Diversified Growth Investment Strategies

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Target audience

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Agenda

- What are Diversified Growth strategies?
- Diversified Growth vs Balanced
- The importance of diversification
- Risk-based, not asset class-based, diversification
- How Diversified Growth strategies can be used in Hong Kong
- Investec Global Diversified Growth
- Outlook

What are Diversified Growth strategies?

Diversified Growth strategies are a <u>brand</u> to describe <u>next generation</u> of Multi-Asset approaches

This is not a buy, sell or hold recommendation for any particular security.

What are Diversified Growth strategies?

Typical characteristics

- Total return outcome orientated return target
- Improved downside protection and reduced volatility
- Traditional and/or non-traditional return sources
- Flexible asset allocation
- Use a number of methods to implement views

Diversified Growth strategies are designed to provide investors with a smoother investment journey

What are Diversified Growth strategies?

Cost of iPhone in 2015 vs cost of separate components in 1991

2015

$600

1991

$3000

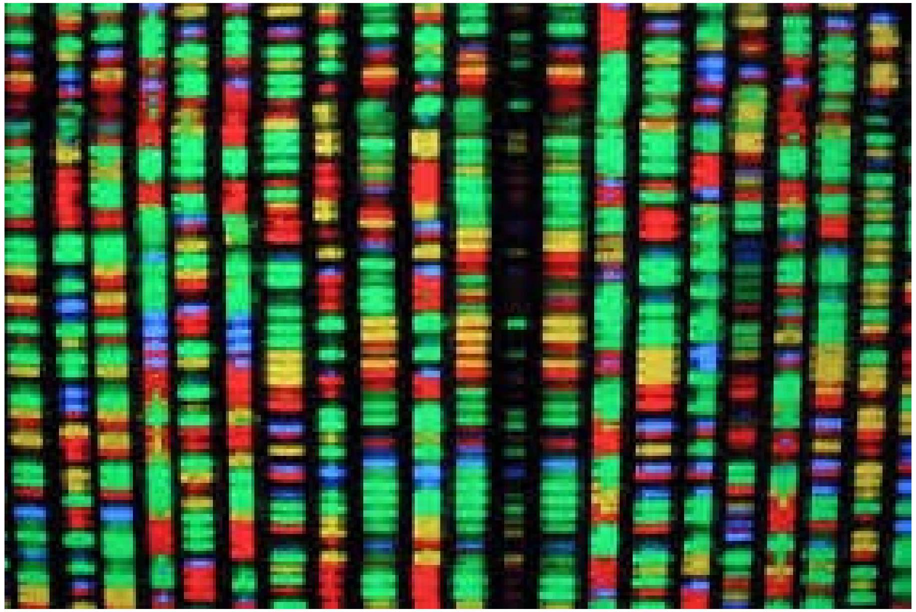
Diversified Growth strategies provide efficient integration of key components

This is not a buy, sell or hold recommendation for any particular security.
Source: AXA Framlington - Market Thinking, Friday 6 March 2015

What are Diversified Growth strategies?

Cost of sequencing the human genome in 2015 vs 1991

2015



$750

1991

$2.5 billion

Diversified Growth strategies give access to latest techniques

Source: Bank of America Merrill Lynch – The Longest Pictures, 22 February 2015

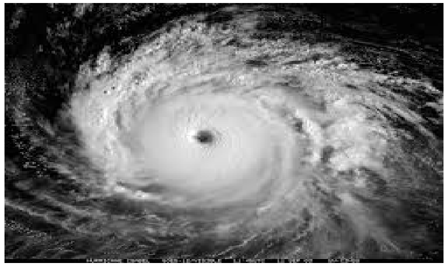
Diversified Growth vs Balanced

Breadth of opportunity set

Diversified Growth opportunity set

Balanced opportunity set

Domestic Equities	Domestic Bonds	Cash
Global Equities	Global Bonds	Global Currencies
Emerging Market Equities	Emerging Market Bonds	Emerging Market Currencies



Diversified Growth strategies take a global approach to investing in a broad range of traditional and non-traditional return sources

Diversified Growth vs Balanced

Asset allocation… from the bottom up

An in-depth understanding of bottom up dynamics helps to make smarter asset allocation decisions and to see the ‘bigger picture’

Diversified Growth vs Balanced

Pragmatic implementation

A blunt instrument?

