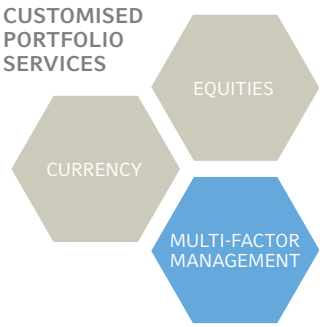
Russell Investments

Multi-asset equities factor portfolio delivers greater control and efficiency

A large multi-asset portfolio manager replaced a passive global equities mandate ($AUD1 billion) with a multi-factor, dynamically managed global factor exposure portfolio. Russell Investments' customised portfolio services provided the manager with greater control and flexibility in managing underlying factor exposures, increased efficiency in managing associated currency exposures and enhanced risk/return profile relative to original passive mandate.



Situation

This Australian multi-asset portfolio manager conducted a comprehensive strategic review and identified an opportunity to enhance the passive component of a multi-billion global equities portfolio.

Instead of assuming that a passive portfolio of developed and emerging market equities was the most efficient solution, the portfolio manager explored alternative ways to structure the portfolio to meet both its cost budget, alpha targets and manage its exposures to return drivers that reflected its investment beliefs.

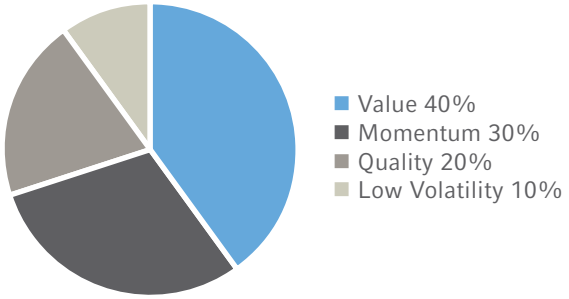
In addition, the portfolio manager sought our advice to achieve a more efficient mechanism to implement its currency exposures across its suite of multi-asset funds.

Solution

In July 2015, a custom active multi-factor global equities portfolio was established. To achieve this, drew on our five core capabilities – capital markets research, asset allocation, manager research, factor exposures and implementation – to deliver an integrated solution for the multi-asset portfolio manager.

Strategic multi-factor global equities portfolio

Figure 1: Multi-factor global equities strategic weights



As active and passive strategies increasingly converge into a middle ground often referred to as smart beta, investors face a range of new considerations. Russell Investments help clients define and implement systematic exposures to factors as part of its centralised approach to portfolio management.

Russell Investments' factor portfolios, which provide investors with a transparent, rules-based methodology, deliver focused exposure to specific factors, market segments or investment strategies. These factor portfolios provide exposure to some of the key equity market factors that we believe will have the ability to outperform over the long run; among these are value, momentum, quality and low volatility[1]. Used individually or in combination, these portfolios help to expand opportunities for both tactical and strategic asset allocation.

Our industry-leading factor portfolio methodology weights stocks in proportion to their factor exposure rather than by their market capitalisation. These portfolios have been carefully designed to provide investors with robust tools featuring active risk awareness, high capacity and low turnover as well as modular construction to facilitate their investability. The portfolios employ a consistent, transparent methodology across all factors and geographies which allow each portfolio in the series to complement the others. This gives investors the ability to combine factor exposures and better manage the total portfolio outcome.

Russell Investments' team of global equities quantitative analysts provided the portfolio manager with research and insights into the factor exposures that were most likely to be rewarded by the market on a long term or strategic basis[2]. They also provided a robust and flexible framework to combine multiple equity factors to help address the cyclicality in performance of any given strategy and tailor their factor allocations according to their return and risk preferences[3]. The resulting strategic multi-factor portfolio is shown in Figure 1.

Dynamic portfolio positions

Flexibility was also built into the mandate to tactically adjust the weights to each individual factor according to market conditions. These dynamic views are informed by Russell Investments' strategist team insights, and our Cycle, Valuation and Sentiment (CVS) quantitative toolkit for evaluating the forward looking attractiveness of the factors.

In addition to factor allocations, all factor portfolios come with residual country and sector bets. The portfolio construction process can also build in active views along these dimensions, informed by our Strategists and CVS framework, to both manage risk and enhance return.

Custom Portfolio

Finally, Russell Investments employ a proprietary optimisation engine to construct the overall portfolio, incorporating total risk management and liquidity to meet the overall portfolio's risk objectives while harnessing the overall insights of the underlying factors. In this case, the client's risk/return preferences and cost budgets were taken into account to create a customised global equities portfolio which best met the portfolio manager's requirements. Figure 2 summarises the different elements involved in the portfolio construction process.

Results

The customised multi-asset equities factor portfolio delivered multiple benefits to the portfolio manager:

- **Control and Precision.**
  The portfolio provides greater control of the underlying factor exposures in the portfolio. It allows the portfolio manager to more precisely target the investment factors that reflect its investment beliefs about which return drivers are most likely to be rewarded.
- **Dynamic management of factor exposures, countries and sectors.**
  The approach tailors its offerings to the specific needs of the portfolio manager. It provides flexibility to adjust

Figure 2: Summary of Investment Process

Strategic	Dynamic	Portfolio Construction
Determine beliefs about which factors win over the long-run › Value › Momentum › Quality › Low volatility	Respond to changing market environments. Use Cycle, Value, Sentiment framework Factors + Sectors + Countries + Currencies	Reflect strategic & dynamic positioning. Incorporate risk management & liquidity.

1. https://russellinvestments.com/au/solutions/our-investment-approach
2. "Inside smart beta: making sense of investment factors." Russell Investments, November 2015
3. "Introducing the Russell Multi-Factor Equity Portfolios", Russell Investments, November 2015

allocations to each factor, as well as dynamically manage the portfolio's aggregate country and sector positions to manage risks and enhance returns, in response to market conditions.

- **Portfolio efficiency.**
  The customised multi-factor portfolio enhanced the risk/return profile of the portfolio relative to the original 100% passive mandate. It provided flexible, cost efficient access to strategic investment beliefs (factors) while meeting the portfolio manager's risk/return preferences and cost budget.
- **Implementation efficiency.**
  The portfolio also delivered significant operational and cost efficiencies with respect to implementing the portfolio manager's active currency decisions across the aggregate portfolio.

"The global multi-factor portfolio has helped us achieve greater efficiency in our global shares portfolio, while staying within our risk and cost budgets. I'm so glad that we explored the alternatives instead of assuming the passive status quo."

Australian multi-asset portfolio manager

For more information speak to:

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Important Information

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