OPALESQUE



# Opalesque Round Table Series '13

# NETHERLANDS

Opalesque Roundtable Series Sponsor:

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# Editor's Note

**How do Dutch institutions invest into hedge funds and alternative investments?**

The Netherlands is a leading financial center in the heart of Europe, with hedge funds and alternative asset managers ranging from start-up size to $10bn. The country also has a well diversified professional investor base allocating to alternative investments and is in fact home to Europe's largest hedge fund investors. Private sector pension funds are the prevalent institutional hedge fund investor besides funds of hedge funds, asset managers, wealth managers, public pension funds and insurance companies.

The 2013 Opalesque Netherlands Roundtable - sponsored by Eurex and Taussig Capital - took place February 14th at the Amsterdam office of Blue Sky Group with:

1. **Mark Burbach, Chief Investment Officer, Blue Sky Group**
2. **Niels Oostenbrug, Head of Alternative Investments, MN Services**
3. **Michiel Meeuwissen, Senior Portfolio Manager Funds of Hedge Funds, Kempen Capital Management**
4. **Michael Kretschmer, Co-Manager, Pelargos Japan Alpha Fund**
5. **Jasper Anderluh, Principal and CEO, HiQ Invest**
6. **Patrick van de Laar, COO/CFO, SAEMOR Capital**
7. **France Schuster, Head of Sales, Eurex**

The group discussed:

- **What are the five return drivers of hedge funds?**
- **Which four hedge fund strategies add the most value to pensions?**
- **How do Dutch institutions invest in hedge funds and alternatives?**
- **Has the role of hedge funds in Dutch institutional portfolios changed over time?**
- **Which hedge fund strategies appeal to Dutch institutions right now?**
- **What is the difference between alternative beta (or smart beta) and non-traditional beta? Are Dutch investors interested in hedge fund replication?**
- **Why do some Dutch pensions not invest in hedge funds? How can asset managers and consultants help them recognize and benefit from allocations to alternatives?**
- **Why does the Dutch Central Bank "flag" institutions that have more than 20% in alternative investments and audits them? What is the Central Bank asking for in this audit?**
- **How can institutions radically lower the capital charge required under Solvency II for their investments in hedge funds?**
- **What types of hedge funds operate from the Netherlands? What fund vehicles are open to them that many other hedge funds are craving for?**
- **How does an Amsterdam based hedge fund manage to add between 100 and 150 new clients every month?**
- **How do Dutch hedge funds prepare for the proposed financial transaction tax and regulations of high frequency trading?**
- **When will EUREX launch its new index derivatives based on the MSCI World, MSCI Europe, MSCI AC Asia Pacific ex-Japan and MSCI Frontier Markets indexes?**

Enjoy the read!

Matthias Knab
Knab@opalesque.com

# Participant Profiles



(LEFT TO RIGHT)

Michael Kretschmer, Michiel Meeuwissen, Patrick van de Laar, Niels Oostenbrug

Jasper Anderluh, France Schuster, Mark Burbach

# Introduction

**Patrick van de Laar**
Saemor Capital

My name is Patrick van de Laar. I am COO/CFO of Saemor Capital. Saemor Capital is a quantitative asset manager which started five years ago as a spin-off from Aegon. Saemor manages the Saemor Europe Alpha Fund, a long/short European equity fund, using dynamic multifactor models. The Fund has $600m under management. Previously I worked for Kempen & Co and Euronext. Currently Saemor is also exploring other opportunities like different fund structures or adjacent propositions like smart beta.

**Michiel Meeuwissen**
Kempen Capital Management

I joined Kempen Capital Management, a niche asset manager based in the Netherlands, in 2000. In the summer of 2005 I co-founded our two multi-strategy funds of hedge funds. One fund of hedge funds is focused on non-directional strategies while the other one has an unconstrained mandate, i.e. it can also be invested in more directional long/short equity managers or global macro managers. The combined AUM is over $700m, invested across 25 to 30 hedge funds. Both fund of funds have generated top quartile performance for four years in a row and thus rank at the top of their international peer group.

**Jasper Anderluh**
HiQ Invest

My name is Jasper Anderluh. I am from HiQ Invest, which is a company I founded together with other people coming from Amsterdam Option Traders Proprietary Desk. We are a combination of traders and quants. My background is more on the quantitative side, I have a Ph.D. in Financial Mathematics, and one day a week I am teaching Financial Mathematics as an Assistant Professor at the Delft University of Technology.

In running our fund we use fundamental relationships among all kinds of products all over the world. We analyze these relationships statistically and then trade them on many exchanges throughout the day. We are able to benefit from very small changes in all kind of price diversions all over the world. We are very active market participants and do between 10,000 and 50,000 trades every day in the fund.

Currently we have 60m Euros ($78m) under management, which seems very small; but we are rapidly growing. Last year at this time we had 30m Euros ($39m) under management, our client base has grown a lot. We have many retail clients as well, which is not so common for hedge funds. In total, we have around one thousand clients in the fund.

**Mark Burbach**
Blue Sky Group

Mark Burbach, CIO at Blue Sky Group. We manage the pension assets for nine pension funds with total assets under management 16bn Euros ($20bn). That means we manage nine customized strategies for our clients. Although we have invested in many different strategies and asset classes, until now we haven't allocated to hedge funds or hedge fund of funds.

**France Schuster**
Eurex Exchange

My name is France Schuster. I am working with Eurex Exchange where I am responsible for sales in Frankfurt. As a leading global derivatives exchange, Eurex Exchange provides an extensive suite of products and offers 11 asset classes, amongst others, the most liquid Euro denominated equity index and fixed income derivatives. Eurex Group operates as well Eurex Clearing, one of the leading CCPs globally – assuring the safety and integrity of markets while providing innovation in risk management, clearing technology and client asset protection. With my team we manage all customer relationships and are instrumental in global customer interaction. We act as the primary contact for all products and services offered by Eurex Exchange, meaning listed and OTC products, as well as clearing services provided by Eurex Clearing.

**Niels Oostenbrug**
MN Services

My name is Niels Oostenbrug. I work for MN. We are a fiduciary manager and work for Dutch and U.K. pension funds. I am responsible for alternative investments, which includes private equity,

infrastructure, special investments and hedge funds. We have been investing in hedge funds since 2001.

