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gaim International 2012

Institutionalisation makes hedge fund managers grow up

Dan Shapiro (far right) chairs today's panel discussion

Institutionalisation of the hedge fund industry was the key talking point in a panel discussion chaired by Dan Shapiro, partner of Schulte Roth & Zabel International. The panel included Jane Buchan, CEO of FoHF firm PAAMCO, Peter Schoenfeld, chairman and CEO of PSAM, Bernard Oppetit, chairman of Centaurus Capital, and Nicholas Botta, CFO of activist fund Pershing Square Capital Management.

Currently, about 60 per cent of the industry's USD2trillion AUM is now institutional money, with Shapiro noting that in a recent discussion he was told that 90 per cent of new money allocating to hedge funds is institutional in nature.

Shapiro's first question to the panel was what institutionalisation meant to their business.

Schoenfeld said that the experience of working at Schroders before setting up PSAM in 1997 meant that dealing with regulators was nothing new and that most of their investors "were already institutional in nature". "Clearly institutionalisation of the industry is steam-rolling. We've got the likes of Form PF to file quarterly, which is basically stress testing our portfolios. The pendulum has shifted towards regulation right now and that's putting pressure on us," said Schoenfeld.

Oppetit said that Centaurus had always had an institutional framework. He said that the golden age of investors queuing up to allocate money was gone. "The nature of the dialogue is changing, investors are much more demanding. We're doing managed accounts for sizeable tickets but it's obviously labour intensive," said Oppetit.

Large institutions like PAAMCO are using separate accounts as opposed to commingled funds which according to Buchan "is helping to improve returns" and she sees this as a continuing institutional trend going forward. She added a second observation: the early adopters of hedge funds are being replaced by big institutions. "The dad is being dragged in to the store by his teenager to buy the iPad. Institutions like pension funds are reluctantly being forced to invest in hedge funds to achieve their annual return targets of 7 to 9 per cent," said Buchan.

"I think institutionalisation has been positive. It's helped get us ready to handle regulation, improve how we communicate internally and with our investors. I want to recognise a weakness in our

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Tielman: We look for people who want to win the Olympics

Jeroen Tielman

Kicking off proceedings on Day 2 at Gaim International 2012, Tushar Patel of HFIM moderated a panel to discuss today's seeding environment and how different seeders approach the investment process. Sitting on the panel were Patric de Gentile Williams of FRM, Mona Aboelnaga Kanaan of Proctor Investment Managers, Jeroen Tielman of seeding platform IMQubator, and Philippe Paquet of Newalpha Asset Management.

In response to why investors allocate to seeders like FRM, de Gentile Williams gave two reasons: to gain exposure to early stage emerging managers for targeted sources of alpha, and also because seed investing gives investors a substantial additional source of return. Tielman, whose firm IMQubator is pure end investor-orientated, said that institutional investors being exposed to seeing opportunities was interesting because it enables them to closely align themselves to managers at a time when their motivation to succeed is at its highest.

"If an investor allocates to an experienced team they know that team will do everything they can to generate returns. Another benefit to seeding investing is that it gives investors access to multiple income streams," said Tielman.

Proctor Investment Managers takes a true private equity interest in managers, investing in the fund management company rather than the funds themselves like IMQ. "We are long-term investors and strongly believe managers should be in control of their business. We don't look to take an overpowering equity stake," confirmed Kanaan.

Paquet added that another reason clients like seed investments is because of the market intelligence seed firms can offer. "Clients such as insurance companies appreciate finding out about start-ups being launched by seasoned professionals who have a clear idea of how to make money," said Paquet.

Different seeders look for different things. Firms like FRM invest in groups whereas IMQ invests in individuals. Said de Gentile Williams: "We prefer to back groups of people who've worked together for a number of years rather than individuals."

Tielman said IMQ has a two-pronged approach to sourcing managers: the people themselves, and technical considerations such as ensuring the strategy has ample liquidity.

"Where we are super focused is on the actual business itself. Are these managers true institutions rather than small shops with limited scalability? We focus on the P&L, capacity, how the teams work together and how they are compensated," said Kanaan.

The panel conceded that today's capital raising environment is tough for managers and seeders alike, but there are signs that momentum is building. "Over the past 12 months we've been more productive at capital raising than the previous five years. We're signing an insurance company mandate tomorrow," confirmed Pacquet. De Gentile Williams said that investors are actively allocating to FRM's underlying managers but added: "The hardest thing for managers is getting access to investors, to get their attention and get invited in to pitch."

"Since the global financial crisis our pipeline has changed from being 50/50 traditional/hedge fund managers to being predominantly larger hedge fund managers. In addition to the capital we put into firms we've been active in marketing to help managers grow in today's difficult environment," confirmed Kanaan.

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Short-selling bans are a mere foretaste of what's to come


Robert Jenkins

In a guest speech prior to introducing a series of panel discussions in the morning session of day 2 at Gaim International, Robert Jenkins, external member of the financial policy committee, Bank of England, offered three personal observations from what he termed a macro-prudential regulatory perspective. Before doing so he candidly explained his role by recounting a story he told his wife. Said Jenkins anecdotally: "We're trying to protect the banks from the financial system and the financial system from the banks!"

Jenkins' first observation, in relation to the Greek situation and market stresses in the eurozone, was that containment was not enough. "The entire premise of the eurozone was that cross-border risk did not exist," said Jenkins. If that were true, Germany today would happily lend to its counterparty Greece in the south. Unfortunately it's not. The Greece situation to say the least has introduced a degree of doubt.

