Redefining Multi Asset Solutions Whitepaper

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Welcome to CAMRADATA's Redefining Multi Asset Solutions Whitepaper

Governments and central banks have reacted to the Covid-19 pandemic with huge monetary and fiscal interventions in a bid to preserve investor confidence and to nurture business recovery. But faced with equity volatility, near-zero interest rates and low yields on government bonds, investors face searching questions regarding how they will manage their asset allocation and fund selection in a post-Covid economy.

Multi-asset funds aim to deliver attractive returns across a wide range of market conditions, employing an asset mix that protects against a sharp rise in correlation under stress conditions.

An attraction of multi-asset investing, say its proponents, is that it enables timely rebalancing of allocations between asset classes, while providing integrated risk oversight that spans the full multi-asset portfolio.

The aim is to deliver portfolio diversification, while offering flexibility to tailor investment outcomes to the needs of the investor, whether this be for growth, income, risk minimisation or absolute return.

Notwithstanding these objectives, multi-asset strategies have had a stormy ride over the past three to four years. However, data from the CAMRADATA universe of multi-asset funds for the period prior to the Covid-19 shock indicates that many of them were broadly delivering to their mandate.

Taking the CAMRADATA Diversified Growth Fund (DGF) universe as an example, many funds in the universe hit their target returns over a 12- and 36-month timeframe to the start of pandemic. DGF funds with an objective of cash plus three-to-five percent generated median returns of 12.06% over the year to 31 Dec 2019 and annualised median returns of 5.06% over the past three years.

But how effectively will Multi asset solutions meet their objectives as the global economy rebuilds after Covid-19? What steps will reinforce the appeal of multi-asset products in the eyes of fund buyers? How will fund managers adapt multi-asset strategies, and their associated fee structures, to thrive in a post-Covid environment?

Redefining Multi Asset Solutions *Roundtable*

The CAMRADATA Redefining Multi Asset Solutions roundtable took place virtually in London on 27 April 2021.

CAMRADATA's 2021 roundtable on multi-asset solutions began by exploring which organisations had felt the need to redefine or recategorise multi-asset. Tom Hawthorn, head of manager research at Cartwright, a pension scheme consultancy, began by saying that Cartwright had split multi-asset into two sub-sectors.

The first, (Market-Driven), included mainly long-only, broad asset class exposures, albeit typically with exposure to alternatives, asset class rotation, active stock selection. The second, (Dynamic,) also included more esoteric sources of return, including shorting and some Relative Value with more of a focus on capital preservation and downside protection in stressed market conditions.

Hawthorn's rationale for the division of multi-asset is that many pension schemes have significant exposure to multi-asset – typically in the form of Diversified Growth Funds (DGF). They might employ two or three DGFs. Like every

> ***" Like every other panellist in this roundtable, Hawthorn believed in employing more than one multi-asset manager where possible. But within a combination, he wanted greater clarity on what each fund is contributing "***

other panellist in this roundtable, Hawthorn believed in employing more than one multi-asset manager where possible. But within a combination, he wanted greater clarity on what each fund is contributing – hence the sub-division.

For Cartwright, broad asset exposure could be achieved by a fairly passive offering: it has one approved strategy that it is predominantly passive. But Hawthorn noted that as fees trend downwards, it was possible to get more active DGF managers for a Total Expense Ratio of below 50 bps where before the cost was 70-100bps.

In each sector Cartwright has a handful of approved strategies, although two had been taken off the list of buy-rated Dynamic funds after unsatisfactory performance during the market volatility of 2020, a period during which the Dynamic funds would be expected to show their worth as equity markets fell sharply and then recovered quickly. Hawthorn suggested that Absolute Return Bond funds (ARB) can play an important role for many schemes, and that in many cases a combination of Market -Driven DGFs and ARBs can preclude the need for Dynamic DGFs, which rely more on manager skill to generate returns and tend to charge higher fees. He asked: "If the more active and dynamically managed DGFs generate lower returns than market-driven, long-only DGFs, and provide less downside protection than ARBs, then what role do they play in a DB scheme's investment strategy?" In his view, the decision

had to be scheme-specific. For example, Dynamic DGFs might be preferable to Market-Driven DGFs for schemes with a weak sponsor, as capital preservation might be the most important criterion in selecting a multi-asset fund or funds. Hawthorn also questioned the Dynamic funds' ability to perform in the next market sell-off, and how much return they might give up looking for it. "Can managers be sure they will provide protection in the next downturn? It's challenging."

For Cardano, a pension scheme fiduciary manager, Simon Woodacre said that are two main components, market beta and alpha generation, to the solutions they provide. Alpha generation includes, but are not limited to, hedge funds, absolute return, credit and long-only equities. "We want to see convexity and an idiosyncratic risk-return profile," Woodacre explained.

