



130/30 – The Long & the Short of it

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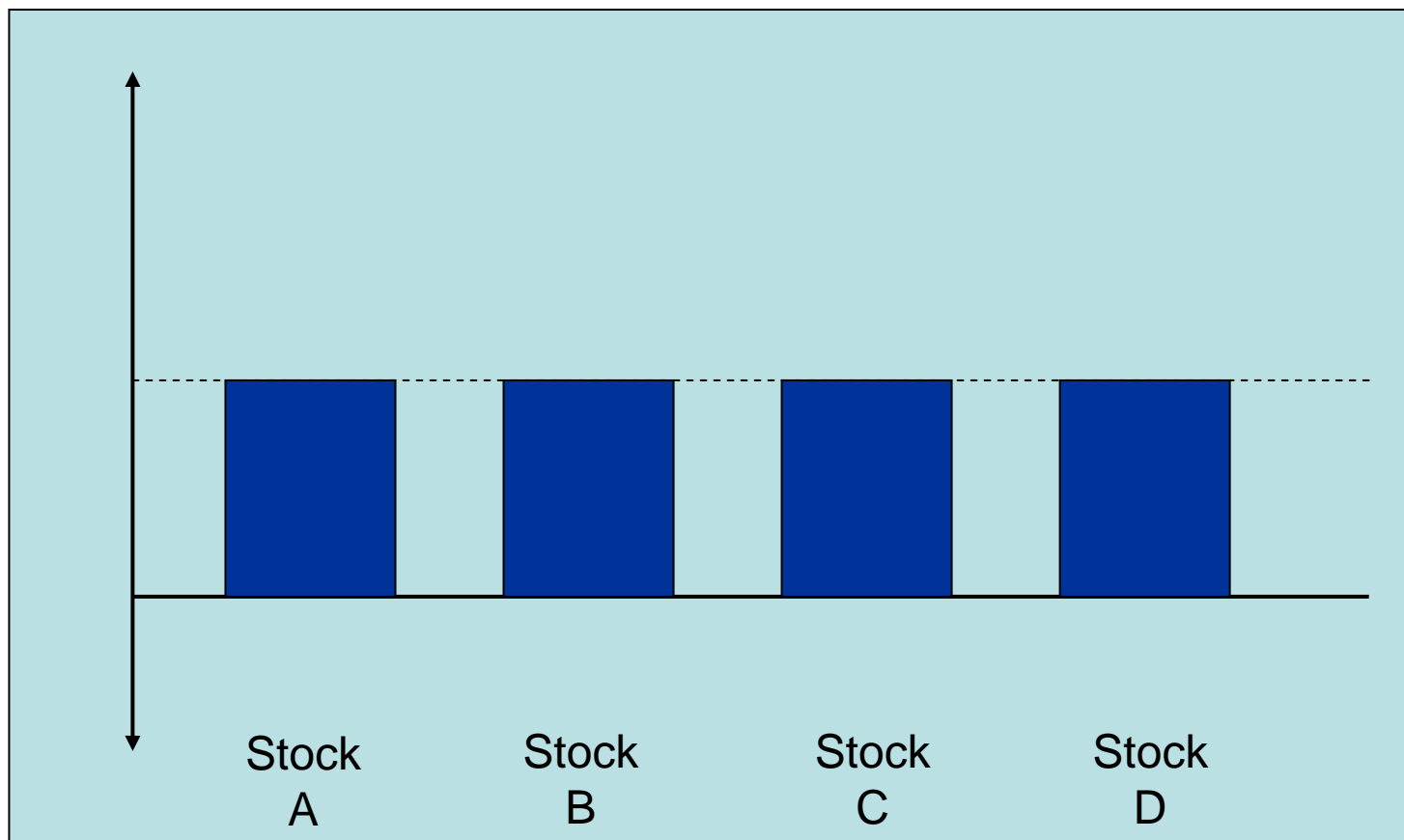
130/30: What Is It?

