SPONSORED ROUND TABLE

How Multi-Asset Investing Can Fit in a Modern Portfolio

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Multi-asset investing, a diversified and customized investment approach that can better manage portfolio risk exposure, is increasingly on the radar of plan sponsors — particularly in the current environment of rising interest rates and fully valued stock prices. The term can include multi-sector fixed income, credit, equities and real assets, typically with a deeper look at the underlying risk premia. But some investors are cautious of the complexities involved in implementing multi-asset strategies. In this round table discussion, K. Stuart Peskin, investment director at Aberdeen Standard Investments, Danielle Singer, portfolio director, multi asset, at Invesco, and Mark Andersen, senior vice president at Callan's Trust Advisory Group, discuss the opportunities and challenges for investors, and the outcome-orientation of multi-asset investing strategies for optimal positioning in all types of market environments.

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Pensions & Investments: What are the macro issues in 2018 and beyond for investors to keep in mind as they consider multi-asset strategies?

DANIELLE SINGER: For some time now, we've been in this muddle-through type of global growth backdrop that could mean that the macro environment continues to be decent in terms of support for risk assets. Our concerns about what could support global growth and guide monetary policy are more structural in nature — areas like private sector debt, servicing that debt and the impact of interest rate increases. For instance, if you look at China credit growth over the last year or two, which has been highly supportive of global trade and global growth, you can drill down into some headwinds of currency risk and dollar liquidity based on the denomination of that debt. Also, more generally, the impact of a lower-wage and lower-productivity environment could have longer-term pressures on global growth. So while cyclical trends may look fine, structurally, there are areas we have to keep an eye on.

STUART PESKIN: I agree with Danielle's list of macro issues to keep in mind. I would place at the top of any list the fact that the stimulus from central banks is fading. It's not going to fade today or tomorrow or through the course of 2018, but as it fades, that will definitely change the environment that has been so positive for traditional assets.

P&I: What makes multi-asset investing compelling for institutional investors today?

MARK ANDERSEN: Some of the things that Danielle mentioned are broad headwinds, or at least no longer tailwinds, to the traditional risk premia that investors have had in their portfolios — those being the equity risk premium and duration, or term-risk, premium — or the equity and bond allocation in plan sponsor portfolios. We expect we're going to get less out of those traditional risk premia going forward. So what can plan sponsors do to seek additional compensated risk exposure? That brings in some of the alternative risk premia solutions that have come to market in the multi-asset space as well as the regime-based or tactical components of multi-asset strategies that are more forecasting oriented.

SINGER: It's very much what Mark just said. It is allowing for a broader opportunity set to help investors meet the rate-of-return assumptions they need to get to their end goals. What multi-asset investing can do, at its core, is provide plan sponsors with more levers and broaden the opportunity set. It allows for more independent risk and return drivers to complement traditional risk premiums, or traditional market return sources, that may be challenged by the environment we're in. Multi-asset investing not only includes asset classes outside of stocks and bonds, but also the idea of doing more relative value or long-short pair trades. It can isolate more idiosyncratic return streams and alternative asset classes.

PESKIN: The taper tantrum of 2013 [when the Federal Reserve announced the imminent reduction of its bond purchase program] gave investors some insight as to the stability of their portfolios, or the types of outcomes they might see in a higher-rate environment, but it's been quite a long time since investors have been able to witness how their portfolios might perform in a choppier, less forgiving environment. It may not necessarily happen in 2018, but it's not too far out. That really means that multi-asset portfolios can be set up to deliver something different — and in a positive manner — when those events unfold. We've seen quite a trend over the past several years of incorporating risk premia-type strategies to multi-asset portfolios in a meaningful way, in a more quantitatively-based-type of exposure.

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P&I: Given that multi-asset can be a catchall name for diversification, how would you define multi-asset investing?

SINGER: You can think about the very simplest multi-asset portfolio as traditional 60-40 portfolio. Multi-asset can be defined as an asset allocation-driven approach, all the way to multi-strategy hedge funds. It really depends on who's defining it, and, even regionally, definitions vary. What ties everybody together is this common thread of trying to deliver long-term risk-asset-type returns, but with lower risk and with some form of diversification. That's the multi-asset nature of it.

