

**Presenting
debate on
contemporary
and emerging
portfolio
construction
issues**



portfolio
construction

CONFERENCE

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PortfolioConstruction Conference 2007

Unconstrained global equity portfolios – When more stocks are better

Greg Cooper

CEO Schroders Investment Management Australia Limited



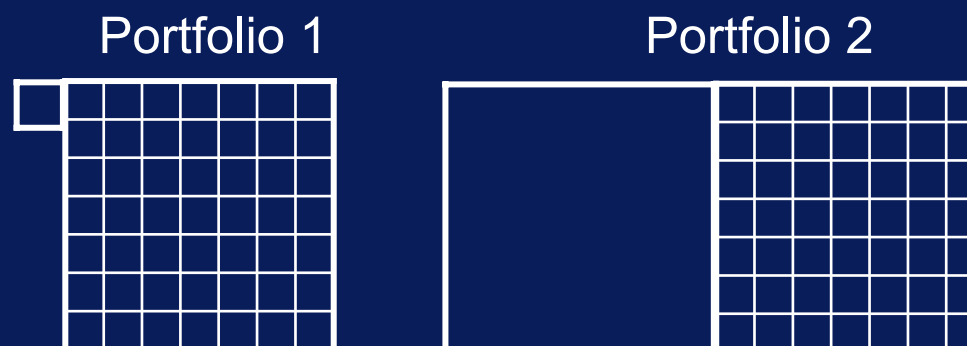
Schroders

Agenda

- What are concentrated portfolios?
- Why are they popular?
- Have they delivered?
- Active Share: A better way to measure conviction
- Unconstrained diversified global equities: when more stocks are better

What are concentrated portfolios?

Question is not as silly as it sounds. Concentration needs a definition



stocks

50

50

% in top 10 stocks

20%

60%

Concentration co-efficient
($1 / \text{sum of stock weights}^2$)

50

3.8

Why are concentrated portfolios popular?

- Potential to generate higher returns from a manager's 'best ideas'
- Better bang for your buck
- Desire to be different
- Bull markets/low volatility environment encourages risk taking
- Increasing use of multi-manager portfolios requires more underlying manager risk to justify active fees

The Fundamental Law of Active Management

A reminder

Information Ratio = $\sqrt{\text{Breadth}} \times \text{Information Coefficient} \times \text{Transfer Coefficient}$

Information ratio depends on:

- Skill (does the manager know what they are doing?)
- Breadth of opportunity set (how many positions can they take?)
- Transfer coefficient (even if they do know what they are doing, is it implementable?)

We spend a lot of time worrying about manager skill (rightly) but relatively little on what we can do to increase the breadth of the opportunity set and raise the transfer coefficient

