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Opalesque Round Table Series '12

NORDIC

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Editor's Note

Diversification by just having a passive allocation across asset classes is becoming less and less useful

During the recent ten years we have seen a steady increase in correlation between basically all markets. You will find a very good illustration for the decreasing diversification by just looking at the **daily moves of the S&P 500 index stocks from 1996 to 2008**. During all those years, there were only 12 trading days when more than 490 of the S&P 500 stocks moved in the same direction on a given trading day. In 2011, there were 15 such days with nearly even up/down ratio – and that's in just one year.

Since August 2009 we have had 17 negative months on the MSCI World Index, and out of 17 months, the broad HFRI Index simultaneously declined 14 times. That is **a 80% down capture by the hedge funds**. The beta is like 0.23 and the r2 is 76%, so it is very obvious there is too much correlation between hedge funds in general and the equity markets.

Many of the more well-known correlations in the market have totally shifted and actually very much resemble the **situation we had in 1929**. Also, given the global macro environment, investors can't really rely on a market beta going forward. Seeking diversification by just having a passive allocation across asset classes is therefore becoming less and less useful.

This new Opalesque Roundtable offers relevant insights **why and how to invest in a diverse portfolio of active strategies and also addresses the issue of asset concentration into the largest, most well-known firms**. For example, the asset concentration the managed futures space is quite astounding. At the moment, the 10% biggest managers have 90% of industry assets. Ten years ago, that number was 80%. You can show that having larger relative asset size negatively impacts your relative performance. The returns of such mega funds will basically be performing in line with the overall industry, which for allocators is a worrying sign.

The Opalesque 2012 Nordic Roundtable was sponsored by Salus Alpha and Eurex and took place August 31st in Stockholm with:

1. **Björn Österberg,** Head of Research, IPM - Informed Portfolio Management
2. **Per Ivarsson,** Head of Investment Management, RPM Risk & Portfolio Management,
3. **Sven Thorén,** Portfolio Manager, Catella Asset Management
4. **Carl Meurling,** CEO, EME Partners
5. **Werner Braunöck,** Portfolio Manager and Co-Founder, Verto Invest
6. **Ulf Sedig,** Co-Founder, Merrant Fund Management
7. **Oliver Prock,** CEO/CIO and Founder, Salus Alpha
8. **Renaud Huck,** Senior Vice President, Eurex

Discussing:

- **Opportunities for alpha strategies in Eastern Europe and Iceland**
- **What is the Nordic investor base like?**
- **Investment opportunities coming out of regulations & in the evolving manager space**
- **Why concept of alpha and beta still puzzles physicians and academics worldwide**
- **Does Russian financial markets really need that much "reform" as Western media like The Financial Times or The Economist write? How have the Russian financial markets done since 2008?**
- **Why Salus Alpha abandoned technical analysis when designing trading systems and moved to statistics**
- **How Eurex Exchange will protect buy side collaterals and positions in case of default of a clearing member**
- **Why value strategies may reap outsized returns in the coming five years**

Enjoy the read!

Matthias Knab
knab@opalesque.com

Cover Photo: Gamla Stan - Stockholm

Participant Profiles



(LEFT TO RIGHT)

Werner Braunöck , Sven Thorén, Ulf Sedig, Per Ivarsson, Björn Österberg

Matthias Knab, Renaud Huck, Carl Meurling, Oliver Prock

Introduction

Renaud Huck
Eurex Group

My name is Renaud Huck, I am a Senior Vice President at Eurex Group. I am based in London and responsible for UK institutional investor relations. Eurex Group includes six businesses and by working together, each business plays a key role in the financial industry. The value we bring to the market is our unique business model that covers the entire process chain in derivatives and securities trading and clearing. There is no other exchange group that covers trading and clearing, risk and collateral management, market data and IT under one roof.

At Eurex Group my role is to reach out to the buy side be they asset managers, hedge funds, high frequency/algo firms and also sovereign wealth funds to provide greater opportunities to the buy side. My background is fixed income trading and equity derivatives trading at various investment banks around the world.

Sven Thorén
Catella

My name is Sven Thorén, and since 2010 I work for Catella where I am the head portfolio manager for a Nordic equity long/short product called Catella Nordic Long/Short Equity. I am also a team member of Catella Hedge, a multi-strategy fund which also incorporates fixed income instruments. I have worked in the industry since 1997 in various positions both in Stockholm, Copenhagen and London. I have worked both on the sell and the buy side, but the last couple of years I have been here in Stockholm working in the hedge fund industry.

Per Ivarsson
RPM

My name is Per Ivarsson, I work for RPM Risk & Portfolio Management. We are a specialist company focusing on managed futures where we provide investment solutions to our investors by allocating exclusively to CTAs and liquid macro managers. We are strong believers in full transparency, daily liquidity and to remain control of our investor's capital and hence we only allocate through managed accounts. We have built up two managed account platforms, one in Luxembourg and one in Cayman. We provide services on approximately US $5 billion and allocate about US $1 billion to managers. I am a physicist and economist by training and used to work as a quant within the interest rate derivatives and credit derivatives side in the late 90s and early 2000s.

Markus Rudling
Salus Alpha

My name is Markus Rudling and I am Head of Salus Alpha in the Nordic region and based here in Stockholm. My role includes business development, fund raising, investor relations, and daily operations. The client base in the Nordics consists of pension funds, insurance companies, banks, asset managers, fund of funds, family offices and distributors. Our UCITS IV funds are mainly for third party distribution while the institutional side is a mixture of tailored mandates, managed accounts and UCITS with the focus on pure quant based strategies. Salus Alpha has been present in Stockholm since 2006 and we have raised about 200 million Euro in the Nordic region since establishment.

Björn Österberg
IPM

My name is Björn Österberg, and I'm the Head of Research at IPM Informed Portfolio Management. IPM is a systematic asset manager, headquartered in Sweden, with US $7 billion in assets under management. We are entirely focused on systematic macro and equity strategies, and work exclusively with large institutions, sovereigns and governments around the world. Our strategies are predominantly based on fundamentals. Before joining IPM, I headed up two quantitative research teams at different investment banks, and I've also managed a global long-only equity portfolio for one of the Swedish national pension funds.

Oliver Prock
Salus Alpha

My name is Oliver Prock, I am CEO/CIO and Founder of Salus Alpha. We are a quant shop with a global presence and manage around USD $1 billion. We also have a presence in Stockholm that is our connection to the market here. As founder and CEO/ CIO of Salus Alpha and in this function I am also involved with developing our quant models. We are 50 people in the group and offer quantitative strategies, not just in the CTA space but in the different strategies such as commodity arbitrage, relative value, Long/Short Equity. All our strategies are based on statistical models. We do

not use any technical analyses.

