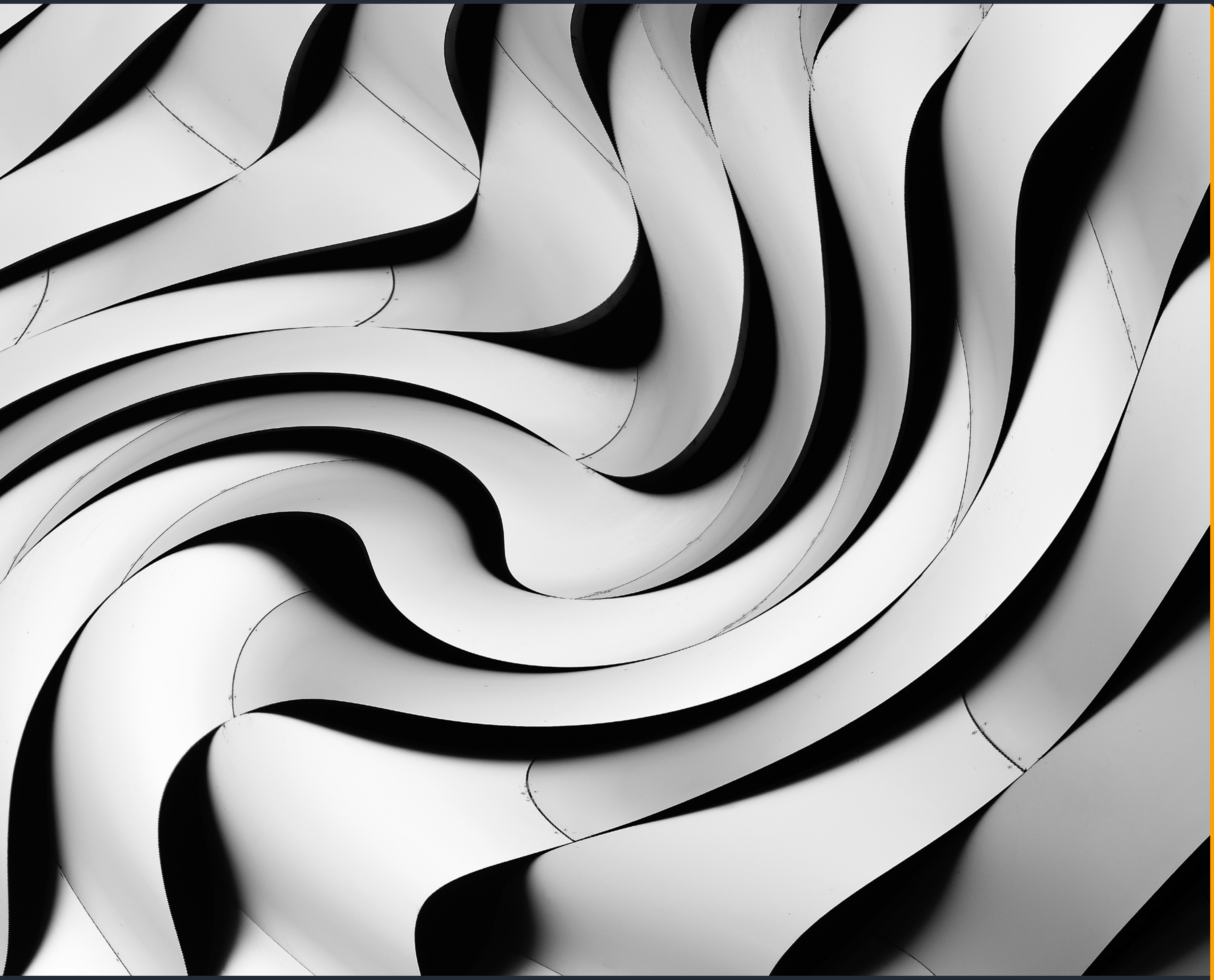


Helping Clients Stay the Course

Advisers are successfully implementing SmartShield Managed Accounts to address client objectives and concerns head on.

