INVESTMENT
INSIGHTS

David Millar
Head of Multi Asset
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Going Anywhere for Diversification with Lower Volatility

David Millar, Head of Multi Asset and Portfolio Manager for Invesco Global Targeted Returns, explains why true diversification can be hard to find.

P&I: Can you describe your team's investment philosophy?

David Millar: We have two very separate but equally important planks to our philosophy. The first is to have an unconstrained research agenda, and the second is to have a robust risk management process. We are seeking to maximize the amount of diversification to deliver good long-term risk asset returns at lower volatility than other investment methods may provide.

The unconstrained research agenda is all about looking for good long-term investment ideas, wherever they might arise, and not at all about starting with any preconceived notion of which asset class you should use to express them. Each of those ideas must be seen as potentially delivering a positive return on a two- to three-year view based on our central economic scenario.

P&I: How does this translate into an investment process?

David Millar: Finding the investment idea is the first step of the process. We have ideas that we develop on our desk independently, ideas that we develop in conjunction with our colleagues here in the U.K., in the U.S. or globally, as well as those from external sources. Once those ideas are approved and on our menu of investment ideas, we move on to the second step of the process.

The second step of the process focuses on risk. Because of the unconstrained nature of the research process, you need to make sure you understand the potential for diversification so you can ensure you're taking enough risk while attempting to deliver the promised returns. Every idea will have an amount of independent risk, which is just the volatility of the idea multiplied by the size of the holding. So we know how much of a contribution that idea can make. But it's also important to know what the risk impact is of that idea on the rest of the portfolio. A critical risk measure shows how all the ideas interact.

P&I: How would you characterize your investment style?

David Millar: The strategy is called Global Targeted Returns. It's an explicit risk and return strategy that aims to achieve 5%-over cash returns with less than half the volatility of the equity market, both over three-year rolling periods. But if you want the strap line, it's just about "investing in ideas." It's a combination of good long-term investment ideas with a low volatility approach.

P&I: Which has the effect of limiting the volatility of the portfolio?

David Millar: This kind of investing is all about limiting volatility. We're judged on two explicit conduits. One is whether we reach our target return. But we will also be judged on whether we achieve that with less than half global equity volatility. With global equity volatility so low since the turn of the year, that's been a challenge.

P&I: Can you explain the specifics of your investment process?

David Millar: It's about trying to see through short-term noise to get to a long-term theme. It's not about jumping on the next market trend. Let's take a straightforward theme: the health of the global corporate sector. The U.S. has done well, but is pausing for breath at the moment. Europe at long last is getting some benefit from lower oil prices and the weakening of the euro. We think the global corporate sector will continue to benefit. That's an idea that just reflects our view on the overall economy.

So how could we implement that idea? For each theme, there needs to be a reason in words as to why this is a good long-term investment idea. Why do we believe it will deliver a positive return in our central economic thesis over a two- to three-year view Then we move to the analytics, which include valuation. We also look to our colleagues to get their views. One of the reasons that I and my colleagues came to Invesco was the breadth and depth of the investment expertise globally. We wanted the opportunity to leverage that long-term thinking. So we debate ideas with our colleagues. We don't always agree, but we always have the discussion.

In this case, we recommended that it should be expressed by buying global equities. Clearly, this is a risk-on idea. We also utilized Invesco's bottom-up stock selection capabilities, because the analytics indicated that some markets were fully valued.

P&I: How long would you generally stay invested in a particular idea?

David Millar: We always assess ideas on the basis that they produce the required return in two to three years, but we don't always get that right. Markets can move quickly. But the point is that we are prepared to hold for that two- to three-year period because we believe the value will come out over that time. Typically, we expect to see turnover of about one-third of the 20 to 30 ideas in our portfolio in any year. Some may stay there indefinitely as long as the central economic view supports them.

