

## Investment update

14 June 2010

### Quantitative strategies team

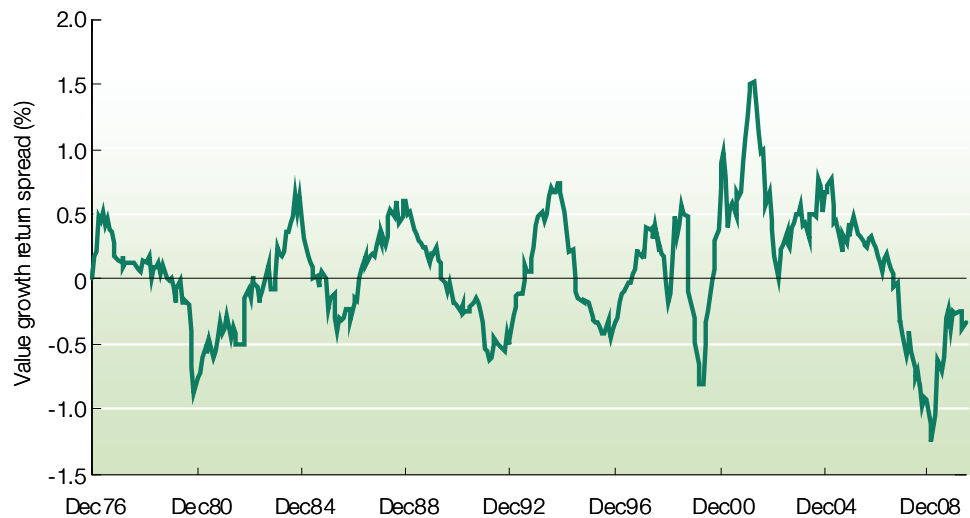
OMAM's quantitative strategies team includes specialists in portfolio construction, research and systems development. The investment process is designed to exploit market inefficiencies and is based on a proprietary multi factor return model. The process calculates a forecast return for each stock and the resulting portfolio is optimised in terms of risk, cost and return.

# Regime against the machine

## Rotating style factors with investor sentiment and macroeconomic environment

The weight assigned to different return forecasting factors of a strategy is a key issue in any quantitative investment process. Typically in the quantitative investment industry these weights have been determined by the long-term performance of a factor. However, it is well understood that most style factors exhibit cyclical behaviour. A classical example is the cyclical behaviour observed between value and growth, as illustrated in the chart below, where we show the monthly return spread 2 year rolling between the MSCI Europe Value and Growth indices.

### MSCI Europe Value - MSCI Europe Growth, monthly return spread, 2 year rolling



Source: MSCI, Datastream

We have also seen evidence of some cyclical behaviour across our style factors. At OMAM, over the last three years, we have dedicated a substantial amount of time and effort in analysing what drives regimes in factor performance. We are confident we have now reached a good understanding that these are not purely statistical occurrences, but instead, these cyclical tendencies in factor performance have links with the overall macroeconomic environment or investor sentiment. Our understanding is well supported in recent academic findings that have explained why the different behavioural biases that drive our alpha factors are likely to be prevalent at different points in the economic cycle.

Having identified these relationships, we then extensively researched a wide variety of modelling frameworks, including advanced econometric frameworks such as Kalman filters, vector auto regression and Markov switching models, to explore the best way of robustly incorporating this information into a dynamic factor rotation strategy. The aim was to design a robust style rotation approach that would explicitly and systematically assign weights to factors based on the current macro environment and investor sentiment.

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Backtested performance results may be reissued in the future on the basis of changes to the investment model. Potential investors should be aware that they may not be in possession of the most up to date backtested performance. These simulated/backtested performance results have certain inherent limitations. The results are hypothetical and do not represent actual trading, and thus may not reflect material economic and market factors, such as liquidity constraints, that may have had an impact on the investment adviser's actual decision making.

Simulated results are also achieved through the retroactive application of a model. The results shown are adjusted for dividends and reflect all fees, costs and expenses a client would have paid (1.5% AMC, 20% of outperformance above a hurdle rate (central bank base rate, applied semi annually), total expense ratio, transaction and shorting fees). No representation is made that a client will achieve results similar to those shown.

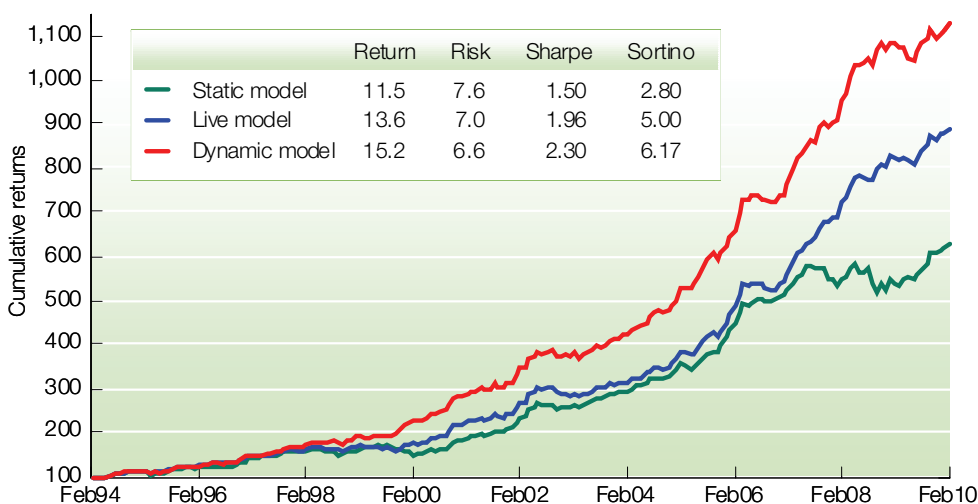
These simulated/backtested performance results have been produced by OMAM's quantitative strategies team and are indicative only.

The first fruits of this project were introduced to our live model in February 2009, when we applied these concepts to the valuation factor, with the enhancement to dynamic valuation. We have now been able to successfully apply a dynamic factor rotation model across all of our factors in a consistent and parsimonious fashion, efficiently incorporating expectations of cyclicity in factor performance.

As with all of the previous changes to our models, we have followed a rigorous research process, working closely with our Academic Advisory Board while researching and developing the strategy, and ensuring that any enhancements to the model are driven by solid investment insights, with strong support from the academic literature.

We believe the macro rotation approach adds substantial value to our historical backtest, in terms of returns, downside risk and drawdown mitigation. The chart below shows an illustration of this improvement in Europe, by comparing the backtest performance of a static model, the current live model, and the latest model incorporating dynamic rotation across all factors.

Europe backtest



Source: OMAM