

Looking for alternative advice



Can the mainstream advisers provide what pension investors need on hedge funds and private equity or do they have to turn to specialist investment consultants?

Gail Moss investigates

Many pension schemes use an investment consultant which can act as a one-stop shop for running their investments.

But in an increasingly sophisticated investment world pension funds now need advice on a wider range of strategies and products than ever before.

“The pension funds we work with in the UK on the private equity side have the greatest admiration for the mainstream consultants,” says Christopher Hunter, managing director of Cambridge Associates in London. “But they have realised that gener-

Hunter says pension funds are looking at private equity more closely than before. “One reason is that they have more comfort with and understanding of the private equity asset class. They also have more tolerance of illiquidity as their overall allocations become more sophisticated. Because of this, the generalist advisers are increasing their recommended allocations to the asset class to 3-4% of the overall portfolio from 1-2%. But that means the pension funds have to have more understanding and more infrastructure in order to select investments.”

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alists aren’t equipped to deal with this asset class.

We are working increasingly with pension funds in the UK and Europe because we are getting more requests for advice on private equity.”

Cambridge Associates offers generalist asset consulting and gives advice on hedge funds, but is best known as a leader in advice on private equity.

For smaller pension funds with a relatively small allocation to private equity, generalist advisers may well recommend a handful of buyout funds, or funds of funds, to cover all the bases, Hunter says.

“But once pension funds wake up to the fact that they are capable of investing in private equity, and can go the specialist route, they tend to look

to us,” he says. “Having said that, some generalist advisers themselves recommend their clients go to specialist advisers for alternatives, and that often leads to us.”

Pension funds can, of course, go it alone. “Some pension schemes hire staff and do their own private equity selection,” says Hunter. “But to do that, they must be able to hire the right expertise and that’s very difficult.”

A specialist adviser can provide a depth of knowledge which generalists would find hard to match, he says. For instance, private equity is extremely labour-intensive because the dispersion of returns from private equity dwarfs anything seen from listed equities.

“For a typical fixed income manager, the difference between the median return and the returns from the better managers in the top quartile is very small,” says Hunter. “For equities, the difference is slightly larger. However, in private equity the difference can be as high as 2,000 bps, that’s 20%. So you need a robust research staff to sift through investment opportunities.”

Cambridge Associates employs 20 people just to look at venture capital, private equity and other alternative investments. “It’s a pretty big staff, and is much larger than what you might find elsewhere,” says Hunter.

And once the investment has been made, the evaluation process is fairly tortuous. “Private equity is more of a qualitative art, and is limited in transparency,” he adds. “Investments are difficult to evaluate and it takes a long

time to tell what the outcome is. So you can’t necessarily put an asset allocation in place for the pension fund from day one. Most generalist advisers can’t work within those constraints.”

Specialist advisers can also build up relationships with fund managers, an all-important asset since this can give access to the better investments.

“Cambridge Associates has been working with alternatives for over 25 years,” says Hunter. “So we tend to be the first stop for managers raising money for a fund. The industry is getting more and more sophisticated, and if you can’t build relationships, you don’t get access to the best funds.”

However, he adds that independence is crucial. “Some specialist consultancies advise clients to take the fund of funds route or offer their own fund of funds products on the side. But their clients aren’t necessarily looking for that. In any event, it can introduce conflicts of interest if the adviser recommends their own funds.”

Hunter says that another reason his company has not taken the funds of funds route is because it does not believe that one size fits all: “So we’ve taken the advisory route instead.”

Cambridge Associates charges a fee that is a percentage of commitments made, but does not charge performance-based fees. The fees for private equity advisory work are higher than those for its own generalist consulting work, but are about 50% lower than those of a fund of funds, according to Hunter. Furthermore, the firm does not charge a carry, which funds of funds often do.