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Amsterdam Investor Forum

SPECIAL REPORT 2020

Growth in alternative commodities

Setting return expectations in 2020

Building early dialogue with LPs

In partnership with **ABN AMRO Clearing**

Wilrik Sinia (2nd from right) participating in the *Hedge fund performance – the elephant in the room* panel

Sustainable investing voted key structural investment theme at AIF 2020

By James Williams

Sustainable investing proved to be the biggest structural investment theme for 2020 and beyond at the ninth annual Amsterdam Investor Forum, hosted on 5th February at the headquarters of ABN AMRO Clearing.

Nearly half (45 per cent) of attendees chose this theme, with one in five opting for US politics, ahead of the November presidential election. This points to a trend that will arguably shape the investment industry for the next decade as countries and global corporations seek to react to the growing climate change crisis.

Marc Brütsch, Chief Economist at Swiss Life Asset Managers, speaking on the opening panel session entitled *Navigating the unconventional and unprecedented macro-economic landscape*, said that rarely does the firm meet institutional clients without ESG coming into conversation.

"It's a key topic across Europe," he remarked. "I was quite surprised by the amount of people who selected US politics, which for us is more or less a non-event for markets this year."

Alternative fund managers are well aware of how investors' perceptions are evolving, as they seek to make ESG criteria a key part of their investment programmes; increasingly, LPs want to see evidence of how hedge funds can be a force for good, as well as generate attractive returns.

In that sense, the pressure to perform has risen a notch higher, requiring managers to continue to innovate.

"How does the manager frame ESG questions such as climate change into their investment process when building positions in the portfolio? If they don't have an answer to this I think they'll be in a difficult spot with investors," said Caroline Lovelace, Founder & Managing Partner, Rose Hill Park, which invests in hedge funds.

Speaking on the panel *Equities – a revived strategy for the future*, Selvan Masil, Founder and CIO of Westray Capital Management, a London-based European equity long/short hedge fund, argued that ESG is becoming a crowded trade, thematically, due to pressure from allocators. What makes this challenging for managers, however, is there is still no standardised approach to rank companies' ESG credentials.

"If your ESG characteristics are improving, that's a good reference for me, based on interactions with management teams and assessing company fundamentals as opposed to trying to evaluate them at an absolute level," suggested Nikki Martin, Portfolio Manager at Trium Capital where she runs a quantamental equity strategy.

That there is a lack of standardisation in how managers approach ESG/sustainable investing could present a competitive advantage to those who take a more granular, data-driven approach.

Those who are able to best optimise the way they interrogate sparse data sets on ESG could be in a beneficial position over the coming years; especially if they are able to show that applying ESG factors to their investment models has been accretive to performance.

Today, ESG touches all asset classes, including commodities. As was remarked during the conference, it is not inconceivable that one of the unintended consequences of government policy could be higher commodity prices. Oil production in the US last year reached its highest level in 14 years, according to National Geographic, and is expected to keep rising.

However, as highlighted by BankTrack, as of September 2019, 22 banks have stopped direct financing to new thermal coal mines projects worldwide, while 26 banks have stopped direct financing to new coal plants projects worldwide.

"We are providing a hedge to inflation, or to limited/excessive supply until government policy stabilises the market."

Matthew Collis, Arion Investment Management

If Wall Street is told it can't lend to fracking companies, this might limit oil supply and lead to a more controlled market with higher prices; good news for long-term investors.

Do commodities and ESG mix?

The issues around ESG for commodity trading firms are complex. CTAs and discretionary traders predominantly trade global futures as opposed to the underlying companies so applying an effective ESG policy has its limitations. "We are providing a hedge to inflation, or to limited/excessive supply until government policy stabilises the market," explained Matthew Collis, Portfolio Manager, Arion Investment Management.

During the panel discussion entitled *Commodities – a paradigm shift yielding fresh opportunities?* which featured Irene Perdomo, Managing Director, Gresham Investment Management and Rob Sorrentino, President of Eckhart Trading alongside Arion's Matthew Collis, it was highlighted that by actively trading and providing liquidity to commodity producers, this in itself can lead to a positive impact; principally by benefiting local communities.

