Switzerland
Hedge Funds
2017

Swiss HFs make effective use of niche strategies
Jabre Capital examines the mid-market sector
Looking ahead to the new era of Alternatives 2.0
In this issue...

04 Niche strategies can help Swiss hedge funds stand out from the crowd
By James Williams

05 The merits of the mid-market manager
Interview with Mark Cecil, Jabre Capital Partners

09 Investing for the future: Alternatives 2.0
By Fiona Frick, Unigestion

13 Syz Asset Management sees value in Asia hedge funds
Interview with Achraf Goneid, Syz Asset Management

16 The importance of ongoing due diligence
Interview with Christian Nauer, SwissAnalytics
IN A CHANGING WORLD,
BY THE TIME YOU MASTER THE GAME,
THE RULES HAVE CHANGED.

ANTICIPATING YOUR BUSINESS ENVIRONMENT
At Securities Services, we support your business in adapting to ever changing regulations. Our expertise across the globe ensures your assets are serviced effectively in over 100 markets.

securities.bnpparibas.com
Niche strategies can help Swiss hedge funds stand out from the crowd

By James Williams

Swiss institutions are looking to diversify their alternative allocations in a bid to improve yield and meet their long-term liabilities. Real estate, private equity and infrastructure funds (and co-investment deals) are a major part of their portfolios with hedge funds still viewed with a degree of caution.

Recently, asset managers like Swiss Life Fund Managers have responded to investor demand by launching the Swiss Life REF European Real Estate Living and Working vehicle, targeting housing, healthcare, office and retail assets. Swiss Life said the fund will invest in “B locations in A cities and A locations in B cities”, an approach known as the ABBA strategy. Real estate assets now account for 21 per cent of Swiss Life’s total AUM.

Part of the reason for Swiss appetite for real estate (and indeed global investor appetite) is that it provides them with a demonstrable route into green, more sustainable investing. The sustainable Swiss real estate fund of Credit Suisse Real Estate Investment Management is a SIX-listed fund that invests in 44 properties in Switzerland with a total value of CHF 2.25 billion and is the fifth largest Swiss real estate fund. Every building fulfills the requirements of the “greenproperty” quality seal developed by Credit Suisse Real Estate Investment Management for sustainable property.

“The hedge fund industry in Switzerland is now in competition with many different asset classes, like private equity and infrastructure funds. As such, in order to raise clients’ interest, hedge fund managers need to excel in terms of delivering on clients’ objectives.
The merits of the mid-market manager

Interview with Mark Cecil

Jabre Capital Partners is one of the industry’s best-known hedge funds. Co-founded in 2006 by Philippe Jabre, Mark Cecil and Philippe Riachi, the Geneva-based hedge fund runs a variety of strategies that include: Multi-strategy, Equity Long/Short, Credit Long/Short, Convertible Bonds and Emerging Markets.

Liquidity management is very much at the core of Jabre Capital’s investment philosophy. Granted, the level of market volatility has been somewhat subdued over the last year or so. The VIX Index spiked following the Brexit vote last June, reaching 25.76, and spiked again in November to 22.51 following the US election, but in general it has remained range-bound between 10 and 15.

All of which would suggest that focusing one’s attentions purely on the more liquid end of the spectrum is overly conservative. But anyone with the same experience of Philippe Jabre knows only too well that it only takes an unexpected market shock to rattle investors.

“Liquidity is a key driver of the investment process and always has been. Philippe has been trading the markets for 35 years and knows full well how quickly markets can change. We adjust to such conditions by focusing on the very liquid end of the spectrum: large-cap stocks, investment-grade bonds, we don’t touch distressed bonds or small-caps; indeed, we rarely have a material allocation to mid-cap stocks,” says Cecil.

One of the more challenging trends in the hedge fund industry in recent years has been the desire for liquid hedge funds to gather large amounts of assets to trade the markets. Some managers have not been willing, or able, to exercise restraint in the best interests of the investment strategy.

At Jabre Capital, the opposite is true. Its Emerging Markets fund, for example, has judiciously maintained an AUM of approximately USD300 million for the last nine years. Some might argue that this is because investors have shown no interest in Emerging Markets but this is missing the point. Some investment strategies are not designed to run beyond a certain AUM. Jabre Capital has made a point of maintaining the fund at around USD300 million to optimise the investment program.

