EVANS &
PARTNERS

Product Review Group

FY24 Review

EANDP.COM.AU

A Message from the PRG Chair

EVANS & PARTNERS

Andrew Moir

Managing Director
Chair, E&P Wealth Product Review Group
Member of the E&P Investment Committee

The pace of change is not a new concept but the intensification of this has been marked, particularly with the emergence of generative artificial intelligence (AI) over the past 18 months. Whilst AI has dominated the headlines of late, there are many other factors driving change. Accenture's Pulse of Change Index ranks six factors of change – Technology, Talent, Economic, Geopolitical, Climate and Consumer & Social – using a range of key indicators to measure these factors' influence on change. As such our navigating through everyday life as consumers, business leaders and merely societal participants provides both opportunity and challenge in adopting to (and accepting) new paradigms brought about by change.

Like the experience of the "real-world" the pace of change in financial markets has been equally relentless, influenced across the various factors above to various degrees at various points in time – the advent of climate change in the last 20 years, geopolitical changes, AI, and payment systems to name a few. In this rapidly changing world, with disruptive threats and opportunities, the challenge we are continually presented is separating the substance from the noise or periphery. Doing this requires us being open to and accepting of the reality of change and thereby looking to apply a disciplined and repeatable framework to assessing the opportunities change presents and threats change may bring to the status quo.

A Message from the PRG Chair (continued)

Over the course of the past 12 months the Product Review Group has met regularly to assess a range of opportunities and importantly monitor E&P's Approved Product List (APL) and High Conviction List (HCL). In addition to our formal meetings, the group, in whole or part, has conducted numerous reviews of a range of opportunities ranging from bespoke private opportunities across infrastructure, private companies, real estate and credit, to more mainstream funds across the fixed income, equities and property asset classes. We remain focused on sourcing opportunities that we feel will add excess return, on a risk-adjusted basis, to your overall portfolio over the course of the investment cycle.

The liquidity crunch post COVID in private capital markets has also seen some innovative changes in the private asset space with some of the world's leading managers providing access for individuals. Once only accessible for institutional capital, we are now witnessing semi-liquid and follow-on private equity, credit and infrastructure opportunities for private clients across a range of top-tier managers. In terms of liquidity, we have also actively engaged with various managers to improve liquidity profiles to provide better access for you, our clients.

Whilst the reality of change is ever present and our framework is accepting of and open to this, we remain disciplined in our assessment approach in looking to capture sustainable opportunities as distinct from those where long-term maintainable return is less certain.

For this Year in Review, we examine the narrowness of equity market returns over FY24 and highlight the consequential impacts on index-relative manager performance and the winners and losers for the year.

With the re-emergence of fixed interest as an asset class over the past 18 months, we also wanted to provide you some focus on the asset class. In particular, you are no doubt well-aware of a lot of press warning about the unabated growth in private credit. Whilst the warnings about this sub-asset class are somewhat warranted, with the opportunistic proliferation of funds, we highlight how not all funds are equal and how we navigate the assessment of funds to determine investment worthiness.

Finally, in our High Conviction List update we highlight the Ares Diversified Credit Fund, which provides access to a global best ideas credit portfolio comprising mainly private credit (with a smaller allocation to traded credit), and the Capital Group Multi-Sector Income Fund, a core fixed income solution that provides actively managed exposure to both investment grade and high yield corporate bonds as well as securitised and emerging market debt.

Key Highlights

Key highlights for the PRG over the course of the past 12 months include:

Met with over 370 investment managers, product providers and research consultants.

Closely reviewed over 120 managers and investments to assess changes / updates to existing products and new opportunities.

15 new strategies were added to the Approved Product List (APL) and 3 were removed.

6 products were promoted to the High Conviction List (HCL) and 3 were removed.

8 products were added to the APL Watch List at different times over the year for ongoing monitoring.

26 wholesale investment opportunity approvals.

The PRG completed in-depth reviews of the global listed infrastructure and open-ended private equity manager universes. The team also completed a review of the HCL, re-testing each product to ensure they remain best-in-class.

