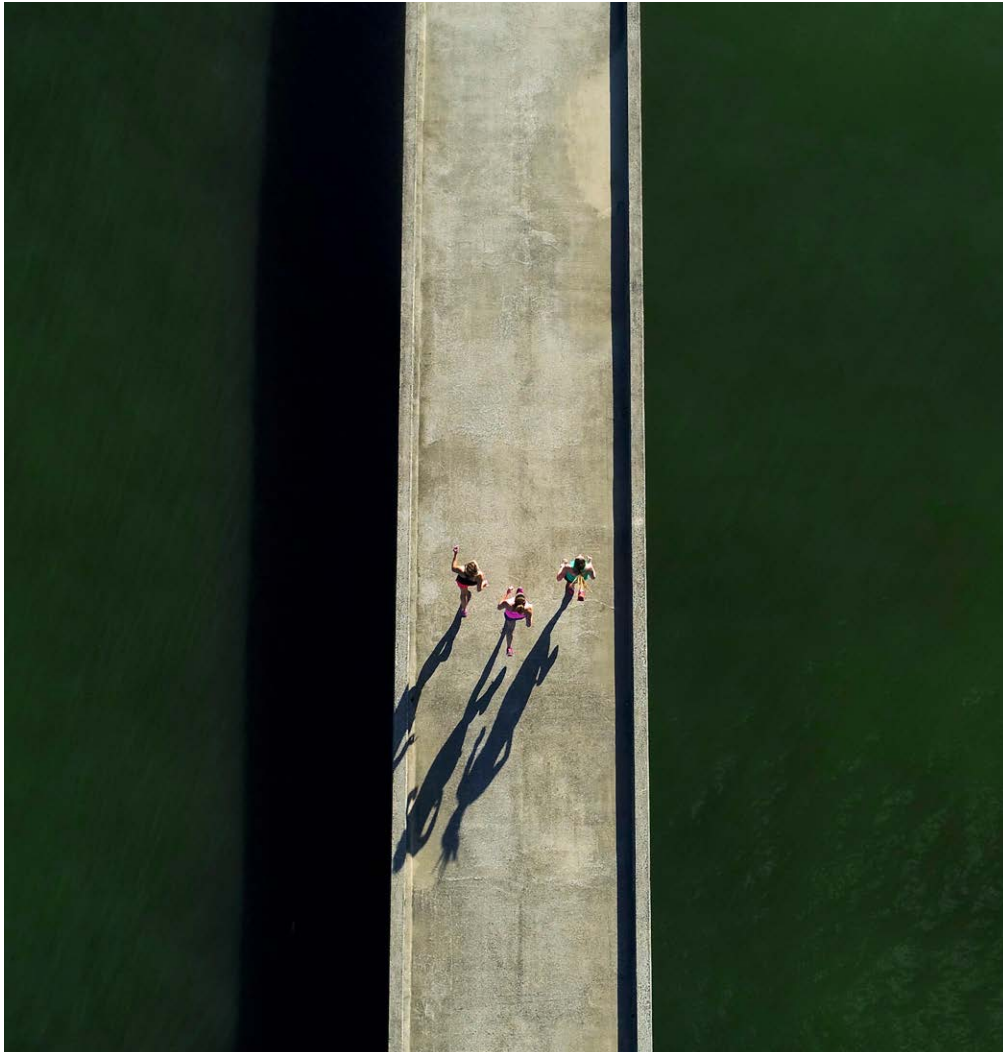


JBWere

# Investment Strategy Group Managed Research

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**Prepared by the Managed Research Team**

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**PUTTING WEALTH TO WORK FOR GENERATIONS**



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# Managed Research Investment Philosophy

We believe...

Shareholder value is driven by long term investment in quality companies



Superior companies with sustainable returns and quality

Market inefficiencies and mispricing create alpha opportunities



Disciplined investment approach that limits behavioural biases

One poor investment decision can undo many good ones



Continuous risk mitigation throughout the investment process

## Managed Research Process

The objective of JBWere's Manager Selection process is to identify a concentrated universe of high quality managed products across all asset classes. It is from this "High Conviction List" that we construct a range of portfolios based on varying investment objectives and risk profiles.

