



GATEWAY INSIGHTS

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18 Specialist Australian equity funds - making sense of it all

The Australian funds management market over the past five years has seen an unprecedented increase in the number and types of 'Australian Equity' funds available to investors. Ten years ago when investors were making allocations to Australian Equities they were typically long only and the decision process was centred on the combination of value, growth or style neutral managers.

Today investors in managed funds have on offer a large number of ways of investing in the Australian Equity market. Investors now have the choice of several different types of specialist Australian equity funds – this includes standalone variable beta funds, multi-strategy funds, market neutral funds, long/short funds, absolute return funds and more! In this Insight we examine how this continued evolution of funds is being led by investors, ratings agencies and market uncertainty.

The rise and rise of specialist equity funds

There are a number of possible explanations for the rising interest in specialist equity funds. The post global financial crisis has created an uncertain environment, investors want reduced volatility but with equity market or better returns as well as downside protection. In the US and UK markets there are a plethora of funds like this available and there is no doubt that Australia currently lags these markets, therefore it may be a case of Australia attempting to emulate trends in global markets. Or perhaps, rising interest is because the sophistication of

Australian investors has increased, and the understanding and use of alternative investments is on the rise. Or is it being led by the institutional consultant community which is having a flow on effect to retail gatekeepers and investors? Whatever the motivation, most investors now realise that with long only exposure and no ability to short, it is much more difficult to take a defensive position when markets are volatile. In Gateway's view a combination of all of the factors above has coincided to make these products the products which are attracting the most attention amongst Australian Equity offerings at present.

What's happening globally?

The Wall Street & Technology Journal¹ reports that in the first five months of 2010, investors in the US poured \$4.2 billion into "absolute return" US equity type mutual funds. The basis of this according to the Journal was investors looking for safety post the global financial crisis. Inflows of this magnitude demonstrate that in the US and globally assets under management in this sector are attracting unprecedented attention.

Scott Burns from Morningstar Inc² believes these types of funds now are very powerful as investors, post the global financial crisis, understand much better that there are risks in investing ie. investments can be volatile and strategies used by specialist equity funds have shown they can reduce this volatility.

Australian research house, van Eyk Research, have recently released their Australian Equities Specialist Funds review. Findings from this review showed that over a three year period to December 2009 that the Australian Equity Specialist managers in the review had "exhibited much lower volatility than the S&P/ASX 300 while significantly outperforming it"³.

The view of their senior analyst Chris Bigg is that managers in this sector "can generate alpha from a wider opportunity set due to their ability to short sell and use derivatives"⁴. The inference being that this gives managers greater scope than a long only strategy could ever achieve as they can vary their net market exposure easily and cheaply.

¹ June 18th 2010 Article No 225700611

² Wall Street & Technology Journal; June 18th 2010 Article No 225700611

³ Money Management, Aust Equities Specialist Funds More Appropriate in Current Climate by Caroline Munro, 25th June 2010

⁴ Investor Daily, van Eyk Critises Specialist Managers, By Vishal Teckchandani, Mon 12th Jul 2010

Institutional penetration vs retail?

In Australia institutional asset managers have definitely led the way with regards to product development and launch. This has over the past few years flowed into the retail space with many managers now offering retail versions of their specialist equity funds. They are also now included on many administration platform menus. The Macquarie Wrap menu, one of the leading industry platforms offers, in their Australian Equity category, a choice of both long/short managers and absolute return managers, some with well known brands, and some new managers.

In the institutional space as an example, JANA Investment Consulting now offer investors a multi manager option for long/short investing - the JANA Australian Share Long/Short Trust which has a line up of three underlying long/short managers, Acadian, BT and Tribeca. This product is available to retail investors through administration platforms.

Implications for fund managers

The increased interest in specialist equity funds creates implications of the for Australian Equity managers - both for those offering these types of strategies and for those who don't. Some of these are:

- **Niche sector** – for those managers wishing to enter this segment by extending their long only capabilities, this is a small but growing sector. There is less competition, but less allocation of funds under management.
- **Capacity** – for some successful existing managers capacity has become an issue. So for those with a track record, and sound investment performance this is an opportunity to pick up market share in this niche category.
- **Risk management** – there is an increased focus on risk management for these kinds of strategies and detailed guidelines need to be put in place which deals with the broader limits.
- **Marketing** – there are a plethora of long only managers in the Australian market, careful branding of funds and strategies will assist investors to find the right Fund for them.
- **Asset allocation** - increased competition for 'vanilla' equity managers from 'specialists' may need smarter marketing, particularly around blending implications.

Head of Alternative Assets Research at Zenith Investment Partners, Daniel Liptak says these funds need to be assessed differently than their long only counterparts. For long only and specialist managers Zenith's overall assessment is based on product structure, business management and investment management. Areas of particular focus for specialist equity managers then also include a key focus on risk management – how independent is the risk management, how is it measured and what the manager's reaction to risk is. Appropriateness of structures, is also a key consideration for these products – this includes fund domicile, liquidity, performance hurdles, investor mix and after fee performance.

In summary

The popularity of specialist equity fund strategies is likely to increase in continuing uncertain market conditions as fund managers and investors look to reduce volatility and risk. As asset consultants and research houses increase the number of managers they cover and investors become more comfortable with the ways in which these funds operate, this space of the Australian equity market is likely to attract continuing and increasing attention. For an Australian equity fund manager looking to diversify their product range, a break-out specialist equity strategy fund managed to the same philosophy and underlying investment process, should be given some consideration.

About Gateway

Gateway Financial Marketing (Gateway) was established in February 2004 by Amanda Rethus and Edwina Best for the purpose of offering fund managers, other product providers and international new entrants, expert advice, services and assistance in negotiating entry into the Australian Retail Financial Services market. Use of Gateway's services provides the opportunity for clients to overcome the hurdles that can often confront fund managers when transitioning from institutional to retail and hence improve participation in retail funds flow. Prior to Gateway, Amanda and Edwina spent over 30 years combined with major institutions in the Retail Financial Services market.

Our qualifications

Amanda has over 20 years experience in the Financial Services industry and was formerly a Divisional Director in the Financial Services Group of Macquarie. Amanda managed investment portfolios for over 10 years, and has spent in excess of 10 years introducing investment products to the Australian Retail market.

Edwina has a Bachelor of Business from UTS majoring in Marketing and International Business. She has over 12 years experience in the financial services market, concentrating in relationship management, product management and marketing. They both have extensive contacts in the retail financial services market especially with key decision makers.

If you would like to confidentially discuss your current approach to the retail market or have any questions on the above please do not hesitate to contact us – Edwina 0404 046 179 or Amanda or 0414 658 323.