

THE INVESTMENT COMMITTEE

WELCOME

Master of Ceremonies - Anne Fuchs (Sunsuper)
Facilitator - Chris Humphry (Humphrey Partners)



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A photograph of a desk with a calendar, a cup of coffee, a pen, and a small plant. The scene is lit with warm, soft light, creating a professional and organized atmosphere. The desk is made of dark wood, and the calendar is open, showing dates from 18 to 23. A white cup of coffee sits on a saucer, and a blue and silver pen lies on the calendar. A small potted plant is visible in the background.

SETTING THE INVESTMENT COMMITTEE AGENDA

28 MAY 2021

DR MICHAEL E. DREW
MANAGING PARTNER

The logo for mgd. private, featuring a stylized cluster of white dots above the text "mgd." and "private" stacked vertically.

mgd.
private

ACKNOWLEDGEMENTS

We thank the CFA Institute Research Foundation for its support and encouragement. In particular, we would like to sincerely thank Bud Haslett, executive director of the CFA Institute Research Foundation, and Larry Siegel, the Gary P. Brinson Director of Research at the CFA Institute Research Foundation, for seeing this project from three pages of ideas to the current volume. We also thank the editorial staff and Jessica Critzer for their kind assistance.

Our monograph "Investment Governance for Fiduciaries" is available here:

<https://www.cfainstitute.org/-/media/documents/book/rf-publication/2019/investment-governance-for-fiduciaries.ashx>

Our op-ed "Investment Governance for Fiduciaries: The How and the Why" is available here:

<https://blogs.cfainstitute.org/investor/2019/09/20/investment-governance-for-fiduciaries-the-how-and-the-why/>



THE INVESTMENT COMMITTEE



Master of Ceremonies



Facilitator



Action Items – By Advisors, For Advisors



Objective

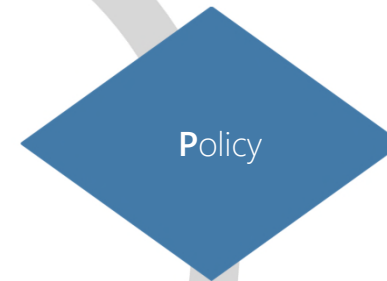


Setting the Investment Committee Agenda

Is My Portfolio Over-Diversified?



Superintend



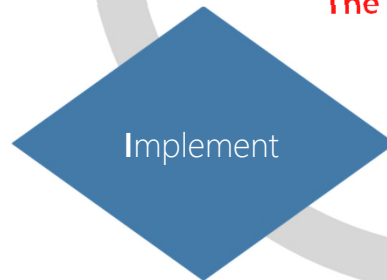
Policy



Investment Governance Under Stress

The Fiduciary Line

Designing and Implementing Family Office Investment Portfolios



Implement



Execute and Resource



The Liquidity Premium – Real or Illusory?



Hedging – Long and Wrong, or Short and Caught?

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OPERIS

Source: Drew and Walk (2019)

ABOUT US



Dr Michael Drew

Managing Partner

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Michael E. Drew is the Managing Partner at MGD Private and a Professor of Finance at Griffith University. He is a financial economist specialising in the areas of investment governance, pension plan design, and outcome-oriented investing.

Professor Drew's research has been published in leading practitioner journals, including the *Financial Analysts Journal* and the *Journal of Portfolio Management*. With his colleague Dr Adam Walk, Professor Drew co-authored the monograph, *Investment Governance for Fiduciaries*, that was released by the CFA Institute Research Foundation in April 2019. He has been invited to make submissions and to testify before numerous committees, including the US Department of Labor and the SEC joint hearing on target-date funds.

Professor Drew serves as a trustee director and member of the Investment Committee at QSuper, a member of the Investment Advisory Board of the Petroleum Fund of *Timor-Leste* (East Timor), and a trustee (and member of the Finance, Audit, and Risk Committee) of Mary Aikenhead Ministries. He received his PhD in economics from the University of Queensland, is an Accredited Investment Fiduciary Analyst®, and is a Life Member of FINSIA, the Financial Services Institute of Australasia.



Dr Adam Walk

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Adam N. Walk is Partner at MGD Private and an Adjunct Professor at the University of Notre Dame–Australia. He is a financial economist specializing in the areas of investment governance, pension finance, and investments.

Dr Walk's research has been published in the *Journal of Portfolio Management* and the *Journal of Retirement*. With his colleague Professor Michael Drew, Dr Walk co-authored the monograph, *Investment Governance for Fiduciaries*, that was released by the CFA Institute Research Foundation in April 2019.

He serves as a trustee director and member of the Investment Committee at Rest, an adviser to the Group Capital and Investment Committee at RACQ Group, member of the Investment Committee at RSL Queensland, a board member of the Archdiocesan Development Fund of the Roman Catholic Archdiocese of Brisbane, and chairman and a trustee of Campion College Australia. Dr Walk received his PhD in financial economics from Griffith University, Queensland, Australia. He is an Accredited Investment Fiduciary Analyst® and a Certified Investment Management Analyst® designee.

DISCLAIMER

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Any advice included in this presentation has been prepared without taking into account your objectives, financial situation or needs. Before acting on the advice, you should consider its appropriateness having regard to these factors and obtain financial advice. Any tax information included in this presentation is not based on your unique circumstances and should not be relied on as tax advice.

MORNING TEA

10.00am - 10.30am

AUSTRALIAN



MONEY MARKET

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PANEL SESSION

Investment Governance Under Stress



DR ADAM WALK

Partner
MGD Private



JANE CROMBIE

Board and Governance Specialist
Directors Australia



MICHAEL FUREY

Principal
Delta Research & Advisory

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The Liquidity Premium – Real or Illusory

Anne Blayney, Portfolio Manager
Sunsuper

Liquidity can dry up during a crisis



APRA releases COVID-19 superannuation early release scheme data

Super fund liquidity could be better: RBA

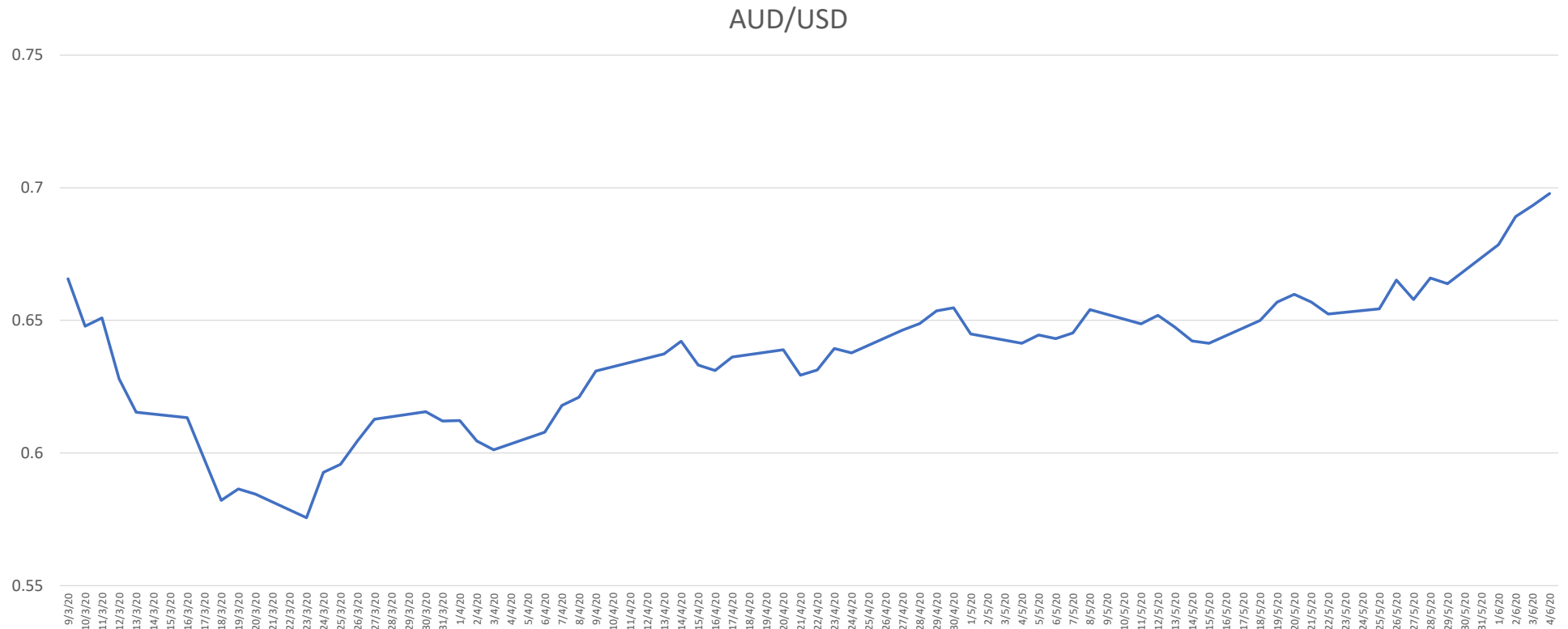
Managing super fund liquidity in the midst of COVID-19

Super funds want liquidity buffer

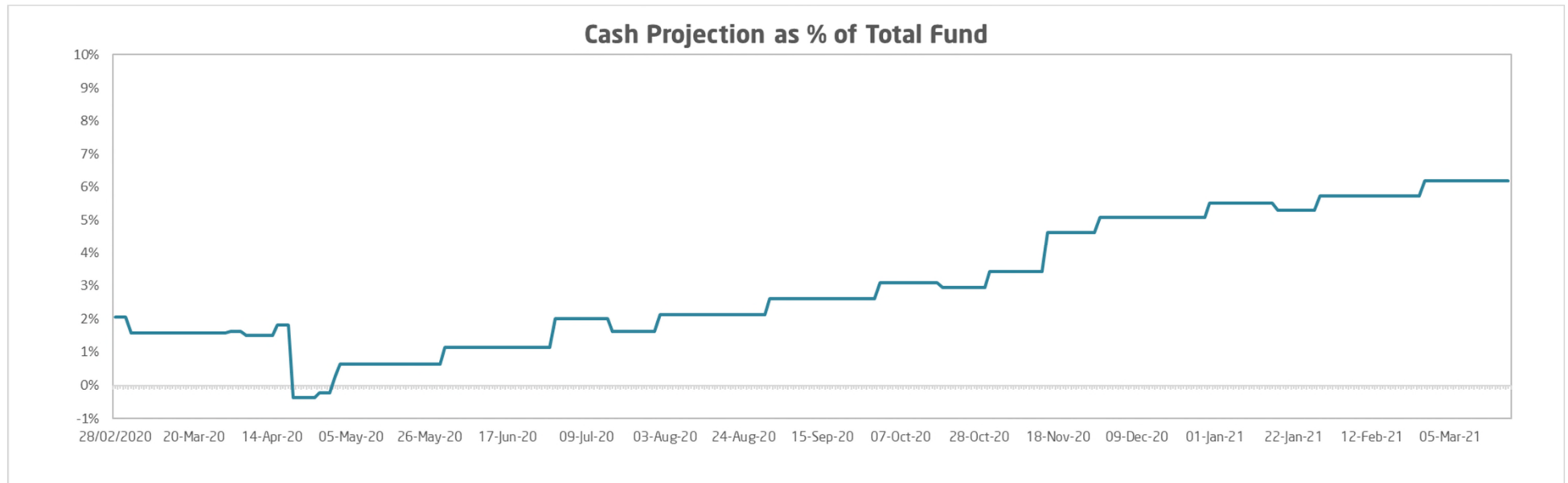
Industry super funds are worried the temporary withdrawal of super will cause liquidity problems, piling further downward pressure on the sharemarket.

Super industry sees liquidity challenge as members switch to cash

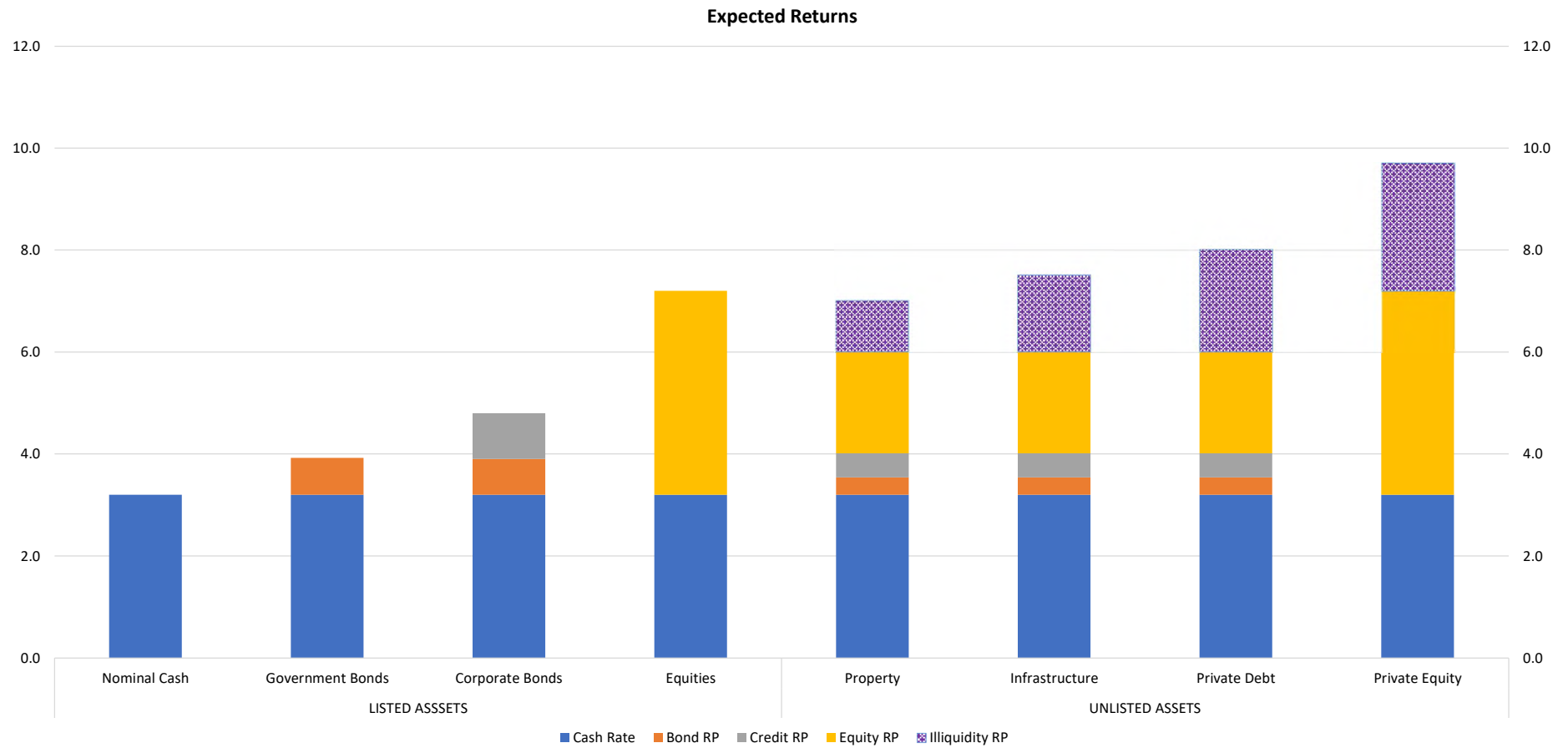
Be careful what you wish for...



Liquidity can deteriorate rapidly



Drivers of returns



What are unlisted assets?



