



building
shock resistant
portfolios

Portfolio Construction Forum

Investors want real returns, not relative ones!

25 August 2010

Representing Schroders:

Simon Doyle – Head of Fixed Income & Multi Asset



Schroders

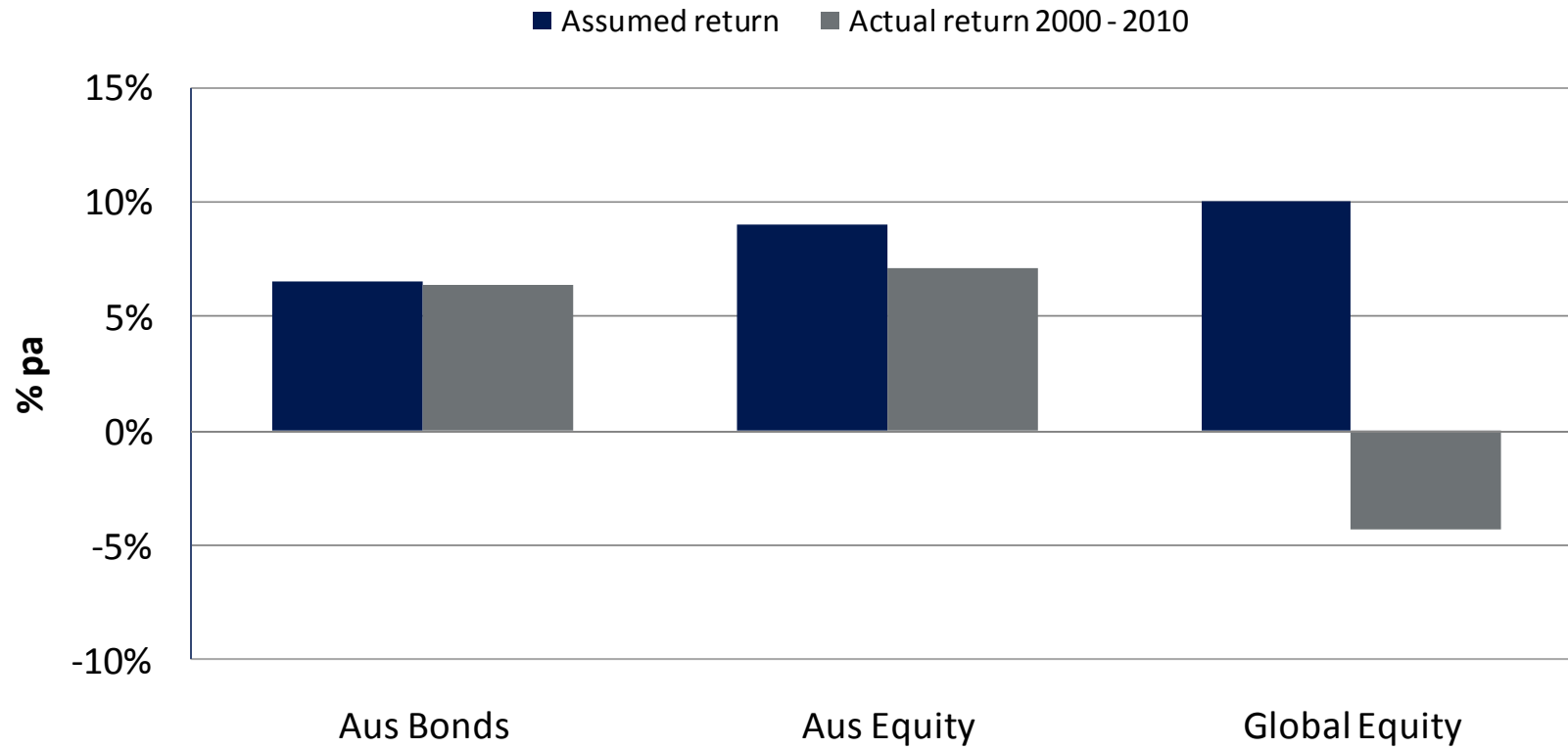
“Most of the things we do, we do for not better reason than our fathers have done them or that our neighbours do them ...”

