

# Hedgeweek Awards 2010



hedgeweek  
AWARDS 2010



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**Website:** [www.globalfundmedia.com](http://www.globalfundmedia.com)

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# The winners

## **Best Hedge Fund Administrator:**

Fortis Prime Fund Solutions

*Our readers say: "Strong expertise, integrity, and responsiveness to client requirements"*

## **Best Prime Broker:** Jefferies

*Our readers say: "Great service, from capital-raising to operations"*

## **Best Risk Management Software Provider:** SunGard

*Our readers say: "Accurate risk management, flexible tools, good research and service"*

## **Best Fund Accounting and Reporting System:**

Advent Software

*Our readers say: "Transparency, speed and accuracy"*

## **Highly Commended Fund Accounting and Reporting System:** SunGard

*Our readers say: "Built for hedge funds, excellent derivative accounting"*

## **Best Managed Account Platform Technology Provider:** Advent Software

*Our readers say: "Speed and accuracy"*

## **Best Managed Account Platform:**

Lyxor Asset Management

*Our readers say: "Comprehensive, robust and accurate"*

## **Best Accounting Firm:** Rothstein Kass

*Our readers say: "Best of breed, accurate, quick and sophisticated"*

## **Best Public Relations Firm:** Walek & Associates

*Our readers say: "Understands the hedge fund industry, well connected, delivers results"*

## **Best Overall Law Firm:** Seward & Kissel

*Our readers say: "Best combination of expertise and pricing, market leader in fund establishment"*

## **Best Offshore Law Firm:** Mourant

*Our readers say: "Expertise, availability and quick service"*

## **Best Long/Short Equity Fund:**

Boyer Allan Pacific Opportunities Fund

*Our readers say: "Focus on delivering consistent returns in the Asia ex-Japan mid-cap space, team's depth of expertise"*

## **Best Market Neutral Fund:**

Gottex Market Neutral Plus Fund

*Our readers say: "Good investment process, their funds are not exposed to any significant directional equity, fixed income, commodity or FX market risk"*

## **Best Relative Value Fund:**

Phalanx Japan Australasia Multi-Strategy Fund

*Our readers say: "Strong 2008 and 2009 performance with a Sharpe ratio of over 3, excellent communication"*

## **Best Credit Fund:** Centaur Credit Select Fund

*Our readers say: "Strong performance in 2009, returning over 45 per cent"*

## **Best Fixed-Income Fund:**

Danske Invest Hedge Fixed Income Strategies

*Our readers say: "Posted a positive return over the financial crisis with more than 40 per cent, also managed to maintain low volatility"*

## **Best Multi-Strategy Fund:**

Investcorp Interlachen Multi-Strategy Fund

*Our readers say: "Prudent approach to leverage, fund met all liquidity requests for underlying investors, never imposing gates or restricting access to capital"*

## **Best Absolute Return Fund:** Dexia Index Arbitrage

*Our readers say: "Consistent performance and low volatility since inception in 2003, rigorous investment process and experienced management team"*

## **Best Global Macro Fund:** CCA Global Macro Fund

*Our readers say: "Managers' flexibility to make directional and relative value investments across a wide range of short- to long-term strategies, markets and instruments"*

## **Best Event-Driven Fund:** Marwyn Value Investors

*Our readers say: "Application of a unique mix of hedge fund and private equity skills to their investments"*

## **Best Managed Futures CTA:** Global Advisors

*Our readers say: "Excellent risk-adjusted returns, unique focus, strong attention to downside"*

## **Best Diversified Fund of Hedge Funds:** GAM Diversity

*Our readers say: "GAM's long-term track record, Diversity's positive returns irrespective of market direction"*

## **Best Specialist Fund of Hedge Funds:** Key Europe

*Our readers say: "Excellent performance over 2009, strong risk-adjusted returns to investors"*

## **Best Energy Commodity Fund of Hedge Funds:**

Man RMF Energy Fund

*Our readers say: "Strong risk-adjusted performance in 2009, expertise in developing and managing themed portfolios"*

## **Best Convertible Arbitrage Fund:** Admiral Flagship Fund

## **Best Regulatory Advisory Firm:** Meteora Partners

*These awards are given by Global Fund Media and do not certify any statutory compliance in any jurisdiction nor offer any assurance about the future performance of any company, product or service. The awards are based on the votes of Hedgeweek readers according to a range of their own criteria including product design and innovation, skills and experience, and quality of client service. Past investment performance is no guarantee of future results.*



# Hedge fund managers move cautiously in an uncertain world

By Simon Gray

While the crisis that afflicted the hedge fund sector in 2008 and early 2009 may be essentially over, with market conditions remaining volatile and investors still cautious, there is no prospect of an immediate return to the buoyant growth conditions that prevailed through the mid-2000s, according to industry professionals. And continuing economic uncertainty, especially in Europe, continues to weigh on prospects for the next 12 months – although some hedge fund managers have been relishing the return of volatility to the markets over the past couple of years.

An average performance loss of around 20 per cent in 2008 was matched by a virtually equal rebound last year, and while hedge fund returns over the first couple of months of this year were patchy, March saw a fresh uplift of as much as 3 per cent – albeit helped by a surge of more than 5 per cent in US equity prices – according to index providers such as hedge fund advisory firm Hennessee Group, whose main index

increased by 3.05 per cent. The Barclay Hedge Fund Index gained 3.08 per cent and Hedge Fund Research's HFRI index 2.70 per cent, while the Lyxor Hedge Fund Index rose by 2.12 per cent and the Credit Suisse/Tremont Hedge Fund Index by 2.22 per cent.

"The financial markets seem to have quickly forgotten about sovereign risk and concerns about central bank exit strategies," says Hennessee co-founder Charles Gradante. "Investors remain willing to assume greater levels of risk, and equity markets rallied sharply in March. During the month, the focus of hedge fund managers was on Greece and its debt level, as well as potential problems in Spain, Portugal and Italy."

The firm's managing principal Lee Hennessee adds: "Hedge funds posted a strong, positive month in March, but underperformed the sharply rising equity markets due to conservative positioning and difficulty shorting. Top performing strategies included emerging markets, financial equities, ▶ 6

# Collaboration across the hedge fund ecology

By Tom Zdon

Advent has been investing heavily in its platform for a number of years, working with industry leaders on building out our functionality. It is the strength of our relationships with our client partners and working with them that has led to our position in this space.

Fund accounting has become a critical component of many firms' infrastructure. Obvious counterparty and investor due diligence concerns are leading to a stronger position for fund administrators and increasing the breadth and depth of services they are being asked to offer.

Last year's buzzword was 'valuations', and this year it's 'middle office functionality'. Advent has responded with the release of Geneva 8.0, which builds out the middle office functionality to enable our fund administration clients to respond to the timeliness of data issues that hedge funds are requesting.

At Advent we have long been proponents of a validation strategy. All development lifecycle decisions are made with client input, validation, prototypes and client involvement throughout the process. This leads to a more accurate feature release process that really meets the demands of our client base.

In addition, our support model includes several levels of connectivity into our firm for our clients. Advent Geneva is used by all three pillars of the hedge fund industry. European hedge funds use Advent Geneva as their portfolio management system (in the US as the accounting system), fund administrators as their fund accounting solution, and prime brokers for portfolio accounting and P&L reporting.

The market is moving toward allowing firms to self-service on their information and provide collaborative workflows between



**Tom Zdon is vice-president for solution consulting and business development with Advent Software**

hedge funds, prime brokers and fund administrators. Advent is uniquely suited to meet those needs given that we have client partners in all three categories.

Our key initiatives deal with providing collaborative workflows that unite these three groups, enabling them to communicate in real time on their investment information. This will allow firms to move from a T+3 environment to real active communication, issue resolution, and collaboration across the hedge fund ecology.

Fund accounting from an external provider helps hedge fund managers to keep their fund's overheads low and to focus on the investment process. Advent provides managers of large, complex funds with the speed, flexibility and functionality they need to gain a strategic advantage. With fully automated integrated functions for research management and investor and fund accounting, managers can focus on making investment decisions and servicing the fund's investors.

External accounting solutions provide speed, with fast access to real-time information and timely reporting to managers and investors. They also give managers the flexibility to handle higher trading volumes and complex instruments and strategies, and facilitates operational efficiency to drive down costs and minimise operational risk.

As an organisation, Advent has been in operation for 27 years, and we have constantly reinvested in our product roadmaps, amounting to an average of 17 to 18 per cent of revenues in recent years. This allows us to lead the market in asset class coverage and deliver solutions that directly address market changes such as Ucits, managed accounts, new fund structures and regulation. ■



4 ► and distressed. All underlying hedge fund strategies were positive in March, with the exception of short biased. Despite lagging in February, most hedge funds are positive for the year due to their ability to limit losses during the sell-off in January.”