Qld Airports Ltd

Gold Coast, Townsville, Mt Isa, Longreach



Discovery Parks

Holiday parks across the country



Brisbane International



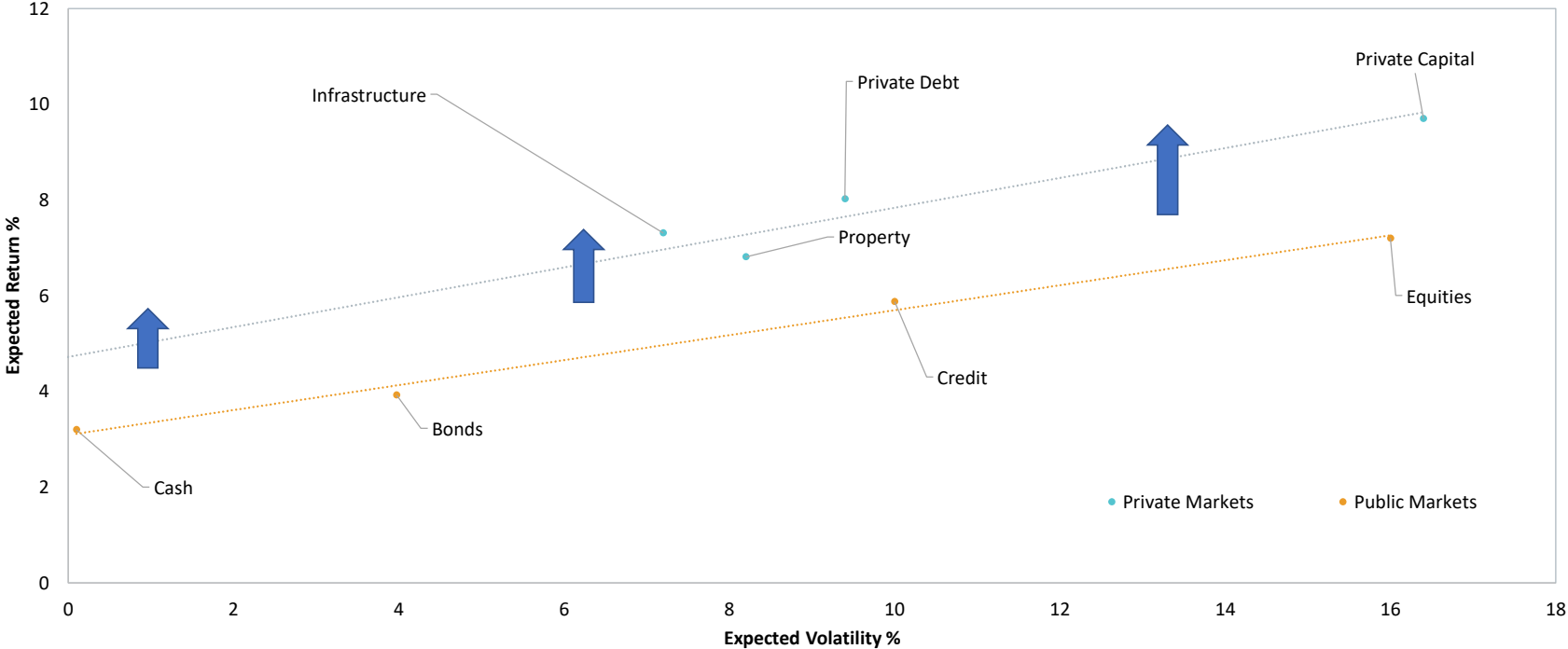
Australian Technology Park

An iconic Sydney property development

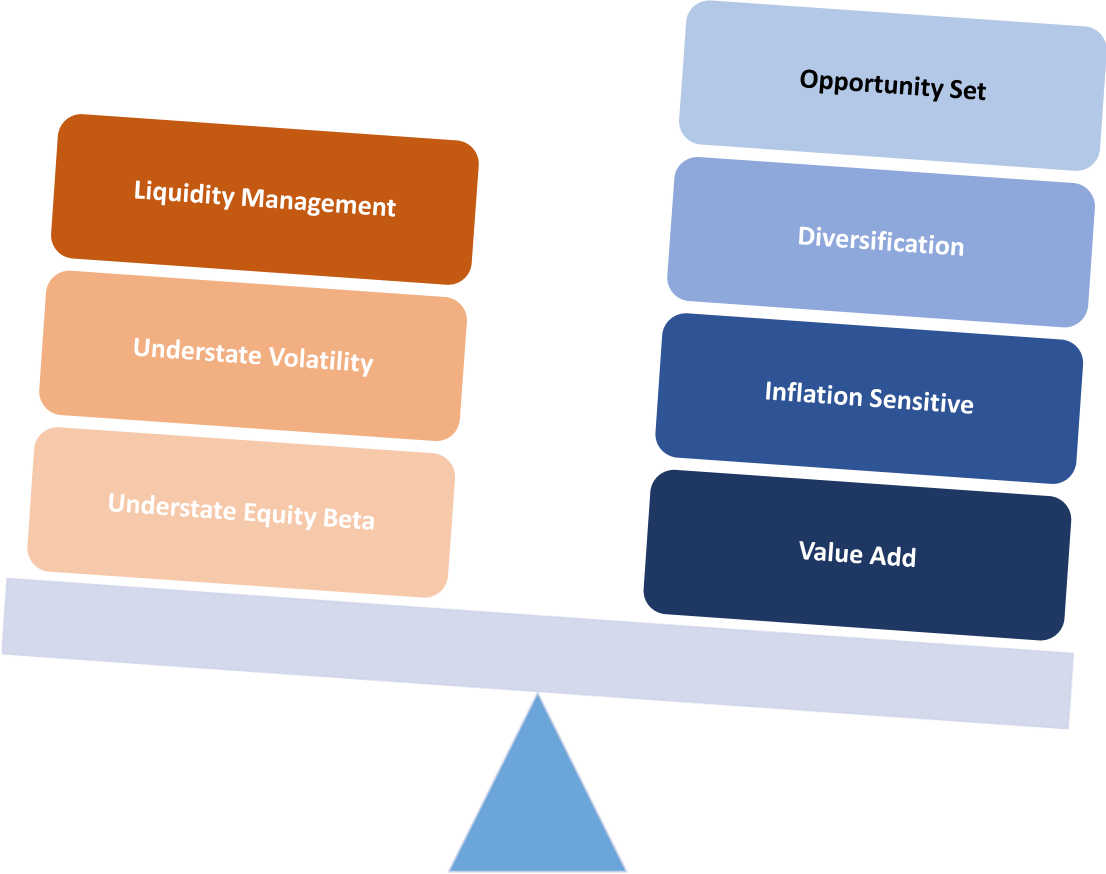
Unlisted assets improve returns



Capital Markets Line - Listed and Unlisted Assets



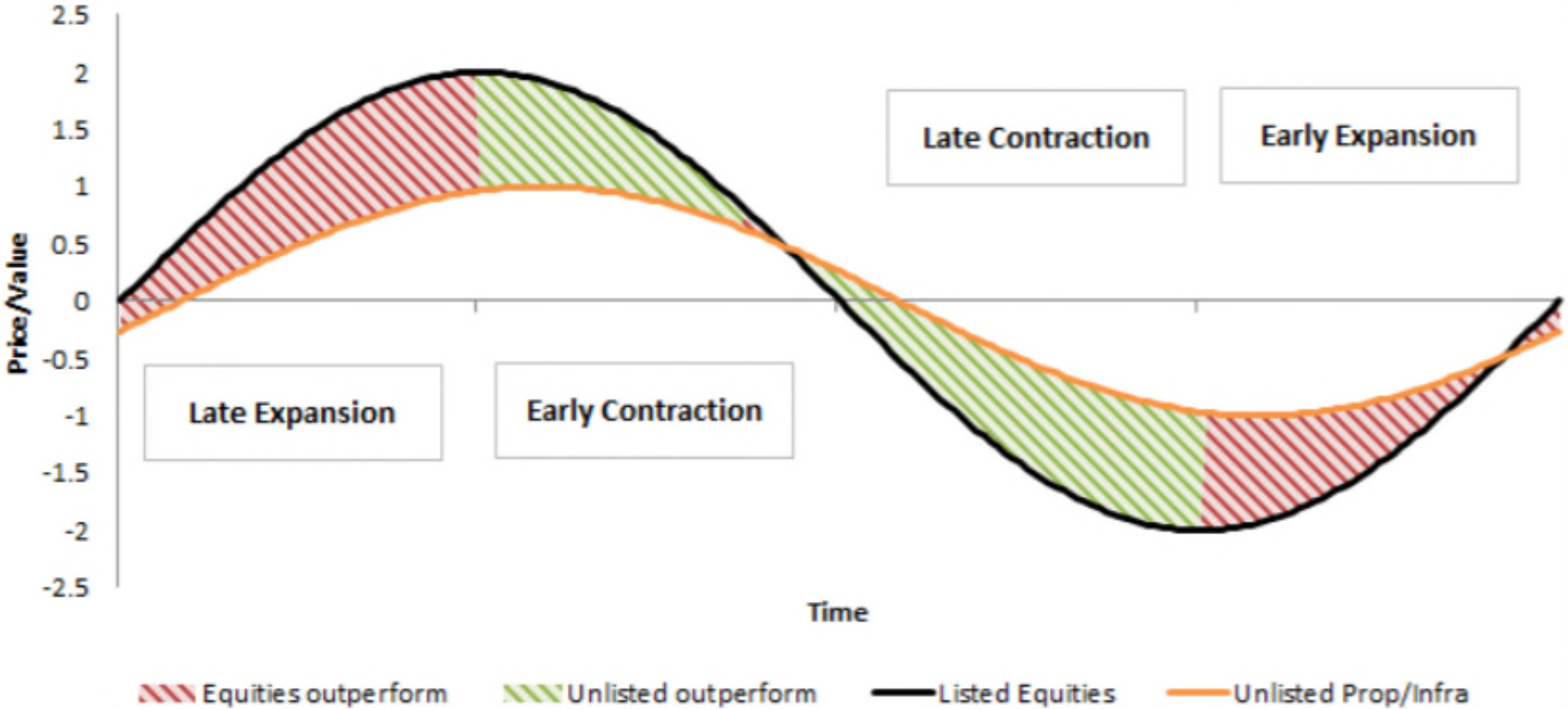
Weighing the pros and cons



Performance is cyclical...



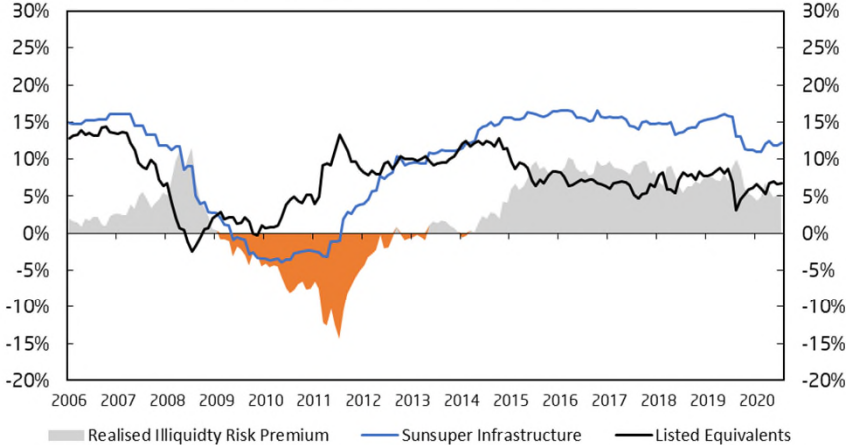
Stylised Valuation Cycle: Listed Equities and Unlisted Prop/Infra



Illiquidity Risk Premium is real

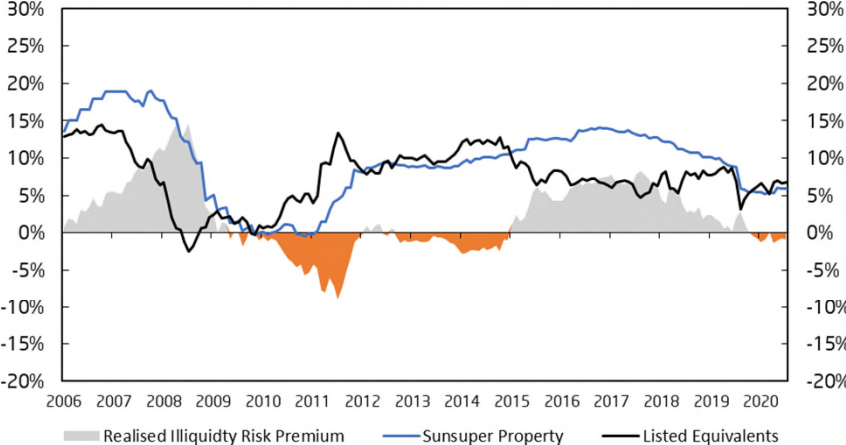


Rolling 3 Year Returns: Infrastructure



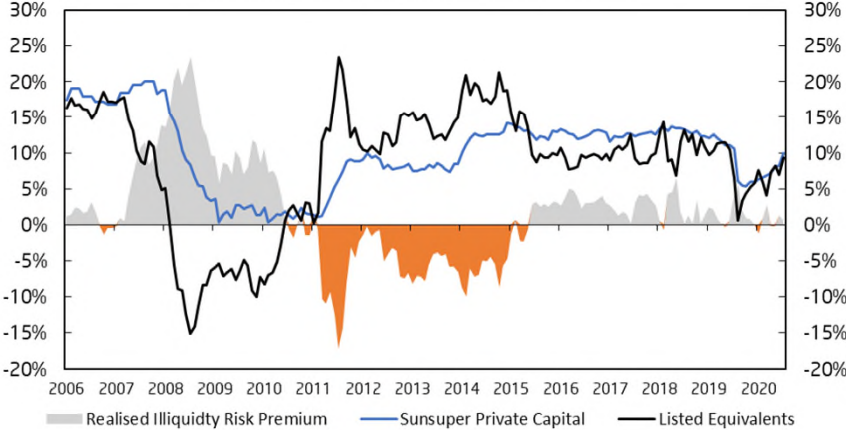
Source: StateStreet (Feb 2021)

Rolling 3 Year Returns: Property



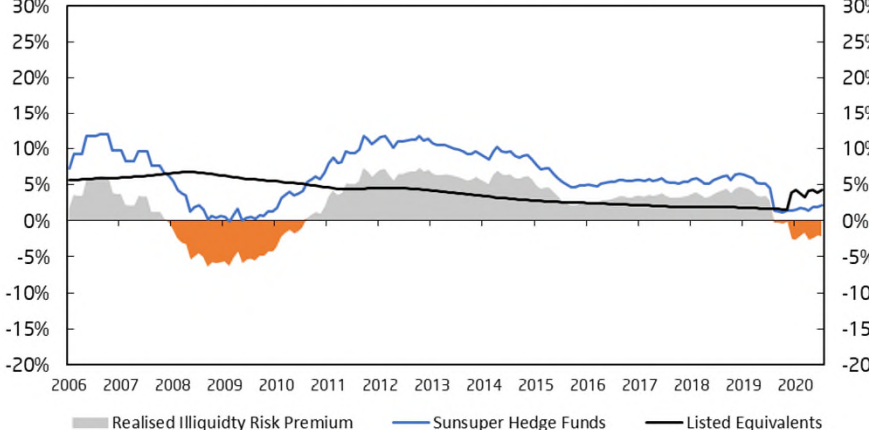
Source: StateStreet (Feb 2021)

Rolling 3 Year Returns: Private Capital



Source: StateStreet (Feb 2021)