It is only recently, given the increased opportunity set for Emerging Markets, that they have decided to grow the fund modestly to USD400 million or USD450 million.

“What you will never see us do is run a huge EM fund because neither the asset class, nor our investment style, allow for that,” explains Cecil.

“We saw a complete turnaround in the second half of last year with respect to emerging markets. Opportunities presented themselves at single stock and thematic levels and part of that was down to uncertainty over the outcome of the US election. Investors are beginning to focus more on fundamentals and thankfully the markets are showing signs of behaving in a similar way.”

The reason for referring to the growth of some hedge funds as a challenging trend can be tied to the fact that performance across the hedge fund industry, in recent years, has been lacklustre to say the least.

Following 2011, investors re-assessed the way they invested in hedge funds and embraced the consultant community to give them an extra level of comfort. In turn, the consultant community looked to larger managers that were more likely to provide lower volatility, which in some instances led to lower returns.

Since the summer of 2016, however, that approach has changed as institutions have come to realise its limitations.

Such has been the effect of central bank intervention in a bid to stimulate economic growth that investors have become
exasperated by lackluster returns in their hedge fund strategies “because they have persisted in all-market conditions,” says Cecil.

There has, he says, been a shift in mindset such that investors are looking more carefully now at smaller managers to target higher returns.

“Managers like Jabre Capital are beginning to see consultants and investors that they haven’t seen for some time coming back to engage in dialogue. This in turn is leading to new inflows.

“There was a worry that the very largest hedge funds would continue to grow unabated on the back of consultant-led institutional allocations. I think these same institutions are now beginning to broaden their horizons to encompass medium-sized managers in the USD1 billion to USD5 billion AUM range, who are probably better positioned to capture stronger upside returns,” suggests Cecil.

There is a suspicion that some managers have become asset gatherers rather than alpha generators. There is a sweet spot in a fund’s size. What you don’t want is any business risk with the manager such that they can continue to compensate their staff during lean periods of performance.

“For hedge fund firms below USD500 million, it is quite tough to avoid having an overhang of uncertainty with respect to business risk. Once you get beyond USD10 billion, you perhaps have to wonder whether the focus moves away from performance because the management fee becomes a meaningful profit centre.

“At that level, the management fee covers all the manager’s overheads comfortably and becomes a key driver of profitability. That’s not to say that performance is completely overlooked, of course not, but the level of hunger is perhaps not quite the same compared to a mid-market manager,” says Cecil.

Such was the level of dissatisfaction last year that an estimated USD110 billion of net outflows were recorded, according to Preqin, despite a more positive level of performance, which saw the average hedge fund return 7.4 per cent.

“It has been a difficult environment for hedge fund managers to move ahead of the index. But in the last six months, there has been a breakdown in correlations and a greater disparity between sectors and regions partly due to divergence in central bank policy (e.g. US versus Europe). That plays into the hands of active stock managers.

“I think we are now moving into an environment where hedge funds can outperform the indices. I think we will see a reversal of the trend among investors towards illiquid strategies, which have become ‘en vogue’. We are already starting to see evidence of investors considering EM strategies. Six months ago they were generally frowned upon. There was just no interest,” says Cecil.

There is no doubt that increased focus among institutions on the mid-market will be beneficial to the hedge fund industry as a whole. Quite how institutions will allocate remains to be seen. Some will be comfortable taking commingled risk, some will opt for customised managed account programs to mitigate risk.

One theme that Cecil believes could emerge over the next two to three years is more joint ventures and branding partnerships between good quality, medium-sized managers who are looking for assets to give their business models more resilience, and platforms/private banks who are looking for talented fund managers to support HNW institutional investors.

“I think this will be an exciting trend. However, I don’t envisage that they will take equity stakes in fund managers. Rather than just being a third party investor in the manager, it will be more of a partnership arrangement with a fee sharing agreement in place.

“Ultimately, to attract the biggest institutions, mid-sized managers need to grow their assets and this could be one such solution,” concludes Cecil.
when using them in their portfolio allocation:
i.e. consistent, decorrelated returns,” says
Achraf Goneid, Senior Analyst at Syz Asset
Management.

