# ING INVESTMENT MANAGEMENT'S TARGET RETURN RESPONDING FLEXIBLY TO MARKET CONDITIONS

**Interest rates have remained very low for many years. Investors were able to achieve good returns when rates declined, but what should they do now? Will rates continue to decline, or will they rise? Many investors want to invest in fixed income, no matter what the prevailing market conditions. ING Investment Management's new Target Return Fixed Income Strategy can provide a fitting solution**

Within the Target Return Fixed Income Strategy the manager is not bound by a benchmark. The manager has the flexibility to select those bonds which he expects to contribute positively to the return. Nowadays, these opportunities are many and varied. The manager may invest in, among other things, government bonds, corporate bonds (credits), high yield bonds, emerging markets debt instruments, asset backed securities and senior bank loans (loans which are paid back first in the event of bankruptcy). All these types of bonds respond differently to market conditions. As a result, the target return strategy manager is able to select those bonds with the best prospects in each market climate. Furthermore, the investment policy is so flexible that the manager can cover the interest rate risk if he expects it to rise. Even in the event of an interest rate rise, the strategy can still offer a positive return.

## FOCUS ON POSITIVE RETURN WHATEVER THE MARKET CONDITIONS

The Target Return Strategy aims to achieve a positive return whatever the market conditions. The strategy aims for an annual return which is 3.5 per cent points higher than the current money market interest rate. At the same time, opportunities for a higher return remain. The strategy also offers protection by means of an innovative and advanced risk policy. This risk policy aims to restrict any negative return to 4 per cent points below the money market interest rate on an annual basis.

## TRADITIONAL INVESTMENT STRATEGIES: BENCHMARK AS STARTING PRINCIPLE

The Target Return Strategy has a different investment policy from traditional bond strategies. Traditional strategies often apply a benchmark. A benchmark reflects the progress of market prices. The objective of traditional strategies is to offer a higher return than the benchmark. As a consequence, these strategies often largely invest in bonds which are also included in the benchmark.

By investing additionally in those bonds with the best prospects, and less in those bonds with the poorest prospects, traditional bond strategy managers attempt to achieve additional return against the benchmark. Ultimately, however, these funds largely follow the market, even if it is negative.

## ADVANTAGES OF THE TARGET RETURN FIXED INCOME STRATEGY

The manager does not apply a benchmark. The strategy therefore does not invest as standard in specific types of bonds. The manager only selects those bonds which he expects to contribute positively to the return.

The strategy can take advantage of any opportunities provided by today's bond markets around the world. And there are many opportunities to choose from. This includes attractive new types of bonds such as senior bank loans. The Target Return Strategy has a different type of risk profile from traditional bond strategies. As the strategy aims for a positive return whatever the market conditions, there is less movement in line with the general bond market. There is therefore more emphasis on specific choices (known as alpha) and less emphasis on general market risk (known as beta). Consequently, this strategy offers increased diversification within fixed income portfolios. As mentioned before, the strategy aims for an annual return of 3.5 per cent points above the money market interest rate. In addition, the ambition is to restrict any negative return to 4 per cent points below the money market interest rate on an annual basis. This is, however, not a guarantee. The satisfaction of a certain gain is lower than the pain of an equal loss: the strategy has a lower probability of an equal positive return.

The strategy invests in all existing types of bonds. In doing so, the managers use the expertise and experience of the fixed income teams within ING Investment Management. These teams have displayed excellent results over the past few years in emerging market debt, European corporate bonds, asset backed securities and senior bank loans.

The manager possesses a great deal of freedom in selecting those bonds which he expects to contribute positively to the return. Achieving the target return therefore depends strongly on the right choices being made by the manager. As a result, it is possible for the strategy to achieve a lower annual return than the target return of 3.5 percentage points above the money market interest rate.

## WHEN DOES THE MANAGER CHOOSE WHICH BONDS?

The Target Return Strategy manager has the flexibility to select only those bonds which he expects to contribute positively to the return. The different types of bonds all have their own characteristics. They all respond differently to market conditions. Consequently, over time their returns will vary in comparison to each other.

**When does the manager choose bonds?**

| Bond category | The manager will choose in the event that... |
|---|---|
| Money Market | ...the bond market as a whole performs poorly and he expects the interest rate to rise. |
| Government Bonds | ...interest rates are expected to decline. |
| Asset Backed Securities | ...the general economic climate is favourable and private households are financially sound. |
| Corporate Bonds | ...companies display sound earnings growth and there is limited demand for financing. |
| Senior Bank Loans | ...companies display sound earnings growth within a sound economic climate or he expects interest rates to rise. |
| High Yield Corporate Bonds | ...the prospects for the economy are favourable and the number of bankruptcies is low. |
| Emerging Markets Bonds | ...there is an upswing in the economic growth of emerging markets and their government finances are sound. |

*Source: ING Investment Management*

## TARGET RETURN STRATEGY INVESTMENT PROCESS

The expertise of ING Investment Management's fixed income investment specialists is used as input. These specialists are organised in globally-operating teams which are experts on each specific sector of the bond markets. This specialisation ensures a strong focus on finding the best opportunities in each market. The local presence of ING's investment specialists in major markets ensures high added value.

**The Target Return Strategy's investment process comprises four steps.**

## STEP 1: SELECTION OF BEST INVESTMENT IDEAS

In the first step, the specialist teams shortlist their best investment ideas. The manager analyses these using four quantitative and qualitative criteria:

- **Conviction:** how strong is the team's conviction about the idea?
- **Correlation and contingency:** is there correlation between the idea and other proposed ideas?
- **Horizon:** when will the idea result in a positive return? In the short, medium or long term?
- **Liquidity:** how liquid is the fixed income security? Can it easily be resold?

## STEP 2: PORTFOLIO CONSTRUCTION WITH OPTIMUM DIVERSIFICATION

The manager determines the weighting of the best investment ideas when included in the portfolio. He is supported in this by an advanced portfolio construction model which calculates how the investment ideas interact within the portfolio. This model measures the correlation between the best ideas in order to create the optimum balance between risk and return. This step ensures that too high concentrations of positions are avoided.

## STEP 3: ASYMMETRICAL RISK MANAGEMENT

A unique – dynamic – risk management model has been developed with the objective of applying asymmetry between the risks of profit and loss. The risk of a loss of 4 per cent points or more against the money market interest rate is restricted. The opportunity for a return of more than 3.5 per cent points above the money market interest rate is explicitly left open. These risks apply to each random period of one year. This asymmetry is achieved by reducing the risk run by the fund during periods of disappointing returns. If the investment return is good, more will be invested in riskier bonds.

In addition to this innovative risk management model, other risk management techniques are also applied. The objective of these is, among other things, to keep in check the market, credit and liquidity risks.

## STEP 4: IMPLEMENTATION AND CONTINUOUS MONITORING

At an order from the manager, the portfolio is implemented by the specialist trading desks. Their task is to search for optimum tradeability and the best prices on the market and to provide feedback on the technical situation on the market.

*The ING Target Return Bond strategy offers access to the best investment ideas of ING IM's fixed income specialist teams. The strategy aims for positive performance in any market situation, including rising interest rates, while the downside risk is limited.*

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