



# The Sustainability of Hedge Funds

*From theory to practice*

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## The sustainability of hedge funds

1. Sustainability of hedge funds
  - ✓ Sharpe ratios
  - ✓ Diversification
  - ✓ Downside risk
2. Sustainability of individual funds
  - ✓ Building an enduring hedge fund
  - ✓ Challenges in the current environment



# Sustainability starts with the set up

## Strong governance, sound philosophy and organizational stability

### ▪ **GOVERNANCE**

AEGON cornerstone investor, independent organization and alignment of interest with investors.

### ▪ **INVESTMENT PHILOSOPHY**

'Value with a twist' = Fundamental value investing within the economic cycle.

### ▪ **RISK MANAGEMENT**

Capital preservation leads capital appreciation.

### ▪ **TEAM**

Experienced team with bottom-up expertise, top-down knowledge and generalist experience who have managed both active long/only as well as market neutral long/short portfolios.

### ▪ **INSTITUTIONAL QUALITY INFRASTRUCTURE**

AUM \$320mIn in Asia and Japan: Majority long-term seeding commitment which leads to stability, lower business risk, liquidity, stringent regulatory framework and transparency.

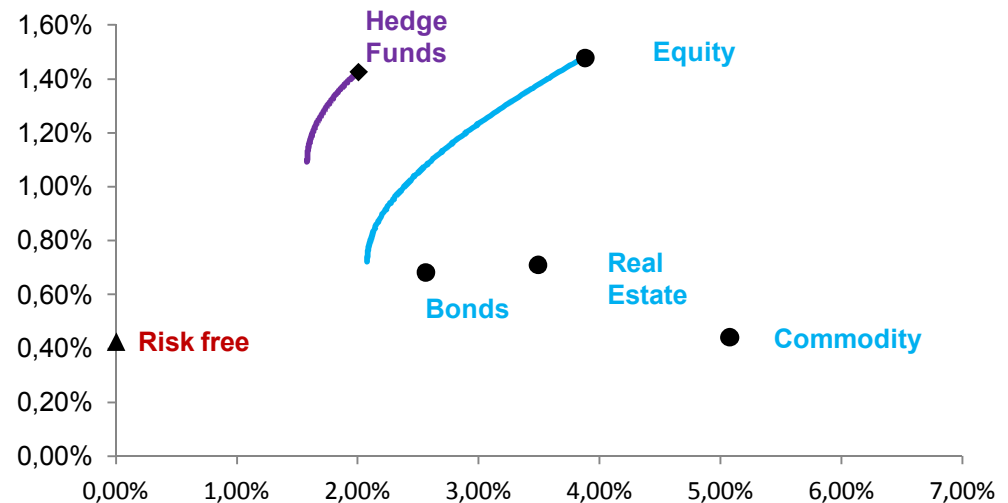


# How can hedge funds sustain their allure?

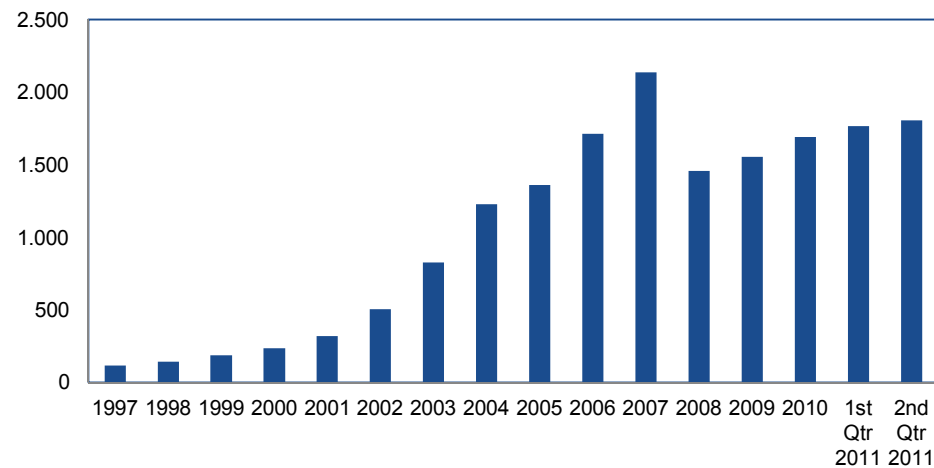
Since 2000 there is a quest for returns and lower risk

