The dilemma of asset allocation during market volatility

Gary Ding CFA - Macquarie

IMAP
Institute of Managed Account Professionals

IMAP and COVID-19

- 2020 Events
  - Awards - August
  - InvestTech - September
  - Portfolio Management Conferences - November

- Webinars monthly

IMAP
Institute of Managed Account Professionals

MACQUARIE

Presented by Gary Ding

The dilemma of asset allocation during market volatility

June 2020

Important information

This information is confidential and is provided to licensed financial advisers only. It is not to be distributed to, or disclosed to, retail clients.

This document has been prepared by Macquarie Investment Management Global Limited ABN 90 086 159 060 AFSL No. 237843 (MIMGL). MIMGL is part of the Macquarie Group of Companies. This document contains general advice and does not take into account your objectives, financial situation or needs. Before acting on this general advice you should consider whether it is appropriate to your situation. This document does not constitute an offer to invest in particular a product. We recommend that you contact your managed account provider for further information. You should read the disclosure document issued by the managed account provider and obtain financial, legal and taxation advice before making any financial investment decision.

Macquarie Investment Management Australia Limited (ABN 55 092 552 611 AFSL 238321) is the issuer and responsible entity of the Macquarie Multi-Asset Opportunities Fund. This is general information only and does not take account of investment objectives, financial situation or needs of any person. It should not be relied upon in determining whether to invest in the Fund. In deciding whether to acquire or continue to hold an investment in the Fund, an investor should consider the Fund's product disclosure statement. The product disclosure statement is available on our website at macquarieim.com/pds or by contacting us on 1800 814 523. This information is intended for recipients in Australia only.

Past performance information is for illustrative purposes only and is not a reliable indicator of future performance.

Future results are impossible to predict. This presentation may contain opinions, conclusions, estimates and other forward-looking statements which are, by their very nature, subject to various risks and uncertainties. Actual events or results may differ materially, positively or negatively, from those reflected or contemplated in such forward-looking statements.

In preparing this presentation, reliance may have been placed, without independent verification, on the accuracy and completeness of information available from external sources. To the maximum extent permitted by law, no member of the Macquarie Group nor its directors, employees or agents accept any liability for any loss arising from the use of this presentation, its contents or otherwise arising in connection with it.

Other than Macquarie Bank Limited (**MBL**), none of the entities noted in this presentation are authorised deposit-taking institutions for the purposes of the Banking Act 1959 (Commonwealth of Australia). The obligations of these entities do not represent deposits or other liabilities of MBL. MBL does not guarantee or otherwise provide assurance in respect of the obligations of these entities, unless noted otherwise.

Bloomberg Finance L.P. and its affiliates (collectively, 'Bloomberg') are not affiliated with Macquarie and do not approve, endorse, review, or recommend the Funds in this presentation. Bloomberg and the Bloomberg AusBond Index<or Indices> referred to in this presentation are trademarks or service marks of Bloomberg and have been licensed to Macquarie. Bloomberg does not guarantee the timeliness, accurateness, or completeness of any data or information relating to the Bloomberg AusBond Index<or Indices> referred to in this presentation.

Agenda

What will be covering today

1. The dilemma of asset allocation during market volatility
    a) COVID-19 crisis and the asset allocation impact
    b) Challenges faced by the traditional SMA structure
    c) A potential solution to the asset allocation dilemma
2. Market update and asset allocation outlook

MACQUARIE

01

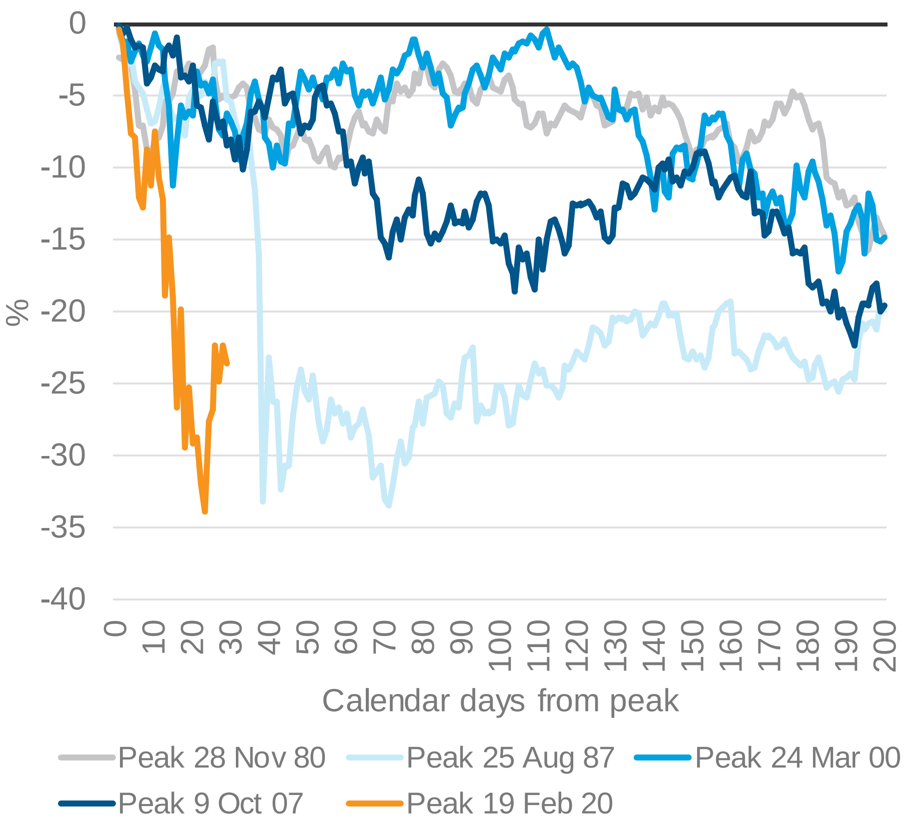
The dilemma of asset allocation during market volatility

March | Risk markets down hard and very fast

MACQUARIE

Equites have seen the fastest fall on record (including 1929)

S&P drawdowns



Investment grade credit spreads

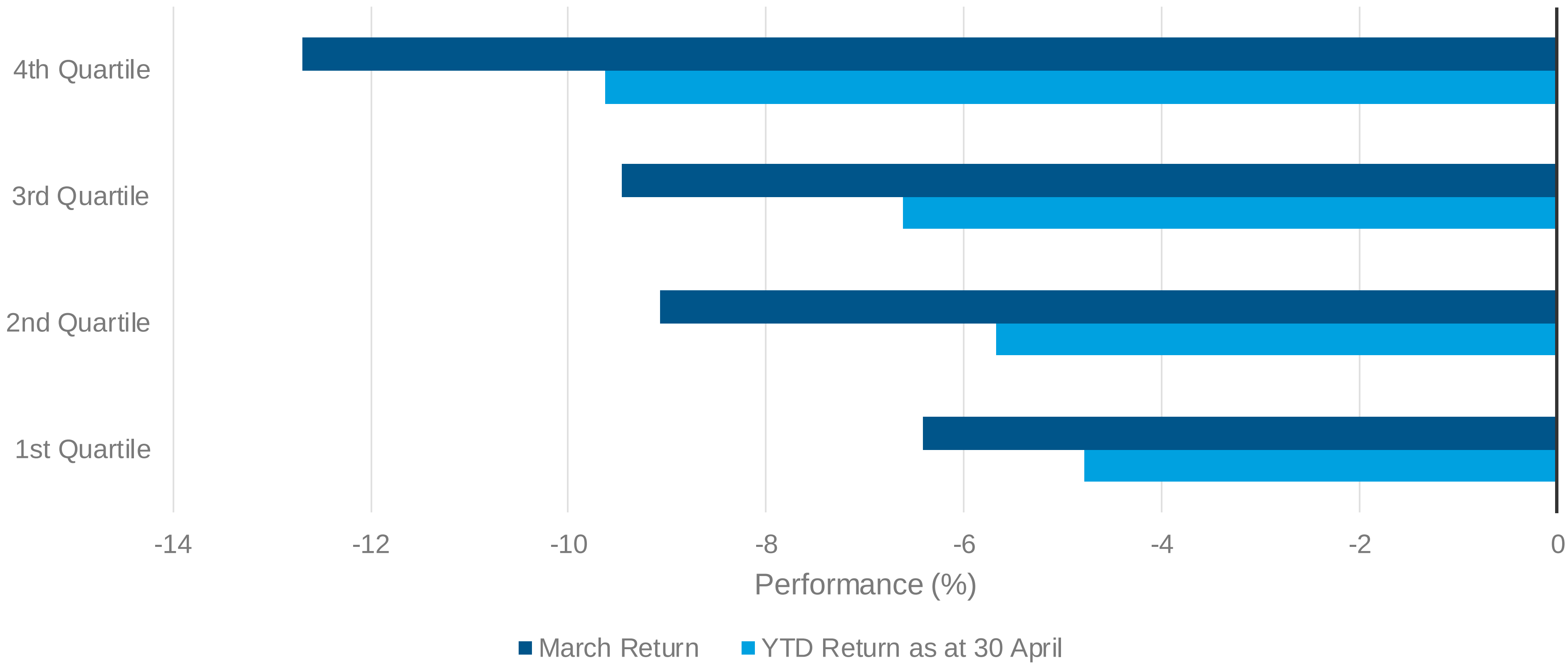
While credit spreads moved from tights to wides in a few days

