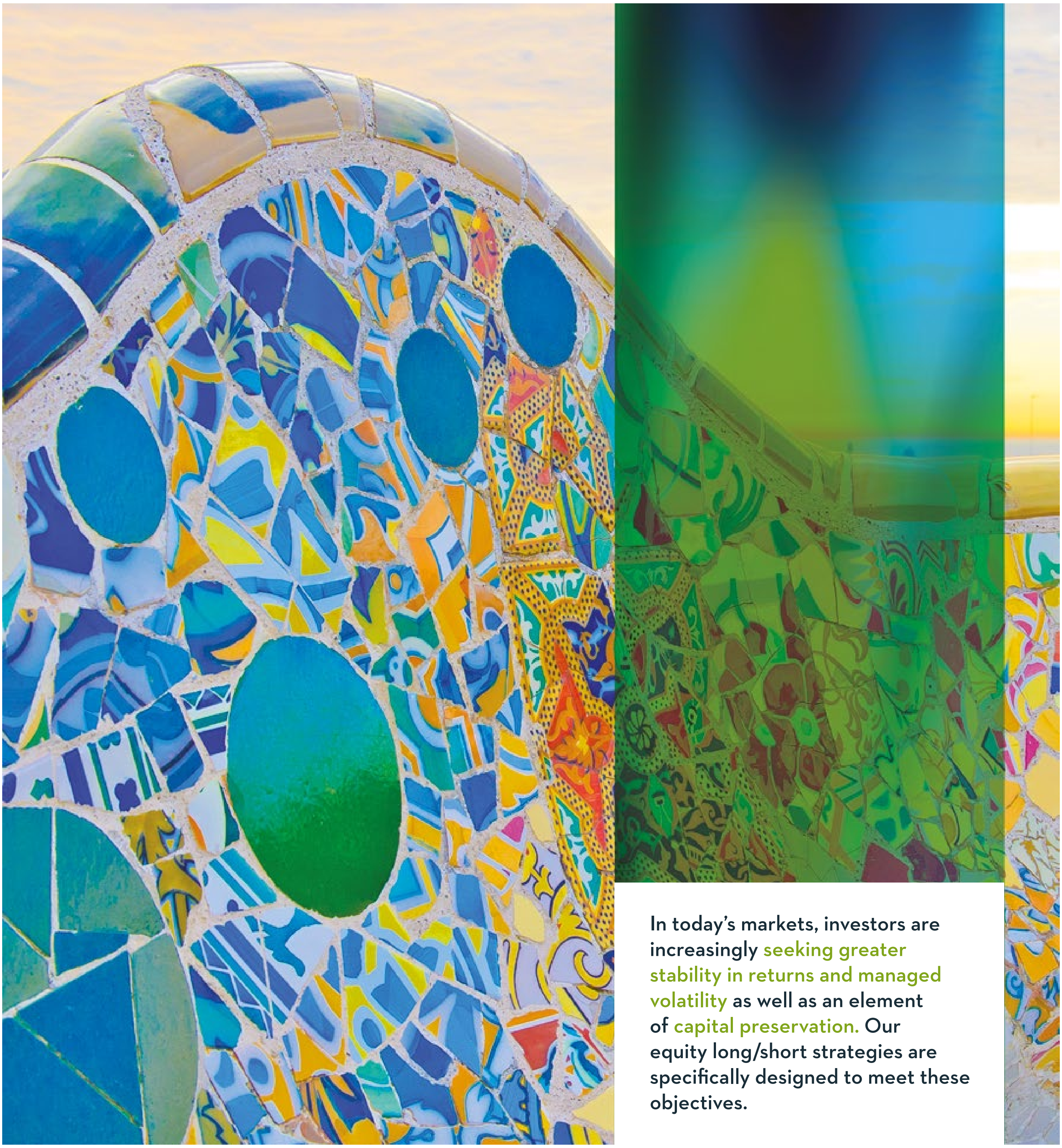
STRATEGY INSIGHT

MARTIN CURRIE

EUROPEAN LONG/SHORT

FEBRUARY 2018 FOR PROFESSIONAL CLIENTS ONLY



In today's markets, investors are increasingly seeking greater stability in returns and managed volatility as well as an element of capital preservation. Our equity long/short strategies are specifically designed to meet these objectives.

