



Hedge Funds, Alternatives & ETFS
A Deeper Dive
April 2015

William Norris
Chief Investment Officer & Head of Asset Management - Private Wealth
wnorris@theprivatebank.com
312-564-1921

Our Discussion: Key Messages



1. Overview of Hedge Funds, ETF's and Alternatives
2. How these are being used in portfolios
3. What are the risks investors and others should be thinking about

"Today, if asked to define a hedge fund, I suspect most folks would characterize it as a highly speculative vehicle for unwitting fat cats and careless financial institutions to lose their shirts."

Mario Gabelli
2002
A Brief History of The Hedge Fund
Investopedia 2015

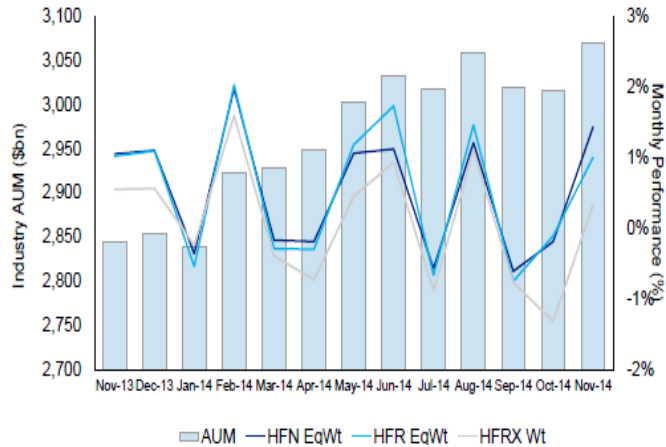
Hedge Funds

- So what do you consider to be a “Hedge Fund”?
- Today the concept or definition of a “hedge fund” varies within our industry
 - What are the strategies?
 - Do all funds “hedge”?
 - How are investors rewarded?
 - What are the structures?
 - How have they performed?
 - Will the industry keep evolving?

Assets Today Exceed \$ 3 trillion



Monthly Industry AUM and Performance



Source: Citi Prime Finance Hedge Fund Industry Snapshot 2014

Spring 2015

5

Hedge Fund Strategies



- **Fund of Funds**
 - Blended approach covering broad allocation to multiple strategies
- **Equity Long/Short**
 - Profit from stock picking and shorting equities. Reduction in beta exposure
- **Dedicated Short Bias**
 - Sell short stocks that are overvalued or sectors not attractive
- **Concentrated Equity**
 - Big bets, low turnover
- **Equity Market Neutral**
 - Equally long and short equities (zero beta exposure) but expected both sides to profit
- **Event Driven**
 - Merger or corporate event triggers activity where managers take positions on one or both firms affected to profit from premium

Spring 2015

6

Hedge Fund Strategies

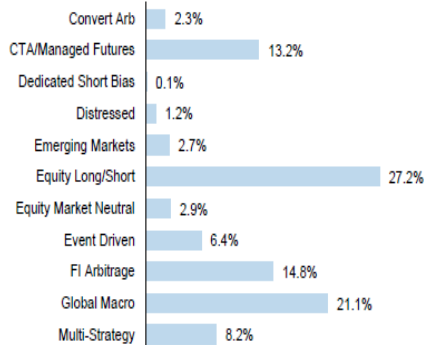


- **Emerging Markets**
 - Tends to be more global macro like where managers look to profit from dislocations in emerging market asset classes
- **Fixed Income Relative Value**
 - Trading across multiple fixed income markets/sectors to take advantage of market dislocations
- **Convertible Arbitrage**
 - Trading in convertible securities taking advantage of return premium in the bond vs. the stock
- **Global Macro**
 - Forward macroeconomic views drive investments across multiple global asset classes (equities, fixed, currencies, commodities etc.)
- **Managed Futures**
 - Trend following strategies focused on currencies, interest rates, and commodities