After substantial fiscal and monetary stimulus globally, higher inflation has reared its head again, leaving central banks scrambling to get it under control. Whether or not they can engineer a soft landing remains to be seen. In the meantime, so long as financial and economic uncertainty remain high, market volatility is also likely to remain elevated.

For advisers and their risk-averse clients, we believe SmartShield offers a compelling solution to gain exposure to markets for its upside potential, whilst dynamically hedging against the risk of a significant market downturn.

The following short articles are excerpts that follow in-depth interviews with four advisers, who are already using SmartShield to address a variety of client objectives and concerns.

Milliman

Rethinking retirement income: new ways to tackle volatility and market downturns

CORIN JACKA
Financial Coach
Priority1 Wealth Management Group

The nature of risk and return is flipped on its head at retirement.

After a lifetime of saving, investors are suddenly faced with the prospect of drawing down an income for decades. Simply riding out volatility and extended market downturns is no longer an option.

Priority1 Wealth Management Group director Corin Jacka says his clients aged 60 and older are often the ones most concerned about market risk.

"If you've just retired, you've got the risk of markets going wrong and at the wrong time, which will affect you more than others," he says.

The issue is sequencing risk, which describes the much larger impact that a market downturn can have on retirees' savings compared to younger investors who are still saving. There are three drivers that create sequencing risk:

A significant downturn has a much larger negative impact on a big retirement balance than a small one in pure dollar terms.

Older investors usually don't have the same amount of remaining time in the market as younger investors who can capture the full benefit of a market rebound.

Retirees drawing a pension are spending their savings after its value has dropped.

Yet retirees still need a healthy allocation to growth assets such as shares to ensure their money lasts for potentially decades. Australians have the third highest life expectancy in the world[1], where a 65-year-old man is expected to live to 87 years and a 65-year-old woman is expected to live to 89 years.[2]

MANAGING THE RETIREE RISK-RETURN CONUNDRUM

About one-third of Jacka's 330 clients are aged over 65 but have relatively low balances of $300,000-$400,000.

"From an investment philosophy perspective, we've always focused on building low-cost, mainly passive index portfolios," he says. "They're very low fee so for clients with up to $400,000 in savings they're quite suitable because they don't need anything overly sophisticated or expensive."

Index portfolios have performed strongly over time, with more than three-quarters of active Australian equity managers failing to keep up with the S&P/ASX 200 last year, according to the SPIVA Australia Scorecard.[3]

Milliman SmartShield's Moderate, Balanced, Growth, and High Growth portfolios are also built using low-cost exchange-traded index funds, with the added benefit of portfolio protection. SmartShield's risk management strategy is designed to provide a cushion – not a guarantee – against significant market downturns and ongoing volatility.

This portfolio's risk management overlay uses liquid exchange-traded futures which are applied using a pre-determined rules-based strategy. When markets are volatile, protection increases, and when markets are benign, protection is lowered.

"The reason why we thought this was a good idea for our clients is mainly around the sequencing risk of pre-retirees and early retirees," Jacka says. "They're the clients that we're having conversations about it with. If you're wealth-creating in your 20s, 30s, 40s and 50s, you can probably be 100 per cent invested in growth because volatility can work in your favour."

1 Life expectancy, 2020 - 2022. (2024, September 20). Retrieved from https://www.abs.gov.au/statistics/people/population/life-expectancy/latest-release

2 Based on ALT 2015-17 with 25 year improvements

3 SPIVA Australia Year-End 2023 - SPIVA | S&P Dow Jones Indices. (2024, February 27). Retrieved from https://www.spglobal.com/spdji/en/spiva/article/spiva-australia

