

Mark Selby talks to Simon Chinnery and Olivia Mayell of JPMorgan Asset Management about absolute return funds and their role in the current economical climate

# A time to be flexible

## How do you define absolute returns?

**SIMON CHINNERY:** I suppose the main thing in an absolute return strategy is that, given that the funds can do as much as they like to achieve a positive return, they are generally measured against cash.

Occasionally they do give a negative return against cash, and then you get angry headlines in lots of papers, but the argument that has always been employed is that because they have this very wide spectrum, they have got great flexibility. They are unconstrained; they can move between strategies and therefore can move out of a strategy that is likely to give a negative return.

**OLIVIA MAYELL:** One key point is the time horizon of the expectation of returns. For an absolute return fund there is an expectation that the return might be very steady, with limited periods of loss, and that over a 12-month period you should probably expect the fund to achieve its objectives.

I think that for some of the more liquid options, the more conventional funds you might see or style of management that might sit in a total return packet, the time horizon may be slightly different – typically you are looking at three years rather than one.

A lot of the hedge funds have been around for a very long time, portfolios have been very flexible for a very long time, but popularity has increased dramatically in the last five years.

## What role can absolute returns play in the current economical climate?

**OM:** We had a lot of conversations with investors and clients at the beginning of last year when people were saying, “Well if I move into this I might get less volatility – it may be a smoother profile for our return rate, but I am going to give up all this gross from the equity market. Why would I want to do that now?”

Whereas today everybody has been reminded what risk is – that a portfolio does not just need to be constructed to get the highest return possible, but

that actually the prospect of being able to weather some of the storms is far more appealing to the overall portfolio.

And in that context an absolute return fund or total return fund has an awful lot more relevance to every type of investor, because they are no longer thinking about chasing that last return, they are thinking more about the potential for loss. That is where absolute returns become particularly relevant.

## What types of investments are suitable for absolute returns?

**OM:** You would expect to see more use of derivatives and a wider variety of asset classes – not just equity and bonds but also convertibles or currency. I think it is about having breadth in the investments that you take and flexibility in how you use them – so very little rigidity. If the fund manager feels that certain areas of investment in the fund are not going to be rewarding they can be effectively switched off.

The market is currently in a position where it is looking for a real return or a return that is more consistent and less reliant on just what the equity market is doing – particularly when people are concerned about their liabilities.

## What is the distinction between a total return fund and an absolute return fund?

**OM:** For a lot of people absolute returns equal hedge funds, which means low-scale management and a lack of liquidity. Our total return fund bridges the central area between more traditional funds that have been available for many years and some of the more flexible, appealing funds available from some of the smaller shops.

We think institutional planners want the breadth, security and transparency of working with the big managers they have always been invested with, but they also want to move away from some of the benchmarks and constraints. The total return fund sits in the middle. It brings the best of what you get with absolute returns



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JPMAM**

but in a way that is transparent, more easily intuitive to investors.

## What is the current perception of absolute returns in the industry?

**SC:** I think with the majority of medium-sized schemes there is now a positive and realistic view of fund of hedge funds. Management is now carried out by large asset managers with lots of resource and the ability to really achieve due diligence on the underlying strategies, so I think there is far less of the histrionics of a number of years ago.

The accepted view is that diversification benefits can be achieved through fund of hedge funds, and the return expectations are far more realistic as well. In these kinds of markets – particularly following what happened last year – investors are now getting that message loud and clear.

We carried out an alternatives survey around a year ago and found that the most popular next switch for pension funds was expected in the fund of hedge funds arena. So the allocation was expected to double. Now, we are definitely seeing a significant increase in actual pitches and mandates for fund of hedge funds, so I think people are seeing the theory in practice.