MERCER

Madison Financial Group

Mercer's portfolio construction and bringing asset classes together

Rebecca Jacques
Senior Investment Consultant, Sydney

welcome to brighter

Agenda

Leveraging Mercer's Global Expertise

45+	**150+**	**20**	**US14.3tn**	**US$306bn**
Years of experience in investment consulting	Staff in Australia	Countries located in	Global assets under advice#	Global assets under management*
25	**1,300+**	**2,800**	**A$1.82tn**	**A$40.8bn**
Years managing multi-manager portfolios	Colleagues globally	Organisations served globally	Australian assets under advice#	Pacific assets under management*

Dedicated consultants and specialists in all relevant areas such as capital markets, manager research, responsible investment, investment governance etc

Data as of | #30 June 2019 | ^30 June 2020

#Assets under advisement includes aggregated data for Mercer Investment Consulting, Inc. and its affiliated companies globally ("Mercer"). Data is derived from a variety of sources, including, but not limited to, third-party custodians or investment managers, regulatory filings, and client self-reported data. Mercer has not independently verified the data. Where available, data is provided as of 30 June 2019 ("Reporting Date"). If data was not available as of the Reporting Date, information from a date closest in time to the Reporting Date, which may be of a more recent date than the Reporting Date, was included. Data includes assets of clients that have engaged Mercer to provide project-based services within the 12-month period ending on the Reporting Date, and assets of clients that subscribe to Mercer's Manager Research database.

Investment Philosophy underpinning everything we do

All clients are different | An investor's true risk is failing to meet obligations | Robust governance is critical to success
Improved risk-adjusted returns necessitate a more complex set of arrangements | ESG can affect long-term outcomes

Don't put all your eggs in one basket.
We get the right mix of assets to smooth out periods of market volatility

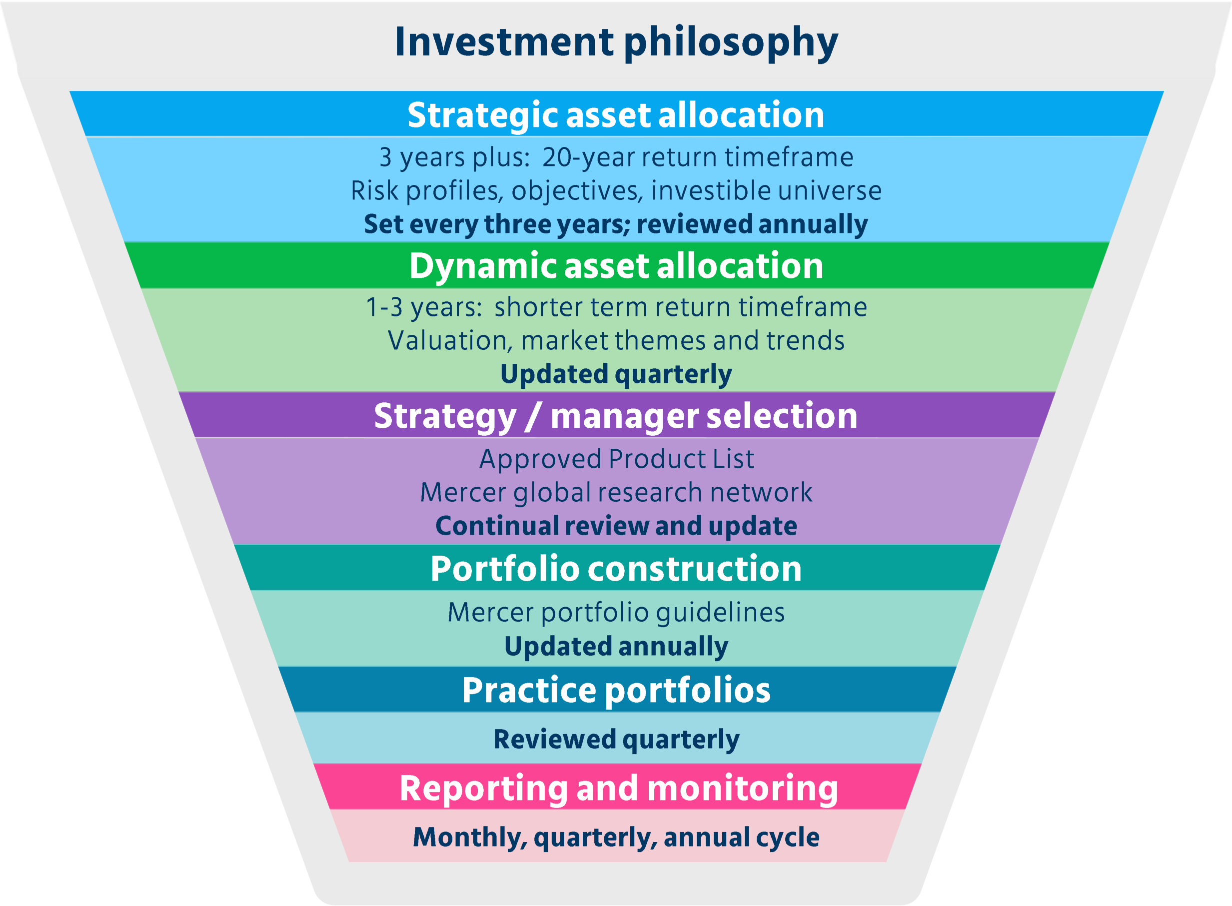
Prepare for the future.
We address potential risks that arise from social or environmental issues, policy changes or failures in governance, and assess how you'll meet your objectives in the future

Exploit opportunities.
We use investment managers who bring skilful judgement in exploiting market inefficiencies to add value

Flexibility gets results.
We intelligently reduce levels of an overly expensive asset class, while increasing exposure to assets with greater potential

Every bit counts.
The routine costs of the investment process can affect returns across your portfolio

Portfolio construction
A clear and robust process



Get to know Mercer's Capital Market Assumptions

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Global Capital Markets Team

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- David Zanutto
- Mariusz Wielocha

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- **Harry Liem***
- Rob Kavanagh
- Philip Houghton Brown
- Brodie Catterick

PACIFIC TEAM

GLOBAL HEAD OF CAPITAL MARKETS

AUSTRALIA / NEW ZEALAND HEAD OF CAPITAL MARKETS

GLOBAL HEAD OF STRATEGIC RESEARCH

Modelling inputs

	FACTOR	MARKET AWARE
MACRO-ECONOMIC	Inflation	Current core inflation + 1 year forecast reverting to central bank policy
	GDP	Current rate + 1 year forecast mean reverting to steady state
CASH & FIXED INTEREST	Term + Credit	Current rates with reversion to long term curves
EQUITIES	Equity Risk Premium	Incorporates current P/E and reversion to long run pricing
ALTERNATIVES	Range of Risk Factors	Based on current pricing of risk premia and the composition of each alternative investment

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Capital Market Simulator

Economic inputs → Capital Market Simulator → Projects up to 90 years of economic scenarios for 2,000 trials

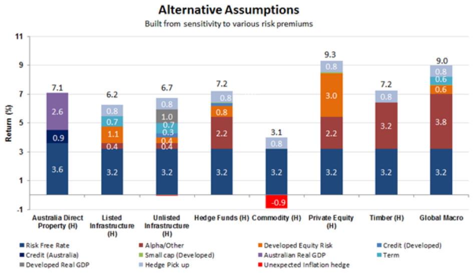
CMS is also known as an ESG or "Economic Scenario Generator" in that it allows for projections of an economically and statistically consistent data set.

