

Morningstar Investment Management Adviser Roadshow



Join the Conversation

#MIMAR

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Morningstar Investment Management

Tackling Key Portfolio Implementation Risks

Our investment principles



We put investors first. We believe the firms that put investors first win in the long term because their investors win.



We're independent-minded. To deliver results, we think it's necessary to invest with conviction, even when it means standing apart from the crowd.



We invest for the long term. Taking a patient, long-term view helps people ride out the market's ups and downs and take advantage of opportunities when they arise.



We're valuation-driven investors. Anchoring decisions to an investment's fair value – or what it's really worth – can lead to greater potential for returns.



We take a fundamental approach. Powerful research is behind each view we hold, and we understand what drives every investment we analyse.



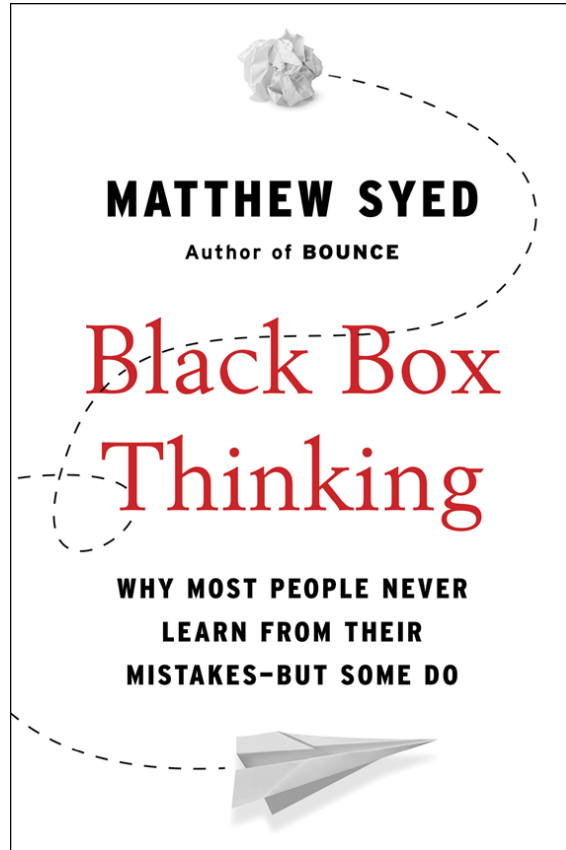
We strive to minimise costs. Controlling costs helps investors build wealth by keeping more of what they earn.



We build portfolios holistically. To help manage risk and deliver better returns, truly diversified portfolios combine investments with different underlying drivers.

Agenda

- ▶ **A perspective of the Investment cycle and managing portfolio risk in 2018**
- ▶ Multi asset Managed Accounts: identifying client needs and innovating fast
- ▶ Minimising costs to maximise investor outcomes
- ▶ Opportunities to respond positively to industry changes



The power of checklists for a pilot

- ▶ Simple to understand and communicate across teams
- ▶ Assists the mission “to enable a safe flight”
- ▶ Founded in sound theory and learning

Early warning
systems

Scenario
planning

Feedback
mechanisms

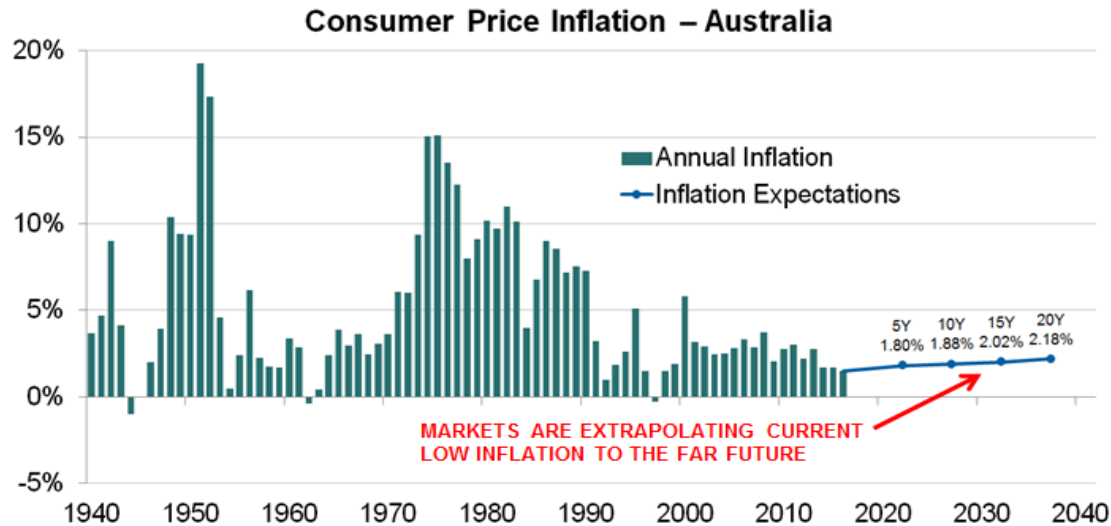
Automatic
stabilisation
mechanisms

Multiple return
engines

Rigorous
transparency

Portfolio Construction and Investment Risk.

