The Frontier Line

Thought leadership and insights from Frontier

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Opportunistic ideas for a challenging return outlook – Part I

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About us

Frontier has been at the forefront of institutional investment advice in Australia for over 25 years and provides advice on $600 billion of assets across the superannuation, charity, public sector, insurance and university sectors.

Frontier's purpose is to empower our clients to advance prosperity for their beneficiaries through knowledge sharing, customisation, technology solutions and an alignment and focus unconstrained by product or manager conflict.

James Gunn

Senior Consultant

James Gunn joined Frontier in 2019 as a Senior Consultant within the Equities Research Team. He has more than 15 years equity markets experience, including direct equities experience. Most recently, he worked as a buy-side equity analyst at Prime Value Asset Management and prior to that he held senior manager research roles with Standard and Poor's and Aviva. He commenced his career as a Financial Analyst with Lincoln Indicators. James recently completed his Masters of Accounting at Monash University and also holds a Bachelor of Commerce from Melbourne University and Graduate Diplomas of Applied Finance and Financial Planning with FINSIA.

Fraser Murray

Head of Equities

Fraser joined Frontier in 2012 and is the Head of Equities. He was previously at Ibbotson Associates/ Intech Investments for nearly 15 years where he held a variety of roles including five years as Head of Manager Research and five years as Head of Equities and Property. Fraser started his asset consulting career at Towers Perrin in 1994 as a Research Analyst in its Melbourne and London offices. Fraser holds a Bachelor of Commerce with Honours from the University of Melbourne and a Graduate Diploma of Applied Finance and Investments from Finsia, and is a Fellow of Finsia.

Background

Over the past two years, Frontier has introduced discrete, opportunistic strategy buckets to our domestic and global equity configuration frameworks. These allocations are designed for long-term investors targeting return enhancing ideas.

The key objective of this paper is to promote this broader lens where appropriate and provide illustrative examples of the types of ideas across developed and emerging markets that might resonate with some asset owners with high-to-moderate excess return objectives.

Additionally, the Frontier Equities Team continues to progress new ratings across a broad range of these 'opportunistic' type areas. While opportunities further down the capitalisation spectrum are typically most relevant to less capacity constrained small/medium-size asset owners, larger investors are actively assessing a broader range of niche ideas, such as China A or specialist climate strategies.

We have broadly organised these ideas into three main opportunistic areas: China A-shares, 'activist', and a broader section on small caps. This edition of The Frontier Line considers the first two of these opportunistic areas. Our next edition will publish Part II of this collective paper where we will solely focus on small caps.

Summary

There are a number of steps investors should follow to establish an equities portfolio configuration in order to meet their underlying portfolio objectives.

This includes setting return objectives that align with the portfolio's investment purpose and investor-specific constraints (e.g. size, fee sensitivity, risk appetite (including YFYS considerations for superannuation funds), ESG objectives and tolerance for complexity). For investors with high-to-moderate excess return objectives, one of the key steps to establishing an equities configuration is determining how much to allocate to return-enhancing opportunities. For international equities, this will include the allocation to active broad-cap developed and emerging market equities but should also consider the allocation to more opportunistic areas, such as those discussed in this paper. This should include the suitability of various opportunistic ideas and how best to access these over time.

We consider a range of niche ideas scalable for small and mid-sized clients (typically down the cap spectrum) but also ideas relevant to large and growing super funds, for example across both developed and emerging markets.

From a timing perspective, we think the forward-looking environment presents a much more challenging return outlook for equity investors given the extended low interest rate, bull market environment that has persisted for large-cap growth stocks until more recently. The implication is that investors may not be able to rely so heavily on headline equity market returns (i.e. beta), hence an increasingly important role for index agnostic, opportunistic strategies delivering less correlated source of alpha/return in domestic equities, global developed and emerging markets.

For example, generating excess returns or alpha has mattered less when equity returns were strong as they have been for much of the period since the GFC, i.e. getting 1% or 2% extra is good, but proportionately small when equities more broadly are giving an end investor +10% from the market benchmark. However, if market returns are a lot lower, say 2%, then getting excess returns of 2% essentially means the excess is 50% of an investor's overall outcome. In times of weak equity markets, excess return is more important than ever!

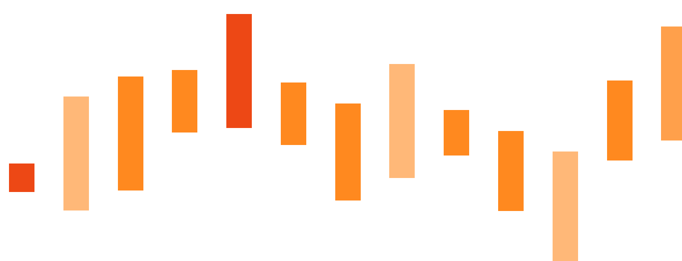
We have summarised some of our key strategy-specific opportunistic views within this summary for Part I, along with portfolio construction and fee considerations.