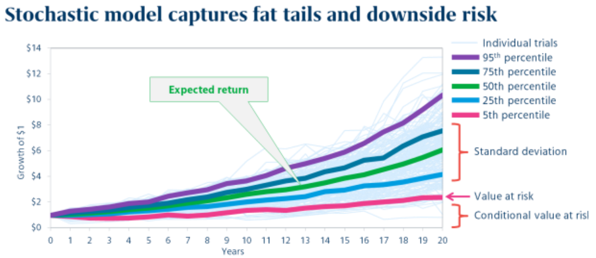
Stochastic: it creates many possible economic scenarios of the world ("trials") to create probability distributions

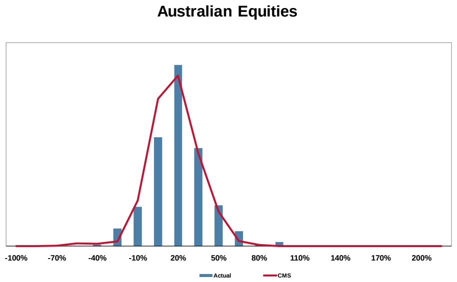
Capital market assumptions

How they derive the strategic asset allocation

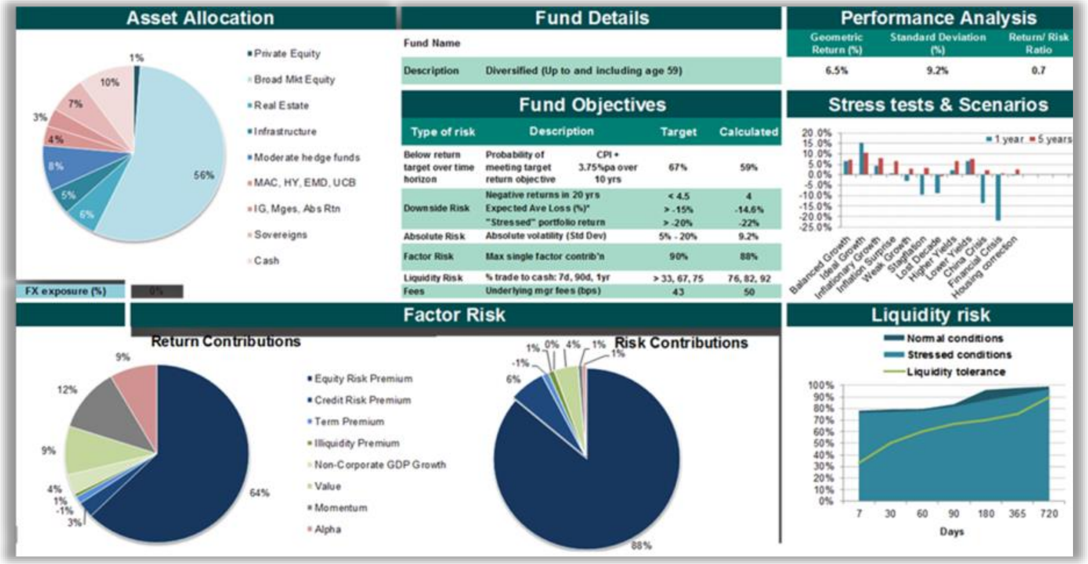
Capital Markets Simulator (CMS)







Risk factor analysis using the Growth Portfolio Toolkit (GPT)



Mercer's December 2020 Market Aware CMAs

December 2020 Market Aware (gross of tax, fees and alpha)	5 Year		10 Year		20 Year	
	Geometric Mean	Standard Deviation	Geometric Mean	Standard Deviation	Geometric Mean	Standard Deviation
Australian Large Caps	6.2%	19.6%	6.6%	19.1%	6.9%	18.0%
Australian Small Caps	6.6%	21.6%	7.0%	21.0%	7.3%	19.8%
Developed Markets Equity (UH)	4.3%	17.9%	5.5%	17.5%	6.3%	16.6%
Developed Markets Equity (H)	3.3%	19.0%	4.6%	18.5%	5.8%	17.4%
Developed Markets Small Cap (UH)	5.0%	21.3%	6.2%	20.8%	7.0%	19.6%
Emerging Markets Equity (UH)	4.1%	22.7%	5.5%	22.0%	8.0%	22.7%
AREITs	6.3%	15.0%	6.2%	14.9%	6.5%	14.9%
GREITs (H)	3.6%	17.7%	4.9%	17.6%	5.8%	17.4%
Global Listed Infrastructure (H)	4.0%	15.0%	5.8%	14.9%	5.8%	14.6%
Global Unlisted Infrastructure (H)	6.0%	11.3%	5.9%	11.2%	6.2%	10.9%
Australian Direct Property	6.3%	11.3%	6.5%	11.2%	6.7%	11.0%
Hedge Funds – Multi-strategy (H)	3.8%	7.7%	4.9%	7.7%	5.8%	7.6%
Private Equity (H)	5.3%	26.2%	6.5%	25.5%	7.7%	24.0%
Private Debt (H)	5.7%	12.5%	7.2%	12.3%	8.0%	11.9%
Global Absolute Return Bonds (H)	1.9%	6.5%	3.3%	6.3%	4.1%	6.0%
Australian Fixed Interest Composite	-0.4%	4.1%	0.8%	4.2%	2.4%	4.6%
Australian Government Bonds	-0.5%	4.7%	0.6%	4.8%	2.2%	5.1%
Australian Non Government Bonds	-0.2%	3.3%	1.2%	3.6%	2.7%	4.0%
Developed Markets Fixed Interest Composite (H)	-1.1%	6.3%	0.3%	6.3%	2.1%	6.4%
Developed Markets Government Bonds (H)	-1.3%	7.4%	0.0%	7.4%	1.8%	7.2%
Developed Markets Non-Government Bonds (H)	-0.9%	5.6%	0.8%	5.8%	2.6%	6.0%
Cash (Bank Bills)	0.4%	1.3%	1.4%	1.4%	2.3%	1.8%
CPI (Australia)	1.8%	2.3%	1.9%	2.3%	2.1%	2.3%

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Setting long term expectations
Implications of capital market trends

Implications of Mercer's capital market assumptions	
Probability of meeting objectives over the long term (20 years)	Reduced
Probability of meeting objectives over short to medium time horizons (3 years to 10 years)	Reduced
Probability of a negative return	Increased
Standard Risk Measure	Increased

The strategic asset allocation process

The purpose of a strategic investment review is to:

- **Ensure the objectives of each Option / portfolio remain appropriate**
- **Improve the risk / return characteristics of the Options / portfolio**
- **Ensure the investment strategies are in keeping with peers or risk profiles**
- **Ensure the SAAs are upholding the Fund's investment beliefs**
- **Comply with regulatory requirements**

An SAA provides a long term neutral portfolio:

Short term (<1 year) = **Tactical Asset Allocation (TAA)**	**Medium term** (1-3 years) = **Dynamic Asset Allocation (DAA)**	**Long term** (5+ years) = **Strategic Asset Allocation (SAA)**
Exploitation of short term inefficiencies through market timing, efficient implementation and active stock selection	Dynamic adjustments to the SAA to exploit medium term opportunities such as significant deviations away from fair value	A diversified asset allocation that is expected achieve the risk and return objectives over time with high confidence, based on long term economic/asset class relationships

