HEDGE
MAR
Issue No. 25
January 1996

Reprint

Steven Abernathy Group

Discovery of Interactive Investing

Publisher's note

This article originally appeared in the January 1996 edition of MAR/Hedge. Some minor changes have been made to reflect updated and corrected information. The article is in all other respects identical to the original.

Reprinted by permission

© 1996 by Managed Account Reports Inc. All rights reserved. Reproduction in any form forbidden without permission.

The reports on investment managers published in MAR/Hedge are based solely on information and data supplied by the respective investment manager. The accuracy and completeness of such information and data have not been verified by the publisher, and therefore we do not and cannot guarantee the accuracy or completeness of such information. Further, any statement non-factual in nature and any statements of opinion constitute only current opinions of the authors, which are subject to change and not necessarily the opinions of the publisher. No information in this newsletter constitutes or should be interpreted as a solicitation for investment in any of the investments reported on. A prospective client should independently investigate an investment manager before engaging the services of that manager, and should consult with independent qualified sources of investment advice and other legal and tax professionals before using the services of an investment manager. Due to, among other things, the volatile nature of the markets in which the investments and investment managers reported in this publication are involved, the investments written about in this newsletter may only be suitable for certain qualified investors, and may be subject to other requirements and/or restrictions enacted and/or enforced by regulatory agencies including but not limited to the Securities and Exchange Commission and the Commodity Futures Trading Commission, and/or other state and federal regulatory agencies. Past performance records as reported should not be considered indicative of future results.

Discovery of Interactive Investing

Clients help manager identify and evaluate investments

By Javed Malik

STEVEN ABERNATHY GROUP
COWEN & COMPANY
Financial Square
New York, NY 10005
USA
Tel: +1.212.495.6827
Fax: +1.212.495-8627

Vital Statistics

Assets under mgt.	$45 million
Aggressive Strategy	$23 million
Moderate Strategy	$12 million
Conservative Strategy	$10 million
Minimum investment	$500,000
Redemption	Annually
Registrations	Broker-dealer, RIA
Fee structure	
Management fee	1%-1.5%
Incentive fee	0%
Domicile	New York
Auditor	
Price Waterhouse	1994

Steven Abernathy and Gary Leet

In the ever-evolving dictionary of financial terms, Steven Abernathy of Cowen & Company's Steven Abernathy Group has added a new entry - Interactive Investing. The concept implies proactive interaction between the investment manager and their investing clients for identifying and researching investment opportunities. Abernathy Group, consisting of a partner of Cowen & Company, and his research, investment and marketing teams, uses these techniques to manage $80 million worth of assets of which $45 million are in three hedge fund like composite strategies.

"This success can be replicated in other spheres of investing; it is, in fact, the investment style of the future," stresses Abernathy. He believes that, much as mutual funds fundamentally changed the way people invested less than half a century ago, his concept will revolutionize the investment world. "The future is for this kind of investing as it is in line with the needs of the times," he asserts.

A basic assumption of the technique is that a traditional hedge fund manager cannot be an expert in all fields and technologies in which he invests. Because the manager's knowledge of particular industries, technologies, and products will always be inferior to the experts in those spheres, a value-added approach could be used to bundle the expertise of the manager and the expert. "Traditionally, hedge fund managers have been wearing all hats to fulfill these functions, but with the rising complexity of the real world, it has become increasingly difficult for them to do so."

The best way to establish a link between the experts and hedge fund managers, in Abernathy's opinion, is to form a partnership in which the experts in their fields invest their assets with the fund manager and provide their expertise to him in the opportunity identification and evaluation process. "This works much better as the investing experts have a stake in their advice and [it] is very cost-effective compared with hiring the experts as consultants," says Abernathy.

Information-edge

The Abernathy Group currently has about 100 experts in the medical, pharmaceutical, and biotech fields who invest their money with the group and work as eyes and ears for the manager when investment opportunities arise in their respective fields. "We can say with confidence that we have the best possible legally allowable information and knowledge of more than 150 companies which fall under our purview," Abernathy says. The group also has interests in electronics, computer hardware and software, telecommunications, wireless communications, networking, semiconductors, and multimedia companies.

The group employs this information-edge strategy for risk control as well. "We do not overdiversify as it hurts the performance," says Gary Leet, senior vice president. He believes that risk can be substantially reduced by obtaining an informational edge, and that it is a common misconception that only diversification can significantly reduce risk. "If one is able to get the best possible information about a company, the risk is already minimized," Leet asserts.

As a result of the group's confidence in this informational advantage, the manager only holds about a dozen positions. "We go out and thoroughly research the companies which we invest in, we not only talk to their management but also to their competitors, suppliers, consumers, and others in the industry; this, along with the insight of experts we have in that industry, helps us form opinions," Leet adds.