HFR points to evidence that the market turbulence has starkly highlighted the difference between the most skilled hedge fund managers and the rest, noting that both 2008 and 2009 saw increased dispersion between the best- and worst-performing funds. The firm says the top performing decile of hedge funds returned an average of 100 per cent in 2009, a year when 80 per cent of funds posted positive performance, while the bottom decile lost an average of 16.5 per cent. In 2008, when just 30 per cent of funds were in positive territory, the top decile gained 40.9 per cent, while the bottom decile lost 62.4 per cent.

Good performers are being rewarded with fresh capital from investors, especially institutions, as the capital outflows from hedge funds in 2008 and the first half of 2009 went into reverse toward the end of last year. The industry appears well on the way to making good the capital it lost during the crisis, although how close that point might be is hard to determine with great certainty, given the colossal divergence between different analysts' assessments of total hedge fund assets.

According to TrimTabs Investment Research and index provider BarclayHedge, hedge funds posted an estimated inflow of USD16.6bn in February, equivalent to 1.1 per cent of the industry's total assets, which reached a 16-month high of USD1.5trn. “Hedge funds sport a stellar win streak, and the average fund outperformed the S&P 500 last year,” says BarclayHedge president Sol Waksman. “Money is chasing performance.”

Distressed securities funds saw February's biggest inflow, equivalent to 4.2 per cent of assets, according to TrimTabs and

**Max Gottschalk, head of European business at Gottex Funds, received the award for Best Market Neutral Fund from Global Fund Media editor Simon Gray**

BarclayHedge, while emerging markets funds lost 0.1 per cent of assets despite having returned 65.6 per cent over the previous year. In addition, funds of hedge funds continued to perform poorly, suffering outflows of USD17.4bn over the three months to the end of February after having underperformed the industry by 13.9 per cent in the past year.

According to HFR, USD13.7bn of new capital was allocated to hedge funds in the first quarter of this year. Combined with the increase in assets due to performance, this amounted to a boost of USD54bn, bringing aggregate hedge fund industry net assets to USD1.67trn. During the final three months of 2009 funds enjoyed net inflows of USD13.8bn, the firm says, but over the year as a whole, net redemptions totalled USD131bn. Strong performance helped global hedge fund assets grow by nearly USD260bn over the final nine months of 2009, but they are still some USD260bn below the peak of USD1.93trn set in the second quarter of 2008.

It should be said that some estimates of the total size of the industry give substantially lower or higher figures for total assets. According to the 2009 PerTrac Hedge Fund Database Study, based on a survey of 10 hedge fund databases, total assets rose by 5.5 per cent last year to USD1.41trn, down from a peak of more than USD2trn at the end of 2007.

But tallies based on surveys of hedge fund administrators yield much higher numbers than reporting by managers. Two such surveys toward the end of last year put single-manager fund assets at between USD2.3trn and USD2.4trn, in each case down from a peak of more than USD3trn, while assets under management in funds of hedge funds were reckoned at between USD900bn and USD1.1trn. Other types of investment in hedge fund strategies, such as managed accounts and Ucits III structures, may swell the total even further.

Not all managers have shared equally in the recovery, according to HFR, which says that 52.2 per cent of all funds returned to their respective high water mark levels over the 12 months to the end of March. In the first quarter of this year, investors continued to allocate new capital primarily to larger funds, with firms with more than USD5bn in assets under management experiencing net inflows of USD14.9bn. These managers

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# Building on the platform

By Ronald Oman

Today's financial era has brought out the importance of the role of managed account platforms in the alternative investment industry. Investors' key decision criteria, transparency, risk control and liquidity, are the order of the day, and Lyxor's managed account platform has succeeded in responding to this.

Clients appreciate the diversity and breadth of the Lyxor investment universe in terms of strategies and styles. We aim to be representative of the wider hedge fund universe and our managed account platform is the largest in the industry by all metrics. This, combined with our weekly liquidity feature, allows clients easily to use our platform for the totality of their liquid-bucket hedge fund investing.

Lyxor has selected highly talented managers in long/short equity, event-driven, CTA, global macro and fixed-income strategies, and we saw more than USD5bn in inflows in 2009, with particular interest in event-driven funds. Lyxor's platform is a scalable business that leverages off the industrialisation of our infrastructure.

With investors demanding greater risk transparency, the role of managed account platforms is gaining traction. The strong performance of alternative investment managers before 2008 contrasted sharply with that year's returns as financial turbulence affected the sector. Now investors are increasingly concerned about risk of fraud and lack of liquidity, and investment security is a key demand. Investors want to be able to understand and control the risk - without it affecting asset performance.

Managed accounts offer investors the benefits



**Ronald Oman is head of external relations for the managed account platform at Lyxor Asset Management**

they are now seeking, which include segregation of assets, independent valuation, independent risk management, enhanced transparency and reporting, and enhanced liquidity. Transparency and liquidity help clients better manage their funds by minimising overlaps, by adjusting their sensitivity to risk factors, and by optimising timing of entry and exit. Put simply, investors can make an informed decision about their allocation using transparency.

It should be noted that almost any strategy except the most illiquid are replicable in a managed account format, in part due to technological advances at prime brokers. However, managed accounts are bringing new tools to 'traditional' funds of hedge funds, which can now use transparency to optimise asset allocation and better manage risks. Gone are the days of once-a-month portfolio adjustment. They are also moving toward a multi-platform model for managed account investing.

Finally, the myth that managed account platforms do not attract the best managers has been definitively debunked. Interest in managed accounts has increased from investors and hedge fund managers alike. Since 2009 Lyxor has added names such as Tudor, Marathon and Caxton to our platform of best-in-class managers.

The recent success of managed accounts represents a structural change in the industry. An investor's decision to pursue hedge fund investing via managed accounts is a strategic one, in most cases approved by the board. This strategic decision will serve as a catalyst for institutions to increase their hedge fund allocations going forward. ■

**Christophe Baurand, head of sales and marketing at Lyxor, receives the award for Best Managed Account Platform from Global Fund Media marketing director Oliver Bradley**



6 ► account for just 5.1 per cent of all funds in the industry but more than 62 per cent of its total net assets. Meanwhile firms managing between USD500m and USD5bn experienced net outflows totalling USD3.7bn. All four main strategy areas identified by HFR enjoyed asset growth, led by USD5.6bn in new capital for event-driven strategies.

There are other indications that the industry is gradually returning to health, such as a decline in the number of hedge fund liquidations, which had reached a total of some 2,000 between the beginning of the crisis and the end of last year. The number of new hedge fund launches increased in the fourth quarter of 2009 while the pace of liquidations continued to decline, according to HFR. The firm estimates that 230 funds were launched and 165 liquidated in the final three months of the year, after launches outnumbered liquidations in the third quarter for the first time since the start of the crisis. Over 2009 as a whole, more than 1,000 funds were liquidated compared with 800 new launches, while the previous year a record 1,471 funds were liquidated and just 659 were launched.

One question that continues to intrigue industry analysts is whether the traumas of the past three years have had any permanent impact on the level of management and performance fees charged by hedge fund managers, or whether the established model, of an annual 2 per cent management fee plus a 20 per cent performance fee for gains exceeding the manager's high water mark, has come through the dislocation intact.

The figures produced by industry data providers are not conclusive but do tend to point toward some degree of movement away from the '2-and-20' standard. According to HFR, management and performance fees averaged 1.6 and 19.2 per cent respectively at the end of last year, although the firm says that in some cases managers agreed lower fees with investors in return for agreeing longer lock-ups on their capital.

The move toward lower fees, if it is indeed a trend, appears to be more pronounced for funds of hedge funds. HFR says performance fees for single manager funds fell from 19.34 per cent in the first quarter of 2008 to 19.2 per cent in the fourth quarter of last year, while performance fees for funds of funds declined from 8.05 per cent to 6.9 per cent over the

same period. The average performance fee for funds launched last year was 17.6 per cent, 1.6 per cent below the broader industry average.

Alternative investment research firm Preqin, which conducted two surveys of 900 hedge fund and fund of hedge funds managers in the second and fourth quarters of last year, goes even further. Its report, *The Fee Debate – An End to 2 & 20?*, says that just 38 per cent of single manager funds now charge according to the standard fee structure, with performance fees for funds currently averaging 18.89 per cent and management fees averaging 1.65 per cent.

However, fund of funds managers are charging an average management fee of 1.44 per cent and performance fee of 11.54 per cent (Preqin found that some funds that were launched toward the end of 2009 were coming to market with management fees higher than those of funds launched in the middle of the crisis). The firm also says that on average, European managers charge lower management and performance fees than their US counterparts.

