

# **Hedge fund investing via Managed accounts**

**Removing regulators and investors fears**

Hedge Fund Investments Japan IQ2007, Tokyo, 11-12 June 2007



## Mouth-watering returns

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- ✎ \$1.44 trillion in assets under management, according to Hedge Fund Research
- ✎ Hedge funds have significant stakes in 38% of the world's public companies
- ✎ The \$ 6 billion Quantum Fund founded in 1970 returned 3,365% during the next ten years
- ✎ Medallion Fund has averaged 37% annual returns, after fees, since 1989
- ✎ On an equally weighted basis, Hedge Funds on average return 13% annually after all fees, with a annual volatility of 7% (3,000 hedge funds in the TASS database from January 1995 through December 2006)

## Eye-watering blow-ups !!

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Wood River

MotherRock

Amaranth

Bayou Group

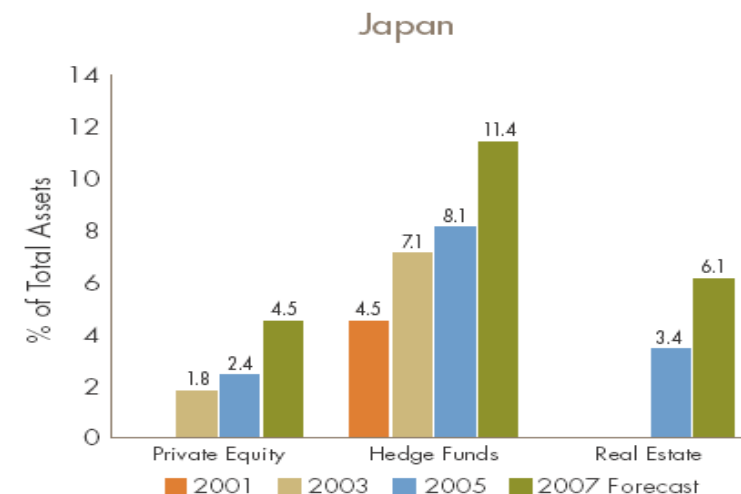
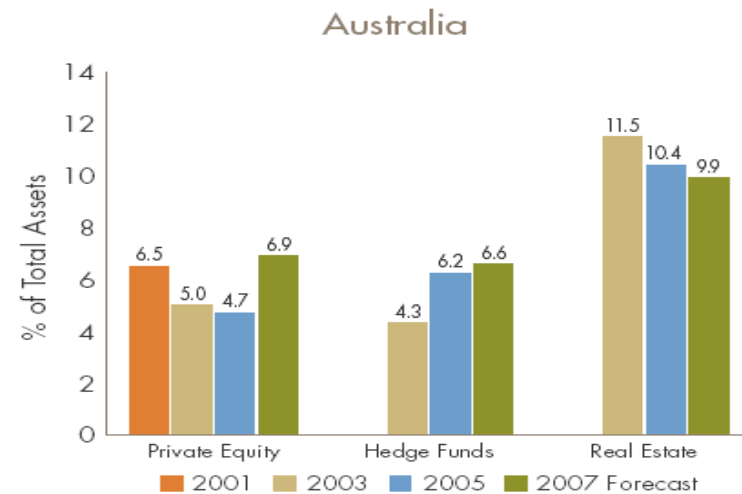
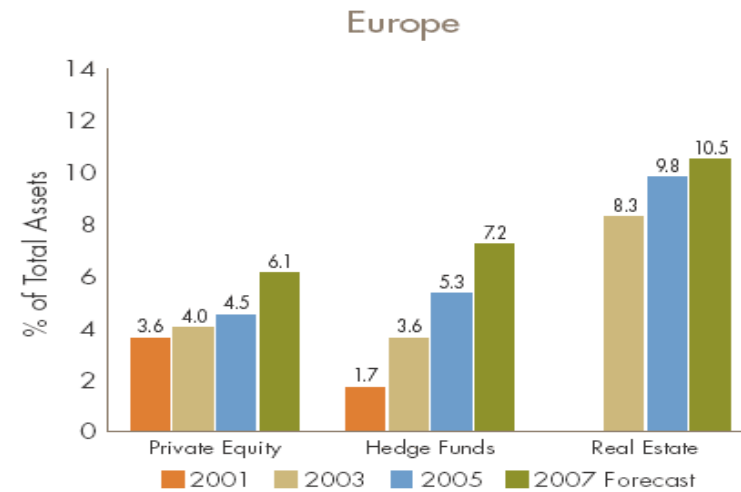
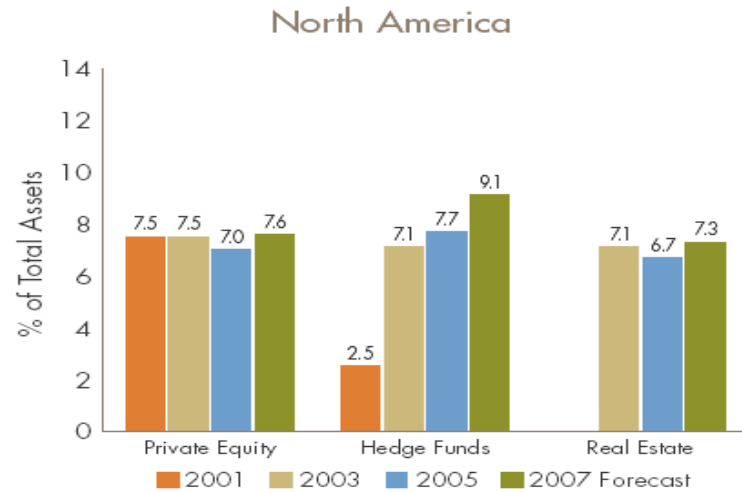
Granite  
Funds

