Reprinted from February 2013

HEDGE FUNDS REVIEW

THE VOICE OF THE GLOBAL ALTERNATIVE INVESTMENT INDUSTRY

OPPORTUNISTIC COLLABORATORS

Cheyne's Stuart Fiertz and Jonathan Lourie

Risk publications

A long partnership and a product offering ranging over five asset classes has given Cheyne an edge other management companies may well envy, discovers Margie Lindsay.

Opportunistic collaborators

One of the key ingredients behind the success of Cheyne Capital is the close friendship of its founders, Jonathan Lourie and Stuart Fiertz. Both attended the same school in Geneva and then went on to the same university in New Hampshire. The two ended up at Morgan Stanley and have collaborated since 1991. Clearly this is a partnership built on a solid foundation.

From its origins as a hedge fund investing predominantly in convertible bonds, Cheyne has become one of Europe's leading alternative asset managers with $6.3 billion of assets under management across corporate credit, real estate debt, event driven, convertible bond and equity strategies with $4.6 billion of this in hedge funds. It is Europe's largest dedicated manager of real estate bonds and loans, running more than $1 billion in this strategy alone.

In their last 10 years at Morgan Stanley, Lourie and Fiertz became experts in convertible bonds.

"Starting in the corporate crisis in the early 1990s, in the Asian crisis in the late 1990s, we were an opportunistic player in convertibles in Asia," says Lourie. Before long, the pair were given the job of building the convertible bond management practice at Morgan Stanley. "We were an opportunistic player in convertibles in Asia and pioneers in structured credit at Morgan Stanley, where we launched the first actively managed convertible bond backed CBO," explains Lourie.

The transition from Morgan Stanley to Cheyne was relatively painless. Lourie and Fiertz together were managing around $750 million in dedicated convertible bond portfolios through managed accounts when they left the American bank. "We saw the future, in terms of financing convertibles and managing the best results for our clients as being through flagship funds."

> "There are conservative investors, there are middle-tier investors and there are certainly those investors who are more aggressive when it comes to risk."
> **Chris Goekjian**

This was something the two wanted to do independently of Morgan Stanley.

"Independence was important to us and it was a very amicable departure [from Morgan Stanley]. It was agreed that our clients would transition to us and that was really the beginning of Cheyne." The name was taken from the first convertible bond backed CBO offering the two developed at Morgan Stanley. "We effectively named the firm after what had been the most public of our transactions," notes Fiertz.

The partnership started in a house on St James's in London with around 20 people consisting of their team from Morgan Stanley. Twelve and a half years later, the company has grown to around 150 professionals and now occupies Stornoway House, next to the former mansion of Barbara Villiers, the most rapacious of all of Charles II's mistresses – possibly a good choice for a hedge fund manager known for its savvy investment strategies in real estate bonds and loans.

"I think one of our strengths is that the principals have complementary talents rather than an overlap or competing talents" says Fiertz.

From the start the emphasis was on building an infrastructure for the long term. This was a business with a long-term horizon and both Lourie and Fiertz wanted to send that signal to investors.

"Markets have enough volatility and challenges so for us a solid infrastructure – the full set of non-front-office elements – was important. We never wanted a lack of investment in infrastructure to be a factor that impacted our growth. So we were always ahead of the game. Sometimes it's tough when you're spending a little bit ahead of yourselves but it meant we were never in a position where the infrastructure was too small to match the growth of the business," explains Fiertz.

The only target they set was to be "in this business for a long time. That was our expectation and commitment," he adds.

This dedication and commitment has been one of the secrets behind the success of the business. "At the beginning all we concentrated on was our success in terms of performing well in the specific asset classes that we were in, originally convertible bonds with corporate credit added a year later," says Lourie.

"For us it was more the excitement of doing things properly in those asset classes." While it was not about gathering assets, the company has expanded exponentially over the years and is still excited about the opportunity set it can offer its investors, now overwhelmingly made up of pension funds, insurance companies, sovereign wealth funds, banks, funds of funds, endowments and other financial institutions.

The strategy behind Cheyne is one they recommend to other start-up managers, although the environment for fund launches is now considerably more challenging on the compliance and regulatory front as well as for asset raising.

Different and distinct

According to chief investment officer Chris Goekjian, who joined Cheyne in 2009 following its acquisition of AltEdge, Cheyne is different from other hedge funds. First on his list is the fact that there are distinct investment teams for each of the asset classes it manages: corporate credit, real estate debt, event driven investing, convertible bonds and equities.

Read more online
For similar articles go to:
www.hedgefundsreview.com/tag/event-driven

Chris Goekjian, partner and chief investment officer

Stuart Fiertz, co-founder, president and director of research

Rob Kennard

Jonathan Lourie, founder and CEO

"We have the capability throughout the whole spectrum of the capital structure. We build from investment-grade down to high-yield, stressed and distressed."

