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# **LAPF Strategic Investment Forum**

## **Is absolute return doing what it says on the tin ?**

**Standard Life**  
**Investments**

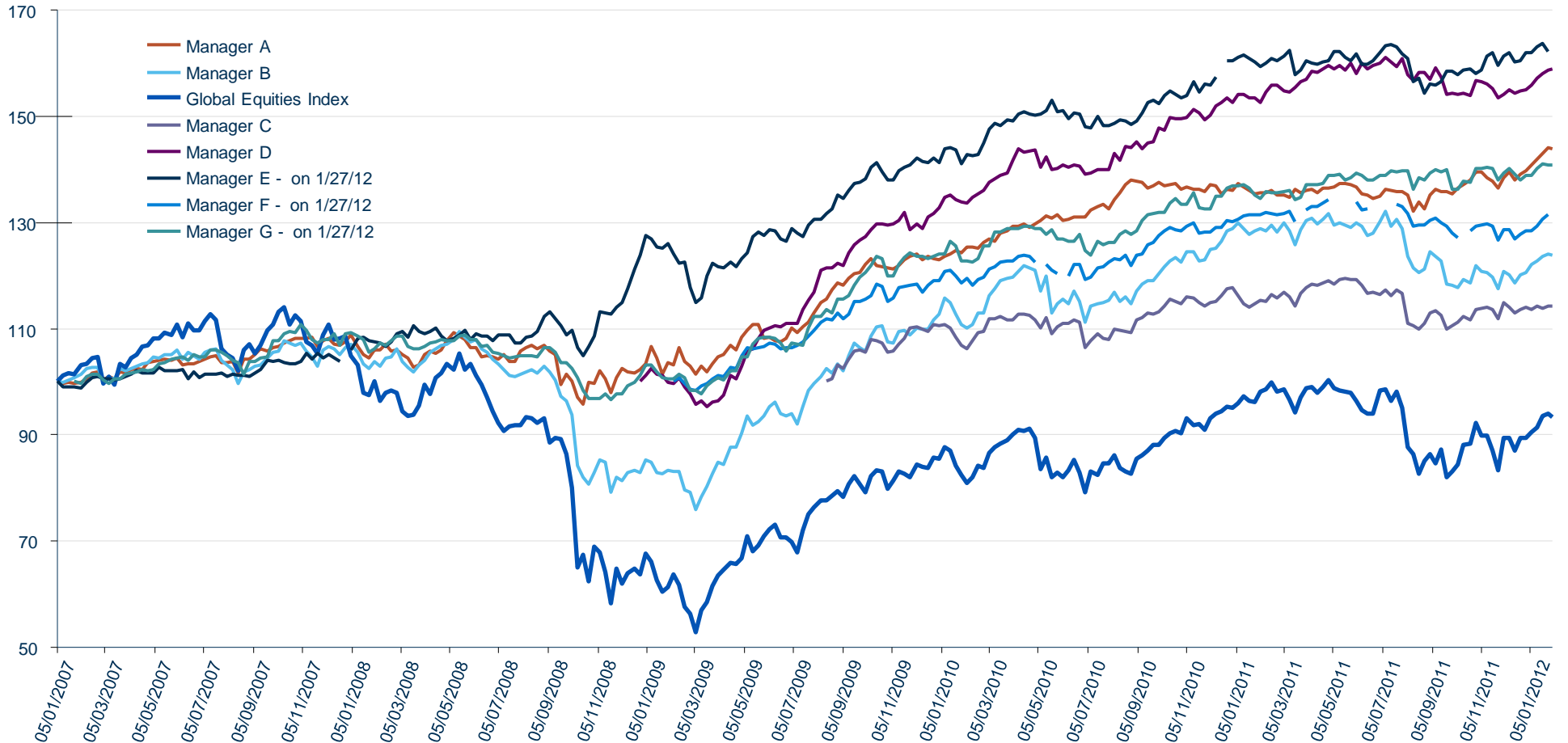
**George Emmerson**  
**Investment Director**

**9<sup>th</sup> February 2012**

# Some of them are ?

- But how do you measure them?
  - Return over a reasonable time scale or market cycle
  - Risk
  - Correlation to other asset classes