**Michael Kretschmer**
Pelargos Capital

My name is Michael Kretschmer. I am a Senior Portfolio Manager and Head of Research at Pelargos Capital. This long/short manager was established five years ago and was seeded, just like Saemor, by AEGON Asset Management. Pelargos Capital manages Asian equities and currently runs two strategies, a long/short Asia ex-Japan equity fund and a long/short Japan fund. I am co-manager, together with Richard Dingemans, of the Japan fund. In total we have some $330m assets under management, and with $130m the Japan Fund is currently among the largest dedicated Japan fund.

Our strategy can be described as relative value, meaning we buy cheap listed stocks and short expensive ones. Simple value strategies tend to work quite well in Japan. We are neither event driven nor buy and hold investors. In our mindset, something has value if the payoff structure is skewed in our favor - meaning an asset has little downside but a lot of upside and we can be patient for it to realize. We are mainly cash equity investors and occasionally use derivatives to manage what I call the distribution of the fund itself. We have been running our value strategy in Japan for five years now and so far quite successfully.



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**Matthias Knab** Niels, as Head of Alternative Investments at MN, you have been allocating to alternative asset classes since 2001. What does your exposure and your alternative investment strategy look like right now, in early 2013? And particularly, how do you integrate hedge funds into your portfolios?

**Niels Oostenbrug:** **The role of hedge funds in the portfolio has not changed dramatically over time. The main role of hedge funds in the portfolios is diversification, most importantly when markets go down. They should have a dampening effect in a year like 2008. Hedge funds however should add value to portfolios in all parts of the economic cycle. In other words, their returns should be attractive as well.**

**A third aspect we feel is important is that the hedge fund should be skill-based. In other words, it shouldn't correspond to betas or other assets that our clients already have in their portfolios. As a fiduciary manager for all of our clients, we manage all of their assets. That is typically a broadly spread portfolio where we invest in equities worldwide, but also in high-yield - U.S. and Europe, private equity, international real estate, and so on. Therefore, not all hedge funds fit.**

**So while the purpose of hedge fund investments has stayed the same over the years, the product itself did evolve. In the past, we tended to optimize portfolios on a standalone basis. That means we eliminated the elements that we didn't want in the portfolio, but other than that the portfolio was optimized on a standalone basis. Now, a recent development that started in 2008 is that our clients express an increasing need for less complexity. They also want to be more in control, and they want fees to be lower. These three aspects have become very important, also because the regulator tells them that they need to have more control of their portfolios in general and that they need to have a deeper understanding of what it is that they own.**

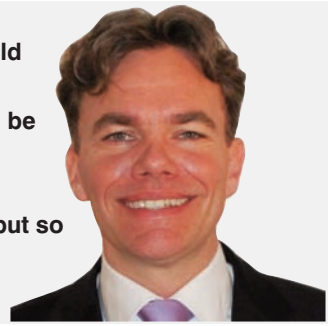


**In our hedge fund portfolios we have responded by shrinking the number of strategies in the portfolio to four strategies which according to our analysis add the most value to pension fund portfolios. Those four strategies are equity market neutral, fixed income arbitrage, global macro and CTAs. That means that while before 2008 we had the portfolio optimized on a standalone basis, we are now expanding this optimization with the existing long-only portfolios, aiming to create a tailor made hedge fund solution for pension funds. By shrinking the number of strategies, the complexity is reduced significantly and it helps our clients to explain their hedge fund investments to the regulator.**

**Another change we have implemented is that we started to use a third party risk provider. All underlying hedge funds we are invested in provide their data to this risk provider who then creates additional reports that we will send to our clients. They will get details about their main exposures and they will get results of a number of stress tests. With this report they will know what returns to expect from their portfolio when equity, fixed income or currency markets move, which further increases their control over their portfolio.**

Let me also mention that we have also been very active in negotiating fees down further or depart from funds that are not willing to negotiate fees.

**Matthias Knab** What would be an appropriate or acceptable maximum compensation for this skill-based asset management that you are looking for as a diversifier?

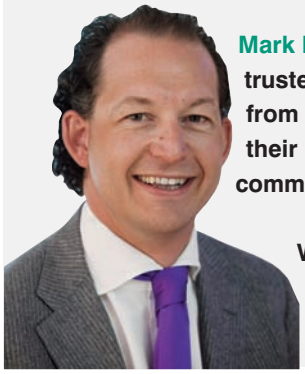


**Niels Oostenbrug: There is no clear cut answer in this fee discussion. Management fees should be enough to pay for the going concern business, and performance fee should be something extra for a manager that has done well. Income for hedge fund employees and owners should be comparable to the income of other people working in the financial industry.**

**Fees have come down over the last five years. Managers charging "2&20" have become rare but so is "1&10". I think that could be an acceptable level over the longer haul.**

**Matthias Knab** You said that about 5% of your assets are in hedge funds. Within MN you are in charge for the overall bucket of alternatives, right? Can you please tell us how much you allocate to the other alternative investment classes?

**Niels Oostenbrug** Private equity is also at around 5-6%. Usually the larger clients include private equity. We have pooled private equity vehicles that we manage for a number of our clients, and separate portfolios for our two largest clients. The larger clients have typically 5% in private equity, for other clients it's usually somewhat less. Infrastructure is 2% and special investments is smaller.



**Mark Burbach: At this time we do not have investments with hedge funds. The reason for that is that trustees of our clients don't see the need to invest in hedge funds. So it would be very nice to hear from Niels and Michiel who have more than a decade of investment experience with hedge funds their rationale for hedge funds in a pension fund portfolio context and how to best explain and communicate these investments to the Dutch (pension) community.**

**We are very much ALM-sensitive, so one aspect that interests us is how to model certain scenarios into an ALM study and see the benefits and perhaps also the pitfalls of adding hedge funds to your portfolio.**

Over the past years we have put some of our efforts into tactical positioning, for instance. Traditionally a portfolio of a Dutch pension fund consists assets of equities, bonds, some real estate and certain risk hedges. Invested amounts stem from ALM studies translated into benchmarks. Any deviation is mostly applied through position away from benchmark weightings. Considerable amounts of costs are involved, thereby determining the time-horizon of deviations to some six to 12 months. Our research efforts have focused on the implementation of a tactical derivatives overlay. In itself that is not very new and lower costs are easily achieved. We look at leaving our long only mandates with external managers as much as possible untouched in terms of additions and withdrawals. We then may separate some percentage points of a total portfolio to invest in tactical deviations, long and short, by derivatives.

