OPALESQUE



Opalesque Round Table Series '12

NEW YORK 2012

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Editor's Note

Boy, how things have changed!

I have been running Opalesque for almost 10 years now, monitoring the hedge fund industry everyday. One of the major changes within that period is how **hedge fund managers have become public figures. Today, the hedge fund manager shows up in television, in soap operas, in movies; the mainstream press discusses who made how much and which manager is right or wrong about what**, and so on. Read in this new Opalesque Roundtable how New York based hedge fund managers are dealing with this new found fame. For example, do they recommend a Wall Street or hedge fund career to their children?

The Opalesque 2012 New York Roundtable took place on September 19th - sponsored by SunGard, Taussig Capital and Eurex – and featured the following speakers:

1. Amanda Haynes-Dale, Managing Director, Pan Reliance Capital Advisors

2. Brad Bradley, Senior Analyst, SunGard

3. Dan Barnett, CEO, Revere Capital Advisors

4. Joe Taussig, Founder, Taussig Capital

5. Matthew Denning, Sr. Research Analyst, PineBridge Investments (formerly AIG Global Investment Group)

6. Nancy Havens-Hasty, President, Havens Advisors

7. Ron DiRusso, Head of Investment Research, FX Concepts

8. Vassilis Vergotis, Executive Vice President and Head of Eurex Offices Americas

The group's candid discussion covered:

⏭ **Risk:** is this the right time to go illiquid or add leverage, or should you keep your powder dry?

⏭ **Opportunities** in long-short trading strategies, structured credit, merger arbitrage, event driven and how to seize international opportunities in Brazil and Africa

⏭ **New seeding deals and offerings** from PineBridge and Revere Capital:

- What is the right seed deal today? How investors can double returns
- Psychological or behavioral aspects to seeding that are very easy to overlook

⏭ **FATCA:** A train wreck waiting to happen?

- Over 100,000 financial institutions affected
- Tremendous withdrawals out of U.S. securities?
- U.S. tax revenues of $7-10 billion versus compliance which could cost $1 trillion a year?

⏭ How hedge funds deal with **the explosion of legal bills and compliance costs**

⏭ How hedge funds benefit from **changes in the asset allocation models of family offices and institutions**

⏭ Efficient and inefficient ways to create **tail risk products**

⏭ Three reasons **why hedge funds create reinsurance firms**

⏭ How U.S. hedge funds can get exposure to European volatility and implement **new alpha generating strategies**

⏭ **Consultants and hedge funds:**

- Do consultants tend to have a rear view mirror approach?
- The lack of accountability: the shrunken fee differential between consultants and FoFs may affect consultants' further growth

⏭ How U.S. managers can **benefit from the growth of UCITS funds**

Enjoy the read!

Matthias Knab
knab@opalesque.com

Cover photo: New York skyline with illustration of the new One World Trade Center

Participant Profiles



(LEFT TO RIGHT)

Matthias Knab, Matthew Denning, Vassilis Vergotis, Nancy Havens-Hasty, Amanda Haynes-Dale, Joe Taussig, Brad Bradley, Dan Barnett, Ron (Renato) DiRusso

Introduction

Nancy Havens-Hasty
Havens Advisors

My name is Nancy Havens; I started Havens Advisors in 1996. We are an event driven manager and have four funds, two original funds and two levered funds. The latter funds are levered at 1.75 times the original funds. We focus on two strategies: event-driven credit situations and worldwide risk arbitrage. Prior to setting up my own firm, I was at Bear Stearns for 15 years where for about half of that time, I ran the bankruptcy and the junk bond departments, and spent the other half in the risk arbitrage department, where I started and was responsible for the international risk arbitrage effort and was Number 2 in the domestic risk arbitrage effort.

Vassilis Vergotis
Eurex Offices

My name is Vassilis Vergotis, I run the Eurex offices in the US. Eurex is one of the largest derivatives exchanges globally. We are the benchmark destination for investors that want to gain exposure in European sovereign debt or equity/equity index derivatives. Bund, Bobl and Schatz futures and options or EURO STOXX 50® and DAX® futures and options are some of our well established and liquid products.

We have around 420 exchange participants globally representing a wide variety of users both from the buy and sell side with approximately 85 of them located in the U.S.

Matthew Denning
PineBridge Investments

I am Matthew Denning, I work for PineBridge Investments, a $68 billion asset manager which invests globally across multiple asset classes. Our Hedge Fund Solutions group has a track record which dates back to 1988, and we have been providing customized hedge fund solutions since then. Today our hedge fund group runs a multi-billion dollar portfolio, which spans the majority of hedge fund trading strategies and geographies.

I am the global head of equity long-short investing within our team. Normally 30% to 40% of our capital is invested in the equity space, not just in developed markets, but also in various emerging markets like Brazil and South Africa. Our global team is always traveling to these regions, trying to find the best managers out there.

Amanda Haynes-Dale
Pan Reliance Capital Advisors

Amanda Haynes-Dale, I am a Managing Director at Pan Reliance Capital Advisors, which is a boutique fund of hedge funds group. I've had the good fortune of being recognized as one of the 50 Leading Women in Hedge Funds by Hedge Fund Journal and Ernst & Young and I've had the opportunity to share my views on CNBC and other media outlets. Our first FoHF has a 21-year and eight month record. It is one of the oldest FoHF in the space. It has outperformed the S&P 500 since inception with half the volatility of the S&P 500 (with dividends) and with only two down years of any note.

We have four funds, primarily multi-strategy, with low and moderate volatility, with onshore and offshore vehicles. We have recently launched a UCITS umbrella fund of funds for non US clients.

I was originally trained as a money manager at the old Wertheim & Co., which is now part of Morgan Stanley.

Brad Bradley
SunGard

Brad Bradley with SunGard, I run the pre-sales group for the variety of products that SunGard offers to the alternative investment community, serving individual hedge funds, hedge fund administrators, hedge fund of funds and similar businesses. Prior to my career at SunGard I was a Portfolio Manager at a hedge fund involved in both Reg S/Reg D investing and in convertible bond arbitrage.

Dan Barnett
Revere Capital Advisors

I am Dan Barnett. I am the CEO of a company called Revere Capital Advisors. Revere was formed approximately four years ago. We concentrate on a research and advisory business dealing exclusively in the emerging manager space. We are involved in identifying, analyzing and helping to develop emerging managers.

I was the Finance Director of EDF & Man back in the late 70s and early 80s, when it was primarily sugar trading company. At that time we began to get involved in the asset management business, for example launching a systematic CTA called Mint, which in fact was the beginning of Man entering into the world of asset management.

I have also been involved twice in developing single strategy hedge fund managers, once with McKinley Capital and then with Broadmark Asset Management both in the long-short space. That means I have some experience with what it is like to start a company from the ground up. Our main business is to research the top emerging talent, discover the next generation of managers, and to introduce these emerging managers to the interested institutional investors that we advise.

Ron (Renato) DiRusso
FX Concepts

My name is Ron DiRusso, I work at FX Concepts, a hedge fund based here in New York with about $3 billion in assets. The firm was founded by John Taylor in 1981, at that time as a research firm. In the mid-80's the firm began to manage client assets. We focus on foreign exchange currency overlays and active asset management. We have three main funds that we manage. All of them are quantitative, systematic model driven. Two of them are more directional in nature, while the third fund is a volatility arbitrage fund that looks to profit from inefficiencies in foreign exchange options pricing.

My role at FX Concept is two-fold. I am a Portfolio Manager, responsible for some of the main exposures in all of our funds along with John Taylor, and in addition I run our research area which is a group of about eight people focused on building quantitative models.

I joined FX Concepts about four years ago after having worked at other funds since 2001. FX Concepts has a strong infrastructure that is ideal for building highly complex trading models. We have quite an edge relative to our competitors in that regard. Prior to 2001 I managed the FX options business at Goldman Sachs and later at Lehman Brothers.

