Alternatives Symposium

Summary Report

23 February 2022
W Hotel, Melbourne VIC

Thinking outside the square
amid a shift in the market paradigm

Alternatives Symposium 2022

SYNOPSIS

The Inside Network's Alternatives Symposium welcomed financial advisers, asset consultants and family offices to collaborate and discuss the challenges faced in delivering CPI+plus returns over the next decade.

Investment decision makers face an uncertain period for portfolio construction after a prolonged era of productive years. The thirty-year tailwind of falling interest rates has dissipated, triggering a new paradigm which will challenge for the outlook for bond and equity markets. Many forecasters are predicting future returns from these traditional asset classes to be among the lowest in recent history.

In this unique environment, advisers and asset allocators are being encouraged to seek less conventional sources of returns and diversification to maximise the probability of delivering the heightened return expectations of clients.

Alternative assets have long been a core component of institutional portfolios, yet remain in their infancy within advised portfolios. Many of the issues driving the lack of adoption in private portfolios have dissipated with investors now able to access to a broader range of high quality strategies and seeing significant growth in the availability of liquid options.

With sub asset classes that span everything from real assets to private equity, venture capital and equity alternatives, the sector requires extensive knowledge and experience to navigate the unique opportunity set and due diligence requirements.

Despite this, the benefits are clear. Recent years have shown that the correlation and diversification benefits of alternative assets smooth returns during periods of volatility. As importantly, they can perform strongly when more mainstream asset classes struggle.

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Koda Capital

Angela Ashton
Evergreen Consultants

Mathew Jeremy
Caravel Consulting Services

Jake Jodlowski
Atchison Consultants

Christian Ryan
Beulah Capital

Matthew Scholten
Scholten Collins McKissock

Scott Carmichael
Escala Partners

Damian Cilmi
Praemium

Lukasz de Pourbaix
Lonsec

Will Hamilton
Hamilton Wealth Partners

Luke Laretive
Seneca Financial Solutions

Jeremy McPhail
FMD Financial

Aongus O'Gorman
Willis Towers Watson

Darien Reimann
Accord Financial Strategies

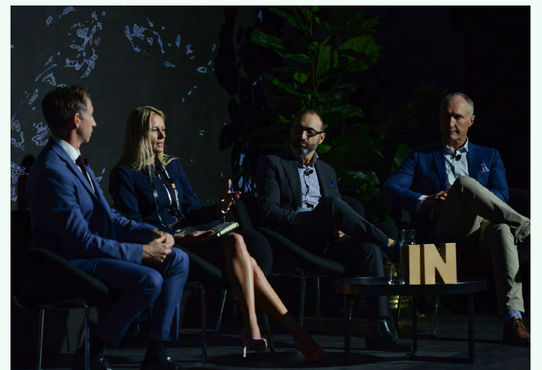
Vessela Tasker
Greenwood & Co

Dragana Timotijevic
AMP

Charlie Viola
Pitcher Partners

Education Partners

A snapshot



Session #1

Practitioners Panel - design principles for alternative allocations

Kerry Craig, J.P. Morgan Asset Management

KEY POINTS

- Expanding on the growing opportunity set within alternative assets, the line should be drawn between 'core' assets, being low volatility and regulated options, which is cycle agnostic, and then 'core plus' or more volatile strategies.
- The biggest driver of institutional capital flows into alternative markets have has been the search for income and stability of said income.
- Alternative asset growth and allocations reached $27 trillion in 2021, 25 per cent higher than 2020 and three times faster than public market allocations.
- Allocations to the sector should be split according to their underlying characteristics which focus on diversification, income or capital return driven.
- Institutional investors are increasingly seeking to protect their balanced portfolios from the downside, whilst also supplementing falling fixed income yields.

