

Hedge Fund Seminar
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The Difference Between
Absolute and Relative Investing

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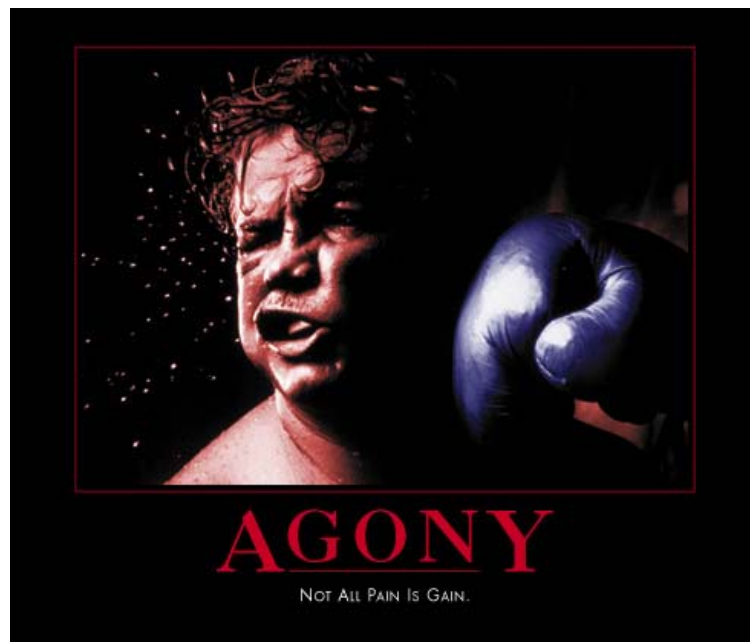
Good Morning

Ah, to be a hedge fund manager. Fabulous wealth. Bohemian lifestyle. No rules and restrictions. These are but some of the attractions.

Unfortunately, they are largely false images.

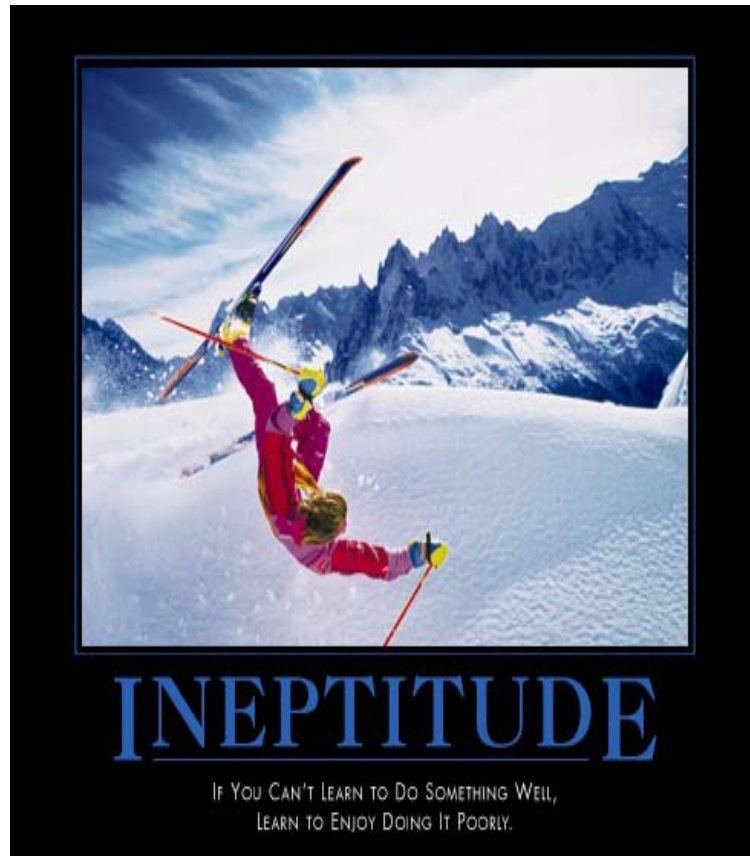
The main purpose of my presentation this morning is to discuss the differences between absolute and relative investing from both a business as well as an investment perspective. In doing so I wish to ensure that everyone leaves here knowing the reality: absolute return investing is hard work.

It is important to note that the following are my own personal observations. They are probably relatively biased views and certainly don't purport to be absolute truths.

