

THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

Hedging Against Market Risk By Using Alternative Investing Strategies



RICHARD BREGMAN, CFA, is the Founder and Chief Executive Officer of MJB Asset Management LLC, an independent, SEC-registered investment advisory firm. Before forming MJB Asset Management, he was a Vice President at Chase Manhattan Bank's global asset management and private banking division, where he managed investment portfolios for private banking clients and was responsible for analyzing and recommending the mutual funds and asset allocation models used in their portfolios. He is a Chartered Financial Analyst and a member of the New York Society of Security Analysts. Mr. Bregman holds a B.A. in economics from Cornell University, a law degree from George Washington University and an MBA in finance with honors from New York University. Previously, he practiced law in New York City. Mr. Bregman has appeared on CNN's "Business Day" and WABC-TV's "Eyewitness News," and is quoted frequently in business publications, including *The Wall Street Journal*, *Barron's*, *BusinessWeek*, *Investor's Business Daily* and *Crain's New York*.

SECTOR — GENERAL INVESTING

TWST: Would you introduce us to MJB Asset Management and the products and services it offers?

Mr. Bregman: MJB Asset Management is an SEC-registered, independent investment advisory firm. We create investment portfolios for individuals and provide investment advice to corporate and not-for-profit retirement plans. Our investment portfolios are designed to take advantage of market opportunities while protecting against market downturns. We've been in business since 1997 and manage over \$100 million in assets.

TWST: Please tell us about your investment philosophy.

Mr. Bregman: My investment philosophy and that of MJB is based on the belief that markets always have risks, some of which are seen, but many of which are unseen. Investors are in a tricky situation because — as is natural — they seek the comfort of predictability, yet the markets in which they invest are completely unpredictable, which results in a high degree of stress for investors seeking certainty in markets that

offer none. How does one navigate the chaos? Is it possible to bring order to the markets? Perhaps or perhaps not, but one can certainly bring order to their investment strategy.

At MJB, we use a wide variety of investment vehicles and techniques to create portfolios that bring a level of certainty to uncertain markets. We utilize traditional stock and bond investments, but also allocate at least one-third of each client's portfolio to alternative hedging strategies. We then place a tactical overlay on the strategic foundation: depending on market conditions and the current investment environment, we shift among those three categories — stocks, bonds and hedging strategies — to manage market risk.

TWST: You've spoken of an "ah-ha" moment in October 2002. Please tell us about that realization and how it led to where you stand now.

Mr. Bregman: The October 2002 "ah-ha" moment came out of an experience that I call "the best client I never got." A former business colleague of mine from earlier in my investment career, when I worked at

a large bank, sought me out to tell me that her mother needed some investment guidance. It was the ideal referral situation and seemed like a sure thing — but, long story short, I couldn't close the deal.

I spoke with my former colleague's mother in October 2002, at the depth of the tech wreck and post-9/11 market drop, when all major equity markets were down 30% to 40% from 2000 highs. She said two things to me. First was, "I'm looking at the paragraph of your investment advisory agreement where it says that you have discretion to manage my portfolio. I wouldn't give anybody that kind of authority." The second was, "I think I'm better off just putting it under the mattress." That was it, no more discussion. And that was my "ah-ha" moment. I suddenly saw that there is enormous dissatisfaction with the delivery of investment advice, particularly at the retail level.

Many people cannot count on their advisers to do much more than put their money into the market, and hope and pray that the markets go up. Of course, as we mentioned before, the markets are completely unpredictable. That engenders hopelessness among investors. It was because of that "ah-ha" moment that I made the commitment to do something different. The conventional wisdom — put your money in the market, hold on for the long-term and all will be well — puts investors on a road filled with potholes and blind curves with no shock absorbers or steering wheels. In effect, it exposes investors to the full brunt of market risk. Many investors are not prepared for that risk, and as a result do not have satisfactory investment experiences. I began looking for ways to limit market risk. My search led to alternative strategies, i.e., strategies that hedge against market risk by using short selling, options, futures and/or swaps.

