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Global research and insights from Frontier Advisors

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**Alternatives and Derivatives European
Research Trip**

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Frontier regularly conducts international research trips to observe and understand more about international trends and to meet and evaluate, first hand, a range of fund managers and products.

In conjunction with insights we share with our Global Investment Research Alliance partners, these observations feed into our extensive international research library.

This report provides a high-level assessment on the key areas and observations unearthed during this recent Alternatives and Derivatives Strategies research trip. We would be pleased to meet with you in person to provide further detail on these observations.

AUTHOR



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Michael Sommers is a Principal Consultant having joined Frontier in 2013 and is the head of Alternatives and Derivatives. His responsibilities include undertaking manager research of liquid and illiquid alternatives strategies as well as derivative strategies, including providing specialist advice for these areas to clients. Michael also provides risk management and generalist consulting advice. Prior to joining Frontier, Michael worked in London for seven years in a number of trading floor based senior risk management roles at CIBC, Lloyds and HBOS. His roles involved advising on the risk and performance characteristics of diverse portfolios and investment strategies. He was also involved in regulatory and risk governance related work at a senior level. Prior to working in London, Michael worked in credit risk modelling at ANZ in Melbourne. Michael holds a Bachelor of Commerce with majors in Actuarial Studies and Finance (including First Class Honours in Finance), a Bachelor of Science and a Master of Applied Finance degree from Macquarie University.

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Iain McMahon joined Frontier as a Consultant in June 2019 and is a member of the Debt and Currency team. Iain is currently responsible for investment and manager research across both Fixed Income and Currency strategies. Prior to joining Frontier, Iain spent seven years across the J.P. Morgan franchise in a range of risk management functions. Four of these years were based in London providing quantitative and qualitative portfolio analysis for a Multi-Asset trading desk. Prior to working in London, Iain worked in an operational capacity with a Fixed Income Derivatives trading desk. He holds a Bachelor of Commerce (majoring in Finance and Economics) and a Bachelor of Science (majoring in Statistics) from the University of Melbourne and has recently passed the CFA level 2 exam.

Introduction

Investors today continue in many cases to search for further diversification opportunities and are also seeking further downside protection for their portfolios. There are numerous factors driving this: most asset classes are seemingly at high valuations (and risk premia, the expected reward or compensation for taking on various investment risks, are compressed); a general view that we are in the late cycle; ever increasing near-term risks from trade wars, Brexit, Trump-tweets and a widening gulf in political affiliations; the potential “Japanification” (where economies and capital market returns become stuck in a low returning environment) of other developed countries. All of these factors have increased the considerations of alternative strategies which diversify the risks from the core asset classes of equities, fixed interest and credit.

On the other hand, there is also a growing view that upside return opportunities are presenting themselves in growth-oriented markets like equities from a renewal of quantitative easing measures and a more dovish tone from central banks.

This uncertainty has increased the interest in upside-focused strategies such as call options (a call option is a strategy which gives the investor participation to rising markets but without the loss-potential from markets falling. This asymmetric return profile comes at a cost which reduces the overall return potential).

Alternative strategies which add diversification to an investor’s portfolio include alternative risk premia (ARP), trend followers¹, global macro² and more esoteric strategies such as insurance linked securities³.

In addition to the upside-potential asymmetric strategy mentioned above, there are also investment strategies which reduce the loss-potential from falling markets, but do not restrict the upside potential when markets rise. These are referred to as put option strategies.

Take outs from this paper

For time-poor readers, we provide the following abbreviated summary of our findings and intended actions from our recent research trip to Europe:

- European investors have become more defensive and are seeking defensive and diversifying strategies relative to equities;
- we believe there is merit in our clients considering a bespoke portfolio of diversifying and defensive strategies if this approach provides the best fit from a total portfolio perspective;
- differentiated systematic global macro strategies have appeal for clients who can invest in capacity constrained strategies and have higher fee and complexity appetites. This may have more applicability for investors with portfolios below \$10 billion;
- life insurance driven strategies have merit for investors given a very stable return profile but we have work to do to confirm the investment case. This may have more applicability for investor portfolios below \$20 billion;
- we did not note any issues with incumbent managers and indeed will be recommending rating upgrades for some of our managers.

Following this trip, we will be undertaking the following:

- working with investment banks and fund managers to progress our due-diligence on bespoke solutions with a defensive and diversifying return profile;
- progressing due-diligence on differentiated systematic global macro managers;
- progressing due-diligence on life insurance driven strategies.

¹Trend followers are referred to in the market as Commodity Trading Advisors or CTAs, a historical term which has evolved to refer to any manager which operates a strategy which predominantly seeks to follow trends where returns often build or compound as these trends extend over time.

²Global macro strategies are strategies which seek to generate returns from investments in different markets such as equities, bonds or currencies based on relationships of these assets to different macroeconomic variables such as GDP growth or inflation.

³Insurance linked securities (ILS) strategies are portfolios comprised of insurance premiums paid for protection against natural catastrophes. Investors provide capital which may be called upon in the event of an insurance claim arising and in turn receive the premiums as compensation for bearing that risk. These are usually diversified across region and the type of natural catastrophe (e.g. hurricane in Florida or an earthquake in California). These portfolios earn a return of between 10-15% if no natural catastrophes occur in any single year but can result in various degrees of capital loss if both a large number of natural catastrophes occur, and the severity of the catastrophes is high.

European research trip

On a regular basis, Frontier will travel overseas to meet with incumbent and new managers to assess their appropriateness for our clients. Each trip has a set agenda. For this trip, the agenda was:

- what were capital markets views/concerns of European investors/fund managers;
- review of incumbent strategies with a focus on any concerns for underperforming managers (was this underperformance expected given economic and capital market conditions or were there any issues which warranted further analysis?);
- assessment of new strategies and managers;
- noting any interesting themes emerging across our meetings which may have implications for clients or which could provide the genesis for further research.

