AIMA

AIMA GLOBAL INVESTOR FORUM 2021

A new era for alternative investments

Round-up

Nine talking points from AGIF 2021

1. The attraction of alts has longevity

A panellist who entered the alternative investment space shortly after the Global Financial Crisis said they expected the market to "normalise" with banks re-entering some private lending sectors, but that has not happened and therefore the alternative space has remained attractive. Speakers representing various forms of institutional investors also stressed that the concerns around fees and liquidity for alternative investment strategies can be offset by complementary public market exposures and liquid passive vehicles. Regarding fees, the usual suggestion was made that allocators must assess whether projected returns from hedge funds can be recreated in cheaper smart beta or passive vehicles. Panellists noted however that hedge funds that can offer idiosyncratic returns and diversification opportunities have nothing to fear.

Moreover, although investors downplayed the long-term impact of the pandemic on their allocation strategies, it was noted that the enormous volumes of central bank financial intervention since 2020 means "it's one of the hardest times to invest in traditional long-only liquid markets". As such, the role of alternatives as an uncorrelated revenue source is more important than ever, they argued. Throughout AGIF, speakers articulated how they are looking not just to hedge funds but to the full spectrum of alternative investments as part of their quest to create a balanced and fit-for-purpose portfolio. "It's time to diversify the diversifiers," one panellist concluded.

Investors' increasingly common forays into private markets to explore infrastructure projects, real estate and private equity and credit strategies were noted by hedge funds seeking to capture these allocations. It was further predicted that private markets will present attractive investment opportunities that will be directly or indirectly created as part of the economic recovery from the COVID-19 pandemic.

2. Investors value hedge funds most for downside risk protection

A panel of institutional investors were asked what they look for in a hedge fund, and the unanimous response was a focus on downside risk rather than seeking outsized returns. Protection against drawdowns was cited as one of the key attractions of allocating to alternative investments.

There was also a focus on cash-generation investment strategies not dependent on the market to drive returns. This has become particularly important with concerns about inflation front of mind. Investment managers seeking to join in the democratisation of alternative investments trends were encouraged not to simplify their approach but instead be educational partners to their clients.

Meanwhile, the AGIF audience was told that although the widely predicted interest rates hike may cause fixed income investors to divert some of their capital away from alternatives, the case for hedge funds in an institutional portfolio will not be undermined.

3. Understanding of ESG is crystalising

The first day of AGIF brought together CIOs from a diverse set of institutions across North America and the Middle East serving foundations, public pensions, insurance firms and private wealth clients. The conversation highlighted the role alternative investments continue to play in helping these institutions meet their mandates and serve their clients during and in the aftermath of the pandemic, as well as the increasing focus on ESG when allocating capital.

Panellists referenced how momentum in ESG was building, urged on by regulators and allocators, particularly sovereign wealth funds. Speakers noted that hedge funds have a well-established track record for reviewing their policies around ‘G’, and now the focus was primarily shifting to ‘E’, and those investment factors negatively affected climate change. One speaker commented that – similar to the journey we have all been on in understanding and combatting COVID-19 – the path to more sustainable financial markets is equally unclear and ever-changing as the science around climate change becomes more sophisticated.

In a separate session that touched on industry diversity, the importance of role models was raised. Further, the need to be transparent about career struggles as to underscore success is rarely a linear path. There was also a call to ensure that diversity outreach is not limited to the elite and the industry should be sensitive to socio-economic diversity. Finally, when reflecting on the lessons learned from studying industry diversity, the advice was simple: “talk less, listen more.”

4. Private credit growth demands constant innovation

The panel on private credit opened with a question on how to define such a fast-evolving market. Panellists responded that the expansion of the asset class means simply saying you're in private credit is no longer sufficient to convey what you do. You need to tell your story: whether you are a direct lender, speciality finance provider, opportunistic lender, etc. In terms of the current market, the proliferation of opportunistic credit strategies reflects the need of borrowers for flexible capital solutions and an ongoing hunt for yield. Speakers noted that it's difficult to predict how markets will fare in the context of the ongoing COVID environment and so having investment structures with flexible mandates can help maximise the opportunity set.

