Agenda

Morning Session

1. Why consider an Objective Based approach?
2. The inputs
3. Portfolio construction exercise

Afternoon Session

4. Review and key takeaways

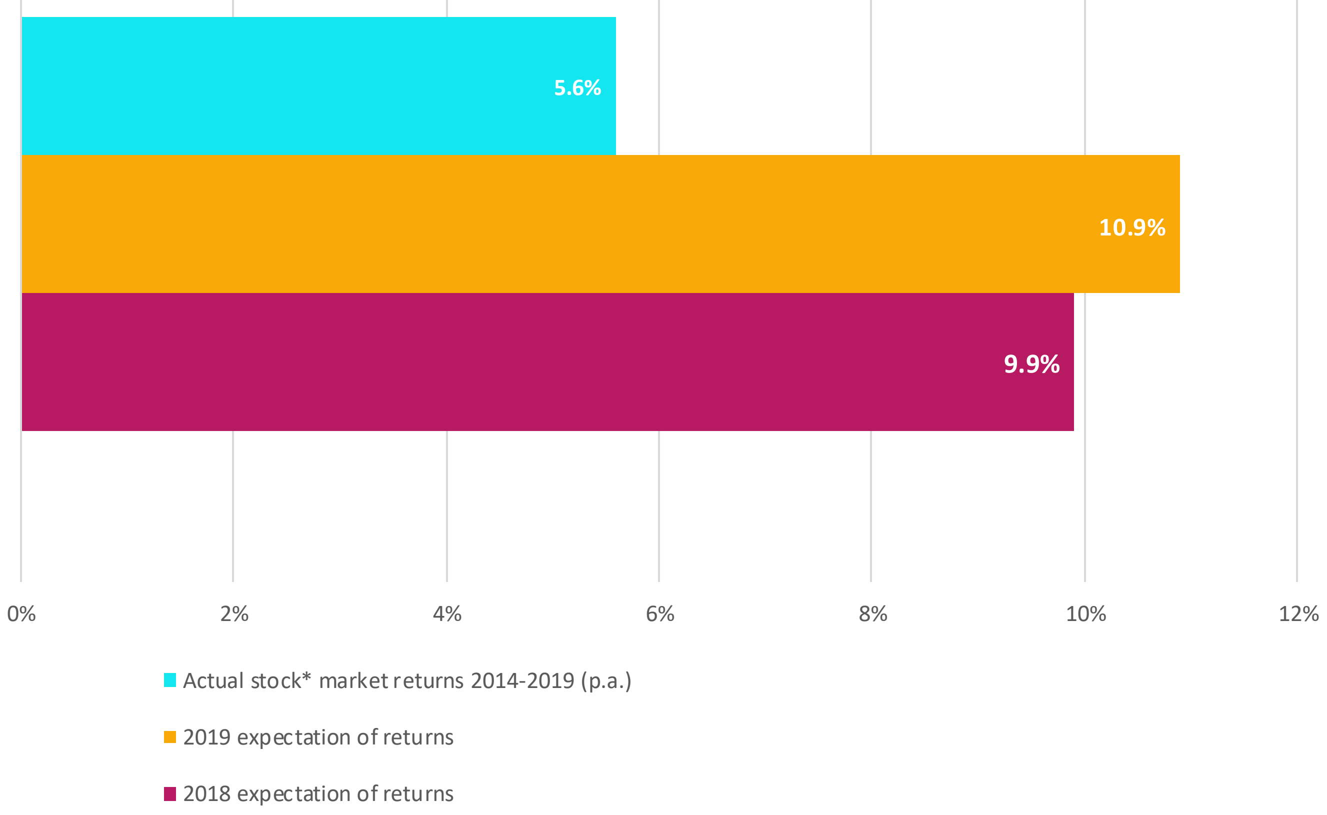
Global Investor Study

Australian investors have unrealistic expectations of return

10.4%

Is the minimum level of income people would expect to receive from their investments

Thinking about their total investment portfolio over the next five years, the annual average total return^ people expect to make, each year versus actual market returns:



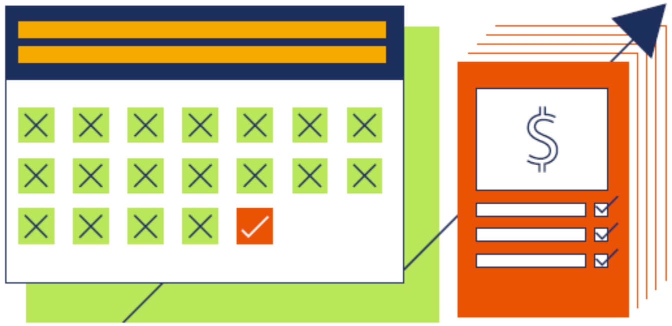
Source: Schroders, Global Investor Study 2019. Data shown for Australian investors.^ income and capital growth *S&P ASX200 data shown for annual returns between 27 May 2014 and 27 May 2019 from Refinitiv

