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Trend: When Tactical Opportunities Knock For Investors

The dislocations in various asset classes are increasingly leading to institutions adding an opportunistic allocation to their portfolio, which allows them to tactically invest in managers who they believe can employ a more versatile, value-oriented strategy.

What is considered to be the beauty of an "opportunistic" category is that there is no specific asset class or strategy box that a manager needs to fill so that, for example, a hedge fund or fixed-income manager that has proven past performance can be given free rein to seek out opportunities in numerous sectors without violating restrictions imposed by the investor. This approach, while not suitable for everyone, has given cadence to institutions adopting 5% to 10% allocations.

Institutional investment consultant **Equitas Capital Partners** is among the firms that have encouraged its clients to consider the approach, believing that there is value in carving out a separate allocation to the unique strategies that do not generally fit into the mold of other asset classes.

The tactical opportunistic allocation, as Equitas employs it, is not about managers—it's about asset classes, said **Derby Gisclair**, senior investment management consultant and chief operating officer. "It's about being able to adjust to changes that could impact portfolio goals on a short-term basis without impacting the overall asset allocation."

By definition, Equitas refers to the allocation as tactical because the firm is still doing a normal strategic allocation for the client, but a portion of that allocation is dedicated to the idea that it will be reallocated frequently to take advantage of opportunities that the market presents. The idea, Gisclair said, is not only to be able to create positions in asset classes that aren't generally included in the portfolio's investment policy statement, but to be able to overweight a position that the board and advisors have significant confidence in over the short term.

"This does not necessarily mean adding to a portfolio's position with one of its existing managers—this approach would incur management fees," he said. "Rather, in a situation in which a portfolio has a large-cap growth allocation, and the board wants to overweight that temporarily, the opportunistic tactical allocation might be partially or fully invested into a **Russell** 1000 Growth ETF to get the appropriate exposure. When the case for overweighting no longer applies, you take the funds out of the ETF. In this way, the client incurs only transaction costs."

For investors and consultants that think of it in terms of both asset classes and managers, an opportunistic portfolio can be integrated into a bucket asset allocation approach to investing, where institutions are not as constrained to put its portfolio managers into specific categories.

The $575 million **Texas Tech University System** endowment has already carved out an opportunistic asset allocation. Texas Tech and consultant **NEPC**, seeing the viability of such an investment, even received approval to increase the allocation to 10% from 5% in May, said **Gary Ratliff**, associate vice chancellor of investments.

Ratliff said the board of regents approved the increase to the new bucket already in place since February of this year as a means to take advantage of strategies that fall outside the traditional fixed-income or equity categories, such as global tactical asset allocation and credit strategies. Hedge fund managers **Blenheim Capital Management**, **Van EcK Global** and **Hunter Global Investors** were three such firms brought on to fulfill a portion of that mandate.

In April 2008, NEPC began suggesting that its clients carve out a 5% to 10% allocation to opportunistic strategies, initially finding that the market downturns would create dislocations in credit that some managers were poised to take advantage of. NEPC CIO **Eric Knutzen** said that while at the time many of those managers were still considered institutional-quality, they were also opportunistic due to the fact they were introducing new products with shorter track records and lower asset levels than a typical firm NEPC recommends for clients.

"NEPC was catalyzed by opportunities in the credit market," Knutzen said. "We put it in the context of a recommendation that clients consider adding a new bucket or opportunistic allocation to take advantage of this and other opportunities."

Knutzen added that while the firm could not anticipate a sudden rebound in what was thought to be two- to three-year downturn, the firm is still recommending an opportunistic allocation for clients, but noted it has taken on a different form than before.

"A large portion of the opportunity in the liquid credit markets has been realized," he said. "…we think this is evolving towards distressed illiquid markets from the liquid credit markets and in mezzanine strategies."

Kansas State University recently approved an investment policy that does not specifically designate funds to an opportunistic category, but that is structured in such a way that it has flexibility to make commitments to managers when opportunities arise, V.P. and CIO **David Weaver** said. Most notably, equities are now put together in one category and include traditional domestic and international, but also direct long/short hedge funds and private capital, which will amount to about 68% of the portfolio. The portfolio was previously known as "marketable alternatives," but Weaver said the fund felt like the equity classifications did not reflect the global markets and the true nature of the asset classes and their respective risk profiles.

"We made it a much more global-oriented policy that incorporates the opportunity to be tactical and opportunistic in much more risk-measured way," he said. "In terms of ultimate allocation, it's still the same."

Other institutions, such as the $368 million **Healthcare Foundation for Greater Kansas City**, for example, has considered an asset allocation recommended by consultant **Ennis Knupp + Associates** recently that would label investments as one of three categories: a 10% high quality structured bond bucket, a 41% global stock index fund bucket and a 49% active management bucket, which would include traditional, opportunistic, real estate and private equity strategies. Under such a structure, a fund is still accomplishing its long-term asset allocation goals, but the guidelines become clear to the investor, and consultants have greater leeway to utilize strategies that do not have to fit nicely into one particular style box.

A manager that could fall under the opportunistic category for its investment approach is **Grey Owl Capital Management**, which tactically adjusts its exposure in multiple asset classes based on valuations and market sentiment, which they believe is to the benefit of investors over one specific style or capitalization, Managing Director **Jeffery Erber** said, adding that opportunistic does not have to go hand in hand with being uncorrelated to equity markets to gain alpha.

For the two years beginning in October 2007 and ending Sept. 30, the firm has seen returns of 5.46% and -5.38%, compared to returns of -6.92% and -27.375% from the S&P 500, respectively. Since inception in November 2006, the firm has returned 9.86% compared to the S&P 500, which has returned -18.10%, according to the firm's Web site.

"From my perspective, it's always a good time to look at investments from an opportunistic standpoint," he said. "…it's not just buying an asset to check the box, it's really saying can we buy "A,B,C" asset today at a price that will give us returns we want over the lifetime we'll hold the asset."

For Equitas, having a tactical opportunistic allocation gives funds the ability to be nimble without abandoning their long-term investment philosophy. Gisclair said that if a board is concerned about inflation over the next year or so, for instance, having a tactical opportunistic allocation allows for investments in TIPS for the fixed-income portion, or the ability to gain exposure to commodities to buffer the equities portion of the portfolio.

"Take for example a board that believes that the 2009 stimulus package means big investment in infrastructure, materials, mining and other sectors or they might wish to invest the opportunistic allocation in ETF sector bets for the next few months," he said. "It provides the ability to move into positions like these without going through a full approval process that might delay action so long that the opportunity disappears before you are able to capitalize on it."