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Alternative investments defy market losses

Christian Süttinger, CFA



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In unsafe times, it is advisable to diversify one's portfolio as broadly as possible. The current scenario – a highly charged mix of extraordinarily high inflation, the central banks' fight and intensifying restrictions against it, and the weakening global economy that may result in a recession – has led almost all asset classes to incur significant losses since the beginning of April: equities, government bonds, corporate bonds, inflation-linked government bonds, industrial metals, gold, and crypto currencies. In the past, these assets – which are crucially uncorrelated, based on a historical perspective – have rarely shed value at the same time. This illustrates the high level of fragility in the sentiment of investors. During the period in question, there was (almost) no place for them to hide.

Only one asset class managed to cut itself off from the rest: alternative investments, which are easily accessible for clients of Erste Asset Management via [Alpha Diversified 3](#) – a fund with a long track record. Our fund manager Christian Süttinger explains how this was possible and what instruments are available to this alternative fund in the following interview.

The extreme volatility on the equity markets and the tense situation on the bond markets are challenging for fund managers at the moment. What is the status quo? Are we at the beginning of a bear market or at the end of a correction?

An economic and geopolitical environment such as the one we are currently finding ourselves has limited historical precedent. But it still makes sense to draw comparisons. For an idea about effects of the central banks' willingness to dampen inflation "at any cost", we can look at the USA in 1981 and 1982. Back then, under Paul Volcker, significant interest increases ultimately led to a weakening economy, which largely resolved the inflationary pressure. A similar scenario may occur in 2022 and 2023. The enormous, pandemically induced demand for goods will decline in favour of services. Due to the increased prices, consumers can already feel a decrease in purchase power. Also, the bottlenecks in global supply chains, which cause inflationary pressure, will improve over time. In other words, if we look at the history of bonds, we can reasonably expect them to bottom out first, and relatively quickly at that. Maybe they have already done so? Share prices should follow suit at a time lag and beat today's prices within twelve months. The risk for this scenario is a noticeable global recession – but so far, there are no signs for it.

□ *"There are currently no signs for a noticeable global recession"*

Christian Süttinger, fund manager Alpha Diversified 3

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What can investors do to stabilise their portfolios?

It is crucial to make use of all available asset classes and investment concepts. Different components will work well in different phases. The fluctuation in the portfolio can be contained by broad diversification. An asset class that is sometimes overlooked are alternative investments. By our definition, those are strategies that can easily be traded daily or weekly. They offer ideas and concepts that cannot be found in other asset classes.

One good example is the chance to benefit from falling bond prices, which has provided the investors with welcome surplus gains in the year to date. Trend-following strategies (managed futures) and global macro strategies, which are multi-asset funds, can open short positions, i.e. they can bet on, and benefit from, falling prices. This has always been an effective way to protect one's portfolio from high inflation and interest rates reversals.

Managed Futures: fund managers create portfolios from all available asset classes (equities, bonds, interest rates, currencies, commodities) on the basis of trend-following models, i.e. without manual interventions.

Global Macro: fund managers create portfolios from all available asset classes on the basis of economic data. The portfolios may benefit from rising and falling prices. The fund management team is responsible for the strategy of the portfolio.

Another set are equity strategies that create a portfolio from expected winners (long) and losers (short) and actively manage or neutralise the dependence of the finished portfolio on the equity market. This is less complicated than it sounds. Long/short strategies offer the chance to put equities to good use for the client. By comparison with the equity market itself, the fluctuations of the fund remain limited.

Long/Short-Equity: fund managers create portfolios from expected winners (long) and losers (short). The dependence of the portfolio on the equity market is limited and ranges from neutral (0 to about 20%) to about 40%. Price fluctuations are much more contained than for the equity market itself.

Lastly, there are also strategies that are based on proprietary investment ideas, almost completely unaligned with traditional equity and bond funds. Among them are, for example, alpha strategies in the commodity sector, to which financial investors only have access via futures. As is equity index arbitrage, which exploits the fact that companies are constantly being admitted to, or taken out of equity indices, which, to a degree, leads to foreseeable, short-term price fluctuations.

We maintain an overview of the investment ideas available and check them for plausibility and likelihood of success. Then, we choose the various components step by step and combine them in the portfolio, which creates added value. We strongly advise not to overlook the asset class of alternative investments. The dramatic losses in share and bond prices since the beginning of April are a good example for the relevance of portfolio components that can self-isolate.

How do you handle the high fluctuations that we see on some days? Trends are hard to establish in such a market.

For Alpha Diversified 3, we have 15 years of experience and select the most promising strategies that are then implemented by our fund managers. This way, we are "idea managers", so to speak. We can maintain our overview while our managers apply their experience and systems to our daily business.

We have heard the term "decade of commodities". Are commodities the new gold in portfolios?

There are two diametrically opposed factors that tend to drive commodities. On the one hand, we can see an enormous demand overhang since the COVID pandemic. This is largely due to the pronounced consumption frenzy for goods that were not accessible during the lockdowns, and it is at the service sector's expense. This effect was exacerbated by far-reaching production halts. On the other hand, we have noticed in the past that the supply of commodities would usually manage to keep up with demand, albeit with a delay. This delay, which may well take years, is caused by the fact that the expansion of production on oil and gas fields and in mines requires a high level of investment. The commodity index below illustrates that the long-term trend is not entirely clear.

Commodity price performance, 30Y

Sources: Bloomberg; Bloomberg Commodity Index TR; 04/1992-04/2022

Note: "Past performance is not a sufficient indicator of the future performance of the fund".

As the chart shows, commodity prices have not reached 2008 or 2011 levels this year despite the "price explosion". Commodities offer welcome diversification for portfolios and are a good protection against inflation. But we cannot guarantee that this trend is set to continue. In the commodity sector, we think that industrial metals have the best long-term outlook. They are indispensable for the necessary transition to clean energy and for the achievement of the global climate goals. The storage and distribution of electricity is impossible without industrial metals.

Conclusion

The losses of equities, bonds, and gold since the beginning of April have put the limelight on the asset class of alternative investments. The [Alpha Diversified 3](#) fund provides easy access to this asset class, and Erste Asset Management has years of expertise in this field.

Risk notes according to 2011 Austrian Investment Fund Act

Alpha Diversified 3 may make significant investments in derivatives (including swaps and other OTC derivatives) pursuant to section 73 of the 2011 Austrian Investment Fund Act.

Alpha Diversified 3 may make significant investments in investment funds (UCITS, UCI) pursuant to section 71 of the 2011 Austrian Investment Fund Act.

The fund employs an active investment policy and is not oriented towards a benchmark. The assets are selected on a discretionary basis and the scope of discretion of the management company is not limited.

For a glossary of technical terms, please visit this link: [Fonds-ABC | Erste Asset Management](#)

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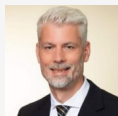
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