OPALESQUE

Opalesque Round Table

JAPAN

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Introduction

Dear Reader,

Welcome to the Opalesque Japan Roundtable, which will be closing the 2008 coverage of the Asian hedge fund centers after having covered New Zealand, Australia, Singapore and Hong Kong. In this Opalesque Roundtable, we unite some of the leading hedge fund managers as well as representatives of the local investor community to **gain unique insights into the specific idiosyncrasies and developments, the issues and advantages of Japan as a hedge fund center.**

The **Opalesque Japan Roundtable** was sponsored by **Nikko Citi Prime Finance** (www.nikkociti.com) and took place in their Tokyo office. We also thank Ed Rogers from Rogers Investment Advisors for helping us put the group together.

After a stellar performance in 2005, Japanese hedge funds were struggling in 2006 and 2007. Is 2008 the turn-around year? The good news is that **endowments, sovereign wealth funds and large global hedge funds are coming back to Japan**. What opportunities do they see? In this Roundtable script, you will learn:

- Background on Japan hedge fund performance and the state of the economy
- Will macro (economy) or micro (corporate governance on company level) catalysts drive the markets going forward?
- Why activist investors and activist hedge funds have been very beneficial for Japan
- Will the Japanese version of the Basel II rules still prevent regional banks to rebuild their hedge fund allocations?
- How do Japanese pension funds and insurance companies view and use hedge funds?

The participants of the Opalesque Japan Roundtable are:
- Angus McKinnon, Senior Partner, Tozai Investment Advisory (www.tozai-advisory.com)
- Nobuki Yasuda, Director of Alternative Investment, Pension Fund Association (www.pfa.or.jp)
- Goro Ohwada, CEO, Aino Investment Corporation (www.ainoinvestment.com)
- Kenichiro Nishi, CEO & CIO, Gaia Capital Management (www.gaiacm.com)
- Scott Callon, Partner/CEO, Ichigo Asset Management (www.ichigoasset.com)
- Rory Kennedy, COO, United Managers Japan (UMJ) (www.umj-jp.com)
- Andrew Hill, Director, NikkoCiti (www.nikkociti.com)
- Koichi Shijima, Director, NikkoCiti (www.nikkociti.com)
- Atsko Nakajima, Director of Hedge Fund Investments, Ueda Yagi Securities Co. (www.uedayagi-sec.co.jp)
- Hideki Hashiguchi, Lead Representative, HSBC Global Fund Services (www.hsbc.co.jp)
- Toshihiko Nishida, Portfolio Manager, GCI (www.gcic.jp)
- Isao Tomoyuki, Chief Investment Officer, Stats Investment Management (itomoyuki@stats.co.jp)
- Rick Okuno, Rheos Capital Works (www.rheos.jp)

Enjoy "listening in" to the Opalesque Japan Roundtable!

Matthias Knab
Director Opalesque Ltd.
Knab@opalesque.com

Cover Photo: Japan's Bullet Train passing by Mount Fuji

Participant Profiles

Standing (left to right)

Nobuki Yasuda, Hideki Hashiguchi, Kenichiro Nishi, Rick Okuno, Rory Kennedy, Andrew Hill Scott Callon

Seated (left to right)

Koichi Shijima, Goro Ohwada, Angus McKinnon, Isao Tomoyuki, Toshihiko Nishida, Matthias Knab, Atsko Nakajima

Introduction

Angus McKinnon
Tozai Investment Advisory

We advise a concentrated directional long/short fund, Trident Pacific Japan Absolute Return which we have been running since 2004. Prior to that, I was with a Japanese fund that also ran various funds, including a long/short fund, small cap, large cap long-only fund, and REITs.

I was one of the founding members of a Japanese REIT, as the first president of that J-REIT. It was listed in 2005. Our company consists of the usual two parts for a Japanese hedge fund; Trident Pacific Capital is the investment management part, based in Australia, and Tozai Investment Advisory is the advisory part, which is based in Japan.

We have two people here in Japan and one person in Australia. We are licensed in Australia for trading and here with an advisory license. We are also registered with the US SEC.

Our strategy is Japanese equities long/short. We have the right to use derivatives like futures, options etc., though we rarely exercise that - most of the time we have straight short equities or straight long equities positions. We are directional, so we choose, at times, to take beta exposure. Our fund is highly concentrated and currently net neutral.

Nobuki Yasuda
Pension Fund Association

Nobuki Yasuda, I work for the Pension Fund Association, which is a corporate pension fund. Our assets under management are roughly $110 billion. Our hedge fund investment program is quite new. We started to invest just six months back, so from that side we are one of the newest institutional investors in Japan to go into this asset class. I myself started my hedge fund investment career late 1999 at Sumitomo Life.

Goro Ohwada
Aino Investment Corporation

My name is Goro Ohwada from Aino Investment - which is my own company - and we focus on fund of funds. Our team members previously worked together at ORIX Corporation. We have managed hedge fund investments since 1989 so, for quite some time now. When we started, there were no other companies doing this in Japan. Our aim is to introduce such alternative investments - absolute return products, to the marketplace in Japan. We are always looking for interesting hedge fund managers on a global basis, and are also engaged in developing Japanese managers in Japan.

Kenichiro Nishi
GAIA Capital Management

My name is Kenichiro Nishi, I am the CEO of the GAIA Capital Management. Our GAIA fund started two years ago, June 2006, as a joint venture between myself and Sumitomo Corp. Sumitomo Corp seeded us and put us on their seeding platform, from which we operate our GAIA fund. Our assets under management are $50 million. GAIA fund is a multi-strategy fund, the Fund trades multi asset classes: equity, credit and volatility.

Scott Callon
Ichigo Asset Management

Ichigo is a Japanese absolute return, value, activist investor. We invest in companies with strong balance sheets that are trading substantially below their asset or private market value --- what Warren Buffett calls "intrinsic value" --- and take action to engage management, existing and potential shareholders, and the sell-side and buy-side communities to catalyze the company's public market value towards that intrinsic value.

Last year Ichigo joined with individual investors to win the first shareholder proxy in Japanese history. Japan is making a positive shift towards better corporate governance, a fact which has gone largely unrecognized. And at current rock-bottom valuations, we also believe that Japan represents the biggest value investment opportunity in the world.

Rory Kennedy
United Managers Japan

My name is Rory Kennedy, I work for a company called United Managers Japan or UMJ, as it is more commonly known. I am COO for UMJ. We are a hedge fund platform headquartered in Japan running a variety of single manager strategies. The Tokyo office acts as investment advisor, and our associated Singapore office has all of the other functions, including trading and is the investment manager to our funds.

Our range of funds is predominantly Japan oriented. Our funds include Japanese equity market neutral, fundamental equity long/short, an Asian tactical trading fund, and we will soon be starting a distressed real estate fund.