Source: Bloomberg and S&P Global, March 2020. S&P 500 Index (LHS). IG – Bloomberg Barclays US Corporate Investment Grade Index(RHS).

Overview of recent multi-asset SMA performance

The speed of market moves and impact on trading was notable

Post fee returns for Multi-Sector Balanced SMAs



As evidenced by the divergence in multi-asset SMA returns

Source: Morningstar, April 2020. Past performance is not a reliable indicator of future performance. The universe of model portfolios shown is the Morningstar Australia Model Multi-Sector Balanced universe.

What drove the underperformance?

Asset allocation decisions are not the sole driver of returns

An unfavourable asset allocation decision
1

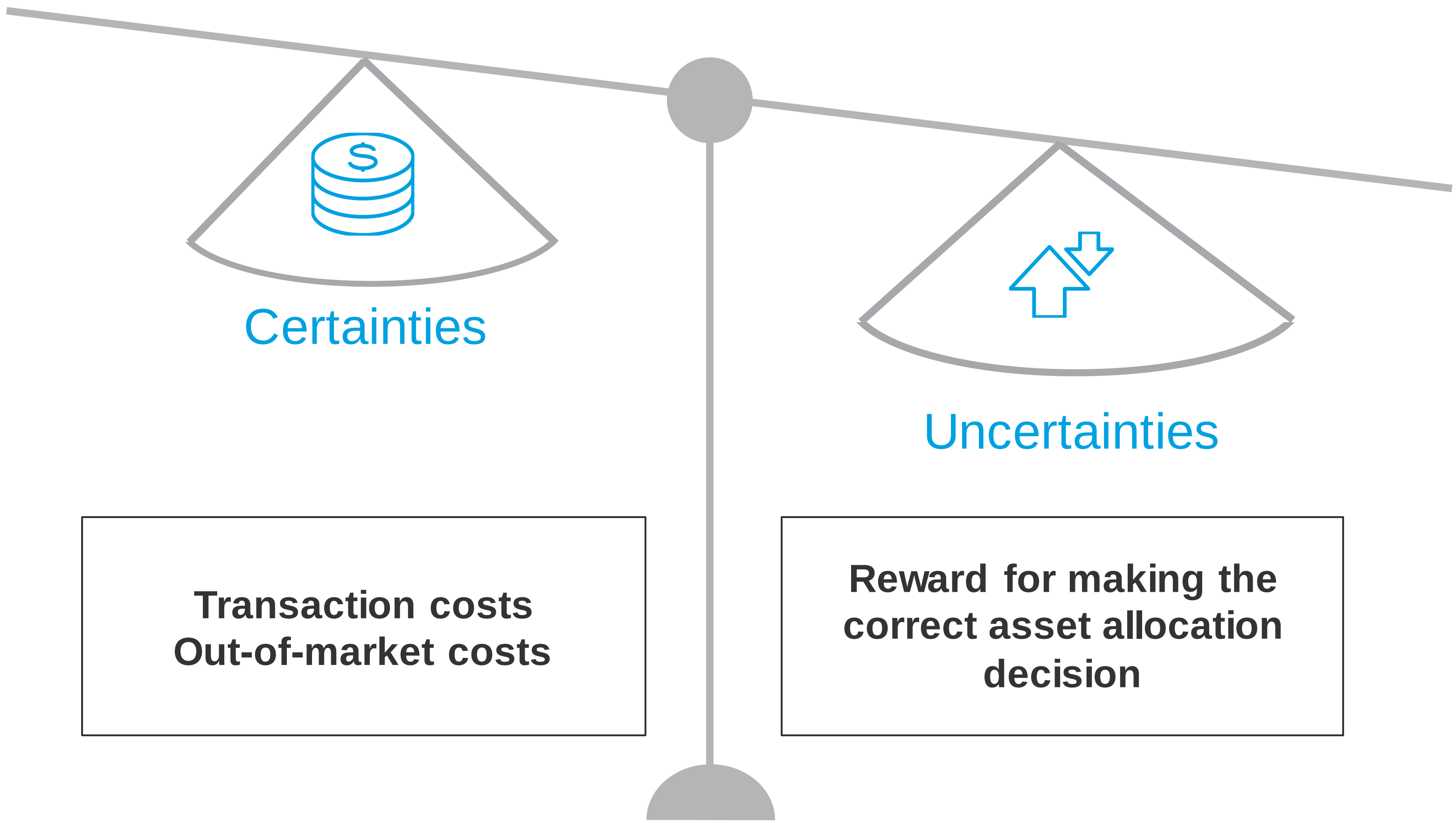
Slow to implement asset allocation decision
2

Very high transaction costs prevented the asset allocator from making changes
3

There are other costs to consider

Asset allocation considerations

Asset allocation costs versus benefits based on the investment rationale



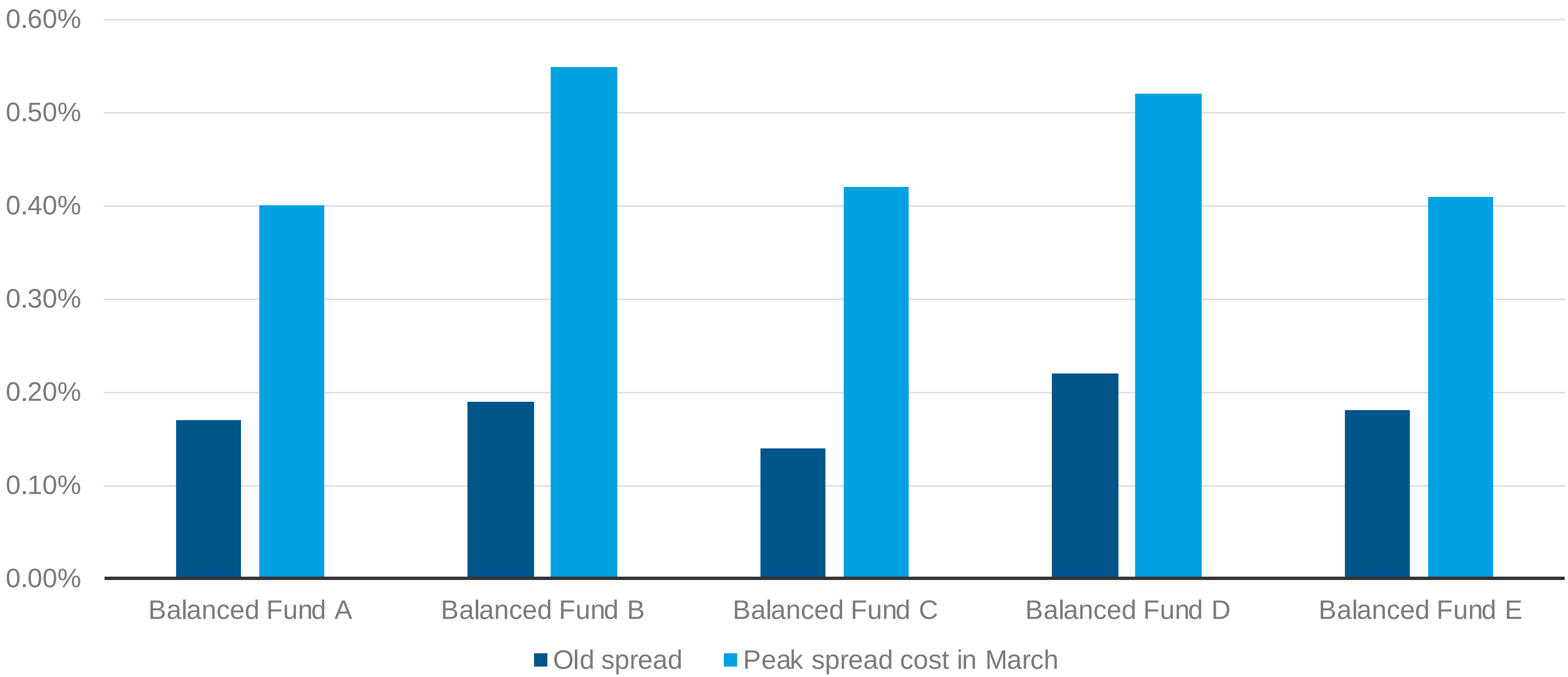
Will costs at times outweigh the benefits?

