The Interview – Tim Gascoigne, HSBC Alternative Investments: “We have steered clear of all hedge fund blow-ups over the past 20 years”

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Tim Gascoigne, global head of portfolio management at HSBC Alternative Investments, says that what is reckoned the third largest alternative business worldwide with more than USD30bn in assets has been built on a combination of bottom-up and top-down research, a focus on diversification and strong approach to due diligence.

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

TG: HSBC Alternative Investments is the reference centre for hedge funds within the HSBC Group. It is responsible for institutional hedge fund mandates, investment adviser to the HSBC funds of hedge funds, and responsible for the performance of the discretionary mandates for the Alternative Investment Group within HSBC. At the end of last year, according to InvestHedge, we were the third largest alternative business globally with USD30.6bn under management.

The HSBC Alternative Investments hedge fund research team currently monitors and rates approximately 230 hedge funds. The members of the central investment team, which makes all investment decisions, average 14 years of hedge fund research.

In addition to these key individuals, HSBC Alternative Investments has an experienced team of investment analysts, so it is not solely reliant on any one person or small group of individuals and can therefore adapt to management changes or replace key people if necessary. Alongside this we have a proprietary system, IKB, containing a wealth of information, meeting notes and due diligence reports for several thousand funds over the last 20 years.

I have been with HSBC Alternatives since 1996, having previously been an equity analyst at Mercury Asset Management. In my current role as global head of portfolio management I have investment responsibility for 11 funds of hedge funds and segregated mandates.

GFM: What is the structure of your funds?

TG: The flagship HSBC GH Fund is a sub-fund within the HSBC Portfolio Selection Fund, an umbrella unit trust authorised as a Class B Scheme in Guernsey. HSBC Alternative Investments has been regulated by the UK’s Financial Services Authority since 2001. Some of the share classes for our fund of funds are listed in Dublin.

GFM: Who are your key service providers?

TG: State Street Fund Services performs fund administration and accounting for the HSBC GH Fund and KPMG is our auditor.

GFM: How and where do you distribute the funds? What is the profile of your client base? What is the split of your assets under management between institutional and private clients?

TG: Our client base is well diversified, including ultra-high net worth individuals, institutions, pension schemes and insurance companies. With a global footprint, we have clients from many jurisdictions. Our private individual/institutional client split is roughly 50/50 and our investors are primarily based in Asia and Europe.

GFM: How has your fund of hedge funds performed?

TG: In retrospect, 2009 was a great year to be long risk assets, particularly from March onward. Credit markets rebounded sharply from their lows and equity markets ended the year with healthy gains. Our hedge funds produced solid returns, protecting assets in the first three months of the year, then capturing the gains after March. The HSBC GH Fund outperformed its peers, with its US dollar class ending the year up 12.3 per cent compared with 11.1 per cent for the HFRI FoF Composite Index.

Investors have seen an increased opportunity set within strategies, notably macro, credit and equity long/short. In addition to the attractive returns available through these strategies, our funds should benefit further from decreased competition from banks and improved investor confidence primarily through increased regulatory oversight.

GFM: What is your investment process?

TG: The approach of HSBC Alternative Investments has always been to deliver the best solutions for our clients by focusing on their exact needs and on the level of risk required to achieve them.

With the core focus on risk and return, our investment team implements top-down market and trading strategy views that we believe will perform best over varying market cycles. Our experience has clearly shown that the hedge fund industry is dynamic and is continually evolving.

We place high importance on development and innovation within our research team. While the structure of the investment approach has remained the same, it has evolved over the years to respond to market shocks, industry trends and developments in underlying hedge funds and the sector as a whole.

The bottom-up evaluation investment process results in the selection of hedge fund managers with strong track records, robust research, and a history of identifying profitable trades across their strategies.

The combination of bottom-up and top-down research, supported by proprietary IT systems, focus on diversification and strong approach to due diligence has guided HSBC Alternative Investments' management of diversified portfolios of high-quality hedge fund managers clear of all blow-ups over the past 20 years.

GFM: How many funds and strategies are in your portfolio?