The China A opportunity

- There continues to be plenty of headlines questioning the investability of Chinese equities, which sold-off heavily in 2021 in response to significant regulatory actions within well-represented segments of the market, including key stocks held by foreign investors in e-commerce, gaming and education. While this continued into 2022 off the back of a number of drivers, including wider-ranging geopolitical implications linked to the Russia-Ukraine conflict, Frontier's view is that the long-term opportunity in Chinese equities remains intact.
- If anything, the events of the past year simply reinforce the importance of diversification away from increasingly concentrated benchmarks (in both EM and DM). We think there should be greater focus from EM (and ACWI) managers on the more domestically-oriented onshore China A market, the second largest equity market in the world. The China A-shares market is not only highly inefficient (i.e. conducive to alpha generation) on account of retail investors still dominating trading volumes, but it is also sufficiently liquid for all investor sizes.
- More recently, given the geopolitical concerns in Russia/Ukraine, a number of investors have also referenced implications further down-the-line pertaining to issues which could emerge in China. While such risks are higher in countries such as China, and could be viewed via an ESG lens, they are not within the remit of this paper. We mention this to acknowledge challenges which can emerge and are worth noting given China's significant and growing size in EM equity markets.

Activist strategies

- We have also dedicated a section of the paper to domestic activist strategies. Activist investors seek to unlock specific sources of value (primarily through engagement activities) by holding company management and boards to account on perceived issues, constraints or unrealised opportunities. Similar value-adding engagement objectives are pursued through mainstream equity managers. However in our view, exposure to an activist-focused strategy provides a more targeted approach through a typically concentrated number of investments.
- What appeals most to Frontier about the emergence of domestic activist-focused strategies is their potential to deliver differentiated sources of alpha/return, at least relative to a core exposure to Australian equities.



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Portfolio construction

The excess return expectations for satellite ideas have two components, a market component 'beta' and excess returns generated through manager skill 'alpha'. The market component represents the additional returns expected from investing in riskier and possibly less liquid sub-asset classes, i.e. the allocation itself would be expected to generate higher returns than the S&P/ASX 300, as an example.

While satellite ideas are clearly not homogenous, they share commonalities in that a greater 'alpha' and 'beta' return is expected given the nature of these opportunities – being typically less researched, less liquid (not always) and often more volatile investments relative to a more mainstream equities exposure.

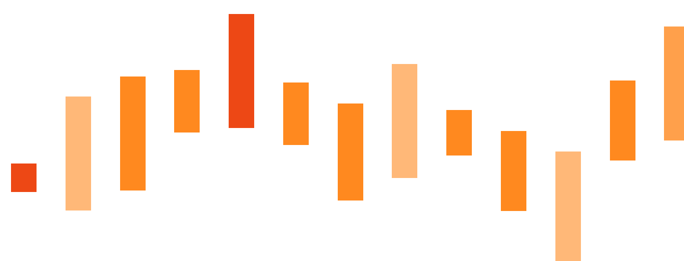
Table 1 is an extract from Frontier's 2022 international equites configuration. For clients pursuing higher alpha in global equities as an example, Frontier has advocated that institutional clients invest between 5% to 15% of their global equities in these opportunistic ideas. We believe skilled managers in these areas, where active management is key, can be expected to generate a return of between 2-2.5% p.a. above an ACWI benchmark (incorporating both alpha and beta components).

However, some satellite ideas such as emerging market small caps or China A, for example, have been more favourable towards active management and therefore a higher excess return component would be expected. Frontier can assist clients in establishing return expectations for specific opportunistic allocations. Importantly, these base-case assumptions can be enhanced through superior manager selection.

Table 1: Portfolio construction guide – High alpha portfolio example

Strategy	Allocation ranges	Expected excess return over MSCI ACWI ex Au with special tax (net)	Tracking error range *	Indicative fees (% p.a.)
Active global equities [1]	55% - 75%	1.2%		
Indexed/enhanced index/ low carbon index [2]	0% - 15%	0.0%		
Emerging markets/ Asia ex Japan	15% - 20%	2.0%		
Opportunistic ideas	5% - 15%	2.2%		
Total		1.4%	2.1% - 2.7%	0.63

* Indicative tracking error required to meet excess return objective. This assumes an information ratio of between 0.5 and 0.6, achieved through active management over the long-term. [1] Higher expected return from higher tracking error strategies. [2] We conservatively assume a 0% excess return from enhanced index.



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Fees

Higher alpha seeking strategies are associated with larger fee loads reflecting their higher levels of discretionary research and more capacity constrained and less liquid nature (not always, i.e. China A). However, industry dynamics (including increased passive management, internalisation, underperformance of active management) continue to create an environment conducive to investors negotiating lower fees for active management, which includes some fee compression even for satellite strategies.

It is very hard to generalise across wide-ranging domestic and global opportunistic strategies however, our broad fee expectation for less liquid domestic micro-cap and pre-IPO strategies, or highly concentrated activist strategies, for example, is c0.80-1.10% (lower for domestic small caps) and c0.78-0.95% for institutional investors accessing global and EM small cap strategies, and potentially China A.

At the same time, some institutional investors will be able to negotiate meaningfully lower fees with managers in some cases depending on factors such as allocation size; how capacity constrained the strategy is; and whether a first mover opportunity exists (i.e. investor is a foundation investor).

Fee compression on active management is not going away with YFYS benchmarks, as one example, assuming a passive approach in their fee assumptions. However, we think there is an important implication here for higher fee strategies as they start to look increasingly good value (relative to passive) given the opportunity for return enhancement and downside protection in volatile markets.