We are focused on providing portfolio solutions that deliver consistent and superior risk adjusted returns. It is our objective to identify funds that will consistently outperform peers and the benchmark over 3, 5 and 10 year periods – not necessarily to identify which individual products will be best performing in its peer group over the next short term period.

We then combine differentiated products into a total portfolio solution. We consider the complementary features of strategies. This includes reviewing the underlying portfolio positioning, source of returns and overall correlations of those differentiated strategies.

# Managed Research Team

JBWere has dedicated and experienced resources responsible for the Managed Research process.

Name	Role	Responsibilities	Years in Industry	Years in Team (JBWere)
Sally Campbell, CFA	Head of Managed Research	Strategy, Investment research, manager selection, portfolio construction	21	21
Chris Karapalidis	Senior Consultant, Managed Research	Investment research, manager selection	17	3
Seb Waters	Analyst, Performance Reporting	Performance reporting and attribution	2	2

In addition to these three resources, JBWere has established a specialist team to focus on alternative assets. Gillian Gordon, Head of Alternative Investments and Responsible Investing, is responsible for the alternative strategy, portfolio construction and the selection of a range of alternative investment strategies, along with Lizzie Smith who is a Senior Analyst in this dedicated and experienced team.

The Managed Research team is also part of the broader JBWere Investment Strategy Group. One of the key differentiating features of the JBWere Managed Research process is when reviewing any strategy, the Managed Research analysts work very closely with other asset class specialists in the broader research team. Not only does this ensure we have a thorough understanding of any strategy we consider, but we also ensure we build a complete understanding of the market in which it invests. This also provides another avenue for our research team to gather information from professional investment management organisations across the globe to feed into the Investment Strategy Group.

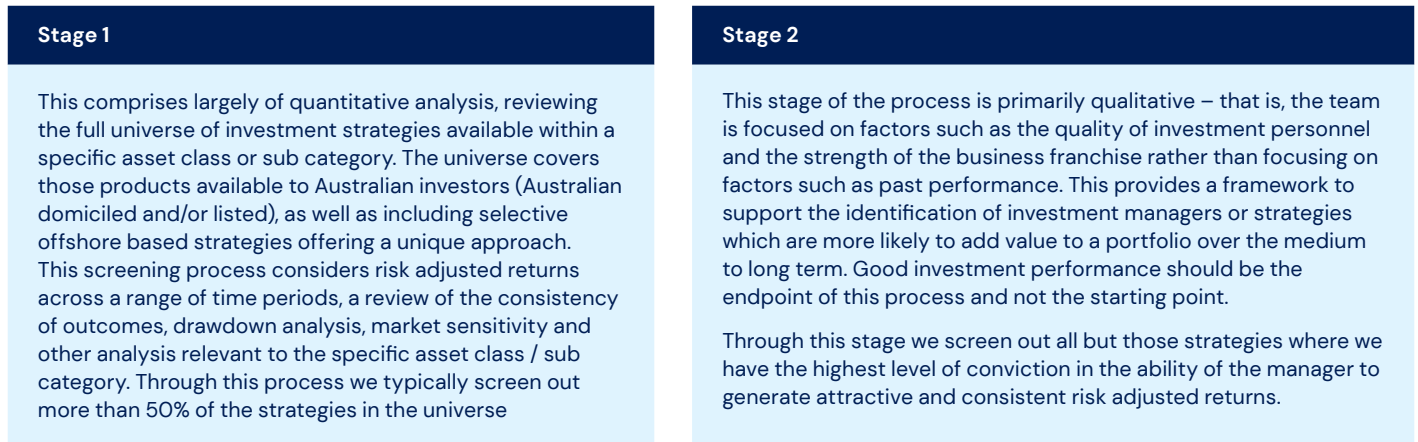
The team undertakes hundreds of manager meetings per year with a range of both domestic and global investment managers. This includes investment updates with existing approved managers, along with meeting a range of managers providing both existing and new products to the Australian marketplace, to ensure we have the highest quality products available to our clients.

