Vernon West, Skyline Capital Management: “Despite the global economy’s mid-cycle slowdown, rates are low, liquidity and economic slack are abundant, and valuations are cheap”

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Vernon West (pictured), chief executive of USD47m global long/short equity specialist Skyline Capital Management, says the firm, which offers its strategy through Cayman and Ucits vehicles, seeks to tap into emerging market growth resulting from accelerating domestic consumption as productivity improvements boost income per head and increased automation as firms substitute capital for labour.

GFM: What is the history and background of your company, principals and funds?

VW: Skyline Capital Management is a global long/short equity specialist with an emerging markets tilt that seeks to expose investors to the next leg of emerging market growth: accelerating domestic consumption stories as income per head rises, reflecting improvements in productivity, and increased automation as firms substitute capital for labour.

Skyline plays this global view both through emerging market local champions and through Western-listed business where growth is driven by emerging markets demand. On the short side we look at the impact of cost-competitive emerging market competition on the established order.

Chief investment officer Geoff Bamber and co-manager David Tovar run the portfolio. I am also a principal and run compliance, risk management, marketing, and legal. Skyline’s assets under management are close to USD47m.

Skyline and ML Capital Asset Management have teamed up to launch the Skyline UCITS Fund, a Ucits IV vehicle that began trading on August 22. ML Capital, which is regulated by the Malta Financial Services authority, is investment manager and promoter to the Irish-domiciled MontLake UCITS Platform, which offers investors access to selected institutional-quality managers within a highly regulated framework with the comforts of liquidity, transparency and security.

GFM: What is the structure of your funds?

VW: Skyline runs a Cayman master-feeder structure with more than USD10m in assets under management, while the Ucits fund has assets of USD37m. The funds have a common stock selection process and macro risk overlay, but the Ucits fund is more diversified and fully divestible within two

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days.

The management fee is 1.5 per cent for institutional share classes and 2.0 per cent for retail classes, and there is a performance fee of 17.5 per cent for both institutional and retail shares.

GFM: Who are your main service providers?

VW: We work with blue-chip service providers including Deloitte, KPMG, SS&C Technologies, Citigroup, Norton Rose, Appleby and Merrill Lynch.

GFM: What is your distribution strategy and targeted client base?

VW: We seek to partner with investors that share our long-term philosophy and investment outlook. Reflecting aggregated investor demand, Ucits distribution is focused on the UK and Europe, while the Cayman fund is aimed at US investors. For both products we seek a client base diversified both by client group and by geography. ML Capital's vast distribution network will open up an avenue of both institutional and retail clients primarily in Europe, but also throughout the US, Latin America and Asia-Pacific.

GFM: What impact has the recent global financial crisis and economic downturn had on your business?

VW: The global financial crisis highlighted numerous issues within the hedge fund industry, including inadequate disclosure, illiquid side pockets, weak corporate governance, and internal NAV generation. Skyline is explicitly structured to mitigate these risk factors: an open book portfolio for investors visiting our office, a liquid portfolio, independent directors, and use of global top 10 administrators.

GFM: Please describe your investment process.

VW: Skyline marries a fundamental approach with a top-down exposure management overlay. In terms of the fundamentals, first we identify long-term thematic tailwinds; secondly, we look for businesses exposed to these macro tailwinds with strong cash conversion and sustainable margins; thirdly, we look for well-incentivised management teams with strong track records of operation; and fourthly, we look for reasonable valuations. Balance sheet management seeks to position the portfolio in light of global valuations and the potential for macro-economic shocks to the global economy.

GFM: How do you generate ideas for your funds?

VW: We have a multifarious and entrepreneurial approach to idea generation, combining conferences, broker conversations, research trips, screens, and conversations with investment professionals.

GFM: What is your approach to managing risk?

VW: Skyline is paranoid about risk, and deploys three robust and independent lines of defence. High research-led hurdles to investment mean we intimately understand the investments in our portfolio. The balance sheet is managed using a transparent tool that links risk taking to global valuations and macro risk, and independent scrutiny of daily risk metrics (value at risk and scenario sensitivities) provides challenge around position sizing and position-level risk/return.

In addition, ML Capital monitors risk on all its Ucits products through the Independent Risk Management system. These programmes have been tailored for both sophisticated and non-sophisticated Ucits to adhere to the regime's constraints.

GFM: How has your fund performed?

VW: Since Skyline launched its Cayman fund in November 2010, we are down 6.4 per cent, which is

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disappointing but ahead of our global long/short equity peers, which are on average down 9.3 per cent, according to HFR. Our target through cycle returns are in the 10-15 per cent range with volatility below 10 per cent.

GFM: Are you looking at any particularly attractive opportunities right now?

VW: Emerging market concerns around inflation, rate hikes, and overheating have led to underperformance. Furthermore, margins have been squeezed, leading to downgrades. The subsequent derating gives Skyline attractive opportunities as the structural story remains intact.

GFM: What developments do you expect to see in your investment sector or industry field in the coming year?

VW: The global economy is currently experiencing a mid-cycle slowdown. However, given that rates are low, liquidity and economic slack are abundant, and valuations are cheap, there are reasons to be constructive. We are waiting for resolution of the US and European sovereign debt issues before increasing our exposure to markets from the current position of 50 per cent.

GFM: What do investors currently expect from managers, and how do you deal with those expectations?

VW: Downside protection is a theme in terms of portfolio management, stock selection and operational/business risks. The implication is an increased focus on consistent processes, something that at Skyline we have been careful to implement since our establishment.

GFM: What differentiates you from other managers in your sector?

VW: Our ability to play emerging market themes through both local- and Western-listed companies is distinctive. Using short technology as a source of alpha is also relatively unusual vis-à-vis emerging market pure play competitors.

GFM: How do you view the environment for fundraising over the coming 12 months?

VW: Skyline anticipates gradual improvement as the risk of global double-dip fades and the superiority of hedge versus long only technology becomes better known. Ucits will remain a sweet spot in UK and Europe, offering liquidity, transparency, counterparty risk management, style drift mitigation mechanisms and strong governance.

GFM: How do you expect your business to be affected by current and proposed regulatory changes?

VW: Ultimately the cost and complexity of doing business is increasing every year, which means minimum efficient scale for funds and managers is increasing. We consult widely on regulatory change and rely on detailed advice from our outsourced compliance advisors, Sigma Partnership.

- Equity Long Short

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