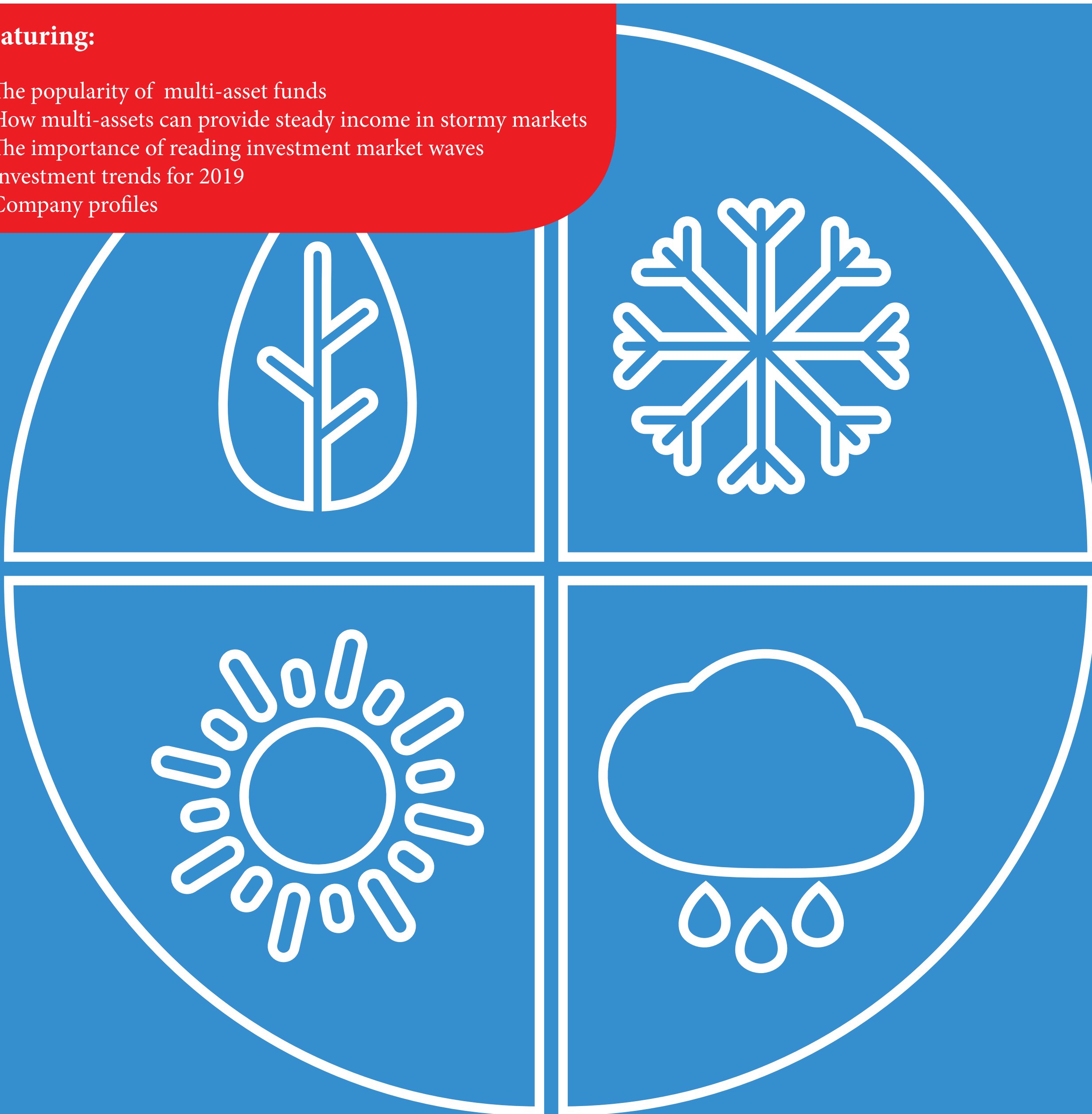
Multi-Asset Guide 2018: An all-weather solution

Featuring:

- The popularity of multi-asset funds
- How multi-assets can provide steady income in stormy markets
- The importance of reading investment market waves
- Investment trends for 2019
- Company profiles



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Summary
• Multi-asset has seen a huge increase in popularity over the past decade.
• Multi-asset income solutions can provide flexibility in offering both income and growth in the capital base, to reflect the investment goals of schemes.
• In view of the fact that the principles of diversification remain extremely relevant - and as innovation continues to drive more competition – it is clear that multi-asset solutions are well placed to support better outcomes for pension fund members.

