

<https://blog.en.erste-am.com/alternative-investment-strategies-part-2/>

Alternative investment strategies: part 2

Gast-AutorIn / Guest Author



Author: Christian Süttinger
Senior Fund Manager Multi Asset Management

*Christian Süttinger, Senior
Fund Manager*

After illustrating what alternative strategies are in part 1 of this series, how they work, and what benefits and disadvantages they come with, we would now like to discuss some of the most important representatives of this set of strategies. In the following strategies (also called hedge funds), the majority of the capital invested is allocated to alternative models.

Long/Short-Equity Market Neutral

In this strategy, the fund manager analyses individual companies with the goal of identifying winners and losers and investing in both at the same time. On aggregate, this leads to a portfolio that is composed of shares with attractive fundamental data (balance sheet ratios) and valuations (long portfolio) and on the other hand shares with negative fundamentals and/or unattractive valuations (short portfolio). The short portfolio bets on falling share price via short-selling. In the optimal case, the aggregate portfolio benefits from rising share prices (long portfolio) as well as from falling ones (short portfolio). Both components contribute to the overall return of the aggregate portfolio. Given that long and short portfolio are constructed independently, the performance of the strategy is relative stable overall.

The selection of the shares for the respective portfolio (long or short) can be handled by the investment management team directly (experts) or via computer models. The expertise lies with the manager and his/her assessment of the situation and the perspective of companies and sectors.

When the share prices de-couple from their so-called intrinsic value (which is based on fundamentals such as company earnings, dividends, sales etc.), for example in situations where "cheap" money causes asset inflows without the valuation of certain shares playing a commensurate role, it becomes tricky. An example is the European Central Bank (ECB) and its policies. The decision by the ECB to not only pursue a zero-interest rate policy but to also act as buyer of corporate bonds has led to a situation where European shares have de-coupled from their intrinsic values, experienced rising valuations, and thus become more "expensive". Sudden changes in the earnings outlook of sectors that may be triggered by economic turning points are also problematic. For example, the expectations for global economic growth were negative at the beginning of 2016, a situation triggered by worrisome forecasts for China. But the picture brightened shortly thereafter, as a result of which the global economy returned to its growth path.

In the "market neutral" version of this strategy, the dependence of the portfolio on the stock exchanges is neutralised. This prevents the fluctuations that stock markets generally experience from feeding through to the bottom line.

Long/Short Equity Variable Bias

In the "variable bias" version, the dependence of the portfolio on the stock exchanges is actively managed (by the manager) and, in the optimal case, is positive for rising equity markets and neutral or negative for falling ones. The fund performance thus hinges on both the analytical competence of the management team and the market assessment.

Global Macro

Followers of this strategy invest in equities, bonds, currencies, commodities, and interest rate products on the basis of a total macroeconomic picture. The strategy allows them to benefit from rising and falling prices and trends. A total macroeconomic picture is for example painted by economic indicators and sentiment barometers, historic data, and the experience of the fund management team. For instance, in a scenario of interest rates rising sustainably and causing falling bond prices as a result, a Global Macro fund may remain invested in bonds and even benefits from this development.

Global Macro involves the (risk-) controlled allocation of capital to those asset classes where economic data and historic models are suggesting the best outlook. The identification of the stage of the economic cycle a country is in, economic imbalances, and shifts between economic areas are factors that affect the composition of the fund portfolio. For example, currencies tend to react very sensitively to economic data and central bank policies.

The strategy often involves setting up a relationship between two developments prior to investing in one or both. For example, the economic development of country A relative to country B. As a result, it is the investment idea that is responsible for the success, not the sentiment on the stock exchanges overall ("relative value").

CTA Managed Futures

CTA is short for Commodity Trading Advisors, i.e. it refers to managers of special investment products. With CTA Managed Futures, the manager looks for trends (momentum) in the asset classes of equities, bonds, currencies, commodities, and interest rate products with the help of information technology. Once a trend has been spotted (up or down), funds are invested systematically. After the expected end of the trend in an asset class, the capital is withdrawn and reinvested in another trend. In order to rule out an emotional component and to diversify the risk, investments are made across numerous different markets. In an optimal scenario, the actual length of an upward or downward trend coincides with the expected length of the trend as modelled for the fund.

Performance issues may arise in connection with this strategy if important trends, i.e. those with high asset allocation, end abruptly or many asset classes are suddenly behaving identically (i.e. are falling or rising at the same time), as sometimes happens under specific circumstances. An example of such a scenario was the announcement by the US Fed in 2013 to curb its supportive monetary policy. The market participants had not expected this to happen in quite that fashion. As a result, shares and bonds were falling at the same time. Both asset classes had been rising significantly prior to that announcement.