Rolling 3 Year Returns: Alternative Strategies

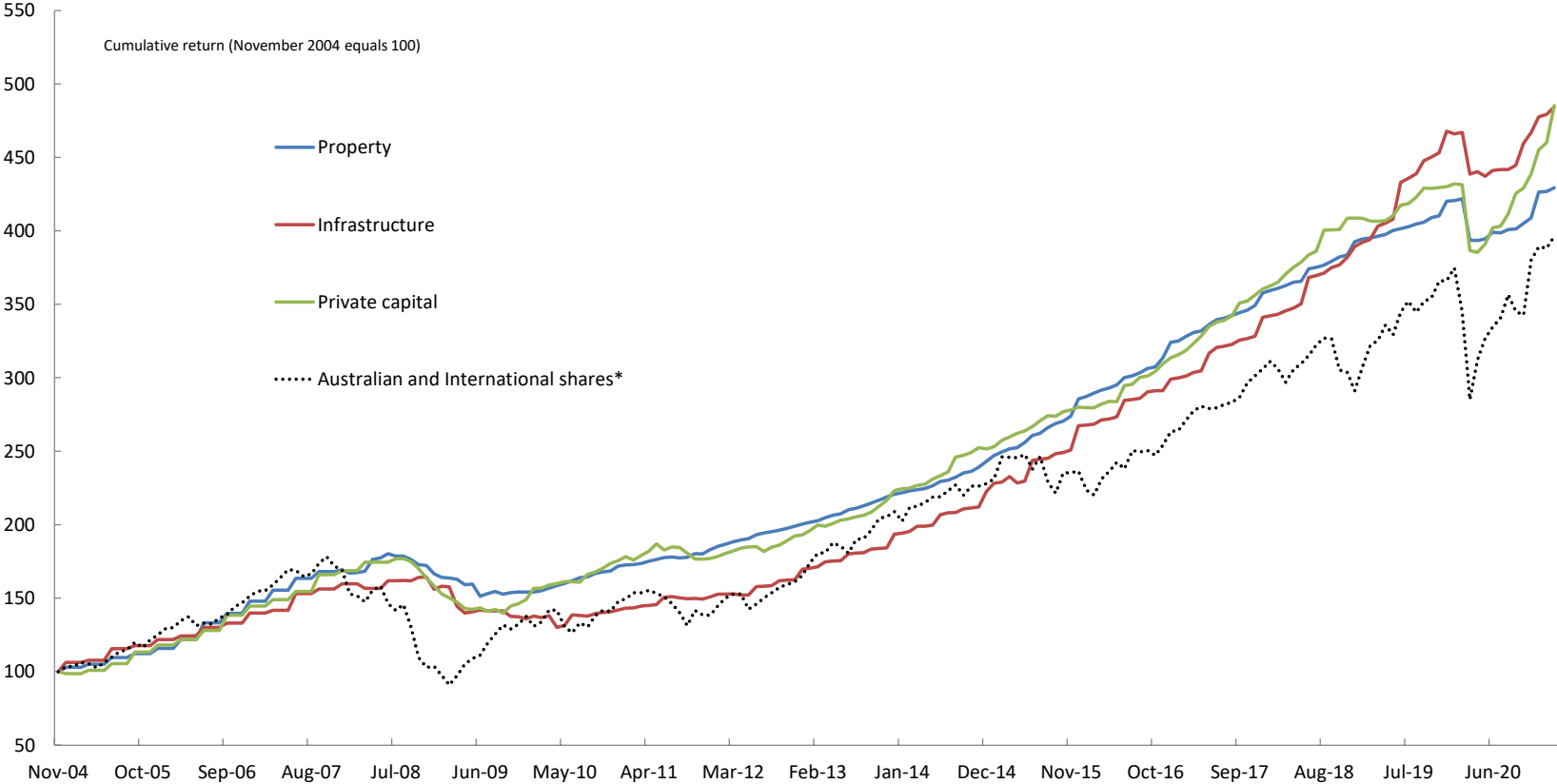


Source: StateStreet (Feb 2021)

Lower volatility, without compromising long-term returns...

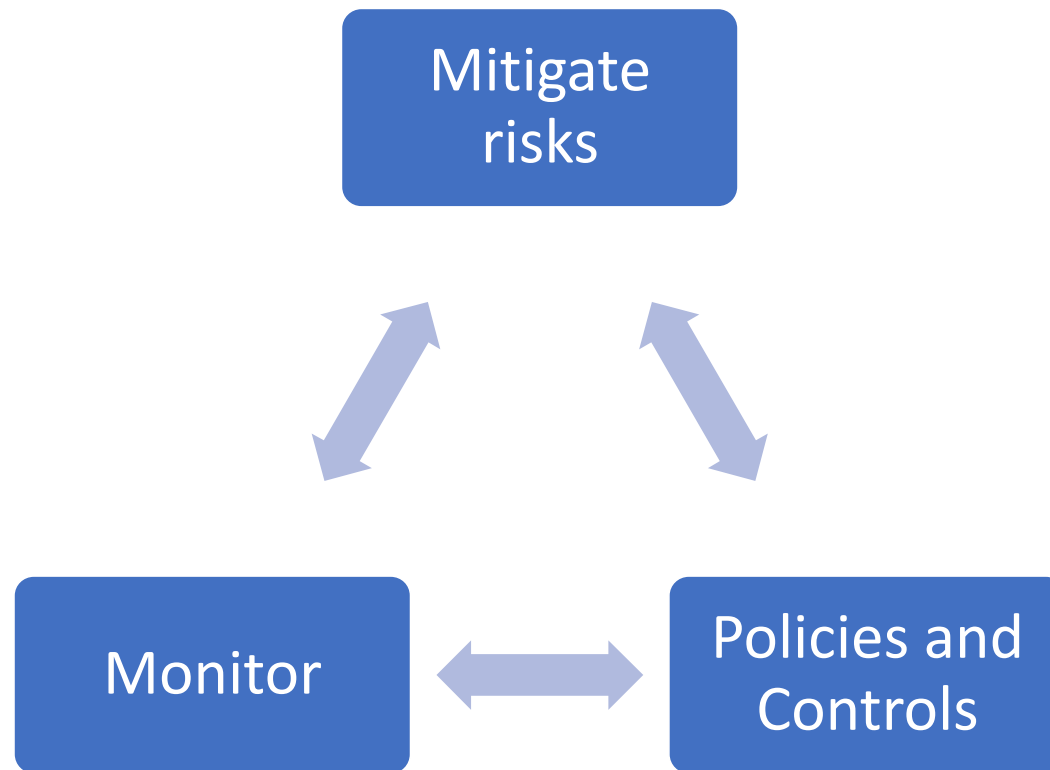


Sunsuper's unlisted assets performance

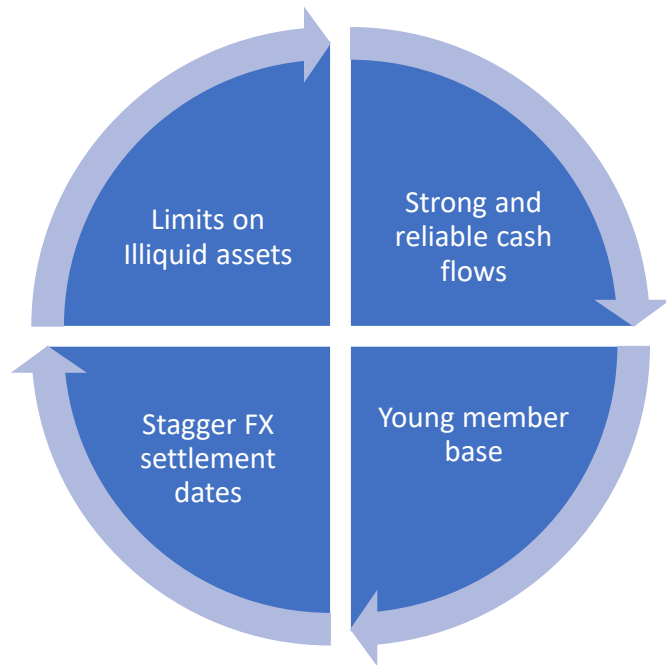


Sources: Refinitiv, Sunsuper. *Total return index comprising 50% MSCI hedged in A\$ and 50% S&P/ASX300 Accumulation Index. Last observation is March 2021. Past performance is not a reliable indication of future performance.

Liquidity management framework



Mitigate liquidity risks



Policies, controls, process



Cashflow Forecast
1 January to 31 December <Year>

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Cash received												
Of 0 grant	18,000	0	0	24,000	0	0	24,000	0	0	24,000	0	0
Grants Trust grant	0	0	20,000	0	0	20,000	0	0	20,000	0	0	20,000
Contract Services grant	0	0	7,000	0	0	7,000	0	0	0	0	0	0
Bank interest	80	80	80	80	80	80	80	80	80	80	80	80
Donations	0	0	2,000	0	0	2,000	0	0	2,000	0	0	2,000
Other profits	2,000	2,000	2,000	2,000	2,000	2,000	1,800	1,800	2,000	2,000	2,000	2,000
Transfer fees	3,000	7,000	0	7,000	3,000	0	0	7,000	3,000	0	7,000	3,000
A. Total Cash Received	21,080	9,880	29,080	33,080	9,080	26,880	33,880	30,880	30,880	28,080	28,880	27,880
Cash paid out												
Administration	2,000	2,300	5,300	2,000	2,000	7,500	2,300	2,300	2,000	2,000	2,000	2,300
Personnel	7,400	8,075	8,725	7,200	7,200	8,725	7,200	7,200	8,725	7,200	7,200	8,725
Vehicle running	8,000	1,900	1,900	1,900	1,900	1,900	1,900	1,900	1,900	1,900	1,900	1,900
Project inputs	12,600	12,600	6,300	12,600	8,900	8,900	12,600	1,200	6,000	12,600	12,600	8,900
B. Total Cash Paid	31,000	24,800	24,825	23,600	28,200	29,725	29,825	12,725	16,825	23,625	23,625	19,825
C. Net cash flow for 31-12	(9,920)	(15,020)	12,680	9,480	(19,120)	(2,845)	9,450	(18,845)	14,055	4,455	(5,745)	8,055
D. Cash available at start of month	8,000	80	(16,320)	(7,840)	8,535	(6,690)	(6,340)	8,115	860	12,295	14,720	1,965
E. Cash available at end of month 31-12	80	(15,240)	(16,040)	(8,360)	(8,155)	(9,535)	(6,890)	8,270	12,240	14,720	1,965	13,820

Being prepared is key

- Annual liquidity crisis exercise
- Design of a liquidity crisis event
- Establish liquidity management team
- Determine action plan and response to crisis
- Self evaluation of lessons learned
- Report outcomes

Key take-outs

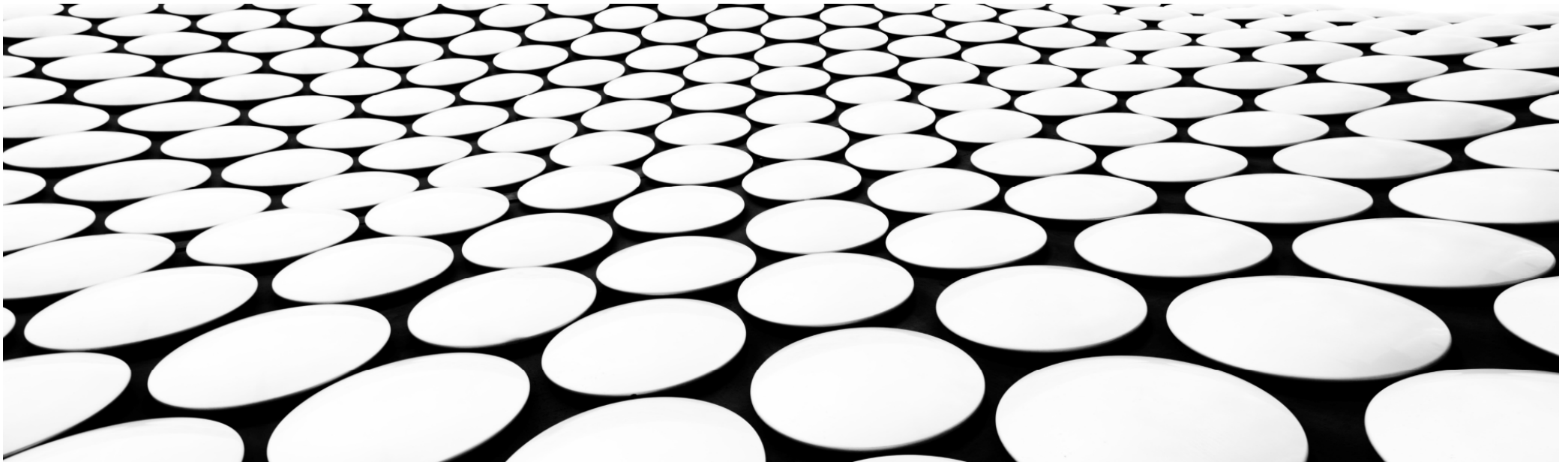
- Illiquidity premium is real
- But we need to have liquidity to hold the assets for the long term...
- ...and carefully manage that liquidity
- Be prepared



Questions?

FOREIGN CURRENCY: SHORT & CAUGHT OR LONG & WRONG

Troy Rieck
Chief Investment Officer
LGIAsuper





DISCLAIMER

Information contained in this module is correct as at May 2021. Because the finance industry changes continually, the information is to be used AS A GUIDE only.

Troy Rieck believes that the information contained in this module is correct at the time of its compilation, however does not warrant the accuracy of the information. While every effort is made to ensure accuracy of information, Troy Rieck accepts no responsibility for losses or other hardship caused by typographical errors or omissions in this module.

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The information contained in the module is provided as general educational material only and is not a substitute for financial advice. The information has been prepared without taking into account your particular financial needs, circumstances and objectives and is therefore not suitable to be acted on as investment advice. A Martini is a drink made from gin and vermouth – one of which I will buy I will buy for anyone that has read this far into the disclaimer.

This is general information only and you should consider if any products or services offered are appropriate for you. You should assess your own financial situation and may wish to consult an adviser before making any changes to your financial affairs.

WHAT ARE FOREIGN CURRENCY EXPOSURES / EXCHANGE RATES?

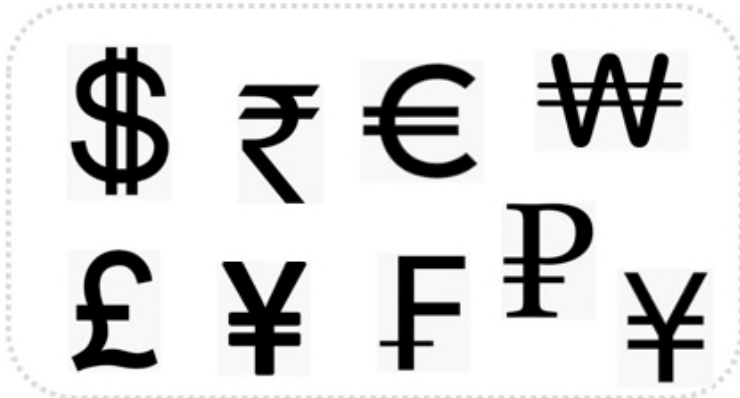


Forex	Indexes	Shares	Commodity
Bond			
	Actual	Chg	%Chg
EURUSD	1.21794	▼ 0.0001	-0.01%
GBPUSD	1.41427	▼ 0.0014	-0.10%
AUDUSD	0.77216	▼ 0.0004	-0.06%
BTCUSD	35687.88	▼ 1812.66	-4.83 %
NZDUSD	0.71659	▼ 0.0001	-0.02%
USDJPY	108.94	▼ 0.0140	-0.01%
USDCNY	6.43526	▲ 0.0008	0.01%
USDCHF	0.89808	▲ 0.0003	0.04%
USDCAD	1.20754	▲ 0.0011	0.09%
USDMXN	19.9432	▲ 0.0011	0.01%
USDINR	72.8630	▲ 0.0460	0.06%
USDBRL	5.3617	▲ 0.0792	1.50%
USD RUB	73.5900	▲ 0.0870	0.12%
DXV	90.045	▲ 0.0285	0.03%

€ EU: Euro	\$ US: Dollar	¥ China: Yuan	¥ Japan: Yen
DM Germany: Deutsche Mark	Fr France: Franc	£ UK: Pound	₤ Italy: Lira
R\$ Brazil: Real	C\$ Canada: Dollar	₽ Russia: Ruble	₹ India: Rupee
₧ Spain: Peseta	A\$ Australia: Dollar	Mex\$ Mexico: Peso	₩ South Korea: Won
f Netherlands: Guilder	TL Turkey: Lira	Rp Indonesia: Rupiah	SFr Switzerland: Franc



WHY IS FOREIGN CURRENCY AN IMPORTANT CONSIDERATION?



