



New Year, New Market

From Reset to Realignment, Institutional Trading, and The Truth About High-Frequency Trading

ETF Debate Heats Up

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Man With a Plan

Anthony Scaramucci wants to pull more investors into hedge funds

SkyBridge Capital Vows to be Different

Managing partner Anthony Scaramucci says fast-growing alternative asset manager will offer a unique value-added product, or die trying

Hedge fund conferences are typically organized by media organizations or industry trade groups. A gathering held by an alternative asset management organization itself is likely to be modest in size, lightly publicized if at all, and with a fairly narrow agenda and roster of speakers. Competitors may, or may not, be allowed to attend.

The SkyBridge Alternatives (SALT) Conference is SkyBridge Capital's effort to break the mold for a hedge-fund event sponsored by an industry player. In only its third year, speakers scheduled for this May's SALT conference include former U.S. President George W. Bush, Secretary of State Colin Powell and U.K. Prime Minister Gordon Brown,

in addition to an assembly of asset management executives. The event, to be held at the Bellagio in Las Vegas, is promoted on a splashy website and is open to firms who may help SkyBridge's business, as well as its competitors.

"We want to be in the thought leadership business. Set up the conference and bring the smartest people in," SkyBridge Managing Partner Anthony Scaramucci told Markets Media in a Jan. 24 interview at his office in midtown Manhattan. "We invite all the funds of funds, all the hedge fund seeders. Every one of our competitors gets an invitation to come to the conference."

The SALT Conference is reflective of the ethos of SkyBridge, led by Scaramucci and fellow managing partners Ray Nolte and Scott Prince: fast-growing, ambitious, and possibly above all, different.

"Do you like vanilla? We like vanilla as an ice cream. We don't like vanilla as a business," Scaramucci said. "It's a good ice cream, but do you want to be a vanilla guy? We don't want to be vanilla guys."

SkyBridge was founded in 2005 and had about \$7.44 billion in total assets under advisement or management as of January 2011. The firm's four business lines are hedge fund advisory, which spans \$5.36 billion of assets; co-mingled fund of funds and custom portfolios, encompassing a combined \$1.48 billion; and hedge fund seeding, \$601 million. About 70 percent of SkyBridge's assets are institutional, compared with 30 percent retail; that has flip-flopped from a 35-65 mix in the company's early days, Scaramucci said.

SkyBridge is aiming at the hedge fund space, anticipating that what was once the exclusive investment realm of institutions and ultra-high-net-worth individuals will continue its democratization and filter down to more retail investors.

"The vision for SkyBridge is that we want to be open for business for the \$50,000 investor and the \$50 billion investor -- the whole gamut," Scaramucci said. "We want SkyBridge to be the hedge fund manager for every dentist in America."

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Assets under management is the lifeblood of the hedge fund industry, and one whale account can be the equivalent of 1,000 or even 10,000 dentists. In that highly coveted institutional space, “we’ve got some very large-scale pension funds that we offer customized advice to,” Scaramucci said. “We have the Kuwait Investment Office in London and we have a couple Kuwaiti philanthropies as investors in our funds. We have business all over the world, in Australia, in the Middle East, in continental Europe. We have some business in Asia but I would say that’s one area of the world we need to be working on.”

Alternative asset management firms come in all shapes and sizes, making apples-to-apples comparisons difficult. Bulge-bracket firms such as Goldman Sachs and Bank of America Merrill Lynch have business groups focusing on hedge funds, as Blackstone Group and other private-equity concerns. Some of SkyBridge’s stand-alone competitors include InvestCorp, NewAlpha, Larch Lane Advisors and M.D. Sass in the hedge fund advisory space, and Hatteras Funds and Grosvenor Funds in the fund-of-funds business.

“There is a ton of competition” throughout SkyBridge’s business lines, Scaramucci acknowledged.

New Twists

SkyBridge has added some new twists to a business model that “is becoming quite common in the fund-of-funds world,” said Benjamin Alpert, who follows hedge funds for Chicago-based Morningstar. “They do seem to advertise their individual manager selection and private co-mingled investments a little more aggressively.”

