

# Absolute Insight UK Equity Market Neutral Fund



FOR INVESTMENT PROFESSIONALS ONLY, NOT FOR ONWARD DISTRIBUTION

The UK Equity Market Neutral Fund aims to provide attractive positive absolute returns in all market conditions. This Fund forms part of the Absolute Insight range of funds.

The Fund's investment process seeks to profit from market inefficiencies which lead to certain stocks being mispriced relative to similar stocks, the sector, or the broader market. The managers identify investment opportunities through focused research and aim to generate positive returns, with low volatility and low draw-downs, through long/short positions which we describe as paired-trades. Stop-loss review triggers provide downside protection for the Fund and are consistent with its low risk characteristics.

## The Fund

- Aims to provide **absolute returns in all market conditions** – this has been demonstrated by the Fund's performance track record since inception.
- **Market neutrality** – strict limits on net exposure and beta ensure that the Fund maintains minimal exposure to the direction of the equity market.
- **Low volatility** – a particular feature of the strategy has been to deliver low volatility and high risk adjusted returns.

## The approach

- **Paired trade approach** – the managers build the Fund from a series of paired trades. Each pair is designed to isolate the specific risks that the fund managers seek to profit from, while hedging out unwanted sector or broader market risks.
- **Stop loss review triggers** – stop losses are applied to each position within the Fund, with the aim of preserving capital by limiting downside risk.

## Key benefits

- Paired trade approach used to profit from idiosyncratic stock opportunities
- Strict limits on net exposure and beta minimise market direction risk
- Stop-loss discipline provides downside protection
- Multi-dimensional risk management surrounds investment team
- Irish regulated UCITS III structure



## Insight's expertise

- **Experienced investment team** – the portfolio managers have been responsible for the strategy since inception. Together with specialist analysts they form a cohesive and dynamic unit which is fully integrated within the investment infrastructure of Insight.
- **Disciplined risk management** – applied through a multi-dimensional and integrated framework.

## UCITS III vehicle

- **UCITS III vehicle** – The Fund is a sub-fund of Absolute Insight Funds plc, an Ireland-domiciled open-ended investment company.

# Investment approach

## Capturing market inefficiencies

This Fund's approach is centred on the concept that markets are not always efficient. In order to capitalise on these inefficiencies, our team has built a process that seeks to isolate stock specific opportunities while minimising unwanted market-related risks using a technique of paired trades.

Managing a long/short equity portfolio through paired trades is very different from managing a traditional long-only portfolio. When managing a long-only portfolio the manager effectively expresses a view on every stock in the benchmark index – stocks which are not owned represent negative views.

Our paired-trade approach allows our managers to express views only where they have strong conviction. This has allowed us to structure our research process in a way that we believe maximises the impact of our analytical skill. We focus detailed research only on ideas which appear to offer significant performance potential; we do not seek to have a view on every stock.

## Portfolio construction

Each paired trade in the Fund consists of two units – a long and a synthetic short. The lead unit (which may be long or short) is expected to drive the performance of the pair, while the secondary unit provides the hedge. The objective of the secondary unit is to create a market-neutral position and isolate the potential alpha identified in the lead unit. The use of derivatives (within a UCITS III regulated framework) enables the managers to achieve a much greater degree of precision than is available to a traditional 'long-only' manager.

The managers typically design three types of paired-trades as shown below:

	Example trade
1. Stock vs stock	Next vs Marks & Spencer
2. Stock vs sector index	Next vs Retail Sector
3. Stock vs market	Next vs FTSE 100 or Next vs Mid 250