- “Long-Only” active management has almost become a derogatory term
- UCITS III framework now permits managers to express negative views
- For €100 invested a 130/30 or “Active Extension” fund may have
 - €130 exposure to favoured stocks
 - funded by investment & proceeds of economically shorting €30 of stocks
 - Net investment in market is €100



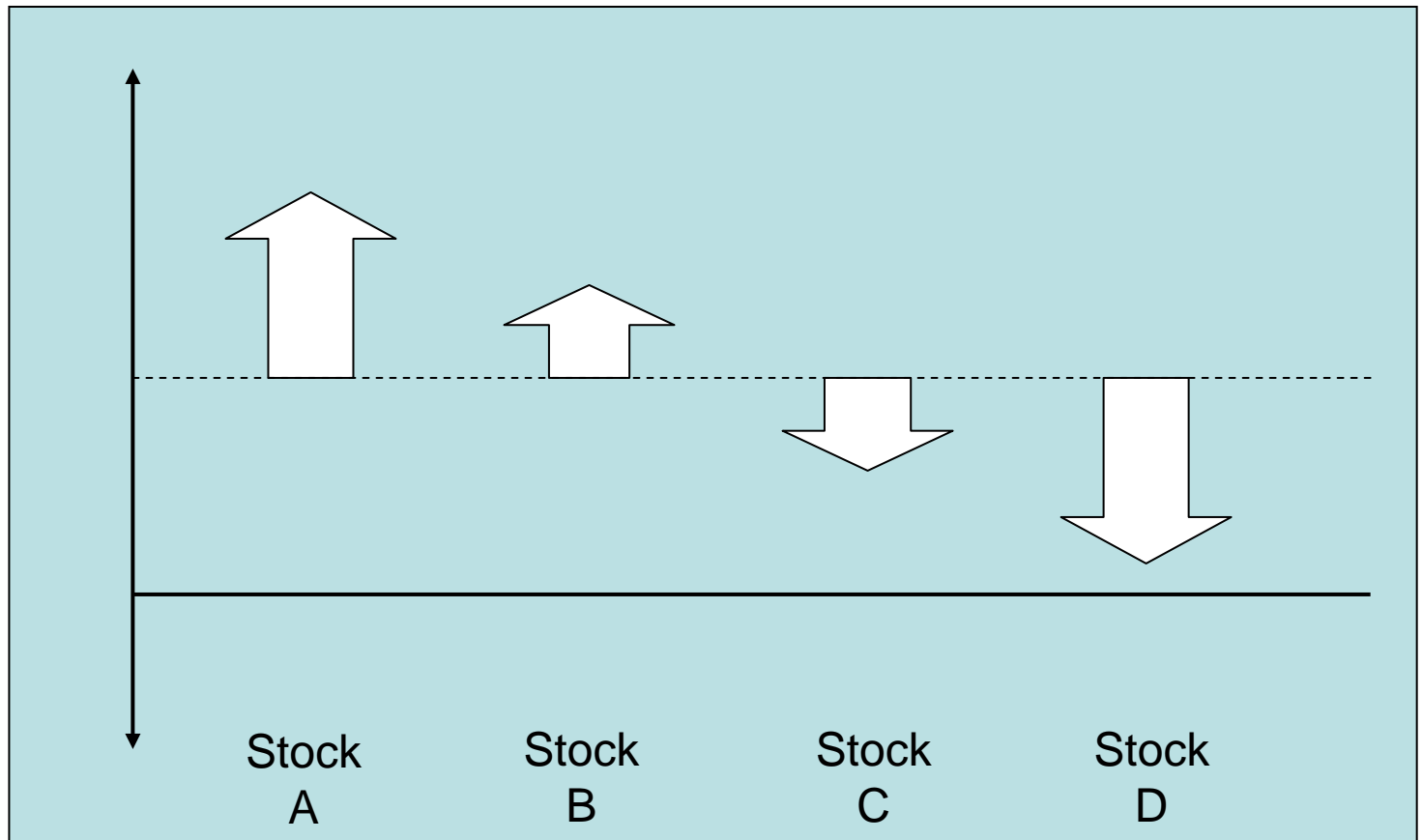


If this is my benchmark and I have both long & short ideas ..



