Amsterdam Investor Forum 2019

Machine learning: The case for alternative data

The global macro picture – finding an edge

ESG investing matures becomes mainstream
From the perspective of many investors, the case for hedge funds is now stronger than ever. That’s because we are in the very late stages of a classic economic cycle. Since the coordinated central bank stimulus of spring 2009, there have been enormous increases in asset valuations globally. Under such circumstances, it doesn’t make much sense to be passively long.

There were some important themes covered at AIF 2019, which included: geopolitics and trade wars, ESG investing, oil dynamics, the role of ETFs, the future of data, and the Asia Pacific investment environment. These themes are summarised within the following pages of this report, providing a snapshot into how fund managers and other industry practitioners are thinking about trends and risks across the asset class mix.

The eighth edition of ABN AMRO Clearing’s Amsterdam Investor Forum had picked its moment well. Held across the 19th and 20th March, it seemed appropriate that 10 days before the UK was officially set to leave the European Union, prevailing market uncertainty and what the direction of travel could be for global financial markets in 2019 helped to create the ideal backdrop against which to debate the key issues facing alternative fund managers.

In her opening address, Delphine Amzallag, Global Head of Prime Services at ABN AMRO, said that looking back to 2018, after multiple years of steady growth, “it was clearly a tumultuous year for investors, particularly in Q4.

“The year was punctuated by many game changing and conflicting events.

“Despite these headwinds, the good news is that investors have continued to stay loyal to the industry. Indeed, some managers and strategies managed to navigate the choppy waters successfully.

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The case for alternative data

One of the major trends to emerge in the global hedge fund industry in recent years has been the growing sophistication and proliferation of quantitative strategies, some of which are pushing the edge of what is possible with machine learning algorithms, in an attempt to uncover novel sources of alpha.

Machine learning strategies are developing rapidly thanks to improved computer processing power. To be effective, however, managers need to feed their models with good data sets.

Speaking on the panel A Data Future, moderated by Stewart Jardine, Director, Market Technology & Data Services, CME, Rani Piputri, Head of Automated Intelligence Investing, NNIP (a Netherlands-base investment manager), said that how one defines a good alternative data set depends on one’s investment process. “We’ve found some alternative data providers who can provide us with very good equity analyst estimates,” said Piputri.

She added that fund managers who use alternative data sets have to think carefully about the cost of alternative data. If an equities data set costs USD500K, how much alpha would one need to generate to cover that cost, based on the size of the portfolio?

It is enticing to think that these data sets could provide a Holy Grail of finding alpha in the market for lower risk, but the reality is quite different. Costs could spiral quickly if managers are not disciplined in how they use alternative data and understand how additive they are to the portfolio.

“Some alternative data is good at giving you short signals, but again, it depends how much short selling you do in your strategy,” added Piputri.

Professor Christophe Boucher is Head of Quantitative Research & Strategy, ABN AMRO Investment Solutions. He cautioned that machine learning models are useful in some but not all areas of finance, such as stock picking, or risk management to classify markets into different risk regimes.

He cited shadow rating of bonds, when there is no publicly available data from ratings agencies, and developing ESG scoring models for corporates, as two areas that the bank has been looking at recently.
There are four key factors that have contributed to the effectiveness of machine learning in the last few years. As the panel explained, these include:

- Research and funding;
- Enhanced cloud computing;
- Libraries of code developed by a fast growing online community;
- Volume of data.

### Strategy first or data set first?

For investors looking to allocate to a quant fund, one of the key questions should be how the manager thinks about data. Do they collect alternative data in the hope that their algorithms will find something? “If so,” said Professor Boucher, “this is a very poor process. It can create highly spurious results. When you use alternative data, you need to have an established hypothesis to explore.”

This is important because data mining can easily lead to the risk of overfitting – where the machine learning model finds correlations in data that do not exist. Alternative data sets are useful, and will continue to be, but they should be used for idea generation, rather than forming the basis of a strategy.

Indeed, as the panel explained, alpha decay is also a risk, alongside overfitting.