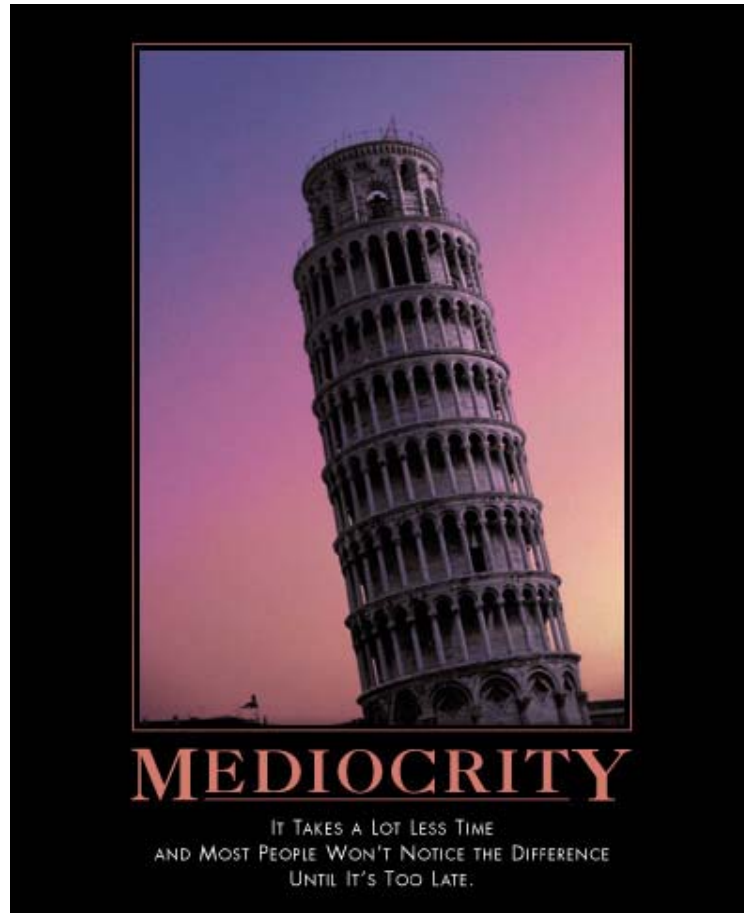


1. AGONY: In absolute investing there lies both potential gain and pain
 - The main difference, of course, is the stated objective:
 - “we did a good job. We only lost you 16% whilst the index went down 20%. Isn’t that great?”
 - Current typical mandate types relative focus
 - What is right going forward – absolute or relative? Consider guarantees, closed funds, accounting standards
 - Most people think that absolute returns = hedge funds. Not true:
 - “hedge funds”: sector specialists; unusual asset classes
 - long only absolute (need for more effort)
 - Shorting: the most obvious investment difference:
 - What is shorting? Definition
 - Problems with shorting:
 - wrong distribution
 - recall risk
 - maximum when $e(r \text{ max})$
 - cost
 - criminal offence if implemented incorrectly
 - problem gets bigger
 - In short: shorting can be agony
 - Fees:
 - Performance basis. Priced like an option

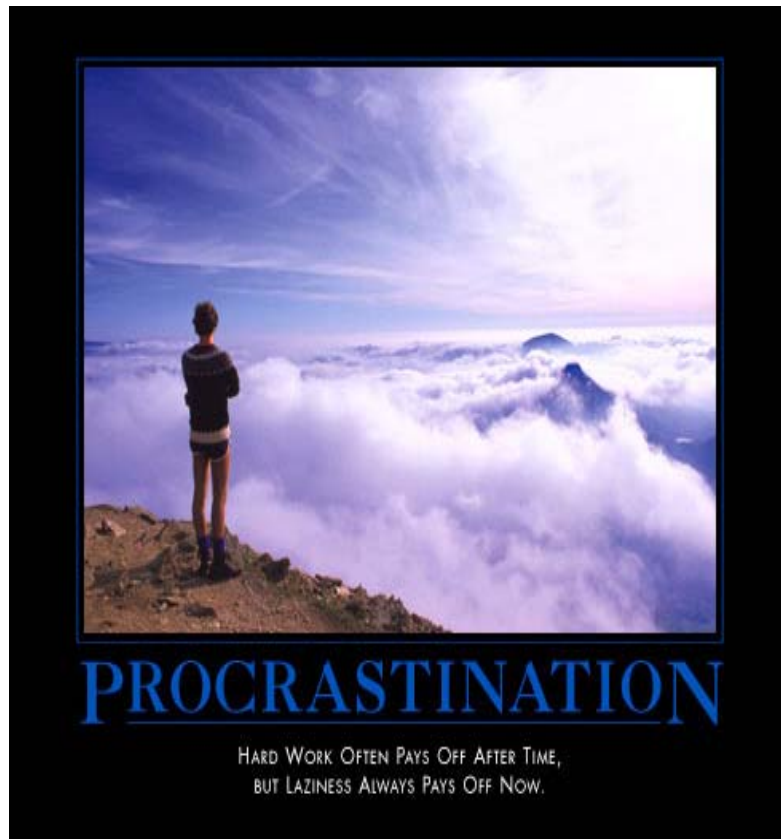
- Not necessarily good:
 - Encourages vol acceptance
 - Viability on %p.a. along
 - Highwater mark / under water?
- Performance based fees might be both expensive (i.e. painful) but also encourage undesirable behavior (i.e. no gain)



