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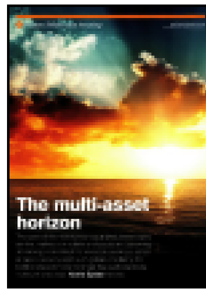

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The multi-asset horizon

The dawn of the new normal has arrived; interest rates are low, markets are volatile and assets are becoming increasingly correlated. For investors seeking a sense of capital security amid such global uncertainty the traditional asset mix is no longer the celebrated safe harbour it once was. **Kerrie Sydee** reports.

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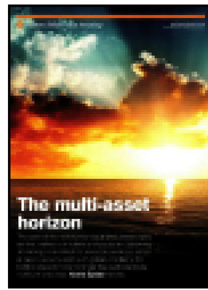

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01:
Vadim Zlotnikov
chief market strategist, AB

02:
Ben Smoker
chief executive, Saxo Capital Markets Australia

03:
Michael O'Dea,
head of multi-asset, Perpetual

While global growth is brightening, investors are timid to hedge their bets on just equities and bonds. For investors with clear risk profiles and set objectives, multi-asset investing can play a crucially defensive roll in alleviating risk and preparing for future macro-economic shocks.

According to AB's chief market strategist Vadim Zlotnikov[01], a holistic approach to investing is now becoming increasingly important to meet investor goals.

"Unconstrained (including alternatives, leverage, and different assets/strategies) multi-asset investing is increasingly critical to investors' ability to meet certain outcomes. These can include inflation protection, current income, diversification of equities and bonds, and specific liability streams," Zlotnikov says.

"There are very few ways to effectively meet these objectives through a siloed view of major asset classes. A holistic approach that affects the entire risk budget of the portfolio is increasingly being adopted by institutional and retail investors."

Revitalising asset allocation

The traditional 60/40 split has been a successful baseline tool for asset allocation, however the increasing correlation between assets in conjunction with negative interest rate territory suggests the traditional split may no longer have the legs to deliver the returns investors are expecting.

Head of multi-asset and macro investing at Standard Life Investments Guy Stern argues that while the 60/40 split has been very successful for investors over the last 20 to 30 years, it will eventually fail to deliver investors the returns they need.

"It will fail either by disappointing investors or it will fail in a magnificent way over the next three, five and 10 years," Stern says.

"Your mix of 60/40 has been volatile in the past and will continue to be. If we get a rising interest rate environment equities and fixed income are positively correlated so they will go down together. In a rising interest rate environment, which I can reasonably expect over the next few years, you're going to get equities suffering, you're going to get bonds suffering, and from a return point of view, failure for the end investor."

Chief executive of Saxo Capital Markets Australia, Ben Smoker[02], agrees the 60/40 split is losing its bearing in modern portfolios. Smoker highlights that while it was the poster child of pension funds for many years, the 60/40 split can no longer be considered as relevant in today's market conditions.

"When fixed income starts to return less than inflation there's inherently a lot of risk in investing in bonds, so the relationship between bonds and equities ebbs and flows but when you have an unprecedented structural headwind like QE driving bonds and equities up together in unison it starts to put the old 60/40 model into question, particularly when yields go to zero and below."

It will fail either by disappointing investors or it will fail in a magnificent way over the next 3 five and 10 years.

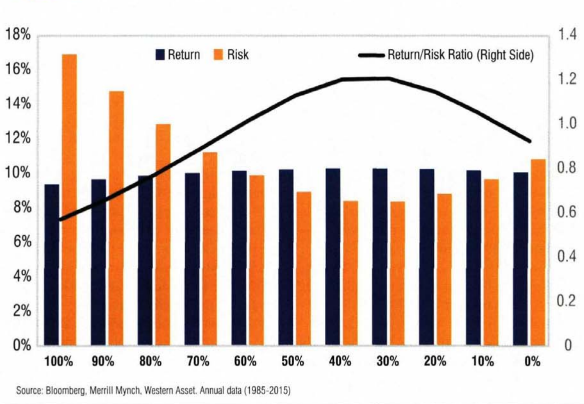
Taking a slightly different approach is head of multi-asset at Perpetual, Michael O'Dea[03]. He does not believe the 60/40 split will fail spectacularly but that there is a strong possibility it will have a rocky ride ahead.

"For many years a 60/40 portfolio suited most investors for most of the time," O'Dea says. "However, there is a genuine possibility that we are nearing the end of a 30 year bull market in bonds, in which case 60/40 portfolios may go through a period of being a source of higher volatility and lower returns while markets adjust.