On this trip, we visited the United Kingdom, Paris and Zurich. This trip involved 31 fund manager meetings over ten working days. These trips are essential for our due-diligence of these highly specialised managers whether they be new managers or incumbent ones. These onsite visits afford us the opportunity to meet with investment and research team members in person whether as a group, to observe the group dynamic (crucial when determining whether a dominant personality may be exist in the team or alternatively whether team members remain engaged in the strategy) or as individuals. We also find that face-to-face meetings allow us to have more influence on certain topics such as fees. Often, there is success in mounting the argument for lower fees directly with the founder of the firm or strategy.

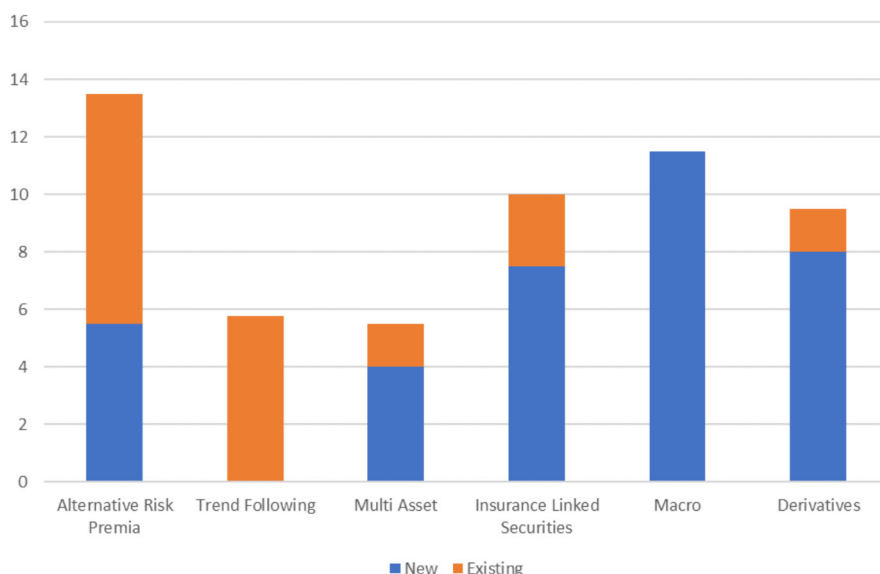
The meetings covered the full spectrum of managers typically researched by our Alternatives and Derivatives team, with strategies playing a diversification role being a key theme. While we have a relatively large bench of managers which offer option overlay capabilities, we still met with a further six managers or investment banks on this trip who offer this type of service. We will cover some key takeaways from the trip and what it means for clients.

A big focus of our trip was on new manager due-diligence with circa 65% of our manager meetings being devoted to this type of due-diligence. Our aim is to continuously seek to bring new ideas to our clients and to continually review both managers which are already rated and whether we can find even better ways to access the themes or ways they invest.

The key new areas of focus were in systematic global macro, insurance linked securities (with a discussion on life insurance strategies as an alternative to natural catastrophe reinsurance) and derivative strategies. It should be noted that the life insurance strategies do not include life settlements. This is important since life settlements have reputational issues primarily associated with investment experience (there have been high profile examples of poor investment outcomes from these types of strategies).

Chart 1 shows the mix of new and existing strategies for the trip indicating our areas of focus.

Chart 1: Number of meeting hours categorised by new vs incumbent managers/strategies



Capital markets views and concerns

One key focus of our trip was to meet with investment banks to understand the focus of their European institutional clientele including examples of strategies which have recently been popular. In doing so, we were able to learn more about the capital markets views and concerns of these investors which includes Sovereign Wealth Funds, pension plans and insurers.

The so-called “Japanification” of Europe is the key area of focus and so some strategies have been created over time to create income when yields, typically used to generate income in traditional markets, have been so low. This term refers to the continuing fall in interest rates across Europe which is reminiscent of Japan’s experience in the 1990s following the housing bust in the early part of the decade. From this point, the Bank of Japan has kept interest rates low to negative and has struggled for many decades since with deflationary risks. The concern is that this experience awaits Europe where the European Central Bank has likewise struggled to spur inflation in the Eurozone.

There is a view across investment bank clients that fiscal salvation is the only way to boost returns as opposed to relying on central banks to boost growth. The higher-level question across the investor-base is whether Japanification is a passing phase or if it is the destination. If it is a passing phase, then this means that interest rates will return to normal...ish levels and so will rise from this point which will lead to a sell-off in bonds. Alternatively, if it is the destination, then equities may have more downside because of the risk of deflation.

How European institutional investors are responding

The consistent message from the banks was that their clients have become more defensive. We note, to date, that this theme has not manifested in general for many Australian institutional clients. Instead of seeking strategies with banks which were more around diversification to equities (which has been a popular set of trade ideas for several years), the focus is more on trade ideas which are expected to rise in value when equities sell off.

Some of the banks’ insurance clients are less concerned about the potential stresses in equities and more about generating income in a very low interest rate environment. The trades

which are popular with these clients involve earning what is termed “carry” within and across different interest rate curves. As background, “carry” is a term which refers to the return which can be earned by receiving the interest rates on one currency’s bonds (e.g. US bonds) and paying out the interest rates on another country’s bonds (e.g. German bonds). Another version of earning “carry” is to invest in interest rates options. Normally, buying options incurs a cost over time. However, there is a current dynamic in interest rate options where buying and holding an interest rate option actually results in earning a return for the first half of the option’s life before starting to incur a cost. This was a consistent popular trade across insurance clients of the banks we met with. We have also noted that this is a popular trade with some fund managers.