What about strategies that bridge the divide between beta and alpha? Woodacre said that there are multi-asset strategies that invest in real assets which create alpha opportunities but these present liquidity constraints. Second, Absolute Return strategies need to demonstrate a differentiated risk-return profile. In other words, Cardano likes to maintain the divide between those that generate alpha and pure beta.

> ***" He noted huge interest in real assets, but also Risk Parity and Global Tactical Asset Allocation. How asset owners and asset managers relate is also varied "***

A similar argument for separation came from Riccardo Lawi, senior consultant at Aon, one of the world's largest institutional investment advisers. He said that multi-asset was mostly long-only or at least directional. It could be active or passive but Aon made a distinction from Absolute Return strategies and hedge funds. "We don't use directional multi-asset to achieve absolute returns" Lawi told the CAMRADATA panel.

He recalled that the origin of multi-asset - in the institutional world - was as a derisking tool for Defined Benefit pension plans: as a way for them to manage beta, not alpha. According to Lawi, that hasn't changed. "We don't include long-short or trading strategies in multi-asset," he said. "We distinguish investing from trading. You can't have investments based on a three-year economic view without onboarding some directional exposure to broad market risks."

Conversely, in the alpha and alternative beta space, just like Cardano and Cartwright, Aon would entertain a host of specialists, including CTAs and Alternative Risk Premia (ARP) strategies.

Lawi was not in favour of a one-stop shop for alpha and beta because that made it harder to tailor risks and returns from investments to each client's needs. With specialist managers, Aon is able to specify and oversee the right mix of risk premia and style exposures .

For bfinance, a manager selection consultancy, Chris Stevens said that multi-asset had grown over time to mean DGFs plus the likes of Standard Life's GARS and all its offspring – "ergo hedge-fund lite" - on the side. Where Stevens reckoned multi-asset had been redefined is in what institutional investors are willing to consider as diversifying. He noted huge interest in real assets, but also Risk Parity and Global Tactical Asset Allocation. How asset owners and asset managers relate is also varied. Stevens said he had completed one search for a small charity which resulted in the hire of a single manager. He had done another for an Asian sovereign wealth fund where it wanted to partner with an asset manager for its market views to be

whether they have the governance to manage the core themselves."

Absolute Return, meanwhile, introduces independent return drivers. Ganatra said it was very important to diversify by manager, approach and style in this component because there is less reliance on market beta.

"Dynamic Asset Allocation is the skill-set that many end-investors may not have ability or the governance structure to implement," continued Ganatra. He then raised the issue of whether there was a role for lower reliance on market betas over the cycle. "In 2009, we would argue 'no' because of the sharp pull to value. All things were righting themselves. But now, in mid-2021, I am not so sure. Equity market valuations are relatively high; inflation concerns are rising. We are seeing economies emerge at diverging rates from the COVID pandemic, with differing fiscal and monetary policies." The upshot, as QMA Wadhwani sees it, is for asset owners to tilt their portfolios towards a more dynamic management of their portfolios.

better informed on Tactical Asset Allocation.

" Historical data should not be relied upon to determine correlations "

James Mee, portfolio manager of the Waverton multi-asset income strategy, then asked the panel's fund selectors whether they look at multi-asset strategies at the fund level or lower down at the individual funds' stock exposures. He wanted to get a sense of the evaluation process of correlations and Beta.

Hawthorn replied that it was an interesting question. "If you look through to line-by-line exposures, and then change your allocations to the funds you hold, you can end up chasing your tail," he said. That was because managers can and do change what is in their funds and the consultant or selector has no control over this. In his view, consultants should focus on advising on the selection of a combination of funds and leave the security-level decision-making to the managers.

"So are you looking for specific beta or at volatility bands?" Mee continued.

Hawthorn responded that he was looking for complementary styles that reduced volatility, especially on the downside.

Woodacre said the evaluation process evolved as managers produced new styles. "Cardano spends lots of time assessing whether there is something that differentiates the portfolio manager from the rest of the market – irrespective of the type of multi-asset," he said.

Stevens agreed. "Historical data should not be relied upon to determine correlations. You have to be careful. Simon is right to interrogate people and process, especially at the more dynamic end of the process." He gave the example of CTAs, which did great in March 2020 but in a previous squall – during the fourth quarter of 2018 – suffered.