Carl Meurling
EME Partners

My name is Carl Meurling, I am CEO and one of the Founders of EME Partners. We run long/short equity strategies in Eastern Europe including Russia and Turkey. We set up at the end of 2007 and were initially capitalized by one of the largest banks in Europe. When the bank decided to leave the hedge fund space in 2008, we on the other hand decided to stay around and we are celebrating our fifth year right now.

Eastern Europe and Russia is an extraordinary, dynamic space. If you look at all the opportunities and challenges within long/short space or maybe even in the hedge fund industry in general, in Eastern Europe and Russia those issues seem to get magnified by the factor ten. In our region we observe significant shifts from playing a beta game to an alpha game, about which I will be happy to talk more about later on.

Ulf Sedig
Merrant

My name is Ulf Sedig, I am a co-founder of Merrant, I have been in the industry for 22 years – starting as a trader, then in equity derivatives, equity analyst, I also worked with corporate finance and spent ten years in venture capital. At Merrant, we manage a market neutral multi-strategy hedge fund of funds. The Fund is constructed to generate positive returns throughout the economic cycle, while preserving capital and maintaining low to negative correlation to major equity and bonds indexes. All underlying strategies are totally uncorrelated to equity and bond markets. We are focusing on achieving true alpha without any beta component in our portfolio. We have a three year track record, annualized return of 6,3%, Sharpe ratio of 3.8, standard deviation 1.6 and only one down month in three years.

Werner Braunöck
Verto Invest

My name is Werner Braunöck, I am the Portfolio Manager and Co-Founder of Verto Invest. We manage one product, the Julius Baer Multiflex SICAV - VERTO Recovery Fund, an Icelandic themed recovery fund solely for institutional, professional clients who aim to participate in the recovery and resurrection within Iceland. VERTO Recovery Fund is not open to private investors and only accepts professional institutional investors. Iceland is perceived as a showcase for the rest of Europe. In fact it is quite isolated from the market volatility coming from the U.S., Europe or the rest of the world. We see tremendous opportunities and a superior risk and reward profile within our own investment space in Iceland.

Currently VERTO manages just over 60 million euros. The fund got seeded in December 2011 and was established as a Luxembourg SICAV. We have a research operation on the ground in Iceland covering and researching potential investments. Our fund is a constituent of the Nordic Hedge Fund Index NHX since a couple of weeks. Within the financial community we are seen as the experts for providing solutions to Icelandic stressed and distressed assets and generating turnaround opportunities from them.



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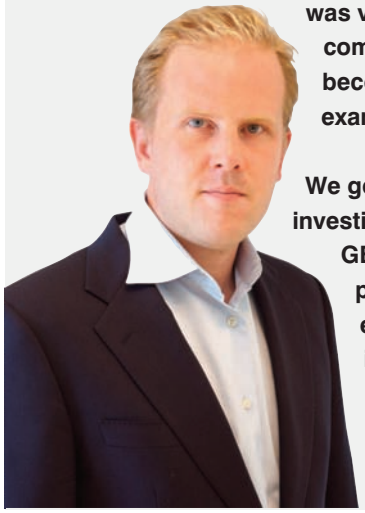
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Matthias Knab **Carl brought up the notion that the beta game is changing to an alpha game in his region, which is probably what investors worldwide are interested in. Can you tell us more about the changes in your respective fields, and how you create alpha for your investors?**

Carl Meurling: Traditionally, Eastern Europe and maybe emerging markets in general have been a beta place for most investors, for a couple of different reasons. For many years, emerging markets were a fantastic place to be for equity investors. If you invested at the very bottom of the RTS index in 1998 and were lucky or smart enough to get out at the very top ten years later in 2008, you would have made 5000%. While that was of course a type of once in a life time type of investment, you could see similar moves in other emerging markets as well. Therefore, investors had no reason to look at anything else but beta while the markets were rallying. In addition, you really couldn't hedge yourself efficiently in emerging markets. Even if for some reason you wanted to run a hedged strategy, it was very difficult to implement. However that has changed over time, so when we set up our company in 2007 we saw that emerging markets and our region in particular were finally becoming sophisticated enough to run more sophisticated hedge fund strategies. For example, our own net exposure is between -20 to +40%.



We generate our returns from stock picking without strong directional exposure. That way of investing is unique not only for equity-oriented hedge funds in Emerging Europe but around the GEM equity space. I would argue that emerging markets remain dominated by funds which primarily give beta-like exposure to their investors. Mis-pricings are more significant than ever in our region, and that allows a fund to make more money trying to extract alpha than in other markets which are more developed and better priced. While we entertain certain macro views, our allocations are primarily driven by bottom-up considerations.

Carl Meurling

The markets have gone through a fundamental transformation since we set up in 2007. Before 2008, the common belief was that there was some beta left to extract, but as the financial crisis has evolved, many investors have moved on to understand that trying to get a significant positive performance from just being long the market is difficult, if not impossible to do. Also, remember we are operating in an environment where markets rallied tremendously, and since the fundamentals still look attractive, a lot of people and investors need to adapt to the "new normal". In our case, we may communicate that we may be able to make a double digit return but not the type of astronomic returns that people became accustomed to during the Goldilock years. Similar to other hedge funds in other regions or strategies, we do face this educational challenge when it comes to managing investor expectations.

Matthias Knab **Can you give us more details of how the markets have evolved in terms of liquidity and shorting capabilities?**

Carl Meurling Sure, let me just point to what happened in 2008 when things were at its worst: Eastern European markets were extreme in the first three weeks of October. The index was down 65% in only three weeks which must be some sort of world record, maybe our Icelandic friend here will disagree, but certainly that drop was one of the worst out of all the bad equity markets in 2008. Our worry back then was that the financial markets in our region would go back to the type of primitive state they were in around ten years prior, let us say around 1998. But luckily that has not happened, the markets in our region continue to become more and more sophisticated. The opportunities and range of instruments we can trade is expanding, and that is very encouraging and makes us optimistic that we can continue to do well going forward.

Today around 80-100 stocks can be shorted in Emerging Europe and we can also use other instruments for protection, such as index futures and an expanding options market. One of the benefits of our region is that it is heterogeneous; the individual countries are quite different to each other and there is sufficient diversification in terms of industries. I like to think our region is sophisticated enough to execute a hedge fund strategy but unsophisticated enough so that we can make above average returns on our work.

