THE AUSTRALIAN
Business
WITH THE WALL STREET JOURNAL.

September 16, 2009 01:12am AEST

Look to your assets: H3 Global Investors

Sara Rich | September 16, 2009

Article from: The Australian

BROTHERS Andrew and Mathew Kaleel consider themselves proof that siblings can make good business partners.

"We haven't killed each other yet," jokes Andrew, 41.

"The fact we have got through almost 15 years is quite a good sign. With any sort of partnership there is a high degree of trust and we have seen more partnerships that are non-family originated have a lot more issues than we have."

Andrew and Mathew, 36, founded H3 Global Advisors, a boutique fund manager that specialises in alternative investments, in 1995. The fund they co-manage, the H3 Global Commodities Fund, has outstripped its competitors and the benchmark since inception in 2005 with an annualised return of 9.98 per cent.

The fund provides investors with actively managed, long-only exposure to commodity markets such as oil, gold, copper, sugar and wheat.

Last year it returned minus 2.53 per cent after fees, while its benchmark, the Dow Jones-UBS Commodity Index, plummeted 35.65 per cent, excluding fees.

You get the impression from talking to the pair that trust has played a big role in getting the business to where it is today.

"The first few years in launching a boutique you don't have a lot under management, you really have to work together and you are not earning a lot of money or as much as you would working for someone else, so it is quite important that you do trust and rely on each other," Mathew says.

The brothers grew up in Sydney and their careers took them in different directions -- investment markets for Andrew and accounting and project management for Mathew -- before they realised the skill sets they had developed complemented each other.

"It was basically bringing two very different skill sets to the table and being able to put them together in a way that we developed a fairly robust, quantitative framework. Now, that would have been difficult for me to do on my own and vice versa for Matt," Andrew says.

In June 2007, St George Bank took a stake in H3 through the private equity firm it co-owns with Kaplan Equity, Ascalon Capital Managers. St George's owner Westpac last week moved to acquire Kaplan's stake in Ascalon. Andrew believes that having the backing of an institution allows the boutique to achieve "the best of both worlds".

"We tend to satisfy a lot of the requirements of our larger institutional investors such as a strong balance sheet, good corporate governance, oversight, compliance and risk management but also bring to the table the benefits attributable to being able to run in a boutique manner," he says. A retail version of the H3 Global Commodities Fund was launched last year and investors can access it via a variety of investment platforms. It has $60 million funds under management and charges 1.65 per cent a year in fees.

How do you value commodities?

We use a quantitative investment approach that factors in both fundamental and technical factors to determine whether a particular commodity market exhibits an attractive future return to risk outcome. The approach also factors in how that particular commodity relates to both commodities in the same sector and in the portfolio as a whole.

What investments have been the best performers for you so far?

Industrial and precious metals have been the stand-out performers, especially gold and copper. Agricultural markets have added value (at) different points. Sugar lately has been outstanding and we see more potential upside. Lead is looking very supply-constrained and we see good upside potential as well.

In Australia, what sectors and stocks do you like most?

We like resources, so the diversified miners such as BHP and Rio look attractive based on spot prices. We also favour those companies leveraged to coal, oil, gold and mining services.

Is the investment climate good for your type of fund?

Yes, the climate is great for our type of fund. Because we are an active manager and run in a benchmark-unaware manner, we have a great degree of flexibility in terms of portfolio construction. Having little or no weighting to natural gas, which has fallen about 60 per cent this year, is an example of how our fund's benchmark-unaware approach doesn't result in us having to hold markets that have poor fundamentals, even though it is a major component of most commodity indices. The investment climate is providing excellent opportunities as we are seeing supply constraints creep back into the market. Commodity markets are moving back towards being driven by more traditional supply and demand factors as opposed to risk on-risk off factors.

Various assets have taken a beating in recent months, has that enticed you to buy up?

Yes, the pullback in gold and silver provided great entry points to two markets that should do well during the medium to long term. Any pullback in commodities generally is a good opportunity to get set for the long term, especially those that are becoming more supply-constrained, such as lead, copper and sugar. We believe we are in a long-term secular bull market in commodities and this, coupled with inflationary pressures and weakness in the US dollar, will continue to underpin various commodity markets.

Outside commodities and resources, higher quality corporate debt and hybrids look interesting but, again, being selective has and will continue to pay dividends during the medium to longer term. We like emerging markets and Asian exposure, and buying on dips during themedium to long term will provide good relative returns.

Where do you see markets heading in the next 12 months?

Markets have run hard following the lows we saw in March. As a result, we believe it will be very much a stock or asset-picker's environment across most asset classes and investors can do well if they are more selective from a relative perspective. During the next 12 months, we believe emerging markets and countries such as Australia will continue to provide better relative opportunities than the US or Britain. From a sector perspective, we like resources, especially those companies leveraged to gold, coal and iron ore. We continue to favour currencies such as the Australian dollar and Canadian dollar. We expect continued US dollar weakness during the medium to long term. We are particularly keen on gold and commodities generally as a result.

What do you see as the main themes that will dominate markets in the next 12 months?

US dollar weakness, an ongoing deterioration in commercial property books in the Organisation for Economic Co-operation and Development economies and unexpected inflation. Assets that have the ability to protect capital, provide inflation protection and benefit from US dollar weakness, such as commodities and real assets, will do well in an absolute and relative sense.

What do you think of the banks and financial services sector globally?

We are mixed on our view of the sector globally. In the US, we tend to like the more trading-oriented and investment banks that have demonstrated an ability to manage their risk appropriately and benefit from commodities and treasury-related trading, such as Goldman Sachs. One would also need to favour banks and financial service companies where bank balance sheets are less exposed to further stress in housing and, more importantly, commercial property markets, which we have a degree of concern over. We do favour the Aussie banks, especially Westpac and the Commonwealth Bank of Australia, Canadian banks and Asian banks. The Chinese banks need to be looked at with caution on the back of what appears to be a frothy and speculative property market.

FIVE HOT TIPS

FOCUS on liquid, real and transparent asset classes and don't be afraid to diversify into uncorrelated non-traditional investments.
Body: BUY gold and commodities as a strategic investment and look at assets that can provide inflation and general risk protection.

UNDERSTAND what you are able to tolerate from a risk perspective. Once this has been clarified, reasonable and realistic return targets can be formulated with a higher degree of comfort and certainty.

CONTINUE to expect the unexpected as markets are in uncharted territory and always question and be sceptical of prevailing opinion.

ALWAYS seek the best advice and be happy to pay for it, within reason. The focus on fees to the detriment of return outcomes may mean you miss out on opportunities that will truly add value to your portfolio.