Family Office Review

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Thinking Cap

Euro Family Offices to Re-Up with Aggressive Alternatives

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The next 12 months will potentially see many European family offices start to decrease their defensive allocations to cash and start to re-engage with more aggressive asset classes such as private equity, equities, real assets and hedge funds, according to the findings of a study from London-based Somerset Capital, an independent private market advisory firm focused on the family office sector. The firm connected with 32 of the family offices in its network in early 2012 in order to gauge their investment plans for the year ahead.

While current average allocations among respondents stood at 24% equity, 10% bonds, 11% hedge funds, 26% private equity, 14% real assets, 3% commodities and 13% cash, it is the present cash pile that is most likely to be scaled back as firms, more settled following the market's dislocations, begin to deepen their re-engagement with risk and reward. Over half of participants reported their intention to decrease their allocations to cash with 63% upping their allocations to private equity, 42% to equities, 41% to real assets and 24% to hedge funds in the next 12 months. According to Somerset Capital's managing partner Jim Miller in a prepared statement, "The main message that comes out of our survey this year is that family offices have built up cash, which they are looking to deploy, selectively, in 2012 across private equity, hedge funds and real assets."

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Survey results indicated, albeit bearing in mind that their historic focus is on firms that actively engage with private equity as an asset class and therefore the results of the survey might be somewhat skewed, the opportunity for "aligned" private equity managers, as Miller describes them, or those "that co-invest and allow family offices direct engagement with the principles," to win business in the space is clear. The base of this potential, according to Miller, is the relative performance of the asset class. He stated: "Our feedback suggests that this has been the best performing sector for family offices in recent years and that family offices tend to have large portfolios in this area, and remain committed."

In terms of their private equity interest, survey participants are open to backing both existing (68%) and new (59%) managers, with over half interested in direct transactions or co-investments, a quarter interested in secondary transactions. The families surveyed have a strong preference for growth equity transactions (70%), plus buyouts (50%) with only 12.5% interested in venture capital. Geographically, 83% are interested in Europe, 56% in the US and 28% in emerging markets. By sector, the research revealed business services, consumer goods, healthcare and manufacturing as the leading interests.

As of now 64% of the survey's respondents invest in hedge funds at an average allocation of 24%. The preferred strategies now are equity long/short, fundamental equity strategies and macro strategies (all have 90% allocations) while less popular are fixed income RV (42% have no allocation) and volatility arbitrage (33% have no allocation). Looking forward identified growth areas are macro (53% intended to increase, CTAs (38% to increase) and equity market neutral (36%) while regionally Asia funds are stand out, with 40% planning an increased allocations.

Regarding hedge funds, 61% of survey respondents were happy to invest in funds with less than $100 million in AUM, 33% would consider seed investments, and 93% would invest in funds with less than $1 billion in AUM while 23% would not invest in funds with AUM greater than $1 billion.

Mixed Picture Across the Market

For others, however, the move to re-upping to the more aggressive asset classes may have started earlier. John Veale, CIO at Stonehage Investment Partners, the investment division of the multi-family office, tells FOR, "We would expect that most family offices will have re-engaged with more aggressive asset classes in 2009/2010. We have held strong allocations to credit and full allocations to defensive equities since 2009." Citing an example of the strategy at Stonehage, Veale said, "For example we have reduced duration exposure in fixed income while increasing exposure to macro hedge fund strategies which have the potential to reposition to profit from market trends in both directions."

Furthermore, says Veale, those family offices and other investors that are still in cash will be faced with "negative real returns." Indeed, if they are still holding significant allocations to cash today they will likely be facing pressure to switch out. Veale suggests "the first port of call for such a move would be to more liquid markets such as high yield bonds and equities" rather than directly into alternatives.

Jonathan Guest, founding partner of Swiss-based specialist private wealth, family and family business advisory firm Apollo Partners says, however, the market for re-engagement with risk and alternative investments is more mixed, with family offices either being "risk on or risk off." He continues: "Some can see no end to the bumpy road while others think they need to be in the game in case it takes off. It is really mixed. In some cases, it is a split between single and multi-family offices with the latter feeling the pressure to improve their investment performance for fear of clients turning back to the private banks."

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According to Somerset Capital's Miller, family offices will be "rationalizing their portfolios, pruning back the less successful relationships, and putting money behind the more trusted managers and occasionally promising new groups." That is why family offices are interested in both old and new and wish to retain a flexible approach on what skills and focus to employ looking forward.

But, Jonathan Bell, CIO of London-based multi-family office Stanhope Capital, the process of rationalization "has been going on for some time. Those with exposure through fund of hedge funds, for instance, have been scaling back to have a more focused exposure. Each of our portfolios has a maximum of four to five hedge fund managers."

