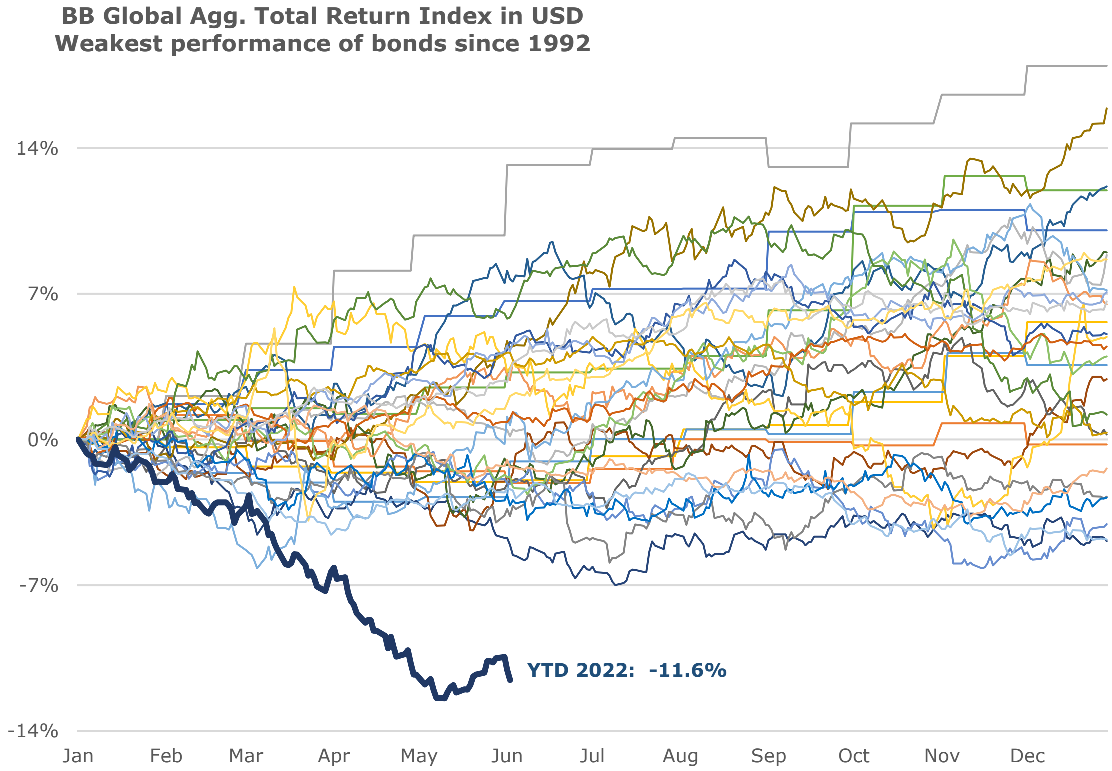
«Absolute Return strategies are experiencing an upswing»

Investment specialists Reto Ineichen and Oliver Rossi of Alpinum Investment Management AG explain in an interview how Alpinum has successfully mastered the difficult 2Q2022 with its "Absolute Return" approach.

How would you describe Alpinum IM's investment philosophy and do you have an example of how it is reflected in the current environment?
R. I.: We are index agnostic. Instead, we always have a focus on short-term capital preservation and long-term capital growth. The difference between our investment philosophy and market-driven products is clearly visible in the current bear market. If, for example, a stock index decreases by -20%, as it did this year, we do not aim to outperform the index or this benchmark, but always focus on the absolute value of the portfolio. At the same time, we aim to preserve capital no matter how negative the markets are. From our point of view, it is unsatisfactory to achieve "only" a minus of 18% in such a negative environment. The relative outperformance of 2% is of little value in this stress situation. Our philosophy, on the other hand, follows the absolute return approach. Structurally, we deliberately limit the market-dependent loss potential for our customers and at the same time try to achieve a positive absolute performance. Of course, absolute return strategies also depend on the market environment and suffer in such difficult times, but the degree of market dependency is very different.

