

MAY 2024

For institutional, professional and wholesale investors only

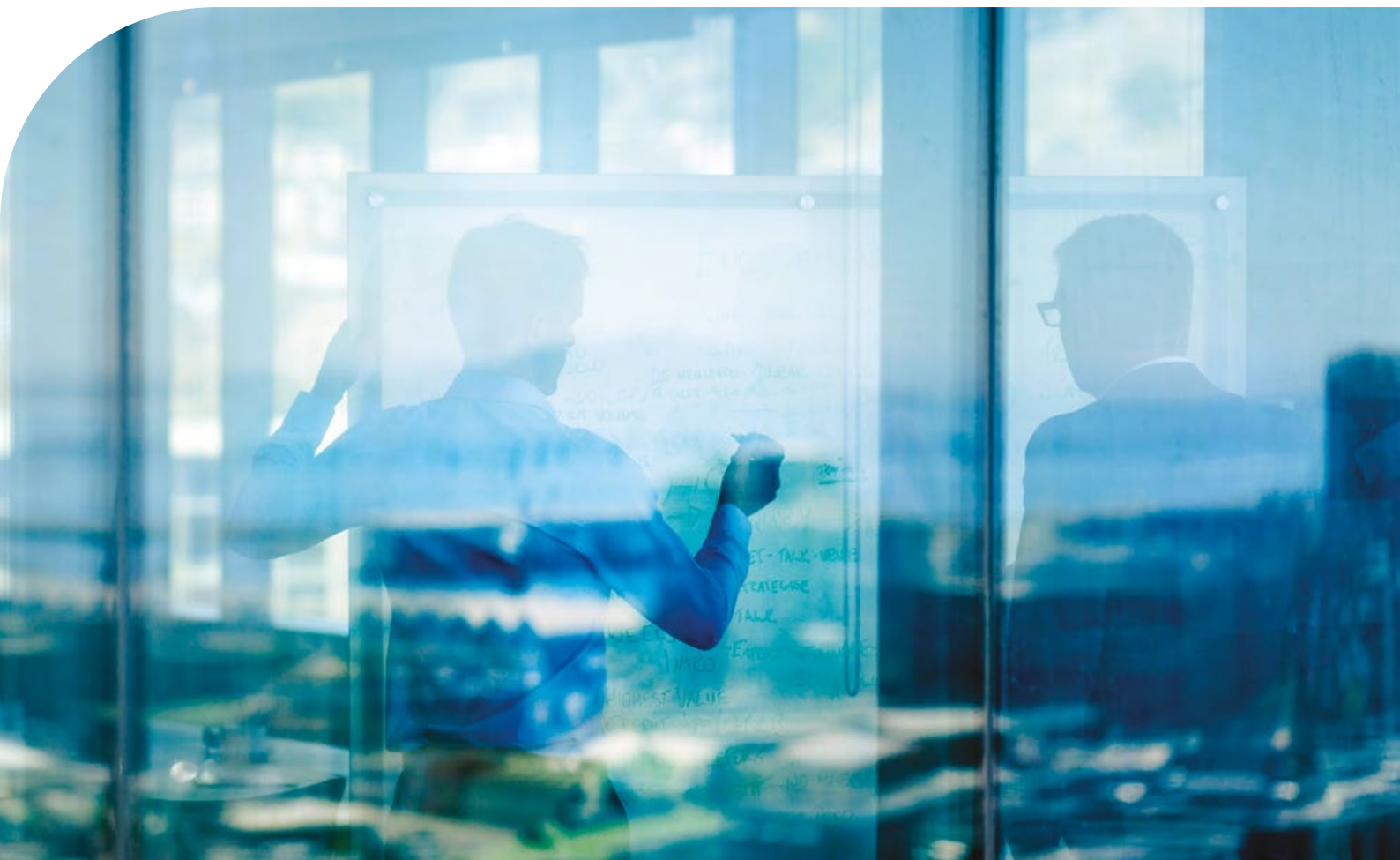
Generating consistent alpha: Focussing on fundamental 'active insights' over style factors



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A strategy for the evolving landscape

At Martin Currie Australia (MCA), we believe that true alpha is best derived from fundamental analyst insights. As such, our proprietary forward-looking research lenses and deep expertise drive the construction of all our actively portfolios.

