# Survey of Allocators' Investment Trends

**March 2019**

Carl Berg, Catalyst Financial Partners
Susan Weerts, Research Analyst

---

## Industry Background

2018 was a mixed year for global asset management. Initial gains fueled by buoyant economic growth stories gave away to a slew of head-winds: change in the interest rate regime at the Fed, declining global economic growth, geopolitical tensions and intensifying global trade disputes. The rally in the broad market fizzled out, and the S&P500 ended down - 6.2% for the year, basically at its lowest point of the year.

The hedge fund industry fared relatively well, finishing down -4.1% on a fund-weighted basis[1]. This marked the first time in the past nine years that the hedge fund industry beat the broader market. The dispersion within the industry was large, however, with for example Odey European (a Macro strategy) delivering a 54% return, while QIM's Quantitative Tactical Aggressive (a Quant strategy) was down - 45%.

The sell-off in the 4th quarter of 2018 – as well as the recent spectacular rebound in early 2019 - has provided observers with yet another way to scrutinize how robust different managers and strategies are. Hedge funds have been widely criticized for their underwhelming performance. The rising markets in the past several years have added additional difficulty in differentiating skill from luck. Funds that managed to prove themselves during the late 2018 correction are certainly in a stronger position.

Other alternative asset classes have done reasonably well, but private equity is suffering from over-valuations and significant dry powder being available: $2.10tr at June of 2018 compared to $1.36tr just three years ago. Real estate did well too, with the largest 300 funds raising over $100bn – putting the industry AUM over $900bn for the first time[2].

## Survey Summary

Based on the survey, we can make the following conclusion: Investors seem to be having both a risk-on and risk-off attitude going into 2019, in a two-pronged approach. At the core portfolio level, investors aim to reduce their idiosyncratic risk by increasing exposures to general markets. However, at the tactical level, they are willing to increase risk by increasing holdings of 'true' alternatives in pursuit of alpha. These often include illiquid assets, niche markets and strategies, and managers that focus on assets with a

[1] Hedge Fund Research, Inc.
[2] Prequin

higher degree of market inefficiency.  Conversely, we should see continued less interest in strategies with large exposures to market beta, particularly such L/S and Long biased equity funds which focus on broad markets without a clear informational edge.

| | Less risk | More risk |
|---|---|---|
| **Portfolio level** | Diversification | Concentration |
| **Tactical level** | General markets | 'True' alternatives |
| | **Beta** | **Alpha** |

Applying an approximate technical expression for these relationships, we think it is increasingly true that investment strategies with a Sharpe Ratio < 1 will often struggle to attract investors, due to either providing too low returns or too few portfolio benefits, or both. The reverse holds for strategies with a Sharpe Ratio > 1.

We see that investors are increasingly moving to private equity in pursuit of alpha, and a long lock-up is less of an issue compared to a few years ago. More importantly, there are far fewer substitutes to private equity exposure than, say, fundamental L/S equity investing.

Among hedge funds, strategies with low market correlation continue to attract the most attention from investors. Event-driven strategies see the biggest jump in investors' interest. This is likely due to their ability to capture price inefficiency and arbitrage in relation to corporate events and news. We see a notable decrease of the substitutability of ETF and mutual funds due to their inability to insulate themselves from market fluctuations. The interest in L/S equity strategies remain reasonably high among the survey's respondents, while it is trending downwards and faces challenges[3].

