A New Arm for a New VA Arms Race

By Editor Test *Fri, Aug 5, 2011*

AllianceBernstein's DAA fund, which aims for 60/40 performance without the tails, has been adopted as a risk-reduced investment option in AXA, MetLife, Ohio National, Sun Life, and Transamerica variable annuities. AB's Mark Hamilton (below) explains.

A tactical investment process that AllianceBernstein created four years ago to provide less volatile returns for wealthy investors has been adopted by several variable annuity issuers who are using it to control investment risk and protect their lifetime guarantee riders.

Last week, the asset management firm announced that its Dynamic Asset Allocation services and/or Dynamic Asset Allocation fund portfolio had been chosen during the past year by these insurance companies to provide a safer investment option in their variable annuities:

- *AXA Equitable*, which is applying the DAA strategy in a new subadvised portfolio to further enhance investment choices in its variable annuity products with guaranteed living benefits.
- *MetLife*, through its affiliate MetLife Advisers, LLC, which created a customized portfolio incorporating DAA for its recent GMIB/EDB max rider launch.
- *Ohio National* and *SunLife*, each of which in the last several months committed to the firm's new DAA Variable Insurance Trust (VIT), where we apply the Dynamic Asset Allocation tool set to an equity-tilted globally diversified portfolio.
- *Transamerica,* which launched its partnership with the DAA service just under a year ago, making it available across a number of their variable annuity products.

According to a two-page product profile, the DAA fund managers, co-CIOs Seth Master and Dan Loewy, have a wide range of latitude. They can put zero to 80% of assets in equities (except emerging market) and 20% to 80% of assets in fixed income instruments. They limit themselves to 15% in emerging market stocks or global real estate and no more than 10% in commodities, emerging market debt or high-yield bonds. During "favorable" stock market conditions, the fund overweights global equities, and during "unfavorable" conditions, it overweights global bonds, the handout said.

Mark Hamilton, AllianceBernstein's investment director, told RIJ this week that DAA doesn't use Constant Proportion Portfolio Insurance, a modified version of which is used in Prudential's HD variable annuity income rider and which offered relatively better protection of the firm's guarantees during the financial crisis.

Not CPPI

"No, it's definitely not a form of CPPI," Hamilton said. "Those strategies are typically a form of portfolio insurance that tends to reduce exposure to the market as the market is falling, with the idea of setting a floor. This is not that. We monitor risk across the marketplace and adjust the fund very actively in terms of its asset exposures.

“I wouldn’t think of it as a hedge fund either, because it doesn’t use leverage or follow a short-long strategy. This is much more of a flexible approach to balancing risk and return.” The investments vary widely across the globe, he said, and may include high-yield bonds, REITs and emerging market equities.

“Post-2008,” Hamilton added, “we’ve seen a number of significant changes both in terms of how insurers think about variable annuities, and what investors are looking for in investment options. Among insurers, 2008 exposed a lot of the potential costs involved during periods of high volatility. They’re looking for volatility solutions so that they can offer more generous guarantees.

“On the investor side, people are less interested in fixed-allocation balanced funds, which they know can entail a great deal of risk. They’re looking for more flexibility, for funds that will respond automatically to the overall risk and return environment.

“This fund and this strategy are designed to meet those objectives. We’re trying to give insurers a fund that manages volatility, and to let them offer the guarantee. We look at both risk and return, and forecast volatility and correlation across markets.

“If you were only looking at risk side, you’d look at VIX triggers. But you can get whipsawed that way. There’s no guidance in the VIX about what the future compensation or expected return might be. If you compare September 2008 and March 2009, volatility was high during both periods. But there was a big difference in what followed. We’re trying to balance those two competing inputs, risk and return. That’s something that you won’t get if you’re just tracking the VIX.

“Typically when we see risk in the marketplace rising, and see credible evidence that it’s not just a blip, we will typically move to reduce risk in the portfolio. That’s part of the process. But we don’t do it in a simple knee jerk fashion the way you would if you were using CPPI or a VIX trigger, which don’t take compensation into account.

“At some point you need to get into the market, and another component of this guides us on getting back in. Sometimes the return perspective provides the early warning signal. When valuations are high, you’re more vulnerable—even when the market isn’t showing high volatility.

“We’re not simply building in some form of tail risk protection. It’s a fund whose strategic allocation over the long run will be comparable to a 60/40 fund, but which also has a lot of flexibility to move around. We could be much below that, or higher than that. Historically, tactical funds have focused more on return than on risk, but we’ve found that the risk component is the key to providing smoother experiences over time for investors. The risk side, in fact, has a better degree of predictability.”

DAA started as a research project in 2007 at AllianceBernstein, Hamilton said. It was first offered to private clients and other high net worth investors, and later was used in target date funds for the defined contribution plan market. About $25 billion of the $70 billion in AllianceBernstein’s private client practice is managed with the DAA method, he said.

AllianceBernstein is part owned by AXA. At June 30, 2011, AllianceBernstein Holding L.P. owned approximately 37.8% of the issued and outstanding AllianceBernstein units and AXA owned an approximate 62.4% economic interest.