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Opalesque Exclusive: Investors may be warming to risk, but do not want managers to be “risky”

From Kirsten Bischoff, Opalesque New York:

As 2010 draws to a close, hedge fund investors are reportedly warming to risk. Perhaps missing the outsized performance returns they saw in 2009, hedge fund investors appear more willing to move money back into “riskier” strategies. Even though many managers have reached previous high water marks, a large chunk of investors are still trying to recoup 2008 losses; and it has become ever more apparent that during the expected, prolonged market stress, every basis point counts.

Firms such as Chicago-based [Horizon Cash Management](#) have seen the change in investor sentiment as well. The firm’s hedge fund clients have seen redemptions taper off and new subscriptions come in, and as that happens Horizon is managing larger amounts of cash for them.

However, the rising comfort level with “risk” (on the part of both managers and investors) does not translate to “riskier” behavior.

Initially, what funds were focused on during and after the financial crisis was “what is safe?” Pauline Modjeski, President of Horizon told Opalesque. “While safety is still paramount, one of the most important things that managers are looking for is to make sure that they also aren’t leaving any money on the table.”

Horizon has been seeing prospective clients that are looking to actively manage cash holdings, due largely to the combination of investor pressure to eke out returns, and the historically low interest rate environment that appears to be in place through at least the first half of 2011. “These managers do not want to take a lot of risk. They are not reaching for yield, like we saw a few years ago, but instead wanting to use investments that are safe, and liquid, and able to generate additional basis points for the fund,” she says.

Paying the operational costs of a fund could, in the past, typically be covered simply through active cash management. Now, with operational costs greater than they were prior to the financial crisis, performance returns lower, and investors receiving increased transparency into the portfolio, hedge fund managers are being asked directly by their investors about the ways they are actively looking to resolve, or mitigate this additional fee burden.

Horizon outlook for 2011

Horizon invests in US Treasury securities, US Agency securities, CP, short corporate notes and repo. Jill King, Sr. Portfolio Manager at the firm [spoke to Opalesque in early 2010](#) about how her team was navigating fixed income markets during the prolonged low interest rate environment to provide added yield enhancements that do not add incremental risk.

King anticipates making gains will continue to be a challenge through the first half of 2011. Although everything is pointing to an improving economy, Fed Chairman Bernanke told the US public earlier this month that he has not yet taken additional quantitative easing steps off the table yet. And while extending unemployment benefits, and tax cuts will likely help the stock market in the US, King also reminds us that the sovereign debt crisis that has been slowly unraveling in Europe is not yet over, and could still cause global market stress.

Allocations have risen in strategies such as distressed securities and Sol Waksman, founder and President of BarclayHedge noted in a recent report, "Hedge fund investors are exhibiting a healthier appetite for risk. They are finally venturing into areas like distressed securities after embracing conservative strategies for most of the year."

"The Fed is not going to do much in 2011, but there are indicators that the market anticipates 2012 will be a real growth year," says King. She says many economists expect that interest rate movement will be seen after the first half of 2011 in 2-year bonds, even if the Fed does not raise interest rates during that time.

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