Investing in Alternatives for 15 years

Q&A

Mike Howard, Head of Alternatives, M&G plc

(Transcript)

What does your team do within M&G plc? (00:09 – 01:04)

I run the M&G Alternatives business which is responsible for doing private equity, real assets and diversifying strategy investments on behalf of PruFund and a number of other multi-asset funds. And we invest in a variety of different strategies within the alternatives field. So, in the private equity space we're investing in venture capital, growth, buy out or we're doing it through funds and also co investments in the real asset space it's predominantly in infrastructure. We're also doing a bunch of other interesting things like aircraft leasing, we do a lot of renewable energy in there and then on the diversifying strategy side of things we've got a combination of hedge funds and we've also got some royalty strategies and we also do things like insurance linked securities. So, looking in that book for real diversification.

What would you say the role of alternatives are in a fund? ((01:06 – 01:50)

Alternatives serve a couple of different sorts of roles. One I guess investors look at them first for diversification, so they're looking for something. And then secondly are we actually getting enhanced returns? So, a combination of slightly better returns of better-quality returns and diversification. That's the primary reason. I think some people find it difficult to access some of those alternative asset classes because of complexity, because of liquidity. So, from our perspective having a large fund like PruFund able to invest for the long-term it's got a big difference. So, we can access opportunities that maybe aren't so readily available to private investors.

What opportunities does this present with regards to PruFund? (01:51-03:10)

One of the things we look at is asset classes that are maybe newer, some more nascent and what we can get out of that is some of the returns that are a little bit more attractive in the early stages. So, we have been early adopters of quite a lot of different alternative strategies. Most recently we got involved in investing in music royalties. So, there we are buying or investing alongside songwriters and buying part of the rights to their songs and where we generate income from, is obviously downloads, airplay, but also interestingly use in films or if you see a Broadway musical, we would also be taking revenues, a share in the revenues from those sorts of activities. It's a relatively new asset class. Why we thought it was quite interesting is that actually those type of returns whether people decide their going to download an album or whether they're going to visit the theatre to go and see a show, not really correlated with what's happening in the broader economy and so we see it as being quite resistant to economic environment. And actually throw us off pretty high yielding returns.

Are advisers surprised when they find out we invest in these types of alternatives? (03:10 – 04:20)

People are surprised when they hear of investing in music, but they understand the rationale behind what we're doing there. We're really looking for opportunities where we can see long annuity type returns. So these were often actually buying established hits, so things that may even have been back in the 70's and 80's where you can look at the long-term track record of that song, how many times it's been downloaded or synced or played on the radio etc. and you can actually model that. So rather than us investing in necessarily the next big thing we're actually looking for established music rights. And really the value add there is about us turning that in many cases neglected asset and looking at how we can market it, how we can produce it into something which is more interesting. As I gave an example earlier of putting onto a Broadway musical or whether we get it in the soundtrack of a film or even a biopic. So, there's lots of different ways of enhancing the return from those assets that people and maybe the music companies hadn't really optimized in the past.

Has the role of alternatives shifted in the 15 years we've had PruFund Growth? (04:20-05:30)

We've been investing in private equity going back before then as Prudential, going back to the mid 80's. We've been investing for a long time in alternative asset classes. We've been pretty early adopters of infrastructure as an asset class. We are a very big investor in renewable energy it's been very important to us and we've invested in it in the UK and Italy and now we're investing in emerging markets. And you now that sort of DNA that we develop over time of having invested in these asset classes at an early stage and then seeing how they roll out throughout the world creates a bit of an edge in itself. It creates a knowledge base that we can then see how that plays out over time, so yes, it's evolved. I would say what we've done is we've added new strategies we've been able to replicate what we've seen work before in different asset classes. And so really, it's been a case of broadening out what we do and we're doing more of it. But the fundamentals are still the same. We're looking for asset classes we think offer value to our investors, that can offer a diversified source of return and deliver a steady and predictable return stream when you combine all the different pieces together.

Tell us about the three different investment processes? (05:31-07:09)

The investment process has three parts. Most obviously we look at the investment case, so do we think that this investment represents good value to our policyholders. Do we like the risk reward? And there's a very thorough due diligence that goes on with that aspect of the process - but then actually maybe less familiar to some of our policyholders we also look at the operational angle. So we're looking at, what are the non-investment risks. What are the risks that our policyholders can lose from things like poor corporate governance within the investment manager? Do they independence on the board? Do they have proper oversight? Do they have good disaster recovery plans? We're often investing with relatively small asset managers because the opportunity has been quite niche. We want to make sure that they are very robust businesses. So, the operational angle is looking at a whole host of risks that non-investment risks. And then on the third sort of leg to the stool is the legal due diligence. So, we have a team of in-house lawyers and we also use external counsel so whenever we're investing in these investments, we're taking the advice of either in-house expertise. But more often than not external counsel to make sure that when we are signing up for what can be a 10 year plus investment, we have all the appropriate legal protections, we are getting the information right. So that if something doesn't go well with the investment which sometimes happens, we understand what our legal position is and what we can do about it.

Would you link in with the manager oversight team for that? (07:09-07:41)

The Manager Oversight Team, we have a close working relationship with them. They similarly will look at some of the same angles that we do the alternatives area is a little bit different from traditional assets. I think because of the requirement to have your investments for a long period of time it's really important that you do a lot more work up front to ensure that in the event that something doesn’t go to plan, you know exactly how your protected. You want to make sure you don’t get involved in something which you’re not comfortable with.

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