After all, many of the world's commodities are produced in developing countries whose communities indirectly rely on the revenues generated. The panel agreed that while it was undoubtedly correct that Western countries should seek to cut their carbon emissions, it is not as straightforward applying such principles to developing nations. To fund the next wave of infrastructure to create smart cities and electric vehicle highways – thereby reducing carbon emissions – it will require capital-intensive programmes to extract commodities like cobalt, lithium, etc.

"It is good for developed nations to cut their carbon emissions. I like carbon trading and think it's a good idea; people should pay for their own pollution," stated Collis.

Sorrentino added that while there is arguably more focus on ESG in Europe than the US, it is nevertheless a global problem.

"We're looking at a forestry firm which has a particular type of tree that eats up carbon. But it's hard in the global futures market to have a dedicated ESG policy," he said.

Eckhardt Trading has been trading commodities for decades and while it focuses predominantly on the most liquid markets, Sorrentino added, "We've started to move into areas like carbon trading. This has been a really good market for us in recent times."

> *"We think the next decade will see a blending of fiscal and monetary policy and the loss of central bank independence will become more transparent. In 2020 we think we will see an overhaul of the ECB mandate."*
>
> Marc Brütsch, Swiss Life Asset Managers

AIF Factor goes green

Carbon trading was the investment focus of this year's AIF winner, Carbon Cap Management LLP. The firm's fund, World Carbon Fund, will deploy two core strategies to trading carbon: a "core long" strategy (with hedge protection) and an alpha strategy.

"Mark Carney, the former governor of the Bank of England, indicated that climate change may be one of the causal factors in the next financial crisis," said Michael Azlen, Founder and CEO, during his three-minute pitch presentation to the audience. "And recently, Larry Fink at BlackRock announced the firm had joined Climate Action 100+.

"After having reviewed more than 200 academic papers, the risk posed by climate change to our society and to investments, is significant."

China is currently implementing the largest carbon market this year, covering 3.3 billion tonnes of CO2 and as Azlen pointed out, "carbon is now a liquid and tradeable asset class. It is an asset class that trades USD1 billion/day, and it is an asset class where supply is systematically removed from the market while demand is correlated to economic growth."

Indeed, part of the Fund's strategy is that as it grows it will hold more carbon, taking this supply out of the market and assisting in providing a strong carbon price "signal" to the market.

"Twenty per cent of the Fund's performance fees will be used to purchase and permanently cancel carbon to have a direct impact on climate change," said Azlen.

More black swan events ahead for 2020?

2020 started off with escalating tensions between the US and Iran following the lethal drone strike on General Qassem Suleimani, which immediately impacted oil prices; although now in an upward trend, the oil price fell some 25 per cent between early January and early February.

This was swiftly followed by a second 'Black Swan' event: the outbreak of the COVID-19 coronavirus in China. Equity markets reacted as one would expect with a short, sharp correction but since the start of February there has been a rebound, despite the total number of deaths now exceeding 2,000 and over 75,000 confirmed infection cases.

Navigating these macro events is never easy for equity-focused hedge fund strategies, or their investors. Which is perhaps why, when asked at AIF 2020, *"What is your preferred market/strategy for equity market protection?"* 35 per cent of delegates voted for tail protection strategies such as CTAs, closely followed by long volatility strategies.

The feeling among some managers at AIF 2020 was that volatility will come back in 2020 – the essential fuel needed for CTAs to perform by exploiting trends. "As long as there's an increase in volatility, we think we will do well somewhere in the market, given the different volatility-based systems that we trade; whether it's a sell-off in equities where we might catch a short selling move or a long move somewhere else that might be reacting to it," said Eckhart Trading's President, Rob Sorrentino.

During the macro panel session, which kicked off AIF 2020, there was a wide ranging discussion over how the US elections, the coronavirus outbreak, and the role of central banks, would influence market sentiment throughout the year.

The panel highlighted that the coronavirus outbreak would have devastating impact on China's economic figures for Q1 2020 given the measures China has taken to limit the movement of people. Oil consumption, consumer spending, manufacturing output, are all likely to have been negatively impacted.

Extending back into Q3 last year and there were fears of a global recession, the yield curve was inverted and yet in Q4, through early Q1, there was a feeling of global recovery. "However, with this virus outbreak the Q1 figures are going to be very weak," said Mark Richards, Multi-Asset

Strategist, Jupiter Asset Management. "Will the markets look through this and interpret it as a shock to the system, rather than a fundamental weakness in the underlying global economy? Or will there be a knock-on effect in to Q2 and Q3? It's difficult to know."