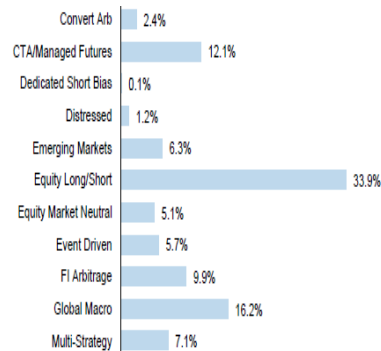
Hedge Funds Strategy Breakdown



Hedge Funds Strategies by Assets



Number of Funds by Strategy



Source: Citi Prime Finance Hedge Fund Industry Snapshot 2014

Form of Investment Structure



- Limited Partnerships:
 - 3(c)7 Structure
 - Limited number of investors allowed in the fund
 - Higher minimums
 - Accredited Investor/Qualified Purchaser Rule
 - Longer lock up periods
 - Registered Investment Companies (RICS)
 - Larger number of investors allowed
 - Lower minimums
 - Shorter lockup periods
 - 40 Act Fund Structure
 - Unlimited investors
 - Open ended
 - Little to no lockup time period
- Subscription Documents
- Taxation

ETF's: Key Points



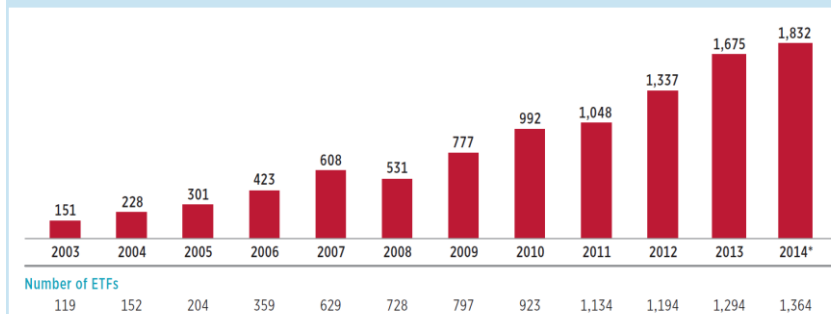
- Exchange Traded Funds (ETF's) are a type of fund that owns underlying assets, divides those assets into shares for the underlying investors to hold/trade
- Traded throughout the trading day and in most cases very liquid
- Originally designed to track benchmarks, making it easier for investors to get exposure:
 - Equities (S & P 500, Dow, total equity market, etc.)
 - Fixed income (long, short, high yield, etc.)
 - Commodities (gold, agriculture, energy)
 - Specialty Funds (sectors, countries, real estate, volatility)
- Industry is shifting toward much broader use of these vehicles
- Similar to hedge funds, the industry has evolved dramatically over the past 20+ years
- Investors are faced with multiple decisions around how to use ETF's in portfolios and what risks should they be aware of

Growth in the ETF Industry



Total Net Assets and Number of ETFs

Billions of dollars, year-end 2003-2014*



*Data are through June 2014.

Note: Data for ETFs that invest primarily in other ETFs are excluded from the totals.

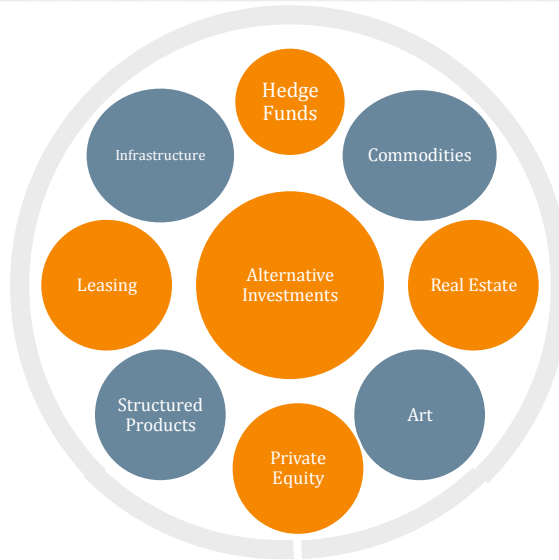
Source: Investment Company Institute

Defining Alternative Investments



- So what do we mean when we use the term “Alternative”
- Many ways to define “alternative investments”
 - Correlation to traditional asset classes
 - Investment type
 - Return characteristics
- Not one single way to define as it varies from firm to firm

The Pieces of the Alternatives Allocation



Spring 2015

13

How Are These Investments Being Used



- **Hedge Funds**
 - Allocation traditionally to lower volatility and enhance returns
 - Stabilize return streams
 - Speculative for some investors
 - Commitment runs from 10%-30% of portfolio
- **Exchange Traded Funds**
 - Core portfolio construction
 - Sector and country bets
 - Diversify smaller accounts
 - Cost reducing
 - Tax efficiency
 - Core satellite approach for asset management decisions
 - Short term trading
- **Alternatives**
 - Diversifying sources of return
 - Reducing risk
 - Seeking emerging ideas
 - Cyclical return streams
- **Trust vs. Agency Accounts** – Is there a difference in terms of their use?

