

Resist peer grouping

Feedback

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Further to the article on diversified growth funds (DGFs) (September 27 FTfm), and in relation to the PiRho DGF report to which the article refers, we at Newton echo PiRho's caution about comparing total return funds as a peer group. In Newton Real Return, we manage one of the most established and successful strategies of its kind, so would benefit from peer group comparisons, but our strength of view is such that we argue peer grouping should be resisted by interested parties.

Total return funds are indeed a disparate set of strategies. Although they share a common thread, an "upward-only" objective, they go about achieving their objective in different ways. The nature of these funds suggests potential investment in a wide range of investment types and the more varied the investment types, whether traditional or alternative, the greater the potential for variance in performance between strategies. Add in the broad spectrum of derivative use – from no such use, to simple downside protection, to

embedded leverage and contingent liabilities – and the vast range of performance outcomes is clear. One only needs to look at the extreme conditions of 2008 to see the disparity of returns that can ensue between strategies.

In considering the evolution of such funds, lessons should be learned from the unravelling of the balanced fund industry and the increased focus on specialisation that occurred during the last decade. These trends can be traced back to criticism of the "herding" instinct, by which managers commit the cardinal sin of watching each other to the detriment of a focus on investment opportunities and risks that lie ahead. The irony, of course, is that many balanced funds started life seeking pertinent objectives (such as to outperform wage/price inflation), and it was only the advent of peer group analysis that fuelled this herd instinct.

Through their varied approaches, managers of total return funds in the UK are trying to bring much needed perspective back to the pensions industry by refocusing on upward-only targets that are commensurate with UK pension funds' long-term

requirements. In order to safeguard this perspective, the temptation to make peer group comparisons or to "pigeon-hole" particular strategies should be resisted.

Instead, each strategy should be assessed in relation to its own risk-adjusted return objectives, and against any other long-term measures that are discussed and agreed between the parties involved in a mandate.

A distinct mindset is required to enable asset managers to succeed in their pursuit of total return solutions. Managers, clients and their advisers need to adopt this mindset through close collaboration. Simply put, there should never be "regret risk" of selecting one fund over another if your chosen fund is meeting its long-term objective. It is our contention that, were the pensions/investment industry to slip down the abyss of over-analysing short-term performance and peer grouping these types of approaches, the impact would eventually be to obscure the very perspective it is trying to find.

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