The CIPFA Pensions Network Workshops

Alternative Investments

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Hedge Funds in the past…

- Viewed as a totally **separate asset class**
- Not part of the overall portfolio: simply as **High Alpha return generator**
- Analysing how it fits with overall portfolio
  - **Much lower downside risk**
  - **Higher risk-adjusted performance**
- Hedge Funds as a different way of managing traditional assets

Eggs are safer in different baskets

Diversification

Smoothing out overall risk / profits of portfolio

Potential Pitfalls of Hedge Fund Direct Investing

Gating and Side Pocketing

Governance

- ESG Policy
- Side pockets & gating
- Regulation ?
  - Dodd-Frank
  - MiFID
  - AIFMD

✓ **Need infrastructure to deal with all this regulation**

Asset Allocation ?

→ **How do you vary this**
- Rebalance
- Market Timing

- L/S Equity or Credit
- Macro (every asset class)
- Event Driven

Fees

→ LGPS fee structure ?
→ Or 2 / 20% ?

Macro Outlook

Mild acceleration of global growth but…

China

- Has been a **key driver of global growth**
- A slowdown in China has been evident for some time but the recent **repercussions on related assets** have been significant – dispersion of returns in Macro HFs : -15% → +10%
- **Related economies** (Australia, New Zealand, Canada, Brazil, oil exporting EM) and **commodity prices** have suffered → Terms of Trade
- More recently – developed markets have suffered

Interest Rates Hikes

- **The US and UK** are furthest along in their Monetary Policy cycle
- The US is poised to **raise rates** for the first time in almost 10 years when other major economies are easing
- For first time since 2008 – **finally seeing divergence** of monetary policy
- Markets are clearly concerned (see April 13 'taper tantrum', October 14 Treasury 'Flash Crash')
- Significant **challenges for asset prices** of a change in the **risk free rate** (Government bonds, credit spreads, equity discount rates.
- **Liquidity crisis ?** Bond Markets – if interest rates rise what happens to bond market liquidity i.e. HY/EMD/Credit

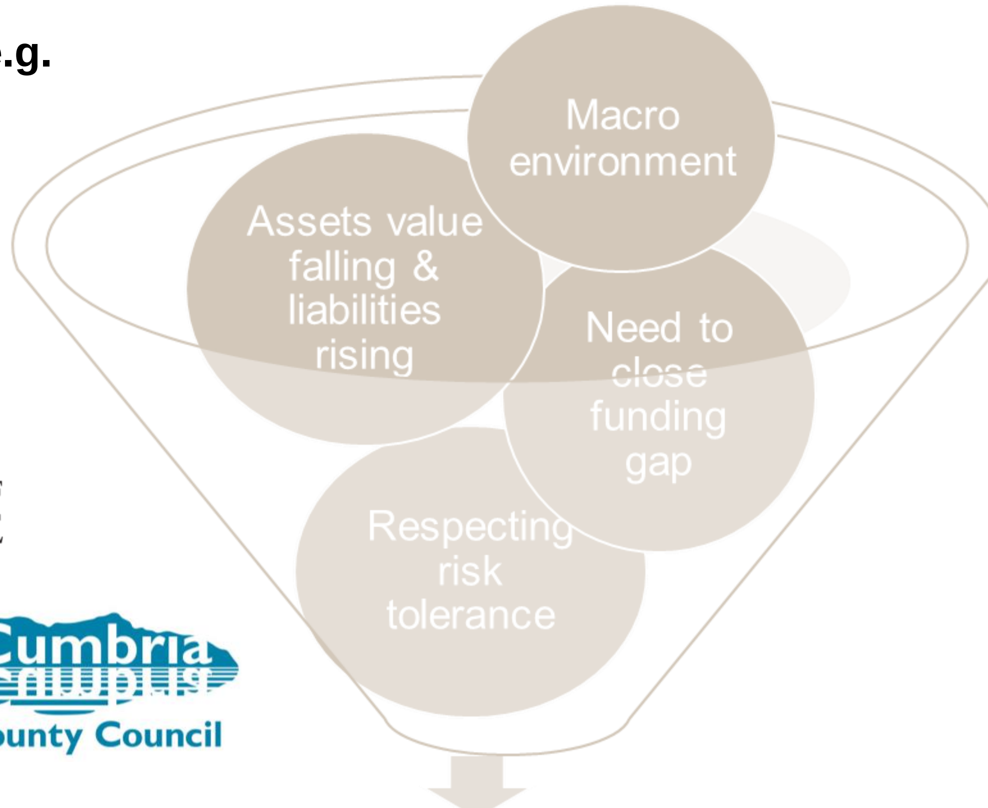
The rise in volatility creates opportunity for Hedge Funds to capitalise on the dislocation

Hedge Funds have evolved, they are capable of much more

De-risking portfolios in a cost efficient manner

Large Institutional Pension Funds e.g.

