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The building blocks of portfolio construction

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Management for Asia Pacific



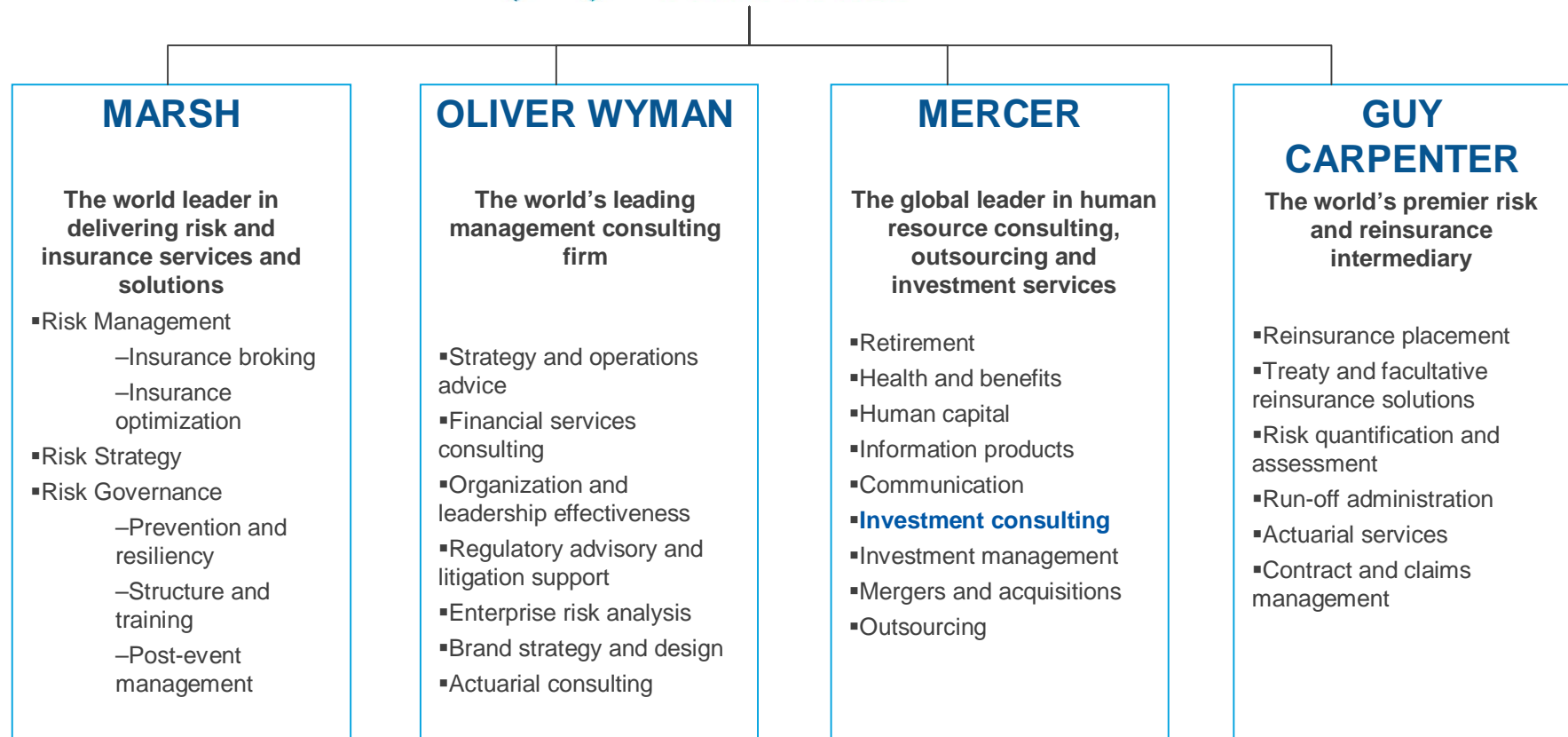
Outline

- Introduction to Mercer
- Buildings blocks for portfolio construction
 - Asset allocation
 - Funds selection
 - Structuring
- Business issues to consider

Introduction to Mercer

Marsh & McLennan Companies

With annual revenues of \$11.5 BN, Marsh & McLennan is a leading global professional services firm



Marsh & McLennan Companies

Uniquely positioned to service wealth management firms in all key strategic and operational areas



- Oliver Wyman
- Mercer – Human resources consulting
- Mercer – Investment management and consulting

Oliver Wyman

- Leading **strategy consulting** firm with clients including 75 of the global top 100 financial institutions; more than 1,000 professionals exclusively dedicated to the financial services industry. Within the **wealth** and asset management space, focus on strategy and M&A, customer management and distribution, profitability value and efficiency, risk and value management