Hedge funds offer:

- ✓ Great risk/adjusted returns
- ✓ Diversification benefits
- ✓ Low downside risk



Hedge Fund Industry AUM



➔ Increased allocations

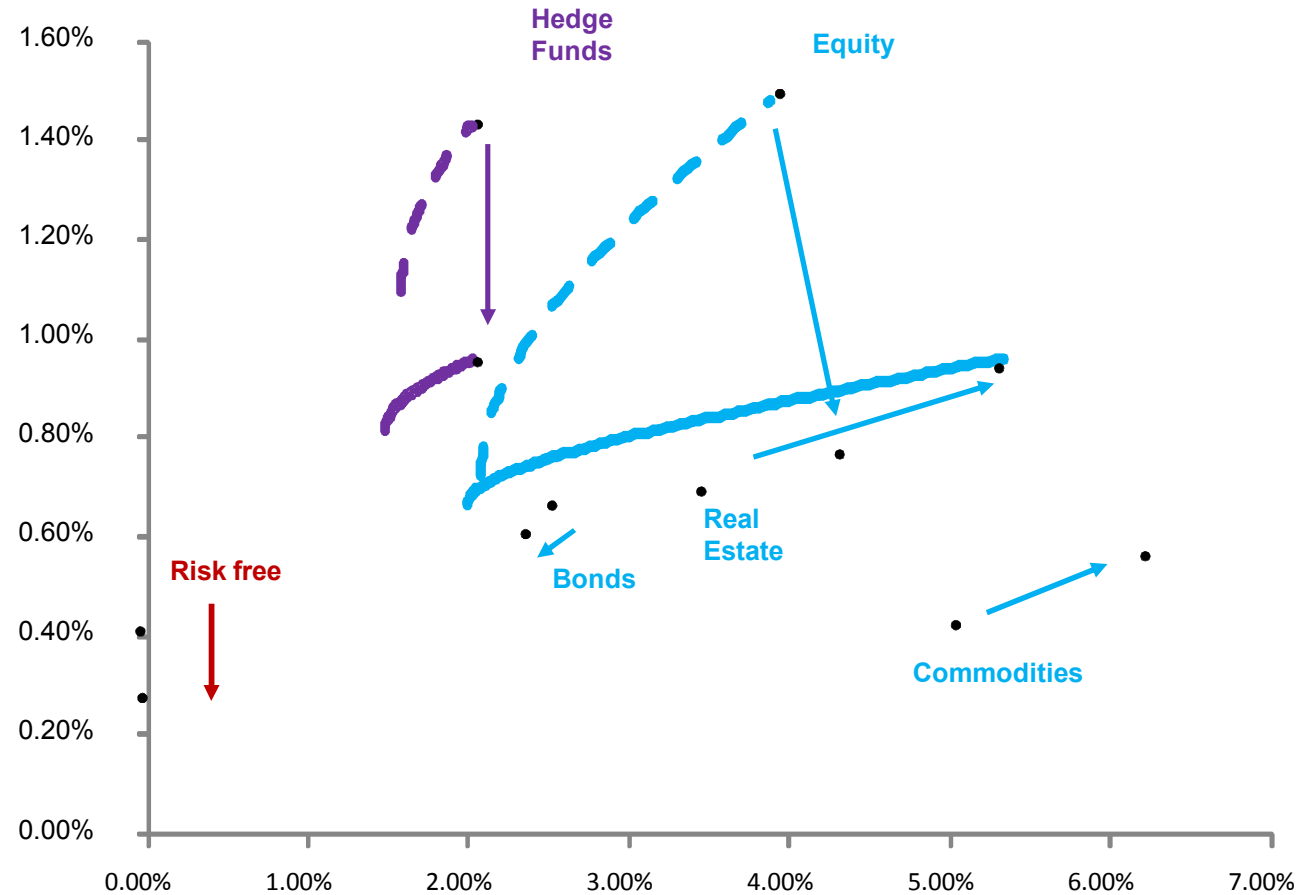


# How can hedge funds sustain their allure?

## Hedge fund benefits are in decline

When more recent data is added, hedge funds are less appealing.

