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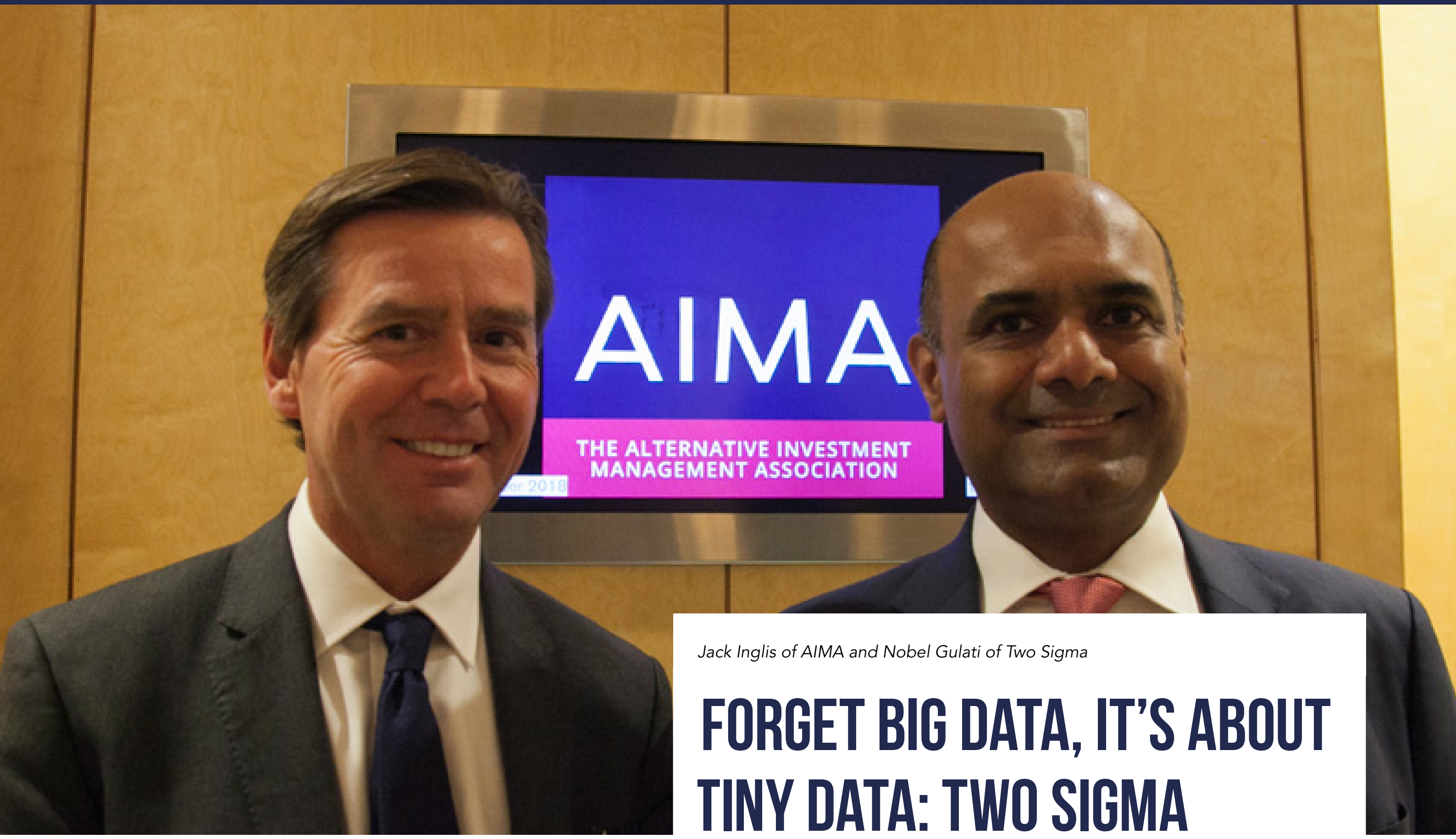

Jack Inglis of AIMA and Nobel Gulati of Two Sigma

FORGET BIG DATA, IT'S ABOUT TINY DATA: TWO SIGMA

The AIMA Australia Annual Forum 2018 held in Sydney on 12 September once again proved that its *'by the industry for the industry'* model packs a punch in gleaning exceptionally rare and candid views of the world's most renowned hedge funds and emerging leaders.