The problem, said Jenkins, was that capital was flowing out of countries that need it to countries that don't need it.

"Containment is not enough. Confidence must be such so as to completely banish cross-border risk and until this is achieved the euro will continue to unravel and economic progress will be constrained," commented Jenkins.

Jenkins' second observation was that the numbers involved in the global financial system had become too large, noting that of the USD600trillion in global derivatives outstanding, one third of those contracts are euro-denominated. Billions, said Jenkins, are for babies: "You are the trillion dollar generation."

Jenkins then went on to quantify the concept of 'trillion' by illustrating that if you were to initial a US dollar bill every second it would take 31,708 years to acquire a trillion dollars; an amount equal to 1/600 of the outstanding notional value of global derivatives.

Jenkins' third and final observation was that the days of unlimited liquidity are over. Many short-term traders, algo traders etc continue to assume that liquidity is freely available and will continue to be so. Bluntly speaking, Jenkins said it would no longer be as regulation causes banks to raise capital requirements and OTCs are moved into a regulated centrally cleared market place.

"Hedge fund strategies will not be able to freely access liquidity – governments will intervene to protect taxpayers. They may not succeed but it's their right to try and your strategies will not get in their way. Short selling bans in Europe are a mere foretaste of what I expect in the future."

Fees prove hot topic

In the final morning session chaired by Al Samper, former chairman of the Virginia Retirement Scheme, the issue of why hedge funds and their fees was still a hot topic amongst investors. The panel was composed of Jim Dunn, CIO of Wake Forest University, Niels Oostenbrug, Director, Alternative Investment Programme, MN Services, Anthony O'Toole, EVP and CIO of American Legacy Foundation, Greg Haenni, CIO of CERN Pension Fund and Bridget Uku, Group Investments Manager, UK LGPS Pension Fund.

Responding to why only a third of public sector firms in the UK invest in hedge funds, Uku said there were a number of contributing factors. Firstly, unfamiliarity; secondly, the fact that some of those who have invested in managers simply haven't enjoyed the returns, and thirdly the issue of fees.

"Fees are high and there's still a perception that hedge funds are risky. Public sector companies are under so much scrutiny that investing in the wrong manager would create a huge backlash," said Uku.

Samper said he was amazed that trustees constantly look at the fee component. "I don't mind paying for performance," said Samper. "You not going to gain a lot by not paying for talented managers. Fees seem to be the flavour of the month: everyone is asking for them."

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Innovative session tests manager presentations

One of the unique features at Gaim 2012 was the opportunity for a variety of fund managers to deliver rapid-fire presentations to a panel of judges comprised of seasoned investors.

The runner-up this year was Ozarslan Tangun of AccessTurkey Opportunities Fund, LLC, whose 90-second presentation caught the attention of the audience and the judges alike, winning him a bottle of champagne. For the benefit of wannabe hedge fund presenters everywhere, here's Ozarslan's rapid-fire effort, summarising a number of themes into a concise presentation.

Ozarslan Tangun

Ozarslan A Tangun, CFA, Director, AccessTurkey Opportunities Fund, LLC

"Founded in 1999, ATOF has the longest and the best track record in Turkey as a single country hedge fund.

"We are a long-biased bottom-up value investor. We make long-term investment in Turkish public equities after conducting private equity like due diligence. We capitalise on mispricings in the market, create an edge with our intense research driven process and Contrarian perspective, in a country where group thinking is dominant and research based investing is limited. High Government bond yields (20% in 2008 and as much as 50% in 2002) have left very little incentive to do real research to generate returns for the local managers. Even today as much as 80% of the local fund portfolios are invested in fixed income securities. Generalist EM funds don't allocate enough of their portfolios to become real experts in the market."

Why invest in Turkey?

"Turkey has the 6th largest economy in Europe, 16th largest in the world. It has the second largest population in Europe with over 71 million people and it is the fastest growing population in Europe. The median age is 27 compared to 41 in EU27.

"The country is going through a major transition with continuing fundamental economic reforms and increased integration into the global economy as a major hub. Transparency, governance standards are improving making investment environment much more friendly for long-term investors like us."

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1 ▶ systems before a smart investor does so it's made us raise our game. We've grown up," added Botta.

On dealing with the difficulties of increased due diligence, Buchan said that one of the main challenges was "information overload" and that pulling out what is mission critical to investors is far from easy. Botta said that Pershing wanted to be as helpful as possible to investors because a "better informed investor is a better long-term investor", particularly during down periods which all funds suffer at some stage.

Schoenfeld admitted that investors wanting to meet portfolio managers, go through trade examples, etc, was a drain on resources but emphasised: "It makes senior people aware of the fact that this is a serious business, not a game."

Slicing and dicing data in different ways for different investors was a challenge in Oppetit's view, who said that giving investors the raw data was "sometimes easier".

All the panellists confirmed that they had raised their level of transparency, with the likes of PSAM happy to discuss key positions, where possible, with investors each month. Transparency is quite natural for an activist fund like Pershing as most of the portfolio's 12 positions, by their very nature, are already known to the market said Botta.

On the issue of fees and how managers are adapting to investor requests, Schoenfeld said that on either side of the 2/20 fee structure it's more a "result of performance than anything else". "The pressure is going to increase on fees. We have created different classes for longer lock-ups," confirmed Schoenfeld.

"The one size fits all approach is no longer relevant. We make special arrangements with certain investors. You don't discuss fees when you visit a brain surgeon. Managers make mistakes and investors understand that," said Oppetit.

Concluded Botta: "We're 1.5/20 so we're already lower than our competitors and under less pressure from investors."