

NZFUNDS

AROUND THE GLOBE IN 14 DAYS

By Michael Lang
and Mark Brooks



During April, our Chief Investment Officer, Michael Lang and our Head of Income, Mark Brooks completed a research trip to London and Los Angeles.

In two weeks of travel they met with 10 hedge funds; nine equity managers; five bond specialists; three private wealth offices and attended the London chapter of the Value Investors Conference, where they heard from a further 10 investment experts. In total around 37 meetings with some of the best minds in the investment management and private wealth disciplines in the world.

We have asked them to share some of their observations for you, and the following are excerpts from their notes...



The big theme

Discussing investment techniques at the equivalent of 2am was not exactly relaxing, but as guardians of our client's wealth it is important that every now and then we travel to the world's financial centres to try and better understand what is going on and consider and analyse how we can position our clients' portfolios to benefit.

In meeting after meeting we were struck by the effects of what is referred to as the "Great Rotation". In response to the global financial crisis, interest rates have been cut to record lows in most countries. This has been great for those with mortgages but less so if you are a saver or are solely reliant on bonds or term deposits to fund your retirement.

The term "Great Rotation" came to prominence in late 2012 and refers to the widespread prediction that record-low bond returns will prompt investors to rotate out of bonds and into shares and other asset classes.

Traditionally, United States pension funds have held a 60% allocation to global shares and a 40% allocation to government bonds. With government bonds today offering only 2% per annum, these pension funds are being forced to rethink where they invest clients' funds. One of the asset classes which is benefitting is hedge funds, especially those with a strong track record in managing risk, they seem to be the asset class of choice for pension funds.

United States pension funds are probably the largest group of investors in the world – they control around US\$16 trillion in assets – so whatever they decide to do will have significant impact on global investment markets. For example, if they allocate only 10% of their portfolios to hedge funds, they will double the size of the hedge fund industry.