Felicity Walsh, Franklin Templeton

KEY POINTS

- Alternative assets can be anything outside your listed equities, income and cash holdings, with real estate and infrastructure traditional examples, but the ultimately objective being to find new return drivers.
- The most important part of portfolio construction in alternative assets is to understand what it is you are trying to achieve, growing capital, improving income or minimising drawdowns?
- Tail risk hedging is of increasing interest in the institutional world, where investors are paying a premium to protect against an equity market drawdown like today.
- Through decades of investment, institutional investors have paved the way for advised clients with more efficient and transparent fee and product structures.
- 2022 should an 'exciting' period for the adviser universe, with an expansion of opportunities in private markets and challenges for traditional asset classes.
- Investors must balance the benefits of correlation with the illiquidity risks, which is not a linear relationship.

James Edmonds, Praemium

KEY POINTS

- From a platform perspective, the evolution of private market investments has been significant and quick, but still in its infancy.
- Three key areas have attracted the majority of capital flows, beginning with income focus mortgage and debt investments, as well as innovation-focused and crypto-related strategies.
- The days of fund managers baffling people with their knowledge are gone, advisers simply won't allocate to strategies they don't understand.
- Administration, tax reporting and valuation remains the biggest challenge for advisers increasing the value of flexible platforms.
- Operational due diligence is the most difficult by the most important for advisers, that is in understand the actual terms of private investments, ability to service the end clients and provide transparency.
- There has been persistency in alternative asset allocations with capital flows tending to return to the same, trusted managers year after year.

Session #1

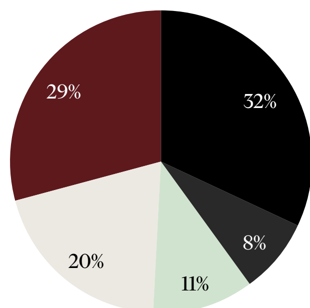
Practitioners Panel - design principles for alternative allocations

Charlie Viola, Pitcher Partners

KEY POINTS

- The last 20 years has rewarded advisers for being lazy, as passive equity and bond market returns supported all portfolios, but the next 10 years will require a different approach.
- It is up to the advice industry to demystify the alternative assets space and focus on educating clients. They are essentially traditional assets, wrapped in different ways.
- The ultimate objective of any allocation to any asset class is to generate returns in different ways, smoothing the long-term ride for investors and ensuring they can meet client drawdown requirements.
- Illiquidity should be of limited concern to financial advisers and clients within a long-term diversified portfolio but requires active management of cash flow timing and understanding client needs.
- Advisers face the difficult challenge of deal flow and due diligence on the broad range of managers, to simplify the process advisers should build their own matrix to understand what they will and won't invest into.
- Fund managers are in many ways like charities, in that every story and pitch you hear is among the best you have ever heard. This means advisers must have a strict framework in place to ensure a structured portfolio is constructed, tending to return to the same, trusted managers year after year.

WHAT IS YOUR PRIMARY RATIONALE FOR ALLOCATING TO ALTERNATIVES?



- Enhance returns
- Lower volatility and limited daily pricing
- Reduce risk of drawdowns
- Unique strategies that just make sense
- Correlation benefits

LEARNING OUTCOMES

1. Investing alternatives is inherently personal, more so than other asset classes, allocations must be tailored to the unique requirements of each investor.
2. Non-traditional income sources have been an area of focus, with significant capital flows seeking to bolster portfolios amid low bond yields and equity market volatility.
3. Alternative asset allocations remain in their infancy despite the allocating growing 25 per cent within portfolios compared to just 8 per cent in public markets.