I completely agree with what Scott is saying. It's an obvious thing to all of us at this table that Japan is sort of the last undiscovered country for value, while at the same time the country is still the second largest market in the world. It is clear for anyone who has been here for a long time, that there are an enormous number of opportunities here. I hope this Opalesque Roundtable forum will be informative for people who may not have been seriously looking at Japan at the moment. For the last couple of years, so many investors have focused on the "easy money" in Asia, so I hope this will help to redirect their attention towards Japan and the opportunities here.

Andrew Hill
NikkoCiti

I am Andrew Hill at NikkoCiti. Koichi Shijima and I are responsible for the NikkoCiti's prime finance business here in Japan. I have been in Japan for 16 years. Although, that number is a little bit misleading; I spent eight years here as a child, and I came back in 2000. I have been with NikkoCiti for a little bit longer than three years. Prior to that I was at Bank of New York, both in Tokyo and in New York, where I was involved with their transaction services business, fund of funds business, hedge fund administration business, and worked closely with the trading side with a joint venture that Bank of New York had with Susquehanna. I originally started my career at Mitsubishi Bank in the New York Branch.

Also from our side I can add that we are very excited about the opportunities in Japan, echoing what Scott and Rory have said. I think we are at a turning point for corporate Japan, where the situation for shareholders and Japan as a whole can make a lot of progress.

At Citi, we are excited about integrating with Nikko within the next year. The firms have announced the merger of their broker dealer entities in Japan by the end of this fiscal year, which in some way is also a sign that corporate Japan is changing. Our new entity here will be quite a differentiator for us given the change we expect to come.

Koichi Shijima
NikkoCiti

My name is Koichi Shijima, I am also responsible for prime financing at NikkoCiti. In my career I worked at the Bank of Tokyo, Morgan Stanley, Nikko Salomon Smith Barney and Credit Suisse. I was involved with Japan equity program trading, and futures & options trading for financial institutions. I joined NikkoCiti Prime Finance in 2005, that year we started a number of services such as cap intro as well as some others.

While Japan is still the second largest economy, there are still a number of issues that need to solved, I would like to point here to the regulatory side. However with the right steps and policies, the regulatory environment can be improved, which can lead to the innovation and growth of the hedge fund industry in Japan.

Atsko Nakajima
Ueda Yagi Securities

I am Atsko Nakajima from Ueda Yagi Securities. We were formed last year as a result of a spinoff of the division from the parent company, and we specialize in alternative products. Our main business is the distribution of hedge funds to Japanese financial institutions. Until last week, my responsibility was the sourcing and due diligence of products to be sold by our marketing group. As of last week, we received our Investment Advisory License, and now I will be responsible for advising a fund of hedge funds, which is expected to be launched in August. Up until last year I was also managing an Asia focused fund of funds at a Tokyo-based asset management firm.

Hideki Hashiguchi
HSBC

My name is Hideki Hashiguchi from HSBC's Global Fund Services unit. We serve as a fund administrator, specializing in alternative investments such as hedge funds, fund of funds, private equity funds, and emerging market funds. With over 40 years of experience, we have significant expertise and market knowledge. We offer a broad range of specialist services through our network in Europe, America, and Asia.

In Asia, we have three offices in Hong Kong, Singapore, and Tokyo. We provide administration services out of Hong Kong and Singapore, while in Tokyo we act as a liaison for our overseas offices, mainly our Hong Kong office.

After living in Hong Kong for 17 years, I returned to Tokyo five years ago to assume my present role. I also serve as the Chairman of AIMA's (Alternative Investment Management Association) Japan CH (Chukan Hojin) Executive Committee.

Toshihiko Nishida
GCI Asset Management

My name is Toshi Nishida, I am a manager of a hedge fund of fund at GCI Asset Management. GCI is a multi-manager platform; apart from the asset management business, we also run a FX retail trading platform.

Our fund of hedge funds is still small - $100 million - and has been going for almost two years. I joined the GCI last July; before that I was in Singapore for about two years working as fund manager and analyst at a Japanese long/short, small cap oriented fund. Today, as a fund of funds manager, it is very helpful to have an experience on the other side as an investment manager.

Isao Tomoyuki
Stats Investment Management

My name is Isao Tomoyuki from Stats Investment. We are managing three Japan equity funds, which are: quantitative market neutral, fundamental long/short sector fund investing into IT and service sectors, and a fundamental micro-cap long/short fund.

Rick Okuno
Rheos Capital Works

Rick Okuno, Rheos Capital Works: I am Rick Okuno. I recently moved from a company I co-founded about five years ago called Teneo Partners (which is active in hedge fund marketing and consulting for startups) to a company called Rheos Capital Works. Before joining Rheos, I already had a joint venture with the firm and did a lot of marketing for them.

Rheos is an independent Japanese asset manager which specializes in small cap stocks. We offer long only and long/short investment strategies. We primarily manage money for pension funds and sovereign wealth funds, and we have about $400 million under management at the moment. We also just became fully licensed, so we have a DIM (discretionary investment management license), an ITM (investment trust management license), and a financial instruments number two license. It is my responsibility to further develop the business at Rheos.

I continue to be, and have been for a while now, bullish on Japan. I'd also like to add that it has also been an honor for me to work with many people in this room over the last few years, and I am especially glad that we are still here to be able to have this kind of conversation.

Matthias Knab **Let's focus for a moment at the macro picture of Japan, the economy and the asset flows. For example, on the 3rd of February in 2008, we carried a story in Opalesque that hedge fund assets are flowing out of Japan. Sure enough, if you look at the chart of the Nikkei and the TOPIX, about six weeks after that - on March 17th, to be precise - the market has turned, and is since then in an up-trend.**

As Japan-based managers, what is your picture on the Japanese economy? Can someone give us a brief market outlook?

Angus McKinnon It's hard to be brief about the Japanese economy, but I will try. Basically, the fear is global recession, which people fear will affect Japan as an exporting economy, and with a weak domestic consumption, Japan doesn't look exciting.

But if you take a closer look, you can find a shift from countries which have been driving exports in the past - basically North America, Europe - to emerging markets. The argument that the emerging markets only act as a conduit to Europe and North America, is becoming less and less true. There is, especially in the infrastructure sector - and Japan of course is one of the largest capital goods producing countries in the world - a very real demand. So we find that a number of companies are actually doing better than people expected, because of this kind of demand.

On the consumption side, the story is not as easy, but it's clear that nominal wages are at least starting to slowly rise. The problem is whether these are real wages, because you are getting "cost-push" inflation instead of "demand-pull" inflation. Cost-push inflation is not helpful in this situation, because it eats into people's savings; it eats into their wages, which puts a damper on consumption.

