

Multiple Perspectives. One Approach.™

A distinctive approach to investing.



Robert W. Lovelace is president of Capital Research and Management Company, Inc., part of Capital Group, and serves on the Capital Group Companies Management Committee. He is also an equity portfolio manager. Rob has 29 years of investment experience, all with Capital Group. He holds a bachelor's degree in mineral economics (geology) from Princeton University graduating summa cum laude and Phi Beta Kappa. He also holds the Chartered Financial Analyst® designation. Rob is based in Los Angeles.

Capital Group has been investing around the globe for more than 50 years. Its unique multiple-portfolio-manager approach, *The Capital System*™, sets it apart from many other global asset managers. Portfolio manager Rob Lovelace has been instrumental in the evolution of the New Perspective strategy. In this Q&A, he explains what differentiates Capital Group, and sets out the importance of collaboration in maintaining a competitive advantage.

What is unique about Capital Group?

At Capital Group, our aim is to manage assets so that people have the financial resources that they need, throughout their lives and in their retirement. We are entrusted with our investors' assets; we manage them and our investors expect their investments to grow over time. We take that responsibility seriously, and have decades of experience of taking a truly long-term approach. We strive to build long-lasting relationships, some of which could last many decades.

We know that there are some asset managers with a long pedigree, but it is unusual to have one - like Capital Group - that is culturally and philosophically the same company as it was when it began.

Many of our competitors have undergone multiple mergers and transformations over time, so those companies simply do not resemble the organisations they evolved from. We have grown, but we have the same goals and underlying principles that we had when the company was founded, in 1931.

*What is *The Capital System*™, and how did it come about?*

We use a multiple-portfolio-manager system that was designed in the 1950s, in response to a problem of succession planning. We recognised very early on that having to switch managers can be challenging in terms of trying to ensure continuity of results. At that time, one significant manager had a health issue,

Q&A

With portfolio manager
Robert W. Lovelace

January 2016

“Our modular system - The Capital SystemSM - allows managers to follow their highest convictions while limiting the risks associated with isolated decision-making. It allows management to flow seamlessly from one active manager to another, if changes are needed, without disrupting the philosophy of a strategy.”

Rob Lovelace
Portfolio manager

and there was a debate about who should replace him. There were two possible candidates, both of whom had similar track records, and it was decided that whoever did better over a two-year period would become the manager.

Over that time, one manager initially did better, but then the other pulled ahead. Overall, however, their returns were broadly comparable over the entire period. This is important - it showed us that either manager might have been effective in the role, but that in working together it could be possible to deliver our investors good outcomes with lower volatility.

In our view, volatility of results matters. Too much volatility may unsettle investors and may lead them to sell at difficult periods. Recognising this helped us to create a modular system that draws on the skills of a number of managers working together.

We maintain extensive records of historical returns and investment characteristics, enabling us to identify established trends and patterns from individual managers. By understanding how managers and individual portfolios have behaved in a variety of market

conditions, we can build balanced teams made up of individuals with diverse approaches. (Former and current New Perspective managers are highlighted in Exhibit 1, below.)

Our modular system - The Capital SystemSM - allows managers to follow their highest convictions while limiting the risks associated with isolated decision-making. It allows management to flow seamlessly from one active manager to another, if changes are needed, without disrupting the philosophy of a strategy. It helps us deal with inflows and outflows effectively too, as we can expand or contract the team as the assets under management change.

Why don't more asset managers use a multiple-portfolio-manager approach?

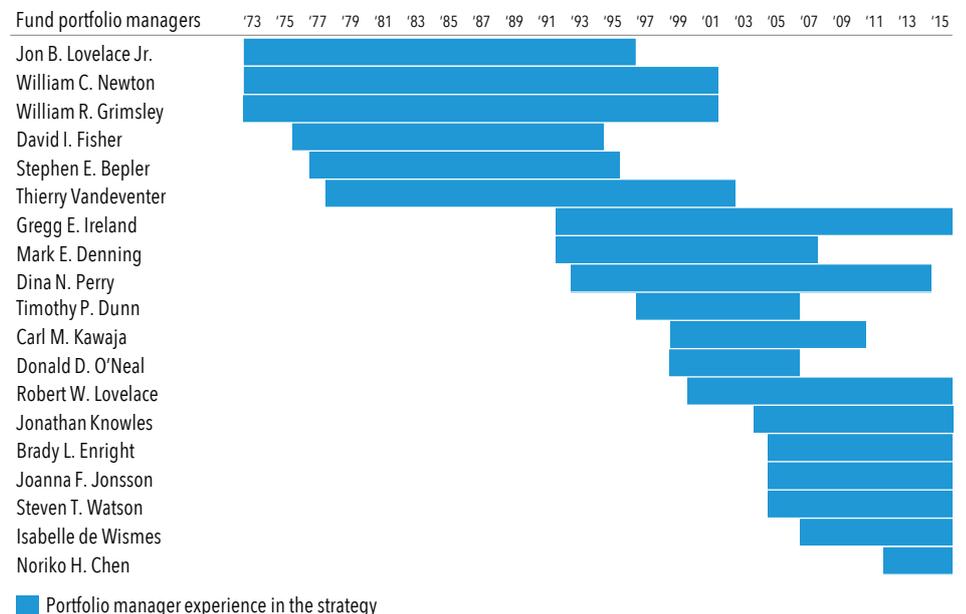
This is a key question we have tried to understand, since the outcomes are so compelling. In my view, one of the issues is that the system is misunderstood since attribution analysis is designed for a top-down, star-style system. The data is most appropriate for single manager structures and simply cannot be used to address multi-manager portfolios effectively.