TG: Since the launch of its two flagship funds of hedge fund s the HSBC Multi-Adviser Arbitrage Fund (June 1995) and HSBC GH Fund (June 1996), HSBC Alternative Investments has continued to develop innovative products while maintaining its strong due diligence and research processes.

We currently have seven strategies within the HSBC GH Fund including equity long/short, multistrategy/event driven, macro, managed futures, high yield/distressed and market neutral, and 56 underlying managers.

GFM: What makes a manager or strategy special enough for you to select them?

TG: The selection process incorporates a bottom-up evaluation that results in the selection of hedge fund managers with superior track records, strong research processes, and a consistent history of identifying the best opportunities across their sectors and strategies. This process also includes a focus on a top-down strategic investment outlook, geared to identify optimal investment strategies in both the near and long term.

Once the strongest managers in the optimal strategies have been identified, HSBC Alternative Investments' team of analysts conduct an extensive due diligence process that has been constantly developed over time and is one of the main pillars of our risk management system.

GFM: What are your criteria for removing managers from the fund?

TG: The circumstances which a manager may be excluded from the portfolio can be split into two main areas, investment and operations. Investment concerns may be triggered by such issues as poor absolute performance, marked rise or fall of assets under management, returns that materially and unaccountably exceed or fall short of expectations from the peer group, which generally suggests that the fund is diverging from their cited strategy, or our discovery of a more suitable strategy or stronger manager in the same sector.

Problems with the manager's operations may include staff turnover, especially that of key team members, administration problems such as slow net asset value calculation, changes in the fund's investment terms or prospectus and/or service providers, especially auditors.

GFM: How many managers do you have on the substitutes' bench?

TG: Across the firm, the funds of hedge funds invest in some 115 managers out of around 230 managers on our approved list. The manager selection for each fund is determined by the portfolio construction process, which aims primarily to ensure the risks and returns are weighed according to a series of measurable absolute return assumptions based on the client's investment objectives. These targets are the bedrock of portfolio construction and include target risk/return, but must be compatible with other portfolio constraints such as liquidity.

GFM: What events do you expect to see in your sector in the year ahead?

TG: One of the most popular areas in 2010 will be launches of new funds that comply with the Ucits III requirements. We have launched the HSBC Ucits AdvantEdge Fund, which offers investors increased liquidity, regulatory oversight and transparency while still benefiting from HSBC Alternative Investments' robust due diligence and global research platform. It also opens up a new source of clients that were previously not permitted to invest in our funds.

GFM: How will these developments affect your own portfolios?

TG: In today's investment environment, hedge fund strategies will become increasingly relevant not only in their traditional offshore format but within the growing Ucits fund universe. With an increase in the Ucits manager universe we will benefit from having more underlying funds to research for our own fund of hedge funds. However, regardless of fund structure, manager due diligence will remain of the upmost importance as we look to build the best possible portfolios of hedge funds for our clients.

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

TG: We believe our competitive edge stems from four main areas: people, process, philosophy and performance. Our due diligence process has developed over the past 20 years and offers comprehensive qualitative and quantitative research of hedge funds with disciplined investment management. Our central investment team have been in the hedge fund business for an average of 14 years.

Our philosophy is to deliver the best solutions for our clients by focusing on their return expectations with the appropriate level of risk to achieve them. We have systematically avoided hedge fund collapses and delivered compelling absolute returns in the fund of hedge funds business since its establishment.

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

TG: Our approach to risk has always been to focus on the fundamental underlying manager in terms of investment and business operations. This initial due diligence is further enhanced by sophisticated portfolio construction techniques using proprietary IT systems that are incorporated on our platform.

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

TG: Our clients expect robust research, thorough due diligence and strong absolute returns. Over its 20-year history HSBC Alternative Investments has aimed to provide exactly this to our investors, and with nearly USD31bn in alternative assets under management we feel our clients have confidence that we will continue perform well for their portfolios.

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

TG: We constantly look at client requirements and share class requirements, but at the moment we are focused on promoting the HSBC Ucits AdvantEdge Fund as yet another strong fund that will compliment our 10 established funds of hedge funds. We are also in discussion with various institutional clients to launch bespoke funds following the same rigorous investment process and making use of the same global research platform.

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