So, we have been doing some research and studies whether we could apply that approach to our portfolios. If you look back about 10 years or so, a lot of funds started to play with GTAA. That's not what I am referring to here. We think of our tactical strategies more like a CTA or a trend-following type of investment.

**Matthias Knab** Would you be using external managers for your tactical investments, or would you manage it internally?

**Mark Burbach** At this time, we have started to think about the concept, we haven't excluded any type of execution yet. Creating an in-house hedge fund manager or CTA type of manager is quite a prestigious goal in general, at Blue Sky Group we will not pursue that route. Equally you need to do a very good job when you formulate such a type of a mandate with an external party and what you expect from that

specific investment. As pensions' asset managers, our goals are to achieve certain real returns, and any additional strategy has to fit into a larger framework. Like Niels, we would not be looking at just one sector of our portfolio and say "let's optimize that one", we have to view the whole portfolio long term.

**Mark Burbach: I can tell you that our trustee boards are very reluctant to enter the area of hedge funds. This has something to do with transparency around hedge funds, but also, as we already mentioned, with the complexity and the technicalities around them. Of course, there are many differences between all the hedge fund strategies, and I also believe that not all strategies should be excluded from, say, even a plain vanilla pension portfolio, because the fact is that we already see some long only managers also apply hedge fund type of strategies.**



**So from that perspective, hedge funds should come a bit out of the dark side of investing, if you allow me to use that term. I am also aware that we have a number of alternative investment managers operating here in Holland, but it is probably not an easy task to get the average Dutch pension fund to do hedge fund type of investing. To use a picture, there is a door and it's a bit open, but passing through is very difficult.**

**Michiel Meeuwissen: With 30% of our investor base consisting of pension funds, we are well aware of the issues Dutch pension funds have to overcome when investing in hedge funds. We help them in several ways.**



**First, we offer education to boards of pension funds *in Dutch*, explaining what hedge funds aim to do, the strategies they run, the kind of risks that come with those strategies and how you can cover those topics in your due diligence and ongoing monitoring. Second, we are very transparent with them, including look-through exposure analysis for example. Third, we are familiar with local regulation and as such can help a pension fund in its dialogue with the Dutch Central Bank (DNB). By way of example, in the summer of 2012 the DNB sent out a questionnaire to pension funds that invested in hedge funds, containing over 50 questions in Dutch. Kempen offered assistance to pension funds to help them answer those questions. With our help, we notice that the pensions feel more in control with respect to their hedge fund investments. This approach has probably helped us grow our pension fund shareholder base.**

**Matthias Knab** From your perspective, what are some of the differences between those Dutch pension funds who invest in hedge funds and the others who don't?

**Michiel Meeuwissen: The first distinction is obviously size. There are a few very large pension funds here in the Netherlands that are large enough to build the infrastructure and a team to directly invest in hedge funds. Here, the pension fund is in full control as they perform the due diligence internally and make the investment decisions. Examples would be APG and PGGM and there are a few others as well.**



**All the smaller to medium-size pension funds can't build the infrastructure that is needed to solidly invest in hedge funds. For those pensions to invest in hedge funds, they need a fund of hedge funds kind of solution. Within that group, there are those that simply do not want to be in a position where they will be questioned by the Dutch Central Bank about their investments in hedge funds, so they do not invest in them at all. And there we have those pensions who see the added value of an investment in hedge funds and are willing to learn and be educated in order to be in control. They will take those extra steps and make or maintain an investment in hedge funds. A Dutch pension fund needs to feel strong and comfortable in order to invest into hedge funds; it's not an easy decision.**

**Matthias Knab** And when the pension invests, what is their motivation in general? What do they expect from hedge funds?

**Michiel Meeuwissen:** **In our educational sessions we make the case that if you break down hedge fund returns, if you decompose it into the return drivers, you can actually see five drivers to returns.**

**Obviously there are the fees, and I totally agree that you should try to keep the fees as low as possible, because it's a negative return driver. The remaining four drivers are the positive ones. One is the simple, traditional beta exposure. Most hedge funds have more long exposure than short exposure; so they bring with them traditional beta. Some may try to time the beta a bit, for example through CTA or macro kind of strategies, so traditional beta timing is another return driver. Then you have exposure to non-traditional betas. You can think of distressed debt, structured credit, insurance-linked securities or frontier market equity, things like that. And then there's alpha, or stock picking skills.**



**What we aim to maximize and what we believe adds value to a pension fund and also high net worth investors is the exposure to the non-traditional beta and to the alpha part of the decomposition. The reason for that is because all investors will already have traditional beta exposure; and many of them will have already tried to tactically time the exposure to traditional betas. That means you should probably not be paying a lot of fees for those two components because you can get them cheaper elsewhere.**

**But the other two components are something they don't have, and the non-traditional betas and the alpha are something that can help them achieve their goals. So our aim as a fund of hedge funds is to optimize our exposure to well-specialized managers in non-traditional markets, both because we think it helps in getting that non-traditional beta but also because those are markets where it is generally also easier to generate alpha. There is more inefficiency in those markets, and being a specialist can be of real added value.**

**Michael Kretschmer:** **I would like to add a comment regarding fees. One can not simply assert that fees should be lower because it is a negative return driver. The truth is that the costs for running a hedge fund have dramatically increased. Over the past five years, the regulatory bodies are increasingly demanding additional resources for procedure documentation, compliance, and legal matters. These days, clients demand more transparency and rightly so, but without sufficient scale it will be difficult to establish and maintain the required IT infrastructure and people for providing that. It seems as if hedge funds with assets less than $200m will have trouble to survive.**



**Another aspect relating to fees, which is often forgotten in the Netherlands, is that specialized, successful managers are delivering superior returns because they have acquired a unique skill set. To maintain that very skill set, and keep its competitive advantage, requires continuous investment in people and resources in general. With lower fees the unique feature of the hedge fund business model is undermined and eventually diminishes the alpha the investor was looking for in the first place.**

**Matthias Knab** What is the experience of Dutch alternative investment managers with their domestic investor base?

**Jasper Anderluh:** Yesterday I was at a small Dutch pension fund, however they actually have a sizable allocation to alternative funds. We showed them our beta plot, visualizing strongly that we have a beta of zero. They seem really interested in such an uncorrelated strategy, and we had an in-depth conversation for two hours.



