



London Borough of Harrow

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Introducing Diversified Growth Funds

John Harrison
Sahul Patel

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Introduction

- Diversified growth funds (DGFs) are actively managed funds that are designed to deliver an equity type return with less volatility by diversifying across a range of asset classes and strategies.
- As a prelude to Newton's training on DGFs, we have carried out some modelling to consider how an allocation to DGFs affects the Scheme's expected return and risk.
- DGF managers seek to gain alpha through:
 - top down dynamic asset allocation, and
 - manager skill.
- Selecting the right DGF manager is very important as there are many variations in the approach taken by managers and therefore differences in the level of alpha attained.

Portfolios modelled

- Currently the Scheme has an allocation of 69% equities, 13% bonds, 13% alternatives and around 5% in cash.
- We have modelled the current portfolio and one containing a 10% allocation to DGFs.
- We have assumed the DGF allocation is sourced from the 5% cash balance and taking 5% from UK passive equities (managed by State Street).

	Current actual	Portfolio with DGFs
Equities	69%	64%
UK (passive)	25%	20%
Global (active)	44%	44%
Bonds	13%	13%
Index-linked	3%	3%
Corporate	10%	10%
Alternatives	13%	23%
Property	8%	8%
Private Equity	5%	5%
DGF	0%	10%
Currency	0%	0%
Cash	5%	0%
Total	100%	100%

Results

- Based on the Scheme's current asset allocation (at 30 April 2012) and our latest capital market assumptions (at 31 March 2012), the portfolio has an
 - **expected return of 8.8% pa** (or 6.1% pa relative to liabilities) and
 - **volatility of 16.3%** (or 18.6% relative to liabilities).
- The portfolio containing DGFs
 - increases expected return by around 0.2%pa
 - offers better downside protection, and
 - has a greater probability of meeting your fund's long term objectives

	Current actual % pa	Portfolio with DGFs % pa
Nominal		
Expected return	8.8	9.0
Expected risk	16.3	16.2
Relative to liabilities		
Expected return	6.1	6.3
Expected risk	18.6	18.6
Range of outcomes		
Best 5% outcome	15.8	15.9
Worst 5% outcome	-3.7	-3.4
Probability of gilts + 1.6%	78.1	79.5

Implementing an investment in DGFs and related costs

- You would be investing in a fund, not awarding a mandate
 - Most LGPS funds treat an investment in a pooled fund as outside the OJEU process
 - This would significantly reduce the time and cost of making an appointment

Indicative Costs

- **Aon Hewitt's indicative fees**
 - Fixed fee of £22,500 for providing a short list of three/four managers to consider and detailed briefing notes
 - Additional costs for administrating process, if required – estimated as £25,000 for full OJEU
 - Additional costs for attending selection meeting, if required – estimated at £5,000
 - Total indicative fee of £52,500 if within OJEU and £27,500 if outside OJEU
- **Transition costs**
 - These will depend on market conditions at the time, the nature of the assets being sold and (most importantly) the dealing spread on the DGFs selected
- **Manager fees**
 - The annual quoted fee should be in the range of 60-80 basis points, depending on the manager chosen
 - In addition, most DGFs use external capabilities to a greater or lesser extent – the annual cost varies from 3-35bps
 - The annual Total Expense Ratio (TER) will be 75-100 bps for most DGFs

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