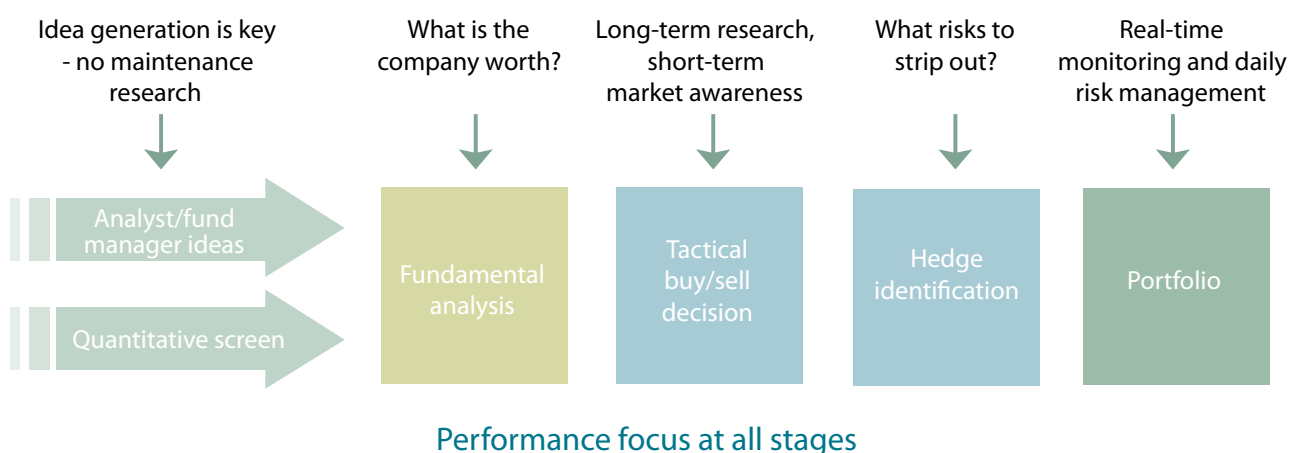
## Specialist investment team

Insight's UK Equity Market Neutral team comprises a cohesive and dynamic group of investors with complementary skills. It has been structured to harness Insight's specialist equity expertise as well as the benefits of being embedded into Insight's sophisticated risk management infrastructure.

The Fund is jointly managed by three portfolio managers, who have worked together since the inception of Insight's UK equity market neutral capability. They are directly supported by two analysts who focus exclusively on generating ideas for the Fund, and also share perspectives with an experienced UK income fund manager.

## Investment process

The UK Equity Market Neutral team employs the following process:



### Analysts and fund manager ideas

Our portfolio managers and analysts are the primary source of idea generation. Daily interaction with companies, industry specialists and the wider investment community highlights stocks which they believe warrant detailed research.

We know from experience that different types of stocks will lead market performance as the investment environment evolves through different phases of the economic cycle, and as investors' risk appetites change. For that reason we are not wedded to a narrow range of predetermined characteristics that stocks must display to be considered as buy or sell candidates. Instead we apply our deep knowledge of individual companies and set that within our assessment of the prevailing sector and wider stock market dynamics. This flexibility has been one of the foundations of the positive returns that the Fund has generated through changing market conditions.

### Quantitative screening

As a supplementary source of ideas we use technology to help screen for stocks that display a combination of characteristics that we judge attractive/unattractive.

## Fundamental analysis

Interesting stock ideas are subject to detailed analysis by our portfolio managers and analysts. They model their expectations on how the fundamentals of a company's business will evolve given the industry and economic dynamics they foresee.

These expectations are used as inputs to valuation analysis. We use a range of valuation methodologies and select what we believe is most appropriate for the company, industry and market context. In stressed situations, for example, price to asset backing measures can be more helpful than forward looking earnings measures. Ultimately, for a stock to be rated a buy or sell (and be considered as a candidate for a lead long or short position) we have to believe that the consensus expectations embedded into the current share price are wrong.

## Tactical decision

Our managers think very carefully about what will cause the stock market to revalue share prices and when those events will unfold. Typically, the team will look to invest in a lead position where they foresee a catalyst within three to six months.

## Hedge Identification

When the portfolio managers have a high conviction lead idea (long or short), they work to select an appropriate hedging position which will isolate the risk they want to take, and profit from, while hedging out other risks.

When selecting the hedging component the managers will assess historic volatility and correlation with the lead position to help with the scaling and beta adjustment of the hedge. Positions within the Fund are monitored constantly and are adjusted as the investment environment and their views evolve.

Every position in the Fund is owned by one of three portfolio managers – ideas generated by the analysts must be sponsored by one of the managers before it can be included in the Fund. Each of the managers has discretion in terms of putting positions into the Fund without the need for "committee" agreement. We believe this allows our managers' flair to impact the Fund and also allows our process to be dynamic. The stop-loss review process discussed below provides a robust bottom-up risk control to support this approach.

The managers ensure that the portfolio as a whole is exposed to a spread of underlying investments risks which should not be correlated with each other. Overall market risk is managed and supervised as discussed under the next section 'Risk Management'.

