


The fear of losing retirement savings sees many people move their superannuation to cash-like or other defensive investments in preparation for this new phase of life. Financial advisers and their clients are increasingly aware of the need to conserve capital, particularly after the Global Financial Crisis (GFC) and the impact that event had on the superannuation balances of those at, or close to, retirement.


Couple that fear with the possible end of the equities bull market that has provided stellar returns since the GFC ended; advisers and investors are understandably nervous. Investors need exposure to growth assets, but at what cost?

The Grant Samuel Global Equity Advantage Fund (the Fund) seeks to maintain the significant capital gains investors have made in recent years. It can help investors manage equity market volatility and drawdowns in a cost effective way.

Q1 What is the Grant Samuel Global Equity Advantage Fund?

The Grant Samuel Global Equity Advantage Fund (the Fund) combines the proven success of two of Grant Samuel Funds Management's (GSFM) investment partners:

 **EPOCH** New York-based global equity specialist **Epoch Investment Partners, Inc.** (Epoch), which manages the highly successful Global Equity Shareholder Yield strategy.

 Sydney-based volatility experts **Triple Three Partners Pty Ltd** (Triple3), which manages a dynamic options-based volatility overlay to mitigate the risk of capital loss in the underlying portfolio.

Q2 How does the Fund work?

The Fund buys units in the Grant Samuel Epoch Global Equity Shareholder Yield (Unhedged) Fund (Underlying Fund) and adds a dynamic options-based volatility overlay (Options Overlay). The Fund is designed to enable investors, particularly those close to or in retirement, to retain an exposure to equities while mitigating the risk of capital loss.

The Grant Samuel Epoch Global Equity Shareholder Yield Funds are some of the most successful providers of dividend income sourced from global shares in Australia. The funds are widely used in income oriented model portfolios, providing the diversification benefits of an investment in global shares coupled with a dividend yield that exceeds the respective benchmark index.

The investment process has consistently identified companies with the financial strength to pay high cash dividends, buy back their own stock or reduce debt. Through employing this shareholder yield strategy, Epoch believes it can produce superior risk adjusted returns and a consistently high level of income.

The Options Overlay aims to reduce downside risk without constraining the upside.

Equity markets have been in a sustained bull run since the end of the GFC; more recently there have been signs this may be coming to an end.

There is understandable concern about the timing and quantum of an equity market correction, which could significantly impact those investors closer to, or in, retirement. It's of particular importance for these investors as they are generally more susceptible to sequencing risk, the risk that the order and timing of investments is unfavourable. Retirees typically have less time to make up any capital losses.

The dynamic Options Overlay utilises advanced quantitative models and forecasting technology built over many years of proprietary research.

By entering into options contracts, which generally move in the opposite direction to the Underlying Fund, the Options Overlay seeks to smooth returns so that the value of the Fund does not fall as far as the Underlying Fund in times of market stress. Reducing and smoothing the volatility of the returns of the Underlying Fund means the Fund may not benefit fully from the upside in rising markets, but its exposure to downside risk in falling markets should be limited.

The Fund is designed to enable investors, particularly those close to or in retirement, to retain an exposure to global equities while seeking to mitigate the potential loss of capital.



Q3 Is there evidence to illustrate the effectiveness of the strategy?

We have back tested the data under different scenarios, which are illustrated in Figures 1 and 2. The Options overlay improves returns and reduces volatility when compared to the Underlying Fund and the MSCI World Index (ex Australia).

Figures 1 and 2 are not actual performance results of the Grant Samuel Global Equity Advantage Fund. The data tables contain actual performance returns of the Underlying Fund plus data comprised of 90% of the Underlying Fund's return plus 10% Options Overlay. This data is provided for illustrative purposes only and should not be relied on as (and is not) an indication of the future performance of the Fund.

Figure 1: For illustrative purposes only; Underlying Fund versus Underlying Fund + Options Overlay versus Benchmark, May 2008 to September 2015

STRATEGY ¹	RETURN % P.A.	VOLATILITY % P.A.	RISK RATIO ²	MAXIMUM DRAW DOWN %	WORST MONTH %
UNDERLYING FUND	8.3	15.0	0.55	-21	-13
UNDERLYING FUND + OPTIONS OVERLAY ³	12.0	12.8	0.94	-16	-10
BENCHMARK ⁴	6.7	15.9	0.42	-33	-16

Source: Grant Samuel Fund Services Limited and Triple3 Partners

1 Returns are net of fees and assume reinvestment of income. Inception date of the Grant Samuel Epoch Global Equity Shareholder Yield (Unhedged) Fund was 15 May 2008.

2 The Risk Ratio is the return divided by volatility; the greater the value, the more attractive the risk-adjusted return.

3 Non actual results. Calculated using 90% of Underlying Fund returns and 10% of Options Overlay.

4 MSCI World ex Australia Index in \$A, Net*.

Past performance is not a reliable indicator of future performance.

The analysis showed that the application of the Options Overlay would have reduced the maximum losses suffered by the Underlying Fund. This resulted in an increase in overall returns with a reduction in the volatility of returns.

Figure 2 illustrates the year-by-year performance of the Underlying Fund on its own and with the Options Overlay applied.

When the equity market rises strongly, the combined portfolio may underperform the Underlying Fund, as occurred in 2013 and 2014.