Kishen Ganatra, product specialist at QMA Wadhwani, followed the consultants' way of thinking on multi-asset: "I split it into two components. The first is a core, whole-portfolio solution. The second is an Absolute Return element," he said. "Separating these two is important. Core is a governance issue. Arguably, every investor is multi-asset so the question for this component is

Mee said the strategies he runs at Waverton are long-only, global, and directly invested, but include options and other hedging strategies to protect the downside. "Outside the institutional investing sphere, multi-asset can be a one-stop shop," argued Mee. "We include hedging in order to facilitate diversifying in a non-linear fashion."

Waverton has modelled adding one percentage point increments of its multi-asset income strategy to a traditional 60/40 equity/bond portfolio to replace the bonds. The findings improved risk-adjusted returns, but on a non-linear basis; Mee made the point that multi-asset should not replace fixed income allocations, but could improve risk-adjusted returns up to a 10-15% weight (in place of a pure 40% fixed income allocation).

"The problem today is what to do with that 40% in bonds," said Mee. "Fixed income is structurally disadvantaged. At Waverton, we have an "inflation-plus 'x' percent" mindset and objectives, depending on the risk appetite of clients. Ultimately, the aim is to compound returns through the cycle."

Brendan McLean, head of manager research at Spence & Partners, a pension scheme consultancy, countered that a 60/40 equity/bond portfolio has achieved a superior risk-adjusted return than many active multi-asset managers. Having said that, he was one of a minority at the CAMRADATA roundtable to have redefined multi-asset. Spence has recently handled the search for one client to appoint a Risk Parity vehicle with strong downside protection. "We are in a different stage in the life- cycle of defined benefit pension schemes," explained McLean. "This is a stepping-stone in clients' derisking journey." He described it as blend of asset class risks with a handbrake in the form of volatility options.

"The strategy has an understandable process. It helps us sleep at night if there is another crash," said McLean.

Ganatra noted that Risk Parity relies heavily on duration as a defensive component. McLean agreed that the strategy was high duration but added that people have been claiming rates have been too low for a long time ."The manager is aware of this and duration is not the only driver: it also has trend-following and ARPs in there," said McLean.

"Outsized bond exposure is a feature, not a bug, in Risk Parity," said Stevens. He gave the example

of Japan, whose long-dated govvies have offered low absolute returns but – on a risk-adjusted basis, one of the best risk-adjusted investments this decade, according to Stevens. "Risk Parity tends to come and go but it has its place in terms of bringing something different to portfolio construction across different risk and return environments," he argued.

Ganatra and Lawi both agreed, emphasising that Risk Parity was a sensible option for a growth allocation but not as a diversifier. "That would be like putting 5% of your assets in a DGF," explained Stevens.

Mee brought the conversation back to the argument for a traditional 60/40 equity/bond allocation. "I accept it has produced extraordinary performance over the last thirty years, but the question is whether it will and can continue? Mathematically, it is very unlikely for bonds."

He added that since 2013, the relationship between equities and bonds has broken down and correlations have become "at best unstable". That was not to say government bonds are now a no-go; "we still own them for their protective qualities in periods of acute market stress, but not as a source of value," Mee said. "We hold US rather than the UK government bonds presently, as well as a number Chinese bonds, China being the only major economy offering a real return of 3%."

" The strategy has an understandable process. It helps us sleep at night if there is another crash "

"What it comes down to is duration premia," said Woodacre. "Whether you can replicate that protective, uncorrelated element you used to get from the likes of government debt."

Ganatra discussed how QMA Wadhwani utilises a range of macro and price data points to dynamically asset allocate between markets, including being long or short fixed income. He mentioned that given its systematic investment approach, the firm can tailor the volatility of their portfolios to offer a fixed-income-like replacement. He cited numerous techniques that QMAW utilises to generate equity-hedge like behaviour, including the use of FX hedges or relative trades in equity sectors.

Mee agreed that it was about disaggregating the elements of capital direction and protection, and taking a view on when and where to do this across all asset

classes. "During the most acute phase of the crisis in 2020, almost all assets declined – except hedging strategies, $/yen and some long/short absolute return," he said. But as there is no such thing as a free lunch in investing, Waverton is cautious about overpaying for protection.

Hawthorn commented on protective strategies that there is a tendency to overcomplicate in the investment management industry. He said: "Cash is underrated. Dry powder can be helpful. Short-dated investment grade corporate bonds might be out of favour but as long as you can take the mark-to-market risk, you can sit on those as a dampener."

Woodacre said that Cardano has option-based structures designed to deal with periods of stress. The challenge is knowing when to apply protection. He questioned how many houses were prepared for a stressed environment last year, and how the environment affected their modelling going forward.

The CAMRADATA roundtable then finished on the issues of timing, alpha creation and varying beta exposure. In terms of cycles, Ganatra said it was hard to look past the coming months. "We have a much shorter time-horizon of one to six months. It is difficult to forecast much beyond that."

