

## **The Interview - Alistair MacDonald, Merrion Investment Managers: “Volatility in markets produces opportunities particularly for investors that can identify both long and short ideas”**



Alistair MacDonald, co-manager of the newly-launched Merrion European Absolute Return Fund, argues that Ucits III hedge funds are benefiting from the current uncertainty over the final form and substance of the European Union's AIFM Directive as well as concerns over the costs of implementing its requirements.

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

**AMD:** Merrion Investment Managers is an independent specialist investment management firm established in Dublin in 1986 that currently manages approximately EUR1bn on behalf of Irish institutional investors across a range of segregated portfolios, Ucits and non-Ucits funds. The firm has 20 employees and is wholly owned by the Merrion Capital Group and its employees.

Earlier this year Merrion recruited a specialist portfolio management team consisting of Michael Nicol and myself to manage the Merrion European Absolute Return Fund, a Ucits hedge fund launched in April with committed capital of USD20m at launch.

### **GFM: What is the structure of your fund?**

**AMD:** The European Absolute Return Fund is a sub-fund of Merrion Capital Investment Funds, an open-ended umbrella-type variable capital investment company incorporated in Ireland in September 2006 and authorised by the Financial Regulator.

### **GFM: Who are your key service providers?**

**AMD:** The fund's auditor is KPMG and the administrator and custodian is Northern Trust. Our legal adviser is McCann Fitzgerald and risk management services are provided by Kinetic Partners.

### **GFM: How and where do you distribute the funds? What is the profile of your current and targeted client base?**

**AMD:** There has been significant interest in Ucits as a vehicle to access the retail market. We are looking at this market and will be seeking retail distribution partners. However, our initial focus is on the institutional market in the UK and Europe where we are talking to funds of hedge funds, private

banks and large pension schemes that are increasing their exposure to absolute return strategies. We also see opportunities in markets where there are currently restrictions on investment in unregulated hedge funds.

**GFM: How would you assess the impact of the recent global financial crisis and economic downturn on your business?**

The financial crisis has highlighted the need for ongoing reform in many aspects of financial services, and we believe that this will result in increased demand for businesses such as ourselves.

**GFM: What are the advantages and disadvantages of offering hedge fund strategies within a Ucits structure?**

**AMD:** Ucits hedge funds have become something of a bandwagon. Existing hedge fund managers are jumping on because they see it as a vehicle to access the retail market. The disadvantage for many of them is that their strategies were not designed for Ucits and often have to be compromised or adapted to meet Ucits restrictions.

Existing long-only managers see Ucits as a means to broaden their retail product range. The disadvantage of these funds is that the managers often come from a long-only background with little experience of shorting or running absolute return funds.

We don't face these problems. We combine the benefits of Merrion's established Ucits platform and administrative infrastructure with the expertise and experience of a specialist equity long/short team whose strategy is not dependent on leverage and works well within Ucits guidelines.

**GFM: What is your investment process?**

**AMD:** We aim to detect mispriced securities through analysis that focuses on understanding companies' business models, earnings drivers and risks. Stock timing decisions are made by identifying valuation anomalies and catalysts that are likely to lead to re-rating or de-rating. At the heart of the investment process is a strong understanding of the nature of risk and a proprietary correlation analysis model that guides portfolio construction.

**GFM: How do you generate ideas for your funds?**

Using information from all available sources including management meetings, company reports and statements, credit rating agencies, brokers and peer group analysis, the team seeks to form a clear understanding of the company's business model and drivers, sensitivities, competition, growth opportunities and risks.

**GFM: What is your approach to managing risk?**

**AMD:** We manage risk on a number of different levels. There are very strong in-house risk controls embedded in Merrion's back office administration systems. We also use Kinetic Partners Risk Management Services to monitor the portfolio's compliance with Ucits risk exposure limits.

However, our approach to portfolio risk is based on a strong understanding of the nature of risk, and we have developed a proprietary correlation analysis model that guides portfolio construction. This ensures that the portfolio is adequately diversified and enables us to control market directional risk far more effectively than simple net exposure analysis.

**GFM: What are your performance expectations?**

**AMD:** Performance expectations are based on actual performance records of the managers over a 10-year period. The fund is targeting 15 to 20 per cent gross performance with annualised volatility of between 7.5 and 10 per cent.

**GFM: What opportunities are you looking at right now?**

**AMD:** Volatility in markets produces opportunities for investors, particularly those that can identify both long and short ideas. Currently we see opportunities in almost every sector but as stock-pickers we highlight individual stock opportunities where business models are poorly represented in terms of valuation criteria.

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

**AMD:** Geopolitical events will continue to affect markets in the coming year. The impact of the global financial crisis is likely to be a long-lasting one with many countries and companies still coming to terms with the cost of financial bailouts and lower credit availability. Although we believe the worst is behind us in terms of market lows, we expect further periods of volatility.

**GFM: How will these developments affect your own portfolio?**

**AMD:** Our investment approach emphasises a pragmatic nature to investment. This means we can adapt to changing circumstances rather than being wedded to one particular style of investment, benefiting from market volatility.

**GFM: How do you assess investors' current expectations?**

**AMD:** The expectations of investors have been reduced as their appetite for risk has diminished. Capital preservation as much as capital growth is now key.

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

**AMD:** We believe we offer a unique blend of experience in terms of longevity and performance in managing both long-only and long/short products. In addition, we believe our knowledge and experience of global markets will be increasingly important. Finally, our strong understanding of the nature of risk gives us an edge in balancing risk and return.

**GFM: How do you view the environment for fundraising over the coming 12 months?**

**AMD:** Fundraising is always a challenging exercise, but we believe the structural difficulties facing investors at both corporate and individual level will continue to highlight the need for absolute return vehicles. In this context, regulated Ucits absolute return funds are likely to be very appealing.

**GFM: How do you expect your market to be affected by proposed regulatory changes such as the EU's AIFM Directive?**

**AMD:** One consequence of the directive has been to raise further investors' awareness of issues such as transparency, liquidity and the need for a greater understanding of the risks arising from leverage and counterparty exposure.

As Ucits III already addresses these issues, we believe that existing Ucits hedge funds will benefit as a result of the directive – certainly in the short term. Also, as Ucits funds are not subject to the directive, they are free of all the uncertainty over its final form and content and concerns over the costs of implementing its requirements.

**GFM: Are you considering any mergers or acquisitions in the foreseeable future?**

**AMD:** Not at present, although Merrion is a well-capitalised business with very stable employee ownership, and we are always on the lookout for opportunities to develop the business.

**GFM: Do you have any firm plans for further product launches?**

**AMD:** We believe that Ucits is the way forward for certain hedge fund strategies and will be actively looking for teams with suitable strategies that could be added to Merrion's established platform.

- [Absolute Return](#)

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