Insight INVESTMENT

An innovative approach to running multi-manager funds

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"*Innovation is the central issue in economic prosperity.*" As Michael Porter's words suggest, the solution to a difficult situation often comes through innovation. Given the combination of low growth and high levels of indebtedness in the western world, investors are understandably nervous about the economic outlook. Furthermore, the low yields available on cash and bonds provide a challenge for those investors looking to generate an attractive return without taking on undue levels of risk.

Looking for return without significant drawdown risk

At Insight, we believe that by taking an innovative approach to investment we can create offerings which better suit our clients' needs. Regarding equity market exposure, our Diversified Target Return Fund employs a multi-manager strategy which differs significantly from that of our competitors and one which aims to deliver attractive positive returns on a 12-month rolling basis, without exposing investors to the risk of a significant drawdown of their capital.

The traditional approaches

While most multi-managers justifiably have the foundations of their approach built around research of the best funds and fund managers, the approaches differ in the way that exposure to these top managers is provided. There are essentially two main strategies which multi-managers employ. The first approach simply involves buying and holding a basket of long-only funds of chosen managers, with a long-term view taken on all positions. The second is a more active approach which involves rotating between chosen managers in an attempt to have exposure to funds only at the points in the business cycle when conditions are most conducive to a particular stock-picking approach; the logic therefore being that manager performance should only be accessed when it is at its best.

How Insight views these approaches

In Insight's view both of these approaches have potential shortcomings from the client's perspective. While manager due diligence is clearly important, investors should remember that it is only one component of the strategy. Research of this kind by definition can only help to identify whether a manager has the potential to outperform the index and not how the underlying market is likely to perform. While buying and holding managers who consistently outperform can be successful in the long run, this approach still leaves clients exposed to the direction of the underlying equity market. If, for instance, the market falls and an active fund falls less than the market, the manager has outperformed and therefore achieved their goal, yet the client has still lost money. As a result, clients' interests are not always aligned with those of an active fund manager. Regarding the second approach, it is crucial to remember that taking a view on which manager performs well at what point of the cycle by its nature involves trying to time the markets. Timing the market is extremely difficult and therefore difficult to repeat consistently. If a multi-manager must take a view on market direction, then there are cheaper ways to reflect that view such as buying market and sector Exchange Traded Funds.

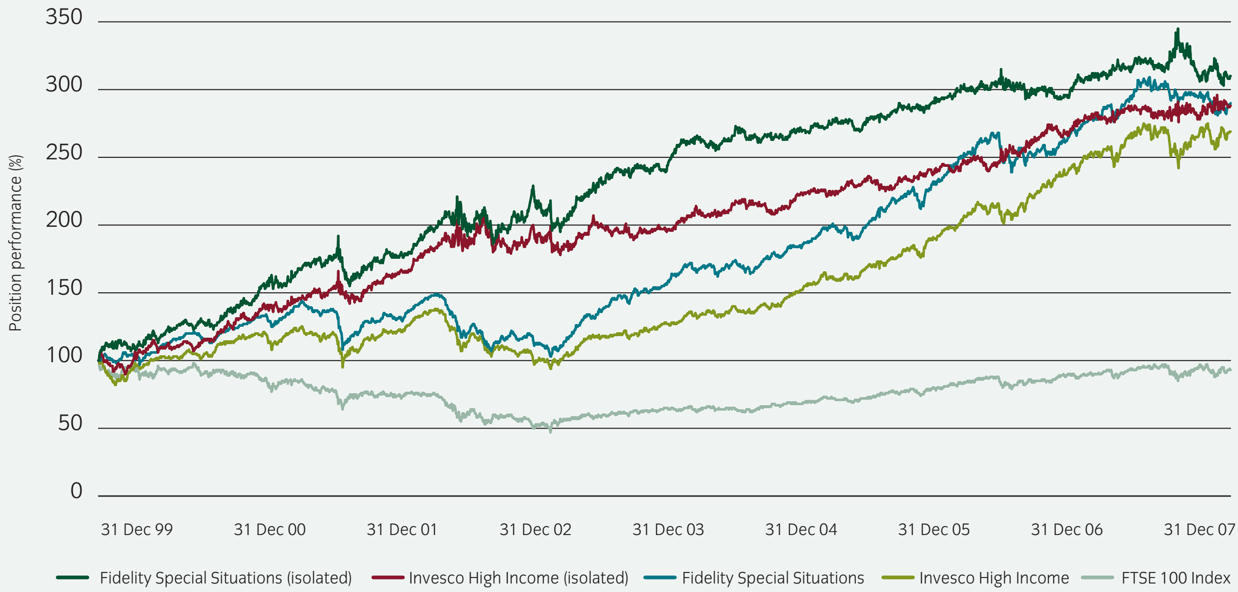
Insight's approach

Once a manager capable of outperforming is identified, Insight believes it is very important to consider how best to gain exposure to that manager. We choose to invest in a selection of funds, each taking a different approach to diversify manager risk, while hedging out an equal amount of the respective equity market index by going short the market futures. This creates a position where our clients stand to benefit from manager outperformance regardless of the underlying equity market moves. We refer to this approach as an isolated equity approach and are convinced of its merits given our belief that it is easier to select an outperforming manager than it is to forecast future equity market direction. The advantage of this being that it enables clients to benefit from the consistent outperformance of top-performing managers without taking on the drawdown risk of the underlying market. This is an approach that Insight believes very few other managers offer.

