THE GREENWICH

Roundtable Letter

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Two years ago we began a series of focus groups to tap into the knowledge of our members. These groups were conducted under the auspices of the Education Committee. We wanted to conduct original research apart from our symposiums, so we began the task of putting together a study on Best Practices in Hedge Fund Investing looking at it from the investors' point of view. This assignment required additional funding, but our ability to raise funds was limited, as our regular membership is closed to new members and the Bruce Museum cannot squeeze any more of us into the Gallery. Still, we get phone calls and emails every day from hedge funds, private equity funds and law firms asking how they can become members. Some of these general partners began making contributions even though we could not include them in the membership. They simply wished to support us with no strings attached, in some cases, anonymously.

In this context, the Research Council was born. First, the Education Committee started with a group of altruistic buy-siders who contributed their time and worked to raise professional standards. Then, the Research Council emerged as a group of equally altruistic sell-siders who provided the funding…to help the investor community document the allocation process. The final result will, we hope, serve to demystify alternative investing and increase understand of the industry.

In November 2004 our Board of Trustees nominated 15 high integrity general partners for Research Council appointments. They were selected because their business activities serve as an example to all practitioners in the industry. We were overwhelmed at the response. Eight accepted their nomination and were appointed. We are pleased to announce the first members of the Research Council of the Greenwich Roundtable. They are:

Amaranth Advisors
AQR Capital
Bridgewater Associates, Inc
CRG Partners
III Offshore Advisors
North Sound Capital
Sagamore Hill Capital Management
Standard & Poor's

What is the Research Council? The Research Council serves as a small group of sustaining sponsors of the research of the Greenwich Roundtable. The purpose is to foster research and publishing in the field of non-traditional investing to better educate institutional and sophisticated investors. Dedicated to the development of best practices, wealth creation and the general understanding and advancement of alternative investments, members of the Research Council provide the funding needed to sustain the research activities of the members of the Education Committee of the Greenwich Roundtable. The Research Council enables the Greenwich Roundtable to host the broadest range of investigation that serve the interests of the limited partners and investors who are its members. For example, such research includes original study in determining hedge fund due diligence techniques. Such techniques are both art and science and have never before been published. Publishing activities also include the development and maintenance of the extensive digital audio and written archives of the GR website. This website is largely the library of original live GR symposiums, literally a front row seat to the birth of an industry. The Council's funding will also enable the GR to explore the difficult issues and those issues of vital importance to the allocator community.

The eight generous members of the Research Council have provided the critical financial resources that were necessary to unlock valuable knowledge from inside the heads of experienced investors. The members of the Research Council were selected for their prior good deeds in raising professional standards within their industry. Now they wish to help the buy-side raise their standards. They also share our belief that education is one of the greatest needs in the marketplace. The Research Council has generously underwritten the entire Best Practices in Hedge Fund Investing series. For that we are all deeply grateful.

How can I assist the Research Council? Please, reach out and show your appreciation to these wonderful people and their organizations.

GR Weighs in on Hedge Fund Regulation

Spencer Boggess

On September 15th 2004 our Government Affairs Committee submitted the following comment letter to The Securities & Exchange Commission. The essence of our comment was: 1) A registration requirement is not so bad. 2) A hedge fund should be defined by the marketability of their investments rather than its lock-up period. A lock-up definition will hurt investors. 3) Unintended consequences will emerge. Now it seems our prophecies are coming true. Recent news reports cite several cases of top-tier hedge funds lengthening the lock-up period. Hate to say we told you so, but…..! Also the SEC staff felt a registration requirement would create a "culture of compliance" to "legitimize" the industry. But a culture of compliance already exists. Investors performing due diligence create a market-based compliance culture. It is not the "specter of an investigation" but rather the possibility of investor redemptions that keeps everyone honest.

Above all, we believe that managing other people's money is a sacred trust. We also believe that truly gifted hedge funds need their competitive advantage protected. Hedge funds are in the business of discovering pricing inefficiencies and investing anomalies. But trademark or patent law does not protect their discoveries as it does in other industries. Currently their only protection is to keep their discovery quiet.

Our Government Affairs Committee was outstanding. Their insight and thoughtful writing is a fine example of the wisdom that lies within our membership. We wish to recognize and congratulate the following Fellows on a job well done!

Ed Barksdale
Spencer Boggess
Richard Breeden
John Griswold
Lloyd A. Hascoe
Robert Hunkeler
Rob Nisi
William Raver
David Storrs

Caroline Gillespie

The Greenwich Roundtable

15 September 2004

Mr. Jonathan G. Katz
Secretary
US Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549-0609

Re: File No S7-30-04: Proposed Registration Under the Advisers Act of Certain Hedge Fund Advisers

Dear Mr. Katz:

The Greenwich Roundtable is pleased to comment on the proposed rules concerning registration of hedge fund managers. The Greenwich Roundtable is a nonprofit research and education group funded by its members, private and institutional investors who are considered to be the most influential and respected investors in hedge funds. This nonprofit group seeks to articulate from the perspective of a hedge fund's limited partner the common concerns and issues that are important to investors in the hedge fund community.

A majority of the Board of Trustees of the Greenwich Roundtable endorses the government's role to protect investors and supports the Commission's desire to formalize a culture of compliance among hedge fund managers, which largely exists informally today. We are not opposed to the objectives that mandating registration of hedge fund managers is designed to address under the Proposed Rule. We question, however, whether registration will resolve those objectives, and we are concerned that the Proposed Rule, in its current form, will have unintended consequences.

