

## The Environment in Asia for L/S Equity.

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### Asian roundtable Introduction

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What do Asian hedge fund managers think about Asian markets and the developments of the local hedge fund industry? Harcourt invited three well established long/short managers to express their views on a few topics.

Michael Thomas, Jean Paul Temperley and Bill Orr from Martin Currie Investment Management Ltd give us insights on developments in Japan. Edinburgh based Martin Currie Investment Management Ltd has a long standing track record managing various Japan equity mandates. Martin Currie's long/short Japan fund has achieved positive and very stable returns since its inception in June 2000.

David Snoddy is the Chief Investment Advisor and principal shareholder of Tokyo based Speedwell Advisors Ltd. David's long/short experience includes positions with Soros Fund Management and Tiger Management LLC. In November 2000 he established his long/short Japan fund, which posted very attractive returns and grew substantially in 2001.

Scobie Ward and Peter Ferry are the founders of Hong Kong based Ward Ferry Management Ltd. Both were previously at Lloyd George Management before deciding to establish their own hedge fund. Scobie's and Peter's long/short Asia fund produced excellent returns in very difficult market conditions since inception in November 2000.

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### Market outlook

***Q: 2001 was a challenging year for Asia. What is your outlook for 2002?***

CURRIE: «We believe 2002 is likely to be an equally challenging year in Japan. There has been much talk of reform but little action. The economy remains beset by deflation, although there is the possibility of a cyclical bounce aided by corporate cost-cutting.»

SPEEDWELL: «Specifically for Japan, I suspect the industrial cycle will improve, which, combined with ample central bank liquidity, should provide some upside.»

FERRY: «We are constructive on emerging Asia and believe that Japan will likely face an inflection point this year under the weight of its banking crisis from which it will become either a major problem spot or a major investment opportunity should the reform process succeed.»

***Q: What would be the worst case economic scenario for your strategy?***

CURRIE: «The current worst case economic scenario would be a sharp sustained economic recovery. However, if this did occur we would immediately reposition the portfolio.»

SPEEDWELL: «Given that we are, in part, betting on an industrial recovery, the lack of that would obviously hurt.»

FERRY: «The worst case scenario for our strategy would be a major/sudden deterioration in Japan that we had not anticipated leading to an overall loss of investor confidence in Asian stocks and currencies. When we are constructive on markets we have significant net long exposure that can make us vulnerable to sudden shocks.»

***Q: We have seen a couple of bankruptcies in Japan's real estate and financial sector lately. Do you think the changes in Japan will be serious and substantial?***

CURRIE: «We believe we need to see more bad news before the government will be forced to act with meaningful reforms. The government have already said that the banking industry will be supported.»

SPEEDWELL: «The answer is yes, but we have had, by Japanese standards, serious and sustained change for 10 years. I suspect that the Japanese policy-making apparatus will continue to do what it has done for 10 years: make changes when forced, but otherwise not do very much. It remains to be seen whether they will have to finally «bite the bullet.» They will certainly have to pile up enough incremental change to enable them to avoid that.»

FERRY: «We are very concerned about the Japanese financial system and monitor it closely as a potential source of instability.»

***Q: How important will China be for the development of the whole region?***

CURRIE: «Very important, both as a competitor in the region and as a customer.»

SPEEDWELL: «Important. It will become THE manufacturing center for Asia.»

FERRY: «China's emergence is a great opportunity for investment throughout Asia as many companies in Hong Kong and Taiwan, for example, are expanding there. It is also a potential threat to many exporters in Japan and elsewhere in Asia who cannot match China's low costs.»

### **Growth of Asian hedge fund industry**

**Q: *We have witnessed an overwhelming growth of hedge fund managers in Asia recently. What is the impact of this growth for you?***

CURRIE: «The growth in hedge fund managers in Asia has obviously meant more competition but has also resulted in greater awareness of and interest in the whole sector. We have seen a number of investors invest recently in the region for the first time ever.»

SPEEDWELL: «We have seen and continue to see inflows.»

FERRY: «Long/short equity investment is increasingly recognized as a viable strategy in Asia. As a result we are seeing more and more interest in our fund and expect to grow our funds under management commensurate with this growth.»

**Q: *What is the immediate impact for your fund when competition from other hedge fund managers is around?***

CURRIE: «Growth in assets has been slightly slower, but there is a wide range of strategies and styles so investors are able to construct well diversified portfolios.»