One issue that divided opinion on the macro panel was that of central bank independence. Rather than point to US presidential developments, Marc Brütsch at Swiss Life Asset Managers said: "I would put the loss of central bank independence at the top of the agenda. We think the next decade will see a blending of fiscal and monetary policy and the loss of central bank independence will become more transparent. In 2020 we think we will see an overhaul of the ECB mandate."

Jupiter's Mark Richards disagreed on this. "Central banks have failed to meet their inflation targets but whether that means they lose their independence or not…I don't think it is the case. You can have monetary and fiscal policy working in harmony. Clearly we are in a low inflation world and have been for some time, and there are going to need to be more fiscal levers to pull; but I don't think we should equate that to a loss of independence," he argued.

Europe continues to hold negative interest rates, yet at the same time economic growth in Italy, France and Germany is stalling; Germany's economy has stalled to a six-year low. The ECB's new president, Christine Lagarde needs to figure out how to stimulate economic growth and whether NIRP is actually holding back that growth by taxing banks to hold cash deposits.

Erik Norland, Senior Economist at CME, suggested that over the next decade central banks will do more experimentation to overcome the limits of monetary policy. "The use of 'helicopter money' is interesting. How do you get out of it when you start such an initiative?" asked Norland. Will central banks consider MMT (Modern

Roy Niederhoffer delivering the keynote on volatility

Volatility

Volatility was a theme that featured in much of the discussion at AIF 2020: will it come back this year? Will it be ephemeral or more sustained?

Roy Niederhoffer, Founder and President of Niederhoffer Capital Management, gave a fascinating keynote presentation on the topic entitled *Financial Stress and volatility – why I love it and how you can too*.

He pointed out that since the turn of the century, since the dot.com bubble burst, central banks have sought to bleed out financial market stress through a consistent injection of liquidity. This intervention strategy has been applied earlier and earlier over the years, as central banks have reacted to volatility.

Citing an array of research and analysis, Niederhoffer demonstrated that, put simply, all financial instruments – including hedge funds and CTAs – have come to rely on this central bank liquidity.

"Every time stress starts rising, the Fed and other global central banks have stepped in and acted quickly to reduce it. The peaks of these stress levels is declining and what this is telling us is that the CBs are going to be there, and they are going to act sooner and sooner with more liquidity," said Niederhoffer.

During benign periods, when there is low financial market stress, stocks have exhibited a 3.5 Sharpe ratio, while hedge funds have exhibited a 3.4 Sharpe ratio and CTAs 1.1.

Conversely, when financial market stress rises, everything falls: not only does the Sharpe ratio for stocks turn negative, but according to Niederhoffer, everything turns negative. The implication is that there is no diversification benefit being offered by hedge funds and CTAs.

In his view, this is where volatility strategies come into play. "In a global bond portfolio, with just a 10 per cent allocation to a truly protective strategy, it can reduce drawdowns and significantly increase risk-adjusted returns," said Niederhoffer.

Eventually, he argued, central banks might be unable to keep market stress subdued. If the system breaks, what are investors going to do?

The R.G. Niederhoffer flagship Diversified Program is designed to do its best during periods of stress, volatility and emotional arousal such as equity market declines, rising interest rate periods, and moments of illiquidity. These are the conditions in which market participants (both discretionary and systematic) are most susceptible to behavioural biases, markets become more predictable, and where the R.G. Niederhoffer Diversified Program has succeeded.

Monetary Theory) and will that be more helicopter money for infrastructure investment?

"It may be easier for central banks to do this if there is only one national economy to deal with. In Europe, might Germany allow the ECB to fund infrastructure spending in Italy? Could the ECB finance projects with green bonds – and could these new instruments be the way to finance Europe's green energy transition?"

Tactics for seeking out alpha

Speaking recently to *Hedgeweek*, Emmanuel Hauptmann, Founding Partner, RAM Active Investments, remarked that the largest risk for alpha from stock selection in 2020 would be central bank interventions, adding that "artificially low interest rates are leading to an un-selective inflation of financial asset prices across asset classes".