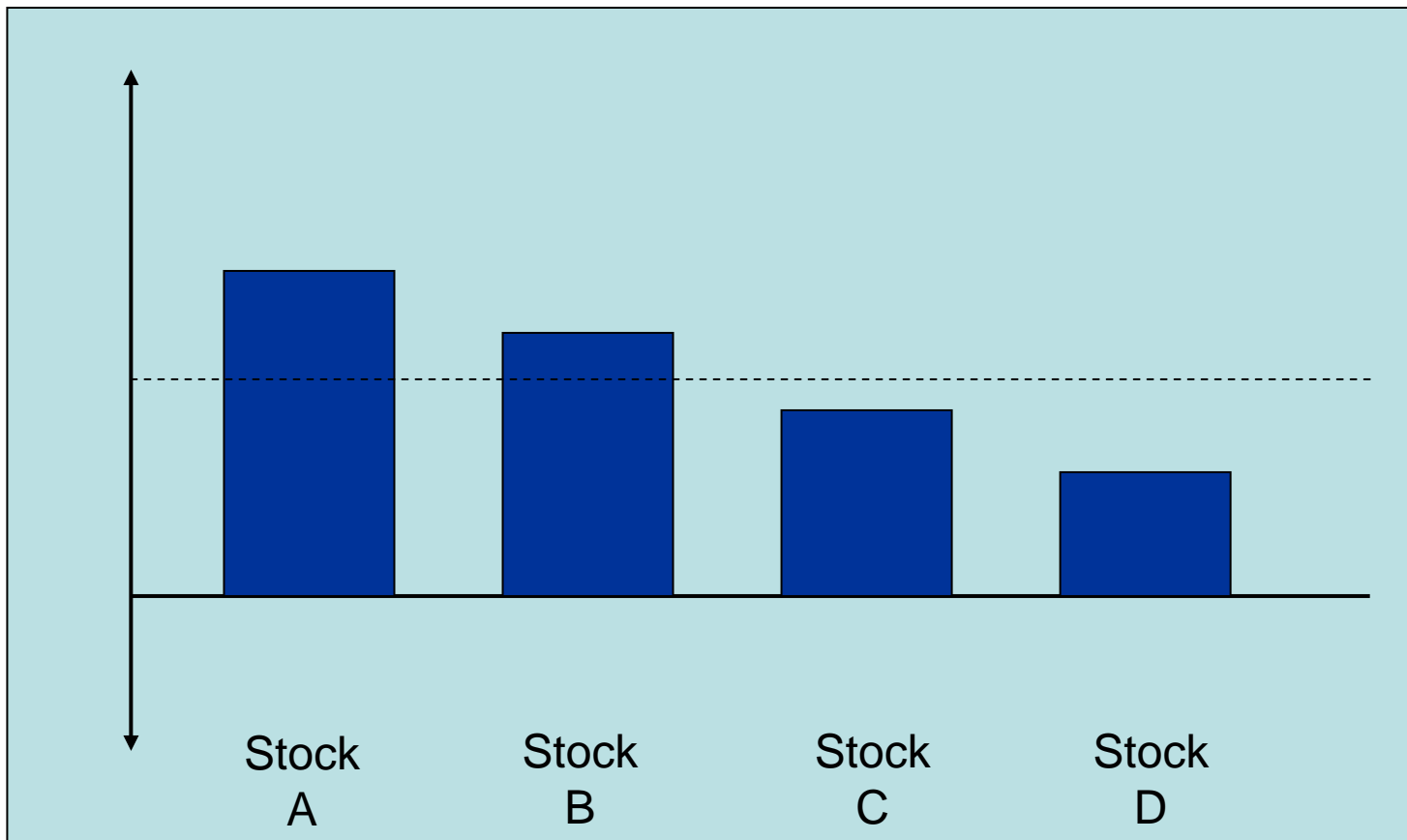


.. and this how I can implement my “best idea” ..