"The issue of fees continues to be much debated within the industry," says Preqin hedge fund data manager Amy Bensted. "Investor calls for more appropriate alignment of interests, coupled with a difficult fundraising environment, have led to shifts in the fee structures charged by managers. Single-manager funds have cut management fees but performance fees have been less affected by the market crisis. Investors that access hedge funds directly are happy to reward good performance, and are willing to pay high performance fees. This has paid off for most investors as the funds that charged the highest performance fees have produced the strongest returns during the difficult markets of the past two years."

For the rest of the industry, though, the optimism is more measured. "The process of recovery is still ongoing in the hedge fund industry," says HFR president Ken Heinz. "A number of firms were able to achieve outstanding results in 2009 amid a very complex economic environment, but the landscape in terms of capital, strategies, service providers, fees, regulation, liquidity and transparency has evolved significantly. These trends are likely to define the growth of the hedge fund industry in the next decade." ■

# Risk protection to help focus on alpha

By Paul Compton

Everyone's talking about risk. Investors are asking about it, and it's no longer enough that managers simply report on risk. Now managers have to explain to investors how risk enters into their investment process, including idea generation and risk monitoring.

The importance of assessing and mitigating risk, especially in these times, shouldn't be underestimated. SunGard's APT, a risk model provider with a 20-year track record and more than 200 clients among alternative and traditional asset managers, recently won the Best Risk Management Software Provider award at the Hedgeweek Awards.

In the alternative investments space, APT's clients are both managers of single hedge funds and funds of funds, as well as some fund administrators and service providers helping managers distribute risk reports to their investors. In terms of the investment process itself, the right risk tools can help skilful fund managers to create alpha – for example, by uncovering the common factors that drive asset prices, they can expose 'unintended bets' in the portfolio, or by suggesting ways to optimise the portfolio around the manager's chosen picks.

Volatile markets are testing not only for fund managers, but also for risk methodologies. When markets are predictable, everyone's risk models will come up with about the same measures. But events like those of 2008-09 are a stress test for everyone's methodologies, and they really allow you to identify which models are able to keep pace with high volatility and structural change in the markets.

Here methodology is at a premium, but it is nothing without empirical testing. At APT we continuously test the performance



**Paul Compton is head of product management at SunGard's alternative investments business**

of our models. Among the things that we found, our fat-tailed measures (of value at risk, portfolio volatility, beta and tracking error) were significantly more capable than traditional normal-distribution measures of predicting portfolio risk during periods such as September 2008.

Over the past few years, service providers have also been realising that risk reporting has become a much more important service for their clients. Regulation and compliance is now at the heart of any successful investment strategy, and for this, good risk management and reporting software should ensure that its products can deliver the information and analysis that managers will need. Apart from 'guarding' the risk, it should also have the ability to meet all client requirements. And with rapidly growing investor sophistication, a sound and flexible risk strategy is a must.

APT's approach is to offer maximum flexibility – anything from our ASP service where you only need to provide a spreadsheet listing your positions to desktop software with fully interactive drilldown, attribution, scenario, optimisation and idea-generation functionality, risk data that can be incorporated into funds' proprietary and third-party systems, and APIs and developer toolkits.

Going forward, we're pushing in several areas. We are always trying to improve the way in which APT fits into the customer's workflow. We are enhancing our optimiser functionality to build into the algorithm the degree of confidence the manager feels about their alpha bets. We are also strengthening fixed-income coverage and working on unified performance and risk attribution. ■



# Risk management at heart of outperformance through the crisis

By Simon Gray

Appreciation of the importance of risk management before it was brutally brought home to the industry in 2007 and 2008 was central to the ability of many of those hedge fund and fund of funds managers who outperformed their peers during the market turbulence of the past couple of years – and whose success was rewarded at this year's inaugural Hedgeweek awards, which were presented in London last month.

Greenwich, Connecticut-based Centaur Performance Group won the award for Best Credit Fund thanks to the votes of Hedgeweek readers impressed by the outstanding performance of the Centaur Credit Select Fund, which returned more than

45 per cent in 2009. "The risk management function is key for us," says chief investment officer Henry Pizzutello. "Our investment process was probably responsible for most of the outperformance."

Central to that process is identifying the primary risk factors to the fund's strategies. "Most people manage the risk – we try to keep it out of the portfolio before we have to manage it," Pizzutello says. "Early in 2009, the primary risk we identified in the US market was not credit quality but access to liquidity in the capital markets. Every investment we made at the beginning of the year was designed to negate that risk.

"Issuers in a distressed financial state or ▶ 12

# Super strategies for the new era

By Lisa Anderson and Michiel Jansen

Recent events in the world economy and in Western politics have led to an increase in global volatility. As countries threaten to default, currency strategies are scrutinised and monetary policies are no longer co-ordinated, a long/short trading strategy that focuses specifically on rates and foreign exchange has encountered great demand.

Citi Capital Advisors runs a global, USD14bn alternative asset platform focused on core competency and value-added approaches in the market strategies, private equity and infrastructure spaces.

CCA's hedge fund business, known as Market Strategies, houses teams with expertise in credit, derivatives, rates, foreign exchange and structured assets. One of our important strengths has been the performance of funds in relation to risks taken. The CCA Market Strategies funds adhere to rigorous risk management tests both at the fund and platform levels.

Our clients, which are predominately institutional, have very high transparency standards. The result is robust risk management, partnership-like transparency and strong fund performance, which have been key contributors to winning this Hedgeweek award.

Some recent major market drivers have been concern about disruption due to fiscal imbalances in Greece and the contagion that could lead to problems in other countries such as Spain and Italy. At the same time certain US states such as California and New Jersey have been the subject of similar concerns.

With a weak global economy, the fact that China effectively increased rates took the markets by surprise and has raised issues about fragile economies being unable to cope with a slowdown in growth



**Lisa Anderson (pictured) is a managing director and head of product management and marketing for the Americas and Michiel Jansen is director of CCA product management at Citi Capital Advisors**

among large GDP countries. Central bank and government normalisation of fiscal and monetary policy is the most likely next development, and global asset markets will have to react.

These shifts in macroeconomic factors and policies create many opportunities. A strategy that permits going both long and short and allows for swift changes in trade allocations between products, regions and markets provides a good platform to benefit opportunistically from those shifts.

With increased regulation and political pressures continuing to change the alternatives landscape, CCA's managers are already fully regulated by the US Securities and Exchange Commission or the Financial Services Authority in the UK. In addition, the ever-changing compliance environment makes the large scale of the CCA platform a major competitive advantage.

Citi Capital Advisors continues to focus on products where we believe we have an edge. In addition to market strategies, we also have large private equity and infrastructure businesses. Some areas to watch are the underserved middle markets space in general as well as certain long/short strategies that take advantage of global volatility.

Long/short funds should be considered by investors only where the platform has robust risk management – an area in which CCA has been hailed as outstanding – and a deep expertise in the strategy. Areas where we have that deep expertise include fixed-income markets such as emerging markets, global macro, municipals, mortgage credit and corporate credit as well as equity strategies that benefit from events such as mergers and acquisitions. ■

10 ► with significant leverage, or credits that were at the bottom of the capital structure, were taken out of the portfolio. Even though these assets gained the most in value for the year, it gave us a runway, and allowed us to invest knowing that we would not be subject to events beyond our control.”

The basic risk profile of the Centaur Credit Select Fund is focused on capital preservation, low correlation to down markets and moderate upside. According to Pizzutello, the 2009 returns reflected unique market conditions. “Last year was exceptional for a number of reasons,” he says. “We target annual returns of 10 to 15 per cent, but we had three successive cycles that earned 15 per cent each.”

Centaur invested in secured high-yield paper early in the year, then convertibles and relative value as capital markets thawed, and toward the latter part of the year the firm made money in distressed assets. “Those cycles would normally occur over a period of three to five years,” says Pizzutello, “but all three happened to be compressed into 12 months.”

According to Pizzutello, investors were impressed that the fund has made outsized returns without shedding its risk-averse philosophy. “One of the things that really resonated with investors was our performance in 2008, because it’s more gratifying when you outperform on the downside,” he says. “Throughout the crisis, we have been flexible enough to capture alpha while being conservative and disciplined enough to stay out of trouble.”

Some managers may have changed their investment approach because of the crisis, but Pizzutello is not one of them; on the contrary, he believes it has allowed the virtues he has espoused for years to shine. “My investment philosophy has been fairly consistent over the years,” he says. “More than anything else, the crisis has provided a way for me to address how our process is different from other strategies. We sometimes lose that opportunity in bull markets.”