Conclusion

Long/short equity strategies can be beneficial if the investor wants to invest in equities but considers them expensive, i.e. overvalued.

Global Macro and Managed Futures have been quite good at shielding investors from the turbulences of the equity market in the past. They are "all-weather" strategies and are also suitable as complement in a mixed equity and bond investment strategy.

Please look out for the third part of our blog series, where we will be introducing further representatives of the alternative strategies.

The author:

Christian Süttinger has been with ERSTE-SPARINVEST KAG since 2002. He is Senior Fund Manager in the Multi-Asset-Management team for alternative strategies. He holds a MSc (Business Administration) from the Vienna University of Economics and Business Administration and has been Chartered Financial Analyst and Chartered Alternative Investment Analyst since 2009 and 2010, respectively.

Legal disclaimer

This document is an advertisement. Unless indicated otherwise, source: Erste Asset Management GmbH. The language of communication of the sales offices is German and the languages of communication of the Management Company also include English.

The prospectus for UCITS funds (including any amendments) is prepared and published in accordance with the provisions of the InvFG 2011 as amended. Information for Investors pursuant to § 21 AIFMG is prepared for the alternative investment funds (AIF) administered by Erste Asset Management GmbH pursuant to the provisions of the AIFMG in conjunction with the InvFG 2011.

The currently valid versions of the prospectus, the Information for Investors pursuant to § 21 AIFMG, and the key information document can be found on the website www.erste-am.com under "Mandatory publications" and can be obtained free of charge by interested investors at the offices of the Management Company and at the offices of the depositary bank. The exact date of the most recent publication of the prospectus, the languages in which the key information document is available, and any other locations where the documents can be obtained are indicated on the website www.erste-am.com. A summary of the investor rights is available in German and English on the website www.erste-am.com/investor-rights and can also be obtained from the Management Company.

The Management Company can decide to suspend the provisions it has taken for the sale of unit certificates in other countries in accordance with the regulatory requirements.

Note: You are about to purchase a product that may be difficult to understand. We recommend that you read the indicated fund documents before making an investment decision. In addition to the locations listed above, you can obtain these documents free of charge at the offices of the referring Sparkassen bank and the offices of Erste Bank der oesterreichischen Sparkassen AG. You can also access these documents electronically at www.erste-am.com.

N.B.: The performance scenarios listed in the key information document are based on a calculation method that is specified in an EU regulation. The future market development cannot be accurately predicted. The depicted performance scenarios merely present potential earnings, but are based on the earnings in the recent past. The actual earnings may be lower than indicated. Our analyses and conclusions are general in nature and do not take into account the individual characteristics of our investors in terms of earnings, taxation, experience and knowledge, investment objective, financial position, capacity for loss, and risk tolerance.

Please note: Past performance is not a reliable indicator of the future performance of a fund. Investments in securities entail risks in addition to the opportunities presented here. The value of units and their earnings can rise and fall. Changes in exchange rates can also have a positive or negative effect on the value of an investment. For this reason, you may receive less than your originally invested amount when you redeem your units. Persons who are interested in purchasing units in investment funds are advised to read the current fund prospectus(es) and the Information for Investors pursuant to § 21 AIFMG, especially the risk notices they contain, before making an investment decision. If the fund currency is different than the investor's home currency, changes in the relevant exchange rate can positively or negatively influence the value of the investment and the amount of the costs associated with the fund in the home currency.

We are not permitted to directly or indirectly offer, sell, transfer, or deliver this financial product to natural or legal persons whose place of residence or domicile is located in a country where this is legally prohibited. In this case, we may not provide any product information, either.

Please consult the corresponding information in the fund prospectus and the Information for Investors pursuant to § 21 AIFMG for restrictions on the sale of the fund to American or Russian citizens.

It is expressly noted that this communication does not provide any investment recommendations, but only expresses our current market assessment. Thus, this communication is not a substitute for investment advice, does not take into account the legal regulations aimed at promoting the independence of financial analyses, and is not subject to a prohibition on trading following the distribution of financial analyses.

This document does not represent a sales activity of the Management Company and therefore may not be construed as an offer for the purchase or sale of financial or investment instruments.

Erste Asset Management GmbH is affiliated with the referring Sparkassen banks and Erste Bank.

Please also read the "Information about us and our securities services" published by your bank.

Subject to misprints and errors.



Gast-AutorIn / Guest Author