YFYS

Many super funds under the constraints of YFYS performance benchmarking are likely to be focused on managing their tracking error, rather than seeking out higher tracking error opportunistic strategies. However, our view is that it is even more critical for super funds (given YFYS) to ensure they are deploying their active risk and fee budget in the most efficient means as it relates to portfolio return enhancement and diversification, albeit consistent with their specific tolerance for high active risk strategies and the associated fee load, additional monitoring/complexity and capacity constraints.

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Opportunistic ideas

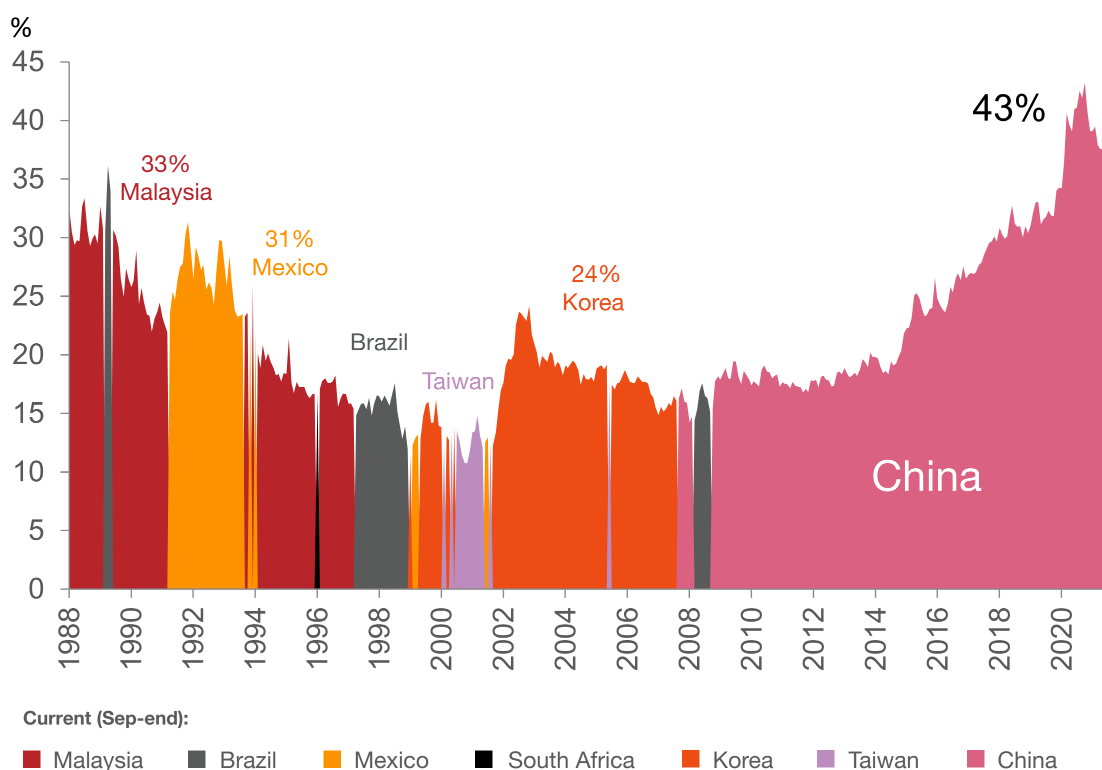
China A-shares

2021 was by any measure a difficult year for Chinese equities. While a number of factors were at play, the speed of the Chinese Government's regulatory crackdown caught many investors by surprise. Impacts on key e-commerce and gaming stocks, as well as other segments well-held by foreign investors like the private education sector was the key driver of significant EM underperformance in 2021. Volatility and drawdowns have always been a feature of investing in China however, the Government's seemingly sweeping policy decisions on areas of the market well-held by foreign investors led to many headlines questioning the investability of China going forward, based on idiosyncratic regulatory and geopolitical risk factors.

The extent of the regulatory actions in China in the view of some managers and asset owners reduced the attractiveness of Chinese equities for some investors outside China, even if those policies are more attractive to its citizens. Investor concerns focused on the Government's true commitment to a market-based economy and the potential for a more permanent de-rating based on reduced profit opportunity going forward in some sectors of the economy, as a direct outcome of the 'common prosperity' focus amongst other long-term policy agendas.

Some assets owners have also taken to reviewing both their strategic allocations to China and/or considering a carve-out of their China exposure from other EM exposure to better control their China-specific allocations through time (for increased implementation flexibility) or at least until they have increased confidence in pricing regulatory risks and determining an appropriate country risk premium. It is noteworthy that China is likely to become an increasingly dominant part of the MSCI ACWI and EM indices over time based on higher inclusion factors for onshore China A-shares. Hence these considerations as to how to access exposure to this market are likely to remain.

Chart 1: Largest market weight in MSCI EM



Source: Goldman Sachs Global Investment Research.

Despite the regulatory challenges and underperformance of Chinese equities in 2021 (which has continued into 2022), we continue to believe the underlying opportunity in under-owned Chinese equities remains intact. The policy direction of President Xi Jinping, being focused on reducing income inequality in China, should provide long-term tailwinds to non mega-cap consumer growth areas with a focus of moving more of the population into the middle classes and stimulating savings through improving affordability/the safety net.