Joe Taussig
Greenlight Capital Re

I am Joe Taussig. Our company partners with fund managers to create reinsurance companies. The carrot for the fund manager is managing all of the assets of the business. The most visible company we have been involved with is called Greenlight Capital Re where David Einhorn manages a little over $2 billion of assets. It is publicly traded so one can research it on EDGAR if you are interested in learning more.

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Matthias Knab: **Where do you invest now?**

Matthew Denning: It is a challenge for investors to decide where to put their money today. There are always specific opportunities within long-short trading strategies, however in general, things don't look great. Many markets have been trend-less, creating issues for macro funds and various asset classes. Then spikes of volatility have been torturing those same trading strategies. It is very tough to get bullish in general within credit given where we are in the cycle, and the performance of equity long-short hedge funds was very disappointing last year, and investors still lack confidence in that space.

That being said, from a broad perspective, we do see a lot of opportunity in the equity long-short world today. We feel that this year has actually been a pretty conducive environment to investing compared to the last three or four years. The excuses that some of the equity managers have given before – about correlations and low quality company rallies that are hurting them, etc. – are getting old now, and there is actually a pretty good environment today for equity long-short. And our equity bucket is doing well this year.



We are slightly underweight in the developed markets today, as we are waiting for Europe to play out before we really allocate more capital there. Within Asia and the US we are equally weighted. As I mentioned, we are doing a lot of work on the emerging markets side. I have been to Brazil multiple times in the past couple of years and to South Africa, visiting the managers there and understanding how allocating to these regions can really improve the diversification within a customized hedge fund portfolio.

We all know that people out there are questioning the hedge fund of funds' return profile, what type of return should we expect in a zero type LIBOR environment where our short proceeds are not making us any money? Too many hedge FoFs may find themselves taking on too much risk to generate a similar return stream that they had in the mid 2000s; this may prove to be a big mistake. That said, you do need to look for some niche specialized pockets of risk, and that is what we are trying to do at PineBridge.

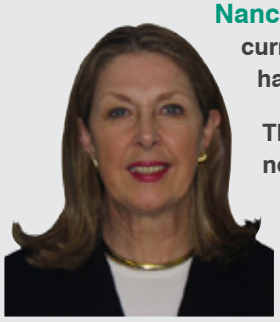


Amanda Haynes-Dale: I echo what you say. I believe funds of hedge funds in particular have to be sold as a solution to get attractive risk adjusted returns. Investors really need to understand the difference between absolute returns and risk adjusted returns. Also, absolute returns don't mean that you are absolutely going to get a return on your portfolio.

I think going forward, hedge funds and funds of hedge funds marketers should ask investors if they want the huge swings in the global equity markets. Many don't, but they can't get much yield from fixed income either. A FoHF with low or moderate volatility could be an attractive alternative for them. However, it is important to explain the risk-reward concept to the investor, because otherwise he is going to ask, "Why should I be in these fee intensive vehicles when all I have to do is buy the S&P 500 index, which is passive and inexpensive?"

Looking at current hedge fund strategies, we like structured credit, because we believe there are significant profit opportunities at the moment. In particular the regional banks are having to de-lever and you can buy a lot of structured credit at attractive prices. The government does not want to have too much TARP for political reasons, and you can also buy some of these loans at very attractive prices.

We also like Nancy's strategy, which is merger arbitrage and event driven investing. Once the fiscal cliff is over and that cloud has been lifted, corporations could get the urge to merge. They have a lot of cash, interest rates are low, and stock prices have recovered from 2008 lows (for stock for stock deals) ; all of this creates a good back drop for strategic alliances.



Nancy Havens-Hasty: **Thank you Amanda, you made the case for me. I actually think that the current environment is very good. We are seeing many deals; they happen to smaller and we happen to be smaller, so it very much plays to our strengths.**

The deals that are being done right now are very good strategic deals. As you know, there are not a lot of private equity transactions, but those that are announced are of very high quality. Equity as a percentage of total capitalization is very high - much higher than what we saw in 2007 when the average equity went down to the low teens, even for technology companies, which to me was a bit extreme. Of course, we have seen this cycle before; in 1987 equity in private equity transactions got down to 5%. Now the number is back to 40%.

We currently have a lot of deals in the $1-$5 billion range. If you are running $20 billion of capital, you'll probably find the current environment a bit more difficult in which to invest. But not for us, we have just under $500 million. We have a lot of opportunities to invest in deals with very large cap buyers including GE and many of pharmaceutical companies. Pharma companies have been purchasing biotech companies because biotech companies have not been able to get financing and many pharmas have expiring patents and are in need of new products.

That means we have a really steady environment of nice, high quality deals. The spreads are not outstanding, on average we see 5-8% spreads. But any deal with hair on it, and actually the slightest bit of hair, will experience enormously increased spreads of 15% or 20%. You must do a lot of work to satisfy yourself that those deals are being unduly harshly punished, but upon completion of the research, you can set up spreads up for very high rates of return.

For example, the acquisition of Dutch company TNT by UPS has a very large spread. People are worried about anti-trust issues and the European economic environment. However, the fact is that UPS has been working on this transaction since before 2004 and they finally got an agreement to do the deal last spring. Their intent is enormously high, and it is going to take a major cataclysm for them to walk away from this deal after working so hard for so many years. UPS also did a very clever job in the way they managed the bidding process avoiding over-paying for TNT. This is a really good example of a high quality transaction that is very likely to be completed.

Ron DiRusso: Quantitative easing by the FED and other central banks recently has injected a huge amount of liquidity into the markets. That liquidity should be good for risk seeking markets, probably at least through the end of 2012.

Where it really gets interesting is if you look beyond 2012, when markets realize that global economies are not responding in a positive manner to the policy moves that have been made. At that point the recent move in risky assets should reverse. In addition, the potential fiscal cliff in the United States and a European recession that will continue to get worse should all combine to make the US Dollar a strong winner in 2013 and maybe beyond that.

There are also headwinds in Asia.The growth story in China is starting to erode, and now it is a question of whether China can withstand a slowing trade account surplus and aging demographics that have stymied growth for its neighbor, Japan, for the last twenty years. The China story feeds into places like Australia and South America, which have been huge beneficiaries of Chinese growth through exports of commodities like copper and iron ore.



So, I see a lot of uncertainty coming out next year, and I see a lot of opportunity in that uncertainty. But, have in mind, the next crisis will not be a repeat of the one we saw five years ago, we don't know yet where the next black swan is.



Matthew Denning: So let's take a step back - there is this issue of liquidity rushing into the markets, yields are at record lows, yet investors need to make a certain return number. We've seen this story before. Yes, today there are certain opportunity sets out there that are attractive even in this low rate environment, but arguably not enough to get to your historic return target. So we question, should we add some more leverage to make some investments look good and hit our targets, and isn't the market forcing us into a little bit more illiquid situations to hit those return goals? Well, that is exactly what happened in the last cycle, and many got burnt in 2008.

If we were really at the beginning of a new economic cycle right now, then we would be fine with a bit more illiquidity and maybe leverage because then the markets would have a certain trajectory ahead of it, we'd have time to monetize those trades. But we are questioning where we are in the cycle or if we are still in a continuation of the risks we mentioned before, a continuation of the 2008 cycle.

This is really a conundrum or an issue for allocators to decide, if they should take some illiquidity risk or what assets to invest in when looking for a smarter way to get those returns.

Ron DiRusso: In fact if you look at the last time a QE took place, I believe oil was $73 per barrel and the S&P was at 1200. This time oil was close to $100 per barrel and S&P was already at 1400. I don't see how QE can be as effective today as it was when QE1 was first launched back in 2008. "That makes the horizon much less predictable than it was in the past. Our trading our models have less conviction about future movements. We have recently exhibited lower volatility in our returns as a result."



