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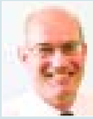

Rob Pemberton, HFM Columbus Investment Director delivers exclusive research on absolute return funds for The Times Money section, April 2015.

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The funds that can help you weather storms in the markets

Pensions 2015

If you want to protect a portion of your retirement cash then absolute return scheme could be the answer, advises **Mark Atherton**

The long-expected rise in UK interest rates from their current rock bottom levels looks set to happen in the next 12 months. When it does, it will pose problems for bond investors, because the fixed rates they are receiving will look progressively less attractive as the rates on ordinary deposit accounts start to climb.

Rob Pemberton , of HFM Columbus, the wealth manager, says cautious investors, such as those putting money into pension funds, will need to consider alternative starategies for preserving capital and eking out positive returns in a market where interest rates are rising and bond prices are falling.

He thinks those looking for a combination of wealth preservation, consistent returns and low volatility may increasingly start looking at absoluter return funds.

These funds seek to deliver positive returns year-in, year-out,regardless of the prevailing market conditions. The sector has suffered from something of a bad press in recent years as many of the funds included failed to deliver the promised positive returns year on year.

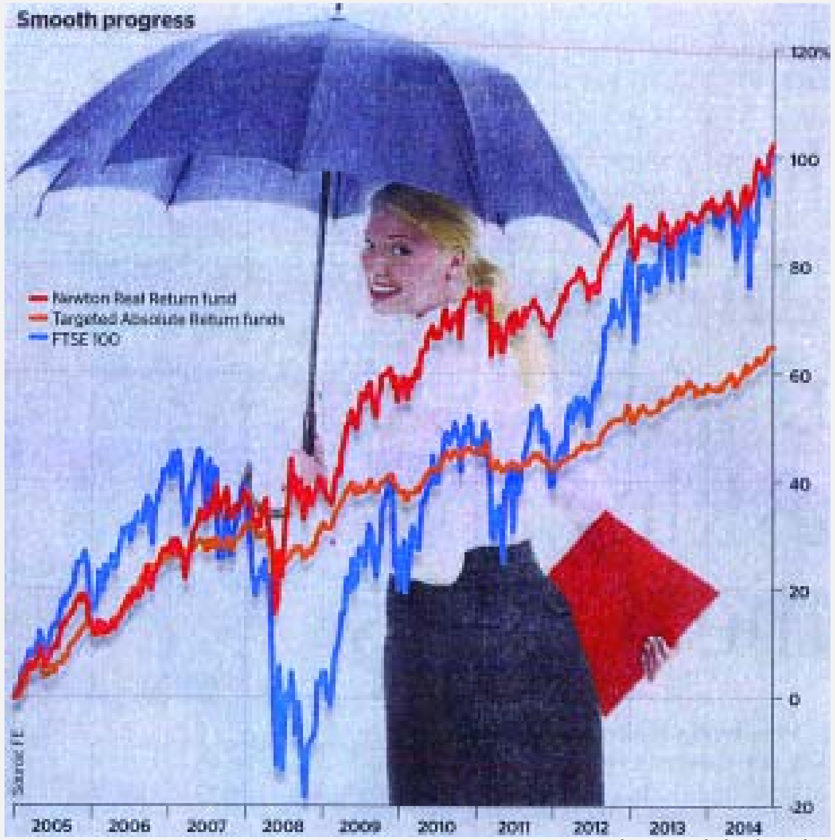
However, things now seem to be improving. In each of the past four years about 90 per cent of funds in the sector produced a positive return., though this year the figure dropped to 79 per cent.

We look at some of the different types of absolute return funds on offer.

Multi-asset funds

One way of delivering steady, if unspectacular, returns has been the multi-asset approach. This is where a fund manager blends together a variety of different assets, such as shares, bonds, property, cash, commodities and private equity. The aim is to achieve smoother returns, through a mix of assets, than could be achieved by focusing on any single one. Mr Pemberton says this traditional method, when carried out by the best exponents, has served investors well for many years. However, he says: { One of the main skills demonstrated by the managers of these funds has been adroitly switching between bonds and equities at the right time. Now that bonds have little upside potential and lots of downside this removes one side of their two-card-trick."

