INFORMATION FOR INVESTMENT PROFESSIONALS

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Managing liquidity is core to every investment strategy

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Whether in certain or uncertain times, well-managed funds containing potentially illiquid assets have a vital place in many investors' portfolios

The asset management industry came under intense scrutiny in 2019, with renewed interest in the potential conflict between holding illiquid assets while offering appropriate daily liquidity.

This followed two high-profile fund suspensions due to illiquidity in the underlying holdings, which affected both equity and fixed income funds. However, we believe there remains a place for less liquid holdings in a portfolio when looking to deliver appropriate risk-adjusted returns.

What is important is to do so with foresight and integrity: by looking ahead it is possible to anticipate the problems that might occur down the line, and by ensuring that the integrity of the fund's investment philosophy remains constant. At the same time this approach is essential to successfully managing clients' money, putting their interests first and seeking to treat them all equally.

In addition, it is vital that end clients not only understand that illiquid assets can provide the benefits of additional returns, but do also come with an enhanced risk around liquidity. This means that in extreme scenarios there is an increased risk of a fund suspension in order to protect clients' investments and manage asset sales to meet redemptions in an orderly manner. It is important that end customers understand these risks before investing.

The client is in the room

Whatever the prevailing economic climate and whichever investment strategy our clients have selected, we ensure their best interests are always front and centre, with one adage in our minds: “The client is always in the room”. We seek to protect them from the volatility inherent within investment markets with a consistent focus on liquidity management. We believe this is an essential component of strong open-ended fund management, ensuring that clients can buy into, and sell out of, funds while protecting current investors.

Illiquidity commands a premium, so portfolio managers may invest in less liquid assets if they believe it will enhance client returns – so long as they can continue to meet purchase and redemption requests. We achieve this through our rigorous liquidity management process.

Firstly, portfolio managers (PMs) must ensure there is an appropriate level of liquidity in a portfolio to meet potential redemptions. Meanwhile, an independent Investment Risk Team produces daily portfolio risk reports, of which a significant component is a measure of liquidity management. Any risk issues are escalated to PMs, team heads and the Chief Investment Officer. The Investment Risk Team also carries out an assessment on liquidity liability, ensuring investor concentrations cannot lead to adverse redemption scenarios that the asset liquidity cannot match.

A further tier of our liquidity checks is provided by our Investment Consultancy and Oversight Team, which is responsible for the integrity of our investment strategies and ensuring the best client outcomes. One of its key responsibilities is to estimate capacity for each investment strategy, regardless of asset class, ensuring that it doesn’t impede liquidity. This is updated on a formal and frequent basis to incorporate market conditions.

We also review output from our specialist committee which looks at daily fund flows and liquidity within those markets. This is a lead indicator that will highlight illiquid stocks and reviews securities that could be considered “at increased risk” from a liquidity perspective.

Containment – proactive liquidity management in action

A further process used to ensure our funds retain liquidity is capacity management, or as we prefer to call it, containment. Containment is a long-tested and applied mechanism to manage client fund flows, particularly to impede unwelcome inflows. Managing scale within any strategy is a fundamental part of looking after people’s money – it isn’t something that is new or negative. Giving every client the same experience, regardless of the size of their investment, gives them the ability to trade within our range with certainty.

Containment is an active approach to not allowing our funds or strategies to breach a comfortable level of capacity. This is achieved through formal measures such as non-completion of requests for proposals from new clients, halting new distribution agreements, restricting access to our investment management team and not adding impacted funds to further investment platforms.

We have successfully used these measures on numerous occasions across our funds. For example, we placed formal containment measures on our daily liquid property fund for retail investors in late 2014 with the primary objective to slow inflows in order to protect the integrity of our long-standing philosophy and process. The fund experienced a surge of demand from investors prior to the UK's EU referendum in June 2016 and turning down inflows meant we could stay true to our proven strategy of avoiding larger, often more expensive "trophy" assets. It also meant that during the subsequent systemic suspension of UK property funds towards the end of 2016 our fund was the last property fund to suspend and the first to re-open.

Consistency aligned with continuity – our watchwords

We strongly believe that, where appropriate, illiquid assets can play an important role within investor portfolios. From equities and fixed income to property they can offer fundamental client benefits. But this must be approached with care and attention. We have a number of long-standing procedures in place to monitor and manage liquidity, including containment, and we are proud of our strong track record in doing so to the benefit of our clients.