

## Buyers' market: Q&A

**Appetite for absolute return funds is increasing so how are fund selectors meeting this demand and are they happy with the performance in this space?**



### Editor's Verdict

There's clearly a hunger for all-weather strategies and for investments that are not directly correlated with equity markets. Whatever the technical definitions, most end investors take the term absolute return to mean a product or strategy that makes money in all market conditions.

Selectors are pretty clear that as a class, Newcits funds and absolute return products in general haven't provided the safety net they were looking for. But while the average manager in almost all categories has lost money over the past 12 months, there are some who stand out as delivering good performance – as readers have highlighted in the following pages.

So despite the overall negativity, this has to be good news for manager selection professionals. If only a few managers are doing well, you can really add value by identifying them.

When it comes to how you do that, Benjamin Bente's approach really grabbed my attention (see page 9). He focuses on the worst market periods of 2008 and the summer of 2011 as a key selection criterion – the implication is that if a fund was down in those periods, it's not doing what it's supposed to do. It sounds fairly brutal, but it's hard to argue that he's wrong.

### Daniel Aymerich Biota

Banco Inversis

Asset managers are finding the absolute return concept is a valuable tool allied with their commercial strategies during periods of market turmoil. In theory, it helps to align the interests of investors wishing for attractive, risk controlled returns with the fund management firms' need for more complex products with higher commission structures in times when investors tend to fly to liquidity. The reality has proved to be very different especially when investors' expectations haven't been met, as many absolute return funds have suffered heavy losses in difficult markets.

We need to help investors understand that absolute return doesn't mean positive returns at all times and that managers need to take some risks in order to capture the market upside. Investors are increasingly demanding products with an absolute return philosophy, but at the same time are becoming impatient with bad performing funds that promise too much and are too complex to understand. Managers and advisers should highlight the risks and describe the scenarios for potential losses associated with these funds so investors' expectations are more realistic. There are nevertheless a few funds available to the retail market we favour including **M&G Optimal Income** and **Invesco Balanced-Risk Allocation**.

**'Managers and advisers should highlight the risks and describe the scenarios for potential losses associated with these funds'**



Results compiled by the Citywire research team

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## Guy Janssens

BNP Paribas Fortis

We are increasingly focused on absolute return funds, but the meaning of 'absolute return' has changed in the last couple of years. In the past absolute return funds tried to generate positive returns in all markets. After 2008 we discovered this was not always possible.



Today, absolute return funds are low volatility funds which try to protect themselves in down markets with derivatives such as futures and put options. A lot of long-only funds are also using derivatives for temporary hedges.

For example, **Carmignac Patrimoine**, one of the biggest and most well-known mixed funds, is using futures to hedge its positions. This approach has enabled it to outperform the classic long-only funds which can't protect themselves.

In the category of defensive funds **JPM Capital Preservation** is doing a great job in these volatile markets. This fund can have a maximum net equity exposure of 30%. The fund has long/short positions in equities and bonds and has Ucits III status. The short positions are working very well in negative markets, resulting in a positive performance year-to-date.

Sometimes equity funds decrease their market exposure by using shorts. For example **Fidelity Active Strategy** can use 30% shorts which generate alpha in down markets. The difference between a typical hedge fund and a long-only fund is disappearing. A lot of hedge fund strategies are being used in classical Ucits III long-only funds. Retail and private banking clients can profit from this evolution as these funds are open to the wider public.

## Arnaud Scarpaci

Agilis Gestion

Investor interest in absolute return is growing because risk aversion has risen strongly over the last three years since the sub-prime crisis in the US and the debt burden in eurozone. Investors have sought to gain returns and cap their volatility which has boosted the popularity of flexible funds and VAR mutual funds.



Absolute return mutual funds have delivered a range of returns during the crisis since there are several asset classes including global macro, convertible arbitrage, merger arbitrage, long/short, trend following, bear market and volatility. Those which have succeeded have come from the latter two categories. The others have dropped like long-only mutual funds.