The European market offers a large and liquid opportunity set with multiple pricing inefficiencies.
We believe an equity long/short strategy, implemented by experienced investors with proven skills, provides the best way to exploit these opportunities.

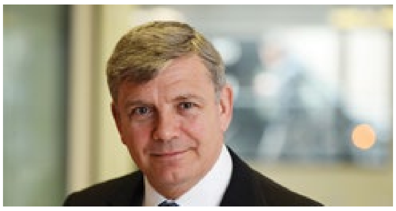
The strategy utilises a bottom-up fundamental investment process based on extensive stock research. Within the process, a disciplined macro framework guides the exposure management.

In our view, the economic and political conditions in Europe will remain uncertain for some time and this is where our long/short strategy can be beneficial to investors – where we aim to efficiently capture uncorrelated European equity returns with managed volatility and downside protection.

LONG-TERM OBJECTIVES

- Absolute return profile
- Upside capture
- Downside protection
- Managed volatility
- Alpha generation long and short books

MANAGERS



Michael Browne
Portfolio Manager
31 years' experience

Steve Frost
Portfolio Manager
29 years' experience

"THE STRATEGY UTILISES A BOTTOM-UP FUNDAMENTAL INVESTMENT PROCESS BASED ON EXTENSIVE STOCK RESEARCH. WITHIN THE PROCESS, A DISCIPLINED MACRO FRAMEWORK GUIDES THE EXPOSURE MANAGEMENT."

OUR APPROACH TO LONG/SHORT INVESTING

Generating consistent outperformance is our goal. We aim to produce consistent returns and apply a stockpicking approach seeking to generate alpha on both the long and short book. We aim to limit drawdowns and manage volatility through active balance sheet management and disciplined risk management.

EUROPEAN EQUITY LONG/SHORT TEAM

Michael Browne and Steve Frost manage our European equity long/short strategies. They are experienced and motivated managers with a proven record. They have worked together for over 29 years.

Michael and Steve are supported by Daniel Medley, a dedicated analyst, focused on researching and identifying the best European stocks for our portfolios. Michael and Steve also utilise the experience and resource of the entire investment team at Martin Currie.

The wider Martin Currie investment team can add value and understanding by researching European companies within a global context.

INVESTMENT PHILOSOPHY

We believe that stock selection is the main driver of alpha generation and consequently our focus is on fundamental analysis and not trading. The philosophy of the European equity long/short strategy is based on identifying valuation anomalies whether longs or shorts and investing in the differential.

> WE BELIEVE THAT STOCK SELECTION IS THE MAIN DRIVER OF ALPHA GENERATION AND CONSEQUENTLY OUR FOCUS IS ON FUNDAMENTAL ANALYSIS AND NOT TRADING.

STOCK SELECTION – UTILISING QUANTITATIVE AND QUALITATIVE ANALYSIS

RESEARCH AND SCREENING	Universe of 600 Pan-European mid-large cap stocks earnings revisions and momentum, balance sheet strength and weakness, valuations relative to historic trends, CFROI, free cashflow to sales.
↓ ANALYSIS	Identifiable business strategy, barriers to entry, quality of management, CFROI spread to cost of capital, balance sheet monitoring, cashflow generation.
↓ COMPANY VISITS	Meet and test management. This is an important stage in the process and the team meet 300-400 companies a year. The wider Martin Currie investment team can add value here by researching companies within a global context.
↓ EVALUATE	Pricing the opportunity with focus on CFROI.
↓ ACTION	Technical analysis to optimise entry/exit points. Explicit price targets, position size conviction and portfolio construction.