## Downside protection

Stop-loss review triggers are applied to each open paired trade in the Fund. A stop-loss message is triggered when a paired trade registers a loss of 15 basis points (bps) of the Fund's net asset value (NAV) and are monitored independently by both the portfolio manager and risk management team. Immediate action is required if a stop loss is triggered resulting in either the closure or re-sizing of the position. This process helps to manage downside risk and preserve capital.



Derivative counterparty exposure is collateralised on a daily basis. We have a team of dedicated collateral managers supported by market-leading collateral management infrastructure systems, known as Colline.

## UCITS III vehicle

The Fund complies with UCITS III regulations in regard to liquidity, transparency, diversification and risk management. Under these UCITS III risk regulations, it is recommended to use the VaR methodology to monitor risk and our portfolio managers have to measure the VaR on a daily basis. The VaR is calculated using a one year time horizon, based on the maximum drawdown over a 5 day holding period with 99% probability. In addition, UCITS III guidelines also require stress testing on at least a quarterly basis. However, we do not use VaR in isolation but as part of our multi-dimensional risk management approach which is supported by our risk teams, internal guidelines and regular stress tests, as outlined in the section above.

## Fund specifics

Objective	To provide attractive, positive absolute returns in all market conditions
Investment universe	UK equity and equity-related securities and their derivatives
Scheme type	Open Ended Investment Company, UCITS III
Umbrella scheme	Absolute Insight Funds plc
Domicile	Ireland
Listing	Irish Stock Exchange
IMA Classification	Absolute Return
Benchmark	Sterling 3-month LIBID (defined as LIBOR minus 0.125% per annum)
Inception date	28 February 2007
Fund manager	Andy Cawker, Iain Brown and Richard Howarth
Share classes	Institutional and retail share classes are available in different currencies, with different minimum investment amounts and annual management charges (AMC)
Fee schedule	10% of any performance in excess of the benchmark return and net of AMC (subject to high water mark)
Base currency	Sterling
Pricing/dealing	Daily NAV calculation and dealing
Custodian	State Street Custodial Services (Ireland) Limited
Administrator	State Street Fund Services (Ireland) Limited
Platforms	Ascentric (FundsDirect), Cofunds, Hargreaves Lansdown (Vantage), Novia, Nucleus, Transact

## About Insight Investment

Insight Investment is a specialist asset manager at the forefront of designing investment solutions to meet our clients' needs. Launched in 2002, Insight is a leading asset manager, with £99.9<sup>2</sup> billion in assets under management across fixed income, liability driven investment, cash management, multi-asset, absolute return and specialist equity strategies. We manage money for private investors, pension funds, sovereign wealth funds, insurance groups, local government, charities and other financial institutions.

<sup>2</sup> As at 31 March 2010.

## Our team

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### **Andrew Cawker**

#### **Portfolio Manager, Head of Specialist Equities**

Andrew joined the UK equity team at Insight in April 2003 and is responsible for the management of UK equity long/short portfolios. Prior to Insight, Andrew was an Associate Partner at Invesco Global Asset Management (Amvescap plc) where he was involved in developing specialist UK equity business alongside the management of a range of UK and global equity portfolios. He was also responsible for pan-European analysis for the retail, food, beverages and tobacco sectors. Andrew began his investment career at Prudential Portfolio Managers in 1988, ultimately becoming a Director, with responsibility for UK equities. He holds a BA honours degree in Business Studies from the City of London Polytechnic.



### **Iain Brown**

#### **Portfolio Manager, Specialist Equities**

Iain joined the UK equity team at Insight in July 2002 and is responsible for the management of UK equity long/short portfolios. Before joining Insight, he spent six years at Norwich Union Investment Management, latterly as Head of Institutional Investment. Prior to this he spent eight years at CIN / Goldman Sachs as a portfolio manager. Iain began his career as an investment analyst with Credit Lyonnais in 1987 following a number of short-term roles, including two years with stockbroker, Charlton Seal. Iain holds a MA degree in Geography from Fitzwilliam College, Cambridge University.



### **Richard Howarth**

#### **Portfolio Manager, Specialist Equities**

Richard joined the UK equity team at Insight in January 2002 and is responsible for the management of UK equity long/short portfolios. Prior to Insight, he held a fund management role at Brewin Dolphin for five years. He began his career as trainee portfolio manager with Capel-Cure Myers Capital in 1994. Richard holds a BA honours degree in Economics from the University of Nottingham and is an Associate of the CFA Society of the UK.

## Find out more

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