Top 3 priorities for investors

Preserving capital and meeting return expectations

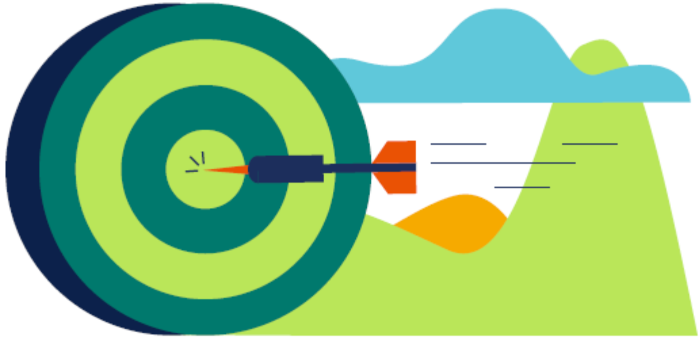
01

Avoiding losing money



02

Meeting my total investment return expectations i.e. income and capital growth



03

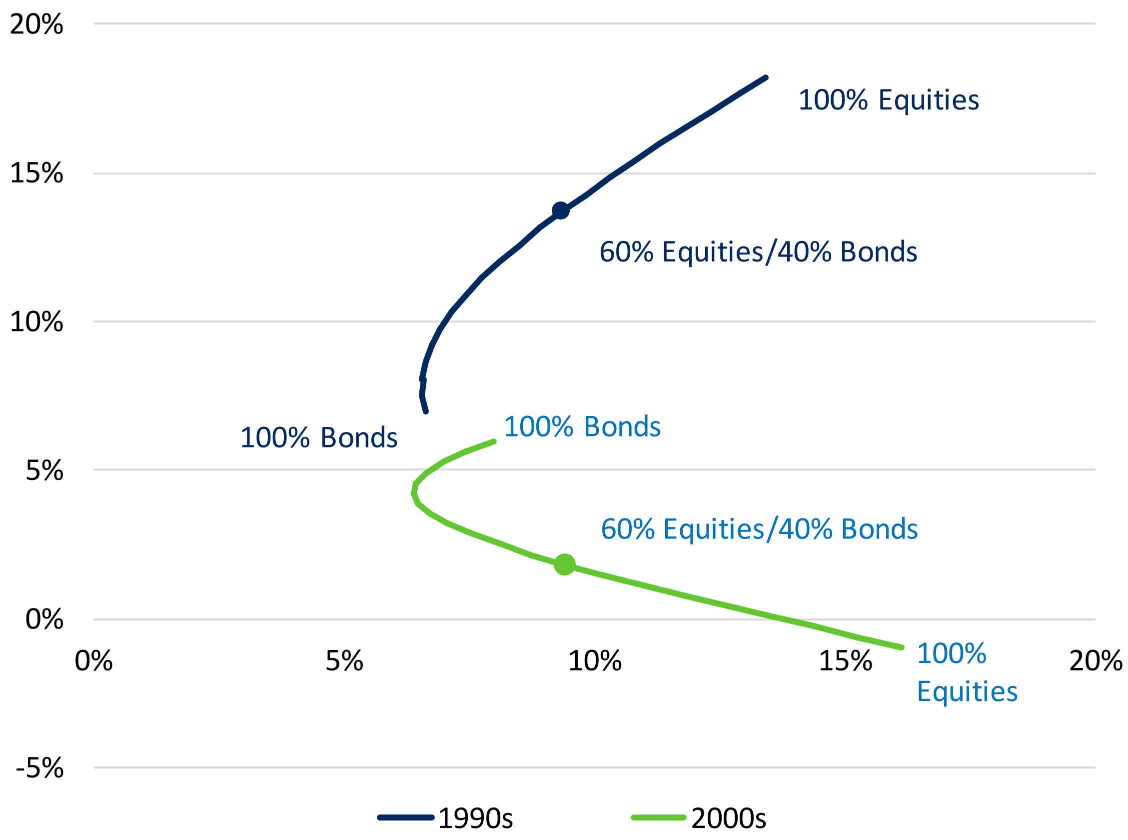
Generating my expected level of income

Source: Schroder Global Investor Study 2019.

Traditional static asset allocation is flawed

Risk return trade off varies considerably

The efficient frontier is not static



Standard Assumptions

- Risk and return trade-off is static
- Valuations don't matter in the long run
- Risk is volatility
- Order of returns doesn't matter

