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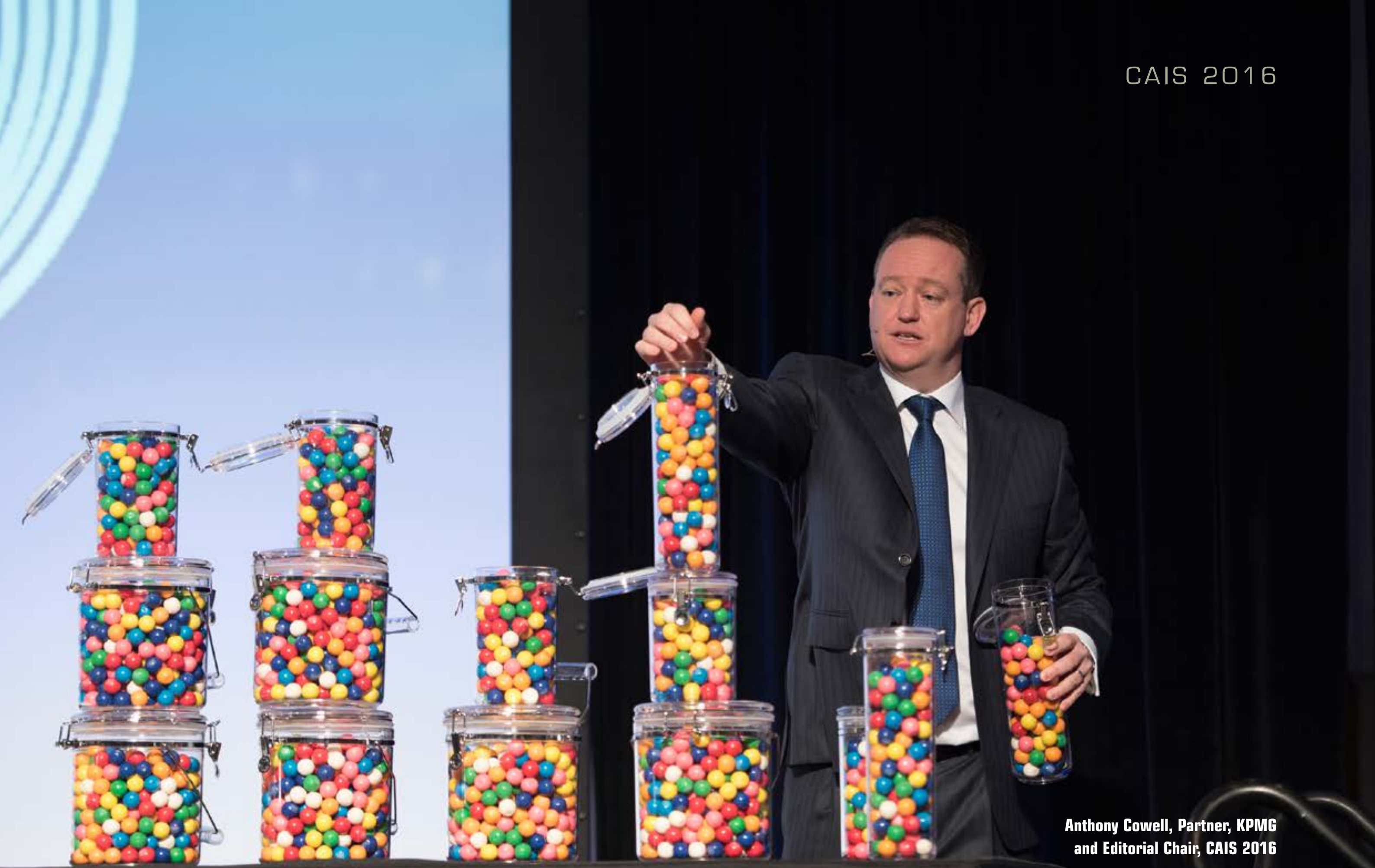
Cayman Alternative Investment Summit 2016

Aligning interests with investors

Extending innovation into new sectors

Macroeconomics and the emerging markets


Anthony Cowell, Partner, KPMG and Editorial Chair, CAIS 2016

Cayman Alternative Investment Summit 2016

Setting the Scene

"We at KPMG believe that there are three disruptive forces at play: Investor divergence, technology and regulation," announced Anthony Cowell, Partner at KPMG and Editorial Chair at this year's Cayman Alternative Investment Summit (CAIS) 2016 organised by DART.

How managers harness those forces by adapting their business models, and pushing the boundaries of innovation, will dictate the winners and losers. This formed the backdrop to CAIS 2016, attended by over 500 of the alternative fund industry's leading practitioners.

The world is evolving at a rapid pace. There are now 6.8 billion people on the planet, and a staggering 4 billion have a mobile phone. Emoji is the fastest growing language. Regulation has ballooned to include all manner of names and acronyms including Dodd-Frank, Alternative Investment Fund Managers Directive, EMIR, CPO-PQR, FATCA, Form PF, Annex IV; the list goes on.

But as the pace of change increases, so does the scope of opportunities for fund managers to develop new strategies and seek returns for their investors. How and where these opportunities can be harnessed to "supercharge" the alternatives industry was debated in detail across the 2-day event.

Indeed, one of the keynote speakers at CAIS 2016, Jonathan MacDonald, Founder of the Thought Expansion Network, said that today is "the slowest pace of change that we will ever experience. There is no such concept as a fast follower approach. There is a huge opportunity for those that elevate up and disrupt themselves."

Using cylinders full of gumballs as a unique visual aid, Cowell showed the extent

to which alternative fund assets, across hedge funds, private equity and real estate funds, infrastructure and commodities have grown in recent years.

In 2007, USD3 trillion was added to the alternatives industry. In 2008, USD350 billion was wiped out. By 2011, the industry had recovered and added another USD1 trillion. Today, that figure stands at USD8 trillion in AUM.

If pension funds were to increase their allocation to alternative assets by just 1 per cent, the potential volume of 'in play assets' would be substantial, which Cowell illustrated by pouring gumballs into an already full set of cylinders, each representing an alternative asset class.