If anything, the events of the past 12 months in Chinese equities serve to highlight the value of diversification in Chinese equities and EM more broadly, noting the highly concentrated index construct in the EM Index (although this has reduced quite meaningfully over the past six months), which includes a fraction of the broader opportunity set in listed Chinese equities. Investors can broaden their EM exposure by allocating to less well-represented opportunities outside China but also through increased exposure to onshore China A-shares (through their EM or ACWI managers or through dedicated allocations). Ironically, these concentration dynamics in EM are even more apparent in the weight to US growth names in the mainstream developed market and ACWI indices.

Table 2: Comparison of index top ten holdings

MSCI EM (31 March 2020)	Index Wgt	MSCI EM (31 Jan 2022)	Index Wgt	MSCI China	Index Wgt	MSCI China A Onshore	Index Wgt
Alibaba	7.1%	TSMC	7.3%	Tencent	14.1%	Kweichow Moutai	4.1%
Tencent	5.9%	Tencent	4.5%	Alibaba	9.0%	Contemporary	2.7%
TSMC	4.7%	Samsung Electronics	3.8%	Meituan	4.7%	China Merchants Bank	2.6%
Samsung Electronics	3.9%	Alibaba	2.9%	China Construction Bank	3.0%	Ping An	1.9%
China Construction Bank	1.7%	Meituan	1.5%	JD.com	2.5%	Wuliangye Yibin	1.5%
Naspers (sig inv in Tencent)	1.3%	Reliance Industries	1.2%	Ping An	2.0%	Midea Group	1.3%
Ping An	1.2%	Infosys	1.0%	Baidu	1.8%	Industrial Bank	1.3%
China Mobile	1.0%	China Construction Bank	1.0%	Netease	1.6%	Longi Green Energy	1.2%
ICBC	0.9%	Vale	0.8%	Wuxi Biologics	1.4%	East Money Information	1.1%
Reliance Industries	0.9%	JD.com	0.8%	ICBC	1.4%	Luxshare Precision	0.9%
	28.5%		24.8%		41.5%		18.5%

Source: MSCI, at 31 January 2022 (unless stated).

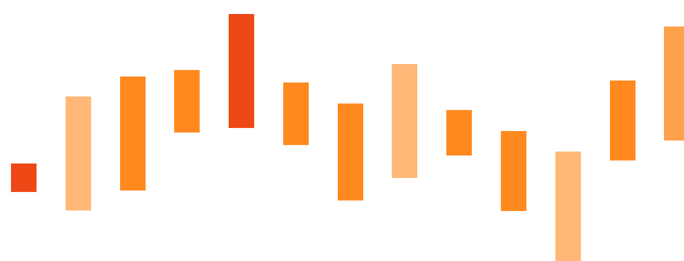
China A-shares are often viewed as a risky part of an EM portfolio and typically are more volatile, however, the breadth of this market can provide significant diversification benefits to other parts of a portfolio.

Table 2: Comparison of China/EM index return and risk metrics to 31 December 2021

Returns (AUD)	1 yr	3 yr (% p.a.)	5 yr (% p.a.)	7 yr (% p.a.)	10 yr (% p.a.)
MSCI China A Onshore	10.4	24.4	9.8	6.6	12.2
MSCI China H	3.3	1.8	4.4	2.8	7.6
MSCI China	-16.9	6.6	9.3	7.3	10.9
MSCI EM	3.4	9.8	9.8	7.9	9.2

Volatility	1 yr	3 yr (% p.a.)	5 yr (% p.a.)	7 yr (% p.a.)	10 yr (% p.a.)
MSCI China A Onshore	12.4	15.9	15.1	20.4	23.0
MSCI China H	9.0	13.1	13.6	16.3	17.0
MSCI China	17.1	16.1	15.1	16.4	15.8
MSCI EM	9.4	11.6	10.7	10.9	10.4

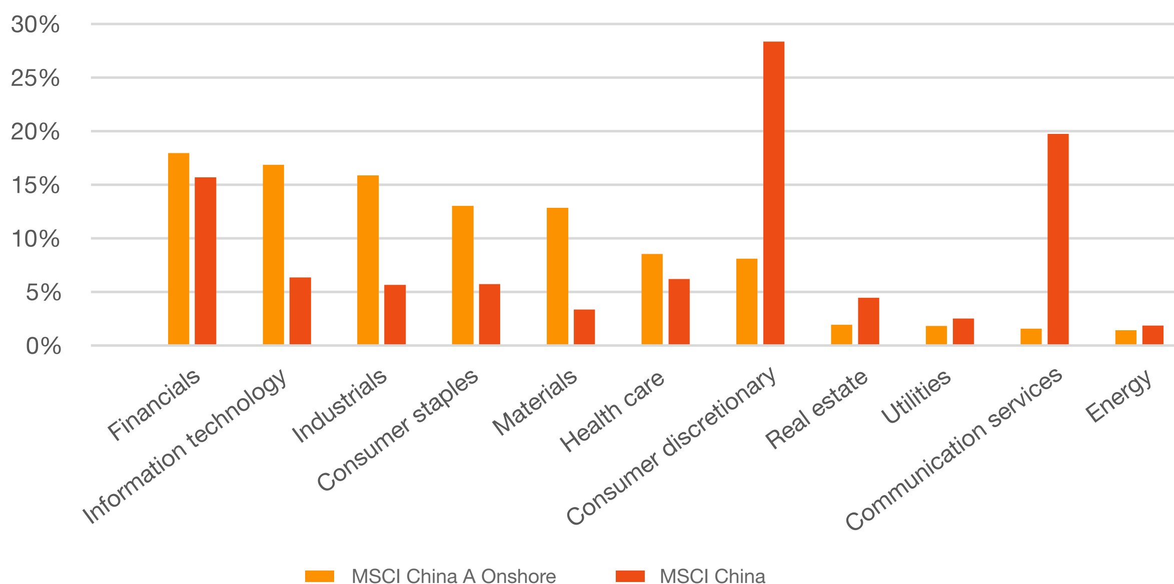
Source: eVestment.



