

**INVESTMENT STRATEGIES**

# Client requirements and the need to innovate

Absolute return is now seen as a core investment. Credit Suisse's asset management business explain how a wide range of absolute return strategies is necessary to cover as many portfolios as possible, regardless of risk budget

**A**bsolute return strategies encompass a broad range of alpha-generating opportunities that make efficient use of available risk to deliver attractive, diversified returns. The rapid growth of this particular fund group in recent years has seen it being increasingly viewed as a core investment, with growing numbers of investors adding absolute return products to their portfolio to generate more consistent positive returns and further improve diversification.

With these developments driven by an ever-changing economic and social landscape, a continuous, evolving product line with new and innovative investment strategies is needed to deliver the solutions sought by investors. Today's investors require, therefore, an asset manager who fully understands their needs and can develop new investment ideas that meet their requirements and expectations.

We believe that a key element of offering absolute return products is that they should deliver the following benefits to investors:

- they can exhibit a low correlation with traditional asset classes, providing additional opportunities to generate alpha while further improving diversification
- they have the potential to generate diversified forms of alpha and can create positive returns irrespective of market conditions
- they provide a high degree of flexibility, with investment strategies not bound to conventional

benchmarks and with some strategies offering a low-volatility solution that can be beneficial to an investor's portfolio

- they incorporate dedicated risk management systems to ensure risk is controlled.

Investors need asset managers who not only understand their needs, but also possess the capability to develop and manage new investment ideas. While much of the attention accorded to uncorrelated alpha and actively managed risk is relatively recent, we have been researching these disciplines for more than a decade. Our experience has taught us that the effectiveness of these strategies is closely linked to a manager's ability to consistently add value across a range of market conditions. As well as the skills of the individuals who are involved, the quality and depth of research and risk management will also play a critical role.

**RISK CONTROL IS KEY IN ABSOLUTE RETURN**

A successful absolute return strategy that generates positive returns for a portfolio over a full market cycle typically invests in a range of equity, fixed income and alternative investment asset classes by taking advantage of the low correlations that exist between them. In doing so, investors can benefit from a strategic and optimal allocation to a wider range of asset classes for a relatively modest risk budget.

The introduction of an

expanding range of more complex instruments, each with its own individual risk characteristics, requires robust risk management systems capable of capturing the risk profile of both traditional and more sophisticated securities contained within the portfolio. In developing absolute return strategies, we focus on ensuring there is in-depth knowledge of these new instruments as well as the expertise to understand and control the risks therein.

By incorporating dedicated risk management systems into the investment process, different asset classes can be included into a single portfolio not only for their potential risk premium, but also for their ability to offset downside risk in the portfolio as a whole. Investors can thereby benefit from maximising potential positive alpha generation within strict risk parameters.

**ALTERNATIVE SOURCES OF ALPHA**

We set out a number of innovative absolute return strategies that we believe have the potential to generate alternative forms of alpha as well as providing diversification benefits. Each strategy offers unique performance and risk characteristics that make them suitable for inclusion in a wide range of portfolios with different risk budgets.

**TOTAL PERFORMANCE STRATEGY**

The Total Performance strategy is

an absolute return strategy to generate a positive performance in virtually all market environments while focusing on capital preservation. The strategy has the potential to outperform money market investments with only slightly higher risk. Using derivatives such as swaps, interest rate risk can be reduced so that a higher yield can be generated by investing in longer-term bonds without the associated level of sensitivity to changes in interest rates.

This strategy is primarily of interest to investors who are looking to invest their liquid funds over the short to medium term, while conservative investors looking for a positive yield over the medium term can also profit from this strategy.

#### TARGET RETURN STRATEGY

Target Return is an innovative absolute return strategy capable of preserving capital with the potential to deliver an attractive positive return over a full market cycle. By focusing on changes in volatility patterns between fixed income, equities and convertibles, a wide range of fixed income asset types are blended to ensure optimal asset allocation.

With preservation of capital key, a dedicated risk management tool developed especially for the Target Return strategy is central to the success of an investment strategy that takes a top-down approach to mixing traditional and specialised asset classes.

