



Asset Allocation
Investing in the new reality...



CONFERENCE

Agenda

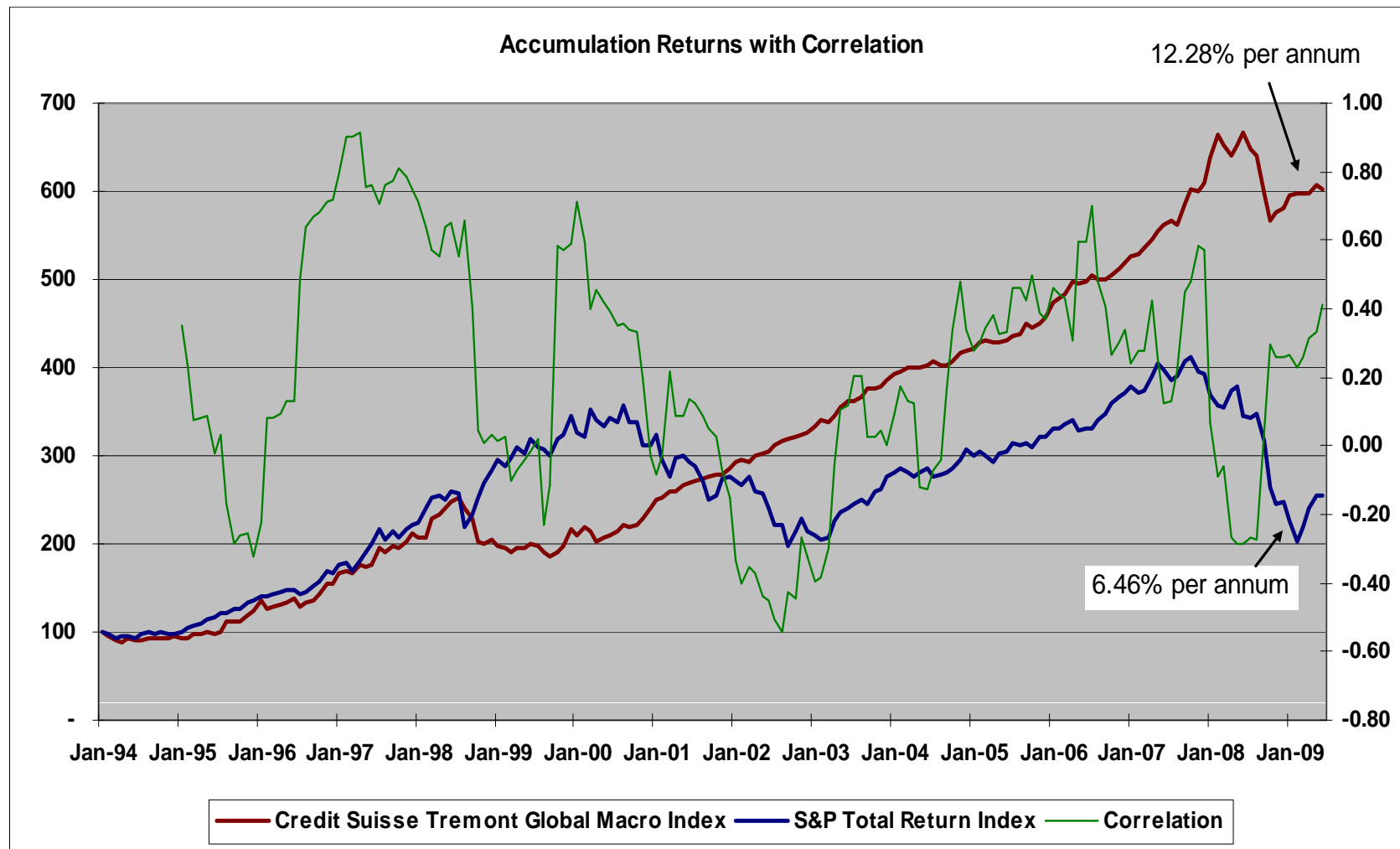
- ❑ Lessons to be learnt in asset allocation
- ❑ BlackRock's Asset Allocation Alpha Fund
- ❑ Investment outlook

