ALTERNATIVE MEDICINE

Alternative investments are gaining traction as an antidote to stuttering global growth and low bond yields. What areas are you targeting to pep up your portfolio? Are you going for infrastructure or property bets or for more sophisticated vehicles like liquid alternatives?

CITYWIRE VERDICT

CHRIS SLOLEY, EDITOR, CITYWIRE SELECTOR

If traditional asset classes were given a health check, the results would be alarming. Declining yields and elusive growth are just some of the symptoms driving investors into uncharted territory. But is it right to prescribe alternatives for a much-needed shot in the arm, or should investors sit tight and wait for conventional markets to recover?

Both Jacobo Silva of Omega Capital and Absolute Return Consulting's Florian Gröschl believe in thinking outside the box when tried-and-tested remedies no longer work. Silva suggests a barbell approach, keeping one foot in the traditional camp, while also tapping into uncorrelated opportunities elsewhere.

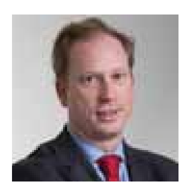
Gröschl pushes the envelope further and says even long/short strategies, once a stalwart for alternative investors, are struggling to provide an antidote. He is instead putting the well-being of his assets partly into the hands of a machine-learning strategy.

Others are adopting a more gradual approach to reviving returns. Afonso Vieira of Total Wealth Management has incrementally upped alternatives exposure over the past three years, while Vontobel's Marc Wong has increased allocations but retained a focus on diversifying the strategies used to unlock new sources of alpha. Regardless of how you take your medicine, José Maria Sanjuán-Martinez, head of fund selection at Santander AM, says alternatives are a 'must' given the dearth of investment ideas elsewhere.

However, Thomas Hellener of German group VSP Financial Services, warns that finding able-bodied alpha generators is not as easy as it sounds.

Read on to find out how this month's leading fund selectors intend to rejuvenate their portfolios.

BUYERS' VERDICTS



FLORIAN GRÖSCHL

Absolute Return Consulting, Austria

Benchmark investing provides market exposure but makes no sense from a risk management perspective. That said, our main area of interest is liquid alternatives and we are always searching for interesting managers and strategies that can provide market-independent returns. Manager and strategy selection is far more important in this area than in the long-only space and is often more interesting.

At the moment, even more traditional strategies in the alternative space, such as long/short equity, are finding it difficult to generate consistent returns in markets manipulated by central banks. Maybe it is time to cast the net a bit farther afield. A fund that we particularly like is the **Tungsten TRYCON Basic Invest HAIG** fund. This strategy consists of 20% traditional CTAs, while 80% is made up of probably the most sophisticated machine-learning strategy that is available in the Ucits space. The beauty of the system is that it takes into account dynamics such as non-linear relations, which are highly complex and not normally on traditional managers' radars.

BUYERS' VERDICTS

FRÉDÉRIC COHEN

OFI Asset Management
France

This incredible bull trend in both equities and bonds seems long in the tooth. As Christopher Rice from Sanditon said recently, investors should be careful what they wish for. On the one hand, the market is long duration and duration proxies, on the other, investors criticise the ineffective monetary policy on inflation and call for radical action like 'helicopter money'.

Clearly, we are not on the side of the long-duration trade, even if it has still got legs. When this trade unravels, both bonds and equities could suffer at the same time. That's why we consider liquid alternatives as the best place to be. But we are very careful about our selection. We invest mainly in market-neutral long/short equity funds or with asset managers that share our macro view.

Liquidity is another issue and is often lacking when most needed. Monetary policy, regulation and a false sense of security have pushed investors to allocate their capital poorly, very often in the same trades. So, if the current trend reverses, everybody will liquidate the same positions at the same time. That's why we are not comfortable with arbitrage strategies outside of long/short equities.

Nevertheless, we do not hesitate to invest in contrarian fund managers, such as **Leonard Charlton** from Dalton, who manages the **Melchior Selected Trust European Absolute Return** fund and **Christopher Rice** who runs the **Sanditon European Select** fund. These managers' recent drawdowns seem a good entry point, rather than reasons to stay away, considering what could happen in a short period of time.

MARC WONG

Vontobel Asset Management
Switzerland

In times of record low yields and negative interest rates the importance of liquid alternatives has increased. Institutional investors, confronted with negative interest rates on cash accounts and negative yields on government bonds are forced to allocate their capital into other traditional asset classes like equities, which increases the risk in their overall portfolio. Alternatively, they can allocate to non-yielding assets like commodities or into alternatives like real estate or hedge funds. Following the financials crisis, hedge funds have expanded their offering by launching part of their strategies in a more liquid format with a least bi-monthly liquidity (Ucits). Since then, the assets under management within liquid alternatives have mushroomed.