Rethinking retirement income: new ways to tackle volatility and market downturns

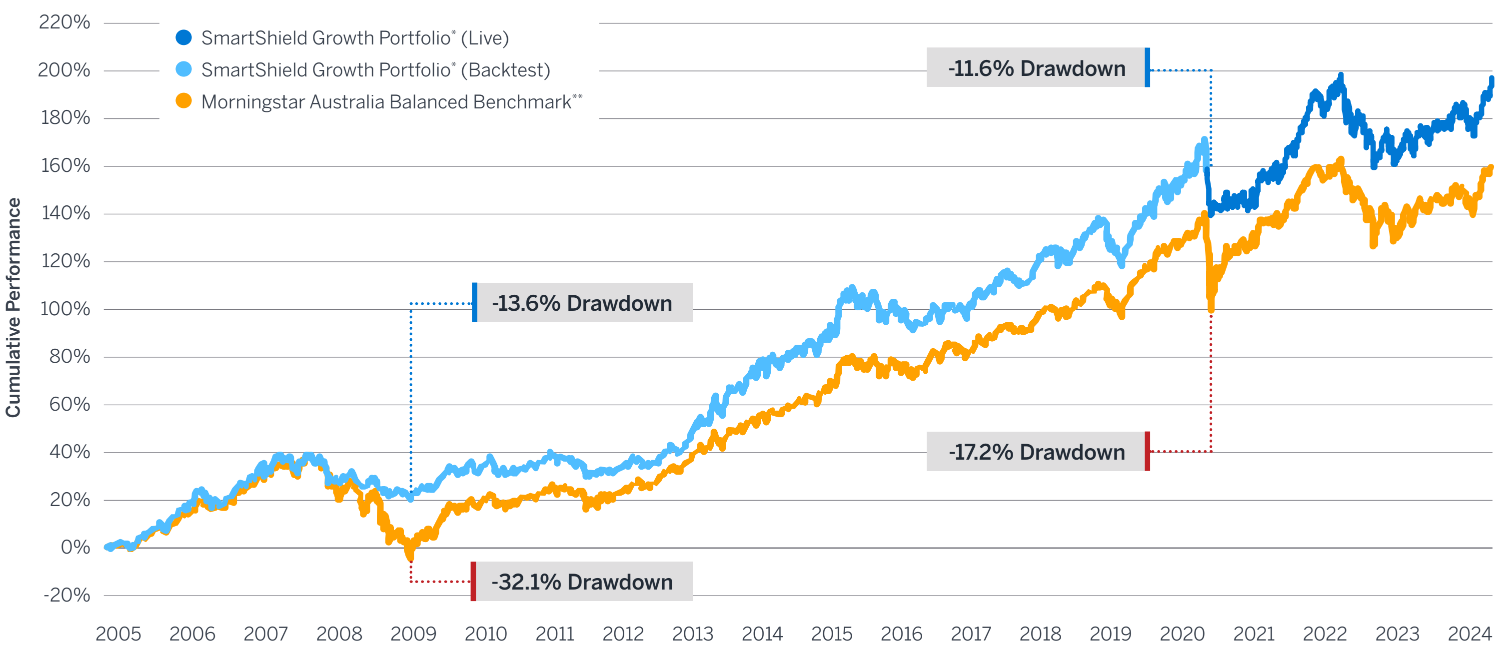
CLIMBING UP THE RISK SPECTRUM

SmartShield's ability to create a more asymmetric risk profile also creates another benefit for clients: the Growth portfolio is expected to deliver risk characteristics that more closely resemble a traditional Balanced portfolio, especially during market downturns. This gives clients the confidence to move up the risk spectrum.

"If they're in the Balanced portfolio and they're passing the 'sleep at night' test, then they could go into the SmartShield Growth portfolio," he says.

"That way, if markets go well, they'll be invested in a higher percentage of growth assets and benefit from that. But if markets become volatile, they're expected to be taking no more risk than what they were in the Balanced portfolio anyway. It's an additional feather in our bow in terms of what we can offer clients in the right circumstances."

CUMULATIVE NET[1] PERFORMANCE ***(JAN 2005 – JAN 2024)***



* Actual performance data is presented from 3rd March 2020 onwards. Prior to this date, performance numbers are back-tested.