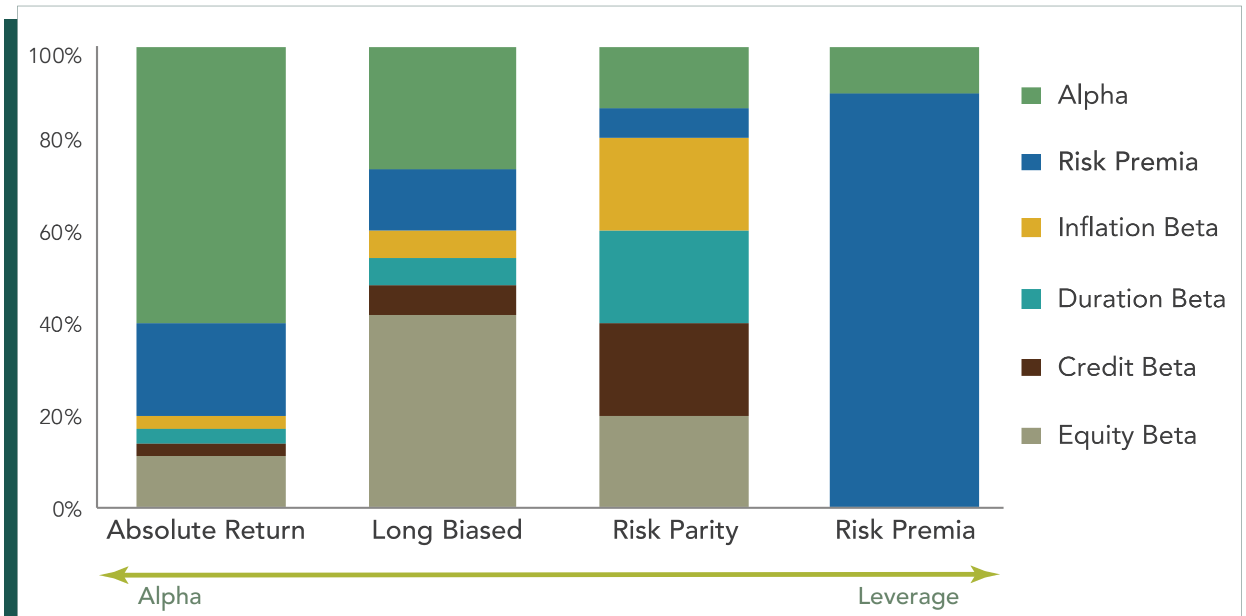
At Invesco, we manage various flavors of multi-asset, including a quantitative team that does it in a more risk-parity style. My team takes a more fundamental macro approach that we call 'investing in ideas.' What we're trying to do is take away all of the notions of asset-class labeling in buckets and give ourselves the freedom to look across all global liquid markets to source good long-term investment themes that we believe can deliver positive return in different types of market environments. When we pull them all together in a portfolio, we then think about what the impact is on overall diversification and risk.

PESKIN: Multi-asset really comes down to approaches that are not benchmark plus. From our perspective, when you're building a multi-asset strategy, you're not only focusing on the return outcome, but also the volatility of the strategy. The outcome orientation is complete with both of those considerations being fairly well defined for the client. Also, in the portfolio construction, you need to have limited constraints to really achieve multi-asset-type exposure.

At Aberdeen Standard Investments, our approach is largely macro as well. We have created a suite where different levels of return and risk can be achieved with different multi-asset strategies.

So whether it's cash plus 3%, cash plus 5%, or cash plus 7.5%, we have an approach — sometimes more than one — that is geared to that different absolute-return objective. And then we have one where the risk is slightly higher, allowing for a little bit more equity beta in the portfolio construction, and we try to achieve equity return through the cycle.

HERE ARE THE RETURN SOURCES FOR MULTI-ASSET



Note: This chart is not representative of an actual portfolio or a prediction of return attribution expectations. Rather, it is an illustration of what plan sponsors might roughly expect across various categories, understanding those categories may be overlapping dependent upon varying definitions. Source: Callan LLC

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P&I: Which investment objectives are dominant for investors considering these strategies today, particularly in the U.S.?

ANDERSEN: The conversation tends to start with diversification and how to get away from, or potentially complement, the significant exposure to equity risk in the vast majority of plan sponsor allocations. The conversation evolves from there but it starts with the question, 'How can we achieve goals without taking on quite as much equity risk as has been the case?' From there, the question — how much return do you need out of the allocation? — tends to inform some of the discussions on whether the plan sponsor is looking for downside protection via a tactical manager who can capture much of the equity upside but perhaps be a bit more defensive in volatile periods, or perhaps looking at a new compensated risk, whether it be alternative risk premia or using leverage to generate some differentiated return streams.