In our mandates we currently use a combination of three different liquid hedge fund strategies: global macro, CTA and equity market neutral. Ideally those strategies should have a standalone volatility below 10% and a negative or zero correlation to each other. Also, they should offer daily or at least weekly liquidity. A successful global macro manager we use is **Lucio Soso**, who manages the **Bellevue Global Macro** fund with a three-year annualised performance of roughly 7%. In the CTA space we are currently allocated to the **SEB Asset Selection** fund, one of the few managers with below 10% volatility and daily liquidity.

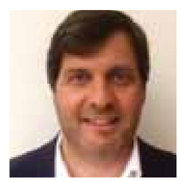
In general it's hard to find consistently outperforming equity market-neutral managers. We used to hold **Marshall Wace Tops** until the fund soft-closed. Instead, we now invest in the **Old Mutual Global Equity Absolute Return** fund, which uses a dynamic equity model we like.

ANDREA PASSONI

Old Mutual Wealth Italy
Italy

Today there are many channels for alternative markets. Alternative investment strategies we like include the **Neuberger Berman US Long Short Equity** fund, and the **Old Mutual Global Equity Absolute Return** fund for its market-neutral approach. To shelter from market uncertainty we invest in the **State Street Global Managed Volatility** fund and for a multi-strategy approach we like the **Deutsche Concept Kaldemorgen** fund.

Although not pure alternative investments, valid substitutes for fixed income include the **Nordea 1 Stable Return** and **Nordea 1 Flexible Fixed Income** funds. We allocate to property via indirect investments managed by Oddo and Morgan Stanley. However, commodities are still too weak to be part of a tactical asset allocation.



JACOBO SILVA

Omega Capital
Spain

With bond yields on the rise, credit markets expensive and equity valuations at fair value, the investment community needs to think outside the box when taking asset allocation decisions. Alternative assets are becoming an essential part of the portfolio construction process in the current low-return, high-risk environment, where the optionality of many traditional investments is moving to the left side of normal distribution.

In order to generate mid-single-digit returns and minimise expected drawdowns, we believe a barbell strategy with traditional investments, based on asset allocation and alternative investments such as low-correlated or quasi-market-neutral funds, is the best approach.

In this area we combine different funds that have low correlation to both equity and fixed income markets. Some of our favourites include the **LFIS Vision UCITS Premia** fund, which tries to exploit inefficiencies in the risk premia world. We also like the **CF Odey Absolute Return** fund for its contrarian investment style, as well as quasi-market-neutral funds, such as **Henderson UK Absolute Return** and **KLS Zebra Global Equity Beta Neutral**, as these should be able to generate positive performance in any market cycle.

AFONSO VIEIRA

Total Wealth Management
Vietnam

If by 'alternatives' you mean all asset classes except equities, debt/bonds, and currencies/cash; then our current exposure is around 25%, up from 20% last year, and up from around 15% in the year prior to that.

There are several reasons for this shift, including low yields in bonds and an equities bull market that is seven years old and largely based on monetarty stimulus rather than fundamentals.

Finally, the low euro vs the dollar has made property in the eurozone more appealing because, if the euro rises against the greenback, the investor will make money on currency appreciation as an added bonus.

BUYERS' VERDICTS

THOMAS HELLENER

VSP Financial Services
Germany

Interest rates are likely to stay near zero for longer than many market participants believe. Bonds are now interest-free risks, so alternative investments have become much more important.

Everybody is looking for the stars of the industry, for managers who are able to generate stable returns even in volatile stock markets with extremely low interest rates. But these so-called 'alpha managers' are hard to find. We invest in the **Loys Global MH** fund, which is a very flexible international equity strategy with an absolute return approach. **Dr. Christian Bruns**, the fund manager, is the largest investor in the fund himself.

We also favour the **STAR Asset Backed ETI**. The majority of its portfolio is invested in **Areca Value Discovery**, a broadly-diversified fund of funds managed by Swiss asset manager Ayaltis. In addition we have increased the weighting of physical gold and silver in our mandates.