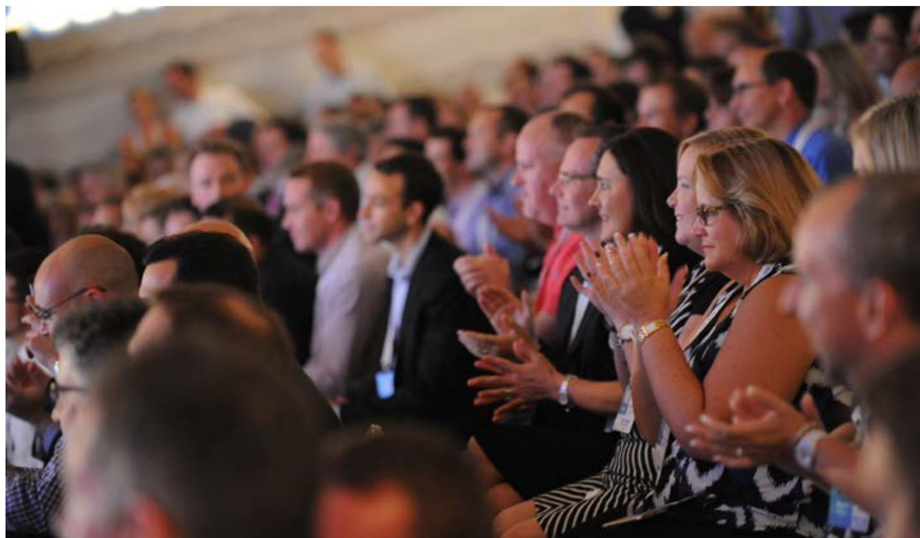
Cowell highlighted some interesting examples of just how fast the pace of change has become. The average company lifespan on the S&P 500 has collapsed from 60 years to 15 years on average, whilst one of the most successful money market funds didn't even exist two years ago.

Commenting on investor divergence, Cowell said: "Institutions want transparency, customisation. But the Milllennials have a different outlook on work, on life. They have been raised in the digital age and they are disrupting the industry – running their own portfolio, sharing portfolios. It has become a more open system. Fund managers need to be aware of these forces at work and adapt. It's important they get their communication right."

Technology is having a profound impact on all aspects of life, including the way people invest. Marketplace platforms such as Lending Club and Prosper Marketplace are growing from strength to strength, connecting investors with borrowers wishing to access non-bank financing.

Robo advisors are employing algorithms to invest based on our idiosyncratic desires and risk appetite. Currently, robo advisors are managing USD60 billion of assets. By 2020, that figure is expected to have grown to an estimated USD2 trillion.

Tom Brown, Global Head, Investment Management, KPMG, raised an important question by asking: "How do fund managers get access to that inflow of capital? Big data and machine learning will create an edge among managers and they will be tomorrow's winners."



Then there's blockchain, a permissionless transaction database that Cowell referred to as a real "game changer". KPMG's Brown stressed that the vast majority of the investment management industry greatly underestimates the impact of technology. "Not just the extent of disruption but the pace of disruption. It will impact every single aspect of our industry," said Brown. He added that blockchain technology will "drastically change the way that transactions are processed in global custody business".

Data – and indeed data management – is at the heart of the alternative investment industry. Some managers are hiring data scientists into the front office and using data analytics to predict customer behavior "but many managers are getting behind. They are struggling with multiple legacy systems and their data is all over the place," stressed Cowell.

Such is the scope of change, that there are myriad ways that fund managers can adapt their operating models to move with the times. Brown's point about machine learning is valid. One only has to look at what Ray Dalio's USD165billion hedge fund manager, Bridgewater Associates are doing to understand this. They now have a six-person artificial intelligence unit headed up by former IBM executive, David Ferrucci.

Cowell concluded his opening address by saying: "The future is ours to create. Fund managers will need to supercharge their business models and further entrust investors as their investment habits evolve. Knowing is not enough. We must apply." ■

Chapter 1

Aligning interests with investors

At a time when the world is grappling with zero inflation, near-zero interest rates and oil prices at a 12-year low, one could be forgiven for thinking that the alternative investment funds (AIF) industry might be supercharging in reverse.

If anything, however, the opposite is true. The AIF brand continues to build and attract new investors.

Retail AIFs are on the rise thanks to the liquid alternatives revolution and total AUM in the AIF industry is forecast to reach USD13 trillion by 2020, accounting for 40 per cent of the investment fund industry's assets and 70 per cent of its revenues, according to Deutsche Bank.

Against this backdrop, one of the key themes that permeated CAIS 2016 was how managers can continue to improve the alignment of interests with their LPs. It remains an issue of intense debate but one thing is certain: failure to do so will hold the alternatives industry back from fully reaching its potential and optimising the AIF brand.

This is a big risk, with technology giants such as Google, Apple and PayPal making vast strides in electronic payment platforms. These companies thrive on data analytics and providing a unique user experience. It will not be long before they expand into financial services, utilising their technology to give investors a unique customer service experience; something the Millennials will be only to happy to embrace.

Using technology to enhance transparency

The challenge, and indeed the opportunity, is for today's fund management community to use the vast amounts of data at their disposal to improve communications with LPs.

One aspect that is enhancing the manager/investor relationship, and improving the level of transparency, is technology. Better IT systems and tools, Big Data solutions, and the increased flow of data are all contributing to a richer ecosystem. As KPMG's Anthony Cowell commented: "The world has changed and we have with it. It is more interconnected, more volatile and more unpredictable than ever before. We've entered an era of transience – continuously fluid global markets."

That said, a careful balance needs to be struck between being transparent, but not so transparent that it risks diluting performance and eroding a manager's edge.