" Cycles are not regular anyway. 2020 appeared to be a whole cycle in a year "

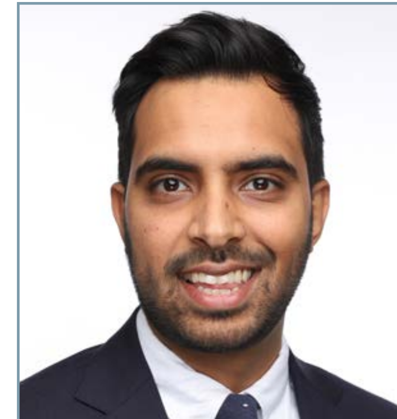
Mee had a different perspective. "What we try to do with the strategy is offer a core solution – appropriate for all markets and seeking to compound real returns through the cycle." This involves multiple horizons, including a real assets horizon of eight years but also the rolling hedges of 3-12 months.

For Aon, Lawi said: "In directional multi-asset, we don't time managers through the cycle. There is a degree of rotation among top performers in shorter timeframes but over the long-run, returns of high-quality propositions tend to cluster as these all access similar drivers of return. "

Woodacre said that the market-cycle element will be captured by the market beta exposure. "We are relatively agnostic about where in the market a manager's style begins to work." He noted that cycles are not regular anyway. "2020 appeared to be a whole cycle in a year."

Stevens' final comment was that, to the extent you are asking managers to do anything dynamic, you should not be timing the strategy or the manager itself. "What you want upfront is a robustly diversified portfolio," he said. Skilled managers practising Relative Value ought to contribute returns decoupled from negative and positive markets.

Roundtable Participant



Kishen Ganatra, Product Strategist

QMA Wadhwani LLP

Personal Profile

Kishen Ganatra, CFA is a Vice President for QMA, based in London. In this capacity, he serves as a product strategist for QMA Wadhwani and focuses on business development and consultant relations across EMEA.

Prior to joining QMA, Kishen was the European Strategic Research Director at Mercer and a member of the Global Strategic Research Committee, where he was responsible for helping to develop Mercer's intellectual capital across key investment themes, asset class views and portfolio construction. Kishen was also part of Mercer's Hedge Fund Research Boutique, leading manager research on multi-asset and alternative risk premia strategies and carrying out research on a wide spectrum of macro hedge fund strategies.

Previously, he was an analyst in the Global Prime Finance division at Deutsche Bank and an associate in the Enterprise Risk Services group at Deloitte. Kishen earned a BSc in accounting and finance from the London School of Economics.

Company Profile

QMA Wadhwani LLP ("QMAW") was founded in October 2002 as Wadhwani Asset Management by Dr Sushil Wadhwani, CBE. Investment operations commenced in January 2003. QMAW is a London-based asset management company, authorised and regulated by the Financial Conduct Authority, which specialises in systematic/quantitative macro investing.

In January 2019, QMAW was acquired by PGIM, the global investment management business of Prudential Financial, Inc.[1] (PFI) (NYSE: PRU). QMAW, while remaining a separate legal entity, is now operating as part of the business of QMA, the quantitative equity and global multi-asset solutions manager of PGIM. The investment platforms of QMA and QMAW, however, operate independently of each other. As of 31 December 2020, QMA managed $120 billion in assets, of which QMAW represents approximately $1 billion in assets.

[1] Please note: PFI of the United States is not affiliated in any manner with Prudential plc, incorporated in the United Kingdom or with Prudential Assurance Company, a subsidiary of M&G plc, incorporated in the United Kingdom.

Roundtable Participants

James Mee, Fund Manager

Personal Profile

James joined Waverton in September 2012 as an Assistant Portfolio Manager for the Managed Portfolio Service Team. He is now the lead manager of the Waverton Multi-Asset Income Fund, and co-manager of the Waverton Real Assets Fund and Waverton Absolute Return Fund. James is also co-manager of the Waverton Protection Strategy and is a member of the Asset Allocation Committee.

James graduated from Bristol University in 2012 with a degree in Law and is a CFA Charterholder. In May 2016 he won the WealthBriefing European Rising Star Award.

Waverton Investment Management

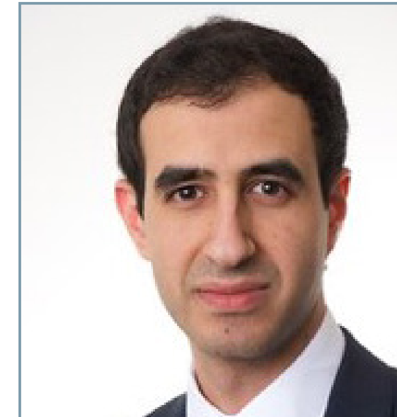
Company Profile

Waverton is an independent, award-winning investment management house dedicated to creating high-quality investment solutions for Private Clients, Charities, Intermediaries and Institutions.

