

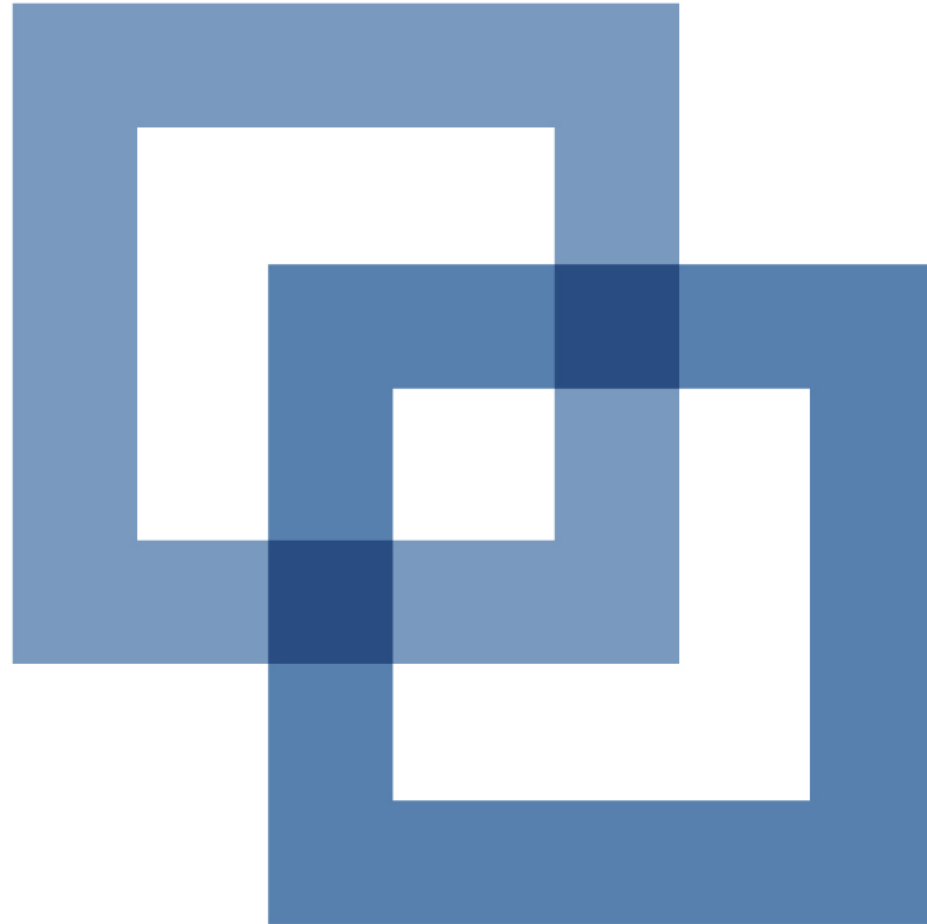


Why Long-Short is the New Long

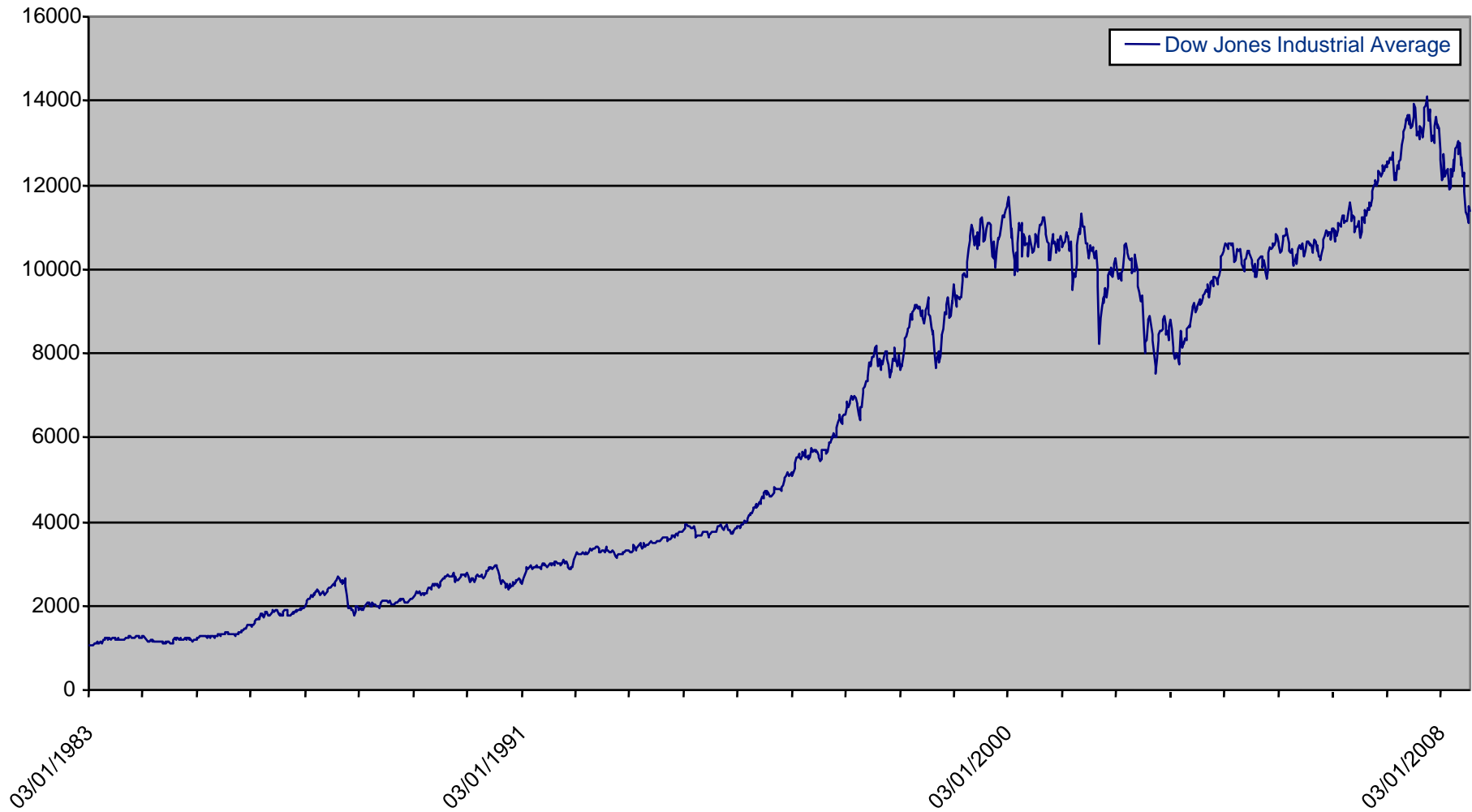
Presentation to PortfolioConstruction Conference 2008

Vasant Khilnani – Senior Portfolio Manager
Paul Sewell – General Manager – Equity Sales

