

## Trustnet News and Research

## Longevity proves attractive to institutional investors



By [David Rawson-Mackenzie](#) 14 Oct 2010

**As an asset class longevity can offer predictable returns with low volatility and market correlation, says Centurion's David Rawson-Mackenzie.**

Longevity as an asset class for institutional investors has been in existence for over 20 years and can provide attractive, predictable returns with low volatility and market correlation, which appeals to a wide range of investors, particularly those targeting inflation-beating returns and capital preservation.

Longevity is typically divided into macro and micro longevity. Macro longevity relates to the general population and is generally represented by a sample size in the tens of thousands of lives, for example a pension fund's pool of annuitants. In recent years, the capital market has been structuring products to transfer the macro longevity risk from pension funds and insurance companies to investors. However, with typical transactions size in the tens of millions, this type of risk was virtually inaccessible for non-institutional investors until the recent introduction of funds which invest in macro longevity.

Micro longevity references a much smaller pool of lives and is a more accessible asset class. The micro longevity stable of investment products includes reverse mortgages, life tenancies and life settlements, with the latter proving to be an increasingly popular choice for investors looking for stable returns with low volatility and correlation to the financial markets.

Historically life settlement funds held a selection of individual physical policies with varying longevity expectations, which when combined in a portfolio aimed to deliver consistent returns with little market volatility. These physical life settlement funds are now being complimented by a second generation of funds which either invest purely in synthetics or hybrid funds which invest in a mixture of physical policies and synthetic longevity products.

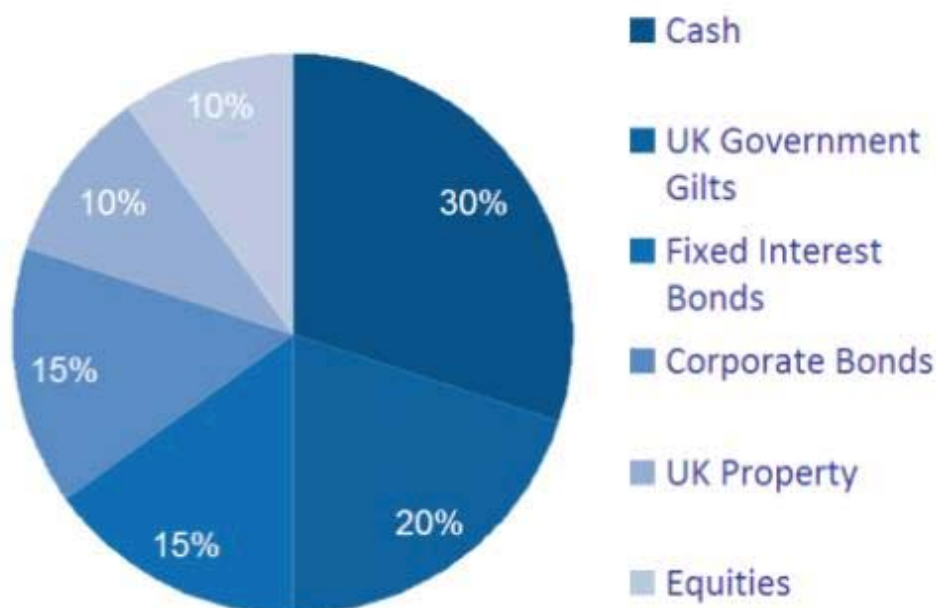
A synthetic is a form of structured macro or micro product which offers investors the opportunity to gain exposure to the longevity asset class without having to purchase the assets directly. Synthetic instruments can include swaps, longevity linked notes and longevity indices with the investment returns referenced to the survival of a pool of actual lives.

The advantage of using synthetics is that they avoid a number of risks associated with physical policies such as origination and taxation risk and can also enhance liquidity as they are both standardised and tradable. Combing physical and synthetic assets in a fund can also help to deliver increased diversification and a reduced risk profile for more cautious investors.

To highlight the positive effects of introducing longevity to an existing asset mix, the holdings in the portfolio below have been modified to reduce exposure to property and equities – the two worst performing asset holdings – and add an element of longevity.

