hedgeweek special report
www.hedgeweek.com
April 2018

Amsterdam Investor Forum 2018

Cryptocurrency: a new tectonic force?

Technological innovation drives partnerships

Global economics provide a complex backdrop

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How are the tectonic plates of active management shifting in 2018?

By James Williams

The tectonic plates of the alternative funds industry continue to move in response to market trends, technology innovation, continuing regulation and the ever-shifting whims and desires of institutional investors.

Last year was a welcome return to performance for global hedge funds, ending 2017 with net gains of 11.41 per cent and net new inflows of USD49.5 billion to take total AUM to USD3.55 trillion, according to Preqin.

And as February 2018 has already indicated, the winds of change have definitely picked up, with a welcome return to volatility and overall sense of optimism among active fund managers.

It was against this backdrop that ABN AMRO Clearing hosted the seventh Amsterdam Investor Forum. In her opening remarks, Delphine Amzallag, Global Head of Prime Services, ABN AMRO Clearing, said: "Technology changes are accelerating, interest rates have started to rise both on the short and the long end and as central banks reduce their lending, volatility has returned.

"New asset classes like cryptocurrencies have emerged. All these changes bring risks but also opportunities so it seems timely that at this year's event we ask ourselves, 'What is coming next?' As Keynes said: 'Successful investing is anticipating the successful anticipation of others'."

Fund managers must constantly hone their investment strategy to stay ahead of the game and justify their fees to investors. This is certainly true in light of the eight-year bull market in US equities. One could argue

Delphine Amzallag, Global Head of Prime Services at ABN AMRO Clearing delivers the opening address

that CTA managers who have been long equities and short rates are not in a position to provide diversification and downside risk, if, as people expect, the markets start to normalise in 2018.

In a panel session entitled: *Trends and dynamics driving the investment decisions*, moderated by Matthew Elstrop, Portfolio Manager - International Asset Management (IAM), Alan Dunne, Managing Director of Abbey Capital, was keen to stress that the firm doesn't see CTAs as a hedge against equities but a diversifier.

"It's important to remember that CTAs are designed to provide absolute returns, primarily when markets experience trends. Historically, those trends have tended to be stronger in equity bear markets" said Dunne.

Abbey Capital's philosophy is to capture returns that trend following can offer and diversify the risk using uncorrelated strategies. In a higher volatility environment, Dunne says that directional volatility is the key to determining what performance might be, going forward.

"Commodities is an interesting sector at the moment," he said. "Trend following commodity-focused CTAs have had a difficult time over the past eight years yet it was commodity trading that was a big source of returns in the early 2000s, not necessarily fixed income. If we start to see stronger inflation in 2018 that could be interesting for commodity-focused CTAs."

What was encouraging from this panel discussion was the open-mindedness over the ongoing issue of fees. Marc Gauthier, University Treasurer and Investment Officer, Concordia University, oversees the pension plan which is 100 per cent focused on active fund management and configured based not on asset classes but on funding objectives.

Gauthier confirmed that 50 per cent of the portfolio was made up of unconstrained dynamic strategies; these are multi-asset, multi-directional investment strategies including hedge funds.

On the fee debate, Gauthier said: "It's all about finding the right complimentary strategies. I have no qualms paying fees as long as the manager maintains his uniqueness. It's when they seek to become more of a commodity that it's no longer worth it for me to pay fees."

Abbey Capital pays fees per unit of volatility, essentially scaling fees depending on the level of volatility being delivered by the manager.

The audience was asked to cast its vote on the following question: **Have hedge fund fees moderated enough?** Some 59 per cent voted Yes, a proxy of how many fund managers were in the audience!

The audience was also asked on how they would increase allocations in 2018. An overwhelming majority, 84 per cent, confirmed they would allocate to active strategies, with 16 per cent preferring passive strategies.

Alan Dunne, Managing Director of Abbey Capital

Marc Gauthier, University Treasurer and Investment Officer at Concordia University

Both traditional and alternative asset managers are in a unique moment of history with respect to technology advances. From big data and alternative data sets to cloud-based platforms, artificial intelligence and machine learning, not to mention blockchain technology, asset managers find themselves on the cusp of re-imagining what it means to be a 21st century financial organisation.