EVANS & PARTNERS

Key Insights

EVANS & PARTNERS

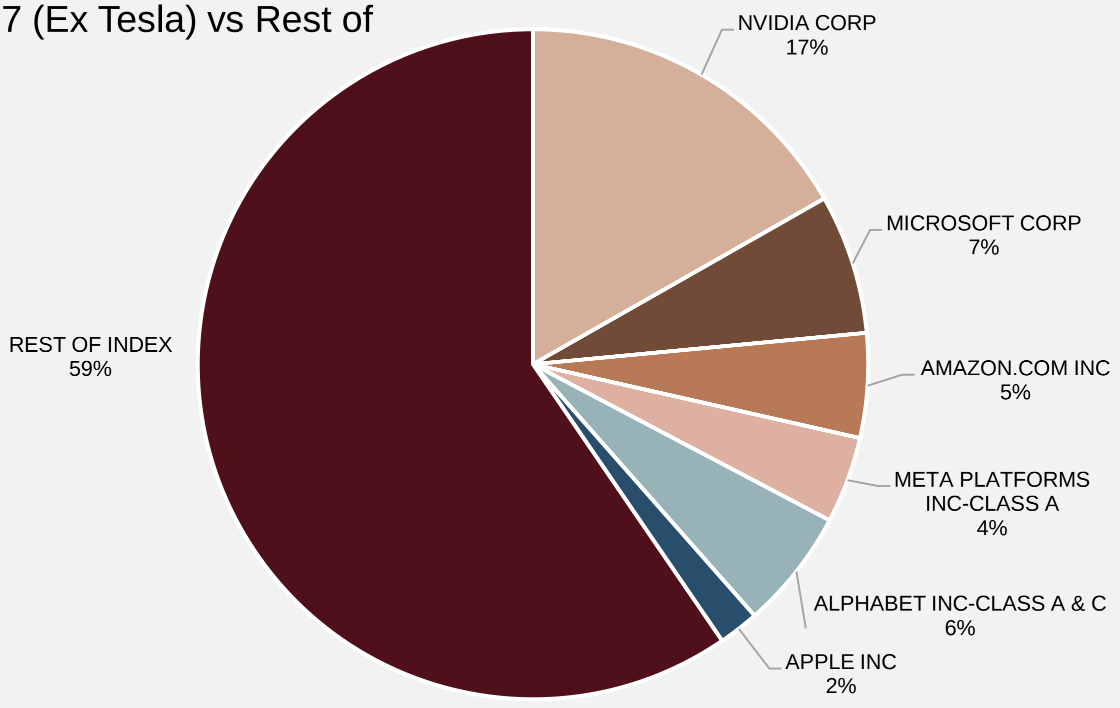
Key Insights

Review of Equity Manager Performance in FY24

One of the key features of FY24 was the narrowness of equity market returns. This has been discussed at length in the financial press, most commonly with reference to the dominance of the US-domiciled ‘Magnificent 7’ stocks, being Nvidia, Microsoft, Amazon, Meta, Alphabet, Apple and Tesla. Looking at the MSCI World Index, which is a broad market index that captures the performance of over 1400 developed market stocks, the Magnificent 7 stock were responsible for 39% of the total index return of 20.5% for the financial year. Excluding Tesla, which ended the year as a detractor from index performance, the remaining ‘Magnificent 6’ stocks were responsible for an even higher 41% of index returns.

MSCI World Index

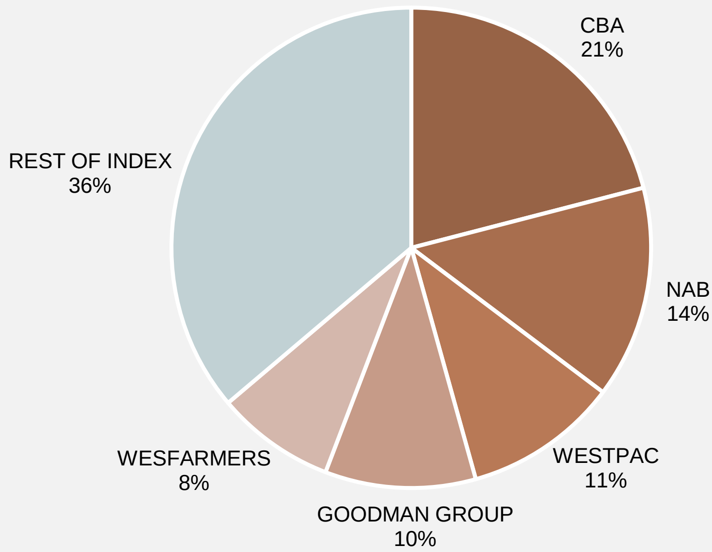
FY24 Performance Attribution of Mag-7 (Ex Tesla) vs Rest of Index



Source: Bloomberg, E&P Research.

This narrowness of equity market returns was not only a US phenomenon. In fact, the returns from the Australian equity market were even more narrowly concentrated, with the top 5 attributing stocks driving 64% of the 12.1% S&P/ASX 200 Index return for the period. These top five stocks included three of the major banks, Commonwealth Bank, NAB and Westpac, as well as industrial property and data centre owner Goodman Group, and conglomerate Wesfarmers.

S&P ASX/200
FY24 Performance Attribution of Top 5 Stocks vs Rest of Index



Source: Bloomberg E&P Research.

From a factor perspective, the dominance of the large cap technology names saw growth substantially outperform value, while small and mid-cap stocks underperformed both globally and domestically. A summary of the performance of key indices for the year is included in the table below, showing this broad dispersion of returns.

Major Indices: FY24 Performance

Index	Asset Class	Style	Performance
Magnificent 7 Index	International Shares	Growth	50.6%
MSCI World Growth Index (AUD)	International Shares	Growth	26.4%
MSCI World Index (USD)	International Shares	Growth	20.6%
MSCI World Index (AUD)	International Shares	Growth	20.5%
MSCI World Value Index (AUD)	International Shares	Growth	13.4%
MSCI Emerging Markets Index (AUD)	International Shares	Growth	12.2%
S&P/ASX 200	Australian Shares	Growth	12.1%
S&P/ASX Small Ordinaries	Australian Shares	Growth	9.3%
Russell 2000 (AUD)	International Shares	Growth	8.0%
Ausbond Credit 0+ Yr Index	Credit (Fixed)	Defensive	5.9%
Ausbond Credit 0+ Yr Index FRN	Credit (Floating)	Defensive	5.6%
Bloomberg Ausbond Treasury 0+ Yr Index	Credit	Defensive	2.7%

Source: Bloomberg, IRESS, E&P Research.