Although an alternative data provider might have generated good alpha when back testing it for the previous decade, by the time it is sold to fund managers, and then applied to the current marketplace, they might find that there simply isn’t much inherent alpha left in the data set. One has to therefore be careful there is still a signal in the alternative data sets being purchase.

Moreover, having data that is too precise is not necessarily going to improve one’s trading strategy. After all, if the rest of the market does not share the same view, it will not be possible to generate a positive return.

There are huge advantages to using alternative data sets, but there are certainly risks, which investors should be mindful of.

### Investor insights on hedge fund performance

One of the key features of the Amsterdam Investor Forum is to gauge how institutional allocators think about alternatives in the current climate.

“Big Data and machine learning are twin sisters. Machine learning can be used effectively because the data is there, and likewise you need machine learning to process large volumes of data.”

Last year was a tough one for hedge funds. Overall performance, on average, was down -4.1 per cent on a fund-weighted basis, according to Hedge Fund Research Inc. When asked to vote, 69 per cent of the AIF audience said they were disappointed by hedge fund results in 2018.

Still, on the back of market volatility in December 2018, 2019 could shape up to be a year for the active trader and give hedge funds a chance to reinforce their value proposition to investors.

As Paul Tudor Jones, founder and CIO of Tudor Investment Corp, told Bloomberg recently, 2019 might be a better time to be a trader than to just hold. “I don’t know if we’re going to have a huge amount of trends. It could just be an enormously volatile period with a lot of back and forth,” he said.

Dampened volatility has really hurt hedge funds since the Global Financial Crash. The central banks have not helped at all.

Per Ivarsson is Executive Vice President and Head of the Investment Management Team, RPM, a Swedish asset manager which focuses on directional investment strategies, specifically managed futures and global macro.
The audience was asked: When trading markets, what is the predominant feature you are looking for? The results were as follows:

- **Value** – 25 per cent
- **Market neutral** – 35 per cent
- **Low volatility** – 7 per cent
- **Inflation protection** – 4 per cent
- **Growth** – 29 per cent

Growth opportunities featured prominently but with equity markets getting toppish, and uncertainty surrounding global economic growth in 2019, market neutral came out as the preferred option, as investors look to reduce directionality and hedge their portfolios against an expected downturn.

Speaking on a second **Investor Insights** panel, Lars Dijkstra, CIO, Kempen Capital Management, which focuses on specialist hedge fund strategies in niche markets, said that equity long/short managers did not fare well last year. "We like managers with a high level of complexity," he said. "Structured credit is one example where we've selected a strong group of managers, as well as those running insurance-linked securities and long volatility strategies."

One of the issues that investors have to contend with, when thinking about allocating in to new strategies is how to confidently identify managers who will turn out to be top decile performers. As Marianne Dernies, Head of Business Development, ABN AMRO Investment Solutions, pointed out, the difference between 2017 and 2018 was that dispersion of returns occurred not just broadly, from strategy to strategy, but within strategies; up to 70 per cent dispersion in UCITS-compliant equity funds.

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been running the strategy? Is the alpha sustainable over time? And thirdly, is the company robust?

She said having specialists in one’s team is important. “We actually like dispersion (of returns). August 2015, for example, was good for volatility strategies, 2011 was good for structured credit, etc. You’ve got to know the personalities of different strategies to win out,” said Wallis.

One of the points made on the panel, which was moderated by Jack Inglis, CEO of AIMA, was the ongoing importance of developing bespoke investment solutions, to try to generate the optimal risk/return profile for end investors. This has led to carve-outs, with managers selected to run a sub-set of their strategy, such as Asian equities for example. According to Wallis, 75 per cent of GAM’s asset base is now allocating in to customised managed accounts.

**ETFs remain resilient in volatile markets**

This desire among asset allocators to develop bespoke solutions comes at a time when the debate between active versus passive investing remains polemical. One of the consequences of central bank intervention over the last decade has been to send equities on a high velocity trajectory. Volatility in Q4 last year did contribute to the S&P 500 ending the year down -4.38 per cent but it has already rebounded strongly.