Conservative investors are mainly invested in bonds, but “low risk” bonds have experienced extreme losses (see chart 1) this year. To what extent does Alpinum offer an alternative?
R. I.: As mentioned at the beginning, we focus on generating absolute returns and are guided by the client's loss tolerance and not by the price trend of an index. Once the client's risk budget has been defined - for example, a maximum loss tolerance of five percent over twelve months - the asset allocation is set and geared to aiming for the highest possible return within this given "loss limit". In portfolio implementation, risks are actively reduced if losses occur - or increased if gains eventuate, provided that market opportunities are still attractive. In our broad bond portfolio, we have deliberately defined a lower loss tolerance because investors typically invest in bonds as they are looking for a defensive investment with an attractive yield. The investment objective has always been achieved since the launch of the strategy in 2014: the strategy showed on average only about 30% of "downside participation" versus the broad credit markets, while the upside participation has been much higher resulting even in an outperformance vs these indices, despite the lower risk tolerance. Moreover, the strategy proved to be uncorrelated to interest rate rises.

Chart 1

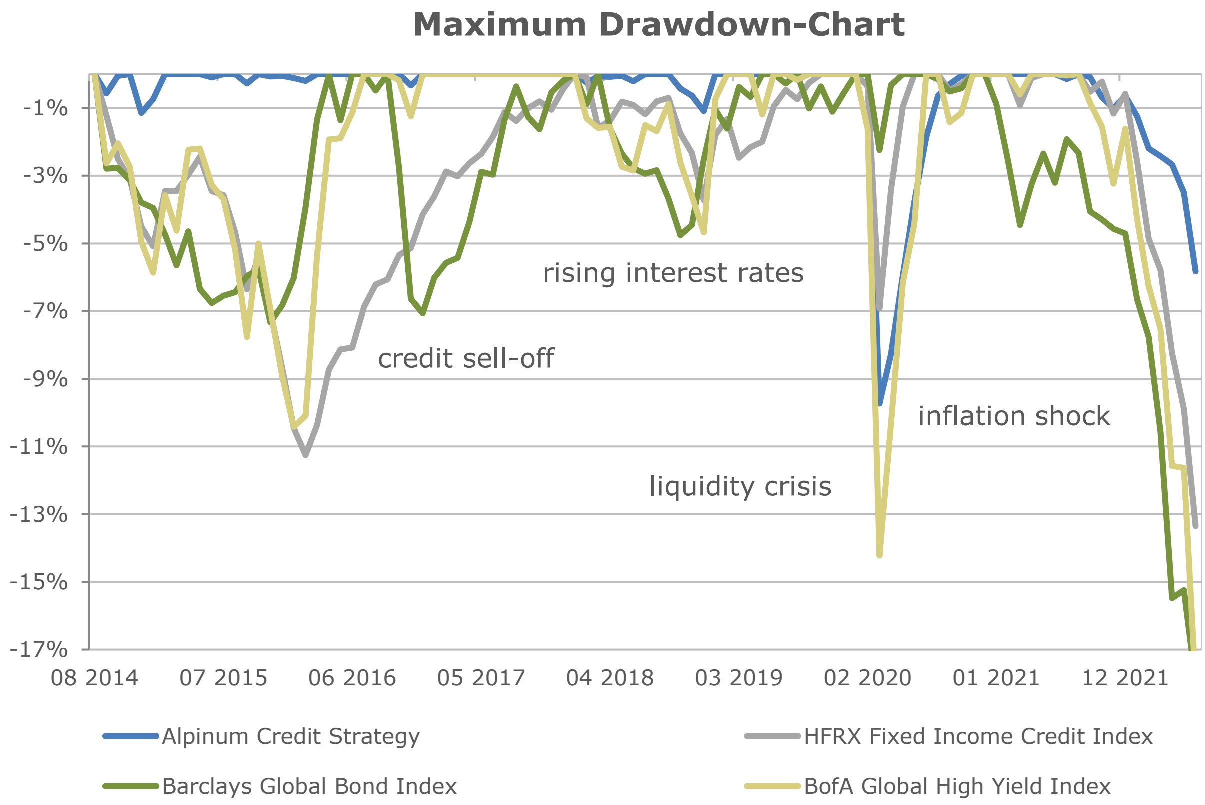


Source: Alpinum IM, Bloomberg

How does your "conservative" fixed income portfolio look like in practice?