The premium is in decline and the diversification benefits shrink.





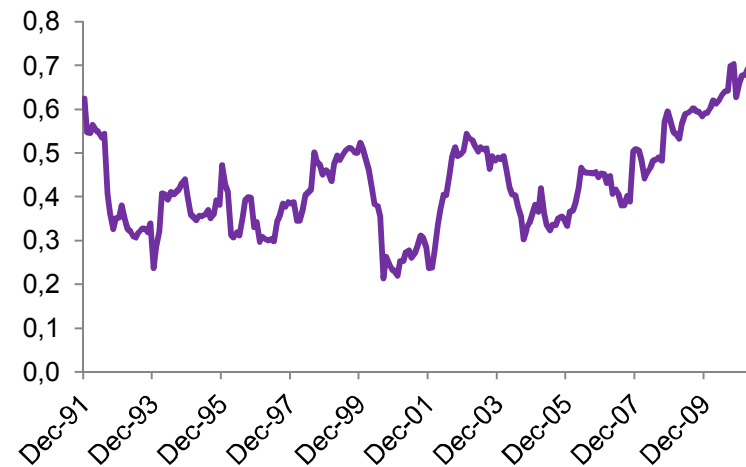
# Hedge funds

Lower hedge fund premium, less diversification and more downside

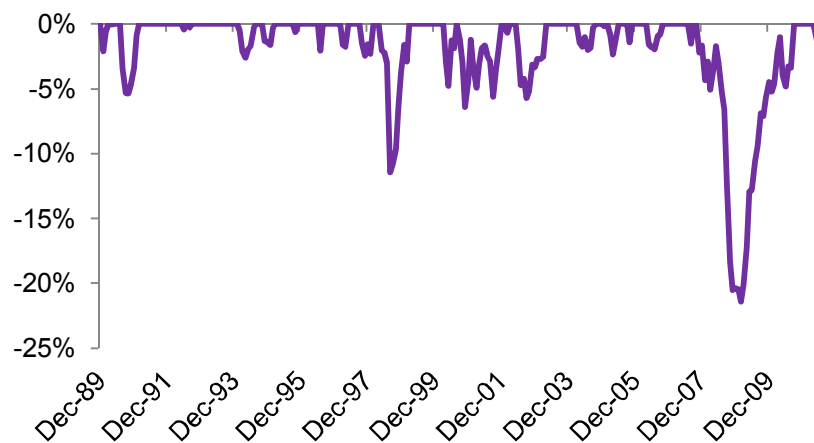
Rolling Sharpe Ratio (24M)



Rolling absolute pair wise Correlation (24M)



Drawdown



And they offer less downside protection

but...

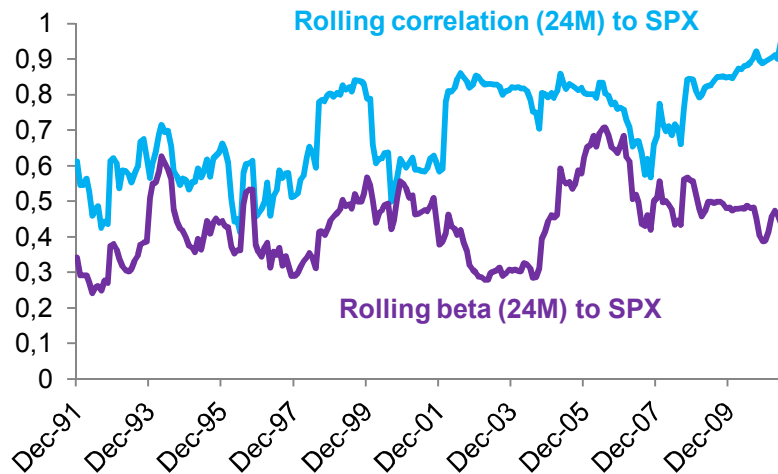
... still beat traditional asset classes.