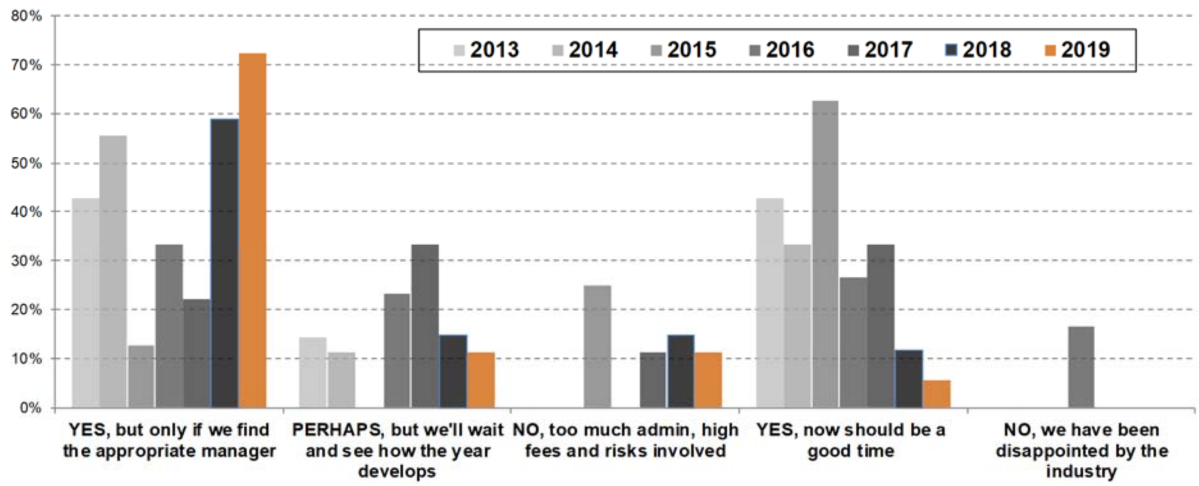
As for niche markets, investors seem to be increasingly drawn to technology innovation as being the basis of an investment strategy. Advanced computing power, new methods in data mining, Big Data, and machine learning are enabling managers to use new quantitative methods to more effectively and quickly exploit mispricing in the market. In addition, advanced computer power helps managers to find market inefficiencies in asset classes with higher volatility, more skewness and kurtosis distribution. Blockchain/crypto and CTAs on Currencies / Commodities would be prime examples.

Fund selection remains partly governed by what portfolio benefits a fund may bring. However, a 'true' alternative strategy needs to enhance absolute return at an investor's portfolio level while reducing idiosyncratic risk. It has proven difficult to find funds which achieve both objectives.

[3] AlphaJournal, February 20, 2019 "Tough time for equity long/short strategies".

