FIVE LEADING EXPERTS GIVE THEIR VIEWS ON FUND MANAGER + INVESTOR OPPORTUNITIES

In conversation with G+T Investment Law Partner, Nathan Cahill.

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I have always loved the idea of turning $1 into $100. And as such I have spent a good part of the last 20 years helping fund managers design investment products for target markets. Whether it be the Metrics credit listed funds that moved the market or Ellerston Capital's first platform listed early stage fund, or the first long term hold funds for Brandon Capital, I love building things that are new and for the future.

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So with the investment landscape for investment products having changed remarkably over the past year I ask our panel of five of Australia's leading fundraising experts what they see as the opportunities for fund managers and investors over the next two years or so.

I am doing this because having worked on the commercial and legal front through three major financial market events over the past 20+ years (the tech wreck; the GFC and now COVID-19) there are familiar patterns and opportunities for fund managers and investors in these times.

Whilst share markets in 2020 may tell a different story, increased sovereign debt, very low interest rates, coming inflation and sustained higher unemployment will both provide opportunities and close the door on some traditional investment approaches. There is a general consensus amongst leading managers that I have been speaking with that these dynamics will remain for a good part of the next five years to a decade. No matter what your view we know that this will not be a return to normal investment behaviour for quite some time.

Before we hit our panel below my observations based on the products we have been designing and seeing perform in the market are:

PE & VC hole: There is a lack of some alternative investment opportunities like PE and VC for retail and retail HNW investors. Investors are looking for exposure to get tax effective higher returns but struggle to find them.

Alt credit going up: Alternative credit is growing rapidly and will become a mainstay of investment portfolios going forward as it as in the EU and USA.

Fees and costs: Superannuation funds remain overly pre-occupied with fees (driven by RG97, benchmarking and government rhetoric). Unfortunately the original intention of driving net returns in retirees' pockets has been lost in a number of cases. This has been driving investment allocation.

New regulation: ASIC has been stepping up its scrutiny of products and managers and with the new product design and distribution obligations retail investors may be further starved of certain types of products.

Impact: There is a great investor appetite for compelling impact investment opportunities however there is not enough quality product to meet this demand.

Inflation: Lastly, inflation driven by the cheap available credit is starting to drive allocation thinking and interest in real estate and infrastructure.

1. WHERE ARE THE FUND FLOWS AT THE MOMENT?

CESAR FARFAN
Perennial Value Funds

Flows in passive ETFs continue to be very strong, as managers continue to struggle to outperform their respective benchmarks. It has been a tough time for value managers. Absolute return active managers (eg long/short, market neutral) plus small, microcap and private assets have also been strong beneficiaries with their ability to generate alpha for clients.

GREG FENDLER
Intermediate Capital Group

Initially in late March & April there was a flurry of rebalancing activity into liquid credit markets e.g. High Yield and Syndicated Loans given the dramatic sell off. That move has paid off nicely given the reflation trade, off the back of massive Central Bank and Fiscal stimulus globally in response to covid-19.

There have been some early allocations to opportunistic credit strategies with many institutional investors still exploring this space as there has been a flood of strategies coming to market in the past 6-12 months. Due to the rally back in public markets alongside the fiscal stimulus there has been less immediate stress versus expectations, but most still expect there will be opportunities arising over the coming 1-2 years.

Lastly, after recovering from the initial covid shock in Q2/Q3 and seeing the resilience of senior private debt strategies investors' belief in lower for longer has driven them back to this asset class in search for stable higher yield.

KEN LICENCE
Principle Advisory

In the first few months of COIVD investors were looking for liquid/trading opportunities to take advantage of mispriced and undervalued securities across equities and fixed interest. This has been predominantly at the HNW and Family office as well as the more nimble super funds. This initial trading had typically been in direct securities but of more recent times the focus has shifted to funds as the markets and currency have stabilized and there is greater clarity around asset allocation and liquidity requirement. Credit/distressed strategies, PE secondaries, as well as assets that will provide an ongoing yield -Property/ Infrastructure (as we go into a lower for longer real return environment) will be of interest.