Unfortunately, our conversation concluded on exactly the point you mentioned, they would love to add more hedge funds and other uncorrelated alternative investment strategies, but it seems they run into issues with the Dutch Central Bank if they invested more into hedge funds. As they already have more than 20% in alternative investments, the Dutch Central Bank kind of flagged them, and they had to go through an audit because of their allocation to alternative investments.

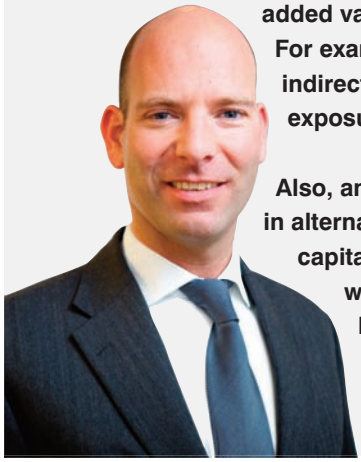
I was wondering what the Dutch Central Bank is looking at in such an audit. Would a consolidated risk report from a provider like RiskMetrics suffice, or would they ask for a line-by-line exposure? For example, we have 1,500 lines now in our portfolio, and they change very rapidly every day. So, even if you look at those positions, you do not really see anything.

**Michiel Meeuwissen:** If you look at the 50 questions from the Dutch Central Bank, they are not requiring that the pension fund knows all the underlying positions, but they do want them to be in control. The kind of questions they ask are: Why do you invest in hedge funds? Do you measure the added value of your investments in hedge funds? What kind of due diligence do you perform before you invest in hedge funds? How do you measure and manage the risks associated with it? Do you perform stress scenario testing? Do you have enough countervailing power in your organization? It's such kind of questions that pension funds are asked when they invest in hedge funds.



By the way, up until 10% investments in hedge funds, the Dutch Central Bank tends to be okay with this as long as the pension fund has the governance in place to be in control. Beyond that percentage, they seem to get harsher on pension funds; that's what we hear.

**Patrick van de Laar:** The questions Michiel just posed are of equal importance to insurance companies. But not only the alternative proposal needs education and explanation and ample (risk) ransparency; to explain its added value, one also has to analyze what the insurance companies need and its current products. For example, investors who are looking into alternatives and only run long only mandates might indirectly already have short exposures as even those traditional mandates would include short exposures taken synthetically via swaps or *short ETFs*.



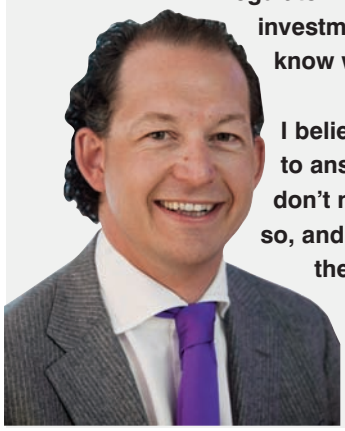
Also, an insurance company has to hold sufficient required capital for the investments they take in alternative investments. Through providing data and risk models one can lower the required capital down significantly from its default level. Models have to be validated and embedded; when done so authorities do grant the possibility to use them and to lower capital required, bringing the cost of capital down significantly for a market neutral proposition like ours. Saemor can provide full transparency on positions, investment policy and all kinds of (risk) statistics.

**Michiel Meeuwissen:** Adding to what Patrick just said, this is true for insurance companies, but not for pension funds. Under Solvency II, insurance companies need to apply a 49% capital charge for their investments in hedge funds. That is as high as emerging market equity, higher than anything else.



But if you are able to calculate and report the underlying look-through exposures to asset classes, you can actually apply a weighted average mix of the risk factor that applies to those asset classes under Solvency II. What we understand is that insurance companies are able to do this using both internal or external risk models.

**Mark Burbach:** I believe what the regulator really likes to see is that you have an organization fit to handle hedge fund investments. So as soon as you deviate from easy to understand investments and get into the more complex ones, you have to adjust your investment staff. And even if the pension invests via an operator like MN or Kempen or ourselves, the trustee board still needs to understand and analyze what it receives from those entities. That is why the regulator will always question the trustees about their knowledge, what do they know about their investments, their strategies and their markets? What is your target? Can you handle it? Do you know what you are doing?



I believe these are in fact basic questions every investor should ask himself, you should be able to answer them. Also, the regulator doesn't want you to report every line of your portfolio, they don't need it, but they want you to demonstrate or tell them that you can, that you are able to do so, and that you have thought about this. I believe there is a bit of a misunderstanding about what the Dutch regulator wants. In essence, they just want to see the pension is fit to invest in these type of investments. I don't even believe the regulator has any preconceived notions or opinions about certain asset classes like hedge funds, but they do want to see whether the trustee board is able to handle these type of investments, which I think is a very fair point.

**Niels Oostenbrug:** I agree with what Mark's point here about the regulator's intention and I think we can distinguish three groups in the Dutch institutional investor community. We have institutions that have always felt very comfortable with their hedge-fund investments and that continue to do so. There are institutions that have never felt comfortable and that probably will never invest in hedge funds. And we have a third group of institutions, and this is probably the largest, that is interested in hedge funds and alternative investments, but that wants to increase the control and understanding of their portfolios.



**Matthias Knab** All of you are based here in the Netherlands. Please tell us how your country has evolved over the past years when it comes to managing or investing into alternative investments.



**Patrick van de Laar:** I believe the Netherlands is an excellent place to start and to operate alternative funds. We have got the talent, the right tax and legal environment, but the rest of the world doesn't know it... It appears to be a discussion item when talking to foreign investors. Fund structures in Europe consolidate in two forms; Luxembourg SICAVs or Irish CIFs. The Dutch fund structure of an FGR is efficient, but requires explanation. However, one not always has the chance to explain and to overcome that hurdle when still being on the long list.

**Mainly as a result of all the new legislation, costs and thereby barriers of entry have increased significantly. On the other hand we have seen quite a number of start-ups in Holland. The challenge is obviously to stay in the game and grow the business, which requires interest from foreign investors. Our prime broker told us recently that the minimum asset base in the long run for an institutional hedge fund set up is already around $200m today. I would expect thus some consolidation of managers or fund closures.**

I ought to believe that the financial sector in other countries, like Luxembourg, Ireland or UK, promote themselves better than The Netherlands. The asset management industry has not really been the prime focus of the Holland Financial Center, a joint venture set up by the financial sector, the government and regulators. Moreover, the resignation of the chairman and the opinion of the Dutch minister of finance about the involvement of the supervisors – giving the impression of a potential conflict of interest – recently led to the decision that the organization in its present form will cease to exist. I understand the impression of a conflict of interest in case of the regulator, but I would not see why the Ministry of Economic Affairs should not be one of the cornerstone partners. It is unfortunate that the baby probably is, or will be, thrown out with the bathwater.