Speaking about the various forces and dynamics shaping the industry, on a panel entitled: *Brave new world in asset management*, moderated by Marianne Dernies, Head of Business Development, ABN AMRO Investment Solutions, Graham Mason, CIO of M&G Investments, told the audience: "We are looking at the younger generation and working with a Silicon Valley company to explore robo-advisory capabilities. It is baby steps at the moment but in a few years I think it'll be a new world. We see technology as a big opportunity more than a threat."

Such is the pace of innovation that asset managers are actively embracing partnerships with FinTech start-ups to develop sophisticated solutions for all their clients, not just millennials. From a front-office perspective, the sheer breadth and diversity of data is giving portfolio managers the ability to develop new indicators.

This was illustrated by Fabrice Cuchet, CIO Alternative Investments, Candriam Investors Group. He said that the firm was starting to balance its internal research capabilities by building partnerships with FinTech firms "with the objective to build new indicators for our fund managers and improve their decision-making. Finding the right indicators is the key to using alternative data sets and add value."

The rise of alternative data sets has been evident over the last 18 months. There has been a tremendous proliferation of different types of data becoming available to systematic traders as well as discretionary fund managers – weather data, social media data, GPS data, etc.

According to Bartt Kellermann, Founder and CEO of Global Capital Acquisition, 31 per cent of it is in the form of raw, unstructured

Left to right: Graham Mason, Fabrice Cuchet, Max Rijkenberg and Marianne Dernies discuss the "Brave new world in asset management"

data. Kellermann moderated a panel entitled: *Quants: Taming the data monster*. What came out of this discussion was that alternative data sets are useful, but only to a certain extent. It also depends on what markets one is trading.

Herman Van der Sluis, Senior Portfolio Manager, PGGM, the second largest Dutch pension fund, confirmed that its long-only multi factor-based investment funds primarily still rely on structured fundamental data – volume data, price data, etc – but it was beginning to use unstructured data to a limited extent.

"I don't believe having a lot of Big Data available to us will significantly change the composition of our portfolio. It's still about striking the right balance in the exposure to various risk factors. That said, there is a lot of information in new data sources and over the past two years we have expanded the research capability within our front-office team, allowing us to better assess this new information.

"We believe this additional information can, for example, help us make better estimates on the cash flows of certain companies and improve its risk characteristics through better diversification of the portfolio. Alternative data remains at the edges of what we do but it can complement what we do and add value," said Van der Sluis.

One of the problems with unstructured data is the amount of work one must do to make any sense of it. Moreover, if one trades opaque markets, the availability of data can also be a challenge. It's not as if volume data on Spanish power markets is readily available in centralised clearing houses, for example.

J. Scott Kerson, Senior Managing Director & Head of Systematic Strategies, Gresham Investment Management LLC, a CTA that trades commodities, said that what tends to get lost in the debate on using unstructured data sets is that it's not just about the alpha component and generating new signals to trade.

'Why am I talking about alpha and not cost?' After all, my investors get a net return – gross alpha less trade costs. The reason we care so much about volume data is we care about risk management and calculating

Bartt Kellermann, Founder and CEO of Global Capital Acquisition

"Quants: Taming the data monster" panellists, left to right: Nicolas Gaussel, Scott Kerson and Herman Van der Sluis

our costs. The one truism in this business is that alpha is usually very uncertain and costs are certain.

"When I think about volume data and how we can use alternative data sets, I try to get my team to think about not just finding a new signal, but can we cut our trading costs and trade more efficiently? That's one of the unsung themes in this debate – using big data for cost reduction and portfolio efficiency," opined Kerson.

The "Crypto fever, new horizons or another tulip bubble?" panel, left to right: Jiri Krol, Isabelle Mateos y Lago, Yves Choueifaty, Michael Moro and Kevin Jacobs

Cryptocurrency – A new tectonic force?

