01:
Peter Fitzgerald
fund manager
Aviva Investors

Income with less volatility

Regardless of global market activity the Aviva Investors Multi-Strategy (AIMS) Target Income Fund pays income monthly, reinforcing its focus on capital preservation with less volatility.

There are few absolute return investment strategies with a dedicated income focus and this distinctive attribute often sets apart one fund from the next.

The Aviva Investors Multi-Strategy (AIMS) Target Income Fund leverages this distinction with an approach that combines the best investment ideas from several asset classes and from a number of different teams within the firm.

As Aviva Investors' global head of multi-assets Peter Fitzgerald explains, there are many conversations and analyses undertaken before the best solutions are made available in the portfolio.

"What we do is ask people to answer a number of key questions: what is the investment strategy, what is the expected return from that strategy, and what are the key risks associated with it?" Fitzgerald says.

It's an interesting conversation to have. The AIMS Target Income Fund has an overall objective to deliver annual income of cash plus 4% and "to do that with as little risk as possible."

The fund also aims to be less than half as volatile as an investment in global equities over any three-year period. The fund is built around an investment timeframe of more than five years.

Fitzgerald says to achieve this, it's essential to build-in a number of different strategies and diversification in to the investment portfolio. The fund aims to help investors diversify portfolios with an approach that targets specific levels of income with lower correlation to equities, bonds and other traditional asset classes.

Generally the fund managers implement investment strategies that fall in to three groups:

1. Market strategies to generate income – Where the fund's analysis of market conditions differs from others as it identifies opportunities that offer greatest value. This could include, for example, equities and REITs for dividend income or higher-yielding bonds for coupon payments.
2. Opportunistic strategies to benefit from market dislocations – This focuses on identifying opportunities created by the actions of other market participants, such as over-reaction to short-term events. This might include, for example, writing "out-of-the-money" call options on individual equities that the fund already owns in cases where it believes the stock has limited upside potential.
3. Risk-reducing strategies to preserve capital and returns – This aims to add returns in difficult market conditions by seeking to identify strategies that make money if near-term market predictions don't play out. An example would be a long position on Australian bonds – as one of the world's biggest commodity exporters, Australia's economy is especially sensitive to fortunes elsewhere. Were they to deteriorate, Australian bond prices ought to rise.

Fitzgerald says the challenge one has when seeking to generate income today is that an allocation to credit or to fixed income in general will come with a material amount of interest rate risk or duration risk.

The AIMS Target Income strategy has a low duration risk, and by bringing in a range of different asset classes and strategies it's able to reduce the risk at a portfolio level. He adds that when comparing to some risk parity strategies, the challenge is always the amount of leverage that is applied to the fixed income component to create a risk parity approach – which "can actually be quite high."

In addition to equities, one of the key areas where the fund has also generated income for clients has been in emerging market debt. The fund manager says this asset class has generated high levels of income. When combined with a broadly diversified portfolio, it can help mitigate some of the risk of investing solely in those assets.

An example in the fund's current portfolio is an allocation to Indonesian local government bonds. Fitzgerald says the yield on these bonds when initial investments were made was in excess of 8.5%.

Having the ability to allocate a small amount to the bonds and diversify away some risk from other strategies in the portfolio "has been a key contributor to the income generated."

The fund's February update to investors says one of its new strategies includes an investment that benefits from a rise in shorter-dated versus longer-dated Swedish rates. It expects the Swedish central bank to move towards a tightening bias later this year on the back of strong domestic demand.

It also added a strategy that would benefit from lower breakeven inflation in the UK, where the fund believes longer-term inflation expectations have become too elevated following the decline in sterling.

Fitzgerald says the duration at fund level is very low (less than one year). This compares favourably to an investment in either credit or government bonds where "the duration on something like the global aggregate index would be materially higher."

He adds equities are one of the key sources of income for the fund, which looks to complement that with option strategies.

The fund made gains across several equity strategies in February, particularly from the global equity income mandate and its exposure to consumer staples stocks. More generally, risk assets did well during the month and positive returns came from emerging market equities, US and Pan-European credit and REITs.

Fitzgerald explains this multi-strategy approach allows the fund to be more flexible and achieve its income objectives. He says one of the key things to bear in mind is that it's really important to manage risk "and to ensure that you don't take excessive amounts to achieve your objectives."

"Because of the flexibility available to us as portfolio managers and because of the resources that we have available, we can look across the different asset classes and different strategies and we're not constrained by any particular geographical region or constrained by a particular benchmark," Fitzgerald says.

Derivative risk, market and exchange rate fluctuations are some of the key risks involved with the strategy. Fitzgerald would argue the investment portfolio focuses on diversifying risk rather than asset allocation and aims to provide investors with specific levels of return or income from a wide range of sources, unconstrained by benchmarks. It allows the fund to focus on providing long-term performance even as market conditions change. FS

The quote

We can look across different asset classes and different strategies and we're not constrained by geographical region or benchmark.

Watch the video on www.fsitv.com