Lessons Learnt in Asset Allocation

1. The traditional equity bond call is too hard

- Build a diversified portfolio of investment thematic

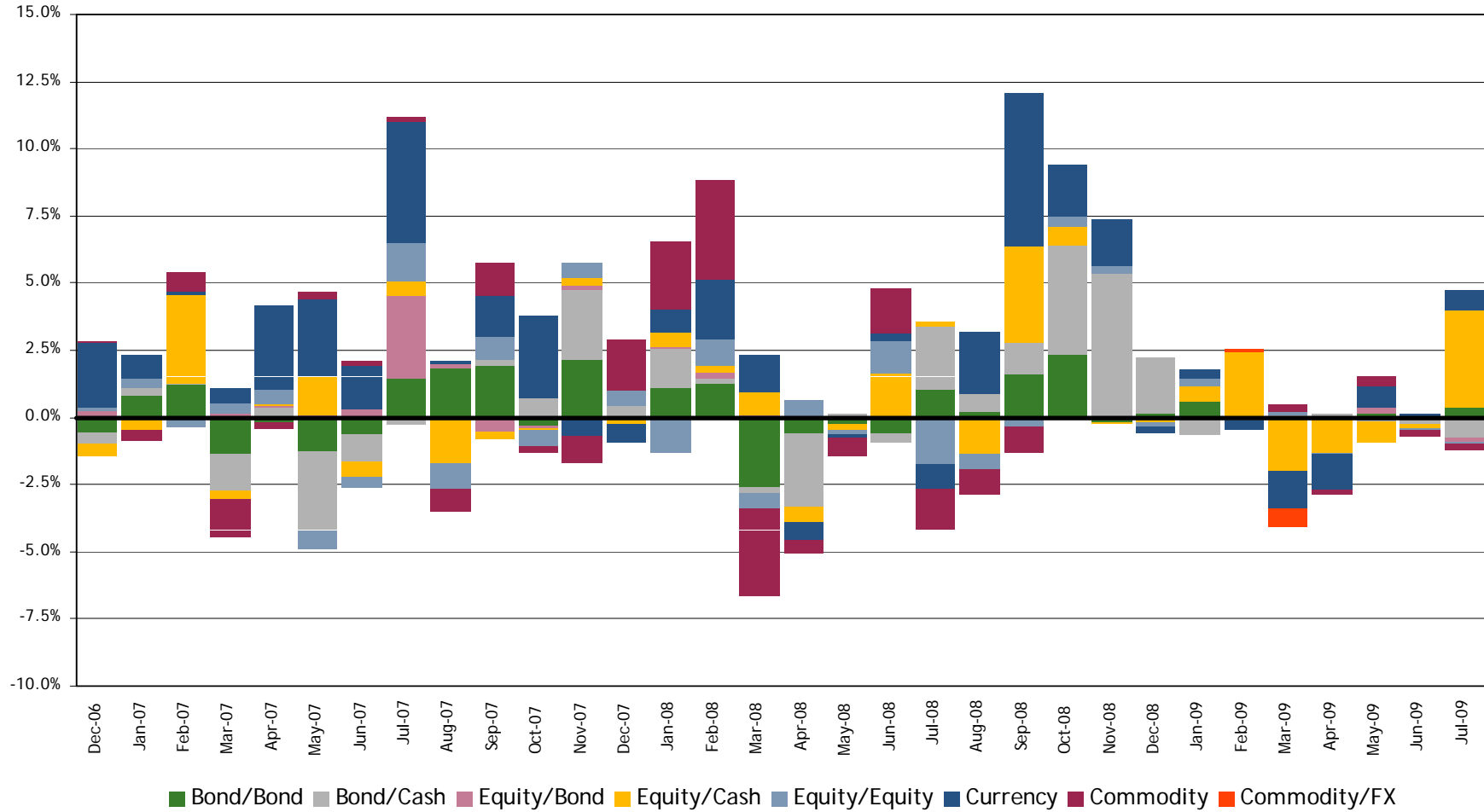
Global Macro Relative Performance Versus Equities



Source: Bloomberg

Asset Allocation Alpha Fund - Risk Book Attribution

AAA Performance Attribution



Source: BlackRock.

Gross Returns per strategy. Past performance is not necessarily a guide to future performance.

Lessons Learnt in Asset Allocation

1. The traditional equity bond call is too hard
 - Build a diversified portfolio of investment thematic
