Platforms continue to record strong AuM growth

Expanding service support for hedge fund managers

New funds designed to mitigate strategy risk
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Photographs: ©European Union

Published by: GFM Ltd, Floor One, Liberation Station, St Helier, Jersey JE2 3AS, Channel Islands
Tel: +44 (0)1534 719780 Website: www.globalfundmedia.com

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Market regulation and the desire among investors for regulated alternative funds has proven to be a fantastic opportunity for platform operators, particularly those supporting alternative UCITS.

This asset class, which had its critics a few years back, has grown from strength to strength. Through June this year, assets have climbed to around EUR240bn (according to Alix Capital), up 20 per cent on end of year assets of EUR190bn.

All of which is good news for banks and independent platform providers. But for hedge fund managers considering such a fund, choosing who to partner up with requires careful consideration.

Many will gravitate towards the wider banking arms of their prime brokerage relationships, with Bank of America Merrill Lynch’s MLiS platform, Morgan Stanley’s FundLogic Alternatives plc platform and Deutsche Bank’s DB Platinum platform having grown to become market leaders.

But as Michael Sanders, CEO and Chairman of the Board at Alceda Fund Management SA (part of the Aquila Group) comments, the fact that its Alceda UCITS Platform (AUP) is independent has proven to be its key selling point.

“With us the managers are free to choose their service providers. In addition, if we decide to provide distribution support (based on factors like fund size, manager reputation etc) we help to actively sell the fund and support the manager’s PR initiative.

“We’ve partnered up with a couple of companies globally that can provide global distribution. We introduce a manager’s
Plenty of room for growth as assets reach USD1bn

Interview with Cyrus Amaria

Last February, just before ESMA published its updated guidelines on ETFs and UCITS, Lyxor Asset Management made its first foray into the alternative UCITS space. Hand picked from its managed account platform, Lyxor launched the Lyxor/Tiedemann Arbitrage Strategy Fund, a merger arbitrage strategy run by TIG Advisors.

It was a wise decision. In a little over 12 months the strategy run on the Lyxor platform has grown to approximately USD650m with the majority of assets in the UCITS fund. Two other UCITS funds currently sit on the platform: a version of Winton Capital’s Diversified Program (above USD215m) and the Lyxor/Canyon Credit Strategy Fund (above USD190m), a credit long/short strategy.

Cyrus Amaria, deputy head of Alternative Investments at Lyxor says that there was a clear plan when launching these funds that they would comply with ESMA’s eligibility rules. “We excluded commodities from our managers’ strategies to stick fully to ESMA’s guidelines. Tiedemann has been the most rewarded fund in terms of asset growth. It’s one of the fastest growing hedge funds regardless of jurisdiction or structure.”

The growth that Lyxor is seeing in its alternative UCITS range is symptomatic of the wider market. Amaria sees no hold up in demand, even though AIFMD is now up and running and offers managers the option to launch regulated hedge funds.

“We think there’s a lack of supply of good quality fund managers in UCITS format. We now have three external hedge fund managers with UCITS funds on the platform and we believe that number can grow, especially as two of the three will likely face capacity constraints at some point,” says Amaria.

“What’s interesting about the alternative UCITS market is that whilst AuM has grown from EUR100bn to EUR230bn over the last few years, the number of funds has actually fallen from around 800 to 700, which we attribute to the regulatory effect of ESMA changing its guidelines last year; there was a restriction placed on financial indexing exposure.

“That’s created a bit of a shakeup in the industry, especially among trend-following CTA managers.”

AIFMD-compliant funds will cater for a different market and there is no reason to suggest that UCITS and AIFs won’t be able to co-exist. Indeed, Lyxor has moved quickly to get its AIFM license approved in France to ensure that its managed accounts comply with AIFMD. It is currently in the process of transferring the MAP from Jersey to Luxembourg.

“We will concurrently run alternative UCITS and AIFs for our investors,” confirms Amaria. He summarises Lyxor’s approach to building out its alternative UCITS offering as follows:

• “As with our managed account platform, identify the highest quality hedge fund managers that can be converted into a UCITS fund

• Look at the UCITS effect on those managers: liquidity, removing non-eligible assets, capacity constraints. We want complete confidence that the strategy will work under the UCITS framework

• Ensure those selected managers can work in the Lyxor risk-controlled framework that has been tried and tested over several market crises

• Conduct a market analysis to gauge investor sentiment. Is the interest there for a particular strategy?

• Structure the fund accordingly by negotiating the best terms for investors for which fees and TER remain a key focus.”

With three funds having attracted almost USD1bn in assets, and with more launches in the pipeline, it seems to be a recipe for success.
strategy to our international partners, get feedback on whether it fits in to a particular market and then contact the manager to offer suggestions on how to develop the marketing plan. If the strategy doesn’t fit, we will tell them frankly. We will provide all the platform services but our sales team won’t actively distribute the fund,” says Sanders.

Sanders observes that managers in Latin America and Asia Pacific prefer to work with independent platforms because rather than becoming merely a sub-fund of an umbrella structure, as is the case for bank-owned platforms, they are able to create their own umbrella structure which Alceda then runs on their behalf.

“The advantage here is that the manager can build up his own brand. We only appear in the fund prospectus as the investment management company,” adds Sanders.

The largest fund on AUP currently is the Aquila Capital Risk Parity 7 fund, a multi-asset strategy with EUR282m in AuM.