Spring 2015

14

How Should We Think About Risk?



- Liquidity Risk
 - Lockups
 - Gating
 - Trading
- Tracking Error Risk
 - ETF's are vulnerable to this
- Portfolio Risk
- Leverage Risk
- Suitability Risk
- Tax Risk
- Fee Risk
 - Are the fees reasonable or prudent?
- Advisor Risk
 - Can advisors explain the strategies?
- Operational Risk
- Counterparty Risk

Summary Comments



- Cannot ignore the evolution of alternative investments – becoming a staple of the overall allocation
- In some cases their use simplifies portfolio management but in other cases it complicates it
- More and more firms are increasing their use of alternatives in portfolios
- There is a wide range of risks that firms and investors need to take into consideration across hedge funds, ETF's and other alternative investments

Q & A

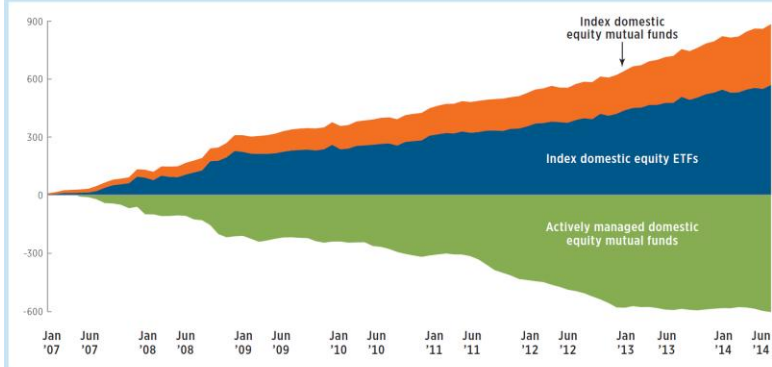
Appendix

Actively Managed Funds Are Losing Assets to ETF's



Some of the Outflows from Domestic Equity Mutual Funds Have Gone to ETFs

Cumulative flows to and net share issuance of domestic equity mutual funds and ETFs, billions of dollars; monthly, 2007-2014*



*Data are through June 2014.

Note: Equity mutual fund flows include net new cash flow and reinvested dividends.

Source: Investment Company Institute

Types of ETF's and Trading Volume



Summary of Primary Market Activity and Secondary Market Trading Across the ETF Industry

Daily, January 3, 2013-June 30, 2014

Investment objective	Number of ETFs ¹	Total net assets (\$ billions) ¹	Primary market ²		Secondary market	
			Average daily creations/redemptions (\$ millions)	Primary market relative to total net assets ³ (percent)	Average daily volume (\$ millions)	Primary market relative to total trading ⁴ (percent)
Equity	1,021	1,489	5,366	0.36%	53,691	9%
Domestic	548	1,049	4,447	0.42	45,113	9
Large-cap	113	462	1,993	0.43	27,459	7
Small-cap	60	88	545	0.62	5,709	9
Other domestic	375	498	1,908	0.38	9,945	16
International	473	440	920	0.21	10,577	8
Emerging markets	180	150	381	0.25	6,051	6
Other international	293	290	539	0.19	4,526	11
Bond	247	273	931	0.34	4,026	19
Domestic	194	254	867	0.34	3,802	19
Domestic high-yield	27	46	149	0.32	738	17
Municipal	35	13	19	0.15	101	16
Other domestic	132	195	698	0.36	2,964	19
International	53	19	64	0.53	224	22
Emerging markets	20	11	46	0.42	169	22
Other international	33	8	18	0.21	55	24
Total	1,268	1,762	6,297	0.36	57,717	10

¹ Number of ETFs and total net assets are as of June 2014.

