

ABSOLUTE RETURNS Where to From Here?

5th March 2019

Agenda



- Introduction
- Defining “Absolute Return” – the Irish peer group
- Charges
- How have they performed?
- Why has performance not been better?
- Is the proposition broken?
- Q&A

Clarus Investment Solutions



Principals

Paul McCarville

Joe Mottley



- Independent boutique investment consultancy – CBI regulated
 - Advice on strategic and tactical asset allocation
 - Portfolio design & selection of components
 - Due diligence and oversight on investment managers & product providers
 - Advice on strategic and tactical asset allocation
 - Education & training services for professional bodies and industry associations
 - Expert witness reports in investment mis-selling disputes

- Client base includes pension schemes, charities, corporates and retail investment intermediaries

What is Absolute Return?

Official ESMA Definitions

Absolute return funds

Box 5

1. UCITS that are managed according to investment policies or strategies which envisage a variable allocation of the portfolio of the fund across asset classes, under the constraint of a predetermined risk limit, shall be considered as absolute return funds.

Total return funds

Box 6

1. UCITS that are managed according to investment policies and/or strategies that pursue certain reward objectives by participating, through flexible investment in different financial asset classes (e.g. in both equity and fixed-income markets) shall be considered as total return funds.

FT Lexicon Definition

This fund aims to deliver positive returns in all market conditions, with low volatility.

The Spectrum of Absolute Return Funds

TRADITIONAL BALANCED FUND

Portfolio Structure

broader palette of asset classes/
greater diversification

use of hedging instruments & derivatives for risk management

non-directional trades

more dynamic & flexible asset allocation

short positions & leverage

Sources of Return

traditional beta

alternative beta

alternative return premia

other idiosyncratic 'alpha' strategies

macro & tactical

relative value trades

MARKET NEUTRAL FUND

The Irish Retail Absolute Return Landscape

Fund	Target Return Margin	Volatility Guidance
Aviva AIMS Target Return	5.0%	< 0.5 equities
New Ireland BNY Mellon Absolute Return Bond	3.0%	5-day VAR 5% @ 99% confidence
New Ireland BNY Mellon Global Real Return	4.0%	"intermediate between bonds and equities"
Friends First Concept K	-	5% - 8%
Friends First Magnet Absolute	3.5%	2% - 5%
Friends First Multi Strategy Global Bond	3.0%	<3%
New Ireland Insight Broad Opportunities	3.5%	"materially lower than equities"
Zurich Invesco Global Targeted Returns	5.0%	< 0.5 equities
Irish Life Multi-Manager Target Return	4.0%	0.5 x equities
Zurich JPM Income Opportunity	-	-
New Ireland Elements	2.5%	-
Standard Life Aberdeen GARS	5.0%	4% - 8%
Standard Life Aberdeen Absolute Return Global Bond Strategies	3.0%	<5%
Zurich BlackRock Dynamic Diversified Growth	4.0%	(0.3 - 0.5) x equities

- 14 funds
- ~ €6 bn total
- 12 quote an explicit return target
- most also give volatility guidance/target
- most are in multi-asset/multi-strategy category

Charges

➤ Incremental AMC over base product AMC:

Range 10 – 70 bps

Average 35 bps

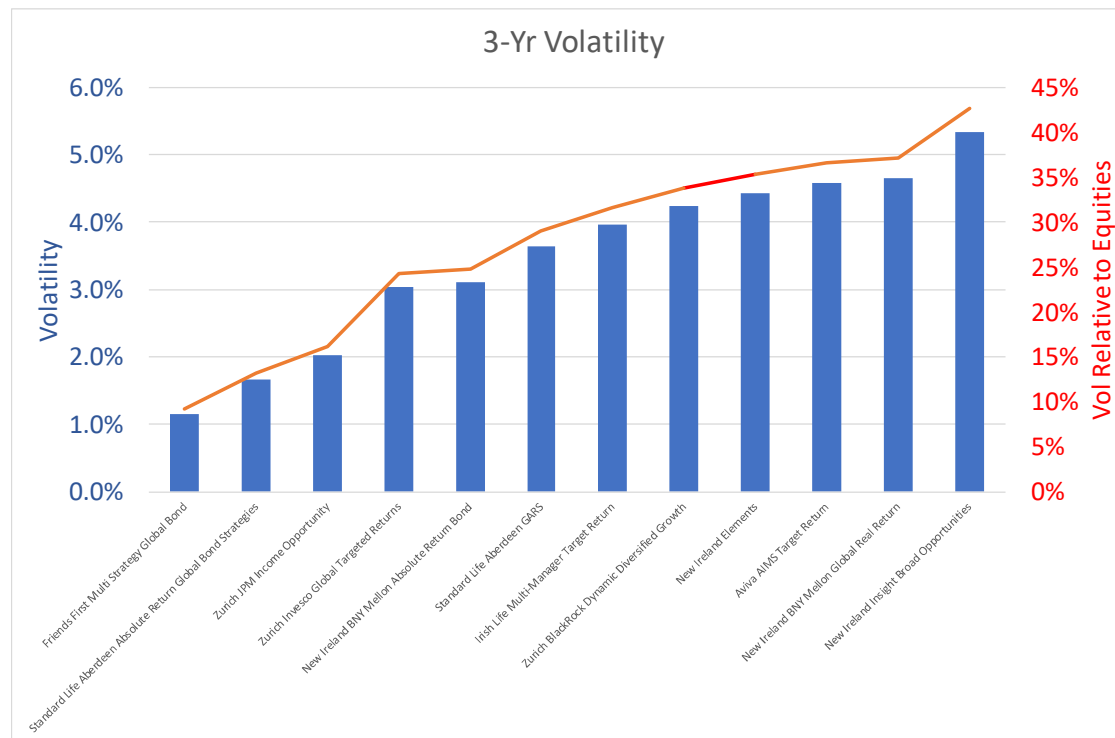
➤ Performance Fees:

3 of 14 funds

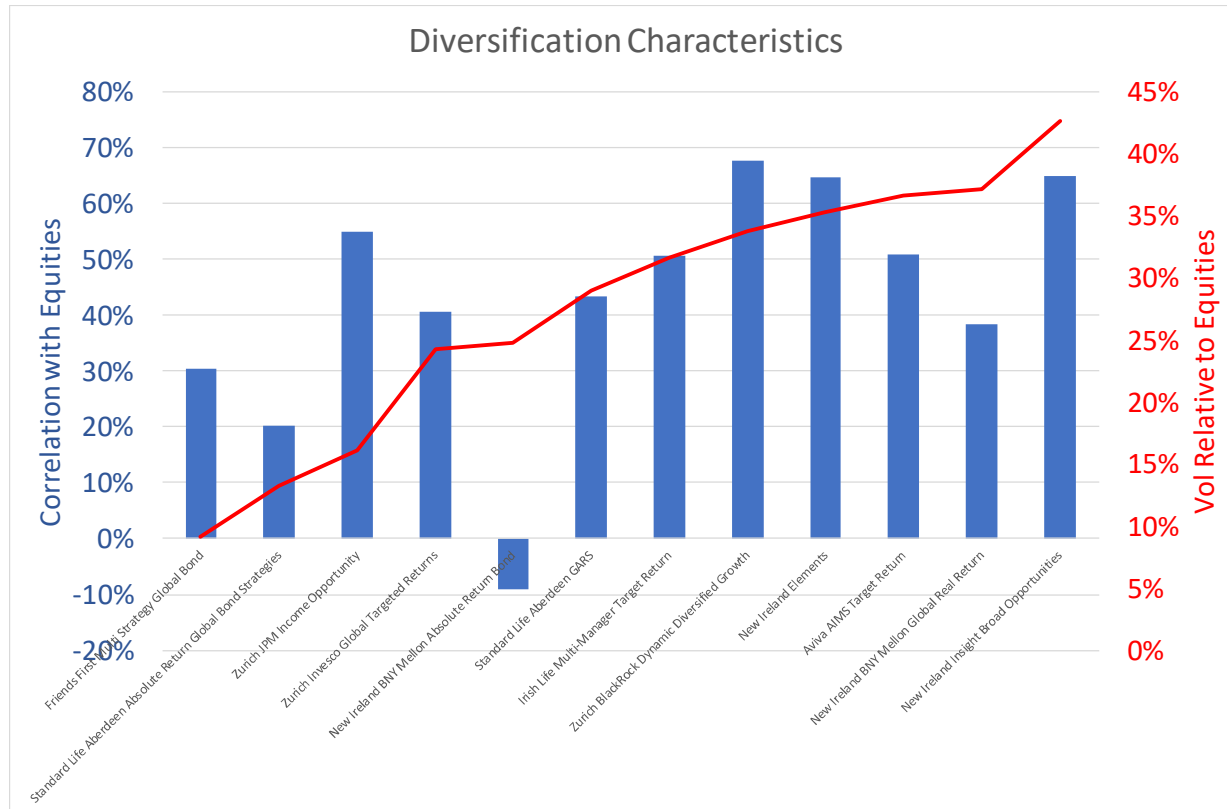
Recent Performance

Returns			
	1 Yr	3 Yr	5 Yr
	(% p.a.)	(% p.a.)	(% p.a.)
Best	4.0	3.4	2.3
Worst	-7.8	-2.3	-1.1
Median	-3.0	-0.2	1.1

Net returns to 21-Feb-19 - Source: FE Analytics



How Much Diversification?



- Group is characterised by relatively high correlation with global equities
- Over past three years, 3 funds > 60%, only 2 < 20%

Why has Performance Disappointed?

1. Most of poor three-year results accrued during 2018 – an *annus horribilis* for all risk assets
2. Failure to harvest more return opportunities in supportive markets of 2016/2017 – most funds tracking below their stated volatility ranges
3. Significant dependence on market returns but also significant dependence on manager skill – an inherently rare commodity!!
4. Declared objectives for most funds are too high – imply unrealistically strong Sharpe ratios

The Clarus View

Difficult to see longer term value in core Eurozone fixed income at current yield levels....will it even outperform cash?



Need a substitute for traditional allocation to fixed income in medium/lower risk portfolios



If AR allocation produces only cash + 1%-2% it will have paid its way

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**Is cash + 1%-2% a realistic expectation?
Perhaps – can come from diversified beta harvested by even by the unskilled
managers**

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