- ▶ Howard Marks of Oaktree
- ▶ Daniel Kahneman, Nobel Prize winner.
- ▶ Ray Dalio of Bridgewater: **What is happening with inflation is the most important driver of the economy.**

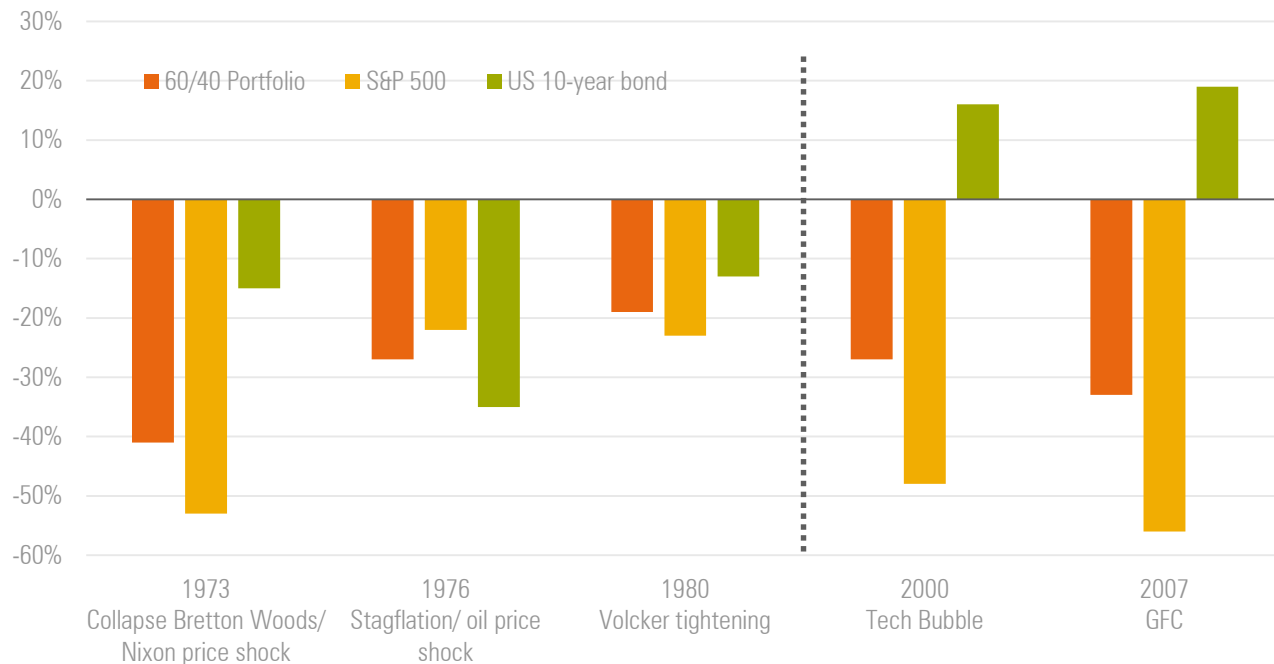


Source: Ardea Investment Management, ABS

What ingredients make for a Diversified Funds drawdown?

Select US Diversified Fund outcomes

Real total return drawdowns > 10% for a 60/40 equity/bond portfolio



Source: Morningstar, Goldman Sachs

The power of checklists for a portfolio manager

- ▶ Based on the mission – investment objective
- ▶ Prepare in advance for the unexpected – manage risk

Early warning
systems

Scenario planning

Feedback
mechanisms

Portfolio liquidity

*Which assets will
ensure the
investment
objective is attained*

*Diversity, peer
review, independent
risk team*

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- ▶ A perspective of the Investment cycle and managing portfolio risk in 2018
- ▶ **Multi asset Managed Accounts: identifying client needs and innovating fast**
- ▶ **Maintaining a focus on costs to investors**
- ▶ **Opportunities ahead to respond positively to industry changes**

The Managed Account opportunity – Morningstar as early adopter to best practice

2012 to 2017

EARLY ADOPTER

CLIENT NEEDS

- Outsourced investment management
- Transparency
- Beneficial individual ownership
- Fewer holdings
- Reduced admin
- Portfolio reporting

CHALLENGES & OPPORTUNITIES

- Limited ETF product range
- Understanding of client benefits
- Lack of multi-asset options
- Platform Technology

The Managed Account opportunity – Morningstar as early adopter to best practice



The Managed Account opportunity – Morningstar as early adopter to best practice



Managed funds vs paper portfolios vs managed accounts

Advisor and client benefits from using managed accounts

Feature	Managed Funds	Paper Models	Managed Accounts
APL Compliance Monitoring	✓	✗	✓
Cost-Effective Low Account Balances	✓	✗	Mixed
Customisation Potential	✗	✓	✓
Direct Ownership of Assets	✗	✓	✓
Portfolio Reporting	Mixed	Mixed	Mixed
Professional Management	✓	Mixed	Mixed
Reduced Administration (SOAs, ROAs)	✓	✗	✓
Tax Advantages (CGT inheriting, portability)	✗	✓	✓
Transparency	✗	✓	✓

