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Engineered Portfolio Solutions

IMPLEMENTATION EFFICIENCY: Shining the spotlight on two areas where good investment ideas can be undone

Raewyn Williams

Director - Research & After-Tax Solutions
Parametric

23 February 2016

PRESENTATION OUTLINE

Why implementation efficiency is a ‘hot’ topic

CGT in multi-manager equity portfolios – the “What Should Managers Manage?” problem

The need for centralised portfolio management & evidence of tax savings

How to measure equity trading costs and trading efficiency

Evidence of the cost of inefficient trading & portfolios most at risk

Close & panel discussion

IMPLEMENTATION EFFICIENCY – A ‘HOT’ TOPIC

- Super adequacy issues
- Difficult investment conditions
- Quality return source
- Business scale v custom member/investor solutions

CGT IN MULTI-MANAGER PORTFOLIOS

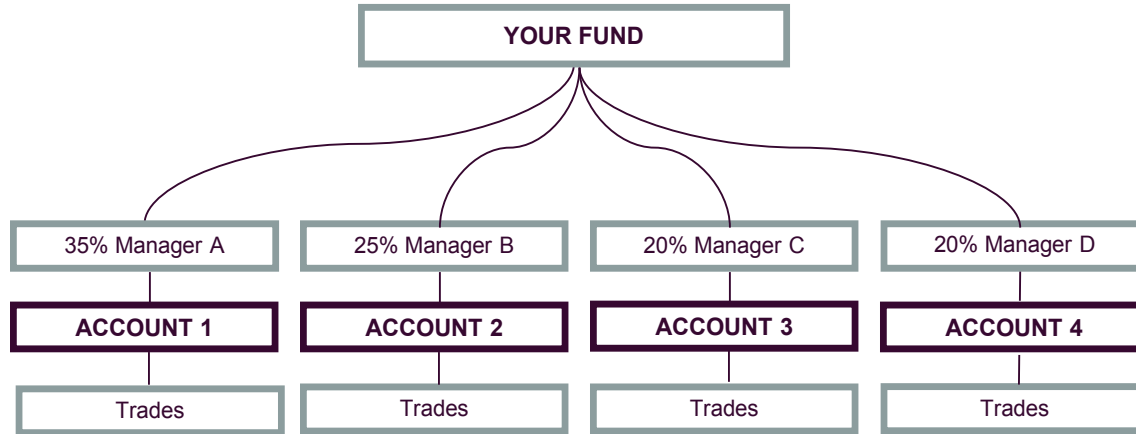
Gain/loss on proposed trade	Equity Manager's Sleeve View						Whole of Portfolio View					Manager's Return Misstatement
	Holding Period	Short Gains Available?	Long Gains Available?	Losses Available?	Expected CGT Impact	Expected Aftertax Return	Short Gains Available?	Long Gains Available?	Losses Available?	Real CGT Impact	Real Aftertax Return	
\$1,000	10 months			Y	0	\$1,000			N	\$150	\$850	\$150
\$1,000	10 months			N	\$150	\$850			Y	\$0	\$1,000	(\$150)
\$1,000	3 years			Y	\$0	\$1,000			N	\$100	\$900	\$100
\$1,000	10 months			N	\$100	\$900			Y	0	\$1,000	(\$100)
(\$1,000)	3 years	N	Y		(\$100)	(\$900)	Y	N		(\$150)	(\$850)	(\$50)
(\$1,000)	10 months	Y	N		(\$150)	(\$850)	N	Y		(\$100)	(\$900)	\$50

Source: Parametric 2014, excerpted from "What Should Managers Manage", Parametric Research 2014

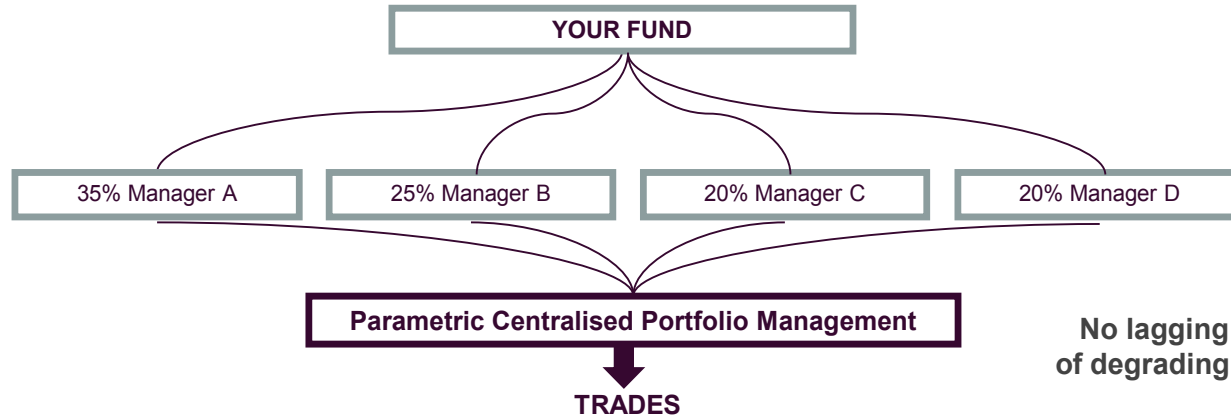
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CREATING A CENTRALISED PORTFOLIO MANAGEMENT APPROACH

