Optima & Forbes Family Trust: Tailwinds for Hedge Funds

New tie up creates synergies

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(L-R): **Dixon Boardman**, Founder, Optima, and **Keith Bloomfield**, CEO, Forbes Family Trust

"Although the equity market has been doing quite well this year, investors shouldn't get carried away," says Optima founder Dixon Boardman. "After all, the market is not cheap, we are late in the economic cycle, and earnings are vulnerable to the global slowdown. And if a left-wing Democratic candidate won the Presidency, equities might drop 30%. So it is prudent to have some protection in the form of hedge funds. It's like fire insurance – you don't buy it after your house burns. Or medical insurance – you pay for it when you need it, and not after the fact." Keith Bloomfield, CEO of Forbes Family Trust (FFT), which acquired Optima (via FFT's holding company FWM Holdings) in April 2019, agrees. "Hedge funds have been climbing a rough hill," he says, "but given where markets are going, there could now be tailwinds – so the timing for allocations might be very good."

FFT is highly selective in its M&A strategy – it has only done two other deals since opening to external capital in 2009. There had been no specific search for a hedge fund specialist, but Bloomfield explains that he "got to know Dixon Boardman through a mutual friend, and grew to understand the business, the quality of people working for him, and the quality of the investments. Their acumen at hedge fund manager selection was what attracted us to them. We are familiar with their multi manager products, and with their single hedge fund manager offerings. We know many other firms in the category, which would not have been of interest."

Optima has also been very picky. Boardman told us in 2017 that he had received various merger overtures, but was determined to retain Optima's autonomy and preserve its culture. Under this deal, says Bloomfield, "Optima will keep its brand name: it's a great, strong and respected brand built over the past 30 years." All Optima staff will stay, building on the strong synergies between Optima and FFT's investment teams. "We look for the same things in manager selection," he continues, "monitoring and due diligence and how managers fit into a client portfolio. We share resources and intellectual capital with Optima. For instance, our AlphaBeta technology operating system is a phenomenal system. We use it as a tool to track funds and look at them through many lenses, in terms of what factors affect them and their entire portfolio. It was built by our co-CIO, James McGrath, 15 years ago and has been improved year by year. We are often asked if we would share it with single family offices or other firms, but we have declined because it is our secret sauce." Both FFT and Optima have kept their process including ODD (operational due diligence) in house.

Generation X, ESG and private equity

Optima clients now have access to ESG and private equity strategies. A growing number of alternative asset managers are incorporating ESG into their investment process, and FFT is heeding client needs in this area. "We are heavily involved in SRI. We represent some very large foundations and endowments that are very focused on it. Any firm with ultra-high net worth clients has to be," says Bloomfield. "Generation X are much more interested in SRI. We deal with some children, usually through a trustee or the previous generation," he adds. "SRI can run through all strategies and asset classes. Both single strategy and multi-strategy funds are adapting their strategies," he continues. FFT clients have moved well beyond the simplest ESG approaches that just exclude certain companies or sectors and focused on "impact investing" solutions, which may provide water, healthcare or medication in Africa.

"Generation X are also a little less conservative and are way more interested in venture capital and private equity," he points out. "We have seen tremendous client interest in private equity and venture capital. FFT is well connected in the space and offers clients preferential capacity through early investments in PE funds ranging from technology-oriented ones in Silicon Valley to some funds in mainland China. Emerging markets make up 10% of a typical portfolio."

Optima's long only strategies

The Blue Chip Opportunity strategy

"This strategy follows a global investment approach focused on premier growth companies that also pay a decent yield. The strategy has several advantages: it is long only; there is no lock up; liquidity is weekly; there is no incentive fee; and it does not trade too actively, which makes it tax efficient for US investors. Dan Strickberger and Steve Memishian, the managers of the strategy, came out of Lazard and WP Stewart & Company, respectively, where they were very effective. They have continued to build an outstanding long-term record. The strategy has an 11.0% annualised return from its inception in February 2011 through the end of June, versus 7.7% for the MSCI AC World Index. Year to date through June 30th, the strategy is up 22.6%. Having known Dan and Steve for decades, we regard the managers as intellectually top rate and two safe pairs of hands," says Boardman.

The Optima STAR strategy

This consists of the five highest conviction long only holdings of 10 hand-picked, top-performing hedge fund managers, and provides daily liquidity, no lock up, no incentive fee, and charges a flat 1% annual management fee.

