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Amsterdam Investor Forum 2016

A global macroeconomic outlook

Considerations for investors in a low yield environment

Strategy perspectives & the regulatory cycle

Amsterdam Investor Forum 2016

There was a palpable air of excitement at the 5th Amsterdam Investor Forum, hosted by ABN AMRO AMRO Clearing at the bank's headquarters on 17th February 2016. This was the biggest event yet with approximately 280 attendees, of whom 42 per cent were institutional investors and FoHFs, 40 per cent were single hedge fund managers, and 18 per cent were service providers including hedge fund consultants.

During the course of the day, a wide range of engaging panel discussions provided insights on some of the key trends and issues shaping Europe's hedge fund industry. And judging by the level of networking over canapés and cocktails at the end of the day, investor interest in hedge funds remains firmly upbeat.

In his opening address, Gildas Le Treut, Global Director Prime, ABN AMRO Clearing, asked what new trends and turmoil would emerge in 2016 on the back of an eventful 2015.

Gildas Le Treut

Delphine Amzallag

"We saw pressure on the Euro, a potential Grexit, geopolitical tension with the Ukraine situation, negative interest rates, China Black Monday...Tuesday...Wednesday, and regulatory pressure on the entire industry. There's no doubt, in my opinion, that 2016 will likewise bring new challenges and opportunities," said Le Treut.

Delphine Amzallag, European Head of Relationship Management Prime, ABN AMRO Clearing, added: "This year's Amsterdam Investor Forum covered many diverse topics that affect and challenge us every day. We were pleased to see it so well attended and delighted to foster so many lively discussions and passionate debates. It was a meeting place for questions to get answered and opinions to be shared."

Over the coming pages, the following key themes from the Forum will be detailed:

- A global macroeconomic outlook;
- Investor considerations in a low yield environment;
- Investment strategy perspectives;
- The regulatory cycle. ■

Chapter 1

A global macroeconomic outlook

Although forecast to grow by 6.4% in 2016, there are fears over the health of China's economy and the impact this could have on the global economy. Coupled with the lack of real growth that developed market economies are experiencing, the threat of slipping back into a global recession is growing. This is despite central bank intervention, with its commitment to low interest rates, which has pumped money into the banking system and created a five-year bull market in equities yet at the same time has failed to generate meaningful inflation.

"I think the actions of central banks over the last eight years have a great deal to do with investment outcomes in pretty much every asset class," said Ewen Cameron Watt, Chief Investment Strategist, BlackRock. "Most central banks are either on the edge or have already set themselves up to abandon their medium term inflation targets. It is essential for them to do that if they move to a negative interest rate policy; it will create a whole different set of incentives including redrawing debt contracts."

Asked to vote on whether the world was heading for a material downturn, which would have (further) grave consequences for risky assets, 64.5 per cent agreed.

Cameron Watt's panel, moderated by Han de Jong, Chief Economist, ABN AMRO Bank, and which also included Jenny Rodgers, Portfolio Manager, M&G and Blu Putnam, Chief Economist and Managing Director, CME Group, did not necessarily agree with the audience.

"We are in a low commodity price era, and in the long run that will support global growth," said Putnam. "This is not a huge deleveraging exercise like in '08, so I'm not really worried about 'grave' consequences. The outlook three or four years down the road I think will be good. 2016 will be a slow growth year."

Han de Jong commences the first panel "Global Macroeconomic Outlook: Trends and challenges for the year ahead"

Cameron Watt said that the lack of nominal growth and the increase in the real cost of debt (and subsequent monetary response), would be a "critical narrative".

"I disagree that the consequences are going to be grave but I do think we are in a constrained nominal growth environment which increases the real cost of debt and the response to that will set the outcomes for asset markets."

Rodgers said that rather than worry about central banks, the oil price etc, it was important to step back and look at the economic data, which would suggest that certain parts of the economy are slowing down (i.e. industrial production) but other parts are improving and that overall there was not a major economic problem.

"The short-term impact on risky assets is being driven by human emotion, rather than fundamental economics. That is what is creating excess volatility in the markets as opposed to the underlying fundamentals. That creates opportunities for investors," said Rodgers.

The audience was then asked whether central banks had little or no ammo left and had lost credibility. Two thirds (67%) of the audience were in agreement, suggesting there is little sympathy in the market for the way that central banks are handling the situation.

Putnam argued that central banks do have more ammunition left, they just aren't willing to use it. His point here was that it matters as to what assets central banks are choosing to buy.

