

Outcome-based Investing



Eugene Botha
Head: Portfolio Solutions



Momentum Investments' equity benchmark

Momentum Investments continually contemplates the appropriateness of the opportunity set and benchmarks used in the client's solutions to achieve the desired outcome of the client. Within an outcome-based investment framework, benchmark selection and optimisation are key in the portfolio-construction phase, as they influence the way the client objective is solved for. The principles of diversification and risk management remain the key determinants in these decisions. This also helps determine, which solution has the highest probability of delivering on the outcome, even at the benchmark level. The choice of benchmark is thus crucial in determining the profile of the investment experience.

The previously preferred equity benchmark, the FTSE/JSE Shareholder Weighted index (Swix), was designed and created to address the concerns related to the concentration risk that existed within the FTSE/JSE All-Share Index (ALSI). However, the Swix developed undesirable characteristics that gave rise to the concentration in a single share, namely Naspers.

Momentum Investments researched the FTSE/JSE Capped Shareholder Weighted Index (Capped Swix) and evaluated the appropriateness of the index as an equity benchmark under an outcome-based philosophy.

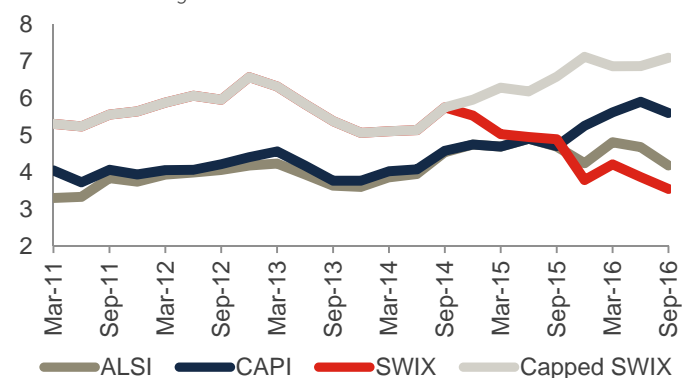
The company's analysis considered the following:

- Concentration
- Diversification
- Sector analysis
- Liquidity
- Risk and return analysis
- Beta

Momentum Investments concluded, based on the evidence and research conducted, that it prefers the Capped Swix as its equity benchmark for stand-alone as well as building block equity portfolios used within the various solutions. To highlight, two of the analyses, a measure of diversification and sector risks is shown below.

PDI (Portfolio Diversification Index)

The number of independent sources of risk in an index is calculated using the PDI measure.



Source: Satrix and Momentum Investments

your goal is our benchmark

The higher the PDI measure, the higher the number of independent risk drivers evident in the index. The Capped Swix clearly shows more independent sources of risk and thus better diversification.

Sectoral analysis

Intuitively, the change does not introduce any material sector risk. If anything, the risk of being overly exposed to a particular sector has somewhat reduced. According to the sector breakdowns, the changes in the sectors are marginal, given the capping is essentially only one share, ie Naspers

Weightings	ALSI	CAPI	Swix	Capped Swix
Resources	22.40%	23.30%	15.00%	16.10%
Industrials	52.10%	50.10%	56.20%	52.80%
Financials	25.50%	26.60%	28.90%	31.10%

Contribution to risk	ALSI	CAPI	Swix	Capped Swix
Resources	60.56%	58.30%	33.44%	33.63%
Industrials	30.25%	31.91%	44.33%	43.96%
Financials	9.19%	9.79%	22.23%	22.41%

Source: Momentum Investments, Barra

However, the bottom table shows the change in contribution to the overall risk of the various indices from the different major sectors. Even though the change in sector weightings does reduce the concentration in exposure to industrials, the contribution to risk is less affected. The increase in PDI would, however, conclude that the drivers of risk on a more granular basis are affected in a positive way.

Portfolio enhancements and other initiatives are continually being considered, as Momentum Investments aims to provide clients with well-diversified, risk-managed and risk-controlled investment solutions that give them the best chance of achieving their targeted investment outcome.