Concentrated portfolios

A closer look

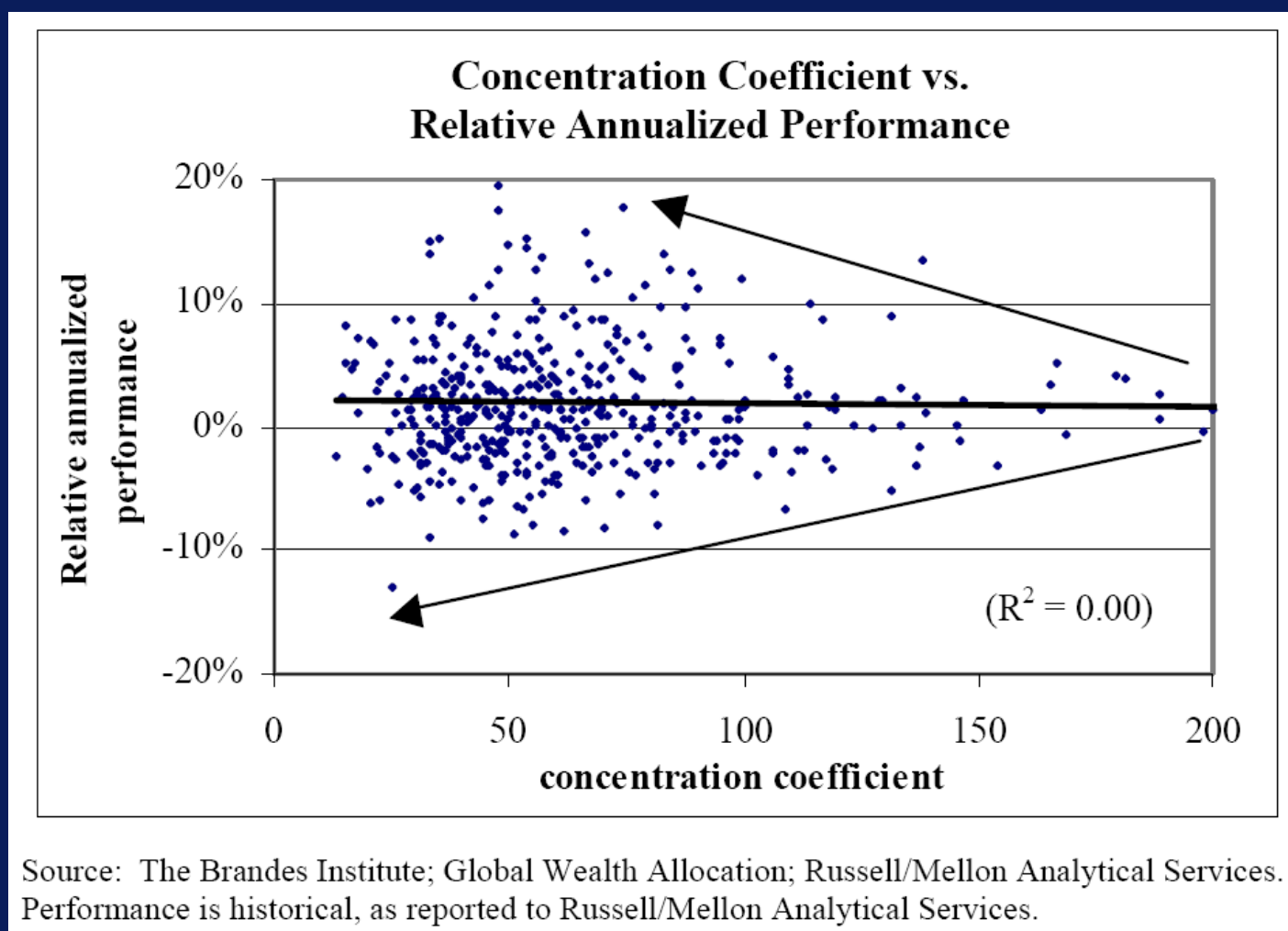
Advantages:

- Higher manager risk (tracking error)
- Longer investment horizon
- Pure stock selection
- Avoids disadvantages of market cap benchmarks

Disadvantages:

- Investment capacity more limited
- Higher portfolio volatility
- Measurement of performance is tricky – greater scope for luck
- Greater scope for underperformance when volatility is high

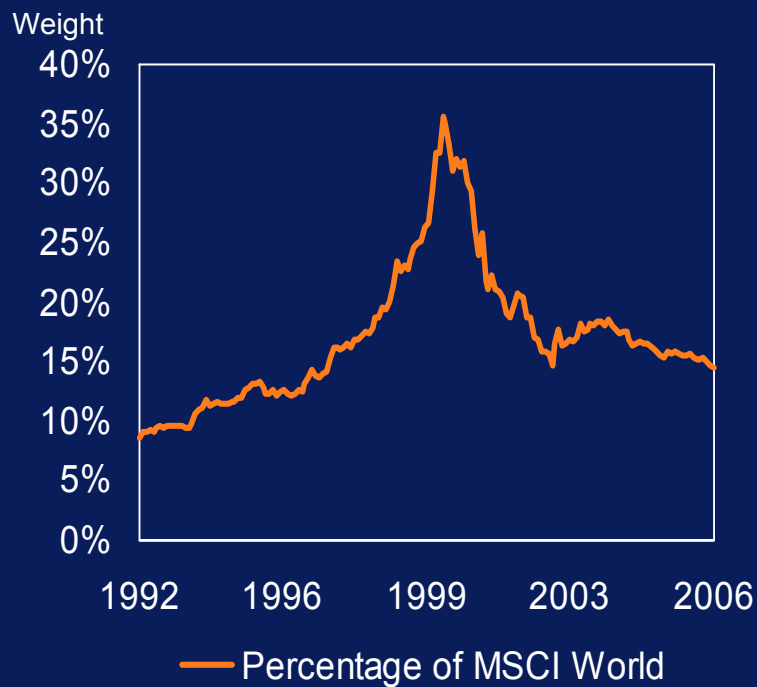
Have concentrated portfolios delivered?



