Rathbone Unit Trust Management

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Rathbones
Look forward

The Rathbone Luxembourg Funds SICAV Rathbone Multi-Asset Portfolios (master fund)

Choosing multi-asset funds, risk-targeted or risk-rated?

An interview with David Coombs,
Head of Multi-Asset Investments

Q1. David, with the continued regulatory focus on client suitability and capacity for loss, our industry has seen an explosion of risk rating tools provided by such firms as Distribution Technology©. There has been a rush by asset management groups to have their funds rated by these firms, is this enough to ensure suitability if the rating matches the rating attaching to client attitude to risk?

A1. The answer is no. Indeed, the point of a risk rating is that if a fund is deemed to be a rating of say 3, then if the client has been determined as a 3, then a match has been made. The problem is that the vast majority of funds that have been rated do not target specific risks as a key part of the investment process. This is a key problem as market cycles are set to be shorter and sharper so advisers are compelled not only to consider future upside potential but downside risk as well.

Q2. So why doesn't the rating build in specific future risks?

A2. The appropriateness of a fund becomes based on a snapshot of risk at point of selection – the rating is a review of what the fund *has done* not what it *will do* and therefore cannot be a match for what the client will want to achieve in the future. Specific risks cannot be built in as there will be no risk targets by which to judge the future performance of the funds.

Q3. So it's about monitoring and timeframe?

A3. Yes, the time horizon won't be considered and the snapshot of risk will be unreflective of the level of risk a fund manager might take in the future if he is not working to a monitored guideline. With risk-targeted funds, risk measures are embedded in the investment process and managed in a consistent and dynamic manner within a strict framework. You'll recognise these funds as they will have a specific risk benchmark such as 'volatility as a percentage of market volatility'. So, with a fund that is purely risk-rated, it is also impossible to ensure continued client suitability.

Q4. What if a client's attitude to risk and targets change over time, I suspect then that risk-rated funds can't be mapped to these targets?

A4. That is correct. Only risk-targeted funds will tend to be forward-looking, building in future expectations for the future risk that investors wish to take and the returns they wish to get.

Q5. David, you are a manager of funds which are risk-targeted, how does that affect the way in which you manage your funds?

A5. My funds are linked to meaningful and logical risk and return targets and I am committed explicitly to working to these targets so that our clients know what experience they are going to get. I shun peer group comparison for this reason – our objectives must always focus on what the client wants and not be relative to the results of others. Hence, you will not find our funds in the traditional 'Managed' fund sectors.

Q6. What's wrong with these collections of funds?

A6. The 'Managed' fund sectors contain many multi-asset and multi-manager (fund of funds) products – it's a good place to start for this type of product but you must be aware of several key factors when choosing from this 'mixed-bag'. Firstly, these funds in the main will target performance comparisons and rankings against their peers, not solutions for their clients' needs – their clients must remain impressed, or not with these relative results and hope they match what they want to achieve. Secondly, these funds qualify for inclusion in the various classifications and quantify risk by virtue of their equity exposure, however risky, without much heed to the nature or changing inter-relationship between the various assets employed nor the types of equities used.

Q7. Thank you David, now that I fully understand the differences between risk-rated and risk-targeted funds, where would I look to find risk-targeted funds?

A7. Most are listed in the 'Unclassified' sector where peer comparison is not allowed. I should tell you that whilst we have risk-targeted funds, for all the reasons above, the added bonus is that they are also risk-rated as well! This is of course good as it is important that comprehensive independent due diligence is carried out on a regular basis by highly experienced analysts.

The analogy that I will leave you with is one of driving. Risk-targeted funds represent good driving practice – mostly looking forward through the 'windscreen' with heed to what is behind or is in the past, through the 'rear-view mirrors'. Risk-rated funds are like driving using only that 'rear view mirror' – which method would you feel most comfortable with?!!

Q8. Lastly, where do you see the debate going from here?

A8. As more investment advisers become familiar with these issues, I see risk-targeted funds assuming a greater importance and gaining greater traction over the next decade and beyond. We at Rathbones are in the strong position of having funds that are both risk-targeted *and* risk-rated. When you add to that a strong investment process and extensive resource, the adviser can concentrate with confidence on monitoring clients' dreams, needs and aspirations through relationship management. We as managers are assessing the balance between risk and reward at all times – the foundation of successful investing.

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