# GYROSTAT
## CAPITAL MANAGEMENT

## *INVESTMENT RISK MANAGEMENT – SIGNIFICANT ADVANCES FOR RETIREES*

### *Protect and grow capital with reliable income through the <u>complete</u> investment cycle*

### Executive summary

- There have been significant advances in investment risk management for conservative investors. By combining the three approaches and adjusting asset allocation <u>now</u>, it is possible to protect and grow capital with reliable income through the <u>complete</u> investment cycle.

- The gap in today's market is the ability to **benefit from volatile markets with capital growth (including large 'one off' share price falls)**. This investment risk management approach is now available on the expanded investment menu.

- When combining the investment risk management approaches they deliver reliable income with stable and growing capital through the complete investment cycle. Each level **reduces** in the downside variability of your investment capital with complementary return characteristics.

  o "Level 1" was diversifying risk- varying the allocation of 'conservative and 'growth' assets.

  o "Level 2" protection sometimes in place using a predictive risk management overlay. This introduced an additional 'growth' asset.

  o "Level 3", the Gyrostat approach, with protection always in place. This produces an additional 'conservative' asset. We complement short term bonds as we deliver higher income and **capital growth** through the investment cycle (in trending and more volatile markets **including large market falls**).

- By combining the three phases conservative investors can protect and grow capital with reliable income through the <u>complete</u> investment cycle

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*Easing the unscripted drama of stock markets*

There have been significant advances in risk management for conservative investors, enabling them to protect and grow capital with reliable income through the complete investment cycle. This is possible from technological advances and deregulation.

In summary:

| | Approach | Feature | Capital value | Benchmark |
|---|---|---|---|---|
| **Level 1**<br>**Diversify risk** | Asset allocation 'conservative' and 'growth' assets | Diversification | Initial capital ± market moves | Model portfolio risk profile |
| **Level 2**<br>**Partial protection** | Protection <u>sometimes in place</u> using predictions | Additional 'growth' asset<br><br>Predictive risk management - technology | Initial capital ± <u>mitigated</u> market moves | Equity index |
| **Level 3**<br>**Always in place protection** | Protection <u>always</u> in place with upside<br><br>Absolute return - <u>always</u> minimal capital at risk | Additional 'conservative' asset<br><br>Lowest cost bought put options - technology<br><br>Active management options - deregulation | Initial capital + capital growth trending and volatile markets (incl large falls) | BBSW |
| **Short term bonds** | Conservative asset (no capital growth) | Nil | Initial capital less defaults | BBSW |

As you move through the levels when constructing an investment portfolio, each level has a reduction in the downside variability of your initial capital. They each have complementary risk-return characteristics through the complete investment cycle.

Level 1 (diversifying risk) is subject to capital value fluctuations from stock market moves. The impact of capital losses may be mitigated at level 2 (partial protection) – hence this is an alternative to 'growth' assets in a portfolio and benchmarked against an equity index. At level 3 (protection always in place) the capital value is stable and rising (with capital gains at those times where level 1 and level 2 approaches are most fragile – in volatile markets including large market falls.).

## *Limit capital losses at or near retirement – sequencing risk*

Throughout the full investment cycle there are periods where investors are exposed to large investment losses. Returns have more impact at some points in your investment lifecycle than at others. Sequencing risk is the risk that markets fall near or early in retirement.  The wrong sequence of returns can have a big impact on your retirement portfolio. Negative investment returns early in retirement can be particularly damaging.

A major challenge now confronting investors is that stock market corrections historically occur every 4 ½ to 5 ½ years. Since 1929, the range of falls has been 25% to 90%, and duration of decline 22 to 160 weeks.  The last correction occurred over 7 1/2 years ago.

By combining the three and adjusting asset allocation, conservative investors can now address sequencing risk and protect and grow capital, with reliable income, through the <u>complete</u> investment cycle.

| | Approach | Falling market (trending) | Volatile market (including 'one off' large falls) | Stable market | Rising market (trending) |
|---|---|---|---|---|---|
| **Level 1** **Diversify risk** | Asset allocation 'conservative' and 'growth' assets | Unfavourable | Unfavourable – capital losses | Favourable | Favourable |
| **Level 2** **Partial protection** | Protection <u>sometimes in place</u> using predictions | Unfavourable | Unpredictable – capital gains and losses | Favourable | Favourable (possibly mitigated) |
| **Level 3** **Always in place protection** | Protection <u>always</u> in place absolute return<br><br>Absolute return - <u>always</u> minimal capital at risk | Favourable (mitigated) | Very favourable – capital growth potential | Less favourable (lower returns) | Favourable (mitigated) |