Another key differentiator of the JBWere process is the close connection the research team has with advisers and clients. We believe this is critical as it enables our team to be clear on how each strategy will add value to our client's portfolios.

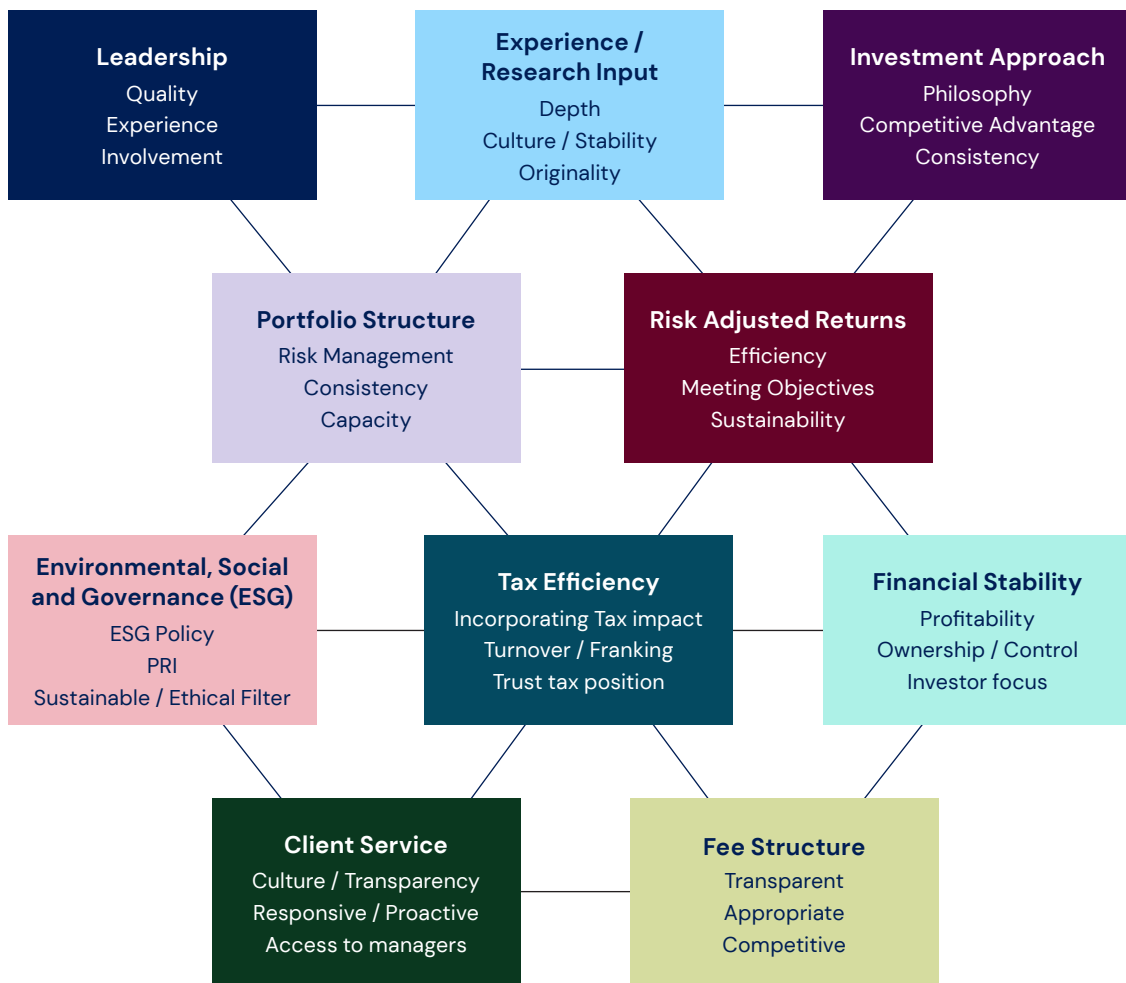
The outcome of this comprehensive approach is that the same reliance placed by our clients on JBWere to advise on strategic and tactical asset allocation, direct Australian and global equities or direct Australian fixed interest investments, can also be placed on our approach to identifying fund managers with the best credentials and combining these strategies to provide superior risk adjusted returns.

