

# It's time to weigh up the odds when you look at absolute return funds

Promising the best of both worlds often means the opposite, warns Jeff Salway

## Absolute Return

THEY are the funds that promised the best of both worlds and investors have duly ploughed millions of pounds into them – but are they delivering?

Absolute return aim to provide returns regardless of prevailing economic conditions, an appealing notion in a climate marked by continued volatility, uncertainty and low confidence among investors.

Thousands of investors and pension savers have diverted money into the funds after being told they would enjoy returns even during turbulent times. Many are currently nursing losses, however.

With several years of performance records under the belts of the older vehicles in the sector, experts warn that absolute return funds are falling short of their promise.

"When times are tough, the investment industry has an uncanny knack of manufacturing a shiny new product which claims to provide a solution to falling markets – but in reality does nothing of the kind," said Barry O'Neill, investment director at Carbon Financial in Aberdeen.

Some £350 million of private investors' money went into absolute return funds in May alone, according to the Investment Management Association, putting it among the best selling sectors.

The biggest is the £11.3 billion Standard Life Investments global absolute return strategy (Gars) fund run by Euan Munro, to which investors added more than £670m in the three months to the end of June.

"The main selling point of absolute return funds is fear and the purported downside protection if there is a stock market crash (or crash in other asset values like corporate bonds)," said Iain Wishart, of Wishart Wealth Management in Edinburgh.

"You could argue that an investor who is fearful shouldn't be investing in the first place and should just deposit."

There are 72 funds in the sector, just

29 of which have produced a positive return over the last year.

Half have performance figures going back three years. And of them, more than half have failed to produce returns matching or beating inflation, including six that have lost money (see table).

Over three years, investors have reaped average returns of 8.6 per cent, while the typical fund is down 1.4 per cent over the past year, according to the Trustnet website.

But there's a huge difference in performance between the top and bottom performers.

At the top, the CF Odey Absolute Return fund is up 55 per cent over that time. At the other end, however, the SVM UK Absolute Alpha fund is down

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20 per cent over three years and more than 9 per cent over the last 12 months, despite its stated aim of beating cash over 12-month periods.

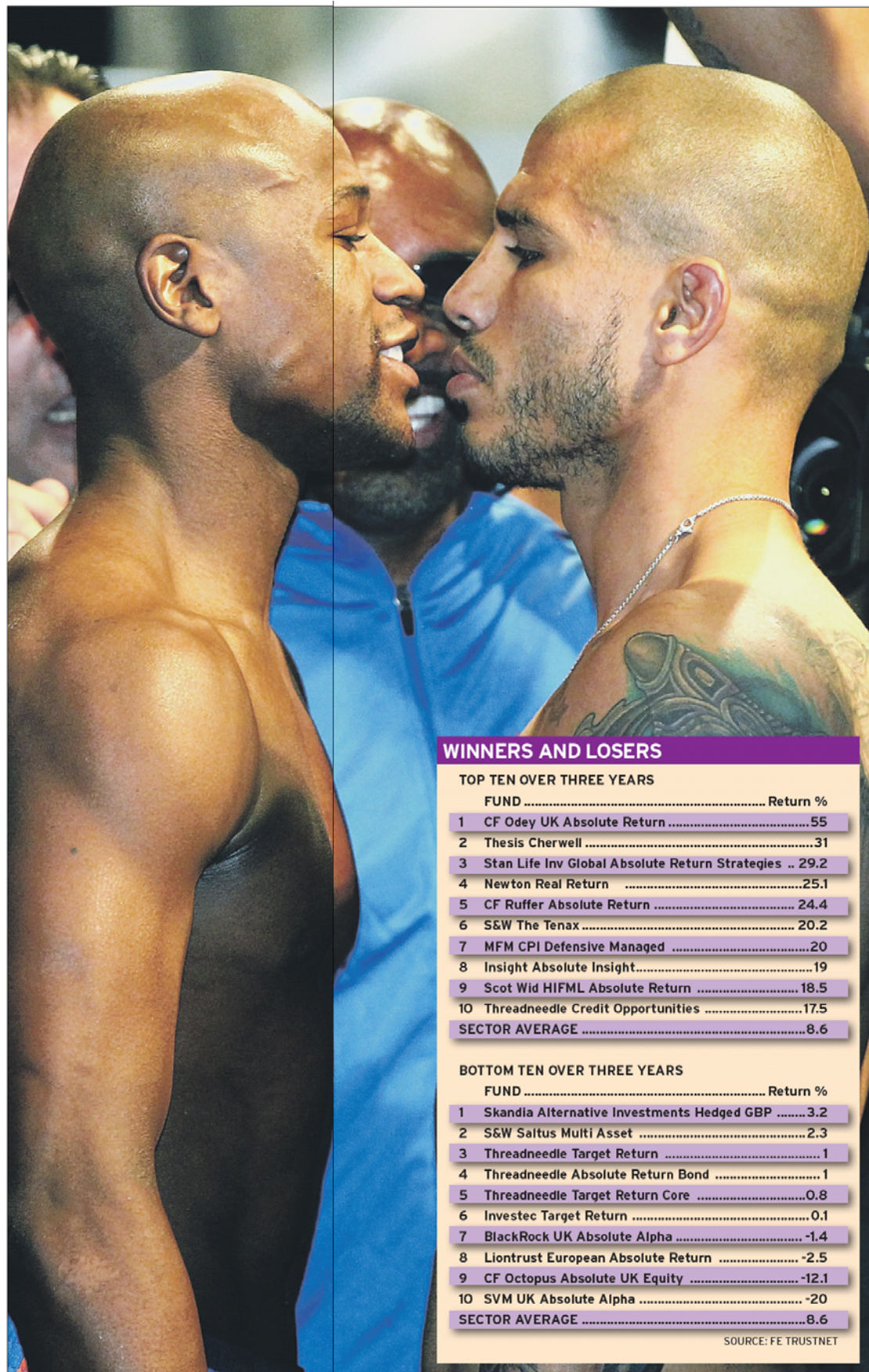
As that suggests, while the average fund in the sector has failed to beat inflation, returns vary significantly.