However, most of the managers we met with were more systematic in nature and so did not have any discretionary macro views on markets (i.e. not a quant-driven model predicting markets). We did meet with a few multi asset managers (these are managers which have an investment process predicated on a fundamental discretionary macroeconomic view of the world) who held similar views to the banks’ clients. These managers, though, were less focused on defensive trades for their portfolio but instead on diversification.

We also met with a UK pension plan. A similar concern was held by this investor who was concerned around downside risks and so was seeking protection against falling equities.

Frontier’s clients use managers to create put option portfolios to help reduce the downside risks from equities. This UK pension plan had opted instead to use an investment bank to create a strategy with a return profile similar to what our clients use but with a bespoke element included which only an investment bank could provide. The governance issues around using a bank vs a manager (i.e. the lack of fiduciary protection) was an initial hurdle which this investor overcame with their investment committee. **There were lessons learnt from this investor which we believe could be valuable for our investor base in Australia when considering how to use investment banks instead of a manager.** The extent of this customisation and engagement may be more applicable to larger institutional clients given the size of their internal strategy teams although we believe that smaller clients can benefit from this approach if the internal strategy team is comfortable with the resourcing requirements.

Review of incumbent strategies

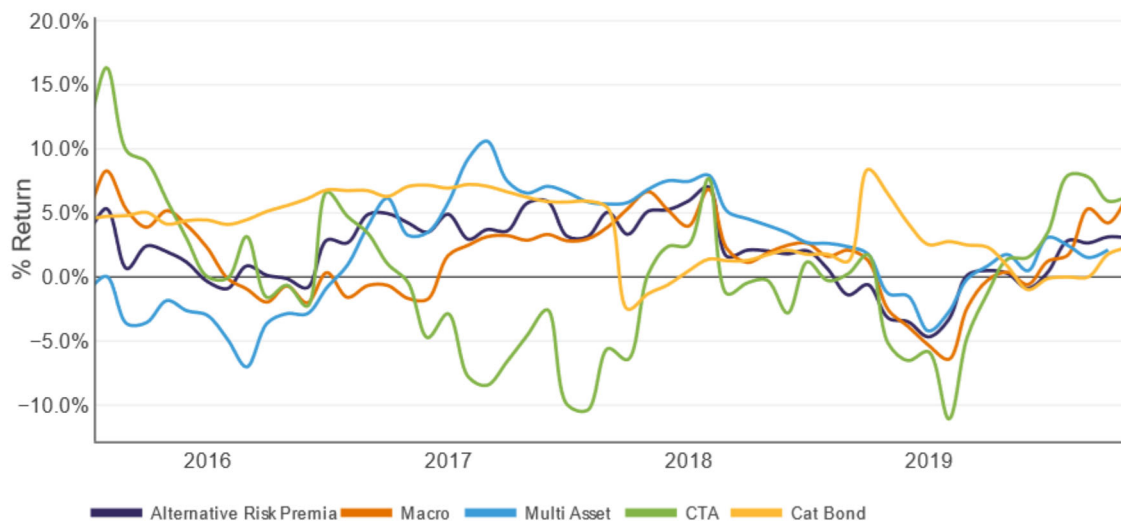
We last travelled to London in March 2019 when the big focus of our meetings with incumbent managers was to perform a post-mortem on the poor performance of several alternatives strategies in 2018 (this onsite review was covered in our trip paper [Frontier International Issue 42](#)). Unlike 2018, 2019 has been a relatively good performing year for most alternatives strategies (see chart 2 which includes rolling 12-month returns for some of the alternatives strategies we met with on this trip).

Given this performance in 2019, the onsite visits on this trip to incumbent managers were less around performance scrutiny and a reassessment of the investment case for strategies and managers, and more around a standard onsite

update to confirm that our conviction in the respective manager remained appropriate, whether any warranted rating or view updates and, more importantly, to check if there were any emerging issues with the team which are not apparent if solely focusing on performance and portfolio metrics. This is the finer art of judgement and experience which is critical for manager research.

Without commenting on observations for each strategy style, we'll only include some key, high-level observations and any lessons for investors who currently invest in these types of strategies.

Chart 2: Rolling 12-month performance for alternatives strategies



Source: eVestment, Frontier Advisors PTY LTD

Alternative Risk Premia (ARP)

In our last trip note, we discussed the divergence in performance, between the best performing and worst performing managers, of up to 40% for ARP managers in 2018 (refer Chart 3).

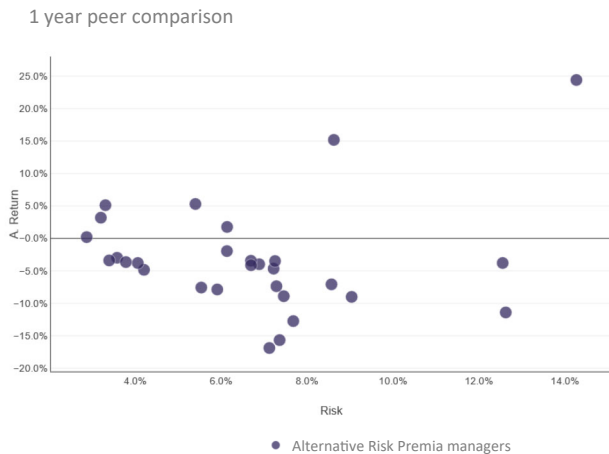
As background, alternative risk premia managers will allocate to well-known return drivers which are based on what are called “risk premia” or factors. These are premia which exist due to the manner in which investors seek to generate returns and in many ways reflect investor behaviour. One factor is trend which reflects how investors seek to chase a trend (i.e. investors buying into a market which is trending upwards and selling out of a market which is trending downwards). Another factor is carry which reflects how investors seek a stable return from the relative interest rates either between two countries’ yield curves or currencies. Another factor is from investments in well-known equity risk premia (also referred to as smart beta investing which is an area of equity investing which has been documented in academia for several decades). The risk premia investing in equities includes factors such as value, growth and quality. The difference to smart beta investing is that alternative risk premia managers can go long and short these factors.

