Hedging Your Bets

by Stephanie Han

High profile bankruptcies and the freefalling Nikkei are all signs of the times. While analysts are saying that the climate will improve – after the first quarter of 2003, many individual investors may find themselves weighing the pros and cons of playing it safe – focusing on capital preservation, or taking advantage of the market conditions in anticipation of brighter days. Contrary to what you might think, it's a time to do both.

While most Asian investors panic at the thought of recession, industry experts simply view this as a stage in the economic cycle and do not move from their basic attitudes about investment. Jennifer Pang, wealth manager of Hong Kong Wealth Management Limited says, "It really doesn't matter if it's recession or not. You have to look at the client and their attitude towards risk investment. Are they the type that can't sleep at night during recession? We advise accordingly, maybe ask them to invest in a bond fund. We're trying to look at the overall situation."

Recession Basics

Most investors have funds in order to gain more exposure to different areas of the market. Now more than ever, you should choose a fund manager that is solid, someone with an established track record, and a good reputation based on past performance. Recession is not the time to entrust your money to that bright young nephew who just got his MBA. And while you might instinctively run to the arms of the tried-and-true bank that has looked after your money since childhood, your exclusive reliance on in-house funds is not always the best solution.

Finding the Fund That's Right For You

With 40,000 funds on the market, it is highly unlikely that any one individual or institution will be able to take care of all of your needs. Banks often market their own in-house funds to clients because they are more familiar with the qualities of the fund, and are more comfortable with their institution's own offerings. They know the needs of their clients, and would rather recommend a fund that they are familiar with, rather than a fund that they themselves have only followed for a year. The message? Listen to advice about funds, but also ask questions. Jeremy McAteer, head of Portfolio Services Asia, UBS Private Banking, says, "Investors should ask whether or not their mutual fund provider markets only its fund products or offers a selection of its own and third-party mutual funds. They should also assess the process by which the third-party fund offerings are selected." He adds that if you are dealing with institutions which offer proprietary as well as third-party funds, you should ensure that the fund selection and due diligence processes are robust. "Investors should look at the quantitative and qualitative analysis employed by institutions to filter third-party products," says McAteer.

About Hedge Funds

In many circles, hedge funds, a type of mutual fund, are a current topical financial discussions. Hedge funds are expected to “hedge” or protect the investment against market volatility. While they weren’t as popular in the early 90s, their “absolute strategy” (making profits even when indices are down) resulting in 10-15% returns in a market that might fall by 15%, have secured their place in many portfolios. While some argue that hedge funds carry a greater risk than the S&P 500, the level of risk is determined by the hedge fund type. Alex Berner, Executive Director of Morgan Stanley AG Hong Kong, says “Generally hedge funds are perceived to be speculative but most are safer than mutual funds (long only) – they cannot go short. I would recommend this asset.” There are over a dozen different kinds of hedge funds with a wide range of characteristics. Jeremy McAteer adds, “the hedge fund exposure is not necessarily any more or less risky than investing in traditional mutual funds. It depends on the type of hedge fund. In an environment of declining equity prices, an investor may wish to be sure that the direction of equity markets does not drive the price direction of the hedge fund. Market-neutral hedge funds have had and continue to have a place in investment portfolios over the past two and a half years.”

Hedge funds use financial instruments to deliver results and are specialized, focusing on a particular market or area, relying on the expertise of the fund managers. “Hedge funds have more of a complex structure than mutual funds, it’s a more sophisticated product. The liquidity for hedge funds is not as high as mutual funds, generally its quarterly and monthly not daily,” says Alex Berner. Managers work on an “incentive fee” meaning that their pay is determined by their delivery of positive returns, and thus hedge funds regularly attract industry “superstars”. These individuals are heavily invested in the funds that they run, and have a personal stake in the fund success. They often run their own boutiques to remain nimble and flexible. Market value is important, but again, ask questions. Most analysts agree that when choosing a hedge fund manager you should be certain of the financial security of the organization. They should have a strong reputation, and the counterparty that has a global reach in terms of its selection of services.

Put Your Money To Work

In a time of high risk and market volatility, strategies towards investment change. Unfortunately, some high net worth individuals fail to understand their investments – with potentially disastrous consequences. Rather than being defensive, recession is a time for you to be aggressive – do your own research, and keep asking questions until you fully understand the strategies a fund is using. It’s your money after all, and knowing what you are buying will give you confidence throughout this period.

(*Hong Kong Tatler, 2002*)