Reality

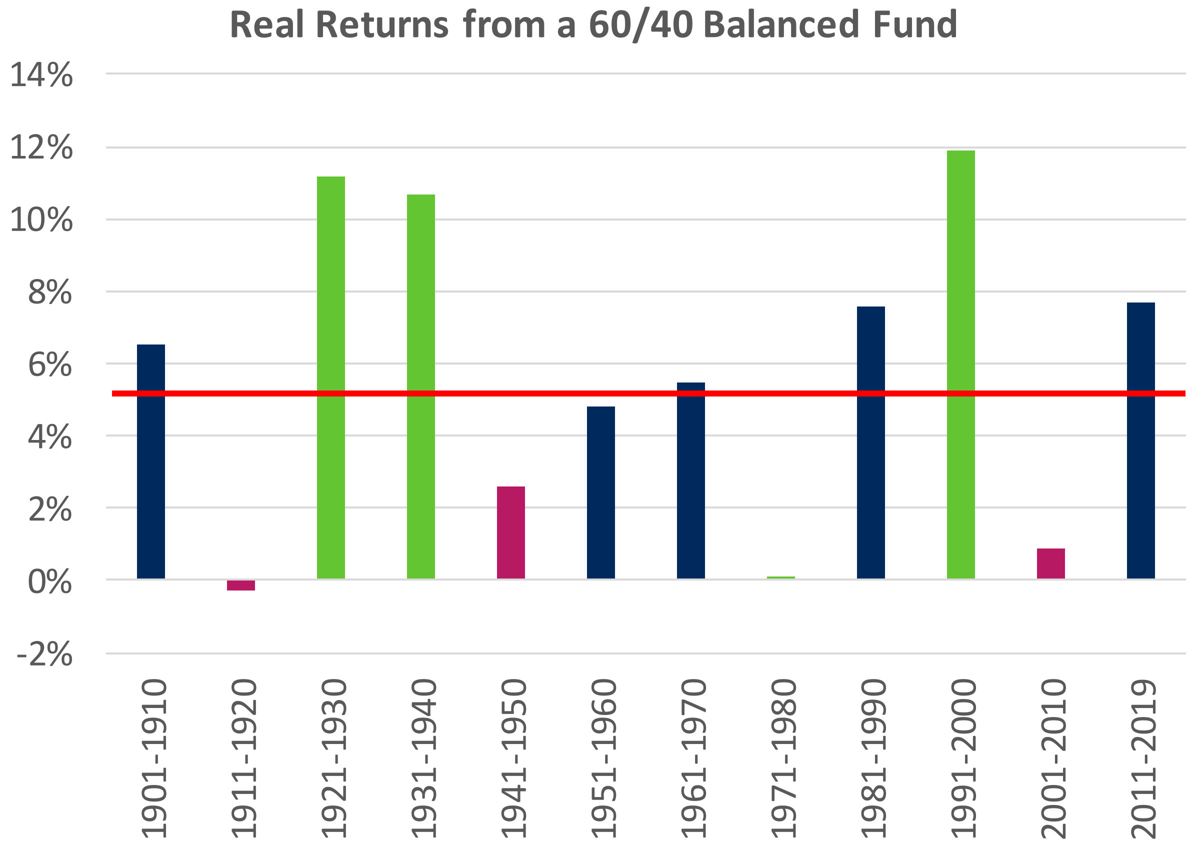
- Risk/return trade-off is dynamic
- Valuations matter
- Risk is not meeting objectives
- The path returns take is important

Source: Robert Shiller, Bloomberg, Schroders cross –asset cyclical group. Efficient frontier for S&P500 and US 10 year Treasuries, from 100%/0% to 0%/ 100% in 5% increments. Sectors and securities mentioned are for illustrative purposes only and should not be viewed as a recommendation to buy/sell. Portfolio holdings can change at any time. Past performance is not a guide to future performance and may not be repeated

Schroders

The long run is a very long time

- Averages mask shorter term volatility
- Investment horizon of 85 years required to be 90% confident of >CPI+5%



Source: Schroders, Global Financial Data, Balanced fund is 30% global equity, 30% Australian equity, 30% Australian bonds, 10% cash.

