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Spin wide web to snare top assets

Investing in new assets may mean occasionally putting yourself in harm's way, writes **Barrie Dunstan**.

Brian Bissaker's CFS will soon start selling Aspect's products on two platforms. Photo: MICHEL O'SULLIVAN

Australian superannuation funds are widening their investments in the search for juicy returns that aren't tied to world investment markets.

New investments include catastrophe reinsurance and managed futures, both of which were being touted recently by visiting fund managers.

The driving force behind the alternative products is the sharp lesson of the global financial crisis which saw virtually all asset classes decline at once, blowing theories of protection via diversification. One potential solution has been to invest in alternative assets that have no correlation to movements in listed markets.

Nephila Capital, a Bermuda-based reinsurance specialist, has raised $US150.5 million ($160 million) from five Australian institutions via a unit trust offering investment in insurance-linked securities such as catastrophe bonds. Among the local investors are AMP and MLC, along with a large industry and a corporate super fund.

While the so-called "catastrophe bonds" are starting to attract some of the more sophisticated institutions, another group is starting to market managed futures to retail investors. London-based Aspect Capital has signed an alliance agreement with Colonial First State to sell its products on to two CFS platforms soon.

Colonial's chief executive Brian Bissaker says the products will give investors access to investments that aim to deliver positive returns across market conditions and exposure to alternative assets, via an Australian dollar-based fund.

Aspect's marketing team, headed by chief executive Anthony Todd, was in town at the same time as Nephila (and staying at the same Melbourne hotel). While the two groups are offering different products to different sectors of the market, they have a lot in common.

Apart from offering products that aim to be uncorrelated to stock and bond markets, both groups have connections with major alternative fund manager, Man Investments, which owns 25 per cent of Nephila.

Aspect was formed in London in 1998 by Todd, Michael Adam and Eugene Lambert. Adam and Lambert were the "A" and "L" in AHL Ltd, a pioneering company in this field, which they sold to Man in 1994. (Todd says all three Aspect founders read physics at Oxford.)

Aspect continues the founders' experience over 27 years in running systematic trading programs. Its managed futures invest in a diversified futures portfolio that includes stocks, bonds, currencies, agricultural commodities, metals, interest rates and energy.

It has had positive returns in each of the market's worst months in the past 10 years and its diversified fund earned more than 25 per cent in the 2008 disaster year (though it lost about 9 per cent in 2009).

Todd says managed futures, which date back to 1948, attracted retail investment in the 1970s and

For investors, this is a long-term portfolio allocation.

1980s before becoming more popular with institutions in the 1990s. He says one attraction is that managed futures are highly liquid and aren't exotic.

Nephila basically runs a hedge fund operation, with five different funds in which institutions invest. It manages about $US2.5 billion of assets invested by about 40 large institutions into funds that act like a reinsurance company.

The concept of reinsurance was born after a huge fire in the German city of Hamburg in 1842, which devastated the local insurance industry. Massive losses in the late 20th century, culminating in New Orleans, led insurers to seek to spread the risk to other investors. So-called catastrophe bonds essentially channel investment money into securities sold by the insurance industry seeking to spread the risks of major losses in areas such as hurricanes in Florida and earthquakes in Japan and California.

Nephila's managing principal Barney Schauble says the local investors like its lack of correlation with other investments. (The group also offers a smaller fund that invests in weather risk covering rainfall, temperature or even wind – for someone with a wind farm.) Investors also are paid a healthy return for taking up some of the slack of the excess risk of catastrophes.

Schauble started in the field with a summer job with an insurance broker in New York. When he decided to write a paper on the concept of investing in bonds linked to property catastrophe insurance, he could get access to the group's 30-plus years of reinsurance contracts. This confirmed that investors could make money investing in the area, and that the risks were not correlated to the investment markets.

He subsequently moved to Goldman Sachs, before joining Nephila in 2004. It was nice to be in at the start of a new asset class, Schauble says, although, as an early mover in this new field, it needed patience.

Nephila's investors, by investing in reinsurance, are putting themselves in harm's way but the theory is that the healthy returns in the years when there are no claims outweigh the one year in 10, say, when a large claim occurs. Returns also are likely to be boosted in years just after a major disaster like Katrina, which saw premiums rise sharply after the 2005 hurricane caused an estimated $US80 billion of damage.

Schauble emphasises that for investors this is a long-term portfolio allocation, not a trade. The size of investors' stakes varies but ranges from 4 to 6 per cent for fund of hedge funds, and is being recommended more by larger asset consultants as a truly uncorrelated asset class for other large institutions.

Nephila, when it was started in 1998, was originally headquartered in London until it realised all the information about reinsurance was centred in Bermuda.

It was named by its two founders, who were looking for a name that involved catastrophes and Bermuda. Nephila is a type of spider native to the island and, according to folklore, it typically builds its web in trees. When hurricanes are coming, the spider builds its web close to the ground. "We have several of them on the payroll in the forecasting area," Schauble deadpans.