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Shah Capital Sees Less Volatility in Long/Short

Hedge fund manager discusses “safe haven” for wary institutional investors

By Jakema Lewis

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We’re living in a post-Madoff world and investors are somewhat skittish on placing their assets in alternative strategies and even more specifically, hedge fund strategies. But, we’re also living in a world where many pension funds are facing an unfunded liability crisis. So, what’s the responsible institutional investor to do?

“There are three alternatives that the pension plans have to deal with considering the fact that they are quite under funded,” said President and CEO of **Shah Capital Management, Himanshu Shah**.

“They can either raise taxes and/or cut retiree benefits. The last option is they can earn their way out by having better performing managers on their platform. The first two alternatives are definitely very difficult to attain. The third alternative—earn your way out—is the one, I think, where Shah Capital comes in.”

The Raleigh, N.C. based firm oversees over \$240 million in assets on behalf of its clients via its long/short long biased equity fund, the Shah Capital Opportunity Fund, which is currently over \$150 million, and its long-only strategy--which has been closed to new investors since 2006. Shah described the long/short biased equity fund as a fundamental, valuation driven extension of the long-only strategy.

And speaking on matters related to the fallen **Bernard Madoff Investment Securities**, Shah said what should have “tipped off” investors about potential conflicts of interest were that Madoff served as the in-house administrator, the custodian *and* the broker.

“We have an independent administrator, an independent auditor and an independent custodian,” he said. “We are just the money manager and have to communicate these points more frequently in the post-Madoff world we are living in. There is bad sentiment out there, but if I were an institutional investor I would look at each fund individually and then make the judgment. There are so many different kinds of funds, you cannot paint them with the same brush.”

For example, with a long/short fund, very little leverage is used, Shah explained, noting that the five-

and 10-year returns of long/short funds have done better than the long-only portfolios that many of the larger pension plans employ.

“If you look at the last 10 years, the market has really gone nowhere, but there have been positive alpha coming out of the long-short space and that will most likely continue,” he said. “The long-short universe also has less volatility.

That being said, the firm is optimistic that it will beef up the institutional side of its business in the coming years, given a proven track record and unique strategy. However, both Shah and the firm’s Director of Business Development, **Rich Callaghan**, are well aware of the roadblocks that face managers when trying to win institutional mandates.

“The institutional space is difficult to penetrate unless you have a lot of connections and been around,” Shah noted. “I think we are at a stage where we have a three-year track record of our fund and a lot of institutions look at a minimum three-year track records before they invest with you. We are really getting into the limelight of institutional investors in the United States. We’re confident that we will be winning a lot more institutional business going forward based on our philosophy and track record.”

Callaghan added: “We are in about 5 different databases right now, so we’re accessible that way. We also reach out to them specifically and I also talk with a number of different consultants who reach out to their clients.”

Frankly speaking, however, what makes the firm stand out are its numbers, said Shah.

“People are always asking how are you doing in the down market and how are you doing in the up market?” he said. “We comfortably beat the averages in 2008, which was a pretty bad year for most investors. This year (2009) is an up year and we’re also beating our averages quite dramatically.”

Shah said the investment strategy also includes a good discipline, meaning the firm does well at timing a good entry point as well as exit point.

“If you look at our fund, in light of the heightened market volatility, we have varied our net exposure, raising it when valuations were cheap, and gradually reducing it as prices went up” he explained. It says a lot about our discipline”

How About Some Chinese?

Meanwhile, Shah Capital is, and expects to remain bullish on China based on the huge pent-up demand, demographics and relatively cheap valuations. The firm’s investment team members-- which are comprised of three senior analysts along with Shah—have experience investing in Asia since 1995. Combined, the team has over 40 years of experience.

“There are not that many firms out there on The Street that have this strategy of focusing on U.S. and China,” Shah said. “Most of the managers are either China, Asia or U.S. centric. If they are

global, they are all over. We are mainly looking at just these two big countries, where we have both contacts and experience.”

He is quick to note that the firm views China as “a developed country from an infrastructure point-of-view” and there are “tremendous investment opportunities - most notably in retail and industrial sectors.”

“Our goal is to scale up to be a multi-billion dollar firm and think we can accomplish this by 2012,” Shah said.

Himanshu Shah founded Shah Capital Management in January 2005 after being in the investment management business for more than 14 years. He was a vice president and senior portfolio manager at UBS before starting the firm. He received a Bachelor of Commerce in Accounting from Gujarat University and an MBA from the University of Akron.

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