Funds, simple passives

Precision access?

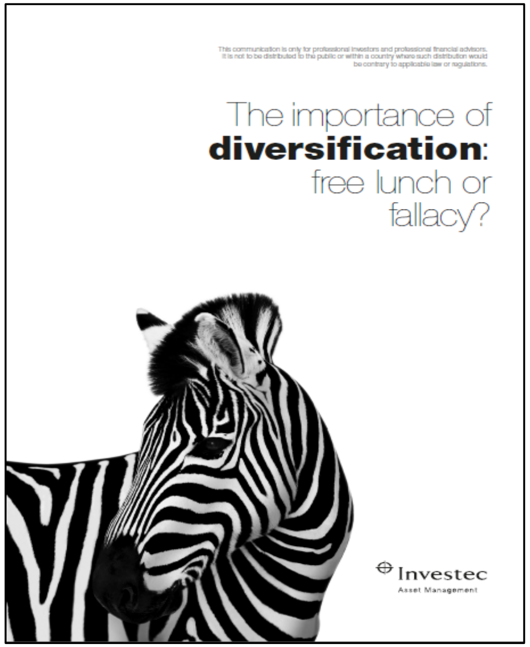
Baskets, tailored beta, relative value

Diversified Growth strategies can use a number of methods to implement a view

The importance of diversification

Free lunch or fallacy?

- Concept of spreading risk – "don't put all your eggs in one basket" – is sound
- Diversification is a key tenet of Diversified Growth strategies
- However, in practice investors' experience of diversification have often been less than satisfactory
- 'Diversified' portfolios have failed to provide the outcomes that would have been expected
- Risk that investors are left unsatisfied



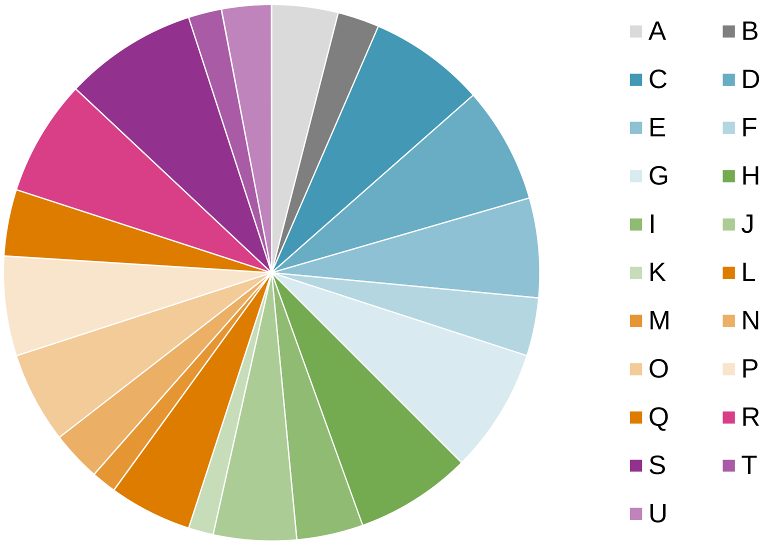
The importance of diversification

Three fallacies

#1: Lots of colours on a pie chart = diversification:

- Breadth alone does not guarantee diversification
- Need to know the underlying drivers of returns for assets
- What optically appears to be diversified may not be so

Example: XYZ Multi-Asset Fund



"The investment objective of the Fund is to provide long-term investment growth through exposure to a <u>diversified</u> range of asset classes"