However, we can see that changing, because eventually something has to give and the system has to change. The companies have to pay the people more, or people will start getting very upset because they can't afford certain goods and services any more. In addition, the money that was in the bank – which is at almost zero interest rates - was actually earning a real rate of return a few years ago because of the deflation - is now earning zero.

So the only place they can get any return is either to invest in J-REITs, or to try to invest overseas. As the carry trade has gone away, some of the money will come back to Japan, unless they try to invest in commodities or some other areas where they think they can get some real rate of return.

With these money flows coming back into Japan, you will see the Yen either remain stable, if not continuing to strengthen. If that happens, it will of course negatively affect the exporters, but it also makes the domestic companies stronger, because it reduces their raw material costs. So while the Yen has appreciated by close to 20%, it has also offset some of the rapid material price cost increase for the domestic companies. The picture is not simple, and you need to take many of those factors into account to figure out who is going to succeed and who is not going to succeed.

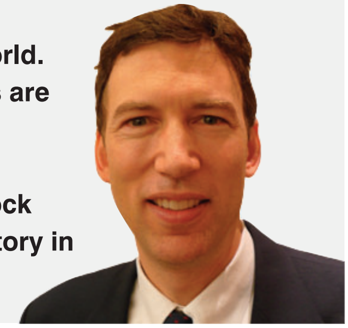
Overall though, we can see that the Japanese companies are doing better than expected, and despite the problems with the government, I think that's what's going to drive the economy forward.

Scott Callon I think that corporate governance is actually a far more important swing factor for the Japanese equity market than the macro-economy. Despite the bad press, the Japanese economy is growing (+2.6% and +3.3% year-over-year in the last two quarters) and it remains incredibly competitive, with continuing massive current account surpluses. And given Japan's current economic outlook and baseline economic strength, I don't foresee a lot of big moves on the macro front, but we potentially could see some very significant upward revaluations of Japanese equities based upon changes in corporate governance.

I actually don't think the key issue here is macro, when we examine what is driving the Japanese equities market. I think it's far more important for all of us here in Japan, and those investors from outside of Japan, to focus on corporate governance issues. The Japanese economy is robust and incredibly competitive. I don't think we are going to see a lot of big moves on the macro front, but we potentially could see some very significant moves caused by changes in the corporate governance domain, and I would add I have already seen some of them.

Specifically, at this point in time you find in Japan the best balance sheets in the world. You have over half of all companies trading below book value. The accounting rules are clear, concise and hard in Japan, there are very little "intangibles" in the book.

There is a number of good news here, for example last year you had the highest stock repurchase activity in history in Japan. You had the highest dividend payouts in history in Japan.



Scott Callon

Specifically, you find in Japan right now what I would suggest are for value investors the best balance sheets in the world. Over half of all Japanese are companies trading below book value. And book is very hard in Japan, with very few intangibles and a lot of financial assets on balance sheets. However, Japanese shareholders have rightly been very frustrated about low payout ratios and a sense that corporate managements are not sharing enough of companies' success with shareholders. So, you have a lot of successful Japanese companies with very low valuations.

The cause of these low valuations can be captured in the following question: What's the value of a highly profitable company that continues to pile up its earnings on the balance sheet and does not ever pay earnings out to shareholders? Answer: Zero. Shareholders require actual returns for there to be value, as the Dividend Discount Model classically suggests. Unfortunately, Japanese companies have been very conservative in their sharing of profits with shareholders, and these low payout ratios are thus driving low valuations. To the extent that it is the distribution of company profits to shareholders, not the presence of profits per se, which underpins corporate value, decisions that Japanese companies make about whether or not they are going to repurchase stock, or whether they are going to pay more dividends, are far more fundamental to Japanese equity valuations than what's going to happen to the macro environment and its impact on earnings.

To put it another way, you have in Japan a lot of great companies generating merely mid-level or even poor ROEs. If you look at the R, returns, they are actually fine. Japanese listed companies' average profit levels are not particularly different from that of US or European firms.

The problem with ROEs in Japan is the E, the equity base. Japanese companies have the world's largest E, a massive accumulation of retained earnings over many years, even decades. And it is this big E in the denominator of the ROE equation which is dragging down Japanese ROEs.

In short, given the accumulated asset bases in Japanese firms, our view is that the major forward driver of Japanese valuations is less earnings than distributions of earnings, so the primary analytic focus as investors should be to evaluate decisions Japanese companies are making about capital policies, specifically their efforts to shrink the E and improve ROEs.

And there is good news here. Last year you had the highest stock repurchase activity in history in Japan. You also had the highest dividend payouts in history. There is actually a developing trend around better capital policy from a shareholder's perspective. To repeat, what is key is not the macro picture, but the micro, company-level picture: look at what Japanese companies are doing with their capital and the earnings they are generating.

Rick Okuno Scott, do we need a catalyst or external factor to create a broad momentum or will these developments naturally continue to happen?

Scott Callon

In my view, we have already had the catalyst, and it is the Japanese Pension Fund Association's (PFA) introduction of guidelines requiring a minimum ROE of 8% from Japanese companies. The PFA is fighting for Japan's future: it cares enormously about making sure the pension system in Japan is funded.

These PFA guidelines have focused Japanese management on ROE. When successful companies look at their returns and their equity bases, they realize they can't do a lot more to improve returns, the returns already there are very good. So if you want to improve your ROE, you need to shrink your equity base. You need to buy back stock or you need to pay higher dividends, and that's the response that has occurred. So I would say the PFA's guidelines have proven to be the broad kind of catalyst that has helped focus Japanese corporate managements on this issue.

Clearly, not all companies are moving at the same speed, and as is always the case, there are some companies that are improving very rapidly, some moderately, some slowly, and some not at all. This means as shareholders we need to discuss with corporate management the actions they are taking to grow the company's value for shareholders and how we can support them in doing so. The PFA has been critical here, and I applaud them for it.

Angus McKinnon

Scott brought up a point that I failed to mention about the economy, a fact which is in a way fortuitous for Japan. Japan does not have a sub-prime problem, it doesn't have a mortgage problem. The economy is much more robust in that respect. It's purely because they took so long to get out of the bad loan problems they had from the bubble, but they happen to be very strong at the moment.

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In that respect, Japan doesn't have a credit crunch problem, to the extent that it is happening in the US. In fact, what appears to be happening here is more of a knee jerk reaction to what's happened elsewhere, because domestically it doesn't make any sense to see the tightening of credit that we saw in the early of the year. Banks appear to have woken up as lending has again begun to expand.

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Rory Kennedy

I would like to point out one more thing. Anyone familiar with Japan knows that if there's any market that has had a good deal of experience coping with recession, it's Japan. We had close to ten years of a nightmarish stagnation environment but quality companies were still making good money even during that difficult period.

While Japan has had a tough time in the last couple of years from an equities market view, investors should not assume that if the rest of the world is doing badly, Japan is automatically going to suffer to the same level.

