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Defensive Asset Risk – A Wolf in Sheep’s Clothing?

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Defining Defensive Assets

- The dictionary gives us....
 - ...able to provide moderately steady growth with minimal risk.
 - ...considered stable and relatively safe for investment, especially during a decline in the economy.

Source: Random House Unabridged Dictionary

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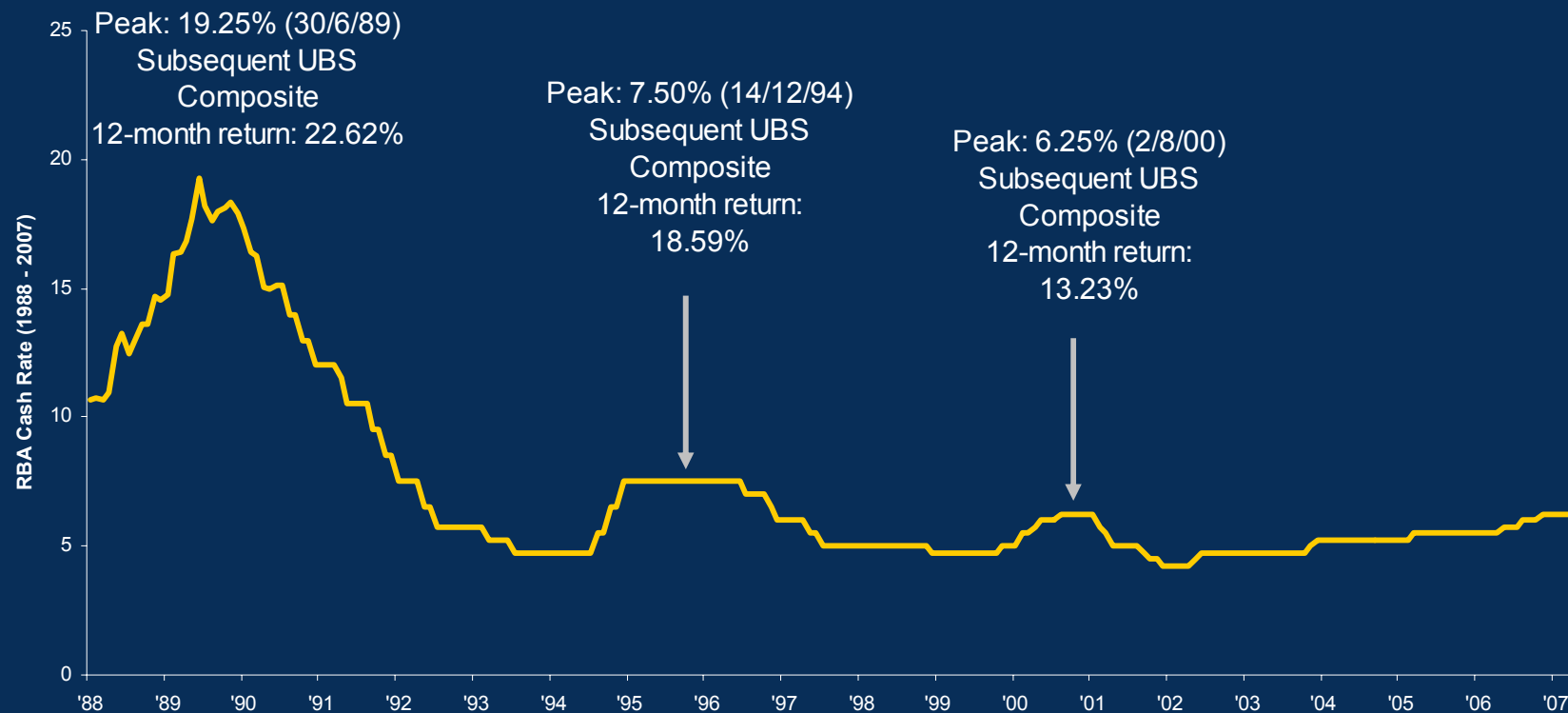
Defensive Assets Characteristics

- Liquidity
- Transparency of underlying assets
- Low volatility
- Preservation of capital
- Predictable return streams
- Yield focus

Bonds are naturally mean reverting assets!

