

HOW INVESTORS ARE LOOKING AT ALTERNATIVES

Global asset owners have been disappointed by hedge funds – yet see them as the best possible asset class to perform amid lofty equity valuations

BY RICHARD MORROW

THE HIGHLY VOLATILE nature of equity markets and the increasing difficulty of finding yields amid the world’s bonds have led institutional investors to increasingly look to put money into private assets instead.

However, these assets have also had a mixed level of success, at least according to Prequin’s Investor Update for the Second Half of 2019. The survey canvassed the views of global institutional investors to find out how they felt about the

performance of their alternative investments, and how they could change their allocations in the coming months.

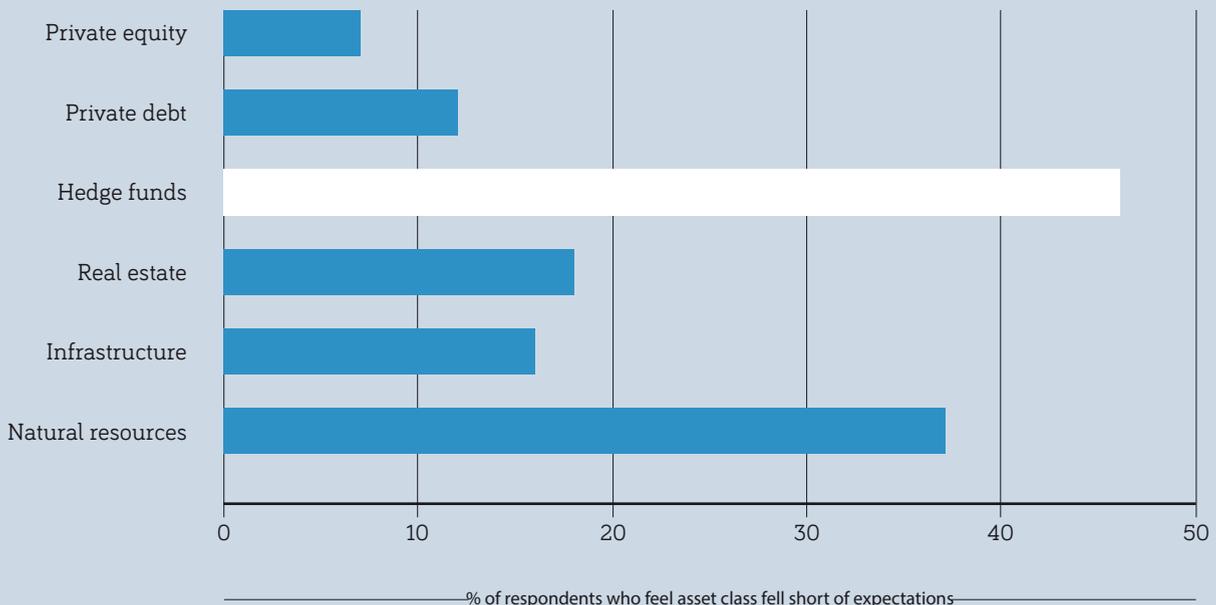
Prequin noted that investors remain upbeat about the future performance of alternatives, but they are less optimistic for the future. A mixture of high equity valuations and huge levels of dry powder means many investors worry that equity valuations are riding at peak valuations, and that a market drop is increasingly imminent. When it comes to private as-

sets themselves, investors appear to have been relatively happy with the strong performance of private equity, and satisfied with private debt, real estate and infrastructure performance. But as the first chart reveals, they are not happy with the level of hedge fund performance, or that of natural resources. And yet, with equity valuations seen as so high, hedge funds may yet have a chance to shine, particularly for defensively minded funds.