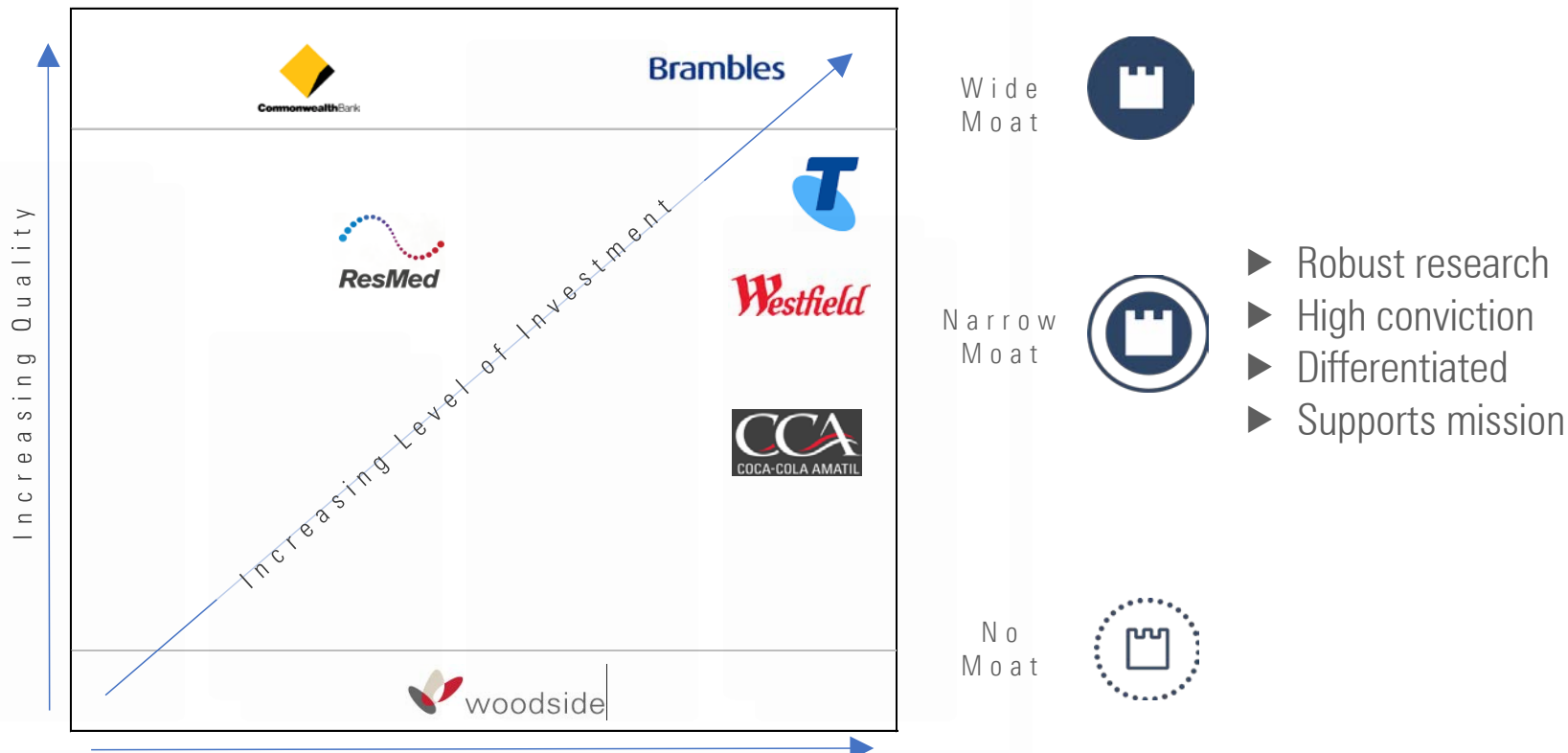
Source: Morningstar

Multi-asset managed account portfolio implementation vehicles

To capture the transparency and tax benefits of the Managed Account structure the portfolios seek to focus on direct holdings wherever possible