Session #2

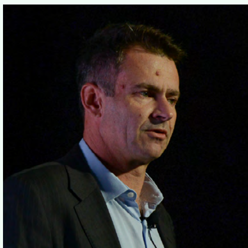
If you can't beat them - pre IPO to listed market options

Christian Munafo, GAM Investments

KEY POINTS

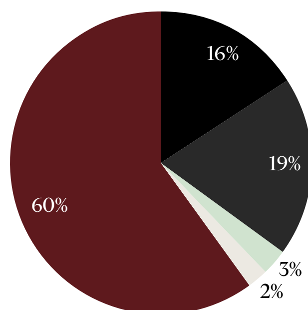
- More companies than ever are choosing to stay private and doing so for longer, meaning a large portion of returns is generate before they reach public markets.
- The number of investable companies on public markets is continuing to shrink, with many companies forgoing IPOs and in many cases selling via trade rather than listing.
- Amid a flurry of new funds and capital raisings, venture capital is highly inefficient and favours the experienced investor with established networks.
- In an environment flooded with capital, deal flow and access is among the most important inputs into success, with longevity and experience central to accessing the best deals.
- Private markets are better suited to fast growing companies operating in growth sectors given greater patience and higher levels of intangible assets.
- Increasingly, private markets are the only way to gain access to some of the most innovative and technology-driven sectors in the market, offering an important source of diversification.

James Brown, Barwon Investment Partners



KEY POINTS

- Despite the increasing competition and capital flowing into the sector, the size and scale of private markets is such that they remain among the most inefficient in the world.
- The information asymmetry and inefficiencies within the sector offer great opportunities for experience, active managers to deliver consistent returns.
- A private equity approach to investing into companies, seeking control, offering capital and patience is far superior to the short-term public market approach.
- Traditional private equity structures, requiring multi-year lockups and capital calls are difficult to stomach and not suitable for most investors, particularly retail clients.
- Advisers allocating to private markets face the dual challenge of diversification and vintage exposure in building portfolios across evolving client bases.
- Investing into publicly listed private market investment vehicles offers investors exposure to the unique return drivers of the sector without the drawbacks.



LEARNING OUTCOMES

1. More companies are opting to stay private and for longer, meaning allocations to private markets must grow to access the return drivers of the future.
2. Traditional, direct private market investments are not suited to the mass market, there are many alternative ways to gain exposure to the key sources of return within private markets.
3. Deal flow is among the most important determinants of success in increasingly competitive private markets, which requires experience, longevity and networks.

Session #3

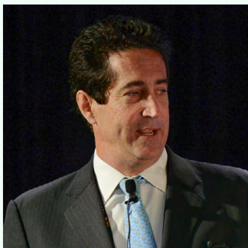
Tough love; allocating capital to private businesses

Claire Smith, Schroders Investments

KEY POINTS

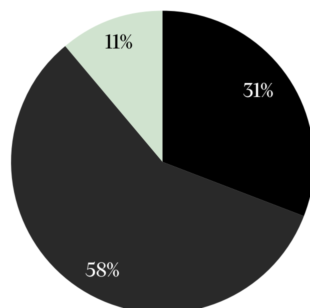
- Australian private equity offers a unique risk-return profile, with the opportunity set tilted towards more mature growth businesses.
- Private markets are better suited to niche, targeted strategies, with experience and skills in specialist areas and sectors.
- The traditional, illiquid, lock up structure of private equity is not suited to the mass market or large retail client base, more flexibility is required.
- Environment, social and governance considerations are not an overlay but a potential return amplifier in private markets given growing capital flows.
- Appropriate deal structuring and having multiple avenues to exit private market investments are central to long-term success.
- Asia and more specifically Australian private equity investments offer unique return benefits to equity-dominated portfolios.

Cameron Brownjohn, Federation Asset Management



KEY POINTS

- Investing in Asia is not as straightforward as investing in developed markets, it requires on the ground experience;
- As many as one third of companies in Asia are 'state-owned', run by politicians, not entrepreneurs;
- Asian and Chinese companies have evolved significantly in the last decade, investors should not give up 'quality' to invest in Asia;
- Asia has imported management and entrepreneurial skill from the rest of the world to become leaders;
- Transparency and honesty span borders and must be a key consideration of due diligence process;
- Asian consumers are increasingly turning to domestic businesses over Australian or global players;
- Technology companies behind traditional sectors, like Ping An Insurance, Huazhu Hotels are driving new leg of growth;
- Yum China, owner of KFC franchises, regards itself as a tech company selling fried chicken, such is their day-to-day decision making focus.



