In DC default design

Fulcrum's Diversified Liquid Alternatives (DLA) Fund is designed with DC investors in mind, seeking a return of cash + 4% after fees over rolling 5-year periods by investing in under-represented asset classes, namely listed real assets, alternative credit and diversifiers. DLA, offers platform friendly daily liquidity with no performance fees and has carefully constructed to complement core equities and bonds and to provide dynamic access to new ideas.

Should a DC default portfolio include exposure to alternative investments through DLA?

The case for including DLA in the default design of a DC pension plan rests on whether there is a belief that it can improve member outcomes, after fees. There are several 'influencing factors' that should be considered:

Influencing factors

Plan/Member circumstances: DC plans may differ in their tolerance for risk and member profiles. This may lead to the need for bespoke investment strategies at different stages of the glidepath.
Fulcrum view: Lower risk tolerance usually leads to greater diversification being introduced and at an earlier stage in the glidepath and vice versa.

Fees: Fees impact net outcomes and therefore the cost of accessing alternative asset classes must to be considered. The DC charge cap for default strategies puts a greater emphasis on this.
Fulcrum view: The Founders class for DLA has an Ongoing Charge of 0.85% p.a. with no performance fees, which we feel represents good value given the nature of the underlying exposures and the resources dedicated to the solution. Paying the right level of fees is key to harnessing the improvements in investment efficiency. Asset managers are service providers with a cost base they need to cover, and alternatives are generally more cost intensive and capacity constrained than say passive equities.

Liquidity: DC schemes are generally invested through life insurance platforms, requiring daily liquidity.
Fulcrum view: DLA only invests in liquid alternatives and does not include exposure to direct (illiquid) real estate, infrastructure or private equity. DLA has strict controls on liquidity, monitored by our independent risk team. Exposure to illiquid assets should be considered separately as this has its own benefits and challenges.

Responsible Investing: Members are likely to care about this a great deal. How is it being integrated?
Fulcrum view: DLA integrates Responsible Investing at multiple levels, reflecting our belief that if approached intelligently it can improve member outcomes.

Diversifying properties: Are you convinced by the long-run diversifying merits of the underlying strategies within DLA and Fulcrum's implementation of them?
Fulcrum view: Theory suggests that adding these strategies to an equity and/or bond portfolio should improve risk-adjusted outcomes over the long run. We aim to improve this further through in-depth research and a disciplined investment process.

Your views on these 'influencing factors' are critical in determining the route forward.

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> "The role of Alternatives in a portfolio is well understood; with DLA they are now more easily accessible for DC savers, especially as part of a DC default"

> A well designed and efficiently structured liquid alternatives fund can incorporate Responsible Investment, diversify across a wide range of under-represented assets and have an overall cost which helps provide investment solutions within DC charge cap limits

At what point in the glidepath should DLA be included?

This depends on what investment outcome you believe DLA can achieve:

A) If you believe that DLA can improve overall risk-adjusted returns and achieve equity-like returns (net of fees) over the long run, then DLA should be included at the beginning of the glidepath and throughout a saver's DC journey.
B) If you believe that DLA can improve overall risk-adjusted returns but will not achieve equity-like returns (net of fees) over the long run, then there is merit in including DLA in the glidepath, most likely at some later stage rather than at the outset.
C) Of course, if you do not believe that DLA will achieve equity-like returns nor improve the risk-adjusted returns of the overall portfolio (net of fees), then there is no point making an allocation to DLA.

How should DLA be implemented in the glidepath design?