The proliferation of low-cost, systematic Smart Beta products, based on style factors such as value or quality, have blurred the lines in the 'passive vs. active' debate. However, we fear that investors risk losing out on some or all of the benefits of fundamental insights. Limitations include the backwards looking nature of factors used, potential high turnover costs, that they are prone to missing turning points in the market, and that they can still underperform the market for significant periods of time.

The shift in investor taste has also exposed the fact that many active fundamental portfolios can be afflicted by the same style factors as Smart Beta. However, these approaches can also show high tracking error, and thus need longer time horizons. This is increasingly less aligned with the risk budget of asset owners facing strict performance benchmarks such as the Your Future, Your Super (YFYS) performance test.

We believe that a 'goldilocks' efficient portfolio of consistent alpha/lower tracking error can be achieved by reducing the impact of style factor cyclicality in the alpha stream of an active fundamental portfolio. To address these issues, we developed **MCA Active Insights**, a strategy that aims to deliver alpha from our investment team's 'pure' fundamental insight whilst minimising such style factor and sector biases. We do this using a unique quantitative process.

With the influence of style factors substantially reduced, and a focus on deep fundamental insight and disciplined risk control, we believe that the MCA Active Insights strategy can:

- reduce the reliance on systematic style factor biases and mean reversion;
- focus the source of alpha on 'pure' fundamental insight;
- embed ESG risk management and active ownership in a way that is difficult for passive, systematic or quantitative strategies to emulate;
- provide investors with tailorable tracking error targets to meet tight risk budgets; and
- ultimately provide a more persistent and efficient alpha stream at a lower cost.

Seeking alpha through a multi-lensed fundamental research process

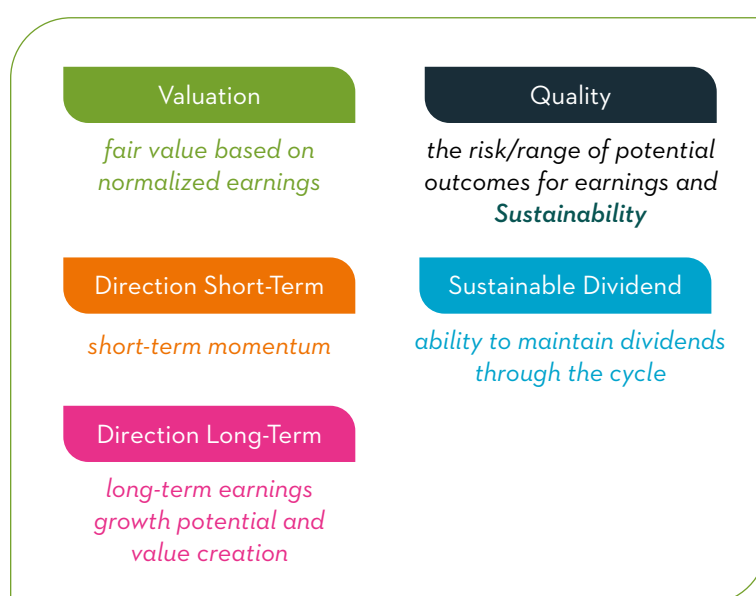
Unique fundamental insights

We believe our forward-looking fundamental insights are the key to investment success.

The investment process for all MCA strategies, including **MCA Active Insights**, starts with bottom-up fundamental research by our specialised industry analysts. The size, quality, and experience of our investment team underpins our proprietary research effort into long-term normalised earnings power, cashflow sustainability, business quality and risk of Australian listed equities.