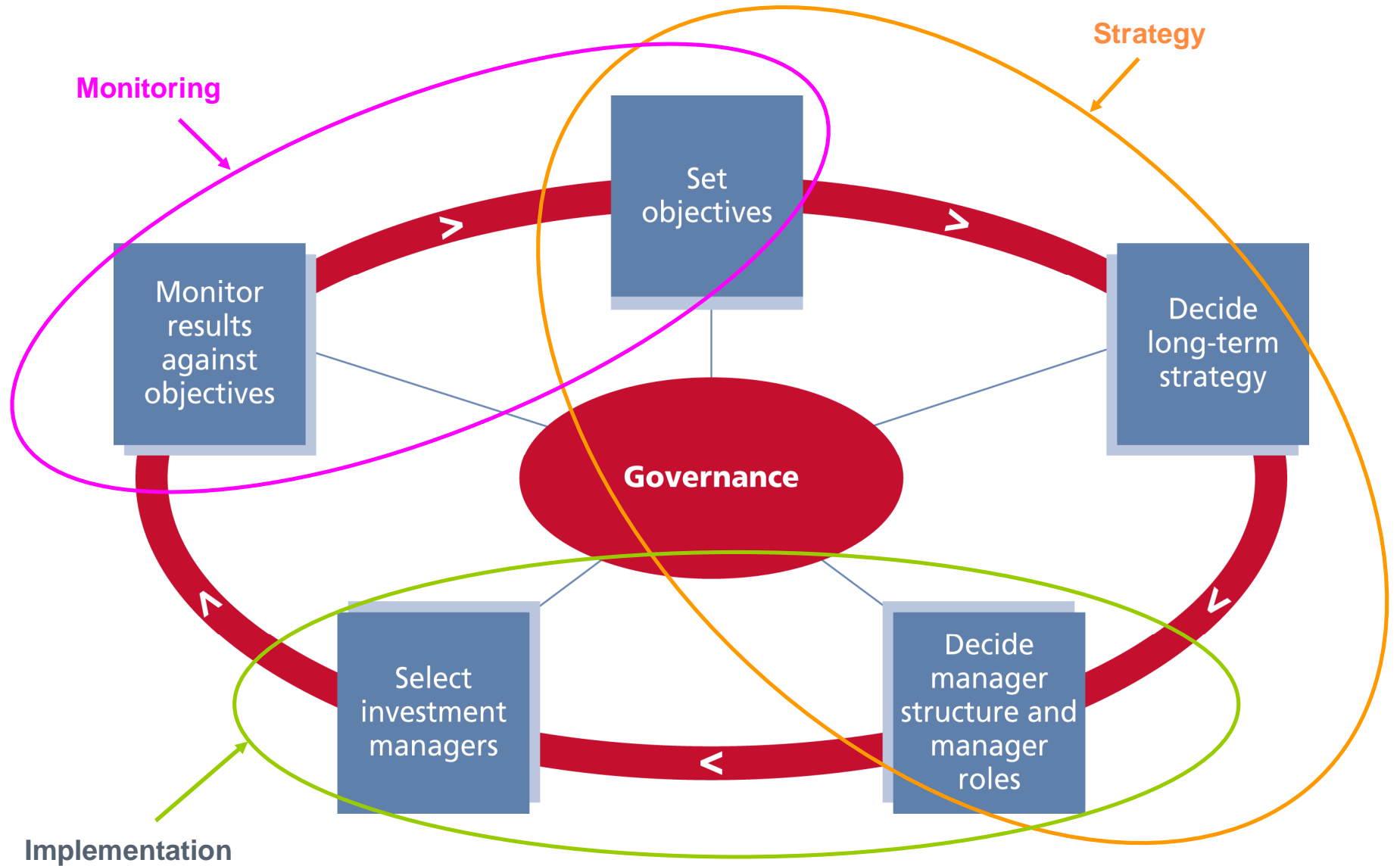
Mercer

- Leading global **investment consulting** firm with **more than 1,000 investment professionals in 52 offices and 2700+ clients with assets of US\$3.7tr+**. Advice on investment issues including governance, investment strategy, fund selection, **portfolio construction** and monitoring, RM training, operational assessments.
- Leading global **HR consulting** firm with 10,000+ clients including 9 of 10 Fortune 100 Firms, 2 of 3 FTSE 100 Firms and majority of Nikkei 225 firms. Services include workforce architecture and development, **rewards**, performance management and M&A