While Hong-Kong listed and offshore Chinese stocks tend to be dominated by e-commerce names within consumer discretionary and financials, onshore indices (e.g. CSI 300 or MSCI China A/China A Onshore) tend to have a greater exposure to broader-based IT and industrial sectors, leading to a wider dispersion of returns.

In many respects China is two markets in one, which was evident in the relative performance of A-shares and offshore stocks in 2021, with the latter more impacted by regulatory actions on the private sector and deteriorating property market dynamics (catalysed by the Evergrande crisis). This is highlighted in Chart 2, noting MSCI China also includes A-shares.

Chart 2: Comparison of MSCI China and China A sector composition



Source: MSCI, at 31 January 2022.

Table 4 illustrates the relatively low ten-year correlation of China A-shares with EM index returns, which confers strong portfolio diversification benefits. However, we note the correlation of A- and H-shares is similar against developed markets (0.30 and 0.29).

Their correlations are particularly low relative to Australian equities (0.15 and 0.23). Correlations of A-shares will likely rise going forward as they become a larger part of indices, including the EM component of ACWI in the future.

Table 4: Ten year index correlations

To Dec 2021	MSCI China A Onshore	MSCI China H	MSCI EM	MSCI World
MSCI China A Onshore	1			
MSCI China H	0.69	1		
MSCI EM	0.47	0.66	1	
MSCI World	0.30	0.29	0.51	1
S&P/ASX 300	0.15	0.23	0.53	0.58

Source: eVestments.

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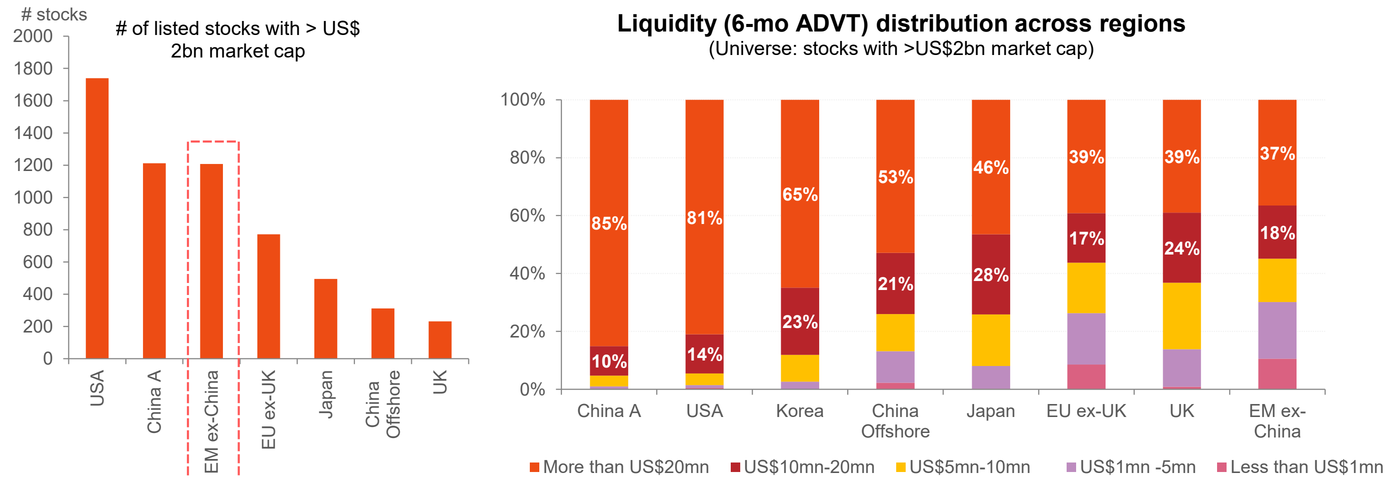
Why China A?

Chart 3: Comparison of China A market capitalisation and liquidity versus other major indices

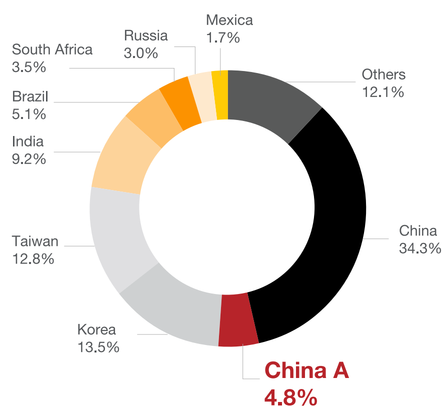


Source: Goldman Sachs Global Investment Research.

