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MAY 2019 • ISSUE 94
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ARE YOU TURNING ALTERNATIVE?

BlackRock is on a mission to make alternatives mainstream but should selectors be following suit? From hedge funds to private debt to Alt Ucits, what does the term mean to you and which funds and managers in these areas are rising up the agenda in your portfolios?

BUYERS' VERDICTS

Lars Murek

Ampega Asset Management, Germany

Alternatives play an integral role in our fund of funds. Our multi-asset DNA is based on the belief that diversification provides the last free lunch in capital markets. For broad diversification we invest strategically in a variety of alternative strategies with different underlying assets, alongside our long-only holdings. We only include Alt Ucits with daily liquidity for our portfolios to ensure funds are managed with the greatest flexibility.

We have mixed feelings about making alternatives mainstream. Growing investor acceptance is generally a positive development, but this in itself may be the root cause for a weaker performance of the peer group going forward. For example, a manager from the long-only space issuing new long/short versions of their funds without having much experience with a short book could underperform quite dramatically. Also, niche strategies that attract too much capital may no longer be able to generate the desired returns due to size constraints. Therefore, a thorough due diligence of alternative strategies remains key. The latest fund we included in our portfolios was **DNCA Alpha Bonds** managed by **Pascal Gilbert** and **Francois Collet**. Currently we are actively screening for a market-neutral long/short equity manager.

Petri Venäläinen

OP Wealth Management, Finland

Investing in alternatives has been a growing theme for a few years, especially since the world entered the zero-interest rate environment. Institutions have particularly increased allocations to real estate, infrastructure and private credit investments, which has served them well. Private banking and retail investors have less possibilities to participate in the illiquid opportunities and therefore asset managers have pushed Alt Ucits funds into the market. The illiquidity and complexity premium has been available for institutional investors, but not for the retail market. Alt Ucits rely on liquid strategies with relatively low overall risk profiles compared with their offshore counterparts, and the results have been mostly disappointing over their history. Therefore, we only invest in a few names in the liquid alternatives space, such as the **Legg Mason Western Asset Macro Opportunities Bond**, **BlueBay Global Sovereign Opportunities** and **Schroder GAIA TwoSigma Diversified** funds. However, we have been more active in the illiquid alternatives area making co-investments with our institutional clients into certain offshore hedge funds, private debt, speciality lending, special situations credit and distressed debt strategies. It certainly makes sense to invest in these areas, assuming you do not need the liquidity, as these alternatives are still able to generate strong returns in a supportive environment, and also take advantage of any forthcoming weakness in the markets.

Bernat Raventós

Solventis, Spain

In a world where central banks are an active player in the market and the risk-adjusted return binomial is becoming more challenging, alternative strategies have become an increasing part of our asset allocation.

It is undeniable that if you want to diversify and decorrelate your client's portfolios you need to add alternatives. When we talk about the alternative universe, we like to include hedge funds, mutual funds and private debt funds.

For example, **Nordea 1 - Flexible Fixed Income** is a fund that has the flexibility to invest in the fixed income universe while yielding attractive returns. This type of alternative fund provides higher returns on a risk-adjusted basis than conventional fixed income rivals.

On the other side of the spectrum, we build our portfolios with funds that provide stable returns and lower drawdowns compared with the equity market. For this reason a fund like **BSF European Absolute Return** is a good fit for our strategy.

If we take a look at private debt, given the mature economic cycle we are in, we need to look for stable, high-quality senior debt. While defaults rates are at historic lows, any tail event may trigger new highs. That's why we like to have a defensive, uncorrelated fund like **Spanish Direct Leasing** in our portfolio.

We are convinced that over time private debt funds will be an even more important part of asset allocation. Identifying, monitoring and selecting the best ones will be key for a successful portfolio.

Pierre Molinero

OFI Asset Management, France

Investors are hungry for yield. Given the low level of rates and spreads, fixed income products are likely to struggle to perform in coming years, so these investors must turn to alternatives. We see alternatives as assets that are able to perform smoothly with a low correlation to risky assets. However, today this doesn't equate to double-digit returns, as was the case for hedge funds before the global financial crisis.

Private debt is an option but we think non-listed assets are becoming crowded with too many inflows for an asset class with limited capacity. The last decade has been tough for hedge funds – lacklustre performance, high fees and lack of transparency have made them unpopular. However, we think the Alt Ucits space offers some attractive opportunities.

The **MAN GLG European Mid Cap** fund is one of them, with a track record of good performance and limited drawdown. **Majedie Asset Management Tortoise** has suffered recently given its bias to the value style but it has been able to generate strong returns in the past. Finally, in the fixed income space, **Montlake Butler Credit Opportunities** has offered a good asymmetry with capital protection during market downturns and strong performance when tailwinds prevailed.

Najib El-Rayyes

Rivers Capital Management, UK

As we enter the latter stages of a mature equity bull market with increasing correlation between equities and fixed income, it becomes even more critical to focus on exposure to alternative assets, or 'diversifiers', within any balanced portfolio. Distinct from 'anchor' and 'enhancer' assets, diversifiers are selected on their ability to derive positive returns while avoiding the primary factors which drive equity and fixed income markets. We define diversifier investments as those with a low correlation to both equity and interest rate risk.

