

Strategic tilting: Guidelines for use in portfolios

August 2009

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Keynesian wisdom

- **“The market can stay irrational for longer than you can stay solvent”**
- **“It is better to be roughly right than precisely wrong”**
- **“Successful investing is about anticipating the anticipations of others”**

Strategic tilting – the what

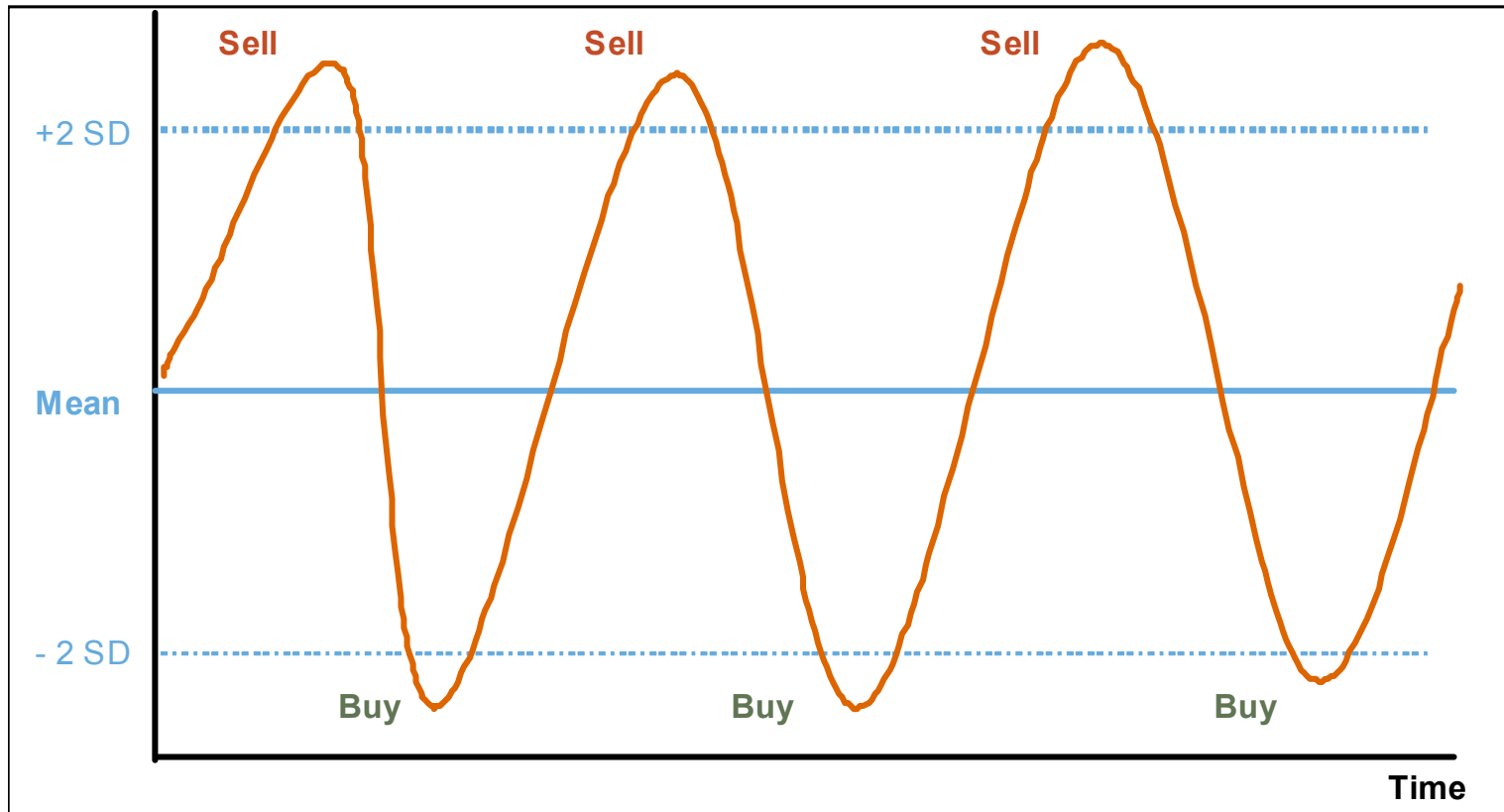
- **Asset markets sometimes at extremes of pessimism or optimism**
- **How to take advantage of this**
- **‘Set and forget’ SAA**
 - **a straight-jacket or**
 - **a necessary discipline**

Different to tactical asset allocation (TAA)