“Hedge funds have been viewed as not
performing too well and expensive by some
Swiss institutions and they’ve been looking
more at private capital strategies: private
equity and private debt have received a
lot of attention, as have systematic hedge
funds and CTAs, which have come back into
favour,” observes Christian Nauer, CEO of
SwissAnalytics.

One such hedge fund is QCAM Currency
Asset Management, an independent Swiss
financial services provider with a primary
focus on currency management. Based
in Zug, QCAM was founded in 2005 and
currently manages approximately USD3
billion in currency volatility and global
macro strategies and bespoke currency
overlay mandates. It is regulated both by
the Swiss Financial Market Supervisory
Authority (FINMA) and the US Securities and
Exchange Commission (SEC).

QCAM’s FX long/short volatility program
is called v-Pro & v-Pro Dynamic. It has a
nine-year track record, a Sharpe ratio of 0.88
and is market neutral in its trading style.
The v-Pro strategy returned 20.06 per cent in
2015, whilst v-Pro Dynamic generated 43.35
per cent positive performance.

It is currently available as a Luxembourg-
domiciled SICAV-SIF and as managed
account. The UCITS-version of the strategy
will go live soon. The main difference
between the two versions is that v-Pro
Dynamic uses around twice the leverage of
v-Pro, although the underlying investment
strategy remains the same.

“Since our inception we always have
been focused on currency management as
the main pillar of our business activities.
For us, the world’s most liquid market with
USD6.3 trillion daily turnover offers a host of
opportunities and we feel investors want to
speak with specialists offering this dedicated
and in-depth expertise,” says Thomas Suter,
CEO of QCAM Currency Asset Management.

Andre Meyer heads up investor relations
and structuring at QCAM Currency Asset
Management. He thinks that interest in all
alternatives will build over time as Swiss
investors turn to a range of strategies

“There aren’t that many who
invest directly with single
managers, they prefer
to take a multi-manager
approach.”

Andre Meyer, QCAM Currency Asset
Management

both liquid and illiquid, systematic and
discretionary, to better protect their
assets against changing global economic
conditions. He observes that aside from
the very largest Swiss pension funds, most
institutions take a FoHF-like approach to
investing in hedge funds.

“There aren’t that many who invest directly
with single managers, they prefer to take a
multi-manager approach,” says Meyer.

This might explain why Swiss investors
have remained slightly reticent with respect
to hedge funds given that many were badly
impacted in 2008. The reason for relying on
external consultants and FoHF advisors in
the first place, however, is because of size
and capacity constraints. In the US, Canada
and the Nordics, it is, says Meyer, a different
numbers game in terms of the personnel
they have for their allocation programmes.

“They have dedicated alternative
investment teams where they analyse
the managers, do the due diligence and allocate
accordingly. But for the mid-tier pension
funds in Switzerland, they prefer to go the
FoHF route where the FoHF manager has
in-depth experience analysing managers on
behalf of the end investors,” says Meyer.

One such management group is Pictet
Alternative Advisors, an independent arm
of Swiss private bank Pictet Group, which
manages north of USD18 billion in alternative
assets. Nicolas Campiche is CEO of Pictet
Alternative Advisors. In his view, it is a fairly
positive backdrop for hedge fund investing,
both from a tactical and a secular point of
view. Indeed, 48 per cent of institutional
investors surveyed in a new Barclays Prime
Services report (Turning the Tide: 2017 Global
Hedge Fund Industry Outlook and Trends)
confirmed that they plan to increase their
allocations in 2017, compared to 33 per
cent in 2016.
Co-creating with you the investment solutions that meet your needs

clients@unigestion.com

www.unigestion.com

WE GUIDE YOU THRIVE
In a world where returns from traditional asset classes are under pressure, many investors are turning to alternative investments to boost their portfolio’s performance potential. However, although an allocation to hedge fund strategies offers potential for attractive risk-adjusted returns and portfolio diversification, the low interest-rate environment has thrown the issue of fees into stark relief.

There is little doubt from our experience that skilled hedge fund managers provide a valuable source of uncorrelated alpha for long-term investors. However, advances in quantitative modelling have challenged traditional definitions of alpha and raised the possibility of accessing alternatives in a more cost-effective way.