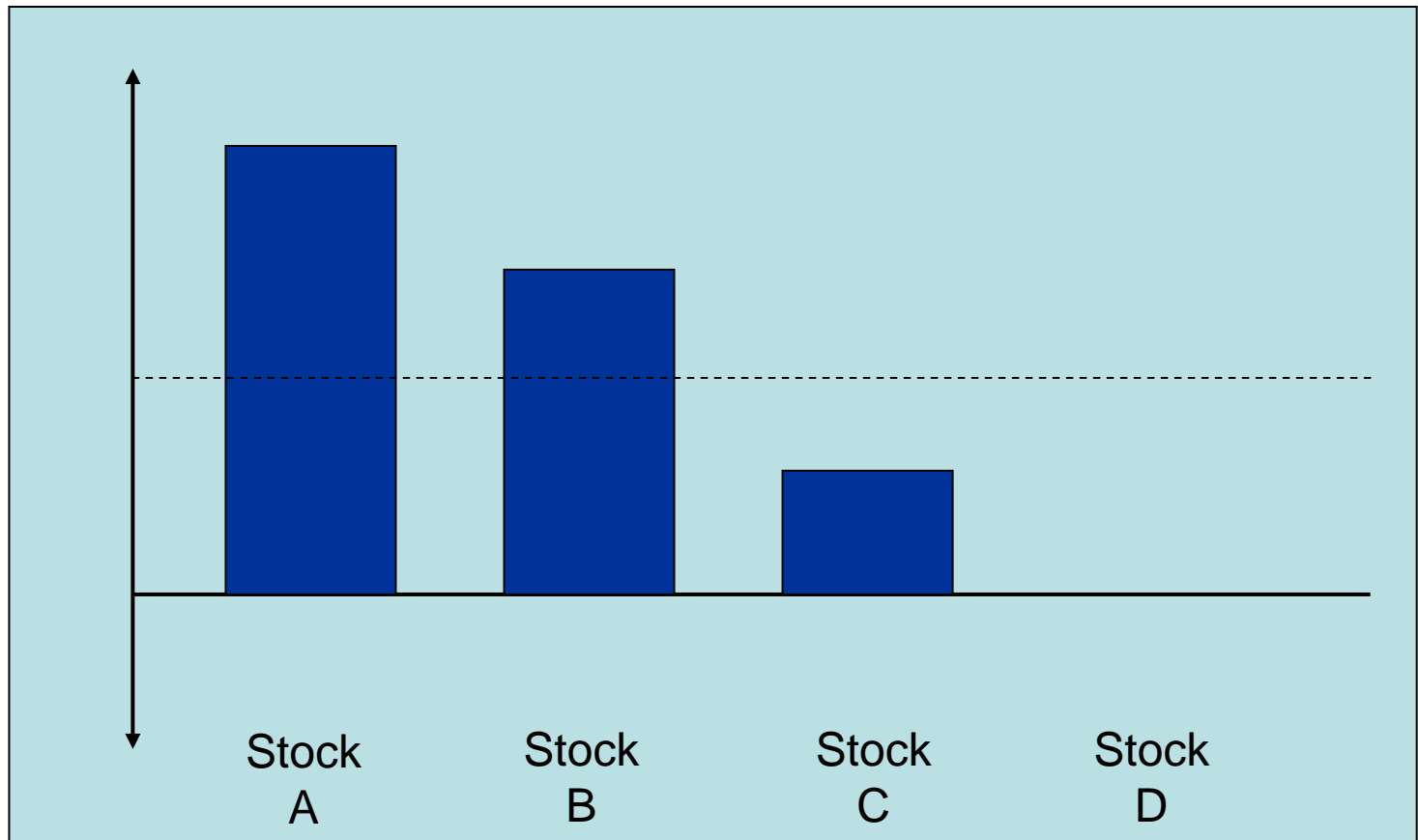


.. I can scale up target risk and expected alpha from idea ..



