



ACT Report Seeks to Answer the Questions That Matter Most to Clients

Promoting a deeper understanding of manager performance

May 2019

KEY INSIGHTS

- The ACT report provides insights for T. Rowe Price clients on their portfolio of active managers, forming part of our ongoing consultative engagement with clients.
- The report is designed to answer specific and relevant client questions in a clear and efficient way, by focusing on unique data visualizations rather than on laborious tables of data.
- The report provides an objective performance evaluation of each manager, shows what each manager has contributed to the portfolio, and displays their relationships with each other and insight into their appropriate sizing.

The T. Rowe Price's multi-asset solutions team believes in consultatively engaging clients to provide innovative solutions that address the various investment needs and challenges they face. As a principle, our work is not transactional, but rather is focused on longer-term, insight-led interactions. Our goal is to help our clients achieve their investment objectives.

As part of this engagement, the multi-asset solutions team has designed a process to provide clients with insights into their current holdings of active managers, a process that results in the ACT (alpha, correlation, and tracking error) report. The ACT report offers clients insight into the behavior, interaction, and sizing of their active managers, facilitating deeper conversations about their portfolios and investment objectives.

The ACT report is based on two foundational principles. First, it is a client-focused report designed to answer specific and relevant questions that matter to a client, as opposed to being a generic report providing generalized answers to common questions. Second, the report prioritizes insight over data, seeking to overcome the data overload problem clients face in today's information-heavy investment environment. The report's objectives are to help clients easily understand their portfolios and explore opportunities for enhancement.

Led by Client Questions

The first foundational principle of the ACT report is that it is designed to help clients understand the particular group of active managers of interest to them. This isn't a generic report produced in a vacuum, but rather is explicitly designed to be bespoke for each client, driven by the



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(Fig. 1) Alpha—Snapshot of Performance Analysis



Source: T. Rowe Price.

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client’s specific holdings and centered around answering specific questions.

The ACT report is best viewed as a library of insights that can be drawn upon to answer a client’s specific questions on the holdings of active managers in the client’s portfolio. For instance, some clients may be curious whether enough risk is being taken by their managers, while others may want to know whether their managers are being too defensive or too aggressive given their own market outlook. Others may want to examine the consistency of their managers’ excess returns, or seek ideas about how to create a more robust blend of uncorrelated alphas to generate more durable alpha. All of these questions, and more, can be answered within the ACT report’s framework, which begins with a proper

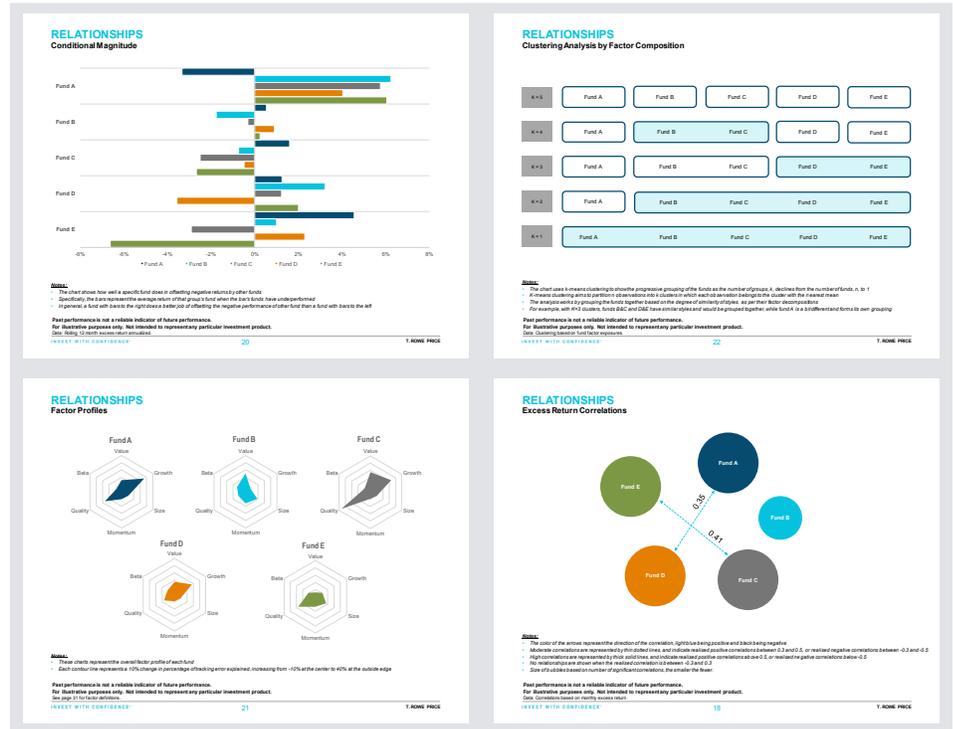
understanding of what questions the client is actually asking.

Providing Insight, Not Producing Data

The second goal of the ACT report is to provide actionable insights, which we believe are significantly more valuable than simply producing data. Today’s world, with its extraordinary computational capabilities and information availability, allows the generation of significant amounts of raw data with relative ease. The problem is that investors want answers to questions, not laborious tables of mind-boggling data. How to produce data that provide real insight? At T. Rowe Price, we have sought to address this problem in three distinct ways:

- The ACT report is question-led, not data-led. We neither produce

(Fig. 2) Correlation—Snapshot of Relationship Analysis



Source: T. Rowe Price.