2. Don't be a victim of fat tails

Lessons Learnt - Fat Tails

Who would have thought?

Last 18 months

- Oil rises 9-fold from 2001 lows to \$147, falls to \$30 and then more than doubles again to \$73
- Credit spreads out to Great Depression levels
- \$A from 98 cents to 60 cents then back to 83 cents

9 years ago

- Tech crash starts -- Nasdaq eventually falls almost 80% from peak to trough

11 Years ago

- Asian crisis

22 years ago

- Stockmarket crash

Fat Tails - Portfolio Construction Implications

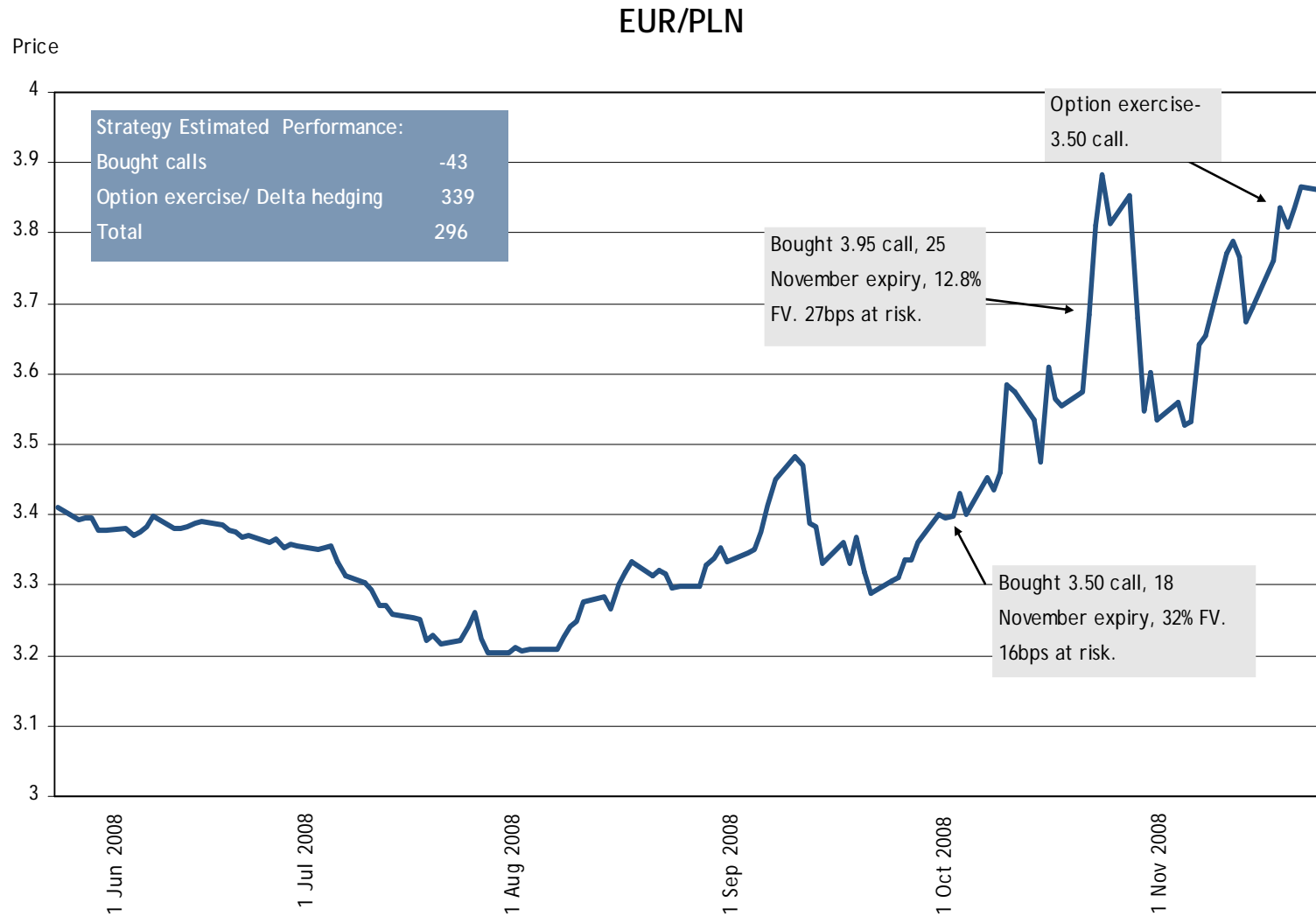
- ❑ Diversify risk away from equity bond call