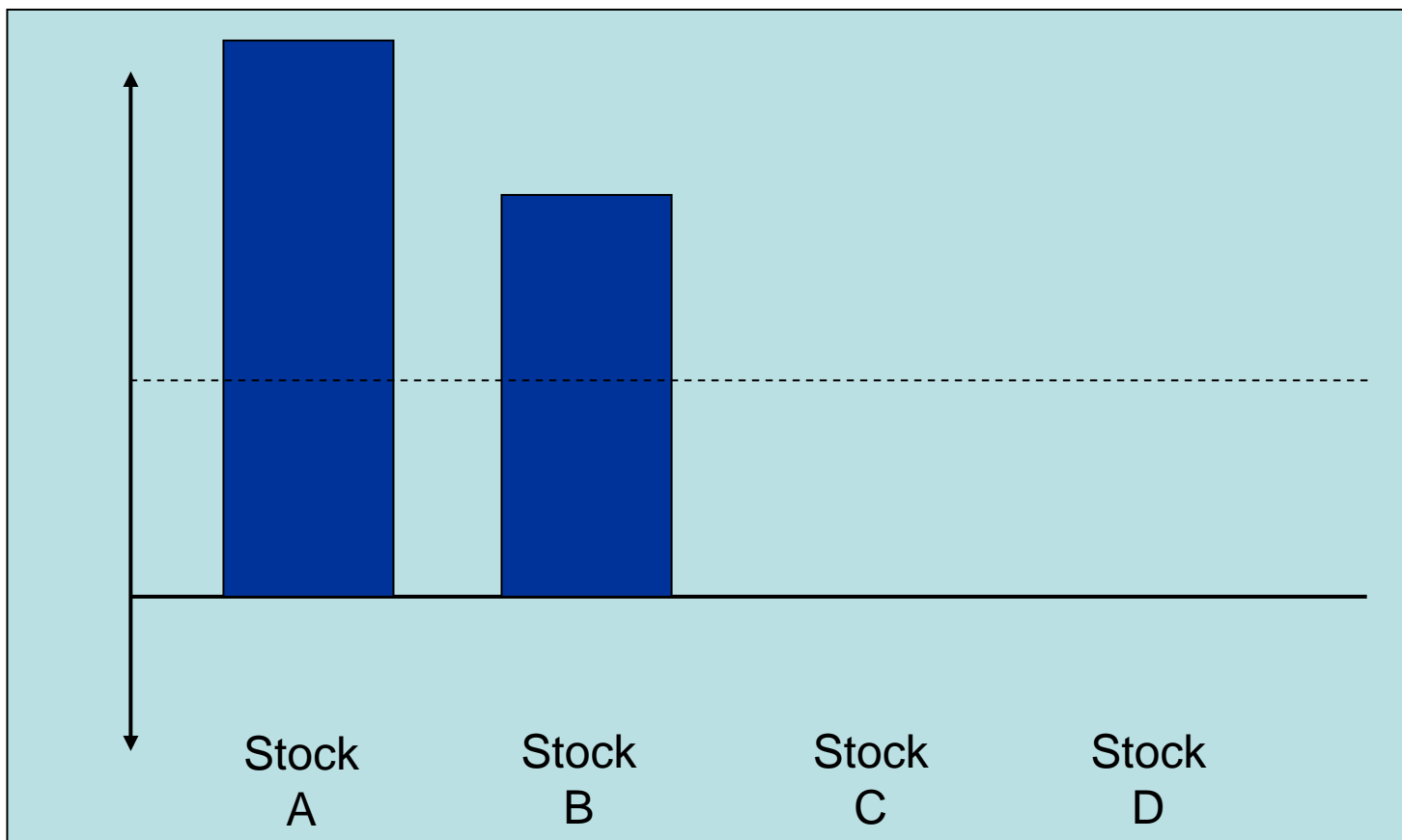


.. until I hit zero weight in *any* stock. For more alpha, I now ..