MLIS platform growth aided by private bank advisory channel

That said, bank-owned platforms are in rude health. The Merrill Lynch Investment Solutions (MLIS) platform launched its first fund back in 2007 with Marshall Wace in the equity market neutral space. The most recent addition, in March 2014, being Sandell Asset Management’s Event-driven strategy: MLIS Castlerigg Equity Event and Arbitrage UCITS fund.

Since 2007, the MLIS platform has grown to USD6.2bn in AuM says Paul Holmes, Head of Hedge Fund Distribution at BoAML.

“Our goal is to have a platform offering investment solutions across as wide a range of strategies as is appropriate within the UCITS framework,” says Holmes.

Two more funds are planned to launch on the MLIS platform according to Holmes. The MLIS Fenician Equity Long-Short UCITS Fund is a tactical trading style fund that will offer investors flexible, low net exposure to the equity markets, with little correlation.

Managed by Corrado Abbattista and Geoffroy Houlot, the strategy combines an active trading approach with fundamental research and macro-economic analysis and employs complementary trading strategies including event driven and special situations opportunities, relative value, pairs and options trading.

“The second fund, MLIS APQ Emerging Markets UCITS Fund, is managed by Bart Turtleboom and Karim Abdel-Motaal. The fund will be a long biased portfolio with allocation flexibility across emerging markets stocks, bonds, currencies and cash, balancing income, capital gains and drawdown control objectives,” says Holmes.

“After these two launches, we are hoping, subject to the necessary approvals, to launch Discretionary Macro, US Equity Long-Short, Equity Market Neutral and China Equity Long-Short funds by year-end.”

What the MLIS platform is doing is merely a microcosm of the wider trends at work in the alternative UCITS space. What is exciting, as evidenced in the previous comment, is the sheer breadth of strategies coming to market.

Provided their strategies adequately fit within UCITS rules, an increasing number of managers, globally, are looking to diversify their client base and sate investor appetite for alternative regulated solutions at a time when equity and bond markets are at perceived high valuations and cash yields are at historic lows.

“The private bank advisory channel has certainly been one of the key drivers of AUM growth for us in recent times. It is a trend I see continuing for some time to come,” says Holmes.

“In Latin America we’ve just started marketing our services. No matter if it’s a family office, an independent financial adviser or a pension fund, they all say the same thing: if they invest into foreign funds they’ve got to be UCITS-compliant,” states Sanders.
Proximity to investors to calibrate the right product offering

Andrew Dreaneen is Head of Schroder GAIA Product & Business Development. One of the UK’s leading asset managers, Schroders’ GAIA platform has witnessed incredible growth in recent times. At the end of 2012, the platform’s AuM was USD1.7bn. By the end of 2013 this had doubled to USD3.4bn and year-to-date assets have again almost doubled to approximately USD6bn according to Dreaneen.

“There are very few US equity long/short managers like Sirios. By having that client-driven approach – many of our clients are mutual fund investors – as your barometer for where demand in the market is, to date has proven to be very successful,” says Dreaneen.

This is where having an asset management business and an existing UCITS distribution network in place lends itself well to supporting alternative UCITS. Schroders is able to tap in directly to what its investors are looking for. Then it’s a case of selecting the best talent (internal or external) to execute the strategy with Dreaneen noting that “we have high conviction in every fund we roll out”.

Such is the demand for getting these funds to market that Schroders is fielding calls from prospective managers every day. Five years ago, the number of managers on Schroders’ short list would have been three or four. Now, says Dreaneen, “we are typically looking at 10 to 15 managers, all of which are interesting. Due to the growth of the ‘40 Act liquid alternatives market in the US along with alternative UCITS in Europe, managers can’t afford to ignore (the regulated markets) if they plan to grow their AuM.”

“We can offer managers access to a broad client base of sophisticated investors by having a global distribution footprint. Our GAIA funds are currently sold in over 30 countries, including places where hedge fund managers and most UCITS hedge fund platforms do not have a presence,” says Dreaneen.

For those who don’t wish to be burdened with the ongoing compliance demands of running an alternative UCITS, SuMi TRUST Global Asset Services (GAS) is preparing to roll out its management company service for external hedge fund managers in the UK. This external management company, which appoints the manager as the investment adviser to the UCITS fund, is known as a host Authorised Corporate Director (ACD).

“If managers are intent on tapping into the UK retail market with a UCITS fund, it’s probably more advisable to do so with a UK UCITS. We have a number of clients running Irish UCITS funds, and whilst it is perfectly acceptable to buy an Irish UCITS, the UK retail investor has a preference for UK funds. They are more familiar with them.

“We are now building out our pipeline to support hedge fund managers. There’s been a fair amount of interest; both among managers wishing to launch alternative UCITS funds and those who are looking to change service providers and/or no longer want to have an in-house ACD.

“The UK and Ireland management company model is up and running. The next stage will be to roll that out in Luxembourg,” confirms Guy Mettrick, Head of Regulated Fund Sales Europe at SuMi TRUST GAS.

Ian Swallow is Head of UCITS Management at Man Group. Like the other platforms, it too has experienced significant growth. The platform runs between 35 and 40 UCITS funds, of which approximately 70 per cent are long-only funds. Over the last 12 months the platform has seen its product range grow by 60 per cent to USD6.61bn. Of this, USD4.97bn came from long-only funds.

“The private bank advisory channel has certainly been one of the key drivers of AUM growth for us in recent times. It is a trend I see continuing for some time to come.”

Paul Holmes, BoA ML
Access our finest ensemble

Schroder GAIA offers investors access to a suite of hedge fund strategies, within a liquid and regulated framework.