A stronger Australian dollar will reduce the translation effect of foreign currency assets, however this is offset by hedging gains.

Conversely, a weaker Australian dollar will deliver a loss from the currency hedges, offsetting gains from the translation effect of foreign currency assets.



Depreciating foreign currency – negative translation



Appreciating foreign currency + positive translation



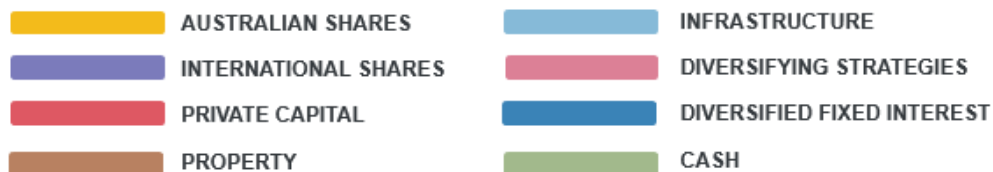
Appreciating AUD + hedge offset



Depreciating AUD – hedge offset

Increasing trend to invest in overseas assets increases foreign currency exposures in diversified portfolios

WHY IS FOREIGN CURRENCY AN IMPORTANT CONSIDERATION?

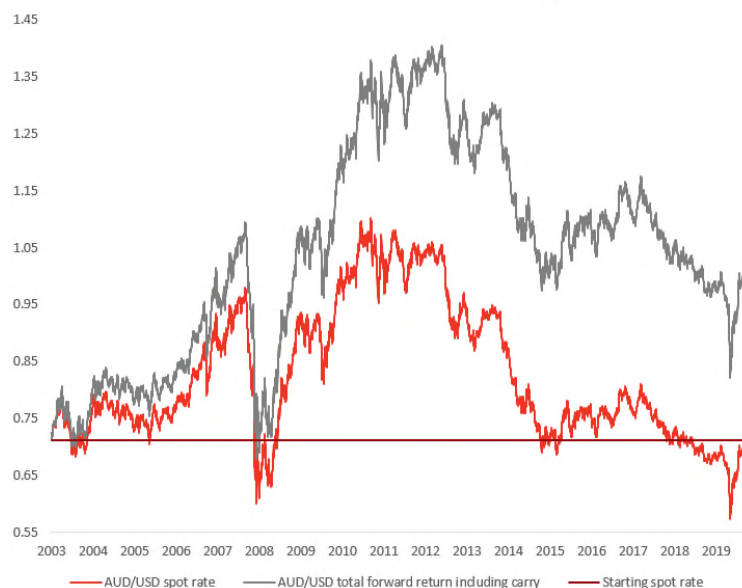


DIVERSIFIED GROWTH



Medium to High

AUD/USD - With and without interest rate carry



Strategic Asset Allocation for a Balanced portfolio	Future SAA	Actual AA	New DSAA
Australian Equities	24%	25%	25%
International Equities	28%	28%	28%
Private Capital	5%	7%	8%
Property	10%	9%	10%
Infrastructure	10%	7%	10%
Diversifying Strategies	0%	1%	0%
Growth Assets	77%	80%	81%
Diversified Fixed Interest	18%	17%	18%
Cash	5%	3%	1%
Defensive Assets	23%	20%	19%
Total Assets	100%	100%	100%
Foreign Currency (DM)	20%	19%	20%
Foreign Currency (EM)	0%	5%	5%
AE / IE ratio	46%	47%	45%
APRA Growth Assets	70%	70%	72%

FX is a large exposure in diversified portfolios, yet it is often not reported upon when looking at allocations

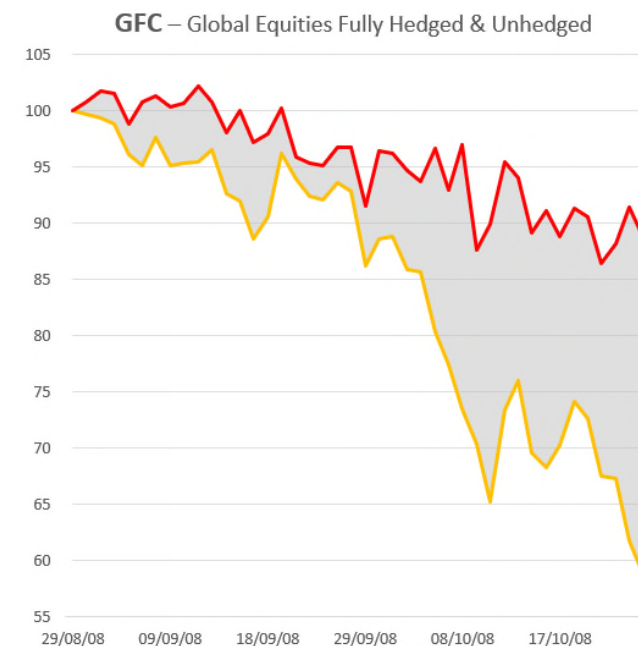
WHY IS FOREIGN CURRENCY AN IMPORTANT CONSIDERATION?

AUD/USD IN 2020 - DOWN THE ELEVATE AND BACK



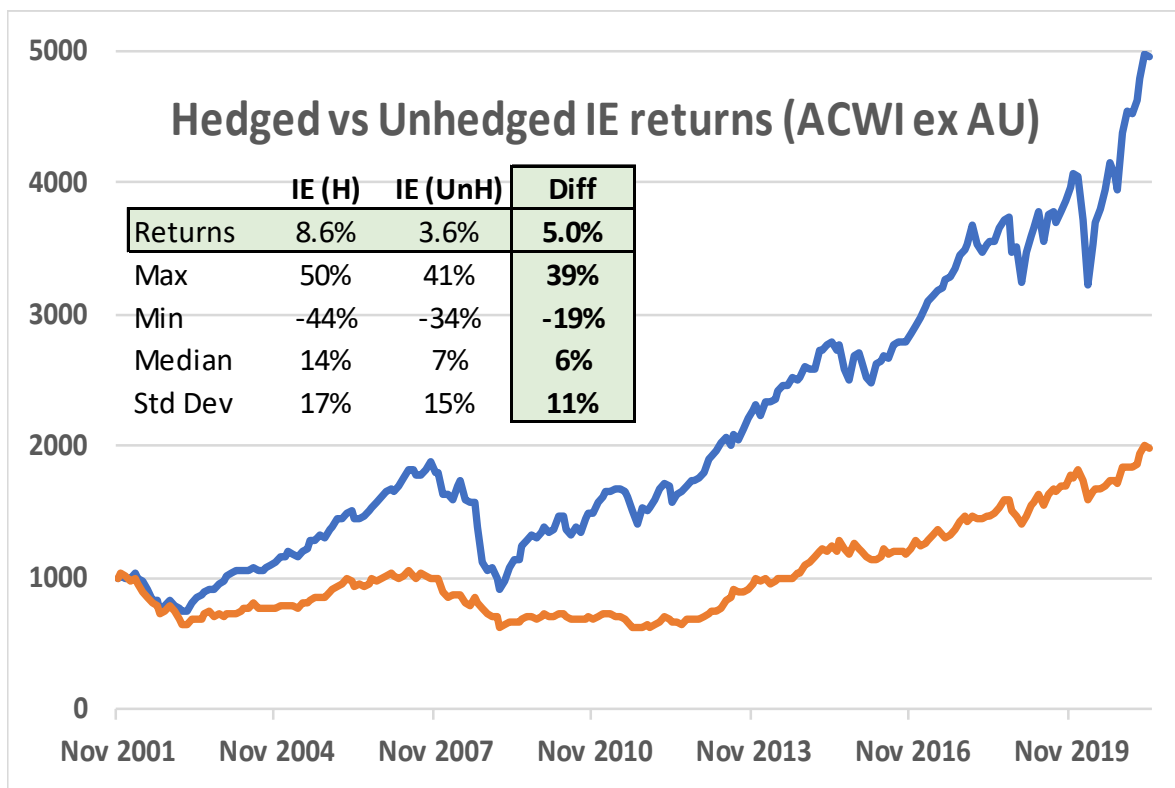
Source: NAB FX Strategy, Macrobond

2020 returns	Monthly Figures		
	IE(H)	IE(UnH)	Diff
Dec 2020	11.2%	4.5%	6.7%
Nov 2020	3.8%	-0.1%	3.8%
Oct 2020	11.0%	7.0%	4.0%
Sep 2020	-2.6%	-0.4%	-2.2%
Aug 2020	-2.8%	-0.3%	-2.4%
Jul 2020	5.6%	2.5%	3.1%
Jun 2020	3.8%	1.4%	2.5%
May 2020	2.8%	-0.8%	3.5%
Apr 2020	4.2%	2.3%	1.9%
Mar 2020	9.8%	3.4%	6.4%
Feb 2020	-13.4%	-8.0%	-5.4%
Jan 2020	-7.9%	-5.2%	-2.7%
Jan 2020	-0.8%	3.6%	-4.4%



Exchange rates can swing wildly over periods of 3 to 18 months through to ten years (e.g. '00 to '11; '11 to '20)
There is some evidence that FX returns can cushion market downturns – but not always e.g. 2001 TMT bubble

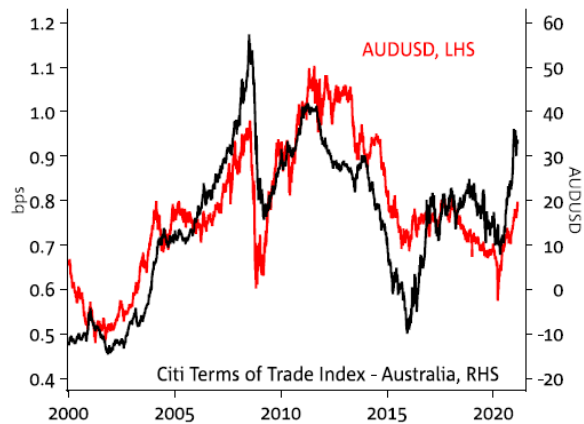
IS FOREIGN CURRENCY A RISK HEDGE?



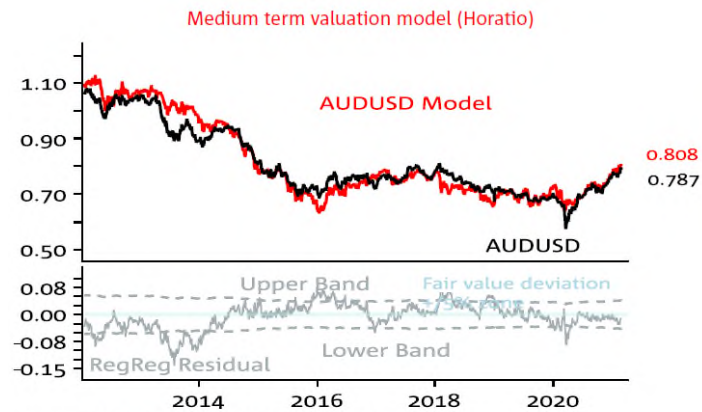
	Annual Figures			Triennial Figures		
	IE(H)	IE(UnH)	Diff	IE(H)	IE(UnH)	Diff
26/02/2021	24.4%	7.8%	16.6%	9.4%	8.7%	0.7%
28/02/2020	3.8%	11.6%	-7.8%	6.8%	11.1%	-4.3%
28/02/2019	1.3%	6.7%	-5.5%	13.1%	11.0%	2.1%
28/02/2018	15.9%	15.1%	0.7%	9.2%	6.4%	2.7%
28/02/2017	23.3%	11.2%	12.1%	9.5%	8.2%	1.3%
29/02/2016	-8.9%	-5.8%	-3.1%	8.9%	15.0%	-6.1%
28/02/2014	21.5%	33.7%	-12.2%	12.2%	10.9%	1.3%
29/02/2012	1.9%	-9.0%	10.8%	22.5%	1.8%	20.6%
28/02/2011	20.3%	4.7%	15.6%	0.4%	-5.1%	5.5%
26/02/2010	49.9%	10.8%	39.1%	-6.2%	-11.7%	5.4%
27/02/2009	-43.8%	-26.3%	-17.5%	-14.3%	-12.7%	-1.6%
29/02/2008	-2.1%	-15.6%	13.5%	11.0%	2.7%	8.2%
28/02/2006	21.9%	20.0%	1.9%	24.7%	13.3%	11.5%
28/02/2005	12.9%	7.8%	5.1%	6.3%	-7.0%	13.3%
27/02/2004	41.0%	12.3%	28.7%			
28/02/2003	-24.7%	-33.5%	8.9%			
31/01/2003	-24.1%	-31.7%	7.5%			
31/12/2002	-22.8%	-27.7%	4.9%			
29/11/2002	-16.3%	-21.8%	5.5%			

There can be large and persistent differences in returns between hedged and unhedged assets
 There is some evidence that FX returns can diversify returns, and cushion in a downturn – but at what L/T cost?
 AUD interest rates generally higher than offshore interest rates, so hedging has been beneficial to returns

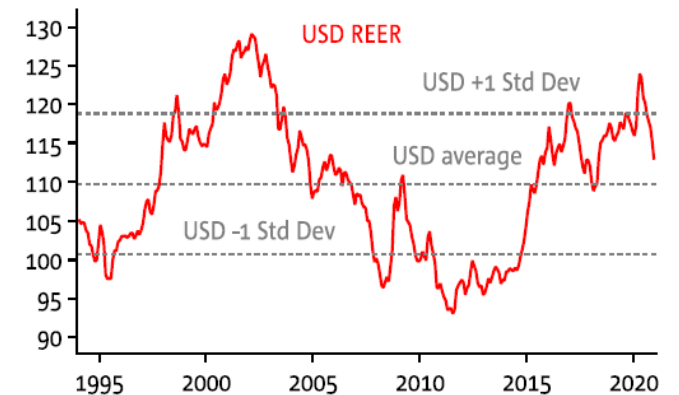
EXCHANGE RATE VALUATION AND FORECASTING....