Stuart Fiertz

Read more online
For similar articles go to:
www.hedgefundsreview.com/tag/credit

Rob Kennard

"We have a good process going and have demonstrated our ability to bring in new talent. It is looking more and more like a sustainable business. We'll just keep doing what we do and evolve."
Stuart Fiertz

"We raise specific assets managed within each one of those classes. Sometimes people think that some of our funds are too opportunity-specific but that's only because we recognise niche opportunities. What we're offering the client are very specific investment opportunities," explains Goekjian. "This idea – let's call it innovation – is driven by our teams. They see an opportunity in the market and think it is attractive. We package it and then basically raise money for that particular investment idea."

This approach has helped to diversify Cheyne but within a select group of asset classes where it believes it has specific expertise. "We believe our core strategies address opportunities in the market, respond to investor demand and are sustainable," says Fiertz. "The idea was that if you were in convertibles, which have both a debt and equity component, you could provide a stronger offering by building up your equity business or your pure credit business or both. It is also the expertise and talent of the teams that make those businesses stronger. Investment up and down the capital structure gives a deeper understanding of the credit universe."

Going from the original core business of European convertibles into the other asset classes was, therefore, logical, giving the company a full spectrum of experience. "That's why all our strategies are fundamentally driven, using different techniques to moderate the risk profile or to provide stable term leverage if that's what is appropriate or interesting for a particular asset classes, adds Fiertz.

Cheyne started with a flagship fund and it now operates a mixture of commingled funds, managed accounts and "something that comes in between" – share classes "so an investor can enjoy the control of a managed account with the efficiencies of a commingled structure", notes Fiertz.

That evolution was a response to the financial crisis when investors recognised the clear advantages of having control over their assets. "Today we see the market evolving, from an investor point of view, to a greater appreciation of possible constraints of managed accounts," continues Fiertz.

This has led more investors to use the share class model although he admits the expansion of managed account platforms (MAPs) has helped, he believes, to promote transparency and better risk management. Some of the MAPs also act as a pooled vehicle but without the worry of early exits by investors, something that is always possible in a commingled structure.

In addition, with some of the regulatory changes and the enhanced reporting requirements, there is now more of a standardised definition of leverage as well as common ways of expressing the exposures in the portfolio so they can be aggregated more efficiently. Initiatives such as Opera (open protocol enabling risk aggregation) and some of the legislation coming from Europe together with the core requirements from the SEC in Form PF, for example, have also added to a more uniform way for hedge funds to report and express a whole raft of risk parameters.

"My sense is that we will see more transparency in an aggregated risk format with the right kind of transparency in the commingled funds," says Fiertz. He predicts that investors will turn [away from managed accounts] and back to commingled funds "because of certain constraints in the managed account process."

In general he thinks investors are beginning to be more comfortable with commingled funds as the "lessons from the crisis have been learnt". More transparency is available, including better risk data.

Meeting investor needs

Finding solutions that fit investor needs is important for the future of hedge funds, believes Cheyne. But in order to offer a selection of commingled, managed account and share class structures, management companies also need the infrastructure and technology to make it possible and ensure all investors are treated fairly.

The future for Cheyne could well be in this approach to investors as well as in its ability to distinguish itself from single-strategy funds. While the company is keen to attract new talent and has been successful at that over the years, it is important to keep the focus. Lourie says the company has been attracting more talent over the last few months with geographical focuses within equities. He thinks this is a logical extension of the range of products as Cheyne is one of the largest credit companies outside the US investing in corporate credit. "It's just a different part of the capital structure. We are effectively managing throughout the capital structure in different silos now."

"We have the capability throughout the whole spectrum of the capital structure," adds Fiertz. "We build from investment-grade down to high-yield, stressed and distressed."

Aside from investor demand, regulation is also changing the industry and could have a profound impact, particularly in Europe. The introduction of the alternative investment fund managers (AIFM) directive has been delayed in the UK until July 2014 but hedge funds will need to assess its ramifications in order to remain competitive. Even though many of Cheyne's investors

Read more online
For similar articles go to:
www.hedgefundsreview.com/tag/convertible-bond

"We are very much involved in the present. We're excited about the opportunities right now."
Jonathan Lourie

are North American, Fiertz says the company is committed to "serving the European investor base".

"We will look to find solutions for products within the new regulations which are still to be defined so that we can market to European-based investors," says Fiertz. "We think European-based investors are as much in need of higher performance products as anybody out there, particularly with the bank lending environment we're in today and the losses they have taken on sovereign debt and so forth. We shouldn't shy away from trying to meet that goal."

