ABN·AMRO Private Banking

Ernst & Young's Global Series of Hedge Fund Symposiums

"Shared Values"
Creating a sustainable Hedge Fund Platform

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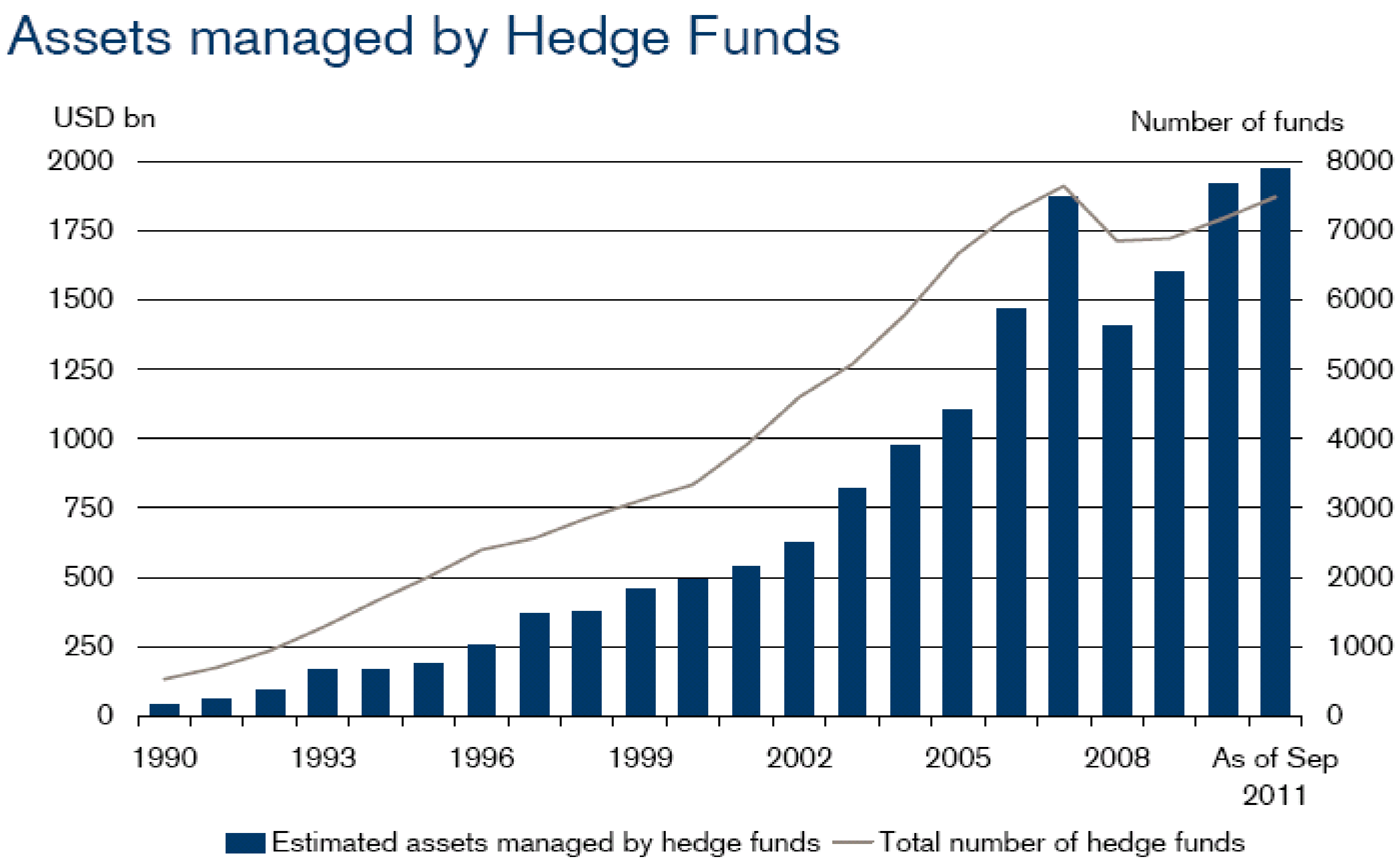
Introduction

We have finally seen a year of growth in the industry again……



Source: HFR, Credit Suisse / IDC

Source of all prices in this presentation: Bloomberg (data download on 18/8/2011).

Performance

However performance has been lousy!

HFRI PERFORMANCES (ESTIMATES)

HFRI Indices	September	YTD 2011
HFRI Fund Weighted Composite	-3.4%	-5.4%
HFRI Equity Hedge (Total)	-5.7%	-9.5%
HFRI Event Driven (Total)	-3.6%	-4.4%
HFRI Macro (Total)	-0.7%	-1.7%
HFRI Relative Value (Total)	-1.4%	-0.4%
HFRI Emerging Markets (Total)	-8.0%	-12.8%
HFRI FoF Composite	-2.8%	-5.3%
HFRI FoF: Diversified	-2.0%	-4.1%

Source: Hedge Fund Research

NEWCITS: Is growth supply or demand led?