Carl Meurling



Werner Braunöck: Iceland is also quite unique in terms of alpha generating opportunities. The country is obviously coming from a very low level after the banking system crashed in 2008 and investor appetite went from a lot to zero. There are a significant number of opportunities on the investment / distressed side in Iceland where many local companies are caught in liquidity constrained situations, meaning they do not have sufficient access to financing, neither locally nor internationally on the banking side, and the equity market is still redeveloping.



Before 2008, the Icelandic stock exchange had high double digit numbers of listed companies, now the OMX Iceland all share index is down to only 8 members. Until this market will develop again to normal levels in three to four or maybe five years, there will be opportunities for investors like us to support these companies and the economy and at the same time participate in this recovery.

This recovery is very independent from the developments and uncorrelated to most of the movements in the Euro zone and the U.S. Investments are coming from a low level but to participate in the resurrection and uplift of those assets and companies can be very attractive from an investor perspective. The financial instruments for that vary between listed and unlisted equities down to bonds, high yields, mezzanine and bridge loans as financing for working capital facilities.

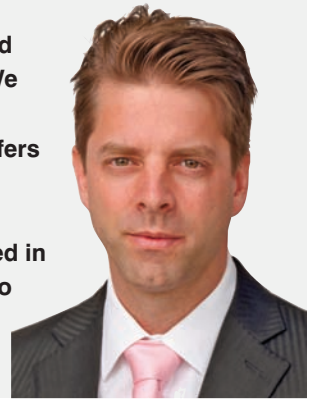
Werner Braunöck

Furthermore, we have experienced that all those instruments are quite uncorrelated to other markets. We as the investor and fund manager are not shy to sometimes also take active management or supporting roles in those companies as a supervisory board member or for example as an international creditor committee member. In some of the big banks restructurings to a certain extent we can also influence or add our opinion to some of the corporate decisions and developments. We like to have a very hands-on approach and direct access to the investments.

For the first months since our launch we displayed very low beta; the fund is rather uncorrelated yielding more or less pure alpha. Sharpe ratio is around 3 with a very low standard deviation. We managed to return 15 % net performance for the first 7 months since inception. I have been working for the past 10 years in the investment space, and in my view the Icelandic situation offers a very attractive risk reward opportunity for investors.

However you have to be aware that access to investments and information can be very restricted in this market. We are mid to long-term investors. Our time horizon is minimum 5 years, which also makes us a bit unique.

Werner Braunöck



Sven Thorén What is the liquidity like trading shares in Iceland? Can you give me an example: how many stocks can I trade €2m in without affecting the price too much? Also related to the recovery - you have a five-year lock up period, but how long do you think the actual recovery period will take, and what

will be some of the triggers that will help the firms to improve their distressed position?

Werner Braunöck At the moment, we have a handful of companies in Iceland like Icelandair, or Marel HF and potentially Eimskip in the future after the planed IPO which basically have liquidities that will fit such liquidity needs.

Werner Braunöck: The interesting thing is that you can find a sizeable backlog of a lot of firms which you can be invested in as a pre-IPO. These companies may want access to financing rounds for six to twelve months for example before their IPO. Pre IPOs are very attractive in general in Iceland as we see it because when the companies hit the public market in an IPO there is massive excess demand for equities from the local institutions like pension funds or insurance companies who need to deploy their cash also partly in the local equity market, given the general low interest environment.

In regards to liquidity there are two ways to improve the liquidity for those Icelandic companies, either through a dual listing in other markets e.g. Denmark, Norway, U.K. or U.S., or by attracting international interest locally.



That is sometimes not easy, because Iceland was neglected from the international investment horizon for quite some time as a consequence of the crisis, and also for systemic reasons like the current FX restrictions. Iceland is steadily and successfully working on building up a reputation and comfort in the international investor community again. This is progressing and Iceland is seen as international showcase.

Sven, you are probably one of the guys who at one point in the future will say Iceland is ready for me to invest in. Certain IPOs offer quite good opportunities, For example Iceland Air came from very low levels 2 years ago and doubled from that time, but it has not changed dramatically on the business plan or economically.

Werner Braunöck

Per Ivarsson: Let me step back for a moment here. Even after 15 years in the industry, the concept of alpha and beta still puzzles me. I still do not really have a clear definition that I am happy with. My understanding is that by beta, people mean correlation with some sort of index. For me an index is just another trading strategy, an index is not really THE market.

Of course, an index is a very common trading strategy, but still it is a strategy and, as any strategy, it will get crowded as investors move in, which seems to be overlooked in these discussions. In my view, institutions with large allocations to index investing are taking a somewhat dangerous route. For instance, profitable trading around an index event, like the S&P 500 rebalancing, shows that the index is not the market but just another trading strategy that can be predated upon or exploited.



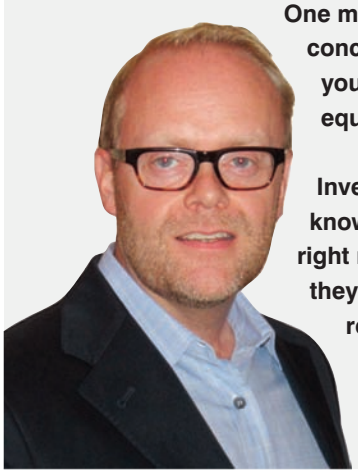
So, if by alpha, we mean returns that are mainly uncorrelated to the major markets, we at RPM provide alpha by just being in the managed futures space. It has been shown over again that there is a benefit of having these technical, broadly based, investment strategies in combination with an equity portfolio.

I think the important aspect is that investors actually want conditional alpha or rather, conditional beta. What I mean is if the equity markets are rallying, they want a high positive beta. If the equity markets are down they want to have negative beta, and you can call that alpha if you will.

Per Ivarsson

Another important aspect of how we provide alternative alpha, or any alpha, is that we provide diversification in terms of active strategies and sub-strategies.

During the recent ten years we have seen a steady increase in correlation between basically all markets. Seeking diversification by just having a passive allocation across asset classes is therefore becoming less and less useful. One must make sure to have a diverse portfolio of active strategies. In addition, we see an asset concentration in our industry, as in most parts of the financial industry. Thus, making sure that you are also diversified across different types of managers in terms of their life cycle is also equally important.



Investors should really make sure they are not just invested with only the largest, most well-known, names. That is one of our main worries and one of the main areas we are working on right now – being invested with these big names does offer a good number of positive aspects, they have sound operational procedures, solid research capabilities, and everything that is required from the operational side. However, there are some drawbacks that need to be addressed too.

