

K2 Asset Management

Absolute return fund manager K2 Asset Management celebrates its 10-year anniversary as a fund bigger, better and stronger than ever, writes MICHELLE BALTAZAR.

Campbell Neal and Mark Newman are a formidable pair in the local funds management industry. As co-founders of absolute return fund K2 Asset Management, they represent the triple threat: good with money, good with people and, unlike other fund managers, good with grim markets.

Not that K2 was immune to the wrath of the GFC and it's not like its performance is foolproof.

But what it lacked in perfection, it made up for in consistency and conviction. If an investor were to base K2's performance scorecard on how the manager fared over the long term; how much capital it preserved during down markets; and how it brilliantly "timed" its entry back into the market this year, then it's easy to see why the fund has withstood the test of time to celebrate its 10-year anniversary this year.

Based in Melbourne, the firm was set up in 1999 after Neal, the managing director, and Newman, the chief investment officer, decided there's another way to make money for their clients other than being fully exposed to the equities markets at all times.

"Having worked in Asia, I saw a couple of severe downturns and realised that when managing money in emerging markets, being forced to be exposed 100 per cent all the time or being long-only, on top of the currency risk, didn't make sense to me from a long-term wealth creation standpoint," said Newman.

That's when K2 was born, a boutique outfit that started as a two-man band but now boasts 26 staff, including nine fund

managers and funds under management of \$670 million.

They have three flagship strategies: Asia-Pacific (ex-Japan), Australia and New Zealand and international.

The fund's target after-fee return is 15 per cent per annum over three to five years. To illustrate, the K2 Asian Absolute Return fund returned 13.3 per cent per annum over 10 years versus the market's 4.8 per cent return over the same period.

In dollar terms, investors who stuck with K2 since inception gained double the returns compared to those who invested in the comparable indices over the same period (see graphs below).

Ultra-active investing

While the package says K2 is a long/short or absolute return fund manager, the firm's best-of-both-worlds strategy contradicts the easy labels.

"In truth, we fall between long-only and traditional alternative," said Newman. "One misconception is that our style of investing is more risky than long-only, but evidence in the last 10 years don't support that," he added.

For example, Newman highlights their cash holdings strategy. While many fund managers are mandated to hold at least 80 to 90 per cent of their funds in equities at all times, K2 can move from zero to 100 per cent cash, theoretically, depending on how much exposure they feel they should have to equities.

During last year's crisis, K2 held as much as 80 per cent of funds in cash. In March (when the market bottomed), the

group moved from 20 per cent equities to 50 per cent. By last month, they were close to being 100 per cent invested in equities.

Similarly, the fund doesn't restrict itself to either a growth or value bias.

"Our investment approach is dynamic. We're not married to investing in one way ... we look at the economic circumstances we find ourselves in and adjust to that. I rotate between value, income, momentum and growth," he said.

And another differentiator? K2 has never used gearing.

"We don't like gearing because it can be withdrawn at the lender's option, and also, in the markets that we invest in such as in Asia, there is already enough volatility [without magnifying that with gearing]," he said.

Aligned to investor interest

Newman said one of the misconceptions about absolute return funds is that they will always produce a positive return. On average, the fund is 35 per cent invested in cash, which allows it to take advantage of sharp sell-offs, but it is also 65 per cent long in equities, which means they have had years where they were in the red.

The fund's fee structure addresses that, with a management fee of 1.5 per cent and a performance fee of 20 per cent subject to a high watermark.

"We're very aligned to generating positive returns. It's not just about beating the benchmark," said Newman, adding, "We've delivered about 90 per cent of what the index has done in the rising years, but conversely, when the market fell, we only



delivered a third of the fall, and in some cases, eliminated that [loss] altogether."

And in a sign of the times, K2 prides itself on being transparent.