Transaction costs

MACQUARIE

Transaction costs to shift portfolio positioning increased markedly

Representative sell spreads in March*



So are the *potential* benefits worth the cost to transact?

Source: Mercer and individual Fund w ebsites. Peak spread cost in March is the highest daily sell spread charged on the Fund.
*All Funds are part of the Mercer Wholesale-Balanced Grow th universe and selected based on FUM over $100m.

Out-of-market costs

MACQUARIE

Asset allocator’s performance will be impacted by “luck”?

Asset class returns for 3 consecutive days (across 1 March – 30 April 2020)

Asset class	Lowest 3-day performance	Median 3-day performance	Highest 3 day performance
S&P 500	-12.96%	0.99%	**17.55%**
DAX	-16.25%	-0.55%	14.41%
ASX 300	-12.75%	-0.06%	12.49%
Global Fixed Income*	-4.58%	0.26%	2.45%
Australian Fixed Income^	-2.07%	0.00%	2.38%
AUDUSD	-6.93%	0.63%	4.14%

Poorly timed (unlucky!) positioning changes can be costly

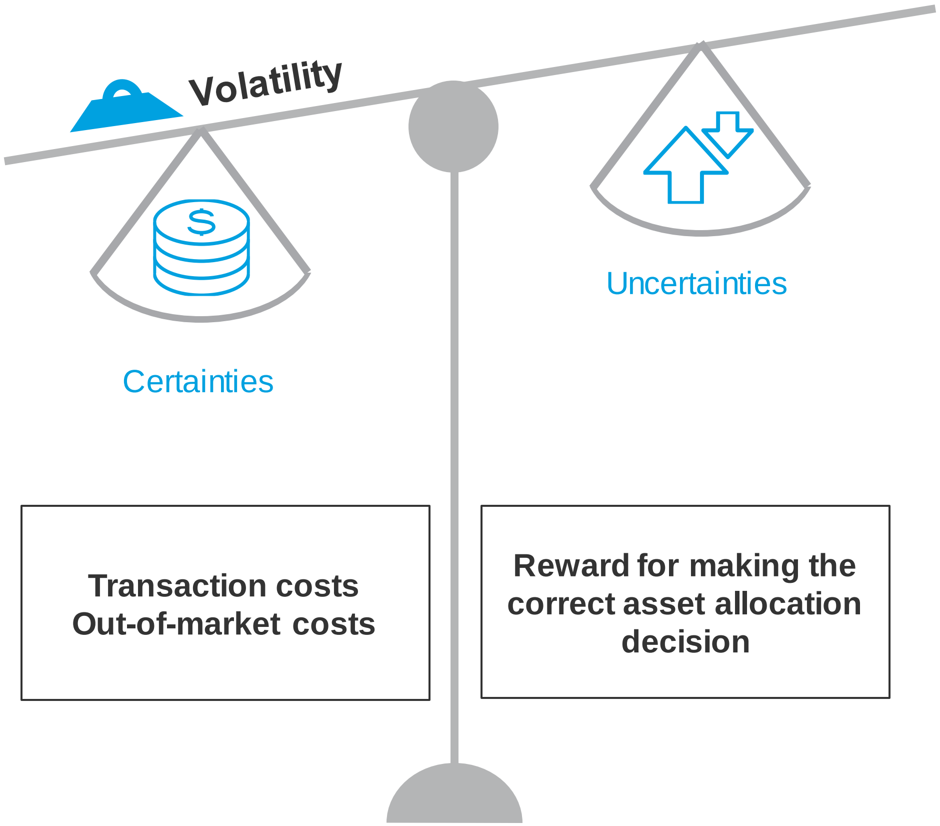
Source: Macquarie and Bloomberg, May 2020. *Global Fixed Income represented by the Bloomberg Barclays Global-Aggregate Total Return Index. ^Australian Fixed Income represented by the Bloomberg AusBond Composite 0+ Yr Index.

Example

Out-of-market costs

MACQUARIE

During volatility, "luck" becomes important?



EXAMPLE: Right idea, wrong outcome!

Decision — **Increase** equities by 10%

Waiting time — 3 days to implement change

Market moves — S&P ↑ **17.55%**

OUTCOME

Opportunity cost to Portfolio of **-1.755%**

Source: Macquarie and Bloomberg, May 2020. Representative example only.

Market volatility poses a significant challenge to the traditional SMA structure

Asset allocation costs are heightened in volatile markets

Drivers of underperformance

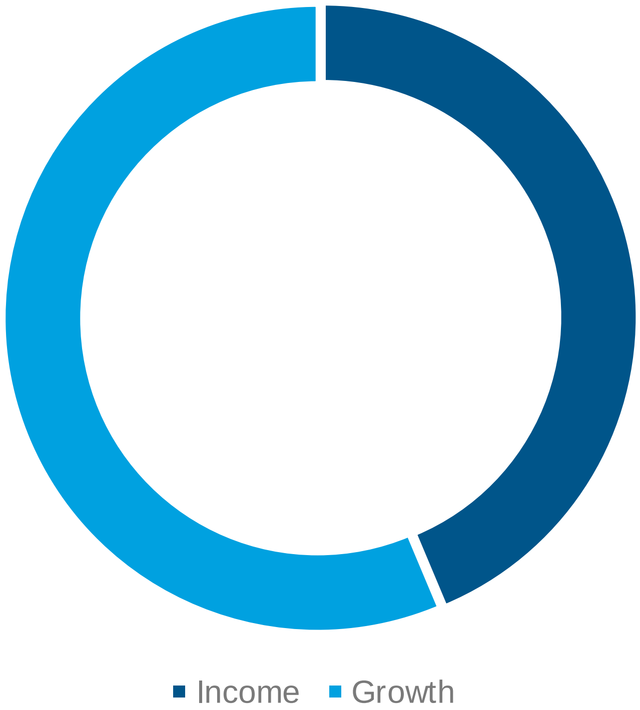
An asset allocator should not be relying on the element of "luck"

Out-of-market costs

An asset allocator should focus on allocation decisions at times when investors need it the most

Transaction costs

The traditional SMA model



Can we do it better?

Addressing the challenges with an asset allocation vehicle

Mitigate asset allocation costs, focus on asset allocation decisions

Asset allocation vehicle

DEFENSIVE GROWTH

Active asset allocation

Allows asset allocator to reposition the portfolio quickly and cost effectively

Derivatives

Asset allocator can utilise derivatives to shift exposures and to manage the downside risks

.