Nancy Havens-Hasty: I have been investing for a long time now, over 30 years, and I've found that when the returns are not there, one really shouldn't invest. That is probably one of the best rules we have lived by.

We had a very good 2008 on a relative basis - we lost money, but our two original funds were down less than 5%. At that time, you could see that the risk was getting worse and people were taking on a lot more risk for lower returns. When that happens, I believe we are better off leaving some cash sitting there and waiting for the time when it is a better time to invest.

That is one of the reasons we are not particularly invested right now; in fact we were more heavily invested a year ago than right now. However we are really happy with the positions we have - they are generating good returns, but again, in general, I don't believe that it makes sense to take on more risk in an environment like this. I recommend you keep your powder dry.



Amanda Haynes-Dale: Going back to 2008, particularly European investors were burned by many of their hedge fund investments. They found themselves in many funds that had invested in illiquid securities and were therefore gated on their redemptions. As a consequence, Europeans are now generally resistant to investing in any hedge funds that may have illiquid securities, and that is why many investors have moved towards UCITS funds, which offer weekly liquidity.

We are launching a Luxembourg-based UCITS fund of funds, with both UCITS hedge funds and traditional funds, in response to European investor demand.



Matthew Denning: **We see the same trend on our side, although some are willing to take illiquidity right now and we feel that through our seeding venture we have done this in a creative way. The venture provides a solution to hitting a higher return target, requiring investors to commit their capital for multiple years. However this illiquidity is not the same as investing in a private company in Europe, or a start-up company in Silicon Valley. I think there are some opportunities to take on some illiquidity in a different or smarter manner that doesn't carry the typical illiquidity risk that we normally refer to.**

Vassilis Vergotis: **From an exchange perspective, the European sovereign crisis and the prolonged low interest rate environment has on one hand negatively impacted fixed income trading volumes, but on the other hand created opportunities for the introduction of additional derivatives instruments and the development of new trading strategies.**



Using German government debt to hedge South European or even French bond exposure is not an option anymore. This new reality created the need for more granular country exposure which we saw as an opportunity to introduce an Italian and French government bond futures segment at Eurex Exchange and offer to the investment community the right instruments to implement their hedging, overlay or spreading strategies.

On the equity side we have seen a good uptake on the volatility segment with significant growth ratios (a fivefold increase compared to last year) in the VSTOXX® futures and options segment. A reflection I guess of the fact that volatility is establishing itself as an uncorrelated asset class but as well as an instrument that can provide portfolio protection against adverse/unpredicted market swings that we have in many instances observed during the crisis. The recent regulatory approval that CFTC granted us, allows us now to offer our VSTOXX® futures to U.S. investors, enabling direct exposure into European volatility and the implementation of several additional alpha generating strategies into their portfolio.

Finally, I would like to mention that one should not underestimate the significant impact that the ongoing global regulatory transformation has on investment decisions. There were many cases where the uncertainty created in the marketplace due to either too general guidelines (e.g. the short selling ban in several European countries) or prolonged discussions on critical industry practices with unknown outcome regarding their final rule implementation (e.g. High Frequency Trading regulation) has affected and is affecting investment decisions as well as the operational planning of several firms globally.

Joe Taussig: **I have lived in Europe for ten years and am watching things up close and personal. Amanda, when you were referring to Europe; you really meant the Swiss banks, didn't you?**

Amanda Haynes-Dale: Yes, primarily the Swiss banks.



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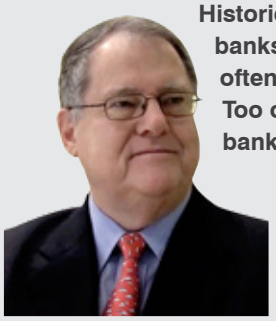
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Joe Taussig: We were involved with the acquisition of a Swiss bank in September of 2008, so I got to watch the impact of the crisis on Swiss banks up close and far too personal. The problem for Swiss banks is that they do not have term contracts with their clients. That is why they all demand monthly liquidity. Unfortunately, there were an awful lot of funds that offered monthly liquidity, even though they could not live up to it in the crisis. So they gated.



Historically, about 20% to 30% of all hedge fund assets have come out of Switzerland. The Swiss banks were the registered owners of the funds and when their clients wanted immediate cash, a bank often had to use its own funds to pay off the clients until the redemptions could reimburse them. Too often, the redemptions never came. Because they do not take deposits to the extent commercial banks do, this was very painful for the Swiss.

UBP was one of the world's largest investors in hedge funds. Today, it is a mere shadow of its former self in terms of hedge fund investing. That is why the Swiss banks have become very cautious and another reason that flows have gone primarily to the largest funds that did not gate.

In addition to this, there are a couple of things on the horizon in Switzerland that will further impact Swiss sources of hedge fund investment. One is called FATCA, which goes into effect at the 1st of next year. It is a train wreck waiting to happen, because there could be tremendous withdrawals out of the U.S. securities. FATCA is already law, so the election won't change anything, as a matter of fact I cannot see how it is going to change.

The second development is that Switzerland will be requiring all managers who want to raise assets in Switzerland to be actually registered in Switzerland as an asset manager. Also this will be having a tremendous impact on the amount of the assets that are available out of Switzerland.

Amanda Haynes-Dale: **Joe would you give us a little bit of color on the FATCA provisions? I understand that it will affect, for example, a Swiss investor who owns securities in the United States?**

Joe Taussig: **Correct, but mind you, this is not just about the Swiss, it's about every non U.S. financial institution. Giving a full explanation on FATCA may be a little above my pay grade, but as I understand it, every financial institution has to do a Sarbanes-Oxley like pledge that everybody in the daisy chain down to the beneficial owner of the securities isn't avoiding any U.S taxes. If you don't sign and get everyone else in the daisy chain to sign, you cannot transact U.S. securities. It is that simple. I believe even currencies are included. The other day I went to a presentation in Switzerland given by a U.S. law firm to the Foreign Bankers Association. 300 people showed up for the event and that is how I understood the ramifications.**



Amanda Haynes-Dale: Yes, there is now a new regulatory regime that is being studied carefully by non US entities that are investing in US securities.

Joe Taussig: I will give you an example. Let us say the Swiss bank has a correspondent in America. That correspondent bank in America has to disclose all of its foreign clients including the Swiss with the IRS. The correspondent is then going to approach the Swiss bank and make it sign something to the effect that all of its clients are U.S. tax compliant and all other entities have signed similar undertakings. The Swiss are going to have to have everybody in the daisy chain sign, all the way out. You can't to otherwise, because the penalties are unbelievably punitive.

My wife is a very senior executive in a major financial institution in Switzerland and her boss and her boss' boss have had knocks on the doors at their hotels at six in the morning in New York to query them. So, all in all, I see a lot of Swiss money potentially leaving the industry, not just for FATCA but also for the registration issue. I don't think foreign managers will put up with having to register in Switzerland. It is hard enough to get them to register in the United States, much less in a foreign country. It will be interesting to see what happens.

Vassilis Vergotis: I agree with Joe, it looks like FATCA will impose several new reporting and registration requirements that will affect a very broad area of the industry. We are in the process of evaluating FATCA both as an exchange (Eurex Exchange) and as a clearing house (Eurex Clearing) and find out what needs to be done to comply with it.



Joe Taussig: The person who presented at this Foreign Bankers Association meeting said the tax revenues for the US from FATCA will be somewhere in the order of $7-10 billion, and compliance could cost $1 trillion a year. There are over 100,000 financial institutions in the world that will be daisy chained in this thing.

Brad Bradley: One of the benefits of doing what I do for a living is that I get to talk to hundreds of fund managers over the course of the year. Those discussions echo this discussion about both liquidity concerns from investors and regulatory concerns.

I wonder if regulatory arbitrage will be the next thing funds do. Will your hedge fund move soon somewhere else? And secondly, instead of just offering different leveraged share classes, will you start offering different liquidity share classes?