Source: National Australia Bank, Macrobond

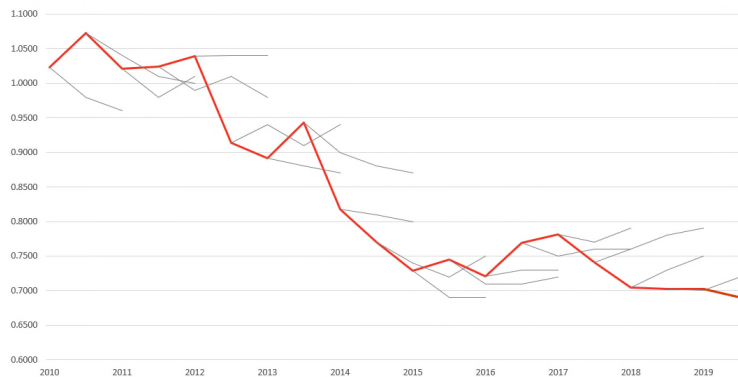


Source: National Australia Bank, Macrobond
* Regressive Model



Source: National Australia Bank, Macrobond

AUD/USD - Median Bloomberg Forecasts and Actual








Big Mac Index

or the most undervalued currencies

Estimating a fair value for exchange rates is difficult, especially over the short term, medium and long term
The Australian Dollar is strongly influenced by Terms of Trade (relative export prices) and real interest rates

FOREIGN CURRENCY MANAGEMENT – FX OVERLAYS

 FX Spot	Simple currency exchange with standardised settlement date (often t+2)	Commonly used for cash management purposes
 FX Forward	The most common hedging instrument with settlement outside the 'spot' date	Price derived from a combination of the spot price and 'forward points' linked to interest rate differentials
 FX Swap	A combination of an FX spot and forward trade, with opposing directions	Commonly used to maintain constant FX exposure in funding trades and rolling hedges forward
 Cross-Currency Basis Swap	An agreement to exchange floating interest rates and principals denominated in two different currencies	Pricing is derived from the spot rate, interest rate differentials, and a 'basis' premium or discount
 FX Option	A right, but not the obligation, to purchase a currency at a specific price in the future	A non-linear payoff profile makes the effectiveness of the hedge more uncertain

Choice of market instruments will depend upon the purpose of the trade, as well as considerations such as counterparty risk, liquidity risk, likely term, ability to absorb losses, etc

TRENDS IN CURRENCY HEDGING

- **Staggered FX hedging** : The focus on managing FX hedge losses during the peak of the COVID linked volatility saw an acceleration to implement hedging over multiple settlement dates .
- **Rebalancing activity broken up** : One observable trend with Superfunds executing larger rebalance transactions was to split these transactions up to minimise market impact during the peak of the volatility
- **Extending notification period for FX settlements** : The peak of the volatility seen in 2020 also placed greater scrutiny on the notification window which Managers provide investors for final settlement of hedges.
- **Extending the tenor of hedges** : Some clients have extended the tenor of the FX hedges and this trend accelerated in 2020.
- **Superfunds have adapted their FX decision making process** : Some Funds have implemented changes in their Investment Governance process post the Covid linked volatility to Improve their ability to make quick and efficient decisions.
- **Out of cycle and more frequent unlisted asset valuations** :This has certainly been more evident since the COVID -linked volatility with more rebalancing of currency hedges as a result.
- **Investors continue to look for additional FX efficiencies** : We have seen a greater focus from investors looking to minimise any possible transaction costs by aligning a spot FX deal for a capital call commitment with the FX hedging they also wish to implement .
- **APRA benchmarking investment performance.** There has been a marked increase in investors reviewing their currency exposures in light of the publication of the indices that APRA will use when assessing the performance of RSE's for MySuper products

FX management becoming increasingly sophisticated and automated – a form of Total Portfolio Management

TRENDS IN CURRENCY HEDGING



Inefficiencies to be captured across aspects of currency management activities

SLIPPAGE WITH CUSTODIANS
BETTER HEDGING INSTRUMENTS FOR CASH FLOW
BANKS PLAY A BIGGER ROLE IN CCY MARKETS
NETTING **COSTS** **INEFFICIENCIES** **EXTERNAL MANAGERS EXECUTE** **SLIPPAGE OWING TO RULES-BASED** **COSTS IN EM** **ISDA NEGOTIATIONS**
INEFFICIENCIES **TIMING**
SYSTEMATIC APPROACH INCLUDING TECHNOLOGY

Source: National Australia Bank

FX trades are another cost of investing – how well are your managers minimising the costs of trading FX?
Use of FX specialist managers likely to reduce costs

KARNOSKY-SINGER (WHY FOREIGN CURRENCY REALLY MATTERS)

Country	Local CCY	Benchmark Weight	Local CCY Benchmark Return	Exchange Rate Return	Base CCY (AUD) Benchmark Return
Germany	DEM	25%	7.00%	1.00%	8.00%
UK	GBP	25%	10.50%	-3.00%	7.50%
Japan	JPY	25%	9.50%	-1.00%	8.50%
Australia	AUD	25%	8.40%	0.00%	8.40%
Total	Blend	100%	8.85%	-0.75%	8.10%

A 10.5% return is larger than a 7.0% return, right?

Not always

Country	FX Rate Return	Local CCY Benchmark Return	Local CCY Eurodeposit Return	Base CCY Eurodeposit Return	Local CCY Benchmark Return Premium
Germany	1.00%	7.00%	5.00%	6.00%	2.00%
UK	-3.00%	10.50%	11.25%	8.25%	-0.75%
Japan	-1.00%	9.50%	9.00%	8.00%	0.50%
Australia	0.00%	8.40%	7.50%	7.50%	0.90%
Total	-0.75%	8.85%	8.19%	7.44%	0.66%

A 2.00% return is larger than a -0.75% return, right?

Yes, yes it is

Separate the asset decision from the currency decision (and hedge back to AUD if you need to)

Invest in high local risk premiums (i.e. where returns are greater than local cash rates)

Hedged returns = AUD cash rate + Risk Premium (+ X ccy basis)

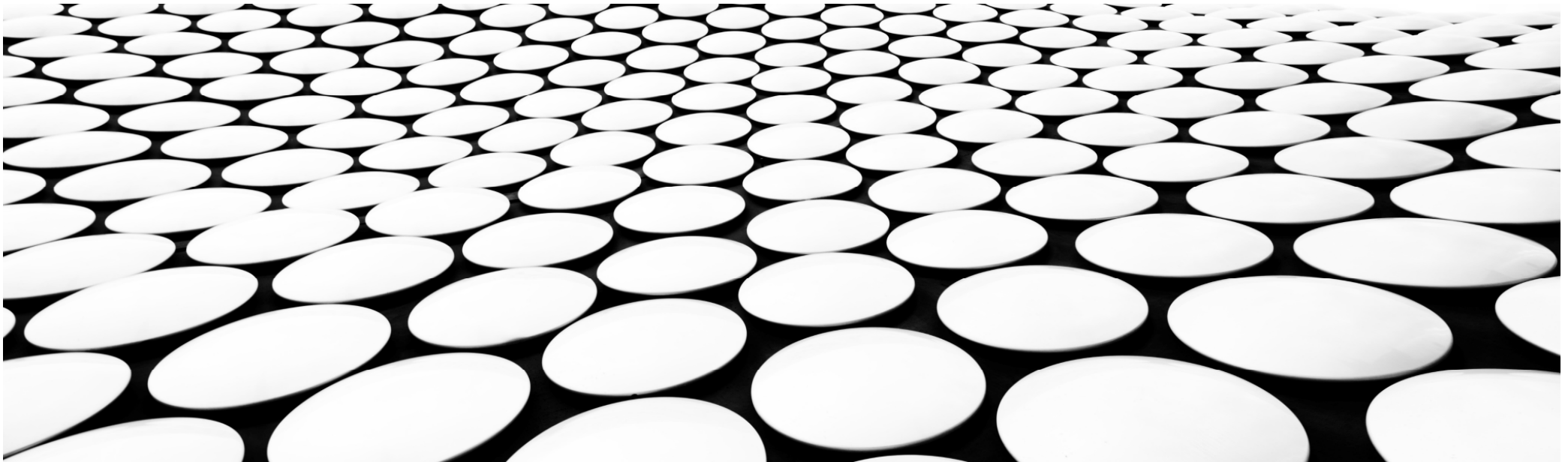
SUGGESTED TAKEAWAYS

- FX is a large exposure in diversified portfolios, yet it is often not reported upon when looking at allocations
- Exchange rates can swing wildly over periods of 3 to 18 months through to ten years (e.g. '11 to '20)
- There is some evidence that FX returns cushion market downturns – but not always & at what L/T cost?
- The Australian Dollar is strongly influenced by Terms of Trade (relative export prices) and real interest rates
- Choice of market instruments will depend upon the purpose of the trade, as well as considerations such as counterparty risk, liquidity risk, likely term, ability to absorb losses, etc
- FX trades are another cost of investing – how well are your managers minimising the costs of trading FX?
- Separate the asset decision from the currency decision (and hedge back to AUD if you need to)
- Invest in high local risk premiums (i.e. where returns are greater than local cash rates)

Investment Efficiency – including FX management - supports effective investment management
Thinking carefully about FX exposures helps to manage risks and enhance returns

ANY QUESTIONS?

Troy Rieck
Chief Investment Officer
LGIAsuper



LUNCH

12.00pm - 1.00pm

AUSTRALIAN



MONEY MARKET

AUSIEX

  #TheIC21



DESIGNING AND IMPLEMENTING FAMILY OFFICE INVESTMENT PORTFOLIOS

28 MAY 2021

DR ADAM N. WALK
PARTNER

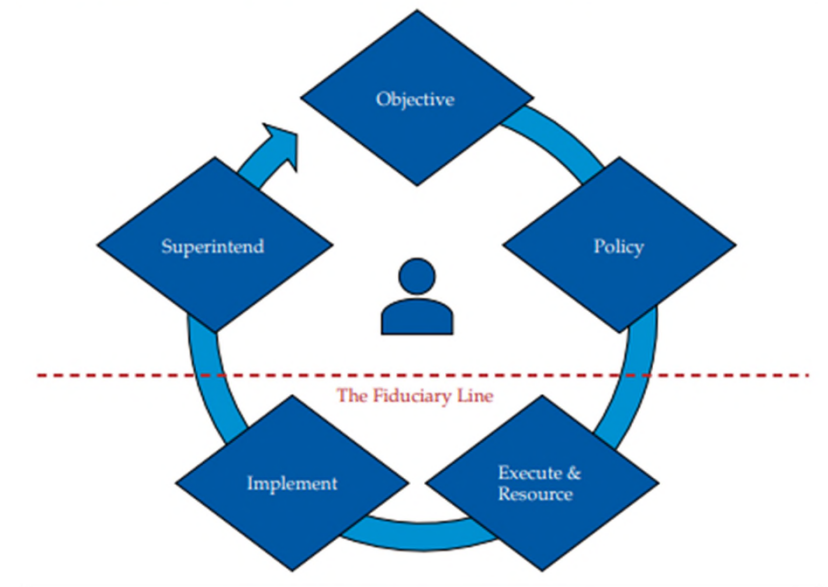


CONTEXT



- People!
- Family governance ↔ investment governance
 - Approval and oversight processes
- Entities and structures (including corporate relationships, domiciles, etc.)
- Financial objectives – higher order question than just investment objectives
- Sources and uses of funds
- Detailed understanding of assets and liabilities (potentially multigenerational)
- Investment beliefs
- Investment objectives (as one aspect of financial objectives)
 - Multiple, competing, prioritized, stated vs. revealed
- Risk preferences – a trade-off between ...
 - Risk required, risk capacity, risk tolerance

Exhibit 2. The OPERIS Investment Governance Framework



Source: Drew and Walk (2019)

ABOUT US



Dr Michael Drew

Managing Partner

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 [@MichaelEDrew](#)

Michael E. Drew is the Managing Partner at MGD Private and a Professor of Finance at Griffith University. He is a financial economist specialising in the areas of investment governance, pension plan design, and outcome-oriented investing.

Professor Drew's research has been published in leading practitioner journals, including the *Financial Analysts Journal* and the *Journal of Portfolio Management*. With his colleague Dr Adam Walk, Professor Drew co-authored the monograph, *Investment Governance for Fiduciaries*, that was released by the CFA Institute Research Foundation in April 2019. He has been invited to make submissions and to testify before numerous committees, including the US Department of Labor and the SEC joint hearing on target-date funds.

Professor Drew serves as a trustee director and member of the Investment Committee at QSuper, a member of the Investment Advisory Board of the Petroleum Fund of *Timor-Leste* (East Timor), and a trustee (and member of the Finance, Audit, and Risk Committee) of Mary Aikenhead Ministries. He received his PhD in economics from the University of Queensland, is an Accredited Investment Fiduciary Analyst®, and is a Life Member of FINSIA, the Financial Services Institute of Australasia.



Dr Adam Walk

Partner

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Adam N. Walk is Partner at MGD Private and an Adjunct Professor at the University of Notre Dame–Australia. He is a financial economist specializing in the areas of investment governance, pension finance, and investments.

Dr Walk's research has been published in the *Journal of Portfolio Management* and the *Journal of Retirement*. With his colleague Professor Michael Drew, Dr Walk co-authored the monograph, *Investment Governance for Fiduciaries*, that was released by the CFA Institute Research Foundation in April 2019.

He serves as a trustee director and member of the Investment Committee at Rest, an adviser to the Group Capital and Investment Committee at RACQ Group, member of the Investment Committee at RSL Queensland, a board member of the Archdiocesan Development Fund of the Roman Catholic Archdiocese of Brisbane, and chairman and a trustee of Campion College Australia. Dr Walk received his PhD in financial economics from Griffith University, Queensland, Australia. He is an Accredited Investment Fiduciary Analyst® and a Certified Investment Management Analyst® designee.

DISCLAIMER

Dr Adam N. Walk is a Representative of MGD Private Pty Ltd as Corporate Authorised Representative of MGD Wealth Ltd (AFSL 222600). The information in this presentation is current as at May 2021.

Any advice included in this presentation has been prepared without taking into account your objectives, financial situation or needs. Before acting on the advice, you should consider its appropriateness having regard to these factors and obtain financial advice. Any tax information included in this presentation is not based on your unique circumstances and should not be relied on as tax advice.

Is My Portfolio Over-Diversified?