August 2008



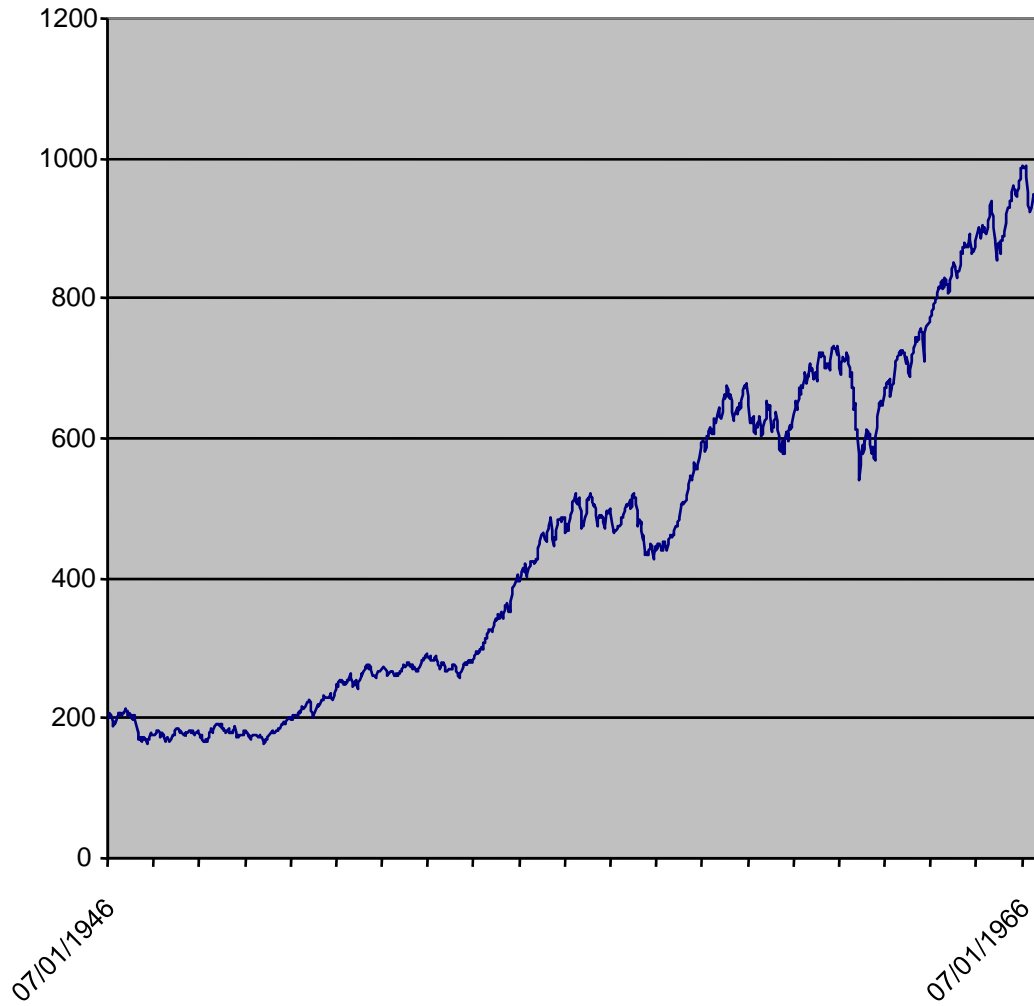
Is this a Normal Market?



Source: IRESS



Or is this a Normal Market?



Source: IRESS



Implications for Investors

- **Need to run portfolio more efficiently**
 - Extract high return for same risk
 - Lower risk for same returns



Clarke, Silva & Thorley

October 2002

$$\text{Alpha} = \text{TE} * \text{IC} * \text{TC} * \text{N}^{.5}$$

Where

Alpha = Excess Return Desired by the investor

TE = Tracking error or risk in the portfolio

IC = Managers skill. It is his/her ability to forecast returns for individual stocks

TC = Transfer coefficient of the portfolio

N = Market breadth or number of independent bets in the portfolio



Ingredients for Alpha

$$\text{Alpha} = \text{TE} * \text{IC} * \text{TC} * \text{N}^{.5}$$

- An increase in the left hand side of the equation (Alpha), can be achieved by increasing any of the terms on the right hand side.
- In absence of any portfolio constraints, $\text{TC} = 100$



How inefficient is the long only constraint?

Clarke, De Silva, Saprà - 2004

	Constraints Removed					
	All	Industry	Sector	Position	Market	Long
	Constraints			Limit	Cap	Only
Transfer Coefficient (TC)	0.332	0.347	0.346	0.298	0.471	0.678
% Change in TC		8%	8%	-7%	46%	108%



Australian Context

Up Month
September
2007

Down Month
January
2008

- Tracking error 3% was chosen as it is typical of an active manager in Australia
- Max number of stocks 100
- Position limits: starting at $\pm 5\%$ for the rank 1 stock and then linearly reducing to $\pm 0.5\%$
- Universe: ASX 300
- Transaction costs were ignored



What is Implied Alpha?

