ALTERNATIVES WATCH

Aspect Capital: Investors seek to recession-proof portfolios with more liquid alternatives

Posted on December 19, 2023 by Susan Barreto

London-based systematic investment firm Aspect Capital has historically helped clients navigate market themes, but next years' trends could be the toughest yet for institutional investors to predict and navigate.

"With rates renormalizing, what we have seen is that the macro environment has become a lot more dynamic and a lot less anchored," said Razvan Remsing, director of investment solutions at Aspect Capital.

Portfolios generally have a lot of private assets in them, but what Aspect is seeing is that allocators have been more galvanized in readdressing how they source that portfolio diversification. Remsing said the last two years have put CTAs back on the map, and the firm had strong gains in 2022 that helped it demonstrate that it could be a "reliable diversifier."

Trend-following has ably navigated a multitude of economic environments over the last five decades, according to Aspect. In reality, the post-GFC, pre-pandemic, QE-dominated 2010-2018 period has been the abnormal one in offering fewer opportunities. In a sense, the lifting of interest rates that began in earnest in 2022 has reinvigorated interest in the systematic investment/hedge fund arena.

Natixis recently surveyed 500 investors and found that 23% were planning on increasing their allocation to hedge funds in 2024, while another 59% planned to maintain their allocation to the asset class. Investors are also more likely to add absolute return strategies as well as options-based strategies, suggesting the need to offset potentially volatile stock and bond markets, Natixis concluded.

Customizing the approach

Remsing sees institutional investors benefiting from a more customized approach that is tailored to the allocator's current portfolio that in large part is heavy on both private equity and private credit strategies currently. So, for some it may be adding more of a macro tilt, while some are very focused on currencies.

"It is like playing Tetris and being able to fix the block as it drops," Remsing said of the customized approach. "There are enough degrees of getting the balance right."

That balance can be found in a risk mitigation sleeve or elsewhere in the portfolio. For investors that dropped hedge funds as an asset class, there seems to be a demand to meet higher return expectations.

In fact, investors now want almost 3% more in returns from their hedge fund portfolios, according to new BNP Paribas research that found almost half of hedge fund investors will overhaul their strategy allocation to take advantage of higher-for-longer interest rates.

The research — which was conducted over the summer — found investors have increased the return target of their hedge fund portfolio by 2.9%, from a 6.85% annual return target to 9.75%, in light of elevated rates.

While investors always chase the latest, shiniest thing, Remsing is committed to educating clients on the value of patience, and of allowing the different components of portfolios to have a role to play at their own times. Indeed, for most investors piling into private markets has been a way to smooth out what could be volatile returns in long multi-year locked up investments where the returns can be ironed out over time.

Generating Sharpe greater than 1.0 has put Aspect's offering back into the conversation as a source of stable liquidity and return in a portfolio. With daily or weekly liquidity, it proves to be a viable option for institutional investors that may have a need for capital.

Markets change, while the method remains

During that long ZIRP period that challenged many trend followers, the alpha in currency trading dried up as it turned out to be a bet on getting the U.S. dollar moves right. For the systematic piece, the price inputs inform the strategy and tend not to spark sudden shifts.

"We are expecting rates not to be high, but not zero," said Remsing. "That dispersion in FX has given us some flexibility. European currencies — throw in the yen and renminbi — and suddenly there is a lot of breadth in currency markets. It hasn't changed our system, but it has given our system another asset class to hunt for these trends."

The reliance on systems is helpful in eliminating bias that can be introduced deliberately or accidentally. The models are struck not by the frequency of what has happened in the past, instead they are directionally agnostic and forward looking. It helped them to capture the trend as dramatic as when yields rose in the most intense way in four decades.

While the firm is not positioned for the doom and gloom scenario that some macro traders have predicted due to the swift rise in rates, they are still able to generate returns when there are difficult markets.

"We've come out of the winter," Remsing concluded. "Our models today are vastly different from 15 years ago, the thesis is unchanged — to be directionally unbiased. The thesis is the one thing that has been consistent and provides confidence in presenting to investors and consultants."

Note: This is a reprint of an article published in Alternatives Watch in December 2023. Any opinions expressed are subject to change and should not be interpreted as investment advice or a recommendation.