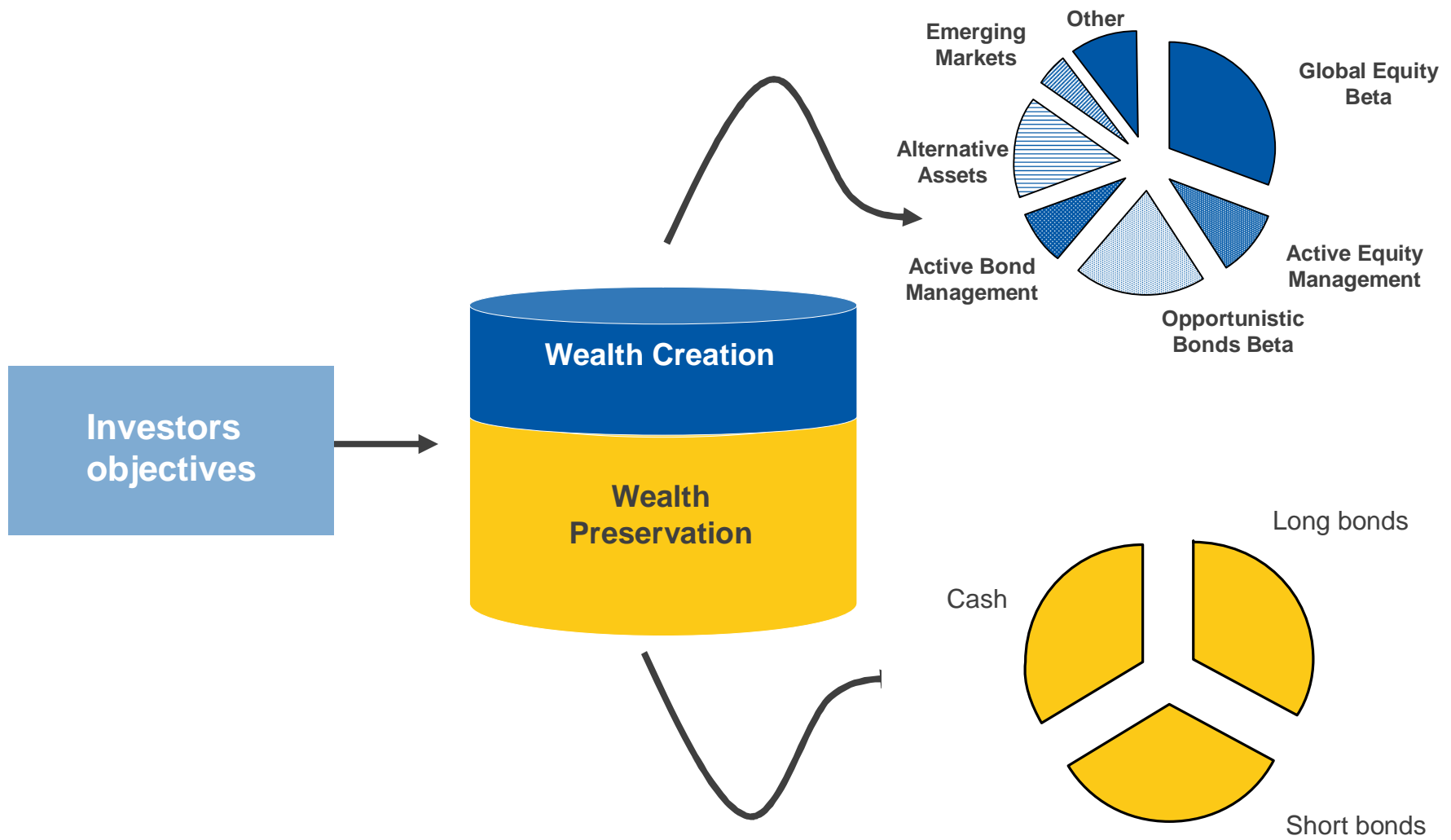


Portfolio construction process

The Investment Decision-making Cycle

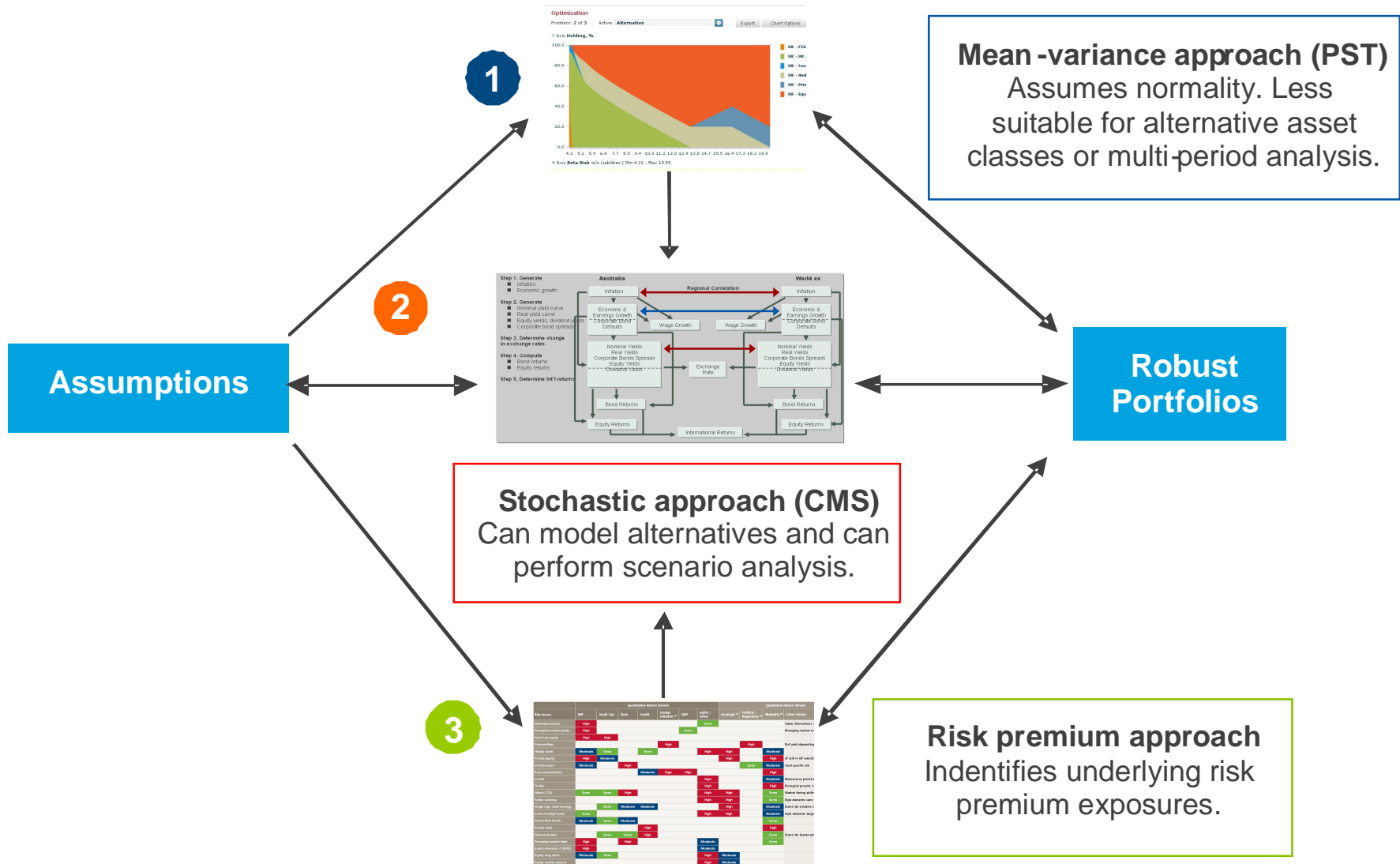


Asset allocation



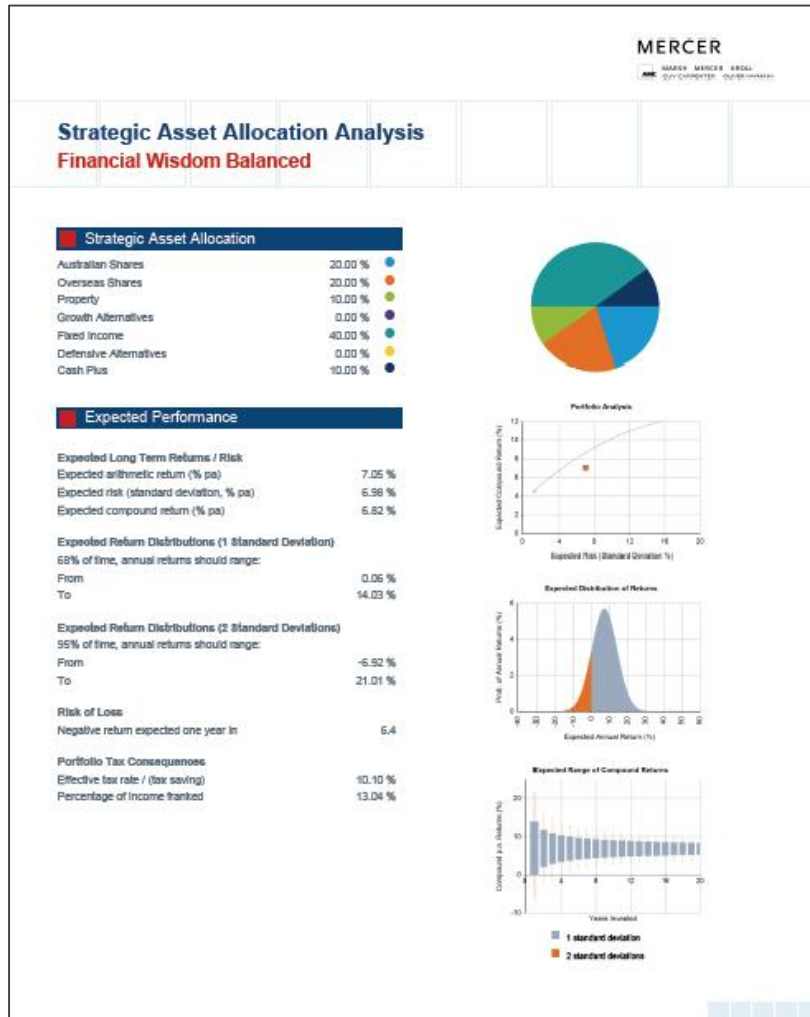
Asset allocation tools

Mean-variance, stochastic and risk-premium approaches



Asset allocation output

Should be clearly linked to investment objectives



- Risk profiles can be centrally distributed by your investment strategy team
- But advisers might need asset allocation modelling tool to show expected returns from existing or different asset allocations



Fund selection approach

“Comfort” and “Fit”

- Three main categories of factors to be considered:
 - Quality
 - Comfort
 - Fit
- “Quality” factor would be based the assessment for each candidate
- “Comfort” Factors
 - What requirements for past track record are required?
 - Are there any preferences for size, status and domicile of organisation?
 - Are there any preferences for rate of growth of assets under management and personnel numbers?
 - What level of personnel stability is considered appropriate?
- “Fit” Factors
 - Level of fees to be charged
 - Level of service to be provided



Fund selection process

- Scoring process of a manager typically has both qualitative and quantitative elements
 - Criteria based screening is important to ensure research and resources focused on appropriate managers
 - Quantitative scoring systems are not able to evaluate the key drivers in the wide variety of investment processes, philosophies and styles of investment managers
- For many organisations applying a quantitative screen to qualitative factors is considered important because of the perceived:
 - Clarity in decision making and ease of explaining the decision making process to various stakeholders
 - Objectivity, independence and robustness
 - Consistent approach for different managers for different mandates and selection panels
 - Clear and defined audit trail of selection criteria
 - Provide equal voice to decision making board/committee members

Manager research tools

Qualitative...

Global Investment Manager Database (GIMD)

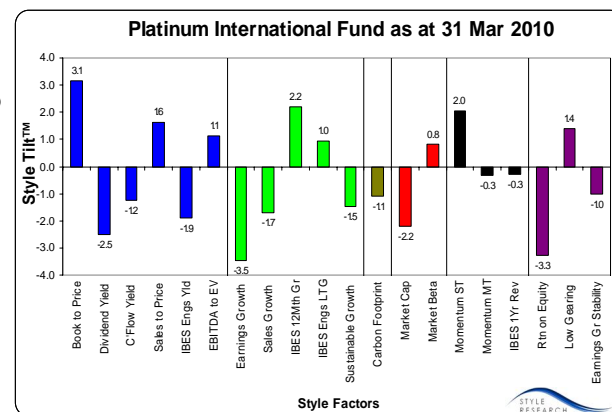
- Qualitatively monitor APL and model portfolios
- Review and monitoring of current APL and Portfolios
- View archive of manager ratings, reports and meetings
- Ability to find and analyse any manager at adviser request
- Efficiently conduct manager searches for all asset classes
- Key tool to manage many types of portfolio risk
- Holdings-based tool to conduct manager blending analysis

MERCER GIMD Inquire

Main menu Maintenance Licence Agreement GIMD website Help Contact us

- Manager Details**
View information about a specific manager
- Investment Strategy Details**
View information about an investment strategy offered by a manager
- Performance Details**
View information about a track record (performance) for a manager
- Portfolio Details**
Style Research™ Output for equity portfolios analysed by Mercer
- Screen Database**
Build your own query, specify criteria, and extract data and Mercer research
- View by Product Type**
View information about all strategies of a particular type
- Reports / Watch Lists**
Run standard reports and queries and create a custom watch list
- Report Writer**
Create a customised report

