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as 'solutions' grow
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Notz Stucki's philosophy favours the human angle over technical jargon

Geneva-based Notz Stucki has emerged from the ashes of its involvement with Madoff to celebrate a healthy 2012 for its two flagship funds of funds. And, with its strong relationship-based approach, the future is looking bright

H

ilmi Ünver, partner and head of alternative investments at Geneva-based Notz Stucki, talks about hedge funds in terms that may sound ultra-traditional to many investors. Instead of alphas, betas and VaR limits, he talks of talent, conviction and the human side of hedge fund investing.

"It is all about relationships, understanding the manager's philosophy, and if they are hungry enough to continue in this business," Ünver says.

Notz Stucki is not a market timer but an asset allocator, he adds. He and his team invest with hedge fund managers they believe have the potential to perform over time.

Notz Stucki's two flagship funds of funds had an exceptionally good 2012. Haussmann Holdings, the \$1.5 billion multi-strategy fund that Notz Stucki co-advises with Banca del Ceresio and Mirabaud & Cie, gained 9.41% compared with 3.87% for its peer group, as ranked by *InvestHedge*. Pendulum, Notz Stucki's restructured \$200 million multi-strategy low-volatility SICAV, was up 8.4% for the year.

These returns are very gratifying for Notz Stucki, which is fighting its way back after being caught up in Bernard Madoff's fraud, one of several prominent Geneva-based institutions to be in this position. The firm manages \$6 billion in assets, down from a peak of \$14 billion five years ago.

Pendulum was the only one of Notz Stucki's FoHFs to be exposed to Bernard L Madoff Investment Securities (BLMIS), via a 7.6% position in a feeder fund. Launched in 1999 as a low-volatility alternative to fixed income, Pendulum had \$4.25 billion under management before the crisis and subsequent restructuring.



Hilmi Ünver

Haussmann Holdings, a blue-chip fund that celebrates its 40th anniversary this year, was never invested with Madoff but suffered outflows, partly because the fund maintained its monthly-plus-20-days liquidity. Ünver is Notz Stucki's representative on the fund's investment committee, along with Federico Foglia of Banca del Ceresio and Umberto Boccato of Mirabaud Asset Management.

But Notz Stucki is seeing new money flowing in as investor confidence returns, partly because of performance, and partly because 18 months ago Pendulum disposed of its remaining illiquid assets in the

By Claire
Makin

last stage of the fund overhaul that began in 2009. "Now we are very much back on track with the returns people expect," Ünver says.

In other signs of renewed confidence, last year Notz opened its Luxembourg funds infrastructure to single hedge fund managers and expanded its business in Madrid, Milan and Bahrain. More recently, the firm's Singapore business was granted a full capital markets services licence.

Founded in 1964, Notz Stucki was a pioneer of hedge fund and multi-manager investing and blew a breath of fresh air through the staid Geneva establishment. Christian Stucki, who co-founded the business with Beat Notz, was a founding board member of the Leveraged Capital Holdings fund with the Rothschild Group. LCH is even older than Haussmann Holdings, which was launched in 1973 and was one of the first funds to invest with George Soros. Stucki, now 80, sits on Notz Stucki's board, and remains an influential figure at the firm.

Despite its downsizing, the firm ranks among Switzerland's leading independent asset managers with 86 employees, including 35 in asset and client management and 12 partners (shareholders).

Its core business is private wealth, which accounts for 75% of Notz Stucki's assets under management. The rest is run on behalf of a wide range of institutions from family offices to pension funds, banks and insurers, and sovereign wealth funds.

Some 45% of assets are invested in the Notz Stucki funds, which cover a wide range of strategies (long/short, macro, relative value, commodity trading advisers) and geographies (US, Europe, Japan, Asia).

Notz Stucki also runs dedicated discretionary or advisory mandates for institutional investors, including white-labelling for third-party managers and specific mandates for pension funds and family offices that share the firm's long-term relationship-driven approach.

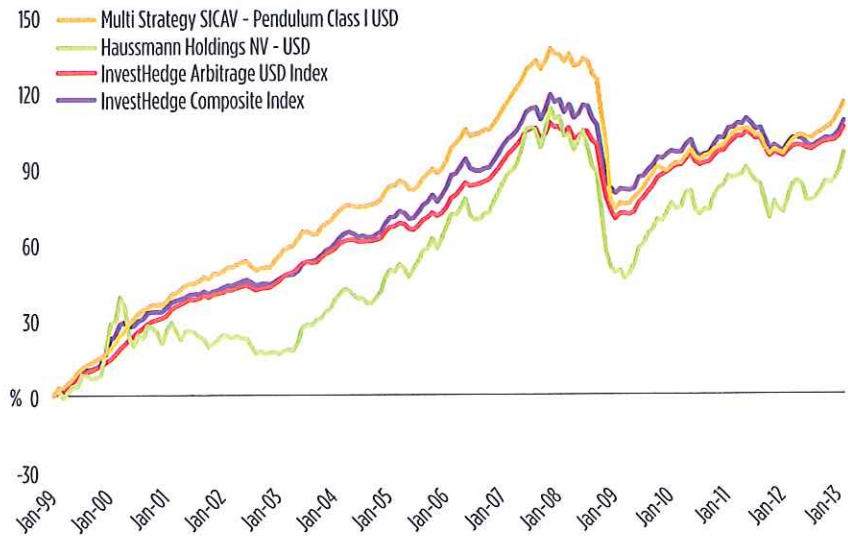
The firm's partners invest their own money alongside their clients, and the firm has been investing with some of its 110 or so underlying managers, such as Louis Bacon's Moore Capital, for more than two decades.