Long-Term  
Capital

Manhattan  
Investment

Aman  
Capital

# The global emergence of the hedge fund investors



# Is diversification really a “free lunch” ?

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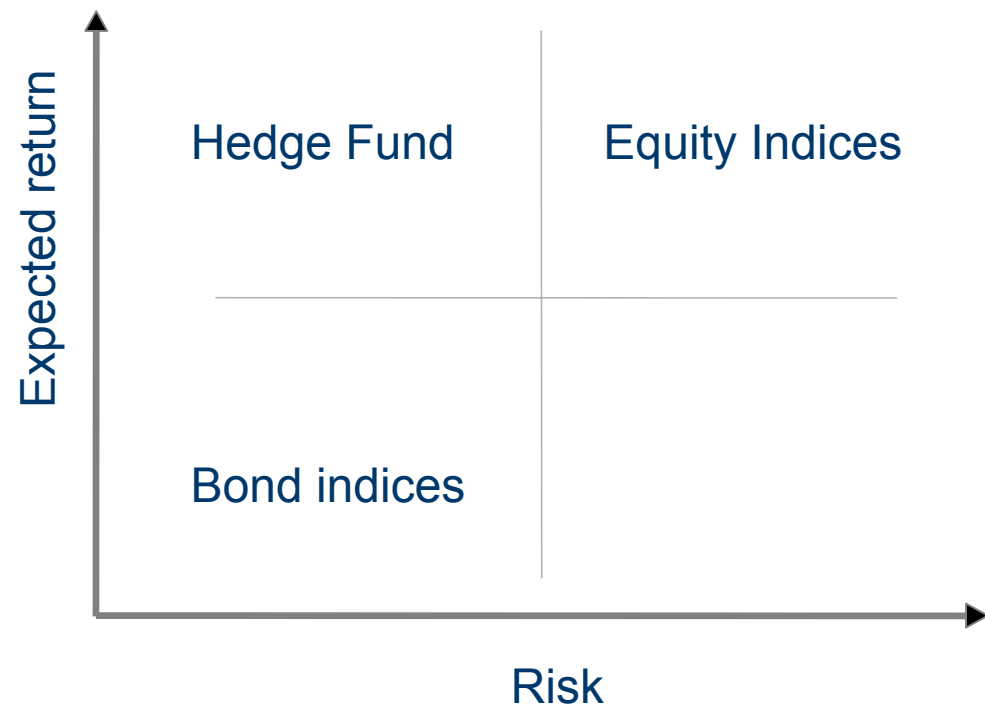
Remember what hedge funds are trying to achieve

Investors like:

- Returns
- Low downside volatility
- Diversification

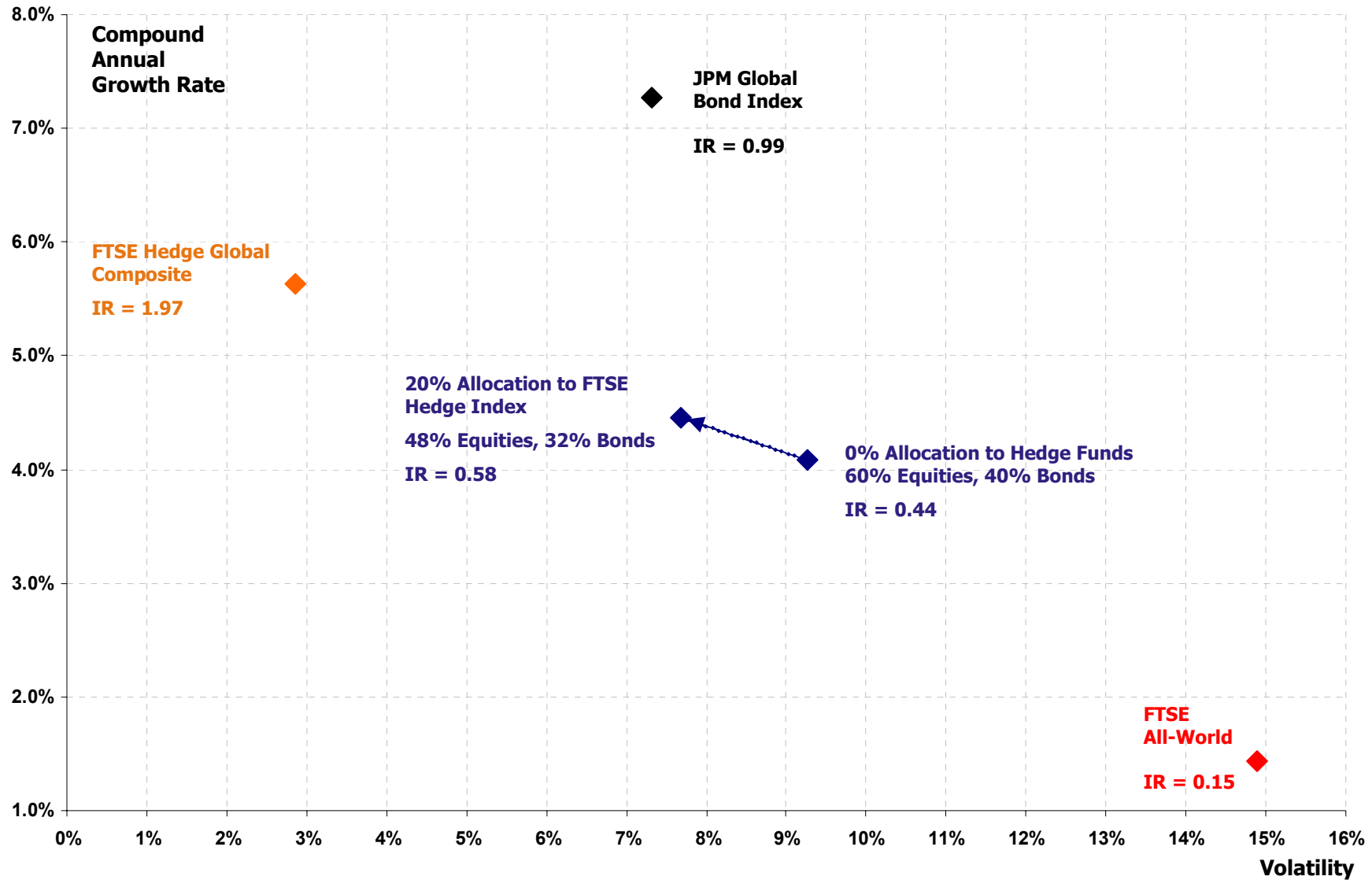
Investors don't like

- Fund structure risks
- Investment risks
- Operating risks
- Lack of transparency



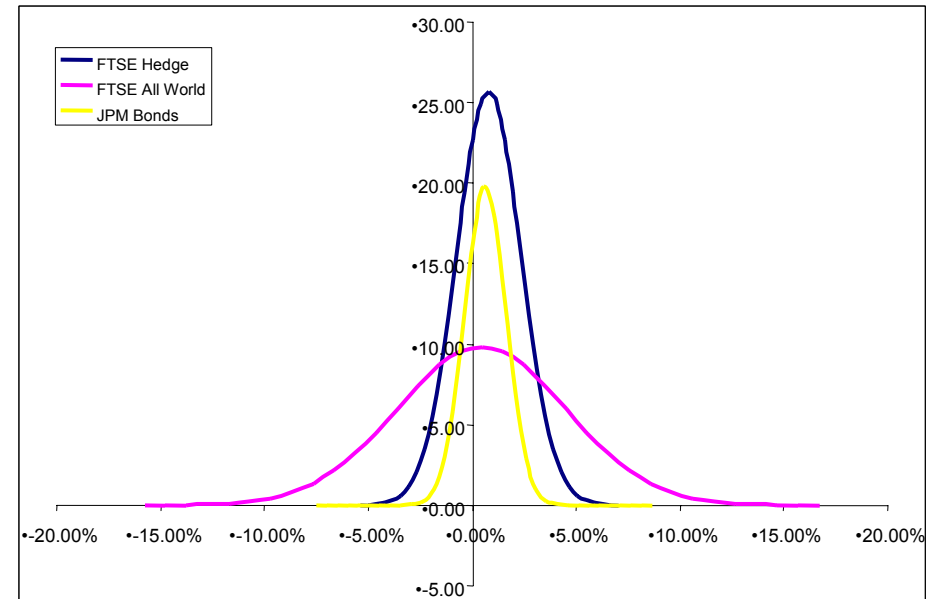
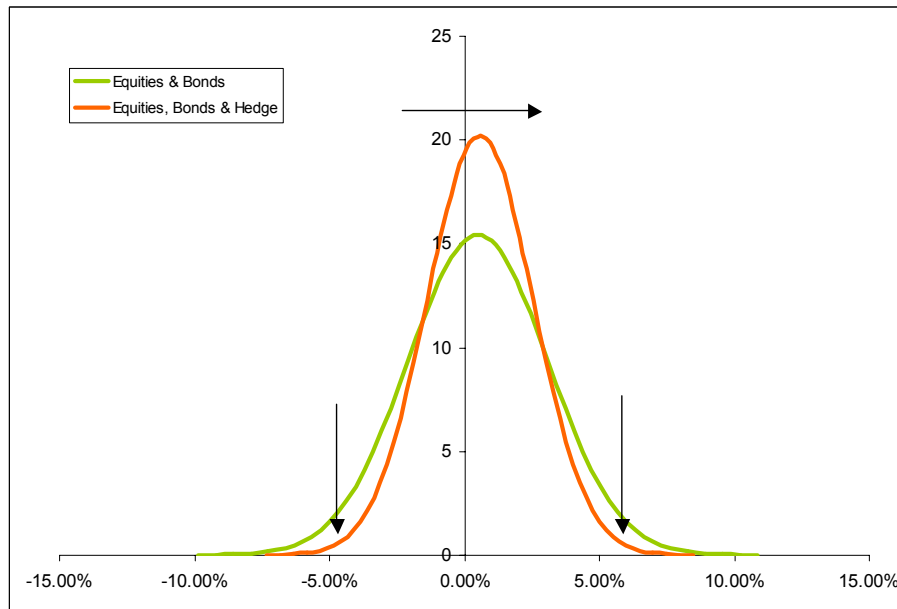
**MSS Hedge Fund Investment Platform**

