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## The Search for Diversity – Innovation in Irish Balanced Funds

Stephen Ryan

# Diversity and Innovation

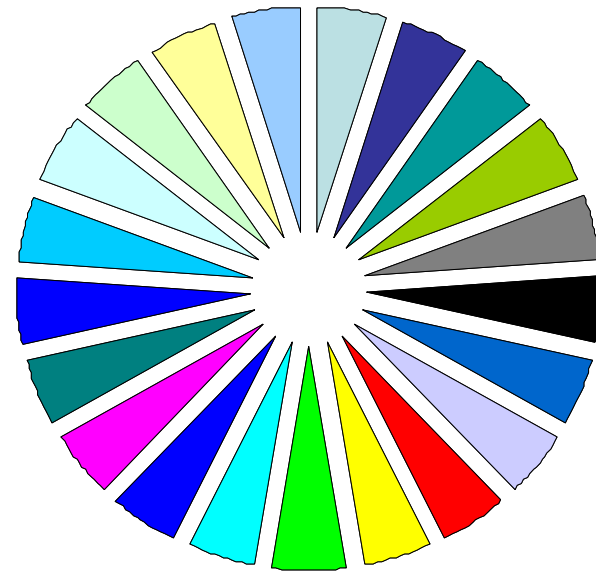
Key drivers:

- Greater breadth of asset classes including alternatives
- Growing importance of Defined Contribution
- Funds and investment ideas spreading more rapidly
- The liquidity conundrum

# Asset Allocation – Wider Opportunity Set



**2002**



**2010**

# Breadth of Asset Classes

## TRADITIONAL ASSETS

Large cap equity  
Small cap equity  
Emerging market equity  
Domestic property  
Investment grade bonds  
Cash