Oliver Wendell Holmes, Jr

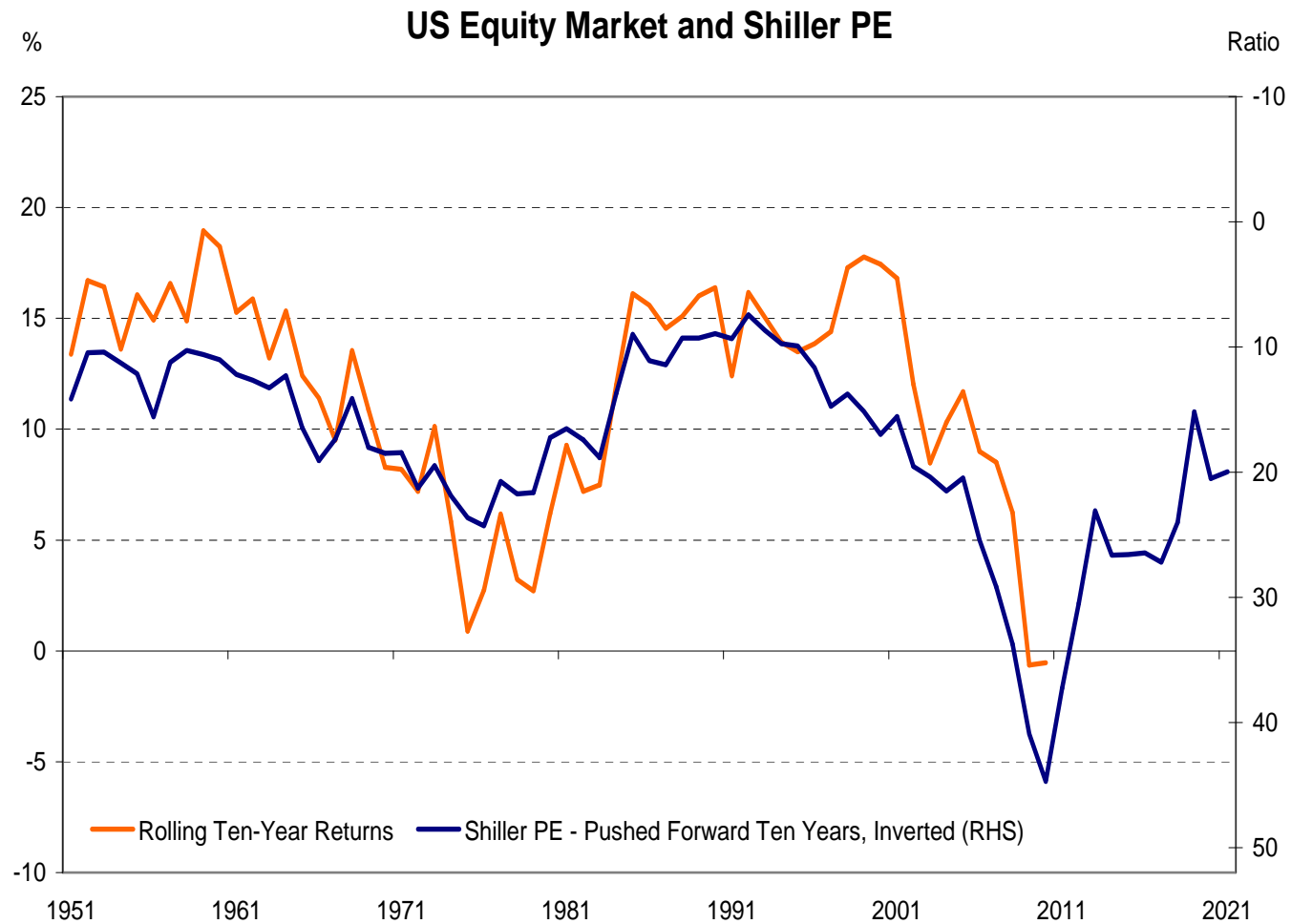
Standard assumptions

- The SAA will meet our objectives over time
- Valuations don't matter in the long run
- Volatility is a good indicator of risk
- The order of returns doesn't matter

