana, a boutique firm established in Geneva with 17 people. We have been selecting hedge fund managers for the last 18 years with a focus on the equity long/short strategy. The firm manages about \$800 million with two funds of funds; an equity long/short fund, and a multi-strategy fund.

Cyrus Fazel

Aramis Capital

I am Cyrus Fazel and I work at Aramis Capital where I am Manager for the hedge fund department. Aramis Capital SA was founded in 2000 as an independent hedge fund third-party marketing firm to introduce institutional investors to the appropriate fund managers and help them to fulfill their investment needs in the alternative investment space. In 2005, the firm expanded with the opening a multi-family office department.

Tony Morrongiello

We use hedge funds really to accomplish two roles; either as building blocks with which to bring about a strategic asset allocation objective. Since we are to a large degree thematic investors, we use hedge funds to achieve risk adjusted exposures to betas that we choose. For example, we run a dedicated Greater China fund of hedge funds built exclusively using local managers.

Secondly, we use hedge funds to give us exposure to niches which are difficult to access, which typically institutional investors cannot research themselves, and where we believe there are rich sources of alpha to be extracted. These niche strategies are typically found in complex markets with large barriers to entry, where there is less capital competing for returns and where therefore true specialists have an investment advantage.

We run three funds, the Caliburn Global Inefficiencies Fund, which is tailored for longer term institutional investors and which has a predominantly pension fund investor base. CGIF is all about alpha generation and has a return target of 6% over Libor with a strict beta cap to traditional asset classes. In addition we run the Caliburn Greater China fund, which aims to give risk adjusted exposure to the region's growth potential as expressed by the MSCI Golden Dragon Equity Index. And finally, the Caliburn Strategic fund, which is thematic FoFs offering risk adjusted exposure to a mix of emerging markets and to the commodities complex.

Anne-Cathrine Frogg Spadola

We work with a variety of strategies and outlooks differ. There are two approaches in the way we go about hedge fund allocations. On the one hand, we run portfolios that are similar to equity proxies, the approach the bank historically has used running hedge funds for private clients. This is very much equity long/short with some macro, always focusing on liquid strategies. On the other hand, we have the more institutionalized and broad way of running diversified hedge fund portfolios.

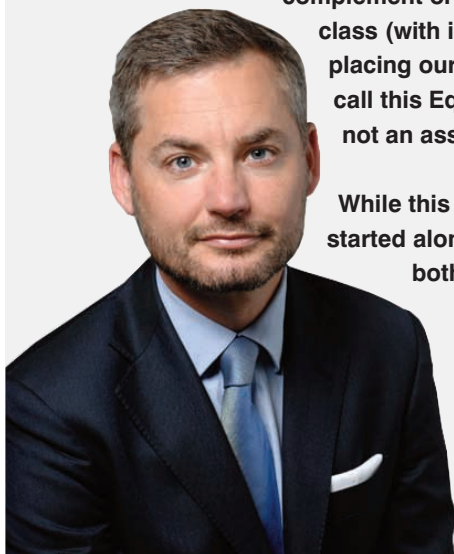
The focus is always on the liquidity element and awareness of the latest trends in the industry, such as UCITS. This attracted a lot of interest at the beginning of the year, but now things seem to have slowed down overall and across the offering.

On the outlook, it is hard to say which area to look at, except for having a well diversified general approach. We are hoping that with macro headwinds that might come down, as some sort of stabilization, there could be an interesting environment from a stock picking perspective. But the environment is very uncertain making it difficult to have a clear outlook.

Cédric Kohler: Our flagship is an equity long/short fund which is getting more and more interest as an equity complement or replacement. Instead of bucketing our FoFs as being part of a hedge fund asset class (with implicitly a Libor-based benchmark and a correlation target of zero), investors are placing our FoFs in their equity allocation. Our benchmark is thus more like the S&P 500. We call this Equity Investing Version 2.0. We encourage our clients to think that hedge funds are not an asset class but a way of managing an asset class.

While this version 2.0 has been going on for a while in the US (the US pension fund Calpers started along these lines back in 2001), it is only starting to come through here in Europe on both the institutional side and on the private client side. But, it is making its way.

It is our experience that equity long/short strategies are structurally safer than other hedge fund strategies. The public equity markets benefit simultaneously from an ample liquidity pool, securities that are easily priced (no Level 3 issues) and are subject to regulations (e.g. filing requirements such as 13F, 13D, shorting rules for US managers). The strategy has the additional advantage that investors can understand it more easily.



These regulatory filings enable manager selectors to have very good transparency on the hedge fund manager's positions. As a result, it is much easier to monitor risk factors such as concentration, both at the portfolio level as well as a percentage of company ownership, and to anticipate potential liquidity problems. This is much harder to do for strategies that use mainly OTC markets (such as Fixed Income Arbitrage) or that operate in unregulated environments (for example Credit or Forex).

Cédric Kohler

It is also important to understand that, for investors who are new to investing in hedge funds, the equity long/short strategy is probably the best ground for starting one's education. Unlike many other strategies, investors are typically used to investing in equities and to fair stock valuation via fundamental analysis. The major investment differences come from shorting and leverage. While not as simple as they may sound, these techniques are more easily understood than automated trading models, securities or convertible arbitrage done by macro, CTA or relative value strategies.

It is an interesting strategy for de-risking one's portfolio without giving up too much of the upside. This year's volatility in the equity market has been tremendous, and has tired quite a few people. Even if equity markets end up flat, the intra month volatility is just tremendous. With an equity long/short strategy, you smooth out this volatility, participate in 50%-60% of the upside and limit to 30% of the downside. With this kind of beta management combined with good stock picking, in the long run, you can systematically outperform the S&P.

From a valuation perspective, we like what we see because the market is discounting an economy in recession or near a recession: the S&P500 P/E at 12-13 is the lowest we have seen since the late 80s vs. a long-term average of 15 paired with cautious street estimates for the 2012 earnings with targets averaging around the current levels of \$100. History suggests that entry points around the 12-14 multiple, yields subsequent S&P 500 annual returns of at least 6% for the next 3 years.

So the outlook for us is actually quite positive but we need to have a little bit of market stabilization (not necessarily a rally) to be able to see the stock picking activity bearing its fruit. But I would say it is for now easier to talk to investors about less complex strategies, such as equity long/short, than more complicated strategies.

Cyrus Fazel

Our core business on the alternative investment side is to assist carefully selected managers to grow AuM. Our mission covers all the marketing functions, from assisting on the fund presentations and drawing fact-sheets and other marketing materials, to maintaining a close relationship with existing and potential investors and better understand their needs and investment constraints to address their requirements.

Our fund managers' selection criteria are based primarily on a qualitative approach, backed up by quantitative confirmation with a simple set of criterion:

- Top credentials fund managers
- A defined absolute return strategy that has negative or low correlation to the markets and to its benchmark
- A strict investment process
- A robust risk control approach
- A maximum transparency
- A proven and outstanding track record

As an illustration, we can mention two outstanding single managers we work with: FORT and Crystalline Management.

FORT's funds are systematic managed futures funds and offers daily liquidity and full transparency: The FORT Global Contrarian program follows a Trend-Anticipation strategy. It had an excellent performance in 2010, with 27.84% return YTD and outperformed its peers by 27% in 2011. It has never lost any money on any single year since inception. As it is uncorrelated to other hedge funds and CTAs, it fits very well in any CTA portfolio, boosting performance when other funds underperform. The FORT Global Diversified program is a blend fund: it combines 45% of the

Contrarian strategy, 45% of the conventional Long-Term Trend Following strategy and 10% of the Short Term Mean Reversion strategy. Performance for 2010 was outstanding (34.45%) and the robustness has been witnessed this year again with 37% YTD performance. Since inception (18 years) it achieved a 18.3 % compounded annual average return.

As Tony Morrongiello, we strongly believe in niche strategies which have low correlations to traditional markets. We have assisted Crystalline Management with their Amethyst Arbitrage fund for several years. It is a convertible bonds and M&A arbitrage fund focused on the Canadian markets. The Canadian market offers a robust regulatory and economic environment. Since inception the annual return is 12%. In addition, the M&A activity is only recovering and credit spreads have not compressed all the way they have in the US and Europe, which can potentially enhance returns further.

Philippe Bonnefoy

I have been investing in alternative investment strategies for over 25 years and it is apparent that most long/short strategies as well as a number of the other hedge fund strategies have a very high beta component. Going back to my history in trading macro in the 1990s; the difference between the current environment and the 1990s is that the beginning of the hedge fund business was really about trying to make the highest risk-adjusted return on capital that you could, and generally when investors allocated to you they would size you appropriately to the expected volatility of your returns. The secret of successful hedge fund investors was creating a diversified portfolio of uncorrelated alpha streams.

