Why absolute-return strategies belong in every Canadian's portfolio

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Mackenzie's Michael Schnitman explains significance of pioneering fund's pure alpha focus.

To most people, May 23 will be just another day. But to Michael Schnitman of Mackenzie Investments, it will mark a crucial milestone for his firm as well as for the Canadian investment industry: the second birthday of the Mackenzie Multi-Strategy Absolute Return Fund.

"We were the first firm in Canada to launch a true alternative-strategies mutual fund under exemptive relief in May 2018," Schnitman said.

It would be another eight months before retail investors get broad access to liquid-alternative funds, thanks to a new regulatory framework enabled by the Canadian Securities Administrators' modernization of NI 81-102. But by rolling out the fund when it did, Mackenzie became a pioneer — and like all pioneers, it had chosen to move with purpose.

"What prompted us to launch when we did was the opportunity to help retail investors achieve long-term objectives in the same way that institutional and high-net-worth investors have been able to for decades," Schnitman explained.

Adopting the institutional playbook

Traditionally, the average retail investor has only been able to put their money in publicly listed stocks or bonds. Larger institutions, with extremely long-term horizons and billions of dollars at their disposal, can go beyond that: they may invest in esoteric asset classes such as private debt, private equity, infrastructure, and commodities; or they can use alternative strategies to invest in public-market assets while generating a non-correlated return profile.

"What alternatives can do is to dampen the volatility in your overall investment portfolio," Schnitman said. "They act as a ballast or stabilizer, which can really help protect against sequence of returns risk."

That risk, as it relates to individual investors, is most critical with respect to when they retire. If their nest egg suffers negative returns as they approach or start retirement, it can have a lasting detrimental effect on the amount of income they can withdraw over their lifetime.

Many Canadian investors caught during the extreme market volatility in the early weeks of the coronavirus crisis are now facing that problem. Both the S&P 500 and the S&P/TSX Composite Indexes saw record drawdowns, while liquidity challenges in the bond markets led to sharp rises in corporate credit spreads. The net result, for both traditional equity and bond funds — and by extension, for many retail portfolios — has been drastic declines in value.

“In that kind of environment, even a fund that outperforms its benchmark by 20% wouldn’t help any investors with their ambitions, such as retirement or funding their child’s education,” Schnitman said. “Our multi-strategy absolute return fund reduces portfolio return volatility by aiming for pure alpha, which in our case means targeting returns between 5% and 9% above inflation.”

An absolute return orientation

Mackenzie’s flagship alternative mutual fund includes a market-neutral equity sleeve, which includes long and short positions. Another major component, the fixed-income credit sleeve, is absolute return-oriented and is similarly able to get both long and short exposure; it’s also able to use leverage to amplify returns from investment-grade bonds.

“The third leg of the stool is global macro, which takes macroeconomic inputs and makes inferences on the relative values of commodities, currencies, equities, and other sub-asset classes in the marketplace,” Schnitman said, noting that Mackenzie also offers a standalone Global Macro liquid alternatives fund. “That slice of the absolute return strategy is managed by two people who have 10 years of experience with this type of approach at CPPIB.”

If the experience of the U.S. is any indication, the forecast for absolute return-oriented funds among retail investors in Canada over the next few years is extremely positive. Schnitman noted that after the financial crisis of 2008, absolute-return strategies saw a dramatic surge in popularity; today, alternative mutual funds domiciled in the U.S. hold around US$700 billion in assets, with around half in alternative strategies that include absolute return-focused funds.

To be sure, Mackenzie has been doing its part to support that wave. Over the past two years, it has expanded its liquid-alt line-up to include a shelf of four alternative-strategy solutions, one alternative-asset fund, and one alternative-asset ETF. It also recently announced lower management fees for three of its absolute return-oriented products.

“I think that Canadian retail investors can benefit greatly from having these types of funds in their portfolios, and we’re very excited to provide these options to help them achieve their goals,” Schnitman said.

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