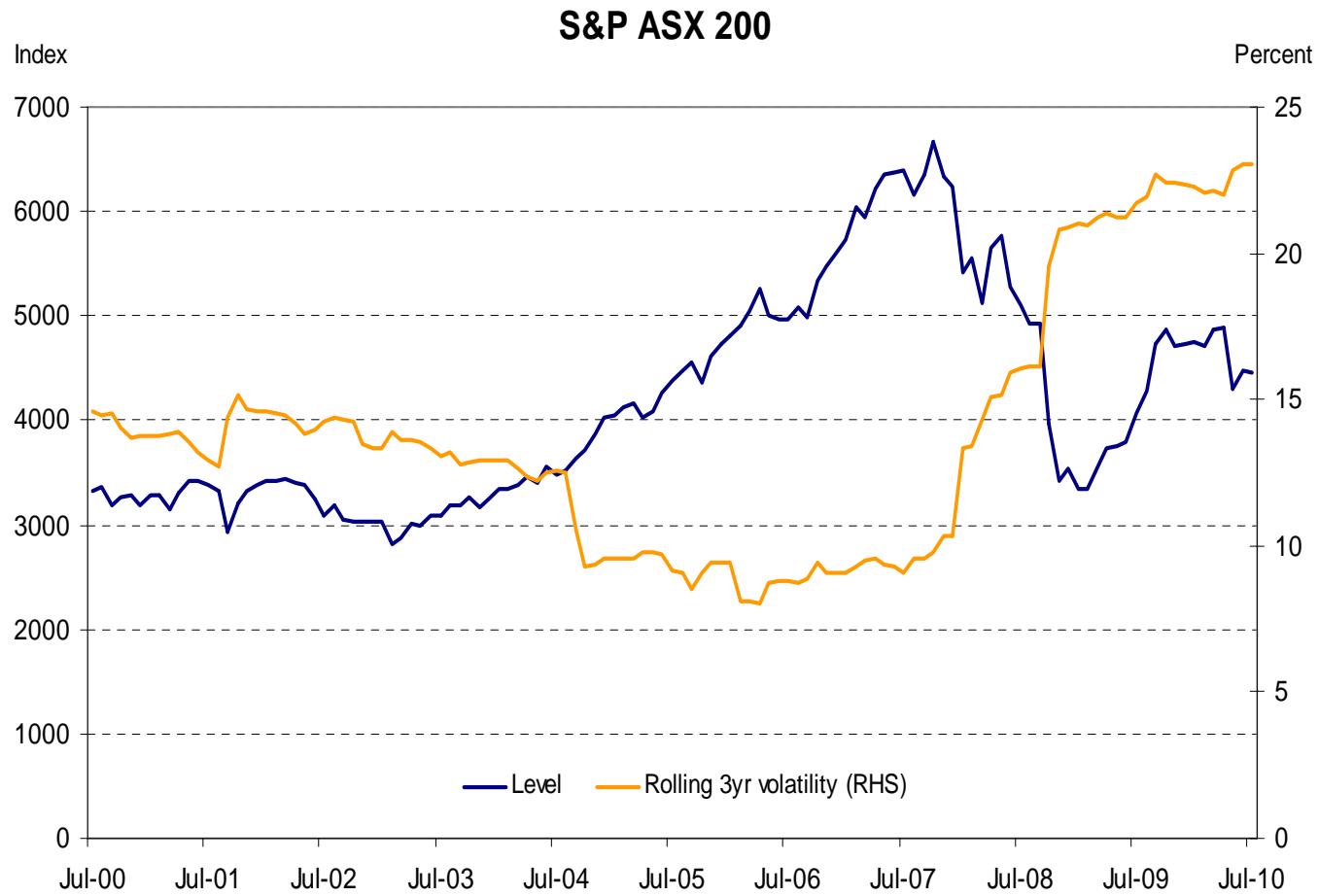
A triumph of hope over experience



Price impacts return



Risk is not volatility

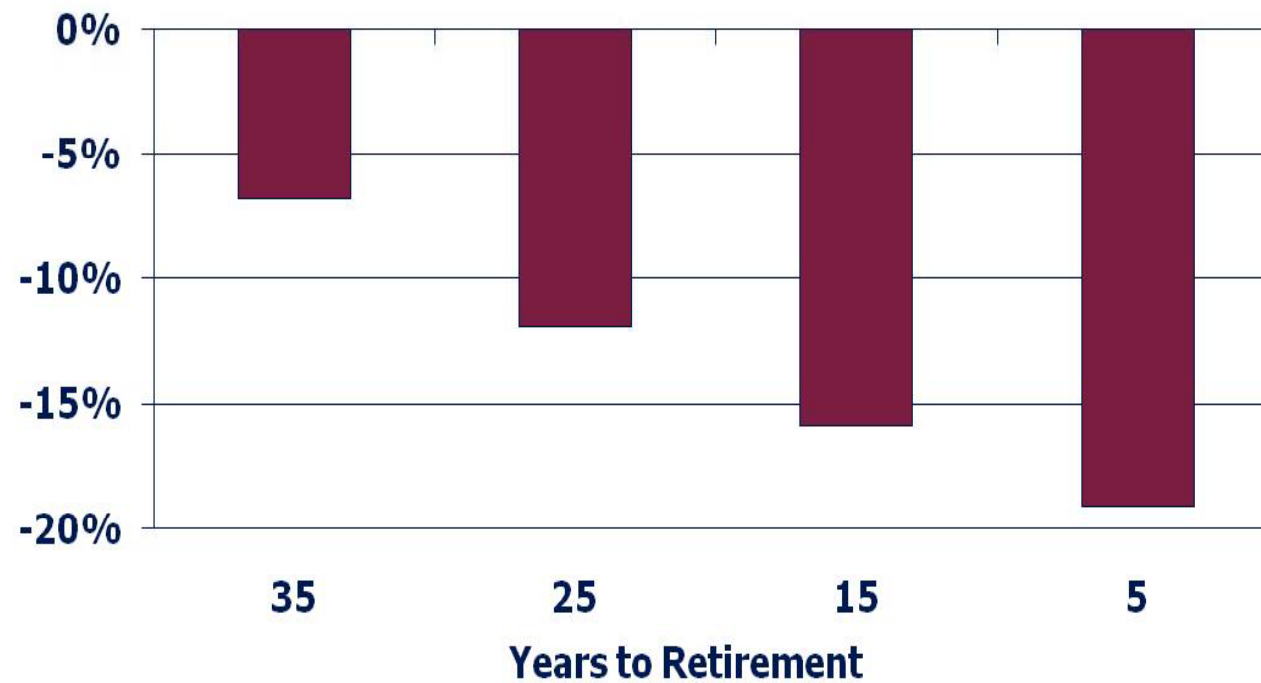


Risk is losing money permanently

Order of returns matters...a lot

Path dependency matters

Impact on lump sum at retirement of 15% negative return



Building a better portfolio

- Focus on the delivery of real outcomes (not relative ones)
- Recognise that risk premium are dynamic - and use them
- Recognise that the path of returns is important
- Manage the risks that matter – not the easiest to measure
- Create accountability for ‘real’ not ‘relative’ outcomes

Pre-requisites for a successful model

- Consistent and repeatable model for generating returns
- Differentiation in return expectations
- A portfolio construction process able to manage uncertainty
- An execution platform that can accommodate substantive asset allocation changes
- Appropriate risk management methodology

A consistent, repeatable, forward looking return framework

- Long run returns vary but can be predicted
- Returns can be decomposed into 3 elements.