Our approach recognises the importance of multiple drivers in generating returns, and we have designed our framework to capture forward-looking insights across our **Valuation**, **Direction Short-Term (ST)**, **Direction Long-Term (LT)**, **Quality** and **Sustainable Dividend** research lenses.

Our multi-lensed framework allows our analysts to detail their independent insights in a step-by-step and consistent manner. This creates a common language for expressing our views on the risks and opportunities across the investment universe, and an environment of team ownership and ongoing R&D.



Past performance is not a guide to future returns.

Source: Martin Currie Australia; data shown for illustrative purposes only.

Consideration of ESG factors in the investment process

Unlike quantitative-only and passive funds, ESG research is integrated deeply into our investment process.

Our experience has demonstrated to us that ESG analysis, engagement and voting should be done by those making investment decisions rather than being outsourced as they are best positioned to develop an informed view of the ESG risks, opportunities and impacts that companies face or create. Therefore, this responsibility lies directly with our experienced team of research analysts and portfolio managers.

Drawing from our extensive experience, we've come to understand that engagement is an ongoing, iterative process that demands both patience and a persistent effort yielding results that unfolds over time. Our investment team's long-term experience with management engagements bolsters our ability to effectively affect company level changes. We have cultivated strong relationships and established open dialogues giving us the opportunity to express any areas of concern and encourage greater transparency on their management of these risks.

By incorporating material and relevant ESG factors that we have uncovered through our bottom-up fundamental research and engagement activities directly into the **Quality** and **Valuation** lenses, the investment process specifically reflects how ESG factors can increase or reduce the risk of companies delivering the normalised earnings, cashflows that our analysts forecast.

The differentiated insights that underpin our research lenses are common to all MCA strategies. This ensures that we can access our best insights for all portfolios. They can also be readily customised and blended to meet client needs across a range of Australian equity and listed Real Asset solutions.

Blending MCA lenses to identify opportunities

Focusing on and customising the source of expected returns

Our multi-lens framework identifies alpha opportunities, and each step in our Valuation, Direction ST, Direction LT, and Quality research lens framework captures our research insights in a consistent manner.

We then adjust our **Valuation**, **Direction ST**, **Direction LT**, and **Quality** inputs to construct risk-adjusted expected returns stock forecasts to identify stocks with the best alpha potential for our different MCA strategies. We customise the way we calculate expected returns in order to align portfolio construction with the specific objectives of each strategy.

Our expected return is the difference between the fair value post the adjustments and the stock's market price. However, at this point, **expected return** may still carry factor/sector biases resulting from the characteristics of the research lenses and interactions between them.

For the **MCA Active Insights strategy**, we want to maintain the alpha generating ability from our investment team's 'pure' fundamental insight, but without adding style factor or super sector risk to the portfolio.

We use our innovative **Mispricing** measure to undertake a multi-factor regression of our expected returns against common style factors and super sectors. The amalgamation of our regression-based adjustments creates a style and sector neutral expected return measure. In this way, **Mispricing** isolates and captures the pure fundamental insights that are unexplained by these common factor risks.

Customising expected returns for client need

Regardless of the strategy, MCA's multi-lensed fundamental research process provides the foundation for all our portfolios.

- For our **Value Equity strategy**, we leave the aggregate benefit of our pure fundamental insights and style factor influences in place and prioritise **Valuation**.
- For our **Equity Income strategy**, we place a greater weight towards the insights generated by our **Sustainable Dividend** lens in our stock selection.
- We weight our **Sustainable Equity strategy** **expected return** towards the **Sustainability** component of **Quality** to a greater extent than in other strategies.

Mispricing drives portfolio construction

We can then use **Mispricing** in portfolio construction, together with experienced fundamental oversight, proprietary alpha & risk signals and systematic rebalancing rules, to construct a portfolio of stocks that neutralises the influence of style or sector bias relative to the index. As such, portfolio positioning aligns directly with our fundamental expertise in Australian equities.