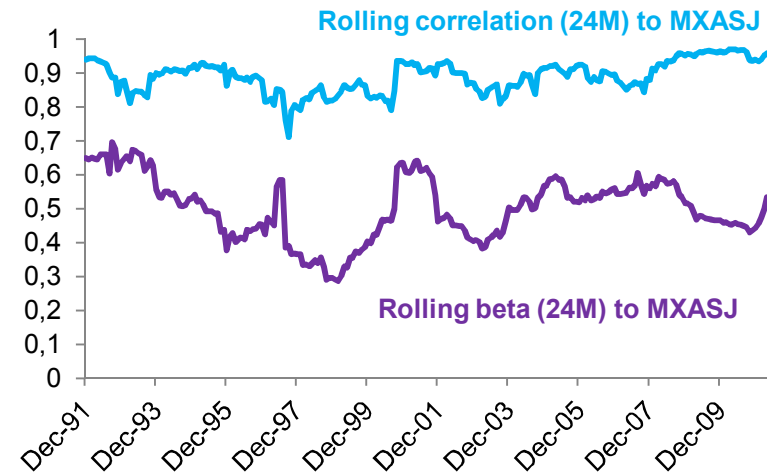
# Caveat emptor

## Where is the hedge in equity hedge?

HFRI Equity Hedge



HFRI Equity L/S Asia ex Japan



Global equity hedge funds have become more correlated to equity markets.

The higher correlation is a problem if it is being marketed as being otherwise.

# Marketing slogans

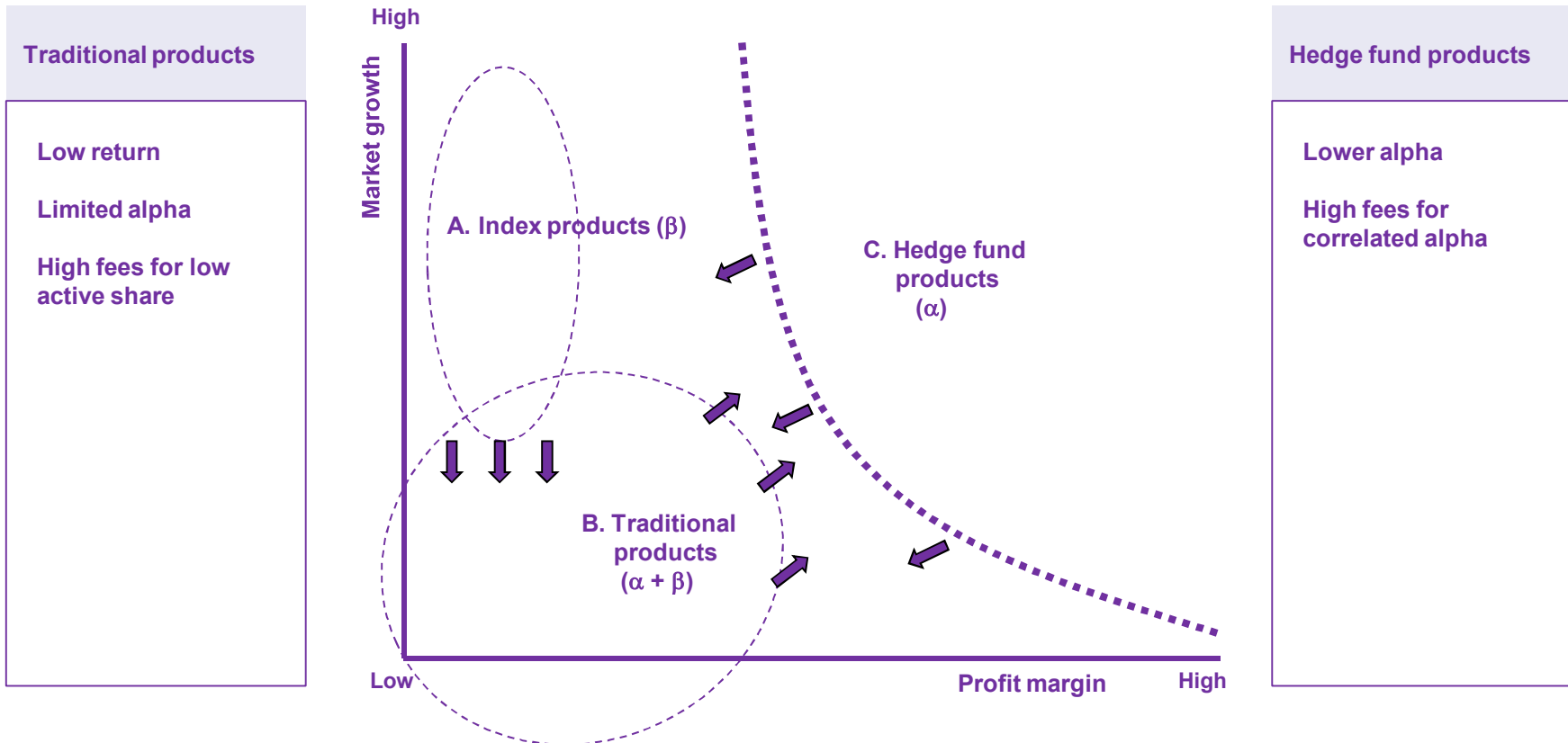
No absolute returns and not uncorrelated





