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20 YEARS OF EUROHEDGE
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From humble beginnings to institutional industry

When the first issue of *EuroHedge* was published in January 1999, the small handful of European hedge funds in existence managed $15bn between them. To call it an industry would have been an exaggeration.

In trading terms, the magazine's launch was a long bet on the prospects of a tiny corner of asset management which used sophisticated investing techniques to post high returns. Having noticed the growth in American hedge funds, the founders of this magazine believed it might just catch on in Europe.

It proved a worthwhile trade. From a humble start, Europe's community of hedge funds has grown into an industry managing more than half a trillion dollars in offshore funds, and plenty more in Ucits and other product types besides. Fortunes have been made, big bets won and lost, and countless headlines printed as hedge funds became a powerful force in financial markets.

It has become an institutionalised industry. After initially focusing on wealthy individuals and family offices, funds now draw most of their capital from retirement and sovereign wealth funds, insurers and other institutions. The shift accelerated after 2008 as the operational spotlight intensified and the influence of funds of hedge funds waned. Firms such as Marshall Wace, Man Group and CQS now manage billions for pensioners around the world.

This special edition of *EuroHedge* does not merely commemorate our twentieth anniversary, proud as we are at reaching the landmark. We have spoken to some of Europe's leading names to take stock of the industry's progress so far, explore its present and, most importantly, analyse what the future holds.

The first chapter contains interviews with most of the industry's leading names who were in business in 1999, our first year. As research on page 34 by *HFM Insights* reveals, 10 firms with current assets of more than $3bn have been trading since then – representing the pioneers of the industry. We have also spoken to several managers who started subsequently, including Leda Braga and Alan Howard, who have made a similarly considerable impact.

We provide an industry chronicle in the second chapter, highlighting the key moments from the past 20 years. *EuroHedge* has been there every step of the way, recording the ups and downs in print and online, and bringing the industry together at its events every year, as my colleague Nick Evans documents. We also look back in detail at the cataclysmic events of 2008.

The third chapter is given over to investors, the bedrock of the industry, and the impact of the march of institutions. In the fourth chapter we explore the operational changes that have defined the past 20 years and technical challenges that continue to set the agenda.

Thank you to all our interviewees for their involvement and to our sponsors for their support. Most importantly, thanks to you, our readers, for supporting the magazine, attending our events and enabling the growth of this dynamic industry.

If the last 20 years are anything to go by, the next 20 will be quite a ride.

Enjoy the issue.

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The pioneers who shaped an industry

Seeds of success for **Marshall Wace** sown in dark days of 2008

BY **WILL WAINEWRIGHT**

Sir Paul Marshall and Ian Wace on how crisis and chemistry have shaped their $39bn firm

Paul Marshall suspected it was important when Ian Wace invited him to lunch in January 1996. He did not remember Wace – who had been the first broker to call him when he started at Mercury Asset Management 11 years before – as a serial luncher.

The pair met at Leadenhall Market. "Ian shared his idea about starting a hedge fund business and, as it happened, I had been thinking of doing the same thing," says Marshall. "It was very serendipitous."

"He was my fifth call, but there you go," jokes Wace during a rare joint interview at the $39bn firm's London headquarters, given to mark *EuroHedge*'s twentieth anniversary. Marshall Wace's position 23 years after that lunch as one of the world's largest long/short equity firms would have been hard to foresee in the early days, when they struggled to raise more than $1m apiece from prospective investors.

"You needed $50m to start and I couldn't for the life of me see where we were going to get it from," says Marshall. Only when George Soros promised $25m could they raise the same amount from other investors and get going.

"It was incredibly difficult," Wace adds. "I think we represented a different proposition to other startups of that time. People were interested in fundamental investing, not trading-focused investing." Eureka, the firm's first product, initially combined both.

Marshall Wace came through the test of Long-Term Capital Management's demise later in 1998, but there were lessons to learn. "It did make me realise our business would be exposed to unexpected events," says Wace. "It taught us to always have a risk parameter that was pretty trimmed."

Eureka became one of the first European funds to reach $1bn in 1999 and limited its size at $1.4bn two years later. Work then started on a proprietary system to measure the value of ideas received from the sell-side. Wace enlisted Anthony Clake, an undergraduate who had been recommended for an internship, to help.

You needed $50m to start and I couldn't for the life of me see where we were going to get it from.

SIR PAUL MARSHALL

"I told Anthony I wanted to measure the value of all the 'inputs' – analyst notes etc – that came in to us. By the end of summer 2001 we had the basis of an application that captured the breadth of the ideas universe."

After developing a success ratio to assess which calls were more likely to be correct, Wace realised the firm had an embryonic trading system on their hands. The result was Tops, which trades systematically on sellside ideas, and remains one of two key struts of Marshall Wace's business, along with fundamentally-driven Eureka.

Wace says there was little interest in Tops at first. But they persevered and converted investors to the system, which has become a powerful force in European markets. It has also facilitated much of Marshall Wace's dramatic subsequent growth.

The young intern joined the firm permanently. "Clake is the sum total of his natural brilliance and what he has learned here. He must be one of the most influential people within finance," says Wace. "I am proud to have had someone as rounded and phenomenally capable as that join as a graduate trainee, and then go on to have the career he has had with us. But he is one of many examples at the firm."

The pair say it helps being a partnership, rather than the firm having a single leader. "Some hedge funds are led by one person who is not challenged, and who ends up falling in love with their own genius and reputation, before blowing up," says Marshall. The balance brought by the partnership is perhaps shown by their positions in the Brexit referendum in 2016, with Wace favouring continued EU membership and Marshall backing the campaign to leave.

"Ian and I are constantly challenging and criticising each other. The culture of the whole firm is like that. No one is ever allowed to be in a dominant position." Between 2005 and 2008 Marshall took time out from the firm to pursue other interests. "In that period it was extremely lonely," recalls Wace. "When you build a business with a partner it gets more difficult when they leave. We were missing his fundamental investing knowledge and passion for markets."

Wace confesses to not sharing Marshall's love for investing. "But I do have the love and passion for building the business. Our partnership has complementary values. I have seen it from the

SIR PAUL MARSHALL AND IAN WACE

Photo © Piers Cunliffe

position of having it, not having it and then having it back. It was a terrific boost when he returned."

Marshall returned just in time for the financial crisis. "It was an environment of total fear and the unravelling of a perfect storm," says Wace, who describes the period as being "as close to a near-death experience you can imagine". Assets plunged from $14bn to less than $4bn in five months.

"My strongest abiding memory was the final quarter of 2008 after Lehman Brothers had filed for bankruptcy," says Marshall. "We thought Morgan Stanley and Goldman Sachs could go down, and most of our prime brokerage balances were with them. Ian and I stood on the terrace at our old office and just thought 'This is it.'"

The firm kept investing through the maelstrom. "We never suspended or gated and always published our NAVs on time," adds Wace. "We had monthly liquidity and resisted the temptation to increase it, which ultimately was one of our great successes, because when the market turned we had no cash and were fully invested."

The crisis was the firm's darkest hour, but also sowed the seeds for its dramatic post-2008 growth. "We committed to the partnership and told our staff we would do whatever it takes to rebuild the business," says Wace. Lessons were learned on the investor side. "We looked to institutionalise our asset base and focused on the US in the following years."

The duo admit the firm had neglected the US investment market and relied too much on funds of hedge funds, which declined rapidly from 2008. "It was undoubtedly a failure of ours not to invest more in marketing," says Marshall. "We didn't hire a marketer until 2006, eight years after launch. Ian and I had previously done it. In 2008 we realised how useful a marketing team could be."

The front office was bolstered. In the second half of 2008 Marshall Wace hired three fundamental managers – Rod Rehnborg, Amit Rajpal and Fehim Sever, who manage Japan Market Neutral, Global Financials and Global Opportunities – who remain with the firm a decade on.

Operations benefited too. "We radically overhauled our risk management applications and invested heavily in our trading architecture," says Wace. "We diversified our revenues. All these decisions were taken in the darkest moments of the crisis. What I most remember about 2008 is just how black a black sky looks."

London's hedge fund industry received unprecedented attention after the crisis, with the practice of short-selling heavily scrutinised. Marshall, who defended the industry in a parliamentary Select Committee appearance in 2009, continues to do so. "Hedge funds are the truth-tellers," he says.

"Shorting the UK banks in 2008 was the right thing to do because they were in trouble. Deep capital markets would be impossible if you can't bet against stocks, as well as go long."

He thinks the industry's reputation has improved in some ways. "Hedge funds have gone from being a cottage industry to being a very respectable branch of the funds industry. But there have been cases of bad behaviour and in many cases an asymmetry of rewards between managers and their clients."

As the firm grew in the years after the crisis, attention turned to how best to structure it for the next phase of growth. "I never wanted to float the company but I did want to make sure staff understood there was a value in the entity," says Wace. In 2015 it was announced US private equity and credit giant KKR had bought a quarter of the firm, a stake which has since increased to almost 35%.

"The chemistry has been superb – there has been total trust," says Wace. "It was a huge endorsement for our business in the US. It is another sign of how we are a different firm to what we were in 2008."

Technology remains a priority. Wace proudly cites the fact Marshall Wace stores 4.5 petabytes, or the equivalent of 270bn 10Mb photographs, on its servers – and data capture is doubling every year. "Tomorrow's world will be utterly dependent on data, shaped by it," says Wace. "You need to be in front, not behind. This is a relentless industry and we have been tireless in making the most of the opportunities presented to us." ◘

Blue-chip name **Lansdowne** rises from "obscurity" on 20-year journey

BY **WILL WAINEWRIGHT**

Sir Paul Ruddock, who started Lansdowne with Steven Heinz, looks back on the firm's growth from its dramatic early days

Few hedge funds endured as turbulent a start as Lansdowne Partners in 1998. Just six weeks after the long/short equity manager began trading, Long-Term Capital Management (LTCM) blew up, throwing markets into chaos.

The market turmoil that year overshadowed Paul Ruddock and Steven Heinz's new venture, which *EuroHedge* labelled one of the "least known" recent start-ups in its May 1999 issue. But initial performance had been good, despite the tumult. "This relative obscurity is unlikely to last much longer," the magazine predicted.

Two decades on, Lansdowne is one of the European hedge fund industry's largest and best-known names, a seven-time winner of EuroHedge Awards. But Ruddock, who was knighted for services to art and philanthropy in 2011, remembers his firm's difficult start only too well.

"When we started there was very little hedge fund money in Europe," he says in his first *EuroHedge* interview since retiring from Lansdowne in 2013. "Egerton was backed by a wealthy US investor. Marshall and Wace had got off to a very good start when they began, about 10 months prior to us. But for the most part, people starting hedge funds in Europe were unproven because they had been long-only or brokers and not worked in a hedge fund environment."

Initial doubts about the industry's longevity were only heightened when LTCM imploded. "People started pulling money out of hedge funds. It was a tough environment."

The timing was inauspicious for Ruddock and Heinz, who had already had one false start. Their initial backer had cold feet when the Asian financial crisis started the year before, postponing their plan to start in 1997.

> **My background was in building brokerage businesses, so I wanted to join forces with a talented stock-picker.**
>
> SIR PAUL RUDDOCK

Some would have thought twice, but Ruddock was convinced of the business opportunity. "The European hedge fund industry was tiny compared to the US," he says, while the "very fragmented and poorly researched" nature of Europe's equity markets offered myriad openings. "Once you got past the top 100 or so companies the research was very poor. So there was a real opportunity in terms of doing good fundamental research on European companies."

First, he needed a business partner. "My background was in building brokerage businesses, so I wanted to join forces with a talented stock-picker," says Ruddock, who built a career at Goldman Sachs and Schroders. He was introduced to Steven Heinz, an analyst at Harvard Management in Boston, by Stuart Roden, who later joined and led the firm.

The partnership of Ruddock, who ran the business, and Heinz, who led the investment side, proved successful. "We had a very good year in 1999, up 67% net, particularly on technology stocks. It wasn't until September 1999 we got to $100m, then a year later we were at $1bn."

The performance bred interest from investors, but Ruddock's challenge was not straightforward. Institutional allocators required a lot of convincing the industry had a stable long-term future. Ruddock focused on the US, rather than the Swiss banks targeted by many peers at that time.

"In the first 12 months of running the business I visited the US 10 times. We talked to a lot of institutions and were quite early, in European terms, in getting big commitments from US and UK pension funds," he says.

"A couple of large sovereign wealth funds allocated to us early in their allocations to hedge funds. We took a long-term view. There was one institution in the US I visited several times over a few years and ultimately got a large allocation."

In its early years the firm made appointments that proved crucial to its long-term future. Roden and Peter Davies joined from Mercury Asset Management in 2001 to start the UK equity strategy, which became its Developed Markets flagship. The fund posted dou-

SIR PAUL RUDDOCK

ble-digit returns for five consecutive years between 2003 and 2007, at an average of 23.9%. Firm-wide assets peaked at $20bn in late 2007.

Then came the crisis, during which the firm's assets halved. "The first reason was the performance loss," recalls Ruddock. "Second was that sterling/dollar went from 2 to 1.40. A lot of our assets were in sterling, so that cost us another $2bn or $3bn." The rest was redemptions.

"The biggest challenge was navigating the counter-party environment," he says. "Morgan Stanley had been Lansdowne's main prime broker and the firm moved quickly to diversify its counterparty risk as the crisis developed (see page 34 for a full 2008 retrospective).

"It was stressful, but it could have been worse. We felt relatively prepared," he adds. "Some of the most stressful times are when you are losing money and you're not quite sure why."

He highlights Lansdowne's fright during the Volkswagen "debacle" in October 2008 as an example. "We were short Volkswagen several hundred million across two of our funds. But the share price was shooting up – it later transpired because of market manipulation involving Porsche and Volkswagen stock," he says. "It went up by something like five times in three days – now that was stressful. We ended up taking some of our losses."

Lansdowne came in for criticism after the crisis for shorting UK banks including Northern Rock. "It was pretty clear to a lot of people the system was very leveraged; that Northern Rock, Bradford & Bingley etc had unsustainable balance sheets relative to the liquidity of their borrowings," says Ruddock. "Frankly the regulators should have been looking at that."

He believes the episode demonstrates the role hedge funds can play in highlighting financial problems. "There is always going to be a segment of society that believes if something goes wrong, other people should not be benefiting," he says. "I would counter with the example of internet stocks, where some people were taken to the cleaners because of crazy valuations. You need people in the market crunching the numbers, providing an alternative voice."

Ruddock continued running the firm until retiring in 2013. Heinz retired the following year, with leadership passing to Roden and Davies in a textbook – and rare – example of effective succession planning by a top hedge fund. Ruddock has since focused on his interests in the arts and philanthropy, as well as chairing his alma mater Oxford University's endowment and investment committee.

"I was very proud that we built Lansdowne into a big business with great partners: of our reputation of being smart, honest and good at our jobs, and long-term, blue-chip investors," he says.

Would it be easier to start Lansdowne today, compared to 1998? Yes and no, Ruddock believes. "Today there are tons of firms started by founders who have years of experience as hedge fund analysts, portfolio managers, what have you. It is easier to have credibility today."

But you need more assets to survive in today's industry. "We started with $40m. Now, Steve and I took no salary for the first year but we were able to cover our costs. You'd need a couple of hundred million to cover your costs today. It is probably harder, too, to differentiate yourself unless you've been a star analyst or manager."

He adds that the last decade's low-interest rate environment since the financial crisis has impacted hedge fund returns. "It is not easy, with all the macro events of Brexit, Trump, Saudi Arabia/Iran, you name it," he adds.

But the end of the bull market will provide an opportunity for hedge funds to prove their worth. "The trouble with being long equities is there are sometimes long periods when you may make a lot of money, but from time to time you are going to lose an awful lot of money. Part of the goal of good hedge fund management is making money consistently in all environments."

The industry has come a long way since the nineties, he concludes. "Hedge funds are now a part of the arsenal of every major investor, which was not the case 25 years ago at all." ◘

Hedge funds “make a difference” – **Systematica’s** Braga

BY **WILL WAINEWRIGHT**

The global industry’s leading woman says performance is the main challenge facing the hedge fund sector

Fittingly, given Leda Braga’s penchant for motorcycling, the Brazilian hedge fund manager has not looked back since leaving Michael Platt’s BlueCrest to start her own firm in 2015. Systematica Investments, which houses the BlueTrend strategy she founded in 2004, now manages almost $10bn.

Despite her firm’s immense growth – which makes Geneva-based Braga the global hedge fund industry’s leading woman – the trend-following pioneer says her job has become harder in the past two decades.

“It is harder in many dimensions,” she says. “Market opportunities have become more evident to all and therefore more difficult to monetise, institutional flows have dictated institutional standards of infrastructure and processes, and the regulatory burden has increased substantially.”

However, advances in technology have helped. “The acceptance of technology and science [in the hedge fund industry] has meant a lot of excitement and developments on the alpha generating front. Overall the job is broader, more mature, one needs to look further forward into the future.”

After a career in academia, Braga spent almost seven years at JP Morgan working on quantitative programs. There she met Platt, the Preston-born macro trader who founded BlueCrest, which became one of Europe’s leading hedge fund firms.

Braga’s strategy soared 43.3% in 2008, a breakthrough year for CTAs when most other strategies declined. Returns in recent years have been leaner and Braga admits performance is the “main challenge” facing the hedge fund industry.

LEDA BRAGA

Systematica now runs a range of different strategies, fee structures and liquidity terms. BlueTrend, which peaked at more than $15bn in 2013, now manages less than $4bn. Like other managed futures firms, Systematica has moved into alternative markets in search of new sources of managed futures alpha.

BlueCrest has been a family office since returning external money to investors at the end of 2015. The minority stake BlueCrest initially took in Braga’s new business was subsequently bought by Boston-based Affiliated Managers Group.

Braga’s enthusiasm for the industry, transmitted in a long profile with *EuroHedge* in March 2018, is again evident in a fresh interview to mark the magazine’s 20-year anniversary. She believes the hedge fund and wider asset management sectors have never been more relevant.

“Our industry can make a difference to the way companies are run, to sustainability, to the way people feel about their retirement possibilities. The hedge fund segment is perhaps the most innovative end of this very relevant industry.”

She hopes this appeal will help the young graduates who are perhaps more tempted in joining big technology firms consider the hedge fund industry. “Investment management is information management,” she says. “The graduate who likes data science – machine learning, AI – will thrive in investment management.” ◘

Evolution of **Man** into Europe's largest hedge fund firm

BY **WILL WAINEWRIGHT**

CEO Luke Ellis looks back at Man Group's journey over the last 20 years to become the world's largest listed hedge fund manager

No firm has undergone so great a transformation in the past 20 years as Man Group, the largest hedge fund manager in Europe. And no one is more aware of that fact than CEO Luke Ellis, who has continued an overhaul of the business initiated by his predecessor Manny Roman.

"We have made a conscious decision to diversify the business," says Ellis in an interview at the listed hedge fund manager's Thameside headquarters. "In the last 20 years, Man Group has gone from being a purely retail-driven business, offering CTAs and funds of funds in various combinations, to having more than 100 different products doing remarkably different things. There are almost no structured products."

When *EuroHedge* printed its first issue, the company was still allied to ED&F Man, the agricultural commodities business which harked back to the company's eighteenth-century roots as a sugar broker. That unit was sold in 2000 and Man Group subsequently focused solely on growing its alternatives business under the leadership of Stanley Fink, dubbed by some the "godfather" of the hedge fund industry.

In 2010 the company stunned markets with a $1.6bn acquisition of GLG Partners, the high-flying long/short equity firm where Pierre Lagrange, Philippe Jabre, Greg Coffey and others had made their names. That was Man Group's breakthrough in strategy diversification, a process which has continued and accelerated under Roman and Ellis in the past five years.

Man Group has fundamentally changed in the past 20 years, but so has the hedge fund industry, according to Ellis. Performance challenges have grown. "It was far easier to find alpha than it is now," he says. "There was much less competition, in terms of the number of hedge funds chasing opportunities, compared to today."

> ***The biggest change I see is that hedge funds are running less vol now.***
>
> LUKE ELLIS

At the same time, costs have increased in the past two decades. "The cost of running a hedge fund was much lower and the regulatory challenges were smaller," he adds. "It was typically easier to raise money to make the business profitable. Hedge fund firms managing $100m could get by, whereas now you need four of five times as much to be profitable, in most strategies."

Man Group's $114.1bn under management makes it the largest listed hedge fund manager in the world, with assets boosted in recent years by a string of acquisitions and consistently healthy inflows. Previously dominated by retail money, 80% of Man Group's investor base is now institutional, a statistic reflecting the transformation in hedge fund allocation trends.

KEY FACT

MAN GROUP IS THE LEADING WINNER OF EUROHEDGE AWARDS (THE FIGURE INCLUDES ALL GLG TRIUMPHS)

Ellis, who spent the decade to 2008 with fund of hedge funds firm FRM, later purchased by Man Group, witnessed the changes in this area first-hand. "Institutions were beginning, slowly, to make their presence felt 20 years ago via the medium of funds of hedge funds, which became hugely influential in the early 2000s," he says. "Their money helped a lot of early funds to get going. The FoHFs space is much smaller now, partly because institutions often invest directly into hedge funds."