In my customer base the liquidity aspect has become much more relevant as managers utilize additional asset classes. For example, convert arb is not just buying the convert and selling the stock against. Now managers use credit derivatives, recovery rate swaps, and other less liquid products to try to find perhaps a more profitable way to engineer a position. Yet investors demand more liquidity. Are different liquidity classes the logical next step?



Ron DiRusso: Our view is that regulations will hurt the industry in the long run. We are still uncertain of how much those regulations will affect us. But certainly once those regulations are in place, like any other company we will look at them and determine how to run our business effectively under those circumstances.



Dan Barnett: **Our firm works with the young or the start-up manager, and I do notice that the young managers are not running off to Singapore. They are still opening up here in New York or in London. Their job is to get their companies up and running and the track record extended. It is probably the larger managers that may reflect about regulatory arbitrage.**

Amanda Haynes-Dale: I remember 20 years ago that emerging managers would be a couple of guys and a phone, and that is how they would start their hedge fund. That has completely changed now and emerging managers cannot start a hedge fund unless they can raise $50-100 million, because of increased regulations and the demands of the consultants. Unfortunately, a lot of the entrepreneurial spirit that emerging managers had 20 years ago has been stymied due to increased regulations and expenses for startups now.

Dan Barnett: **You are right, setting up has become more complicated, but it has always been a challenge. Sure, today you cannot start with $5 million. Since 2008 we have watched seeding go full cycle. Before 2008 it was $100 million or $150 million, and there was the stigma of negative selection. Then after 2008, people thought $40 million or $50 million might work. Today some of the big boys have come back to seeding and it's $100 million or $150 million again. The manager and seeder are conflicted again and the concept of negative selection is alive and well.**



Of course, people still take $40, $50 or $60 million to start and build their track records. They are willing to get advice on regulations and compliance, and they know they are really not going to make any money until they establish that track record and get their feet on the ground.

Despite or maybe because of the uncertainty in the market, I am convinced that hedge funds are actually here to say. Remember the argument we had some years ago if hedge funds were an "asset class" or not? I did not care about the nomenclature, what I really cared about is if we could look like the real estate industry in the 70s and 80s and the institutional investor decides to use more alternatives in his portfolios, then our industry will grow dramatically. So, I am not worried about today's market, markets always go full cycle, but I am interested in a change of the paradigm which is happening now where hedge funds and alternatives, from small and large firms, will always be part of well diversified institutional portfolios.

I also think that regulation is always a bit of a challenge. I will tell you a story about the CFTC when it did not exist. My boss in Britain was against its formation. I told him to "stop fighting against the CFTC, it is going to exist! Embrace it, dance with it, and we will be a better company in the U.S." And of course, nobody could stop the CFTC legislation.



Matthew Denning: **Dan mentioned the cycle of seeding going through smaller and larger allocations. On our side, our first seeding vehicle was $400 million from which we seeded five managers. We earmarked ticket sizes up to $125 million potential per manager. We feel we invested with some good managers, but true, negative selection can occur. We also realized that we passed up on some good opportunities that would have been around the $40-$50 million seed size.**

For some managers, you aim for a, say, 10 times asset growth potential. There are quite a number of strategies where the manager would max out at $400 million or $500 million AUM range, in order to stay small enough to generate the best returns for an investor. So Dan, you are right, we have also seen such a cycle in terms of seed deal sizes, and it will be interesting to see how the next part of the cycle goes. Our next seeding venture will now include these smaller ticket seed deals.



Dan Barnett: **There is a psychological or behavioral aspect to seeding that is very easy to overlook. We were very careful about making sure our managers knew when we would get in and when we would get out, the price was set for our exit dependent only on AUM, not time. We did not really want to hang around a manager when we were contributing less and less and were not welcomed anymore.**

The timing of your exit is of course very difficult, keeping the essence of the bargain even. When the relationship seems one-sided, particularly to the manager, it can be a de-motivator or dis-incentiviser. We have had very good managers in terms of their performance but in a few cases we found ourselves in certain interesting emotional dynamics with the manager. Either they are really struggling, so they are scared and you have to be the big brother to them and put your arm around them, and if they start to take off for the moon, they start thinking they actually never needed you in the first place, no matter if you gave them $25 million or $150 million. These behavioral aspects are sometimes not so easy to identify and manage.

Matthew Denning: I agree with you again Dan, and I think one of the more underappreciated aspects of investing, in general, is the psychological battles investors and allocators each go through. Seeding appears to be fairly easy on the outside, and in reality the skill set you have for traditional LP hedge fund investing is applicable for seeding. But there are many other considerations, and a learning curve you need to climb in order to be successful at seeding. There's more to it then what you initially think, and it is only experience that can help teach you those lessons.

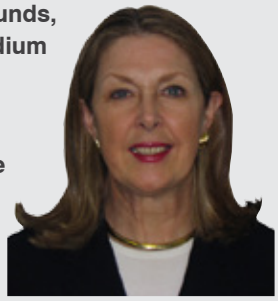
Matthias Knab: **What other trends and developments do you see?**



Amanda Haynes-Dale: **I believe institutions will continue to allocate to the funds of hedge funds investment space, if they don't have a sufficient asset base or expertise to invest directly. Remember that UPIA, the Uniform Prudent Investor Act, requires diversification amongst different asset classes by fiduciaries. As an example, trustees of a small or medium-sized pension fund can invest in a FoHF and get that instant diversification. Another point that has not gone unnoticed by institutional investors is that in the last 2008 crisis year, when the S&P 500 was down 38% and the MSCI World ex-U.S. was down 43%, FoHFs were down roughly half of what these indices lost.**



Dan Barnett: **I believe one of the key reasons for the distorted asset flow we see, with the vast majority going into the mega hedge funds, lies with the consultant community. The consultants have, just as most other investors, a tough time working their way through the emerging and even the evolving manager space. They do not understand it and tend to keep away from it, but to tell the truth that is still better than what they did in the 90s and early 2000s when they criticized hedge funds as unworkable, citing lack of capacity, opaqueness, greed, expense, whatever was negative. Today, the wind has turned and you see how consultants are trying to figure out how to get their piece of the hedge fund business. So, the consultants are starting to screen the hedge funds, which has arguably also become easier now than when I started 30 years ago, for the reason that hedge funds' practices today are much better than they were in the past. Still, the institutional investor is going to follow that consultant, because it conforms to the prudent man rule requirement.**



Nancy Havens-Hasty: **We talked a bit about emerging and evolving managers and the mega funds, but there is a segment kind of in between – funds like us, we are not small but maybe small-medium or large-small, but a lot of people, including consultants and institutions, expect us to have the structures in place that for a mid-sized business like ours are difficult for us to afford.**

Our legal bills and compliance costs have literally exploded in the last couple of years - they are triple what they were just few years ago. This increase in costs is a conundrum for funds of our size with about half a billion dollars. I don't want to even think about how such demands for things like very expensive independent directors or officers' policies affect the bottom line of smaller funds. You cannot load them up with all these expenses and still expect them to perform.



Amanda Haynes-Dale: **I agree with what you are saying. Twenty years ago, it was mostly high net-worth individuals and family offices who were invested in hedge funds and fund of funds. When institutions discovered the attractive non-correlated returns of hedge funds, they turned to the early alternative investments consultants. These consultants institutionalized the due diligence process and ongoing monitoring process of HFs and FoHFs; small and mid-sized firms were forced to beef up their infrastructure in order to compete with the larger firms for consultant-directed dollars; this increased their expenses dramatically. At the same time, many of the consultants tend to have a rear view mirror approach instead of looking through the windshield.**

As an example, in 2008 macro managers were amongst the best performers, and convertible arbitrage managers were amongst the worst. In 2009 many of the consultants recommended macro managers, and as we saw at the end of 2009, the convertible arbitrage managers were amongst the best performers that year, and the macro managers were amongst the worst.