Supply side

1949	1993	1998	2002
First hedge fund founded by AW Jones	First ETF created on S&P 500	HF Managed Accounts emerge	UCITS III framework issued

- ETFs as a growing threat to the traditional mutual fund industry
- Liquidity problems (side-pockets), and the fall out from Madoff pressures for more regulation and liquidity
- The upcoming European directive could introduce additional complexities for the hedge fund industry.
- Large mutual fund providers are making the move towards 'Absolute Return'
- Hedge fund managers are making the move towards regulated alpha

Total ETF AuM Growth over USD 800bn

Source: BlackRock, ETF Landscape, Industry Review, June 2009.

NEWCITS: Is growth supply or demand led?

Demand side, the events of 2008 have led to a change in client demands

Hedge Funds pre 2008

— Darling of the industry

— Permanent de-correlation

— Outstanding performance

Hedge Funds post 2008

— Still the darling of investors but more selective

— Standard FoF business model under huge pressure

— Hedge Funds' AUM is expected to rise to pre-crisis levels by the end of 2010

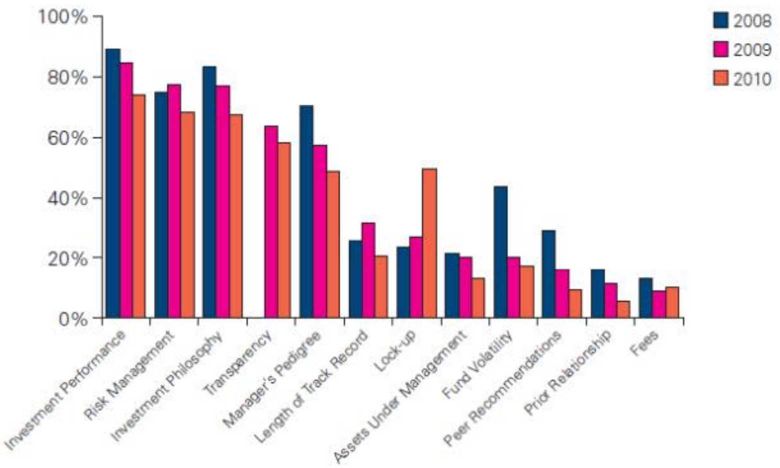
— Lost trust and confidence in FoFs in Europe and in Asia

A change in client demands

— Demand for good and almost guaranteed liquidity

— Demand transparency

— Demand for due diligence and independent controls



Source: Deutsche Bank Hedge Fund Survay 2010, "What five factors are most important when assessing a hedge fund?"

NEWCITS: Is growth supply or demand led?

….a combination of both lead to the regulated alpha industry trend

Mutual fund industry under pressure

- Investor access and growth of ETFs threaten traditional business models
- Underperformance of many MFs vs indices in 2008
- Long term buy and hold and asset allocation thesis being questioned (over last 10 years equity returns have been negligible)

Hedge fund industry under pressure

- Regulatory threat through new potential European and US directives
- Perception of illiquidity due to legacy gating, side pocket and restricted issues
- Transparency issues
- Asset custody and safety concerns

Move from Beta to…

Regulated Alpha Strategies

Move from unregulated to…

Clients demand…

A change in client requirements

Demand for liquidity, transparency, due diligence and independent controls

Source of all prices in this presentation: Bloomberg (data download on 18/8/2011).

UCITS represents a replacement for the disappointing FoF industry in Europe.

The hedge fund asset class has adapted to meet investor concerns. Going forward we anticipate that the future of the hedge fund industry will encompass a range of models and structures to meet the varying needs of different investor groups:

- **Traditional offshore** hedge funds will continue to exist for institutional clients, those seeking an illiquidity premium and UHNWIs who have the resources to conduct a comprehensive due diligence investigation and do not require a high level of liquidity.
- **Managed accounts** will exist for institutional and UHNWI who require security, transparency, liquidity and investment flexibility
- **UCITS funds** will exist for retail and selected institutional investors and those requiring regulation, liquidity, flexibility and lower minimums

- Given the pressure on performance and variation of returns of individual managers intra-strategy, manager selection and active management will be crucial to performance.

What issues do we face with UCITS?

The challenges we face

- Finding sufficient diversification between funds to create a portfolio, this has been elevated as the industry has grown.