- **TAA**
 - Frequent medium and low conviction positions
 - Bias is to take positions
- **Strategic tilting**
 - High conviction positions
 - Bias is to stay at your strategic asset allocation (SAA)

If only it was this simple

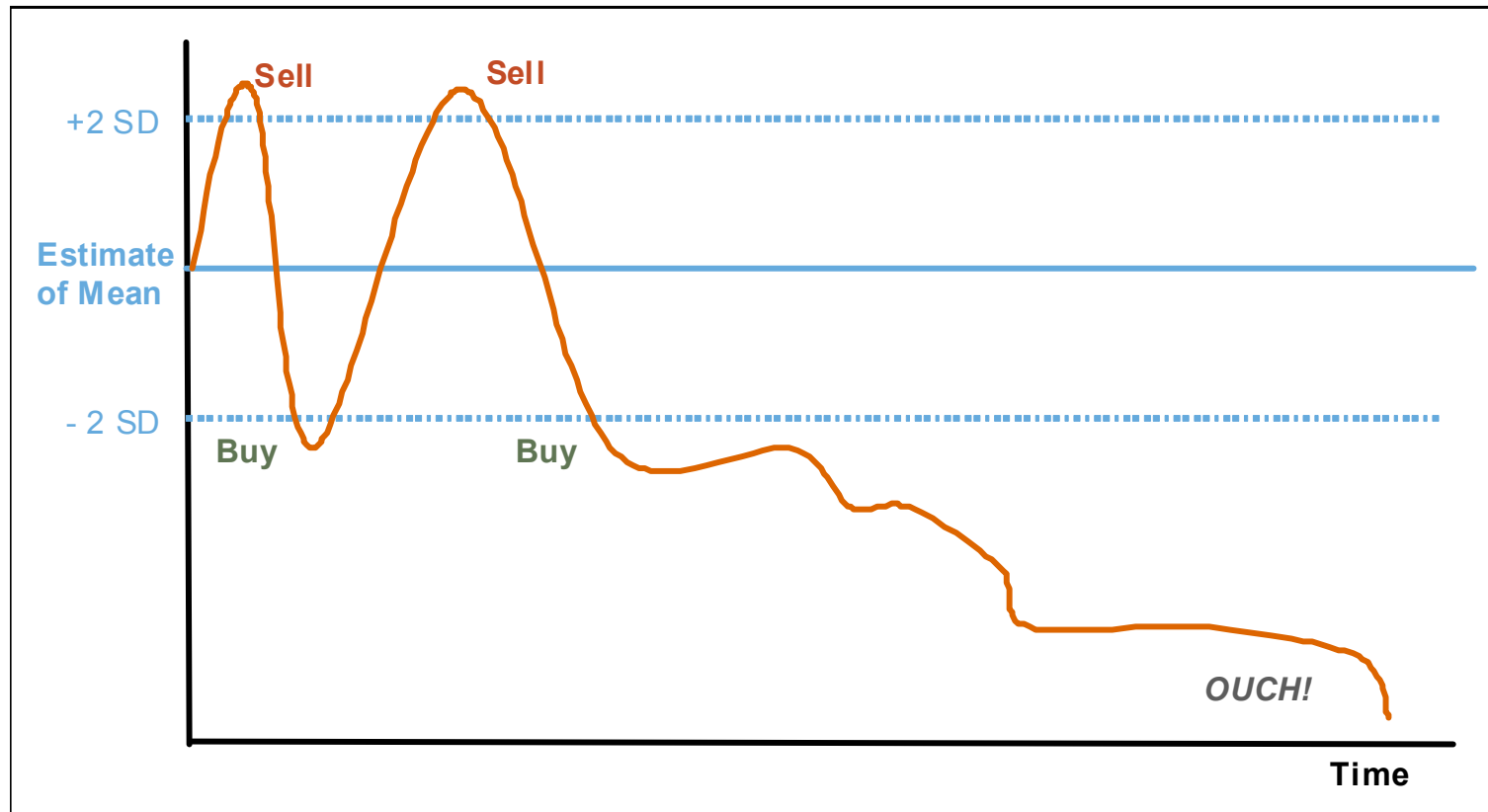
How Mean Reversion is Supposed to Work



Source: Russell

But reality can be this

Getting the Mean Wrong



Source: Russell

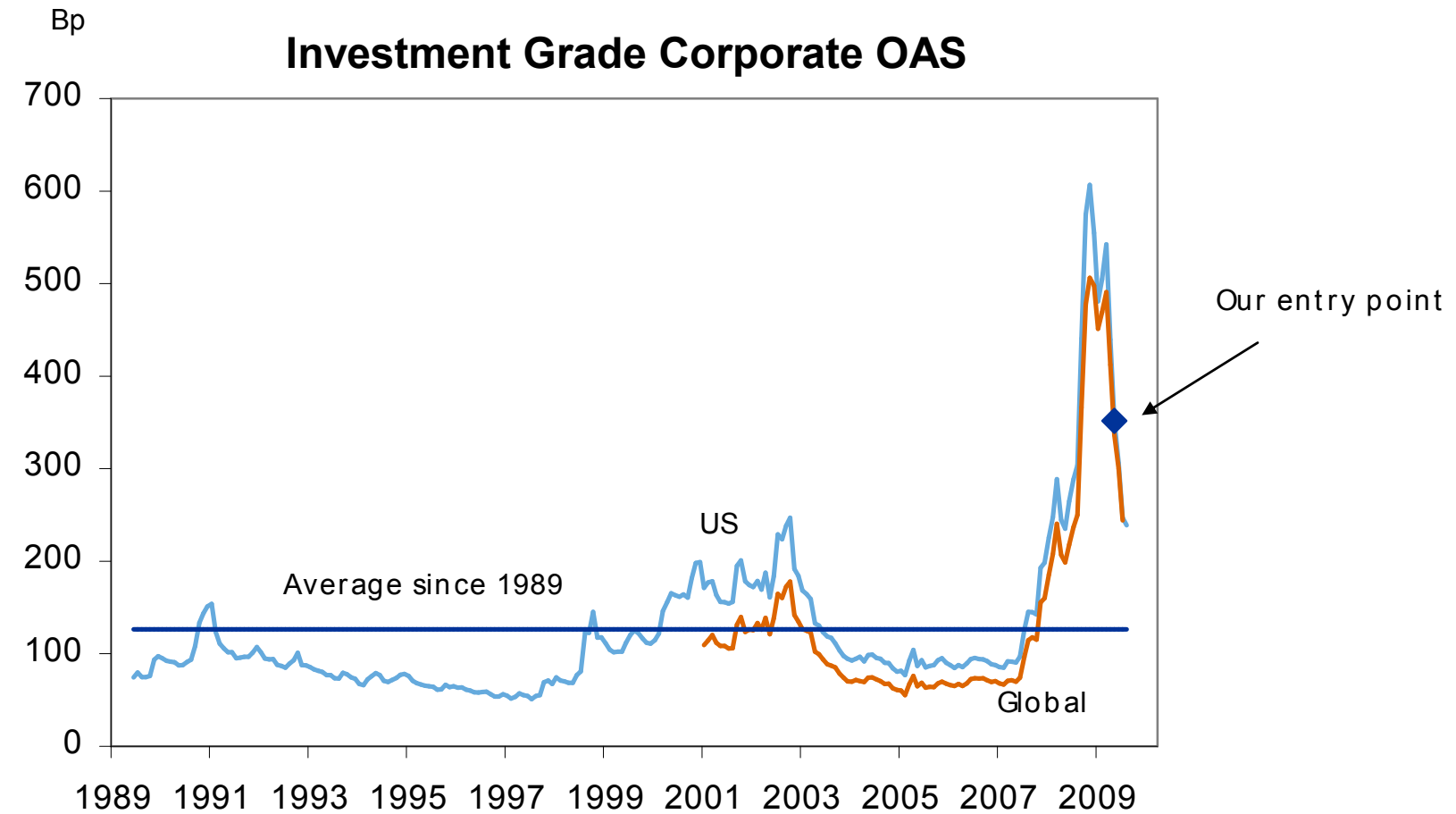
Strategic tilting - Can you?

- **Avoid forecasts**
 - **Imply spurious science and accuracy**
 - **Stop listening when someone says “my model predicts...”**
- **Ignore market gurus**
 - **Become trapped by a view**
 - **High profile experts want to be heard (right & boring versus wrong & interesting)**
- **Be pragmatic & disciplined**
 - **Respect the market**
 - **Have a disciplined process**