Notz Stucki has also run long-only mandates for 20 years. In fact Stucki made industry press headlines in January when he was reported as saying that the firm now favoured long-only strategies, and was apparently turning its back on its hedge fund heritage.

According to Ünver, this was a misunderstanding. "We are still very much committed to hedge funds," he says. The reality is that Notz Stucki also wants to highlight its knowledge of long-only products, as the lines blur between traditional and alternative investing.

The involvement of Notz Stucki and other Geneva institutions in Madoff has been widely reported, but Ünver adds that Pendulum's po-

Performance: Multi Strategy SICAV – Pendulum Class I USD / Haussmann Holdings NV



Source: HedgeFund Intelligence Database

“The hedge fund industry is about relationships, taking bets and having conviction, but also making sure that managers don’t get overwhelmed by their own ego”

sition was run like a cash alternative, not a core hedge fund holding. The position was instigated several years before Ünver joined Notz Stucki in 2006 having been a partner at Octogone, a Geneva private wealth manager, and had previously worked at Lombard, Odier & Cie and Republic National Bank of New York.

In January 2009, Notz Stucki took the tough decision to restructure Pendulum. A liquidation share class was created in March 2009 for investors wanting to redeem, along with a continuing share class for those who chose to stay invested in Pendulum. Additional liquidation share classes were issued in June, Septem-

ber and December 2009. Notz Stucki reduced its management fee from 1.5% to 0.25% on the four liquidation share classes.

It was important for both the liquidating and continuing share classes to hold identical positions, Ünver says: "We wanted them to have the same portfolio so that people who wanted to redeem didn't think they were getting the bad names, and people who continued didn't get the impression that they were paying for the ones who wanted to redeem."

In the process, the number of Pendulum's underlying managers was cut by nearly two-thirds from 60 to 23 managers who had behaved impeccably during the crisis, Ünver says. Only one of the 23 had side-pocketed a single position, which was resolved within eight months. Throughout the process, Notz Stucki sent out detailed risk reports to investors to enhance its service quality and rebuild client confidence. "That's the only way to get the trust of investors back," Ünver says.

In the final stage of the restructuring, the side-pocketed assets were sold to a single buyer in 2011 in an auction process that took eight months. This was the real turning point

Pendulum core holdings

Investment Fund	Manager	Investment style	Inception
Millennium International	Israel Englander	Diversified arbitrage	February 2007
Moore Macro Managers	Louis Bacon	Low-volatility trader	August 1993
Citadel Kensington	Ken Griffin	Multi-strategy arbitrage	December 2011
1798 Relative Value	Steven Bulko	Multi-strategy arbitrage	June 2009
Tyrus Capital	Tony Chedraoui	Event-driven	October 2009
Castlerigg Merger Arbitrage	Tom Sandell	Event-driven	May 2011
Third Point	Dan Loeb	Event-driven	October 2010

FoHF profile

for Notz Stucki, given the stigma attached to illiquid legacy assets by investors and counterparties.

Pendulum's underlying funds are now more liquid than before the restructuring, even though its terms are less attractive – monthly with 95 days' notice compared with 35 days pre-crisis. But the terms are a better match with underlying funds' liquidity terms, Ünver says. The gate has also been raised from 5% to 20%. "We don't intend to activate it but it gives people confidence that they won't suffer stress because of a huge redemption," he notes.

Ünver acknowledges that the past few years have been discouraging, not least because it is tough to manage a fund where assets are draining away every month. One reason why Notz Stucki and other Geneva-based asset managers were hit so hard is that many of their clients were third-party wealth managers whose end investors panicked.

Retail investors had started to believe that hedge funds were "magical products", Ünver says. When their expectations were shattered, the result was "a huge purge of retail money that will take a long time to come back".

He and his team have had to run portfolios with larger cash weightings than they would have liked, which limited their scope to add to their highest-conviction ideas and managers as the market rallied. "We probably missed some good opportunities," says Ünver. In the face of this challenge, Ünver praises the Notz Stucki investment team for doing a terrific job.

Now, spirits are improving as investors' confidence returns.