The years leading to the 2008 financial crisis are often viewed as the hedge fund industry's heyday. "The noughties were the most profitable time for the hedge fund industry," says Ellis. "Cumulative profits peaked in 2007 – since then, assets have gone up, as have costs, but fees have gone down."

But he does not wear rose-tinted glasses. "In 2008 it stopped being easy. The industry is more rigorous now – investors are more careful with their money, ask more questions and negotiate over fees. Do I think any of that is unhealthy? No."

The financial crisis proved that the rocketing asset prices in the preceding years were not sustainable, says Ellis. "It is interesting to consider whether 2008 is an outlier year, or whether in

fact years like 2006 and 2007 were the outliers."

Ellis has a theory about why average hedge fund performance has been lower since 2008 compared to the decade before. "The biggest change I see is that hedge funds are running less vol now. Many were running at 10-12% vol before 2008, while it is around 5% now for many. But the Sharpe ratio has not doubled in any chart I've seen – it's stayed basically the same before fees."

Fee levels should reflect this new reality, he believes. "I think that two-and-twenty fees are reasonable for a fund running vol at 10-12%, with a gross Sharpe of 1.5; it produces a perfectly fair income for the manager of about 30% of fees." When vol is lower, he thinks fees should be too.

Ellis disagrees with the prevailing view that the increasing influence of institutional investors explains the lower vol levels (the suggestion being funds reduced vol due to fears of being jettisoned after a big drawdown).

"I don't think institutions are any quicker to let go of under-performing managers than high-net-worth individuals were 20 or 30 years ago. I think in some cases the key cause for lower vol was funds taking in too many assets and diluting their returns."

Changes in technology have reshaped the way hedge funds trade. "Aside from systematic strategies practised by the likes of Man AHL, it is remarkable how little technology was used 20 years ago," says Ellis. "It wasn't quite blotting pads but, compared to today, it wasn't far off."

The scale of technological change in the industry and society more broadly guards Ellis against making major tech predictions. "Twenty years ago, smartphones didn't exist," says Ellis. "The notion of a smartphone had not even been imagined. So it is very hard to make predictions on a 20-year time horizon. The speed at which technology has moved on is incredible and looks unlikely to slow."

Man Group has been innovating in artificial intelligence and other areas. But Ellis, who believes driverless cars will be the norm in London within 20 years, thinks discretionary fund managers will be around for a few years yet. "They may use technology to improve their processes. The proportion of computer-driven strategies may increase. But I believe there will be a role for the foreseeable future for good discretionary managers."

LUKE ELLIS

Looking to the future, Man Group has been increasingly focused on issues around responsible investment and started a podcast series on sustainable investing. Ellis says an increasing number of clients are now asking about ESG (environment, social and governance) issues.

"The question is how you do it in a hedge fund format," he adds. "And what is a better investment: something that is 'good' from an ESG perspective, or something that is 'bad' but getting better? There are very different mindsets among clients on that."

More generally, Ellis is fundamentally positive about his sector's future, which the rise of institutional clients has helped secure. "The hedge fund industry has gone from strength to strength in the last decade and now serves the needs of millions of pensioners, which it didn't do 20 years ago." ◘

Aspect Capital targets market inefficiency

BY **HUGH LEASK**

Co-founder and CEO Anthony Todd reflects on 20 years of evolution in systematic strategies

The launch of Aspect Capital reunited most of the original team behind AHL, the pioneering quantitative hedge fund. The firm's early days were emblematic of the forward-looking entrepreneurial spirit and almost-DIY ethos which drove much of the hedge fund industry in the late 1990s.

"It was literally just the four of us – Mike Adam, Marty Lueck, Eugene Lambert and myself – in a room on Gloucester Place," remembers Anthony Todd, Aspect's co-founder and CEO, of the firm's origins in Marylebone. The quartet had the responsibility of setting up the entire business, from building the infrastructure and sourcing and securing data to researching and building the trading models.

"Right from the start, our approach was to look at everything we knew about medium-term trend following and work out how we could extract every element of performance, from data input right the way through to execution," Todd says of the strategy.

However, with the stock market riding high, a computer-driven systematic programme offering diversifying returns proved a tough sell to potential investors. "The pervading view at that point was that one couldn't use systematic approaches to beat the markets, that markets were completely efficient," says Todd.

The founders stuck to their guns and ultimately launched their flagship, Aspect Diversified, with $30m in seed capital. Two-thirds came from a $40m ticket supplied by RMF, the Swiss fund of hedge fund manager (with the remaining $20m going to Aspect's other programmes).

"A $40m allocation in 1998 – that was a big launch in *EuroHedge*," says Todd. "But $40m these days barely even touches the sides. It is inconceivable you can start a business with that level of capital today."

The new millennium would see Aspect hit its stride, racking up four consecutive years of double-digit returns as the dotcom bubble's burst sent markets into a tailspin.

"Some people had looked at the tech-wreck of the early 2000s, and saw the performance of managed futures, and wondered whether those sorts of returns would ever be repeatable," Todd recalls. "But just five years later, it happened again."

The 2008 crisis was the second time in a decade that managed futures had been able to provide strongly diversified returns. With Aspect Diversified gaining more than 25% in the immediate aftermath of the meltdown, Todd believes the events of the year emphatically demonstrated, once and for all, the diversifying benefits of CTA strategies for investors.

The market crash and subsequent regulatory upheaval transformed the industry, says Todd, with new investor expectations leading to changes in operational infrastructure, transparency and due diligence. The institutionalisation means firms now need more assets to get by.

"Now, for the level and calibre of infrastructure and the investment in R&D that institutions quite rightly are looking for, you have to have a critical mass north of $1bn," says Todd. Sub-billion-dollar managers "don't have the ability to invest in building that robust infrastructure, particularly in the quant space," he adds.

ANTHONY TODD

Aspect currently manages $7.3bn in nine different strategies across a range of quantitative funds spanning managed futures, alternative risk premia, currencies and multi-strategy. Staff numbers total 130, with offices in London, Stamford and Hong Kong.

Conversation turns to which firm – other than Aspect – Todd would invest with, given the choice. "For me, looking at my portfolio construction, I'm going to be looking for something completely diversifying from what we do at Aspect." He would consider discretionary managers uncorrelated to quant strategies and picks out Crispin Odey, praising his "remarkable" long-term track record.

"It's 100% discretionary, conviction-based and to me that's going to provide a huge level of diversification from the rest of my investments. It's terrific the way he's doing well this year – and good for him. Everyone had completely written him off."

Todd remains confident about the future of the hedge fund industry. "Over the course of the next 20 years, the investment environment is going to be very different," he says.

"Many pension funds have got return targets of Libor +500, or Libor +600 or +700. How are they going to find those returns in a very different environment from the last 35 years? That's where I think hedge funds, managed futures, and quant investment strategies are absolutely going to play an important role. I'm extremely optimistic." ◘

Hintze builds **CQS** into credit giant after "daunting" start

BY **WILL WAINEWRIGHT**

Sir Michael Hintze's hotly-tipped 1999 launch now one of global industry's largest credit firms

"Many investors believe that Hintze's fund could quickly become one of the giants of the European hedge fund industry," reported *EuroHedge* as it broke news of the impending launch of CQS in 1999. Led by Michael Hintze, a promising British-Australian convertible arbitrage trader, and backed with $200m by Credit Suisse First Boston, his former employer, the new firm was expected to thrive.

Two decades on, CQS has more than $18bn under management and the founder a knighthood in recognition of his philanthropy. But Hintze says the early days of his firm were not as straightforward as they sound. "It was daunting and very challenging, quite honestly," he says in an interview reflecting on the twentieth anniversary of *EuroHedge*, which started just months before CQS began trading.

Despite initial fears, Hintze says he felt ready for the task – plus a keen sense of duty towards the staff he was taking on which has persisted to this day. "I saw risk, but I also saw opportunity. There are big responsibilities; to the client to generate returns, but also you are responsible for people, their livelihoods, their careers and their families. It's a big deal."

The task of running CQS, which has since diversified into a multi-strategy credit-focused asset manager, has kept him busy ever since. The firm's flagship strategy, CQS Directional Opportunities, which Hintze personally runs, has been named EuroHedge Fund of the Year three times, an achievement matched only by Sir Chris Hohn's The Children's Investment Fund (TCI).

Hintze celebrated his sixty-fifth birthday in 2018 but shows no signs of slowing down, beginning his working day with a 5.30am trip to the gym. He is usually at his desk and trading by 7am. Hintze – a self-confessed "news junkie" – has a legendary appetite for information and might send 50 or more emails of heavily-annotated research and analysis pieces every weekend to staff to read on Monday morning.

"I love problem-solving," says Hintze.

CITIZEN OF THE WORLD

Hintze was born in northern China on the day the Korean War ended, to a family that had fled from Russia after the Bolshevik Revolution in 1917. A fluent Russian speaker, he was raised and educated in Sydney – after his family left Maoist China and were taken in by Australia as stateless refugees – before joining the Australian Army. He later pursued a finance career on Wall Street before starting CQS in London. His varied background inspired the artwork, below, for the July/August 2018 cover of *EuroHedge*.

"The markets are a giant puzzle and working out how to generate alpha has always excited me. Performing for clients is critical. In that sense, the job has not changed much."

The love of puzzles is closely connected to the advice he has for students or graduates interested in a career in hedge fund management. "It is important to be curious," he says. "Read a lot of books about markets and the history of finance to understand the fundamentals, but also read more widely – context is important.

"We have a graduate scheme here at CQS but plenty of the banks offer schemes too which would offer a good grounding. Have an open mind, never lose that curiosity, be focused and be humble."

In terms of key turning points, the year 2008 stands out to Hintze as acutely as it does to most other leading founders. His firm came through the trials of that year, but the behaviour of some prime brokers serving CQS at the time will not easily be forgotten.

"Some behaved well, they were honourable. Others did not, increasing our margin and then trying to buy our portfolio," says Hintze. "We had been good clients and treated them with respect during the good times but that didn't seem to count for much – among some providers – when the crisis hit. Fortunately, we always had multiple prime brokers and we were able to move balances."

The liquidity test was also unprecedented. "As a team we battled hard to maintain the liquidity levels in port-

SIR MICHAEL HINTZE

folios necessary to meet redemption requests if they came," he says. "Hedge funds were seen by many investors as ATMs, but some peers failed to meet that liquidity (which, it should be pointed out, benefited them in the long term, and led to higher redemptions elsewhere)."

After losses in 2008, several CQS funds had their best year in 2009: Directional Opportunities was one, up 56.3%. CQS's client base was transformed as institutional investors became the dominant force in hedge fund allocations. "This meant an institutionalisation of the firm, a focus on client solutions and increased complexity in running the business – regulation, compliance, operations, HR," says Hintze.

He also thinks there have been changes in market structure since 2008. "Liquidity and the prevalence of passive investment funds and algos has dramatically changed the investment environment," he says. "Markets appear to be resilient to news, there's little apparent volatility and then there are gapping markets."

> ***I love problem-solving. The markets are a giant puzzle and working out how to generate alpha has always excited me. Performing for clients is critical. In that sense, the job has not changed much.***
>
> **SIR MICHAEL HINTZE**

CQS is a different business now compared to the pre-crisis era, with the long-only side of the business now larger than the fully alternative side, which "would have been hard to predict in 1999," admits Hintze. "I am proud of what we have achieved at CQS and how the shape of the business has changed over time."

Among Europe's leading hedge fund managers, one would be hard-pressed to find a more passionate advocate for the industry or enthusiastic supporter of other leading names. When asked who he admires, Hintze has not one but a list of contenders.

"There are so many: the industry is filled with talent," he says. "I would pick out Greg Coffey at Kirkoswald, Chris Rokos, both of whom are exceptionally talented traders, and Marshall Wace, who have built a great business. Pete Davies at Lansdowne, David Harding at Winton... I could go on."

He is philosophical about the challenges facing the industry. "Performance is and always will be the main challenge," he says. "Providing clients with investment solutions will be an even greater imperative. There will be a blurring of the lines between hedged, long-only and private equity."

And will he still be running money at CQS two decades from now? Despite reaching the official UK state pension age, he is still relatively youthful in an industry where iconic investors like George Soros and Warren Buffett are in their late eighties. "In 20 years' time, who knows?" he says. "God willing I will still be running money (if my investors let me!)" ◘

Scandi innovator **Brummer & Partners** continues 22-year journey

20 YEARS OF EuroHedge Class of 1996

BY **WILL WAINEWRIGHT**

Founder of the region's first hedge fund sees a long-term future for the Swedish giant

"The challenge for every hedge fund business – especially if you've been around for 22 years – is how you reinvent yourself," says Patrik Brummer, founder of $13bn Swedish manager Brummer & Partners. "That is a constant challenge."

Few individuals in Europe have played as important a role in their home region as Brummer, whose firm established the first hedge fund in Scandinavia. The company's collaboration with regulators in Sweden led to the development of the country's hedge fund industry and cleared the way for Zenit, a long/short equity fund, to launch in 1996.

Zenit was the first Brummer fund and there have been many since – nine currently sit on the platform, spanning a range of strategies and geographies. Brummer has an ownership stake in each manager and invests in their commingled funds via Brummer Multi-Strategy, its flagship fund of funds product. Its oldest CTA, Lynx, is one of the nine European names in existence when *EuroHedge* started which currently manage more than $3bn.

Brummer knows only too well the importance of choosing to invest with the right managers at the right time and, when required, an ability to be ruthless. "Individual funds can die, sometimes because they are operating in a difficult market environment, or if they underperform," he told *EuroHedge* in a feature interview last summer. The firm's decision in 2016 to withdraw its investment in Zenit was evidence of the approach in action.

"We are the most active and informed investor in all these funds," says 69-year-old Brummer, who co-manages BMS alongside Mikael Spångberg. Perhaps the most distinctive aspect of Brummer's model is its attitude to fees, which remain set at one-and-20 for investors in BMS – despite the same 1% management and 20% performance fees being charged by underlying funds.

"Our attitude to low fees is real," says Brummer. "It's in the walls here." But Spångberg thinks there is more pressure from investors now. "We get more credit from UK consultants than we did five or 10 years ago because they value our approach more now than in the past."

The firm employs about 400 staff and more than half of the risk-takers at its nine underlying funds are based outside Sweden. "I want Brummer to be here 22 years from now," says the founder. "The business model has been tested for 22 years – the structure has stood the test of time." ◘

PATRIK BRUMMER

Photo © Dan Coleman

Cheyne finds credit in post-crisis markets

BY **WILL WAINEWRIGHT**

Stuart Fiertz and Jonathan Lourie describe how their London-based firm changed after 2008

At the height of the financial crisis in 2008, Cheyne Capital co-founder Jonathan Lourie bumped into a long-term investor on the street. Worried about navigating the turmoil and protecting the jobs of Cheyne staff, he was told to remember, "the best type of steel is tempered steel".

These words have resonated with Lourie in the decade since. "One wouldn't trust a pilot who had never been exposed to severe turbulence," he tells *EuroHedge* in a joint interview alongside co-founder Stuart Fiertz. "Today, as a result of the financial crisis, I believe the hedge fund industry is among the most aligned businesses for its investors."

Lourie, Cheyne's CEO/CIO and Fiertz, its president, started the firm at the turn of the millennium. "Starting at that time meant we caught the absolute peak in the Nasdaq and the tech bubble, so we had to cut our teeth in a difficult equity market backdrop and with a business that was principally equity and convertibles-driven," says Fiertz. "Whilst it was a challenging backdrop, navigating that stood us in good stead for the ensuing years."

The pair had managed credit investments for wealthy individuals at Morgan Stanley before launching Cheyne. The firm remains a credit specialist at heart, though a small part of its $8bn under management is invested in other asset classes. Lourie describes the firm's mission as identifying opportunities presented by market dislocations, examples being European commercial mortgage-backed securities in 2007 and real estate lending in 2011.

Our mantra is to keep it simple.

STUART FIERTZ

The events of 2008 had a big impact on Cheyne's business, in terms of both operations and strategy. "We moved to rigorous matching of fund liquidity with investment liquidity, capacity targets for our funds to protect performance, back-ended performance fees in most of our funds, lower fees, hurdles etc," says Lourie. The importance of aligned interests was underscored. "More than ever, we invest substantial sums of money in our funds ourselves and always provide the seed capital for them."

Regulation following the crisis played a "huge part" in increasing the opportunity set for alternative managers, he adds. Cheyne bought up books of loans from banks who had to retreat from the space after 2008 and has made inroads in real estate lending and affordable housing provision. "More recently, we've identified a significant structural opportunity as European banks shed non-core loans, which led us to start our stressed credit business, Cheyne Strategic Value Credit," adds Fiertz.

The firm has been re-shaped in consequence, with the more traditional hedge fund strategies it has managed since the start now accounting for just half its assets. "This means we now have a diversified and complementary offering with a large private markets business alongside our more liquid strategies," says Lourie. "What has not changed is our DNA, with good old-fashioned fundamental analysis continuing to underpin everything we do."

On the subject of technology, Fiertz sounds a note of caution on the rise of passive and quantitative strategies made possible by new tech. "We fear that strategies such as factor investing can cause winners and losers to acquire a momentum regardless of their intrinsic value, with the inherent pro-cyclicality of factors themselves – especially momentum – leading to the risk of them becoming overcrowded," he says. "Our mantra is to keep it simple."

The industry has faced performance pressures in the last decade, but Fiertz is optimistic. "Many years of low interest rates and, until this year, low volatility has been a major challenge," he says. "It looks like we are now set for a change of environment that should suit certain strategies."

His co-founder agrees. "It's hard to predict what the next 20 years will hold but, as we come out of a 36-year bull market in bonds, interest rates look set to rise and if equities are as volatile as they have been in other such periods, this could be good for hedge funds." ◘

JONATHAN LOURIE AND STUART FIERTZ

Brevan Howard surfs the macro wave

BY **WILL WAINEWRIGHT**

Co-founder Alan Howard, whose firm returned to form in 2018, has stark advice for next generation

Being a hedge fund manager, let alone in global macro, is not for the faint-hearted. Just ask Alan Howard, who co-founded one of Europe's longest-running and best-known macro names.

"You have to be totally consumed with the job and have the right balance of risk appetite and discipline. It's a mindset. If you can't live with risk and don't have discipline, being a hedge fund manager is not for you no matter how smart and hardworking you are."

Howard, a former Salomon Brothers trader, started Brevan Howard with a team of Credit Suisse First Boston colleagues in 2002. In an interview to mark *EuroHedge*'s twentieth anniversary, Howard says assembling the team was the most difficult aspect of starting the firm. "It is not easy to put together a group of highly skilled, motivated and ambitious individuals."

The $8bn firm uses interest rates, currencies and other instruments to trade macroeconomic trends. Giving a rare insight into his strategy, Howard says the basics of macro investing have changed little in the last 20 years. "The core functions will always remain understanding the evolution of macro policy, what the market is discounting and how to structure convex payoffs to scenarios that you think are mispriced. There are potentially more tools available, but the basic job remains the same."

His business has had ups and downs in its 16-year history. The highpoint remains the financial crisis, when Brevan's flagship posted annual returns of 25.2%, 20.4% and 18.7% between 2007 and 2009. Howard anticipated the credit crunch and had 85% of the portfolio in cash and short-term securities as a pre-emptive measure.

Assets subsequently reached a peak of $40bn in 2013 before falling as demand for macro ebbed in an era of quantitative easing and little interest rate movement. The flagship returned to form last year with a double-digit gain after losses in three of the previous four years. It was a major boost for Howard, who admits markets "seem to be far less prone to dislocations, which of course lead to trading opportunities".

The firm's client base became more institutional after the 2008 crisis, with pensions and sovereign wealth funds replacing funds of hedge funds. "These new investors demanded a much higher level of service and transparency, which we needed to provide," says Howard, adding that regulation has also had an impact on how he runs the firm.

> **There will always be a demand for uncorrelated attractive risk adjusted returns.**
>
> ALAN HOWARD

He differs from some peers by downplaying the impact of technology, saying advances have affected the firm's support functions rather than trading. For trading, individual talent will always be key for Howard. "We remain discretionary managers," he says. "Technology has provided more tools for traders to follow markets and form views but trading success is ultimately still a function of individual trader skill."

Making money for Brevan's investors is his greatest source of satisfaction. "I also get a lot of satisfaction from finding and developing trading talent, but nothing comes close to making money for investors."

Howard has advice for students and young financiers who want to be part of the next generation of hedge fund managers. "Be intellectually honest with yourself as to whether you have the right mindset for the job," he says. "It is an incredibly competitive industry with huge potential rewards. What makes you think you can win against thousands of people competing for the same dollars in the market who are just as smart as you and work just as hard as you? Being smart, hungry and a hard worker just gets you into the game." Having the correct mindset is all important.

Looking ahead, Howard says it is impossible to predict the next 20 years but that the future will be determined by performance, regulation and what viable alternatives exist for investors.

"There will always be a demand for uncorrelated attractive risk adjusted returns. So there will always be a hedge fund industry," he says. "How big it gets and which investors it caters to will be a function of how well it delivers on its promise and how regulation evolves. Overall I suspect that the lines between traditional 'hedge funds' and mutual funds or Ucits will continue to blur as managers try to cope with regulation and fee pressures and investors seek diversification and lower cost."

