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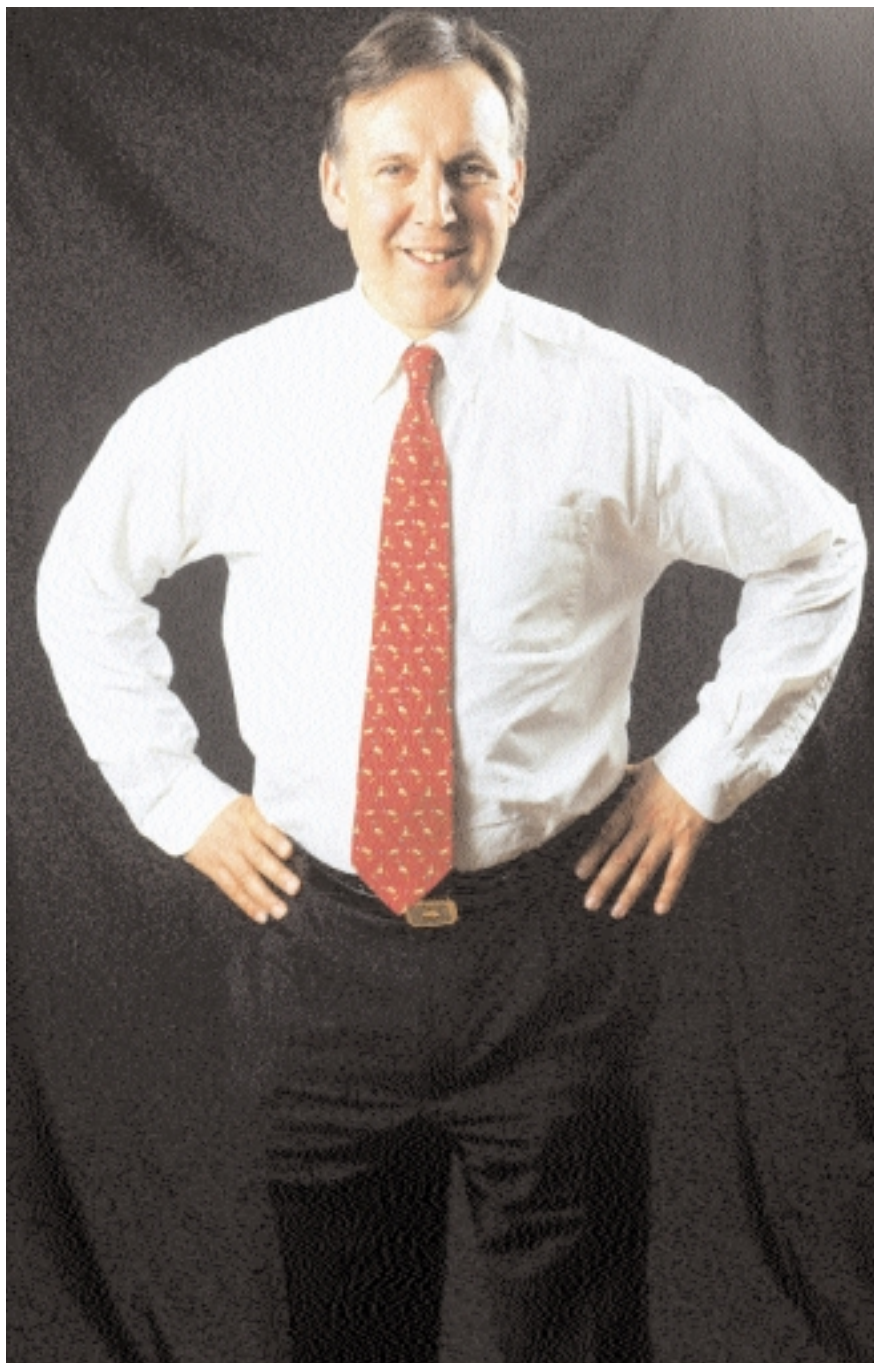
Stanley Fink, CEO
of Man Group, the
world's largest
hedge fund manager.

- ▶ State Street's Spina on diversifying a specialist
- ▶ Preparing for the wrap revolution
- ▶ FX survey results revealed



MAN'S APPETITE FOR EXPANSION

STANLEY FINK ON ACQUISITION,
DISTRIBUTION, AND MAKING IT IN THE US



"Most big hedge funds were based in New York. We were raising money where others didn't look, and we were business people who happened to be in hedge funds."