Strategic Tilting – The Approach

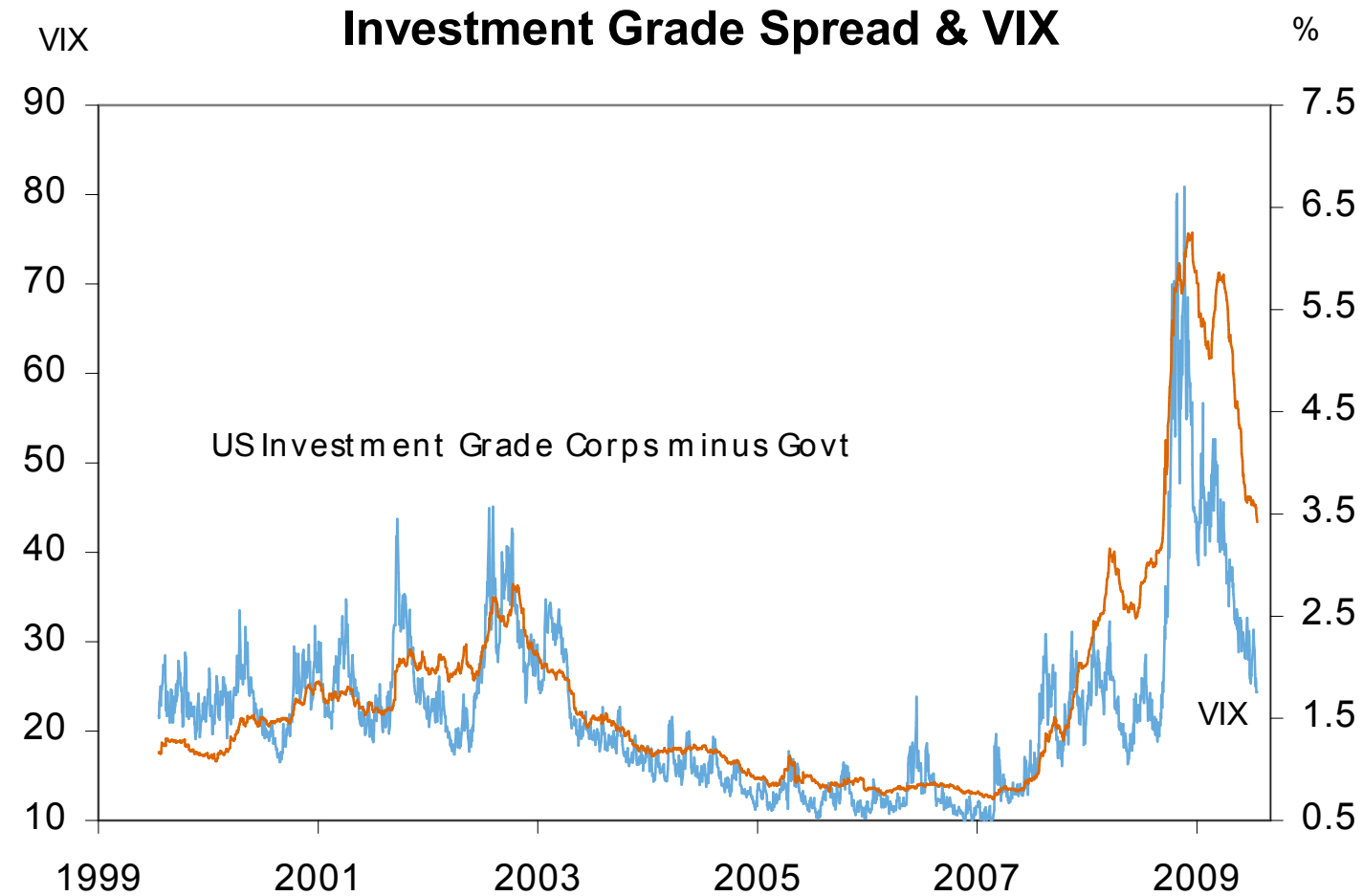
- **Two stage process**
- **Stage one: Asset class at an unsustainable extreme**
- **Stage two: Conditions in place for a return to normal**
 - **Macro indicators**
 - **Stance of monetary & fiscal policy**
 - **Investor sentiment**
 - **Supply/demand balance**