- Initial negative capital returns accrue to bond holders when interest rates rise....
-but investing at higher yields more than compensates bond investors in a higher rate environment

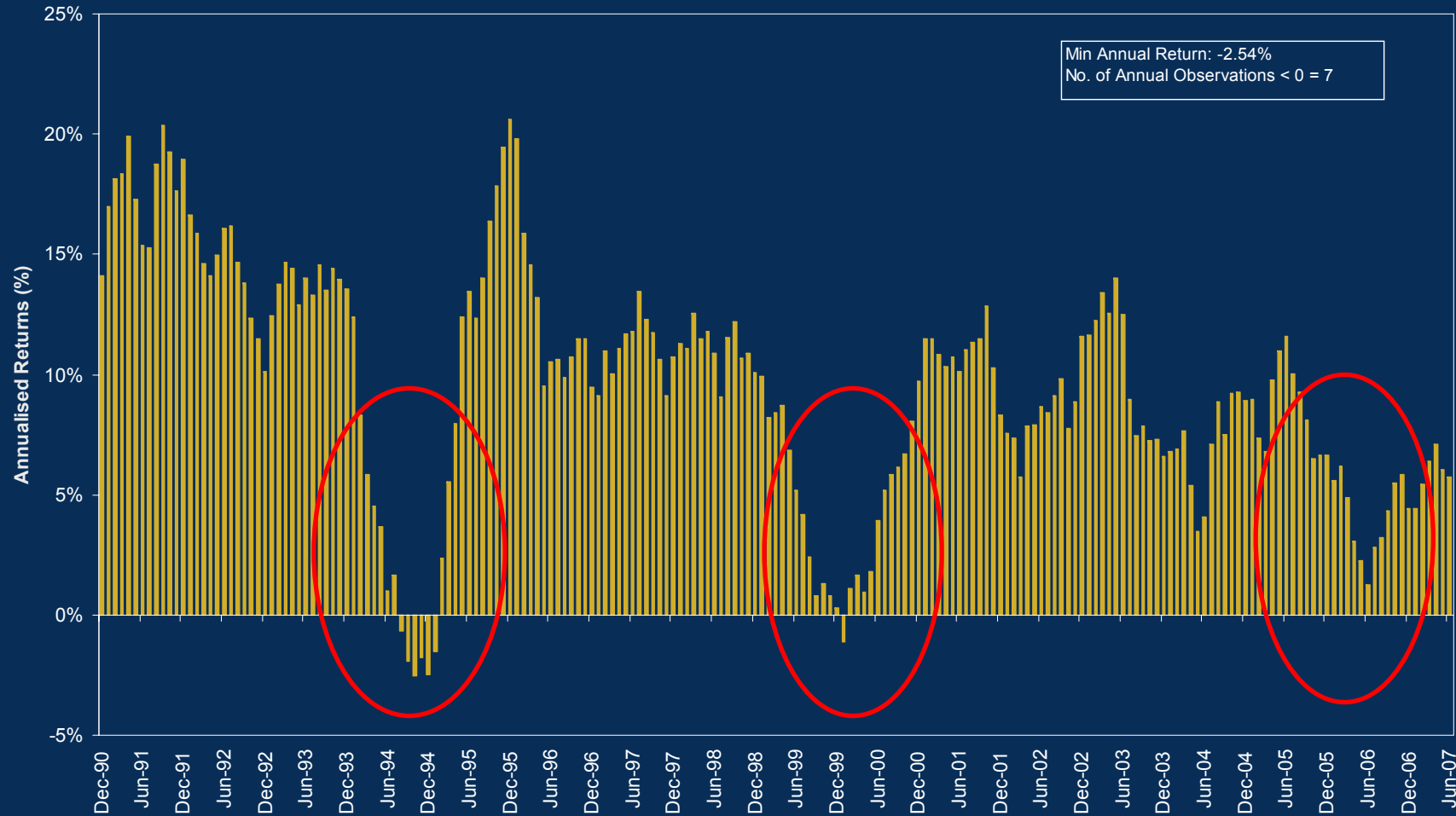
High Interest Rates – A Positive Climate for Bonds