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At MJB, we implement our strategies primarily through open-end mutual funds. Back in 2002, very few mutual funds utilized hedging strategies. I began incorporating those funds into our client's portfolios. By 2003, a wider variety of hedging strategies had become available in mutual funds, and I had developed a strategic commitment to using many of those hedging strategies to protect our clients against so-called "unforeseen" market drops. In effect, we are insuring against catastrophic losses in client portfolios, willing to give up some upside in exchange for protection on the downside.

Our rationale for doing so is twofold. First is the math of large losses. The more you lose, the more difficult it is to recoup the loss, e.g., if you lose 50%, you must earn 100% to get back to sea level — so it is better to limit losses as much as possible. Second is the tendency for investors to make suboptimal, often knee-jerk decisions when markets are at extremes, like piling in just when market valuations are unsustainably high or selling just ahead of the post-drop rebound, so it is wise to take the ex-

trêmes out of the market. Our goal is to keep our portfolios smoother and allow our clients to relax a little bit in the face of market volatility.

TWST: You've also talked about investing in the moment, which is one of your big themes, and making investment decisions based on the current investment environment. How do you incorporate macro events and day-to-day news as you do that?

Mr. Bregman: Day-to-day news is important, but it does not typically influence our investment decisions, at least not immediately. In fact, day-to-day news — e.g., European debt crisis, Arab Spring, debt ceiling gridlock, things that drive markets down 5% in a week — is much of what we're hedging against so that we do not make impulsive and possibly suboptimal decisions.

As macro events take shape and affect the pricing and/or risk levels of stocks and/or bonds, they present potential opportunities to make significant gains and/or avoid significant losses. My job is to observe when those opportunities arrive and take advantage of them by choosing whether to shift our allocations among stocks, bonds and alternative hedging strategies. Given that we have a risk mitigation strategy in place, we can stay "in the moment" — free to be flexible and make changes without being stuck in the past or lost in the future — as we adjust portfolios to help our clients reach their goals.

TWST: How does the typical portfolio break down these days?

Mr. Bregman: Right now, we are underweight in bonds, at perhaps 20% of a typical portfolio. We have moved our equity exposure to between approximately 33% and 40% of client portfolios. Alternative strategies make up the remaining 40% to 45%. Within the bond allocation, we are finding value

Highlights

Richard Bregman discusses his firm's investment philosophy, which focuses on limiting market risk in clients' portfolios. He says shifts among stocks, bonds and hedging strategies are made depending on market conditions and the prevailing investment environment. Mr. Bregman talks about how MJB implements its strategies primarily through open-end mutual funds. He also discusses the typical makeup of his clients' portfolios and the fund selection process, in which he meets with management and auditions mutual funds in his personal account, and then integrates them into clients' portfolios.

in distressed credits and high yield. Within the equity markets, we are allocating to deep-value managers as the current environment favors value-oriented stockpickers who are able to find and load up on really great stock bargains and position themselves and their shareholders for the updraft to come. Within alternative strategies, we are finding opportunities in arbitrage strategies, including merger arbitrage and convertible bond arbitrage.

TWST: Last time we spoke, you talked about the selection process that you use for choosing funds. Rather than repeat that, would you give us an example of a new fund you've added and some background on why you chose it?

Mr. Bregman: When analyzing a fund, I draw a line between relative return and absolute return strategies. Funds in the world of relative returns track and measure their performance against a benchmark such as the S&P 500. Anything that can potentially cause the fund to deviate significantly from its benchmark is cause for concern. On the

absolute return side of the line, the analysis is very different. Absolute return funds, we also call them alternative strategies, seek a low correlation with standard benchmarks and/or reduced volatility compared to standard benchmarks.

There's a new fund that I've recently selected that is investing primarily in "special situation" stocks, i.e., stocks of companies that are misunderstood and thus undervalued by the market but that are well-positioned because they have a catalyst in place for change, e.g., a merger or spinoff, a new product launch, a change in management, etc. The stocks are not darlings of investors at the moment, but the companies have good fundamentals. This particular fund happens to be new. Many investment advisers want to see a three-year track record and a Morningstar rating, but I am prepared to invest much sooner if I believe in the fund's management team.

