AsiaHedge

roundtable discussion

January 2006

The quest for alpha in Asia

VISION INVESTMENT MANAGEMENT

FRM Financial Risk Management

LIBERTY ERMITAGE

CONTENTS

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INTRODUCTION

As foreign investors and hedge fund groups flock to Asia, the question that is on everyone's mind is whether or not this current craze is just a temporary fad, or the start of Asia's place on the hedge fund map?

Asia is now seen as *the* new alpha playground, with foreign investors such as the California Public Employees Retirement System, World Bank and the Ontario Teachers Pension Plan, all known to be looking for managers based in the region. Funds of funds and international hedge fund groups such as Citadel are flocking to set up operations, both for research and marketing purposes, picking a variety of locations including Hong Kong, Singapore, Japan and Australia in which to set up shop. But the key question on everyone's mind is: Is the latest Asia craze just another cyclical fad or has Asia's time finally come?

This *AsiaHedge* Roundtable will start by looking at the appeal of Asia and whether or not the current exponential asset growth and performance momentum can be sustained. Chapter 2 will examine which countries in the region are in vogue and why, as well as whether or not China, India and Australia will provide investors with long-term returns. The story of Japan is told in Chapter 3 and, despite its geographic location in Asia, it seems that it is a law unto itself in terms of its own history and performance, which seems to be largely uncorrelated to the rest of Asia.

Strategies, tools and risks are the subject of

Chapter 4. One of the keys to success seems to be picking the right combination of all three in the right market, a task that some say is as complex as understanding the alchemist's secrets. Yet, by mixing these components correctly, participants in Asia's growth are likely to discover new sources of alpha in the future in terms of country, strategy or tools. From an outsider's point of view, the largest hurdle with Asia is deciding where to start.

As Asian investors become more sophisticated, Chapter 5 analyses what they are buying in terms of local or foreign hedge fund products, as well as what their investment needs and concerns are. The discussion concludes with a look at whether or not foreign firms need to have a local office to win mandates in the region and, if they do, where it should be located and how it should be staffed?

Part of the problem with Asia, at least if it is viewed from the outside, is the differentiation between myth and reality. To unravel these mysteries, *AsiaHedge* has gathered a group of top managers and investors who focus on the region to debate whether or not the latest interest in Asia is the beginning of a new hedge fund arena and, if it is, what is the best way to enter and succeed in the region.

PANELLISTS' BIOGRAPHIES

Sarah Allen
Liberty Ermitage

Sarah Allen is the executive vice president of investment strategy research for Liberty Ermitage and has 22 years' experience in the finance industry. She undertakes detailed sector/thematic research on hedge fund strategies to ensure that Liberty Ermitage is analysing the important trends that affect top-down decision-making on strategy optimisation. Before joining Liberty in 1999, Allen had extensive experience as a proprietary trader and hedge fund manager specialising in Japanese financial markets. She spent four years with IKOS partners where she worked in quantitative investment strategies. Before that Allen managed the Cresvale Sterling Hedge Fund and established a technical research department covering Japanese convertible bonds and warrants.

Stuart Leckie, The Hong Kong Retirement Schemes Association

Stuart Leckie, founder of Stirling Finance, advises on pensions and investments in Hong Kong and mainland China. He is the founding chairman of the Hong Kong Retirement Schemes Association and acts as a trustee of a number of retirement schemes. Leckie worked in life insurance in the UK before moving to Hong Kong in 1979. He served as the chairman of Watson Wyatt in Asia-Pacific and as chairman of Fidelity Investments, Asia-Pacific. He has advised the Chinese Government on pensions reform and is also significantly involved in the development of stock market indices in Asia, as well as advising the Hong Kong Government on the establishment of the Mandatory Provident Fund.

Doug Barnett
Quest Management

Doug Barnett has 18 years' experience in the investment banking and fund management business and has specialised in the Thai stock market for the past 15 years. Prior to founding Quest Management in 1994, Barnett worked for four years as the managing director of Swiss Fund – the Thai division of the global Unifund group – investing all across Asia but specialising in Thailand. Barnett worked in Los Angeles for three years as a broker at Morgan Stanley before developing his experience in the Thai stock market. He earned a bachelor's and a master's degree in mechanical engineering, both from Princeton University. Barnett also worked for five years as a project engineer for Chevron Corporation.

Niki Natarajan
InvestHedge

Niki Natarajan is the editor of *InvestHedge*, the monthly publication about investors in hedge funds and has more than 10 years' experience as a financial journalist. Natarajan joined HedgeFund Intelligence from *Financial News* in 2002, where she launched the monthly hedge fund and securities finance coverage.

Natarajan started her career as a journalist at *Institutional Investor* in 1997, where she wrote for *Global Money Management*, going on to become editor of *Foreign Exchange Letter* and launching *Global Fund News*. Natarajan has also contributed articles on these subjects to the *Financial Times* and the *Handbook of World Stock, Derivative and Commodity Exchanges*.

Jerry Wang
Vision Investment Management

Jerry Wang is the founder and chief executive officer of Vision Investment Management in Hong Kong. Wang, who has been in the asset management industry for 14 years, established Vision in 2000. As the Chief Investment Officer of Vision, Wang works closely with the investment team to continuously enhance every phase along the investment process. This has resulted in a business with solid clientele globally and with US$1 billion of assets under management.

Prior to forming Vision, Wang was an executive director at Scudder Kemper Investments. Before that he was the director of marketing at Merrill Lynch Capital Management Group. Wang received a Bs. in industrial engineering and management science from the McCormick School of Engineering at Northwestern University in the US.

Mark Cutis
Shinsei Bank

Mark Cutis joined Shinsei Bank in May 2004 in the newly created position of chief investment officer. Cutis was formerly with Bayerische Hypo und Vereins Bank, originally hired in their New York branch as treasurer for the Americas. He was reassigned to Tokyo, as chief executive officer, where he was responsible for developing and directing the proprietary allocation to alternative investments.

Cutis' career background has revolved around trading, investments and treasury activities – working in New York, London and Frankfurt. This includes a 10-year stint with Merrill Lynch in London and New York as well as the position as treasurer of the European Bank for Reconstruction and Development in London. Cutis, who holds an MBA from the Wharton School as well as a BA in economics from Emory University, began his career with Bank of America.

Jon Easton
EN Asset Management

Jon Easton is the managing director and co-founder of EN Asset Management, a specialist Japanese long/short equity asset manager. Founded in 2001, ENAM now manages over $300 million for a variety of clients. Before founding EN, Easton worked at Schroders as senior portfolio manager where he was responsible for over $1 billion of Japanese equities. He was seconded to their Tokyo office between 1997 and 2000.

Easton started his career training as an actuary before his interests in investment and Japan led him to AMP Asset Management. There he became Japanese portfolio manager and was jointly responsible for the management of over $2 billion of Japanese equities. Easton, who is based in Tokyo, holds a BSc degree in mathematics from Brunel University and is an associate of the UK Society of Investment Professionals.

Mark Reinisch
Financial Risk Management

Mark Reinisch is a director and head of marketing for Financial Risk Management in London. He is responsible for managing the marketing and client relationship team covering Europe and Australasia (ex-Japan), as well as new business development with institutional investors across Europe.

Reinisch, a language graduate from Edinburgh University, is also the product manager for global equity long/short products and sits on the Portfolio Management Committee for single-sector portfolios.

Reinisch, a CFA and graduate of Thunderbird in Arizona, joined Financial Risk Management in May 2002 from Zurich Scudder Investment, where he was director of international equity research analyst teams in Europe and Asia since 1999. Reinisch joined Scudder in 1995 from Surfax Limited, having started his career at Mercury Asset Management in 1998 based in both London and New York.