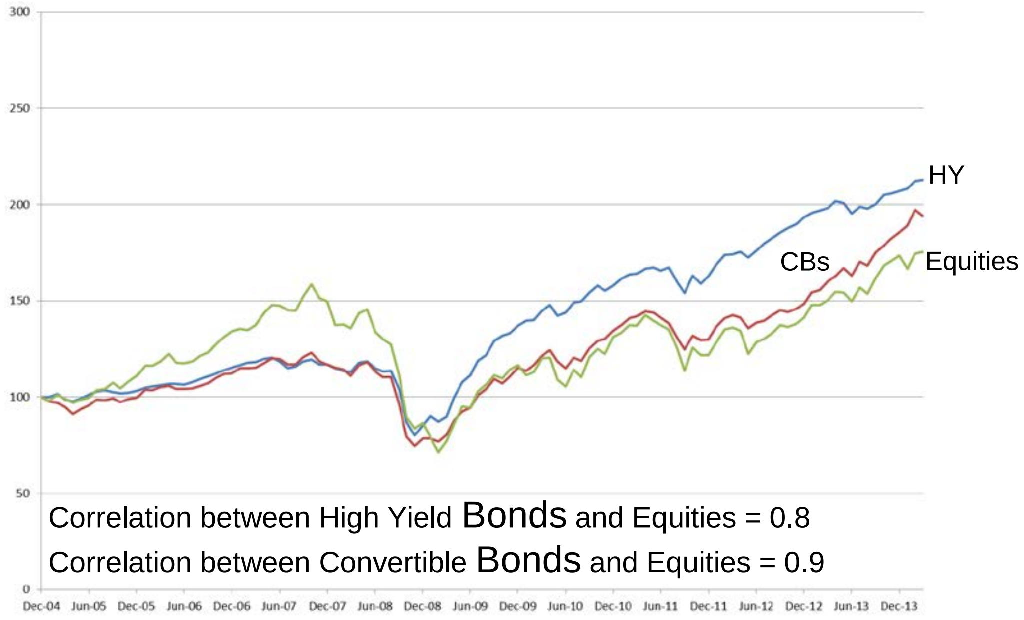
The importance of diversification

Three fallacies

#2: Asset class labels accurately describe their behaviour:

- Not always the case
- Certain bonds in particular behave more like equities

Performance of High Yield Bonds, Convertible Bonds and Equities:



Source: Bloomberg. April 2014, Equities using MSCI AC World TR Net USD; High Yield using Bank of America Merrill Lynch Global High Yield Index; Convertibles Bonds using Bank of America Merrill Lynch All Convertibles Ex Mandatory All Qualities Index

The importance of diversification

Three fallacies

#3: Asset relationships are constant over time:

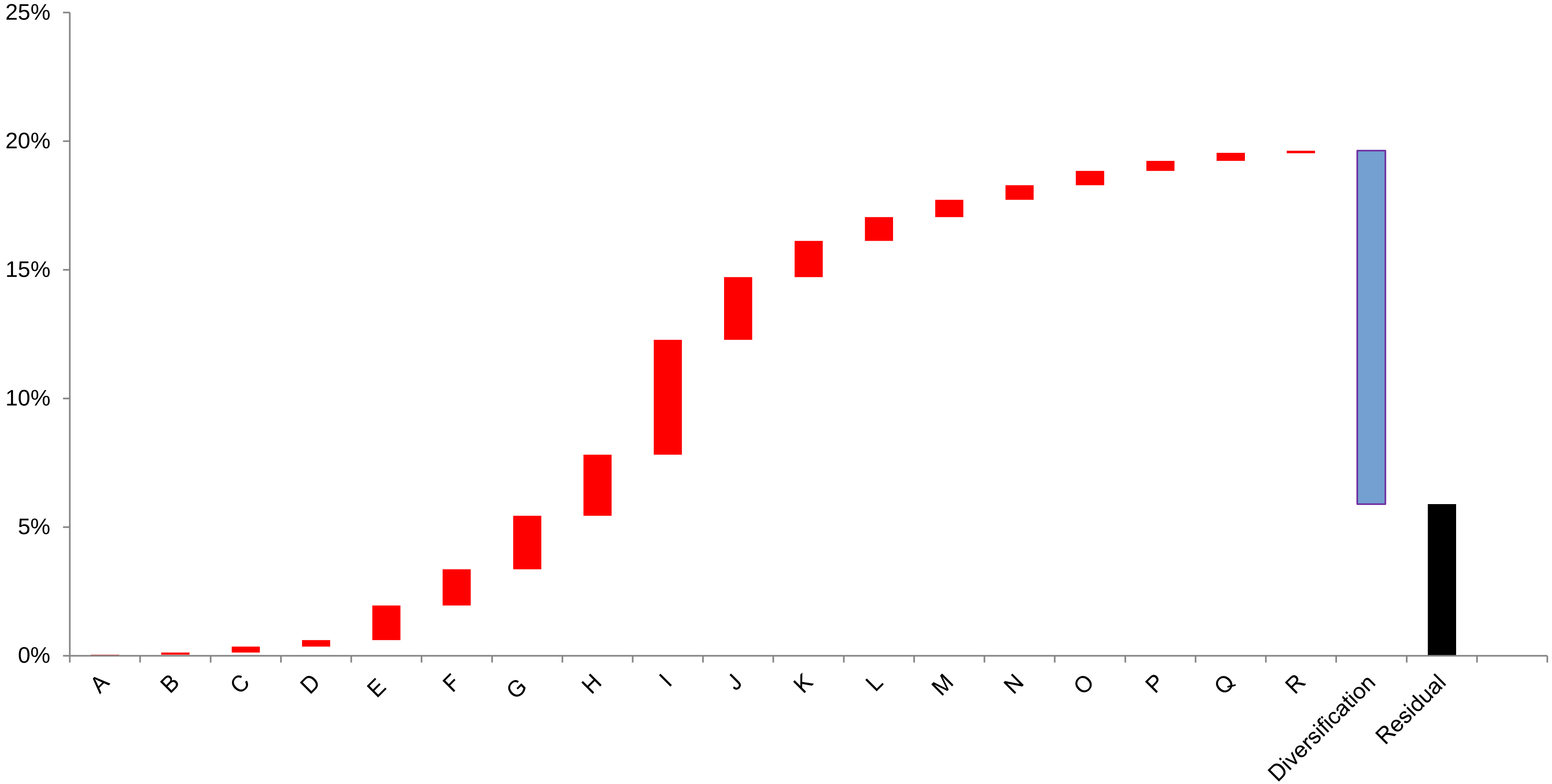
- Asset relationships and behaviours can vary significantly over time
- They need to be continually re-assessed

	Nineties (1990 - 1999)	Tech Bust (2000 - 2003)	Pre GFC (2004 - 2007)	GFC and On (2008 - 2011)	Average over 4 periods
Developed Market Equity	100%	100%	100%	100%	100%
UK Equity	75%	90%	81%	96%	85%
Emerging Market Equity	62%	82%	81%	92%	79%
UK Small Cap	56%	79%	66%	81%	71%
US High Yield	42%	53%	60%	81%	59%
Emerging Market Debt	64%	50%	34%	73%	55%
Property	37%	34%	55%	81%	52%
Hedge Fund: Equity Market Neutral	17%	-18%	64%	55%	29%
Gold	-5%	1%	41%	16%	13%
Hedge Fund: Trend-follower	-13%	-29%	52%	-5%	1%
US 30 yr Treasuries	25%	-22%	-25%	-35%	-14%
UK Gilts 25yr+	-10%	-26%	-12%	-14%	-15%
Defensive / Cyclical Spread	-49%	-72%	-57%	-79%	-64%
Volatility	-62%	-82%	-72%	-86%	-76%

Source: Investec Asset Management, DataStream and Bloomberg, as at 31 December 2012
Developed Market Equity: MSCI World; UK Equity: FTSE 100; Emerging Market Equity: MSCI Emerging Markets; UK Small Cap: FTSE Small Cap ex IT; US High Yield: BofA Merill Lynch US High Yield Master II; Emerging Markets Debt: JP Morgan Emerging Markets Bond Index Global Composite; Property: FTSE NAREIT Composite; Hedge Fund: Equity Market Neutral: HFRI Equity Market Neutral; Gold: Gold; Hedge Fund: Trend-follower: Newedge CTA; US 30 year Treasuries: BofA Merill Lynch US Treasury Current 30 year; UK Gilts 25yr+: BofA Merill Lynch UK Gilts, 25+ yrs; Defensive / Cyclical Spread: (1/3 MSCI World Healthcare + 1/3 MSCI World Consumer Staples +1/3 MSCI World Utilities) / (1/3 MSCI World Industrials + 1/3 MSCI World Information Technology + 1/3 MSCI World Materials); Volatility: Negative of CBOE Put Write Index

