



## The long and the short of global investing

David Smythe says long/short strategies can generally provide clients with a more well rounded and diversified portfolio.

For the better part of the past two decades a single global equity fund manager has largely operated without peer or competitor in the retail marketplace. That fund manager is Platinum Asset Management, which has accumulated in excess of \$20 billion in funds under management within its global long/short equity product suite since launch in 1994. Some industry service providers report that close to 50 cents in every dollar invested in the asset class from financial advisers is invested in Platinum funds.

It is almost inconceivable that a competitor of equal standing hasn't emerged. Granted, when Kerr Neilson and his fellow founders sprang from BT they came with a solid track record and strong pedigree and the industry has subsequently witnessed the disappearance of many of the "names" of the 1990s and 2000s, at least in their previous joint venture forms (Perpetual/Fidelity, Credit Suisse/Capital et cetera).

But it is not an exaggeration to say the manager has done as it's pleased in the asset class. This is in complete contrast to Australian equities (also a high-profit-margin asset class) where the landscape has been ultra competitive for many years. Perhaps

the only period of exception in Australian equities was when Chris Cuffe and Greg Perry formed a formidable and unwavering force from the early 1990s to early 2000s at Colonial First State.

The other remarkable fact is the investment strategy of the manager is absolute return orientated and can include the active use of currency and stock/index shorting; and it is perhaps this fact which is one of the key points of difference that resonates loudest with advisers and clients.

The competitive makeup of the long/short global equities landscape is changing however, with the likes of Five Oceans (with key personnel also coming from an ex-BT heritage) and K2 Asset Management having made steady progress in capturing funds under management over the past three years. The fact remains that for every 100 long-only international equity funds sitting on the major Australian-based administration platforms, there are only 8.7 funds with an absolute return, long/short persuasion. Given that the "average" investor appears first and foremost interested in capital preservation, this statistic is all the more surprising.

Rewind the clock just three years to 2008 and investors learnt a quick lesson on the danger of

carrying too much equity exposure in portfolios. Thankfully, with significant portions of the industry having exposure to Platinum, this pain was far less pronounced in global equities than in domestic equities. For example, the Platinum International Fund (which is about \$9 billion in size) fell by 7.4 per cent in 2008 versus falls of 27.2 per cent and 24.9 per cent respectively for the median fund in the asset class and the MSCI World ex Australia Accumulation Index \$A.

This is not the first time Platinum has "saved" clients from significant downside in falling market conditions. Since the Platinum International Fund was launched in March 1995, there have been two calendar years in which the MSCI World ex Australia \$A index has produced a "double digit" negative return; 2008, as described above, and in calendar year 2002, post the September 11 terrorist attacks of the previous year. In 2002 the MSCI World ex Australia \$A index plunged by 27.4 per cent, yet the Platinum International Fund with its flexible mandate delivered only a slight negative outcome for investors, at -3.02 per cent.

Let's consider some further analysis. There have been six negative calendar years (that is, not just the double digit one) since the Platinum International Fund opened: 2010, 2009, 2008, 2003, 2002 and 2001. These calendar years have, on an accumulation basis, delivered a -67.3 per cent return. Over the same corresponding period the Platinum International Fund has delivered a +40.6 per cent return - a massive +107.9 per cent return differential.

The point is not that Platinum alone can deliver this type of absolute return outcome, although Zenith does regard them to be an exceptional fund manager, but rather that long/short strategies have a role to play and Australian investors should be offered greater choice.

Fund Name - as at June 30, 2011	1 year	3 years	5 years	Rating
Platinum International Fund	-7.36%	6.98%	1.74%	Highly Recommended
Platinum International Brands Fund	10.70%	17.57%	7.18%	Highly Recommended
K2 Select International Absolute Return Fund	18.19%	7.04%	8.30%	Recommended
8IP Asia Pacific Partners Fund	21.54%	n/a	n/a	Recommended
PM Capital Absolute Performance Fund	-5.98%	-1.44%	-8.42%	Recommended
Five Oceans Wholesale World Fund	3.62%	4.98%	1.16%	Recommended
Aurora Sandringham Global Income Trust	3.69%	7.76%	n/a	Recommended
MSCI World ex Australia \$A Index	2.64%	-3.28%	-5.15%	
MSCI World ex Australia Hedged \$A Index	26.72%	1.15%	2.01%	
Pengana Asia Equities Fund	-13.42%	3.90%	n/a	Approved
Platinum Asia Fund	-5.58%	5.88%	7.11%	Recommended
MSCI AC Asia x Japan A\$	-0.85%	4.09%	3.64%	

To this extent, Zenith holds the administration platforms in part accountable for the "one dimensional" investment menus which have become rampant in the industry and the lack of alternative strategies that can deliver "real" diversification to a portfolio and assist in protecting clients during extreme market events.

Common sense would argue we don't need to see yet another long-only global equity fund added to a menu where most of the universe already tracks within a 200 to 300 basis point band of the benchmark and the return of the benchmark itself has been very poor.

It is true that some funds within the global long/short equity category will "give away" some upside in bull market conditions, particularly given this may be a period in which they hold less than 100 per cent net equity exposure and/or a significant cash balance, but you rarely hear of a client who complains about a +20 per cent return when the benchmark has produced +30 per cent.

Clients become vocal, however, when their "nest egg" is being eroded, often with dire consequences, particularly for those in retirement phase where delaying retirement isn't an option, salary/wages aren't an alternative source of income, and the sale of part of their super is often the only way to maintain the previous level of income.

The alternative is their investment drawings fall and the quality of their retirement deteriorates. And it's not just their current capital base and the ability to generate income which are hit. If equity markets pull back significantly, the road to recovery can be extended on the way back up.

For example if a \$1,000,000 portfolio falls 30

per cent to \$700,000, it takes a 43 per cent recovery to return the client to their previous portfolio size (\$300,000 / \$700,000 = 43 per cent). The moral of the story is capital preservation becomes "king" for many investors approaching or in retirement phase and far too many of these investors carried excess equity market risk in their portfolio in the lead-up to 2008.

Considering these facts, Zenith is firmly of the view that long/short strategies should be strongly considered for most clients given they can help mitigate the potential magnitude of any portfolio declines and generally provide clients a more well-rounded, diversified portfolio.

While Zenith has identified some of the "best of breed" global long/short funds available to Australian investors as part of its due diligence of this sector, we believe there is significant headroom for improvement in the size of the potential pool available for selection. ■

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