

## SHINING A LIGHT ON..... STANDARD LIFE GLOBAL ABSOLUTE RETURN STRATEGY FUND

### Market Overview (provided by the team)

Markets were volatile in Q3 2013, dominated by uncertainty over Federal Reserve policy. Despite this, developed market equities posted strong gains, with positive momentum continuing up to year-end. However, worries over reduced global liquidity drove persistent capital outflows from emerging equity, debt and currency markets, which underperformed their developed market counterparts. Core government bonds lost favour in the second half of 2013, as the improving global outlook emboldened investors to move up the risk spectrum. Credit registered modest gains, with high yield outperforming investment grade.

In December, the Fed finally announced it would start tapering QE from January 2014, at the same time, reiterating its commitment to low interest rates. Investors welcomed the news as further evidence of US economic recovery, while taking comfort at the prospect of continued cheap funding, for the time being at least.

During Q1 2014, markets were unsettled by the conflict between Russia and the Ukraine, and its possible repercussions for global growth. This, coupled with further evidence of slowdown in China, tempered risk appetite. Emerging markets were hardest hit, although at a regional level, performance was mixed. Global fixed income made good progress and outperformed equities, as investors sought lower-risk assets. Benchmark government bond yields in the US, UK and Germany moved lower, providing support to credit markets. US credit led the way, while European credit lagged the US and UK.

### Fund Activity (from our discussions with the management team)

In our discussion with the team we discussed both a positive and negative attribute to the performance of the fund as well as two other strategies they have in place.

The objective of the fund is to achieve libor cash plus 5% (gross) over a 3 year rolling period. The performance this year has been flat and the manager was asked whether he thought the fund would achieve 5% this year.

The response I felt was honest and reflective of the way the fund is managed. The manager stated that there was no guarantee over the next 7 months that the fund can achieve this but with the strategies in place he is confident it can over a 2 to 3 year period. I felt that perhaps there was a hint that the fund wouldn't achieve 5% this year but the manager added that subject to the whims of the market he felt 5% could be achieved. (Perhaps a sitting on the fence answer!)

The point he was making was there are many factors which can unsettle the markets and have done year to date. Ukraine being the main one but Europe is still at the early stages of recovery, and there are concerns around China etc. However the fund is focused on strategies which work over a 2 to 3 year timeframe and this is crucial for investors to understand.

The key for the fund is risk control. The managers seek returns across all different plausible sectors and return is not aligned to one particular view. Where volatility across the global sector is around 14% this fund is sitting at just 5%. Essentially the manager described the fund as dull because it looks to achieve 5% with as little risk as possible.

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For investors seeking long term returns above cash with exposure to equities this fund still remains a viable option.

We then moved onto one of the positive attributes to the fund. At the end of 2013 the markets predicted that emerging markets would continue to decline and developed markets would do well. The managers took a position to protect against the reverse. In fact although parts of emerging markets have struggled others have seen a rally against market expectations and developed markets have failed to deliver as expected. One trade which benefited from this was Mexican Government Bond vs the Euro.

A negative attribute to the fund is Japanese vs Korean Equities.

Korean Equities this year have been flat; the expected pick-up in PMI data has not come through and the Won is a headwind for equities. It has appreciated by 40% against the Japanese Yen and struggled against other currencies and this is holding back the markets.

Japan on the other hand has seen a pick-up in inflation, an increase in asset prices and consumers and corporates are positive on the outlook. Consumers are looking to spend money and for the first time in many years Tokyo has seen the sharpest increase in property values (up 10%). Corporate profits for the year ending March 2014 were up 75% and it is expected this will feed into greater corporate activity. The market is also significantly cheaper than both the US and European markets.

However, many have been disappointed by the lack of further stimulus to the market and there is a feeling that the market has overreacted. It is expected that this trade will reverse and become a positive attribute over the coming months.

Another trade which has worked well for them but is over a 3 year time frame is an investment in Oil Majors (placed in July 2011). At the time the 6 major oil stocks (Shell, Exxon, Chevron, BP, Total and ENI) were trading on 20 year lows. As a group their credit rating was AA with a yield of 3.9% growing by 2 to 3% a year.

They had to ensure these were not value traps and once it was clear they were not the strategy was added to the fund. This has been extremely rewarding to the fund at a time when only now is this sector starting to attract interest from investors.

Another strategy they have added to this year is US Equity Larger Cap Technology vs Small Cap. The argument behind the trade is that NASDAQ is 55% US and 45% overseas companies making it more global whereas the Russell Index is 90% US and more domestic focused.

Although bullish on the US economy the Small and Mid-Cap Sector tend to do better in Recovery Phases and as the cycle matures there is a move towards large cap. The view is that with the end of tapering and the increase in interest rates small cap will struggle and this strategy will benefit the fund over the next 12 to 18 months. If the US economy doesn't respond as strongly as the market expects then the Russell Index is likely to suffer the most and therefore the strategy will again benefit from this.

Although disappointing this year (i.e. flat returns) the manager was keen to emphasize the three year period and the importance of allowing strategies to work through. This provides an overview of a few strategies but the fund has a number of strategies that will work at different times. The fund struggled for a large part of 2013 and still returned around 7% for the year. Although the manager

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will not be drawn into whether it can deliver 5% this year strategies like Japan have the potential to turn around performance and if this happens it will benefit the fund.

## Fund performance

The table below shows performance since launch (28 January 2008):



	2008	2009	2010	2011	2012	2013	2014	Since Launch
Standard Life GARS Fund	-0.62%	19.39%	10.64%	2.88%	7.73%	7.00%	0.31%	7.39% p.a.
IMA OE Money Market	2.01%	0.95%	0.32%	0.03%	0.49%	0.23%	0.10%	0.66% 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 multitude of strategies mean that the fund can appear to be doing nothing however equities have been volatile this year delivering flat or negative returns for investors; this fund has continued to keep volatility low and delivered a small positive return for investors.

There is nothing from our meeting with the manager to suggest that the strategy has changed and that investors should be worried. But there are no guarantees and investors need to be aware of that and should not assume that asset values cannot fall.

*The source of information in this note has been provided by Standard Life and is correct as at May 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.*