



The Investment Conundrum: Active, Passive, and Other Investment Solutions



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A JANUS CAPITAL Group Company

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- Global financial crisis has eroded an unprecedented amount of wealth.
- Investors need positive excess returns/alpha.
- But picking the right manager is difficult.
- Gaining an information advantage in large developed markets is difficult.
- Predicting which currency, sector, country will outperform is very difficult.
- Volatility – friend or foe?

- 2008 was a shock to the system.
- Many funds have been sitting on their hands.
- Interest in passive equity investing is way up.
 - Eliminates underperformance risk.
 - Sounds like a “safe” thing to do.
 - Active management is often disappointing.

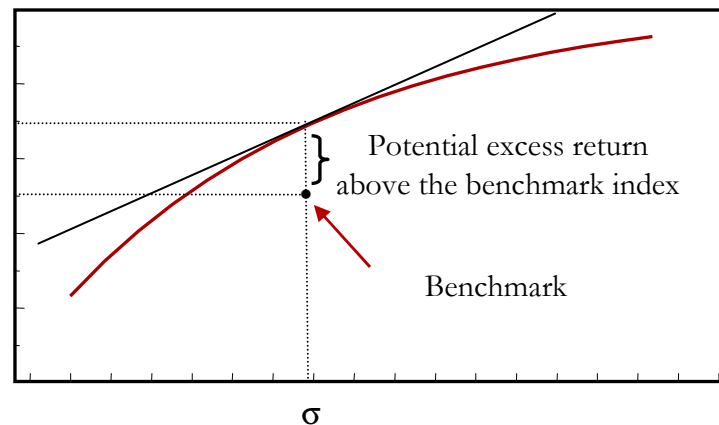
If the current challenges are too great, should we just index?

- Actively managed equity funds saw net outflows of 6% in 2008*.
- Index fund inflows grew at a 7% rate in 2008*.
- Exchange-traded products captured record US\$176 billion in 2008**.
- Asian institutional investors are increasingly looking towards passive investing and have started to reallocate assets accordingly per a recent Greenwich Associates survey.

*Source: The Future of Money Management, Empirical Research 1/30/09

**Source: Strategic Insight Mutual Fund Highlights

- An efficient market is not the same thing as an efficient portfolio.
- A passive index gives little consideration to covariance.
- Covariance is the critical element in Markowitz's theory.
- A cap-weighted benchmark is unlikely to be an efficient portfolio.



There is no theoretical impediment to creating a portfolio with market-like risk and above-market expected return.

- It's the investment process that matters.
- Chasing performance is a dangerous game.

Suppose you have 1 good manager and 20 bad managers, each with a 10-year track record.*

	<u>Good Manager</u>	<u>Bad Manager</u>
True Relative Return:	200 bps/year	0 bps/year
True Tracking Error:	800 bps/year	1,000 bps/year
True Information Ratio:	0.25	0.00

- What is the probability the good manager will have a higher cumulative return than all of the bad managers?

