AN ASSET INTERNATIONAL COMPANY
Strategic Insight

Managed Volatility: The Anatomy of an Investing Trend

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I. Executive Summary

Managed volatility funds represent an important new investment trend. This category predated the financial crisis of 2008 and the oldest fund we have identified was incepted in 1993.

However, the broader implementation and acceptance of these strategies is only now arriving with their use by insurance companies to complement risk management within variable annuities (VAs). Much of the discussion of this trend centers on VAs because they are driving the bulk of product development and asset accumulation.

Nevertheless, interest in managed volatility extends into the retail mutual fund market and beyond. Furthermore, we see increasing attention to other similar and related categories, such as low volatility funds.

Managed volatility funds use strategies or mechanisms that act in anticipation of or response to a severe market event. This, in turn, helps insurers manage the risk associated with market-linked living and death benefits. Within VAs, these strategies have helped insurers reduce the cost of supporting benefits and allowed them to both remain engaged in the marketplace and reduce the risk of legacy blocks of business.

For asset managers who operate in the VA space, managed volatility has become the latest catch phrase, and much of the new fund activity surrounds these funds rather than more traditional mandates. More importantly, insurers are increasingly mandating or encouraging the use of these funds for all or a part of guaranteed assets.

There is reasonable concern that interest in managed volatility in VAs and elsewhere is simply a passing trend or "hot dot." Within the annuity industry, investment management has irrevocably become an integral component of risk management.

Indeed, the implementation of these strategies may represent a trade-off in terms of cost and/or the sacrifice of some market gains. This perspective is not shared by all investment professionals, with many arguing that certain strategies can improve overall returns by reducing the impact of performance-draining downturns.

In addition, there is growing potential for managed volatility strategies to find a place outside of VAs. This investment trend provides valuable risk mitigation that many investors are looking for, particularly for assets that are earmarked for retirement. Sequence of returns risk can wreak havoc as investors begin drawing down assets, so managed volatility funds can legitimately fill a complementary role to guarantees.

Key Findings:

- Strategic Insight identified 98 VA and 77 open-end mutual funds for a total universe of 175 funds from 32 different advisors;
- In Q1 of 2006, managed volatility assets totaled $2.4 billion, when assets in mutual funds ($967 million) were more than double that of VA funds ($442 million);
- Managed volatility funds have grown to constitute $108 billion of assets in the VA space and $21 billion in mutual funds;
- The conversion of funds to managed volatility brought in, at the time of conversion, a total of $20 billion in assets to VAs and $2.8 billion to mutual funds.

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