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Specialists cut long story short for big funds

Brendan Swift

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Managers are casting a wider net in the search for higher returns and greater diversity, says Brendan Swift. The booming superannuation sector is threatening to crack the \$1 trillion mark for the first time in the next year. The industry's coffers - along with multi-manager funds - are being pumped up to record levels thanks to surging equity markets and strong inflows from investors looking to share in the bounty. The twin lures of higher, yet more durable, returns have seen funds turn increasingly to boutique fund managers, global equity managers and alternative asset specialists to keep the party going. Mercer Investment Consulting says it conducted 44 searches for new fund managers last year on behalf of its Asian-based clients, which include super funds and other institutional investors. It placed \$US3.4 billion (\$4.4 billion) into new investments, with client demand underpinned by the search for higher returns and greater diversity.

Global equity mandate searches more than tripled to 36.4 per cent of all searches last year as funds looked to increase their exposure after three years of stellar returns on the local bourse.

"In 2006, we expect to see sustained interest in search activity as Asian markets continue to open up to offshore investments and institutions," says Marianne Feeley, Asia head of research for Mercer. Emerging markets are also winning a growing proportion of global equity inflows after outpacing investment returns in developed markets over the past five years.

Australia's largest corporate super fund, Telstra Super, recently invested \$15 million in a so-called BRIC fund, which focuses on the emerging regions of Brazil, Russia, India and China, while industry fund MTA Super is funding a \$72 million emerging markets mandate. The \$2.1 billion Military Super is also considering increasing its exposure to emerging markets, according to chairman Charles Kiefel. "It's diversifying more into assets to strengthen our capital preservation strategy," Kiefel says. Early last year, several Frontier Investment Consulting-advised clients including JUST Super, Vision Super, STA and HESTA Super made emerging-market investments via Hong Kong-based fund manager Lloyd George.

Global property is also becoming a focus for Australian funds. Property searches accounted for 23.7 per cent of all Mercer searches last year, from 10.9 per cent the previous year, with the consultant placing \$US1.1 billion (\$1.4 billion) into new mandates for Australian clients.

"Where activity has actually fallen in the last two years is the amount of funds switching managers in the active listed property trust fund manager category," Mercer principal Nicholas Kelly says.

"This is a sector in which our client base made major changes from 2001 to 2003 and most of these mandates were awarded to strong performers to this day."

Several Australian funds have recently launched global property products, including AMP Capital Investors, Colonial First State and Macquarie Bank, as legislation is passed globally allowing

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real-estate investment trust structures.

While most super funds and multi-managers have been lowering their overall allocations to Australian equities after a three-year bull run, boutique fund managers are continuing to win money as funds turn towards high-conviction managers with a stake in their own business.

The \$4.4 billion Hostplus industry fund established a boutique incubator fund in February in an attempt to reserve future capacity among the next generation of boutique fund manager stars.

"It's about funding those initially but also locking in ongoing capacity as Hostplus continues to grow.

One of the dilemmas for us is your 452s or Paradise Coopers are closed and as much as you'd love to give them more money you can't," Hostplus chief executive officer David Elia says.

Hostplus has reaped strong returns by backing Australian equities boutique 452 Capital, launched by former Perpetual fund manager Peter Morgan in 2002, and the small-cap fund launched by former Mercantile Mutual manager David Paradise in 1999, now under the Paradise Investment Management banner.

Hostplus's new incubator fund is slated to grow to about \$250 million and has already invested \$40 million each into the Acadian Australian Equity Long Short fund and Perpetual's Quantitative Investments Long Short fund.

As larger funds management firms become more prone to losing portfolio managers wanting to strike out on their own, the big firms are increasingly striking up exclusive retail distribution deals with boutiques. Colonial First State offers Acadian's funds on its First Choice platform, while Challenger is set to take an equity stake in a new boutique to be launched by three members who departed Merrill Lynch's Australian equities team last month.

With equity markets booming, the majority of boutiques have prospered, including MIR Investment Management, which has built its funds under management to \$3.2 billion since launching in January 2004, according to managing director Michael Triguboff.

"We clearly believe that boutiques, where the investment team own the equity and are significant investors into their own funds, is the optimal vehicle for hedge funds," he says.

MIR offers a range of Australian equities funds including large-cap, small-cap, geared and long short, winning several major mandates over the past year with Westpac Staff Super, Telstra Super, as well as Advance and Russell's multi-manager funds.

But while equities have driven returns over the past three years, several industry and public-sector funds are continuing to beef up their allocations to alternative assets such as private equity, infrastructure and hedge funds, which attempt to generate returns in all conditions.

Les Fallick, managing director of private equity adviser and placement agent Principle Advisory Services, says the appetite for alternative assets is growing as funds themselves become larger.

"With the amalgamations, the bigger super funds can handle the illiquidity of alternative assets much more easily than smaller funds," Fallick says. "So we're much more likely to see the amalgamated STA and ARF put up to an additional billion dollars in alternative assets almost immediately." Billions of dollars in assets are likely to move between fund managers when the two

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funds complete their merger later this year, which will create a \$20 billion super fund giant called AustralianSuper. The two funds have between 5 and 10 per cent of assets allocated to private equity and hedge funds. But increasing that exposure is becoming more difficult as more money enters the private equity sector after some spectacular gains by funds offloading investments onto the raging sharemarket. CHAMP Ventures recently completed a \$300 million capital raising from institutional investors following the \$950 million it raised in a separate fund last year, while Pacific Equity Partners raised a record \$1.2 billion earlier this year.

Funds such as Telstra Super, which has just reserved \$10 million for a US-based private equity energy fund and \$15 million in a private co-investment in the US, are turning offshore to gain their exposure.

Late last year, Military Super realised a \$30 million commitment to Sigular Guff's BRIC private equity fund-of-fund.

"Demand for global private equity is almost unstoppable," Fallick says.

The \$8.5 billion REST industry fund is still attempting to raise its exposure to alternative assets such as hedge funds from its current level of 13 per cent to around 15 per cent of its portfolio, because of ongoing low yields in bonds.

The fund also allocated \$100 million to a long-short equities fund run by Harris Alternatives last month. "As the weighting to bonds has drifted down, they've wanted to increase their exposure to equities and the long short is a way of doing that without taking on the full equity-market risk," according to Steven Carew, divisional director of research with REST's asset consultant, JANA Investment Advisers.

A survey earlier this year by the University of NSW, commissioned by the Alternative Investment Management Association, found super fund allocations to alternative assets were set to jump by \$1.5 billion in the next two to five years as funds attempt to enhance returns and manage risk.

Search mode

- * Big firms are striking more exclusive distribution deals with boutiques.
- * Global equity mandate searches more than tripled last year.
- * Emerging markets are winning a larger share of global equity inflows.

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