Consulting. Outsourcing. Investments **Exit**

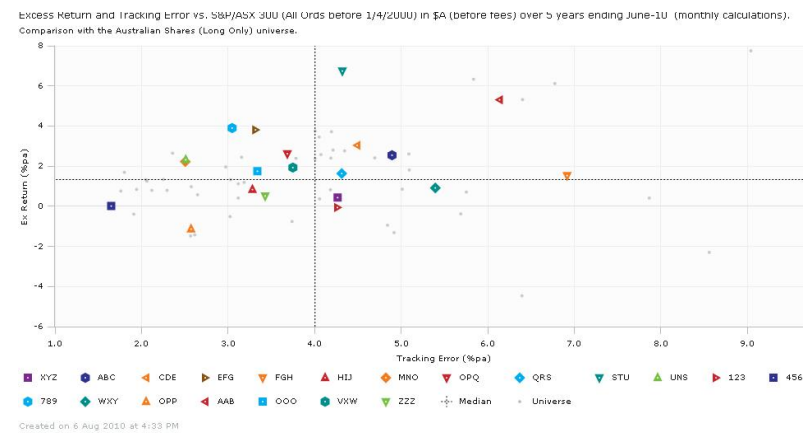
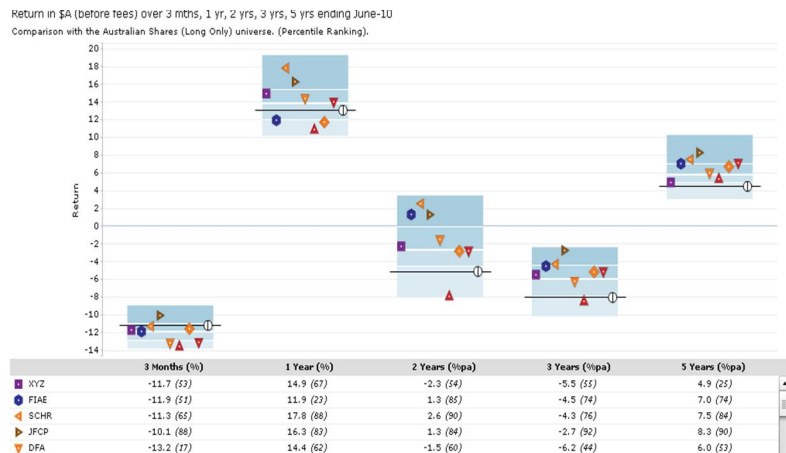
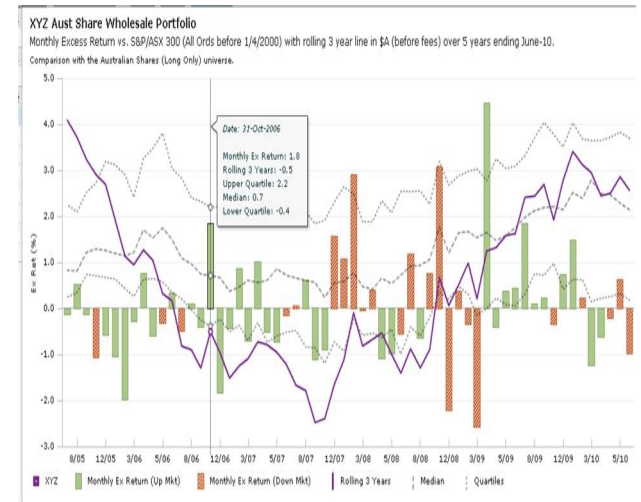


Manager research tools

...quantitative (performance)

Manager Performance Analytics (MPA)

- Quantitatively monitor APL and model portfolios
- Efficiently produce APL and asset class monitoring reports for internal stakeholders and advisers
- Assess adviser portfolios
- Produce visual exhibits for adviser bespoke portfolios