Our investment process for taking a short position mirrors our process for taking a long position. For example when selecting a stock for shorting we look for:

- **Negative change in company data and business models**
- **Stocks where volumes are unusually high and shares are towards the high end of their valuation range**
- **Stocks with peaking profit margins at the operating level as an indicator of slowing earnings momentum**

FILTERING THE MACRO ENVIRONMENT

Our process focuses on stock fundamentals, but we believe it is also important to consider the macro environment in order to optimally position the portfolio. We do this qualitatively, via our market traffic lights, and quantitatively, using our macro matrix. The qualitative inputs are an aggregation of views and opinions which are subjective in nature and draw on the extensive experience of the portfolio managers and the companies they speak to. The quantitative side removes emotion from the data, delivering a robust objective assessment that reacts quickly to changes in market conditions.

QUALITATIVE MARKET TRAFFIC LIGHTS – PROVIDING A STRATEGIC VIEW

To complement our bottom-up stockpicking process we utilise our market 'traffic light' system to provide us with a strategic view on the current broad market conditions and what is likely to drive future market performance - both positive and negative.

We examine a number of factors that give us **insight into prevailing market conditions and sentiment.** These factors behave differently in bull and bear markets (as shown in the table below) therefore, allowing us to apply a red, amber or green traffic light to each. This provides us with a simple summary of the overall market environment that the portfolio is operating in.

We use this analysis to think about portfolio exposure trends – both net and gross and also as a 'road map' to guide the potential future direction of our fundamental stock and sector analysis. This ensures we can plan and adapt the portfolio to the constantly evolving market conditions. We have been using this system since 2004.

Please note **this tool does not pick our stocks** – it simply allows us to optimise the construction of the portfolio based on the current market situation as the sample below illustrates.

Allows us to optimise our portfolio construction

QUANTITATIVE – CATCHING INFLECTION POINTS USING POSITIVE AND NEGATIVE INDICATORS

In addition to our strategic view, we examine a series of quantitative indicators. These provide short-term and tactical information, which further aids our balance-sheet management and helps us identify market-inflection points. We summarise these indicators in our proprietary 'macro matrix'.

This matrix applies a binary rating to selected credit, economic and commodity indicators over various periods then aggregates the results. The findings help drive our short-term net and gross exposure levels when we see opportunities in, or threats to, the wider market. The key to the matrix is that it allows us to identify early signs of change in market sentiment, along with the direction, duration and strength of change. Measuring the strength of the change in the indicators, combined with our experience, gives us confidence on the market's potential future direction – whether up or down.

THE MATRIX IS MOST USEFUL:

- **As an early warning system.** As short-term indicators move daily, they can signal material changes to the market.
- **For downside protection.** When all the indicators fall fast and in aggregate break through certain values, this has been a reliable predictor of equity-market stress. This then allows us to reduce our gross and net exposures to protect the portfolio.
- **For upside capture.** The matrix supports our conviction in our net-exposure level and allows us to capture market rises.

The matrix is not a short-term timing tool. It simply highlights specific indicators which have high correlation to the European equity markets and **signals areas for the managers to take a closer look** at in order to **consider the impact for the stocks in the portfolio.** In trending markets (up or down) the influence of the matrix will be less, but what is important is the early signalling of potential change away from the trend.

We also use quantitative measures to guide us when initiating or closing positions to optimise entry and exit points.

PORTFOLIO CONSTRUCTION

For each stock idea, one manager acts as the analyst and the other the portfolio manager. The analyst will propose the investment case and the portfolio manager will test it. The portfolio manager will judge whether to reject or weight the idea in the current portfolio.

Once a stock is in the portfolio both managers assume full responsibility for the position. Positions are monitored live and on a beta-adjusted basis. Entry and exits are usually carried out gradually.

The portfolio has no country limits so we have a **broad European focus,** including exposure to Eastern Europe. Although permitted, our Eastern European exposure is controlled due to liquidity restrictions.

Our aim is to trade in or out of the position within two days trading. It is very unusual for us to hold a position in a stock greater than one day's trading volume. Consequently the **portfolio is very liquid** and at least 95% of the portfolio can be liquidated within one day.

We have a **longer-term outlook** to our stock selection. The time horizon of our long book is 6-24 months; for the short book it is 3-9 months.

