Constraints for managers subtract alpha to investors

Donegani, CEO of Prisminvest, is doubtful on UCITS III because he expects underperformces vs. the offshore funds

by Valerio Magni

The company

Prisminvest is an independent asset manager set up in 2000 in Switzerland by Dr. Michel Donegani and Marc Zosso. It manages the asset of Swiss and European pension funds, private banks, insurance companies, family offices and third party managers. Prisminvest is member of the Swiss Association of Asset Management and regulated by the FINMA. It favours a multi-style, multi-manager approach by investing in funds managed by specialists in various asset classes for traditional or alternative portfolios. Prisminvest leans on the quality of its research team to identify strategies and managers that will achieve the desired risk/return with a forward looking philosophy. It currently manages CHF 1.5 billion in 28 funds of funds and 5 managed accounts.

Although a lot of investors, especially private, but also some institutions, are moving their alternative allocation to the hot vehicles of the moment, such as UCITS III funds or managed accounts, there are those who are still convinced that the old-fashioned way of hedge fund investing through offshore funds is the best way to have access to the alternative asset class. "There are still investors able to differentiate between the box (fund's legal structure) and what is inside the box, which is in the end what you are buying", **Michel Donegani**, CEO of the Morges-based Prisminvest says. And he underlines that "the more constraints you add to a strategy, the less alpha is left to investors". Since the same investors are paying good fees for alpha (the TER of alternative UCITS III products is expected to be higher or at least the same as hedge funds, according to a recent survey) all this makes a lot of sense.

How is your clientele composed?
Our clients are mainly Swiss Institutions: pension funds, corporates, private banks, independent asset managers, but we also have private clients through family offices structures. We manage private labeled fund of funds or tailor made accounts. It is important to underline that we are active both in long only and hedge funds and that we have bias towards emerging markets. We launched our first Chinese fund of funds in 2001.

What is the role of hedge funds inside the portfolios you build for investors?
Very often, we do have access to our client's global asset allocation. We are then able to structure an optimal hedge funds portfolio to achieve the main role of our mandates: bringing diversification to their current assets. This is the way we profile our service.

What are the requests coming from institutional investors about HFs?
For the majority, we have to generate stable returns, at least equal to their liability target, with reasonably low correlation to market movements (equities and bonds). Note that unless by adding a derivative overlay, low correlation is hardly achievable during extreme markets shocks (like in 1994, 1998 and 2008).

Today, what is the average weight of HFs in your client's portfolios?
It varies in general between 5% and 15%, with a few exceptions above 25%.

How do you select the hedge fund managers?
We emphasize the qualitative analysis of manager's strategy (which means that transparency is required), even though we are in the continuous process of developing statistical techniques in order extract relevant information imbedded into past performances. Qualitative and quantitative measures enable us to compare a fund within his peer group, with more objectivity. The selection process is formalized and requires the involvement of different competences: strategy analyst, compliance officer, dedicated operational analyst. At least one on site visit, involving the CIO or the CEO with the head of analysts team is required prior to any investment. As we decided to concentrate our research from one single office, travelling expenses come just after salaries! But our clients appreciate that the whole knowledge is concentrated and directly available to them. This ensures as well the coherence of the investment philos-

ophy, which I have experienced to be almost impossible with a multi-site structure. All our internal processes are formalized, transparent to our clients.

The offer of alternative UCITS III products is booming in the last months. What do you think about these products?
Unless required by clients, we will not choose UCITS III funds to access the valued added of talented managers. Everything else being equal, the more constraints you add to a strategy, the less alpha is left to investors. It is like a nature's law. Very few portfolios and strategies can be copied form offshore to UCITS constraints without significant changes (liquidity, sizing, leverage, etc.). Except during stress periods, when risk taking is not rewarded, I expect the UCITS to underperform their offshore mirror.

And what about managed accounts? Could they be an alternative to hedge fund investing?
Managed accounts platforms could be interesting as they provide in general better liquidity than offshore funds, but the strategy is often different as the liquidity of the fund has to match the liquidity of the underlying securities. Unless required by the client or because of liquidity constraints imposed by the fund of fund's own liquidity, we would choose the flagship fund of the manager, i.e. very often the traditional offshore version.

From our point of view, it seems that the hedge fund business in the Anglo-Saxon world is established, while in continental Europe "UCITS" is the mantra. Do you agree?
Yes. Even though this is not the case in Switzerland, a growing number of European institutions have included the "UCITS" label into their investment guidelines. Fortunately, there are still investors able to differentiate between the box (fund's legal structure) and what is inside the box, which is in the end what you are buying.

What could be the role of Switzerland inside these trends?
Unless a significant improvement in the "reciprocity" between Switzerland and Europe regarding access to funds and services (which is currently mainly one way), there is a risk that Swiss based asset managers and Swiss funds will be accessible only by private European clients. Still today the access to European institutional money is very challenging.

What do you think of the proposals to regulate hedge funds in Europe?
Any regulation that could provide a better protection of client's interest is welcome. I have the feeling that the hidden agenda of the current and proposed new regulations are biased towards protecting the local government fiscal appetite. I am more in favour of an appropriate regulation of asset management firms rather than of investment vehicles. The current situation in Europe is in that sense already much better (as the majority of asset managers are regulated) than what we find in the US market. But in the end, regulating hedge funds without imposing the same rules to banks for their proprietary capital is simply unfair and useless as most banks run their own money with hedge funds type strategies (with much more leverage).

During the first quarter 2010, hedge funds posted good and uncorrelated returns during volatile times. What are your preferred strategies for the coming months?
As the credit market is still very friendly and there is plenty of liquidity, it is not surprising that hedge funds are doing well. But this could change as soon as interest rates start rising and credit spreads widening. It is a fact that the majority of hedge funds are long less liquid assets and short the more liquid ones. I think it is time to come back to basics again : avoid too much leverage (the leverage providers always sacrifice their clients before their own balance sheet), concentrate on reasonably liquid instruments (the era of free money will end) and invest in economies or sectors where there is above average growth (if your manager has no alpha, at least you will be rewarded by his portfolio's beta). Within that universe, I would then overweight trading styles versus strategies taking too much directional bets. ■