Considering inflation uncertainty, investors are mindful of the balance between rate sensitive and non-rate sensitive assets within their portfolios, with some having targets to hedge against perceived risks. Panellists noted that the speed of any interest rate movement, or impact of rising costs in energy and commodities, will likely be more important than the length of time rates are higher.

When asked about future headwinds, panellists noted that the speed of the growth in private credit means market participants cannot take their eye off the ball, or risk being left behind. Similarly, as new market entrants appear, the risk of crowding will intensify, with a potential knock-on effect on overall market performance.

5. APAC demands global investor attention

China and the whole APAC region was repeatedly described as a driver of alpha thanks to the overall growth in regional markets, as well as providing a useful diversifier for global institutional investors that might otherwise be overweight EMEA or North American equities.

Since the Global Financial Crisis, APAC has matured to become "one of the pillars of growth going forward," a panellist argued. Despite the recent volatility, the region has remained resilient and embraced foreign institutional investors. This has led to a blossoming of products and strategies and has also created an environment where large institutional investors will find it increasingly difficult to justify not having a local presence in the APAC markets they're active in. The community of GPs has also followed this trend. A fellow panellist noted that APAC-based GPs of interest to institutional investors used to be largely associated with firms headquartered outside of the region, but now an expanding pool of domestic GPs are offering access to new strategies based on local expertise.

Global trends are also playing out on a local setting in APAC, ranging from Singapore planting its flag as a hub for digital assets to opportunities for ESG-focused products in Australia, Japan, and elsewhere. A panel of global institutional allocators noted that hedge fund managers in APAC will be well-positioned to capture allocations if they can offer a broad range of products and strategies that cover pan-Asian exposures and country specialisms. Although the panellists were not completely aligned on whether generalists or specialists were preferable, they did agree that they are looking for long-term regional partners to satisfy their requirements and offer exposure to alpha-generating market trends, wherever they may be.

6. China is still a wait-and-see market

There are undeniably tantalising opportunities for alpha-generation in China as retail consumption grows and sectors such as internet-based technology stocks boom. However, the uncertain local policy and regulatory situation is giving some offshore investors pause for thought. "There are a lot of interesting investment options in the mix and we are cautiously looking to increase our exposure in the onshore market, but we are waiting for things to settle down a little bit [concerning policy changes]," explained one speaker. Applying a macro and geopolitical lens to the question of China also highlights concerns for some panellists who said they are seeking certainty that the regulatory and social agendas at play do not represent acute risks to investments.
The recent underperformance of Chinese equities in part due to the pandemic, as well as emerging worries around other sectors, such as real estate, may mean global interest in Chinese capital markets may appear lower than expected. But, over the long-term, the interest from offshore investors in China will bear fruit, panellists agreed.

7. Emerging managers: Neglecting your operational infrastructure could cost you

Emerging managers will lose out on investor allocations if their operational infrastructure isn't up to scratch. The ability to leverage technology such as cloud-based data sharing "is a prerequisite" to getting institutional allocation, according to a panellist at a US pension fund. "The pandemic has made investing in cloud-based applications and your operational infrastructure vital to attract institutional money."

The centralised working environment exacerbated the bifurcation of the industry between those who had previously focused on their technology stack – not just in the front office – and those that had to scramble to get digital solutions in place to maintain BAU processes once the pandemic shut down many city centres last year. Allocators said that where a prospective hedge fund fell on this divide often becomes apparent during the due diligence process when it comes to IR functions, data sharing, and operating in the virtual environment.

8. 2021 is a standout year for fund launches

It has been one of the best years for European fund launches in the past decade, claimed one allocator panellist. It was however also noted that these were mostly larger fund launches as smaller funds have been more likely to struggle with capital raising in the decentralised working environment. Moreover, many of the smaller launches in late 2019 have been forced to shutter due to inauspicious timing. One speaker said they were bullish that managers who were forced to operate on a platform or delay their spinouts will feel confident to do so in the near term, creating a wave of new opportunities for allocators.

