

# Strategy update

Changes to the MLC multi-asset portfolios

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*“In complex, constantly changing market conditions, we believe introducing a real return strategy to the MLC Index Plus portfolios should benefit our investors by helping to improve the returns we generate for the level of risk we take.”*

**At MLC, we’re always researching ways to improve and evolve our investment strategies.**

That’s why we’ve made changes to the benchmark asset allocation for the MLC Index Plus portfolios and widened the asset allocation ranges for our multi-asset portfolios.

The changes to the benchmark asset allocations for the MLC Index Plus portfolios are a result of our regular benchmark reviews. There are two key changes. The first is introducing a real return strategy within a new allocation to alternatives, which we believe will give us greater flexibility to manage risk and smooth returns in the portfolios. The second is introducing a derivatives capability, which will assist in positioning the portfolios and managing interest rate risk. These changes are in line with those we made last year to the MLC Horizon portfolios.

The change to the asset allocation ranges for our multi-asset portfolios will give us more flexibility to adjust the portfolios, enabling us to better manage potential risks and take advantage of potential return opportunities.

## What changes have we made?

- Changed the benchmark asset allocations for the MLC Index Plus portfolios, including making new allocations to a Simple Real Return Strategy, within alternatives, and to a derivatives capability.
- Widened the asset allocation ranges for MLC’s multi-asset portfolios.

## Which funds are affected?<sup>1</sup>

The benchmark asset allocation changes affect only the MLC Index Plus portfolios.

The wider asset allocation ranges apply to the MLC Index Plus portfolios, MLC Horizon portfolios and the MLC Inflation Plus portfolios.

## How may investors benefit?

We believe these changes will:

- help to smooth out returns by better managing downside risk, and
- provide higher returns for the level of risk we take.

## Why do the MLC Index Plus portfolios have a benchmark?

The MLC Index Plus portfolios are market-oriented portfolios, aiming to deliver returns similar to their benchmarks, while reducing risk when market risks are high. The benchmarks are a combination of market indices.

However, what ultimately matters to investors is not that their portfolio delivers

<sup>1</sup> All funds affected are listed in the Important Information section at the end of this document.



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returns similar to a benchmark, but that it generates a return above inflation over the long term. The benchmark asset allocation therefore reflects our view of how the assets in the benchmark can efficiently generate above-inflation returns (ie real returns) based on our long-term return and risk expectations of those assets.

Because the risk level of each asset class in the benchmark changes constantly, we don't simply invest according to the benchmark asset allocation. We frequently make adjustments away from the benchmark asset allocation based on our scenario analysis (the Investment Futures Framework). The risk aware nature of our scenarios approach tends to mean that value is usually added through defensive positioning when market risk is high, potentially reducing our investors' exposure to losses.

To ensure the MLC Index Plus portfolios remain true-to-label, deviations from the benchmark are limited to defined ranges.

### What are the changes to the benchmark asset allocations?

We review the benchmark asset allocation regularly, and formally every two to three years. Through these reviews, we are improving the quality of asset class exposures and adjusting the benchmark's asset allocation with the aim to enhance the portfolios' expected returns.

Since our last benchmark asset allocation review we've experienced complex market conditions. As a result of the recent review, we're introducing two new allocations to the MLC Index Plus portfolios: the first is introducing a Simple Real Return Strategy (described below) within a new allocation to alternatives, the second is introducing a derivatives capability.

We believe the allocation to the Simple Real Return Strategy will help increase diversification and smooth out the portfolios' returns in challenging markets.

The allocation to the Simple Real Return Strategy also brings these portfolios more in line with the MLC Horizon and Inflation Plus portfolios, which have had allocations to carefully selected alternatives for many years.

The allocation to the derivatives capability means we'll be able to use derivatives in the portfolio to help manage risk and implement investment insights more efficiently and at lower cost. This allocation will appear in asset allocations as 'Risk management strategy'.

### What is the Simple Real Return Strategy?

Like the MLC Inflation Plus portfolios, which are also managed by our Capital Markets Research team, the Simple Real Return Strategy's focus is to provide risk-controlled real returns. This cost-effective strategy aims to deliver a return of 4% pa above inflation (before fees) over five year periods by limiting the risk of negative returns over this time frame.