# Sample of main AR funds vs Global Equities



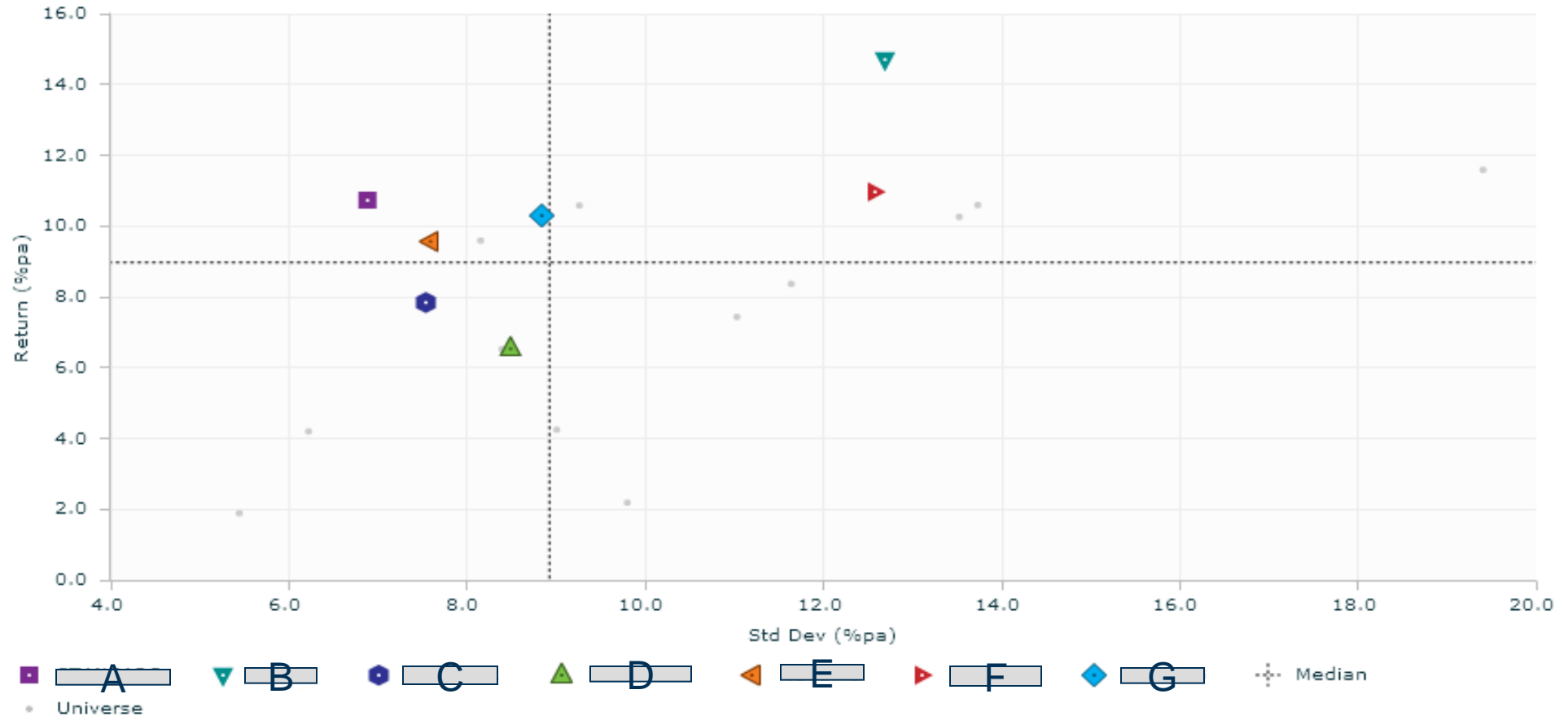
Source: Standard Life Investments

# And when you add risk .....

## ABSOLUTE RETURN QUARTERLY REPORT

Return and Std Deviation in GBP (after fees) over 3 yrs ending December-11 (quarterly calculations)

Comparison with the Multi Asset Diversified Growth (Net) universe



Created on 24 Jan 2012 at 1:14 PM

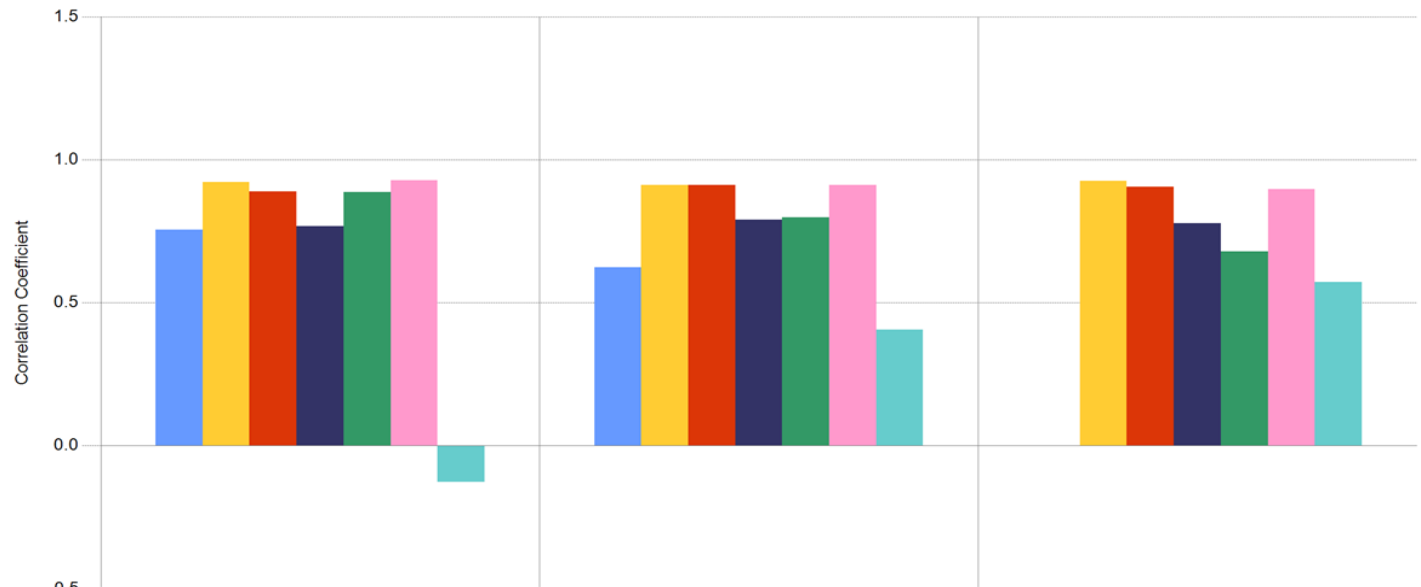
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# What about AR Funds correlated to equities.....