"It is very important for investors to decide on whether they are a long term investor, in which case they should own equities and hold them for the long term, or whether they need to manage risk in the near term. Managing portfolio risk has become more complex than simply buying bonds to diversify the portfolio."

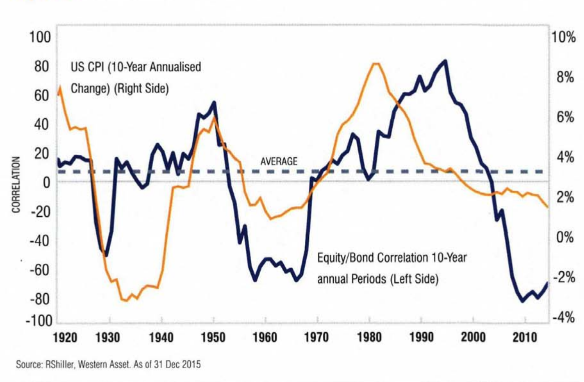
Head of investment strategy, multi-asset team at BlackRock Australia, David Griffith[04], agrees the 60/40 asset allocation split has fared investors well in the past having been aided by a

Figure 1. 30 Years Equity-Bond Relationship



Source: Bloomberg, Merrill Mynch, Western Asset. Annual data (1985-2015)

Figure 2. Correlation



Source: RShiller, Western Asset. As of 31 Dec 2015

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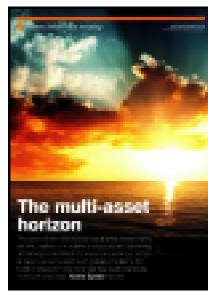

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04:
David Griffith
head of investment strategy, multi-asset team, BlackRock Australia

05:
Debbie Allison
head of multi-asset portfolio management, AMP Capital

06:
Luke Roberts,
director, Unica Wealths

favourable policy mix but will still serve investors in the future.

"Traditional growth/defensive portfolios have served investors well over the past 15 to 20 years," Griffith says. "More recently these strategies have enjoyed stronger than average returns as most asset classes have benefited from policy stimulus measures deployed post the financial crisis.

"Given the subdued outlook for global growth in the period ahead, we would anticipate that returns from these strategies may be somewhat less than what we have seen in recent years."

Achieving client goals

AB's Zlotnikov highlights the 60/40 allocation carries about 90% of outcome risk in the performance of equities and given current equity valuations and poor earnings growth it may not be the "ideal starting point." Instead he says that future asset allocation splits will be more varied and based on the requirement of individual outcomes.

"In the future we expect the 'core' of the portfolio to be more tailored to client's explicit outcomes, rather than generic 60/40 allocation. However, the 60/40 (or variations such as 40/60) will remain important benchmarks for evaluating performance of multi-asset approaches and will not simply go away."

Building on the idea of investing for outcomes, AMP Capital head of multi-asset portfolio management, Debbie Allston[05] notes that portfolios built on a static growth/defensive allocation split are becoming less relevant in the Australian market; a shift which has been influenced by the move to goals-based investing. Through moving to goals-based investing there is a movement away from a risk based measure of suitability to products that are instead designed to meet the end needs of investors.

"If they haven't already done so, advisers should develop a goals-based narrative that seeks to align an individual client's needs to the investment that is best placed to meet that need," Allston says. "Often, these needs or goals are best met by a multi-asset fund or with a combination of funds focused on different asset classes."

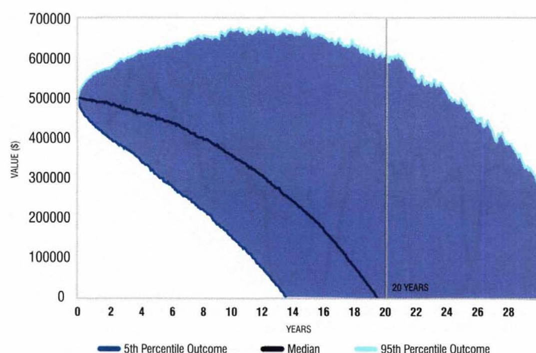
Perpetual's O'Dea adds it is important for advisers to reiterate the importance of staying focused on managing absolute risk rather than managing to a market capitalisation benchmark.

"Pursuing short term relative performance is often at the expense of achieving long term investment success," O'Dea said.

He highlights that while multi-asset strategies, or real return strategies, are favourable for clients approaching or in retirement, they are of high value to clients in all life stages including those looking to buy a house or generate higher returns than a term deposit.