Alpert noted that funds of hedge funds have increasingly

offered additional services such as customized consulting in recent years. Funds of funds have lost some traction overall in the wake of the financial crisis of 2008-2009, but the vehicle still makes sense for many investors, the analyst said.

“Outsourcing due diligence to a fund of funds may customize risk and tailor it to the portfolio,” Alpert said. “A fund of funds is a good way to access a number of management styles for a fairly small institutional investor. Once you get to a certain size as an investor, fund of funds becomes less attractive. There is an extra layer of fees and the risks may not be aligned with your portfolio.”

A watershed year for hedge funds was 2008, when aggregate returns of minus 22 percent dispelled the notion that the investment vehicles made money in any kind of market. The disappointing results and higher-than-expected market correlation in many instances prompted some investors to question the value proposition of hedge funds.

Hedge funds’ comparatively high fees were an easy target for disillusioned investors, and there were skirmishes that resulted in some fee reductions. Funds of funds and smaller hedge funds with limited track records were pushed especially hard to give ground, and the largest buy-side investors had the most success in squeezing fees. But the end result has manifested itself on more of a case-by-case basis rather than a seismic shift in hedge fund fee structures, as funds who were proven alpha generators saw no need to discount.

“Fund of funds fees are under pressure, but we don’t think hedge fund fees are under pressure because we don’t see it in the marketplace. If a guy can perform on an absolute basis, he’s going to get the 1.5 and 20,” Scaramucci said, referring to fees of 1.5 percent of assets under management plus 20 percent of investment gains. “On a one-off basis, are gigan-

tic, high-volume chunks of capital going to come into the hedge fund industry priced below 1.5 and 20? Yes. But that doesn't mean the entire pricing umbrella is going to break."

In response to tepid investor enthusiasm regarding fund-of-funds products, SkyBridge created SkyBridge Direct, which customizes direct-investment hedge fund portfolios for institutional investors. The unit is headed by Peter Carey, who had been a senior investment officer for New York State Common Retirement Fund until he joined SkyBridge in late 2010.

"This is going to be our version of cloud computing. This will be a financial-services application of the cloud," Scaramucci said. "We're going to go to big states and say instead of hiring a ton of people internally, let us take it for you. We will become an application service provider to large-scale capital. We have a 17-person research team. . . You're going to get that research team and due diligence quality and risk transparency and we'll bespoke a portfolio for you and we'll charge you a rate that's in line with what institutions are willing to pay for that service."

SkyBridge has taken in about \$100 million per month on the fund-of-funds side and expects inflows to stay at about that level, driven by a deeper pool of potential investors. "It may not be the institution, circa 2003 -- it may be the individual," Scaramucci said. "We're going to 'retail-ify' and push this."

Scaramucci has misgivings about the Dodd-Frank Wall Street Reform and Consumer Protection Act, which was signed into law in 2010 and is slated for implementation starting later this year. The specific provision of Dodd-Frank that is expected to be most meaningful for hedge funds is the so-called Volcker Rule, which was drafted to prohibit banks from engaging in proprietary trading or owning stakes in prop firms.

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The Volcker Rule helps hedge funds by removing competition from bank trading desks, but Scaramucci is against the regulation in a bigger-picture sense. "It's a rule that we disagree with because anytime you take speculators out of the marketplace, you widen spreads. You widen spreads, you create market inefficiencies," Scaramucci said. "So from a global perspective. . . we don't think it's a rule that makes any sense."

Rather than barring banks from prop trading, Scaramucci suggested a more effective way to minimize systemic risk via regulation would be to rein in bank leverage. Leverage ratios that had swelled to as high as 35:1 around 2006-2007, from about 20:1 just a few years earlier simply were not sustainable, Scaramucci said.

"There's not a person on planet earth who is smart enough to run one of those businesses at 35:1 leverage. You have no margin of error," Scaramucci said. "You have a slight move in the markets with 35:1 leverage and you wipe out your equity. The system was working at a lower leverage ratio."

"Dodd-Frank is very good for the hedge fund industry but bad for the general public," Scaramucci continued. "It's really good for us because we'll be able to seed new managers, we'll be able to get personnel who are very talented from an intellectual capital basis out of (banks) and put them into funds."