There are a number of positive factors contributing to this; some catalysts will be corporate, and in addition Japan has somewhat decoupled itself from America and towards China. Japan is well-known for making those middle class consumer items, and there are now hundreds of millions of Chinese and Indian consumers who are going to be looking for those goods for the first time, irrespective of a recession in the US and Europe.

Matthias Knab **Let's look at the investor view on Japan. Where is the investor confidence? Will money come back to Japan? Does Japan still have an image problem?**

Rory Kennedy Clearly Japan has an image problem; there's no doubt about that. We have talked to investors all around the world in the last two years and so many investors have cut their exposure to Japan. If they are not underweight Japan in their portfolios, it's only because they have to be in Japan due to their mandate. Many feel it's very difficult to make money in Japan or to find good fund managers. At the same time, over the past few years they have been able to play the beta very successfully in the rest of Asia.

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However, the low hanging fruit in Asia is now gone. You could still make 100% in China or India this year, but you could also lose 50%.

Looking at the asset flows, it is true that Japanese hedge funds have seen massive outflows (with the exception of a few managers and strategies). But, over the last two years, the oil tanker of investor money seems to have started to turn. Endowments and sovereign wealth funds are all coming back into Japan. Typically, they are seen as the most long-sighted investors because they can put money in for several year lockups, amongst other things.

So these people may look like geniuses in three years time if they have doubled, tripled their money, but that is also due to the fact that they can ride out the turbulence in the markets at the moment.

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So these people may look like geniuses in three years time if they have doubled, tripled their money, but that is also due to the fact that they can ride out the turbulence in the markets at the moment. Typically, I think where that kind of investor goes, investors with more liquidity concerns will follow as well over time.

Andrew Hill We mentioned the importance of the company or "micro" level, I have a good example for that. I think it was today or yesterday when Shiseido announced they are going to have a payout ratio of 57%. They are going to dismantle their poison pill. Companies are now starting to look at shareholders as owners. When those headlines are on the front page of the newspaper, then the CIO or the fund of funds allocator can go to the board and say "look, I am not crazy, we need to get back into Japan now."

We certainly have seen sovereign wealth funds come to Japan for physical assets, as well as investing in public firms that have a substantial asset base. Another encouraging development is

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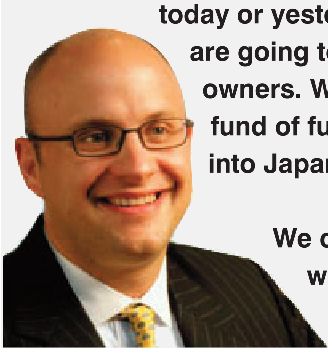

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Andrew Hill

happening in the REIT regulations, where announcements have been made to ease some corporate activities like consolidations and so on.

Rory Kennedy

In the West very often catalysts cause short, sharp shocks, whereas in Japan things often happen in the form of a more gradual process. I think when we look back in a couple of year's time, we will be able to see the connections more clearly. The Japanese government has stated it wants to catch up with and grow a financial industry like Singapore and Hong Kong. Positive factors will continue to happen, but maybe not just at the pace that investors want to see them happen.

Kenichiro Nishi

There is a trend of less and less investor meeting requests. Two years ago I could easily find serious investors, but nowadays, it is not the case. Investors come to Tokyo as a usual check, and are still keeping a wait-and-see stance for Japan. As it is so, they stay in Tokyo just for two or three days and fly out to Hong Kong and Singapore. Two years ago, they definitely stayed in Tokyo for a week.

Matthias Knab

Is this a contrarian indicator to come back now?

Kenichiro Nishi

I hope so. Actually, some investors do see value in Japan. Their thesis is that more than half or half of the listed companies are trading below real book value, so the value play could really catch on.

But there is one thing that gets into the way of such value plays. As a fund manager, we guarantee monthly or quarterly redemptions to the investors, but you need a two years or three years, or could be five years investment horizon to make that investment style work. A lot of hedge-funds have had a problem in asset-liability mismatching, and even our investors, such as FoFs have had the same issue. As it is so, longer time horizon strategy implementation is quite difficult for most of us. If you could lock in the money for three or five years, you should be able to take advantage of it. That is for sure.

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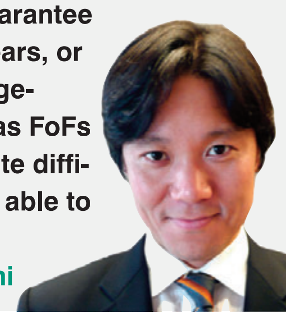


Kenichiro Nishi

From the global leveraging-deleveraging cycle's perspective, we are in a middle of a de-leveraging cycle. I believe we still have to go through at least another six months or one year of deleveraging. After this, Japan should attract more interest because of its cheapness and healthier balance sheets.

Scott Callon

I agree with Nishi-san. To earn outsized returns from the valuations in Japan right now you are far better off with longer-term money. Unfortunately, a lot of money seems to be very short-term. The markets are very choppy, a lot of investors are very nervous, there have been a lot of redemptions, and in turn managers don't want to take a lot of risk.

To get back to our view that the key focus should really be on evolving corporate governance rather than trying to predict the macro environment, if I could invoke the basic valuation equation: corporate value = current asset value + operating value, where operating value reflects a view on the future earnings stream discounted back to the present. Thus, when you are a company with very little asset value, your value is all about earnings, it's all about the future. So if earnings come down 20%, that's very impactful to full corporate value.

However, in the case of Japan, there are so many companies that are trading at a discount, I mean a true discount, to their asset value. Alternatively, their market value is very small in proportion to even a very conservative view of their ongoing operating value. If a company is trading at 0.6 book, where book is real, it is at a 40% discount to asset value. If the economy turns down and the view is that future earnings are going to go down 20%, the company may move from 10 times earnings to 12 times earnings, but it is still at a deep discount to asset value. Management thus has a lot of options in a case like this, even with earnings declining, in order to increase the company's market value, with buying back stock frequently being the best option.

Rory Kennedy

One of the reasons why the Japanese hedge fund industry in particular has had a difficult time is quite simply because of the poor performance by local fund managers. Also the investors themselves are in a different position now, particularly because of problems in their own portfolios. Whether they are fund of funds or any kind of allocator, they are seeing correlations where there were none before.

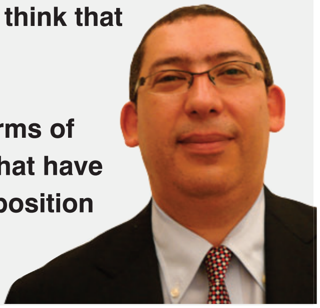
As a consequence, I believe some of the regional or geographic biases are starting to go away. If you think about it, Japan, like most countries, has a number of good managers with good performance. But they may have been overlooked in the past because investors have blanked out Japan as they don't want to be there as a macro view. But as more and more investors look at pure performance, if they can find decent performing managers, it shouldn't matter what country they are in.

