



**Diamond Age**

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*August 2007*

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## ESCAPING RISK

Having left the USSR in the late 1980's, Slava Rabinovich became a successful investment manager. What is his working style? Cautiousness. *Pavel Miledin.*

Sprawling before our eyes from a window in his 22nd floor office of the Tower 2000 business centre off Kutuzovsky prospect is the construction ground of the "Moscow-City" mega-complex. "Maybe we will have our office there", says Slava Rabinovich, CEO of the asset management company Diamond Age Capital Advisors, pointing at the mirror-like skyscrapers still under construction. The company manages a hedge fund of the same name whose assets amount to \$105 million US Dollars.

The Federation Tower – soon to be the tallest building in Europe – as Rabinovich calculated, is growing at a speed of three floors per month. Within the same period, his fund's assets usually increase by several percent. In 2005, in the first incomplete year of its existence, Diamond Age returned a +43.5% profit for its investors, in 2006 +53.7%. From the beginning 2007 and until the end of June, the fund was positive +11.1%, while "the market" as per the Russian Trading System (RTS) Index had dropped by (1.3%) during the same period. Today, based on the Sharpe Ratio co-efficient, Diamond Age is the best (excluding funds with monthly valuation pricing) among hedge funds operating in Russia, (i.e. represents the smallest risk per unit of profitability; such ratings are available, for instance, to HedgeFund.net subscribers).

Rabinovich first learned "to minimize risks" growing up in Leningrad. His father was a Kirov Theatre viola-player, and his mother was a teacher of the Russian language and literature, who graduated from the Leningrad State University. But it was difficult to enter Leningrad State University at that time - one of the leading universities in the USSR - with his family name. It was 1983 – the war in Afghanistan was in full swing and military service was the alternative in store for him. Having no desire to serve in the army, Slava entered the Leningrad Electro-Technical Institute of Communications. Upon graduation in 1988, Rabinovich made up his mind to emigrate, and in the autumn of the same year he obtained permission to leave the USSR. America was his goal.

He left the country, as he says, with a hundred dollars in his pocket and with two suitcases. Those contained binoculars, telescopes, cameras, soviet badges – all for sale.

On his way to America he stopped over in Italy, where Rabinovich made his living as a fruit-picker on a farm, and on Sundays he sold soviet goods in a flea market in Rome. Several months later, by the time he received the status of a refugee and authorisation to enter the USA, his fortune had increased to several thousand dollars.

On his arrival in the USA, the Young Men's Hebrew Association assisted him in finding a job. He worked in its New York centre in Manhattan, and later he sold electronic equipment and mobile telephones. In 1994, he borrowed US\$100,000 and set off to earn an MBA degree at the New York University Stern School of Business. A year later he received his American citizenship and the name Slava in his passport. Today he has dual citizenship; his Russian passport that he received in 1995 instead of the one that was taken away on his departure still has his former name – *Vyacheslav*.

Upon graduating from the business school in 1996, Rabinovich found himself at Hermitage Capital Management established by Bill Browder, an investment fund dealing in Russian securities. Help came to him from Yuri Lopatinsky, managing director of Creditanstalt Investment Bank (now the owner of the First Mercantile Capital Group). It was he who showed Slava's term paper on valuation of Russian companies to Browder.

At first Slava was tasked with analytical work; later he was entrusted with making transactions. For four years he was Browder's assistant portfolio manager. "I realised that Bill was not going to retire and I would be forever his right-hand man with no other prospects", Rabinovich recollects. With these feelings he left Hermitage Capital Management in the year 2000.

For a while he worked at Renaissance Capital, another investment company, created by foreigners, and later for the MCM Capital Advisors established with the support of Andrei Melnichenko, one of the founders of the MDM Group. The MCM fund was dissolved in 2003 due to Rabinovich's leaving the project.

That was how the Diamond Age Capital Advisors was born. At first, it managed a little over \$2 million US Dollars – "friends and family money" from Rabinovich himself, and past business acquaintances. Gradually, private and institutional investors joined the list of Diamond Age clients. Today there are more than 80 investors in the Diamond Age Russia Fund; among them, according to Rabinovich, four members of the Russian Forbes "Golden 100" and several representatives from the Forbes list of the wealthiest international businessmen.

Diamond Age has a client policy similar to that of its multiple competitors – hedge funds dealing with Russian assets: for instance, the Red Star Double Alpha (managing company Red Star) or the Russian Prosperity Fund (Prosperity Capital Management). To become a Diamond Age investor one ought to transfer no less than US\$100,000 to the fund's administrator on the Cayman Islands – CIBC bank (Canadian Imperial Bank of Commerce). Investors can subscribe each Friday and redeem shares monthly. If the money is transferred from Russia the investor is obliged to explain its origin, and if, for instance from Switzerland, then it is not necessary. Management fees are 2% of assets and a 20% performance fee on profits above a "hurdle rate" of LIBOR +0.5%.

What is the strategy of the fund? Rabinovich points out a peculiarity of Russian market: as Diamond Age informed its clients in May, in 2006 the raw materials and extractive industries constituted 26.2% of the GDP. However, their aggregate contribution to GDP growth is only 2.8%, meaning that market capitalisation is nearly ten times larger than its share of “growth” in the Russian economy. In other words, the largest weights in the market (represented by the RTS index, for instance) often have the lowest growth rates and often trade at the highest valuations; while the fastest-growing sectors – infrastructure, real-estate, telecommunications, financials, transportation, healthcare, retail, and consumer goods – are underrepresented on the Russian stock market.

In order to construct a portfolio of enterprise specific investments which is inclusive of all of these industries which represent both value and growth, the Diamond Age Russia Fund invests globally, in addition to Russia and the former Soviet Union, in the assets of foreign companies whose core business is tied to economic expansion of Russia and the CIS countries. For instance, the shares of the Great Wall Motor Co, a Chinese automotive manufacturer, that successfully sells its SUV’s in the local market. In 2006, the shares of that company soared from HK\$2.5 to HK\$7.51, by more than 200%. Another example is the Jinhui Shipping and Transportation Limited, a Hong Kong company which trades on the Oslo exchange in Norway, whose vessels sail under the Liberian flag; which actively transports freight and raw materials from Russia to the rest of the world. These shares have more than doubled by 121% since their acquisition by the fund eight months earlier.

The multi-asset class fund invests both long and short in 35 countries around the world, with 130 individual line items in the portfolio. “In this way, we diversify risks”, says Rabinovich. He is also used to risk assessment in selecting his counter-parties, among them there are practically no people whom he has not known for at least seven years. The current maximum investment of the fund into the shares of any single issuer is 5%, the next in size is 3.5%. About 10% of the fund’s assets are “sold short” (predominantly, the shares of specific oil companies and currency derivatives).

What are the results of comprehensive diversification? It is better to evaluate the success of a manager when the market is slipping. In May – June 2006, during the period of 6 weeks, the RTS Index fell by 24.7%, while the Diamond Age Russia Fund lost only 12.4% – which is one of the best results among the Russian hedge funds peers (the best result was shown by the Trust Hedge Fund of the Trust Investment Bank – minus 7.88%). Slava Rabinovich, cautious and seeking not to depend on circumstances, demonstrated his signature style in the Diamond Age project as well.

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