PRSA Seminar

Tuesday 15 October 2002
Half-Day Morning Seminar
in the Berkeley Court Hotel

Brochures and Reservation Forms will be available shortly.

Motor Insurance Seminar

Friday 8 November 2002
Half-Day Morning Seminar

Brochures and Reservation Forms will be available nearer the time.

Member Survey

The Society is delighted with the response to the Survey to date. However, if you have not completed and returned the survey yet, we would encourage you to do so immediately. We have extended the deadline for receipt of surveys to 30 September 2002. If you have mislaid your survey, please contact the Society for another copy.

Healthcare Committee

Tony Jeffery, Chairman of the Healthcare Committee, would be delighted to hear from any members interested in joining the committee. Tony's email address is:

TOJeffery@Deloitte.ie

External Survey

The Society has commissioned Lansdowne Market Research to carry out a survey to establish the opinions of key decision makers with whom actuaries have regular contact.
The survey will address the current role and standing of the actuarial profession in Ireland and, in particular, how well or otherwise the profession is fulfilling its objective of serving the public interest. Based on the results of the survey, we will identify areas where work is needed to explain and promote the profession.

Annual Report

The 2001/2002 Annual Report of the Society will shortly be available on the Society's website www.actuaries-soc.ie

On the Move

Fellow Members	Kathy Murphy has moved from HCM International to Hewitt Bacon & Woodrow
	Noel Coughlan has joined L & P Financial Trustees
	Sinead Lane has joined Hibernian Insurance from Life Strategies
	Oliver Coakley has joined Mercer HR
	Claire Branagan has moved from Hibernian Insurance to Centre Solutions
	Eoin Murphy has joined Ernst & Young from Scottish Legal Life

Society of Actuaries in Ireland
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Newsletter

September 2002

The Society of Actuaries in Ireland

Prize Winner

John Caslin's paper entitled "Hedge Funds" was highly commended by the council of the Institute of Actuaries at its meeting last July. John will receive a certificate from the Institute marking the award and his name will be entered in the Institute Prize's Book.

The paper was presented to the Society of Actuaries in Ireland on 9th October 2001 to what was the biggest turnout ever for an evening meeting of the Society. It was also presented to the Staple Inn Actuarial Society (SIAS) in London on 22nd January 2002 to what is believed to be one of the biggest turnouts ever for a SIAS meeting.

The paper covers a number of aspects of hedge funds including:

- How adding certain types of hedge funds to existing portfolios can reduce the volatility of the portfolio and increase its expected return;
- The mechanics of how certain types of hedge funds make money and the different kinds of risk they face in doing so;
- Questions that investors should ask their prospective hedge fund manager regarding investment strategy and volatility risk management strategy; and
- The importance of such issues as regulation, liquidity and an analysis of the distribution of daily returns in choosing managers.

The paper was sponsored for the award by the Staple Inn Actuarial Society.

This is the second entry in the Institute Prize's Book for John and the third entry for the actuaries in the Caslin family. In 1995, a paper John co-authored on derivatives won an Institute Prize and in the following year a paper Peter co-authored on the actuarial aspects of the insurance accounts directive was highly commended by the Institute council.

John's paper is available on the Society's website **www.actuaries-soc.ie**

News in Brief

News from the Life Committee

The focus of the Life Committee for the remainder of the year is likely to be on mapping a way forward for Peer Review of Appointed Actuaries, and finalising the work of the With-Profit Working Party led by Brenda Dunne and the Critical Illness Working Party led by Neil Guinan.

We have also been giving consideration to introducing briefing papers on financial matters for consumers, financial journalists and other interested parties. Two draft papers have been prepared on the impact of lower investment returns and on with-profit business. We will decide whether to issue these in the next few months.

Contents

Quiz

Answer Time

For the following quiz, you are given the answers and you must supply the question. In the spirit of the quiz, please don't contrive obscure questions just to fit the answers - you could reasonably expect to be asked most of the questions at a table quiz. Prize is sponsored by Bank of Ireland Life.

1. ***Q***

A **Karol Wojtyla**

2. ***Q***

A **Albania, Georgia, Russia, Switzerland**

3. ***Q***

A **350, 5th Avenue, Manhattan**

4. ***Q***

A **Clarke Gable, Errol Flynn, Marlon Brando, Mel Gibson**

5. ***Q***

A **Morris Garage**

6. ***Q***

A **Adams, Bush, Harrison, Johnson, Roosevelt**

7. ***Q***

A **Bill Bixby and Lou Ferrigno**

8. ***Q***

A **up, charm, top, down, strange, bottom**

9. ***Q***

A **"Don't Panic"**

10. ***Q***

A **1970, 1980, 1987, 1992, 1993, 1994, 1996**

Please return your answers to the Society by latest Friday 4 October 2002

Name		**Company**	
E-mail		**Fax**	

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Report on Captain's Day

When the first 3-ball out had a "3 and a half feet" and a "2 and a half feet" (or 30 inches), John White's team were entitled to feel that they had won at least one prize! Not so. Up stepped Piers Segrave-Daly to go a remarkable (wait for it!) 29.5 inches independently measured by Brendan Lynch and Ciaran Long, we were told! But it was all immaterial in the end with Brian Murphy putting his ball inside it at 26 inches to win the "nearest the pin" prize.