He believes that the current market environment will allow skilled managers to demonstrate how they stand out from their peers even more. “This year is going to be much more of an opportunity for differentiation, because last year almost every asset class was moving up in concert,”



he says. “Unless you really got behind the numbers and understood how people were achieving their returns, you might as well have put your money into the S&P 500. This year we really expect to see differentiation among asset classes as well as fund managers.”

For many managers caught up in the savage downturn of 2008, the crucial issue was whether they could recover, and carry the confidence of investors with them. One who did was Michael Petry, chief portfolio manager with Copenhagen-based Danske Capital, whose Danske Invest Hedge Fixed Income Strategies Fund received the Hedgeweek Award for Best Fixed-Income Fund after achieving a return of more than 40 per cent for its investors over the course of the financial crisis.

Petry says that in the wake of the downturn he and his team have been even more focused on their downside risk lest the market should run into a fresh period of extreme turbulence. “At the beginning of the crisis, when Lehman collapsed, we lost 20 per cent, and we would very much like to avoid it happening again,” he says. “We are very focused on whether the same things should happen again and how much we would lose or gain. But apart from being more focused on risk, we are doing more or less the same as we did before.”

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# Dynamic strategy decisions at play

By Max Gottschalk

The Gottex flagship market neutral products, which now have a track record exceeding 10 years, demonstrated excellent performance last year, outperforming all major fund of funds indices by between 5 and 8 per cent over the 2008-09 period.

Gottex and its market neutral products differentiate themselves from the firm's competitors for various reasons, including diversification. Its products have an investment style that minimises single-strategy manager overlap with the general universe of fund of hedge funds holdings. For that reason, Gottex is an excellent diversifier of single-strategy hedge fund exposure for a fund of funds investor.

In addition, the market neutral products avoid allocations to directionally-biased long/short equity funds, futures and macro strategies, and require that each underlying hedge fund is market neutral in itself. Gottex's approach involves the gradual re-allocation of capital over time to strategies that it believes will outperform over a six- to 12-month time horizon.

Gottex's investment philosophy is rooted in the belief that strategies become efficient over time and consequently excess returns will erode as capital floods the opportunity set. The firm therefore takes a dynamic view to strategy decisions and is constantly on the lookout for new strategies and sources of alpha.

It expects that allocations to older, more established traditional strategies will fluctuate and be replaced by new strategies and opportunities that are not as well understood and therefore provide greater opportunity for return.

In the current market environment Gottex believes opportunities for market neutral investment strategies remain very good.



Max Gottschalk is head of European business at Gottex Funds

Although 2009 was an exceptional year for market neutral strategies, leverage and risk associated with these strategies have been reduced dramatically during the crisis, and when combined with a much less competitive marketplace, it allows managers to take advantage of the abundant opportunities that have been created and generate attractive risk-adjusted returns for their investors.

On the operational due diligence side, the scale of Gottex's business enables it to have an 11-strong team that reviews the legal and operational aspects of hedge fund managers the firm is considering investing with. This dedicated operational due diligence team is involved at all levels of the due diligence process.

The review includes an assessment of the operations and back office, policies and procedures, risk management controls, fund documentation and legal structure, background checks, systems and IT infrastructure, third-party relationships and counterparty risk.

Additionally, since the crisis started Gottex has focused on managed accounts, setting a target of 25 to 30 per cent of its portfolios to be invested through separate accounts. Gottex has developed its own managed account platform, mitigating to a large degree the operational risk of a hedge fund.

Last but not least, Gottex's global reach – with investment professionals located in New York, Boston, London, Lausanne and Hong Kong – allows members to become entrenched in their local investment community and get local insights that can be quickly passed on to the rest of the team. This enables each Gottex portfolio to shift investments to regions where its investment professionals see the best opportunities. ■

12 ► The fund invests in the euroland, US and Scandinavian fixed-income markets, eschewing corporate bonds, and using techniques such as short selling, derivatives and leverage to generate high absolute returns. Petry says investors have mostly been very satisfied with the way the fund has been run – “Of course they did not like the drawdown after the Lehman collapse, but no-one really blamed us, they fully understood that the Scandinavian market was one of those hardest hit at that time” – but the fund did face redemptions later, ironically, after it had started making money again.

“We had most redemptions after we really started giving investors a good return,” he says. “Perhaps it was because when people looked at their various investments, they could see they had a 40 per cent return from our fund, whereas they might have lost 20, 50 or 80 per cent of many of their other investments. They were taking a profit from one of the few investments where that was possible.”

Petry acknowledges that many managers who were able to maintain liquidity through the crisis were punished because they were among the few places investors could go to raise cash, but he is confident that the fact his fund was able to maintain liquidity will ultimately yield benefits as investors come back into the market. “We are starting to see that now,” he says. “We are getting more and more enquiries from different kinds of client who are interested in our fund because of its returns during the crisis.”

Daniel Farrell, director of marketing and investor relations at Phalanx Capital Management, which is based in Chicago with an office in Hong Kong, argues that being a “truly hedged” hedge fund – being genuinely capable of making money whether markets are rising or falling – was central to the Phalanx Japan Australasia Multi-Strategy Fund winning the Hedgeweek Award for the Best Relative Value Fund.

“If you look at our returns from 2008, that was a very difficult year for a lot of investors, but we were able to make money,” Farrell says. “Market conditions changed throughout that year. And in 2009 we were able to make money as well. We endeavour to make money in all market cycles.”

He notes that volatility in the markets in which the fund invests – Japan, the rest of

Asia and Australia – tends to be far greater than in Europe and other Western markets. “The market movements are a lot larger, and we are able to capitalise on that through the asset classes we use, including convertible bonds, volatility, OTC or listed equity options, swaps and merger arbitrage,” he says.

According to Farrell, the fund’s managers are positioned for a hiccup in its targeted markets. “While it’s difficult for us to predict what the market is going to do overall, our personal feeling is that there will be a correction at some point,” he says. “The premise of our business is to be able to protect against fat tail events and to profit from them. We will always have a bias toward the downside wherever we’re able to make money, and we feel there will be some type of correction coming up.”

During the crisis, he argues, Phalanx and its investors benefited from its principals’ experience of extreme market events. “Our chief investment officer, Chris McGuire, has been around since the late 1990s and has been through Long Term Capital Management and the Asian debt crisis,” Farrell says. “One of the things we did that was unique among most convertible funds was to use asset swaps, which are much cleaner than using credit default swaps. We used that experience to navigate through the markets with a rational mind. There was a lot that we had already learned from the experience of the past.”

The fund’s success over the past two years enabled it to win mandates from investors at a time when other managers were experiencing capital outflows. “We’ve always had strong performance with good numbers, and our target return is 15 to 20 per cent every year,” Farrell says. “We’ve seen tremendous opportunities in this space and have been able to capitalise on them to make oversize returns over the past couple of years.

“Investors have responded to that very enthusiastically. We started 2008 with a much lower level of assets under management, but having gained a tremendous amount of momentum we’ve been able to attract fresh capital over the past year while most investment managers were losing assets. A lot of our competitors have shrunk, but we’ve had very few redemptions and we’ve been able to bring in new money.” ■

# Positive outlook for prime brokerage business

By Glen Dailey

Jefferies picked up the award for Best Prime Broker at the 2010 Hedgeweek Awards, and we are thankful for the recognition shown by our clients for outstanding service and the quality platform we have built over the past four years.

In 2006, Jefferies announced plans for the significant expansion of its prime brokerage unit to enhance the firm's overall commitment to being a leading provider of financial services to hedge funds. The development of this group was a natural progression to complement Jefferies' leading sales, trading and research platform in serving the institutional investor community.

We continue to see a vast opportunity to meet the needs of small and mid-sized hedge funds underserved by Wall Street, which is why we went about building this critical part of the business. Over the past two years, however, prime brokerage has experienced more changes than at any other time in my career.

The financial crisis has resulted in larger funds using multiple prime brokers, and large prime brokers have been focusing their efforts almost exclusively on USD1bn-plus funds. These trends have created a great opportunity for Jefferies. As a result, our business has grown nicely over the past two years and we now have more than 350 clients on our platform.

Our prime brokerage platform is largely focused on long/short equity funds. By offering a full-service integrated prime brokerage platform that includes research, securities lending, cutting-edge technology, competitive investment financing, access to an institutional trading desk, state of the art



Glen Dailey is head of Jefferies' prime brokerage unit

electronic trading, capital introduction and technology support, we can accommodate the business requirements of the most sophisticated hedge funds.