Waverton's investment managers are active and bottom up in their approach; investing with conviction for the long-term.

Managers are given the freedom to implement their own strategies within the framework of an institutional grade infrastructure. All managers invest in their own strategies. Strategy capacities are monitored and stressed on a regular basis to ensure that investment processes are not compromised by excess AUM.

Waverton manages approximately £7.1bn of assets (as of 31st March 2021), the business is 37.5% owned by management and staff with the remainder owned by Somers Limited.



Riccardo Lawi

Senior Investment Consultant

Riccardo is a senior investment consultant within the Liquid Alternatives manager research division of Aon in London. His activity mainly focuses on Global Macro, Multi-Asset and Commodity funds.

Before joining Aon in 2016, Riccardo worked at Euromobiliare Asset Management conducting due diligence on alternative and traditional strategies for the firm's fund of funds and discretionary mandates. Prior to this Riccardo worked as a hedge fund analyst at IN Alternative, a multi-strategy fund of hedge funds based in Milan.

Riccardo is a CFA Charterholder, holds a B.A. degree in Finance from Università Bocconi and a Master of Science degree in Finance from the University of Manchester.

Chris Stevens

Director, Diversifying Strategies

Chris is a Director within the Diversifying Strategies team at bfinance and is responsible for liquid alternative and multi-asset research. Chris joined bfinance as an analyst in May 2011 from JM Finn & Co where he worked in client services.

Chris graduated from the London School of Economics with a Masters in the Philosophy of Science and also holds a BA (Hons) in Philosophy from the University of Warwick. Chris is also a CFA and CAIA Charterholder.

Roundtable Participants

Simon Woodacre

Investment Analyst

Simon joined Cardano in February 2021 as an Investment Analyst in their manager research team where he focuses on researching discretionary macro, multi-asset and credit related strategies. He joins from Buck Investment Consultants, where he worked as a Senior Multi-Asset Research Analyst for 4 years. Before that he worked at Pictet Asset Management as an Associate for 3 years. Simon has passed Level II of the CFA Program; he also holds the IMC and graduated from the University of Southampton in 2011 with a 2:1 in Economics.

Tom Hawthorn

Senior Investment Consultant

A highly experienced senior investment consultant, Tom has been advising UK DB pension schemes on investment strategy, funding level triggers, bulk annuity transactions, portfolio structuring, other de-risking mechanisms and manager selection for more than 17 years.

Tom designed and developed investment strategies that combine absolute return bond funds with Liability Driven Investment (LDI) more than ten years ago, and in the last decade this approach has been widely adopted by UK pension schemes.

Tom is Head of Platform and Fund Research at Cartwright and has extensive manager research experience and knowledge, having built absolute return bond, multi-asset credit and diversified growth manager universes.

Brendan McLean

Head of Manager Research

Brendan is Head of Manager Research and is responsible for recommending and monitoring investment managers across all asset classes. He joined Spence in 2017 and has gained many years of manager research experience by working at a variety of firms, including an investment consultant and a family office.

Brendan is a CFA Charterholder, has the Investment Management Certificate (IMC), CFA Certificate in ESG Investing and a degree in Finance and Investment from the ICMA Centre, University of Reading.

Moderator

Brendan Maton

Freelance Jounalist

A highly experienced financial journalist with an expansive network of contacts in the UK and across Europe. Brendan has written about pension schemes and national welfare systems from Finland to Greece for 18 years and understands the retirement savings industry in each European country.
Brendan has interviewed EU commissioners and national ministers; central bankers; pension scheme heads; insurance chief executives; chief investment officers; actuaries; union officials; professional and lay trustees.He worked at Financial Times Business for eight years, finally as editor-in-chief of all international pensions titles. Brendan has spent the last ten years as a freelancer for a number of publications, including Financial Times, Responsible Investor, Nordic region pensions news and IPE. He is also Chief webcast host for IPE.
Brendan has acted as conference chair for Financial News, the UK National Association of Pension Funds, Dutch Investment Professionals Association (VBA), Corestone, Insight Investment, Marcus Evans, Robeco Asset Management, Sustainable Asset Management (SAM), Towers Watson.

The Importance of Agility in Navigating Unchartered Waters

Agility seems to be of paramount importance given the current quickly changing economic environment. Dr. Sushil Wadhwani, Chief Investment Officer for QMA Wadhwani LLP (QMAW), and Kishen Ganatra, Product Strategist, outline the biggest risks to the market and the potential benefits of allocating to a dynamic absolute return manager.