Noting this backdrop, post the end of FY24, Product Review Group members completed a review of the performance of equity managers on the E&P High Conviction List and in the E&P Example Portfolios. Not surprisingly, these managers also showed a wide dispersion of returns depending on their style and portfolio composition. The more technology focused managers who had a greater than index weighting to the Magnificent 7 stocks, for example, the Orca Global Disruption Fund and Munro Global Growth Fund, significantly outperformed the index, while value focused managers such as Pzena and Barrow Hanley underperformed. Similarly, funds with a small and mid-cap bias such as the Cooper Investors Global Equity Fund and Franklin Global Growth Fund also underperformed.

With respect to the technology focused managers, while they posted excellent one-year performances, it is important to remember that most of these managers were particularly hard hit in the previous financial year by the rotation from growth to value stocks as rates rose over calendar year 22. As such, part of the outperformance this financial year is explained by factor rotation reversing and mean reversion. The result is that on a three-year view, a number of these managers remain behind the index notwithstanding their stellar year.

While the small and mid-cap parts of the market lagged large and mega caps, we saw a good level of outperformance from managers operating a dedicated strategy at the smaller end of the market. For example, in Australia, the small and mid-cap manager peer group delivered an average return of 13.6% for the year, compared to the S&P/ASX Small Ordinaries Index, which returned 9.3%. Likewise, the global peer group returned 11.4%, beating the MSCI World Mid Cap Index at 10.4%. The OC Premium Small Companies Fund was a strong performer domestically, while the Fairlight Global Small and Mid Cap Fund also outperformed.

Finally, performance in regional specific funds was mixed over the period. Both of our emerging market managers, Northcape and Fidelity, underperformed both their peer group and the MSCI Emerging Markets Index for a number of reasons including index relative positioning and specific stock selection. Likewise in Asia, the Fidelity Asia Fund, which is a concentrated, contrarian strategy, underperformed both its peers and the benchmark on a one-year view.

Whilst we observe all time periods when monitoring our High Conviction List and Approved Product List managers, our over-arching focus is on a manager’s ability to consistently out-perform indices and peers on a rolling 3-year basis. Additionally, risk adjusted characteristics are also monitored in our ongoing assessment.

Looking forward, our house view is that we expect a broadening of equity market returns, and we expect that managers that underperformed over FY24 may fare better over the period ahead. We continue to advocate for tactical exposure is small and mid-caps, emerging markets and value managers, and encourage you to talk to your adviser about options in each of these segments.

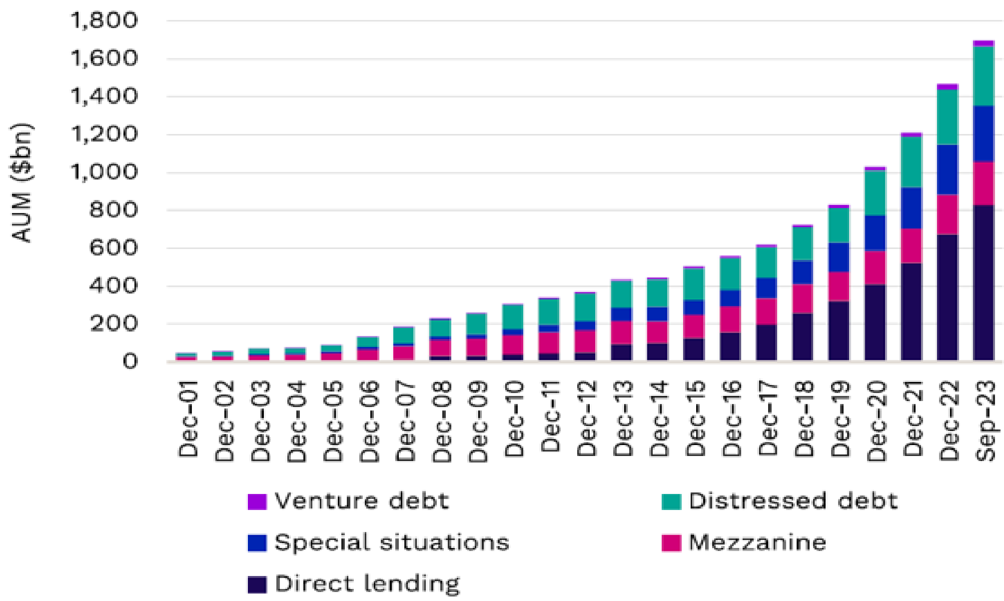
Assessing Private Credit Opportunities

Another topic that continues to receive substantial press attention is the growth of private credit and potential associated risks for investors. While there are clear benefits to the inclusion of private credit in an investment portfolio, the warnings about this sub-asset class are in some cases warranted, and with the opportunistic proliferation of funds it is imperative to have a disciplined process in place for fund selection and due diligence.

Background

It is important to recognise that private credit is not a new asset class and has been around for several decades in the form of syndications, collateralised loan obligations (CLOs), speciality asset-finance and higher risk lending. However, the industry has transformed and grown rapidly over recent years. Specifically, the asset class has quadrupled over the past decade, driven mostly by growth in direct lending.