Rick Okuno

Yes, performance has been bad since the beginning of 2006, on the other hand, we have to mention that you really do learn from experience. This means that most managers, many of whom started in 2004-2005, particularly on the equity long/short side, are now through one full cycle almost, and I think that -- it sounds like a cliché, but necessity really is the mother of invention.

Performance has been bad since the beginning of 2006, on the other hand, we have to mention that you really do learn from experience. This means that most managers, many of whom started in 2004-2005, particularly on the equity long/short side, are now through one full cycle almost, and I think that -- it sounds like a cliché, but necessity really is the mother of invention.

Over the last two years a lot of work has been done inside the firms for example, in terms of risk management, hedging strategies and techniques like that. And those managers that have survived this bear market in the hedge fund industry here will probably be in a better position to produce alpha.



Rick Okuno

Over the last two years a lot of work has been done inside the firms for example, in terms of risk management, hedging strategies and techniques like that. And those managers that have survived this bear market in the hedge fund industry here will probably be in a better position to produce alpha. Whereas if you look at other parts of this region, I still think there are a lot of beta chasers out there, but in Japan we have learned the hard way that we have to produce alpha.

The other thing that I would mention and I think it's relevant to this sort of question about new strategies, we are always looking for new strategies here, but I think it's also important to turn that one on its head. I mean, we looked at our business and we say, we are Japanese equity managers, this is our core business, and we offer two strategies; long/short and long only. There are various ways of defining alpha, and more of the institutional mandates that we are getting define alpha as outperformance within a long portfolio over a pre-determined benchmark. And more and more of the institutional mandates are coming with performance fees. Now, that used to be a classic definition of the hedge fund.

So I think the way we looked at our business is: we are managing Japanese equities as a core business. We offer long only and long/short, and do our very best to produce alpha, but are realistic enough to realize that a lot of our returns will come from beta, and that it's not necessarily a bad word. We can produce value added for the investors within that particular type of framework, which essentially is more of a convergence between alternatives and traditional investment styles.

Matthias Knab **A number of quant managers globally have had performance issues starting in summer of 2007. Isao, Can you tell us a bit about the Japanese quant managers, some back ground on quantitative managers, and how did you fare in those markets?**

Isao Tomoyuki My understanding is that many of the quant managers in Japan came originally from big asset management companies or banks or insurance companies. Most of these managers' models tend to include valuation factors because they were highly effective in the past few decades.

And yes correct, from August last year till this March, many quant funds' performance was pretty bad, especially from November to March. I believe this was caused by large quant funds or hedge funds reducing their positions which were in fact selling undervalued stocks and buying overvalued stocks to accommodate their investor redemptions.

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My fund was down too during that time, however I would like to point out that after having launched in July 2005, we were up 8.4% in 2006 - when many other Japan funds struggled - and as for 2007 we were sort of flat (0.33%) when for example the Eurekahedge Japan index was negative again (-1.43%). But even for quant type funds, there are some that performed flat in 2006 and good in 2007.

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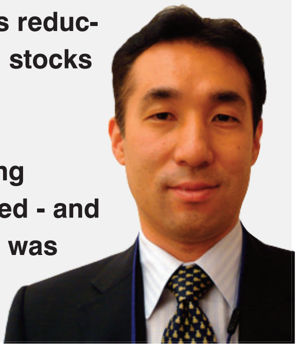

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We believe that going forward value style investing will become effective again because market pricing had been distorted due to the mentioned reasons.

There is continued interest in market-neutral funds in Japan because they fit the Japanese investor profile. For example, mainly Japanese institutional investors and fund of funds invested in our quant fund, and mainly foreign fund of funds went into our long/short fund. So it seems Japanese institutions like market-neutral funds.

Toshihiko Nishida

Looking back at 2004 and 2005, with Koizumi in power, Japan had a momentum and a lot of money was coming in. New funds and new firms were formed, and managers coming from a long-only background went into long/short. Long only managers or Japanese long/short managers in general are quite good on the long side, but not good on the short side. This has to do with the stock borrowing capacity and liquidity for the whole Japanese market as well, to some extent is also true in other parts of the world. We have then had the phase where managers were primarily long biased, mostly just riding on a nice wave on the long side, and then of course they came down when the markets turned.

Looking back at 2004 and 2005, with Koizumi in power, Japan had a momentum and a lot of money was coming in. New funds and new firms were formed, and managers coming from a long-only background went into long/short. Long only managers or Japanese long/short managers in general are quite good on the long side, but not good on the short side. This, to some extent is also true in other parts of the world.

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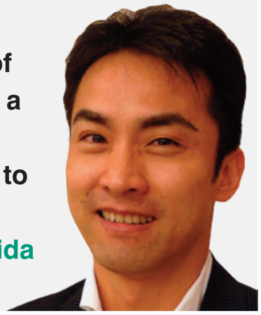
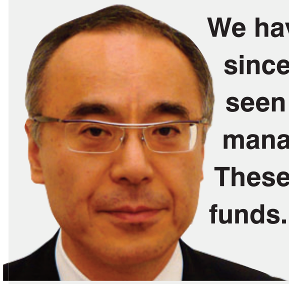


In regard to the outflows that happened, I think this is due to the normal cycle the Japanese hedge fund industry is going through, a cycle of expansion and retraction.

When you can provide the investor with strategies that are disciplined, long-term oriented, and well-focused, then the money can stay.

Hideki Hashiguchi

We have also observed that some funds closed and hedge fund investments were redeemed since last August until the first quarter of 2008. However, interestingly, we have also recently seen a new trend with the launch of new Japan funds, coming from both boutique-type fund managers and also existing managers, large financial institutions, and asset managers. These new funds range from hedge funds to private equity funds and more securitization-type funds.



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There is a lot of capital in Japan, coming from financial institutions, high net worth investors, retail etc. and we know that Japan is definitely on the watch list for international investors. They're currently observing what new funds are being formed, and as soon as they are convinced of the opportunity, they will come back and allocate to Japanese hedge funds.

Matthias Knab **How is the Japanese hedge fund market now evolving? Are there new strategies coming up, or is it still more or less the long/short?**

Andrew Hill From the prime broker perspective, of course it is correct that some time back we had a lot of Japan long/short managers who struggled to differentiate themselves from each other. But now, new strategies have emerged. In this Roundtable we have the long-term activist like Scott, for example, or Toshihiko with the sector fund - we are seeing some sector focused funds, which is a new trend. We also see people staying more in the liquid segment of the equity markets. Also, corporate activity, corporate actions etc. are creating opportunities for special situations and for event traders.

