Fund selection – a complex reality

Johann Schwimann
CEO-Partner
jschwimann@seven-cm.com
+33 1 42 33 75 20

"On the XXXX database, this fund is in the 1st decile over one year, three years and five years. What about over ten years? It's impossible to compare – there aren't enough funds. It's a huge company, so there's no risk if it loses value, I won't get blamed for it... I'm buying it."

Fund selection is a financial decision, just like buying a share, a bond or any other security. It involves both a real act of decision-making and making an investment. It becomes even more complex if you incorporate due diligence into the selection process.

Beyond the due diligence aspect, which we will not address in this study, selecting a fund requires advanced knowledge of quantitative analysis, because performance alone is only the small, visible tip of an enormous iceberg.

Sébastien Bauchart
Portfolio Manager
sbauchart@seven-cm.com
+33 1 42 33 75 37

In this study, we will analyze and dissect the three key criteria for selecting a fund.

- The Iso-Return point
- The Omega ratio
- Real performance, adjusted for real risk – drawdown (maximum loss recorded over the study period)

We will conduct this study on an increasingly popular fund asset class, the diversified / flexible / mixed / balanced / absolute return / « Patrimoine » fund asset class.

Using non-mainstream, though no less pertinent, analysis tools, we will attempt to offer investors a new perspective on their fund selection process.

Analysis universe

Our analysis universe comprises more than 500 funds.

These funds were identified using the “Fund Screener” function in the Bloomberg financial database.

The following criteria were used to select the funds to be included in our universe:

1)French or Luxembourg funds

2)Fund has existed since at least January 1, 2008

3)Fund has assets under management as at the end of March 2015 of at least €100 million

4)Fund is denominated in euros

5)Only the performance of the share class of the fund with the most assets under management is taken into consideration

6)The Bloomberg classification of the fund is “Mixed Allocation”

It is important to point out that our selection suffers from **survivorship bias,** as it does not include funds that were liquidated in the period from 2008–2015, nor funds whose assets under management fell below €100 million due to poor performance.

Therefore, the performance of the universe presented to you in this study is an **“optimistic” representation** of the actual performance of diversified/flexible/mixed/balanced/absolute return/income funds as a whole.

Selected Screening Criteria	Matches
Universe Criteria	569537
Market Status: Active	260151
Fund Asset Class Focus: Mixed Allocation	52945
Country of Domicile: France,Luxembourg	9879
Currency: EUR	7196
Fund Primary Share Class = Yes	3926
Inception Date <= 1/1/2008	1678
Analytic Criteria	1678
Fund Total Assets (mil)	1678

After applying our filter for assets under management, the analysis universe comprises 507 funds.

The Seven5050 Index – a reliable indicator of industry performance

The **Seven5050 Index**, which will be used throughout this study, is an index comprised of both the DJ Euro Stoxx 50 index (excluding dividends) and the EuroMTS 7-10 years (excluding coupons) index in equal proportion.

In order to conform with the theoretical weightings of the index components, every half-year, we shall rebalance the weight of each component.

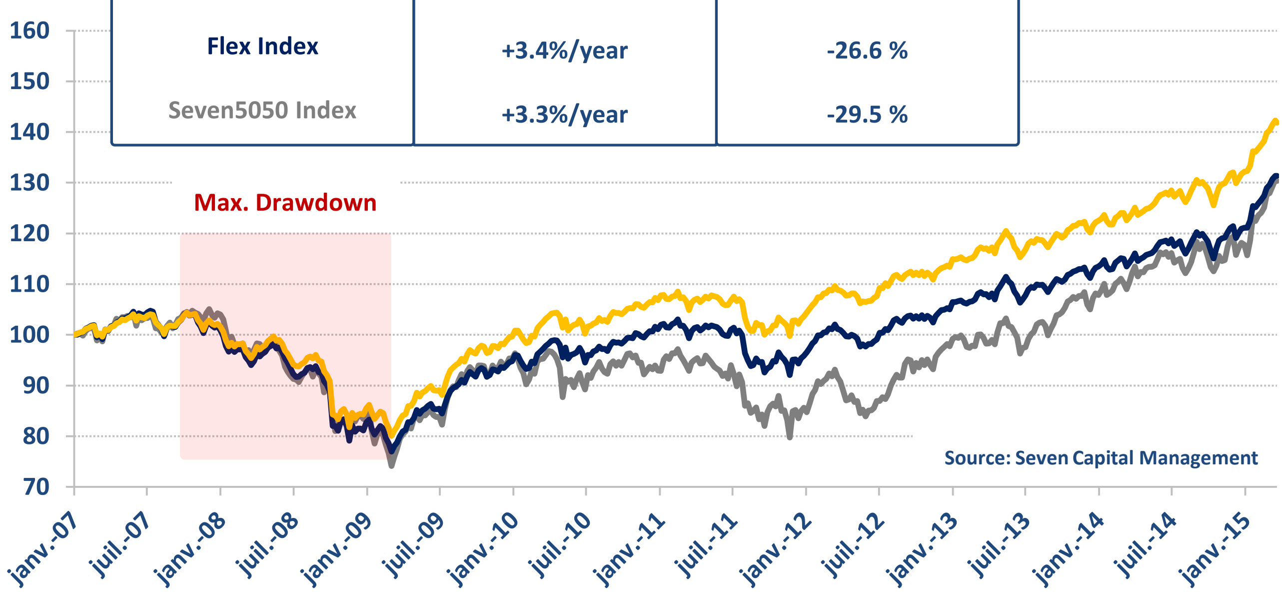
The performance of the diversified/flexible/mixed/balanced/absolute return/wealth management industry will be summarized using an equally weighted index of the performance of the 507 funds comprising our universe, the **"Flex Index"**.

Furthermore, in order to gain an accurate overview of the performance of the heavyweights in the diversified management industry, we have also created an equally weighted index of the performance of funds with over €1 billion in assets under management as at the end of March 2015, the **"Circle of Billionaires"**.

The 507 funds comprising our universe represent, as at the end of March 2015, assets under management of €243 billion. The **"Circle of Billionaires"** alone represents assets of €106 billion split between 34 managers, or only around 7% of the total number of funds in our universe.

Performance of the three indices from January 2007 to March 2015

	Annualized Return	Max. Drawdown
Circle of Billionaires	+4.3%/year	-23.3 %
Flex Index	+3.4%/year	-26.6 %
Seven5050 Index	+3.3%/year	-29.5 %



