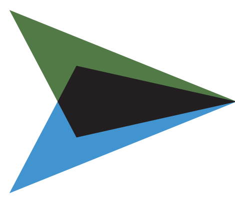
Investment **INSIGHTS**



# With risk and volatility elevated, multi-asset strategies may provide stability

**DAVID MILLAR**
Head of Multi-Asset
Invesco

**SCOTT WOLLE**
Chief Investment Officer, Global Asset Allocation
Invesco

Recent extreme market volatility has created sizable asset class exposure shifts in many institutional portfolios. Invesco portfolio managers Scott Wolle, chief investment officer, global asset allocation, and David Millar, head of multi-asset, discuss what they are hearing from clients about the current risk climate and offer insights into strategies for resetting allocations to help optimize potential investment outcomes and provide some downside protection.

**Pensions & Investments: What trends are you seeing as institutional investors respond to the current market landscape?**

**DAVID MILLAR:** Some investors are expecting a relatively quick V-shape recovery from the current economic displacement, which is in sharp contrast to the general reaction in 2008, when investors' comfort around taking on risk was a much slower, painful process. Unfortunately, investors' memories can be notoriously short. Fortunately, investors today have an incredibly diverse selection of strategies to help better manage and fine-tune portfolio volatility exposures, which allows a broader introduction of lower- and non-correlated assets to more traditional asset class allocations. This approach can help strengthen overall defensive and upside characteristics. Over the past 10-plus years, investors have learned the importance of being prepared for a broad range of market scenarios. Over that same time period, most investors have been richly rewarded for taking on equity risk. Market pullbacks have been relatively short-lived and have typically turned out to offer attractive buying opportunities.

**SCOTT WOLLE:** One of the most common themes has been around the importance of liquidity — and the challenges of finding it during major market disruptions. Similar to the 2008 economic crisis, risk assets of all types experienced a sharp global sell-off as the potential human and economic toll of the COVID-19 pandemic became increasingly apparent. That initial broad market free fall seems to have stabilized, to a degree, after governments and central banks worldwide quickly stepped in with unprecedented fiscal and monetary stimulus responses[1]. However, the crisis has been a stark reminder that investors should always keep in mind where they can turn to quickly for liquidity in their portfolios when everything seems to be falling.

Highly liquid multi-asset strategies can provide a compelling choice in this type of uncertain climate by offering the potential to pursue steadier return streams with attractive upside beyond most typical traditional fixed income securities but without the drawdown exposures often experienced in equity markets. This can help provide investors with an expanded range of levers and a broader opportunity set to expand expected return consistency during strong and volatile investment environments. That, in turn, can help strengthen longer-term portfolio outcome potential across full market cycles.

**P&I: How can multi-asset strategies work for risk mitigation?**

**MILLAR:** The flexible nature of many multi-asset strategies allows for a shift away from specific market- and benchmark-driven performance to more absolute return and other outcome-oriented solutions that strive for greater control over risk exposures. A major advantage of these strategies is that they offer a way to increase potential portfolio risk efficiency with greater liquidity, transparency and cost efficiency compared to other popular alternative investment strategies such as hedge fund, private equity and venture capital investments.

> *Multi-asset solutions offer a way to increase potential portfolio risk efficiency with greater liquidity, transparency and cost efficiency compared to many alternative investments.* - DAVID MILLAR

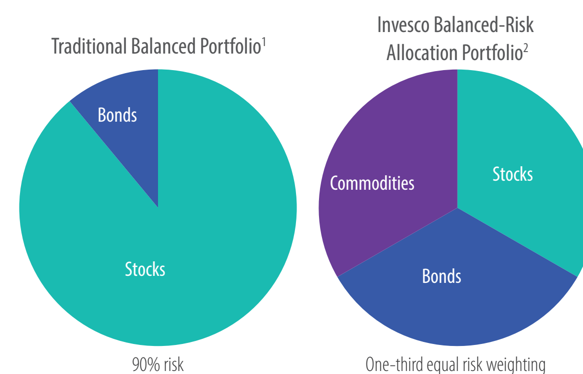
**P&I: What are some of the different ways these strategies attempt to shape risk exposures?**

**WOLLE:** The multi-asset segment includes a wide range of strategies, from traditional 60/40 balanced portfolios to more customized, sophisticated solutions. In terms of risk mitigation, let's start with risk parity, in which allocations are designed based on volatility contribution rather than capital exposures.

