Strategic Insights looks into “managed volatility”

By Editor Test *Thu, Jan 10, 2013*

A new proprietary research report asks, among other questions, whether managed volatility funds actually enhance market performance or if they sacrifice too much upside in exchange for downside protection.

Managed volatility investment strategies are emerging as a solution for investors who want protection from future stock market losses, according to “Managed Volatility: The Anatomy of an Investing Trend,” a new research report from Strategic Insight.

Managed volatility assets have accelerated in less than a decade to $129 billion as of September 2012. The report identifies a total of 175 funds from 32 different advisors.

A major component of the growth comes from funds converting to managed volatility mandates, the report found. At the end of September, $61 billion, or 47% of the total assets in managed volatility funds, came from converted portfolios. Most of this activity has been in the variable annuity space, which also commands the bulk of assets.

The report focuses on several key issues, such as whether managed volatility is a kind of fad, whether managed volatility funds will find a significant market outside variable annuity separate accounts, and whether these funds sacrifice upside potential for downside protection or not.

“The implementation of these strategies may represent a trade-off in terms of cost and/or the sacrifice of some market gains. This perspective is not shared by all investment professionals, with many arguing that certain strategies can improve overall returns by reducing the impact of performance- draining downturns,” the report’s executive summary said.

“The managed volatility trend has really taken off since the financial crisis in 2008,” said Tamiko Toland, managing director of Retirement Income Solutions at Strategic Insight. “These funds include a dynamic element that readjusts the investments for periods of high volatility or market declines. This kind of strategy is directly useful to clients but is also valuable for insurance companies providing guarantees against assets held in variable annuities.”

Because managed volatility funds can help insurers better manage the risk of living and death benefits, these funds have proliferated within variable annuity funds. However, this trend is also gaining steam among retail mutual funds. Managed volatility mutual fund assets have grown substantially from $967 million in the first quarter of 2006 to $21 billion at the end of the third quarter of 2012.

While 84% of today’s managed volatility assets are held within variable annuities, this investment category is gaining a foothold among retail mutual funds and is likely to grow in other areas, including college savings and retirement plans.

With so many players, there are a wide variety of approaches, all classified and identified within the report.

“The report is the first of its kind to quantify the managed volatility opportunity and analyze the biggest players,” Toland commented. “We’ve also seen a lot of interest from mutual fund boards for analysis on this trend.”