**Improving absolute and risk adjusted portfolio returns**



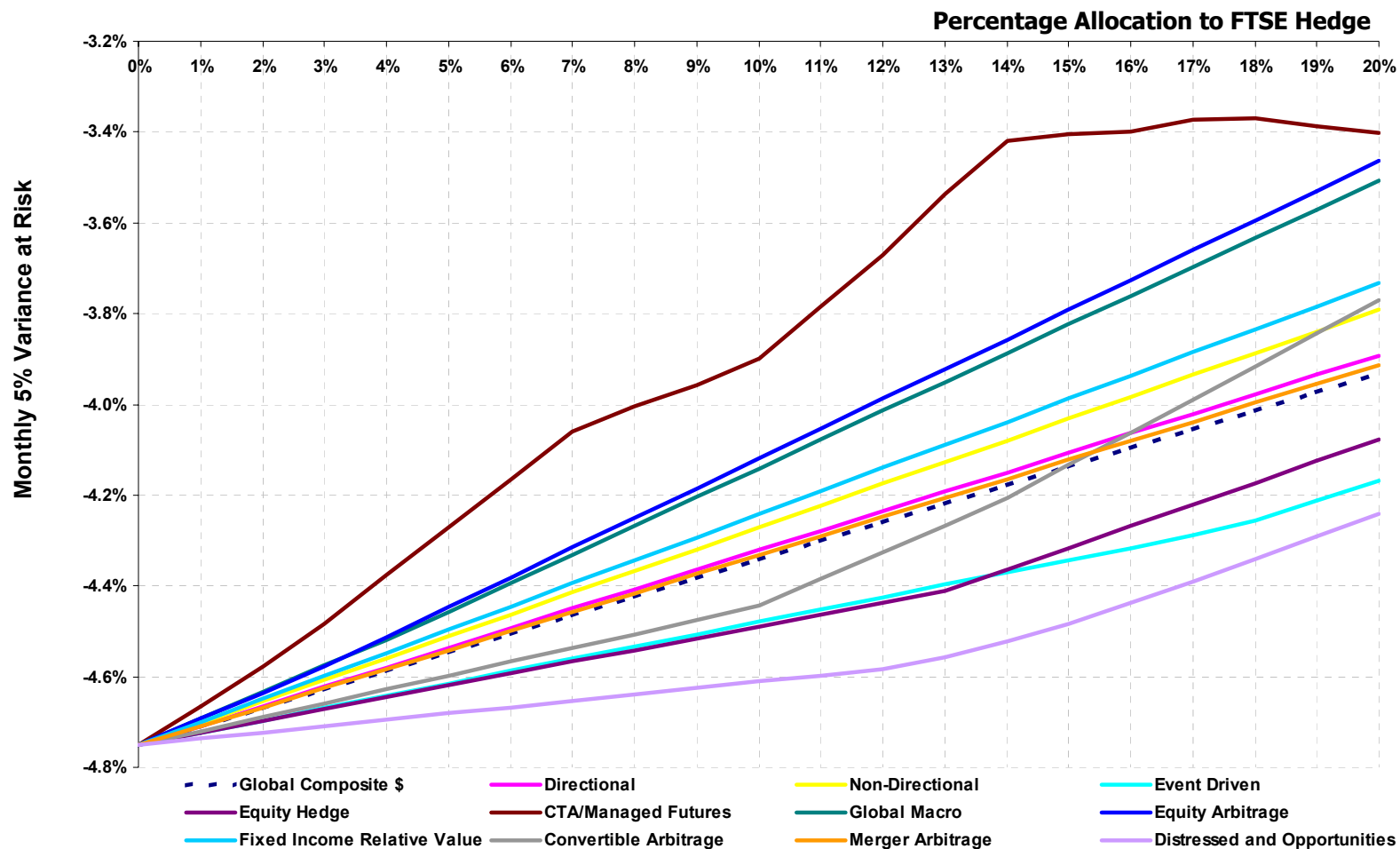
# Reshaping the portfolio distribution

A portfolio of hedge fund returns is more positively skewed and has less tail risk



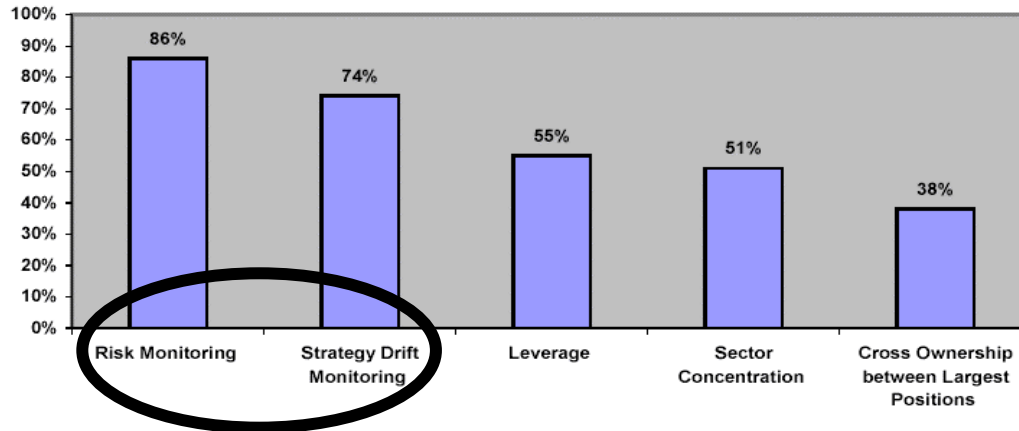
A portfolio of assets including hedge funds has higher average returns and lower variance