SPEEDWELL: «Trades can get more crowded, and we've had to be careful about checking out how crowded trades are before we get in them. I've also noticed that the increasing sell side trend towards «hedge fund sales» exacerbates this problem, and where possible we do not talk to the hedge fund specialist brokers.»

FERRY: «The total free float of all major Asian stock markets is approximately USD2.4 trillion. The hedge fund community in Asia is broadly managing USD14.6 billion across all asset classes and strategies. There is little impact from competitors currently.»

**Q: *Will the growing competition make it harder to repeat attractive returns?***

CURRIE: «We do not think the growing competition has affected our returns so far and the Japanese market continues to offer plenty of good ideas and liquidity. Over time it may become harder in Asia, but no more so than the more established hedge fund markets in the USA and Europe.»

SPEEDWELL: «There are two issues here: ideas, and borrow availability. Investment ideas may get somewhat more crowded over time than they are today, raising the value of fundamental research at the same time as it lowers the value of momentum investing. Being early will matter more. Regarding borrow, it seems to me that supply has been growing as fast as demand, and we have only had significant problems borrowing names where we compete with the CB arb world.»

FERRY: «We do not view this as an issue presently.»

**Q: *What do you think is the key driver for the growth of the Asian hedge fund industry?***

CURRIE: «The poor performance of global stockmarkets and the relatively inefficient Japanese market.»

SPEEDWELL: «Returns.»

FERRY: «One of the key drivers for the growth of the Asian hedge fund industry is continued deregulation of the Asian capital markets, especially on the equity borrowing/shorting area.»

### **Manager skills**

**Q: *Significant market draw downs can never be ruled out. How do you manage your fund so that it will survive market turbulences unharmed?***

CURRIE: «We have developed a comprehensive, tailored risk management system giving both ex post measurement, ex ante management and daily VaR. The result has been the recent conservative use of the balance sheet and a well diversified portfolio.»

SPEEDWELL: «We have stop loss system which we employ religiously.»

FERRY: «We monitor our portfolio daily for exposure risk. This ensures that we maintain broad country and industry exposure at all times. We closely monitor the net long exposure of the portfolio as well. We stress test the portfolio and monitor the overall liquidity of the portfolio to ensure they are maintained within our guidelines. Finally, we have found that our stop loss policy has helped us in controlling risk in the overall portfolio.»

**Q: In your view, what will be key for a successful hedge fund manager in Asia next year?**

**What should be the particular skills that a hedge fund manager needs in Asia?**

CURRIE: «Good stockpicking skills and a particularly good understanding of the technology and financial sectors.»

SPEEDWELL: «You probably need a better familiarity with macro issues than is the case in the West. But at the end of the day the ideas drive the portfolio, and while I firmly local experience helps you pick better stocks, the basic tools of analysis are similar.»

FERRY: «Stock selection and risk control.»

**Q: Are there still cultural and technical difficulties in shorting stocks and generating good shorting ideas in Asia?**

CURRIE: «In Japan it is generally easy to short stocks. At Martin Currie we have the added advantage of managing a further \$1.7 Billion in long only money in Japan, which means most Japanese companies are happy to meet with us. These meetings ensure a good supply of both long and short ideas.»

SPEEDWELL: «Not in Japan.»

FERRY: «We have not experienced any cultural or technical difficulties in shorting stocks. In fact, borrowing stocks in Asia continues to improve, as Korea will soon be an additional market that foreign investors can short.»

## Meeting investor expectation

**Q: What kind of investors should invest in L/S Asia/ Japan managers and who should not?**

CURRIE: «There are a wide range of different styles, strategies and risk profiles so most hedge fund investors should be able to find a Japan/Asian hedge fund which matches their needs. The Martin Currie ARF – Japan Fund offers investors low volatile, steady and uncorrelated returns with a focus on preserving initial capital.»

SPEEDWELL: «Well it has been our experience that Europeans are, all other things being equal, more interested in Japan than are Americans, which may result from them having to look outside their home markets for a lot longer. But at the end of the day, good adjusted returns are good adjusted returns and if they continue to come out of Asia money will continue to pursue them.»

FERRY: «Investors in Asia typically have higher risk/return profiles. Hedge funds can mitigate the risk side of the profile and attract a wider universe of investors.»

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