- Not explicitly supplied by the portfolio manager
- Implied by the manager's portfolio



An Implementation Case Study

- Can an existing Long-only process benefit from Long-Short strategy?
 - Super imposed short positions – Long Investment process untouched
 - Implied alphas used
 - Done 6 years ago



Back Test Methodology

- Long positions same as ASF
- Monthly Rebalance
- Use of Implied Alphas for short positions

→ Share Plus = 120% ASF + 20% Short Positions



Back testing of Long only Vs Long-Short Portfolio

August 1997 - August 2002

	Long Only	Long Short	Change
Benchmark return p.a.	7.41%	7.41%	
Portfolio Return p.a.	12.05%	17.55%	
Active Return p.a.	4.64%	10.14%	
Active Risk (TE)	4.29%	6.17%	
Information Ratio (IR)	1.08	1.64	51.90%
Absolute Risk (Risk of losing money or beta risk)	12.13%	12.26%	1.07%



Some implementation considerations for Short Selling strategies

- **Risks**

- Risks in the short position are skewed

- **Stock Availability for short selling**

- In Australia, most if not all short positions are implemented by borrowing stock from a prime broker

- **Franking credits**

- Domestic Vs Overseas Lenders



Conclusion

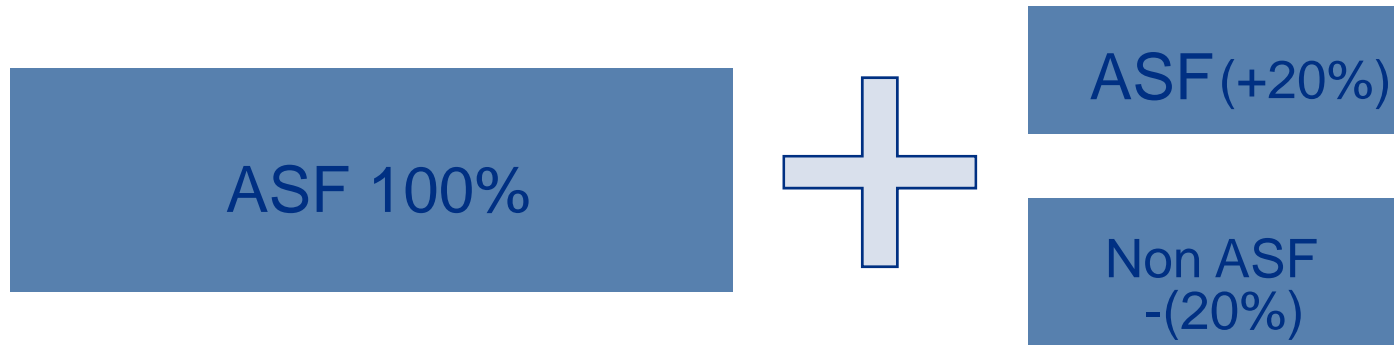
- Not running a portfolio at its maximum possible efficiency is like driving a six speed car in second gear.
- The short positions are inherently more risky than long positions but the risk can be managed.
- Even a modest amount of short selling can have dramatic impact on the portfolio efficiency.



Questions and Answers



The Plus in SHARE-PLUS



SHARE-PLUS Performance

June 2003 to June 2008

	ASF	Share-Plus	Benchmark	Excess
12 Months to June '04	24.77%	25.79%	21.75%	+4.04%
12 Months to June '05	27.63%	25.20%	26.04%	-0.84%
12 Months to June '06	25.77%	24.91%	24.01%	+0.90%
12 Months to June '07	24.28%	22.68%	29.20%	-6.52%
12 Months to June '08	-9.62%	-4.89%	-13.67%	+8.78%



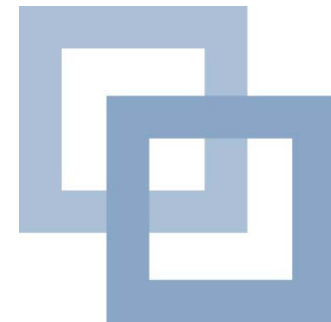
Key messages

- Not hedge fund – core equity product
- Leverages off our stock picking skills
- Risks similar to traditional equity products



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-Let's start thinking about...

-This session was:

-1. awful

-2. mediocre

-3. good

- 4. excellent

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