For example, we respectfully disagree with the Proposed Rule's definition of a "private fund" as a fund that permits investors to redeem their interests in the fund within two years of purchasing them. Using "redeemability" as a factor to define "private fund" is likely to cause hedge fund advisers to lengthen their redemption periods. Longer redemption periods do not benefit investors, and may force many investors to redeem their investments prematurely. If the intention of the Rule is to specifically exclude venture capital and private equity funds, then those funds can more easily be excluded without harming genuine hedge fund investors. We would suggest instead that the Rule apply a test that focuses on the marketability of a fund's holdings, rather than on an investor's willingness to lock-up an investment. For instance, if a fund invested a certain level of its assets in marketable securities (as defined by the Staff), that fund should be considered a "private fund" under the Rule. A requirement tailored along these lines will separate hedge funds from venture capital and private equity funds, but will not encourage behavior that is clearly disadvantageous to investors. The Roundtable does not support a "private fund" test based on the length of lock-up periods.

Further, the Proposing Release states that registration will "legitimize a growing and maturing industry." The hedge fund industry is already a highly legitimate and professional industry. Sophisticated investors in the hedge fund community make significant allocation decisions based in large part on the rigorous due diligence examinations that they personally perform prior to making an investment. We would hope that requiring registration of hedge fund managers would not encourage investors who meet eligibility requirements, but who are not truly sophisticated investors, to invest in hedge funds.

We appreciate the opportunity to comment on the Commission's proposed rule, and we hope that the Commission will find these comments helpful. Please feel free to contact our executive director, Steve McMenamin at 203-862-1401 if the Staff would like to discuss any of these comments in greater detail.

Sincerely,

Stephen McMenamin

Board of Trustees
The Greenwich Roundtable

July, 2004
UNDERWRITTEN BY –
FLAG Capital Management

Healthcare and Life Science Strategies

Our session titled *Healthcare and Life Science Strategies* was an optimistic continuation of the April 2000 session where Craig Venter announced the mapping of the Drosophilous genome; the growing importance of proteonomics and those commercial genomic applications which would not be ready for 30 to 50 years. Paul Queally guides the healthcare practice for one of the oldest bulge bracket buyout shops. Terry McGuire is a founder of a venture capital fund with eye-popping returns. Rob Langer is a prolific scientist whose work may easily rival Thomas Edison for its quality and its quantity. Arnie Snider wasn't available so we excluded healthcare hedge funds due to their mixed results. Peter Lawrence thoughtfully guided the panel in his third annual examination of the lucrative private market strategies. peter@flagcapital.com

Diana Frazier

Paul Queally
Welsh Carson Anderson & Stowe

We tend to back the same management teams with proven records. We tend to do big deals of scale where our portfolio companies cross sell to one another. We do not speak to the media. We grow our portfolio companies. EBITDA of our portfolio companies is growing at 14 percent. Twenty-five public healthcare companies can trace their roots to WCAS. Healthcare dynamics are compelling. Our population is aging. Technologies are proliferating. People are living longer. One percent of the population consumes one third of the costs. Ninety percent consumes another third. The healthcare industry is terribly under managed. 85% of the hospitals are non-profits who are inefficient and they lack sophistication and capital. Fifty percent of all healthcare information technology projects fail…unprecedented by any standard. Healthcare spending will continue to grow faster than GDP. Employers are pushing healthcare costs onto their employees. Healthcare investing is risky. Expect returns in the mid twenty percent ranges. Higher returns are available if you truncate your holding period or take unusual risks. Healthcare-services investing has more predictable returns. Healthcare investing suffers from headline risk. It has 5-7 year cycles influenced by regulation, government spending and altering payment methods. Fraud and abuse generate headlines and stocks drop. That's the best time to buy. We buy when others are selling. We buy at 6 times EBITDA and sell at 10 times. Healthcare stocks are pricey and we are net sellers today. We use our domain knowledge to catch market dislocations. Our last three deals were bought on negative news outside of the auction process. Most buyout firms don't understand healthcare. They confuse improving multiples with growth prospects. We only invest in control positions. We don't like to partner with other firms or share our domain knowledge. We want to limit our dependence on Medicaid or Medicare payers. Corporate buyers are back. Valuations are above historic norms. Leverage is increasing. Today we are focusing on smaller proprietary deals and aggregating service providers who can be made more efficient. pqueally@welsh-carson.com

Terry McGuire
Polaris Venture Partners

At the other end of the spectrum, our model is different. We do early stage investing…at the University level. Everything but the idea and the founder is missing. EBITDA is not discussed in our companies yet. My portfolio has a 47 percent return. Our challenges and opportunities arise from the marriage of science and business… a transfer from University to commercial. For the founders, it requires a paradigm shift from academic to business. Academics were previously rewarded on a different scale. The biggest challenge is the long path from idea to product launch. Often it involves ten years of hundred million dollar losses and give-aways. Opportunities are huge. Some have billion dollar products with ninety percent profit margins. The path demands a big idea. It must meet an unmet compelling need. Or it must impose a compelling threat to an existing product. It must innovate. Then a first rate team must be built. We can't do it by ourselves. Syndication is necessary. We need to partner with other venture capitalists or corporate types. Capital is flowing back to early stage opportunities. We look for a fair deal with corporate partnerships. Adding partners or management teams is dilutive. Managing these dilution events is the challenge. Unlike IT investing, there are few returning entrepreneurs in life sciences. We been successful because we've been able to recruit great teams and work with great partners such as Rob Langer. We've also paced ourselves. It is a marathon. You can't lose your nerve. Other firms have failed because they've been too concentrated. It produces irrational behavior when the hard times hit. Others have over committed up front. Some companies tried to finance themselves and failed. Finally, other firms have jumped in and jumped out of healthcare. They bailed in the darkest days and lost opportunity at the best possible time. Rob Langer is prolific. His portfolio has a 55 percent return. He also hates dilution. Tmcguire@polarisventures.com