Yvonne Chan
Hospital Authority
Provident Fund Scheme

Yvonne Chan is the assistant director-investment of the Hospital Authority Provident Fund Scheme in Hong Kong. The Hospital Authority Provident Fund Scheme, which was established in 1991, employs a team to oversee the investment and operation of the Scheme, reporting directly to the trust board. The plan, which covers more than 50,000 doctors, nurses and support staff, oversees more than $2.6 billion.

Chan's role covers investment related issues including investment strategy and configuration advice, manager selection, performance and risk monitoring, and working with external service providers. Chan is an actuary by training and, prior to joining the Hospital Authority Provident Fund Scheme in mid-2003 she was a consultant specialising in pensions and investments.

Paul Storey
AsiaHedge

Paul Storey has been the editor of *AsiaHedge* from the time of its launch in September 2000, developing the editorial content for the publication and the weekly news alert. Storey is also largely responsible for the content and for sourcing many of the high-profile keynote speakers for the annual two-day *AsiaHedge* conference held in Hong Kong. The conference is followed by the *AsiaHedge* Awards for top performing Asian managers.

Prior to becoming a journalist in 2000, Storey worked as head analyst of RCP & Partners, the hedge fund fiduciary rating agency, and before that he was head of research at Asia Equity and an equity broker at WI Carr.

1 WHAT IS THE APPEAL OF ASIA?

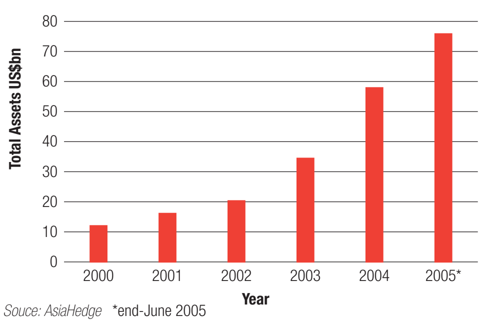
Asia is definitely growing up – with the number of hedge funds and their assets increasing exponentially, as well as performance holding its own

Paul Storey, *AsiaHedge*
This year has been a very, very strong year growth wise for Asia-Pacific assets. As you can see from the graph below, the past 12 months have seen a significant growth in the assets under management of single-manager hedge funds. Looking at the bigger picture, this growth has been steady and almost exponential since 2002.

From the annual *AsiaHedge* asset surveys, we are able to give a conservative estimate of about $80 billion in hedge fund assets in Asia. I think if you were to include all of the quasi-alternative investment funds, it would be well over $100 billion and that is up from about $12 billion five or six years ago. In terms of the numbers, when *AsiaHedge* first started looking at hedge funds there were about 120 products, while now there are well over 600 hedge funds in the Asia-Pacific region.

Not only have the number of hedge funds grown but the strategies have broadened. Local investors now do not really have to go and invest elsewhere – they have enough choice in the region and so can invest here. This is an ability that has occurred over the last couple of years and one that has made the landscape more solid that it ever was before. I actually think that what we are seeing is the potentially exponential growth that we saw in Europe over the last five or six years.

Asia-Pacific: assets overall



Souce: AsiaHedge *end-June 2005

Niki Natarajan, *InvestHedge*
What is driving the current enthusiasm for Asia? Is it sustainable beyond the 'cyclical fad' that a few sceptics have labelled this current mania in the region?

Stuart Leckie, The Hong Kong Retirement Schemes Association
To answer this, I think we have to start with conventional long-only investments. If you start by looking at these, then Asia looks comparatively cheap. Asia looks a whole lot more attractive than perhaps North America or Europe as their currencies are undervalued and the stock markets have been through quite a difficult few years since the Asian financial crisis. At the same time, I would say that Asia has been rather neglected in the past – or that it was a backwater as far as hedge funds are concerned.

Stuart Leckie, The Hong Kong Retirement Schemes Association

Now things are changing and Asia is becoming more in line with Europe and the US – although there is still a long way to go.

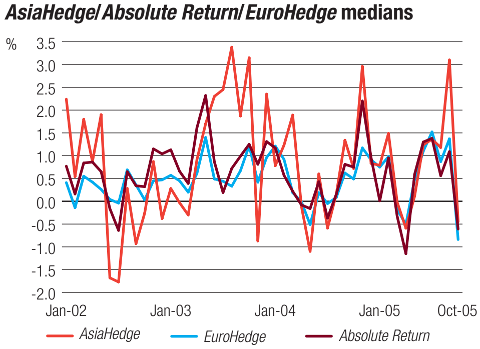
Mark Cutis, Shinsei Bank

In addition to the obvious under-valuation of Asia, the striking difference from occasions when Asia has previously been the centre of attention is that you now have enormous pools of endogenous capital. It is no longer a function of foreign buyers boosting the local markets.

Mark Reinisch, Financial Risk Management

From the client perspective, particularly in Japan, we have seen investments in our products for more than six years out of the region, so we cannot honestly say that hedge fund awareness is new. But what is definitely new is that the focus is now turning to Asia ex-Japan.

***AsiaHedge/ Absolute Return/ EuroHedge* medians**



Souce: AsiaHedge

Sarah Allen, Liberty Ermitage

The reason Asia is becoming so appealing to the funds of funds community is that it offers diversification – essentially a new source of alpha. This explains why so many groups are interested in having some sort of research presence. The cycle in Asian markets is at a different stage in terms of the exploitation of inefficiencies, and therefore not only provides diversification to portfolios by region, but by opportunities at a strategy level.

Paul Storey, *AsiaHedge*

In each of the five years that I have been covering Asia as the editor of *AsiaHedge*, the median performance of Asia-Pacific hedge funds has regularly outpaced hedge funds based elsewhere, although this may not necessarily be the case in 2005 by comparison to Europe. Only now, however, is it becoming obvious that what has held investors back is this notion of risk. Now that everyone is chasing every last drop of performance the attention has turned to Asia, but the key question to ask is: Is the quality of managers in this region satisfactory enough to satisfy international investors?

Mark Reinisch, Financial Risk Management

As a fund of hedge funds, we can see that there is clearly a higher beta in the Asian equity markets than there is in a number of more developed markets such as the UK or US – this may be reflective of the greater growth opportunities.

Mark Reinisch, Financial Risk Management

I think that all investment opportunities from the client perspective go through, to use the old market expression, the classic fear and greed cycle. Right now investors are more in the greed end of the spectrum than they were three years ago when the motivation for private investors, as well as institutions, was absolute returns and downside protection. So currently, the momentum is behind looking at strategies in Asia that give slightly higher volatility and prospects of higher return than investors were looking for three years ago.

Niki Natarajan, *InvestHedge*
Surely part of the appeal of Asia is that the beta is so high and adds an even greater reason to exploit the market to get additional alpha.

Sarah Allen, Liberty Ermitage
Indeed, and part of the real question we should be starting to answer as we look at Asia is: What is Asia offering us in terms of investment opportunity? Should we be looking at hedge funds in terms of their higher beta so we should expect higher absolute returns from them or should we take out the beta and simply look at the alpha and compare them to US and European hedge funds? This is part of the conundrum that less sophisticated investors typically overlook.

Doug Barnett, Quest Management
I think people are interested in investing in Asia because most of them perceive the growth for the next 40 to 50 years will be in this region. Just look where Americans get most of their manufactured products from these days and look at how fast European economies are growing.