Providing a potential solution for SMAs in volatile markets

A potential solution to the asset allocation dilemma

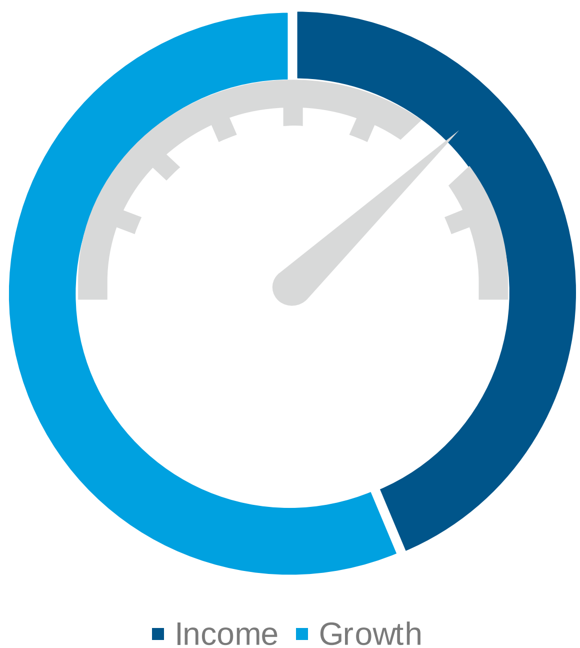
MACQUARIE

Combining an asset allocation vehicle with a traditional SMA approach

Asset allocation vehicle

Macquarie Multi-Asset Opportunities Fund as the asset allocation vehicle

Macquarie Evolve Multi-Asset SMAs



Flexible satellites

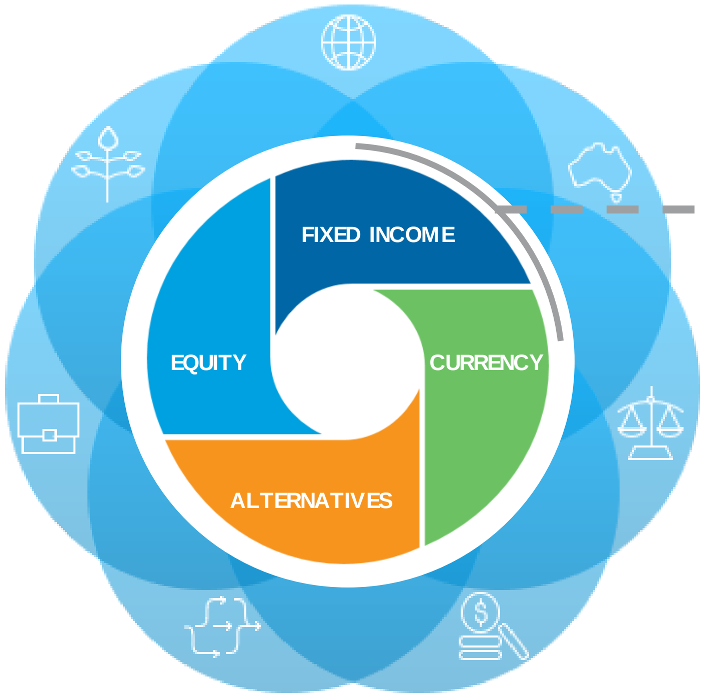
Flexible satellites to tailor the SMAs into three risk profiles

Allows the asset allocator to focus on making investment decisions

*Asset allocation mix based on the Macquarie Evolve 'Balanced' Portfolio positioning

Macquarie Evolve Multi-Asset Portfolios

An asset allocation vehicle to complement the traditional SMA structure



High quality asset allocation vehicle

Macquarie Multi-Asset Opportunities Fund

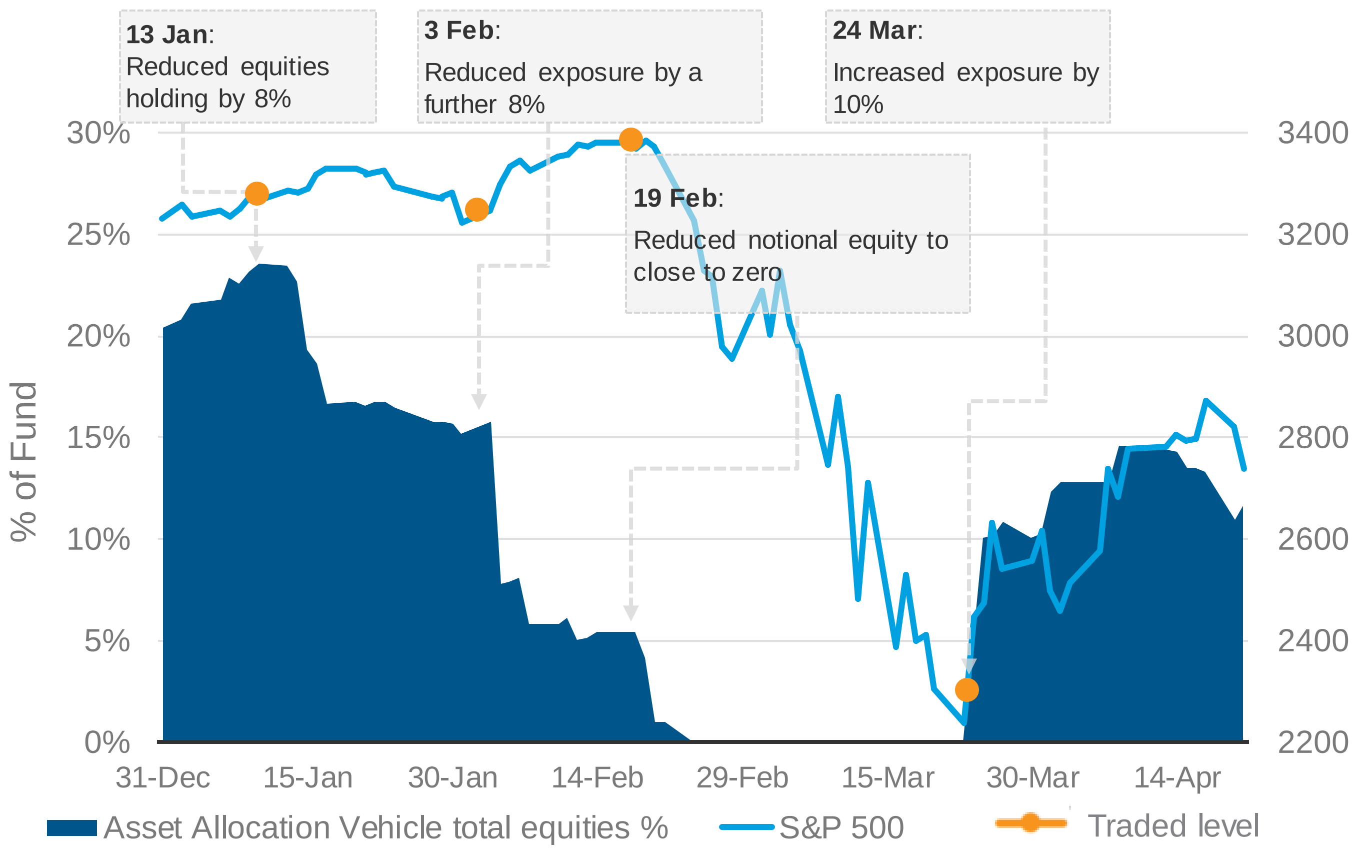
- ✓ Allows asset allocator to focus on asset allocation decisions during different market conditions
- ✓ Mitigate transaction and out-of-market costs
- ✓ Maximising efficiency for investors