Terry McGuire

Robert Langer
Massachusetts Institute of Technology

After my PhD, I published my research to help people. It was gratifying but not enough. Starting companies has become my passion. Good science can be judged. From a people standpoint, recruiting good ones is important. From a science standpoint, there are four helpful elements. First, publish your paper in a critical, peer-review journal like Science or Nature. Second, translate it into a good blocking patent with claims that make it difficult for others to infringe. Third, is taking what you've found and moving it far enough for investors to believe it has a shot at success. This involves getting proof of principle in an animal, not a test tube. Fourth, is developing a platform technology where the same manufacturing process can be used over and over again. This gives you multiple shots at success. If one shot fails, you've got more behind it. In 1994, David Edwards and I examined the absorption rate of aerosol inhalers. It was 2-3 percent. Manufacturers tried to redesign the aerosol injectors. But we redesigned the molecules of the fluid. The absorption rate increased to 60 percent. We experimented in animals. We published in Science. And we got a blocking patent. Paul and I started the company. He got multi-million dollar deals with Lilly, Glaxo and Pfizer. We were in clinical trials in a few months. Finally, we sold the company for an IRR of 500 percent. Glycomics is an under researched area. The science of sugars is complex. My graduate students at M.I.T over 20 years sequenced and cloned enzymes that broke down polysaccharides. We published and got the patents. We formed another company with Polaris. Sold it to Novartis for an IRR of 125 percent. Going forward we are now working on nanotechnologies or microelctromechanical devices. These microchips can hold a whole pharmacy with a biosensor that determines what you need. Beyond the molecular level, tissue engineering and stem cell research hold great promise with near term commercial application. rlanger@mit.edu

Robert Langer

Please join me in expressing our gratitude to Diana Frazier of FLAG Capital Management. FLAG is one of our favorites because they keep us rooted in venture capital and private equity. Diana and her colleagues run one of the best private market fund of funds and remind us that alternative investing is not the exclusive domain of hedge funds. FLAG has generously provided the grant for today's session. diana@flagcapital.com

August, 2004

UNDERWRITTEN BY –

Commonfund Institute

Proposed Regulation of Hedge Funds

Our session titled Issues and Implications on the *Proposed Regulation of Hedge Funds* was a special Town Hall meeting called to provide the key policy makers in Washington with the sophisticated investors' perspective. Our panelists repeatedly challenged us to get involved in the current debate surrounding hedge fund regulation or face the undesired outcome of over-regulation. Cindy Fornelli, an important author of the SEC staff study, explained their reasons for regulation. Adam Cooper, Chairman of the Managed Funds Association, articulated the industry case against regulation. Bryan Corbett, a thoughtful lawyer for the Senate, warned of a growing misperception in Congress surrounding the industry. Sapna Delacourt, a lawyer for the House, spoke of her Committee's support for proposal but expressed some concerns. Chris Shays, a veteran member of the US House who votes his conscience, energetically moderated the session.

John Griswold

Cynthia Fornelli
Deputy Director, U.S. Securities & Exchange Commission

The SEC is here to listen to you…the investors. Two years ago, former chairman, Harvey Pitt, concerned about the rapid growth, began a study of the industry. It was estimated to be 7000 funds with USD 650 billion of assets. Two years later, it was estimated to be USD 1 trillion. There is no accurate data on hedge funds. Secondly, he was concerned with an increase in fraud. Finally, we were concerned with "retailization". The accredited investor standard hadn't been updated in 25 years. Then the staff performed a study. We solicited industry and public comment. In September, we issued our conclusions at http://www.sec.gov/news/extra/hedgestudyfacts.htm (see the executive summary). We found that fraud was increasing but not disproportionate. We found that the less sophisticated "retail"

Cynthia Fornelli

was investing in hedge funds through their pension funds. In July, the staff recommended and the SEC proposed a rule requiring hedge funds to register as Investment Advisors. We want your comment on this rule by September 15th. The staff will review your comments and make a recommendation to the SEC on final approval of the rule. Separately, we are rethinking our existing surveilling process and how we husband our resources. The specter of an SEC investigation creates a climate of compliance and more accurate valuations. Congress has not given us authority to go beyond disclosure. There is no "slippery slope". This is a modest proposal. It will not impair the hedge funds' competitive edge or creative freedom.