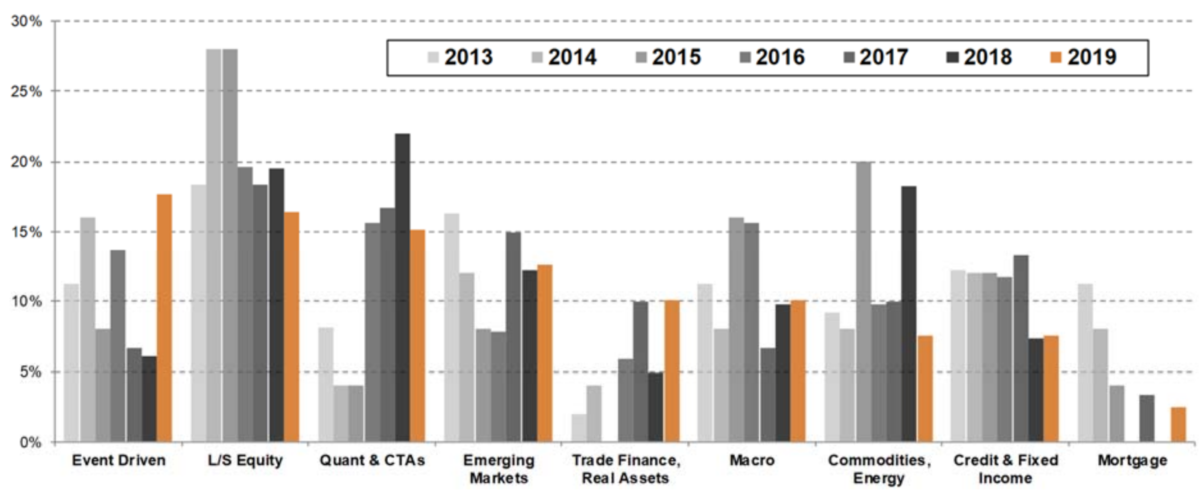
# Survey Results

### 1. In 2019, would you consider allocating to alternative investing funds?



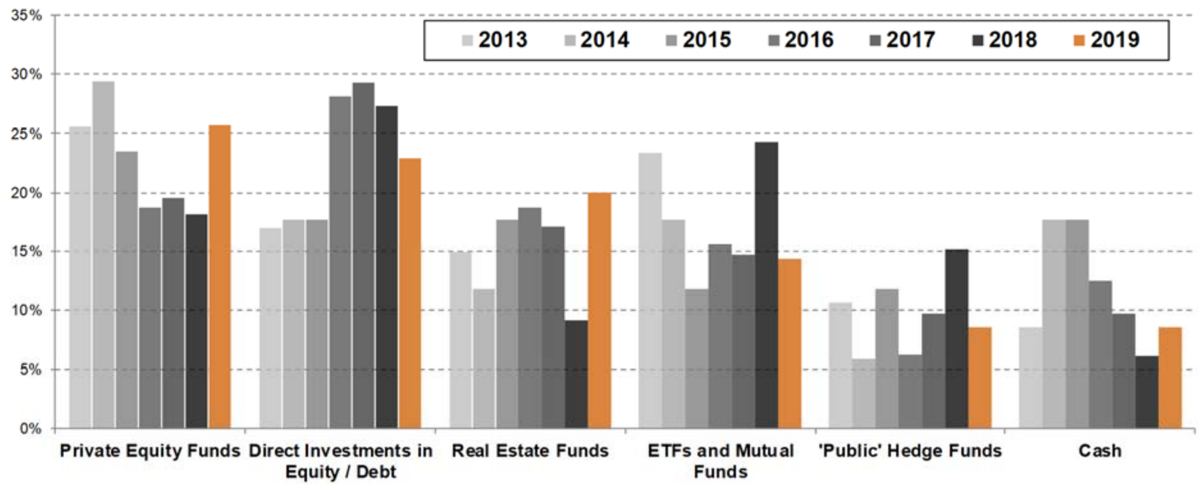

- The appetite of investing in alternative investing funds is fairly strong in 2019. However, there is caution as they would only invest after a rigorous search and if the timing is right.

### 2. Within the hedge fund space, what sectors do you think would be especially interesting in 2019?



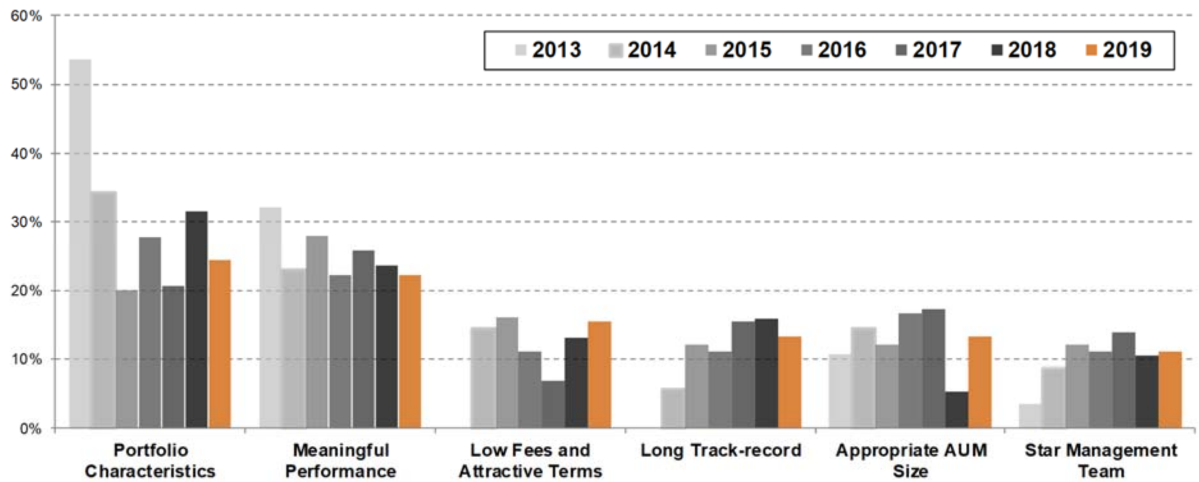

- **Low-correlation strategies continue to dominate investing preferences.**
- **The top preferences are Event Driven, L/S Equity and Quant strategies**. 2019 should be a favorable environment for managers with an active management style that can capture price spreads and arbitrage.