Measurements called into Question for "Nearest the Pin"

The day was fine, the rough was high, the golf was mixed, the conversations were flowing, and the pin was very close to the water on the 18th! With a record 48 actuaries and 7 guests participating, the biggest cheers of the day were for some unfortunately long approach shots on the short par 4 finishing hole, watched by a relaxed gallery sitting out on the balcony viewing the golfers come in over a well deserved drink.

As usual there were two main focuses to our prize-giving on the day, the match play competition and the Captain's prize. This year, our president Eamonn Heffernan managed to add his name to the list of winners on the Piers Segrave-Daly perpetual trophy, a feat he believed was beyond him at the start of the year because of all the "young tigers" coming through the ranks. The initial 28 entrants were whittled down to 2 in the final, where Eamonn prevailed against John White in The Glen of the Downs. Our congratulations go to both John and Eamonn.

There were some good scores on the day, but one was exceptional, with a gross round of 72 from one Irish Life visitor, Kevin O'Hara, giving him 47 points off a handicap of 12 (not anymore!).

To mark the growing interest in the golf society, an illustrious group of golfers, known collectively as the "past captains", presented a new perpetual trophy to Barry Cudmore the winner of the Captain's prize. The inaugural winner played very well on the day and eventually came out a clear 3 points ahead of the chasing field. During his acceptance speech, Barry told us that he was chastised by his team-mates for having the audacity to win during his first year qualified!

For the record, the winners were:

1st	Barry Cudmore	(41 points)
2nd	Tony O'Riordan	(38 points)
3rd	Paul Duffy	(38 points)
B9	Shane Wall	(22 points)
F9	Brian Murray	(22 points)
Guest's Prize		
	Kevin O'Hara	(47 points)
Longest Drive		
	Brendan Lynch	
Nearest the Pin		
	Brian Murphy	

It has been a privilege to captain the Golf Society and I thoroughly enjoyed bringing the outing to Glen of the Downs. I look forward to bigger and better next year, as I pass the baton to Paul Duffy for 2003. Count me in for Scotland Paul!

Bryan O'Connor
Captain

Golf


1


2


3


4


5


6


7


8


9

Day


10

11


12

Who's Who

1. Eamonn Heffernan on the 18th
2. Bryan O'Connor with John White, runner up in the Matchplay
3. Brendan Lynch (Longest drive), Eamonn Heffernan, Bryan O'Connor
4. Brian Murphy (nearest the pin), Eamonn Heffernan, Bryan O'Connor
5. Brian Murray (Best Front 9 with 22 points), Bryan O'Connor
6. Michael Brennan & Joe McElvaney on the 18th
7. Piers Segrave-Daly presenting his trophy to Eamonn Heffernan (Matchplay Winner), Bryan O'Connor
8. Piers Segrave-Daly, Ciaran Long & Brendan Lynch
9. Jimmy Joyce, Tony O'Riordan, with guests, Paul Fleming & John Morrissey
10. Paul Duffy (3rd with 38 points), Eamonn Heffernan, Bryan O'Connor
11. Prizes
12. Tony O'Riordan (2nd on 38 points), Eamonn Heffernan, Bryan O'Connor
13. Brian Griffin, John O'Connell, Bryan O'Connor, Brian Murray
14. Kevin Reynolds, Neil Guinan, Barry Cudmore
15. John White discussing the day's play, overlooking the 18th
16. Paul Duffy (the 2003 Captain)
17. Shane Wall (Best Back 9 with 22 points), Eamonn Heffernan
18. Barry Cudmore (Winner of Captain's prize on 41 points), Eamonn Heffernan, Bryan O'Connor


13


14


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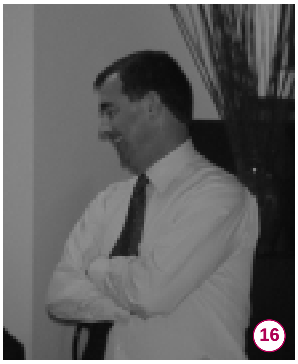
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"Negative Returns

If your portfolio goes up 50% and then falls

The title of this article is a quotation from David Welch of Paradigm Global Advisors who addressed an evening meeting of the Society on 16th April 2002 on the topic:

Modern Portfolio Theory & its Application to Hedge Funds.

David delivered a very clear and incisive presentation to a well-attended evening meeting of actuaries from the life, pensions, investment and general insurance industries and to a small number of invited guests. Here is a selection of some of the interesting points that David made during his presentation:

Diversification

Negative returns just kill a portfolio. The key to reducing negative returns is to construct a portfolio of assets and managers that don't all perform in the same way at the same time. There is little point in trying to diversify a portfolio by investing in equity hedge funds that have a 70% correlation to the S&P 500 index.

