

# An Intriguing New Fund Aimed at Protecting Investors from Black Swans

The Contrarian | Russel Kinnel

## Our Contrarian Approach

I go against the grain to find overlooked funds that may be ready to rally.

A new fund from PIMCO is one of the most intriguing funds to come down the pike in quite a while.

**PIMCO Global Multi-Asset** PGMDX is designed to combine tactical asset allocation with tail-risk protection—something no one else has tried. They've assembled an all-star team: Mohamed El-Erian, current CEO and co-CIO of the firm, and former head of Harvard's endowment; Vineer Bhansali, an expert on hedging risk; and Curtis Mewbourne, who knows bonds and insurance quite well.

Tail risk, also known as Black Swans, refers to the unusual extreme events at either end of a normal distribution curve. Last year was laden with tail risks as a number of extreme outcomes that history indicated were very rare, all happened together. What makes this approach different from, say, ordinary shorting is that it's insuring you for the right thing.

A regular, humdrum single-digit loss isn't going to throw your investment plan off. Plain old diversification handles that just fine. Rather, it's those rare extreme losses and the knock-on effects that they can have elsewhere that are the problem. Moreover, this kind of insurance is much cheaper than simply shorting stocks.

It requires only a modest piece of the portfolio to acquire tail-risk insurance. Comanager Vineer Bhansali says tail-risk insurance is quite cheap provided you have the foresight to buy it before the crisis begins. Moreover, it means you have less of a drag on your portfolio than you would if you had more money tied up in short positions, as those will be a drag on performance most of the time because stocks generally go up.

How do they do it? They use options and other derivatives similar to buying out-of-the-money puts on markets and credit defaults. These won't pay off if heck breaks loose—only financial Armageddon

will make these pay off, but then they'll pay off when you need it most. Bhansali says another strategy is to "invest in positions with negative correlation to tail risk such as momentum strategies that move with volatility indicators including the VIX (CBOE Volatility Index)." In other words, bet on volatility. A third idea is to buy Treasury and eurodollar futures because those securities rally sharply when there's a flight to quality or easing of monetary policy. Finally, they can reduce risk exposure where the risks are greatest. Bhansali says they don't need to predict precisely what the risk is but only to protect against its likely consequences, such as a market sell-off or a spike in volatility.

Besides insuring against tail risk, the fund does tactical asset allocation as it chooses among stocks, bonds, and commodities here and abroad. The focus is once again on risk factors rather than typical asset exposure. For broad asset allocation, they use the institutional shares of PIMCO's enhanced index funds. Those funds buy futures of the index they want to track and then invest remaining capital in a short-term bond portfolio that is designed to outperform Treasury bills. If it does, the fund will beat its index (before fees), and if it doesn't, the fund will lag the index.

OK, I know all that got a little complicated, and usually I hate complication but in this case it's required given the tricky task at hand. You're really getting expertise you couldn't duplicate, and with PIMCO's trading desk you're getting access and prices for these derivatives that you couldn't possibly get on your own.

The only disappointing thing is that PIMCO isn't cutting you a great deal on fees. When you roll up the underlying fees of the funds and this fund's fees, the cost is around 1.50% for retail investors, though about 0.95% if you have a way to gain access to the institutional shares. However, given the added price you'd pay just in trying to buy those out of the money derivatives in the first place and, of course, the expertise of knowing when they are most attractively priced, it still looks like the cheapest way to do this. ■■■



*Investors should consider the investment objectives, risks, charges and expenses of this Fund carefully before investing. This and other information is contained in the Fund's prospectus, which may be obtained by contacting your financial advisor, by visiting [www.allianzinvestors.com](http://www.allianzinvestors.com) or by calling 1-888-877-4626. Please read this prospectus carefully before you invest or send money.*

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The article states that the Fund uses institutional shares or PIMCO's enhanced index funds. While it does have the ability to invest in PIMCO's enhanced index funds, as of June 30, 2009 the Fund did not hold any positions in the PIMCO enhanced index funds. As of June 30, 2009 the Fund did have positions in other PIMCO funds. The Fund is a fund of funds and has the ability to invest in most PIMCO Funds in addition to other investments.

The Fund's Class A and Class D shares gross expense ratio is 2.09% and the net expense ratio is 1.66%. Net expense ratio reflects contractually guaranteed expense reduction through 7/31/10. Expenses are different for other share classes of the Fund.

**Past performance of the markets is no guarantee of future results.** This is not an offer or solicitation for the purchase or sale of any financial instrument. It is presented only to provide information on investment strategies and opportunities. The material contains the current opinions of the author, which are subject to change without notice. Statements concerning financial market trends are based on current market conditions, which will fluctuate. References to specific securities and issuers are for illustrative purposes only and are not intended as recommendations to purchase or sell securities. Forecasts are inherently limited and should not be relied upon as an indicator of future performance.

Fixed income securities will fluctuate in value because of changes in interest rates. The value of equity securities can fluctuate due to general market conditions not specifically related to a company, factors related to a company's industry, or factors related to the specific company. Investments in non-U.S. securities may be more volatile and subject to special political and currency risks. Non-U.S. securities involving emerging markets may be subject to enhanced levels of these risks. The underlying funds may invest in mortgage-related securities, which are subject to the risks of the mortgages being prepaid. There is no assurance that any private insurers of the underlying mortgages will meet their obligations. High-yield bonds generally involve greater risk of default than investment-grade bonds. The underlying funds' use of derivatives may involve certain costs and risks such as liquidity risk, interest rate risk, market risk, credit risk, and the risk that the fund could not close out a position when it would be advantageous to do so. Portfolios investing in derivatives could lose more than the principal amount invested in those instruments. A risk of the Fund is that the allocation among the underlying funds could be less than optimal, contributing to poorer relative performance or negative performance. The Fund's net asset value will fluctuate in response to changes in the net asset values of the underlying funds. Investments in commodities may be affected by overall market movements, changes in interest rates, and other factors such as weather, disease, embargoes and international economic and political developments. An investment in commodities may not be suitable for all investors. The cost of investing in a fund of funds will generally be higher than the cost of investing in a mutual fund which invests directly in individual stocks and bonds.

The CBOE Volatility Index® (VIX®) is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices. Since its introduction in 1993, VIX has been considered by many to be the world's premier barometer of investor sentiment and market volatility.

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