

momentum shifted to low-cost index funds, which have a role to play but the question is, how big should that role be?"

Blayney says the way indices are currently constructed needs to be examined to ensure their relevance.

"While they can be useful tools and make sense in certain circumstances, they have flaws," he says.

While an index can be an efficient means of gaining exposure to a particular asset class, Hopkins is concerned that current demand for index funds and exchange-traded funds is a result of investors' obsession with fees and the sad fact that too few active managers are able to beat the benchmark.

He points out that some funds that are benchmark-unaware are able to add significant value.

AMP Capital's Multi-Asset Fund holds unconstrained managers, hedge funds and other alternatives. Hopkins admits that fees are expensive in that space. However, the fund has delivered compelling risk-adjusted, after-fees performance.

Richards says time frame is also important when considering fees. "If you're trying to add value to a portfolio, sometimes you have to spend a little bit extra for those *skills* because they're specialist areas and they cost money but it can be worth it," she says.

MLC has programs in private equity and infrastructure and also invests in "opportunistic assets" such as leasing agriculture but all assets must adhere to its strict liquidity requirements.

Perpetual has some exposure to private equity but is also constrained by its liquidity requirements.

Blayney says opportunities currently lie in the mortgage sector because of a shortage of capital.

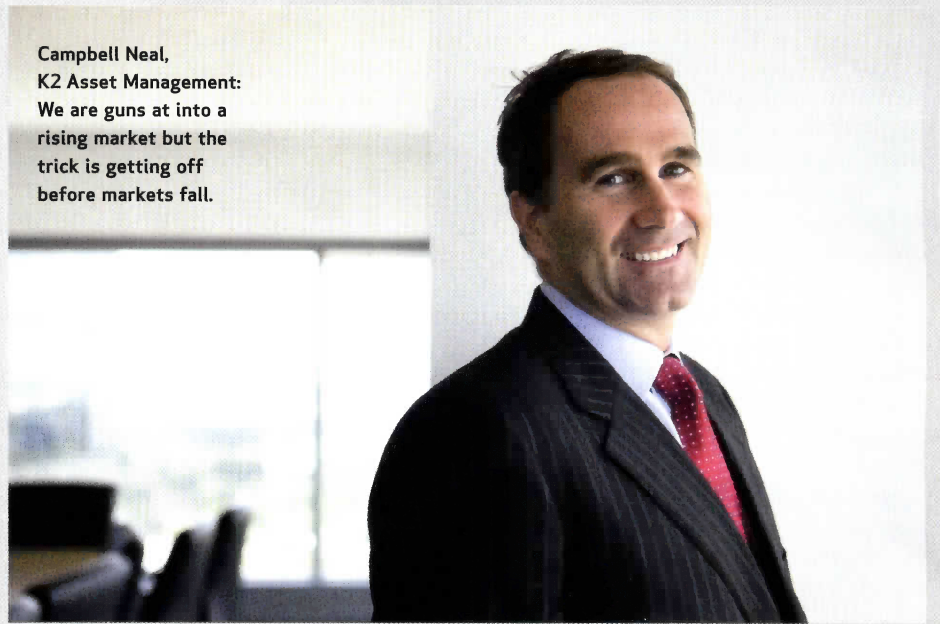
"These things tend to go full-circle," adds Richards.

"Balanced funds used to be the only funds people invested in," she says. "Then they wanted to do it themselves so advisers started doing their own asset allocation and manager selection. And then, post-GFC, balanced funds came to the rescue.

"Similarly with Australian equities, first investors wanted benchmarks and then they wanted benchmark-unaware managers – and then benchmarks became fashionable again." ❏

## Nimble funds jump in and out of cash

**Campbell Neal,  
K2 Asset Management:  
We are guns at into a  
rising market but the  
trick is getting off  
before markets fall.**



Fund managers should be able to dynamically shift out of equities and into cash when markets are down and opportunities are scarce, according to the listed Australian fund manager K2 Asset Management.

Using a benchmark-unaware approach, which allows it to allocate up to 100 per cent in cash, the K2 Australian Fund returned 10.5 per cent a year for the three years to October 31, compared with the S&P/ASX 200 Accumulation Index, which returned 6.9 per cent.

Similarly, the K2 Select International Fund (hedged in Australian dollars) returned 10.7 per cent for the same period, against the MSCI World ex Australia Index, which fell 5.8 per cent.

In the current uncertain environment, Campbell Neal, chairman and managing director of K2 Asset Management, says fund

managers need to adopt a flexible investment style and actively adjust net equity exposure.

In order to protect clients' capital, it's important to allocate capital dynamically and measure risk in an absolute sense.

"Superior risk-adjusted returns can be achieved through the investment cycle while protecting clients' invested capital," Neal says.

Currently, the K2 Australian Fund is almost 90 per cent invested, with about 4 per cent of the portfolio in short positions. Earlier in the quarter, the fund was only 60 per cent invested and 40 per cent in cash.

Neal says K2's strength lies in its ability to get back into markets quickly before they rise.

However, he admits there's still room for improvement when it comes to predicting when markets are about to fall.

"We are guns at getting into a rising market but the trick is to get off before markets fall," he says.

"Investors fear that we'll still be in cash when markets rise but that's not our weakness. We need to work on getting out quicker."

In isolation, K2's fees appear high, charging a management fee of 1.5 per cent and, if it hits a target of 6 per cent, a performance fee of 20 per cent applies to all gains. However, it aims to deliver 15 per cent a year after fees over a three- to five-year horizon.

"With market volatility an increasing fact of life, capital protection is paramount," Neal says. "We invest in equity markets to generate growth but also focus on protecting our clients' gains by moving to cash during volatile periods."

LENG YEOW

JESSICA SHAPIRO