- Manager A
- Manager B
- Manager C
- Manager D
- Manager E
- Manager F
- SLI Ltd

Correlation to Global Equities  
December 2011



	DS	VT	RM	1 Yr	2 Yrs	3 Yrs
Manager A	IM	IMF	GF	0.8	0.6	---
Manager B	IM	SA	GF	0.9	0.9	0.9
Manager C	IM	SA	NF	0.9	0.9	0.9
Manager D	IM	SA	GF	0.8	0.8	0.8
Manager E	IM	RA	NF	0.9	0.8	0.7
Manager F	IM	IMF	NF	0.9	0.9	0.9
SLI Ltd	IM	SA	GF	-0.1	0.4	0.6

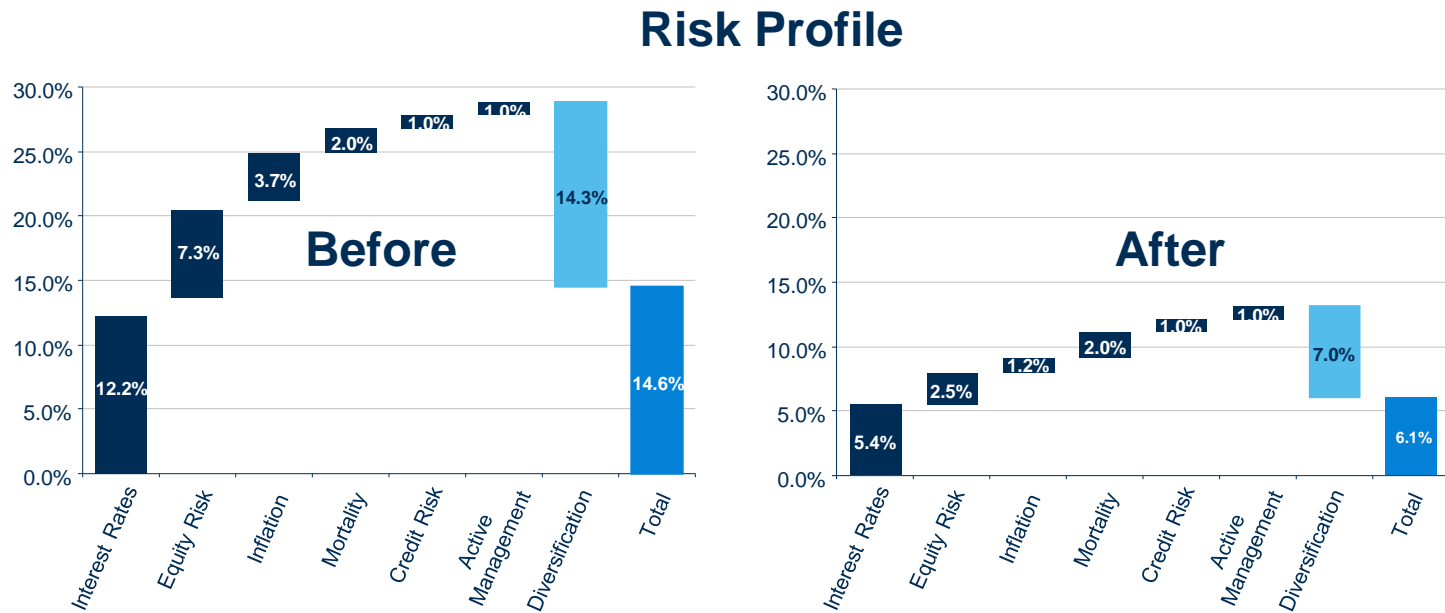
Results displayed in Pound Sterling (GBP)

MSCI ACWI-ND

Source: eVestment Alliance, December 2011  
Correlation has been calculated using monthly data points

# It does work for some.....

Demutualisation of Standard Life was the trigger  
Investment manager played a key role:



Designed and built a liabilities-plus absolute return solution

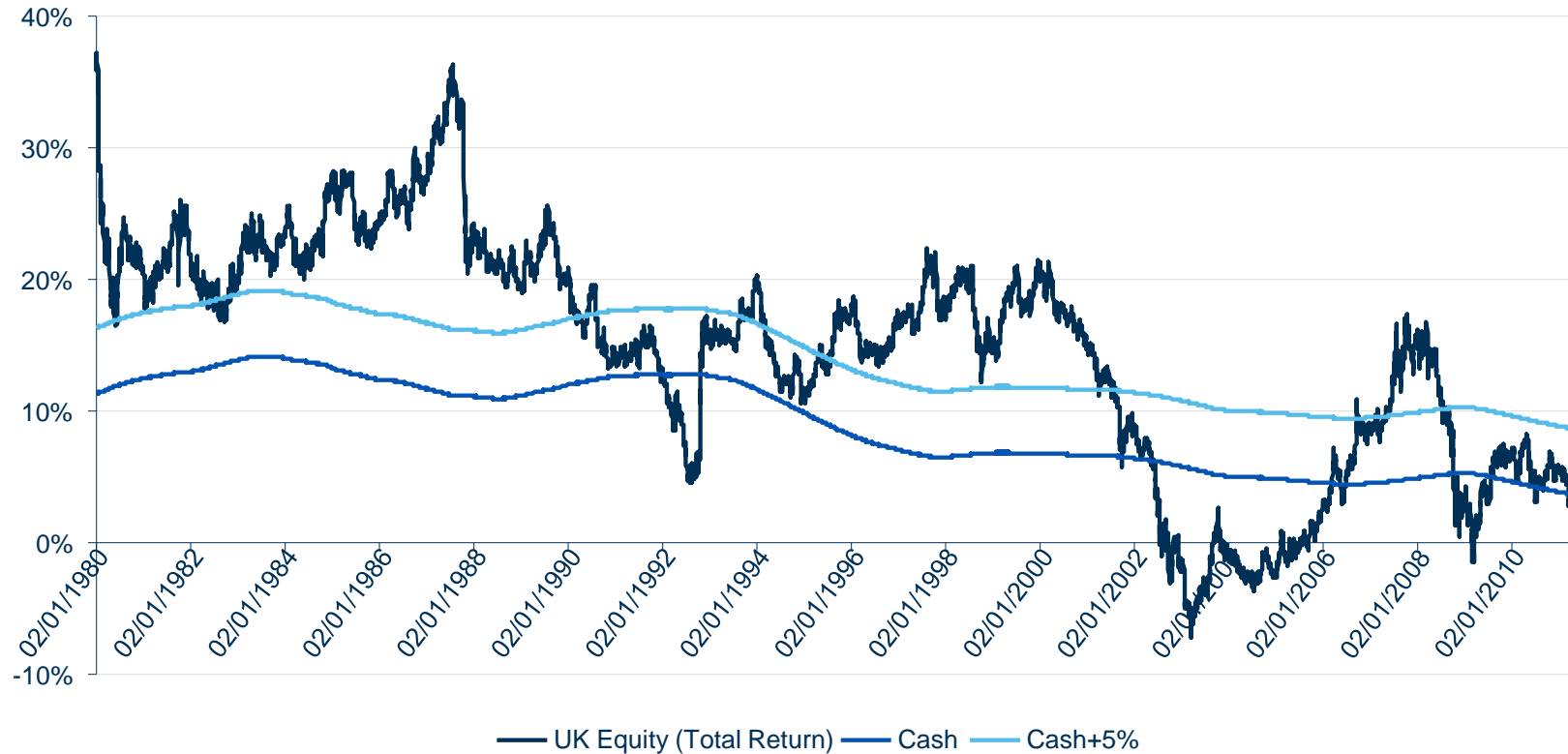
- Liabilities + 2.2%

Phased implementation

Ongoing responsibility for risk budget

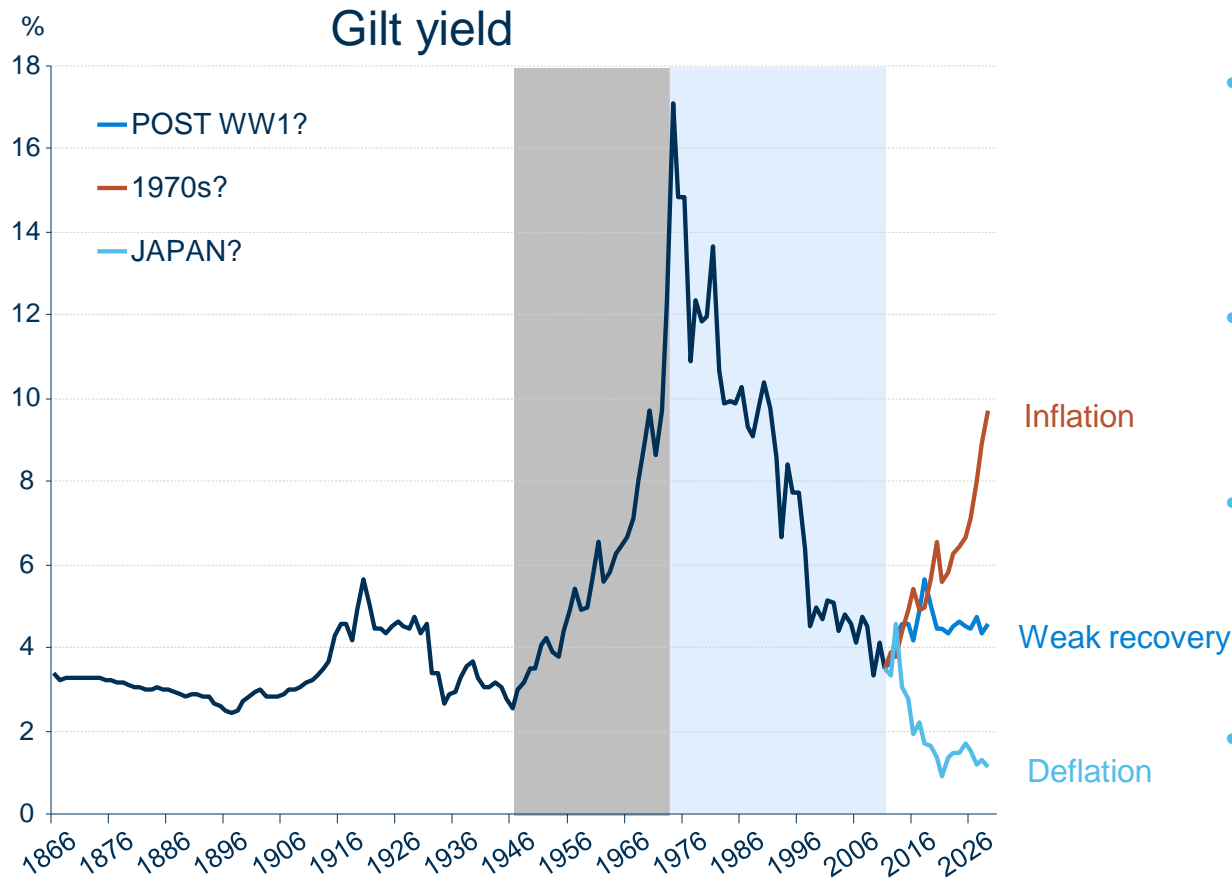
# How reliable is equity investment?