The Seven5050 Index – a reliable indicator of industry performance

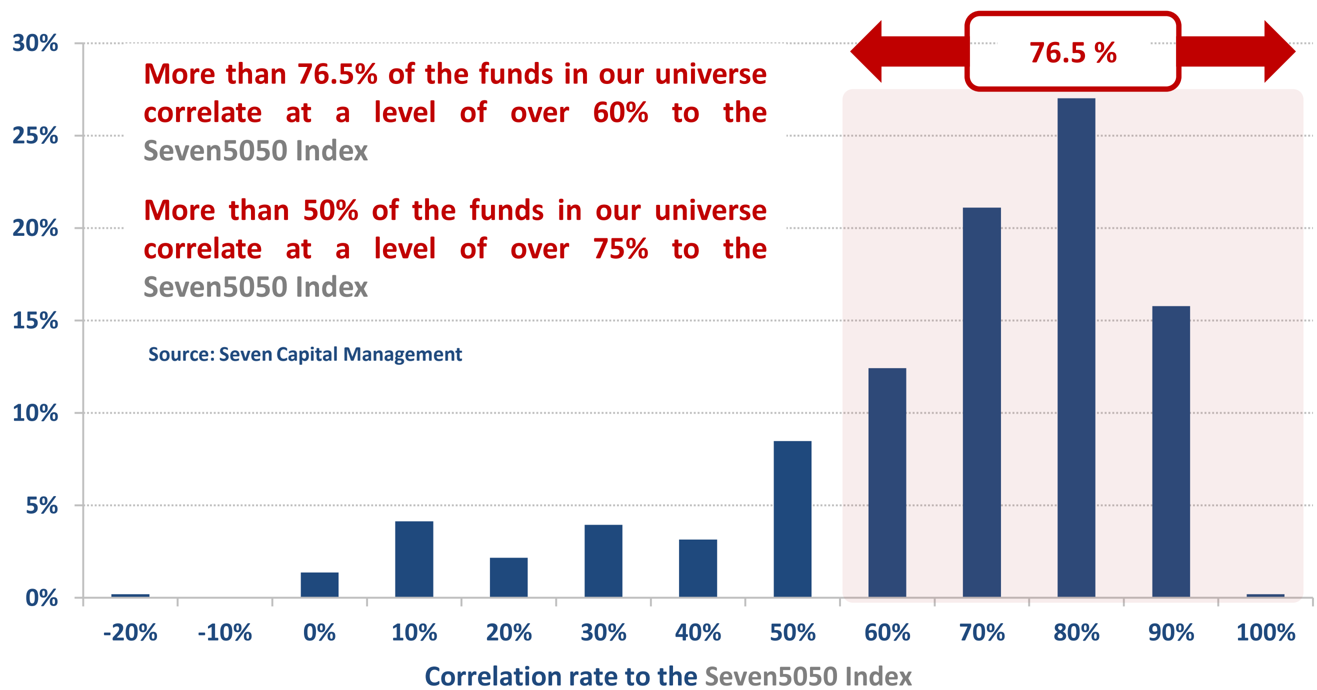
A few important notes:

1) Visually, we can see that the performance curves of the various indices are very similar

2) The correlation level between these different indices confirms this impression

	Seven5050 Index	Flex Index
Flex Index	**82 %**	
Circle of Billionaires	**80 %**	**99 %**

3) A detailed analysis of the correlation between the funds comprising the investment universe shows that 76.5% of the funds correlate at a level of 60% and higher to the **Seven 5050 Index**



The **Seven5050 Index** (**excluding coupons and dividends**) is therefore truly representative of the performance of our diversified management universe and will constitute a reliable reference for the rest of this study.

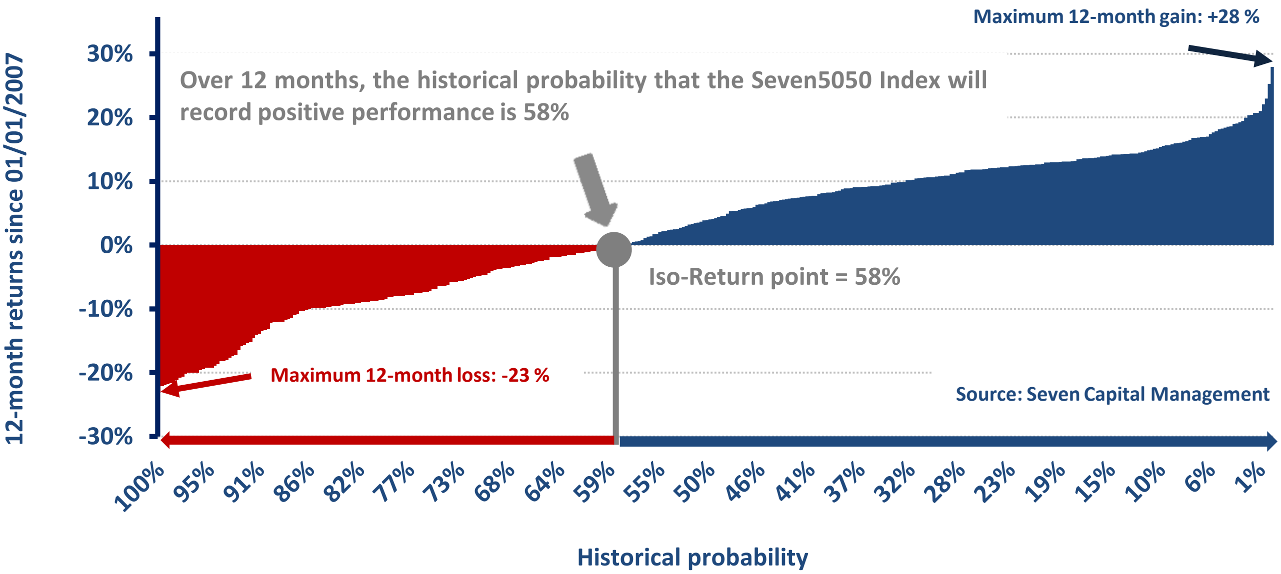
Our performance analysis criteria

We have chosen to study the performance of the funds in our investment universe using three variables, which allow for a much more advanced analysis that simply studying historical one-, three- or five-year performance, **which totally disregard any notion of risk**.

1) The Iso-Return point

The Iso-Return point simply represents **the probability of an investor achieving, as a minimum, a positive return over 12 months, based on historical performance**.

Increasing distribution of returns over a 12-month rolling period
Seven5050 Index from 2007 to 2015



The closer the Iso-Return point is to 100% (towards the left of our graph), the higher the probability that the investor will achieve a positive performance over 12 months.

The**Seven5050 Index** comes out at 58% here, meaning that over the analysis period (eight years), irrespective of the date on which the investor chose to invest, they had a 58% chance of obtaining positive performance after 12 months and a 42% chance of obtaining negative performance after 12 months.

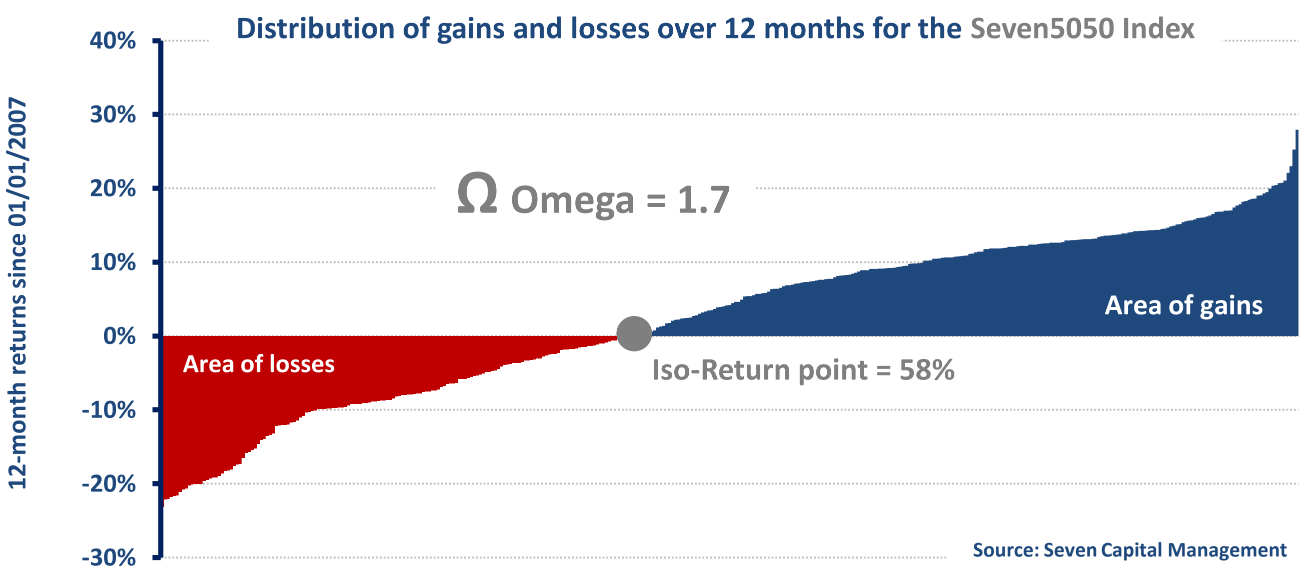
Although it gives investors a fairly reliable insight as to a fund's capacity to protect their capital over 12 months, the Iso-Return point does not indicate the extent of gains and losses that might be encountered over 12 months.