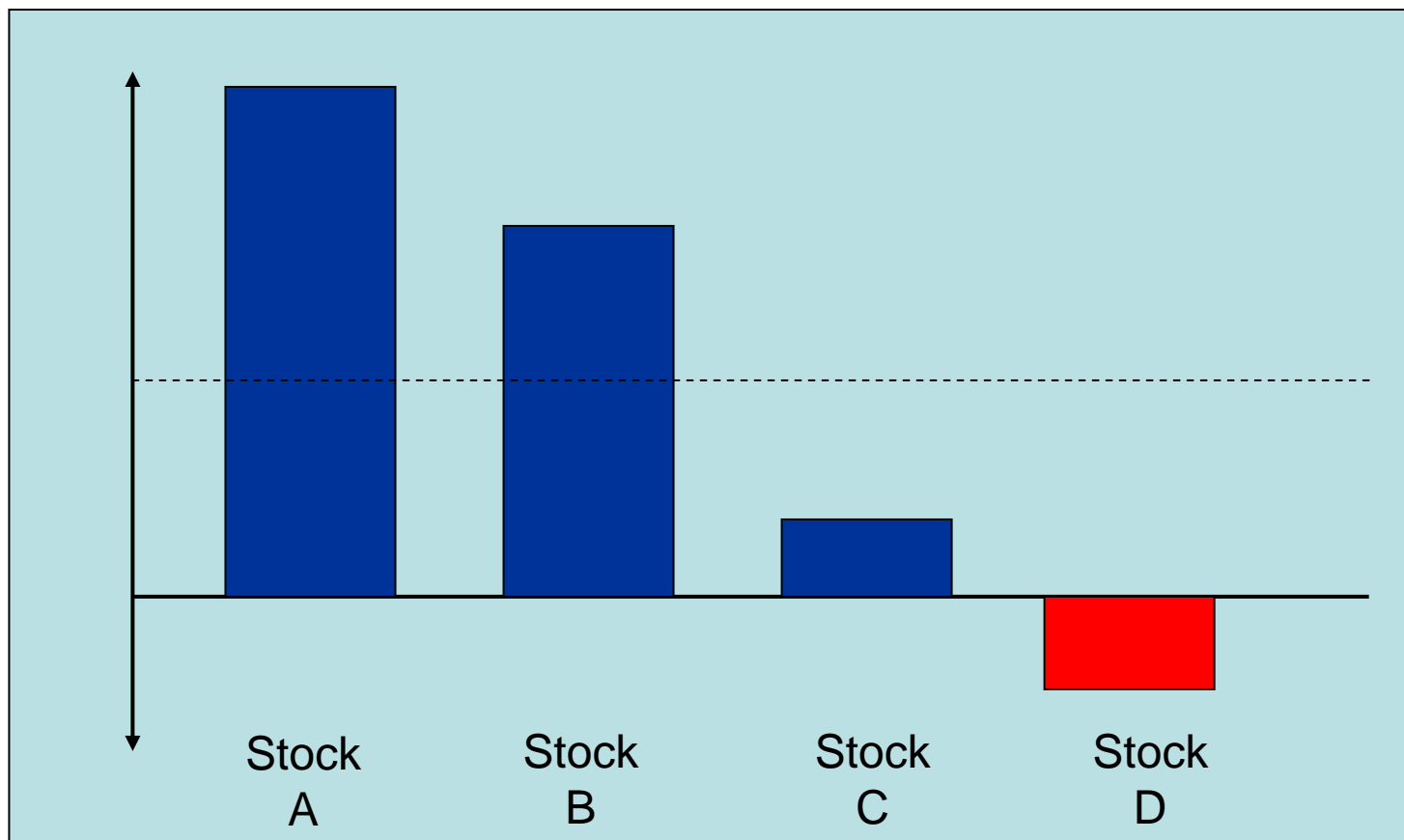


.. either stay “long-only” & scale up a less attractive idea, or ..