Flying high

Multi-asset investment has seen a huge increase in popularity over the past decade and there are significant opportunities within the asset class. So, what have been the key recent trends in the adoption of multi-asset investment strategies amongst pension funds? Andrew Williams investigates

In broad terms, a multi-asset portfolio identifies where asset classes, countries or markets offer real value and use those value opportunities as strategic foundations for an asset mix. Multi-asset strategies can help investors achieve their investment goals in a wide range of market conditions. According to M&G's director of global institutional distribution, Annabel Gillard, such goals can include sustainable capital growth, regular income or, for lower volatility, the need to invest within a specified tolerance for drawdowns.

In Gillard's view, pension schemes' need for income is "intensifying despite the uncertainty and asset price reversals we see in financial markets", and the supportive long-term decline in global interest rates "appears to have abated and even reversed, suggesting that the ability to generate strong returns from simply buying and holding a static mix of traditional asset classes may not be replicable going forward".

"A regular, stable and growing income stream from all available scheme assets can be enormously supportive in helping a scheme manage its cashflows. Multi-asset income solutions can provide flexibility in offering both income and growth in the capital base, to reflect the investment goals of schemes," she says.

As Investec Asset Management's head of global consultants, Ed Evers, explains, pension funds have been diversifying their investments "by ensuring that not all their eggs are held in one basket for decades, if not centuries". However, over the course of the past decade or so, he reveals that multi-asset investment strategies have grown in breadth and depth to now constitute a wide spectrum of "outcome-oriented" investment strategies, targeting inflation-beating or above-cash returns over the medium and longer term.

Interestingly, Evers observes that the UK has led the way globally, with investors in the country now able to choose from a broad range of new and established funds with objectives across income and growth, all achieved through forms of multi-asset investment. In the UK pension fund world in particular, Evers points out that diversified growth funds (DGFs) have come to dominate the multi-asset growth space, with "almost 100 products vying for attention in a highly competitive marketplace".

"DGFs have become the go-to one-stop growth solution for smaller and mid-sized corporate pension schemes, on both the DB and DC side, as a means of harnessing the principles of diversification, leveraging economies of scale and increasingly accessing alternative investments within one convenient product," he says.

"More recently UK pension funds have increasingly turned to a wider range of multi-asset strategies to solve funding challenges, including multi-asset income funds (MAIF) and multi-asset credit (MAC) funds," he adds.

Consistent growth

Elsewhere, Wellington Management's pensions strategist, Steve Jones, observes that the performance of some DGFs has "come under closer scrutiny of late" – and he stresses that managers "really need to understand what drives the returns of a multi-asset strategy".

"We believe more consistent growth can be achieved by combining three return drivers in particular: traditional betas, alternative risk premia and alpha," he says.

"Given where we are in the cycle, there is more emphasis on the ability of a multi-asset strategy to provide protection when traditional market betas are doing poorly – that is, in less benign markets for equities and bonds than the past few years. Consequently, we are seeing growing interest in multi-asset strategies that go beyond traditional betas and that seek to perform in a wide range of market environments," he adds.

In this light, Jones argues that managers with a broader tool kit will be "better able to navigate an environment in which traditional asset classes struggle to generate the growth and provide the protection that pension funds need". He adds that "simply bolting equities and bonds together may not be enough in a more volatile, and potentially more correlated, market".

"In our view, strategies that give true consideration to diversification, beyond diversifying by asset class, will be more likely to satisfy pension funds' demand for attractive risk-adjusted returns," he says.

"Multi-asset investors also need to ensure they are getting value for money. Fees in multi-asset strategies vary significantly, so it is important to know you are getting access to a broad range of investments at a reasonable cost. You do not want to be overpaying for traditional betas," he adds.

When selecting a fund manager Barnett Waddingham's senior manager research analyst, Gaurav Gupta, stresses that emphasis should be placed on understanding the drivers of returns – largely because each DGF varies, and gaining a better understanding of when they should perform well or poorly "should lead to better client outcomes".

"For example, some DGFs have a long-only exposure to markets, meaning their performance is more susceptible to the market cycle, whilst others may have a higher allocation to alternative assets or relative value strategies that have tended to have a lower beta to equities, and perform differently. When adopting a blend of DGFs, allocating to fund managers with different styles of investing provides diversification benefits, smoothing out long-term performance," he says.