**Mark Burbach** Do you think this comes down to an image problem or are there other reasons for this failure?

**Patrick van de Laar** It is both, so an image problem, and a cultural issue as well. We rather tend to be very critical on each other and believe that the grass is greener at our foreign neighbors. There were two triggers for Holland Financial Center now to quit, but in general the Dutch do not quickly brag about themselves how outstanding they are. Even though all elements for having a sound asset management industry are here: technical and financial infrastructure, well educated and financial literate people, as well as developed legislation and enforcement.

**Matthias Knab** As a Dutch-based manager, you can also run Luxembourg or Irish fund structures, right? You are not really limited to running a Dutch structure, even though you say it has advantages?

**Patrick van de Laar: That is true, however I was talking about the general attraction of the Dutch alternative investment industry. For some US investors who do visit London, Holland is a channel too far. The Netherlands should not lose its critical mass for alternative investments going forward. Support functions, service providers and prime brokers are already concentrated in centers like London, New York or Hong Kong. Also for legal advice on international items, one frequently needs to turn to foreign lawyers.**





**Jasper Anderluh: We started in 2007 with our own money and some money from friends and family, and next we were successful in raising money from retail. As a smaller start-up, we discovered that it was very hard to get institutions involved. We did in fact find that nobody was doubting that we did something good at our previous proprietary trading desk, but the institutions we talked to were not willing to invest on that. We then decided to broaden the retail client base, and that was very helpful for us as we fund that retail has two advantages.**

**First, you have not one client, but many. Many hedge fund managers advised us against having retail, but we found them a very sticky client base, once they understand your process and have trust in you and your organization. Our office is in downtown Amsterdam, and once in a while we open it up and invite people to come over to our office. We then have sessions with 50 or 60 people presenting the way we manage the**

**fund. We show them the dealing room, they can see it is very active until 10 pm at night, we explain to them the strategies and they can see we are really busy with their money. And should you have four months of bad returns, they are not leaving but stay because they know what you do.**

**The second advantage is that you don't have this discussion on fees. They see your net returns, and if they are attractive enough, you can charge a certain level of fees. We let people invest in our fund from 2,500 Euros ($3,250) upwards, which is a very small amount. There is a separate class for that for which we charge 2 and 30, which I think you cannot sell to any institution. That allows us to cover our costs with fewer assets under management. The diversified client base does give us growth and stability. The retail client base is now helping us to reach 100m Euros ($130m), and from there we target again the institutional investors.**

**Mark Burbach** So basically you tackled the image problem by getting more personal and having a closer relationship with your clients.

**Jasper Anderluh** Jasper Anderluh: Yes I believe we do have pretty good and close relationships, we tell people exactly what we do.

**Jasper Anderluh: Apart from retail, we have also some asset managers and family offices invested with us, that is another growing sector. Many owners of family offices have in fact owned or still operate one or more successful businesses. They are used to taking certain risks, and they like the risk-return profiles that we can offer them. Also here, sometimes the people behind the family officers come themselves to our office. And even though we have been around for five years now, we are a still a young company with a young team, and many of those investors tend to get enthusiastic and invest in us.**

**We touched on the Dutch fund structures and their benefits. Well, when we went to the "Battle of the Quants" conference in London, we found that a good number of other quant funds that had gathered there were very amazed that it is possible in the Netherlands to offer these kinds of funds to a retail base. They say it might be only possible in the Netherlands, and in the place they are domiciled you cannot get a retail client investing in their fund with 2,500 Euros ($3,250). Our fund is market neutral, so we aim to be hedged at all times, but still we are between five and 10 times leveraged in our exposure. We are doing a lot of trades in all kind of products: futures, options, bonds, everything, all over the world, 24 hours a day. So, in a lot of ways we are not a standard product, and that a legislator or regulator allows you to target retail with the product is actually goosing all these other funds.**



**And it even becomes better, because our Dutch license will automatically extend into an AIFM license, which means that we can target all over Europe. We feel that we have a unique product and a unique proposition, so we have a very positive outlook regarding our future. At the moment, our assets grow at a rate of 10% a month. Since 2012 we get between 100 and 150 new clients every month now since last year, so we should hit 100m Euros ($130m) this year, and from there on everything is open. And as I said, Europe will opens up as well for us, so maybe in the end we don't even need the institutions. If you have 500m under management in a 2 and 30 share class, you have much more to invest in your people and your company than with a much less paying share class.**

**Matthias Knab** One of the other unique features about your firm is the proprietary trading infrastructure and exchange connectivity you have built, which is now even used by third parties. Can you tell us more about that?

**Jasper Anderluh:** **We are a trading fund and started to rent infrastructure to access all the different markets; but we soon found out that we couldn't rely on external providers for our trading. For example, if your provider now and then sends you prices of zero, there is something wrong with that. In the end, we built everything ourselves, that means we run and maintain a whole technical infrastructure from exchange connection to strategy design and execution for 65 exchanges. Our infrastructure is co-located in several datacenters all over the world. At this time, we are doing this with a team of 25 people, and we are hiring 10 more.**



**We are renting out the exchange connectivity and the execution capability of this infrastructure to other hedge funds, basically all the big hedge funds here. Of course, they do not get the algorithmic part of our infrastructure; but they can send an order to Chicago or to Osaka, wherever they like, and our systems will also take care of the clearing, book keeping and daily reconciliation. The client doesn't have to do anything regarding these issues, because we have all the required software and systems to do it.**

At this time we are extending our client base to share our infrastructure. At some point in the future we may even operate a retail brokerage platform, because through our high aggregate trading volumes, we can offer someone a price for a transaction that will probably be much lower than from any other broker he may have access to. To us, this powerful infrastructure we have developed over the last five years is like a free gift on top of our hedge fund business, and we are looking forward to continuing developing and capitalizing on it.

**Mark Burbach** What do you think, France, from an exchange point of view?

**France Schuster** For us that's good news that firms like Jasper's are around, because they have a great potential. Japer's input reflects some specificities of the Dutch market: it is a retail oriented market and it is characterized by a strong entrepreneurial spirit. This gives a good basis for business from The Netherlands and that is why Eurex Exchange has a lot of participants from here.