## Expanding the investment menu

Conservative investors now have an expanded investment menu to protect and grow capital with reliable income through the complete investment cycle. .
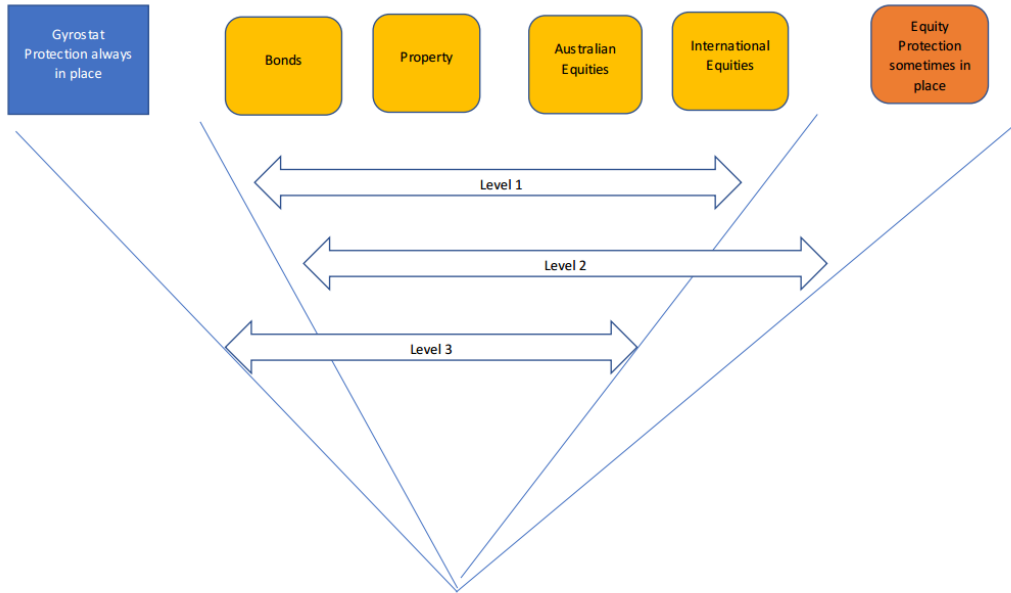


You can now construct a portfolio to protect and grow capital with regular income through the complete investment cycle. As the risk profile of an investor reduces as they age, there are additional 'growth' and 'conservative' assets available.

Australian equities can be replaced with level 2 sometimes in place protection as a 'growth' alternative.

Short term bonds can be replaced with level 3 always in place protection as a 'conservative' alternative. If the overall risk profile has reduced, an allocation can also be made from Australian equities.

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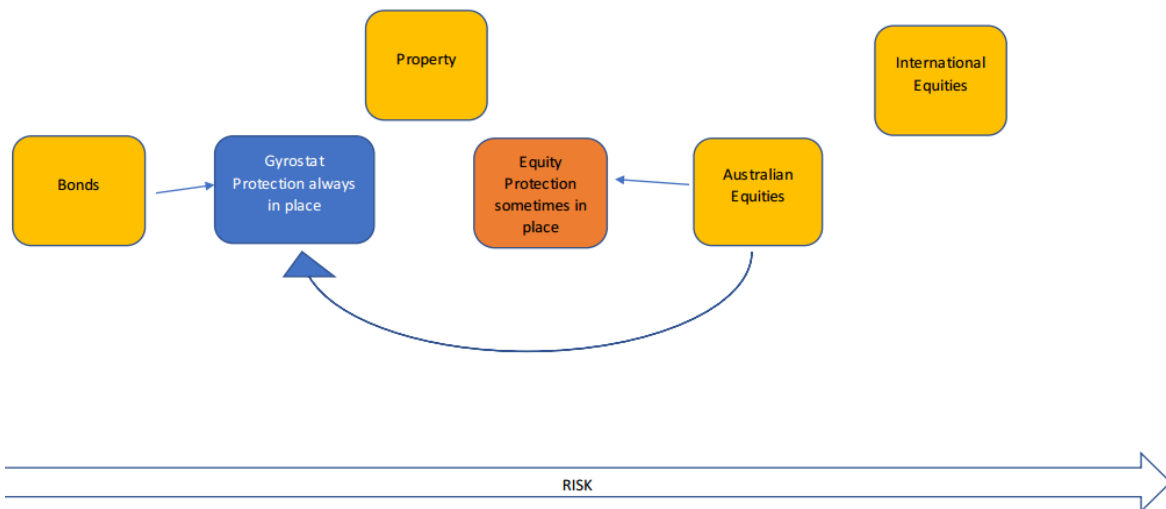
## *Our solution – the three step investment approach*

Our investment risk management approach has **protection <u>always</u> in place** with <u>**absolute returns**</u> **through the investment cycle.** With protection <u>always</u> in place we complement short term bonds and are benchmarked against the absolute return BBSW90. Our expected returns vary with the stage of the investment cycle and prefer trending and volatile markets as this provides the opportunity to re-set protection levels and lowers the costs.

Our investment objectives are:

- **Returns:** 6% - 8% pa in trending markets, greater than 8% pa in volatile markets, short term bond returns in stable markets

- **Income**: Minimum cash rate + 3% paid semi-annually (currently 4.7% p.a.) from dividends and franking credits

- **Protection:** No quarterly NAV draw-downs exceeding 2%

By adding our fund to a conservative portfolio we complement Level 1 and Level 2 strategies. In particular:-

- Volatile markets provide more profit opportunities to participate in share price upside and protect on share price falls
- Gyrostat always has additional downside protection in place in case of large market falls

By combining these three strategies conservative investors can protect and grow capital with reliable income through the complete investment cycle.

Throughout the complete investment cycle our risk management approach has a risk-return profile which always has minimal capital at risk at the stock specific level with upside return potential. Each stock always has a protection level in place near the current stock price. This level is re-set as stock prices move to protect on share price downside and participate in upside.

Super impose a 'hockey stick' pay off at all times on a share price chart, moving the protection level on market moves.

### Gyrostat investment approach

1. **Buy and hold blue chip shares with protection** on the Australian Stock Exchange.

2. **Set amount of protection** - to always participate in the upside with minimal capital at risk.

3. **Reset the protection level on market moves for risk-return profile to match stock view** - if the share price rises, increase protection level, on falls reduce protection level.



The Gyrostat "**hockey stick**" payoff.
Blue chip shares with insurance

Protection Level
Reset on market moves