And who does he admire? Asked which European hedge fund manager he would invest with, Howard initially jokes he would "double up on myself". He then names Rokos, his fellow co-founder who left in 2012 and set up his own macro firm in 2015, at which point Brevan took a stake in the new business. ◻

ALAN HOWARD

Transtrend bears witness as CTAs move to mainstream

BY **WILL WAINEWRIGHT**

"Hedge fund" term should disappear, says Dutch firm's founder

Harold de Boer, who founded Rotterdam-based Transtrend in 1991, has witnessed CTA fund management move from the margins to the mainstream over the course of his career. "It has changed from being a somewhat eccentric job to something that is now widely accepted," he tells *EuroHedge*.

The $4.4bn firm, which has been trading its Diversified Trend Program since 1992, had hoped for a better initial reaction from Dutch investors, bred on an investing diet of stocks and bonds. "We expected that a truly different investment style would be of great interest to the pension funds and other institutional investors," says de Boer. "But our expectation turned out to be a naïve one: there was no interest whatsoever!"

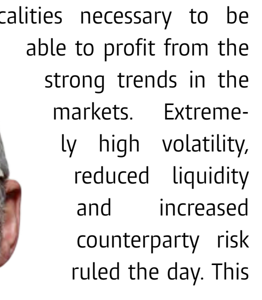
The firm was managing $225m by 1999. "Most of these assets came from investors that we initially had not targeted," says de Boer. "We were better known in London, Switzerland and Sweden than in the Netherlands." The firm's first non-European allocation came from the US, where investors were already acquainted with CTAs.

Unfamiliarity with commodity markets and strong trust in stock markets were to blame in the Netherlands. "It was not until the collapse of the dotcom bubble that more people became seriously interested in our investment strategy," he adds.

> ***It was not until the collapse of the dotcom bubble that more people became seriously interested in our investment strategy.***
>
> **HAROLD DE BOER**

Annual gains of more than 26% in 2001 and 2002 undoubtedly helped attract interest in those years. The financial crisis period proved equally important, with gains of 22.4% in 2007 and 29.4% in 2008 placing Transtrend among the best CTA performers of the era.

De Boer says keeping a grip on operational control was the key to success in those volatile years. "Most of our efforts focused on the practicalities necessary to be able to profit from the strong trends in the markets. Extremely high volatility, reduced liquidity and increased counterparty risk ruled the day. This environment above all required operational excellence."



HAROLD DE BOER

In terms of ops and technology, the firm is unrecognisable compared to its early days. "Recently, one of our guys in the electronic trading team told me that we were working a few thousand different orders simultaneously for our Diversified Trend Program," says de Boer. "Imagine how many traders at the desk we would have needed to work that amount of orders without the current technology."

Looking ahead, de Boer has an interesting wish for the hedge fund industry – he would like the term "hedge fund" to disappear. "What it essentially represents is active investment management, which I believe is the only sustainable type of investment management," he says.

"So, the term 'investment management' should by then clearly represent active investment management, and what are now called 'hedge fund strategies' should be an integral part of that. A new and more appropriate name needs to be introduced for 'investment management' that isn't active."

In an age of rising interest in ESG (environmental, social and governance) investing, de Boer praises the positive impact markets can have on improving society. "I am happy to see that such developments are on many people's agendas, including a growing number of investors' agendas," he says. "Well-functioning markets serve as a riverbed guiding such developments, they are essential in achieving real progress. Contributing to that brings me satisfaction." ◘

Systematic macro pioneer **IPM** runs largest Scandi hedge fund

20 YEARS OF EuroHedge Class of 1998

BY **WILL WAINEWRIGHT**

Strong post-2008 growth takes Stockholm firm to almost $9bn

Stockholm-based Informed Portfolio Management has been quietly pioneering the use of systematic macro for as long as *EuroHedge* has been in business. Strong growth in the last decade has lifted assets to almost $9bn, transforming the Nordic manager into one of Europe's heavyweight firms.

"We had not been very active marketers," admits Lars Ericsson, who has been with the firm since 2002 and currently serves as acting CEO. "Our marketing team has now grown and a few years ago we started targeting the US investor base for the first time, which has paid off to the extent that we are now opening a US office."

Its systematic macro flagship now manages $5.6bn, making it the largest hedge fund in Scandinavia (a title long held by Lynx, the Brummer-backed CTA). IPM uses models to systematically trade liquid instruments such as currencies, government bond futures and equity index futures. The firm also has $3.1bn in long-only strategies.

"The systematic macro universe of managers is relatively small and heterogeneous and has therefore not been on the radar for many investors," says Ericsson. "Bridgewater and other big US names tended to dominate investment exposures but investors have branched out and are looking for further diversification."

IPM was founded by Anders Lindell and Jonas Rinné, former colleagues at Sweden's JP Bank, a leading fixed income trading house. Other senior staff at IPM share the same background, including CIO Björn Österberg, JP Bank's former head of quantitative analysis, and COO Stefan Detlof.

With revenues in the fixed income business declining, as falling spreads and interest rates limited profits from trading and market making, Lindell and Rinné spotted an opportunity. Pension funds and other institutional investors were growing in Sweden but lacked the capability to seize tactical opportunities across asset classes and markets.

IPM was among the first to import the Global Tactical Trading Allocation (GTTA) approach to Europe, initially offering mandates to investors via managed accounts. "A lot of IPM's early allocations came from Nordic, UK and Dutch institutional investors," says Ericsson. Its systematic macro strategy launched in a commingled format in 2006 and its breakthrough year came two years later, the fund posting a 31.3% gain in 2008.

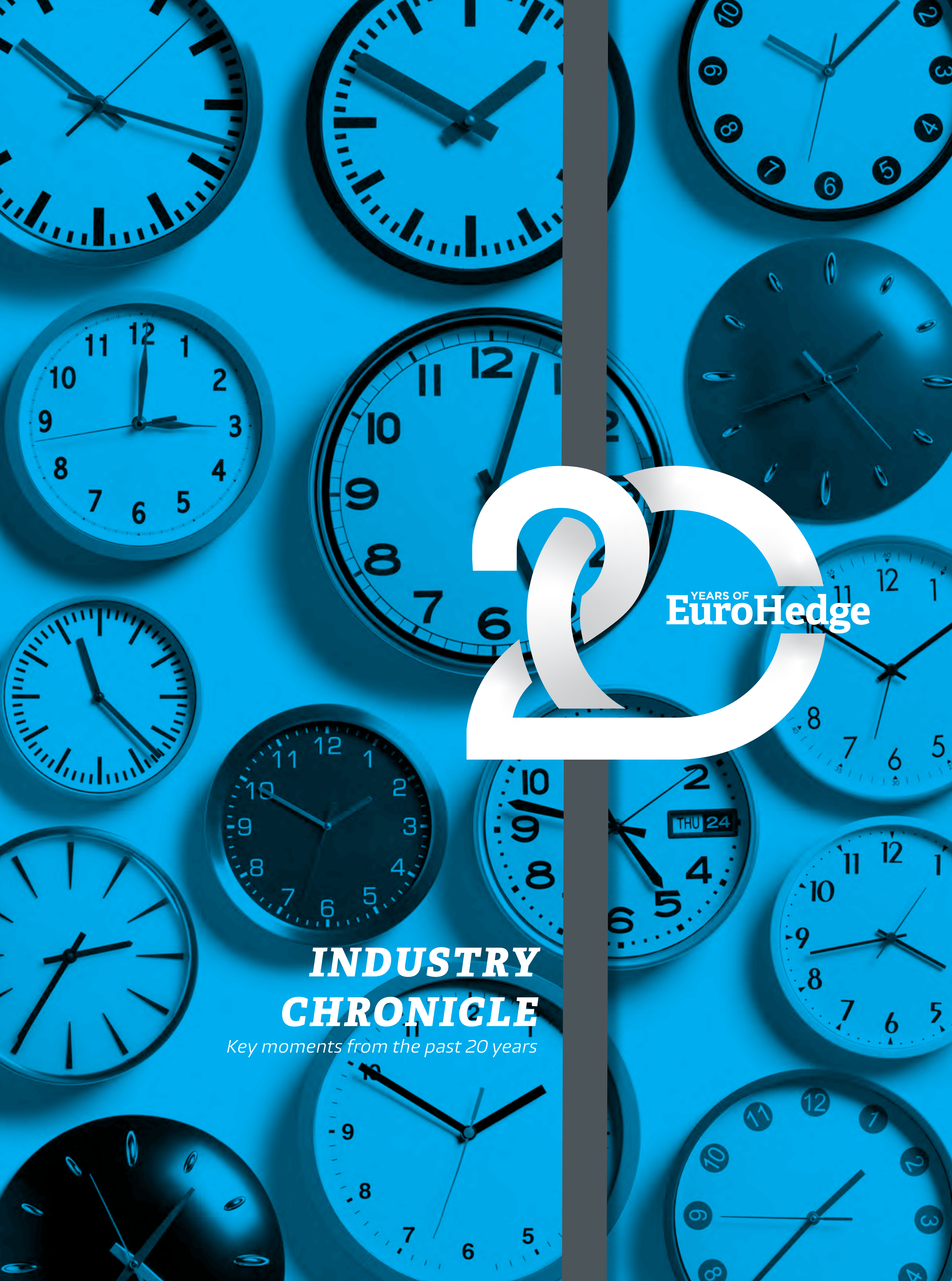
"It was a very exciting time. Our best year ever," says Ericsson. "We have always wanted to be a different type of diversifier – the strategy was built to provide low correlation to equities and to trend-following strategies, given the lack of momentum exposure. The strategy was well positioned to benefit from what we saw as a normalisation [in 2008] after years of excessive risk taking, particularly so in the subprime markets."

There was also a "normalisation" in FX, which helped IPM's systematic currency fund rise 27.9% that year. "After years of sustained and leveraged carry trades in currencies, valuations of funding currencies were abnormally low while the typical carry currencies saw their valuations pushed to unsustainable levels," says Ericsson. "When risk assets sold off significantly in 2008, the strategy continued to capitalise from our currency positions."

At the time, the strategies managed less than $1bn between them. Subsequent growth has been rapid and Ericsson says the firm is approaching capacity in the macro strategy, which opened in a Ucits format in 2015 and already runs $1.6bn.

Staff numbers recently hit 60 and may increase to 70 in the next year or so, he adds. "Some time in the future we may expand into another strategy using the same fundamental and systematic DNA, but there are no imminent plans." ◘

LARS ERICSSON


YEARS OF
EuroHedge
INDUSTRY
CHRONICLE
Key moments from the past 20 years

1999: the first year of *EuroHedge*

BY **WILL WAINEWRIGHT**

The first issue of *EuroHedge* was printed in January 1999 and ran to eight pages in length. Its purpose? To shine a light on a quickly growing but little-understood area of asset management: European hedge funds.

"Promising new fund managers often 'close' within a few weeks of launch, which means that it is imperative to find them quickly," stated an editorial in the first issue. "You have to find them. They won't find you. And it is worth looking because, although there is little information available on European hedge funds, they are an expanding asset class and are performing well."

The magazine was initially a cottage enterprise. Founder Iain Jenkins, a financial journalist, wrote the entire first issue in his spare room and his wife Suzie proof-read the articles. But interest in the magazine (initially titled *EuroHedge Update*) quickly grew, both from investors keen to learn about a sparsely-covered sector in Europe and managers interested in how rivals were faring.

Two decades on, it is uncanny how some articles in the first few issues strike parallels with today. "Investors forgive Odey with $75m boost" runs a headline in the January 1999 issue, which reveals how the fund manager had regained investor trust in the years following a record drawdown in 1994. The fortunes of Marshall Wace, Sloane Robinson and other still-familiar names are tracked in the early issues. But in many other ways it was an entirely different industry, not least size: the sector in Europe managed just $15bn at the start of 1999.

That year was a landmark one not only for *EuroHedge* but the industry in general. Many of Europe's leading names, including Lansdowne Partners, Aspect Capital and CQS, were finding

EuroHedge
UPDATE
Issue 2: February 1999 Volume 1

In this issue:

- Last-chance saloon: the high-flying funds that are close to 'closing' to new investors – page 3
- De Putron is Europe's best performing market neutral fund with returns of 28.9% over the past 12 months – page 8
- New fund news: Mitchell dubbed the new Armitage. Also – Roddy Campbell launches event-driven fund and Argyll launches a European fund of fund – page 5
- Performance news: Copernicus top of the pile in January, SBC claws back lost ground, and Telewest gives Eureka a brisk start – page 7
- Defying sentiment: three new European small cap funds launch – page 4

Next month:

- It isn't just a London phenomenon – now hedge funds are springing up on the Continent. *EuroHedge Update* scours Germany, Switzerland, Italy and France for the most promising hedge funds.

Europe bucks the trend and wins new money

Bacon backs former employee with $120 million

Puzzle over Chenevix-Trench move into SR Asia

their feet, while the sector's rapid growth defied the gloomy predictions sparked by the demise of Long-Term Capital Management a year earlier. As the magazine celebrates 20 years, we have delved into the archive to chronicle 1999 using *EuroHedge* headlines.

JANUARY

Sweden's high-flying Zenit pushes into the US

Stockholm giant Brummer & Partners had launched Zenit, the first Scandinavian hedge fund, in 1996. The $900m long/short equity fund was the top performer in Europe in 1998, gaining 90.8%. Performance was boosted by the fund's decision in the summer to raise its coverage of US equities from zero to 36% of its portfolio. "It paid off," reported *EuroHedge* in its first issue. "While many other European-based hedge funds missed the early part of the post-October rally, Zenit didn't."

FEBRUARY

Europe bucks the trend and wins new money

The early issues have a clear message: Europe's hedge funds are on the rise. A piece on the second front page cites research estimating the size of the European industry to be $15bn, up from $14bn a year earlier. "Europe is the hot place for hedge fund investment," the magazine reported in February. "Despite heavy redemptions from US managers after the Long-Term Capital Management debacle, European-based managers, particularly those investing in European bond and equity markets continue to attract capital."

Truth and lies in the closing game

"Working out which hedge funds are about to 'close' is the new game in Europe," declared another February article. "Investors need to know the 'closing' rules, as some funds, it appears, are more 'closed' than others." There follows a list of funds which were either closed or almost closed, with an explanation of their admission policy. For instance, John Armitage's $1.5bn Egerton flagship was one of Europe's biggest funds and closed to all investors, while Marshall Wace's Eureka flagship, running $550m, was only accepting money from existing investors.

MARCH

Vive la différence continentale

"It is easy to believe the European hedge fund industry is just a London phenomenon – but it isn't," *EuroHedge* asserted in issue three. "While most managers are indeed based in London, there is a growing band of promising managers on the continent." The piece informs readers about hedge funds managed in Frankfurt, Paris and Lugano and says investors are keen for non-UK exposure to diversify their

portfolios. "Rather alarmingly, many of the London managers were running the same 'shorts' (SAP, Nokia and M&S) at the start of the year."

APRIL

Uncle Sam struts into London

The fourth issue said growth in the London hedge fund industry was driven not only by domestic managers starting funds, but US firms such as Citadel starting UK offices. "Tempted by talk of huge opportunities and less competition than they face in their home market, US funds are crossing the Atlantic to set up research and trading operations." Other US firms mentioned were Och-Ziff and Moore Capital, whose founder Louis Bacon "is now part of the social and shooting set in London and owns a house in The Boltons, near Chelsea."

MAY

Eureka approaches $1bn as top funds 'close'

Marshall Wace was growing quickly in the early days of *EuroHedge* and the magazine reported on its plan to cap its assets of Eureka, its flagship, at $1bn. The firm was not alone in running out of capacity. "Eureka's growth has been the most spectacular as it is on the point of rocketing to Europe's elite billion dollar club of Sloane Robinson, Egerton and Zenit in eighteen months."

Hintze picks $200m arb fund team

Michael Hintze was putting the final touches to his new team after leaving Credit Suisse First Boston to start CQS. He was backed with $200m by his old employer. "CSFB's decision to hive-off Hintze's proprietary trading desk into a separate fund – owned by Hintze – is likely to persuade other banks to do similar deals with their prop desk stars," wrote *EuroHedge*, a prediction which came true in the years which followed.

Lansdowne poised for lift-off

Lansdowne assets had hit $63m by May, but few had heard of Paul Ruddock and Steven Heinz's long/short equity firm. "The fund is still one of the least known of the clutch of European long/short managers that launched last year, partly because it started trading in the eye of the third quarter storm," reported *EuroHedge* in a profile, which tipped the firm to succeed following strong early performance. "With Long-Term Capital Management blowing up and the market seemingly in freefall, it is hardly surprising that Lansdowne scarcely made a ripple on the stormy waters."

JUNE

Ex-AHL team launch CTA and European equity quant funds

"A new range of quantitative products is being launched by Aspect Capital, a company which reunites six of the team from AHL, the successful quantitative investment company that was bought by ED&F Man in 1994," reported the sixth issue. Swiss investor RMF was to be an early backer, showing the important of funds of hedge funds to many early startups. Aspect was one of several new launches attracting support, with *EuroHedge* data suggesting new hedge funds drew in $1.5bn in the first half of 1999.

JULY/AUGUST

Brokers square up for prime fight

The growth of European hedge funds affected many areas of the financial ecosystem. Prime brokers, in particular, were well-placed to benefit. "Extraordinary things are happening in the world of London prime broking which have profound implications for investment banks, hedge funds and investors," *EuroHedge* reported in July. "The first is a dramatic explosion of broking salaries. The second is the move by investment banks towards 'capital raising' for hedge funds. Both are part of a looming 'prize fight' between investment banks eager to win a greater part of the booming European hedge fund market."

Salomon team crosses Rubicon with macro fund

Paul Brewer's launch of Rubicon, one of London's longest-running global macro funds, was reported in the summer of 1999. He was previously the co-head of the Salomon Brothers global foreign exchange operation in London. "The fund will launch in the autumn and continues the pattern of high-profile defections from the proprietary trading desks of the leading London investment banks," reported *EuroHedge*.

SEPTEMBER

Risk arb funds race into Europe

Like global macro, risk arbitrage was another strategy starting to put down roots in the Europe industry, which had hitherto been dominated by long/short equity. "Europe is the hottest risk arbitrage market around," claimed *EuroHedge*. "Europe, which was once a tiny merger market compared to the US, is starting to catch up."

OCTOBER

Trading secret of Gartmore's Guy

Roger Guy, one of the most successful long-only traders of the nineties, had turned his hand to long/short equity in February 1999 and it had quickly proved successful. *EuroHedge* reported that Gartmore are hoping Guy "will successfully lead them into the brave new world of hedge funds with some style." The firm went onto be one Europe's main hedge fund players in the following decade.

NOVEMBER/DECEMBER

US cavalry rides into Europe

"From family offices to the legendary 'Dallas doctors', endowment funds and the growing army of fund of funds, US investors are increasingly willing to invest in European hedge funds," *EuroHedge* reported in the final issue of the year. "Many US investors say that they are now looking to invest slugs of $100m in the right European manager, and most say that their preferred strategies are convertible or merger arbitrage." US money was not the only route to fresh investment mentioned in the issue. The move by Stamford Associates, a UK pension fund consultant, to start a hedge fund investment vehicle was labelled "the first indication that mainstream pension fund consultants are ready to embrace hedge funds." Industry growth was accelerating: 70 hedge funds started in 1999, almost three times the 25 which started in 1998. They attracted a record $3.5bn compared to $1.5bn the year before. ◘

Twenty years of European hedge funds

BY **NICK EVANS**

1999

$15bn industry assets

EuroHedge Composite Index: **19.7%**

First issue of *EuroHedge* in January. Total assets in European hedge fund industry stand at $15bn. EuroHedge Composite Index posts median annual gain of 19.7% in 1999, its highest-ever return to date. Egerton Capital is biggest European hedge fund with $1.5bn in AuM. CQS and Aspect Capital launch.

EuroHedge

NYLon joins fixed-income top tier with $1.2bn launch

Hohn fund raises at least $18m for charity after 43% debut year

BNP Paribas mulls multi-strat spin-out of prop trading team

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LIFE'S NOT TOO SHORT

THE RECOVERY BEGINS

THE EUROHEDGE SUMMIT

EuroHedge

Brummer moves into London with Observatory tie-up

Long/short equity pioneer Ton Tjia joins Sharpe's Ratio

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PLUS: The full report on The EuroHedge Awards for 2009

2000

$46bn industry assets

EuroHedge Composite Index: **13%**

Number of funds: **310**

Nasdaq Composite stock market index peaks in March before starting to crash, bringing end to dotcom bubble. Hedge funds substantially outperform stockmarket indices and traditional asset managers in global equity bear market that ensues. Cheyne Capital and BlueCrest launch. Man Group demerges from agricultural commodities business, ED&F Man.

2001

$64bn industry assets

EuroHedge Composite Index: **6.5%**

Number of funds: **446**

Ex-Mercury Asset Management/Merrill Lynch Investment Managers duo Peter Davies and Stuart Roden join Lansdowne to launch UK Equity fund, which becomes Developed Markets flagship. Assets at Marshall Wace Eureka capped at $1.4bn. Firm begins work on system assessing sell-side ideas, which becomes Tops.