Provides a potential solution to the asset allocation dilemma

Asset allocation vehicle (MAO) in action

MACQUARIE

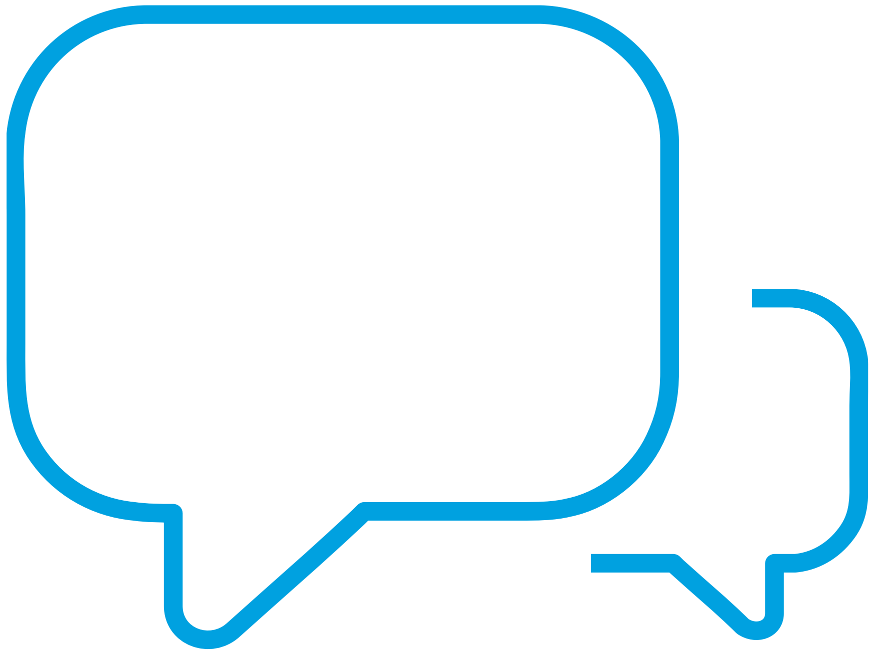
Navigating the coronavirus uncertainties



This structure allows the portfolio to respond to market events, seeking to capitalise on gains or protect capital as required

Source: Bloomberg and Macquarie, March 2020. References to specific stocks, countries, sectors or baskets are shown for informational purposes only. This information is not a recommendation to hold, purchase or sell securities or other instruments

Questions?



