ABSOLUTE RETURNS

Absolute return provides in fair and foul weather

With the current low interest-rate environment and with equities performance making investors rather cautious the absolute returns style is proving its worth as fund inflows are booming

Absolute return management vs. traditional management

- **Objective: x per cent or Eonia + y per cent rather than outperforming the benchmark index**
- **Main source of performance: alpha rather than beta**
- **Risk management: maximum Value at Risk rather than Tracking Error**

Absolute return management main features

- **Sources of performance: arbitraging interest rates, credit, equities or convertible bonds; event driven; currencies; global macro**
- **Management techniques: leverage effect, long/short, complex derivatives**
- **Specific organisation**
- **Leeway granted to the fund manager.**

The absolute return market is booming in France: just 14 funds were offered to investors in 1996 (retail as well as institutional), this went up to 75 in 2001 and surged to 132 in 2005. Many factors explain this enthusiasm: exceptionally low interest rates, the search for lowly correlated multiple engines of return combined with the desire to be detached from upward interest rate trends and a cautious return to the equities. Against this backdrop, absolute return strategies meet objectives in terms of capital growth, regardless of the market environment.

Absolute return management differs from traditional management in many ways. Its objective of performance is expressed in x% (or Eonia) + y%, rather than outperforming the benchmark index and its main source of performance is alpha rather than beta. Risk management is performed with maximum Value at Risk (VaR) rather than tracking error.

Absolute return management is based on various sources of performance: arbitraging interest rates, credit, equities or convertible bonds; event driven; currencies; global macro with specialised management techniques, such as leverage effect, long/short and complex derivatives. Furthermore, leeway is granted to the fund manager.

Crédit Agricole Asset Management (CAAM) has been active in this market, both in terms of the number of absolute return products it has launched and in its innovation in taking advantage of absolute return strategies to produce alpha returns. Its aim is to implement diversifying asset classes through a range of absolute return solutions.

DIVERSIFICATION

As a result, it uses greatly diversified strategies and constantly enhanced expertise. Its absolute return offerings have been developed with different levels of risk budgeting for the same strategy.

Launched in 1999 with multi-strategy products based on VaR and enhanced cash management, its absolute return capability broadened in 2000 to include credit and volatility strategies. In recent years, CAAM began to identify foreign exchange and equities volatility as sources of performance in their own right.

A successful company in this area needs three major assets to allow it to benefit from the boom in absolute return management. It needs long-standing experience in developing this type of product, to provide hindsight, know-how and long-term commitment. The magnitude of the investment universes and strategies used by the teams should be ideally suited to an absolute return approach.

The third key point is risk control and the necessity of budgeting risk ex-ante (maximum volatility and Value at Risk levels as a percentage of the assets managed in the absolute return style).

A large, well-established group such as CAAM has the ability to bring all of these aspects together in order to ensure rigorous steering towards absolute returns in all its funds.