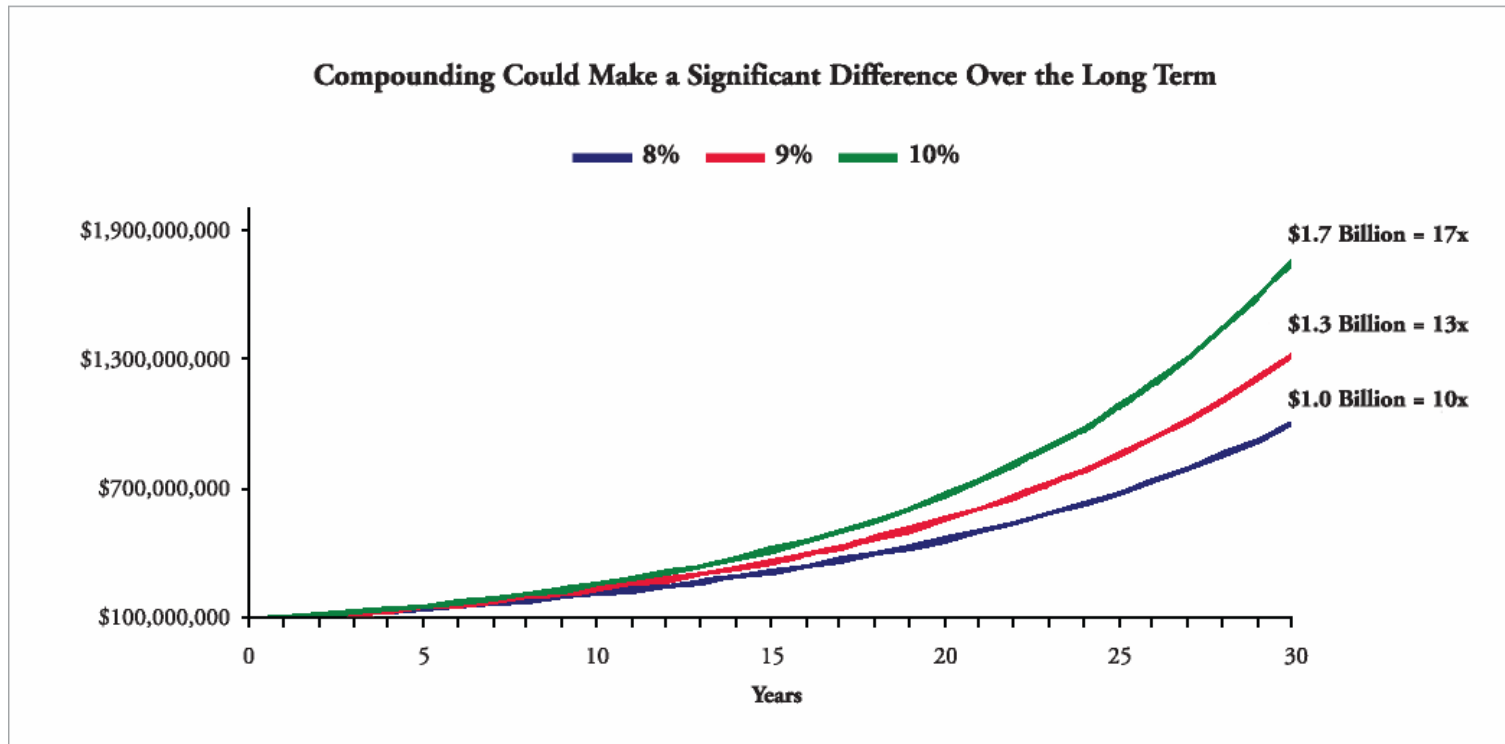
- **Answer:** 9.6%.

- Suppose the investor always hires the manager with the best 10-year cumulative relative return.
 - Invests with the good manager 10% of the time.
 - Invests with a bad manager 90% of the time.
 - Average relative return: 19.3 bps/year.
 - Average tracking error: 980.7 bps/year.
 - Effective information ratio: 0.024.

Choosing managers by cumulative relative return is a dangerous game.

- Low nominal returns are expected by many market participants for the foreseeable future.
- Many pension funds are facing significant under funding due to poor returns.
- Many investors are fearful of investing though, as they have experienced a major reduction in portfolio assets.
- Expansion into alternative investments and hedge funds generally have capacity and fiduciary constraints along with other risks.