"The highest quality asset purchases such as US Treasuries are not going to increase credit growth or impact the real economy other than lower bond yields. I think the only ammo that would work now is to buy government debt associated with government spending; a fiscal policy basically. Though this is very unlikely," suggested Putnam.

Rodgers said that the likelihood of a further rate hike by the US Federal Reserve would very much be "data dependent", with Cameron Watt adding that investors should wait to hear what central banks say with respect to their medium-term inflation rate targets. "That will inform you how far down the negative nominal rates cycle they want to go. I think the US Federal Reserve is likely to have one more rise but it likely won't happen before June," said Cameron Watt.

Perhaps one of the most significant tail risk events over the last 18 months has been the extent to which the crude oil price has fallen. As Michael Coleman, Managing Director, RCMA Asset Management explained in his keynote address ("Commodities – How low for how long?"), the current price of oil has yet to find a bottom as it continues to grapple with a fundamental oversupply issue.

The world is literally flooded with oil meaning that even at low prices the demand response is not coming through. And it won't happen until global GDP growth picks up. What was interesting was that when asked, "Where do you think average global GDP growth will be in the next few years?" 60% of the audience voted that it would be below 3 per cent, with 34% voting between 3-4%. At the same time, when asked, "Where do you think the price of nearby Brent will be in three years?" some 61% of the audience voted for between USD30-50.

Problem is, said Coleman, "to get meaningful recovery we need to see global GDP growth of 4% or more".

He showed that natural gas and bulk freight prices were seven years in to a price correction, yet crude oil was only two years in "and there is no sign that demand correction has worked". With the Saudis and Iranians at an impasse, with the latter wishing to increase supply, the likelihood is that oil prices could remain suppressed for longer than expected.

"It is hard to know how much further oil prices could fall. It is trying to find a bottom but it's not there yet; we simply haven't seen a supply response. The last thing producers want to do is cut production. It means they can't service their debt. Producers have to be ground through the mill to pull back on production supply," said Coleman.

With the potential for a continued period of low oil prices, and central banks adopting negative interest rate policies, the macro headwinds are likely to remain for some time to come. ■

Chapter 2

Investor considerations in a low yield environment

For hedge fund investors, trying to enhance portfolios in the current low yield environment is a challenge. As such, strategy selection and risk management are key tools to provide end investors with diversified returns that both compliment their long-only allocations to traditional assets, and protect against whipsawing markets.

This topic was discussed in detail in a panel session moderated by Lukas Daalder, Executive Director, CIO Investment Solutions, Robeco, entitled "Enhancing portfolios in a low yield environment".

Daalder asked the audience to vote on how long low yields will last. Only 11% of the audience felt it would be for "Two Years Max", with 25% voting for five years. However, the majority of the audience, 51%, said that the low yield environment was a "New Reality" and that low rates would remain low for decades to come, signaling a clear concern that the markets face a long period in the trenches.

"Structurally speaking we had many decades of a credit binge and it will take decades to deleverage," said Eric Ebermeyer, CIO, Neuflize OBC Investissements, which provides multi-manager solutions and has close to EUR40 billion in assets.

Logically, therefore, one would expect government bonds to be unappealing. This was felt by the majority of the audience, with 52% confirming that at current levels, government bonds offered low returns at high risk and were not worth it. Only one quarter of delegates felt that as long as there was a positive yield, bonds still held value at limited risk.

"Mid- to long-term they don't look attractive but investors will still need to hold some government bonds in their portfolios. We see some short-term opportunities to go long bonds but they are very specific ideas

Irene Perdomo, Principal & Founding Partner, Devet Capital, winner of the 2016 AIF Factor

that we implement in the book," said Simone Tarozzi, Head of Trading Strategies, Cardano, a prominent pension fund consultancy.

Investors are rightly concerned over the lack of upside that could be on offer in their fixed income allocations over the coming years, and given the increased level of volatility in global equity markets, many are relying on FoHFs and seeding firms to seek out "extra juice" by reallocating to other assets.

Indeed, when asked which other assets they would prefer to allocate to, 31.5% of delegates chose liquid absolute return strategies, and 31.5% chose hedge funds.

"We've started to move more into liquid alternative strategies; not to a huge extent. It's really more of a structural rather than tactical change to identify where we can make money," confirmed Daniel Capocci, Senior Investment Manager, Architas, the multi-manager arm of AXA Investment Managers. He said that for 2016, Architas favours market neutral strategies. "Three years ago we were 40 per cent allocated to market neutral, but over the last couple of years we have favoured more event-driven

strategies. Now that there is higher market volatility we have gone back to market neutral," added Capocci.