² Daily creations or redemptions for each ETF are estimated by multiplying the daily change in shares outstanding by the daily NAV from Bloomberg. Aggregate daily creations and redemptions are computed by adding creations and the absolute value of redemptions across all ETFs in each investment objective each day. Average daily creations and redemptions are the average of the aggregate daily creations and redemptions over the 375 daily observations in the sample.

³ Computed as the ratio of average daily creations and redemptions (column 3) to total net assets (column 2).

⁴ Computed as the ratio of average daily creations and redemptions (column 3) to the sum of average daily creations and redemptions (column 3) and average daily volume (column 5).

Source: Investment Company Institute

Asset Class Distribution



	STOCKS				FIXED INCOME				ALTERNATIVES					CASH Total		
	Total	U.S.	Developed	Emerging	Total	U.S.	High Grade/ HY	Developed	Emerging	Total	Real Estate	Commodities	Hedge Funds		Pvt-Equity	Other
HSBC Private Bank	45.0	17.0	21.0	7.0	29.0	16.0	13/3	3.0	10.0	25.0	4.0	3.0	13.0	5.0	0.0	1.0
Janney Montgomery	48.0	31.0	13.0	4.0	38.0	38.0	34/4	0.0	0.0	12.0	1.0	2.0	9.0	0.0	0.0	2.0
JPMorgan Chase	41.0	25.0	14.0	2.0	20.0	20.0	18/2	0.0	0.0	33.0	3.0	2.0	23.0	5.0	0.0	6.0
Key Private Bank	65.0	44.0	16.0	5.0	35.0	29.0	19/0	3.0	3.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
LPL Financial	65.0	60.0	2.0	3.0	26.0	26.0	19/7	0.0	0.0	6.0	0.0	0.0	6.0	0.0	0.0	3.0
Merrill Lynch Wealth Mgt	47.1	24.3	17.8	5.0	26.7	26.7	24.3/2.4	0.0	0.0	25.2	0.0	3.1	13.3	8.8	0.0	1.0
Morgan Stanley	50.0	20.0	22.0	8.0	26.0	19.0	14.0/5.0**	2.0	0.0	20.0	0.0	3.0	9.0	0.0	8.0	4.0
Neuberger Berman	48.0	32.0	10.0	6.0	32.0	26.0	21/5	2.0	4.0	17.0	4.0	0.0	8.0	5.0	0.0	3.0
Northern Trust	37.0	24.0	9.0	4.0	41.0	41.0	31/10	0.0	0.0	22.0	3.0	4.0	6.0	6.0	3.0	0.0
PNC Asset Mgt	50.0	39.5	8.5	2.0	30.0	27.0	24/3	0.0	3.0	20.0	2.0	4.0	8.0	2.0	4.0	0.0
Raymond James	65.0	47.0	14.0	4.0	28.0	24.0	20/4	4.0*	0.0	5.0	0.0	0.0	5.0	0.0	0.0	2.0
RBC Wealth Mgt	56.0	30.0	21.0	5.0	37.0	26.0	22/4	7.0	4.0	0.0	0.0	0.0	0.0	0.0	0.0	7.0
Silvercrest	56.0	43.4	7.0	5.6	15.0	15.0	11.2/3.8	0.0	0.0	24.0	0.0	0.0	24.0	0.0	0.0	5.0
UBS	37.0	24.5	7.5	5.0	44.0	41.0	32.5/8.5	1.0	2.0	19.0	0.0	4.0	10.0	5.0	0.0	0.0
U.S. Bank Wealth Mgt	46.0	34.0	7.0	5.0	28.0	23.0	20/3	3.0	2.0	26.0	5.0	2.0	13.0	6.0	0.0	0.0
U.S. Trust	48.0	32.0	10.0	6.0	24.0	23.0	20/3	1.0	0.0	26.0	5.0	6.0	8.0	7.0	0.0	2.0
Wells Fargo	52.0	31.0	12.0	9.0	16.5	11.0	6/5	1.5	4.0	28.5	8.0	4.0	12.5	4.0	0.0	3.0
William Blair	50.0	20.0	20.0	10.0	18.0	15.0	10/5	0.0	3.0	30.0	5.0	0.0	5.0	0.0	20.0	2.0
Wilmington Trust	54.2	34.5	16.4	3.3	22.2	22.2	20.2/2	0.0	0.0	17.8	2.0	0.8	15.0	0.0	0.0	5.8
AVERAGE	51.0	32.5	12.8	5.7	27.1	24.2	23.4/5	1.0	1.6	19.1	2.7	1.7	9.8	3.3	1.6	2.9
PVTB Balanced	36.5	19.0	13.0	4.5	30.0	30.0	23.5	0.0	0.0	29.5	3.5	0.0	18.0	0.0	8.0	4.0
PVTB Growth	47.5	25.0	16.5	6.0	18.5	18.5	13.5	0.0	0.0	29.5	3.5	0.0	18.0	0.0	8.0	4.5