#### ACTIVE CURRENCY MANAGEMENT STRATEGY

Returns and volatility of globally-invested portfolios come from two sources: performance of the underlying assets and fluctuations in local currencies relative to the investor's home currency. A range of strategies is now available to help manage the currency element, from currency overlay to manage risk more effectively, to absolute

## "A CONTINUOUS, EVOLVING PRODUCT LINE IS NEEDED TO DELIVER THE SOLUTIONS SOUGHT BY INVESTORS"

return currency alpha strategies that can be leveraged to enhance returns. The decision-making process incorporates a blend of fundamental and behavioural factors together with a proprietary quantitative model to ensure an optimal asset allocation. This strategy holds a diversification benefit for investors as well as the potential for positive returns across all market conditions.

#### TOTAL RETURN GLOBAL STRATEGY

The Total Return Global strategy adopts a flexible approach to investing in equities to generate positive returns regardless of the prevailing market conditions. The strategy exploits market opportunities by assuming extreme portfolio positions in a wide range of asset classes while taking into account preservation of capital and ensuring volatility remains low. Asset allocation occurs between low-cost futures on equity and fixed income indexes, as well as exchange traded funds, money market and currency overlay instruments to ensure the overall strategy suits the ever-changing investment environment.

#### TOTAL RETURN ASIA PACIFIC STRATEGY

To take advantage of the long-term potential of this region, the Total Return Asia Pacific strategy invests in equities and bonds across the Asia Pacific region. A combination of top-down and bottom-up investment ideas are used to capture

the upside during any market environment. Total flexibility is achieved through asset allocation to achieve a total return through investments in both bonds and equities without limits on either asset class.

#### ENGINEERED TOTAL RETURN STRATEGY

Financial instruments such as credit and interest rate derivatives have revolutionised the market for fixed income securities, and recent regulatory advances now provide private investors with the opportunity to profit from these developments. Using derivative instruments the Engineered Total Return strategy is able to control these three risk elements of interest rate, credit and currency independently of one another through holding either long or short positions. As these positions are unfunded, an opportunity exists to generate additional uncorrelated returns through a portable alpha equity index arbitrage strategy that actively exploits the inefficiencies that regularly arise when the composition of an equity index changes. All the systematic equity risk is hedged away leaving only a systematic excess return.

#### DIVERSIFIED GROWTH STRATEGY

Recent accounting and regulatory changes in the UK have encouraged institutions, pension plan sponsors and trustees to focus their attention on LDI solutions as well as gaining exposure to alternative asset classes other than equities. This need to capture high sustainable returns within risk limits, as well as to achieve adequate diversification, requires a dynamic approach to active portfolio management.

The Diversified Growth strategy uses growth assets with low correlation and can be used either as a standalone investment or as part of a wider LDI programme. Growth assets include equities,



emerging market bonds, commodities, property, private equity and hedge funds together with a currency overlay. With a focus on intelligent allocation of risk and optimal diversification, the strategy has clear attractions for Defined Benefit schemes and may also be suitable as a 'lifestyle' option for Defined Contribution schemes.

**PROPERTY DYNAMIC STRATEGY**

The Property Dynamic strategy targets a long-term absolute return of between six and eight per cent a year from a balance of stable, income-orientated properties and more dynamic, opportunistic components with prospects for capital gain: interchangeable property

**THE DIVERSIFIED GROWTH STRATEGY CAN BE USED AS A STANDALONE INVESTMENT OR AS PART OF AN LDI PROGRAMME**

types, such as offices or shopping centres. Dynamic components, on the other hand, capture different market cycles in various locations and countries and wider usage ranges (such as hotels and multi-storey car parks). Overall portfolio diversification is achieved through a mix of property characteristics

such as location, type of use, market cycles, life cycles and market maturity. This strategy will suit investors seeking an actively managed mix of income and capital gain.

These strategies demonstrate the diverse range of approaches that can be taken to generate absolute returns for investors. They reflect the increasingly complex range of solutions sought by investors, as well as the innovation that is required. An understanding of client needs as well as risk control is vital. By offering this, we believe we can offer clients the maximum benefit from potential positive alpha generation within strict risk parameters, making absolute return strategies a key offering for today's investors.



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