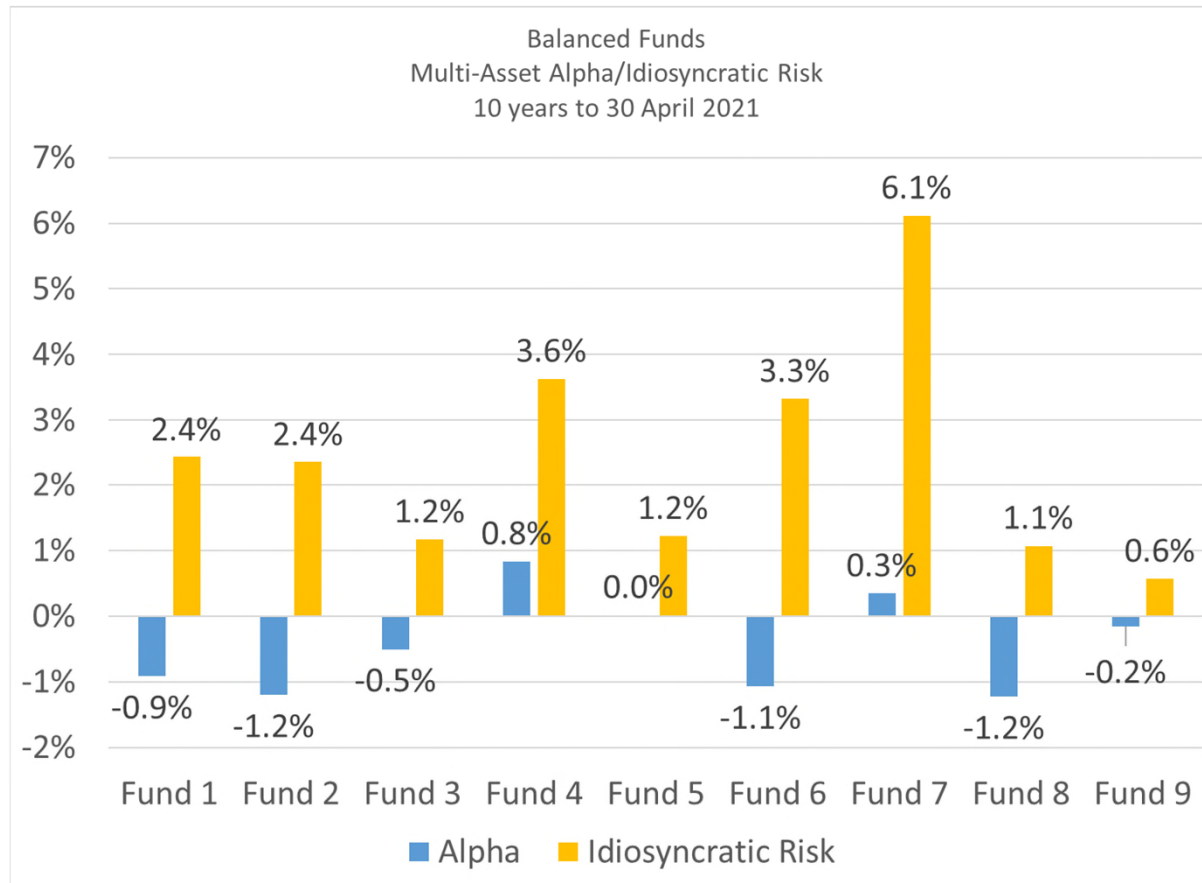
By Michael Furey

28 May 2021



DELTA
Research and Advisory

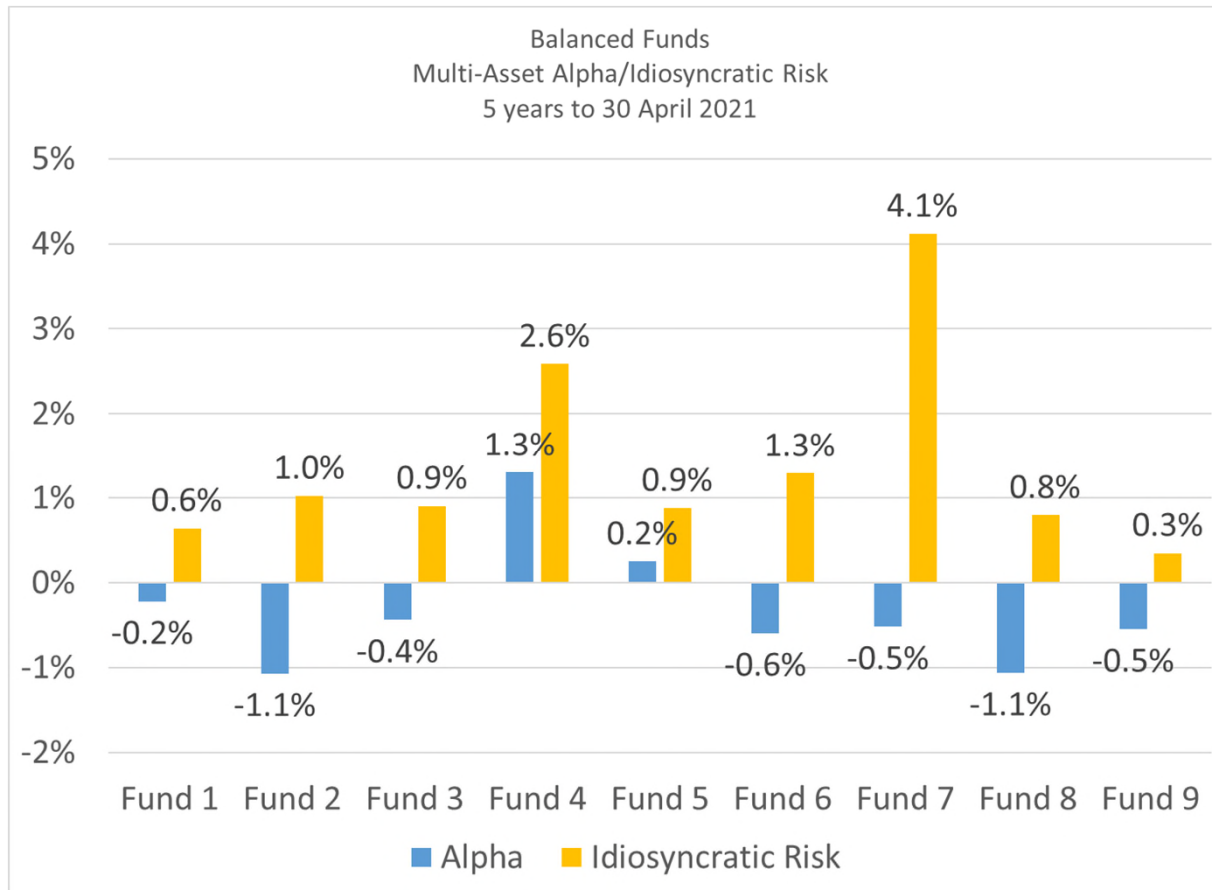
The Problem - Remember BHB



Source: Delta Research & Advisory



The Problem

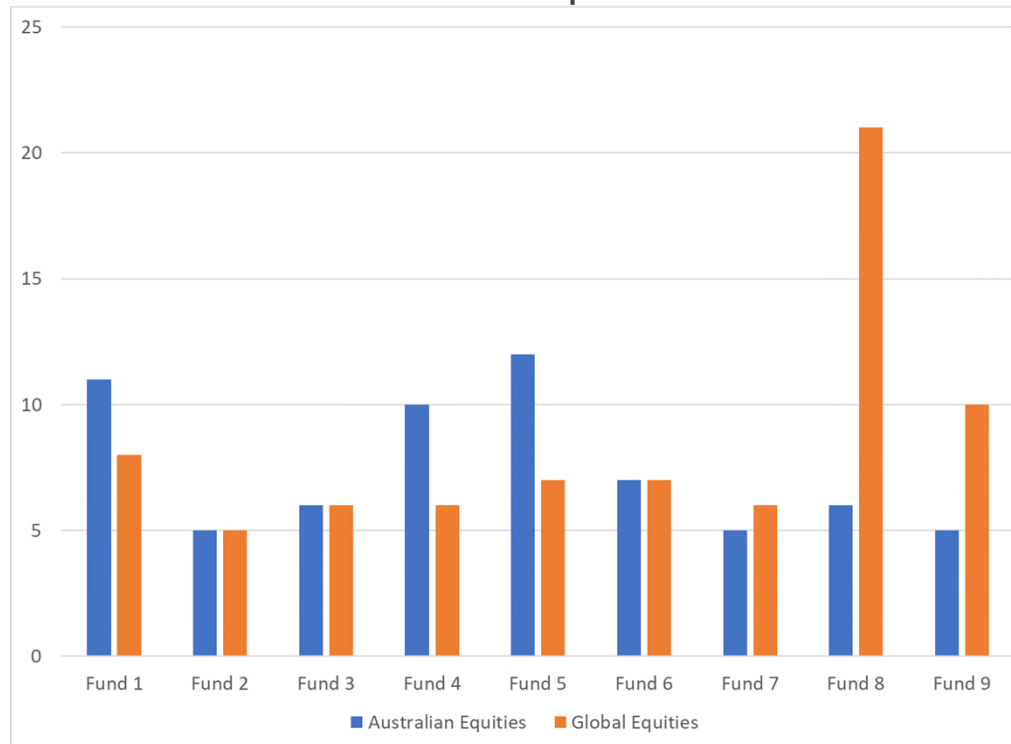


Source: Delta Research & Advisory



The Problem

- ▶ Number of funds within Australian and Global Equity Asset Classes of some of the larger retail Australian Balanced portfolios



Source: Lonsec, Delta

Concerns

- ▶ Multi-manager portfolios are constraining their active return potential

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 - ▶ Choosing too many strategies/products ...

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Concerns

- ▶ Multi-manager portfolios are constraining their active return potential
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 - ▶ ... meaning it becomes very difficult to add alpha after fees

Concerns

- ▶ Some Multi-manager portfolios are constraining their active return potential
 - ▶ Choosing too many strategies/products ...
 - ▶ ... that diversifies away the portfolio's idiosyncratic/non-market risks ...
 - ▶ ... meaning it becomes very difficult to add alpha after fees
- ▶ Managed Accounts are vulnerable to overdiversification
 - ▶ Constraints

A Popular Solution

- ▶ Building a portfolio of managers with high idiosyncratic risk (generally exhibiting strong alpha). May consist of:
 - ▶ Concentrated funds with less than 15-20 securities
 - ▶ Variable beta ... non-market risk may be from market timing
 - ▶ Regional
 - ▶ Sector
- ▶ In practice ... typically 4-5 concentrated funds maybe a variable beta fund

Interactive Slides

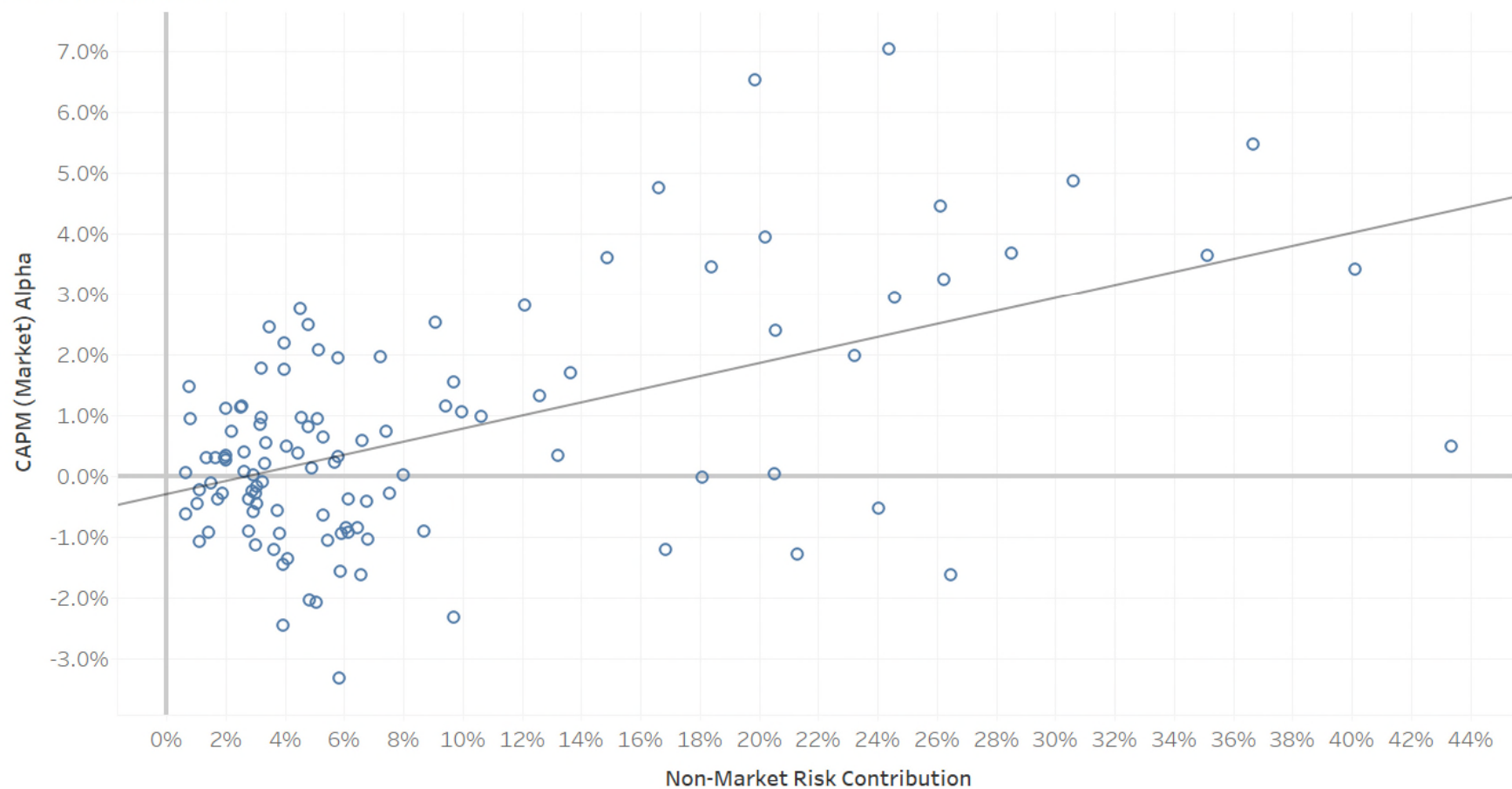
- ▶ https://public.tableau.com/shared/87S9GQZSN?:display_count=y&origin=viz_share_link

Delta Factors
Understanding Investment Performance Behaviour
Market Alpha vs Non-Market (Idiosyncratic) Risk Contribution

10 Years to Mar 2021

Time Period

- 5 Year Analysis to 31 Mar 2016
- 5 Year Analysis to 31 Mar 2021
- 10 Years to Mar 2021

