Whitepaper | April 2023

The case for ReturnPlus

An approach to optimise strategic cash returns

Todd Cutting and Rakesh Girdharlal

It takes Aviva Investors

AVIVA INVESTORS

Todd Cutting, CFA
Senior Portfolio Manager, Liability Driven Investment

Main responsibilities

Todd is a portfolio manager within our LDI team and is responsible for portfolio management, structuring and reporting for insurance and pensions portfolios. He is also the lead manager for the ReturnPlus range of portfolios.

Todd develops and implements investment strategies in low risk relative value opportunities, and has a particular interest in structural dislocations in global funding markets.

Rakesh Girdharlal, FIA
Head of Liability Driven Investment and Liquidity

Main responsibilities

Rakesh is responsible for Aviva Investors' Liability Driven Investment and Liquidity team within our Credit function.

Responsibilities include managing LDI portfolios for pension and insurance clients. Rakesh oversees portfolio analysis, structuring and reporting for duration management portfolios and the funds for our liquidity solutions.

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Key takeaways

ReturnPlus is a unique offering that can draw on a range of credit spread premia to optimise returns from strategic cash.

The strategy is structured to deliver better risk-adjusted returns than cash and a solution for investors seeking to de-risk from riskier assets.

ReturnPlus is designed to be duration-neutral.

The strategy has a history of outperformance in periods of market stress.

Introduction

All institutions need to hold cash and maintain sufficient levels of liquidity, but not all cash needs to be accessible immediately. Consequently, many institutions are looking to optimise returns from the tranche of their strategic cash allocation not required on a T+0 basis.

Our ReturnPlus strategy is designed to help investors enhance returns on excess cash by investing in short-maturity, highly rated fixed-income securities. We invest in liquid sovereign and corporate debt, taking modest credit spread risk, mitigating other risks and maintaining liquidity. We access a range of return drivers for different sources of alpha and to enhance portfolio diversification, while hedging interest rate and currency exposures back to the base currency.

Designed to help investors enhance returns on excess cash by investing in short-maturity, highly rated fixed-income securities

Our approach benefits from our extensive experience managing assets to meet clients' specific liabilities and risk-based capital requirements. For more than a decade, our investment team has managed Aviva's portfolios to optimise return and capital efficiency, using derivatives for downside protection and to access select credit market premia. Drawing on this knowledge and taking advantage of market dislocations has allowed us to deliver a strong track record and historically low volatility.

In this article, we set out what we consider the main benefits of the ReturnPlus strategy, namely:

- Enhanced returns over money market funds (MMFs)
- Cash optimisation
- Capital preservation and liquidity
- ESG integration in our investment process

Key features

Enhanced returns

Targeting SONIA[1] +0.75 per cent p.a., ESTR[2] + 0.50 per cent p.a.

Capital preservation

Investing in high-quality short-dated debt, keeping risk low using a variety of tools

Liquidity efficiency

Investing in highly liquid instruments. Daily redemptions, settled T+3

Investor benefit 1: Enhanced returns

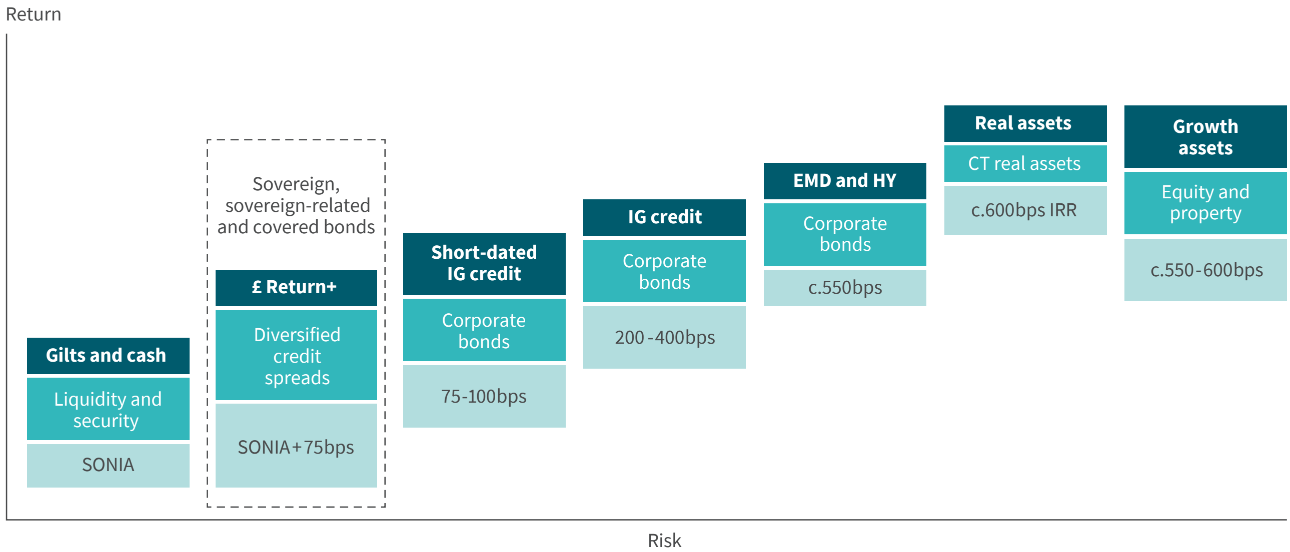
The ReturnPlus strategy can access a wide range of global fixed-income markets while hedging the interest rate and currency risks those markets may otherwise introduce.