Stanley Fink, CEO, Man Group.

COVER STORY

COVER STORY

THE RISE OF MAN

Man's impressive growth over the last three years rests on a series of shrewd acquisitions and a distribution strategy that has embraced white labelling and open architecture. Now Man is hoping to replicate its success in the US market. *Maha Khan Phillips* reports.

The Rise of Man

► **MAN EYES THE US**

The world's biggest hedge fund manager has astounded critics and supporters alike with its seemingly endless acquisition sprees and stellar organic growth. Its rise to the ranks of mainstream fund managers says as much about the changing face of asset management as it does about Man's own capabilities. And now Man is looking to the US.

Maha Khan

Phillips reports.

PLUS ► THE ORIGINS OF MAN

► MAN'S CORE MANAGERS





Man Group's CEO Stanley Fink, in his office at Sugar Quay, London.

COVER STORY

Man's regional offices and distribution networks continue to expand globally. Now John Kelly, US head and former marketing chief, illustrated below, is duplicating the model in the US.

IN 1894, IN A CANDY store in Vicksburg, Mississippi, a relatively unknown fountain beverage was making its mark. The beverage proved popular enough to spur Joseph A Biedenharn, the store's owner, into bottling it and selling it, something the manufacturers of the drink had not thought of doing themselves. Alongside two lawyers from Tennessee, Biedenharn approached local entrepreneurs across the US and asked them to set up bottling plants.

There is no way he could have predicted what happened next. In the 1920s, there were no less than 1,000 bottlers in the US, all of whom

have a sales and marketing reach that is incredible. And they have done a tremendous service by raising the profile of the hedge funds industry."

Such is the power of the £30 billion-plus London-listed hedge fund group that a quick straw poll of European pension funds, asked to name the provider they most associated with alternatives, came up with Man or one of its subsidiaries every time. Hardly surprising, given that the firm has more than double the assets of most of its competitors. A strength in onshore structured product offerings, combined with an aggressive distribution strategy and the transparency of being listed have catapulted Man to success. "Man has currency because it is publicly traded. Unlike other players in the market, Man's shares are worth something," explains Joe Seet, founder of Sigma Partnership.

Bear market boost

It also helps that most schemes prefer to go down the fund of hedge funds route, which have grown from 18% of the market in 2000 to around 30% in the first half of last year. Though this is still a fragmented market, Man is estimated to hold roughly 7% of the market globally, putting it in the number one position. And though over half of its clients are retail, pension funds consider it to be very much an institutional player, and also like the fact that unlike most hedge funds created and sustained by the cult of one individual, Man has no star

"We believe that leadership, scale, track record, and currently strong investment performance is disproportionately helping the market leaders, such as Man," said a Morgan Stanley report.

In the year to April 2003, Man had new assets of US\$5.5 billion. The six months to September 2003 added new assets of another \$5.5 billion. And in July last year, it raised a record \$740 million for its Man AP Unison fund of hedge funds.

Yet there are plenty of sceptics who believe that Man cannot sustain its strategy. They argue that high fees, a need for capacity, and a dependency on guaranteed products will prove to be Man's downfall. For their part, Man supporters point out how wrong critics have been in the past. Speculative investors were badly burnt last year for example, when they shorted Man's stock, despite a 15% share price rise over a six-week period. Short selling hedge funds and proprietary trading desks were responsible for borrowing a fifth of Man's shares in September and October last year, according to EuroClear Crest, the settlement house.

There has been a great deal of confusion about where a semi-institutional hedge fund player sits in the hierarchy of the asset management industry, although CEO Stanley Fink is adamant that this is a

contributed to the massive success of the drink. Today, the long arm of Coca Cola reaches into 200 countries, from the Amazon, where water-borne distribution is common, to the Andes, where Coca Cola is sometimes transported by four-legged power. Yet there was no demand for Coca Cola in the Amazon until the company itself created it, but once they had tried it, most consumers agreed that Coca Cola tasted good.

"It is exactly the same with the Man Group," says one industry commentator. "They



thing of the past. "The market didn't understand us, but that is changing. The analyst community follows us very well," he argues.