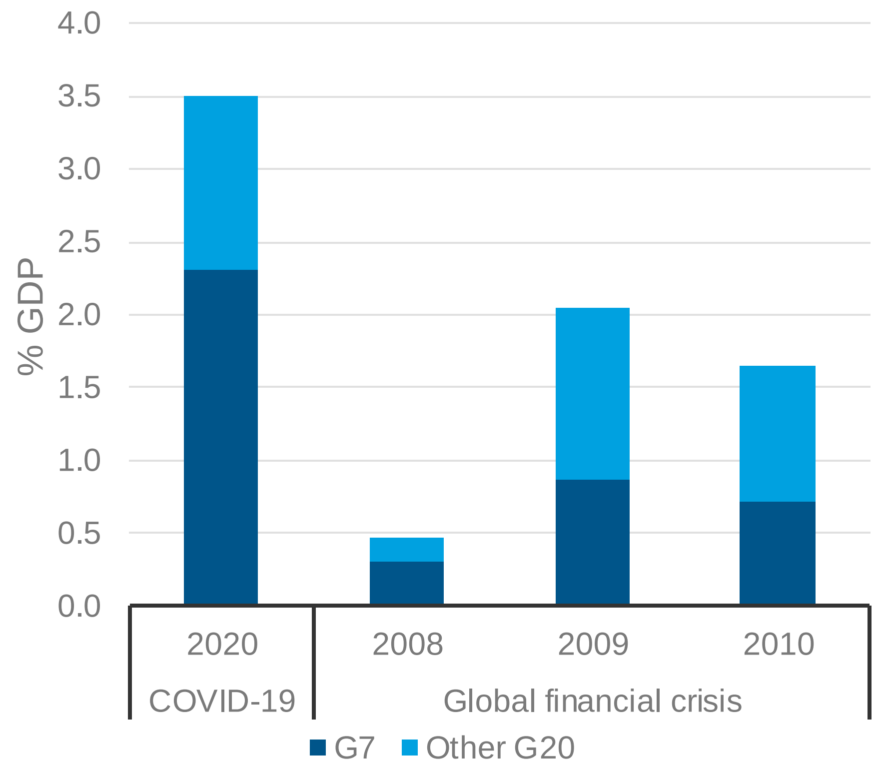
02

Market update and asset allocation outlook

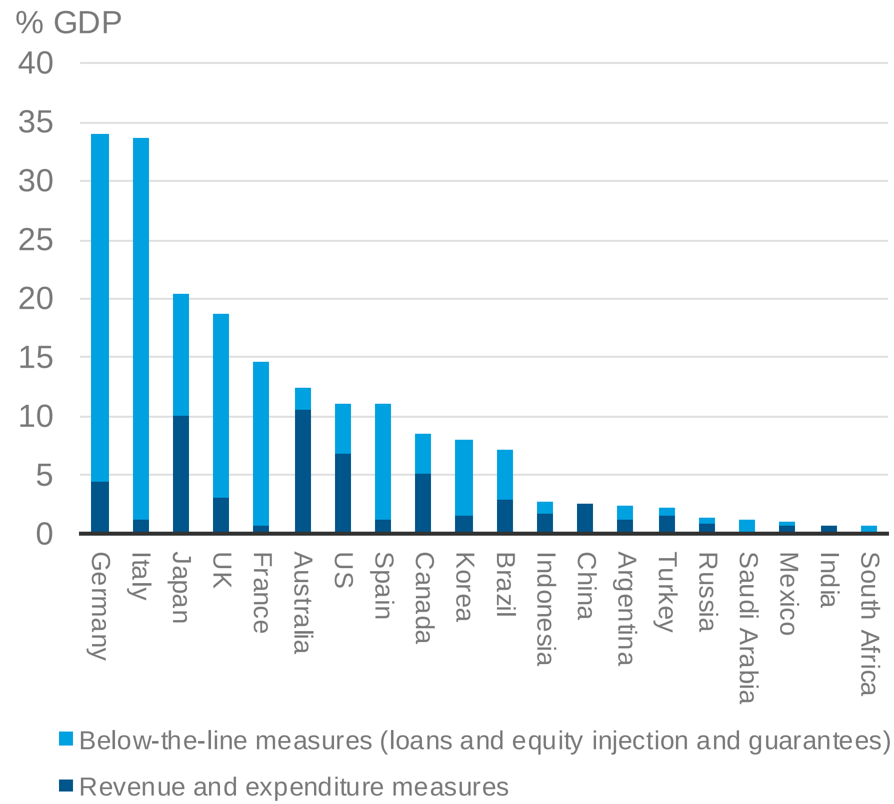
Fiscal response has been enormous

Europe total fiscal response has been larger than rest of world

Direct fiscal response to COVID-19 vs the GFC



Fiscal per country including below line guarantees



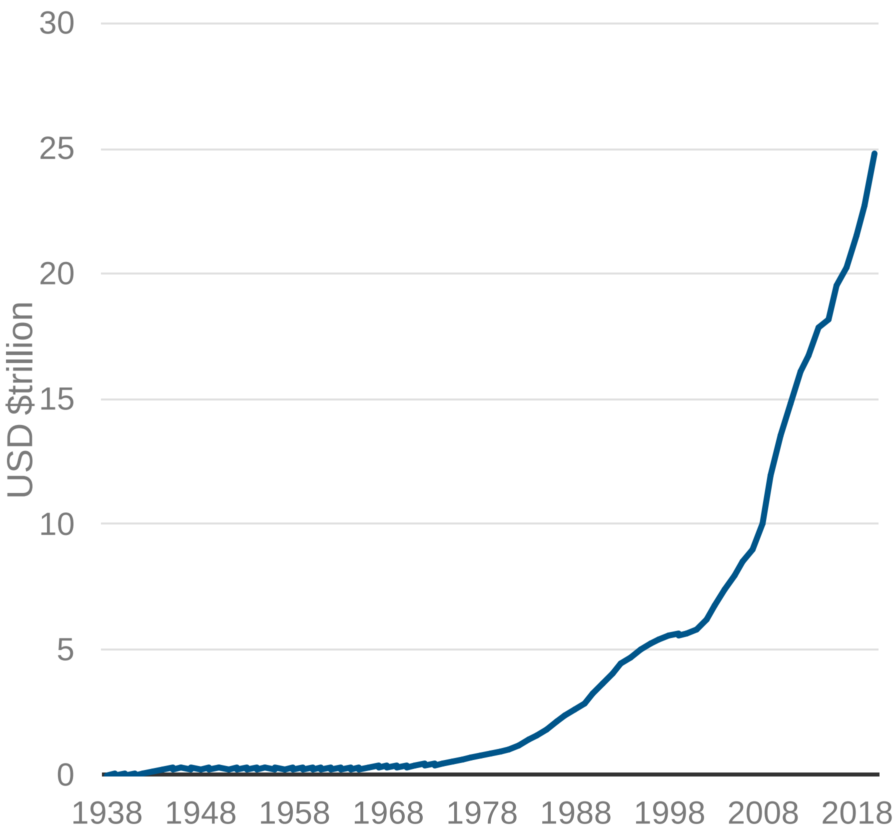
Mainly in below the line measures

Source: Bloomberg, April 2020

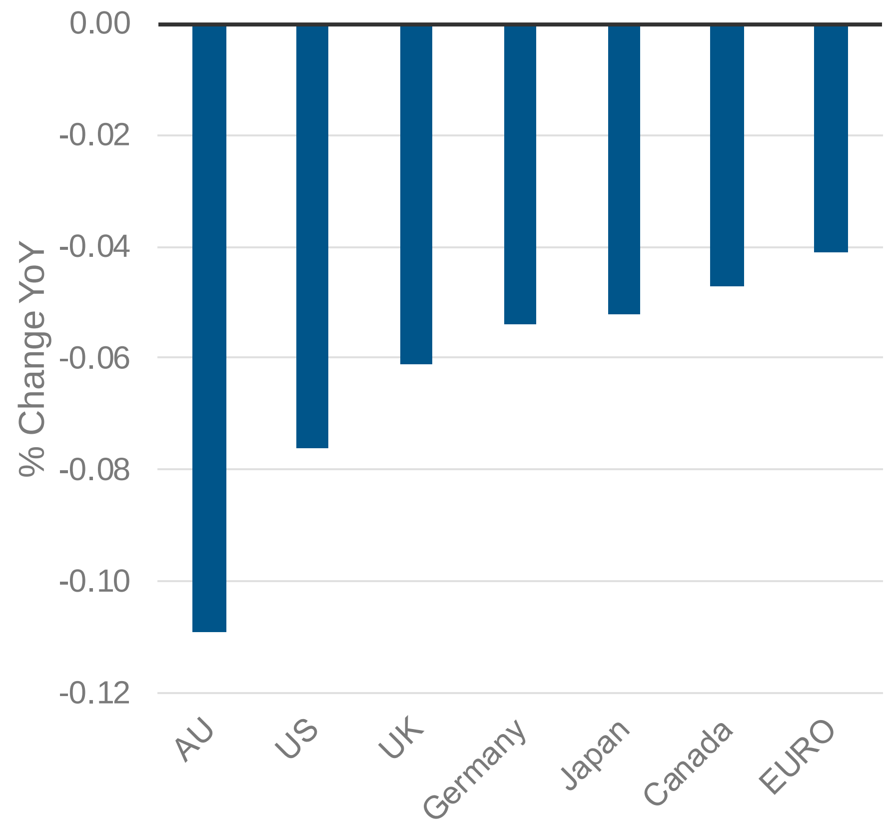
Government debt continues to grow

Fiscal spending adding to government debt

US Government Debt Outstanding



Change in primary budget for year 2020



Building the bridge, filling the gap but what is the consequence?

Source: Bloomberg, April 2020

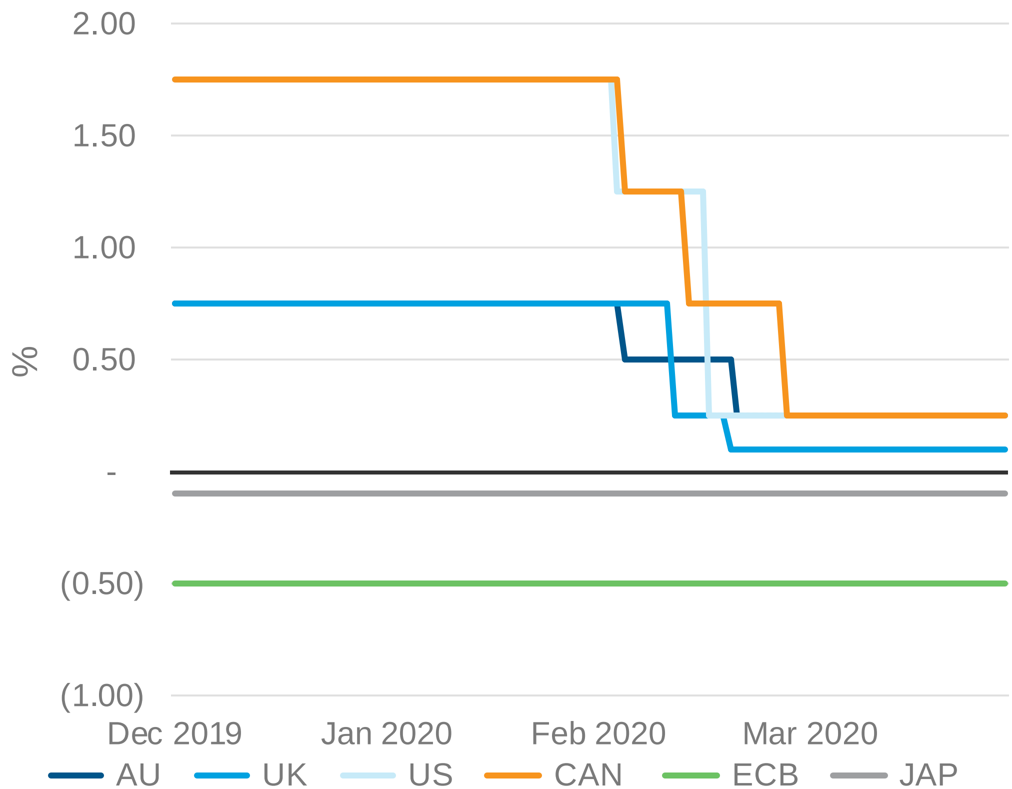
What has changed since January

Central banks have gone all in on monetary policy

Cash rates

Country	Current Yield (%)	Change since Jan 2020
US	0.25	-1.50
UK	0.10	-0.65
AU	0.25	-0.50
GER	-0.50	0.00
JP	-0.10	0.00
CAN	0.25	-1.50

Central bank policy rates



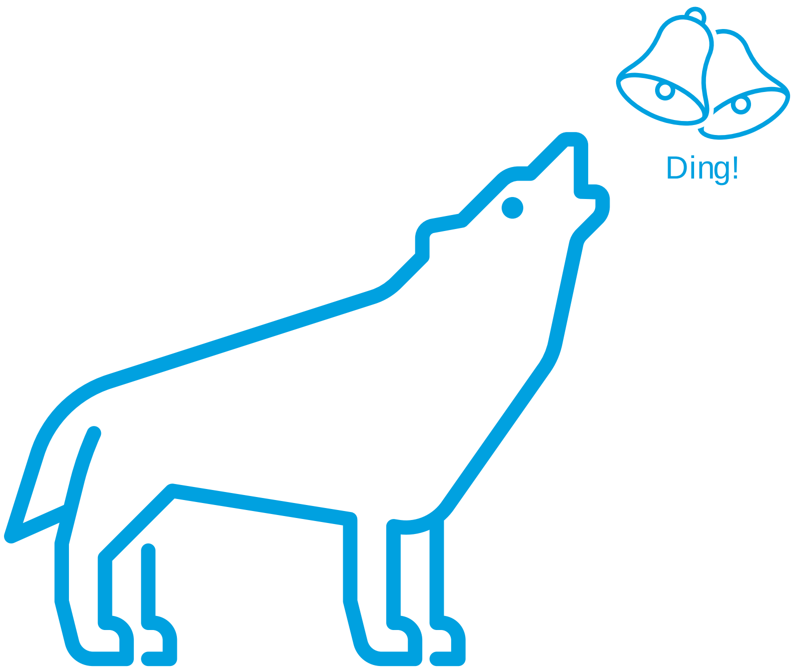
Central banks are at their effective lower bounds…for now

Source: Bloomberg, April 2020

Central banks ring the QE bell again

Asset market responds

"Pavlov" with his dog



$$\textbf{Discounted cash flow formula} = \frac{CF_t}{(1+r)^t}$$

- Central banks can lower the **r** through rate cuts and liquidity measures which increases NPV
- At some stage though **CF** matters

