



Complexity of Absolute-Return Funds Makes Picking Difficult, Advisers Say

By Ben Steverman - Apr 12, 2011

Mutual-fund companies looking to attract investors are betting on the words “absolute return.”

Twelve absolute-return funds have begun since the start of 2010, according to Chicago-based research firm [Morningstar Inc. \(MORN\)](#), bringing to 32 the number of funds with “absolute” in their titles. The funds have little in common beyond their names, which makes evaluating them difficult except for the most experienced investors, [Bloomberg Businessweek.com](#) reports.

Absolute return is primarily a marketing concept that has gained popularity since the recession and stock market decline, said Nadia Papagiannis, alternative investment strategist at Morningstar. Funds labeled absolute return follow a number of strategies and imply investors won't lose money and will always make money, she said. “It preys upon peoples' fears that another 2008 is going to happen.”

The funds use bonds, derivatives, commodities, currencies and stocks in strategies designed to produce consistent returns unaffected by broader market moves.

“Absolute return describes the goal rather than the investing strategy,” said Joseph Jennings, an investment director for PNC Wealth Management in Baltimore, who uses some of the funds for his clients. The aim is to “generate positive returns in any market environment and do so with fairly low volatility,” he said.

Financial advisers such as Keith Amburgey at Rutherford Asset Planning said they're investing in the funds amid concern interest rates will rise and decrease the value of bonds, which generally have been used to provide consistent, steady returns.

Interest Rates

“If you're worried about interest rates, you end up turning to these to fill out your portfolio,” said Amburgey, chief investment officer at Rutherford, who's based in Creeskill, New Jersey.

Absolute-return funds try to reduce market risks such as interest rate changes or falling stock prices. The \$3.4 billion Absolute Strategies Fund from [Portland](#), Maine-based Absolute Investment Advisers LLC uses 13 different strategies to accomplish this. The Eaton Vance Global Macro Absolute Return

fund, the largest absolute return fund with \$7.6 billion in assets, invests in global debt, currencies and derivatives. A similar approach is used by the newest fund, the Legg Mason BW Absolute Return Opportunities Fund, which started Feb. 28.

It's difficult to compare funds against each other, so investors "need to look under the covers and understand what the fund strategies are," said Robyn Tice, a spokeswoman for [Eaton Vance Corp. \(EV\)](#), based in [Boston](#). Eaton Vance's absolute-return fund became so popular that the firm closed it to new investors last October, she said.

Limited Track Record

For most of the funds, "you don't have enough of a track record to make a prudent decision," said David J. O'Brien, head of O'Brien Financial Planning in Midlothian, Virginia.

The track record of older funds is mixed: Of the 10 existing absolute funds in 2008, all except two lost value. For example, the Absolute Strategies fund lost 14 percent in 2008 while the Standard & Poor's 500 Index dropped 38 percent.

Investors should read descriptions of fund strategies carefully and try to gauge the skill of fund managers. Absolute-return funds tend to borrow the approaches of [hedge funds](#), according to Morningstar's Papagiannis. Because many of the funds hedge market risk with derivatives, much depends on these strategies' details. Derivatives are contracts whose value is derived from stocks, bonds, loans, currencies and commodities, or linked to specific events such as changes in interest rates.

Hard to Evaluate

"There aren't too many managers you want to trust with that," said Rutherford's Amburgey. Investors need to learn as much as possible about a portfolio managers and make sure they are "smart and knowledgeable," he said.

Evaluating absolute-return funds isn't something that can be done by the vast majority of investors or even their financial advisers, O'Brien said.

While absolute-return funds are designed to be less volatile than the markets, "they're still risky," said Robert Dowling, a financial adviser at [Modera Wealth Management](#) in Westwood, [New Jersey](#). Because their performance can be unpredictable, it's best to make sure you're not betting on just one alternative approach, financial advisers such as Dowling said. Buy several funds or make sure a fund includes several different strategies, as the Absolute Strategies fund does, Dowling said.

[Capital Gains](#)

Absolute funds have other disadvantages: Because most trade so often, any gains may trigger higher, short-term capital gains rates. Fees may also be higher. Expense ratios for absolute- return funds may vary from less than 1 percent to almost 3 percent, according to Bloomberg data. Expense ratios will decline with time, said Morningstar's Papagiannis.

Absolute-return funds may not be worth the effort it takes to evaluate them and fit into a portfolio. If an investor's goal is to reduce volatility, they should stick with investments like bonds, said Robert Schmansky, founder of Clear Financial Advisors in West Bloomfield, [Michigan](#).

For example, Treasuries can be bought and structured in a way that they provide a guaranteed income stream much like an annuity, he said. The technique is called "laddering" in which investors buy bonds with varying maturities that correspond to when they will need [cash flow](#).

"After the fees and costs of these funds, there are better options out there that have more of a track record," Schmansky said.

To contact the reporter on this story: Ben Steverman in New York bsteverman@bloomberg.net

To contact the editor responsible for this story: Suzanne Woolley at swoolley2@bloomberg.net.

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