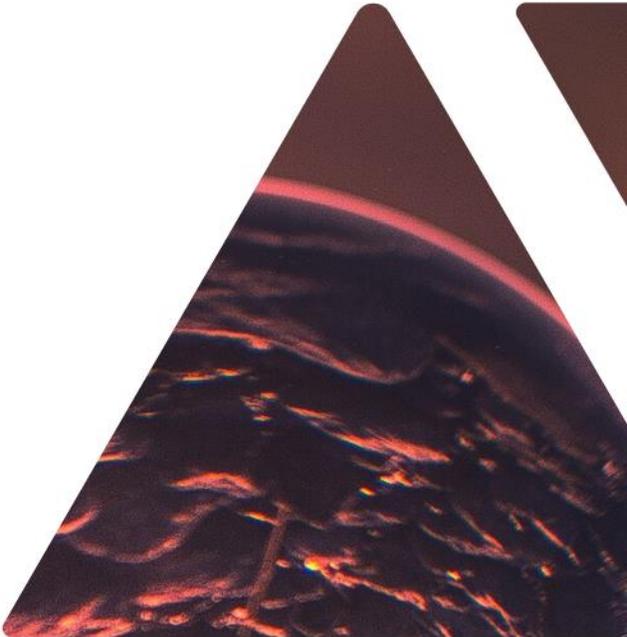


Portfolio Construction in the Age of Uncertainty

Heathcote Partners – Meet the Managers

Noah Schiltknecht, Consultant

September 2022



It starts with you

What is my purpose?

What do I believe in?

Makao Investments

Making advice affordable – for those that need it the most



Noah Schiltknecht, CFA

- Swiss-born, Kiwi citizen
- Before Makao: Head of Institutional, Russell Investments, NZ
- Volunteers for Surf Life Saving



John Horrell, CFA, CAIA

- Raised in Southland
- Before Makao: Strategy and Implementation, Russell Investments, UK
- Volunteers for CFA Society



Ruth Thorburn

- Raised in the Waikato
- Before Makao: Commercial Banking team at ASB, BCOM UNSW
- Ngāi Tahu heritage

Integrity

Transparency

Humility

Signatory of:



Bronze sponsor of



Makao Investments

Our investment beliefs

Investing without a process is like driving without your seatbelt on



Ensure your **governance** structure is fit for purpose.

Use a **systematic** framework for modelling expected returns.

Prioritise investment opportunities with a **strong process**.

Understanding the ingredients will give you a healthy experience



Account for similar exposures across your portfolio.

Seek **evidence of ESG** integration and engagement.

Always **include fees, tax and inflation** in your analysis.

No one has the perfect crystal ball



Be prepared for a variety of scenarios.

Improve **diversification** with offshore investments.

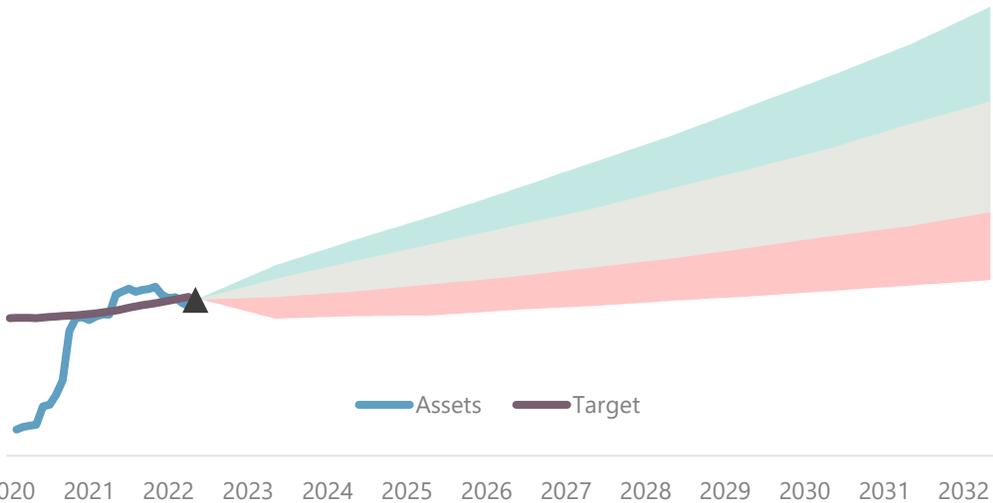
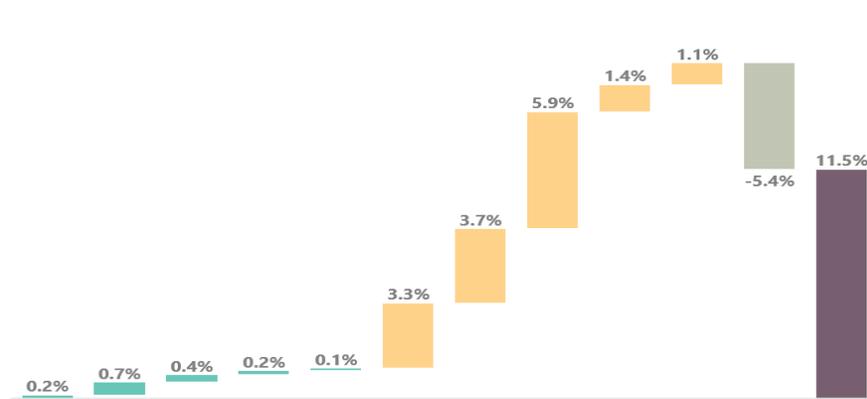
Use **diligence and discipline** when making tactical decisions.