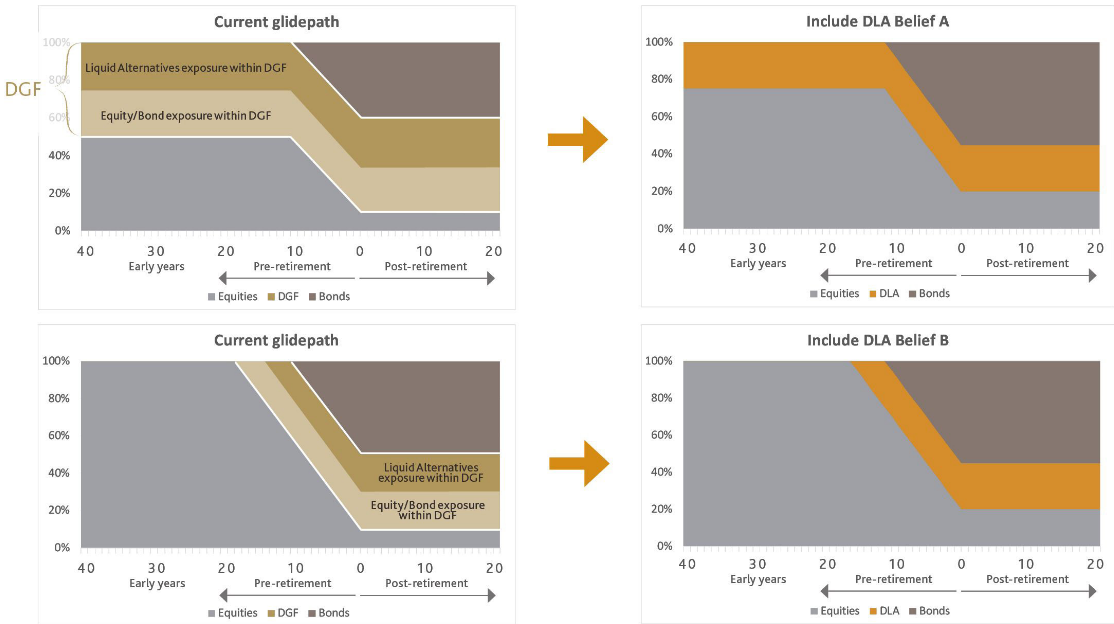
There are many starting points for investors considering DLA; for example, the portfolio might comprise core equities and bonds only or include an allocation to diversified growth and/or absolute return funds. There may be less liquid holdings in the glide path or a combination of specialist mandates or multiple DGFs. Below we explore one illustration of how a DC glidepath could be enhanced by including DLA at different start points depending on whether you believe A) or B) above.

Glidepath currently comprises equities and traditional active DGF, transitioning to bonds over time

A traditional active Diversified Growth Fund generally has structural exposure to equities and bonds in addition to some liquid alternatives. Therefore, there is cost inefficiency in selling equities through the glidepath and buying a DGF (that has equities in it). Because of its careful design, replacing the DGF with DLA and passive equities removes this potential inefficiency.

On the basis that a typical traditional DGF has around 50% combined in equities and bonds, replacing it with DLA and passive equities should either improve expected returns (net of fees) and maintain the level of fees paid OR maintain the level of expected returns (net of fees) and reduce the level of fees paid. The allocation to DLA could be adjusted according to the underlying equity exposure within the current DGF it is replacing. Note, if the DGF is a passive DGF, then including DLA may lead to an increase in overall fees.

Scenario 2



For illustrative purposes only.

However, the range of underlying exposures within DLA are likely to be very different to those included within a passive DGF and the diversification benefits that switching to DLA brings should be greater.

Below, we have chosen to show the impact of replacing a DGF allocation by increasing equities and introducing DLA in keeping with Belief A, at the outset of the glidepath. The analysis can of course be extended to different points on the glidepath as required.

Investment	Typical Ongoing Charge	Current Allocation	Potential Allocation
Passive Equities	10 bps	50%	75%
Active DGF	65 bps	50% (of which half is generally in traditional equities and bonds)	0%
DLA	85 bps (Founders class)	0%	25%
Overall Ongoing Charge		37.5bps	**28.75bps**
Expected Return (net of fees)			Improvement

> "A traditional active Diversified Growth Fund generally has structural exposure to equities and bonds in addition to some liquid alternatives; replacing it with DLA and passive equities should improve overall investment efficiency"

Conclusion

We hope this article gives some colour on how to approach more optimal DC portfolio construction along the client's glidepath and helps investors, consultants and advisors understand the potential benefits to investor outcomes of including Fulcrum's Diversified Liquid Alternatives Fund in a DC Glidepath. We would be pleased to engage in further and more bespoke discussions at your convenience.

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Fulcrum Asset Management

Pioneering Liquid Alternatives for DC Savers

Our innovative Diversified Liquid Alternatives (DLA) solution provides DC investors with exposure to a wide range of under-represented assets across the main alternative asset classes of Real Assets, Alternative Credit and Diversifying Strategies.

For further information, please contact us at ir@fulcrumasset.com or visit the alternative strategies section of our website www.fulcrumasset.com

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