Just to complicate things, while some multi-asset funds appear in the absolute return sector, others are found under the categories of flexible investments and mixed investments.



> **These funds offer wealth preservation, consistent returns and low volatility**

Long/short equity funds

This is a strategy that combines the buying of favoured stocks (going long) and selling unatractiveones (going short). It can be used in all market conditions but is especially well suited to times when markets are flat or falling.

The focus here is on equities rather than bonds and the idea is that, by judicious stock selection, the fund manager can make money whether the markets are rising or falling. Two key things to measure in funds of this tpe are the gross exposure and the net exposure. Gross exposure is the total of both long and short positions added together. So if you have 70 per cent long exposure and 50 per cent short, then your total gross exposure is 120 per cent.

The net exposure is expressed as the long minus the short figure and in the above example would be 20 per cent (70 minus 50). This is the actual exposure to the stock market. This means that, if the market went up or down 10 per cent, the fund would basically go up or down by a fifth of that – 2 per cent in this case.

This means that the fund tends to produce more modest but smoother returns which is likely to suit cautious investors.

Best buys

If you want to tuck away an absolute return fund in your pension pot, Brian Dennehy says the only one he really feels comfortable recommending is Newton Real Return. "In many ways it is the least sophisticated of such funds, not being up to the gunwales in derivatives and vague strategies. However, it is one of the longest running such funds, and has a clear track record through a major downturn."

Rob Pemberton likes the Threadneedle UK Absolute Alpha fund and the Henderson UK Absolute Return fund. He says: "They are both long/short equity funds and have demonstrated the ability to both capture upside in in rising markets and to protect capital when the market is falling." For a higher risk global macro fund he suggests Natixis H20 MultiReturns fund which, he says, "has produced impressive returns over the past year".

Juliet Schooling Latter, of Chelsea Financial Services, goes for Henderson UK Absolute Return Fund and Premier Defensive Growth. She says: "The Henderson fund is a long/short fund that aims to deliver 10 per cent per annum in all market conditions. The manager looks to identify stocks that will either exceed of fall short of analysts' expectations, and construct a portfolio of both long and short positions. Unlike many of its sector peers, it has achieved its stated aim, which is to provide equity-like performance but with one third the volatility.

"The Premier fund invests in a portfolio of assets, such as shares, private equity and commercial property, that offer a predictable return over a defined period of time.

"The strategy has been thoroughly tested by a wide variety of market conditions and has continued to deliver. It is one of the few absolute return funds that have not disappointed investors."

Global macro funds

They use a variety of different strategies to make money for investors, often using financial instruments known as derivatives. The best known example is Standard Life's giant £24 billion Global Absolute Return Strategies fund. Mr Pemberton says: "These funds are the acceptable face of hedge fund investing. They employ much of the same methodology but instead of being offshore, unregulated, illiquid and expensive, they are FCA-regulated, onshore and have daily dealing like a normal unit trust."

Some strategies involve betting that a particular market or asset will rise or fall. Others are paired bets, where the manager will go long in one market and short in another similar one. For example, a manager might go long on the US dollar but short on the euro.

Going global is one option

Although these kinds of strategies may provide some sort of cushion against market falls, everything depends on the skill of the manager. If he or she makes a succession of wrong calls, then the losses can quickly mount up.

Other potential problems are cost and complexity. Some funds adopt the same sort of pricing structure as hedge funds with a high annual charge of up to 2 per cent and a performance fee which can be as high as 20 per cent.

Brian Dennehty, of Fundexpert, the financial website, says; "Some absolute return funds are much riskier or more complicated than others. It's essential that you that you take a look under the bonnet and find out exactly what type of fund you are buying. Performance in the sector may have improved but it is still very mixed, Some funds are just treading water while others, such as the Cf Odey Absolute Return fund, have produced spectacular returns in some years and then losses in others.

"I happen to think that the odey fund is a good fund – but it is in the wrong sector. I think that neither it, nor the funds that tread water, represent what absolute return funds are supposed to do."

He adds: "I worry that some advisers have given up on selecting more focused individual funds and are istead directing clients into this sector as a way of outsourcing the task of investment selection."