DIVERSIFIED STRATEGIST PORTFOLIOS: A ROBUST APPROACH TO RISK-TAKING

In the aftermath of the global financial crisis, many individual investors were left questioning the effectiveness of their investment strategies. While many believed their portfolios to be well-diversified, as the financial system faltered, they saw a large portion of their investments decline simultaneously. These same investors have grown weary of fund managers who profess to provide returns above and beyond the overall market, when in actuality, gains they realize are often significantly diminished by fees.

Despite these challenges, investing remains an essential tactic for funding life-time goals. But now, investors are more keenly focused on portfolio risk and efficient, cost-effective implementation.

So given this heightened focus, how can advisors help investors work toward their goals efficiently and effectively?

START WITH QUANTITATIVE EQUITY

Northern Trust employs factor-based quantitative equity strategies that systematically combine what we believe to be the best of active and passive investment management. The strategies offer targeted exposure to a combination of factors (e.g., quality, value, low volatility, size and dividend yield) that have historically demonstrated attractive risk-adjusted returns. By aiming to capture exposure to specific factors, either individually or in combination, investors can potentially further enhance results. Factor-based equity strategies are designed to capture compensated risks that active management has traditionally sought, while delivering it efficiently and cost-effectively by directly targeting the intended risk factor via a non-traditional index approach.

We’ve used quantitative equity as a growth engine for our Diversified Strategist Portfolios, to help prepare investors meet their lifetime goals.

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THE DIVERSIFIED STRATEGIST SOLUTION

The Diversified Strategist Portfolios (DSP) are a turnkey, cost-efficient managed account solution that is designed to help financial advisors help their clients invest smarter and smoother through robust diversification, flexible asset allocation and compensated risk exposures. DSP offers solutions for five risk objectives, from maximum growth to income.

The Diversified Strategist Portfolios are designed to maximize return potential while adhering to a specified risk tolerance. Ultimately, the focus is on the investor, and helping to efficiently achieve improved investment outcomes, provide greater consistency, manage risk and potentially enhance returns.

Northern Trust’s time-tested strategic asset allocation approach provides a globally diversified base allocation for each of the five Diversified Strategist Portfolio risk objectives. Tactical asset allocation shifts are executed periodically, in an effort to participate in up markets and minimize the effects of market downturns. Finally, the investment strategies implemented at the asset class level are designed to provide exposures to risk factors that have shown persistent return premiums over time.

DIFFERENTIATING FEATURES

A few key elements serve to differentiate our portfolio construction discipline:

- Our Risk Asset/Risk-Control Asset approach seeks to allocate to an optimized mix of risk and risk control assets for robust diversification across various market environments.
- Unlike “set and forget” strategies, the Diversified Strategist Portfolios implement tactical shifts in asset class positioning to anticipate, and potentially capitalize on, an ever-changing market environment. Changes and rationale are communicated fully in a timely manner.
- The Diversified Strategist Portfolios are separately managed accounts fulfilled with Northern Trust’s quantitative equity ETFs and active fixed income mutual funds. This structure provides enhanced transparency into the asset allocations for each risk objective. Additionally, it provides flexibility in the event investment objectives change in the future, allowing for small changes in holdings instead of 100% turnover.
- Quantitative equity strategies are employed in an effort to provide the potential for higher returns with less risk. Equity factors with relatively longer cycles appear in higher-risk, growth-oriented portfolios while shorter-cycle equity factors appear in lower-risk, income- and capital preservation-oriented portfolios.
AN EFFECTIVE MULTI-ASSET CLASS STRATEGY IN THREE STEPS

1. Establish the optimal strategic asset allocation

2. Exploit market dislocations through tactical positioning

3. Implement with proven risk factor combinations

THE ANATOMY OF THE STRATEGY

Our investment methodology defines assets as either Risk Assets (all asset classes with equity market exposure, including high yield) or Risk-Control Assets (everything else). By categorizing assets in this manner, we are better able to provide an optimized level of diversification across all market environments.

Growth and income are essential building blocks of asset allocation, helping to provide robust diversification and facilitate the achievement of client goals. However, the Diversified Strategist Portfolios go a key step beyond typical multi-asset class solutions by including assets that focus on risk management, such as inflation-sensitive assets.

Inflation-sensitive assets include FlexShares® ETFs invested in real assets—specifically natural resources, infrastructure and real estate—and Treasury Inflation-Protected Securities (TIPS). These asset classes have historically exhibited a low correlation with traditional stocks and bonds, and have historically helped defend against purchasing power erosion.

The growth component includes quantitative equity which offers the potential for long-term higher returns with less risk than traditional equity indexing, as well as historically consistent performance, lower fees and greater transparency than fundamental active management.

The fixed income portion looks to capitalize on market inefficiencies by unearthing opportunities through extensive fundamental research across sectors and issuers, as well as relative value analysis. Our active management approach touches on opportunities related to yield curve positioning, credit analysis, sector rotation and issue selection.
A COST-EFFECTIVE MULTI-ASSET CLASS SOLUTION

Northern Trust understands the challenges inherent in meeting the needs of today’s increasingly sophisticated investors, including generating acceptable levels of return while providing appropriate levels of diversification—all in a cost-efficient manner. The Diversified Strategist Portfolios seek to meet these challenges, efficiently and effectively.

First, the Diversified Strategist Portfolios provide a single, cost-efficient, globally diversified, turnkey solution for a variety of risk objectives. Second, the portfolios leverage tactical asset allocation in an effort to take advantage of potential market opportunities while preserving capital during market downturns. Finally, the portfolios are fulfilled with cost-efficient FlexShares® ETFs and Northern Trust mutual funds, allowing access to institutional-quality investment expertise.

Keeping investors appropriately informed and invested through ever-changing markets—and doing so with an eye on costs—can be difficult. We’ve designed the Diversified Strategist Portfolios to help advisors help their clients achieve improved investment outcomes with less risk through a simple cost-efficient solution that is Engineered to Perform.

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Northern Trust generally utilizes its own funds within this strategy, Northern Trust receives various fees from the funds via the fund expense ratios. Clients will incur these fees. Clients who access these portfolios through a financial intermediary firm will typically pay additional fees to that firm. Clients should speak to their Financial Advisor for more information. Financial intermediaries that employ Northern Trust for model management or overlay services may compensate Northern Trust for those services a fee of up to 0.25%.

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