We seek opportunities in global fixed-income markets that sit between cash and investment-grade (IG) credit that offer higher returns than cash and money market instruments and provide a diversified source of credit spreads. Our investment universe includes short-dated sovereign, sovereign-linked and covered bonds that tend to be less risky than traditional IG credit (Figure 1).

Our investment universe includes short-dated sovereign, sovereign-linked and covered bonds

The strategy offers the potential to achieve higher returns than MMFs, which offer high-quality credit exposure and competitive yields that reset quickly to overnight rates, without resorting to commonly used methods like extending duration or introducing exposure to asset-backed securities. The strategy is not limited to any single currency or geography.

Figure 1. **ReturnPlus on the risk/reward continuum**



Note: For illustrative purposes only. Expected return targets may not be achieved due to market conditions and the value of an investment may go up or down.
Source: Aviva Investors, March 2023.

ReturnPlus offers:

- Optimisation for strategic cash not required T+0
- Scope for higher risk-adjusted returns than cash through investing in high-quality global fixed income, and a potential solution for those seeking to de-risk from IG credit
- Duration-neutral design
- The opportunity to go beyond LDI and address the liquidity challenges pension schemes have in a risking/de-risking environment
- Investments with low Solvency II capital charges for insurers

Investor benefit 2: Cash optimisation

Strategic cash – the cash institutions hold for various purposes like unexpected "rainy days" or in preparation for mergers and acquisitions – can be utilised to generate higher returns than MMFs. This is a role we seek to fill with ReturnPlus, which can help meet the different demands facing institutions while reducing the drag on returns from MMF holdings. MMFs are helpful for meeting operating and reserve cash requirements (see *An Introduction to Money Market Funds*), but not optimal for cash likely to be held for longer periods and required intermittently.[3]

The arrival of persistent, high inflation and major shift in central bank policy since early 2022 has made it even more important to optimise cash allocations.

Strategic cash can be utilised to generate higher returns than MMFs

Putting cash to work

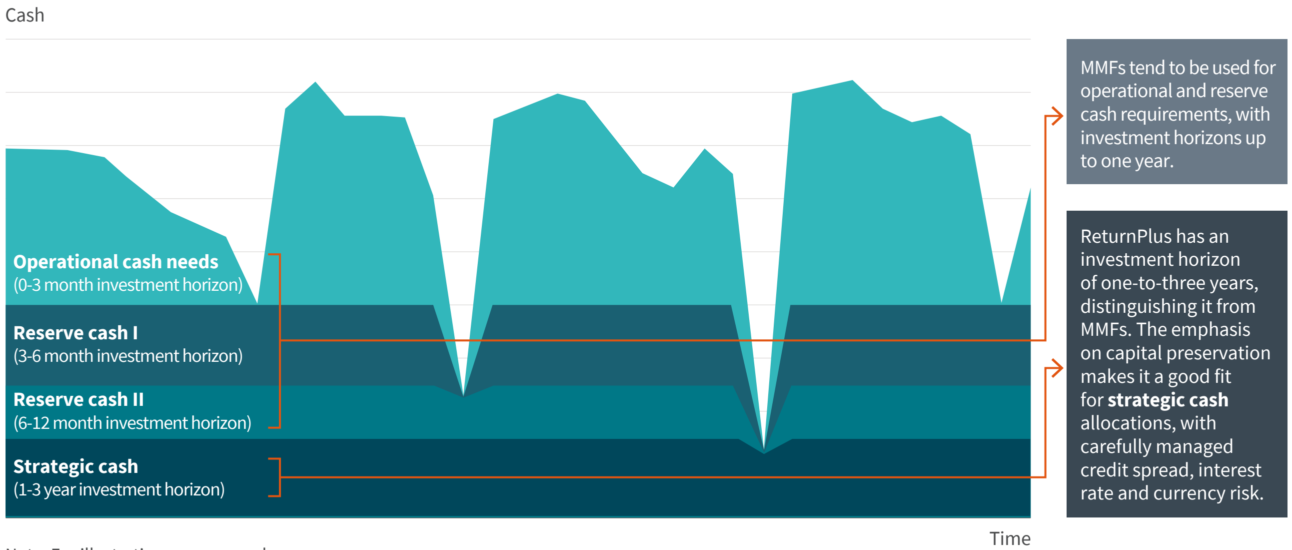
Many investors use sophisticated forecasting techniques to project future cashflows. Based on this analysis, they typically segment cash into three buckets:

Operating cash: Held for daily use; the balance is likely to be highly variable.

Reserve cash: Held for infrequent or periodic use, such as before making a coupon payment on a bond. The cash may be dipped into periodically, but the amounts held tend to be relatively stable.

Strategic cash: Held for longer periods. This broad category might include funds kept in reserve to navigate unexpectedly difficult market conditions or for mergers and acquisitions.

Figure 2. **Segmenting cash by needs and investment horizon**



Note: For illustrative purposes only.
Source: Aviva Investors, March 2023.

Investor benefit 3: Capital preservation and liquidity

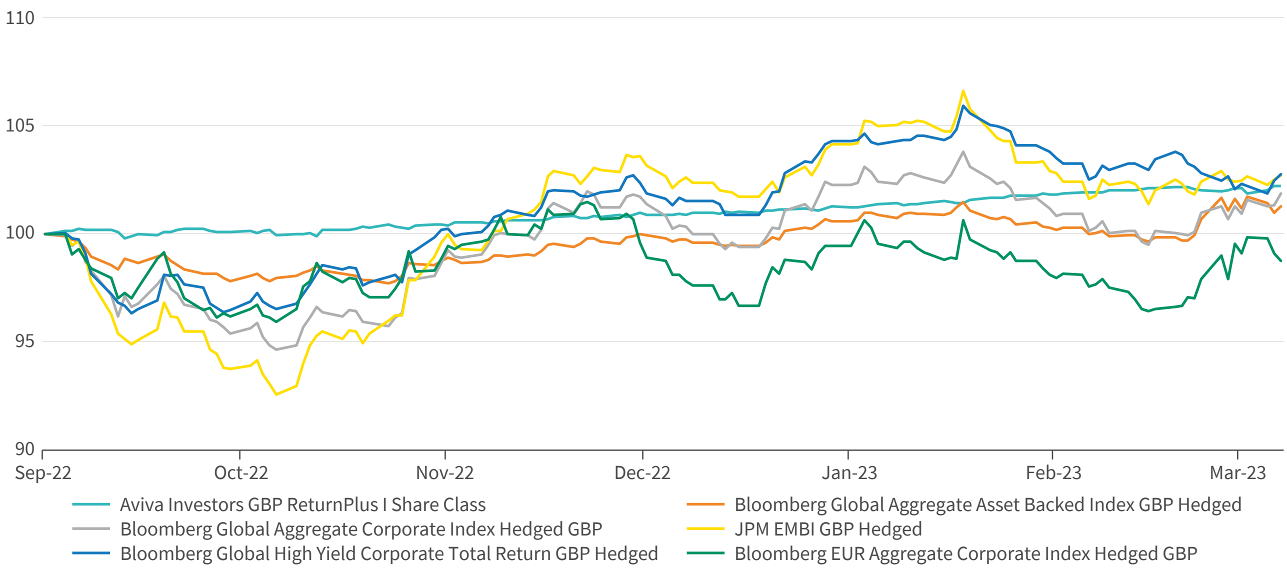
The UK liability-driven investment (LDI) crisis in September 2022 tested investors' ability to preserve capital and maintain liquidity. ReturnPlus performed well during this period.

The crisis was precipitated by the UK government's "mini-budget" in September 2022; the value of the pound and gilts plunged as investors became concerned about how the proposed growth plan would be funded.