Additionally, we enable our clients to trade from anywhere in the world, while centralising all clearance, settlement, financial and administrative services and responsibilities. Our clients can also consolidate all transactions into a single account and take advantage of outstanding portfolio and risk reporting through a web-based platform.

In short, our firm's full-service capabilities in equities, coupled with our robust prime brokerage platform, experienced staff and deep resources, have made Jefferies the prime broker of choice for growing and mid-sized hedge funds.

Going forward, the future of the prime brokerage business seems bright. We expect that the momentum that has returned to the industry in 2010 will continue over the next few years amid greater transparency for investors and lower levels of leverage. The industry has experienced its most difficult period in history, and has come through the crisis with greater risk controls, more appropriate operating leverage and a more balanced and improved business model.

Hedge funds will continue to attract some of the greatest talent on Wall Street and will likely be one of the top performing asset classes over the next 10 years. With prime brokers by the side of hedge funds, helping them clear their trades, introducing them to investors and providing the support they need, the hedge fund-prime broker relationship can only grow stronger. ■



# Fortis Prime Fund Solutions Your natural choice

**PrimeFundSolutions**

Since 1969, Prime Fund Solutions (PFS) has pioneered the provision of fund services and financing to the alternative asset management industry.

Our long experience has helped us shape a unique, client-orientated operating model that enables us to provide clients with solutions across the entire alternative asset management value chain. From global financial institutions to boutique asset managers, all of our clients benefit from the robust global infrastructure, experienced staff and client focus that characterises our offering.

No matter what their size, our clients have one thing in common: they expect operational excellence and superior client service for their funds and for their most important asset, their investors. By building lasting partnerships rather than simple transactional relationships it is our aim to exceed the expectations of our clients on a daily basis.

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# Robust relationships key to success in fund administration

By Charlie Woolnough

Fortis Prime Fund Solutions' receipt of the Best Hedge Fund Administrator award at the 2010 Hedgeweek Awards is a result of our uniqueness. What has differentiated us from other brand name administrators over the past year has been the focus that we placed on our clients, understanding that it is during times of difficulty that the strongest relationships are built

We realised very early on that although our income would fall as a result of contraction in the industry, we would benefit over the longer term if we increased our service provision to help clients survive the crisis. While other administrators either raised their fees and/or reduced staffing levels, PFS has honoured all of its obligations (including finance facilities) during the period and has continued to invest in both technology and human capital.

The past few years have seen a move toward the institutionalisation of the administration process. Clients now expect a consistent error-free process supported by advanced IT infrastructure. Administrators are also far more transparent about their operations and financial health, encouraging hedge fund managers to visit their offshore offices and make informed decisions about the counterparty risks that they present.

Following the failure of Lehman Brothers, administrators – like all service providers – need to be far more transparent about themselves. The important characteristics of successful firms are strong operational infrastructure, staff that are experienced in hedge fund administration (not just 'fund' administration), and global networks of offices enabling consistency of servicing in multiple jurisdictions.



**Charlie Woolnough is European regional director of Fortis Prime Fund Solutions**

PFS stands out in the expertise that we have in areas such as advising on innovative fee and liquidity structures set by funds, gating, side-pocketing, redomiciliation and restructuring of funds. This expertise allows us to go over and above what most fund managers generally expect of their administrator.

Furthermore, we believe that we have the most robust relationship management model in the industry, which not only allows better planning for the business growth of our clients but enables us to understand better the issues and trends in the industry.

Our actual process is not totally dissimilar to those of other large SAS 70-audited firms, although we do place great emphasis on oversight by experienced employees. However, we are one of the few firms to offer genuine 24-hour processing capabilities thanks to best of breed technology coupled with highly qualified and trained staff in multiple jurisdictions.

PFS is currently developing its middle office capabilities for both single manager funds and funds of hedge funds. Although a small number of administrators do already offer middle office-type services, they are generally seen by most funds as second choice to having them in-house.

Many of the existing middle office providers also have areas of limitation to their operating models. We see a huge opportunity for any firm that can enter this market by providing a good quality service with excellent operational standards. We are also building out our private equity capabilities and plan to begin offering our existing services to Guernsey-domiciled funds. ■



# Institutional attitudes to the fore in the post-crisis world

By Simon Gray

In the space of less than three years, the landscape of the hedge fund industry has changed fundamentally. While the basic investment skills that propelled managers to the fore and lured investors seeking higher risk-adjusted returns remain critical to success (and some of the props used by the less skilled, notably high levels of leverage, have been kicked away), the crisis has changed the basis of the relationship between managers and investors.

Over the past couple of years there has been extensive discussion of the new importance of transparency and liquidity, but the word that seems to be on most lips throughout all facets of the hedge fund industry is institutionalisation. It is a term that applies equally to investors, managers and service providers, and it appears to foreshadow increasing consolidation around the largest players in the sector, albeit with important qualifications and hedges.

In some respects the institutionalisation of the industry is not new at all but a process that has been underway for much of the past decade. The share of investment by institutional investors has been gradually

overtaking that of wealthy individuals and families over the past few years, but the transition has undoubtedly been accelerated by the crisis as institutions (in the main) proved more patient during the 2008 downturn and have been quicker to allocate capital to hedge funds again over the past six months or so.

“Different types of investor behaved very differently during the crisis,” says Max Gottschalk, senior managing director and head of European business at fund of hedge funds manager Gottex Fund Management. “Institutional investors proved very stable and in general remained confident. We started to see institutions making investments again toward the end of 2009, a trend that has gathered momentum in 2010. The institutions typically work with consultants, who have been proactive in promoting hedge funds and fund of funds products to their clients as a way to diversify away from their equity and fixed-income exposure.

“Overall investor confidence on the institutional side has remained steady through the crisis, and we are seeing renewed interest in our products and in the hedge fund industry overall. But individuals seem to ▶ 20

# The Geneva connection

By Chris Cattermole

Advent has long been a key provider to the buy-side industry, and we have seen significant changes in the levels of service firms are providing to their institutional and high net worth clients. Geneva – Advent's managed account platform technology – is uniquely suited to this business due to its 'on demand' nature, complex asset class coverage and forecasting capabilities.

Our model has always been multi-prime, multi-counterparty, and multi-asset class based, giving us capabilities that truly allow for discretionary and fund management within a single platform. We are honoured that our clients have selected us as their partner in solving the challenges they have faced and in particular the issues they are encountering in this turbulent time in the financial industry.

With the focus on greater risk transparency, investors are demanding not only that firms check off on real risk measurement and operational workflows, they want to actually see them in process. Multiple systems and tracking items offline – or not having a true view of cash flows – has led to investors placing redemptions and consolidating assets in firms that can show true front-to-back operational risk management.

Geneva release 8.0 delivers full post-execution to reconciliation functionality



**Chris Cattermole is Geneva sales manager for Advent Software EMEA**

with workflows, case management, and managerial reporting that lets firms really get a grip on their operational processes, manage multiple counterparties, and report on these issues to both their management and their clients. With Geneva 8.0, our clients today can know about issues long before they hit the reconciliation queue.

Geneva is built for the fund community. Our clients are our partners – we feel the most effective way to continue to build on the product is to work in tandem with clients to solve the issues that they face. Geneva requires no more effort than any other portfolio management system. The difference is what it does behind the scenes – providing a full fund accounting solution without the additional overhead.

Our clients profit from this model by gaining better insight into their investment data, being more collaborative with their administrators, and gaining the ability to manage cash and perform forecasting directly in the system. Add to that the ability to manage both discretionary business and fund products – and link the two – and you get a system that is really unique in its ability to service firms in the separately managed account space.

Account platforms really need to move more toward workflow and unified processing. Today funds may manage allocations for funds, and then have separate systems for allocations to investors. Account platforms have to manage the entire process from manager to investor – and allow for the connectivity to the market that enables these processes to occur with as much straight-through processing as possible.

This means embracing the market and its players. Our footprint across prime brokers, fund administrators, asset managers and hedge funds means that connectivity and communication are issues we are uniquely positioned to solve. ■



**Chris Cattermole receives the award for Best Managed Account Platform Technology Provider from Global Fund Media marketing director Oliver Bradley**



18 ► have suffered more in terms of performance. Typically their hedge fund investments were more geared and they invested in more directional products, so we expect them to take a bit longer to come back to the market.”

Kier Boley, who is responsible for emerging markets and Asian multi-manager investments at GAM as well as manager of a commodities-focused fund of hedge funds, agrees: “The type of investor is the major difference. In the mid-2000s, the market was dominated by private banks, wealth managers and their clients, but coming out of the crisis it’s much more institutional. The mandates will be much larger, from pension funds and funds of funds, but they will be fewer and farther between.”