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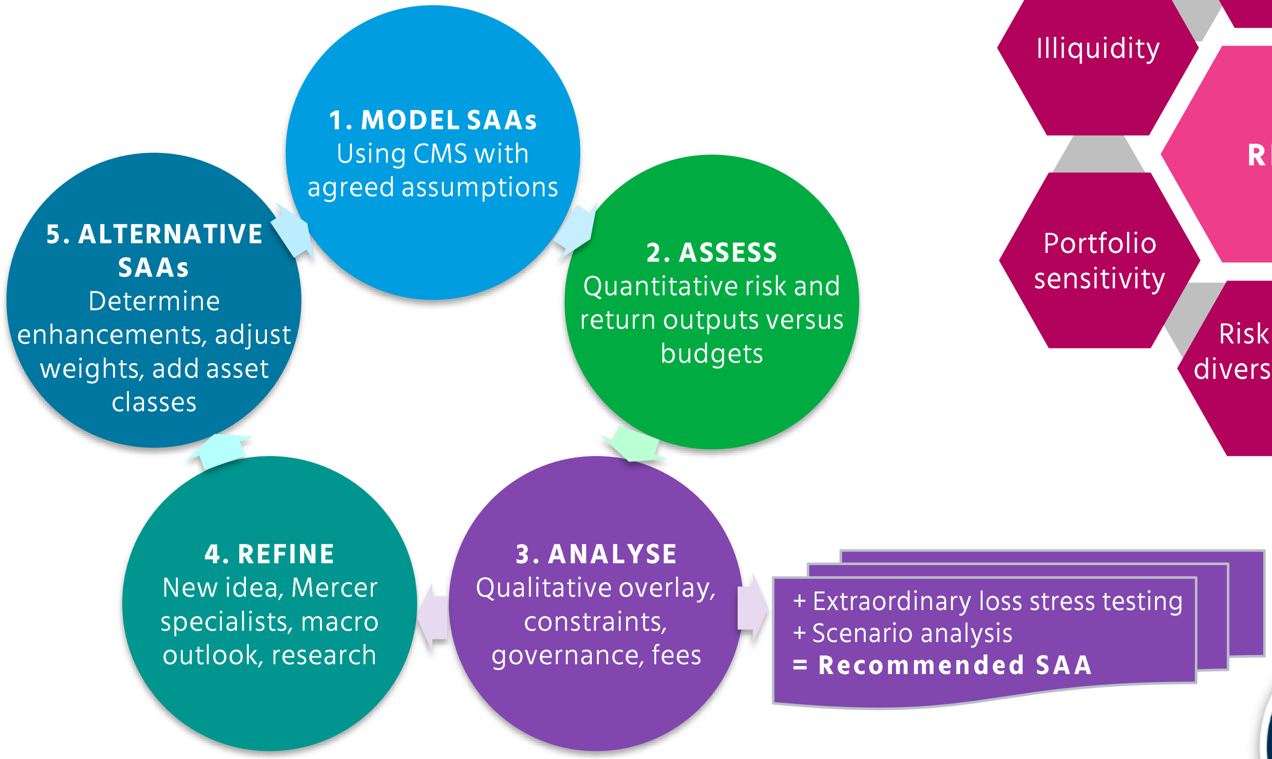
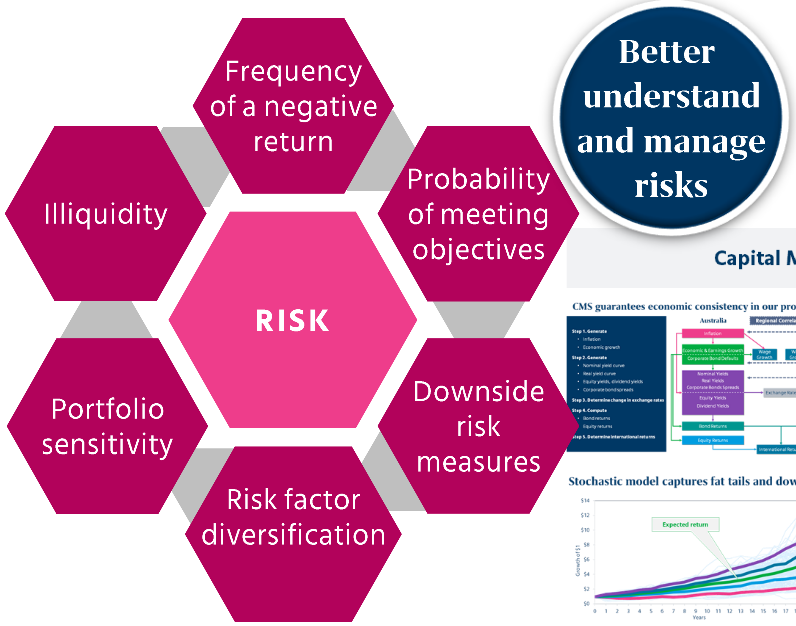
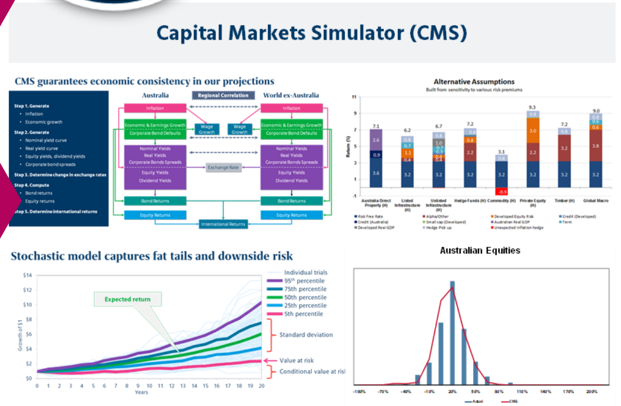
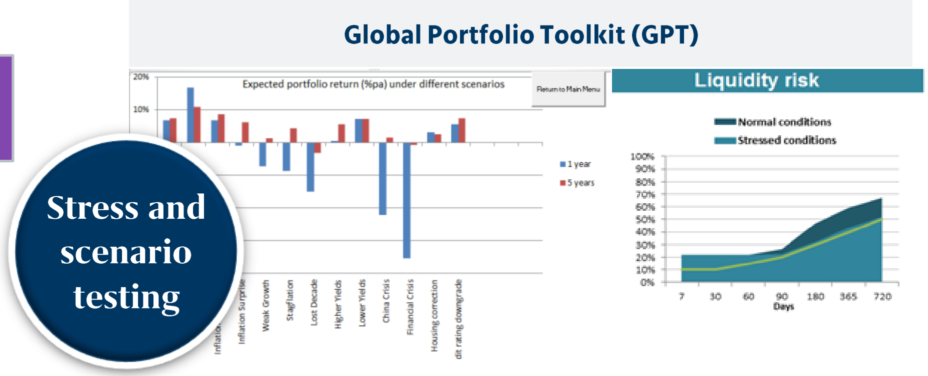
The strategic asset allocation process



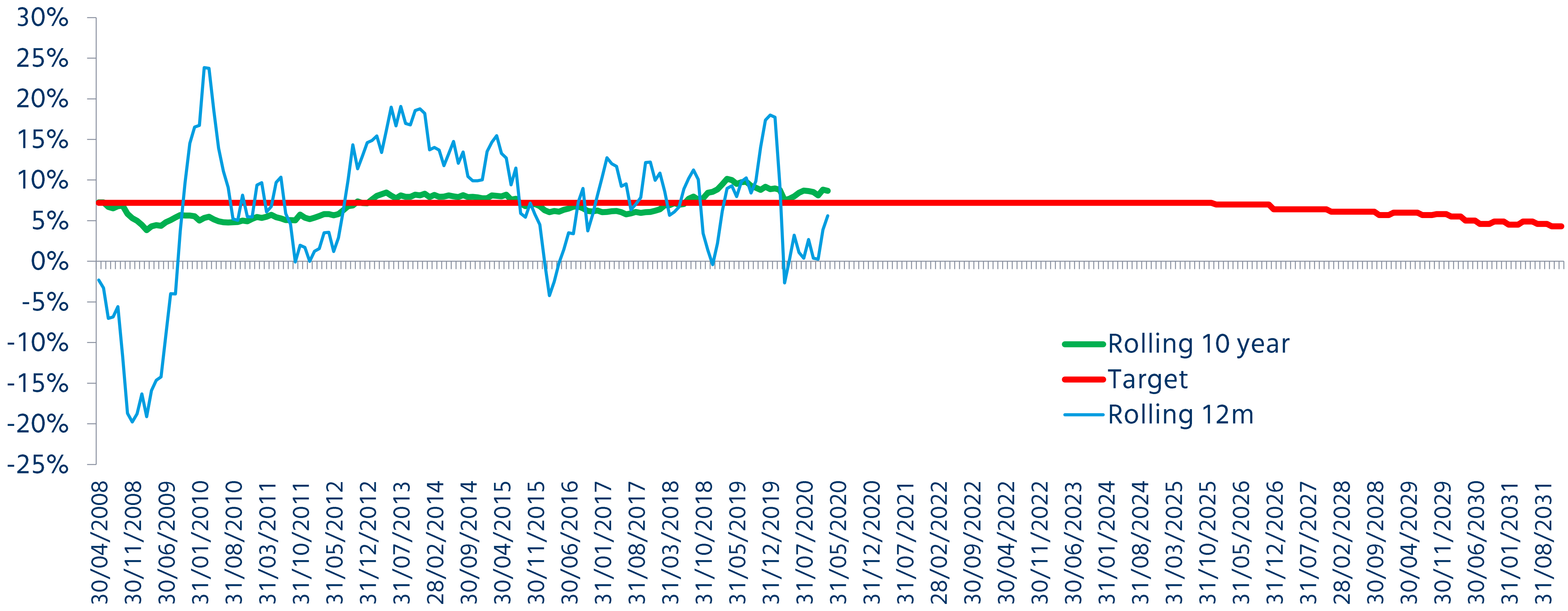






Comparison with actual rolling 10 year returns for a sample balanced fund*

Over the period from 2010-2020, our average target return (the red line) was 7.2% p.a.
The actual average of the 10 year rolling returns (the green line) was 7.3% p.a.



*A sample 60/40 portfolio consisting of 30% Australian Shares, 15% Overseas shares UH, 15% Overseas shares H, 20% Australian Fixed Interest, 20% Overseas Fixed Interest) before tax and fees.