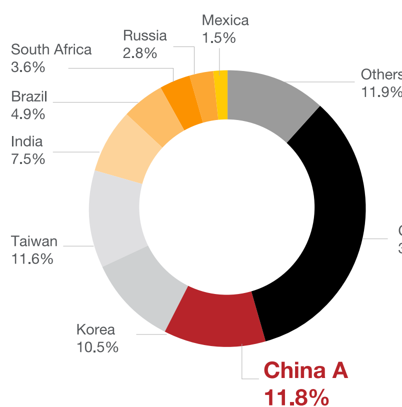
The conundrum for battered EM investors is that China and the China A market specifically is too big to ignore (nor would they want to), despite its underrepresentation in EM and global indices. The China A-share market, which comprises Renminbi-denominated shares traded on the Shanghai and Shenzhen stock exchanges, is now the second largest equity market in the world behind the US. Furthermore, the A-shares market will become a much larger component of key MSCI indices with rises in its inclusion factor.

Chart 4: Potential weight of China A-shares in MSCI EM on full inclusion

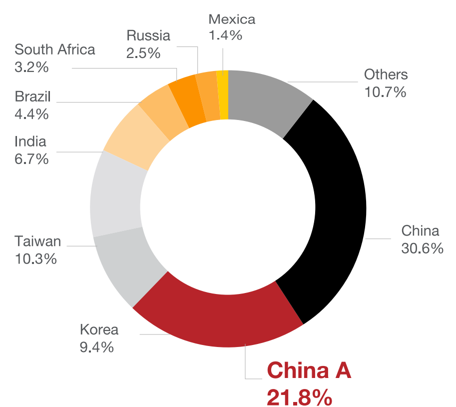
Current status
(If greater than 20%)



Potential future inclusion
(If greater than 50%)



Full inclusion
(If at 100%)



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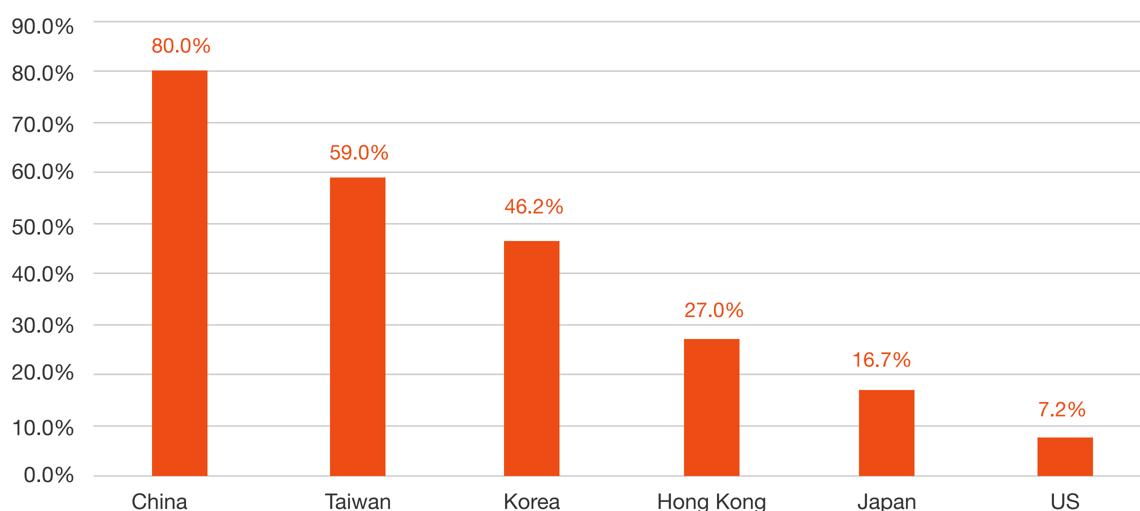
The key attraction to the A-share market is that it is both a highly inefficient market (i.e. conducive to alpha generation) but also sufficiently liquid for all investors sizes. Additionally, the onshore Chinese equity market generally provides much more domestic exposure to the long-term Chinese middle-income consumption growth story and in-turn diversification benefits relative to well-held offshore listed Chinese stocks more prevalent in mainstream EM indices and investor portfolios.

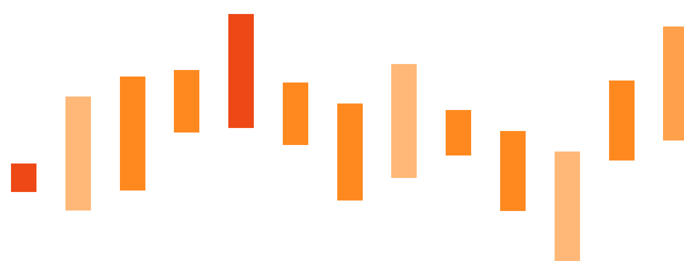
The alpha opportunity in China A-shares is primarily driven by the dominance of retail investor trading flows. These retail investors tend to have a more short-term focus and are less fundamentally-orientated than institutional investors. While institutional share of trading flows is increasing, foreign ownership remains low by developed market standards, particularly with the market still underrepresented in market indices.

With significantly improved access for foreign investors (primarily through Stock Connect), these dynamics will change over time, with greater correlation to other markets and arguably a reduced alpha opportunity. On the other hand, increased foreign ownership should increase the standards of corporate governance, which are below Western standards and the extent to which the market is driven by fundamentals, which could contribute to reduced volatility overtime.

Chart 5: Retail investor share of equity trading volumes



Source: CEIC, Citi Strategy Research, Invesco, Data as of June 2019.