The 1% Difference

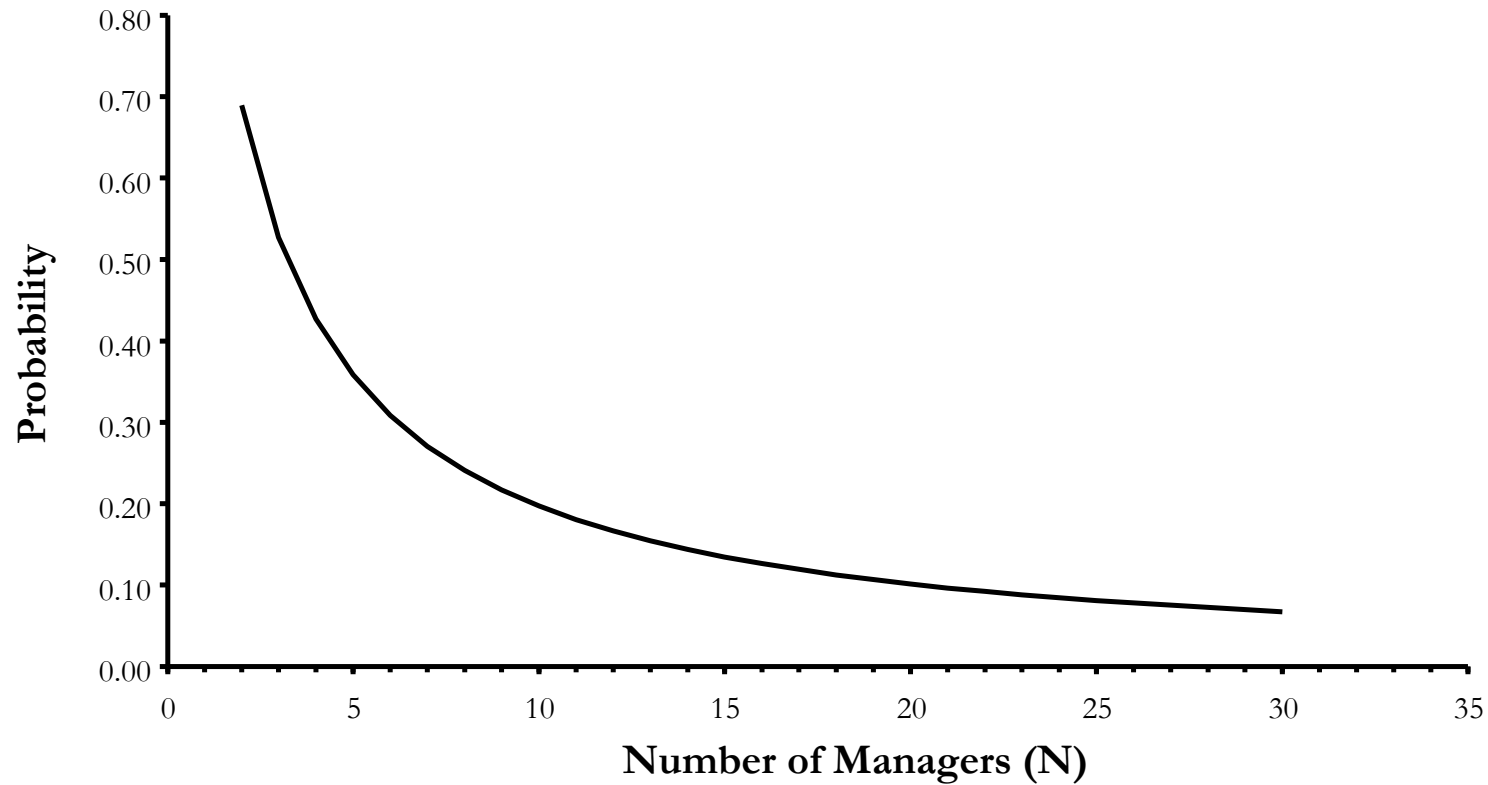


The chart illustrates the growth of a hypothetical \$100 million for 30 Years at 8%, 9% and 10%, and does not represent the returns of any particular investment.

- Adding just 1% in excess return, yields \$1.3 billion at the end of 30 years or 13 times the original investment.
- An excess return of 2% yields \$1.7 billion or 17 times the original \$100 million investment

Enough Bad Managers Always Beat the Good Manager

Probability That Manager 1 Beats Managers 2 to N



	Manager 1	Managers 2 to N
Mean relative return (annual, decimal):	0.02000	0.00000
Standard deviation of relative return (annual, decimal):	0.08000	0.10000
Information ratio:	0.25000	0.00000
Time horizon (years):	10	

Hypothetical illustration based on the assumptions shown above.

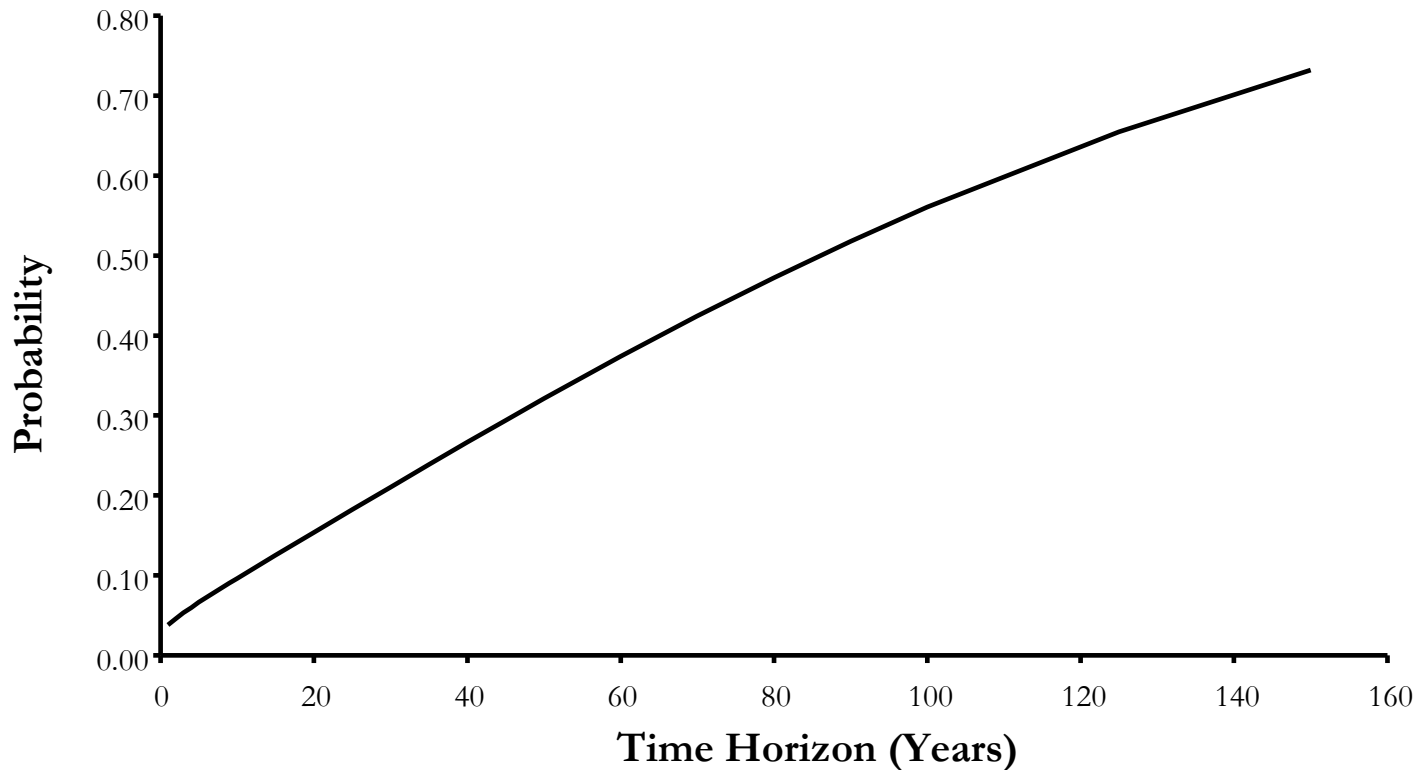
It Takes Forever for the Good Manager To Stand Out From the Bad Managers