Senior Council, U.S. Senate, Banking Committee

In April 2003, chairman Donaldson testified before our committee about the need for regulation. Then the Canary scandal put hedge funds on the front page. Today, Congress and regulators are being pressured to take action. Congress is driven by headlines, not the profits. Problems and issues are brought to a committee for study, recommendation and legislation. We may intervene or allow the SEC its traditional discretion. If there is another scandal, Congress may intervene more aggressively. Hedge funds are under scrutiny. Congress is reviewing the SEC proposal. Congress may not understand the value that hedge funds perform in the marketplace. In July, our committee held a hearing. A hearing is the first forum for information gathering and debate. Chairman Shelby was, first, concerned that the problem is clearly identified and the remedy is tailored to fit. For example, if less sophisticated investors are at risk through their pension funds, perhaps we change the ERISA eligibility rules. If fraud is a problem, then the SEC's enforcement authority fits. If more data is needed, it has been suggested that hedge funds voluntarily file information. Second, there is strong concern about "regulatory creep". The SEC has limited authority to go beyond registering hedge funds but we are concerned about future Federal Reserve and Treasury regulation. Third, there is concern, as Chairman Greenspan has suggested, that regulation may lead to less liquidity and greater market disruption. Fourth, we are concerned about interagency cooperation. The CFTC already regulates CPOs. In 1999, after LTCM, the President's Working Group recommended that more regulation was unnecessary. What has changed since then? There is also concern about the allocation of limited resources. If the SEC examines hedge funds, how will that impact their resources? Finally, the outcome is uncertain. Hedge funds have recently been associated with negative headlines on the "Hill". Few in Congress may be willing to stand up for a hedge fund. The industry is vulnerable to regulation. Go on-the-record, get involved.

Sapna Delacourt
Council, US House, Financial Services Committee

We believe that investors should be free to select their investments based on their suitability. Our committee and Chairman Oxley believe in full and fair disclosure. Transparency is the foundation of our capital markets. Hedge funds are an important part of the markets. We are concerned that the SEC proposal may damage or impair hedge funds' role. After the SEC rule is final, we will formally review the hedge fund issue in 2005. We are concerned about the SEC's ability to monitor this industry through registration. The SEC did not detect and could not prevent problems in the mutual fund industry. Why will they do a better job with hedge funds? We also grapple with the issues. Will registration lead to more regulation? Is this a "slippery slope"? Will regulating hedge funds disrupt the liquidity of the markets? Will it add a regulatory cost to hedge fund operations? Will registration provide a false comfort to investors? We are sympathetic to Chairman Donaldson who is dedicated to the hedge fund issue. We will watch the final SEC rule and whether any modifications are needed. Unlike mutual funds, we do not hear from hedge fund participants. Our committee is listening and interested in hearing from you. sapna.delacourt@mail.house.gov

Sapna Delacourt

Adam Cooper
Chairman, Managed Funds Association

Hedge funds help pension funds, endowments and family offices achieve diversification in their portfolios. Hedge funds are ethically aligned with investors through the incentive fee structure. Investors, through hedge funds, provide risk capital to illiquid markets, act as a shock absorber in a crisis, and should be compensated for that role. It is important to continually reexamine the suitability of our role. Clearly, the regulators and Congress are doing this with great care. We believe that imposing a new regulatory regime will not improve the investor's condition or benefit the capital markets. In contrast to the SEC's concerns, rapid growth of the industry does not represent structural flaws. We believe rapid growth is a measure of hedge fund's ability to satisfy investor's future funding needs and attributable to several Congressional reforms such as Section 3(c)7. Secondly, how can the SEC be concerned with fraud when its own staff report found no disproportionate incidence of fraud? The dissenting SEC Commissioners noted that the proposed rule would not address an increase in fraud. We share everyone's contempt for fraud. We propose the SEC increase its coordination with other regulatory agencies and authorities to combat fraud. We propose the SEC revisit its oversight methods rather than look for more hedge funds to inspect. Third, we believe the proposed rule does not address the "retailization" issue. Hedge-fund-of-funds who gather assets from less sophisticated investors are already registered as Investment Advisors and subject to SEC oversight. Also, pension funds already have professional fiduciaries that are subject to comprehensive pension regulations. Only one percent of pension assets are invested in hedge funds versus six percent invested in (unregistered) private equity and venture capital. We propose the SEC update and double its accredited investor standard. What's the real issue? The proposed rule will open the door to more regulation in the future. It will create a climate of uncertainty that will stifle our ability to conduct business. It will undermine and inhibit the industry's willingness to engage in innovative strategies for fear that our intentions will be misunderstood or second guessed. The "specter of an SEC investigation" is a preview of the slippery slope. Investors, the marketplace, already impose a "climate of compliance" onto hedge funds. It will reduce the profit and the risk-return profile that investors seek from hedge funds.

Christopher Shays
Member, U.S. House of Representatives

Hedge Funds are the largest industry in the Fourth Congressional District. I'm here to moderate and to listen. Hedge funds and their investors should worry about another scandal erupting in your midst. Then Congress will get political and people who do not understand your industry will decide your fate. If you do not contact us, in Congress, you do so at your own peril and I cannot act as your advocate. rep.shays@mail.house.gov

Please join me in expressing our gratitude to the Commonfund Institute who has generously provided the grant for today's session. jgrisw@cfund.org

Christopher Shays

I urge you to call or write, either formally or informally, these influential policy makers listed above. They are giving us a unique opportunity to help them shape future regulations and lawmaking. steve@greenwichroundtable.org

September, 2004
UNDERWRITTEN BY –
The Citigroup Private Bank

Asset Allocation for 2005: Navigating Risks, Charting Opportunity

Our session titled *Asset Allocation for 2005: Navigating the Risks, Charting the Opportunities* is one of the most durable themes of the Roundtable. It was held as our ninth annual prediction on the winners and losers in the alternatives world. Ramon Koss is one of the most seasoned allocators in the alternatives world. Doug Cliggott is the uncannily accurate research chief for a Swedish hedge fund group. Ken Shewer moderated this session with two decades of perspective. First, he counseled those who felt it has been a lousy year to lower their expectations. Second, he calmly reassured us that it's been worse before.... much worse.

