Wearing Multiple Hats

Stockholm (HedgeNordic) – The ability to dampen volatility in equity portfolios may not have been in particularly high demand in the pre-pandemic period, as stocks had been moving up in unison in usually calm market conditions. The market environment was not especially fertile for long/short equity managers in the decade before the Covid-19 pandemic, which begs the question: what is the role and future of long/short equity hedge funds? After all, the future of long/short equity managers is crucial for the broader hedge fund industry, as the strategy is a significant part of the hedge fund universe, accounting for a meaningful portion of hedge fund assets.

There is no one preeminent rule of thumb that defines the role of long/short equity hedge funds in portfolios. The role may depend on each investor's objectives, the existing composition of their portfolios, or many other factors. For its portfolios, Helsinki-based alternative investment manager AIM Capital views low-net or zero-net strategies as the most compelling strategy in the current environment. "In our core allocations, we seek to maintain a low correlation to equities and therefore focus on strategies that have predominantly market-neutral characteristics, as is the case in our AIM Diversified Strategies Portfolio," Miikka Hautamäki, the chief executive officer of AIM Capital, tells HedgeNordic.

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“Broadly speaking, we tend not to invest much in generic long/short equity strategies as we feel that the embedded equity beta can be captured in a more cost-effective way,” argues Hautamäki. “However, the types of equity strategies that we find relevant in our portfolios are market-neutral strategies and sector specialists, both of which can generate differentiated alpha,” he emphasizes. “The allocation between these styles depends on the objective of the portfolio,” says Hautamäki, who runs two funds of funds and bespoke advisory mandates for institutional investors.

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“In some of our more ‘aggressive’ portfolios and managed accounts, we have focused on TMT and Healthcare sector specialists, as these are the sectors where significant alpha opportunities have existed,” Hautamäki tells HedgeNordic. However, the pockets of alpha are subject to change due to changes in market conditions. “As is the case with all hedge fund strategies, the opportunity set changes over time and economic cycle, meaning that there have been periods when we have had no sector-specific equity long/short managers in the portfolios,” says Hautamäki. In the current environment, an allocation to market-neutral strategies could increase the resilience of investor portfolios by providing valuable downside risk-mitigating benefits in addition to potential alpha sources.

Manager Selection

Whereas many have dubbed the classic broadly diversified FoHFs setup obsolete, AIM Capital’s Diversified Strategies Fund maintains an edge that allows the fund to survive and thrive. The edge revolves around long-lasting relationships with the highest-quality managers and concentrated investment approach. Manager selection, therefore, is crucial for its objective to deliver absolute return across all market environments with low correlation to stocks and bonds.

“We have been investing in hedge funds since 2001. Based on our observations and experiences of hedge fund performance in different market cycles, we have differentiated our approach by focusing on managers that have a proven and tested investment process producing persistent and uncorrelated returns, even in extreme market conditions,” Hautamäki tells HedgeNordic. “As a consequence, AIM Diversified Strategies investments have gravitated to the best resourced hedge funds such as Citadel Advisors, D.E. Shaw & Co. and Two Sigma."

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"Through our long-standing relationships with some of the leading hedge fund managers around the world, our fund provides access to many high-quality and difficult-to-access funds," explains Hautamäki. "In terms of exposure by investment manager, the fund is concentrated because we believe only a small percentage of managers are worth investing in," he emphasizes. A meticulous selection process is required to find the small percentage of managers worth investing in.

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"In addition to the normal due diligence requirements that we set to all our managers, evidence of alpha-generating ability in general is the obvious primary requirement" for investing in new equity managers, according to Hautamäki. "Specifically, though, we look for managers that can steer away from excessive commonality and crowding risks. We look at how the manager has navigated periods of volatility," he continues. "Resources and capability to adapt to changing markets and ability to generate returns in all environments is key."

Hautamäki goes on to add that "we are also keen on understanding the firm culture and how it has evolved." Lastly, "the assessment of the opportunity set against the risk of alpha decay, as well as the manager's style and fit with our specific portfolio requirements is a key consideration when making the final investment and sizing decisions," the CEO of AIM Capital tells HedgeNordic.

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"We believe the next five years are likely to be more challenging due to structurally lower growth and changes in the inflationary regime. This may have profound implications for the markets and hedge fund alpha," Hautamäki describes a future scenario. "We believe some equity managers are better positioned and have a culture better suited for adaptation to changes in the markets."

This article featured in HedgeNordic's "Finding Alpha in Equities" publication.