Q & A

Sasha Jensen, of Context Jensen Partners, speaks to Mark Koschik, senior portfolio manager and head of asset allocation for the $40bn Exelon Corporation Investment Office, on hedge fund due diligence and the growth in private credit

Sasha Jensen
CEO, Context Jensen Partners

Mark Koschik,
senior portfolio manager, Exelon Corporation

Q What is Exelon's approach to selecting hedge fund managers? What do you look for?

A The criteria are pretty extensive throughout our overall due diligence process. However, from an initial screening standpoint we are looking for funds that we believe will be additive to performance throughout the various market cycles with an investment process that we view to be repeatable and successful. Given the level of equity risk in most institutional portfolios, including ours, we also are conscious of the level of equity beta in a fund's returns. I'm also focused on the fund's beta to long duration bonds given that we are managing a liability-driven investment strategy and that's a big exposure in our portfolio. Lastly, there have been periods recently where hedge funds, in particular, have dramatically underperformed, so we focus on the fund's performance in those periods.

Q How has the market for private credit evolved in the last year?

A It has expanded dramatically. We started doing direct lending in 2011 and later expanded the initiative more broadly into private credit. Initially, we had to be proactive in finding strategies that were attractive and met our set of criteria. It's been a successful allocation for us and others so it's not surprising to see the introduction and increase in allocations from institutional investors and also the sharp increase in product offerings from managers. I tell this anecdote to give a sense of the current market from a fund's perspective. Last year, from August through December, I tracked inbound enquiries from direct lending managers and, excluding other private credit strategies, we received about 50 different pitches, so there definitely has been an increased focus.

Q What is your outlook for private credit?

A Even given the above comment on the space potentially being crowded, I still view it as an attractive asset class. A component of that positive view though is that I think it continues to be attractive relative to other options such as equities and fixed income.

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Our portfolio is structured where a significant portion of the overall returns are yield-generated, so we are less dependent on market appreciation to drive performance, which contributes to my positive outlook. However, I think there are strategies in the overall private credit space that are getting crowded and investors need to be mindful of the potential downside risks. Because of that we are trying to be more selective on the types of strategies on which we are focusing.

Q How does private credit compare to hedge funds when it comes to evaluating managers or structuring portfolios?

A There is overlap in what we are looking for in terms of performance and consistency across market cycles. We are more conscious in the private credit portfolio though about our allocations to certain strategies – specifically to direct lending and real estate credit given that they have been bigger exposures. An additional aspect in the private credit portfolio is the called capital and uncertain timing of when capital is returned. Because of that we have to be conscious when adding investments of how they will impact our strategy exposures two to five years out.

Q What's the biggest mistake that marketers make when trying to sell you a fund?

A I would actually point out two of them. One is not taking the time to figure out what we are trying to do from an overall portfolio perspective, as well as the objectives in each of the underlying asset classes. A marketer may have the best fund manager or strategy in the world but if it does not fit well with what we are trying to accomplish, the hurdle is pretty high. The second is to understand the level of inbound calls and e-mails that allocators receive. I try to make a point of always responding but patience is appreciated as well as an understanding if something slips through. ■

Mark Koschik is a senior portfolio manager and head of asset allocation for the Exelon Corporation investment office, which manages approximately $40bn across the firm's pension, nuclear decommissioning, Veba and employee savings plans. Koschik has asset allocation responsibilities across the firm's defined benefit retirement trusts in addition to overseeing Exelon's hedge fund and private credit portfolios.