The uncertainty resulted in large reductions in the value of LDI funds, commonly used by UK pension funds to hedge their liabilities. But thanks to the downside protection offered by ReturnPlus, our clients were able to meet collateral demands, without underperformance (Figure 3).

The UK LDI crisis in September 2022 tested investors' ability to preserve capital and maintain liquidity

Figure 3. **ReturnPlus strategy – performance versus traditional indices during LDI crisis**



Past performance is not a guide to future performance. Illustration shown net of fees.
Note: Indexed to 100, September 16, 2022 to March 22, 2023.
Source: Aviva Investors, Bloomberg. Data as of March 22, 2023.

LDI funds typically utilise leverage via repurchase (repo) agreements and derivatives. The sharp rise in gilt yields resulted in substantial collateral calls against these positions. In normal market conditions, calls can be met by liquidating assets in an orderly way. This was not always possible directly after the mini budget; even normally liquid bond markets suffered, resulting in spread widening and inflated transaction costs, while some other assets proved illiquid within the required timeframe.

Collateral management practices have subsequently been a key focus for investors (see *Time to rethink collateral cash*), with the LDI crisis providing a timely reminder of the need to diversify portfolios by tapping into multiple liquidity sources.[4]

During that period, we were able to liquidate assets on behalf of our clients, all settled within three working days from the time of request. Disposals included highly liquid Japanese government bonds, as well as euro-denominated and Scandinavian covered-bond positions.

Investor benefit 4: ESG integration

The business and investment cases for acting responsibly are hard to dispute. Companies that conduct their business in a respectful and sustainable way are more likely to succeed over time, benefiting everyone.

ReturnPlus recently achieved Article 8 classification, joining most of our liquidity range, under the EU's Sustainable Finance Disclosure Regulation (SFDR). Such funds promote environmental or social characteristics, or a combination of them, provided the companies in which investments are made follow good governance practices.

> ReturnPlus recently achieved Article 8 classification under the EUs SFDR

We aim to improve our risk management and investment performance by building responsibility into our investment processes, to create investment solutions fit for the future. Environmental, social and governance (ESG) considerations are embedded beyond the conventional approach and form an integral part of our fundamental assessment of issuers.

Having well-resourced and integrated credit and ESG research teams helps identify risks through engagement. Engaging with corporate and sovereign issuers also forms a key part of our macro-stewardship agenda, which we believe can contribute to better ESG practices. We see ESG integration as a vital part of the toolkit to deliver better client outcomes.

Beyond any binding ESG constraints in the strategy and baseline exclusions policy, the investment manager retains discretion over final investment decisions, taking into account wider risk factors.

Case studies: How our clients utilise ReturnPlus

Our pension and insurance clients use ReturnPlus in a variety of ways to meet their requirements.

