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The wages of sin: shares rise faster than S&P 500

Sindex.

STIRLING LARKIN THE AUSTRALIAN 12:00AM October 22, 2016

There remains good money to be made across global markets this year despite the fact that we face a world of low numbers.

These numbers include interest rates hovering near zero — 40 per cent of the world's sovereign debt is in negative yield territory — while earnings expansion, economic growth and inflation are near record lows around the world.

This is now being accepted as indicative of what we should expect over the rest of this decade.

What has also become evident more recently is that global investors need to remain flexible while at the same time avoiding one-way bets — this is not an easy task.

What this has also meant for the ultra high net worth community is that as well as remaining flexible, liquidity and redemption of capital must remain high priorities when considering continuing strategies that embrace the search for yield.

There are important reasons why this high priority matters more to UHNW investors than to other Australian investment communities.

With traditional allocations, such as equities and corporate bonds, likely to offer low returns, Australian UHNW investors have, over the past three months, been presented with a greater number of allocations within a broad category referred to as "alternatives".

With no agreed definitive definition of what constitutes an alternative, these presented opportunities have widely ranged from property developers recycling

real estate assets to international private banks packaging liquid alternatives for investors with fungible wealth in excess of $US20 million ($26m).

Liquid alts are a rapidly growing subcategory within asset management.

They seek to combine many of the characteristics of hedge funds — which usually offer monthly redemption of capital terms — with daily liquid unit pricing structures.

Liquid alts have been pitched as an alternative investment exposure that achieves returns with a lower correlation to equities and bonds, while at the same time purporting to offer investors similar redemption characteristics to that of shares.

Of course, for all Australian investment communities considering global alternative investments, lucrative options remain in the higher risk investment categories, which include:

• Exchange-traded funds and US mutual funds facing companies within the ISE "Sindex".

This index represents sin stocks that collectively represent sectors including alcohol, gaming, marijuana and tobacco. Since the nadir of the global financial crisis, it is up 325 per cent, double that of the S&P 500 over the same horizon. The Spirited Funds and Whiskey + Spirits ETF (WSKY: US) was launched this week in New York.

• US MLP, or master limited partnership funds, which in essence tactically invest across US shale, gas and energy assets. This specific US investment structure enjoys tax benefits of a limited partnership with the liquidity of publicly traded securities but can only qualify for these if they generate at least 90 per cent of their income from "qualifying sources". These include only those activities related to the production, processing and transportation of oil, natural gas and coal in the US.

With the quest for yield driving MLP fund inflows higher during the first half of 2016 than all flows of 2015, there has been a noticeable uptick in talks with investors seeking yield.

MLPs have screened more attractively given relative underperformance versus US utilities, REITs and telcos. In play this month was SemGroup Corp (SEMG: US), which announced it had completed the acquisition of all of the outstanding common units publicly held of its underlying MLP, Rose Rock Midstream

(previously RRMS: US).

Remembering to avoid taking one-way bets, the investment philosophy global investors must embrace is not to try to find hedges for certain things going on but to remain focused on finding returns that make sense to them.

For many this has meant avoiding blind allocations to US or Australian equities, without thinking about which areas could display growth or value.

One of the things that has gone missing is that equity markets have not been very highly correlated over the past year. The S&P 500 went up 5 per cent while European markets went down by about 8 per cent.

Accepting that it has not been growth markets that are highly correlated but rather sovereign debt markets, it was interesting to note that there was nothing about Brexit that should have driven down bond yields in the US or in Australia — but that is exactly what happened.

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