Expected return and Mispricing in action

James Hardie Industries (JHX) manufactures and sells fibre cement, fibre gypsum, and cement bonded building products. Our fundamental analyst's investment thesis is that JHX is a high quality long-term structural growth story in a slow-moving cyclical industry. With its near monopoly position in US fibre cement siding, as a substitute external siding product replacing vinyl/bricks the group has recently shown expanded share and proof points on execution.

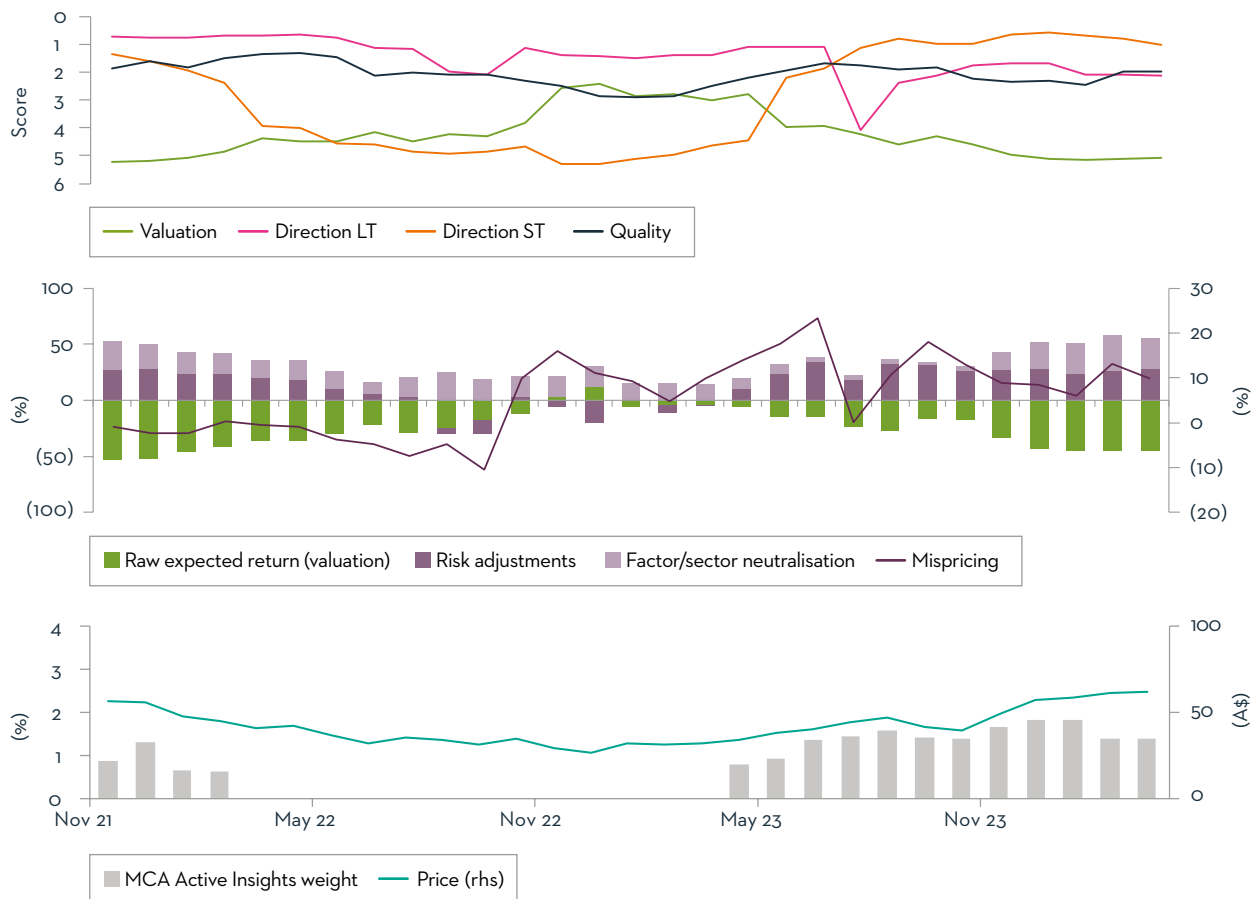
Whilst our assessment of **Valuation** shows the price as full, the company is a large index weight, high Quality stock, with very strong **Direction LT** scores, and an improving **Direction ST** score since 2023.