The challenges we are still facing

- We still need greater diversification in terms of manager plus higher returns.
- UCITS indices are being developed, but are not widely used yet.
- The short track record and variety in structures requires additional research effort to understand all risks.
- Size of funds is still relatively small, leading to concentration issues.

The new challenges the industry may face

- Will performance after fees be good enough?
- Liquidity of underlyings in a crisis period is still to be proven with some managers.
- Possible regulatory changes/adjustments of regulation.
- Counterparty risk management.

UCITS….getting there..but beware!

Liquidity

- By-weekly or even more frequent liquidity allows for flexible allocation while easing risks management and matching liquidity terms.

Regulatory Oversight

- UCITS III Funds are subject to regulatory oversight.
- Transparency, monitoring and ‘official’ controls bring more comfort to all investors and remove many distribution barriers

Transparency

- Transparency and liquidity can help to reduce the level of security under the UCITS III constraints.

Regulated Service Provider

- Regulated service provider and independent risk monitoring provide comfort and a higher level of security under the UCITS III constraints. Investors are unlikely to be subjected to potential operational risks often associated with investing in offshore vehicles.

Tax aspects / transparency

- In some countries the distribution status of UCITS III gives a more favourable tax treatment.

Investor diversification

- The UCITS III framework is accepted by a broader range of investors, including pension funds and insurance companies.

Small minimums

- Affluent clients can now invest in hedge funds

Competitive Fees

- UCITS III often have lower fees than funds of hedge funds.
- The extra fee charged vs standard share classes can be seen as the price for a daily liquidity

Major hedge fund strategies

- HF strategies reliant on high leverage are unsuitable for UCITS III structure
- All the illiquid strategies are excluded from this framework
- Some periods will see UCITS III underperforming standard HF indices

Universe relatively small

- At the moment the good managers are approx 20
- Good news is that most of the big hedge fund houses make the move
- Also, some HFs will not make the move

Some other findings….

Alix Capital, Index Provider to the UCITS Alternative Index, is pleased to present the results of the latest edition of the UAI Quarterly Industry Survey. The survey was sent mid-September 2011 to all recipients of the UCITS Alternative Index performance updates.

Key Findings

- Fund of Hedge Funds and Long/Short Equity funds are the most disappointing strategies in 2011.

- Investors are most likely to increase their allocation to Macro and CTA funds, rather than decrease it, and are most likely to decrease their allocation to Event Driven and Long/Short Equity funds.

- 44% of respondents expect systematic strategies to perform better than discretionary strategies in Q4.

- 51% of respondents believe the current market environment will have either a positive impact or no impact at all on the growth of UCITS hedge funds…

- …however 60.7% of respondents believe recent performances will have a negative impact on new UCITS hedge funds launches.

Is the problem the level of fees?

Since 2008, many investors have been disappointed by the performance of hedge funds. Yet given that hedge fund returns are often at least correlated with interest rates, returns in a world of low to zero rates, are likely to settle at lower levels than historically.

The HFRI Fund Weighted Composite Index generated an annualised return of just 5.5 per cent from 2006 to June 2011 compared with 14.1 per cent from 1990 to 2005. It would be easy to conclude that the hedge fund model is broken, but comparative returns tell a different story.

Is the problem the level of fees?

Between 1990 and 2005, on a gross basis, hedge funds returned 4.4 times USD Libor and 3.0 times the return of the MSCI World Index; between 2006 and June 2011 they still returned 3.6 times USD Libor and 3.0 times the MSCI World.

Looking at net returns reveals another picture. In the past, a 20 per cent gross return could be assumed, leading to 14 per cent net. With the classic 2 and 20 hedge fund fee structure, investors received 70 per cent of the gains and the managers took the rest. Fast forward to 2011 and gross expected returns of 10 per cent net only 6 per cent for investors.

By a sort of law of diminishing returns, the 70/30 split has shrunk to 60/40 and could even end up at 50/50 when fees are a tad higher. If investors take all the risk and end up with only half the reward the equation looks less attractive. Rather than a performance issue, there seems to be a problem with fees**…..if the industry wants to be(come) sustainable…we will need to see this paradigm change!!**

Final thoughts!!

- The Netherlands (more flexible for offshore registration) is not Europe!
- It is also about a new standard of ODD – not just MDD
- This includes Transparency….but also reporting……
- Regulation……there to protect investor….but regulator must be aware of innovation (e.g. use of Swap structures – not necessarily bad – but probably better to allow direct replication)
- Cross border marketability of non-UCITS funds…..needs uniformity – c.f. Spain, Italy, Belgium……
- Bifurcation between Equity (perhaps credit) L/S strategies and true Hedge Funds such as RV, CTA, Macro and to a certain extent ED.
- ….and finally…..……………………... Performance!!!!

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