In the last decade, our market became much more institutionalized. The trend has changed enormously and the allocators want managers to perform most of that risk management allocation function themselves and control volatility at a much reduced level. But controlling volatility at a lower level really almost pre-determines their often lower returns.

And so approaching macro in a new way in this evolving environment, we wanted to achieve two objectives: to create pure uncorrelated alpha from trading and to continue to have high investment return objectives whilst also constraining downside volatility. We systematize essentially what a trader would do working inside a flow desk of a bank.

A trading rather than an investment approach will do very well over the next few years. In currency trading, there is a daily turnover of \$4 trillion and there are very few dedicated currency managers. Most of the dedicated currency managers are either collecting carry and they are typically highly correlated to a CTA-like trend following strategy, or they provide institutional hedging overlay services.

Philippe Bonnefoy



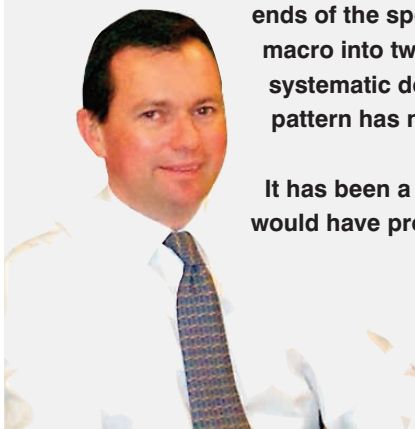
There is an opportunity to introduce a much more trading orientated return in order to monetize the noise in short-term trading, so most of our trading occurs from thirty minutes up to about two days.

We are looking for that time period to deliver to us weekly returns that average somewhere between a 1/4 to 3/4 of 1%. We have two main trading models to do that because obviously the market is not the same everyday, one is a mean reversion model, the other is a short-term directional model. We have been working on taking human behavioral psychology and systematizing it - as opposed to the usual way it is approached in this business, which is quantitative managers trying to fit their models into markets. This is a completely different approach to how people look at trading markets as we fit our investment experience into trading models rather than the other way around.

Over the last four years we built out those models, started incubation testing about fifteen months ago and we have just launched a Cayman fund and a managed account. We will also launch a UCITS fund in early 2012 to trade those models in the most liquid developed currency markets. We have had very good success so far in outperforming our target investment objective of a net 20% per annum return on capital.

We do not think there is any equilibrium coming into currency markets anytime soon. The instability of currencies makes it a very interesting place, we like volatility and we expect to be able to monetize that quite well as none of the big political or economic challenges that we face have been resolved which makes it a perfect environment for our trading style.

Simon Collard: We manage a global macro fund, and 2011 has been a difficult year. Within the global macro space, what is interesting is the divergence of returns; you have a few outstanding and terrible funds at both ends of the spectrum. But most people are clustered around the +10% or -10%. You can split global macro into two main categories: systematic and discretionary. Very often you have years where systematic does very well, and other years where discretionary does very well, and this sort of pattern has not emerged this year.



It has been a very politically-driven market, a very volatile market and a degree in political science would have probably been as good as a degree in economics this year.

The outlook is still good for macro. It is the original hedge fund strategy and it has proven itself over a large number of years, but I think the current year has favored much more short-term traders rather than people who have longer-term thematic ideas.

Simon Collard

Although we have had a challenging year, over a three year period we have returned over 24%, which puts us firmly in the top quartile, and I think investors look over a longer term period and also look at risk adjusted returns and volatility as well.

Katherine Hill

At Palladio, we do not manage any funds; we do not market any funds, we receive no retrocession from hedge funds, so we are completely unbiased and aligned with our investor's interests. We conduct research and due diligence on hedge funds for our clients and we also create customized research. So, I can discuss with you what we see in terms of research trends, what people are looking for and asking from us.

There has been this trend since 2008 for increased transparency and managed accounts and focusing on liquidity, but just recently this year, we have been getting interesting research mandates for illiquids, niche strategies, and side pocket research.

Investors still want their liquid piece, but they are looking for these niche strategies as well and focusing more on smaller and mid-sized managers. People have been disappointed. You have these huge multi-billion dollar hedge funds out there but there are small and mid-sized managers who are performing very well, but investors are nervous about them. And they feel like they need to go the big names. And some large banks are starting these seeding platforms again, which they have not done in years.

Investors are looking for alpha, but they are looking for performance in other places because they are disappointed by the massive funds that frankly have not performed. So those are some of the trends that we are seeing.

Another trend that I wanted to mention is there are lot of these tail risk funds coming out, but we are very skeptical of them because they are selling insurance basically on your portfolio... but isn't the job of hedge funds to hedge in the first place? So why should you pay for an extra layer? Those are some trends to watch.



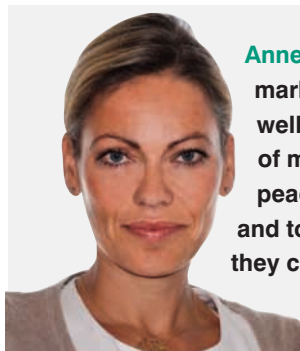
Katherine Hill

Cyrus Fazel

The Fort Global Equity fund is a recent addition. It is effectively a long only equity fund, with an equity indices hedge overlay. The stock picking methodology follows a simple and very effective systematic value alpha generating process with yearly performance of 8.55%.

Meanwhile, we are working on the launch of UCITS versions for the Global Contrarian and Global Diversified programs. Using a total return swap provided by a top credit bank, we will avoid any significant tracking error from the original strategy.

We are also constantly screening new managers and we expect to work with at least one additional firm in 2012. We will keep you posted on these new developments.



Anne-Cathrine Frogg Spadola: We launched a fund on December 1st 2011. It is a global emerging market fund, so just in itself that part is not original. But it is a combination of absolute return as well as hedge funds and we are working together with an NGO called Interpeace. We pay back part of management fee to Interpeace, an organization allied with the United Nations that promotes peace within emerging market countries. It is a way to invest in the region, both to get performance and to give back. Investors can buy a share class where they pay an additional fee to Interpeace, or they can just go with basic fees, but Mirabaud will pay part of its management fee in all circumstances. That is our innovation for the end of the year.

Tony Morrongiello

We are not planning any new launches. As a fund of funds manager, you need to achieve scale at a firm and product level and this has been our focus rather than new product launches. Barriers to entry are certainly getting higher in terms of minimum AuMs required by institutional investors

But the most fertile space is undoubtedly Asia, particularly the greater China space where we see the best source of new talent, particularly coming out of mainland China. If you fast-forward five years or ten years, it is going to become, after the US, the biggest asset management talent pool in the world. This is simply because China is the second biggest economy in the world and the local asset management firms have got the resources to develop extremely deep research benches and have a fast growing domestic equity market to tap into.

Tony Morrongiello



Katherine Hill

I agree about Asia, but not just China, also Japan for example. There are some incredible Japanese hedge funds that have been doing well; around 7% of assets went to Japanese hedge funds last year and this trend towards Asia is going to continue. We travelled the globe this year and we believe Asia will be very interesting to watch as well as other areas such as Russia.

And in terms of hedge fund strategies, I think there will be a lot of volatility. There is also going to be a lot more trading, which is where managers will make the money, not on your fundamental bottom up analysis, as it is going to be very volatile.

Simon Collard

We do not have any new product in the offing. I do not think we could really squeeze our strategy into a UCITS structure, but we would welcome joining a good hedge fund platform run by a major bank. That would offer advantages for investors who might want to invest in us. This year has seen the biggest managers attract all the assets. The advantage of these big platforms to us would be their marketing power.



Philippe Bonnefoy: As I mentioned, we just launched our Cayman fund, the Eleuthera Currency Fund, which trades short-term currency strategies. Foreign exchange markets are interesting because they tend to sit for a while in certain trading ranges and then they break quite swiftly on to a new range. That is one of the reasons it's always been a tricky asset class to trade. Some managers trade ranges very well, others trade directions very well, but it is unusual to find investment managers that can do both well. We have engineered our trading to be able to perform in both types of markets. I think that is level of price volatility is not going to change very much in the next two years presenting us with tremendous opportunities.

Philippe Bonnefoy

We also have a UCITS fund planned for Newscape, the Newscape Currency Fund, in early 2012. It will be a UCITS version of a very similar strategy to that already deployed by the Eleuthera Currency Fund.

The interesting thing about UCITS so far is that most strategies have been very much driven by long/short and equity strategies. There is not a lot of correlation inside the UCITS universe and we hope to be able to add a bit of de-correlated alpha to investment portfolios.

Cédric Kohler

Fundana has no new funds either. However, we are seeing demand to package our existing expertise developed over the last 18 years differently.