$$R = Y + G + V$$

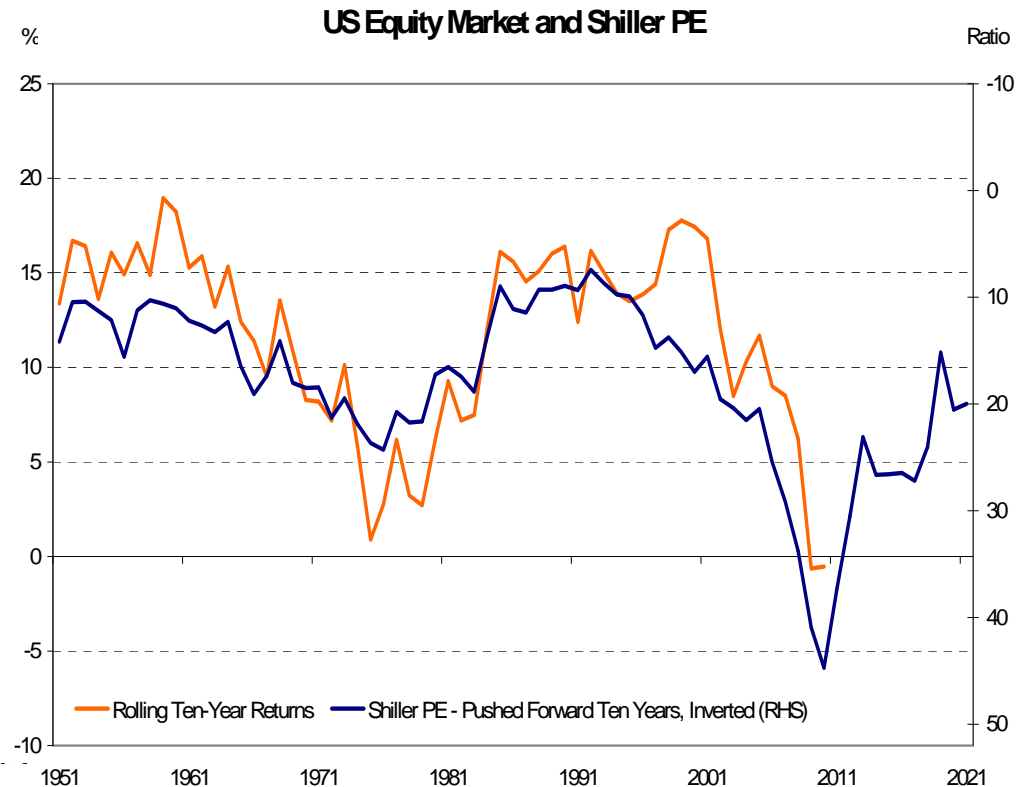
Where:

Y is the current investment yield

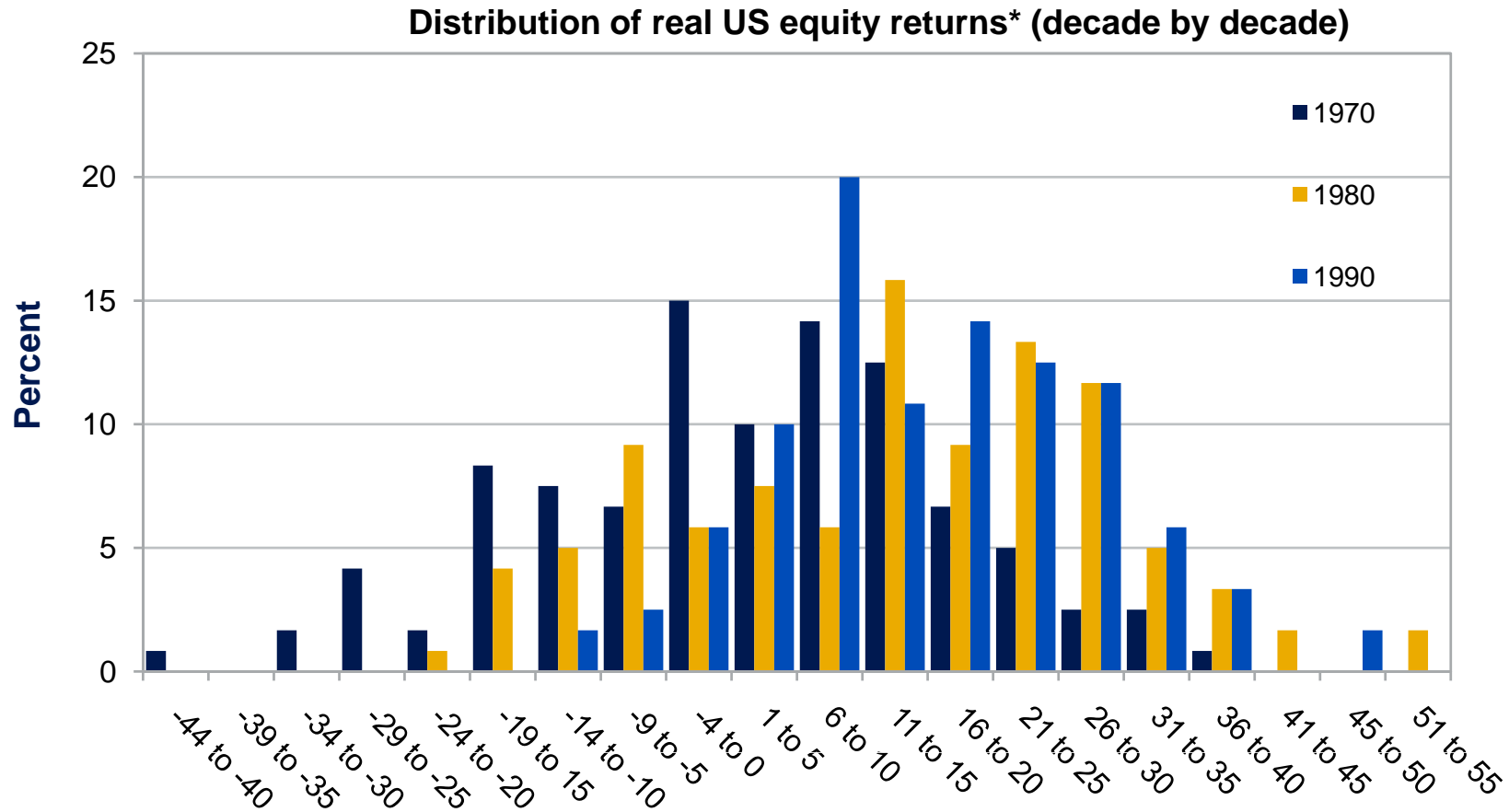
G is the annualised growth in income

V is the valuation effect

- The path taken to achieve these returns is more difficult to predict

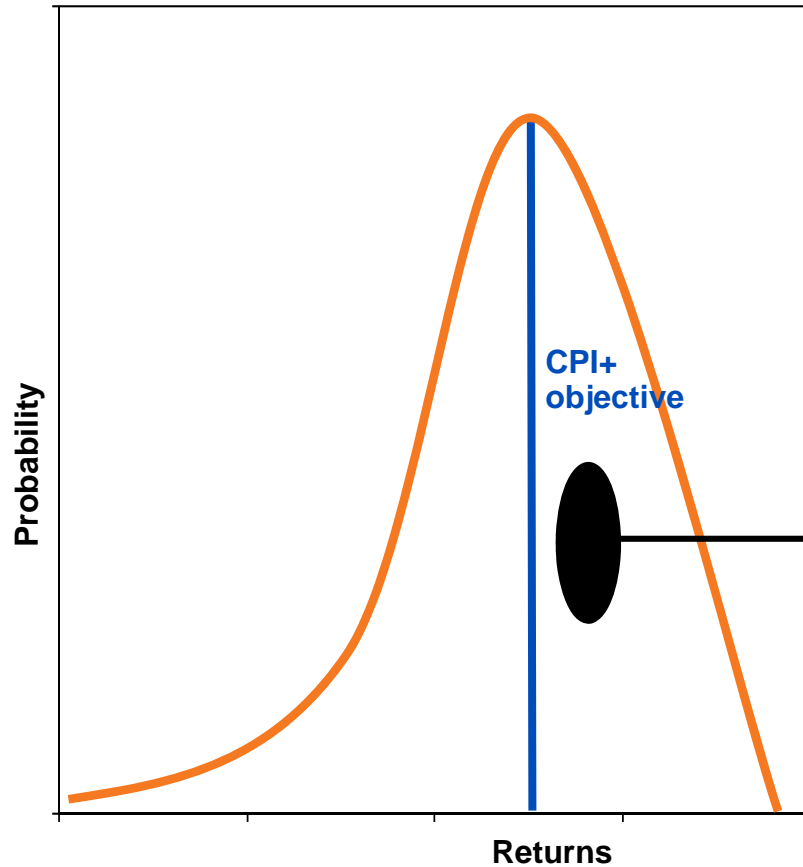


Understand asset market behaviour

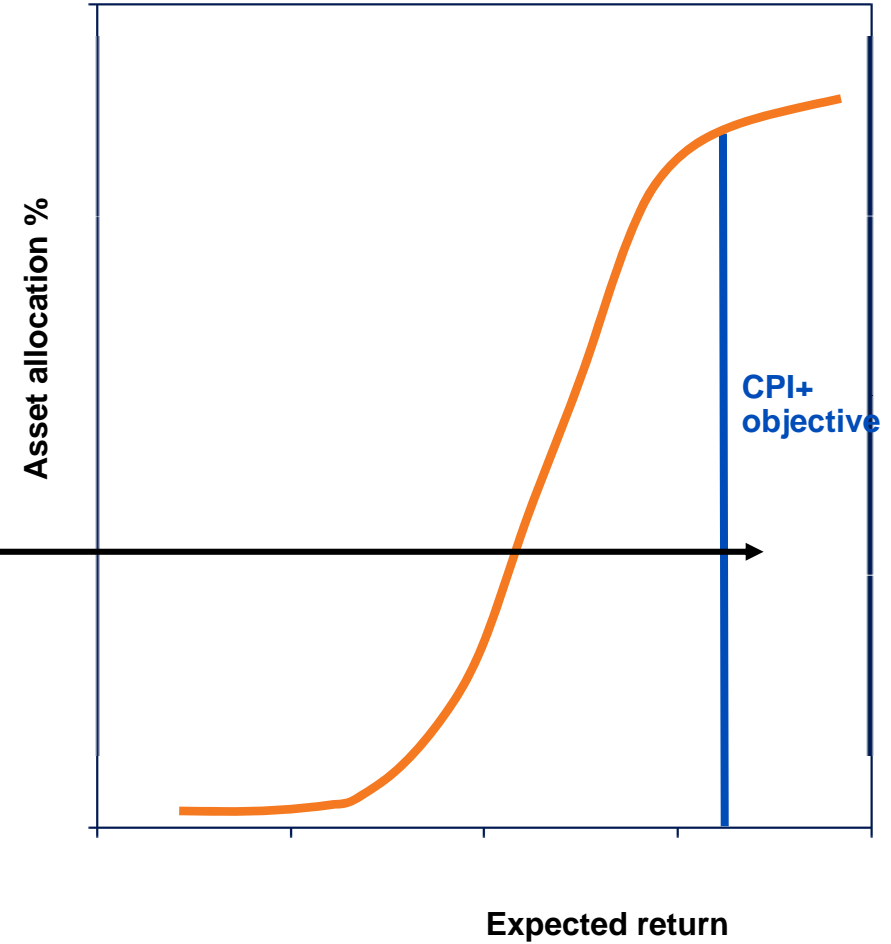


Own assets that meet the real objective