Our performance analysis criteria

2) The Omega ratio

The 12-month Omega ratio is the ratio between the area of gains over 12 months and the area of losses over 12 months over our study period (January 1, 2007 - March 31, 2015).

$$\Omega \text{ Omega} = \frac{\text{Area of gains}}{\text{Area of losses}}$$



Based on historical performance, the Omega ratio of the Seven5050 Index is **1.7**.

This means that over 12 months, the potential gain for investors holding this index in their portfolio was 1.7 times higher than any potential loss.

Ideally, investors should seek funds with a high Iso-Return point and a high Omega ratio.

SEVEN CAPITAL MANAGEMENT
39, rue Marbeuf 75008 Paris - France - Tel. +33 1 42 33 04 50
Société par Action Simplifiée SAS - Agréée par l'AMF N° GP 06000045 - Capital de 560 000 euros - RCS B 491 390 464
www.seven-cm.com

Our performance analysis criteria

3) Performance adjusted for maximum drawdown

At the beginning of this study, we defined maximum drawdown as being the real risk borne by the investor.

Maximum drawdown is the maximum historic loss that an investor may have suffered if they had invested in a fund at the worst time and sold their fund units at the worst time.

Unlike volatility, which measures the variability of returns, drawdown represents the true **ultimate risk** to which all investors are exposed when choosing to invest in a fund.

Although there is often a link between drawdown and volatility, this link in no way guarantees that a fund will not experience significant drawdown simply because it has low volatility.

It is precisely for this reason that we chose to start this study in January 2007: to properly evaluate funds that aim to protect investors' assets, it is essential that these funds have had the opportunity to demonstrate their aptitude to do so in a real market stress situation.

Without this information, it is not possible to evaluate a manager's degree of resistance to market turbulence – the length of a manager's track record is therefore an essential element in investors' decisions.

In this study, we have chosen to set our maximum target drawdown at -10%.

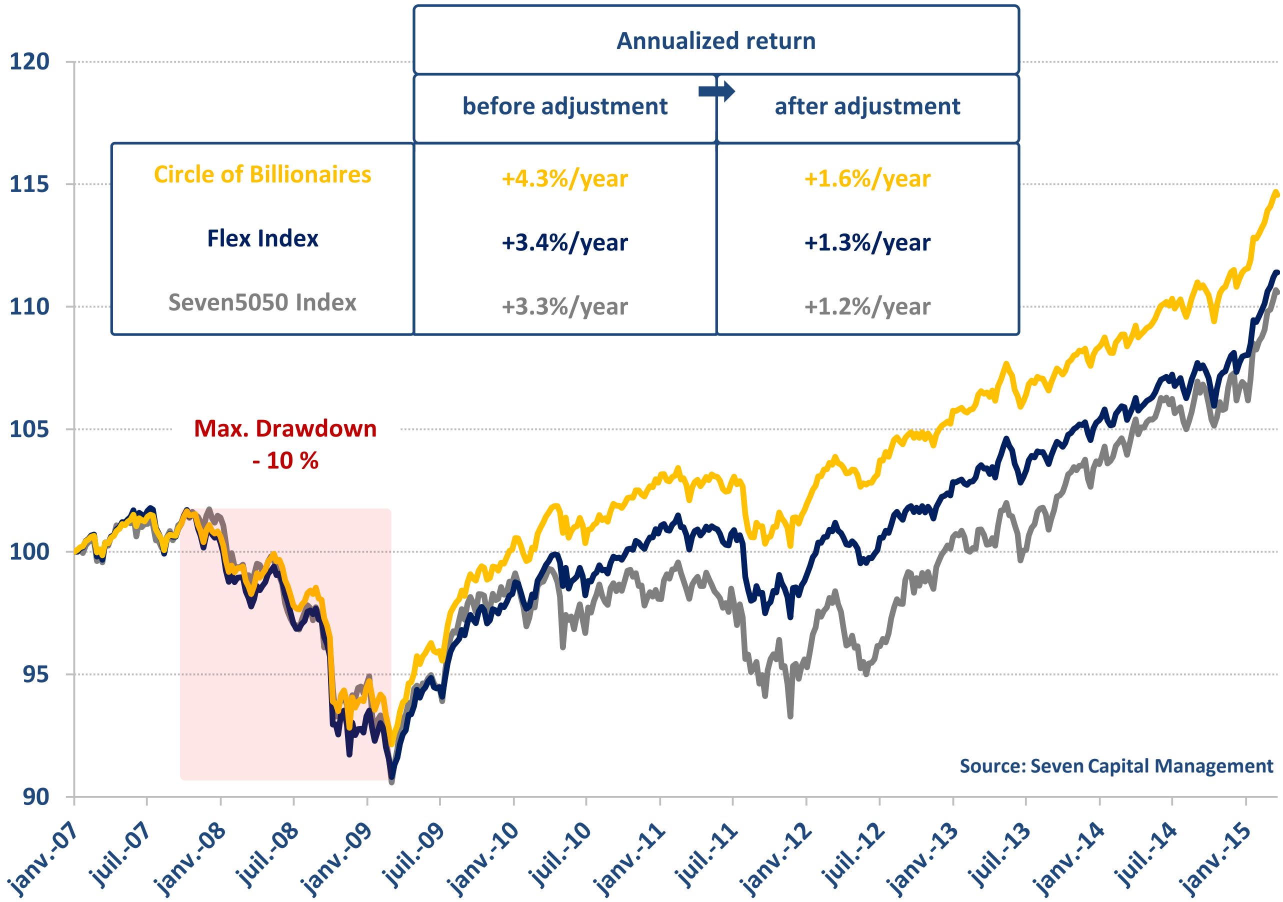
Knowing the maximum historic drawdown of the funds comprising our universe, we can make the necessary adjustments so that our -10% target is respected.

$$\%\ \text{of adjusted variation of max. drawdown} = \%\ \text{of variation} \times \frac{\text{Max. target drawdown}}{\text{Max. historic drawdown}}$$

Our performance analysis criteria

At an equivalent drawdown (-10%), the performance of our three indices can be compared, analyzed and classified in relation to one another.