## Average returns over 5 years



- Some global equity markets have delivered negative returns over long periods, prompting a review of equity allocations
- Cash + 5% delivers equity-like returns
- Is there a more reliable way to deliver similar returns?

# Bond yields bottoming out – which way next?



- Over 100 years UK bonds have outperformed cash by 0.4% on average
- However this hides periods of extreme volatility
- 1950-1980: Bonds underperformed cash by nearly 2%
- 1980-2011: Bonds outperformed cash by nearly 2%

Source: Global Financial Data, Standard Life Investments

Bonds cycles can be long and varied – bull market coming to an end?



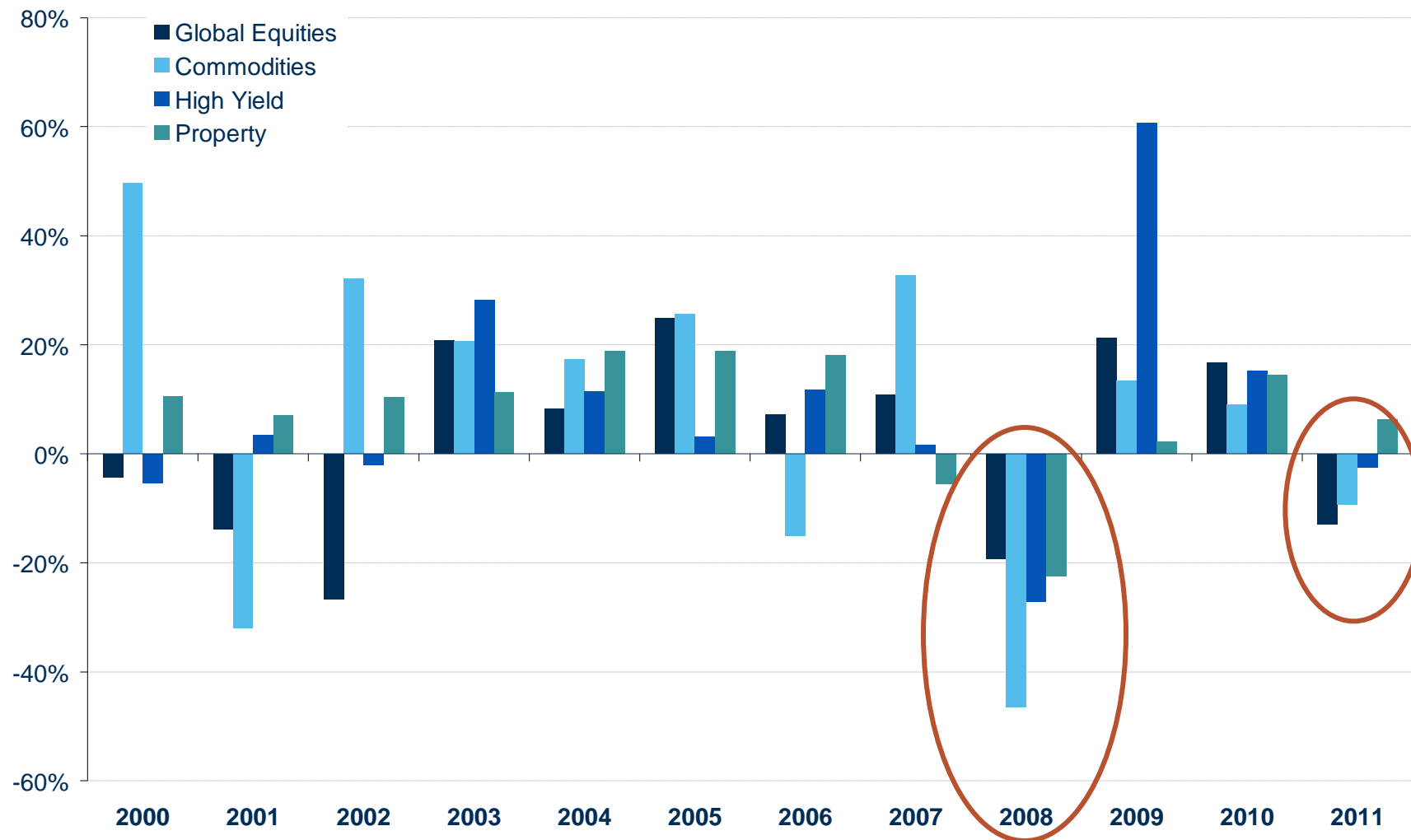
# Q: Whats wrong with the usual suspects?