Confusion may have served the firm well though. According to David Harding, co-founder of Winton Capital and AHL, now a Man subsidiary, general misunderstanding would help to explain why the group has survived without being attacked by investment banking predators. "The investment banks didn't get it. It was like saying, how could it be that Bill Gates, and not IBM, came up with Microsoft?" he says.

The distribution model

Man traces its origins back to 1783 when it was a cooper, making barrels of rum and sugar for the British Navy (see box, page 29). It rapidly evolved into a commodity merchant and trader, and was later an early user of futures contracts. Its brokerage division, Man Financial, still accounts for roughly 18% of earnings, performing consistently well, with Man Investments, the alternatives arm, making up the rest.

The early seeds of its distribution model stem from former head Colin Barrow's discovery of Mint Investment Management, a two-year-old CTA run by Larry Hite and Michael Delman out of New York. Man's purchase of a 50% stake in Mint in exchange for a trading account so they could trade their own system was its canniest acquisition – the credit line was never used.

"Really the seeds of the distribution model were planted to raise money for Mint, which was the jewel in the crown," explains John Kelly, president and CEO of Man Investments in the US. "But over five to six years we realised we couldn't have such a nucleus of distribution resting on one product." Kelly is now trying to replicate the model across the continent, and is widely credited with bringing wealthy investors on board.

The firm uses 1,484 intermediaries, comprising independent financial advisers, banks, and asset managers around the world. It does not sell directly to the private clients that make up half of its market. "We got efficient at accessing high volume distributors," Fink says. "Most big hedge funds were based in New York. We were raising money where others didn't look, and we were business people who happened to be in hedge funds. We very much approached it as a business."

Open architecture and white labelling are also critical to Man's success. In Europe the firm has white labelling arrangements with Credit Suisse, ABN Amro, and Deka, and analysts predict that it will be a key beneficiary of the retail development of hedge funds on the continent. According to Christoph Moeller, head of global sales and marketing, 30% of Man's private client business comes from white labelling. It also has co-branded relationships with some of its distributors, such as Société Générale, National Bank of Bahrain, and Westpac Banking in Australia. "Open architecture has also been of great benefit," he says. Observers also point to the firm's foresight in being the first hedge fund manager to open an office in the

Middle East. "Some of our longest established relationships are with structured products clients in Bahrain and Australia," points out Moeller. Regional offices around the world support Man's distribution network and service local clients. Its widespread reach is the reason that many independents have been attracted to Man. "Man had already raised \$1 billion for Mint when it bought a share of AHL, which had only \$50 million at the time," explains Anthony Todd, a former Man veteran who is currently managing director at London shop Aspect Capital. AHL is expected to have assets of \$8.64 billion at the end of this month, according to Morgan Stanley.

Says Winton's Harding: "It's a miracle that the whole thing has survived, there is no logic to it. It stays consistent with its own past, you couldn't invent the model." However, he is quick to point out that it is easy to ignore Man's investment performance and place success squarely in the context of distribution. "Sceptics forget that Man's systems really do work," he says.