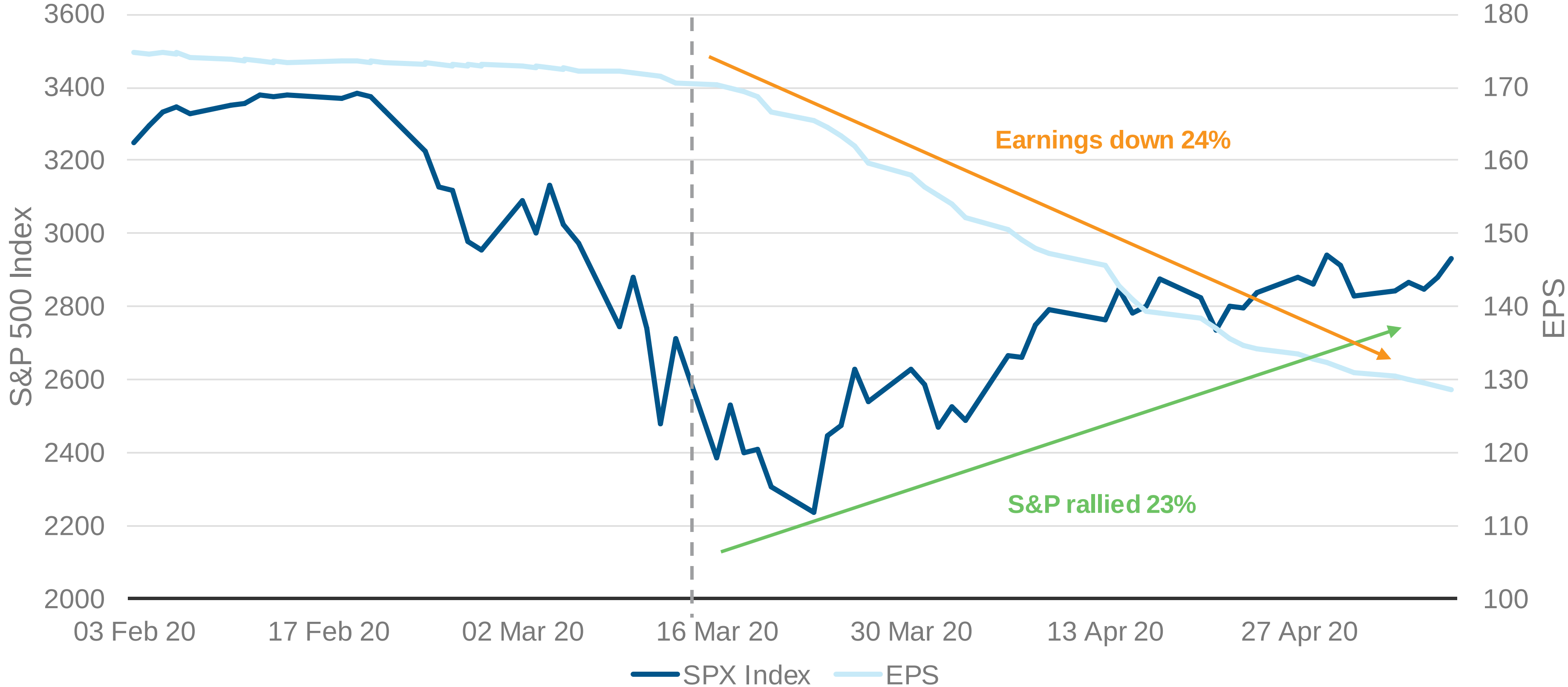
But at some stage fundamentals should matter

Equity valuations versus fundamentals

MACQUARIE

QE – a significant market distortion

S&P 500 versus earnings



Does the market have its wires crossed?

Source: Bloomberg May 2020

Global bond yields are at the lower end of range

There is still a role for bonds

The diversification benefits of bonds have decreased but bonds still play a role in a multi-asset portfolio

A selective approach for fixed income should be utilised, identifying regional and curve opportunities

We view US Treasuries and Australian Government Bonds as attractive opportunities on a hedged basis

Multi-asset portfolios require high quality liquid assets

Investment highlights and outlook

Continue to maintain an overall more defensive tilt

Equities

- Rich valuation, PE expansion driven largely by the unprecedent monetary and fiscal policy support
- Stay opportunistic, watch earnings guidance
- Economic/earnings downturn will persist

Fixed income

- Both downside or upside risks are limited given the unprecedented amount of monetary support as well as the unwillingness of stepping into a negative rate territory
- Diversification /expected return diminished

Infrastructure / property

- Continued to benefit from a very low / negative real rate
- Be selective, particularly in the commercial real estate sector

Alternatives

- Continued to offer uncorrelated return source
- An important asset class in the current environment of market uncertainty to create a return buffer

Currency

- Preference for safe-haven currencies
- Continue to see AUD trade lower in the short term
- Plan to increase portfolio hedge level on AUD weakness

Portfolio asset allocation

MACQUARIE

Positioning for the uncertainty

Increasing expectations for a slow and un-even global recovery

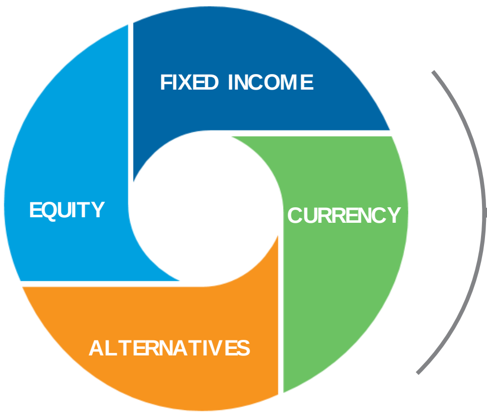
Fundamentals are very weak, but central bank support acts as a floor to markets. Additional risks to consider post COVID-19 such as political uncertainty, de-globalisation, sovereign risk, defensive assets becoming less defensive?…

Utilise a flexible approach to asset allocation in order to protect capital or enhance returns in these uncertain times

Defend, Defend, Defend

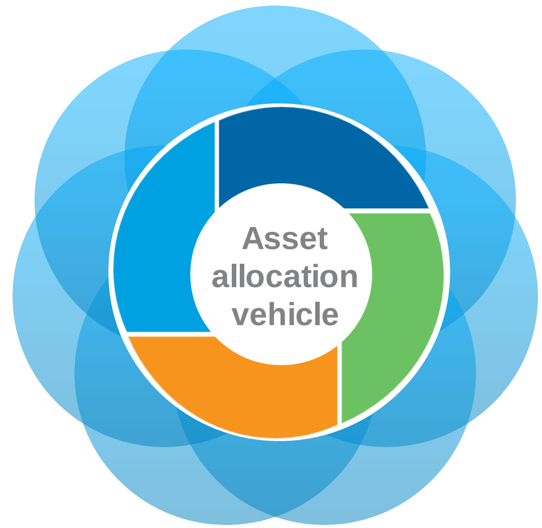
Macquarie solutions seeking to address the asset allocation dilemma

Macquarie Multi-Asset Opportunities Fund (MAO)



- Targeting attractive and stable **real returns**
- Focus on **active** asset allocation
- Suitable for a core allocation within a diversified SMA