Per Ivarsson

Matthias Knab **Let's go into this right now, Per. Please tell us more how you are different from other firms and what to do about the asset concentration that is happening in both the hedge fund and the CTA world?**

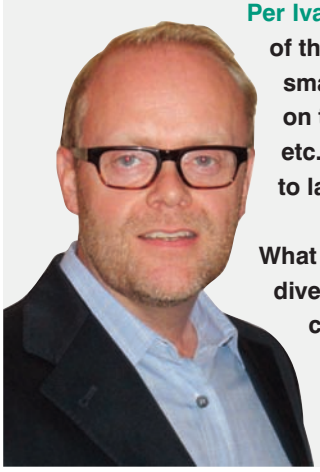
Per Ivarsson: If you look at the managed futures space, the asset concentration there is quite astounding. At the moment, the 10% biggest managers have 90% of industry assets. Ten years ago, that number was 80%.

That means that managed futures have become a very concentrated industry. You can show that having larger relative asset size negatively impacts your relative performance. The returns of such mega funds will basically be performing in line with the overall industry, which for us as an allocator is a worrying sign.



Per Ivarsson

Matthias Knab **So how in detail does your firm handle the asset concentration in the managed futures space? What do you do?**



Per Ivarsson: Given the asset base of the larger managers, they have to spend an increasing amount of their research efforts on issues related to execution and other size related matters, whereas smaller managers are more flexible and can generally execute their strategies with less impact on the market. Smaller managers can focus on the core part - the strategy, the signal generation etc. They can also be active in a larger number of markets that are not deep enough to be useful to large managers.

What this means for us as an allocator is that we are looking to create a portfolio which is well diversified in terms of size of managers and in terms of where they are in their respective life cycles. This is vital for us in order to add value to our investors. The household names are known to everyone, so sourcing the big names and allocating to them is not difficult. Finding the next generation of stars or actually the managers that are evolving into becoming the new stars, that is more resource demanding and requires specific skills and experience.

Matthias Knab **Can you also add some insights into the auto correlation of the big names and how do you go about blending them together and also add the smaller managers?**

Per Ivarsson: Well, one thing we find interesting is that if you try to replicate a sort of naïve institutional investor that invests with the best performing of the biggest managers and base your expectations on recent history, you will in theory have a very nice portfolio. Unfortunately, that approach to investing can be shown to underperform the industry by a wide margin.

In addition, if you simulate a dynamic portfolio of the biggest managers based on recent performance, you will find that at any given point in time the portfolio will, looking back, somewhat surprisingly seem to be independent of fixed income market returns. However, the same portfolios will be heavily dependent on fixed income looking forward. That shows that the dependence on fixed income markets for the large players in our industry seems to be quite high.

Per Ivarsson



On the other hand, the correlation between managers that employ similar strategies over the recent period has been exceptionally low. Small differences in asset allocation between markets have had a huge impact. A few markets have seen sustained trend moves: gold and some other commodities and the fixed income markets, otherwise most markets have been fairly trend-less, so the correlations between the managers have been fairly low.

Renaud Huck Do you not think that it is normal for these players to be heavy users of fixed income, considering that as an asset class fixed income is much bigger than any other?

Per Ivarsson This is correct.



To your point, when you as a manager grow, you will go into fixed income and FX because those markets are basically the only ones where you will fit. Therefore, if you go down the asset size ladder, you will see that smaller managers have less dependence on the fixed income market. Historically, over the last 15-20 years with falling rates it has been good to have a large allocation in fixed income. Going forward we believe it is more difficult to make money in this sector. As rates go down you profit not only on the rallying bond prices, you also have the carry in your favor. As rates rise, you can make money from being short bonds, but the carry works against you.

Per Ivarsson

Matthias Knab **Who else wants to talk about your investment products, process and how you produce alpha?**

Sven Thorén: I think in our case there are a couple of factors that contribute to our success. First, we have a critical scale which I think is important. Our clients want to know that we will be around in 5 years time. Second, in today's environment asset managers need good sized teams made up of various individuals with different knowledge base. And third, you need a proven method how you go about investing.

Catella is probably the largest Nordic investment management organization focusing just on Nordic equities and Nordic bonds, which means that we are roughly 14 individuals, investment managers looking at the 500 to 700 listed companies in the Nordic region. We all live and work close to the companies we invest in. We get great discussions internally also because of the diverse background and expertise as I mentioned before.

Sven Thorén



I personally have been focusing on equities during my career but in various roles as an analyst, long only PM and hedge fund PM. I have covered equities globally but focused on Nordic equities for the last five years. My colleagues at Catella have other backgrounds ranging from fixed income research and portfolio management, trading, equity strategy, corporate finance, hedge funds etc

Oliver Prock: I had to smile listening to Per before, because he mentioned he is physicist by training. I could have guessed already when he said he does not have a right concept of alpha and beta for him, because also in our organization we have a couple of physicists who say the same thing.

I enjoy listening to physicists and obviously I learn from them, and the more I think about it, the more I believe they are right. For example, one thing they say is that you can call many things alpha. You could call "negative beta" alpha, or could call a return that derives from illiquidity or timing alpha.

So, a lot of these questions or aspects are not covered or described at all. In my view, this fuzziness makes the industry inefficient. But again, I am also part of that industry, and what we on our side aim to do is to achieve a return that is different from some others' returns – different from an index or other managers – which again you may call alpha.



In order to be different you have to do other stuff. When I started in the CTA industry 20 years ago, I began with trading systems based on technical analysis but in the late nineties I gave up on technical analysis and moved to statistics. I was thinking how can we be different if we use the same tools everybody else has? We started to research portfolio construction and did more work on price forecasting, and today we operate a model based on price forecasting with a feedback system based on forecast quality in our flagship product. Through this approach I would say we produce alpha, together with a low correlation to other industry peers, for example our correlation to Winton is just about 34%. Additionally the model has not the same downside as a CTA portfolio in general.

Oliver Prock

We are very lucky to have bright quants that actually think outside of the box. They are not brainwashed by the industry's discussion about alpha and beta, but just drill their task down to achieving a result that is different and not doing the same thing as all the other people.

With over 20 years in the industry, I usually try to avoid the alpha – beta discussion, however sometimes you still have to go into it for marketing purposes.