Model portfolios

Structuring – combining asset allocation and fund selection

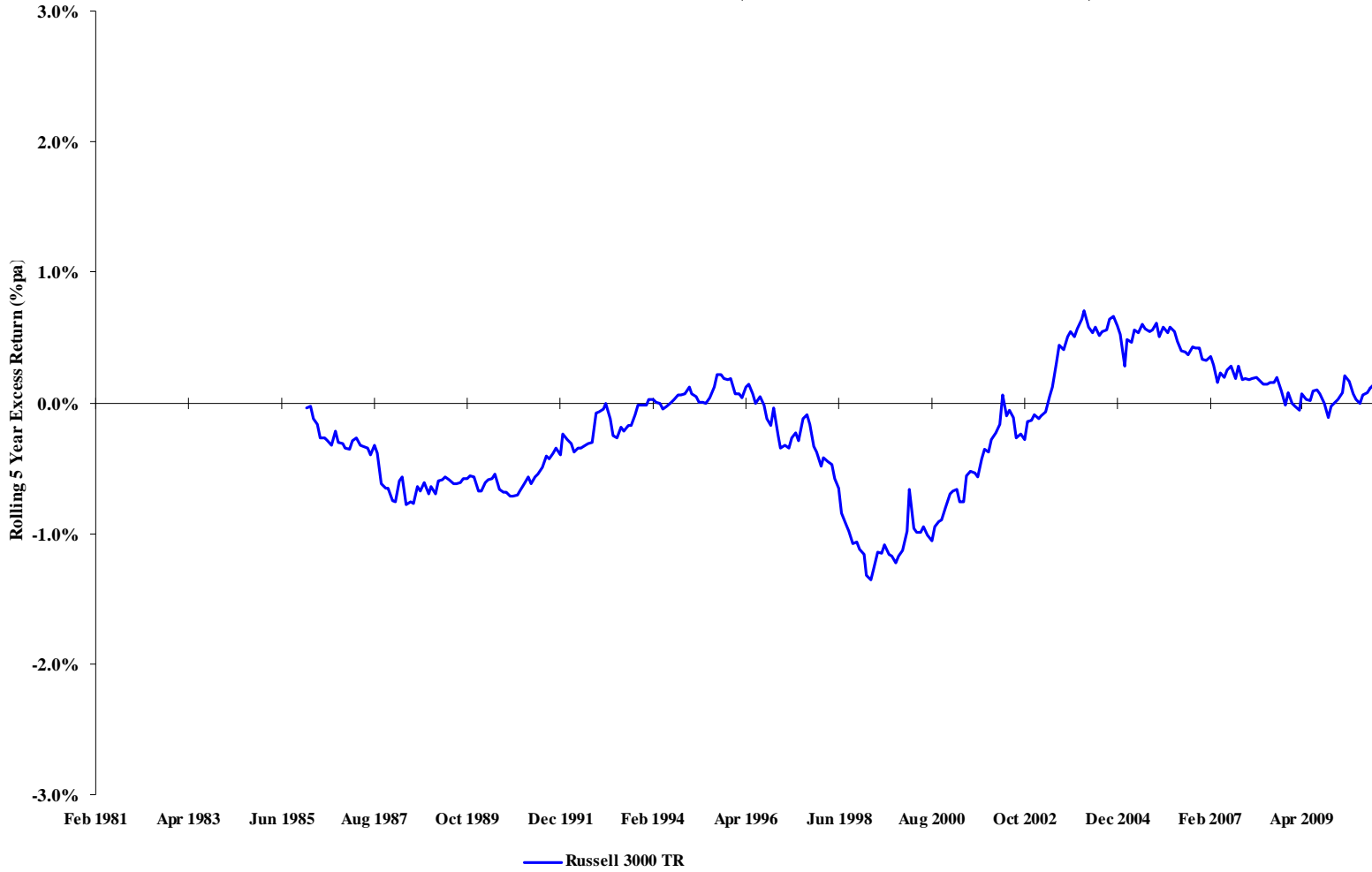
- Active or passive?
 - Opportunities to add value depend on no of securities and market environment (higher volatility is better)
 - Have managers added value?
- How many managers?
 - The more active the managers, the more of them you will need to have consistency
- What type of managers?
 - Style biases, size bias, stock selection process (top down/bottom up)
- Benchmarks and targets
- Are the fees appropriate relative to the value-add?

Model portfolios

Effects of style

Small Cap Returns - Large Cap Returns

Excess Return in Equity - US - All Cap from Feb 1981 to Dec 2010
Russel 3000 versus Russell 1000 (before tax and after fees in \$S)



Data Source: Lipper, A Thomson Reuters Company

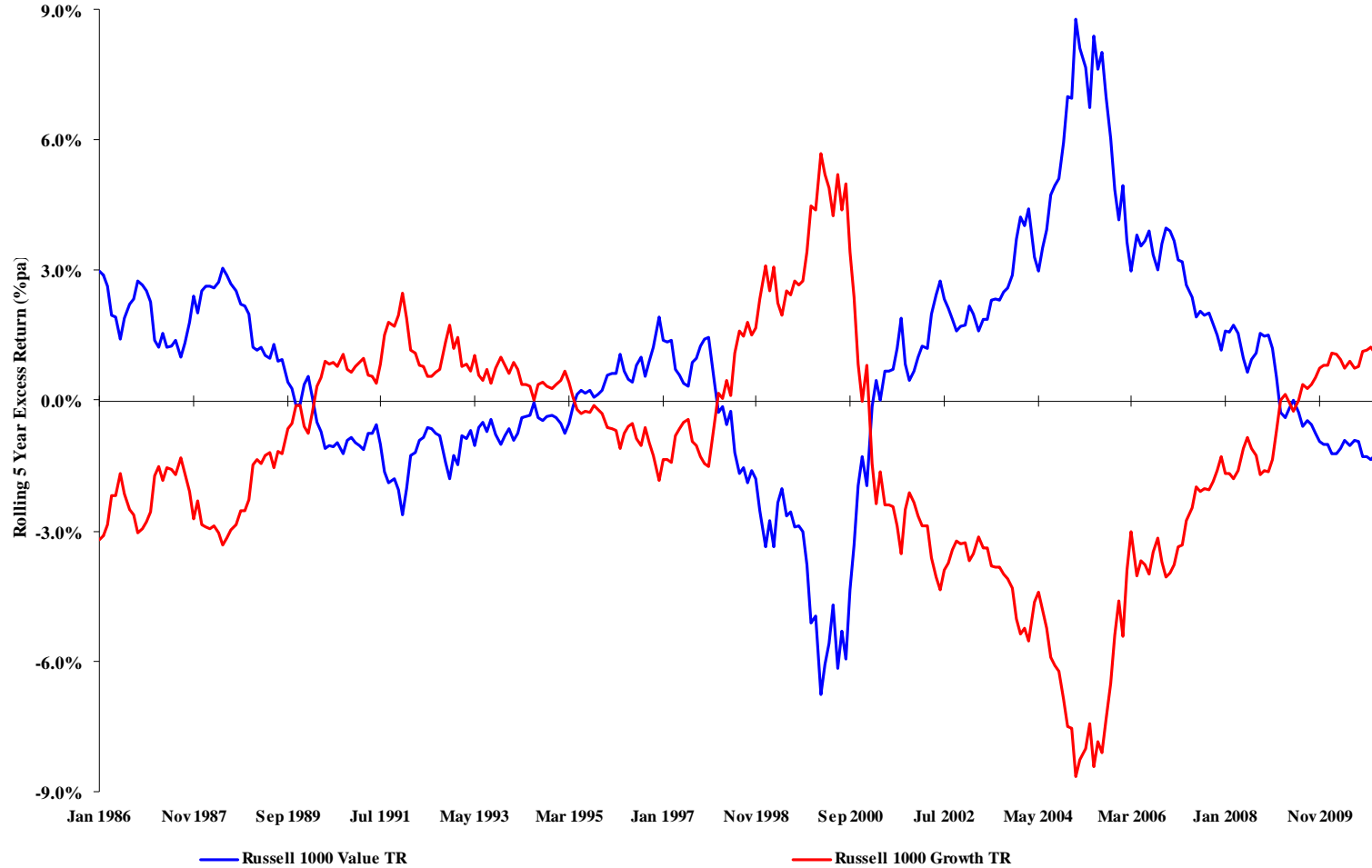
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Model portfolios