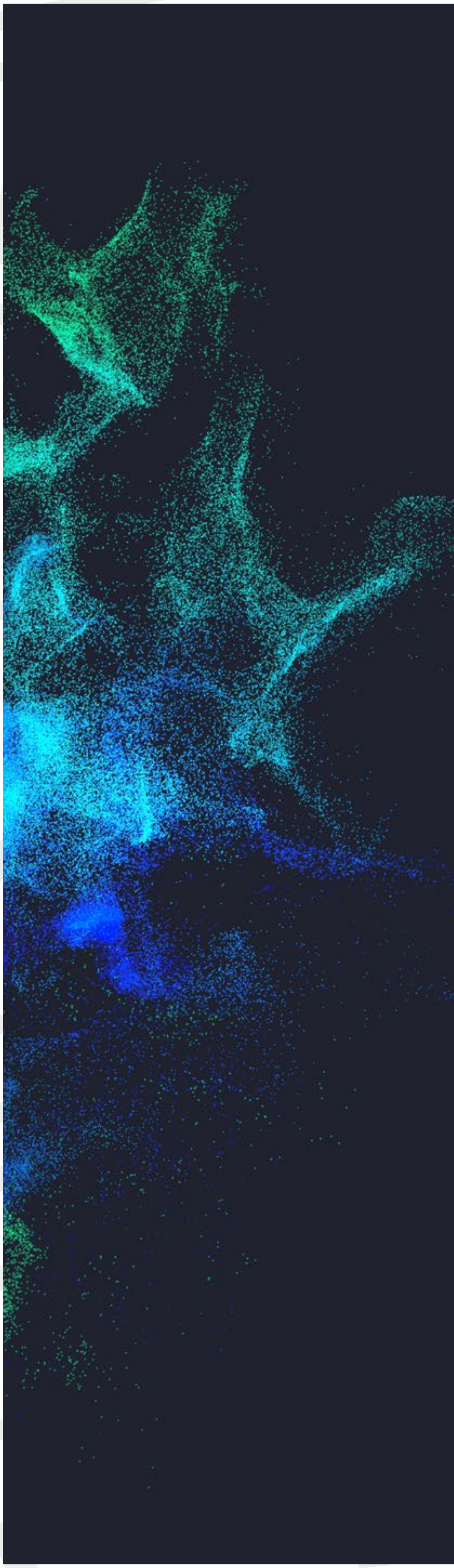
Another optimistic allocator noted that now they were more comfortable with doing at least part of the due diligence process virtually, it will make the process easier for all parties in the future. For fund managers, virtual meetings offer the opportunity to demo their model and make themselves available more readily to answer questions from allocators in other regions. For allocators, it allows them to bring more resources to bear on the due diligence process, including using virtual meetings as training opportunities for junior staff that might otherwise not be present when physically visiting a prospective manager's office.

9. Institutional investors are increasingly comfortable with digital assets

The value of digital assets – specifically cryptocurrencies – are being acknowledged by institutional investors as either a hedge against rising interest rates or as a more liquid form of venture allocation. The most popular cryptocurrencies such as Bitcoin are beginning to exhibit regular cycles in their volatility that consistently trend upwards on a multi-year time horizon, which is giving investors that previously shied away from digital tokens the confidence to reconsider their position.

Panellists noted that Bitcoin also benefits from the most established ecosystem of service providers – including some of the largest financial institutions – compared to other cryptocurrencies, which significantly improves the value proposition. On the other hand, speakers said the most exciting opportunities in digital assets are essentially everywhere but with the frontrunner cryptocurrencies, and those interested in the space should instead look at financing participants in the digital asset sector or market services in some capacity.

Reinforcing this point, a speaker offered an analogy between digital assets and the California Goldrush which inspired the metaphor: "during a gold rush, sell shovels". As the products, strategies, and ecosystem around digital assets mature and allow even newer innovations – such as non-fungible tokens – to thrive then there will likely be a steady stream of opportunities to benefit from this emerging asset class that can be discussed at future AGIF events.



Future AIMA events for investors not to be missed:

AIMA Australia Annual Forum 2021

10th December 2021
8am - 5pm Sydney Time

AIMA & ACC Private Credit Investor Forum

24th January 2022
9am to 3:30pm ET

The conference formerly known as the Alternative Credit Council US Summit took place in New York previously and we look forward to convening delegates in the new location of Miami during Global Alts '22 at the Fontainebleau Miami Beach.

AIMA Canada Investor Forum 2022

October 2022
More details will be available in due course

More information about AIMA events available at aima.org

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