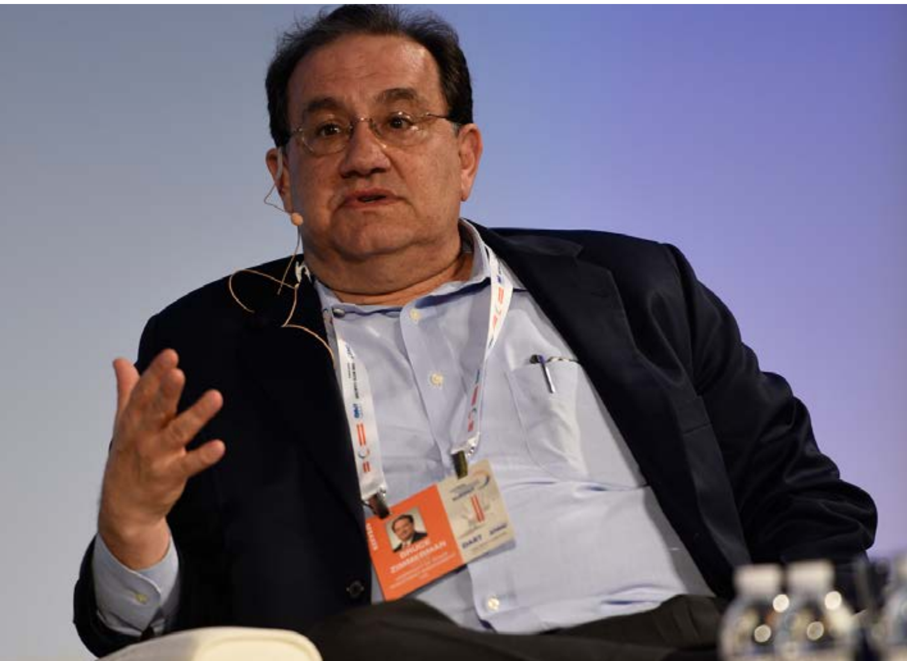
Providing a private equity perspective, Sean Donohue, Head of Valuations, Apollo Global Management LP, said at CAIS 2016 that investors were getting smarter and more involved in the valuation process. "They are no longer just taking the GP's word for it. There are more due diligence meetings. They want to understand the differences in valuations between a target company with 8x EBITDA and a comparable company that has 10x EBITDA," said Donohue.

With a growing appetite for more and more data, it is clear that investors are looking to use it to evaluate asset managers and get a tighter grip on the performance attributions of all their alternative investments.

Improve the channel of communication

Technology can go someway to addressing the transparency point, but at a time when alternative fund managers are launching multiple products across multiple jurisdictions to establish a global business model, the art of communicating effectively to different investor types is becoming a vital skill.

"Alternatives must develop a trusted brand that goes beyond the metric of performance," said Andrew Bastow, Vice President



Bruce Zimmerman comments in the "Creating a better alignment of interest" panel

and Head of European Structuring and Regulatory Affairs, AQR Capital Management. "In my opinion, managers need to develop global localised communication skills. It is becoming increasingly incumbent upon managers to solve issues and provide customised, outcome-based solutions for investors. I also think embracing regulation is a means of enhancing the alternatives brand. Make it your strategic advantage."

Of course, different investors have different preferences when it comes to the level of communication and transparency they expect from prospective fund managers.

Donald Lindsey, CIO, American Institutes for Research, said that he would always want to know what percentage of a manager's net worth was invested in a fund before committing capital.

"A manager will behave differently if they have 100 per cent of their net worth invested in the fund compared to a manager who has 25 per cent invested, said Lindsey, who added: "If, when conducting my due diligence, a manager doesn't tell me about their investment process because it is 'proprietary', I'm going to walk away. What is it that motivates a fund manager? What gets them out of bed in the morning? Is it to make money? Is it profit? Is it simply to do a good job for his investors?"

Knowing how to deal with different investor expectations, different demands on fees, different liquidity lock-up provisions, is no easy task for AIF managers. It becomes a plate spinning exercise. But as Bruce Zimmerman, CEO and CIO, University of Texas Investment Management Co., commented during CAIS 2016: "You have to be honest and say that you may not be suitable to all investors. Sovereign wealth funds might have lower return hurdles compared to a public pension fund. So managers cannot be all things to all men. They have to think carefully about the type of investors they want to attract."

LPs need to align with their trustees

For all its complexity and sophisticated trading strategies, alternative fund investing still comes down to personal chemistry. It is, ultimately, a relationship-based business. And with more institutional dollars flowing in, the more incumbent it is upon managers to engage with investors as partners, and move away from the mindset of 'Trust us, we're the experts. We'll update you next quarter on the fund's performance'.

Gerald Alain P. Chen-Young is Vice President and CIO, UNCF, Inc, where he manages three investment portfolios totaling USD1 billion. As well as ensuring there is an alignment of interests between manager and LP, he thinks there also needs to be an alignment of interests between the LP and its trustees. "I would not hesitate to invite managers that we invest with to speak directly with our investment committee. I also believe that the investment mandate is key, making sure that there is an alignment of cash flows across the lifecycle of the investment strategy," said Chen-Young.

This is especially important for investors who increasingly rely on alternative fund managers to deliver liability-driven investment solutions.

Performance is still king

Improving the dialogue with end investors will help to add lustre to the AIF brand but this is not to suggest that investors will be satisfied by merely feeling more involved in the investment process. At the end of the day, performance is still king. It is fundamental to supercharging the alternatives brand, especially given the lean pickings that hedge funds, in particular, have offered in the last couple of years.

Spiros Maliagros, President of Tiedemann Investment Group, summed this up succinctly, saying: "From our perspective, it is getting the best risk-adjusted exposure for the opportunities that the manager is looking to achieve, communicating that clearly to investors, delivering on that premise and making sure that performance is exactly what the investor was looking for."

In his mind, the AIF brand will also improve with continued investor education, particularly as fund managers proliferate the number of investment products across offshore structures, onshore regulated structures, managed accounts, funds-of-one etc. This involves identifying market opportunities and then working with investors to align their interests. It is a much more consultative approach.

"What are they looking for in their portfolio? What are the opportunity sets they care about? What are the regulatory structures they need to invest effectively in alternatives? That helps build long-standing relationships. We have some investors that have stayed with us for three decades because we engage with them on what matters most," emphasised Maliagros.

This underscores precisely how important relationships are in this industry.

Better alignment of fees

One final aspect of the manager/investor relationship, and where a misalignment of interests remains a significant issue, is fees.