There won't be time for this today



Risk Contribution



- 

BUY
High conviction
- 

HOLD
Medium conviction
- 

HOLD-
Low conviction
- 

SELL
No conviction
- 

EXIT
Immediate concerns

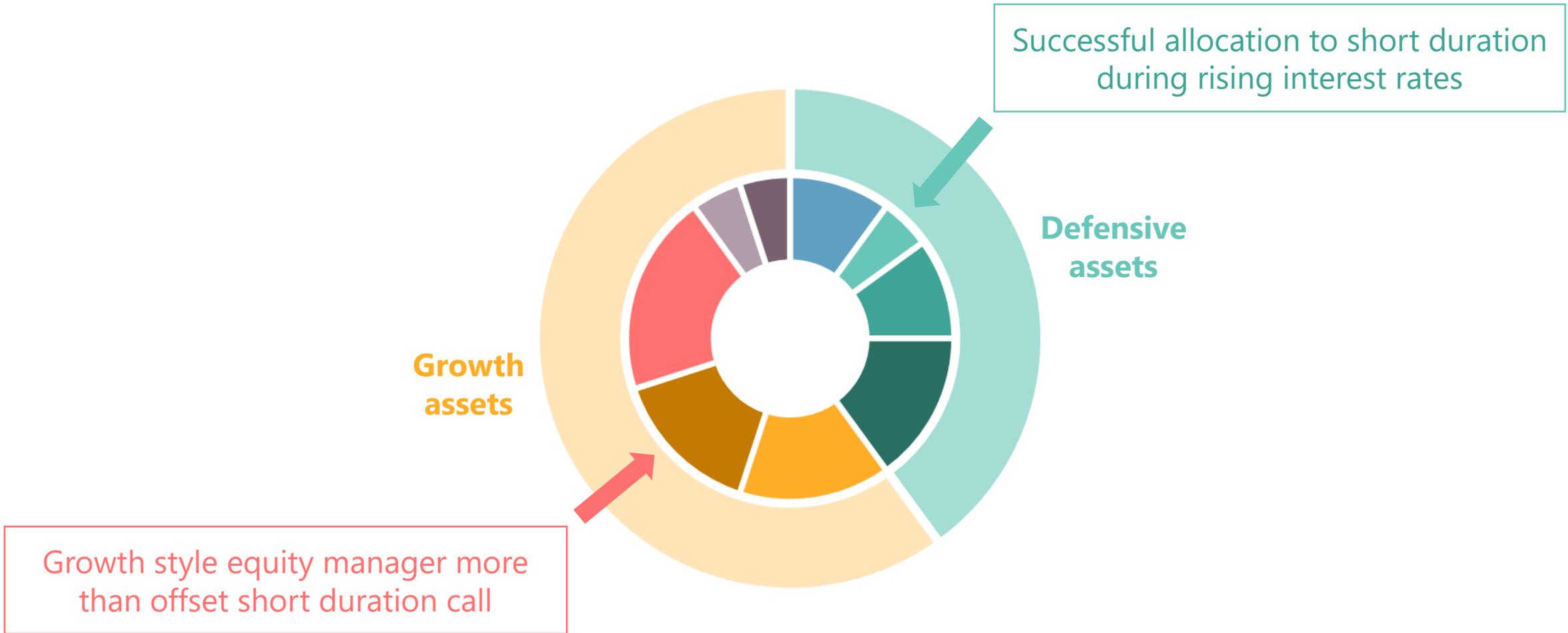
3 handy hints for portfolio construction

