Did defensive funds protect investors during the market sell-off?

From investment trusts and gold, to absolute return funds and 'volatility managed' funds, Kyle Caldwell examines the performance of defensives during a turbulent time.

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Those outright pessimists who long warned a financial apocalypse was around the corner during the 10-year long bull market for financial markets had concerns over unsustainably high levels of global debt, trade wars and sky-high valuations for the US equity market. Each worry was plausible, but ultimately none of them proved to be the straw that broke the camel's back. Instead it was Covid-19, a deadly disease no one had heard of until the start of this year, which sent markets into meltdown.

At such times, defensively positioned funds should, in theory, prove their worth and cushion investors by limiting losses. After all this is the role they are designed to perform in a portfolio, and indeed the reason why investors willingly accept the trade-off of lagging returns in a rising market.

But, research by Money Observer has found a number of defensive funds did not in fact prove their worth during the sell-off. Using data from FE Analytics, covering the period from 21 February (when the sell-off started) to 23 March (prior to US and Asian markets having their best three-day streak since the 1930s), we examine how different types of defensive funds fared.

Capital preservation-focused investment trusts

There are a handful of wealth preservation investment trusts, which prioritise protecting investor capital and invest on the principle that they would sooner keep £1 rather than risk losing it to try and win £2. The four trusts that meet this description are Capital Gearing, RIT Capital Partners, Ruffer Investment Company and Personal Assets. Each has a low weighting to equities and plenty of defensive armoury, such as low-risk inflation-linked bonds and a small weighting to gold.

But over the period of the sell-off, performances markedly varied. Ruffer held up best (with its share price total return down 1.9%), while Personal Assets (-11.2%) and Capital Gearing (-11.8%) produced similar losses.

RIT Capital Partners, meanwhile, posted a heavy loss of 30.5%, which was steeper than global tracker funds. Over the same period, the FTSE World index return was -24.7%. This is far from the steady ride its shareholders expect, but can be explained by the fact that it moved from trading on a small premium (of 4.3% on 21 February) to a 20% discount (on 23 March), according to data from investment trust analyst Winterflood. Over that period there was clear selling pressure, therefore, which harmed its share price. However, it should be pointed out that this abnormally wide discount did not last for long, as a week later (30 March) its discount fell to -9% and its share price rose by 20%.

James Carthew, head of investment company research at QuotedData, says the fact that RIT Capital Partners only publishes its net asset value once a month “created some uncertainty”. But he thinks the sell-off has been unjustified. “In addition to the net asset value issue, a large part of the portfolio is invested in hedge funds and unquoted investments and the value of these is less visible. Providing its net asset value holds up well, we see no reason why the discount should not close.”

The other three wealth preservation trusts have not been under selling pressure. Over the period Ruffer’s small discount tightened towards par, while both Personal Assets and Capital Gearing saw their small premiums slightly increase.

Peter Spiller, manager of the Capital Gearing investment trust, which has a very low allocation to equities (17% at the end of February), is continuing to adopt a cautious stance. He says: “A big constraint on buying (despite the sell-off) is that the S&P 500 is expensive. If Wall Street goes down, then so will global markets.” As such, Spiller argues, value is not yet compelling…