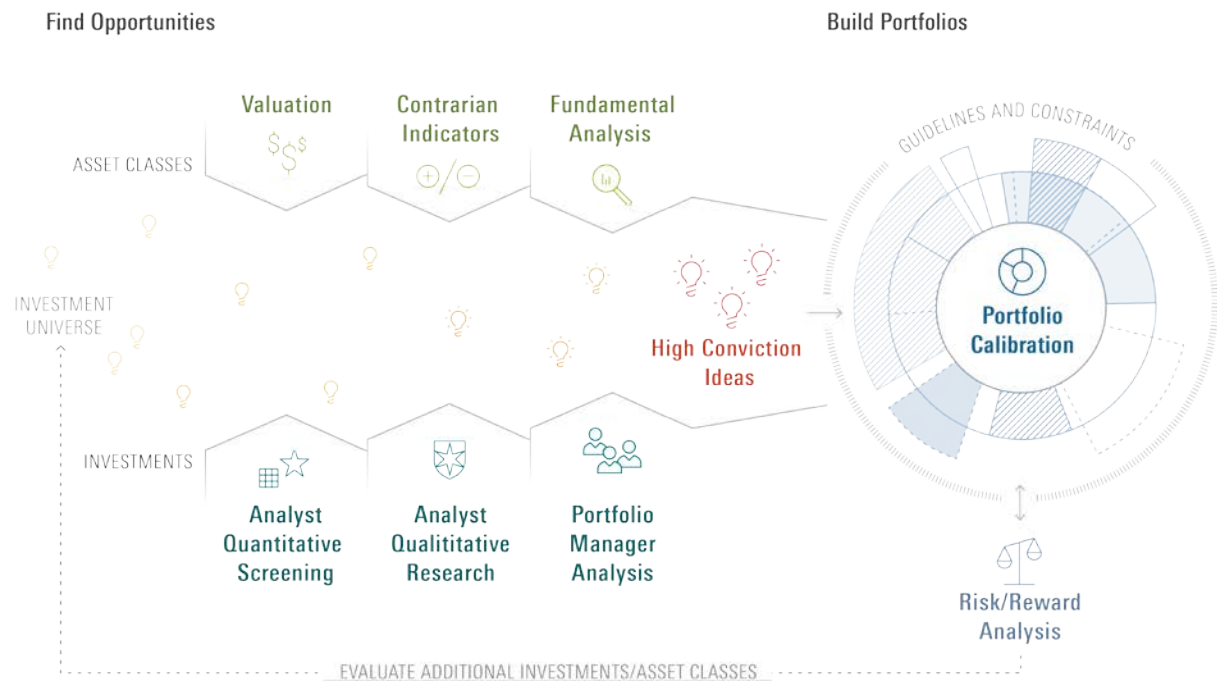


Moat ratings and valuations drive position-sizing within the portfolios



Source: Morningstar; Balanced SMA equity holdings as of 2017-12-31

Building multi-asset portfolios applying these core principles



For illustrative purposes only. There is no assurance that the techniques and strategies discussed are suitable for all investors or will yield positive results.

Morningstar's multi asset managed account product range

- ▶ Best Practice at scale
- ▶ Operational efficiency
- ▶ Communications focused

Conservative Managed Account

- ▶ Targets CPI + 0.75% p.a. over rolling 2 year periods

Moderate Managed Account

- ▶ Targets CPI + 1.0% p.a. over rolling 3 year periods

Diversified Income Managed Account

- ▶ Targets CPI + 2.0% p.a. over rolling 4 year periods with income above cash

Balanced Managed Account

- ▶ Targets CPI + 2.5% p.a. over rolling 5 year periods

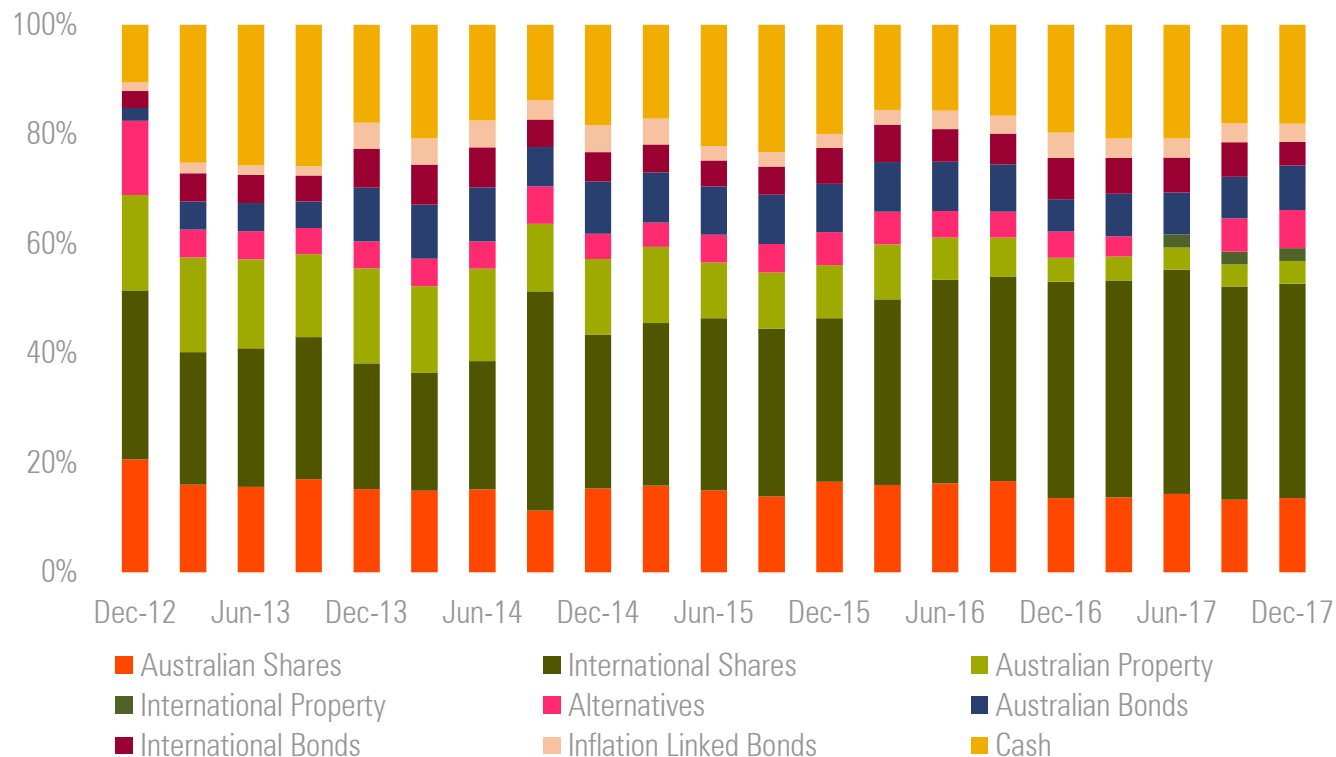
Growth Managed Account

- **Targets CPI + 3.5% p.a. over rolling 7 year periods**

High Growth Managed Account

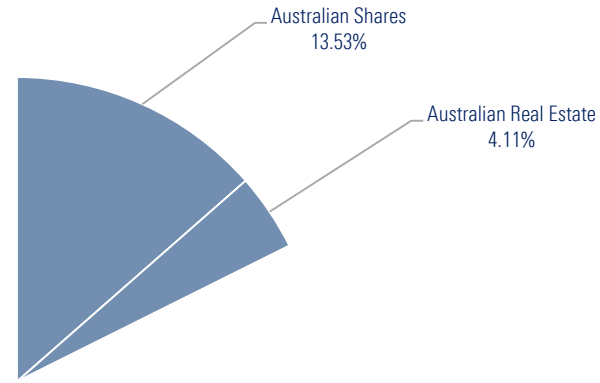
- ▶ Targets CPI + 4.5% p.a. over rolling 9 year periods