Source: The Brandes Institute; Global Wealth Allocation; Russell/Mellon Analytical Services. Performance is historical, as reported to Russell/Mellon Analytical Services.

Risk - Concentration can be one of the problems

Technology/Telecoms Bubble



Japanese Stock Market Bubble



Source: Schroders, MSCI

* Technology includes telecommunications

The objective = Conviction not concentration

Conviction =
Backing your investment ideas

Not looking like the index

Concentration

- Reduce number of stocks and increase bet size

Drop constraints

- Allow greater flexibility in stock, sector, region and currencies

New sources of alpha

- Take off index bets
- Emerging, small/micro caps, etc
- Shorting

Active Share

- Active share is the best measure we have of measuring how ‘active’ a fund manager is.
- Active share is the % of a portfolio that is different from the benchmark

Active Share = Sum of all active positions / 2

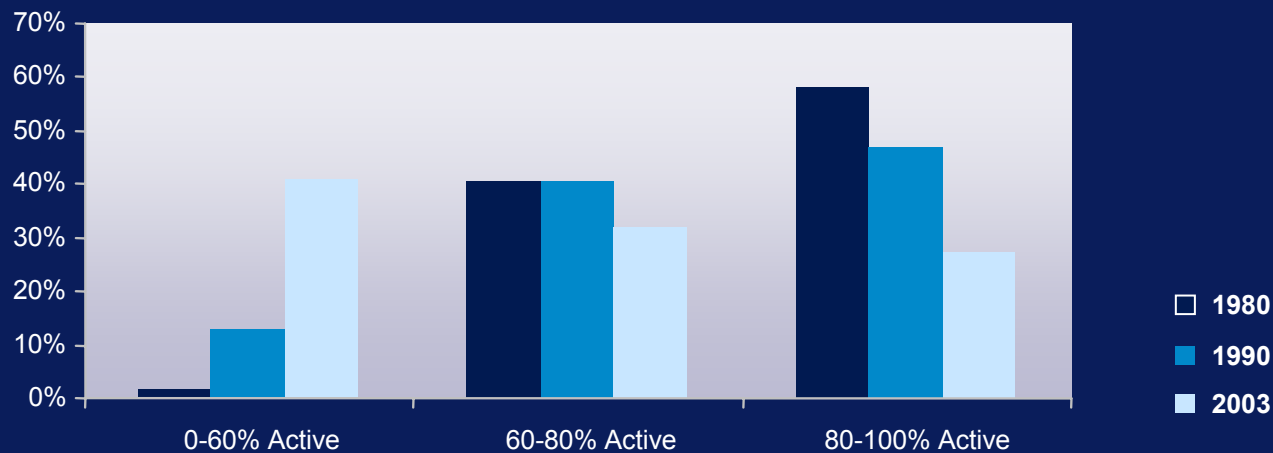
- Tracking error is also used to measure how different a fund is to a benchmark (or more accurately how much risk is being taken vs a benchmark).
- Tracking error looks at the historical volatility and correlation of stock returns while Active Share looks at actual holdings

Active Share of managers has been falling

Not surprising – many suspect active managers have become “closet indexers”

