Outlook: The Alger Dynamic Opportunities Strategy with Portfolio Manager Greg Adams

Alger Dynamic Opportunities Strategy Portfolio Manager Greg Adams gives up to date outlook on the strategy.

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Greg Adams: Our goal for the Dynamic Opportunities Strategy is, first and foremost, to provide lower volatility than the market over a three- to five-year cycle and capture two-thirds or more of the upside and half or significantly less than half of the downside over time.

The challenge in the third quarter was an increase in volatility in the markets, especially in August and September with negative data on China's economy and trading activity and the volatility and the reversal in some of the health care and biotech names. But in a quarter where we had a little bit of a difficulty on the long side, our short positions were down reasonably more than the stocks we were long and have helped hedge our performance. Therefore, we were making money on those positions and hedging what we were doing on the long side.

I think where people run into trouble in long short investing over time is when you have mismatched long and shorts, and the reason for that is everyone will go through periods where your style and your stock picking is out of favor, and if you're mismatched long and short in those periods, you could have very negative returns.

When we're constructing our long and short portfolios, we're really looking at the hallmark of Alger, the idea of dynamic change. The names we're long are companies we feel are benefitting from dynamic change, and the companies we are short are disadvantaged from dynamic change. So we're long a portfolio of growth stocks we think are attractive and short a portfolio of growth stocks that may be experiencing weakening fundamentals while being on the wrong side of dynamic change.

I think this quarter demonstrated why that's so important. In a period where you have a little bit more difficulty on the long side, if you're short very different types of stocks that can lead to very negative performance.

For the third quarter, the health care sector was our biggest detractor with the reversal from what had been the leading sector year-to-date prior to the third quarter. One of the challenges for us in health care, especially with biotech, is that it is a little bit harder to hedge given the very high risk in shorting individual biotech stocks, not only because of the data flow, but the very strong M&A market we've seen over the last year or two. One of the ways we manage our risk on the biotech side is by managing our overall exposure on the long side and then using some of the index hedge exposure to help cushion a little bit on the downside.

In a quarter where healthcare was weak, we lowered our exposure modestly throughout the period to manage that downside risk. By doing that we eliminated some positions that we had less conviction in and then redeployed some of that into our higher conviction biotech names. The net result was the overall lowering our biotech exposure.

For the third quarter, we got the most benefit relative to the benchmark from our limited exposure to the energy sector, which sold off dramatically. We had limited long exposure and a little bit of short exposure and that combination worked out very well for us in terms of adding value versus the benchmark.

Another sector that was a positive contributor for us in the quarter was the industrials sector. This was a sector that was under a reasonable amount of pressure relative to the market with concerns especially about the slowing economy in China weighing on a number of stocks. The stocks we were long were down in the quarter but down a bit less than the market overall, so we had reasonable stock selection. But where we really added value was on the short side where the stocks we were short were down significantly more than the market and it was one of our bigger short exposures from a sector point of view and that allowed that sector to be another positive contributor for us.

One of the ways we manage the Fund and help cushion downside risk is to adjust our exposures. Throughout the year we had lower gross exposure than we typically do. This is really reflecting our view that we were going to see increased volatility in the markets at some point during the year as we approach the potential for the Federal Reserve to begin raising interest rates. That really did not manifest itself at all in the first half of the year. In fact, volatility in U.S. equity markets remained low despite the fact that there was significant volatility in currencies, a strong move in the dollar, a steep fall in energy and other commodities, and significant volatility in equity markets outside the U.S. But in the third quarter we did start to see more significant volatility in equity markets in the U.S., so our lower gross exposure helped dampen that impact a bit.

We expect the market to remain volatile, but our expectation is that the economy in the U.S. remains reasonably solid. There is no question we've had a little bit of an impact from weak energy prices and that is filtering through as energy companies lower their capital spending and drilling activity. We have also had some impact on our export economy with the higher dollar versus last year. But underlying employment trends continue to remain pretty solid so our expectation is for continued growth and potential upside for the equity markets as we move toward the end of 2015.

The themes that we continue to emphasize in the portfolio include the Internet and despite the performance in the third quarter, health care. With the Internet, we're seeing increasing advertising share that is moving to Internet leaders. On the short side we are focusing on companies that are losing advertising share in the traditional media space.

With health care and biotech, the innovation we're seeing continues and we think there is still more potential room to the upside in many of those names as products roll out over the next year or two. That remains a theme for us despite having lowered our exposure modestly during the quarter.

In closing, I would like to thank our clients for trusting their assets with our firm and emphasize that we will continue to focus on using our research-driven investment strategy to find the most attractive investment opportunities for our clients.

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