Ebermeyer said that strategy selection ultimately depends on the individual investor. He said that insurance company clients are moving up the illiquidity curve and requesting more real estate, private equity, loan and infrastructure assets and that private investors were "definitely looking for liquid AR strategies. We have put in place target-based risk budget strategies to cap expected outcomes such as maximum drawdowns, while at the same time trying to compensate by minimising the impact of market corrections," explained Ebermeyer.

With respect to hedge funds, Mark de Klerk, Head of Seeding Strategies at Tages Group, highlighted that there was a lot to be positive about. Tages Group is one of the most active seed investors in Europe, having seeded or provided acceleration capital to more than 10 funds over the last few years. This is, said de Klerk, one of the solutions that institutional investors are looking for with respect to Solvency II, as they look to meet their liability funding gap.

"Flows into hedge funds are continuing and our belief is that in a low yield environment, if you can do a 'cash plus' type return in a portfolio of hedge funds, but also get a share of the managers' equity, that can help enhance returns for those investors who have a long-term investment horizon," said de Klerk.

Gildas Le Treut, Global Director Prime, ABN AMRO Clearing and the five AIF Factor finalists (left to right: Serone Capital, Devet Capital, Puzzle Capital, Done Hedge Fund, Mint Tower Capital)

The AIF Factor

The AIF Factor gives five hedge fund managers three minutes to pitch why their fund should be considered by investors. This year's finalists included: Serone Capital, a structured credit specialist; Mint Tower Capital, a convertible and volatility arbitrage strategy; Puzzle Capital, a merger arbitrage strategy, and Done Hedge Fund, an equity market neutral strategy and London-based Devet Capital, a systematic market neutral strategy that uses statistical arbitrage to trade across commodity curves.

Devet Capital falls into the bracket of 'liquid AR strategies' and was deservedly voted this year's winner of the AIF Factor.

Irene Perdomo, Principal & Founding Partner, Devet Capital said: "We are so pleased that our strategy convinced this professional audience. They really liked our track record of consistent positive risk-adjusted returns, with controlled drawdowns, combined with a strict risk management approach. This is achieved through an efficient combination of machines for trade selection and human intervention for the risk management."

"This was the 4th year we've held the AIF factor and the five finalists, selected by an esteemed jury panel, delivered high quality, concise and effective pitches. With the audience as the ultimate judge, it really was a close call. Congratulations to our 2016 winner Devet and the runner-up Mint Tower," commented Amzallag. ■

Chapter 3

Investment strategy perspectives

Delphine Amzallag, European Head of Relationship Management Prime, ABN AMRO Clearing

All investors are keen to hear where the next market opportunity lies or why a particular investment strategy is well suited to the prevailing economic wind, and this was no exception at the Amsterdam Investor Forum. During his opening address, Gildas Le Treut asked the audience to vote on the following question: What alternative investment strategies do you see best performing in 2016?

The results were as follows:

- CTA ~ 32% (even though this was the least performing strategy in 2015, returning -0.49%);
- Multi-Strategy ~ 17% (+4.14% returns in 2015);
- Macro ~ 14% (+2.38% returns in 2015).

Clearly, CTAs are expected to provide protection to investors' portfolios this year and bring a diversifier effect, but knowing which CTAs to select, given that they employ a variety of styles (short-term trend following, long-term trend following, counter-trend etc.) is not always easy.

The obvious starting place in any selection methodology is performance. One CTA that did well last year was ISAM, whose fund, ISAM Systematic Trend, returned 15 per cent. The strategy uses adaptive trend-trading models to capture alpha from market divergence. "We make a diverse set of investment decisions across different systems, strategies, algorithms and we manage them. Markets throw things at us that we have to risk manage; how you deal with the difficult scenarios is key," said Alexander Lowe, Managing Partner, speaking on a CTA panel moderated by Alan Dunne of Abbey Capital.

CTAs are often thought about as thriving in periods of volatility, which typically favours short-term strategies. Richard Mathieson, Managing Director, Scientific Active Equity, BlackRock, said that he expects to see a structural shift in higher volatility during 2016. When it comes to idea generation, he said that "everything we do is based on some kind of economic hypothesis; coming up with new theories to answer the same questions in different ways. What's alpha today is beta tomorrow," confirming that Scientific Active Equity uses machine learning strategies that can be effective in terms of understanding different parts of a trade.