- ❑ Build a portfolio at the intersection of investment views and good risk reward strategies
 - Strongest investment views can be allocated no risk if risk reward opportunity does not exist

 - Low to medium conviction views can be allocated risk if the risk reward stacks up

- ❑ Express views through bought options when volatility is cheap relative to prospective volatility

Trade Example: EUR/PLN - Medium conviction, very attractive risk reward

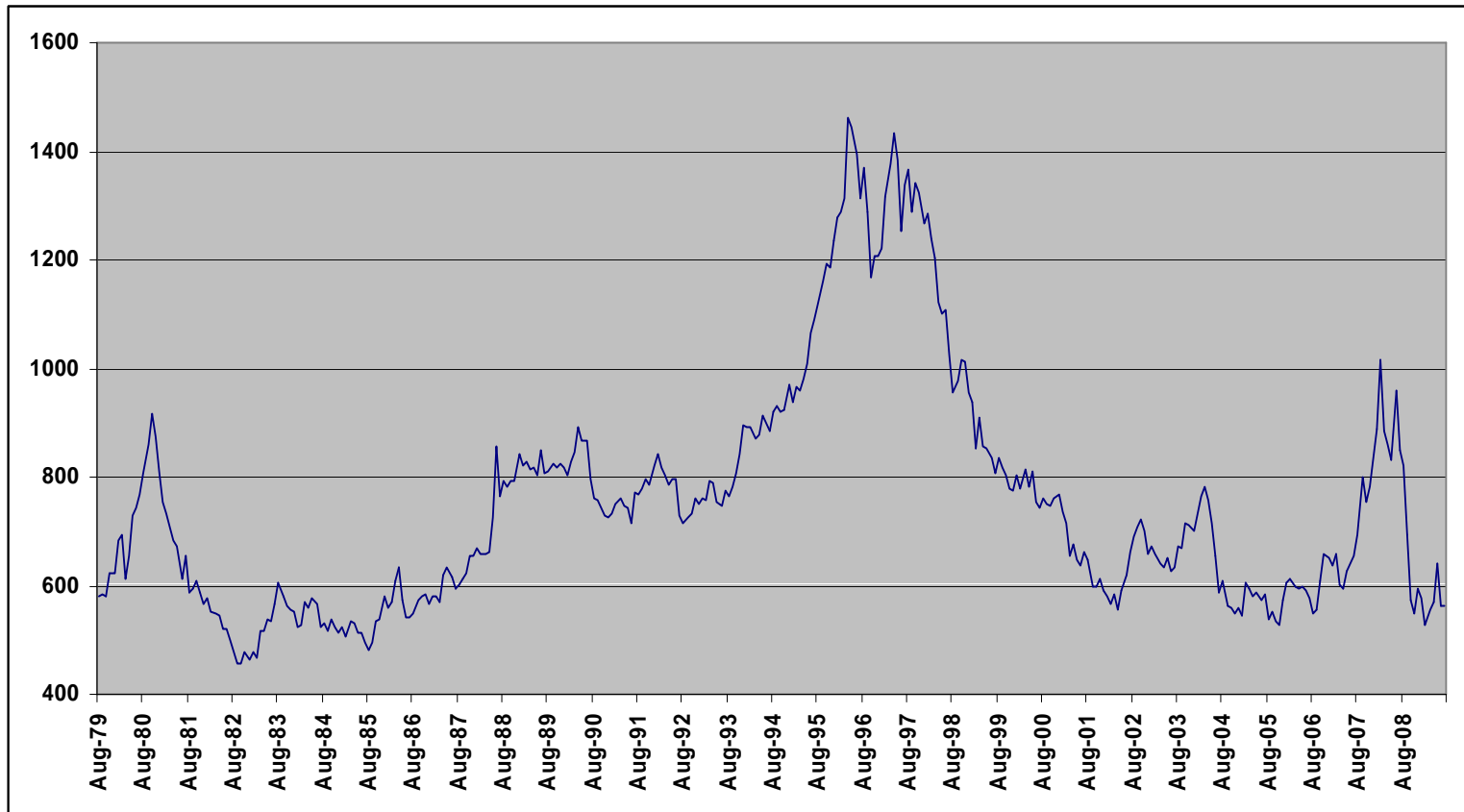


Source: BlackRock

Fat Tails - Risk Management Implications

- ❑ Investment universe restricted to liquid securities
- ❑ Strong investment views (including mean reversion trades) can be very dangerous without risk control
- ❑ Stop losses make sense
- ❑ Maintain participation while taking profits on winning strategies
- ❑ Technical analysis can add value