**A new paradigm for defining hedge fund returns**

Academic research has questioned the unique attribution of hedge fund returns to market beta plus alpha, less fees.

\[
\text{Hedge Fund Net Returns} = \text{Market Beta} + \text{Alpha} - \text{Fees}
\]

The reality is more nuanced, with much of what was thought of as alpha proven to arise from differentiated alternative risk premia which can be captured through liquid investment strategies. There is still room for true alpha, but this opens up the possibility of a new way of accessing alternative investment returns.

\[
\text{Hedge Fund Net Returns} = \text{Market Beta} + \text{Alternative Risk Premia} + \text{Alpha} - \text{Fees}
\]

**Alternatives 2.0: how Unigestion combines alternative risk premia and hedge funds**

We believe that harvesting risk premia and generating alpha are best viewed as separate categories, to reflect very different liquidity terms and pricing structures. Drawing on our expertise in this area, we combine a directly managed allocation to alternative risk premia with a number of carefully selected diversifying third-party hedge funds, selected for their ability to generate uncorrelated alpha.

The result is an integrated alternatives solution, with the characteristics many investors are looking for and which can also overcome many of the challenges associated with traditional approaches such as high costs, liquidity and transparency.

**Constructing the Alternative risk premia core**

Not every risk commands a premium, and considerable work is required to establish which risk factors deliver sustainable and economically meaningful risk premia. Today, our knowledge and experience lead us
alpha, which cannot be explained by risk factors, remains valuable for portfolios as a source of uncorrelated returns.

We strongly believe that top hedge fund managers can deliver a substantial degree of alpha. Manager selection is crucial here, and Unigestion has a 30-year track record of researching and selecting high quality managers. As one of the first in the industry to establish a dedicated operational due diligence team, we believe that our experience in this field and in-depth understanding of each manager we invest in leaves us well placed to identify suitable managers to complement the core exposure to alternative risk premia.

With a thorough understanding of the components of hedge fund returns comes the ability to construct a truly diversified portfolio. Key to this is our comprehensive analysis of each manager’s sources of return using advanced modelling tools we have developed. In this way we ensure low correlation with alternative risk premia as well as low cross-correlation between the different managers we select.

An integrated alternative solution built for the future

In a world where traditional investments may come under pressure, interest in alternatives remains high, but a new way of accessing these returns is needed.

Drawing on the deep experience of Unigestion’s equity, multi-asset and alternatives teams, we believe Alternatives 2.0 is the right solution for many investors to access in a new and cost-efficient way the return potential of alternative investments. We believe this sets us apart from hedge fund managers, who will tend to treat alternative risk premia as alpha, producing a very different portfolio composition. Our approach is also quite different from pure quantitative managers, whose models tend to rely on historical correlations and which can prove less reliable at times of inflection in the markets.

Furthermore, our extensive experience of working with clients permits us to co-create holistic alternatives solution which addresses the challenge of costs, liquidity and transparency in a uniquely modular and flexible format.

Adding uncorrelated alpha from hedge funds

While alternative risk premia can be harvested efficiently in this way, genuine
In traditional asset classes there are low expected returns, hence the attraction of hedge funds that can potentially provide diversified sources of returns to investors. This seems to be confirmed by the higher level of demand we are seeing on the hedge fund side. In our funds, many investors are looking to increase their allocations,” says Campiche.

From a tactical point of view, Campiche is of the opinion that the current environment creates a number of opportunities.

“The first that springs to my mind is the expected volatility in markets this year, which should be sustained by a number of things, such as the political environment in the US and Europe, which I think hedge funds will benefit from.

“Secondly, we view the interest rate trend in the US as a long-awaited change in the environment, which should benefit some hedge fund strategies,” comments Campiche.

Sourcing alpha generators

There are a number of things that Pictet Alternative Advisors will look for when building a portfolio. Aside from allocating to the right strategies, of more importance is identifying the right managers. This sounds obvious but it is very difficult to implement. A FoHF manager needs to identify very specific expertise among managers, such as sector-specific equity long/short managers with expertise in trading the energy sector.

“It could include identifying a manager who is able to benefit from a barrier to entry. For instance, we view expertise in running distressed strategies as a clear barrier to entry. Executing these strategies successfully is not something that a large number of managers can do. If we can identify such a manager, operating in a niche area of distressed debt where there are still inefficiencies to exploit, we think that is a way to generate alpha today.

“We also look for managers that have some kind of proprietary process in the quantitative space and have the ability to generate new signals for alpha generation,” explains Campiche.