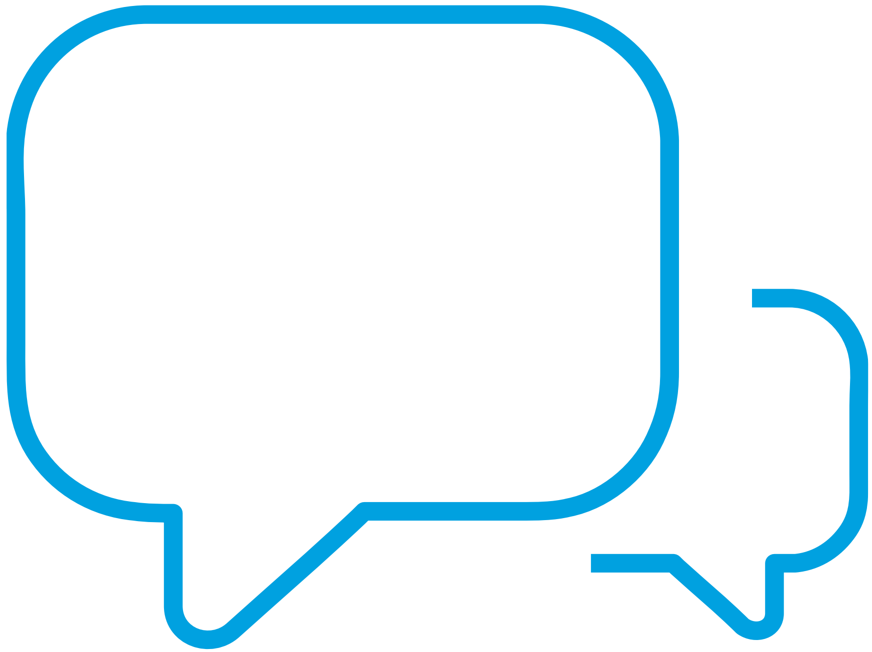
Macquarie Evolve Multi-Asset SMAs



- Three **investor risk profiles,** using MAO as the core
- Delivers a fee conscious approach **blending active and low cost strategies**
- Available on the **Macquarie Engage and Elevate** wrap platforms

Contact Macquarie to find out more about these solutions

Questions?



Significant risks of the Macquarie Evolve Multi-Asset Portfolios

Investment risk	The Macquarie Evolve Multi-Asset Portfolios seek to generate higher returns than traditional cash investments. The risk of an investment in the Portfolios is higher than an investment in a typical bank account or term deposit. Amounts distributed to investors may fluctuate, as may the portfolios' values. The portfolio values may vary by material amounts, even over short periods of time, including during the period between a redemption or application request being made and the time the redemption unit price or application unit price for the underlying Funds are calculated.
Manager risk	There is no guarantee that the Portfolio will achieve its performance objectives, produce returns that are positive, or compare favourably against its peers. In addition, the investment strategies and internal trading guidelines may vary over time, and there is no guarantee that such changes would produce favourable outcomes.
Income securities risk	The Portfolios may have exposure to a range of income securities, including high yield, emerging markets, and structured securities. The value of these securities may fall, for example due to market volatility, interest rate movements, perceptions of credit quality, supply and demand pressures, market sentiment or issuer default. These risks may be greater for securities offering higher returns, for example high yield or emerging market securities. These risks will be greater for Portfolios with a higher exposure to fixed income securities.
Market risk	The investments that the Portfolio has exposure to are likely to have a broad correlation with share markets in general. Share markets can be volatile and have the potential to fall by large amounts over short periods of time. Poor performance or losses in domestic and/or global share markets are likely to negatively impact the overall performance of the Portfolio. These risks will be greater for Portfolios with a higher exposure to equities.

More information on the risks of investing in the SMA are contained in the respective platform provider's Product Disclosure Statement, which should be considered before deciding to invest in the SMA.

Significant risks of the Macquarie Multi-Asset Opportunities Fund

MACQUARIE

Investment risk	The Fund seeks to generate higher returns than traditional cash investments. The risk of an investment in the Fund is higher than an investment in a typical bank account or term deposit. Amounts distributed to unitholders may fluctuate, as may the Fund's unit price. The unit price may vary by material amounts, even over short periods of time, including during the period between a redemption request or application for units being made and the time the redemption unit price or application unit price is calculated.
Manager risk	There is no guarantee that the Fund will achieve its performance objectives, produce returns that are positive, or compare favourably against its peers. In addition, the investment strategies and internal trading guidelines may vary over time, and there is no guarantee that such changes would produce favourable outcomes.
Income securities risk	The Fund may have exposure to a range of income securities, including high yield, emerging markets, and structured securities. The value of these securities may fall, for example due to market volatility, interest rate movements, perceptions of credit quality, supply and demand pressures, market sentiment or issuer default. These risks may be greater for securities offering higher returns, for example high yield or emerging market securities. Income security risk may cause unit price volatility and/or financial loss to the Fund.
Market risk	The investments that the Fund has exposure to are likely to have a broad correlation with share markets in general. Share markets can be volatile and have the potential to fall by large amounts over short periods of time. Poor performance or losses in domestic and/or global share markets are likely to negatively impact the overall performance of the Fund.
Default risk	Issuers or entities upon which the Fund's investments depend may default on their obligations, for instance by failing to make a payment due on a security or by failing to return principal. Such parties can include the issuers of securities held by the Fund (or those referenced in credit derivative transactions), and may include sovereigns, supranational entities, governments and states, as well as corporations. Counterparties to the Fund may default on a contractual commitment. Counterparties may include over-the-counter derivatives counterparties, brokers (including clearing brokers of exchange traded instruments), repurchase agreement counterparties, foreign exchange counterparties, as well as the custodian. Default on the part of an issuer or counterparty could result in a financial loss to the Fund.
Credit risk	The value of the Fund's investments may be sensitive to changes in market perceptions of credit quality, both of individual issuers and of the credit markets in general. The Fund may invest in credit related securities and takes credit risk in order to achieve its investment objectives. Deteriorations in the market's perception of credit quality may negatively impact the values of such securities, and hence the Fund's unit price.

More information on the risks of investing in the Fund is contained in the Product Disclosure Statement, which should be considered before deciding to invest in the Fund.

Some of the significant risks of the Fund are described above, but there could be other risks that adversely affect the Fund.

Term sheet – Macquarie Multi-asset Opportunities Fund

MACQUARIE

Key information	
APIR code	MAQ3069AU
Inception Date	30 September 2013
Benchmark	Bloomberg Ausbond Bank BIll Index
Management Fee	0.70% pa
Indirect Cost*	0.038% pa per PDS dated 20 November 2019
Platform availability	Macquarie Wrap, Netwealth, PowerWrap, uXchange, mFunds

*Based on indirect costs incurred in the previous financial year. Actual costs may vary including by material amounts. Past costs may not be a reliable indicator of future costs. See the Fund's Product Disclosure Statement for further information on fees and costs.

Term sheet – Macquarie Evolve Multi-asset SMAs

MACQUARIE

Key information	
SMA codes	SMAMAQ05S: Macquarie Evolve Balanced Multi-Asset Portfolio SMAMAQ06S: Macquarie Evolve Conservative Multi-Asset Portfolio SMAMAQ07S: Macquarie Evolve Growth Multi-Asset Portfolio
Inception Date	25 November 2019
Benchmark	Benchmark Unaware
Management Fee*	0.205% p.a.
Indirect Cost*	Conservative: 0.417% p.a. Balanced: 0.417% p.a Growth: 0.401% p.a *Due to a reduction of the management fee on one of the underlying strategies, we would expect indirect costs to be below 40bps and the ICR below 60bps across all risk profiles moving forward*
Platform availability	Macquarie Wrap

*Refers to the fee and costs applicable for investing in the Macquarie Evolve Multi-Asset Portfolios via the Macquarie Consolidator II – Engage Platform. Indirect cost figures are generally estimates for a previous financial year and the prevailing level of indirect costs may be different.

Further information is available in the Macquarie Separately Managed Account Product Disclosure Statement and a separate information booklet titled Macquarie Separately Managed Account Additional information to the Product Disclosure Statement.

Key contacts

MACQUARIE

Jimmy Byrne
State Sales Leader
P (02) 8232 0604 **M** 0422 429 865
E jimmy.byrne@macquarie.com

Mike McGill VIC TAS
Business Development Manager
P (03) 9635 9340 **M** 0427 996 186
E mike.mcgill@macquarie.com

Damian Orazio QLD
Business Development Manager
M 0427 915 147
E damian.orazio@macquarie.com

Fred Guimbeau WA SA
Business Development Manager
P (08) 9224 0695 **M** 0438 137 723
E fred.guimbeau@macquarie.com

Stephanie Pereira VIC TAS
Business Development Executive
P (02) 8245 5791
E stephanie.pereira@macquarie.com

Ryan Murphy
Business Development Executive
P (02) 8245 5792
E ryan.murphy@macquarie.com

Tim Mimis
Business Development Executive
P (02) 8245 4892
E tim.mimis@macquarie.com

macquarieim.com