Bufferfund adjusts investment policy as market disruption bites

7 Jul 2020 by Marc Wolterink

The Dutch open-ended fund's investment policy came under pressure in March after the extreme volatility on the financial markets.

Since its launch in August 2016, Bufferfund has aimed to outperform its benchmark, the Eurostoxx 50, by investing in (capped) bonus and discount certificates listed on the Frankfurt and Stuttgart exchanges, while at the same time achieving a lower volatility than the index.

However, the fund's objectives took a hit in March when the panic surrounding the Covid-19 pandemic let to an extreme situation on the global financial markets.

"We had a terrible market in March," said Marcel Tak *(pictured)*, statutory director and fund manager of Bufferfund. "Our goal always has been, and still is, to try to limit losses when financial markets are sharply falling but especially between 15 and 20 March, that target came under severe pressure due to the massive fall in prices.

"At one point, the Eurostoxx 50 had dropped 38% and we were down 35%. That is slightly less, but not what we had in mind when we set up our objectives".

The core of the strategy used by the fund is to have bonus and discount certificates in its portfolio, and to sell these products when their buffer becomes too small if the financial markets fall.

"During that period in March there was so much volatility that it was simply not possible anymore to sell. That is one reason why we decided to make some changes in our strategy, but there are other reasons too.

"The adjustment of our policy is firstly due to the events on the financial markets, and secondly because after evaluation we realised that we might miss opportunities if we do not start thinking about a somewhat more extensive set of instruments and a more varied set of underlying assets," said Tak.

New product types and underlyings

Marcel Tak: We no longer exclusively focus on bonus certificates and discount certificates. There are also circumstances when it would make more sense to use other product types, such as capital-protected certificates, turbos, options and ETFs, or when underlyings other than the Eurostoxx 50 – such as individual shares – would be better suited.

We are not going to become a stock picker, but sometimes you do see quality shares with which you can achieve an attractive return with bonus certificates, without this share having to increase or even allowing for a limited fall. These sometimes have more attractive risk/return ratios than you would be able to achieve with an index.

Puts and calls can be used very aggressively, but you can also use them defensively

In our policy we have stated that we also have the option to include tailor made solutions. We may make use of this in the future, but for the time being we are still focusing on listed products in the German market.

Capital-protected certificates, turbos, options, and ETFs

Marcel Tak: It does not mean that we are going to implement all of this immediately, but we could buy all these different product types, as long as our objective remains intact. We are adjusting our strategy precisely because we want to maintain our objective, which is to mitigate the risks and to participate as much as possible in the long term and to achieve a healthy return.

Of course, turbos and options are very different instruments than bonus certificates, but you can still apply them in such a way that they can achieve a risk/return ratio that is similar, or better than for bonus certificates, otherwise we wouldn't do it. Puts and calls can be used very aggressively, but you can also use them defensively. I think we will use them in general to try to achieve returns through a defensive strategy.

To give an example, you can write a put on the Eurostoxx 50 that is 10% below the current value of the index. That in itself is a defensive strategy. You receive a premium and imagine that if the financial markets fall by 30%, at least you would not have experienced the first 10%, plus the premium of say four percent. By using puts in a defensive way, we believe we can achieve our objective for the fund in a better way than by only focusing on a limited number of products.

Stop mirroring short-term performance of one benchmark

Marcel Tak: We have some ideas but are not 100% sure yet. We are thinking about a number of indices and investors then can judge for themselves what they think of the performance of Bufferfund. If we show different indices, we are not going to say beforehand that we want to beat that index, or that we want at least half the risk of that index.

We will focus less on short-term performance. For example, we have always indicated that if the share prices fall by 10% in a short time, the fall of Bufferfund should be limited to seven percent. We have decided to let go of this short-term tactic, because it cannot be properly implemented under specific circumstances, for example when volatility is rising sharply. Moreover, such a short-term tactic often leads to forced adjustments in our positions that are not in the interest of our participants in the longer term.

*As of 30 June 2020, **Bufferfund** had €33.2m assets under management. The fund has currently positions in bonus certificates (24%), capped bonus certificates (20%), reverse capped bonus certificates (1%), and liquidities (55% cash).*