Matthew Denning: **Consultants have forced conventional hedge fund allocators to adapt, but I think we are moving into a period where they will now need to adapt. I feel you may actually see consultants who are going to copy the fund of funds model, quite honestly, in order to continue their success. When consultants started to thrive a few years back, a pension fund could save a lot of money, maybe 80 bps and potential performance fee payments, utilizing a consultant vs. a typical Hedge FoF. Consultants started to pick off a lot of money, but Hedge FoFs have reacted. An 80 bps spread has now been cut to 10 or 15 bps today, as big hedge fund of funds players have significantly reduced fees for their flagship portfolio products.**

And when you look at what the consultants are producing and what some of these institutionalized FoFs are producing, I think you more than happily pay 15 basis points more to get what the FoF is providing. Consultants need to be willing to provide more hand holding, take on more accountability, and really do what FoFs are doing, because the fees right now are -- I mean they are getting to that point where again, I think for 10 or 15 basis points, you would rather go with the higher level of service a FoF is giving.

Again, this is not to trash consultants, they are providing a service, their service is to facilitate information flow, and for some investors that is all they need. We are clearly seeing some of the limitations of consultants though, broadly speaking. Also, If you have a blow up or recommend a fund that does not do well, that ruins a nice money generating business. So the consultants do have to stay a little bit safer, and I think a lot of it can be explained by accountability, and hedge FoFs are willing to take on that accountability, whether it is asset class allocation, or simply responsible for normal portfolio construction. Whether it is again being willing to go into the niche areas and geographies and investing the time and taking on that responsibility and saying, we did the work, if this does not work out, okay blame us for it, but I think accountability is a good word to describe most of it. And I think consultants will have to start down the path and take more accountability, as the fee differential between them and FoFs is probably not going to justify heady growth on the consultant side, from here going forward.

Dan Barnett: I have a question for the fund of funds here. When you create your product, are you driven by your own judgment when selecting managers and opportunities you invest in, or is it driven by what you think your investors want? I believe you have the same question with the consultants. Here, I believe if you have to wait for the consultants to drive anything or take any direction, you could wait for a long time. But if the investor's needs start to drive his consultants, that is another story.

Matthew Denning: Our firm has been in this business since 1988. I would say that up until about ten years ago, you had mostly the "one size fits all" hedge fund of funds, but since then people really started to do more customized accounts. So, this can happen in many different ways. For example, a client may give you a core portfolio and ask you to build certain satellites around it. Some of them will also tell you what they want as complements, so in those cases you could say the client takes on the accountability, although we're clearly responsible for the manager selection. Another example would be a mandate we won where the client was concerned about inflation. They came in with a specific desire and request, asking us how to structure that portfolio, so we tried to help them understand how certain exposures would perform during different market environments, and how to creatively structure the geographical allocations within this portfolio. In this case I feel we are adding value and are willing to take on that accountability, not just with manager selection.



Joe Taussig: We have some background in this. Almost 40 years ago, we had a little division that we decided to spin off. It was called Callan Associates and is one of the five largest consulting firms today. Back then, I was the project manager for the spin off. Callan's number two and number three guys were John Casey and Ed Barksdale, who went on to create another one of the major consultants, which became Rogers Casey and Barksdale and the iteration today is called Casey Quirk. I am not sure if I agree with you on the fees, because their model then, and I think it still is, is that they are largely paid in soft dollars.

I cannot get mandates for our services for soft dollars, because they are not classified as "research". But investors can use the transactions with Wall Street that are generated by their portfolios to pay for these consultancy services in the name of "research".

We also saw a couple of consultants migrating into the fund of funds business. Ed Barksdale spun off from Casey and Rogers to create RCB Trust and later sold it to Northern Trust. After doing his stint at Northern Trust, he has returned to the fund of funds business as Federal Street Partners. I think Bill Crerend did a similar thing when he formed Evaluation Associates. I believe the model has really bifurcated the business in the sense that consultants and fund of funds are not very compatible. You almost have to be one or the other but not both. I could be wrong on Evaluation, but I know for a fact and Rogers and Casey remained consultants and Ed became an asset manager.

I am not sure which way the industry is heading. At one time, you saw a lot of people coming into the fund of funds space. I am not sure all were capable of doing the job, because a viable fund of hedge funds is about a lot more than just picking managers. Raising assets, getting people to trust you with your money, and paying hard dollars for research is not as easy as the consulting business. Many talented people are called, few are chosen.

Matthew Denning: I agree, it is not easy. I just would argue that at a 15 basis point fee differential which is your fee now for say a $500 million plain vanilla diversified fund of fund, that fee differential is very slim and in fact a lot slimmer than it was a year ago. And I think the consultant world would have to adapt.

Joe Taussig: That's part of my point here. The difference is substantially greater than 15.

Brad Bradley: I do not think it is all soft dollars and certainly I do not have the statistics to back it up. I know that you are allowed to pay for research services with soft dollars.



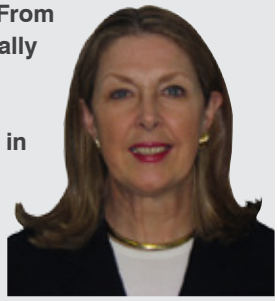
One of the things I wonder about is how much of the individual asset manager's time is spent being a businessman instead of being an asset manager? During the eleven years I have been working on the vendor side, I have seen how the life of a hedge fund manager has changed. When I was a portfolio manager, I would meet with investors three or four times a year, to go over the books and show them how things were going. But now investor communications seems to have become a constant job, not only for the compliance and IR staff, but the portfolio managers as well. It almost seems as if the portfolio managers have to run two infrastructures now, the first for public consumption, and then a second structure to run money. To put it a bit more bluntly, how much of your time is spent generating information for investors that you might not use, versus actually managing the portfolio?



Ron DiRusso: Actually, I see the interaction between us as managers and investors as a way to really listen to our clients. I have been on the hedge fund side for about eleven years, and throughout this time, even as a young portfolio manager when I was just starting to get involved, I loved listening to clients, because it helps you to better manage and build your portfolios in what you are trying to achieve with them. Is it down side protection or a return target? Part of our role is to understand our client's objectives.

Brad Bradley: Isn't then the portfolio management team led by the investor? And how are you handling the demands for your time while you are in the middle of structuring your deals or positions?

Ron DiRusso: I understand your point about being a deal structurer and of course, the portfolio manager's challenge to balance his time remains. Managing client's portfolios the way that we do enables us to systematize a proportion of the management along central model guidelines, and we can include individual client specific requirements in each portfolio. Therefore, it is really relevant how well organized and efficient your teams and your procedures are. I do believe it is very important to listen to clients, but there are portfolio managers that do not operate that way.



Nancy Havens-Hasty: **Apart from more time, more money is flowing to running the business. From the very beginning, when we launched the firm, we had systems in place worked perfectly. Actually we had no errors ever. I had run the junk bond department at Bear Stearns which was basically like having my own business. There, I had the reputation of being the fussiest person about our internal controls and internal accounting, which is really important in junk bonds and especially in distressed because interest payments are not always completely clear, so you have to be really careful.**

We had to completely revamp our system that worked wonderfully for 16 years to appeal to large institutional investors. Our system was viewed to be vulnerable to interaction with our traders. Now, in my lifetime, I have had many, many people working for me. I truly believe you can tell the honest ones from the dishonest ones within a month after you have hired them. And what makes such systems work has more to do with the people than how bulletproof they system is. As we have seen with all the investment bank trading scandals all over the world, one person can always find a way to fool the system. Nevertheless, we still spent several hundred thousand dollars to revamp our trading system so that we could appeal to institutional investors.