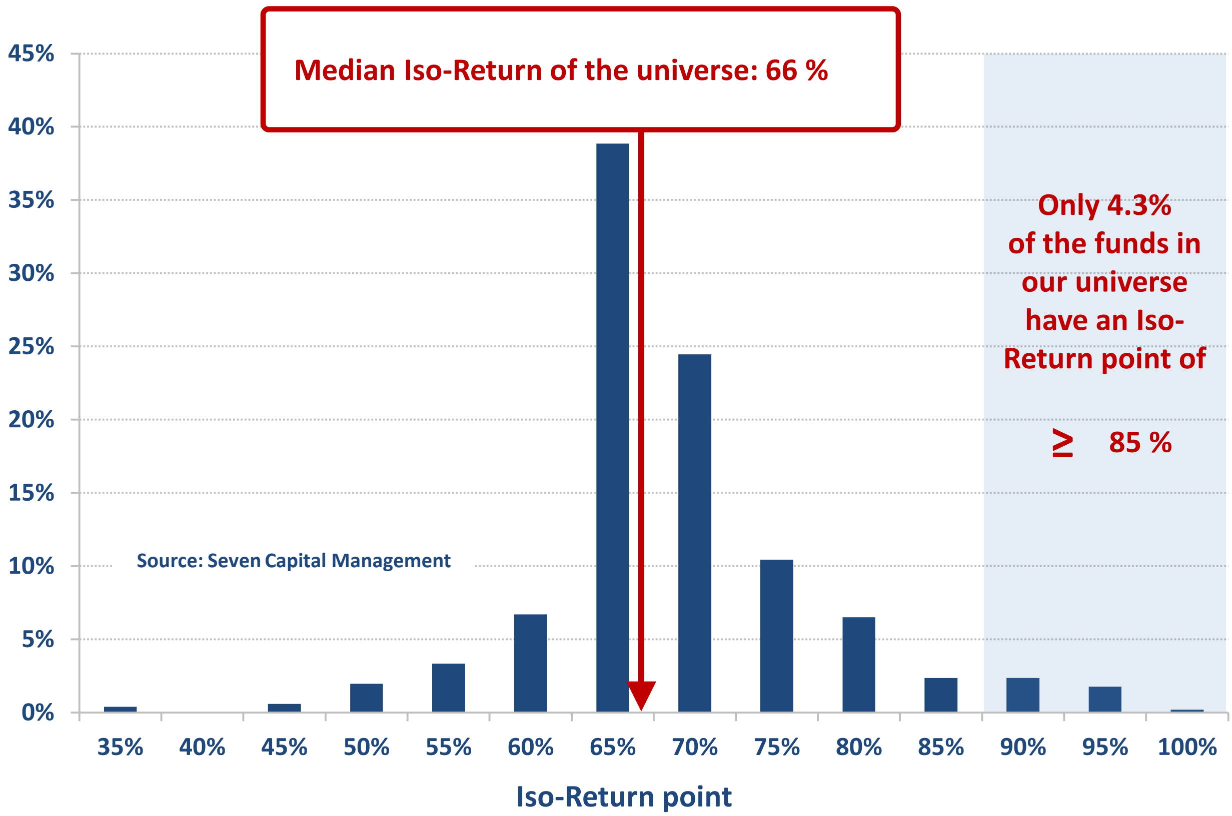
	Annualized return	
	before adjustment	after adjustment
Circle of Billionaires	+4.3%/year	+1.6%/year
Flex Index	+3.4%/year	+1.3%/year
Seven5050 Index	+3.3%/year	+1.2%/year



Setting all of the funds in our universe an equivalent target drawdown of -10% allows us to eliminate an unknown from our equation, as we now know, using an equivalent unit of risk, the standardized return produced by the manager over the analysis period.

A closer look at the flexible/diversified management universe

1) Iso-Return analysis



Iso-Return point

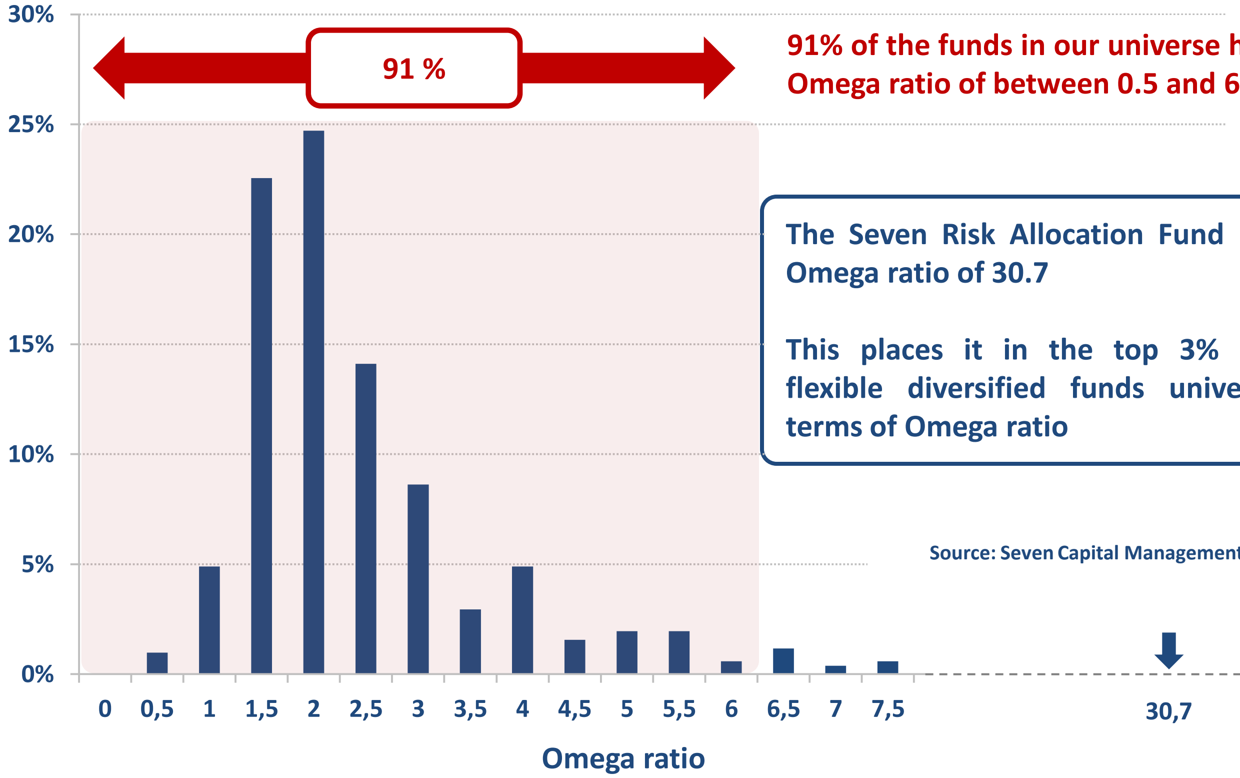
Seven Risk Allocation Fund	86 %
Circle of Billionaires	69 %
Flex Index	65 %
Seven5050 Index	58 %

Classification within the universe: 19th out of 507 funds

Over the period 2007–2015, an investor holding units in the Seven Risk Allocation Fund had an 86% change of obtaining a positive return over 12 months, compared to 69% for the Circle of Billionaires.