2. INEPTITUDE: In absolute investing you cannot afford to do anything poorly
- In my experience good absolute return managers tend to have broader skill sets
 - A key difference: No division between research, fund management and trading:
 - “Typical” relative house
 - “Typical” Asian absolute house
 - Because of the need to always deliver there is typically less mandate restrictions. But, this means a manager needs to be multi style and multi asset class:
 - Types of styles: risk-arb, cb-arb, equity valuation, distressed debt
 - Skill sets required; derivative, credit, fundamental, technical (charting)
 - Implication: absolute more experienced

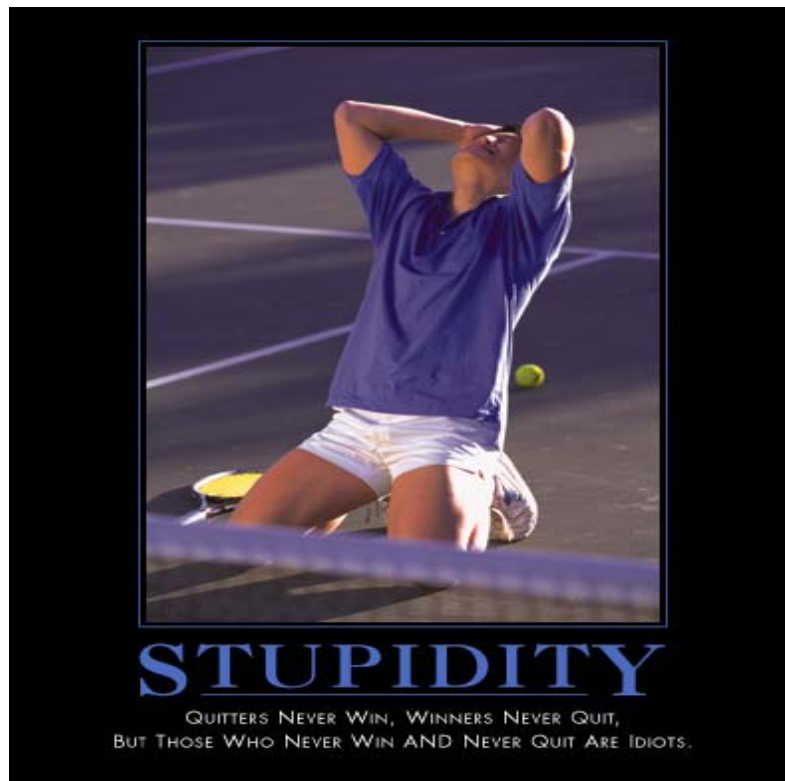


3. **MEDIOCRITY:** In absolute investing there is greater research effort; things are not done ‘on-the-fly’
- In my experience greater effort is required to run absolute return funds and there is less room for research error
 - Need to know not only what others are thinking but also absolute values
 - Perhaps a few examples may help:
 - Macro: Importance of flows. Jet fuel price. Don’t need to know in relative but must know if you are definitely going to say whether CX will make a profit or not
 - Attention to detail on arbitrage: tax rates, takeover code – voting counted
 - Completely different call from same valuation (if 100% sure) e.g. HKE
 - Smaller number of holdings (except stat arb)



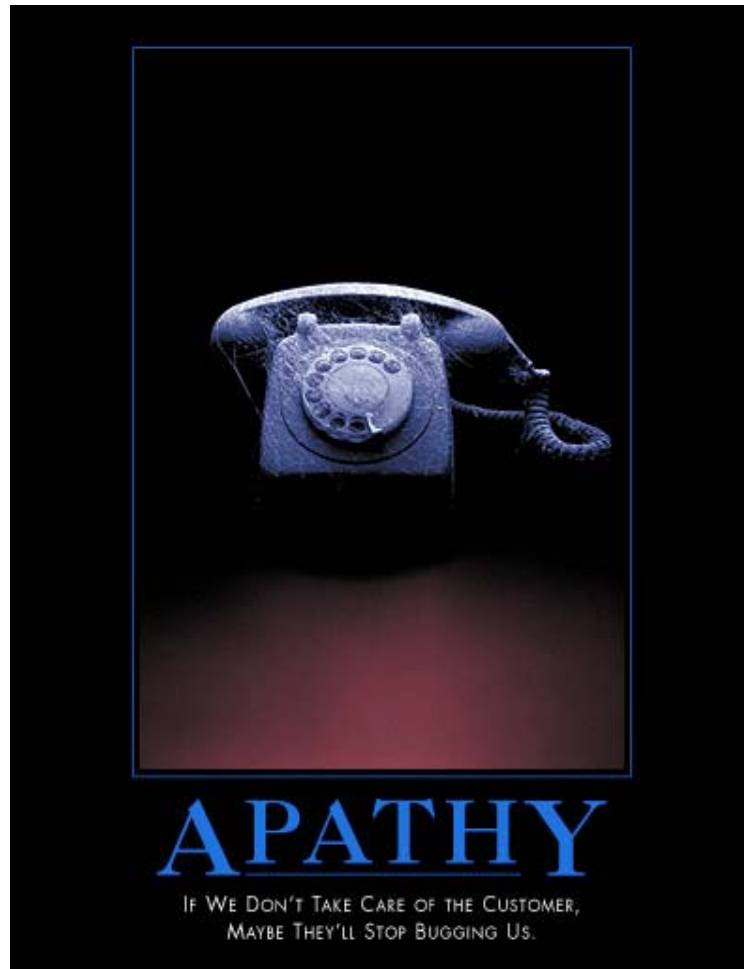
4. **PROCRSTINATION: In absolute investing you need to be sure; now!**

