Summary
- Multi-asset funds constitute a huge and varied investment space.
- The funds' asset allocations are tailored to meet the set objectives of fund managers.
- Strategy, liquidity, complexity, and regulation all form a framework of constraints within which multi-asset managers work.
- De-risking is a key role for multi asset – but it shouldn't be seen as a panacea.
- Returns have been disappointing, prompting criticism from detractors.
- The place for multi assets within pension schemes appears to be assured, and they will continue to offer diversification and the chance to smooth out volatility.

Lifting the lid

Multi-asset investing is a broad term. Sandra Haurant explores the variety of options available within multi-asset investing and its latest trends

As the name suggests, the world of multi-asset funds is a big one. Arguably the offspring of the balanced mandate, multi-asset funds can contain a veritable multitude of assets, spanning asset classes and sectors to create a cocktail of investments that can be more or less tailormade to the requirements of the fund's investors.

Indeed, multi asset is such a wide-reaching label that it scarcely does this area of investment justice, says Cardano manager research deputy team head, Dev Jadeja: "This catch-all term completely overlooks the wonderful diversity of styles found in the multi-asset space, as well as the plethora of assets in which these funds can invest."

"The benefit of multi asset is that the manager can use a very broad variety of asset classes to achieve the objective of their particular fund," says Jupiter's head of strategy, multi asset, Talib Sheikh. "Rather than trying to perform relative to a particular benchmark that might have no relation to an investor's actual objective, a multi-asset fund will try to achieve a target with a closer relationship to an investor's objective," Sheikh says. So if a pension scheme is looking for a specific level of income, for example, or a return of a certain percentage above cash or inflation, a fund manager can build a fund that can aim for those targets while fitting in with a set level of risk.

"These type of funds typically aim to generate an equity equivalent return but with a lower volatility over three to five years," says PiRho investment analyst, David Garcia. But, he adds: "Multi-asset funds are not homogeneous. Constraints are quite broad and rely upon each individual fund investment beliefs and philosophy."

Exploring multi-asset funds

There are many different flavours of multi-asset fund. "Many of these funds offer access to liquid, low cost, broad global asset exposure, while others take a more focused approach, investing in individual companies using a bottom-up framework for example," says Jadeja. "These funds are not constrained by geographic borders and can traverse the world for attractive assets, picking equities in North America and government bonds in South East Asia, to structuring ideas through derivative contracts in Europe or Japan. The multi-asset eco-system is also teeming with different investment styles; with 'long-only' managers at one end of the spectrum to 'long-short' or 'relative value' managers at the other, both of which can be either implemented by a 'discretionary' or a rules-based or 'systematic' investment framework."

"Allocations to absolute-return funds are also common," says Mercer senior associate, Shailan Mistry, who adds: "There a few exceptions out there that have higher than average allocations to alternatives and can include some more esoteric asset classes, such as insurance linked securities, private equity and secured finance." By mixing it all up in this way, the funds can create a level of diversification that should, in theory, protect the fund from market lows while benefiting from the highs.

With such a huge variety of asset classes to choose from, how does a

manager narrow down the right combination to fit in a fund? "The asset classes used will depend on that fund's objective," says Sheikh. "For example, our income fund focuses on asset classes that can deliver income such as high-yield and emerging-market debt, income equities, and so on. In our view, the optimal approach is to give the manager the broadest possible discretion over the range of asset classes, avoiding unnecessary constraints: almost any investable asset should be on the table."

Royal London Asset Management head of investment solutions, Lorna Blyth, adds: "Multi-asset funds enable investors to invest in a diverse range of assets, which allows them to benefit from investment return while also protecting them during periods of market volatility," she says. "This offers a smoother return over time, which means investors should not be as affected by peaks and troughs in the market." It's a benefit that is of particular interest to pension investors, she says. "Sharp drops in the value of their investment close to retirement can have a huge impact on the amount of income they are able to take in retirement."

"It also allows the manager the flexibility to adapt the portfolio as markets evolve into the future," says Sheikh.

Fitting into a framework

Of course, even for a fund investing broadly, there is a requirement for some form of framework. Just because all assets are on the table does not mean they are all going to be right for a given multi-asset fund – there are considerations to take into account. "The primary constraint should be the objective of the strategy, which should be clearly defined," says Sheikh. "Three other constraints are liquidity, complexity, and regulation."

"The important thing is that the liquidity of the assets a fund holds is in line with the liquidity promised to investors," says Sheikh. Illiquid assets such as real estate and private market debt might feature, as long as the fund's liquidity terms allow, he argues, but where liquidity, or a lack of it, is not at levels investors expect, there can be real problems. Sheikh adds: "We also like to shun unnecessary complexity: we want our investors to understand where performance is coming from and what we're doing in the portfolio. Finally, funds have to be structured to take into account regulatory constraints."

Well-diversified funds seem to be a natural choice for pension schemes looking to ensure steady returns, and there are certainly arguments for placing multi-asset fund in their portfolios. "The core multi-asset strategies have typically been popular with two types of investors; those that are searching for a low governance, all-in-one type solution, and those with a long-term investment horizon that want equities to remain the main driver of returns within a strategy but also want to achieve a 'smoother ride' relative to a pure equity portfolio," says Mistry.

Cutting the risk

But de-risking is also a key role for multi-asset funds. "As defined benefit (DB) and defined contribution (DC) schemes invest, multi asset can smooth the journey from higher-risk assets such as equities into lower-risk assets such as bonds," says Sheikh. "By acting as an intermediate stage in the de-risking process, providing growth but for less risk, multi asset can smooth the de-risking journey for maturing DB schemes or ageing DC investors, helping to avoid regret of de-risking too late or too early."

Jedeja advices caution, though: "Many pension schemes see the introduction of multi-asset funds into their investment strategy as a way of de-risking. This is predicated on the view that multi-asset funds, with their in-built diversification and a non-zero exposure to safe haven or bond like assets, can diversify a traditionally equity-heavy investment strategy." But, he warns: "While multi-asset funds can play an important role in a robust, well-diversified portfolio, they should not be seen as a panacea for the pension industry's ever-increasing de-risking objective."

The downside?

While there are many reasons for considering multi-asset funds, they are not without their detractors. A report by the investment research firm Finalytiq into multi-asset funds claimed that the majority of funds didn't "add any value through their asset allocation" and indeed that they "detract from value". The report went as far as to say: "It's clear that many investors in many of these high-cost multi-asset funds are being taken for a mug," with the "vast majority" of funds underperforming against what it calls its 'no-brainer' portfolios (benchmarks constructed using global bond and equity indices to replicate global geographical asset allocation) on a risk-adjusted basis.

There may have been relatively disappointing performance of multi-asset funds over recent years. "However, this has to be put in context," says Sheikh. "Since the financial crisis a combination of economic recovery and massive quantitative easing have driven equities and fixed income towards record highs. Over the past 10 years, simply holding a 50/50 portfolio of equities and bonds would have delivered very strong results."

With a backdrop like this, he argues, any portfolio seeking to diversify away from simple assets is likely to have come unstuck. But, says Sheikh: "One key learning point from the past few years for multi asset is that, even when valuations are stretched and geopolitical risk elevated, there are still returns to be made to avoid disappointing investors."

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