Meanwhile, continued uncertainty over private placement rules as well as how close the Irish qualified investor fund (QIF) rules will be to a Ucits structure are issues that need to be resolved before funds can make informed decisions. On that front, Cheyne believes hedge funds will continue to look at Ucits as a good way to access European investors. Last year Cheyne launched two Ucits funds: Cheyne Global Credit Fund and the Cheyne European Real Estate Bond Fund. It first began using the Ucits structure in 2009 with a converts fund.

"If we can deliver a strategy without compromising our ability to manage it and if we think we can deliver it in a way where the higher cost of running a Ucits fund doesn't detract from that attractiveness, we would still consider launching under Ucits today," says Fiertz.

The first "cut-off" will be the liquidity requirement under Ucits. The second concerns the specific rules that could make it difficult for the portfolio manager to use the tools that the strategy needs.

If the Ucits route is not possible, then Cheyne will continue to look at Irish QIFs as well as traditional offshore structures.

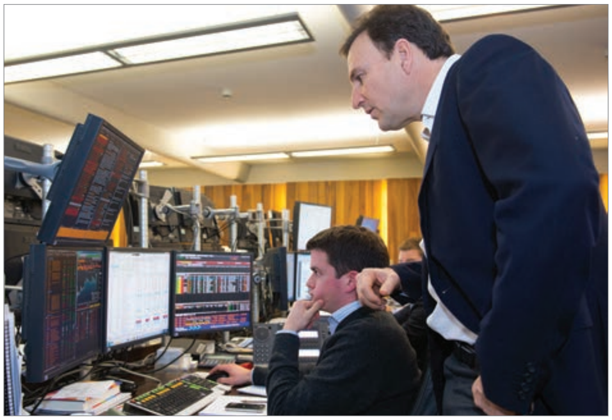
Unsettled regulation

Aside from the challenges presented by the AIFM directive and the continuing requirements under Dodd-Frank in the US, regulations are adding costs as well as unsettling the industry. In addition there are increased reporting requirements from stock exchanges or national regulators on trading positions as well as mandatory reporting requirements and changes that could happen overnight such as short-selling bans.

This requires hedge funds to respond quickly and to have systems that are able to communicate new limits to portfolio managers as well as produce the appropriate reports and monitor trades. Such requirements require investment and for smaller funds are a daunting prospect if they do not have the necessary IT infrastructure and ability to make needed investments.

These and other factors are continuing to push investment into funds with $5 billion or more under management. Institutional investors want the reassurance of robust operational risk management systems capable of producing much more detailed reports for them as well as for regulators.

It is not just the need for flexible systems; it is also a question of having strategies that can work within a more controlled environment. "Since we don't seek to take control positions in public companies, we've always maintained a fairly diversified portfolio structure because we think that is essential to manage risk on the downside. The reporting thresholds actually haven't hurt our strategies at all. In terms of bans on shorting financials, while these made it difficult to profit from the financial sector in certain parts of the cycle, we never had set out to run a pure financials fund," says Fiertz.



Rob Kennard

Cheyne's offering

Cheyne Capital runs a variety of interrelated strategies in what it calls a multiple strategy business that encompasses traditional hedge funds as well as long-only products and some Ucits vehicles.

There are five main strategies offered by the company. It is best known as one of Europe's largest portfolio management groups specialising in investment-grade and crossover corporate credit. It manages long-only and long/short strategies investing in credit default swaps (CDS) and bonds. The corporate credit team seeks to take advantage of the opportunity in investment-grade credit through both long-only and long/short strategies, gaining exposure both synthetically and via cash bonds. The team manages a total of $1.5 billion of net assets. The flagship fund in this area is Cheyne Total Return Credit Fund with $682 million in assets under management, which returned 71.28% for the year ending December 2012. Other principal funds include Cheyne High Income Regulatory Capital Fund, Cheyne Global Credit Fund (Ucits) and Cheyne Long/Short Credit Fund, a directional fund positioning corporate credit through both carry and relative value books.

Cheyne is also recognised as a leading investor in European real estate debt, focusing on opportunities in securitised real estate debt and direct mezzanine lending. The team's investment approach combines a valuation of the underlying residential or commercial property and a detailed analysis of the debt structure. The team manages $1.6 billion.The flagship fund in this area, Cheyne Real Estate Debt Fund, was launched in 2009 to take advantage of the indiscriminate selling of European mortgage-backed securities (MBS). The fund, now with $793 million AUM, returned a healthy 18.4% in 2012.

Another area where Cheyne has developed expertise is event driven strategies. The team invests only in liquid, event driven situations with defined short-term catalysts and specialises in investing in credit as well as equity. At the end of 2012, the Cheyne Event Driven team managed assets of approximately $907 million.