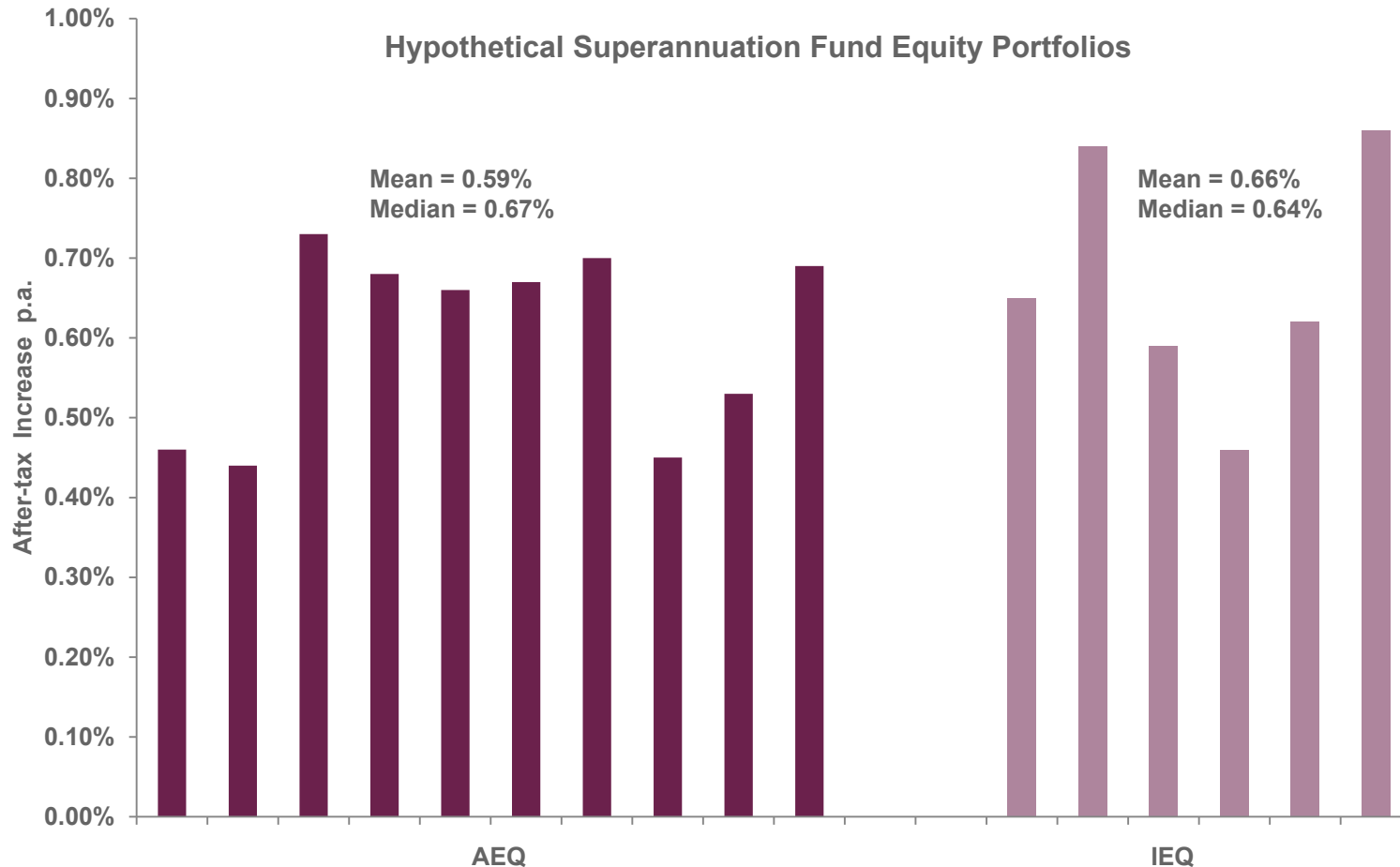
Traditional MM Structure



Centralised Portfolio Manager



EVIDENCE OF TAX SAVINGS FROM CENTRALISING



Source: Parametric, excerpted from "The Road To Reward", Parametric Research 2015. Hypothetical results are for illustrative purposes only, do not represent the actual returns for any investor or client and may not be relied upon for investment decisions. Actual portfolio returns will vary. All investments are subject to loss.