Koichi Shijima There is also some talk about fixed income strategies, which is still relatively hard to pull in these crank markets. Also, you have to have in mind that when an investor had redeemed a Japan long/short fund, he has to have a convincing reason to go back in to a Japan long/short fund; he will also very actively look at some other, niche strategies.

When looking for new strategies, well, if you focus just on Japan, it becomes a little bit difficult, but going beyond that into the diversified Asia strategies, Asian Pacific, including Japan, we are hearing requests for credit or currency strategies.

Matthias Knab **A London firm also just launched a Japan-focused convertibles fund.**

Andrew Hill And of course there is statistical arbitrage and volatility trading going on. Japan is still one of the largest destinations for stat-arb strategies. Some the big hedge funds still run a lot of stat-arb money in Japan to profit from the market inefficiencies and the liquidity here, there are smaller programs being run quite successfully as well. We also see some macro type of strategies being run out of Japan now, there are two or three.

Matthias Knab **Let's look at what the Japanese investors are now interested in. Mr. Yasuda, there was an article in the FT recently which said the PFA would be setting up a 50-100 billion Yen hedge fund of funds. Can you tell us a bit more about this investment? What are the steps being taken and what are the aims?**

Nobuki Yasuda We have not yet disclosed our allocation in this area. The only thing I can say is our AUM is $ 110 billion. You mentioned that one newspaper article, but that article is totally false.

But, before commenting on our activity let me first explain to you that we use hedge funds as a tool for portable alpha strategies. We invest into fund to funds or single manager hedge funds, building an overlay to traditional fixed income assets or for equities.

In this sense, we generally aim to avoid beta risk, so we expect a fund of funds manager to construct a well diversified, low correlated portfolio, aiming at 3-5% alpha over LIBOR with a relatively low volatility.

We were discussing money flows, some investors still avoid or reduce Japan, and others already come back. Actually, when I compare the current PFA or a life insurance portfolio, to let's say five years ago, quite interestingly, the allocation to Japanese focused managers is currently smaller than five years ago.

Why is this? One of the reasons for this reduction is that some of the Japan allocations have shifted to emerging market managers, especially Asia - that is one element. Another element I would like to point out is the performance. We generally avoid beta, but, even though one manager has a net long exposure and has a beta, as long as the portfolio is diversified and the manager has low correlation with others, we are ok with that allocation. That is why we invest with, say, a Chinese long/short manager - basically they are super long, but as the allocation to such a manager is just about 1% or so of the total portfolio, it's a good kind of a diversifier. But a diversifier needs better performance, needless to say.

Matthias Knab **In creating your portable alpha strategies, what are the hedge fund vehicles that you use? Do you use a fund of funds? What is the structure? Or do you create a dedicated structured product?**

Nobuki Yasuda At this moment we only have two staff members to oversee our hedge fund investments, so the core of our portfolio, about 70% is in fund of funds. About 30% goes directly into hedge funds as a kind of active satellite investment on top of the core fund of funds portfolio. We invest in global hedge funds.

Matthias Knab **Do you see the PFA itself coming back to Japan as an investor? Do you see the same opportunities as we have discussed here now about how corporate Japan is at potential rebound?**

Nobuki Yasuda I may not have a right answer, but generally we tend not to focus on the market direction. We want to invest with a manager who has, wherever the markets, proven skills to generate returns. We don't follow the market view, but look for a process, the skill or ability to generate returns in various market environments. That is value for us, and that is what we expect.

Goro Ohwada Fundamentally, Japan is in quite good shape now. A friend of mine, who happens to be a hedge fund manager in the U.S., came to Japan recently. We were walking around the Shinjuku area and he suddenly stopped and said surprised: "Japan is the richest country in the world, I have never seen any other place where you can see homeless wearing ties!"

However, we live in a globalized environment where economies compete for capital, for allocations, in our case China, Hong Kong, Singapore, India etc. We also know that from a demographic perspective, Japan, like other countries in the West, needs more young people, as the population is decreasing.

One way other nations handle this problem is through controlled immigration. Whereas Japan is sort of doing the opposite, they have even announced stricter guidelines for immigration, basically if you can't speak Japanese, don't come here.....

Matthias Knab **I just read a commentary somewhere that said "Immigration is America's secret weapon", also Europe is far behind the curve here...**

Goro Ohwada Still, I believe Japan is probably one of the largest emerging markets in history. Why do I say emerging? If you step back and look at the bigger picture, you can see that in various ways the Japanese market is probably 20-30 years behind the United States. This is particularly visible in the financial field. For example the deregulation of the brokerage fees, which took place in the States in 1975, happened in Japan in 1999. Or the ascent of activist investing, M & A etc,, which was very popular in the States in the 80s, is now coming to Japan. Also, of course, when it comes to the development of a domestic hedge fund industry, Japan is 20-30 years behind of the States. In that sense, we are still quite optimistic about the Japanese market, as there is still a lot of potential.

We discussed activist investing, corporate governance and shareholder value - these issues also touch the Japanese media and even the public. Sometimes I talk with our U.S. managers about the Bulldog Sauce case. This is of course a joke for us financial professionals who understand

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Sometimes I talk with our U.S. managers about the Bulldog Sauce case. This is of course a joke for us financial professionals who understand capitalism, but there, a top representative of the firm goes to the media and says the firm would be in trouble now, because "somebody who doesn't know how to make sauce is going to buy my company", and the media then says "oh, that's a problem!", that makes you think, but it also shows the opportunities.

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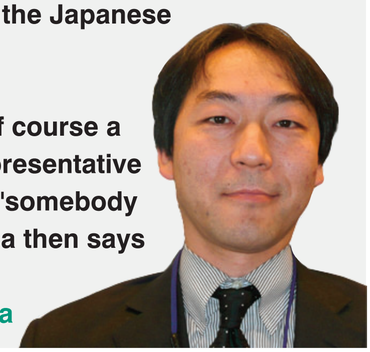

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Recently, this has been changing, and as we said the PFA has a quite a strong stance on governance and has been pushing for improvements in the last few years. As I had mentioned in that Bulldog anecdote, the Japanese market, maybe the society as a whole, also has to further develop and apply common sense, as we are all acting in a globalized world. Once Japan starts doing this, the country may have quite a large potential to recover.

Matthias Knab **Some of these activist battles, like Bulldog, were also carried into the media, and not always were the hedge funds or investors involved victorious. By the way, this is not only a concern from the hedge fund side, also Railpen, a British pension fund, demands for example that Japanese boards rethink their structures. Where are we now in this tug-of-war? Is there still a lot of resistance, or more openness now on the corporate level?**

Angus McKinnon The activists have been very beneficial for Japan, bringing some of these issues to the open. If you look at the way Japanese companies have reacted for the last say, ten years, and what the tendencies are for the last three or four years under the impact of the activist investors, you find there is more disclosure, there is credit transparency etc, and all these things are very helpful.