Exhibit 1: Our sustainable approach is backed by a pool of experienced investment professionals

Source: Morningstar, portfolio manager data as at 31 March 2015

Succession planning is built into the system

Example: Smooth transitions in the New Perspective strategy



“Capital Group’s investors enjoy some of the most stable and long-tenured investment teams around. That level of experience includes not only portfolio managers but also extends to the firm’s analyst roster.”

Morningstar
October 2015

If you run our portfolios through standard portfolio analysis, some may appear to lack conviction. That’s deceptive. In fact, what we have is a number of high-conviction portfolios, together. In practical terms, that might mean a manager holding a series of strong convictions in their own segment of the portfolio, but their views could be different or even diametrically opposed to someone sitting opposite them. (See Exhibit 2, below, for more detail on Capital Group’s process for selecting best ideas.)

Another reason our system cannot be easily replicated by others relates to the culture at Capital Group: we have a true team approach – managers work within a system that fosters cooperation and respect. At the same time, we emphasise individual responsibility within pre-set boundaries – no-one tells anyone else what they can or cannot do.

Within a strategy, some of our managers may take a balanced view with regard to risk when managing their own share of assets. Other managers may have more concentrated portfolios containing greater risk than a single, ‘star’ manager could if he worked alone, and was therefore responsible for all of the portfolio risk. The power of the system lies in the fact that the total portfolio is

made up of a number of high-conviction positions, with different investment styles helping to dampen volatility.

Of course, we do have controls in place to prevent inappropriate concentrations of risk – at the security level and in aggregate. The mandate manager and the Investment Committee monitor these issues as well.

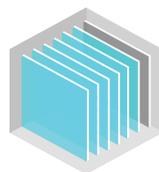
How does The Capital SystemSM ensure that managers gain the experience that they need to prepare for senior portfolio management roles?

We select managers that we believe have the skills and approach to be additive to a strategy’s overall return profile, looking across cycles from peak to trough.

One of the key features to highlight is how much experience all of our portfolio managers have. All of our analysts gain experience of managing assets in client portfolios over an extended period that could last more than a decade, before they can take on full portfolio management responsibilities. The extensive data we have is very important, because we need to ensure that we have the right people working together, with the correct mix of management styles, to deliver on a strategy’s objectives in a consistent way.

Exhibit 2: Investment process

Designed to capture and continually evaluate the best ideas from our research



Career analysts gather investment ideas from around the world

- We only aim to invest in companies we have met
- Equity, fixed income and private equity analysts share insights

Portfolio managers choose highest-conviction ideas

- All have flexibility across the entire range of opportunities
- Each portfolio manager independently selects securities

Investment committee and mandate manager oversee total portfolio

- Each individual seeks to achieve the risk-return objective
- Mandate manager oversees total portfolio
- Risk monitoring throughout the process

January 2016

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Rob Lovelace
Portfolio manager

If you take a strategy like New Perspective, we have had 19 managers progress through our system since inception in 1973 (see Exhibit 1, page 2). That is a notable amount of change, but because of the way in which The Capital SystemSM works, the overall approach should remain consistent – it should be seamless.

What are the advantages of active management?

Active management is at the heart of what we do. We believe it has a key advantage – it allows us to deliver better results for our investors, with lower volatility.

Our analysis suggests that an active approach can add value in down markets. So, if you are thinking about the longer term, you need to recognise that compounding excess returns over a number of years, while avoiding the most extreme down markets, will add up to significant differences in outcome.

Capital Group is a complex organisation. How do you ensure that people work together effectively?

When we work, we break into smaller teams. We have found that groups of around 12 people working together can be very effective.¹ We build those smaller groups into large teams, all working in a collaborative, collegial way.

We have a truly global approach, with analysts and portfolio managers based around the world. Their investment responsibilities often extend well beyond their home regions, forcing us all to take multi-regional and global perspectives. We find that this can help us bring a new level of insight to what is really taking place. It is very different to the approach of many other managers, where research and analysis are often regionally based, focused only on the regions in which the analysts live.

How are your managers incentivised to take a long-term view?

We have a distinctive compensation structure based around one-, three-, five- and eight-year cycles. It is important to think about how this changes the psychology of what we do. A single year of poor results will stay with an investment professional over a long period of time. This contributes to a heightened awareness of downside risk, which we believe is squarely aligned with our clients' goals.

Overall, I believe that the structure helps our managers to develop a longer term perspective and encourages lower portfolio turnover. In my own case, I have certain stocks that I have owned for more than 20 years. My own portfolio turnover with the New Perspective strategy is around 10% each year.²

1. Capital Group's research 'clusters' bring together groups of dedicated analysts working across asset classes, for cross-fertilisation of ideas. Depth of coverage means that groups may be made up of more than 12 individuals. Source: Capital Group
2. Turnover methodology is the lesser of purchases/sales divided by average market value. Based on representative account as at 31 December 2014. Source: Capital Group

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