Nobel Gulati, the CEO of mega fund Two Sigma and one of our best Aussie exports, Shane Finemore, founder of the more fundamental Manikay Partners, headlined the full day event for the 400 industry participants in attendance. AIMA's global and Australian leaders, Jack Inglis and Paul Chadwick respectively quizzed the two New York based industry champions revealing just how fast hedge fund investing is maturing and how they are keeping pace. Their different perspectives set a rich backdrop for lively discussion and constructive debate about which trends, skills, technologies and strategies are here to stay and how they are expected to reshape the future of alternative funds investment.

By WOUTER KLIJN

Systematic investment manager Two Sigma is known for generating phenomenal returns using complex algorithms shifting through no less than 10,000 different datasets.

But Nobel Gulati, Chief Executive Officer of Two Sigma Advisers, which incorporates Two Sigma's asset management division, says that Big Data is not the right term to use for these datasets.

'We talk about Big Data, but Big Data is a misnomer. It is actually a notion of little data, tiny data with an enormous amount of noise,' Gulati said at the AIMA Australia Forum in a rare and candid discussion with AIMA chief executive Jack Inglis.

'This distinction is important because it takes away the notion that systematic managers, such as Two Sigma, simply let computers analyse vast amounts of data and trade without the intervention of people.

'It is not that you can unleash a vast amount of computer power to a vast amount of data through an algorithm. That would actually be quite dangerous," he said. "The human context matters: it is about channeling the intuition, the context and the understanding of the markets into more scalable actions. That is where technology comes in," he said.

Although Two Sigma is a technology company first and an investment firm second, Gulati argued that the investment process itself is not unlike that of other managers and asset allocators.

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IF YOU FAST-FORWARD OVER TIME AND BELIEVE THAT MORE OF THE DATA WILL GET COMMODITISED, THEN HAVING THE RIGHT DIFFERENTIATED ENGINEERING CAPABILITY WILL BECOME IMPORTANT

Nobel Gulati interviewed by Jack Inglis

"The investment process, no matter what you invest in, is essentially very similar and comes down to three phases, broadly speaking," he said. "You are forecasting the return and risk of securities or assets and then you are building what you consider to be the optimal portfolio: balancing your objectives, constraints and risk that the portfolio will be exposed to. And finally you are trying to implement that as efficiently as you can. For us, those three phases exist [too].

"What has changed fundamentally in all of these [phases] is the abundance of data and the fact that each unit of information is just not worth that much for a small period of time," he said.

Gulati compared today's process with the work a fund manager would have carried out a few decades ago, when supply lines, corporate structures and stock markets were relatively simple.

"If you were a fundamental analyst and you were analysing General Motors, for example, life was actually pretty simple," Gulati said.

"GM was a vertically integrated company; it was not that global. You could actually watch the factory and see raw materials going in one side and cars coming out on the other end. It was sort of easy to get your arms around what that company did.

"And when you visited management and you came back, you had weeks to build a model and glean an insight which had enough signal in it for a long period of time that you could actually make a useful decision.

"If you look at the world today, GM probably has thousands of different suppliers, who are interconnected globally. It is impossible to analyse one company without understanding the whole ecosystem.

"The sheer amount of information that is available for everything is just moving so fast," he said.

Gulati believes that this explosion of data is only going to accelerate, especially with the wider adoption of the Internet of Things. This means more emphasis will be placed on the structuring of datasets and the engineering of the data integration.

"When you think about data there are three aspects to it: there is the sourcing of unique datasets, in particular the unstructured data sets. Buying something from a vendor is fine, everybody can do that, but most of that data is unstructured. About 90 per cent of the world's data is unstructured. It is not neatly presented to you to be consumed.

"The engineering to integrate that data is enormous, because data comes in all shapes and sizes, for example, the velocity of data matters.

"Then you have the interpretation of the data. In the early days, sourcing the data was the differentiator. You sort of needed engineering to be able to do that, but the engineering didn't matter as much because having the data was powerful enough.

"If you fast-forward over time and believe that more of the data will get commoditised, then having the right differentiated engineering capability will become important. The balance of power will shift to the interpretation ability," he said.

The human brain is the real black box; you don't really know what goes on in there

Despite the increasing use of technology by all asset managers, systematic managers such as Two Sigma are often accused of running black box strategies, where it is hard to see what is going on.