Distribution of returns



Asset allocation

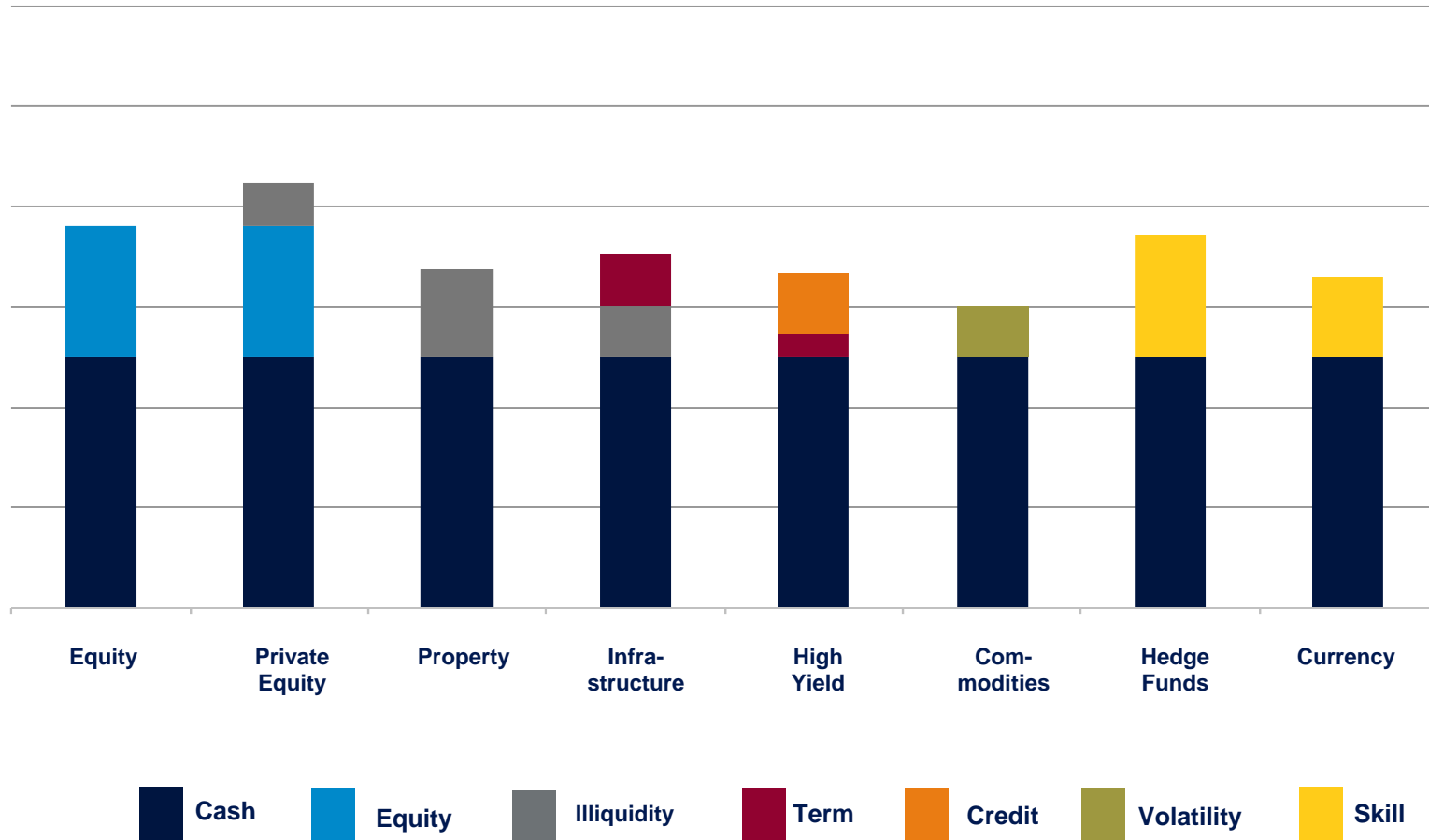


Source: Schroders
Graph for illustration only



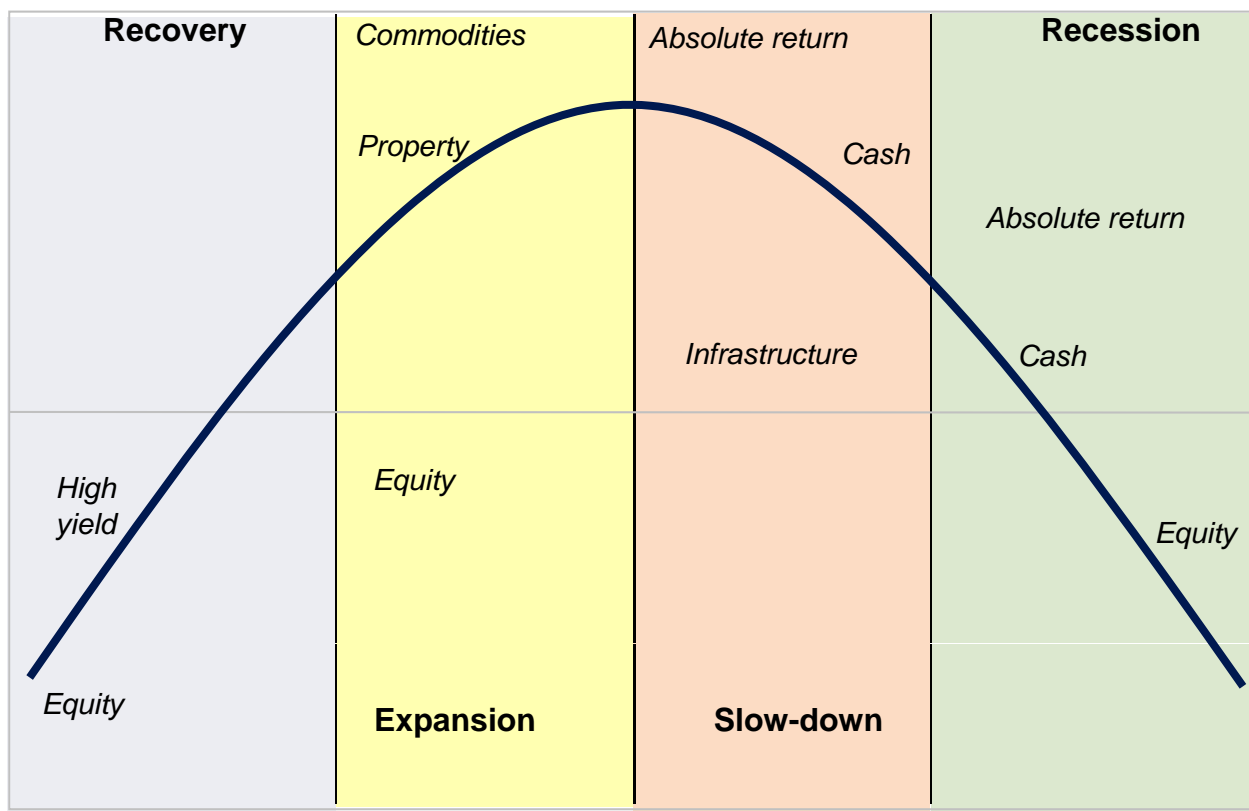
Managing for uncertainty

Earn a broad range of risk premia over time



Managing for uncertainty

Adjust asset class exposure over the cycle