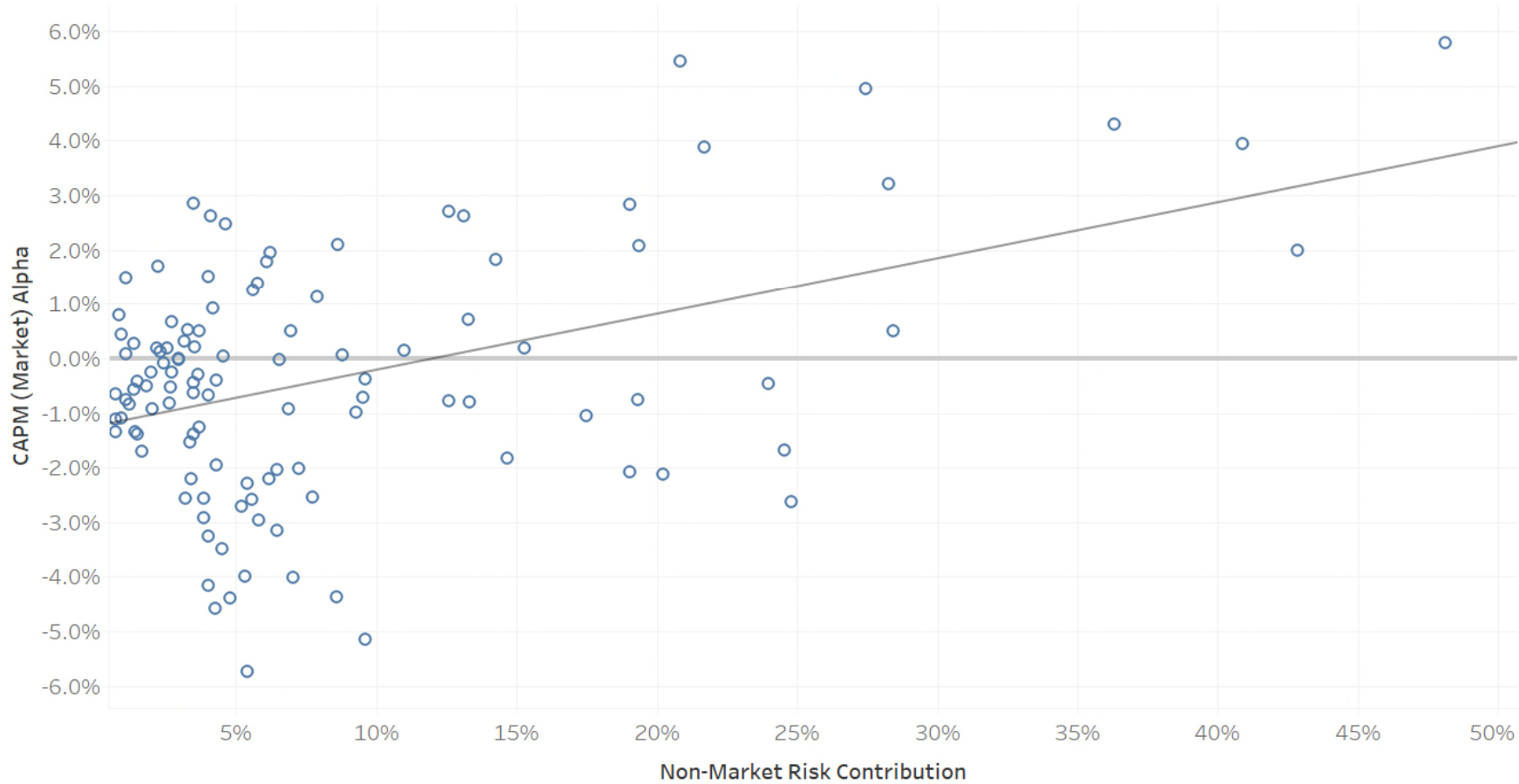


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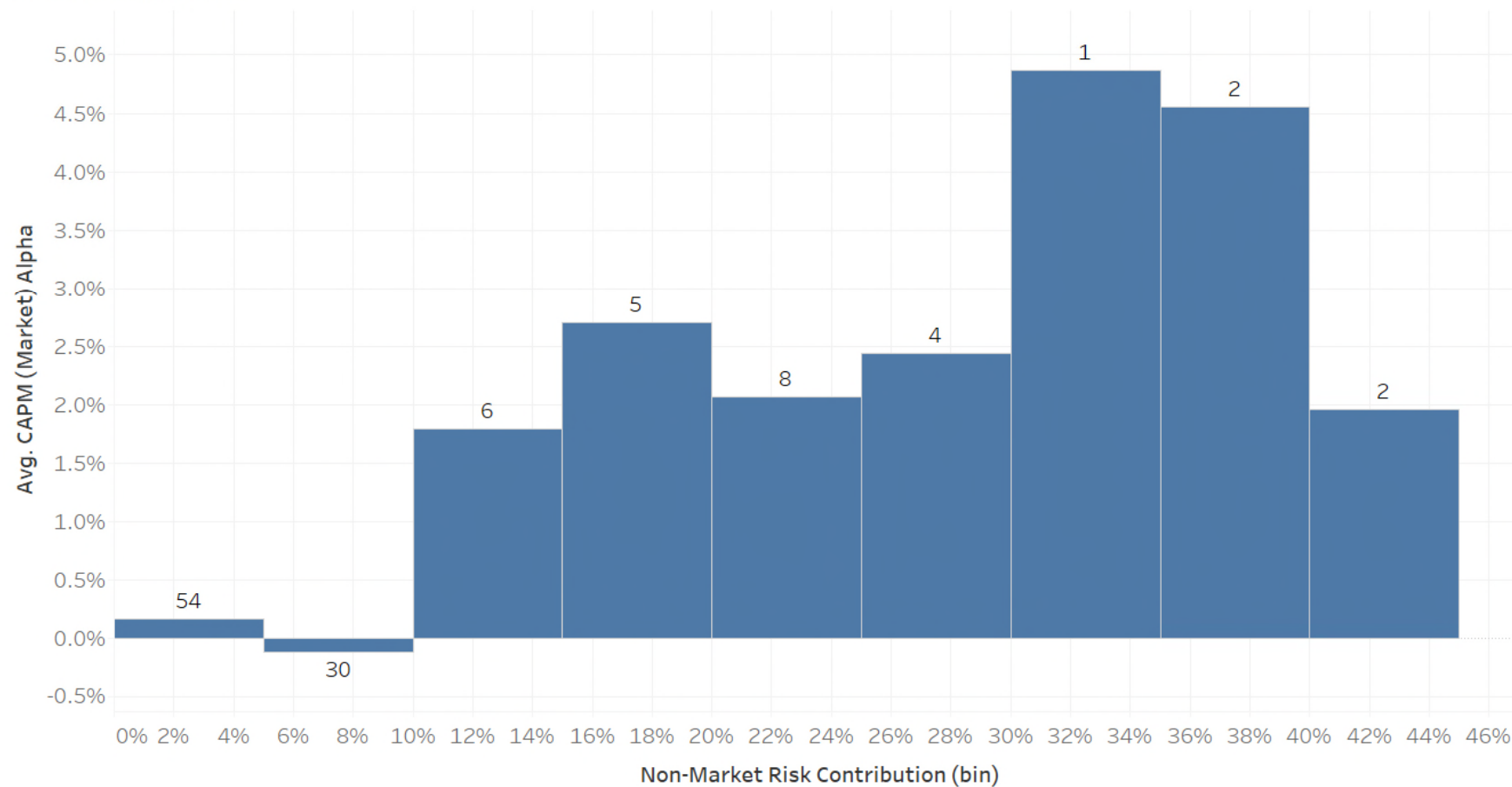


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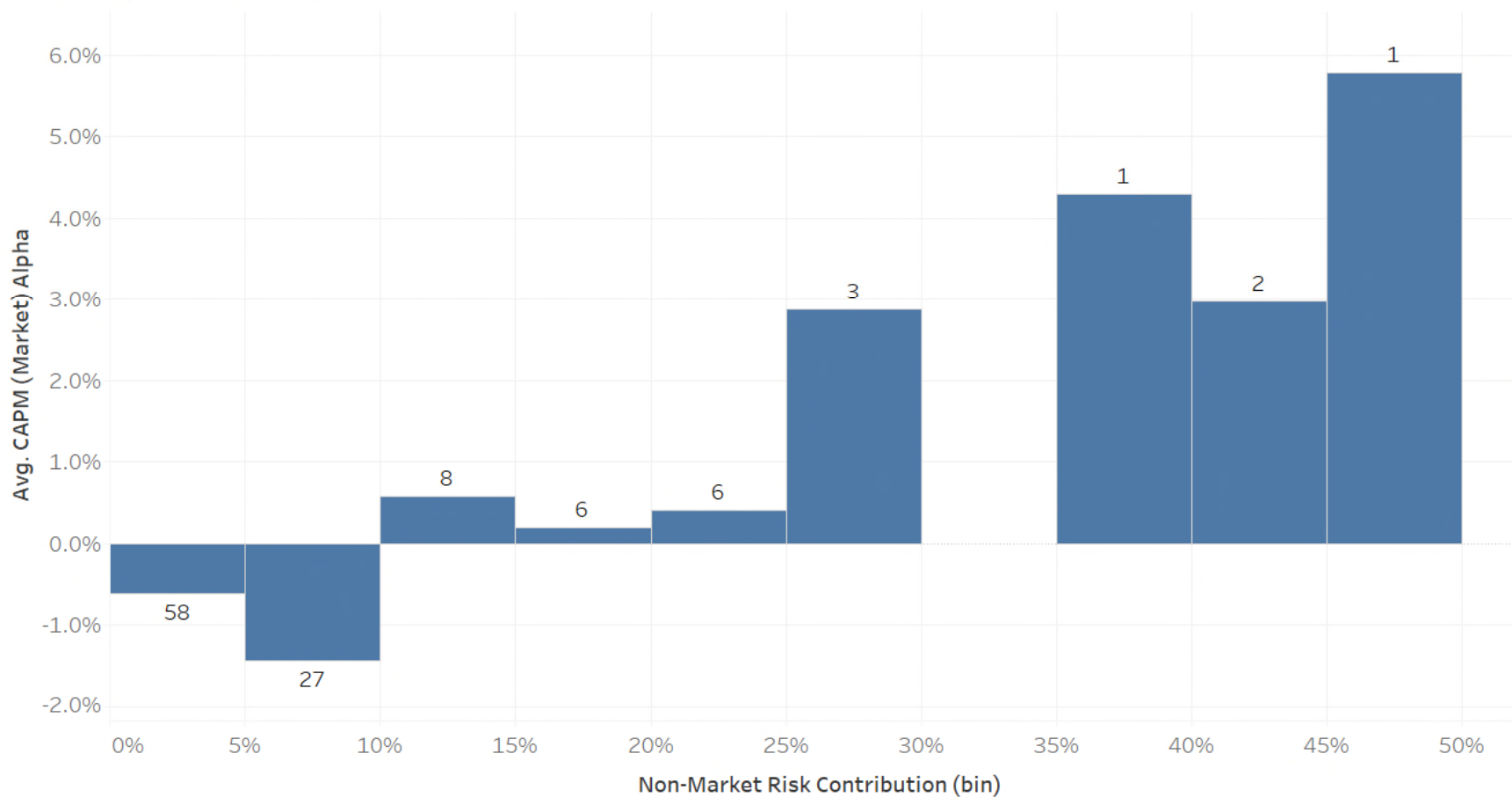


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Old Evidence Example for Concentrated Funds

Risk-Adjusted Metrics for Concentrated Portfolios

Concentrated Portfolios	Relative to Own Fund			Relative to Own Index		
	Excess Return (%; p.a.)	Tracking Error (%; p.a.)	Information Ratio	Excess Return (%; p.a.)	Tracking Error (%; p.a.)	Information Ratio
Top 5	3.75	16.49	0.23	5.26	17.68	0.30
Top 10	2.41	12.94	0.19	3.90	14.06	0.28
Top 15	1.69	11.00	0.15	3.16	12.12	0.26
Top 20	1.17	9.62	0.12	2.67	10.68	0.25
Top 25	0.83	8.69	0.10	2.30	9.69	0.24
Top 30	0.52	8.04	0.07	1.97	9.00	0.22

For the period 1999 to 2009

Past performance is not a reliable indicator of future results. This information is for illustrative purposes only and does not represent any product or strategy managed by Lazard.

Source: Yeung et al. (2012)

Yeung, Danny, Paolo Pellizzari, Ron Bird, and Sazali Abidin. "Diversification versus Concentration ...and the Winner is?" *Working paper series, University of Technology Sydney*, September 2012

Table source: Lazard Asset Management "Less is More : A Case for Concentrated Portfolios", *Investment Focus*, September 2015

Non-Market Risk Breakdown by Number of Managers
Australian Equities

10 Years to Mar 2021

Rando..

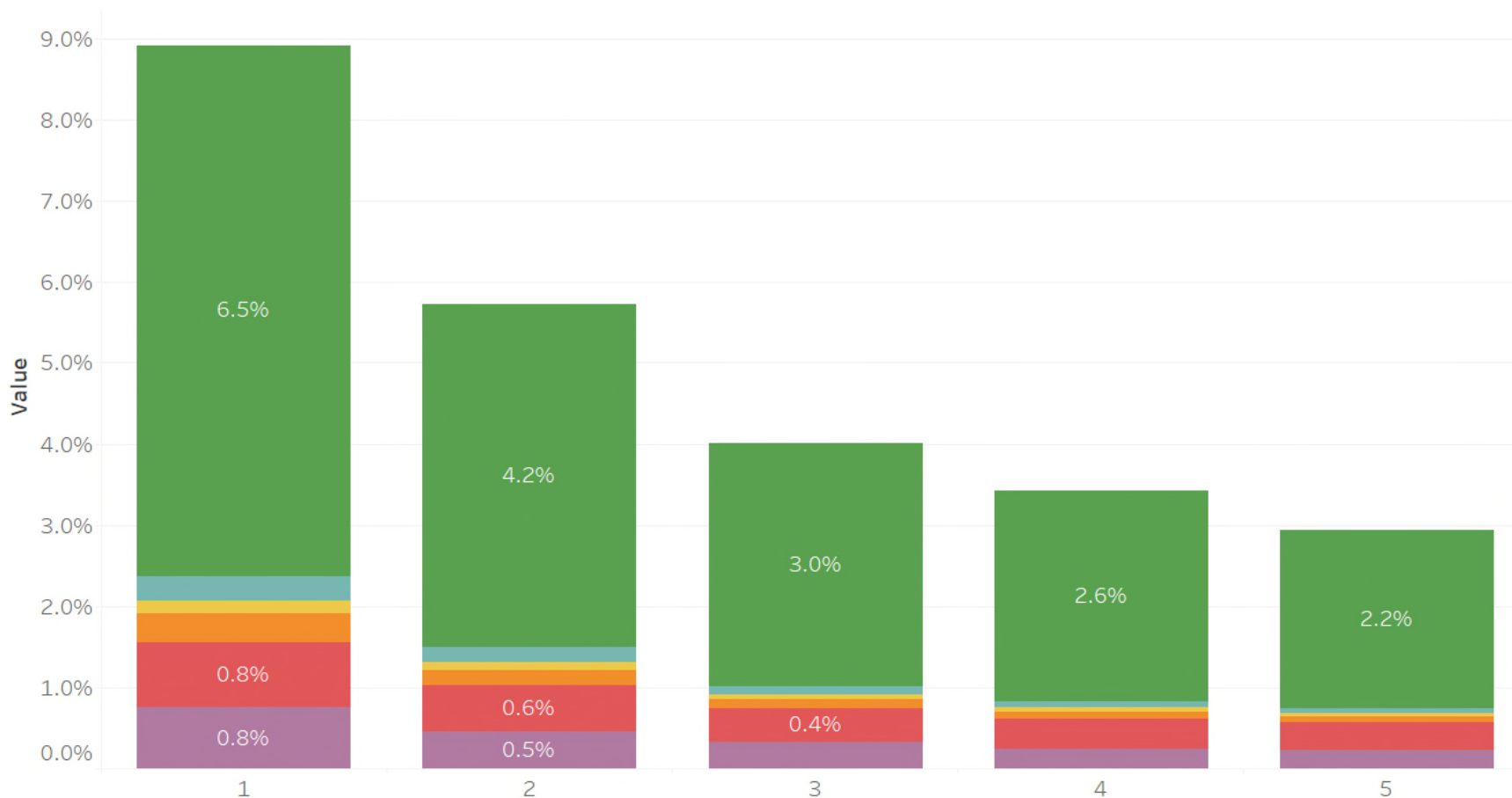
Time Period

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Measure Names

- Avg. Idiosyncratic Risk Contribution
- Avg. Min Vol Risk Contribution
- Avg. Quality Risk Contribution
- Avg. Momentum Risk Contribution
- Avg. SMB Risk Contribution
- Avg. VMG Risk Contribution

Each column shows the Non-Market Risk Contribution breakdown by various style risks plus Idiosyncratic (or unexplained) risks. The 1 column represents all individual active Australian equity strategies over the last 10 years. The 2 to 5 manager columns are 500 random combinations of each active strategy taken from the 1 sample of funds (doubles-ups can occur)



Market Alpha vs Non-Market (Idiosyncratic) Risk Contribution
Australian Equities and Combinations