The 'F' word is still a source of huge debate, and will likely roll on for some time. One could argue that fees are fully justified. Fund managers are profit centres not cost centres: does an investor really benefit by paying 1/15 to a manager returning 3 per cent annualised compared to an investor paying 2/20 to a manager returning 10 per cent?

But regardless of whether fees are justified or not, getting improved transparency on how and where those are calculated will further strengthen relations; particularly in private equity funds where it is not always known how many expenses are incurred before the net return is calculated.

Adi Divgi is President/CIO, at EA Global LLC, a single-family office. Speaking at CAIS 2016, he said that he felt measures had been taken to improve transparency on fees but "there is still a large disconnect between managers and investors and there's still a lack of standardisation. With hedge funds, it is still quite disparate in terms of what investors are paying. Sometimes they include transaction costs, other times they do not and are added on top. It is up to the LP to keep pushing on this but also for GPs to allow transparency to be disseminated across the industry."

Spiros Maliagros comments in the "Supercharging our industry brand in a shrinking globe" panel

One potential way of arriving at an appropriate fee structure is to bring the investor in at the product development stage. "That is symptomatic of innovation today – what do you as a manager do well, and how can you deliver that in a better way to investors? Even if it means doing it for lower fees," suggested Michael Rees, Managing Director, Neuberger Berman, DYAL Capital. He added: "Investors realise that managers can't deliver purely alpha returns in an USD8 trillion industry, they understand there's going to be a mix of beta and alpha."

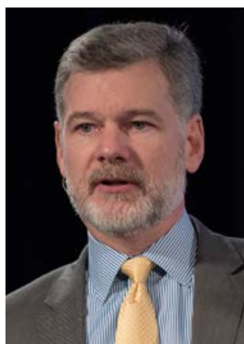
Given the relatively muted level of performance, particularly in the hedge fund space, over the last few years, going forward fees will need to be more closely aligned with performance. As one manager commented at CAIS 2016, "in order for alternatives industry to flourish those alignments of interests will be vital". ■

Chapter 2

Extending innovation into new sectors

One of the biggest drivers of change in the alternative funds market in recent years has been large institutions investing directly into large blue chip managers, concentrating 80 per cent of the industry's total AUM in the upper decile of fund managers. Consequently, it could be argued that hedge funds have morphed in recent years into something that no longer represents the original essence of what a hedge fund was meant to be.

Hedge funds used to be about making money. "Now it is about reducing volatility and generating risk-adjusted returns. The only ones really trying to make proper returns are private equity fund managers," postulated Mark Yusko, CEO and CIO of Morgan Creek Capital Management, in his keynote address at CAIS 2016.



Mark Yusko, CEO and CIO of Morgan Creek Capital Management

Size is the enemy of alpha

Institutional investors, along with market regulation, have driven the alternatives industry down this road; one where the speed limit is a safe 30mph, rather than 100mph on the German Autobahn.

Pre financial crisis, hedge funds were more willing to embrace risk to produce stellar returns but over the last six years, continued institutionalisation of the industry has crowded out individual HNW investors. This has allowed the bigger fund managers to get bigger but as Yusko pointed out, size is the enemy of alpha; it's impossible to produce consistently high returns with large AUM without moving markets.

To compensate for this, the smarter institutions are looking to chase the returns that hedge funds used to generate by developing in-house capabilities, building their own alternative investment teams. They have realised that small, boutique managers are the alpha generators and are, to an extent, re-embracing the original spirit of what a hedge fund used to represent.

Spiros Maliagros is President of Tiedemann Investment Group, a private investment advisory firm with USD9 billion in AUM across the group. On the size issue, Maliagros confirmed that TIG takes an incremental approach to capacity. "We like to test the capacity of funds. We take a careful approach to our funds' growth, closing funds to new investors and then re-opening them," said Maliagros.

One investor that is also training their sights on smaller managers to improve returns is Adi Divgi, President/CIO, EA Global LLC, a single-family office he established in 2005. Prior to his current institutional investor role, Divgi oversaw the Opportunistic Fixed Income investment program at the New York City Bureau of Asset Management from March 2011 to April 2014.

Speaking at CAIS 2016, Divgi said that the smallest amount that would get allocated in the Opportunistic Fixed Income program was USD200mn. Given that there was a restriction to invest in managers where the program owned no more than 10 per cent of a fund's total AUM, this limited Divgi to managers with USD2 billion or more in AUM.

"Now, I invest in meaningfully smaller managers that can generate alpha. Large pension funds will have to continue investing in the largest managers unless they create a FoHF platform," said Divgi.

The evolution of customised solutions

As well as evolving to invest directly into hedge funds, SWFs and other large institutional investors are exploring funds of one, segregated managed accounts, as well as buying GP stakes in hedge funds; essentially taking a long position on hedge fund fees.

All of this, said Scott Soussa, Senior Managing Director, The Blackstone Group, is

great news for the industry. "The evolution in hedge fund investing has been taking place for over a decade. We now call ourselves a hedge fund solutions provider. Investors who are the most flexible have done the best. And managers are now more willing to play. We do everything from managed accounts to funds of one, '40 Act funds, taking slices of managers' strategies to access consistent alpha generation; even if this means paying higher fees," commented Soussa.

Michael Rees, Managing Director, Neuberger Berman, DYAL Capital, made a similar point to Soussa, confirming the importance of becoming a solution provider not just a product provider.

"We are seeing more product innovation than ever before, largely because of fee pressure among investors. It's now about customising solutions for investors based on exactly what they are looking for. This is the next phase of institutionalisation as hedge funds deliver solutions," suggested Rees.