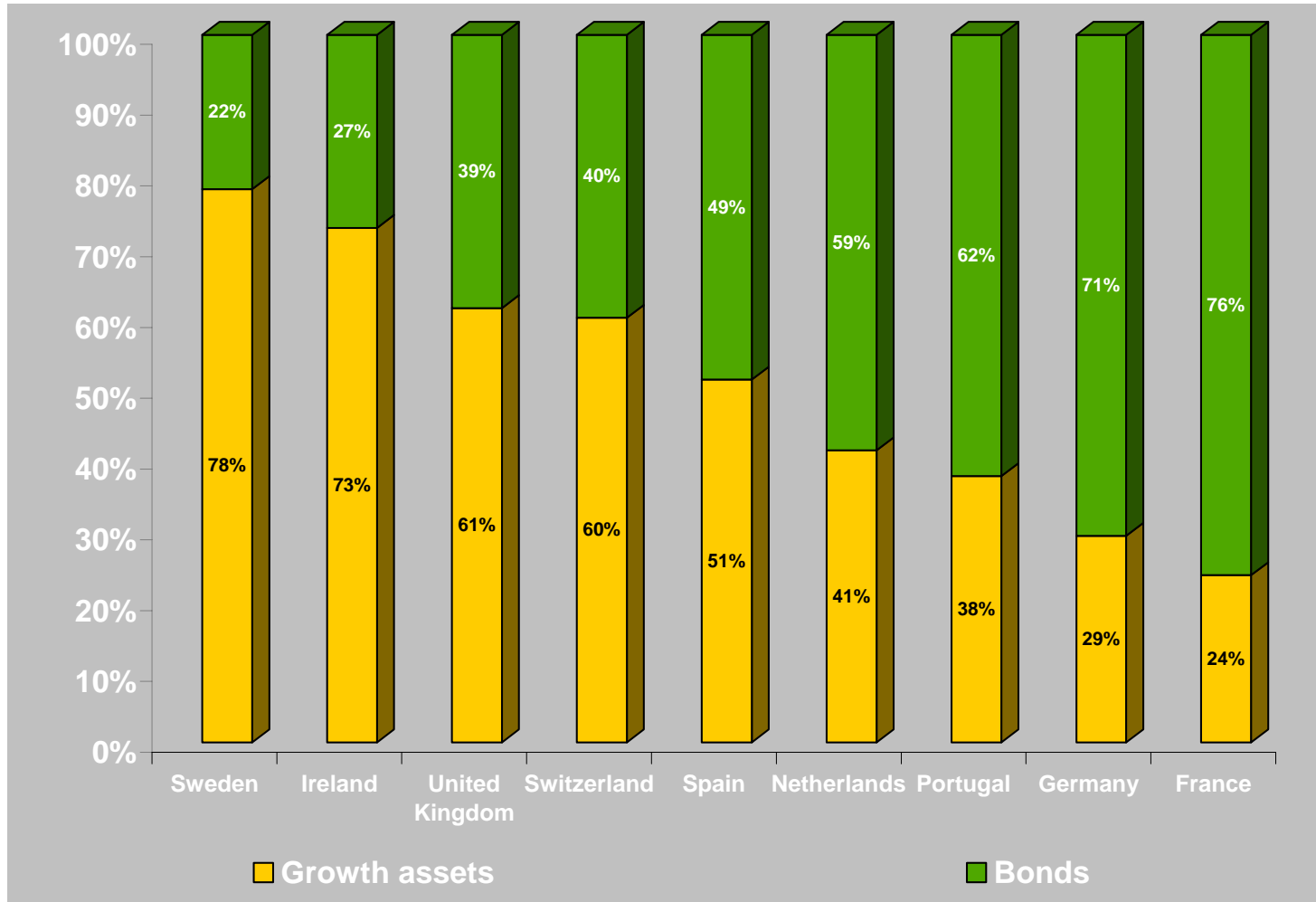
## ALTERNATIVE ASSETS

Infrastructure  
Private equity  
Forestry  
Commodities  
Foreign property  
Hedge funds  
Currency  
Global Tactical Asset Allocation

# Quick comparison

## Average asset allocation across Europe

Ireland