A closer look at the flexible/diversified management universe

2) Omega ratio analysis



91% of the funds in our universe have an Omega ratio of between 0.5 and 6.5

The Seven Risk Allocation Fund has an Omega ratio of 30.7

This places it in the top 3% of the flexible diversified funds universe in terms of Omega ratio

Source: Seven Capital Management

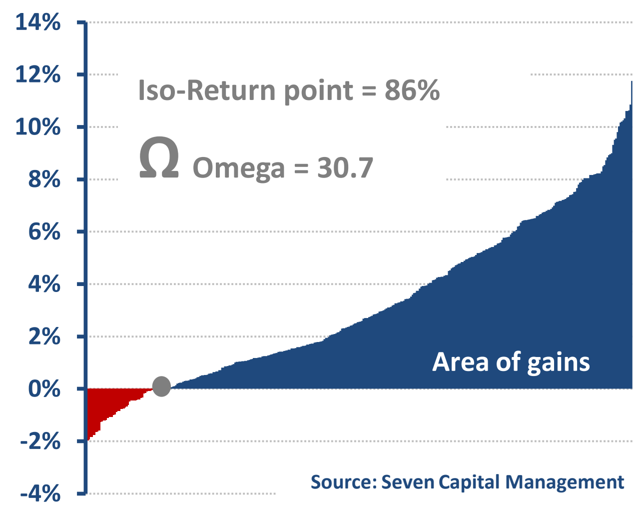
Omega ratio

Seven Risk Allocation Fund	**30,7**
Circle of Billionaires	**2.7**
Flex Index	**1.9**
Seven5050 Index	**1.7**
Median Omega of the universe	**1,9**

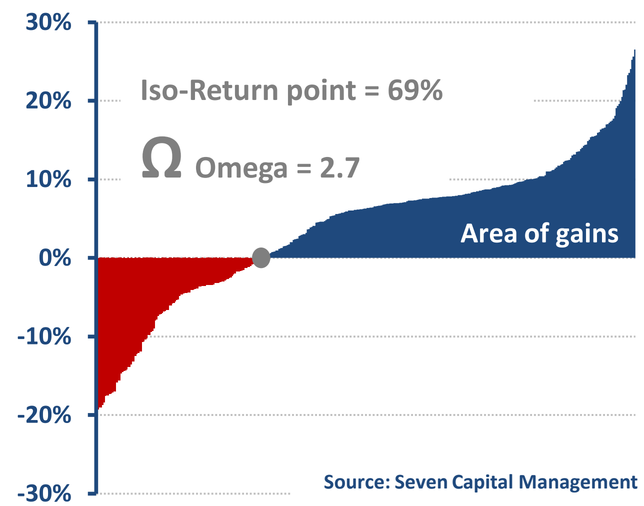
Classification within the universe: 14th out of 507 funds

A closer look at the flexible/diversified management universe

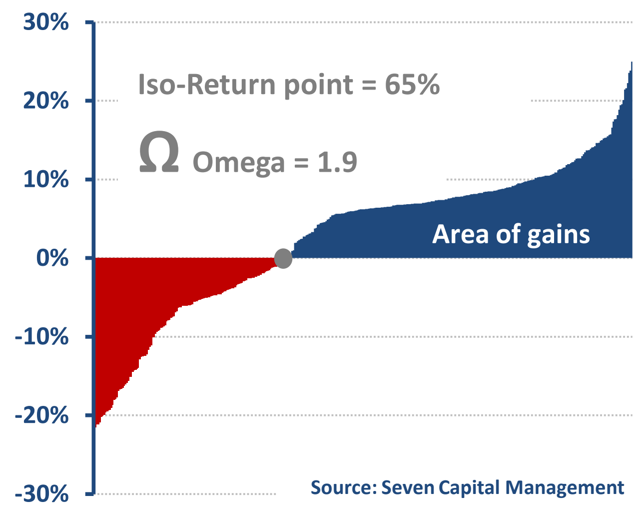
Seven Risk Allocation Fund



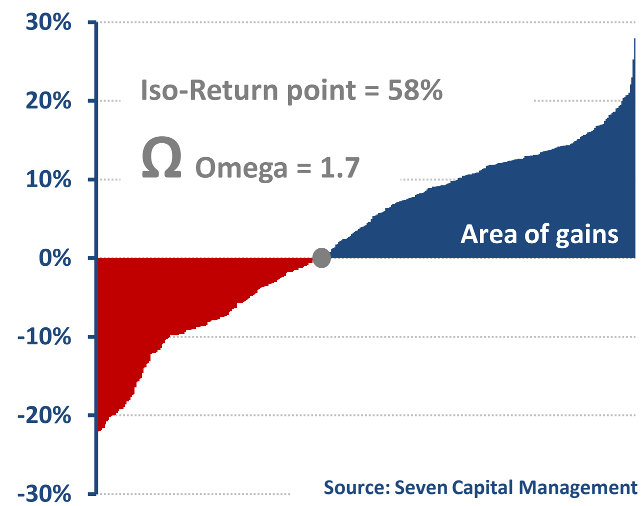
Circle of Billionaires



Flex Index



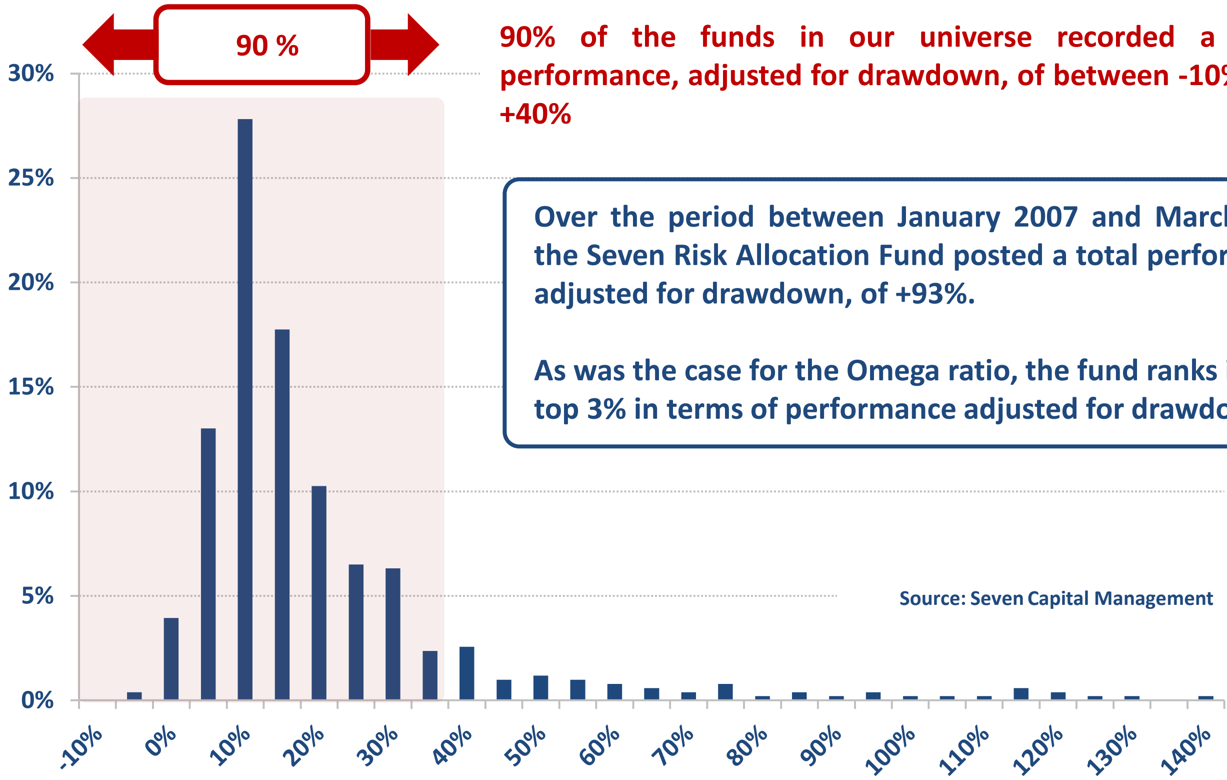
Seven5050



The excellent performance of the Seven Risk Allocation Fund in terms of Iso-Return and Omega ratio can be clearly seen from these four graphs. The Seven Risk Allocation Fund's Iso-Return point tends very heavily towards the left and the area of gains is much larger than the area of losses.

