



## FEATURE ARTICLE

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### **Cautious Managed – Friend or Foe?**

Just as you should never judge a book by its cover I have come to understand that you should never judge a fund by its sector.

Due to the more than 2,000 UK regulated investment funds that IFAs and investors can potentially invest in the Investment Management Association (IMA) runs a classification system which provides thirty sector definitions within two categories, namely income and growth funds.

These sectors are designed to provide investors with a rough guide as to what the funds within a particular sector definition invest in, for example North American Smaller Companies or Europe Excluding UK. Indeed on the IMA website they confirm that, “The sectors are designed to help you find the best fund(s) to meet your investment objectives and to compare how well your fund is performing against similar funds.”

However, when analysing the sector definitions in a little more detail we discover that some sectors are very structured and do not allow much room for flexibility while others have far wider parameters that enable a multitude of different funds to co-exist within that sector. The cautious managed sector being a case in point.

The IMA actually states that in order to be included in the cautious managed sector a fund must invest in a range of assets with the maximum equity exposure restricted to 60% of the fund and with at least 30% invested in fixed interest and cash. There is no specific requirement to hold a minimum percentage of non UK equity within the equity limits. Assets must be at least 50% in Sterling/Euro and equities are deemed to include convertibles.



Now if you ask the average investor what they want from an investment I would suggest that many will say they want a stable return above what they would receive in the building society with as little risk as possible and this is what the funds within the cautious managed sector are perceived generally as trying to achieve. Ultimately it must be remembered however that cautious managed funds are not about never losing money but about reducing volatility relative to equities through investment limitations on a percentage of the fund.

Having said that the main issue for me is that the wide limitations placed on where a cautious managed fund can potentially invest does not prevent a fairly wide variation in investment strategies and a commensurate wide variation in performance. Indeed if we look at the performance tables for the last 12 months for the cautious managed sector we find that there are 174 funds listed in this sector with the average performance being 19.5%. Of course for “cautious” investors a performance of 19.5% over the last year would be acceptable but this figure is simply an average which means that around this figure we find a wide variation of performance from gains of over 30% achieved by the likes of Invesco Perpetual European High Income Fund and Schroder Multi Manager Cautious Managed Fund, down to a small positive performance from the Neptune Cautious Managed Fund.

Now I accept that twelve months is a very short time frame in investment terms and we certainly live in what historians may well refer to, certainly from an investment perspective, as extraordinary times, but if we look at the Invesco Perpetual European High Income Fund and the Schroder Multi-Manager Cautious Managed Fund in a little more detail this gives us an insight in to the potential of not comparing “apples with apples” in the cautious managed sector.

As its name suggests the Invesco Perpetual fund aims to achieve a high level of income and capital growth through a portfolio of primarily European equity and fixed interest securities. According to the December 09 factsheet the fund has 44.3% invested in European direct equities and 54.2% in European direct fixed interest securities with the fixed interest element having around 42% in high-yield debt and the remainder in investment grade debt. In my opinion the fund is ultimately dependant on the hugely successful fund management skills of Paul Causer and Paul Read but the question in terms of its sector classification is whether the funds focus on Europe and its significant exposure to European high-yield debt can really be described as “cautious”? Indeed the Invesco Perpetual website confirms that, “The Invesco Perpetual European High Income Fund has a significant proportion of high-yielding bonds, which means that there is more risk to investors’ capital and income than from a fund investing in government or investment-grade bonds.”

Turning to the Schroder Multi Manager Cautious Managed Fund this takes a completely different investment approach to the Invesco Perpetual fund. The fact sheet for this fund confirms that it, “Provides a one step solution for investors looking for a flexible product that accesses a broad range of assets and financial markets.” The fact sheet goes on to confirm that this is a fund of funds



investment which as well as investing in traditional markets such as equities, bonds and cash will also seek to add value through opportunities in alternative asset classes such as commodities, hedge funds, derivatives, private equity and property.

So we have two funds, both classified within the cautious managed sector with similar 12 month performance numbers, but which I would suggest are as different as apples and pears.

Now I was interested to note that in a recent survey conducted by Prudential they discovered that, based on interviews with 100 IFAs, 73% expect clients to invest in cautious managed growth funds over the next year. Putting the size of the survey to one side it also found that 72% of those interviewed were expecting an increase in the number of clients looking to invest in equities over the coming year but that the majority expect their clients to invest in cautious products due to continued economic volatility, hence presumably the findings regarding potential investment into cautious managed funds.

It is important, I think, to understand that in terms of its sector definitions the IMA has explained that these are asset based and not risk based. Indeed I recently saw an “IMA spokesman” quoted in the press as saying “You have to read the definition and that does tell you exactly what it is invested in.”

Now broadly I can understand where this statement is coming from but ultimately it has important implications as it means that for sectors such as cautious managed when choosing funds from within this sector advisers and investors really do have to look closely “under the bonnet” of a particular fund in order to understand precisely what it is they are buying.

Historically cautious managed funds have been seen by some as entry point investments for cautious investors but I hope you will agree that a fund such as the Invesco Perpetual European High Income Fund would not fit into this category, although a fund such as the Schroder Multi Manager Cautious Managed Fund might – yet they are both listed in the Cautious Managed sector.

Ultimately the conclusion that surely must be reached is that just using a sector classification, such as cautious managed, as a filter when selecting funds isn’t good enough. Sector classifications might help but as the IMA have confirmed these are asset based and not risk based classifications and therefore it is always advisable to carry out additional in depth research on any potential investment.

I would describe that as erring on the side of caution.

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