# Improvement in Variance at Risk due to Hedge Fund Exposure



# Recognising hedge fund risks

## Primary reasons investors require additional transparency\*

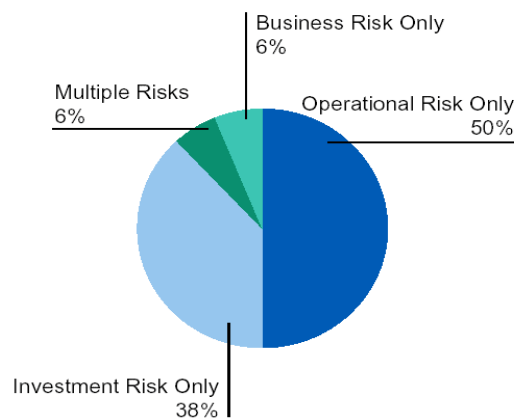


Source: Deutsche Bank

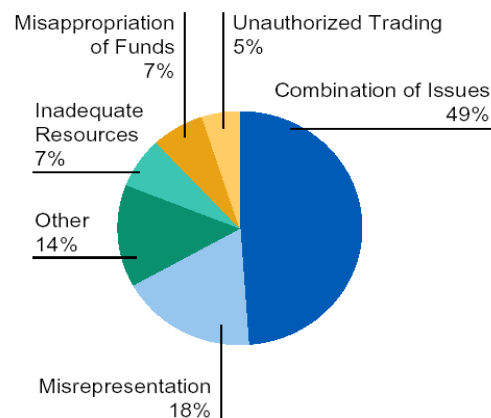
Strategy drift causes 40-50% of hedge fund failures.....

Hedge with transparency and diversification?

## Breakdown of Fund Failures



## Breakdown of Operational Failures



Source: Capco

Operational failure causes 50-60% of hedge fund failures.....

Hedge with due diligence procedures?

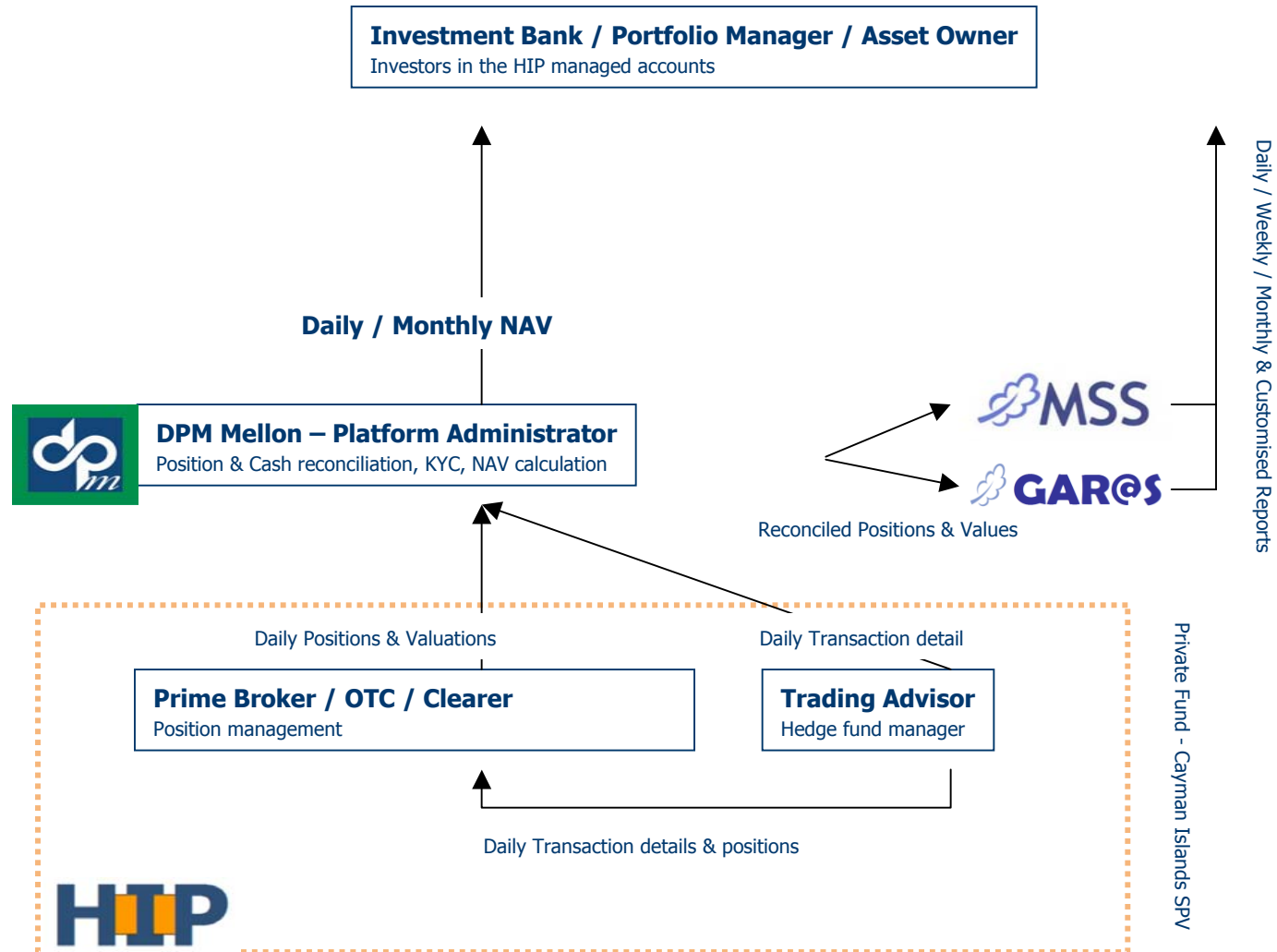
# Transferring “un-hedged” risk with managed accounts