Alternative risk premia managers will usually invest across these different risk premia and across asset classes in equities, currencies and bonds.

The main driver of performance disparity in 2018 was the performance of single-stock risk premia (specifically equity value). Most managers experienced losses from having a long-bias to equity value which, as a standalone factor, has been experiencing losses for more than five years (this is a well-known issue for investors in their equity portfolios). The driver of differences in performance across managers was around how to size the risk within an alternative risk premia portfolio to this factor.

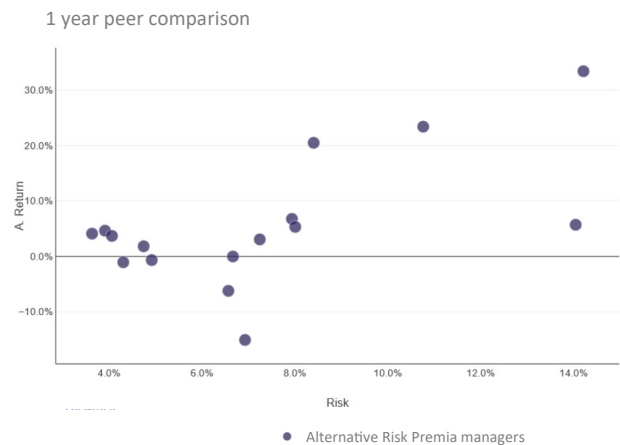
Those with a higher allocation to single stock premia continue to underperform (and again, these managers are suffering losses up to 10% in 2019) while those with lower allocation (or specifically no allocation) are performing better in 2019 with returns of 5% - 10% or more in 2019 (refer Chart 4). The incumbent managers we met with size the risk to single stock premia at a lower level which has meant that they have performed well. **It highlights the importance of diversification within a portfolio.**

Chart 3: Performance for 12 months to end Dec 2018 for alternative risk premia managers



Source: eVestment, Frontier Advisors PTY LTD

Chart 4: Performance for 12 months to end Oct 2019 for alternative risk premia managers



Source: eVestment, Frontier Advisors PTY LTD

Trend following managers or CTAs

Chart 5 displays the last 12 months performance for CTA managers. 2019 has proven to be a very strong year for many CTA managers that we follow.

2019 has been a year characterised by strong trends in fixed interest and equities. Bonds rose strongly in value from the beginning of the year until around end August as interest rates for most developed countries went lower and lower throughout this period. Most CTAs were following this trend in bonds and devoting a large portion of their portfolio's risk to bonds. Bonds rapidly reversed in September and October which detracted materially from the very strong returns earned to the end of August.

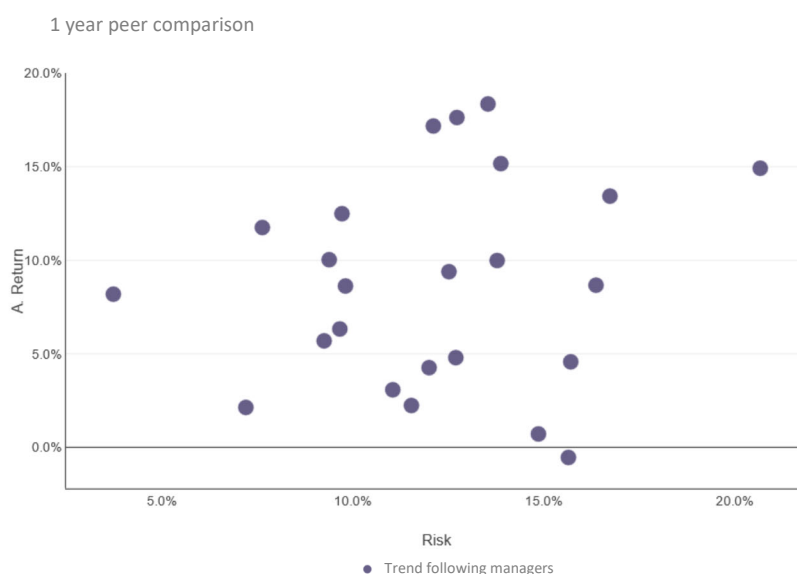
Different approaches by managers led to different outcomes:

- those managers which only focus on trends, and which don't manage the risk allocation to overextended trends, will have suffered material losses in September and October;
- managers with better risk management processes started reducing their risk allocation to bonds in July which helped reduce the losses in September and October and sustained year to date value being added for their clients;

- managers which allocate to non-trend factors, as a means to add diversification into the portfolio, outperformed their pure-trend counterparts;
- those CTAs which allocate to alternative markets also materially outperformed their pure-trend counterparts.

CTAs which focus on alternative markets (or what we call "Niche" CTAs) are a group of managers in which we have strong conviction. As background, alternative markets refer to markets that historically have not been found in typical trend following or CTA portfolios – less liquid commodity markets (i.e. German Power, Newcastle Coal), Credit Default Swaps (market instruments which benefit when credit concerns increase for companies within a specified credit rating band) and Interest Rate Swaps (market instruments which allow an investor to generate a return based on movements in the yield curve of a country). These products cannot all be traded electronically, and specialist execution traders are often required. Often these traders will not travel internationally like many portfolio managers do, therefore, meeting with these traders onsite provides an opportunity to assess how well they consider liquidity and transaction costs in implementing the investment strategy.