We recognise that **short positions inherently carry more risk than the long ones.** Even a moderation in the momentum of negative change can trigger short covering. We will not hold a short position where we can identify a specific risk of a corporate takeover or merger.

In the first instance we will always look for direct long and short stock positions for both alpha generation and market risk reduction. A control policy for using any derivatives is monitored by the European equity long/short team and the portfolio risk management team.

RISK MANAGEMENT

Our approach to risk management emphasises the following factors:

- **Value at risk (VaR).** We aim to limit VaR to <6% (defined as 95% probability of such a move in the portfolio over a two week period). We monitor carefully the contribution of each position to VAR.
- **Stock correlations.** We aim to build a portfolio with a wide range of share price drivers and avoid concentrations of correlated positions, particularly when such stocks exhibit high volatility. We use heat maps to monitor correlations across the entire portfolio.
- **Macro factor sensitivity and stress testing.** We employ a 'reverse stress testing' approach to monitor portfolio sensitivity to a large number of factors. We apply more than 150 independent shocks to individual factors such as countries, sectors, economic indicators, styles and currencies. Using our core risk model (SunGard APT), we shock each factor by 1 standard deviation and calculate the expected return of the portfolio in both absolute terms and relative to the market. This gives us an indication of what would hurt the portfolio the most. These stress tests are performed every day as part of our regular risk profile monitoring.
- **Liquidity.** We assess liquidity daily, based on the average volume traded in each of the portfolio's positions over the previous 60 days, assuming we can participate in up to one-quarter of this average daily volume. We set limits over 4 liquidity hurdles (10, 20, 40, and 100 days) for each of our strategies, and a portfolio is deemed to be in 'soft breach' if it exceeds one of the limits.

In our view, the above factors give a more meaningful picture of the strategy's risk profile than do traditional measures based on net or gross exposure at the sector, country or portfolio level.

PORTFOLIO CHARACTERISTICS

- **European equity long/short strategy**
  - Gross exposure +50 to +200%
  - Net exposure -30 to +100%
- **40-70 stocks**
  - Long book – normal position size 2-5% maximum 9%
  - Short book – normal position size 1-4% maximum 6%
- **FX all hedged exposure**
- **No use of futures, options or ETFs**

RISK MANAGEMENT

- **Liquidity**
  - Most stocks between US$2bn and US$10bn market cap
  - Can liquidate 92% of the portfolio in ten days*
  - UCITS vehicle liquidity managed to meet daily dealing
- **VaR**
  - Internal soft limit – maximum two-week VaR 6% (95% confidence level)
  - UCITS hard VaR limit – maximum 10 day VaR 8.5% (95% confidence level)

Past performance is not a guide to future returns.

Source: Martin Currie and SunGard APT as at 31 January 2018.
Data calculated for the representative Martin Currie European Long/Short account.

*Figure calculated from daily numbers.

FIND OUT MORE

For further information on Martin Currie please visit our website – **www.martincurrie.com**
You can find your local contact at **www.martincurrie.com/contact_us**

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Risk warnings – Investors should also be aware of the following risk factors which may be applicable to the strategy.

Investing in foreign markets introduces a risk where adverse movements in currency exchange rates could result in a decrease in the value of your investment.

Emerging markets or less developed countries may face more political, economic or structural challenges than developed countries. Accordingly, investment in emerging markets is generally characterised by higher levels of risk than investment in fully developed markets.

This strategy may hold a limited number of investments. If one of these investments falls in value this can have a greater impact on the portfolio's value than if it held a larger number of investments.

Smaller companies may be riskier and their shares may be less liquid than larger companies, meaning that their share price may be more volatile.

Investors should be aware that the currency hedging strategy employed by the strategy mitigates the currency exchange risk, but may substantially limit shareholders from benefitting if the portfolio currency falls against the reference currency.

The strategy may invest in derivatives (CFDs (Swaps), Index futures and FX forwards) to obtain, increase or reduce exposure to underlying assets. The use of derivatives may restrict potential gains and may result in greater fluctuations of returns for the portfolio. Certain types of derivatives can be difficult to purchase or sell in certain market conditions.

MARTIN CURRIE

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