LEARNING OUTCOMES

1. Private markets, but particularly private equity offer a valuable source of diversification to challenged 40/60 portfolios.
2. Manager selection within private markets is paramount, with out performance tending to be persistent.
3. In a sector that is ripe for active management, skilled managers can utilise specific experience to deliver persistent returns.

Session #4

To be or not to be – equity alternatives

Lewis Prescott, Mingshi Investment Management

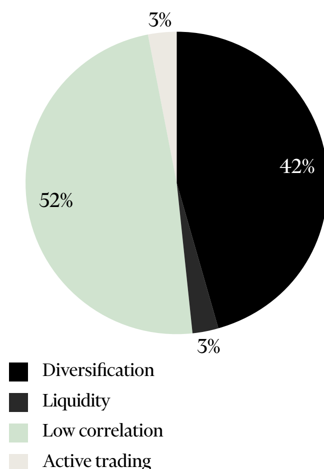
KEY POINTS

- Despite the headlines, Chinese equities offer true diversification to equity portfolios and with meaningful size.
- China A share market is the second largest in the world by size and listings, but the most inefficient in the world with just 68 per cent of companies by multiple analysts.
- China's underlying market structure favours onshore managers due to the high barriers to entry, trading costs, regulatory hurdles and limited hedging options.
- Quantitative, data-driven equities in China offer a form of differentiated alpha, delivering with lower perceived risk.
- Domestic retail investors drive the majority of capital flows in China, with limited institutional involvement, resulting in an environment suited to 'signal' and momentum-based trading.
- Chinese equities are significantly less correlated to the ASX, despite being Australia's largest trading partner, with quantitative-based strategies further reducing correlation.

Brendan Paul, Atrium

KEY POINTS

- Liquid alternatives are critical to delivering the genuine portfolio diversification that is required to navigate an increasingly complex and divergent environment.
- Technological advancements and innovation are occurring everywhere in finance, quantitative strategies represent an embrace of this evolution.
- Risk analysis but particularly factor allocations should form a central part of portfolio construction.
- Quantitative, factor-driven analysis offers the ability for advisers to assess whether they are 'getting what they paid for' and 'know what they are buying'.
- Over the long-term, trend following strategies have delivered powerful diversification and correlation benefits, reducing the worst drawdowns by as much as 50 per cent.
- As correlation between traditional fixed income and equity assets converges, genuine diversification is more critical than ever.



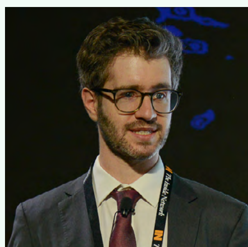
LEARNING OUTCOMES

1. Both trend-following and quantitative, data-driven investment strategies have proven diversification benefits for balanced portfolios.
2. Chinese equities offer true diversification to portfolios, with meaningful size and massive inefficiency.
3. Fast evolving market conditions require a greater understanding of and control over factor, and risk exposures within portfolios.

Session #5

Correlation vs. diversification - refreshing quant and macro strategies

Josh Berelowitz, J.P. Morgan Asset Management



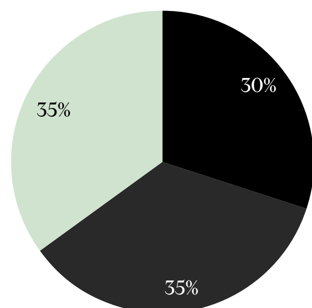
KEY POINTS

- Traditional portfolio construction assumes that asset class correlations are stable, yet history shows they are not.
- Whilst difficult to predict, macroeconomic inputs are important and central to both growing and protecting capital.
- With data suggesting that traditional 50/50 balanced portfolios will deliver returns well below the last 20 years, alternative assets only increase in value and importance.
- Investors must seek a 'full spectrum' approach to investing into the market, looking beyond traditional definitions, guides and benchmarks.
- Building protection against unexpected and expected events will be a key source of diversification and central to building robust portfolios.
- With the majority of the global economy in slowdown mode, diversification opportunities will be key, with active management in public markets and higher alternative allocations potential sources of alpha.