In the same context of technology innovation, as referenced above by the growing adoption of alternative data sets, one unavoidable topic of discussion over the last 12 months has been the rapid rise to prominence of cryptocurrencies.

It is a subject that splits opinion and this was no different at this year's AIF event.

The audience was asked: Do you consider digital assets to be a bona fide institutional investable asset class? Only 30.7 per cent responded Yes, suggesting that there is still some way to go to convince people of the merits of bitcoin, ether and other crypto assets. Some fund managers are dipping their toe in, constructing cryptocurrency overlays, much like a traditional FX overlay, but there is no obvious sign that the industry is embracing it wholesale.

Isabelle Mateos y Lago, Chief Multi-Asset Strategist, BlackRock, speaking on a panel entitled: *Crypto fever: new horizons or another tulip bubble?* said that whilst BlackRock has seen increased client interest in the potential of crypto products, it remains very much "open-minded" but is yet to be convinced that this has reached the point of becoming an investable asset class.

"That said, we are fascinated by the underlying technology and how blockchain might help us to optimise our operations going forward," said Mateos y Lago.

Mateos y Lago was the lone voice of caution on this panel. One of the early investors in cryptocurrencies is Yves Choueifaty, CEO, TOBAM, a leading French asset manager.

Having watched liquidity deepen in bitcoin in 2016, the TOBAM team decided that 2017 would be a year in which cryptocurrencies would become compatible for investments from large investors.

Prior to this, between 2014 and 2016, it was relatively difficult to invest in this asset class from a liquidity point of view, said Choueifaty, adding: "We were right to believe that in 2017 liquidity would grow enough for bitcoin to be considered as a potential investment by large investors."

This culminated at the end of the year with the launch of the TOBAM Bitcoin Fund; the first bitcoin fund to launch in one of Europe's most heavily regulated markets.

Choueifaty referred to six fundamental qualities and three empirical qualities that make cryptocurrencies a compelling investment opportunity.

Yves Choueifaty, CEO, TOBAM

Those fundamental qualities include: unchangeable, non-inflationary, non-forgeable, cannot be manipulated (i.e. by central bank authorities), exchangeable and difficult to seize.

That bitcoin cannot be manipulated, altered or interfered, given that all transactions are held on blockchain, which is immutable, is reason to believe that in time, bitcoin will have the fundamental qualities to become a potential standard of value, according to Choueifaty.

Discussing diversification as one of the key empirical qualities of bitcoin, Choueifaty compared its use to that of chlorine. Chlorine is highly dangerous in concentrated form, but adding a drop of chlorine to water creates drinkable water. Similarly, if you put 1 per cent of bitcoin in a portfolio you will reduce the overall risk of the portfolio because of the low correlation that bitcoin has to other assets.

"We believe that the characteristics of bitcoin, the fact that it is a very high risk but well diversifying and liquid asset, make it compatible with the criteria of large investors," argued Choueifaty.

S. Michael Moro, CEO, Genesis Global Trading, a US broker-dealer that trades seven or eight different tokens confirmed the deepening liquidity profile in crypto assets.

To assuage fears over the wild volatility swings in cryptocurrencies, Moro stressed to the audience that there is a clear bifurcation in the market between retail and institutional. Much of the volatility occurs on retail exchanges like Coinbase, with volatility far less pronounced on the institutional side.

"We don't have panicked sellers reaching out to grab the falling knife. They don't pay too much attention to the day-to-day price fluctuations. They understand that liquidity is thin and wait for prices to stablise either on the way up or down before placing transactions. We started Genesis in March 2013 and it took us three years to reach USD1 billion in monthly turnover. Now we are seeing USD1.5 billion each month. The average transaction size is USD250K," said Moro.

He added that hedge funds are able to use the platform to borrow crypto assets in much the same way as traditional security lending activities.

Global economics: How will the tectonic plates shift in 2018?

For hedge fund managers, both systematic and discretionary, utilising technology to hone their investment strategies is only half the story. Market dynamics, GDP trends and the role of central banks, not to mention geopolitical risks, provide a complex backdrop against which traders must try to eke out alpha.