"The ideas that were good in the late 80s are still good, for the most part, today. However, a slight change in the volatility regime can completely change the effectiveness of ideas. We don't data mine research to create ideas, we come up with ideas/theories from scratch and try to tap in to human behaviour with the models that we build," said Paul Buethe, Senior Portfolio Manager, Crabel Capital Management.

100 Women in Hedge Funds chaired by Amanda Pullinger (far right)

Education needed

Whilst CTAs appear to be coming back onto investors' radar screens, there is still a lot of education required. Part of the issue, according to Lowe, is that some investors view trend following as an easy strategy to implement and do not necessarily see the value of them. Of course, the opposite is true. CTAs have to build strategies that combine the right number of markets and asset classes and ensure that the right technical indicators are embedded in the model to identify longs and shorts, and react to volatility.

Most investors are well educated but the biggest issue is explaining that CTAs do suffer large drawdowns periodically. "We expect investors to understand that they might have to deal with a 20% drawdown, because if a CTA has had a great couple of years' returns I can guarantee there's a landmine just up ahead," said Lowe. Mathieson said that when drawdowns happen it pays to take down risk quickly "so our portfolio managers follow drawdown guidelines closely".

Certainly, there are signs that more investors are returning to CTAs. Nicolas Gaussel, CIO, Lyxor Asset Management said that CTAs were a preferred strategy for 2016, along with macro strategies; both of which can be thought as risk mitigating strategies to alleviate the impact of allocation mistakes. CalSTRS, for example, plans to increase their allocation to these risk mitigating strategies from USD1 billion to USD10 billion over the next three years.

Market opportunities in equities

With respect to equity long/short strategies, Marc-Antoine Chatin, Partner, Parus Finance, is finding more short selling opportunities in the market than longs. Speaking on the panel, "Is life too short to be long?" moderated by Nicolas Campiche, CEO, Pictet Alternative Advisors, Chatin said that one aspect of Parus Finance's short strategy is based on the oversupply of mining and commodities driven by China. Another key driver of its short strategy is the limit of future quantitative easing.

"We stayed above 80% net long between 2009 and 2013, holding very few shorts. But then we started to see that valuations of our longs were getting challenged. Our long book today is 30% and our shorts have increased from 0 to 50%. The short book accounted for 90% of our returns last year. Currently, our net short exposure is -8%, so we make money when markets lose money," explained Chatin. He said that currently Parus Finance's largest short positions are in energy and mining stocks.

Speaking on the "100 Women in Hedge Funds" panel at the Amsterdam Investor Forum, Rani Piputri, Senior Portfolio Manager, Saemor Capital, a Dutch quantitative investment manager, said that there were stock picking opportunities in European equities. "We see stock dispersion in Europe. It is a fertile source of alpha both on the long and short side for us. However, you have to keep a level head and stick to your strategy in periods of market volatility," said Piputri.

Fellow panelist Anne-Sophie D'Andlau, Co-Founder and Managing Partner, CIAM,

a Paris-based event-driven fund, said that CIAM had been able to identify better entry points amidst the recent market volatility, particularly for its special situations investment book. "Our strategy is holding up well amid higher volatility. Medium-sized spreads are widening which is benefiting our merger arbitrage book. We are able to take advantage of the inefficiencies in the markets right now," said D'Andlau.

Amanda Pullinger, CEO of 100 Women in Hedge Funds, moderated the above panel. 100 Women in Hedge Funds was founded in 2001 and has become an important driving force in the industry, counting more than 13,000 members globally. Education, professional leverage and philanthropy are the three key pillars of the organisation. "We put on around 100 industry events globally in 20 locations. I'm pleased to chair this particular panel as it is our first ever in Amsterdam," said Pullinger.

European telecoms

On the long side, opportunities exist in growth companies that are innovating their business models and bringing disruptive technology to the marketplace. Identifying the next Apple, Facebook or Tesla – companies which are having a major disruptive effect on the world and are difficult to stop once they start growing – is no easy task but the technology sector, at large, could yield good sources of returns over the next five years; especially if one considers the fact that billions of advertising dollars are set to move from TV into the online domain.

Daniel Avigad is Portfolio Manager, Lansdowne Partners, where he runs a long-only equities book. Commenting on market sectors in which he had the highest level of conviction, Avigad made reference to European telecom companies, which have USD1tn of debt both on and off balance sheet and are too big to fail.

