

L/S equity will dominate 2018, says Swiss advisory chief

By Alexandre Cave / 20 Feb, 2018



The appetite for long/short equity strategies is surging as investors seek to capitalise on increasing opportunities amid growing global growth.

But, how should you best tap this fast-moving market? Fundana's head of advisory, Cédric Kohler, talks through the firm's top tactics for playing the sector.

Long/short equity will be the dominant strategy in 2018. It is not only in demand from traditional hedge funds investors but also by investors who are coming back to hedge funds.

Given this strategy-type's performance last year, which was more than 10% return, it is no surprise to see it being the most sought-after strategy, while also taking the lion's share in terms of allocations.

Long/short equity is a great complement to an equity allocation, as opposed to being just a hedge fund strategy, as these managers are bottom-up stock pickers.

It's different from strategies such as equity market neutral or dedicated short bias, as well, while the most in-demand managers will typically have a sector focus such as TMT or healthcare.

While their net exposure is typically between 20% and 60%, most of the best managers' returns come from alpha. We favour managers with a medium size – so \$200 million to \$2 billion – and with a small balance sheet.

This being those typically with around 100% long and 50% short. From a geographical standpoint, we continue to find the best manager opportunities in the US.

Fundamentals and flows have rarely been so positive at the same time for the strategy, however. Given last year's strong performances, we can expect continued flows into this area of the market. In addition, the Goldilocks scenario – with good growth and sentiment, as well as inflation being contained – seems to be prevailing in developed markets.

Specific opportunities abound in major sectors such as TMT, which includes ecommerce growth, online advertising spending, electric vehicles, new markets being driven by home assistants, and artificial intelligence, to name just a few.

In the healthcare sector, the combination of cash repatriation from abroad by US companies and the need to acquire specific research has led to increased M&A activity in the sector. The best example being Sanofi and Novo Nordisk which entered a bidding war for Ablynx in January, pushing the share price up +258% since last October.

On the other hand, while the Federal funds rate increases in the US are a market positive for now, that will change at some point.

Until then, managers are still able to find plenty of short opportunities, either with company specific problems, e.g. Steinhoff which lost 68% in December 2017 due to accounting issues, or with secular themes such as retail disruption due to ecommerce, such as Vitamin Shoppe, which fell 81% in 2017.