"This environment is strongly reminiscent of the market environment of the start of the year 2000, two decades ago, which proved to be the start of a multi-year recovery for stock selection alpha, and for active managers capturing the attractive valuation opportunities lying around mostly within small and mid-cap segments," said Hauptmann.

At AIF 2020, Hauptmann's colleague, Hasan Aslan, Senior Investment Product Specialist at RAM AI, contributed to a lively debate on the panel, *Equities – a revived strategy for the future*, referenced earlier.

Discussing where the alpha might be in 2020, he said that RAM AI sees long equity opportunities in the UK and Italy and is underweight Germany and Swiss. He was encouraged by the growing dispersion between industries and sectors in European equities.

"If you look at the way they are behaving, there is a high correlation (close to 1) between bond yields and stock prices. We see a lot of opportunities as a result of dispersion to explore over the next few quarters," said Aslan. He added that inversion of the yield curve acts as a signal for future volatility. While he did not go as far as to suggest there would be a recession, he cautioned that "risk concentration across portfolios has built up and investors will need to be mindful of this".

Dr Christophe Boucher (right) moderating the *Equities* panel

UK equities could be a good driver of equity returns in 2020 now that Brexit has been finalised; a period of uncertainty that put the handbrake on UK growth over the last two years. With a period of certainty now lying ahead, equity-focused hedge fund mangers feel this is an opportune time to find alpha.

Westray Capital's Selvan Masil said that over the last few quarters they had increased the fund's exposure to UK equities. "Brexit has held the UK back – UK valuations are 30 per cent below MSCI World and 20 per cent below Europe. We at least now know that a deal with Europe will be done; good or bad. And over the course of 2020, this will play to the advantage of UK stocks; not necessarily the FTSE 100 but more mid-cap stocks in the FTSE 250," said Masil. This sentiment was echoed by Trium Capital's Nikki Martin.

When asked, *Which market segment will offer the best trading opportunities?* 52 per cent of AIF 2020's delegates selected "Alternative markets and less crowded markets".

Alternative commodity markets are a potential source of alpha for investors this year. At Eckhart Trading, Rob Sorrentino suggested that Iron Ore could be an interesting investment, citing the potential for trading opportunities in China. "I think it will become mainstream in the next five years and I think there's going to be a lot of opportunities in China," he said.

Capacity can preserve returns

One of the challenges for active managers is knowing how to uncover returns in less crowded areas of the market. Technology and growth stocks were voted the most crowded/expensive trade by the AIF 2020 audience, which show a high degree of correlation. When constructing the portfolio, Martin explained that she looks for a combination of value, quality and growth.

"It is very difficult at the current time because the negative correlation between value and quality and growth is so huge. We have to spend a lot more time on fundamentals to decide how to position the portfolio within the current environment," she said.

One aspect to preserving alpha in hedge fund portfolios is for managers to exercise a high degree of discipline in respect to setting capacity. It's tempting for managers to aggressively grow their AUM but the risk is they end up trading against themselves in the market, eroding returns, which in turn can then lead to investor redemptions.

The best fund managers in the world can't make money when they constantly have investor capital redeeming out of their strategy.

Mads Ingwar, Co-Founder & Chief Executive Officer, Kvasir Technologies, a hedge fund which uses AI and machine-learning techniques, explained that most systematic strategies are limited by alpha decay. As a result, Kvasir Technologies spends a lot of time understanding the cost of trades.

"This is what some of the most successful quant shops focus on. If you understand what you are trading, and that you're not trading against yourself, and you can estimate the cost of a given trade down to the cent, that can create the ability for a fund's capacity to grow well into the billions," suggested Ingwar.

Performance – the elephant in the room…

When asked to vote on how they felt about the performance of hedge funds in 2019, two thirds of the delegates said they were either "satisfied" or "slightly disappointed".

This sentiment underscores a prevailing issue that hedge funds have had to deal with over the last decade. When equity markets like the S&P 500 rally 30 per cent in a year, as it did in 2019, it is impossible for the average hedge fund to compete. The value of active risk management and low drawdowns diminishes in an extended equity bull market.

