MI Momentum Focus Series Funds

Scopic Spotlight

Portfolio Structure	Unfettered Fund of Funds
Investment Strategy	Volatility Corridor
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	None

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

Head of Investment Management, James Klempster, has co-managed the Focus series funds since launch – initially with former UK CIO, Michael Allen, until his departure in 2017 and – latterly alongside Co-Head of Research and Portfolio Manager, Jernej Bukovec. They are closely supported by two further Co-Heads of Research; Alex Harvey and Andrew Hardy – both of whom also act as Portfolio Managers.

Klempster joined the company in 2007 having previously worked at NW Brown and Avebury Asset Management. He now leads the strategy for Momentum's global multi-asset investment solutions. Bukovec joined Momentum in 2006 as an equity research analyst and has also managed the company's IF Global Equity Fund since March 2009. Prior to joining Momentum, he worked as an equity research analyst at Lehman Brothers, New York.

Although the Focus Fund Series is managed on a team-based ethic, Klempster and Bukovec lead the day to day decision making on asset allocation as well as having fund research responsibilities that cover both traditional and more esoteric asset classes.

Both Klempster and Bukovec sit within a 14-strong team, which comprises investment professionals; portfolio managers and research analysts - whose collective experience spans equity, bond and multi-asset strategies - as well as a quant analyst, two systems analysts and a senior dealer. The responsibilities of the investment professionals include; analysing market data, formulating views on markets and asset classes, defining the future rates of return that might be expected from different asset classes, agreeing directionality for tactical asset allocation and finally, deciding how to implement the team's views. All members of the inner investment team can challenge and contribute views irrespective of seniority. Overall, the team hierarchy has a flatter structure when compared to some peers where the process leans more heavily on individual lead managers.

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), directly held government bonds and cash. Investment trusts are used to a lesser extent. There is no exposure to structured investments and derivatives are used only for efficient portfolio management.

Unlike some, there are no prescribed percentage asset allocation limits.

Holdings can span all equity regions – although dedicated exposure to an individual region can be avoided - and may include global funds as well as convertibles. Equity exposure is generally unhedged, except in exceptional circumstances. Bond exposure can encompass any part of the debt spectrum and whilst government bonds are accessed directly, investment grade bonds are generally held using exchange traded funds (ETFs) - with actively managed funds reserved for covering more specialist bond markets and strategies. All bond holdings are typically hedged back to GBP sterling.

REITS and other closed ended funds are employed for property exposure, but as a Ucits structured fund, real bricks and mortar open ended property funds cannot be held. Within alternatives, the choice of asset class is flexible and can include commodity and infrastructure funds as well as Ucits compliant hedge strategies and risk premia strategies. There is no exposure to private equity. Cash is employed tactically.

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

Investment Approach

Whilst one of the principal aims is to deliver returns within risk-reward parameters suggested by an optimised model operated by Distribution Technology (DT) – the investment team does not make use of the strategic asset allocation derived from the model. Instead, the portfolio's long term strategic asset allocation is established using the team's own proprietary 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. Although the strategic asset allocation is reviewed annually, any change is intended to be incremental and, to date no changes have been made.

The investment team uses its analysis of; the macroeconomic environment and investor sentiment, expected 5-year return forecasts for different asset classes under a range of different market scenarios, as well as market valuations, to guide its forward looking tactical asset allocation decisions versus the in-house model's strategic asset allocation.

Overall, the analysis seeks to establish a base case scenario for markets, with bull and bear case scenarios then providing context for decision making together with the potential for asset class returns to revert to their longer-term averages. Prospective price earnings ratios (PEs) for different equity markets, broad industry sectors and styles are modelled using the current PEs, sales per share growth, margins and dividend yields for their company constituents. The results are then discounted back to the present day in order to evaluate expected 5 year returns and to assess fair value in current share prices. Similarly, the yield curve, default rates, recovery rates and spreads are used to generate expected rates of return across the debt spectrum.

The resulting expected rates of return for each asset class together with their 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 on those asset classes with 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 - 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. Tactical changes tend to reflect identified beta and valuation trends and the tactical approach is therefore less focused on the short term when compared to some – with the team taking 5 year views.

Overall, the approach is reactive to changes in data, with a view to being counter-cyclical and less driven by emotion. The tendency is to withdraw risk early.

Expected portfolio volatility as a result of any planned changes to tactical asset allocation or to fund selection, is then scenario tested prior to implementation, with realised volatility also monitored on a monthly basis to check for consistency with the DT volatility parameter.

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. Returns based analysis using MiPort (a proprietary tool originally developed in-house) is employed to assess the latter; helping to construct a bias towards quality style managers within equity holdings, which is maintained throughout the cycle, with subtle tactical adjustments then being applied to managers with growth and deep value styles in accordance with the team's views. Overall, the aim is to establish more consistent outperformance from the portfolio's equity holdings with modest tracking error relative to the MSCI World Index.

Whilst longer term strategic holdings employ predominantly actively managed, but also passive vehicles, shorter term tactical holdings tend to be articulated using ETFs. All proposed investments must first be approved by the in-house operations team.

Performance Expectation

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

Tactical asset allocation, the focus on relative, as well as absolute valuations and, an emphasis on maintaining exposure to quality-style managers, 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. Consequently, we ought to expect better risk adjusted returns to shine through over longer periods.

Whilst the portfolio invests globally, equity holdings exhibit a bias towards the UK and all bond holdings are either in GBP sterling or GBP sterling hedged share classes. Larger UK companies tend to have greater exposure to overseas earnings - the value of which is amplified when GBP sterling weakens relative to other currencies. As a result, we might expect a weakening in the value of GBP sterling to act as a tailwind to returns relative to peers that offer greater overseas currency exposure – and vice versa at times when sterling strengthens.

Whilst the IA Flexible sector offers the scope for greater investment flexibility – with no restrictions imposed on asset class parameters - the portfolio's objectives make it highly unlikely that it will invest 100% in equities, which is the full extent of the scope offered to funds in the sector. The IA Flexible Investment sector therefore provides a poor peer group within which to make performance comparisons in our view. Instead, risk adjusted performance should be assessed in light of the portfolio's own volatility and return objectives and compared against peers aiming to achieve similar outcomes and with the same time frame.

Analysis should not be conducted on the portfolio in isolation in our view, but in the context of the others in the Focus Funds suite.