Cédric Kohler: Some investors want to create a fund replicating our flagship fund but dedicated to them. Other investors are more interested in our emerging managers program. We have been selecting for the last 18 years many emerging managers coming out of relatively well known shops, where they typically were the number two or number three portfolio manager. We were for instance day one investors with Cobalt, JAT and SRS Partners just to name a few. We follow them from \$50-\$200 million up to two billions. At that stage, we start to reduce our positions to avoid liquidity problems (especially on the short side) and to remain with the most motivated managers.

Some other investors are also interested in managed accounts which give them asset ownership and of course total transparency. This can have big implications for some of these institutional investors who need to have transparency for capital reserve purposes, especially insurances.

And so our focus has been to quickly adapt to the new ways we deliver our expertise as opposed to changing fundamentally our expertise.

Cédric Kohler



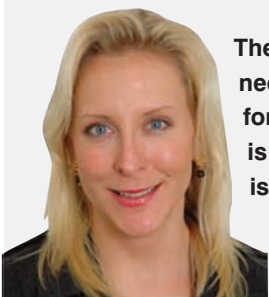
The changing regulatory environment has forced many investors to invest differently in hedge funds. But while our expertise has evolved over time, our delivery mechanisms have been revolutionized over the last few years.

Benedicte Gravrand

I would like to link to what Cédric just said about the currently evolving regulatory environment. Do you have any comment on the matter? I think everybody here does.

Katherine Hill

Well, we are rather opinionated about regulation at Palladio. Even though we do not manage a product, we have an opinion about UCITS and regulatory frames in general.



There is a necessity for it. But the thing that investors really need to be cautious about is that it is not necessarily a true safety net. People cannot be lazy in due diligence with funds that are in the UCITS format. And that is what happens because people think, the manager is registered by the SEC, or, it is a UCITS fund, therefore it cannot blow up or the manager cannot do something wrong – and this is completely untrue.

Katherine Hill

I just want to make that point that regulations are necessary, but it is no excuse for not doing proper due diligence, and it is not a pure safety net.

Tony Morrongiello

I could not agree more.

More often than not, these European domestic regulatory environments end up costing money to the end investor rather than actually providing true protection. Look at the Italian example of the SGR Speculative, which incurred huge costs and did not actually end up providing better protection for the end investor.

In addition these regulatory frameworks are often protectionist in nature and designed to defend domestic asset management industries and unsurprisingly they fail in that role as well. Retailer investors certainly require a coherent regulatory framework, but many aspects of the UCITS framework focus on form rather than substance.

Tony Morrongiello



Cédric Kohler

On the regulatory side, it has been a busy year and it is going to remain very busy for the foreseeable future, especially here in Switzerland. In fact, you have the following new regulations going on at the same time: cross border agreements (i.e. bilateral tax agreements), the new collective investment scheme act (a necessary response to the AIFMD), FATCA, Basel III, Too Big To Fail, etc...

While these changes are necessary, what is concerning is the speed of the simultaneous changes while some of the details are still being drafted by or between governments. It thus becomes very difficult for bankers or advisors, to provide the best advice to clients.



The new head of FINMA, Anne Héritier Lachat, has a busy agenda ahead of her. One of the challenges for FINMA (the Swiss Financial Market Supervisory Authority), is that they are more of a supervisor than a regulator. Politicians are the regulators. So a major law change can take a long time before being approved.

I would like however to thank here some groups like AIMA (the Alternative Investment Management Association) and the SFA (the Swiss Funds Association) for the work they have done, bridging as much as possible the gaps between the politicians' ambitions and the industry reality. They are really working hard.

Cédric Kohler

I agree that UCITS does not replace the due diligence that you have to do. It certainly provides a framework. But it is a framework that, like many others, has some shortcomings. There are well known issues with UCITS that investors need to be aware of, for example the counterparty risk coming from swaps or the high risk levels authorized by the law (maximum authorized risk is a 20 days 99 confidence interval VaR of 20% which equates to an annual volatility of 36.5%!!), just to name a few.

So we have important regulatory changes coming in the next few years which are again important but need to be clarified as soon as possible so advisors know what should be done for their clients.

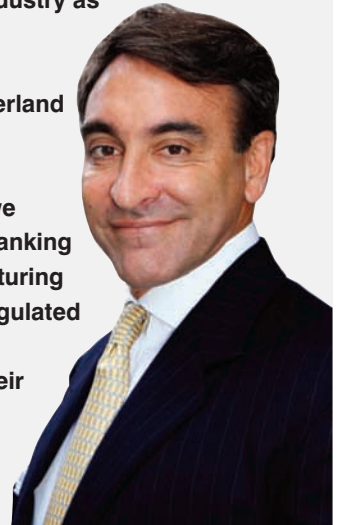
Philippe Bonnefoy

Let us pick up on Cedric's last point; the reality is that most experienced financial regulators actually do a very good job particularly in respect of alternative and absolute return managers.

The staff level regulators are thoughtful and experienced because they usually involve the industry as part of a general stakeholder conversation. And they do not rush into pushing for reactive legislation as they know they will be the ones who have to enforce it. The best regulation has evolved over time. Good regulation is nuanced, thoughtful and considered regulation. Switzerland is very good at that, as is the UK.

The scary part is when politicians get involved. They pump up the media, and all of sudden we suddenly need more pan-European regulations for hedge funds. The primary source of the banking crisis is the instability of the banks' own wholesale funding and their poor credit, credit structuring and investment decisions; it had nothing to do with hedge funds. Banks are the most over-regulated part of the financial economy, so it is clear that lots of regulation did not prevent the current problems from occurring or from some banks being in excess of 40x leveraged today with their funding problems being patched over by the European Central Bank.

Philippe Bonnefoy



Mr Rasmussen, the ex-Danish prime minister, has pushed very hard for pan-European financial regulation to regulate hedge funds and other non-bank financial firms in order to create "a level playing field." I assume that he does not intend for hedge funds to have the same level of leverage? Regulation didn't keep the banks safe, even in the case of Madoff, whose firm was not a hedge fund but a trading firm registered in New York as a broker/dealer. Madoff was essentially a stock broker, he didn't operate a fund – he operated individual accounts – with no management or performance fees – for his clients. Regulation didn't help here either. Regulation also needs to be effectively enforced.

Everyone I have spoken to thinks it is appropriate to have very solid regulation. The question is just how deep and how inhibiting it should become. It is best to have people who understand what they are trying to achieve and to put the appropriate rules in motion, rather than a political knee jerk reaction where you need to pound on someone, and make it very hard for business. We saw that in Dodd-Frank in the US, it was a complete overkill. And now we are going to see years of reverse engineering to take out the unintended consequences from poor politically motivated regulation.

In Switzerland, there is a lot of industry consultation going on with FINMA's staff, and with the self-regulatory organizations, the same goes for the UK's FSA, and often with the US' SEC. It is a matter of passing regulation that works well for all stakeholders in the industry.

Simon Collard

Firstly I am very pleased that we decided to be based in Switzerland. The Swiss government is very pro-business and pro the investment management industry. I am not sure that that is the case in Europe.

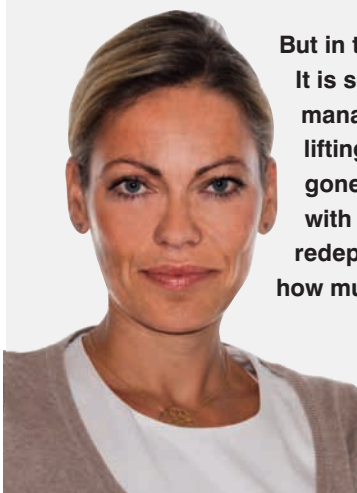
I am also very pleased that FINMA are actually going to start directly regulating alternative investment managers based here, because not being regulated was a disadvantage when you went to see non-Swiss clients; they did not really understand why you were not directly regulated.

And with the AIFMD coming in, it is going to be essential to gain equivalency to Europe as a regulated market. There is no guarantee that Switzerland will gain equivalency but I think FINMA are doing everything that they can to make sure that they do. Their response is very measured and very sensible, and they are definitely engaging with the industry and listening to the industry. Switzerland therefore is a good place to be based, and we will continue to be very pro-business in my view.

Benedicte Gravrand

It is said at the moment that some hedge funds have reduced their leverage, are shrinking their positions and are trading less. Some would even like to move all their money in cash but cannot because they have to justify the fees and obviously it is not their job to do so anyway. Have you observed such a trend or are you doing that yourself?

Anne-Cathrine Frogg Spadola: On the cash side, considering the year we went through, we found that the creation of cash in portfolios was slow throughout the year. We would have expected to see higher cash levels earlier based on just markets and the type of results.



