Staying on track
with Overlay Management

Product information
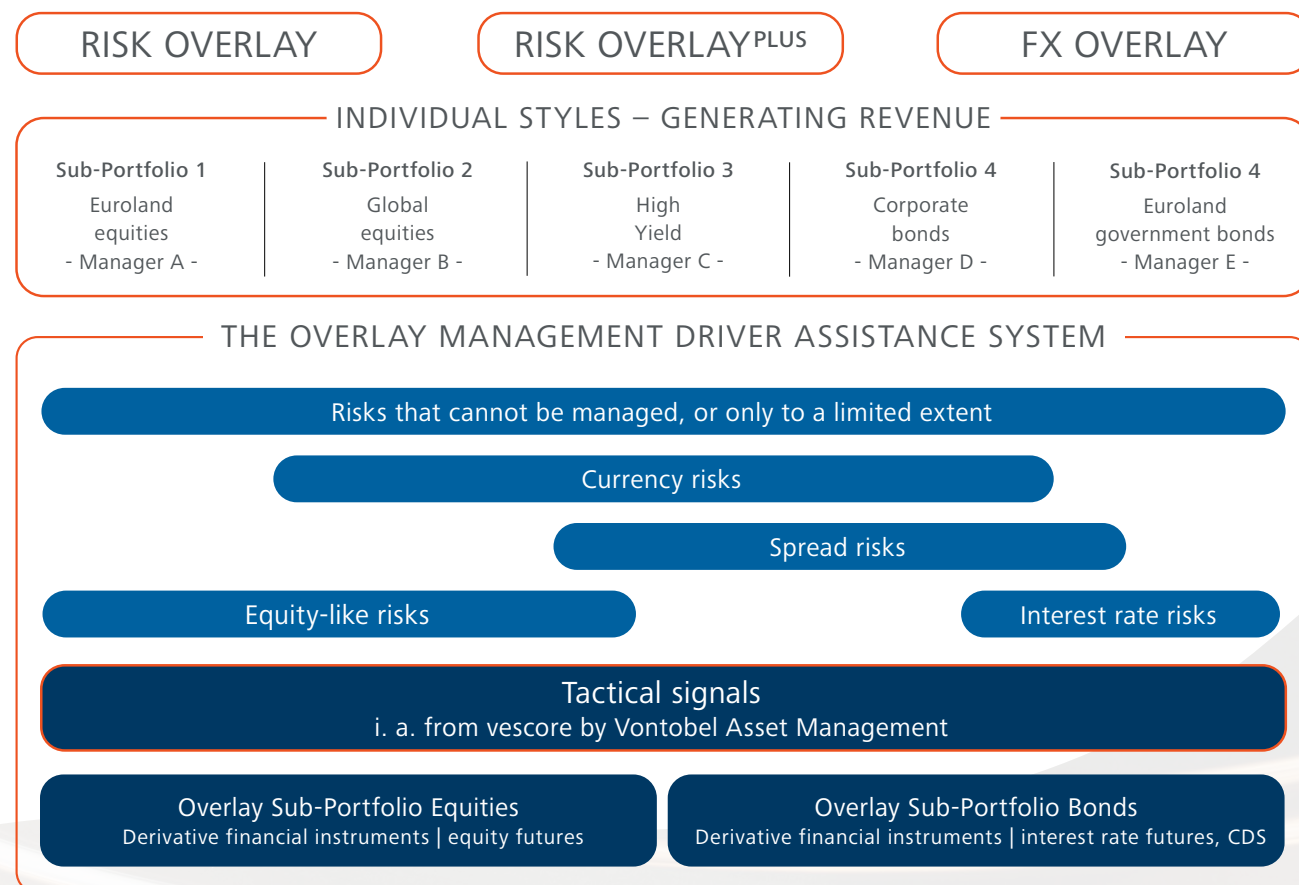
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UNIVERSAL INVESTMENT

The ideal line – staying on track with overlay management

Each investor has his own preferred driving style, his approach to strategic asset allocation. Maintaining the ideal line and staying on track in the process is, however, a challenge in complex and fast-moving markets.

Using a proven overlay approach with tailored and modular features, the portfolio management team has competently, professionally and successfully put overlay mandates on the ideal line for the last 20 years and kept them on track. Overlay mandates under management (on your platform of choice as well as outsourced overlay management as administrative KVG) total 38 billion euros (as of December 2021).