Let me reflect for a moment on the bigger picture and why all these things are happening. As a matter of fact, these changes occurred after 2008. And they have really nothing to do with us or any hedge fund like us who did business like us. Rather, as Amanda said before, given that everybody got so burned in 2008 especially for those who had invested with Madoff that these investors have now tried to put structures in place that will prevent this kind of thing from happening. Regarding Madoff and the issues with the gating of funds, which often resulted from a mismatch of liabilities and asserts on the side of managers, I still believe that if anybody had really done true due diligence, they would have avoided these problems, but unfortunately an awful lot of people did not.

For us, this is an unfortunate path the industry has taken. It is expensive and somewhat frustrating to spend money on structure instead of spending money to hire more analysts or portfolio managers.

Talking about hires, I have to admit that sometimes you get a positive surprise from hiring more "institutionally-friendly" personnel. We hired a superior CFO and a spectacular trader as a result of our new requirements. The trader was more expensive than our previous trader, but in the end, you need to do the things that are required by your business. I just cannot say enough about these two hires are and how much they have helped our operations. Of course, part of the reason why we hired them was because they had experience with the systems that the institutions are now demanding.

Matthias Knab: **Brad, you as a former portfolio manager and now working for SunGard in the service provider field, you have a unique perspective. How else has technology changed the hedge fund industry?**

Brad Bradley: First of all, I would like to think that any time we sell a piece of software, the firm is using it aggressively for the purpose intended and they are deriving a ton of value from it. I would guess there are times when investments in systems and technology may be done initially just to check the box on an investor DDQ. This is of course disappointing at times, but such things happen.



From a risk management perspective, the post Madoff era institutional level controls the markets have implemented were long over due. I remember when I started selling software in 2001, Enron was the big issue then, blowing up an enormous amount of money. Later Bernie blows up an enormous amount of money, and five years from now someone else is going to blow up for an enormous amount of money, and for sure there will be people who miss it because they are not doing their jobs, to echo Nancy's point.

These reactions come in cycles of blow ups and answers from institutional risk management. I believe we are moving away from a check the boxes' approach to a scenario-based methods,

including the analysis of how much leverage people actually employ. That is particularly important when it comes to derivatives, where for example some small derivatives position that appears to be close to zero percent of assets may actually carry several hundred million dollars in notional contract size, with a potential to blow things up at any time.

Obviously, there is a substantial requirement to be able to handle these asset classes and the risk management around them. I just wonder how much of a fund manager's efforts and resources are used for such purposes, and how much may rather be seen as sort of burning your fees that could be used to hire another analyst that might find you a deal. This dilemma appears to be a a great source of frustration from the vast majority of my customers and prospects.

I remember when I ran my small $50 million hedge fund in 1995 or 1996, our annual software budget was about $15,000, whereas now I would imagine that a typical start-up that you may be seeding with $100 million may run a software budget that is probably closer to $200,000 or $300,000 a year. Boy, how things have changed!

Dan Barnett: The demands for more technology and systems have of course increased the barriers of entry for new managers. As we know, in today's world a fund manager must be able to offer managed accounts as well as fund structures and what we did to enable the emerging managers to meet that criteria is to take a stake in a company called SRL, a technology provider. Together with them, we can figure out what the manager needs and give it to them. This is just another aspect of the new business paradigm where your success as a manager not only comes down to your investment skills, but also to the right operations, structures and technology.

Brad Bradley: That is correct, without a structure you cannot even think about offering your investment skills.

Ron DiRusso: Brad is right, the software budgets today versus just a couple of years ago are enormous, for emerging and the large, established managers. FX Concepts has worked with managed accounts for a long time, and looking back it took years of proprietary work and vast amounts of money to put together and bring the infrastructure to deal with many accounts to the point we are now. Our systems can hold any number of clients and automatically generate pro-rata allocations every time we do a trade. We are constantly adapting our infrastructure to evolve with constantly changing requirements. While I would like to say we have come a long way, it always feels like a work in progress.

Matthias Knab: Let's move from technology to New York as a hedge fund center. How do you like being here, what's new about working here as a hedge fund manager?



Nancy Havens-Hasty: As a hedge fund manager I cannot imagine wanting to be anywhere else. We are sitting within 10 blocks of virtually any conference we want to attend. Any corporate CEO who is on the road will come through New York City, and even though we are not a huge hedge fund, we frequently get visits from CEOs and CFOs, New York is just a very easy place for us to do business.

Amanda Haynes-Dale: Also, we are well-situated in the Tri-State area and can glean from that pool of talent in New Jersey and Connecticut, as well as New York.

Matthias Knab: **Today Forbes published its new Forbes 400 list of the richest people in the U.S., and in their announcements they made a huge point of the fact that 31 of the Forbes 400 are hedge fund managers. That is 8% of the total, a record percentage when you compare it with all the previous years.**

Now, I have been doing this Opalesque publication for almost 10 years now, monitoring this industry on any day, and one of the things that's changed too is how hedge fund managers have become public figures. Today the hedge fund manager shows up in TV, in soap operas, in movies, the mainstream press discusses who made how much and which manager is right or wrong about what, and so on. Being a public person now, speaking metaphorically, how has that changed your life?



Joe Taussig: I want to add some thoughts about the Forbes "rich list". We once made a calculation where we looked at the 100 largest hedge fund managers that had been around for more than ten years. We then calculated what their fees were and particularly their deferrals. The deferrals were one of the great secrets of the hedge fund industry. A million dollar investor who is offshore used to be worth two to 16 times more in future after-tax fee income than the onshore investor when you impute how staff were paid with onshore fees and consider deferrals. Someone like Soros virtually never paid taxes, he just accumulated everything pretax, and continued to compound pre-tax.

The TARP legislation eliminated the practice beyond 2008. All deferrals have to be repatriated by 2017, but many repatriated funds in 2010 in fear that the Bush tax cuts would expire (better to pay taxes in 2011 at a lower rate than later at an uncertain higher rate in the future). A number of other managers are repatriating deferrals this year in anticipation of uncertain but higher rates after 2012.

Based on the calculations that we made, we estimated that over a 100 hedge fund managers should have been on the list at the time and I think they were only 12. I do not know what the number should be now, but likely greater.

In addition, we gave the managers zero credit for the value of their hedge fund business. If you look at people like Buffett or Gates, they get credit for the value of their business. The irony is that the hedge fund managers on the list get zero credit for the value of their businesses. It is strictly based on past earnings, and future earnings are not accounted for in any way.

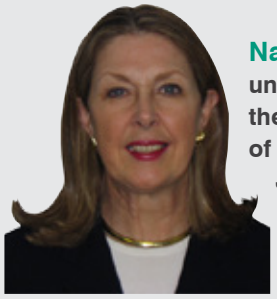
Dan Barnett: To Matthias' point about a hedge fund manager having become a public figure, one of the risks for a young manager now is that he's actually getting blinded by the light at some point. We always try to understand a young manager's motivation, why does he want to be in such a difficult business? What is he doing this for, because it is very hard work? If someone tells you honestly because he wants to go from a Volvo to a Jaguar, he may not be somebody we want to help build a company.



Ron DiRusso: Ten years ago I would go to a party and say "I am a hedge fund guy", but nowadays people like me may just say they "well, I work in finance" or a similar kind of statement. The image and perception of hedge fund managers has changed, particularly since the crisis in 2008. However, our role is still to return positive numbers for our clients, that is still the bottom line.



Amanda Haynes-Dale: If you go back to the 80s, there were really only three major hedge fund managers, George Soros, Julian Robertson and Mike Steinhardt, who were getting all the attention. However, they did not have Occupy Wall Street picketing outside of their homes and didn't have to hire bodyguards for their children. Over the years, many famous hedge fund managers have been on the Forbes 400 list, it just seems that there are more of them on it now. What has changed is that being a successful hedge fund manager now comes with more criticism than decades ago.