Björn Österberg

I agree that alpha and beta are hard to define. I always thought that beta can also involve adding value, for example by exposing yourself to certain risk factors. For instance, I could mention the carry trade which of course is a well-known strategy in the FX market. You can see it as almost a commodity and also as highly correlated with actual beta. So if you take a closer look, a strategy may just boil down to or become transferable to a beta.

I also agree with your observations that alpha generally means just outperformance versus something, thus adding value to clients.

As I mentioned before, we run two main strategies, and one of the pillars we believe in when managing assets is mean reversion. We believe that in the long run, markets will return to equilibrium in some way, and that in the short to medium term, other forces drive the markets away from equilibrium, but at one point or another they will return.

Our model in the systematic macro space is fundamentally based. It uses around 40 different indicators and trades relative equities, relative bonds, relative FX and also manages the asset allocation between those. The indicators we use are basically fundamental data, measuring things like valuation and risk premium in markets that we use to measure macro economic events and try to form an opinion about what will happen going forward.

In systematic equity we believe in the 'noise in price theory' that suggests that markets are inefficient and that you simply have to break the link between market capitalization and portfolio weights to achieve outperformance. We then diversify the original concept and add further risk factor exposures into the strategy. The result is a strategy that has so far shown significantly better performance than comparable risk factor indices like, for instance, value indices.

Björn Österberg



Matthias Knab **Let us look at the Nordic region now as a whole. Can you share with us some of the recent developments here?**

Björn Österberg

One development that affects us, like all the other regions, is that the regulatory demands are increasing, which in fact also contributes to the trend that the biggest managers become even bigger. There are fewer start-up hedge funds and, to a certain extent, fewer types of new strategies coming out. On the other hand there is a high demand from the investor side for diversification. These issues are not specific for the Nordic region, but it remains a challenge that since 2008, diversification as a whole has been slowly decreasing.



You will find a very good illustration for the decreasing diversification by just looking at the daily moves of the S&P 500 index stocks from 1996 to 2008. You will find there were only 12 trading days when more than 490 of the S&P 500 stocks moved in the same direction on a given trading day. In 2011, there were 15 such days with nearly even up/down ratio – and that's in just one year. That really illustrates how diversification has been going down, which is one of the bigger problems we try to address.

Björn Österberg

Per Ivarsson

We mentioned that there are less start-ups in our industry, which is sort of a paradox especially within systematic strategies. In the past, managers had to overcome a fairly high technological hurdle, for example by establishing a server room, getting data etc. Now you can buy extremely powerful computers and get hold of high quality data with relative ease compared with 10 years ago. On the other hand, the increased regulatory and sometimes operational demands are going in quite the opposite direction, which is not very good for the industry, because it neutralizes the positive effects from the lower technological hurdles.

What is happening now is that we – or the investors, ultimately – are just paying lawyers and auditors. To put it bluntly, the only sector in the financial industry which is untroubled and thrives is the compliance-related one. That is another problem not only for the Nordic region alone, but globally.

Oliver Prock For us the region here is great. We love to work with educated investors and with Nordic investors especially. Nordic investors are sophisticated in analyzing risk and managing risk. So many of our quant strategies are well received here and well understood. Of course the Nordic region also is chasing returns, however I think they do a better job than other regions in selecting new strategies for their portfolios. For sure the environment is not easy and someone needs to be creative but this is what it is all about i.e. getting the best return for the smallest risk possible.

Ulf Sedig: Let's take a look again at diversification and correlation. We launched our fund in August 2009, since then we have had 17 negative months on the MSCI World Index, and out of 17 months, the broad HFRI Index simultaneously declined 14 times. That is a 80% down capture. The beta is like 0.23 and the r2 is 76%, so it is very obvious there is too much correlation between hedge funds in general and the equity markets.

So what people usually do is build portfolios with all of the main strategies and end up with too much beta in it. That means that institutional investors find that their "alternatives portfolios" will be adding the same kind of volatility they already have. Thus it will not increase the efficiency in the portfolio.

We were talking about being different – we believe our approach to alternatives is different too as we are strategy agnostic and invest in liquid hedge fund strategies that have the ability to generate sustainable Alpha and explore market volatility regardless of directional movements of the global equity and bond markets. We offer a "true" market neutral portfolio as all underlying strategies are market neutral, mutually uncorrelated and uncorrelated to major equity and bond markets. Thus we have a different approach from the majority of fund of hedge funds, whom usually seeks the "best of breed fund" within different hedge fund strategies. This commonly used allocation strategy results in a portfolio with too much downside correlation and linearity with main equity and bond markets.

When doing the quant analysis, we do it differently. We look at the actual distribution in short time intervals, compare that to the distribution of returns on the equity and the bond markets and we scrutinize the correlation on the down side in varying detail.

On top of that we have a very stringent due diligence on the actual strategy. We focus on a number of criteria that has to be fulfilled e.g. there should be no style drift, high consistency in the way the strategy is applied and its outcome, proven ability to generate alpha in all market conditions and no opportunistic trading, because then you do not really know what's in or what will be in the portfolio. I call our strategies "nitty gritty" trading strategies with proven ability to add alpha in all of the market environments.

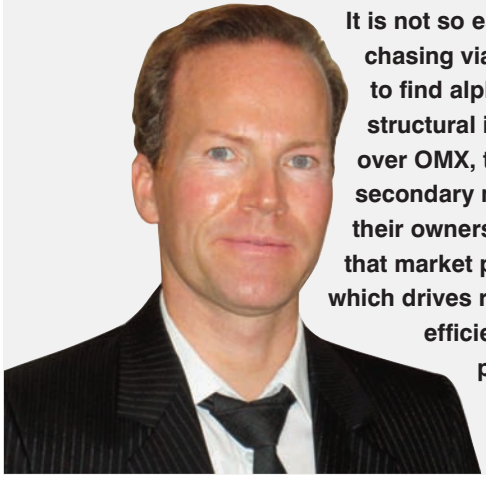
Another criteria we look at is that they have to be doing the same thing like for +10 years. The last fund we added has been trading the same strategy since 1989. This type of people has done all the mistakes and still survived the market. They are capable of handling the risk and making the correct overlay discretionary decisions for handling their portfolio in different market environments.

Ulf Sedig



Let's talk about liquidity next. All our strategies are liquid, which is an important factor when determining the redemption terms of a fund. As you know, some funds, even macro funds, can have redemption periods of 90 days or more. What often happens is that a lot of fund of funds end up with a portfolio that has a whole spectrum of different liquidity redemption terms, but still offers investors shorter redemption periods. The problem is that in a big downturn in the markets, people will have to suspend the redemptions of the funds, like it happened in 2008.