The strategy has a similar investment approach as the MLC Inflation Plus portfolios. It can invest in a wide range of assets and strategies and we have the flexibility to make large changes to the strategy's asset allocation to manage risk and capture opportunities for returns as the investment environment evolves. We expect this diversification, flexibility and ability to tailor risk exposures should help us to generate higher performance for the level of risk we take in the MLC Index Plus portfolios and smooth the portfolios' returns.

The Simple Real Return Strategy has a broadly similar asset allocation to the MLC Inflation Plus Moderate Portfolio. However, the strategy has less exposure to the more expensive alternative strategies (eg Low Correlation Strategy) and managers due to the cost constraints of the MLC Index Plus portfolios. The Simple Real Return Strategy therefore has the same level of risk, but lower return expectations.

As with the MLC Inflation Plus portfolios, derivatives will be used in the strategy as an efficient tool to help manage risk, maintain high liquidity and implement investment insights more efficiently and at lower cost. We don't use any leverage in the strategy.

Table 1 shows the Simple Real Return Strategy's asset allocation ranges and Table 2, the strategy's current asset allocation.

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**Table 1 – Asset allocation ranges for the Simple Real Return Strategy**

|  | Min | Max  |
|--|-----|------|
| Cash   | 0%  | 100% |
| Fixed income   | 0%  | 100% |
| Shares and property  | 0%  | 80%  |
| Less liquid assets (eg insurance-related investments and bank loans) | 0%  | 15%  |

Source: JANA Corporate Investment Services Limited.

**Table 2 – Current asset allocations for the Simple Real Return Strategy as at 31 December 2016**

|                                      | %    |
|--------------------------------------|------|
| Defensive Australian shares strategy | 5.0  |
| Global shares (unhedged)             | 5.0  |
| Defensive global shares (unhedged)   | 18.0 |
| Multi-asset real return strategy     | 10.0 |
| Australian non-government bonds      | 25.0 |
| Global bank loans                    | 6.0  |
| Australian inflation-linked bonds    | 5.0  |
| Enhanced cash                        | 23.0 |
| Risk management strategy             | 3.0  |

Source: JANA Corporate Investment Services Limited.

### How has the Simple Real Return Strategy performed?

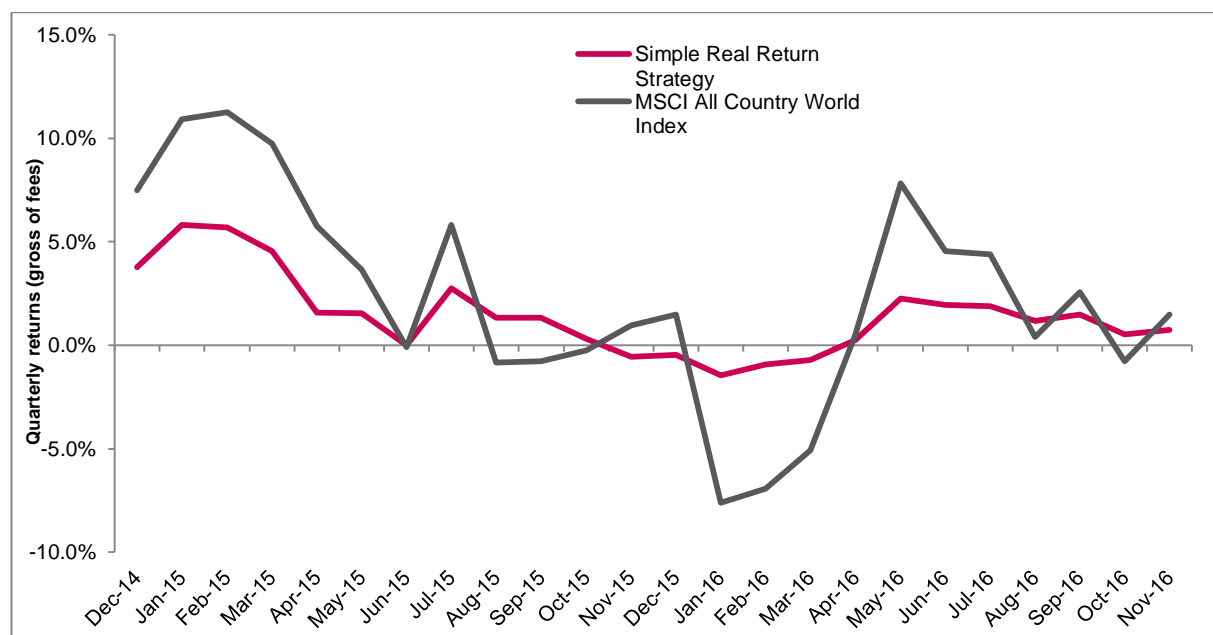
We've been managing the Simple Real Return Strategy since 2014. So far, we've maintained a fairly defensive position in the strategy. This positioning reflects our assessment of the current investment environment where finding asset classes that can offer strong potential returns without unacceptably increasing a portfolio's risk of negative returns has been challenging. This stance is consistent with our other multi-asset portfolios.