Schroders

Volatility matters when there are cashflows

Dollar weighted and time weighted returns can be very different

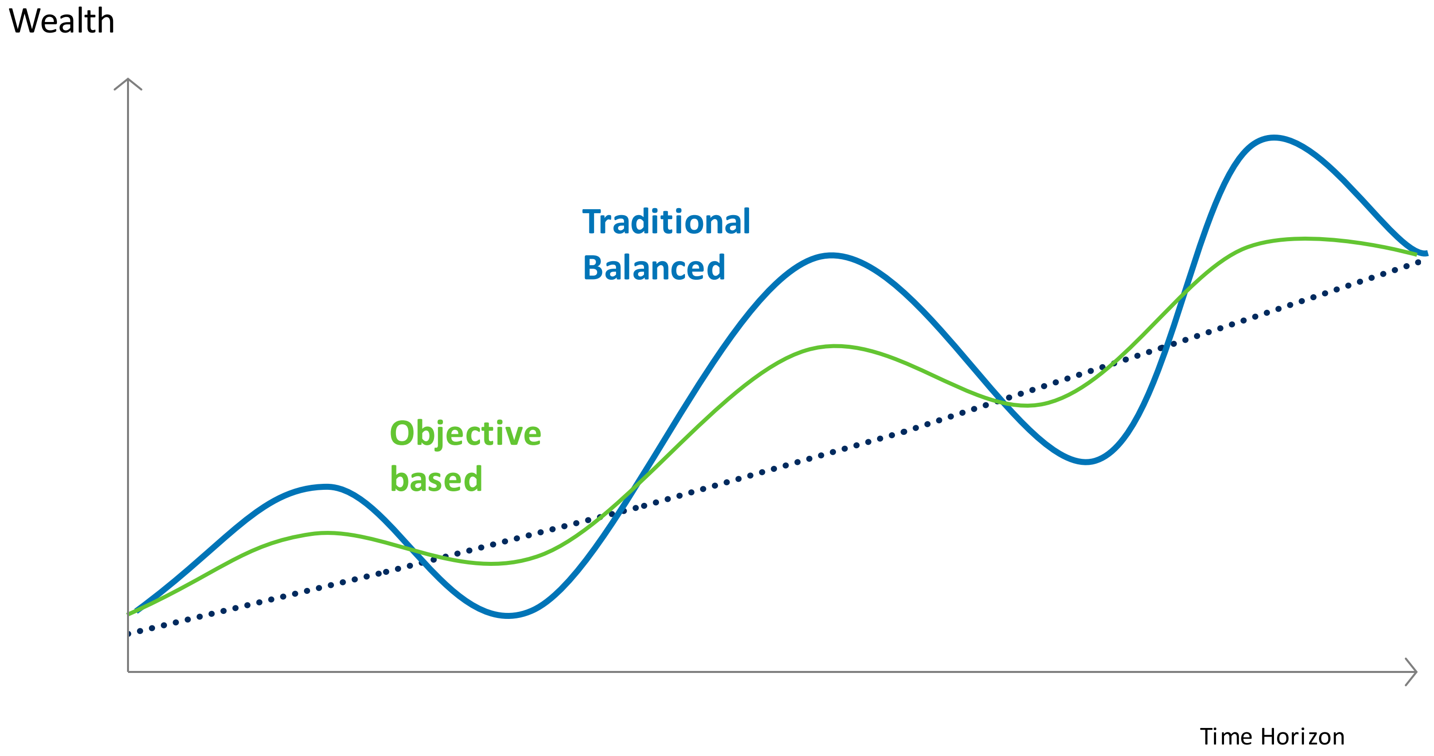
Contributions of $100 per year		Boris	Donald
Return for Year (%)	Year 1	7.0%	25.0%
	Year 2	7.0%	30.7%
	Year 3	7.0%	-25.0%
Average return (% p.a.) 'Time weighted return'		**7.0%**	**7.0%**

Source: Schroders. Global Financial Data. Investment return based on stylised balanced fund with fixed strategic asset allocation of 30% global equity, 30% Australian equity, 30% Australian bonds and 10% cash and contributions of 11% of salary each year. * Dollar weighted return is calculated as the Internal Rate of Return

Schroders

What is an objective based approach?

Stylised comparison of traditional versus objective based investing



Requires flexibility in asset allocation

Benefits

Growth of wealth

Reduced volatility

Lower downside risk

Schroders

Constructing an “objective based” portfolio

No “risk-free” portfolio to deliver CPI+5%

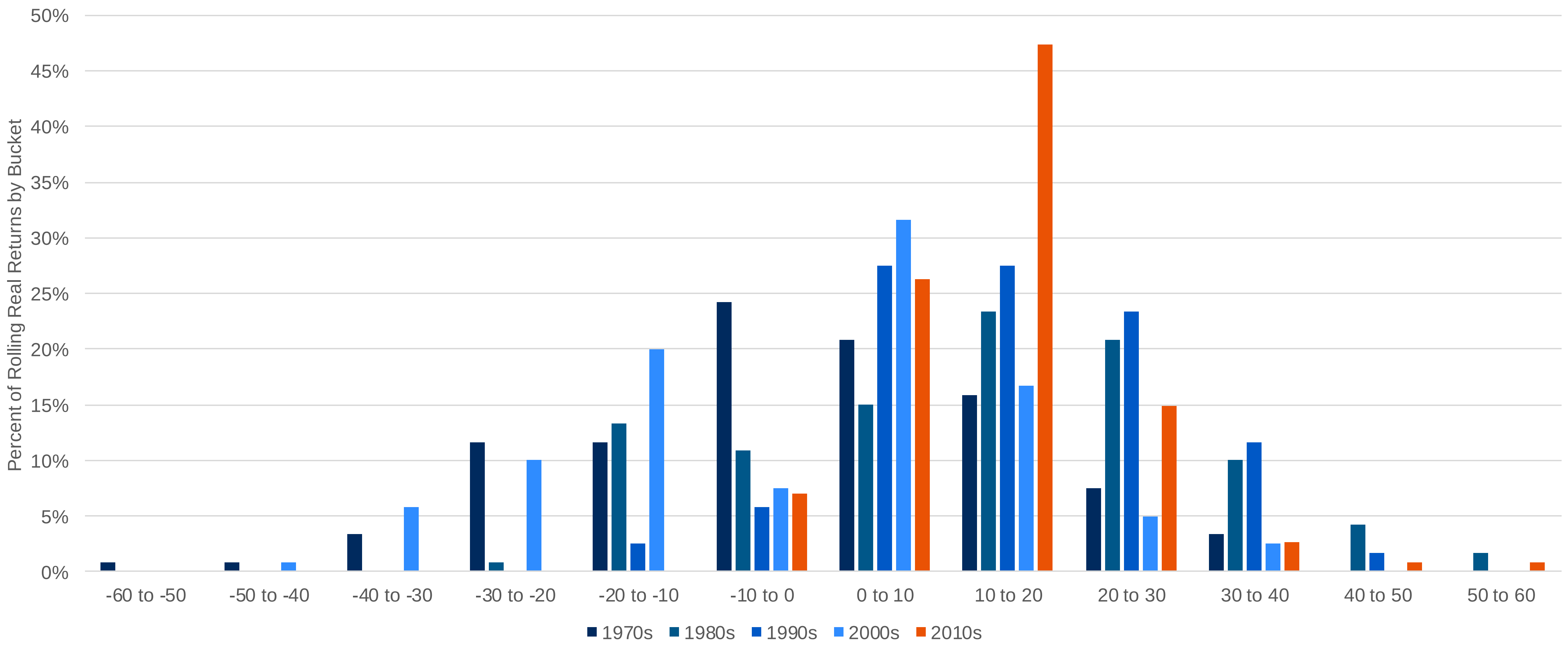
Decisions framed against objective
(not an arbitrary SAA)