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But Gulati argues that fund managers which rely heavily on a star manager is far more risky. "The human brain is the real black box; you don't really know what goes on in there. But everything we do is documented and audited."

Yet, he admitted that Two Sigma wasn't always as transparent as it is now. Although the firm currently has US$ 55 billion in funds under management, it didn't get there in a straight line, he said.

"It is perhaps not as well known that in the [from] 2007, we lost 40 per cent of our assets. That is not because we lost any money, because we made money in 2007 and we made money in 2008. We were making money every year.

"But we were not transparent, our fees were high and we were so focused on alpha that we sort of ignored our investors. So the kind of investors we attracted in the early days of the company were return chasers.

"We paid the price for that in having many investors disappear on us and that was when we scratched our heads and asked: 'How do we get real institutional investors?'

"So we changed everything except for the alpha factory to become more of an institutional manager," he said.

Gulati argued that Two Sigma wasn't alone in ignoring the end beneficiary of investment strategies and he hoped that the increasing use of technology would help in redirecting the focus back on asset owners' needs.

"If you think about the asset management industry overall, we've done a pretty lousy job of putting the client at the centre. This industry has been designed by asset managers for asset managers, legitimised by consultants. We've created hundreds of categories and thousands of products, that frankly have no reason for being and don't ask what the allocator wants.

"I hope that technology will be the leveler of the playing field," he said.

FUTURE LEADERS STEAL THE SHOW WITH NEW STUDENT HEDGE FUND

ASAM participants Henry Chen, Advait Joshi, Salman Aamer, Doron Haifer

Australia's newest hedge fund, Australian Students Asset Management (ASAM), is Australia's first university student run hedge fund.

Launched at the AIMA Australia Annual Forum and wholly supported by AIMA, ASAM is the vision of University of NSW student Doron Haifer who, with AIMA Australia General Manager Michael Gallagher and student support, has created an investable student run hedge fund.

The fund, a public ancillary fund registered with the Australian Charities and Not-for-Profits Commission and open to industry donations, will launch with an initial strategy to generate CPI+4% returns from ASX300 stocks with an ESG focus.

Gallagher says that while the fund is set up for performance, its overarching objective is to provide students with a realistic and immersive funds management experience that helps to attract, nurture and build human capital for the industry.

"Many of us older industry folks hail from broker firms, investment banks or other disciplines because there was simply no clear path to forge a career in hedge funds out of university," he said.

"Further, our industry has endured many pain points, so it's been hard for hedge fund firms to build a footprint into universities, meet those smart students and allow them to demonstrate their aptitude and talent as potential future leaders in alternative investing.

"ASAM allows students to finish degrees as well-rounded industry participants who are able to hit the ground running in roles across the whole spectrum of investment management, as well as allow funds to compete for top talent that is being drawn into tech titans such as Google and Apple.

"It has been very encouraging to see the mix of students keenly participating throughout the front, middle and back offices including investor relations."

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Gallagher says the fund will operate in UNSW in close alignment with Sydney University, UTS and Macquarie, and then expand to Melbourne allowing for student cycle turnover.

Doron Haifer, having already established the Alternative Investment Society of UNSW, has led the fund's establishment with Gallagher, shoring up resources and mentors to support all aspects of investment management, from idea inception to execution, trading, risk management, settlement and middle and back office functions such as dealing with administrators, auditors and legal advisers.

Haifer says the fund will invest long and short in the ASX 300 with an ESG filter designed by ASAM that scores companies from 0-10 eliminating companies below five.

