



asset allocation
masterclass

[Asset Allocation Masterclass 2010]

Developing your investment philosophy?

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CONFERENCE

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Why have a philosophy?

- Better decisions
- A touch-point in times of stress
- Basis for communicating and affirming decisions to clients
- Reduce the noise and clutter
- Streamline your business

Key dimensions of investment philosophy

- What am I trying to achieve for my clients?
- Are markets efficient?
 - Broad markets
 - Individual securities
- What are the key drivers of returns?
- Do I have any skills, or access to skills that will let me take advantage of any market inefficiencies?
- What is risk? How can I manage it?
- What sort of process do I need to establish to implement this philosophy efficiently?

What am I trying to achieve?

Case Study 1

- Bill Smith, age 55
- Experienced investor
- Will retire in 10 years
- Spends \$90kpa, saves \$10kpa
- Investable assets of \$1million
- Projection software suggests this is obtainable with a return of 6.5%pa

Case Study 2

- John Smith, age 55
- Novice investor
- Will retire in 10 years
- Spends \$90kpa, saves \$10kpa
- Investable assets of \$0.75million
- Projection software suggests this is obtainable with a return of 8.5%pa

Are markets efficient?

Across sectors

- Can I pick winning and losing sectors?
 - Over what time frame?
 - How?
- What's my competitive advantage?
- Typical strategies
 - Economic analysis
 - Valuation processes
 - Charts
 - Consensus estimates

Within sectors

- Can I pick winning and losing stocks or funds
 - Over what time frame?
 - How?
- What's my competitive advantage?
- Typical strategies
 - Fundamental research
 - Manager visits
 - Track records
 - Value/growth bias

What are the drivers of returns?

- Market level?
 - The equity risk premium
 - Income
 - Income/earnings growth
 - Market sentiment/valuation levels
 - Value add
- Fund level?
 - Size of positions
 - Manager skill & luck
 - Value/growth bias
 - Trading skills
 - Fees

What is risk? How do I measure it and manage it?

Risk	Measure?	Manage?
Volatility of returns?		
Tracking error?		
Credit risk?		
Concentration risk?		
Liquidity risk?		
Counterparty risk?		
Loss of capital?		
Loss of purchasing power?		
Not achieving my goals?		

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Does my process capture this philosophy?

Risk	Belief	Process implications
What am I trying to achieve?	Maximise returns for a given risk tolerance.	<ul style="list-style-type: none"> • Identify clients risk appetite and position asset allocation accordingly
What is risk?	Volatility of returns.	<ul style="list-style-type: none"> • Seek out unlisted assets
Are asset sectors efficient?	Generally yes, but very occasionally go to extremes. The equity risk premium drives returns.	<ul style="list-style-type: none"> • Maintain stable SAA
Are securities efficient?	<ul style="list-style-type: none"> • Fairly efficient. Only exceptional managers add value. • Small stocks outperform big stocks • Fees are a significant drag on returns. 	<ul style="list-style-type: none"> • Favour passive managers and some active with very rigid guidelines • Index funds and active small company funds • Avoid high fee managers

Building an investment philosophy?

- What do we believe?
- What's important, what isn't?
- How do we prove up our beliefs?
- How do we translate those beliefs into a process?
- How do we communicate all of this?

What develop a philosophy?

- Better decisions
- Strength in stressful situations
- Better communication
- Streamline your business

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