The NEI Investments Asset Allocation Process:
Committed to Success Through Active Management
INVESTMENTS DONE DIFFERENTLY

Asset allocation is one of the most fundamental decisions any investor can make. How you allocate capital among different investment types, asset classes or manager styles can have a significant impact on both the risk and reward of a portfolio.

Effective asset allocation demands investment experts with both an intimate knowledge of the investment tools at their disposal, as well as how those tools can best work together. This is where we believe NEI Investments has a distinct advantage. NEI’s in-house Asset Allocation Team combines deep expertise in asset allocation with an intimate understanding of our roster of third party fund managers gained through NEI’s proprietary Portfolio Manager Selection and Monitoring Process.

The result is a high degree of applied asset allocation expertise unique to NEI Investments.
GUIDING PRINCIPLES

When making asset allocation decisions to build and adjust portfolios, NEI adheres to five core investment principles. These principles direct the way we conduct our asset allocation decisions and are of paramount importance in our effort to deliver value to investors.

1. Truly active management
   We believe achieving superior returns requires efficient, active allocation of capital. And we believe this is achieved at two levels:
   - At the fund level, NEI’s portfolio managers are selected for their distinct, diverse and proven active management approaches.
   - At the portfolio level, NEI aims to efficiently allocate capital among managers and asset classes at both strategic and tactical levels.

2. Prominent portfolio managers
   NEI’s experienced third party portfolio manager network allows the team to cast a wider net and tailor specific portfolio needs to asset class managers from around the world.

3. Focus on managing the risk of losing money
   NEI defines risk as the chance of losing money over the long term. Our asset allocation approach is clearly aligned with this belief by focusing on maximizing opportunities while minimizing risks in accordance with our funds’ investment objectives.

4. Rigorous oversight & risk management
   NEI conducts an ongoing review of performance, operations, and market conditions and maintains an understanding of the true underlying exposure of all NEI funds. The information gleaned from this process drives asset allocation decisions.

5. Add the value of Responsible Investing
   NEI believes that adhering to the principles of responsible investing can help mitigate risk and add value. Environmental, Social, and Governance (ESG) factors are incorporated into risk and company selection decisions.
NEI'S ACTIVE MANAGEMENT FRAMEWORK

**Active Asset Allocation.**
NEI’s internal Asset Allocation Team actively manages the asset mix of our portfolios developing strategic asset allocation guidance and executing tactical shifts to take advantage of changes in the markets.

**Active Portfolio Manager.**
NEI uses third party sub-advisors to manage our funds. All are quality, global wealth managers with a wide spectrum of portfolio management experience.

**Active Oversight.**
NEI’s Portfolio Management Team uses a rigorous oversight process to carefully select and monitor our investments and market conditions.

Combining top-down and bottom-up
THE NEI APPROACH TO ASSET ALLOCATION

Rather than simply focusing solely on returns, investors must also be cognisant of how much risk they are taking to achieve those returns. A multi-asset portfolio takes advantage of the unique risk/return characteristics of each asset class, as well as correlations (or lack thereof) between each asset class in an effort to achieve optimal risk/return characteristics superior to that of investing in a single asset class.

Unencumbered by restrictions, the NEI Asset Allocation Team meets frequently as part of the unique asset allocation method to support a stringent process of deep fundamental analysis. Using this distinctive approach, our goal is to offer outperformance during the boom years, but more importantly, offer downside protection during the bust years.

NEI’s approach to asset allocation consists of two integral components:

- Strategic Asset Allocation (SAA)
- Tactical Asset Allocation (TAA)

SAA aims to optimize a multi-asset portfolio for a long-term 3-5 year investment horizon. TAA is then overlaid to take advantage of short-term market dislocations by making temporary adjustments to the SAA asset mix. With an investment time horizon of anywhere between 1-6 months, TAA brings an active approach to managing a multi-asset portfolio.

A portfolio’s strategic asset mix is reviewed annually while tactical asset allocation decisions are made as opportunities or market conditions dictate. As the portfolios are monitored and rebalanced on a daily basis, this diligent approach brings the portfolio’s asset mix back to target by selling outperforming asset classes while buying underperforming assets (selling high and buying low).
Four Steps to Strategic Asset Allocation (SAA)

STEP 1: DEFINE RISK AND REWARD

All solutions overseen by the NEI Asset Allocation Team are optimized for risk and reward. The team’s definition of reward is conventional: earning positive returns on investments. However, the team’s definition of risk as ‘the probability of losing money long term’ differs from the traditional definition of ‘the variability or volatility of an asset’. Viewed this way, risk is not dictated by negative or positive price swings, but measured by Conditional Value-at-Risk (CVaR), which assesses the total chance of losing a certain amount of money in a single variable.

In quantifying risk for professional management purposes, we believe CVaR is superior to standard deviation:

A) Standard deviation assumes investors care about volatility when, in reality, they care more about losing money.