If the markets change, though, we can change our minds. But the important point is that we go back to the process. We never short-circuit the process, because it's all about the balance in the portfolio. For instance, we're short the euro. But it took us until April and May last year before we thought the conditions were right to do this, even though the economics said that the euro needed to weaken and the valuation said that it was overvalued. The behavioral analytics, though, suggested there were too many buyers. So we waited until the central banks stopped diversifying their dollars into euros.

Our target for the euro was $1.25, after we invested close to $1.40. But we clattered through that to $1.24 in a matter of months. So we return to the process and look at it afresh. Do we believe that the idea still has a two- to three-year time horizon?

P&I: How often do you reassess the portfolio this way?

David Millar: We have a regular review of all of the ideas. Every month we review at least a third of them alongside new ideas that are brought to the table. Even if not much is happening, every idea will be reviewed at least once a quarter. Sometimes, we may review more. For instance, we reviewed 80% of the ideas in January because of the unprecedented fall in oil prices. That changed the whole macro landscape. You can't ignore that. But the response was to go through our ideas and refresh our thinking because we couldn't wait for the next quarterly cycle of reviews.

P&I: How do you assess the relative attractiveness of one idea compared to another?

David Millar: In our weekly meetings, we review the entire portfolio both for general care and maintenance, but also to ensure that we are getting what we believe to be the best combination of those ideas. We add in the information that we are getting from the risk modeling side and have a discussion as to whether we'd like to substitute one idea for another that's on the menu.

P&I: How important is the lack of constraint to this investment approach?

David Millar: It's the heart of our philosophy. We believe you get greater diversification by removing those investment constraints. We have access to a larger toolkit than just traditional asset classes. We can express ideas through volatility, currency, inflation—including using pair trades that allow you to go long one market and short another. However, I've learned that once you think you have the perfect diversifying portfolio, you need to look for new diversification because sources of diversification will keep changing over time.

What's important here is that investment opportunities don't start with labels on them. Say you want to have a view on the Australian economy because of the slowdown in mining and the potential weakening of a strained economy. That's the idea.

Then you have the question of how to express that idea or theme. Do you want to sell Australian equities or sell the Australian dollar? These are choices you make later. You start with the idea and the choice of implementation can come second. That does turn the traditional balanced investing-asset allocation model on its head a bit.

To me, the removal of those constraints and the freedom to look for ideas is absolutely critical. But there's a reason behind it—because it allows us to search for greater diversification than investors have likely experienced before. ❖

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Invesco

Global Targeted Return Strategy

www.invesco.com/us

$798,300*
Invesco AUM ($Millions)

$257,600*
Invesco Institutional AUM ($Millions)

* As of March 31, 2015

TEAM LEADERSHIP

David Millar, FIA
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Richard Batty, PhD
Portfolio Manager

Strategy Spotlight

Investment Objective

The strategy seeks a positive total return over the long term in all market environments. The strategy targets a gross return of 5% per year above US three-month Treasury bills and aims to achieve this with less than half the volatility of global equities, as represented by the MSCI World Index over the same rolling three-year period.

Distinguishing Attributes

- FINDING THE BEST IDEAS. Changing market dynamics require access to an unconstrained approach in order to generate positive returns over the long term. The team starts with an investment idea and then determines the best way to gain exposure – regardless of asset class.
- PROVEN, FOCUSED TEAM. The dedicated investment team is composed of macro specialists with a fundamental, long-term investment view. The portfolio managers have managed targeted absolute-returns strategies for more than 21 years collectively.
- INTEGRATED RISK MANAGEMENT. The dual mandate of achieving long-term risk asset returns with lower risk can only be achieved through genuine diversification across the investment ideas. For this reason, risk management, including scenario analysis and stress testing, is a core element of portfolio management.
- DRAWING ON BROADER RESOURCES. The team leverages Invesco's global trading desk, derivatives capability and worldwide network of portfolio managers and asset class specialists. Invesco's support minimizes distractions so that the team can concentrate on researching and implementing investment ideas.