- 1 good manager, 20 bad managers.
- Desired probability that the good manager beats all 20 bad managers: 75%.
- Required number of years in the historical records: 157 years.

**Choosing managers by cumulative
relative return is a dangerous game.**

It Takes Forever for the Good Manager To Stand Out From the Bad Managers

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	Manager 1	Managers 2 to N
Mean relative return (annual, decimal):	0.02000	0.00000
Standard deviation of relative return (annual, decimal):	0.08000	0.10000
Information ratio:	0.25000	0.00000
Number of managers:	21	

**Choosing managers by cumulative
relative return is a dangerous game.**

But Which Manager Can Provide Alpha?

- It is difficult to differentiate skill versus luck.
 - Unskilled managers with good performance may have been lucky.
 - Skilled managers with mediocre performance may have been unlucky.

- Historical returns potentially can be an unreliable guide to future returns.
 - Market factors can impact performance.
 - For example, all managers tend to be sensitive to changes in Diversity, which measures the traditional size effect, or returns of large vs. small stocks.

Active vs. Passive: The Conundrum Summarized

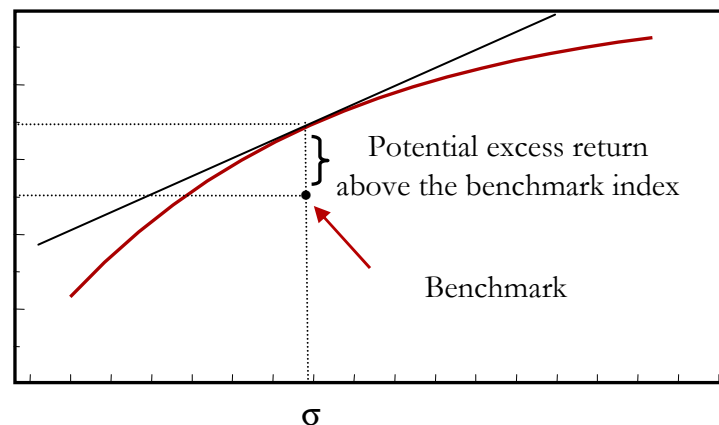
PASSIVE		ACTIVE	
Strengths	Weaknesses	Strengths	Weaknesses
<ul style="list-style-type: none"> •Low cost •Implementation Efficiency (Low turnover; trade costs, liquidity) •Consistency of returns (you are supposed to 'get the market') •Difficult to beat net of fees •'Safe' choice for decision makers and plan sponsors 	<ul style="list-style-type: none"> •Aggregate of the market •No potential for excess return •Cap weighted benchmarks are inefficient •Subject to market fads •Net of fees, typically underperforms index it is tracking 	<ul style="list-style-type: none"> •Potential for above market returns •Potentially more efficient portfolio than passive •Opportunity to avoid market fads •Can be critical in low-return environments •Compounding positive relative returns can be a powerful advantage over the long term 	<ul style="list-style-type: none"> •Generally higher cost •Difficult to identify managers who can consistently outperform •Potential for periods of large underperformance •Requires patience and long-term perspective •Additional due diligence

The Conundrum: Is There a Solution?

- An equity strategy that can generate alpha.
- An equity strategy that can generate alpha at relatively low tracking error.
- An equity strategy that can achieve a high information ratio.
- An equity strategy that has a high probability of avoiding large relative losses.