S&P GSCI Agriculture Total Return Index



Source: Bloomberg

Fat Tails - Risk Management Implications

- ❑ VaR measures can be very misleading during a crisis
- ❑ At all times, monitor downside risk in basis points if all positions hit stop losses or options expire worthless
- ❑ Daily P/L best guide to risk - particularly during a crisis
 - Reduce risk when P/L says correlations have increased and negatively affecting performance

Lessons Learnt in Asset Allocation

1. The traditional equity bond call is too hard

- Build a diversified portfolio of investment thematic

2. Don't be a victim of fat tails

- Stay liquid
- Stop losses make sense
- Lock in profits while maintaining participation when you are right
- Technicals can be an important input

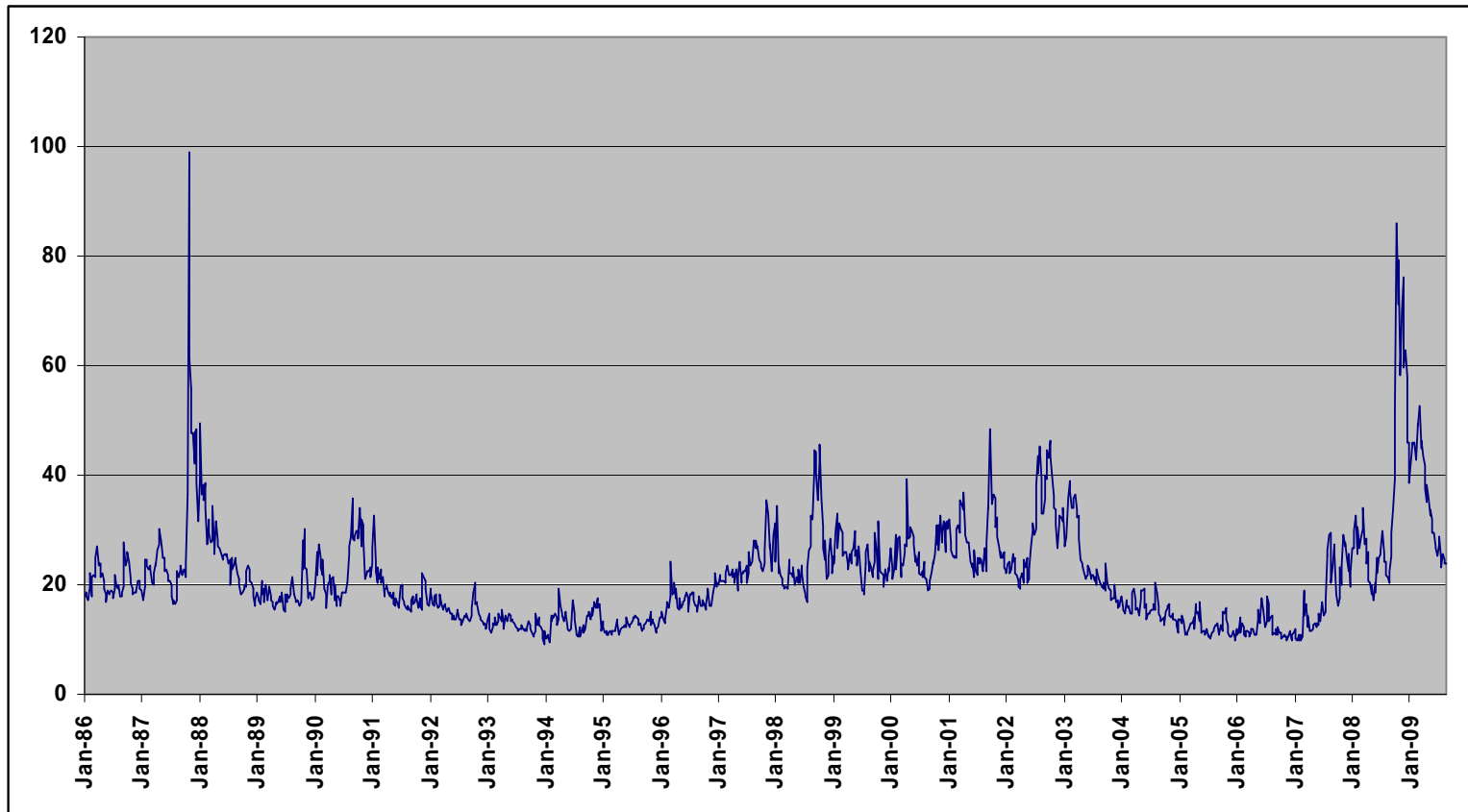
Lessons Learnt in Asset Allocation

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 - Build a diversified portfolio of investment thematic
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3. Try to build a right hand skew in the return profile

Right hand skew in returns

- ❑ Momentum matters
- ❑ Mean reversion is important, but an *a priori* exit strategy is crucial
- ❑ Judicious use of bought options improves the skew of the return profile
- ❑ As much as possible, maintain risk when portfolio is performing well, take it off when it is not