"For investors approaching, or already in retirement, the focus often shifts from maximising returns to minimising risk and targeting a specific level of return. Real return strategies can provide the focus on managing risk that investors facing retirement often require – protection from volatility, without sacrificing growth. This can provide the peace of mind to enjoy life leading up to retirement and beyond," O'Dea says.

Figure 3. Impact of traditional accumulation strategy in retirement



Source: AMP Capital

> *Pursuing short term relative performance is often at the expense of achieving long term investment success.*

"But real return funds aren't just for investors approaching or in retirement. They are designed for any investor looking for greater diversification of their investment portfolio, lower volatility and more regular investment returns."

For director at Unica Wealth[06], Luke Roberts, it is critical for clients to hold a multi-asset portfolio to ensure diversification away from the Australian asset bias.

"Our view is that multi-asset investing is essential, of course the asset classes need to be blended to match an investor's appetite for risk, but holding a blended set of assets is a critical part of any portfolio construction," Roberts says.

Similar to O'Dea, Roberts believes holding a multi-asset portfolio is essential for providing and meeting outcome based objectives, reiterating the absolute need for understanding all client needs and expectations.

"All clients want to make a return but no client would choose to risk a long term negative return that can come with a single asset strategy. The key is blending a portfolio to ensure the appropriate risk profile is in place for the individual client and their goals," Roberts says.

"What we strongly advise clients on is to match the risk profile on their needs and outcomes, taking into account the current markets we're operating in…clients need to have a really good understanding of what returns they can expect that potentially going forward, those returns may be lower than they have previously become accustomed to."

Griffith adds that advisers have the building blocks to build both diversified and cost effective multi-asset portfolios, but must understand the risk and return trade-offs for each asset class when building the portfolio to ensure the investor can achieve the returns they are hoping for.

Griffith emphasises that both advisers and clients must wholly understand the objectives and risks that involved with the strategy to ensure the best possible solution can be delivered.

"Being clear with clients around what objectives the client is looking to achieve, whether that's a particular growth or income objective and choosing a multi-asset portfolio that can best suit the client needs," Griffith says.

"In addition, clearly outlining the risks involved with the strategy so the client has a good understanding of how the strategy may perform in different market environments."

Adding to this, Colonial First State head of investments Scott Tully[07] cautioned the plethora of multi-asset products entering the market will make it even more integral for advisers and clients to understand the strategies they're using and how they will react in different market conditions.

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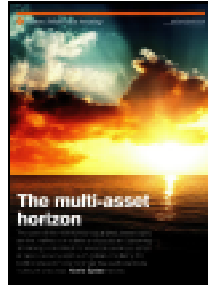

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Scott Tully
head of investments, Colonial First State

08:
Simon Ho
chief executive, Triple 3 Partners

09:
Jim Christensen
managing director, global multi asset at QIC

"There are more people marketing these types of products, so there will be more interest, but ultimately I think the question comes down to do people understand what they're buying?" Tully said.

"Do they understand the scenarios in which an investment strategy will succeed and understand the scenarios in which it will fail? There is the potential that some of these products are not fully understood by the people using them and that the environment we've been through has made them look good, but if environments change the outcome is going to be different."

Chief executive of Triple 3 Partners Simon Ho[08] iterates that while many clients may be looking to multi-asset portfolios for diversification and a home away from volatility, that volatility in itself is not such a bad thing for portfolios.

"Multi-asset investing has a role to play in portfolio diversification, but volatility as an asset class needs to be considered, and incorporated into the multi-asset portfolio construction process," Ho says. "With negative correlation to equities – and most other asset classes – volatility can be used to enhance returns, manage risk and potentially provide an additional source of alpha to a portfolio."

Adding to this Ho highlights that while the pursuit of diversification is the top of many advisers and investors minds, spikes in cross correlation can make diversified portfolios less effective.

"We believe that the long standing tenant of portfolio diversification remains a good idea, but cross correlation between assets and markets have steadily increased in the past decades and are well known to spike during times of financial distress - thus rendering diversification less effective," Ho says.

Offering a complimentary course of action, Ho suggests clients should use options to insulate themselves from adverse market and economic movements.

"Options can re-shape a portfolio distribution more effectively and precisely than any other instrument," Ho says. "What's more, they are able to be used in both an 'offensive' and 'defensive' setting – they can prevent losses beyond a specific level or to generate income, such as with a covered call writing program to buffer moves to the downside."

What's next for multi-asset?