Algorithmic trading represents a large part of our business. This is also the reason why we do offer the technology for this kind of business.

**Mark Burbach** Do you cater for the special needs of hedge funds or other say more demanding market participants?

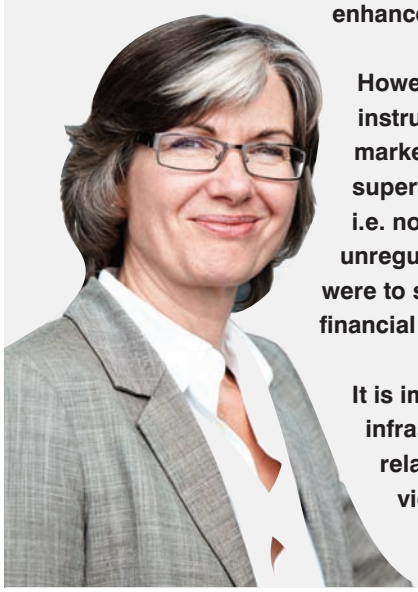
**France Schuster:** **We offer products, services and technology for all market participants and types of businesses including hedge funds and quants. I would like to mention the introduction of our New Trading Architecture that we believe will revolutionize the way traders and investors access market opportunities worldwide. Our new platform has been designed to enhance trading performance across the board, including reduced latency and increased throughput. In terms of pricing we also offer fee rebates for high volumes contributors for the trades booked on their proprietary position accounts (P-Account).**



**Matthias Knab** As an exchange, what is your view on financial transaction tax that 11 EU countries have recently decided to introduce?

**France Schuster:** **There are a lot of different regulatory initiatives in preparation. One of these is the financial transaction tax. In light of the financial market crisis, Eurex Group and Deutsche Börse Group understand the political**

**motivation is to make the financial sector share the costs of the crisis. We have taken note of the recently published proposal by the EU Commission for a directive to introduce a financial transaction tax within enhanced cooperation in Europe by 2014.**



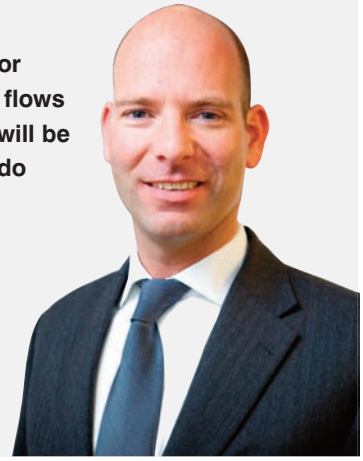
**However, we are not convinced that a financial transaction tax is the appropriate instrument to effectively support the goal of increasing safety and integrity of the financial markets. A tax that penalizes the turnover made on regulated markets – transparent and supervised markets – thus indirectly rewards the turnover made on unregulated markets – i.e. non-transparent and unsupervised markets. Such a tax would be a gift to the unregulated financial centers of the world. Even if introducing this tax all over the world were to succeed, its effect would still be doubtful, given that the requirement of recording all financial transactions for taxation would be extremely laborious with gaps highly likely.**

**It is important to Deutsche Börse and Eurex Group as a provider of highly regulated market infrastructures with reliability and integrity that every regulatory measure – also taxation related – serves to strengthen the transparency, integrity and stability of the markets, in view of experience gained from the financial crisis. Thereby, it is also important that the measures do not lead to competitive distortions and regulatory arbitrage.**

**Jasper Anderluh**

In France, not all market participants are required to pay the French financial transaction tax. Retail investors need to pay it, but for professional market participants there is a way around it. If your transaction is a hedge, then you don't have to pay. So what you do is putting a prime broker in between who takes the position on this book. He gives you a contract for differences, so you as the hedge fund only have the COD as your position, and don't need to pay that tax. As a consequence of the whole initiative, there is less volume on French exchanges and also less income than they expected.

**Patrick van de Laar: The financial transaction tax is a much needed and welcome source of income for the states, but its justification is unclear. It started with a (political) discussion about banks, but the ones who now pay the tax are end investors. Also, the examples used by politicians to justify the tax referred often to macro funds (who often take large and longer term exposures), and not to the higher frequent trading funds or institutions, who in fact bear the impact of the tax now.**



**There are economic theories which claim that some market hindrances, like trade barriers or taxes, could actually result in a more optimal efficient allocation of capital, as the arbitrage flows became too large and result in an opposite effect of undesired volatility. I do not think this will be the case here. The financial transaction tax is a political statement, which has not much to do anymore with the initial goals of having stable financial healthy actors in the economy.**

**Regarding the French exemption on derivatives, I expect those exemptions to disappear ultimately when a harmonized European tax would replace the country initiatives. A European FTT will have significant impact: its cost per transaction can be 10 fold of the broker cost. It will have impact on many trading and portfolio models which incorporate the cost barriers, resulting in lower trading signals.**

**Matthias Knab** How are you preparing for the EU financial transaction tax?



**Patrick van de Laar:** **Well, if you wanted to get a positive angle out of it, we could look at the assumption that when markets become less efficient, that's generally good news for alternative funds. The direct effect however is that the cost for the end investor increases, volumes will decrease, and in general most economists would agree that hindering capital will not result in a better efficient allocation of it. We first need to wait for final proposals of more countries, and then investigate how to optimize our trading by altering our portfolio models.**

**Matthias Knab** I have been observing this discussion about the financial transaction tax from the beginning. I view it as a real threat to the financial system. And what makes me wonder is that no amount of research, fact finding and common sense could stop it. This tax is based on pure political will and nothing else.

**Jasper Anderluh:** **I was speaking for a Dutch political party where they asked me to talk about high frequency trading. When I asked them who was against it, it was almost the whole audience. I then asked them if Jerome Kerviel was a high frequency trader, and about 90% of them thought he was one and that people like him should be stopped. Unfortunately, most people, including probably the majority of the politicians, are so far away from the realities of the financial industry, they really have no clue.**



**Matthias Knab** I agree. Looking at the Netherlands again, what else can you tell us about running or investing into alternative investments here?