Chart 5: 12 months performance to end October 2019 for CTA managers

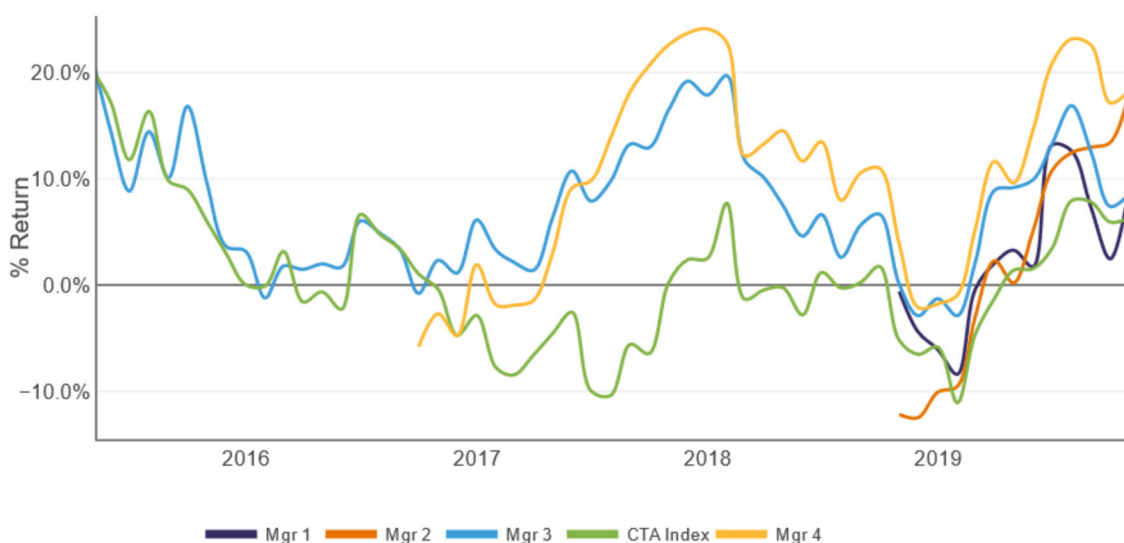


Source: eVestment, Frontier Advisors PTY LTD

Chart 6 shows the rolling 1-year performance of several alternative markets managers relative to the Soc Gen CTA Index (this is an index of trend following managers which is based on an average performance in each month for a large group of these managers. This index is a good method for comparing the performance of a type of trend follower relative to the wider population of trend followers). In terms of overall performance, managers that implement the same

trend models across both the standard markets and alternative markets have delivered higher Sharpe ratios with the latter. These strategies have proven to be very popular amongst investors with most managers close to capacity. Nonetheless, there are a few managers with remaining capacity; **we believe this should be an area of consideration for investors able to invest in capacity constrained managers.**

Chart 6: Rolling 12 month performance of niche CTAs



Source: eVestment, Frontier Advisors PTY LTD

Insurance Linked Securities

Insurance Linked Securities (ILS) strategies (see Footnote 3, Page 1 for definition) are appealing for many investors because natural catastrophes are uncorrelated with the rise and fall of all other return drivers investors portfolios (meaning if equity markets fall, this will have no bearing on whether a hurricane or earthquake occurs) and hence such investments offer both attractive returns and risk diversification benefits. And secondly, where portfolios are constructed with are diversified across natural catastrophes, these events tend to be independent of one another i.e. an earthquake in California will not have any bearing on whether a hurricane occurs in Queensland. **It is this diversification profile which improves the appeal of ILS.**

The five years leading up to the end of 2016 were fairly benign for natural catastrophes. Hurricanes were forming but mostly these didn't make landfall and therefore did not cause losses. 2017, though, was a year with material losses following three consecutive hurricanes (hurricanes Harvey,

Irma and Maria) while 2018 was also a year with sizeable losses caused by a mix of hurricanes, Japanese typhoons and California wildfires. 2019 has been a more benign year. While there have been wildfires again in California, these have been relatively well managed by the government and utility companies which shutoff power to ensure that the power lines did not cause further fires. There have, however, been two damaging typhoons in Japan which occurred in quick succession in recent months. Incumbent ILS managers suffered small losses reflecting a relatively low allocation to Japanese typhoon insurance. So overall 2019 has been relatively good with most ILS managers on target for a relatively strong performing year of between 5-10% (although some fared worse depending on their exposure to Japanese typhoons). **This highlights the importance of having a very deep understanding of the risks in an ILS manager's portfolio because, in our experience covering over ten ILS managers, it is rare for two ILS managers to have similar portfolios.**

Assessment of new strategies and managers

There were two strategies which we covered on this trip and which we believe warrant further investment due diligence. The purpose of these connections on the trip was not to complete all the research but rather to connect at a surface level (given the time constraints) and assess whether there are tangible benefits for our clients and whether deeper research is warranted. This was in systematic global macro and life insurance related insurance linked securities.