Sarah Allen, Liberty Ermitage
Doug is right, one of the reasons we are all here today is that Asia is still a small part of the hedge fund industry – something like 7% – and therefore it is probably, in terms of opportunity, the most under-researched, under-invested, under-utilised space. The outlook for the next

Sarah Allen, Liberty Ermitage

two to three years is very positive in terms of assets, and it is crucial to determine how to play the Asian market. Key to this is to have the belief that the current growth is not just a temporary phenomenon.

Paul Storey, *AsiaHedge*
Actually, in the first six months of 2005, asset growth exceeded even my expectations. It is growing very significantly with about $3.6 billion raised from new funds in the first half of this year.

To be honest, in the first half of 2005, I was actually expecting asset growth to stall a bit, and maybe even slow down, but it has gone completely the other way which, to me, seems to indicate that there is definitely a change in attitude towards this region.

I think managers will have to broadly improve their comparative performances for that to continue in a significant way, but the signals are definitely there for a continuation in underlying structural growth.

Sarah Allen, Liberty Ermitage
The reason I believe that the growth is here to stay and is not just a cyclical fad is that this time you are seeing more infrastructure, you are seeing the global hedge fund players coming out here and establishing themselves in Asia. It feels, to me anyway, that it is a more established and mature industry than it was.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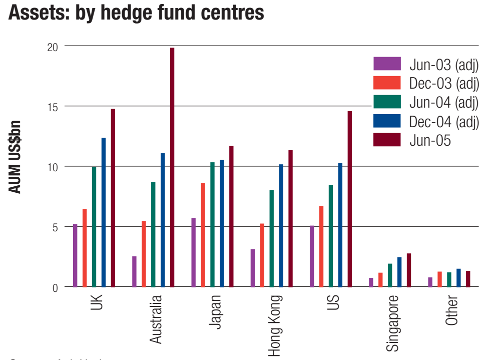
2 WHICH COUNTRIES ARE HOT IN ASIA?

Asia, unlike the US, is not a homogeneous region and each country has its own peculiarities that add to the potential alpha-generating opportunities

Niki Natarajan, *InvestHedge*
What is clear about Asia is that it is not a homogeneous arena – like the US, nor is one centre simply the only hedge fund capital – as London is to Europe. And it seems that part of the trick of maximising potential returns is the ability to pick the market that is going to be the next hotbed of activity. This will involve keeping an eye on changing regulation, which will affect investors, as well as the type of instruments that can be developed. Until now Japan has really been the investment centre of Asia, and for this reason it seems to have an ecosystem all of its own. But beyond Japan, what are the other hot markets in Asia?

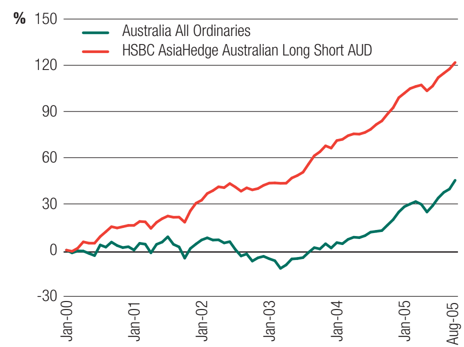
Jon Easton, EN Asset Management
I agree with Niki. Japan is not Asia and the two are fundamentally different. I personally like to look at things on a longer-term perspective. Let's looks at the population of Japan which is now declining. There were at least 127 million people in Japan in the first half of this year and if you look at the very long-term projections, if present trends continue, then the population of Japan at the end of this century will be 45 million. What is interesting is that in the 1900s the population of Japan was 45 million, so it has taken 105 years to increase from 45 million to 127 million and, if present trends continue, another 95 years to go from 127 million back down to 45 million. So despite being based in Japan and running a Japan portfolio, I am very optimistic in Asia and very pessimistic in the longer term about Japan.

Assets: by hedge fund centres



Source: AsiaHedge

HSBC AsiaHedge Australia Long Short, vs Australian All Ordinaries



Source: AsiaHedge

Niki Natarajan, *InvestHedge*
If the alpha opportunities are going to run out in Japan because people are not going to be born at a fast enough rate, which other countries should we be looking at in Asia?

Paul Storey, *AsiaHedge*
By simply looking at the asset growth numbers by hedge fund centre, it looks like Australia is the place to be. And certainly, looking at performance, Australia cannot be overlooked. At the *AsiaHedge* awards ceremony held in Hong Kong in October last year, six of the 11 awards were taken by Australian-based firms and many of them were noting how global investors are now having to trek to Australia.

Jerry Wang, Vision Investment Management

Sarah Allen, Liberty Ermitage
Everyone talks of China as the next exciting market. Are there really any alpha opportunities and absolute return opportunities in China?

Paul Storey, *AsiaHedge*
China is still an emerging market with limited ideas and opportunities. The volatility is still high, but it is a long-term play as it is only in the early stages of industrialisation. The difficulty is figuring out how to play the stock market, in particular as the domestic 'A' shares are policy driven, and I think investors have been a little bit disappointed possibly by performances. Things look like they could be a bit different in 2006, however, with positive prospects for something of a resurgence in China equities.

Mark Cutis, Shinsei Bank
In my view, you can probably make more money in private equity and direct investments rather than investing in the public market in China. However, I think making money in China will continue to disappoint. Here is an economy which grew 7% to 9% every year for a decade and then the Shanghai Stock Index sets a new low. Part of the reason for the underperformance is that Chinese companies are simply building market share and consistently disregarding profitability. They are simply undercutting the price of everyone else, so they do not have earnings.

But, as an investor in the stock market, you are investing in a factory that is probably not going to pay back the debt that they borrowed to build the factory. Their pricing, their products, and the fact that they are undercutting everyone else in the world, means that they are not making profits for themselves. They are keeping a lot of Chinese employed which is about keeping 300 million young men off the streets. Ultimately, it is a policy decision, so it is hard to make money from a government policy decision like that.

Jerry Wang, Vision Investment Management
China is an important theme but, at present, the best way to participate is via the peripheral countries rather than going directly into China. As Mark said, right now China may not necessarily be a great public market investment for a number of reasons. Another reason is its subpar corporate governance. I think the majority of the listed companies' balance sheets in China are highly questionable and potentially fraudulent.

We have been looking at China ever since day one when we started our fund, but we never really got into it. We decided to participate through its peripherals due to our lack of confidence in China's corporate governance.

Going back to Sarah's question, you probably would make attractive absolute returns if you were invested in the 25-30 Chinese companies with 'real' balance sheets. Ironically, if you could get all of the hedge funds in Shanghai to open their portfolio, you would see that it does not matter if they take a top-down, bottom-up, or thematic approach to equity investing; they come out investing in the same 20 to 30 Chinese companies.

Niki Natarajan, *InvestHedge*
What about India? I was reading in the AIMA journal about India and about how foreign institutional investors have poured close to $17 billion into the Indian equity markets since January 2004 and how the BSE Sensex, the large-cap Indian equity benchmark, has climbed passed 8000 since its low of 4505 on 17 May 2004. Has India's time come, or does it still have a long way to go to fulfil its promise?

Paul Storey, *AsiaHedge*

It does seem that India has been flavour of the month recently. This past year actually there was some 60% growth in the market, the launch of quite a few hedge funds and even some funds of funds. Right now, the demographics are driving the growth and there is an outsourcing boom in India, which is driving the economy.

India's growth, however, has been independent with acceptable liquidity and the regulatory changes have been positive. There is also a growing derivatives market, although India still needs to open up the stock borrow market so that investors can short individual stocks, which will help in reducing volatility.

Mark Reinisch, Financial Risk Management

Our analyst who covers Asia believes that Korea and India get the most press as they are the ones where there seem to be growing opportunities. Some of the risks to bear in mind that are associated with India are that the trades can be very crowded in some of the stocks that the non-Indian international investors are buying into. And this means that you are seeing a repetition of the similar kinds of names in portfolios.