A More Efficient Portfolio Than the Market?

- An efficient market is not the same thing as an efficient portfolio.
- A passive index gives little consideration to covariance.
- Covariance is the critical element in Markowitz's theory.
- A cap-weighted benchmark is unlikely to be an efficient portfolio.



There is no theoretical impediment to creating a portfolio with market-like risk and above-market expected return.

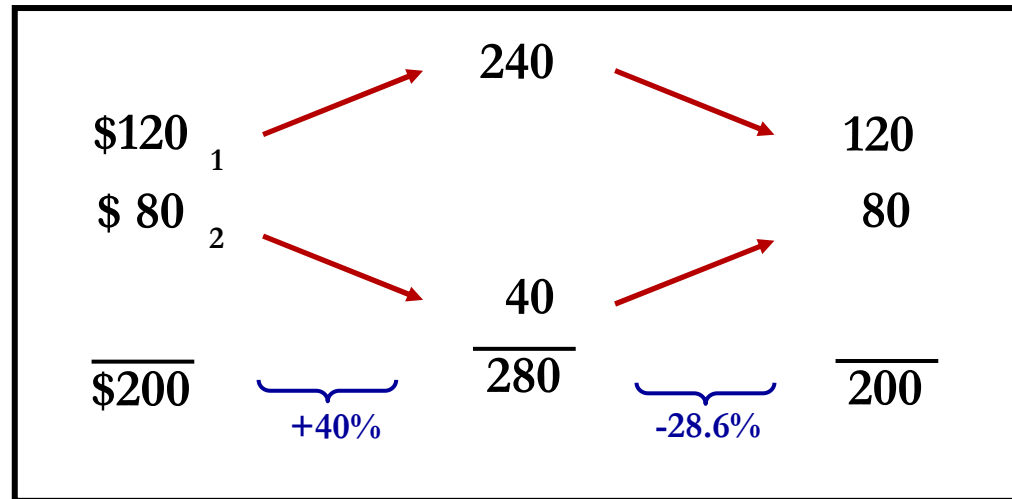
WE BELIEVE WE CAN ADD VALUE USING NATURAL STOCK PRICE VOLATILITY THROUGH A **MATHEMATICALLY** BASED, RISK CONTROLLED PROCESS

- **VOLATILITY CAPTURE**
INTECH does not pick individual stocks or forecast stock alphas, but uses natural stock price volatility and correlation characteristics to attempt to generate an excess return. Essentially, INTECH adjusts the cap weights of an index portfolio to potentially more efficient combinations.
- **RISK MANAGED**
Risk management is at the heart of INTECH's investment process.
- **STYLE CONSISTENCY**
Structured process results in virtually no style drift.

How INTECH's Process "Captures" Volatility

PASSIVE PORTFOLIO

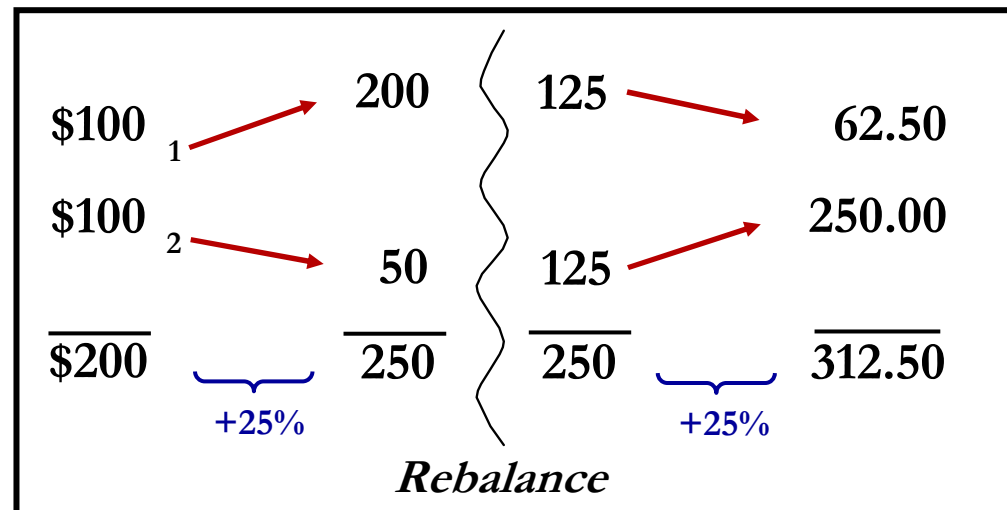
- Passive portfolio produces no net gain. Stocks have volatility, but opportunity to generate excess return has not been captured.



Compound Return = 0%/Period

INTECH PORTFOLIO

- INTECH applies its mathematical formula to establish potentially more efficient weights. Dynamic process of maintaining and re-establishing those weights produces the potential excess return.