Risk-based, not asset class-based, diversification

Understanding contributors to expected volatility

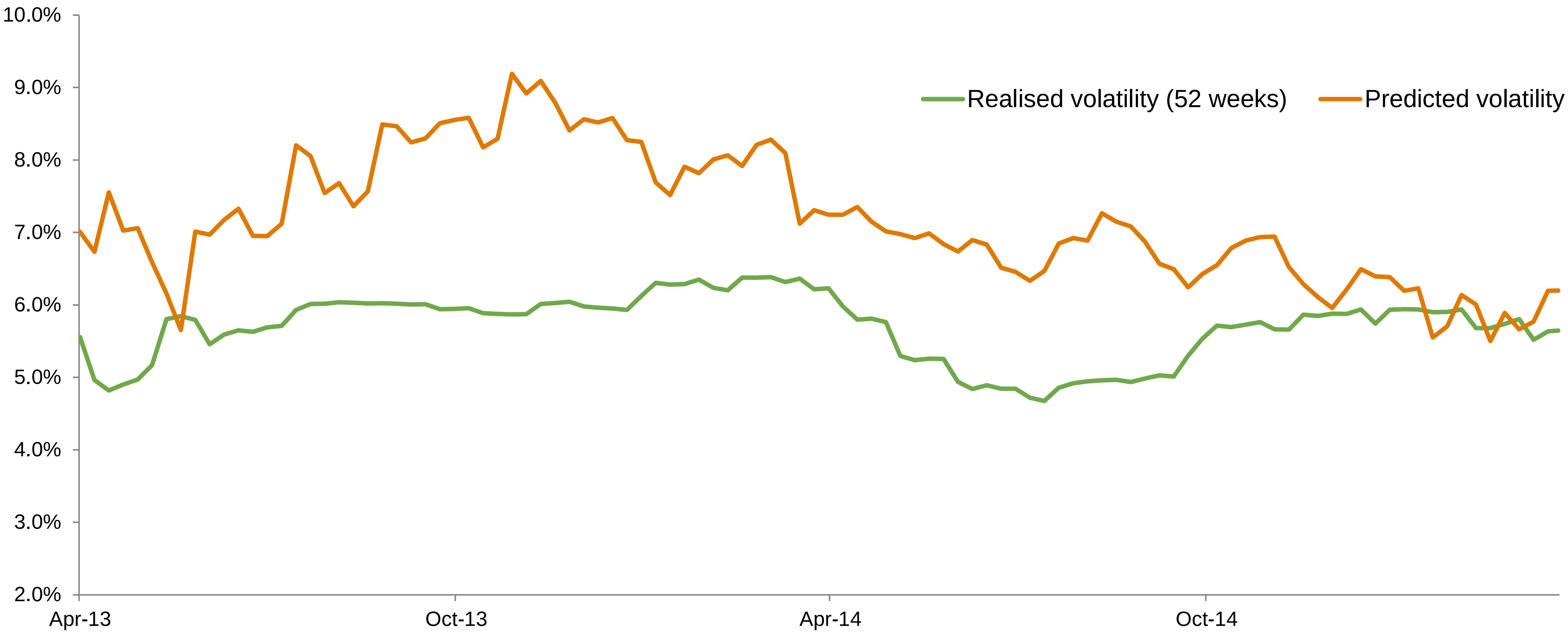


Understanding how positions contribute to overall volatility is important for deciding what to own and how much to own