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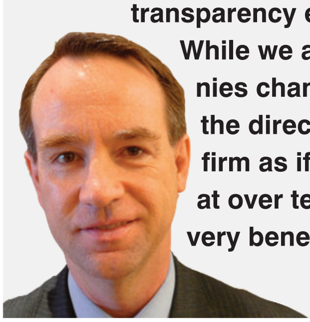

While we are not yet at the stage where activists have been successful in actually making companies change in terms of dividend payouts and share buyback so much, we are at a stage where the directors are much more aware of the people who own the company, rather than running the firm as if it was the directors' own private property. From my personal experience, looking back at over ten years of company visits that I have had, the change is very extensive. So that's been very beneficial.

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Matthias Knab **Lately there has been not only a lot of talk, but straight demands, white papers and concepts from the government, governmental or private entities about bringing back the asset and financial industry to Tokyo, "Tokyo wants to be Asia's London" is one of the headlines I found in the Opalesque archive. Will this happen, is there any likelihood for this?**

Rory Kennedy When you look at Japan's competitors in Asia, Hong Kong and Singapore, when it comes to attracting hedge funds and hedge fund managers, the clear differentiating factor is not so much to me the tax or the regulation, as the attitude of the government in charge.

So for example, in Singapore the government is inviting hedge funds to come and set up an office, they are encouraging investment and asset management. More importantly, every single government department will toe that line. The problem here is that Tokyo will say, "We want to be the London of Asia, we want to hold the Olympics, we want to do all these other wonderful things", but because of the current paralysis in the government, the bureaucrats don't necessarily have to toe the line.

So for example, on the one hand this year, you have the regulators and the tax office clarifying things for hedge funds, which improves the situation. But then you have a senior bureaucrat commenting in public saying public companies should be able to choose who their shareholders are. So you have got this constant flow of mixed and contradictory messages being sent out. Until we have a government that can effectively unite the opinions, or at least make sure that the different government departments are following government policy, you can't truly grow the local hedge fund industry to any great extent, in my opinion.

Toshihiko Nishida When we launched a long/short fund in Singapore, we called up the Monetary Authority of Singapore (MAS), to ask several questions regarding set ups, tax, and such things. In Japan, maybe they answer these questions too, but it takes, I am guessing here, about 15-20 minutes before I reach the person.

But those people at the MAS were like businessmen, they were really pro-business and service-oriented, answering the questions completely, and then they follow up very nicely. That is a different kind of mentality and behavior.

You don't even have to look as far as history or culture to explain the differences between some jurisdictions - just look at the principles which govern the regulations or laws. In Japan, often regulations can be interpreted in this way or that way, depending on the bureaucrats or the politicians or the industry. I think that lack of principles is the problem. In my view, that is the gap.

Matthias Knab **The Japan FSA has just published 14 principles that are supposed to be a balance between the rules-based regulations, and principles-based speculations.**

Toshihiko Nishida I saw it as well, yes.

Matthias Knab **A previous initiative was the Financial Instruments and Exchange Law (FIEL), what was the effect of that? Or do you still see a room for improvement?**

Rick Okuno Right now clearly Singapore and Hong Kong are more easily used domiciles to manage hedge funds. But I think that if you look at the longer historical perspective, the Japanese do make progress over time if they think it's in their national interest. I remember the large US investment banks pushed for access in the 1980s and the global money managers did the same in the 1990s. In both cases, the Japanese financial community largely accommodated them.
I tend to look at the hedge fund industry here more in terms of an independent asset management industry, where only 1% of the assets in Japan are managed by asset managers which are not affiliated with banks or brokers or financial conglomerates. Independent asset management in Japan is the next big growth story.

As part of this trend, we have decided to become fully licensed, and to put up with the glare of the regulation, in the belief that if we do it that way, it's harder, but over time we can build a reputable, scalable business, and that's what we want to do, because of the growth perspective that I had mentioned.

If you want to be opportunistic and keep playing in the offshore gray zone, sure, that's an option, and a lot of people do that, and that's fine. But the other option is to really scale out, pursue a dialogue with the regulators, and to deal with all the issues that you have to deal with to operate here within the Japanese tax and regulatory framework.

Hideki Hashiguchi When we talk with start-up managers who are looking to set-up funds, most of them seem to prefer setting-up the investment management entities in Singapore, with Tokyo playing the role of investment advisor. Both Singapore, and to a slightly lesser degree, Hong Kong, are very business-friendly environments.

In Japan, the regulators are addressing certain areas, for example, through the FIEL laws introduced last September. From the perspective of an investment manager, there are still other things that can be considered, for example, the capital requirements necessary for a Discretionary Investment Management License (DIM).

One idea being suggested is creating a "DIM Light" with a lower capital requirement and to optimize some compliance procedures to reduce the costs for compliance.

Rory Kennedy A DIM Light is a great idea. We need to convince the Japanese Government this is actually good for the country. They could perhaps setup a regulatory regime like Singapore where you can set up as an "exempt" fund manager, as long as you don't have local investors. Not allowing local investors under a certain license for example would help reduce potential political risks for the politicians who sponsor the idea.

Matthias Knab **As Chairman of AIMA Japan, how is the interaction with the domestic regulators?**

Hideki Hashiguchi The AIMA Japan Regulatory Committee shares information with the FSA and other government related entities, such as the Bank of Japan and Ministry of Economic and Trade Industries, about the overall hedge fund industry and the overseas activities of AIMA UK.

As Japan gains a better understanding of the nature of the hedge fund industry, this will benefit the managers and the industry as a whole.

The financial institutions, which are our main client base, require a high degree of transparency and liquidity. Most of the regional banks require monthly full position reports and monthly or shorter redemption terms with one-month notice, at most. Some can only invest in Japan domiciled funds which can be done by repackaging the products. This is all due to trying to conform with the Basel II requirements. As we are all aware, the implementation of the Japanese version of the Basel II rules has affected most of the financial institutions in Japan.

Atsko Nakajima

Matthias Knab **Atsko, you are building a global fund of funds, what is the current demand from the Japanese institutions for hedge funds or fund of funds? What are the requirements of Japanese institutions when investing in hedge funds?**

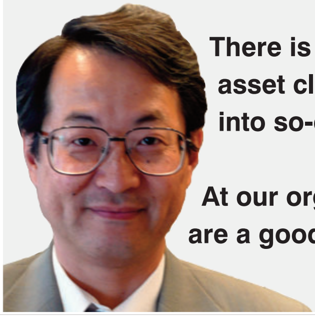
Atsko Nakajima The financial institutions, which are our main client base, require a high degree of transparency and liquidity. Most of the regional banks require monthly full position reports and monthly or shorter redemption terms with one-month notice, at most. Some can only invest in Japan domiciled funds which can be done by repackaging the products. This is all due to trying to conform with the Basel II requirements. As we are all aware, the implementation of the Japanese version of the Basel II rules has affected most of the financial institutions in Japan and as a result, many regional banks have redeemed their hedge fund holdings altogether, which is not a good development for at least the Japanese financial industry at this time.

