

MAY 2018



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Consultant

Iain joined JANA in January 2018 as a member of the alternative investment strategies research team. He will also have consulting responsibilities for some of JANA's large institutional clients.

Iain was most recently in London, where he spent 11 years at Aurum Funds, a specialist hedge fund firm where he was a senior member of the investment team. He brings specific experience in direct investing across the whole spectrum of hedge fund strategies. Over the years he has built strong relationships with senior JANA personnel. Prior to moving to London in 2006, Iain held positions at NAB and Frontier.

Iain is a CFA Charterholder, holds a Certificate of Applied Finance and Investment (FINSIA), and a Bachelor of Commerce in Finance from the University of Melbourne.

## GLOBAL MACRO - AN ALTERNATIVE INVESTMENT STRATEGY

### Introduction

JANA has been recommending diversifying strategies within its asset allocation advice for some time, recognising that most traditional asset classes are at best fully valued, or in the case of bonds outright expensive. In this edition of MyConsultant we will profile one example of a diversifying strategy that can play a role in further diversifying an investment portfolio.

The classic hedge fund strategy known as global macro is one of several investment strategies that can be used to diversify investor portfolios.

We discuss why now is an appropriate time to consider alternative strategies, outline the evolution of global macro through time, assess its recent performance and detail the increased opportunity set for the strategy.

The return of market volatility in the first quarter of 2018 is a timely reminder that relying on traditional long only investment strategies is not a free lunch and it is timely for investors to look beyond the traditional long-only investment strategies of equities and bonds in order to construct a more diversified investment strategy.

Since the fall out of the 2008 global financial crisis, investors have been rewarded handsomely for investing into traditional long only equities and fixed interest portfolios, with the tail wind of ongoing monetary stimulus benefiting both asset classes.

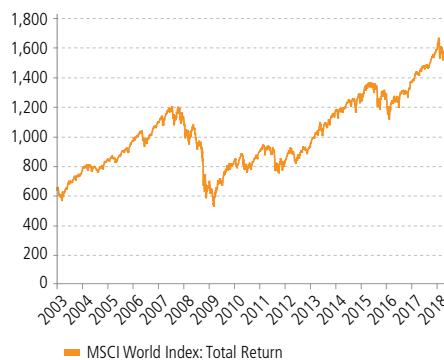
Other traditional diversifying asset classes including Property and infrastructure have also been huge benefactors of a decade of ultra-low interest rate policies.

However, with the US Federal Reserve now in interest rate hiking mode, and with other regions reducing stimulatory monetary policy, it is timely to assess alternative investment strategies.

### Why consider alternative strategies now?

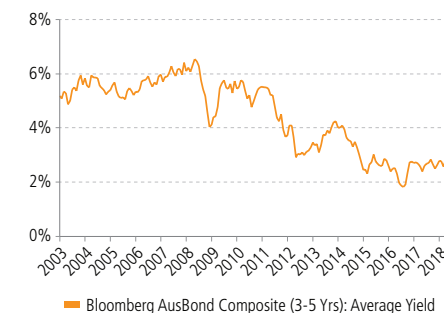
Equities and Fixed Interest have enjoyed strong performance, but prospective returns look challenged, especially for Fixed Interest.

#### Chart 1: Global Equity Performance



Source: JANA/FactSet

#### Chart 2: Average Yield on Bloomberg Ausbond Composite



Source: JANA/FactSet

## What are the alternative options?

Global Macro is one of the classical hedge fund strategies, made famous for outsized gains made by George Soros and Paul Tudor Jones in the 80s and 90s, with Jones making large gains for clients by being positioned to profit from the 1987 market crash.

While few funds of that generation are still around, the strategy has developed significantly over the past 20 years, with many institutional investors utilising it as a strategy to diversify away from equity, bond and credit risks. In essence, it's a diversifying return stream for a traditional balanced portfolio that is not dependent on underlying market direction.

Over the past decade, the institutionalisation of the strategy, increased technology and transparency and lower fees have now made this strategy a mainstream solution for large sovereign wealth funds and leading institutional investors around the world.

The changing characteristics of the strategy over the past 20 years are summarised below:

## Global Macro - evolution over the years

Table 1

	1980/90's	Now
<b>Fees</b>	Often more than "2 & 20" – 2% base fee and 20% performance	Alternative strategies with fees vary from 0.5% to "2 & 20"
<b>Style</b>	Concentrated & volatile	Diversified & risk-managed
<b>Liquidity</b>	Quarterly or annual redemptions	Daily, Weekly, Monthly redemptions
<b>Transparency</b>	Little to none / brief investor letter	Up to full transparency / detailed risk exposure reports, frequent investor calls, Portfolio Manager access
<b>Structure</b>	Offshore fund with regulation light jurisdiction	Onshore trusts, regulated vehicles (e.g. UCITS)
<b>Investors</b>	Private, wealthy clients	Pension funds, Sovereign Wealth Funds, leading endowments.

## History of Global Macro

Global macro takes its name from the study of macroeconomic data and policy to predict changes in price for asset classes and securities. This could include studying weather crop yields to speculate on the price of corn or analysing Federal Reserve speeches to assess future monetary policy.

It is perhaps the broadest of all hedge fund strategies, the ultimate 'go anywhere' investment approach. Early practitioners of the strategy were drawn to it by the freedom of not being bound by arbitrary benchmarks, the ability to go both long and short, and the freedom to focus their energies and capital on their best ideas.

