

## **The Interview - Michael Azlen, Frontier Capital Management: “More multi-asset funds entering the market will help highlight our proven track record and low-cost philosophy”**



Michael Azlen, founder and executive chairman of Frontier Capital Management, says his firm’s index-based approach to multi-asset investing is modelled on the tried and tested approach of US university endowments, aims to create a globally diversified portfolio through exposure to eight traditional and alternative asset classes or strategies to generate long-term uncorrelated real returns above inflation and cash.

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

**MA:** Frontier Capital Management was founded in 2004 to deliver a unique multi-asset investment proposition to the institutional, high net worth, private banking and independent financial adviser marketplaces. Previously an ‘endowment-style’ approach to multi-asset investing, with a strategic asset allocation across both traditional and alternative asset classes, was only available to institutions and ultra high net worth individuals. Frontier Capital was the innovator in making true multi-asset investing passive and low-cost.

The Cayman-based Multi Asset Platform Fund SPC was launched in September 2005 and provides investors with a globally diversified portfolio that has exposure to eight traditional and alternative asset classes or strategies within a single fund: global equities, global fixed income, emerging equities, emerging bonds, real estate, commodities, hedge funds and managed futures. It had USD394.3m in assets under management as of April 15 and is listed on the Irish Stock Exchange.

The IFDS Frontier MAP Balanced Fund, which is authorised by the UK’s Financial Services Authority, was launched in March 2009 to offer an investment strategy consistent with the Multi Asset Platform Fund. It had GBP52.6m in assets as of April 30.

The Global Hedge Fund, which was made available to external investors in April 2009, is designed as a diversified, low-cost proprietary investment proposition to access the returns of the global hedge fund industry by blending synthetic replication with investments in single manager hedge funds. It is also listed on the Irish Stock Exchange and had USD77.7m in assets as of April 15.

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

**MA:** The Multi Asset Platform and Global Hedge funds have HSBC as administrator and custodian and Ernst & Young as auditor. The IFDS Frontier MAP Balanced Fund has IFDS Managers as authorised corporate director, State Street as fund accountant and custodian, and Deloitte as auditor.

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

**MA:** Currently, the funds are primarily distributed within the UK, although we do have investors across Europe and the Middle East. The majority of investments have come through UK-based financial planners and intermediaries, providing the funds with a stable and diversified base of assets. The offshore multi-asset fund has a white label arrangement with the National Bank of Kuwait. The funds also manage money for family office and high net worth investors.

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

**MA:** The investment proposition behind the multi-asset funds is based in part upon the diversification benefits of combining traditional and alternative asset classes, similar to the US university endowment funds. The investment philosophy is based on Frontier Capital's Four Pillars of Investing.

First, traditional and alternative asset classes generate real returns, above inflation and cash, over the medium to long term, five to 10 years. Alternative asset classes have embedded sources of excess return combined with attractive volatility and correlation properties.

Secondly, the strategic asset allocation of a portfolio will determine the vast majority of its return and risk. Market timing and tactical asset allocation are unlikely to add value over time and will increase cost and potentially increase portfolio risk.

Thirdly, modern portfolio theory states that diversification across multiple asset classes increases risk-adjusted returns, creating a more 'efficient' portfolio. Leveraging or deleveraging an efficient portfolio is a superior method of changing the risk/return profile to altering the portfolio asset allocation.

Finally, index investing captures the return of an asset class at very low cost and outperforms the majority of active managers. Outperformance increases with time.

The multi-asset fund aims to build a diversified portfolio consisting of multiple asset classes that will be as close as possible to the 'super efficient or 'market' portfolio.

Frontier believes that each of the eight asset classes in which it invests contains an embedded source of long-term structural risk premium, and that they exhibit return, volatility and correlation properties that add value to a portfolio. The result is a highly diversified portfolio with access to the returns of over 15,000 underlying securities/funds.

The firm has chosen a highly diversified and replicable index to represent each asset class. The funds employ an active indexing strategy in order to track asset class returns at extremely low cost while maintaining low tracking error, high liquidity and low counterparty risk.