A closer look at the flexible/diversified management universe

3) Performance adjusted for drawdown (target: -10%)



90% of the funds in our universe recorded a total performance, adjusted for drawdown, of between -10% and +40%

Over the period between January 2007 and March 2015, the Seven Risk Allocation Fund posted a total performance, adjusted for drawdown, of +93%.

As was the case for the Omega ratio, the fund ranks in the top 3% in terms of performance adjusted for drawdown

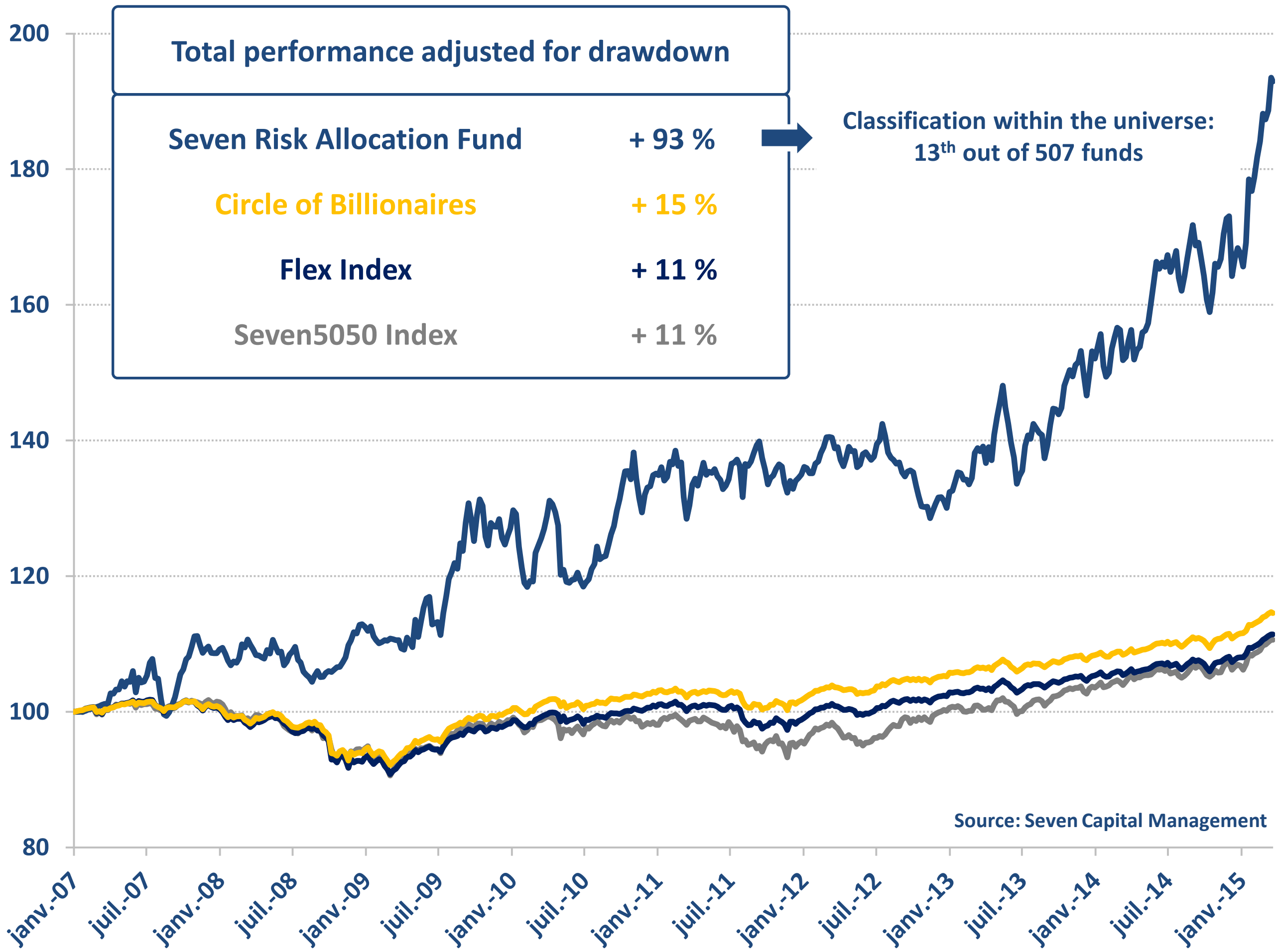
Source: Seven Capital Management

Performance using an equivalent unit of risk: drawdown of -10%

Seven Risk Allocation Fund	+ 93 %
Circle of Billionaires	+ 15 %
Flex Index	+ 11 %
Seven5050 Index	+ 11 %
Universe median	+ 11 %

Classification within the universe:
13th out of 507 funds

A closer look at the flexible/diversified management universe



The above graph illustrates the strong performance of the **Seven Risk Allocation Fund** versus the **Circle of Billionaires**, the **Flex Index** and the **Seven5050 Index** in terms of risk-adjusted performance (drawdown)

Although the **Circle of Billionaires**, the **Flex Index** and the Seven5050 **index** experienced their drawdown period at around the same time (the 2008 financial crisis), it is interesting to note that the **Seven Risk Allocation Fund** evolved fairly independently of our three comparison indexes during periods of market stress (the 2008 financial crisis and the 2011 European sovereign debt crisis).

