Bev Durston, Managing Director of Edgehaven Ltd participated in the FIS Digital Symposium conference in April 2021, where she took part in the session: Paradigm shifts: Managing liquidity and risk management.

The session offered a discussion into portfolio considerations and decision-making when managing liquidity during volatile market conditions, as well as considering asset allocation, alternatives, and risk management.

Beware highly leveraged and less-liquid strategies

Jessica Sier May 6, 2021 - 10.22am -

Whether it's the 1987 Black Monday event, the 2008 Global Financial Crisis or the 2020 Covid19 ruction, the most common elements of price dislocation and market freeze are highly leveraged and generally less-liquid strategies.

"These are the two dangerous elements," Bev Durston, managing director at Edgehaven said at the *Investment Magazine* Fiduciary Investor Conference.

“But what surprised many market participants in March 2020 was the mortgage REITS, the CLOs and the structured credit that had traded like they were liquid but turned out to be not liquid at all,” she said.

Durston pointed out rescue trades in those areas proved to be very lucrative for those who provided capital.

John Lucey, chief investment manager at Avant Mutual, said the Australian dollar was a great tail-risk currency and could provide protection in hedged equity markets when you’ve got a risk-off situation.

“But when you’ve got your hedges, that means you’ve got unrealised losses at the end of the quarter, at the end of the month, and that can be a really bad result,” he said.

He added that on 31 March 2020, many fully-hedged global property and fully-hedged asset classes had funds on unrealised losses becoming realised.

“We think we learn from our mistakes, but we’ve got short memories and that was proven again,” Lucey said.

Twelve months on from the events in March, Durston said there is some advantage in having an allocation to private markets, even though it does make portfolios generally less liquid.

“Mitigation can occur in the dry powder from private equity and private credit that is able to jump in during times of volatility,” she said.

That said, price discovery is critical. Some people aren’t willing to deal with transactions at prices 20 per cent lower unless they really have quality investment processes, she added.

“That’s where managers with contingency funds were able to jump in, when they have pre-prepared funds to go in at times of distress and take advantage,” Durston said.

One mistake fund managers often make during times of great distress is they focus too much on their existing portfolio rather than new opportunities that emerge.

“Be careful and make sure that you choose high quality managers,” warned Durston. “I’ve seen some managers waste the opportunity because they’re running around focusing on rescues for their existing large AUM rather than the new things for their new funds.

“So, the timing of where a manager is in their fundraising cycle matters.”

Lucey said managers that pulled different levers during a crisis, like utilising derivatives, could offer liquid strategies and stay on top.

“Also, you can have cash on the ready for drawdowns and use derivatives to your advantage to maintain market exposure,” he said.

“Then as that cash gets cold, or is used as part of a cash flow program, then you just take derivatives over the top.”

The large elephant in the room is always the actions of the US Federal Reserve and Durston pointed out the swift V-shape recovery was largely thanks to the ‘Pavlovian dog’ response to the Fed’s promised asset purchasing programs.

“It’s amazing how the V-shape recovery is getting quicker and quicker and how investors are so well trained to think, don’t fight the Fed,” Durston said.

“But of course, there are those of us who think it can’t go on forever, and that at some stage they’re going to overstep the mark and not be able to rescue everything.”