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December 8, 2008

Pensions&Investments

THE INTERNATIONAL NEWSPAPER OF MONEY MANAGEMENT

FACE TO FACE: Girish Reddy

Ready for the future

Girish Reddy believes the current market turmoil and an expected hedge fund shake-up will turn out to be good for the industry

By Christine Williamson

Girish Reddy has an obvious passion for his job at Prisma Capital Partners LP.

Mr. Reddy co-founded Prisma five years ago as an institutionally focused hedge fund-of-funds manager after leaving Goldman Sachs, where he was co-head of equity derivatives. He began his career at Travelers Investment Management Co., where he was senior vice president of portfolio construction and asset allocation when he left.

An academic at heart with a research-biased mind, Mr. Reddy harbors a strong passion for education. His charity work has focused on improving rural elementary education in his native India and establishing the well-regarded Indian School of Business. He noted that if he could no longer work in money management, a second career as a finance professor or government policymaker would be his preference.

You trained as an electrical engineer; how did you end up in money management? In India, where I grew up and was educated, your career path is determined when you are quite young. Because you make your choices very early, you really evaluate what you want to do much later in life. It's the reverse of the American (educational) model, because you're really not exposed to the alternatives in the early part of your educational career. When I came to the U.S. to do my master's degree at Cornell (University), I took some finance courses just to see what else one should be thinking about before starting work. I really became fascinated with the changes that the money management industry and Wall Street were going to go through with the introduction of quantitative techniques and derivative instruments.

You never looked back? No, I've never looked back. I (loved) the intensity of capital markets. And I think the whole space, particularly derivatives — which is where I grew up in the industry — was expanding and innovating so rapidly that you never had a dull moment.

What brought you to money management, specifically hedge funds of funds? My career started in money management. For the first 12 years, I was in money management; for the next 12 years, I was at Goldman Sachs. I really came back full circle to money management.

William Neumann

When I left Goldman Sachs and looked at the fund-of-hedge-funds business, the thing that struck me the most was that the strategy or the asset class, depending on what you want to call it, was becoming more institutional in nature. But the services provided, whether it was risk management or transparency, were lagging relative to the standards that traditional asset managers provided to instituttional investors. So one of the things we were excited to bring to Prisma was that risk focus and transparency to institutional investors.

How have your clients been affect by the liquidity squeeze? In terms of private equity and real estate investments, institutional investors have been caught short of the capital recycle that they were expecting. So when they made the commitment (to these strategies) they expected a certain amount to be harvested (and returned to them). Clearly there's a gap between what's being harvested and what's being called upon. It's not surprising because in sharply declining markets, you find more investment opportunities than harvesting opportunities. This is what you want them to do — make investments — but I think institutional investors got caught because they didn't expect the gap to be so wide.

So that's clearly creating a cash flow squeeze. Compounding that problem is that very liquid assets like equities have collapsed considerably. So there are fewer degrees of freedom as to which well they can go to to reach for liquidity. So fixed income, and to some extent hedge funds are sources of capital for them.

The ironic thing is that hedge funds have done significantly better than liquid assets like equities and so have exceeded asset allocation targets in institutional portfolios. So under these circumstances, you get punished for outperforming because of the rebalancing rules of many pension funds. Hedge funds and funds of funds are being impacted by performance, but not by their own performance.

How has Prisma been navigating such difficult market conditions? We've made two major changes in our portfolios and that has worked well with regard to relative performance.

First, our strategy focus changed significantly over the past 12 to 18 months. Starting in the summer of 2006, we felt that borrowers of capital were very well positioned because capital was cheap. Equity and event managers were able to borrow cheap capital and they were performing very well, so we had exposure to them because of the private equity tail wind. Starting in August of 2007 as the subprime market started to melt down, our clear shift was that the lenders of capital would be in a much stronger position and for the first time, was being paid (appropriately) for risk. So our strategy over the last 12 months was a 10% to 15% shift in the event and equity manager area and slowly adding that on to either macro or to lending fixed-income type strategies.

The second thing was realizing that markets will continue to be volatile. We adjusted the portfolios in a couple of ways, starting by adding managers who specialized in vol(atility) because we thought that not only would they make money, but they would be uncorrelated to financial asset performance. That has been helpful.

(We) increase(d) our attention to managers who had high gross exposures and move away from them. In the past, most of the focus used to be managers who had net exposures because you're worried about betas. But in a higher volatile environment you need to be much more focused on gross exposures as well as on managers who had an asset-liability mismatch, meaning either they were funded incorrectly for a strategy that should have a longer term lockup period or they were offering liquidity to their investors that was inconsistent to their strategy.

We were also concerned with leverage because the lender of capital was in the driver's seat and anyone who needed capital would have a hard time. So we avoided leveraged credit strategies and areas like that.

What lasting impact do you think difficult markets will have on the hedge fund industry? The industry will shrink because it had grown rapidly. When I look back on my derivatives experience, that industry also evolved rapidly, shrunk for a bit and then grew again. That is because innovation always precedes infrastructure. Infrastructure catches up and once it does, innovation takes over again. …

I think hedge funds are there now. They have grown rapidly and haven't had all the infrastructure buttoned up, whether that is CDS clearing or stock lending or prime brokerage funding. These issues have to be addressed and they are being addressed.

So we will see a pause and probably a shrinkage, which I think is a good thing, because it sets the stage for the next stage of growth. ■

SNAPSHOT:
Girish V. Reddy

- **Current position:** Managing partner, Prisma Capital Partners LP, New York
- **Assets under management:** $4.4 billion as of Nov. 1
- **Employees:** 32
- **Age:** 53
- **Education:** B.S. in electrical engineering from Indian Institute of Technology, Madras; M.S. in engineering and M.B.A. from Cornell University
- **Personal:** Married, two children
- **Charity and board service:** Member of the Cornell University Council and the executive board of the Indian School of Business
- **Performance:**

Prisma Spectrum Fund Ltd.
1-year return: -4.88% Benchmark: -8.35%
3-year return: 12.95% Benchmark: 7.63%

Prisma Spectrum Fund LP
1-year return: -4.27% Benchmark: -8.35%
3-year return: 17.90% Benchmark: 7.63%

Prisma Select Fund LLC
1-year return: -4.90% Benchmark: -8.35%
3-year return: 20.72% Benchmark: 7.63%

Benchmark: CASAM CISDM Fund of Funds Diversified Index. Source: CASAM CISDM Hedge Fund data base