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These unique characteristics have seen the median manager in China deliver very strong and consistent alpha relative to both the China A-share Index and the broader MSCI EM Index. While passive allocation provides a lower-cost means of gaining access to the China A market, Frontier recommends an active management approach to A shares in consideration of the high level of market inefficiencies and the opportunity to distinguish opportunities on governance and broader ESG considerations through discretionary stock selection. We believe a median China A alpha assumption of up to 5% p.a. is still reasonable based on our analysis of historical returns, while acknowledging manager return surveys like eVestment are biased to better performing managers in China A-shares.

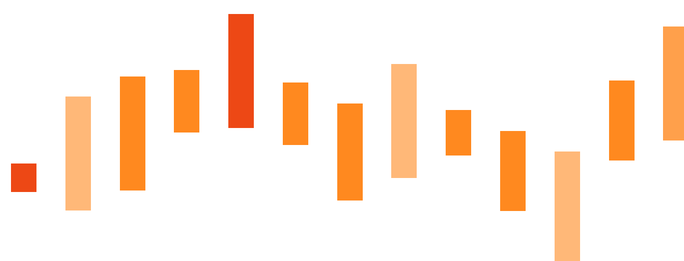
While institutional investors recognise the potential alpha opportunity in the onshore market, many are also reluctant to pursue this opportunity in the absence of broader-based hedging instruments to neutralise the beta. It is important to acknowledge risks that have contributed to higher levels of market volatility and drawdown in the onshore China market. This is also a relevant focus on index providers in considering an increase in A-share inclusion factors. Positively, there have been developments on this front, which has perhaps been somewhat missed amidst broader China concerns being expressed by many investors.

Chinese derivative markets are now offering a wider scope of financial instruments to enable investors to smooth the volatility of buying mainland shares. This is a direct result of the Government relaxing its position on shorting, including an increased appreciation that the development of derivative markets (and reduced suspensions) is critical to both institutional investors and the index providers like MSCI, which ultimately drive foreign capital allocations. Specifically, the launch of the MSCI China 50 Connect Index Futures contract in October 2021 has been an important step forward. However, it is also clear broader contracts are required (e.g. covering small-cap stocks) to hedge against concerns domestic retail investors exit on masse when inevitable downturns occur (adding to this downward pressure in onshore share prices).

While the active management opportunity in China A-shares is well-recognised, often the bigger question is how best to access A-shares. Where there is demonstrable capability and willingness to invest in the market, investing through EM managers is still our preferred approach to gain exposure to China A-shares (rather than through ACWI managers). However, Frontier is also supportive of an additional allocation towards a dedicated China A-shares strategy in specific circumstances as a form of portfolio completion (i.e. where a client is 'under-allocated' to China A-equities via its EM managers or simply to gain additional exposure to a highly prospective market). Such an allocation would not be appropriate for all clients, given the underlying complexities and governance issues associated with China A-shares, which requires a heightened level of due diligence and ongoing monitoring.

At this point, Frontier's preference is to access China A opportunities through offshore managers, which we view as more likely to have a better appreciation for the Australian context for institutional asset owners; be better equipped for the type of information and engagement sought by asset owners and more likely to adhere to a long-term buy-and-hold strategy than the high turnover, momentum-driven approach that is more common among domestic Chinese managers. Our expectation is the former will promote higher governance standards and potentially better protections for institutional investors based on an expectation of greater adherence to higher EGS standards and avoidance of stocks with poor governance. While we do not have evidence that an offshore manager approach is best for generating the highest outperformance (versus higher turnover onshore managers), we believe this is the most appropriate means of access for Australian investors today.

Frontier produced a comprehensive research piece on investing in China A-shares in 2020, which is available to clients. Furthermore, we are currently undertaking a dedicated China A focused manager search, which will ultimately result in us rating a small list of dedicated China A strategies in the near future.



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Activist strategies

Activist investing seeks to unlock specific sources of value (primarily through engagement activities) by holding company management and boards to account on perceived issues, constraints or unrealised opportunities. Activists will typically seek to engage boards and management teams privately, at least initially, often in conjunction with other institutional shareholders. However, they are also willing to progress to public activism and pursue their regulatory options (if necessary) to drive forward their proposals. The more concentrated the exposure, the larger the amount of stock that can be acquired from a given pool of capital and the greater the opportunity the investor has, in theory, to engage, pressure and ultimately influence corporate strategy. However, that is not necessarily a requirement where an activist has the support of other major shareholders. While an activist approach conjures up images of hostile takeovers and management/board overhauls, engagement is often collaborative and supported with deep research on financially favourable proposals for companies to consider. These can be improvement-focused around governance practices, capital allocation, asset optimisation and operational performance, but is also increasingly ESG and climate-focused. In practice, this could mean engaging on a sub-optimal capital structure; encouraging the demerger of an undervalued business unit; or advocating for more defined decarbonisation pathways.

Similar value-adding engagement objectives are pursued through mainstream equity managers (often with significant effect in small-caps). However in our view, exposure to an activist-focused strategy provides a more targeted approach through a typically concentrated number of investments, deeper research conducted on these concentrated holdings and with the potential for higher, less correlated portfolio returns.

The emergence of activist strategies in Australian equities is where we think this approach has most merit for consideration by Australian asset owners.

An emerging opportunity set in Australian equities

Activist focused strategies have not been a feature of our market like they have in other sophisticated but larger markets, most notably the US, where household names have turned these strategies into a separate asset class. This is despite a highly conducive regulatory landscape and other factors encouraging of productive engagement. But this is changing, with a number of institutional-quality local strategies attracting the attention of both Frontier clients and other large superannuation funds.