Between 2009 and 2017, the index gave investors annualised returns of 15.65 per cent.

Why pay 2/20 for an active equity long/short manager when all one needed to do was take a long position on various indices using a selection of low cost, highly liquid ETFs?

In a compelling panel debate entitled **Trends and challenges driving ETF market growth**, Marlene Hassine Konqui, Head of ETF Research, Lyxor, highlighted how investor sentiment towards ETFs has changed in recent times, going against an ingrained market perception that ETFs are the first instrument to be jettisoned when markets get stressed.

Hassine Konqui explained that performance in 2018 for both active equity and fixed income managers was poor and

**Oil price dynamics**

Since the turn of the century, the price of oil has whipsawed significantly, falling 75 per cent between November 2014 and March 2016 alone. Over the last 20 years, the market has moved from Peak Oil to Peak Production of oil, to one of Peak Demand for oil.

Speaking about how he views oil price dynamics in conversation with Erik Norland, Senior Economist, CME, Doug King, Partner at RCMA Capital, a London-based commodity trading firm, said that with the shale oil revolution in the US, with technology improving annually, “there is enough oil and enough production capacity to sate the demand for the next 15 to 20 years”.

With major oil companies only just moving into the space, King said the shale oil revolution has only just started.

“I think this is going to accelerate production; 20 million barrels in the next five years is certainly possible,” said King.

At present, 12.1 million barrels/day are being produced in the US. When asked what they think US oil production will be closest to by 2025, 48 per cent of the audience said 15 million barrels/day.

If shale oil grows 1.5 million barrels/day, it will meet global demand growth per year, meaning all of that market share growth will go to the US.

“I think OPEC is okay with that provided you get a window of maybe 10 years at USD70-75, while Saudi Arabia weans itself off oil. OPEC are clear that they will support prices, and are supporting prices. They are getting some geopolitical help in this. US sanctions on Iran have taken 1.5 million barrels/day off the market, and then there’s the Venezuelan situation. We think production is down to 700,000 barrels/day.

“Saudi Arabia is able to pump 10 million barrels/day and able to get USD70/barrel but that could change, especially if Iran was allowed back into world markets and produce 4 million barrels/day,” outlined King.

Asked to vote on when OPEC will next raise production, 43 per cent of the audience felt it would be in 2020.
that for the first time in Europe, “we saw passive flows exceed active flows. Not only in equity, which was already the case for the last few years, but in fixed income.”

From July 2018 onwards, alpha generation among equity hedge funds went into reverse, culminating in substantial losses in December. Fixed income strategies, on average, have returned -1.23 per cent over the past 12 months according to Hedge Fund Research.

Research has shown that if actively managed fixed income funds do not outperform over three to six months, one starts to see outflows.

“2018 was the first time we observed this phenomenon in fixed income markets,” said Hassine Konqui. “I think some progress has now been made in using fixed income ETFs for portfolio allocations.

“We saw another interesting development during the market correction in Q4 2018. Normally, one might expect people to sell their highly liquid ETFs first in a difficult market. In Q4, however, there was EUR100 million of net outflows in active funds compared to EUR6 billion of inflows into passive funds.”

This goes against the belief that passive funds add to a trend when markets experience a downturn. Rather, in Q4, passive funds showed their resilience. This is a new phenomenon and one that ought to reassure investors of the role of ETFs in global financial markets, suggested Hassine Konqui.

The AIF Factor
This year’s AIF Factor was won by Greenland Investment Management; a systematic strategy focusing on global commodity arbitrage opportunities.

The four other contenders included: Bainbridge Partners, a systematic equity market neutral strategy; Typhon Capital Management, whose Vulcan hedge fund trades market microstructure inefficiencies in metals; Walnut Algorithms, a machine-learning focused investment strategy, and Molinero Capital Management, a fundamental quant commodity programme.

Anant Jatia, Founder of Greenland Investment Management, founded India’s first onshore hedge fund, Forefront Capital Management, before setting up Greenland Investment Management five years ago.