Valuation Driven Asset Allocation



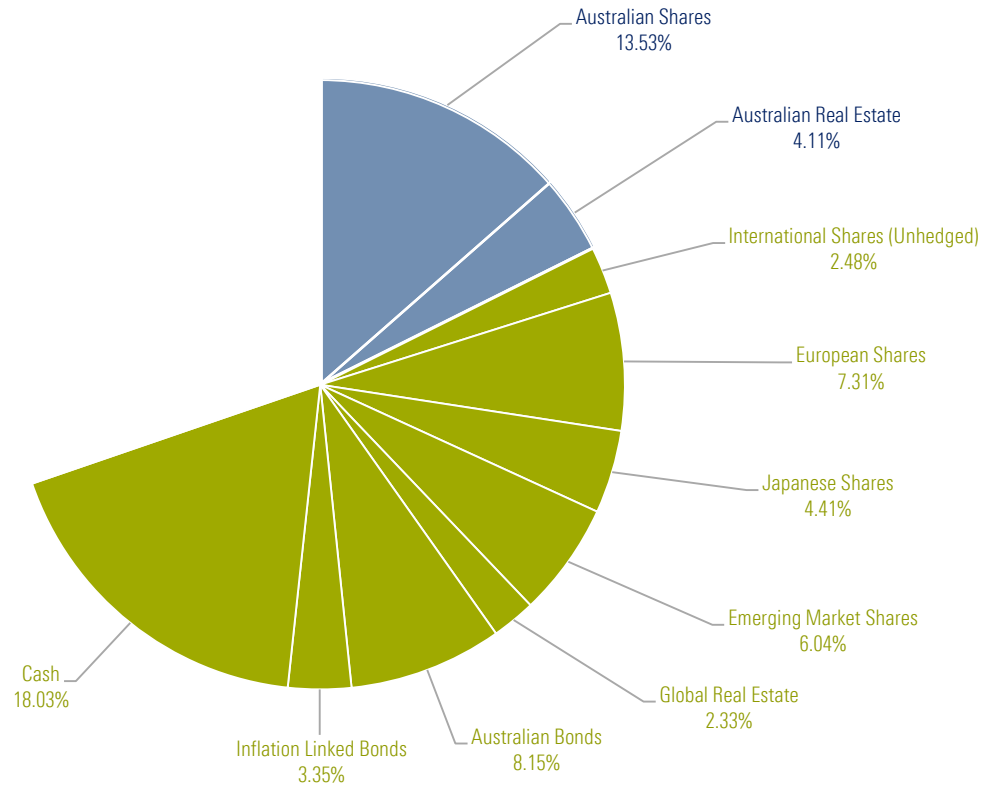
Source: Morningstar. As at 31 December 2017. Representative of the Morningstar Growth Managed Account.

Morningstar Growth Managed Account current exposures



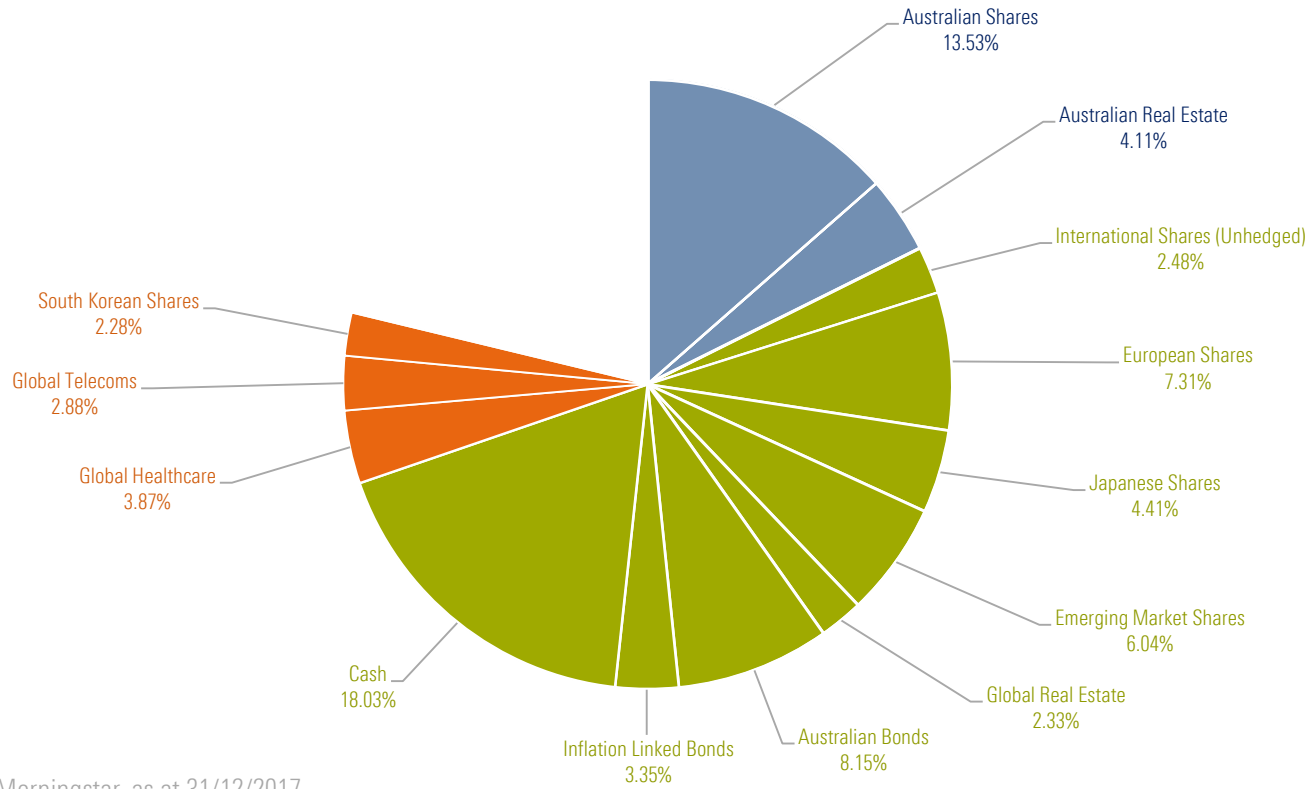
Source: Morningstar, as at 31/12/2017.

