

GLOBAL PENSIONS Weekly Edition

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Merseyside undergoes asset allocation shake up

By **HEATHER DALE**

The Merseyside Pension Fund in the UK has revamped its asset allocation in order to help it recover from its £1bn deficit (US\$1.98bn).

Following an asset allocation study, the target allocations for the £4.3bn fund now include 30% UK equities (down from 31%), 29% overseas equities (up from 25%), 10% property (remains the same), 1% cash (down from 2%), 20% fixed income (down from 26%), and 10% in alternatives (up from 6%).

The fund's 4% increased allocation to overseas equity will see an additional 1% going to Europe, 1% to Japan, 0.5% to Pacific ex-Japan and 1.5% to emerging markets.

The 6% decrease in fixed income will be split between UK gilts (-3%), UK index-linked (-1%) and corporate bonds (-2%).

The change comes after the fund's latest actuarial valuation revealed its £1bn deficit. The review showed this represented a funding level of 80% relative to the funding target.

Leyland Otter, senior investment manager, Merseyside Pension Fund, said: "The deficit will be recovered over 25 years through asset allocation changes resulting from the asset liability study."

"The asset liability study happens every three years and effectively sets our asset allocation going forward."

The latest actuarial valuation revealed if assumptions were to be based purely on returns available on conventional and index linked gilts, the deficiency would be as high as £2.5bn.

The actuarial valuation, com-

puted by Mercer, said it was not possible to construct a portfolio of investments which produced a stream of income exactly matching the expected liability outgoings.

But it added it was possible to construct a portfolio which closely matched the liabilities and represented the least risky investment position.

It said such a portfolio would consist of mainly long term index linked and fixed interest gilts. It said the greatest risk to the funding was the investment risk inherent in the equity based strategy.

Otter said: "This represented the least risky portfolio, but clearly you are not going to get sufficient returns from that kind of asset allocation to recoup your deficits."

FoHFs risk increase in correlated returns

By **ELIZABETH PFEUTI**

Pension funds could inadvertently increase correlated returns by investing in funds of hedge funds (FoHFs), according to research by Fitch Ratings.

Fitch showed some FoHF vehicles contained over 100 underlying hedge funds, leaving an investor over diversified and exposed to greater correlation with market risks.

Aymeric Poizot, head of the EMEA Fund and Asset Manager Rating Group, Fitch Ratings, stated: "Having several hedge funds in one FoHF can bring diversification to a portfolio, but too many can leave the investor with excessive market correlation, especially equity risk."

Poizot referred to studies by hedge fund expert Francois-Serge Lhabitant, which showed correlation between returns of FoHFs and the S&P 500 increased when there were more underlyings in the basket.

He said: "Of course exposure to more underlying funds means there is less blow up risk, but



Aymeric Poizot, head of EMEA Fund and Asset Manager Rating Group, Fitch Ratings

managers of these vehicles should be carrying out due diligence to reduce this to a minimum anyway."

Des Hogan, business development manager at consultancy Liability Solutions, said he knew of vehicles containing as many as 120 underlying funds.

Hogan said: "The number of funds depends on the strategy a manager takes, but it would be out of the ordinary for even a

multi-strategy fund to have more than 70."

Pension funds often use FoHFs as a stepping stone to the single strategy space. However, Hogan warned investors should investigate if a manager was including a large number of funds.

"It may be a capacity issue," he said. "As the FoHF raises assets, they may not be able to invest in their existing or preferred hedge funds, so they have to add other funds; this would raise questions about the quality of their fund."

He said a vast spread of funds could also denote a manager trying to raise capital quickly, which may not be a good sign.

Hogan and Poizot agreed 30 to 40 funds would be the ideal number of underlying managers in a FoHF. The UK's FSA directs FoHFs to have no less than three underlying managers, with France stating a minimum of sixteen, soon to fall to ten.

Hogan concluded: "There is no hard and fast rule, but pension funds must look into why managers act in a certain way."