** Index consists of the Morningstar Australia Multi-sector Balanced Total Return Index until 28th February 2022, before it was retired by Morningstar and replaced by the Morningstar Aus Balanced Target Allocation Index, which is used as the benchmark from 1st March 2022 onwards.

1 Performance are net of fees. Fees applied on the index represent the asset-weighted median fee charged by Australia domiciled allocation funds (Morningstar study "Global Investor Experience Study: Fees and Expenses", 17 September 2017).

There are times when Priority1 Wealth Management Group's analysis suggests that markets are overvalued or undervalued. But trying to time markets is a fraught business.

"We've never felt that we can add too much value ourselves by trying to time when markets are at their peak or when markets are at their lowest," Jacka says.

"What we found with SmartShield is it takes that decision away from us. If we're concerned about the world or markets, we can use SmartShield and if the world does go a bit pear-shaped, we've got protection that kicks in to minimise that downside risk."

It is a current concern for some clients who see news such as the conflict in the Middle East or ongoing tension between the US and China. However, staying invested through such uncertainty tends to pay off over the long term.

"I think the fact that clients know they're in SmartShield will just give them a little bit more peace of mind when they're watching the news."

How one financial planner uses an innovative approach to portfolio protection to minimise clients' cash bucket

JOHN STALLMAN
Principal Adviser
PlanningIQ

John Stallman knows that markets generate wealth over time. It's a position that has helped make his clients wealthy over his nearly four decades as a financial planner.

"You can't stop growth and humanity's desire to improve itself," he says. "That just adds value – markets work. It's just a matter of how to manage that growth for clients without getting blown up."

While those core financial concepts have stayed the same, it's the way Stallman provides that portfolio protection to clients that has changed in recent years. He previously had clients in a portfolio that de-risked its asset allocation in response to falling markets. But it charged a hefty 2.2 per cent fee.

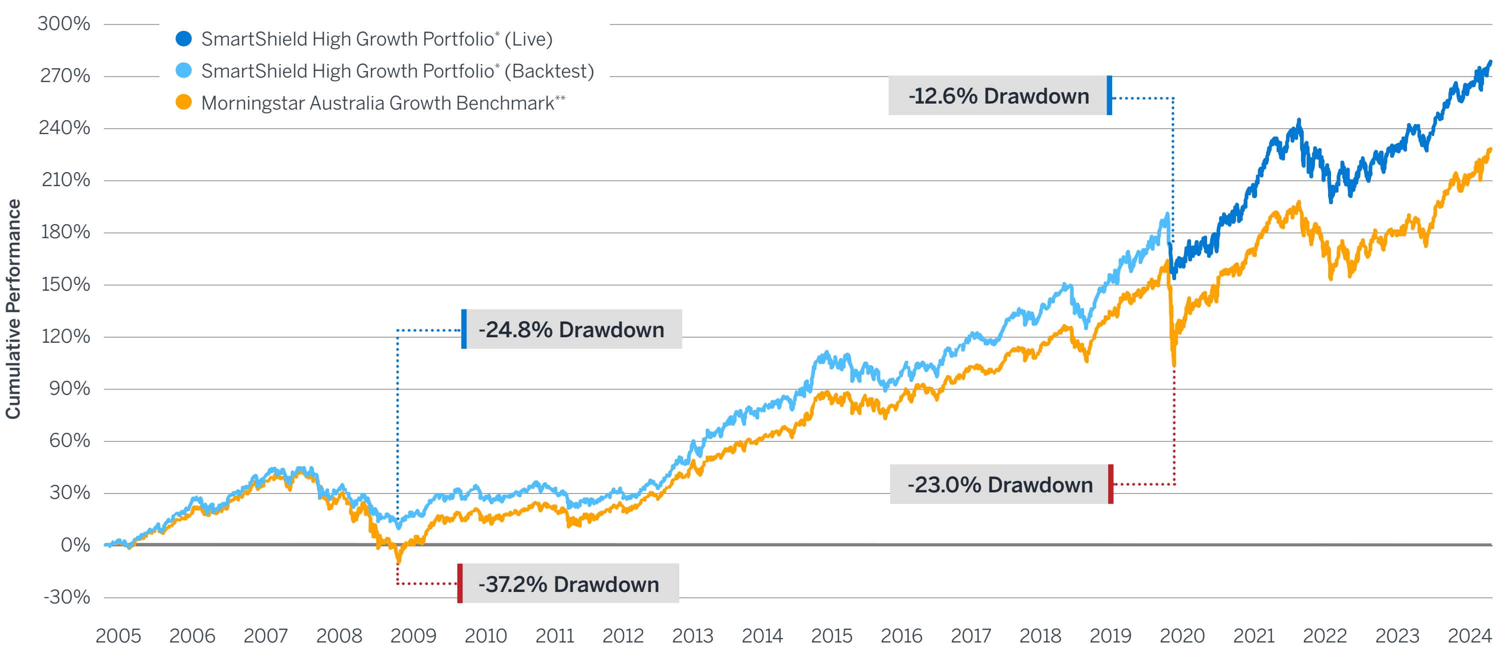
"The problem with that expensive product was it always had a performance drag because you missed the upside when markets rebounded. You'll never get the return if you miss the upside."

