

ABSOLUTE RETURN FUNDS

SYMMETRY

Focusing fully on fixed income

THERE'S JUSTIFIED ANGER and a sense of bewilderment among the public about the seemingly poor performances of a relatively small number of absolute return funds, but generally there's a commitment in the local fund industry to sensibly address the trade-off between risk and return.

The issue is central to the sector's future.

One person who has done a lot of work on the subject is Fred Liebenberg, head of absolute and alternative manager research at Symmetry Multi-Manager in Cape Town.

Leon Kok spoke to him.

Has anything significantly new emerged out of the absolute return space during the past year or two?

Very much so – local absolute return funds (ARFs) have been tested to the hilt, having been through a very severe period. We've seen for the first time what they're all about.

Has the world changed considerably as far as Symmetry is concerned?

Not necessarily, though that doesn't mean that we haven't learned any lessons from the experience. One is that there are several ways of managing risk in absolute funds, each of which will work best during different times of a market cycle. It's therefore important to ensure your investment is diversified across more than one of these strategies, to ensure you don't get caught in certain parts of the cycle. At the same time, it must be recognised that current events are not a good indication of what should be expected over the long term, so we have not changed the fundamentals of how we manage our absolute return funds.

How have local managers compared with their overseas peers?

Pretty good. If anything, we've made far fewer mistakes in the absolute return space than they have. Offshore, of course, absolute return space means hedge funds. However, convergence is unfolding on both sides. We're including more hedge funds in our absolute return sector and they're beginning to use what they call long only investing. It's essential to have alternative investments that give you non-market exposure. Hedge funds may have looked like laggards in the recent bull market, but many turned in outstanding

performances in the downturn.

The biggest problem South African ARF clients are facing at present?

Probably a crisis of expectations, as many feel let down. There are those who feel that their funds didn't perform as well as they would have liked during the boom years until 2007, and there are those who complain that their funds fell short of their benchmarks since then.

Is there merit in those views?

It's relative. The answer is yes and no. But in many cases the problem has been underpinned by unrealistic expectations and/or clients not understanding the nature of the funds that they're invested in. For example, three years ago they might have complained that ARFs were significantly underperforming balanced funds, and more recently they might have been concerned about negative returns.

One of the reasons for the confusion in expectations is the wide variety of absolute targets in the market that often don't correspond to the actual returns of the funds.

Another problem is that too many people see inflation-plus-type targets as a promise, and they're not a promise. In general terms, for instance, an equity fund may set its target as outperforming the JSE All-share index

(Alsi), but it doesn't mean that it'll do that all the time. Rather, it means that over time it expects to outperform the Alsi. ARFs and their return targets are no different.

Also disconcerting is that many investors interpret "absolute" to mean no negative returns whatsoever. To be honest, the only asset class that gives you that is cash and even that's not a certainty. Japanese investors, for instance, may well dispute that cash provides consistently positive returns.

What precisely does "absolute" mean in your terms?

People need to understand that "absolute" means

that capital is managed in a way that tries to protect it, but you will not always succeed. You have to take risk to achieve inflation-plus returns, and that risk may translate into negative returns on occasions.

The shortcomings of ARF managers?

There have been funds that have been misleading in their proclaimed targets. Most ARFs have inflation-plus-type targets, but often those targets are out of sync with the degree of risk that investors take on. You may have a situation where a fund offers inflation + 3% (relatively low risk), but has an inordinate exposure to equities. The fund manager in that case clearly is more focused on maximum return than managing risk. That should ring an alarm bell.

What are the different target thresholds?

As mentioned, this varies extensively between funds. At Symmetry we divide the absolute space into three risk/return categories.

In chasing inflation + 7% returns, three to five year horizons are required and periods of negative returns are inevitable. These are impossible to achieve with a fund manager sitting on 90% cash for long periods. Typically, investors in these funds would have enough capital to cover their short-term requirements.

Next, the typical inflation + 5% investor would also want to grow his or her capital, but wouldn't want to take big knocks over any 12-month period.

At the bottom end an inflation + 3% target would provide the investor with better than a cash return (inflation + 2%) but monthly negative returns would be negligible.

What do you believe is Symmetry's greatest strength as a multi-manager?

Understanding what a fund manager does, looking at his record, and weighing up what he tells you he is doing. You then need to marry your findings with what you believe the manager is capable of. ■



Fred Liebenberg
A crisis of expectations.