Based on these risk adjustments, our **Direction ST**, **Direction LT** and **Quality** research lenses each provide an uplift to JHX's risk-adjusted expected returns, despite its initially negative **Valuation**.

For the **MCA Active Insights** strategy, we now look to further adjust expected return to isolate **Mispricing** from a factor and sector influences.

From a style perspective, expected returns for stocks in our covered universe are typically underweight momentum relative to S&P/ASX 200 index. As such, we want to amplify the expected return for an individual stock if it has positive factor expose that can help to neutralise a lower universe exposure.

As JHX has good relative momentum, in addition to attractive growth and size characteristics, each give its expected return an uplift, which results in positive **Mispricing**. Our active positions are aligned with the magnitude of their **Mispricing**.



We currently hold an 1.4% target active overweight in JHX because of the greater **Mispricing** benefit. The holding in JHX today diversifies our bets to unique macro drivers and improves the *growth* and *momentum* and size characteristics of the **MCA Active Insights** portfolio relative to the S&P/ASX 200 Index. Note that the **Mispricing** process is dynamic, and undertaken daily. This is reflected in the change in our target weights over time.

Past performance is not a guide to future returns. The information provided should not be considered a recommendation to purchase or sell any particular security. It should not be assumed that any of the security transactions discussed here were, or will prove to be, profitable.

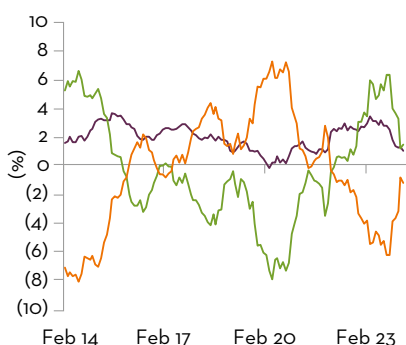
Source: Martin Currie Australia; as of 31 March 2024. Data shown for a representative Martin Currie Australia Active Insights - portfolio. Index: S&P/ASX 200 Accumulation.

The role of Mispricing and Active Insights in an asset allocation

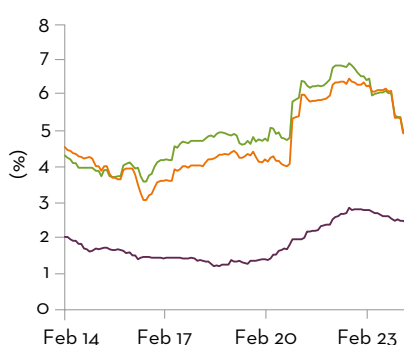
A portfolio for all seasons

As the charts below show, MCA Active Insights strategy alpha over the S&P/ASX 200 Accumulation Index is not dependent on the mean reversion of style factors.

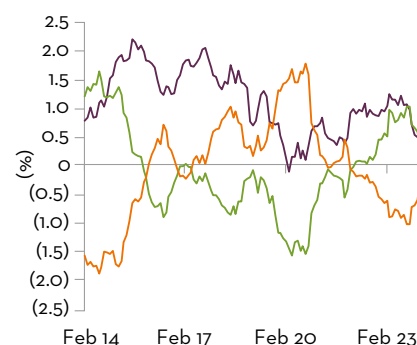
Rolling three-year active return vs. S&P/ASX 200



Rolling three-year tracking error vs. S&P/ASX 200



Information ratio



— MCA Active Insights — MCA Australia Value — MCA Australia Growth

Past performance is not a guide to future returns. These numbers do not represent the performance of an actual portfolio and should not be considered as an indication of future returns.

