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The Importance of Liquidity

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The Tacit investment approach places a very high value on liquidity when selecting investments due to the team's experience rather than a academic dislike of certain investments.

During the 2008 credit crunch, whilst working for some very large investment companies, we experienced first hand how certain assets do not fit comfortably with an investor's needs during periods of market stress.

Property funds are a simple example of this in our view.

Open-end property funds have a history that dates back several decades in the United Kingdom. The origin of these funds can be traced to the development of collective investment schemes that allowed individuals to pool their money to invest in property. Generally these were purchased in pension and life policies which are by definition longer term investments. Since the turn of the century these funds however have been purchased in other wrappers such as ISAs as the savings landscape in the UK has evolved.

Open-end property funds in the UK, like in other countries, can sometimes implement temporary measures such as gating to manage liquidity issues. When a property fund is open-end, it means that investors can buy and sell units of the fund on a daily basis. These funds invest in illiquid assets such as properties, and a challenge can arise when a large number of investors want to redeem their units simultaneously, especially during times of market stress.

Here are two primary reasons why open-end property funds may implement gating:

A liquidity mismatch: The assets held by property funds, such as commercial real estate properties, are not easily or quickly convertible into cash. When a surge in redemption requests occurs, the fund may not have enough readily available cash to meet those requests. Gating helps the fund temporarily suspend redemptions to prevent a fire sale of assets at distressed prices.

To protect remaining Investors: Gating can protect the interests of remaining investors. If the fund were forced to sell properties quickly to meet redemption requests, it could result in lower sale prices, negatively impacting the value of the fund for those who stay invested.

It's important to note that gating is a temporary measure, and a fund typically reopens for redemptions once the liquidity situation improves. The length of the suspension period and the specific conditions for reopening may vary from one fund to another and are often determined by the fund's management and regulatory authorities.

For us liquidity matters for another reason however.

Periods of market stress have historically provided some of the best investment opportunities for investors and you must be in a position to take advantage of these opportunities when they arise. If you cannot get your money out of another investment for three months, the opportunity will be lost. In reality, certain investments just do not lend themselves to active management and can actually hurt longer term returns by limiting opportunity.

It does not surprise us that certain high profile property funds have experienced gating over the past year and reminds us again of risks associated with such funds during periods of changing market conditions.

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