But in the last few months, we have seen increasing cash levels. It is just starting to make sense. It is somewhat similar to 2008, and maybe more specific to long/short managers. These managers are focused on fundamentals, and see strengths there, but somehow have a problem lifting their heads and seeing what is going on around them. Now that that point seems to have gone through, we do not however observe any unusual cash allocations. We are quite happy with it in markets like these because hedge funds can be more tactical than we can in redeploying the cash as well as protecting the portfolios. It is always a tricky subject to know how much should be there.

But overall I would say the second half of the year has seen lower levels of gross investment overall, but not as low as we could have expected.

Anne-Cathrine Frogg Spadola

Cédric Kohler

With regards to equity long/short, what we have seen is, like Katherine said, a little reduction in gross (current levels now around 130%) and net exposure (current levels now around 35%). In addition, managers are focusing on their core ideas, and thus eliminating their low conviction ones. They have also been very careful not to miss any rebound. We saw in October how these rallies can be violent and quickly become short squeezes. Bad mismatch between longs and shorts can result in terrible performance. So it has been for our managers a balance between managing their net exposure, staying nimble in their core positions while at the same time being well positioned for rebounds.

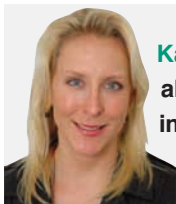
Philippe Bonnefoy

At Newscape, we create customer portfolios that allocate to fund managers. What I have seen is a number of equity managers who have been very good stock pickers and who worked out that their net directionality of the portfolio was beginning to penalize them in these very volatile markets. So a lot of managers pull in their net to just focus purely on stock picking and they worked out that when they apply traditional long/short stock picking, how it is supposed to be, they can actually make very good returns because they get paid on both sides of the book. It is also important to understand that investing in asset classes such as interest rates, government bonds, FX trading – generic macro strategies – are normally reasonably levered, because they are highly liquid and easily priced. Less liquid strategies like distressed debt or midcap equities should generally avoid leverage because they are often illiquid.

Simon Collard: We have certainly reduced our leverage this year compared to previous years, and that is purely a reaction to the volatility in the market. If the volatility went down, we would probably increase leverage. And if it continues, we would stay at around the level of leverage we have.

Simon Collard





Katherine Hill: One thing that we have seen of managers is, yes, they are bringing down gross exposure. But also, investors are keeping cash, they are waiting until the right moment to redeploy it. But what is interesting is, even after August and September, we have not seen an increase of redemptions. So people have stuck by their managers and are hoping that they can recover for the rest of the year.

Tony Morrongiello

We have not seen enough contrarian thinking from your average hedge fund manager. That is what we need more of but it takes courage and value investing has been very challenging in the last few months.

Fund of funds are increasingly finding it difficult to justify their existence, but one place where they can add value is by knowing their managers properly and adding to the good managers when they are down and taking money away from them when they are up. Increasingly we have to demonstrate to our investors that we have the ability to do buy value because that is where fund of funds can and should generate additional alpha. I see little evidence of this in the industry.

The first managers that we saw bringing down exposure this year were the credit funds because there was a clear message by May of this year that you really were no longer being rewarded for taking credit risk, especially in developed markets. Proactive credit pickers may well be the first to start adding exposure as spreads have blown out in the last quarter. On the other hand, equity managers on average, with the exception of managers in China, had been far too slow once again to cut their net long exposure whilst markets were resilient in the first part of the year.

Tony Morrongiello



Cyrus Fazel

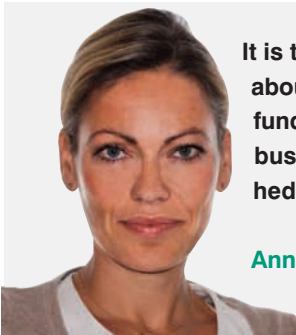
This year was definitely all about fixed income. There was a very bullish trend in the last two years. As for the long/short equities managers, we have witnessed that some managers have reduced their exposure and went in cash and are waiting for the rebound.

Benedicte Gravrand

To latch on to what Katherine just mentioned about investors; some investors at the moment are sticking with their funds, even those that generate negative returns (like John Paulson's for example). Some say it is because they do not want to sell at the bottom like they did in 2008, or because they cannot think of an alternative investment. What you have observed among investors?

Anne-Cathrine Frogg Spadola

To follow up on the topic of redemptions, we had the exact same observation that there does not seem to be that much redemption, and we certainly do not see them in our portfolios.



It is the type of year where you would expect redemptions, again because we are very disturbed about what went on in 2008. We believe to a certain extent that people who are invested in hedge funds now are the ones that were there before 2008 as well and stuck through it. They know the business, they know what it is about and they are not scared off. They are not recent investors in hedge funds.

Anne-Cathrine Frogg Spadola

We know that there have not been big flows of new investors, which was a different case in 2008. So people understand more. The specific case of John Paulson, a case we do not know in detail, but a situation where given the type of performance you have had in the past, you might stick with such

a manager for a while. There is no magic, if you make that kind of returns, there has to be risk somewhere as well.

Cédric Kohler

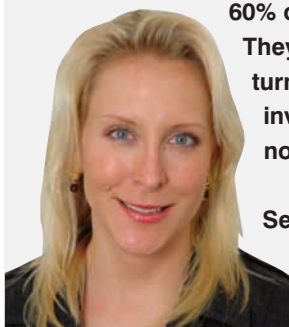
What we have seen is that our investors – who for the most part have been with us for quite some time – understand well what we do. They thus know what to expect: if the equity markets are down, then our managers will be down, on average, 30% of that equity market loss. If the equity markets are up, we will be up about 50% to 60% of that gain. As long as we stay within these ranges, we are in line with our investor's expectations. This may not seem like much, but if you captured 60% of the upside and limited to 40% of the downside since 1993, when our fund started, you outperformed the index by 40%! Active beta management can thus improve return while at the same reduce the risk of your portfolio. It is really important to manage your drawdown because when you have a 50% drawdown (like you did twice in equity since 1993), it takes a 100% return to get back to your high water mark. Whereas if you are down 20%, it only takes a 25% return to get your money back. That's a huge difference of course. In addition, a good equity long/short will have half of the index volatility and drawdown.

It is true that a lot of investors are now waiting on the sideline partly because they are getting tired of the volatility of financial assets (equities, bonds) but also because of the lack of real returns at the end of the day. Many are now either thinking of actually investing in real estate (even in Geneva if you can still believe that), or in art. Actually, there is one thing to be said about art: at least you can enjoy it more than once each day! This is not true for all financial assets.

Cédric Kohler



Katherine Hill: The hedge fund industry has evolved from a cottage industry to more institutional industry, so now over 60% of investments come from pension funds for example, which really changes the whole landscape. They cannot move quickly to invest, redeem, or reallocate. they are like huge ships that cannot just turn around quickly, unlike family offices or other investors who do not always have huge investment committees or are just able to react more quickly. That is one reason why there have not been massive redemptions.



Secondly, why would you redeem when you are at the bottom and hoping that the manager will come back up (if you still believe in them). There is also the lack of where to put the money if you do redeem.

Katherine Hill

As I mentioned before, we have been asked to do a lot of research – outside our standard hedge fund due diligence – to look for illiquids in hedge funds or hard assets or things like art, wine and timber. We have really had some interesting mandates.

The lack of heavy redemption is due to the lack of where to put one's money, waiting for the manager to improve, and the inability to quickly redeem. Or that the investors are locked.

Cyrus Fazel

Katherine brought up a very interesting point. The investor base is more institutionalized. In 2008, investors who got out of hedge funds had to sell at the bottom, many of them being squeezed on liquidity.

Today, investors are starting to understand the real benefit of hedge funds; which is that it is not about when you are getting in, but more importantly it is when you are getting out. One analyst at FORT LP has released an interesting study showing that a CTA investor with a five year investment horizon will have a good ride if he holds on to his position for at least this 5 year time horizon. Indeed, the most important is to not sell after a big drawdown, and it seems that institutional investors are starting to understand this as a discipline.

Cyrus Fazel



Benedicte Gravrand

Tony, you just spoke about funds of funds finding it increasingly difficult to justify their existence. It is true their image has suffered since late-2008. You mentioned they should apply a contrarian approach, invest in managers when they are down, for example, or in niche products. How else can they can regain investor's trust?

Tony Morrongiello

No question that the fund of funds industry is in a very difficult place and that the landscape has shifted.

We set up this business in 2005 to compete for institutional assets, fully aware of the resources and dedication required to crack this market. However, barriers to entry have risen significantly in the last 24 months and there is pressure on costs with the double layer of fees posing significant problems to the institutional FoFs industry. The consultants, themselves are getting challenged by their own clients to demonstrate that their fund of funds providers are adding value, and overall the scrutiny of total expense ratios is becoming a key focus point for institutional hedge fund investors.

