ASCALON CAPITAL

DAA

Ascalon Signpost Series

Dynamic Asset Allocation

Our Dynamic Asset Allocation (DAA) process is our active investment strategy that adds value to our Strategic Asset Allocation (SAA) capabilities. The process adds exposure to assets that are undervalued and reduces exposure to assets that are overvalued.

The DAA process is disciplined and repeatable. We make changes to portfolio allocations when our signals tell us that we can materially reduce downside risk or improve returns.

> DAA is our active investment strategy that adds value to our Strategic Asset Allocation (SAA) capabilities.

What does Ascalon mean by Dynamic Asset Allocation?

DAA is our active investment strategy that adds value to our SAA capabilities. DAA allows us to adjust portfolio allocations to specific asset classes including equities, government bonds, credit, currencies and alternatives.

Our DAA process is built around some of the investment advantages available to PAS. PAS uses a long-term, repeatable, fundamental investment process. We believe markets will move to reflect fair value over the medium-term. Our DAA process can add value by improving returns and reducing volatility over your investment journey.

Our DAA process adds exposure to assets that are undervalued and reduces exposure to assets that are overvalued. The valuations are based around quantitative, measurable and repeatable medium-term valuation signals.

We distinguish DAA from market timing. Our DAA process does not aim to incorporate market timing or momentum factors. We believe a longer-term horizon improves the certainty around investment outcomes. We focus on a five-year period for our DAA positions. This allows us to clearly link our longer-run outcomes to medium-term fundamentals.

Signal	Market price movements that are extreme relative to our valuation models can be a signal for a DAA change.
Horizon	DAA does not incorporate market timing or momentum factors. We focus on market dislocations that will resolve over a period of six months to five years.
Judgement	DAA is not a purely quantitative exercise. We overlay expert judgement to capture any concerns not addressed by quantitative modelling.
Allocation	The size of the DAA allocation away from the SAA reflects the magnitude of the market signal. We use disciplined limits and strong governance to manage risk.
Monitoring	Our DAA positions are reviewed and challenged by the Investment Committee. We monitor risk and return in real time and regularly test outcomes using scenario stress testing.

Figure 1 The DAA framework is intended to be simple but not simplistic.

How does Ascalon do Dynamic Asset Allocation?

Our DAA process tilts portfolio allocations away from the long-run SAA based on market misvaluations. Our valuation metrics are simple but not simplistic – we use a range of quantitative techniques to compare market pricing with medium-term fair values.

We take material positions within a disciplined set of risk limits. We do not "trade" the portfolio. It would be unusual to completely remove exposure to a preferred manager within the portfolio as a result of a DAA signal. Instead, the exposure would be changed to help improve the chance of meeting your investment objectives.

Because our process is anchored around medium-term valuations, the market misvaluations required to justify a DAA change are typically quite significant in magnitude.

As an example, global equity markets might need to move more than 15% to justify a material DAA tilt.

Our medium-term horizon means that DAA tilts are usually held for a reasonably long period. But the DAA process is more active than SAA-only frameworks. In a normal environment, market price movements could result in 4-6 DAA changes over the course of a 12 month period.