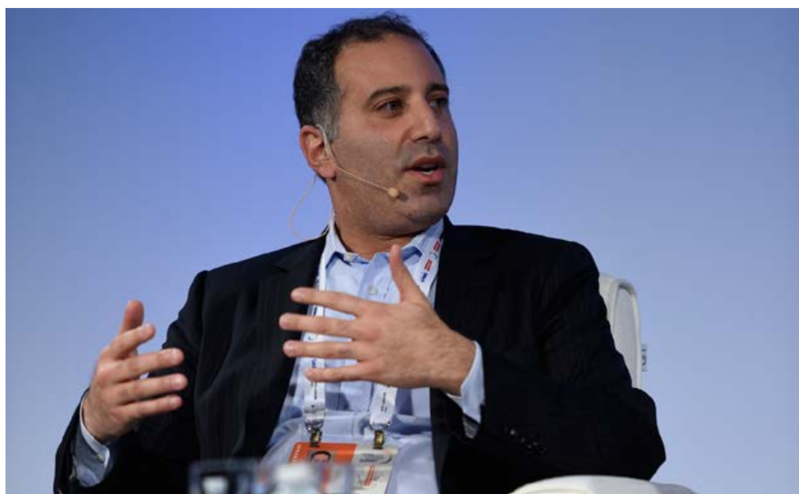
Embracing regulation

To help supercharge the industry brand, some alternative fund managers are beginning to embrace regulation rather than try to fight against it. Part of this is to enable them to expand their fund product range to include regulated funds to compliment their existing offshore structures. This is something that TIG has done by entering the European UCITS market with one of its fund strategies.

"We're now looking towards Asia. Rather than open offices locally we've found partners with the right distribution and legal and compliance frameworks to allow us to evaluate, incrementally, whether we want to go direct into those markets over time. Again, this is an incremental approach. I think UCITS has a place, and also the US '40 Act space," said Maliagros.

One prominent US hedge fund manager that has been quick to recognise the opportunities on offer under AIFMD regulation in Europe is AQR Capital Management. As Andrew Bastow, Vice President and Head of European Structuring and Regulatory Affairs outlined at CAIS: "Few US managers have set up as an AIFM in Europe. AQR is one of few that have and we are already seeing the benefits of that."

One aspect of regulation, however, that needs to improve is for countries like the US to introduce tax efficient wrappers to help improve investors' abilities to invest in real assets including infrastructure.



Scott Soussa comments in "The force awakens" panel

Domestic pension plans could be far better utilised, as is the case with Superannuation funds in Australia, especially when one considers the US has a USD2.3 trillion infrastructure shortfall. It is estimated that in the US, retirement plans amounted to USD26.5 trillion in 2015. Even if a 10 per cent allocation were to be made, that would go a long way towards bridging that fund gap; and, crucially, would allow pension funds to generate yields of 8 to 12 per cent in long duration assets: something that cannot be underestimated as the world grapples with punishingly low interest rates.

"A lot of sovereigns are holding dollars that could be used to invest in US infrastructure. That highway of investment needs to open up," suggested Rodrigo Real, Director, Cindat Capital Management. Michael Underhill, CIO, Capital Innovations LLC, added that within the US water sector there are infrastructure opportunities in desalinisation plants in California, as well as in wastewater, utilities, energy and transportation.

Product Innovation

Managers wishing to diversify their product offering to supercharge their brand and push the innovation button might do well to consider China. It is estimated that USD7 trillion could enter China's stock markets as Chinese pension funds are allowed to increase their allocations under regulatory reform. "Private companies in China will be listing A shares on the mainland's stock markets and that is

where the investment opportunities will be," suggested Charles Mautz, CEO and Founder of Chinus Asset Management.

The demand is certainly there among investors. Mark Makepeace is Group Director of Information Services and Chief Executive of FTSE Russell Group, London Stock Exchange Group. He said that access to China was on a short list of issues "that I would estimate are on the agendas of 75 to 80 per cent of large asset owners that we speak with."

Indeed, Vanguard recently received, on 29th January 2016, a renminbi qualified foreign institutional investor (RQFII) quota of USD3 billion – the largest quota to be issued to date – to invest in China's A-shares markets. Hong Kong-based CSOP Asset Management Limited, quick to tap in to demand among foreign investors, became the first ever Chinese asset management company last March to list an ETF – the CSOP FTSE China A50 ETF – on the NYSE Arca.

The rise of marketplace investing

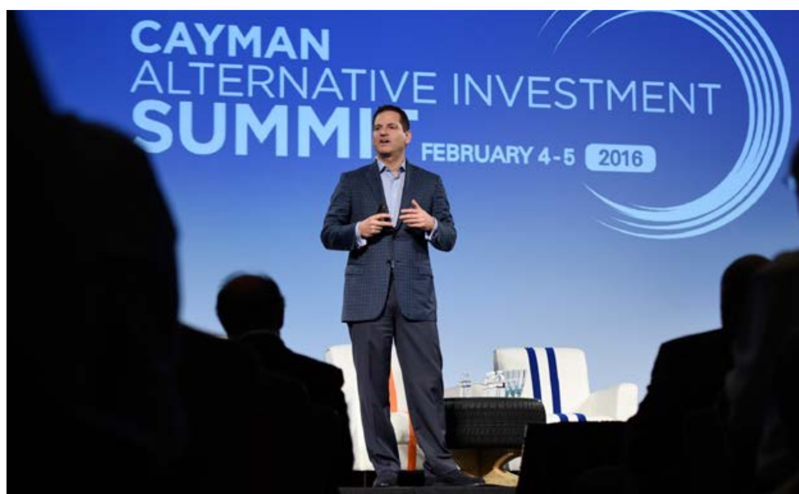
Alongside the burgeoning ETF market, as fund sponsors respond to the gradual opening of China's capital markets, one of the clearest examples of where disruptive technology is propelling product innovation is the rise of marketplace investing. What used to be referred to as peer-to-peer lending, allowing investors the opportunity to invest in chunks of consumer loans on platforms such as Lending Club and Prosper Marketplace, has evolved such that institutions can now buy whole loans that match their duration objectives.

Speaking at CAIS 2016, Ron Suber, President, Prosper Marketplace, said that marketplace investing represented a collision of Wall Street and Silicon Valley. So fast has been Prosper's growth that there are now Prosper bonds in the market, rated by Moody's and Standard & Poor's.

"Our platform is still yielding 6.3 per cent net every year, paid monthly, even as the economy changes, interest rates rise. Investors have moved from buying fractions of loans to what we call 'whole loan passive', where they ask for an equal slice of whole loans on the platform.

"Marketplace is in every part of credit market, not just consumer loans. We're only in the second innings," said Suber.

