Alternative Assets - Defined Return Funds

Within the MAIA portfolios, more emphasis has recently been placed on utilising alternative type assets which have a differing risk and return structure to conventional equities and bonds.

Within this asset class, recent exposure within the MAIA portfolios has been to include defined return asset funds. These funds invest in equity markets through derivative instruments to provide the investor with a known outcome at the end of a pre-defined term. Also known as structured products; defined investments are a series of swap-based contracts where an underlying investment is made to replicate a market index, and a swap contract is entered into, to exchange the market return for a fixed defined return based upon certain parameters. This is normally expressed as a percentage and will have a defined return period to generate that outcome.

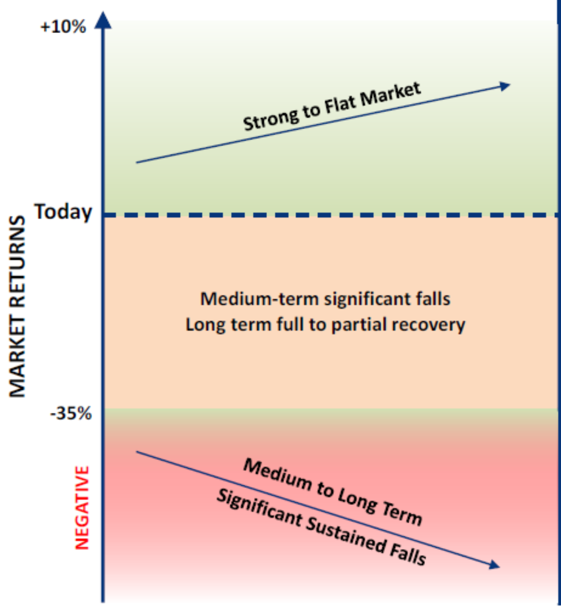
Many of these types of investments are placed through some of the world's largest banking institutions to help provide liquidity and investment returns overtime. The investments are bonds which have underlying linkage to equity markets, and investors will gain set returns if certain parameters are met.

The use of these types of funds helps to reduce risk and volatility within portfolios due to the defined return nature held within the process.

Funds process

The funds will invest in a series of structured investments with differing time horizons as well as various indices for replication and return outcomes. These, utilised together in one fund structure, will provide investors with diversification, a known return outcome and a defined measure of risk and volatility. The MAIA investment team are not new to investing in Structured Products. Previously at Investec and Williams de Broe, Laurence Boyle created numerous structured products to meet the needs of the funds he was managing at the time. Laurence, and therefore MAIA, no longer buy direct structured products but buy defined return funds which have the same principles, and are assembled in a fund structure, which adds diversification and greater liquidity.

These funds will look to provide investors with the following types of return through differing market conditions:



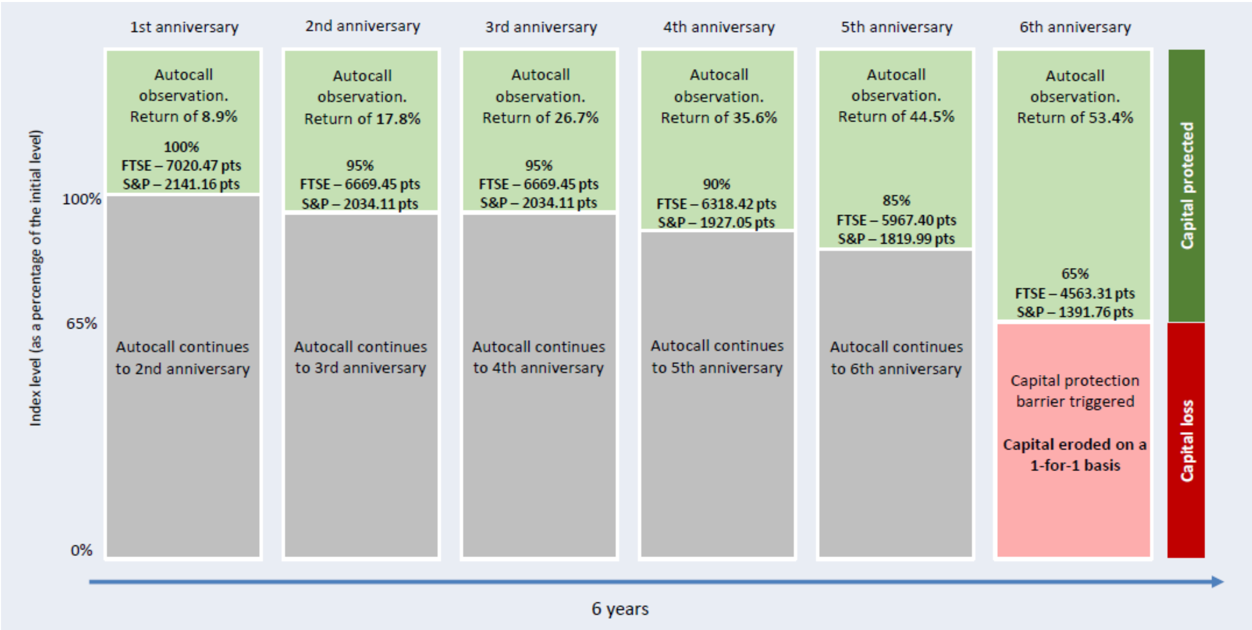
Returns	Volatility
+7% to +8% annualised	Relatively Low
+7% to +8% annualised	Relatively High
Equity-like with no dividends	Equity-like with no dividends

