

SHINING A LIGHT ON..... SLI GLOBAL ABSOLUTE RETURN STRATEGIES FUND

At a glance

The Standard Life Investments (SLI) Global Absolute Strategies (GARS) Fund was born out of the desire of their own staff pension scheme to manage scheme assets in a more effective way. The strategy itself was launched to market in 2008 but had been used by their pension scheme for a number of years prior to that.

Essentially the trustees of the pension scheme wanted a strategy which was not dependent on the rise and fall of the market and more importantly not dependent on single risk factors. In essence they wanted to hedge out market risk.

This dilemma is now faced by many investors where the bond bull market has come to an end. Investors can no longer expect the same level of returns and potentially there could be much greater volatility. Additionally as we have seen with equities significant price fluctuations are the nature of the beast and volatility is what investors hate - the swing in the value of their investments, particularly in a negative direction.

Therefore for investors who have concerns about excessive volatility this fund gives strong growth potential with much reduced price variations.

We see the fund as a potential bond replacement fund with the aim to drive down the volatility to bond type levels but deliver returns at around 70 to 80% of equities. The target return is cash plus 5% after charges. It has thus far been successful and the fund now has over £30 billion of assets.

Often these types of funds are seen as complex because of the many different strategies employed and investors avoid them for this reason. The fund is a blending of ideas which draw down on the management's view of the world, and these are referred to as themes. They don't mind which asset class or classes have the potential to deliver returns but concentrate on the impact on the overall risk and reward within the portfolio.

Who are the team behind the fund?

Standard Life has over 30 people working on their strategy. Although there are key members this is seen as a team investment approach. One of key individuals is Guy Stern who is Head of Multi Asset / Macro Management and he has been part of the strategy since 2008. However, we have seen members of the team leave to join Invesco to launch a 'me-to' option, and Euan Munro who was the architect of the strategy has left to join Aviva Investments as their CEO.

Because this is more about the team than the individuals it means that the overall strategy is a collective view and should individuals leave it doesn't impact on the fund. For example, Euan had only introduced one strategy over the last three years and therefore had very little input to the investment themes. Therefore his leaving although a blow to SLI was less of a blow to fund.

What is the story behind the investment?

Portfolio construction emphasises the need to have bonds as part of the portfolio primarily because they are seen as low risk and drive down volatility. Bond funds are moving away from a bull territory where returns were easier to achieve to potentially bear territory.

We are starting to see more of these alternative bond type funds which aim to respond to rising interest rates and the potential negative impact this could have on bonds. For some of these the managers are keen to emphasise that they can control the volatility and still drive returns of 1% to 2% p.a. With inflation around 2% this means effectively this will deliver flat returns.

This means investment managers need to be clever to provide an element of “protection” to portfolios similar to bonds but deliver higher returns. Different strategies are now coming into the market but this fund has the track record which other funds don’t.

In essence this investment is a hedging fund, removing significant market risk however it will not appeal to all investors and cannot be marketed as a direct bond replacement strategy although returns should significantly exceed cash.

Fund highlights?

In the recent update we had with the management team we discussed four main themes the managers are tracking.

The first is multi speed global growth – they are exploiting this by taking long positions in the US technology sector vs short the MSCI Taiwan Sector as a whole. The reason for this is that the US tech sector is well funded and has net cash surpluses; they also have good pricing power. The opposite is true in Taiwan where they have commoditised products with a lot of competition and cheaper pricing coming from the likes of Korea and China.

Another example is German vs French equities where they see German equities continuing to perform well whilst French equities struggle because the Government is failing to tackle labour market issues and competitiveness generally.

The second theme is Central Bank Policies, they are looking at European interest rates with the view that although interest rates in the UK and the US may rise they are likely to remain low for longer in Europe.

And the third and fourth themes are earnings potential and Chinese economic change.

The view is that there will going forward be different drivers of the global economy and the team look to identify investments which will benefit from these. As there are multiple strategies in place these will respond at different times and there will be periods in the short term where these appear less successful.

The key to the fund however is encapsulated in this type of strategy where risk is controlled. Many assets are assembled which are broadly uncorrelated to each other, other than that they will be beneficiaries of changing economic and market forces so volatility is kept much lower than a straight long equity fund.

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Fund performance

The strategy has to be viewed over a long time frame. It is not about pinpointing monthly performance as the fund delivers negative returns over short periods. As an example in 2013 up to May it had delivered nearly 7%, in June it lost 5% but over the year it was up nearly 6%. So over short periods the strategies can go against the fund but the aim is to have a diverse range of strategies which maximise a range of different scenarios to deliver positive returns.

The table below shows performance since launch in 2008.

	2009	2010	2011	2012	2013	Since launch
SLI GARS Fund	18.67%	9.90%	2.19%	7.02%	6.28%	6.57% p.a.

You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well as rise. The total return reflects performance without sales charges or the effects of taxation, but is adjusted to reflect all on-going fund expenses and assumes reinvestment of dividends and capital gains. If adjusted for sales charges and the effects of taxation, the performance quoted would be reduced.

Conclusion

The fund targets a return of cash plus 5% over a rolling three year period. In 2008 it had a horrible start losing over 5%. However this was the year of the crash when markets were down 30 to 40% in some cases so it proved its credentials and with much lower volatility.

It has delivered 6.57% p.a. since its launch with bond like volatility. There will be doubters around this strategy and whether it can continue and we have no crystal ball to the future. However in 2013 the fund had a horrible time in June but still delivered over 6% for the year. It is our belief that the team together with the multiple strategies have the ability to continue to perform and for this reason we continue to see this as a main underpin to the portfolios.

The source of information in this note has been provided by SLI and is correct as at January 2014. These are notes from meeting the fund manager or representative and should not be seen as a recommendation to purchase any fund mentioned. Any reference to shares is not a recommendation to buy or sell. Should you wish to make a decision based on these notes we cannot take responsibility for this and you should carry out your own research before making a decision. You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well rise.