Do not	Do	Example
Analyse asset classes in isolation	#1 Account for similar exposures	Tilt out of long duration bonds
Invest by looking back	# 2 Use scenario analysis	Unexpected inflation
Let emotions get the best of you	#3 Avoid biased decision-making	Manager selection

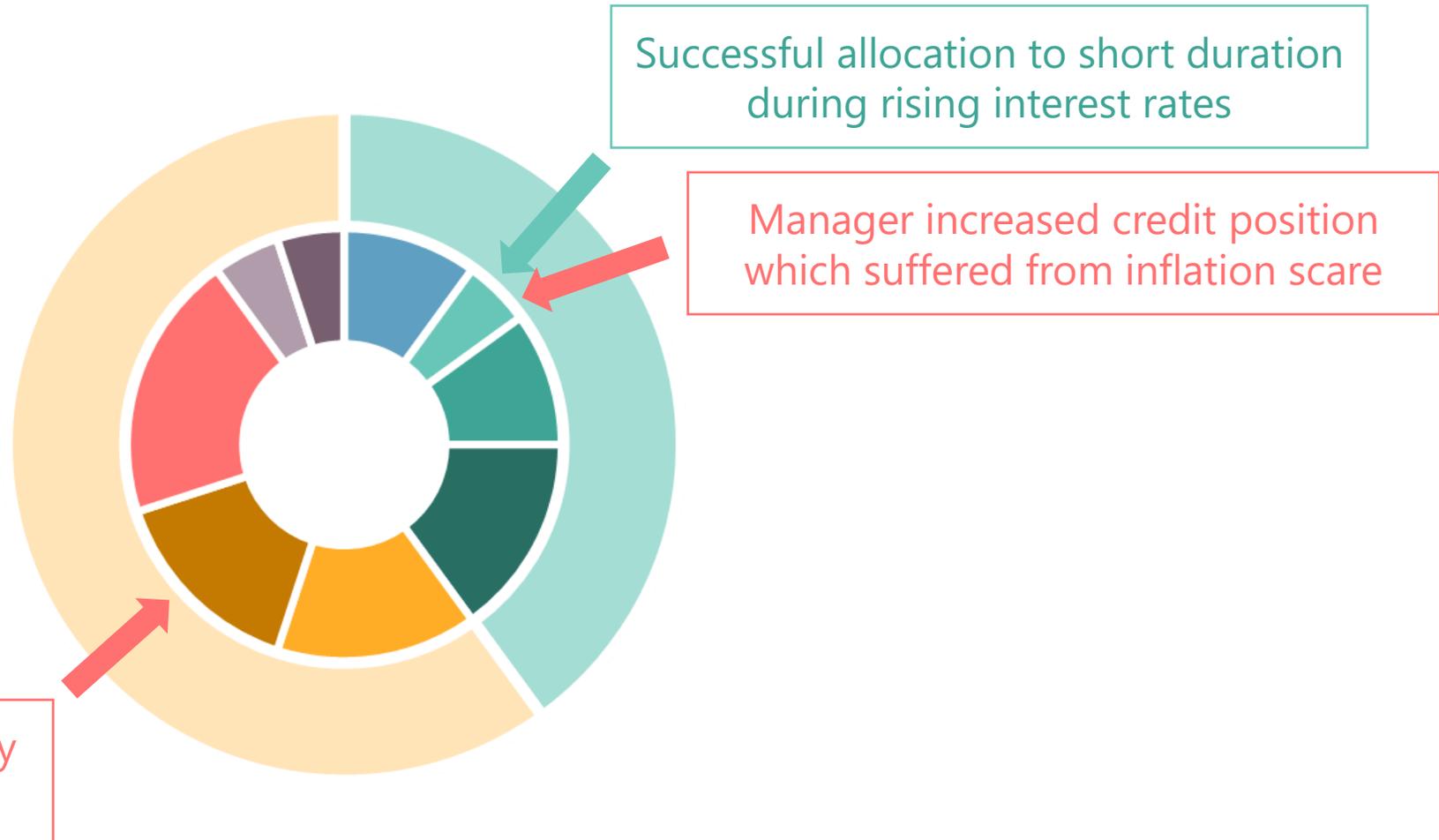
Hint #1

Account for similar exposures

Think holistically



Think holistically (#2)

