

Take Note

US SMALL CAP EQUITY FUND (RIC) – MANAGER CHANGE



We have recently replaced Goldman Sachs with PanAgora and ClariVest.

Why did we make the change?

In our continual focus to enhance the Fund's structure, this change provides investors with access to our latest manager research ideas. Although both managers use a quantitative approach to stock selection, their different processes increase the diversification within the Fund.

PanAgora pursues a "core" approach (portfolios comprise a combination of growth and value characteristics) to its quantitative-based security selection and portfolio construction practices. It identifies mis-priced securities through sophisticated modelling techniques that seek to treat each security differently based on its unique traits including (but not limited to) size and industry membership.

ClariVest utilises a unique quantitative model that is further enhanced by a fundamental qualitative overlay. Its portfolios are well-diversified and the manager is sensitive to benchmark-relative risk exposures.

Further details on PanAgora

PanAgora, based in Boston, has provided quantitative investment strategies to institutional clients since 1985. With nearly \$20 billion in assets under management, PanAgora utilises the resources of Putnam Investments and Nippon Life Insurance, both of which have been co-owners of the company since 1997.

The main drivers of PanAgora's process are: **1) Valuation:** purchasing reasonably priced stocks with higher potential for price appreciation. **2) Fundamentals:** the team purchases companies in good lines of business that are well run by evaluating fundamentals such as earnings quality, operating efficiency and management. **3) Market sentiment:** factoring in overall investor psychology regarding the expected direction of the market.

PanAgora is distinct in its approach relative to other quant managers in a number of ways. Each stock in the investment universe is individually modelled based on its risk characteristics – for example size and industry – as part of the bottom-up stock selection process. This adds an extra dimension during stock selection rather than solely focussing on return expectations. PanAgora also makes adjustments to take advantage of variable investor preference during different times of the year.

PanAgora maintains an ongoing research effort to enhance the forecasting ability of the models. Frequently, research generated by this investment team is at the heart of idea flow throughout other parts of the firm.

Further details on ClariVest

San Diego-based ClariVest is an institutionally-focused asset management company that is entirely employee owned. It manages domestic, international, and global equity portfolios across the market-cap spectrum.

The manager's investment approach is based on academic research in behavioural finance which indicates that investors react inefficiently to changing information creating mis-pricing opportunities. In our opinion, ClariVest's quantitative model compares favourably to peers. Its superior process includes the following factors:

- 1) **Unexpected earnings innovation.** This could include stocks with rising and accelerating consensus earnings estimates. The additional overlay would mean that not only the changes in consensus earnings estimates are evaluated but, just as important, the rate of these changes.
- 2) **Evaluating the foundation for the persistence of earnings innovation.** Key characteristics include changes in free cash flow yield.
- 3) **Market reaction.** ClariVest seeks stocks in which persistent earnings innovation is rewarded through stock price appreciation.

The stock selection process also includes a qualitative overlay to evaluate fundamental developments that are not yet reflected in the quantitative scores. Russell believes that the team's efforts in this area are very effective as it allows for dynamic application of the most recent ideas. We believe that the process benefits from the additional focus on verifying the model's underlying input data.

One of the reasons for our high confidence in the manager is our favourable view of lead manager Stacey Nutt, who has exhibited a willingness to aggressively explore new ideas in an effort to improve the investment process. He shows a good understanding of the strengths and weaknesses of quantitative investing and is complemented by several strong quantitative professionals.

Changes to manager weights in the RIC US Small Cap Equity Funds

Manager	Mandate	Previous Fund Weight (%) [*]	New Fund Weight (%)
Next Century	Growth	13	13
Transamerica	Growth	18	18
Gould	Growth	13	13
Goldman Sachs	Market oriented	20	-
Integrity	Core Value	20	20
David J. Green	Value	6	6
Nicholas Applegate	Value	10	10
PanAgora	Market oriented	-	10
ClariVest	Market oriented	-	10

This material is being issued for information purposes only and does not constitute an offer or invitation to anyone to invest in any Russell products, or use any Russell services, and has not been prepared in connection with any such offer. This material is for distribution to professional investors only and unless otherwise specified, all information included is current at the time of issue. Opinions included are the opinions of Russell and any views expressed do not constitute investment advice and are subject to change. Unless otherwise noted all information is sourced by Russell.

Issued by Russell Investments Limited, authorised and regulated by the Financial Services Authority. Registered office: Rex House, 10 Regent Street, London SW1Y 4PE. Tel: 020 7024 6000