10 Years to Mar 2021

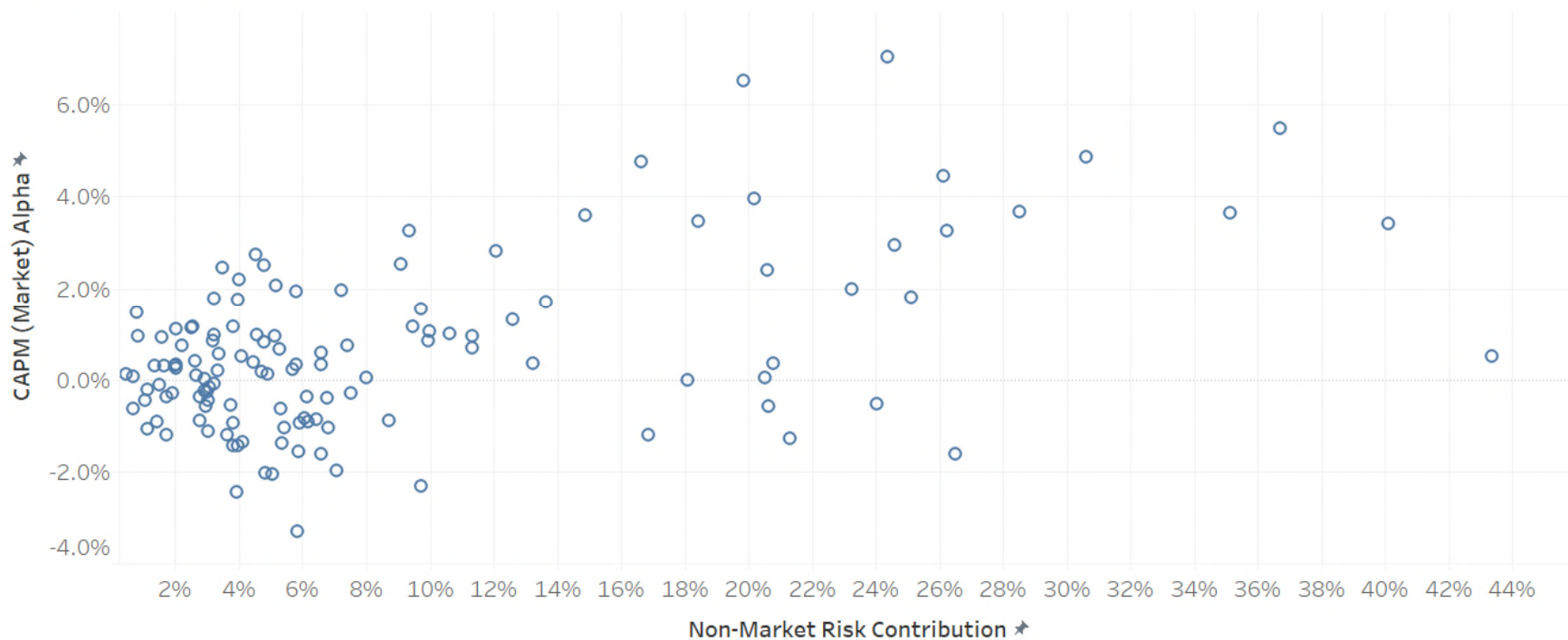
Time Period

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- 5 Year Analysis to 31 Mar 2021
- 10 Years to Mar 2021

Number of Random Fund Combinations

- 1
- 2
- 3
- 4
- 5

Number 1 represents all individual active Australian equity strategies that commenced 10 years ago. The 2 to 5 numbers are 500 random combinations of each active strategy taken from the 1 sample of funds (doubles-ups can occur). For example, 3 means a combination of 3 random funds



Number of Random Fund Combinations

■ 1

Non-Market Risk Contribution

0.004 to 0.577916290

Delta Factors
Understanding Investment Performance Behaviour
Market Alpha vs Non-Market (Idiosyncratic) Risk Contribution
Australian Equities and Combinations

10 Years to Mar 2021

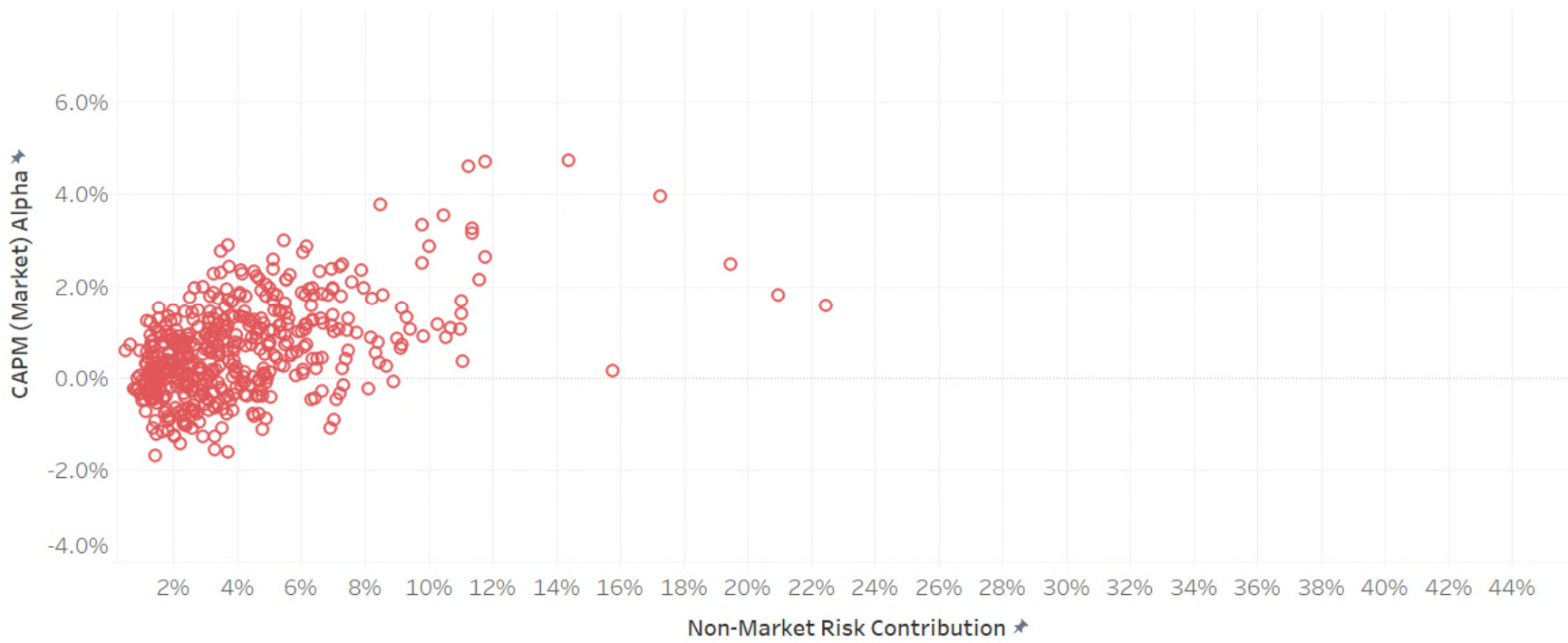
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Number of Random Fund Combinations

■ 3

Non-Market Risk Contribution

0.004 to 0.577916290

Market Alpha vs Non-Market (Idiosyncratic) Risk Contribution
Australian Equities and Combinations

10 Years to Mar 2021

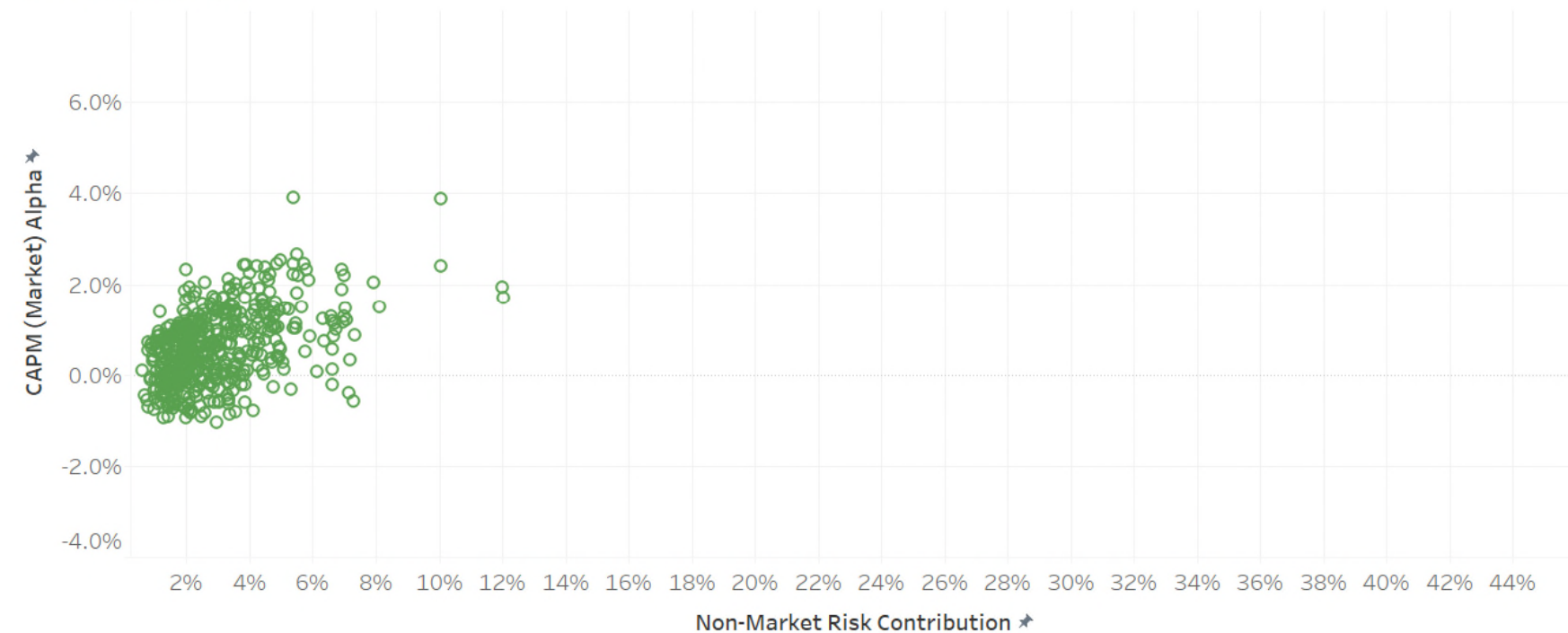
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Number of Random Fund Combinations

■ 5

Non-Market Risk Contribution

0.004 to 0.577916290

Risks can change ... & blatant plug

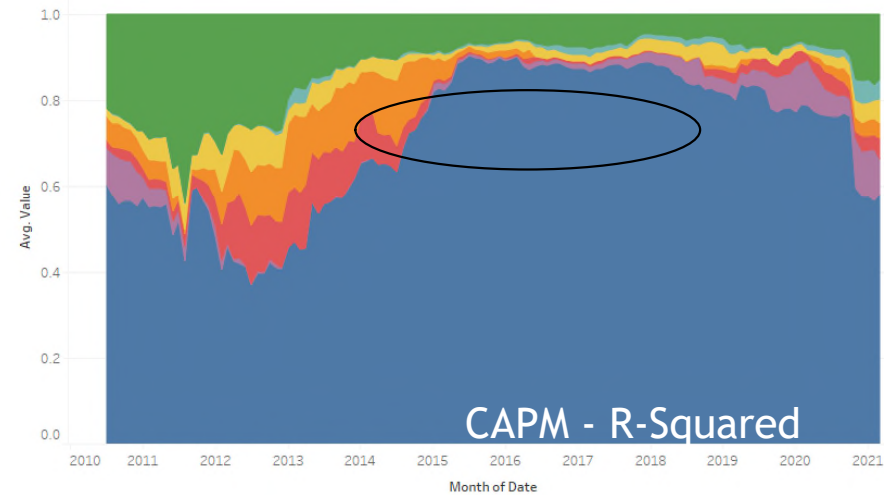


Delta Factors
 Understanding Investment Performance Behaviour
 Global Equities Benchmarks
 Rolling 36 months

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 ABN: 43 155 969 163 AFSL: 420093

Benchmark: MSCI World
 Sector: All
 APIR Code: All

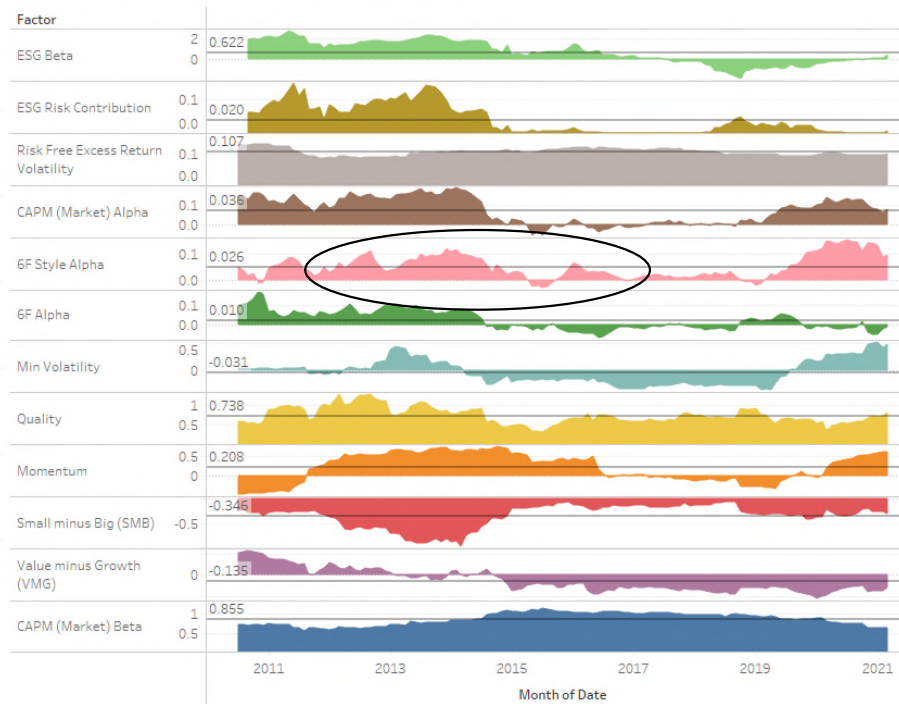
Portfolio Risk Contribution



Factor
 6F Idiosyncratic Risk Contribution
 Min Volatility Risk Contribution
 Quality Risk Contribution
 Momentum Risk Contribution
 SMB Risk Contribution
 VMG Risk Contribution
 Market Risk Contribution

Date
 31/07/2007 to 31/03/2021

Exposures (Betas), Value-add (Alphas) & Risk (Volatility)



Portfolio Considerations (to avoid overdiversification)

- ▶ Idiosyncratic (Non-systematic) risk analysis should play a bigger role in multi-manager portfolio construction
 - ▶ More not less
- ▶ If you believe active management can produce positive alpha and you believe you can pick skilled managers, prioritise high conviction managers, then be high conviction
 - ▶ Tracking error risk budgets can be managed with low-cost index funds, as opposed to increasing style diversification (which decreases portfolio efficiency) ... but don't forget index funds still eat into your alpha target due to their fees
 - ▶ Less is more
- ▶ Build portfolios comprising of separate and desired risks
 - ▶ ... as opposed to diversifying away Alpha potential styles

Questions?

Michael Furey

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Research and Advisory

PANEL SESSION

Action Items - By Advisors, For Advisors



DR MICHAEL DREW

Managing Partner
MGD Private



ANNA WELLS

Associate Private Adviser
ANZ Private

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AUSTRALIAN

MONEY MARKET

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CLOSING REMARKS

CHRIS HUMPHREY

Managing Director
Humphrey Partners

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MONEY MARKET

NETWORKING & DRINKS

3.00pm

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