**3. What other investment opportunities would you consider other or rather than hedge funds?**



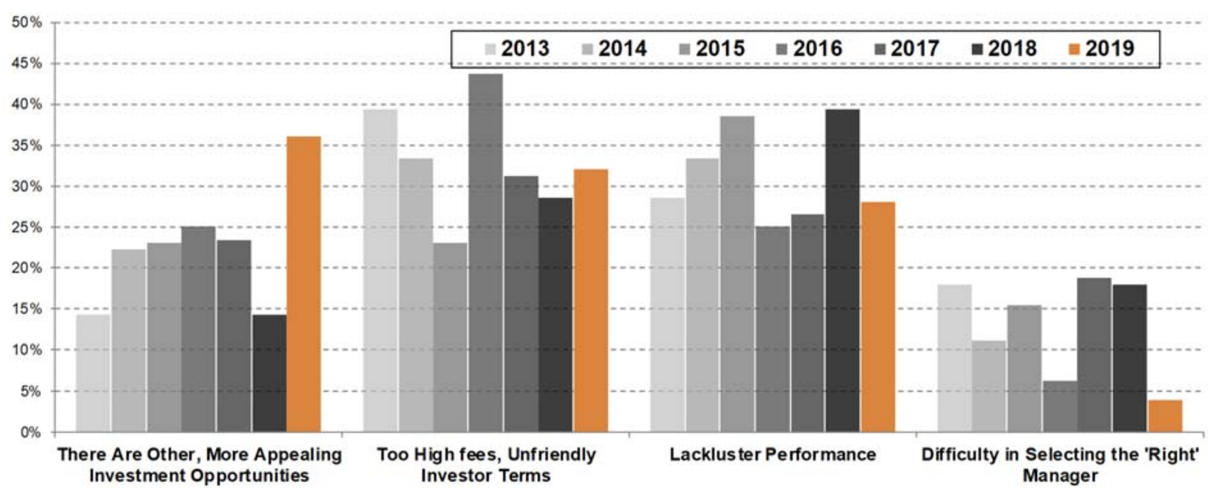

- **Private Equity funds have become more attractive.** Investors position themselves into mid/ long term illiquid assets. Moreover, private equity funds offer access to deals and private companies, something liquid markets, and investment managers that focus on same, cannot easily do.
- **We see a surge of interest in Real Estate funds.** This might indicate that that investors are hunkering down for an economic slowdown.
- **Interest in ETFs and Mutual Funds sees a large drop**. Despite being cheap in term of fee structure, ETFs and mutual funds don't provide risk reduction.

**4. What are the most important criteria for an alternative fund that you would consider investing in?**



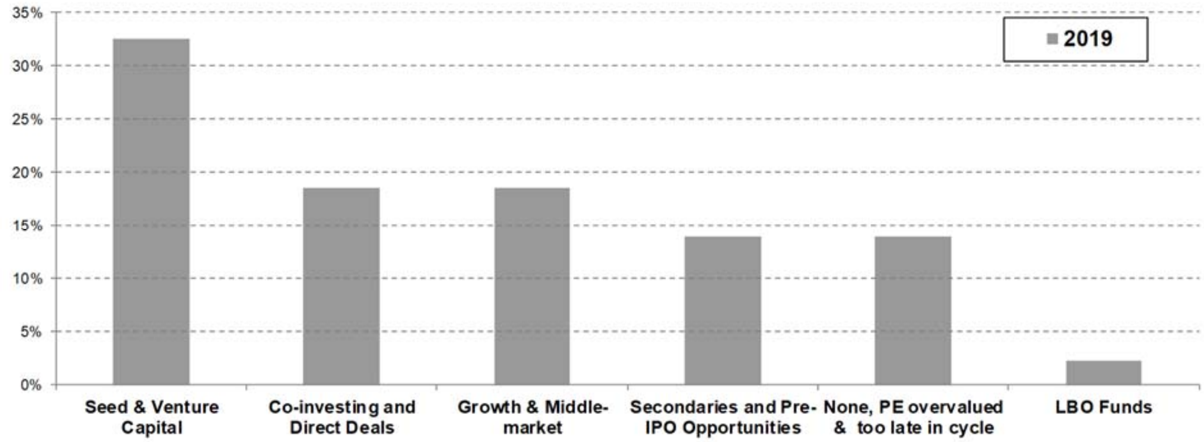

- **Portfolio Characteristics are important, and in first place:** How an investment product fits in an investor's portfolio and what portfolio benefits it may bring, continues to be a crucial determinant.
- **Meaningful Performance is also an important criterion.** Performance during recent selloffs revealed the strengths and vulnerabilities of different trading styles, separating winners from losers.