Growing pains

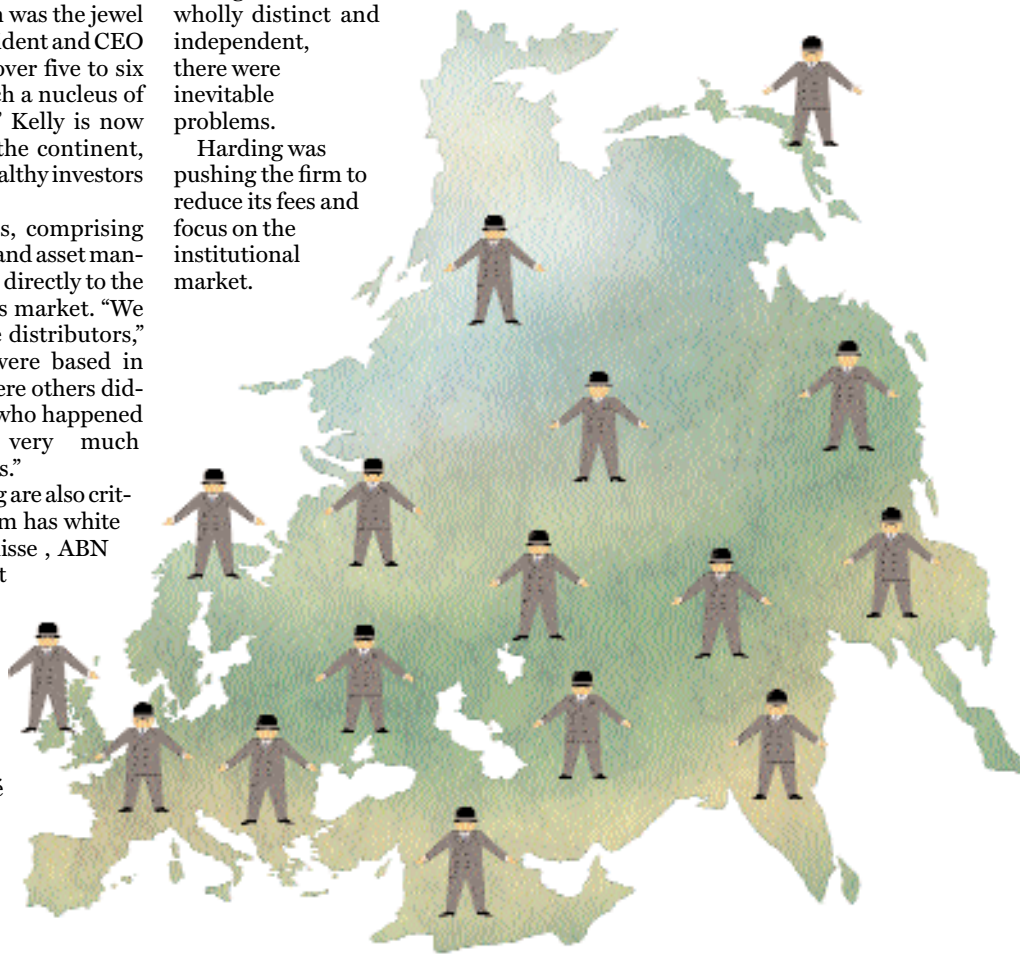
Historically AHL, a managed futures shop targeted mostly at private clients, has been the most profitable of Man's subsidiaries. Its three founders, Michael Adam, Martin Lueck, and David Harding, studied physics together at Oxford, as did Anthony Todd. Man took a share of the business in 1989, and then bought it entire in 1994. Despite the fact that portfolio management remained

wholly distinct and independent, there were inevitable problems.

Harding was pushing the firm to reduce its fees and focus on the institutional market.

**GLOBAL SALES
BY REGION:**
53% Europe
26% Asia Pacific
12% US
9% Middle East

**Key offices:
Switzerland
(sales/
distribution)
London
Chicago
Dubai
New York
Tokyo
Hong Kong
Montevideo**



All About Stanley



STANLEY Fink is a history buff. Staring out of the window of his Sugar Quay office, he points to the HMS Belfast, which served during the Second World War and played a leading role in destroying the German battleship Scharnhorst at the Battle of North Cape. He came to history "late in life"; at his Manchester grammar school it was mathematics at which he excelled.

He then went to Cambridge, where, because he thought it would get him into business, he studied law. "I was in a quandary over my career. I got a very mediocre law degree," he laughs. The remarkably genial CEO qualified as a chartered accountant in 1982, after which he

joined Mars confectionary, focusing on marketing and branding. He then moved to Citibank, where he was one of the youngest vice presidents in the UK. He was involved in some early stage buy-outs and met Man in 1986 when it needed help doing a leveraged restructuring of the company, as part of a generational change in ownership.

MANAGING MAN

He worked closely with Michael Stone, and after joining Man in 1987, became a board member when he was still under 30. He now believes the management style at Man must change. "The partnership culture doesn't work when you get to 1,000 people. It's why we recruited new people like Chris Chambers to run the day to day aspects of the business." But ask most people about Man, and it is Stanley Fink that they point to, not Chambers. Fink is philosophical. "When I was making the biggest difference to this business no one wanted to see me, they all wanted to see Harvey [McGrath]. The perception of what's going on takes a long time to catch up with the reality."