Effects of style

Value and Growth Excess Returns

Excess Return in Equity - US - All Cap from Jan 1986 to Dec 2010
R1000 Value & R1000 Growth versus Russell 1000 (before tax and after fees in \$\$)



Data Source: Lipper, A Thomson Reuters Company

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Model portfolios

Benchmarks and target returns

Issues to Consider

- **Consistent with investment styles**
 - Absolute return versus relative return
 - Investment universe → risk management implications
- **Risk management**
 - Higher target → more discretions → higher tracking error to be expected

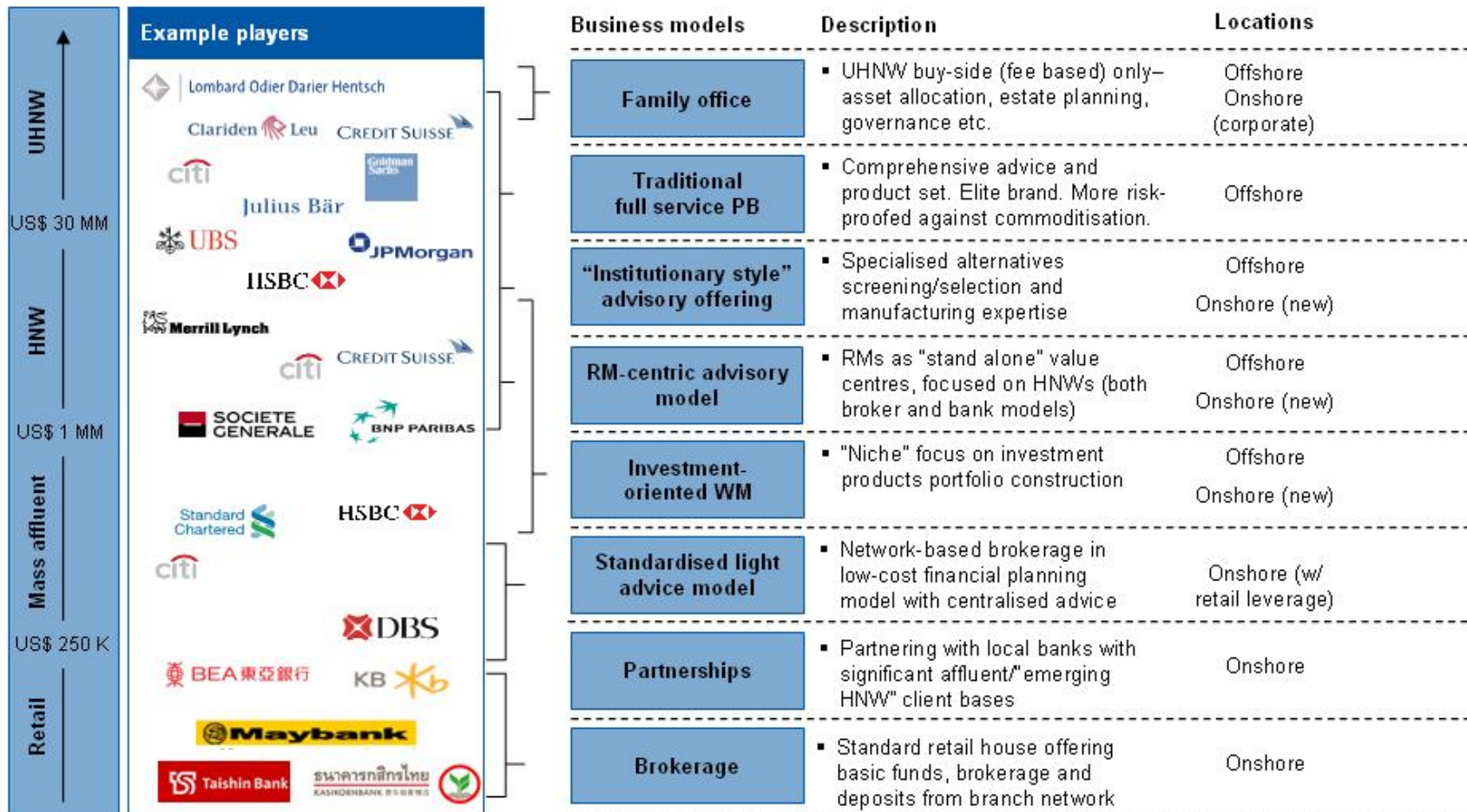
Model portfolios Management

- Advisers can build bespoke portfolios
 - Using preferred platforms
 - Using preferred managers and combinations
 - Efficiently analyse and compile client reports using portfolio review tools