A: They don't address the main themes that are facing pension funds in the future

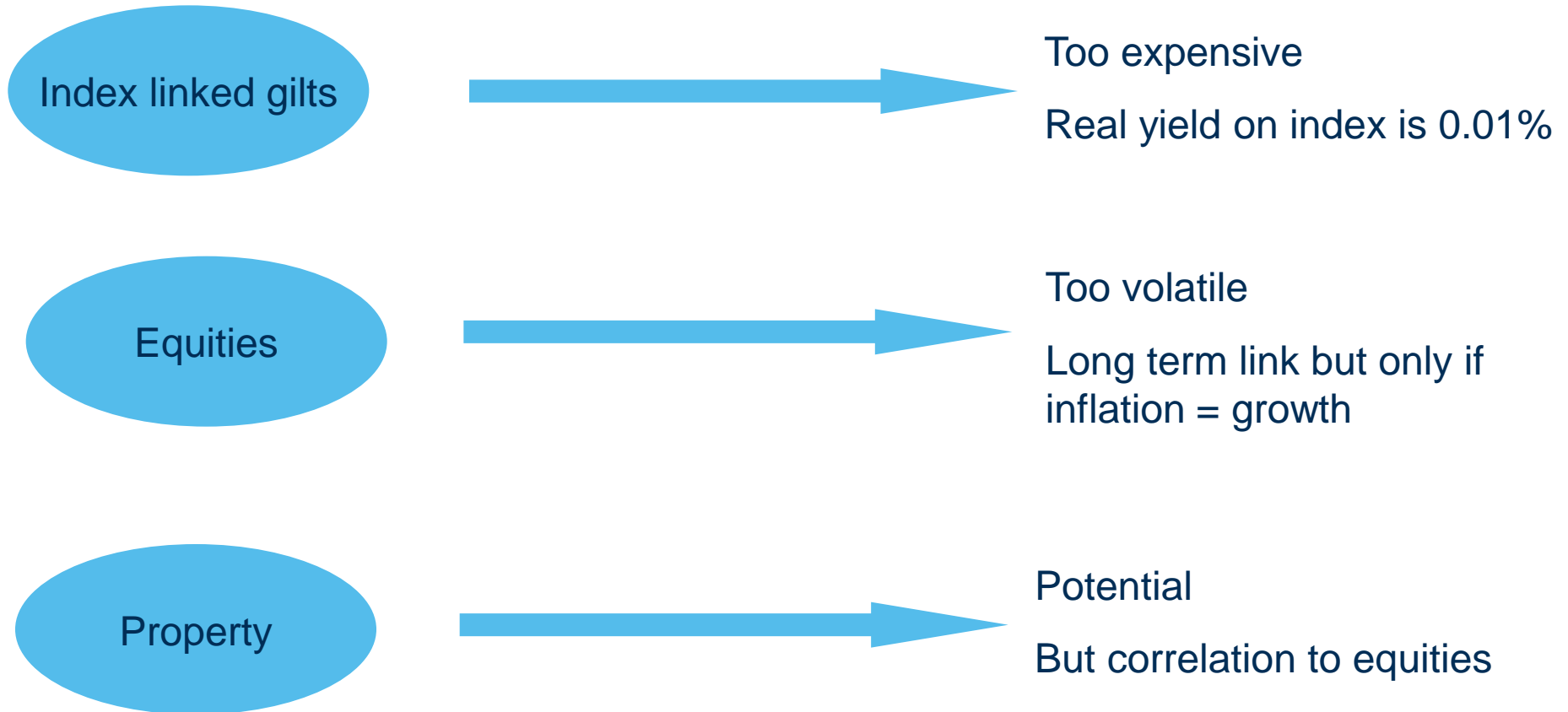
- Inflation
- Volatility
- Liabilities

# Diversification in good times and bad?



# Hot topic at present....How to tackle inflation risk

Usual suspects – real assets



# Alternatives?

Global inflation  
linked bonds



Improved yield  
Global vs UK inflation?

Corporate bonds



Good yield to cushion from  
unexpected inflation  
Link to corporate sector  
provides real exposure

Long Lease  
Property



Longer lease means value is  
better related to income  
stream  
Lots of assets available with  
RPI linked rent

# Diversification in Local Authority pension schemes

- Historically pooled balanced funds
  - A limited asset mix
  - Mirrored in institutional asset allocation
- Diversified growth funds
  - Allocation to a range of asset classes
  - Limited diversification
    - ♦ “Foul weather” correlation
    - ♦ Stock-selection “tied” to market exposure
  - Strategy subject to peer pressures
- Absolute returns – true diversification
  - Cash benchmark means a wide opportunity set
  - Precision focus to deliver best return strategies
  - Equity/growth asset and fixed income strategies

# Building a resilient absolute return portfolio

Portfolio has to deliver stable performance in a wide range of scenarios

Range of investment strategies implemented therefore have to reflect

- Fragile economic recovery
- Continuing levels of high volatility in the market
- Surge in commodity prices
- Collapse in commodity prices
- Inflation becoming a major problem
- Deflation fears growing
- Emerging Markets growing ever faster
- Emerging Markets bubble popping
- ....and many more

Building a portfolio to allow for this range of eventualities is no easy task!