Beverly Buker

Douglas Cliggott
Brummer & Partners Research

Let's examine the outlook for the US equities. We need to find the trend in corporate profits to find an intermediate trend in equities. Profits can be gauged by the difference between consumer spending and wages, how investment spending is changing, how government spending is changing in relation to taxes and how the trade balance is changing. I've expressed this as P=(C-W) + I +(G-T) + (X-M) where P is profit, W are wages, C is consumer spending, I is investment, G is government spending, T is taxes and X-M is the net trade balance. This simple framework helps me develop an informed judgment about the behavioral characteristics of the US economy. Profits improve when the saving rate is falling and we spend more than our wages. The savings rate in the US is rising. This hurt profits. Investment activity fell as inventories evaporated. This had a neutral

Douglas Cliggott

effect. Growing governmental deficits have a positive effect on corporate profits. Total surpluses of local and national governments are falling. This helped profits. The US trade balance deteriorated. This dampened profits. The federal budget deficit exploded. There was a huge transfer between the US Treasury and corporate balance sheets. This is not sustainable. Corporations aren't hiring or expanding because they sense that they cannot keep robbing from the Treasury to maintain their profitability. US households are saving only 1%. Over 3 years savings rates will rise when interest rates rise. This will depress profits. Residential investment will fall when interest rates rise. Business investment will stay low because capacity utilization is low and revenue growth is weak. Our healthcare sector is being outsourced to other countries because our intellectual capital is too expensive. Our federal budget deficit will keep growing because spending continues to grow unabated. Our trade deficit continues to grow and it will continue to depress profits. In short, corporate profits will stink. PE multiples are 20 now. Long-term average PE is 16. Earnings growth outlook is bad. Earnings volatility is much greater. The world is a mess. Policymakers are clueless about how to improve the situation. Pay a lower multiple for stocks when uncertainty is so high. Greenspan never allowed a real recession to move through our economy. Now we are left with the legacy of several structural imbalances. Buy Asian equities but don't hurry. They are high beta and high risk. US 10-year bonds are only 4%. Spreads are tight. Inflation adjusted Treasury Bonds are attractive. European government bonds will be attractive as the US dollar falls. Commodities whose supply is difficult to increase will be attractive. China and India continue to put demand pressures on oil. In the presidential elections, my head says Bush and my heart says Kerry. No change in the markets with either. Congress may change in 2006. douglas.cliggott@brummer.se

Ramon Koss
Credit Suisse

I share Doug's views. But a fund of funds manager should express his views by allocation, instead of imposing it on his managers. The environment in the past six months was difficult overall, but the behavior and opportunity sets of hedge fund strategies remain heterogeneous. Within each investment style, a closer look reveals very different opportunities. But when positioning a portfolio, we need to also look at the specific threats each strategy brings with it. Many equity long-short managers, for example, remain highly correlated with the stock markets. They often have a long bias and many are similar to each other. But they do provide long-term upside and have good capacity. Equity market neutral strategies on the other hand often have a mismatch of philosophies between their long positions, which are fundamentally driven, and their short positions, which are more technically driven. Large- versus small-cap and value versus growth remain important differentiating considerations when analyzing such managers. Vanilla convertible bond arbitrage is faced with highly compressed spreads today. It used to work better in the good old times when a majority of investors ignored the inter-relationships between stocks and bonds. Given today's convertible valuations the pure convertible arbitrage strategy offers little upside. Diversification into non-US and non-Western European issues can offer some relief, and so does the credit play. But make sure you know which risks you buy when investing in a specific fund! Capital structure arbitrage seems to offer some unique opportunities for now. Faced with a severe liability overhang, many pensions are forced to re-structure their investment portfolios and further diversify their risk with non-traditional investments. Already now, skill-based returns are hard to find. Going forward, so-called skill-based strategies may well become less unique and increasingly clustered. A trillion dollars from pensions will simply accelerate this trend. But many alternative investment strategies will continue to offer return streams that are fairly uncorrelated with traditional investments. In addition, amateurs flocking into alternatives are creating ample opportunity for astute investors. We are therefore considering an increase in our allocations to alternative investments. Focus must lie on risk-reward rather than solely on return. In terms of large asset inflows, short-term arbitrage strategies are the first to experience capacity problems. We must be aware that some employ higher leverage to juice their dwindling returns. Macro and trend following strategies will not face capacity issues of the same severity. Buy directional strategies because of their ability to capture longer-term inefficiencies, and because of their lower sensitivity to size, but be aware of swings. The returns generated by some fixed-income arbitrage strategies sometimes include hidden carry; such returns obviously erode quickly in a flat yield curve environment. We like what we call "silo" arbitrage, that is, astute managers who attempt to exploit any situation where different sets of people don't talk to each other, or don't act and react in the same way or at the same time, thereby creating inefficiencies. ramon.koss@credit-suisse.com

Please join me in expressing our gratitude to Beverly Buker of Citigroup Private Bank. Citigroup has provided the grant that made this symposium possible.

