

# **Global Islamic Finance Forum – March 2007**

## **Build A More Flexible and Stable Portfolio**

**Trends in Institutional Investment Management with  
Implications for Wealth Management**

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# Introduction

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## Two important trends in investment management

- Building “flexibly” structured portfolios
- Performance attribution

# Are you meeting your investment objectives efficiently?

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## Equity Portfolio: Traditional Structure

Equity  
Outperformance

+

Equity Market  
Performance

## Equity Portfolio: Flexible Structure

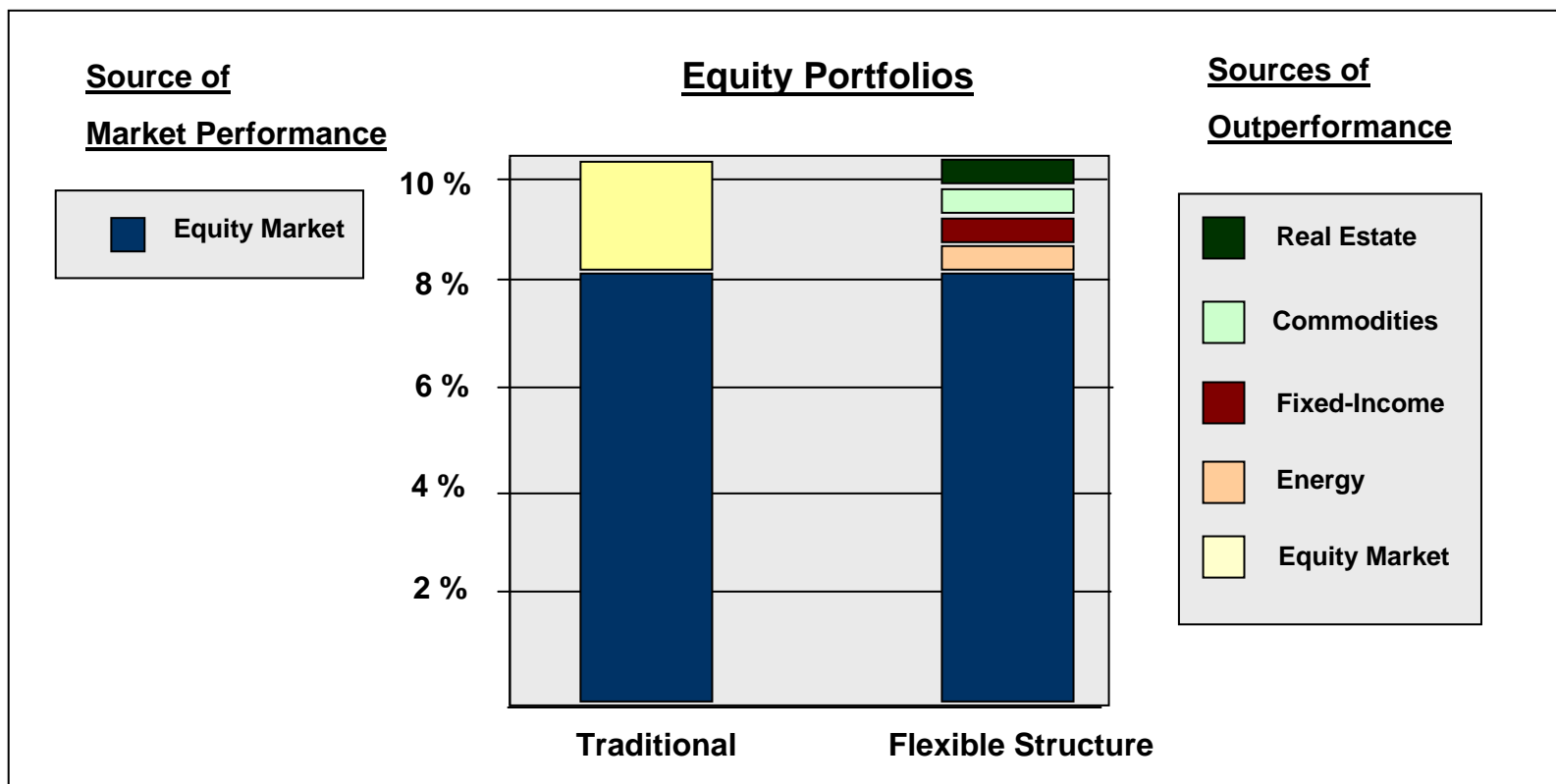
Fund of Funds  
Outperformance

+

Equity Market  
Performance