Wilrik Sinia is the Founding Partner & Director, Mint Tower Capital Management, which runs a volatility-based arbitrage strategy. To counter this perceived lack of performance, Sinia, speaking on the panel session *Hedge fund performance – the elephant in the room*, said it was important for investors to understand that what Mint Tower offers is a "specific statistical solution". "Our strategy is designed to offer low or negative correlation to a normal or balanced portfolio. If they are looking for uncorrelated assets, investors need to understand what these will add to their portfolio performance over the long term," commented Sinia.

How investors interpret performance is open to conjecture. It will

The future of quant investing

Scott Kerson, Senior Managing Director & Head of Systematic Strategies, Gresham Investment Management, gave a fascinating James Bond-inspired presentation on the evolution, and current plight, of trend following strategies.

Entitled: *No time to die: Breaking the Cycle of Futility in Trend Following*, Kerson chronicled the birth of quantitative trading, starting back in the 1960s when Ed Thorp famously observed that a pack of cards has memory, leading him to develop a set of rules that he ultimately applied to statistical arbitrage trading.

Over the next decade, as computer processing power and processing speed increased, and storage costs declined, the modern quantitative industry was born; Bridgewater Associates developed systematic macro, while in the CTA space, Paul Tudor Jones, William Eckhart and others gave birth to the modern concept of the trend-following strategy.

Fast-forward to the 1980s and 90s and the modern CTA business was born, led by the likes of AHL in London, and D.E. Shaw in New York, followed a few years later when David Harding and Martin Lueck span out of AHL to form Winton Capital and Aspect Capital respectively, kicking off a CTA arms race.

This was, said Kerson, "a golden period for CTAs", as trend-following strategies outperformed the stock market and technology tailwinds made it easier to launch funds. By the end of the twentieth century, the appeal for active fund managers was at its apogee.

This continued up until the financial crash in 2008, which brought Kerson to the hub of his presentation. What went wrong with trend-following post-crisis?

He pointed out that whereas before the financial crash it took the average CTA 12 months to recover from a drawdown period, post-crisis investors have had to sit back and wait year after year. It's as if trend following has been stuck in an extended drawdown, unable to recover a positive Sharpe ratio.

"What broke?" posited Kerson. "Was it that the signal disappeared? Actually, the trend following signal has behaved identically post-crisis as it did pre-crisis. And yet, as an industry, we've gone from a Sharpe ratio of approximately 0.7 to 0.2. Why? Because big moves in the markets are less common."

His argument for breaking that cycle of futility was for CTAs either to use alternative data sets, look for new signals in alternative markets, or to apply the same signals and trend-following strategies used in traditional markets, to those alternative markets.

"AUM in alternative markets has grown from approximately USD2 billion to USD12 billion," said Kerson.

He added that alternative commodities were of particular interest to him, offering lower correlations to established indices.

As trend-following strategies evolve to trade these new markets, it could potentially lead to them generating the same attractive Sharpe ratios of yesteryear. And give investors renewed optimism.

always depend on the size and composition of the institution. A large public pension plan will likely accept modest returns with low volatility compared to a family office, whose risk/return profile might be notably higher.

With respect to risk, it will also depend on whether the investor is looking at systematic or idiosyncratic risk factors. "Are you looking for a higher return or a higher Sharpe ratio?" posited Nicolas Mirjolet, Chief Executive Officer, Quantica Capital AG, a systematic CTA based in Zurich.

Usually, the more the manager focuses on systematic sources of risk the more one would expect them to generate higher returns but if they are focusing more on idiosyncratic risks, one should expect higher Sharpe ratios.

"The only issue is that usually such managers generate lower returns and you need higher leverage to keep up returns; and there is only so much leverage you can take. Investors have to take into account the limitations that come with the current environment – it is all about properly setting one's return expectations," argued Mirjolet.

> *"The exchanges will hopefully be able to trade bitcoin into whatever the national cryptocurrency is. We have to remind ourselves constantly that the price of bitcoin and its prosperity rests on the shoulders of the regulators. Whenever any new regulation comes out, it affects the price of Bitcoin."*
>
> Eric Naritomi, AP Capital Management

Another factor that has impacted how hedge funds generate performance is the change in market structure. Central bank intervention, lower volatility, a shrinking public equities market (the size of the US stock market is half what it was two decades ago), and the proliferation of passive investment strategies, have all contributed to a far more challenging landscape for active managers.