VOLATILITY (TRACKING ERROR VS BENCHMARK) TO SEPTEMBER 2003:

Man Global Strategies:
Man IP 220 fund, inception December 1996
18.9% pa vs HFRI Fund of Funds Composite Index 6.8% pa
RMF Investment Management:
RMF Absolute Return Strategies I, inception July 1998
3.9% pa vs HFRI Fund of Funds Composite Index 6.9% pa

Adam's view was that more financing should be spent on the systems. On the flip side, Barrow argued that packaging and marketing were all that mattered, and poor products would do well if the timing and packaging were right, according to one Man insider.

For Fink, targeting the institutional marketplace then was a matter of numbers. "We had pure AHL, and there were issues of limited capacity. Any rational businessman would use that capacity on the highest margin business," he says. He also makes no bones about his preference for private clients. "Given the choice, I would always choose a private client because it's high margin. Although there are probably more redemptions than institutional, they are more predictable redemptions. Private clients are less demanding on portfolio managers' time, and you are less held to ransom if your key investment managers leave." Currently, private clients make up 55% of the business, and Fink says he is happy with the balance. But according to Huw Van Steenis, an analyst at Morgan Stanley, dependence on private clients remains a hurdle.

Man's business model is such that its portfolio managers are completely focused on investment. In its three-tiered model, each of its core managers, AHL, Glenwood, Man Global Strategies and RMF, run their own portfolios, and retain their own brands. Product

development, structuring and management is overlaid, and unified across the business.

The model makes sense when you realise just how important the structuring overlay is. A great deal of Man's success comes from its structuring capability and the guaranteed products it offers. 63% of private client assets are in structured products, and according to its 2003 report, private client products made up 64% of sales over the period. The firm's products generally offer a guaranteed return of principal at maturity of the fund, typically in around 10 years' time, in some cases with a step-up guarantee to lock in the level of good performance across the term of the product. The guarantees are underwritten by third party banks and other financial institutions. "We were the first company ever to come out and sell a guaranteed futures fund," says Kelly. "Outside of investment management, I don't think there's been any single feature of the business that's been so important – they've been stunningly successful." The idea of coming up with the product in 1985 is credited to Larry Hite of Mint.

After the structured overlay, comes the global distribution tier, divided in to private/retail and institutional clients. It is not a business model that requires divisional CEOs, admits Moeller, and may help to explain why both RMF's Rainer-Marc Frey and Glenwood's Frank Meyer, both founders of their businesses, opted to take a step back. Both are still involved in an advisory capacity.

The AHL trio ended up going their separate ways. Adam and Lueck set up Aspect alongside Eugene Lambert, also ex AHL, while Harding set up Winton. It is ironic that Adam, Lueck, and Todd now find themselves back in the fold. RMF bought a 25% stake in Aspect, and was subsequently acquired by Man. Industry commentators say the firm was furious about the deal, but Todd insists that this is not the case. He points to the change of control clause that would have allowed Aspect the option to buy RMF out. "A lot of people are going to assume that we weren't happy but if that was the case we would have used our option," he insists.

Harding is blunter about his feelings: "Man has done a very effective job of wrapping its loving tentacles around entrepreneurs, who then get spat out," he says.

Playing football

In 1994 Man moved its operations to Pfäffikon, a small Swiss village on the shores of Lake Zurich, which offers attractive tax breaks. Fink moved as well. RMF, set up by Rainer-Marc Frey after a prop-trading career at Salomon Brothers, was also based there. It was a purely institutional fund of hedge funds player. Both firms were aware of each other, and even shared office space.

"It used to be that you walked into some place and you heard voices talking in English and you knew they were from Man," laughs Urs Spörri, who co-heads the RMF business. In fact, the two firms used to play football together. "At the beginning they were always beating us and then we hired younger guys and beat them. That's why they bought us," Spörri jokes. The firms could not be better suited. Spörri says RMF had been looking to increase its distribution muscle,

The origins of Man

JAMES MAN, founder of the Man Group, was an apprentice barrel-maker in the sugar trade, before he set up his own sugar brokerage in 1783. He became a rum supplier to the British Navy, a contract that was held for over 200 years. His two grandsons, Edward and Frederick, inherited the business, which became ED&F Man, named after them. The firm's London office is a testament to its past - it is located at Sugar Quay, on the shores of the Thames.

Between 1783 and around 1970, ED&F Man were commodity merchants and traders. Under the leadership of the then chairman Michael Stone, the company moved into futures, principally because it needed to hedge its own positions. It then became a member of London Fox, the early exchange, and set up Mantrad, the money

brokerage firm that became Man Financial.