How would this approach have performed?

As an example, let us look at the performance of the funds of top performing managers Anthony Bolton (Fidelity) and Neil Woodford (Invesco)[1]. Choosing the seven-year period from the start of the decade to the end of Bolton's tenure gives us the period of 31 December 1999 to 31 December 2007, as shown in Chart 1. For reference, it is worth noting that both of these managers had long tenures of consistent outperformance prior to the period under review and as such had demonstrated strong, repeatable stockpicking abilities. This chosen period is also a good one to highlight, as it includes a variety of extreme market conditions including the end of the tech boom, the subsequent global recession, the terrorist attacks of 11 September 2001 and the strong 2003 to 2007 market recovery.

Chart 1: Illustrating Isolated equity performance



Past performance is not a guide to future performance.

Source: Datastream.

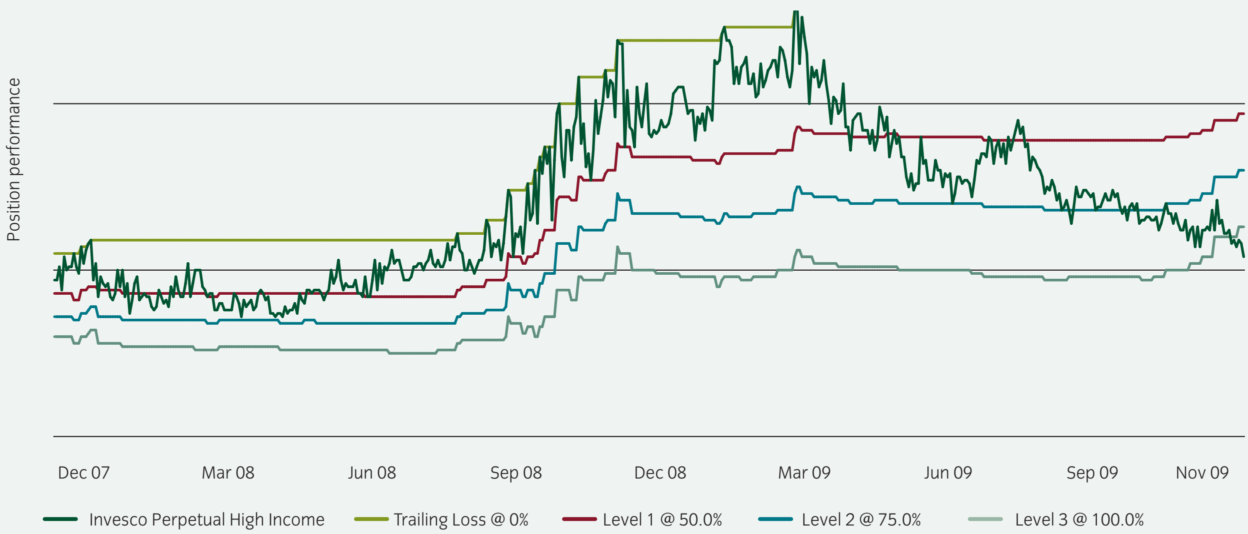
The results are enlightening, with the performance on the isolated equity positions providing very similar overall returns to what would have been achieved by holding the funds long only but with significantly lower volatility. Furthermore, unlike the active funds, the isolated positions would have generated positive returns in every calendar year and a maximum drawdown of around 10% compared to over 40% from the underlying market and 30% from the active funds.

[1]Example for illustrative purposes only. Please note that the Invesco Perpetual and the Fidelity funds were not held by Insight during this period.

What would have happened during the recent recession?

The Invesco Perpetual High Income fund saw strong outperformance during 2008 as markets fell, meaning that an isolated equity position would have continued to generate strong positive returns during this time[2]. Although the fund subsequently underperformed in the rally of 2009 our stop loss levels would have been used to reduce position size and limit losses to our portfolio. Once the position falls below level one, 50% of the position is removed, 75% at level two and 100% at level three, as shown in Chart 2.

Chart 2: Using stop loss levels to monitor performance



Past performance is not a guide to future performance.

Source: Insight and Bloomberg.

In line with Insight's innovative approach to investment, our team strongly believe in the merits of their multi-asset and multi-manager approach to targeting active equity exposure in the Insight Diversified Target Return Fund. Insight believes that if selected active managers can demonstrate an ability to outperform the market consistently, this outperformance can be captured by isolating the active component of their funds. However, past performance is not a guide to future performance.

In this way our Fund can offer exposure to top-performing mangers while aiming to deliver positive absolute returns regardless of the prevailing markets conditions; meaning that fund manager interests are closely aligned with those of our clients.

The value of investments and any income from them will fluctuate and is not guaranteed (this may be partly due to exchange rate fluctuations). Investors may not get back the full amount invested.

For more information on our Diversified Target Return Fund, including the prospectus and simplified prospectus, or any of our other multi-asset solutions please visit **www.insightinvestment.com** or contact us on the numbers overleaf.

[2]Although the Fidelity fund continued to outperform throughout the great recession, the position would most likely have been sold in line with our risk parameters following Bolton's departure at the end of 2007.

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