Compound Return = 25%/Period

Criteria for hypothetical illustration: two-stock portfolio, perfect negative correlation, move by a factor of two. Mathematically, a 50%/50% target weighting for a two-stock portfolio with equal growth rates maximizes long-term return. The hypothetical illustrations shown are provided to demonstrate INTECH's trading process and how relative volatility can be captured. Trading costs and other expenses have not been considered.

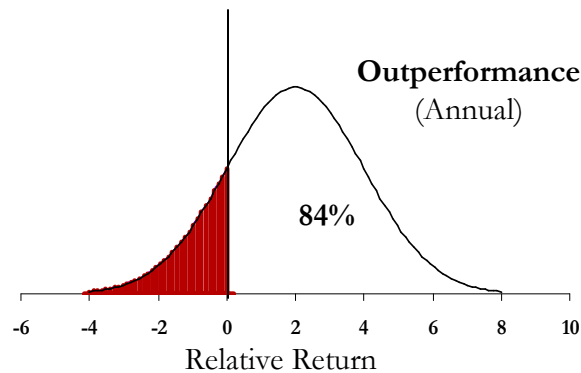
INTECH strives to:

- Identify potentially more efficient weightings of the stocks in a benchmark index, utilizing a specific mathematical optimization and disciplined rebalancing routine.
- Eliminate stocks that do not increase excess return or reduce tracking error.
- Maximize the information ratio.

High information ratios, over the long term, suggest a significant amount of risk control relative to excess return and a higher probability of outperformance over time.

Why Information Ratio is So Important

- The ratio of Relative Return to Tracking Error.
- A good measure of portfolio efficiency in broad-based strategies.
- Measure of consistency of relative returns – how often, on average, is the portfolio likely to outperform?