# Managed Research Investment Process

Our investment process is split into two stages.



We have identified several key factors that we believe will contribute to the likelihood of consistent outperformance over the long term, which we consider when reviewing all products regardless of the underlying investment strategy. These factors are discussed below.



Source: JBWere

# | Key Factors

## Leadership

We believe that any team responsible for the investment of third party funds must be led by a strong and effective leader or leaders. We are looking to identify those individuals with considerable investment experience, in particular, those with a well-established track record of meeting their objectives within their specific field. Whilst we are attracted to those strategies with clear and identifiable leadership who ultimately bears responsibility for the performance of the fund, we will also consider those organisations implementing a team approach to portfolio construction, provided there is clear accountability for all investment outcomes across the team. We also value those organisations with a clear succession plan, acknowledging that investment management is a dynamic industry and changes can occur rapidly.

## Experience & Research Input

Individuals with influence over investment policy decisions must be well qualified, experienced professionals and ideally have been involved in the investment management of the organisation for a reasonable period of time. We are attracted to stable investment teams, in favour of organisations which may have experienced considerable turnover in staff. This becomes important when considering whether the historical performance of the fund can be attributed to the incumbent investment team. Naturally, we look for adequate depth of experience to be able to withstand the loss of any team member.

The role played by the manager's research team must be consistent with the investment approach. We expect adequate resourcing to undertake detailed research over the investment universe. We highly value those organisations that generate value adding internal research, in favour of those that may rely heavily on external sources. We also prefer a clear delineation of responsibilities across the team.

## Investment Approach

JBWere seeks out managers that can articulate its investment philosophy and how this will be implemented through varying market environments. We do not have a preference for value, growth or style neutral investment styles specifically, rather we aim to identify those managers that are true to label and generate investment outcomes in line with our expectations given the investment style. We do have a preference for those managers implementing "benchmark unaware" strategies as we believe those managers skilled in stock selection should have the flexibility to build portfolios to optimise the benefits of that skill, rather than hold securities simply because they have a representation in an index. An organisation must also have a clear process for security selection on both the buy and the sell side, which has been consistently implemented over a number of years.

## Portfolio Structure

A manager's investment philosophy must be reflected in its portfolio structure. Diversification rules in structuring a portfolio must be clearly described and consistent with the overall investment approach. Issues, such as the liquidity, capitalisation and dividend yield strategy (most relevant for Listed Investment Companies), must be clear and identifiable.

Liquidity is not only important at the individual company level, it is also critical at the product level. Our preference is for daily liquidity for those strategies investing in liquid markets. We acknowledge that some strategies may not be able to offer daily liquidity, but in those circumstances, we expect investors to be rewarded for the liquidity risk imbedded in those types of strategies. The critical aspect is to ensure the liquidity of any investment strategy (be it daily, monthly, quarterly or longer) is in line with the liquidity of the underlying asset.

Whilst we are comfortable for managers to have flexible investment guidelines, we believe it is critical to ensure that manager portfolios are in line with the guidelines of the strategy. To ensure this is the case we require full transparency of the underlying portfolio and positioning. We also consider the manager's time horizon and whether that is consistent with the realised level of turnover in the portfolio.

## Analysis of Risk Adjusted Returns

An examination of year by year returns relative to the economic environment, the relevant benchmarks and the appropriate peer group enables us to draw conclusions about the consistency and style of the manager. Annualised returns for multiple year periods (3, 5 and 10 years in particular) give some indication of longer-term alpha generation ability. Analytical methods seek to identify the source of (out or under) performance as a means of validating the contribution made by the investment process.

We consider whether a strategy generated a majority of its outperformance in weak or strong markets to provide an indication of the likely return profile in different market conditions going forward.

Importantly, it is not simply an analysis of the total returns: the level of risk assumed in the portfolio is equally as important as the return. We measure risk in both relative and absolute terms and compare the risk adjusted returns of each strategy against the benchmark and its peer group over the long term.