Defining dynamic absolute return investing

QMAW's multi-asset investment approach looks to offer three key characteristics:

- Dynamic asset allocation: Our investment approach systematically combines investment styles that utilise both fundamental (macro, value, carry) and technical (momentum/trend, sentiment, market linkages) data across multiple asset classes (equities, fixed income, currencies and commodities) to offer agile and dynamic asset allocation strategies.

- Diversifying: Our approach, therefore looks to create strategies that generate independent return sources from traditional beta, which results in return profiles with low betas to equity and fixed income over a full market cycle.

- Drawdown-aware: Given this dynamic nature of our approach, there is a strong focus on capital preservation and the ability for the strategies to potentially generate returns when traditional markets are suffering (positive convexity).

“ The impact of medium-term inflation depends on the inflation scenario that each investor thinks is the most plausible ”

The possible impact of medium-term inflation on asset class forecasts

We think the impact of medium-term inflation depends on the inflation scenario that each investor thinks is the most plausible. From our point of view, there are three relevant scenarios.

1. The first scenario is one where the rise in inflation turns out to be temporary and inflation subsides without any policy action being needed. The big output gap we have, globally, becomes important, and inflation just automatically comes down by itself. And in that Goldilocks scenario, obviously, equities and bonds are likely to do well.

2. There's scenario two where inflation persists into 2022 and 2023, and central banks remain patient. They may remain patient because of implicit government pressure, but they may also remain patient because they've announced they're going to be behind the curve. Now, that scenario, where inflation expectations rise and get embedded, could actually be quite subversive of both bonds and equities, because clearly with higher inflation expectations, other things being equal, bond yields will go up. If higher inflation expectations lead to higher nominal bond yields, you may get a higher earnings yield, i.e., a lower price/earnings ratio, so you could get multiple contractions in the equity market as inflation goes up. That means equities and bonds fall together. So, this is a scenario where inflation expectations are dislodged.

3. Scenario three is that the US won't allow inflation expectations to be dislodged because if the Fed thinks they're about to be dislodged, it will respond forcefully and promptly. In this third scenario, there is inflationary pressure in the economy, but the central bank then responds aggressively. At the beginning of this year, the markets weren't expecting a rate hike until well into 2023. Now those expectations have been brought forward into early 2023. In this scenario, the Fed may end up having to hike in late 2022. It may be that if we see building inflationary pressure, the Fed may well respond, especially if inflation has a three handle through 2022, which is not at all implausible. If the Fed suddenly starts tightening at the end of 2022, we believe that both equities and bonds will go down meaningfully.

We have to choose between these scenarios and that, to some extent, is what all the modeling work we do attempts to accomplish. But it is clear that what happened in February this year is that the markets went from believing our first scenario was a 90% plus probability to thinking that maybe scenarios two and three had meaningful probability, and that scenario one wasn't a done deal.

In our view, both growth and inflation are likely to surprise the consensus on the upside during 2021. Since neither scenario is good for a traditional 60/40 portfolio, investors should seek diversification*. Once we get into 2022, if inflation fails to come down sufficiently, we suspect that the Federal Reserve will "do the right thing" and, in that sense, scenario three is more likely than the second scenario within which inflation becomes embedded within the system. Of course, were the Fed to turn aggressive in the second half of 2022, then equities, bonds, gold and inflation-linkers would all fall together.

The potential benefits of dynamic absolute return strategies given current market conditions

We believe the single biggest impact of the pandemic on markets that could turn out to have the most profound consequences is the impact on macro policy, because the way policymakers are talking about it is so different from the so-called Washington Consensus over the last 20 years. Views on fiscal policy have changed globally and everyone is talking about higher budget deficits because it's more affordable now with interest rates being so low.

Both developed countries and several emerging markets (EM) countries have taken the view that their already substantial budget deficit can grow even more. We think in 10 years' time, we'll have seen a big regime shift. This has profound potential implications for wealth preservation, and, we believe, to be able to protect one's wealth and hedge against this profound policy change, one way is to allocate a portion of your portfolio to a dynamic absolute return manager because they're best positioned to respond to this policy change.

A couple of other advantages which go with a dynamic absolute return strategy are that if it turns out that we don't have inflation, then macro managers are likely to flip their positions very quickly and therefore, you don't psychologically get locked into a particular hedge. Essentially, if you are worried about a change in policy regime, you have two choices.

One choice is to add things like long-only exposure to commodities and inflation-linkers to your portfolio. These positions will work in some, but not all scenarios. If inflation becomes persistent and the central banks don't react, you should benefit from these trades. But if the central banks react and get aggressive, you definitely don't want to be in either commodities or inflation-linkers.