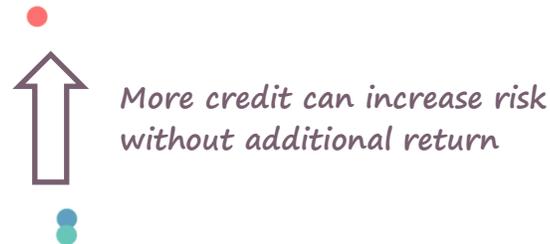


Account for similar exposures - example

Credit and Sovereign exposure should be modelled separately for portfolio construction

Volatility

Conditional Value at Risk (CVaR)



Return

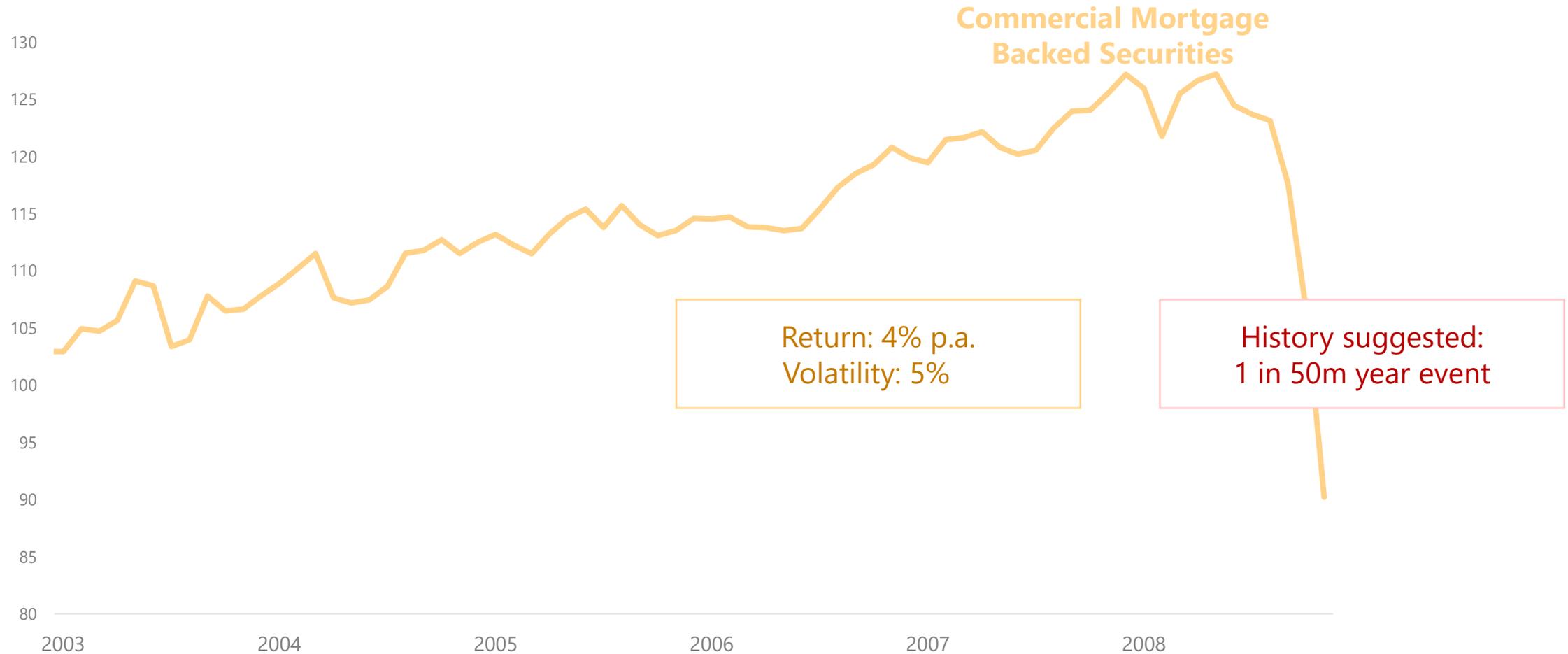
Return

	Mostly credit	Index allocation	No credit
Global Shares (50% hedged)	44.0%	50.0%	52.0%
Global Credit	50.0%	12.5%	0.0%
Global Government Bonds	6.0%	37.5%	48.0%

Hint #2

Use scenario analysis

Stable asset class?