Key is inputs (returns, risk and diversification assumptions):
- Forward looking
- Comparable (across assets, regions and countries)
- Repeatable / systematic
- Logical & empirically robust

How are the inputs combined:
- Portfolio construction framework
- No one right optimization, need to trade off risk and return

Schroders

Distribution of rolling 1 Year US equity returns



Source: Schroders, GFD

Forecasting Returns

Choosing a framework?

- Extrapolation
- Back the Fed
- Long-run history
- Valuation based
- Dividend discount model
- Other

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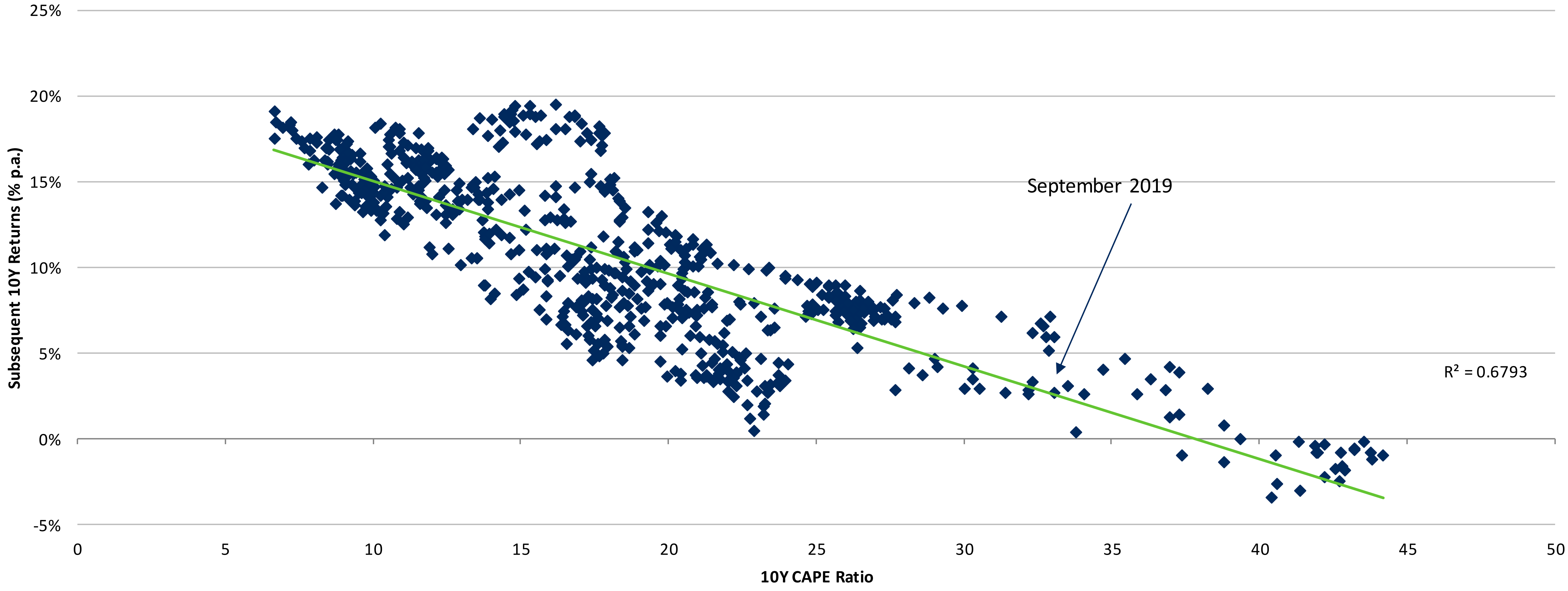
Valuations matter

Low expected returns given current valuations

US CAPE v 10-Year Real Returns (from 1950)