Source: Barron's March 3, 2015 & PrivateBank

Disclosures



The PrivateBank and Trust Company ("the Bank") is an Illinois chartered bank and a wholly owned subsidiary of PrivateBancorp, Inc. Private Wealth is a line of business within the Bank. Private Wealth includes Trust and Investments, Private Banking, Lodestar Investment Counsel, LLC and Financial Advisory.

Trust and Investments provides investment and wealth management, fiduciary, escrow and custody services. Securities products and brokerage services offered through Financial Advisory is available through LPL Financial, an independent broker dealer, registered with the Securities and Exchange Commission and a member of FINRA.

This commentary is intended to be general information only. This commentary is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and needs of any specific person. Investors should seek professional financial advice about the appropriateness of investing in any financial instrument and in any financial strategies discussed in this commentary. No financial instrument is suitable for all investors. Any decision to purchase securities must be made on the basis of public information. To the extent that this commentary addresses ongoing legal proceedings or issues, it has not been prepared to provide any legal conclusion opinion or advice. The information contained in this report may have been obtained from third parties and we do not guarantee its accuracy. PrivateBancorp, Inc., its affiliates and subsidiaries and their respective employees, officers and directors does not accept any liability whatsoever for any direct, indirect, or consequential damages or losses from any use of this report or its contents.

Investing in assets such as securities, annuities and mutual funds involves risks, including but not limited to loss of the principal amount invested. Investments are not FDIC insured and there is no guarantee by the Bank, the government or any other entity on the investments. Past performance is not a guarantee of future results and loss is possible regardless of the investment objective selected or whether investment discretion is exercised by us, retained by you or delegated to another party. Diversification, asset allocation and rebalancing does not assure a profit or protect against loss. Investment performance can never be predicted or guaranteed and portfolios will fluctuate due to market conditions and other factors. Market forces may cause particular sectors, industries or securities to appreciate or depreciate dramatically. Any investment will pose unique or particular risks.

The client (or legal account owner) is responsible for all tax liability arising from any security transactions, as well as all other tax liabilities resulting from any other transactions for the client's account, and is encouraged to seek the advice of an accountant or attorney about any tax aspects relating to the management of the client's account. The Bank does not provide legal, tax or accounting advice. The information contained in this commentary is not intended to be tax advice and should not be construed as such.

This commentary may address "Alternative Investments" including but not limited to hedge funds, private equity or other private placements. Alternative Investments are speculative and illiquid investments suitable only for certain accounts and only for a limited portion of the risk segment of a portfolio. Alternative Investments are not bank deposits; they are not backed or guaranteed by the Bank or any other entity; nor are they insured by, issued by, guaranteed by or obligations of the FDIC, The Federal Reserve Board or any other government agency or bank. Investing in Alternative Investments is not suitable for all clients and such investments should be regarded as fixed, long term and illiquid. Most Alternative Investments are illiquid and will not be listed on any exchange. Some Alternative Investments may use leverage and other speculative practices that increase the risk of investment loss. Alternative Investment firms such as hedge funds or private equity firms may not be required to provide periodic pricing or valuation information for investors. Alternative Investments may not be subject to the same regulatory requirements as mutual funds or other more traditional investments. Investors can expect fees and costs associated with Alternative Investments to be higher.

When Private Wealth invests account assets in shares of, or interest in, mutual funds, exchange traded funds, Alternative Investments or other pooled investment products Private Wealth, the Bank's subsidiaries, or affiliates may receive compensation such as distribution fees, 12b-1 fees or other shareholder servicing fees.