Redefining Risk: Why standard deviation is not necessarily the best measure

<table>
<thead>
<tr>
<th></th>
<th>Investment A</th>
<th>Investment B</th>
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<tbody>
<tr>
<td>Average Return</td>
<td>10.4%</td>
<td>-3.0%</td>
</tr>
<tr>
<td>Standard Deviation</td>
<td>6.2%</td>
<td>1.5%</td>
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</tbody>
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In this illustration Investment A has a larger variance of returns and larger standard deviation, making it appear to be more risky than Investment B. Yet Investment A consistently outperforms.

B) Using standard deviation as a risk measure assumes that investment returns fall under a normal distribution (blue line curve). In reality, markets can behave more like the green line curve, where extreme positive or negative returns occur more often. Returns are considered extreme when the probability of such an event under a normal distribution is near impossible, but happens anyway.

Since positive returns are always welcome, when the team optimizes portfolios using CVaR, they aim to minimize any returns that could fall to the left of the fat tail (grey dotted line).
STEP 2: BUILD CAPITAL MARKET ASSUMPTIONS

SAA requires long-term risk and reward assumptions for each asset class. As historical risks tend to forecast future risks reasonably well, the team uses a wide range of historical data to estimate risks and their correlation within each asset class. For equity asset class returns the team uses the Black-Litterman model\(^1,2\), which allows the team to combine their own views on asset class returns with the long-term market equilibrium. For fixed income asset classes, the team adds market term premiums and credit premiums to the market risk-free rate to arrive at long-term return expectations.

STEP 3: CREATE AN EFFICIENT FRONTIER

After establishing risk and reward expectations for each asset class, the team then models these characteristics, and through an optimization process, creates an efficient frontier of asset mixes. Each asset mix profile on the efficient frontier represents an ideal asset mix that has the potential to generate the highest expected return at the portfolio’s level of risk tolerance.

STEP 4: PORTFOLIO CONSTRUCTION

We believe that adopting a multi-manager approach is the most effective structure for a multi-asset portfolio as it allows efficient separation of asset allocation and security selection functions. The top level manager – the NEI Asset Allocation Team – has the flexibility to move between various portfolio sleeves while the underlying managers specialize in selecting the best securities.

At the underlying fund level, because NEI employs actively managed funds in all core portfolios, there is a second potential source of alpha in addition to asset allocation.

Four Steps to Tactical Asset Allocation (TAA)

STEP 1: DISCOVER AND PROCESS NEW INFORMATION

NEI analyzes ever-changing market conditions using proprietary economic, sentiment, and valuation factors to identify new risks and opportunities. Based on this information, and where deemed appropriate, the team will tactically adjust the asset mix to capitalize on short-term opportunities.

This first step of TAA looks at markets through 3 complimentary dimensions:

A) Economic
An understanding of the current economic environment is required to capitalize on potential tailwinds. By keeping abreast of changes in government and central bank policies and economic growth prospects, the team can understand how certain asset classes, sectors, and industries can become more or less favourable from the changing economic environment.

B) Sentiment
Market sentiment is the overall attitude of investors towards particular securities or market segments and is often the primary driver of market direction on a day-to-day basis. Investors must be quick to act on these rapid market swings, whether it be to take a prudent approach and wait for further events to unfold, ride the wave to capture opportunity, or make a contrarian call and exit a crowded trade.

C) Valuation
Valuation analysis reflects the current market price of an asset class. The team would typically overweight an asset class when valuations are cheaper and underweight an asset class when valuations look more expensive. In the event that valuations hit extreme levels, a contrarian call may be justified as extreme valuations are generally unsustainable.

While each dimension is influenced by different factors, it is crucial to consider all three holistically in the TAA process. Economic tailwinds can prop up asset prices, and understanding where we are in the economic cycle can identify additional upside potential even when valuations look quite expensive or market participants show negative sentiment.

STEP 2: RESEARCH REVIEW

New market information is priced in to varying degrees and different markets depending on the efficiency of that market. The team conducts a thorough review by combining internal and external research to ensure the information gathered can provide indications of the current market conditions and insight into future market behaviour.

STEP 3: DETERMINE APPROPRIATE TACTICAL SHIFTS

Based on the analysis and research, the team determines asset allocation targets and implements those targets within the portfolios based on logical judgment and degree of conviction.
STEP 4: CONSTANT MONITORING

New information over time can sharply change market dynamics that drive investment returns. The market requires constant monitoring.

Market participants face a constant stream of new information, which is reflected (or priced in) to different degrees in different markets depending on the efficiency of that market. New information can indicate current market conditions as well as provide insight into future market behaviour. As markets can be very dynamic, we must be constantly monitoring and digging for new information. Once this information is priced into the market, the team returns the asset mix to its strategic allocation.
Success Through Active Asset Allocation

We truly believe that an active approach is necessary to optimize a portfolio's risk and reward profile. While the long-term focus is always the strategic goal of the investor, ever-changing markets provide opportunities that shouldn’t be ignored.

Using an intricate asset allocation process, the NEI Asset Allocation Team strives to blend both strategic and tactical factors into high quality investment portfolios optimized for today’s market conditions.