

PROFILE

When curiosity leads to great things

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In the 1990s, brothers Andrew and Mathew Kaleel became fascinated with a concept that was in its infancy at the time in Australia: quantitative investment management.

Their curiosity with applying mathematical formulas to price assets, including stocks and bonds, led to the creation of boutique H3 Global Advisors in 1995.

“Mathew came from an accounting and project management background so we had two distinct skill sets,” Andrew Kaleel says.

“I had quite a bit of institutional experience in trading equities, futures and currency markets so brought a practical bent to the equation and had some idea as to some concepts which I thought were viable, robust and valid.”

The firm’s initial plan was to build and test its investment process, then raise money and give investors exposure to markets that they would typically not have exposure to, Andrew says.

The Kaleels also targeted offering an investment that had a distinct non-correlation to traditional asset classes.

“We spent a few years refining the process and gravitated towards FX (foreign exchange) and futures markets primarily because of the ability to go both long and short and because of the diverse range markets you could gain exposure to FX equities, bonds, interest rates and currencies,” Andrew says.

The brothers’ hard work in testing and refining has certainly paid off, with Westpac-owned boutique fund incubator Ascalon Capital Managers building a 45 per cent stake in H3 Global.

H3 Global’s flagship product is its H3 Global Commodities Fund, which offers investors exposure to major commodity markets globally.

“The fund invests across all major sectors such as energies, metals, grains, softs, livestock and agriculture,” Andrew says.

“Rather than gain this exposure via investing in resource stocks, the money goes direct to the source and gains exposure via futures markets, giving us direct exposure to the changes in price underlying commodities as opposed to changes in price in the resource



MATHEW AND ANDREW KALEEL

company; two quite different things.”

The Kaleels believe futures are the most liquid, cost-effective and efficient way to gain exposure to commodity markets.

“Whilst futures can involve leverage, the fund does not use leverage and all positions are fully cash backed,” Andrew says.

“Our models right now have the portfolio fairly defensively placed as we are not seeing any evidence of true underlying organic demand for commodities outside of the restocking process, which is fairly well complete.”

The brothers use their qualitative investment process to identify commodity markets that have the potential to offer attractive risk-adjusted outcomes, he says.

“The factors used are both of a fundamental and technical nature. The best opportunities typically arise when both technical and fundamentals are in sync,” he says.

“The fundamental factors cover areas such as inventory levels, storage costs and interest rates. The technical factors look at momentum and volatility.”

Risk is managed at the market, sector and portfolio level by using exposure constraints, stoplosses and value-at-risk models.

The fund is flexible as it can be fully invested or 100 per cent in cash.

“We run in a benchmark unaware manner and are not constrained by tracking error. We actively allocate to cash if we cannot justify an investment in a commodity that will give us a potential return above the risk-free rate,” Andrew says.

H3 Global targets annualised volatility of 12-14 per cent across its Global Commodities Fund irrespective of underlying volatility.

FOCUS

Standard & Poor’s rates the H3 Global Commodities Fund four stars, reflecting its high conviction that the manager will consistently generate risk-adjusted fund returns in excess of relevant investment objectives and relative to peers.

The fund invests in an underlying Cayman Islands-domiciled master fund that has a 44-month track record.

It provides daily liquidity, although a redemption restriction may apply if more than 25 per cent of the fund’s net assets are requested in any period.

Both features are slightly unnecessary given the liquidity profile of the assets, but are in place ahead of a larger funds under management (FUM) base.

Individual fees are not large, but are cumulative due to a high responsible- entity fee payable to Ascalon as well as recoverable expenses. As FUM increases and the service-provider cost savings provided by Ascalon flow through, we would expect these to fall significantly.

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Source: Standard & Poor’s

Currently, sugar and livestock markets have good weightings in the portfolio, Andrew says.

Commodities, including industrial metals and energy, that are leveraged to a pick-up in global gross domestic product have little or no weight.

Andrew says the fact Ascalon in February raised its stake in H3 Global to 45 per cent from 30 per cent does not mean the business will run any differently.

“Their model is to assist the manager in other areas, which leaves more time for the internal portfolio managers to focus on what they do best,” he says.

“The increase of Ascalon’s stake in H3 highlights the faith they as an investor have in the H3 business.”

H3 GLOBAL COMMODITIES FUND

PERFORMANCE AS AT 31 JANUARY 2010	1 YR	3 YR
Annualised return (%)	8.37	5.96

Source: Morningstar