AMP Capital recently announced its Multi-Asset Fund had exceeded $1 billion in funds under management (FUM), citing market volatility as a factor in the significant increase in customer and adviser interest.

AMP Capital multi-asset fund senior portfolio manager, Matthew Hopkins, says the strong growth was because the funds have been specifically designed to meet objectives rather than outperform benchmarks.

"FUM has increased significantly during the last 12 months as a result of increased communication with investors and improved awareness of the benefit of multi-asset investing," Hopkins says. "Markets have also been more volatile during the last two years, which has led to many advisers and customers looking for investments that are better able to navigate the market's ups and downs. The Multi-Asset Fund has been a good home for that capital."

Unica Wealth's Roberts agrees and anticipates interest and investment in multi-asset funds will continue to grow as investors become increasingly educated.

"With reducing interest rates across the globe investors will be looking for other sources of return," Roberts says. "Multi-asset investing will only increase as people understand and are educated on the diversification benefits and on the returns available outside of Australian shares."

A manager of multi-asset funds for more than 25 years, QIC has noted an increased interest in liquid alternative portfolios and solutions.

"Typically, these liquid alternative portfolios target equity-like returns with significantly less risk. Liquid alternative portfolios rely on their exposures to factors such as value, carry, quality and momentum across a range of asset classes to generate solid risk-adjusted returns," managing director, global multi asset at QIC, Jim Christensen[09] says.

For O'Dea the appetite for multi-asset strategies will continue to grow into the future, as investors continue to see the value of aligning their investments to tangible goals and investments.

"We believe real return investing is a permanent shift back to aligning portfolio construction with what is important to investors: to produce healthy returns over inflations while managing downside risk," O'Dea says. "It also represents a move away from a sometimes unhealthy obsession with managing to a peer group and hiding behind, sometimes deeply flawed, long term return assumptions."

> *All clients want to make a return but no clients really want to lose money over the long term, so the key is blending a portfolio to ensure the appropriate risk profile is in place for the individual client and their goals.*

Global outlook

AB's Zlotnikov anticipates developed markets will continue to perform well through to the year's end but cautions that returns will remain in the low single digits, making additional risk taking through active management and uncorrelated factor exposures increasingly important for investors moving forward.

Similarly QIC anticipates global growth will trend broadly sideways in the second half of 2016 and will experience a modest pick up over 2017. QIC predicts global growth in advanced economies will accelerate from a "lacklustre" 1.5% in 2016 to 1.9% in 2017 but warns the picture is mixed at a regional level.

"We expect the US economy to rebound in 2017 as the headwinds from the energy sector and the run down of excessive inventories diminish," investment director, global multi asset at QIC Neil Williams said.

"On the other hand we forecast the UK to slow in the face of the fall out from Brexit and we also expect the Euro area to lose some momentum in 2017. Japanese growth is expected to pick up marginally in 2017 but will remain low."

Managing director and head of multi-asset strategy and multi-asset solutions at J.P. Morgan, John Bilton agrees the global growth outlook is starting to brighten but notes positive outlooks still carry fears of hawkish turns in policy.

However, J.P. Morgan believes such fears are overstated and instead the Federal Reserve (Fed) will raise rates glacially, benefiting assets like credit and allowing emerging market assets to recover further.

"Our base case sees the economic outlook improving into year-end as risks in developed economies become more balanced and the worst of the downturn in emerging economies fades," Bilton said.

Bilton acknowledges the mix of slow but positive growth and extended asset valuations does present a number of challenges for investors. He notes that economic optimists must accept that equity multiples are very full and are sensitive to higher policy rates. For pessimists he said they must recognise that near-zero bond yields make for lean pickings in cautious portfolios.

"Our 'low growth, no recession' view of the world continues to drive portfolio allocation… The improved trajectory of growth and full valuations of government bonds are reflected with a mild overweight (OW) to stocks vs. bonds," Bilton said.

"The U.S remains our preferred equity market. We add an OW to UK equity, based on currency support, and an OW to EM equity based in receding economic risks and stable dollar; out least favourite market is Japan.

"In fixed income, we learn further into credit with an OW to U.S and European high yield, as well as to EM debt, all funded out of the investment grade; we maintain a neutral duration view with a preference for U.S Treasuries over UK Gilts and German Bunds."

In his conclusion Bilton added: "While we do adopt a slight pro-growth tilt, we are under no illusions that asset returns will be anything but meagre. Returns are capped either by rich valuations or limits to plausible global growth - or both. Yet we do believe that this economic expansion has further to run and, more important, that policy makers are acutely aware of their role in making this happen." FS