To compete in the traditional multi-strategy space, you need scale and the larger funds of funds are winning the lion's share of the institutional mandates, but fees are under pressure. We are seeing fees of just 40 basis points as the starting point for large multi strategy US institutional FoFs mandates.

Unless you are part of the bulge bracket FoFs community, in order to compete you have to provide investors with investment solutions that they cannot achieve directly or through their current roster of providers. We do see appetite in our search for smaller managers, niches and thematic exposures. You have to put it in the research effort to truly understand the top down rationale for the exposures you have through your managers and researching complex inefficient niches requires a lot of heavy lifting.

The question that institutional investors are asking themselves today is "of the alpha that I managed to generate through my alternative portfolio, how much am I paying away in fees?" And the surveys out there point that investors are often paying well in excess of 50% of their alpha away in fees. 50% or lower is probably what is considered to be an acceptable level. Fund of funds have to be compete with that in mind and obviously to report to very demanding standards, which requires them to determine exactly the betas that they are taking and the alphas that are being generated across asset classes.



We believe that there is merit in using funds to give you risk adjusted exposure to certain betas. But that is not necessarily a model that will work with all institutional investors, because they will not want to pay fees for any beta that they will argue they can obtain directly and more cheaply. Institutional investors are rapidly pushing FOFs towards models where they will only pay fees for alpha.

Tony Morrongiello

Overall we are still bullish on the hedge fund industry as a whole as we think the huge shift towards alternative assets will continue. However, fund of funds will need to adapt and to specialize.

Anne-Cathrine Frogg Spadola

Just to add on to what Tony was saying, another change in the current challenge is the speed at which you have to react, either by launching new products or trying to identify a theme in products that are already there; there is a need to be original. If you just sit back and look at what you have done in the past, this might not apply to the future. You have to really step outside of your usual thinking and come up with some new ideas.

Cédric Kohler

Funds of funds are indeed going through big structural changes. The industry had a very long ride during which it did not have to really think about what was its true core added value. With the crisis,

they have had to rethink their business model and especially the fact that one-size-fits-all does not work.

Institutional investors for example want to have strategy specific FoFs so they can have more flexibility in their top-down allocation and get help in sourcing managers.

In essence, these sophisticated investors certainly do not need us to invest in the likes of Citadel, Brevan Howard or Och-Ziff. But they need FoFs to find out who the next Ken Griffin or Alan Howard will be. That's where we can add value, by sourcing tomorrow's stars. This is, by the way, the roots of the industry and that is where we've got to come back to a certain extent. We have to be able to offer our investors relatively simple strategies, simple concepts that they can grasp and not just products on top of products. The more investors understand the investment process, the more they will be able to stay the term. And staying for the long term is critical for them to accumulate performance.

Cédric Kohler



So it is, again, by going back to the roots of our industry that we can add the most added-value to our clients. After all, even industry veterans such as Alfred Jones created his own FoFs in the mid 1980s.



Simon Collard: Niche is obviously something that everybody here seems to believe in. But the other thing that is important is being local. If I had a big property portfolio, I'd want the manager to be close to those properties to be able to go in and see them on a very regular basis, to see if there was a problem with the plumbing in one place or the roof in another place.

The value in FoFs being close to the managers geographically and being able to visit them very often, to know for example something very simple such as if the manager is having a problem with his personal life, which could really affect performance, is key.

Simon Collard

These are things you are only going to know if you are in the same community as the manager and if you are close to them. Having an office where your managers are is valuable.

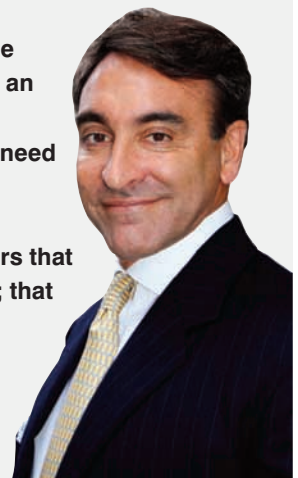
Philippe Bonnefoy

As Simon just said, all around Lake Geneva, you are really looking at the godfathers of the hedge fund business; people, who were active in the late 1960s and 1970s, who were the original seed capital providers for some of the most famous hedge fund managers in the world. And in some respects they were part macro traders themselves, they were looking at global trends, they also tried to find people that they believed in. They were certainly not afraid to double down if someone was having a Paulson-like year and they believed in the manager and his convictions.

But the bigger question about fund of funds is that the many have become investment-committee driven; there are 14 people or 8 people around the table and no one can make, or wants to make an edgy instinctive or "gut" view, so they go to group-think. I am not sure how Louis Bacon or Paul Jones would get started today without a few prescient investors once again taking a "view." We need smart tactical investors and not rely on a 26 year-old MBA with a check-list.

A problem that developed was that there was a mis-promise or miscommunication to the investors that alternative investment funds were always going to produce positive returns and be uncorrelated; that is what some of the private banking clients bought into, perhaps some of the institutions as well, and the reality is that it is all about diversified sources of return.

Philippe Bonnefoy



The problem in 2008 was that 40% of the market or more was invested in long/short strategies; many of those long/short managers were very directional, so they had a lot of correlation to down equity moves. The job of most alternative investment managers is to try and provide uncorrelated returns because clients can buy beta much cheaply than we can provide it. So the shakeout is going to produce a handful of institutionally friendly mega \$10 billion plus FoFs, where it is all about scale and resources, like firms such as Blackrock. And then there are going to be the managers who are pursuing niche strategies, who can become specialists in long/short, arbitrage strategies or CTAs. The final alternative is going to be firms that have in-house distribution like Mirabaud, or Pictet where you have very seasoned deeply skilled fund of fund managers who instinctively understand what managers are doing and instinctively often make the call based on a “sense” for the manager.

So we are going end up with the mega fund of funds, the specialist funds of funds, and the in-house fund of funds at the private banks.

Cyrus Fazel

It’s true that the double layers of FoFs fees make it difficult to justify their existence, especially for those who generate average returns with a multi-strategy focus. We often hear as well that most FoFs have a strong correlation among themselves, as their top 5 picks are the same biggest funds. Furthermore, several FoFs managers like to invest with single managers geographically concentrated in the main areas such as London Mayfair, New York City and Hong Kong as it makes their due diligence process easier and it reduces costs.

We at Aramis Capital think the opposite.



We are convinced there is more value in working with managers who are in different locations, also with those who manage more “out of the box” and have niche strategies and competitive edges. The managers we mentioned earlier are based in Washington DC and Montreal (Canada).

The sad thing about this, is that most investors stick to heard mentality: we always say that they should focus on emerging managers and people who think out of the box. But at the end of the day, most people are still investing in the biggest funds, which are in the main locations with the biggest AuM.

Cyrus Fazel

Philippe Bonnefoy

The other thing that has not been discussed is that often institutional investors want managers to have lot of assets, and many cases the alpha you are looking for actually occurs in small-sized funds. When funds get to a certain size, the alpha is often gone. There is a bifurcated view saying “I need this manager to have scale.” But at a point the manager becomes ineffective at a certain AUM size. That is often a reason some of the investment returns for some of the larger funds of funds begin ebbing away. They simply have too much money to manage and can’t invest in smaller emerging managers.

Tony Morrongiello

To take up on a point that Simon made on being local and using specialists, I believe that this is particularly true in Asia.

With the development of the hedge fund industry locally and particularly in China, you have to be able to speak the same language and you have to build a local network. Without a network in the local market, you do not have much of a chance to pick winners.

Look at all the Chinese equity frauds of this year. Those who got caught are mostly the developed market investors who use in the US listings as an easy way into these Chinese stocks. But on average, if you look at the Chinese managers, very few of them had any exposure to these companies.

Tony Morrongiello



Being local is an advantage; we prefer to go to Brazil to find a manager who can give us exposure to Brazilian equities. But that takes a lot of work and a lot of costs. We have built a presence in Asia with seven people now in Singapore. At the end of day, we took people out of our Geneva office, out of our London office and relocated them to Singapore and hired locally. So, going forward, Asia will continue to grow, to the detriment of job opportunities in the traditional hubs of London, Geneva and NY.

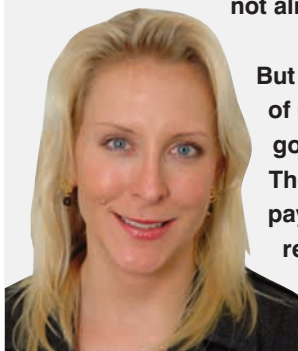
Benedicte Gravrand

Would anyone else like to comment on what Philippe has just said about some funds being very large but not necessarily good performers?

