



# an exceptional performer

## September 2008

The BlackRock UK Absolute Alpha Fund has been the leading performer by some way in the IMA Absolute Return sector, attracting remarkable inflows during the last 12 months.

**Mark Lyttleton** explains how he has achieved this success and provides an update on how he is managing his portion of the Skandia UK Strategic Best Ideas Fund.



The difficult market environment of the past 12 months following the well-publicised credit crunch has caused many investors to seek alternative ways to either preserve capital or, more importantly, continue to generate positive returns on their investments. As Graham Bentley has highlighted earlier in this issue, clients have consequently begun to recognise the potential benefits of absolute return products and one beneficiary of this trend has been the BlackRock UK Absolute Alpha Fund.

While many funds have tried to achieve the ambitious objective of providing

investors with a positive absolute return regardless of the direction of the UK stock market, the BlackRock UK Absolute Alpha Fund has built a successful track record of delivery. Since the beginning of 2008 and in volatile markets the Fund has returned 6.8%, compared to the FTSE All Share which has fallen 14.1% and cash which has risen just 1%. Since the launch of the Class P units in March 2006, the Fund has returned 24.6% versus the FTSE All Share which has fallen 2.3%\*. (I should point out that the BlackRock UK Absolute Alpha Fund is not aligned to a benchmark and the figures are for comparison purposes

only). This enviable track record has seen the Fund receive an AA-rating from Standard & Poor's; the only Fund with an established track record in this sector to have received such an accolade.

Thanks to our performance on more traditional long-only funds clients have had considerable confidence in our ability to generate returns on the long side of the portfolio, but felt the burden of proof rested with us as to our ability to produce short alpha, or to make money from shorting shares. The Fund's performance over the challenging market conditions of the last 12 months has allayed any fears

they may have had. We have had notable success from our negative view on companies exposed to changes in consumer discretionary expenditure and those with inappropriate levels of financial gearing. That continues to be a major theme, as we consider dislocation in the credit markets to be a medium-term phenomenon.

## low correlation

The Fund has grown rapidly over the last year as clients have recognised the potential benefits of absolute return products. As well as targeting positive returns irrespective of market direction, the lack of correlation with other asset classes has been seen as a significant virtue. We have always constructed the portfolio with the ambition that it would become a market leader, and therefore liquidity has been a key consideration, enabling us to invest sizeable inflows with ease. Clearly this implies a bias towards large and mid-cap companies within the portfolio. We are fortunate to have access to BlackRock's considerable resource and therefore are never short of new investment ideas

Since inception the Fund has delivered a positive return in each quarterly period, however we acknowledge that market conditions may not always make this possible and encourage our clients to consider the Fund's performance over the medium term. We are always grateful for

our clients' patience in enabling us to take longer-term thematic views where we are confident there is sufficient return.

## reducing volatility

For both the BlackRock UK Absolute Alpha Fund and the Skandia UK Strategic Best Ideas Fund (see panel below), the ability to employ the wider strategies available under UCITS regulations is especially valuable during periods of market volatility. Not only do these strategies enable managers to cope during difficult markets and even generate positive returns, but over the long term they can help to reduce volatility and provide investors with a much smoother journey than they might experience with a traditional long-only fund.

At the same time, it is important to acknowledge that with these types of Funds a portion will always be positioned to protect them from market falls. As a result they are likely to lag conventional long-only funds in rising markets. Nevertheless, the potential for consistent positive returns and reduced volatility with little or no correlation to the broader market is an attractive combination and should see demand for funds using broader investment techniques, such as the BlackRock UK Absolute Alpha Fund and the Skandia UK Strategic Best Ideas Fund, grow significantly in the years ahead. ●

## achieving a positive return

Myself, co-manager Nick Osborne and the team utilise some of the wider investment powers under UCITS III and employ four principal investment strategies:

**Long positions** – where we have a strong conviction that the stock price will rise.

**Synthetic short positions** – where we have a strong conviction that the stock price will fall.

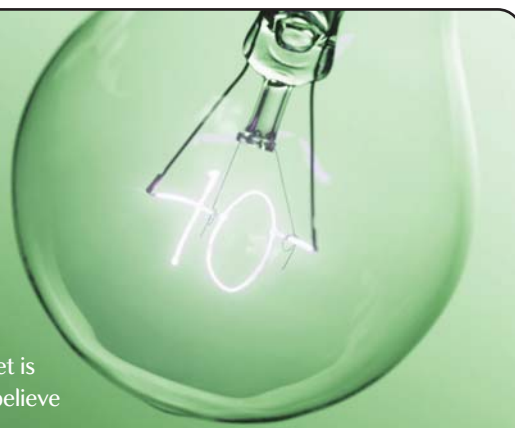
**Pair trades** – a pair trade invests in a combination of long and short positions with the aim of minimising the sector and market risk. For example, if we do not have a particularly positive view of the banking sector but we feel that commercial banks will outperform mortgage banks, we can open a long position in a commercial bank and a short position in a mortgage bank.

**Cash** – in certain market conditions, we have the flexibility to invest up to 100% of the portfolio in cash or cash-like instruments, but under normal market conditions we do not expect to hold more than 40% cash for tactical purposes.

## the very best ideas

When managing my part of the Skandia UK Strategic Best Ideas portfolio in falling or volatile markets, being able to employ the same strategies as those detailed above is a key source of alpha for me. For example, the ability to go short and utilise pair trades provides me with a flexible style of investing where I can try to create a balanced portfolio of shares which can

deliver steady performance in all market environments. Another of the advantages of the UK Strategic Best Ideas Fund is the ability to adjust the net position of the portfolio, moving it lower when the market is falling and increasing it when I believe share prices are rising.



The BlackRock UK Absolute Alpha Fund and the Skandia UK Strategic Best Ideas Fund are available through Skandia's Life, Pensions, and MultiFUNDS fund ranges and the Selestia Investment Solutions investment platform.

\*Source: BlackRock. P class units, bid to bid, net income reinvested in sterling terms to 31 July 2008. Class P units were launched 31 March 2006 whilst Class A units launched on 29 April 2005 but are no longer available for investment.

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

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