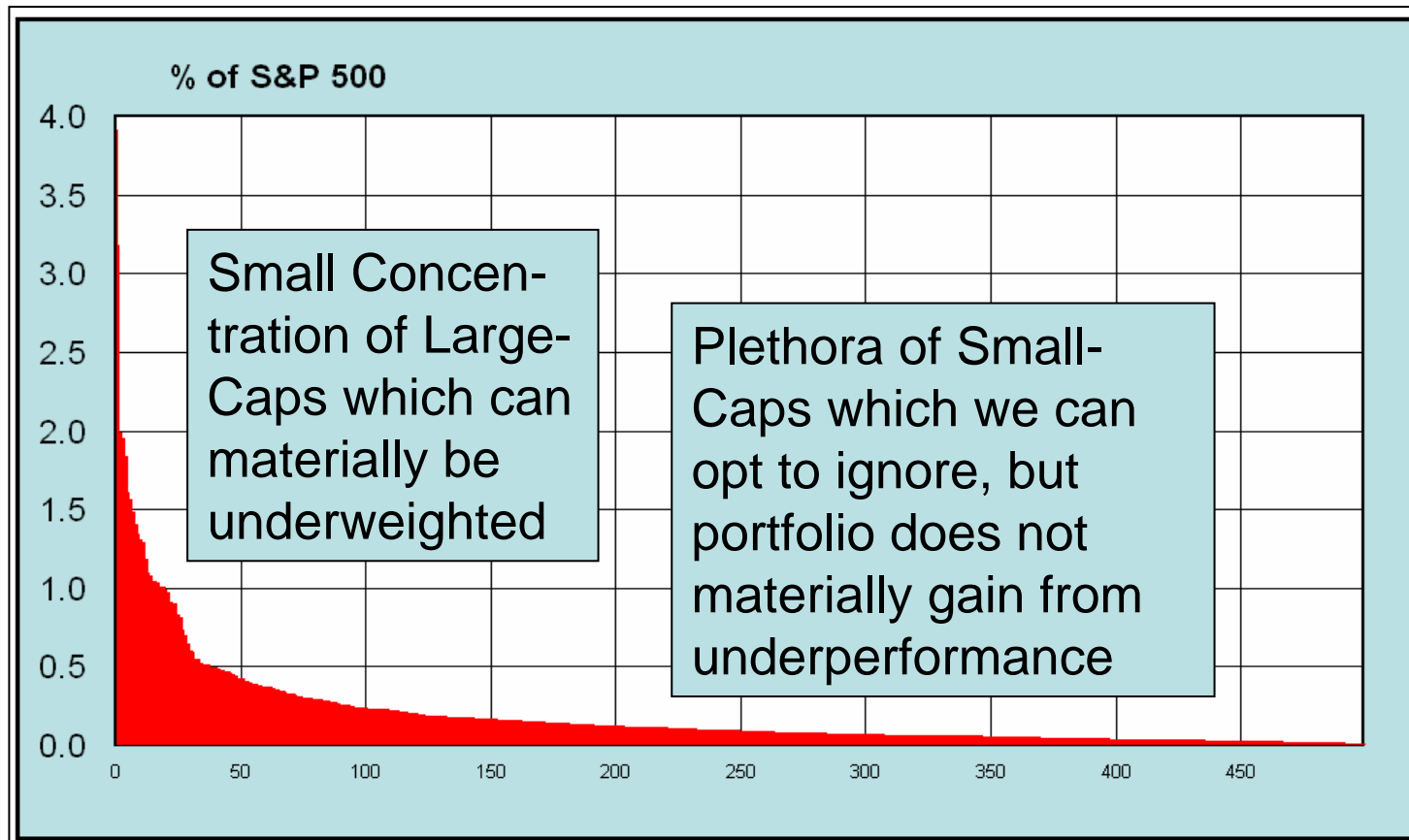


.. start to short-sell and maintain profile of my original idea.