Katherine Hill

There is a trend of investors moving from fund of funds to single managers, but there always will be a need for funds of funds. That is because there are certain investors who can only invest in them, for example.

But there will be increased pressure on the big bloated fund of funds that do not deserve their fees, who invested in managers who were good at one time but the fund of fund has not looked for new talent. Those asset gatherers are not aligned with their investors anymore. Those are clearly going to be cleaned out.



But it is the evolution of the industry and it is going to compress, because there were low barriers of entry so almost anybody could start a fund of funds, but they are no longer performing. The good ones, the ones that are niche or specialist or have something unique are going to survive. The ones that are in all the big names we all know are not going to survive because, why should I pay them when I could go directly into those managers? Everybody knows them anyway. The only reason is if the funds are closed to investors, but many reopened as of 2008-2009..

Katherine Hill

It is evolutionary. There will be fewer funds of funds, just like there will be fewer hedge funds, but that is the way the industry should be.

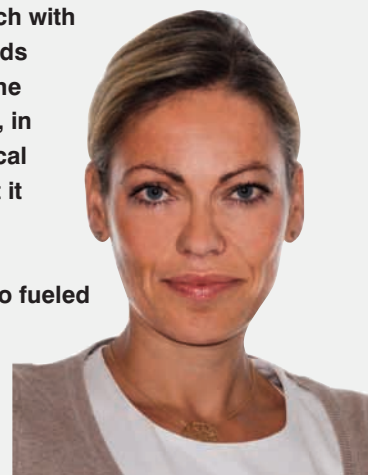
Anne-Cathrine Frogg Spadola

We are invested in funds ranging from the relatively small size, from \$100m and up to \$20 billion plus. We do not do any seed investing, but we are allocated across the whole range.

Our criteria is finding what is best, it is not about having this much with big ones, this much with small ones. What we have observed this year, having had the same intellectual bias towards “large is not necessarily good,” is that it has not been true. A number of larger firms are the ones that have been doing best, and there seems to be something in the investment style, in the true trading approach that has been quite defensive; they used their ability to go tactical for very short moments of time, to apply contrarian thinking and controlling risks. For that it has been a very interesting year.

We have seen increases in the death ratio on the smaller funds; it has been large, and also fueled by the fact that people are not necessarily allocating money to smaller structures as it is true that from an operational perspective there can be a certain amount of risk.

Anne-Cathrine Frogg Spadola



We always try to take it from the break-even approach; you have to see the manager some distance away from their break-even before you give money to them. You do not want to be close to that area because you do not want to get stuck there and have the manager lose their focus. So it is a complex

situation, but it is a long shot to say that big is no longer aligned with the investor; it is not an easy observation to make.



Simon Collard: Professor Narayan Naik of London Business School conducted research into hedge fund returns compared to size of AuM and he found that the most alpha actually comes from the two ends of the scale; the small emerging managers and the huge mega managers. The conclusion was, as an investor, you should have a barbell strategy and not bother with people in the middle. One reason given by the Professor Naik was that these mega managers often resemble funds of funds internally. They have lots of different people managing different pots of money and trading. The good performers get rewarded with more money to manage and the poor performers get less and eventually get fired. So they really differ from the mid-size managers.

Cédric Kohler

It comes back again to the question, what are investors really looking for and at what price? Some investors have the ability to do some of the work that funds of funds normally do. For some investors however, it is a lot harder to be able to source, select and monitor emerging managers for example.

The positive outcome of '07 and '08 is that now we have several years where managers have showed what they can do, or not, in terms of managing their risk. At least now we have some interesting data points against which we can benchmark these managers.

It is true that at times, it has been easier for big funds to source information, to dig deeper in special opportunities and to respond to the increased demand from regulators. This has indeed been harder for smaller managers, but on the other hand they have been able to remain nimble and to trade around their book much more easily. There is also something to be said for those smaller managers who are hungry as they want their fund to succeed. By the way, most of these managers have their entire net wealth in their fund so you are well aligned with them as an investor. And so over the long run, we have seen emerging managers outperforming more established managers, especially in the equity long / short space.

The bottom line for this year in particular is that I think the dispersion is so big that it's a little too early to be able to tell if larger funds did better than smaller ones as a group.

Cédric Kohler



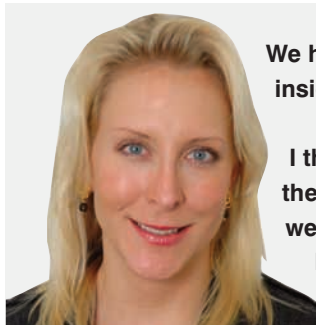
So far, I have seen only anecdotal evidence and we would need to see a study on the full year to conclude one way versus the other.

Benedicte Gravrand

Some of you have mentioned illiquids, niche products, non-financial assets being more in demand. Would you like to elaborate, give examples?

Katherine Hill

A trend that we have seen from our investors has been that they are looking for things that are not correlated; they are looking for illiquid assets and niche (actually this is an umbrella for many things).



We have been asked to do studies on water funds, wine, side pockets as well – or what still exists inside the side pockets. We are bridging the gap between hedge funds and private equity.

I think investors just want something new and fresh to look at. They realize that there is a need in their portfolio for liquid investments, but there is a need in the portfolio for illiquid investments as well. But the later can take more time with due diligence work, and so you have to be patient and have the right entry point.

Katherine Hill

Tony Morrongiello

To continue on that point, liquidity terms for FoFs should be more polarized. If you want to offer your investors truly uncorrelated niche strategies, those investors have to accept much longer liquidity terms.

Our products have either gone much longer or much shorter, so we have moved away from the quarterly 45-day model. Our institutional fund has moved to a one-year lock-up, with quarterly plus 90-day liquidity. That is where we put the niche strategies in. They are not suitable for private investors because they cannot tolerate that level of illiquidity. But when we speak to some institutional investors, in particular the US endowments and pension funds, they actually want even longer terms to be able to do more creative investing.

But where we are taking beta, for example in our Greater China fund, the terms are very liquid, as we provide monthly liquidity with just 45 days' notice and we can liquidate 80% of the of the underlying investments within the terms. We have nothing in the middle really, but if you want to do niche assets your investors have to accept illiquidity.

Philippe Bonnefoy

Katherine, do you think that illiquid strategies are truly uncorrelated of it just because the pricing methodology is different? Some of the obvious ones, like wine funds, which were high in '07, collapsed in '08, came back quite quickly and now they're negative this year. Infrastructure funds too – because infrastructure is popular but that really depends upon the credit that was available and that could have been available.

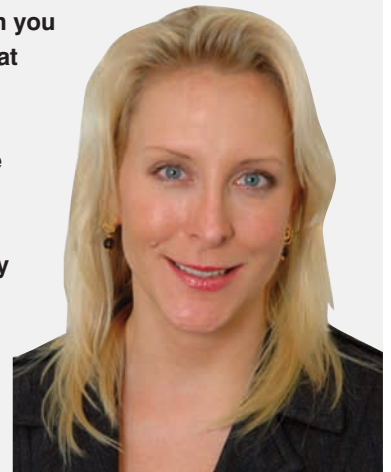
You begin thinking about macro and credit cycles and you wonder – there are clear exceptions such as forestry – if some of these funds are less correlated funds because they are not marked-to-market, if you tied them up for longer term maturities, that is fine. Infrastructure such as buying London City Airport will be a different price now that it was when it was last sold in '07 based on the financing being available for a transaction, so you have got you know whether it is the big credit cycle driving the investment returns of a lot of the stuff that fits into the uncorrelated bucket. Maybe they are quite highly correlated – but they just don't trade often, so they don't appear to be because there is no regular independent and transparent price of the assets.

Katherine Hill: Something that you touched upon that is really important, especially when you are doing due diligence on these kinds of strategies, is how they mark their portfolio. That throws out a lot of funds automatically.

Also, you are right, there were a lot of funds launched prior to '07 and a lot of those have completely disappeared or blown up, because of exactly the reason I stated.

Something that you have to especially pay attention to is how they price it; and that really narrows the managers that you choose in those strategies, so it becomes very small. It depends how often they mark the portfolio, because it is not liquid like equities. Many only have quarterly valuations, so it really depends. How and how often they value the assets in the portfolio is a very important item to pay attention to.

Katherine Hill



Tony Morrongiello: One way of looking at it is that you are getting rid of your beta, but you are taking tail risk. All these niche strategies are about understanding, quantifying and managing tail-risk. Obviously the starting point is proper due diligence but in addition you have to build portfolios with a genuine qualitative diversification of that tail-risk. You can often cumulate all types of tail-risk that on paper look different, but at the core, you are taking the same source of risk. You might be simply dependent on the same source of liquidity, or operating in the same geography.