2002

$84bn industry assets

EuroHedge Composite Index: **4.2%**

Number of funds: **578**

EuroHedge Awards held for first time in London in January. Inaugural winners include CQS, Gartmore, Tosca, Barclays Global Investors (now BlackRock), Perry, BlueCrest, Rubicon, Threadneedle and Lazard. Brevan Howard launches.

2003

$168bn industry assets

EuroHedge Composite Index: **7.7%**

Number of funds: **810**

Man Group buys 25% stake in BlueCrest for £105m. Perry European manager Chris Hohn quits to start The Children's Investment Fund. Lazard Asset Management hedge fund business rocked as William von Mueffling leaves to set up Cantillon, raising a record $2.5bn at launch. *EuroHedge*/Hedge Fund Intelligence acquired by Euromoney Institutional Investor.

2004

$256bn industry assets

EuroHedge Composite Index: **6.3%**

Number of funds: **1,030**

RAB Capital floats on London Stock Exchange's AIM market, at 25p per share. Inaugural EuroHedge Summit held in Paris in spring. First-year speakers includes Peter Davies, Luke Ellis, Reade Griffith, David Harding and Sushil Wadhwani.

2005

$325bn industry assets

EuroHedge Composite Index: **8.7%**

Number of funds: **1,258**

Marshall Wace co-founder Ian Wace keynotes at second EuroHedge Summit. Hohn's TCI becomes first manager to win fund of the year in consecutive years, a record which still stands.

2006

$459bn industry assets

EuroHedge Composite Index: **9.7%**

Number of funds: **1,509**

Jabre Capital Partners founded in Geneva and raises $2.5bn at launch, three years after Philippe Jabre received record £750,000 market abuse fine from Financial Services Authority. More than 4,000 industry participants attend Albourne Partners' Hedgestock hippie-themed 'conference' at Knebworth House. Vega's assets under management plummet from peak of over $11bn in 2005 to low of $1bn following two years of poor performance.

2007

$575bn industry assets

EuroHedge Composite Index: **7.6%**

Number of funds: **1,617**

Hedge Fund Standards Board (initially Hedge Fund Working Group) formed by leading European hedge funds as clouds gather over financial markets and threat of political interference rises. GLG floats on New York Stock Exchange, with Jabre protégé and star emerging markets/macro trader Greg Coffey ringing NYSE opening bell on first day of trading.

2008

$399bn industry assets ◀

EuroHedge Composite Index: **-4.8%**

Number of funds: **1,638**

Problems in securitised credit markets escalate into full-blown financial crisis. Lehman Brothers goes bust, global financial system nearly fails. Short-selling bans introduced by regulators. Hedge funds suffer losses but outperform plunging stockmarkets, despite market liquidity crunch and heavy redemptions. Many asset managers impose gates and other withdrawal-limiting measures. Sharp rise in fund closures, notably $3bn Peloton Partners. Madoff fraud uncovered. Coffey quits GLG, joins Louis Bacon's Moore Capital.

2009

$382bn industry assets ◀

EuroHedge Composite Index: **9.7%**

Number of funds: **1,309**

Tsunami of new regulatory measures aimed at hedge funds in the US and Europe. First draft of EU's Alternative Investment Fund Managers Directive emerges. G20 calls for increased scrutiny of "systemically important" hedge funds. Markets start to recover from crash. Hedge fund performance rebounds dramatically. Trafalgar's Lee Robinson moves to Monaco.

2010

$423bn industry assets ▶

EuroHedge Composite Index: **6.0%**

Number of funds: **1,223**

Eurozone crisis erupts. Man Group acquires GLG Partners for $1.6bn as pace of industry consolidation intensifies. Adoption of Ucits onshore hedge fund framework by managers and investors starts to take hold in Europe as 'liquid alternatives' appeal to investors' changing needs. Key Gartmore European equity duo Guillaume Rambourg and Roger Guy quit listed group.

2011

$427bn industry assets ▶

EuroHedge Composite Index: **-2.6%**

Number of funds: **1,158**

Global hedge fund performance weakens again with a second negative year after the 2008 industry debacle, fuelling widespread investor disenchantment and frustration. RAB Capital delists from London Stock Exchange, at 10p per share. Henderson buys Gartmore for 92p per share, less than half its IPO price at the end of 2009.

2012

$436bn industry assets ▶

EuroHedge Composite Index: **4.8%**

Number of funds: **1,084**

Ex-Goldman prop trading star Pierre-Henri Flamand's Edoma Partners shuts down, less than two years after raising $2bn in one of the largest and most feted European hedge fund launches on record. AIMA opens office in New York. Lansdowne co-founder Paul Ruddock knighted for services to arts and philanthropy. Coffey 'retires' from Moore Capital and hedge fund industry, at the age of 41.

2013

$475bn industry assets ▶

EuroHedge Composite Index: **8.2%**

Number of funds: **1,074**

Sir Chris Hohn's The Children's Investment Fund becomes first fund to win the EuroHedge Fund of the Year award three times. Brevan Howard's AuM peaks at over $40bn, BlueCrest's at $37bn. Former GLG co-CEO Manny Roman takes over from Peter Clarke as chief executive of publicly-quoted Man Group. Reputation of CTAs, which soared in 2008, dented as trends dry up.

2014

$479bn industry assets ▶

EuroHedge Composite Index: **3%**

Number of funds: **1,047**

AIMA establishes Alternative Credit Council, underlining growth in private credit and non-bank alternative asset management. Jon Hiscock's GSA International flagship fund wins EuroHedge Equity Market Neutral & Quantitative Strategies award for fourth time in six years. Brevan Howard co-founder Chris Rokos contests non-compete restriction with old firm.

2015

$511bn industry assets ▶

EuroHedge Composite Index: **3.7%**

Number of funds: **965**

US private equity group KKR acquires 24.9% stake in Marshall Wace (which has subsequently increased to almost 35%) to form long-term strategic partnership. BlueCrest goes private, returns all outside capital to investors. Leda Braga starts Systematica Investments in Geneva after leaving BlueCrest, taking the BlueTrend CTA program with her. Rokos starts Rokos Capital Management.

2016

$484bn industry assets ◀

EuroHedge Composite Index: **2.2%**

Number of funds: **935**

Sir Michael Hintze's CQS Directional Opportunities wins EuroHedge Fund of the Year award for third time. Cheyne becomes second group to win a third Management Firm of the Year award. Luke Ellis succeeds Manny Roman as CEO of Man Group. Marshall Wace co-founder Paul Marshall knighted for services to education and philanthropy. Brexit referendum divides industry heavyweights.

2017

$565bn industry assets ▶

EuroHedge Composite Index: **5.4%**

Number of funds: **1,059**

Man Group's assets under management pass $100bn mark for first time. *EuroHedge*/Hedge Fund Intelligence acquired by Pageant Media, owner of *HFMWeek*. Greg Coffey prepares for industry return with Kirkoswald Capital Partners in London.

2018

$579bn industry assets (at mid-year) ▶

EuroHedge Composite Index: **-1.5%**

Number of funds: **1,147** (at mid-year)

Global hedge fund assets hit all-time high at over $3trn. ExodusPoint leads a resurgence in major new fund launches in the US and Europe. Assets under management at Rokos Capital Management overtake Brevan Howard. Coffey's plan to move firm from London to New York revealed. Volatility and market routs in February and October trigger heavy hedge fund losses across most strategy areas. Philippe Jabre announces return of capital to investors after losses. ◘

Two decades in the front row

Nick Evans, who edited EuroHedge between 2004 and February 2018, reflects on the magazine and industry's joint journey over the past two decades

EuroHedge began life in the aftershock of one seismic financial crisis, starting just a few months after the collapse and bail-out of the Greenwich-based hedge fund Long-Term Capital Management in 1998.

At that less-than-auspicious juncture, there was hardly a European hedge fund industry to speak of – with the performance data listings in the early issues of the magazine barely filling a page. And there were plenty of people who doubted that there would ever be one of any note.

Well, they were wrong – and Iain Jenkins, the founder of *EuroHedge* and the creator of the business that developed into Hedge Fund Intelligence, was right. It may not always have been an altogether smooth or straightforward ride, but boy has it been an entertaining and eventful one.

In the two decades since then, *EuroHedge* and its sister publications – and the now $3trn-plus global hedge fund industry that they collectively cover – have lived through the bursting of the dotcom bubble and the ensuing bear market, the 9/11 attacks, the 2003-2007 hedge fund industry surge, the 2008 crash and the near-failure of the entire global financial system, the credit crunch, the Eurozone crisis, QE, the second tech-fuelled equities boom and umpteen other ups and downs along the way.

Over those 20 years, the industry has changed out of all recognition from its pioneering, freewheeling, renegade, have-a-go, seat-of-the-pants origins – morphing into the more mature, institutionalised and straitlaced global alternative investment management business that exists today.

Countless funds have come and gone in that time. Myriad new stars have emerged, only to be extinguished again. Numerous smart new wheezes have turned out to be not quite so smart after all. And there have been endless other surprises and shocks along the way too – not least in terms of some of the firms that haven't made it and sometimes, it has to be said, in terms of those that have.

The investor base these days bears almost no resemblance to that of old – with the wealthy individuals, the private banks and the funds of funds that previously dominated the hedge fund clientele giving way to pension funds and other institutional investors, along with their attendant consultant advisors, who see things through a profoundly different prism.

Gone are the glitzy cocktail parties, the perpetual chatter and gossip, the continual need to be "in the know", the permanent quest for the hot new thing.

Gone too is much of the glamour and mystique that characterised the industry back then – and, as some might say, the "sex, drugs and rock 'n' roll" element of what felt like a distinctly edgy, anti-institutional and ever-so-slightly naughty culture.

> ***It is a remarkable fact that many of the funds and firms that launched around the same time as EuroHedge have emerged and endured as the true leaders and standard-bearers of the industry in Europe.***
>
> NICK EVANS

But, for all the changes of the past 20 years, at the heart of the industry there remains that sense of community, of innovation, of individualism, of breaking the mould, of pushing the envelope, of doing things that others either don't or can't, of offering something distinctive and valuable to investors, of creating enterprises of real substance and sustainability. Above all, of identifying and exploiting an "edge" – and one that is demonstrable, repeatable and scalable.

Hedge funds may not yet have become entirely respectable, and in some respects it is perhaps a good thing if they never do. But the good ones, of which there are many, have certainly become respected – even if they have probably long since given up hope of being liked.

In many ways the transformation in the industry – certainly here in Europe – since *EuroHedge* first appeared has been total. But in one key respect, little has changed.

It is a remarkable fact that many of the funds and firms that launched around the same time as *EuroHedge*, in those early go-go days, have emerged and endured as the true leaders and standard-bearers of the industry in Europe.

Marshall Wace, Lansdowne, GLG, CQS, Cheyne, TCI, Brevan Howard, BlueCrest – these, and others before and since, have been the firms that turned Europe's hedge fund community from a backwater cottage industry into a mainstream area of the asset management world.

EuroHedge has grown up alongside them – and, in lots of ways, we have all grown up together. They've all had their highs and lows over the years, as have we. There have been bumps and scrapes and incidents galore. But it has been an unforgettable journey to have been a part of – and we wouldn't have missed it for the world.

So here's to the next 20 years. ◘

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2008: the year that changed everything

BY **WILL WAINEWRIGHT**

Sir Paul Ruddock, Alan Howard, Sir Michael Hintze, Luke Ellis and Lee Robinson discuss the events and impact of a defining year for the industry

The memory of one meeting stands out as Lee Robinson recalls events leading up to the financial crisis a decade ago.

The co-founder of Trafalgar Asset Managers, a leading London hedge fund, was shown the short-mortgage trade by Deutsche Bank's Gregg Lippmann, who was later written into the history books in *The Big Short* by Michael Lewis.

"I remember the hair on the back of my neck standing up – I thought it was one of the best risk/reward trades I'd ever seen. We put the trade on, leading me to see we were going to have a credit crisis much worse than 2002/03 and needed to get our investors through it unscathed."

Robinson was one of the few managers to successfully navigate the crisis in 2008, as Catalyst, his flagship fund, rose 5%. Many other funds tanked. It was a cataclysmic period for financial markets, in which hedge funds and their service providers were tested to the limit.

Alan Howard remembers his "absolute determination" to cut his fund's gross exposure and remove anything "complex" from the portfolio. "That consumed us from the day it became obvious Bear Stearns was in trouble," he says. Brevan Howard's

2008: TIMELINE OF A CRISIS YEAR

FEBRUARY: UK government announces Northern Rock to be nationalised, five months after biggest run on a British bank in more than a century.

JULY: US financial authorities step in to assist America's two largest lenders, Fannie Mae and Freddie Mac.

SEPTEMBER: Fannie Mae and Freddie Mac rescued by US government in historic bailout. Lehman Brothers files for bankruptcy. Lloyds TSB takes over HBOS after run on shares of UK's biggest mortgage lender. A second, Bradford & Bingley, is nationalised. US politicians announce $700bn financial rescue plan.

OCTOBER: US Congress passes rescue plan in biggest intervention in markets since Great Depression. UK passes series of measures to prop up banking sector.

NOVEMBER: US government announces plan to rescue Citigroup. IMF agrees $2.1bn loan for Iceland after a collapse in its banking sector.

DECEMBER: US enters recession. President Bush announces plan to use some of US rescue package on saving car-makers. Interest rates cut across the world.

flagship rose 25.2% in 2007 and 20.4% in 2008, its best two years on record.

For Sir Paul Ruddock of Lansdowne Partners, navigating the counter-party environment was the biggest challenge. "We had always had Morgan Stanley as our main prime broker; we also had Goldman and UBS, and were adding Deutsche Bank. In the wake of Bear Stearns collapsing we had cut counter-party risk with Lehman and Merrill Lynch by taking positions back to the fundamentals (e.g. instead of running a swap we'd just run the cash position)."

You couldn't rely on counterparties being solvent. Fiat currency, the banking system, it is a house of cards that could fall apart.

LEE ROBINSON

The firm had barely any exposure to Lehman Brothers by the time the US investment bank filed for bankruptcy. "The majority of our assets were with Morgan Stanley, so we moved rapidly to diversify that. We shifted about $5bn of cash, $5bn of short positions and $5bn of long positions away from Morgan in those 24-48 hours. The cash went to places like HSBC, which we thought was very safe, and the shorts and longs to a combination of UBS, Deutsche etc."

The sovereign nature of UBS and Deutsche Bank was a factor in that decision. "It was almost inconceivable the IMF would let them go under, even if other investment banks were," says Ruddock. "Maybe that was naïve, but we tried to chase the safest havens we could."

Losses, currency movements and redemptions led to Lansdowne's firm-wide assets halving during the crisis from a peak of $20bn in 2007. The firm could handle redemptions without any forced sales. "Some of the firms which really struggled in the wake of Lehman were those with not enough liquidity, too much leverage or both."

Ruddock, who retired from the firm in 2013, is philosophical. "It was stressful, but it could have been worse. We felt relatively prepared."

Liquidity is a recurring theme during retrospective interviews with leading managers of the day. "As a team we battled hard to maintain the liquidity levels in portfolios necessary to meet redemption requests if they came," says CQS founder Sir Michael Hintze. "Hedge funds were seen by many investors as ATMs, but some peers failed to meet that liquidity (which, it should be pointed out, benefited them in the long term, and led to higher redemptions elsewhere)."

The behaviour of some counterparties also stands out. "Some behaved well, they were honourable," says Hintze. "Others did not, increasing our margin and then trying to buy our portfolio. We had been good clients and treated them with respect during the good times but that didn't seem to count for much – among some providers – when the crisis hit. Fortunately, we always had multiple prime brokers and we were able to move balances."

It was a fraught time. Robinson remembers it as "fantastic in some ways, horrible in others" due to the extreme range of the possible outcomes. "This time a decade ago, we were positioned correctly, but knew that if Morgan Stanley or Goldman Sachs went under we would take a 20-point hit, maybe more – it was just horrible."

The week Lehman Brothers went under will not easily be forgotten by those trading at the time. "Wow – what a week," says Robinson. "If you take the ten half-days of that week, nine different things happened. Over a period of three weeks, something like 24 banks went bust. We had one bad half-day when Gordon Brown banned the shorting of banks, but overall we played it well."

The EuroHedge Composite Index lost 4.8% in 2008, its worst year on record, but bounced back with a 9.7% gain in 2009. Having come through the ultimate operational and liquidity test, survivors felt vindicated in their business practices and the industry recovered from its assets slump, growing significantly in the next decade.

The period left deep scars, however. "You couldn't rely on counterparties being solvent. Fiat currency, the banking system, it is a house of cards that could fall apart," says Robinson. "It was probably as late as 2010 I was able to take stock and realise quite how big that period was for financial markets."

The typical profile of investors allocating to hedge funds changed. "We were forced to become much more 'institutional' as our client base changed over a period of less than 12 months from being overwhelmingly funds of funds to overwhelmingly pension plans and sovereign wealth funds," says Howard. "These new investors demanded a much higher level of service and transparency, which we needed to provide."

CQS went through a similar transformation. "This meant an institutionalisation of the firm, a focus on client solutions and increased complexity in running the business – regulation, compliance, operations, human resources," says Hintze.

Man Group's Luke Ellis counters the widely-held view that 2008 was the unusual year. "It is interesting to consider whether 2008 is an outlier year, or whether in fact years like 2006 and 2007 were the outliers," he says. "Asset prices were shooting up, but it was not sustainable – as 2008 showed. In 2008 it stopped being easy. The industry is more rigorous now – investors are more careful with their money, ask more questions and negotiate over fees. Do I think any of that is unhealthy? No."

Markets have never been quite the same since, with historically low interest rates and the tsunami wave of bond-buying by central banks distorting markets. "Liquidity and the prevalence of passive investment funds and algos has dramatically changed the investment environment," says Hintze. "Markets appear to be resilient to news, there's little apparent volatility."

The turbulence in 2018, a decade on from the crisis, could be the precursor to a return to market norms – but few can say with any certainty whether or not a similarly historic crisis lies around the corner. ◘

Growth of Europe's largest brand names

HEDGE FUND AUM
FIRM AUM

AuM Jan-99
AuM Jan-09
AuM Jun-18

Man Group
HQ: UK
Formed: 1783

$3.8bn
$46.8bn
$19bn**
$113.7bn
$42.4bn

Transtrend
HQ: Netherlands
Formed: 1991

$0.2bn
$8bn
$4.9bn

Egerton Capital
HQ: UK
Formed: 1994

$1.5bn
$4.2bn
$3.2bn**
$19.5bn***
$6.4bn

Brummer & Partners
HQ: Sweden
Formed: 1996

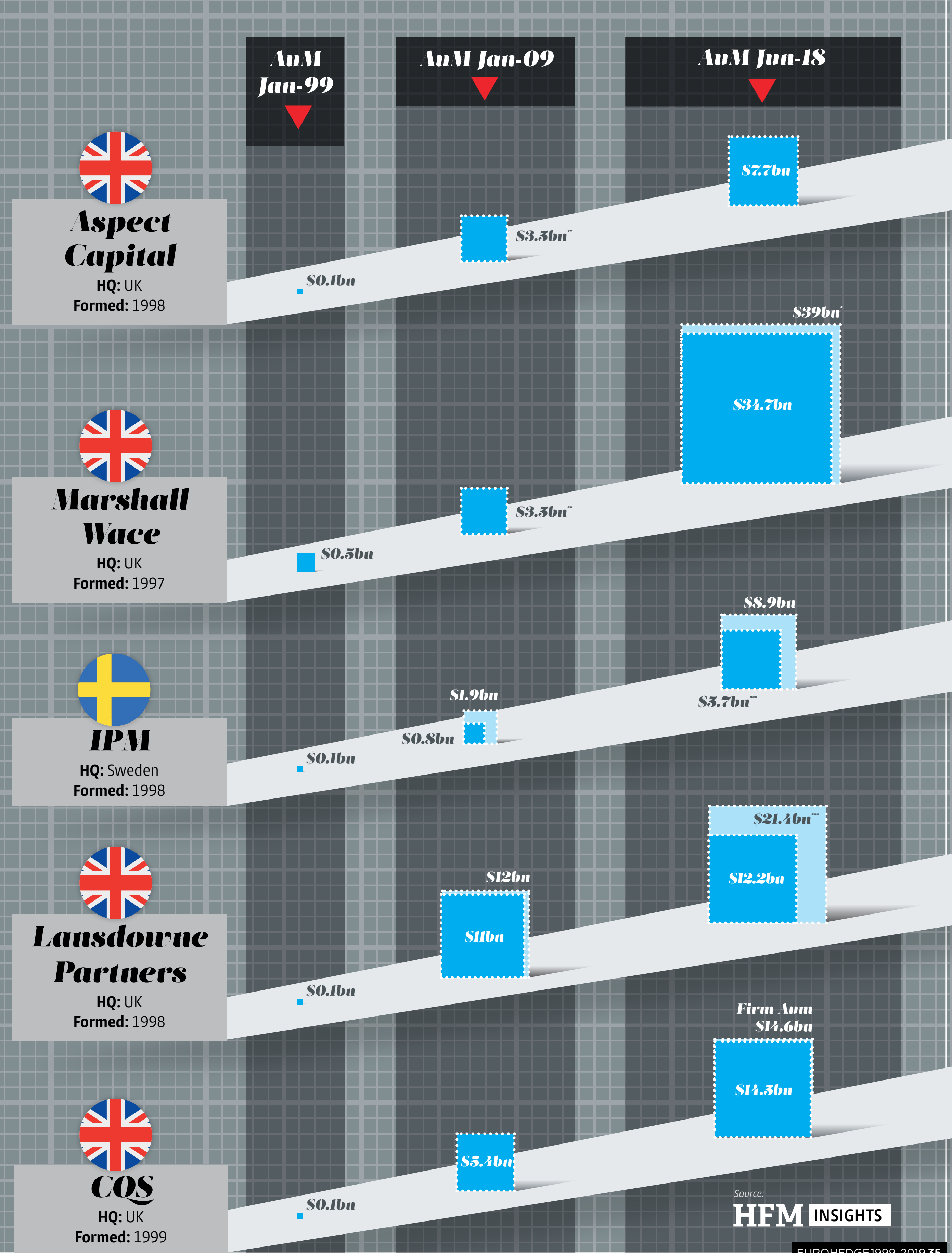
$1bn
$5.6bn
$12.8bn

Winton
HQ: UK
Formed: 1997

$0.1bn
$13.3bn
$30bn*
$26.5bn

*Estimate
**June 2009
***Egerton, March 2018; Lansdowne, May 2018; IPM, Nov 2018

Listed are the 10 European firms in business since 1999 that now manage more than $3bn in hedge fund assets. Aspect and CQS started trading in 1999, but after January; IPM was only consulting. *Research by HFM Insights.*



EuroHedge events: provoking debate and rewarding performance since 2001

BY **NICK EVANS**

The ups and downs of the industry have been chronicled by our events for almost two decades

The EuroHedge Awards and Summit have been staple and keenly-anticipated annual fixtures in the European and global hedge fund calendars for the past 18 and 15 years, respectively.

