MI Momentum Factor Series Funds

Scopic Spotlight

Portfolio Structure	Unfettered Fund of Funds
Investment Strategy	Volatility Target Return / Positive Return Target
Timeframe to Achieve Strategy	Factor 3 Fund: Rolling 4 years, Factor 4 Fund: Rolling 5 years, Factor 5 Fund: Rolling 6 years
Asset Class Building Blocks	Multi-Asset
Asset Allocation Approach	Moderate Tactical Activity v Optimised Model's Strategic Asset Allocation
Investment Selection Approach	Blending Manager Styles
Performance Driver(s)	Predominantly Asset Allocation
Geography	Global / UK
Special Focus	Volatility Management

Scopic Spotlights are qualitative, factually based commentaries taken directly from Scopic Prism - an online look through to a unique database of information on multi-asset investments that contains search and filter options designed to assist intermediaries with their due diligence needs. Scopic Prism can be found at www.scopicresearch.co.uk.

Under the Microscope

The MI Momentum Factor Fund series comprises three multi-asset portfolios within a volatility targeted suite. The aim is for each fund to deliver good risk adjusted returns in excess of inflation whilst keeping its pattern of returns within volatility parameters suggested by an optimised model managed by Distribution Technology (DT). Each fund has its own inflation-plus return objective, upper and lower volatility parameters and minimum investment timeframe.

Factor 3 seeks to generate annualised returns equivalent to CPI + 3% per annum, whilst maintaining its volatility in line with that suggested by DT risk level 3. The minimum suggested timeframe for achieving the strategy is over 4 year rolling periods.

Factor 4 seeks to generate annualised returns equivalent to CPI + 4% per annum, whilst maintaining its volatility in line with that suggested by DT risk level 4. The minimum suggested timeframe for achieving the strategy is over 5 year rolling periods.

Factor 5 seeks to generate annualised returns equivalent to CPI + 5% per annum, whilst maintaining its volatility in line with that suggested by DT risk level 5. The minimum suggested timeframe for achieving the strategy is over 6 year rolling periods.

Manager and Team

James Klempster, Head of Portfolio Management, and CIO, Michael Allen, have co-managed the Factor series funds since launch, with Klempster leading on day to day decision making on asset allocation and fund selection, as well as having fund research responsibilities covering both traditional and more esoteric asset classes. Prior to becoming CIO, Allen's previous experience included stints as Head of Research and Head of Fixed Income.

Both Klempster and Allen sit within the company's 7-strong Investment Strategy Group - chaired by Allen - comprising senior investment team portfolio managers and lead researchers whose collective experience spans equity, bond and multi-asset strategies. The responsibilities of the Investment Strategy Group includes formulating views on markets and asset classes and defining the future rates of return that might be expected from different asset classes.

Members of the Investment Strategy Group constitute part of a wider investment team that includes a further 6 analysts who provide specialist support on; market analysis, strategy, manager research and implementation.

Investment Scope

The scope is multi-asset with access mainly provided via open ended onshore and offshore funds, closed ended funds, exchange traded funds (predominantly physically backed) and cash. Investment trusts are used to a lesser extent. There is no exposure to direct securities or structured investments and although permitted, FX forwards are currently not employed. Derivatives are used only for efficient portfolio management.

For Factor 3, whilst there are no prescribed percentage allocation limits with respect to allocations to cash, bonds and alternatives, the exposure to equities is capped at 35%.

For Factor 4, allocations to cash, bonds and alternatives can each vary between 0% and 80% - with between 20% and 60% then being allocated to equities.

For Factor 5, allocations to cash, bonds and alternatives can each vary between 0% and 60% - with between 40% and 85% then being allocated to equities

In practice however, in aiming to deliver each fund's returns within the volatility parameters established by the relevant Distribution Technology risk level, the degree to which tactical asset allocation varies in relation to the fund's own strategic asset allocation position is guided by forecasting asset class volatilities and examining their inter-correlations of return.