Institutional investors are increasingly demanding that the managers they deal with adopt the same standards. “Managers are having to start thinking more about how they position themselves in dealing with investors,” says Steve Kass, co-managing principal of New York-based accounting firm Rothstein Kass. “There is more concern about transparency, having the right service providers, having the right administrators and building more of an institutional-type structure internally.”

During much of the early and mid-2000s some managers of hedge funds and funds of funds had a more relaxed approach to operational issues and selection of counterparties, but Kass says that as the industry matures, managers are focusing on improving professionalism throughout their activities. He says: “We see our fund of funds clients building a more robust infrastructure, in some cases involving general counsel in the organisation, appointing chief operating officers and selecting more professional service providers.”

That means new challenges for hedge fund administrators, too. One that has probably had more than its fair share already is Fortis Prime Fund Solutions, which had to battle to maintain its position as a global leader in hedge fund administration during a severe downturn for its clients at the same time that its parent group was having to be helped out of its financial difficulties by the governments of the Netherlands, Belgium and Luxembourg.

Ironically, the fact that Prime Fund Solutions’ parent company ended up as a state-owned entity turned out to be a major benefit, according to European regional director Charlie Woolnough. “During the time of greatest fear in the markets, we benefited from being able to tell our clients and their investors that we were ultimately owned by a very strong and stable government entity,” he says. “We were able to distance ourselves from some of the other large administrators whose financial stability has been brought into question and returned to our usual role of giving comfort to fund investors rather than being a source of worry.”

The parent group, Fortis Bank Netherlands, announced in March that it was close to an agreement to sell the Prime Fund Solutions business to Credit Suisse, although completion of the deal could take a few more months. Although unwilling to comment on the proposed sale, Woolnough acknowledges that to be part of a large and solid financial group is becoming increasingly important to service providers’ clients.

“Counterparty risk was a buzzword during the crisis and it’s not going away,” he says. “There is now a much greater emphasis on who your counterparties are. Clients are looking behind brand names because some of them have failed over the past couple of years, but they do want administrators who are owned by large entities.

“Many hedge fund managers have become so big, with USD20bn in assets under management or more, that in many cases they have outgrown their administrators. In the past many service providers were privately owned, but now that’s definitely changing. The trend toward institutionalisation applies not just to asset management firms but administrators as well, and consolidation in the sector is taking place right now.”

Investors are already flexing their new ► 22

# Hedge fund accounting in the investor's spotlight

By Paul Compton

Transparency is one of the watchwords of the age. Predating the crisis, the big shift within most hedge funds' investor bases from high net worth individuals to institutional money brought with it a significant change in expectations. The new hedge fund investors started to require more detailed reports from managers and were more demanding in areas such as valuation processes, standards and operational integrity.

All this has only intensified post-Madoff and post-Lehman. Our customers tell us that they are having conversations with their investors every single day about these issues, and more than ever they need to be able to demonstrate the integrity of their NAV and to have information about their portfolios at their fingertips.

There is now evident demand from investors for regulated and transparent products. Hedge fund managers have responded by offering fund structures such as separately managed accounts and, in Europe, hedge fund strategies within Ucits III-compliant vehicles.

Regardless of the legal structure, fund accounting is one of the areas most in the spotlight. The right purpose-built technology can really help fund managers to run tight operations and to show they are on top of their portfolios.

With the shift for many funds from a single prime broker to multi-prime, it has never been more important for them to have their own books and records, and to reconcile daily against both prime brokers and their third-party administrator. And talking of the administrator, we detect that the practice of shadowing the administrator's books is more prevalent than had been thought,



**Paul Compton is head of product management at SunGard's alternative investments business**

**Paul Compton receives the award for Highly Commended Fund Accounting and Reporting System from Global Fund Media publisher and editorial director Sunil Gopalan**

even if at some funds this is still done using spreadsheets and manual effort.

SunGard's VPM is the only hedge fund accounting system on the market that was designed from its very first conception specifically to be a hedge fund accounting system, and over the years it has been developed in partnership with some of the most demanding people in the hedge fund community. This is one of the main reasons why VPM was recognised as Highly Commended Fund Accounting and Reporting System at the recent Hedgeweek Awards.

Going forward, we think investor accounting is one area where technology will play a bigger role in future. We continue to be surprised at the number of even large hedge funds that run robust processes in their operations and portfolio accounting, but rely on spreadsheets for investor allocations and distributions. Another area of importance is client reporting, especially where this can be automated over a secure web-based portal. ■



20 ► muscle in relationships with managers to obtain more beneficial terms, according to Woolnough, but they are also insisting on vetting their service providers too. “Managers were traditionally in a position of power in relationships with their investor base,” he says. “Many larger funds were closed to new subscription because they’d reached critical mass and didn’t need new money. But things have changed, and the balance of power has shifted back somewhat.

“Investors are less passive now and have a lot more say in how the industry is developing, whether it be in fee structures and levels, fund governance or governance of the asset managers. Funds are now open because they need investment, and they have to listen more closely to the people that are providing that money.”

Administrators are now seeing a sharp upsurge in due diligence visits by larger investors. “Whereas before 2008 we’d perhaps have five or six visits a year to our operational offices in Europe, there are now almost two or three a month,” Woolnough says. “Not just pension funds but funds of funds doing due diligence on underlying hedge funds, endowments and high net worth investors are taking the time to come to Dublin, the Isle of Man or Luxembourg.

“They are going through the processes we use to calculate the NAV, in particular how much input the manager has in production of the NAV and whether they are providing prices – which they are certainly not doing with us. There are instances, with NAV-lite for example, where the exact demarcation of roles in the process between administrator and manager isn’t clear. In these situations investors are asking, rightly, who does what and how the number is produced. We encourage that – we believe our processes are industry-leading and we’re happy to be transparent. And indeed, that’s the way the industry is going.”

Woolnough expects the number of investor visits only to increase further in the future – and he also believes a shake-up could be in prospect as managers start to look again at their choice of service provider. “The landscape froze somewhat in 2008, because many fund managers weren’t in the best shape to move service providers, but I see this thawing now. Some managers believe, rightly or wrongly, that they have

been treated unfairly by an administrator or prime broker, and they are starting to look round and consider their options again.”

As this process plays out, he expects larger service providers with institutional owners to benefit. “This isn’t to say that large administrators or prime brokers necessarily do things better than smaller players, but it’s a fact of life that institutional investors want institutional counterparties to service their funds. So anyone who is institutionally owned has something of an advantage going forward.”

Investors are also paying greater attention to the quality and capability of the IT tools used by managers and administrators. “Investors are putting more pressure on the managers themselves to provide more granular exposure reporting – not only counterparty but true cash exposures of the underlying instruments – on a variety of different exposures and are demanding faster service turnaround times,” says Chris Cattermole, Geneva sales manager for Advent Software in Europe, the Middle East and Africa. “That also means a lot more demands on service providers to deliver the granularity that investors are looking for.

“From a due diligence standpoint, institutional investors are looking at managers in more detail than they used to. One of our manager clients told me that investors are not just asking how they do things but they’re asking to see them in actual practice. If pension funds or other institutions saw offline processes or Excel spreadsheets being used to value their funds, they would become a bit uncomfortable about their investments. Managers are now having to prove to investors that their money is being managed on pedigree technology.”

In the aftermath of the crisis, this particularly applies to risk management systems, according to Paul Compton, head of product management at SunGard’s alternative investments business. “The way hedge funds approach risk has had to change,” he says. “In years gone by risk numbers weren’t always an integral part of the fund manager’s own investment process. Now investors are not just asking for metrics but are asking questions about how risk enters into the manager’s investment process in terms of idea generation and risk management.” ■

# Working in harmony for long-term success

By Steve Kass

Rothstein Kass was voted Best Accounting Firm in the inaugural hedge fund service provider awards conducted by Hedgeweek based on voting by registered users. Rothstein Kass has served the alternative investment community for more than 30 years, providing clients with advice on initial hedge fund organisational structure, supervision of audits, and ongoing consultation regarding many diverse operational and tax matters.

Even before the global credit crisis, the perception of the accounting firm as strictly a service provider had begun to erode. Successful firms have come to recognise that their accounting and auditing relationships are a consideration for investors confronted with a vast array of options regarding their allocations.

In this climate, firms are becoming more thorough in evaluating professional relationships. Demonstrating industry-specific expertise, Public Company Accounting Oversight Board registration and the continuity of account teams are more commonly factored into the selection process.

In the near term, regulatory uncertainty and changes to fair value accounting rules will continue to drive demand for accounting and advisory services. Because of the complexity and ambiguity surrounding these issues and the shortfall of qualified advisors, we are anticipating continued strong demand across practice areas.

