OPINION

New jewel for pension funds

Barry Critchley, Financial Post · Aug. 25, 2011 | **Last Updated: Aug. 25, 2011 3:06 AM ET**

It's been said Tim Hortons Inc. is an overnight sensation, even though it took decades to build the operation.

Some believe equity minimum risk strategies - a relatively new investment approach for pension funds first talked about in academic circles two decades ago - is set to become the next undiscovered jewel.

At least one pension fund - a Quebec-based industrial company - has allocated part of its equity portfolio to building a portfolio of stocks that have the lowest volatility available in the market at that time.

AlphaPro Management Inc., which manages the AlphaPro Balanced ETF, is also using the strategy.

Howard Atkinson, chief executive at Horizions Exchange Traded Funds, said the goal of equity minimum-risk strategies "is to capture the equity risk premium with less volatility. The idea is [to be] indifferent to return but try and minimize risk. In layman terms [it's a case of] 'let's avoid the big drawdowns,' " he said.

And it's worked: While the one year-old fund has underperformed the S&P/TSX composite benchmark over the past year by about 500 basis points, it has outperformed by 620 basis points over the past three months, when markets have been at their most volatile. The fund is an active trader.

Adding to the impetus is the news that two benchmarks - one by Morgan Stanley and the other by Barra - have been developed using equity minimum-risk strategy.

"The risk is lower but you can still get equity-like returns," said Chris Guthrie, chief executive at Hillsdale Investment Management, the money manager that's advising the Quebec pension fund and AlphaPro.

Mr. Guthrie is bemused by investor behaviour during the most recent market turmoil, which has seen them pile into the safe haven of government bonds - all of which has driven yields to record-low levels - while ignoring good-quality, high dividend-paying corporates.

He cites the case of Bell Canada, which is now paying a yield of 5.28%, far higher than what's available from Canada bonds. He also cites the case of Tim Hortons, which, because of its lower volatility, has a much larger weight in its portfolios than in the S&P/TSX composite.

He then produces a 10-year chart that compares the weight in the portfolio of Shaw Communications and Royal Bank: For the past three years, Shaw's weight has been at least one percentage point higher than Royal's. The reason? Since the collapse of Lehman Bros., Royal is far more volatile.

Adds Harry Marmer, Hillsdale's executive vice-president of institutional investment services: "If you are looking to capture the equity risk premium with less volatility, there is a much better solution than the S&P/ TSX composite index. The strategy searches for the lowest-risk portfolio that's available in the market and, in our view, should be part of any institutional investor who is looking at their opportunities. The problem is that we are dealing with old paradigms, in this case, market-cap benchmark indexes."

Hillsdale has three variations of its minimum-risk strategy: one based on 20 stocks, one based on the S&P/TSX 60 index and another based on 100 stocks. In all cases, the portfolios are constructed with the weights allocated using a proprietary model that's based on each stock's volatility, with larger weights given to the less volatile stocks. Among sectors, energy and materials are underweight while telecom and consumer discretionaries are overweight relative to the benchmark

bcritchley@nationalpost.com

Cuba's export-import businesses.