

Aberdeen Core Plus Fund

Aberdeen Asset Management breaks the mould in fixed income investing through a fund that aims for solid alpha in a strategy that already boasts a huge following overseas. MICHELLE BALTAZAR writes.

Fixed income has never looked this good. Think of Aberdeen's new fixed income fund, the Aberdeen Core Plus, as a car with the safety record of a Volvo and the turbo charge of a Ferrari. It will appeal to investors who are cautious but demand more alpha than a traditional core Australian fixed income fund could offer.

Aberdeen Core Plus invests mainly in Australian bonds, the "core", but aims for extra alpha, the "plus", through a multi-tiered strategy that involves global fixed income and derivatives. In short, it is a fund with the domestic and international fixed income portfolios under one umbrella with the investor leaving the asset allocation decision to the fund manager.

But this escalator pitch belies all the work that happens under the bonnet to make sure investors get what they want, plus more.

Optimise, overlay, outperform

Instead of a single trump card to underpin its alpha returns, Aberdeen Core Plus has several.

First, there's the group's optimisation strategy. "One thing we spent a lot of time doing is looking at our optimisation, of how much we should allocate to each of our asset classes: Australian bonds, global bonds, emerging markets, high yield," said Leanne

Bradley, Aberdeen's fixed income specialist and product manager.

"We go through quite a rigorous process analysing historical returns versus forecasted returns, the tracking errors, the nature of these asset classes and how they correlate," she said.

Then there's Aberdeen's investment strategy to separate duration management from stock selection. "One thing that differentiates us from a lot of our global peers is that in our global credit portfolio we neutralise the duration so there's no directional exposure there. That's all covered by the interest rate overlay strategy."

Aberdeen's two-fold overlay strategy, one in global interest rates and another in currency, is perhaps one of its more potent tools, particularly in the current climate.

"We have two separate dedicated teams (interest rate and currency). We only allocate 3 per cent of the Fund's cash to them but they should provide alpha of around 50 to 60 basis points of the total 150 basis points the Fund aims to deliver," said Bradley.

"It doesn't matter where we're at in the economic cycle or where we're at in the credit cycle, they should produce that consistent level of return."



The idea worked in theory and practice. "There's proof in the pudding that it worked because up until April, when the credit markets were not delivering returns, the overlay part of the portfolio still produced a decent level of return," said Bradley.

Proven template, specialist teams

Juggling multiple fixed income assets and coordinating that with a sophisticated overlay strategy may sound like a lot of hard work but the secret is that Aberdeen didn't have to start from scratch. The local arm may have just launched Core Plus in Australia but the strategy has been around for 10 years, winning mandates in the US, Europe and the UK.

"We spent quite a lot of time selecting the underlying components and to some degree we already had the template from overseas so it wasn't exactly uncharted waters for us," said Bill Bovingdon, Aberdeen's chief executive and head of Australian fixed income.

"We knew what we needed to do and we knew what infrastructure we needed because obviously there's a lot of moving parts and you need a good risk management structure to support your fund managers so I guess it was easier for us to bring this to market at a reasonable cost," he added.

Central to Aberdeen's 10 year track record in core plus globally is a series of dedicated teams. For

example, Aberdeen has separate teams to cover regional fixed income and sectors, macroeconomic sectors, portfolio selection, trade execution, quantitative analysis and derivatives.

Bradley said it is this multi-structure with each team working independently of each other that is partly behind the Fund's success. "Our other competitors might create a Core Plus fund where they don't have a track record in certain asset classes. For example there are lots of global managers who don't have a dedicated capability in Australia."

She continued, "Whereas we're probably one of the few managers that have a very strong domestic capability and a global one."

It's also the strength in dedicated portfolio construction resources that enables the Fund to regularly monitor their weighting in each asset class. "So our Fund doesn't just give you a static weighting, it also gives you ranges to manage within through different parts of the economic cycle," said Bradley.

"You can be completely out of or overweight in a particular asset class - which a lot of our peers don't do as they have static weightings."

No more credit crunch blues

The Fund's aim is to deliver in excess of 1.5 per cent per year above its benchmark, the UBS Composite Bond Index, over roll-

ing three-year periods. Bovingdon said this target is ideal in the current market and is not based on overly engineered and therefore unsustainable yield.

The key is that in a world where bond managers are starting to treat their portfolios as if they were another growth asset, Aberdeen Core Plus retains the defensive characteristics of a locally benchmarked portfolio.

"We think that's the kind of thing that's been overlooked in such buoyant financial markets over the last 10 to 15 years. There's been a real search for yield in fixed income and the tendency has been to look for assets that provide yield and using them interchangeably with fixed income. But we think there's a real danger in that because a lot of those assets don't have the defensive characteristics that you'd get from owning traditional Australian bonds," said Bovingdon.

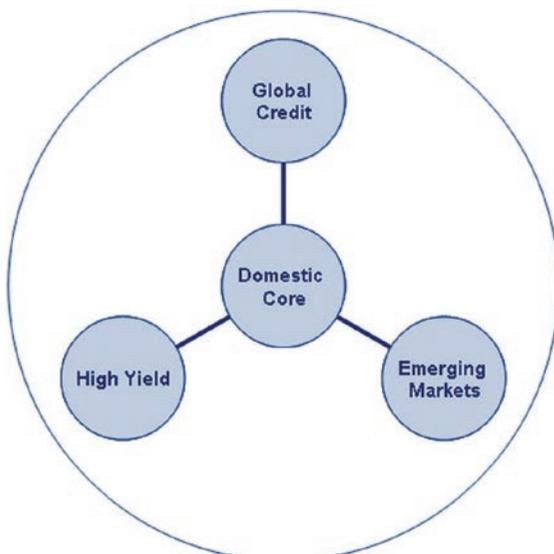
He continued, "So we started with that premise, that it was really important to have the underlying benchmark as a traditional Australian bond portfolio that can benefit from falling interest rates and that would give you your direct offset against Australian equity."

But at the same time, that product has to perform well in both growth and recessionary environments. "It was also important for us that the product wasn't too dependent on high yield, hybrids and emerging markets, all of which correlate with equities in market downturns so that was the starting point - to be less dependent on credit markets."

In a nutshell, Aberdeen Core Plus uses various strategies which are optimised to meet its above-average return targets while giving local investors the peace of mind that the Fund's benchmark is local and therefore counter balances the risk/return profile of their corresponding shares portfolio.

"It's a fund that is very responsive to what's going on in the market and makes sure that the returns cycle of the product - while being high - is still smooth. It's fixed income so at the end of the day, investors don't want too much of a bumpy ride." ■

Interest Rate overlay



Currency overlay