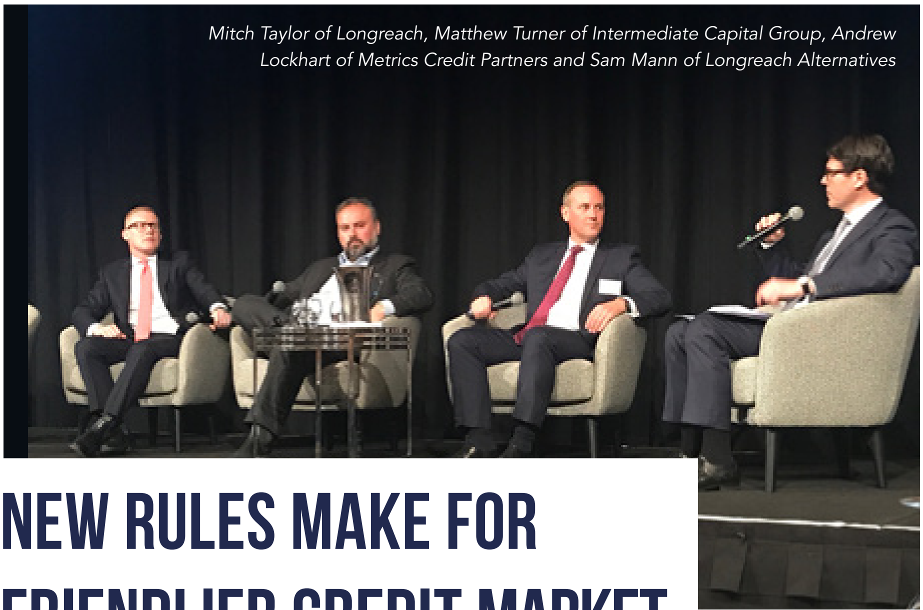
"The ESG focus is something students really wanted, and while it is the strategy for now, the fund can shift its strategic focus to whatever the demand is of the students of the time.

"We're aiming to achieve approximately 15-20 positions, to allow for some diversification while also giving us enough time to put in decent research into our investment ideas."

Gallagher is urging industry participants to consider becoming involved with ASAM as it grows its footprint within universities, as mentors, members of ASAM's advisory committees and board of directors.

"ASAM is a great initiative for students that provides a critical platform for the alternative investment funds sector to engage with future leaders."

ASAM was unveiled to industry at the AIMA Australia Annual Forum last week. The registered name of the fund, pending name change, is the Student Impact Investment Fund. For industry participants interested in supporting the fund, please see the fund's website: https://australianstudentsam.org/ or Linked In page: https://www.linkedin.com/company/student-impact-investment-fund/ or contact Michael Gallagher.



Mitch Taylor of Longreach, Matthew Turner of Intermediate Capital Group, Andrew Lockhart of Metrics Credit Partners and Sam Mann of Longreach Alternatives

NEW RULES MAKE FOR FRIENDLIER CREDIT MARKET

By JOHN KAVANAGH

Under a reform to the Corporations Act that took effect on July 1, the ability of counterparties to terminate contracts with companies entering insolvency, using so-called "ipso facto" clauses, has been restricted. The aim of the reform is to make it easier for distressed business to be restructured and keep operating.

The ipso facto reform is one of a number of changes to the regulatory landscape making Australia a friendlier environment for non-bank commercial lenders and credit investors, according to credit market participants.

Mitch Taylor, the head of credit at Longreach Credit Investors says another important reform is the introduction of insolvent trading safe harbor rules last September, which give directors an exception from liability where they are developing a course of action which would lead to a better outcome for their company than administration or liquidation.

Taylor says: "Companies were going into insolvency too early because directors had personal liability for trading while insolvent. What these reforms do is deepen the pool of robust borrowers and make this a better jurisdiction for credit."

Another speaker at the forum, Matthew Turner, the head of Australia senior debt at Intermediate Capital Group, says the other area of regulatory change that is driving the credit market is tighter capital requirements for banks.

"Higher capital levels for business and corporate loans are a permanent feature of the banking market. Bank risk appetite is not going back to what it was," Turner says.

Andrew Lockhart, the managing partner of Metrics Credit Partners, says banks have been reducing their exposure to a number of areas, such as commercial real estate and development finance.

"As a result, we can take less risk on the loans we do and earn a higher margin," he says.

Lockhart says changes to the regulatory environment give creditors greater scope to negotiate with a distressed borrower. "In some cases an adverse credit event can lead to gains. You can negotiate to get some upside, even if the loan has deteriorated. As an unregulated lender, you can take a different view from a bank."

Turner agrees, saying banks often destroy value for investors by selling debt at heavy discounts.