In a traditional balanced portfolio of 60% stocks and 40% fixed income, history shows that up to 90% of portfolio risk would be generated by the equity allocation, which isn't balanced at all. By contrast, our Balanced-Risk Allocation strategy optimizes allocations across equity, fixed income and commodity market exposures with the goal of each asset class contributing an equal amount to overall risk. It then adds a tactical overlay to help take advantage of current market conditions. Futures and other derivatives are used to gain efficient, highly liquid exposure to the three asset classes and up to more than 30 sub-asset classes.

Focusing on balancing risk contributions across these assets can offer a stronger economic diversification model. Stocks tend to do well in non-inflationary growth environments but can struggle during other phases of the economic cycle. Long-duration government bonds can offer attractive defensive attributes during recessions and crisis periods. Commodities can help defend a portfolio during inflationary growth periods. As volatility rises in one of these segments, capital exposure naturally decreases through a systematic monthly rebalancing of the portfolio's strategic and tactical risk allocations. The goal is to deliver more consistent performance across the full economic cycle, with less risk than a traditional 60/40 allocation. Further, while the strategy's returns are still expected to be linked to what is transpiring

**A MORE BALANCED APPROACH TO RISK EXPOSURE**




*[1] Sources: Invesco analysis and DataStream. Time period represented: Aug. 31, 1973 to March 31, 2020.. Over this time period, a hypothetical portfolio of 60% stocks and 40% bonds derived 90% of its overall risk from stocks and 10% from bonds based on historical correlations and standard deviations. Bonds are represented by the Bloomberg Barclays U.S. Treasury Index. Stocks are represented by the S&P 500 Index. An investment cannot be made directly in an index. Past performance is not a guarantee of future results. [2] For illustrative purposes only. Risk contribution refers to Invesco's targeted strategic allocation whereby one-third of the overall targeted portfolio risk is assigned to various asset classes used within the fund. *Risk target (standard deviation of monthly returns).*

Investment INSIGHTS

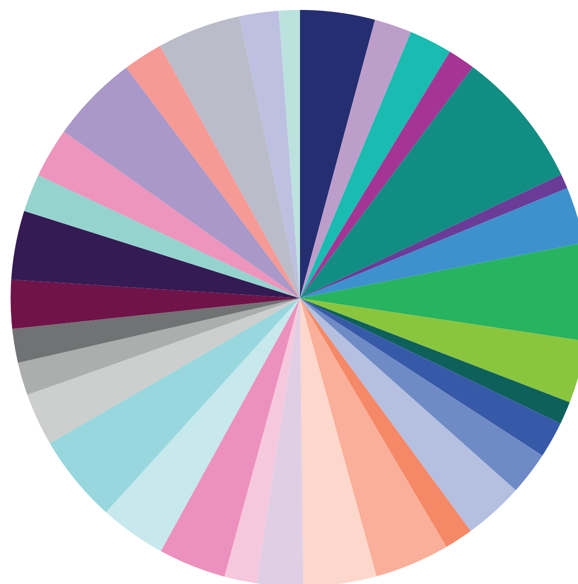
in the underlying markets, its methodical, disciplined use of risk targets has resulted in lower correlations to global equities and U.S. fixed income markets of 0.73 and 0.49[2], respectively, since inception[3].

**P&I: How can absolute return strategies work in today's market environment?**

**WOLLE:** Absolute return approaches can vary widely in terms of philosophy and execution, offering investors a broad selection to help meet their specific needs and goals. For example, the Invesco Macro Allocation strategy utilizes some of the tools from our balanced risk allocation strategy, but significantly dials up the tactical overlay to be the primary driver of returns, representing approximately 80% of overall expected return. It also has the ability to invest in long and short positions, which allows the portfolio greater flexibility to seek positive absolute returns over complete economic and market cycles, with performance independent from broader capital market indices.

The strategy's dynamic approach is differentiated from other absolute return approaches by its systematic use of risk premia exposures rather than alpha potential for portfolio allocation decisions. It starts with a risk-balanced core and then applies active tactical positioning based on directional and relative volatility trends. The result has been a unique risk/reward profile that historically has delivered consistently positive returns over longer timeframes, with attractive defensive attributes during difficult markets and uncorrelated behavior compared with traditional assets and other types of absolute return strategies.