Focus on the star funds of the flexible/diversified management universe

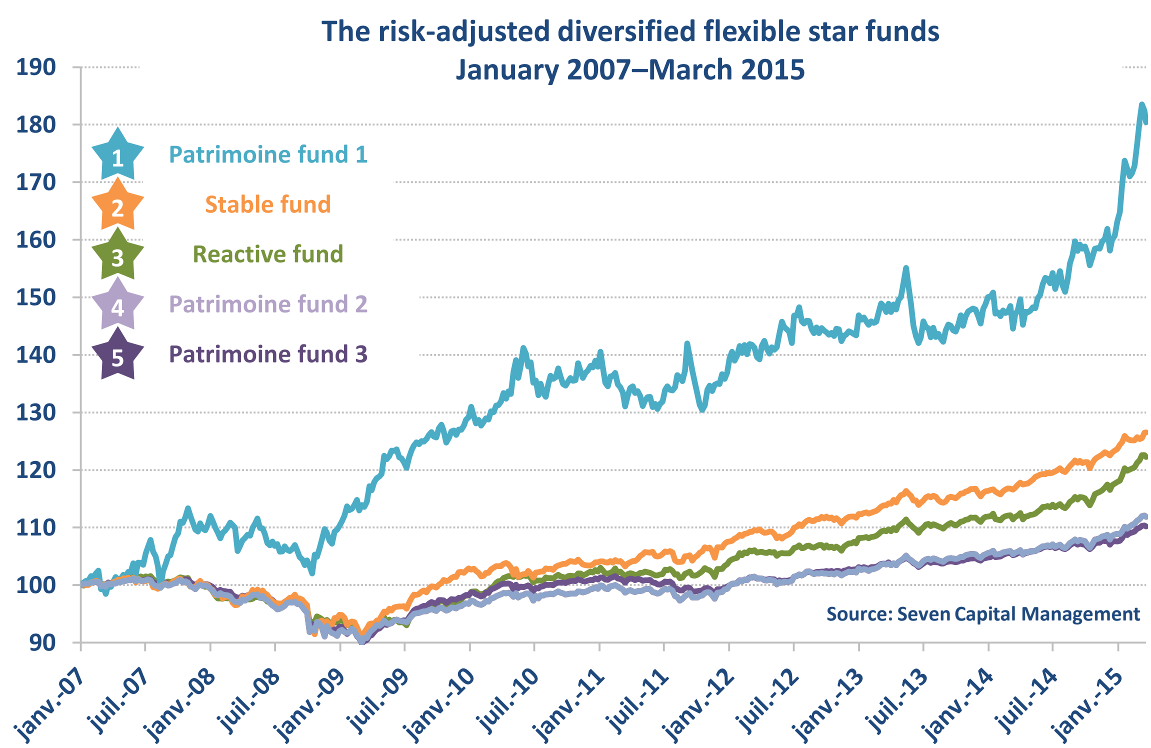
Our analysis of the performance of the flexible/diversified management universe would have not been complete without an analysis of funds approved by investors and observers in terms of inflows and awards.

We identified five “star” funds, of which the first four come top in terms of inflows (as at the end of February 2015), from a life insurance platform that many people know and use.

The last fund in our group of stars received the “Best EUR allocation fund” prize in 2015.

The management objective of these funds’ is very clearly advertised, with three of them containing the word **« Patrimoine »** in their name, another claiming to be **REACTIVE** and the last indicating that it aims to generate **STABLE** overall performance.

Finally, we have chosen to put our flexible diversified fund, the **Seven Risk Allocation Fund**, to the test by comparing it to these star funds , using our usual analysis framework:
Iso-Return/Omega ratio/risk-adjusted performance.



Focus on the star funds of the flexible/diversified management universe

Iso-Return analysis

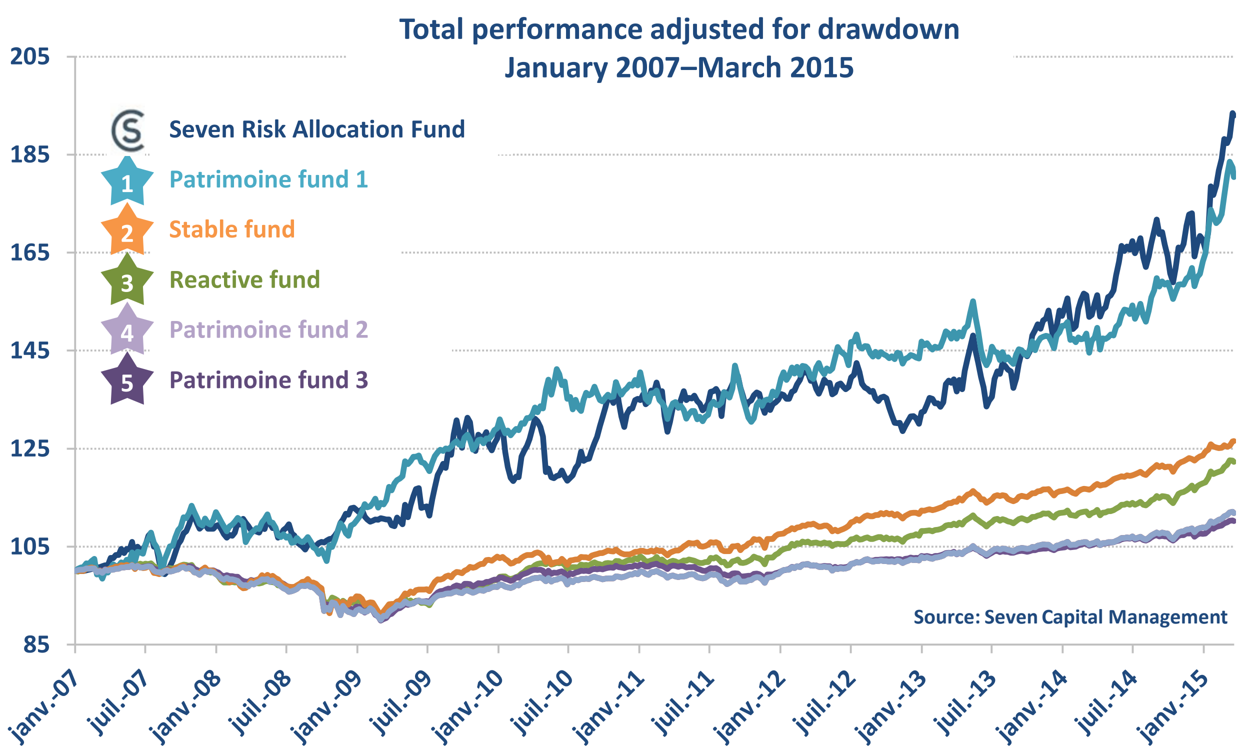
Iso-Return analysis		Classification within the universe
Seven Risk Allocation Fund	86 %	19th out of 507 funds
Patrimoine fund 1	81 %	30th out of 507 funds
Stable fund	78 %	40th out of 507 funds
Reactive fund	75 %	65th out of 507 funds
Patrimoine fund 2	69 %	135th out of 507 funds
Patrimoine fund 3	67 %	188th out of 507 funds
Median Iso-Return of the universe:	66 %	

Omega ratio analysis

Omega ratio analysis		Classification within the universe
Seven Risk Allocation Fund	30,7	14th out of 507 funds
Patrimoine fund 1	15,5	24th out of 507 funds
Stable fund	4,6	74th out of 507 funds
Reactive fund	3,3	117th out of 507 funds
Patrimoine fund 2	2,1	215th out of 507 funds
Patrimoine fund 3	2,0	234th out of 507 funds
Median Omega of the universe	1,9	

Focus on the star funds of the flexible/diversified management universe

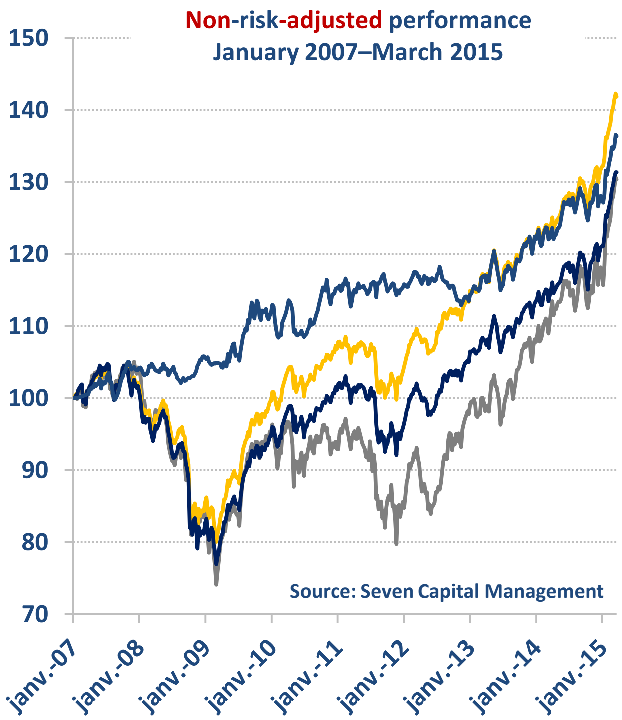
Analysis of performance adjusted for drawdown		Classification within the universe
Seven Risk Allocation Fund	+ 93 %	13th out of 507 funds
Patrimoine fund 1	+ 80 %	16th out of 507 funds
Stable fund	+ 27 %	93rd out of 507 funds
Reactive fund	+ 22 %	118th out of 507 funds
Patrimoine fund 2	+ 12 %	239th out of 507 funds
Patrimoine fund 3	+ 10 %	275th out of 507 funds
Universe median	+ 11 %	