Private Debt AUM, by Strategy



Source: IMF

Growth in direct lending over the last decade has been driven by two key factors. Firstly, there have been changes in bank regulation that have resulted in direct lending moving off bank balance sheets and into private lenders. Secondly, there has been a significant increase in investor demand for yield products over the low-rate period since the Global Financial Crisis.
Despite the rapid growth in the private credit market, it remains a relatively small part of total lending. The IMF estimates that it represents 7% of outstanding credit in the US, 1.6% in Europe and 4% in Australia.

Focus on product risks

There are clear benefits to a private credit allocation including high current yield, reduced mark-to-market volatility and enhanced portfolio diversification. However, private credit funds also have a number of potential risks:

- Traditionally the asset class has been high risk within the credit sector because many of the loans were those that the banks would not do. This is now changing with the growth in the industry, regulation driving banks away from creditworthy borrowers, and a broader range of corporates using direct lending funds for their flexibility and pricing.
- The private credit sector has neither price discovery nor supervisory oversight to facilitate asset performance monitoring, and the opacity of borrowing firms makes prompt assessment of potential losses challenging for outsiders. Most funds employ independent Responsible Entities and have asset quality assessed by independent accounting firms on a regular basis to address this risk.
- Smaller, inexperienced managers have entered the space and may not have the capacity to undertake appropriate credit assessment or manage the work out of poorly performing loans. This adds to the lack of clarity on asset quality. There is a contrast, however, between big and small funds. Bigger funds may be in a better position than banks to cope with workouts because funds are able to convert debt to equity and work out problems over time; regulation makes this prohibitive for banks. Further the private credit lender can negotiate bespoke bilateral loans with specific industry related covenants.
- Private credit is predominantly floating rate and charges higher interest rates to borrowers so there will be greater vulnerability to a downturn. Weaker firms with low or negative earnings and high leverage are less likely to secure bank loans and are more inclined to borrow from non-bank sources. Interest rate duration is typically low, and credit risk is the dominant risk in private credit portfolios.
- Leverage can be deployed by private credit funds and the private credit value chain is a complex network that includes leveraged players ranging from borrowers to funds to end investors. Funds that use only modest amounts of leverage may still face significant capital calls in a downside scenario.
- As the underlying loans are illiquid, private credit funds could become locked up and offer less liquidity than promised in periods of distress. This could reflect an increase in withdrawal applications but could be made worse by the need for the fund to extend terms of loans if borrowers are under pressure. Reflecting this, most evergreen private credit funds only offer liquidity on a best endeavours basis, while they will also typically have a ‘liquidity sleeve’ of publicly traded bonds to meet redemptions.

The scale of these risks varies by fund, and many will have procedures in place to mitigate the effects. The principal ways to mitigate the risk of loss is through seniority, security, covenants and terms and conditions. Private credit funds argue that they are well positioned because they have more flexibility to negotiate terms and maintain a close relationship with the borrower throughout the term of the loan. Publicly traded debt typically comprises generic structures and terms with limited lender protections and less ability to vary terms in the events of stress.

Manager selection and PRG process

As a firm we have been inundated in recent years with inbound pitches from private credit funds and bespoke private credit opportunities. A number of these inbounds do not progress past initial screening and exposures across the firm are mainly concentrated in a small number of centrally endorsed, institutional quality funds.

Our initial research and screening effort focuses on the team's capability and process. In respect of private credit, our research is focused on a manager's capability to analyse credit risk at the individual credit level and the broader systematic level to ensure an overall book of credit is appropriately risk weighted, with a particular focus on managing of downside risk. Some factors we examine include:

- How do they manage credit risk, both in aggregate and in individual loans?
  - Book size, diversification, assessment approach, experience and depth of the credit analyst team, loan maturity profile, tenor/turnover and sourcing.
- How do they manage conflicts of interest?
  - Many of the largest private credit managers are also private equity managers. We will generally look negatively on private credit lenders that are in some way or another related to the borrower, particularly via an equity interest.
- Does the manager intend to employ leverage at a fund level?
  - Most private credit funds are unleveraged but some use financial and synthetic leverage to enhance returns. Private credit funds may face large collateral calls on leveraged portfolios during times of stress.
- How effective are their 'early warning' signals and what current stress are they seeing across their book?
  - We ask for details of monitoring they have in place and how this has evolved, how technology enabled are they in respect of real-time information and how well resourced their credit monitoring and servicing team is.
- How effective and well-resourced is their workout function and what is their historical loss experience?
  - We discuss specific examples where they have had to act to preserve capital through workout/restructuring. Defaults and the management of impairments and delinquencies is a reality of all credit books and crucial from a coupon and capital protection standpoint.
  - The influx of financial players who lack the required experience and or infrastructure to manage arrears and impairments is an immediate red flag.

- Has the business attracted and retained significant institutional capital?
  - We view the ability to attract and retain significant institutional capital as materially important as it speaks to the quality of a firm's credit assessment and risk management processes. The ability to grow funds under management (FUM) also ensures that the firm can remain sufficiently profitable and well resourced, maintain its deal pipeline by being a preferred lender, have sufficient portfolio diversification and maintain diversification of capital sources.

