

Ventura's asset allocation mitigates the pain of the Euro-zone crisis

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with Andrew Sneddon Portfolio Manager, Russell Investments

In the September 2011 quarter, amid sovereign credit rating downgrades in both the US and Europe, investors were gripped by fears of a potential 'Euro-Lehman' bank crisis and return to global recession. We speak to Andrew Sneddon, the Portfolio Manager of Ventura's diversified funds.

1. Following three consecutive years of strong peer outperformance by the diversified portfolios to 30 June 2011, the September 2011 quarter provided yet another very stern test. How did Ventura's diversified portfolios fare in the September quarter?

The September 2011 quarter was an extremely painful one for investors as the Australian and international (\$A hedged) share markets posted large negative returns of -11.7% and -14.7%, respectively.

The double-digit percentage falls in share markets resulted in negative absolute returns for diversified portfolios in the September quarter, although peer relative performance was mixed.

2. What were the key drivers of Ventura's diversified portfolio returns in the September quarter?

Asset allocation was a positive for diversified portfolio performance in the September quarter. The asset allocations – both strategic and active – were more defensive in the September quarter 2011 than at any time over the last three years.

The portfolios continued to be positioned between 'modestly underweight' and 'neutral' relative to their strategic asset allocation weight to growth assets. Further, the 'medium' strategic tilt against the \$A – increased from 'low' in May this year – added around 0.4% to the Growth 70 portfolio over the September quarter as the \$A depreciated. As discussed in last quarter's Q&A, we expected the \$A tilt to provide a defensive cushion for the portfolios in the event of heightened risk aversion and that proved to be the case in the September quarter.

By contrast, active sector underperformance was a material negative for the diversified portfolios over the period. Ventura's 'core' Australian and international share and bond active sector strategies all underperformed their benchmarks.

However, Ventura High Growth 100 was less adversely impacted as it employs more aggressive active sector strategies that outperformed core strategies. For example, in the Australian shares sector the more aggressive Australian Opportunities Fund outperformed the benchmark by 1.4%¹ in the September quarter, whereas the core Australian Shares Fund underperformed by 0.6%¹.

3. What role did alternative and unlisted assets play in the September quarter?

While the magnitude of share market declines in the September quarter were extreme, the relationships between asset classes – including the diversification benefits of alternatives vis-à-vis listed shares – were more conventional. The September quarter highlighted why we have materially increased the exposure to alternatives and unlisted assets in the diversified portfolios over the last two years.

The best-performing growth assets in the diversified portfolios in the September quarter were those unlisted and alternative strategies introduced in late 2010 – Australian unlisted property (Dexus²) and absolute return (Russell Alpha Fund³). The Dexus and Alpha strategies returned +2.8% and -1.0%, respectively.

Other alternative strategies such as Global Strategic Yield³ and Global Listed Infrastructure \$A Hedged experienced single-digit negative returns of -4.1%³ and -8.9%¹, as opposed to the double-digit negative returns of the Australian and international (\$A hedged) share markets.

4. Why did Ventura's core active sector strategies generally underperform the benchmark in the September quarter?

The Euro-zone crisis and global recession fears had an adverse effect on core active sector strategies in Australian and international shares and bonds over the



quarter. Broadly speaking, investor fear trumped valuation considerations in the September quarter.

Ventura's core Australian and international shares portfolios maintain underweight positions in what we believe are 'expensive' defensive sectors such as Telecommunications, Utilities and Consumer Staples. Notwithstanding unattractive valuations relative to more pro-cyclical stocks, these defensive sectors outperformed as investor fear dominated.

Similarly, core Australian and international bond strategies, which are positioned for broadly higher yields, underperformed as risk aversion pushed bond yields toward new record lows (i.e., prices toward record highs). Credit spreads also widened sharply throughout the quarter, detracting from performance.



5. How has Russell's investment outlook evolved since we last spoke? How is this impacting on positioning in the diversified portfolios?

The two opposing 'cyclical' and 'structural' market forces we've discussed in these Q&As over the last year continue to shape the direction of investment markets.

When we last spoke, I highlighted Europe's structural sovereign debt woes as having the potential to have an acute adverse impact on growth assets. This has certainly been the case in the September quarter, with investors gripped by fears of a potential 'Euro-Lehman' bank crisis and return to global recession.

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For Ventura's diversified portfolios, we retain a constructive medium-term view on growth assets. However, market volatility related to the Euro-zone crisis leads us to continue to be defensive for now.

Importantly, we anticipate a continuing need to respond swiftly to new developments – positive or negative – in the Euro-zone crisis by increasing or decreasing overall diversified portfolio risk. The Euro-zone crisis remains the single greatest focus of Russell's investment team worldwide.

Looking toward 2012, we have been working on new active strategies to further enhance the strategic asset allocation of the diversified portfolios with respect to alternatives and unlisted assets. Further, there are opportunities for enhancements within traditional asset classes. I look forward to discussing these pending enhancements in detail when we next speak.

- 1. All figures for the underlying sector strategies and are gross of expenses.
- 2. The Dexus Wholesale Property Fund is not available to retail investors.
- 3. This Fund is established under the laws of Ireland. It is not registered for sale in Australia.