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FACE TO FACE

Hedge fund veteran claims that skill in cherry picking the best is not replicable

Alan Djanogly, IAM head of investments, tells **Pauline Skypala** that if you get the managers right performance follows

Alan Djanogly: 'I saw what hedge funds could do in a collapsing market.' Daniel Lynch

Contacts are what count in the fund of hedge funds business. "It is very much a people business," says Alan Djanogly, head of investments at International Asset Management, a $5.2bn (£ 2.6bn, ?3.9bn) group.

Any active asset manager might say the same. But in the guarded world of hedge funds, being on first name terms with the most respected managers carries significant advantages. Adding value really does come down to having the right relationship at the right level, says Mr Djanogly.

He reels off a list of high profile hedge fund names IAM has invested with, including Renaissance Technologies' Medallion fund, Sloane Robinson, London Diversified, John Armitage's Egerton Capital, and Raptor Global, part of the Tudor Group. "We invested early with those managers - from the beginning with Hugh and George [of Sloane Robinson], London Diversified and Armitage."

Mr Djanogly is a veteran in the fund of hedge fund arena, having begun researching hedge funds when he joined Drexel Burnham Lambert in 1987. He was persuaded of the superiority of the hedge fund approach by the 1987 stock market crash. "I saw what hedge funds could do in a collapsing market."

He and former Drexel colleagues Albert Fuss and Anthony Forward set up IAM in 1989, and sold it to ABN Amro Asset Management early in 2006. The deal brings the advantages of access to ABN Amro's private bank, as well as its institutional clients. "It also gives us the ability to focus on managing money," says Mr Djanogly.

But there is no question of unconstrained growth. "If you take on too much money, returns go down. ABN understands we will control our growth in a measured way," he says. AIS, for example, has been "carefully grown", with the latest fundraising of £101m, just completed, taking the total assets to $635m.

The weight of money going into hedge funds is an important issue. "We apply our own guidelines on capacity to other hedge funds. You have to reassess [if a fund grows significantly]. Can a manager who is good at running $1bn run $10bn? Can single strategy managers that suddenly become multi-strategy groups control all the strategies and traders?

"Most of the groups that we have seen fail have been those that at the height of their success took on too much money," says Mr Djanogly.

He does not think much has changed in his 20 years of researching hedge funds. "If you get the managers right, performance follows." The universe of funds has expanded considerably, from 100-150 of note in the mid-1980s, to perhaps 10,000 now. But most of these do not meet Mr Djanogly's definition of a hedge fund: they are too small, directional, and run by inexperienced managers.

True hedge funds hedge out market risk rather than just jumping on a strategy and riding the trend, he says. "There are a lot of strategies out there that are directional leveraged plays not hedge funds."

It is a mistake to describe hedge funds as high risk, he says, although they can be "if you don't know what the manager is doing". The track record of IAM's listed vehicle, Alternative Investment Strategies, is proof of what hedge funds offer if you can get access to good ones, says Mr Djanogly. AIS, the first fund of hedge funds to be listed on the London Stock Exchange in 1996, has provided annualised returns of 10 per cent over a 10- year period. "It kept up in the bull market and didn't lose money in the bear market. So I would say the only risk is not being in hedge funds."

IAM focuses on the highest quality hedge fund managers - maybe 10 per cent of the 10,000 universe, albeit a changing 10 per cent. "The managers we pick understand how to run a hedge fund business for the long term. We want consistency. So we are very selective about who we approve each year in terms of new managers," says Mr Djanogly.

IAM invests with about 150 managers, half of which are core investments and half earlier stage. It has another 300 or so in the pipeline it is researching. It will typically hold 25 in a portfolio, and no more than 30. "Running 100 managers is a waste of time - painting by numbers," says Mr Djanogly.

He is not a fan of a top-down approach to hedge fund investing either. It plays to the institutional world, he says, which likes the asset allocation element. But IAM, whose business is 70 per cent institutional, takes a bottom-up approach, with its views on asset allocation formed by what the hedge fund managers are saying, as well as ABN Amro's economic view.

"I won't make a call on commodities, or so on. But I will make a call on a manager," says Mr Djanogly. He will also take a view on strategies, "but we need transparency with managers, so we can blend different approaches". Some strategies are complex and difficult to understand, he admits. "We are very careful evaluating anything to do with leveraged loans, for example. I would question putting money into a lot of the new strategies because they aren't proven."

IAM has avoided any hedge fund blow-ups. It wasn't in Amaranth, for example, due to concerns about the structure of the fund, the fees and transparency. "It fell over because it threw out the risk control book," says Mr Djanogly.

Looking forward, he is not too concerned at the threat to the hedge fund of fund business posed by replication strategies, such as those launched by Goldman Sachs and Merrill Lynch. "We know how hard it has been to get to where we are now, and we don't have a single solution that fits all client requests. When they talk about back-testing, it shows they haven't managed money in this area yet. So we must wait and see.

"But I believe in the cult of the manager, judging experience, character and discipline. We are like the conductor of an orchestra or the manager of a football team - we have to cherry pick and change individual members to suit the environment. That is very hard to replicate."

CURRICULUM VITAE

Alan Djanogly

Born: 1962

1984: City of London Polytechnic (now London Metropolitan University), BSc (Hons) degree in Computing and Economics

1986: Investment management marketing, Robert Fleming Investment Management

1987: Assistant vice-president, Drexel Burnham Lambert

1989: Founder, International Asset Management

INTERNATIONAL ASSET MANAGEMENT

Date established: IAM was independently established in 1989. The founders started investing in hedge funds in 1984

Headquarters: London. IAM Research LLC office in New York was opened in 2003

Ownership: IAM is 100 per cent owned by ABN Amro Asset Management as of February 2006

Assets under management: $5.2bn (£2.6bn, €3.9bn) as of end December 2006

Number of employees: 56