Scale and diversification remain key criteria in our view. There are numerous sub-scale credit opportunities in the market where firstly lack of diversification and secondly the managers' inability to manage the growth in FUM cause us to question the ability to sustain risk / return cadence.

Another key risk mitigant is the semi-liquid nature of the funds that we are most exposed to. Having to provide ongoing liquidity to investors means that managers tend to keep the tenor of their loan books relatively short. This means problems can be more quickly identified, and loans can be repriced or allowed to mature and exposure to borrowers pivoted as the economic environment changes. Further, pricing and impairments are regularly tested, including by third parties, given these funds are open to accept new subscriptions on a regular basis. This compares to closed-end funds, where we have limited exposure, which tend to have longer tenors, less regular testing of pricing, and no optionality for investors to reduce their exposure as their views change.

Finally, we note that when compared to global private credit funds, Australian private credit is materially overweight towards property. This has particularly been the domain of financial players. For this reason, one screen has been to avoid financial players who solely rely on LVR and lack the requisite track record to extricate or manage out distressed situations. While we have recommended funds that are exclusively property focused or partly property focused, we have also endeavoured to provide advisers with fund options that have little or no property exposure so they can ensure clients' overall exposure to property specific risks is appropriately managed.

While a lot of the private credit product that has come to market in recent years has been Australian focused, this year we have seen an increase in the number of globally focused products. In general, these global opportunities tend to be from larger, higher quality, well-resourced firms such as PIMCO, KKR and Goldman Sachs, and have lower exposure to property sector lending. We welcome the entrance of these firms into the Australian wealth market to increase the choice of quality product available to our advisers.

EVANS & PARTNERS

High Conviction List Update

EVANS & PARTNERS

High Conviction List Update

The HCL is a concentrated list of asset managers drawn from our APL which we deem to be of the highest calibre. The HCL is split via asset class and sub-category and reviewed periodically, with manager performance and developments monitored monthly. Inclusion to the HCL is based on a series of metrics based on the conviction of the PRG into the expertise of the manager in executing its particular investment strategy.

To give clients an overview of the HCL process in practice, below we have spotlighted two managers on our HCL and the reasons for their inclusion.

Your adviser has access to the full list and can discuss these options with you.

Ares Diversified Credit Fund

Ares Management Corporation is a leading global alternative investment manager operating an integrated business across credit, real estate, private equity, secondary markets, and strategic initiatives. Founded in 1997, Ares has a long track record of managing and underwriting private and public credit.

The Ares Diversified Credit Fund is a multi-credit income strategy that primarily provides exposure to Ares' directly originated US and European direct lending capability. Ares employs a dynamic and opportunistic approach, which invests across an unconstrained global credit universe based on absolute and relative value analysis of credit markets. The Fund aims to provide superior risk adjusted returns across various market cycles by investing in a diversified portfolio of liquid and illiquid asset classes throughout the global credit spectrum. Specifically, the Fund aims to deliver high single digit returns net of fees.

Through the Fund, wholesale investors gain exposure to a portfolio of directly originated loans, secured floating and fixed rate syndicated loans, corporate bonds, asset-backed securities, commercial real estate loans and other types of credit instruments.

Our Chief Investment Office Team remains positive on private credit in the current environment, however notes that not all managers are equal. As detailed above, selecting appropriate managers is critical. As a firm we have been inundated in recent years with pitches from private credit funds, and we are rigorous in our assessment. Experience, resourcing, process and governance are critical factors that we review, and we prefer funds with scale and diversification.

The Fund was promoted to the HCL in March 2024 as the PRG's preferred global direct lending product. In making this decision, the PRG noted:

- Ares' long track record (20+ years) of managing private and liquid credit over multiple cycles
- A collaborative, integrated, highly resourced investment team with deep experience and expertise in global credit investing and strong multi-channel sourcing capabilities

- The primary focus on direct origination of loans, which has historically provided better terms and protection for investors. Ares' track record of capital protection across these directly originated loans is compelling
- A thorough fundamental credit process
- Ares manages ~US$5.5 billion across this strategy and the Fund provides exposure to 750+ issuers, providing significant diversification.

Investors assessing the Fund for inclusion in the Interest Rate Securities component of their portfolios should consider it as a higher yielding 'satellite' exposure that complements and provides diversification benefits to a traditional 'core' fixed income portfolio.

Capital Group Multi-Sector Income Fund

Founded in 1931, Capital Group is a privately owned investment manager with ~US2.5 trillion in funds under management. Within global fixed interest, Capital manages ~US$498 billion, spanning sovereign bonds, composite or aggregate bond strategies, investment grade credit and high yield.

The Capital Group Multi-Sector Income Fund provides investors with access to an actively managed multi-sector credit strategy. Investing across emerging market debt, high yield, investment grade credit and securitised bonds, Capital implements a multi-portfolio manager approach.