Systematic Global Macro

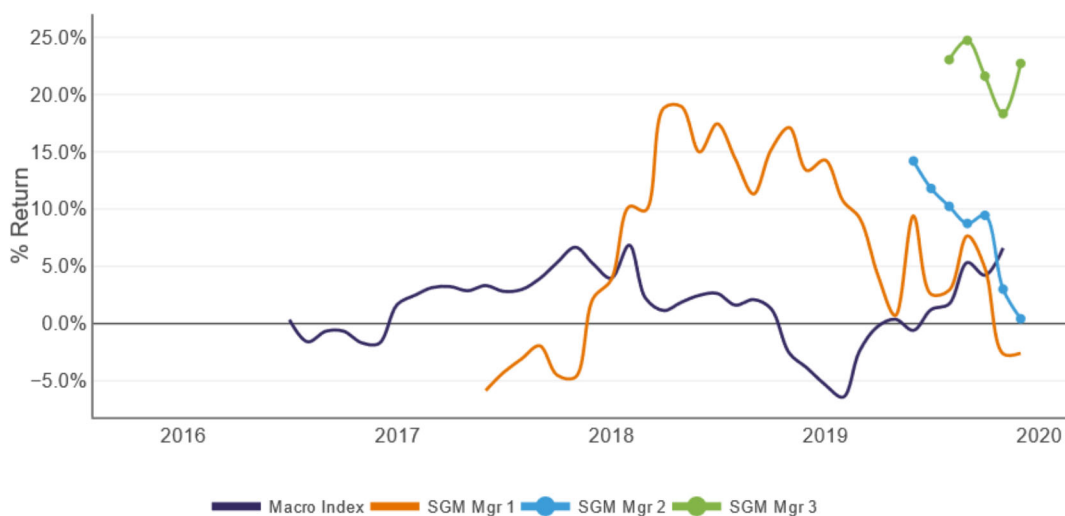
We already cover several managers who follow a systematic process based on fundamental macroeconomic factors to drive returns. These types of strategies are more medium-term in nature (i.e. usually invest on a 3-5 year timeframe). The macroeconomic views are based on valuations of different asset classes (e.g. equities) and markets within those asset classes (e.g. S&P 500). These valuations may be driven by predictions of macroeconomic data such as GDP growth or inflation. The asset classes include equities, bonds, currencies and commodities. The investment process will take a long position in assets which are deemed as being undervalued and a short position in those which are deemed to be overvalued. In doing this, the portfolio will usually have a low sensitivity to broader markets and therefore offer appealing diversification properties with an investor's wider portfolio, but will be impacted by the relative performance across the long versus the short position. The investment process may also take positions in assets which offer appealing carry

(recall from earlier in this paper that carry is the return which can be earned from having a long position in one asset and a short position in another asset). Finally, these strategies may also take positions in markets if that market has been following a trend either up or down. The timeframe for measuring this trend is usually more medium-term in nature (e.g. circa one year).

There are several strategies like these which we already cover so our focus on this trip was on systematic macro strategies which were less about valuation, carry and trend and more about alternative data sets to improve the speed of predicting macroeconomic data (e.g. predicting a country's inflation quicker than other market participants). These strategies may also involve shorter term trades to take advantage of market participants which invest into the market in a fairly predictable and repeatable fashion, and which yields short term trading opportunities and then compounding these trading opportunities over time to deliver a rewarding return. Finally, we observed several examples of how artificial intelligence and machine learning were being appropriately used to discern trading signals within very large datasets.

Chart 7 shows the performance of three of these strategies as well as the performance of a global macro index. The performance has tapered off in recent times for some of these strategies but the discussions we held around the process and the return drivers gave us conviction in the strategies when measured over time horizons longer than a few months.

Chart 7: Rolling 12 month performance of differentiated systematic global macro managers



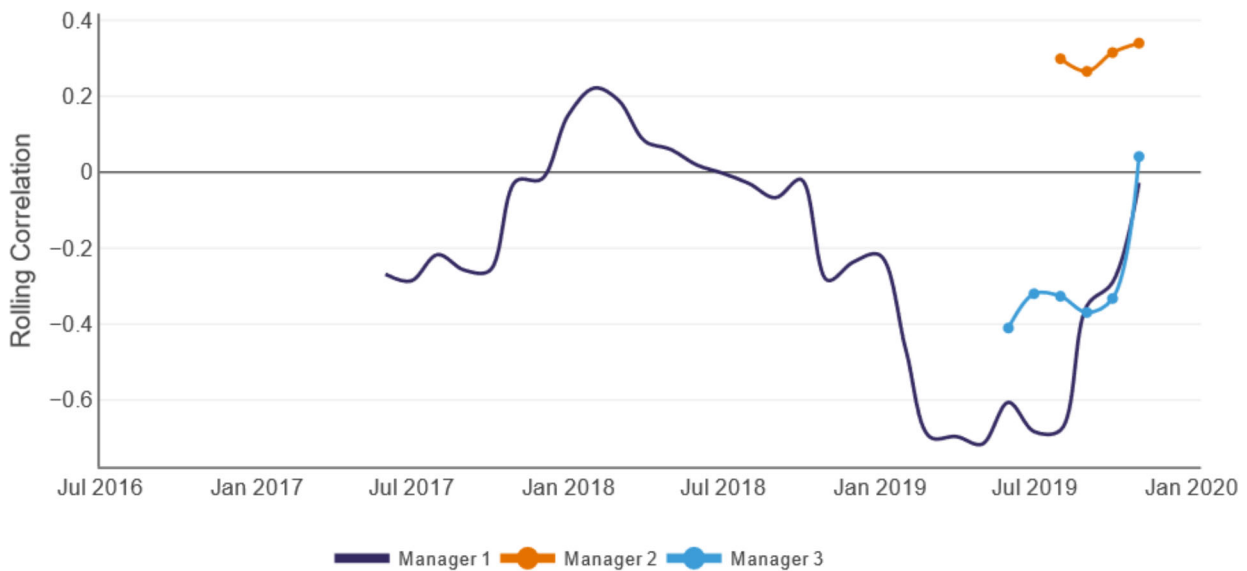
Source: eVestment, Frontier Advisors PTY LTD

Chart 8 highlights the correlation of these strategies with this global macro index and highlights how different these strategies are relative to the broader macro index with correlations negative or slightly positive.

The managers we met with were relatively transparent with the types of markets in which they invest and the type of market flows of which they seek to take advantage. This intellectual property is critical to the managers' success and so for this reason we do not go into detail in this paper with examples. **We would note, though, that the examples provided during our due-diligence were value-adding and differentiated from the aforementioned standard systematic**

global macro strategies. This is the key appeal of these new strategies, namely the diversification not only with broader markets but also with other existing systematic global macro managers. These strategies are suitable for a client's alternatives sector, especially one which is seeking a high and diversified return profile. These strategies, though, are relatively capacity constrained and so will likely only be suitable for investors with portfolio sizes below \$10 billion. The track record is relatively short for some of these and so clients may be able to take advantage of early-bird fee offers. We have identified a few managers to progress due-diligence with from this trip.