Chris Santore, PIMCO

KEY POINTS

- Managed future trading involves leveraging a data-driven process, to profit from short, medium and long-term movements and trends in all capital markets.
- The divergence of performance across managed futures strategies in history evidence that no managed futures strategy is the same.
- Advisers should focus on the key differences of trend following strategies and their suitability including single or multi-strategy focused, the signals they seek, speed at which they trade and size of their markets.
- Trend following strategies have consistently proven to provide strong downside protection in periods of market stress, protecting capital in the worst selloffs.
- Trend following thrives on volatility and more consistent market movements, the low volatility, positive conditions of the last decade have capped returns.
- Trend following strategies significantly improve the efficient frontier of balanced portfolios, reducing volatility and drawdown risk, whilst exhibiting lower volatility.



LEARNING OUTCOMES

1. Understand the macroeconomic views and future drivers offers a powerful tool for making active management decisions.
2. Trend following strategies are all unique, but have proven to deliver significant diversification benefits over the long-term.
3. Risk management and portfolio protection, whether from events, or reversal of trends will be a powerful source of alpha in a more volatile environment.

Session #6

The only thing that is real – unlisted assets

Amanda Clegg & Ashley O'Connor, Invesco

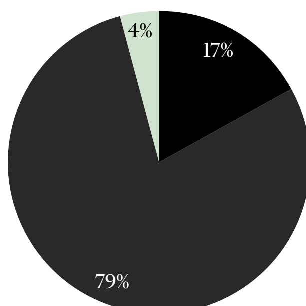
KEY POINTS

- Real property is the oldest asset class in the world, offering proven inflationary and volatility hedging benefits during periods of public market stress.
- Institutional grade property assets offer true diversification to balanced portfolios, behaving significantly differently in varying economic conditions.
- Throughout history, real estate has provided solid, consistent returns even when the asset is purchased at the top of the prior share market cycle.
- Direct property has shown strong positive correlation with inflation in previous periods of rising prices, with rent pass through central to this inflation hedge.
- Whilst a key driver of long-term returns, capitalisation rate expansion has been overstated, with capital flows and the macro backdrop more powerful in the medium term.
- Direct property investments offer a unique, less volatile option to gain exposure to key secular trends including biotech research, innovation, e-commerce, and the cloud.

Chris Cornforth, Harvest Hotels

KEY POINTS

- Hospitality venues including well-located pubs offer a natural hedge against inflation, particularly when both lease and freehold are controlled.
- The hospitality market, despite some consolidation, remains highly fragmented offering significant opportunity for value add by experienced operators.
- Whilst recent institutional interest has grown, capitalisation rates within the hospitality sector remain as much as double more popular sub sectors.
- Institutionalisation of the sector, with a surge in demand, is expected to result in a contraction in cap rates and strong long-term returns.
- Individual assets within the sector offer diversified earnings profile, with the ability to add value leveraging the advantages of scale.
- Inflation protection is delivered in multiple forms, ultimately through asset ownership but also ability to pass cost increases onto consumers.



LEARNING OUTCOMES

1. Property and real assets, the oldest asset class in the world, are among the few sectors that offer true diversification to portfolios.
2. Direct property has exhibited a consistently positive correlation with inflation rates in recent decades, with the pass through of rents a contributing factor.
3. The relationship between capitalisation rates and interest rates is not linear, capital flows and macroeconomic trends are a powerful influence.