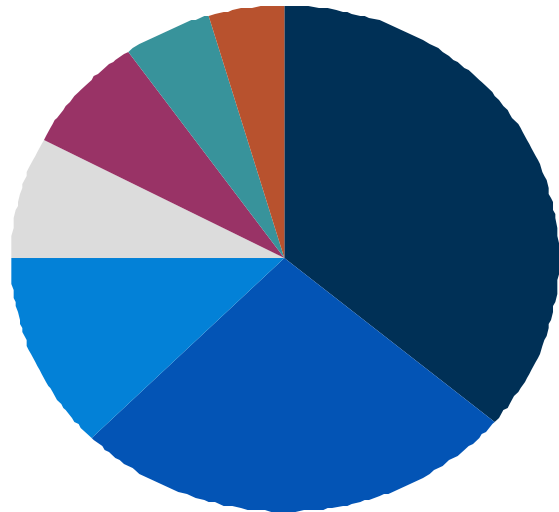
# The benefits of risk-based investing

- More pension schemes are now managing risks relative to 'liabilities'
- Establish clear picture of what risks are and what tolerance levels do Pension Committee members have to these
- Delegation of some risks
  - Pension Committee members to decide which risks they can manage and delegate some risks
- No unrewarding risks
  - Clear allocation of responsibility for all risks: Committee or delegated
- Diversification and balance of risks
  - Chosen specifically to work well together
  - Genuine diversification is a central objective

# Diversification - standalone risk contributions

## Balanced Portfolio – stand alone contributions

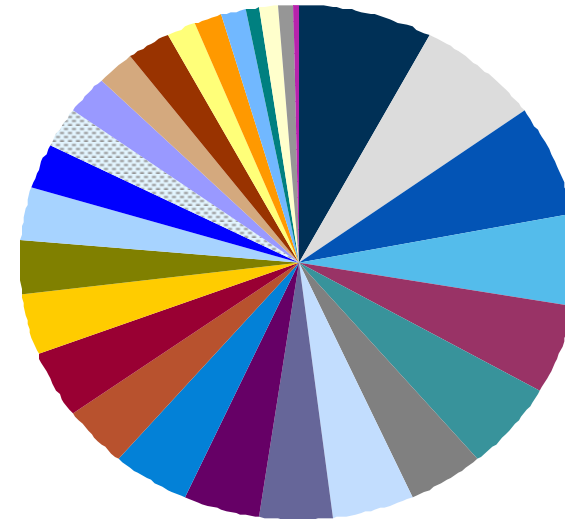
Expected Portfolio volatility 10.43%



■ UKEquity ■ GlobalEquity ■ Property ■ Gilts  
■ Credit ■ GiltLinkers ■ Alternatives