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- Schroder GAIA Global Macro Bond
- Schroder GAIA Paulson Merger Arbitrage

With $5.6 billion* invested, Schroder GAIA has been received with applause by professional investors and advisers worldwide.

To find out more visit [www.schroders.com/gaia](http://www.schroders.com/gaia)

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Manager selection yields substantial results

Interview with Andrew Dreaneen

Last year, the average long/short equity alternative UCITS fund returned 11.07 per cent according to Alix Capital. It was the first sign that these regulated funds could hold their own against their freewheeling offshore equivalents.

Little wonder, then, that investor sentiment for equity-based strategies (including market neutral and event-driven) has grown. One major beneficiary of this has been Schroders, whose GAIA platform has grown from USD3.4bn of assets at the end of 2013 to approximately USD6bn year-to-date.

This has been helped by the launch of four successful fund products.

"Last November we launched Schroder GAIA Cat Bond (a catastrophe bond strategy) which has hard closed at USD800m. We launched Schroder GAIA Sirios US Equity (a US long/short equity manager), which now has USD3bn in assets, and Schroder GAIA Avoca Credit (a credit long/short strategy) which has USD530m in assets. A few weeks ago we launched Schroder GAIA Paulson Merger Arbitrage which is already up to USD250m in assets," says Andrew Dreaneen, Head of Schroder GAIA Product & Business Development.

In addition to Sirios Capital Management, the GAIA platform also houses Egerton Capital (Schroder GAIA Egerton Equity), which launched back in 2009. The fund hard-closed 18 months ago at USD1.5bn confirms Dreaneen, adding: "We still get a lot of people calling us to ask if they can invest in this fund."

Egerton is historically a European-focused fund but in the last few years they’ve extended their exposure more meaningfully into the US; today it’s around 50 per cent exposure to the US, 50 per cent to Europe/rest of the world. Both Egerton and Sirios are directional long/short managers.

“The stock market recovery has led to investor interest in capturing the upside but still with downside protection; this has favoured directional long/short managers. We would consider a pure play European manager, a global manager and also an Asia/Emerging Markets manager to offer more of a diversified range to investors. “As Sirios and Egerton are more directional, we would also consider one or two managers that are market neutral or lower net long biased. Something that delivers strong downside protection to complement what we already have on the platform. It’s certainly part of our current focus,” confirms Dreaneen.

Once a short list of managers has been drawn up by Schroders a rigorous qualitative and quantitative process is applied. Emphasis is placed on the manager’s track record: Egerton and Paulson have 20-year plus track records, 15 years for Sirios, 13 years for Avoca.

As Dreaneen explains: "We look for sizeable well-established managers who were pioneers in their asset class from the beginning and a thought leader in their specialised field. Basically blue-chip managers where we can establish a strong brand partnership."

“We also place a lot of importance on risk and liquidity management, derivatives management and the suitability of the strategy under UCITS. All of our funds have a high overlap between the offshore fund and the UCITS. We also take into account the TER of the fund; certain hedge funds still charge 2 and 20 and if they are distributed through private banks the TER can end up going north of 3 per cent. We have deliberately guarded against that on the GAIA platform.”

Watch this space as Schroders builds out its stable of high profile managers.
and USD1.64bn came from alternative UCITS. “To the end of June, the year-on-year growth rate for our alternative UCITS range was 62 per cent (USD4.26bn in June ‘14 versus USD2.62bn in June ‘13). Flows have primarily been into our long-short market neutral equity funds. For example, the UCITS version of our GLG Global Long/Short Equity strategy launched last October and now has in excess of USD500m.

“More recently, we’ve seen steady flows into other new launches in 2014 trading alternative equity and alternative convertible strategies,” says Swallow.

AIFMD – a barrier to future growth?
Despite the meteoric rise in alternative UCITS, one has to consider what potential impact the AIFMD will have on these funds. Whether the same level of AuM growth continues remains to be seen. What is clear, however, is that European investors now have another regulated fund structure that will present a far wider choice of funds than the pre-existing QIF and SIF onshore hedge fund market.

“I see no reason why AIFMD will cause alternative UCITS to disappear. They broadly target two different markets. AIFs will continue to be more of an institutional product, whereas UCITS will continue to have more of a retail focus. I think that will remain the case for some time to come,” opines Swallow.

Indeed, regulation in markets such as Germany is such that institutions can only really invest in UCITS funds with Swallow observing that the vast majority of inflows from German investors go into its UCITS funds “and I don’t think AIFMD will have a drastic impact”.

“Also, a key structural difference between UCITS and AIFs is that the liquidity on UCITS funds is generally superior. If you’re an investor and you want to allocate to an equity long/short strategy that isn’t constrained by UCITS restrictions, why wouldn’t you choose to invest in a more liquid fund structure? In that sense, selecting a UCITS becomes an easy choice,” says Swallow.

The paradox in Europe right now is that managers of AIFs are set to incur higher levels of responsibility than those running UCITS funds, with remuneration rules being a case in point. This is something that is likely to be addressed under UCITS V. Regardless of whether the fund structure is an onshore hedge fund, an offshore hedge fund or a UCITS, Mettrick believes that there will be a long-term future for all three fund vehicles.

“What we are trying to do is to offer our clients a one-stop shop solution for these different fund structures and support them in their business growth,” says Mettrick.