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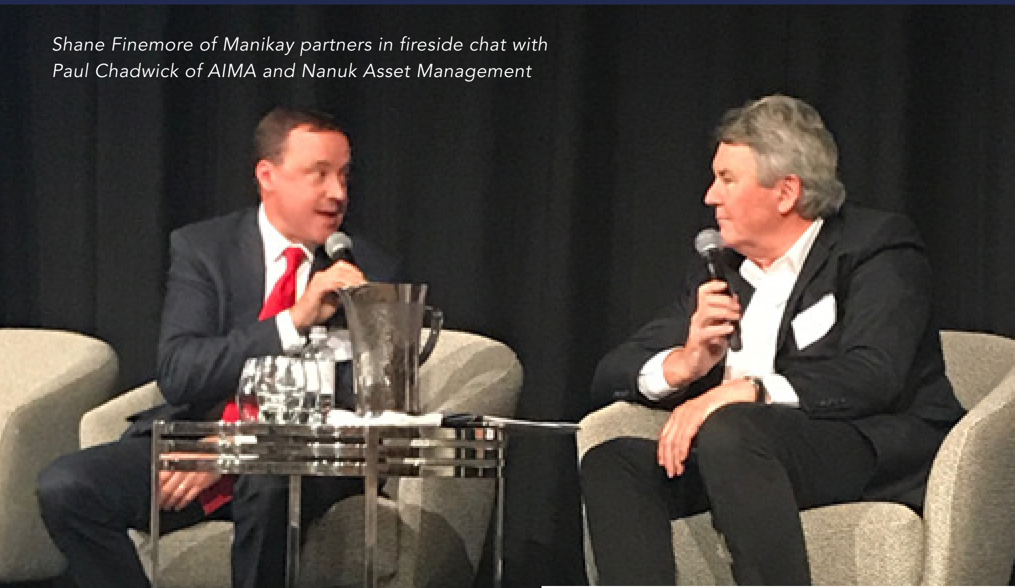


Shane Finemore of Manikay partners in fireside chat with Paul Chadwick of AIMA and Nanuk Asset Management

FINEMORE'S LESSONS FROM THE TRACK, AND TRUCKS

By GREG BRIGHT

Aided by "complexity and fear", the family office-style fund manager Manikay Partners has bought into the privatisation of the Tel Aviv Stock Exchange. It's the best sort of business, like a royalty stream, says Shane Finemore, from the famous trucking family company.

Shane Finemore, the managing partner and CIO of Manikay, which invests about US$160 million of the family's money and more than $3 billion in total, told the AIMA Australia Forum in Sydney on September 12 that growing up in a trucking business family taught him many lessons about business. Business was what was discussed all the time around the dinner table at the family home in Wagga Wagga, the discussion usually led by his father Ron Finemore.

"Trucking businesses are very tough," he said. "They are capital intensive with low margins." He also learnt a lot from the race track. The race track was a good place to learn about investing because it was "all about price".

Interviewed by Paul Chadwick, the retiring chair of AIMA Australia who has been elected to the organisation's global board, Shane Finemore, said the very best businesses provided royalty streams. Stock exchanges had high returns and also provided network effects. With the Tel Aviv exchange demutualisation, Manikay bought 19.9 per cent and organised another 50 per cent for its clients. The clients were offered the deal first. "We could have sold it 50 times over," he said.

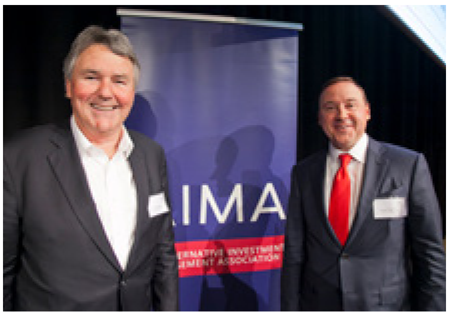
Finemore joined the broking firm of Hattersley and Maxwell after leaving school and then joined the old DBSM, which became UBS. He started going to the US in the 1990s for business and saw that, while Australia was a great place for business, America was 20 times the size. "You should go where the money is," he said.

Manikay, which he founded in 2008 with Russell Aboud, who has been his business partner for about 30 years, is a highly concentrated value manager, investing in between eight and 12 stocks.

> **"WE FIND A VERY SMALL NUMBER OF MISPRICED OPPORTUNITIES THAT WE CAN UNDERSTAND. WE MAY MAKE ONLY ONE OR TWO DECISIONS A YEAR.**

"We find a very small number of mispriced opportunities that we can understand. We may make only one or two decisions a year. How many times can you have an insight? Why would you want to put more money in your 11th best idea? Complexity is our friend. Complexity and fear."

