LEVENDI

INVESTMENT MANAGEMENT

PROTECTING AGAINST LOSSES IN THE SHORT TERM AND LONG TERM

DEFENSIVE EQUITY EXPOSURE

The Levendi Thornbridge Defined Return fund aims to offer investors “defensive” equity exposure. What we mean by this is that in addition to our headline objective to generate about 7% over the cycle, we have several “defensive” targets;

- We aim to generate a positive return under a broad range of market conditions
- No reliance on rising markets or falling yields to generate positive returns
- Reduce losses for investors when markets fall compared to direct equity investment.

In the short term, our share price will fluctuate with changes in the market. The investments we hold are linked to major equity markets and so we expect a high level of correlation, but we have deliberately invested in assets that have a low level of exposure to changes in the level of markets in the short term.

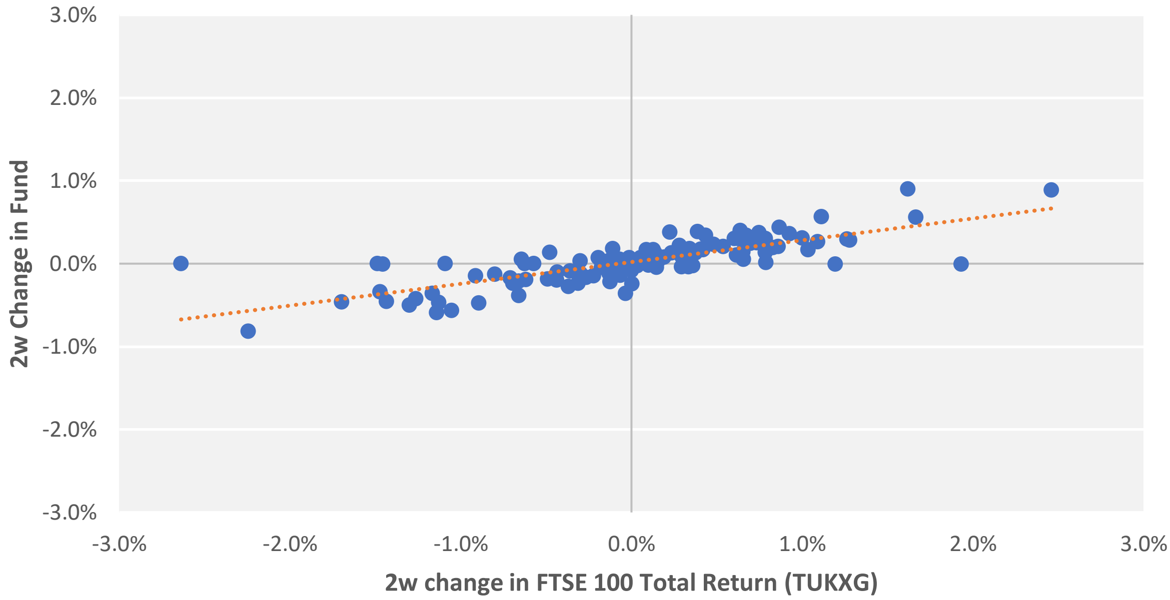
Over time, the assets we hold in the fund offer a positive carry. They are expected to accrue value month by month, and so can generate positive returns under a wide range of conditions. This means that we don’t need markets to rise to generate a positive return for investors. Additionally, most of the assets we hold have been designed so that they will generate a positive return even if markets fall significantly at the maturity date of the investment.

In this note we look at both at how the fund has been performing in the short term and how the assets we hold have been designed to offer protection in the long term.

SHORT TERM; LOW MARKET EXPOSURE / HIGH CORRELATION

The performance of the fund in the six months since launch has been in line with our expectations. If we use a rolling 2-week observation period to calculate the sensitivity of the fund to changes in the market, we observe that when the level of the market changes by 1%, the share price of the fund changes by 0.3% on average. However, the correlation has been high at 0.85%. This means that there is a very close relationship between changes in the level of the market and changes in the share price.