SINGER: That's exactly it. In the U.S., where this is a relatively newer allocation for many plan sponsors, it is more about the core philosophy of diversification and the impact on the portfolio. In the U.K., multi-asset strategies have been around for over a decade and have evolved to be a true equity replacement for pension plans, and they are being used even more as a de-risking asset in DC plans. So the objectives may vary, and may be borne out of regional expectations and investor needs. I expect that as these conversations continue in the U.S., we'll see some clearer trends in terms of where this fits in an overall asset allocation and funding source.

PESKIN: It's very much the diversifying characteristic that's dominant, though there's the occasional de-risking desire that investors have. More and more, we also see investors struggling with their fixed-income allocation and what to do with that. The overall objective is, I want something that doesn't perform like stocks and bonds, so from an environmental standpoint, my outcome will be different and won't necessarily fall at the same time when my stocks or bonds are weak.

I would say that [the take up of multi-asset strategies] has evolved a bit differently, meaning that the prevalence of multi-asset was here in the U.S. but the terminology was different — often it was called GTAA (global tactical asset allocation), and also risk-parity strategies that I think fit into a sub-class of multi-asset. There was a lot more risk-parity take-up in the U.S. than there was in Europe. In the U.S., multi-asset will become more prevalent when the performance differential between what multi-asset is delivering and what investors are getting from equities or core fixed income is incrementally better, either because it's more stable or the return is higher.

P&I: What are considerations for multi-asset to be incorporated into a portfolio or implemented for a total investment portfolio?

PESKIN: We see it's typically a portion of the total portfolio. And a key driver in the decision-making when creating the allocation is that the plan sponsor is likely to go with a mix of two or three managers. It's the complementary nature of one vs. the other manager that tends to be the big point of discussion, even for investors who may be considering multi-asset for the first time. Some considerations may be, for instance, the degree to which a strategy is long-biased, the equity beta and downside potential of some strategies vs. others, the style of management or the nature of idea generation, how long the time horizon might be, how ideas are generated in terms of the buildup of the investment process, and return histories. There often is a deeper dive into decision-making, but a lot of it comes down to the quantitative exercise.

SINGER: When we've spoken to plan sponsors in terms of their allocation as a percentage of their total portfolio, a lot of it has come down to their funding status. Because these strategies tend to trade off some of the larger upside potential of equity markets for better downside capture, and you limit some of the tails in the distribution, it becomes a more consistent return stream that tends to better suit a plan sponsor who is better funded. What we've seen when the plan sponsor needs to have some of that equity

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volatility or higher beta in their portfolio to have a chance of meeting their returns, they tend to be more willing to take on left-tail risk. Another consideration is the plan sponsor's comfort level with these strategies. They may be just dipping their toe in the water and may want to see how multiple managers coexist — and so they'll develop more of a sleeve approach as opposed to thinking about this for the whole plan.

ANDERSEN: With the holistic multi-asset approach, one of the headwinds to a significant adoption from a total portfolio perspective is maverick risk. If you're a chief investment officer reporting to a board of directors on a frequent basis, being drastically different from your peers and completely changing the approach to your plan's asset management is a pretty significant risk. Particularly in the U.S., we continue to see multi-asset as being a tool in a broader portfolio vs. a top-down solution that filters its way through the entire portfolio. Level of sophistication, experience with multi-asset and comfort with some of the alpha-oriented nature of some of these strategies is a big part of the adoption as well.

P&I: What are some of the tradeoffs in active vs. passive approaches in security selection in multi-asset investing?

SINGER: The tradeoff varies based on the style of the multi-asset manager. If the manager is doing more of the pure alternative beta-type of management, maybe this comes less into play. For fundamental managers like us, we're thinking about macro themes.

For example, if you think about Asia ex-Japan broadly as a market beta and want to get exposure to that, you could just go into, say, an MSCI-Asia ex-Japan index derivative. But what you'd really be getting is an outsized exposure to China and to technology and financials. So you may end up with a very big sector and regional domination, when the macro story that you're really trying to hone is much broader. In fact, you may see China as having potential headwinds and may want to downplay that a little bit. So that's where taking a passive exposure may not get you to the granularity or exactness of the macro theme that you're trying to express. In that case, you may want to take a more active approach, where you either have the ability to leverage some bottom-up security selection skills or think about actively allocating in some sectors or regions within that broader index.