Alceda’s Sanders is confident that alternative UCITS will continue to enjoy AuM growth over the next two to three years. By 2018, managers will have no choice but to sell regulated funds to European investors as national private placement rules get phased out. This will likely support a dual market with alternative UCITS being favoured by retail and private banking clients (and some institutions) and AIFs supporting the more sophisticated end of the investor market. Either way, AIFMD is not an immediate threat.

“Looking ahead, in five or 10 years time I think AIFMD will have the same gold standard that UCITS has today. But right now, UCITS remains the preferred choice, not just for European investors but global investors. If they are forced by financial authorities and regulators to only invest in regulated products then alternative UCITS is a natural market to meet their objectives of generating stable returns with low volatility,” says Sanders.

By way of a final illustration of how this market is maturing, in June Schroders launched the Schroder GAIA Paulson Merger Arbitrage fund and as Dreaneen confirms: “Of all the funds we’ve launched on GAIA, it has been the most successful day one fund in terms of assets raised. It’s an opportunistic time for managers to be considering alternative UCITS. We’re optimistic about the future.”
The AIFMD sets out a number of regulatory requirements that need to be met by alternative investment fund managers marketing funds in the European Economic Area (EEA). Alternative investment fund managers that market non-EEA alternative investment funds to professional investors in EEA countries must comply with Depositary Lite regime.

Through its Depositary Lite solutions Sparkasse Bank Malta will be able to support these alternative investment fund managers falling within scope of the AIFMD.

**Services include: provision of Bank account, cash flow monitoring**, **safekeeping of assets** and **oversight duties**.

Contact our dedicated teams of experts for further information. The Depositary Lite service forms part of our overall AIFM solution but is available as a standalone too.

1 Vide Article 36(1)(a) AIFMD
2 Vide Article 21.7 from the said directive
3 Vide Article 21.8 from the said directive
4 Vide Article 21.9 from the said directive

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Towards the end of 2013 Harcourt Investment Consulting, the alternatives arm of Vontobel Asset Management, launched a family of three funds under the moniker of “Research-Driven Strategies” (RDS). The objective of these funds was simple: to harvest strategy-specific risk premia in a UCITS fund structure and deliver to investors an absolute return profile independent of market conditions.

The three funds launched in October and December of 2013 are:
- Vontobel Fund – Pure Momentum Strategy;
- Vontobel Fund – Pure Dividend Strategy;
- Vontobel Fund – Pure Premium Strategy.

The collective aim of the three funds is to generate annualised returns of between 300 and 500 basis points above US-dollar three-month Libor. Each strategy is highly systematic and, as the name implies, is based on rigorous academic research.

Jan Viebig is CEO and Head of Alternative Investments at Harcourt and the lead portfolio manager of the VF – Pure Momentum Strategy. Discussing the team’s approach to running these strategies Viebig says: “Roughly 90 per cent of the risk/return in investor portfolios (in equities, bonds, commodities) comes from asset class movement. The problem is, interest rates are at historic lows and stocks are no longer cheap; the Shiller P/E ratio is currently in the highest percentile. As the expected returns on traditional risk premia is low, investors search for alternatives.

“Today investors can not only diversify across traditional asset classes, but also across different strategies. Each of our strategies is research-driven and what we found in academic literature was that there are three strategies which have a statistically significant positive return over the long term: momentum strategies; premium strategies, which are no different to what insurance companies are doing by collecting premia through underwriting options to the financial markets and hedging out the tail risks; and finally dividend strategies.”

As the three funds complement each other, when investors allocate one third to each strategy, the overall risk (or volatility) target is nearly halved as compared to investing in, say, just the Pure Momentum Strategy.

On its own, this fund has delivered annualised performance of 7.67 per cent, based on historic back testing between 2003 and 2013, and a volatility profile of 9.82 per cent.

However, when combined with the other two strategies, the volatility falls to 4.35 per cent whilst still preserving performance at 7.20 per cent.

“Each strategy has different risks, they do well in different periods of the market. This reduces the overall risk when allocating across all three strategies,” says Viebig, who continues: “Momentum is a trend following strategy so this is good when markets move substantially. The premium strategy, by design, is extremely good when markets don’t move much (it’s basically a short volatility strategy). Each strategy is designed to offset the risk of the two other strategies.”

Today, the risk in many client portfolios is highly concentrated. The exposure to traditional asset classes - stocks, bonds and commodities - typically explains over 90% of the risk and return variations of most portfolios.

There are upwards of 20 different hedge
fund strategies to mitigate asset-class risk. The trick for investors is picking the right selection of strategies. As Viebig explains: “We don’t believe that if an investor has three or four traditional risk premia (in their wider portfolio) that they then need to look at 20 different alternatives strategies.

“They just need to pick the best three to five alternative risk premia to ensure that this strategy-specific risk offsets the asset class risk in their wider portfolio. We want to make sure that our RDS product achieves this for investors.”

**Pure Momentum Strategy:**
A lot of momentum funds rely solely upon time-series futures market models to detect upward and downward trends. Where the VF – Pure Momentum Strategy differs is that it combines a time-series momentum model with a cross-sectional momentum model.

As Viebig explains: “We look at certain baskets of stocks and build only those baskets that demonstrate positive momentum characteristics. We then hedge out the risk by shorting futures so the basket is effectively market neutral.”

The fund takes advantage of global equity and bond market trends. If it builds a basket of 30 German stocks, for example, it would then achieve risk parity by shorting DAX futures.

