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Portfolio Strategies

Bigger firms bag 130/30 business

Large money managers snare the lion's share of a declining market

By Christine Williamson

Aggregate assets in 130/30 strategies declined 24% since their heyday in September 2008, but a few top managers have had a field day since then, scooping up the few searches that have been put out to bid.

Assets of 130/30 managers with more than $100 billion under management totaled $35.87 billion as of June 30, down from $47.2 billion as of Sept. 30, 2008, near the peak of the popularity of these active-extension equity strategies that allow managers to short up to 30% of portfolio assets.

As institutional investors fled 130/30 strategies after the August 2007 quant crash and the 2008 financial crisis, the pack of managers offering the approach thinned to about 45 now, from 70 in late 2008, sources said.

While consultants said institutional demand is nearly non-existent and lower-tier managers who run 130/30 strategies as a sideline said they aren't even marketing their funds, the top cadre of managers more dedicated to the 130/30 premise told a different tale.

A *Pensions & Investments'* comparison of assets managed in 130/30 strategies as of June 30, 2012, and Sept. 30, 2008, at the height of their popularity, found mixed fortunes, even among the largest managers:

- J.P. Morgan Asset Management, $18 billion in 130/30 strategies, up 81.2%;
- BlackRock Inc., $3.2 billion, down 67.9%;
- D.E. Shaw Group, $2.06 billion, up 138.7%;
- Jacobs Levy Equity Management Inc., $1.5 billion, down 60.2%;
- First Quadrant LP, $1 billion, up 70%;
- Acadian Asset Management LLC, $924 million, down 56.5%, and;
- Pyramis Global Advisors LLC, $909 million, up 726.4%.

P&I's analysis is based on its own data as well as 2012 information for some managers from database provider eVestment Alliance LLC.

Interest, inflows up

These top 130/30 managers retained a core of their institutional client base after the market crash and report that interest — and asset inflows — are picking up. They predict a modest renaissance because of investors' willingness to lift constraints and give managers more places to uncover alpha.

The truth of that tale is borne out by the $108.9 billion Teacher Retirement System of Texas, Austin, which added a new $296 million allocation in March to AQR Capital Management LLC's small-cap 130/30 strategy. It already had a $959 million investment in D.E. Shaw Group's flagship 130/30 approach.

Ohio Public Employees' Retirement System, Columbus, started searching for 130/30 managers in 2010 and now has $400 million total managed by four different firms, confirmed Michael Pramik, a spokesman for the $76.4 billion fund, in an e-mail. The firms are The Boston Co., Los Angeles Capital Management & Equity Research Inc., J.P. Morgan Asset Management and AQR, which was hired in March. The size of each manager's mandate could not be learned.

"It's early to make any determinations about the success of the program, but as a group they are outperforming their benchmark this year," said Mr. Pramik in his e-mail.

Demand for the J.P. Morgan Asset Management Large Cap 130/30 strategy has been so strong that the investment team closed it to new investors three years ago and keeps a waiting list, said Lee Spelman, managing director and head of U.S. equity client portfolios for the New York-based firm. About $17 billion is invested in the large-cap core 130/30 approach.

A strong driver of JPMAM's growth over the past few years has been mutual funds. Retail mutual funds account for 48% of the firm's $18 billion total in 130/30 strategies; institutional separate account and commingled funds comprise the remainder.

Ms. Spelman said the "definite pickup in institutional interest" is in large part "recognition that the environment is tough for active equity managers. You need all the tools you can lay your hands on to create alpha and if you can make money by investing in stocks you like, why not take advantage of being able to bet against those stocks that you don't like?"

While JPMAM offers a fundamental approach, hedge fund specialist D.E. Shaw Group, New York, offers quantitative 130/30 strategies and also is experiencing demand from institutional investors, said Trey Beck, managing director.

Mr. Beck said D.E. Shaw has been involved in 11 searches during the past two years and won six of those contests. Five potential investors and three of the firm's existing long-only institutional clients also are considering a move to the strategy, he said, He declined to identify them.