NICOLE CONNOLLY
Allegro Funds

Investor flows in the PE space have largely been to existing managers, as due diligence in a post-COVID world is more challenging without the ability to visit managers onsite. Raising capital from new investors has proven more difficult in this environment. Additionally, the length of time required to conduct appropriate due diligence virtually has lengthened - deeper and more expansive reference checking is occurring before investors are committing to funds.

JOSH PEEL
Partners Group

We have had successful closes for our infrastructure and private equity fund offerings and strong institutional demand for our diversified SMA solution that allows clients to pivot between strategies and asset classes. Credit and secondaries have received a lot of interest. New relationships with new managers have to clear a VERY high bar.

2. WHAT WOULD YOU DO AS A FUND MANAGER IN THIS MARKET TO INCREASE FUM?

CESAR FARFAN
Perennial Value Funds

Focus on the client and ensure you can generate alpha and/or meet your stated objectives. Be an asset manager and not an asset gatherer. We have found strong demand in our Microcap, Private to Public strategies. On the credit fund, Daintree's absolute return credit fund has had strong flows, generating reasonable levels of income and preserving capital is challenging in this environment. On the global front, Fairlight's global small to mid-cap fund has also generated strong alpha, once again an under researched and difficult area of the market to access.

GREG FENDLER
Intermediate Capital Group

Primary focus on making sure your existing clients are well serviced with lots of communication on their current investments with you through this difficult period. This will build long-term trust and opportunities to grow your relationship with them.

Remaining active in speaking with prospective clients as despite the higher bar given covid-19 restrictions to on-board new clients there are still opportunities to grow business with many investors looking to make opportunistic allocations or undergoing larger portfolio strategy shifts in response to the COVID/post COVID world we live in.

KEN LICENCE
Principle Advisory

One of the key challenges fund managers face is how do they engage/re-engage with investors given the reality that international travel will most likely not be allowed for at least another 9-12 months. Managers need to be encouraging investors to undertake online due diligence and give them the comfort and confidence that they can get to know the manager and underlying assets using virtual methods only.

Fund managers that have already established trusted relationships and dialogues with investors have a distinct advantage in the short term. They should move quickly to leverage this advantage particularly where you can build on an existing capability and offer new products builds.

NICOLE CONNOLLY
Allegro Funds

Stick to what you do well. There will no doubt be opportunities across sectors and strategies as government support rolls off. It is a great opportunity for many to buy well, but particularly those managers with skills in buying and turning around operationally and fiscally challenged companies.

I would also highly recommend 'over communicating' with your investors. There is a lot of uncertainty out there with snap changes to travel, retail closures, stay-at-home measures etc. Clearly articulating measures that you have in place to minimise the impact on your portfolio companies will provide investors with a level of comfort.

Finally, I would recommend using this opportunity to highlight to prospective investors how you as a manager have handled COVID, the measures that you adopted to improve the resilience or defensiveness of your portfolio and showcase the opportunities that uncertainty and a challenged environment can bring to you as a manager if applicable.

JOSH PEEL
Partners Group

Better understand the challenges faced by clients. For example, we have worked to create solutions that allow flexibility in client portfolios, our SMA clients are always able to scale up and down the pace of deployment of their portfolio. In times like these it is extremely difficult to understand where you will be next month let alone 6 months, with ERS and other external impacts on flows. Working across asset classes allows clients the flexibility to pivot into areas they and/or we see value and opportunity.

3. WHAT PRODUCTS WOULD YOU BUILD?

CESAR FARFAN
Perennial Value Funds

We've been building absolute return products with a focus on under researched sectors of the market or difficult to access sectors, like private companies. More Australian companies are staying private for longer and looking to partner with companies like Perennial who can provide access to growth capital and expertise in getting the business IPO/trade sale ready.

GREG FENDLER
Intermediate Capital Group

As investors are looking for bond alternatives; a global income focused product that invests across a diverse set underlying alternative asset classes e.g. senior RE Debt, senior corporate loans, structured debt, and Asset backed income securities. The common theme being contractual income, senior ranking security and lots of diversity.

More specifically, Real Estate is interesting given the significant impacts of COVID on the asset class and banks continuing to withdraw from lending to the sector. This dynamic creates new risks to consider, but also shakes loose a variety of interesting opportunities.

KEN LICENCE
Principle Advisory

Investors will look for managers that have been through a cycle and have a proven track record.

