



LIONTRUST

for financial advisers only

an absolute necessity?

August 2009

Rob Page underlines the significance of absolute return funds in an increasingly risk-averse climate.



When there is a flood of fund launches in a particular sector or asset class, it is often time for advisers and their clients to turn and head in the opposite direction. While there is certainly a proliferation of absolute return funds, with the likes of Cazenove, Gartmore and ourselves following BlackRock's lead, we believe the sector will have an important role to play in investors' portfolios.

This is mainly because investors' risk appetite has been decimated over the past couple of years. Even though there was a minor bull run from early March 2009, investors are still extremely risk averse and continue to worry about future volatility in stock markets. Furthermore, while governments have undertaken unprecedented action to prop up the banking system and prevent an economic depression, no-one really knows how this will unwind itself in the future. At a time when advisers and investors are not sure whether the FTSE® 100 points total will start with a 3 or a 5 in a year's time – and there are those with bigger IQs than me making entirely plausible cases for both scenarios – it is not hard to see why more cautious products will prosper.

increasing presence

Given this backdrop, we believe absolute return funds will increasingly form a central part of investors' portfolios. Those fund managers with the skill to successfully short

stocks, as well as take long positions, can produce low or even non-correlated returns to equities. This means they can seek to generate positive returns even when stock markets are falling. Thus, they offer cautious investors the potential ability to smooth returns and deliver gains over each market cycle. Naturally, this has a tremendous resonance with today's beleaguered and investing public.

But it is important to remember that absolute return funds are not guaranteed products. They do not claim to never deliver a negative return. Absolute return funds aim to deliver lower volatility returns than the stock market and produce a positive return over a market cycle. Therefore, investors can use such funds as core holdings within their portfolios. Actively managed funds that investors believe will deliver 'alpha' (but with higher volatility) can then be added to portfolios in a classic core/satellite approach.

careful due diligence

However, for advisers and their clients who decide they want to use absolute return funds, the due diligence they need to carry out before selecting any of them can be more time-consuming than for long-only funds because of the varied ways in which they are managed and the consequent impact on their risk/return profiles. This comes from the increased number of

instruments that absolute return funds can use, such as contracts for difference to short stocks, compared to long-only retail funds.

The lack of homogeneity in the sector is shown by the wide variation in performance of funds. Indeed, Standard & Poor's said very few absolute return funds achieved their performance targets in 2008, reiterating the need for careful due diligence by investors.

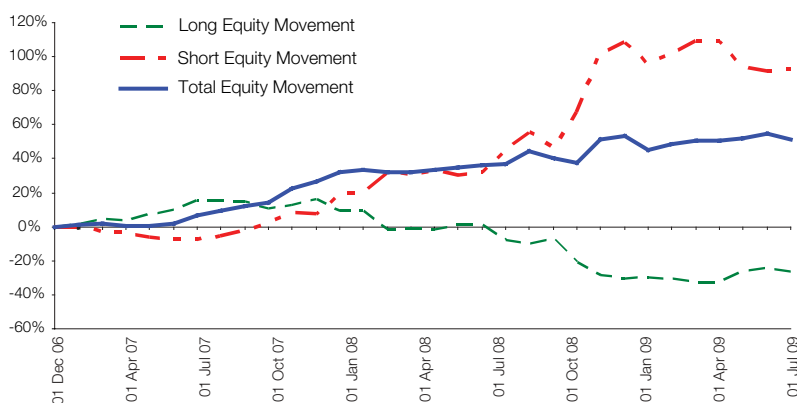
experience at the helm

Gary West and James Inglis-Jones, who manage the Liontrust European Absolute Return Fund, have successfully run long/short funds since 2003. The sterling share class of the Liontrust European Long/Short Fund, which is available for professional investors only and is also managed by Gary and James, returned 51.61% from launch on 6 December 2006 to 30 June 2009 against a loss of 14.80% by the FTSE All-World Developed Europe Index, according to Financial Express.

Shorting ability and experience is one of the factors investors should consider (see panel). As with long-only funds, it is important to understand the investment process and how fund managers select stocks. It makes sense to check whether the stock selection process is the same for shorting stocks as it is on the long side.



European equity long/short performance



Source: Liontrust, 1 December 2006 to 1 July 2009. Past performance is not a guide to future performance.

manager experience is crucial

There are a number of factors investors need to consider when selecting absolute return funds, most prominent being the experience of fund managers in shorting stocks. In this, there are three types of managers:

- Long only managers who have experience of shorting stocks through successfully running a long/short fund.
- Long only managers who have experience of shorting through running a paper portfolio.
- Long only managers who have no experience of shorting stocks.

The first group are able to provide reassurance to investors through their proven ability to short stocks and therefore to manage absolute return portfolios. Shorting stocks poses a different level of risk to investors than long holdings. Losses from a short position that is moving in the wrong direction for the manager can potentially be limitless, demonstrating the need for shorting skill, experience and risk management.

For example, the Cashflow Solution investment process that Gary and James use in finding good companies for the Liontrust European Absolute Return Fund also points out the ones more likely to fail. They have faith in their process and persist with it regardless of the market environment.

Additionally, questions need to be asked about the risk management process used by the fund manager and whether stop loss positions are used. What is the range of gross and net exposure that the manager will take in running the fund? What is the expected average annual return, the level of volatility and the turnover of the portfolio? For example, the Liontrust European Absolute Return Fund seeks to control risk by factoring out market risk. The Fund takes a bottom-up approach so most risk is stock specific.

Absolute return funds can act as core holdings in investors' portfolios during all market conditions through their potential ability to deliver low and non-correlated returns to equities. But the investment process, risk return profile, experience of the fund managers and risk management process vary significantly between funds in the sector. This can lead to significant differences in returns and highlights the need for careful due diligence to select the most appropriate funds. ●

Rob Page is Marketing Director at Liontrust.

Liontrust European Absolute Return is exclusively available via Skandia's Life and Pensions fund ranges and the Skandia Investment Solutions platform until the end of 2009.

The Skandia fund will not mirror the performance of the underlying fund because of Skandia fund charges, taxation adjustments (if appropriate) and the Skandia investment process.

Past performance is not a guide to future performance.



www.skandia.co.uk

Calls may be monitored and recorded for training purposes and to avoid misunderstandings.

Skandia provides you with access to its investment platform, known as Skandia Investment Solutions. Within this platform you can open an ISA and Collective Investment Account provided by Skandia MultiFUNDS Limited, a Collective Retirement Account and Collective Investment Bond provided by Skandia MultiFUNDS Assurance Limited and an Offshore Collective Investment Bond, distributed by Skandia MultiFUNDS Limited but provided by Old Mutual International (Guernsey) Limited.

Skandia Life Assurance Company Limited, Skandia MultiFUNDS Limited, Skandia Investment Management Limited and Skandia MultiFUNDS Assurance Limited are registered in England & Wales under numbers 1363932, 1680071, 4227837 and 4163431 respectively. Registered Office at Skandia House, Portland Terrace, Southampton SO14 7EJ, United Kingdom.

All companies are authorised and regulated by the Financial Services Authority with FSA register numbers 110462, 165359, 208543 and 207977. VAT number for all above companies is 386 1301 59.

Old Mutual International (Guernsey) Limited is regulated by the Guernsey Financial Services Commission and is licensed to write long-term business under the Insurance Business (Bailiwick of Guernsey) Law 2002. Registered number 2424. Registered Office at The Beehive, PO Box 121, Collings Road, St Peter Port, Guernsey GY1 3HE, Channel Islands.