Firms Benefit From Using Alts, ESG Both Here And Abroad

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Kimberly Flynn, managing director for alternative investments at XA Investments. Read the Q & A below as Kimberly discusses how money managers benefit from opening London-based unit investment trusts – roughly the equivalent of a US-based closed-end fund – and how the strategies have synergies, especially with illiquid alternatives, that are making for new and interesting investments, notably right now in the development of ESG-based infrastructure funds.

Kimberly Flynn

The podcast can be found on AICA's website by clicking here: https://aicalliance.org/alliance-content/pod-cast/

CHUCK JAFFE: Kimberly Flynn, managing director for alternative investments at XA Investments is here, and we're talking about why more U.S. money managers are and should be looking across the pond for their next investment products. Welcome to The NAVigator. This is The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator's brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry from users and investors to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator's going to point you in the right direction. And today, well, it's pointing us across the Atlantic Ocean towards England, and it's doing that with Kimberly Flynn. She is managing director of alternative investments at XA Investments, which you can learn more about at XAInvestments.com, and she is of a mind that U.S. money managers and asset managers should be looking at the London listed investment trust marketplace. We've talked about it a little bit before on The NAVigator, we're going to go a little further with a slightly different look at it. If you want to learn more about investing in closed-end funds generally, and also in business-development companies and interval funds, AICAlliance.org is the website for the Active Investment Company Alliance. Kim Flynn, great to have you back on The NAVigator.

KIMBERLY FLYNN: Thanks Chuck, glad to be here.

CHUCK JAFFE: Let's talk just a little bit about what asset managers gain when they're working both sides of the pond. Because it's not just, "Hey, I can go off and do this for business." There's perspective, there's opportunity, there's a number of things here. So why does it matter that a U.S. asset manager should be going there? And what are the real opportunities of saying, "Hey, I want to have some London based investments?"

KIMBERLY FLYNN: Sure. We encourage U.S. asset managers, in particular alternative managers or investment teams that are really focused on ESG or impact investing to consider capital raising in the UK investment trust market. And the reason is that investment strategy that will work in the U.S. listed closed-end fund market may or may not work in the UK market. And so it really gives an asset manager an opportunity to explore fund launches and broaden out their opportunity set. And so we talk with a lot of our consulting clients about this market, the London market is not something that U.S. asset managers are all that familiar with today.

CHUCK JAFFE: In terms of the way things work there versus here. There, talking about investment trusts, here you're typically about closed-end funds for you. What's the difference? How are the two sides different?

KIMBERLY FLYNN: So to compare for example the U.S. listed closed-end fund marketplace, those funds IPO and they typically are listed on the New York Stock Exchange or the NASDAQ, and they are often sold through the wire house channel to investment advisors that will invest on behalf of clients. And most of what is done in the U.S. listed market is traditional investment strategies with a focus on income. Well, there's a connection. The UK marketplace is also focused on income, largely focused on income. But the UK market for London listed funds is more than institutional marketplace, and so U.S. asset managers that have private fund strategies or capabilities that may not fit well in a U.S. listed fund, things that are less liquid or alternative in nature would be a good fit for the UK institutional investor audience. And it's because these are both exchange-listed vehicles that we're talking about, a lot of the advantages for an asset manager of having that type of investment pool benefits investors, right? What we like about listed closed-end fund vehicles like the U.S. listed closed-end funds or the London listed investment trusts is that there's no cash drag, that you can put less liquid investments to drive returns, and things like alternatives can fit well there. And so we're seeing more and more investors consider this audience, which is largely institutional, for launching. What's working now are things that are more ESG or impact oriented, and so in some ways the U.S. market is just now catching up with what the UK investor base has been focused on for some time.

CHUCK JAFFE: Indeed, that's what I was going to say. Is that from the standpoint of what you're seeing, it sounds like although you're encouraging money managers to go abroad, it sort of sounds like just as they did with mutual funds in general, they called them unit investment trusts but they had them a long time before we had mutual funds here. It sounds like some of the innovation is happening there and then coming across the pond. So are there things that you would wind up expecting if they become a little more popular with money managers who are using them in London that they will also be things that we'll see more of here in the United States?

KIMBERLY FLYNN: I do, and I think that some of the transfer of strategies and ideas that you're talking about is that it does go both ways. An example of this is the U.S. interval fund market, and we've talked before about the growth of the interval fund market in the U.S., which is where alternative strategies fit well. And so we are seeing a lot of interest frankly from the London Stock Exchange, they're talking with asset managers who have interval funds or tender offer funds, and they're talking with them about why also the London listed market might be a good fit for that strategy. And what really decides that or determined what works in that market, is where's the institutional demand. The UK market does move very, very quickly, and so the trends and the themes that are working in a given quarter or a given year, right now that's infrastructure. Obviously in the U.S., that's a trend that I think we're going to start seeing a lot more product around infrastructure in the coming months as the Biden infrastructure plan really is implemented and those investments are deployed.

CHUCK JAFFE: Will we see infrastructure mixed with ESG? Because we're talking about ESG being as important as it is, infrastructure not always an environmental, social, governance-friendly kind of investment area.

KIMBERLY FLYNN: You know, it's an interesting point but in the UK investment trust market, having ESG integrated is really table stakes for any asset manager be it U.S. or UK or any other asset manager that wants to get to that market. Those institutional investors expect ESG to be integrated, and so I think we're seeing that trend as well in the U.S. across firms and across investment strategies, is that more and more managers are moving to integrate it so that it's essentially part of their process. Infrastructure is a good example. It may not be something that you would think about as ESG, but if the process itself factors in ESG factors, where it may not be something that is intuitive. But the benefit is that we're seeing considerations for those ESG factors and I think we're going to see a lot more of that in the U.S. as well.

CHUCK JAFFE: Lastly, you're encouraging money managers to work on both sides of the pond, but so much of the business is still about economies of scale and the rest. Starting rather than buying existing, why?

KIMBERLY FLYNN: So some UK investment trusts are actually set up as feeders into existing funds. So to your point, they can gain additional scale that way. Some are set up as distinct pools of capital. So if you think about infrastructure or real estate or farmland investing, where scale is really important to driving returns, it would make sense that the incremental assets are raised through a feeder so that all of the investors, be it U.S. or UK, are benefiting from those scale economies. Sometimes it's a limited capacity type of opportunity, consider venture capital or some of these other niche alternative strategies where the investment manager can only deploy $100 to maybe $200 million in a set period of time. In the UK marketplace, the invest setup that's typical is about nine months, and so if you're investing in less liquid investments, nine months may seem like a long time but that's why you might have a capped or constrained strategy for something like that. And so you do see both types of funds come to market.

CHUCK JAFFE: Kim, thanks for joining me to talk about it.

KIMBERLY FLYNN: Absolutely. Thank you, Chuck.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. I am Chuck Jaffe and you can check out my show on your favorite podcast app or at MoneyLifeShow.com. To learn more about interval funds, closed-end funds, and business-development companies go to AICAlliance.org, the website for the Active Investment Company Alliance. They're on Facebook and LinkedIn @AICAlliance. Thanks to my guest, Kimberly Flynn, she's the managing director for alternative investments at XA Investments, and the firm is online at XAInvestments.com and on Twitter @XAInvestments. The NAVigator podcast is new every Friday, follow along on your favorite podcast app and come back next week to learn more about investing with closed-end funds. Until then, have a great holiday and stay safe. Happy investing!

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