“Typically we are investing in up to 40 futures in the time-series model, and anywhere between 40 and 120 global stocks/bonds in the cross-sectional model to diversify away idiosyncratic risk. We use different baskets for different countries,” adds Viebig.

Currently, the VF – Pure Momentum Strategy has a 65.4% net long position in equities which is completely hedged by short positions in futures (cross-sectional strategy).

**Pure Dividend Strategy:**
Like the Momentum Strategy, the VF – Pure Dividend Strategy offers something different to the market. Most dividend funds seek to identify stocks based on the high dividend yields they offer without necessarily reducing equity market risk.

“The goal of this strategy is to extract value out of the market. The difference between traditional dividend funds and our fund is that we select high dividend stocks with strong cash flows, high earnings and a stable balance sheet - that’s on the long side. Then, we hedge out up to 50 per cent of the market risk using futures and the other 50 per cent we hedge out dynamically using a trend model to make sure we avoid having large drawdowns.

“This ensures that we are extracting dividend premia and hedging out market risk,” says Viebig.

Only high quality liquid stocks such as BP are selected for the long book. Index futures are used depending on which market the stocks reside in i.e. US stocks will be hedged with Russell 2000 futures, European stocks with STOXX Europe 600 futures etc.

**Pure Premium Strategy:**
The VF – Pure Premium Strategy is designed to harvest the volatility risk premium.

This is achieved by implementing what are referred to as “butterfly structures” in different markets. At the heart of this strategy at-the-money call options are sold to the market to collect the risk premia whilst out-of-the-money options are bought to hedge out tail risk; that is, to guard against any sudden upward movement (volatility) in the markets.

“When markets don’t move your returns are based on harvesting the volatility risk premia. You want to implement the butterfly structure when you get the highest premia based on assessing the spreads between implied volatility and realised volatility. When implied volatility (which is what you collect when selling options) is high compared to realised volatility, that’s when you implement this butterfly structure.”

Aside from the strategy risk diversification benefits, the RDS portfolio has also been designed to offer investors a cost-efficient solution. No double fee layer is imposed and the total charges are a 75 basis point management fee and a 10 per cent performance fee. Regardless of whether investors allocate to one fund or all three, there is no cost impact.

“Alternative UCITS is a growing market segment so it made sense to launch the three funds because investors want more cost-efficient, more liquid, and more transparent alternative funds,” concludes Viebig.
“Over the first six months of this year there’s been an acceleration of AuM growth. According to our database, assets in alternative UCITS have grown by 24 per cent. This is the largest growth, in percentage terms, since we started tracking the universe at the end of 2009,” says Louis Zanolin, CEO of Alix Capital which runs the UCITS Alternative Index series.

At the end of 2013, assets were roughly EUR190bn. That figure has since climbed to EUR235bn. When one considers that the average fund is only up 0.94 per cent year-to-date, and returned 4.12 per cent in 2013, the vast majority of this asset growth is down to investor net inflows.

“The growth in alternative UCITS has been phenomenal. In 2011, the AuM was approximately EUR100bn,” says Cyrus Amaria, deputy head of Alternative Investments at Lyxor Asset Management. “Whilst offshore hedge funds are growing at 10 to 15 per cent per annum, alternative UCITS, at least in 2014, are enjoying a higher growth rate.

“We are seeing huge demand from clients, both in terms of allocating assets and asking us questions on what we offer in the UCITS space, what’s out there, and can we help educate them. As for who it is allocating to these funds, we see a rough split between institutional investors (some FoHFs that suffered in 2008, insurance companies who...
are looking for liquid alternatives) and private banks whose HNW clients want the comfort of regulated products."

Zanolin thinks that there are two main explanations for this growth trajectory. First, equity-focused funds did particularly well last year. The average equity long/short fund returned an impressive +11.07 per cent and this pushed investors to allocate more money. To hedge against this, investors also favoured equity market neutral funds.

“So far this year, both strategies have grown by 46 per cent and 47 per cent respectively, with respect to AuM. Second, it seems that as soon as funds reach a certain level of assets they start to naturally attract more capital.

“Investment in funds when a fund has reached, say, EUR500m. So aside from performance, once a fund has reached a good level of assets it experiences an acceleration in AuM and then closes. This year, 18 funds closed to new investors, which is considerably higher than last year,” comments Zanolin.

Schroder GAIA Sirios US Equity and MLIS Marshall Wace TOPS UCITS are two examples of funds that have closed this year.

This is encouraging because it should hopefully push investors to look at a wider range of smaller funds, many of whom are not sat at the top table and feasting on the glut of new inflows coming into the market. Like the offshore hedge fund market, it is a highly asymmetric growth profile. Only the biggest seem to benefit.

“There are still a large number of small funds that are struggling to get on investors' radar screens. They face the problem of how to get from EUR30m to EUR300m and attract the attention of larger investors. For offshore funds, it’s okay to have one marketing person for Europe. But that doesn’t work for alternative UCITS. Funds that are raising a lot of money tend to be part of larger organisations - give or take a few exceptions - and can leverage large distribution networks,” explains Zanolin.

The HSBC Ucits AdvantEdge Fund, a FoHF vehicle, was launched by HSBC Alternative Investments Ltd to give both institutional and retail investors the opportunity to build their exposure in the best alternative UCITS funds available.

“Over the first six months of this year there’s been an acceleration of AuM growth. According to our database, assets in alternative UCITS have grown by 24 per cent.”

Louis Zanolin, Alix Capital

The fund launched in December ’09 and since that time Peter Rigg, CEO of HSBC Alternative Investments Ltd, says the market has changed considerably.