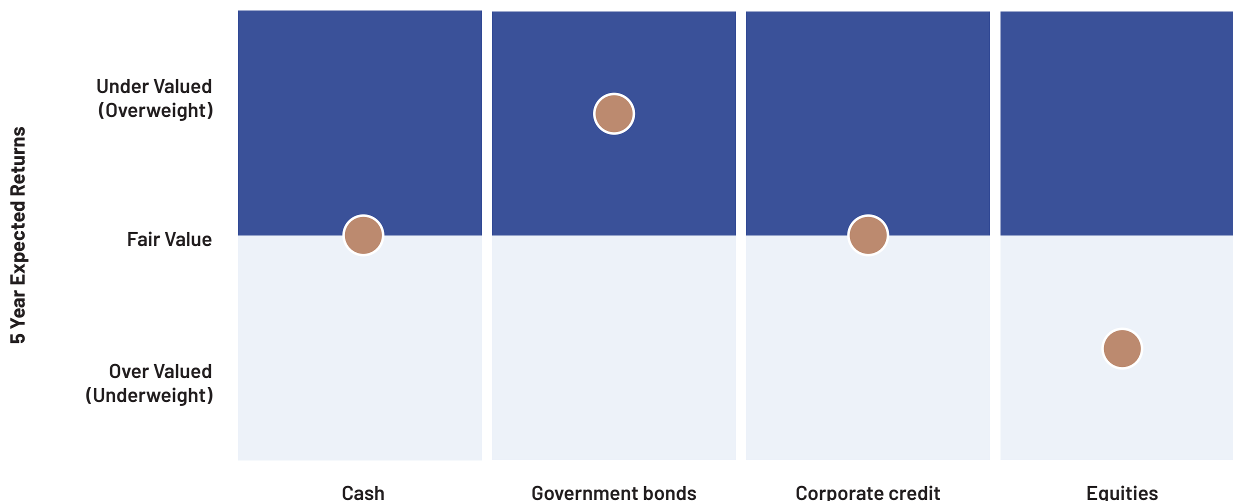

Figure 2 DAA increase exposure to undervalued assets (Dark area) and reduces exposure to overvalued assets (Light area). Government bonds would have an increased exposure while equities would be reduced. Cash and corporate credit would be at the SAA weighting.

Why should you rely on the Ascalon DAA process?

DAA can help improve the probability that your investment mission and objectives are achieved. It has two levers to help with mission success:

1) Dynamic risk management

Risk management is at the heart of our investment process. DAA helps protect returns to the downside by reducing exposures to assets that look the most overvalued.

When our process indicates that an asset, say Australian shares, is over-valued and vulnerable to a downward correction, we reduce our allocation (Fig 4). We don't try to time the market—we are reducing exposures as the valuations increase.

The DAA process helps to protect you against the risk of a capital drawdown which would impair your investment mission and objectives.

Protecting capital from drawdowns is important because a greater percentage gain is required to cover portfolio losses. For example, a 10% loss requires an 11% gain to recover to the original amount. A 50% loss requires a 100% gain to recover to the original amount. It can take a very long time to generate a 100% gain.

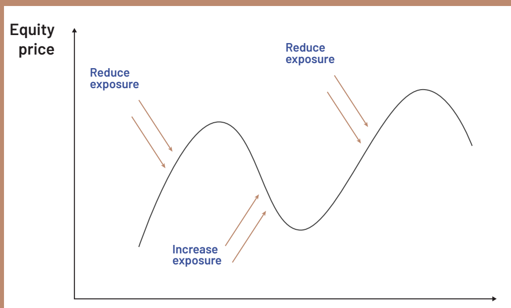

FIG 3: DAA DYNAMICALLY MANAGES DOWNSIDE RISK THROUGH THE INVESTMENT CYCLE.

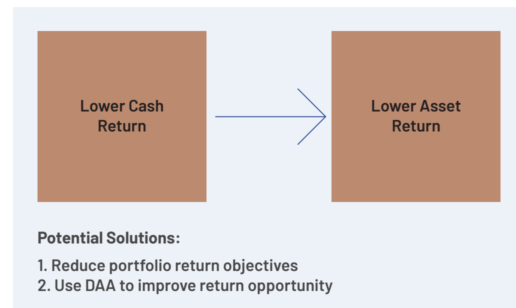

FIG 4: DAA DYNAMICALLY MANAGES DOWNSIDE RISK THROUGH THE INVESTMENT CYCLE.

2) Dynamic return generation

Achieving your investment mission and objective is a crucial focus for our investment process. This will become more challenging in a world of low interest rates. We expect returns will be lower on average over the medium-term. This increases the risk that portfolio returns are lower than historical returns.

In response, you could lower your return objective or improve your return opportunity. Our DAA process targets the latter. When equity valuations look cheap, for example, our DAA process will send a signal to allocate more to those assets. That increases the probability that you will be able to achieve your investment mission and objectives.

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