



TALES FROM THE TRENCHES

A plan sponsor's take on the alternative marketplace.

So many alternatives products and strategies to choose and pick from! I'm told, "Every big fund in the country is doing it," so it must be good for our fund. Ever the cynic and failed comedian, I respond, "But with their high cash flow and large staffs they need to keep busy and put their money to work, so they can afford to invest in many things." In spite of large economies of scale, are their investment results any better?

Alone and deep in the trenches of a \$2.4-billion plan with a good history of plan governance and investment results, how do I manage to review every new proposal that I receive on hedge funds, real estate, private equity and infrastructure, let alone find time to review the plan's existing holdings?

When in doubt, I stick to some of the lessons I learned early on in my career. For better or worse, I have made personal adjustments to various teachings and attribute no errors to any individuals that influenced me. That said, I make the following—albeit incomplete—observations on alternative investments.

I think I like private equity, but like the archer that rarely strikes the bull's eye I ask myself: is it a good thing that I need to pick the top third managers to really succeed, or else risk having passive public equity strategies outperform me? Yet the attractiveness is there: the opportunities to buy cheap assets, better growth opportunities, influence strategies through "legal" inside information and then exit at a public premium can be compelling. Never mind the infamous "J-curve"—there is a pot of gold at the end of the rainbow.

I like a lot of hedge fund strategies. However, I'm not sure that I like it when long-only strategies are "hidden" within fund strategies. In the past two years, many directional managers greatly benefited from their exposures to emerging market and high-yield securities. Couldn't our plan have bought these exposures directly and for a lot less? I know that right now someone is saying "Yes, but you also have to know when to get out of these strategies." Maybe I do want currency management, asset allo-

cation or commodity exposure, but do I want it at 2%-plus-20% fees? I also can't help to think that if the plan's horizon is lengthened to two or three years or more, shouldn't it take on hedge fund-like characteristics? In the classic risk/return trade-off, the pension plan will display better risk/return characteristics than individual asset classes, just like hedge funds. Isn't this like following basic diversification strategies and benefiting—if your plan has the luxury to do so—from the impact of time? Show me unconventional assets or investments like the ones some of us participated in during the 1970s and 1980s. Have you considered going long viaticals (purchasing life insurance policies on unhealthy individuals) and U.S. municipal tax liens against unpaid property taxes, and shorting out the interest exposure? Looks like a market-neutral LIBOR-plus 6%-to-10%-return investment. You probably won't have a lot of takers, however, as many do not

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like to deal in death and taxes.

Real estate is an asset many love and hate. Many start off with good intentions to buy income-producing properties but sometimes end up with development projects, with no tenants, no positive cash flow and a need to spend money to redevelop. Maybe we can rent space in our building and pay ourselves rent; after all, real estate is a good diversifier. I like real estate, but it really helps when it generates significant cash flow from day one! With no internal staff, my next project is looking at infrastructure or investing in long-life assets with little direct competition, not too much government intervention, in businesses involved in basic consumer-type necessities and, oh yes, where there is positive cash flow from day one! ■