RISK OVERLAY	RISK OVERLAY PLUS	FX OVERLAY

INDIVIDUAL STYLES – GENERATING REVENUE

Sub-Portfolio 1	**Sub-Portfolio 2**	**Sub-Portfolio 3**	**Sub-Portfolio 4**	**Sub-Portfolio 4**
Euroland equities - Manager A -	Global equities - Manager B -	High Yield - Manager C -	Corporate bonds - Manager D -	Euroland government bonds - Manager E -

THE OVERLAY MANAGEMENT DRIVER ASSISTANCE SYSTEM

Risks that cannot be managed, or only to a limited extent

Currency risks

Spread risks

Equity-like risks

Interest rate risks

Tactical signals
i. a. from vescore by Vontobel Asset Management

Overlay Sub-Portfolio Equities
Derivative financial instruments | equity futures

Overlay Sub-Portfolio Bonds
Derivative financial instruments | interest rate futures, CDS

Risk analysis
„Tracks"

Risik management
"Pursuing the ideal line and keeping the portfolio on track"

Source: Portfolio Management Universal-Investment-Luxembourg S.A., Frankfurt branch

Driving Technique – a prerequisite

Each overlay mandate is tailored to the investor's specific requirements.

– The chance to participate in positive market developments, as well as to mitigate the effects of negative developments
  (defending the lower limit)
– The chance to react quickly and flexibly to market risks
– Risk monitoring of individual securities – including outsourced overlay management by an external asset manager (KVG)
– Modularity: separate budgets for different risk types
  – The main risk categories: equity-, interest-rate- and currency-related risks
  – Non- or only partly-manageable risks, including, for example, spread and overnight risks
  – Dynamic risk budgeting by means of tactical signals possible (Risk Overlay^{PLUS})
– Assessment of different asset classes, risk categories and overlay specifications
  – Hedge quality, risk allocation, risk budgeting
  – Regulatory and governmental guidelines
– Management of risk categories either individually or as a whole
– The tailored overlay is underpinned by a customised software solution

Driving Dynamics – a necessity

A modular overlay approach – hedging only where necessary.

– Allows a customised approach through modular concepts
  – Separate management of multiple risk categories from Risk Overlay to Risk Overlay^{PLUS}
– Consistent risk overlay process tailored to various risk categories
  – Targeted use of derivatives: derivatives hedge risk categories rather than asset classes
  – Reduces the tendency of a pro-cyclical reaction by making anti-cyclical risk budget
    transfers between individual budgets (Risk Overlay^{PLUS})
  – Diversifies where appropriate and hedges risks where necessary
  – Reduces the likelihood of an expensive full hedge
– Increases risk transparency, for example through performance by risk category

Components of the driver assistance system – tactical signals

Overlay control logic is fine-tuned to tactical signals.

– Can be used irrespective of the signal provider

  – Successful cooperation with Vescore by Vontobel Asset Management for more than 10 years

  – Tactical signals play a fundamental, active role

– Fine-tuning in key overlay levers

– Performance harvesting through signal-dependent limits for risk budgets

– Anti-cyclical, tactical re-entry into the market through signal-based budget release

– Intelligent risk budget allocation through tactical signals
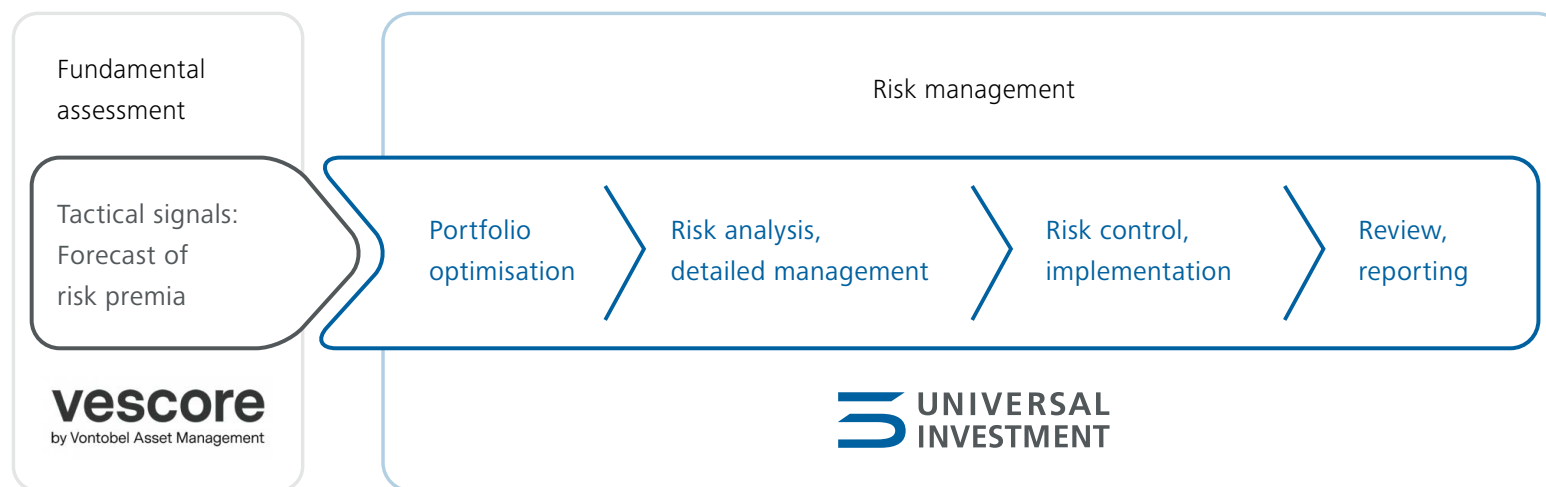
FX Overlay

