September 1, 2005

NZARA Press Release 2 – For New Zealand Media

Chairman – Andrew Freeman-Greene (Managing Director, FGI Asset Management Limited)
Deputy Chairman – Anthony Limbrick (Chief Executive Officer, Pure Capital Limited)
Secretary – Richard Hollington (Managing Director, 36 South Investment Managers)

The New Zealand Absolute Return Association was established in a meeting of Alternative Asset Managers at Clearwater Resort on the 30th of July. Commonly referred to as "hedge funds" these are money managers that operate in the global capital markets seeking out trading profits. The managers generally operate fairly actively to exploit market inefficiencies and earn the tag "alternative" because of their diverse structure and the fact that they are not traditional passive "buy and hold" investors. NZARA's brief is to operate in the interest of, and for the benefit of, Alternative Manager's yet membership will be broad based including individuals, fund of funds (ie people that allocate to Alternative Asset Managers), and service providers (eg domestic and international law firms, accounting firms).

Customers for these fund managers tend to be large saving institutions and high net worth individuals that are attracted to potentially higher returns that are not correlated to more passive investment strategies. This has been a huge growth area globally. Andrew Freeman-Greene, the Chairman elect for NZARA, is keen to see New Zealand become a destination of choice for industry participants albeit it that may take some time and doing -

"New Zealand has never fancied itself as being able to compete well in the international fund management space. Yet when our talent goes abroad they seem to do extremely well in the international financial arena. Many can not return because there simply are no jobs here that capitalise on their expertise. Many with young families would love to return, and many that do end up semi retired, or worse still, in politics!"

There are some major changes taking place in the funds management world and the growth of hedge funds reflects this. Traditional money management is becoming more commoditised because the main theory behind it is that markets are efficient and so buy and hold is the optimal choice. That business has become one driven by efficiency and scale and ever reducing fees given there is not a high level of skill in "being or matching an index". Hedge Funds represent the antithesis to this offering investors the chance to profit from market inefficiencies. Modern fund management then is evolving to allow cheap access to "buy and hold" traditional managers, but now offers a whole host of choices in building a portfolio of active managers with different styles and strategies. It is an extremely dynamic environment that inevitably drives markets towards greater efficiencies as capital flows to more profitable trading areas. Andrew challenges the assumption that markets are efficient –

"I have no problem with traditional investments, the merits of owning shares and bonds. However history has shown they do get cheap and expensive and there are times to be more wary than others. The idea in buy and hold and efficient market theory is not an absolute but a matter of degree. Worse still the entire theory is based on the ultimate contradiction that to be efficient people need to act to make them so. If the whole world buys and holds who is going to do that?"

People in New Zealand simply do not realise the global scale of the industry. For example Andrew points out the CEO's of the top 20 US Companies earned average compensation of US 10mln last year whereas the equivalent top twenty hedge fund managers earned US 250mln each. It is no wonder that traders have been pouring out of investment banks and traditional money management firms to chase this sort of remuneration.

Hedge Funds have a reputation as being extremely risky and dangerous with regulatory and media focus on the destruction that can be wrought by the instruments they trade, frequently heavy in derivatives. People think of Nick Leeson bringing down Baring Bank or the implosion of John Meriwether's Long Term Capital that forced the US Federal Reserve to react and help orchestrate a rescue package. It really is a space that requires specialist knowledge to understand the various strategies, the amount of leverage (or risk taken), and how different managers or strategies inter relate.

Nonetheless this is rapidly becoming the face of modern money management and the improving means of ranking, benchmarking, and reporting on these groups is a sign of the industry slowly maturing. It should be recalled that there is a lot of similarity between fears about hedge funds today and those about owning shares when they emerged as an asset class. That is why the term Alternative Asset Managers has caught on, reflecting the industries desire to shake off the public perception of hedge funds being excessively risky.

Trading for a living is one of the worlds oldest industries yet this relatively new structure for trading is rapidly allowing access to people who previously would not have had access. Experts are emerging that are skilled in building portfolios of these managers and these products are being bundled and sold to retail investors. In New Zealand this has been a very popular investment and form of diversification.

Still despite selling offshore managers into New Zealand the development of managers on the ground here has been almost non existent until recently. Andrew says

"Most clients – in general – are professional offshore investors who are not too caught up with "location" but are concerned about global competitiveness. It is a tough business with high rates of attrition, especially for young and small firms. It is quite neat that a manager can be sitting in New Zealand, trading the international capital markets, with money raised from New York and London. That was unthinkable a few decades ago."

Andrew sees the regulatory and structural environment as a major impediment to growth of the industry here. The purpose of the NZARA is to try to improve the situation –

"New Zealand has never asked itself – do we want these types of fund managers here? We want that issue to be addressed because the default setting which we have is a clear "NO". Australia has a regime that encourages the industry growth and they have a vibrant and growing industry because they have recognised the benefits to developing an industry with capital market expertise. Andrew says -

"The question "should we encourage this" is, in my mind, a no brainer. It creates expertise in capital markets, it creates wealth, it creates clusters of excellence, and it creates a platform to keep and attract some of our brightest talent. The New Zealand Superannuation Fund is an exciting development that will help foster the funds management industry in New Zealand. They are going to become an enormous allocator with a sizeable allocation to Alternative Asset Managers – why can't some of them be home grown where the manager can be more easily monitored and fostered? Tie this together with the maturing Asian markets and China's emergence on the world stage and the case for expansion seems indisputable. Lets do it ourselves in New Zealand."

So NZARA also wants to change the perception and improve the profile of Alternative Managers. It is too easy to dismiss the first entrants in this space in New Zealand as maverics and small. The degree of professionals and level of experience is actually quite impressive.

"The first thing we are trying to achieve is to make the regulations less onerous than they are. New Zealand doesn't have the infrastructure or the critical mass to build a cost effective regulatory environment for hedge funds. We need to make use of those in place in Australia or, more appropriately America. It does not work if the default setting forces Alternative Asset Managers to become introductory brokers of the NZX as the current law stands. We should not be overly penalised in this area versus managers located in Australian or American – both in terms of cost and compliance.

There are also some synergies amongst ourselves that the Association benefits from. We do not view each other as competitors. One problem in getting investors is that we are too far away with too few managers. If more managers emerge then it will become worthwhile for some of the worlds large fund management firms (that allocate money to this area) to visit.

We also want to be involved in discussions about whether there is a regime that would encourage managers to locate here. It should not be lost on people how much of Ireland's move from one of the lowest per capita incomes in Europe to the highest was driven by policies designed specifically to develop incentives to grow as a financial centre. We would like to be involved in developing a sensible platform for growth. It is a situation where we think everyone's interests should be aligned."