

SPECIAL REPORT BUSINESS

'A need for a complete rethink'



Daniel Pinto of Stanhope Capital.

BY BARBARA WALL

Fraud, greed and leverage have culminated in the worst period of wealth destruction in decades. Daniel Pinto, managing partner and chairman of Stanhope Capital, one of the largest multi-family offices in Europe, debunks some long-held notions about investing

and offers a fresh insight into the techniques that will help rebuild and preserve capital in a future recovery.

Q. How has the economic crisis altered perceptions of the investment universe?

A. The financial meltdown has blown apart a widespread belief that equities are the only route to long-term outperformance. The reality is that over the past 40 years, U.S. equities haven't done better than 20-year government bonds. The evident fragility of capital markets during the crisis has demonstrated a need for a complete rethink about the way investment portfolios are managed. Any adviser who says otherwise is either in denial or ruinously rigid.

The notion that investors should dogmatically stick to a given long-term asset allocation model regardless of market conditions — recalibrating the model according to performance — is clearly impractical and potentially disastrous.

Q. Stanhope Capital has always advocated the use of hedge funds to manage risk and preserve capital. But last year was an unmitigated disaster for the asset class in terms of redemptions and performance. Has your view of the hedge fund industry changed?

A. For us, hedge funds have always been only one component of highly diversified portfolios. Over all we have reduced our exposure to hedge funds, and our approach to selecting these funds has evolved.

Many hedge funds got into difficulty because they were willing to accept short-term money from fund-of-funds managers despite pursuing strategies that require a longer-term investment horizon. The hedge fund industry was spending all its time battling with redemptions when it should have been focused on doing what it does best: managing risk.

Hedge funds have their merits, but if we are to invest in them we want to know who the other investors are. If the hedge fund has too many fund-of-funds managers as investors, the management team would have to offer up a compelling case to get our money.

Finally, it is important to ensure that you are selecting hedge funds in relevant strategies where they can really add value. Many of the so-called long/short equity hedge funds are of no interest to us, as performance has been hugely disappoint-

ing. Many of these funds are glorified stock pickers with hefty fee structures. At this point in time, we prefer to focus on niche hedge fund managers with proven expertise in specific areas such as distressed debt and convertible arbitrage.

Q. Private equity firms have also suffered huge losses during the crisis. Are you concerned about the current state of the industry? Do you have any exposure to private equity funds?

A. Private equity funds have lost as much, if not more, than public equity markets, as many carry the additional risk of debt default and bankruptcies. But the sheer scale of the carnage has resulted in some very compelling investment opportunities, particularly in the secondary private equity market where existing investments or units can be bought at huge discounts to their net asset value.

Individuals and institutions who bought into private equity funds in 2006, for instance, would have had 70 percent of their initial investment called by the funds, with the remaining 30 percent still to be invested. Today, those investors are sitting on huge losses, but the secondary market enables them to sell their units at a discount and be liberated from future commitments. For us, this represents a buying opportunity.

Q. Are you encouraged by recent rallies in equity markets?

A. There is a sense that the fiscal stimulus efforts and the Geithner plan on toxic assets will end up restoring a degree of liquidity into the markets, but I'm afraid we still have some difficult moments ahead of us. I do not think it is necessarily the right time to add to risky assets in a substantial way, though we are cognizant of the dangers of being too conservative. It is probably a good time to identify exciting investment themes and take positions around the edges.

Q. Which investment themes do you like now?

A. In the low-risk category, we have increased our exposure to high-quality, investment-grade corporate bonds, which are offering very attractive yields of 5 percent to 6 percent more than government bonds of the same maturities.

When it comes to higher-risk investments, we are spending more time looking at small and mid-cap stocks which have experienced falls of up to 80 percent. Yet many of these companies are basically sound and not overly leveraged. There comes a point when investors have to trust their judgment and make a call.

The same argument can be applied to real estate. When you start seeing deals on prime office space netting 9 percent rental yields, then it may be time to play the distressed real estate card.