Investment Monitor

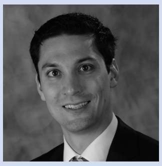
Edition 4

Welcome

James Day

Welcome to the latest edition of the Peritus newsletter intended for our Trust and Private Clients around the world.

New Team Member



We have continued to strengthen our Investment Manager analytical research process by hiring Benjamin Schoch from PPCmetrics who has recently joined the team.

The Logo – Does it mean anything?

Our logo was of course a multi million pound branding exercise and for a change, it does actually mean something! It symbolises three worlds; the world of Private Clients, the world of Investment Managers and the world of Peritus. Peritus Investment Consultancy seeks to guide Private Clients to the most suitable Investment Managers by sharing the expertise and knowledge of the Peritus team.

E – Mail Delivery

If you would prefer to receive our newsletter by e-mail, please let us know at james.day@peritus.co.uk. Equally, if you know of other people who wish to receive a copy, we would be glad to hear.

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RECENT INVESTMENT MANAGER DEVELOPMENTS

Recessions and Bear markets are tumultuous times for Investment Institutions. This period has been quite exceptional and the magnitude of change in personnel, corporate structure and most importantly investment processes have been quite significant.

Not only have there been head-count reductions but many senior employees have elected to leave their firms during the last few years. Of course, cost cutting impinges on human resources at not just the client service level but also research. One firm slashed their travel budget by 75% and in doing so the company's direct research output collapsed.

Other firms which suffered material losses in performance have been soul searching whether their investment philosophy and process were appropriate. The result is often a change in process and activities, many of which are untested.

All of these changes can often lead to an improvement in results but they can also be a warning signal that performance may suffer in the future. A performance platform can tell you about these problems several years after the changes are made, however, only deep, pro-active due diligence can provide early warning signals and alert you to these issues long before your performance platform gives you even a nudge. This is why we invest heavily on Qualitative Due Diligence and send our analysts all over the world to spend as much time as is needed to fully understand what is going on behind the scenes of the Investment Managers we review.

> *"There is hardly anything in the world which someone can't make a little worse and sell a little cheaper – and people who consider price alone are this man's lawful prey"* John Ruskin

INVESTMENT RISK MANAGEMENT
THE CHANGING ROLE OF THE GATEKEEPER

Most Trust Companies have a structured set of procedures, policies and processes in order to handle the day to day investment risk that arises from the appointment and monitoring of Investment Managers.

As a Consultant to many Trust Companies we have noticed some very significant trends in the industry over the past few years.

The most interesting development has been the evolution of the investment risk management model. Traditionally, Trustees never gave investment advice as it was perceived that this could create conflicts with clients perceiving that the Gatekeeper was the advisor and as a result, hold the Trust Company accountable. The first change is that some Trust companies are blurring the role and in search of covering the Gatekeeper's costs are permitting investment advice in exchange for a percentage of a manager's fees or time spent charges.

This wish to cover the rising overheads of the Gatekeeper has also led to the second new development which is to replace the Gatekeeper with an outsourced "pay as you go" solution. This approach has the advantage that the Trustee can focus on their areas of expertise and does not have to create an expensive internal resource whose costs must be covered.

"Quis custodiet ipsos custodies."
- who will guard the guardians

TRUSTEE INVESTMENT RISK MANAGEMENT RECENT DEVELOPMENTS

We have recently concluded another case where we have been engaged to support a Trustee in a matter involving claims of negligence regarding a firms' Investment Policies and Procedures and their process when firing an Investment Manager. What were the main points that were learned?

Client Profiling:- Stronger analysis by the Trust and investing more time assessing the investment risk profile would have added greater value.

Manager Assessment:- Structured and frequent reviews of the Investment Manager could have highlighted issues at an earlier stage and resolved the issue.

Performance Reviews:- If not undertaken or against the wrong performance measure, remains a major issue. Overly simplistic benchmark selection has proven to be equally flawed.

Trail Fees:- Receipt of trail fees, if not communicated, applied fairly or demonstrated to be independent, reduces a Trustee's defence materially.

Application:- Designing Policies and Procedures yet not adhering to them in full is a high risk strategy.

Performance Platform:- Using a performance platform is no defence if managers are not relegated or if the platform's methodology is flawed.

"Where is there dignity unless there is honesty?" Cicero

FORTHCOMING RECRUITMENT

We are planning to recruit an additional Senior Client Consultant. This person will be responsible for nurturing a select number of relationships in Switzerland and overseas. Extensive travel is necessary to meet our clients on at least a quarterly basis.

The candidate should have a genuine passion and interest in people from all walks of life and should have a career path demonstrating the highest level of ethics and integrity.

We are also looking to recruit an additional Investment Analyst. Having identified those managers who consistently exceed their benchmarks, the analyst will be required to travel widely to interview existing and prospective firms. Each site visit may take up to two days for each manager.

The candidate will need to have a keen forensic mind with a background in either Investment, Management Consultancy or have worked as a Fund or Investment Manager Analyst.

HEDGE FUNDS – TIME FOR FEES TO FALL?

Three years ago, Hedge Fund Managers forecast rolling 5 year compound annual returns for Multi Manager Hedge Funds in the region of 12% - 15%. More recently, 6% per annum is now the expected average return.

There are many good and reasonable explanations for this decline in the forecast returns but a key question is with the total expense ratio for a Multi Manager Hedge Fund standing between 4%-8%, whether investors should be satisfied with the fee dilution on their returns.

For a traditional active manager, fees comprise a Management Fee in the region of 0.5% - 1.5%. This type of fee is typically charged by a pro-active Equity Manager while Bond Managers who have outperformed Fund of Hedge Funds charge even less. So, in our opinion, a fair management fee should be in the region of 0.5% - 1%.

We applaud the concept of performance fees as they align investors' and managers' interests. However, there is no doubt that most Fund of Hedge Funds have not lived up to their 'Absolute' return promise and we see no reason why investors should pay inflated fees for risk adjusted returns which more closely match those of sovereign bonds!

So, is it time for more transparency and fairness for the investor? Apart from suggesting lower Fund of Hedge Fund fees, we also feel managers should become more aggressive in securing better terms with the underlying single Manager Hedge Funds.

No doubt, in response, managers would argue that this will dilute their investment into new resources and thus increase risk. Traditional Fund Managers have managed their salary and cost base much more effectively than Hedge Fund Managers and it is clear that lower fees must be met by superior cost management and a move away from the excess of the last thirty years.

"If a man does not know to what port he is steering, no wind is favourable"
Lucius Annaeus Seneca 4 BC – 65 AD