closer to UK and US than continental Europe



# Overall Trend

## FROM

Long only relative return equity + naive bonds + domestic bias

## TOWARDS

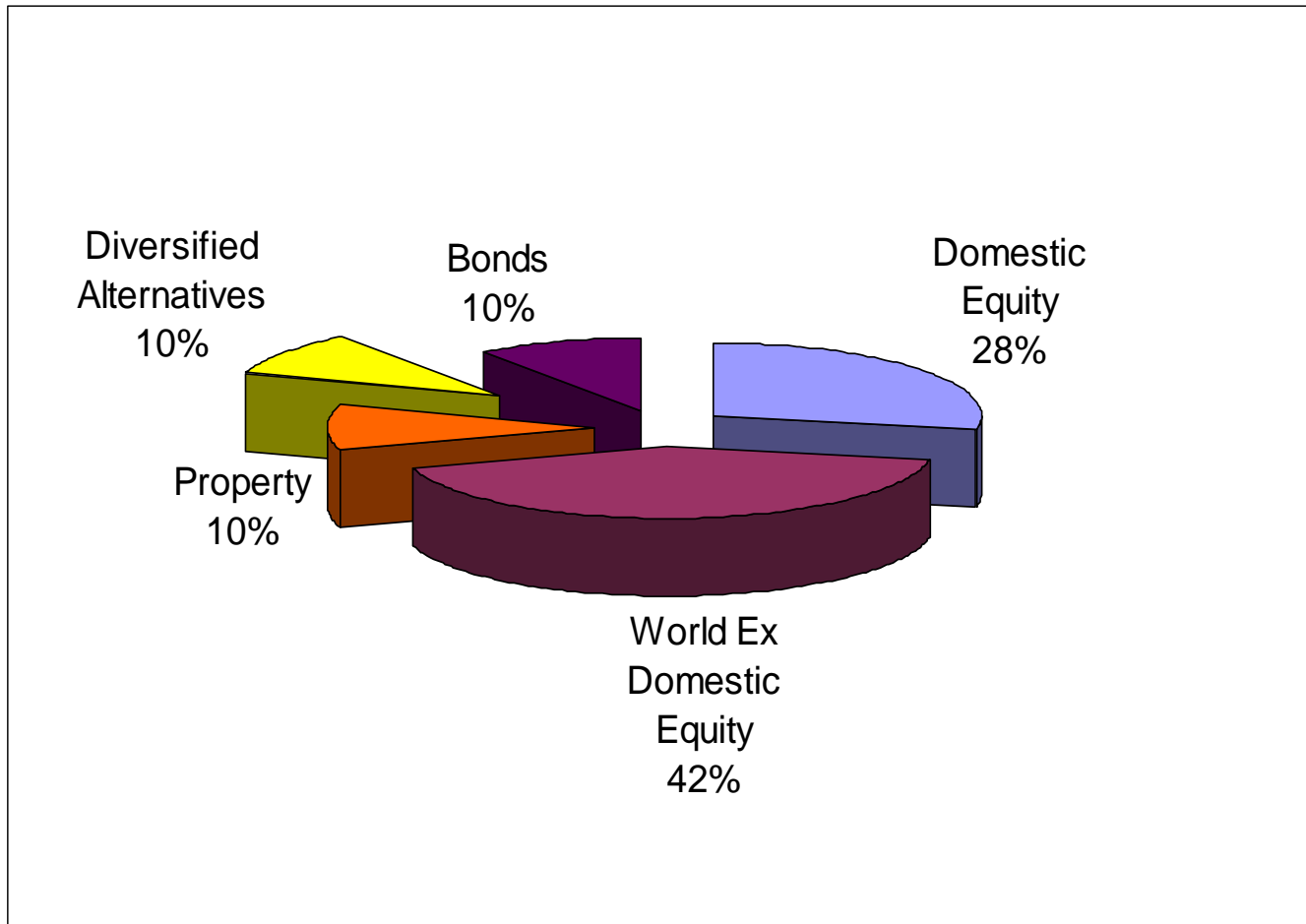
Diversified growth + sophisticated bonds + global diversification throughout