"The strategy combines two powerful investment principles. First, long-term investment success is most likely to come by allocating to the 'best and the brightest' money managers you can find. Second, those 'best and brightest' money managers are most likely to outperform if they concentrate on their highest conviction stock ideas. As Warren Buffet once put it, 'Diversification may preserve wealth, but concentration builds wealth,'" declares Boardman.

The portfolio is constructed by following a three-step process. "First," he explains, "Optima screens its universe of hedge funds to identify the 10 most attractive, based on quantitative measures of performance, volatility, correlation, etc as well as qualitative assessments of each manager. Next, Optima selects the top five positions by market value from each of the chosen managers, using public filings. Finally, risk guidelines are applied to check liquidity, sector concentrations, etc. The result is a portfolio of 50 'highest conviction' equities from 10 'best in class' hedge fund managers. The 10 managers follow different but complementary investment approaches: three focus on growth, three focus on value, and four are opportunistic. The portfolio is adjusted over time to reflect newly available public filings."

"Many of the managers are either closed to new investors or have prohibitively long lock ups," he adds. Performance for the strategy from its inception on April 28, 2016 through June 2019 is up 47.5%. This calendar year through the end of June, it is up 25.2% versus the S&P 500, which is up 18.5%.

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Joining forces with FFT results in FFT managing $6.5bn, broadening out the combined offering: "Clients endlessly asked us to manage their whole portfolio – so we thought, maybe we should. FFT now goes some way towards the concept of a one stop shop," says Boardman. "We lead with investment at the core, but we offer a full spectrum of family office services, including planning, education for the next generation, philanthropy, tax and inheritance planning. We quarterback for UHNW's existing tax and legal advisers, supercharging the quality of advice," adds Bloomfield, who co-authored *The Family Office: Advising the Financial Elite*, published in 2010.

FFT's resources have recently been augmented by two other deals: Wealth Partners Capital, a wealth management aggregator whose managers previously worked for Affiliated Managers Group, took a minority stake in FFT in 2017. Beyond this, in 2018, FFT acquired multi-family office, AM Global Family Office, which was founded by Andrew Mehalko, who is now co-CIO of FFT. "We have two co-CIOs, and 15 investment professionals who dedicate a lot of time to due diligence for hedge funds and fund of funds, depending on client needs. We are very much a fiduciary and do not invest clients into our own products as such," says Bloomfield. "Being on the ground with a team of investment professionals located in Palm Beach provides a real edge in servicing local clients," he adds. WPG and AM Global have offices in Palm Beach, Florida, which is attracting refugees from high taxes in New York, where FFT also has an office. Another is located in Philadelphia. FFT's minimum portfolio size is $20m, but the average across its 70 clients is higher, working out at around $80m.

FFT has been offering its clients access to hedge funds and fund of funds for 15 years and Optima has been doing so for 31 years. "Hedge funds come under our alternatives bucket, where the average allocation is 20%, but it can range from 10% to 30% with different clients," says Bloomfield. The mix between commingled vehicles, managed accounts and co-investments depends on the client.

"We cover all types of strategies, but our wealthy family clients are particularly interested in market neutral ones at present. These could be equity market neutral, fixed income arbitrage, and convertible bond arbitrage," he says. Clients can also access more esoteric areas such as direct lending and life settlements.

Optima's single hedge fund strategies

Optima is distinguished from most other fund of funds managers by offering single hedge funds as well as multi-manager products. "In our history, we have been asked to market many funds, but we only pick the very best. We have had much success with our single manager funds," says Boardman, who highlights two hedge fund strategies (and two long only strategies) that he judges to be particularly well attuned to the current state of financial markets.

The OPTIKA strategy

"This is one of Optima's best performing strategies, which has built an investment record that truly stands out. Since its inception in May 2015, the OPTIKA strategy has had a cumulative gain of 96.8% (net), which is nearly double the 51.8% return of the S&P 500 and significantly better than the 62.0% return for the NASDAQ – but with an average net exposure of only 60%. Such absolute and risk-adjusted performance is very impressive, especially versus many of OPTIKA's strategy peers. Year to date through June 30th, the strategy is up 28.8% versus 18.5% for the S&P 500 and 20.7% for the NASDAQ. During May 2019, when the NASDAQ was down -7.9% and the S&P fell -6.4%, the OPTIKA strategy was up over +6% – but with an average net exposure of just under 50%. In 2018, when so many other funds had a difficult time, the OPTIKA strategy was up almost 25%," points out Boardman.