Source: Martin Currie, as of 31 March 2024. Data shown for a representative Active Insights account and Active Insights - Diversified back test. Index: S&P/ASX 200 Accumulation. Data shown for illustrative purposes only. Back test sample period from 31 March 2011. Actual returns shown from 1 December 2021. Gross performance data is presented without deducting investment advisory fees, broker commissions, or other expenses that reduce the return to investors. Theoretical results are shown without transaction costs that would reduce the return to investors.

The lower style factor influence reduces the risk of extended periods of under-performance which often exceed the time horizon and relative risk tolerances of most investors. With the potential for greater portfolio efficacy, and alpha unbiased by the influence of factors whose use may be widespread elsewhere in a client's portfolio, we believe that this makes the strategy particularly suitable for use within an asset allocation that is subject to YFYS performance tests. With lower fees than traditional fundamental-only strategies, the strategy is also a cost-effective way to access the fundamental insights and imbedded Active Ownership approach of a highly experienced investment team, alongside the disciplined risk control and portfolio construction of a more systematic strategy.

Factor and sector volatilities, such as what we saw in 2023, highlight the benefit of an approach that use multiple lenses to deal with the typical range of market style, factor, and super sector risks.

A modernised application

Potential applications for the MCA Active Insights strategy in a typical Australian equity asset allocation include:

- a complementary exposure alongside existing Passive or Smart-beta factor-based core portfolios without adding factor & sector risk; and
- a robust core factor / sector neutral Active Fundamental strategy, either stand-alone or within a multi-manager Australian equity roster.

The strategy is also suitable for use in more concentrated separately managed account (SMA) portfolios and can also be readily customised to suit client needs for different tracking error levels and select factor exposures.

How to access

Learn more about Martin Currie Australia and the Active Insights strategy [here](#), or contact a member of our sales team for more information about how it can be tailored to suit your investment needs.

Important information

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The views expressed are opinions of the portfolio managers as of the date of this document and are subject to change based on market and other conditions and may differ from other portfolio managers or of the firm as a whole. These opinions are not intended to be a forecast of future events, research, a guarantee of future results or investment advice.

Some of the information provided in this document has been compiled using data from a representative account. This account has been chosen on the basis it is an existing account managed by Martin Currie, within the strategy referred to in this document. Representative accounts for each strategy have been chosen on the basis that they are the longest running account for the strategy. This data has been provided as an illustration only, the figures should not be relied upon as an indication of future performance. The data provided for this account may be different to other accounts following the same strategy. The

information should not be considered as comprehensive and additional information and disclosure should be sought.

The information provided should not be considered a recommendation to purchase or sell any particular strategy / fund / security. It should not be assumed that any of the security transactions discussed here were or will prove to be profitable.

It is not known whether the stocks mentioned will feature in any future portfolios managed by Martin Currie. Any stock examples will represent a small part of a portfolio and are used purely to demonstrate our investment style.

The analysis of Environmental, Social and Governance (ESG) factors forms an important part of the investment process and helps inform investment decisions. The strategy/ies do not necessarily target particular sustainability outcomes.

Risk warnings – Investors should also be aware of the following risk factors which may be applicable to the strategy shown in this document.

- Investing in foreign markets introduces a risk where adverse movements in currency exchange rates could result in a decrease in the value of your investment.
- This strategy may hold a limited number of investments. If one of these investments falls in value this can have a greater impact on the strategy's value than if it held a larger number of investments.
- Smaller companies may be riskier and their shares may be less liquid than larger companies, meaning that their share price may be more volatile.
- The strategy may invest in derivatives (index futures) to obtain, increase or reduce exposure to underlying assets. The use of derivatives may restrict potential gains and may result in greater fluctuations of returns for the portfolio. Certain types of derivatives may become difficult to purchase

Risk warnings for the back-test – The back-test results presented in this document are based on simulated performance results. Please be aware these have certain limitations. Back-tested performance returns do not represent the impact of trading. The trades in the back testing have not been executed and may not fully reflect the impact of market factors such as liquidity. Martin Currie makes no representation that any account will or is likely to achieve returns similar to those illustrated as a result of the back testing presented in this document.

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