The second choice is you allocate to an agile macro manager, which I believe on average will serve you well through what's likely to be an incredibly challenging period for wealth preservation – wealth preservation in real terms.

* Diversification does not protect against a loss in a particular market; however, it allows you to spread that risk across various asset classes.

Kishen Ganatra, CFA
Product Strategist

Sushil Wadhwani
Chief Investment Officer

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IN FOCUS

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Redefining multi-asset as risks abound

WAVERTON
INVESTMENT MANAGEMENT

As global economies continue to recover after various phases of lockdown, the multi-asset universe will be critical in delivering client investment objectives.

The global recovery from the pandemic has been supported by seemingly unlimited monetary stimulus and fiscal largesse which, combined, have led inflation risks higher, and bond yields with them. Rising bond yields mean declining capital values for bonds, which in turn will make generating positive real (even nominal) returns nigh on impossible given the very low starting yields. Having enjoyed a confluence of macroeconomic and geopolitical tailwinds for almost four decades, we are likely entering a new macroeconomic environment, within which the traditional "40%" allocation to fixed income securities will be challenged.

One does not need to be bullish on inflation and rates to see that the outlook for bonds is poor. Even if inflation were to remain subdued, and the US, UK and Europe all to follow in Japan's "lower-for-longer" footsteps, bond mathematics imply a lower total return from the asset class.

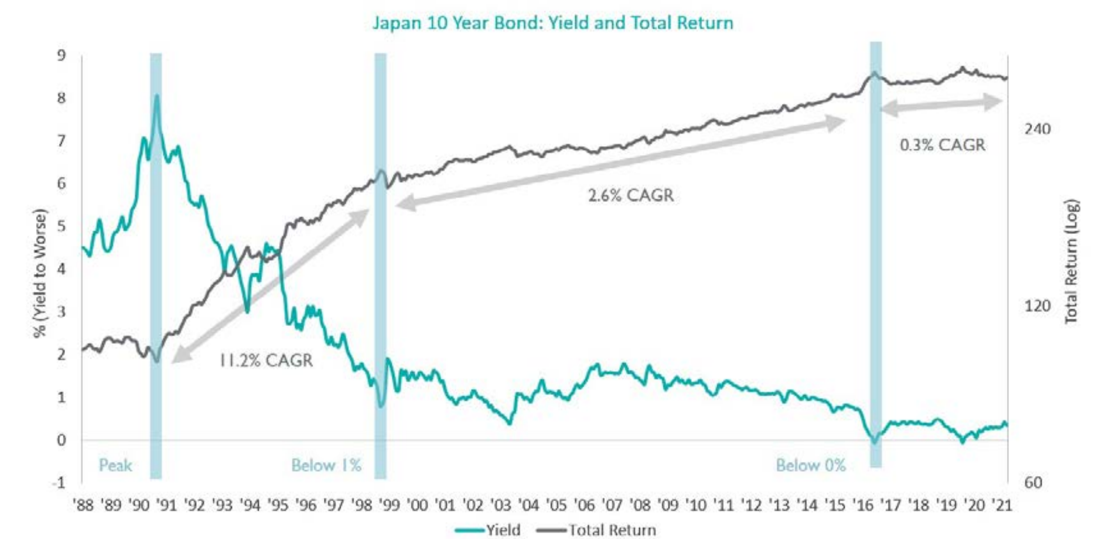

Figure 1. Source: Bloomberg, Waverton. Data as at 31.03.21.

If that weren't enough of a challenge, we can also observe that the traditionally negative relationship between government bonds and equities has become meaningfully less stable.

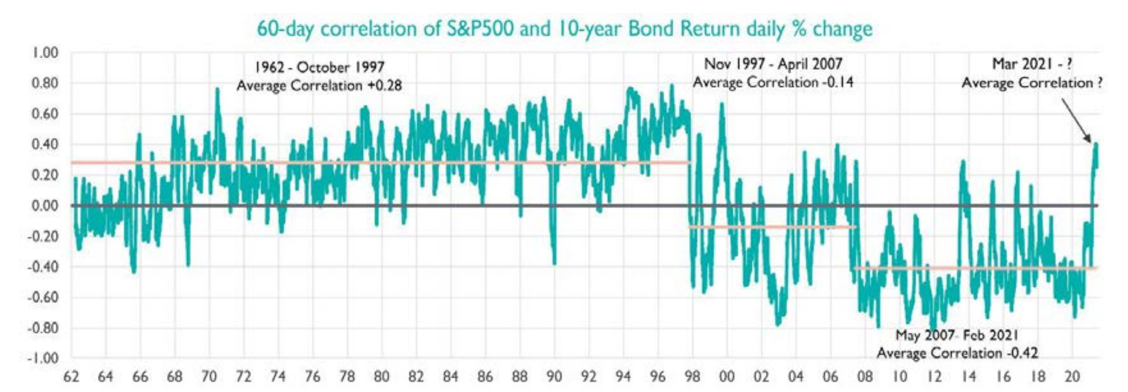

Figure 2. Source: Bloomberg, Waverton. Data as at 01.06.21.