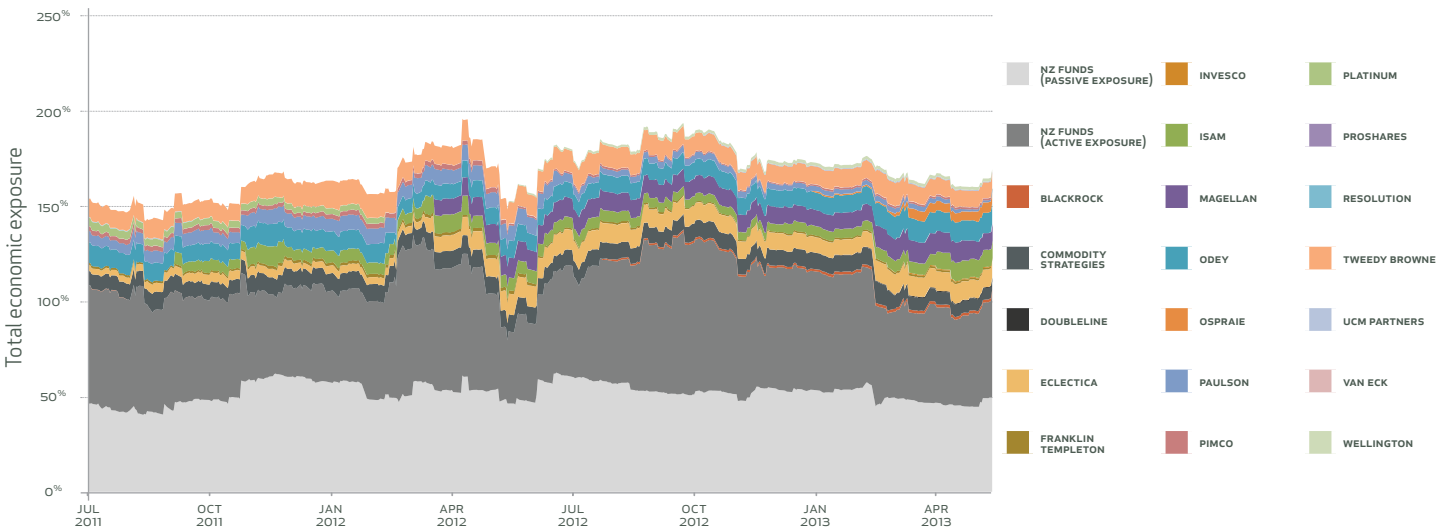
True diversity

Over the last four or five years we have worked hard to expand the range of managers we employ to manage our clients' portfolios, seeking to build a truly diversified range of world class investment managers. Each year we invest around \$2 million in external investment management fees.

One area where we have been particularly proactive is in ensuring our clients' wealth is managed by many of the same world class investment managers and hedge funds as are employed by the very best wealth management organisations in Europe and the United States. This means clients' portfolios are constructed using a far wider range of managers and asset types than is traditionally the case.

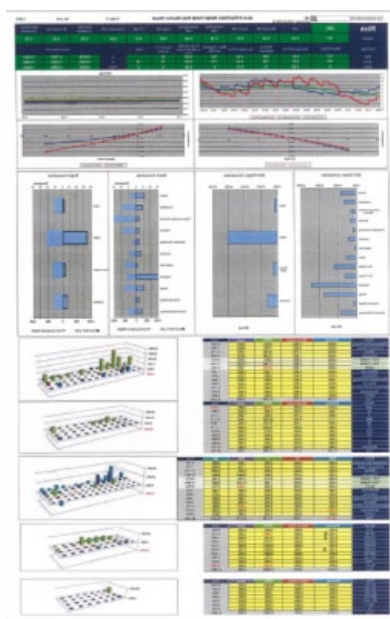
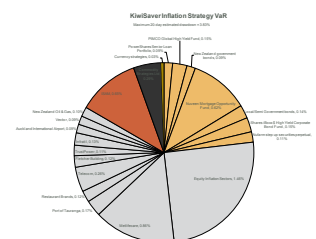
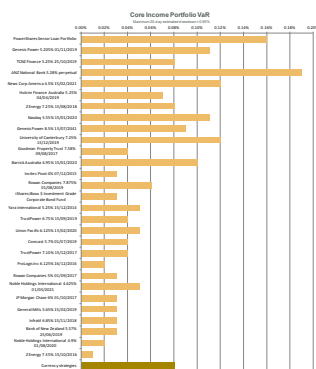
It was nice to see the large global pension funds and industry consultants starting to embrace a similar approach. No doubt many of the Australasian financial conglomerates will begin to follow suit. In the meantime, we think NZ Funds really stands out by offering clients a truly diversified range of investment managers. The technical term is "diversified sources of alpha" and below is a diagram which shows how this approach is applied to the NZ Funds KiwiSaver Scheme.

NZ Funds' client portfolios built with multiple sources of manager alpha
Indicative NZ Funds KiwiSaver Scheme client 0-45 years old



SOURCE MATERIAL AVAILABLE ON REQUEST.

Focus on risk



During the global financial crisis, most private investment management organisations (particularly hedge funds) survived because they were extremely conscientious at managing risk. Everywhere we went at least half the meeting was spent discussing how the firm managed risk, in the many shapes and forms that risk takes. It was intriguing to hear traditional "buy and hold" investment managers, who would normally talk about stock picking and investment returns, also talk about how much of their energy is now spent on mitigating the downside for clients. The emphasis placed on risk management was music to our ears.

While we came away with pages of notes on the different approaches taken, we observed that the risk management system NZ Funds has built over a number of years (which we continue to research and refine) is right up there with those of the leading risk managers in the world. NZ Funds' ongoing investment in proprietary risk management systems should be an important point of differentiation over time. On the left is an example of the outputs from NZ Funds' risk management system and that of GLG's (the second largest hedge fund in Europe). Not that different!

