The Interview - Paul Kennedy, GWM Group: "There is now less dislocation within markets and opportunities are increasing on the short side"

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Paul Kennedy, managing director and chief investment officer of GWM Group, says investors are looking for funds, such as the firm's newly-launched long/short European Ucits fund 7H Absolute, that provide low net exposure and generate alpha through a strategic long-term approach and a short-term trading overlay to maximise returns without an increased risk profile.

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

PK: GWM Group is structured to maintain the time-honoured tradition of conflict-free financial service. Our aim is to achieve an alignment of interests with private, corporate and institutional investors by providing a full range of advisory, wealth management and family office services.

We currently have approximately EUR2bn in assets under management. Through GWM Institutional, we invite external investors and clients to participate in two funds, a fund of hedge funds as well 7H Absolute, a Luxembourg-domiciled long/short European Ucits fund run by GWM Asset Management that we launched in June.

GFM: Who are your key service providers?

PK: The fund's administrator is Fastnet Luxembourg, the custodian is Caceis Bank Luxembourg and the prime broker is Morgan Stanley. The fund's auditor is PricewaterhouseCoopers and our law firm is Linklaters.

GFM: How do you distribute the fund? What is the profile of your current and targeted client base?

PK: At present GWM Institutional is distributing the fund directly, but in future we will seek to maximise exposure for the fund and access various existing platforms. Our target investors include funds of funds, insurance companies, pension funds, endowments, foundations and any other institutions keen to obtain absolute returns.

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

PK: The crisis has affected everybody in the industry. One effect upon the hedge fund industry is increased attention to regulation and liquidity; another has been the decline in assets under management from 2007 levels and the number of funds that are still below their high water marks.

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

PK: As a portfolio manager, if you have a strategy that fits within the stringent rules and restrictions of the Ucits framework there should be no difference between managing a Ucits fund or a non-Ucits portfolio. 7H Absolute’s average exposure and liquidity are well within the Ucits limits. The real advantage of offering a fund through a Ucits structure is to attract investors that are requesting products with greater regulation, transparency and liquidity.

GFM: What is your investment process?

PK: The investment process of 7H Absolute is purely bottom-up. While macro issues may impact a company’s operating environment, our decision to invest is based entirely upon bottom-up criteria.

GFM: How do you generate ideas for your funds?

PK: The portfolio managers, Simone Chelini and Pietropaolo Rinaldi, screen for companies with attractive valuations. We focus only on sectors of which the managers have an in-depth understanding and where they believe they have a competitive advantage, such as telecommunication, media and technology, consumer, industrials and financials. They tend to avoid sectors that are primarily influenced by macro factors, such as pharmaceuticals and commodities including mining and oil.

After this initial screening the managers arrange company visits with the chief executive, chief financial officer, chief investment officer and divisional managers to assess the company further and determine whether it is a suitable candidate for either the long or short book within the portfolio. This is followed by quantitative modelling to determine an earnings estimate that is compared to market expectations.

Based upon this evaluation and the manager’s convictions, they will size the position accordingly. Positions are limited to 5 per cent long, 2.5 per cent short and 10 per cent in a single sector. In addition to the strategic book, which typically accounts for 80 per cent of gross exposure, they employ a strategy to trade tactically trade the same companies held within the strategic book. Alpha is also generated through active management of the gross exposure and beta of the fund.

GFM: What is your approach to managing risk?

PK: The portfolio managers are the initial and primary risk managers of the fund and endeavour to comply with the internal limitations and regulations set for the fund. Our internal risk manager, Nicola Chiarini, monitors the portfolio and highlights risk characteristics in a report produced daily for the portfolio managers and the GWM management team. We also have an external risk manager, Degroof Gestion Institutionnelle in Luxembourg.

GFM: How has your recent performance compared with your expectations and track record? What are your performance expectations for the future?

PK: The managers have a six-year track record and have consistently outperformed their peers. In its first month 7H Absolute was up 0.87 per cent compared with a decline of 1.5 per cent for its peer group.

GFM: What opportunities are you looking at right now?

PK: Compared with the past 18 months, there is currently less dislocation within markets and opportunities are increasing on the short side. We have avoided shorting individual names in the past few months, but we are now seeing opportunities to short single names where valuations have become excessive relative to their growth prospects and expectations. While we produced good results in 2009, the prevailing environment is ideally suited to our strategy.

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

PK: Volatility will remain high within the financial sector, which should provide an opportunity to enhance returns by trading individual issuers within this sector.

GFM: How do you assess investors' current expectations?

PK: Following the recent crisis investors have become more conservative and more realistic. They are increasingly seeking funds that can provide positive returns with low volatility, and recognise that funds promising high returns come with matching levels of risk. Investors are looking for funds, such as ours, that provide low net exposure and generate alpha through a strategic long-term approach and a short-term trading overlay to maximise returns without an increased risk profile.

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

PK: The main differentiating factor is our focused bottom-up approach and depth of experience, and the managers' long-term record of success.

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

PK: Raising money in this environment is challenging for everyone, but we have found greater appetite for products such as 7H Absolute that are liquid and utilise a straightforward and transparent strategy.

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

PK: We are currently assessing a UK asset manager specialising in a sector that we believe will have the same growth profile as the mobile industry in the 1990s. This process is ongoing and we hope to make an announcement shortly.

- Equity Long Short

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