## Advantages of a Flexibly Structured Portfolio

- Market performance slice is simple – and should be low cost
- More opportunities to find outperformance
- Stabilizing benefits of diversification



# Examples of Flexibly Structured Smith Breeden Portfolios

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**S&P 500  
Equity Portfolio:**

**Fixed Income  
Outperformance**

**+**

**S&P 500  
Performance  
(Futures Contracts)**

**Short Duration  
Yen Portfolio:**

**Fixed Income  
Outperformance**

**+**

**Yen Performance  
(FX Forward Contracts)**

**EAFE Equity  
Portfolio:**

**Fixed Income  
Outperformance**

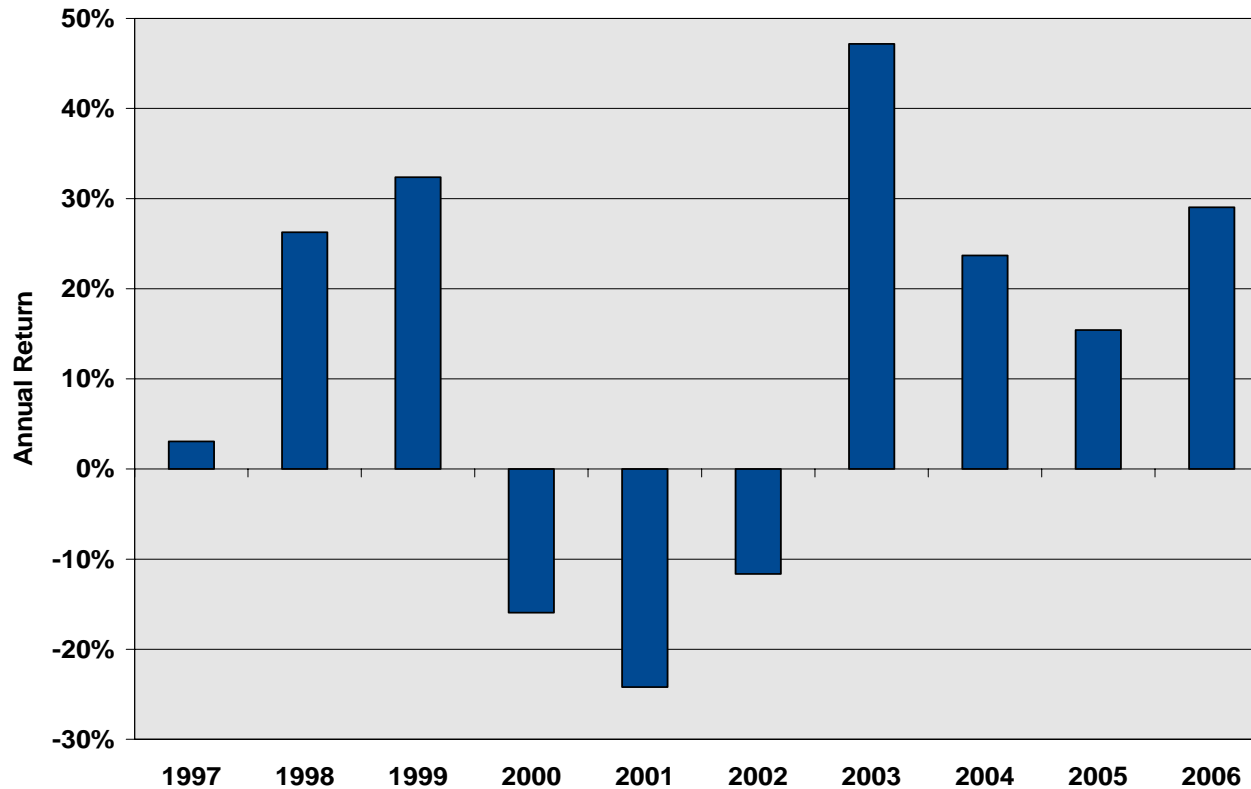
**+**

**EAFE Performance  
(Futures, Swaps and  
FX Contracts)**

# Understand Results with Performance Attribution

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## Example Returns for a Non-Dollar Equity Manager:

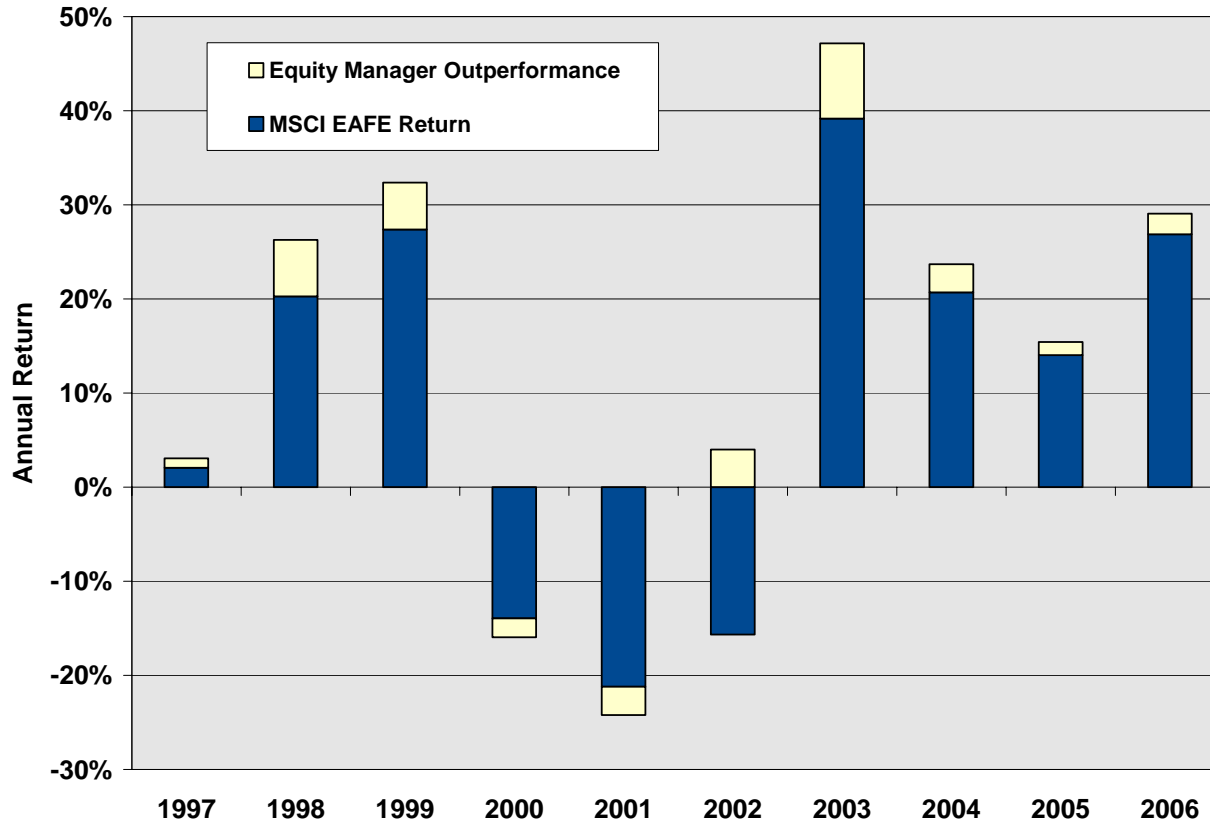


**Average Annualized Return = 10.15%**

***Are these good results? How much would you pay for these results?***

# Quantify the Size of Outperformance

## Example Returns for a Non-Dollar Equity Manager:



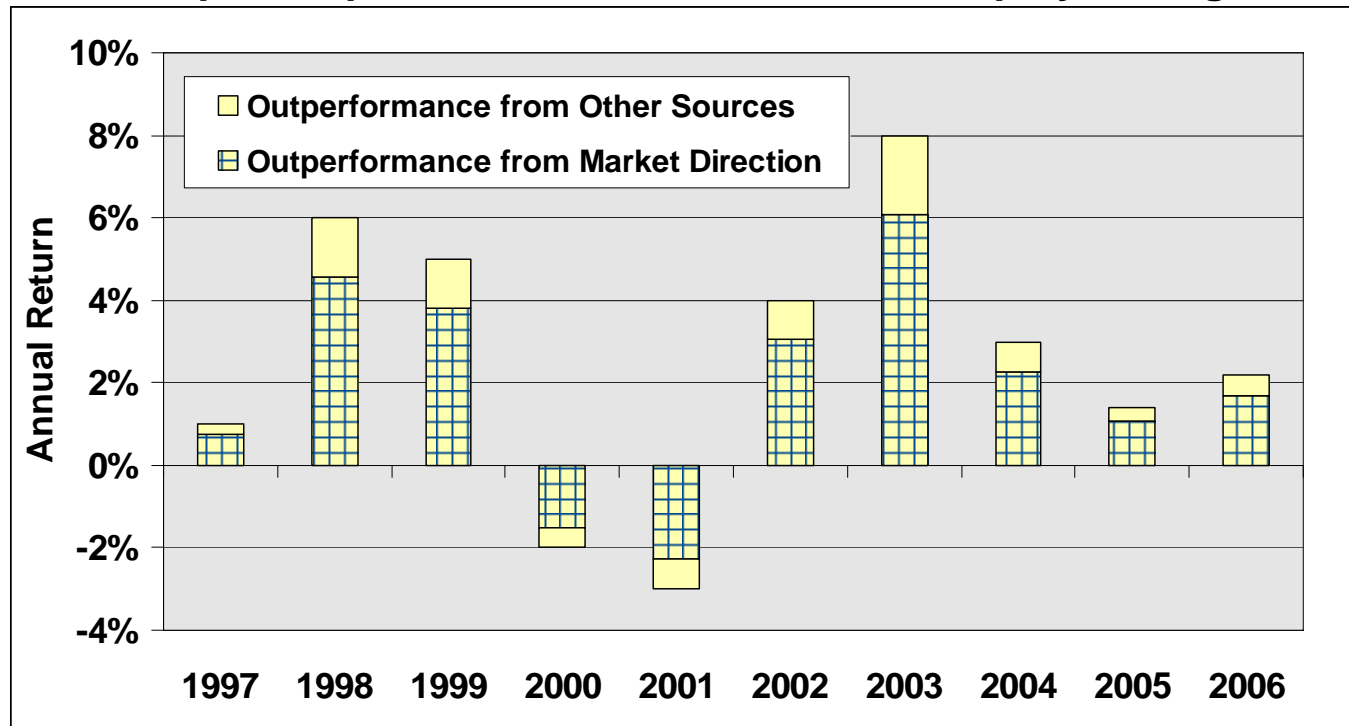
### Average Annualized Returns

Equity Manager Return	10.15%
MSCI EAFE Return	8.06%
Equity Manager Outperformance	2.09%

## Determine the Sources of Outperformance

- Bet on overall market direction
- Rotation across market sectors
- Security selection

### Example Outperformance for a Non-Dollar Equity Manager:



## Measure the Quality of Outperformance

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- **Stable and Consistent is Best**

$$\begin{aligned} \text{Information Ratio} &= \frac{\text{Average Outperformance}}{\text{Volatility of Outperformance}} \\ &= \frac{2.08 \%}{3.42 \%} \\ &= 0.61 \end{aligned}$$

## Conclusion

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- **Flexibly Structured Portfolios**
  - Becoming increasingly popular
  - Offer more sources of outperformance
  - Seek to exploit benefits of diversification
- **Performance Attribution**
  - Makes bets more transparent
  - Clarifies risks
  - Leads to better decisions