Managers can take both long and short positions on a wide range of bonds, equities, commodities and currencies based on their analysis.

In the 1980's, macro managers initially focused on commodity and FX markets given the early use of futures in these markets. However, with the development of derivatives and liquidity of financial markets, including emerging markets, coverage has grown to cover all asset classes in every corner of the world.

Crucially, macro managers are not tied to a specific style or benchmark and can perform in a wide scope of market conditions. For example, many macro managers were able to post double digit returns through the financial crisis of 2008 by taking positions in relation to falling US interest rates and currency movements.

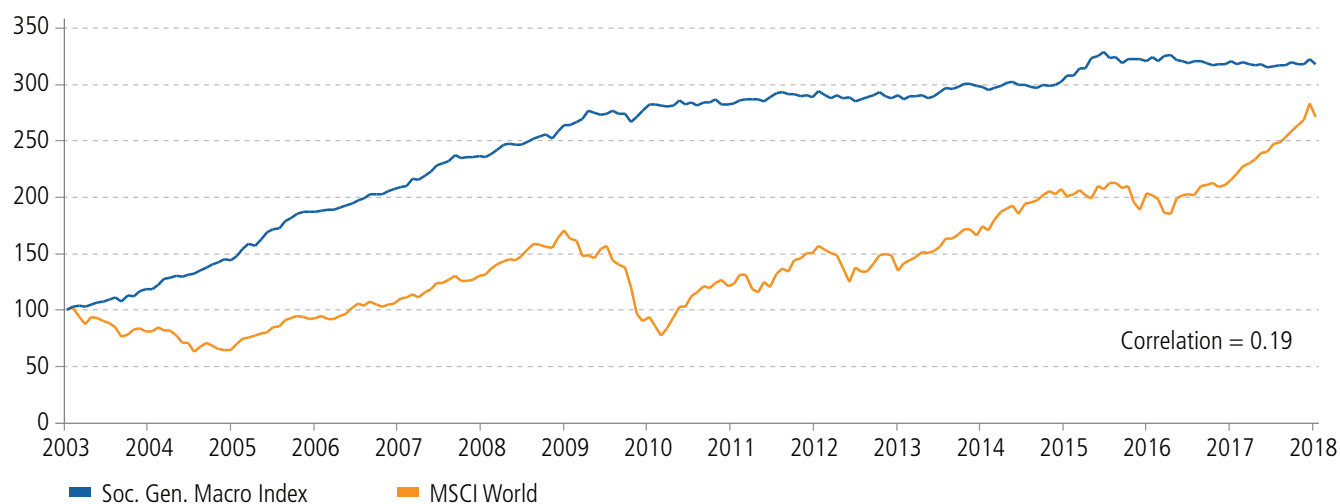
While there were only a handful of macro funds in the 80s and 90s, there are now several hundred active managers, ranging from diversified multi-billion-dollar firms such as Bridgewater Associates, to smaller boutique funds with focus on a specific market (i.e. US interest rates).

## Recent Performance and Looking forward

The performance of the strategy has struggled over the past few years, as can be seen in the chart below. Many managers would argue that the extreme levels of Quantitative Easing (QE) since 2008 has altered valuations beyond fundamentals and has created a situation where 'all boats rise'.

QE has also arguably led to ultra-low levels of volatility in both equity and interest rate markets, which is not typically supportive of global macro trading which looks to benefit from significant change and higher levels of volatility.

Chart 3: Global Macro performance versus Global Equities: Macro has lagged in recent years



Source: Société Générale, MSCI, FactSet

However, there are signs that the investment opportunities are increasing for global macro strategies. The US Federal Reserve is currently in full interest rate hiking mode, with two or three additional hikes expected in 2018.

This is likely to have implications for the pricing of assets all over the world, as everything from property, equities and corporate bonds are influenced by this 'risk free rate'.

An increase in interest rates means that investors will have to be more selective in allocating across and within asset classes, which will most likely mean an increase in cross asset market volatility.

For example, rising interest rates and a rising US dollar could have a significant impact on assets in particular areas of the emerging markets, where governments often borrow in US dollars.

Political uncertainty, as well as potential trade wars could further impact performance dispersion amongst countries. While long-only and benchmark-focussed managers fear large change and disruption, macro funds often benefit from increased volatility.

With emerging markets rising in economic power, large tectonic shifts occurring in demographics and consumer taste, and tightening monetary conditions after 10 years of stimulus, global macro funds are more optimistic about their strategy than they have been for years.

## Conclusion

There are numerous options for investors concerned about forward looking returns from their traditional equity and bond allocations. One of these is to consider an allocation to global macro, one of the classical hedge fund strategies. This strategy is becoming more institutional with lower fee, increased transparency and liquidity in recent years. As a result, global institutional investors are now looking to the space to diversify their portfolios.

Like any strategy, an allocation to alternative strategies such as global macro does not guarantee positive performance. However, JANA believes that a moderate allocation to global macro strategies, as part of diversified portfolio, can provide attractive characteristics, but patience, strong manager due diligence, fee considerations and appropriate sizing of allocations are paramount to success.

Global macro managers have the tools to generate positive performance in a wide range of markets, including bear markets or conditions where there are large shifts in sentiment. While performance has been mediocre over the past few years, there are signs that the prospects have increased for this sector with the recent increase in volatility, rising interest rates in the US, and large changes in the global political landscape.

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