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## Petite potatoes: Canada's hedge fund industry

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*It's small to the point of being stunted, and while there are good managers, many are starving for capital*

Those who talk about Toronto's future as a global financial centre should spend a little time at Canada's annual hedge fund summit before they get too starry-eyed.

The gathering last week, known as the World Alternative Investment Summit Canada, was a small affair that fit in a few conference rooms in a hotel overlooking Niagara Falls.

A handful of exhibitors, mostly lawyers and brokers, lined the walls of one room. In another, fund managers gave quick presentations in hopes of rounding up new investors in "capital introduction showcases" that felt a bit like speed dating, except there weren't really any dates to be had because pretty much everyone else in the room was either a fund manager or some sort of supplier to the industry. And that, one manager glumly observed, was pretty much emblematic of life in Canada's hedge fund industry.

It's a different universe from the life of a hedge fund manager in financial capitals such as London and New York. In the United States, the five largest hedge funds alone managed more than \$100-billion (U.S.) in aggregate as of last year. The top 10 funds in Europe run almost \$150-billion.

The whole Canadian industry, encompassing about 150 managers, manages somewhere around \$35-billion (Canadian). The result is that most funds are small shops running around \$50-million or \$100-million, less than many retail stockbrokers.

Sure, Canada's banks are great, but a visit to the hedge fund conference is a stark illustration that the country, for all the talk of its ascendance on the global financial scene, is a long way from having the full spectrum of financial infrastructure needed to be a real global power. It's surely one of the reasons Toronto placed in 12th spot in a ranking of world financial centres published Monday, well behind cities such as London, New York, Hong Kong and Singapore.

To be sure, some large funds were missing from the Niagara Falls conference, but for the most part the subdued affair gave an accurate picture of Canada's hedge fund business. It's small to the point of stunted, and while there are good managers, many are starving for a lack of capital.

It's a glaring example of missing a big opportunity. The alternative strategies that hedge funds represent are certain to be attractive to many investors frustrated by today's unpredictable markets. Globally, even after the market crash, there's something like \$1.5-trillion (U.S.) under management in hedge funds. Having a real taste of that begets ancillary

activities such as brokerage fees for banks, billable hours for lawyers and perhaps most importantly, a source of capital for local businesses.

It's not that Canadian managers aren't talented. For example, Toronto is home to Warren Irwin of Rosseau Asset Management, whose fund is the top-performing event-driven hedge fund in the world for the past five- and ten-year periods, according to rankings by BarclayHedge. Rosseau has about \$200-million (Canadian) under management, a pittance compared to what a firm in the United States with similar statistics could be expected to attract.

There are two big reasons. Canadian hedge funds are viewed as too small to work for the big pension funds that have their hands on so much money in this country, and too unpredictable for banks to market to customers.

Pension managers such as the Canada Pension Plan Investment Board are so large that they either run strategies in-house or need to write such large cheques that they only work with hedge funds that manage billions. Smaller pension funds and endowments tend to outsource the choosing of hedge funds to U.S. firms that specialize in picking managers, so that money heads out of the country never to be seen again.

After that, the main source of funding is high-net-worth clients, but many of them deal with brokerages and banks that are reluctant to let hedge funds into their distribution systems, especially after some very damaging frauds in the industry. There's also a sense that hedge funds are too volatile for brokerage customers, which is ironic given that most hedge funds try to avoid volatility and are less bouncy than mutual funds.

For all that, the hedge fund managers in Niagara Falls last week were optimistic about the future of their industry, hoping that bumpy equity markets will push those high-net-worth investors to seek out hedge funds. The problem is that, even then, it's difficult getting from the \$100-million or \$200-million level that's doable with a good network of high-net-worth clients to the \$1-billion or even \$10-billion that's necessary to attract global capital and the big Canadian pension plans.

Something needs to be done to help bridge the gap. If the government is serious about wanting Canada to be a financial capital, finding ways to encourage the alternative asset management business is somewhere to start.