Portfolio compatibility

In broad terms, Gillard believes that the clear benefit of multi-asset solutions for income delivery is that they are "not bound to any single asset and are able to capture the best opportunities from around the world, while avoiding those areas where prospective returns are low".

"Multi-asset strategies need to quickly respond to opportunities that emerge through volatility. Since January 2018 such periods of volatility have resulted in more attractive valuations in equity markets globally, and in emerging markets across asset classes," she says.

For pension schemes seeking to maximise their income, often from traditional portfolio building-blocks, Gillard also points out that this volatility has "likely been painful". Even so, she argues that such unpredictable conditions are "well-suited" to active multi-asset investment strategies, which "seek to generate an attractive income yield from a globally diversified portfolio and have the freedom to asset allocate dynamically between markets".

"As UK DB schemes focus ever more on generating income from their assets, flexible income solutions that seek relative value from a wide range of assets globally should be best placed to adapt to the changing environment to meet these needs," she says.

Meanwhile, Jones observes that traditional beta multi-asset strategies face potential headwinds as the cycle slows - leading him to point out that pension funds that still require return "may want to consider a wider range of multi-asset approaches, including those that use alternative factors".

"Another potential benefit of multi-asset strategies is that they can consolidate risk exposures within a smaller number of investment approaches. This can be particularly useful given the time pension funds need to devote to meeting cashflow requirements, managing liabilities and responding to regulatory developments," he says.

"However, consolidating exposures in this way will obviously increase manager concentration, so it will be imperative to ensure that the multi-asset strategy is diversified, credible and stable, and is focused on delivering attractive risk-adjusted returns over the long term," he adds.

Generally speaking though, Evers reveals that there are very few pension funds in the UK that do not already utilise multi-asset investment techniques in building their portfolio, so it "feels intuitive that a multi-asset approach can be very compatible with how pension fund portfolios should be run".

"Multi-asset investment strategies for pension funds are here to stay. With the principles of diversification still very much alive and kicking, and with innovation driving more competition, multi-asset solutions are well placed to support better outcomes for pension fund members," he adds.

Written by Andrew Williams, a freelance journalist

Steady in the storm

Steven Andrew explores how multi-asset income solutions can provide steady income from stormy markets

It has not been an easy year for investors drawing stable and growing income from financial markets. Stock markets have stormed both up and down, the S&P hitting a new record for the length of a bull market in August, the FTSE 100 reversing the entire year to date's gains in a handful of trading sessions in October.

The sell-off in stocks has been in part a consequence of continuing rises in bond yields. The bond market sell-off, particularly in developed markets, has now extended for more than two years as major economies have moved to tighten monetary policy and raise interest rates. Ten-year US Treasury yields have risen to above 3 per cent; 10-year UK gilts are above 2 per cent.

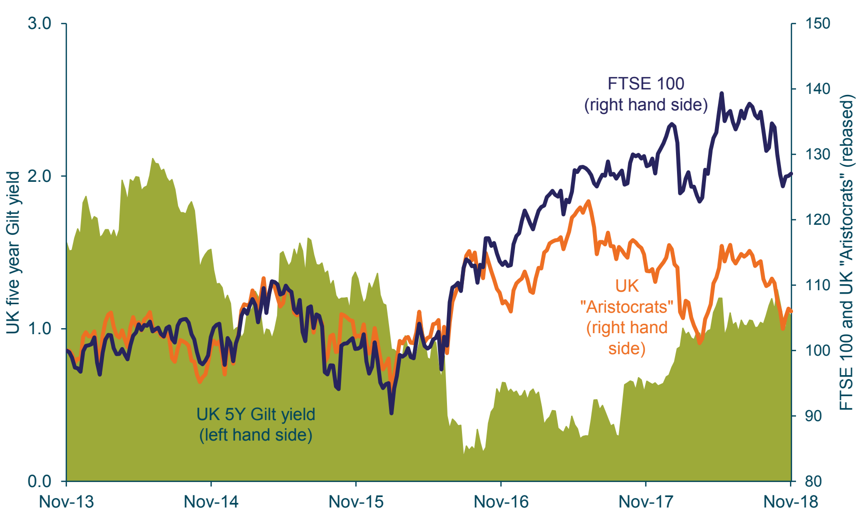
The source of volatility has been driven by concerns around growth and US interest rate rises. Fears of an overheating US economy in the first quarter were replaced in the third by concerns over the robustness of emerging markets and a peak in corporate earnings growth.