Dynamic Asset Allocation (DAA)

Taking advantage of medium term opportunities

In the managing portfolios, Mercer also seeks to improve portfolio outcomes through DAA. Mercer's DAA committee meets quarterly and provides a structured framework to arrive at a formal house view on core asset classes with a one to three year time horizon

Medium-term investment horizon

Economic outlook	Defensive / growth view	Asset class views	Customised fund recommendations
• Growth • Inflation and monetary policy	• Market valuations • Risk appetite	• Absolute and relative valuation measures • Momentum	

DAA Dashboard
2021 Q1 at a glance

Asset class views

NEUTRAL	Expected to perform in line with Mercer's long-term return assumption over two years
ATTRACTIVE (Unattractive)	Expected to exceed (lag) Mercer's long-term return assumption over two years
EXTREMELY ATTRACTIVE (Extremely unattractive)	Expected to outperform (underperform) Mercer's long-term assumption substantially over two years *('Substantially' is considered to be outside a range of +/- 15% of the cumulative performance over two years based on Mercer long-term assumptions)*

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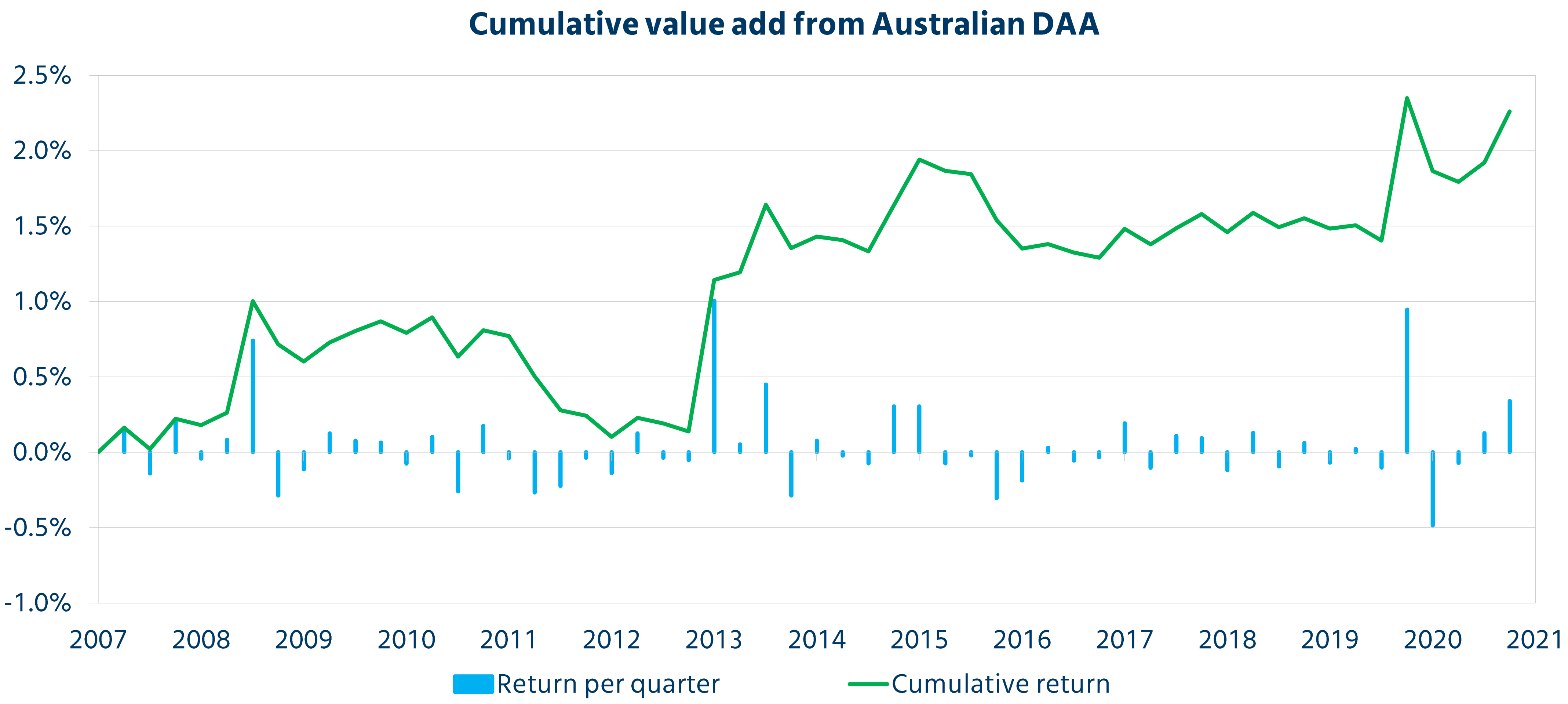
DAA track record
A proven ability to add value



Selecting investment managers
Global and rigorous

Gather data (MercerInsight™)
6,705 Managers
35,622 Strategies
11,817 Strategies are Rated
55% of Rated Strategies are A, B+, or B

Prioritise candidates
Review of MercerInsight entry
Previous Mercer research
Market intelligence
Performance and portfolio analysis

Worldwide due diligence
Idea generation
Portfolio construction
Implementation
Business management

Ratings
Ratings Review Committee
Highly rated candidates (ongoing monitoring)

Candidates

Idea generation
How strong is the manager's ability to generate value-adding investment ideas?

Portfolio construction
How effectively are these investment ideas translated into weightings within portfolios?

Implementation
How much of the value-add is given back in the form of transaction costs and opportunity costs?

Business management
Well-managed investment firms are more likely to maintain and enhance the competitiveness of their investment strategies over time.

A Above average prospects of outperformance
B+ Above average prospects of outperformance but with some reservations
B Average prospects of outperformance
C Below average prospects of outperformance
N Not rated
R Early stage research / Research no longer maintained

*Manager and Strategy Statistics as of 30 June 2020, includes sub advised strategies.

https://www.mercer.com/content/dam/mercer/attachments/private/nurture-cycle/gl-2018-wealth-guide-to-mercers-investment-strategy-research-ratings-mercer.pdf

Reviewing investment managers
A robust process is key to the rating

Broader asset class

- Equities
- Real assets
- Bonds
- Cash

Filtered for A and B+

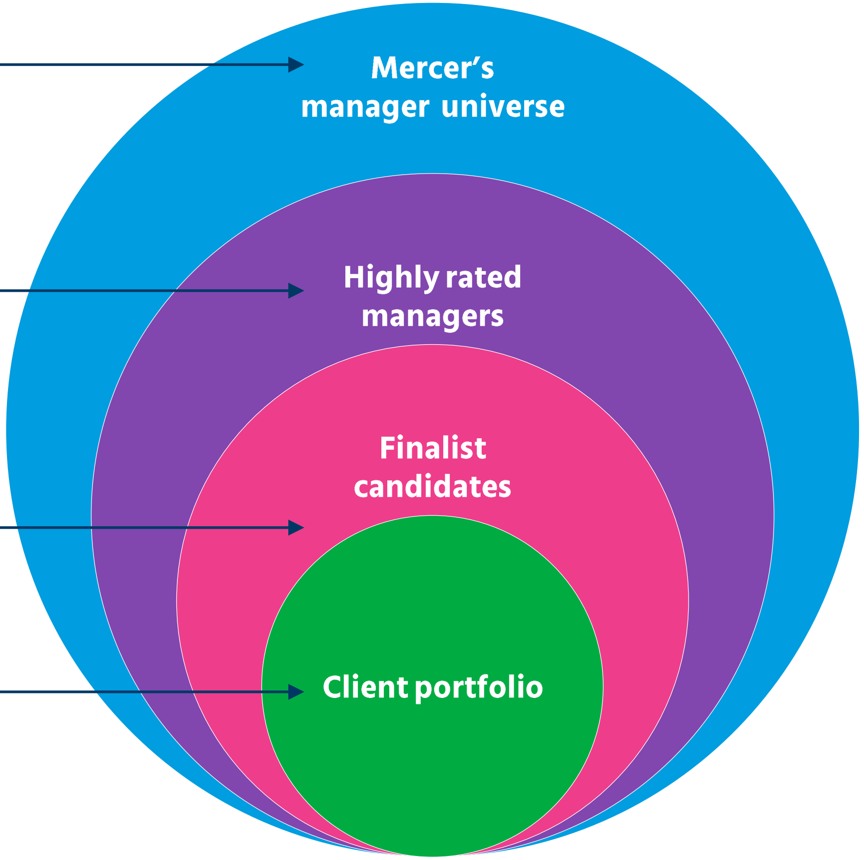
- Idea generation
- Portfolio construction
- Implementation
- Business management