Jerry Wang, Vision Investment Management

With India, liquidity is critical. From our perspective, we like the India story as it has an enormous growth potential. At the moment, in spite of the crowded trades, we are positive on themes such as consumer spending and the emergence of the middle class in India. We are not as positive on the manufacturing and exporting themes in India, for which we believe China is still far more competitive than India.

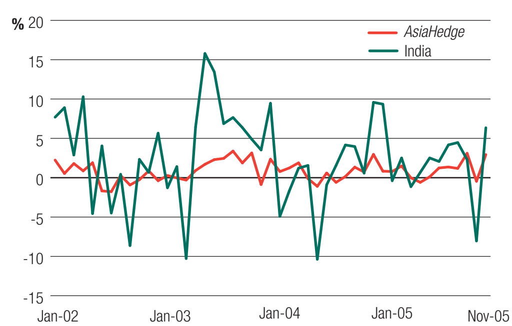
Mark Reinisch, Financial Risk Management

Paul Storey, *AsiaHedge*

India is definitely a growth story, whereas we do not necessarily think of Korea as so much of a growth story but a re-rating story. You are inevitably going to get P/E expansion in Korea as the domestic institutions begin to participate in a meaningful way. If you look at the Korean insurance companies who have been making money on their local fixed income from as high as 16% interest rate to what it is today, where do they go next?

Furthermore, the same thing is true with the local pension plan sponsors. Basically, Korean institutional investors will have to put their money to work with or without foreign participation in the local equity market where they have been absent for years, thereby supporting the equity prices domestically as has already happened in Australia. The superannuation funds in Australia have provided, to a certain extent, a fairly decent support for their local equity market and that is likely to happen going forward in Korea.

India versus *AsiaHedge* - medians



Source: AsiaHedge

3 THE JAPAN STORY

Japan may be located in Asia but the performance as a market behaves in an almost uncorrelated fashion to its regional neighbours

Niki Natarajan, *InvestHedge*
Given that Jon has helped us isolate Japan as an investment category in its own right, it is important to understand what the real story in Japan is now? It was always seen as the forerunner of anything that happened in Asia, which is why it is often considered a market in its own right. Is Jon's pessimistic view of Japan in the long term valid, or does Japan need to be observed at arms length from the outside to really be appreciated?

Paul Storey, *AsiaHedge*
Just to set the scene here a little bit. Japan, in terms of assets under management growth, increased slightly over 20% in the first six months of the year – up to about $28 billion. Before that it was as flat as a pancake for about 18 months – investors were not interested in Japan really. Indeed, they switched their money out of Japan to Asia ex-Japan.

But the scenario looks to be changing dramatically. The story of Japan is one of ongoing growth and development. There are a sizeable number of major institutional investors – including pension funds, insurance companies and banks – that are participating in the hedge fund industry. There is also a hungry high-net-worth market bordering on retail that is buying the guaranteed products that everyone is racing to sell.

Meanwhile, equity market returns have had a fantastic 2005, which in reality is actually better for long-only products than hedge funds. But, that said, there are some 25% of assets allocated to alternatives.

Sarah Allen, Liberty Ermitage
Yes, the equity market rally, which saw the Nikkei 225 Stock Average up 40% last year, has triggered the debate in Japan about whether to participate via beta exposure to the long-only world or via the long/short equity hedge funds. The rally was prompted by Kozumi's re-election, with an enhanced parliamentary majority and stronger mandate within the party to continue his reform programme.

That said, the case for long/short investing in Japan is still strong for a number of reasons. One is the fact that the Japanese market remains dominated by domestic investors who tend to be more passive and technically driven, leaving the small pool of hedge funds ample opportunity to invest in the rest of the market.

Japan also has structural forces starting to take effect, such as the unwinding of cross shareholding, which has led to technical imbalances between supply and demand. The third change in Japan is the advent of shareholder value. Company management is becoming increasingly focused on their share price and the concept of shareholder value. But the fact that there are still many poorly run companies who are destroying value means that this is fertile ground for long/short investing.


Jon Easton, EN Asset Management

Mark Cutis, Shinsei Bank

Jon Easton, EN Asset Management

I agree. The factors driving the Japanese market are somewhat different to those driving other Asian markets. I think Japan, while being more expensive than other Asian markets, is still very cheap even though it has almost doubled from its lows. I think the restructuring continues to drive the market.

As with long-only investments in Japan, a lot of investment is still being driven by foreigners. It is quite astonishing that, even now, Japanese domestic investors are very sceptical about their own market. If you look at the position of most large domestic investors, it is still massively overweight bonds and the predicted big shift from JGBs into equities has not even started.

For this reason, while Japan is more sophisticated than many of its neighbours, it is still very, very embryonic and focused on a gatekeeper type approach to investing. Things are starting to change as some institutions with more of a risk appetite are exploring new avenues, but a lot of Japanese money is still finding its way into Japanese hedge funds via Chicago.

I think that part of the problem with Japan is that people get mesmerised by the word 'restructure' and I think: How many times have we heard about Japanese restructuring and markets going to go up and tonnes of people go in and then it does not happen? It is a bit like the boy who cried wolf. Realistically, we do not necessarily want to play that restructuring card and I think in my opinion it a dangerous PR campaign.

The final thing to look at in the Japanese market is that volatility has gone down. If you look at the TOPIX Index over the last six or seven years, it tended to range at about 20% to 25% volatility. If you look at the market now, it is running with a volatility of probably 12% to 14%, and yet the indices have almost doubled in value.

Mark Cutis, Shinsei Bank

I think the absence of volatility is a global phenomenon and not just in Japan. Volatility has declined across the board as more money has been put to work in riskier asset classes.

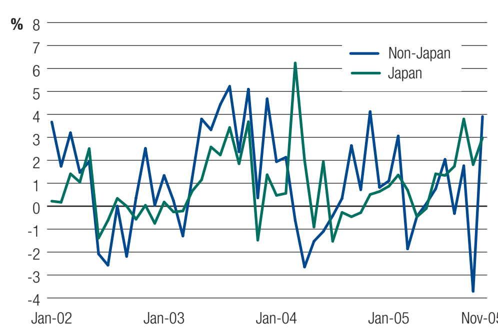
Euro-yen volatility is at a historical low, which I think is a function of the fact that the world and the region is full of cash and the central banks have been managing short-term rates. As we migrate into a higher interest-rate regime, I am sure volatility will pick up. This will mean that, as is the case in Europe and the US, stock picking rather than the beta will start driving the returns in Asia.

Paul Storey, *AsiaHedge*

The one big caveat in Japan at this stage is Basel II and this could be the fly in the ointment in terms of future institutional investor growth in Japan. At the moment this is still unclear, but the essence of this Basel accord is that financial services companies will be required to have a more risk-sensitive framework when assessing regulatory capital.

I think we need to see how it all pans out, because in reality it should only impact hedge fund allocations from banks and not from pension funds and private investors. The upside could also be that hedge funds will have to institutionalise their systems and operations.

Asia: Japan versus non-Japan



Source: AsiaHedge

4 STRATEGIES, RISKS AND TOOLS

Asia's appeal, in part, is that it is a constantly evolving picture in terms of strategies, risks and tools. Picking the right combinations is an art form

Niki Natarajan, *InvestHedge*
When mixing the Asia cocktail, there are a number of different ingredients that need to be considered at the same time. Picking the right country is key, but many strategies might not work if the underlying instruments are not available or liquid enough in a given region. Each country is going to have its own idiosyncratic risks, as well as more generic risks to consider. Looking at the table below it seems that market-neutral type strategies are the most prevalent. Is this changing? What are the risks associated with investing in Asia, and are there any tools missing in any of the markets that are holding back the country's development?