R. I.: We define two priorities: low interest rate risk and low probability of default of individual bond issuers. Structurally, we invest primarily in short-dated bonds that have low sensitivity to business cycles. We complement these with "senior secured loans", which carry a floating interest rate mechanism and are therefore largely immune to interest rate rises, but not to a widening of "credit spreads". These two core strategies are supplemented by low correlated, liquid niche strategies. In combination, such a portfolio generates more stable returns and shields the assets from larger drawdowns , especially in a rising interest rate environment. Chart 2 with the "maximum drawdowns" shows that the strategy is also negatively affected in stress situations, but to a much lesser extent. This leads to lower price fluctuations in the short term and attractive return generation in the long term.

Chart 2



Source: Alpinum IM; Bloomberg; Daten vom 01.08.14 - 30.06.22 in USD

Coming back to the difference between relative and absolute return. How can absolute return be characterized?
O. R.: The concept of absolute return dates back to the 1950s and is experiencing a resurgence in the current environment. The approach stands in stark contrast to conventional investment concepts, which usually apply a comparison to an index, the benchmark. With absolute return investing, the intention is to achieve absolute - if possible positive - returns across all market cycles.

How do you achieve "Absolute Returns"?
O. R.: It all starts with the investment mindset and the initial positioning: Do you put your investment emphasis on minimizing risk or maximizing return? Where do you get the most return for the risk taken at any given time? This typically demands for a very active approach, and it requires constant adjustments to the prevailing market environment. It's a question of mentality - with absolute return you can't hide behind a benchmark, you are always "active". In these days, the advantage of this mentality becomes apparent.

What are other advantages of the credo of keeping losses as low as possible?
R. I.: If you are confronted with only a small loss, you also need a shorter path to get back into positive performance territory. To put it simply, if you have lost 50 percent once, you have to hope

for a future return of 100 percent (in purely mathematical terms) in order to achieve a return of zero percent. This is an extreme example, but it illustrates the dilemma of benchmark-oriented investments. Quite a few portfolios are down double digits these days, even with a balanced approach. It will take a lot of time to make up for losses, especially with the current uncertain future prospects. Successfully implemented investments with an absolute return character shows a higher risk-adjusted and more steady return over the long term. This may not seem spectacular in individual years, but over time it is of great advantage, as one benefits from the compound interest effect. In addition, the investor can sleep more relaxed knowing that he or she is less exposed to market volatility.

How does Absolute Return work at Alpinum? How do you achieve the goal of attractive risk-adjusted returns?

R. I.: All our portfolios are managed with the absolute return philosophy - but with varying degrees and risk budgets. We focus on rigorous risk management, diversification and very active portfolio management, considering prevailing market conditions. It requires detailed knowledge of markets, strategies and instruments. We also deliberately work with different economic scenarios, which forces us to continuously stress-test our portfolios. Top-down meets fundamental bottom-up analysis, implemented with a certain "Swissness", which requires both, high discipline and pragmatism in implementation.