Suber stressed that Prosper's model works such that the left leg (capital), which represents investors looking for loans for a particular duration, has to balance the right leg (product), which represents the borrowers. Assuring that lenders and borrowers are aligned on the balance sheet allows Prosper to run a highly transparent, disciplined business model.



Ron Suber, President, Prosper Marketplace, addresses the audience

"At Deutsche Bank, we have looked to develop a platform where marketplace loans can be traded on the secondary market. Transparency is crucial – these platforms have all the necessary data, skin in the game, underwriting skills etc. We forecast that the short duration securitisation market will grow so long as platforms maintain their standards of underwriting," said Nicole Byrns, Director, Deutsche Bank.

Prosper is also the first platform to have done a securitisation. The 'S' word may still haunt some investors. But things have moved forward substantially since the financial crisis when nobody really knew the inherent value of the underlying mortgages that were being sliced and diced.

Looking ahead, Suber commented: "Retail investors will eventually be able to click on a symbol and buy marketplace loans from their JP Morgan or Charles Schwab account and invest internationally in consumer loans. The platform marketplace will look very different going forward."

There are countless ways for alternative fund managers to innovate and remain relevant to investors. The challenge for managers is to understand how to innovate in the right way without losing sight of their core values. Either way, this is a fertile period for the alternatives industry to evolve the brand. ■

Chapter 3

Macroeconomics & emerging markets

When considering how to "supercharge" the alternative funds industry, one region that continues to offer growth potential is Emerging Markets. There are myriad opportunities to harvest yield, but equally there are plenty of risks to navigate. As such, fund managers will need to take a measured, country-by-country, sector-by-sector approach in 2016 to realise gains.

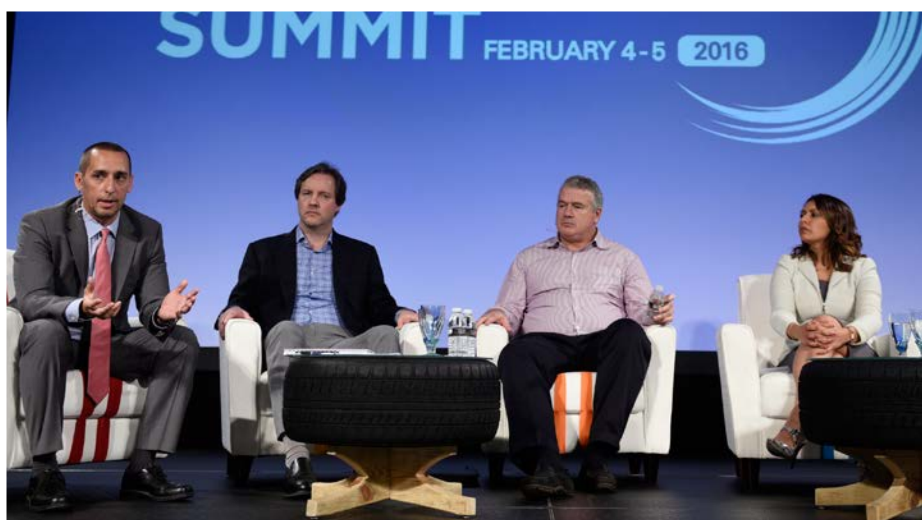
As Paul Schulte, Founder and Editor of Schulte Research commented on one of the panel sessions at CAIS 2016: "Alibaba in China is going to become one of the largest banks and media companies in the world. At the same time, I would suggest that the number one most toxic area of the market today is Brazil corporates."

Despite the fears over some emerging markets such as Brazil, the trends in other markets are compelling. Consider the following figures: There are approximately 835mn people in India below the age of 35. Over the next four years, 990mn people in India will be coming online with mobile phones. Asia now has 900 of the world's billionaires, with China ranked number one and India ranked number three.

It is hard to ignore these numbers, said Asma Chandani, General Counsel and Chief Compliance Officer at Chinus Asset Management, LLC, which seeks out the best local managers in Asia to tap into the region's emerging wealth. "Growth in wealth is not yet being reflected in global equities," said Chandani.

The opportunities for alternative fund managers over the next few years are likely going to be substantial to supercharge returns. This is despite the negative press on emerging markets that continues to flow out of the West. Indeed, for some, the opposite is true.

Charles Mautz is CEO and Founder of



Charles Mautz (second left) in "The Reports of my death have been greatly exaggerated" panel

Chinus Asset Management. He said that when visiting Asia, he noted a palpable difference in terms of how local people view the development of their economies, versus the perception that exists in developed market economies. Said Mautz: "China hedge fund managers are very bullish, adding more personal assets into their funds. Contrast that to what you read in the US press and China is perceived to be falling off a cliff. The West underestimates China's willingness to avoid a hard landing."

Anne Richards, Global CIO, Aberdeen Asset Management, said that from a macroeconomic perspective, the current level of disconnect (top down versus bottom up) "is quite possibly the highest I have ever seen. Sooner or later fundamentals will return, but timing it will be difficult. There is a laziness and a convenience among politicians to blame emerging markets for everything. China, after all, is forecast to grow 6.4 per cent in 2016."

Navigating through turbulent waters

That is not to suggest, given the wild volatility seen in January, that China is a low

