

# BARRON'S Alternatives

Hedge Funds, Alternative Mutual Funds, Private Equity, Commodities, Master Limited Partnerships, Real Estate Investment Trusts

**KG has a “long dating” period prior to entering a serious relationship with a stock, says chief investor Ilya Zaides.**



## Talking With **Ilya Zaides**

Chief Investment Officer  
KG Investments Fund

## Informed Skeptic

by Eric Uhlfelder

AS A FIRST-YEAR ASSOCIATE AT THE LAW FIRM MILBANK Tweed, Ilya Zaides was reviewing a pending Enron debt offering. His reaction: “It didn’t make any sense” for the proceeds from the sale to flow through about a dozen different entities. Was he just too inexperienced to understand? No, it turned out the merchant energy giant was mischaracterizing the debt as revenue, the sort of accounting miscue that eventually sank Enron.

Zaides, 44, comes by his skepticism naturally. His Russian father and mother were scientists—a physicist and chemist, respectively—hardened by anti-Semitism and the worst effects of a Soviet bureaucracy they believed held back their careers in St. Petersburg. The family, carrying only a handful of rubles, was part of the first refugee wave that left the Soviet Union in the mid-1970s.

In the U.S. Zaides took an indirect route—starting as a New York lawyer—to portfolio management, drawn by the chance to conduct his own research and make his own decisions.

His nine-year-old hedge fund, KG Investments Fund, is event-driven, but executes in a different way than other event-driven funds that target various mispriced assets resulting from mergers, bankruptcies, and management changes. KG’s focus is on high-quality, high-growth equities with strong balance sheets. Market-cap agnostic, KG studies companies for years, creating a top 100 list that it continuously refines, waiting for an event to affect the stock price. It is a “long dating” period, laughs Zaides, as KG aims to post 25% gross annualized returns typically over a three- to five-year period. The result is a tightly concentrated portfolio of less than 20



stocks; it now has nine long positions and nine short.

So far it's worked. Zaides' team of five investment professionals has generated annualized returns of 18.1% with 13.2% volatility since it launched in 2009. The Standard & Poor's 500 index's numbers: 14.9% gain and 13.7% volatility.

The fund aims to align investor and manager interests. According to CEO and co-founder Ike Kier, KG shares research with clients, sticks to industries it knows well (technology, finance, media, and consumer), maintains investments compatible with the fund's liquidity, and keeps the majority of the

Market Beater

|                            | Total Return* |       |       | Since Inception** |
|----------------------------|---------------|-------|-------|-------------------|
|                            | 1-Yr          | 3-Yr  | 5-Yr  |                   |
| KG Investments Fund        | 30.7%         | 17.9% | 16.3% | 18.1%             |
| Barclay Event Driven Index | 10.2          | 4.4   | 5.8   | 7.7               |
| S&P 500                    | 18.6          | 10.8  | 14.2  | 14.9              |

\*Returns as of 9/30; three-, five-, and lifetime returns annualized. \*\*Jan. 2009  
Source: BarclayHedge

principals' wealth in the fund.

It also has a 5% hurdle rate, which means its 20% performance fee does not get paid unless the fund's returns exceed that threshold. The management fee is 1.75%.

Despite its performance and other attributes, KG still runs \$245 million in assets. Zaides thinks his unorthodoxy—entering finance from a legal job rather than via Wall Street and his unusual approach to investing—has kept investors on the sidelines.

**One KG success is Verisign** (ticker: VRSN). The internet registry has a virtual monopoly translating IP codes into URL names for dot-com and dot-net domain names. The company went through its own boom and bust after making \$20 billion in acquisitions amid the internet craze. Several years later it started unloading assets and buying back shares. KG started following the company in 2010. Just a couple of years later, investors were starting to write the company off because mobile internet didn't require registration. Attracted by the company's cash position and ability to buy back shares, KG bought the stock at an average cost of \$54.38 in July 2014. The stock soared in the second half of 2015, driven in part by a surge in Chinese registrations. KG checked out at an average price of \$75.39.

Having previously researched **Mastercard** (MA) and **Visa** (V), KG had an advantage when it started looking into **MoneyGram International** (MGI) in 2010. With new competition headed MoneyGram's way,

Zaides and his team figured shares of the world's No. 2 money-transfer service were vulnerable, particularly because of its hefty fees (about \$5 per \$100 transferred). Then MoneyGram lost its exclusive spot at U.S. Wal-Mart in 2014 to a rival. Wal-Mart Stores had accounted for nearly a quarter of MoneyGram sales and a third of profits.

Although the stock fell in 2014, Zaides calculated that it was still overvalued by 35% and built a short position between May and September at an average price of \$13.45. In the next two months it covered the position at an average of \$10.86 a share. MoneyGram later reported 2014 operating income collapsed 60% from the prior year.

When MoneyGram modestly recovered in the first half of 2015, KG again shorted the stock. In all it posted annualized returns of 34% over 18 months.