Experience is also an important element when looking under the hood. Has a manager only generated alpha in a bull market over the last few years or have they traded through an entire market dislocation phase where they’ve been able to stress test their strategy?

The latter, says Campiche, can be helpful, but warns that it can also be detrimental to a manager’s ability to generate alpha; he notes that following the ‘08 crash some managers reduced their levels of risk.

“There is no magic bullet to finding the best managers. That said, we are trying to be more sophisticated in terms of analysing the track record, identifying the source of returns, benchmarking managers to passive strategies and really trying to nail down what has made a difference in the past and is likely to repeat itself in the future,” confirms Campiche.

Building a due diligence risk framework

For institutions – Swiss or otherwise – that decide they want to directly allocate to hedge fund managers, it is critical that the due diligence they perform on the manager is ongoing and not just focused on the pre-allocation phase. This is even more important given the rising trend towards institutions investing in more esoteric strategies such as bank loans, distressed credit, etc, where the assets tend to be Level 3 assets and hard to value.

This is something that SwissAnalytics can support clients with, both in terms of investment due diligence, and, following its recent merger with Castle Hall Alternatives, operational due diligence.

As investors search for yield, credit and private asset strategies have become much more popular. These strategies are, however, much more complex operationally. “What we find most consistently challenging is custody and confirmation of existence of assets, and valuations,” explains Nauer. “To what extent can investors rely on independent providers.”

Nicolas Campiche, Pictet Alternative Advisors
IN CONVICTION WE TRUST

Multi-Asset / Equities / Fixed Income / Alternatives

SYZ ASSET MANAGEMENT

CREATING PERFORMANCE

For professional investors only. This advertisement has been issued in the United Kingdom by SYZ Asset Management (Europe) Ltd (authorised and regulated by the Financial Conduct Authority – with reference number 666766)

www.syzassetmanagement.com
Syzy Asset Management sees value in Asia hedge funds

Interview with Achraf Goneid

According to last year’s Preqin Global Hedge Fund Report, Asia Pacific’s hedge fund industry had USD159 billion in AUM and the largest allocator, with USD29.9 billion of committed capital, was China Investment Corporation (China’s Sovereign Wealth Fund).

In total, there are an estimated 1,709 active hedge funds being managed in the region, and whereas last year’s performance relative to the global hedge fund industry was disappointing (1.76% compared to 5.40%), over a three-year period Asia hedge funds have outperformed the US and Europe, returning 6.84% compared to 5.49%.

These facts have not been lost on Achraf Goneid, Senior Analyst at Syz Asset Management.

The firm’s Oyster Alternative Funds of Hedge Funds which invest in portfolios of 30 to 40 hedge fund managers, have traditionally focused their attentions on the US and Europe. Back in 2013 there were four Asia hedge fund managers in the books, but these were gradually divested for various reasons and a more thorough, detailed appraisal of Asia hedge funds was embarked upon.

“If you look at stock exchanges by size you will notice that the US is the largest, followed by Asia Pacific and then Europe. For me this was a little counterintuitive because two thirds of our managers were based in the US, just under one third were based in Europe and a very small number were based in Asia. To my mind, this was a very Eurocentric way of looking at things.

Whilst it is true that asset management in Asia started later than the US and Europe, we believe that Asia has now matured into a very good hedge fund industry and offers enough depth for us to look more closely at it,” explains Goneid.

One of the issues that European allocators have had with Asia hedge funds is the terrible performance they suffered in 2008 in the wake of the financial crash. Many so-called hedge funds were nothing more than glorified long-only funds with little evidence of skill-based performance. That is now changing.

“We spend a lot of time speaking to Asia managers that are trading with much less market directionality and they are becoming alpha generators in the truest sense.

“The managers that we see today are people that have spun out of existing hedge fund managers or large prop desks that have a very similar background to some of their top-notch European and US peers. They are well trained, well educated and have tremendous experience in the region. They aren’t trading the same markets, so by design they have the potential to provide decorrelated return streams than you can’t get merely by investing with western managers,” says Goneid.

This ability to generate alpha in different markets is helped by the fact that Asia’s markets are far less orderly and efficient as those in the West. That inefficiency creates trading opportunities. What’s more, as Goneid points out, Asian investment banks sell structured products to retail clients, and because they cannot keep the risk on their book they then sell the associated derivatives to hedge fund managers at a discount. This creates additional trading opportunities for managers that their US and European peers don’t necessarily have access to.