This move will be achieved in two ways

Evolution: Existing balanced funds gradually evolving

Product Development: New funds being launched

# Funds Evolving (UK Balanced Example)



## 2. Asset Allocation at 30 September 2008

	€m	%
Large Cap Equity	11,173	59.8
Small Cap Equity	714	3.8
Emerging Markets Equity	294	1.6
Private Equity	563	3.0
Property	763	4.1
Commodities	157	0.8
Fixed Income	3,313	17.7
Currency and Other Funds	218	1.2
Cash	1,494	8.0
<b>Total Net Assets</b>	<b>18,689</b>	<b>100.0</b>



# Influence of DC - Benchmarks May Change

## Today

Focus on relative performance

Beating or matching the peer group

Beating or matching the index

But.....

***“You cannot eat relative performance”***

## Tomorrow

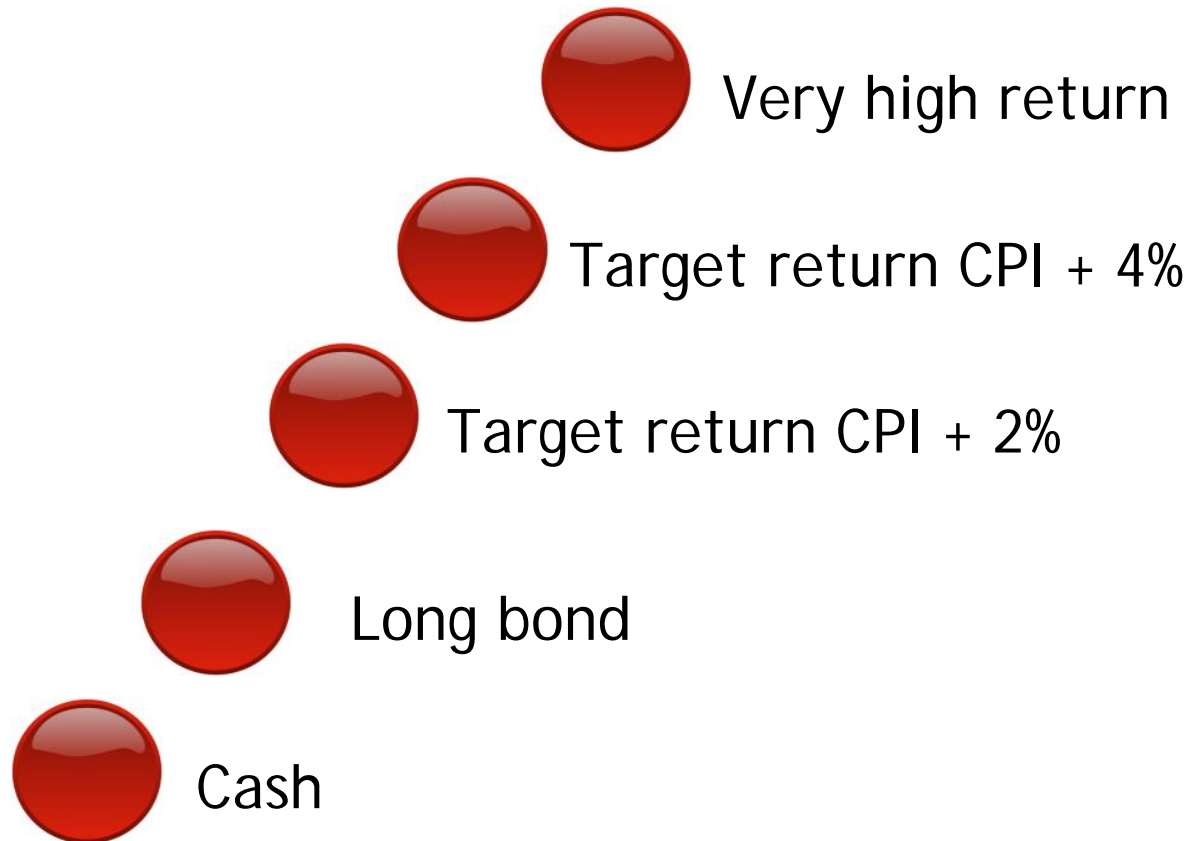
Focus on absolute returns or at least

CPI +

Cash +

Hierarchical benchmarks

# DC Benchmarks – Australian Model



# Gaining Exposure to Alternatives

- Singly
- Grouped
  - Beta only
  - Alpha only
  - Combined alternatives
- Grouped and combined with traditional asset classes

*Diversified Asset Funds*

# Diversified Assets Funds

## TRADITIONAL ASSETS

Large cap equity  
Small cap equity  
Emerging market equity  
Domestic property  
Bonds  
Cash

