For Professional Clients only and, in Switzerland, qualified investors

FOUR RISK-MANAGEMENT DEVICES YOU WANT FROM FUND MANAGERS

Risk management should be core to any fund manager's approach, here are four questions to help decipher if they are truly taking risk seriously, says Newton's global head of fixed income, Paul Brain.

1. **Does their strategy have some volatility dampening characteristics?**

"Taking a multi-asset fixed income approach means combining the 'risk-on' characteristics of high yield and emerging market debt with the 'haven' nature of government bonds and investment grade credit. Having the flexibility to adjust this mix to suit the economic cycle can also reduce risk," says Brain.

2. **Do they have a repeatable process to enable them to anticipate the changing economic cycle?**

Brain says: "Newton's thematic process has proved itself useful in anticipating a credit crisis and keeping us from going short duration despite the markets paranoia about low yields. These themes are supported by a variety of proprietary models that help us determine value and changing economic trends."

3. **Are there some in-built constraints that prompt diversification and limit losses?**

"To avoid over-concentration within the portfolio, we maintain a level of diversification that is consistent with the broad universe of available bond markets. In addition, we follow a few other guidelines in constructing these portfolios, including:

- No more than 50% in each of the four main components (government bonds, emerging market bonds, high yield and investment grade).
- A maximum of 5% in any corporate issuer at purchase; this is limited further to a maximum of 2% in any one high-yield corporate
- A minimum of 50% in base currency.

"There are also price triggers that prompt a review of a holding. For example if a high yield position was to fall more than 5% the analyst responsible needs to review the position with the lead manager," says Brain.

4. **Do they use forward looking scenario analysis and daily monitoring of their positions?**

"Rather than using backward looking Value at Risk analysis we prefer to stress test the strategy based on the possibility of events in the future. This is done both on the desk and also by Newton's Investment risk Group. The output may lead to a re-evaluation of positions if we are not comfortable with the allocation. Monitoring of the strategy using live pricing can also highlight where the current allocation is working and were we may be vulnerable to a change in direction. This is one of the most valuable sources of information on the level of risk being taken and whether the mix of assets is correct for the current market environment," Brain concludes.

The value of investments and the income from them is not guaranteed and can fall as well as rise due to stock market and currency movements. When investments are sold, investors may get back less than they originally

invested. This is a financial promotion for Professional Clients. In Switzerland, this is for Regulated Qualified Investors and Qualified Investors only. This is not investment advice.