Chart 1 shows the rolling quarterly performance of the Simple Real Return Strategy relative to the global share market (unhedged) since 2014. It shows the strategy has generally performed as expected – outperforming in weaker markets, underperforming in stronger markets ie delivering a smoother pattern of returns.

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**Chart 1 – Performance of the Simple Real Return Strategy relative to unhedged global shares (before fees)**



**Source:** JANA Corporate Investment Services Limited. Past performance is not a reliable indicator of future performance.

### How have we widened the asset allocation ranges in the MLC multi-asset portfolios?

For the MLC Horizon and MLC Index Plus portfolios, we've widened the benchmark ranges for total growth and total defensive assets from +/-5% to +/-10%. This will give us more flexibility in future asset allocation decisions to implement our insights on changing risk and return opportunities among asset classes and, in particular, to better manage the potential for downside risk.

For the MLC Inflation Plus Conservative and Moderate portfolios (in MLC MasterKey Super and Pension products) we've included a separate range for Private Assets (previously included under 'Alternatives'), and widened the asset allocation range for Alternatives. This will allow greater flexibility and improve consistency of their asset allocations with the MLC Inflation Plus Assertive Portfolio.

### What are the new allocations?

The new benchmark asset allocation and ranges for the MLC Index Plus portfolios are in Appendix 1.

The benchmark asset allocations and ranges, target and actual allocations for all our portfolios are available on [www.mlc.com.au/fundprofiletool](http://www.mlc.com.au/fundprofiletool).

A complete list of the portfolios affected by the changes in this paper is in the Important Information section at the end of this document.

### Are there fee implications?

There are no changes to fees as a result of these changes to our multi-asset portfolios.

Investment fees are available in the Fund Profile Tool on [mlc.com.au](http://mlc.com.au) and [mlcinvestmenttrust.com.au](http://mlcinvestmenttrust.com.au). For further information regarding fees please refer to the relevant Product Disclosure Statement.

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### Appendix 1: New benchmark asset allocations and ranges for the MLC Index Plus portfolios

The new benchmark asset allocations and ranges for MLC Index Plus portfolios are shown below. We have used portfolios in the MLC MasterKey Super & Pension Fundamentals. New allocations will also impact the funds listed in the Important Information section of this document.

The benchmark asset allocations and ranges for all our portfolios are available on the Fund Profile Tool on [mlc.com.au](http://mlc.com.au).

**Table 3 – New benchmark asset allocations, and changes from previous allocations, for MLC MasterKey Super & Pension Fundamentals**