THE BIGGEST ASSET DISAPPOINTMENTS

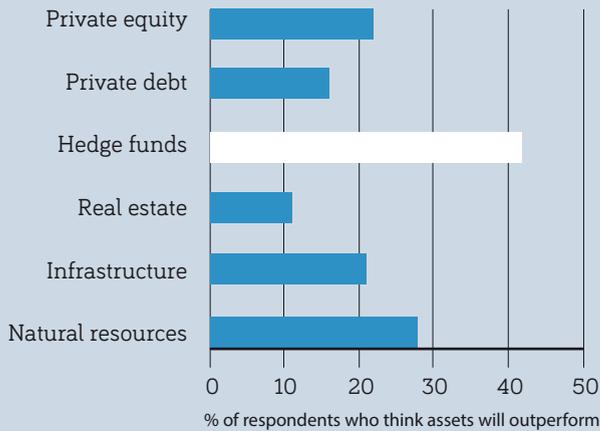
HEDGE FUNDS HAVE long been a disappointing asset class for asset owners, and the first half of 2019 was no exception.

Forty-six percent of respondents were disappointed by its performance, comfortably ahead of natural resources, which sat in second with 37%. In contrast, the strong performance of private equity, infrastructure and private debt meant that there were relatively few disappointed investors; 7%, 12% and 16%, respectively.



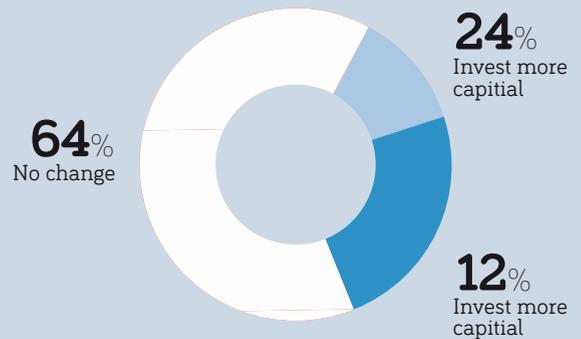
HOPES OF INVESTMENT RETURNS

WHILE INVESTORS HAVE felt let down about hedge fund performance so far, they also saw the possibilities of the vehicles weathering volatile and potentially falling markets. Hedge funds were the most positively viewed alternative asset class in terms of outperformance potential, with natural resources second. An interesting shift in expectation versus the experience of both asset classes doing so badly before.



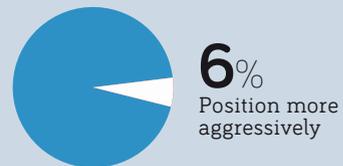
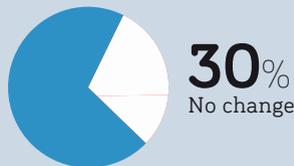
PRIVATE EQUITY PLANS

GENERAL PESSIMISM ABOUT equity valuations hasn't prevented interest in private equity. Nearly two-thirds of respondents intend to hold their private equity positions, but 24% said they would keep adding, no doubt anticipating the long-term asset class would ride out a year or two of poorer performance and flourish once more. Just 12% intend to cut back. Private equity remains in vogue.



HEDGE FUND CAUTION

IN THE HEDGE fund space, investors believe the flexibility of these products can help them err on the side of caution and potentially position their portfolios more defensively. All-told, 64% were looking to position their hedge fund positions to a more cautious position, and just 6% were feeling bold and aiming to do the opposite. With trade wars, geopolitics and economic slowdowns likely to dominate headlines for the coming months, this mindset is understandable.



EQUITY VALUATIONS PEAKING

74%
THE AMOUNT OF respondents who felt equity valuations at at their peak

THE U-TURN IN belief about which asset classes will perform going forwards can be explained in large part on this figure. Almost three-quarters of respondents think the equity markets have peaked, meaning the only way is down. And in a falling market, only vehicles able to manoeuvre around and actively short (hedge funds) or assets that are uncorrelated and actively defensive in nature appear to appeal. Meanwhile, with signs emerging of slowing global growth, the coming months might be bad ones in which to be long equities – at least according to investor expectations.

All of the charts data are sourced from Preqin's Investor Update: Alternative Assets, 2H 2019