# The trend in the industry

The demise of asset classes, morphing of industries, and fee challenges



**Traditional products**

- Low return
- Limited alpha
- High fees for low active share

**Hedge fund products**

- Lower alpha
- High fees for correlated alpha

# Building an enduring firm

## Raising the bar



### DISTRIBUTION

Empowered distribution team

Client-centric culture

Systematic relationship development and management

Client tiering and service levels

Managing capacity

Strategic marketing

### INVESTMENT

Source of alpha and investment edge

Disciplined investment process

Investment leadership and team

Aligned investment team compensation

### BUSINESS

Real business leadership

Strategic vision and objectives

Business strategy

Client-centric culture

Product development process

Aligned compensation framework

### OPERATIONS

Operational resources

Independence and empowerment

Counterparty diversification, quality and monitoring

Third party administration

Delegation but not abdication

Effective tracking and reporting

Strong controls and compliance



# The challenges

## A fine balancing act



### Regulatory environment

- transparency
- risk management
- operational excellence
- distribution fees
- bonus schemes

### Market environment

- performance
- competitive market
- size is important

### Investor environment

- liquidity
- downside risk
- limited correlation
- fee pressure
- location



## The sustainability of (hedge) fund performance

1. Sustainability of hedge fund returns
  - ✓ Returns are less appealing
  - ✓ Returns are too correlated
  - ✓ Traditional and hedge fund models will merge
2. Sustainability of individual funds
  - ✓ A sustainable hedge fund:
    - Has more than 5 FTE
    - Manages at least USD 100mIn per fund
    - Checks all operational and regulatory boxes

# Pelargos Capital Summary



- **Pelargos runs fundamental alpha focused strategies in Asia**
- **Pelargos promises opportunistic and independent thinking, transparency, liquidity**
- **Pelargos has an institutional quality infrastructure with \$320mln AUM and a 5 year fixed seeding contract**
- **Pelargos targets first quartile risk adjusted returns**

**AuM: \$320 million / €235 million**

**Employees: 9 FTE**

Numbers per Sep 2011

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