	Funds	Prime brokerage	Basic Managed account	Advanced managed account
Segregation of assets		●	●	●
Enhanced liquidity			●	●
Elimination of misrepresentation risk			●	●
Elimination of misappropriation risk		●		●
Elimination of mispricing risk				●
Elimination of the risk of trading outside of the OM				●
Elimination of other operational risks				●

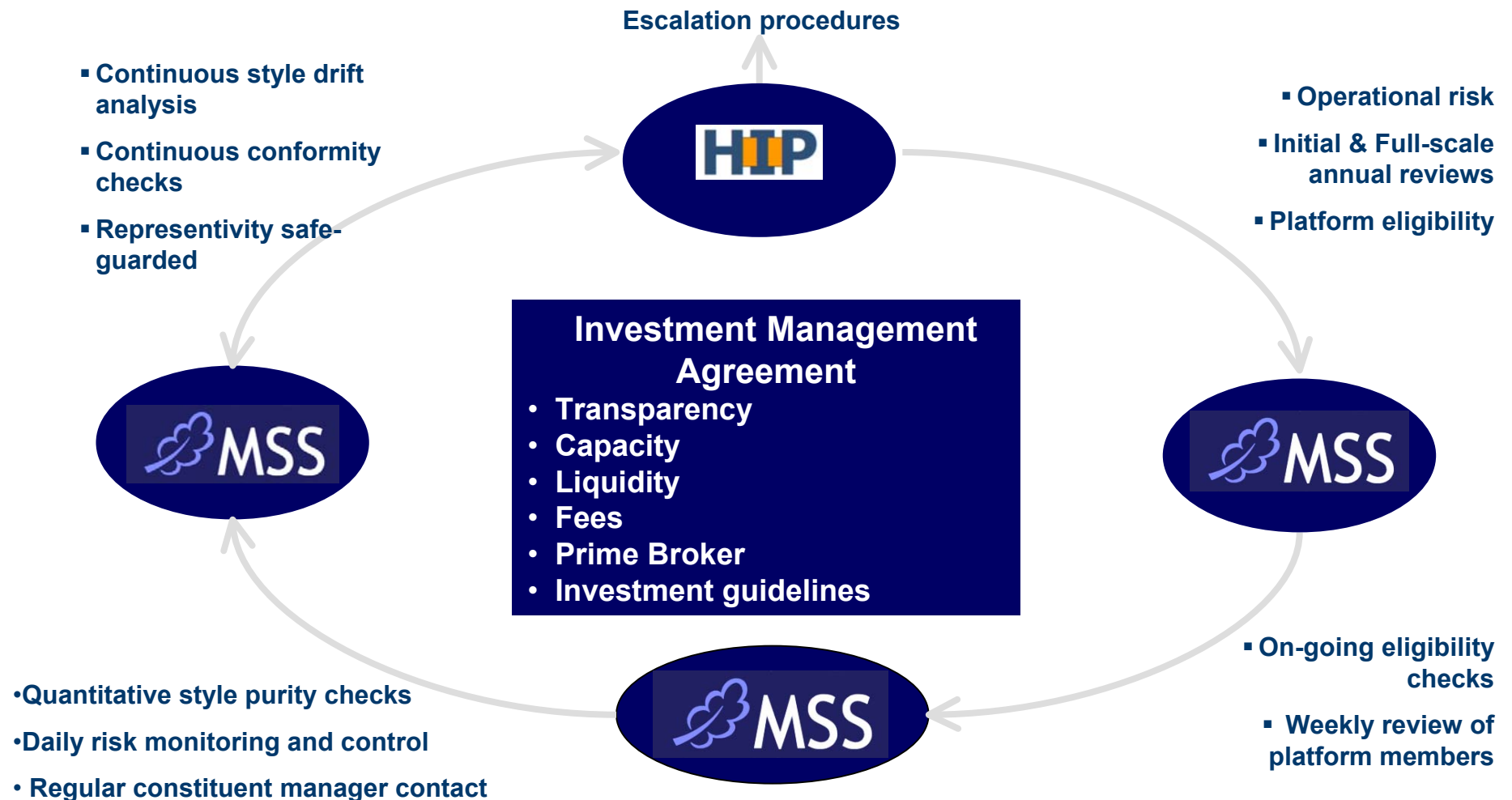
(Source: Edhec, MSS)