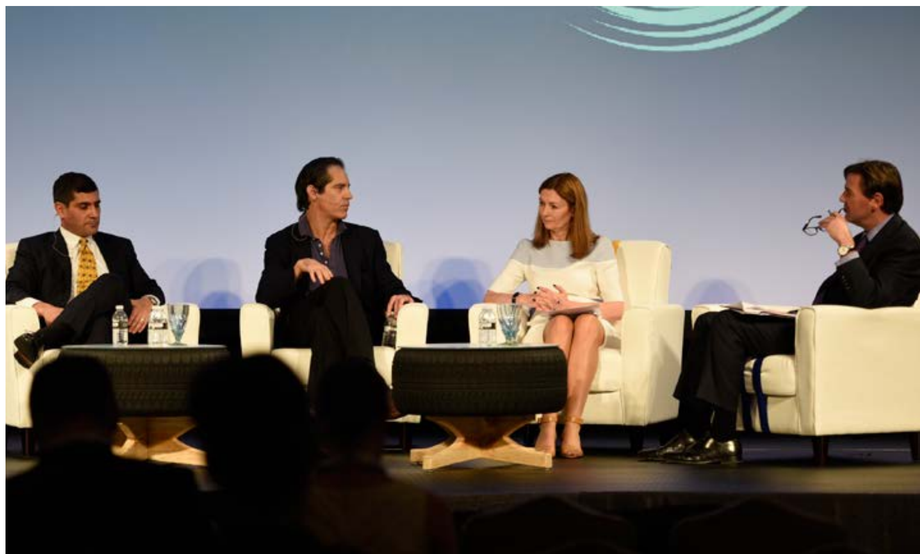
risk strategy. Credit risk is creeping higher, with non-performing loan default rates expected to rise from 1 per cent to 1.5 per cent in 2016. Numerous Chinese corporates that are uncompetitive and have borrowed substantial amounts from banks at low rates are at risk if and when interest rates rise in China.

Moreover, currency risk has been introduced with the recent devaluation of the RMB, prompting Mark L. Hart III, Chairman and CIO of Corriente Advisors LLC, a Texas-based hedge fund manager, to forecast that the RMB could devalue by 50 per cent when foreign investors divest their positions in China.

Quite what impact that would have is anyone's guess but if, at the same time, the US dollar appreciates further in 2016, emerging markets could be a vortex to navigate over the near term and won't be for the fainthearted.

Raoul Pal, Economist, CEO and Founder, The Global Macro Investor, and CEO and Co-founder, Real Vision Group, forecasted that the US dollar would continue to rise in 2016, on the back of a 7 per cent appreciation in 2014 and 10 per cent appreciation last year. "Even if the US Federal Reserve cuts rates the US dollar will still rise, as was seen in the 80's and the late 90's. I think we will see another 10 to 15 per cent increase this year," said Pal.

Pal was speaking about global macroeconomic forecasts at CAIS 2016 on an esteemed panel that also included Nouriel Roubini, Chairman, Roubini Global



Anne Richards comments in the "Running with the Grain of Reforms in Emerging Markets" panel

Economics (also known as "Dr. Doom"), and John Mauldin, Chairman, Mauldin Economics.

The panel was chaired by Constance Hunter, Chief Economist, KPMG. Hunter identified three themes for 2016: bifurcation, debt, and 'flation'.

"We see bifurcation everywhere as a result of divergent central bank policy. The US is raising rates, Brazil is raising rates, New Zealand is raising rates with pretty much everyone else lowering rates and going from a zero interest rate policy (ZIRP) to a negative interest rate policy (NIRP). This has huge implications. In the latest stress tests issued by the US Fed, it is asking banks to look at what the impact of NIRP would be on the US economy. But for now, we still see the Fed on a raising interest rate trajectory and the rest of the world on a declining interest rate trajectory," commented Hunter.

Roubini pointed out that policy divergence has not been the rule historically; if anything the opposite. It was only the smaller central banks looking to do negative policy rates; the Danes, the Swedes. Now the Bank of Japan have started doing it.

Roubini: "Rates will go negative"

"I will make the provocative suggestion that the Fed will introduce more quantitative easing and rates will go negative. I think -1 per cent will become the new zero. The amount of debt will dictate this. You have to keep on monetising it to avoid deflation," said Roubini.

Mauldin for one does not see the debt cycle continuing. "We'll have hit the

debt re-set button by 2030 and so many opportunities will arise. It's going to be cool," enthused Mauldin.

For the time being, central banks will continue to do everything within their power to support higher asset prices and create much needed inflation by suppressing interest rates. This is Neo-Keynesian economics at work, with the objective to push consumption not production. Problem is, central banks are fast running out of room because the money being borrowed is not producing growth. The next step, as we've seen in Japan, is NIRP.

"It's precisely the wrong policy but the central banks are going to do it anyway. We'll be lucky to do 1 per cent global GDP growth over the next 10 years. Welcome to a decade of disruption," said Mauldin. He added: "Ben Bernanke said you have to put negative interest rates on the table. I would suggest that most fund managers in this room have not stress tested their own portfolios for NIRP. They have to start war gaming."

Investment suggestions from the experts

Roubini does not think policy makers have been Keynesian enough. There is still more supply than demand in the system, and not enough consumption. Asked by Constance what his two investment suggestions would be for 2016, Roubini replied: "US bond yields will fall closer to 1 per cent rather than stay close to 2 per cent. Also, buy protection against a 20 per cent correction in the S&P and global equities. The risk of a global bear market is rising day by day."

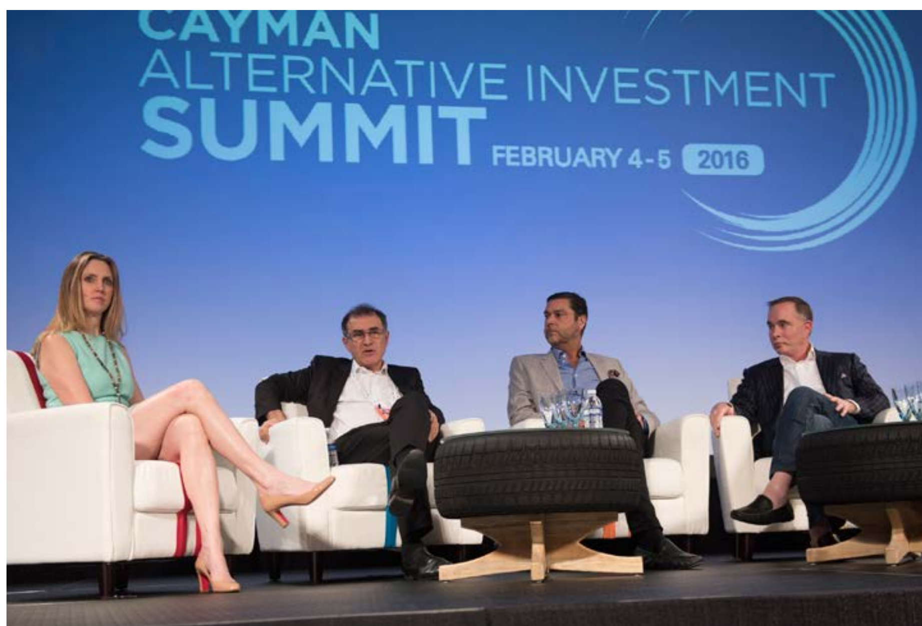
Pal said that he predicts US 10-year Treasuries to fall closer to 0.5 per cent in the next 12 to 18 months. He added that as a higher risk investment opportunity, "Iran is a fantastic investment market and is relatively isolated from the global markets."

