

Take Note

CONTINENTAL EUROPEAN EQUITY FUND (RIC) – MANAGER ADDITION

We have replaced Nordea with AQR Capital Management and Schroder Investment Management recently.

AQR Capital Management

Founded in 1998, Connecticut-based AQR Capital Management employs quantitative models to exploit inefficiencies in global equity markets. Its investment products range from aggressive high volatility market-neutral hedge funds to low volatility benchmark-driven traditional products. It has grown strongly since start-up to manage approximately \$23bn across its series of investment products today. The firm has managed international equities for many years (and has been held in Russell's international funds for US clients since 2001), but has not, historically, offered a Europe-only capability. AQR's Europe ex-UK product is a new offering, but is supported by a similar model to the one that underpins the firm's international equity product. It is our favourable view of AQR's approach to international equities, as well as significant research and testing of a Europe-specific approach, that has given us the confidence to invest early in this new product.

AQR's investment professionals have very strong credentials in the quantitative arena. Cliff Asness, the firm's founding principal, is well-known in the industry for his contribution to academic debate and we believe he sets the tone for the strong research-oriented environment. The other key professionals previously worked together for a significant period of time at Goldman Sachs Asset Management. We see the fact that they have already worked together as a major strength of the proposition. Our view of Robert Krail and John Liew, who, respectively, lead the stock selection and country/currency groups, is strongly positive. More generally, the quality of investment staff at AQR is one of the highest in the industry.

AQR has long held the belief that value and momentum are key drivers of return and it uses quantitative models based primarily on these broadly-defined factors to select stocks, countries and currencies. The firm employs distinct models to derive expected returns across each of these three dimensions and implements each model separately. This is a unique approach in this asset class, effectively creating a product with three distinct return sources, and distinguishes AQR from the other managers in the universe. AQR's track record in adding value through its currency model is particularly strong and we believe it has an edge over the competition in this regard. The firm has significant experience managing currencies and unlike many European equity managers believes that it is an important source of excess return.

As a result of its strength in country and currency forecasting globally and its separation of country and currency decisions from stock selection, we have given AQR some leeway to invest outside of the index and to sell countries and currencies short (to gain from the decline in price of a security). From a regulatory perspective, the latter is made possible by the Fund's move to UCITS III. By relaxing these constraints somewhat, we believe AQR's ability to add value increases materially. The extent to which AQR can utilise this leeway is controlled by its investment guidelines which incorporate a tracking error limit and a mix of model weights that places most emphasis on the firm's stock selection model.

Schroder Investment Management

Headquartered in London, Schroders has a global presence and employs more than 250 investment professionals in its network of offices around the world. Russell has a long history researching Schroders across its product range and, although relatively new to European equity investing, our analysts know Denis Clough, Head of Schroders' European equity team and portfolio manager for Russell's account, well. Denis has spent his entire career at Schroders and prior to transferring to the firm's Europe team in 2005 had invested successfully in Japanese equities for over 20 years. Our historical perspective and confidence in Denis Clough's stock selection and portfolio management skills led our analysts to rank the product highly in the early stages of its development. This gives us the confidence to invest early in the life of this product.

This is a relatively aggressive, all-cap product, emphasising quality, relative valuation and a longer investment horizon than the majority of managers in the European universe. Schroders believes that equity markets are inefficient and that a longer-term perspective allows these inefficiencies to be exploited by avoiding short-term behavioural influences/shortcomings. Clough focuses on fundamentals and will be patient with his holdings if underlying fundamentals are sound.

Clough follows a tangible and repeatable approach which trades off valuation, earnings growth and earnings quality. He honed this approach during his years investing in the Japanese market and we expect it to work well in a European context. He is supported in terms of idea generation by a team of research analysts and portfolio managers. This team uses a combination of quantitative screens and qualitative research to focus their efforts, with final portfolio holdings exhibiting exposure to alpha sources such as hidden growth, the potential for a corporate action, turnaround/recovery stories or discounts to asset value.

Clough is aiming to deliver high levels of return using this approach and manages his portfolios with limited attention to benchmark weightings. Strong portfolio construction skills are critical in such a context and his experience in balancing risk and reward in weighting decisions, his disciplined use of price targets and skilled use of Schroders' proprietary risk management tools are driving forces behind our favourable view.

Impact on the Fund

The Fund's characteristics are not expected to change significantly as a result of these manager additions.

The number of managers in the Fund has increased from six to seven with the addition of AQR and Schroders. Process diversification has been enhanced with each manager having distinctly different approaches to investing in this asset class. With respect to the managers added to the fund, Schroders' all-cap focus and emphasis on quality creates portfolios with an element of small company exposure and, typically, more risk adverse characteristics. AQR, by virtue of separating stock, country and currency decisions, employs an approach to investment that is unique in this asset class and therefore contrasts well with the other managers in the mix. Its ability to take short country and currency positions and integrate non-benchmark countries and currencies in its approach is also a differentiating feature. There is a value element to AQR's approach, but one that is different from that employed by Bernstein or AXA.

Changes to manager weights in the Continental European Equity Fund (RIC)

Manager	Mandate	Previous Fund Weight (%)*	New Fund Weight (%)
AXA	Quantitative stock selection, value bias	15	15
Bernstein	Value-oriented stock selection	20	20
Invesco	Pragmatic stock selection, mix of quality, growth and valuation perspectives	15	15
Capital	Growth-at-a-reasonable-price	15	10
BlackRock	Market-oriented with a growth bias	20	20
AQR	Quantitative stock, country and currency selection	-	10
Schroders	Aggressive, all cap, focus on quality and relative valuation	-	10
Nordea	Thematic stock selection, growth bias	15	-

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