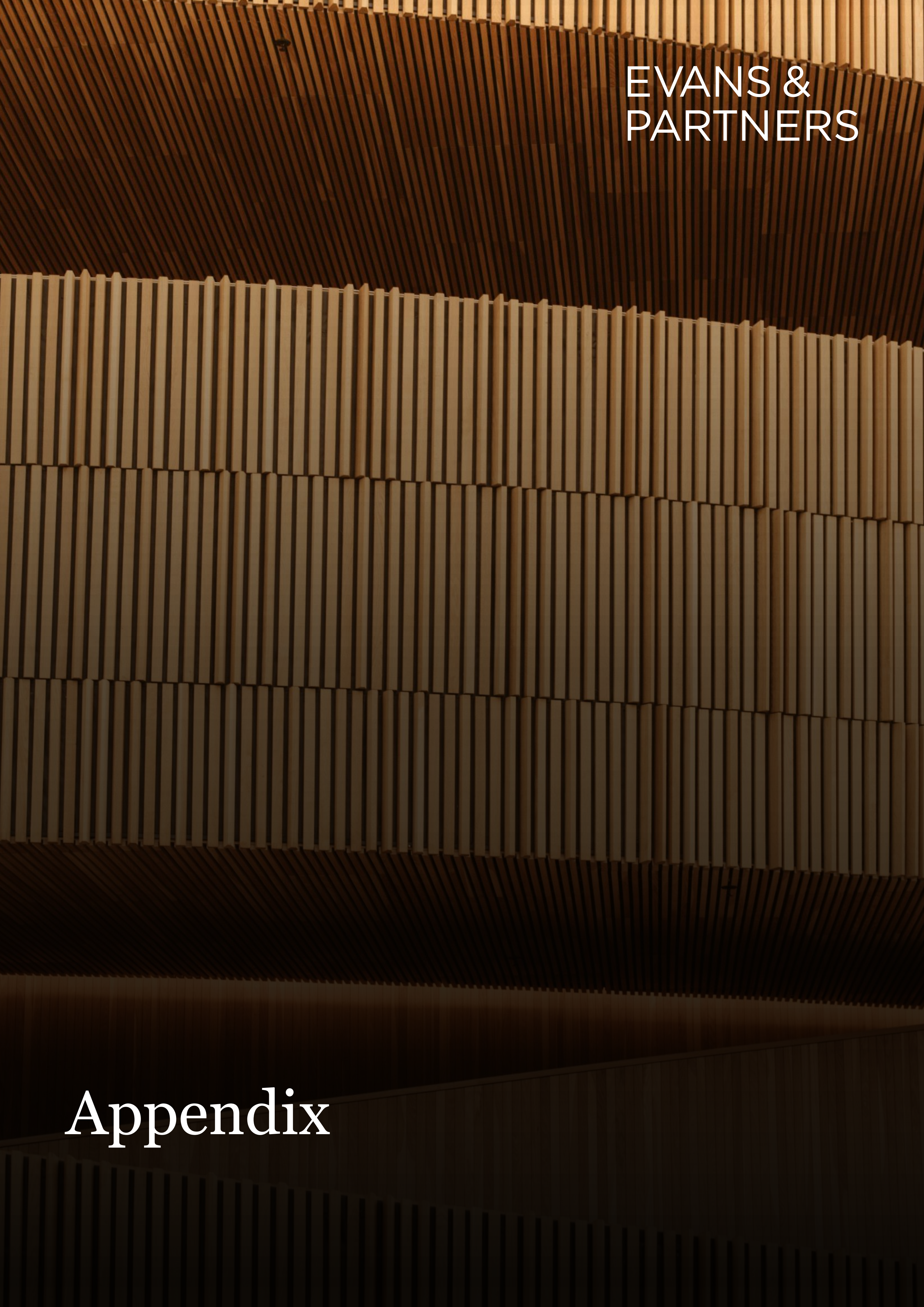
The Fund's targeted objective is to produce an annualised 5-7% total return (gross of fees and in USD), with volatility of 5-7% over a full market cycle. To achieve these objectives, Capital's approach is centred around producing proprietary bottom-up fundamental research, with a focus on generating outperformance from multiple sources, particularly security selection and sector rotation.

The Fund was promoted to the HCL in August 2024 as one of the PRG's preferred 'through-the-cycle' credit exposures. In making this decision, the PRG noted:

- Capital's experienced and well-resourced management team
- The Fund's well-defined risk limits that provide guardrails for Capital to allocate between sector sleeves, while allowing for respective sector specialist investors to express their investment views
- Consistent duration exposure, which differentiates it from other managers that are more macro driven
- Potential to be an appropriate solution for less active investors who can invest in one strategy and allow Capital to allocate/pivot between different sleeves at different points in the cycle
- Ability to blend well with other managers (given the two points above)
- Capital manages ~US$14.2 billion in this strategy and the Fund provides exposure to 800+ securities, again providing significant diversification.

Investors assessing the Fund for inclusion in the Interest Rate Securities component of their portfolios may consider it as a 'core' exposure that can blend well with higher yielding satellite strategies or more conservative bond strategies at different points in the cycle.

EVANS & PARTNERS



Appendix

Appendix

Overview of the PRG

The Product Review Group (PRG) has the responsibility of overseeing the sourcing, assessment and monitoring of product suitability and is overseen by the E&P Investment Committee (IC).