The first thing I do is meet with the manager. In this case, I knew the manager from his prior experience. However, that is not enough, so I asked detailed questions about the portfolio, his strategy, his decision to form a mutual fund when he has hedge fund experience, family office experience and institutional experience. I asked him about his goals, his background and his business strategy. In my view, integrity is a huge issue. I look for managers with integrity, who understand what they're doing and have a vision of what they want and why they want to do it. If those criteria are met, I buy a position in the fund in one of my personal accounts to see if it performs the way I expect.

This particular fund is a directional strategy, primarily long and global in focus. But they always have a portion of the portfolio hedged, because they want to control and mitigate risk. The asset base is still small, so they can be nimble. In this case, the fund performed nicely in my personal account, and I started integrating it into client portfolios. That's one type of strategy.

Here's another example. A well-known mutual fund company came out with a new fund in which they combined their existing fundamental, bottom-up, long, non-U.S. stock-picking strategy with a quantitative-based short strategy — seeking to maintain exposure to the markets while protecting against downside risk. I was in the room with both the fundamental long manager and the quantitative short manager, and I wanted to see how they interplayed with each other, and if there were any potential biases because they know each other and work for the same firm. I wanted to see what happens if the long manager loves "ABC" stock but the short manager wants to short it. They said it doesn't happen, but that if it did, they have risk control measures in place to reconcile that in a way that makes sense for the portfolio. Again, I bought the fund for my personal portfolio, and it performed as I expected it to. I've begun integrating it into client portfolios as well.

On the fixed income side for standard bond funds, we look at standard criteria: risk, returns, duration, correlation to the market. But for funds taking an alternative approach to the bond markets, such as investing long-short or in distressed credits, we assess the absolute side of things. We see the manager, hear about strategies, evaluate the absolute performance and make a decision.

TWST: What are the two or three best reasons for a long-term investor to look closely at MJB Asset Management?

Mr. Bregman: The number one reason is that through our investment philosophy and the way we implement it, we are really seeking to provide calmness amid the chaos. That's a differentiating feature. I do not tell clients we are going to beat the market and get unbelievable returns all of the time. I tell them that the future is unknown, and rather than give them sales lines like "we've got analysts on the ground in Singapore, Beijing, London and Sydney" or "every time we've been in the third year of a presidential cycle with interest rates below 2% and a split Congress, the market has done 'X,'" I tell them sincerely that although the markets are unpredictable, I will be with them every step of the way, and we are going to protect against unforeseen market drops and still participate in unforeseen market boosts. We are going to be steady and not hit the extremes.

Second, we seek to remove limitations and remain flexible every step of the way. We seek to be in the current moment so that we can keep our portfolios in line with what is currently best for our clients and adjust their portfolios in a way that is appropriate for each of their unique, specific and sometimes changing goals. In that regard, we view the road to our clients' goals as a journey embarked upon in partnership. We are there to plan and guide the way. Of course, our plans must be flexible and allow for changes, because the future is unknown. We might not know what's behind a bend in the road until we get there — this is why we hedge our portfolios.

We do not limit ourselves to just putting money into some combination of stocks and bonds in year one, and then sitting back and hoping and praying that the market goes up. We don't follow conventional wisdom just for the sake of it. We do what makes sense. We take an active approach to limit risk and seek gains where they are available. I believe that's different from many advisers. Many investors pay lip service to that, but do they actually do it? And that has to do with our "ah-ha" moment and what we do.

TWST: Is there anything else you would like to cover?

Mr. Bregman: Another differentiating factor is our strategic commitment to including alternative strategies in every portfolio. We want to make sure that everybody is protected in a substantial and significant way against the vagaries of the market. Although the market is uncertain, there are terrific opportunities to be had, but you must seize them when appropriate and avoid them when not, and of course, hedge against the unexpected part. Also, we eat our own cooking. We invest personally in exactly the same way we invest for our clients.

TWST: Thank you. (MJW)

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