No Guessing Games

Stockholm (HedgeNordic) – The ability of central banks to reverse an economic downturn appears limited as the global economy approaches the ends of both the short-term and long-term cycles. “Since interest rates have been cut down to zero or even below zero, the maximum work has already been done to get everyone – governments, companies and individuals – loaded up with the maximum amount of debt,” warns **Tommi Kemppainen** *(pictured)*, the CEO of Finnish asset manager **Helsinki Capital Partners**.

“While many market participants are very much aware of the shorter-term cycle, extremely few seem to be aware of this much longer debt cycle coming to an end,” reckons Kemppainen. The high debt load of many developed countries along with ageing populations pose a significant risk to the economies of those countries and the global economy as a whole. With workers ageing out of the workforce and fewer people contributing to economic growth, there is no obvious solution for how to generate economic growth to work that debt off. “There is no natural growth in the gross domestic product if the workforce is shrinking,” explains Kemppainen. The ability to pay off debt, therefore, decreases as a result of changing demographics and subdued productivity growth.

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decade is artificial in the sense that the growth was built by borrowing more money."

According to Kemppainen, major developed countries "are facing the same phenomena Japan has been struggling with over the past three decades." An unprecedented monetary expansion after the 2008 financial crisis fuelled what is now considered healthy economic growth. "The hardest thing for investors is really to go back to the fundamentals of the global economy and understand that a huge chunk of the GDP growth in the past decade is artificial in the sense that the growth was built by borrowing more money."

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Credit expansion plays an essential role in driving economic growth and does so by increasing the amount of debt in the system. As the debt cycle inverts at some point, lower levels of credit lead to lower consumption and investments, and economies slow down. **HCP Black**, a multi-strategy, multi-asset fund investing across a range of non-correlated alternative assets, "has been positioned to protect capital against the consequences of a potential depression."

A Little Bit of Everything

Kemppainen allocated HCP Black's assets under management to a select group of alternative investments, allotting only a small part to stocks through investments in the other two long-only equity funds under the umbrella of Helsinki Capital Partners: **HCP Focus** and **HCP Quant**. Discussing the most attractive alternative assets from a risk-reward standpoint, Kemppainen says that "none of the alternatives is a no-brainer, because absolutely all of them exhibit risk."

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To protect against a potential or even imminent economic downturn, "one would maintain a collection of different kinds of alternatives that do not get in the same trouble exactly at the same time," he argues. "This is key in my active diversification." At the end of 2019, HCP Black had about 27 percent of its managed assets allocated to trend-following strategies, 26 percent invested in

insurance-linked securities, 11 percent in real estate, and 10 percent in physically-backed gold. The remaining capital was invested in HCP Focus, HCP Quant, silver, tail-hedge and equity special situation strategies.

"Instead of trying to get exposure to as many alternative assets as possible, we focus on analysing the fundamentals of each asset to select investments that are as different from each other as possible," explains Kemppainen. "Considering the set of risks in the world today and that the entire economic system and individual economies are fragile, having some real assets that have some positive value regardless of what happens is a prudent way of allocating capital."

Institutional investors use trend-following strategies as a tool to collect "crisis alpha" in times of turmoil, which is why HCP Black has roughly one-fourth of its assets invested in this type of strategies. Explaining the relatively high exposure to trend-following, Kemppainen says that "it is almost by definition that financial assets are going in one and the same direction for long periods of time when you have a financial crisis of any sort." Investors, however, should not expect a smooth ride from trend-followers, warns Kemppainen.

"When markets start to sink fast, trend-followers do not typically deliver good performance at the beginning of the phase, but later on, as trends become more established, trend-following strategies generate strong returns," explains Kemppainen. "The same goes for gold," he adds. With central banks around the world keen to inject more stimulus to offset any slowdown risks, the environment remains bullish for gold. "There are a lot of questions marks over more or less all currencies everywhere," argues Kemppainen, who adds that "it is possible that gold will have a really good run."

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Kemppainen, however, emphasises that "it is the combined allocation maintained by HCP Black that is attractive and not any asset class in particular." His approach to allocating capital is not a guessing game, he stresses. "Trying to guess when the recession will unfold or how financial markets will react is just very hard, I am not equipped to predict the next moves," acknowledges Kemppainen. "But I see the root cause of the problems in the global economy and understand that the economy is fragile, so I do my best to position HCP Black

wisely and accordingly." The CEO of Helsinki Capital Partners says that "HCP Black's current allocation is the best way I know how to invest when there is anxiety over a recession, depression and the end of a long debt cycle."

Invert, Always Invert

Instead of looking for the most attractive alternative investments, Kemppainen starts from the opposite end and tries to find and avoid the least attractive investment opportunities. "I see the least attractive risk-reward opportunities in equities and bonds," points out Kemppainen. "Regardless of which valuation metrics I look at, I expect zero annualised returns on equities for the next 12 years forward." Equity valuations, therefore, would have to drop to some extent in order for investors to be able to receive the equity premium that compensates them for the risk associated with holding equities. "The least interesting risk-reward is equities."

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Bonds are not appealing either, reckons Kemppainen. "Looking ahead for the next 12 years, I do not expect lower interest rates than the current level," he adds. "If one sees a higher probability of rising interest rates over the next 12 years, then everyone holding a fixed-rate bond of any sort or form will be losing money." The process of inverting a problem helps Kemppainen find the most suitable investment opportunities for HCP Black, his asset management firm and investors. "It is easier for me to say what I am not touching at all."

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Kemppainen puts his own and his company's money where his mouth is. "All of our company's money is currently invested in HCP Black," he says. "We are in the business of asset management, which is a really cyclical business, especially considering that two of our three funds are long-only equity funds." With all the company capital invested in HCP Black, "we want Helsinki Capital Partners to do well in bad times too." Kemppainen concludes by saying that HCP Black is a suitable alternative for "all investors who already have enough risk on other

fronts and are looking for a vehicle that would maintain the buying power even in nasty markets.”