Morningstar Growth Managed Account current exposures



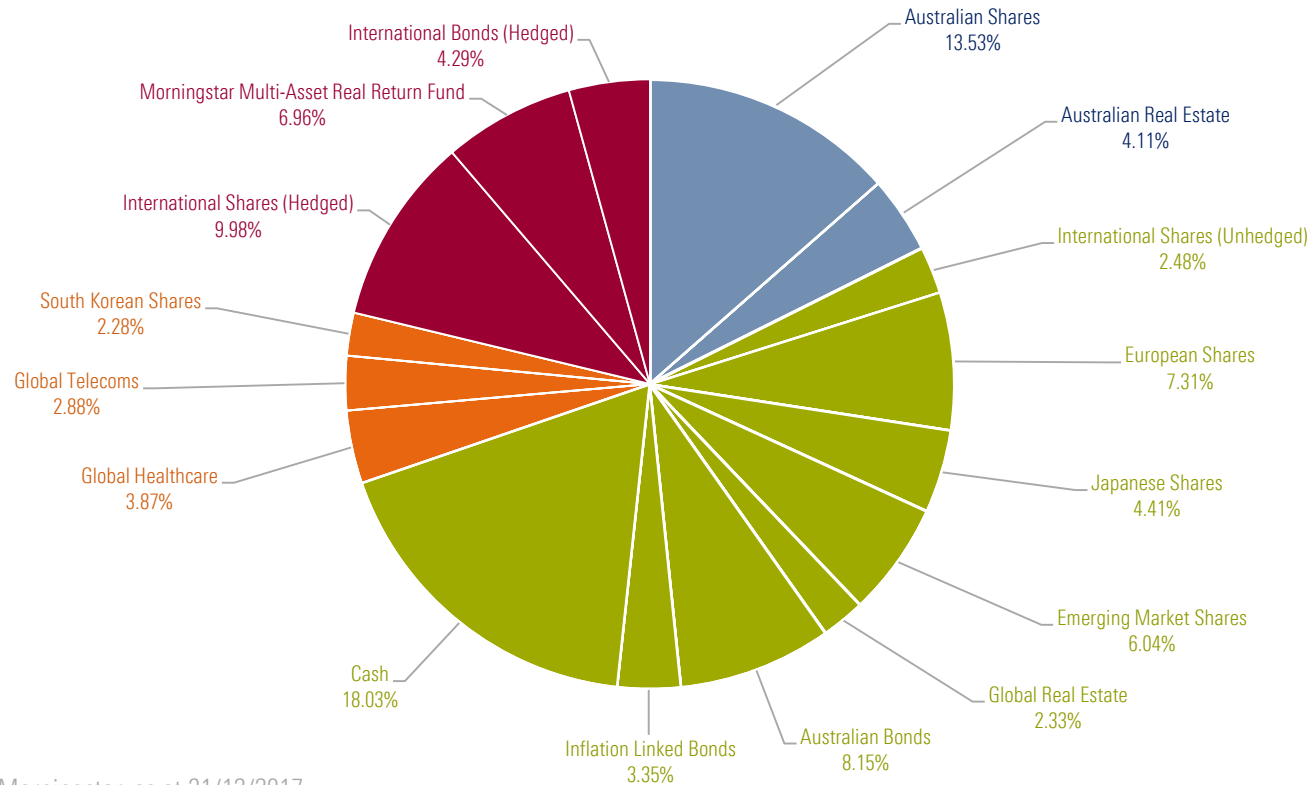
Source: Morningstar, as at 31/12/2017.

Morningstar Growth Managed Account current exposures



Source: Morningstar, as at 31/12/2017.

Morningstar Growth Managed Account current exposures



Source: Morningstar, as at 31/12/2017.

Investment Trends Survey – May 2017

Q55 Why do you recommend (or intend to recommend) managed accounts?

(Multiple responses permitted) among planners interested in recommending managed accounts.



