

The Interview - William Kitchin, Alternative Advisors: "Our clients are now more focused than ever on regulation, transparency and liquidity"



Alternative Advisors' William Kitchin (pictured), portfolio manager of the Castillon Diversified Fund, a Ucits absolute return fund of funds, says that while the fund is constrained in its selection of underlying managers by the need to match the liquidity it offers to investors, this is not a particular disadvantage in the short term given the current macro economic conditions.

GFM: What is the background to your company and fund?

WK: Alternative Advisors was founded in 2006 to advise high net worth individuals and institutional clients on investment in hedge funds and funds of hedge funds. Philippe Dupuy and Cedric Lamielle are the partners of Alternative Advisors, which is an FSA-authorized investment manager.

In January 2010 we obtained a mandate from a family office to pool their hedge funds allocation into a single fund with more liquidity and transparency, so we decided to adopt the Ucits format. I am the portfolio manager of the Castillon Diversified Fund, a Ucits III absolute return fund of funds, which was launched on June 24 with EUR60m in assets under management.

GFM: What is the structure of your fund?

WK: The Castillon Diversified Fund is a sub-fund of the Whitefleet umbrella fund, a Luxembourg-domiciled Sicav established under part I of the 2002 funds legislation.

GFM: Who are your key service providers?

WK: Central administration is provided by Credit Suisse Asset Management Fund Service (Luxembourg). Our custodian bank is Credit Suisse (Luxembourg) and the fund's independent auditor is KPMG Audit.

GFM: How and where do you distribute the funds? What is the profile of your current and targeted client base? Are you looking for distribution in emerging Ucits markets such as Asian and Latin America?

WK: Our current client base consists of family offices and private banks in Europe but we are also targeting financial advisors, insurance companies and pension funds. We will be looking for distribution in Asia and Latin America at a later stage, probably with a local distribution partner.

GFM: How would you assess the impact of the recent global financial crisis and economic downturn on your business?

WK: Our clients are now more focused than ever on regulation, transparency and liquidity.

GFM: What are the advantages and disadvantages of offering hedge fund strategies within a Ucits structure? Are there particular issues relating to funds of funds?

WK: As with all fund of funds structures, our investments need to match the liquidity that we provide to our investors. Therefore, given the restrictions on liquidity in the Ucits III framework, we are unable to invest in funds that target less liquid and possibly higher alpha-generating securities and asset classes.

However, given the current macro economic conditions, we don't see this as a disadvantage in the short term. We are quite happily invested with funds and managers that have proven track records of producing stable low-volatility returns while remaining extremely liquid. The liquidity that they are 'forced' to adhere to in this framework, though not at all a departure from their previous styles, leads to very flexible portfolio management that is a welcome addition to any portfolio.

GFM: What is your investment process?

WK: Our investment process stems first and foremost from a detailed understanding of the universe of funds that we work within. This includes which strategies are more suited for the Ucits III framework as well as the prevailing market environment.

From this base we have a very iterative process that constantly feeds back into itself through three basic levels. The first level involves identifying the managers and their peer groups. Here we source managers, conduct numerous meetings and develop a short list of ideas that could potentially integrate into the existing portfolio.

The second level of the process is where the meat of the research, analysis and due diligence takes place. This consists of fundamental, operational and quantitative analysis as well as background and reference checks, risk assessment and a hypothetical portfolio contribution analysis.

The third and final level of the investment process is the approval and monitoring stage, where the fund is taken to the investment committee and either approved or rejected. Once a fund is approved we establish how it will be sized in the portfolio as well as develop a formal monitoring template and process for each individual fund

Simultaneously, the strategy allocation and risk exposures of the portfolio are analysed to understand and potentially hedge the unwanted risks in the portfolio, and to feed the direction of ongoing sourcing of new managers.

GFM: How do you generate ideas for your funds?

WK: New ideas for the portfolio come from various sources. The breakdown of new idea generation is roughly 45 per cent from industry contacts, 20 per cent from conferences, 15 per cent from other hedge fund managers and the remaining 20 per cent from prime brokers, strategic investors and the press. After the ideas are sourced there are two main inputs for generating a new investment idea, the overall macro economic outlook that shapes the strategy allocation, and the fundamental analysis of the manager.

GFM: What makes a manager or strategy special enough for you to select them?

WK: Typically, a manager that is selected for our portfolio is one that we have known for a number of years. Of these managers, we must first believe that their strategies are directly transferable into the Ucits III framework or that they have amended their strategies in a way that makes them compliant while adhering to their core competencies.

From here we perform varying levels of analysis, depending on the strategy and establish whether or not the manager meets the threshold for investment. Key components of this threshold are experience, organisational stability, risk and liquidity management, track record, strength and repeatability of process, opportunity cost, portfolio fit and strategy outlook.

GFM: What are your criteria for removing managers from the fund?

WK: Each fund is looked at on a case-by-case basis. We do not believe that every manager can be put into a box and that investment decisions can be made entirely on hard and fast rules. With all managers that we add to the portfolio we have a strong understanding of their potential in terms of profit and loss, maximum downside and correlation.

We aim to use this knowledge to build expectations into our fund monitoring systems and when we observe a variance from our expectations we can investigate further for style drift and other anomalies from our original investment thesis. If the expectations have been breached for unsatisfactory reasons the manager is terminated.

However, understanding the causes of the breach is key to the decision-making process. We want to know whether the environment is the cause for the recent underperformance or if the manager is indeed lagging a representative peer group and if so, why. Changes in the operational infrastructure, manager departures, style drift and numerous other factors come into the equation when making the decision, but, each manager is looked at on a case-by-case basis.

GFM: What is your approach to managing risk?

WK: We look at each fund individually and build customised monitoring templates for each fund we invest with. In these templates we monitor not only the return variations and correlations but also the typical exposures and shapes of the portfolios over time. From this we can gain a stronger understanding of how and where a manager invests their assets over time, when they are successful and in what environments.

These details can also be aggregated to give us a stronger understanding of where the risks lie at the portfolio level. When the risks at the portfolio level get out of our comfort zone we then take steps to hedge back the exposures to a more reasonable range or remove the manager.

GFM: What are your performance expectations?

WK: This year was always going to be a difficult one in which to make significant profits given the macro uncertainty on the back of the strong performance in 2009. However, we do see various opportunities in the market and believe we can return 2 to 4 per cent through the second half of the year, with a worst-case scenario of protecting the assets we have invested.

GFM: What opportunities are you looking at right now?

WK: We are currently looking to increase our exposure to macro, statistical arbitrage and other higher-frequency trading strategies to take advantage of the volatility in the market.

GFM: What events do you expect to see in your sector in the coming year?

WK: The major game-changing event over the next 12 months will be the introduction of the Ucits IV regulations.

GFM: How will these developments affect your own portfolio?

WK: The new amendments to the framework could have vast consequences on the types of investments Ucits funds of funds can make in relation to the 'trash bucket' allocation, TRS look through, commodities and so on. We are preparing the portfolio and our pipeline to deal with any possible outcome.

GFM: How do you assess investors' current expectations?

WK: Our clients are very cautious; at the moment they are focused on preserving capital

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

WK: Our strengths are independence, investment philosophy, dynamic portfolio management, transparency, experience, proprietary risk management and risk systems.

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

WK: The environment for fundraising is difficult in general, but we see a growing interest in liquid, transparent and regulated funds.

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