

U of T diversifies with hedge funds

Hillsdale to invest \$38M in pension endowment assets



BARRY CRITCHLEY
Off The Record

The University of Toronto, the only Canadian university to have its own money manager, has allocated \$38-million to Hillsdale Investment Management to seed two hedge funds now being marketed. This is the first time that U of T Asset Management has selected a Canadian-based hedge fund manager to invest part of its assets.

For Toronto-based Hillsdale, the \$38-million more than doubles its assets under management. It also gives the manager — formed in 1996 by Chris Guthrie — the lead institutional order on two new Canadian hedge funds it is marketing, a market-neutral fund and an aggressive fund.

UTAM — which has \$3.8-billion of assets under management, including \$600-million in so-called operating funds — has, in total, committed \$220-million to hedge fund investments. That figure represents about 7% of its endowment and pension fund assets and all have been parceled out over the past 18 months.

Don Lindsey, UTAM's chief executive, said hedge funds are attractive because they represent a way of diversifying its pool of assets. And they are important for a couple of reasons:

- The returns from equity investments in the future will be significantly lower than they were in the recent past, a view shared by Ontario Teachers Pension Plan Board. "Accordingly, the ability to control volatility and provide diversification is much more important than it was over the past two decades," said Mr. Lindsey;
- A hedge fund can generate out-performance — the so-called alpha — by either short sales or stock selection. "[That combination] has proven to be a very important skill in this type of market," said Mr. Lindsey, who came from the University of Virginia to U of T to set up a stand-alone money manager.

He said a long/short fund is particularly attractive in Canada because the Canadian stock market is more inefficient than the U.S. market. "You can easily find stocks that are undervalued or overvalued in Canada relative to the U.S."

Mr. Lindsey said Hillsdale was selected because "our due diligence found it had very robust quantitative process in selecting stocks to go short and long."

UTAM's selection process was a little different because it didn't put a hedge fund mandate out for review. Instead, it approached Hillsdale because some of its managers knew the company. UTAM spend four months on due diligence.

Added Hillsdale's Mr. Guthrie: "The funds we are offering are designed to offer protection during declining markets and low correlation to traditional asset classes. They also qualify as Canadian content. And our timing is good because

more than half the Canadian equities are indexed."

Mr. Guthrie said the Market Neutral Equity Fund is an "absolute return strategy" targeting annual returns of 8% to 12% with no exposure to market direction — or in technical terms, a zero beta. The Hillsdale Canadian Aggressive Hedged Equity Fund is a "long-short equity strategy" targeting returns in excess of the TSE 300 with exposure to about one-half of the market's direction.

The \$220-million allocated by UTAM to hedge fund investments is split 50/50 between its \$1.2-billion of endowment assets and its \$2-billion of pension assets. In total, six managers have been awarded mandates for such exotica as distressed securities, long/short (including one with a mandate on real estate investment trusts), merger arbitrage and special situations.

And UTAM plans to make more allocations to hedge fund managers, including those that focus on convertible arbitrage and those that are based in Europe and Asia.

The overall goal is to have 20% to 25% of total assets invested in hedge fund mandates. "There is no particular timetable because it can take along time to find attractive mandates," said Mr. Lindsey

But along with Barton Biggs, legendary strategist at Morgan Stanley, Mr. Lindsey is concerned about the flow of resources into U.S. hedge funds and what that implies for returns. "Over-capacity could become a problem and we want to be careful about getting into funds that have grown too large too quickly"