Source: RBA

Tail Risk (negative returns) in Fixed Interest is low

Monthly Rolling Annual Returns to Global Fixed Interest

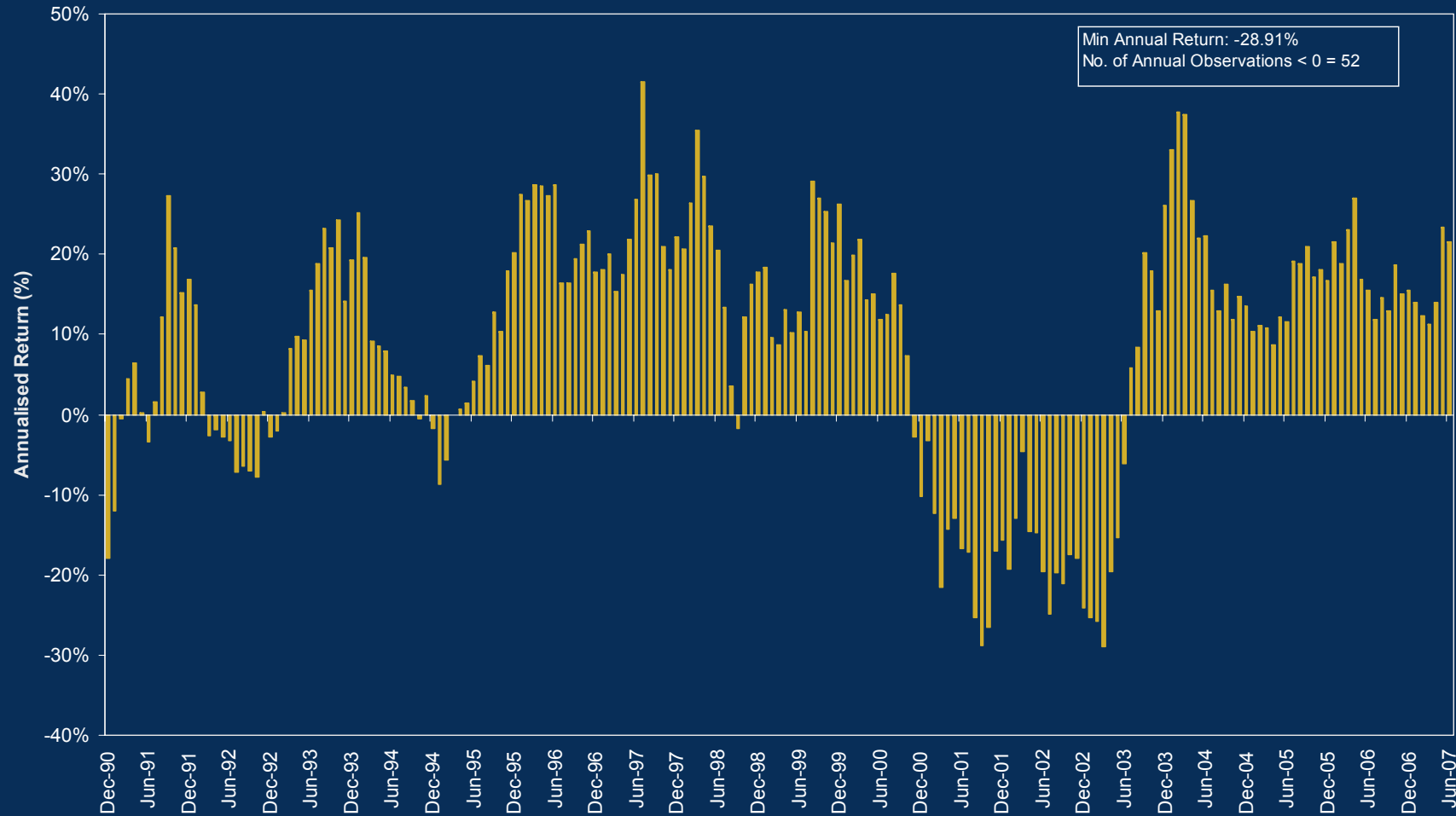


Source: Lehman Brothers

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Particularly when compared to a more volatile asset class such as Equities

Monthly Rolling Annual Returns to Global Equity



Source: MSCI

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The Probability of Below Zero Returns