Figure 4. **Examples of ReturnPlus usage**

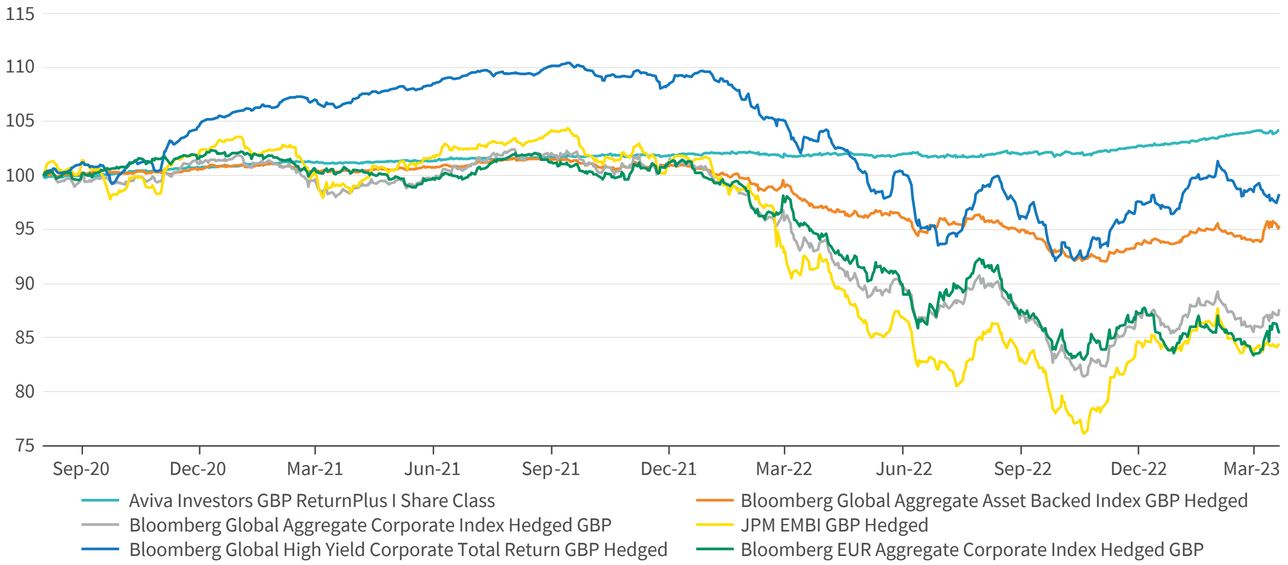
Investor type	Role of strategy	Key characteristics
Pension scheme A	Diversified source of spreads within a cashflow-driven investment (CDI) strategy	Strategic allocation as a diversified source of credit spreads within CDI. Positioned between LDI strategy, including gilts and swaps, and buy-and-maintain IG credit strategy on the risk/reward spectrum.
Insurer B	Enhancing return on capital (ROC)	Allocation to back non-annuity liabilities. It provides a diversified source of credit spreads and attractive return on Solvency II (SII) capital, while interest-rate risk is contained through swaps.
Pension scheme C	Re-leveraging LDI	Improving funding levels allowed pension scheme to de-risk asset allocation and reduce LDI leverage. To improve portfolio returns without taking excessive risk, the LDI portfolio was then re-levered, and the proceeds reinvested in ReturnPlus as the scheme approached its endgame.
Insurer D	Fixed-income optimisation	Allocation to diversify core sovereign and IG corporate exposure in the fixed-income portfolio, providing diversified sources of credit spread while optimising return on SII capital and improving liquidity.

Source: Aviva Investors, March 2023.

Comparison data against other traditional indices

ReturnPlus has shown a positive track record versus a variety of benchmarks for investors seeking to preserve capital and maintain liquidity, with historically low volatility.

Figure 5. **Performance since inception**

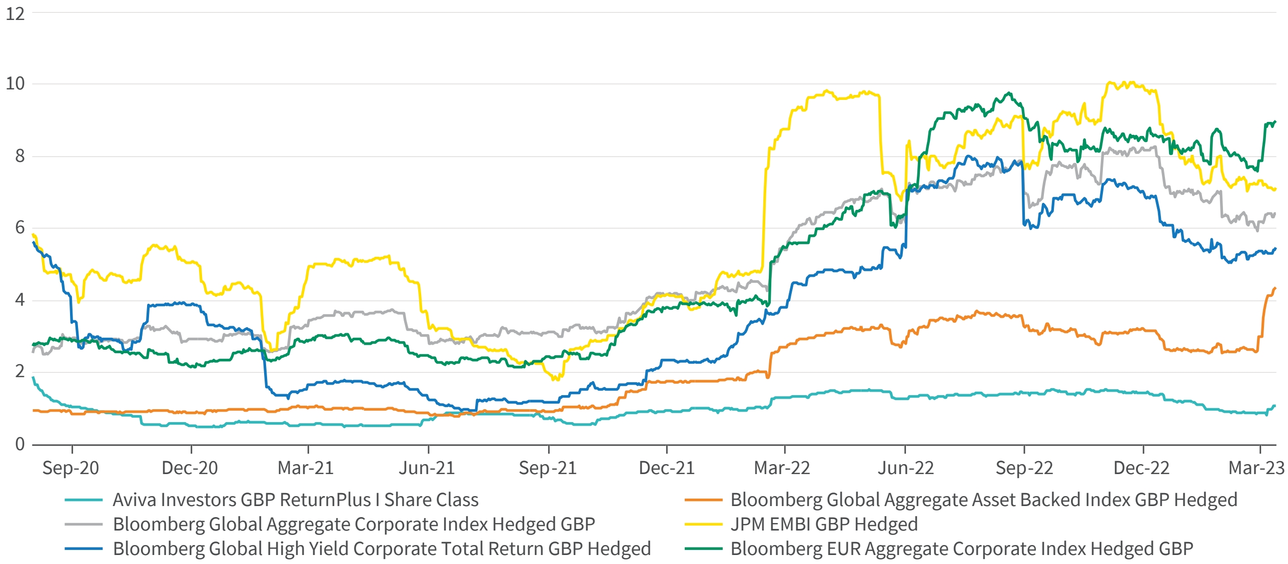


Past performance is not a guide to future performance

Note: Indexed performance to 100, August 8, 2020 to March 22, 2023. Performance expressed net of fees in GBP.

