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Investors race to alternatives

There's more to investing than just shares

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Equities have rallied more than 50% this year and yet fund managers are increasingly looking for alternative ways to make rosy returns for investors.

Litigation funding has become one of the most fashionable alternative investments. Mayfair-based Harbour Litigation Funding, for example, is backing the Michelle Young divorce. The wife of property tycoon Scot Young suspects him of hiding £400m.

Fund managers Neil Woodford of Invesco Perpetual and Sanjeev Shah of Fidelity are also getting in on the act, having snapped up stakes in Burford Capital, the commercial litigation firm, after its AIM listing.

Man Investments, the listed hedge-fund provider, is to make its services available to retail investors this month with the launch of Man AHL Diversity, a "trend-following" fund.

Fund firms are also launching hedge fund-style schemes for retail investors, run by their star managers. Jupiter's Philip Gibbs is poised to manage an absolute return fund that will aim to make money in any market conditions, while Roger Guy at Gartmore now runs the European Absolute Return fund for private investors alongside his institutional hedge fund.

Private equity is back in vogue, too, with Hotbed, the private investor network, hailing it a "once in a lifetime" opportunity. Here, we look at the return of alternative investments.

LITIGATION

The nascent business of financing lawsuits for profit in Britain has typically involved commercial disputes, where third parties unconnected with the case, such as banks or hedge funds, provide financing in return for a share of any compensation awarded.

The retreat by private banks from the divorce market in the wake of the credit crunch has created a niche in cases involving estranged couples. Harbour, set up in 2007, provides funding for cases with a minimum claim value of £3m.

Woodford, who runs the Invesco Perpetual Income and Perpetual High Income funds, snapped up 45% of Burford Capital, while Fidelity's Shah, manager of the UK Special Situations fund, took a near-10% stake in the group, which specialises in investing in disputes between companies.

Last Wednesday's £80m flotation of the firm, which has its headquarters in Guernsey, was London's second-largest this year, behind the £200m float of Max Property in May. The shares, which listed at £1, closed last week at £1.08.

HEDGE FUNDS

Hedge fund values plunged 16% last year as managers were caught out by the credit crunch and investors rushed to pull out their cash. However, professionals are moving back in. Dirk Wiedmann, of Rothschild Private Banking & Trust, turned positive on hedge funds in the summer and has been increasing holdings.

Investors have a growing choice of funds that can go long or short — in other words, profit from rising and falling prices.

HSBC will launch Advantagedge, a fund of hedge funds, next month, while Man AHL Diversity will follow trends in everything from currencies and interest rates to agricultural assets and metals. Minimum investment is £100.

There is also a growing band of absolute return funds that short-sell indexes, shares, commodities or currencies.

Killik, the stockbroker, likes Gartmore European Absolute Return fund, which has returned 11% since its launch in January. Some 240m of 270m available shares have been issued and it expects the remainder to be bought by the end of this month.

The fund is a retail version of the Cayman Islands-based AlphaGen Capella hedge fund, which Roger Guy has managed since 1999. Since then, it has returned an average of 12.4% a year.

Jonathan Jackson at Killik said: “Absolute return funds offer a number of advantages over hedge funds for British retail investors: they give daily liquidity, which means you can exit when you want, compared with once a month with many hedge funds, and a more favourable tax treatment as these funds can be held in an Isa.”

Adrian Lowcock at Bestinvest, the broker, also recommends the Gartmore fund and Blackrock UK Absolute Alpha, up 8.5% in the year to date.

Danny Cox at Hargreaves Lansdown, the adviser, tips Cazenove UK Absolute Target, up 3.4% so far this year, against the FTSE All-Share’s 23.4%. He said: “When the market rises sharply, absolute return funds do not rise as much, but over the long term you would expect them to provide more consistent, less volatile returns.”

PRIVATE EQUITY

Private equity investors lost 30% in the year to the end of March, beating America’s S&P 500 index, which fell 38%, the MSCI Emerging Markets index, down 47%, and MSCI Europe, down 50%. However, Preqin, the data provider, believes that the market is bottoming out. Etienne Paresys, its head of research, said: “The recovery in the public markets is also being seen in private equity.

“Returns are stabilising and it’s likely that future quarters will show a modest increase in net asset value.”

Indeed, investors who bought into private equity funds in the last recession enjoyed stellar returns in the years that followed: those who invested in 1991, when Britain’s GDP fell 1.4%, saw an 82% return on their original investment every year for the following five years, figures from the British Venture Capital Association show.

Gary Robins of Hotbed said: “Those who backed private equity during the last recession were very handsomely rewarded and the next 18 months are going to prove the opportunity of a lifetime to invest.

“Companies looking for funding are being charged astronomical rates by the banks as they try to repair balance sheets — if they can get financial backing at all.”

Private equity funds are stepping in to fill that gap.

The downturn also means that investors are able to tap into low company valuations. About 60 of Hotbed’s 800 members are funding the management buyout of a software development firm. The business is being valued at four times its profits, giving investors a 10% annual yield. Two years ago, before the recession, the business would have attracted a higher purchase price, resulting in a much lower yield of about 5% for investors.

It costs £495 to join Hotbed, and £1,000 to shelter investments in a self-invested personal pension, small self-administered scheme or family trust. Investors must buy units worth £25,000.