"However, the regulatory environment has been designed to make them fail in many ways. My contention is that 180 telecom companies in Europe could potentially have shrunk to five major names in the next five years, comparable to the five main telecom operators in the US. Deutsche Telekom is already a large stakeholder in British Telecom (via BT's GBP12.5 billion acquisition of EE) and we could see Orange and Telecom Italia merge, for example," said Avigad. ■

Chapter 4

The regulatory cycle

Regulation continues to weigh heavy on the shoulders of global fund managers.

When asked the question, "What worries you most about your portfolio in 2016?" some 30% of attendees said increased regulatory pressure, with 17% citing higher jumps in volatility.

With more regulation coming down the pipeline, most notably the pervasive second iteration of Markets in Financial Instruments Directive, MiFID II, due to be transposed across Europe in January 2018, the need to update and improve operational systems and procedures will continue at pace to cope with increased transparency demands.

Indeed, the Alternative Investment Fund Managers Directive ('AIFMD') is designed to make fund managers more accountable but as Jack Inglis, CEO of AIMA, which represents the interests of the alternative funds industry, stated: "Regulation has three main objectives: to secure financial stability, to protect investors and to prevent market abuse. Those objectives need to be assessed. Personally, I don't think AIFMD has delivered more investor protection."

Regulatory costs

Thirty-four per cent of attendees said that increased regulatory costs was the single biggest impact that AIFMD was having on their fund(s) and 31% said it was increased reporting requirements. The majority of attendees (42%) confirmed that they were availing of the EU passport for marketing purposes in the EU, with 21% still using national private placement rules and, perhaps surprisingly, 21% using the reverse solicitation route.

"In terms of regulatory compliance, the reporting aspect is challenging for smaller fund managers. Cayman funds rely on NPPR and are grappling with the demands of reporting in different EU Member States. Moreover, a large number of funds will soon face an additional layer of reporting on their investors with Common Reporting Standards, which is similar to US and UK FATCA but for the fact that 95 countries have signed up to it. More compliance, more costs. This is making it harder for smaller managers. I would say less than 50% of start-ups that I see coming through the door actually succeed in getting to market," reflected Heidi de Vries, Partner at law firm Maples and Calder.

Impact on market liquidity

One fear that some within the funds industry have with respect to the seemingly endless wave of regulation is that it is making markets more illiquid. That makes it more expensive to change a position, sometimes even impossible to change a position when counterparties refuse to trade, according to Thijs Aaten of APG, a large Dutch pension provider. "The lack of market making activity has become more prominent in the last couple of years. It is valuable. It provides

Nicolas Campiche CEO, Pictet Alternative Advisors (far right) moderating the panel "Equities: Is life too short to be long?"

immediacy to the markets. But it has been very much affected by regulation," said Aaten.

Inglis added that reporting was "the number one bugbear of our industry; not just regulatory risk reporting (Annex IV, Form PF), but transaction reporting under EMIR. The ESMA reporting template has 65 fields to complete per transaction; is that going to damage market liquidity? It very possibly will. It produces potentially worrying issues, especially for liquidity in bond markets."

Short selling disclosures have had some impact on liquidity in European equity markets and given the singular focus on improved transparency, at the pre- and post-trade level under MiFID II, this could disincentivise market making activity even further, going forward.

"MiFID II is a big item on our agenda," confirmed Sheila Nicoll, Head of Public Policy, Schroders. "What will regulators do with the information that is reported? The FCA recognises the importance of feeding back the information they gather under AIFMD. Regulators have a lot more data on AIF managers compared to UCITS managers, which opens the debate on whether asset managers are systemic or not." Nicoll believes that asset managers like Schroders will increasingly need to demonstrate how the liquidity in the group matches the liquidity of the underlying funds they invest in on behalf of their investors.

"It is our activities that might be viewed as potentially systemic rather than the entities we invest with. A fund manager is not likely to bring the financial system crashing down. I think that is where regulators are going to focus their attention going forward," suggested Nicoll.

Indeed, the FSB and IOSCO agreed last year to start looking at the activities of funds (both in the long-only and alternatives space) rather than just their size. "I think that was absolutely the right thing to do. It sent a positive signal that you can get things done properly when interacting with regulators," concluded Inglis.

Conclusion

There are significant regulatory and market challenges that lie ahead in 2016. But those managers who have the rigour and the discipline to continue to seek out inefficiencies in different asset classes will likely prosper. If anything, regulation, and technology, is pushing alternative fund managers to enhance their business operations and seek out greater workflow efficiencies.

This is another sign of the ongoing institutionalisation of the hedge fund industry. And with exciting hedge funds such as Devet Capital and Mint Tower impressing investors, there is plenty to be optimistic about. ■