Tony Morrongiello

When we construct our portfolios of niche strategies, we build a tail-risk matrix and then we actually quantify the risk that we are taking. The only way we can diversify that is by combining strategies that provide real qualitative diversification.

Cédric Kohler

I think you are all wrong. You just want to sleep better by NOT marking to market your portfolio, that's why!

Coming back to Switzerland, the real estate market is something that's been booming quite a bit. I had to make sure I remembered what "agio" meant. In the hedge fund world, we are much more used to the word discount! But if you look at some of these public real estate funds, they trade at significant premiums above their NAVs. For example, the UBS Sima fund (one of the largest Swiss real estate fund) traded at a 24.25% premium to its NAV as of the end of November. IAZI CIFI, a real estate Swiss consultant, publishes indices on the Swiss market which show that Geneva prices for example, grew as fast as US house prices from 2000 until 2007 but have not much corrected since the crisis! So, when people buy these funds, thinking that they will be better off, they are just switching from one risk to another. Once again, what they should really be doing is performing their due diligence to make sure they fully understand the current valuation, what is generating the revenues, are these sustainable, and what is the investor's exit strategy?

The problem is very acute in Switzerland especially for pension funds now which are getting tired of the volatility in other parts of their portfolio (such as equity for example) and getting into real estate funds. But right now, one can ask if all these investors going into such a tiny market is not in itself creating frothy market dynamics.

Benedicte Gravrand

Are you seeing any trends in emerging markets investments? You have already talked about China, but what about other emerging or frontier markets?

Anne-Cathrine Frogg Spadola

Maybe the demand has been stronger for emerging markets. If you measure demand as in what people are asking for and not necessarily where the money is moving to, if we can distinguish it in that way, that is what we have observed.

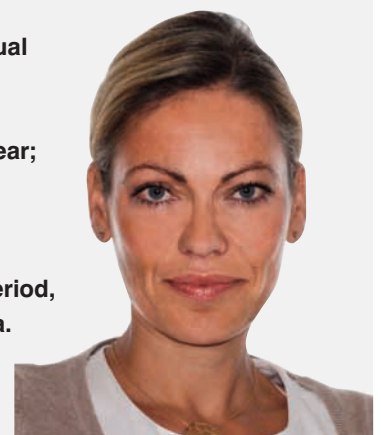
The new project that we have launched (together with Interpeace), is a product that is based on a portfolio we have been running in-house prior to that, which was more a frontiers market portfolio but which was been redirected more to global emerging markets. We have seen some of the challenges, not having the people available locally. As Tony said, you really need to be close to it. In some cases, you have the cultural differences and the language barrier, and you have to be well prepared to invest in some of the frontier markets.

From our perspective there has been demand for emerging markets, but not as much actual dollars have gone there as demand would have indicated.

Although our capital raising has been relatively good considering the challenges of the year; as an investor you know yourself where you would put your money. It is very hard to feel confident to put your money anywhere currently.

The emerging markets fund is the only one that has raised some asset over this recent period, but of course we do have another story to the product that also pushes people to the area.

Anne-Cathrine Frogg Spadola



Tony Morrongiello

Even in emerging markets, you have to at times be prepared to invest against the prevailing trend. Listed Chinese real estate developers, which everybody hates, are now trading at 50% discount to NAV. China is very out of favor; the market is on 8.5 to 9 times earnings. Russia's very cheap as well.

But the problem is that hedge funds do not add value in every single emerging market. For example you will be very hard pressed to find hedge funds that add value in India and in general you will be best served by accessing that beta passively or through long only providers. That's to a large degree true in Russia too.

But hedge funds in our experience add tremendous value in China and to a large degree in Latin America and South Africa, where the local peer groups have done an excellent job. To some degree it is down to underlying markets providing sufficient dispersion of returns to allow alpha to be generated from stock or sector picks. If hedge funds are operating in very concentrated and correlated markets, then you are unlikely to be rewarded for the fees that you are paying your equity long/short managers.

And that is why to a larger degree, we are also seeing in Europe that long/short funds are struggling to add any value, because there is been very little equity disposure, everything is so correlated, so you end up paying fees for, in a lot cases, not very much. You have to drill down into the individual markets and understand if the managers have the raw materials with which to generate alpha. In China, you've got a local market that's worth \$ 4 trillion with 5,000 listed companies, so it is a big universe with which to play.



I don't think the institutional investors are ready for this, but the true model for FoFs includes chasing beta: for example, for FoFs that are thematic, the model is to have the courage to mix long-only with hedge funds. Why am I paying two in twenty to get to India when I can do better with a long-only manager who uses cash or invest passively?

The model of using exclusively hedge funds right across a FoFs portfolio belongs in the past. Why not for example run a global emerging market equity portfolio using a combination of hedge funds, long only funds, direct positions and hedging instruments, in order to achieve the desired risk return profile.

Tony Morrongiello

Anne-Cathrine Frogg Spadola

I could not agree more on that. It is something that we have done in two products actually; on the one hand on the UCITS side, because it is also a universe that is smaller to begin with in hedge funds; and on the other hand we also use both within emerging markets. These managers know liquidity issues, have access and allow you to avoid some of the issues relating to shorting.

It is silly to cut yourself off of whole areas of managers who are really excellent money managers, who give you exactly what you need in the liquid format, without all the complications that a hedge fund can come with, who often have better quality of returns. You might have larger drawdowns but hedge funds give that too. There isn't that much advantage in only sticking to hedge funds.

In the past, we had a team working just on long-only separate from the hedge fund team. For the past couple of years we work closer together because there is not that much difference and it provides interesting cross references. It's a shame not to look at both areas.

Anne-Cathrine Frogg Spadola



Philippe Bonnefoy

On that point, where does ETF investing fit in? If I look at the emerging market index ETF, it has outperformed a lot of long-only and a lot of emerging market long/short managers. When you bring two teams together – presumably the long only selection team is looking at ETFs as well – are you going to get to a level where you end up with a portfolio split between active, passive and hedge fund as well?

**Anne-Cathrine Frogg
Spadola**

Our team is focused on absolute return, so the portfolio management team for the ETFs.

ETFs are something you can't ignore or overlook, somewhat perplexing often, they provide the liquidity, access the data, and it's something we have to deal with. People are in ETFs sometimes rather than hedge funds, especially since 2008. It's something we live with, with the outperformance overtime and not necessarily on shorter time periods.

Tony Morrongiello

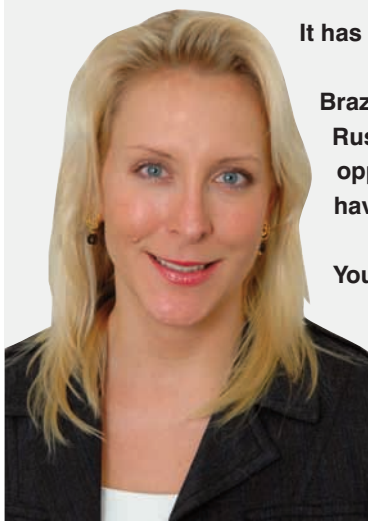
I would love to see the day when an institutional investor will give us a mandate to use whatever instrument we feel fit to use to achieve the desired risk return outcome; long-only, ETFs, futures. I don't think that day is there yet, because they still compartmentalize alternative assets. They are just coming to the point where they would use long/short as an equity substitute. But five years forward, if you package a fund that has a specific mandate, for example, to give you risk adjusted exposure to emerging markets then why not mix hedge funds where they provide value and long-only where they don't.

On the issue of ETFs, it's a mixed bag, because in certain markets ETFs are a real disaster, particularly when you look at China where there are massive benchmarking issues. So what you get when you buy an ETF is not what you want. You buy your HSCI ETF, and you are really not getting the proper representation of the real economy; what you actually have are massive market cap and sector biases. Your typical HSCI ETF has a big bias to the large state owned enterprises in China, big weightings in China Mobile, petro China and offers hardly any exposure to the real domestic consumer. ETFs in this case are definitely not a solution in my opinion.

Katherine Hill

Back to the original question about emerging markets, and as was mentioned before; Asia is definitely a place for growth but frontier markets as well.

But you do have liquidity issues there, and it comes down to the manager. At the end of the day, I don't care about the average return of a China hedge fund; I want to know what the best China hedge fund is, with the best risk management.



It has to come down to the manager.

Brazil performance has come down, they had a 12% interest rate, now they are revising that; Russia has big corruption problems but the stocks are so cheap there, it could be a great opportunity; India has terrible problems, infrastructure problems, and hedge fund managers haven't been doing well there.