Example: investment grade credit



Source: Barclays

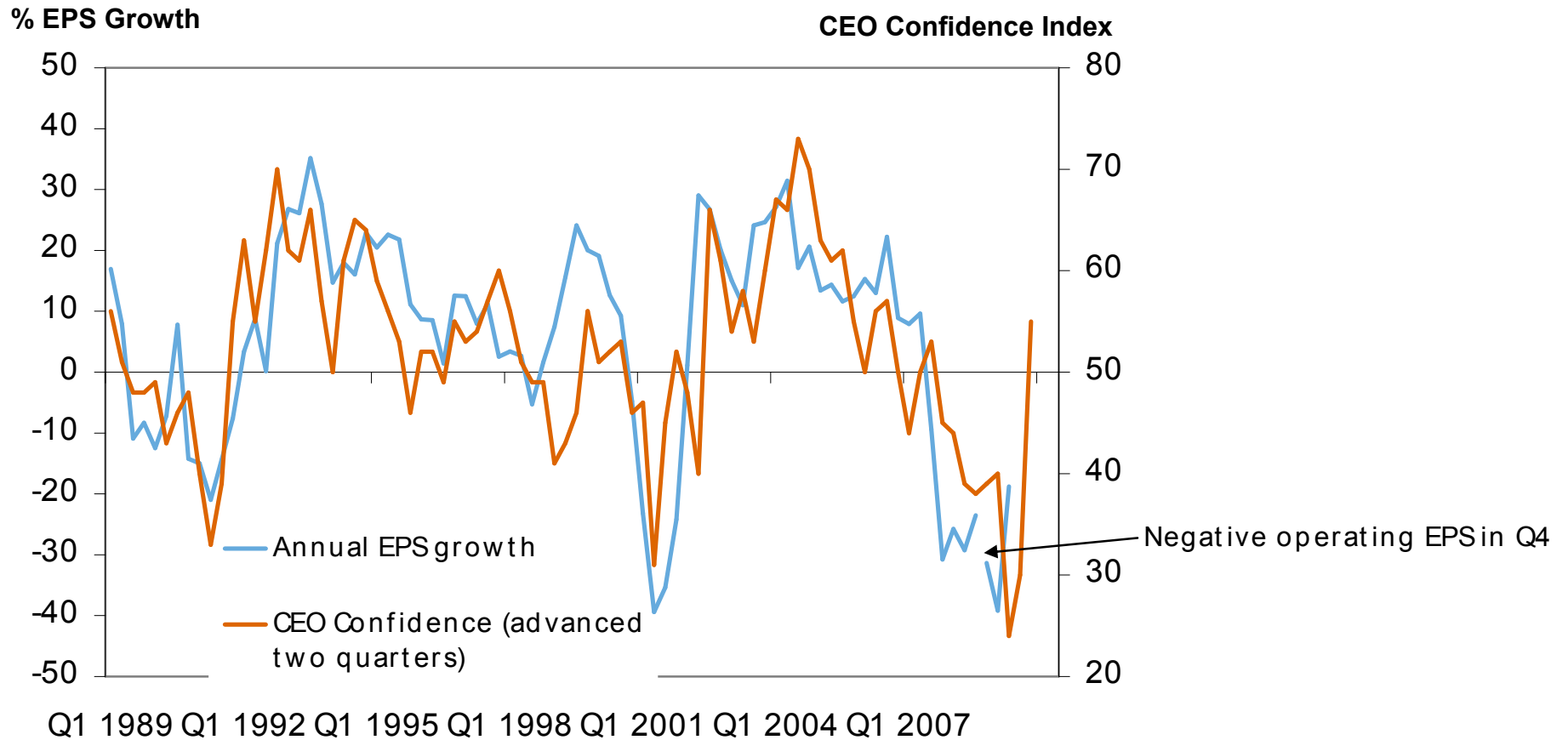
VIX is trending lower



Source: Barclays, Datastream

CEO Confidence Signals EPS Recovery

CEO Confidence & S&P500 Operating EPS



Source: Standard & Poor's, The Conference Board

Current Strategic Tilting Views

- **Credit tilt underway – upgraded from low in June to medium in July**
- **Equities versus bonds – good long-term value, not at valuation extreme**
- **No strong valuation gap between Aust and global equities**
- **A-REITs cheap – but are they too concentrated?**
- **Global REITs cheap but so are global equities**
- **A\$ expensive, but not at valuation extreme**

Operating principles

1. First, do no harm

Bias is to do nothing.

Avoid false positives.

2. Process matters more than signals

More sophisticated models do not add value.

Focus on the decision making process.

3. Attribution is essential

Know why a decision was made.

4. A clear exit strategy

Enter a trade with exit strategy in place. Markers need to be set.

Strategic Tilting – should you?

- **You need the following:**
 - Capacity for longer-term view
 - Committed to strategic tilting as a concept
 - Continuity of decision making
 - Ability to be dispassionate in reviewing decisions
 - Proper governance in place

- **Can you cope with underperformance?**

- **Can your employer cope?**

- **Can your client cope?**

Conclusion

- **What? – High conviction, market extremes, occasional**
- **How? – Discipline & process**
- **Should? – not for everyone**

Ye shall know the truth, and the truth shall make you mad.

Aldous Huxley

It is one thing to praise discipline, and another to submit to it.

Miguel de Cervantes

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