Greenland’s second fund offering, Greenland Global Fund II, is a carve-out of its existing flagship fund and is set to launch 1st May 2019.

“While we don’t look to trade physical commodities we look at the divergence from fair value, which is the cost of transportation, and systematically trade as the physical arbitrage takes place,” Jatia said during his presentation.

The strategy trades 16 such relationships in the portfolio. Where Jatia believes the strategy has an edge is how the team calculates fair value. With links to a family-owned commodity trading business, which has direct contracts with shipping companies, truckers, warehouses and insurance providers, the team is able to develop a proprietary dataset of transportation costs for shipping a commodity from point A to point B.

The strategy then systematically models the deviations in fair value and builds positions using an in-house, ultra-low latency high frequency trading infrastructure spanning 10 different global locations.
The global macro picture

Understanding how the global macro picture might unfold this year, and on into 2020, plays a key role in how active managers seek out opportunities for their portfolios. If, as suggested, market neutral strategies (and other low directional beta strategies) are preferred by investors, where might these strategies find an edge?

Dr Anoosh Lachin, Portfolio Manager, Aspect Capital, runs a systematic macro strategy. Speaking on the How to invest globally, now panel, moderated by Professor Mary Pieterse-Bloem, Global Head Fixed Income, ABN AMRO, Lachlin shared what seemed to be a prevailing view at the forum; namely that central banks had and would continue to interfere in the markets to avoid economic collapse, and had stripped away a lot of volatility. But he said 2018 presented some good opportunities.

“We are still big buyers of the US dollar. We like it on many different levels. It’s not just a carry trade. Bar political instability, the USD looks good on every measure,” said Lachin.

The audience was asked: When do you think the US economy will hit its next recession? The overwhelming majority, 68.8 per cent, said they felt this could happen in 2020.

Forward guidance has changed this year, with the US Federal Reserve indicating there would be no further rate hikes in 2019. Some feel the impetus to the US economy following the decision to cut corporate tax rates is now diminishing, and with trade agreement negotiations with China still ongoing, there is some concern that the US economy will start to slow following a slowdown in Q4 last year to 2.2 per cent.

“I’m not sure we need to be worried about a US recession,” commented Gerlof de Vrij, Managing Partner, Capstone Investment Advisors. “Most of the hiccups last year were technical and sentiment-driven. Flatness of the US yield curve is not a predictor of a recession but the tightening process is mature and will proportionately drag up bond yields. I think at this stage there’s little sign of anything imminent happening.”

‘Japanification’ of Europe…?

Thijs Knaap is Senior Strategist, APG, one of the world’s largest pension administration organisations with over 4 million pension fund members. When the panel discussion turned to Europe, there was an agreement that whilst the marketplace had been waiting for European reflation, it just hasn’t happened. Knaap commented that in his view, Europe is beginning to look a lot like Japan: low GDP growth, low population growth, low interest rates and low inflation growth, not to mention debt levels building up that show no sign of being resolved.

“I’m not sure there’s a clear catalyst for a crisis in the next 12 months,” remarked Knaap. "We need inflation but it’s hard to see where it will come from, right now.”

The ECB has signalled that the first rate hike won’t happen until 2020 at the earliest and has cut its GDP growth forecast for 2019 to 1.1 per cent from 1.7 per cent previously estimated. It said that these monetary policy decisions were taken to ensure that inflation remains on a sustained path towards levels that are below, but close to, 2 per cent over the medium term.

“I don’t think Europe’s economy will become Japan-like but it might take on some of its characteristics,” said de Vrij.

The US/China Trade War

China, and the wider Asia Pacific region, featured in several panel discussions at AIF 2019.

“FX volatility has died, partly because interest rate volatility has died. We are on track for Q1 2019 to be the tightest EUR/USD range since it was created, and on track for the toughest 10-year US Treasury range in history. Volatility on the whole has disappeared.”
China’s economy has its own dynamics and doesn’t follow western business cycles. The Shanghai Shenzhen CSI 300 Index is already up 32 per cent YTD, compared to 13.9 per cent for the S&P 500.