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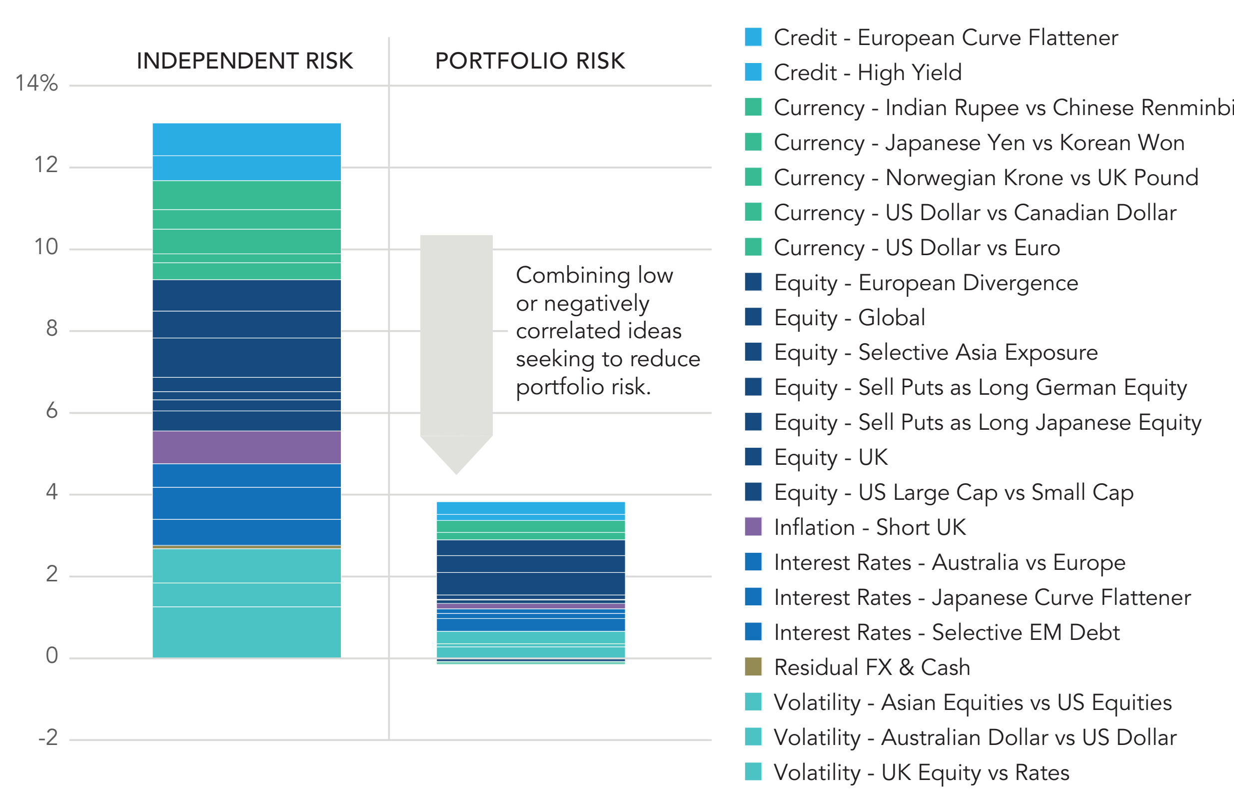
Vehicles Offered

MUTUAL FUNDS
SEPARATE ACCOUNTS
COLLECTIVE TRUSTS

Investing In Ideas: Risk-Based Allocation



RESEARCHING IDEAS. The Investment team takes a global macro perspective in looking across classes, geographies, currencies and sectors for approximately 20-30 good long-term ideas.

COMBINING IDEAS. Ideas are selected to run concurrently in a single risk-managed portfolio. By combining low or negative correlated investment ideas the team is seeking to reduce portfolio risk.

IMPLEMENTING IDEAS. Each idea is considered for its individual risk, as measured by standard deviation, and potential return attributes. Ideas can be implemented using what the team believes to be the most cost-efficient and effective vehicles, including derivatives.

All data provided by Invesco unless otherwise noted. Invesco Advisers Inc. is an investment adviser; it provides investment advisory services to individual and institutional clients and does not sell securities.

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