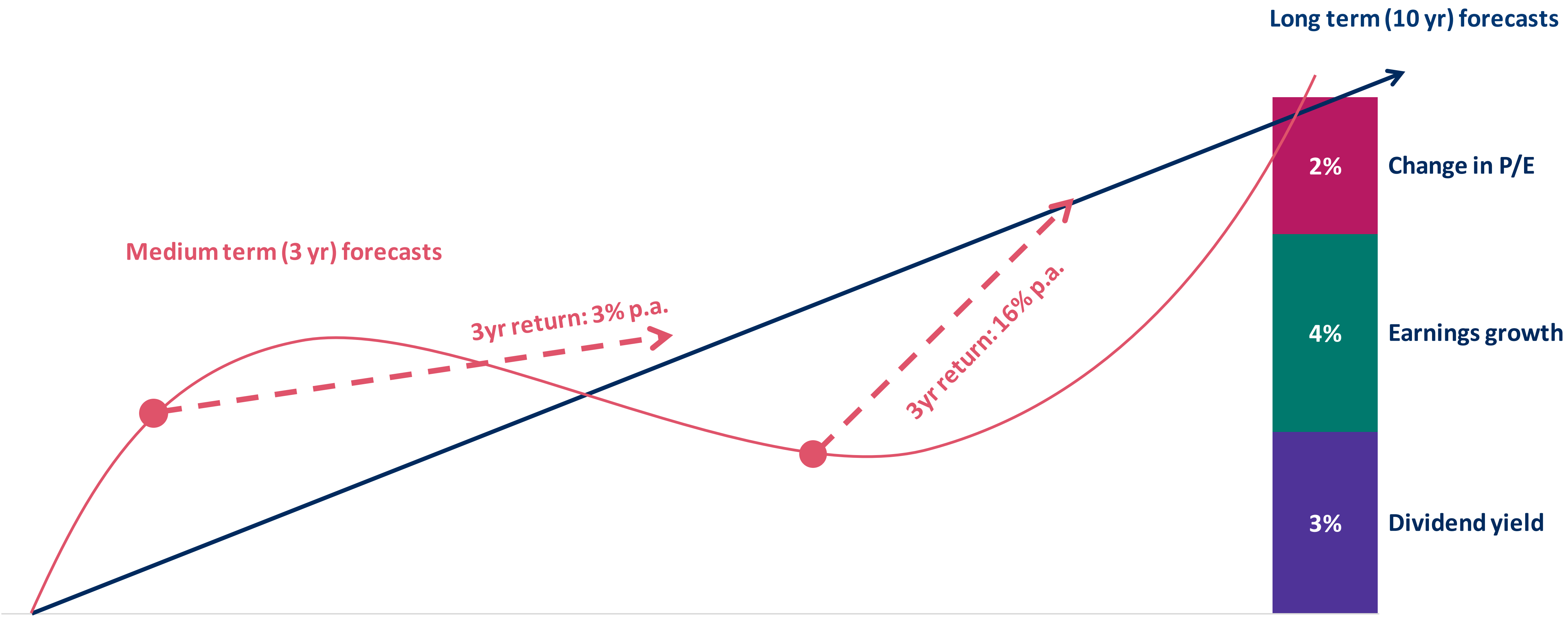


Source: Schroders, Datastream, GFD
The above contains past performance (which are no indicator of future performance) as well as forward-looking projections (which are not a guarantee of any future performance).

Schroders

Building a return forecasting framework

Use valuation models that capture cyclical opportunity

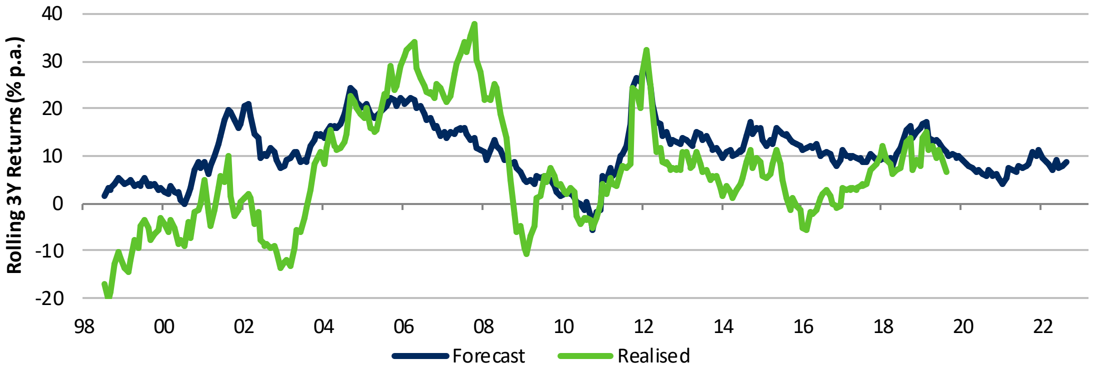


Source: Schroders. For illustrative purpose only; Past Performance is not indicative of future returns.