**Michael Kretschmer:** **I am Austrian and I moved to the Netherlands 11 years ago to join Robeco, one of the largest asset managers in Europe. Back then, there was a rich asset management culture in the Netherlands compared to other parts of Europe, with plenty of talent around at big financial power houses like for example ABN AMRO and ING. During the past 10 years the financial landscape changed dramatically in the Netherlands. Robeco is being sold to foreigners, ABN has been nationalized and ING has an undecided strategy due to pressure from Brussels. The rise of cheap beta proxies such ETFs accelerated the retreat of the traditional long only players. Unfortunately and maybe due to high regulatory barriers to entry and lack of hedge fund culture, the alternative space could not fill the void.**



**When we present our strategy in overseas markets, especially the US, we are confronted with this image problem the Netherlands and maybe all of Continental Europe face in general, except maybe Switzerland.**

**Of course in today's world it does not matter where one is physically located, but knowledge and social networks tend to be highly concentrated in the major financial centers. Thus I think that the key to the image problem is to recognize it as such and adapt. It is probably a good idea for a Dutch firm like ours to have someone marketing us in London and somebody on the ground in Asia. That way we use our Dutch talent and at the same time access local knowledge and investors.**

**Michiel Meeuwissen:** **I would split my observations with respect to hedge funds in The Netherlands in two parts. On the one hand you have the funds of hedge funds industry in the Netherlands, and on the other hand there is the single**

**manager hedge funds industry. If you take the first one, about six years ago there were six funds of hedge funds that each managed more than $500m. Today, there is just one left and that's us. So that part of the industry has obviously shrunk over the past six years.**



**If you look at the local hedge fund industry, there is one large hedge fund in the Netherlands, a CTA-manager called Transtrend that manages close to $10bn. Then, at the other end of the spectrum, there are quite a few managers below $100m, which are all trying to get to that point because that opens up international prospects. Performance for these managers has generally been good, but it's a bit of a chicken and egg discussion with respect to size.**

**In between, there are just a few managers that are between $100m and $1bn and it would be good to have more funds in that range or beyond $1bn. Two days ago, I spoke to a recent successful startup, a spinoff of APG. They already manage more than $500m and I like the fact that they started the business here in the Netherlands.**

**Matthias Knab** What are some of the opportunities that you are looking at this year? Tell us more about the things that you do, are you developing new products, for example? How do you invest? Do you do something different now than before?



**Niels Oostenbrug: We are looking into macro managers who are qualified and set up to profit from changes in volatility in the markets. I looked up the VIX this morning and saw that arrived at 12.6, and I recalled that the last time we invested in volatility macro managers was in 2007 when the VIX was around the same level. Back then that value was 25-year low, so that we are seeing the same low vol right now seems sort of weird, considering the tensions we have in the economies and markets around the world. Everything looks a little bit brighter than it should, and there are still a lot of things that may go wrong.**

**Michael Kretschmer: That is an excellent point. Regulatory, fiscal and monetary policy actions around the planet are massively interfering with the structure of the markets as a whole. It simply comes down to a concerted effort to manipulate capital markets. You see it everywhere, in bond and equity markets, FX and as a consequence in commodities. Central bank actions still have huge influence, and these days, they seem to be in the business of managing risk premiums. Just look at the Swiss Central Bank, for example, it is a listed company and on its balance sheet you can see that it bought a large amount of equities, as did the Bank of Japan. The Bank of Japan is not only buying the broad market, but real estate investment funds in particular with the aim to lower the risk premium in the real estate sector. Real estate stocks in Japan sky-rocketed last year and as a result fresh capital was issued and invested in real property. How does this all rhyme with a VIX of 12%?**



**All these monetary actions have led to a huge disconnect between the real economy, financial markets and the pricing of risk. And of course, this disconnect offers a great opportunity, as it leads to misallocation of capital which eventually will be corrected. I don't want to make a directional comment because things can work both ways. Central banks are powerful forces who in the end often get what they want, but maybe not always and certainly not forever as unintended consequences will pop up.**

**So from our perspective, with current volatility measures being that low, it offers the opportunity to have aggressive risk allocation and cheap insurance at the same time. In this barbell approach investors can go aggressively long under-appreciated, cheap assets with a lot of upside potential, and hedge that exposure with cheap insurance. A strategy we currently deploy in Japan.**

**Patrick van de Laar:** From our perspective as a quant manager, we see the market normalizing in the sense that volatility has come down. The dispersion of returns has increased, which is good news for a portfolio manager. We also see that long-term factors like value, price momentum and earnings momentum do well. In that sense, all stars are aligned for quant managers, and in the last half year we also saw proof of that. That being said, while the market seems normalized now, a specific event in, for example, Italy can be quite disruptive.



A second comment I would like to make is that we have never seen such a high allocation to fixed income while interest rates are so low already. We are awaiting the great rotation: a move out of bonds into equities and alternatives. This flow would provide opportunities for us as an alternative manager. Hopefully this will be a gradual process that will happen, as an increase of interest rates faster and/or quicker then expected would lead to severe losses that would affect the whole industry.

Further we see US pension funds and consultants increasing their allocation to hedge funds. Equity market neutral strategies like ours appear to be one of the strategies which are currently in favor.

**Michiel Meeuwissen:** As a fund of hedge funds manager, we obviously have a few perspectives. First of all, the dispersion in returns of hedge funds in the same hedge fund strategy are such that we don't really need to have a strong opinion about which strategy to be invested in, as long as we select good managers within them.

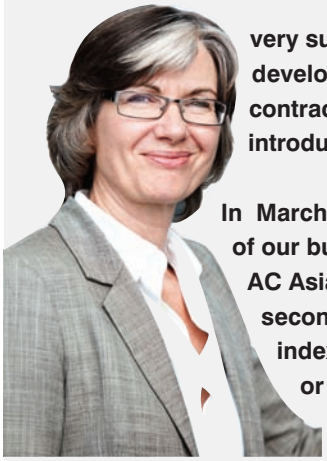
That said, there are times when it is easy to have a strong strategy preference in your outlook. For example going into 2012, it was probably easy to have a strong outlook for structured credit as the asset class had very favorable risk/reward potential and just a few specialized players within it, i.e. little competition. We added to our exposure to structured credit managers and that really came true in 2012 as structured credit was the best performing hedge fund strategy out there.

Going into 2013, we do not have such a strong view with respect to strategies. Like Patrick, we also see an increased dispersion of security returns within sectors/regions and that should be positive for stockpickers. We also expect a wave of distressed opportunities in Europe in the longer-term. Even though things have calmed down here in Europe at the moment, banks still have to shrink their balance sheets significantly. If you look at the combined balance sheet of European banks, they are about three times the GDP of Europe, compared to about one time in the U.S.