Some of the most popular diversifiers among multi-asset managers have been absolute return strategies. This makes sense but the UK's five largest absolute return funds have struggled to perform over the last three years. Recent increased market volatility may see them recover but in the meantime we are increasingly favouring non-traditional investment approaches. Some, like the **AHFM Total Return** fund, use derivative selling to harvest premium regardless of market direction, alongside hedged equity and commodity exposure. This multi-strategy approach works to de-correlate it from other asset classes.

Traditional property funds are well used as diversifiers and the **BMO Property Growth & Income** fund is solid and has outperformed many larger competitors. However, the potential risk of suspending redemptions and the high levels of cash many property funds are carrying, in order to manage for a poor Brexit outcome, may drive investors into other assets.

We have recently included infrastructure among our diversifiers and added the **FP Foresight UK Infrastructure** fund which has a low correlation to other assets and pays an annual income of about 5%. We have also been encouraged by a resurgence of interest in ABS and funds that take advantage of what has been an out-of-favour asset class. **Wyetree's North American ABS** fund managed to stay up almost 3% in what was a difficult 2018 and will be a good hedge should we at some point return to a rising-rate environment.

The alternatives market has a huge variety of instruments so it is good to see money flow into funds other than the largest absolute return strategies. As long as investors tread carefully around overly-complex strategies with high fees, and ensure assets are uncorrelated to equities and fixed income, diversifiers should make up an essential part of any portfolio. This is particularly the case at a time when broad equity and fixed income markets could come under pressure.

Julius Böttger

MM Warburg, Germany

Anyone seeking an attractive return in times of extremely low interest rates cannot get around illiquid assets, especially when taking risk measurements into account. According to computer simulations we've run, adding alternative assets increases the expected return slightly, and the probability of attaining that return with only little diversification rises dramatically. For this reason we promote and believe in alternative assets as an integral part of a well-diversified portfolio, especially private equity funds. Even in times of crisis – such as the dotcom bubble or Lehman Brothers – private equity funds were able to generate an average return of between 6% and 8% a year. However, we cannot emphasise enough that not every addition of alternative and illiquid assets makes sense. A thorough and well-informed selection process is key. The **Astorius Capital IV** fund stood out in our selection as a vehicle for clients seeking a private equity investment. The fund of funds invests in three to eight target strategies with a focus on the European small- and mid-cap segment. In this way, Astorius indirectly invests in various industries and sectors in Europe resulting in a diversified and risk-reducing basic investment in private equity.

Agnieszka Suplat

CaixaBank Asset Management, Spain

BlackRock's business formula seems to fit perfectly with the current regulatory environment. A differentiated offer, expert teams and added value products with high alpha combined with low-cost passive products creates a perfect mix in a highly competitive environment. In these challenging times we are adding more diversified sources of alpha, especially within the space of quantitative-focused managers. A mix of fundamental strategies and quantitative managers helps us construct robust portfolios with upside potential, protection on the downside and low correlation to markets. Being nimble is key nowadays, especially when looking for new opportunities. Within the alternatives space there are a lot of

BUYERS' MARKET

different, appealing strategies that can add value to a portfolio and one of those is undoubtedly private debt. Although these strategies can be very attractive, we are currently focusing only on the regulated vehicles, in particular Ucits. We construct our portfolios taking into consideration the time horizon of each manager. We are trying to bring together strategies with a longer-term view with more agile managers that adapt quickly to the changing market environment, given that absolute return funds are long-term investments by nature. We are not trying to time our managers although we try to be nimble whenever a new opportunity occurs.

Renato Viero

Akos, Italy

Being a multi-family office firm focused on high-net-worth individuals, our approach might be different from those of traditional institutional investors. In particular we like to have direct exposure to alternatives to retain full control of the features which makes these asset classes so important in a diversified portfolio: the liquidity – or lack thereof – and the correlation with traditional asset classes. We particularly like direct private equity investments in the form of direct participation in the capital of private companies in geographical areas and sectors familiar to our clients. We take the time to dig deep into the balance sheet and get to know the management. Given the state of the market, with private equity firms willing to pay a lot in terms of multiples to be able to deploy capital, we are also looking at a diversified portfolio. This would use public companies with private equity characteristics in terms of fundamentals and capitalisation but with the benefit of liquidity, transparency and efficient cost structure. Verdad Capital is a case in point.

Pierre Bellot

Invesco, France

Most private markets have experienced strong growth over the past years. Private equity, for example, has grown 7.5 times bigger since 2000, according to McKinsey – twice as fast as public markets. In 2018 alone, it increased 18%. While investments such as infrastructure – underfunded worldwide – make sense, the growing trend toward private markets seems to be reaching dangerous territory, especially on the equity side, with valuations now significantly higher than the 2007 peak. Fuelled by the financial repression initiated by major central banks since 2009, this rush toward the few existing growth opportunities forced too much capital to chase too few opportunities. The diversification benefits – mostly gained through infrequent pricing – are flimsy and unlikely to hold when the global economic cycle turns. Furthermore, the resulting asset inflation after years of excessive investment is starting to appear in the public market with, among others, unprofitable ride-sharing companies listing at outrageous valuations at around 10x sales. As far as hedge funds are concerned, the continued extremely poor performances in many areas, from global macro to long/short, should keep investors sceptical.