Portfolio construction

- Quantitative assessment
- Qualitative assessment

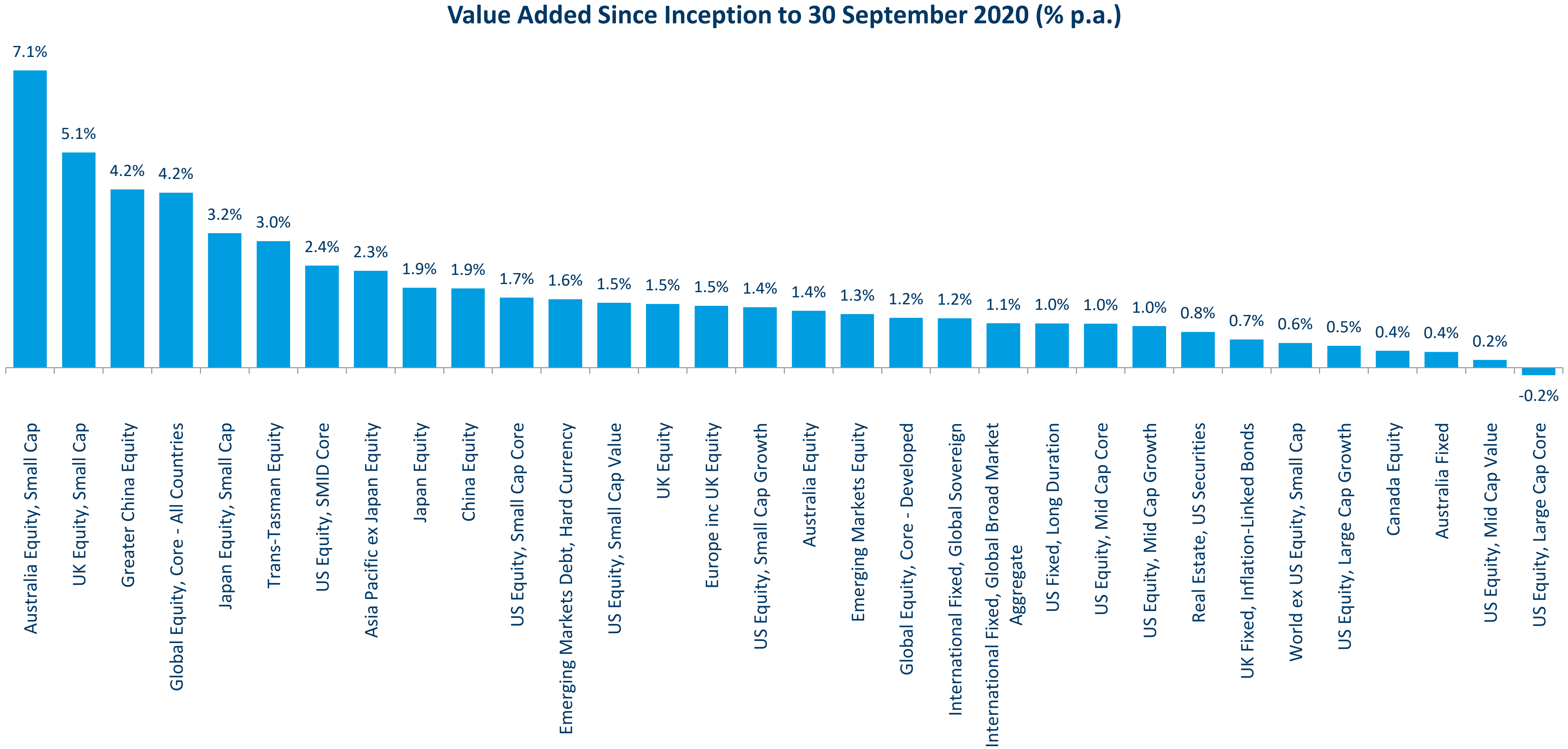
Suitability

- Thorough due diligence
- Costs



Real value for clients

Consistently developing Alpha

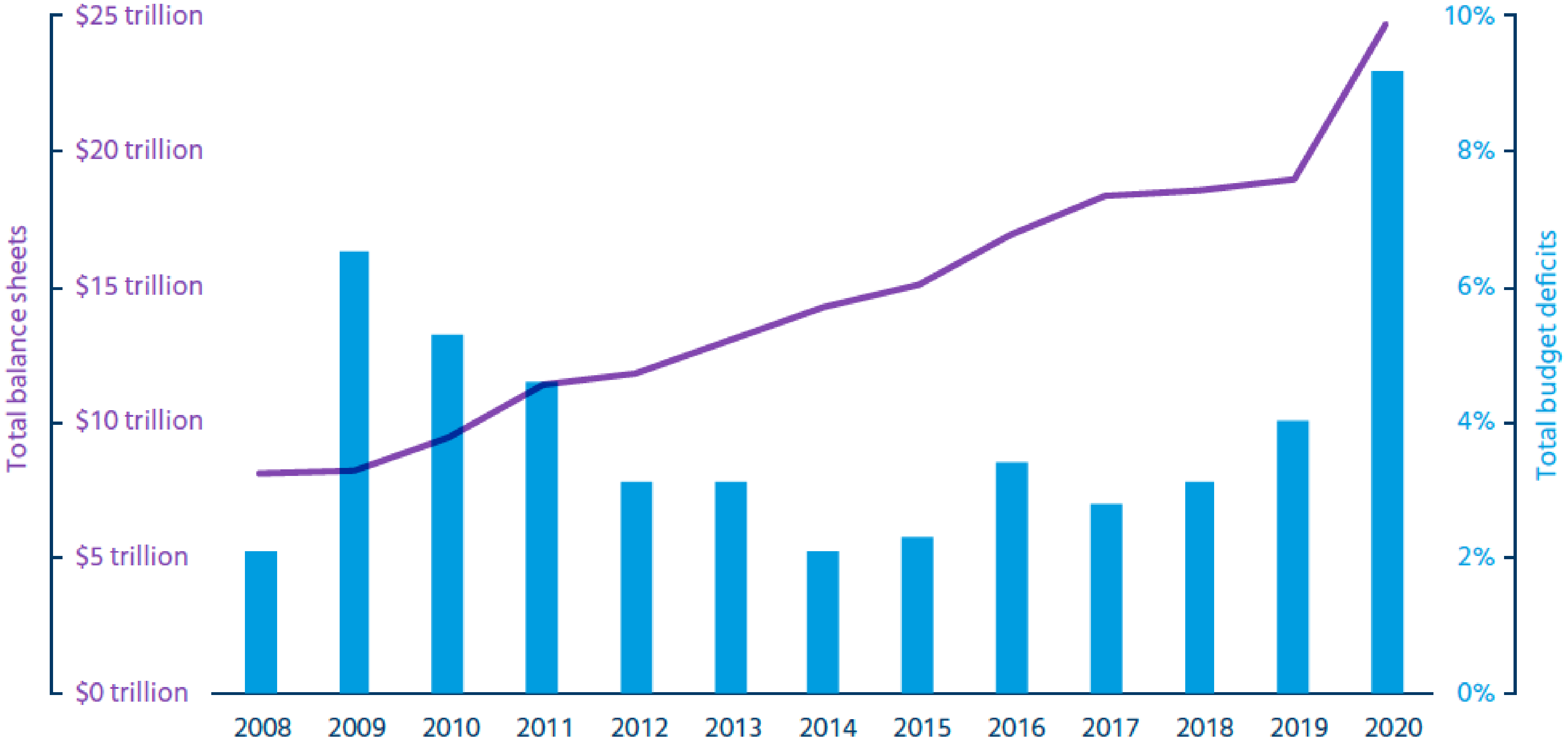


Fixed Income in the New World

Policy distortions

The New World
Policy distorting the economy

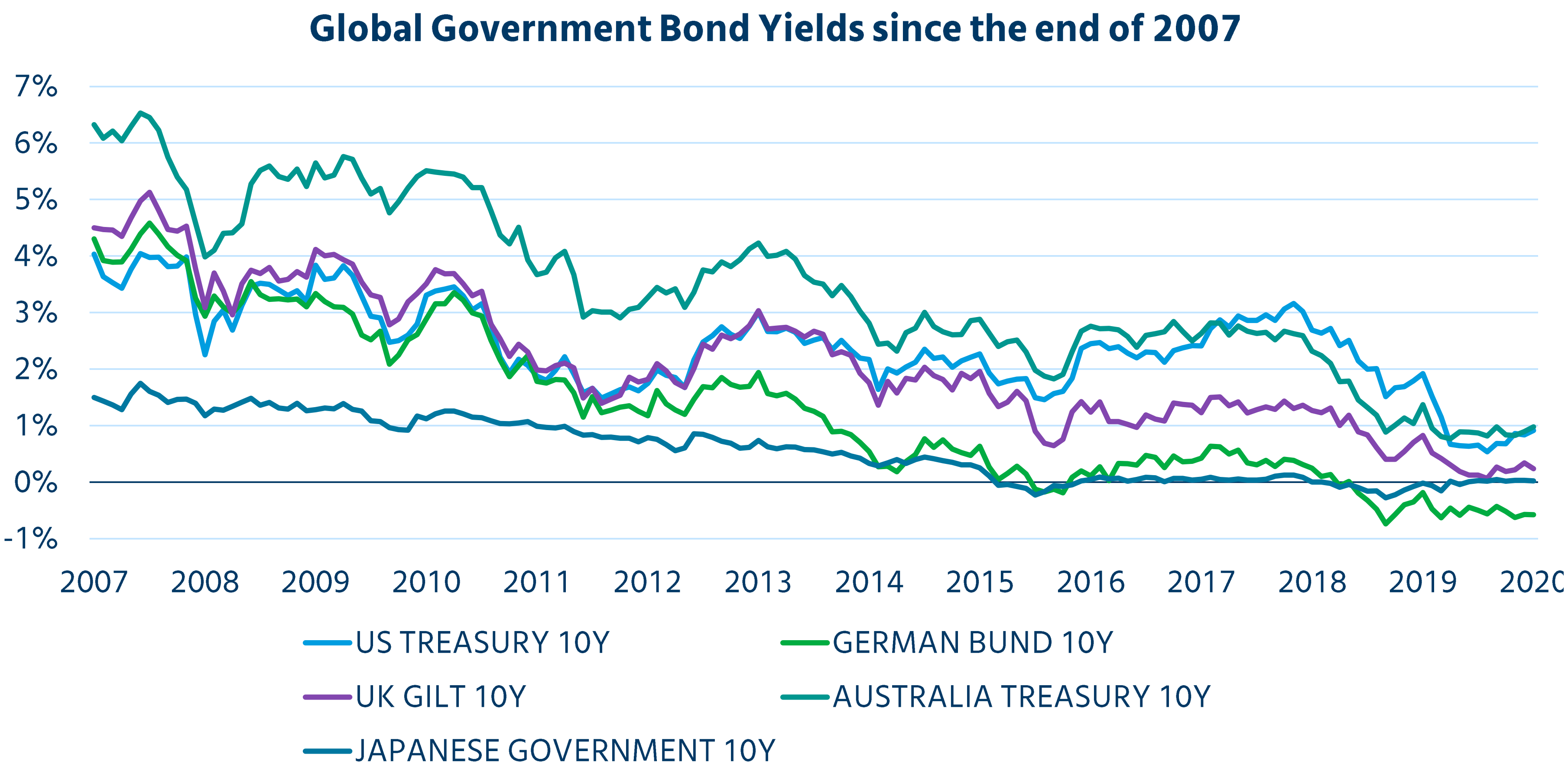
Unprecedented policy stimulus



Sources: Bloomberg for central bank balances sheets. Haver Analytics, CEIC, Morgan Stanley Research forecasts for budget deficits. Total balance sheet figures represent data from the European Central Bank, the Bank of Japan and the People's Bank of China. Total budget deficit figures represent the China, Eurozone, Japan and US government headline budget deficits.

