

New launch: Pacific Precious

II Going for gold - Pacific Fonder in precious metals alternative fund launch

By Jonathan Furelid - HedgeNordic

For investors looking to diversify their portfolios of traditional assets, gold has become a particularly sought-after alternative asset in recent years. The rise of exchange traded products offering exposure to the precious metal has further added to the pick-up in investor interest. There has however been very few options for those seeking an absolute return strategy that actively invests in the precious metals sector. The Swedish fund management company Pacific Fonder are looking to change that with the launch of their alternative UCITS fund - Pacific Precious.

"Pacific Precious gives the investor what it looks for in gold and other precious metals as an alternative asset allocation, namely a defensive investment with low correlation to traditional investments such as stocks and bonds. However, we are allowed to trade the sector from both the long and the short side and tactically allocate between different strategies which provides for a different return stream compared to a long-only investment in a gold ETF for example", the fund's portfolio manager Eric Strand explains.

The fund uses so-called ETCs (Exchange Traded Commodities) to gain exposure to the precious metals market. As the fund cannot hold physical gold and silver,

this is the most cost-efficient way to approach these markets while at the same time keeping counterparty risks to a bare minimum, according to Strand.

"As opposed to other commodities, precious metals are traded using spot prices. Through the use of ETCs we can efficiently access these markets and ignore the contango effects that are present in futures contracts, typically used by other hedge fund strategies such as CTAs when trading these markets."

When analyzing exploitable investment opportunities, Strand considers both fundamental data as well as more sentiment-driven information such as investor flows, looking at the relationship between commercial and speculative positions among other things.

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"We seek to get an idea of where the market is heading for the medium- to long-term by analysing the fundamental data picture, however from time to time, the markets are increasingly driven by speculative flows, which serves as input for our shorter-term positioning", Strand explains.

As input to his investment decisions, Strand uses external research both on macro level as well as on individual metals contracts. Which is a good way to get a professional second opinion on his own trading ideas, he argues.

"On individual metals contracts, we make use of expert opinions from four value specialists as well as from three technical specialists, all independent sources. On top of that, well renowned macro research is subscribed to in order to form bigger picture ideas."

On strategy level, the fund trades precious metals through allocating to four different strategies using what is referred to as an unconstrained tactical allocation approach. To express his market views, Strand either takes on directional positions in the spot market, or buys into stocks linked to the price changes of gold and silver.

"Should we have a bullish view on silver for example, we essentially could express that in three different ways given our strategy setup. Either we buy directly into silver ETCs, or we buy into silver streaming and royalty companies that benefit from a price increase in the underlying commodity while not bearing the risk associated of owning mines. Thirdly, we could go into silver mining stocks, but in that case, we would hedge out the market risk by shorting an index of precious metals mining stocks in order to capture alpha."

"In the case of us holding a bearish view, we would either go short the spot market or buy into stocks that benefit from lower input prices, such as precious metals retailers", Strand explains.

In the final strategy layer, the fund uses active currency hedging in order to adjust for currency effects at times when the dollar is judged overbought or when there is a case for the Swedish krona to strengthen.

"We are trying to smooth out the currency effect that is a result of us holding USD denominated assets in a SEK denominated fund. Even though there is typically a negative relationship between the USD and precious metals prices, we could actually benefit from a stronger dollar given the fund's structure".

" I see inflation as a potential driver for gold as it ultimately will put upwards pressure on the metal."

"In certain times, usually coupled with extreme market events, there could also be a positive correlation between the USD and gold for example. If we were holding a positive view on the metal in this scenario, we would benefit from both the gold price increase as well as from the US dollar appreciation. By hedging out some currency risk, the overall risk would be reduced".

Over the longer haul, the fund's exposure to precious metals will be biased to the long side as the fundamental picture works in favour of these metals, according to the fund manager.

"Today there are many assets that are inflated given years of expansionary measures from the world's central banks. However, that development cannot persist forever and it is not far-fetched to believe that we have built substantial systemic risks into the financial system, which at one point will create significant stress. Gold and silver will be one of very few places to hide for capital preservation and growth in that scenario.



Strand also points to the value of gold as an efficient hedge to an environment where inflation is picking up.

“Inflationary pressures will ultimately pick up and real rates will be getting even more negative as the inflation will be rising faster than central banks are rising rates. Going forward I see inflation as a potential driver for gold as it ultimately will put upwards pressure on the metal.”

The Pacific Precious fund targets a similar volatility as the price of gold, which is significantly lower than that of gold mining funds, with the goal to achieve positive and better returns whatever market period. According to Strand, the fund will have a similar profile as a CTA in times of market distress, as risk aversion typically tend to work in favour of the precious metal sector, an environment where CTAs tend to shine as well.

“We are looking to create a return stream that acts protective in times of financial market distress, similar to

the profile of a CTA. Over time we will however behave differently as our strategy is limited to one sector and not explicitly targeting price trends”, he says.

Since launching in February 2016, the Pacific Precious fund has performed solidly in what has been a somewhat challenging environment with continued risk appetite and suppressed volatility. As might be expected, the fund had its best month around the Brexit vote when investors, albeit briefly, turned to gold for safety. As of end of May 2017, the year-to-date return stood at 4 percent, adding to a 5.5 percent gain in 2016.

“We have produced good numbers in what has been a rather tricky period for alternative investments. As volatility is likely to pick up from these extremely low levels, we remain very optimistic about the future prospects for the fund. It will come a time when investors flock to gold and silver just like they are flocking to equities today, this will be our time to shine.”



Eric Strand, Hedge Fund Manager for Pacific Precious (Yogi and former Olympic Fencer)