The known return of the funds is due to each underlying investment having a defined result if certain parameters are met. This means the managers can provide on-going indications of how the funds will perform in differing market conditions.

Where we believe these types of funds will help provide investors with better risk adjusted returns going forward, is that they have lower correlation to equity markets and have the opportunity to gain positive returns in flat or slightly lower markets.

These types of funds will have protection built in to the underlying structured investments due to the defined nature of the return.

Where the protection comes in to place is through the individual investment and how it has been setup by the underlying issuer. One example of this is through the Atlantic House defined returns fund which has invested in one of the below auto call investments.



The above example shows how the defined investment will provide a set return to the investor if the underlying market level is reached.

It also shows how the protection will kick in and returns can be made even if markets have fallen. This specific product has a step-down function allowing for returns to be made even if the underlying market falls by a total of 35% over 6 years.

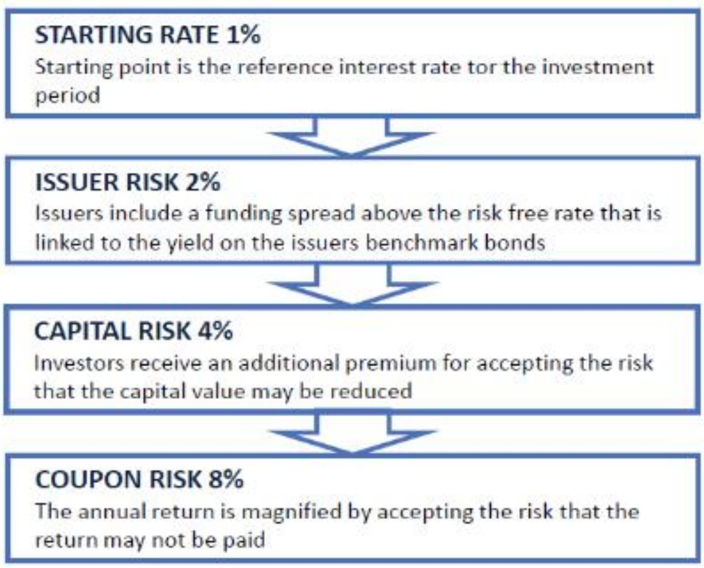
The risks to these types of investments is if the protection barrier is breached and then underlying capital can be eroded.

This does mean that full protection will not be achieved in very volatile and large loss periods. However, this fund is being utilised as an equity market proxy and so it is known that it can fall with markets during highly volatile loss periods.

How the return is calculated

When looking at the return profile for these types of funds, the result is known to the investor as this is set up with the price and capital protection barriers at the start.

What many will realise is that the return offered for this bank's bond is far greater than what is available on the retail market. The below diagram shows how this is the case:



The additional capital risk taken from the underlying investment allows for a greater return to be paid out.

The underlying investments may not pay any coupon and may even generate a capital loss, which is why continued due diligence is performed on the underlying funds and managers to make sure they are investing wisely.

In Conclusion

The funds we have put into the MAIA portfolios are heavily focused on developed market indices, with downside protection a key theme for all the funds. They are all looking to generate modest defined returns whist looking to limit volatility and correlations to equities and bonds.

Having a defined outcome allows for a known return on an investment which will be key for the lower risk portfolios, where risk to return management is the primary objective.

Where capital protection is being utilised within the underlying investments, it will also allow for uncorrelated returns to occur in flat or slightly downwards markets, which again will help the lower risk portfolios as markets move towards the end of their current cycle.

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