**INVESTMENT IDEAS FORM THE BUILDING BLOCKS OF THE PORTFOLIO**



**33 IDEAS**
Each idea is sized to deliver an estimated 25-50 bps contribution to return[1]

**7 ASSET CLASSES**
Each asset class must contribute less than 50% to total risk[1]

**17 REGIONS**
Reduce risk of concentration to a particular country/region

*Source: Invesco as of Mar. 31, 2020. For illustrative purposes only. Portfolio characteristics are subject to change without notice.*
*[1]There is no guarantee these targets will be achieved.*

**MILLAR:** The Global Targeted Returns strategy takes a different approach, breaking from traditional asset allocation models to pursue absolute returns through an idea-driven portfolio. The strategy combines extensive, unconstrained research with a risk-based portfolio management process, and the portfolio typically blends together 20 to 30 investment ideas identified by searching across global assets, geographies, sectors and currencies for opportunities that can provide an attractive blend of risk and return. These ideas can then be expressed using a wide range of assets across credit and government securities, equities, commodities and currencies, as well as other exposures such as inflation, interest rates, volatility and relative value pairs trading.

The strategy's approach to implementing emerging market ideas offers an interesting example of this process. Our research allows as us to isolate relative value opportunities that pair fundamentally attractive assets with those that we believe represent the challenges within the broader emerging markets segment. One such idea pairs a long position in the Russian ruble with a short position in the Chilean peso. The portfolio has benefited from holding the slightly cheaper, higher-carry ruble over the peso, as the twin-surplus Russian economy has been better positioned than the twin-deficit Chilean economy. Foreign direct investment flows also have been clearly in Russia's favor. As the ruble has strengthened against the peso, the portfolio has captured a steady, attractive gain. This type of drilldown to find compelling ideas can offer investment return potential without being dependent on the direction of emerging markets.

Each idea is selected based on its potential to add independent, positive return to the portfolio over a two- to three-year time horizon. The idea's relative size within the portfolio is based on return potential and expected volatility exposures under various economic scenarios, both in isolation and in relation to other ideas. The goal is to collectively deliver a strong consistent hit ratio, with the majority of ideas generating additive returns and no single idea or risk exposure dominating performance. Offering investors access to many diversified return streams is designed to positively skew historical monthly portfolio return distributions while significantly lowering equity beta exposure and avoiding extreme drawdowns.

**P&I: How are institutional investors incorporating these types of strategies into their portfolios?**

**WOLLE:** Ultimately, it depends on the strategy and its portfolio characteristics, and the investor's goals and investment guidelines. The Balanced Risk Allocation strategy is often used as a more risk-efficient option for, or complement to, a traditional 60/40 portfolio allocation, given its potential for a higher Sharpe ratio. Some investors have also introduced a multi-asset sleeve into their portfolio allocations to help take advantage of the diverse return objectives and correlations offered across the segment. Macro Allocation is usually placed within a liquid alternatives sleeve or as a hedge fund complement or replacement, due to its excess return focus, relatively low fees, daily liquidity, daily pricing and absence of lockups.

**MILLAR:** Global Targeted Returns is frequently placed in a global tactical asset allocation or opportunistic sleeve, typically with other liquidity alternatives or hedge fund investments. One of the unique characteristics within the multi-asset space is that in addition to having lower correlations to traditional assets, these strategies also often exhibit lower correlations to one another due to the relatively wide range of investment styles. Because of this, investor allocations can include complementary strategies to further optimize portfolio risk/reward exposures.

*Looking ahead, we expect that the multi-asset segment will continue to experience growing demand. Investors are naturally interested in solutions that are less dependent on broader market performance. The recent market volatility highlighted how critical it is for investors to carefully think through their potential equity risk exposures. Multi-asset solutions offer a way to further round out their asset allocations with an added outcome-oriented perspective that may help with both risk mitigation and more resilient positioning for portfolio success over the long term.*

sponsored by:

www.pionline.com/invesco_multiasset

[1]As of April 30, 2020
[2]As of April 30, 2020
[3]June 2, 2009.

This document is intended only for institutional investors in the U.S. It is not intended for and should not be distributed to, or relied upon, by the public.
This is for informational purposes only, is not to be construed as an offer to buy or sell any financial instruments, and should not be relied upon as the sole factor in an investment-making decision. This document contains general information only and does not take into account individual objectives, taxation position or financial needs. This does not constitute a recommendation of any investment strategy for a particular investor. As with all investments, there are associated inherent risks. Investors should consult a financial professional before making any investment decisions if they are uncertain whether an investment is suitable for them. The opinions expressed herein are based on current market conditions and are subject to change without notice. These opinions may differ from those of other Invesco investment professionals. All data as of April 30, 2020, unless stated otherwise.
Invesco Advisers, Inc. is an investment adviser that provides investment advisory services and does not sell securities. NA5186

P&I CONTENT SOLUTIONS GROUP

This sponsored Investment Insights is published by the P&I Content Solutions Group, a division of *Pensions & Investments*. The content was not produced by the editors of *Pensions & Investments* and *www.pionline.com* and does not represent the views of the publication or its parent company, Crain Communications Inc.