Mauldin confirmed that his biggest trade for 2016 is going short the Yen with 10-year options. Second, to hedge against negative interest rates Mauldin said he would buy option puts.

"I would qualify that trade further and go long on European negative interest rates via put options. I would also go long Argentina," added Hunter.

Moving back to the idea of supercharging returns in emerging markets, it is worth pointing out just how nascent China's stock market is. The vast majority of investment activity on the CSI 300 Index is still retail. As corporate governance improves, and the mainland makes it easier for global asset managers to participate in its capital markets, the level of volatility could soften. For now, however, the global economy still relies heavily on China consumption. As soon as its economy experiences a hiccup, the ripple effect is significant. As Cowell pointed out:

"Its clear now that when China has an accident the world gets hurt."



Constance Hunter and Nouriel Roubini comment in "The winding road" panel

Paul Schulte compared China's transition towards an inward consumer-focused economy to that experienced by Taiwan in 1990. For the time being, however, he warned managers to avoid the value traps of investing in China via Hong Kong H-shares. "There is a 40 per cent discount price in Hong Kong. It is drowning in money. The SEHK is a quicksand market. I wouldn't be chasing that discount right now," said Schulte.

Macroeconomics are likely to create plenty of investment opportunities in 2016 because of bifurcation, debt and a potential move to negative interest rates in developed markets beyond Japan. And whilst this is going to create further volatility in emerging markets, asset managers who can formulate unique strategies to tap into the region's growth, especially among commodity consuming nations such as India and China, could be well placed to succeed. ■

Conclusion

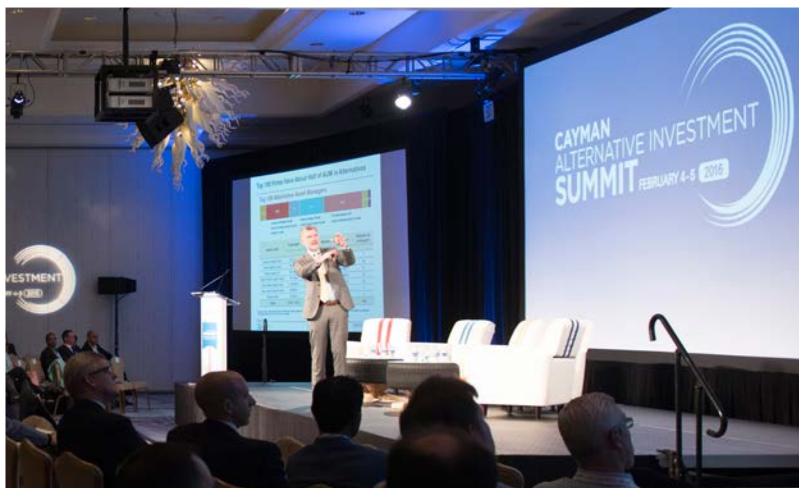
The overall sentiment within the room at CAIS 2016 was one of optimism. This is perhaps the most exciting period the alternatives fund industry has known and as assets continue to flow into the industry, there is no sign that the brand is running out of steam.

Tomorrow's winners will be those who embrace the pace of change, particularly in respect to regulation; directives such as AIFMD, Dodd-Frank, and the more pervasive MiFID II, are forcing alternative fund managers to re-imagine their business and operating models to enhance the level of transparency. This, in turn, will help forge closer alliances with end investors as their desire for data and solution-driven outcomes continues to build.

In that respect, technology is key. Big Data solutions, more advanced data management capabilities, predictive analytics: all will help arm alternative fund managers and allow them to keep pace with the evolution of the marketplace although a close eye on cybersecurity protocols will be necessary to protect sensitive assets. One point that came across strongly at CAIS 2016, however, is that there's still a long way to go to embrace the speed of change and improve the level of communication with investors.

"The biggest challenge for the industry is how to navigate the opposing forces of: on the one hand reducing systemic risk and protecting consumers…while on the other hand, encouraging people to save and invest for the long term," suggested Cowell.

From a global macro perspective, Emerging Markets will continue to provide individual opportunities for managers, especially as China embarks on its One Belt One Road initiative to link China with Europe (a 21st Century Silk Road in effect) and gradually opens up its capital markets to foreign investment. On the commodity side, energy MLPs provide attractive valuations, along with Argentina farmland, gold and timber, whilst in the credit markets, marketplace lending could begin to see more securitisation of loans and increased secondary market opportunities for investors going forward.



Mark Yusko, CEO and CIO or Morgan Creek Capital Management addresses the audience

As a final, thought provoking conclusion, here are some potential surprises – not predictions – for 2016 offered by Mark Yusko, CEO and CIO or Morgan Creek Capital Management:

- There goes the boom – developed markets fall into recession.
- Two wrongs won't make a right – further rate increases on hold, by 2H16 begging to do QE4. Inflation expectations are that there will be deflation.
- Save us Kuroda-san you're only hope – Yen falls dramatically.
- Saudi is not fracking around – Saudi abdicates its role as wing producer within OPEC and oil heads back towards USD40-50 by the end of the year.
- The black swan alights in Europe – messy bankruptcy of one or more commodity trading companies as the 2011 commodities bear market comes to a head.
- Déjà vu – welcome to Year 2000 2.0. S&P at similar level to 2001. Time to get hedged
- King dollar gets dethroned – USD peaks and begins to weaken against other global currencies.
- Cure for low prices is low prices – commodity prices begin to find a floor, investment opportunities amidst bankruptcies in MLPs.
- The bus stops here – go short high yield credit. Lots of defaults on the horizon. ■