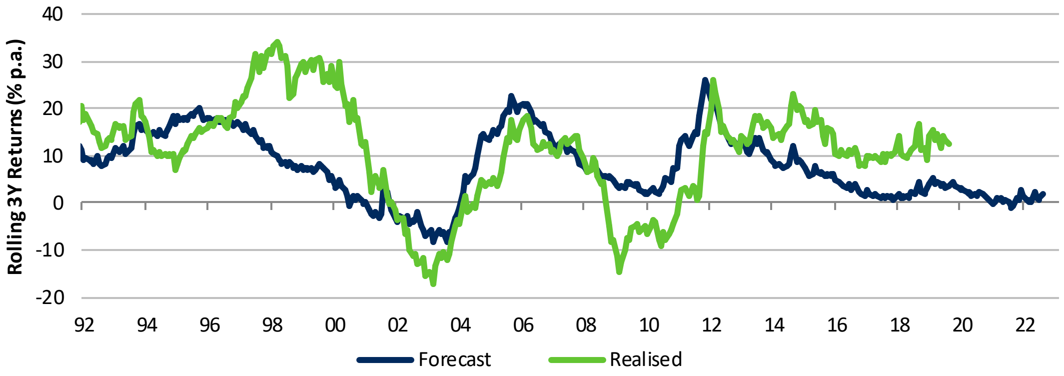
Forecast vs Realised Returns

Equity, Credit and Bond Examples

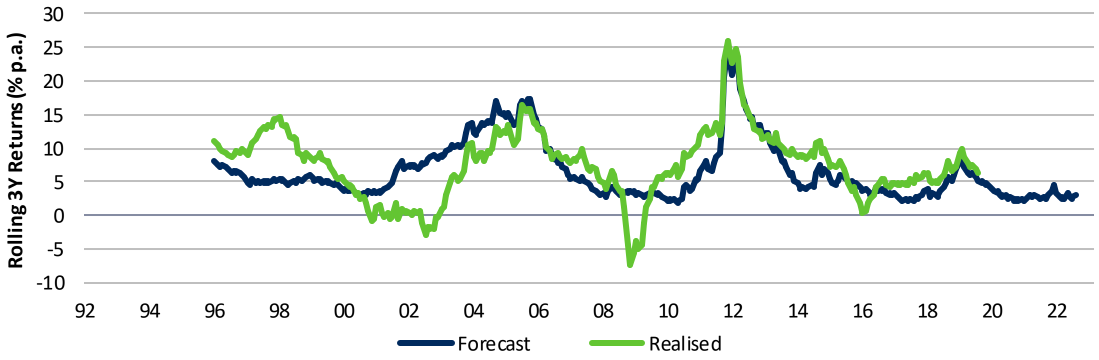
Asia ex Japan Equities: Forecast v Realised 3 Yr Returns



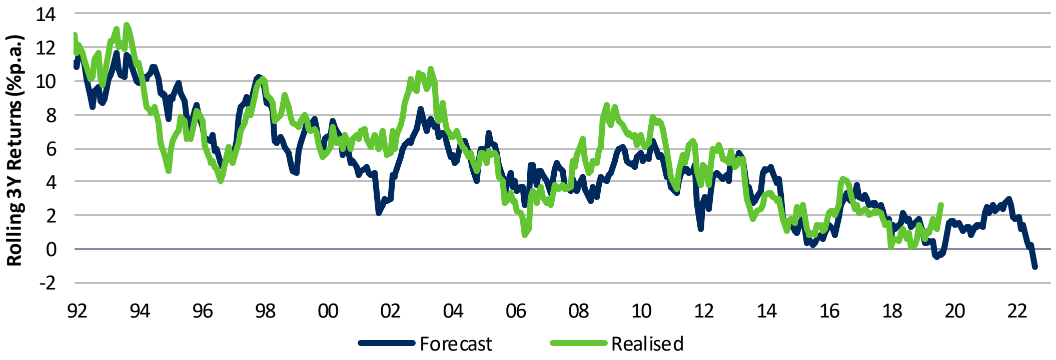
US Equities: Forecast v Realised 3 Yr Returns



Global High Yield Debt: Forecast v Realised 3 Yr Returns



US Bonds: Forecast v Realised 3 Yr Returns



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How do you define risk?

Which risks matter most?

- Volatility
- Risk of loss
- Liquidity risk
- Peer risk / career risk
- Sequencing Risk
- Not achieving objectives

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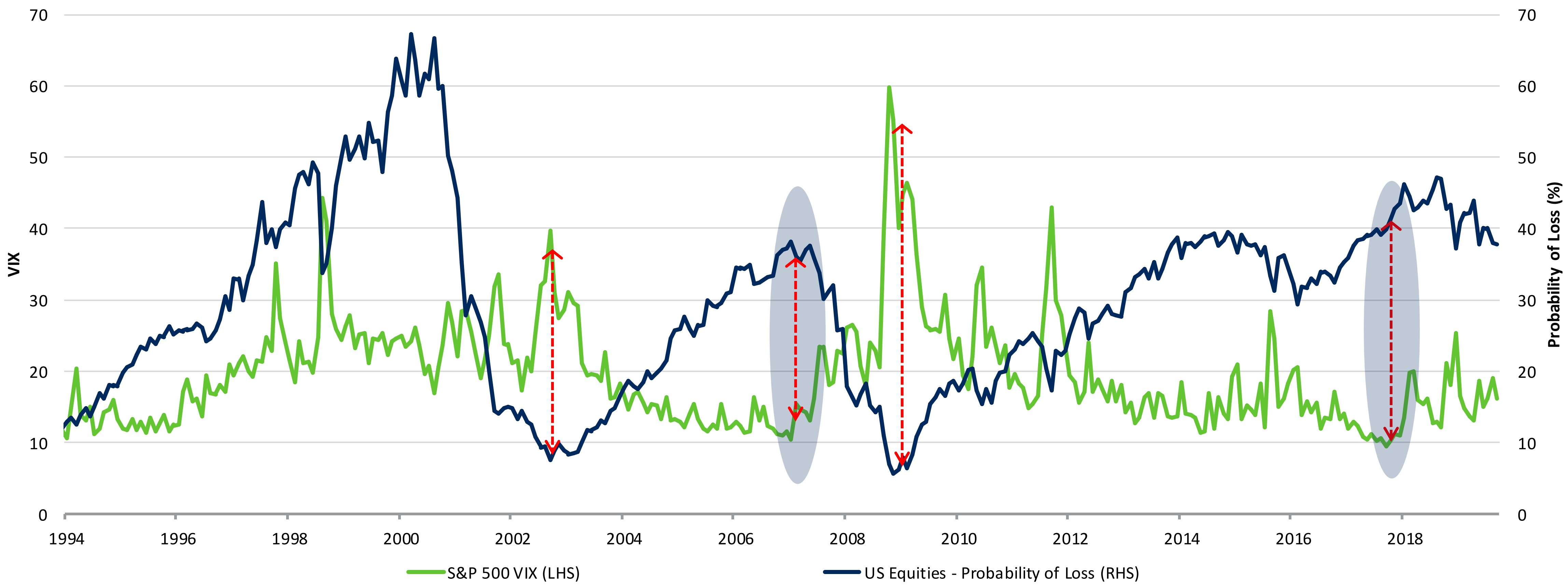
Volatility is not risk