Ulf Sedig: Since I a trader in the beginning 90s there have been significant changes in how the market trades, there is much more correlation between the asset classes. For example, equity markets trade totally different today, this is quite obvious in the Swedish market and also in many other countries in Europe.



It is not so easy to find inefficiencies in the market today, so some investors revert to index chasing via ETFs etc. as also from a fundamental perspective it has become much harder to find alpha. For one, the investment environment has become much tougher, but also structural issues are affecting the markets. For example, I believe since NASDAQ took over OMX, the functionality of this market place as provider of a functional primary and secondary market place has declined. If you have a market place whose main objective for their owners is to maximize profits, their interests are not aligned with the participant of that market place. An example of this is the frequently debated high frequency trading, which drives revenues for NASDAQOMX. If you have a market where you can engage in high efficiency trading without any regulations, my observation is that this causes problems.

Ulf Sedig

Matthias Knab **Can you elaborate a bit more on that?**

Ulf Sedig Well, the focus of the exchange now is to make money on OMX whereas before they did a better job at market supervision and regulations. Now they want just to maximize the profits and they encourage higher frequency trading, which of course gives them more revenues. That is one problem if you have this kind of ownership of the market, your exchange is owned by a company that is chasing revenue. On the other side, they do offer a really good infrastructure for the market participants. I have seen a lot of other countries as well where insufficient exchange trading and connectivity issues are problems on their own.

Carl Meurling I am coming from one of the regions where some investors have exaggerated expectations on what reasonably can be achieved from a market. Ulf, we talked before and you mentioned your fund is up 3% or 4% as of mid 2012, which is a good number.

My question is what do you think a minimum return should be for investors to actually choose a fund which will always be less transparent to them compared to going directly into the market and buying say a corporate or even a sovereign bond, or for the sake of this discussion even stay in cash and have your money in a bank account. A hedge fund is a complicated instrument for most investors, so will maybe 5% or 6% be enough to get their attention?

Ulf Sedig Sure, good question. For institutional investors we offer the transparency they need to feel confident of our strategy and investment process. For retail investors I would say that the "proof is in the pudding". We have now three years of track-record and have been nominated to Europe's best Multi-strategy Fund in 2010, 2011 and 2012. This gives us validity for our work and strategy.

Markus Rudling Given your unique approach and very convincing results so far, should you not keep the strategy intact with pure market neutral underlying strategies but offer the fund geared twice or maybe even three times, increasing the volatility and the target return? Investors will then have the opportunity to gain double digit returns from pure alpha and access to "hard-to-find-and-analyze" strategies and further, not having fixed income related products as reference products in their overall portfolios?

Ulf Sedig Yes, we get that asked a lot but in our view each investor should decide on their own about their risk preferences and leverage. There is also a practical issue involved that makes it unattractive for us to manage geared portfolios.

Matthias Knab **Can you share with us more insights into the evolution of the Nordic investor base, their sophistication, demands and preferences?**

Markus Rudling Even before the financial crisis, information, communication and transparency have been really key for the Nordic investor community. If you cannot communicate, if you cannot open up, if you cannot have a muted discussion, you will not have any investors, irrespective of what kind of performance you have or model or strategy you run. If the investors and the seller do not meet in the middle, nothing will happen.

Sven Thorén Here as anywhere else, the investor behavior is influenced by market returns.

We have observed that corporate bond funds have been popular. We launched a corporate bond fund in December 2010, Catella Nordic Fixed Income Opportunities Fund, and during the last six months we have seen an increased interest. We also launched a Nordic L/S Equity fund at the same time, which I and my colleague Jonas Wikström are responsible for. We have seen interest from European investors, for a couple of reasons.
We had a very good first year, +9%, which is obviously very attractive in otherwise rocky markets. The other thing is that we are Nordic focused which stands out, similar to the Icelandic fund would stand out. We're different. The third aspect involves the currency. I found that a lot of investors in Southern Europe like the Swedish Krona. It is perceived as a safe haven, which I do not think it will be, because in the end there are also a lot of risks in this region.

Sven Thorén



Matthias Knab **Is your business affected by global regulatory pressures?**

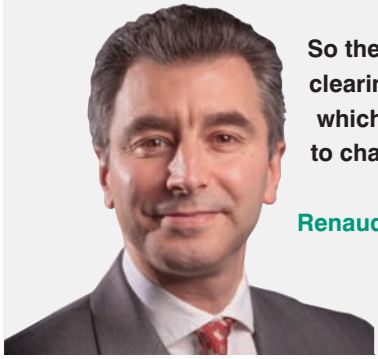
Per Ivarsson Systematic managers, especially if they are directional and not biased in terms of direction, such as trend followers, are agnostic about what is actually driving the trend. It can be fundamentals, regulatory issues or any other force driving the market. That means that regulatory changes can affect the markets and initiate or influence trends. This can actually be good for our types of strategies.

On the negative side, we already mentioned fewer firms and funds get set up because there are more challenges and pitfalls to overcome. The managers that have emerged and are on their way to evolve into established players is an interesting segment for us. They have relatively short track records which means as an investor you have to focus more and more on certain non-performance related criteria when evaluating their strategies.

Renaud Huck As a global derivatives exchange and European based multi-asset clearing house, our role is to answer the needs of the entire industry regarding the upcoming regulatory changes. Obviously for us, the Nordic regions have needs in that space.

Though they are not necessarily directly impacted by the regulatory changes, whether EMIR or Dodd-Frank, nevertheless a majority of the Northern European buy side have investment vehicles labelled in different currencies, one of them being the euro.

For an exchange like us, we see a need on that side to deliver clearing solutions as far as OTC clearing is concerned. We also see an opportunity for the Nordic buy side to distinguish themselves from their peers by offering investment solutions which will fall under the new regulatory regime. We know that a lot of investors are quite concerned about what happened to the financial system a few years ago and do not want it to be repeated. They obviously want to ensure that their investments are safe.



So there is definitely a range of opportunities and for us, one is the launch of our OTC IRS clearing solution in the fourth quarter. We're working hand-in-hand with the buy and sell side which I think is going to make a difference in Europe because the regulatory horizon is going to change for good. Regardless of which side of the fence you sit –you will have to adapt.

Renaud Huck

Oliver Prock It is a fact that the regulator wants the financial industry to be smaller, and this is what actually happens right now all over the globe. Personally I haven't come across investment opportunities triggered by regulatory changes, rather challenges on the business development side.

