Retirement Income
JOURNAL



# Risk-reduction strategy pays off for UK fund

By Editorial Staff *Thu, Sep 11, 2014*

*Using a custom diversification measure, where 0 signifies absolute correlation and 1 no correlation, the manager of the Now Pensions fund adjusts its portfolio to stop unexpectedly correlated assets from bringing down overall performance.*

Now Pensions, the unit of Denmark's ATP pension fund that provides defined contribution plans in the UK, saw investment returns on its centrally-managed retirement fund of 14.2% for the year ending June 30, 2014, thanks in part to actions taken by the manager to buffer correlation risks, according to IPE.com.

The fund, which is nearing £50m (€62.4m) in assets and operates on a risk-allocation basis instead of asset allocation, said strong returns were helped by final quarter performance. The target 35% exposure to equity risk returned 4.3% in the three months from March, while its 10% exposure to commodity risk returned 6.6%.

Other risk factors – credit, rates and inflation – all performed positively, adding to the eventual 14.2% investment return over the year. The three factors are generally exposed to corporate bonds, global sovereign bonds and inflation-linked bonds, respectively.

Now Pensions said the return figure was well above its 'cash +3%' benchmark and well above the return from holding a basic 60% equity/40% UK Gilt portfolio.

The provider is wholly owned by Danish pensions organization ATP and operates a single investment fund for all of its 300,000-plus members. It runs investments through the DKK641bn (€86bn) fund's in-house investment team in Denmark.

It said it implemented a correlation control mechanism in the early part of the year to protect the portfolio when asset performance became overly correlated.

Using a bespoke diversification measure, where 0 signifies absolute correlation and 1 no correlation, the manager adjusts its portfolio to stop unexpectedly correlated assets from bringing down overall performance.

When the measure falls below 0.45, it immediately re-distributes poorly performing assets to the top-performing classes, and it does not shift back to tactical holding levels until the measure rises above 0.5.

It used the mechanism six times up until the end of June, which chief executive, Morten

Nilsson, described as more frequent than expected. “It has been a funny 12 months, with very atypical returns,” he told IPE.

“It is still not a healthy world, and the correlation control usage has been more frequent than you would expect in a normal environment.” The manager also implemented portfolio risk controls, which automatically de-risk investments in periods of falling performance.

Now Pensions said, for every 2% drop in overall fund value over a three-month period, the investment strategy will de-risk by 20%. As a result, a sudden 10% fall in value will see the entire fund de-risked and moved into cash and cash equivalents.

Nilsson said the single investment fund, unique in the UK, allowed the pensions manager to implement such mechanisms into its investment strategies.

“The new investment structures put in place are very difficult to do on an individual basis,” he said. “You can operate it across a single fund, but if you offer fund choices, it is difficult to get members to diversify the portfolio and manage risk efficiently, as there are not individual tools available.”

In July, the UK master trust announced it was overhauling its at-retirement investment strategy and would shift member assets into cash, as it expected members to use changes to legislation and withdraw pots entirely in cash. However, Nilsson said Now would evaluate its strategy as account sizes continued to grow and further innovations in at-retirement strategies were brought to market.