Reproduced by permission from Investment Trends, May 2017 survey

Investment Trends Survey – May 2017

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TOP 6 RESPONSES

Efficient way to access professional funds management

Less admin burden versus holding direct shares

It frees up my time to focus on other tasks

Allows clients to see underlying shares held in portfolio

Does not have the compliance burden of direct shares

Most effective way of implementing model portfolios

Reproduced by permission from Investment Trends, May 2017 survey

Industry consolidation has already begun and more is inevitable

Key to survival is differentiation, a focus on costs, repeatable investment processes that generate consistent returns, and adaptable business models

Engagement

Traditional engagement methods are not achieving cut-through

Innovation

Managers without differentiated offerings are likely to be disrupted

Fees

Increasing cost scrutiny at both the regulator and client level

Transparency

Investors want to know what they are invested in and why

Performance

The majority of active managers do not outperform their index

Technology

Investment in advice technology is key in providing scale

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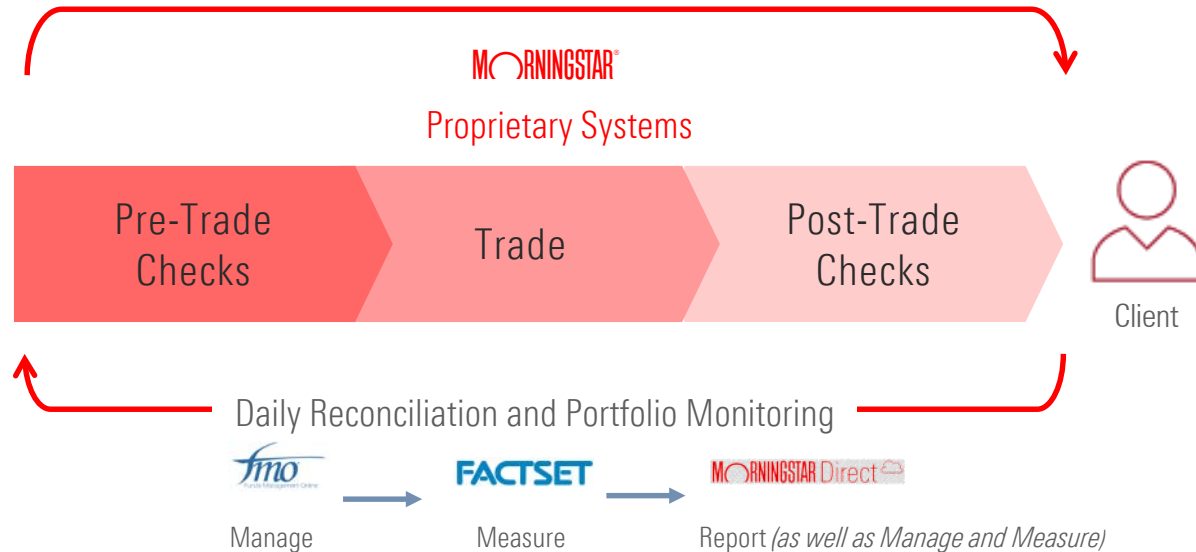
Why do investors receive “lower than model” outcomes?

Implementation shortfall is the gap between the model portfolio return and the actual investor \$ return



Robust SMA implementation, rebalance and monitoring process

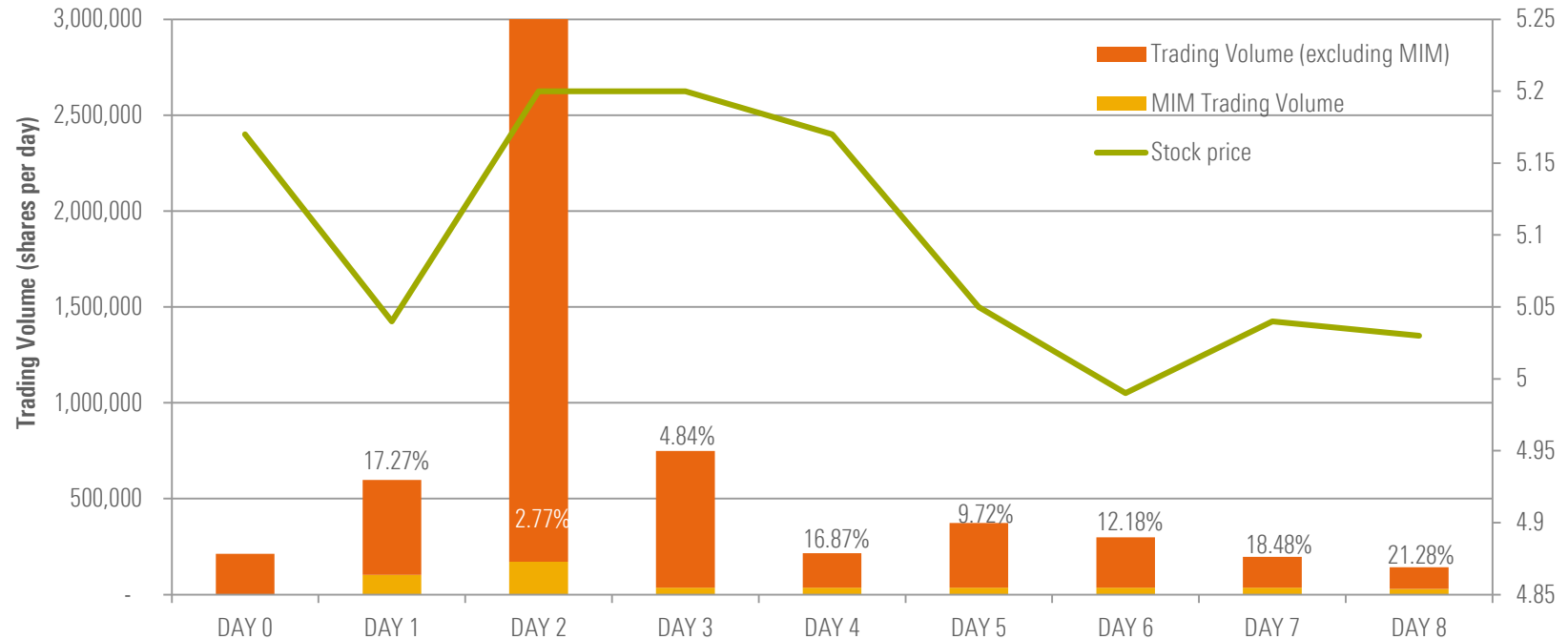
- ▶ Operations and PM team collaborate with platforms to minimise market impact of trades
- ▶ PM team and Compliance enforce trading black-list to ensure no front-running.



