

Five minutes with Lucas Turton

Managing Partner and Chief Investment Strategist of Windham Capital Management.

“Windham’s strategy employs insights that help investors participate in the upside faster and provide better returns over the long term”.

What is the history and background of your company and strategies?

Windham creates and manages portfolios and single strategies featuring active risk management. Its disciplined portfolio construction is supported by proprietary research to assess asset class behaviour and gauge opportunities through various market environments. Since its establishment, Windham’s growth in assets under management has been aggressive, quadrupling this year to approximately USD700m despite global economic challenges and sustained financial market volatility.

Based in Boston, Massachusetts, Windham Capital Management was founded in 1988 as an SEC-registered investment advisor. In 1996, Windham partnered with State Street to form State Street Associates, an investment research think-tank, which provided portfolio risk management advisory services to sophisticated institutional investors.

As a diverse yet closely-knit team of experienced investment professionals, Windham has roots in both institutional asset management and academic research. Its investment management team has expertise in portfolio and risk management, research, operations, compliance and client service.

Firm principals include Mark Kritzman, managing partner and chief investment officer; Stan Shelton, managing partner and head of investment management; myself, managing partner and chief investment strategist; Tim Adler, managing partner and director of research and technology; Scott Carleton, managing partner and director of client service and operations; Charles Cutrell, managing partner and chief legal and compliance officer; and Karen Fernandes and Chris Arnold, vice-presidents for client relationship management.

What differentiates you from other managers in your sector?

Windham has a long track record of actively managing risk in the institutional marketplace. Many of our risk management technologies have been proven in the marketplace and are now embedded within all of our investment strategies.

Importantly, we do not time the market. Our strategy is highly disciplined and employs insights that help us participate in the upside faster and provide better returns over the long term. As evidence, many asset managers got out of the market in 2008 and didn’t return in 2009, whereas our models kept us in the market and more able to participate in the rally that began in March 2009.

What impact has the recent global financial crisis and economic downturn had on your business?

Because Windham is first and foremost a risk management firm with a unique approach to measuring and managing risk, the crisis and its aftermath have actually helped our business. Despite unprecedented economic and financial market challenges, Windham's rigorous risk management process held up very well, enabling us to quadruple assets under management this year and take the opportunity to reinvest in our business.

Describe your investment process?

Windham's investment process employs three steps to generate excess returns. In Step 1, we research the ETF universe and identifies those that satisfy our criteria for investment. Specifically, we look for exposure to an important risk factor, the ability to track the designated index, sufficient liquidity for meaningful investment and an acceptable expense ratio.

In Step 2, we construct optimal portfolios for each phase of the investment risk cycle, conditioning our estimates of expected return and risk on the behaviour of assets during each risk environment. In Step 3, we identify transition points from one risk environment to another within the investment risk cycle and shift to the optimal portfolio for that phase.

How do you generate ideas?

Our ideas are based primarily on Step 1 of our investment process in which we conduct our own independent research, scouring the globe for investment opportunities that meet our criteria for security selection and asset allocation.

Further, we seek investments that will complement and enhance our portfolios in one or more investment environments. We also factor in cost to avoid reducing performance unnecessarily. Rather than the typical bottom-up fundamental analysis of a particular stock, we perform a top-down, global macro evaluation of potential investments.

What is your approach to managing risk?

We manage risk to maximise returns. Through our proprietary Windham Investment Risk Cycle™, we measure and evaluate financial market sensitivity to changes in levels of market turbulence and systemic risk. The risk cycle provides an early warning signal of fragile markets and is a key input to our economic analysis, portfolio construction and implementation process. Through daily monitoring of the risk cycle, we can see indications of risk that others may be missing, and inflection points indicating that we are shifting into a different market climate.

Rather than follow the industry norms based on assets behaving as they have done historically, Windham believes that interactions among asset classes change according to the current risk environment. For example, an environment might dictate taking risk above the benchmark when markets are calm or reducing risk below the benchmark in turbulent environments where there is no compensation for taking risk.