In early 2010, KG began tracking a Dutch-listed holding company, **AP Alternative Assets** (AAA.Netherlands), managed by Leon Black's Apollo Global Management. More than half of AP Alternative's value was cash and liquid assets. The balance was

private-equity stakes, half derived from then-private **Athene Holding** (ATH). A U.S. annuities provider, Athene, with \$10 billion in assets, was created post-financial crisis and thus didn't have higher paying legacy contracts suffering from ultralow interest rates. The shares, however, reflected only AP Alternative's cash and liquid asset values.

As a shareholder by early 2011, KG suggested to Apollo that it reward investors by returning a good chunk of the company's cash and liquid assets to investors through share buybacks. Apollo eventually went along. By early 2014, KG had 20% of its fund in AP Alternative at an average cost of \$15.35 and had taken a private-equity stake in Athene at an average price of \$26 a share.

Athene got great deals buying annuity firms reeling from unprofitable contracts. The going price was about 50% of book. Now public, Athene has \$93 billion in assets and trades at \$53. AP Alternative trades at \$31.50 a share, having distributed the equivalent of \$24.67 in cash and Athene shares.

KG knows what it is to be on the wrong side of a trade. Its worst was **Lumber Liquidators** Holdings (LL), which was accused of selling toxic Chinese flooring in the U.S. Zaides bought after the stock plummeted 70% to \$30. When the longtime CFO left a few weeks later, KG rethought its position, closing it out at \$24. "This suggested internal management problems worse than we had anticipated," says Zaides. Less than a month after KG sold, the CEO left. Even born skeptics get taken occasionally. ■

TOP PERFORMING HEDGE FUNDS

High-ranking hedge funds for the past month and year

| SECTOR/HEDGEFUND   |  | Performance (%) |        |        |        | AUM<br>(mil)  |
|--|--|-----------------|--------|--------|--------|---------------|
|  |  | 1 Month         | YTD    | 1 Year | 3 Year |               |
| EQUAL WEIGHTED HEDGE FUND  |  |                 |        |        |        |               |
| 1-Month  | TPH Energy Equity Opportunities Fund     | 18.62           | 1.39   | 11.88  | N/A    | 101.00        |
| 1-Year   | Pabrai Investment Fund 3                 | 9.19            | 61.31  | 81.31  | 45.04  | 213.90        |
| EQUITY MARKET NEUTRAL  |  |                 |        |        |        |               |
| 1-Month  | Amazon Market Neutral                    | 6.80            | 9.87   | -4.81  | -5.97  | 123.45        |
| 1-Year   | Cedar St Levered Market Neutral Strategy | 5.05            | 8.36   | 7.15   | 21.90  | 125.40        |
| FIXED INCOME ARBITRAGE   |  |                 |        |        |        |               |
| 1-Month  | Metacapital Mortgage Opportunities Fund  | 0.99            | 0.98   | 1.07   | 5.10   | 1201.50       |
| 1-Year   | Barnegat Investments Ltd - Class B       | 0.87            | 18.34  | 18.02  | 23.58  | 633.75        |
| CONVERTIBLE ARBITRAGE  |  |                 |        |        |        |               |
| 1-Month/1-Year   | Wolverine Flagship Fund Trading Limited  | 1.91            | 8.44   | 12.03  | 21.28  | 1490.00       |
| EVENT DRIVEN MULTI-STRATEGY  |  |                 |        |        |        |               |
| 1-Month/1-Year   | UG Hidden Dragon Special Opportunity Fd  | 4.77            | 57.38  | 50.98  | 147.61 | 701.66        |
| MERGER ARBITRAGE   |  |                 |        |        |        |               |
| 1-Month/1-Year   | PSAM WorldArb Partners LP                | 1.62            | 9.49   | 13.26  | 12.35  | 873.00        |
| DISTRESSED SECURITIES  |  |                 |        |        |        |               |
| 1-Month  | JLP Credit Opportunity Cayman Fund Ltd   | 0.91            | 5.24   | 24.34  | -9.74  | 262.30        |
| 1-Year   | CONTRARIAN EM OFFSHORE FUND, LTD.        | 0.42            | 16.77  | 28.81  | 54.89  | 314.50        |
| EQUITY LONG/SHORT  |  |                 |        |        |        |               |
| 1-Month  | Dorset Energy Fund Ltd Series A          | 18.53           | -36.48 | -37.53 | -60.52 | 103.70        |
| 1-Year   | Pabrai Investment Fund 3                 | 9.19            | 61.31  | 81.31  | 45.04  | 213.90        |
| GLOBAL MACRO   |  |                 |        |        |        |               |
| 1-Month/1-Year   | Templeton Global Summits Fund Ltd (CYM)  | 4.79            | 11.19  | 36.33  | 4.45   | 177.75        |
| N/A=Not available. Data is of 9/30/2017. Note Universe limited to funds with at least \$100 million in assets. |  |                 |        |        |        | Source: CISDM |

