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Unconventional wisdom

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BY LENG YEOW

Investors are starting to feel a little more adventurous and are looking to diversify their portfolios with nontraditional assets that offer lessobvious opportunities, but these may not suit the everyday family.

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During the global financial crisis, investors retreated from highrisk investments to safe, liquid traditional assets such as bluechip shares and term deposits. But in the past 12 months, interest in alternative assets like private equity, commodities, infrastructure and structured products, has increased, particularly frominstitutional and highnetworth investors.

According to the Investment Trends/Centric Wealth High Net Worth Investor Report, released in May, highnetworth investors - defined as those with portfolios valued over $1million - are feeling more adventurous than during the GFC, with only 14 per cent of respondents accumulating cash, compared with 40 per cent in 2008.

Half the respondents said they were looking to buy undervalued assets on an opportunistic basis; more than 10 per cent said they planned to sell defensive investments to capture the higher growth opportunities; and 10 per cent said theywere looking to diversify their portfolios by gaining greater exposure to alternative assets.

Fiftythree per cent of respondents held some form of alternative investments, although these formed only a small part of their total portfolios, on average 6 per cent.

"Demand for alternatives broadly is returning, with highnetworth investors saying they would be comfortable allocating a maximum of 12 per cent of their portfolios to nonmainstream assets at this juncture, up from a ceiling of 10 per cent during the GFC," says Mark Johnston, principal of the Investment Trends research group.

"We're interested in gauging attitudes towards specific products that were implicated in some of themore dramatic crashes and downturns. Those definitely out of favour postGFC include agribusiness andmortgage trusts."

But alternative asset classes also lost some of their appeal during the GFC, as the performance of many industry superannuation funds suffered due to markdowns on the value of alternative assets such as infrastructure and hedge funds, and unlisted ones like direct property.

In 2008, the value of unlisted assets plunged 12 per cent, and in 2009, as equity and bond markets bounced back, unlisted assets continued to fall, which led to retail master trusts, which have high allocations to listed assets, outperforming industry funds.

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The median retail super scheme posted an 18 per cent increase for the 12 months to December 31, 2009, about 6 percentage points higher than themedian industry fund, according to data by ChantWest. Industry funds still trump retail master trusts over the long term.

The median industry fund (growth option) returned 6.1 per cent per annum for the 10 years to April 30, 2010, comparedwith the median master trust (growth option), which returned 4.9 per cent.

According to Chant West, the greatest distinction between the asset allocations of master trusts and industry funds is that industry funds have a significantly higher allocation to unlisted and alternative assets.

In 2009, the average industry fund held 28 per cent of its portfolios in unlisted assets, against 9 per cent for retail funds.

Industry funds like the Motor Trades Association of Australia (MTAA) Super and the West Australian Westscheme - both advised by Access Economics - hold 50 per cent and 40 per cent respectively in unlisted assets, while Colonial First State FirstChoice has no exposure to unlisted assets and other retail funds such as the BT Multimanager Balanced Fund and the Russell Balanced Opportunities Fund have little exposure.

ChantWest predicts master trusts, which are largely owned by banks and institutions, will gradually increase their exposure to alternatives over time.

Chief investment officer at IOOF, Stephen Merlicek, agrees that retailmaster trusts will begin to tap into the illiquidity premium attached to unlisted assets, but he doubts that the retail funds will be as aggressive as the not for profit sector.

"Retail funds have traditionally had more emphasis on liquidity and listed assets because of the importance of daily pricing and liquidity for investors," he says.

IOOF, along with its asset consultant Russell, recently completed a full review of strategic alternatives, with Merlicek citing areas such as emerging markets, highyield credit and the smaller end of the private equity sector as potential opportunities.

"The review was all about seeing where the opportunities lie and where we could potentially get the best bang for our buck," Merlicek says.

"The opportunities are generally where other people aren't because if everyone else is there, you're probably not going to get the optimumreturns."

Merlicek joined IOOF in October last year, from the $10 billion corporate fund Telstra Super, and is one of the growing number of professionals and consultants from the institutional sector entering the retail side.

Jeff Rogers, chief investment officer at AXA's ipac,was formerly head of investments at theVictorian FundsManagement Corporation, and AMP Capital investment director, Sean Henaghan, was at asset consultant WatsonWyatt (now TowersWatson) formore than a decade before he joined AMP.

Since their appointments in 2006, both ipac and AMP Capital have increased their funds' allocation to unlisted assets.

Henaghan, who is responsible for AMP's multimanager platform, Future Directions, was instrumental in the creation of AMP's alternatives program, which kicked off last year and invests in three key alternative categories: private equity, infrastructure and opportunistic investments.

AMP Capital has a large team of infrastructure experts, and leans on USbased StepStone Group for customised investment management and advisory services, and global access to specialist private equitymanagers.

According to Suzanne Tavill, AMP Capital's head of alternatives multiasset group, the Future Directions Funds has adopted a 910 per cent target allocation to alternatives to provide portfolio diversity given its potential for low correlation with more traditional asset classes while delivering competitive returns.

"Within the alternatives strategy, suballocations to infrastructure, private equity and other opportunistic illiquid investments allow access to an array of opportunities aiming to deliver improved returns to investors," she says.

"Alternatives provide diversification to listedmarkets, and - when listed assets are not doing so well -

alternatives should bulk up performance and enhance the riskreturn profile."

Gaining direct exposure to alternative assets is hard for retail investors because of the large minimum investments required, high fees and difficulty in getting access to deals andmanagers.

For the majority, the best way to access alternatives is through an industry fund or a diversifiedmultimanager.

"Sadly, the main exposure retail investors had in the alternatives space prior to the GFC was long/short hedge funds, which didn't performduring the crisis and didn't hold up to their end of the bargain as a diversifier, but our focus is on alternative assets, which by their nature have a lowcorrelation to the listedmarket," Tavill says.

"Private equity is regarded as having a high correlation to listed markets, butwe're trying to build a private equity portfolio that is truly diversified and that comes down to asset selection."

Despite starting its alternatives program in 2009, AMP has been carefully watching nontraditional investments for more than three years. In 2006, coinciding with Henaghan's appointment, the group looked at building an exposure to alternatives to diversify its portfolio away frommarket risk.

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