China Rising

Scaramucci expects China to be a big area for economic growth and by extension, for providers of financial services. The Asian giant will surpass the U.S. as the world's largest economy within a decade, according to some projections.

"As a student of history you can't look at China and think that China is not going to get where it wants to get to," Scaramucci said. "That doesn't mean the U.S. is not going to be a global superpower for the next 200 years; I believe it will be. But we do think that you are going to have an ascendant China and if you're an asset manager, you need to figure out a way to tactically get on the ground there and have a good retail business and a good institutional business."

Another macro trend cited by Scaramucci is rising taxes for higher-income individuals, which he expects will prompt a renewed focus on the

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tax efficiency of investment vehicles including hedge funds. “Taxes are going up for rich people around the world,” Scaramucci said. “They may not go up today or tomorrow, but they’re going up because they have to pay for all these entitlements, they have to pay for large government services.”

After a hedge-fund industry contraction in the wake of the financial crisis of 2008-2009, a rising stock market and an absence of high-profile blowups have recharged the sector. Observers say the hedge-fund space is poised for growth in 2011 and beyond, albeit at a slower pace than was recorded in pre-crisis years. Hedge fund seed capital may reach \$5 billion in 2011, according to industry estimates.

“There are quite a bit more start-ups opening their doors,” said Andrew Schneider, co-founder of HedgeCo Networks, a hedge fund research and services firm. “Since we are seeing an uptick in start-ups, we expect incubators to follow suit and continue the trend.”

Many new hedge funds are being started by managers who were displaced from the financial industry since 2008. “Job seekers are teaming together and launching their own asset management firms or hedge funds,” said Schneider, who added that his firm gets about five inquiries per day from people who want to start a fund. HedgeCo has “never been busier,” Schneider said.

If the economic recovery continues, new managers may find ample money to put to work as more investors regain confidence in financial markets and risk-taking. “Money is on the sidelines,” Scaramucci said. “There are trillions of dollars in money markets, there are a lot of people who are frozen.”

SkyBridge expects a sell-out crowd of 1,500 for this year’s SALT Conference, for which admission is free for some end-user investors but can cost about \$3,000 to \$4,000 for competitors and as much as \$5,000 for service providers.

“We want to make the conference ideological, but non-partisan,” Scaramucci said. “We’re probably going to bring in some (U.S.) Army colonels from Iraq that I met (recently)

to come talk about the situation in Iraq and Afghanistan. We don’t want this to be your grandfather’s hedge fund conference.”

SkyBridge promotes SALT via “new-style” marketing of creating programming and content and essentially letting the conference sell itself, according to Scaramucci. “We’re going to bring you to us. We’re going to reverse engineer the marketing process as opposed to old-style marketing, (which) is like going door-to-door and knocking: ‘Hi, I’m SkyBridge. I want your money.’” Scaramucci said.

“We want this to be a conference where you will see the intersection of content you want to learn from and people you want to meet, and hopefully -- third and equally-important to the first two -- is to have some fun,” Scaramucci continued. “If people aren’t having fun, their barriers aren’t breaking down and they won’t be able to bond as easily.”

In the wide-ranging interview, Scaramucci cited lessons to be learned from winning non-financial enterprises, including Netflix, Facebook, Apple, and Starbucks. In the latter two cases, visionaries built hugely successful businesses off of what had been considered essentially commodity products -- cellular phones and cups of coffee.

Steve Jobs “created a phone out of thin air -- it’s almost like a hand-held computer,” Scaramucci said. “When people say that there’s no innovation left in America, they have to drop dead. There’s a ton of innovation left in America.”

SkyBridge’s business model is hardly fixed and the company is prepared to adjust to market conditions as warranted, Scaramucci said. “We’re not sitting here telling you this is the vision for our business and that’s our story and we’re sticking to it. We’re going to look at what’s out there and say “that guy has a better mouse trap than we do. We have to figure out how to tweak that and bring that into our system and bring that into our business.”

“We want to go into the future with the right products. We are not going to be the yellow pages -- let the other fund of funds be the yellow pages,” said Scaramucci. “If there’s something wrong with our business, we’ll break it down and we’ll redo it. It’s adapt or die.”