S&P Volatility Index



Source: Bloomberg

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 - Technicals can be an important input
3. Try to build a right hand skew in the return profile
 - Increase importance of market momentum in portfolio construction
 - Mean reversion strategies need an exit strategy
 - Be long volatility where ever possible
 - Keep risk on when portfolio is performing well, take it off when it is not

Three Additional Points

- ❑ Try not to be a market commentator or become heavily identified with one view
- ❑ Without recommending over-trading, trading more often **with skill** increases the information ratio (as well as confidence in significance of any positive information ratio)
- ❑ Run a process whereby you are running very low risk when you are getting it wrong and under-performing and medium to high risk when you are getting it right

Lessons Learnt in Asset Allocation

1. The traditional equity bond call is too hard

- Build a diversified portfolio of investment themes

2. Don't be a victim of fat tails

- Stay liquid
- Stop losses make sense
- Lock in profits while maintaining participation when you are right
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3. Try to build a right hand skew in the return profile

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Investment Philosophy - The BlackRock Asset Allocation Alpha Fund

- ❑ Invest in liquid derivatives - liquidity is under-priced in asset markets
- ❑ Wait for momentum to turn - 'black swans' make fighting market momentum a poor investment proposition
- ❑ Invest in 'vanilla' derivatives - complex derivatives underwrite investment bank profits and undermine returns
- ❑ Create a diversified portfolio of asset allocation views, rather than excessive reliance on one theme
- ❑ Constantly monitor the risk reward trade-off to lock-in profits, while maintaining participation in winning positions and cut risk on losing positions

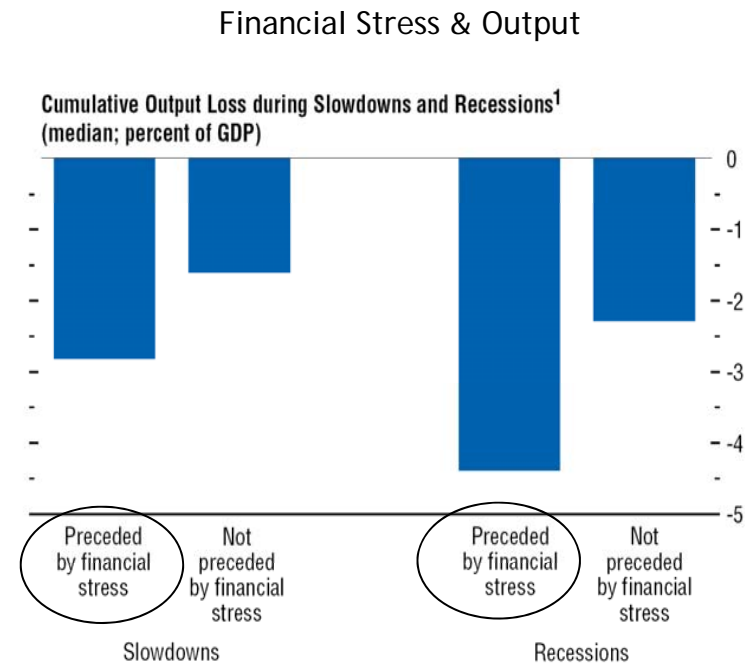
Investment Style: Discretionary asset allocation fund aligning market momentum with BlackRock's investment views.



Investment Outlook

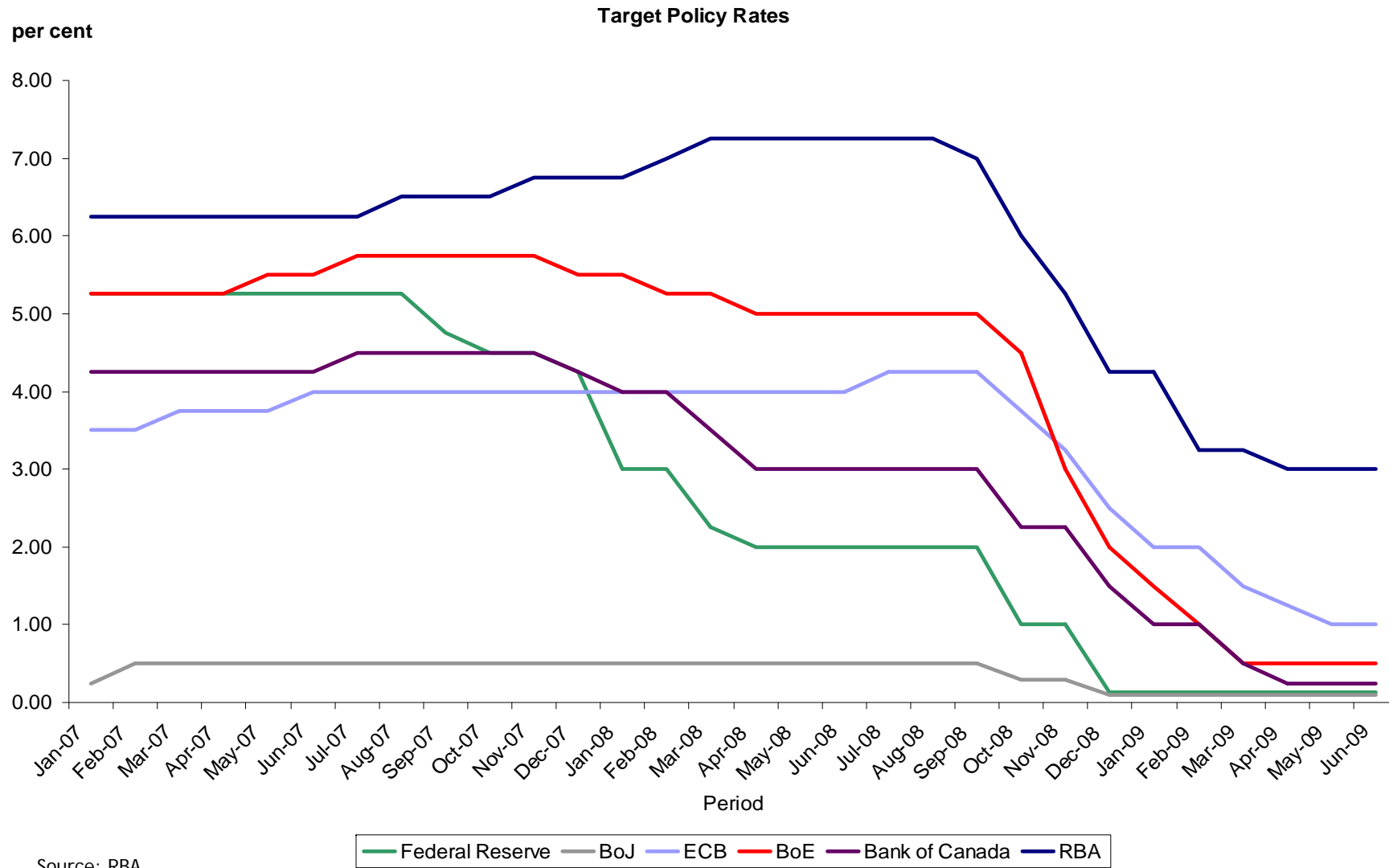
Global Growth: steep descent, what kind of recovery?