ANDERSEN: We think multi-asset is an active universe. There are certainly elements of systematic investing under the hood, but multi-asset is active by definition. How you implement that active strategy can be done through index positions to get at some of the things that Danielle touched on from a very broad macro level. It can get pretty niche-y but still index-focused, and then it can get all the way down to active security selection. The tradeoffs, from the strategy perspective, are the scalability of having more systematic or passive exposures means you generally can run much larger portfolios. As you integrate significant security selection flavor into your multi-asset program, that can limit capacity.

PESKIN: It is an issue of going too far with active stock selection as what you don't want to have happen is that part of the strategy becomes a dominant force. In my thinking about multi-asset, you don't want it to tip over to become too much about the active stock selection, because then the integrity of what the multi-asset strategy is meant to deliver would fall apart.

P&I: With all the sophisticated risk management available, how can investors best understand and manage their multi-asset allocations?

PESKIN: Particularly in those periods where market upsets have been short, that is the really important part of the risk management process for a plan sponsor to be actively engaged during those periods — to hear from the manager, what their drawdown was and why, what they think were the drivers of the return and was it as expected? That makes risk management something much more meaningful and tangible. Different investors spend more or less time on risk management, but I think this is one aspect they should spend more time on.

Sometimes it can be torturous for us to witness what investors go through just to employ sophisticated software that can deal with multi-asset portfolios. It's really a very small subset that have the wherewithal to get down to the holding-level type analysis. Most investors are largely dependent on their managers. For ourselves, we have an on-desk risk team that makes the risk outputs meaningful and offers more of a summary to our portfolio managers. The portfolio managers may need to understand how the factor model works, but they are focused on the investment ideas and need the risk team to put the risk analysis in summary form.

SINGER: We need to get investors more comfortable with moving away from more traditional ways of looking at risk, especially those that tend to work better in single-asset strategies or strategies that don't use derivatives. For example, using notional exposure as a way to understand portfolio risk does not really translate very well into multi-asset. Clearly, having 2% in developed government bonds vs. 2% in emerging markets debt is very different in terms of returns and volatility. Therefore, investors may want to consider risk from a more standardized perspective, where they can truly compare like for like. Additionally, they might look at multiple complementary risk perspectives. I also believe that asset managers should be transparent with how they evaluate risk and their risk management process, as these strategies are very multi-dimensional in terms of how you may want to evaluate risk.

ANDERSEN: I agree across the board: many measures of risk, looking at exposures, volatility, correlations, beta across three different lenses — historical, scenario analysis and forecasting. And then the measures of exposure, limits on exposure, and portfolio positioning relative to specific factors and asset classes — are all good communication tools to help asset owners understand how the strategies work and what they should expect from them in the future. One of the things that Danielle also touched on is that transparency is important. But we're not convinced that radical transparency is all that useful to the asset owner. Transparency that is presented well, and presented in a consumable fashion is definitely important from the asset owner perspective as they look out at the multi-asset strategies market.

P&I: How do you think multi-asset investing will evolve over the next several years?

PESKIN: More ongoing conversation and education, whether it's around corporate plans and de-risking; the expansion of target-date funds and a willingness to do something a bit more nuanced; and even as an alternative to hedge funds for investors looking to achieve higher returns — all offer opportunity for multi-asset strategies. The broader view is that as investors get more comfortable with outcome-oriented strategies as a way to approach the building of their overall portfolio, that just means more opportunity for multi-asset.

ANDERSEN: A broader manager opportunity set across the multi-asset taxonomy is what I'm eagerly anticipating. We follow about 100 strategies at this point, and I'd love to see that number continue to rise over time. As asset owners and plan sponsors continue to look at this space, the ability of managers to point at a flagship product and then take it to the next level and talk about customization to a specific plan sponsor's needs is going to be a huge evolution as we watch multi-asset over the next five or 10 years. I don't think we'll get away from a product-centric view of the multi-asset space, but, increasingly, asset owners will want to see that flagship product and then understand how it can be tailored to their specific needs.

SINGER: For the U.S. or North America more broadly, you may start to see how overseas managers will think about how they can help U.S. investors. To Mark's point, while the number of multi-asset managers that are offering vehicles in the U.S. right now is fairly limited, there is no shortage of a much broader global set of managers that play in this space. I think it's going to be a growing piece of business, especially as people look to what has been their historical source of diversification, whether from traditional bonds, at one end of the liquidity spectrum, all the way to hedge funds. Now, seeing that there are potentially lower-cost, higher-transparency, higher liquidity complements can increase the appetite for multi-asset. ■

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