Generally upbeat and celebratory, at times more sombre and subdued, often contentious or controversial, and always well-attended, the two events have in many ways reflected the evolution of the industry – acting as a mirror to the changing fortunes, environments and moods of the hedge fund community and serving as a barometer of shifting sentiment, trends and issues.

The awards were held for the first time in London in January 2001. Judged solely on a transparent and tried-and-tested quantitative methodology focused on risk-adjusted returns, they have become known both as the "Oscars" of the industry and also – by the odd wag – as the "kiss of death".

There has been the occasional mishap, for sure. None more abrupt than when highly-rated firm Peloton scooped two awards in January 2008 for the stellar performance of its $2bn asset-backed securities fund in 2007 (having returned almost 90% with a Sharpe ratio of over 3), only to be out of business five weeks later after one of the swiftest and most stunning collapses the industry has seen.

And the accompanying Roll of Honour list of the EuroHedge Awards winners over the years does contain many names of other funds and firms that are no longer with us, or which shone brightly for a brief time only to fade away.

But what stands out most clearly from that leaderboard is how consistently successful the brand-name players in this business have been in winning awards (and nominations) over the years. In an industry that is ultimately all about performance over the long term, that says it all.

Man GLG heads the ranking with a haul of 12 awards thus far, with Cheyne in second place on 11 and BlackRock, CQS and Sloane Robinson (which won four awards last year alone) each having claimed 10 trophies over the years.

Behind them come a further seven firms that have also been leading players on the European and global hedge fund scene over many years: AlphaGen/Gartmore, BlueCrest, Marshall Wace, Brummer & Partners, GSA, Toscafund and Lansdowne.

Given the intense level of competition for awards every year, to keep winning trophies over the years

Continues on page 38

EUROHEDGE AWARDS HISTORICAL WINNERS OF THE MANAGEMENT FIRM AND FUND OF THE YEAR AWARDS

Year	Management Firm of the Year	Fund of the Year
2001	Gartmore	Lazard European Technology
2002	GLG	Henderson European
2003	Vega	Sloane Robinson International
2004	BlueCrest/Cheyne	The Children's Investment Fund
2005	Lansdowne	The Children's Investment Fund
2006	RAB Capital	Parvus European Opportunities
2007	Sloane Robinson	GLG Emerging Markets
2008	BlueCrest	Brevan Howard
2009	BlueCrest	Jabcap Multi-Strategy
2010	BlueCrest	CQS Directional Opportunities
2011	Marshall Wace	Brevan Howard
2012	Cheyne	CQS Directional Opportunities
2013	Jabre Capital	The Children's Investment Fund
2014	Chenavari	Man AHL
2015	Lansdowne	BlackRock European
2016	Cheyne	CQS Directional Opportunities
2017	Pharo/Sloane Robinson	Kairos Pegasus

(sometimes for the same funds, but also often for different ones) is a tribute to the consistently outstanding long-term performance of these and other firms.

Sloane Robinson's achievement in winning four trophies in 2017 marked only the second time in the history of the EuroHedge Awards that a single firm has landed four awards in one year – 14 years on from 2003, when the then high-flying Madrid-based macro manager Vega Asset Management (a name with which many more recent entrants to the industry may not even be familiar) swept the board by winning in four categories.

But even more impressive perhaps are the four Management Firm of the Year awards won by Mike Platt's BlueCrest Capital – including its remarkable hat-trick of three successive victories in 2008, 2009 and 2010 that underlined the firm's outstanding multi-year performance during the crisis era – and the three Management Firm of the Year trophies won by Cheyne over a period of 12 years.

As for individual funds, the two that have been most frequently decorated over the years as the overall Fund of the Year are both run by knights of the realm – which have both won the ultimate accolade at the EuroHedge Awards on no fewer than three occasions each.

Sir Chris Hohn's The Children's Investment Fund became the first to achieve that notable feat in 2013 – adding to its previous back-back-victories in 2004 and 2005 – while in 2016 Sir Michael Hintze's CQS Directional Opportunities Fund joined this super-elite club, winning its third Fund of the Year award following earlier trophies in 2010 and 2012.

Although entirely sober in its purpose, the EuroHedge Awards dinner has always been a big party night – a time when the hedge fund community comes out in force for an event that is in many ways as much of a social occasion as an industry gathering.

The high water mark in that respect was probably reached in 2005 – when a well-known entrepreneur and *bon viveur* in the industry kicked off a three-day stag party by taking a table just for him and his mates before flying down to Spain to continue the merriment. Those were the days...

It has always been an evening that combines a lot of fun, a dash of glamour and even drama – some brilliant (and occasionally awful) acceptance speeches spring to mind. Long may it continue, through the good years and the not so good ones.

The inaugural EuroHedge Summit took place in Paris in 2004. Year after year London-based delegates flocked to Waterloo – and, later, St Pancras – in droves to board the Eurostar to the City of Light for two days (and two nights) of networking and entertainment.

People have gone to extraordinary lengths to attend. Never more dramatically or determinedly so than in April 2010, when the ash cloud from the eruption of the Icelandic volcano Eyjafjallajökull resulted in the almost total shutdown of European airspace for the duration of the Summit – requiring conference-goers journeying from further afield to resort to some extraordinarily creative and committed back-up travel methods and routes.

The line-up of speakers over those 15 years has been a roll-call of the leading lights in the European industry: Manny Roman, Luke Ellis, Ian Wace, Paul Marshall, David Harding, Michael Hintze, Chris Hohn, Leda Braga, Paul Ruddock, Peter Davies, Jonathan Lourie, Stuart Fiertz, Philippe Jabre, Greg Coffey and many, many more besides.

They – and countless other top-tier managers, investors and intermediaries – have provided many memorable moments of keynote speeches, panel sessions, fireside chats and general discussion and debate. We thank them all for their time and their contribution.

The summit has seen agreements and arguments galore. There's been glorious spring sunshine and torrential downpours. There've been times of high optimism and confidence, and times of deep gloom and apprehension too.

There have been numerous ritzy soirées and gourmet dinners, in some of the finest restaurants and most chic venues on the planet. And there has also been the odd late night or two in the Buddha Bar and other celebrated Parisian *boites de nuit*, it must be said. Its first year in London was eventful last June, as Sir Michael Hintze keynoted and John Glen MP, the British government's City Minister, made headlines with his comments on Brexit.

The awards and the summit have always been a blast. Neither event would ever have been possible without the help, support, engagement and encouragement of so many people in the industry over all these years. We appreciate your help hugely – and hope that you've had as much fun as we have, and you'll continue to enjoy our events in the years ahead. ◘

EUROHEDGE AWARDS ROLL OF HONOUR AWARD WINNERS 2001-2017, BY MANAGEMENT FIRM

12 Man GLG
11 Cheyne
10 BlackRock, CQS, Sloane Robinson
9 AlphaGen Capital/Gartmore, BlueCrest, Marshall Wace
7 Brummer & Partners, GSA, Lansdowne, Toscafund
6 Chenavari, Polygon
5 Brevan Howard, CFM, IKOS, Vega
4 Henderson, Napier Park, Pelham, RAB, The Children's Investment Fund, Trafalgar Asset Managers, VR
3 Alcentra, Boussard & Gavaudan, Danske Capital, Duet, Horseman, Jabre Capital, JP Morgan, Kairos, Pelagus, Pharo, Selwood, TT
2 Alcentra, Amplitude, Argo, Asgard, Ben Oldman, BGI, BTG Pactual, Endeavour, Ennismore, Finisterre, Gemsstock, GLC, Hengistbury, Insch, ISAM, KBC, LFIS, LMR, Man AHL, Millennium Global, Morley/Aviva, Odey, Oddo, Parvus, Peloton, Perry, Polar, Polunin, Promeritum, Rhenman, Rubicon, Threadneedle, Zebedee
1 36 South, AKO, Algebris, Altavista, Altima, Antares, Argenta, Armajaro, Andurand, Auriel, Aventicum, Bailey Coates, Black River, BlueBay, BlueGold, Caius, Camox, Capricorn, Cazenove, CDAM, CFP, Charlemagne, Clareville, Concordia, Copper Street, Covalis, Cube, Cumulus, Dalton Strategic, Deep Field, Deephaven, Dominice & Cie, Dromeus, Duet, Dynamic, East Lodge, Edale, Eiffel, Eikos, Eisenstat, F&C, First Geneva, Focus, Fortelus, Fortis, GAM, Gladstone, Global Advisors, GO Capital, Granada, GZC, Halkin, Hermitage, Insight, Jacobson, Julius Baer, Kairos, Kinsale, Krom River, Lancelot, Lazard, Lionhart, London Diversified, Lyxor, Madrague, Maple Leaf, Marwyn, MKM Longboat, Moore, MPC, Mulvaney, New Amsterdam, Newman Ragazzi, NewSmith, North, North of South, Numen, Nykredit, Oslo Asset Management, OxAM, Pensato, Pictet, Pivot, Portland Hill, Powe, Premium, Progressive Capital, Prologue, Radar, Sabre, Sector, Securis, Serone, SGAM, Sofaer, Spinnaker, Stone Milliner, Syquant, Systematica, Theleme, TradeWind, UFG, Urwick, Visio, Wadhwani, Winton, York

20
YEARS OF
EuroHedge
INVESTOR VIEW
March of the institutions

Investor twists, turns and trends

BY **JASMIN LEITNER**

From seeking high-octane returns to the growth of Ucits and risk premia; the modus operandi of European allocators has changed significantly over the last two decades

When I started, hedge funds were leveraged. Now they are hedged. In the past, managers were traders from brokerage houses; today, they have MBAs. They were willing to bet the ranch and investors were willing to tolerate a drawdown of anything up to a third of NAV. No investor today would tolerate anything like that level of volatility."

These are the recollections of the late Georges Karlweis, the legendary Edmond de Rothschild banker who gave George Soros's Quantum its start, and who founded one of the early fund of hedge funds, Leveraged Capital Holdings.

"Investors understood that their managers were taking risks. [During an] exceptional crisis, I remember one manager having, in one day, turned his, maybe, 400 long currency, gold and stocks into the equivalent short position," Karlweis recalled.

"We had fantastic performance. Today, I still own hedge funds, but I have reduced my return objectives... quite dramatically."

Karlweis was retired in the Bahamas when he gave *EuroHedge* sister title *InvestHedge* this somewhat melancholy interview in 2002, reflecting on what had changed since he started out in the 1960s. His descriptions don't seem radically out of place today.

Of course, plenty has changed in the last 20 years, from the underlying investor base and due diligence practices to strategy appetite and the way investors engage with hedge funds.

"If you think about the last 20 years, it's been a big change from something that was more of a high-net-worth, private bank industry that not many people actually knew about, it wasn't really reported on in the mainstream press, to one which is regularly reported on," explains Robert Howie, a principal in the hedge fund team at Mercer.

While the investment consultant has been a behemoth in the broader financial services industry for several decades, in the late nineties and early noughties, it didn't have a dedicated hedge fund team.

In 1998, family offices and HNWIs made up almost two-thirds of the industry's assets globally, while FoHFs made up another 24%.

Far less concerned about month-to-month liquidity and volatility, the nimble HNWIs and entrepreneurial family offices were an ideal match for Europe's fledgling managers, who were, in Karlweis's words, willing to "bet the ranch".

An *InvestHedge* survey in May 2002 of nearly 50 managers, of which 21 were European, revealed that pension funds and insurance companies accounted for only 4% of small start-ups, 5% of medium-sized funds and 12% of larger, hard-closed funds.

The research polled star Merrill Lynch trader Adrian Holmes' Cambrian Capital Management and the new unit formed earlier that year by CSFB to invest in prop desk start-ups such as the one Alan Howard went on to form.

Even when institutional investors made larger forays into hedge funds, they did so predominantly through FoHFs.

An early mover in the UK was the Railways Pension Scheme, which started exploring the space in 2001.

The then-$30bn scheme didn't deploy any capital until 2004, when it split a $1bn mandate between US groups Blackstone, the Rock Creek Group and Grosvenor Capital Management. Investment director Brendan Reville explained at the time that they selected firms across the pond simply because there was more choice, and because European FoHFs were not as mature.

"The UK-based firms at the time did not have enough coverage of the US, and vice versa for the US firms, but the majority...were based in America."

The road to transparency

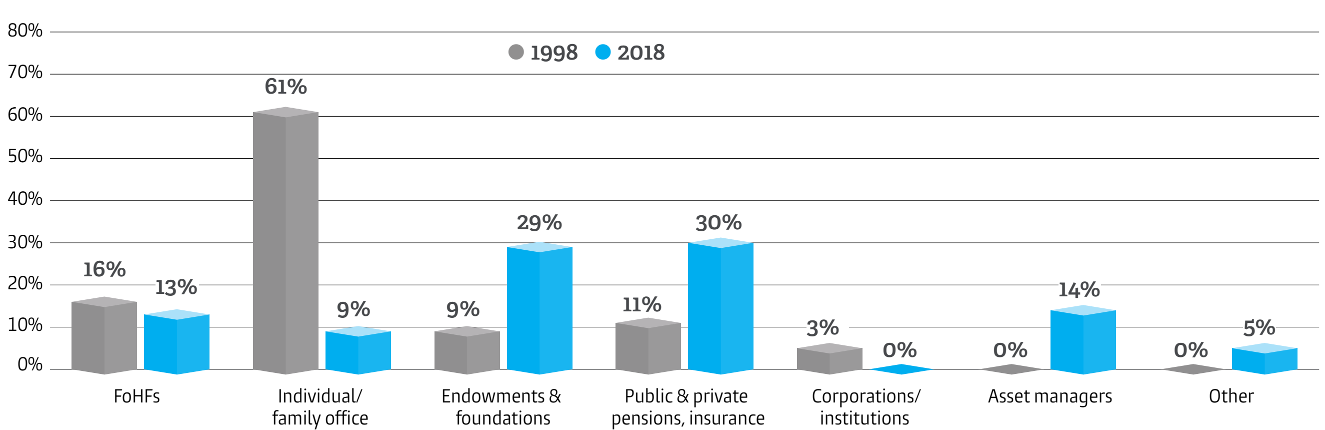
The financial crisis and the years that ensued were seminal for European hedge funds and their investors.

The scale of Bernie Madoff's $65bn fraud was revealed and its impact was far-reaching, explains Kevin Gundle, CEO of Aurum Research, the FoHF group that provided data to *EuroHedge* when it first launched.

KEVIN GUNDLE

ROBERT HOWIE

The changing investor base: 1998 vs 2018



Sources: Estimates based on data from Hennessey Group, investment bank cap intro surveys, Preqin and HFM data

"Capital from the Swiss private banking sector was exposed to Madoff, and this sector had significant allocations to hedge funds.

"Madoff really put a shot across most investors' bows even if they did not have exposure to Madoff (which was the majority). There was a sense that there was a risk that they could become contaminated by an industry that clearly had problems."

Following Madoff and other crisis-related revelations around redemption terms and side pockets, investors realised that much more focus on operational due diligence was needed, ushering in expanded roles for specialist and generalist consultants.

That also coincided with the start of a continued contraction among FoHFs.

Many larger institutional investors making their hedge fund debuts after the crisis bypassed FoHFs in favour of making direct allocations with the help of consultants, including the UK's pension fund for Royal Mail postal workers.

"If you look back perhaps 10 to 15 years, most UK pension schemes that bothered investing in hedge funds, which wasn't many, used FoHFs and of course with that, they were paying an extra layer of fees," explains CIO Ian McKnight.

He says the board considered fees, transparency and liquidity and concluded that making direct investments was preferable, with the caveat that internal governance needed to be robust to manage a portfolio well.

"What we wanted was low correlations to equity, credit or anything else we held in our return-seeking assets and we wanted [the portfolio] to have low volatility, which hedge funds should be and generally are. We wanted to get away from this perception that [hedge funds] are all very risky investments.

Hedge funds really started to struggle and not deliver the returns that they promised.

CLAUDIA STANGHELLINI

"I think after the Madoff scandal people thought hedge funds were risky, dangerous and expensive. They might well be expensive, but you have to pay for skill," he says, adding that they were able to get comfortable with fees but that it was "a big deal back in the day".

CLAUDIA STANGHELLINI

On the internal governance front, Royal Mail hired Bev Durston, the former head of alternative investments at British Airways Pensions, to lead its implementation in 2013.

McKnight says they wanted to create a concentrated portfolio of specific themes, ideas and investments which delivered on their goals.

They initially split $100m between Halcyon Asset Management, MKP Capital and Swiss commodity specialist Krom River, Elementum and Pacific Alliance Asia Opportunity Fund. Krom was dropped the following year, with Brevan Howard, Och-Ziff and Taconic Capital Advisors added instead.

Today, the hedge fund portfolio of the £10bn-plus pension fund is worth just under $500m, although that could double over the next few years, McKnight says. Brevan Howard remains the only European manager on the roster.

"We're not bothered where [managers] are based, if they've got the characteristics we want and the opportunity set is better, it's more [about] looking at whether it's an event or macro or commodity hedge fund, that's a more important decision in terms of relative difference than exactly where they are running that strategy," he says.

He adds that fund jurisdictions must meet Royal Mail's requirements from a compliance and legal perspective.

Other institutional allocators approached by *EuroHedge* agree.

"We have a mixture of managers and strategies, we don't select by geography," explains Claudia Stanghellini, head of external management at SEK 351.1bn ($39.5bn) Swedish pension fund AP3, although she adds that they find managers in Europe and the US to be more institutional and able to cater to its needs than Asian ones.

"We started our portfolio in 2007 with exposures to CTA and macro

managers, gradually building a more diversified portfolio, with long/short equity, long/short credit, event-driven and emerging markets strategies."

AP3 had exposure to some 20 managers at its peak but reduced this significantly over the last few years as performance has been disappointing, Stanghellini explains.

"Hedge funds really started to struggle and not deliver the returns that they promised and so after many internal discussions, two or three years ago, we decided to start taking down risk from the portfolio."

She adds that they have reduced the number of managers as well as the amount invested, retaining only a few with whom they have long-standing partnerships.

A recognition that big is not always better has also prompted other sizeable European allocators to rethink their investment approach in hedge funds.

"Most people that invest in this area tend to go for the largest established managers," says Roy Kuo, head of alternative strategies at the Church Commissioners, which manages the Church of England's £8.3bn endowment.

"The problem with that is that if you're trying to generate any sort of alpha or outperformance over the industry, you are bearing the hefty cost of fees charged and generally lower market beta, both of which put you at a performance disadvantage.

"The outperformance needs to be very material and that is very difficult to achieve when you're a large shop," he adds.

"You have to be fairly small and specialised to actually deliver that type of return, so we've been transitioning some mandates to smaller managers – more sector or country-specific."

Kuo caveats that they don't really invest with emerging managers, but many of the holdings in their portfolio run less than $2bn.

Concentrating manager relationships and placing more emphasis on partnership are two trends that have played out across Europe, as well as other markets, particularly as performance has been challenged.

Looking for liquidity

The demand for greater liquidity has been especially prevalent in Europe – a hangover from the financial crisis – and the move to further regulating the industry has led to an influx of onshore products in the form of Ucits.

Appetite for these funds was relentless after the crisis, bringing alternative strategies into the portfolios of conservative institutions and retail clients that wouldn't otherwise get exposure to them.

Alternative Ucits funds managed less than €20bn in 2003, when Ucits III was enacted. Assets crossed the €100bn mark in 2012, had grown to some €350bn in 2016 and as of 30 November 2018, stood at €426bn ($487bn), according to data from *Morningstar* and Deutsche Bank.