Income-producing assets have been particularly hard hit by this environment. It has been the reliable, income-generative bond proxy sectors of stock markets, and the historically dependable income sources of developed-country government and corporate bonds that have borne the brunt of weaker investor sentiment in 2018.

For pension schemes seeking to maximise their income, often from traditional portfolio building-blocks, the volatility has likely been painful. However, unpredictable conditions such as the present are well-suited to active multi-asset investment strategies that seek to generate an attractive income yield from a globally diversified portfolio and have the freedom to asset allocate dynamically between markets.

As UK DB schemes focus ever more on generating income from their assets, flexible income solutions that seek relative value from a wide range of assets globally should be best placed to adapt to the changing environment to meet these needs.

UK equity relationship with gilt yields



Source: M&G, Datastream, as at 13 November 2018

Income investing in volatile markets

The clear benefit of multi-asset solutions for income delivery is that they are not bound to any single asset and are able to capture the best opportunities from around the world, while avoiding those areas where prospective returns are low.

In building multi-asset portfolios we aim to identify where asset classes, countries or markets offer real value and to use those value opportunities as strategic foundations for our asset mix. We determine what we consider fair value or 'neutrality' for a wide range of assets globally and then compare that with prevailing real yields on assets to create a robust valuation framework.

We combine this rigorous valuation analysis with elements of behavioural finance when implementing the M&G Multi-Asset team's 'Episode' investment process.

Our approach is based on the recognition that financial markets periodically move irrationally as a consequence of human behaviour. By our definition, 'Episodes' are periods when asset prices are influenced by investors' emotional behaviour rather than fundamental drivers of long-term returns, causing valuation misalignments. They are usually temporary, though not necessarily short-lived, and can present opportunities to adjust strategic allocations or implement tactical ideas.

We seek to identify these points at which temporary changes in sentiment cause a market overreaction that diverges from assets' fundamental values.

Our investment process enables us to quickly respond to opportunities that emerge through volatility. Since January

2018 such periods of volatility have resulted in more attractive valuations in equity markets globally, and in emerging markets across asset classes, allowing us to invest in a diverse basket of assets to generate a reliable, steady income stream.

On occasion this causes us to adjust positions very actively as valuations have changed. For example, in January we reduced our equity holdings based on our view that the rally in share prices had materially reduced their attractiveness, before rebuilding the positions following sharp price falls.

A global view of income assets

Fortunately, a growing global universe of income-bearing assets means that multi-asset managers with an income objective have far more avenues to pursue today than in the past. The corporate bond market has become broader and deeper in the UK and overseas, more global companies are focusing on returning cash to shareholders via dividends and buybacks, and both alternative and emerging markets have also matured significantly.

This means that delivering income does not necessarily mean 'reaching for yields' in ever more risky assets, so long as investors are willing to look across financial markets to source assets offering attractive value. Diversification within asset classes, as well as between them, can enable a manager to target a reliable income yield even at times when markets behave unexpectedly.

A good investment strategy is likely to take a detailed view of where value lies within each asset class in order to effectively diversify income sources. For example, we continue to view large parts of the global equity universe positively since, by our assessment, the equity risk premium remains elevated, both in their own right and particularly relative to many developed market government bonds.

However, within equities we see particularly attractive opportunities in European financial groups, Japanese companies, US banks (which can offer some resilience in the face of rising rate pressures) and technology businesses – as well as domestically-oriented stocks in the UK, which have become more relatively attractive as a result of Brexit fears.

Bond markets offer very different properties in different countries worldwide. Long-dated US Treasuries – those with at least 10 years to maturity – in our view can offer attractive diversification properties and relatively high yield. These can be combined with higher yielding government bonds from European and emerging markets for still more robust potential diversification.

Delivering income in a rising rate world

Pension schemes' need for income is intensifying despite the uncertainty and asset price reversals we see in financial markets. The supportive long-term decline in global interest rates appears to have abated and even reversed, suggesting that the ability to generate strong returns from simply buying and holding a static mix of traditional asset classes may not be replicable going forward.

A regular, stable and growing income stream from all available scheme assets can be enormously supportive in helping a scheme manage its cashflows. Multi-asset income solutions can provide flexibility in offering both income and growth in the capital base, to reflect the investment goals of schemes.

We expect investors to have to look across a diverse investable universe for attractive income sources to support their goals. However, targeting a constant yield level should not incentivise chasing yields in ever riskier assets, simply because traditional sources are unavailable.