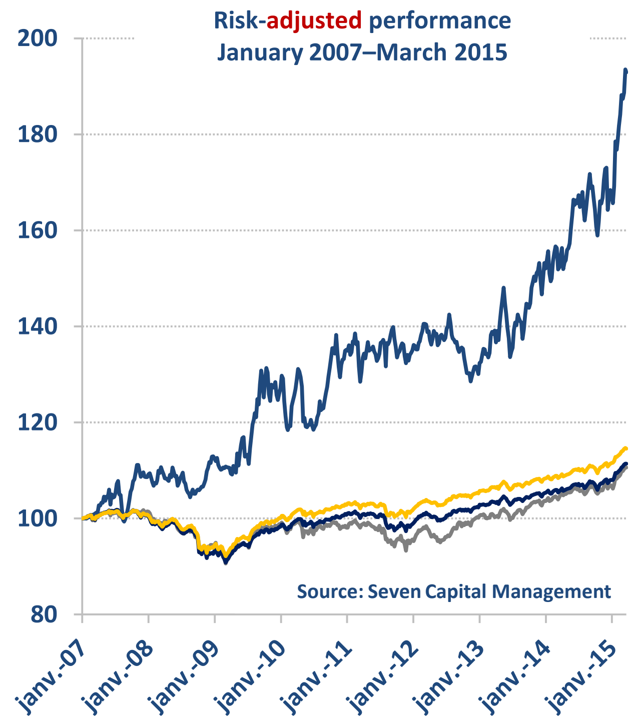


SEVEN CAPITAL MANAGEMENT
39, rue Marbeuf 75008 Paris - France - Tel. +33 1 42 33 04 50
Société par Action Simplifiée SAS - Agréée par l'AMF N° GP 06000045 - Capital de 560 000 euros - RCS B 491 390 464
www.seven-cm.com

Conclusion

While selecting funds based on performance constitutes an initial step, we believe that we have demonstrated in this study the relevance and necessity of conducting an analysis that goes far beyond this initial level of analysis.





Seven Risk Allocation Fund **Circle of Billionaires** **Flex Index** **Seven5050 Index**

The two graphs above are a perfect illustration of the weakness of an analysis based solely on performance.

On the left are the non-risk-adjusted performances of the **Seven Risk Allocation Fund**, the **Circle of Billionaires**, the **Flex Index** and the **Seven5050 Index.**

The risk-adjusted performances (equivalent unit of risk) are shown on the right.

The analysis based solely on performance, though advantageous for the **Seven Risk Allocation Fund**, does not highlight the very strong outperformance of the fund with an equivalent unit of risk.

SEVEN CAPITAL MANAGEMENT
39, rue Marbeuf 75008 Paris - France - Tel. +33 1 42 33 04 50
Société par Action Simplifiée SAS - Agréée par l'AMF N° GP 06000045 - Capital de 560 000 euros - RCS B 491 390 464
www.seven-cm.com

An **Iso-Return/Omega ratio/risk-adjusted performance analysis** confirms the quality of the management and performance of the **Seven Risk Allocation Fund**.

This is reflected in the fact that, against a universe of star competitors, the fund comes first irrespective of the analysis criteria.

As we know the classification of the fund for each of our analysis criteria, we can establish its overall rating within our diversified / flexible / mixed / balance / absolute return / income fund asset class.

The **Seven Risk Allocation Fund** came 19^{th} out of 507 in terms of Iso-Return, 14^{th} out of 507 in terms of Omega ratio and 13^{th} out of 507 in terms of risk-adjusted performance.

Based on this multi-criteria analysis, the fund is ranked 12^{th} out of 507 overall.

The manager with the most assets under management and considered one of the stars of our analysis universe came 23^{rd} out of 507, which, given its size, represents a great performance.

This multi-criteria classification system is valid for all asset classes and management methods, and the criteria used can be refined according to investors' needs (including excess Omega).

Investors seeking gross performance may be able benefit from the risk/reward profile of the **Seven Risk Allocation Fund** by using a "dynamic" version of it.

As the **Seven Risk Allocation Fund** only invests in **ultra-liquid** assets, the manager would have no difficulty in introducing a higher-risk version of the fund.

The systematic approach used by the manager also represents a guarantee of the consistency of the application of the management methods and compliance with the investor's desired risk budget.

Finally, in an economic environment characterized by the fund's increasingly low remuneration in euros, investors keen to find an alternative to this investment product will find that Iso-Return analysis is a particularly informative tool.

If the euro fund's key characteristic is its capital guarantee, replacing it must involve selecting funds with the highest Iso-Return from within the diversified management universe, as this criterion most closely resembles the notion of a capital guarantee.

SEVEN CAPITAL MANAGEMENT
39, rue Marbeuf 75008 Paris - France - Tel. +33 1 42 33 04 50
Société par Action Simplifiée SAS - Agréée par l'AMF N° GP 06000045 - Capital de 560 000 euros - RCS B 491 390 464
www.seven-cm.com

Notice:

This document was created by Seven Capital Management, a management company authorized by the French Financial Markets Authority (Autorité des Marchés Financiers – AMF) as a portfolio management company under number GP-06000045, whose registered office is located at au 39 rue Marbeuf - 75008 Paris, France.

This document was created for information purposes only and does not constitute an offer, a personalized recommendation or a solicitation to purchase the products or services presented. The investor alone shall judge the appropriateness of the transactions they may conclude.

Seven Capital Management shall not be held responsible for any investment or divestment decision taken based on the information contained on this site. The information, services and products presented are subject to change without prior notice.

Subscribing to units or shares of UCITS may present certain risks. UCITS are not guaranteed or protected, their net asset value may increase or decrease according to market fluctuations and investors may not recoup their invested capital.

Furthermore, before any transaction, investors must:

•familiarize themselves with the key investor information document and prospectus of each UCITS, understand the nature of the chosen investment, its characteristics and its risks

•ensure that the chosen investments are appropriate in terms of their financial position, investment objectives and the risks they are prepared to accept.

•Please note that past performance is not an indication of future performance. Past performance should therefore not form the main basis for subscribers' investment decisions: consideration must be given to other elements, detailed on the reporting sheets for each UCITS. The key investor information documents and prospectuses for the UCITS presented can be obtained from Seven Capital Management on written request or from the company's website at www.seven-cm.com

•Finally, the taxation to which any investment in units or shares of UCITS is subject depends on each investor's individual circumstances. Investors are therefore recommended to consult with their tax advisor.