Mr. Beck stressed that despite the widespread abandonment of the 130/30 model four years ago, "the idea has fundamental value. It's rational to look for equities that outperform, and long-only managers should always be looking for them. But it's in the shorting that managers can look for securities that they believe will go down.

"The problem is that for managers without skill in shorting, 130/30 strategies just give them more rope to hang themselves with."

D.E. Shaw just released a white paper "130/30 Version 2" on its website — http://www.deshaw.com/News.shtml — that argues the case for 130/30 strategies.

A number of 130/30 managers attributed their firm's decline in assets to the changing investment needs of clients. That was the case with quantitative specialist Jacobs Levy Equity Management, Florham Park, N.J., said Bruce I. Jacobs, principal, in an e-mail.

Mr. Jacobs said about $2 billion of the firm's decline in assets was the result of two clients, which he declined to name, moving their assets to other Jacobs Levy strategies.

"One client was concerned with the stability of their French prime broker and that client decided to convert to our long-only strategy with the same benchmark. The other client for whom we subadvise converted their multimanager funds to defensive equity, and our 130-30 mandates were converted to our Defensive Equity Strategy," Mr. Jacobs said.

BlackRock, New York, received its stable of quantitatively managed 130/30 strategies from Barclays Global Investors, which it acquired in 2009. Brian Beades, a spokesman for BlackRock, said in an e-mail that the decline of the $9.6 billion of 130/30 strategies that BGI managed as of Sept. 30, 2008, was partially due to recategorization of assets after the acquisition and client redemptions.

In 2007 and 2008, when 130/30 strategies were the big craze in institutional money management, many large money managers with equity management capabilities quickly pulled together an offering, often at the request of an existing client. These managers largely have continued to manage 130/30 mandates for clients that still wanted, but they are not actively seeking new clients.

Modest decline

Madison Square Investors LLC, New York, experienced a comparatively modest 21.2% decline in 130/30 assets to $457 million as of June 30, but executives remains enthusiastic and committed to its strategies.

Michael Maquet, CEO and president, acknowledged the firm isn't getting a lot of 130/30 business beyond retail mutual fund subadvisory assignments but said there has been an uptick in inquiries from European and Middle Eastern institutions.

"We know from these and other investors that unconstrained mandates are very popular. A decade ago you were penalized for not rigidly tracking a benchmark, but these days differentiated returns are rewarded. That's what 130/30 approaches offer. We're gearing up because we really do expect to see RFPs for 130/30 sooner rather than later," Mr. Maquet said.

Numeric Investors LLC, Boston, also hasn't seen a rush of new client interest in 130/30 but because performance has been very good in the past two years, institutional investors likely will be looking again, said David Stewart, director-relationship management. Numeric managed $668 million in 130/30 strategies as of June 30.

D.E. Shaw Group's analysis of eVestment Alliance data showed that on a gross-of-fees basis, 2010 median excess returns over the individual benchmarks of all 130/30 strategies in the universe were 36 basis points, compared with 86 basis points for quantitatively managed 130/30 strategies and 57 basis points for active long-only equity strategies.

In 2011, however, D.E. Shaw researchers found that the median excess gross return was 255 basis points for all 130/30 strategies and 294 basis points for quantitative 130/30 strategies. Long-only active managers produced a median 28 basis points of gross excess return.

Despite the optimism of managers and good returns, consultants said they just aren't seeing much movement on the 130/30 front, although they agree institutional investors are becoming more entranced with less constrained global equity and fixed-income strategies.

"When our clients want a long/short equity approach, they invest directly in long-short hedge funds. They aren't taking a half-step to 130/30 equity strategies," said Susan McDermott, chief investment officer-institutional advisory and a partner at investment consultant Pavilion Advisory Group Inc., Chicago.

"130/30 never really went away. Some institutions clung on to it, but new demand is minimal and searches have dried up," said Christopher Riley, associate partner at consultant Hewitt EnnisKnupp, Chicago.

"My question is why no one has followed until now on predictions made by 130/30 managers in press stories that 130/30 strategies would hit $1 trillion by 2010. Obviously, that didn't happen," Mr. Riley quipped.

Mr. Riley said the saving grace for many 130/30 managers is that the strategy generally doesn't account for a big percentage of their assets. ■