Session #7

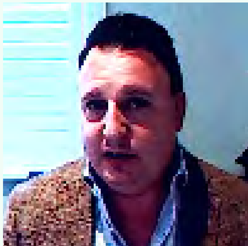
Digital assets – the signal versus the noise

Craig Hobart, Monochrome

KEY POINTS

- Digital assets remain in the early stages of their adoption, despite reaching a market capitalisation of US$1.7 trillion they remain tiny in the context of financial markets.
- Advisers educating themselves and their clients of the risks, opportunities and role of digital assets will be central to their success.
- Despite ongoing price volatility, Bitcoin remains by far the most powerful asset in the sector due to its scale, liquidity and strength of the underlying protocol.
- Investing in the sector is not for the unprepared, with many ways to skin a cat when it comes to custody, ownership and trading of investments.
- ASIC's recently released paper, REP 705, must read for advisers seeking to advise on the sector, which offers significant correlation benefits to traditional portfolios.
- Portfolio construction and allocation limits are imperative to investing in the sector, institutional guides in the US suggested limiting exposure to 1 to 5 per cent.

Richard Galvin, Digital Asset Capital Management



KEY POINTS

- Digital assets have been mislabelled as 'cryptocurrencies' by the media and financial industry, simplifying what is a complex area of finance.
- The digital asset sector has an abundance of protocols and use cases, which now span everything from trading to gaming and non-fungible tokens.
- Digital assets represent a generational growth opportunity that is thus far-seeing faster adoption than the internet.
- Growth in sector is being driven by younger demographics and caused by emerging social trends, falling trust in traditional institutions, and a preference for decentralisation.
- As has been the case in most asset classes, disruption occurs first in the most monetizable use cases, like currency, but a highly inefficient market rewarding fundamental conviction.
- Institutional and experienced investors are increasingly using the sector as a hedge against the disruption it is creating in traditional financial company focused investment portfolios.

Michael Armitage, Apollo Capital

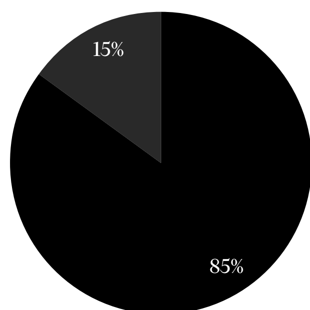
KEY POINTS

- The world has entered a new era where large parts of our daily lives will be digitised, digital assets and the block chain are the foundations on which this will be built.
- Despite running for over a decade, this revolution in money and finances remains in its early days, with adoption and price discovery only touching the surface.
- Financial advisers are accelerating their adoption of digital assets and decentralised finance beyond the first movers and speculators, but hurdles remain for retail investors.
- To gain an exposure to the key return drivers in the sector a multi-strategy approach is required to consider DeFi, Blockchains and new projects.
- Digital assets share many traits with early-stage venture capital companies, offering large asymmetric returns and significant volatility.
- The nature and emergence of the sector is such that a small allocation within traditional balanced portfolios can have a meaningful impact on returns and diversification.

Session #7

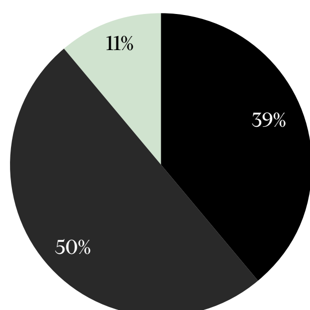
Digital assets – the signal versus the noise

HAVE YOU RECEIVED SPECIFIC CLIENT REQUESTS FOR CRYPTO AND DIGITAL ASSET INVESTMENTS?



- Yes
- No

HOW WOULD YOU DESCRIBE YOUR KNOWLEDGE OF THE SECTOR?



- Strong enough to recommend
- Not enough to be caught out
- None and happy to say to

LEARNING OUTCOMES

1. Custody and education remain the challenge and opportunity for widespread adoption of digital assets in client portfolios.
2. There is growing range of 'investable' options emerging in digital assets spanning both single and multi-asset.
3. Digital assets are the foundation of a generational evolution of finance with the potential to be a US$50 trillion sector.

The Inside Network
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