Cheyne's experience of investing in convertible bonds dates back to the company's inception in 2000. The team, which manages $404 million in convertibles and equities, uses bottom-up fundamental analysis to identify undervalued companies on a global basis.

Experience with equities also dates back to inception. The team combines fundamental investing in research driven opportunities and undervalued companies with a proactive approach to trading. Portfolio managers cover opportunities such as global long/short, South-East Asian long/short and European mid-cap. Cheyne also offers a range of multi-strategy products with active asset allocation and portfolio management by CIO Chris Goekjian. Total AUM for multi-strategy is $314 million.

Watch more online
Video: Cheyne Real Estate Debt Fund: Cheyne Capital Management. Winner of best credit/distressed hedge fund in the 12th European Single Manager Awards 2012
www.hedgefundsreview.com/2181679

Successful triumvirate

Cheyne Capital is run by what the founders describe as a triumvirate consisting of Jonathan Lourie, Stuart Fiertz and Chris Goekjian.

Lourie, founder and CEO of Cheyne Capital Management (UK), worked from 1985 at Morgan Stanley where he was responsible for the creation and development of the convertible bond management practice. He was educated at the International School of Geneva and at Dartmouth College in New Hampshire, from which he graduated in 1983.

Fiertz, co-founder, president and director of research, also worked at Morgan Stanley before helping to start Cheyne. From 1991 to June 2000 he was responsible for the development and implementation of customised portfolio strategies and for credit research in the convertible bond management practice at Morgan Stanley. Before that Fiertz was an equity research analyst for the Value Line Investment Survey from 1984 to 1986 and a high-yield credit analyst in Boston at Merrill Lynch from 1986 to 1988 and in New York at Lehman Brothers from 1988 to 1990. Fiertz was also educated at the International School of Geneva and Dartmouth College, graduating in 1984.

The third member of the group is Goekjian, partner and CIO. Goekjian has more than 25 years of experience in investment and risk management. His previous experience includes serving as head of the global fixed income division of Credit Suisse's investment bank where he oversaw more than $300 billion of trading positions. Immediately before joining Cheyne, Goekjian was CEO and CIO of AltEdge Capital (UK), a London-based fund of funds manager he founded in 2001 and whose business was integrated into Cheyne in 2009. Goekjian has overall responsibility for risk management of all Cheyne funds and investment products, oversight of portfolio management teams and development of new investment products.

Rob Kennard

"We never traded sovereign risks except from time to time to hedge more macro stocks at the core of the strategies. We have been able to find other combinations of positions to create our tail risk hedges that might have been disrupted [by regulation]."

As many hedge funds also struggle to keep performance up and volatility low, Cheyne has found a happy medium that helps it continue to report double-digit growth for many of its funds. For example, the $682 million Cheyne Total Return Credit Fund was up 71.28% in 2012. The Cheyne Real Estate Debt Fund was up 18.4% for the year.

Because a lot of time is spent understanding exactly what kind of risk/return expectations and profiles an investor wants, Goekjian believes Cheyne is able to respond to those needs with exactly the right kind of structure.

"In many of our different asset classes, there are opportunities to run a fund with different risk/return profiles," says Goekjian. The first question, he says, is to find out what risk/return profile the investor wants. "Then you make sure that the product responds to that. You need multiple products within an asset class to deliver different risk/return profiles. One example on the lower risk spectrum is the Ucits products, which usually offer lower risk and lower return."

Providing a spectrum of funds with the ability to provide differing risk/returns for investors, believes Goekjian, is now essential for hedge funds. "To my mind that's the way we're going. There are conservative investors, there are middle-tier investors and there are certainly those investors who are more aggressive when it comes to risk."

Whatever the appetite is for risk, Cheyne is convinced that more money will flow into hedge funds. "Institutional investors for the most part still allocate to hedge funds, real estate funds and private equity and sometime commodities as the 'alternative investment' allocation. It's typically anywhere between 5% to 20%. Even if it is only just 5%, that could still be a lot of money," explains Goekjian.

"On a long-term basis, I'm very bullish on the growth of the alternative investment management industry, particularly in hedge funds."

This is good news, since Cheyne clearly believes it has a future. Succession planning and business development is not necessarily something the principals are concerned about at this stage. "We are very much involved in the present. We're excited about the opportunities right now," says Lourie. "We really want to build out some of our products, particularly some of those launched over the last couple of years. There's no endgame other than to do what we do and to do it properly. If we do something well and it's an enterprise, it has a value."

"We have a very deep bench of very talented, next layer of management so we're not worried on that side," adds Fiertz. "We have a good process going and have demonstrated our ability to bring in new talent. It is looking more and more like a sustainable business. We'll just keep doing what we do and evolve." ■