Source: Investec Asset Management, EM Applications, April 2015

Risk-based, not asset class-based, diversification

Expected vs realised volatility

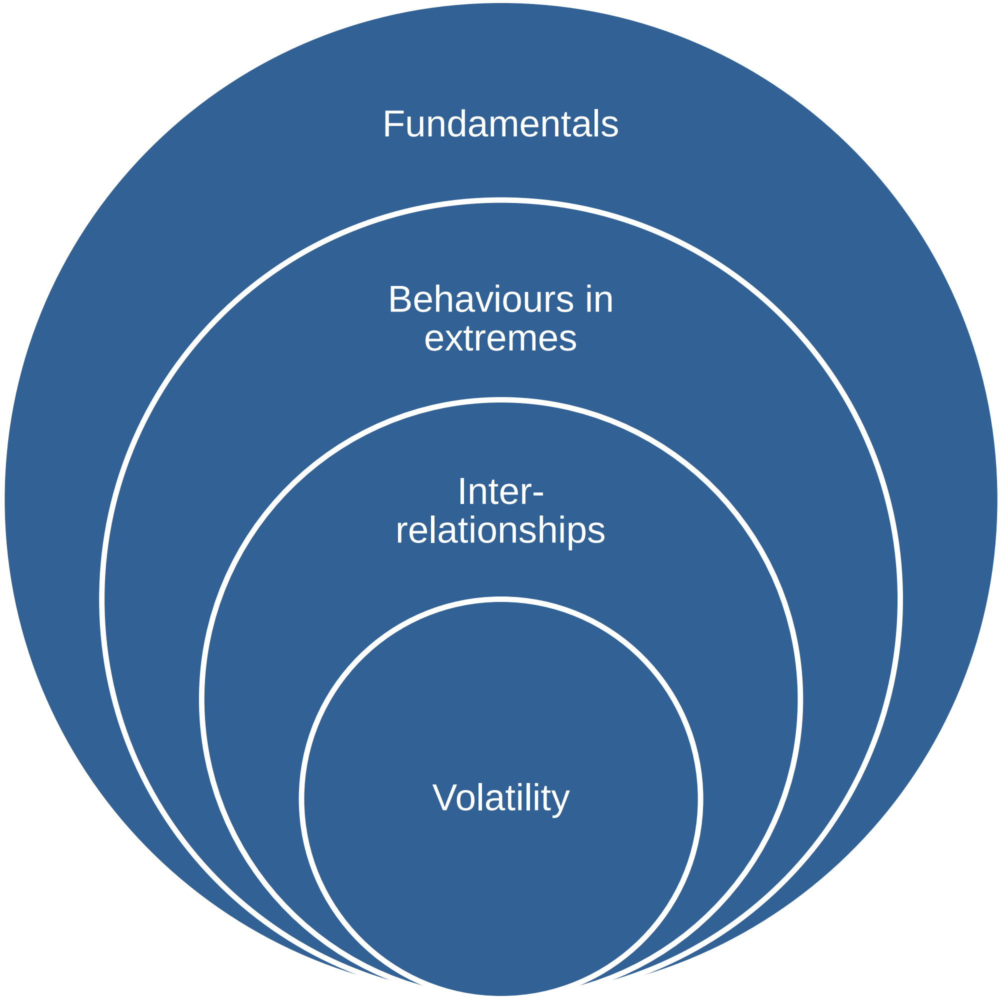


The interaction between 'what has happened' and 'what is predicted to happen' is informative

Source: Investec Asset Management, EM Applications, April 2015

Risk-based, not asset class-based, diversification

Risk does not equal volatility!!



Volatility is just one measure to assess risk – do not rely on what a risk model is telling you!!