Nancy Havens-Hasty: I always struggle with the assumption that all hedge fund managers are unbelievably rich and have billions of dollars. When you run a smaller hedge fund, that is just not the case. For example, while most people in our industry are engaged with charities, and some of the larger managers in a really impressive way, not all of us are John Paulson or Paul Tudor Jones.

This is not something I am pleased about, and similar to Ron, when I register at a doctor's office, I no longer write down hedge fund manager but investment manager.

Brad Bradley: One of my best childhood friends who is 41 years old like myself ran a foreign exchange option book on the buy side. He got to the point where he was unable to sleep more than an hour-and-a-half at a time at night from constantly being pinged. Finally, he said "never again, I won't even talk about FX", and he is now completely divorced from the financial markets and never wants to have anything to do with them ever again.



He was very good at what he did, and one thing he was excited about is that at 41 he now has the chance to reinvent himself - he is a clever guy and I do not have any concerns for his well being. I actually think he is going to be much happier. He has a little freedom now to go and find something else he'll love to do and make a comfortable living.



Ron DiRusso: Well there are parts of this business that wear you down. But what I personally always found gratifying in this business was not knowing what exactly was going to happen next. Having a game plan in place for the uncertainty of tomorrow is always a challenge but an exciting one.

I love the research side of my job and finding new ideas, and I also enjoy the fast environment that the global markets possess. Having to deal with new regulations creates more challenges going forward. We have to find the opportunities in these challenges, and not look at them solely as obstacles.



Dan Barnett: **I believe a lot of reputational damage that is being done goes unchallenged because of the private nature of hedge funds. We do not have the kind of PR that other financial institutions or successful industries have. More need to be done to correct our image. There is really nobody who stands up and corrects what have become gross accepted errors like all hedge funds are "high risk". I don't think that even the more visible people in this industry would like to stand up and engage with the public or the media, due to the private corporate structures.**

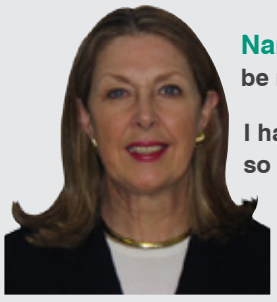
Matthew Denning: **I was wondering in what environment hedge funds would ever get positive press? In what environment? If the market screams higher, hedge funds are lagging; of course they are lagging, any sophisticated investor knows they should, but we still get bad press. If the market is down 40%, like in 2008, and they are only down 15% - weren't they supposed to make money in every environment? Bad press again. In years of mediocre returns, even if they outperform the long-only benchmark on lower net exposures, then the media focuses on the fees hedge funds are generating, so we get bad press. So really, in what environment will a journalist write something positive about hedge funds?**



Look, there are 8,000 hedge funds out there, and many bad apples, so there's always going to be that handful of duds the media can focus on. And I always cringe a bit when I read about these new high-profile hedge fund launches, because they will have an almost similar failure rate as the hedge fund world in general, so again, there is plenty for the media to focus on the negative side. But I get worked up when the whole industry is painted with a negative brush, and hedge fund managers portrayed as overpaid rich folks who don't know how to invest.

As far as I'm concerned, we can have a very valid argument as to why hedge fund fees need to come down, and I want them to come down. But you can have an overpaid manager hitting their net performance objectives, having returns in line with your investor expectations. Just like you can have a great iPhone, that is a technological dream, but it could still be overpriced. Please, when a hedge fund is hitting their performance objectives, report that in the papers that they are performing well, but separately they are overpaid. It should not be a journalistic sin to write that the hedge fund industry is achieving its performance goals.

Now in some years, like 2011, the press should be writing about how disappointing hedge fund returns were, especially in the equity long-short space for that year. But it is not like that every year. I sometimes am in awe that I am actually defending overpaid hedge fund managers in certain aspects of investing, but the press in general can be so frustrating, that I feel I have to. There are actually some really good features about hedge funds though, and, shocker, about some innovative and ethical things going on there. However, just don't try looking in the mainstream newspapers to learn about it.



Nancy Havens-Hasty: **The one piece of good news is that with the JOBS act there will hopefully be more options for us.**

I have to say I still get a charge out of coming to work every day. I love being a fund manager, so when it comes to my space – both in the credit–event and merger arbitrage spaces – I am a really happy camper. I love what I do. I love making money and even from losses I always learn something.

As Ron said, the markets constantly change. For example, we are currently investing in deals

involving African assets being purchased by Chinese buyers for the first time in my investing career. This involves not only understanding the assets, but also learning all about African regulations, but I really like doing these things.

The key thing that I would love to change is to spend my entire day doing nothing but trading and investing and research - the things I really enjoy. I would love to spend less time on regulatory and marketing issues. What's interesting is that the pressure for infrastructure changes are coming from institutional investors, not individual investors, many of whom have been with us since inception 17 years ago and know us well. Generally, our investors are very happy with the relatively low beta returns we have been able to provide them with in many different market environments.

Matthias Knab: **Ron, a lot of investors are concerned about their tail risk. Tell us more about what you see from your perspective?**

Ron DiRusso: **As all investors will know by now, the markets do not move the way they used to and the world has become a very unbalanced and unstable place, so in general there is huge scope for the work that we as hedge fund managers do to protect against tail exposures.**



As an options trader, I have always endeavored to create portfolios that have positive convexity. A number of our clients, among them some fund of funds and some insurance companies, have inquired over the last few years about how to add tail risk to their portfolios. Of course, there are different ways to create a tail risk solution. There are some inefficient ways to do it, and I believe that unfortunately a lot of people have focused on those since 2008, but there also are more efficient ways to do it. For example, we have strategies that can make money in low volatility environments, and are still able to provide the upside that one looks for in a tail product when markets move down in a big way.

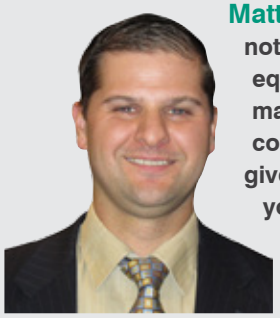
To develop that was a both a great challenge and a fun thing to do. We are actually at the point of implementing the strategy for a couple of clients and are using it in one of our portfolios right now. It is an extremely interesting product, in my view. We also developed some other very unique, custom products. We built a G3 de-basement product based on the premise that emerging markets have outperformed developed markets over the last several years and they will continue to outperform. Most of these products come from ideas we get from speaking to clients. Clients drive much of our research and product development.

Brad Bradley: SunGard serves the traditional asset management community, and the trend is towards beta eventually being free. So my core asset management customers are trying to figure out how they will be able to maintain their 75 bps to 100 basis point fees. Ron, your firm also provides currency overlays which some of the international, more traditional asset managers may now also want to offer on top of their traditional funds, trying to add 50 bps on top of their returns. Is anyone seeing competition from the vanilla asset management community trying to offer some blend of alpha on top of their beta?

Ron DiRusso: We certainly do a lot of work in currency overlay, this is an area where we have traditionally been strong. Typically the fee structure for these tends to reflect the amount of alpha the manager is providing. We have not seen as much competition from traditional managers in this area. Their typical pitch is to sell an alpha product to a beta investor. I guess we have been more successful in coming up with solutions based on a client's needs, rather than purely on our performance in our alpha product. The fees simply end up being a factor of the risk we are taking relative to the clients' benchmark. Clients don't want to overpay for alpha they are not looking for. We try to keep this in mind when coming up with a solution.

Matthias Knab: Is anyone else working on new products or services? Any other trend you see you want to comment on?

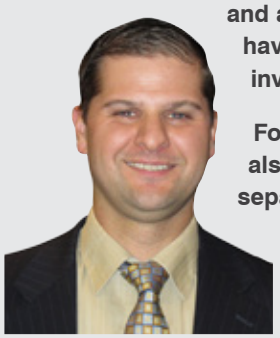
Dan Barnett: Given what we do, we are not involved with too many new products; we try to identify good emerging managers and try to develop them as quickly as we can. However, given the fact that over the last three-and-a-half to four years we may have seen nearly 1,800 emerging managers or traders, it might be fun to develop a diversified product of 60 or 70 of the managers we have selected. This will for sure look like a fund of funds or beyond that, like an emerging manager index that could also serve as a benchmark for people looking at this space. I believe my research people don't like to call it an index, but it would be interesting.