Instead, taking advantage of the diversification benefits that come with a wider universe and considering risk management tools such as active currency and duration management allows multi-asset solutions greater scope to deliver outcomes that could once be expected from simple baskets of assets.

We believe adopting a dynamic, multi-asset approach provides pension funds with attractive alternatives for a less volatile growth engine to achieve their investment objectives in the current market environment. M&G's multi-asset solutions aim to provide pension funds with the appropriate mix of return objective and risk to meet the outcomes they require.

For more information, please visit www.mandg.co.uk/multiasset

Written by Steven Andrew, fund manager, M&G

In association with

Surfing markets for consistent growth

Matthew Bullock highlights the importance of reading the waves of investment markets

Growing up on Australia's coast, I spent as much time as possible in the water — with or without a surfboard. I was shown how to read the waves, but above all I was taught to treat the sea with respect, because a dangerous rip could pull you far from the shore if you weren't careful. The key lesson was to always be ready to deal with difficult conditions.

I see parallels with investment markets. After a period of strong market returns and relatively low volatility, we have been reminded that benign conditions can change fast. Yet we know we must remain invested to generate returns — we have to stay in the water.

So what should investors do?

We think it's important to focus on the outcomes we want, rather than on how we allocate between different asset classes. To this end, in creating growth solutions for clients, we favour a modular approach — that is, constructing portfolios by combining different sources of return.

For example, at the core of a multi-asset growth portfolio could be an absolute-return-seeking component (such as an allocation to **'alternative risk premia'**), designed to perform independently of the direction of wider markets. We could combine this with components of **'manager alpha'** (aiming to exploit the stock-picking skill of Wellington's analysts) and **'market exposures'** (aiming to exploit the tendency of markets to rise long term).

Using equal weightings of the above three components creates a strategy we call Multi-Asset Absolute Return (MAAR). It's an approach designed to meet the needs of many investors because it aims to produce consistent returns across a cycle. In surfing terms, it seeks to ride the smaller waves and avoid the 'dumpers'.

What are alternative risk premia?

Some investors ask us to combine the components in a bespoke way. We are particularly seeing investors wanting to isolate the alternative risk premia approaches that MAAR uses. A risk premium is an excess return that compensates investors for taking risk — alternative risk premia are simply the excess returns that can be earned from investing in non-traditional ways; i.e., beyond 'long-only' exposures to shares or bonds.

Strategies that seek to generate alternative risk premia include those that:

- Identify trends that are likely to persist (trend)
- Buy an undervalued asset and sell an overvalued asset (convergence)
- Capture the difference in yield between assets (carry)
- Exploit characteristics that can drive share prices (equity style premia)

The drivers of each of these alternative risk premia are very different, which can offer diversification benefits.

One of the features of alternative risk premia strategies is that they are executed through taking both long and short positions. This can help generate smoother returns — particularly when markets become choppy.

Wellington has managed alternative approaches for over 20 years. Our alternatives capabilities are powered by the innovative spirit of a boutique investment manager combined with the stability and deep resources of a global asset manager. We believe that this gives us an edge in constructing alternative risk premia solutions for clients.

To view our alternative risk premia white paper, visit: https://www.wellington.com/en/insights/understanding-role-alternative-risk-premia/

Written by Matthew Bullock, investment director, multi-asset strategies, Wellington Management


Alternative risk premia demystified
ALTERNATIVE INVESTMENTS
TARGETING DIVERSIFIED RETURNS THAT DON'T RELY ON RISING MARKETS
www.wellington.com/understanding-alternative-risk-premia/
Professional investors only. Capital at risk.
Wellington Management is one of the world's foremost investment managers in alternative investments, having managed alternative approaches for over 20 years. Our alternatives capabilities are powered by the innovative spirit of a boutique investment manager combined with the stability and deep resources of a global asset manager. We believe that this, alongside our ability to manufacture exposures for our clients in-house, gives us an edge in delivering alternative risk premia and helps us tailor solutions to the needs of individual clients.
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Diversified investing against a headwind

Michael Spinks and Atul Shinh identify the three drivers that are expected to continue in the investment markets into 2019

At a glance

- We identify three main drivers that could continue to dominate the investing environment and resulting strategy: receding liquidity, slower global growth and populist shifts in the political order.
- We approach 2019 with cautious positioning. Growth orientated positions that pay us an attractive risk premium and are capable of compounding investor returns over the long term are still warranted.
- The regime has clearly shifted however and this justifies a broad range of Defensive and Uncorrelated strategies as well.
- We expect this shift to lead to more attractive risk premia than has been the case for some time. Our ability to exploit these will be a key factor in future returns.

