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Diversified growth funds: what do we know so far?

PSIT opinion by:
Ian Eggleden, Scheme Manager

The first diversified growth fund (DGF) was launched over a decade ago and today there is still much debate about whether they are an actual asset class or simply an investment concept. In this article I look at whether DGFs work, who likes them and if they are here to stay.

Background

Not all diversified growth funds are the same. There are a range of different styles; some based on capital preservation, others on absolute returns or hedge funds. Then there are a whole host of underlying strategies - and terminology that goes along with them - such as: diversified; dynamic; complex; and algorithmic (used mainly in Europe).

The actual fund names can then add yet another layer of complexity, for example:

- Barings Dynamic Asset Allocation (DAA)
- Standard Life Global Absolute Return Strategies
- Newton Real Return Fund

Across all the different DGFs there are **two key things to remember**:

1. **return versus volatility** is the key equation
2. the **investment process is as important as** the investment **manager's skill**

Do they work?

The majority of investment consultants regularly analyse 10-30 DGFs, although some look at as many as 100. Analysis from Camradata shows that, since inception, **DGFs have delivered returns in the range 7.6% - 12.5% a year**.

DGFs certainly seem to avoid the problem of herding, but are they too diverse and do they take enough risk?

So far, only two of the main DGFs available - Baillie Gifford and Ruffer - **have achieved returns similar to equities but with less than two-thirds of the volatility**. There are also some more general results:

- dynamic and diversified funds have demonstrated the highest correlation with equity returns
- dynamic funds have both the highest and lowest range of volatility
- diversified funds show the highest volatility range
- complex and algorithmic DGFs are less successful and some funds have negative returns

As is so often the way with investment approaches, the answer to the 'do they work?' question appears to be **'some seem to, others don't'**.

Continued...

Who likes them?

DGFs are a strategic option for managing investment risk. They are popular with investment consultants and trustees, particularly for small and medium defined benefit (DB) schemes.

More recently, we have also seen their popularity with defined contribution (DC) scheme trustees rise.

Are they here to stay?

Just a year ago, Camradata revealed that there were 52 diversified growth funds with combined assets under management of £65 billion. This demonstrates their popularity, despite the fact that **only three** of those funds **have a track record exceeding three years**.

That said, the **DGF universe is already maturing**:

- four funds have closed to new money due to size
- another (Barings) has seen a distinct outflow of funds following the departure of key members of the asset management team, which may impact the ability of others to exit the fund in future
- new funds are being launched, such as the JLT Growth Fund designed to help trustees with limited budgets

Diversified growth funds have certainly taken hold of the pension market, and have done so quite rapidly. In terms of the future, with pension schemes there are two things we can be sure of:

1. **to meet their funding challenges DB schemes need growth, but with less risk than equities**
2. **trustees who are cautious and risk averse like smooth returns**

DGFs attempt to deliver these two things with more consistency - if they succeed, they are very likely to be here to stay.

Finally, let us not forget that there are also new opportunities - the global reach and sophistication of DGFs could be extended and, in the DC world, they may prove to be the ideal default. Will they continue to prosper and expand or will they be overtaken by some new, clever concept designed by the investment world? Perhaps, but only time will tell.

What do you think?

Share your thoughts with us,
email **ian.eggleden@psitl.com**

Source of figures quoted in this article: Camradata, Making Sense of Diversifired Growth Funds