Mark Reinisch, Financial Risk Management
For me the key risk across Asia is liquidity. You can invest in as many of these markets as you want but if there is no liquidity, particularly in times of trouble, then the diversification that Asia potentially offers is limited.

Jerry Wang, Vision Investment Management
I agree that there are risks with everything associated with investing in Asia, including politics and currencies, and a lot of it ends up affecting liquidity. What we try to do is focus on minimising overall portfolio draw-downs as one of the ways to control risk.

Therefore, everything we do in terms of determining the asset allocation, is really on the basis of a worst-case scenario and how we minimise portfolio draw-down. We also may pit one hedge fund against another and essentially use hedge funds to hedge against one another. In doing so, we create a portfolio of Asian hedge funds that we are comfortable with. Should the worst-case scenario happen, the portfolio will greatly reduce draw-downs and preserve capital.

Assets: by strategy (US$bn)

	Jun-03	Dec-03	Jun-04	Dec-04	Jun-05
Japan long/short and market neutral	9.85	14.22	21.1	23.05	28.86
Asia ex-Japan and market neutral	3.47	5.73	9.06	11.87	13.7
Asia inc-Japan and market neutral	6.28	7.8	8.38	10.62	11
Other	3.1	6.69	9.55	12.36	22.26
TOTAL	22.7	34.44	48.09	57.9	75.83

Source: AsiaHedge

Doug Barnett, Quest Management

Doug Barnett, Quest Management
Long/short investing in the conventional sense is not really possible in Thailand, as you cannot effectively short. What we do instead of shorting is to hedge by raising cash. It is not unusual for us to have 50% or 60% in cash when the market is going down or when the market has gone up a lot. We try to ride it up and then get off the elevator and wait for things to settle down, because the Thai market tends to go in long runs up and long runs down.

When you see the volumes start to drop off again, you go back to cash and short whatever you can. For us, a huge short position would be 5%. Sometimes we get index shorts of up to 25%, but that is very rare.

Sarah Allen, Liberty Ermitage
At the moment I think there is good access to Japan, Hong Kong, and Australia where you have got the derivative instruments to be able to put on the more classic arbitrage strategies. Soon, however, as we start talking about India and China, we cannot really access them with classic hedge fund strategies. Therefore, can we justify charging hedge fund fees for what are essentially long-only funds?

In terms of pure alpha generation, I feel very optimistic about the outlook for Japan. Classic long/short managers have had a good year, but with the emergence of a real macro move towards the recognition of 'shareholder value', we are starting to see interesting opportunities in other value-based strategies, such as event driven. The rally in the stock market has also stimulated renewed interest in established strategies, such as convertible arbitrage.

Paul Storey, *AsiaHedge*
With all its sophistication, the one thing missing in Japan is that it does not have a single stock options market, which is extraordinary for a developed economy. About 10 years ago, the Tokyo Stock Exchange had a go at starting it, but I think one was compelled to physically deliver. You could not cash out all the options, so it never really worked.

Paul Storey, *AsiaHedge*

Sarah Allen, Liberty Ermitage

Sarah Allen, Liberty Ermitage
One area that I think is limited in Asia is the credit or high-yield market. Everything is equity related and the credit markets in Asia are not yet well developed, so things like Credit Default Swaps are practically non-existent.

Paul Storey, *AsiaHedge*
I am not so sure. I think the basic tools for credit trading are actually there, even if in most countries it is impossible to short. I heard someone say the other day that the CDS market has some 60 liquid names and, until there are some 100-125 names, Asia will continue to lag behind Europe and the US. I am told the best way to play it at the moment is via the sovereign debt markets, which are more liquid and the volatility averages 7%-8% with returns of 20% plus in Asia.

Mark Cutis, Shinsei Bank
I am curious about what people think about activist strategies. This style is very popular, at least with non-Japanese investors in the last six months. My own personal view is that it is a great idea whose time has not come yet. That said, it seems that a lot of money is being raised and what is interesting is there has not really been any successful examples of activism yet.

Jerry Wang, Vision Investment Management
I think, by and large, a lot of companies in Asia need a bit of a shake-up. They are just too sleepy. The fact is that a lot of these small- to mid-cap

companies are enormously cash rich, while making steady profits in terribly unexciting businesses; therefore, they never get coverage. So for them, activism is not necessarily a bad thing.

In Japan, company founders and chief executives are getting older and they do have a succession issue. A good portion of the founders are currently near retirement age and they do not necessarily have the next generation to pass it on to, unlike Chinese who just pass it on to whoever carries the last name, rightly or wrongly.

The Japanese do not function in that way, so in that sense, activism creates a monetisation event for the founding partners or individuals. I do see some value in that. There are, however, certain funds or new start-ups that perhaps take it a bit further and stretch activism to a different definition and that can get a bit more dangerous.

Doug Barnett, Quest Management
In Asia, the companies self-select themselves. You go and talk to them and if they say, "we don't want you to tell us how to run the company, there's the door," you just do not invest in them. Over the past 16 years, however, we have taken very large positions (more than 15% of our portfolio) or more than 10% of the company's shares in 63 different companies, and we have had board seats on six of them. All of those companies are willing to work with us.

Normally, in Thailand, the major shareholder of the company runs the company and as we are usually the second or third biggest shareholder behind them, so our interests are aligned. We all want to see the stock price go up.

Jerry Wang, Vision Investment Management
One of the features of Asian emerging markets is that while the founders/chief executives are very good at building profitable businesses, they do not know how to use money to make more money or to be more creative in tapping the capital markets. This is often the case as the chief financial officer used to be the accounting manager that joined the company at inception. There is a difference between someone who understands the international capital markets

Doug Barnett, Quest Management

versus someone who can balance the income statement. Hence, having a hedge fund partner who brings you that expertise, does add value and can be mutually beneficial amongst owners, management, and shareholders.

Niki Natarajan, *InvestHedge*
As one of the few regions on earth where there is not a single currency-type platform for a large part of the region, how big is currency risk, and how do people work round it?

Doug Barnett, Quest Management
It should not be an issue at all, as it is hedgeable at a very low cost. If someone buys Thai stocks and leaves the currency position open, then he is making a specific kind of bet.

Sarah Allen, Liberty Ermitage
Bigger macro-economic issues, such as the outlook for growth in China or the potential decoupling of regional currencies against the dollar, may have an implicit impact as this will affect market sentiment.

Yvonne Chan, Hospital Authority Provident Fund Scheme
I remember when the Hong Kong dollar was under attack by funds, the government intervened by injecting cash into the economy. The problem with that was that a lot of institutions took Hong Kong equities away from the securities lending programme. That probably will not happen in Hong Kong again, but it could in other countries.

5 WHAT ARE ASIAN INVESTORS BUYING?

Although Asian product development is growing fast, many local investors are only now slowly beginning to look at hedge funds and fund of funds

Niki Natarajan, *InvestHedge*
One of the most interesting issues from my perspective, running a publication about investors in hedge funds, is watching the surge in product launches. And at the same time listening to the hedge fund investors I talk to, both funds of funds and pension funds, and hearing that what they actually want does not exist, is in the wrong jurisdiction; not available in the currency they need; or only available in a pooled option without a tailoring that would make all the difference to them. With all the products on offer, I am curious to find out what is it that investors are actually looking for from hedge funds.

Doug Barnett, Quest Management
We have about 180 investors and $240 million in assets. We want to diversify the risk of our investor base. Most of our money comes from the personal accounts of other hedge fund managers. We find this to be the stickiest money because they understand what we are doing and are very tolerant of volatility because they understand the process and how difficult it is to hedge.

