

A Day in the Life of a Hedge Fund Manager

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Hedge Funds

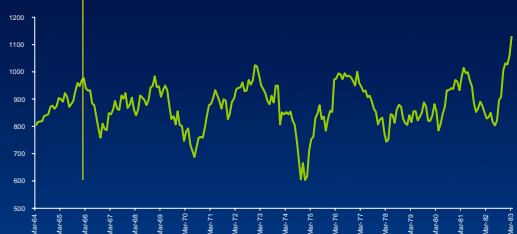
- Small investment management companies
- Usually owned by manager(s)
- Dozens of clients, not thousands
- Managed for absolute returns
- Proposition designed around manager skills
- Use leverage and 'shorting'



Some history

Fred Jones
- 1948

First Wave of Hedge Funds



- Markets going nowhere
- Necessity – Mother of Invention

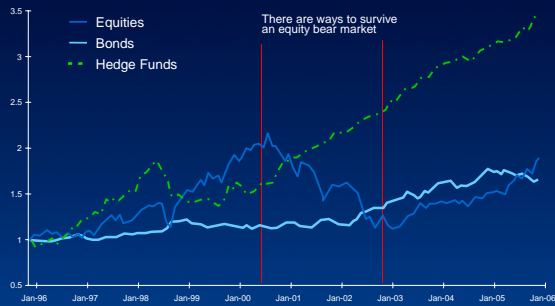


Once again needs must...

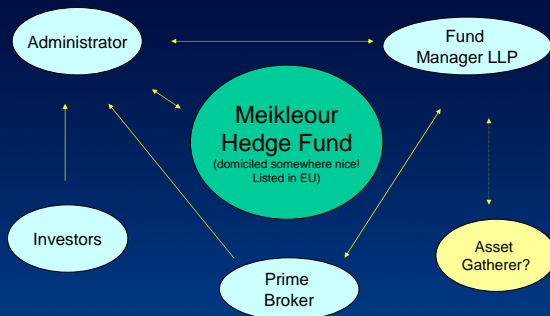


Second wave begins in late 90s





Broad Structure



Fund Styles

- 📌 Global Macro *fx / bond alpha**
- 📌 Long / Short *equity alpha (+ some beta)**
- 📌 Market Neutral *e.g. Royal Dutch vs Shell*
- 📌 Managed Futures *systematic futures trading (CTAs) **
- 📌 Convert Arb *equity/bond/convertible arbitrage **
- 📌 Short Bias *short side trading*
- 📌 Event Driven *takeover plays (long prey/short predator) **

* Key Styles for pension funds
 * Usual source of negative press



Managers' Background

Prop Desk

- 📌 Active trading
- 📌 Data accuracy crucial
- 📌 Risk control
- 📌 Governing framework

L/T Investor

- 📌 Glacial movement
- 📌 Low turnover
- 📌 Analysis key focus
- 📌 Recall threat



Manager's Motivation

- 📌 Self determination
- 📌 Avoid the bureaucracy / politics etc of large companies
- 📌 Concentrate on key skills / 'pleasures'
- 📌 Enlightened clients
 - 'partners'
 - Not everyone gets to be a client!
- 📌 Rarely 'get rich schemes'
 - Managers usually wealthy beforehand

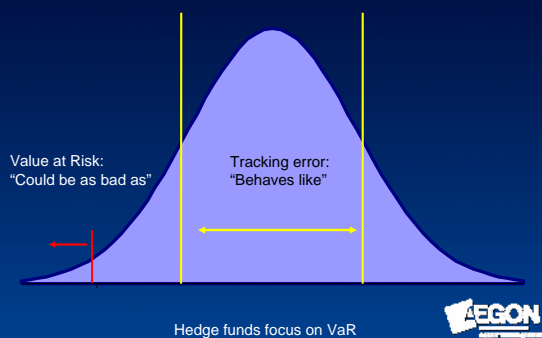


Manager / Owner close to..

- 🔗 Everything!
- 🔗 All support functions
 - Administrator
 - Custodian / prime broker
- 🔗 Threat of loss
- 🔗 #1 focus?
 - Measuring and managing risk
- 🔗 Managing capacity



Risk: VaR vs TE



VaR vs Tracking Error

VaR

- 🔗 Value added presumed or accepted as uncertain
- 🔗 Risk is short-term adverse behaviour

TE

- 🔗 Benchmark guides return
- 🔗 Risk is long-term drift against expectations



Daily Agenda

☞ All risk is active so,

- Is current VaR appropriate?
 - Event risk
 - Proximity of 'stops'
 - Return objective

☞ New trades

- Individual risk
- Decremental / Incremental impact



Leverage and Shorting

☞ Irrelevant

☞ VaR assessment captures market risk

☞ Except that VaR can't capture recall risk

- Threat that short 'recalled'

☞ Daily monitoring of stock lending 'market'



Shorting

☞ Selling (shorting) someone you don't own

☞ Only an issue at settlement

☞ Manager borrows stock in order to sell it

☞ Lender has option to recall loan

☞ Borrower needs to buy back stock to return loan

☞ Can create sharp price moves (upwards)



Summary

- 🔗 Hedge funds are pure alpha bets
- 🔗 Myriad styles available
- 🔗 Absolute not relative return objectives
 - Ideal for low inflation environment
- 🔗 If its right to invest in a hedge fund, its better to own it
- 🔗 Now admissible for lifecos (FSA PS06/14)



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