Business issues to consider

Various APAC business models are emerging – each with strategic focus, product competencies and competitive strengths



Source: Oliver Wyman analysis, Company information, press releases

Product and service propositions

Segmentation, and other factors have limited product development and propositions

- Product and marketing approaches in Asia are an area of potential innovation
 - Traditionally been RM and broker driven, particularly in offshore HNW and UHNW segments and Japan
 - Product development, marketing, communications and wider support functions support bankers rather than institutionalization of clients
 - Affluent client more branch/institutionally driven and more institutionalized

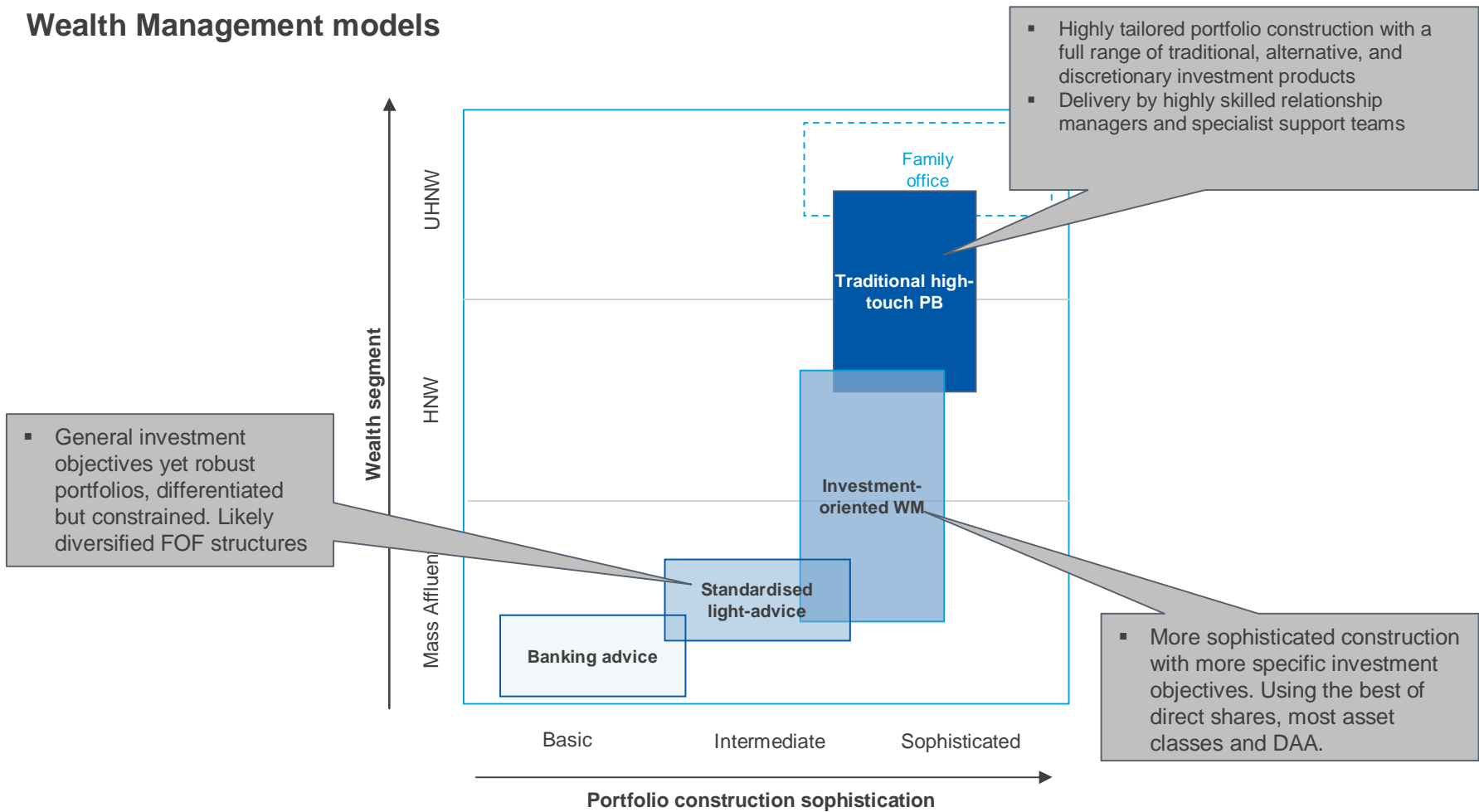
Disguised industry example

Typology	Client description	Product needs
Confident	▪ Career orientated innovators of change Active investors and consumers of advice. Little interest in status purchases	<ul style="list-style-type: none"> ▪ Debt (education), deposits, banking ▪ Planning, advisory AM (all classes), portfolio mgmt.
Familists	▪ Women and family focused. Little energy in finance and trust family over institutions. Limited status purchasing, bar property	<ul style="list-style-type: none"> ▪ Debt (school, property), deposits, banking ▪ Family planning, portfolio mgmt. (limited)
Headliners	▪ Male, business owners. Self-directed investors and seek status success in all aspects of life, inc purchasing	<ul style="list-style-type: none"> ▪ Debt (leverage), banking, wholesale banking ▪ Planning, succession, global execution and "active deals", equities, funds, passion investments
Surfers	▪ Employees with limited ambitions and seek fun. Self-directed with advice inclinations. Limited status purchasing	<ul style="list-style-type: none"> ▪ Debt (education, property) deposits, banking ▪ Planning, advice and portfolio mgmt.

Typical PB requirements

Focus on portfolio construction

Wealth Management models





Summing up

- Portfolio construction is not just selecting funds from the approved list; process has to consider many issues
- However, the process depends on
 - wealth segment
 - business model
 - business capabilities
 - product platform
 - adviser/client sophistication



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