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Hedge funds target retail investors

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Hedge funds are targeting retail investors who have crowded into the sharemarket under the "there is no alternative" premise, arguing not all hedge strategies are high risk.

The long-only fund managements industry has come under increasing pressure to justify their fees, with two thirds unable to hit or exceed the benchmark index return.

Hedge fund managers say investors, particularly those entering retirement and unable or unwilling to weather the volatility of the equity market, which is delivering anxiety but mediocre returns at best, should embrace alternative investments.

Alex Zaika, a director at iShares, global fund manager BlackRock's exchange-traded funds business, said in the US between 2012 and 2015, $US390 billion ($511 billion) flowed out of core active strategies, while $450 billion flowed into alternatives, and $US1.3 trillion flowed into passive funds.

It's a trend that's emerging in Australia as well. High net worth clients are turning to hedge funds, but adopting them around core passive strategies, Mr Zaika said.

"A common allocation to alternatives is 10 per cent, we're seeing that increase to 15 or 18 per cent in some cases," he said.

"It's not a debate around active versus passive, it's really more around when and where do investors choose to pay for active management and when and where investors look to save costs and go into passive."

Sophisticated strategy

Investing in long-short strategies require a greater level of sophistication, and the myriad of strategies heighten the perception of risk. They also generate higher fees and some have liquidity restrictions.

They therefore remain underused in self-managed super funds, but Geraldine Barlow, general manager of investments at Australian Unity Investments, said for one, the quality was improving.

"The hedge fund industry has cleaned itself up a lot. I think the choices today are a lot better than they used to be," she said.

Mark Burgess, the portfolio manager of the Bennelong Kardinia Absolute Return Fund, said long-short strategies have more room for outperformance because shorting is a much smaller segment of the industry than in other countries. Critically, investors should not judge a hedge fund on its returns alone.

Mr Burgess said there were three major long-short strategies in the market: active extension, or 130/30 funds which aim for a 100 per cent market exposure, market neutral funds, where the aim is zero market exposure and variable strategies.

Investors need to judge a fund based on its returns over more than five years, rather than one stellar year, Mr Burgess said.

Standard deviation

More important however is to assess the standard deviation – the percentage the returns fluctuate from the benchmark – the amount of leverage in the fund, and the performance in down months.

Glenn Rushton, executive director at Rushton Financial Services which operates a Global Market Neutral Fund, that is diversified across seven countries and currencies in 400 positions to reduce exposure to market moves, said long-short funds present less risk for retirees than the All Ordinaries, in an era when returns are set to remain indefinitely low.

"Why are all these people that can least afford the volatility being driven and forced into [long funds] when we've got better options," he said.

"If we can remove that risk eventually completely, by being equal long and short, then if the market falls 20 per cent overnight, you would at least neither lose nor would you gain."