You really have to know each market well and have a local manager who speaks the language, an office and representation there. You can't just say "oh, I want to invest in emerging markets," in some generic sense you have to evaluate each one separately and figure out where and how and why it will fit in your portfolio, and why and how you want to do, it if it is only through hedge funds.

Katherine Hill

Benedicte Gravrand

Coming closer to home, I would like to know how you are positioning yourself with regards to the current uncertainties in Europe.

Tony Morrongiello

We are not directly exposed to in European risk assets of any kind. Since inception, we have been very bearish towards developed economies.

Markets are possibly oversold and there is room for a bounce here, but structurally, in the developed economies, we live in a world that will be characterized by long term capital scarcity. I can't see how a short term fix in Europe is going to change this fundamental problem; there is not enough capital to go around to support these economies, the banks have to de-leverage, the governments have to de-leverage, which is very deflationary and does not give a great outlook for the European consumer. The U.S. is in the same position.

Tony Morrongiello



Long-term structurally, we are going through this shift of wealth from West to East and that's where you want to position your capital.

Simon Collard

I agree with Tony, there is a lot of risk in Europe.



Simon Collard: Europe is in very bad shape indeed, but on the corporate level, there are some fantastic companies that are now very good value; companies that might be based in Europe but have a lot of the sales in Asia, in the U.S., in Latin America. You have great balance sheets; you get paid to own them wherever you look in the capital structure, whether you are looking at shares or at bonds.

There is some real value now in some European companies and there are interesting opportunities, but generally overall Europe is risky so I would hedge out the general market and currency risk.

Philippe Bonnefoy

We are going through a period where the governments are trying to get the fiscal house in order, and that generally involves some raising of taxes and higher taxes do not create any jobs.

In the U.S. the last data I saw suggested that to get back to peak-employment level, including the new labor coming into the market, which the current data does not really include properly; you would need to create 400,000 jobs a month. We are way beneath that, and that's 400,000 jobs a month on average over another seven to eight years just to return to the previous peak employment level. We are going to be sub-par growth in the U.S., which is probably better structured than Europe.

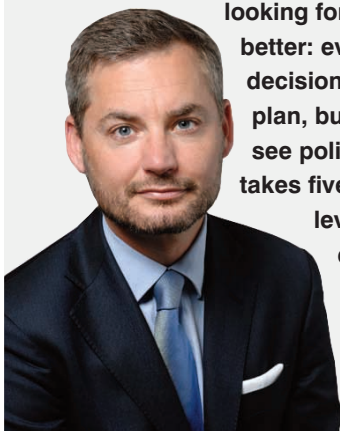
In Europe, if you think the GDP is created from consumption, government spending and capex; all these are diminishing. Also Europe seems to be a place where there is a political view that big government is great, big corporates are great. But the reality is the corporates have been shedding jobs for the last 20 years. SMEs and small businesses, the ones which create jobs, can't get any credit from banks. Banks are being told to withdraw credit and make their capital ratios better. That leaves us in a period of low growth with a lot of structural headwinds. It's great for trading strategies and volatility investing, we can make money from that. It's going to create hard-to-price assets because you are going to have little clarity as to what the correct valuation is.

The inability to price fair value for the Euro against other currencies due to all these political, economic and structural uncertainties creates a number of possible daily trading opportunities for our currency fund.

Philippe Bonnefoy



But the reality is, it's going to be unlike previous economic recoveries, not like the drama of the 1930s, but a period of slow grinding growth. We are going to have to adjust that a little bit. I'm not sure the bond yield is going to be a very attractive return for investors. There is only so much real estate the Swiss funds can own. The challenge to us in the alternative space is to create new strategies and find strategies that are able to monetize this for the next five to ten years.



The problem though in Europe is that the political uncertainty has been and continues to be so big. Investors are tired to hear that the Europeans have agreed to have a plan to make a plan (i.e. marginal solutions). Investors are now looking for big solutions with real decisions and spending. This is where the US has been doing it better: every time they came out with a statement, you knew what the plan was, you knew the decision was final and that the plan would be implemented. You may argue that this was not the right plan, but at least it gave investors a roadmap. This is what has hurt Europe quite a bit. And until we see politicians in Europe being able to provide a clear path towards a resolution, even if that path takes five years or ten years, investors will stay away because either at the macro or at the micro level, there will be too much uncertainty. Politicians and the ECB need to work out a clear plan quickly or else we will continue to have these 5% swings. Markets are quickly pricing in big solutions (up 5%) when in reality what they get are incremental solutions (down 5%). The only certainty we have achieved so far is a VIX at 30%.

Cédric Kohler

Because of these reasons paired with the fact that we have not found that many strong European managers in the current context, we have an overweight towards US managers.

Many investors remain in cash. In the hedge funds space, HFR released a study on the total inflows between 2010 and today. It showed that 75% of the inflows are actually coming from US investors, whereas Europeans only represent 25%. US investors have more faith in hedge funds whereas Europeans are mainly on hold as they see too much risk and are happy with zero return on their cash.

**Cyrus Fazel**

As I mentioned before there is just not much flow. From a flow perspective it has been a very boring year whereas from the performance point of view we could have expected more outflow. The year started with inflows, we had quite a bit of interest in the UCITS fund. But the Japanese earthquake signaled the end of people thinking it might be an okay year. Ever since that event, there has just been very little from a flow perspective.

From 2000 to June 2008, we probably had 40% of our assets coming from Switzerland, with is a significant proportion from Geneva. Today, that's probably less than 10%. And we are seeing no signs of that changing yet.

In our offices based in Geneva, we do have Swiss clients but also clients from all over. As Anne-Cathrine was saying, there does not seem to be much happening either in new allocations or redemptions. But people are collecting research and getting themselves prepared. Once they are comfortable, they will make decisions very quickly. But it is just a matter of gathering research and deciding where they will put their money once they are comfortable.

My impression is that Geneva got hurt much more during the crisis. I think there is more happening in Zurich and London, but very little in Geneva.

Philippe Bonnefoy

Geneva tends to be more of a family office and private banking market, and so it was much more impacted by the withdrawal of capital. And most private clients, of all sizes and shapes, tend to be much more defensive right now and just want to ride through, with more liquidity than they had in the past.

That being said, we also see more intuitive and adventurous investors (those open to uncorrelated new strategies) approaching us. That is interesting too, because we are doing something different.

In Zurich, where the market has always been much more institutionalized, they continue to be active in the market but a little slower in allocations. It is more of “first let’s have a conversation, a second conversation and see you in a couple of months for a third conversation.” There has been a bit more turnover amongst some of the institutional people in Zurich.

I think money is around, but it has to be a bit more convinced that you have something unusual, and then it takes much longer to invest, certainly longer than it was in previous years.

Cyrus Fazel

I agree a hundred percent with both of you.



The 2008 side pockets and the Madoff scandal frightened all the Geneva-based investors, especially private clients and many family offices. As of today, many are still reluctant to invest in hedge funds. They think that buying pure beta is more secure than pursuing Alpha with hedge funds. People still think that hedge funds are not transparent, are black boxes. They will not hesitate to buy banking stock or others, which can lose 40% or more of their value as observed this year, and consider that as a safer play...

Whereas in Zurich, people have a more “institutional mentality”; they are convinced that hedge funds have a great risk reward profile if the investment horizon is respected. Therefore most assets raised in Switzerland tend to be concentrated in Zurich.

Cyrus Fazel

Cédric Kohler

We do not see people going from 5% to 10% in allocation to alternatives. But what we do see from hedge fund investors is that they are clearly looking at re-evaluating their providers. Rightfully so, they want to make sure that they understand the provider’s real added value, that they have the appropriate fees, transparency and structure. This sort of thinking is providing us with some flows.

In general, it is difficult right now for investors to know what to do. But with enough perspective, you realize that things change – I just want to try to end on a positive note.

Actually, I was reading the other day something that really surprised me; it was an article from 1970 by Carol Loomis from Fortune Magazine (“Hard times come to hedge funds”) which was saying that hedge funds were dead and that the SEC was coming in to regulate all of them. But the cherry on the cake was that Warren Buffet was going to close down Berkshire Hathaway as he saw no more opportunities and he was going into municipal bonds! However, only four years later he was also saying that he had never seen so many opportunities in his lifetime!

So look, there will be opportunities again, whether in existing markets or in new markets. What is important is to continue to focus on basic principles, on your core expertise, your real added value, on being passionate about what you do and on the relationship with your clients. The rest will follow.

Cédric Kohler



Katherine Hill

That is why I love this industry: there is always something new around the corner, it is so exciting, I learn something new everyday and meet fascinating people. It is like a Hollywood movie sometimes – rags to riches stories, incredible innovation, billions created, but also there has been tremendous fraud and people who have faked their own death. How can you not love this industry?

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