Investor Lawsuits against Allianz Global Investors Highlight Concentration Risk

Lisa Phu   September 29, 2020   FundFire

“Generally when institutional investors allocate capital, they want to invest in various asset classes and typically have a variety of managers”, says **Tom Donahoe, Principal and Practice Leader for Governance and OCIO Search at Manager Analysis Services LLC**. For example, investors may have an allocation of 8% to particular asset class, e.g. hedge funds, but typically don’t allocate 10% or even 5% to a single hedge fund manager” he says. “Large institutional investors usually allocate to a number of managers in an asset class to protect against the risk of picking a poor manager. Sometimes a certain portion of the portfolio will be dedicated to passive investing. Diversification in asset allocation is key to long-term returns.”

Donahoe says “the thing that’s surprising is that they chose to allocate 5 or 6% of their strategy to a single volatility-based investment, and to do it solely with a single manager. Whether an institutional investor relies solely on an in-house staff, an independent investment consultant, or OCIO, the investor should have strong governance.” Donahoe says “institutional investors should have an investment policy statement specifying permitted asset categories, acceptable ranges, and prohibitions against over concentration. Also they have to perform the appropriate amount of due diligence that corresponds to the type of asset class they are investing in. Going long using US Treasury‘s will require dramatically less diligence compared to more complicated strategies.

He explained that the Allianz GI Structured Alpha products are a complicated strategy containing a number of sub strategies that are occurring within the strattgey. Donahoe says “the primary component of the strategy was buying and selling a portfolio of option contracts. Was that truly understood by the people who were buying it? The investment strategy should’ve been categorized as a high risk, short options strategy focused on net short volatility. This strategy appeared to be part of an alternative allocation.

“My interpretation is that there was confusion on the part of the pension plans that this was an equity allocation” says **Christopher Cutler, Founder of Manager Analysis Services LLC.** “They thought they were invested in an equity program when in fact they were investing in equity plus a huge amount of volatility in the marketplace and they were massively exposed to a market shock.”