Matthew Denning: A trend we have seen on the asset allocation side is that our investors are not viewing hedge funds as an allocation or a separate pocket, per se, but instead they put equity long-short into their equity basket with long-only equity managers. Multi-strategy event managers are falling within their fixed income bucket. We have had a couple of pension funds come to us and say, "I want it broken out this new way now, can we re-create our hedge portfolios given this...?" So within that conversation, we discuss things like beta and the differential versus your traditional long-only managers, return expectations for the entire basket. It is a different conversation that is occurring and there is an evolution and I think to our earlier discussion, about a tailwind for asset flows into the hedge fund side, there will be incremental money flows into the hedge fund industry due to this.

Amanda Haynes-Dale: We have also noticed that a number of Family Offices have approached us about how their asset allocation models have changed. In the past asset allocators used a sequential investment model: US stocks, international stocks, US bonds, international bonds, and alternative investments, which included hedge funds and hedge fund of funds. Now, the asset allocators are frequently using the side by side investment model, in which, for example, a long/short US equity hedge fund is included in the US equity pie slice.





Matthew Denning: This is an extremely interesting development that has a lot of ramifications and also affects the return characteristics people are expecting from hedge funds. Investors have started to view hedge fund returns in the context of a basket. This should help long-only investments also.

For example, if you were to view an allocation to a long-only commodity index on its own, and also a basket of macro hedge fund managers on its own, both of those individually may, at separate points in time, have a volatility shock that scares an investor, and makes them redeem out that portion of their portfolio. But when you combine the two and smooth out returns, you can handle that diminished overall volatility, and stay invested in both areas. So I think this new development of simply classifying and bucketing your hedge fund exposure is actually a meaningful thing.



Joe Taussig: **Our new product really excites me. Just to put it in perspective, there are at least 14 managers we know of that have come into the business of running their reinsurance company, each with at least quarter of a billion dollars. This is serious endeavor on their part. Just this year two new ones were set up with nearly $1.5 billion startup capital.**

There are three reasons that these managers create these reinsurers:

(1) There is a virtual certainty that the reinsurers will outperform their funds;

(2) The reinsurers are very effective asset gathering machines; and

(3) All of the assets are permanent capital.

The hurdles to get into reinsurance were very high. The two recent players needed 18 months and two years respectively to get going. To address this issue, we have created and gotten regulatory approval for a platform where managers can get up and running in 60 days. We will be running the company as the master reinsurer that reallocates the reinsurance to satellite reinsurers proportionate to their capital. Each manager can join by redeploying as little as $1 million of assets (which minimum statutory capital). If they grow large enough, they can go to the capital markets like Greenlight Re did. It is a great opportunity for a manager interested in significantly increasing AuM and securing permanent capital.

Matthew's people have looked at one company we set up, although he did not know it was one of ours. Yet, he and his team know the work we have put into this, and hopefully a number of other managers will be willing to participate in these opportunities. We believe we can set up two managers a month.

I am saying this with a straight face: if you think your fund can return 5% per year over any five year rolling period of time, you are virtually certain to outperform your funds, generate a lot of new AuM, and secure permanent capital.



Vassilis Vergotis: **On our side, we are excited to be able now to offer our European volatility – VSTOXX® futures in the U.S. Many hedge funds and CTAs, most of them New York based actually, have been bringing up the topic of gaining exposure into European volatility. So we are happy that we can now offer it and open up the possibility of a whole range of investment strategies to them.**

The strong presence of ETNs into the VIX market for example and the effect on the price steepness of the front to back month maturities due to the roll activity around expiry is missing in the VSTOXX® markets since the European ETN activity is still in its infancy. Any spreading strategy developed around this fundamental difference of market structure between the U.S. and European volatility could result in alpha generation for portfolios. Other applications could include market making, exploiting differences in the pricing mechanisms for both futures contracts (i.e. VIX versus VSTOXX®) or as Ron mentioned certain tail risk strategies.

Matthew Denning: **We continue to work on our seeding ventures, which again for us is an example of taking a little bit of illiquidity for the end investor, albeit not as bad as traditional private equity, in order to target a doubling of the return profile of the traditional hedge fund offering. So, if you are looking at a 7-8% return profile from a traditional diversified hedge fund investment, we think we can get an additional 3-5% from this revenue pot via the seeding arrangements. This will be a perpetual revenue stream, even after you have redeemed the seed capital. Hopefully we monetize that perpetual stream down the road, and it could add a 1-2% kicker to the return profile, so that is something that is interesting.**



We are also doing a lot more work on the emerging markets side. This is an interesting conversation, because you really have to factor in the amount of capital you are able to put to work there. Larger allocators can have their hands tied by their capital base, as they simply cannot put enough money to work in some of these geographies and expect

a meaningful effect on their overall portfolio. Some larger players may say it does not make sense, or that they can't do it effectively. This is one great example where being a medium-sized allocator is a huge benefit for us, as we are able to allocate capital efficiently in these markets, and see a marked difference in our portfolio return profile, in a way that does not significantly add to volatility.

This is certainly an area where solution providers like PineBridge can really add value through a sophisticated approach to include both emerging managers and lower capacity strategies and geographies.

Amanda Haynes-Dale: I believe that going forward we will see more UCITS funds of funds with weekly liquidity for non US persons and we will also see more 1940 Act funds of funds offering the same liquidity for US persons. There seems to be a big demand for this type of liquidity from US and non US investors and they seem to be willing to sacrifice higher performance for this liquidity. As I mentioned earlier, we are launching a UCITS fund of funds, and this launch is completely client driven by our European investors.

Matthew Denning: There is certainly a number of underlying hedge fund strategies that will not into an offering with weekly liquidity, probably the provider needs to alter the set of managers he can put within that product.

As long as the end investors understand what they are getting, it can be a very successful product. The fear I have is that there could be some fund promoters that just want to raise money and who may not go thoughtfully about it.

Amanda Haynes-Dale: Some of the restrictions imposed by UCITS funds address this issue. For example, certain credit strategies, which have a higher probability of illiquidity in a crisis, cannot be used in a UCITS format.



Joe Taussig: In the 70s I worked for a while for a marketmaking firm. We always used to talk about the liquidity premium. When I look at the markets today, the current liquidity premium is huge, like 300 to 400 basis points, as people give up superior returns for a liquidity rights. I have been absolutely and consistently wrong about UCITS. When I first saw the product at the time it came out, I said this thing is not going to fly because the frictional costs and all those liquidity demands and investment restrictions layered on top will destroy returns. I have been wrong because the current market is willing to pay the price for liquidity and accept the significant levels of underperformance.

Brad Bradley: You have to look at the entire market, at the competition, so to speak. Where else can an investor make money these days? To put it bluntly, returns everywhere are not great, and when returns everywhere are not great, liquidity becomes the next thing that is important. Maybe one day soon we will transit back into a real risk-on world across the board, and risk free rates will ease back up to 4%, 5%, 6%, and this dynamic about the liquidity premium will change in the face of competition from other asset classes.





Amanda Haynes-Dale: You have to keep in mind that a lot of UCITS funds of funds are being marketed and sold as bond substitutes. The question for the investor is the following: Would you rather get 6-9% as a cumulative total return at the end of three years in investment grade corporate bonds, or would you rather get 12-15% in a low/moderate volatility UCITS fund of funds? It appears more investors are interested in buying UCITS funds of funds with weekly liquidity than low yielding bonds, which could drop in price when interest rates eventually rise.

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