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\$20B Highland Packs Pipeline with ETFs, Alts in Retail Push

By Peter Ortiz

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In a bid to expand its retail presence, Highland Capital Management launched a platform last month that unifies its research, risk management and investment processes for liquid alternative mutual funds.

The platform, called Highland Alternative Investors, is being used to promote the Dallas, Tex.-based firm's existing liquid alt funds, but Highland also plans to use it to help launch more products in the space.

Exchange-traded funds play a role in Highland's planned retail expansion too. The firm recently registered 17 alternative ETFs, some of which it expects to launch this quarter, executives say.

Most of the firm's \$20 billion in assets under management are concentrated in alternative credit strategies in the non-'40 Act space. However, the firm offers 12 mutual funds, six of which are liquid alts, and one ETF. Those 13 funds represented \$4.7 billion in assets with the liquid alts making up \$3.9 billion as of the end of February, Morningstar data show. Total assets in the funds were \$1.7 billion in 2011, at which point five of the liquid alt funds (one of the liquid alt funds, Opportunistic Credit Fund, launched last year) represented \$1.3 billion.

Three quarters of the investors in the six funds that Highland categorizes as liquid alts are retail, while the rest are institutional, says Michael Gregory, global head and CIO of the new platform and lead portfolio manager of the Long/Short Healthcare fund.



Michael Gregory
Global Head & Co-CIO
Highland Alternative Investors

"Liquid alts have been one of our fastest growing segments within Highland's entire business," Gregory says.

The firm has 20 years of experience with alt strategies and is well positioned for a retail liquid alts push, he adds. Highland last year hired Jennifer Ricci as director of national accounts for the independent broker-dealer channel and charged her with helping to expand the firm's liquid alts business. And in 2013, the firm hired Robin Thompson as national sales manager, to help with its retail alts push.

The new platform "is important as the capstone on what has been a slow-moving shift in focus for Highland away from its traditional hedge fund and [collateralized loan obligations] business towards liquid alts offerings," says Morningstar alternative strategies analyst A.J. D'Asaro. "I think it's very possible that their liquid alts business outgrows their hedge fund business."

In addition to the fund Gregory manages, other products in the line-up include the Long/Short Equity, Global Allocation, Floating Rate Opportunities, Energy MLP and Opportunistic Credit funds. Only the Long/Short Equity, Long/Short Healthcare and Opportunistic Credit funds are classified as liquid alts by Morningstar.

At this point the ETF business is not considered part of the Highland Alternative Investors program, Highland's Gregory says.

The 17 newly registered ETFs will use passive strategies with underlying indexes that “seek to track the returns of hedge funds that employ fundamental value strategies by including securities held by such hedge funds,” a regulatory filing notes. The underlying indexes do not include hedge funds, according to the filing.

Many alternative asset managers have been broadening their product lineups to include liquid alts, but Highland was one of the first to enter that space with its two long/short equity funds, says Michele Giuditta, associate director at Cerulli Associates. A platform specifically supporting a shop’s liquid alt offerings and that helps advisors understand the products may help Highland address challenges related to distribution and education alt providers continue to face, she says.

Highland’s Long/Short Equity and Long/Short Healthcare funds have long track records relative to most liquid alt funds, with launch dates of 2006 and 2008, respectively, says Morningstar’s D’Asaro.

Net flows in the Highland Long/Short Equity and Long/Short Healthcare funds were \$678.5 million and \$451 million, respectively, from January 2008 to last month, according to Morningstar. Total assets in the Long/Short Equity and Long/Short Healthcare funds were \$896.8 million and \$488.9 million, respectively, as of the end of February.

Despite the relatively long track records of its two long/short funds, Morningstar still considers Highland a new entrant in the liquid alts space, says D’Asaro. The firm is going where it sees opportunity, and asset growth in the hedge fund space has been “muted” since 2008, he says.

After net outflows of \$68.3 million from 2008 to 2013, the Global Allocation Fund rebounded with net inflows of \$922 million last year. That figure outpaced inflows for all of Highland’s mutual funds, according to Morningstar, which classifies the product with its world allocation category. The fund has been ranked in the top 1% of funds in its category for performance for the one-, three-, and five-year periods and is ranked in the top 4% year-to-date. Over the last five years, the number of funds in the category has grown from 327 to 608.

The Long/Short Healthcare fund’s performance ranked in the top 9% among its peers for the one year period, 6% for the three-year time frame and 9% over the five-year period, according to Morningstar.

The Long/Short Equity fund year-to-date has returned 4.36% compared to its category average of 1.42%. But it has experienced mixed performance over the years, lagging the category average in 2012 and 2014.

Six of Highland’s mutual funds saw net outflows last year; the Floating Rate Opportunities fund bled the most with \$722 million. As of the end of February, the fund represented about \$827.9 million, according to Morningstar. The fund realized higher returns than the average bank loan fund tracked by Morningstar from 2011 to 2013.

The Floating Rate Opportunities Fund on Wednesday won the 2015 Lipper Award for its performance over the three- and five-year period within the loan participation category. On Wednesday, the firm also promoted Chris Mawn to co-portfolio manager of the fund. He had served as managing director of research at Highland and has been responsible for the retail credit mutual fund business since October 2012.

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