Regulating Private Funds: Culture of Compliance or Unintended Consequences

Our topic *Regulating Private Funds: Culture of Compliance or Unintended Consequences* was held as we sought out differing viewpoints on the SEC's recent rule to register hedge funds. This follows up on the session where the SEC staff, as well as lawyers from the House and Senate made their case. Today we heard the independent minded SEC Commissioner Paul Atkins declare his opposition to the rule. Dick Blumenthal, Connecticut's Attorney General and a leading consumer rights advocate, cautiously indicated his support of the rule. And Brian Borders, who authored the National Venture Capital Association's comment letter to the SEC, spoke of that group's concern for the "slippery slope" of future invasive regulation. Don Putnam, a leading investment banker served as both moderator and industry advocate. His many erudite insights on the unintended consequences of the rule can be heard at www.greenwichroundtable.org

Luke Imperatore

Richard Blumenthal
Attorney General of Connecticut

My role here today is unfamiliar. As a consumer advocate I find myself here championing the rights of wealthy investors, a group who does not normally need my help. Sophisticated investors have rights too. Secondly, I find myself supporting increased Federal oversight here. Normally states resist increased federal intervention. But a fact of political life is that this industry is growing in size and its appeal to the general public. Hedge funds have power and impact. Last week my office uncovered a hedge fund fraud. Should investors rely on Connecticut to detect fraud and monitor this industry? Although Connecticut has uniform securities laws, the federal government is better equipped to provide oversight. Hedge funds are destined for some kind of regulation. If it doesn't come from the federal government, it will come from the states. The political cauldron and the constituency already exist. No one wishes to inhibit hedge fund's entrepreneurial and economic role. So we are wary of any unintended consequences. I'm wary of the illusion of safety that Form ADV carries with it. The tobacco industry hid behind the Surgeon General's label for decades. One of the most compelling arguments against the new rule relates to the sufficiency of resources. Inadequate resources may produce bad investigations. Bad investigations may focus on the wrong targets and fail to produce evidence against the right defendants. It will harm the credibility of the regulating agency and may chill the industry's creativity. Given the opportunity, I would act to protect the anonymity of whistle blowers. attorney.general@po.state.ct.us

Richard Blumenthal

Paul Atkins
Securities Exchange Commission

I voted against the hedge fund registration rule for 3 reasons. One is philosophical. There are two hundred thousand sophisticated investors in hedge funds. There is no retailization as the staff claims. Second, practically speaking, the SEC does not have the resources or the talent to adequately examine the industry. If every hedge fund registered with us, there is no way, realistically that we could examine each one. Our agency's resources are better allocated to protecting 95 million mutual fund investors rather than the thousands in hedge funds. Our examiners are not experienced to understand the often complex strategies. Last month we found fraud at a large registered hedge fund in Boston. Tipsters, not examiners, brought it to our attention. We need to rely on the marketplace, investors, to provide tips and to further a culture of compliance through their due diligence process. Third, good government shouldn't shoot first and ask questions later. Only now are we examining the impact of the rule. The SEC has been working towards more risk-based examination approaches. Periodic examinations cannot uncover systemic risks. Only more intrusive regulatory approaches such as banking-style regulation regimes or a more balanced approach where we collaborate with the states, CFTC, Federal Reserve and the Treasury can accomplish this. I think we need to focus on a cooperative-good government approach. CHMURAKT@SEC.GOV

Paul Atkins

Brian Borders
National Venture Capital Association

At first venture capitalists wondered, "what's this got to do with us?" Venture capital is similar to hedge funds in our exemption from registration. Otherwise, our industry is very different in our approach and market impact. Early on, the SEC reassured us that the registration rule would have nothing to do with venture capital or private equity. Thus, the NVCA had no official position. But after reading the 2003 SEC Hedge Fund Report, it was obvious that anyone could remove the word "hedge fund" and replace it with "venture capital" and the same logic would apply. Our neighbor's house is burning down and we're next. Currently the only practical distinction between hedge funds and venture capital is the two-year lock up test. This liquidity test was created when we helped the Treasury for anti-money laundering reasons. However the Greenwich Roundtable's concern is valid. This liquidity test will unintentionally harm hedge fund investors. We are troubled by the SEC's rational for regulation. Fraud will not be reduced by this rule. Retailization does not exist in pension funds as the SEC staff claims. Pension funds are overseen by fiduciaries. Regulatory agencies tend to expand their reach. Thus we are concerned that the SEC in the future may decide to regulate venture capital for the wrong reasons. The most serious consequence will occur when a general partner wonders 'how will the SEC view this?' even though the investment is legitimate. That will stifle innovation. www.nvca.org

Brian Borders

Please join me in offering our thanks and gratitude to Founder's Council member, Putnam Lovell NBF, who generously provided the underwriting for this important symposium. DKochav@PutnamLovellNBF.com

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UNDERWRITTEN BY –
Putnam Lovell NBF

Regional Perspectives on Equity Investing in Europe

Our topic, *Regional Perspectives on Equity Investing in Europe* was held as we continue to examine the major equity markets of the world. John Bennett is the seasoned Scottish portfolio manager who beat a very optimistic drum. Jim Kester, a large institutional private equity investor, offered his tips for hiring a buyout manager there. Brad Conger is a nimble hedge fund manager who painted a pessimistic portrait of the region. Rian Dartnell energetically moderated this session armed with an insider's insight.

