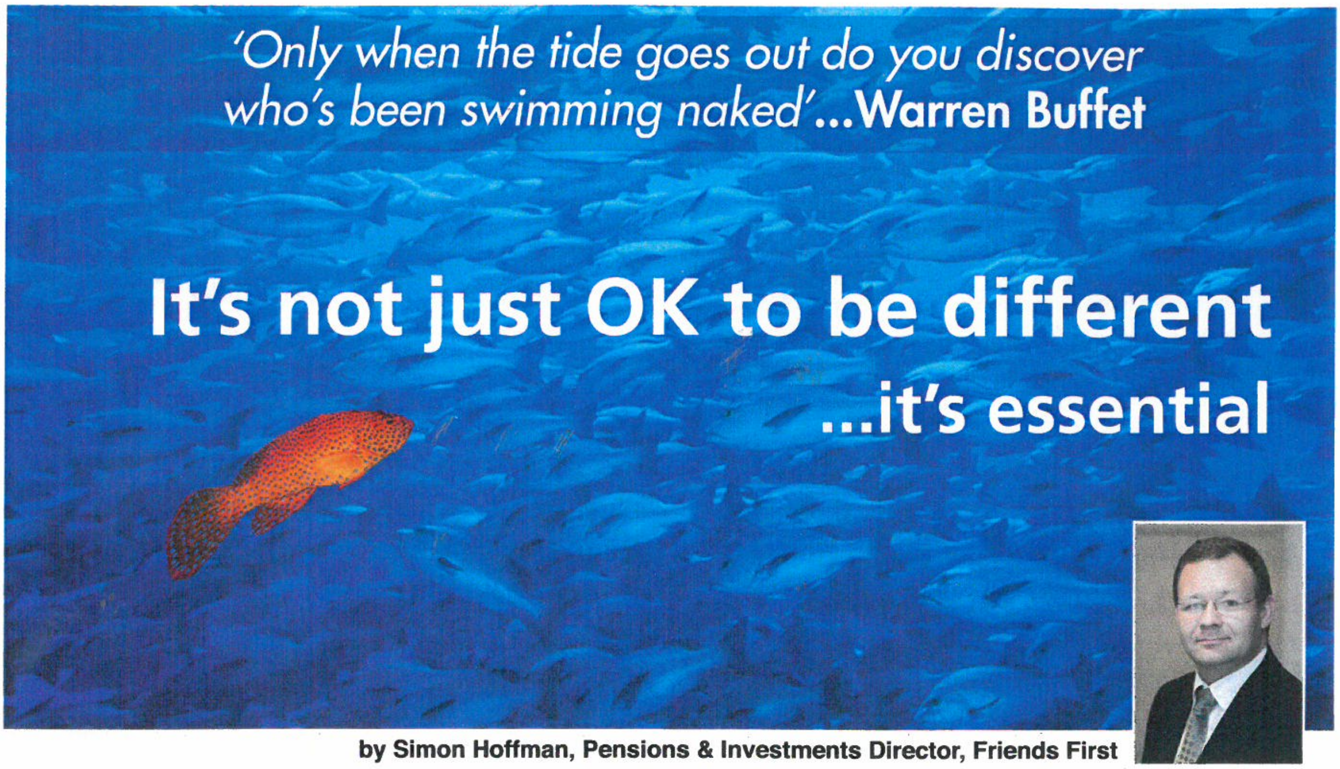

*'Only when the tide goes out do you discover who's been swimming naked'*...**Warren Buffet**

# It's not just OK to be different ...it's essential

**by Simon Hoffman, Pensions & Investments Director, Friends First**

They say that diversification is the only 'free lunch' when it comes to investing. I couldn't agree more and it's great to see this 'mantra' applied across the array of easy to use multi-asset target risk products currently available.

**But is multi-asset enough ?**

When we talk of an asset class we generally mean a group of securities that have similar characteristics and behave in a similar manner. The main asset classes being equities, fixed income bonds, property and cash. Despite some speed bumps along the way both property and equities have enjoyed some of the longest bull runs those asset classes have ever enjoyed. As for defensive assets, bonds have also delivered significant upside and have not (as of yet anyway) collapsed to the extent that has been predicted as being imminent for the last few years. Cash on the other hand is probably now more of a 'know how much you will lose' asset than a defensive asset.

Multi-asset funds were introduced to meet very real client needs and there are very few (reasonable !) clients who can complain about how they have done. Although it has not been plain sailing all the way, they have generally performed as good as, if not better, than expected. However, we must recognise that they have been introduced during a bull run in most traditional assets. This has undoubtedly helped them flourish.

Most companies report that their ESMA 4 target risk funds are the most popular. These funds have actually shown a surprisingly high correlation to equity markets. 11 products have a three year track record (to 18th January 2017) and the range of correlation between these funds and equity markets is 89% to 97%.

The other thing to note is that these funds are also highly correlated to each other. The range of correlation between funds is also very high at between 84% and 99%. Now, that is not to say they are all the same or that these high correlations will continue. Some funds have performed better than others (and we are very happy with the performance of our Magnet and Compass ranges !). It just says that over the last three years they have tended to move in the same direction at the same time, and are very influenced by equity markets.

So what's the point ? The point is that it is hard to test the benefits of diversification across traditional asset classes when markets are relatively benign. In bull markets everyone does pretty well so you need a bear market to test the metal. As a certain Mr. Buffet said "only when the tide goes out do you discover who's been swimming naked."

At Friends First we have always referred to our target risk funds as 'Portfolio Funds' as we believe they are not just multi-asset funds, they are multi-asset, multi-strategy and multi-manager portfolios. We diversify across both traditional and alternative asset classes but it is the multi-strategy element that gives the most scope to provide that something different. In particular alternative or targeted absolute return type strategies.

I think it is fair to say that during the current bull run some 'alternative return' strategies have been getting a bit of a hard time as they have not delivered on the upside.

But when looking at alternative strategies there are two things you must not lose sight of. Firstly, by definition strategies that try to behave differently are not all the same ! And secondly the key to true diversification is understanding that all investments have good and bad periods, the trick is including a mix that have them at different times.

By my count when we launched Concept K and Magnet Absolute it brought the number of 'alternative strategies' being widely promoted by life offices to seven*. I regularly meet financial brokers who succumb to the natural tendency to group all these 'alternative' funds together, however, if you use correlation as a proxy for similarity you'll see that they are most definitely not a homogenous group. In fact since May 2016 (when Friends First introduced our offerings) the range of correlations between each strategy has been a staggering -21% to +71%. And their correlation to equity markets ranged from 6% to 86%.

Concept K and Magnet Absolute have both performed very well since we introduced them, but it is not just their track record which makes them very important constituent components of our Magnet and Compass funds, it's their potential to deliver something different if markets turn. So although everything is going along nicely now, it may be no harm to stick your head under the water and check if you've anything in your clients' portfolios that might save your blushes when the tide goes out.

* 'Alternative strategies' included are Concept K & Magnet Absolute; Aviva's AIMS; New Irelands BNY Mellon Real Return Fund; Irish Life's Multi Manager Fund; Standard Life's GARS and Zurich's Invesco Global Targeted Return. Source : all correlation data Financial Express