**5. What are the considerations that discourage you most in investing in an alternative fund?**



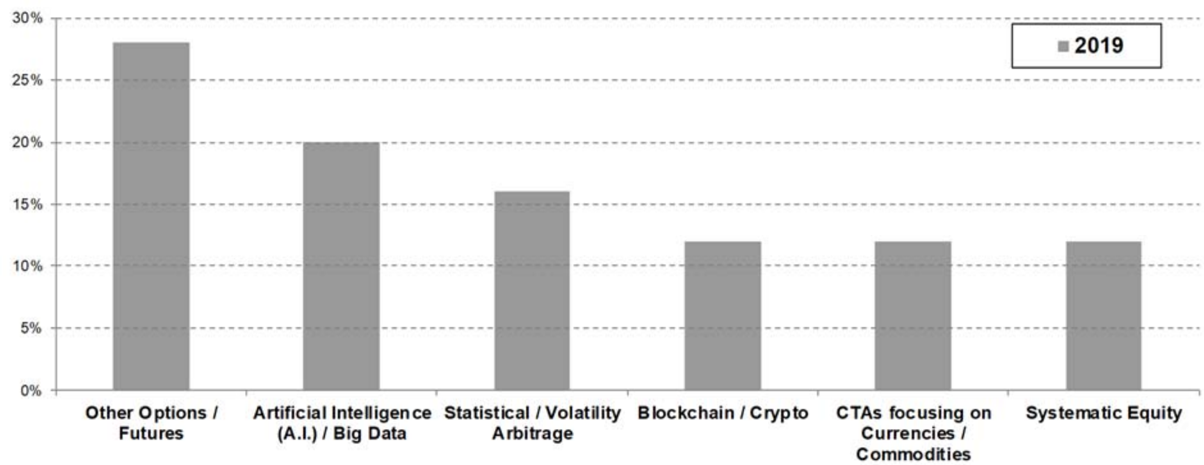

- **Investors are opportunistic.** With a plethora of investment products available, competition is fierce.
- **High fees and unfriendly investor terms keep allocators at bay.**

## 6. Special Question 1: In Private Equity for 2019, where do you think the best opportunities can be found:



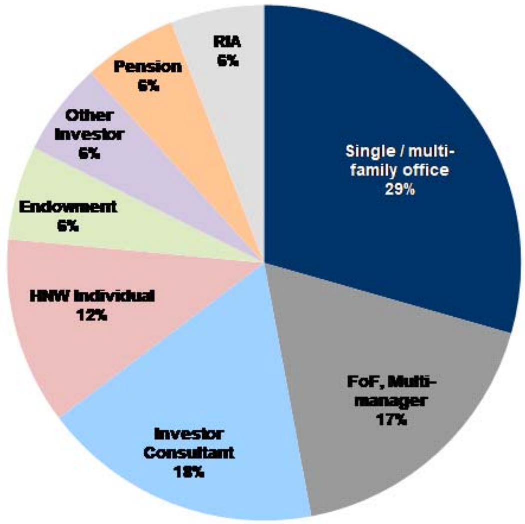

- Interest in 'Seed & Venture Capital' is the strongest and reflects that investors have a high risk-appetite.

## 7. Special Question 2: For 2019, what innovative quant related strategies do you find the most interesting?




- Investors are increasingly looking for innovative options/futures strategies to gain access to alpha producing managers.
- New technologies, such as Artificial Intelligence, Big Data, and machine learning, enable managers to more effectively and quickly exploit mispricing in the market.
- Advanced computer power helps managers to find market inefficiencies in asset classes with higher volatility, more skewness and kurtosis distribution.

**What type of allocators participated in the survey?**




- **Over 500 allocators were sent the survey in early 2019, of which a portion responded.** The largest groups of responders were family offices, multi-managers and consultants.
- **Eight types of allocators responded.** There was no analysis made on the basis of allocator type; the survey responders were anonymous, and the answers were aggregated.

## About the Authors

**Carl Berg** runs Catalyst Financial Partners, an investor events firm for the private funds industry. The firm links alternative investment managers and investors together through investor events. It has established itself as one of the leading, independent cap intro providers. He also works with selected alternative investment firms in a capital raising capacity and consults with investors on their allocation decisions.

**Susan Weerts** is an independent research analyst, investment consultant and a contributing writer to Seekingalpha.com. Current research areas are strategic trading games on ETF and its underlying index, market-neutral L/S strategy. She is also a consultant on China-related business. szweerts@yahoo.com



*Catalyst Financial Partners LLC*
*1345 Avenue of the Americas, 33rd Floor.*
*New York, NY 10036*
*T: +1 212 966 2993*
*E: info@catalystforum.com*