Will you rise to the challenge?

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J.P. Morgan Asset and Wealth Management Challenge (AWMC) 2018

Case Study

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Assume that your team of investment specialists is part of a fictitious asset management company (which is based on your registered team name). Your team is responsible for providing portfolio management and advisory services for clients across a variety of asset classes – particularly specializing in the traditional asset classes of equity and fixed income.

Background

Mr. Kenneth Lee and Mrs. Sarah Lee are currently 40 and 35 years old respectively. They are married with three children aged 4, 6 and 9. Mr. and Mrs. Lee are the founders of a successful internet startup that was formed five years ago after they left careers working in large, multinational technology companies. In November 2017, the couple sold their shares in the start-up, making US$100 million in cash. After some discussion, Mr. Lee decided to continue serving as a technical director in the company (albeit with no more equity stake in the firm) given that he still wanted to play a part in the company's future. Mrs. Lee took up the role of managing their family wealth and is now the key decision-maker for all financial decisions for the family going forward.

Mr. James Smith is a long-time friend of both Mr. and Mrs. Lee and was an established investment consultant before he retired. They decided to approach him to understand how to manage their family wealth in a sustainable and structured manner, with an aim to preserve capital for the benefit of their future generations. Mr. Smith has since been advising Mrs. Lee on prospective asset managers, and your company has won the initial mandate following a month of intensive due diligence.

As part of an investment management mandate opened with your company in January 2018, the account currently holds US$100 million in investments based on the asset class composition given below in Figure 1. Mr. Smith highly values your team's investment insights and looks to you to provide clear direction in the increasingly uncertain market environment.

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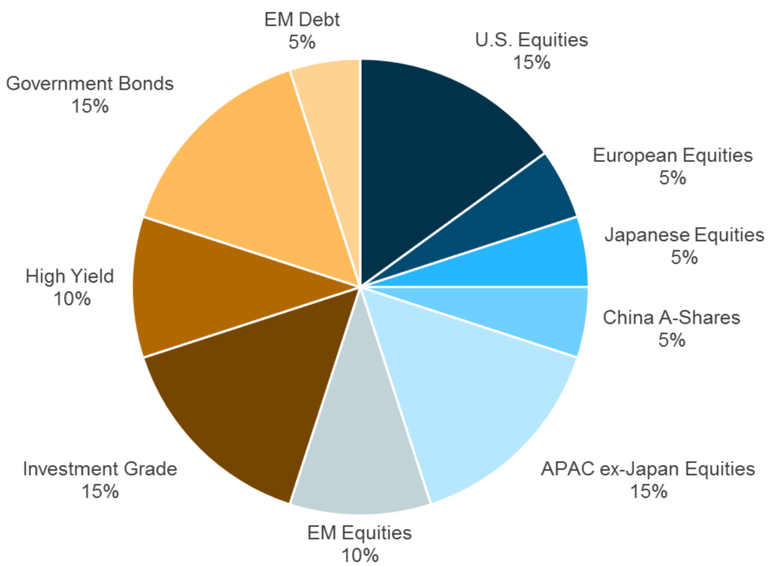
Figure 1



As part of the inaugural portfolio review to take place at the beginning of the year, Mr. Smith has contacted your team with some requirements following initial discussions with Mrs. Lee:

1. The expected annual return should be at least 5%.
2. The portfolio must make annual cash distributions of US$1 million at the end of the year in order to provide for the family's combined living expenses.
3. In 10 to 15 years, Mr. and Mrs. Lee plan to send each of their three children to the US for their university studies. They plan to fund their studies by drawing upon the investment portfolio when needed.
4. The portfolio should take no direct/external loan (or leverage).
5. The portfolio should not hold alternative investments (zero allocation) at this point in time, although that might be subject to change in the future.
6. The portfolio must be sufficiently diversified. Each asset class (e.g. US Equities, Investment Grade Fixed Income etc.) should not constitute more than 40% of the portfolio.

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Mr. Smith was pivotal in convincing Mrs. Lee to place their cash into investments in the first place, and she is implicitly dependent on him to provide her with direction in managing the family's investments. However, having worked in the technology sector for 20 years, the couple has been a party to several crisis scenarios (like the tech bubble of 2000) and understands how one major event can wipe out a lifetime of savings if improperly managed. Hence, Mrs. Lee would be concerned if the portfolio experiences a loss of 12% or more in any given year.

As a part of the agenda for the review, the clients are interested in listening to your macroeconomic outlook and asset class views for 2018. In particular, the clients would like you to address the following requests:

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Request 1:

Mrs. Lee views herself as a traditional investor, and Mr. Smith has always stuck to the mantra of keeping his clients in diversified portfolios with a 60/40 allocation across equities and fixed income. This has served him well in the past. He is looking for your team's advice on how to navigate an uncertain market environment, especially over the long term.

