

A&O PORTFOLIO ENGINEERING PROCESS

Our investment process is based on a top-down approach to determine which countries, sectors, and styles are most likely to generate the expected highest returns. In this effort, we seek to both discover unique sources of information and also to exploit inefficiencies uncovered through unique analysis of widely available information.

The process uncovers these inefficiencies at three distinct levels. In order of importance they are:

- Country Exposure: identify which countries are most likely to outperform.
- Economic Sector Exposure: identify which economic sectors and industries are most likely to outperform;
- Security Selection: identify the group of securities within a particular category which maximize the likelihood of beating the overall category.

We use a multitude of indicators or “drivers” to determine style and sector allocations. These drivers are a part of the top-down portion of the investment process and provide the basis for establishing relative risk and return expectations for categories defined by country, sector and style. The first set is economic drivers such as monetary policy, yield curve, and relative GDP growth analysis. The second set is political drivers such as taxation, governmental stability, and political turnover. The third set is sentiment drivers that primarily measure consensus thinking to identify the relative popularity of investment categories. The interpretation of such investor drivers is typically counter-intuitive (avoid what is overly popular and seek what is largely unpopular).

Our investment decisions are often predicated on exclusionary management. This involves determining what categories to avoid or underweight based on expected relative risk, and therefore over-weighting the remaining categories that should have the highest relative expected return. Our investment Policy Committee (IPC), with the assistance of the firm’s research staff, continuously monitors these drivers to ascertain whether any of them are indicating an extreme reading, and if so, whether the market has discounted the factors yet. Only material readings that may not be fully discounted into pricing are acted upon. The IPC uses this information to determine country, sector and style weights relative to the benchmark.

Once portfolio weights are determined, a series of multivariate risk factors screens based on desired style (market capitalization and relative valuation) characteristics are applied to each category requiring a weight. Securities passing this screen are then subjected to further quantitative analysis that eliminates companies with excessive risk profiles relative to their peer group, companies with excessive leverage or balance sheet risk, and securities lacking sufficient liquidity for investment. Candidate companies are then subjected to fundamental research to accomplish two goals:

1. We seek companies possessing strategic attributes consistent with higher-level themes in the portfolio derived from the aforementioned drivers. For example, if we believed owning companies with dominant market share in consolidating industries was a favorable characteristic; we would search for companies with that profile within the particular category we were examining.
2. We seek to maximize the likelihood of beating the category of stocks from which we are selecting. For example, if we determine we want a particular weight in the universe of large –cap Nigerian banks, and need four stocks out of seventeen that meet the quantitative criteria, we would pick the four that, as a group, maximize the likelihood of beating all seventeen as a whole. This is different than trying to pick the best four. By avoiding stocks likely to be extreme or weird outliers versus the group, we believe we can reduce portfolio risk while adding value at security selection level.

Based on this analysis, the IPC selects securities for purchase. The IPC applies risk management controls based on, among other things, a covariance analysis to prospective stocks to assess their correlation to the balance of the portfolio to identify unintended risk concentrations in the security selection process.

Disclaimer:

The forecasting methodology discussed herein is for illustrative purposes only and does not represent on its own, the sole method used by the Portfolio Manager to make investment recommendations. Other techniques may produce different results, and the results for individual clients and for different periods may vary depending on market conditions and compositions of their portfolios. Past performance is no assurance for future returns.