What Now? Rethinking Today's Investment Alternatives

J. Mack Robinson College of Business
Georgia State University
Gauging the Economic Turnaround - May 19, 2004

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Partner, Chief Investment Officer
First Quadrant, L.P.
Firm Overview
As of March 31, 2004

• Founded in 1988
• Offices in Pasadena, CA., Boston, and London
• Joint Ventures: Tokyo, Toronto, Stockholm
• 76 total employees, 22 investment professionals
• $18.2 billion total assets and overlays under management*
• Largely oriented towards large institutional clients

*Supplemental Information. For purposes of this slide, First Quadrant ("FQ") is defined as the combination of all discretionary portfolios of First Quadrant, L.P. and First Quadrant Ltd, and all discretionary and non-discretionary portfolios managed by joint venture partners using First Quadrant, L.P. investment signals as well as assets not managed by FQ, but which are subject to First Quadrant, L.P. overlay strategies.
Investment Products

- Global Asset Allocation
- Volatility Arbitrage
- US & Pan European Equities
- Currency Management
Conventional Asset Allocation

- Bonds
- Stocks
Institutional Investors

• Increasing diversification of asset classes
  - Stocks
  - Bonds
  - Real Estate
  - Private Equity
  - Commodities
  - Timber
  - TIPS
  - Hedge Funds

• Separating “active” return from “market” return
  - Separation of “alpha” from “beta”
  - Separation of “active” from “passive”
Concepts – Alpha and Beta

• Beta
  - Average return on the market
  - All asset classes have a “beta,” not just stocks
  - Shouldn’t have to pay much for it
  - What you get if you can’t “beat the market”

• Alpha
  - Skill based return in excess of the market return
  - Is applied in all asset classes
  - This is what you should pay for
  - The additional reward for taking active risk
Separating Alpha From Beta

<table>
<thead>
<tr>
<th>Allocation</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Stocks</td>
<td>60%</td>
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<td>Bonds</td>
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## Separating Alpha From Beta

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*Return from taking market risk*
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*Return from taking active risk*
What Is An Investor?

Lender
or
Entrepreneur?
Gaining In Acceptance…
Alpha-oriented

- Stocks
- Bonds
- Funds of Funds
- Hedge Funds
- Private Equity
- Commodities
- Real Estate
Hedge Funds

- More opportunistic given fewer constraints
- Greater focus on active risk (alpha)
- Higher fees per $1 managed, but not necessarily higher per unit of active risk
“Buffett called hedge funds a ‘fad’ that was more about Wall Street marketing than sound investing.”

CNNMoney, May 1, 2004,
http://moneymag.com/2004/05/01/markets/buffett_derivatives.reut/
“[Buffet] was especially critical of those who advise some sort of specified 60-40 percent split between stocks and bonds... ‘It's nonsense,’ he said. Instead, Buffett advised the audience to seek out bargains no matter what type of investments they are.”

CNNMoney, May 1, 2004,
http://moneymag.com/2004/05/01/markets/buffett_derivatives.reut/
Observations From Institutional Perspective

- Increasing diversification of asset classes
- Beta’s no longer the only game in town
- The hedge fund concept is here to stay