The MSCI has announced that the MSCI Emerging Market index’s weighting to Chinese A-shares will rise from 0.7 per cent to 3.3 per cent this year, which will give investors greater opportunity to invest in China’s growth story.

The audience was asked: Are you happy that China A shares are included in the MSCI equity index? Two thirds (64 per cent) of the audience voted Yes to this.

Against this China sentiment, it was interesting to hear the thoughts of economists, who led an entertaining discussion that asked, “Are trade wars spiralling into a currency war?”

For the US and China, the battleground is substantially uneven in the sense that China basically controls all of the possibilities to manipulate its currency, whereas the US has limited measures to do likewise.

As FXCM has written, last July the People’s Bank of China set the reference rate for the Chinese renminbi to 6.7671 RMB against the US dollar. It led to an instant 0.9 per cent devaluation.

“If there were a currency war, it would be an uneven one,” said Lukas Daalder, Chief Investment Strategist at BlackRock (Amsterdam). Europe and the US have little scope to control their currencies because there is hardly any room left to cut interest rates. Daalder believes this will be more of a trade war than an FX war.

Claire Dissaux, Head of Global Economics and Strategy, Millennium Global said initially President Trump’s strategy was to have trade wars with everyone: Japan, Korea, the EU, China. This evidently was not going to work. By selecting a country (China) that you import more goods from than they do from you, “then you’ve got more goods on which to impose tariffs”, said Dissaux.

70 per cent of the audience cited the US, when asked which country posed the biggest threat to a currency war. In addition, 49 per cent said the US dollar would emerge as the strongest currency.

There was a mixed reaction when asked if this trade/FX war was negatively impacting them as an asset manager. One third of the audience said Yes, while 44 per cent said No.

On the FX side, the RMB has been stable and if anything is overvalued. The government does not want the RMB to depreciate too quickly because it would lead to capital outflows in the economy. As such, the RMB has one of the lowest implied volatilities among the major currencies traded globally, and it is one of the best outperforming currencies.

There are signs that the US and China trade talks are progressing, in which case the panel highlighted the risk that President Trump could select Europe as the next candidate for introducing trade tariffs.

Europe is effectively a proxy China play in that a large part of its economic performance relies on exporting to China. If China’s economy remains strong, it would offset some of the effects of US export tariffs, were this to happen. But as the panel concluded, longer term, Europe will continue to be an underperformer – either in a good world where there is a US/China trade deal or in a bad world where there is no deal.
Asia Pacific – a sea of liquidity…?

To a lot of investors looking for growth and yield opportunities, the prevailing perception with Asia Pacific markets is that they represent a high risk, compared to more developed western markets. This perception was challenged during a panel discussion entitled *Asia’s game changers and strategic opportunities* chaired by Gary John-Baptiste, Chief Commercial Officer, Asia Pacific, ABN AMRO Clearing.

When asked “What percentage of your investments will be focused on Asia in 2019?”, two thirds of the audience voted it would be less than 20 per cent.

“There is an image problem I think,” said Tobias Hekster, co-CIO, True Partner Capital, a relative value volatility manager based out of Chicago and Hong Kong. “In 2018, the US markets showed more movement and presented more of a risk. I would therefore argue that going forward there could be more risks and frothiness in parts of the US markets than in Asia.”

Asia presents a massive opportunity. It is home to the 2nd (China) and 5th (India) largest economies in the world, and as the panel highlighted, one of the exciting trends that will likely play out over the next 10 to 15 years is frontier markets developing their export economies as India and China move further towards consumer-driven economies.

“Bangladesh has been following the Asia model of exporting products, which started with textiles and has moved on to pharmaceuticals. We see a stunning rate of change in Vietnam, which has a well-educated population ready to move up the income ladder. This is not just a China story,” commented Laura Geritz, CEO, Rondure, a Utah-based investment adviser with a focus on value investing.