Rian Dartnell

John Bennett
Global Asset Management

Europe is a market of stocks rather than a stock market. In a low GDP growth market, I look for cash flows and inflection points. We live in a growth-obsessed world, a world obsessed with black and white. Nowadays there are few absolutes so I look for shades of gray. With constant downward pressure on pricing and margins, it's hard to expand cash flows. I look for rising cash flows in companies who are shrinking invested capital or who were formerly destroyers of capital. Wasteful deployment of capital is being stopped. Europe has reached its inflection point. The Germans have a failed model and they realize this. They will lead the change. They have no choice. Their companies have their backs to the wall. European capital markets are not yet liberated but their product markets are being liberated. European politicians cannot block pricing transparency for its products any longer. EU accession is a strong liberating force. Eastern Europe does not have rigid labor laws and so it is growing faster than France and Germany. "Euro-sclerosis" is a sterile, tabloid concept. Buy Europe on the sights and sounds of riots in the streets. Germany is changing. France will follow. Germany's largest union just abandoned its 35-hour workweek. Bonus schemes are being linked to an individual's productivity. The German stock market is trading at half its peak price. Its market is full of misery and depression. As a value manager, that's exciting! jbennett@gam.com

John Bennett

James Kester
Allianz Private Equity Partners

We invest over $2.5 billion in private equity partnerships in European and US companies. Europe is large and it is growing. Europe has passed the US in private market transactional value for the first time ever. The deals are large and getting larger. Is this sustainable? The large conglomerates have been net sellers but can they grow without acquiring? European buyout returns have outstripped US returns since 1980. But US venture capital returns are double the returns in Europe. Europe is not a unified monolithic market. Germany has been a market of large corporate restructuring deals. Germany's middle market of tightly held family businesses has not been willing to sell. Italy is the same. France has a vibrant private equity market. Their managers are embracing buyouts as a way to ownership. Capital is scarce in European venture capital and an entrepreneurial culture is emerging. Irish technology is promising. An American once said 'the French don't have a word for entrepreneur'. Spain is the engine of growth in old Europe. Each country has different qualities. Employing a pan-European strategy from an office in London is dangerous. The yanks are coming. KKR, Bain, Carlyle Group are raising large amounts of capital to deploy in Europe. They are highly evolved investors with deep sector expertise but they've made their share of mistakes in the past. Bigger deals are driving the markets. Tread lightly there. There is no substitute for proper due diligence. Beware of returns listed in a PPM. Examine only realized returns. Beware of marks. Follow the money. Examine the management fees and the transactions fees they earn. Know thyself. If you don't have the resources to perform the due diligence, hire someone who does. Know your neighbor. You're getting married for ten years to a general partner in a shotgun wedding. Do the references and background checks. James.kester@apep.com

James Kester

Brad Conger
Narragansett Overseas Fund

We take an agnostic, bottom's up view of Europe. We look for narrow informational asymmetries. Diversification does not work as it once did. European stocks all correlate to 1 in times of stress. Traditional managers recognize this. Alternative managers don't. Markets are becoming much more efficient and much more correlated. The US and Europe are becoming linked. Opportunities are diminishing. There are still some undervalued mid and small cap companies. Hedge fund investors still believe that long-short strategies are different for Europe. Europe is not cheap relative to the US. Europe has an unsustainable social safety net. I'm bearish on the pace of change. It will happen but it will take a generation to do it. Contrary to popular beliefs, consumer debt is higher than the US. Home prices have grown faster than the US. The Euro currency is a disaster. Short rates will be rising. Exceptional values exist. The buyout firms are the catalyst, unlocking value in Europe. They've got the money, the skills, the financing and the motivation to unlock value. These companies will emerge from the restructuring process much more focused. Invest with managers who think like owners, like buyout firms. Avoid the macro players. Opportunities will lie with managers who are narrowly focused. bconger@namllc.com

Brad Conger

Please join me in honoring Aaron Dorr at Putnam Lovell NBF for generously underwriting this symposium. Aaron and his team run the M & A practice and have led some of the most rational marriages in the money management industry. ADorr@PutnamLovellNBF.com

The Rise and Fall of Volatility: Buy, Sell or Hold?

Our session on *The Rise and Fall of Volatility: Buy, Sell or Hold?* was held as many hedge fund strategies have seen their predictable return streams begin to break down as volatility began hitting multi-decade lows. Many of these strategies are dependent on volatility for their results. Steve Bloom is the thoughtful, straight-talking hedge fund manager who explained the relationship between fear and volatility. Amy Falls is a highly respected fixed income research analyst who was bullish on global macro and currencies. Bernie Tew is the statistical arbitrage manager who warned that rising stock correlations are more serious than falling volatility. Hunt Taylor helped us understand this complicated area of market structure with his clear-headed moderation. hunt.taylor@hartztrading.com