Last year was exceptional for all asset classes. Strong growth was seen throughout the year in most parts of the world, while at the same time inflation went missing in action and interest rates continued falling.

As Isabelle Mateos y Lago, remarked: "This was a market environment that happens very rarely, with exceptionally low volatility and exceptionally high returns.

"In 2018, we will likely see a moderate rise in volatility but this is still a strong growth environment. I don't think there are risks of inflation surging in a way that would force central banks to aggressively tighten monetary policy. Overall, it should still be good for risk assets but the clouds are building on the horizon and people need to be a bit more vigilant than last year."

The combination of sustained growth and low inflation is sometimes to referred to as a Goldilocks economic environment, where economic conditions are neither too hot nor too cold.

When asked whether Goldilocks' death has been greatly exaggerated, 62 per cent of the audience replied Yes, reflecting a bullish sentiment for the year.

Erik Norland, Senior Economist, CME Group, agreed with the majority. However, he cautioned that the threat to Goldilocks could be if a trade war leads to an inefficient allocation of resources “and create some inflationary pressures. But we haven’t seen them yet.”

Since the AIF event, Norland’s warning over a potential trade war has already manifested with the US Government confirming it was planning to impose tariffs on USD60 billion of Chinese goods. China’s commerce ministry said that China doesn’t hope to be in a trade war “but is not afraid of engaging in one”. Trump’s announcement caused the Dow Jones Industrial Average to fall 2.93 per cent on Thursday 22nd March.

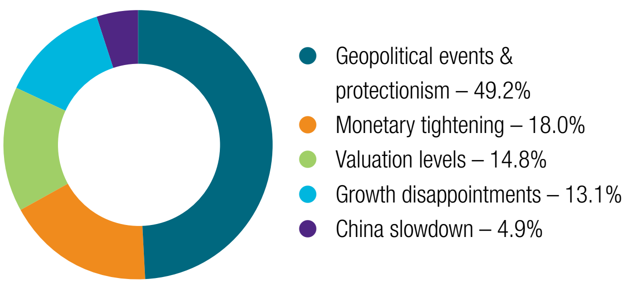
Chairing the economic debate entitled: *A global macro perspective: analysis and forecast*, Han de Jong, Chief Economist, ABN AMRO Bank, asked the audience what the biggest risk to ‘risky assets’ would be in 2018/2019. The results are shown in the chart below.

A trade war initiated by the country that has been at the centre of the free trade order since the Second World War is becoming a real threat and is sure to create market uncertainty over the coming weeks and months.

Geopolitical risk tends to have a short-term impact on markets, but trade is different. Investment slows because of uncertainty. One only has to consider Brexit: the UK is still in an open trade regime with the EU but investment has slowed significantly.

Mateos y Lago said that whilst US corporate tax cuts mean corporates will have

What will be the biggest risk to ‘risky assets’ in 2018/2019?



Han de Jong, Chief Economist at ABN AMRO Bank moderates the “A global macro perspective: analysis and forecast” panel

to decide whether to do share buybacks, sit on cash or increase their investment activity, “if they are not sure about the trade regime over the next five years it could play against investment and hence hold back growth.”

On a more positive note, when asked about upside risks in 2018, she remarked: “There has been a lot of investment in information technology that hasn’t delivered the boost to productivity that historically was the case. It is possible we are on the verge of a pick up in productivity growth which could mean we remain in this Goldilocks phase for much longer than the markets are currently expecting. That would be very good news for risky assets.”

Norland cited Europe as his example: “I think we’ll see a combination of fiscal and monetary support creating phenomenal growth here in Europe. That’s where I see the biggest upside risk.”

A shift towards partnerships?

How fund managers choose to navigate the various forces that shape the markets this year will depend on their long-term growth strategy. Regulatory costs and the pressures of complying with MiFID II, AIFMD, etc, are raising the barriers to entry for new managers and leading to consolidation in the marketplace.

Within consolidation there are different routes to take: often, it involves big players buying other big players, or small players

being bought by mid or large players. The latter can help asset managers to diversify their product offerings and is often less disruptive than a merger between two large players.