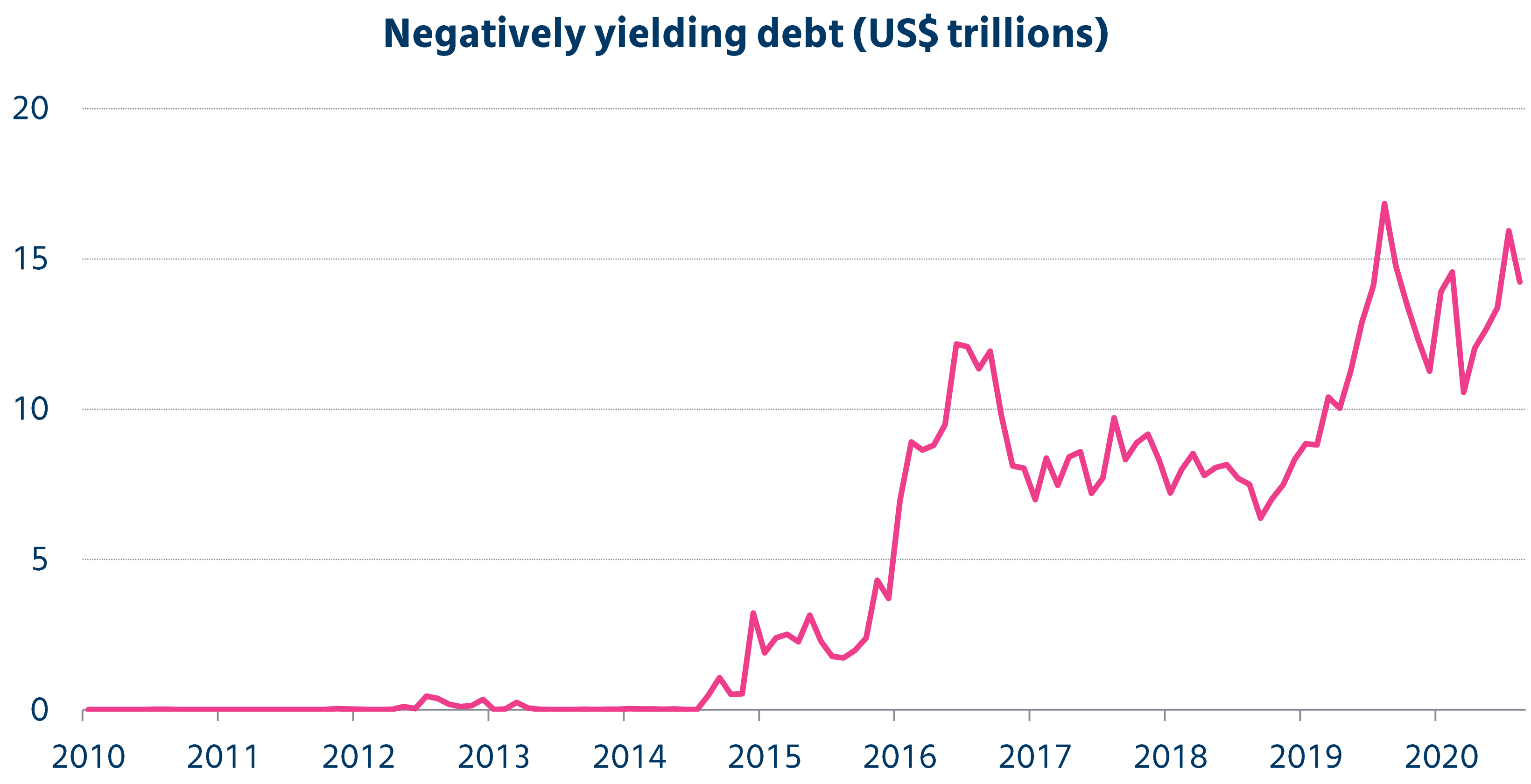
The New World

From fixed income to no income



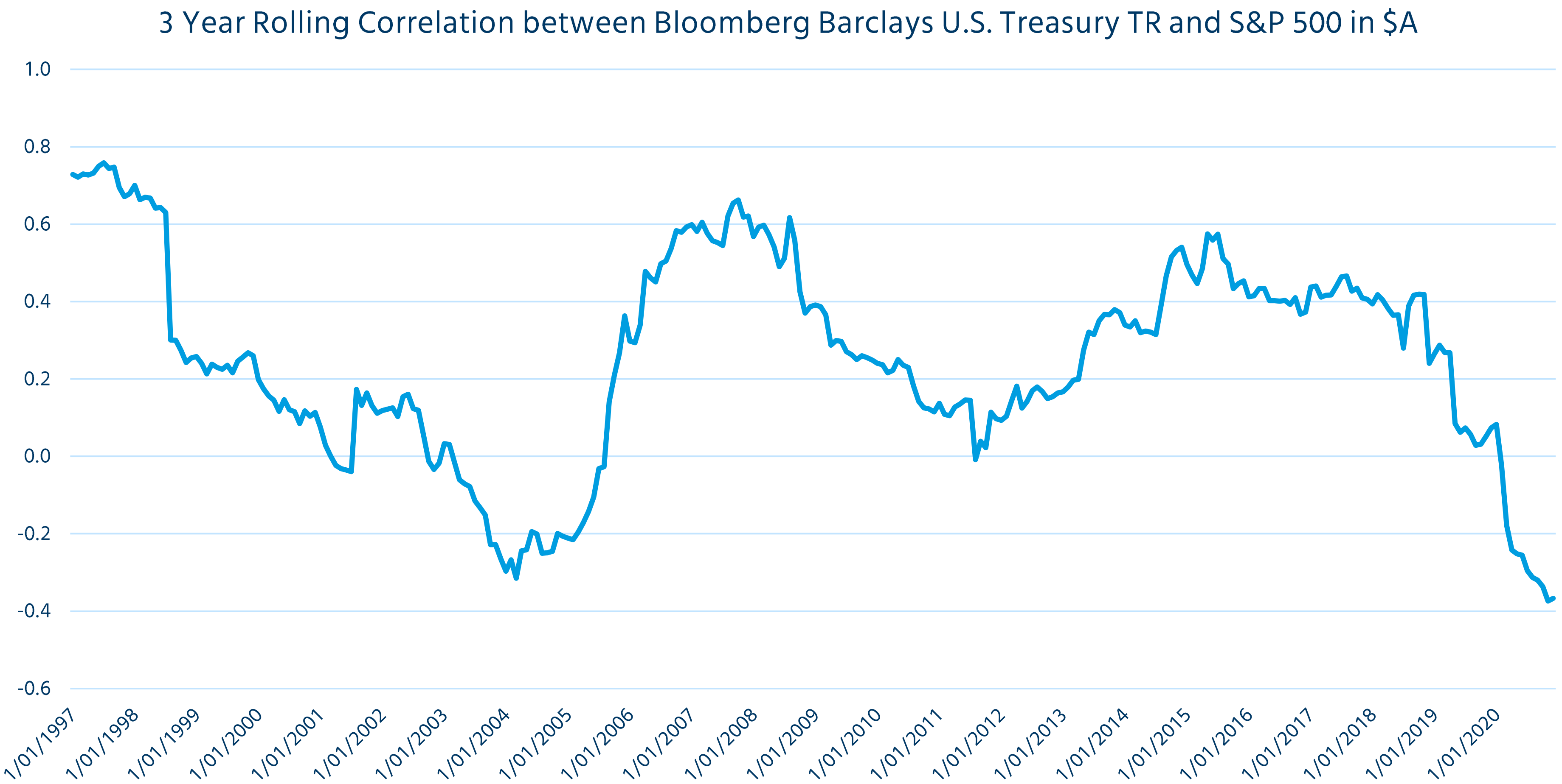
Source: Datastream

The New World
The rise of negative yielding debt



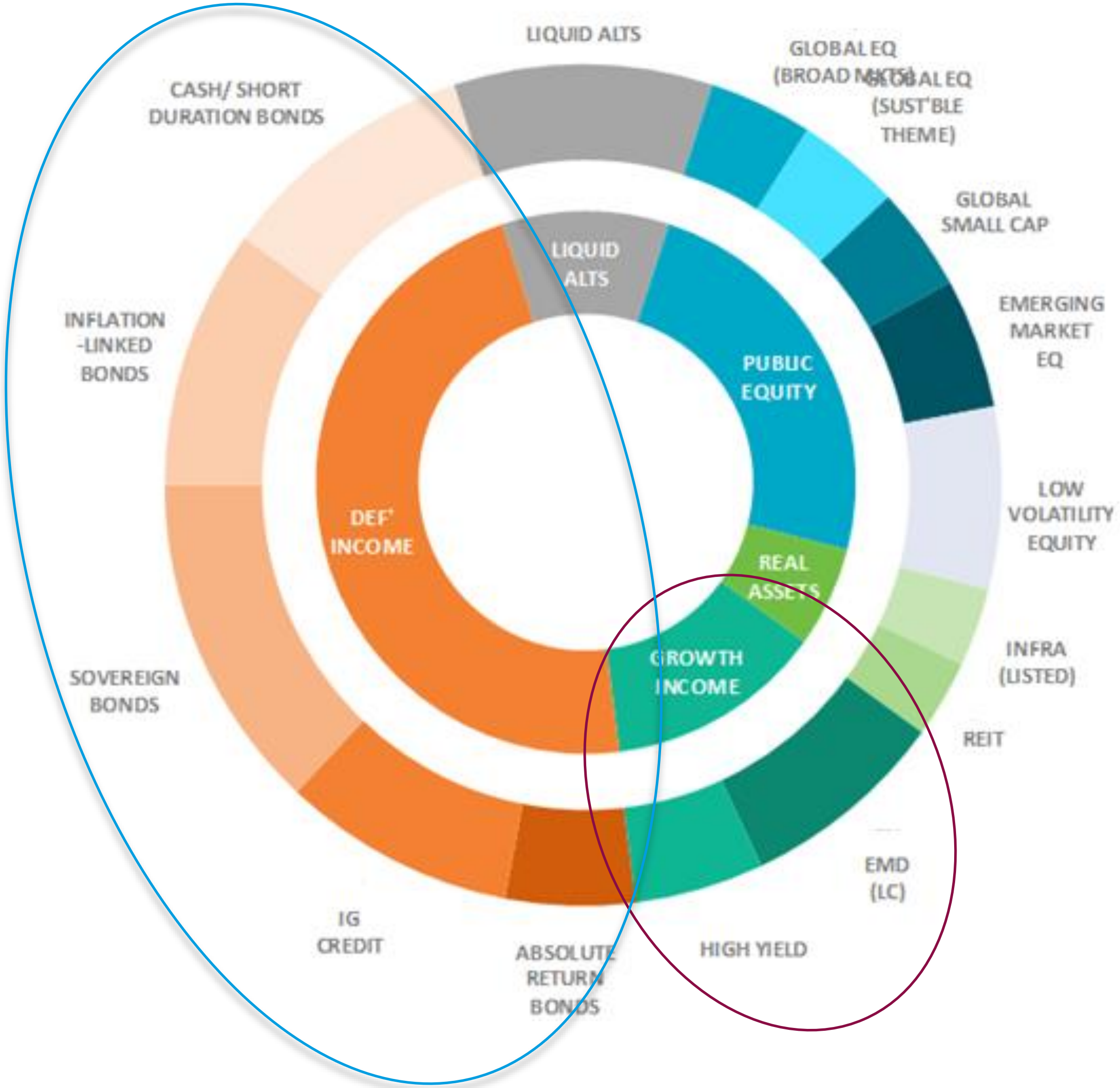
Source: Bloomberg

The role of fixed income
Traditional considerations

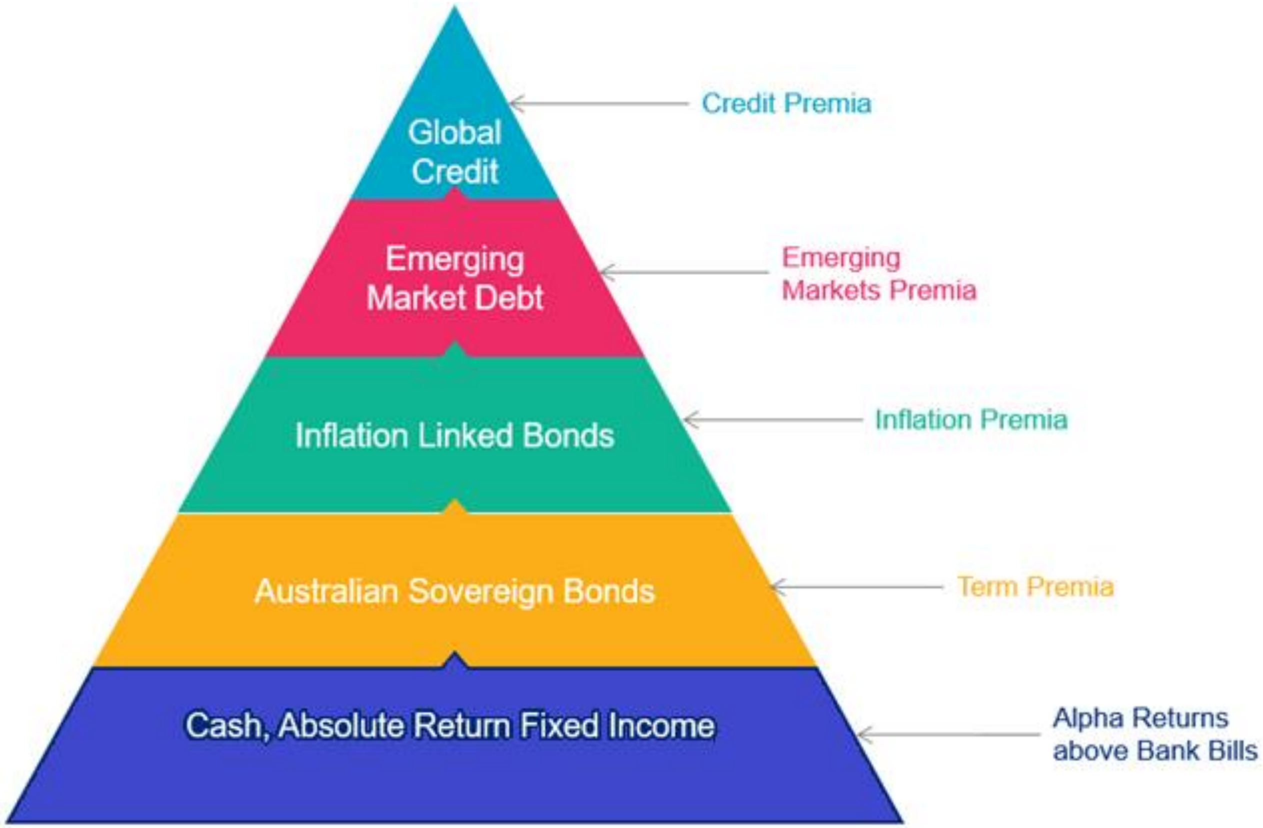



Watch your tail

The New World
Fixed Income in Mercer's reference portfolios



The New World
A complete and diversified fixed income portfolio



Global IG Credit/High Yield Bonds

Mercer View: Neutral

- Premia driven by positive economic growth/activity, contracting spreads
- Mercer is currently neutral to global high yield. High-yield spreads are still moderately attractive entering 2021 despite the significant tightening as we remain constructive regarding the prospects of vaccines, ongoing Fed support and improving default activity over the next few years.