NZ Funds Management daily risk reports

GLG daily risk reports

Integrated wealth management

As investment managers we are constantly looking to Europe and the United States for the latest thinking in investment management and we expected that the same rules would apply for wealth management. It did and it didn't. We were amazed at how successful Odey Private Wealth was in the United Kingdom offering a very simple but well managed portfolio offering. We were also a little shocked after two hours with a pretty downbeat executive from America Funds. Despite managing US\$1 trillion (that's not a typo) in client funds, they are still mired in a high front end fee, hot fund, high client turnover model and they cannot work out a way forward. They reminded us of the "wealth management" models of lots of banks and insurance companies in our market, where the focus is on just trying to sell each client more share IPOs or themed funds, rather than to actually identify and help to solve their key wealth challenges.

The highlight of our private wealth meetings was without a doubt Bernstein. The chap we met ran Bernstein on the West Coast of the United States. He personally oversaw US\$1 billion in clients' funds, mentored 1,700 advisers and had driven for one and a half hours to meet with us at six o'clock at night. He gave us insight after insight into how they were building a truly integrated wealth and investment management business.

The thing that stuck with us most was how much conviction the advisers we met had in the integrated wealth management approach. As Bernstein puts it, clients need a working car not a collection of parts. The pick and mix from a long menu of funds (or shares) approach used by banks and insurance companies and brokers were not the first choice for wealthier clients. He showed us a humorous but very clever and cuttingly true video clip – who would you rather have managing your family's savings?

Click to watch the video below.

<http://hightoweradvisors.com/en/why-we-re-different/philosophy>

People make this business

It is easy to forget – or at least underestimate – how much individuals make the company and not vice-versa. Perhaps it is possible to select a world class collection of investment management organisations from New Zealand by simply choosing big well known brands, but given the hundreds of funds they open and close on an almost daily basis it does not feel like a sound strategy for growing New Zealanders' wealth over the next 10, 20 or 30 years. When we contrast that with some of the remarkable individuals who have spent their entire working career building a business based on high quality client outcomes, it is hard to believe that a faceless institutional behemoth will do better overseeing our clients' funds.

Take Crispin Odey for example. Odey Asset Management manages approximately US\$9 billion in client funds. Crispin, the founder, personally oversees all investments and has done so since he founded the business. Over the last 20 years he has increased the value of clients' initial investments by more than 1,000%, so naturally we were a little apprehensive about meeting with him. Not that we should have worried. Shortly after arriving the door burst open and tall and imposing Crispin leapt into the room with his coat wrapped around his head, shouting "I am the greatest thief of future earnings you have ever met, I have on my Harry Potter cloak of invisibility!"

After the theatrics we got into the meat of our discussion and it transpires that Crispin was especially excited because he expects to double or triple his (and our clients') capital through a number of

investments he has recently made in expectation of the United States economy continuing to recover.

In particular he has acquired a number of businesses exposed to the United States replacement/capital expenditure cycle. It might have been hard to take him seriously had we not been sitting in the same room in which George Soros sat when he broke the British pound in 1992. In fact Soros was one of Crispin's first investors and is still one of his largest. Our clients sit side by side with Crispin and Soros in the same portfolios: what more could we offer?

Of the 30 odd investment meetings, there were a handful of exceptional individuals like Crispin. A 32 year-old portfolio manager called Vikram Kumar at TT Funds, who analyses over 800 companies a year, was another who stood out for his insight and obsession with finding attractively valued investing opportunities. These are the types of managers who we will be working hard to either increase clients' allocation to, or to include in client portfolios for the first time. So look out for a number of new additions across the 11 Managed Portfolio Service portfolios and the three KiwiSaver portfolios we manage.

That is just a brief snapshot of our trip. There were many more things we observed which we think we can adapt or adopt in our quest to deliver an unparalleled wealth management experience for our clients.

To request a copy of an Investment Statement for the NZ Funds Managed Portfolio Service or the NZ Funds KiwiSaver Scheme, please contact NZ Funds on 0508 733 337 or at info@nzfunds.co.nz

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