The Interview – Alex Orus, Blue Diamond Asset Management: “The self-serving nature of much of the asset management industry is illustrated by the current asymmetry of fee structures”

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Alex Orus, chief investment officer at Blue Diamond Asset Management, says the Blue Diamond Real Return Strategy is designed to address investors’ twin concerns of inflation and market bubbles and crashes by seeking to maximise real returns and outperform inflation by an average of 5 per cent over a full market cycle in the investor’s designated currency.

GFM: What is the background to your company and fund?

AO: Blue Diamond Asset Management was officially launched in March this year, although I started work on founding the company, designing our investment strategy and building quantitative models in late 2009.

My colleagues and I have all spent decades working in the investment industry and, from our experience, we felt that no asset management company was providing investors with what they needed – strategies that preserve capital by maximising real returns.

The industry’s obsession with market index benchmarks, nominal returns and relative outperformance do not serve investors whose spending requirements and currency-specific liabilities are indexed to inflation. We can see this more clearly after the experience of the financial crisis.

A shared perspective prompted us to create a new asset management company – unencumbered by corporate structures, pre-existing investment policies and biases or legacy information technology systems – centred on what we perceive to be the true needs of investors.

Blue Diamond is a wholly owned subsidiary of Impact Investment Partners, a privately owned partnership established in Switzerland in June 2010 to create a federation of wholly owned, transformative investment management boutiques. Impact provides its boutiques with non-investment services such as marketing, legal and compliance, allowing the boutiques to focus on realising their investment objectives and creating sustainable, real value for their clients.

GFM: Who are your key service providers?

AO: Wegelin Fondsleitung – part of Wegelin & Co., Switzerland’s oldest bank founded in 1741 – is the

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fund administrator. As a limited partnership, Wegelin is one of the few remaining Swiss private banks whose partners have unlimited liability. Lausanne-based Banque Cantonale Vaudoise is the custodian and prime broker.

GFM: What is the profile of your current and targeted client base? What is the split of your assets under management between institutional and private clients?

We currently manage money for private investors as well as a Swiss pension plan. We believe our strategy will meet the needs of a wide range of qualified investors, including high net worth individuals, private banks, family offices, pension funds, foundations and endowments, who have the same primary investment return need: to outperform inflation, preserve their wealth and spending power, keep pace with the cost of living and/or to meet liabilities.

GFM: Have there been any recent key events such as changes to the management team?

AO: Impact Investment Partners hired Tobias Mueller in April as head of European business development. Based in Wollerau, Switzerland, Tobias joins from Grantham, Mayo & Van Otterloo, where he was responsible for business development and client relations activities in Switzerland.

In addition, we are forming an advisory committee. Todd Doersch, a leading expert in behavioural finance, has accepted our invitation to serve on the committee and we are currently in talks with other academics and investment professionals.

GFM: What is your investment process?

AO: The Blue Diamond Real Return Strategy addresses investors' twin concerns of inflation and market bubbles and crashes. It aims to maximise real returns and outperform inflation by an average of 5 per cent over a full market cycle, in investors' designated currency. It will be benchmarked against the most appropriate measure of inflation for investors, such as the Landesindex der Konsumentenpreise (LIK) for Swiss investors or the consumer price index for US investors.

The strategy has two components, a valuation process and a momentum process. The valuation process invests in a variety of global and domestic equity and bond markets as well as cash. We calculate the fair value of asset classes, in real terms, based on mean reversion over a full market cycle because, for us, mean reversion acts as a force of gravity for financial markets. Our process then allocates capital dynamically to undervalued asset classes and stays out of expensive asset classes, thereby avoiding bubbles forming in the markets.

The momentum process provides diversification by capturing robust asset price trends. In addition to equities and bonds, this process invests in commodities and can take short positions.

GFM: How has your fund performed?