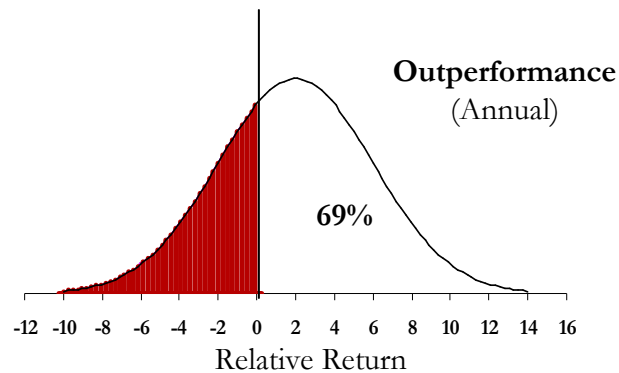


Manager A

Information Ratio: 1.0

% of distribution < 0: 16%

Average frequency of underperformance: 1 year in 6

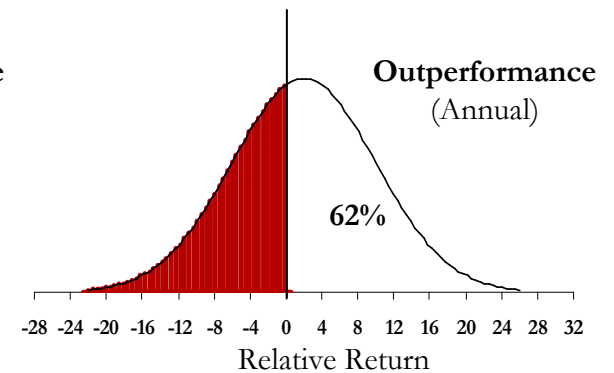


Manager B

Information Ratio: 0.5

% of distribution < 0: 31%

Average frequency of underperformance: 1 year in 3



Manager C

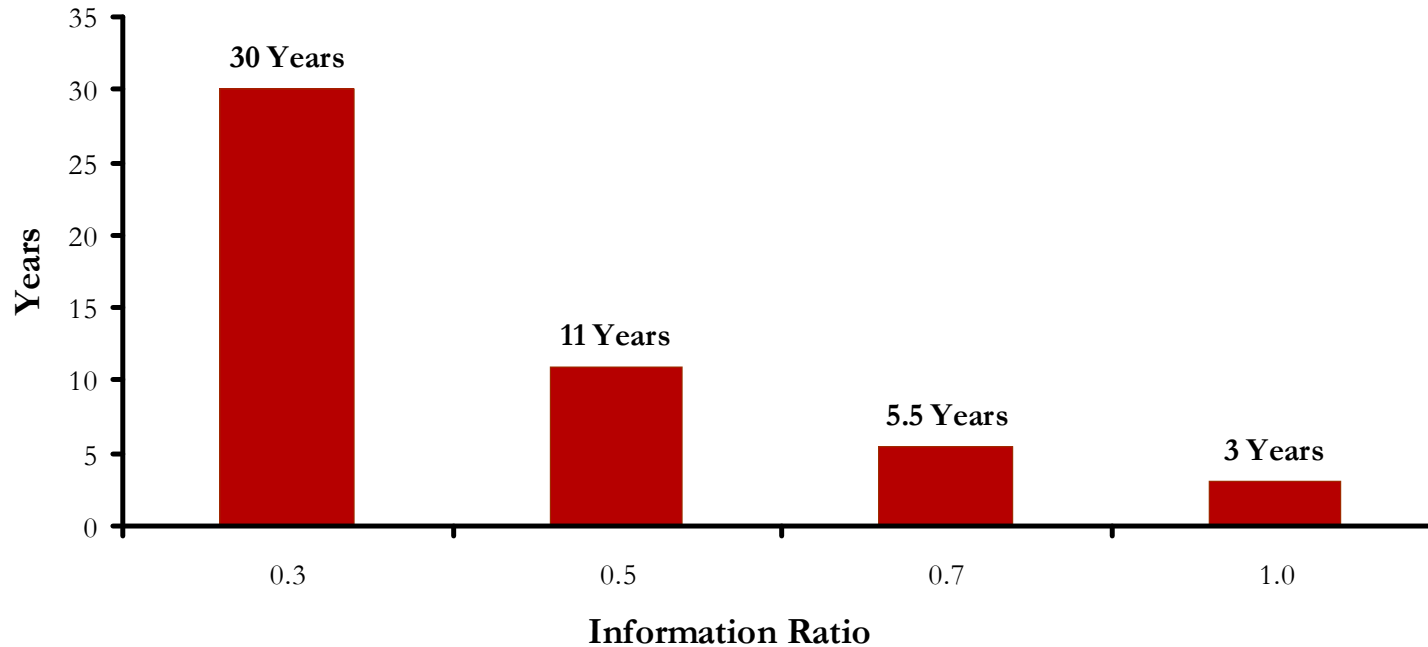
Information Ratio: 0.3

% of distribution < 0: 38%

Average frequency of underperformance: 1 year in 2.6

What is the Real Benefit of Information Ratio?

Shortest Period with at Least a 95% Probability of Outperformance



A manager with an Information Ratio of 1.0 has a 95% probability of exceeding its benchmark in 3 years, compared to 30 years for a manager with an Information Ratio of 0.3.

Skill vs. Luck?

As of June 30, 2009

	Inception Date	Annualised Excess Return	Annualised Tracking Error	Information Ratio*	t Statistic	One Tail Significance
Hypothetical:						
Manager A - Enhanced : S&P	1/7/1987	1.56%	2.03%	0.77	3.61	0.02%
Manager B - LC Growth : S&P	1/7/1993	4.60%	4.50%	1.02	4.09	0.01%
Manager C - LC Value : S&P	1/7/1993	2.12%	4.23%	0.50	2.00	2.34%
Manager D - Enhanced Index : S&P	1/4/1998	1.34%	1.70%	0.79	2.65	0.45%
Manager E - LC Core : S&P	1/8/2001	2.50%	3.01%	0.83	2.34	1.08%
Manager F - Global Core : MSCI World	1/1/2005	2.22%	3.08%	0.72	1.53	6.63%

- **The One Tail Significance is the estimated probability that pure luck would produce the portfolio's observed alpha or better.**
- **A good *a priori* reason for thinking an investment process should work combined with a low one tail significance should provide a high degree of confidence to investors.**

*Source: FactSet. Information Ratio = Excess Return ÷ Tracking Error

Data presented reflects past performance, which is no guarantee of future results.

Data presented is gross of fees.

Chart includes strategies with at least a three-year track record.

See Composite Performance and Presentation Notes for additional information.

- Passive vs. active is a key decision for investors.
- Both passive and active have strengths and weaknesses.
- Active management provides alpha opportunities.
- We believe it is possible to create a portfolio of greater efficiency than the market portfolio.
- Identifying a manager that can produce consistent alpha is difficult.
- Key statistics such as information ratio can help in the decision making process.

Jack Lin **Co-Chief Executive Officer – Janus Capital International**

Jack Lin is Co-Chief Executive Officer of Janus Capital International, the international division of NYSE-listed and Denver-based Janus Capital Group Inc.

Jack joined Janus in 2008 as Managing Director - Asia Pacific. In this role he was primarily responsible for overseeing and growing Janus' operations in Asia Pacific and Australasia, with its regional offices in Hong Kong, Tokyo, Singapore and Melbourne. In his role as Co-Chief Executive Officer he is jointly responsible for the firm's non-US business. Started in 1998, the international business is now active in more than 20 countries with offices in London, Milan, Hong Kong, Munich, Tokyo and Melbourne. As a specialist manager focused on US and global fundamental and mathematical approaches, Janus Capital International delivers the firm's investment capabilities to a broad range of clients including public and corporate pension funds, sovereign wealth funds, insurance companies, multi-managers and global and regional private banks.