Many of the blue-chip managers profiled in this special edition of *EuroHedge* have been front and centre of this trend, including Marshall Wace, Aspect and IPM, although not everyone views it as positive.

Madoff really put a shot across most investors' bows even if they did not have exposure to Madoff.

KEVIN GUNDLE

"Many investors, from a compliance and regulatory standpoint, are compelled to buy Ucits. I think the tax framework has made it more difficult to potentially own offshore funds," Aurum Research's Gundle says.

He adds: "The essence of what hedge funds are all about is an unconstrained approach to investing and as soon as you put constraints [on that], you diminish outcomes and opportunities."

Another trend that has characterised the industry over the last few years is alternative risk premia.

Seeking to provide systematic exposure to various risk premia that have an academic, economic or behavioural rationale underpinning expected returns, these strategies have arguably been a blessing and a curse for managers, who need to weigh up the investor diversification and asset-raising benefits against the threat of cannibalisation and overall lowering of fees.

An additional consequence is that simpler, cheaper, more liquid products increase the pressure on managers to demonstrate that their high-octane, higher-fee products can deliver the alpha they promise.

"There was kind of a feeling that hedge funds had some sort of magic in the past, whereas now the growth of alternative risk premia has shone a torch on some of the things that hedge funds were doing that were inherently capturing a risk premium out there," says Mercer's Howie.

He adds that mainstream asset managers launching hedge fund-like products also compounds that pressure.

Indeed, the convergence between mainstream and alternative has been two-way, with firms such as CQS, Man Group and Lansdowne becoming as well known for their long-only offerings as their hedge funds.

The Church Commissioners' Kuo argues that many investors are better off investing in risk premia products than traditional hedge funds due to the limited alpha generated by the latter compared to their costs, but he cautions that implementation needs to improve significantly to be effective.

"If you do [alternative beta] as a dedicated allocation you will underperform everything, you need to do it as an overlay on your existing holdings. If you buy passive equities and then overlay it with alternative beta then you can actually create a better risk and return profile over the market."

He suggests this is one area where allocators in Europe can learn from their US counterparts.

Others predict that continental hedge fund appetite may increase if managers can deliver outperformance during the next market downturn and beyond.

The European hedge fund industry has undergone a remarkable transformation over the last 20 years.

The next two decades will no doubt bring about more change in Europe, which managers and allocators will have to adapt to and embrace. ◘

Consultants for change

BY **JASMIN LEITNER**

EuroHedge sits down with Albourne Partners co-founder Simon Ruddick to discuss fraud warnings, allocating in the aftermath of Lehman and shifting the conversation on fees

The collapse of LTCM and Bernie Madoff's fraud: events that occurred almost a decade apart with little in common, except that they played a key role in cementing Albourne's credibility as a leading investment consultant for hedge funds.

In February 1998 the London-based firm produced a document that was hugely bearish on fixed income arbitrage. It was one of Albourne's first strategy reports, drafted by Hitoshi Nagata, whose hedge fund, Cambridge Financial Products, had recently closed and returned investor capital because of the limited opportunity set.

Unlike other pieces of research, which were only shared with clients, Albourne widely distributed its concerns on fixed income arb, which played out a few months later when hedge fund giant LTCM saw the value of its trades drop by 50% as a result of Russian currency devaluations and a flight to US treasuries.

"It wasn't luck that we wrote that, it was skill, but what was luck was that we gave it to everyone we knew," explains co-founder Simon Ruddick. "In the summer of 1998 that was the whole story and we had this document from February pointing out all the issues, so that was a huge leap in credibility."

The second "leap" took a bit longer to play out, although it also started in the last quarter of 1998, when the consultant began to warn people about Madoff.

They took a similar tack in disseminating their views, telling "everyone", not just clients, that they should avoid Madoff.

SIMON RUDDICK

Ruddick recalls that they were "teased enormously" by their peers for talking about something that, at the time, didn't seem to materialise.

"If you keep going on about something, it sounds like you were wrong," he says. Eventually – a decade later – they were proven right, once again boosting their status in the hedge fund advisory world.

Right but wrong

The *raison d'être* for setting up Albourne was also an example of Ruddick and his colleagues being right at the wrong time.

Founded in 1994 by derivatives traders Ruddick and Guy Ingram, who had worked together at Westminster Equity, Albourne was established to help a small group of clients assess the risks in their portfolios. This select group of allocators was already too sophisticated to use a FoHF and just wanted some advice, says Ruddick, adding that from there, they "just over-extrapolated".

"We were absolutely convinced, in 1994, that institutions would want advice to be able to top up their direct investments.

"That was at least six years too early, but it meant that everything we did was in preparation for such a day, with that type of client base, that type of sophistication and transparency. So we were quite fortunately placed when that's the way the world went."

Among the ways Albourne differentiated itself was that it researched hard-closed funds as well as those raising assets, unlike some of their competitors, who only focused on funds they could put client money into.

Their approach served them well during the crisis, Ruddick says. "In the fourth quarter of 2008 no one was closed. All the top funds reopened, and we were allocating client money to firms that were previously impossible to get into.

"That helped our clients, but also those funds, who thought it was a miracle to be getting money at that time."

Alphatraz and Opera

The aftermath of the crisis was sobering for many reasons, but was a reminder of what Albourne wanted to focus on.

Ruddick recalls the firm's corporate planning committee gathering after the collapse of Lehman Brothers. At prior meetings, the discussion had always been around how the consultant could continue on its 50% annualised growth trajectory, but post-Lehman it was obvious that such a focus was inappropriate.

"I started the meeting by saying, instead of talking about 50% growth, why don't we talk about how we potentially manage a business through what could be a severe corporate-life-threatening decline and [prioritise] the best interests of our clients as well as trying to secure employment for our colleagues, given it's their livelihood and the livelihood of their dependents."

He describes the experience as salutary and sobering, adding that while he wouldn't want to repeat it, it brought home the idea that corporate responsibility went far beyond bonuses and dividends.

A slightly more bizarre anecdote Ruddick shares from the days following Lehman's collapse relates to a client

event called *Escape to Alphatraz*, held at Alcatraz Prison, which had been planned for months and included convict-style jackets to be handed to clients.

"I remember thinking, it's slightly awkward because this might be the end of the world...when's a good time to hand out the convict jackets?"

Albourne's themed events are not simply a way to show the world the company's quirky culture, they serve a distinct purpose – arguably to push their clients, and the industry, forward on the path to institutionalisation.

Among the things born out of the crisis were administrator transparency reports and Open Protocol, a risk reporting standard initially dubbed 'Opera', launched in 2011.

Ruddick is keen to stress that the industry had started considering what was best practice before the crisis, evidenced by a hedge fund working group which evolved to become the Hedge Fund Standards Board (and since renamed the Standards Board for Alternative Investments).

He adds: "2008 was a huge wake-up call and it triggered a lot of changes that we were passionate about. Some of them happened quickly, some of them happened slowly and some of them have absolutely not happened at all."

He emphasises that many of the problems that led to the last financial crisis have returned. "It concerns me deeply that we have not learnt the lessons that really count and matter from 2008."

These include high levels of leverage and weak lending documentation related to structured products which are now parked in money market funds and other products sold to the mass market.

"If the last financial crisis felt scary, we will literally have seen nothing yet. A financial crisis gets most scary when retail investors realise it's happening."

Regulators, frustratingly, have the wherewithal to model and manage systemic risk but are failing to do so, he says, due to a lack of harmonisation and cooperation between jurisdictions.

Performance plight

And what is Albourne's take on the sector's underperformance over the last few years? "With institutional money and their longer time-frames, there is less flight of capital risk than in the past," says Ruddick.

"The more stable capital base and greater amounts of capital have been paradigm shifts which mean the rational expectation of return is smaller now."

While investors should have moderated their return expectations, he caveats that performance should not have been as disappointing as it has been.

Ruddick says that the performance of the "Fangs" – Facebook, Amazon, Apple, Netflix and Google – has made active managers, and hedge funds in particular, look like "charlatans", but that this is a phase and not a paradigm shift.

"The key thing for hedge funds at the moment...is there is less tail risk in hedge fund portfolios than in a long bond portfolio. Hedge funds are a phenomenally complicated way of earning almost no money, but they are still just about worth it."

> ***2008 was a huge wake-up call and it triggered a lot of changes that we were passionate about.***
>
> **SIMON RUDDICK**

He predicts that hedge funds will do well out of the next crisis, not because of their holdings at the time, but because of their ability to react in the aftermath.

"People like to think that hedge funds should gain during a crisis – if markets go down, hedge funds rise – but it is completely coincidental what they're holding.

"Their job is not to guess what others will do and do the opposite, their job is to be smarter than everyone else if there is a spike of inefficiency in the market and use their more flexible mandate to profit. The best time for them is immediately after a disruption and the reversion to a long-term norm or equilibrium."

He likens hedge funds to hyenas "poking around in the aftermath of a kill and scavenging returns."

Fees and future innovations

Investor disappointment with the less-than-meaty returns of 2014, 2015 and 2016 tipped the balance and allowed Albourne to bring to fruition a campaign it had started much earlier – creating a more equal conversation around fees.

At the end of 2016, Albourne and one of its largest clients, the $155bn Teachers' Retirement System of Texas, revealed a new fee structure, 1 or 30.

The 'or' structure is designed to ensure that allocators receive 70% of alpha or outperformance generated by managers, while also guaranteeing the latter a fee – the higher of performance or management – regardless of returns generated.

Having conquered that industry bone of contention, some might think Ruddick would be content to take a step back from pushing for further reform.

They couldn't be further from the truth. In October, Albourne unveiled its second Investor Manifesto (IMII), having released an initial tome in 2013.

The document, revealed during Albourne's annual meeting in London, contains 50 proposals designed to improve the alternative asset management industry for the benefit of investors and fund managers, with Ruddick stepping down from Albourne's executive committee to focus on championing the initiative.

Given the number of proposals on the table, Albourne doesn't anticipate delivering all of them and intends to spend the next 12 months carrying out further consultations with clients and managers to determine what to focus on.

Ruddick is fiercely committed to the sector and "passionately" convinced that hedge funds are good for Albourne's clients and for the world.

But he is also never one to shy away from speaking his mind and has some strong views on how a number of Europe's heavyweights have involved themselves in the political debate around Brexit.

"The crowning irony of Brexit, if it happens, will be that those who voted for it will suffer the most while those hedge fund managers that funded it will most likely benefit as they run businesses with US dollar-denominated revenue and a sterling cost-base." ◘

Lyxor sees rising hedge fund interest as bull market slows

Nathanael Benzaken

Nathanael Benzaken, Lyxor Asset Management's chief client officer responsible for global business development, products and solutions, gives his take on the progress of his firm and the wider hedge fund industry over the past two decades.

Can you give a brief history of your firm?
NB: Lyxor was founded in 1998. The company started a managed account business after seeing an opportunity to make investing in hedge funds more efficient and scalable, through extra transparency, enhanced liquidity and a greater focus on risk management. Investors liked the line-up of hedge funds we put together. Our range of business lines has developed from that start. We had as much as $13bn in our managed accounts before 2008. We navigated the crisis quite well and developed two new businesses since then: dedicated managed account solutions for institutional investors and our Ucits platform.

Do you see another 2008-style crisis coming?
NB: I will not go so far as to predict that. But I do think that Lyxor's 20-year history, and the fact we came through the most difficult years in the industry's history, puts us in a good position if there is a repeat. We have seen all the ups and downs in the past two decades – just like *EuroHedge*.

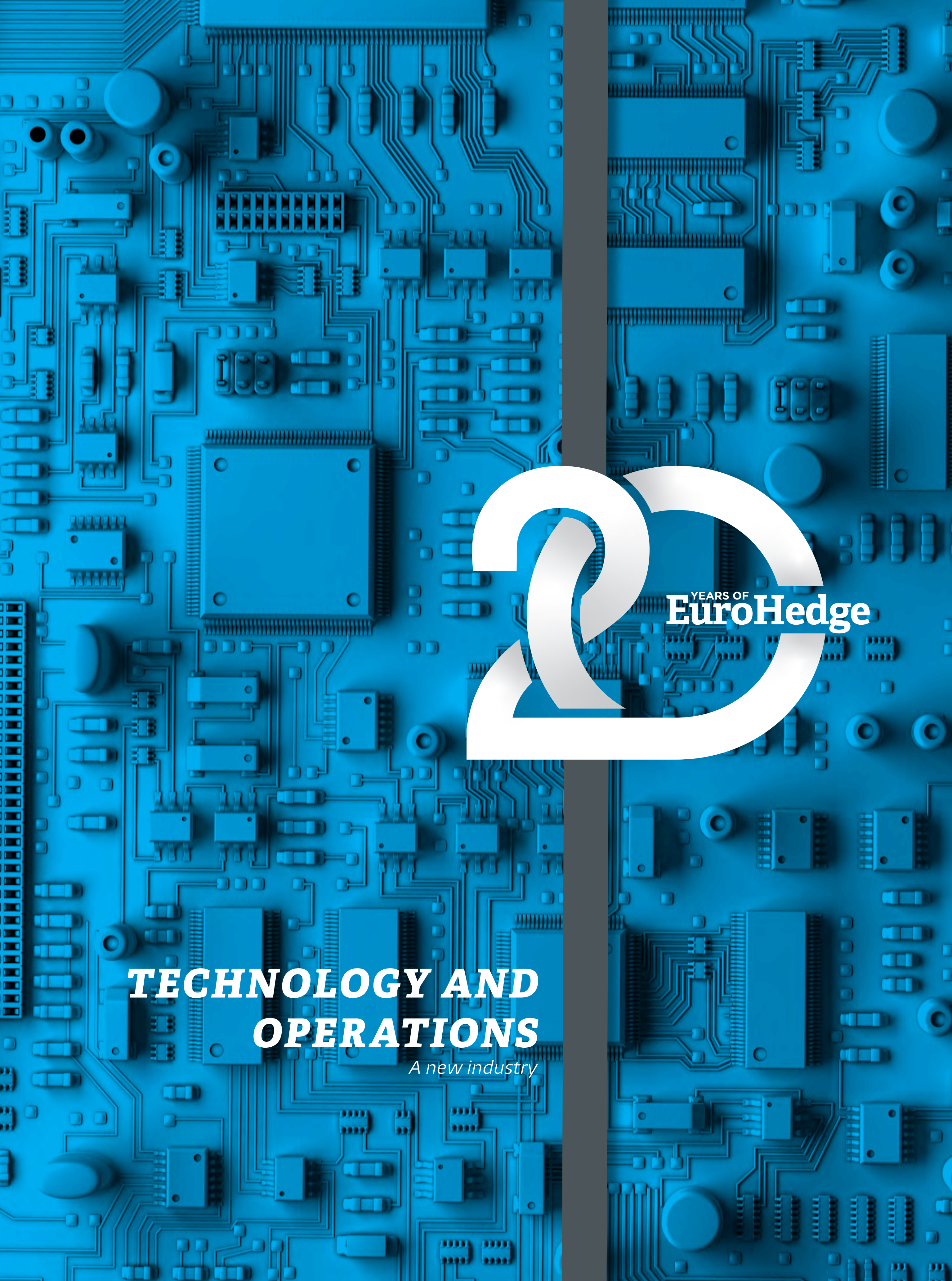
Which investors are investing in managed accounts now?
NB: We have observed a tidal wave of large institutions putting money into hedge fund managed accounts in recent years. Pensions, in particular, ask us to form dedicated managed accounts for them with selected managers. Growth in the last year or two has been particularly strong, and I think that is because we are reaching the end of a ten-year cycle of rising equities and interest rates near zero. Investing passively in equities was just as profitable, and often more so, than hedge funds. The environment is likely to be more challenging. Equities are wobbling, interest rates in the US are normalising and volatility is changing regime, to a higher level. We see a growing interest in hedge funds now from investors globally because more volatile markets and a potential downturn will create more opportunities for them.

Are investors more forward-looking now?
NB: Yes, definitely. And I think many investors realise that now is the time to reinforce hedge fund allocations, even though – or perhaps because – recent performance has been subdued. Hedge funds are a diversifier and now would seem a good time to build or expand a portfolio of diversifying strategies, away from equities. Investors are also more open to a greater range of strategies now. We have seen a rise in demand for alternatives to hedge funds, such as alternative risk premia strategies. They can offer a hedge fund-style return with good liquidity and usually lower fees. The Ucits format has really taken off in the past decade, which helps provide investors with a different type of access to hedge fund management. The interesting fact about Ucits is that it has been adopted beyond the borders of Europe, especially Asia and Latin America, offering a greater opportunity of investors and asset managers.

Where do you see fresh demand?
NB: Growing demand for diversifying strategies will come not only from investors familiar with investing in alternative strategies but also from new types of long-only investors such as private bank clients, mutual funds and asset managers. Alternative Ucits will provide new investors access to these diversifying strategies in a liquid, transparent, tax efficient, and regulated format.

On the subject of fees, what changes have you seen?
NB: Increasing pressure on fees has brought average levels down in the last decade. Unless performance goes back to the higher hedge fund performance numbers seen before the great financial crisis, that pressure will continue to rise. There is a perception that clients take all the risk and managers most the rewards. Fees should be a function of the hedge fund manager's ability to make money, and managers should offer different fee models to investors, providing a better alignment of interest.

How do you see the next 20 years playing out?
NB: Three trends I have mentioned will continue to deepen: the industry will offer a broadening range of strategies, pressure on fees will mount and investors will demand ever greater diversification in their portfolios. Markets, as I said, may be approaching another turning point – but I think the hedge fund industry is well-placed to serve investors well in that scenario. Lyxor remains committed to the development of its alternative Ucits range as well as its institutional dedicated managed account solution, and has ambitious growth plans. With an average rate of 30% since 2014 (and 40% YTD 2018), our Alt Ucits platform is one of the fastest-growing platforms in the industry and we have strong ambitions for the future. Our architect-manager business model will help drive this future growth. Through an agile combination of our passive, active and alternative strategies, Lyxor is well-positioned for the next 20 years. ◘


20
YEARS OF
EuroHedge
TECHNOLOGY AND OPERATIONS
A new industry

Operational overhaul

BY **JAMES SIVYER**, SENIOR RESEARCH ANALYST, *HFM INSIGHTS*

Research division HFM Insights explores the changing face of European hedge fund operations, as firms strive to improve their infrastructure despite pressure on costs

Hedge fund operations have advanced considerably in the past 20 years, with several consistent trends having a major impact. The ever-increasing regulatory burden, higher expectations from investors and new technology have all contributed to wholesale changes in how hedge fund managers run their businesses.

At the same time, many managers have seen their fee revenues squeezed due to investor pressure, while lower performance levels have eaten into the profits of some firms. Firms of all stripes have sought to bring costs down through automation and outsourcing, as well as leaning on service providers in a bid to reduce costs. Drawing upon data and analysis from HFM's *Insights* team this section examines these trends within the context of the European hedge fund industry.

Automating operations

It has become a cliché – but remains true – that when *EuroHedge* began "two guys and a Bloomberg" was virtually all it took to establish a basic hedge fund firm. The institutionalisation of the industry over the past two decades has seen managers take on a raft of new costs in a range of business areas. Lacklustre returns have also lowered or erased performance fee gains, adding a sense of urgency to the issue of cost management.

As a result managers have sought to cut costs and streamline their workload through the automation of operations. European managers polled by *Insights* during last year's *Ops Survey* were leading the charge towards automation, with London-based firms in particular leveraging the city's fintech talent to build sophisticated operational infrastructure.

The process allocators most wanted to see automated was compliance and mandate reporting, thanks to the additional transparency and accuracy this can bring.

A major consideration behind managers' efforts to automate has been the views of investors. As we see from exhibit 1, most investors would like to see managers go further in automating their operations. Those investors who were keenest on automation were also more likely to increase their allocation to hedge funds in the year ahead than those who were indifferent or averse to the idea (*see exhibit 2*). Indeed, one European allocator the team spoke to noted that when presented with two similar funds, the strides each firm had made towards automation could be a deciding factor in their choice of fund.

European managers have focused on automating "core" processes in the life of a trade, such as risk attribution and monitoring, as well as reconciliation and trade allocation and monitoring.

KEY FACT

$600,000 – $700,000

PRIME REVENUE CONSIDERED A "BORDERLINE" AMOUNT FOR A SINGLE-VEHICLE HEDGE FUND MANAGER LOOKING TO MAINTAIN THEIR TOP TIER PRIME RELATIONSHIPS

Least likely to have been automated by European firms are treasury-related functions, such as cash payments and margin, with managers indicating that investors remain jittery about the prospect of a "robot" wiring their money to the wrong place (*see exhibit 3*).

The process allocators most wanted to see automated was compliance and mandate reporting, thanks to the additional transparency and accuracy this can bring. This process was the second least likely to be automated by European managers, in common with the global average, suggesting this may be an area for managers to focus on in the future.

