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Funds eye long-short strategy

Several Canadian money managers are now aggressively marketing an investment strategy dubbed "hedge fund light" to institutional folks. And it won't be long before retail investors will be able to buy closed-end or mutual funds using the so-called 130/30 long-short strategy that is becoming popular in the United States, industry players say.

"I wouldn't be surprised to see one or two companies launch products in time for RRSP season," said Colin Bugler, a managing director in the prime brokerage unit at RBC Dominion Securities Inc.

The 130/30 concept, which aims to capture "alpha" or returns in excess of a market benchmark, has two elements. A manager will buy shares that he believes will go up, and this is known as "going long." But he will also be "going short" by borrowing shares of a stock that he believes will drop, and selling them with the expectation - or hope - of buying them back after its share price falls.

The short position is limited to 30 per cent of the value of the fund. That percentage is considered a sweet spot (particularly in the U.S. market), where the strategy does not appear to incur extra risk. The proceeds from shorting are used to buy more long positions, resulting in a fund that goes 130 per cent long and 30 per cent short.

Connor Clark & Lunn Investment Management Ltd., TD Asset Management and **Hillsdale Investment Management Inc.** are among the Canadian players who have plowed their own cash this year into starting institutional funds using this hybrid strategy. And they are trying to convince clients to climb aboard.

"Allowing for a small amount of shorting opens up the opportunity tremendously," said Martin Gerber, head of the quantitative equity team at Connor Clark & Lunn. "When a stock is not a good buy, all we can do in a traditional portfolio is not buy it." There has been a "tremendous shift" to the 130/30 strategy, with estimates ranging between \$50-billion and \$60-billion (U.S.) for assets run this way globally, Mr. Gerber said.

Observers say there is a certain skill set required for 130/30 or similar 120/20 portfolios - strategies that narrow the gap between traditional and hedge fund managers. Many players tend to be quantitative managers whose computerized stock-ranking strategies lend themselves to shorting.

"We knew it wouldn't be a big leap for us," said Kevin LeBlanc, managing director with TD Asset Management, which uses quant strategies, and also runs hedge funds. "It was really a small tweak to run 130/30 portfolios."

While the hybrid strategy has fans in the United States and Europe, it's taking time to catch on in Canada, where pension funds must change investment mandates to allow shorting. "It's new territory for a lot of investment boards," said Jamie Collier, a partner with Toronto-based Integra Capital Ltd.

Integra launched its \$42-million (Canadian) Integra 130/30 U.S. Equity Fund last year, and it is run by Los Angeles-based Analytic Investors Inc. - pioneer of this hybrid strategy five years ago. The U.S. fund is a holding in Integra's \$1.1-billion Integra Diversified Fund held by institutional investors.

In the United States, several players offer mutual funds using the 130/30 strategy. But Canadian companies still have regulatory hurdles because of restrictions on selling short. "You can short up to 10 per cent [of a mutual fund] if you get some exemptions," Mr. Gerber said. "But I think the regulatory framework is likely to change over time."

Publicly traded closed-end investment funds do not have restrictions on shorting. That's why Brompton Funds Management Ltd. of Toronto filed a preliminary prospectus in the summer to launch a U.S. equity fund using the strategy.

The Brompton 130/30 Equity Fund was to be run by U.S.-based UBS Global Asset Management, and replicate its institutional fund offered in the United States. But Brompton opted in August to put its offering on hold until later this year or next year. "There was a lot of instability in the capital markets so we just decided that it wasn't the right time," said Brompton's chief executive officer Mark Caranci.

It's early days not only in Canada, but also in the United States, where 130/30 mutual funds have come on the market over the past two years. "They haven't been around very long so it's hard to gauge how they will do in different market environments over the long haul," said Marka Norton, fund analyst with Chicago-based Morningstar Inc.

The success in any fund using the 130/30 strategy ultimately depends on the person pulling the trigger, Ms. Norton said. "A really good stock picker is hard to find."