After the COVID-19 downturn in early-2020, Stallman found a new solution: Milliman SmartShield. These portfolios provide a rules-based, dynamic risk management strategy that helps stabilise volatility and reduce the impact of large market falls. The protection is then automatically dialled down when market conditions recover, so clients still benefit when markets are moving up.

"Milliman gives you the best of both worlds," Stallman says. "When the markets work, which they do, you'll capture that higher return and make hay while the sun shines. But when you need, it'll shift you down to being a conservative investor over a matter of weeks."

The SmartShield Growth Portfolio would have lost almost one-third less than the Morningstar Australia Balanced Benchmark through the COVID-19 downturn despite having a higher allocation to equities.

CUMULATIVE NET[1] PERFORMANCE ***(JAN 2005 - SEP 2024)***



* Actual performance data is presented from 3rd March 2020 onwards. Prior to this date, performance numbers are back-tested.

** Index consists of the Morningstar Australia Multi-sector Balanced Total Return Index until 28th February 2022, before it was retired by Morningstar and replaced by the Morningstar Aus Balanced Target Allocation Index, which is used as the benchmark from 1st March 2022 onwards.

1 Performance are net of fees. Fees applied on the index represent the asset-weighted median fee charged by Australia domiciled allocation funds (Morningstar study "Global Investor Experience Study: Fees and Expenses", 17 September 2017).

Milliman

How one financial planner uses an innovative approach to portfolio protection to minimise clients' cash bucket

MEETING THE REAL NEEDS OF RETIREES

A constant concern among Stallman's retired clients is their fear of running out of money.

Studies have shown that retirees are significantly more loss averse than younger investors. It's a natural response given they face sequencing risk, which describes the larger impact that a market downturn has on their savings. It's a consequence of drawing down an income rather than saving, which compounds the impact of a downturn, and limits their time in the market to benefit from an eventual market rebound.

Stallman previously used a classic 'bucketing strategy' with clients, setting aside cash to cover two to three years of expenses in the event of a downturn. The portfolio protection built into Milliman SmartShield has allowed him to cut that cash buffer to just three months.

"With the protection, I don't need to hold that cash bucket," he says.

"While there is still some sequencing risk in a long-term drawdown market, it isn't going to be as bad as what it would have been, and clients will pull their head in and stop spending. The benefit that you have by holding cash is not justified by the lost opportunity of being in the market most of the time."

HOW PORTFOLIO PROTECTION WORKS WHILE KEEPING COSTS LOW

Milliman's SmartShield Moderate, Balanced, Growth and High Growth portfolios are built using low-cost exchange traded funds.

S&P's SPIVA Australia Scorecard showed that three-quarters of active Australian equity managers failed to keep up with the S&P/ASX 200 over 2023, with international equity managers posting similar lacklustre results.

"I've been around the block so much that I know you can't beat the market," Stallman says. "I'm really an index investor by nature, which also helps keep costs down."