Combined, these two factors lead us to favour multi-asset as a strategy to diversify away from fixed income, and to deliver investment performance over the next 30-40 years.

WAVERTON
INVESTMENT MANAGEMENT

Waverton's multi-asset approach

Philosophically, we believe in investing capital as if it were our own, ensuring diversification across regions, asset classes, sub-asset classes and currency.
We spend our time analysing companies and markets, and invest globally, across asset classes and across the capital structure of analysed businesses. We employ a macro framework to instruct portfolio construction, and we focus on two types of investment risk: loss of purchasing power from underperforming inflation, and permanent capital loss.

Participating in the upside & outperforming inflation

We seek to grow capital in real terms by investing in durable businesses with a focus on free cash flow generation. These businesses compound over time, using their sustainable competitive advantages to deliver high and/or rising returns on invested capital. Beyond equities, we also look to alternatives to deliver real returns over the long term; specifically, within the real assets investment universe. We have developed an expertise in alternatives investing over the past decade and consider it a differentiator for our clients. We disaggregate our alternatives allocation into real assets (return-seeking) and absolute return (capital protecting). Real assets (which we define as property, infrastructure, commodities, asset finance and specialist lending) are long-only, return-seeking assets which seek to deliver equity-like returns with lower volatility. Critically these investments capture a differentiated risk premia to those found in the equity market (e.g. liquidity, term and complexity, amongst others). Many of these assets have cash flows linked to inflation.
Absolute return (which we define as specialised fixed income, capital protection strategies and structured opportunities) seeks to deliver a positive absolute return over a 12-month rolling period.
The combination of these two alternative sources of return (in different weights depending on the economic cycle and the risk/return objectives of the strategy) enable us to deliver outcomes for portfolios that traditional fixed income has done in recent decades. We expect to deliver those returns with less risk than that inherent in fixed income today.

The importance of downside protection...

The objective of growing real value of capital over the long term also requires that portfolios do not suffer excessive losses in periods when risk-off is the dominant market narrative. While some protection is provided by investing in best-in-class businesses, and more from our allocation to absolute return alternatives, the importance of hedging portfolios against the most deleterious outcomes ("left tail risk") cannot be overstated. By protecting against drawdown risk, we are able to smooth the return profile over the cycle and enable portfolios to compound from a higher base.

Inflationary pressures are building...

News flow suggests inflation has replaced Covid-19 as the biggest threat to the global economy. While we remain cognisant of rebasing and bottleneck effects driving up headline inflation, we believe that the increases we have seen in many commodity prices imply that rising demand goes beyond simply re-stocking. Couple this with surplus household savings in the US and UK and pent-up demand after eighteen months of on and off lockdowns, and we could see prices rise further still. A properly diversified multi-asset strategy can help portfolios and investors deliver on stated objectives even in that environment.

James Mee
Fund Manager

Conclusion

True multi-asset investing – including a sophisticated use of alternative and hedging strategies – will be critical for managers seeking to outperform inflation and meet client's investment objectives over the long term.

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Waverton
Multi-Asset Solutions

We believe in a focus on real returns, which are best achieved through responsible active management across all asset classes.

Our global multi-asset investment universe offers investors the best opportunity to maximise risk-adjusted returns.'

Strategies worth talking about

For further information on multi-asset solutions, contact Jonno Ross on +44 (0)20 7484 7491, jross@waverton.co.uk or visit waverton.co.uk/institutional-investors.

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Registered Office 16 Babmaes Street, London, SW1Y 6AH.
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Meet the Team!

Sean Thompson

Managing Director

Natasha Silva

Managing Director, Client Relations

Amy Richardson

Senior Director, Business Development

Natasha Fletcher

Senior Associate, Client Relations and Business Development

Yasmin McKeon

Associate, Marketing and Events Co-ordinator

Sam Buttress

Associate, Business Development

Mithursha Kesavan

Database and Publication Support Associate

CAMRADATA

CAMRADATA
5th Floor, 11 Strand,
Charing Cross, WC2N 5HR

+44 (0)20 3327 5600
camradata.com

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