- ❑ Near term inventory rebuild, stimulus biting
 - Sharp recessions lead to sharp short term recoveries
- ❑ Financially-driven recessions (chart)
 - Research shows they are longer and deeper than most
- ❑ Structural vs cyclical experience
 - Cyclical in Asia but structural problems in the US may hinder medium term growth



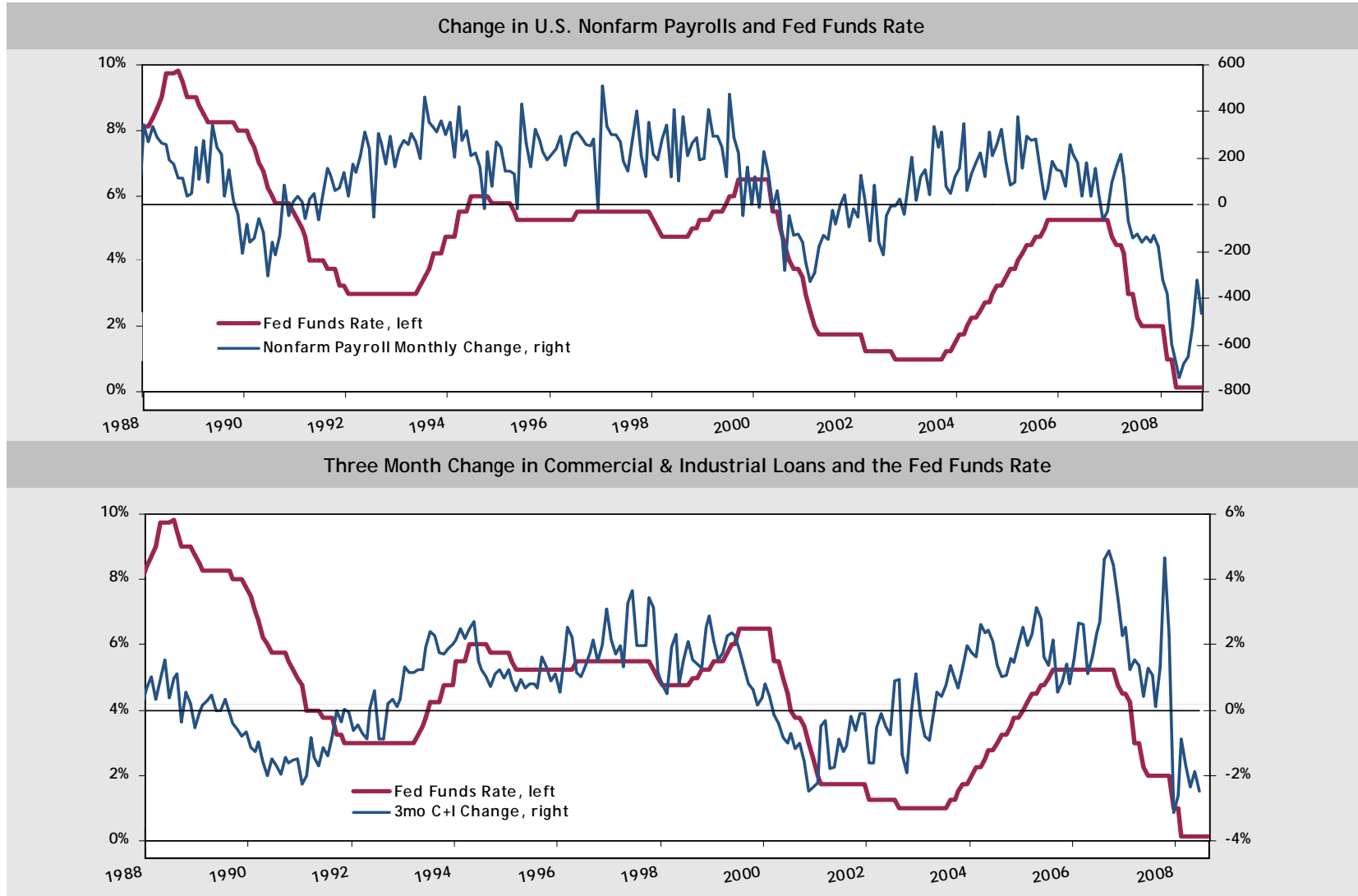
Source: IMF

Massive Policy Response



Source: RBA

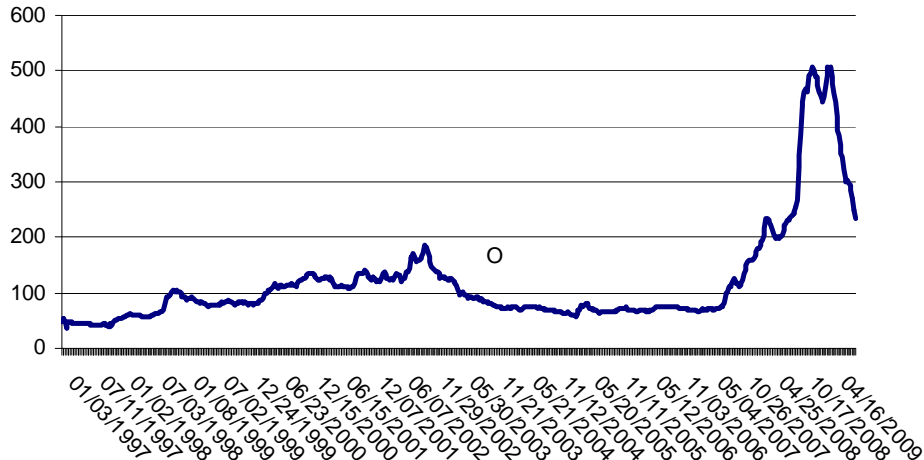
Pre-conditions for a tightening a long way off yet



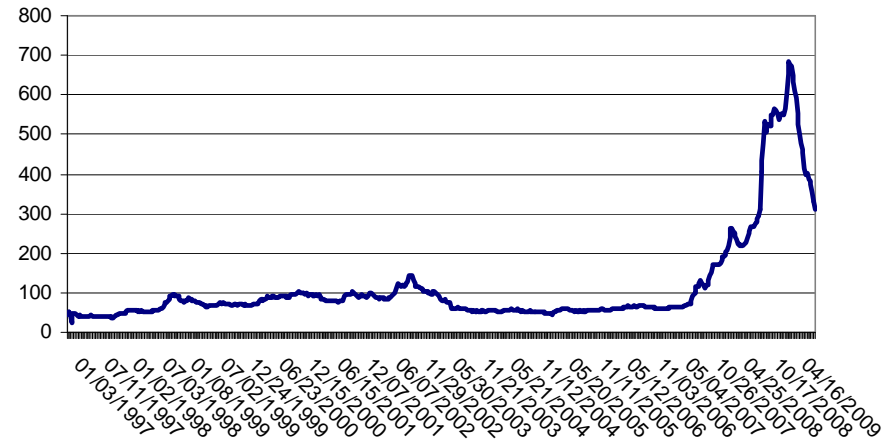
Source: Credit Suisse, BlackRock

Is the worst behind us?

- ❑ The liquidity crisis in banks is mostly over and structured asset write-downs are no longer the biggest worry
- ❑ Government intervention worldwide has helped stabilize the banking sector and facilitated recapitalisation
- ❑ The key concern going forward for banks is asset quality and exposure to macro-economic factors. Tackling this may bring losses forward during FY09, triggering a need for more capital