Overall, in a late-cycle set-up, investors might be better off starting to head for the exit instead of chasing an already very mature and overplayed trend.

Linsay McPhater

Danica Pension, Denmark

Alternative investments encompass a disparate choice of investment strategies that are best defined as those which offer a different approach to risk/return than traditional investments. Selectors should be aware that while there are benefits to diversification, the risk and return will vary widely among alternatives compared with conventional investments, so should not be considered mainstream. Selectors need to think about the objectives and appetite for adding alternative investments into their portfolios.

We are particularly focused on co-investments and direct deals. These give us potential access to the best-performing deals, more control over the investments, more valuable insights and lower fees, as they typically offer no, or limited, transaction costs.

Alternatives covers a wide array of investments including hedge funds, private debt, private equity, infrastructure, forestry and agriculture. We think the best opportunities are currently within private equity, private debt and infrastructure. We are looking to invest in some of the global players and also the local Nordic markets. We don't restrict our search within this area to just Alt Ucits products and consider all alternative funds. Hedge funds, however, are not a key focus at the moment.

SPOTLIGHT ON SELECTORS' PICKS

Bernat Raventós, a selector at Solventi, has recommended the BSF European Absolute Return fund as a source of stable returns with lower drawdowns compared with the equity market. Managed by Stefan Gries and Citywire AAA-rated David Tovey (pictured), the strategy was recently closed to all new investors for capacity reasons. The company wrote to shareholders on 9 January announcing plans to shutter its fund.

Meanwhile, the DNCA Invest Alpha Bonds fund, highlighted by Lars Murek from Ampega Asset Management, is one of the newest launches from this month's list of funds highlighted by the fund selection community. Managed by François Collet and Pascal Gilbert, the strategy has accumulated €3.19 billion in assets since its start in December 2017.

Citywire Verdict

Jessica Beard, Deputy Editor

The road less-travelled can be a welcome change from plodding the beaten track, whether you veer off from necessity or choice. The attractions of a diverging path are particularly strong in the financial world at the moment, as traditional sources of return face increasing challenges.

However, defining the direction of travel is up for debate. The widely-used term 'alternatives' can refer to any number of asset classes. From hedge funds to private debt and from real assets to infrastructure, the catch-all term embraces a variety of more unconventional investments.

But should these alternative solutions become mainstream? The answer is 'no' for Denmark-based fund selector Linsay McPhater, who says that risk and returns vary widely among these investments compared with more commonplace opportunities. However, the likes of BlackRock are on a mission to bring these types of investments into everyday use as it recently initiated a push to take its alternative business to the next level. In doing so, the financial giant created a separate unit for this purpose earlier in the year, a sure sign of commitment.

One thing this month's fund selector panel do have in common is a belief that the alternative universe has truly started to gain momentum and these types of strategies merit some allocation in their portfolios. Whether they have been forced to turn further afield in the hunt for yield and diversification, or whether they have been long-term advocates of alternatives, all selectors are plotting a way forward using this increasingly important stream of returns.

SELECTORS' PREFFERED FUNDS: OLD FAVOURITES AND NEW ADDITIONS

FUND	MANAGER	CITYWIRE RATING
AHFM Total Return	n/a	n/a
Astorius Capital IV	n/a	n/a
BlueBay Global Sovereign Opportunities	Mark Dowding, Russel Matthews, Mark Bathgate	CITYWIRE AAA (Dowding and Matthews)
BMO Property Growth & Income	Marcus Phayre-Mudge, Alban Lhonneur	CITYWIRE + (Lhonneur only)
BSF European Absolute Return	David Tovey, Stefan Griess	CITYWIRE AAA (Tovey only)
DNCA Alpha Bonds	Pascal Gilbert, François Collet	CITYWIRE + (Gilbert only)
FP Foresight UK Infrastructure Income	n/a	n/a
Legg Mason Western Asset Macro Opportunities Bond	Kenneth Leech, Prashant Chandran	CITYWIRE A (Leech only)
Majedie Asset Management Tortoise	Matthew Smith, Tom Morris	n/a
MAN GLG European Mid Cap Equity Alt	Moni Sternbach, Louise Pugh	CITYWIRE + (Sternbach only)
Montlake Butler Credit Opportunities	n/a	n/a
Nordea 1 - Flexible Fixed Income	Karsten Bierre	CITYWIRE +
Schroder GAIA TwoSigma Diversified	n/a	n/a
Spanish Direct Leasing	n/a	n/a
Wyetree's North American ABS	n/a	n/a

INTRODUCING TWO NEW FUNDS

Sturdza Family Fund &
Strategic Bond Opportunities Fund

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