Chart 8: Rolling 12 month correlations to the Barclays Global Macro index



Benchmark: Barclay Global Macro Index - I - USD
 Source: eVestment, Frontier Advisors PTY LTD

Life insurance commission financing

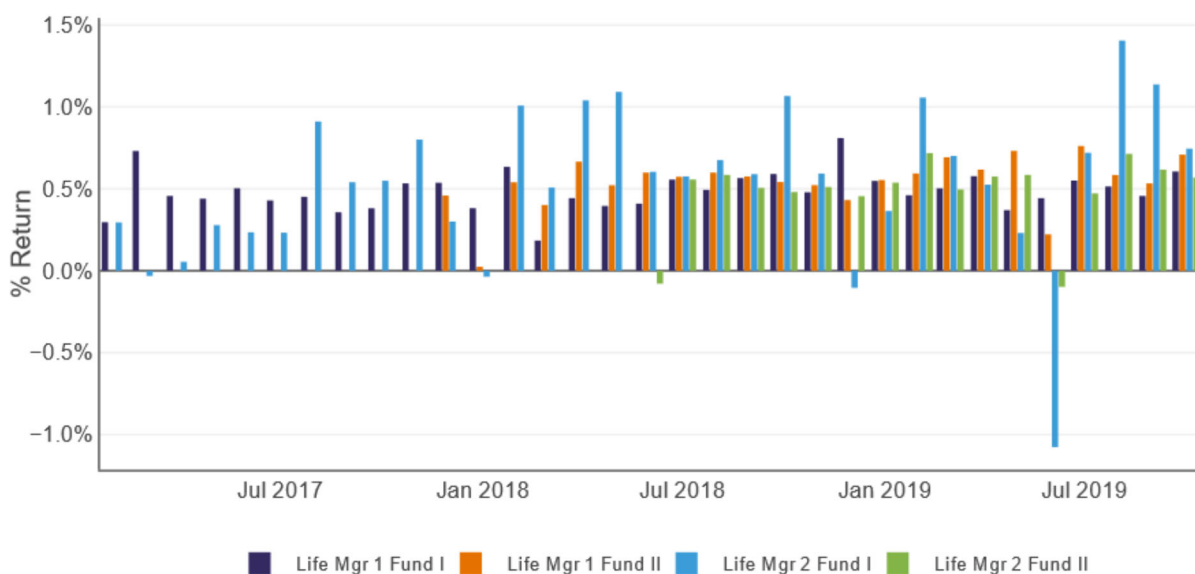
These discussions evolved from our existing relationships with incumbent ILS managers, many of whom offer standalone products where returns are driven by cash flows related to life insurance premiums.

The most prevalent of such structures is what is called an embedded value loan. Life insurers need to pay their brokers upfront commissions. Suppose the present value of future life insurance premiums from a client is \$100 over the term of the contract but each premium is \$5. Now because commissions are due upfront, the life insurance company needs capital to fund this and so life insurance companies will often source financing for these commissions from entities such as ILS managers. The ILS manager will provide less than the \$100 (say \$80) of the financing and in return will be paid back from the receipt of the future life insurance premium cash flow. This type of investment is known as receivables financing. It is important to note that the ILS manager will not receive future premium cash flows if the life insurer defaults. Therefore, adjudicating the credit risk of the life insurer is

critical. Another risk to the future cash flows for the ILS manager is if the cohort of life insurance contracts reduces in size. This would happen if a large number of policy holders lapse on their life insurance contracts. It should be noted that an estimation is made by the ILS manager about the level of lapse behaviour and so a reduction in return for the ILS manager would only occur if this lapse experience proves to be higher than their original estimate.

Chart 9 shows the monthly return experience for three of these ILS funds from two different ILS managers. Returns for such products have been very stable and broadly consistent with stated objectives (as the majority of the return is driven by a relatively predictable cash yield). Performance has exhibited minimal (if any) drawdowns and volatility remains benign (typically less than 1% p.a.). These sticky return streams, uncorrelated with traditional markets, make such products attractive candidates for further work.