How have your strategies performed?

Over the past 12 months, our strategies have outperformed their benchmarks, as we expected. Despite the social unrest in the Middle East, we did not adjust risk below our benchmarks, given that our models showed no significant increase in systemic risk (and thus no imminent danger of a sustained market sell-off). After a brief sell-off, markets rebounded and we were rewarded for holding our positions.

Similarly, although markets did fall during the week after the earthquake in Japan, our models showed low systemic risk and little chance of a global market sell-off. Again, we were rewarded for maintaining our positions. Finally, in August the Windham Investment Risk Cycle™ showed market turbulence and systemic risk rising, indicating fragile markets. For the first time since May 2009, where we tapped a long period of positive returns for riskier assets, we adjusted risk down twice.

Looking ahead, at least in the short run, the environment doesn't favour taking investment risk. We are seeing unfavourable rises in systemic risk, and until that begins to subside, we are more cautious of risky assets.

Are you looking at any particularly attractive opportunities right now?

At this point, given the unpredictability, we don't believe it's worth taking interest rate risk, so we're avoiding that area of the market. We do think, however, that short- to intermediate-term credit is better than buying longer-term bonds.

Anticipating that inflation will become an issue, we want to hold inflationary assets in our portfolios – global in particular – so we're looking to commodities, foreign real estate and global inflation bonds to protect us in this environment. We also believe we can find inflation protection in many equities, so we're leaning toward companies with low price-to-book value.

What developments do you expect to see in your investment sector or industry field in the coming year?

Given the success of and greater demand for risk-based strategies, we see more products coming to market with expensive downside protection components. Plan sponsors and institutional investors are devouring these products but, in our view, they are significantly flawed.

Buying insurance in a portfolio is very costly; the more events you insure against, the less you earn. We prefer to identify shifts in the risk cycle and make appropriate adjustments in our portfolio. Another development we anticipate is demand for greater transparency and liquidity – needs that are addressed in separately managed accounts – and certainly through the use of ETFs.

How will these developments affect your firm and the performance of your strategies?

We believe in very positive ways, since we've created products that meet the demands of the market today. From a performance perspective, our drill-down approach is completely different from our competition. We are investing in very large asset classes with significant capacity, so we're not concerned about being blocked out of our investment ideas.

How do you view the environment for fundraising over the coming 12 months?

We see this as a very favourable environment for managers that provide transparency, liquidity and ample communication, all within the context of a risk-managed approach.

Do you have any firm plans for further product launches?

Based on market demands for liquidity strategies, we will be customising versions of our strategies to meet these needs. These liquidity strategies will focus on generating alpha, but also reducing risk as dictated by our models, allowing our clients to use them as a liquidity source.

We believe these strategies will provide an attractive alternative for institutional investors with large cash balances. Recall that in 2008 and early 2009, some large institutions were forced to use their endowments to meet operating budgets, resulting in a fire sale of less liquid assets. Our customised liquidity strategies could help these institutions avoid this experience in the future.

What is your distribution strategy and targeted client base?

Windham provides investment management for private clients, family offices, investment advisors, foundations, endowments and select institutions. While focused on North America, Windham cultivates global distribution networks to fulfil the investment needs of these markets in other regions, currently Europe and Australia. Institutional clients account for roughly 80 per cent of Windham's current assets under management, the remaining 20 per cent coming from private wealth management.

Lucas Turton, CFA is a Managing Partner and the Chief Investment Strategist of Windham Capital Management, LLC.

Lucas joined Windham in 2004 and is responsible for the development and management of Windham's investment solutions for high-net-worth individuals, family offices, financial advisors and select institutions. Prior to business school, Lucas spent five years with United Technologies Corporation where he was an engineer focused on the development and application of customised technology solutions.

Lucas received a Bachelor of Science degree from Cornell University and a Master of Business Administration degree from the Massachusetts Institute of Technology. Lucas is a member of the CFA Institute and the Boston Security Analysts Society.



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