– peer pressure, risk aversion relative to benchmark

Share of US Equity Mutual Fund Assets by Active Share 1980 to 2003

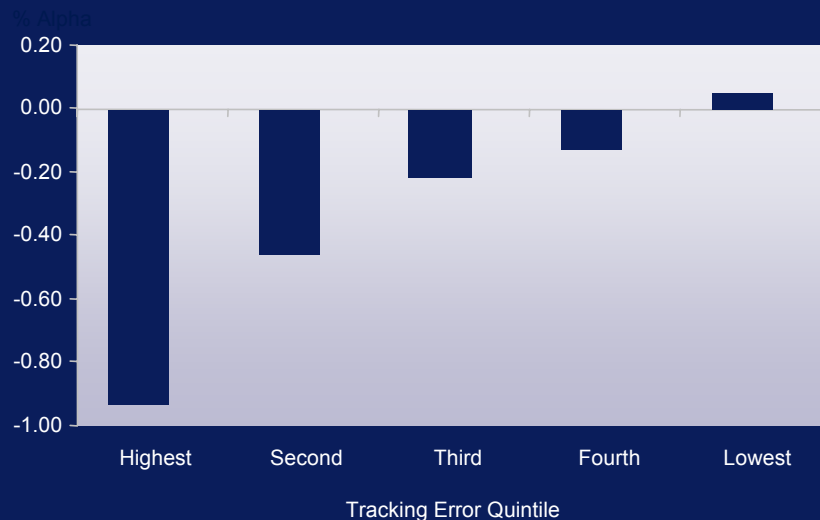


Source: Cremers, M. and Petajisto, A. 2006 "How Active Is Your Manager?", Empirical Research Partners

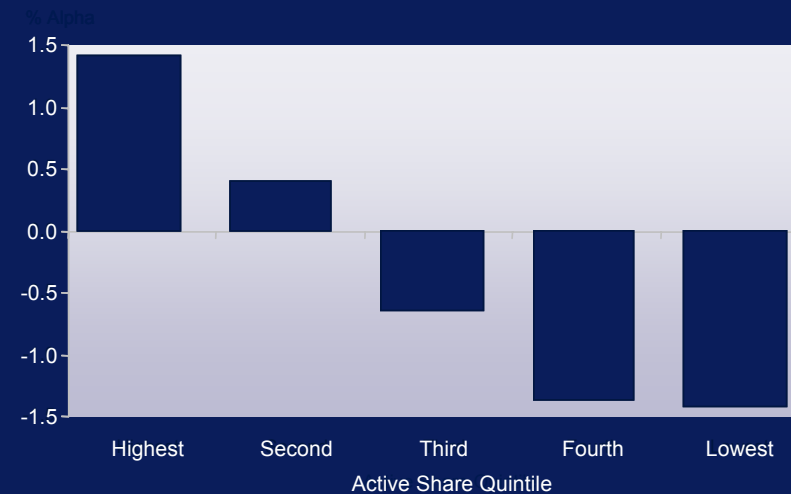
Active Share not Tracking Error is what counts

Research published by Cremers and Petajisto indicate that Active Share is a good predictor of manager outperformance while Tracking Error is not.

Alpha (%pa) of Equity Mutual Funds
Sorted by Tracking Error 1990 to 2003



Alpha (%pa) of Equity Mutual Funds
Sorted by Active Share 1990 to 2003



Source: Cremers, M. and Petajisto, A. 2006 "How Active Is Your Manager?", Empirical Research Partners

Concentration vs Active Share

Concentration will lead to a high Active Share but so can a diversified fund *IF* its unconstrained.

Fund name	% Asset in Top 10	# of Stocks	Active Share
Schroder Global Active Value Fund Hedged	4.5	576	0.88
Vanguard – Index International Shares Fund	9.8	1456	0.10
Dimensional – Global Value Trust	14.4	900	0.75
AXA – Wholesale Global Equity – Core Fd	14.8	456	0.66
Templeton Global Equity Fund	18.5	98	0.83
Walter Scott Global Equity Fund	21.2	61	0.92
ABN Amro – Global Equity Fund	22.5	80	0.83
MFS Fully Hedged Global Equity Trust	23.9	92	0.84
Platinum International Fund	28.2	169	0.94
GVI Global Industrial Share Fund	30.0	64	0.89
Perpetual W/S International Share Fund	30.6	65	0.84
PM Capital – Absolute Performance Fund	44.1	44	0.92
Morgan Stanley Global Franchise	49.5	31	0.95
T. Rowe Price Global Equity Fund	86.7	77	0.96

