FULCRUM
Asset Management

a refreshing alternative

April 2009

Gavyn Davies, Chairman of Fulcrum Asset Management, explains how the Fulcrum Alternative Beta Plus Fund is designed to capture many alternative streams of investment returns.

Since the summer of 2007, portfolios have been battered by dramatic losses in almost all financial markets. Equity markets, for example, have experienced some of their sharpest periods of decline in recorded market history. Although capital preservation is difficult in current adverse market conditions, Fulcrum Alternative Beta Plus (FAB+) has returned 1%* since launch on 1 November 2007.

FAB+ forms a core investment within two Skandia fund propositions launched last year – the Skandia Spectrum Funds and Skandia Alternative Investments Fund – and we are delighted to be launching FAB+ across Skandia's UK fund ranges shortly with daily liquidity. The Fund provides a potentially attractive source of 'alternative' returns in a regulated UCITS III format suitable for retail investors. It is designed to achieve a low correlation to equities, while ensuring greater liquidity and transparency, with lower fees than standard hedge funds.

the Fulcrum team

Fulcrum Asset Management was established to manage private client assets in 2004 by myself and Andrew Stevens, formerly an investment manager at Goldman Sachs, along with a core team from Goldman. We are now 25 people at Fulcrum, most of us having worked together for much of our careers, and our client base has expanded to include private clients, charities, pensions and institutions. We have been investing in both hedge funds and conventional money managers for many years, through good times and bad.

The design of FAB+ recognises that successful alternative managers have added diversification and therefore reduced portfolio risk when combined with traditional asset classes like equities and bonds. While we are not seeking to replicate hedge fund returns on a month-by-month basis (and in fact have done much better than the hedge fund universe since launch), we believe that many of the strategies successfully adopted by alternative managers over many years can now be made available to retail investors in a single fund.

alternative advantages

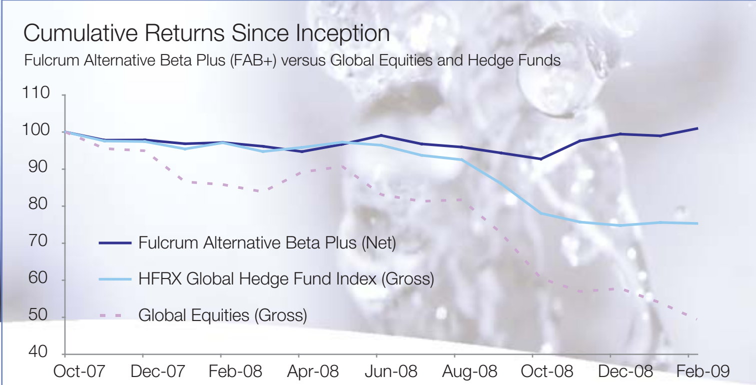
There are three fundamental advantages which alternative managers have developed over traditional managers. Alternatives can maximise their gains by diversifying their investments across a broader range of asset classes and securities than traditional managers (and can short a falling market); they can use more active trading strategies and exploit market trends in ways which traditional managers cannot; and they can offer their investors greater downside protection than is common in traditional 'balanced' portfolios of equities and bonds. All of these advantages are included in the design of FAB+. Let us consider them in turn.

Diversification

Traditional portfolios generally have exposure to rising or falling equity and bond markets (or 'market betas') and, because equities tend to go up and down much more than bonds, the performance of these portfolios is dominated by bull and bear trends in global stock markets. The primary function of FAB+ is to create a diversified portfolio of 'alternative betas' from the broad range of asset classes which form the investment universe for alternative investments, including about a dozen different investment strategies in the global equity, bond, credit, currency and commodity markets.

In constructing this portfolio of diverse investments, FAB+ breaks free from the constraint of equities dominating risk in a balanced portfolio. Instead positive returns can potentially be earned from many sources of risk – even in an equity bear market. A key innovation is that we size all our positions so that the different sources of return can all make a similar sized contribution to the performance of the Fund. As a result FAB+ can capitalise on movements in lower volatility asset

> "...designed to achieve a low correlation to equities, while ensuring greater liquidity and transparency"



Source: Fulcrum and Bloomberg. Past Performance is not a guide to future performance.

classes in a more meaningful way than traditional managers. In broad terms, since inception, FAB+ has generated positive returns by reducing its risk exposure to the highly volatile equity markets (compared to traditional managers) and by allocating more of its risk exposure to bonds, currencies and commodities.

Trading strategies

Successful alternative managers do not simply remain passively exposed to the market risk outlined above. They actively trade many individual assets in all of the markets to achieve positive trading returns, whatever the overall direction of the markets. We believe that successful traders tend to follow established trading techniques, which can greatly impact their returns over lengthy time periods. Our analysis of these techniques has helped us to design the active trading strategies contained in FAB+. Our trading strategies, which are based on factors like price momentum, mean reversion and stop losses, have contributed 21% to the returns of FAB+ since inception. We do not expect to replicate all aspects of human skill, but FAB+ has offsetting advantages, such as lower fees, greater liquidity, and greater transparency, than standard hedge funds.

Downside protection

Traditional portfolios tend to 'hug' their benchmarks, so they inevitably suffer when equity and bond markets decline. Furthermore, when markets become more volatile, the risk and volatility of a traditional portfolio automatically increases, exposing the portfolios to the risk of large losses over short periods of time. By contrast, FAB+ has no benchmark and is constructed so that its position sizes are quickly reduced when market volatility starts to rise. In bad market conditions, this can help reduce losses.

Furthermore, since we know what assets are held in the portfolio (unlike a fund of hedge funds), it is more feasible to use options to help protect the portfolio against the risk of sudden, large losses – for example, in a market meltdown. These are genuine 'hedging' strategies, once thought to be a hallmark of hedge funds but which were not always followed sufficiently rigorously in the hedge fund universe last year. Given the nature of financial risk, we certainly cannot guarantee complete protection, but the hedging strategies of FAB+ have contributed positively to fund returns since inception, and have sharply dampened monthly volatility.

In summary, we believe that the design of FAB+ can take advantage of many diversified return streams more efficiently than conventional portfolios. No portfolio of risky assets can guarantee positive returns in all environments, but FAB+ has significant advantages which we expect to help it navigate the varied and possibly turbulent market conditions ahead.

The Fulcrum Alternative Beta Plus (FAB+) Fund will be available through Skandia's Life & Pensions fund ranges and the Selestia Investment Solutions platform shortly.

*As at 28 February 2009. Source: Fulcrum, calculated on a NAV basis. Past performance is not a guide to future performance.

The Fund, or some of its underlying assets, may hold derivatives and may have some exposure to credit risk if a provider of derivatives fails to honour their obligation.

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.

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

Selestia Investment Solutions investment platform gives you access to an ISA and Collective Investment Account provided by Skandia MultiFUNDS Limited, a Collective Retirement Account and Collective Investment Bond provided by Selestia Life & Pensions Limited and an Offshore Collective Investment Bond distributed by Skandia MultiFUNDS Limited for Old Mutual International (Guernsey) Limited.

Skandia fund platform gives you access to MultISA and MultiFUND provided by Skandia MultiFUNDS Limited and to products provided by Skandia Life Assurance Company Limited.

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