## Absolute Return Portfolio – stand alone contributions

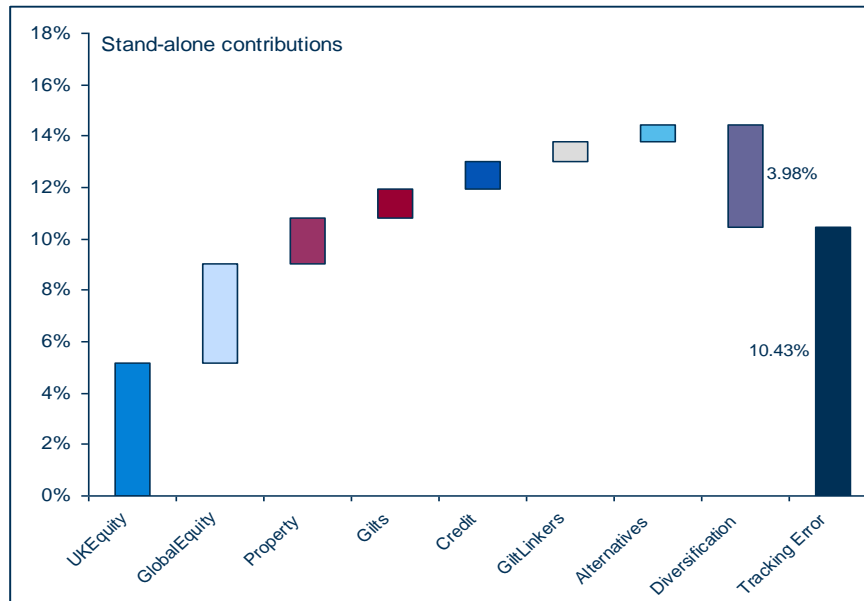
Expected portfolio volatility 5.94%



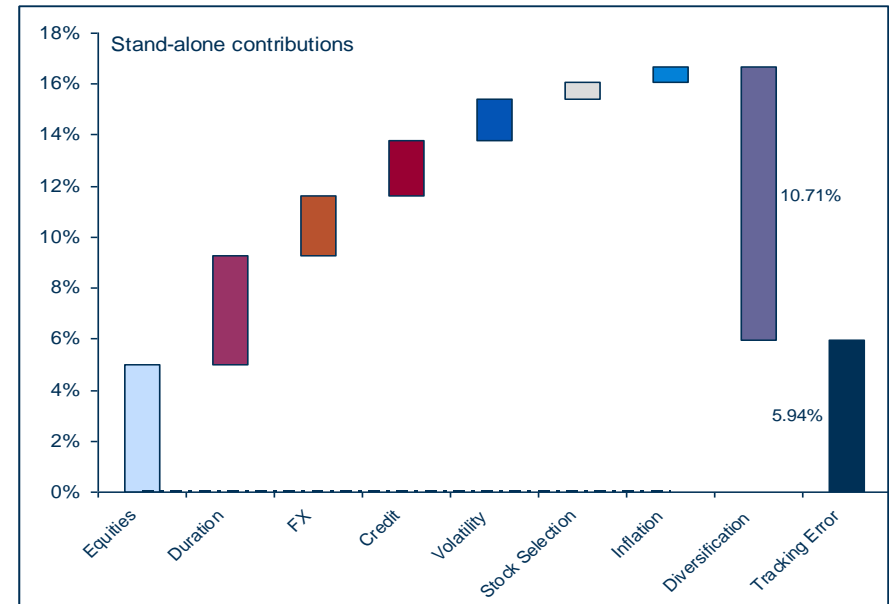


# Diversification – aggregate portfolio risk

## Balanced Portfolio

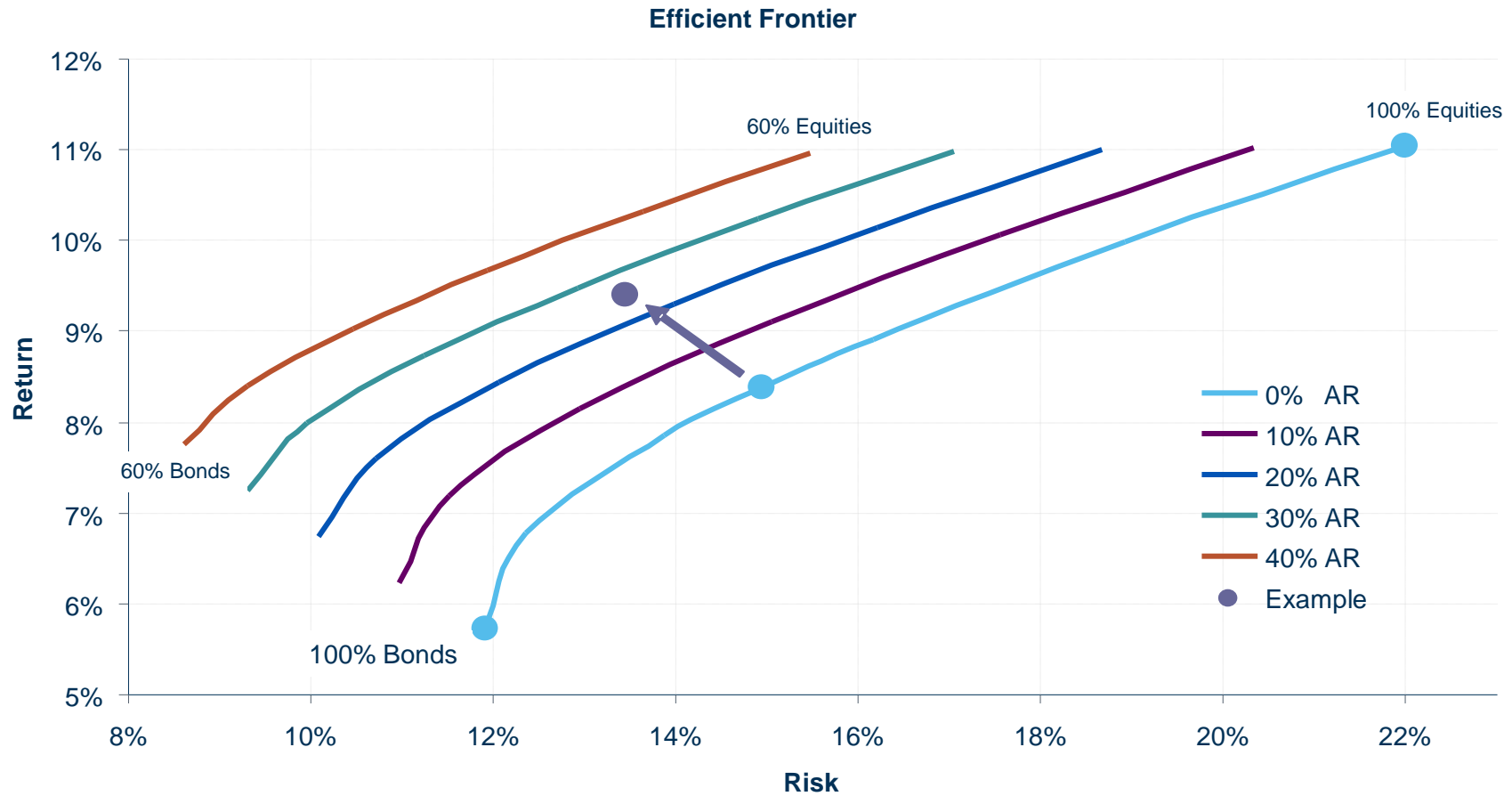


## Absolute Return Portfolio



- Broadly equivalent return potential from the absolute return and balanced portfolio
- Aggregate risk less total standalone risks gives a measure of diversification
- Greater diversification in the absolute return portfolio

# Adding absolute return to a portfolio



# What Absolute Return brings to your portfolio

## Genuine diversification

- Specific individual strategies chosen to work well together

## Accessibility and liquidity

- Regular access at short notice
- Highly liquid underlying asset pool

## Transparency

- Portfolio risks are clear
- Return attribution – open to scrutiny

## Fit to existing portfolio strategy

- Low correlation to equities

Exceptional rewards for modest risk levels

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