"We see many small boutiques who are delivering good performance but who are struggling to grow and to break even," remarked Candriam's Fabrice Cuchet on the "Brave new world in asset management" panel. "The AUM threshold to get institutions to buy one's funds is rising, especially in the UCITS world. You need bigger funds and more infrastructure to attract institutional money."

Of course, there are plenty of fund managers who launch and wish to run their own businesses. In that respect, the multi-boutique model is a good one, where managers join an existing, established manager to run their strategy. This brings associated benefits of using high quality infrastructure, a halo effect (in investors' eyes) of operating under the auspices of the established manager, whilst retaining independence.

The panel agreed that there are, in effect, four possible models: consolidation, multi-boutiques, partnerships and spin-offs. The consensus view was that for 2018, partnerships would become the most important trend; especially as long-only managers seek out the right partnerships with alternative fund managers in order to leverage their track records.

"We expect the number of providers on distribution platforms to continue to narrow from 80 or so providers to 15 or 20 providers, in Europe," said Graham Mason, CIO M&G Investments. "We are seeing a trend towards asset managers partnering with banks but not necessarily offering their own funds – rather it is the bank's fund, with the asset manager being appointed to run it as the appointed sub-advisor."

Cuchet concluded by saying that many distributors are looking to partner with a limited number of asset managers: "We see more and more distributors selecting managers as an advisor to a fund that they are launching themselves or to whom they are acting as the management company."

No doubt when the AIF attendees reconvene next March, there will have been further shifts in the tectonic plates and new trends emerging. Strategic partnerships could be a way to navigate these shifts, both among fund management groups and managers partnering with FinTech firms to craft new ways of investing. And who knows, cryptocurrencies might by that time have become an institutional product. ■


The 2018 AIF Factor finalists

The AIF Factor

As with previous editions of the Amsterdam Investor Forum, this year saw five shortlisted fund managers given the opportunity to present a 3-minute pitch presentation to the audience. This year's winner, as voted by the audience, was Firth Investment Management, whose fund – Firth Asian Systematic Equities Fund – was presented to Dr Hamish Macalister, portfolio manager and Deputy CIO (second from right in picture).

The other four finalists included:

- Arion Investment Management – Raptor Commodities Fund
- Elite Fund Management – Dutch Darlings Fund
- Gresham Investment Management – GreshamQuant ACAR Fund
- Hellebore Capital Ltd – Hellebore Credit Arbitrage

When people think about Asian equities, features such as deep cyclicality, poor data quality and volatility often spring to mind – in other words risk.

Firth Investment Manager has designed a strategy specifically to target those risks and turn them into alpha.

"We've designed an Asian equity strategy that uses stock data to do two things: one of course is to pick stocks, the other is to manage macro risk. The second point is key. We use fundamental stock data to manage macro risk. We use risk signals at the individual stock level, which are then aggregated to give us macro risk signals that we implement by automatic adjustment of beta in the portfolio," Macalister told the audience.

Seeking out hidden macro information in micro data is certainly quite a novel approach. In addition, the Firth Asian Systematic Equities Fund utilises a range of risk features often used by activist short sellers i.e. earnings manipulation by management, poor corporate governance, etc, to weed out stocks with a high probability of disaster. The portfolio invests in what is left over.

The result, said Macalister, is a strategy designed to generate Asia plus returns for less than Asia market risk:

"We've just reached our two-year anniversary for the fund, which is a Luxembourg domiciled UCITS fund. Over that time we've generated a total return net of all fees and costs of 71 per cent with a Sharp ratio of 3. That's an 80 per cent higher return than European equity markets over the same time period for 25 per cent lower volatility."

This is achievable because there is so much untapped inefficiency in Asian equity markets, said Macalister.

On winning the AIF Factor, Macalister responded: "This was a superb outcome for us. We believe we offer a strategy that is genuinely innovative, which in turn results in an attractive and diversifying mix of risk and return characteristics. It is wonderful to have an independent audience of industry heavyweights come to the same conclusion." ■