Holdings span all equity regions and can include convertibles. Bond exposure may encompass any part of the debt spectrum - with government bonds and investment grade bonds generally accessed using ETFs. Use of actively managed funds is reserved for more specialist bond market coverage. REITS and closed ended funds are preferred for property exposure and real bricks and mortar open ended property funds avoided despite the Non-Ucits retail status. Within alternatives, the choice of asset class is flexible and can include commodity and infrastructure funds and, potentially Ucits compliant hedge strategies - although the latter have not been used to date. There is no exposure to private equity. Cash is employed tactically.

Unlike some, there is no exposure to in-house funds.

Investment Approach

The investment team does not make use of the strategic asset allocation derived from Distribution Technology's (DT) backward looking optimised model. Instead, it establishes each fund's long term strategic asset allocation using Momentum's own proprietary optimised model. This results in a moderate degree of difference in relation to DT's suggested strategic asset allocation – most notably a lower allocation to government bonds and an allocation to commodities. The strategic asset allocation is then reviewed annually, with changes made incrementally over time. To date no changes have been made.

The investment team uses its analysis of; the macroeconomic environment, investor sentiment, expected 5-year return forecasts for different asset classes under a range of different market scenarios and, market valuations, to guide its tactical allocation decisions for each fund versus the strategic asset allocation position. Prospective price earnings ratios (PEs) for different equity indices representing; regional markets, broad industry sectors and styles, are modelled using current PEs, sales per share growth, margins and dividend yields for each indexes' constituents. The results are then discounted back to today to help evaluate expected 5 year returns for each equity market and to assess fair value in current share prices. Similarly, the yield curve, default rates, recovery rates and credit spreads are used to generate expected rates of return across the debt spectrum. The resulting expected rates of return for each sub-asset class examined within equity and bond markets together with their respective hurdle rates (the minimum expected rate of return considered appropriate in order for the team to move overweight) are then used to focus tactical asset allocation decision making on those asset classes offering the most attractive risk reward characteristics.

Unlike some, there are no +/- tolerance limits for the degree of tactical asset allocation versus the strategic asset allocation position - to the extent that asset classes used in the optimised model can be zero weighted, or entirely new asset classes not used in the optimisation process introduced as tactical plays. Expected portfolio volatility as a result of any planned changes to tactical asset allocation or to fund selection, together with realised volatility, is then monitored on a monthly basis to check for consistency with the current DT volatility parameters.

The fund selection process is predominantly qualitative, with the team seeking to identify active managers who have a clearly stated philosophy, a repeatable process and who can demonstrate adherence to a given investment style throughout the cycle. The aim to blend equity manager styles, rather than to skew each fund's style towards a particular view of the macro environment, leads to asset classes with larger allocations being populated with a blend of growth, deep value and quality style managers. Smaller regional equity allocations are then populated by single funds – generally those exhibiting quality or value oriented characteristics. Longer term strategic holdings are articulated using either actively managed or passive vehicles, but shorter term tactical holdings tend to be mainly via ETFs. Government bonds and investment grade bonds are also generally accessed via ETFs. All proposed investments require approval from the in-house operations team.

Performance Expectation

The focus on valuations means that the Factor Series Funds are likely to lag in more momentum driven markets and to perform better when investors appreciate underlying fundamentals.

Tactical asset allocation and the focus on valuations are the principal tools for defending against downside risk. However, tactical asset allocation is focused on 5 year rather than more immediate term views. As a result, there is a tendency towards taking a longer term view when compared to some peers seeking to achieve similar objectives. Consequently, success would be for better risk adjusted returns to shine through over longer investment timeframes.

The funds are categorised in the IA Flexible Investment sector, which provides them with complete investment flexibility in asset allocation terms with equity exposure permitted up to 100%. Although there are also no internal asset class restrictions imposed on the Factor Series Funds themselves, their investment objectives make it highly unlikely that they will invest 100% in equities. The IA Flexible Investment sector therefore provides a poor peer group within which to make performance comparisons. Instead, performance should be assessed in light of each fund's volatility, return objectives and investment timeframes, with comparisons also made against peers seeking to achieve broadly similar outcomes.