Absolute return mutual funds I monitor include: **Elan France Indice Bear**, **BNP Paribas Long Vol** and **CCR Centrale Long Vol**.

## Benjamin Bente

Vates Invest

Funds of funds usually have a long bias because they allocate mainly into long-biased funds. We are focused on the behaviour of our target funds during periods of market stress. Therefore, performance in 2008 or August 2011 is a key selection criterion for us.



We combine an index futures overlay, based on behavioural finance and run by ourselves, with a mix of long-bias funds, a significant number of short-bias funds and really uncorrelated funds, measured by their performance during times of crisis. A good example for those true absolute return funds is the constant volatility fund **AC Risk Parity 7** (2008 +9%, August 2011 +0.7%). Another interesting group are funds with behavioural finance strategies: **Sentix Fonds 1** was able to generate positive returns during the crises and **M4 Alpha Bonds** is one of our calls for the next crisis.

## Guido Alberto Rescia

Sopaf Capital Management

Investors' interest in all total return tools has increased, fuelled by the savings investment industry and by an ever more difficult context in which the focus is now on products that are able to obtain positive results independently from the markets' fluctuations.

But confronted with the choice and use of absolute return funds, investors appear less enthusiastic due to the fact that confusion still hovers around the various types of absolute return funds. It seems difficult to find one's bearings in the midst of the various asset classes, strategies and risk profiles which characterise these funds grouped into just one category. For that reason we believe it's opportune to dismantle these into sub-categories to allow each investor to identify the most adequate fund or types of funds. Of the funds which performed best, we can identify **Exane's Archimedes** fund (long-short), **Zest Global Strategy** (global macro) and the **Assenagon Credit Basis** (bond strategies). Those we follow include **Seven Capital's Absolute Return** fund, **CF Eclectica** (global macro), **Invesco Balanced Risk Allocation Multistrategy** and the **MLIS Theorema European Equity Long-Short**.



## Stephen Brierley

Symmetry Multi-Manager

South Africa's classification of absolute return funds incorporates both traditional absolute return funds and hedge funds. The two strategies both target absolute rather than relative benchmark returns, but absolute return funds have definitive periodic negative return constraints in their mandates, while hedge funds generally attempt to protect capital at all times.

At Symmetry we produce a monthly survey of single-strategy hedge fund managers' returns which represent approximately 80% of both number and assets under management of the industry. From these returns we compile a monthly index of the total industry return as well as the constituent strategies. In 2008, the South African JSE ALSI index returned -23%, the MSCI World -20% and the S&P 500 -15%, in South African rand, while the Symmetry hedge fund index return was flat, the long short index -10% and the market neutral index +9%.

In 2009, with the JSE ALSI rebounding to +32% and the MSCI World and S&P 500 only slightly up in rand terms, the hedge fund index returned +14%, the long short index +19% and the market neutral index +14%. To September 2011, the JSE ALSI is -5.5%, while the hedge fund index is +4.5%, with the long/short and market neutral indices +4% and +5% respectively.



## Thorsten Schutz

Auricos Asset & Portfolio Management

We prefer to invest in funds with absolute return performance, which doesn't necessarily mean investing in absolute return funds. Quants and fundamentals do not work in times when countries can lose their AAA credit rating overnight. During the crisis, high volatility and strong correlations between nearly all asset classes have made it difficult for absolute return asset managers to perform. The crisis is not over yet and defensive investments are still our favourites. As long as financial markets are so volatile we prefer the bunds, gold and real estate equities from Scandinavia and Germany.

We like **Michael Welter** from Lampe Asset Management. He did a good job with his **LAM Absolute Return** fund. **Mack & Weise Privat Fonds** also delivered a pretty good performance. Both invest in all asset classes and still have a big stake in precious metals and German bonds.



