RADAR ALERT – DISTINCTION DIVERSIFIED REAL RETURN

Newly-launched vehicle run by former Insight duo sits atop sector after first six months

Distinction hits half year at peak of the Cautious Managed sector

PATRICK ARMSTRONG **ANA CUKIC-ARMSTRONG**

- Joint managing partners and head of portfolio strategy and construction at Armstrong Investment Managers since June 2009.
- Co-managers of Diversified Dynamic Solution fund since November 2009 launch and Distinction Diversified Real Return fund since January 2010 launch.
- Previously at HBOS as co-heads of Insight Investment's multi-asset group from 2002 to 2008.
- Co-managers of Insight's Diversified Dynamic Return, Diversified High Income and Diversified Target Return UK Dynamic Managed and Wealth Builder Balanced.

By Barney Hatt

Distinction Diversified Real Return recently celebrated a successful six months since launch by topping the IMA Cautious Managed Sector.

The vehicle is up 5.45% over six months to 19 July compared to a sector average increase of 0.2%, according to Morningstar.

The fund is managed jointly by Patrick Armstrong and Ana Cukic-Armstrong, the former co-heads of Insight's multi-asset team, who quit the firm after six years in November 2008.

The duo set up their own multi-asset investment boutique, Armstrong Investment Management (AIM) in June 2009.

The Armstrong boutique launched its first fund – Diversified Dynamic Solution – in November 2009. DDS is available to small and mid-sized pension funds and institutional mandates, as well as high-net-worth individuals.

Armstrong and Cukic-Armstrong were among the first to bring multi-asset investing to the retail market, first at UBS, which they joined in 2000, and then Insight.

They managed three diversified portfolios for Insight – Diversified Dynamic Return, Diversified High Income and Diversified Target Return – as well as the UK Dynamic Managed and Wealth Builder Balanced funds.

Diversified Dynamic Return was consistently first quartile in the IMA Active Managed sector, while the Wealth Builder Balanced fund achieved the same in the IMA Balanced Managed sector. The Diversified Target Return fund also achieved a first quartile ranking through its five years under the duo's management.

Previously known as IM Armstrong Diversified Real Return, the vehicle was renamed Distinction Diversified Real Return last month following a joint venture with Distinction Asset Management (DAM) last month.

Armstrong says: "Distinction Diversified Real Return is basically just an extension of what we were doing for the last decade as a team, applying multi-asset investing and being agnostic to the vehicle."

He believes a lot of fund managers like to "box themselves into buy-only funds - that is they only buy equities or only buy bonds."

"We think the best benefits of multi-asset are achieved through investing in many types of vehicles and strategies," he says.

According to Armstrong, the fund is differentiated from most vehicles in the Cautious Managed sector because it is based on the view that asset allocation determines the risk and potential return of a portfolio.

"This is where we spend the focus of our efforts – determining asset allocation and allocating tactically to the right region and asset class," he says.

Armstrong adds: "Lots of people say 'it is not my fault equities are down, we buy equities' or 'it is not my fault we are down 20%, the peer group is down 25%'.

"By contrast, we target consistent real returns above inflation, and asset allocation is the driver of this."

Armstrong and Cukic-Armstrong are supported by analyst Vlade Milanovic, who is also a partner of the firm, plus portfolio manager Eugen Fostiak. Another portfolio manager, James de Bunsen, is due to join at the end of July.

Explaining the distinctive roles of the managers, Armstrong says:

"Ana and Eugen are much more quantitative."

"They look at different asset classes through their implied risk premier models which give an expected return for equities, for each region within equities and each sub-sector, and similarly in commodities, property and bonds."

He adds: "James and I will focus much more on the instrument selection within those asset classes, whether it is selecting a third party manager, investing in a direct stock or a structured product."

Armstrong believes the fund's strong performance since inception is because the managers' investment style works well during market downturns.