As long as the market sticks to a Japanese-style long-term low rate environment, it will continue to present a far different risk perception to investors than it would have done a decade ago. But this is not to suggest hedge funds won't still find ways to make outsized returns.

"If investors look at performance from the perspective of the S&P 500 we will continue to have a difficult time. But if markets become less smooth, without going into recession, it would be a welcome development for hedge funds," remarked Mirjolet.

Digital finance

One way for hedge funds to keep one step ahead for 2020 is to continue to embrace technology innovation. During AIF 2020, the audience was asked: *"What can AI do for your business?"*

The top result, selected by 38 per cent of the audience, was "Optimising the investment process". This is likely to become increasingly important as hedge funds seek out alpha in new areas of the market, using both structured and unstructured data sets to help them uncover new trading signals or insights with AI and machine-learning tools. "In our process, we see a lot of value in assessing risk and constructing the portfolio, which we do using machine learning techniques. A balanced approach between data mining, risk management and portfolio construction is optimal; there is a lot of potential alpha generation in all of these steps," explained Kvasir Technologies' co-Founder, Mads Ingwar.

From a trading perspective, the extent to which digital currencies become embedded into the global economy could be a particularly rich source of returns for fund managers. The growth of cryptocurrency exchanges over the last five years has been impressive, led by institutional-quality exchanges such as Bitstamp, Gemini, Kraken and Coinbase.

Could these digital exchanges begin to challenge traditional exchanges? And if so what would the implications be? Part of the reason why a lot of crypto exchanges have invested heavily in infrastructure, licensing and developing banking relationships has been bridge the gap between the old world and the new.

"These platforms are becoming increasingly high-performance using native FIX matching engines. Traditional stock exchanges have taken 150 years to develop, we hope we can get there a bit faster than that.

"It's not so much about disruption but enabling a new asset class to reach a broader audience and help broaden investors' portfolios; both retail and institutional," commented Miha Grcar, Head of Business Development, Bitstamp. Grcar was speaking on the panel, *Digital currencies – a compelling new way to participate in the financial system*.

There is a lot of debate as to whether cryptocurrencies such as bitcoin and ethereum ought to be licensed by global regulators but it boils down to perception. After all, traditional FX markets remain largely unregulated and are one of the most actively traded asset classes. To further grow, and for liquidity to deepen might require cryptocurrencies to likewise remain free of regulatory oversight.

How managers trade crypto and digital assets, compared to traditional assets, is quickly evolving thanks to the underlying blockchain technology.

"We have clients tokenising commodities like gold, as well as equities and bonds, and putting them into a blockchain environment. These exchanges aren't talking about blockchain, at risk of potentially confusing people; what they are doing is saying their exchange does what the

Oliver Gaunt (right) moderating *The investors' continuing case for hedge funds* panel

other exchanges do, but cheaper, faster and in a more automated way," said James Burnie, Head of Blockchain & Cryptoassets UK, Eversheds Sutherland.

The audience was asked "What will be the dominant crypto currency in 2025?" Bitcoin came out on top with 47 per cent of votes but somewhat surprisingly, ether only garnered 3 per cent of the vote. A national central bank issued cryptocurrency was selected by 39 per cent of attendees.

Eric Naritomi Partner at AP Capital Management, a Hong Kong-based brokerage and asset management firm which also has a digital currency investment management division, thinks that China will be the first national government to issue a central bank cryptocurrency.

"That will increase the use of bitcoin and the exchanges will hopefully be able to trade bitcoin into whatever the national cryptocurrency is. We have to remind ourselves constantly that the price of bitcoin and its prosperity rests on the shoulders of the regulators. Whenever any new regulation comes out, it affects the price of Bitcoin," said Naritomi.

While there are disagreements, volatility is likely to remain spiky in this fast growing digital asset class.

Investors want early, open dialogue with managers

Investors remain upbeat on hedge funds, despite feeling underwhelmed by performance. Some 60 per cent of delegates at AIF 2020 said they would increase their hedge fund allocations in 2020. Managers can solace from this but remain under no illusion that remaining vital, and successful, in today's financial markets, is a challenge.

Some hedge fund investors, such as Titan Advisors, feel that there is a case to be made for hedge funds in a more volatile environment – the question is, how volatile can we expect markets to be?