- Based on a clear assessment of the client's priorities and investment options, would a 60/40 strategic asset allocation[1] continue to be appropriate?
- As a fiduciary that works in the best interests of your client, would your team recommend an alternate allocation?

[1] Strategic Asset Allocation is the long-term asset allocation of a portfolio for at least a ten-year investment horizon. These allocations are typically determined after considering the asset classes' long-term expected returns and volatilities, investor's returns and risk preferences, liquidity requirements, and other relevant parameters.

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Request 2:

Mrs. Lee and Mr. Smith want to understand your macroeconomic outlook for the next year. Mr. Smith is somewhat concerned about various developments in the markets recently – with his key concerns being about the Federal Reserve interest rate hike and equity market valuations.

- Building upon your earlier recommended strategic asset allocation, what is your tactical asset allocation[2] over the next year that you would recommend to accompany your macroeconomic outlook?

[2] Tactical Asset Allocation is the short-term asset allocation changes to the portfolio for a one-year horizon. The Tactical Asset Allocation typically does not deviate by more than 10% from the Strategic Asset Allocation.

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Request 3:

Having had twenty years of corporate experience under her belt, Mrs. Lee has a keen understanding that prudent risk assessment is an integral component of a comprehensive portfolio review.

- Considering historic market cycles and key market events, conduct a scenario analysis on your earlier recommended strategic asset allocation and identify how these can be mitigated (if possible).

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Request 4(a):

Having been convinced thus far of your investment insights, both Mrs. Lee and Mr. Smith are keen to proceed to the next step – which involves understanding how your ideas are implemented into an investable portfolio. Mr. Smith is intrigued by the trend of investors moving towards passive investment vehicles, away from the active management that he has used all these years.

- Explain the considerations for choosing between active or passive vehicles, and the underlying reasons for why this trend is taking place.

Request 4(b):

J.P. Morgan Asset Management offers expertise across a broad range of mainstream and specialist investment strategies, including equities, fixed income, liquidity (cash) and mixed-asset funds. Given that the client is currently invested based upon his strategic asset allocation into the list of mutual funds (Figure 2), determine the optimal vehicles for the client within each asset class based on your earlier considerations. Additionally, you are expected to justify how your decision benefits the client from a portfolio perspective, so that he can assess your decision independently.

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Asset Class	Sub-Asset Class	Fund	Passive Vehicle
Equities	**U.S.**	JPM America Equity A (acc) - USD	Vanguard S&P 500 ETF
	Europe	JPM Europe Dynamic A (acc) - USD	iShares Core MSCI Europe ETF
	Japan	JPM Japan Equity A (acc) - USD	Lyxor Japan TOPIX DR ETF
	China	JPM China A-Share Opportunities A (acc) - USD	Deutsche X-trackers Harvest CSI 300 China A-Shares ETF
	Asia Pacific ex-Japan	JPM Asia Pacific Equity A (acc) - USD	Lyxor MSCI AC Asia Pacific Ex Japan UCITS ETF
	Emerging Markets	JPM Emerging Markets Equity A (acc) - USD	iShares MSCI Emerging Markets ETF
Fixed Income	**Investment Grade**	JPM Aggregate Bond A (acc) - USD	State Street Global Aggregate Bond Index Fund
	High Yield	JPM Global High Yield Bond A (dist) - USD	SPDR Barclays High Yield Bond ETF
	Government Bonds	JPM Global Government Bond A (acc) - USD (hedged)	PIMCO 25 Year Zero Coupon U.S. Treasury Index ETF
	Emerging Market Debt	JPM Emerging Markets Debt A (acc) - USD	iShares J.P. Morgan USD Emerging Market Bond ETF

Asset Class	Sub-Asset Class	Benchmark
Equities	**U.S.**	S&P 500 Index (Total Return Net of 30% withholding tax)
	Europe	MSCI Europe Index (Total Return Net)
	Japan	TOPIX (Total Return Net)
	China	CSI 300 (Net)
	Asia Pacific ex-Japan	MSCI All Country Asia Pacific ex Japan Index (Total Return Net)
	Emerging Markets	MSCI Emerging Markets Index (Total Return Net)
Fixed Income	**Investment Grade**	Bloomberg Barclays Global Aggregate Index (Total Return Gross)
	High Yield	BofA Merrill Lynch US High Yield Master II Constrained Index (Total Return Gross)
	Government Bonds	J.P. Morgan Government Bond Index Global (Total Return Gross)
	Emerging Market Debt	J.P. Morgan Emerging Market Bond Index Global Diversified (Total Return Gross)