“The number of funds available has levelled off. That’s not to say there aren’t new funds coming out but the industry is certainly maturing and the average fund AuM is increasing. That means the quality of funds is consolidating. There have been some excellent launches lately,” observes Rigg.

One notable trend according to Rigg is the increasing number of US fund managers coming to market to attract European investors.

“We’ve been investing more into US funds through our AdvantEdge fund. Importantly, there is now a much more diversified mix of strategies compared to when we launched the fund in December 2009. For example, early on in the fund only 5 per cent of the portfolio was dedicated to event-driven strategies and there was 0 per cent in credit. Now, we have 15 per cent allocated to each.

“That’s a reflection of how the industry has developed over the last five years. We try to respond to new opportunities and this has helped us build a much more diversified portfolio,” says Rigg.

Michael Sanders, Managing Director and Chairman of the Board at Alceda Fund Management, which operates the Alceda UCITS platform (AUP), notes that the firm is getting a lot more approaches this year from loan and credit managers and is currently looking to potentially bring a US-based MBS manager onto the platform.

“Investors are looking for credit strategies as well as Asian long/short equities but it depends which market you talk to. In the German-speaking market they are looking for alternative bond strategies such as our...
Dispelling the myths about alternative UCITS

By Ian Swallow

A framework, not an endorsement
The popularity of the UCITS ‘brand’ is beyond question and this continues to be one of the fastest-growing segments of the fund-management industry. Indeed, our own anecdotal experience suggests that investors outside of Europe often prefer to invest in a fund under the UCITS banner.

One of the issues associated with the ability to label a product as UCITS-compliant is that this status alone can influence the perspective of investors over its potential suitability. For example, a risk-averse investor may incorrectly consider that each and every UCITS vehicle is effectively approved by local and international regulators as being suitable for all.

The UCITS framework should indeed ensure that the relative risks undertaken by investment managers are commensurate with their published strategy and that the potential returns justify the absorption of such risk. However, the regulations do not aim to ensure that all UCITS-compliant products have the same risk/return objectives or offer similar levels of downside limitations.

A separate but related point is that some strategies that are not specifically excluded under the UCITS directive are not wholly compatible with it. This means that there is a moral responsibility – that may not always be strictly adhered to – on the part of providers to only wrap appropriate strategies within a UCITS format.

Consequently, we believe that a perception that all UCITS funds are made equal has led to some strategy or provider-specific issues being afforded myth-like status and blanketed across the entire universe. Clearly, objectivity demands that the following commonly quoted myths are dispelled.

UCITS funds carry a performance drag
Some investors believe that the performance of an alternative UCITS fund will, by definition, lag that of the offshore strategy on which the offering is based because significant re-engineering of the portfolio is required in order to satisfy the UCITS directive. However, the rationale behind a number of alternative product offerings being made available under the UCITS banner is that the underlying offshore strategy is largely, or even completely, aligned with UCITS regulations. Consequently, where no major modifications are required, the offshore and UCITS funds will often trade pari-passu.

A liquidity mismatch could cause redemption difficulties
Liquidity mismatches arise when the terms of redemption offered are different to the rate at which the portfolio could be unwound in the event of a flood of redemptions. Some investors fear that where the redemption terms of the offshore product differ from that of the UCITS offering, managers will not be able to provide the advertised liquidity.

It is true that some hedge fund strategies, such as certain offerings falling within the event-driven category, require additional time to unwind a portfolio because the underlying assets themselves are relatively illiquid. However, many hedge fund providers stipulate a longer redemption period in their non-UCITS offerings than that specified by the UCITS directive simply because they have a small number of very large investors. Consequently, in the event of a significant redemption, they wish to protect the interests of other investors by unwinding positions over a longer period to avoid slippage. It is often the case that the assets could, in practice, be crystallised in line with the UCITS specifications.

A large number of alternative strategies are not replicable under the UCITS provisions
A number of investors have noted that,
for example, the Eligible Assets Directive (EAD) prohibits the holding of physical commodities. Consequently, strategies that harness commodities-related earnings streams, such as Managed Futures and Global Macro, are not fully replicable.

Clearly, there are a number of issues related to the holding of physical commodities, such as storage, potential damage, insurance and transport costs. However, alternative UCITS providers can gain commodities exposure through (for example) index options, which are highly liquid and meet other UCITS rules relating to diversification and collateralisation.

Consequently, the ability to deliver commodities-related return streams is not only highly desirable for investors seeking investment performance that is uncorrelated to traditional assets, it is also perfectly permissible under the EAD.

UCITS rules prohibit short selling

A popular misconception is that some of the best hedge-fund strategies are not available in a UCITS format because they rely on short selling, which is not permitted under UCITS regulations.

Clearly, short-selling is one of the most powerful tools in the armoury of a hedge fund manager, as it allows investment professionals to express a negative view on an asset. This provides a further potential source of alpha and the short book can also be used to hedge the performance of the long positions. However, the practice has often come under the scrutiny of regulators because it can be dangerous if not conducted prudently. Consequently, stock exchanges have periodically banned ‘naked’ short selling, which is a form of speculation that involves selling stock that is not owned with a view to buying it at a lower price in time for settlement.

Under the terms of the UCITS directive, even ‘covered’ (where stock is legitimately borrowed before selling) shorting is prohibited. However, synthetic shorting can be achieved through the use of cash-settled derivative instruments, which are perfectly permissible. As such, the regulations are not a barrier to operating a long/short strategy that is aligned with its offshore counterpart.