## ALTERNATIVE BETA

Infrastructure  
Private equity  
Forestry  
Commodities  
Foreign property

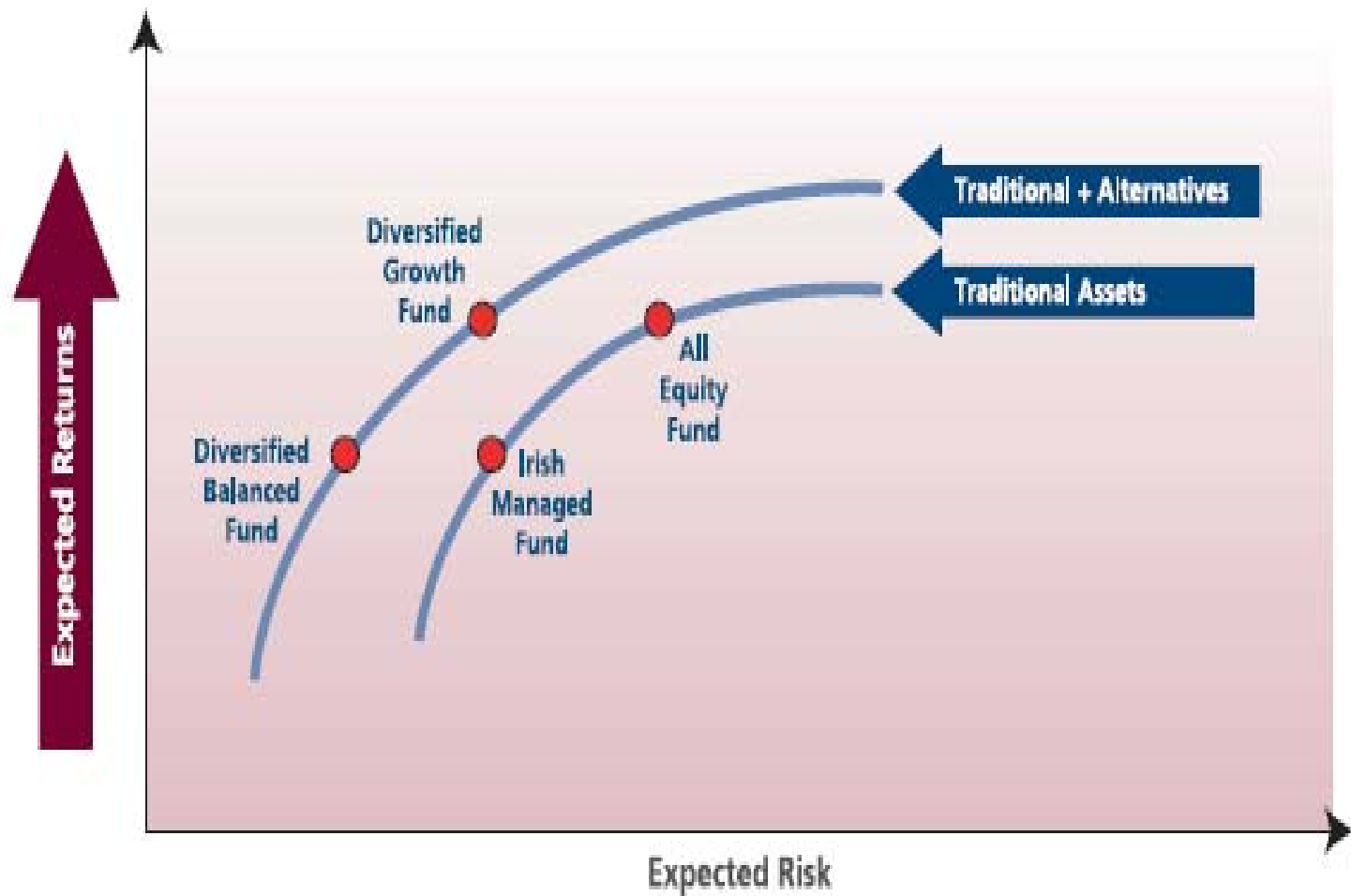
## ALTERNATIVE ALPHA

Hedge funds  
Currency  
Global Tactical Asset Allocation

# Funds Currently Available in Ireland

	Fund #1	Fund #2	Fund #3	Fund #4	Fund #5	Fund #6
Commodities	*	*	*		*	*
Hedge funds and absolute return		*	*		*	*
HY & EM debt					*	*
Infrastructure					*	*
Private equity		*				*
Property incl REITS & forestry	*	*	*		*	*
Non-traditional equity		*	*	*	*	
Global equity	*	*	*	*	*	*
Bonds	*					
Cash						*
Currency				*		

# Diversified Assets Funds



# Characteristics

- What are the objectives?
  - Return target expressed as a premium to cash or inflation
  - Specific risk target, expressed in terms of volatility or VaR
- How do they work?
  - Seek to capture returns from all or some of:
    - Allocations to a diversified set of asset classes
    - May include alternatives and emerging opportunities
    - Active allocation decisions
    - May rely on internal suppliers of beta and alpha...
    - ...Or source from 3<sup>rd</sup> parties