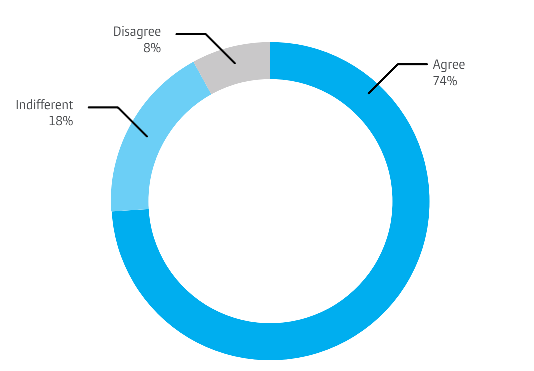
With the hedge fund capital of Europe, London, frequently ranked top in global fintech league tables, it was unsurprising to find European firms making the most of the rich seam of tech talent to develop operational processes in-house (*see exhibit 4*). Off-the-shelf solutions also proved popular among European hedge fund shops, although temporary contractors were spurned by managers concerned about knowledge of key systems leaving the firm once projects were completed.

Time for R&R? Service provider rotation and renegotiation

When asked by *Insights* in a *2017 Ops Survey* how they had sought to improve margins over the preceding 18 months, almost a third of European managers said they had renegotiated fees with service providers (*see exhibit 5*). A sense of injustice, as well as cost pressure, was partly responsible, with some managers complaining that service provider contracts contain "fairly egregious" terms, often lacking in

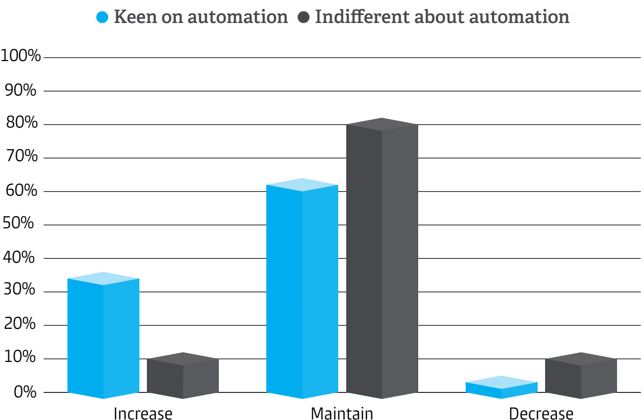
1 Investor sentiment toward managers' need to do more to automate operations, 2018

Analyst note: Investors were asked whether they agreed with the statement "Hedge fund managers need to do more to ensure their key operational processes are automated."



Source: HFM Insights Allocator Survey - H1 2018

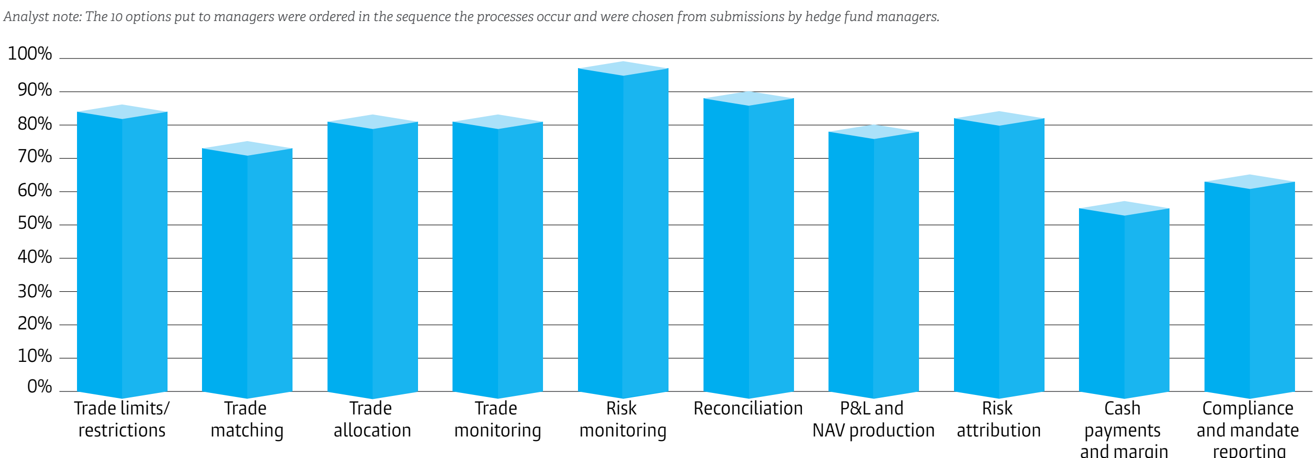
2 Investor plans for hedge fund allocation in the year ahead broken down by views on automation, 2018



Source: HFM Insights Allocator Survey - H1 2018

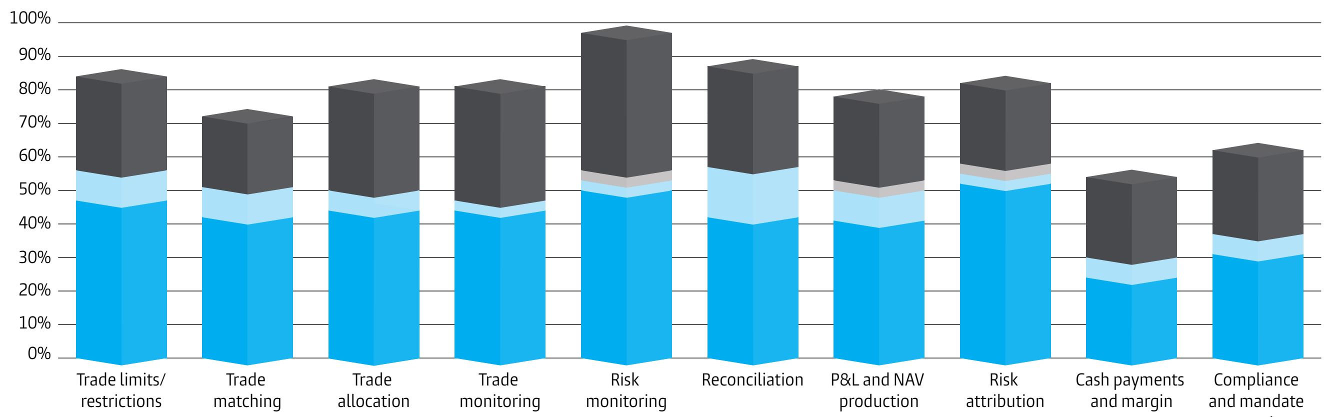
3 Operational processes automated by hedge fund managers, 2018

Analyst note: The 10 options put to managers were ordered in the sequence the processes occur and were chosen from submissions by hedge fund managers.



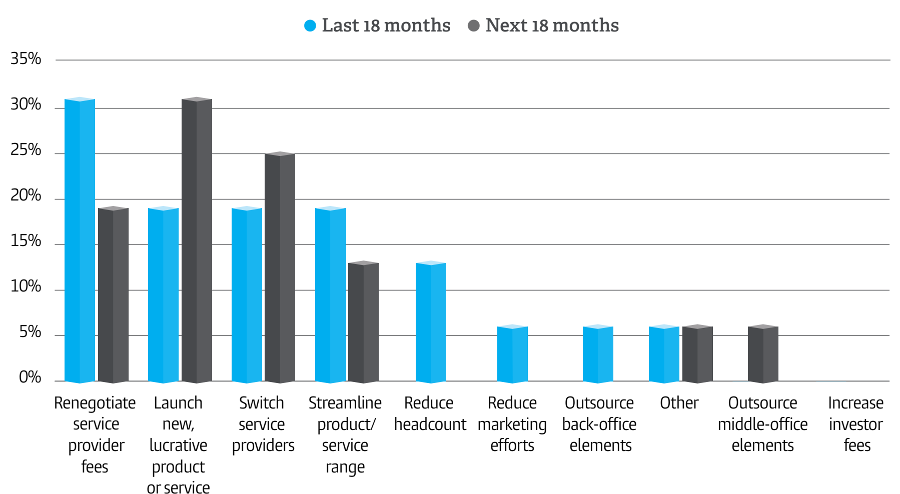
Source: HFM Insights Ops Survey - Q2 2018

4 How hedge fund managers automate operational processes, 2018



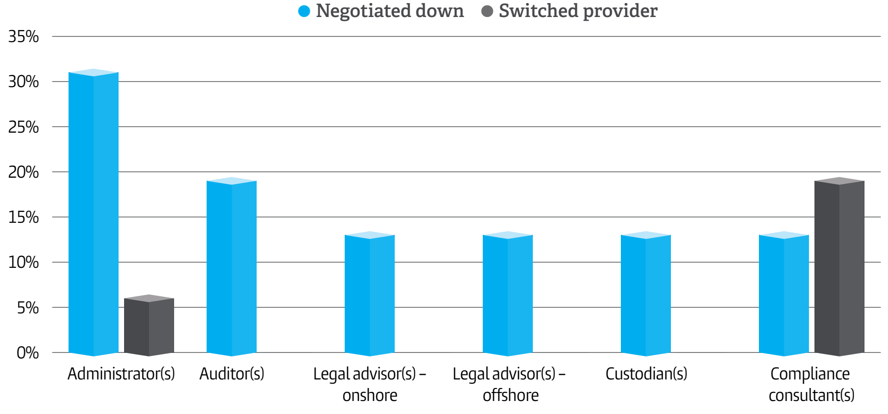
Source: HFM Insights Ops Survey - Q2 2018

5 Margin improving methods hedge fund managers use or plan on using, 2017



Source: HFM Insights Operations Survey Q2 2017

6 Service providers that managers successfully negotiated down on fees or switched in the past 18 months, 2017



Source: HFM Insights Operations Survey Q2, 2017

7 Where managers believe the balance of power lies between prime broker and client, 2018

Analyst notes: Equities and fixed income/credit managers said they 'mainly' trade these instruments. 'Mixture/other' managers are those that said they mainly trade 'a true mixture of instruments' or 'commodities'.

Balance of Power: Hedge Fund (HF) or Prime Broker (PB)		Manager HQ	Manager AuM	
		Europe	Non-BDC	BDC
Instruments primarily traded	Equities - high volumes	Tie	HF	PB
	Equities - low volumes	PB	PB	PB
	Mixture/other - high volumes	HF	PB	HF
	Mixture/other - low volumes	PB	PB	Tie
	Fixed income/credit - high volumes	HF	Tie	HF
	Fixed income/credit - low volumes	PB	PB	Tie

Source: HFM Insights Ops Survey - Q2 2018

sunset clauses and other provisions, leading to a multitude of hidden costs.

Many managers were also looking to pursue the riskier margin-improving strategy of launching new products, with an eye on generating fresh revenue streams from investors. Switching vendor also proved popular, with service providers that failed to play ball over fee discussions presumably losing out.

With pan-European directives such as AIFMD and MiFID II bringing new levels of regulation to hedge fund operations, the role of compliance consultants has taken on more significance in the past 20 years, particularly in the last decade. This helps to explain why compliance consultants were joint bottom for service providers negotiated down on fees.

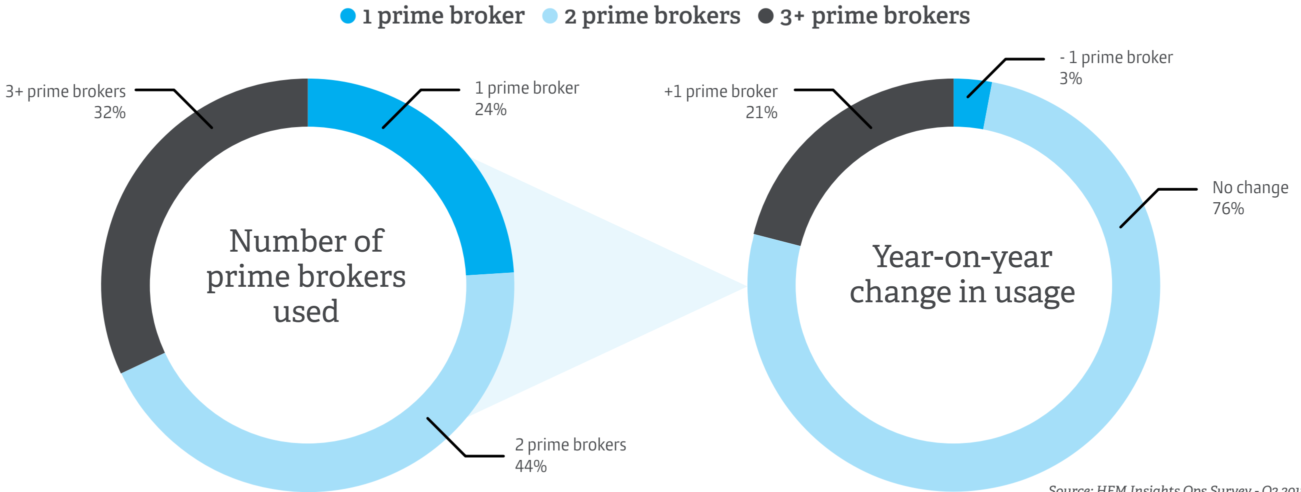
That said, managers changed their compliance consultant more often than they changed other providers (*see exhibit 6*). *Insights* heard from European firms who said they switch compliance consultants every few years as a matter of course, hoping to gain a fresh perspective on regulatory compliance within their business.

Fund administrators appeared to have borne the brunt of the fee negotiation onslaught from European hedge fund managers, followed by audit firms (*see exhibit 6*). This dynamic can work both ways, however, with one London-based hedge fund COO telling *Insights* his firm had been "fired" by their administrator after failing to meet certain revenue targets – a phenomenon more commonly associated with prime brokers.

Shifting sands in the PB power balance

The growth of the prime brokerage business ahead of 2008, as banks sought to grab a slice of the market, combined with steady AuM growth gave many hedge funds leverage in their prime relationships. But the restrictions placed upon trading businesses at banks since then have seen many brokers pull back, with less lucrative hedge fund clients being ditched or put on watch by their primes. This may help explain why none of the Eu-

8 Prime broker usage by European hedge fund managers, 2018



Source: HFM Insights Ops Survey - Q2 2018

ropean managers surveyed by *Insights* had successfully renegotiated fees or switched prime broker in 2017.

Yet research conducted by *Insights* into the balance of power between manager and prime indicates that a shift may be occurring. As banks seek to rebuild their market share, managers previously spurned by prime brokers are starting to hear from them again. Indeed, one London-based firm interviewed by *Insights* said the very primes that had fired them a number of years earlier for failing to meet revenue hurdles were now trying to woo them back.

Despite these signs of thawing, European managers are less confident than their US or Asian counterparts of being in the driving seat in their prime relationships. The Brexit cloud hanging over the UK financial services industry may go some way towards explaining this, with many survey respondents running Ucits funds that may be negatively impacted in the event of no-deal, while some global investment banks have been reluctant to invest in their European businesses in a landscape dogged by low margins and business uncertainty.

At the strategy level, the picture was more nuanced. Among European participants in the *Prime Power Games 2018 report,* managers of high volume-trading strategies were most likely to feel they held the balance of power (*see exhibit 7*). Equally, larger firms were more confident in their dealings with primes. Earlier conversations *Insights* had with managers suggested that between $600,000 and $700,000 in prime revenue would be a "borderline" amount for a single-vehicle hedge fund manager looking to maintain their top tier prime relationships, with $1m considered a more respectable sum.

> ***The majority of investors will now expect to see at least one "tier one" broker on a firm's books, if not two, while managers themselves have sought to spread their risk and partner with primes that are able to offer a full spectrum of services.***

The rise of multi-prime

More than three quarters of European hedge fund firms employ at least two prime brokers (*see exhibit 8*) – a statistic which would have been hard to envisage when *EuroHedge* started. The multi-prime phenomenon has occurred in response to the industry's growth and more complex trading practices, as well as the perceived need for diversification after banking scares during the 2008 financial crisis.

The majority of investors will now expect to see at least one "tier one" broker on a firm's books, if not two, while managers themselves have sought to spread their risk and partner with primes that are able to offer a full spectrum of services. The multi-prime phenomenon has also allowed some firms to play off primes against each other on both price and offering.

Moving forward

European hedge fund managers have gone to great lengths to professionalise their operational infrastructure over the past two decades. At the same time cost pressures have seen managers adopt innovative new solutions, while wringing the most from their service provider relationships. Although considerable progress has been made, *Insights* expects to see firms straining every sinew to continue the march towards automation in the years to come, while also keeping a watchful eye on costs.

Indeed, European managers surveyed by *Insights* felt they had yet to reach the limits of what they could automate. Firms were also quick to extol the virtues of automation and outsourcing, with the ability to scale up without adding large numbers of staff, and by proxy additional cost, chief among these. Success in the hedge fund industry, then, is no longer just about performance, but also cost management and streamlining as well. ◻

Industrial evolution: the changing COO role

BY **HUGH LEASK**

The role of chief operating officer has been transformed during the sector's advance from entrepreneurial cottage industry to institutionalised business

It is not only portfolio managers who have had to contend with a dramatically reshaped investment landscape over the past two decades: COOs and other ops staff have seen their jobs change, too.

As the hedge fund industry globally has surged beyond $3trn in assets, it is no longer enough for a prospective firm to be built around the strong investment track record of a skilled trader or charismatic lead portfolio manager.

The business of launching and running a successful hedge fund firm has become intrinsically linked to a whole new raft of regulatory requirements, due diligence processes and extensive investor demands, bringing major changes to the COO role.

Many COOs acknowledge the buccaneering entrepreneurial spirit which helped spur the sector's growth during the late 1990s has steadily given way to a more institutionalised and professionalised industry.

"It's changed completely – it's a night-and-day situation. There's not really the aspirational, let's-just-have-a-go mentality anymore," says Phillip Chapple, COO of London-based long/short equity manager Monterone Partners. "Twenty years ago, you could set up a hedge fund with two people."

Though perhaps not quite the wild west, laissez-faire landscape so often depicted by mainstream commentators, Europe's hedge fund industry in 1999 nevertheless carried an air of mysterious allure for investors. Operating almost as a glamorous cottage industry out of quiet, unassuming Mayfair townhouses, the sector offered eye-catching returns across a range of strategies, but precious little in the way of transparency or operational detail.

"Here were these mythical, wonderful beasts that basically were all about an alpha return, and investors were lucky if they got any detailed information or definitions," Chapple recalls.

Twenty years ago, you could set up a hedge fund with two people.

PHILLIP CHAPPLE

"In the past, many managers saw themselves as these superheroes who could manage money and produce amazing returns, and investors needn't worry about how they did it," suggests another senior ops professional at a London-based fund. "But we are looking after, and taking responsibility for, other people's assets. Those people have a fiduciary duty to look after those assets, which they are then passing on to us. It's an important point which a lot of people, particularly in the early days, often forgot."

A watershed moment

Questions of transparency and operational risk among were already becoming live issues for both managers and investors following a handful of hedge fund blow ups during the early 2000s. But it was the monumental events of the 2008 crisis that proved to be a watershed moment, and the biggest driver behind the industry's transformation to where it is today.

By ushering in a more stringent regulatory regime directly affecting alternative investment managers, the crisis brought a whole new focus on operational and counterparty risk and regulatory control, altering the relationship between managers and investors, and throwing a bigger spotlight on the position of hedge fund COO. *HFMWeek*'s annual COO Summits subsequently became must-attend events.

"The line in the sand primarily has been 2008 – it really was that clear-

PHILLIP CHAPPLE

JESSE MCCORMICK

cut," observes Jesse McCormick, COO of London-based Palmerston Capital Management, a European credit-focused specialist. "The institutionalisation of the industry after 2008 has been phenomenal in terms of its pace."

The sheer volume of rules impacting hedge funds directly on both sides of the Atlantic – Volcker, AIFMD, EMIR, short-selling rules, disclosure regimes, Mifid II, FATCA, anti-money laundering regulations and more – has led some to draw parallels to the considerable compliance burden faced by investment banks and more traditional mainstream asset managers.

"When I first took a role as a start-up COO in 2003 I probably spent 5-10% of my time on compliance," says David Mace, COO at London-based Altavista Investment Management, which has a global equity focus. "The last few years it's been more like 50%."

The events of 2008 opened investors' eyes to the very real possibility that assets could be lost not only through negative performance, but also as a result of an operational or counterparty failure. "Investors were willing to lose assets via the strategy, but they're not willing to lose assets through lax operational control," Chapple says.

Investor attitudes

A decade on from the financial crisis, hedge funds are now faced with an investor community much more strident in its scrutiny of underlying businesses. Allocators' keener focus on due diligence issues surrounding back-office operations, technological capabilities and legal documentation has brought about far-reaching implications for the role of COOs.

DAVID MACE

"When I was first working in operations in hedge funds, the focus was on just that – the operations. It was literally settling trades," says Chapple. "Due diligence was simply: 'Who's your prime broker, who's your admin, who's your auditor? Tick, tick, tick'."

> ***You always get a big tick from investors when you use technology intelligently for your operational support.***
>
> **JESSE MCCORMICK**

The amount of regulation, best practice and reporting requirements now mean a COO can no longer do things on a shoestring.

"There are many areas of focus – investors can spend between $60,000 to $100,000 on due diligence; you must have a fully developed infrastructure with all the appropriate processes, systems and controls," he says. "Investors view the sector with a whole new mindset, spending more time and money on the process, factoring in different scenarios and potential impacts on their capital. Despite the fact our customers are sophisticated investors, and not retail clients, regulation has increased exponentially."

While larger, more established firms have for the most part weathered this sustained regulatory upheaval, one consequence of this recalibration of focus towards operational risk and greater due diligence has been the creation of extra barriers to entry for smaller managers and start-up names with limited resources.

"That's been a really big problem for the smaller managers since the 2008 crisis, and you saw money flowing to the big managers as a result," says McCormick. "You ended up with assets going to the established managers which created additional challenges for the emerging managers who are the lifeblood of the industry."

