

# Lack of additional exposure from the institutionals' side

*Diego Liechti, investment consultant at the Zurich-based PPCmetrics, bets on the EU Directive to restore confidence*

by Valerio Magni

## The company

*PPCmetrics AG is a leading investment consulting company for institutional investors since 1991 with offices in Zürich and Nyon. The shares of the company are mainly owned by partners that also work for the company. With a headcount of about 60 experienced and well educated investment consultants and controllers, the company provides independent services and advice for pension funds, insurance companies, banks, firms and high net worth individuals. This includes all kind of services regarding investment controlling, investment organization, investment strategy, portfolio structure, selection of asset managers and custodian banks, legal advice, quantitative analysis, and training and education. To guarantee independence, the company does not undertake portfolio management.*

Pension funds and institutions are now the main investors in Swiss registered funds of hedge funds, as we underlined in the survey published in the last issue of this magazine (see MondoHedge Swiss Nr. 34). But now, "there are not much pension funds or other institutional investors that are looking for new or additional exposure in hedge funds". This is what **Diego Liechti**, investment consultant at the Zurich-based PPCmetrics, is experiencing, and he also adds that the most discussed EU Directive on Alternative Investment Fund Managers "might help to restore the confidence of investors". Investors are now looking to the new alternative UCITS III funds, but "some institutional investors even fear that after repackaging hedge funds under a UCITS, they lose their performance potential because of restrictions".

### **How is your clientele composed? How many institutional investors do you give advice to?**

PPCmetrics is a Swiss investment consulting firm for institutional investors. Among our clients are pension funds, public and private insurance companies, banks, firms as well as high net worth individuals and their advisers. Currently, we give advice to more than 100 institutional investors; most of them are Swiss pension funds. However, we do get more and more other institutional clients as well as international clients.

### **Many say that the hedge fund business is going to be more and more institutional. Do you agree with that?**

Institutional investors are always looking for possibilities to reduce risks and

simultaneously increase expected return in their portfolios. The hedge fund industry makes such claims and, therefore, institutional investors are interested in hedge funds. Although hedge funds provided on average a downside protection during the internet bubble, holding hedge funds did not help much during the recent financial crisis. As a consequence, it remains unclear if hedge funds will be institutional or if it is mostly an asset class for wealthy individuals who are looking for additional return potential.

### **The offer of alternative UCITS III products is booming in the last months. What do you think about these products?**

I am not sure if this trend will hold on. Even if there are several advantages for investors such as an increased transparency, the increase is mainly driven by better distribution possibilities and the restrictions of some institutional investors. Some institutional investors even fear that after repackaging those funds under a UCITS, they lose their performance potential because of restrictions. Moreover, setting up UCITS is expensive and there are other operational problems.

### **What are the requests coming from institutional investors about hedge funds and alternative UCITS III funds?**

At the moment, there are not much pension funds or other institutional investors that are looking for new or additional exposure in hedge funds. Because of the relatively poor results during 2008, the redemptions, the liquidity issues such as side pockets, the high management costs, and some operations problems, most institutional investors are more cautious about

alternative assets and hedge funds in particular. Moreover, there might be also more and more political reasons for our clients not to invest in hedge funds.

**Today, what is the average weight of hedge funds and alternative UCITS III funds in your client's portfolios? And what is the aggregate allocations from your customers in hedge and alternative Ucits III funds?**

The weight ranges from 0% up to about 10% of the clients' portfolio value. Hedge funds potentially complement the traditional asset classes through a potentially better diversification. Before we recommend hedge fund investments to a client, we carefully analyze his situation. Specifically, for most of our clients, we derive the strategic asset allocation from an asset-liability analysis with its' return objective and the risk budget. Furthermore, it is crucial that the board of the pension fund is well informed about the fact that hedge fund investments belong to a special asset class with asymmetric non-traditional risks. In the end, the client has to decide if he wants to invest in this asset class.

**What type of hedge funds and alternative Ucits III funds do you advise to your clients?**

We only suggest funds of hedge funds products to our clients. There are two reasons for that. First, these products are diversified and their unsystematic risk is substantially lower. Second, most of our clients neither have the necessary portfolio size nor the monitoring capacity to invest in several single hedge funds. In the range of funds of hedge funds products, we usually recommend three approaches. As an initial investment, we typically recommend widely diversified multi-strategy/multi-manager funds of hedge funds. For investors with the necessary experience and size, a style focused FoHFs might complement an investment in a traditional asset class. For example, a Long/short equity fund of fund could be a good supplement for a passive equity mandate. For investors who are looking for door open-

ers to new assets segments, we typically recommend alternative beta hedge fund investments.

**Investors also look at managed accounts as an instrument to access to hedge funds in a different way. Do you advise them to your clients?**

Managed accounts increase the transparency and the liquidity. Furthermore, they give the investor the possibility to take part in the decision making process, which might be also useful for the institutional investor to gain market intelligence for the other asset classes he is invested in. However, those hedge funds with an extraordinary track record are a bit reluctant to run managed accounts because it increases their costs without increasing their returns. This creates a trade-off for investors, i.e. do they want increased transparency and liquidity or do they want to invest their money in the, at least historically, best funds?

**In 2009, hedge funds posted very good returns, and so did in the first quarter. What are your preferred strategies for the coming months?**

Unfortunately, I do not have a crystal ball to see the future. And with predictions, I am in line with Nobel Laureate in physics Nils Bohr who said that prediction is very difficult, especially about the future. Therefore, we would suggest to diversify and to follow several potentially good performing strategies.

**What do you think about the proposed EU Directive on Alternative Investment Fund Managers?**

Because of the increased popularity of the asset class and as a consequence the potential systematic risk for financial markets, hedge funds are a hot topic for politicians. Although the EU Directive is imposing some rules for alternative fund managers that do make sense, we do not see a good rationale for the restrictions for hedge fund managers outside the EU. Our opinion is that this is only a protectionist move and hopefully the parliament will change that restriction. The other rules might help to restore the confidence of investors. ■