A highly active diversified approach

Schroder Global Active Value

1. Unconstrained

Without MSCI linked constraints such as market capitalisation, regional or sector weights

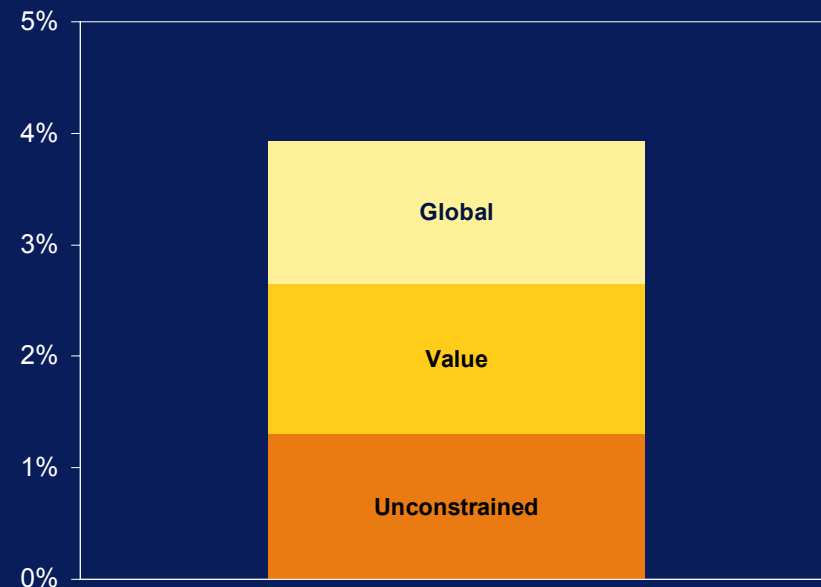
2. Value

Value orientated strategies generate the highest long run return

3. Global

Invest in the broadest opportunity set in a diversified manner

Expected outperformance



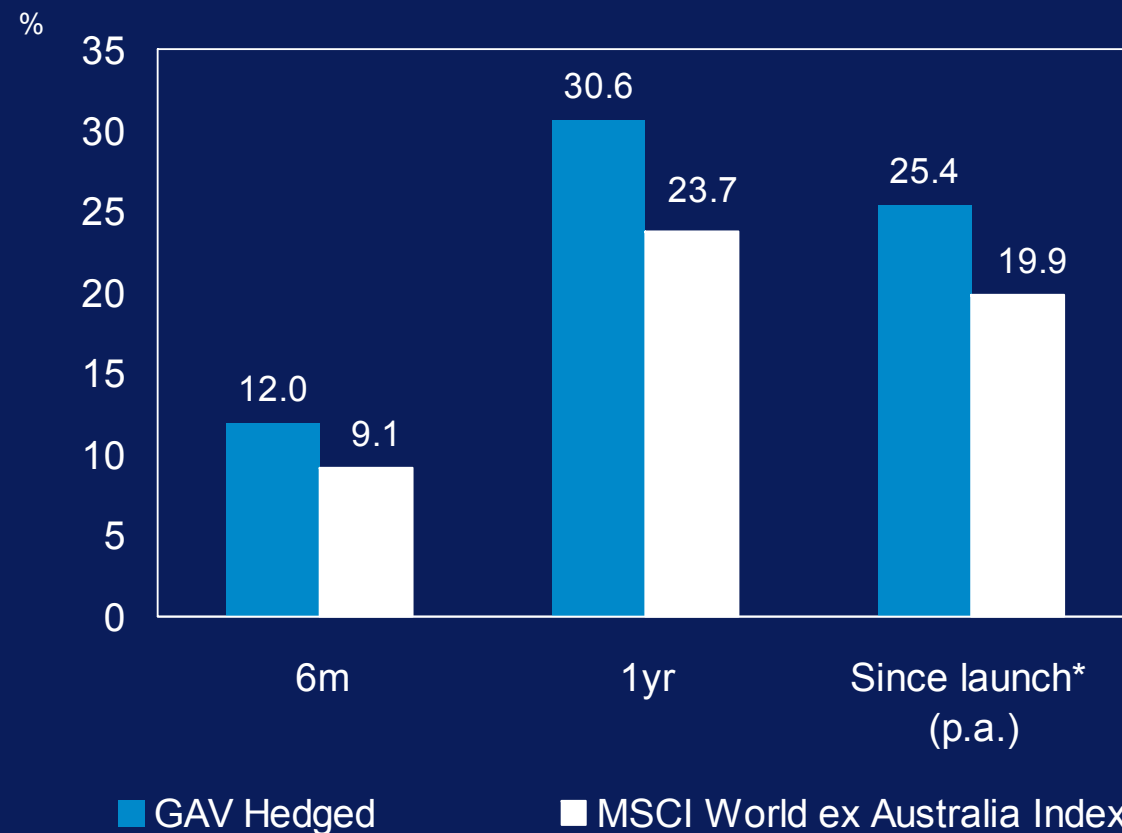
Schroder Global Active Value

Performance:	Long run excess returns of +3-4 % relative to the MSCI World ex-Australia index
Tracking error:	Who cares?
Style:	Global value, all capitalisation, unconstrained
Regional/sector weights:	Unconstrained bottom up
Currency:	Fully hedged or unhedged options