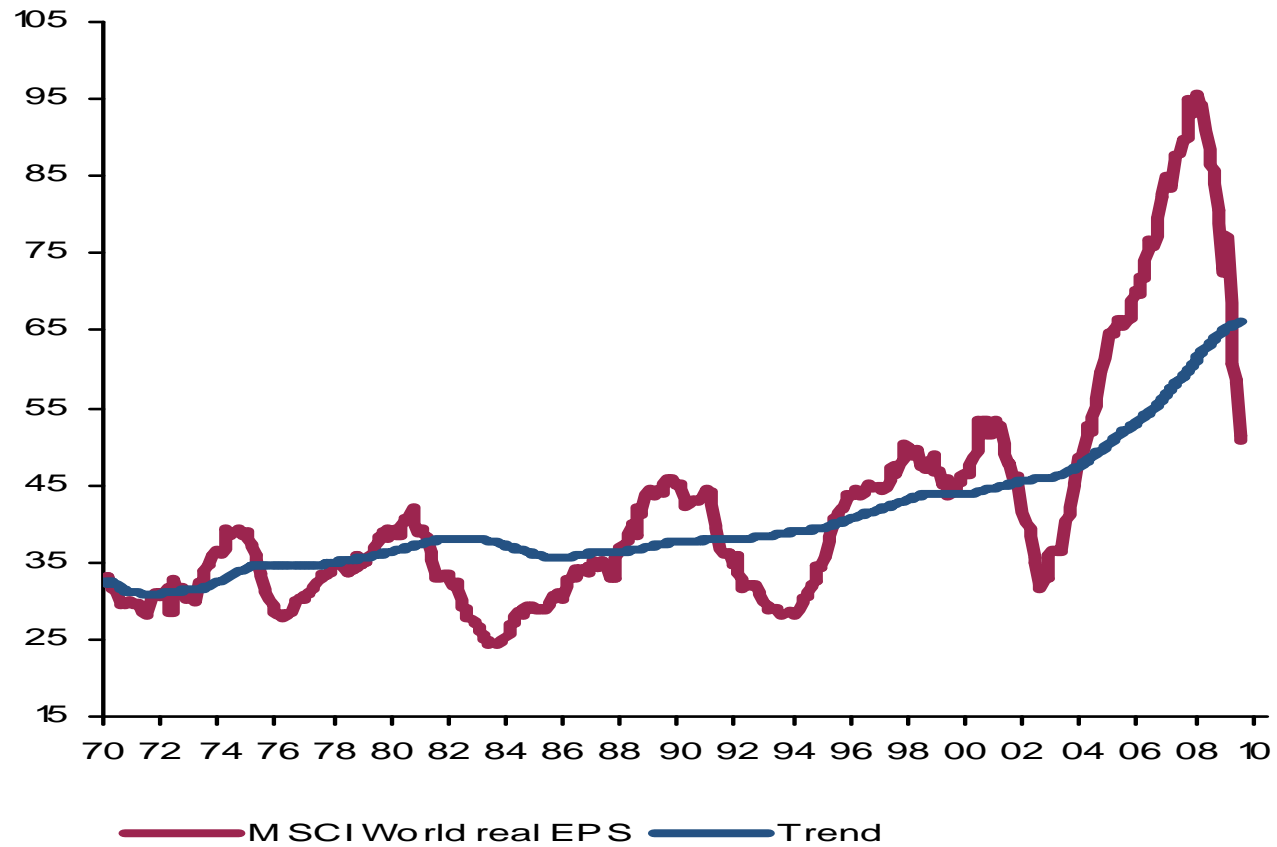
Global Broad Market Financial Index OAS



Source: Bloomberg

Earnings Relative to Trend

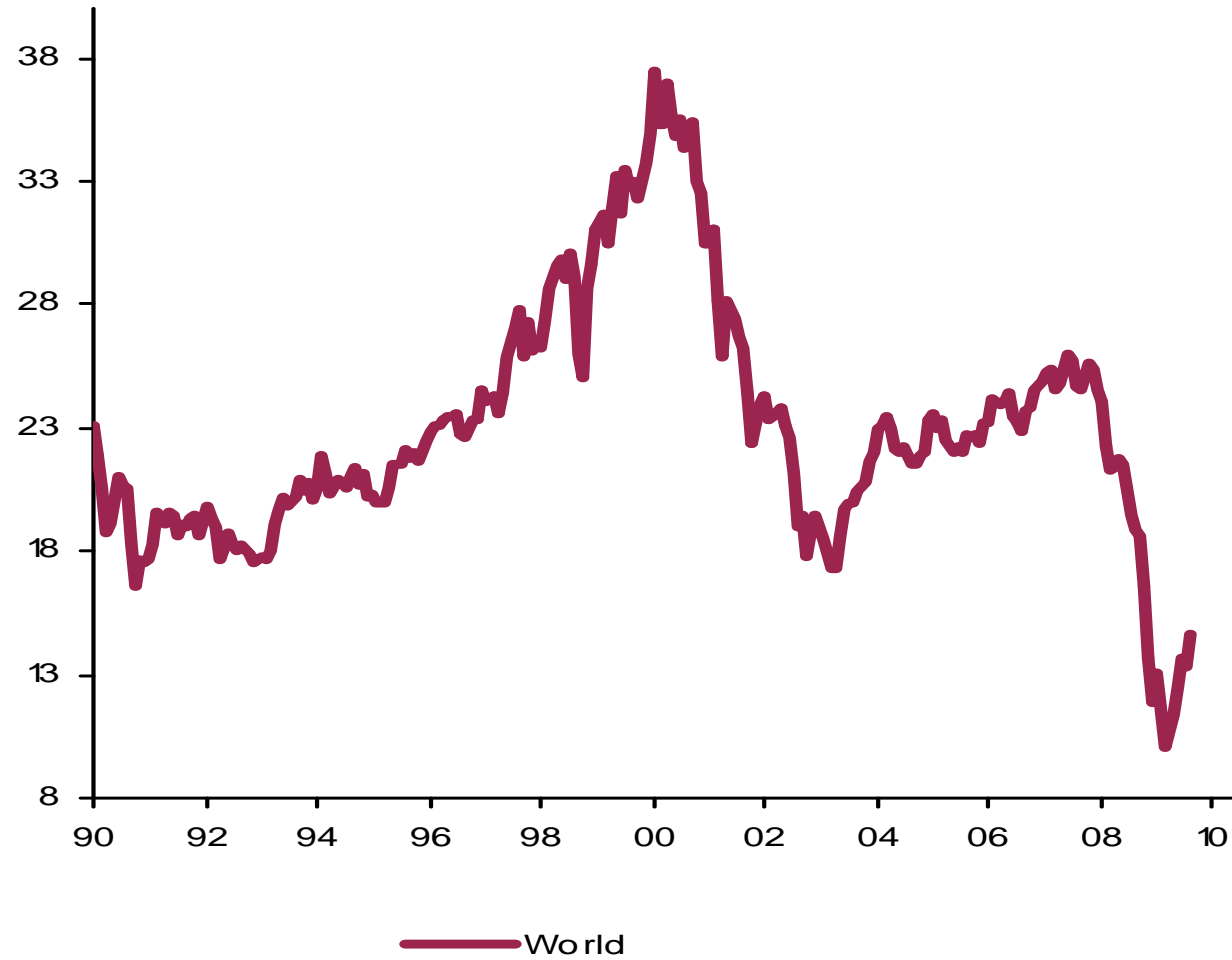
Real EPS (US\$)



Source: Thomson Datastream, BlackRock

Equity Valuations

MSCI
Normalised PE



Source: Thomson Datastream, BlackRock

Additional Information

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