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Financial advisers increasingly turning to alternative investments

With investors struggling to find low-risk yield plays, Alan Kohler speaks with the founder of Evergreen Consultants, Angela Ashton, about the growing interest in alternative assets such as private equity and venture capital, the rise in passive investing, and Ashton's favourite three Australian fund managers.

By Alan Kohler
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Angela Ashton is the Director and Founder of Evergreen Consultants, which provides a consulting service for financial advisers and they've just launched a new business called Evergreen Ratings where they're looking at rating alternative investments like private equity and venture capital and so on. Angela's been around a long time, got a lot to offer in terms of investing so I thought it'd be a good opportunity to talk to her about the current environment.

Here's Angela Ashton, founder and director of Evergreen Consultants.

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Angela, obviously these are difficult times for investors, but in particular, for people who are retired or approaching retirement, usually in defensive investments, they move towards more defensive investing and look for income, but that's so difficult at the moment. What are you suggesting your clients in the financial services world that financial advisers do about that?

That's a great question and obviously, an extraordinarily difficult one. I think one of the big issues is that it's unlikely that any time soon, and by soon I mean in the next few years, will defensive assets show those defensive characteristics and show that yield characteristic that we're so used to from them. It's not just a matter of making do for six months or a year or anything like that. This is going to probably be a fairly long-term problem that a lot of investors have.

One might suggest something like going up the risk spectrum in terms of considering shares for their ability to generate dividends, obviously, that's been somewhat impacted very much at the moment but over the fullness of time we'd expect that to come back. The problem with that though is that there's obviously volatility in share prices which means that for a lot of investors, having a lot of those sorts of investments doesn't make sense...

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There's also volatility these days in what used to be capital stable investments as well, so it's very difficult to find non-volatile investments full stop, isn't it?

Yeah, look, it is, absolutely. The way to manage it in some respects, and this isn't I guess the answer for everyone, but you do need to ensure that the degree of defensiveness that clients need is the primary thing that you're looking after, because no one's going to thank you if you can create enough income but the capital moves far more than people want. The reality is, you can think about something like a bucketing technique which does work very well for a lot of retirees, whereby say two years' worth of cash is held in a bank account and then you can start to think about how you might manage those other assets outside of that and potentially take on a little bit more risk there and ability to generate potentially some income there.

I think that's one way of thinking of it, about splitting out the uses of capital, if I put it that way, and making sure that anything that's not capital stable is not going to be touched for a number of years and therefore that volatility isn't as important. But it is a very difficult time. Another way to think about it is to think about assets that can provide income that aren't potentially standard types of products that financial planners have used in the past and an example of that might be private debt. There's a lot that people need to understand about that type of asset class before it becomes valuable in a portfolio, but that is an option potentially.

We'll get onto that in a moment, but with asset allocation are you suggesting that rather than look at it in terms of percentages of your assets in various asset classes, in particular in cash versus more risky assets, are you suggesting that you look at it in terms of time? That is to

suggesting that you look at it in terms of time? That is to say, you have a certain amount of time, whether it's one or two years in cash in the bank, so it's not a percentage, it's rather a time-based asset allocation?

Look, yes, that is one way of thinking about it. It's not necessarily the way everyone should do it but it's certainly one way of thinking about it. It's actually not uncommon, a lot of advisers and institutions have been using that type of approach with retirees for a long time. The other thing you do find with that, interestingly, is often when you combine all the assets, you actually end up with a comparatively similar asset allocation overall, as you might give the client otherwise anyway. So it's about splitting up the parts of the asset allocation, if I put it that way, and thinking about each in terms of their role over time.

Because obviously, cash provides no yield at all at the moment so it means your yield has to come from taking a risk, right?

Yes, exactly. But the problem with taking the risk is that at the moment, in particular, you have to take capital risk with it, being through shares or something like that to generate that yield. If you allow people the time to think about that, i.e. and to withstand that volatility maybe a couple of years, then it makes it a lot easier for people to think about and manage overall. But you're absolutely right, the cash isn't going to give you any yield but what it does give you is security and knowing that that money will be there. Therefore, the money that's sort of three years away, you know, you can cope with that volatility there.

Your business involves advising financial advisers on their asset allocation, I think you've got a couple of models, you've got an active model and a defensive model that you provide to advisers.

Yes.

And now you've recently launched Evergreen Ratings which is focusing on alternative assets such as private equity and so on. Is that because the financial advisers, in search of yield, are starting to turn to those assets and need some advice on those things?

Yes, it's not just about yield though. That's definitely a driver for some of those sorts of funds, absolutely, but in others, it's other types of needs that are coming to the fore. Private equity and venture capital, for example, have been driven by a couple of things, I think. The VC or the venture capital part of the world has been driven by, I guess, the move to things like start-ups and venture capital generally, so a lot of people are looking to invest in that, but it's very illiquid. Private equity, in a similar way, a lot of the demand or interest in that type of asset class has been driven

because a lot of the companies that might have gone to the stock market previously, are actually not going to the stock market anymore.

If you look at the numbers of companies that are actually listed globally, they've been falling pretty steadily now for 20 years and a lot of companies are preferring to use private equity or something like that in order to get funding, because there's just less work involved in actually keeping the market informed and so on. We're finding more and more companies are turning to private equity, there's more and more supply of those sorts of funds. Advisers are starting to use a lot of those funds more because they offer things that are quite different to what a normal managed fund would offer. There's sort of different drivers, private debt definitely provides yield. Private equity, not so much, it's more about growth. But we are seeing more and more of it come to market and more and more of our clients were asking us to look at this stuff for them.

