Strong demand for liquid alts despite disappointing performance – Jupiter AM

Stockholm (HedgeNordic) – Despite a weak showing for liquid alternative funds in recent years, there is still strong demand for the asset class, this according to Magnus Spence Head of Investments – Alternatives (pictured) at UK-based asset manager Jupiter Asset Management.

In an interview with HedgeNordic during a visit in Stockholm last week, Spence says that the average liquid alternative investment fund has seen performance numbers coming down significantly in recent years.

”The average liquid alternative fund has, during the last 2.5 years, generated an annualised return of 1.5 percent net of fees which compares to 4 percent annualised return during the eight years following the financial crisis”.

As a result of the performance weakness there is confusion among investors how to approach their liquid alternative investments, Spence says.

”As for bonds, investors feel that the market has become stretched, especially since we have interest rate hikes around the corner. Even within equities investors are feeling increasingly worried over valuations given the strong performance last year. This has led to a positive demand picture for absolute return products, at the same time investors feel that this asset class has not delivered in line with expectations in recent years.”

According to Spence, the increased demand for liquid alternative funds is structural rather than tied to market developments as of late. With regards to what investment strategies that are most sought after, Spence says that funds that can deliver uncorrelated return profiles are in high demand among institutions.

”Institutions that are looking for long/short equity exposure tend to have a preference for market neutral strategies for example. Investors also look for strategies that they understand and there is a strong focus on fees”.

Spence highlights that funds with low volatility profiles have attracted significant inflows, which in turn has led to disappointed investors once it became clear how much of the gross returns that were consumed by fees.

”80 percent of the fund flows to liquid alternatives in the last five years has gone to funds with annualised volatilities below 5 percent. If the manager has skill, he might be able to produce a Sharpe-ratio of one, which means an annualised return of 5 percent. If the manager, on top of this, charge a management fee of 1.5 percent and a performance fee of 25 percent, then 40-50 percent of the gross returns disappears into the hands of the asset manager.”

”Investors have come to realise that fee levels for low-volatility products are too high and have become more sensitive to fees over time, Spence concludes.