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HOW TO MEASURE EQUITY TRADING COSTS AND TRADING EFFICIENCY

TWO DIMENSIONS OF TRADING EFFICIENCY



TOTAL
COST
OF
TRADE



EXPLICIT
COSTS



IMPLICIT
COSTS

EVIDENCE OF THE COST OF INEFFICIENT TRADING AND PORTFOLIOS MOST AT RISK - AEQ

Table 1. Cost of trading Australian equities

Portfolio Traded	Order Size (MDV)*	Trading Costs		
		Explicit Costs	Implicit Costs	Total Costs
		(bps)	(bps)	(bps)
Panel A. Trade Slice of ASX 200 index				
\$100 mln slice	2.4%	5	16	21
\$250 mln slice	5.9%	5	25	30
\$500 mln slice	11.8%	5	33	38
\$1 bln slice	23.6%	5	43	48
Panel B. Trade Active portfolio that invests in every fifth stock in ASX 200 index (sorted by cap)				
\$100 mln slice (Cap-wt)	12.7%	5	32	37
\$100 mln slice (Equal-wt)	62.9%	5	61	66
* Order Size is measured as % of 21-day median trading volume (MDV) to fill the order				

Source: Parametric, excerpted from "Under the Spotlight: How much does it cost to trade equities?", forthcoming Parametric Research 2016.

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EVIDENCE OF THE COST OF INEFFICIENT TRADING AND PORTFOLIOS MOST AT RISK - IEQ

Table 2. Costs of trading International (Developed ex Australia) equities

Portfolio Traded	Order Size (MDV)* (%)	Trading Costs		
		Explicit Costs (bps)	Implicit Costs (bps)	Total Costs (bps)
Panel A. Trade Slice of MSCI World ex Australia index				
\$500 mln slice	0.2%	5	6	11
\$1 bln slice	0.5%	5	8	13
\$2.5 bln slice	1.2%	5	14	19
\$5 bln slice	2.4%	5	21	26
Panel B. Trade Active portfolio that invests in every fifth stock in MSCI World ex Australia index (sorted by cap)				
\$500 mln slice (Cap-wt)	1.2%	5	14	19
\$500 mln slice (Equal-wt)	3.4%	5	20	25
* Order Size is measured as % of 21-day median trading volume (MDV) to fill the order				

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EVIDENCE OF THE COST OF INEFFICIENT TRADING AND PORTFOLIOS MOST AT RISK - INCREASING URGENCY

Table 3. Trading costs and urgency in trade execution

	Implicit Costs under different levels of urgency for trade execution			
Portfolio Traded	Patient	Neutral	Aggressive	Very Aggressive
	(bps)	(bps)	(bps)	(bps)
Panel A. Trade Slice of ASX 200 index				
\$100 mln slice	16	17	19	23
\$250 mln slice	25	25	29	37
\$500 mln slice	33	35	42	55
\$1 bln slice	43	46	62	83
Panel B. Trade Active portfolio that invests in every fifth stock in ASX 200 index (sorted by cap)				
\$100 mln slice (Cap-wt)	32	36	42	57
\$100 mln slice (Equal-wt)	61	64	81	119
Panel C. Trade Slice of MSCI World ex Australia index				
\$500 mln slice	6	10	11	11
\$1 bln slice	8	12	14	15
\$2.5 bln slice	14	16	20	22
\$5 bln slice	21	22	26	31
Panel D. Trade Active portfolio that invests in every fifth stock in MSCI World ex Australia index (sorted by cap)				
\$500 mln slice (Cap-wt)	14	16	19	22
\$500 mln slice (Equal-wt)	20	23	27	32

Source: Parametric, excerpted from "Under the Spotlight: How much does it cost to trade equities?", forthcoming Parametric Research 2016.

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CLOSE AND PANEL DISCUSSION

- Tax and trading are two areas of potential implementation leakage where good investment ideas can be undone and the damage can be hidden to the investor or member
- Multi-manager structures have inherent inefficiencies that require a centralised approach to address
- Trading costs can be implicit, not just explicit
- Larger portfolios, more active portfolios and strategies with a less patient trading style create more risks around trading costs and inefficiencies

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Parametric is headquartered in the United States at 1918 8th Avenue, Suite 3100, Seattle, WA 98101, with Australian offices at MLC Centre, Suite 6502 Level 65, 19-29 Martin Place, Sydney NSW 2000. For more information regarding Parametric and its investment strategies, or to request a copy of Parametric’s Form ADV, please contact us at +61.2.8229.0222 (Australia) or +1.206.694.5575 (U.S.) or visit our website, www.parametricportfolio.com.