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It is expensive to bring an alternative UCITS strategy to the market so fee loads are greater

The costs associated with structuring a UCITS offering are very much dependent on both the scope of the issuer and the compass of the strategy offering. There is no doubt that economies of scale apply and some small alternative investment houses could find that any or all of the following points are barriers to cost-effective implementation for both manager and investor.

• Platform size (fixed costs can be large for small platforms)
• Complex compliance monitoring requirements can be difficult to monitor and are thus labour intensive
• Production of additional materials (eg. KIID)
• Passporting/registration, upfront and ongoing maintenance costs (including translation costs)
• Maintenance of or contracting with an onshore management company to manage the funds
• Lack of experience in dealing with regulators (both directly and via legal counsel)

The last point is not a question of expense in monetary terms, but it can be a drain on human resources and regulatory inexperience frequently leads to unforeseen delays in proposed launch dates (and thus fee-income accumulation).

Resources and innovation

As is often the case with myths, there is usually some substance to the misconceptions that are frequently applied to alternative UCITS strategies. However, these issues may be specific to either the issuer, the specific approach pursued or both. It is unquestionably the case that some of the most popular UCITS products, such as managed futures and equity long-short, are naturally aligned to the liquidity provisions of the UCITS directive.

Consequently, adhering to the principles of the offshore strategy on which the offering is based and producing returns that are closely aligned to it within a UCITS framework is seldom a barrier. This is especially the case for large-scale players who are able to devote, time, expertise and resources to uncovering innovative methods of mirroring the offshore strategy within the UCITS regulations.
risk parity strategies whereas a Swiss family office might be more interested in long/short equities. We have Superannuation pension funds in Australia that are looking for everything within the alternative space!” confirms Sanders.

Paul Holmes, Head of Hedge Fund Distribution at Bank of America Merrill Lynch says that event-driven strategies are popular right now. “For those who have experience in this space and the specialist skills to analyse these situations, the opportunities they provide to an investor can be very interesting on an absolute and risk-adjusted basis,” comments Holmes.

**Positive performance, please**

When one looks at performance within the alternative UCITS space, there have been some impressive funds. At Man Group, the best performing fund in 2013 was its UK Equity Long/Short strategy, returning +13 per cent. Through 22nd July 2014, the best performer has been its well-known trend following strategy, Man AHL Trend. The fund has so far locked in gains of +17.3 per cent (in its USD institutional share class).

Over at Lyxor Asset Management, despite only having three alternative UCITS funds it’s fair to say that they have proven their worth. The following table shows the performance of these funds through 24th June 2014, each being based on institutional share classes.

Lyxor has been running a managed account of the Tiedemann offshore fund since 2001. As the strategy exhibits low volatility, Amaria says that it was immediately identified as “the ideal choice for one of our first alternative UCITS funds. Investors are looking for strong drawdown control, a long successful track record and an established manager.”

Amaria says that there have been no style drift issues in any of the three funds.

“We monitor this closely. There may be differences in performance due to variations in liquidity, concentration and instruments traded depending on the manager. However, take Canyon Capital, for example. What we will say to them is ‘Where you have themes – e.g. in corporate credit or restructuring coming from stressed and distressed companies – look for the most liquid trades and build those trades into the UCITS portfolio’. They’ve achieved that and as such performance and volatility have been closely in line with the more illiquid offshore hedge fund.

“Both fund structures achieved double-digit returns in 2013. That for us is a sign of quality.”

Jan Viebig is CEO/Head of Alternative Investments at Harcourt Investment Consulting and the lead portfolio manager of the Vontobel Fund – Pure Momentum Strategy. This is just one of a suite of three funds launched towards the end of 2013 by Harcourt under the name of “Research-Driven Strategies”. The other two funds run a pure dividend and a pure premium strategy respectively.

Right now, the momentum strategy is up +7.10 per cent YTD and ranks in the top decile of its peer group says Viebig.

“Whilst offshore hedge funds are growing at 10 to 15 per cent per annum, alternative UCITS, at least in 2014, are enjoying a higher growth rate.”

**Cyrus Amaria, Lyxor Asset Management.**

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<thead>
<tr>
<th>Lyxor Alternative UCITS (I USD) Strategy</th>
<th>Strategy</th>
<th>WTD</th>
<th>MTD</th>
<th>YTD</th>
<th>ITD</th>
<th>Launch Date</th>
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<tr>
<td>Lyxor / WNT Fund</td>
<td>CTA, Diversified</td>
<td>0.88%</td>
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<td>3.42%</td>
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<td>Jan-13</td>
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<td>Lyxor / Canyon Credit Strategy Fund</td>
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<td>4.56%</td>
<td>15.32%</td>
<td>Feb-13</td>
</tr>
<tr>
<td>Lyxor / Tiedemann Arb Strategy Fund</td>
<td>Merger Arbitrage</td>
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<td>1.74%</td>
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<td>14.59%</td>
<td>Feb-13</td>
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Expanding support for alternative UCITS hedge fund managers

Interview with Guy Mettrick

SuMi TRUST Global Asset Services (GAS) has been supporting UCITS funds from its Dublin operation since 1995 and non-UCITS funds since 1990. With the growth of alternative UCITS in full swing, the firm is already extending its support to alternative managers beyond its existing (long only) UCITS platform.

According to Guy Mettrick, Head of Regulated Fund Sales Europe at SuMi TRUST GAS, the firm is currently in discussions with a number of partners to launch joint venture alternative UCITS platforms both in Ireland and the UK.