Definition of a Hedge Fund Manager

David explained that in the past agriculture and latterly manufacturing were the creators of wealth but today wealth is created through superior access to information and the superior ability to interpret it. Hedge funds are the product of the information age. In the light of this, David defined a hedge fund manager as follows:

"a highly skilled entrepreneur who expresses opinions about and derives profits from real time information changes using financial instruments without reliance on market exposure".

Central to the definition is the lack of reliance on market movements to generate return. Thus a mutual fund management house that offers a "hedge fund" which is a leveraged version of one of its actively managed long-only equity funds is unlikely to be classified as hedge fund under this definition. Nor would a stock picking mutual fund manager who includes a few short positions in his portfolio meet the definition.

The definition of a hedge fund used by Paradigm Global Advisors rules out:

- Stock pickers (this rules out about 50% of entities describing themselves as hedge funds);
- Fixed beta managers;
- A high proportion of emerging markets strategies;
- Trend followers and
- Market or mutual fund timers.

Paradigm also rules out any kind of hedge fund where the underlying securities cannot be marked-to -market. So private equity and venture capital funds would be ruled out by Paradigm.

Where Do You Find Such Hedge Fund Managers?

David made the point that you don't find hedge fund managers that meet this definition working for large fund management houses or investment banks. Anyone with the skills in the definition has gone out on their own and set up their own hedge fund. An independent business operation signals confidence.

Institutional Owners of Hedge Funds

In fact, Paradigm's analysis shows that where good hedge fund managers were taken over by large investment banks or fund management houses their investment performance tended to disimprove. This might be due to the fact that such owners of hedge fund managers had wider objectives which sometimes clashed with the objective of generating good investment returns for their hedge fund clients. For example, an equity hedge fund manager owned by an investment bank might be prevented from shorting the stocks of companies from which the investment bank was trying to get mergers and acquisitions business.

Analysis of Hedge Fund Returns

In the search for good hedge fund managers Paradigm perform a number of tests and David briefly outlined two of these.

Alpha

The return of hedge fund managers was expressed as follows:

Manager's Return =
$\alpha + \beta^*$ (Index Return)

The Index Return is a proprietary index created by Paradigm to reflect the manager's peer group.

David explained that a manager's return could be either because he had a high β or because he had a high α. A high β is great when the index is rising but it killed returns when the index is falling. Paradigm looks for managers with a high α which means they choose managers with high skill levels. He showed the following example on one of his slides:

R_{Trader} =
$\alpha + \beta$ (Hedge Fund Index) + e
13% = 0 + 1.3 (+10%)
9% = 2 + 0.7 (+10%)

Just Kill a Portfolio.

50% you've just lost 25% of your capital.”

and explained that he preferred the manager with the 9% return because he had skill as measured by his alpha (2) and operated at a lower risk level (β = 0.7). By contrast, the 13% manager had no skill as measured by his alpha (0) and operated at a high level of risk (β = 1.3).

Research conducted by Dr. James Park, founder of Paradigm Global Advisors, shows that hedge fund alpha measured using past performance data is a statistically significant predictor of future hedge fund performance at the 99.99% level. The Park Ratio (defined as hedge fund alpha divided by standard deviation) is also a statistically significant predictor of future hedge fund performance at the same level of significance.

Drawdown Analysis

Paradigm also focused on the analysis of managers drawdowns (a drawdown is where the value of your investment falls) looking at the size, frequency and the time taken to recover from drawdowns.

Database of Managers

Paradigm has a database of over 6,500 hedge fund managers; of these only about 3,000 meet the Paradigm definition of a hedge fund. Those managers that did not make the cut to the 3,000 club would include stock pickers who add a few short positions and leveraged mutual funds. David asked the question: Why would you pay 2% management charge and 20% performance fee for a leveraged investment in the S&P 500 when you could borrow money yourself and invest in the index for just 10 basis points per annum? David said that Paradigm had only allocated money to about 75 managers but intended to raise this number to about 100 in the near future.

Fund of Funds

David made the point that new funds of hedge funds were popping up all over the place whereas there were no more than 10 or 12 funds of hedge funds that had been around for more than ten years. He said that funds of hedge funds needed 50 to 100 managers whereas most of the new ones had less than 50 managers. With under 50 managers there just was not enough diversification.

Closed Managers

David said that many new funds of hedge funds claimed to have access to hedge fund managers that were closed to new business and many people thought that this was something special. In fact, there is an active secondary market for gaining exposure to closed hedge fund managers as many funds of hedge funds wished to withdraw funds from such managers (to meet redemption demand) and generally did so by selling their exposure to others. So access to closed managers was not as special as it seemed.

Biases in Hedge Fund Performance Information

David outlined the various biases in past performance information of hedge funds including survivorship bias, liquidation bias and self-selection bias. He explained that Paradigm's manager database included defunct and existing managers which allows it to construct a reliable benchmark.

Conclusion

David's talk gave us some very interesting insights into hedge fund investing and their use in reducing the volatility of investment portfolios.

John Caslin