Risk-based, not asset class-based, diversification

Our approach – focus on asset behaviours rather than asset labels

- All investments exhibit either **Growth**, **Defensive** and **Uncorrelated** characteristics

- We believe a blend of these characteristics results in superior diversification and therefore more consistent outcomes

Growth

- Equities
- High yield debt
- Emerging market debt and currency
- FX carry
- Commodities
- Property
- Private equity

Assets that return inline with expectations of real economic growth

React positively to increasing corporate earnings, cash flow and risk appetite

Defensive

- Government bonds
- Index linked bonds
- Investment Grade bonds
- Volatility strategies
- Shorting growth

Assets that react positively to declining expectations of real economic growth

Safe havens in market crises

Uncorrelated

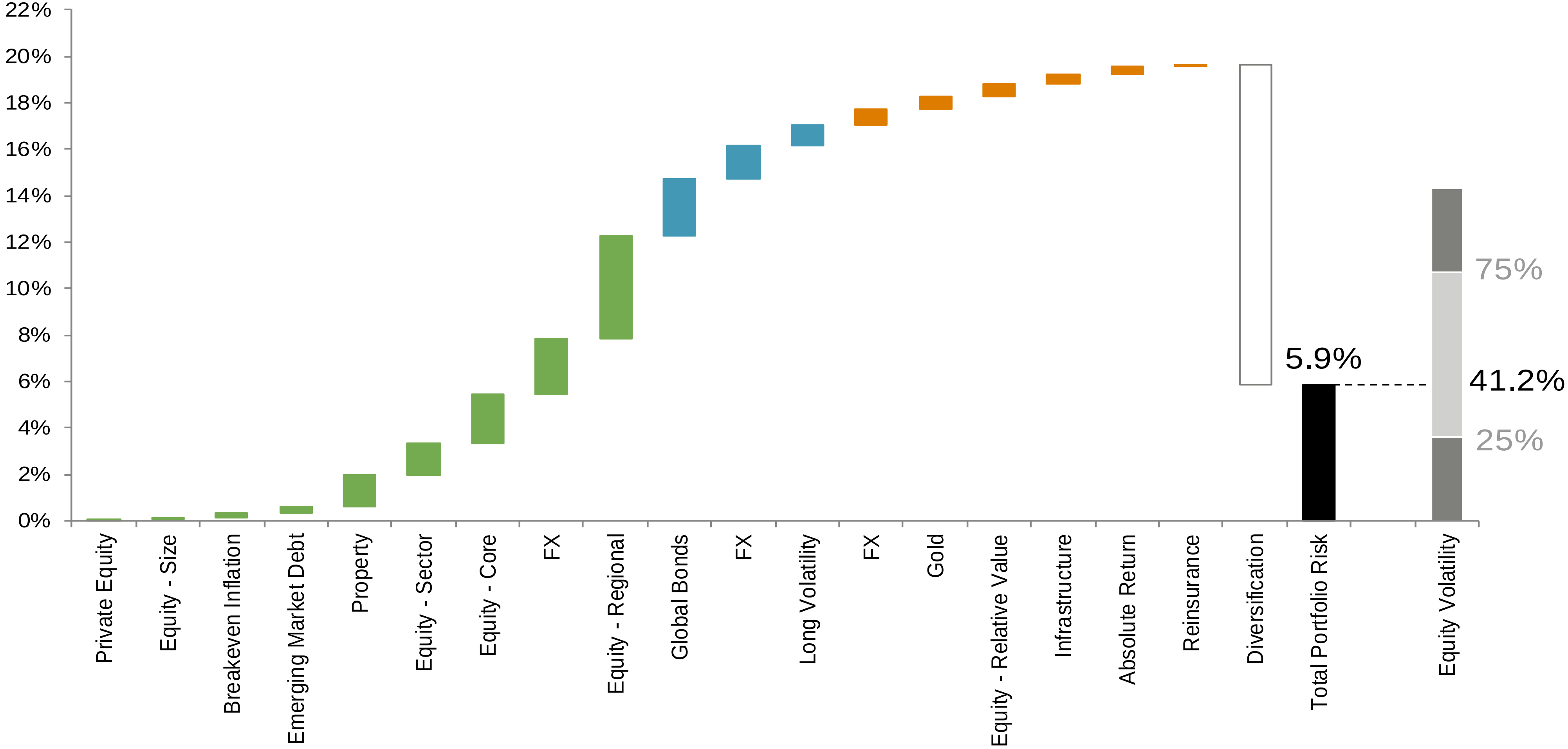
- Infrastructure
- Insurance
- Commodity trading
- Event strategies
- Relative value

Variable relationships with growth and risk appetite

Performance is generally unrelated to real economic and corporate earnings growth

Risk-based, not asset class-based, diversification

Understanding contributors to expected volatility



Understanding how positions behave is important for deciding what to own and how much to own

Source: Investec Asset Management, EM Applications, April 2015

How can Diversified Growth strategies be used?