Frontier Capital currently uses five main approaches to gain exposure to the underlying asset class returns, namely direct purchase of underlying instruments represented in the index, purchase of futures contracts linked to the index or a basket of futures, purchase of an index tracker fund at institutional pricing, purchase of an exchange-traded fund, and purchase of an OTC derivative linked to the index.

The investment decision as to which method to use for a particular asset class will be determined by factors including tracking accuracy, liquidity, cost and risk. These factors are constantly changing due to market dynamics, which is why it is necessary to monitor all methods on a continuous basis and switch to the best method when appropriate.

The funds are managed on a currency-neutral basis by hedging the embedded global currency exposures of each asset class back into the reference currency, with the exception of emerging market equities.

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

**MA:** The investment committee constantly monitors the funds and the market to ensure that asset class returns are accessed in a cost-efficient manner. We would also consider adding new asset classes if they were proven to enhance the current portfolio.

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

**MA:** The strategy employed by the fund is based on asset allocation, which in itself delivers return against low levels of risk or volatility due to the low correlation across asset classes. Asset allocation is highly disciplined with a detailed investment policy governing changes to the policy asset allocation.

The investment strategy itself provides a built-in volatility control mechanism by aggregating assets with different risk profiles and varied correlations. This minimises the vulnerability of the fund to extreme changes in the markets by avoiding correlation to volatility events. The securities held are mostly index-tracking instruments and index replication securities, whose market risk is mitigated by diversification.

Tracking error is managed actively. Various OTC derivatives, ETFs, direct investments and index funds have been used to minimise tracking error and maximise performance. Portfolio allocations are reviewed daily and compared with the policy weights in order to identify discrepancies. Asset class weights are constrained to within five percentage points of policy weights at all times.

Fixed leverage reduces credit risk for the Moderate and Plus funds and counterparty risk is managed by trading with only AA-rated counterparties.

**GFM: How has your recent performance compared with your expectations and track record?**

**MA:** The multi-asset funds have returned the returns of the indices that they track. They do not have a target return, but do target volatility of 5 to 7 per cent over five- to 10-year rolling time horizons. This target is the result of detailed quantitative analysis of historical efficient portfolios.

While historically this target volatility had been achieved, volatility spiked during the 2008-09 bear market and has remained high. The annual asset allocation review in March 2010 therefore paid attention to reducing fund volatility while remaining consistent with the strategic, long-term and diversified approach exemplified by US university endowments.

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

**MA:** We expect to see more multi-asset offerings launched and a drive to lower costs. More funds coming into the marketplace will help to highlight our own proposition, which has a proven track record and a low-cost philosophy.

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

**MA:** First is our track record. In the past couple of years there have been a number of entrants into the multi-asset passive space, although Frontier Capital was the innovator in this area and now has some five years' experience.

Frontier Capital offer a true multi-asset proposition, diversified across traditional and alternative asset classes with an allocation inspired by the US university endowments such as Harvard and Yale. Similar to the endowments, the allocation to alternative asset classes is significant, particularly hedge funds and managed futures.

To our knowledge, we are the only multi-asset fund that includes an allocation (currently 17 per cent) to managed futures, a true portfolio diversifier. They have historically shown the lowest correlation to other asset classes and have provided positive returns in each of the five largest equity bear markets over the past 30 years.

Asset class returns are currency hedged to ensure that investors receive the true returns of the asset class without being exposed to currency volatility.

Finally, Frontier Capital is committed to investor education and holds monthly in-house seminars covering the evidence behind our investment philosophy.

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

**MA:** Within the IFA sector, we expect an increasing number of advisers to outsource all or part of their investment management function. We see this as a positive for our multi-asset funds, which are ideal as a low-cost, diversified core investment. As our assets under management grow, we expect to develop other client sectors, including high net worth and family office investors.

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

**MA:** Frontier Capital is committed to innovation in investment management and we expect to launch further funds in 2010, although none can be confirmed at present.

- [Fund Manager Interviews](#)

**Source URL:**

<http://www.hedgeweek.com/2010/08/30/interview-%E2%80%93-michael-azlen-frontier-capital-management-%E2%80%9Cmore-multi-asset-funds-entering-ma>