Predictive scenario – recent example

Unexpected inflation

Client XYZ Asset Allocation Report **December 2020**

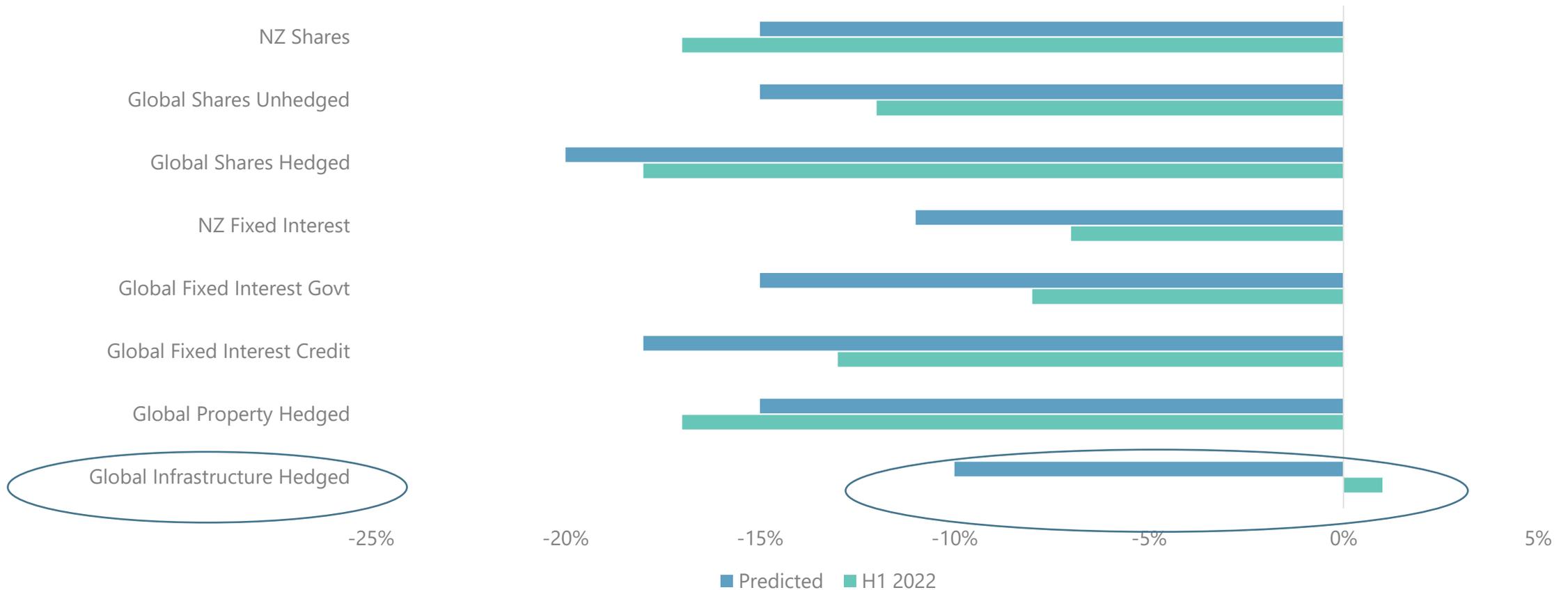
Inflation rises significantly, and **central banks globally begin to raise interest rates** to cool an overheating global economy.

However, the **shock in inflation is sustained for longer than expected**, and as a result, **government bonds sell-off**.

Shares are hit as well, as investors worry about future earnings and growth in light of **accelerating increases in interest rates**. However, the decline in shares is somewhat contained as investors expect that some of the increase in costs from higher inflation can be passed on through higher prices.

Actual vs prediction

Unexpected inflation



Hint #3

Avoid biased decision-making

How skilled is this hedge fund manager?

- **Investment strategy:** relative value trades between countries using derivatives
- 14 trades: **11 correct calls, 3 incorrect calls**
- **Each derivative trade sized at 5%** of total portfolio, rest held in low interest yielding cash
- **Annualised return: + 75%**

Meet the manager – Paul the Octopus!



- *No process*
- *Pure luck*
- *Zero skill*

Outcome bias

- We **assess the quality** of the decision-making process based on the **outcome**
- **If the wrong process** has led to a good outcome we are bound to continue using it
- **Just one example of a bias – there are lots more** (hindsight bias, recency bias, loss aversion etc)
- Biases affect portfolio construction, manager selection, tactical calls

=> *Try and account for - or eliminate - biases that you or your clients might have*

3 hints for portfolio construction

#1 Account for similar exposures

#2 Use scenario analysis

#3 Avoid biased decision-making

Get in touch if you want to learn more about how we approach portfolio construction

contact@makao.co.nz

Makao Investments



Integrity



Transparency



Humility

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