Portfolio Construction: Tapping a misunderstood alpha source

Portfolio construction in investment grade corporate bond strategies

November 2019
Key differentiators for a better portfolio

- Portfolio construction: Viewed as independent source of persistent alpha
- Low correlation: Complementary to peers
- Downside protection: Embedded downside constraint

Past performance is no guarantee of future results
Source: Aviva Investors. Risk-adjusted return: On a gross basis, see risk-adjusted return vs eVestment peer group - since inception slide.

Aviva Investors: Confidential
Portfolio construction can be a consistent alpha source for generating excess returns

<table>
<thead>
<tr>
<th>Behavioral biases</th>
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<tbody>
<tr>
<td>There can be up to 5X more “outperform” ratings for BBB credits compared to A credits</td>
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<th>Structural inefficiencies</th>
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<td>Be AWARE of your tracking error, but BEWARE of its flaws</td>
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<th>The advantage</th>
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Behavioural biases

Credit analyst recommendations vs % of index with research coverage


Aviva Investors: Confidential
Using Spread Volatility to Filter Our Security Selection

Past performance is no guarantee of future results.
Source: Barclays Live as at 30 September 2019.

Forecasts are not a reliable indicator of future performance.
Source: Aviva Investors. For illustrative purposes only.
Unique sector creation using spread volatility

<table>
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<tr>
<th>Typical sector-based process</th>
<th>Aviva Investors Risk Allocation Framework</th>
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<tbody>
<tr>
<td><del>Not Considered</del></td>
<td>High volatility</td>
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<tr>
<td>Benchmark-based sectors</td>
<td>Low volatility</td>
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<tr>
<td>Benchmark-based industries</td>
<td>11 custom broad sectors</td>
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<tr>
<td>Security over/underweight</td>
<td>39 custom sector/credit ratings</td>
</tr>
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<td></td>
<td>Unconstrained bottom up security selection</td>
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✓ - Unique to Aviva Investors

Example:
Walmart vs Nordstrom? OR Walmart vs Microsoft?

For illustrative purposes only.
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Low correlation to market direction

Uncorrelated excess returns vs credit spreads

The portfolio continued to outperform

Spreads Widen

Continued Outperformance

Past performance is no guarantee of future results.

Source: Aviva Investors and Barclays Point as at 30 June 2019. Returns are shown gross of fees. Indexes are unmanaged, do not reflect fees and expenses and are not available for direct investment. The effect of compounding has been removed from the above graph.
The value of an investment and any income from it can go down as well as up and can fluctuate in response to changes in currency exchange rates. Investors may not get back the original amount invested.

Bond values are affected by changes in interest rates and the bond issuer’s creditworthiness. Bonds that offer the potential for a higher income typically have a greater risk of default.

Illiquid assets: Certain assets held in the Fund could be hard to value or to sell at a desired time or at a price considered to be fair (especially in large quantities), and as a result their prices could be very volatile.
Thank you
Important information

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