As opportunities in fixed interest and equities become less obvious, investors are starting to look for longer-term dislocation investment opportunities and are also starting to re-focus on illiquid investments such as private credit, stressed/distressed opportunities, niche and yielding real asset strategies backed strongly with covenants over the assets. Private equity secondaries are also of interest.

NICOLE CONNOLLY
Allegro Funds

The same products we always have! Allegro has continuously focussed on turnaround, distressed and transformational companies. Opportunities always exist as poorly managed companies, industries that are exposed to secular downturns and companies requiring significant operational improvements to kick start growth will always be around. There will simply be more of these opportunities for Allegro as government support rolls off. I wouldn't build additional products; I'd build a bigger team!

JOSH PEEL
Partners Group

An Alternatives solution that meets the needs of the local market and satisfies their reporting. There will have to be a point of compromise from the funds where they recognise the need to include alternatives more broadly in their portfolios. The evolution of the defined contribution (DC) plans in the US will have impacts here.

4. WHAT ARE THE OPPORTUNITIES POST COVID – 19?

CESAR FARFAN
Perennial Value Funds

Businesses that can benefit from the continued digitisation of the economy, fin-tech, health-tech, medical diagnostics and remote learning.

GREG FENDLER
Intermediate Capital Group

While we are not out of the woods yet, senior secured private debt is holding up well through what one could argue is an ultimate test for a relatively new asset class that only rose to prominence post the GFC for institutional investors. Given the "lower for longer" expectation private debt should be a beneficiary post COVID for managers who have been able to protect investor capital through the crisis.

In the RE space long dated triple net lease strategies are interesting given they provide a level of inflation protection.

KEN LICENCE
Principle Advisory

Yielding real asset strategies. Strategies that are taking off the long-term sector growth such as technology, healthcare.

NICOLE CONNOLLY
Allegro Funds

If I look at this question from an investor's perspective (my own!), I'd say equity valuations are high and credit is tough. Property and infrastructure will continue to benefit from the 'lower for longer' interest rate environment. Additionally property and infrastructure will benefit as valuations improve post initial COVID write downs.

JOSH PEEL
Partners Group

Opportunities will be for those who are getting set now with dry powder and flexibility. Investors have faced a very difficult time in 2020 with valuation impacts, shuffling of Asset Allocations and ERS having massive impacts on long term planning. There will be opportunities to invest into secondaries across all assets as investors seek to rebalance portfolios. There will be opportunities because of the huge amount of infrastructure needed across many parts of our economies (and government spending to stoke growth) and further focus on renewables.

5. ANYTHING ELSE YOU WOULD LIKE TO ADD?

CESAR FARFAN
Perennial Value Funds

Important to continue to find ways to engage with clients – webinars, Zoom lunches, virtual conferences, small lunches. We are going to be in this pattern for a while, let's get use to it and get better at it.

GREG FENDLER
Intermediate Capital Group

Keep the spirits up! The human race has come through pandemics many times before and we'll come through this one too!

KEN LICENCE
Principle Advisory

There remains a continued and growing interest amongst the investor base in socially responsible and impact investing strategies. Strong ESG policies and credentials are an increasing area of focus for Australian investors when reviewing investment managers.

Valuations in the some technology based companies starting to become highly exuberant - Tesla is now the 6th largest company in the US and the highest valued car maker in the world despite many others with far greater revenues and manufacturing far more vehicles. As Tesla only just got into the index as well creating some distorted buying behaviour.

NICOLE CONNOLLY
Allegro Funds

Check in with your investors regularly – ask what is working for them and what is not in this new environment. Change it up if you need to. We are all learning a new way of working and interacting, so it is important to be flexible. Most importantly chin up! History has shown us that investing in times of turmoil can yield the best results!

JOSH PEEL
Partners Group

Funds will need more than ever to try and differentiate their offering, and chasing peers for fee comparisons will not be the way to succeed. I do think the Australian Funds will be less of a focus with US DC plans coming online and start to explore investing into Private markets. With COVIDs impact on global travel, as well as new investors vying for relationships in the US, I believe there will be a shift away from Australian super funds whose first question is generally about fees and costs before they seek to understand capabilities and what it may do for their fiduciary clients?

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