One obvious thought is "if markets are manipulated and not allowed to fall", then the right product will be long-only, correct? All we do is based on neutralizing risk - we can also call it risk equalization or risk parity. We did some research on our risk equalization models by focusing on four asset classes i.e. (equities, bonds, short term interest rates, and commodities) and by skipping the short side. Voila, the strategy achieved a 16% historic return with a volatility of 9% and a Sharpe of 1.3. I think this is the right product for the environment we are in and institutional investors are pushing us to launch the strategy as a fund.

Oliver Prock





Per Ivarsson: When it comes to the question of how regulatory changes can create trading opportunities, the effect is visible, but subtle. For instance, when uniform risk frameworks are being enforced broadly, this forces investors to behave in the same way given certain events. That means sell-offs will be deeper and broader, and in the end the regulations are in a way counterproductive. By trying to mitigate risks, they are creating even larger moves. Market participants from the alternative investment industry that are not bound by some of these frameworks are able to profit from the market behavior induced by the regulation.

Per Ivarsson

Carl Meurling: I have to say actually that it is quite instructive to work with countries like Russia, which many people believe to be extremely political, tightly regulated and difficult to do business with. In some cases this might be true, but if you look at interventions on the financial markets, which also result in strange moves, these things do actually happen in Western Europe.

Short selling bans and market manipulations happened across the E.U. nations, and one of the big paradoxes is that all of this is happening in developed markets while many emerging economies show a lower degree of state intervention and an improving infrastructure and a maturing legal environment. This process has been extremely rapid and has yet to be completely understood by mainstream investors in the US and Europe,

In spite of the fact that the markets have been so volatile and also in spite of the fact or the perception that Emerging Europe politicians can take liberties when crafting public policy, we see our region continuously becoming easier to invest in. That actually makes me very skeptical when the word "reform" is being used for places like Russia, where

often you can hear Western political pundits say it's so important to implement reforms in Russia. I think what those Western pundits are demanding is not a better business climate but a more Western-like political policy (and an associated US-friendly foreign policy). Those things do not necessarily equate.

So maybe as investors we should be happy that there is not as much reform in Russia as maybe The Financial Times or The Economist would want, because we might see Emerging Europe emulating the mistakes we have made in the West. I would definitely prefer our region to move forward using a model which is right for their unique situation and which fits the people who live in Emerging Europe.

Carl Meurling



Sven Thorén But wasn't the Hungarian central bank's independence questioned or restricted recently? Also, weren't the Russian markets closed for - I might be wrong here - five days or so during the 2008 crisis? Are the markets you talk about really that insulated?

Carl Meurling There are of course exceptions to the rule of non-interventionism in Emerging Europe, and Hungary has a very infected political situation which is particular to that country. Looking at Russia, their handling of the markets post-Lehman led the politicians there to conclude that halting trading on the Russian exchanges and defending the ruble/dollar rate at all costs did not do much to prevent market volatility or create a higher confidence in the Russian economy. So compared with four years ago, the Russian central bank allows greater flexibility in the ruble exchange rate and a greater responsiveness in terms of monetary policy.

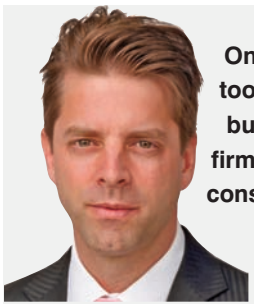
Oliver Prock I consider all market intervention bad but it is the flavor of the current times. Market intervention makes us feel safe but actually we are all sitting on landmines. Look at 2008 for example.

Carl Meurling Yes, there were some market interventions and also bail outs of some of the oligarch-led companies. But as we all know 2008 post-Lehman was a period of extreme financial stress around the world, and I cannot really think of any politician in any country who adopted a complete "laissez faire" approach to the disastrous markets at the time.

If you look at what happened in the United States with the bail-out of some of the large financial institutions and industrials, in hindsight I would say there was justification for an activist policy given the huge systemic risks we were facing at the time. As the U.S. goes into election mode, we see that one of Obama's strongest arguments is that General Motors is still around. I would argue that Russia had a similar national interest in saving some of its largest industrial groups. Also, unlike the United States, Russia's sovereign balance sheet was extremely solid at the time so why not use those resources if the financial markets stop functioning?

There were countless opportunities for Putin and the Russian leadership to nationalize more or less everything in Russia after having bailed out some of the oligarchs in 2008. The fact is that the Kremlin refrained from doing so might indicate that there are fewer opportunities than before to use the Russian state for personal gain. One interpretation of Russia's handling of the financial crisis that the country's leadership possesses more business acumen and maturity than some of the politicians here in Western Europe and the United States.

Werner Braunöck: When discussing investment opportunities coming out of those regulations, we should also mention for example Basel III which restricts the banks doing some of the business they have done in the past and forces them to reduce their balance sheets. This creates opportunities for funds in the alternative investment world and other financing sources to do business out of those types of regulations.



On the flipside, the stricter and stronger the regulation is, the more costly will it be to run a fund, and too many regulation and compliance related costs may prevent smaller funds from continuing in business. We have seen how in the U.K. for instance that pressure can force investment management firms to leave the country. Keeping the right balance is also a challenge for politicians in general, considering that the financial industry is still one of the biggest cash cows in those countries.

Werner Braunöck

Renaud Huck: I tend to agree with you, it is like tax, too much regulation kills regulation. But I think that at the end of the day there is a bigger picture. If we refresh our memory, five years ago the financial and global system almost went down the cliff and overnight the regulators had to take the reins in their hands because the situation was critical.

Therefore, there are reasons why we are in the current situation; the regulators obviously had to step in. However, if there are any positive results out of this, these benefits are for your investors. To be honest with you, as an asset manager or hedge fund it is easy to show alpha when markets have a double digit growth. It does not take much expertise and a lot of knowledge to do it. However, when markets are at rock bottom, the growth is negative and there is inflation etc. Then you have to show what stuff you are made of. If you are an end investor and you give money to someone to invest, it is not to replicate the index, it is to show expertise and ingenuity.

Renaud Huck



I think that there is no point blowing against the wind of regulations. Sometimes you have to say "well, we are going to have to adapt." And I think that at the end of the day your end investors have now the guarantee that the money that you as buy side entities have invested in collaterals, in securities is going to be safe and you are not going to lose it the same way you lost it with Lehman Brothers.

Ulf Sedig I disagree on that last one because it is really I think like UCIT IV, this aspect seems to me like the icing on the cake. It is good, we have some regulations and boundaries regarding how portfolios can be allocated, but it does not take away from the investor that has to do a thorough due diligence.