## ESG Considerations

JBWere believes consideration of Environmental, Social and Governance (ESG) issues are critical in understanding the long term earnings potential and value of investment opportunities. We are attracted to those organisations that publically commit to including ESG considerations within their investment process including becoming signatories to the United Nations supported Principles of Responsible Investing (PRI).

We also review the investment guidelines to understand whether there is a focus on responsible investing either via negative filters relevant for specific industry exposures, or positive filters in favour of companies proactively seek change within industries.

## Tax Efficiency

No investment review would be complete without consideration for the final after tax return of any strategy in the hands of the investor. Whilst many managers may indicate an aim to enhance after tax returns, we look to confirm this through investigating the outcomes delivered to investors over the long term. Within domestic equities the benefits of franking credits are considerable for most investors; therefore we are attracted to those managers incorporating this benefit into the process.

We also review the age and size of a unit trust, as older trusts may have large imbedded capital gains in their structures, which may lead to inefficient after tax outcomes for new investors. The level of turnover and the ability to pass through discounted capital gains can also be valuable to high tax payers, therefore we prefer to see managers maintain more moderate turnover levels and maximise the distribution of discounted capital gains.

Notwithstanding this, higher turnover levels doesn't necessarily ensure a strategy would be excluded from our approved universe. Rather we would highlight the strategy is more appropriate within a lower tax paying structure (superannuation portfolio).

## Financial Stability

It is crucial to establish whether an organisation has an appropriate level of financial stability to survive a climate of weaker markets during which reduced fee income or staff movements may be experienced. This became particularly relevant through the Global Financial Crisis in 2008. In the case of new boutique structures, we remain in close contact with investment managers regarding the profitability of an organisation and its ability to sustain the business in an environment of low growth.

## Client Service

It is possible to overlook the importance of client service when reviewing managed strategies, but we believe it is a critical issue for consideration. This is particularly evident when there is a period of weak investment performance from a manager. We would not necessarily look to remove a manager from our High Conviction List due to short term underperformance, but we believe it is critical that the manager is willing to communicate with JBWere, to ensure we understand the current positioning of the portfolio and the investment thesis that resulted in the underperformance.

We require managers to disclose portfolio holdings (in many cases the full portfolio), regional and sector positioning on a regular basis to ensure we can incorporate all of the relevant information into our portfolio construction process. We also require managers make themselves available to the JBWere network to provide updates on views across the respective markets. We would not recommend a product unless we believed the manager would be able to provide both the level of transparency and support required to ensure we could maintain a strong relationship over the long term.

## Fee Structure

Consistent with JBWere's attitude to costs, attention is given to fee structures of products, including ongoing fees, performance fees, buy/sell spreads, entry fees and exit fees. As the number of funds charging performance fees has been increasing, so has the level of complexity in comparing fee structures. There are flat fee structures with and without performance fees. There are performance fees on absolute returns, or excess returns over a range of benchmarks (including cash). Some managers charge performance fees on negative returns and some don't. There are high watermarks to ensure a performance fee isn't charged unless an investor's portfolio is above the previous peak and then there are those managers that can reset the high watermarks each quarter.

This was once a segment of our process that was almost an afterthought. Today, every meeting with a new manager includes considerable time spent discussing all of the intricacies of their fee structure. We don't specifically exclude a strategy with a higher than average fee structure, but we do ensure that advisers and investors are aware of all of the actual and potential fees and will only recommend a strategy where we believe the manager has the potential to add value after all fees.

We also negotiate fees with existing and potential managers on the High Conviction List, leveraging the scale of the over \$10b JBWere clients have invested in managed strategies on the JBWere Approved List. There are a number of occasions where JBWere clients benefit from reduced fee structures, typically rebated to investors via cash or additional units on a quarterly basis. In some cases, this has reduced the fee by almost 50% compared with the standard fees for those investing directly with the manager.

