

# Horizon Absolute Return Fixed Income Fund

## Fund update by Daniel Beharall – December 2008

Since June, we have successfully polarised the investments in the portfolio. At one end of the spectrum we wanted to hold onto good value illiquid assets, tolerating the volatility, and at the other end we wanted to benefit from that volatility and tactically trade the most liquid instruments. It is our view that these two extremes represent the best possible use of risk capital in today's markets, with a good balance between the two likely to deliver strong risk-adjusted returns over the medium-long term.

The trading activity has been successful, with material gains achieved from positions in liquid G7 interest rate markets and emerging market FX, benefiting particularly from the rapid repricing of global monetary policy expectations.

Regarding the illiquid assets, it is obviously too early to know if that was a good decision, as the strategy was long-term in nature; but, in the short-term, the continued market weakness means returns have been negative so far, outweighing the gains made from tactical trades, and the net asset value (NAV) declines have reflected this.

In September, we sent out a note explaining that we saw no reason to liquidate these assets at depressed prices, as we felt these were all quality assets with excellent yields, and in a portfolio with a stable asset base we would continue with this approach.

Unfortunately, the portfolio, as a UCITS fund, cannot be assumed to have a truly stable asset base due to the provision of daily liquidity to clients. In a liquid market this is not in itself a problem, but as market liquidity has further evaporated 'post-Lehman', we are unable to facilitate withdrawals without making a charge to the redeeming client for the liquidation expense of that portion of the portfolio. The levy is calculated as the difference between the level at which the portfolio assets are valued at in the NAV, and the level at which the assets could actually be sold in the market, a methodology that is fair to the existing investors and also the redeeming investor. As an asset manager we have a duty to treat clients fairly.

This levy, once calculated, manifests itself as a 'price swing', meaning that the published NAV is reduced by the calculated percentage. This would normally be mostly reversed the following day (in the absence of further redemptions or major market movements), but with a large price swing this NAV fall would be damaging to the returns of the overall portfolios of existing investors, even if only for one day. It would also make the fund NAV appear considerably more volatile than it really is.

Because of these features, even though it is acceptable practice and certainly fair, neither the fund manager nor the sales teams are happy about the existence of this levy, and the clients are naturally less than happy. The only way this levy will disappear naturally is if good liquidity returns in these assets. Even if liquidity improves in the new year, it would take a considerable length of time to reach levels that would eliminate the levy.



Therefore, we have chosen to take a positive course of action, to ensure that this levy moves towards zero even if market liquidity does not return, and have decided to reduce our holdings in illiquid assets. Whilst we are selling the assets at lower levels than might otherwise be desirable, we are not selling at completely distressed prices, but have been working slowly over several weeks to take advantage of pockets of liquidity as they arise.

It should be noted that the fund presently holds approximately 50% cash. Please do not confuse the existence of the dilution levy with fund liquidity – with 50% cash we are clearly a very liquid portfolio, but this does not mean we can meet redemptions with no levy. A client who redeems receives the benefit of this cash, which comprises approximately half their holding, but on the other half of their holding there has to be an exit cost.

It should also be noted that the overall result of these actions is not a major change in strategy. We still believe that the best use of any risk capital in the current market is to be split between value assets and tactical opportunities. The split, however, must change to respect the unpredictable daily client flows, with a very small allocation to value exposures, in only the most liquid names, with a majority allocation in tactical liquid positions.

We are making good progress on this strategy and are working towards completion on a daily basis. The tactical positioning has made a good start already in December and we believe that executing and continuing with this strategy will start to show through in NAV gains in the coming months. By eventually eliminating the dilution levy, through elimination of the main illiquid asset risk, we believe that clients will have greater clarity as to the risk in the fund and greater confidence in their holding of the fund. We believe that the tactical opportunity set we are trading represents a huge opportunity going forward given the volatility and uncertainty in markets.

By keeping the current portfolio structure, potential clients would be deterred from purchasing the fund due to uncertainty about the existence and level of the levy if they wished to exit. By moving to a highly liquid profile, and maintaining this liquidity profile as fund policy into the future, clients can invest in the portfolio with confidence that the levy, once reduced or eliminated, will be less likely to return.

Figure 1 shows how the fund is currently positioned to give transparency on our progress.

**Figure 1: Fund positioning as at December 2008**

Asset class exposures (%)	AAA	AA	A	BBB	BB	B	CCC	Total Investment Grade	Total High Yield	Total
Credit	0.0	6.3	-8.7	9.5	-3.1	6.1	2.0	7.2	5.0	12.2
ABS	0.9	0.0	0.0	0.5	0.0	0.0	0.0	1.4	0.0	1.4
Developed	92.7	0.0	-1.2	0.0	0.0	0.0	0.0	91.6	0.0	91.6
EM	0.0	0.0	0.0	16.3	33.9	10.3	0.0	16.3	44.3	60.5*
<b>Total</b>	<b>93.6</b>	<b>6.3</b>	<b>-9.8</b>	<b>26.3</b>	<b>30.9</b>	<b>16.5</b>	<b>2.0</b>	<b>116.4</b>	<b>49.3</b>	<b>165.7</b>

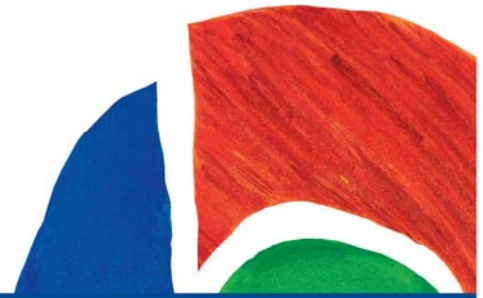
Market value (%)	Exposure (%)
Cash	49.8
Bonds	10.2
Derivatives	10.0
<b>100.0</b>	<b>100.0</b>

Exposure (%)
Bonds
Derivatives
<b>Total</b>

Source: Henderson Global Investors, as at December 2008

Note: \* Please note that the Emerging Market exposure appears large but has an aggregate duration of only 0.4 years as several positions mature in the next six months.



For further information on our Henderson Horizon Funds please contact your local office or visit our website: [www.henderson.com](http://www.henderson.com).

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