Manikay has 20 staff in three offices – New York, Sydney and London – and nine partners. Finemore said that while the period from about 2001 to 2006 represented the heyday for investment banking, he got sick of the large institutional environment. David Lowy and Goldman Sachs helped him start Manikay. With a small firm you can set the culture, he said, and decide the firm's core values. "We have a long-term philosophy and that's a cultural thing that we bring to the table."



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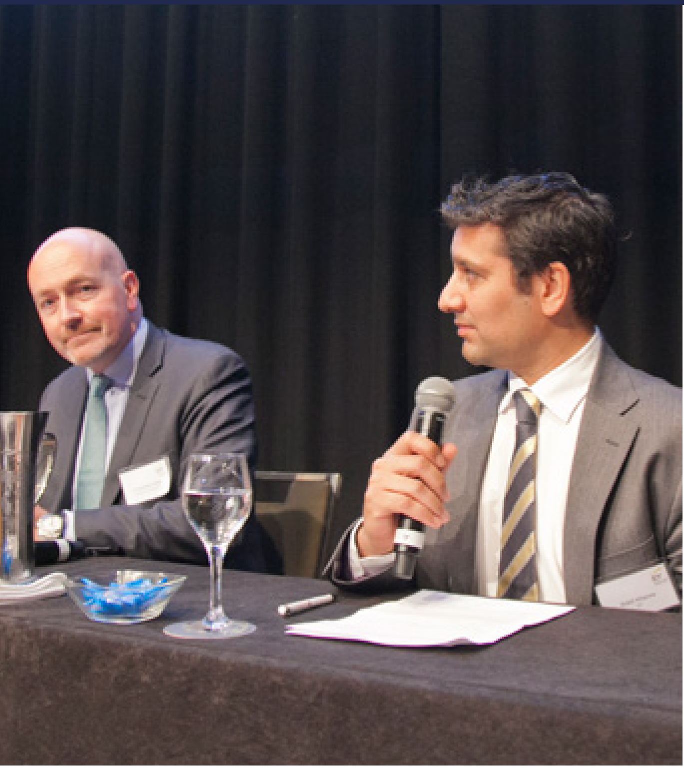
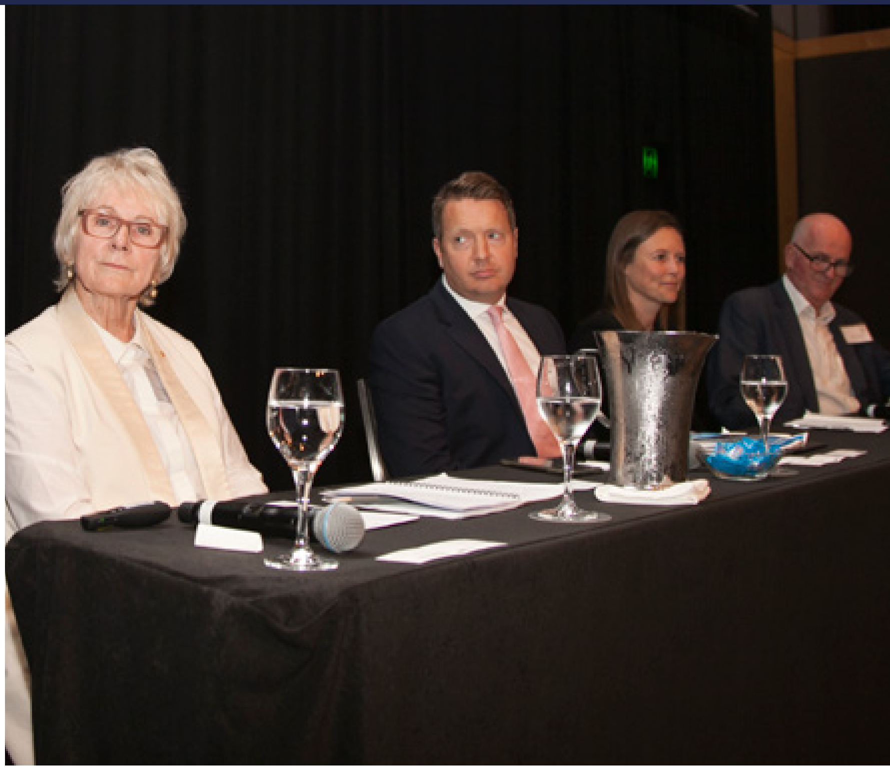