Ironically, we have no Thai investors because we are prevented from having them by the Thai SEC. Our investor base is about a third from Asia, a third from America and a third from Europe, by design. We expect that US investors will drop very significantly because of the new SEC regulation. We think that the two-year lock-up rule, to become exempt from registering with the SEC, will mean a lack of new US investors. But surprisingly, Japanese high-net-worth individuals are now investing in our fund, even though we are not marketing it to them. I think they're actually looking around for investments within Asia.

Doug Barnett, Quest Management

Jon Easton, EN Asset Management
We are based in Tokyo and run about $320 million, from a variety of sources. I think probably the most interesting point to note, on a geographical basis, is that we have seen very little interest from Japan. In the whole history of our operation, and we started the company almost five years ago, we have only ever had minimal interest. US investors have always been quite receptive towards Japanese strategies, and this is driving our decision to get full SEC registration.

Sarah Allen, Liberty Ermitage
We actually have a Japan fund of funds. And, interestingly, the demand for our Japanese product is coming from Europe and the US. We have not yet managed to make many forays into Asia in terms of our investor base, but Europeans and Americans clearly seem to want Japanese products as a diversifier.

Mark Cutis, Shinsei Bank
Actually, what we are seeing, at least in Japan, is Asian investors coming into the market looking for opportunities. Typically, Asian investors have preferred to look to the global ex-Asia markets for investments. I would be interested to hear from Jerry if he has actually seen Asian participation in Asian hedge funds, because it is my impression that we are seeing a lot more of Asian capital being allocated to this region.

Jerry Wang, Vision Investment Management
Our investor base is very diversified and predominantly institutional. One irony is that although we are based in Hong Kong, we do not have a single Hong Kong institutional investor. Other than that, we have investors from Asia/Australia, Middle East, Scandinavia, Japan, North America, Europe, South Africa, and Latin America.

Niki Natarajan, *InvestHedge*
That is very interesting Jerry, not a single Hong Kong investor and you are based there. Yvonne, you are a Hong Kong-based investor. Why do you think Vision does not have local investors; is it that Hong Kong investors are looking for global product?

Yvonne Chan, Hospital Authority Provident Fund Scheme
Size is one of the issues that we need to consider. We are not big enough to diversify regionally and justify a European, US and Asian fund. I know that Asia offers a lot of opportunities, but if you look at the total global opportunity set, then Asia is only playing a small part.


Jerry Wang, Vision Investment Management


Yvonne Chan, Hospital Authority Provident Fund Scheme

Niki Natarajan, *InvestHedge*
If that is the case, then where does your Asian exposure come from in your portfolio? You said long only, but is it just long-only equities or is it fixed income?

Yvonne Chan, Hospital Authority Provident Fund Scheme
Both equities and fixed income and the funds of funds that we employ will have some allocation to Asia.

Niki Natarajan, *InvestHedge*
Yvonne, what are you looking for from hedge funds? How did you enter the market and decide between the direct versus fund of hedge funds route?

Yvonne Chan, Hospital Authority Provident Fund Scheme
We did not have any experience at all in hedge fund investing, so the thinking at that time was to start with a gatekeeper to make a number of decisions for us. The reasoning for this was because we were not familiar with the hedge fund industry at the time, we didn't know which strategies or regions would be optimum for our scheme.

We decided to look for a fund of funds to make that decision for us. We ended up investing in two global multi-strategy multi-manager

Yvonne Chan, Hospital Authority Provident Fund Scheme

funds of funds. Institutional investors are very different from high-net-worth investors, especially the institutional investor community in Hong Kong. In Hong Kong, we are all starting quite slow. A lot of the schemes in Hong Kong, or Asia in general, are not very big in size, so very few can really diversify too much if they want to pick hedge funds on their own.

This is the reason funds of funds offer a very good platform for investors with profiles like ours. We cannot justify a team of our own doing due diligence on the underlying managers. I know we are paying quite a high fee for the gatekeeper, rather than investing directly, but I think that's a good starting point.

Our fund is $3.5 billion, but when we started investing in hedge funds, the fund size was only about $2 billion. Now, if you want to build up a reasonable team to look at underlying managers and monitor them, I have not worked out the dollar amounts that we need to spend, but probably, at that stage, we would not be able to make a justified call to pay our own team.

Niki Natarajan, *InvestHedge*
As a first time investor in hedge funds, what were the characteristics of hedge funds that appealed to you, and where did your hedge fund allocation come from?

Yvonne Chan, Hospital Authority Provident Fund Scheme
I guess different end investors have different objectives for their own liability profile, but for us, our main purpose is to control the risk so we are not really looking for a return enhancement.

We took the hedge fund allocation out of our fixed-income portfolio, so we are not going to compare our hedge fund investment against equity investment, which is a barometer of how well the economy has grown in the region or worldwide.

Niki Natarajan, *InvestHedge*
What is the consulting community like in Asia, a help or hindrance in selecting hedge fund managers?

Yvonne Chan, Hospital Authority Provident Fund Scheme
When we first thought of investing in hedge funds, we asked consultants to help us with the asset allocation. As in most parts of the world, the local consultants have a lot of influence, but clients still retain their say, particularly if they feel strongly about something.

Niki Natarajan, *InvestHedge*
Would there ever be a circumstance whereby you might invest directly?

Yvonne Chan, Hospital Authority Provident Fund Scheme
Yes in theory. If our fund continues to grow in size, I think at some stage it will be more economical. It would make sense to have our own team doing the due diligence but that, again, takes time to build up. I am not sure how big the team would need to be, but we would need

Niki Natarajan, *InvestHedge*

to hire more people. The other question to ask is where would these people come from? We would need to pay them very well for their skills, which they could use at a fund of funds or investment bank for a bigger salary.

Mark Cutis, Shinsei Bank
This is an interesting conundrum. I think to do it on your own successfully you should focus on Asia where you are close to the market, as opposed to the world at large. So, from our perspective, we want to work with people who have a regional specialisation because we realised that we cannot really follow everyone.

As we are based in Japan, we could probably monitor and assess managers in the region, but managers in the US or Europe becomes a more difficult task. The fee issue is obviously on everyone's mind and rightly so. If you think about the dynamics of the 2% management fee and the 20% performance fee for the underlying hedge funds, on top of the 1% and 10% for funds of funds, you can get some strange outcomes.

Assume a risk free rate of 5% and a fund that generates a 10% return after a 2% and 20% fee structure; you end up with Libor + 100 basis points. In the end, the investor has to look carefully and ask: "I'm doing all this due diligence and all this staying up at night thinking about what could go wrong for Libor +100 basis points? What am I doing here?"

Niki Natarajan, *InvestHedge*
We have touched on the fact that many of the institutional investors in Asia are smaller and

Mark Cutis, Shinsei Bank

Sarah Allen, Liberty Ermitage

are therefore taking the fund of funds route, but I was hoping that Mark would talk a little bit about FRM's relationship with Sumitomo, which is emerging as a product provider in its own right in Japan.

Mark Reinisch, Financial Risk Management
Japan is a very interesting market. I was portfolio manager in the late 1980s and saw that market hit 39,000. Then they had an extraordinarily long bear market, coupled with zero percent interest rates for an extended period. And because investors could not get returns from the traditional domestic asset classes, this explains why Japanese institutional investors, insurance companies and pension funds started looking earlier than others in the region for an alternative way of getting returns.