He says: "When we launched in January markets were quite weak. We delivered positive performance by allocating towards dollar denominated assets and being short European industrial stocks."

During the recent downturn the managers held a large amount of cash.

"We were at 30% cash and more defensive equities, utilities and infrastructure assets. So when the markets have been going down is when we have really outperformed," Armstrong says.

"During the recent sell-off, and the sell-off in January, we added quite strong performance versus most other funds."

In recent months the managers have been adding dividends to the fund, which currently account for about 5% of the portfolio.

Armstrong explains: "We think this is a very compelling opportunity, whereas dividends sold off about 25% last month.

"It is a technical factor where there are some forced sellers of dividends. When volatility spikes up and the equity market goes down, a lot a proprietary desks of banks and structured product providers sell dividends to hedge their books."

The portfolio is positioned to benefit from a number of themes, including assets the managers believe will grow in real terms in an inflationary environment, such as precious metals, utilities and infrastructure.

On an equity basis, Brazil and Canada are two of their preferred regions, based on the view both countries have very strong fiscal balances, current account surpluses and are commodity-backed economies.

Armstrong points out Distinction Diversified Real Return is the only cautious managed fund without exposure to UK equities.

"We are avoiding European and UK equities because of the fiscal situations of all of Europe, with big fiscal deficits and large amounts of debt," he says.

"We think we are getting much better valuations with Brazil and Canada, global water assets and utilities."

As well as the problems of the sovereign debt crisis, Armstrong is bearish on the prospects for the UK economy, which he does not think is in recovery.

"We think there is potential for a double-dip, and we think Europe will suffer quite a lot if this scenario does play out," he says.

Armstrong is happy with the positioning of the portfolio, but says he will increase his equity holdings if the asset class sells off much more.

The managers removed the fund's short positions in equities at the end of June.

Armstrong explains: "We were short European industrials and small-cap US stocks and just as the market sold off, Ana and Eugen's model started to say those regions were no longer overvalued.

"They are not good value but they not necessarily overvalued so we removed those. If there any specific rallies we will probably put those shorts back on. And if there are any other big sell-offs we will add to our equity exposure."

The manager believes investors should not think of targeting cautious managed funds just because of the market environment. "It should be a function of your risk tolerance, investment horizon and what you are trying to achieve," he says.

DISTINCTIONASSETMANAGEMENT

Distinction Asset Management (DAM) launched in June with £184m of assets under management. Distinction runs assets on behalf of advisory firm The Fry Group. The firm has a long standing fund management relationship with the Armstrongs and will be the first adviser group to qualify for a stake in DAM.

AIM will be responsible for the manager selection in any future investment strategies launched by DAM. It will also establish an adviser focus group to suggest new strategies based on client demand.

The DAM range of funds will be marketed by Harrington Cooper. Founded by Patrick Cooper, the group distributes funds to the discretionary end of the investment market on behalf of groups such as Eclectica and Sustainable Asset Management.

WHAT THEY SAID BEFORE

Investment Week **21 April 2008**

Insight rings changes on Diversified

Managers Patrick Armstrong and Ana Cukic-Armstrong have added various products to the Diversified Dynamic Return, High Income and Target Return funds. These include a Goldman Sachs Curve Steepener note which reflects their outlook that bond markets are underestimating the level of inflation over coming years.

Cukic-Armstrong says: "Inflation in the current environment is likely to be higher than the Bank of England's 2% target given that commodity prices have spiked higher, money supply growth has accelerated and central banks are easing policy to counter a global slowdown."

"This note will benefit from a steepening of the yield curve, capturing the differential between 10-year and two-year gilts.

"There is still the potential for a spike in agricultural commodities so that is a theme we want to continue.

"We have been long agricultural since 2005 based on record low grain inventories globally, and livestock is a natural extension of this theme. Historically, a 100% increase in grain prices should lead to over a 30% increase in livestock with a three- to six-month lag.