The Increasing Allure of Alternative UCITS

Stockholm (HedgeNordic) – With continuing positive inflows, Alternative UCITS are proving an appealing option to investors looking to diversify investment, particularly in the looming shadow of a likely rising interest rate environment and its effect on fixed income portfolios.

Following years of investors piling into fixed income at low or zero interest rates, the election of Donald Trump and an expected rising interest rate environment is now raising fears of an end to the permanent bull market. James Williams, Managing Editor with HedgeWeek, suggests this could be good news for Europe's alternative UCITS market, which could benefit from investors wanting to know what Federal Reserve rates increases will mean for their fixed income investments, and moving if even only small percentages of their traditional long-only capital into alternative UCITS, which could be worth hundreds of billions of dollars in new assets. The alternative UCITS market has already been expanding markedly with total industry assets at EUR409 billion as of October 2016, up from approximately EUR 260 billion two years prior, according to LuxHedge. Deutsche Bank puts total alternative UCITS AUM at approximately EUR 400 billion, which amounts to a 26% annual increase since 2008.

European institutions themselves will be looking to protect themselves with inflation-linked and fixed income absolute return products. "We are of the opinion that the alternative UCITS market is going to grow substantially over the coming years for reasons that relate to the fact that fixed income markets are not yielding anymore," says Benedict Peeters, CEO of LuxHedge. "Investors are looking for alternative ways to generate returns and they want to invest in a way that is less correlated to interest rate movements. I believe the alternative UCITS market offers very good opportunities to do that," he says.

If, in addition to interest rate increases due to Mr Trump's victory, European bond rates also rise concurrently with less ECB monetary intervention in Europe, it could have significant consequences for traditional bond portfolios. Meanwhile, as Europe's alternative UCITS environment continues to expand, investors will be looking beyond traditional environments to find the best talent to allocate to. Those seeking portfolio diversification might have broader approval by purchasing UCITS products than when considering AIFMD-compliant funds, as these already impose restrictions on hedge fund liquidity and concentration limits in their pursuits of returns to meet liabilities (e.g. in the pension fund market), as opposed to achieving the best return possible, thereby circumventing the need to obtain special authorisation.

Deutsche Bank's 2016 Alternative UCITS survey found nearly 70% of investors surveyed allocate to alternative UCITS funds, 58% of which confirmed this demand was made by underlying institutional clients. "Our survey results suggest that growth is set to continue, with two thirds of alternative UCITS respondents expecting to increase their allocations this year. We are also seeing a growing number of hedge fund clients embrace UCITS as a growth strategy for their businesses, leading to an increase in new interesting fund launches," says Anita Nemes, head of Hedge Fund Capital Group at Deutsche. The survey also found that systematic equity market neutral and fundamental equity market neutral are the most sought-after strategies by alternative UCITS investors.

Of the three main buckets – Equity long/short, Equity market neutral and Fixed Income arbitrage – into which new launches within the alternative UCITS space tend to fall, Fixed Income arbitrage accounts for approximately one quarter (EUR 109 billion) of total alternative UCITS assets, according to LuxHedge. The Fixed Income Arbitrage UCITS is up +2.18% YTD in an otherwise tough year for the market, with other strategies in positive territory being CTAs up +0.84%, global macros up +0.78% and volatility arbitrage up +0.58%. As a result, more U.S. managers are considering adding alternative UCITS products.

Read the full analysis from HedgeWeek's James Williams here.

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