Alternatives

Hedge funds re-evaluate strategies amid RMB slide

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China's move towards a more market-driven exchange rate is unlikely to dampen demand for pan-Asia hedge fund strategies, say managers. The diversification of positions is expected to become ever-more important.

The Chinese central bank's surprise devaluation of the renminbi is likely to have a significant effect on strategies pursued across Asia, according to hedge fund managers.

With the People's Bank of China (PBoC) attempting to create a more market-driven exchange rate, managers have had to re-evaluate their positions to ensure they are adequately diversified.

The question now is over what happens next and what the effect will be on other currencies, with yesterday's regional slide adding to the strength of the dollar even before the US raises interest rates.

The PBoC yesterday (August 11) announced that it will set the daily central reference rate with reference to the previous day's close. Yet that may just see more intervention in the market to ensure that the previous day's close does not shift too far away from the new central parity.

Vincent Lam, Hong Kong-based CIO of $100 million-plus AUM VL Asset Management, observed that it would be "dangerous to build an expectation that the renminbi will continue to move further downward". He saw a "need to calm down the market's expectation" for a further depreciation.

At the same time, Lam's view is that the "renminbi depreciation is too little, too late" given the decline in other Asian currencies.

During the three months until the PBoC's move yesterday, the Korean won dropped by 7.2% against the US dollar, the Singapore dollar declined by 4.2% while the Taiwanese dollar slid 3.2%. During Asian trading hours yesterday, in reaction to the Chinese move, all three currencies fell a further 1.3%. Those moves have added to investor interest in macro-focused hedge funds.

Yet the PBoC's move also highlights the broader need for Asia-focused fund managers to have a macro view.

Asia is "still developing, so macro plays a huge part" in any strategy, said Tom Gallagher, partner at Cap Intro Solutions, which introduces investors to hedge funds. Investors look for long-short equity managers who are "great at fundamental research and stock picking," said Gallagher, but investors also "want to know how that fits into the grand picture."

"Market-driven is what the government is saying but in reality it's still interventionist," said Lam. "Our approach is to try not to second guess what the government is going to do as a next step, but to anticipate what the long-term general trend for the economy will force the government to do".

Hedge fund VL Asset Management launched its first retail fund on Monday – the VL China Fund – with a mandate to invest in event-driven opportunities. Still, Lam acknowledged that "it's difficult to run a portfolio where every position is event driven."

He described the firm's main strategy as a thematic approach to investing in companies and sectors that will benefit from social, economic and demographic trends in China.

That approach highlights the fact that Asia-focused strategies seldom fit neatly into categories which were originally developed to describe mature market investment strategies.

Asia-focused hedge fund managers are adapting. To date, all of the strategies that $1 billion-plus AUM Hong Kong-based **Asiya Investments** has launched have focused on emerging Asia, which excludes developed markets like Japan and frontier markets like Vietnam. Asiya is including Japan investments in the mandate for a new Asia long-short equity strategy it plans to launch in October, partly due to the greater ease of short selling stocks listed there.

"Investors are leaning towards pan-Asia" hedge funds, said Gallagher. "They want exposure to China but like diversification across Asia."

Diversification is also seeing more Japan-focused managers launch Asia strategies. Singapore-based Kimco launched a pan-Asia long-short equity strategy in 2014, for example, which wound down marketing this year following strong fundraising, according to one source. That adds to the manager's Kimco Japan long-short equity fund which was launched in 2007.

Still, data provider HFR's Asia inc-Japan hedge fund index is up 2.35% in the first seven months of this year, less than HFR's Asia ex-Japan index which has risen 4.54%. Returns are also far below the 8.79% rise for HFR's Japan hedge fund index. The HFR China index is up 9.38% year-to-date despite -3.67% and -7.74% returns in June and July.