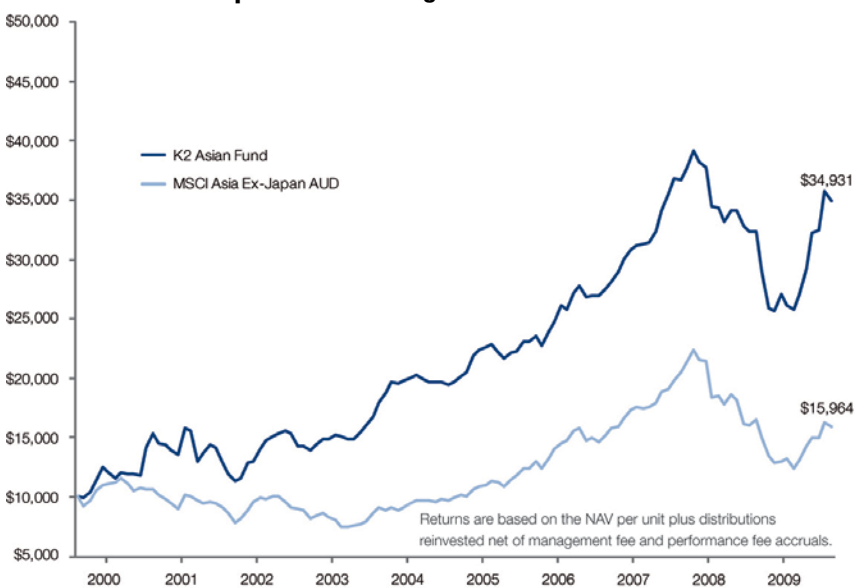
"We've always been quite open. We give our top 10 positions in our monthly newsletter and we are happy to provide full disclosure and attribution to ratings agencies, consultants and clients of where our performance is generated."

In the end, it all comes down to what clients think, one of whom sent Newman an email recently.

"One of the most satisfying things is having happy clients. One of our first clients sent me a very nice letter after they received their financial year-end results and told me how their investments 10 years ago has turned into a substantial sum ... they have investments elsewhere and they said we're the one that delivered the best returns."

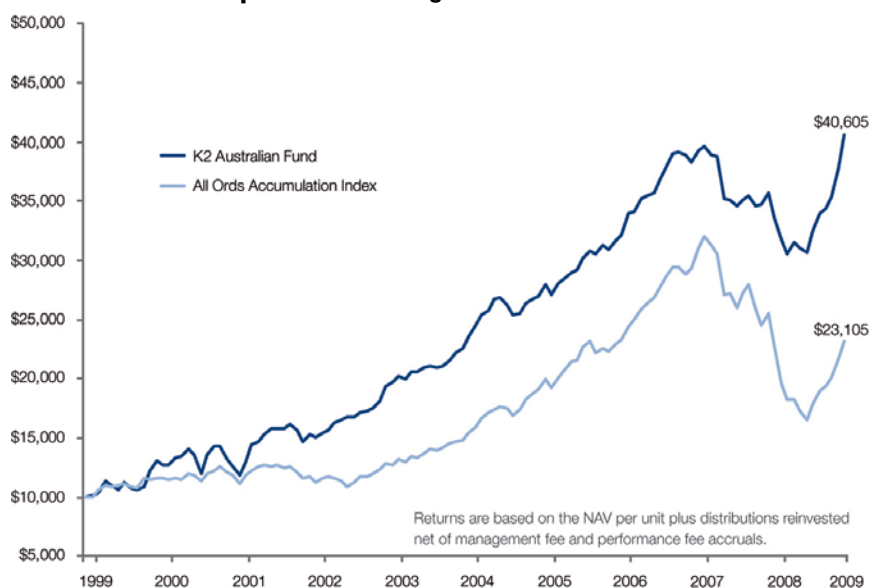
In fact, Newman said one of the highlights of their decade-long existence is the high level of client satisfaction. Winning a Fund Manager of the Year Award this year, having low staff turnover and protecting clients' capital in hostile markets are almost just icing on the cake. *Almost.* ●

Figure 1. K2 Asian Absolute Return Fund growth of \$10,000 since inception as at 31 August 2009



Source: K2 Asset Management

Figure 2. K2 Australian Absolute Return Fund growth of \$10,000 since inception as at 31 August 2009



Source: K2 Asset Management