We’ve been learning recently about an increased appetite in Switzerland for Alternative Ucits funds and alternative strategies in general. So is this true, what's driving it and which funds and managers are EAMs following in this category?

A question mark hangs over whether equities can sustain their impressive growth.

Real estate investments can help diversify portfolios.

Ben Bernanke’s comments in 2013 set off the now infamous ‘taper tantrum’.
Nowadays, with the very low level of interest rates, fixed income instruments are uninteresting. An increase of the rates will come sooner or later and this will impact negatively on bond investments.

SGWM has observed that, as a result of the current aversion to fixed income investments and higher dividends, equity markets have delivered exaggerated numbers for many years. Upside is now limited and riskier. The choice among asset classes is evidently now biased towards alternative strategies.

In the ideal world of alternative investment, both investors and fund managers should be on an even footing and thus benefit equally from the investments creating an all round ‘win-win’ situation.

This hasn’t been the case for many years, as the alternative industry has been weighted in favor of the fund managers, especially hedge fund managers. However, with the Ucits framework, the imbalance is slowly being corrected in favor of the investors.

Increased regulation and better liquidity are the main advantages of the Ucits funds. Some funds or strategies, like highly leveraged funds, won’t be able to adapt. This certainly narrows our choices with regards to various strategies and funds.

SGWM currently recommends investments in long/short strategies, market neutral funds and trend-following instruments to replace bonds and equity allocation.

‘Fixed income instruments are uninteresting’

Our investors are ready to lose a little of the upside in exchange for some ‘insurance’ and accept that their downside could be diminished.

Our recommendations are, among long/short hedge fund managers, the Odey Absolute Return fund and the MLIS Och Ziff fund.

Among market neutral funds, we recommend the Marshall Wace Tops fund and the Kames Equity Market Neutral fund. As for trend following funds, we like the MAN AHL Trend and the MLIS Graham Capital Systematic Macro funds.

‘Today’s markets are uncertain, volatile and show a low level of expected returns’

Today’s markets are uncertain, volatile and show a low level of expected returns. Taking into account all asset classes, building a portfolio has become more challenging.

Understanding underlying securities, costs, macroeconomics, structures and risk management are key elements to take into account when creating a permanent income stream for clients.

Fixed income doesn’t bring returns anymore, except for high yield bonds. Interest rates can only go up in the future (impacting yield) and sovereign debt represents high levels of uncertainty.

Developed equity markets recovered from the last crisis, nearly doubling during this period in some cases and reaching unprecedented levels.

We therefore need to take account of volatility and risks in keeping such exposure. Real estate and commodities remain good hedges against inflation and suitable assets for diversifying portfolios, however, these cannot make up 100% of a portfolio and need to be used tactically.

Consequently, it’s clear that alternative investments are coming back to the forefront. Managers need to be able to go long and short while adjusting exposure from cash to investments (i.e. hedge funds).

Direct investment in private equity funds and collateralised private bonds are also appreciated by investors with an understanding of the underlying companies.

We don’t follow specific funds but we define what criteria should be considered when selecting alternative investment funds.

Bearing in mind that 80% of assets are invested in the same big names, we try and take a step back: big names have high operational costs, are often closed to new investors, can be expensive due to past success, cannot apply fully their strategy due to reputational concerns driving the investment process, and have sometimes reached their capacity.

Emerging managers (under $100 million and a track record of less than three years) often provide a solution to all of the above issues; however, an understanding of structure and risk management should be increased sharply and external counterparts can help in the process.

These emerging fund managers or early stage fund managers bring diversification to investments while offering a real potential of return. Being able to access a basket of niche emerging hedge fund managers adds value to a portfolio in the context of the current market.
We currently find ourselves in a low interest rate environment (in developed markets) and with a question mark over whether equity markets’ impressive growth over the last few years is sustainable.

Several fixed income funds we follow, which in the past few years achieved a return of at least 3%, are struggling this year to reach such levels of performance, while the clients’ demand for a return has not changed. The challenge is even increased when you need to satisfy your more demanding clients who insist on higher returns.

If you have invested in equities in Japan, Europe or pharma-biotechnology, the return still appears somewhat achievable this year; however, next year might prove trickier.

Taking the above mentioned issues into consideration, I do indeed believe that the appetite for alternative investment has increased, not just in Switzerland but globally.

Specifically in the Ucits space, we prefer to work with the Schroders GAIA platform, particularly GAIA Siros and GAIA Paulson. We also follow some offshore funds such as Ayaltis Areca Value Discovery and Catam CAT Gryphon. All of these have managed to outperform equities over time, combined with a significantly lower volatility and an impressive annualised return.

The market for regulated hedge funds has gained momentum, as the latest statistics about EU-regulated hedge funds show. Private investors are starting to ask more and more about these types of alternative assets. The main reasons for this trend are increased transparency and better liquidity terms.

Swiss clients have an interest in funds that can generate alpha and we believe they increasingly understand the benefit of Ucits. Even clients who did not want to invest in hedge funds up till now are becoming more and more open to alternative investments via a Ucits strategy.

The expected returns for bonds are currently less than 1% net, for stocks expected returns are 4% net. For hedge funds we expect up to 7%. This implies that this investment category should be included in an investment portfolio.

But we also know now that after the financial crisis in 2008 the big American university trusts such as Yale had to re-evaluate their investment strategies. The until then successful category of alternative assets became illiquid from one day to another and created problems that were not anticipated.

Currently, however, hedge funds are meeting investor demand for liquidity, in particular via Ucits vehicles. By offering liquid investment opportunities hedge funds have become attractive again for risk-aware investors.

We think risk appetite for Ucits funds is increasing as clients seek to generate steady returns. At the same time, clients want to achieve steady performance with their portfolios with low volatility.

But there is another factor, which is nearly as important as liquidity: the taxation of investments. Gains from offshore funds are being taxed regarding the domicile of the fund. However, funds should reflect the individual tax situation of the client. Needless to say, it poses problems for the hedge fund industry to deal with tax questions as well.

We have successfully implemented the following Ucits alternative funds: OYSTEr UCits Multi Strategy fund and the Swiss Hedge Twin Trade fund. Both funds have the flexibility to perform in different market situations which limits the volatility.

Since 2013, after Bernanke’s remarks on a tapering of QE brought a period of high volatility, there has been increased interest for alternative managers. These represent a very smart solution for getting stable and higher returns than fixed income, without having to accept equity-like volatility. At the same time the Ucits format guarantees a fair degree of transparency, a regulated framework and high level of liquidity.

Clients still remember the bad experiences of post-2008 investing in traditional hedge funds, which, especially in Switzerland, has often been penalised by illiquidity, side pockets and frauds. We are part of an advisory team investing in an alternative fund of funds and have recently observed increased interest in the theme. There are plenty of opportunities in the space, spanning from long/short equities, CTAs, global macro, event driven and so forth.

So a multi-manager fund of funds can offer a best in class-type of sub-categories and top fund managers. To name just a few, we like the JPM European Equity Absolute Alpha, which is a low net long/short European equity fund aiming at positive performances with a low volatility and low correlation to equity markets. The fund has delivered high levels of alpha, gaining also on the short side even in periods of strong bull markets.

Another example would be the Schroder Gaia Paulson Merger Arbitrage, which is the Ucits version of the well known Paulson merger hedge funds. The fund seeks above average returns with low market correlation playing in the merger arbitrage/event driven space capitalising on a strong research team and the accelerating trend in M&A worldwide.