Notz Stucki's approach is to pick the best-of-breed managers in each strategy, and let them run money in an unconstrained manner, but with a strong focus on capital preservation. To make this work, the firm employs a mix of extreme caution and high conviction. Despite thorough vetting by separate operational due diligence, risk and investment teams, new positions are nearly always instigated with allocations of less than 1%. By contrast, the top 10 core managers of large portfolios run 50% of the assets.

This is because Notz Stucki aims to build up its trust in a manager over time, rather than piling in at the start of the relationship on the basis of analysis. Its distinctive approach is to divide managers into four groups – anchors, kickers, opportunistic and trial.

This is a variation on Haussmann's method, used by several Swiss institutions, which is to invest with a core of tried-and-tested managers and a 'farm team' of newer names who receive more money as trust increases.

In Notz Stucki's case, core managers are known as 'anchors'. The list includes Caxton Associates, Moore Capital, Tudor Investment, Egerton Capital and other experienced managers who have developed their own distinctive style and take controlled risks. Pendulum typically invests up to 10% in

Notz Stucki: at a glance

Headquarters: Geneva

Ownership: independent

Assets under management: \$6 billion
(25% institutional; 75% private client)

FoHF assets under management:
\$2.2 billion

Flagships: Pendulum, Haussmann Holdings (co-advised with Banca del Ceresio and Mirabaud & Cie)

Employees: 86

Investment team: 35 employees in asset and client management

Underlying managers: 110

“When I first came into the industry, 23 years ago, managers said, ‘This is what I do and this is how I’m going to work, because this is my money and my conviction.’ Now they say, ‘These are my risk parameters’”

one of these managers.

'Kickers' are managers such as Glenview Capital's Larry Robbins, who runs a "punchy portfolio" with deep embedded values, Ünver says. From time to time, his positions pay out in a big way. "When valuations come right it is a home run," Ünver notes. Glenview had a solid January.

The 'opportunistic' group includes managers who are consistently able to profit from the investment opportunities that no good manager should miss, Ünver says, such as shorting the yen while going long Japanese equities at the end of 2012. There is some cross-over with the 'anchors', but Pendulum typically invests 3% to 4% with each of its opportunistic managers and 'kickers'.

Trial managers are newer additions and are typically allocated less than 1% in the hope that they will grow into 'anchors' over time. The key challenges are finding the real hidden gems, which is far more difficult than it was, and making sure that as they grow, these managers remain fully engaged with what they do, and hungry to make money.

This is an absolute requirement for Notz Stucki, and applies to established as well as new names. After Ken Griffin's Citadel funds plunged in 2008, Notz Stucki – which had been out of Citadel – was keen to re-invest.

"People said, 'You're crazy.' I said, 'No, Ken won't give up. He will make it up to investors,'" Ünver says.

Griffin did make it up. One of his funds rose 62% in 2009; Citadel has reported 20% plus returns for the past two years and is above its high water mark, although Notz Stucki was unable to go back in until 2011 because of Pendulum's restructuring.

Humility is another quality that Notz Stucki values in its managers. Ünver warns against arrogance and complaisance, as the two characteristics with the most power to damage returns. "The hedge fund industry is about relationships, taking bets and having conviction, but also making sure that [managers] don't get overwhelmed by [their own] ego," he says.

Managers who admit that they are wrong and address their problems are held in high esteem. "This is not passive investment. If you have guts and conviction you will make mistakes," he points out.

There is top-down input to Notz Stucki's portfolios in the form of theme-based ideas that drive strategy allocation. However, Ünver is adamant that FoHF investing is not about adding value with dynamic allocation. "I'm a strong believer that if you are a good market timer you should buy ETFs and make the right sector rotations," he says.

Another concern is that pension funds' expectations of hedge funds as a form of volatility management are very different from the industry's roots in private wealth management, and that the end result will be disappointment. "They want steady, small, nice numbers, but if that is what you want, you are not going to outperform, especially if you put fees on top," he points out. Fortunately, he says, Notz Stucki's institutional investors understand the firm's approach.

Ultimately, Ünver worries that the hedge fund industry is going too far in placing strait-jackets on managers, and that this is leading to process taking priority over talent and best ideas. Most managers now play the game by positioning their funds to appeal to the institutional focus on risk-budgeting. "When I first came into the industry, 23 years ago, managers said, 'This is what I do and this is how I'm going to work, because this is my money and my conviction.' Now they say, 'These are my risk parameters,'" he observes.

But he sees the early signs of a reaction against this mindset, and a feeling that the industry is remembering its roots. "Managers are starting to realise that they need to take what the market can give up," he says.

Looking ahead, Ünver is optimistic that Notz Stucki is well-placed to rebuild its brand. Clients who have given the firm \$6 billion of assets to manage are attracted not by claims of superior risk metrics and proprietary systems but by strong relationships and the firm's focus on talent, he believes. "The truth is, there are wonderful managers out there," he says.