Chris Addy of Castle Hall and Rohit Khanna of EY



Melda Donnelly of Coolabah Capital, Michael Shepherd of Allen & Overy, Carla Liedtke of Control Risks and Andrew Main, MC, Writer and Media Trainer

EXPANDING WORLD OF OPERATIONAL DUE DILIGENCE

By GREG BRIGHT

Operational due diligence (ODD) has come a long way over the past few years, moving beyond the realm of alternatives managers and the domain of only the largest super funds which can afford to pay for the service.

But there is still some controversy surrounding the AIST's scheme which gets managers to pay for ODD reviews. Chris Addy, the managing director of global specialist Castle Hall, said that ODD encompassed multi-asset classes and various types of risks, including liquidity risks, when depended on the manager's strategy, and risks in the management of the firm.

Rohit Khanna, a financial services partner at EY, said the AIST initiative meant that smaller industry funds could now move to "the next level" with ODD. However Addy countered with his observation that Australia was the only market in the world where managers paid for the service rather than the asset owners.

"The elephant in the room is the potential conflict of interest," he said. "If I'm buying a house I don't get a property inspector who's selected by the vendor." But he added that anything which moved the process ahead was a good thing. ODD was an ongoing process.

Michael Elsworth, an executive manager of investment consulting at Lonsec, said that an important question was how you use the transparency which was available because of developments in data collection and usage. His research firm was taking more of a quantitative approach with its ODD.

The ODD session was part of a breakout stream on operations and regulations.

CRISIS MANAGEMENT

Another popular session was on crisis management, at which Melda Donnelly, a director of Coolabah Capital and a former managing director of QIC and a director of UniSuper, said that people might find themselves in a situation where they had never been before and not trained for.

One of the most important things was managing upwards, she said. "We need to know what we don't know," she said. "What is it we are really trying to keep. The most basic thing is trust."

She said that the firm's message should be as honest as it could be and as factual as it could be without jeopardising future legal possibilities.

In terms of media, Andrew Main, an experienced freelance journalist and media trainer, said the message also had to be consistent. "There's an old saying that a lie goes around the world while the truth is still putting its boots on," he said. Social media made everything happen more quickly.

CRYPTO CURRENCY FUNDS NESTLE IN

By JOHN KAVANAGH

Richard Galvin of Digital Asset Capital, Daniel Weinberg of Kenetic Capital, Dave Chapman of OSL

A growing number of investment banks and other financial institutions are working on a range of cryptocurrency business opportunities, including asset custody, exchange services, insurance and portfolio management. In the process, a market infrastructure is starting to emerge that will encourage institutional investors to back the asset.

Dave Chapman, the chair of Hong Kong based cryptocurrency brokerage Octagon Strategy Ltd, says: "A couple of years ago bankers were describing cryptocurrency as a ponzi scheme. They are not saying that now."

Speaking at the AIMA Australia Annual Forum in Sydney, Chapman says he is aware of a number of institutions going through proof of concept on business opportunities.

Another speaker at the conference, Richard Galvin, the chief executive of Digital Asset Capital Management, says cryptocurrency is a very volatile assets class and investors are looking for some comfort in the form of custody services, custody insurance, banking services and regulation.

When those things fall into place, the investors will follow.

Galvin says there was an important development last month, when Kingdom Trust, a company that stores digital currency for investors, secured insurance cover through Lloyd's of London to protect against theft or destruction of those assets.

Kingdom Trust holds US$12 billion of assets. The company has been seeking insurance since it started operating in 2010, and the fact that Lloyd's has come to the party has been seen as an important sign that the insurance industry is overcoming its reticence about dealing with the cryptocurrency market.

Another important development was Intercontinental Exchange, the parent company of the New York Stock Exchange, announcing the formation of a new company Bakkt to develop a mainstream cryptocurrency exchange, with the backing of companies such as Boston Consulting Group and Microsoft.

Daniel Weinberg, chief executive of blockchain technology company Kenetic Capital, says the investment case for cryptocurrency has moved on from a speculative play to more of a venture capital focus.