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## François Rimeu

La Française des Placements (Groupe La Française AM)

We have always focused our range of products towards absolute return funds, and this is especially true over the last couple of years. The current markets are very difficult, hindered by political intervention and with very low visibility over the medium term, and our clients need strong risk control and other sources of returns than the equity or credit markets. We have therefore emphasised low or anti-correlation consistency as well as drawdown control in our fund selection.



Brevar Howard has again been one of the big winners this year thanks to wagers on low rates especially in Europe. **Capital Fund Management**, with its **Stratus** or **Discus** funds has also been able to show strong returns and no correlation at all since the beginning of the summer. This is also the case with **Balyasny Asset Management**, with **Dmitry Balyasny** showing his skills in managing beta and risk. In the more liquid space, **Lafitte Capital Management** has run its fund remarkably even if merger arbitrage has been difficult for some of its peers.

## Marta Campello

Abante Asesores

Investors ask for positive returns and low volatility in any market conditions. Since we have experienced a prolonged spell of volatility they are looking for shelter in so-called absolute return funds, but they do not show a clear preference for a specific type of absolute return. In fact, it does not matter if it is a global macro, market neutral, flexible beta or any kind of arbitrage, to mention just a few – they just want good performance and consistency while they look at equities from the corner of their eyes. The recent financial crises have become more of a stress test for absolute return managers than any fund analyst could have imagined.

From a fund researcher point of view we cannot be happy with the absolute return funds as a whole. Some good managers are beginning to think they are losing their skills, as this market is playing havoc with their track record. There are, nevertheless, very good managers who are able to cross these turbulent waters while protecting their boat from sinking. Some examples of good performance in this environment are **Dexia Index Arbitrage**, **GLG European Alpha Alternative** and **Abante's Maral Macro**.

The latter has returned 3.96% since launch in June this year.



## Miranda van Rensburg

Absa Investments

Absolute return funds have gained in popularity, partly due to the move towards multi-asset class funds away from speciality funds. But increasingly this trend is due to investors becoming more savvy in their financial planning. Gaining wealth in absolute terms is preferred to merely beating some benchmark which itself is still losing money. However, absolute return funds' performance has diverged. In the

South African market it appears that those funds which achieve their goal through strategic and tactical asset allocation have outperformed those that rely on the use of derivatives for protection. This could

relate to the pricing of options and other derivatives which has risen due to increased share price volatility. Any explicit guarantees provided are also expensive – thus while protecting on the downside investors are not always achieving the returns they desire. Time will tell whether (besides pure manager skill) asset allocation

or the use of other protection strategies will achieve the best results in absolute return funds.



## Lionel Henrion

Delta Lloyds

Alternative investment strategies cannot be entirely replicated through traditional investments in other asset classes.

Therefore, those strategies will improve the risk/return profile of a portfolio. Now, investors have to be aware not only of their risk aversion level, but of their risk definition. If investors

accept a lower return most of the time they will be able to find some funds that really bring protection and prevent huge loss in extreme environments. This is the way we see alternative investments. The classic market neutral strategy is the best example; some arbitrage strategies may also play that role, and did very well this summer. The problem is that the pressure of sticking to a low-return fund in a bullish environment is more difficult than it appears. Investors are often tempted and switch toward more directional exposure or opportunistic strategies whose correlation changes more quickly, mostly during extreme circumstances.

This being given, investors still have to find a suitable manager in the selected investment strategies – a manager able to stick to his process whatever the conditions, who will avoid behavioural bias such as myopic loss aversion, trends extrapolation or prospect theory.



## Montserrat Formoso Fragua

Tressis

An absolute return approach has more to do with asset allocation, risk control and fund picking than a focus on a specific product. Asset allocation can help ensure a portfolio is flexible enough to adapt to any substantial market change or to reposition itself when any decision is not working properly.

Other factors to consider include opportunity costs, as investors get similar returns to directional products in down markets, but less performance in up markets. Secondly, daily liquidity has damaged returns in some strategies that were obtained with less liquidity. Finally there is the issue of carry: with interest rates near zero, risk needs to be higher in the portfolios to obtain the objectives assumed.