So, European banks have to reduce their balance sheets. They have just been waiting and waiting until they can take the pain, because so far they weren't able to sell those assets at the prices the market could clear them at. And now as their Tier ratios are going up, banks are starting to have some room to sell those assets at realistic prices, and that is very attractive for the few specialized distressed managers here in Europe. So, if I have to name one opportunity that could be attractive, not necessarily over the next few months but over the longer period of the next few years, it will be European distressed.

**France Schuster:** At Eurex Exchange we continuously look after market needs and new market developments. Few years ago we realized that our traditional interest rate products Euro-Bund, Euro-Bobl and Euro-Schatz did not fully cover the requirements of the market anymore due to the widening spreads between European countries. Eurex Exchange responded with the introduction of the Italian Government Bond (BTP) Futures segment, which has become



very successful. In April 2012 we launched the 10-year Euro-OAT Futures. The contract has developed quite well with approximately 30,000 contracts traded per day and more than 200,000 contracts as open interest in January this year. We will extend the product range in March with the introduction of the Mid-Term Euro-OAT Futures.

In March 2013 we will also launch additional MSCI index derivatives which are very welcomed by a lot of our buy side customers. These new products are based on the MSCI World, MSCI Europe, MSCI AC Asia Pacific ex-Japan as well as MSCI Frontier Markets indexes. This summer there will be a second tranche with further derivatives on regional and country specific MSCI emerging markets indexes. As a leading exchange, we are always in dialogue with market participants be it buy side or sell side, and are eager to offer the products and services they need, be it traditional or alternative products.

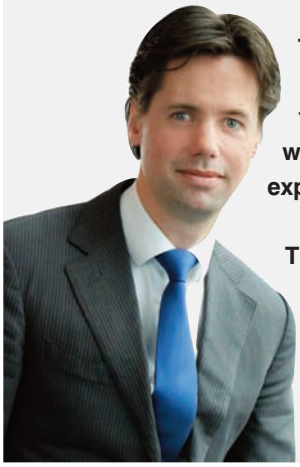
**Matthias Knab** Patrick mentioned you are looking into developing a smart beta product. Can you tell us more about the demand for such products, and what exactly will it look like? And also from the investor side, is this something you are interested in? Have you also looked at hedge fund replication?



**Patrick van de Laar:** There is quite a lot of interest amongst Dutch pension funds for these concepts. Smart beta is one of the faster growing areas in our industry, and provides opportunities for us as quant managers. Our dynamic multi factor models and portfolio optimization techniques could be easily made suitable to create baskets of stocks with systematic tilts towards classic factor premia like value, momentum and low-volatility. An example is a basket of stocks which ranks well on value and momentum, or which is not market cap weighted but risk weighted. Risk weighting can be done according to different methods like risk parity or minimum variance.

We can thus repackage our alpha generating strategies into easily accessible units. Alternatively, we could consult pension funds on these smart beta solutions, or manage a tailormade mandate for them.

**Michiel Meeuwissen:** It's really important to distinguish between alternative beta (or smart beta) and non-traditional beta because they are easily confused. What Patrick and most people mean when they talk about alternative beta is alternative ways to invest in traditional beta, mostly with a long only approach. Things like fundamental indexation, minimum variance, etc. Non-traditional beta on the other hand is about alternative asset classes, such as distressed debt, etc. As I mentioned in the beginning, if you decompose hedge fund returns, non-traditional beta in one of the attractive parts, together with alpha.



Turning to the topic of hedge fund replicators: yes they are transparent; yes they come along with a limited operational risks and the fees are a lot lower but the bad thing about them is that they give you exposure to (the timing of) traditional beta, just the two components you don't want to get exposure to because you already have them in your portfolio. And they won't give you exposure to non-traditional beta or alpha.

This is specifically true for return replicators. Recently some players have started to come up with strategy replicators. Those could be somewhat more attractive, but again, you won't get exposure to the non-traditional beta markets like the ones I have mentioned – distressed debt, insurance and securities, structured credit, etc. So while these products do have a few advantages like lower fees, it won't give people the kind of returns they are looking for when they are investing in hedge funds.

**Niels Oostenbrug** I agree with Michiel. Indeed, most hedge fund replication strategies are factor based strategies that replicate the things that you don't want to have. They basically replicate a broad peer group with hundreds of hedge funds that as a group have a lot of beta.

**Niels Oostenbrug: Replication strategies that are interesting are naïve or simplified implementation models for hedge fund strategies. The following is an example. A typical convertible manager picks convertibles (typically new issues), sells equity against it, and hedges the delta exposure because of the optionality in the convertible.**

**Some groups offer, for an attractive fee, a service where they will simply buy all new issuance instead of selecting the new issue, and they will hedge it at a fixed delta exposure of say 30, and a standard amount of equity is sold against the convertible. It boils down to a rules-based implementation of a hedge fund strategy, and some of those do seem to be attractive.**



**I also wanted to come back to Mark's question at the beginning about the added value of hedge funds for pensions. I guess most ALM analysis is done top down. Outcomes vary, and more often than not, the results are quite positive. However the sources of return and diversification can stay pretty abstract. I think bottom up examples help to put some color to the results. Recent drivers of return were for example funds that were long Japanese equities and short the yen and short bonds. It worked very well, and that type of exposure typically isn't found somewhere else in the portfolio, hence it diversified. So from a bottom up perspective, a hedge fund portfolio boils down to a basket of little trades that profit from imbalances in markets.**



**Michiel Meeuwissen: You asked about the current climate with respect to investments in hedge funds in The Netherlands. Two things are making a decision to invest in hedge funds difficult at the moment. For one, a simple mix of equity and government bonds has performed extremely well over for the past few years, and secondly the 'average' hedge fund hasn't performed well. So with that historic perspective, one could ask: why bother?**

**Forward looking, however, we all know that rates are really low currently, so you could ask the question whether that same simple mix specifically on the bond side will give you a good return going forward. And if you perform serious due diligence on hedge funds you can end up with those that truly add value. With that, I wouldn't be surprised if over the next few years an investment in carefully selected hedge funds proofs to be the best risk-adjusted way to achieve your return objectives.**

**Matthias Knab** Also, what I hear from many institutions who invest with hedge funds, and by the way also large family offices, is that the people in charge there really enjoy the interaction with the hedge fund for the purpose of their own idea generation. Some investors tell me they are happy to pay hedge fund fees just for the extra benefits of that idea exchange, education and access to market knowledge.

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