Jack came to Janus after nine years with Franklin Templeton, latterly as managing director of its Asian institutional business. Prior to that, he served as Chief Executive Officer of Franklin Templeton's Shanghai-based asset management joint venture, which he helped establish in 2003. During his career at Franklin Templeton Jack also managed teams in Vietnam, Korea and Japan. Previous roles have included being a managing partner of Asia Vest Investment Limited, a mergers and acquisitions corporate advisory firm focusing on the Greater China markets of the People's Republic of China, Hong Kong and Taiwan, and as Chief Investment Officer and Senior Vice President of Strategy at Nasdaq-listed media and technology company Chinadotcom. He began his career as an attorney with international law firm Loeb & Loeb in Los Angeles, California.

Jack holds a bachelor's degree in economics from Vanderbilt University, USA, and a juris doctor degree from the University of California at Los Angeles School of Law. He also earned a Master's in Business Administration from the Anderson Graduate School of Management at the University of California at Los Angeles.

Presentation Notes

INTECH, an indirect subsidiary of Janus Capital Group Company, is an independent investment adviser registered under the Investment Advisers Act of 1940 utilizing an investment process based on a mathematical theory. INTECH is affiliated with Janus Capital Group Inc. and its subsidiaries. These subsidiaries and/or affiliates include Janus Capital Management LLC and Perkins Investment Management LLC. Past performance cannot guarantee future results. Your principal may be at risk during certain market periods. Performance results reflect the reinvestment of dividends and other earnings. Portfolio performance results shown are time-weighted rates of return using daily valuation, include the effect of transaction costs (commissions, exchange fees, etc.), and are gross of non-reclaimable withholding taxes, if any. The composite(s) include all actual fee-paying accounts managed on a fully discretionary basis according to the investment strategy from inception date, including those no longer under management. Accounts meeting such criteria enter the composite upon the full first month under management. For periods of less than one year, performance is not annualized. Reporting currency is USD. Differences may not agree with input data due to rounding. INTECH claims compliance with the Global Investment Performance Standards (GIPS®). To receive a complete list and description of INTECH's composites and/or presentations that adheres to GIPS standards, please contact INTECH at finance@intechjanus.com.

The gross performance results presented do not reflect the deduction of investment advisory fees and returns will be reduced by such advisory fees and other contractual expenses as described in the individual contract and INTECH's Form ADV Part II.

The net performance results do not reflect the deduction of investment advisory fees actually charged to the accounts in the composite. However, the net performance results do reflect the deduction of model investment advisory fees. Through December 31, 2004, net returns were derived using the maximum fixed fee in effect for each strategy. As of January 1, 2005 net returns are calculated by applying the standard fee schedule in effect for the respective period to each account in the composite on a monthly basis. Actual advisory fees may vary among clients invested in this strategy. Actual advisory fees paid may be higher or lower than model advisory fees.

The S&P 500 Index is the Standard & Poor's composite index of 500 stocks, a widely recognized, unmanaged index of common stock prices.

The MSCI World Index is a free float-adjusted market capitalization index that is designed to measure global developed market equity performance.

All Indices returns are provided to represent the investment environment existing during the time periods shown and are not covered by the report of independent verifiers. For comparison purposes, the indices are fully invested, which includes the reinvestment of dividends and capital gains. The returns for the indices do not include any transaction costs, management fees or other costs. Composition of each separately managed account portfolio may differ from securities in the corresponding benchmark index, the indices are used as a performance benchmark only, as INTECH does not attempt to replicate any indices. Because INTECH's sector weightings are a residual of portfolio construction, significant differences between sector weightings in client portfolios and the index are common.

The hypothetical illustrations contained in the presentation are provided to demonstrate INTECH's investment process.

Trading costs and other expenses are not contemplated in the illustrations.

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Gross performance of the composite reflects reinvestment of dividends and other earnings. Results for the full period are time weighted rates of total return using daily valuation. Composite results are dollar weighted based on beginning of month asset values. Fully accrued, trade date accounting is used. Performance results are stated gross of fees, which vary by account size and other factors. Returns for each client will be reduced by such fees and expenses as negotiated in any client contract. No account has been taken for taxation as the impact of taxation depends upon individual circumstances. INTECH claims compliance with the Global Investment Performance Standards (GIPS®). A complete list and description of INTECH's composites and/or presentations that adheres to GIPS standards is available on request. Past performance is not a guarantee of future results. There is no assurance that the investment process will consistently lead to successful investing.

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