Risk is the probability of loss

VIX versus probability of loss for US equities



Source: Schroders, Datastream as at 30 September 2019

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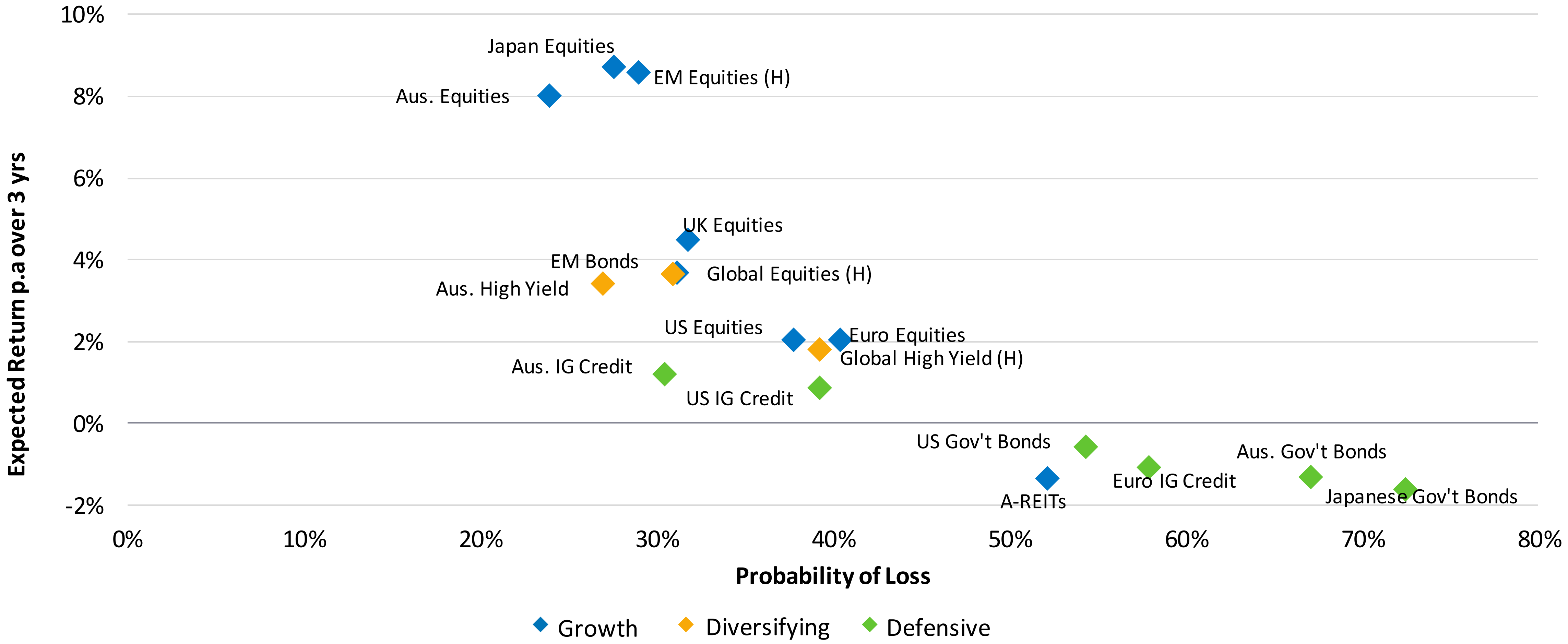
Low returns and high risk of loss across all asset classes

Forecasts

Expected return vs probability of loss – September 2019



Source: Schroders as at 30 September 2019. Countries, stocks and sector weightings and returns are mentioned for illustrative purposes only and should not be viewed as a recommendation to buy/sell

Portfolio Construction Exercise

Objective: CPI+5% return with a low risk of loss over 3 years

New QR code being created

Use your phone to scan the image and enter your portfolio

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