Our experience with Sumitomo Trust Bank (STB) is more than six years of creating broadly diversified funds of funds products to be able to offer pension fund-orientated product as opposed to private client-style products. This has meant a solid cash-plus-return profile that has low volatility and is uncorrelated to traditional assets. Within the funds of funds that we build, we allocate to long/short managers including those in Asia. Our first forays were to Japanese long/short managers, but now also include other Asian managers.

I think the next level may be one of two things. Firstly, an evolution of what we do, for example, a client may want a portfolio of just long/short managers or just credit long/short managers. Or, secondly, as clients gain confidence with hedge funds, they can build up portfolios of managers directly, as Yvonne's team may do in time.

But working along side fund of fund investors, they can cover the due diligence on domestic managers, with guidance and assistance from us. So breaking up of the existing model could lead to the evolution of a model of more specialisms within hedge funds and give sophisticated investors the ability to invest in parallel.

Sarah Allen, Liberty Ermitage
I have been working in the Japanese market for years, and still find it interesting that the Japanese, given their risk profile we just talked about and their need for bond type returns, that they have they been relatively slow on the take-up of hedge fund investments?

Mark Reinisch, Financial Risk Management
I am probably not the best person to answer that as I am not on the ground in Japan, but our experience in the country has, as noted earlier, been on the positive side. Part of it may be the inherent slow moving conservative nature of the investment community.

Jon Easton, EN Asset Management
If you go back a couple of years, there would be a lot of institutional investors in Japan who would not know what a hedge fund was. There was a TV documentary, which was quite a send-off because everybody watched it. People

Jon Easton, EN Asset Management

Mark Reinisch, Financial Risk Management

talked about hedge funds and nothing else for the next two or three months. I think people in Japan have seen land prices fall every quarter for 12 straight years; equities have been a disaster, and just to put into perspective how bad the market got, we actually broke through a 40-year moving average in about 2002.

Things are so bad that in Japan, you could actually save for 40 years, an entire working lifespan, and still basically lose money in nominal terms. Against this background it is not surprising that people are reluctant even to go near the equity market or the more sophisticated markets.

Niki Natarajan, *InvestHedge*
Mark, you are a Tokyo-based investor. What is your view on this?

Mark Cutis, Shinsei Bank
I think what you say makes sense on one level. We have seen many investors looking for two things – principal protected investments coupled with returns of cash plus 50 basis points. These two factors point to extreme risk aversion and lack of sophistication. You can get the 50 bps only by taking some kind of extension risk, forgetting all the fees that are being made to the managers and the structurers. Fees generally exceed the economic returns that investors get in these types of arrangements.

What is interesting about the Japanese investor market is it is skewing relationships in other markets, such as correlation and volatility. The danger is that the Japanese investor base is buying these seemingly basic strategies where they are as usual implicitly selling options. What will happen is that the underlying gamma hedging relationships will break when you break out of the implicit ranges and then there will be pandemonium because no one is prepared for these barriers to be breached.

I think Japanese rates are going to start going up in mid-2006 and early 2007, and the effects will be catastrophic. Not only is the market not prepared, but you also do not have traders in the JGB market who remember high rates. You have gone from 8% in JGBs in 1990 all the way down to 50 basis points in May of 2003. Even a one-third retrenchment, which is customary, can easily take you to 3% 10-year yields. Nobody is prepared for that, least of all countries like the US that have enjoyed ample credit at favourable terms.

In understanding Japan, you have to realise Japan is comprised of two sectors. One is the Japan of Toyota or Kyocera where people are hyper-sophisticated, on the cutting edge of electronics and then you have the financial sector, which is let's say, somewhat basic in its thinking. This phenomenon is well documented and was a result of years of regulation and official guidance.

Niki Natarajan, *InvestHedge*
How does Shinsei Bank approach hedge fund investing?

Mark Cutis, Shinsei Bank
In 2004, we stayed away from making any investments principally as we observed every fund of funds hawking their wares with abandon. We were also lucky as we were in the process of reassigning internally responsibilities for these activities. We saw everyone in Tokyo running around selling hedge funds, and realistically when everyone is jumping on board, you should really pause and take a deep breath. We started investing again and we are growing our portfolios, which we are managing on a diversified basis.


Niki Natarajan, *InvestHedge*


Mark Cutis, Shinsei Bank

At the moment, we are coming to grips with this issue about beta versus alpha. We are investing via a fund of funds but also doing part of it ourselves. We believe we cannot operate everywhere but we need to have people that are our eyes and ears in the markets we cannot reach effectively. It means you need savvy partners who have credibility as they risk their own capital. That combination we will pay for.

Niki Natarajan, *InvestHedge*
So, do you have the size of team that will allow you to do adequate due diligence?

Mark Cutis, Shinsei Bank
Yes, but we use outside consultants. We have a large network of people around the world to help us. I think you cannot underestimate the importance of people in this business.

If you are a large fund or a large investor and you try to put $3 billion to work, it is quite a task if you want to maximise both alpha and beta. Actually, the bigger you get, the less likely it is that you can extract alpha from these kinds of strategies.

6 CONCLUSION: DO YOU NEED A LOCAL PRESENCE?

The attraction of Asia is clear, but many new entrants are still debating whether or not a local presence is necessary and, if yes, where?

Niki Natarajan, *InvestHedge*
We have had a pretty lively discussion so far on whether or not Asia's time is here for good, and it seems that around this table at least, the consensus is that it is. It is interesting to see that over time more and more assets are actually being managed in the region. And one of the only topics we have not covered yet is whether or not you need to have a local presence to participate in Asia and, if so, what type and where should it be based.

Many funds of hedge funds have already announced plans to open research offices next year, while others are starting with marketing operations in the region. Among these Gottex Fund Management, Tremont Capital Management and Swiss Capital have opened their first offices, while EIM and Permal have gone as far as opening their second office. Sarah, is Liberty Ermitage considering an office in Asia?

Sarah Allen, Liberty Ermitage
Yes, it is on our corporate plan to potentially open an office in Asia but, at the moment, the Japan fund of funds is run out of Europe. From a fund of funds perspective, we are looking to open our office in Asia because I think it does add value, specifically on the research side, and, of course, on the marketing front. But from an actual investment perspective, we are investing with managers globally, who trade in Asia and trade in Japan.

Assets: by location of manager (US$bn)

Region	Jun-03 (adj)	Dec-03 (adj)	Jun-04 (adj)	Dec-04 (adj)	Jun-05
Australia	2.46	5.4	8.63	11.02	19.78
UK	5.14	6.4	9.87	12.3	14.7
US	5.01	6.64	8.39	10.2	14.52
Japan	5.65	8.53	10.27	10.46	11.62
Hong Kong	3.06	5.18	7.95	10.1	11.27
Singapore	0.67	1.1	1.85	2.39	2.7
Other	0.71	1.19	1.13	1.43	1.25
TOTAL	22.7	34.44	48.09	57.9	75.83

Source: AsiaHedge

Niki Natarajan, *InvestHedge*
Does a hedge fund or fund of funds actually need to be based in Asia to successfully either pick managers or pick stocks?

Sarah Allen, Liberty Ermitage
Interestingly, we screened our databases and we found that Japan located fund managers have added a small percentage of value over the course of 2005 to date, which I know is a very short period of time, but I think it sort of backs up Jerry's point. I also think that as we get more Asian strategies evolving, such as value or event-driven strategies, or more distressed strategies, then it might be more important to have people on the ground for research. At the moment, the Asian markets have been very much dominated by long/short managers, which depending on the strategy, may be located elsewhere.

Mark Cutis, Shinsei Bank
I think it is crucial to be in the region, especially for the feel and understanding the diversity of countries and companies. We have invested in managers that have run Japan strategies from London, and we have invested in managers who have done it from the US and the West Coast, as long as these people spend a lot of time in Japan.