Where we see the largest demand today



- Opportunities portfolios within LGPS – Strathclyde

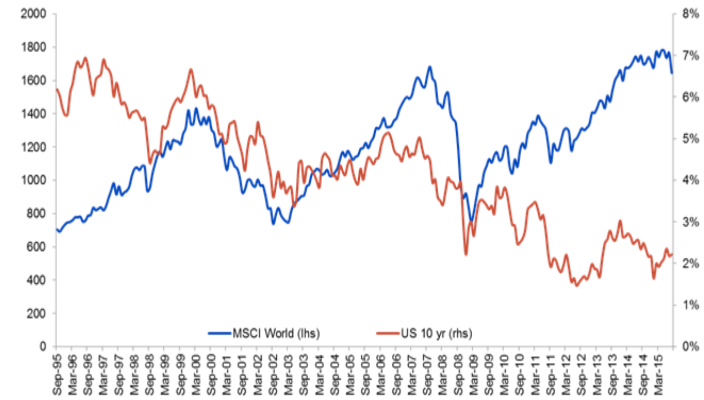
What is going to provide that in the **safest possible environment** is a Managed Account Platform

Can Hedge Funds address your concerns?

Fixed Income is doing nothing and there is risk of Equity market swing

- With Equity and Fixed Income markets at **secular and cyclical highs**, **the risk of a change in direction is elevated.**
- It is time for investors to **revisit tactical allocations ?**
- Changes in yield led to **portfolios assets re-pricing**
- Investors should seek **alternative sources of return** and diversification

Historical returns of Equities and US 10yr Treasury yields



Source: Bloomberg

Bespoke solution approach

Defensive solution

Limit downside risk

Customized to satisfy your specific needs

Absolute Return via Managed Account

Why Absolute Return

- **Investors** put capital to work and they **will be given** a return for a defined level of risk/volatility
- Absolute Return differs **from Relative Return**: it is only linked to the return of a particular strategy, and it does not compare to any benchmark

Why do Investors look at Absolute Return investments?

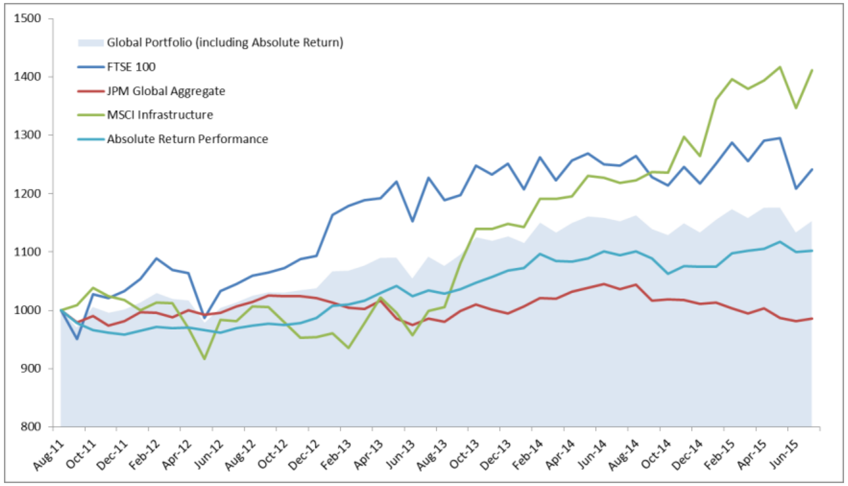
- ✓ Not to match any benchmark but to diversify their traditional Equity and Bond holdings, with a desired risk/return profile
- ✓ Not to be at the mercy of markets
- ✓ Positive return in all market conditions

Risk and Return in the context of your portfolio

An Example on the benefit of diversification

- Portfolio assumptions:
  - 20% in Absolute Return Funds [(1)]
  - 40% in Equities *(UK FTSE)*
  - 30% in Bonds *(JPM Global Aggregate Bonds)*
  - 10% in Property and Infrastructure *(MSCI Infrastructure)*

- Impact of Absolute Return investments on the portfolio since Sept 2011 (Gross returns):



Source: Bloomberg

	Correlation
FTSE 100	0.52
JPM Global Aggregate	0.21
MSCI Infrastructure	0.31

	Annualised Alpha	Beta
FTSE 100	1.54%	0.16
JPM Global Aggregate	2.63%	0.2
MSCI Infrastructure	1.59%	0.1

Source: Bloomberg

(1) Allocation e.g. Dedicated Mandate managed by Amundi AI for a German Corporate Pension Fund

How to invest in Absolute Return funds?

Direct	Vs	Via managed Accounts

How to invest in Absolute Return Funds? What is AIFMD ?

Managed Accounts	Benefits to Investors
European Set up	

Managed Accounts

European Set up

- European **onshore domiciled**
- **AIFMD Framework**. Enhanced information sharing to investors and Regulatory Authorities
- **Obligation to have 100% independent service providers**

Benefits to Investors

- Ensures **safekeeping** of investors' assets
- Avoids **risk of contagion** effect
- Minimizes **operational risk**
- **Reduces resources** required to monitor investments' operational risks
- Ensures **equal treatment** of investors

How to invest in Absolute Return funds?

Via Managed Accounts – Why MAP better than FoHF?

Managed Accounts' characteristics	Benefits for Investors
Improved Risk Management of your Portfolio	**Full transparency[1]**
Rigorous control/ Governance	**Additional safety net for Investors**
Enhanced liquidity	**Managed accounts get preferential liquidity from underlying funds**

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