Transparency identifies the risk, segregation provides the liquidity to manage that risk

# Segregation throughout



# IMA drives the risk management continuum



# MSS Hedge Fund Investment Platform

## Style Purity – Daily risk control

Static and Dynamic data is accessed via a web browser front end including positions, capacity, strategy and style, historical performance, peer comparison, primary contacts, AUM history, Key People, competitor analysis etc etc

**Dashboard**  
MSS ADVISORS | MSS Fund (888888) | Performance Days: 360 | Tracking

**SPV/Fund MSS Marketing Managed Account #1**  
Fund Name MSS Marketing Hedge Fund Dummy  
Open? Yes  
Redemption Monthly  
Style: Global Macro  
Fund Ccy USD  
Mgt Fee 1%  
Leveraged? Yes  
Domicile Cayman Islands

**Legal Structure US**  
BMF Ccy USD  
Inc Fee 20%  
Leverage Max 1.5%  
Prime Broker: UBS Financial Services Inc  
Auditor: PWC  
Counsel: Eversheds/Walkers  
Systems Advent  
Founded: 01 January 1998  
HQ London

**OTC Counterparty (ISDA's)**  
Credit Rating: AA+  
Bear Stearns: AA-  
Morgan Stanley: A+  
Goldman Sachs: A+

**IMA GAR Risks**  
Fund/Portfolio: MSS Marketing Hedge Fund Dummy | FD: 888888

Measures:	As At		Risk Parameter (Click to reveal chart)	Value	Minimum	Maximum
Risk Parameters	31 December 2005	Comments...	Number of Short positions	55.0	.0	50.0
Risk Mappings	31 December 2005	Comments...	Gross Short Market Value / Net Asset Value	1.4	.0	2.0
Commentary:	31 December 2005	Comments...	Gross Exposure (LIV + SMV) / NAV	2.8	.0	4.0
Risks (All)	31 December 2005	Comments...	Daily Rate of Return	.0	-2.0	2.0
GAR Risks (per FD)	31 December 2005	Comments...	10yr Equivalent Long Exposure / NAV	1.5	.0	2.0
Charts:	31 December 2005	Comments...	10yr Equivalent Gross Exposure / NAV	2.8	.0	4.0

