

# THE ROLE OF REAL RETURN FUNDS IN A DIVERSIFIED PORTFOLIO



PERPETUAL INVESTMENTS  
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So far, we have examined what makes a real return fund, [how these funds work](#) and [why you would consider investing in one](#). This article looks at the important roles real return funds can play in a diversified portfolio.

The traditional approach to a diversified portfolio, or diversified fund, has been to allocate an investment range to growth and defensive assets. Typically, the growth component has been dominated by Australian and global equities, which generally account for 50–60% of the portfolio.

However, despite representing just over half of the typical allocation, equities are the single largest source of risk – in fact, equities account for 85–95% of total portfolio risk<sup>1</sup>.

This isn't always a bad thing. Investors who have the time to ride out market fluctuations have historically been well rewarded for taking on the risk. On the flipside are those investors without the luxury of time to recoup their losses, often those approaching retirement or already retired. That risk can mean the difference between a comfortable retirement and one dominated by financial stress.

A more intelligent approach to diversification, one with as much emphasis on risk as on return, is needed. This is where real return funds come to the fore.

## Where does a real return fund fit in a balanced portfolio?

Equity and bond markets are marking historic territory. Equity indices regularly overtake past high points as company valuations soar. On the other hand, quantitative easing programs around the world continue to impact bond yields and therefore prices. Volatility is the new norm and investment managers face increasing complexity as they construct diversified portfolios.

Investors need to explore new solutions without taking on more risk than they can afford, particularly as markets enter uncharted territories. Real return funds can play three main roles in a diversified portfolio.

### 1. **Stable core**

Real return funds are generally well-suited to investors seeking a more regular profile of returns and protection from volatility. Having a stable core of one or more real return managers allows investors to take carefully considered risk with other potentially higher returning and higher risk satellite portfolios.

### 2. **Shock absorber**

Many investors could benefit from incorporating active asset allocation as a way to diversify their portfolio's sources of return. Real return funds can help otherwise static portfolios shift underlying equity and fixed income exposures in favour of the most attractive opportunities at any one time.

### 3. **Diversifying alternative**

Real return funds can be used as a substitute for existing investments. The funding for this real return portion could come from an allocation to alternative investments, or, for example, from a portion of an investor's existing allocation to equities and bonds.

The greater investment breadth and active asset allocation provided by real return funds can improve the diversification of equity and bond-dominated portfolios by providing access to asset classes that may be difficult for investors to hold directly.

Real return funds provide access to traditional and non-traditional asset classes. In an investment environment where it's anticipated that volatility will become the new normal, many investors will be looking for returns that minimise drawdowns, which occurs when an asset class or investment falls in value. A real return fund can play an important stabilising and diversifying role in investors' portfolios.

**Find out more about the performance, strategy and holdings of [Perpetual's Diversified Real Return Fund](#).**

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1. Source: Morningstar Multi-Sector Growth Index and Barra

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The product disclosure statement (PDS) for the Perpetual Diversified Real Return Fund, issued by PIML, should be considered before deciding whether to acquire or hold units in the fund. The PDS can be obtained by calling 1800 022 033 or visiting our website [www.perpetual.com.au](http://www.perpetual.com.au).

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