Emerging Market Debt

Mercer View: Neutral

- Premia driven by positive in commodities, broader economic growth and lower US interest rates/dollar.
- Mercer is currently neutral to EM debt given the elevated risk levels despite attractive valuations. Despite the recent rally, EM FX continues to be inexpensive relative to the USD.

Global Sovereign Bonds

Mercer View: Underweight

- Premia driven by outperformance during economic downturns and early stage recessionary environments as investors seek liquidity and creditworthy counterparties.
- Mercer is currently unfavourable to global sovereign bonds and safe haven assets given relative spreads and current valuations. In spite of yields rising in some cases, government bonds are still expensive by historical standards.

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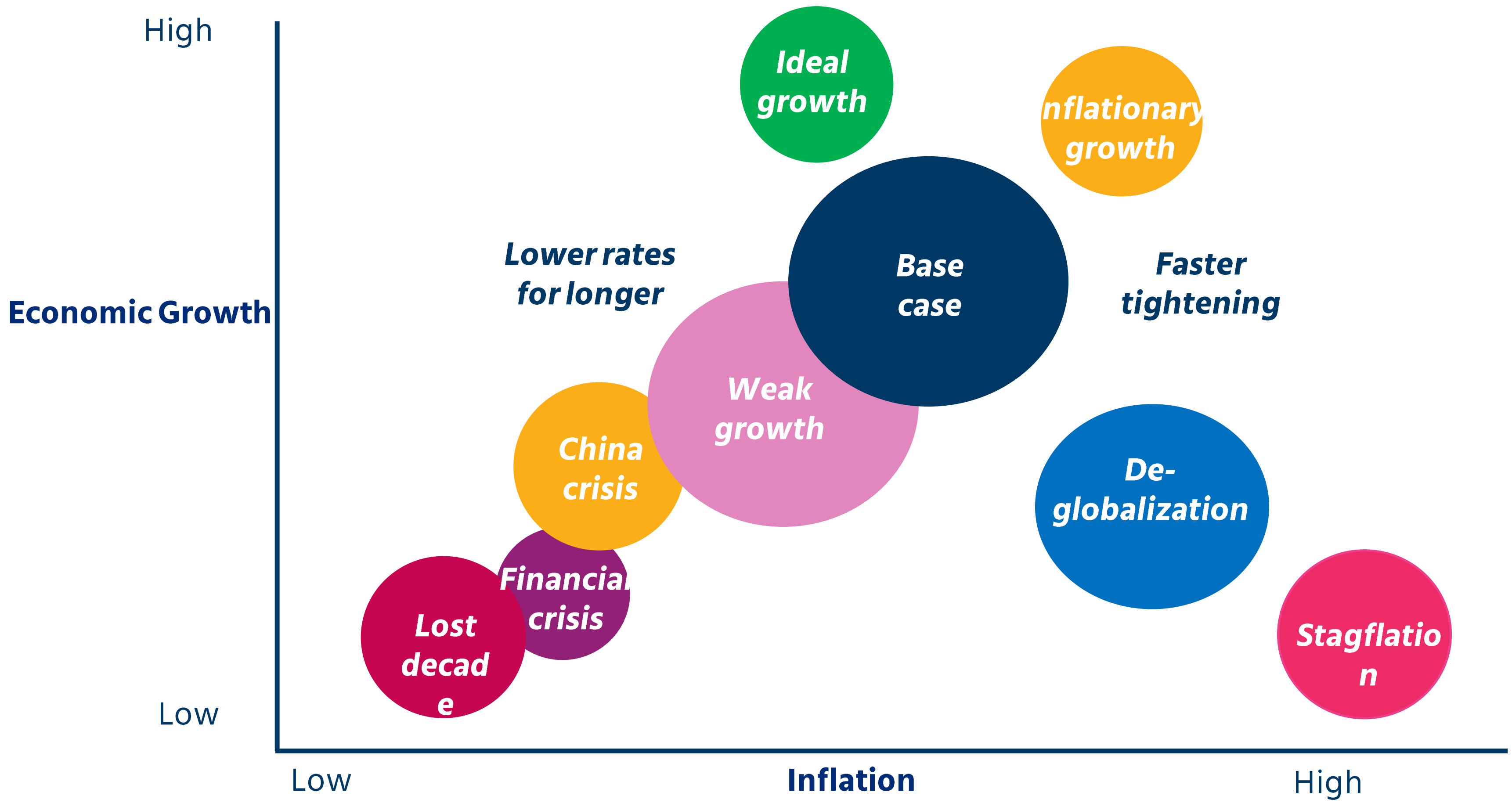
The New World
A Credit cycle allocations

	Early (Recovery)	Mid (Expansion)	Late (Downturn)	Recession (Repair)
Cycle Stage Characteristics	Free cash flow generation, improving credit metrics, deleveraging underway	Easy lending standards, availability of capital, increased borrowing, rising leverage metrics	Lending standards tighten, more shareholder friendly behavior, borrowing costs rising, liquidity diminishes	Operating environment bottoming, balance sheet stabilization, cost cutting, asset sales to raise liquidity
Asset Allocations				
IG Corporates	🟢	🟢	🟡	🟡
HY Corporates	🟢	🟡	🔴	🔴
Bank Loans	🟢	🟢	🔴	🟡
EM Debt	🟢	🟢	🟡	🔴
Structured Credit	🟢	🟡	🔴	🟡
Governments	🟡	🟡	🟢	🟢

🟢 = Strategic (overweight) allocations in core plus, unconstrained and multi-asset credit portfolios
🟡 = Tactical (or marketweight) allocations in core plus, unconstrained and multi-asset credit portfolios
🔴 = Opportunistic allocations depending on portfolio return objective and risk tolerance

Source: Western Asset. As of 31 Jul 19

The New World
Scenario testing



Note “lower rates for longer” and “faster tightening” reflect asset class returns under unexpected changes to central bank policy rather than actual economic GDP/inflation drivers

The Proactive Managed Portfolio – Fixed Income Manager Line-up

A diversified portfolio of complementary strategies

MANAGED FUNDS	Role in Mercer's Managed Portfolios for Proactive Portfolios
Australian Fixed Interest	
Franklin Templeton Australian Absolute Return Bond Fund	*Active exposure to high quality (A+ average) domestic and global fixed corporate and government related income securities for alpha generation and diversification of risk and duration in a lower for longer environment.*
Macquarie True Index Australian Fixed Interest Fund	*Free index exposure to Australian fixed interest index comprising majority Australian government and semi-government bonds for defensive characteristics and portfolio downside protection.*
Global Fixed Interest	
Colchester Global Government Bond Fund	*A specialist global sovereign bond strategy with a clear and relatively simple investment strategy. The fund does not invest in credit securities and does not seek to generate retruns from the more complex and nuanced fixed income trading strategies.*

Questions?

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- The value of stocks and shares, including unit trusts, can go down as well as up and you may not get back the amount you have invested.
- The value of Gilts, bonds, and other fixed income investments including unit trusts can go down as well as up and you may not get back the amount you have invested.
- Investments denominated in a foreign currency will fluctuate with the value of the currency.
- The value of investments in real estate can go down as well as up, and you may not get back the amount you have invested. Valuation is generally a matter of a valuer's opinion, rather than fact. It may be difficult or impossible to realise an investment because the property concerned may not be readily saleable.
- Certain investments, such as illiquid, leveraged or high-yield instruments or funds and securities issued by small capitalization and emerging market issuers, carry additional risks that should be considered before choosing an investment manager or making an investment decision.
- For higher volatility investments, losses on realisation may be high because their value may fall suddenly and substantially.
- Where investments are not domiciled and regulated locally, the nature and extent of investor protection will be different to that available in respect of investments domiciled and regulated locally. In particular, the regulatory regimes in some domiciles are considerably lighter than others, and offer substantially less investor protection. Where an investor is considering whether to make a commitment in respect of an investment which is not domiciled and regulated locally, we recommend that legal advice is sought prior to the commitment being made.

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