Absolute fortitude paying dividends

Aurora boasts positive returns in almost nine out of every 10 months

ANDREW MAIN

SYDNEY-BASED Aurora Funds Management's Fortitude Absolute Return Fund, founded by John Corr, has produced positive returns every year since its inception in March 2005. Sheriden Hure and Andrew Ward are the senior portfolio managers responsible for this fund.

Your fund has been categorised as an absolute return fund. What does that mean?
An absolute return fund tries to make a positive return for the investors, irrespective of the sharemarket conditions, whether it is going up, down or sideways. This is not always easy to do, and involves a lot of active portfolio management and strong risk control. We aim to make distributions of 2 per cent each quarter.

What sort of assets does the Aurora Fortitude Absolute Return Fund invest in?
The fund focuses on three things: income, liquidity and capital preservation. It only invests in Australian equities and uses a variety of techniques to provide risk management of the capital. We consider ourselves as an alternative to the cult of equity that has developed in Australia, where all you had to do was buy a basket of shares that only ever went up in value. We think that the last few years have proven to investors that they need greater diversification and lower volatility. Our objective is to provide a more active and consistent return out of the equity market.

FIVE HOT TIPS

- Hope is not a strategy. Be realistic about the downside when making investments and be disciplined in selling those that are wrong rather than hoping they will recover.
- Avoid crowded trades. If everyone is talking about an easy way to make money, it is probably about to end in tears.
- The market will be open tomorrow. It will continue to provide opportunities, and if you are disciplined in limiting your losses it will give plenty of opportunities to make positive returns.
- Success has many fathers but failure is an orphan. Do lots of research, listen to advice, but you alone are responsible for the execution and management of your investments.
- Expect the unexpected. We believe equity markets are more volatile than people expect.

How has your fund performed since inception in recent years?
Since inception in March 2005, the fund has returned 8.9 per cent per annum with every year providing a positive return. In a bad year we have delivered our investors returns similar to cash rates, and in a good year up to 16 per cent. Our worst month in almost seven years has been -1.6 per cent, with our best month up 3.6 per cent. The importance of risk management procedures is reflected in the fact that the fund has produced positive returns in almost nine out of every 10 months.

What's the structure and history of your funds management business?
Aurora Funds Limited was listed in July 2010 as an Australian boutique fund manager and 70 per cent of the business is owned by the staff. It is a merger of three separate fund management businesses: Aurora Funds Management, Fortitude Capital and Sandringham Capital. The founders of each of the businesses — Alastair Davidson, Steuart Roe and John Corr — had worked together at Citibank.

John Corr started started the fund and Fortitude Capital, which Aurora acquired in July 2010. The Absolute Return Fund had originally been available only to institutional and high net worth investors and until 2008 a majority of money in the fund was sourced from overseas investors. A retail version of the fund was launched in October 2010.

What's the minimum investment your fund will accept?
We offer two alternatives to access the fund. First, through a traditional unlisted managed fund, which financial advisers tend to use through platforms. Second, through a listed investment vehicle, which trades under the ASX code ABW. This is in order to meet the growing demand of self-managed super funds that wish to avoid platform fees by going direct to the ASX. Importantly, ABW is open-ended, which means it allows applications and redemptions and as a result trades very close to its net asset value. As our funds are aimed at retail investors, ABW can be bought on the ASX for a price of about $1 a unit. Through our managed funds the minimum is $10,000.

Sheriden Hure and Andrew Ward, senior portfolio managers of Aurora Funds Management's Fortitude Absolute Return Fund

DAN HIMBRECHTS

How many staff do you have and how much does your fund and your overall business have under management?
The business has 12 staff in total and over $500 million in funds under management, in a variety of different strategies. Aurora manages over $110m in the Absolute Return Fund for local retail, institutional and superannuation investors.

What separates you from your peers in terms of your approach?
We believe that markets can be significantly more irrational and volatile than most participants expect. Seasoned investors expect big market events to occur every 20 years, and the market volatility you expect every 10 years occurs roughly every two years. To be ready for these market movements either up or down we buy both call and put options. Call options in case the market moves up and put options in case the market moves down. When the market moves significantly it is this part of our portfolio that makes good profits, with the best example of this during the global financial crisis.

In order to pay for this capital protection, we look for short-term opportunities that have a high probability of producing a positive return. During the current agreed takeover for Foster's by SABMiller, we bought Foster's on the market and we are expecting an annualised return on this position in excess of 12 per cent. We can participate in these short-term situations because our cost of brokerage is significantly lower than that of retail investors. Our investment strategies provide varying levels of returns depending on the stock market conditions.

Our option strategy is concentrated in the most high turnover stocks such as BHP, Telstra, Woolworths and the banks, so when the market has an unexpected fall, this capital protection kicks in and generates good returns. More often, when the market is flat or rising, the takeover and yield strategies typically do consistently well. The aim is to have a balance of offsetting risks that provide regular positive returns.

While the takeover strategy has been the strongest performance contributor over time, there can be concentrated risks that result in drawdowns if deals fail. This has been the case historically when takeover deals such as Indophil Resources and Redflex Holdings don't complete for illogical reasons, which has resulted in our worst months of performance.

Do you plan to launch any funds in the short term?
We are looking at launching a protection fund to the institutional market. This would aim to make significant profits in a falling market, allowing institutional investors to maintain traditional equity exposure with a level of downside protection when markets look increasingly uncertain.

We think that increased volatility in financial markets is now a fact of life, and we have the requisite skills to make money for our investors from that new market paradigm.

Are you an activist fund manager in terms of making changes to the management of underperforming companies?
We are not an activist manager, though we will profit from others creating opportunities for takeovers and demergers. We are big supporters of the efforts of the ASX and Chi-X to increase liquidity and to bring more dual listings and corporate debt issues into the Australian-listed market.