In 1983 Colin Barrow joined the firm as assistant treasurer, having known Harvey McGrath, then treasury chief and now chairman of the group. He was sent to New York to investigate CTAs in the market that had become big futures clients. It was there that Barrow came across Mint, run by Larry Hite and Michael Delman.

MAKING A MINT

Hite was an expert in game theory, and had used it to trade futures. Under Barrow's recommendation, ED&F Man bought a 50% stake in Mint, which was doing phenomenally well. Man subsequently decided that exposure to only one player was a business risk, and in London, its eye fell on AHL, then a small player. Stanley Fink joined the group in 1987 as



Chris Chambers, CEO of Man Investments, joined the firm from CSFB, freeing up Stanley Fink to focus on overall group strategy.

an M&A specialist. Man then moved to Switzerland, and in 1994 the firm went public, floating at £400 million.

In 1996 Barrow left to start up his own hedge fund, Sabre, and Fink took over as head of Man Investment Products. The same year, the firm took a stake in Glenwood. In March 2000, it sold off its commodities business for over £500 million, and the rest of the business became Man Group.

McGrath became chairman and Fink CEO of the overall operation. In February 2002, Man appointed Chris Chambers, formerly co-head of European ECM at Credit Suisse First Boston, as head of the asset management arm. RMF was bought the same year, and Kelly also moved to Chicago to start up US distribution. Last year, it shortened the Man Investment Products brand to Man Investments.

having no presence outside Europe. It wanted a US operation, but had no resources to go about developing one. The firm had been approached by several potential buyers, but the relationship it developed with Man made a difference.

"The deal was done very quickly on a handshake," says Spörri. "Two months later it was all settled. People always think that the Man/RMF transaction was one between Switzerland and London, they don't realise both houses are in Pfaffikon, Switzerland." The deal was completed in May 2002, and Man paid a stunning \$833 million for RMF, a figure that still amazes some commentators. "They always pay a fortune for everything. Blue Crest was a record in terms of the multiples being paid," says one Chicago-based CTA, referring to Man's most recent acquisition of a London-based debt manager.

But for Man the logic was clear. Not only was RMF adding millions worth of capacity, it was also a necessary diversification into institutional. RMF also brought key structuring capabilities to the table. "If you look at RMF's business, it is very well structured and disciplined and now is the basis for Man Investments. It's a very systematic approach, which is important in order to be successful going forward," says one London-based head of prime brokerage.

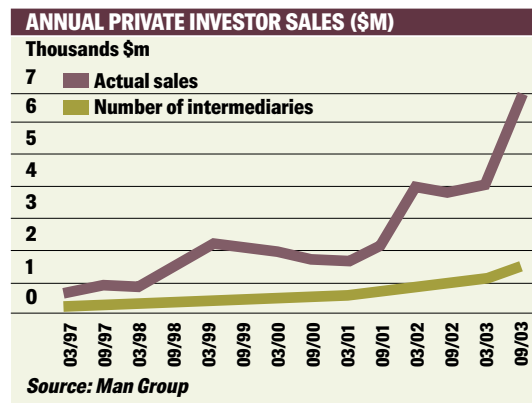
And earlier this month, RMF launched its first product for the retail market. The Man RMF Multi-Style Fund is a capital guaranteed product which will invest in equity hedged, event driven, global macro, managed futures, and relative value strategies. "This

is the first time we've offered access to RMF in guaranteed form. We've said for some time that we wanted to introduce RMF to our private clients, after it was fully integrated and bedded down into Man Investments," explains Mark Chambers, regional director.

In search of capacity

Acquisitions are a necessary component of the Man model. In 1995 it formed a joint venture with Chicago-based Glenwood Capital Investments, one of the oldest fund of funds groups in the US, which it subsequently bought in 2000. It also owns GNI, the derivatives broking house. It has joint ventures with several players and individuals, and strong relationships with the funds it seeds (one floor of the

VOLATILITY (TRACKING ERROR VS BENCHMARK) TO SEPTEMBER 2003:
Glenwood Capital Investments: 5.6% pa vs MSCI World Equity Index 15.0% pa
AHL: Man AHL Alpha, inception October 1995 15.4% pa vs Stark 300 Trader Index 10.4% pa



London office is dubbed “trader hotel” because of all the start-ups who set up shop there before establishing their own infrastructure). It all comes down to capacity, which analysts and critics say is Man’s biggest challenge.