“There is a lot of disintermediation in Asia (IPOs, block trades) which you also see in the US and Europe but this seems to lead to a greater impact on returns in Asia,” states Goneid.
Goneid, who explains that as part of the process of building portfolios that are robust and capable of offering diversified sources of returns, Syz Asset Management views Asia with increasing importance.

“We are more interested in the types of trades that a manager does as opposed to just looking at a manager who has returned 20% per annum as performance can be difficult to forecast. We want to understand the discipline of the manager in terms of where he tries to capture returns. This is easier to assess. When we build portfolios, we try to think out of the box. I think we are one of the few hedge fund investment groups in Switzerland that still travels regularly to meet managers in Asia.”

Many of Asia’s current generation of hedge fund managers have attended US and UK universities and their overall approach to stock picking and trading global markets is broadly similar. So whilst the fundamentals are the same, the difference is how these managers view the markets from a top-down perspective.

Goneid confirms that when he joined Syz Asset Management in 2013, the firm had allocations to four or five Asia managers but the problem was that some were Mandarin speakers only, and the strategies they were running were broadly similar.

“Since that time we’ve engaged in a careful process of going to Asia to meet a lot of different managers, understand their investment strategies, and now we have started to re-allocate. For a very long time we focused on the equity long/short space but now we are looking more closely at relative value and macro strategies.

“Early on we were attracted by the decorrelation benefits that Asian equity markets had to offer and we benefited from this. Now we are looking to do something similar with our RV and macro allocations. We are in the process of onboarding one new manager and there could be space for one or two more later in the year, which would bring our Asia manager allocation back to where it was previously,” explains Goneid.

He says that the manager currently being onboarded is an Asia multi-strategy manager with a Japan activist tilt.

“We think the changes happening in Japan could produce some significant tailwinds. We liked the operational set-up of this manager, the process they have in place, and the return stream that they can offer.

“As the talent pool in Asia deepens, there will be more opportunities to find new talent, especially as third generation fund managers start emerging. A lot of the managers we’ve been working with for a long time in the US and Europe are closing their funds to new capital. As we attract new investor inflows it means we aren’t able to allocate to these existing managers and this is prompting us to seek out the next generation of talented managers; not just in Asia, but globally,” remarks Goneid.

When asked what Syz Asset Management’s investors sentiment is towards Asia hedge funds, Goneid says that whilst most investors like to hear about the large blue-chip names in the industry, they understand that Asia is becoming a future powerhouse for investing and appreciate the decorrelation attributes on offer.

“Asia managers aren’t doing the same trades as those in developed markets where more managers suffer from being crowded in similar trades. It’s a more nuanced approach. When we look at managers we have to be certain that they speak English and we also look very closely at how they operate from a compliance perspective; especially managers based in Mainland China where the regulatory environment is different. We have very strict rules on this.

“Overall, we believe that Asia hedge funds face fewer competitive hurdles than those in the US and Europe, and can benefit from operating in markets that are maturing but remain inefficient,” concludes Goneid.
being involved? Does the administrator, for example, have access to independent sources of information?

“We see an increasing number of independent fund administrators being appointed by managers, which is encouraging, but in the closed-ended fund space a lot of information is still being provided by the manager. There is also no independent pricing being done by the administrator.”

There are ways around this, as investors can demand additional checks and balances. Take private capital funds, for example. While there will typically be no independent custody of assets, there are usually independent providers involved which can be used to seek independent verification of information: for example, there will often be law firms involved who will hold copies of the deal agreements, providing at least one way of independently verifying the asset(s).

“With respect to private debt structures, in many cases there are loan agents servicing the loans, which, if independent third parties are appointed, can provide another route to sourcing information on the underlying loans in a fund portfolio. We are consistently surprised when we find administrators not completing independent asset existence checks for all or at least part of a portfolio, instead relying on documents forwarded by the manager,” add Nauer.

He believes that investors, generally, are more reluctant to vote with their feet and force change once they’ve already allocated to an open-ended fund manager, particularly in Switzerland where perhaps there is a cultural trait that causes institutions to take longer to warm up to the investment manager on a personal level.