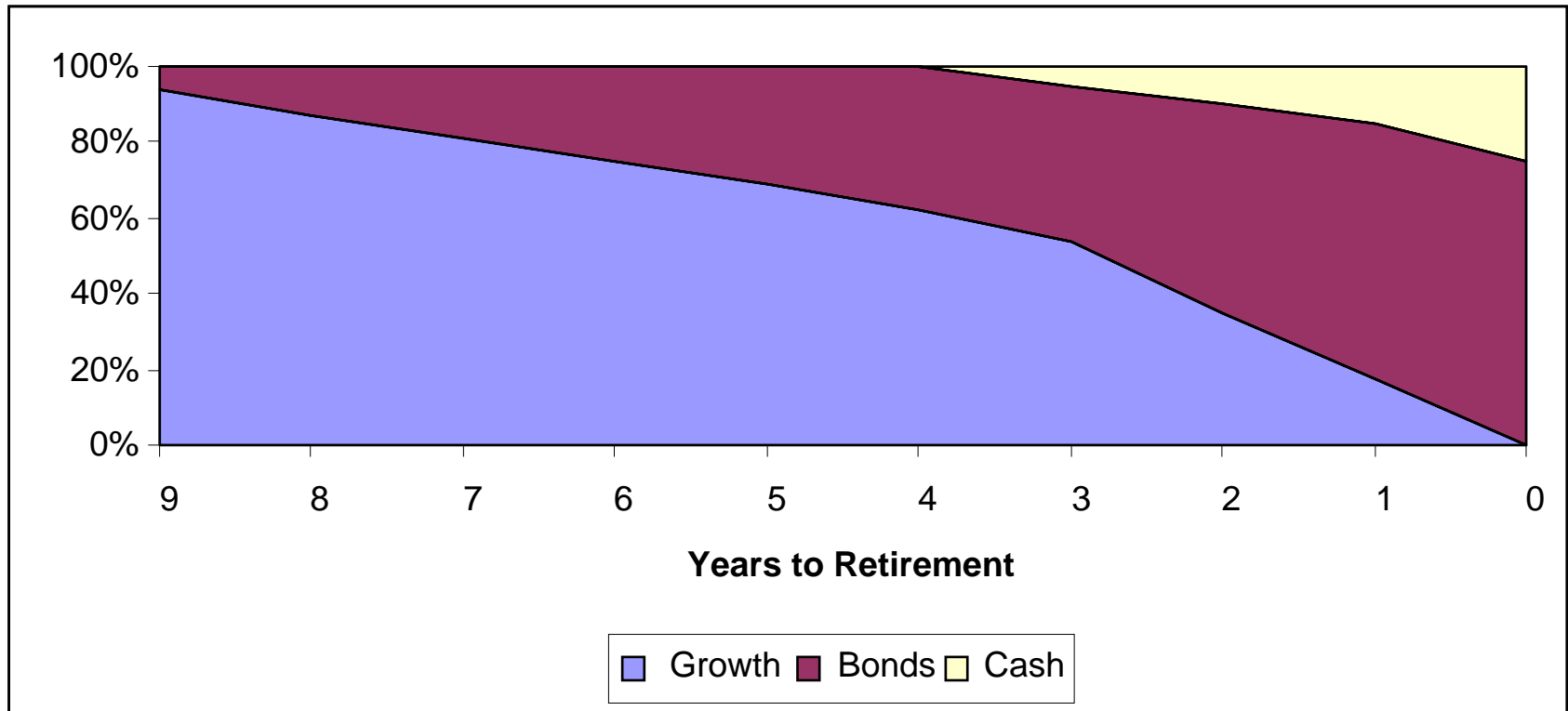
## Benefits

- Breadth of asset mix
- Degree of reliance on traditional sources of market risk
- Appetite for relatively illiquid assets
- Breadth and depth of sources of alpha
- Approach to risk management
- Fees, liquidity terms, transparency