Werner Braunöck I agree with Renaud's comment that alternative asset managers have now the opportunity to show alpha. But they also should get paid for generating alpha. Investors cannot always rely on or wait for riding out the upward waves like high beta or index products And this is why the alternative asset manager space can demand higher fees than other funds.

Matthias Knab **Oliver talked about his new long-only product, does anyone of you prepare a new product or focus on particular opportunities?**

Renaud Huck As an exchange and clearing house, we are of course very active with the upcoming regulation.



In the fourth quarter we're about to launch a full segregation model that the buy side are interested in, obviously for their IRS clearing solutions. And for us it is most important to offer the possibility to protect the collaterals or the position of the buy side in case of default of their clearing member as well as to have a broad range of accepted collaterals so the buy-side has greater flexibility. So I think that we have worked hard with the sell side, but we also have a very strong buy side vision for these solutions and I would say that is what will keep us awake during the last quarter.

Renaud Huck

Per Ivarsson: **I want to point once more to what we call the evolving manager space. We, and a lot of the investing institutions, are very worried about the asset concentration story within managed futures. In order to address that risk we want to continue to invest in newer, smaller and more nimble managers as a complement to the big names.**

To get full benefits from investing in emerging managers, one really needs to take a venture capital approach with equity stakes and coaching these managers when building their business. We are not in that game. However, by defining an evolving manager space we look at managers that not only have a clear trading idea but have also established a proper business structure while not yet being hampered by the problems that follows with very large assets.

We now offer a new product that only invests in these evolving managers to complement our broader CTA product offering. Since we see this need in our own portfolios, we believe that this product would be a perfect complement to the holdings in well-known large CTAs that many institutions already have.

Per Ivarsson



The evolving manager space is a segment where the investing institutions basically do not have the resources to source those types of managers internally since you need to screen a large number of managers. An evolving manager portfolio needs to contain 10 managers or more, with relatively higher manager turnover, to exhibit the desired characteristics. We are very excited about this product.

Matthias Knab What is your midterm investment outlook?

Sven Thorén: **I think the world is going to be a very exciting place for the next two or three years. I see a lot of opportunities both on the long and short side, even if you just focus on the Nordic countries like us. And by the way the Nordics are very exposed to companies exporting into countries like Germany and China, Asia, Latin America. Let me add that I do not think any region is particularly stable in the medium term. I believe every region, including China, has serious issues and could crack up, and to add a contrarian touch, perhaps even Europe would look like a stable place in such an environment.**



So I do believe that a lot of those larger risks are definitely not priced in at the moment. Of course it is really hard to say when these things will unfold, but I believe these are opportunities to make money if you are an unbiased fund.

Sven Thorén

Björn Österberg: **One of the important themes that we touched upon earlier is the decrease in diversification. It is a very important fact that many of the more well-known correlations in the market have totally shifted and actually very much resemble the situation we had in 1929.**

So what will work? If you look at value strategies for example, probably all of us around this table are young enough to characterize value as a defensive type of strategy, which it has been for the last 30 years or so. Looking at it from a longer perspective, you can actually see that the correlation between value and beta is not negative, which means that it is not always a defensive strategy, since correlation is actually around zero.

What has happened since 2008 is that in fact value has been positively correlated with beta, and that is something that I think disturbs the picture for many people. What is interesting is that this correlation pattern is exactly the same correlation pattern that occurred during 1929.



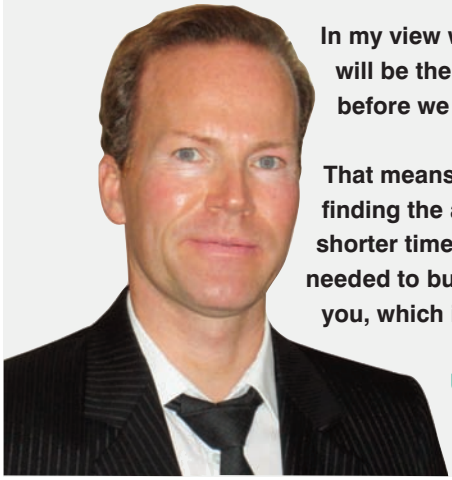
From a research point of view, the current situation creates all types of exciting opportunities, but of course this type of research is hampered by the difficulty to get good data sets for data simulation, etc.

My point here is that due to this shifting correlation between valuation and beta we have had the longest drawdown in history for value type strategies. As a generic strategy in the equity markets, value is in a five-and-a-year downturn principally, that we have only seen once before – in 1929. For the next five year period, I am personally very much in favor of value type strategies because they do display a very strong mean reversion.

Björn Österberg

Ulf Sedig: I think these are very strange times due to the structural problems and uncertain macro picture both in U.S. and Europa. Decades of growth that have been financed by lending are now coming to an end. When I started in 80s we had triple (public, trade and current account) deficits in U.S., we still have it, and we have had it almost all the time, except a during couple of years in the 90s. Somewhere down the line there is no more capital available and you have to pay the bill yourself. We are at that crossroad now and the problem is solved by printing new money. The U.S. stopped publishing the M3 numbers since Q1 2006, do you have any idea why? Because they don't want to show the massive increase in money - in the long run if you print more money than the real growth in the economy, you create a surplus of money that spills over to inflation.

We have a situation with even negative nominal interest rates in countries like Germany and Switzerland, which is not a sustainable mid/long term market equilibrium – and never has been. Operation Twist is tweaking down the yield curve in U.S., but for how long. The central banks' aggressive monetary policies are a risky strategy which leaves the economies vulnerable through the increased sensitivity for interest rates increases, both in Europe and the U.S.



In my view we will continue to see very uncertain and volatile equity markets. Of course, there will be the usual rebounds, but in the end the fundamental problems have to be solved before we can see a healthy long trend in growth.

That means that investors can't really rely on a market beta going forward, it will all be about finding the alpha in the market or try to trade on and be in and out of the markets during shorter time periods. When I was a trader, the toughest thing to do was to time the market, you needed to buy and sell at the right times. That is easy to say, but when a trend goes against you, which it always eventually does, it's hard stay rational and make the correct decisions.

Ulf Sedig

Equity
Innovation
Global Macro
Equity Derivatives
Base & Precious Metals
Commodity
Energy
Transportation
Trade Finance
Merger Arbitrage
Relative Value
PIPEs
Entertainment Investing

OPALESQUE'S GOT TALENT

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Behavioural Finance
Collectibles
Funds of Funds
Statistical Arbitrage
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