Letter from Germany

Markus Hill surveys the landscape of the German investment market, giving an update on mutual funds, hedge funds, and the impact of UCITS III

2008 is an attractive year for asset management companies with a strong position in the so-called private label fund sector. The new German capital gains tax acted as economic motor for this type of company. One example: Universal Investment, market leader in Germany, also active in Luxembourg, or capital investment companies in Luxembourg such as IP-Concept and LRI Invest, can practically work extra shifts launching fund projects now. Investment funds and mixed funds especially profit from this development. Recently, more and more hedge funds are cropping up which package their products in the form of investment funds of a special variety. Investment funds especially seem an interesting marketing-tool for foreign asset managers or sellers of hedge funds. as their importance may not yet seem clear to the German market. However domestic companies have for years shown an increasing interest in developing sales channels to supplement the classical special fund mandates with great success, although additional information for the investors is still needed. The information level of various trust funds and public utility companies is highly diverse. There are still considerable divergences between the world of public relations and the sales world, however.

UCITS III, "super funds" – established routine with practical tests

The presently accomplished realisation of the UCITS III guideline (discussions of UCITS IV are going on) is making its mark on the German fund landscape. Since 2004 a large number of funds were launched as so-called "Super funds". As opposed to the traditional fund of funds concept, in these "super-fund" one is allowed to invest in all kinds of investment products, in addition to mutual funds – single stocks and single bonds, certificates, and derivatives. In the meantime, some managers have learned their lessons with the implementation of derivative strategies concerning risk management.

For instance, it turned out that target goal aims and safety instruments do not always go together. An additional weak point sometimes is a limited research capacity of the "small" firms in view of the extensive certificate sector in Germany. These are all areas, however, in which there is a headstart in know-how at this time compared to the "big" company-bound competition.

Fund boutiques, active and passive management – chances for offerors

Many fund boutiques functioning as fund advisors for private label funds in Germany have as background a tradition as independent estate managers. For reasons of efficiency, a classical administration on the basis of single values was introduced as a next step towards standardised equity management on a fund base. The next "organic" development was frequently the launching of a fund of funds and a "superfund" variation (or a mixed fund is often another variation). For this reason, one often speaks in Germany of an equity management approach whose clear strength lies in the area of asset allocation. This element is in contrast to the specialisation expertise of the Anglo-American approach where there is a clear separation of classes of assets or investment styles.

For the foreign asset manager, this development in the fund of funds area presents an established sales potential as sales potential for actively managed products. Opposed to this we have passive products developments which are used increasingly by fund of funds as core investments (i.e., Barclays Global Investors, Lyxor). One reason for this use is that an optimal match can here be made of index finds combined with security investments and extra "bets" can be placed in excellent actively managed products.

Hedge funds and mutual funds, 130-30 products – experience and discussion in Germany

Published and public opinion on hedge funds strangely fall apart in Germany. Much is published based on the legal opportunities in the media and publications for private and institutional investors. There is a monthly series of events called "Hedgework" in Frankfurt *(www.hedgework.de)* which has been used by foreign product providers and multiplicators for the industry as well. At this stage less emphasis can be laid on discussions about products and legal issues. It is true that there seems to be the potential for optimising these. Perhaps the introduction of classical hedge fund strategies like 130-30 products (which have dropped out of public discussion for the present) will give some additional impetus as well as increased efforts to pack hedge funds into investment funds.

The location of Germany as a platform for launching new funds based on variations of revenue funds, such as "mixed funds" and "other funds" is almost surpassing Luxembourg in importance.

Outlook: Launching and selling mutual funds

The investment fund industry at present is getting some interesting impetus through the increased acceptance of these funds as investment opportunities by institutional investors as well how fund issues with a hedge fund strategy support this trend. Supplementing the UCITS III regulations, the location of Germany as a platform for launching new funds based on variations of revenue funds, such as "mixed funds" ("Gemischtes Sondervermoegen") and "other funds" ("Sonstiges Sondervermoegen") is almost surpassing Luxembourg in importance. These "new" concepts could be the first step in this direction. In the area of hedge funds, it is interesting to observe which kind of hedge funds in an investment fund guise are being launched. These will compete with the traditional long-only products which can already be bought ("Vermoegensverwaltende Ansaetze"). Private and institutional investors have reason to rejoice – competition means business! ■

Markus Hill is an independent asset management consultant. His professional background includes, among others, the SEB Bank and Credit Suisse Management. His activities include management of mandates (for example: Arcturus/BG Funds) in the areas of sales, marketing, and public relations. He is also active in the areas selecting themes in the special areas of target funds with a multi-management aspect based on special tasks with special themes of fund boutiques and mutual funds for institutional investors. He is further actively engaged in the cooperation with the market-leading Private Label Funds Master KAG in Germany (Universal Investment). He is an initiator of such authoritative studies on the first all-German Consultant Questionnnaire by RCP-Telos etc. Various publications here and abroad underscore his wide-ranging activities as branch networker.

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