# Risks

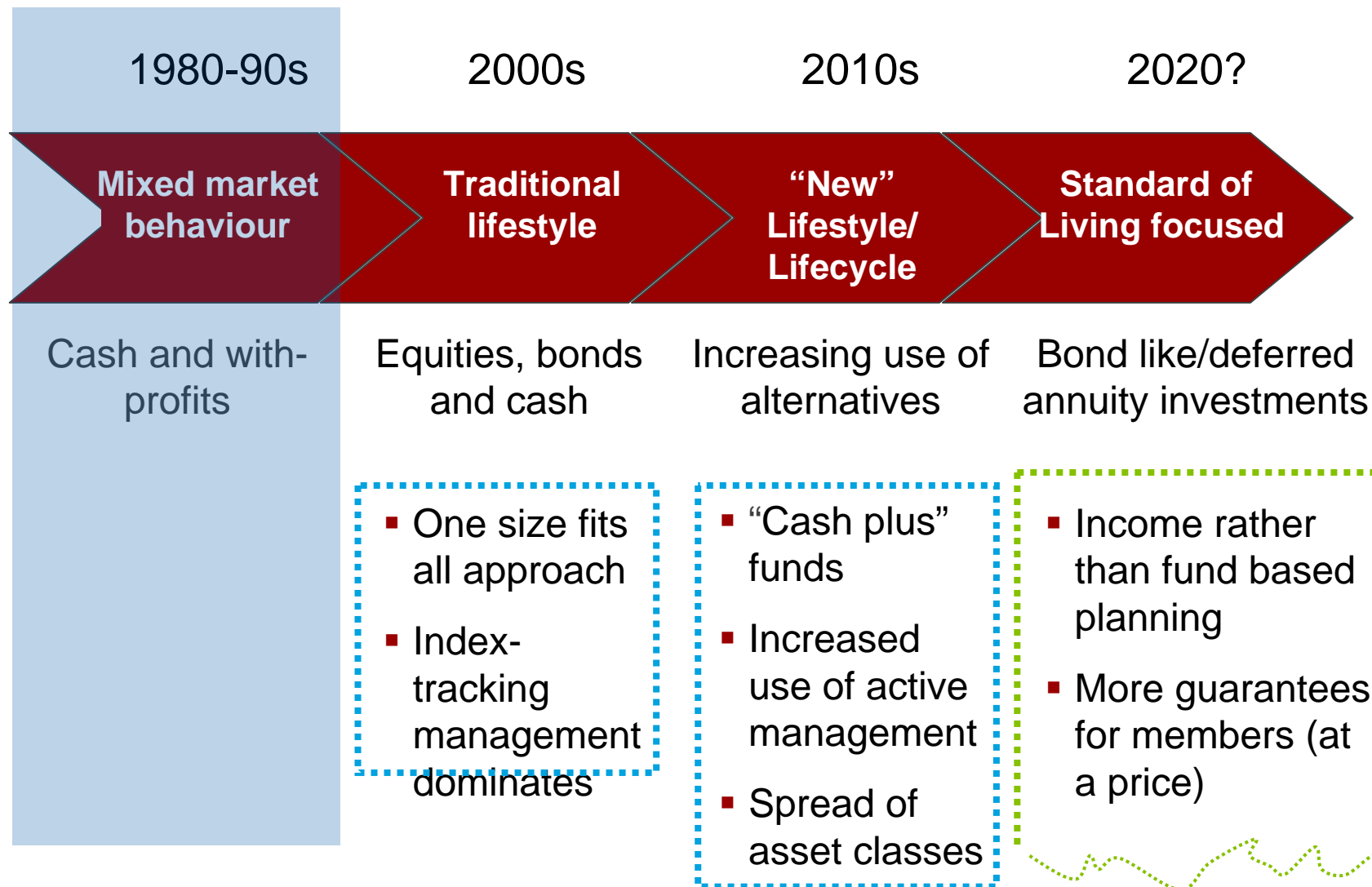
- What are the risks?
  - Single manager exposure
  - Greater than expected cross-correlation:
    - Across the asset classes used, or
    - Within the alpha “pool”
  - Implementation risk – use of derivatives and leverage
  - Liquidity risk in some cases
  - Higher than justified fees

## DC influence #2 – Lifestyling



- Note progression from equities to bonds and cash
- Ideally, progression will be defined as curved de-risking program rather than based on asset allocations

# New DC paradigm?



# Speed of Innovation

- International fund managers
- Multinational employers like consistency
- Ideas from abroad arriving in Ireland faster than before
- Trustees willing to take on new ideas
- Members want innovation



## The Conundrum of Illiquid Assets

- High returns for long term investors
- Smoothing of returns can be useful
- But hard to trade, especially at times of stress
- Particular problem in DC if member needs to redeem
- How to embrace?

## It's A Brave Old World

“It is advisable for one that he shall divide his money in **three parts**, one of which he shall invest in real estate, one of which in business, and the third part to remain always in his hands (as it may happen that he will need cash for a profitable transaction)”

From the Talmud, circa AD 600

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*I confirm that I have read and understood the advice and recommendations contained in this document.*

Signed \_\_\_\_\_

Date \_\_\_\_\_

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