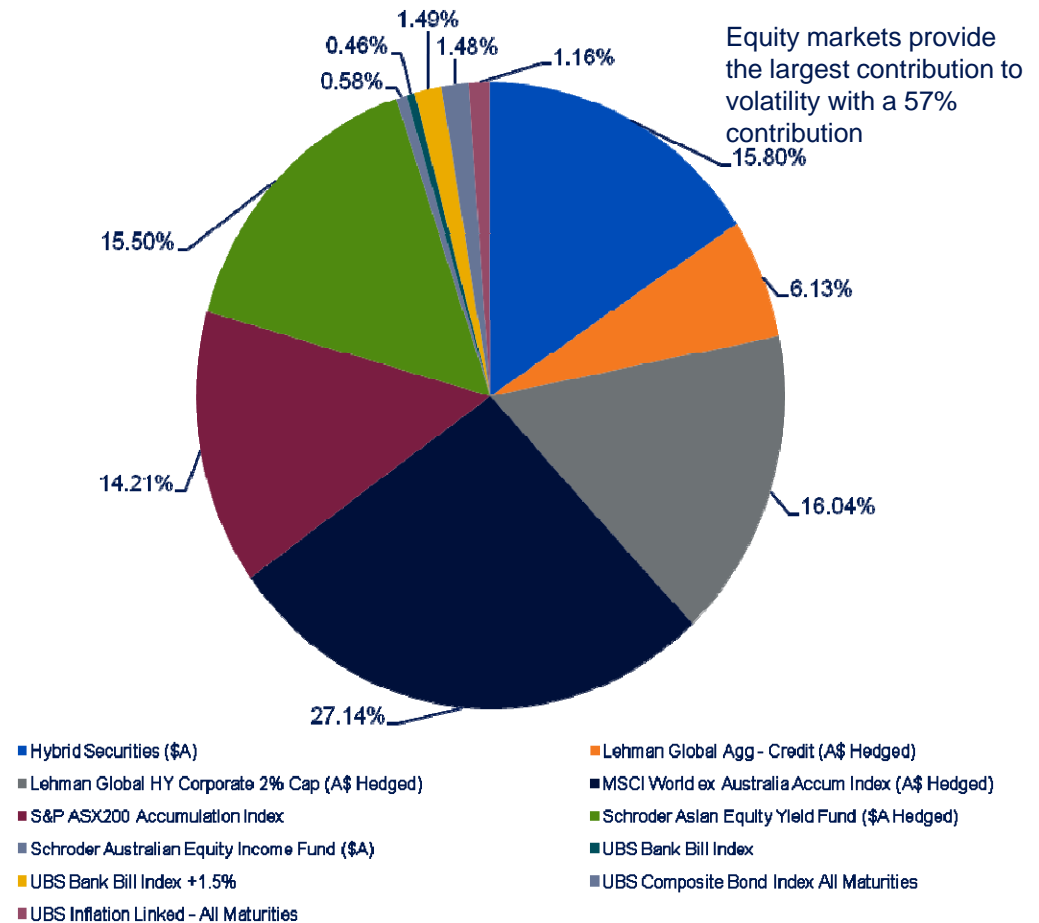


Measuring and managing the risks that matter

Key Metrics

Expected Return	8.7%
Volatility	5.5%
95%VaR	-1%
95%VaR	-5.1%
Prob. of Loss	6.3%

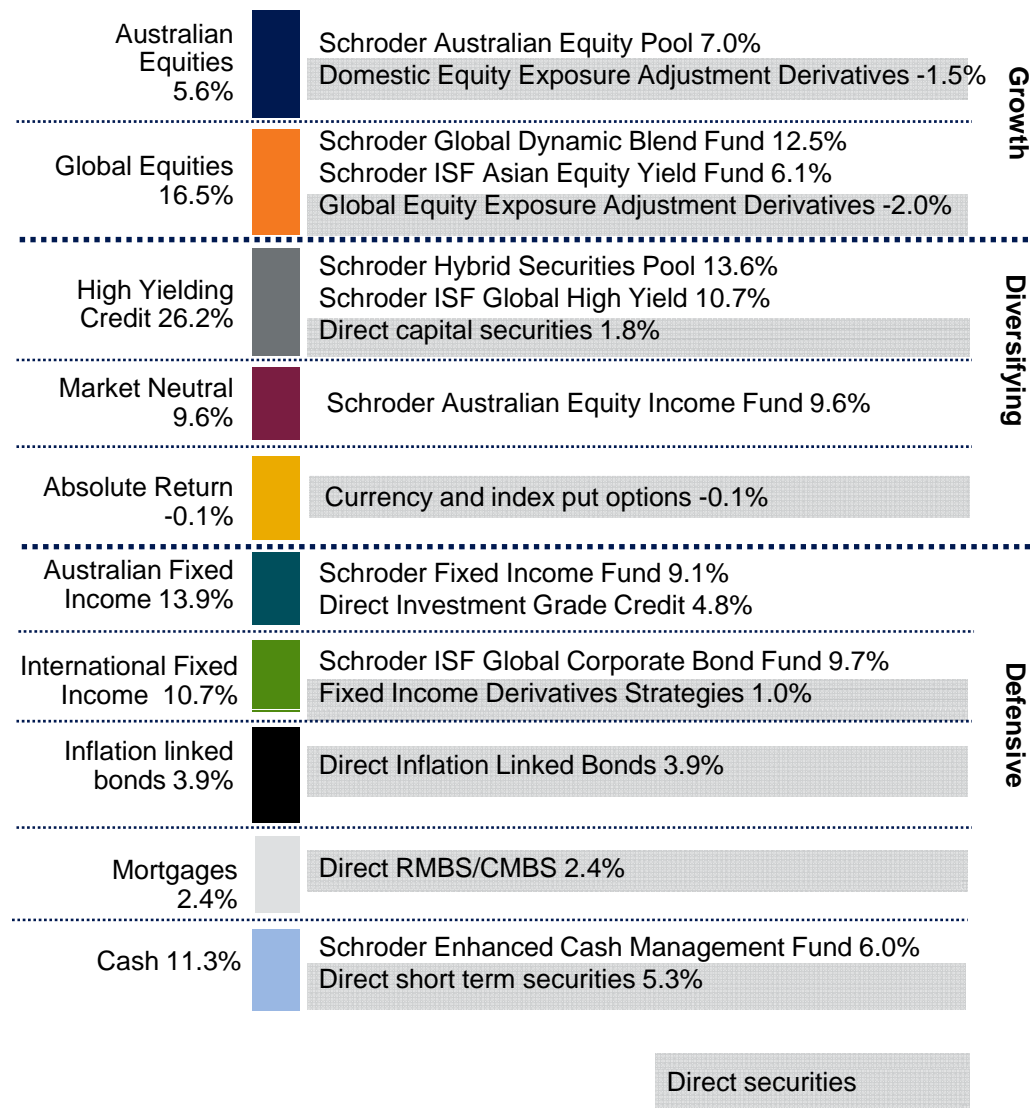
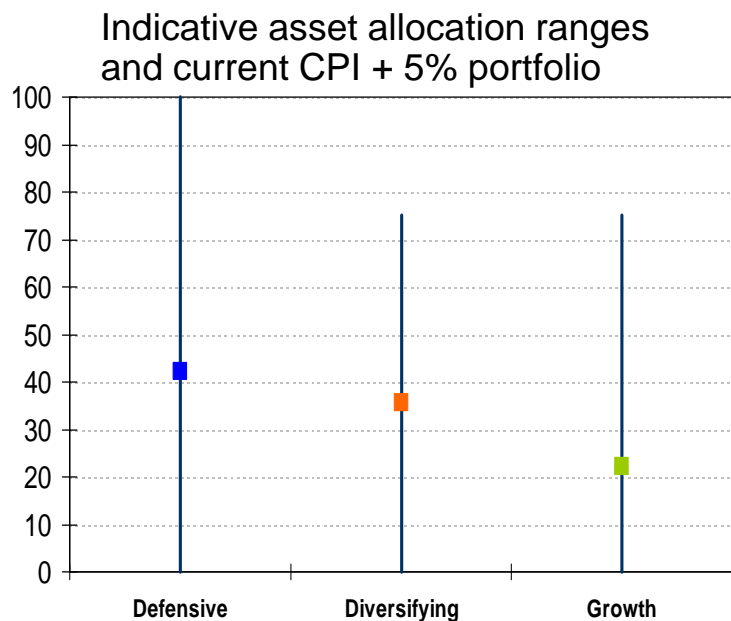
Contribution to Volatility



Shows the decomposition of risk at the asset class level

Current Schroder Real Return Fund

Diversified and low risk



Where does it fit?

All, core or alternative?

CPI+ as a core of the portfolio



Investors want real returns not relative ones

- Fixed SAA won't work in this world
- Peer group risk will rise, BUT absolute risk will fall
- Simple, transparent and cheap

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