"In addition to his performance, our view is that Brad Farber is one of the best and the brightest in the business because he possesses a rare combination of attributes," he continues. "Following 18 years of investment experience, Brad has demonstrated that he has a proven edge in fundamental company research. He has honed his ability to add value by taking a research-intensive 'growth-at-a-reasonable-price' approach, with a focus on the healthcare, TMT and consumer discretionary sectors." He continues that Farber "has distinguished himself by identifying unique growth stocks overlooked by many other investors. Typically, his portfolio exposures are very different than other managers, and his correlation with market indices is relatively limited. Brad's risk management has been highly effective, resulting in strong risk-adjusted returns across different market conditions." Beyond this Farber "is not only a great stock picker, long and short, but also a 'man of the markets', given his record in avoiding the market's downside. There are very few long/short equity managers with comparable absolute and relative performance records. I sincerely believe that the OPTIKA strategy represents what we used to expect from a hedge fund," he concludes, making no secret of his regrets about the institutionalisation of the hedge fund industry.

Optima's Asia ex Japan strategy

He goes on to declare that, "In our view, we are entering the Age of Asia. Asia is the largest economy in the world based on GDP, and it has been growing at triple the rate of the developed Western economies. Moreover, the region's economy is highly dynamic, as exemplified by the ongoing transformation of both China and India. Both countries are becoming increasingly developed and are joining the ranks of the world leaders in technology and science. The equity markets of India and China are characterised by their large size, high growth rates, depth of offerings, and increasing maturity." He continues that, "Financial markets across the region also are maturing, and corporate governance has been improving. Although Asia is underrepresented in many institutional portfolios today, it is expected that the flow of capital into the region will accelerate. Notably, Chinese A-shares are in the process of becoming a larger allocation in the FTSE Russell and MSCI indices."

Boardman further argues that, "these are durable trends that will not be fundamentally altered by global trade friction or regional political tensions. Because the region encompasses such a diverse range of countries, markets, currencies, and valuation levels, we think that in-depth, bottom-up fundamental analysis and comprehensive top-down research can add value by identifying overlooked or misunderstood companies and industries."

To that end, Optima has selected Robert Lloyd George – grandson of prime minister Lloyd George – to manage the strategy. Lloyd George opined in his recent Investment Outlook that, "a balanced portfolio of China, India and Southeast Asia will produce the best returns in the next five years with exposure to the best companies in the fastest growing regions in the world".

He has more than four decades of experience investing in Asia since the 1970s. Beginning in 1978, he worked at Fiduciary Trust Company on international investments for the UN Pension Fund. He authored *A Guide to Asian Stock Markets* in 1989 as well as *The Handbook of Emerging Markets: A Country by Country Guide to the World's Fastest Growing Economies* in 1994. From 1984, he was Managing Director of Indosuez Asia Investment Services in Hong Kong, launching the first closed-end country funds for Thailand, Indonesia, Philippines, China and India. In 1991, he founded Lloyd George Management with the backing of Eaton Vance, Mirabaud and Sal Oppenheim. The firm developed funds for China, India, GEM and BRIC, reaching a maximum AUM of $17.7bn in September 2007. In 2011, Lloyd George Management was sold to Bank of Montreal (now BMO Global Asset Management). In 2015, he established Lloyd George Advisory to build on his 40-year track record. The firm is based in Hong Kong and manages investments throughout Asia. "The strategy managed for Optima aims to generate superior returns over a market cycle by investing in Asian equities while seeking to reduce volatility through selective hedging," says Boardman. "An active long/short equity approach will be taken, combining top-down, bottom-up, and thematic analyses. The stock selection criteria include the strength of cash flow generation, the sustainability of dividend yields, potential earnings growth, valuation metrics, balance sheet quality, management capabilities and integrity, and industry trends. In the current environment, the portfolio is expected to focus on the financial and consumer sectors, as well as communications, healthcare and technology – with basic materials, industrials, utilities and funds comprising the balance."

"The strategy will invest across Asia, excluding Japan and Australia," he continues. "The strategy will not invest in any private, non-traded equities. Gross exposure is not expected to exceed 150%, and net exposure may range from 50%-100%. The portfolio is expected to consist of 25 to 40 equity positions on the long side; the short side is expected to consist primarily of options on indices or market futures (certain markets restrict shorting). Position size is generally 2-5%, with a maximum position size of 8% measured at market. Positions of more than 5% will not have an aggregate size of more than 35%, to match the UCITS rules," he adds.

Boardman concludes that, "For investors seeking superior returns, it is critical to be highly selective. But you cannot be selective – and effective – unless you have years of experience in the business. You also must have access to the best managers, many of whom require prohibitively high minimum investment amounts. Because we launched 30 years ago – in the heyday of hedge funds – we have the experience and the access." **THFJ**