SmartShield's built-in risk management strategy is applied using liquid exchange-traded futures to stabilise volatility and efficiently replicate the asymmetric payoff of put options at a lower expected cost. Milliman has been using this strategy at the institutional level with large insurance and pension funds for decades.

To help offset the typical cost or performance drag associated with risk management strategies, each of the portfolios have an intentional tilt towards growth assets to provide an uplift to long-term expected returns.

The combination of ETFs and Milliman's global trading scale means the total fee for each SmartShield separately managed account is under 0.5 per cent.

However, Stallman says retirees are far more worried about the impact of losses than outperforming the index. He's seen the impact that market downturns can have and tells clients that they're likely to experience at least two major market crashes over their lifetimes.

"If you avoid getting blown up – that value destroying proposition where markets take 10 years to come back to where they were in real terms – you'll be so much further ahead."

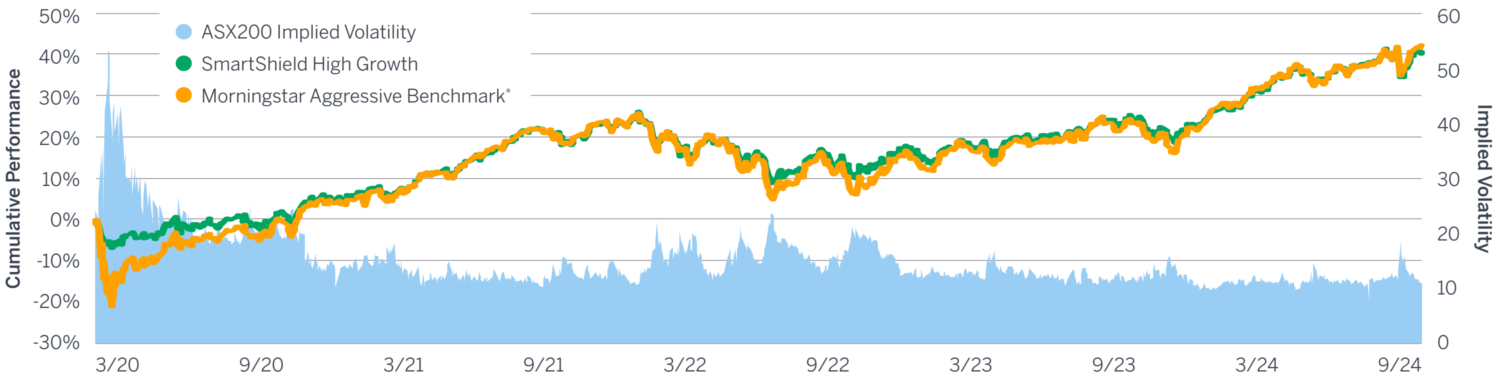
SmartShield for your clients

As we said at the start, SmartShield offers a compelling solution for maintaining exposure to the market's upside potential, while dynamically seeking to hedge against its downside risk.

The hedging strategy dampens market volatility and provides a cushion against systemic market falls. It uses futures contracts dynamically so investors can have greater participation when markets are strong, and offers more protection when volatility spikes.

Fees are also kept low by leveraging Milliman's institutional scale and using ETFs to build the underlying Moderate, Balanced, Growth and High Growth portfolios.

SIMULATED HISTORICAL PERFORMANCE



* Morningstar Australia Aggressive Benchmark (Blend) consist of the Morningstar Aus Multi-sector Aggressive Total Return Index from inception to 28th Feb 2022, before it was retired by Morningstar and replaced by the Morningstar Aus Aggressive Target Allocation Index, which is used as the benchmark from 1st March 2022 onwards.

	Moderate	Balanced	Growth	High Growth
Milliman	0.31%	0.31%	0.31%	0.31%
Investment Costs†	0.11%	0.10%	0.08%	0.08%
Total Fee	**0.42%**	**0.41%**	**0.39%**	**0.39%**

† Includes indirect costs assuming target weights

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