JOSÉ MARÍA MARTÍNEZ-SANJUÁN

Santander Asset Management
UK

Given the current market environment, we believe an allocation to alternatives is a must in anyone's portfolio. The complexity of the strategies to employ will be a function of the investor's liquidity constraints and risk aversion. Within the illiquid space, direct lending is definitely the place to be. Investors in this asset class will benefit from a higher-yielding strategy compared with investment grade, while being exposed to the most senior part of the capital structure if they are more risk averse. Yields could vary depending on the leverage employed by the manager and the risk strategy, but high single-digit internal rates of return are achievable within senior and unitranche debt.

If the investor prefers more liquid strategies, senior loans are investable through open-ended structures and tend to offer no worse than monthly liquidity. This asset class will offer a nice yield with little, if any, exposure to interest rate risk and in many cases a senior secured exposure.

Finally, within liquid alternatives, we like long/short equity strategies that are able to benefit from a wider dispersion and may be less exposed to market beta or CTAs.

GISELA MEDINA

BBVA Asset Management
Spain

Alternatives are attracting a lot of interest for a number of reasons, the main one being diversification. Global growth uncertainty, the rise of geopolitical risk and the 'lower for longer' environment in rates have made investors more aware of the need for different sources of returns.

Each client has a particular risk profile and looks for a different attribute in the alternative investment universe. That's why we are targeting funds from the whole spectrum of illiquidity. For those willing to accept more illiquid products, we are selecting from private equity and private debt, to more direct assets like infrastructure and real estate. For those not prepared to assume such a liquidity risk, we are targeting liquid, regulated alternative funds, and looking for attractive risk-adjusted returns and capital preservation in daily or weekly vehicles. We favour quality managers that offer diversification benefits, and therefore prefer those who diverge from traditional investments. We also target flexible and opportunistic managers with proven track records, who add value by having a unique approach. This could cover equity market-neutral, via a quantitative or discretional approach, to opportunistic long/short, as well as global and emerging fixed income and truly diversified multi-strategies.

SPOTLIGHT ON SELECTORS' PICKS

The Bellevue Global Macro fund, picked out by Vontobel's Marc Wong, is producing stellar returns in the highly-competitive Global Macro section of Citywire's database. Citywire AAA-rated Lucio Soso (pictured) has steered the fund to fifth on a 12-month basis out of 52 strategies, and sits fourth over three years and sixth over five. The €215 million fund, which was showcased in the Liquid Alternatives section of this magazine in March 2014, has a keen focus on short-dated bonds, and 55% of the strategy's gross long exposure is allocated here, according to the latest available data. Soso aggressively cut core bond exposure over the start of the year due to fears about low growth.

However, speaking over the summer, he said he was making use of the 'go anywhere' brief of his fund to uncover attractive opportunities in fixed income, particularly in using a barbell strategy to invest in 'safe' government debt, while he had a smaller allocation to riskier debt situations, such as EMD, financials and corporates.

...AND THE REST OF THE FUNDS IN FULL

Funds	Managers	Citywire rating
Areca Value Discovery	n/a	n/a
Bellevue Global Macro	Lucio Soso	CITYWIRE AAA
CF Odey Absolute Return	James Hanbury, Jamie Grimston	CITYWIRE + (Hanbury)
DWS Concept Kaldemorgen	Klaus Kaldemorgen	n/a
Henderson UK Absolute Return	Luke Newman, Ben Wallace	CITYWIRE A (both)
KLS Zebra Global Equity Beta Neutral	Roger Ibbotson & Eric Stokes	n/a
LFIS Vision UCITS Premia	n/a	n/a
Loys Global MH	Dr. Christian Bruns	n/a
Melchior Selected Trust European Absolute Return	Leonard Charlton	n/a
MLIS Marshall Wace Tops Ucits	Anthony Clake, Alan Hofmeyr	CITYWIRE AA
Neuberger Berman US Long Short Equity	Charles Kantor	n/a
Nordea 1 Flexible Fixed Income	Karsten Bierre	CITYWIRE +
Nordea 1 Stable Return	Asbjørn Trolle Hansen, Claus Vorm, Kurt Kongsted	CITYWIRE A (Vorm) CITYWIRE AA (Kongsted)
Old Mutual Global Equity Absolute Return	Ian Heslop, Amadeo Alentorn, Mike Servent	CITYWIRE A (all)
Sanditon European Select	Christopher Rice	n/a
SEB Asset Selection	Hans-Olov Bornemann	CITYWIRE A
State Street Global Managed Volatility	n/a	n/a
Tungsten TRYCON Basic Invest HAIG	Michael Günther, Pablo Hess	CITYWIRE + (both)

SOURCE: Citywire