AO: In the first five months of 2011, the Blue Diamond Real Return strategy returned 1.64 per cent in Swiss franc terms, compared with 0.8 per cent for the benchmark LIK.

GFM: What differentiates you from other managers in your sector?

AO: Blue Diamond's differentiator is our singular focus on maximising real returns using the measure of inflation and the currency most appropriate to our clients' specific investment needs.

We know of no other manager offering strategies quite like Blue Diamond's. The majority of real return strategies tend to aim to protect against inflation, using so-called real assets such as TIPS or index-linked gilts, property and timber. We do not think any asset class intrinsically protects against inflation if they are not valued properly. For instance an investor buying property in the US in 2006 received no inflation protection for the subsequent years. That is why we approach all asset classes in terms of their real fundamental valuation.

Looking at how the asset management industry has evolved, we think of ourselves as a

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third-generation manager. The first generation of investment managers focussed on nominal returns, comparing themselves to market indices and using the information ratio as a measure of portfolio efficiency.

The second generation of managers, including hedge fund firms, focused on absolute returns and tried to outperform Libor, Eonia or another cash equivalent. Their preferred measure of portfolio efficiency was the Sharpe ratio.

As a third generation manager we go beyond absolute returns to real returns, not just aiming to beat cash but also striving to outperform inflation in investors' designated currency. We define portfolio efficiency according to the Calmar ratio, which measures real returns in relation to real maximum drawdown.

GFM: What is your attitude toward risk in the current environment?

AO: To us, the primary investment risk is the permanent loss of capital. This definition of risk is also tied into our valuation models; we consider buying expensive assets to be the predominant risk in investing. For this reason, we currently hold a substantial cash position. Our investors understand that cash is a bona fide investment option, not simply a place to keep our powder dry.

We also differentiate ourselves from value managers in how we conduct a fundamental valuation of asset classes. For instance, based on our fundamental long-term valuation methodology, US large-cap growth stocks could potentially be cheaper than US large-cap value stocks. In this case, we would allocate to growth stocks, unlike a traditional value manager that would diligently avoid them.

With the current level of interest rates, investors are extremely uneasy about the future and are continually putting on and taking off risk. The negligible cost of money further fuels this type of irrational and erratic behavior. Low or zero cost of money results in an increased use of leverage, creating a situation conducive for asset bubbles.

GFM: How would you assess investors' expectations, and how do you deal with them?

AO: In spending time working with and having conversations with investors, we realised that many asset managers push products to enrich themselves, instead of creating solutions to meet investors' needs. The self-serving nature of much of the asset management industry can be most clearly illustrated by looking at the current asymmetry of fee structures.

Specifically, investors require strategies that maximise real returns, after accounting for their most relevant inflation measure and in their local currency. In other words, they need investments that preserve their capital and deliver positive returns in all market conditions, and which are not eaten away by the pernicious effects of inflation and currency fluctuations.

For example, the Swiss franc has been so strong recently that Swiss investors have lost money from most international assets because of their currency exposure, even if those international assets have performed well in nominal terms. In fact, since 1997, an investment in the MSCI World Index in US dollars would now be worth 50 per cent more than an investment made in Swiss francs. For this reason, we will offer strategies in our clients' home – or most appropriate – currency and actively manage currency exposure.

But it's not just about the investment strategy – the business model is equally important. Investors want to work with managers who put them first, who are honest and transparent, who offer liquidity and who charge an appropriate fee.

At Blue Diamond, we have a base management fee to cover our fixed operating costs and we charge a performance fee on returns investors earn above inflation. Therefore, we only make money when our clients do, aligning our real success with that of our clients.

GFM: Are you planning any further launches in the near future?

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AO: We expect to launch several funds based on the Blue Diamond Real Return Strategy, using the same underlying investment strategy but structured to meet the needs of investors with different base currencies and inflation benchmarks. Fund launch plans are being finalised, but we expect to go public with Swiss franc, euro and dollar funds.

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