The experience and insight gained through firm-wide co-operation allow our professionals to learn and develop throughout their careers by working side by side with industry leaders and innovators. As a result, our dedicated audit, tax and advisory professionals are experts in their fields, harmonising with clients to anticipate opportunities on the horizon rather than react



Steve Kass is co-managing principal of Rothstein Kass

to short-term competitive pressures. This, in our view, represents a model for long-term success within the accounting space.

Over the past three decades, Rothstein Kass has developed an impressive network of industry relationships that complements our experience and insight. As the firm's reputation within the industry continues to grow, we have allocated additional resources to advocacy and educational initiatives. Working in collaboration with industry leadership enables our firm constantly to review and enhance best practices and technological capabilities.

At the core of our success story is our ability to hire, develop and retain smart, motivated and energetic individuals possessing an entrepreneurial spirit that mirrors that of the sophisticated business and financial services communities that we serve.

Even during periods of global economic uncertainty, our standing as an employer of choice enables our firm to make strategic additions that enhance and augment the quality and range of service we provide, while developing market-driven solutions that address growing compliance concerns.

Our unified approach creates deep and broad client relationships that support lasting affiliations. This philosophy also informed the official launch of our Rothstein Kass Business Advisory Services affiliate late last year. The formation of the group represents a significant expansion of our advisory service capabilities while helping our clients and professionals to stay on the leading edge of innovation.

Beyond audit and tax services, Rothstein Kass provides a full array of integrated services, including strategic business counselling, regulatory compliance and Securities and Exchange Commission advisory services, insurance and risk management consulting and family office services. ■



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# Traditional structures under challenge as industry looks to the future

By Simon Gray

One of the most striking changes that has emerged within the hedge fund industry in response to the upheavals of the past three years is a rethink of the structures through which managers offer their strategies to investors. The dominance of the offshore pooled fund model has been challenged, albeit certainly not yet overturned, by the growth of regulated onshore structures including European Ucits funds on one hand, and by a surge in the use of separately managed accounts both by funds of hedge funds and large institutional end-investors on the other.

In particular, the use by hedge fund managers of Ucits structures – regulated vehicles that can be freely sold to retail as well as other investors throughout the European Union and that are also

increasingly accepted by regulators in Asia, Latin America and other markets – may help the industry to reconnect with individual investors, which have been slower than institutions to return to the market following the hefty losses and liquidity problems in 2008 and early 2009.

This is the belief of Max Gottschalk, senior managing director and head of European business at Lausanne-based fund of hedge funds manager Gottex Fund Management, who argues that individuals are increasingly attracted by more regulated fund structures. “We have seen the emergence of new products, in particular Ucits hedge funds and funds of funds, and we expect retail investors to come back via these investment vehicles,” he says.

Charlie Woolnough, European regional ▶ 26

# Trading opportunity for multi-strategy fund

By Jonathan Havice

Investcorp and Interlachen are proud to accept the award as Best Multi-Strategy Fund in the 2010 Hedgeweek Awards, recognising the excellent returns produced by the Investcorp Interlachen Multi-Strategy Fund in a very turbulent 2009, with only one modestly negative month (March).

While the managers are delighted with the overall result for the year, a closer inspection of the drivers of those returns reveals something even more compelling. Despite investing in some of the most hard-hit areas of the market in 2008, such as convertibles, credit and fixed income, Interlachen positioned the portfolio entering 2009 to emphasise liquidity and low levels of leverage.

This unlevered approach in the first half of 2009 allowed the fund to meet any investor requests for redemptions without ever impairing liquidity through the use of gates or suspensions, which were prevalent in the dislocated markets in which the fund invests.

By mid-year, Interlachen became more confident that the worst of the financial crisis had passed and allowed a modest (one-half turn) amount of leverage in the portfolio with emphasis on value investments in the credit and convertible markets.

The managers feel their adoption of a 'clean' portfolio positioning at the beginning of 2009 produced high risk-adjusted returns rather than simply capitalising on a rebound of levered trades that had gone wrong in 2008.

The Investcorp Interlachen Multi-Strategy Fund has unique characteristics that have enabled it to be successful. First, its size allows the fund to be much more liquid and transparent than many larger funds. Additionally, the Interlachen and Investcorp partners combined are the largest investors in the fund.



Jonathan Havice is managing partner of Interlachen Capital

This alignment of interests motivates the managers to shift capital in a nimble fashion to the most attractive opportunities and away from the less attractive, while allowing for hedging across the different strategies in a manner optimal for performance characteristics. For instance, if there is more value in the credit arena, the fund may position that portion of the fundamental value strategy to be long risk and simultaneously enter 'short' risk trades within the volatility strategy where risk premiums may be lower.

This 'all weather' approach with capital allocated to long and short risk across different asset classes in a nimble vehicle is distinctive in an era of opaque, illiquid, mega-funds. Lastly, Investcorp provides independent, institutional quality risk oversight as well as additional transparency and reporting to investors.

The fund also has fee advantages over other investment vehicles. Through the netting of all profit and loss across strategies prior to the deduction of incentive fees, investors benefit relative to those vehicles in which investors bear the netting risk of one strategy producing gains that are not offset by losses in another.

Interlachen continues to find compelling investment opportunities in the marketplace. Further deleveraging and restructuring in the US will likely continue to favour value investing in distressed and high yield debt.

Additionally, declines in volatility have made it more attractive to add exposure to long option strategies in the US and Asia. The uncertainty of both fiscal and monetary policy globally should continue to create excellent trading opportunities for those who are flexible and nimble and able to capitalise with efficient movement of capital. ■



24 ▶ director at Fortis Prime Fund Solutions, sees a trend toward the domiciling of funds in the EU centres of Dublin and Luxembourg, which built their market position with retail Ucits funds but are seeing increasing success with more lightly regulated structures aimed at sophisticated investors. “We are certainly seeing a trend toward ‘onshoring’ in Europe,” he says.

“Historically we have had a long-only presence in Luxembourg, but we recently launched a specialised office dedicated to hedge funds, funds of funds and private equity to cater for the trend of managers to move more toward Luxembourg Specialised Investment Funds or Irish Qualifying Investor Funds, but also Ucits products as well. This is perhaps to cater particularly to investors looking for passport-regulated structures in the light of Madoff and one or two other unsavoury incidents that have occurred over the past couple of years.”

Chris Cattermole, sales manager for Europe, the Middle East and Africa for Advent Software’s hedge fund portfolio management, reporting and accounting software package, Geneva, says that amid a large influx of money from pension funds and other big institutions, he is seeing not only a surge in the launch of Ucits funds but many investors turning to the use of managed accounts.

He says: “The challenges that our clients currently need to address involve the capability to service individual investors rather than being able to bundle investors together with others in a single fund and provide fund-level reporting. It’s a much more high-touch environment, and the less manual that environment is for the managers, the more efficient they will be.”

Lyxor Asset Management has been running a managed account platform since

1998 and has been a major beneficiary of the demand by investors for greater liquidity, transparency and control over their hedge fund investments. “The managed account platform provides investors with a risk-free framework within which to invest in hedge funds,” says head of sales and marketing Christophe Baurand. “We eliminate operational problems while controlling the risks of the funds, providing superior transparency to investors and better liquidity terms than in the traditional hedge fund space. In addition, we have a very large offering and access to leading managers such as Caxton, Tudor and Paulson.”

Baurand notes that the Lyxor managed account business, which now has more than USD10bn in assets, has benefited from two high-profile industry debacles a decade apart. “We have had two catalysts in the development of the platform,” he says. “One was Long Term Capital Management – Lyxor was created as a response to the problems linked to operational issues that became evident back in 1998. The second is Madoff.

“Investors still very much appreciate the advantage of hedge funds in terms of risk-return profile and decorrelation benefits over traditional asset portfolios, but they are extremely cautious about the lack of transparency and liquidity, and about practices in the hedge fund space. Everybody has in mind Madoff, Amaranth, and all the operational issues that regularly emerge.”

The past 12 months have seen a wave of new providers of managed account platforms, including large banks, service providers and fund of funds management companies, but Baurand cautions that the barriers to entry are high. “A platform is a large operation,” he says. “You need systems and a lot of human resources if you want to control operations within the managed accounts. The first hurdle is the level of resources you put into the business. We currently have more than 100 people working solely for the Lyxor platform, which represents a significant investment. There’s also the issue of credibility, which comes with the passing time as you build up a business over the years.”

Baurand is convinced that demand for managed accounts will continue to grow

▶ 28

# Standing out from the crowd

By Thomas Walek

For more than a decade, hedge funds of every size and strategy have turned to Walek & Associates to look after their visibility, reputation and brand. From defining market positions to managing media visibility, taking charge in crisis situations, supporting portfolio holdings, improving investor outreach, safekeeping reputations and handling the rarefied needs of highly successful hedge fund executives, Walek & Associates has pioneered the design and execution of public relations campaigns to support the hedge fund industry.