We have been undertaking detailed work on some of these domestic activist strategies but expect to see other institutional quality activist-focused strategies (including offshore managers) coming-to-market targeting large asset owners, particularly where there is an opportunity for additional co-investment in specific underlying investments alongside the fund manager. To the extent possible, we think it is important the approaches and positions taken by an activist-focused manager align strongly with the specific views of investors, given the potential of higher profile actions.

The primary focus of these strategies in an ESG context is the 'G' but we also see a material opportunity for environmentally and socially-focused impact engagement in an Australian context. We've seen in the US how activist hedge funds (in collaboration with the voting power and voice of index providers and pension funds) have delivered unprecedented climate-focused outcomes, for example the Exxon board upheaval.

An activist strategy focused primarily on large and mid-cap ideas is likely to be a more scalable and relevant Australian equities niche for larger and growing asset owners compared to less liquid and capacity-constrained return-enhancing strategies like micro-caps. This is perhaps akin to the more liquid China A opportunity set being a more relevant return-enhancing global equities niche for larger investors, compared to say emerging market small caps.

What appeals most to Frontier about these activist-focused domestic strategies is:

- Their potential to deliver less correlated sources of alpha relative to a broad-based exposure to Australian equities (particularly given the more challenged return outlook).
- The scalability for large and growing investors relative to less liquid opportunistic niche strategies mainly accessible only to smaller asset owners.

Manager selection for a highly concentrated strategy is clearly critical. Our analysis of underlying portfolios highlights forecast tracking error of c10% (relative to the S&P/ASX 200). Some of the key manager success factors coming through in our assessment of strategies include evidence of:

- requisite scale/FUM and the associated relationship networks
- broader skill sets (i.e. not just traditional bottom-up stock selection skill) to identity the most relevant opportunities but also implementation hurdles
- exceptional engagement skills and gravitas with company managements/boards (including advisory skills)
- high quality full coverage research (ideally public and private markets experience) but also dedicated and accountable strategy-specific resourcing
- valuation also being key to constructing portfolios with strong downside support and asymmetric upside, given high levels of stock-specific risk
- superior stock selection skill!

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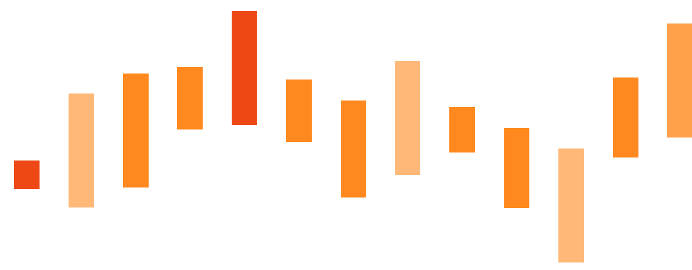
Table 5: Pros/cons of domestic activist strategies

Pros	Cons
Potential for less correlated sources of alpha.	Higher fees than typical concentrated offering but appears meaningful scope for negotiation for large funds (including fee structuring).
A more liquid alternative to generating potentially outsized, PE style returns.	Very high tracking error adds to YFYS benchmarking risk.
A more scalable niche (where large/mid-cap focused) for larger supers.	Few long-term track records running activist-focused strategies.
Opportunities for co-investment.	Narrower engagement opportunity set (large/mid-cap) in Australia relative to pursuing an activist strategy in other markets.
Deep research undertaken on a focused number of stocks, which is often centered on less obvious and more labor-intensive pathways for value creation.	Large residual style/sector skews (stemming from highly concentrated portfolios) have the potential to dominate stock-specific drivers (including identified engagement catalysts) at times. This can also reduce the effectiveness/relevance of traditional attribution analysis.
Highly conducive regulatory landscape.	New ideas and exits can also drive meaningful changes in portfolio characteristics.
Significant levels of institutional ownership also supportive.	The profile & engagement style of some forms of activism (or specific escalations) may not align with the long-term approach of some supers.
Can align/contribute to total portfolio ESG objectives.	
Evergreen structures should improve alignment with investor horizons and liquidity flexibility for a listed equities exposure.	



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The final word

This paper presents a focused list of niche ideas for expanding into return-enhancing areas. However, there is a much broader range of strategies that could fit under an investor's opportunistic bucket (depending on fit).

This could extend to a dedicated allocation to other regional strategies like Indian equities; private equity; other activist opportunities benefitting from major reforms (like Japan) just to name a few. Specialist climate-focused strategies is another area that is sometimes bucketed as opportunistic, given they tend to share a number of characteristics common to niche strategies by virtue of their typically higher tracking error approaches. Notwithstanding, Frontier generally views these specialist 'green' strategies as one of the building blocks of a portfolio's overall decarbonisation strategy rather than a standalone, return-enhancing opportunistic idea.

While our research to date has been limited to manager engagements in some of these areas, within other areas like climate specialist or small caps we have a number of open and recommended strategies for clients. We intend to continue to rollout a steady pipeline of new ratings within the most relevant and compelling opportunistic areas for all investor types, albeit superannuation funds will need to be cognisant of Your Future Your Super (YFYS) considerations.

Want to learn more?

If you want to learn more about opportunistic ideas for a challenging return outlook, Frontier can help. Please reach out to your consultant or a member of the Equities Team.

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