From Fink’s point of view, capacity is not of primary concern. He argues that it was the key challenge three years ago, but now the systems and processes put in place will continue to generate capacity. Others disagree.

“This business is not a scalable one. If you look at the guys at Glenwood, they are flying all over the place trying to source good managers and avoid operational risk and fraud,” says a Chicago-based CTA, concerned that Man, as an asset-gatherer is putting pressure on its subsidiaries to take in too much money too quickly. The CTA also suggests that David Gordon, vice-president, left Glenwood after a period of underperformance when he came under tremendous pressure to improve performance and assets by altering the investment strategy to include strongly performing global macro, despite capacity concerns.

John Rowsell, Glenwood’s president, declined to comment on the reasons for Gordon’s departure, but points out that the firm has built its business on risk management. “That does drive us away from certain strategies. Some of the areas we have tended not to participate in include the highly leveraged fixed income strategies. We’ve stayed away from the mortgage type strategies that exist as well and the firm still does not invest in global marco,” he explains. Glenwood requires a robust understanding of the risk profiles of its underlying funds, he adds. One prime broker says capacity is a very localised issue. “I understand that there are capacity issues specifically with AHL, because any of Man’s recently launched series 220 products have a large allocation to AHL. But I’m not aware of any capacity concerns at the Glenwood funds, some of which can have up to 100 underlying managers.”



RMF’s Urs Spörrli: Runs a tight, disciplined process rated strongly by consultants.

with raising their fees. “The same is true for fund of funds, if you can secure access to good talent, managers that are closed to other investors, you justify a certain level of fees.” But he thinks that there will be pressure on capital protected products. “The whole structuring process is becoming more standardised and cheaper, so there will be some pressure,” he says.

Over 12 months to March 2003, performance fees from Man’s hedge fund products more than doubled to £115 million. Analysts expect fee income to continue to rise sharply. Fee structures vary between product and sector, but can be as high as 4% plus a 20% performance related fee. According to Moeller, RMF generally charges a management fee of 1% and a performance fee of 5%. On structured capital guaranteed products management fees are generally between 1%-3%, with an underlying performance fee of between 15%-20%. Glenwood’s Rowsell declined to comment on fees, but the firm says institutional pricing is very much in line with RMF.

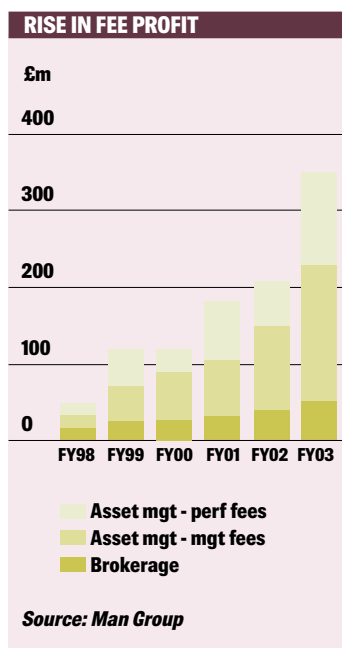
Still, Fink has a point when he says that pension funds don’t mind paying for decent performance, especially after their long-suffering relationship with closet trackers who do nothing to justify what they earn. “There is no extra alpha being added there. There is a slight tendency in this market to polarise between the extremes. I would rather be in BGI’s

Fees and performance

Another more frequent criticism is made of Man’s fee structures. Industry commentators point out that Man will have to keep performing solidly or suffer huge redemptions because of its fee structure.

“If performance wanes, then you could have a situation where a manager could take excessive risk to go back to the glory days,” argues one competitor. “I would also question the validity of an institution investing in a guaranteed fund in the first place. They are a moment-in-time product, and maybe that moment has peaked. People’s appetite changes from fear to greed, and as the stock market rises, it will be difficult for them because they have built their business on guaranteed structures.”

One prime broker doesn’t agree that management fees will come under pressure, arguing that in practice, star managers have been able to get away



“I don’t see why Man would implode at all. You could have made that argument in the 1980s but now there is a diversification of products and clients.”

business - pure index tracking - or in hedge funds, but not in the middle."