"What we see is the evolution of initial coin offerings into a form of crowdfunding for early stage venture capital. Some interesting technology is emerging from that direction.

"Some of the big US venture capital funds are getting into the ICO market because they are following proven entrepreneurs who have taken that route.

"There is still a lot of riff raff in the market that is still to be washed out but there is value there as well. The key is to take a broad portfolio approach."

Chapman says there are now around 280 cryptocurrency funds operating around the world. "Investors want diversification and this asset class is not going away," he says.

The sector may pass another important milestone at the end of this month if the US Securities and Exchange Commission approves an application from fund manager VanEck to launch a cryptocurrency exchange traded fund.

The SEC has turned down several crypto ETF applications in the past but commentators have said the regulatory climate is changing and VanEck's application is more likely to succeed.

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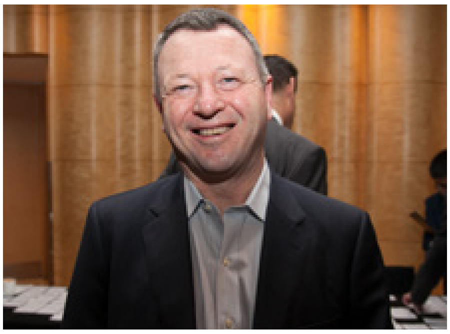
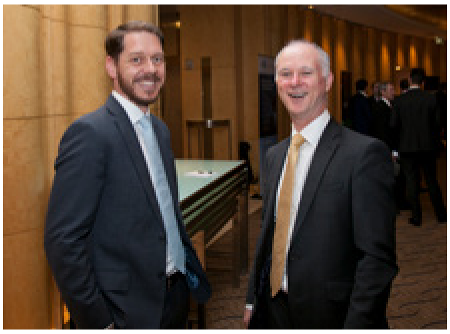
CAUGHT DURING THE BREAKS...

Eti Amegor of Axius Partrners, Steve Shepherd of CFM and AIMA's Michael Gallagher



Nigel Douglas of Douglas Funds Consulting

Margaret Bishop and Cleyde Hazell of BNP Paribas



Jeff Dunn of AQR and Andrew Harrex of PE Investments

Stephen O'Brien of Nanuk and Chris Thompson of RF Capital

Jack Inglis of AIMA, and Mark Bennett of Citco

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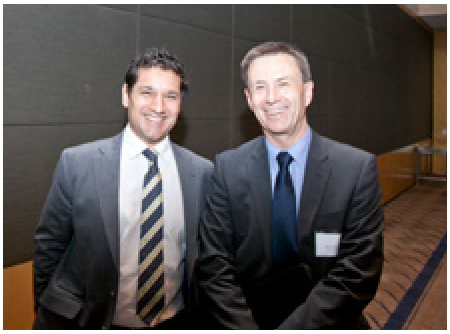
CAUGHT DURING THE BREAKS...

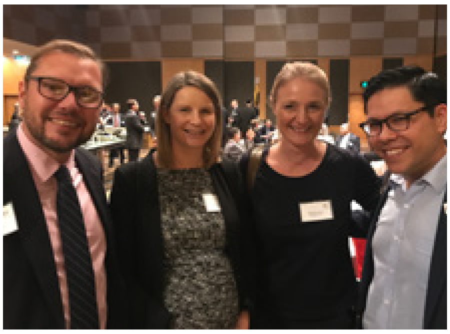


Rohit Khannna of EY and Grant Harslett of Maritime Super

Juan Tan of Two Sigma and Damien Jasczyk of Deutsche Bank

ASAM participants Jennifer Liao, Salman Aamer and Doron Haifer (director)

Sam Mann and Alex Nisbet of Longreach Alternatives



Alex Wise of Castle Hall, Jennifer Lyon of Macquarie Group, Wietske Blees of Fund Business and Matthew Chan of Rainhoffer

Harvey Kalman of EQT and Patrick Liddy of MSI Group

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ABOUT AIMA

The Alternative Investment Management Association (AIMA) is the global representative of the alternative investment industry, with more than 1,900 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2 trillion in assets.

AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry.

AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. The ACC currently represents over 100 members that manage $350 billion of private credit assets globally.

AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors).

To learn more about AIMA please visit our website here

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