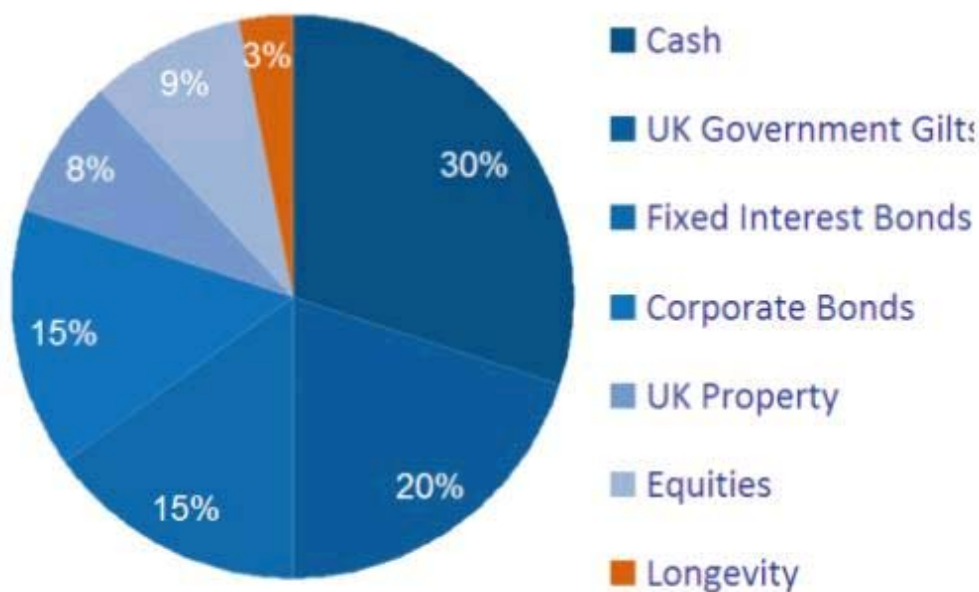
## Ex-longevity assets

## Original portfolio: asset allocation



## Inc-longevity assets

## Remodelled portfolio: asset allocation

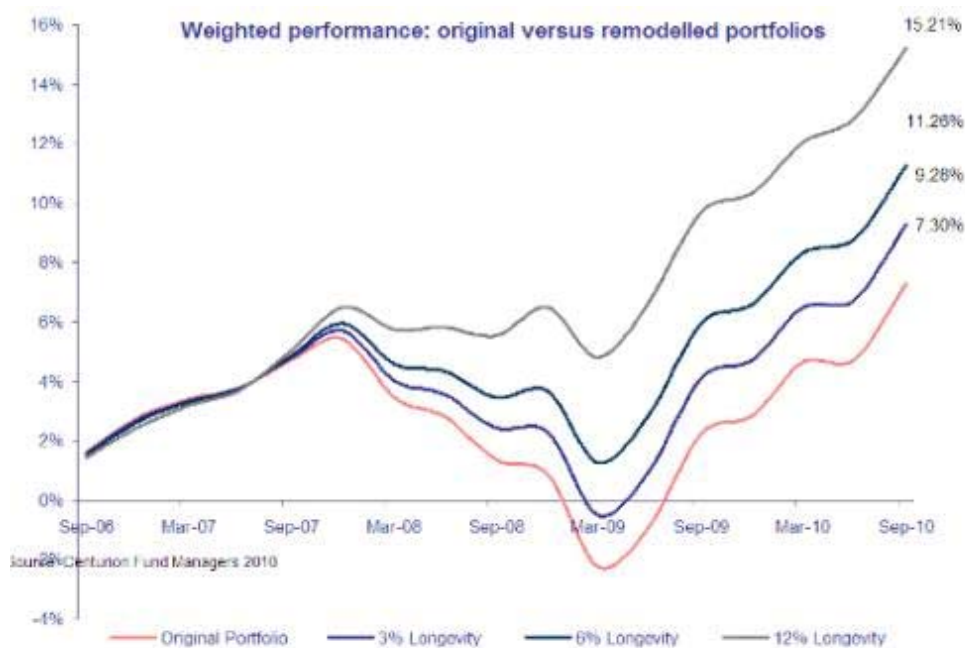


Source data: Reuters. Cash: UK Base rate minus 0.5%, UK Gilts: UK Government Gilts (10yr), Fixed Interest: FT Fixed Interest 5-15yr Index, Corporate Bonds: ML Total Return Index - Sterling Corporate Securities, Property: FTSE UK All Property Index, Equities: FTSE 100 Index

Immediately this has a positive effect on the balance of the portfolio by adding additional diversification and demonstrating that even the smallest element of longevity can improve the overall portfolio performance.

Finally the overall risk profile has been eased by substituting the exposure of the potentially more turbulent equity and property markets for a relatively stable and predictable asset class.

### Performance inc-longevity assets



David Rawson-Mackenzie is a director at [Centurion Fund Managers Limited](#) (pictured above). The views expressed are his alone.