From: John Wiseman <jwiseman@greenwoodcapital.com>
To: Soura, ChristianChristianSoura@gov.sc.gov
Date: 6/17/2014 3:34:04 PM
Subject: FW: (BN) Trotsky Warns Hedge Funds Massachusetts Won't Pay for Luck

---

Thought you might like to see the below article from Bloomberg today.

Best regards,
John

-----Original Message-----
From: John Wiseman (GREENWOOD CAPITAL) [mailto:jdwiseman@bloomberg.net]
Sent: Tuesday, June 17, 2014 2:59 PM
Subject: (BN) Trotsky Warns Hedge Funds Massachusetts Won't Pay for Luck

(BN) Trotsky Warns Hedge Funds Massachusetts Won't Pay for Luck
(1)

+--+

Trotsky Warns Hedge Funds Massachusetts Won't Pay for Luck (1)
2014-06-17 15:50:41.301 GMT

(Updates with outcome of board vote in penultimate
paragraph.)

By Kelly Bit and Martin Z. Braun
June 17 (Bloomberg) -- Michael Trotsky, like many other investors in hedge funds, is tired of paying superstar fees for mediocre returns. As chief investment officer of the $59.1 billion Massachusetts Pension Reserves Investment Management Board, he's in a position to do something about it.
The Boston-based pension plan has about $6 billion spread among 23 firms including Bill Ackman's Pershing Square Capital Management LP, Brevan Howard Asset Management LP and Cantab Capital Partners LLP. As Massachusetts seeks to add as many as eight more managers within two years, Trotsky wants to strike a harder bargain.
"We love to find skillful managers and we're happy to pay fees for that," said Trotsky, who joined in 2010. "We're unwilling to pay for beta exposure or luck," he said, referring to returns that mirror benchmarks.
PRIM, as the state plan calls itself, started this year pushing all its hedge-fund managers to cut fees, a move that could yield savings of $7 million for each $100 million invested, Trotsky said. The system will continue to unwind its allocations to funds that invest in hedge funds, a process that began in 2011, to end paying two sets of fees, he said.
PRIM's hedge-fund investments gained 12.6 percent in 2013, compared with a 15.2 percent gain for the total portfolio. The Standard & Poor's 500 Index rose 30 percent. The pension plan pays an average 1.6 percent of a hedge fund's assets and 19 percent of its profits, compared with 1.5 percent and 18 percent respectively for the industry, according to Chicago-based Hedge Fund Research Inc.

Steady Fees

The $2.7 trillion industry has been able to keep fees at about this level even after funds trailed the U.S. benchmark stock index for the fifth straight year in 2013. In comparison, U.S. stock mutual funds charge about 0.9 percent for actively managed strategies, according to Morningstar Inc.

Billionaire Stan Druckenmiller, who produced annual returns averaging 30 percent for more than two decades, in November called the industry's results a "tragedy" and questioned why investors pay hedge-fund fees for annual gains closer to 8 percent.

"It's mixed -- a $300 million hedge fund will probably negotiate because they want that marquee client," said Jay Rogers, president of Irvine, California-based Alpha Strategies Investment Consulting Inc., which advises hedge-fund clients and managers. "But people are still willing to pay. There's a handful of managers that charge 3 and 30 but they've had such good performance for so long they're willing to pay that."

Wisconsin Requirement

PRIM's campaign is paralleled by other pensions, including the State of Wisconsin Investment Board, which requires the system to keep at least 70 percent of a fund's return after subtracting factors such as beta exposure, or performance in line with benchmark indexes, before it pays fees. Wisconsin's hedge-fund portfolio rose 6.6 percent in 2013.

"It doesn't make sense to hire low-quality hedge funds for lower fees," said Chief Investment Officer David Villa. "We are interested in the fee split of the profits."

Massachusetts and Wisconsin are spelling out that only performance above market indexes deserves the type of fees that alternative investment managers have traditionally charged.

PRIM's initiative, called Project SAVE, includes shifting a portion of its private-equity portfolio to co-investments that don't require paying a management or performance fee, a push that began in the first quarter, according to an April 30 presentation, a copy of which was obtained by Bloomberg News.

Potential savings add up to an estimated $101.2 million.

'Prudent Thing'

"If you've got the purchasing power of an entire state pension system behind you, it's the prudent thing to do to negotiate fees," Rogers said.

The move comes alongside a decision that PRIM replace Cliffwater LLC for hedge-fund advisory services with Arden Asset Management LLC, which the system's board voted on and passed today.

Another potential cost-saving measure that the Massachusetts system and other pensions are interested in is adding hedge-fund managed accounts, or customized portfolios that tend to offer more control over assets and sometimes lower fees compared with commingled funds, in which multiple investors are grouped, Trotsky said.

For Related News and Information:
Investors Seeking to Alter Hedge-Fund Fees Backed by IRS Ruling NSN N6ZBXE6JIJUY <GO>
Bridgewater Gains in May as Tudor Falls With Hedge Funds Up 1.2% NSN N6RQJS6K50XT <GO>
Hedge Funds Trail Stocks for Fifth Year With 7.4% Return in 2013 MSN MZ20QC6K50Y7 <GO>

--With assistance from Katherine Burton in New York.

To contact the reporters on this story:
Kelly Bit in New York at +1-212-617-1097 or kbit@bloomberg.net; Martin Z. Braun in New York at +1-212-617-6849 or mbraun6@bloomberg.net To contact the editors responsible for this story: Christian Baumgaertel at +1-617-210-4624 or cbaumgaertel@bloomberg.net Pierre Paulden