Chart 9: Monthly returns for different life insurance related strategies

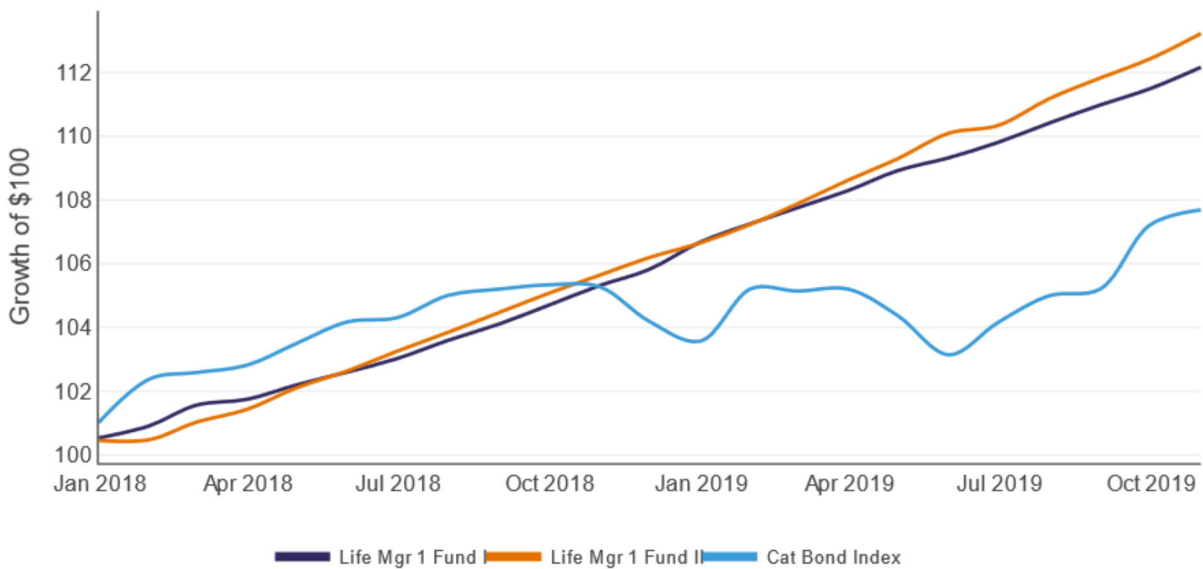


Source: eVestment, Frontier Advisors PTY LTD

Chart 10 shows the cumulative returns experience for two different types of ILS funds from a single ILS manager as well as the ILS index. Life Fund I for this manager has the commission financing type of transactions in the portfolio but also has some other types of life insurance transactions in there including contracts which lose value if a pandemic occurs. Life Fund II was a fund which was solely focused on the commission financing type of transactions. The very stable return profile is clear for these two types of life insurance strategies relative to the Swiss Re Cat Bond Index (this is an index based on all of the catastrophe bonds in the market)

which has been impacted in recent years by natural catastrophes (e.g. US hurricanes). **This stable return stream is a key reason why we believe investors should consider these strategies.** We would note that capacity is not high with around \$1 - \$2 billion being considered by different managers seeking to raise funds.

Chart 10: Cumulative performance of different types of ILS strategies for the same manager



Source: eVestment, Frontier Advisors PTY LTD

Themes

It emerged during the trip that there were three key consistent themes.

Customisation/bespoke tailoring

Bespoke solutions were mentioned in different areas during our trip. These included investment banks, but also fund managers, which noted how they were working with their investors to offer combinations of different strategies which they offer. For example, one trend following or CTA manager noted that investors had been discussing how to combine its flagship trend product with systematic global macro offering as a means to diversify the volatility which arises in a pure trend strategy.

We believe there is merit in our clients considering how to work with a manager or investment bank to create a bespoke solution if this approach provides the best fit from a total portfolio perspective. Likewise, selecting targeted bank offerings also has merit.

Embracing complexity

It became clear from our discussions with investment banks that their European institutional investors were comfortable embracing complexity. Several of the strategies discussed on our trip needed to be complex as means to offer the type of diversification and defensiveness being sought by the investor.

In our view, a client should only embrace complexity if this is appropriate for its portfolio. Embracing complexity will also have non-investment considerations such as the investment committee's comfort with complexity and the additional resourcing required of the client's internal investment and operations teams.

Other examples of European investors seeking complexity are with the alternative markets CTAs and the life insurance commission financing strategies.

Differentiation

Finally, differentiation was a key theme with managers seeking areas to differentiate themselves from peers. Examples included the use of alternative data sets and machine learning as part of the investment process.

We believe that investors should consider strategies with this differentiated approach given the diversification with other managers within an alternatives sector. There is also a potential intellectual property transfer element if this is of interest to an investor.

The final word...

2019 has proven to be a good year for most alternatives strategies which follows a very difficult year in 2018.

We performed a post-mortem on the 2018 experience as part of our research trip in March and so were able to focus on this trip more on reviewing incumbent strategies to reaffirm or change our views and to also take the opportunity to meet with new managers and strategies. We didn't note any concerns from our incumbent managers.

We also believe that there are a few very promising areas which warrant further research and these were valuable take-outs for us and we believe could lead to value adding investment opportunities for clients. These included:

- Systematic global macro but those of which are highly differentiated from standard macro strategies due to their more niche investment approach. These are relatively capacity constrained and so will likely only be suitable for investors with portfolio sizes below \$10 billion.

- Life insurance receivables financing strategies also look appealing. These have proven to have very stable return profiles. More work is needed to review managers but our work thus far suggests that the differentiated return profile warrants focus from investors. These are also relatively capacity constrained and likely only suitable for investors with portfolio sizes below \$20 billion.

Finally, it is clear that European institutional investors are becoming more comfortable with assuming complexity but also more comfortable using investment banks to source bespoke strategies for a desired risk/return profile. We believe that the bespoke nature of investment bank offerings is the key reason for considering using investment banks. There are costs involved which can be relatively high and so this is an important consideration but there are definitely benefits for an investor's strategy team and/or alternatives team from being able to select individual trades which offer the best fit for the total portfolio.

Frontier's Alternatives and Derivatives strategies research

Frontier's Alternatives and Derivatives strategies team researches all of the above alternative strategies and also advises on the asymmetric call and put options strategies referred to above.

We strive for our research to be contemporary and to reflect on these markets and the potential opportunities they offer. We are continually seeking new and differentiated managers/strategies to broaden our suite of strategies and managers in these areas.

We also research strategies which are capacity constrained and so only appropriate for smaller-sized investors which are able to devote enough of their portfolio to these strategies. These capacity constrained strategies are usually higher fee in nature but, in some cases, we believe these strategies warrant the higher management fees although certainly not

to the "rack rate" fee levels published by these managers (and where additional fees and additional complexity is embedded, we continue to underpin any recommendation with deep and thorough research to ensure the confidence we have is well founded).

Frontier also believes investors in certain cases can benefit from considering customised strategies from managers by only investing in a few of the manager's trade ideas (from a total portfolio perspective, it can be better for the portfolio from a diversification perspective to only invest in a portion of a manager's strategy). Each investor will need to carefully assess any consideration of customisation and ensure those components being utilised are fit for their specific purpose. Frontier can assist in this regard.



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