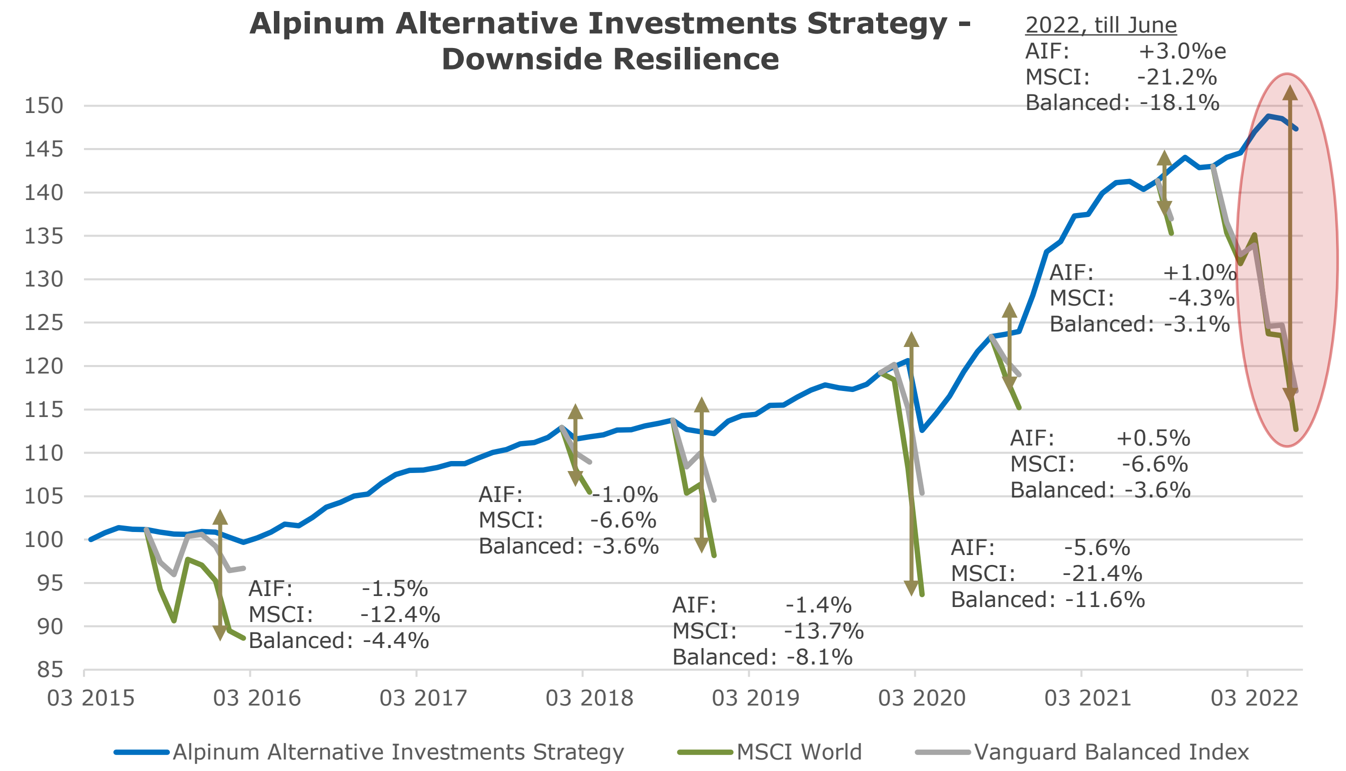
Which one of your Alpinum portfolios comes closest to the absolute return philosophy?

O. R.: The absolute return philosophy is applied in every Alpinum portfolio. However, the "Alternative Investments Strategy" implements it most strictly, which is also reflected in its performance: The strategy is up about three percent this year. Since 2015, we have paid attention to little market correlation and low market beta in order to minimize losses, while generating positive returns. Over the past five years, we have achieved an annualized performance of 6 % in USD with a volatility that is around three and a half times lower than that of equities.

What does chart 3 show and what's its conclusion?

O. R.: It illustrates how absolute return works at Alpinum. During market stress, our portfolio shows strong resilience thanks to the absolute return philosophy and broad diversification. Relative portfolios and index-based strategies are exposed to the market one-to-one. The Alpinum portfolio tends to lose little in a difficult market phase - but can still score with attractive returns in a positive environment. So far, this has resulted in high risk-adjusted performance. With this solution, we offer investors a very stable component in their asset allocation, which continuously contributes to long-term asset growth.

Chart 3



Source: Alpinum IM, Bloomberg, data from Feb 27, 2015 – June 15, 2022, Estimate in USD

Info box:

Alpinum Investment AG is an independent Swiss investment manager based in Zurich, which emerged in 2014 as a spin-off from a globally active asset manager. The FINMA-licensed firm manages approximately CHF 2 bn and has established itself with its expertise as a recognized boutique for traditional and alternative investments in the credit/fixed income, direct lending and hedge fund sectors.

Please refer to **alpinumim.com** for more information.