|                                     | MLC Index Plus Conservative Growth Portfolio |             | MLC Index Plus Balanced Portfolio |             | MLC Index Plus Growth Portfolio |             |
|-------------------------------------|--|-------------|-----------------------------------|-------------|---------------------------------|-------------|
|                                     | %  | % change    | %                                 | % change    | %                               | % change    |
| <b>Shares and property</b>          | <b>44.5</b>                                  | <b>-5.5</b> | <b>64.5</b>                       | <b>-5.5</b> | <b>79.0</b>                     | <b>-6.0</b> |
| Australian shares                   | 18.5   | -2.5        | 28.0                              | -4.0        | 33.0                            | -4.0        |
| Global shares (unhedged)            | 13.0   | -2.0        | 16.0                              | -2.0        | 23.0                            | -1.0        |
| Global shares (hedged)              | 10.0   | -1.0        | 16.5                              | +0.5        | 19.0                            | -1.0        |
| Global property securities          | 3.0  | -           | 4.0                               | -           | 4.0                             | -           |
| <b>Fixed income and cash</b>        | <b>49.5</b>                                  | <b>-0.5</b> | <b>29.5</b>                       | <b>-0.5</b> | <b>16.0</b>                     | <b>+1.0</b> |
| Cash                                | 6.5  | +1.5        | 3.5                               | +3.5        | 2.0                             | +2.0        |
| Australian bonds                    | 27.6   | -1.0        | 16.7                              | -2.2        | 9.5                             | -0.5        |
| Global bonds                        | 15.4   | -1.0        | 9.3                               | -1.8        | 4.5                             | -0.5        |
| <b>Alternatives</b>                 | <b>6.0</b>                                   | <b>+6.0</b> | <b>6.0</b>                        | <b>+6.0</b> | <b>5.0</b>                      | <b>+5.0</b> |
| Real return strategies <sup>2</sup> | 6.0  | +6.0        | 6.0                               | +6.0        | 5.0                             | +5.0        |
| <b>Total assets</b>                 | <b>100</b>                                   | <b>-</b>    | <b>100</b>                        | <b>-</b>    | <b>100</b>                      | <b>-</b>    |
| <b>Total growth assets</b>          | <b>48.7</b>                                  | <b>-1.3</b> | <b>68.7</b>                       | <b>-1.3</b> | <b>82.5</b>                     | <b>-2.5</b> |
| <b>Total defensive assets</b>       | <b>51.3</b>                                  | <b>+1.3</b> | <b>31.3</b>                       | <b>+1.3</b> | <b>17.5</b>                     | <b>2.5</b>  |

Figures are rounded to one decimal place.

**Table 4 – New asset allocation ranges for MLC MasterKey Super & Pension Fundamentals**

|                               | MLC Index Plus Conservative Growth Portfolio |       | MLC Index Plus Balanced Portfolio |       | MLC Index Plus Growth Portfolio |       |
|-------------------------------|--|-------|-----------------------------------|-------|---------------------------------|-------|
|                               | Min %  | Max % | Min %                             | Max % | Min %                           | Max % |
| Australian shares             | 5  | 35    | 15                                | 45    | 20                              | 50    |
| Global shares                 | 10   | 35    | 20                                | 40    | 20                              | 55    |
| Property                      | 0  | 15    | 0                                 | 15    | 0                               | 15    |
| Alternatives – Other (Growth) | 0  | 10    | 0                                 | 10    | 0                               | 10    |

<sup>2</sup> Through the MLC Index Plus portfolios' investments in real return strategies, the portfolios gain exposure to multi-asset real return strategies, defensive Australian shares and defensive global shares.



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|                                  |           |           |           |           |           |           |
|----------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|
| <b>Total growth assets</b>       | <b>40</b> | <b>60</b> | <b>60</b> | <b>80</b> | <b>75</b> | <b>95</b> |
| Cash                             | 0         | 20        | 0         | 15        | 0         | 15        |
| Australian bonds                 | 10        | 40        | 10        | 30        | 0         | 20        |
| Global bonds                     | 5         | 35        | 0         | 25        | 0         | 20        |
| Alternatives – Other (Defensive) | 0         | 10        | 0         | 10        | 0         | 10        |
| <b>Total defensive assets</b>    | <b>40</b> | <b>60</b> | <b>20</b> | <b>40</b> | <b>5</b>  | <b>25</b> |

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#### The funds affected by these changes

The following funds are affected by the changes to the MLC multi-asset portfolios. These funds are offered through MLC’s platforms and MLC Wholesale, in addition to some external platforms.

|  |   |
|--|---|
| MLC Inflation Plus Conservative Portfolio    | MLC Horizon 2 - Capital Stable Portfolio      |
| MLC Inflation Plus Moderate Portfolio        | MLC Horizon 2 - Income Portfolio              |
| MLC Index Plus Conservative Growth Portfolio | MLC Horizon 3 - Conservative Growth Portfolio |
| MLC Index Plus Balanced Portfolio            | MLC Horizon 4 - Balanced Portfolio            |
| MLC Index Plus Growth Portfolio              | MLC Horizon 5 - Growth Portfolio              |

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