

November 2011

The case for an absolute return approach to fixed income investing

Financial markets have endured a roller coaster ride over the last four years. Today, in the face of eurozone debt fears and concerns regarding a double dip recession, where can investors turn? One solution to consider is an investment approach that invests in fixed income on an absolute return basis.

An absolute return fund is typically designed to deliver the attractive combination of positive returns and lower volatility, irrespective of future market direction. It will also typically provide some level of downside protection given that preserving existing capital is an essential prerequisite to delivering a positive return. How much protection is provided inevitably depends on the investment approach, the performance objective and the skills of the fund management team. This contrasts with a traditional index-benchmarked fund, which will usually be expected to have a high correlation to the movements of the market it is invested in. Absolute return funds differ from traditional funds in three main ways:

- an investment objective to deliver returns in excess of cash.
- greater investment flexibility.

- broader use of investment techniques in order to be able to capture positive returns from both rising and falling markets.

(e.g. rolling 3 years). By comparison, 10-year gilts are now yielding less than 3%, hence the timing for a shift to absolute return looks compelling.

A cash plus objective

In isolation, generating a positive return may be achieved simply by investing in cash. Liquidity funds can provide an attractive and very convenient means of doing this for institutional investors. However, cash yields are currently very low, with the majority of long-term investors seeking a higher return on their capital. Whereas traditional index-benchmarked funds aim to outperform the benchmark index of the relevant asset class, such as the FTSE All-Stocks Gilt index, the objective of an absolute return fund will typically be to beat a reference cash return such as 3 month LIBID by a specified margin (e.g. 2% p.a.) over a specified time period

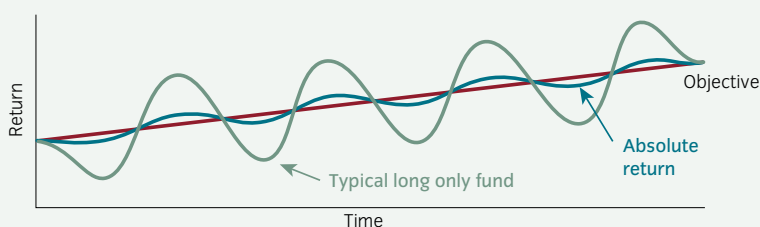
Greater flexibility

Traditional index-benchmarked funds that aim to outperform a particular market return will usually be restricted in terms of where they can invest according to the weighting of particular asset classes, countries or sectors within the reference index, with the majority of capital held in benchmark or near-benchmark assets. In order to be able to generate positive returns, irrespective of market conditions, absolute return funds often have broader, more diverse investment guidelines in order to be able to invest in whichever areas of the market they feel the best opportunities currently lie. This includes the option of having zero or even negative (short) allocations to asset classes or sectors which are unattractive, unlike traditional funds which may be forced to maintain an allocation to such holdings, even if on an underweight basis.

Enhanced investment tools

In order for absolute return funds to be able to both minimize or eliminate downside risk, and make efficient

A smoother path to achieve objectives



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investment decisions (including creating negative exposure to unattractive assets), they need to have the ability to utilise a much wider 'tool kit' of investment techniques, including derivatives. Whilst the use of some of these techniques is questioned by some, our view is that in the right hands, and within the right risk-management framework, they remain a powerful tool and can both improve risk-management and enhance returns. As well as enabling a fund to take short positions, derivatives can also provide exposure to markets that may ordinarily be prohibitively small or illiquid. It is important to note that such absolute return pooled funds, whilst sharing many of the characteristics of hedge funds, can be set up and regulated in the same way as other institutional pooled funds, providing full transparency in terms of portfolio construction, performance measurement and fee rates.

The value of investments and any income from them will fluctuate (this may partly be due to exchange rate changes) and investors may not get back the amount invested. Past performance is not a guide to future performance.

For further information please contact:

Institutional Business Development

business.development@
insightinvestment.com
020 7321 1547

International Business Development

internationalsales@bnymellon.com
+44 (0)20 7163 2367

www.insightinvestment.com

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The Insight Bonds Plus Fund

With interest rates at record lows and the outlook for growth and inflation so uncertain, it can be a challenge deciding not only what long-term fixed income investment strategy to pursue, but how to pursue it. One way of addressing this is to consider a broad-spectrum fixed income fund, managed on an absolute return basis, such as the Insight Bonds Plus Fund. Here, tactical asset allocation within the fixed income universe is decided by fund managers with expertise across the full spectrum of fixed income asset classes and who are experienced in taking both long and short positions. This approach can address many concerns investors may have around the consistency and volatility of returns.

Consistent performance

The Insight Bonds Plus Fund is designed to deliver attractive, positive returns throughout the economic cycle. It is a 'best ideas,' portfolio, focused on generating absolute returns, calling on the experience and expertise of Insight's large, well-resourced fixed income team. It currently has more than £1.5 billion of assets under

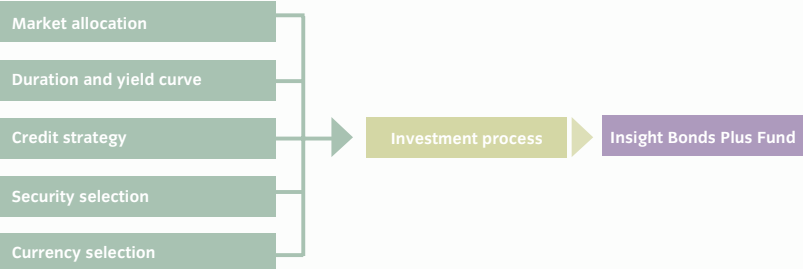
management held on behalf of both the local government pension schemes and corporate pension funds, with an average client size of c£100m.

- The Fund's objective is to outperform its cash benchmark of 3-Month Sterling LIBID by 2% per annum over rolling three-year periods¹.
- Derivative freedoms allow the Fund to express both positive and negative views, aiming to generate positive performance in any market environment.

Broad and diversified

The Fund is able to take both long and short positions in government and corporate debt and can also invest across the credit rating spectrum, both investment grade and sub-investment grade debt. It not only considers whether to invest in sterling-denominated securities, but can also take foreign currency risk. This flexibility allows the Fund's managers to allocate their risk budget across the fixed income spectrum, taking advantage of opportunities as and when they arise.

Insight Bonds Plus – A wide range of return sources



¹ Gross of annual management fees and expenses.

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