How do you determine fundamental value?

Fundamental value is critical to our investment approach, and it is behind every decision we make in the Macro Allocation Fund. But what does fundamental value mean? Well, for assets, equity markets and bond markets, fundamental value is the present value of future cash flows. Simply stated, we identify the future cash flows that will accrue to an equity market, a bond market, a sector, an equity sector or a bond category. We then discount, using interest rates, discount those future cash flows back to the current value to determine what, ultimately is fundamental value, for the equity market or the bond market. For currencies, we use what is known as purchasing power parity, and purchasing power parity simply means that the exchange rate finds its fundamental value when it equalizes the prices of goods and services in each country. That is fundamental value. And if the exchange rate differs from that, it will gravitate back toward fundamental value.

For example, if goods are cheap in Germany, a U.S. investor has the opportunity to go to Germany, buy those goods, bring them back to the U.S. and sell them and make a profit. In doing that, that cheap currency gets pushed higher back to fundamental value. In all instances, if prices are below fundamental values, we will buy. If prices are above fundamental values, we will sell. We don’t transact in commodities directly because we don’t have the ability to determine fundamental value through a discounted cash flow process.

We’ve also discovered something else over the years. Prices converge on fundamental value for exchange rates or currencies faster than for equities and for bonds. For currencies, it’s on the order of about four or five years; for equities, it’s on the order of about eight to ten years. The bond markets are somewhere in between. What that means is fundamental value is a very powerful tool for currency management and it’s for that reason that within the Macro Allocation Fund we allocate a significant portion of our risk budget to currency management.

DISCLOSURE

The opinions and forecasts expressed in the following interview are those of Brian Singer as of February 3, 2014, and may not actually come to pass. This information is subject to change at any time based on market and other conditions and should not be construed as investment advice or a recommendation of any specific security. Not all securities held in any William Blair strategy portfolio performed as favorably as those discussed, and there is no guarantee that these or other securities will perform favorably in the future. Investments are subject to market risk.

The Fund involves a high level of risk and may not be appropriate for everyone. You could lose money by investing in the Fund. There can be no assurance that the Fund’s investment objective will be achieved. The Fund is not a complete investment program and you should only consider the Fund for the alternative portion of your portfolio. Separate accounts managed by the Advisor may invest in the Fund and, therefore, the Advisor at times may have discretionary authority over a significant portion of the assets invested in the Fund. In such instances, the Advisor’s decision to make changes to or rebalance its clients’ allocations in the separate accounts may substantially impact the Fund’s performance. The Fund is designed for long-term investors.

The Fund may use investment techniques and financial instruments that may be considered aggressive—including but not limited to the use of futures contracts, options on futures contracts, securities and indices, forward contracts, swap agreements and similar instruments.
How do you determine fundamental value?

Such techniques may also include short sales or other techniques that are intended to provide inverse exposure to a particular market or other asset class, as well as leverage. These techniques may expose the Fund to potentially dramatic changes (losses) in the value of certain of its portfolio holdings.

Investments are subject to a number of other different types of risk, including market risk, asset allocation risk credit risk, commodity risk, counterparty and contractual default risk, currency risk, and derivatives risk. For a more detailed explanation and discussion of these risks, please read the Fund’s Prospectus.

Please carefully consider the Fund’s investment objective, risks, charges, and expenses before investing. This and other information is contained in the Fund’s prospectus, which you may obtain by calling +1 800 742 7272. Read it carefully before you invest or send money.