# Reviewing Recommendations

Importantly, for any fund which is added to the JBWere High Conviction List, this by no means ensures the product will remain there for the long term. These factors are not only considered when reviewing new strategies, the Managed Research team reviews the ratings assigned to each factor, on each of the products available on our High Conviction List on a quarterly basis. We will also make a change to a rating or recommendation mid-quarter if a trigger event occurs.

There are a number of triggers that might prompt a review of a recommendation including:

- Performance outside of expectations for a specific strategy
- Portfolio deviates from expectations, with regard to risk targets, fundamentals or style drift.
- Changes in investment personnel/team dynamics
- Disruption in organisational environment
- Or simply a better idea in the manager universe is identified.

The chart below details our process for reviewing recommendations following the occurrence of any one of these triggers.

1. Identify trigger	2. Evaluate broader impact of trigger	3. Outcome
<ul style="list-style-type: none"> <li>• Performance outside of expectations</li> <li>• Portfolio deviates from expectations                             <ul style="list-style-type: none"> <li>– Risk targets</li> <li>– Fundamentals</li> <li>– Style drift</li> </ul> </li> <li>• Change in investment personnel/ team dynamic</li> <li>• Disruption in organisational environment</li> <li>• Better ideas in manager universe</li> </ul>	<ul style="list-style-type: none"> <li>• Is the manager delivering on our expectations (performance and risk)?</li> <li>• Have team or organisational changes adversely impacted the manager’s ability to deliver on expectations?</li> <li>• Is the manager still playing the role we expected them to in a broader portfolio construct?</li> <li>• Have we identified a higher confidence manager to fill the role?</li> </ul>	<ul style="list-style-type: none"> <li>• Conviction reaffirmed</li> <li>• On watch</li> <li>• Terminate</li> </ul>

Source: JBWere

It is important to highlight that over the last few years there have been few changes to our preferred managers. This is to be expected given the level of detailed research we undertake when reviewing any manager. Our intention is to select managers we will partner with over the long term; we have no intention of churning a portfolio of managed strategies.

Notwithstanding this, a majority of our downgrades have tended to reflect issues other than performance. A very common reason for a change in our recommendation has been as a result of personnel departure. The fact the departure of key personnel has been the catalyst for downgrades within our universe does not always spell doom for a manager, but it does trigger a full review of the strategy.

In the past, we have also downgraded managers following changes to the underlying investment style. This is a critical issue because we select managers with a particular style to play a specific role in our clients’ portfolios. If a manager was to change its investment style, or deliver outcomes outside of our expectations it will impact the overall characteristics of our clients’ portfolios, leading to unintended biases across their total portfolio.

## Governance and Approval Process

The Managed Research team is responsible for making recommendations related to managed investments to the JBWere Product Governance Committee (PGC). The PGC has oversight and final approval for all changes to the JBWere Approved Product List (APL). The PGC meets at least once per quarter to review the existing investments on the JBWere APL, as well as consider any recommendation changes (either additions or removals) related to the APL.

JBWere has a tiered APL. Those investment strategies considered highest quality are assigned to the High Conviction List. Other investments, including passive investment strategies (seeking benchmark-like returns), or investments within a particular niche (including ethical strategies) will be included on the broader APL.

JBWere’s Managed Research process has been developed over the last 20+ years and we will continue to enhance the process as we search for successful and innovative strategies to combine together in portfolios to achieve superior risk adjusted returns over the long term.



# About JBWere Investment Strategy Group

Our Investment Strategy Group (ISG) is a team of highly experienced investment strategists and analysts; the driving-force behind our investment recommendations and asset allocation strategies. The ISG group undertakes in-house research across a diversified suite of asset classes, including international and domestic equities, international and domestic fixed income, and alternative investments. Supporting the team's research is a wide range of views including those from our domestic and global research partners and other well-respected external industry research bodies.

Drawing on these insights, the ISG provides the intellectual property, insights and tools for JBWere's Advisory Team to manage clients' portfolios including:

- The economic outlook;
- Analysis of global investment trends, opportunities, challenges and investment markets;
- Strategic asset allocation and the identification of tactical portfolio tilts;
- Direct model portfolio and advice; and
- In-depth managed strategies research.

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