	Annualised Return	Annualised Standard Deviation	Probability of below Zero Return
Australian Equity	12.95%	12.18%	14.46%
Global Equity	6.94%	13.66%	30.51%
Australian Fixed Income	9.30%	4.30%	1.54%
Global Fixed Income	9.37%	3.18%	0.16%
Australian Property	16.35%	8.22%	2.33%
Global Property	11.97%	15.69%	22.37%
Hedge Fund of Fund	9.80%	5.50%	3.75%

Australian Equities are as of the 30/06/1992

Australian Property returns are as of 30/04/2000/

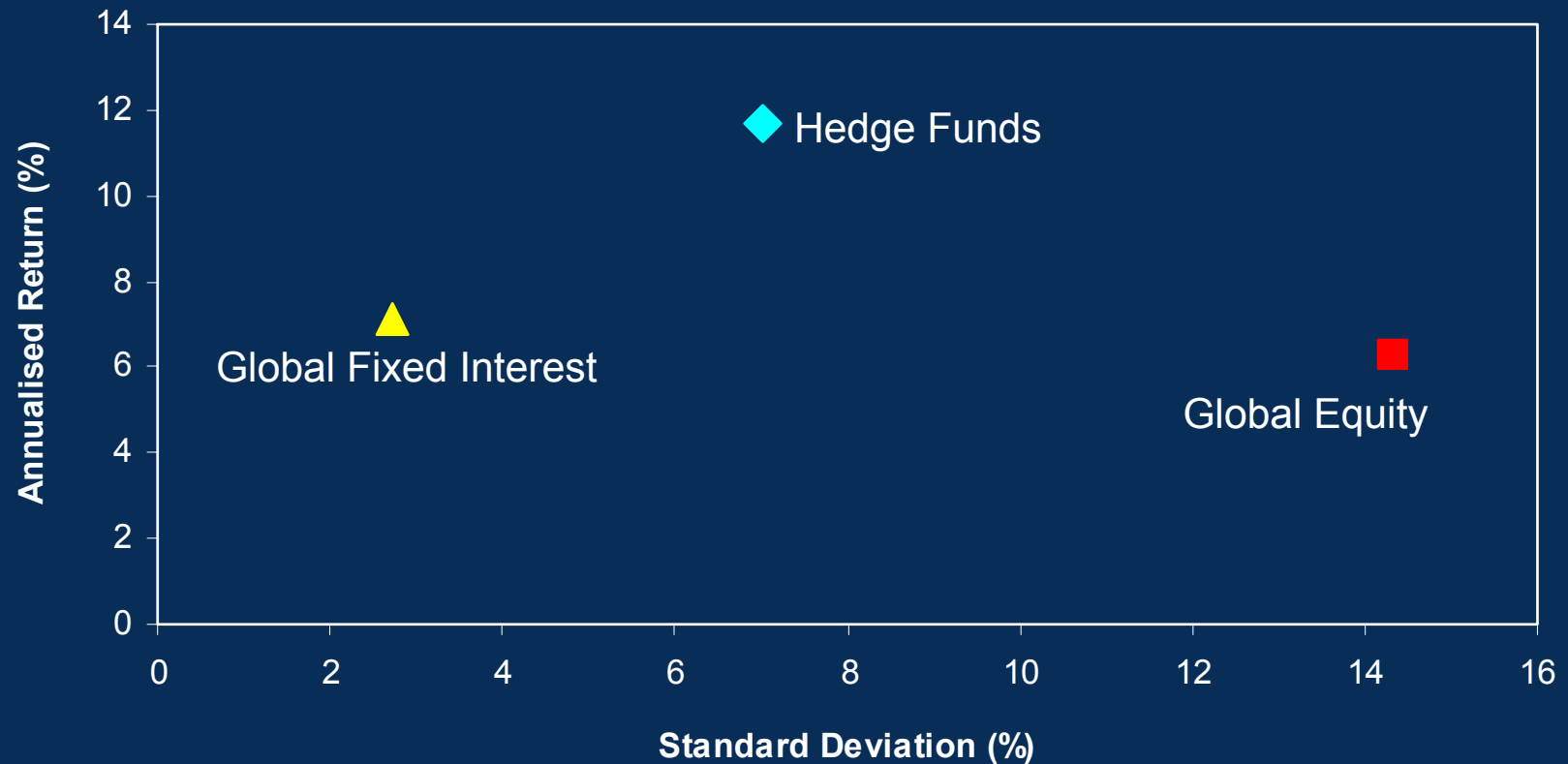
Hedge Fund of Fund returns are from the 31/01/1990 to 31/08/2006