Source: Aviva Investors, Bloomberg. Data as of March 22, 2023.

Figure 6. **Three-month rolling volatility (per cent)**



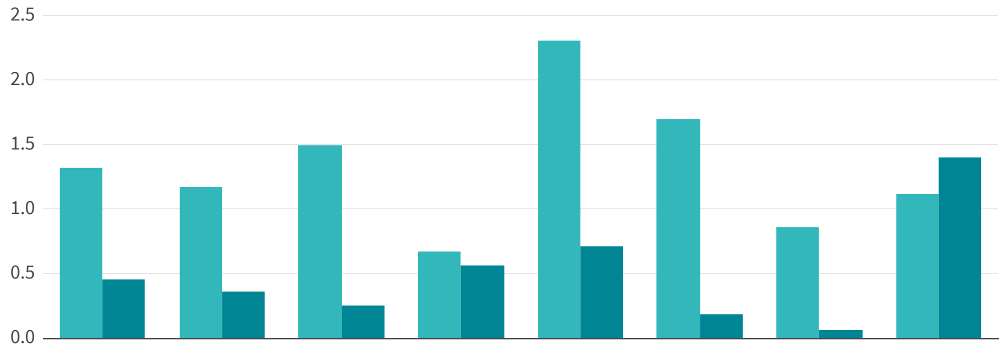
Past performance is not a guide to future performance

Note: Three-month rolling volatility from August 8, 2020 to March 22, 2023.

Source: Aviva Investors, Bloomberg. Data as of March 22, 2023.

ReturnPlus performance

Figure 7. **GBP composite calendar year performance**



	2015	2016	2017	2018	2019	2020	2021	2022
GBP ReturnPlus I Share Class (gross)	1.32	1.17	1.50	0.67	2.31	1.70	0.86	1.12
GBP ReturnPlus I Share Class (net)	1.17	1.02	1.35	0.52	2.16	1.55	0.71	0.97
Benchmark	0.46	0.36	0.25	0.56	0.71	0.19	0.06	1.40
Return versus benchmark (gross)	**0.86**	**0.80**	**1.24**	**0.11**	**1.59**	**1.51**	**0.80**	**-0.27**

Past performance is not a guide to future performance

Note: Inception date is October 31, 2014. Performance is shown gross and net of all fees and fund expenses in GBP. Benchmark is SONIA: Sterling Overnight Index Average.

Source: Aviva Investors. Data as of December 31, 2022.

Key fund facts

Fund name	Aviva Investors ReturnPlus Strategy
Fund managers	Todd Cutting and Rakesh Girdharlal
Investment objective	To achieve a 0.75 per cent per annum gross return above the Sterling Overnight Index Average (SONIA) over a 3-year rolling period, regardless of market conditions. To achieve a 0.50 per cent per annum gross return above the Euro Short Term Rate (ESTR) over a 3-year rolling period, regardless of market conditions.
Fund structure	SICAV-SIF
Currency of fund	GBP/EUR
Strategy launch date	August 3, 2020 and March 17, 2020
Share class /currency	I GBP and I EUR
ISIN code (launch date)	LU1985796611 and LU1985796371
Ongoing Charges Figure	0.15 per cent
Status under SFDR	Article 8

References

1. Sterling Overnight Index Average.
2. Euro Short-Term Rate.
3. Alastair Sewell, "An introduction to money market funds: The role of MMFs for cash management", Aviva Investors, February 27, 2023.
4. "Time to rethink collateral cash", Aviva Investors, December 13, 2022.

Key risks

Past performance is not a guide to future performance.

Investment risk

The value of an investment and any income from it can go down as well as up and can fluctuate in response to changes in currency and exchange rates. Investors may not get back the original amount invested.

Credit risk

Bond values are affected by changes in interest rates and the bond issuer's creditworthiness. Bonds that offer the potential for a higher income typically have a greater risk of default.

Illiquidity risk

Some investments could be hard to value or to sell at a desired time, or at a price considered to be fair (especially in large quantities), and as a result their prices can be volatile.

Important Information

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Where relevant, information on our approach to the sustainability aspects of the fund and the Sustainable Finance disclosure regulation (SFDR) including policies and procedures can be found on the following link: https://www.avivainvestors.com/en-gb/capabilities/sustainable-finance-disclosure-regulation/

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374377 – 31/03/2024

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