Hedge funds were not always well served by PR. When Walek opened its doors in the late 1990s, hedge funds were by and large a boutique curiosity on the financial landscape. At that time, the PR that existed to support hedge fund organisations consisted primarily of overexposure for those that struck it big or an uninspired “no comment” from those who tried, in vain, to hide.

The spectacular, headline-grabbing collapse of Long Term Capital Management in 1998 ushered in a new era for hedge fund innovation, growth and influence. As part of this, hedge funds started to evolve as businesses – not just asset managers – and began to take steps toward embracing concepts such as marketing, branding, investor relations and visibility. Walek was there early on to guide this evolution.

As the inaugural winner in 2010 of the Hedgeweek award for Best Public Relations Firm, the web site’s readers said the Walek firm “really understands the hedge fund industry,” is “well-connected” and “delivers results.” That’s a far cry from the comments frequently heard when we started 12 years ago: “I didn’t know hedge funds had PR



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firms,” and “What would you ever do for a hedge fund?”

Today, hedge funds are an integral part of the global financial fabric. And along with that, they attract more attention, more scrutiny and more criticism than ever. As our latest Alternative View: 2009 Hedge Fund Media Survey revealed, last year was a record one for media use of the term ‘hedge fund’, which appeared in an average of 150 articles every day – more than 63,000 in total over the year.

The events that have occurred over the past two years underscore the necessity of clear and open communication between hedge funds, their investors and the broader market. But there remains much work to be done at an industry level as well as by fund managers, fund of funds firms and the professionals who serve them.

Our Alternative View report found that more than 80 per cent of media surveyed didn’t blame the global financial crisis on hedge funds and that the media still adhere to a long-held and unanimous belief that hedge fund managers are “smarter about the markets” than their retail mutual fund counterparts. However, the report also found that half of the professional journalists surveyed believe that hedge funds are not a safe investment.

The next generation of hedge fund leaders will be those that harness the power of the press as they expand into new strategies, new markets and new investor segments. As the industry continues to institutionalise and mature, Walek will guide that process globally with a continued focus on delivering knowledge, service and results to our clients. ■

26 ► and will be sustained even when the trauma of 2008 begins to fade. “Every time there is a new crisis, every time hedge funds fail, people remember that there are risks associated with the asset class, and that creates new momentum for managed account platforms and set-ups,” he says.

“The trend toward greater liquidity and transparency and more risk control is permanent. Ten years ago, investors in hedge funds were mostly private investors. Now the institutional world is investing massively into hedge funds, and their stringent criteria for investing makes it impossible to go back to the old days where you would allocate money to a manager simply because he had a great reputation. Those days are over.”

Advent Software, which won the Hedgeweek Award for Best Managed Account Platform Technology Provider, continues to see demand expand in this area, according to Cattermole. “Three years ago, there was very little demand for that kind of capability,” he says. “Having discretionary and fund management on the same platform is a major advantage for us. Coupled with the level of granularity we can go down to, plus the breadth of asset classes that we can service for individual investors, this represents a unique offering in the separately managed account space.”

Cattermole says the current environment is as demanding for a software firm like Advent as it is for managers and their service providers. “We have to remain at the leading edge of today’s requirements, because our clients span fund administrators, prime brokers and hedge funds,” he says. “Service providers need the latest technology to manage the new asset classes that are constantly appearing. We’ve always been multi-prime, multi-currency and multi-asset class, but we are now seeing new developments around the delivery mechanisms of reporting and slicing and dicing the information as the investor would like to see it.”

The current environment is extremely fluid, according to industry members. For example, Steve Kass, co-managing principal of accounting firm Rothstein Kass, points to the high turnover of managers. “A lot of people who have been in the industry

are exiting it, but others are leaving large financial institutions to create their own entrepreneurial businesses,” he says. “Although we’ve seen some closures, we’re seeing a lot of new opportunities as well.”

Spinning off from an existing business is far from an easy option, suggests Woolnough. “Raising money is terrifically difficult right now, and launch sizes are down,” he says. “Managers today are launching with perhaps USD50m, whereas someone with the same credentials might have raised USD300m to USD400m three or four years ago. A lot of investors are sitting on the sidelines, asking why they should invest on day one and take that new manager risk and operational risk. Why not wait six to 12 months, see how they perform, let everything bed in, and invest then? So managers are having to incentivise investors to invest on day one, in areas such as liquidity or fees.”

As they become more important to investors, risk structures are developing a higher profile within hedge fund managers, according to Paul Compton, head of product management at SunGard’s alternative investments business. “Greater importance is being given to the risk role within hedge funds, which now have more chief risk officers than they did five years ago, more risk committees and generally more management oversight of the risk within portfolios on a day-to-day basis.”

This emphasis is reflected in SunGard’s product development plans. “We’re always interested in making our products fit better into customers’ workflows and making it easier for hedge funds to use our risk products,” Compton says. “We’ve invested a lot in the area of scenario analysis, enabling fund managers to run their portfolios through historical scenarios and to come up with their own scenarios. We’re also looking closely at the area of integrated risk attribution and performance attribution.”

In this environment, fund of hedge funds managers in particular are under pressure to justify the value they add for investors, but GAM investment manager Kier Boley is convinced that the best managers will continue to be rewarded with investors’ business. “The main qualities we bring to fund of hedge funds investing are our

rigorous investment process and risk management," he says. "The approach we've applied for at least 15 years is very rigorous in terms of identifying managers, but also once we're invested in how we monitor the managers, when we decide to increase our allocations or indeed when we decide to redeem.

"The past two years were among the toughest times ever for investing. In 2008 we outperformed our peer group by a significant amount because we focused on liquid strategies, we didn't believe in leverage, and we wanted to keep in areas where investments were really marked to market, rather than marked to model. So we did well in the very difficult times, which was important for investors, but also when things improved and we could start taking risks again in 2009."

Boley says that continuity within an investment team is among the most crucial criteria when selecting underlying managers. "The most important thing, even for a new start-up, is that the team has worked together before in a previous environment," he says. "The hedge fund might be new, but they will have worked together at another fund or a proprietary trading desk.

"The real deciding factor is that they've been through at least one major crisis and they've stuck together, because it shows there's an emotional bond between them. You see with a lot of groups that if things go badly or tough times arise, they separate. That's not a group we want to be with, rather with people who stick together for at least five to seven years."

Boley argues that the crisis has highlighted how many managers have depended for their returns on passive beta, and that this approach is no longer viable. "Many funds have tried to generate their fees out of just being long the market, long credit or long equity," he says. "That's not what investors want going forward. For investors returns are still important, but it's much more about the level of beta or correlation that the fund demonstrates. They're not willing to pay hedge fund fees for what is essentially just being long the market."

He remains confident that the industry's rebound is sustainable, although the period of explosive growth seen in the middle of

the past decade is unlikely to be repeated. "We've passed the low point in terms of asset shrinkage," Boley says. "In 2010 we expect probably about 5 to 6 per cent growth through new money coming into the industry, and at least 7 to 8 per cent compound growth. The industry will develop at a much lower rate than between 2003 and 2006, but there are plenty of opportunities for capital to be raised."

Gottschalk is also positive about prospects over the next two years. "Hedge funds did phenomenally well in 2009 on the back of a poor 2008, and the environment is still very favourable," he says. "We believe hedge funds will be able to generate very strong performance over the next 12 to 24 months as capital flows come back into the markets and as leverage gets reapplied to some strategies. Hedge funds have a tail wind behind them."

He argues that the above-average performance of the Gottex Market Neutral Plus Fund in 2008 and 2009 maintained investor confidence at a time when other fund of funds managers were struggling. "The portfolio is constructed to be conservative as a diversified portfolio of hedge funds," he says.

"We also make sure that the underlying managers have very little exposure to markets, which dampens losses on the portfolio in times of dislocation, as in 2008. In fact, a lot of the strategies that were affected in 2008 performed extremely well in 2009, and we were able to position the portfolio accordingly. The defensive nature of the product demonstrated its credibility over the two-year period."

According to Gottschalk, the way hedge fund managers treated investors during the crisis is now an important consideration in selection of underlying managers. "We look for established managers with a track record and the ability to generate consistent performance over a period of time, full transparency, and obviously the integrity of the product," he says. "But while performance is a key factor, there are a lot of other things to take into account. The crisis has enabled us to differentiate even further good managers from bad, not only in performance but also in the way they behaved through the crisis." ■