Source: Lehman Brothers; MSCI; UBS; S&P; HFRI; ASX; Citigroup

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Which risk/return point is hedge funds?

10 Year Annualised Return - Hedge Funds, Global Equities and Global Fixed Interest



Source: Lehman Brothers; Credit Suisse; MSCI

Defining Alternative Assets

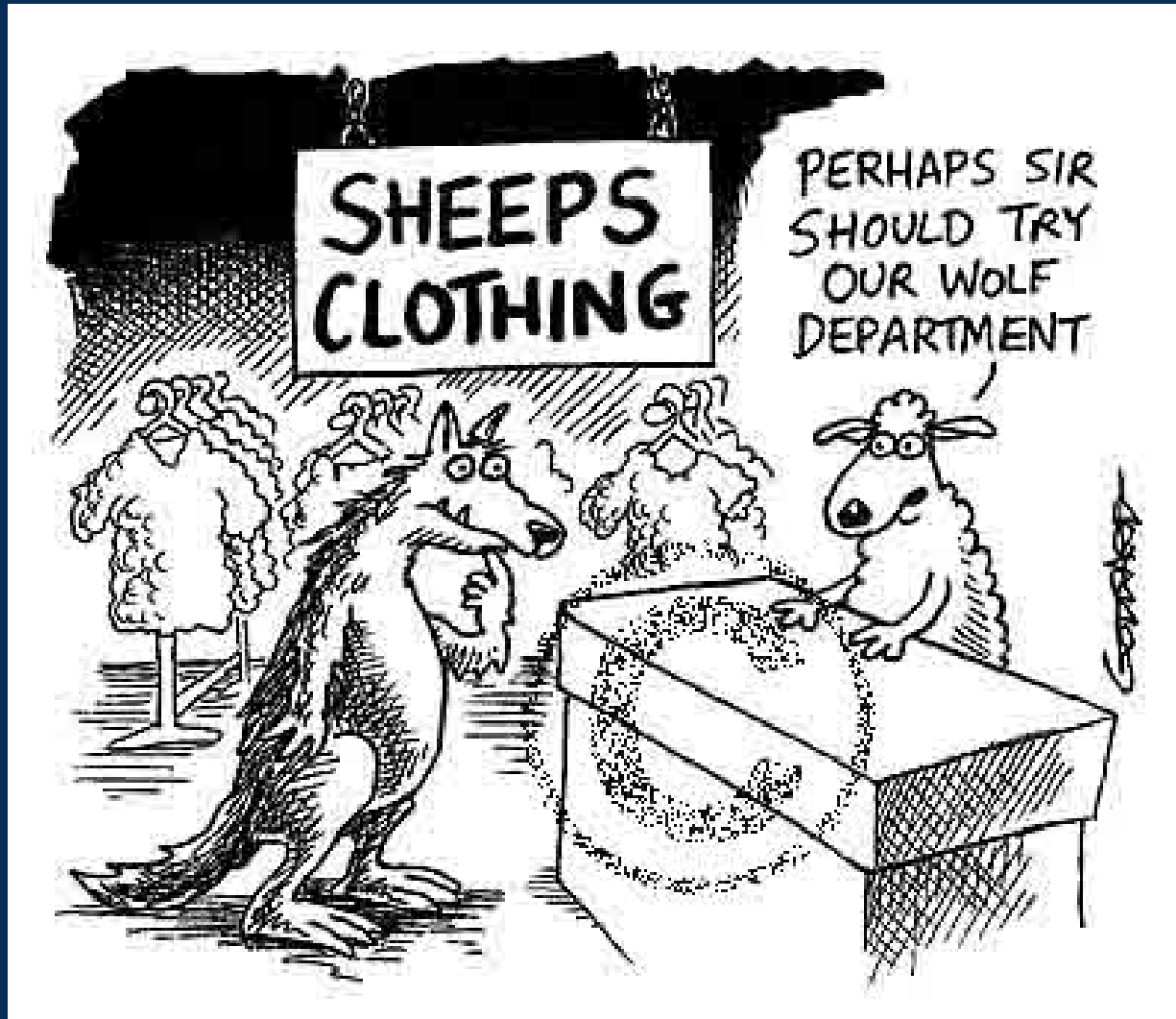
- The dictionary gives us....

A term referring to any non-traditional asset with potential economic value that would not be found in a standard investment portfolio. Due to the illiquid nature of some of these investment assets, valuation may be a problem.

Source: Investopedia

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A Wolf in Sheep's Clothing?



Alternative Assets Characteristics

- Less liquid
- Less transparent
- High volatility
- High returns
- Frequency of yield can be uncertain

Defensive Assets versus Alternative Assets

Defensive Assets	Alternative Assets
Fixed Income	Mortgage Trusts
Cash	Hedge Funds
	Infrastructure
	Private Equity
	Art and Antiques
	Precious Metals
	Fine Wine
	Rare Stamps and Coins

Mortgage Trusts – An Example of the required due diligence

- Need to analyse the underlying risks in these investments:
 - the robustness of the mortgage investment process
 - the level of investment in construction loans
 - diversification of mortgage investments across states, locations and property types
 - quality and independence of the property valuation
 - an assessment of borrowers ability to make repayments
 - whether the security offered is a first registered mortgage
 - whether the trust makes development loans
 - level of the loan to valuation ratio (LVR)
 - extent of in-house development loans

What's happening in our own backyard?



Source: Economist

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What does this crisis tell us as investors?

- Don't confuse less liquid assets with defensive assets just because their risk is hidden by less frequent pricing
- Know what you are investing in. Do the due diligence and request transparency from your fund manager
- Yield funds should receive and provide dependable regular income – don't accept a wolf dressed in a sheep's clothing if your client simply wants YIELD + INCOME
- Look to fixed interest as a transparent and liquid defensive asset investment

PIMCO Pooled Fund Products

Australian Bond Fund

Global Bond Fund

Global Credit Fund

Diversified Fixed Interest Fund

Global Real Return Fund

Global Commodity Real Return Fund

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