TOP PERFORMING ALTERNATIVE MUTUAL FUNDS

Funds pursuing specialized strategies ranging from managed futures to real estate to MLPs

| SECTOR/FUND  |  | Performance (%) |       | AUM    |                     |         |  |
|--|--|-----------------|-------|--------|---------------------|---------|--|
|  |  | 1 Month         | YTD   | 1 Year | 3 Year              |         |  |
| BEAR MARKET  |  |                 |       |        |                     |         |  |
| 1-Month/1-Year   | PIMCO StocksPLUS® Short Institutional/PSTIX    | -1.55           | -8.99 | -11.39 | -8.75               | 2170.38 |  |
| LONG SHORT CREDIT  |  |                 |       |        |                     |         |  |
| 1-Month  | Avenue Credit Strategies Institutional/ACSBX   | 1.24            | -1.00 | 0.25   | -5.07               | 507.31  |  |
| 1-Year   | Legg Mason BW Alternative Credit I/LMANX       | 0.57            | 8.22  | 9.33   | 2.17                | 333.13  |  |
| LONG SHORT EQUITY  |  |                 |       |        |                     |         |  |
| 1-Month  | RMB Mendon Financial Long/Short A/RMBFX        | 4.87            | -1.87 | 12.05  | 10.46               | 127.23  |  |
| 1-Year   | Calamos Phineus Long/Short I/CPLIX             | 2.05            | 6.88  | 18.48  | N/A                 | 297.04  |  |
| MANAGED FUTURES  |  |                 |       |        |                     |         |  |
| 1-Month  | 361 Managed Futures Strategy I/AMFZX           | 1.61            | 2.53  | 0.98   | 1.55                | 234.25  |  |
| 1-Year   | Equinox IPM Systematic Macro I/EQIPX           | 0.98            | 3.84  | 4.01   | N/A                 | 456.70  |  |
| MARKET NEUTRAL   |  |                 |       |        |                     |         |  |
| 1-Month  | PIMCO RAE Fundamental AdvantagePLUS Inst/PFATX | 1.60            | -1.93 | 1.71   | -0.74               | 532.96  |  |
| 1-Year   | BlackRock Global Long/Short Equity Instl/BDMIX | 0.17            | 10.34 | 11.90  | 0.04                | 607.61  |  |
| MULTIALTERNATIVE   |  |                 |       |        |                     |         |  |
| 1-Month  | Driehaus Event Driven/DEVDX                    | 2.89            | 3.19  | 5.56   | 1.60                | 161.08  |  |
| 1-Year   | GMO Special Opportunities VI/GSOFX             | 1.43            | 21.23 | 20.10  | 9.44                | 1021.70 |  |
| MULTICURRENCY  |  |                 |       |        |                     |         |  |
| 1-Month  | JHancock Absolute Return Currency R6/JCURX     | 0.95            | -2.44 | 2.02   | -0.54               | 155.81  |  |
| 1-Year   | PIMCO Emerging Markets Currency Instl/PLMIX    | -0.50           | 10.53 | 7.13   | 0.53                | 4024.12 |  |
| MASTER LIMITED PARTNERSHIPS  |  |                 |       |        |                     |         |  |
| 1-Month  | Tortoise MLP & Pipeline Investor/TORTX         | 2.58            | -2.12 | -0.90  | -6.64               | 280.06  |  |
| 1-Year   | Transamerica MLP & Energy Income I2/           | 1.86            | -0.27 | 2.82   | -9.94               | 210.68  |  |
| NON TRADITIONAL BOND   |  |                 |       |        |                     |         |  |
| 1-Month  | Bramshill Income Performance Instl/BRMSX       | 1.77            | 2.45  | 3.04   | N/A                 | 239.22  |  |
| 1-Year   | Western Asset Macro Opportunities IS/LAOSX     | 0.67            | 13.81 | 12.36  | 6.89                | 175.07  |  |
| OPTION WRITING   |  |                 |       |        |                     |         |  |
| 1-Month  | First Investors Covered Call Strat Adv/FRCDX   | 1.80            | 7.19  | 9.62   | N/A                 | 113.97  |  |
| 1-Year   | JPMorgan Hedged Equity I/JHEQX                 | 1.13            | 9.45  | 13.78  | 7.15                | 990.39  |  |
| REAL ESTATE  |  |                 |       |        |                     |         |  |
| 1-Month  | Morgan Stanley Inst US Real Estate I/MSUSX     | 1.14            | -0.62 | -2.58  | 7.44                | 358.27  |  |
| 1-Year   | CGM Realty/CGMRX                               | 0.09            | 17.42 | 28.25  | 10.22               | 957.66  |  |
| N/A=Not available. Data is of 9/30/2017. Note Universe limited to funds with at least \$100 million in assets. |  |                 |       |        | Source: Morningstar |         |  |