## Jan Leistner

Dr Bauer & Co.

Negative real interest rates and highly unsteady share prices require active management.

The reasons to go for an absolute return manager in this type of environment are obvious: absolute return strategies pursue positive, partially share-like returns. Profits should be achieved with low volatility and in the whole range of market situations that exist. The success of the investment largely depends on the quality of the fund manager as well as the cost structure of the portfolio. Despite their flexible frameworks many strategies fail to convince. The majority of fund managers do not achieve profits after costs. But there are exceptions to the rule such as **Richard Woolnough's M&G Optimal Income** fund and **Guy Stern's Global Absolute Return Strategies** fund.



## Anders Wallace

Wassum

There has been a huge return dispersion among funds marketing themselves as focused on delivering absolute returns during the crisis. Generally, we are not impressed by the risk-adjusted returns of these funds, but do recognise that most capital markets have experienced a period of elevated price volatility and high correlation among individual securities from a historical perspective.

We follow some Nordic-based hedge funds and some international fixed income/currency funds with wide investment mandates. Some funds that have done well include flagship funds in the **Brummer** group – **Nektar**, **Futuris** and **Lynx** as well as the **PIMCO Unconstrained Bond** fund.

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## Attila Rébak

Quantis Investment Management



Even though I agree with those who expect a small premium from risky assets (at least compared with the experience of the past 20-30 years), I am not convinced that absolute return funds should be the main vehicle to achieve superior returns. As Barton Waring so clearly explained the expected premium from risky assets is unconditional, thus you can expect it as a compensation for bearing risk. Alternatively, the expected value added from active return is conditional on the skill of the manager and your ability to find those managers.

Based on this premise I advocate a diversified portfolio as the core of clients' assets which could be augmented with a diversified absolute return portfolio. As far as the first is concerned, I feel the allocation should diversify among risk/return drivers, take into account hidden/hardly measurable risks and make common sense. The relative size of the latter should depend on the ability to identify managers who could add value.

I only follow Newcits funds and not offshore vehicles and even though there are a few really good managers, the performance of the majority of absolute return funds is not so attractive from a risk/return perspective. It is enough to take a look at Newcits indices, most of which are in negative territory year-to-date. I feel that the market is not so deep at the moment, and I can imagine that selectors will be able to build good absolute return fund of funds in the future as more and more managers launch vehicles.

## Patrick Lenhard

Vontobel

When building a portfolio with an absolute return target, we do not only use absolute return funds, but all liquid asset classes. Nevertheless, absolute return funds are an important part of asset allocation, because Libor+ strategies tend to be weakly correlated with the other asset classes. Absolute return funds as a whole have disappointed this year once again. Not one of the Lipper Global Absolute Return peer groups in euros or US dollars is positive year to date.

The one good thing about this situation is that we can identify who the capable fund managers are and who is only performing in up markets. A strategy we recently added is the **AC Risk Parity Funds** of Hamburg-based **Aquila**. The quantitative model designed by Harold Heuschmidt gives the same amount of risk to all asset classes, combined with a behavioural overlay. Other strategies we currently allocate to our portfolios are **Amundi Funds Volatility Euro Equities** and **SEB Asset Selection**. Both are more or less flat this year. Another house with very interesting funds is Assenagon.

They recently launched the **Assenagon Credit Debt Capital**, which uses inefficiencies between a firm's debt and equity to generate a market neutral return of three-month Euribor + 450 bp.