"In our funds, returns have improved as dispersion and volatility has picked up, so I would still argue that downside protection and correlation benefits are reasons to continue investing in hedge funds," opined Chris Svoboda, Head of Equity & Macro Strategies (Europe / Asia), Titan Advisors.

Speaking on the final panel, *The investors' continuing case for hedge funds*, Svoboda was keen to highlight the importance of backing emerging managers. Titan Advisors has had an emerging manager programme since 2005, providing capital to new managers in order to negotiate terms early, track performance, and secure capacity for future use. "Our outside investors see more value to aligning closely with managers early on, when they are smaller and more nimble," he said.

This was a sentiment shared by the panel's other two speakers: Ed Lewis, Partner, Albourne Partners, a well known investment consultant, and Caroline Lovelace, Founder & Managing Partner, Rose Hill Park, which focuses on managers with niche and other specialised strategies.

"Hedge funds help plug the gaps in risk and performance that you don't get from other asset classes. Part of our focus – not exclusively – is on managers with diverse backgrounds as investors look to extend their emerging manager programmes," explained Lovelace.

Albourne looks at over 500 hedge funds on an ongoing basis and has evolved in response to shifts in investor allocations by moving into private markets, including private credit and

Delphine Amzallag Global Head of Prime Services at ABN AMRO Clearing

real estate. Since 2016 it has had a dedicated emerging manager coverage team in order to spot exciting talent ahead of investor interest. As Lewis outlined: "The sooner we engage with emerging managers the better prepared we can be. This acts as a useful lens to monitor who is coming down the pipeline so that when they reach a critical AUM size or track record, investors can pull the allocation trigger."

Building dialogue early was an important point that the panel stressed, when highlighting their respective approaches to investing in hedge funds. Moreover, there was consensus that managers need not necessarily have institutional-quality operations in place.

"Our head of ODD has veto power," said Svoboda. "It's important to have that independence in place. With newer managers, we try to work with the manager where we can, as opposed to taking a black and white approach to ODD. For example, we may be more inclined to have side letters in place requiring them to do things like appoint an independent board member within six months of us investing."

Rose Hill Park has relationships with service providers who look specifically at emerging managers and understand the kind of infrastructure they need. The firms uses this as to help guide and advise managers but Lovelace was adamant in saying: "If they're not open to having a partner who is more knowledgeable, who can advise on what they need, then we won't invest."

Nearly half of managers in the audience said that a lack of AUM or track record was the biggest hurdle to raising assets.

Attendees acknowledged that they have to be able to communicate what they do well to investors and demonstrate a clear solution. Over past five to seven years, volatility has fallen, returns have fallen and fees have fallen, creating a more challenging environment for managers.

"We are working on higher volatility profiles in our strategies to show stronger rates of return similar to what we saw in the early stage of the commodity cycle," said Eckhart Trading's Rob Sorrentino.

Conclusion

It was apparent at AIF 2020 that ESG is a top line item for institutional investors as they look to factor in sustainability to their investment portfolios. It is becoming a key focus of ODD, and ongoing reporting. This is putting pressure on managers as they compete for institutional dollars, particularly as there is a lack of standardisation in terms of ranking companies and assessing their green credentials.

The good news, however, is that out of adversity comes opportunity, as Benjamin Franklin famously remarked. Hedge funds are already seeking out ways to creatively trade carbon, and other alternative commodity markets, to drive returns. And with digital currencies becoming part of the wider fabric of the global economy, there should be myriad ways to find uncorrelated returns to traditional assets; this extends to niche protection strategies too, including volatility funds.

How the global macro picture plays out remains to be seen. Stock dispersion should auger well for equity-focused managers, with UK and Japanese equities two favoured markets among this year's panellists.

Reflecting on the success of this year's event, Delphine Amzallag, Global Head of Prime Services at ABN AMRO Clearing, concluded: "2019 was a challenging and unpredictable year for our industry. There was plenty to keep investors and managers on their toes and I am pleased that we were able to cover these relevant topics during the day. As the year came to a close, many claim it was as captivating as it was unpredictable, however the case for hedge funds still remains strong.

"The hedge fund industry remains as dynamic and exciting as ever but also competitive as hedge funds continue to seek their advantage. It was wonderful to welcome so many prominent and influential hedge funds, investors and service providers that continue to shape and influence the industry." ■