The reason they are outside, nine times out of 10, is for personal reasons. They will always say that being outside is good because it gets you out of the local mindset. I still think, however, it is very important if you are managing money in the region to understand what is happening there.

Jerry Wang, Vision Investment Management
We do not have a specific requirement, but in our portfolio we do have a guideline that 75% of our managers have to be physically based in the region. Some decisions are more strategy specific, particularly if your investments tend to be research intensive, small cap or distressed. At this point, we certainly have a very strong bias to managers who are physically based in Asia. But, if you are doing trading oriented, arbitrage type of strategies, it matters less.

Paul Storey, *AsiaHedge*
As editor of *AsiaHedge*, I am based outside the region for personal reasons. We have a solid editorial presence in the region too but, at the end of the day, I don't think it matters at all where you are based. Some of the best value managers I know are based in New York, which is about as far away as you can get from the Asia-Pacific region. In this regard, in terms of performance, I cannot see the benefit of being based in Asia. That said, I think it is great that we are starting to see an increase in the assets under management within the region, as you can see from the graphs (see p.26 and p.28).

Mark Reinisch, Financial Risk Management
We invest in managers who invest in Asia, but who are not located here, and we invest in managers who are located here. In other words, we have got experience of London and New York-based managers as well as Hong Kong-based managers for our Asian long/short products.

That said, we do have a client-facing office for Japan in Tokyo, which we have operated for some time as we have had Sumitomo as a client for some six years. We also do our

Jerry Wang, Vision Investment Management

research on Japan from the Tokyo office. We are actually considering a Hong Kong office to take our business to the next level in Asia.

We also have a presence in Australia, which is also client facing. As a fund of funds, you always think about the client part of the business as well as the research part. One of the questions we are asking at present and reviewing, as are other funds of funds, is whether it is appropriate to have a client-facing presence in Asia as well.

On the research side, I wonder whether if you dig below some of the larger funds to the specialists and to the small and mid-cap type funds, whether it is better to be on the ground, as opposed to being based somewhere externally. We do think there might be advantages for a fund of funds to have a research presence locally, if you also have a global network where you have interaction with other analysts who are covering the various strategies and sectors.

Jon Easton, EN Asset Management
Firstly, I think you are right that the majority of people who are not located in the region do it purely for personal reasons. In terms of the Japanese markets, it has become much more efficient compared to how it was three years ago when the market was less forgiving. You see volumes, the flow through the market and inefficiencies do not generally endure for three or six months as they did before; so I think there is a need for people to act more clearly. We took the decision that we did need a Japanese office, and that was an important decision because it is quite expensive.

Paul Storey, *AsiaHedge*

In terms of our break-even point, I think establishing a Japanese office probably doubled it. Whereas before we probably had a break-even of about $80 million of assets under management, now the break-even is about $150 million, so it is not a cheap thing to do. Also, Japan is not necessarily the easiest place in which to locate, but I think it is a lot easier than people say. Although the regulatory environment is pretty complicated, the plus side is that is not that difficult to get decent real estate. The real problem is actually in getting decent staff.

Mark Cutis, Shinsei Bank
The issue of cost is certainly an important factor. Now, I would argue that from the numbers I have seen from going back and forth to London, that London is much more expensive than Tokyo for opening up an office.

Jon Easton, EN Asset Management
That is definitely the case. In London, we are based in the city, which is significantly cheaper than the West End. I think it is something like a 40% discount compared with space in the West End. But comparing City of London rates to Tokyo, in Tokyo we have an office which is significantly cheaper, maybe a couple of kilometres outside the central business centre, but it is a modern skyscraper that was completed in November.

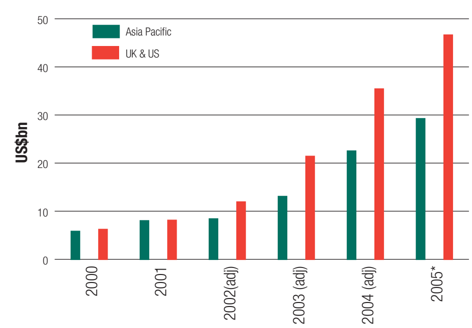
In Tokyo, we have a floor, which we can partition and give smaller units to others; so in a way you can get additional income. In Tokyo we find that not only is it cheaper, but more flexible. Typically, in London, you have to sign up for a five-year lease, while in Tokyo, we have a two-year flexible lease, and leases almost down to six months notice are quite commonplace, which is a huge issue for start-up hedge funds. In terms of regulation, I think I am correct in saying that the legal work for our Japanese investment licence cost us 1.3 million yen.

Niki Natarajan, *InvestHedge*
Yvonne, when you hired the two foreign funds of funds, was having a local office important to you?

Yvonne Chan, Hospital Authority Provident Fund Scheme
In terms of client servicing and marketing, we do not care where the people are based. Research is a matter that the fund manager will have to decide on their own. Our point is that if they have a client servicing office in Hong Kong, often if we ask them any detailed questions they are still going to get back to head office to get the answer anyway. So the turnaround time is the same, and it would be just as easy for us to send an email to New York or London without going through Hong Kong.

Doug Barnett, Quest Management
We are based in Thailand, and we could not really be based anywhere else because we have a very concentrated portfolio and we have board seats on three of our portfolio companies. Also, we want to be influential with management and we talk to them and see them all the time. Ours is really a quasi-

Location: Asia vs UK and US



Source: AsiaHedge *end-June 2005

Stuart Leckie, The Hong Kong Retirement Schemes Association

private equity approach and we would be on the plane an awful lot if we were based somewhere else.

Paul Storey, *AsiaHedge*
Drawing on the example of Australia, where it is comparatively cheap to run a hedge fund operation, there is also the fact that it is difficult to get to. And not many investors, until recently, wanted to go all the way to Sydney or Melbourne. It is difficult if you are located somewhere like that to get the investors to come out to do due diligence and to give you the money. That is actually where the problem lies, and not with performance. In the earlier part of the decade, especially if you had been based in New York or London and investing in Asia-Pacific, you had much more potential to be bigger than a hedge fund based within the region. That is still a little bit of a problem these days, but much less so than it used to be.

Niki Natarajan, *InvestHedge*
What is certain from the discussion we have had today is surely that Asia's story is currently unfolding and it is a long-term project, which is good for firms trying to plan their strategies. For the most part, the investors in hedge funds in the region are still investing a small amount, largely via the fund of funds route, and ironically via foreign-based firms.

Stuart Leckie, The Hong Kong Retirement Schemes Association
On the subject of whether or not you should have an office in Asia, I personally believe that the question should not be "should you have an office in Asia?" but rather "whether your second office should be in Singapore or Tokyo?", after your first office in Hong Kong.

Niki Natarajan, *InvestHedge*
And in an attempt to try to answer this question of having a base in the region, clearly if Stuart's view represents the local mind, then at least one office in Hong Kong will be seen as a good first step to making a long-term commitment to the region. The need is perhaps larger for managers that require access to on-the-ground information for the purposes of research.

As Yvonne mentioned, unless the office has a serious figurehead that can make their own decisions, a marketing office at the institutional level is less important as clients in the region are already comfortable investing with overseas managers. Now with email, many of their concerns and questions can be answered almost instantly.

What I hope we have been able to do today is separate some of the myths from the realities of Asia, both for ourselves and also for anyone reading this to look for guidance about whether or not to tackle the Asian market. The one thing that we all seem to be unanimous about is that Asia's time is here to stay, although how smooth the ride will be is part of the fun of the journey.

Niki Natarajan, *InvestHedge*

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roundtable discussion

The quest for alpha in Asia

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