Source: Morningstar

Trading plan for an ASX 200 security being exited from an SMA model in November 2017

Target. Sell \$2.5m (or 500,00 shares) of a single ASX 200 stock without market impact



Opportunities to respond positively to industry change

Evolving the multi asset model and industry stakeholders

Role of ETF
providers

Platform trading
partners

Research houses

Goals based advice
framework

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Innovation required

Enable Direct US
(and Global
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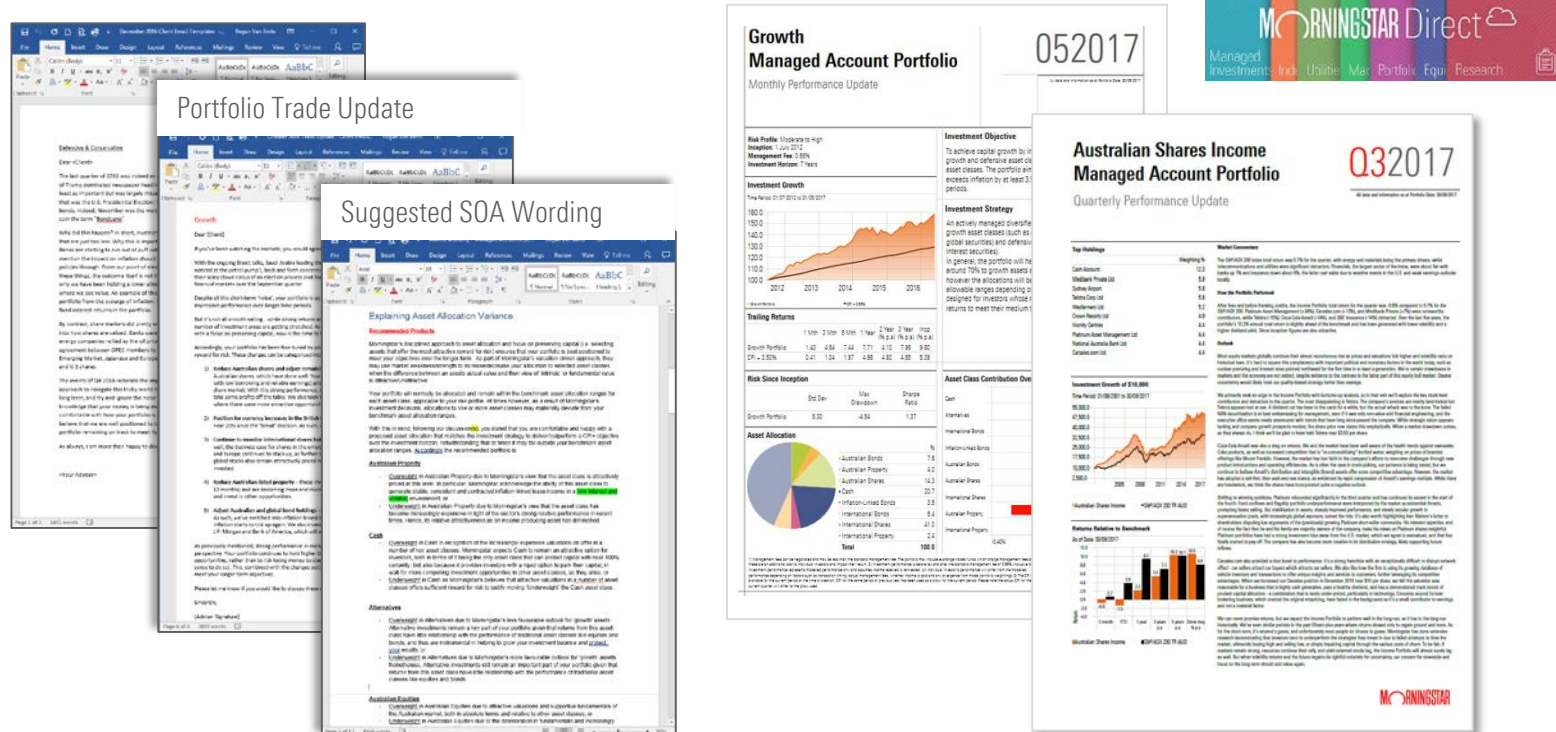
Enable Direct US
(and Global
markets) Equity
portfolios

AND/OR

Utilise managed
fund exposures with
ease of access and
transparency

Transparency – improving advisor-to-client communications

Monthly & Quarterly Portfolio Update



Source: Morningstar

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