Style Drift Monitoring

**Performance and Volatility**  
Tracking

**Volatility and Peer Performance**

Managed Account versus Benchmark Fund Tracking Variance Analysis

**Express**

**Risk Parameters**  
Fund/Portfolio: MSS Marketing Hedge Fund Dummy | FD: 888888

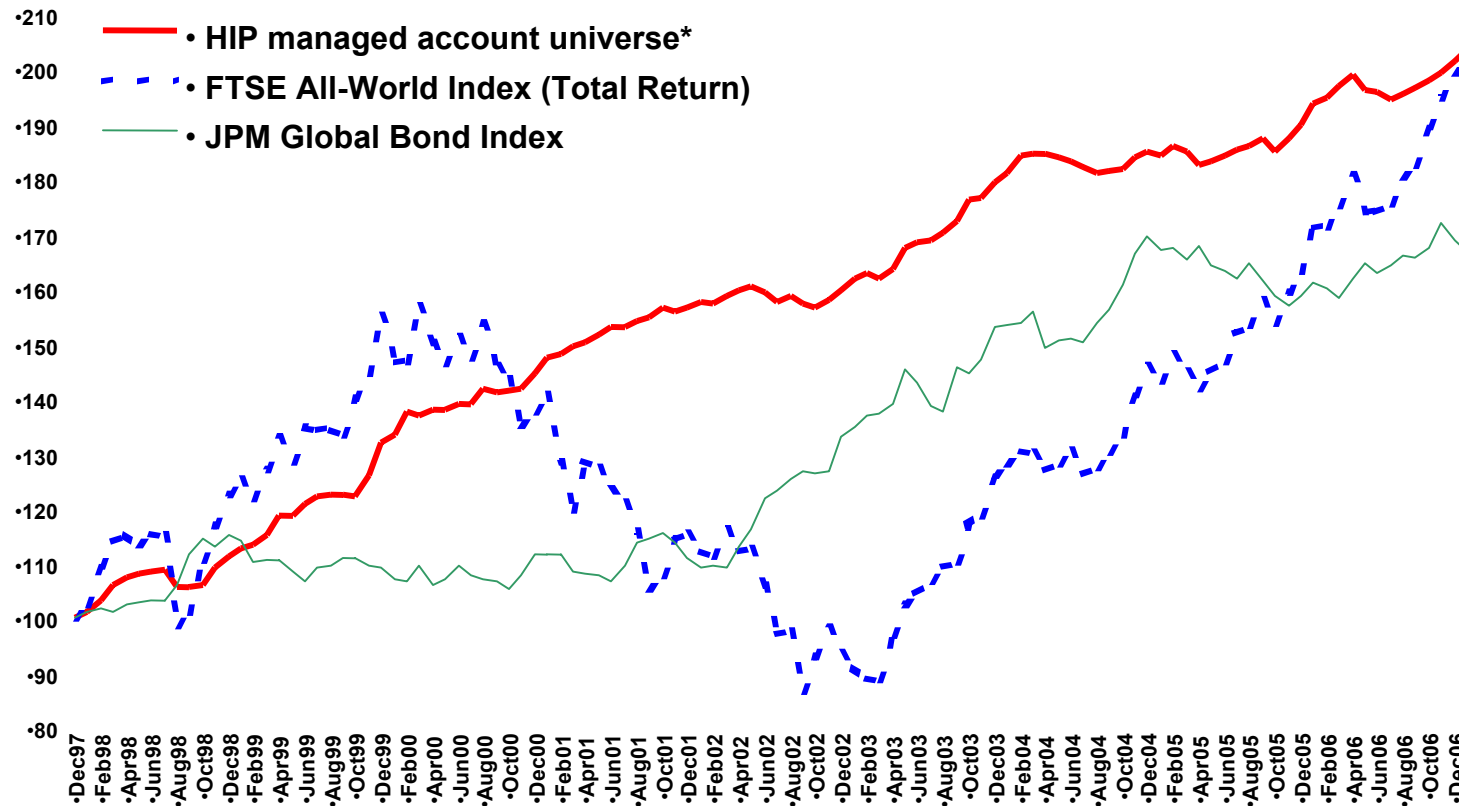
- 3: Gross Long SMV/NAV
- 4: Gross Short SMV/NAV
- 5: Number of Long Positions
- 6: Number of Short Positions
- 7: Largest Country Exposure / NAV
- 8: Net Exposure (LIV+SMV)/NAV %
- 9: Asset weighted average number of issues required to replicate the portfolio
- 10: Asset Weighted MFC CAC of underlying
- 11: Gross Assets (LIV+SMV)/NAV
- 12: Instruments: Equities
- 13: Instruments: Options
- 14: Instruments: Futures
- 15: Instruments: Bonds
- 16: Instruments: Struct
- 17: Maximum Exposure to any Single Issuer (excluding OTC's) / NAV
- 18: Exposure to Issuer of a single security (incl OTC's) / NAV
- 19: Largest Long Position (excluding OTC's) / NAV
- 20: Largest Short Position (excluding OTC's) / NAV
- 21: Largest Regional Exposure by Continent / NAV
- 22: Largest Exposure by Country (incl OTC's) / NAV
- 23: Largest US Issuer Country (incl OTC's) / NAV
- 24: Largest Asset Class Exposure of NAV %
- 25: Maximum Credit Exposure by counterparty (excluding Prime Broker) / NAV
- 26: Instruments: Convertible Bonds
- 27: Instruments: Warrants
- 28: Instruments: Struct Income
- 29: Instruments: Struct Income
- 30: Instruments: Struct Income
- 31: Maximum Exposure to any Single Issuer / NAV
- 32: Exposure to any Single Issuer (incl OTC's) / NAV
- 33: Asset weighted average market capitalisation of underlying
- 34: Gross Long Market Value / Net Asset Value
- 35: Gross Short Market Value / Net Asset Value
- 36: Gross Exposure (LIV + SMV) / NAV
- 37: Net Exposure (LIV + SMV) / NAV
- 38: Maximum fraction of outstanding share capital exposed to in any single security
- 39: Largest Issuer Exposure / NAV
- 40: Largest Asset Class Exposure / NAV
- 41: Largest Exposure by Issuer (incl OTC's) / NAV
- 42: Instruments: Credit Derivatives
- 43: Instruments: Interest Rate Derivatives
- 44: Instruments: Commodity
- 45: asset weighted average duration (age) (days)
- 46: Largest Regional Exposure by Continent (excluding North America) / NAV
- 47: Largest Asset Class Exposure (excl OTC's) convertible bonds of issues / NAV
- 48: Instruments: Futures
- 49: Instruments: Repurc
- 50: Instruments: Commodity
- 51: Margin / NAV
- 52: Largest Exposure by Market / NAV
- 53: Largest fraction of average daily contract trading volume held by contract
- 54: Largest long position (excluding short term interest rate instruments) / NAV
- 55: Largest short position (excluding short term interest rate instruments) / NAV
- 56: Largest Net Asset Value (excluding short term interest rate instruments) / NAV

Over 450 ratios are calculated daily including V@R - New ratios and risk measures are being added all the time.

**GAROS alerts the Risk Manager if a potential breach is about to occur (AMBER) or an actual breach has occurred (RED)**

# Adding Managed Accounts to the portfolio – Diversifying performance

Hedge funds improve stability of return






\* As measured by the performance of the HIP managers weighted as per the methodology of the FTSE Hedge Index




## The impact of managed accounts in a portfolio

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### **Combine the traditional exposures to:**

-  Absolute return less marginal costs
-  Low downside risk retained
-  Diversification benefits preserved

### **Together with new benefits:**

-  Improved Liquidity
-  Enhanced Transparency
-  Segregation provided

### **Just a cost of doing business:**

-  Institutions – Insurance policy for costs saved
-  Retail – Structured products
-  Regulators – Protecting the vulnerable

**Portfolio fully risk adjusted returns rise**

## Contact Details

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Graham Colbounre

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