2-WEEK CHANGE IN FTSE 100 TOTAL RETURN / FUND PRICE

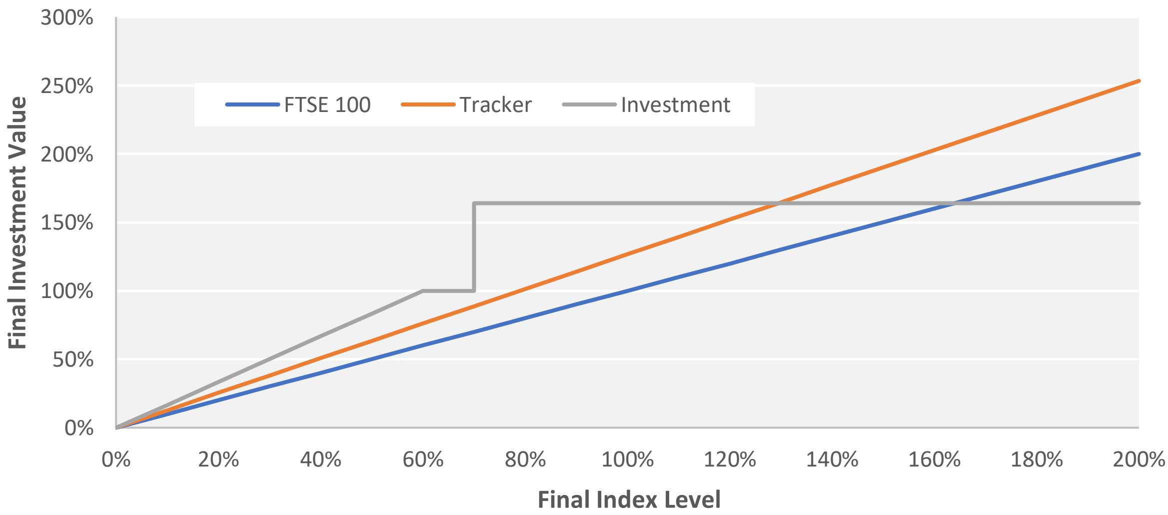


Source: IPR, Bloomberg

LONG TERM; POSITIVE RETURN EVEN WHEN MARKETS FALL

To look at the long-term performance of the fund, it is helpful to look at how the maturity profile of the assets we typically hold compares to investing in a tracker fund.

COMPARING FINAL INVESTMENT VALUE OF TRACKER VERSUS INESTMENT



Source: IPR, Bloomberg

The chart shows the final value of a FTSE Tracker fund versus a typical investment that we hold in the fund.

TRACKER

To estimate the returns from a tracker fund we have assumed an 8-year holding period. The tracker includes a 3% per annum credit for dividends less fees, so 27% over the holding period if the market is unchanged. We have additionally assumed that dividends will increase or decrease in line with the value of the index.

INVESTMENT

Our example investment is an 8-year note that offers a return of 8% each year. There are three possible outcomes at the maturity of the product;

- If the index is above 70% the maturity value is 164%.
- If the final index is between 60% and 70% the maturity value of the product is 100%
- If the index is below 60% the final value is reduced by 1.66% for each 1% below the put strike

The chart shows that if the final index level is at or slightly below the current level, the return from the investment will be significantly greater than a tracker. If the index is unchanged the investment offers a 65% return compared to a 27% return from the tracker. The investment always offers a higher return than the tracker if the market falls.

If the market rises, the return from the investment is capped but the returns from the tracker are not. In this model the breakeven is at about 130%. If the final index level is above that level the tracker returns will be higher than the returns from the investment. This represents a total return of 6.4% per annum.

CONCLUSIONS

The Levendi Defined Return Fund offers defensive equity exposure

- The share price of the fund will move up and down with changes in the level of the underlying indices in the short term
- The short-term sensitivity is fairly low, it is currently about 0.3%
- The assets we hold are designed so that they are expected to offer a better return than a tracker fund that tracks the underlying market if markets remain at current levels or fall.
- The return of investments we hold is capped, and so will not offer the same return as a tracker if markets rise.

FURTHER INFORMATION

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