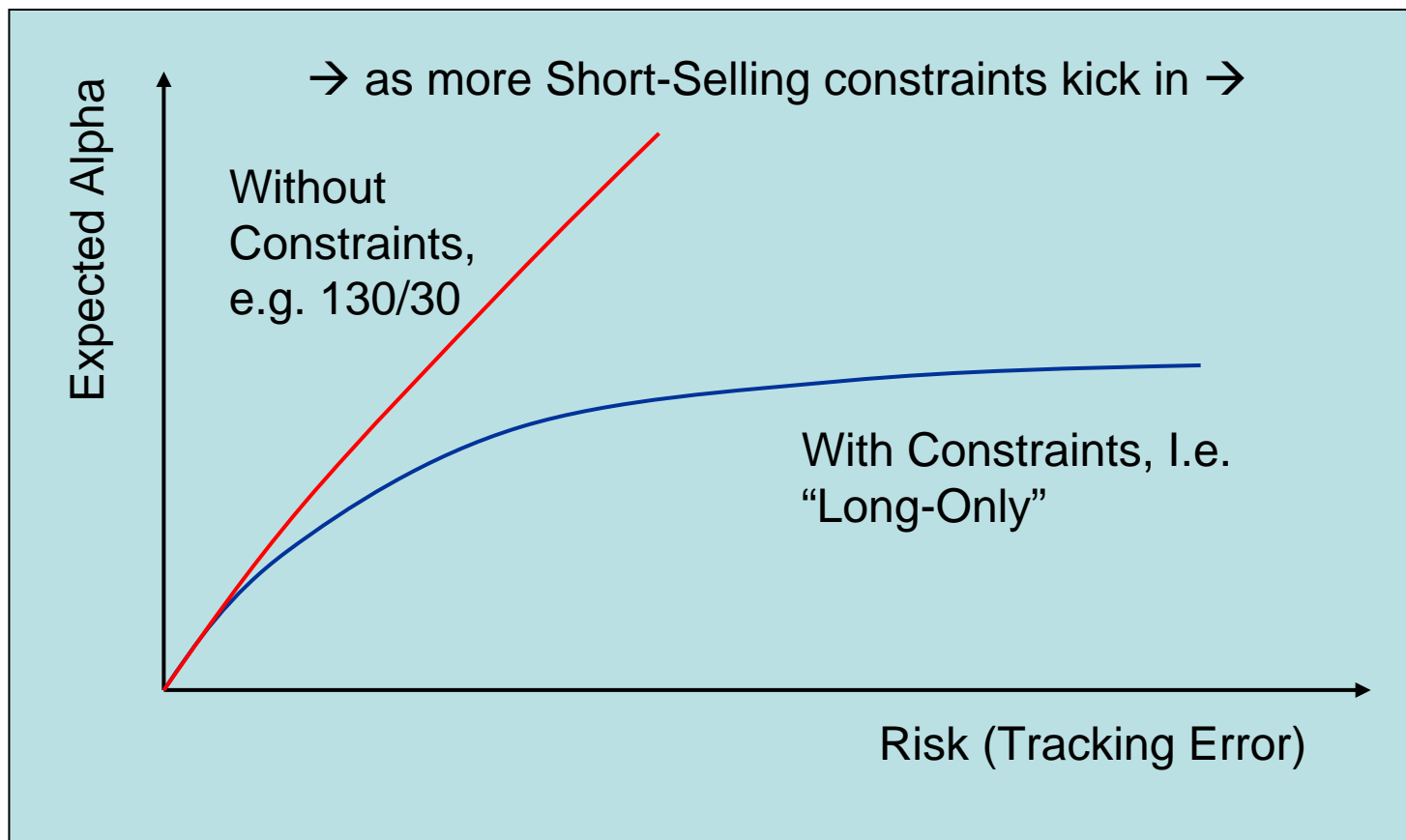


Typical Benchmark Profile





Theoretically, a Superior Risk-Return trade-off is achieved.





130/30 in Practice

- Borrow €30 of stock (post collateral), & agree to rebate Total Return at some future date
- Sell borrowed stock in the market raising €30
- Invest €130 in a portfolio of stocks

OR

- Hold a €100 portfolio of stocks
- Enter “Total Return Swap” receiving the performance *spread* between €30 long basket and €30 short basket, paying funding cost





Thoughts on Shorting

- Active managers historic focus on picking “winners” – different mindset picking losers
- Risks can be different e.g. M&A
- Asymmetric risk - most you can lose “long” is investment, can lose more if stock e.g. trebles
- Quant processes are better suited as generally produce full top to bottom rankings/screens
- Easiest to short liquid large-caps - Capacity issues, low liquidity can cause a short squeeze





Operational Issues

- 130/30 requires major Infrastructure
 - Legals, Collateral Management etc.
 - Custodians, Prime Brokers
 - Appropriate Fund Structure
 - Risk Control, Market & Counterparty
- *Active Extension = Cost Extension*
- Fees for existing 130/30 products mixture of Flat and Flat+Incentive
- Newness of product means no track records!





Current Marketplace

- About \$80-\$100bn globally is currently in 130/30 – predominantly Institutional
- A report by Merrill Lynch suggest that \$1tr will be invested in the product by 2010
- Current Offerings are largely from “Long-Only” houses rather than from Hedge Funds
- 80-90% of 130/30 funds are Quant
- Most major global fund managers have an offering: SSGA, BGI, GSAM, Jacobs Levy – Activity in Ireland & also in Fixed Income





130/30 Checklist

- Can your manager add value?
- Does your manager have a process for deciding on what to short?
- Does your manager understand the risks?
- How efficiently does your manager short?
- What are the embedded costs?
- Does your manager have appropriate infrastructure and risk controls?
- Are you paying over the odds for Beta?





IAPF

Annual Investment

Conference

2008