"In Ireland we have a ready made umbrella structure - trustee, management company, administrator, custodian - into which managers could position their own sub-fund. This will bring clear time and cost benefits to managers,” says Mettrick.

In the UK, SuMi TRUST GAS already provides the ACD (Authorised Corporate Director) role for UK-domiciled funds – where it acts as the management company of an OEIC - through London based SMT Fund Services (UK) Ltd; a wholly owned subsidiary of the SuMi TRUST Group.

"If you’re a London-based hedge fund manager looking to set up a UK UCITS fund, but don’t want to develop all the fund and regulatory infrastructure, we can help you launch and manage the day-to-day operation of the fund. By appointing us as the host ACD we help with the development of the fund prospectus, appoint the administrator and depositary in the UK, and between us we then submit the fund prospectus to the FCA for approval. We make sure everything is in place for the manager, allowing them to run the fund and focus on delivering returns and raising assets,” continues Mettrick.

The role of the external management company is to ensure the investment manager follows the guidelines as required under UCITS and local regulation and that the investment strategy is doing exactly what it says it should be doing in the prospectus.

Mettrick confirms that SuMi TRUST GAS currently provides this host ACD for an existing client, whose fund has now grown to over GBP700m in assets. With growth in the alternative UCITS space showing no signs of easing up, SuMi TRUST is now ready to “replicate this service and offer it to all external clients managing hedge funds”.

"The UK and Ireland management company models are up and running, the next stage will be to offer the same services from Luxembourg, giving SuMi TRUST coverage in the three major fund domiciles,” confirms Mettrick.

Before thinking about launching an alternative UCITS fund, “A manager has to be clear that their strategy which has worked in the offshore world is, if not perfectly replicable, able to deliver a similar level of performance,” says Mettrick.

There are substantial costs to launching and maintaining a standalone UCITS fund. To that end, the distribution strategy is key to attract enough assets so that ongoing costs do not impact the performance of the fund.

“My advice to managers is to make sure they have good partners in place that have the necessary expertise, systems and commercial terms to support the success of their new fund. In the case of a UK fund, your chosen ACD should be one with a strong capital adequacy to match the growth of the funds under its supervision. Have a clear understanding of the fund’s objectives and speak to SuMi TRUST who can advise you on the best fund structure to meet those objectives,” concludes Mettrick.
financial market stress, when investors suffer losses with traditional investments in stocks and bonds.

“An equally weighted portfolio that consists of all three RDS strategies has outperformed the HFRX Global Hedge Fund Index both YTD and since inception of the funds. One reason for the outperformance is that we concentrate on risk premia that are statistically significant. Another reason for the outperformance is simply that the fees of our RDS strategies are lower than those of hedge funds and we do not charge double fee layers,” says Viebig.

The momentum fund’s cross-sectional strategy has worked well in both the Korean and German markets, adds Viebig.

On the Alceda UCITS Platform, the best performing fund through June 2014 is the AC Risk Parity 17 fund, up +16.25 per cent. But whilst the range and performance of funds is improving, there are still gaps.

“The constraints of UCITS don’t fit well with certain strategies. Distressed and global macro strategies, due to liquidity constraints and the use of derivatives and/or leverage, are the two main strategy gaps that we currently see,” says Rigg.

The growth of regulated hedge funds is not only confined to Europe. In the US, there is an increasing prevalence of ‘40 Act funds being launched by hedge fund and private equity managers to tap into the retail space, according to Joe Holman, CEO of Orangefield Columbus, a global fund administrator with approximately USD30bn in AuA.

That clients are now launching ‘40 Act funds and alternative UCITS is certainly helping administrators build their roster.

“We have five or six of these ‘liquid alternative’ funds in the pipeline and expect to see a few successful launches before year-end. There’s USD15trn in the mutual fund space versus USD3trn in the alternative fund space; if managers can get a small percentage of that mutual fund money it could grow the alternative fund market by a significant amount. That’s the pot of gold at the end of the rainbow for managers who launch these regulated funds,” says Holman.

One potential sticking point for US managers is the proposed remuneration rules that are set to be introduced under UCITS V. This will require 50 per cent of any variable remuneration (i.e. bonuses) to consist of units of the UCITS fund concerned.

The problem is, US managers running UCITS funds are not allowed to invest in them and cannot therefore acquire shares.

“This is something that concerns a lot of US managers. With all this regulatory uncertainty in the EU, I think it’s causing some US managers to step back and wait on the sidelines. Why would an analyst work for a European fund when they could move to the US and earn twice as much?” says Holman.

It’s certainly something to be aware of. Hopefully, a resolution will be forthcoming. If not, US managers could shy away and focus their efforts instead on the ‘40 Act fund domestic market.

Nevertheless, Amaria thinks that one of the biggest developments in the alternative UCITS space moving forward will be more higher quality managers coming to market.

“For non-EU managers, they are looking at the UCITS market closely for two reasons. First, long term they do not want to rely on reverse solicitation under AIFMD and they will not become registered AIFMs. Second, they see what’s happening with the growth of ‘40 Act funds. However, the best managers are not going to take quick decisions on whether to launch a UCITS fund. They will take their time and may even do it themselves, or they may come to us and partner up.

“The biggest success factor for our three managers has not necessarily been performance. It’s that each manager grew AuM across their offshore funds, their managed accounts with us and our UCITS funds. That tells you the overall quality of each manager has grown,” concludes Amaria.