

GlobeOp CEO Hufschmid highlights hedge fund industry trends – Milken Institute Global Conference

LONDON, NEW YORK – 14 MAY 2010 – Investor due diligence, managed accounts, the role of large hedge funds, and return expectations were industry trends highlighted by Hans Hufschmid, CEO, GlobeOp Financial Services (LSE:GO.) at the Milken Institute Global Conference held recently in Los Angeles, CA.

Hufschmid's panel – which also included executives from Albourne America, Coventry, The Ewing Marion Kauffman Foundation, The J. Paul Getty Trust and Skybridge Capital – debated the evolving world of alternative investments. The panel's video and Global Dispatch summary can be accessed on the Milken Institute Global Conference website.

Highlights of Hufschmid's comments include:

Due diligence

- As a hedge fund administrator, part of an investor's due diligence on a fund is done with us. We saw a 30% increase in due diligence meetings in 2009 versus 2008.
- When you invest in a hedge fund you invest in a small business, so you've got to trust your manager. But the focus today really is on "Trust but verify." That is the big difference.
- Credit exposure became a major issue post-Lehman Brothers. That event meant hedge funds could not only lose money through markets, or a fraudulent manager, but also by having exposure to bad credit. Clearly investors are now focusing on who the fund is doing business with, what that counterparty credit exposure is, and how it's managed.

Managed Accounts

- When you invest there is a great deal of operational due diligence required up front, in addition to analyzing the trading strategy and its merits.
- Until Madoff brought this to the fore in 2008, investors typically asked how returns were performing and whether strategies were adhered to. Then the key question became, "Are the assets actually there?" That is very important – everything else is moot if assets disappear through fraud.
- If you invest via managed accounts you own the assets and account, but someone else has the power of attorney to deal on your behalf. That sounds good but why doesn't everyone do it? ...In reality it's not that simple to execute. Because investors own the account, they must negotiate all the agreements to allow the manager to trade derivatives and finance the portfolio. It's a very tedious process and most investors can't do the operational work required, which includes reconciling cash, positions and trades, as well as measuring risk.
- We see many large institutional investors working seriously to convert their fund investments to managed accounts. And 1.5 years after Madoff they're still not up and running – that shows the complexities involved.

- For managers it's also additional work to proportionally allocate trades to a separate account as well as to the main fund.

The important role of large hedge funds

- Smaller hedge funds are generally more nimble. Research suggests that in their first three years, hedge funds actually outperform – or at least these tend to be their best three years in business. However, if that's really the premise of investing in hedge funds, we don't have an industry. A large institution doesn't have the infrastructure or the time to invest \$20 million per fund in 100 different funds.
- There are large hedge funds that are successful. The markets are efficient enough that if you grow big and you don't perform, you grow small pretty quickly.
- Large funds probably have a competitive advantage in risk management, in infrastructure and in the investor base they service.
- We need them for our industry to function.

Hedge fund returns in a de-levered environment

- I object to a fund saying it will produce 8 or 10% returns, because that is a function of what the equity markets are doing and where interest rates are.
- When hedge funds started in the '80s and early '90s, the primary investors were wealthy individuals, who invested because the leading funds generated 30% returns. But it was 30% because the equity market at the time generated 20% returns.
- Now we've had a decade of zero growth in the equity market and I would expect hedge funds to outperform the risk-free rate by 3-6%. So a 5-8% return has become an acceptable return for a hedge fund.

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Notes to Editors

About GlobeOp Financial Services

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