Figure 2: For illustrative purposes only; Underlying Fund versus Underlying Fund + Options Overlay versus Benchmark - annual returns (calendar years)

STRATEGY ¹	2008 %	2009 %	2010 %	2011 %	2012 %	2013 %	2014 %	2015 ² %
UNDERLYING FUND	-6.1	-5.2	-1.6	5.7	8.6	43.4	15.7	7.9
UNDERLYING FUND + OPTIONS OVERLAY ³	11.9	0.1	2.0	6.3	10.6	34.8	11.8	13.8
BENCHMARK ⁴	-18.8	0.8	-1.9	-5.6	14.4	47.0	14.7	10.0

Source: Grant Samuel Fund Services Limited and Triple3 Partners

1 Returns are net of fees and assume reinvestment of income. Inception date of the Grant Samuel Epoch Global Equity Shareholder Yield (Unhedged) Fund was 15 May 2008.

2 Returns for period ended 30 September 2015.

3 Non actual results. Calculated using 90% of Underlying Fund returns and 10% of Options Overlay.

4 MSCI World ex Australia Index in \$A, Net*.

Past performance is not a reliable indicator of future performance.

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Importantly, during the period 2008–2009 when most global equity investments suffered significant capital losses due to the GFC, the addition of the Options Overlay would have significantly reduced drawdowns, leading to improved outcomes for investors.

This analysis found that the Options Overlay generates positive returns when the Underlying Fund experiences capital loss, while the drag on the overall portfolio is small when the Underlying Fund experiences strong positive performance.

Overall, back-testing demonstrated that **negative returns were reduced by 40–50%**, while **75–80% of the upside gains** were maintained, suggesting the Options Overlay can be an effective strategy to mitigate downside risk.

Q4 How can this strategy help mitigate sequencing risk?

Sequencing risk is the risk that the order and timing of investments is unfavourable. The wrong sequence of returns can have a big impact on a retirement portfolio.

For example: an investment is made toward the end of the accumulation phase, just before a market correction. If the market falls 30%, the market needs to return 43% just to get back to the same point. A retiree may not have time to recoup such losses.

Volatility in markets and the order in which investment returns occur can make a big difference to the capital base once investors begin to draw on their retirement savings. If investors experience positive investment returns in the first few years of retirement, they will be better placed to ride out market downturns.

Figure 3: Market drawdowns and gains needed to recoup losses

LOSS	GAIN NEEDED TO RECOUP LOSS
10%	11%
20%	25%
30%	43%
40%	67%
50%	100%

Source: Triple3 Partners

However, if returns early in retirement are negative, then proportionately more capital is required to fund ongoing living expenses. This was the case for many retirees on the cusp of the GFC; they were withdrawing from an already diminished capital base, which significantly reduced the possibility of recouping losses over time.

A growth investment with a volatility overlay allows retirees to maintain the exposure they need to growth assets to mitigate longevity risk, while providing a buffer that aims to limit the downside and help manage sequencing risk.

Q5 How will the overlay effect the income distributed by the Fund?

A major goal of the Global Equity Shareholder Yield strategy is to provide investors with income from its global equity investments. Using the Options Overlay enables the Fund to benefit from gains in its option positions as these will increase the Fund's income distribution. Conversely, any losses in its option positions will come from the Fund's distributable income.

In managing the Options Overlay, the Fund may engage in covered call writing where Triple3 will sell call options with the purpose of generating an income stream from the options premium.



Q6 How does this overlay compare with other strategies?

There are a number of overlay strategies employed by investment managers to mitigate downside risk. Each has a number of pros and cons:

Futures strategy

A futures-based approach manages volatility by selling stock index futures when forecast volatility rises above a target threshold; in effect it reduces the portfolio's equity exposure.

PROS	CONS
Simple to understand, relatively easy to implement	It may not help meaningfully in a prolonged slow market decline (e.g. 2000–2002)
Can transact in large volumes	A futures-based strategy will perform less than expected during sharp falls due to liquidity issues
Low cost solution	It needs to sell more futures as the market goes down – if the strategy is being deployed in significant size, it may have a cascading effect and result in catastrophic losses (e.g. 1987)
Investor retains the alpha produced by the underlying investment	It cannot generate net positive returns in down markets, nor extra income for investors

Covered call writing

Covered call writing, also known as a 'buy-write' strategy, is a commonly used volatility management tool. Quite simply, an investor holds a long position in an asset and writes (sells) call options on that same asset in an attempt to generate increased income from the asset.

Selling covered call options can help offset downside risk, but it also means the investor trades the cash received from the option premium for any upside gains beyond the current value of the share until option expiry.

PROS	CONS
Can earn income from the premium	Can forgo some or all of the upside
Can reduce portfolio volatility and boost risk adjusted returns	Not effective where there are significant falls in the market

Tail risk hedging

Tail risk hedging strategies are comprised of investments in options (generally buying put options) that are designed to mitigate large, unexpected adverse moves in the market, such as those experienced during the GFC. The majority of tail risk strategies are actively managed because of the significant cost involved in purchasing options, particularly during times of market volatility.

A tail risk hedging strategy can be very expensive and often the benefits are vastly outweighed by the losses that accumulate in times of rising markets.



As illustrated in Figure 4, a tail hedge can be effective during periods when the S&P 500 Index¹ (SPX) is declining, notably 2001–2003 and 2008–2009. As the market regains its footing and commences an upward trend, the value of the dollar invested steadily declines.

Figure 4: Growth of \$1 invested in the S&P500 Index



Source: Triple3 Partners, Yahoo Finance

Note: The tail risk hedge strategy represents the purchase of a 5% out-of-the-money put option each month.

PROS	CONS
Provides 'insurance' against large market declines below certain levels	Can be very expensive and the cumulative costs can erode longer-term returns

Q7 Who is this Fund most suitable for?

The Grant Samuel Global Equity Advantage Fund may be an ideal investment for:

- The **investor** who needs growth but is concerned about market volatility
- The **income investor** who needs to look beyond term deposits in a low interest rate environment
- The **retiree** worried about loss of principal but requires growth and income to maintain their lifestyle
- The **alternative investor** looking for absolute return strategies.

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