

# VOLATILITY

...BOUNCINESS...UP-AND-DOWN-NESS...NO MATTER WHAT YOU CALL IT, IT IS IMPORTANT TO UNDERSTAND IT AND MANAGE IT!

David Haslam, Head of Retail in Irish life Investment Managers, takes a look at volatility and what they have done in their recently launched Multi Asset Portfolio (MAPS) strategies to manage it.

The American novelist Philip Roth once commented that "fear tends to manifest itself much more quickly than greed, so volatile markets tend to be on the downside". Indeed, they do and for that reason Irish Life Investment Managers (ILIM), the investment arm of Irish Life Group, gave a considerable amount of time and resources to lowering volatility in their recently launched Multi-Asset Portfolio (MAPS) strategies.

ILIM recognised that, in many instances, people make good investment decisions but don't reap the rewards because they sell out at the wrong time, usually driven by a period of increased volatility. By lowering volatility, and thus the highs and lows, we can help get people invested and keep them invested, which improves their return over time.

Volatility is commonly equated with risk. As such, the higher the volatility is, the higher the risk and the returns potentially are. That is accepted and understood by most investors, but clearly if there was a way to lower volatility without directly impacting performance - that would be even better. MAPS aims to do just that. It is important to note that the Dynamic Share to Cash (DSC) Model is designed to monitor long-term movements and trends in the market, not one-off or short-term shocks.

## HOW DO WE DO IT?

1

Diversify across asset classes: MAPS invests in equities, bonds, cash and alternative assets, like commodities for example.

2

Diversify within asset classes: within each asset class, MAPS invests in more than one type of asset. In equities, we invest in global equities, emerging market equities and minimum volatility equities. Within bonds we invest in government, corporate and emerging market debt.

3

Diversify investment styles: MAPS is made up of active and passive funds. Passive funds invest in indices, which provide a further natural element of diversification.

4

Diversify across fund managers: within MAPS, the passive funds are provided by ILIM, and active funds are managed by four external, world class fund managers.

**Warning: If you invest in this fund you may lose some or all of the money you invest.**

**Warning: The value of your investment may go down as well as up.**

**Warning: These funds may be affected by changes in currency exchange rates.**

## HOW DOES THIS HELP?

This high level of diversification means that your investment is being spread out over many underlying exposures - by geography, by sector, by currency etc. The greater the diversification, the less exposed you are to negative performance from one asset affecting the overall investment which, in turn, lowers the volatility of a fund. We try to enhance the level of diversification in MAPS by specifically choosing assets that historically behave in different ways to each other.

It is possible to show the benefit of lowering volatility, through diversification, in performance terms.

Let's look at what would have happened over the period from December 2003 to December 2012. The table shows the asset allocation in MAP4, for example, in the first column. As we go across the columns from left to right, we remove an element of diversification compared to MAP4. In Mix 1, we remove the DSC model. In Mix 2 we remove DSC AND the External Managers. In Mix 3, we remove DSC, the External Managers AND the Bonds. Finally, in Mix 4, we are just left with 100% Global Equities.

At the bottom of the table, you can see the impact reducing diversification would have had on the peak-to-trough fall (also called drawdown) over this 9-year period. In other words the most you could have lost during the financial crisis in MAP4 was 18%. With no diversification, a fund with 100% global equities would have fallen 48.2%.

	MAPS 4	MIX 1	MIX 2	MIX 3	MIX 4
Global Equities	30-0%	30%	40%	50%	100%
Emerging Market Equities	5%	5%	6.5%	10%	
Minimum Volatility Equities	25%	25%	33.5%	40%	
1-5yr Bonds	7.5%	7.5%	10%		
Corporate Bonds	4.5%	4.5%	6%		
EM Debt	3%	3%	4%		
External Managers	25%	25%			
Cash (DSC)	0-30%				
Total	100%	100%	100%	100%	100%
Max Drawdown	18%	29.2%	35.8%	43.8%	48.2%

These figures are before any taxes or charges.

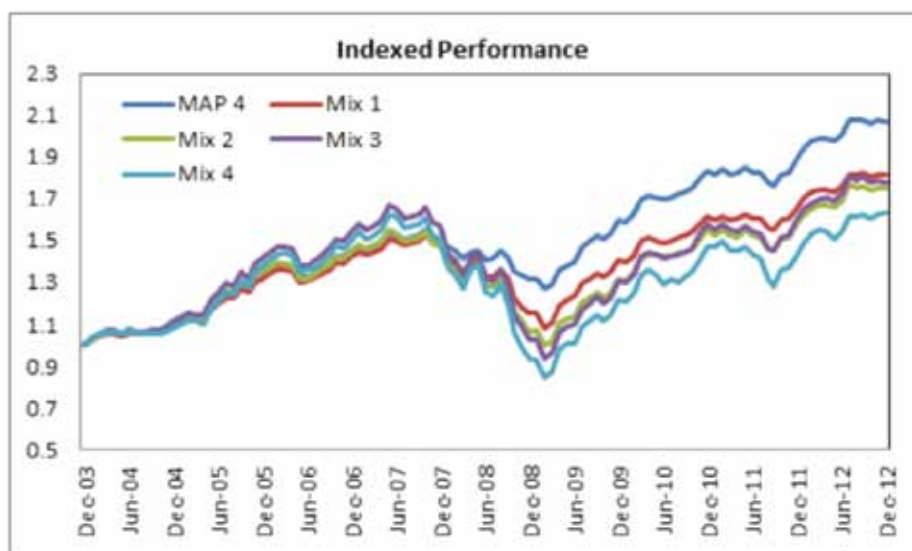
Source:ILIM

**Warning: These figures are estimates only. They are not a reliable guide to the future performance of this investment.**

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To put this in context, for every €100 invested, you would have had €82 (€100 less 18%) when the recovery came if you were invested in a lower volatility, diversified fund like MAP 4 (some of this performance is attributable to DSC). If you were in high volatility fund with very little diversification like Mix 4, you would only have had €52 (€100 less 48%) in your fund when the recovery came. Needless to say, it takes a lot longer to get back to €100 from €52 than it does from €82. This can also be illustrated in a graph.



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Volatility is also a key consideration for making decisions around an appropriate risk exposure for clients. Irish Life follows a risk rating system which has 7 distinct bands of volatility, or risk. We have designed a MAP fund to correspond to each risk category i.e. MAP 2 for risk category 2, MAP 3 for risk category 3 and so on.

To decide on what risk category is appropriate for a client, we use a risk questionnaire which has been compiled by eValue, an independent third party provider, who are the largest provider of risk questionnaires to IFA's in the UK. A copy of the risk questionnaire and more information on eValue is available on [www.blinc.ie](http://www.blinc.ie).

**The MAPS funds are available now on Irish Life's Complete Solutions Pensions and ARF products, Signature investment products and Pinnacle savings product. For more information see the dedicated MAPS section on [www.blinc.ie](http://www.blinc.ie) or talk to your account manager.**

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