On the flipside, while advances in technology have added considerable complexity to trading models and algo-based strategies, they've also benefited firms' operations – particularly at the COO level where reporting requirements have been aided by more advanced monitoring systems.

For Mace, the big shift here for COOs has been the development of cloud technology. "No more comms room to worry about, no swapping out back up tapes, no more-or-less flaky 'DR site' arrangements," he explains. "With everything in the cloud we can access everything and do anything we need to from anywhere with a reasonable internet connection. Hand in hand with this is the massive reduction in the price of data storage – we can now keep everything."

"You always get a big tick from investors when you use technology intelligently for your operational support," McCormick says. "They have an appreciation that you have systems and processes in place which allow you to automate as much as you can, focus on exceptions, and build control scalability into those processes."

He adds: "Whether it's the portfolio management system or reconciliation software, we're in a completely different league to where we were. Some of the functionality you can get in off-the-shelf products from system providers certainly wasn't available 13 or 14 years ago."

Hiring headaches

In the past, managers tended to source portfolio managers, traders and sales staff through investment banking channels, while compliance and operations staff were hired through administrators and prime brokers. Recruitment has evolved markedly in the past two decades, with COOs highlighting a lack of new ops talent coming into the industry.

"Speaking with others in the COO community, it's a huge challenge," says Chapple. "The prime brokers have all very much slimmed down. They have smaller teams, and you don't have a lot of people coming through the prime broker route anymore," he explains. "In the past you could hire people from operations through the investment banks, but they don't have the same

graduate schemes any more."

This dearth of fresh talent is partly attributed to the negative image of the financial services industry which took hold during 2008. Some believe the sector is no longer seen as an attractive place to go and work among many graduates.

Underlining this point, the senior ops professional contrasts the extensive rules and requirements which now affect all corners of the banking and fund management with the tech industry, where there is seen to be a less onerous regulatory burden by comparison.

"There's a sense that if you are a young, bright graduate and you want to get in the front door, you should go to Silicon Valley, not Wall Street," he observes. "Twenty years ago, going to Wall Street was seen to be frontier – things were growing, finance was in expansion mode. Where are the frontiers of knowledge now? The frontiers of knowledge are no longer in the City, or in investment banking. They're in Silicon Valley and in AI."

Mace adds: "Being a COO has always been a challenging, and often lonely, role – it's more so now." He observes how the increased bureaucratisation has made the role harder work, more time consuming, and more tedious for little or no actual business purpose in most cases.

"The challenges are still there, as is the satisfaction of creating and growing something, and the variety of the role, but generally it's a lot less fun than it was."

When I first took a role as a start-up COO in 2003 I probably spent 5-10% of my time on compliance.

DAVID MACE

A more fundamental cultural change within the industry, which demands hedge fund staff have the correct experience, has also altered the ways firms build their business. For their part, COOs must help ensure more detailed background checks and extensive references are carried out during the formal hiring process.

"You can no longer just hire your friend who happens to be a salesman who once knew a little bit about the markets. There now has to be a proper hiring structure," the senior ops professional adds, noting the process is set to become more onerous when the FCA's senior managers & certification regime (SM&CR) takes effect in late 2019.

The relatively low rate of success among new hedge fund firms is also a factor and has a bearing on how firms develop and foster their own corporate culture, particularly during the initial launch period, adds McCormick.

"Culture fit is very important – if you have five people in a tiny room, and people aren't getting along, it could make a challenging time harder," he suggests. "You're in the trenches together trying to get something off the ground and trying to get some traction. Personality fit has to absolutely be there."

Reflecting more widely on the 20-year evolution of the business, the COOs each believe that despite the increased regulatory costs, greater time and resource spent, and heftier compliance burden for firms, the changes have left the hedge fund industry in a better place.

"Nobody runs a hedge fund from their back room or their garage anymore, which many did 20 years ago," observes the senior ops professional. "There are fewer instances of fraud, and many of the poorly-run, bad entities are weeded out much more quickly now."

The prevailing sense that start-up hedge funds had a period of grace before regulatory requirements truly kicked in has also disappeared amidst the professionalisation of the industry. "That's completely gone – you've got to hit the ground running now," he observes.

Chapple believes that COOs are very much part of the company narrative in a way that was not the case in 1998. "Hedge funds now need to ensure they have a product that is understandable, and a proof of concept, which investors will buy into, as well as an infrastructure that is fully built out with all the regulatory bells and whistles, which wasn't necessarily the case 20 years ago." ◘

HOW 2008 AFFECTED THE HEDGE FUND ECOSYSTEM

Service providers are in firm agreement with hedge funds on the cataclysmic impact of 2008, which had significant long-term consequences for all sides of the industry.

"In Europe, the use of outsourcing in administration and other areas of fund management had been on the rise well before 2008, but the crisis and the regulation that emanated post crisis made the shift towards independent outsourcing irreversible," says Declan Quilligan, European head of hedge funds in Citco's fund services division. "Many of us will remember the fear at the time and everyone became very conscious regarding the counterparties they were using and the risks on their balance sheets."

The impact on the prime brokerage business was substantial. "Unlimited hypothecation was a big issue. We had many clients which had Lehman Brothers as a counterparty (including some funds of hedge funds invested in underlying funds facing the bank)," says Abigail Bell, specialist funds partner at law firm Dechert. "When Lehman went under it became clear the bank had rehypothecated the assets and nothing was held in custody. These funds were unsecured creditors with respect to the portfolio, so were immediately locked up and couldn't recover their assets."

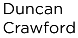
Most of the assets held with Lehman Brothers were eventually recovered, but the process took so long that a lot of funds were in wind-down by the time that happened. Giving the legal perspective, Bell adds: "I think it resulted in a wholesale change in the relationship funds and managers have with their counterparties. It is now standard market practice to include prime brokerage rehypothecation limits in English law contracts which are broadly equivalent to those in the US. Also, most funds will now start with at least two prime brokerage/custody arrangements so they are able to move assets quickly to another custodian in the event of another Lehman-style event."

Duncan Crawford, Societe Generale's global head of hedge fund sales, witnessed the resulting shift first hand. "After the 2008 crisis there was a shift in favour of multi-prime as hedge funds sought to reduce their counterparty risk by having a greater number of prime brokers," he says. "But more recently there has been a shift in the other direction, with Basel III regulation putting pressure on prime brokers to justify their worth to their parent bank on a balance sheet basis."

The expansion in product and strategy offerings in the wake of the financial crisis means Citco clients are far better diversified now compared with prior to 2008, adds Quilligan. "The fund administration industry similarly adjusted. The Citco group of companies today is a full-scale asset servicer across the whole gamut of products and strategies."

Nathanael Benzaken, Lyxor Asset Management's chief client officer, describes 2008 as a turning point for the industry. He says the Paris firm's favourable liquidity terms meant it was often the first provider of liquidity for clients during the crisis, leading to a decline in assets. "But they recovered (we are above $17bn as of today) and in the long term the lessons of the crisis benefited us: managed accounts were considered a useful way of investing large amounts of money in hedge funds. Running the same hedge fund strategy but holding assets in segregated accounts provides a layer of protection and customisation many needed. Some labelled the initial post-2008 growth in managed accounts a "knee-jerk reaction" to the crisis but the last decade has shown it was a long-term trend."

SocGen: Prime brokers eye closer relations in a new era



Duncan Crawford

The hedge fund and prime brokerage businesses have transformed in the past 20 years – and now work together more closely than ever, says Duncan Crawford, Societe Generale's global head of hedge fund sales.

What changes in the European hedge fund industry have you witnessed in the past 20 years?

DC: It is a different business now – the investor base has been transformed, operational standards have progressed hugely, the technology is unrecognisable… I could go on. Legislation has altered what was virtually an unregulated industry. It was a very innovative business at the beginning and the investor base reflected that, with entrepreneurs, wealthy individuals and family offices dominating. They have been replaced by pension funds and other institutions, which have far greater expectations in terms of operations and due diligence. This is all positive – the chance of a risk management issue or a fraud are much lower. The growth of the industry may have compressed returns, but as we enter a new market environment there are reasons to be hopeful on that front.

How has prime brokerage changed?

DC: Basel III regulation has put pressure on prime brokers to justify their balance sheet basis worth to their parent bank. Some brokers have "cut their tails" and got rid of less profitable clients. It has never been more important for prime brokers and their hedge fund clients to have a meaningful relationship and understand each other's business needs. In many ways the relationship has got closer. Prime brokers want to have larger relationships with a smaller number of clients. I have always believed in strong relations with all sides of the firm, from investing to operations. We probably had less time in the past to ensure all those relationships were in place – we have more regular visits and discussions with clients now.

How have changes at your business boosted the service you provide?

DC: NewEdge has been fully-owned by Societe Generale since 2014, which means we are able to combine our historic strength as a prime broker to CTAs (we were originally a futures house) with a growing footprint in equities, fixed income and indeed commodities & FX. Societe Generale's stock-lending desk and strength in equity derivatives have been invaluable as we expand our business lines and provide a fuller service to clients. We have long-established strengths in cap intro and consulting, which we have been able to increasingly apply in areas other than CTAs.

Aside from Basel III, what regulatory changes have re-shaped the industry?

DC: Mifid II has affected the ability of banks to provide research to the industry. The price of research has come down more than many would have hoped since the regulation passed. The Volcker Rule and other restrictions on prop trading by banks was transformative and had a dramatic impact on the hedge fund seeding business.

How popular are CTAs with investors now?

DC: Managed futures have been on quite a journey. 2008 was a breakthrough year in terms of performance, but many suffered heavy redemptions due to their high liquidity. The strong performance attracted a lot of institutions to the sector and new money flowed in in subsequent years. We were an important source of information and education helping facilitate this. There has been a shift recently in favour of more esoteric strategies, as managed futures move into increasingly niche areas including over-the-counter markets. It is very encouraging.

What has caused that?

DC: Diversification is your only free lunch, as the saying goes. In theory, managers should be as diversified as possible because every additional market added, with a lower correlation that one to any market already in the portfolio, adds diversification and should improve the Sharpe ratio. There are many smaller and seemingly improbable markets which can serve as a source of healthy returns for CTAs, for instance carbon.

Do you think hedge fund fees will continue to go down?

DC: Hedge fund fees are a marketplace like any other, driven by supply and demand. If you are doing something different from other people and it's adding value you are going to be able to charge higher fees. If you are doing something more replicable, it is harder to charge higher fees, particularly if you have very large capacity. Volatility, capacity and uniqueness of the strategy – not solely the gross return and sharpe ratio – should be considered by investors when thinking about an appropriate fee level and split. We explored some of this in our *Don't worry fee happy* report last year.

Are you confident for the industry's future?

DC: Very much so – we are entering a new market environment, so performance should improve. Assets have been highly correlated in the decade since 2008. Quantitative easing and near zero rates globally have made it difficult for active managers to outperform the market, but that could be changing now. We could be entering a period where hedge funds perform more in line with expectations and seem less expensive. ◘

Industry changes – the legal perspective

Gus Black and Abigail Bell, specialist funds partners at law firm Dechert discuss the significant changes in the industry over the past 20 years and the legal impact on hedge funds.

How has the hedge fund industry changed in the past 20 years?
GB: We set up our London funds practice back in 1997, so, as a firm, we have watched this industry mature from both sides of the Atlantic over more than two decades. Processes have become much more sophisticated on pretty much every front. There is a much greater regulatory overlay, more transparency and a greatly diversified manager and investor universe.

How does the fund formation process compare today to 20 years ago?
AB: The type of investor allocating to hedge funds has changed significantly. Family offices, funds of funds and high-net-worth individuals have been joined by pensions, foundations, insurers and other large institutions on a global scale. They often have their own commercial, legal, regulatory and tax requirements. Start-up fund managers will often be engaged with their seed investor from a very early stage, and the overall fund formation process can be heavily negotiated.

What about from a jurisdictional perspective?
GB: We have domiciled funds the world over, but Cayman still represents the most common hedge fund domicile. That said, as the investor base has diversified, we had to develop structures that can be marketed and accessed by different types of investors in different locations and that can involve different jurisdictions. We do a lot of structuring in the US, across Europe and increasingly Asia, depending mostly on the target investor requirements and distribution plan.

What is the situation now in terms of liquidity management?
AB: There is more scrutiny to ensure that the liquidity terms match the liquidity of the underlying portfolio. Many investors will push for additional liquidity management tools in documents because they have seen the value of them, particularly following the global financial crisis.

Gus Black

Abigail Bell

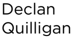
What was the impact of regulation imposed after the crisis?
GB: One impact from a documentation perspective was disclosure, which in simple terms has boosted transparency. As the regulatory environment has changed, the whole approach to compliance and its cultural significance within firms has changed. Much of the cultural change would probably have been pushed for by investors regardless, as the industry became more sophisticated.

AB: The introduction of AIFMD has created operational challenges. Managers have been required to adapt their systems and controls to comply with the risk management and reporting requirements as well as impacting on remuneration arrangements and fund distribution.

More stringent capital requirements applicable to prime brokers have impacted on their trading relationships with funds. Markets regulation including Mifid II has changed the manner in which funds buy and use research as well as trading processes including reporting, best execution and record keeping. EMIR has impacted on the way in which OTC derivatives are traded as well as introducing additional reporting requirements.

What are current industry priorities?
AB: For investors and regulators, I would say transparency. Investors are interested in their exact exposures and not just whether they are invested in "hedge funds" or some other blanket term. Funds will struggle if they are not transparent about what they invest in. Regulators are looking more at substance in terms of tax, operations, accountability and a raft of other areas. Where people are based, where is the core of the operation located? It is very different from 20 years ago. ◻

Technology and independence remain fund admin buzzwords



The pace of change does not look set to slow in the next 20 years, says Declan Quilligan, European head of hedge funds in Citco's fund services division.

How has hedge fund administration changed in the last 20 years?
DQ: Fund administration has been transformed in several ways, not least the extent of services provided to the hedge fund industry and the technology and tools required. As the industry has grown significantly, the trend has been to outsource more to top-tier admin firms, which have earned the trust of investment managers. In the nineties, not every fund structure used an independent fund admin – now it is highly unusual not to. The trend towards independent admin has been driven by many factors: their enhanced capabilities and technology; regulation; and a changing investor base with strict requirements for independent calculation of valuations.

In what ways has fund admin remained the same?
DQ: The critical importance of technology, and the need to remain at the cutting edge of innovation, have not changed. By focusing on proprietary solutions and core systems, we have led the changes in the industry when it comes to technological innovations. We launched Æxeo Technology in 2002, our proprietary front-to-back technology, and Æxeo Investor (AXI) transfer agency and allocation system in 2009. More recently, we have launched CitcoOne, our new web portal and our Citco Waterfall and Citco Treasury technologies, while our latest technology CitcoConnect helps investors manage their allocations through a secure online environment. Technology and our people were the key factors for clients and prospects 20 years ago and that remains unchanged. Staying close to our clients, understanding their needs and aligning our strategy to that of our clients has been critical.

What is the most important industry change you have observed in the last 20 years?
DQ: The shift towards independence stands out. When I joined the Citco group of companies in 1996, it was in the era of the so-called "10 Commandments" where offshore funds managed by US managers had to have their administration performed outside of the US to avoid the fund being subject to US taxation. Upon its repeal a year later, independence in the NAV-striking process, especially for US LP structures was viewed as a "nice-to-have" rather than an essential. The change towards independence has been driven mainly by the shift towards institutional allocators, which now dominate the investor base. Transparency reporting has become common practice with institutions who demand it from administrators independent of the investment manager. There is no tolerance whatsoever for operational risk – excellence in operations is essential for managers and their administrator.

In what ways has fund admin grown?
DQ: There has been significant consolidation in the fund admin sector, with M&A deals regularly reshaping the rankings. Consolidation continues apace with admins affiliated with investment banks selling out, given the challenges and perceived conflicts. Our strategy has been to grow organically and not to have to deal with the distractions of integrating teams and technologies etc. We have carried out a limited number of deals over the years but only for strategic reasons. We also believe our position as an "independent" provider is enhanced by the fact we are not part of a larger investment bank or institution. Asset servicing is our core business, as a result we understand clearly our risks and there are no conflicts of interest. Even if acting as independent valuer under AIFMD is not commonplace amongst service providers, we understand the risks involved – and the benefits to clients and investors – and are happy to offer this service.

Do the events of the last decade make you confident or worried for the future of hedge funds?
DQ: I'm very confident. The industry bounced back from 2008 and investors continue to show faith in the industry to hit their return targets. Start-up activity is not at historically high levels but we are seeing more activity and some pedigree names launch. Producing good performance has been more difficult in the era of low interest rates but a changing market environment should provide better trading opportunities. Assets are still near record highs. With investment in technology so critically important, I am guarded that increasing focus on total expense ratios should not lead to a race to the bottom in terms of fees. Nevertheless, the industry continues to brim with talent and is continually innovating – I have no doubt it has an exceptionally bright future.

What is your priority now?
DQ: We intend to remain at the forefront of all technological changes while continuing to provide industry leading service. Data is so critical these days, hence us concentrating on a data services offering. Ensuring data is used in an efficient, secure and timely fashion is critical. We are actively implementing machine-learning and artificial intelligence solutions. Citco group companies have had a ringside seat for all the twists and turns for as long as *EuroHedge* has been covering hedge funds and we are preparing now for the next 20 years. ◻

Ops: past, present and future

George Ralph

George Ralph, managing EMEA director of managed IT service provider RFA, on the hedge fund industry's tech progression – and its future challenges.

When it comes to the technology used by hedge funds, the landscape is unrecognisable from 20 years ago. Back then, most hedge funds would have had an IT manager or technician in-house to look after the internal servers and storage systems, which handled data, email and website systems. IT was complex, bulky and expensive. It was a huge effort.

Thankfully, times have changed and the technology needed on-site is now minimal. Data and systems are moving to the cloud and are now more scalable and flexible than ever before. This transition to offsite cloud services has not been without issues and we experienced initial resistance to the idea of running IT systems remotely. Many firms felt safer with their data and systems onsite. Today, the opposite is true and physical infrastructure is seen as posing a greater risk and management challenge.

Software-as-a-service offers secure access to systems and straightforward end-user experience, which is crucial. Hedge funds only really want to focus on one thing; trading. They don't want the distractions of operational issues and worries. Many managers I speak to aren't interested in how things are done, which vendors are used, or how the technology operates. Their main concern is the end-result; systems that are secure and efficient and data that is protected.

We also find that where manual processes can be automated, firms are able to improve the user experience and improve the efficiency and profitability of their business. However, all of this increases the reliance on data, which means that adequate data security solutions are critical. The complex and highly competitive nature of hedge fund management means data breaches can be disastrous.

With the move to cloud-based systems and services comes the need for next generation security solutions. The introduction of artificial intelligence and machine learning technologies into cybersecurity solutions means that data and systems are protected wherever they are, from the edge to the core of a firm's operations and wherever the user goes. Our managed detection and response service protects against known and unknown threats and even pre-empts threats before they happen.

In addition, the EU's GDPR regulation has provided another layer of complexity around data protection and firms cannot afford to fall short, running the risk of huge fines and risk to their reputation. In such a tightly controlled and regulated environment, it is essential that firms have adequately future-proofed their technology systems. ◘

Dan Page

Enterprise risk management will be an important ingredient for success, says Dan Page, head of asset management advisory with KPMG Ireland.

Europe's hedge fund industry has enjoyed a stellar ride over the past two decades, led by a "golden generation" of founders such as Sir Paul Ruddock and Alan Howard, who helped create a hedge fund industry worthy of the name.

But what about the next generation? We are consumed by the question of who is best positioned to flourish in the next 20 years – and believe that strong enterprise risk management will prove the key to success in the industry's next chapter.

The industry has significantly raised its operational game in recent years, partly due to the rise of institutions and their more sophisticated demands as hedge fund allocators. But there remains room for improvement, with hedge funds sometimes behind other areas of asset management in terms of managing enterprise risk.

Sensible business management has become even more important as the industry has diversified, with hedge funds increasingly running their strategies in different formats, such as Ucits, or starting long-only or other versions. These moves, while logical, can easily create a less straightforward operational environment than may appear at the first assessment and as a result present a series of risks of which managers may be unaware.

Take an issue as core to enterprise risk as vendor management; hedge funds and their boards do not commonly review the fit for purpose nature of their funds vendor relationships in a formal and independent manner; a practice commonplace in other sectors. Constant and consistent vigilance on services and pricing is key to a solid governance framework. Similarly, succession is rarely an ingrained consideration early on in a mangers life cycle.

Why are these things so important? Aside from the obvious – managing risk sensibly will reduce the chances of things going wrong – if businesses are better run, they have a greater chance of creating equity value. The hedge fund industry has a mixed record when it comes to takeovers, with the superb Marshall Wace/KKR deal the exception rather than the rule. Managers who want to sell stakes in their businesses need to have industry-leading operations, as well as performance.

This is important for the next generation of start-ups, too. Aside from the performance potential, seeders and other backers of emerging managers need to be convinced the enterprise is watertight from a business management and operational risk perspective.

It may sound less sexy than double-digit returns, but enterprise risk management will prove every bit as important as performance for European hedge funds in the next 20 years. ◘