The main goal of an FX overlay is to mitigate the currency risks associated with investments in global equity, bonds and illiquid assets. Based on this, Universal-Investment offers rule-based currency hedging, either directly in the respective fund or centrally in a separate overlay sub-portfolio. A choice of FX overlay structures is available:

– **FX Overlay – with FX Futures / FX Forwards**
  – Static hedging of fixed hedge ratio
  – Netting effects used at master fund level in centralised overlays
  – Effective mitigation of currency risks
  – Clear and transparent processes

– **FX Overlay - with a combination of FX forwards and FX options**
  – Innovative mechanism: hedging of currency risks using a combination of forwards and options, potentially reducing cost of carry
  – Zero-cost-collar structures possible, eliminating initial premium costs for options
  – SAA and FX exposure adjustments done via forwards, adjustments to the optional structures usually not required

The advantages

Of using an overlay sub-portfolio to manage currency risks can potentially include a reduction in cash requirements and considerably lower costs as a result of competitive trading according to a best-execution approach.

Good to know

Universal-Investment also offers collateral pool management to complement the overall FX overlay process.

Experience – irreplaceable

There are several reasons for going off track with a portfolio. And there is a tried-and-tested way to stay on track.
The following simulation based on Strategic Asset Allocation (SAA) illustrates what this can look like:
40 % global equities, 60 % bonds (government bonds) Euroland, USD-EUR hedge, 8 % risk budget, hedging via index futures.

Risk Overlay^{PLUS} – Tactical signals Vescore by Vontobel

Simulation: Performance 2021 with and without Risk Overlay^{PLUS}
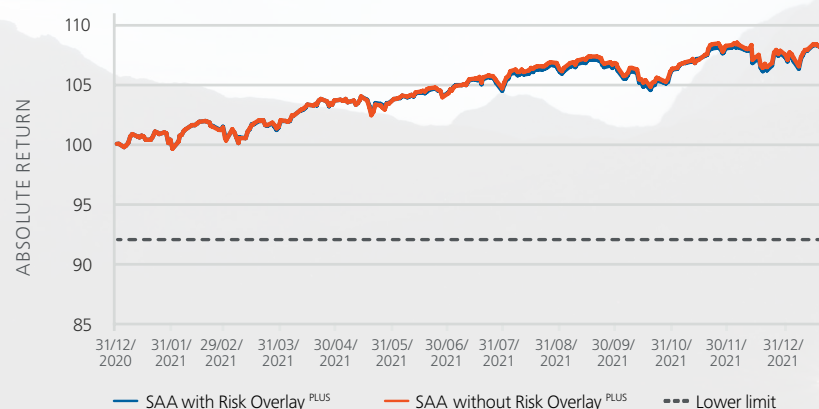
- SAA with Risk Overlay^{PLUS}: optimal hedging of downside risk and timely reentry into the market
- Bonds: minor difference in performance due to hedging in summer
- Equities: benchmark performance was achieved 100%
- Upward and sideways market: no effect on SAA with Risk Overlay^{PLUS}

with Risk Overlay^{PLUS} 8,29 %

without Risk Overlay^{PLUS} 8,32 %

Simulation: Performance 2020 with and without Risk Overlay^{PLUS}

- SAA clearly crosses the lower limit of 92 % in March 2020
- Risk Overlay^{PLUS} holds the lower limit: Outperformance through hedging and timely re-entry

with Risk Overlay^{PLUS} 6,77 %

without Risk Overlay^{PLUS} 5,79 %

Please note:

Opportunity costs may be incurred when using an overlay. There is no guarantee that the lower limit will always be maintained. Past performance is not a benchmark for future performance.

Dates: Own calculation / results of the portfolio insurance concept in the context of a simulation study.
Source: Universal-Investment-Luxembourg S.A., Frankfurt branch

Stay on track with overlay management. We provide solutions for both, cross-segment overlay management for portfolios on your platform of choice as well as outsourced overlay management as administrative KVG. Universal-Investment has extensive experience in the implementation of overlay management concepts: individual, modular and tested.

Universal-Investment is the largest independent fund service platform in the German-speaking region and market leader among Master KVGs.