Matthias Knab **The Basel II situation, are there any new developments? Will there be more clarity?**

Atsko Nakajima Personally I wish so, but it is not yet visible. Given the fact that Japan has adopted the strictest guidelines compared with other countries, with time the rules may be amended to be more realistic or in line with global standards. In the meantime, since the regional banks are under subject to heavy oversight by the financial authorities, it is expected that most will choose to stay away from hedge funds for a while. We aim to expand our client base to include pension funds and other types of corporate institutional investors. .

Matthias Knab **What is now the perception at the level of the domestic pension funds; do they see hedge funds still as some sort of cowboys or have hedge funds become a reputable asset class they really want to invest in?**

Atsko Nakajima I am on the fund management side and do not talk to the investors directly and can only say what everybody else knows, mainly that there is a lot of variety among the pension funds; some are very educated and some are not, there is quite a difference in terms of where everyone is on the learning curve. I believe that most Japanese investors are aware that hedge funds are here to stay given the relatively attractive risk return profiles, and even if the portion allotted to alternative



There is a trend that with increased experience investors treat hedge funds as an independent asset class. Given the poor performance of Japanese equities, there is a clear shift of money into so-called absolute return vehicles or hedge funds, this is a current trend.

At our organization, we don't think hedge funds are dangerous vehicles, and apparently they are a good source of return. That is why we started the program.

Nobuki Yasuda

investments is yet small, research and analysis is being conducted for the long term as a permanent part of the overall portfolio.

Matthias Knab **What is your experience here, Nobuki Yasuda?**

Nobuki Yasuda Coming from the insurance world, I am quite new to the pension fund industry having just joined six months ago, however there is a trend that with increased experience investors treat hedge funds as an independent asset class. Given the poor performance of Japanese equities, there is a clear shift of money into so-called absolute return vehicles or hedge funds, this is a current trend. At our organization, we don't think hedge funds are dangerous vehicles, and apparently they are a good source of return. That is why we started the program.

Matthias Knab **You worked at Sumitomo Life, you were in charge for the hedge fund program there. What is the situation in the insurance sector?**

Nobuki Yasuda A life insurance company has typically, let's say, five to ten years experience investing in hedge funds. The situation varies from firm to firm, but at least more or less they do treat hedge funds as an independent asset class and not a temporary reservoir for cash. You have to have in mind that a firm's asset base can be quite large, like $200 billion for example, so even though they allocate just a 1%, it comes to $2 billion, which is enough size for experience.

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On the other hand this means that, given the size of the program, the management in charge can get a little bit nervous, especially about reputation risk, in other words headline risk. In order to lessen such risk, people generally prefer to use fund of funds for investment instead of direct hedge fund investment.

Institutional investors aim to diversify their portfolio by adding hedge funds, and they have achieved lowering the volatility of the total portfolio. Recently in 2008 the performance is tough, but if you look back at the 2006 or 2007 returns - LIBOR plus 5% for many investors - I believe most of them are happy with the results.

Matthias Knab **Let's quickly examine how this industry could develop over the next couple of years.**

Rory Kennedy I see two clear developments right now. As we pointed out, the Japanese hedge fund industry is in an attrition phase, and numerous funds have closed down over the last two years. There is a feeling that those left will receive assets simply because they will now have a track record that's long enough for some institutional investors' requirements and if they are of an appropriate size, for example having crossed let's say $100 million AUM. So even if their recent market performance has been mediocre, for people wanting to get back into Japan, they are going to go into those funds which have survived the current shake-out and are of larger size.

The second trend I see as well is that the large global hedge funds are coming to Japan. They are already starting to beef up their structures here, looking for offices, staff and experts in the local markets. For a $20-30 billion hedge fund, to put several hundred million dollars to work in Japan is a blip on their radar but can be very profitable in the medium term.

Andrew Hill

True, the big global hedge funds are coming back, they are hiring bankers and getting expertise on the ground in Japan. It is important to notice that they are not just looking for traders, but experts for the corporate activities we discussed here, to work with corporate management, for example in restructuring some of the balance sheets and some of the businesses that still need help. There is a lot of that activity going on, that's very encouraging.

Opalesque

Opalesque leads the finance media space for its in-depth and innovative products. Since February 2003, Opalesque is publishing Alternative Market Briefing, the premium news service on hedge funds and alternatives. The launch of these Briefings was a revolution in the hedge fund media space (”Opalesque changed the world by bringing transparency where there was opacity and by delivering an accurate professional reporting service.” - Nigel Blanchard, Culross) combining proprietary news with the ”clipping service” approach of integrating third party news. Each week, Opalesque publications are read by more than 360,000 industry professionals in over 100 countries.

Opalesque is the only daily hedge fund publisher which is actually read by the elite managers themselves (www.opalesque.com/op_testimonials.html).

About Opalesque Publications

Alternative Market Briefing

A daily newsletter on the global hedge fund industry, highly praised for its completeness and timely delivery of the most important daily news for professionals dealing with hedge funds. Alternative Market Briefing offers both a quick overview and in-depth coverage. Subscribers can also access the industry’s largest news archive (26,000 articles as of March 2008) on hedge funds and related topics.

A SQUARE

Opalesque A SQUARE = Alternative Alternatives is the first web publication, globally, that is dedicated exclusively to alternative investments. A SQUARE’s weekly selection feature unique investment opportunities that bear virtually no correlation to the main stream hedge fund strategies and/or distinguish themselves by virtue of their ”alternative” motive - social, behavioural, natural resources, sustainable /environment related investing.

With its ”research that reveals” approach, fast facts and investment oriented analysis, A SQUARE offers diversification and complementary ideas for: private, high net-worth and institutional investors, pension funds and endowments, portfolio and hedge funds managers.

Technical Research Briefing

Delivers three times a week a global perspective/overview on all major markets, including Equity Indices, Fixed Income, Currencies, and Commodities. Opalesque Technical Research is unique compared to most available research which is fundamental in nature, and not technically (chart) oriented.

Opalesque Roundtable Series

In an Opalesque Roundtable, we unite some of the leading hedge fund managers (single and multi strategy managers) as well as representatives of the local investor base (institutions, fund of funds, advisers) to gain unique insights into the specific idiosyncrasies and developments, the issues and advantages of individual global hedge fund centers.

No matter if you are a hedge fund investor looking for new talent, a hedge fund interested in diversifying your investor base or a service provider looking for new clients, you will get to know some of the leading heads of each hedge fund center and find invaluable information and intelligence right on your desk, without any travel involved.