“The Swiss tend to be more loyal than other cultures. Investors are more willing to give the benefit of the doubt. That’s fine but what we advise is, ‘Have a consistent framework and policy to determine at what point in time enough is enough. Force yourself to make a decision.’

“Ultimately, the investor has to be sure that the investment continues to be consistent with their objectives based on liquidity, the amount of leverage etc.,” comments Nauer. “It is always tough to exit a manager. However, if a manager’s strategy evolves from excellent to a more mundane ‘good enough’, investors incur the opportunity cost of not redeploying capital to a new manager who is truly ‘excellent’.”

He says that the key aim is to ensure that an investment’s asset can be independently verified and checked, and that the manager is sticking to the investment guidelines. “If the manager says they are independently verified on a regular basis, who is doing that work, and what procedures are performed? And if they are using independent third parties, are they truly independent – bringing professional skepticism and active engagement – or are they just rubberstamping things? Who is driving the decision as to when to recognise that sometimes an asset needs to have a write-down?” questions Nauer.

Complex strategies require simple communication

Jonas Stark is the CEO/CIO of Blue Diamond Asset Management, a market neutral statistical arbitrage hedge fund that focuses predominantly on trading equity volatility based out of Pfaffikon, Switzerland.

He confirms that whilst Blue Diamond’s investor base is global, there are some family offices in Switzerland that are showing interest in managers such as Blue Diamond who are able to offer strategies with a low correlation to equity and bond markets.

“We have a track record of more than five years, we have USD400 million in AUM, and as we grow we are starting to see more interest from family offices,” says Stark.

Asked whether he thinks Swiss investors are shy post-allocation, when it comes to questioning the manager, he replies: “The institutional investors in our fund all have a good understanding of what we do. Should there be styl drift, or we do something...
The importance of ongoing due diligence

Interview with Christian Nauer

Recently, investor demand has increased for private equity, hybrid public / private funds and alternative yield strategies such as direct lending, asset leasing and royalty streams. As such, the more complex nature of these strategies makes both pre- and post-investment due diligence far more important.

Swiss investors, like all investors, have behavioural biases, which can lead to thorough pre-investment due diligence, but a more laissez faire approach to ongoing diligence post-allocation. Given that many of those "fashionable" strategies hold assets which can be hard to value and may have asset existence issues (assets are not held with a custodian or prime broker), that can be a dangerous game to play.

Indeed, in the US, the recent USD1 billion fraud investigation into Platinum Partners, where assets were allegedly inaccurately valued, has focused investor attention on illiquid strategies.

"Swiss investors can sometimes neglect what they can do post-investment" says Christian Nauer, CEO of SwissAnalytics. "To a degree, Swiss allocators can be a little shy in questioning the fund manager once they’ve made the allocation".

SwissAnalytics helps institutions build a risk-based framework to perform operational and investment due diligence. This January, the firm joined forces with Castle Hall Alternatives’ global due diligence platform.

"We often notice a self-confirmation bias, whereby the investor agrees to allocate to a manager by focusing at the pre-investment stage on information that supports their initial hypothesis. A risk arises, however, if an investor is slower to act, post-investment, when they are presented with information that no longer supports that initial hypothesis," says Nauer.

For institutions overseeing client assets or pension funds, however, there is increasing recognition that they are responsible for effective due diligence across all external manager relationships, irrespective of asset class. "In the event of a financial loss, it is simply not a plausible defense for an investor to say ‘oh, that was a private markets fund, so we didn’t ask the same questions’," says Nauer.

“Our advice to investors is, ‘Establish a clear due diligence program and have a consistent framework and policy to determine how to monitor every third party fund. A well drafted due diligence policy will specify how and when to conduct due diligence and how to escalate issues which could arise on either the investment or operational side’.”

Once invested, an effective ongoing due diligence program will consider frequency, timeliness, completeness, consistency, and objectivity.

“Risk-based approaches are a smart way to define the frequency of ongoing reviews as a function of the risk – be it asset class risk, manager specific risk, or the size of the allocation,” he adds.

For SwissAnalytics and Castle Hall, increasing focus on ongoing due diligence has allowed the firms to develop new due diligence solutions.

“External diligence experts can benefit from economies of scale and can pass these on the clients,” says Nauer.

