WHY INSTITUTIONAL INVESTORS ARE EMBRACING MULTI-ASSET STRATEGIES – BUT NOT ALL ARE EQUAL

Q&A with Schroders fund managers about why not all multi-asset strategies are well suited to navigating our current uncertain and volatile environment, and a 60/40 approach may just not cut it anymore

While no one can predict the future with any certainty, there are features of today's investment environment that we see as becoming important drivers of future returns. These are our "inescapable investment truths"; a combination of global economic and disruptive forces that we believe will result in low growth, low inflation, low interest rates and low market returns compared to the last 10 years. The advent of Covid-19 has only served to reinforce these trends, creating a challenging backdrop for institutional investors looking to deliver on both return target and risk/volatility objectives.

We spoke to Ugo Montrucchio and Michael Devereux, multi-asset portfolio managers at Schroders for their views on how multi-asset strategies can help institutional investors overcome these difficulties.

UM: "South African investors are no strangers to multi-asset investing. According to the Association for Investment and Savings South Africa (ASISA), just under half of the assets under management in collective investment schemes are held in SA multi-asset portfolios. But the term "multi-asset" encompasses a broad range of strategies and not all are well suited to navigating the uncertain and volatile environment we find ourselves in today."

What about a traditional balanced, 60/40 approach?

MD: "This has been a popular way of approaching the age old problem of balancing risk and return. As we've written previously (Can static 60/40 portfolios still deliver?), with lower expected returns from both asset classes over the next 10 years, as well as a break down in the traditional negative correlation between the two, the 60/40 approach may face some challenges going forward".

UM: "Traditional balanced funds have generated strong performance over the past decade as both asset classes have performed well. But bonds, having rallied hard, now appear expensive and it's hard to see how they can generate similar returns starting from today's levels. In our view, this also means that bonds are less likely to provide efficient diversification to other cyclical assets held in balanced portfolio. As a result, investors are relying primarily on the equity component to deliver returns, without the degree of protection from bonds that we have seen in the past. This means portfolios will be increasingly dominated by equity risk which, by definition, is not particularly appealing to the 60/40 investors. You need a more diversified, dynamic and active multi-asset approach than a traditional balanced fund to realise targeted returns at lower risk."

How does an investor achieve this?

MD: "Markets are seldom predictable, but current levels of uncertainty and the range of economic and market outcomes that are possible makes a compelling case for spreading your eggs across more than one or two baskets. While equities and bonds still have an important role to play in a portfolio, further diversification can be achieved by including alternative asset classes, such as real estate, infrastructure and commodities (including precious metals), and by investing on a global basis as opposed to a singular focus on your domestic market."

UM: "It makes sense for investors to be spreading their exposure across multiple asset classes. But we also believe in the value of taking a dynamic approach to asset allocation because different asset classes perform differently in different stages of the economic cycle. You don't want to get caught in the wrong asset class at the wrong time (see chart below). Being able to adjust the asset allocation and use a variety of asset classes to better achieve an outcome an institution needs is critical."

	Expansion	Slowdown	Recession	Recovery
S&P	4.73%	-2.12%	-1.44%	13.85%
R2000	1.44%	-0.92%	7.69%	15.20%
ACWI ex US	3.05%	-6.98%	-1.27%	12.06%
US 10Y	6.75%	11.62%	3.83%	5.03%
US Agg	5.14%	10.45%	4.70%	4.00%
TIPS	4.50%	12.71%	6.14%	4.32%
Global Agg (USD Hedged)	4.73%	8.53%	4.42%	4.33%
Gold	7.04%	18.67%	11.69%	8.99%
Commodities	3.69%	-0.69%	2.07%	0.02%
US HY	1.89%	7.15%	11.19%	8.00%

Source: Schroders, Datastream from 31/12/1999 to 30/06/2020. Returns are annualised arithmetically from monthly data as observations are not all consecutive. Figures highlighted in green are the highest returns in the cyclical environment, figures highlighted in red are the lowest returns in the cyclical environment.

UM: "The very fluid market environment calls for a flexible approach: to be able to capture returns as they become available in a favourable market environment but to balance the portfolio using more risk-reducing assets to minimise losses during adverse conditions like market drawdowns."

With global growth and SA GDP forecast to be the lowest since the 1930s, institutional investors can no longer rely on one or two asset classes to generate the type of returns that have been seen in the past. Financial markets are also highly volatile which means portfolios that incorporate a means of protecting returns are likely to be more palatable. To meet these needs, institutional investors have increasingly been turning towards global multi-asset funds that are genuinely diversified but also nimble enough to react appropriately to a constantly evolving market landscape.

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