Yet they have their role when markets are turbulent. For example, in the year to May 2009, the period in which the banking crisis unfolded, the typical absolute return fund grew 3.4 per cent. With many other funds taking losses, the appeal of absolute return funds seemed clear for nervous investors.

But the discrepancy in performance is an issue. To some extent it reflects the different strategies used by the different funds, making it difficult to compare on a like-to-like basis. That's because the funds have the ability to invest in assets ranging from bonds and equities to derivatives and other opaque investment tools.

While some funds stick to relatively mainstream assets, others employ all the tools at their disposal.

It's fair to say that no two funds in



Make sure you check the figures at the weigh-in if you are considering absolute return funds. They are often too risky for the cautious without rewarding risk  
Picture: Getty Images

the sector employ exactly the same strategy, while their objectives also differ.

The range of strategies available is the big selling point for absolute return funds, as it that flexibility that enables them to promise protection against volatility.

It's also the downfall of the sector, however, because the sheer variety of objectives and strategies makes comparison of absolute returns almost impossible.

O'Neill said: "Some aim simply to beat cash over a rolling time period whilst others are more aggressive."

For example, while around one in three funds in the sector are equity-focused, around 15 are essentially fixed interest funds. Another dozen or so are derivatives based and a quarter are mixed-asset funds.

Haig Bathgate, chief investment officer at Turcan Connell, said: "Investors need to do their homework before investing and be realistic about their prospects – if a fund has very low volatility with traditional equity markets

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Barry O'Neill

and does preserve value, the chances are that it will be unlikely to produce compelling returns over the longer term."

But despite their underwhelming performance so far, Bathgate believes certain types of absolute return funds could yet come up trumps for investors.

"As the European situation starts to calm down in time you'd expect a number of these strategies to start performing much better," he explained. "We generally invest in funds which have a bit more volatility, accepting that it is a longer-term investment and that we therefore shouldn't worry about short term volatility."

The homework investors are advised to do when weighing up absolute returns extends beyond performance and the composition of the funds – look closely at the costs too. Average charges on absolute return funds are higher than those on the typical investment fund, acting as a drag on returns.

"Performance figures quoted tend to hide the real dealing costs and fees, so the real investor return is usually much lower than that quoted on the fund factsheets or advertising billboards," said Wishart.

Keep an eye out too for performance fees, which are particularly prominent among absolute return funds.

"Paying more in fees to get a higher return might seem reasonable, but if you end up paying 20 per cent of any return above cash then it becomes a very expensive investment strategy," O'Neill pointed out.

So if the promise of returns regardless of conditions appeals to you, the message is to do your homework. If you're not sure, there are other ways of limiting losses while retaining the prospect of some capital growth.

"The evidence would indicate that investors who can be patient and disciplined in the longer term, would be better off in a well diversified low cost investment portfolio that is rebalanced," said Wishart. "Don't panic out at the first sign of volatility. Buy and hold."

## WINNERS AND LOSERS

### TOP TEN OVER THREE YEARS

FUND	Return %
1 CF Odey UK Absolute Return	55
2 Thesis Cherwell	31
3 Stan Life Inv Global Absolute Return Strategies	29.2
4 Newton Real Return	25.1
5 CF Ruffer Absolute Return	24.4
6 S&W The Tenax	20.2
7 MFM CPI Defensive Managed	20
8 Insight Absolute Insight	19
9 Scot Wid HIFML Absolute Return	18.5
10 Threadneedle Credit Opportunities	17.5
SECTOR AVERAGE	8.6

### BOTTOM TEN OVER THREE YEARS

FUND	Return %
1 Skandia Alternative Investments Hedged GBP	3.2
2 S&W Saltus Multi Asset	2.3
3 Threadneedle Target Return	1
4 Threadneedle Absolute Return Bond	1
5 Threadneedle Target Return Core	0.8
6 Investec Target Return	0.1
7 BlackRock UK Absolute Alpha	-1.4
8 Liontrust European Absolute Return	-2.5
9 CF Octopus Absolute UK Equity	-12.1
10 SVM UK Absolute Alpha	-20
SECTOR AVERAGE	8.6

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