We recognise the importance of finding best-in-class investment solutions across all asset classes that enable our clients to build high-quality investment portfolios aligned to their unique objectives. We target asset managers that have the requisite skills, experience and resourcing to produce consistent risk adjusted return outcomes in line with their mandates. We undertake a rigorous investment manager selection process, with our due diligence including both a quantitative and qualitative evaluation in addition to a detailed Sustainable Investing assessment. We also provide analysis and portfolio construction guidance on blending these high-quality managers together in a diversified portfolio.

The PRG is responsible for monitoring the firm's APL, including recommending additions and removals, as well as the condensed HCL. The PRG also provides input with respect to the construction of the Example Portfolios, which are suggested multi-manager portfolios across various risk profiles. Our Example Portfolios include balanced, growth and defensive alternatives, as well as a Socially Responsible Investing (SRI) aligned portfolio – which our advisers tailor to our clients' unique circumstances.

In addition to manager sourcing, assessment and monitoring, the PRG also undertakes assessments of a range of bespoke direct opportunities primarily in the private equity, private credit and real asset markets that are often exclusive to clients of Evans and Partners.

Composition

The PRG currently has ten voting members, comprising of the Chair and nine senior members of E&P Financial Group, including senior investment advisers and research personnel. Members have diverse and complimentary skillsets as well as significant levels of experience in financial markets.

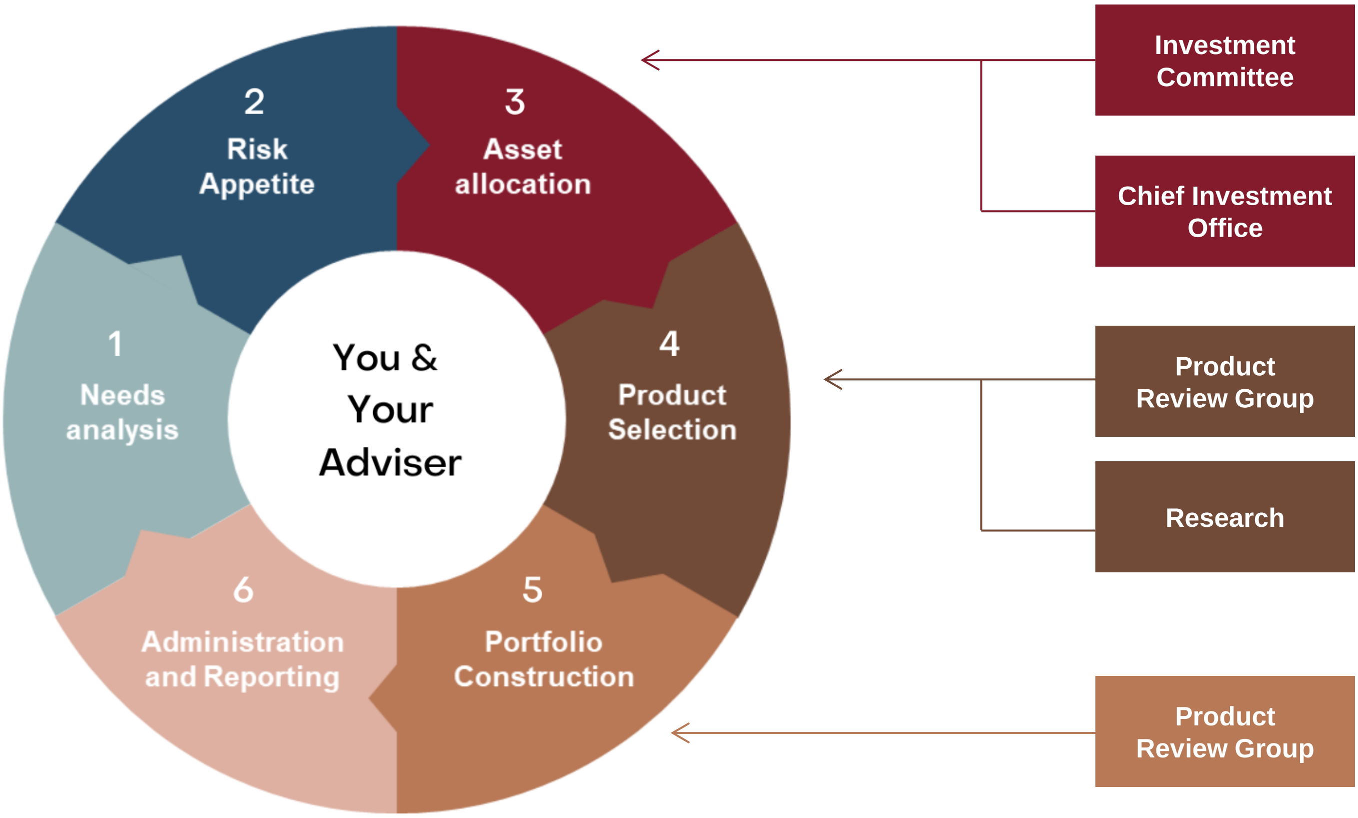
Corporate Governance Structure

Getting the decision-making structure, rules and processes right is crucial in getting the best outcomes for our clients. As custodians of our clients' capital, we have designed our corporate governance structure on the key principles of transparency, responsibility and accountability.

The diagram on the next page outlines the roles and responsibilities of the IC, led by Independent Chairman Honor McFadyen, the Chief Investment Office Team, the PRG, and our Investment Advisers in delivering tailored investment solutions to our clients.