So how do you approach rating these assets? Run us through the asset classes that you're looking at.

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The sorts of things we're looking at, for example, at the moment are private equity. We're looking at a solar farm, we're looking at agricultural funds, for example, we're looking at property syndicates and various other things. We're looking at some hedge funds and those sorts of things. They often are the things that are a bit more complex or require a bit more work or a bit more specialist knowledge to look at, so they're not the sort of standard things we would see day to day like equities or fixed income. To look at them, you need people that have got some experience in those sorts of areas so it's a bit more specialist, but they also need to understand funds and they also need to understand our audience. There's a melding of those sorts of skills that's needed.

We have people that have a lot of experience in markets, generally, and have had some experience in at least some of those areas. We've got people who've got hedge fund experience, private equity experience, property syndicate experience and so on.

How do you approach those things? I mean, if you're trying to rate or assess a solar farm, for example, what do you look at?

Behind it, there's a fairly standard sort of scoring type sheet, if I call it that. We're looking at all the things that you would expect us to look at, the quality of the issuer, the quality of the management in there, the sorts of experience they have, the processes they use. Their ability to on-sell or sell the actual electricity or whatever is generated from that asset class and the quality of the actual structure. In terms of what you look at, it's actually quite similar to how you might analyse a managed fund, but the way that you look at it and the things that might be important are different, if I put it that way.

You need to have the people who have experience looking at solar farms, for example, to understand how they might sell their wares and so on and how that might look and whether the pricing that, say, the issuer is talking about makes sense or something of that nature. It's just about having the requisite experience, but the overall scoring sheet is pretty similar.

Are there many of these things around to invest in?

Oh my goodness, yes. Yes, and it's getting more and more interesting and more and more complex all the time. There's lots of things like property syndicates, so we're still seeing lots and lots of those. We're seeing things like some interesting hedge funds, a lot of private debt at the moment, lots and lots of private debt, private equity, a lot of seed capital. Not so many solar farms but agricultural funds we're seeing, funds that are buying up farms and so on.

How do you find them? Where do you find them?

They come to you. In the end, they often want distribution of some sort, so they want people to look at it, so either they know some financial advisers or they want something that gives them entre to more financial advisers and so on. They'll tend to find you, there's no problems with that.

They don't find me! How do I find them?

[Laughs]

They find you...

Well, I can send them to you if you like, I get enough emails... I'll send them to you.

Righto.

[Laughs]

The other thing that's obviously been an interesting discussion in recent years has been active versus passive, with a huge rise in passive investing, where do you stand on that?

Look, I think I've been in the industry so long that I do believe active does add value. I think it's been an interesting year this year with respect to this argument. Certainly, through 2018, 2019, the vast majority of active managers had a very tough time and it was extraordinarily difficult to find a group of managers, no matter how you categorise them, that sort of consistently beat the index over that sort of period. This year has been very different and I think it's been a year where, if I look at numbers in terms of managers with different styles, I don't think I've ever seen a greater distance between performance, I'll put it that way.

The growth managers, for example, here in Australia, the strong growth managers have beaten the S&P200 by 15 to 20 per cent over the course of this year, whereas the value managers have performed often by the same amount.

You can see a growth manager and a value manager at the moment have differences of 40 per cent. That's obviously very strongly style-driven, but I think it does tend to show very strongly that managers can outperform the index and we're in a period at the moment where I think there's a lot of opportunity to do that. I don't think active is dead. I know that even this year a lot of money has gone into passive, I don't think that's the right thing to do in these markets, particularly around fixed income. I think when there's issues around something like fixed income, credit, in particular, you are far better off with an active manager who can hopefully shield you from credit that's going to go bad and so on. But I don't think active's dead and I think this year actually proves it more than ever.

Well, in fact, an active growth manager has just had to buy a bunch of tech stocks and sit tight because it's been

buy a bunch of tech stocks and sit tight because it's been enormous. Some of those stocks have just taken off.

They have. When you're looking at a manager like that though, you do look for evidence that it's more than just a few tech stocks in there. You're looking for evidence that it comes from an array of stocks and that there's a process in there that's picking up much more in terms of the companies that they're finding than just the latest group of really sexy stocks. You're looking for managers who can do more than just that, and I think there are managers here in Australia who can and they've shown that. We're definitely looking at things like attribution when we talk to managers, to make sure it's not just driven by one or two stocks, that's the last thing you want. We're trying to find, I guess, evidence that they're finding a broad array of stocks that are performing well.

Who are your favourite managers? You can tell me, come on…

I'm happy to say, I guess. I think we use a lot of managers across the style spectrum. Some of the managers I'll mention actually haven't performed well at all recently. But we like Bennelong, we use a fair bit of Bennelong who have performed extraordinarily well. A group called DNR based out of Brisbane, they're a quality manager and have done quite well as well. But in the value camp, we like Allan Gray, very contrarian, very deep value and have performed quite poorly this year, but they have periods where they'll do very well. If you believe that the economy at some point will recover or the market starts to believe it will recover, they will do quite well through that period. They're three in Australia that we look at.

Well, it's been really good to talk to you, Angela, thanks.

Thank you, Alan.

That was Angela Ashton, founder of Evergreen Consultants.

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