Concentrating on healthcare and technology, the aggressive strategy has returned a well-above-average annualized return of 67% during five years of operation, compared with 19.4% for the

Steven Abernathy Group
Cowen & Company

PERFORMANCE HISTORY

January 1991-October 1995

	Aggressive Strategy	Conservative Strategy	MAR/Hedge US Opportunity Median
Return (%)			
Annual Comp. Rate	67.05	25.63	19.39
1991	142.65	N/A	23.00
1992	44.47	11.12	21.19
1993	147.18	63.75	19.50
1994	-6.25	1.02	1.02
1995 (10 mths)	46.99	30.44	19.18
Risk (%)			
Annual Std Dev	42.21	26.48	12.30
Maximum Decline	-40.23	-28.20	-9.63
Return/Risk			
Sharpe Ratio	1.02	0.90	1.02
Correlation with Benchmarks			
S&P	0.02	0.06	
T-Bills	0.00	0.00	
Lehman Bond Index	0.03	0.01	
MAR Trader Index	0.06	0.01	

MAR/Hedge median of US opportunity hedge funds. The strategy returned huge returns of 142.7% and 147.2% during 1991 and 1993 respectively.

"We only invest in the company's growth, and our approach is micro-based. Relative value is what we are looking for and that is why we are able to identify value even in the technology sector."

The managers call themselves investors as opposed to traders and put great emphasis on the future cash flow of a company when deciding to take a position. "We are only interested in growth and do not care about income," Abernathy explains. They do not invest in an industry that is growing at less than 20% per year. Positions are only taken in publicly traded companies. "We are presently generating venture capital returns by using publicly traded companies," says Abernathy.

Long-term fundamentals

A company may be followed for years before a position is taken, and once the position is taken it is held until a desired event has taken place, like the development of a new product. One example of this long-term investment is Orion Pictures, which the group owned from February 1993 until the end of 1995 before taking profits.

The group's best risk adjusted investment was AT&T, in which the group went long in mid-1991 when AT&T's stock was trading in the $25-$30 per share range and closed the position in 1993 when it was in the $60 per share range.

The worst trade the group ever made was in Altera Semiconductors. The group went short in 1994 when Altera's stock was trading in the low-$30 range and decided to take their losses when it was trading in the low-$50s. This trade turned a positive 1994 into the only year in which the strategy's return was negative.

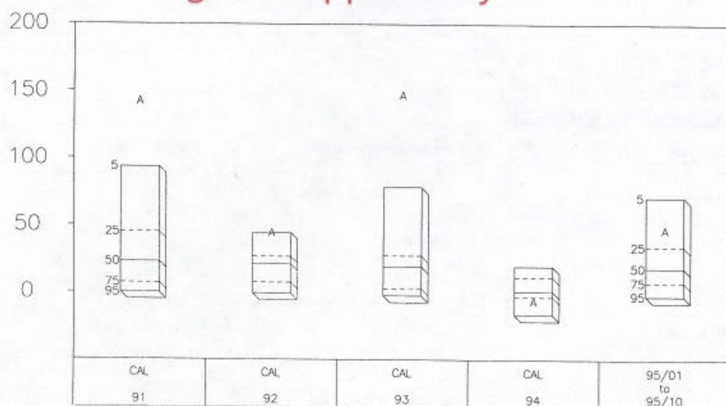
The managers do not equate volatility to risk. "A true investor embraces volatility as it puts money to work more inexpensively," Leet explains. "We try to figure out the business cycle and the business plan of the company and invest according to our expectations of that plan maturing," he adds. If a manager is able to maintain his position for the time period anticipated to bring in the desired results from a new product or business maturity, risk is significantly reduced, according to Leet.

"When people look at our very high returns they think we must be taking a lot of risk to make this possible but this is absolutely not the case," says Leet. Volatility, as reflected by standard duration and maximum decline, are much higher than the MAR/Hedge median. The Sharpe ratio for the aggressive strategy is 1.0 and for the conservative strategy, 0.9.

They do not use stop-loss orders, believing that the market makers tend to take advantage of them at the investor's expense. The group occasionally uses futures and options to hedge its positions.

The management fee is 1.5% for assets up to $1 million and 1% for assets over $1 million.

Returns: Aggressive Strategy vs MAR/Hedge US Opportunity Universe



The Interactive Investing trademark is owned by Steven Abernathy and Gary Leet.

HEDGE

MAR

Managed Account Reports, Inc.
220 Fifth Ave., 19th Floor
New York, NY 10001-7781
United States of America
Tel: (212) 213-6202
Fax: (212) 213-1870

President
Greg Newton

Editorial
Managing Editor and Vice President
Lois Peltz
Associate Editor
Mark Aronson
Javed Malik
Editorial Assistants
Cindy Aber
Karyn Fry
Indira Peters

Subscriptions
Subscriptions/ Customer Service Manager
Lydia Soto

Conferences
Conference Manager
Lora Ballato
Conference Officer
Jeannie Lee

European Operations
Managed Account Reports Inc.
Park House, Park Terrace
Worcester Park, Surrey KT4 7HY UK
International Business Manager
David Setters
Tel: +44 (171) 827-9977
Fax: +44 (171) 827-5236
Associate Editor (Europe)
Katy Massey
Tel: +44 (171) 827-9977
Fax: +44 (171) 928-6539

Publication Consultants
Leon and Joy Rose
11120 Woodelves Way
Columbia, MD 21044
Tel: (410) 730-5359
Fax: (410) 730-3873