SHINING A LIGHT ON……
BSF GLOBAL LONG / SHORT EQUITY FUND

At a glance

We are facing a different environment in which it is likely to challenge investors' expectations of future returns. This is driven by the fallout of the global financial meltdown in 2008 where QE is coming to an end (or has come to an end), interest rates will remain lower for some time to come and inflation is expected to be low.

With this background analysts expect after inflation annual returns from cash to be flat, bonds between 0 and 2% and equities between 5 and 7% over the next 5 to 10 years. The challenge for investors is that cash and bonds are perceived to be low risk income producing assets. But with income being received from these asset classes, the capital in real terms will start to fall. Therefore more investors are realising that to generate income and capital growth they need to take more risk. But the reality is that they don't want to do this because of the risk – catch 22!!

The financial market is responding to this need by developing a raft of different products to respond to this changing environment. Arguable one of the main funds available to retail investors in the UK is the SLI Global Absolute Return Strategy Fund but alternatives are appearing all the time from the likes of Invesco, Threadneedle, Premier, Aviva, GLG and many others.

For investors the strategies employed can be complex and in some cases for little perceived return. However, you could argue that some bond strategies are complex!

One new fund for UK retail investors is the BSF Global Long / Short Equity Fund. This fund was launched in the UK in 2014 but a version has been running in the US for a couple of years and overall BlackRock (who run the strategy) have been managing these strategies for a number of years.

In this update we talked to one of the members of the team to understand why their approach is different and why investors might consider this as an alternative to bonds, and some of the other options in the market.

Fund highlights?

However, you try to dress this up the fund is complex. In simplest terms it uses a process called scientific active equity management to manage downside risk but at the same time aiming to deliver attractive returns of between 5% and 7% net per annum.

For many investors this may be enough, if they believe that BlackRock have the capability to deliver on this strategy than why delve further.

The reason for investors to delve further is to provide support to their belief. So in the discussion there were two main areas we focused on – firstly to understand what they are doing to achieve the returns and secondly to understand how this is supported.

Just touching on the second part this is really important because many of these strategies are complex, we have seen some strategies rely on the skills of one or two people and these we believe bring in additional risk for investors. What we want to understand is the breadth and depth of the team behind the strategy. We accept that one person (or two) may be the overall manager but the theory is that they are not key to the strategy working, so if they go it doesn't damage it.

Turning to the management of the strategy, this to some extent is fairly straightforward. Effectively this is what is called a long / short strategy where the manager bets on the things they think will go up against the stuff they think will go down.

However, BlackRock argue that the strategy is more scientific than this simplistic view. In the discussions they explained that the team will 'go long' companies they anticipate will increase in value and short sell companies that they anticipate will decrease in value but in doing this they are looking to reduce the market related risk. What this means is that what happens in the market shouldn't impact on the returns in the fund.

So for example, the managers might go long European exporters and short US exporters because the Euro is depreciating which is good news for European Companies because there their goods are cheaper and therefore more attractive and bad news for US exporters because their goods are more expensive and less attractive.

It is therefore more than picking one company it's about taking a more rounded look at different factors which could drive potential returns.

The strategy partly crosses over to the importance of the team, the amount of data we receive is more than we can comprehend. They went on to expand on this to say that 90% of data has been created in the last two years which makes it really hard for an individual to go through that data and identify opportunities. In fact on an average day, over 4,000 analyst reports are generated around the globe.

The challenge is how to crunch down that data to identify what they call "non-obvious" opportunities. This is fed into their systems which identifies key components which is then analysed by an in-house team of 'data scientists'. This analysis will help the team identify companies which will be caught in the ripple effects of other company specific or market wide events. Looking at the support data provided by BlackRock one example they used of how this data can be used focused on the Spanish Recovery in 2013.

Effectively the team using the ecosystem of data quickly identified that consumer and executive sentiment was increasing in Spain. In April 2013, the fund invested in firms that could benefit from a strong Spanish economy, building positions before the market began to rise in June 2013.

I was interested to know how long positions are held and the average period is 3 to 6 months. So this shows a very active fund. Some positions can be very short up to days and some like demographic trends can be long term.

One other area which we discussed was risk and this is where the mix of systems and human intervention is so important. Many people correctly relate volatility to risk, the fund is set to keep volatility low. However, volatility over the last three years is artificially low and therefore to base the volatility on what the past has done can create problems. So this is where human intervention has to come to play to adjust the target volatility to a level which they believe is reflective of the future.

An area we should touch on because it is important and that is the people. Because although this has a sound process, fantastic systems etc the people are integral its success. In the conversation we had the stand out comment was that the fund could 'fly itself' but it does need a portfolio manager to step in when the models aren't showing the right data. Firstly BlackRock have a team of 80 investment professionals who have managed long / short portfolios since 1996. The trading team is based across the world in San Francisco, London, Hong Kong and Sydney providing not only a local perspective but also a 22 hour trading day. It is worth touching on the team based in San Francisco in Silicon Valley which includes a NASA scientist (effectively reaching into the rich resources available) and finally the team is backed by over 130 research professionals, quantitative analysts and traders.

In summary this is a complex strategy that uses systems to crunch data and identify hidden opportunities. Controlling risk is at the heart of the strategy and it may appeal to investors looking to enter the equity market from low risk assets, or it may act as a blend with other assets.

The only question is on performance. The strategy has been run in the US for a couple of years and other strategies have been in place for a number of years but this actual fund has no track record. We have seen a number of new funds launch on the back of successful strategies and not deliver. This doesn't necessarily mean that someone shouldn't invest but caution should be exercised. For some investors waiting 12 months (or more) to see how it responds may be wise particularly in this very volatile period.

For those who believe in the process, and the team may feel that they can deliver but this is an important consideration. On paper the process appears strong and the team solid. The question is can it deliver on what it says it will……..

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