



Are Hedge Funds Struggling to Please Asset Allocators?

Stockholm (HedgeNordic) - Considering the muted performance of hedge funds in the past several years, the assumption was an audience largely composed of hedge fund managers would be eager to hear what capital allocators think about the current state of the hedge fund industry. For that specific reason, the panel discussion at the Nordic Hedge Award on April 26th 2017 in Stockholm included representatives from different Nordic asset allocators: Claudia Stanghellini, Head of External Management at the Swedish state buffer-fund AP3, Helen Idenstedt, Analyst, Alternative Investments at AP1 and Christer Franzén, CIO at Ericsson Pensionstiftelsen, the Stockholm-based \$2.3 billion pension fund covering Ericsson's employees.

The panelists touched upon the trust between hedge fund managers and allocators and the relatively disappointing performance of the industry. They also offered insights into their allocation plans for the foreseeable future and shared thoughts on what catches their attention. The discussion was moderated by Aline Reichenberg Gustafsson, Editor-in-chief of NordSIP - a Nordic Sustainable Investment Platform - Hedge Nordic's recently launched sister site. Gustafsson kicked off the discussion by asking the three panelists about the "secret sauce"

hedge fund managers should use. More specifically, the panel participants were requested to pinpoint the most important aspect allocators care about that managers usually underestimate or overlook.

A solid company and operational structure; interesting niche strategies; and strong risk control of the drawdown were the three main factors laid out by Stanghellini. Idenstedt pointed out that transparency and trust are crucial in the asset allocator-hedge fund manager relationship. Franzén highlighted that long/short equity managers, for instance, need to prove that they don't have too much Beta in their portfolios. This is not to say that the level of return he expects should be much different than that from the market over the long run but he wants managers to generate equity-like returns with less volatility than the market. There was no surprise in the room when the lackluster hedge fund performance became a topic of discussion. An attendee asked the panel participants whether they saw the disappointing hedge fund performance as "just a bump in the road".

Franzén indicated that it would be much easier for hedge fund managers to generate decent returns should interest rates normalize, as government bonds used to generate some income for hedge funds several years ago. Stanghellini expressed some disappointment with the "modest hedge fund performance" in recent years, but she reassured managers in the room, saying that her team continues to have faith in the hedge fund industry. "We are still believing in hedge funds, but we have concentrated our assets in hedge funds to some high conviction names," said Stanghellini, mentioning that costs also triggered an impulse in this dynamic. Idenstedt said her team at AP1 was satisfied with their hedge fund allocations, mentioning that global macro and CTA hedge funds have performed in line with their expectations. A non-Nordic fund manager attending the event sought to find out the most efficient method to keep asset allocators updated about what hedge funds are doing without "bothering them too much". The panel participants seemed to agree that they would rather perform the search process on their own instead of being "bombed" with e-mails. Both Stanghellini and Idenstedt mentioned that they focus on a restricted number of strategies at any given time, which allows them to reduce the number of candidates to examine, and sometimes they are the ones approaching managers. Idenstedt also pointed out that in the search process for hedge fund managers AP1 sometimes also engages consultants and other partners screening the hedge

fund universe. As the Ericsson pension foundation has less capital than the AP funds, Franzén's team mostly finds managers through private channels. Although the hedge fund industry as a whole has been evolving quite rapidly in recent years, there is no clear universally-applied definition of a hedge fund.



Claudia Stanghellini, AP3



Christer Franzén, Ericsson Pensionstiftelsen



Helen Idenstedt, AP1

Gustafsson attempted to get the panel participants to formulate their own definition. "Hedge fund as a word is pretty confusing. It's like emerging markets, what is that? I don't know really," said Christer Franzén with a twinkle in the eye. The panel agreed that the term "hedge fund", even if boundaries are sometimes blurry, defines investment vehicles that should contribute to asset allocation with alpha-like, absolute returns that, by definition, are uncorrelated to other asset classes. The audience was also interested in finding out the necessary fund size a hedge fund should have in order to be able to get the attention of asset allocators. While all panel participants claimed they didn't have any hard limits on size, some of them prefer seeing some assets before subscribing to a new hedge fund. Stanghellini emphasized the idea that hedge funds need to have the appropriate structure and infrastructure to handle the minimum investment tickets offered by pension funds, typically around \$50 million dollars. She also mentioned that her fund may need to invest quite early on some occasions before the capacity of hedge funds is filled up, but would prefer to see hedge funds managing between \$300M and \$500M prior to investing.

Meanwhile, Idenstedt and her team started looking into the possibility of investing during early stages, which might prove to be a great opportunity for freshly-launched funds. As to the question of whether the asset allocation of pension funds will look different within three years, all panel participants seemed to suggest that the allocation won't change significantly going forward. More importantly, Idenstedt revealed that her team would like to increase their capital

allocation and exposure to the hedge fund arena, but the relatively hard constraints on costs has not allowed them to significantly increase this exposure so far. Franzén said that there are no plans to change anything regarding the current allocation, but he did mention that it might become a different story should hedge fund managers generate more alpha. Gustafsson asked for the panel participants' thoughts on sustainable investments within the hedge fund industry.

It is well known that the Swedish buffer funds have a mandate to invest responsibly, with both Stanghellini and Idenstedt acknowledging the importance of ESG factors and sustainable investments overall. Idenstedt mentioned that a few newly-launched hedge funds focus their strategy on extracting alpha from sustainable investments, but for some other funds, it is particularly difficult to incorporate ESG factors, due to the nature of the strategy, for example in the case of CTA funds. When asked if he cared about sustainable investments, Franzén jokingly answered that "you can't say that you don't care." While Franzén highlighted the importance of sustainability when it comes to the wider investment universe and the importance to focus on substance rather than appearance, since otherwise it will risk diluting the cause. He stated that for some hedge funds, who cannot have a direct influence on their investments, like derivatives on stock indices, ESG issues are much smaller in range, and that therefore, it is not a central issue for him when selecting this kind of managers.

Last but certainly not least, when asked to pinpoint a game-changing trend within the hedge fund industry, the panel participants seemed to jointly agree on the idea that the transition to big data will be noticeable in the near future. Idenstedt mentioned that artificial intelligence had certainly become an important trend and that she expected it to continue to grow. On this inspiring outlook, Gustafsson thanked the panel for their candid and insightful answers and tongue in cheek, invited the three allocators to find new investment targets amongst the winners of the upcoming award ceremony