- In my experience to be successful in absolute decisions need to be made quickly, accurately and decisively
- Time: two dimensions - risk and return
 - Risk:
 - When the ship starts sinking....
 - Stop loss
 - Return:
 - Arbitrage could appear at any time
- Precision: use of limit orders
 - Never c.d.
 - VWAP is CRAP



5. STUPIDITY: Absolute investing is a harsh environment

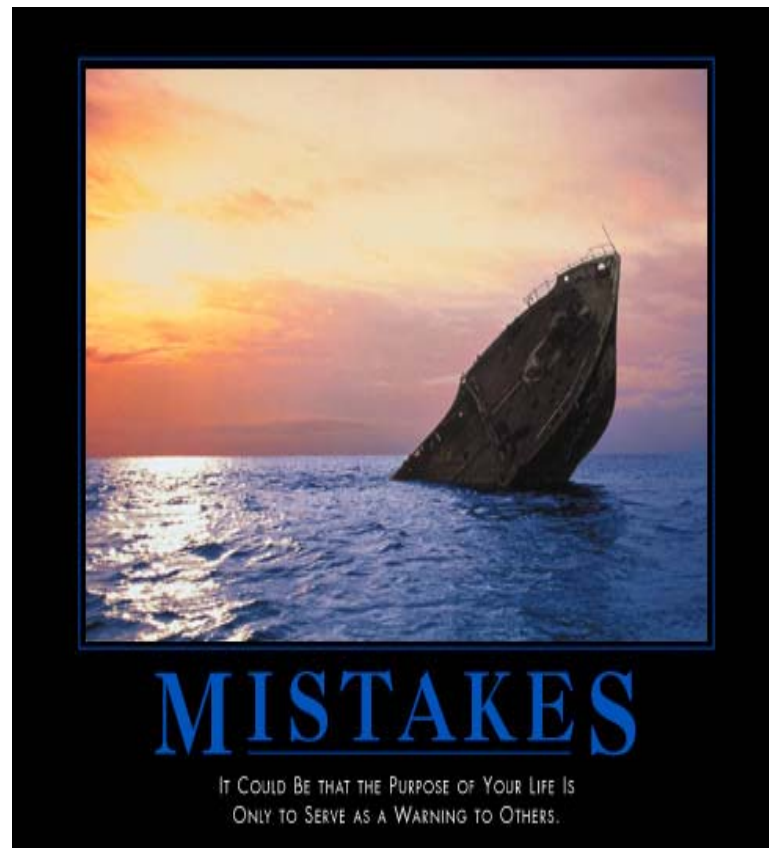
- From an investment perspective it is easy to look stupid:
 - Relative world 50/50
 - Absolute world: Best case is 50/50
- Not liked by some / governments
- Need both business and investment skills:
 - Small FUM – non viable
 - Capital required not to quit
- Exit strategy?



6. APATHY: Absolute investing has a (traditionally) very different client base

- Who is a typical investor:
 - Relative:
 - Trustees
 - Absolute:
 - FoF's
 - Know the markets
 - Very successful in own right
 - Active not passive

- Potential change



7. **MISTAKES: My lessons**

- I have been self employed in hedge funds for the last 7 years and would like to pass on what I have learned / observed are the main differences between relative and absolute:
 - Humanity as much as fund management
 - Employed / self employed; capital
 - Self trust / ambition / commitment
 - Greed / partners / morality
 - Few with the right experience in Asia
 - Government / SFC / perceptions and reality: scapegoats and regulatory change
 - Fickle / match asset and liabilities