EVANS &
PARTNERS

Our Investment Process



Manager Selection

We target asset managers that have the requisite skills, experience and resourcing to produce consistent risk adjusted return outcomes.

Our approach to Manager Selection

Modern Portfolio Theory, as theorised by Harry Markowitz in 1952, is premised on the argument that an investment's risk and return characteristics should not be viewed alone but should be evaluated by how it affects the overall portfolio's risk and return. This process adopts the assumption that no single exposure or investment style can perform well in all markets and deliver superior performance across all phases of the investment cycle. The PRG adopts a similar approach by attempting to identify and allocate capital to strategies that play a defined role within a portfolio and when combined with complementary strategies, create an efficient blend of exposures.

In order to assist with this process, the PRG advocates a core-satellite approach where underlying exposures are either defined as 'core' or 'satellite' and allocated to respectively. The core-satellite approach recognises that asset allocation is the primary driver of long-term returns, while attempting to access supplementary returns via market timing and security selection. Under this approach, allocations to core exposures are expected to be relatively static over an investment cycle, providing investors with exposure to a market and typically only making changes during the rebalancing process or when a strategy no longer meets the PRG's stated investment criteria. The satellite component is designed to be more active and fluid, providing investors with the ability to be overweight in specific sectors, regions, styles or thematics in an attempt to take advantage of shorter-term economic and market conditions and provide a source of outperformance.

The core-satellite approach places emphasis on identifying strategies that are complementary to one another. Complementary strategies are those that enhance portfolio diversification by delivering an uncorrelated series of returns, primarily by accessing different sources of risk. We attempt to identify strategies that are complementary to one another by observing a wide range of statistics including, but not limited to, correlation of returns and excess returns, attribution and downside deviation. However, statistics are often backward-looking measures and cannot be relied on in isolation, and as a result we must make a judgement as to whether this will remain consistent going forward. This requires a deep understanding of a range of qualitative factors surrounding the strategy, such as the investment philosophy and the people managing the strategy.

Table 1: Example of PRG Due Diligence and Assessment Process

Qualitative	Quantitative
Is the investment process transparent?	What is the investment track record?
Does the organisational culture align with E&P?	Is the style consistent with mandate?
What is the depth, experience, and continuity of the investment team?	What is the performance in different market and economic cycles? What is the consistency of performance over rolling 3-year periods?
What is the remuneration structure, is the manager aligned?	Is the track record consistent and commensurate with risk exposure?
Does the process integrate ESG evaluation?	Is there a history of alpha generation?

After defining the portfolio construction process and selection criteria, our goal is to build and maintain a High Conviction List of managers and strategies that we are comfortable integrating into the portfolio construction process and investing with over the long-term.

This list is designed to assist advisers in selecting the most appropriate exposure for a client's personal circumstances by providing a range of solutions the PRG and IC have endorsed via an extensive due diligence program. Monitoring of the list is unremitting to ensure exposures continue to meet our investment criteria, while the PRG will also stay well-informed of alternative strategies to ensure the selected exposures remain 'best in breed'.

Fortunately, E&P's scale and extensive network of relationships with global investment managers provides our clients with access to some of the best and differentiated investment ideas from around the world. Further, we are able to leverage off and utilise a wide range of resources, both internal and external, to assist with the strategy selection process and optimise the portfolio construction process.

Table 2: Example of Core/Satellite Exposures Within Respective Asset Classes

	Core	Satellite
Fixed Income	Benchmark aware duration	Opportunistic and distressed credit
Equities	Large cap with low tracking error	High conviction with high active share
Real Assets	Diversified property	Single asset fund
Alternatives	Private equity with broad portfolio	Portfolio hedging instrument

Selecting Core Exposures

Our preference within this component is for strategies that have exhibited consistent performance at or above the benchmark while providing a greater level of downside protection. This draws us to place emphasis on risk metrics such as rolling volatility, downside deviation and Sortino ratio, a measure of return adjusted by the strategy's standard deviation of negative returns (downside deviation).

These investment preferences encourage us to opt for an appropriate blend of actively and passively managed strategies. Active managers have the ability to better position their portfolio to manage and mitigate systematic risks. This ability can result in outperformance during down markets. However, we note where a suitable active manager cannot be identified, passive strategies may prove optimal as they offer a low cost and effective way to get exposure to a specific market, albeit they are unable to respond accordingly to mitigate downside risk during periods of market stress or changing conditions.

Selecting Satellite Exposures

The satellite component of the portfolio is designed to produce alpha (outperformance) or provide exposure to a market or opportunity that may not be held over a full market cycle. Examples of this include targeting a market that is less efficient and where pricing anomalies often exist such as emerging market equities or micro-cap equities. Another example is employing a manager that takes a high conviction or concentrated investment approach in the attempt to generate returns well in excess of its benchmark.

In conjunction with your adviser, discussing the appropriate risk/return balance, the satellite exposure selection process can prove more important in some cases more than others, as the difference in top and bottom performing exposures (dispersion) can be vastly different dependent on the asset class. Further, we will typically have a greater willingness to allocate a larger proportion of a portfolios fee budget towards satellite exposures as these exposures will often have a greater probability of delivering outperformance or providing valuable diversification benefits.

EVANS &
PARTNERS