Steven Bloom
Sagamore Hill Capital

Is volatility an asset class? No, not really. Volatility trading is a zero-sum game played amongst sophisticated professionals. It is brutally efficient. The consistent winners are the dealers because of the structural advantage that emanate from customer order flows. Otherwise, volatility is littered with mediocre performers. Do we buy, sell, or hold? It is seductive but difficult to make a directional bet on volatility. There are subtler, more reliable bets available. One is the skew bet that recognizes different volatilities in option pricing. Another bet is dispersion trading or the correlation trading that arbitrages the difference between an index and its components. Third is trading around the term structure of volatility and the differences in time horizons. In November all hedge fund strategies made money again. What happened? Volatility was an indication of risk. After the election there was more certainty and a decreased perception of risk. As risk aversion decreased, volatility increased. Risk premiums were embedded in many volatility spreads. These spreads then decreased as uncertainty decreased. The overall volatility of equity markets is at 10-year lows. There's room to fall further. Individual stock volatility is at historical lows and correlations are high amongst index stock components. Something's going on in the market. Structural changes have dampened volatility. The increased activity of mean reversion strategies such as statistical arbitrage and long-short traders, coupled with low transaction costs, created a viciously efficient stock market. Returns are low across the board. Fear, as measured by purchases of out-of-the-money puts, is high because dealers still hold the liabilities on their books from the principal protection products they sold in the 2001-02 period. Stock pickers have a very difficult environment. Without volatility, they've got to take more risk. Being diversified doesn't protect the portfolio as it once did either. Convertibles had a difficult year. Supply no longer outstrips demand. But how much lower can they fall? Holding a portfolio of converts is akin to holding a portfolio of puts. bloom@saghill.com

Steven Bloom

Amy Falls
Morgan Stanley & Company

Yes. Buy volatility in the interest rate and foreign exchange markets. It's still at low levels in the currency markets. Buy the global macro strategies. The obvious imbalances exist with balance of payments and the budget deficits. Inflation pressures will put upward pressure on volatility. Credit markets are in uncharted territory. The impact of a volatility spike hasn't been stress-tested with high levels of leverage and derivatives. Declining inflation, declining interest rates and rising independence of central banks were secular forces that dampened currency volatility. Ballooning mortgage-backed markets was the secular force that drove interest rate volatility higher. These are serious forces. Cyclical issues include volatility in short-term interest rate coming down from historic levels. Low interest rates and the quest for yield have investors selling volatility. Also, buying volatility is a negative carry trade and that is unattractive as the Fed telegraphs its intention to raise rates. Volatility in the Euro is rising. Given the anxiety over the budget deficits and the dollar, volatility should be higher. It's only a matter of time before FX volatility is trending higher. Interest rate volatility is much more complex and was much lower in the 1980's. FX markets will put upward pressure on interest rate volatility. Falling interest rates cause mortgage refinancing which creates upward pressure on interest rate volatility. Interest rate correlations rose as FX volatility fell. Increasing FX volatility is impacting foreign government monetary policies. Massive uncoupling in global bond markets is unfolding. Active risk takers will find opportunity here. Emerging markets add even more to the set. Seek active duration management by over weighting and under weighting countries. Avoid the US government bond market as the secular issues battle the cyclical issues. Asian central bank demand for dollar denominated assets is still huge but incremental demand for Treasuries is falling. This is significant. The money is chasing higher yielding assets such as mortgages and stocks. Cash levels are way above what's prudent. Central banks are funding alternatives such as local projects and the credit markets. This will keep the bid levels high in corporate credit markets. Beware when leverage exceeds the liquidity in credit markets. Asian demand for Treasuries has bought Washington some time. Given the rate of government borrowing, we estimate the 10-year rate should be 3.5%. Today the real rate is below 2 percent. If Asian purchases drop, the fair value should rise to 5 percent. But convexity will amplify moves on the way up and on the way down. Societies get the inflation rate they need. I worry about deflation. Amy.falls@morganstanley.com

Amy Falls

Bernie Tew
New York Life Investment Management – QED

Today I'd like to talk about volatility, correlations between stocks, and the change in correlations. Today stocks are in a low volatility state. Stocks are normally in a low volatility state. Average volatility for the S & P index is usually low. Why does this cause difficulty now? Why are things changing? Stocks have been in a trading range. This causes volatility to compress. The change in volatility also compresses. Today the change in volatility is at historic low levels and for a prolonged period. Correlation and volatility are related. We don't yet understand which causes which. They follow each other. Their relationship is expressed as a ratio. Historically this ratio has been 5. When volatility goes down, correlations go down. When correlations rise, volatility rises. Trading markets or trending markets have little effect on the ratio. Rarely does the ratio contract, expand or invert itself. The ratio inverted on September 11. The ratio inverted during the Tech Bubble years. The ratio widened on the day of the Madrid bombings. Recently the ratio was at 15. Terrorism causes volatility to compress. There are local macro effects. Volatility in the Tel Aviv market drops after a terrorist event. What does this mean? There is a lot of macro risk in the US stock market. Global macro strategies have an advantage. Volatility is moving back to normal states. Will volatility stay low? Well, yes. It's always been low. Spikes of high volatility are more unusual events for the stock market. Falling correlations will have more impact on stock pickers in the future. More importantly, the correlations between stocks are abnormally high and widening. These are difficult conditions for stock pickers. The logical extreme will be that the stock market will become one stock that does not trade. The real story is that stocks and their correlatedness are more influenced by macro events. Market participants are doing many different strategies when volatility is falling and correlations are falling. Mean reversion strategies are not pushing volatility down. bernie_tew@nylim.com

Please join me in expressing our gratitude to Bob Aaron. DPM generously sponsored today's symposium. DPM has underwritten most of our symposiums on market structure beginning with the 2002 examination on valuation. raaron@dpm-llc.com

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Spring-Summer Symposia

VERY IMPORTANT! Sessions are typically held on the third Thursday of each month, but last minute changes do occur. Consequently, our schedule can change at a moments notice. Here is a tentative list of dates. Do **not** plan on being at the Museum without first receiving an invitation and a confirmation.
RSVP@GreenwichRoundtable.org

March 17, 2005

April 21, 2005

May 13, 2005

June 16, 2005

July 21, 2005

August 18, 2005

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