“Ongoing diligence also involves a lot of work to contact managers to ask ongoing questions, which can be below the pay grade of the internal investment team. Investors can use external providers to handle the data gathering process - and particularly organise that data and perform quality control checks. This then frees up the internal team to move to an oversight role, where they can review the results and react to questions raised.”
we said we weren’t going to do, they will question it, regardless of whether they are located in Switzerland or anywhere else in the world. It’s important to note that Swiss investors are global; there is a wide mix of nationalities working at these institutions.

"Ultimately, it’s important that investors understand what you do. There is always risk inherent in any hedge fund strategy, and no strategy is guaranteed to make money all of the time. If investors understand why the strategy makes money, and what the risks are, they are more likely to stay with a manager (even during periods of poor performance)." adds Stark.

Investors appreciate this fluid approach and whilst it might sound obvious, lack of transparency and communication is still often cited as a key issue by hedge fund investors. Blue Diamond, for example, conducts quarterly calls with investors and produces updates when there are big movements in the markets. "This way, investors have a better understand what works and what doesn’t work in the strategy.

"When it comes to raising assets and keeping assets, being transparent and keeping investors updated on what you do as a manager is a key success factor. Over time it builds a lot of trust in the relationship," he says.

One approach that QCAM Currency Asset Management takes to build a close alignment of interests with investors lies outside of the fund product and is more of a customised solution, which in simple terms provides active currency overlays for investors’ portfolios.

"We are seeing a lot of interest in this solution. It might be used by an investor with, say, a 90 per cent passive currency hedge in equities and fixed income currently who wish to take advantage of currency moves in the future to generate additional return.

“They come to us to provide an overlay solution, which is typically a rules-based approach based on the needs of each client. We’ve seen good traction in this and we expect this to continue over the near-term," explains Meyer.
The discretionary manager – a dying breed...?
Increasingly within the investment management industry, more and more strategies are becoming systematic and quantitative in their approach where investors have to put their faith in algorithms and complex machine learning strategies that have limited discretionary input.

In some ways this is advantageous as it strips out the emotion and the myriad behavioural biases that plague even the very best portfolio managers. But in other ways it makes it harder for investors to know when to redeem. How do they know when to trust the machine and when not to?

This places managers like QCAM in a strong position. Unlike many FX-focused managers, they are completely discretionary in their approach.

"On the one hand it is a challenge because we are not mainstream in the eyes of investors but on the other hand it is quite interesting to operate in such a niche as I believe it offers an advantage, over time, and a way to differentiate us from other funds in the market," says Meyer.

"We are positioned to be long volatility in the portfolio, overall, so low volatility regimes do not favour the strategy at present. The recent US elections produced some volatility in the currency markets in November and December but it has since reduced. That said, investors understand that there aren’t always going to be dislocation opportunities. The vPro and vPro Dynamic strategies are a diversifier and recently investors have been generating more returns from other parts of their portfolio. They view us in a wider portfolio context for this reason, not on a standalone basis."

In the world of systematic trading, Blue Diamond, which has seen its AUM climb from USD150 million to more than USD400 million, positions itself to investors by bringing to the table a singular focus on equity volatility. It is a highly targeted approach to avoid investor confusion and to try and stand out from the crowd.

"Whilst we run a systematic strategy, one of the key success factors is that we’ve adapted the strategy over time,” says Stark. "We’ve conducted quantitative research on the market to improve the strategy over time and harness new opportunities as they’ve arisen.

"It’s important to try and constantly improve how you trade the markets. The team is always seeking out new opportunities. Also, we’ve spent a lot of time getting our operational processes to a very high level. We have two dedicated programmers that work on model calculations, reconciliations and so on. Everything from fee reconciliation to cash management and reporting to clients is fully automated. That is something that investors really appreciate when they visit us.

“A good operational infrastructure allows us to better work with clients and focus on the investment strategy rather than get caught up in daily operational tasks that offer no value add to the investor.”

Campiche concludes by highlighting the fact that Pictet Alternative Advisors has evolved to become much more granular at analysing the track record of the manager rather than his skill-set; in other words, the work has become a lot more quantitative.

“We have become more adept at constructing portfolios to better balance the risks and understand where and when we should allocate to certain managers. It is like putting together a jigsaw puzzle; you want each piece to fit and to play a specific role in the portfolio. That is something we’ve increasingly focused on over the last few years.”