Track record of Global Active Value

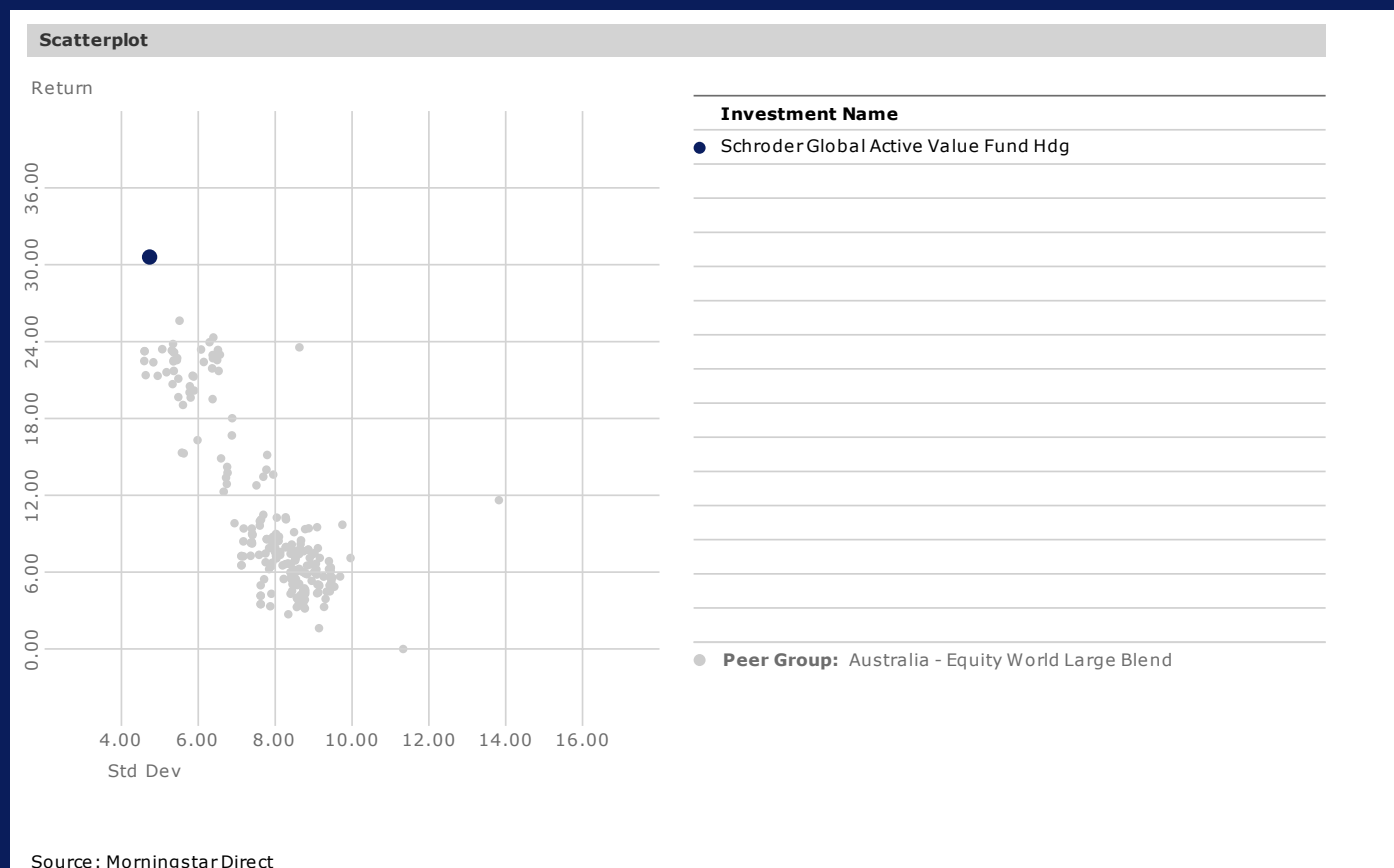
Consistently outperforming MSCI world

Net Performance of GAV vs MSCI World ex Australia Index to 30 Jun 2007



Performance vs other global equity managers

Risk versus return over 12 months to 30 June 2007



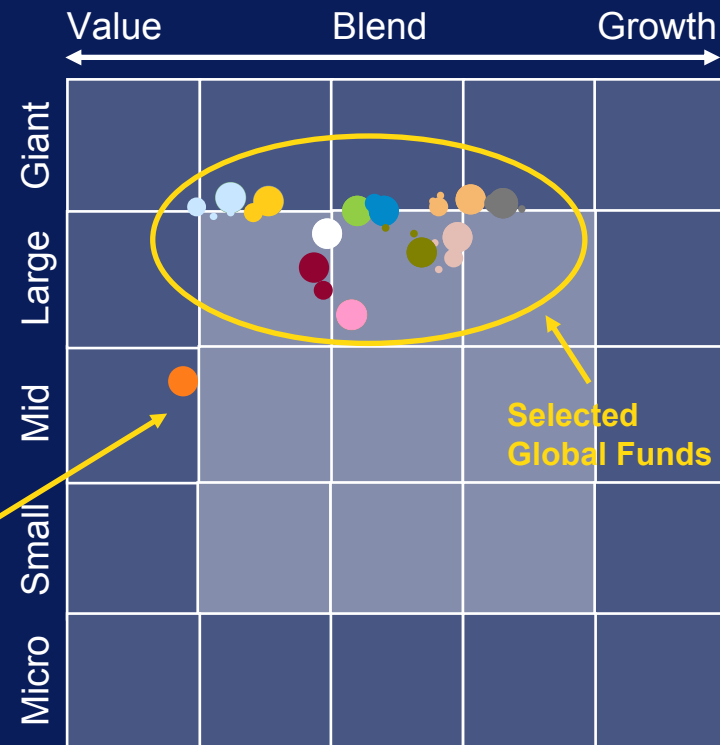
A unique fund

Global quantitative active value offers unique positioning

Global Active Value style analysis versus selected competitors

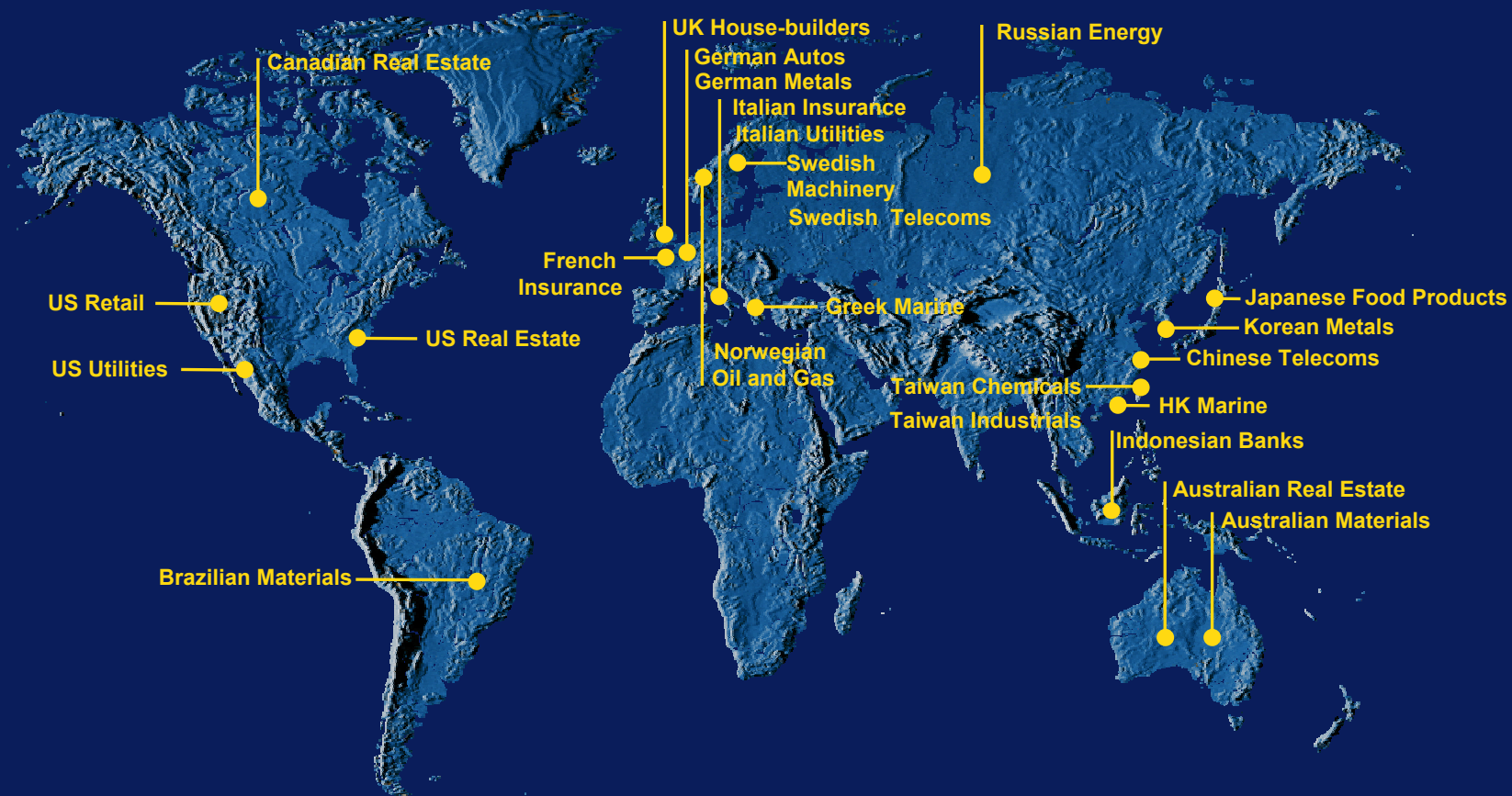
- **Global Quantitative Active Value is all cap and all Value**
- **There are few funds in the same space**
- **The freedom to take advantage of opportunities is unusual**

Global Quantitative Active Value



500+ opportunities

Somewhere in the world a fortune is being made



an example of regional sectors where we made money in 2006

Unconstrained Equities

Weighing it up

	Fundamental Index	Concentrated Unconstrained	Diversified Unconstrained
Avoid disadvantages of market cap benchmarks	✓	✓	✓
Longer investment horizon	✓	✓	✓
Return expectation	Medium	High	High
Impact of stock selection	Low	Very High	Medium
Investment capacity	Higher	Limited	Very High
Bear markets diversification	Marginal	Questionable	Improved
Measurement of performance	Simple	Tricky	Reasonable
Portfolio volatility	Slightly lower	Higher	Slightly lower

Conclusion

Concentration is a means to an end

The objective is to create highly active funds

Diversified unconstrained investing can achieve the same result at potentially lower risk

Schroder Global Active Value

A robust and repeatable process for capturing opportunities from global equity investing

Available from:

- Asgard
- BT Wrap
- Macquarie Wrap
- MLC Masterkey Custom
- Ausmaq
- SMF
- or come direct to Schroders