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reports that are excessively long, nor produce information that isn't directly connected to answering a particular question. We seek to get the order right: First, clarify what questions are important to the client, then focus on the particular analysis that will best answer those specific questions. To avoid data fatigue, we carefully consider and scrutinize the additional information provided by each bit of analysis included in a report. We try not to answer a question in three different ways when one way will do.

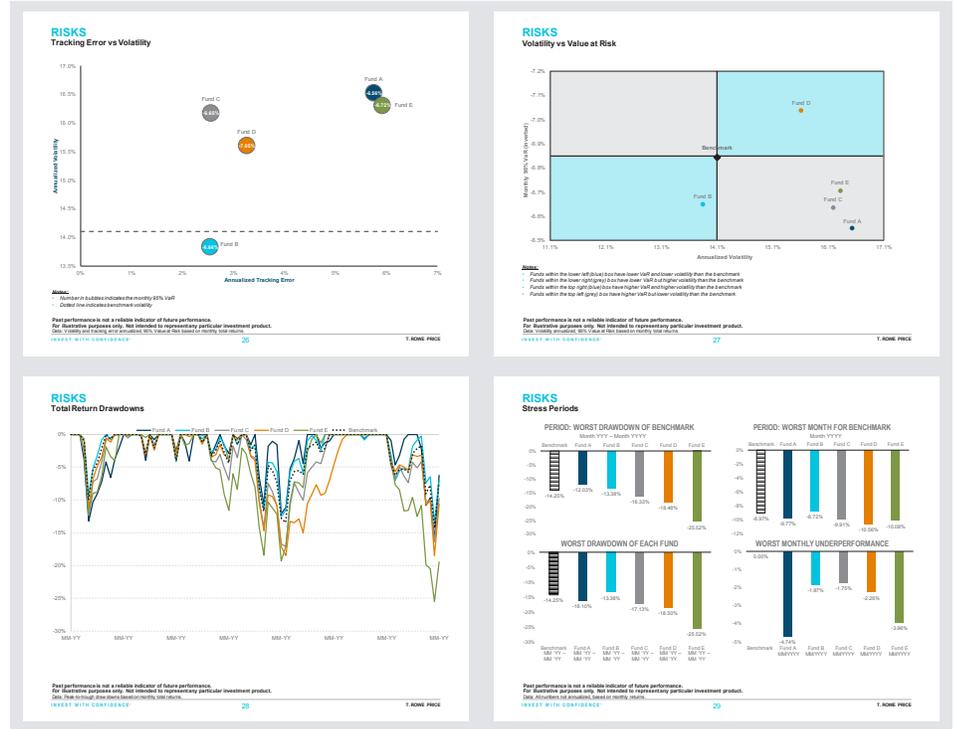
- We focus on data visualization as the means of communication versus generating endless tables of data. This is a key part of our process: Once we know the questions to answer and the specific analyses that address

them, we then focus on how to visually present relevant information in an efficient, compelling, and clear way. We believe this lucidity—which is often overlooked in investment reporting—is critical to effectively conveying insight to our clients.

- Finally, the ACT report is a supporting document and not the main event, which is the ongoing conversation between the client and us. These conversations are at the heart of engaging clients. The ACT report is designed to facilitate an interactive and constructive dialogue with clients on their portfolio of active managers, not a standalone document by itself.

The next sections briefly introduce the structure of the report and the types of analysis it can provide.

(Fig. 3) Tracking Error—Snapshot of Budgeting Analysis



Source: T. Rowe Price.

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Insights

While the ACT report is customized to answer specific client questions, the typical structure is based on three central themes:

- the characteristics of the strategies themselves;
- the relationships between the strategies; and
- the various risk aspects of the strategies.

The first section of the report focuses on the various characteristics of the strategies on a standalone basis. Among other items of interest, we look at performance across different time periods, the statistical distribution of each manager’s returns, the consistency of performance over time, manager

behavior in different market regimes, and the factor decompositions of the manager’s performance profile. Figure 1 provides a visual snapshot of how we present some of this information.

The second section of the report looks at the behavior of active managers in relation to each other. The focus is on both the direction and the strength of the relationship between the excess returns of different managers. For instance, a portfolio in which excess returns are all highly correlated is likely to have a more volatile excess return profile than a portfolio where alphas are lowly correlated.

While simple correlations are useful, we augment them both with similarity metrics (such as k-means clustering) and with conditional performance metrics to provide a different view of

how managers are or are not related. Figure 2 is a snapshot of some of the analysis included in this section.

The third and final section of the report explores the various risk aspects of the managers, focusing on both relative and absolute returns. Among other aspects, this section focuses on the relationship between the manager's volatility and tracking error, between the central part of the risk distribution and the tails of the distribution, and among the various types of drawdowns. Figure 3 provides a snapshot of some of the analytical work in the tracking error section.

Conclusions

The ACT report is designed to provide T. Rowe Price clients with insights into their portfolios of active managers, helping us to have more informed conversations with them. Importantly, the ACT report isn't linked to any particular product. It is a tool for informed conversations, not a sales aid. The ACT report forms part of a broader process of engagement with our clients undertaken by the multi-asset solutions team. Our goal is to use the ACT report as part of our toolkit of investment analytics, products, and strategies to help our clients achieve their investment objectives.

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