## MANAGERS THE SELECTORS ARE BACKING

Funds	Managers
Abante Maral Macro	Juan Manuel Mazo
AC Risk Parity 7	Harold Heuschmidt
Amundi Funds Volatility Euro Equities	Gilbert Keskin
Assenagon Credit Basis	Jochen Felsenheimer
Assenagon Credit Debt Capital	Wolfgang Klopfer
BNP Paribas Long Vol	Veronique Philippon
Brummer Futuris	—
Brummer Lynx	—
Brummer Nektar	—
Capital Fund Management Discus	—
Capital Fund Management Stratus	—
Carmignac Patrimoine	Edouard Carmignac
CCR Centrale Long Vol	—
CF Eclectica	Hugh Hendry
Dexia Index Arbitrage	Emmanuel Terraz
Elan France Indice Bear	—
Exane Archimedes	Gilles Lenoir/Cesar Zeitouni
Fidelity Active Strategy	Anas Chakra
GLG European Alpha Alternative	Phillipe Isvy
Invesco Balanced Risk Allocation Multistrategy	Scott E. Wolle
JPM Capital Preservation	Talib Sheikh/Neill Nuttall
LAM Absolute Return	Michael Welter
M&G Optimal Income	Richard Woolnough
M4 Alpha Bonds	Christian Schiweck
MLIS Theorema European Equity Long-Short	Giovanni Govi, Paolo Mortarotti
PIMCO Unconstrained Bond	Chris Dialynas
SEB Asset Selection	Hans-Olov Bornemann
Sentix Fonds 1	Oliver Harth
Seven Absolute Return	—
Zest Global Strategy	Maurizio Novelli/Alessandro Cereda

SOURCE: Citywire

## Fund of funds favourites: Absolute return

Volatile markets are testing the limits of absolute return funds. We highlight the ones multi-managers are backing

Gilbert Keskin



The strength of the Amundi volatility franchise can clearly be seen from the group's strong showing in this list. The fact that overall, funds in the Volatility Trading category of our Newcits database did well during the worst of the summer's market turmoil will have justified fund buyers' faith in these products and the Amundi

funds, under lead manager Gilbert Keskin (pictured), have also posted respectable one-year figures.

Our table of the most widely-held funds, put together for us by the research team at Lipper, is based on Lipper's own categorisation of absolute return funds and reflects the picks of 2,000 funds of funds across Europe.

From early 2012, Citywire will be producing fund manager ratings for the Newcits universe, tracking the individual risk-adjusted performance of managers in this space.

## THIRD PARTY FUNDS OF FUNDS' MOST POPULAR HOLDINGS

SOURCE: Lipper

### Fund Sector: Absolute Return & Alternative Strategies

Funds	Managers	No. FoFs Invested*	FoF Assets** (€m)
Amundi Funds Absolute Volatility Euro Eq	Gilbert Keskin	115	288.9
Julius Baer BF Absolute Return	Paul McNamara	112	246.5
Dexia Index Arbitrage	-	79	178.2
JPM Income Opportunity	Bill Eigen	76	203.8
Exane Funds 1 - Archimedes	-	72	152.9
Threadneedle Credit Opportunities	Barrie Whitman	49	52.8
Amundi Volatile Actions Euro (French)	Gilbert Keskin	45	95.4
Amundi Funds Volatility Euro Equities (English)	-	-	-
Schroder ISF Em Mkts Debt Abs Ret	Geoff Blanning	44	97.8
Amundi Dynarbitrage Volatile	-	42	102.6
GLG European Alpha Alternative	Philippe Isvy, Philippe Isvy, Pierre Valade, Pierre Valade	42	103.1
Julius Baer BF Absolute Return Plus	Timothy Haywood	39	65.2
Man AHL Trend	-	36	34.4
Exane Funds 1 - Templiers	-	34	73.0
Amundi Fds Absolute Volatility World Eq	Gilbert Keskin	33	131.7
Julius Baer BF Absolute Return Defender	Timothy Haywood	33	126.7
DB Platinum IV dbX Systematic Alpha Index	-	32	77.5

Note: Analysis based on universe of 2,000 European third party funds of funds;

\* i.e. number of third party funds of funds investing in the underlying fund; \*\* i.e. assets in underlying fund sourced from third party funds of funds