And Man's capabilities in delivering are not in question. Over a year to September 2003, Man Global Strategies returned 18.9% compared with the benchmark return of 7.4%. RMF's Absolute Return Strategies Fund returned 7.6%, outperforming its benchmark by 1.9%. AHL Alpha returned 20.2%, versus the Stark 300 Trader Index which returned 10.4%. And Glenwood, after a period of underperformance, returned 11.6%, compared with the MSCI World Equity Index return of 5.6%.

Kelly is clearly tired of the argument that Man might implode after a period of underperformance. "I don't see why Man would implode at all. You could have made that argument in the 1980s, but now there is a diversification of products. There are regular sales going through, and there is diversification of the client as well. Different clients come in on different levels of the performance curve. A draw down might irritate clients but it would be far less effective than others. To take an extreme example, an investor who has been in a product for several years would be less impacted by one who has just come in. We are also very geographically diversified."

Coming to America

Maintaining almost 50% growth per annum is going to be impossible for the company in the future, but establishing a reputation with US investors will bring in new sources of revenue. It is a market that Man has traditionally shied away from, largely because of the amount of competition. US endowments have roughly 20% of their allocations in hedge funds already, for example. Only one in 50 UK institutions allocate to hedge funds, compared to one in six in Continental Europe, and one in five in the US, according to Greenwich Associates.

"Looking at the distribution power they have, and the expertise that resides in the group, they have a lot of potential in the US," says one prime broker. He says that there is a lot of US domestic competition in the market, but fewer players with international components.

Kelly says he wants to see 20% of business coming from the US eventually, but does not put a time frame on it. Making a mark there has not been easy. "It's going very well for the distribution model, we have a number of organisations signed up. But it's far slower in getting the product to market."

He says that the combination of a difficult regulator environment, combined with the challenge of operational issues - getting custodial agreements, and platforms for broker dealers - is proving to be more complex than originally anticipated. In its traditional hunting grounds, Man is also facing new competition. Long-only managers are all developing fund of hedge fund capabilities. Gartmore, Deutsche

Man's core managers

A round up of Man's four core investment arms.

AHL: AHL runs two main managed futures programmes, the AHL Diversified Programme and the AHL Institutional Programme. The programmes are quantitative and directional in nature, meaning they seek to identify and take advantage of upward and downward price trends. Instruments primarily traded are futures and OTC forex forwards and metal contracts. AHL was founded in 1983.

Glenwood: Chicago-based Glenwood is a pioneer of funds of hedge funds, focusing on low risk portfolios by investing across a diversified group of managers. It was set up in 1987, and has shown annualised capital growth of around 11% from 1987 to March 2003.

RMF: Founded by Rainer-Marc Frey in 1992, it is focused on funds of hedge funds, leveraged finance, and convertible bonds. It is headquartered in Pfäffikon, and has over \$13 billion in assets under management from institutional players. It is co-headed by Fred Siegrist, who is also chief investment officer, and Urs Sporri, who heads portfolio management, hedge funds, and new alternatives. It has been ISO-certified since 2001.

Man Global Strategies: The division constructs and manages style and multi-style portfolios, including the portfolios of Man Investment's structured products. It also creates customised portfolios for institutional clients.

Asset Management, UBS, and CDC Ixis are only a few of the firms that have opted to set up dedicated shops. "We're the biggest player in the market, and if we get it right, we will grow faster than the industry," argues Fink.

He also says that many distributors who are also competitors with private banking arms have been forced to adopt open architecture. "If you're a private bank, it's generally easier selling an independent's product over your competitors." There is also the regulatory environment to consider. The switch from offshore to onshore and subsequent compliance issues will be harder on smaller players, and Man has an economy of scale that is hard to match.

Van Steenis is overweight on Man, as much because of its own capabilities as because the market is embracing hedge funds. Structural changes and deregulation are ongoing, and Man is in a position to benefit. He forecasts gross sales increasing from \$9.8 billion to \$11 billion, because of the recent BlueCrest deal and white labelling opportunities.

And yet there are some who argue that hedge funds are a passing trend. "Do you really think Man will be a FTSE 100 company in another 10 years?" says one industry participant. Perhaps Roberto C Goizueta, former CEO of Coca Cola, summed it up best when he said: "Now the saying is you have to be global. But we were global when global wasn't cool." **E**