Anant Jatia, Founder, Greenland Investment Management explained that the Stock Connect and Bond Connect programmes had been successful in opening up China’s market, and that commodity trading on the mainland was set to be the next major development, referring to China’s commodity markets as a “sea of liquidity”. This is because they are largely untouched by institutional investors and dominated by retail flow.

“For us as an arbitrage player, that presents a huge set of opportunities to take advantage of that sea of liquidity as we start to see the internationalisation of Chinese onshore commodity contracts,” said Jatia. Crude oil and iron ore futures can now be traded by overseas investors.

India is also planning to allow foreign participation in its commodity markets in 2019. For active managers, having access to two major onshore commodity markets could provide new ways to seek out alpha over the coming years.
One aspect of change that has started influence the way alternative fund managers think about their strategies is the increased focus on sustainable investing among institutional allocators. ESG considerations are becoming part of the manager selection process, as a way to determine what ESP principals are being applied, how this affects the investment process, and what tools, if any, can be used to benchmark performance.

Piet Klop is Senior Advisor Responsible Investment, PGGM, a leading Dutch pension fund service provider with approximately EUR211 billion in AUM. He believes there are several sides to the ESG debate.

“I like to separate the risk side from the opportunity side,” said Klop.

“On the risk side, I think the emphasis will be on forward-looking ESG data. A lot of that will include data from unconventional sources including machine learning data, satellite data, etc, and building out ‘what if’ scenarios; in other words, to move away from only looking backwards in the rear view mirror and thinking about risk in more forward-looking terms, using ESG data to project scenarios, such as climate change, which right now we believe are still underutilised in ESG investing.

“On the opportunity side, I think there’s going to be an increasing emphasis not only on doing things right but also on doing the right thing. There is demand on institutional investors, especially in northwestern Europe, to demonstrate proof of impact of their ESG investments. I believe that will be a big trend.”

One important point made during AIF 2019 was a moral conundrum. As ESG creeps into alternatives, how does a fund manager argue the case for shorting what is believed to be a solid ESG-focused company, yet whose stock price they feel is overpriced? Can one
Overall, there was a clear sense of optimism in the auditorium at this year’s AIF event. The feeling was that even if volatility spikes higher this year, there will still be new investment opportunities to explore, be they growth stocks in Asian frontier markets, trading different parts of the oil complex, or using alternative data sets to generate insights in global markets that managers may previously have overlocked.

In her concluding remarks, Amzallag said:

“arbitrage in an ESG market? It’s an ongoing discussion that investors need to have. The audience was asked: Regarding your firm’s investments/investment process, in 2019 ESG considerations are:

- **Increasingly important to your firm – 64 per cent**;
- Equally or less important than last year – 36 per cent.

Also, 62 per cent of the audience said they believed asset owners could best influence adherence to ESG.

To exercise that influence, however, fund managers need to see more ESG investment tools in the marketplace. Little has happened in the managed futures space, for example, with Eurex only recently launching three ESG-compliant futures contracts. So while interest in ESG is undoubtedly growing, more work is needed to develop ESG-compliant futures contracts, green bonds, and so on.

Otherwise, the extent to which ESG principals influence investment strategies will remain stymied.

“There is growing interest but it remains to be seen if people are actually pulling the trigger,” said Nick Samuels, Head of Manager Research, Redington, a London-based investment consultancy. “Defined benefit pension schemes are starting to focus on ESG but so far it’s only been in the equity long-only space, although there are now some green bonds and some UK real estate opportunities.”

Throughout the course of the ESG debate, there was broad agreement among panellists and delegates that a common definition and a common reporting framework are needed to help standardise and benchmark ESG investing.

**Conclusion**

"It’s been wonderful to welcome some of the most prominent and influential hedge funds, investors and service providers in our industry and to hear about their incredible enthusiasm for the role they play in our industry. Reflecting on all conversations over the last two days, I am reminded of the strength of our industry and the openness of all to address the challenges and opportunities ahead and 2019 as long as we pay attention to the changes and use agility in our processes."

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