Relevant for both Defined Benefit and Defined Contribution schemes

Access to new asset classes	Reduce reliance on equities
Growth Potential	Asset allocation

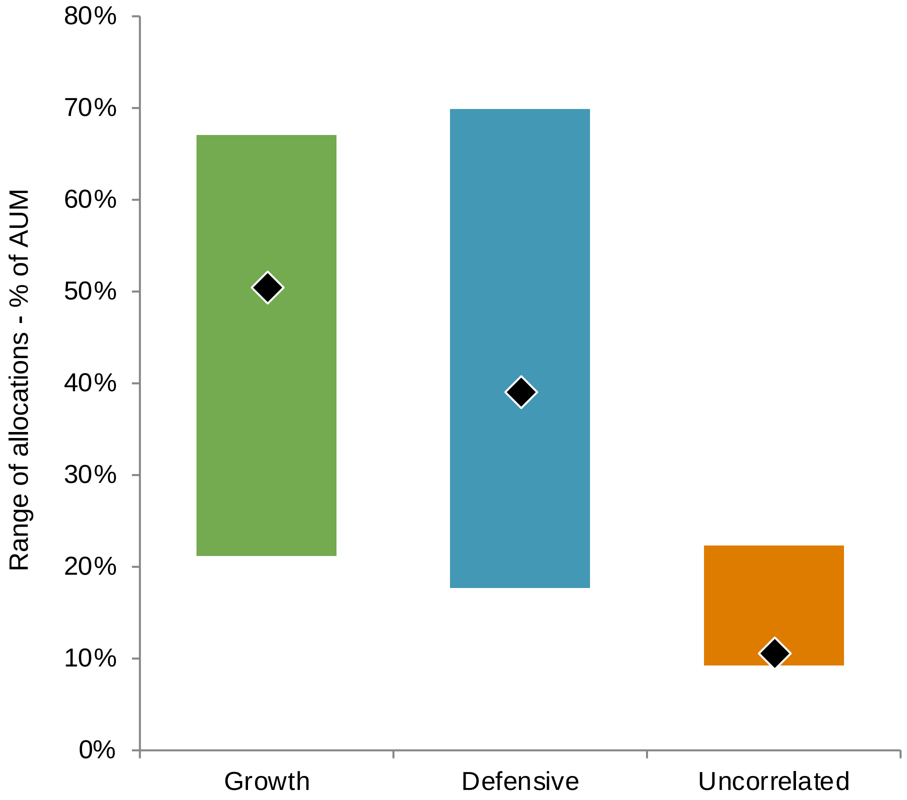
Can play a key role as part of 'default' solution in DC schemes and as core allocation in DB schemes

Investec Global Diversified Growth

Aiming to provide investors with attractive real growth while limiting volatility

- Return target:
  - CPI +5% p.a. gross of fees*
- Risk objective:
  - Half the volatility of equities
- Time horizon:
  - Rolling five year periods

Current and historic allocations to Growth, Defensive and Uncorrelated assets since 2008*



Source: Investec Asset Management. Range since May 2008. *This is an aim and may not be achieved.
Current position (diamond): 31 March 2015. **Historic positions of a sterling denominated representative portfolio

Outlook summary

Our views

Equities	
US	→
Europe	→
UK	→
Japan	↗
Asia ex JP	↗
EM	→

Bonds	
US/UK	→
EU/Japan	↘
Inflation Linked	→
Investment grade	↘
High yield	↘
EMD	→

Currencies	
USD	↗
EUR	↘
GBP	→
JPY	→
EM	↘
RMB	→

We are moderately positive about equities

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