Global economic growth diverged in 2018, with the US economy supported by a large dose of fiscal stimulus through tax-cuts and public spending hikes. In contrast, most of the rest of the world is seeing the opposite with developed markets (ex-US) and emerging markets coming under pressure as China reduced its stimulus and rising US interest rates squeezed liquidity.

As US fiscal stimulus wanes and interest rate increases bite, we expect a deceleration of the US growth trajectory. More specifically we have identified three primary drivers that broadly characterise the investing environment for our strategy:

Receding liquidity
Large central banks withdrawing extraordinary money policies and US interest rates rising.

Slower global growth
The US should revert to a trend rate of growth, or potentially below trend, as the effects of fiscal stimulus wane.

Populist shifts in political order
Politics and related policies, such as import tariffs, may continue to upset markets.

Positioning in this environment
Macro concerns are an enduring feature of markets and over the past 10 years asset markets have generally surmounted them. At this time, the valuation of many assets and high company margins raises the risks from slower growth, tighter liquidity and less predictable politics. These concerns suggest a cautious positioning, with diversity designed to help offset these risks alongside target Growth-orientated positions. The potential shift in the liquidity environment could expose the weaker links in global financial markets.

We hold positions that continue to offer meaningful long-term return potential and predominantly take this risk through equity markets rather than debt or currency. The core of our equity exposure is invested in a 'total-return' approach. This approach seeks to invest in high-returning companies that are underappreciated by the market for their ability to reinvest their profits and compound returns sustainably due to their durable competitive advantages that compound with time. We continue to find companies that satisfy these criteria.

However, years of extraordinary liquidity provision and low interest rates have compressed the risk premia offered by the full range of asset classes, which inflated valuations. This has particularly been the case for income-generating asset classes. Likewise, the sharp increases in capital flowing to private debt markets indicate the tail end of this trend.

Growth divergence and shifting interest rate policy over the past year has however introduced some valuation dispersion within asset classes, taking Asian equities relative to the US as one example. We expect the macro risks and regime shifts over the next year to generate attractive opportunities and greater variability in risk premia. Achieving our return objectives requires us to increase portfolio risk at times when there are more plentiful opportunities. We will take advantage of these as they arise.

Written by Michael Spinks, co-head of multi-asset growth and Atul Shinh, investment director, multi-asset, Investec

In association with Investec Asset Management

The value of investments, and any income generated from them, can fall as well as rise. Where charges are taken from capital, this may constrain future growth. Past performance is not a reliable indicator of future results. If any currency differs from the investor's home currency, returns may increase or decrease as a result of currency fluctuations. Investment objectives and performance targets may not necessarily be achieved, losses may be made.

can yield better results

Investec Multi-Asset Credit Strategy

Focused on delivering higher yield with reduced volatility, its low sensitivity to interest rates, we believe, make Multi-Asset Credit investing a highly relevant solution for today's persistent low-yielding bond markets.

- **A one-stop solution dynamically investing across global credit markets**
- **Targets[1] an attractive total return of cash in excess of 3 month GBP LIBOR +4%, gross of fees, over the credit cycle. Current yield[2]: 5.2%**
- **A truly 'best ideas' approach, built from the bottom up, that seeks to control risk while taking advantage of the extremely diverse opportunity set**
- **Portfolio Managers Jeff Boswell and Garland Hansmann have over a decade of experience, putting them at the forefront of Credit investing**

For pension funds looking to de-risk core equity holdings, re-invigorate vanilla credit portfolios, or to address low-yielding government bond portfolios, **is it time to consider an alternative to traditional fixed income?**

www.investecassetmanagement.com/MAC

The value of investments, and any income generated from them, can fall as well as rise.
[1]Performance target may not necessarily be achieved, losses may be made.
[2]Based on a representative USD portfolio, GBP yields will differ.

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M&G Investments

M&G Investments is the European asset management arm of Prudential plc, operating in the UK, Europe and Asia. As a trusted partner, our clients' individual needs are at the heart of our business. We align our interests with those of our clients and develop value-based strategies to generate strong and consistent returns. Our goal is to help our clients meet their long-term liabilities regardless of the market environment.

With £278 billion* of assets under management (including £120 billion* on behalf of Prudential) across fixed income, equities, real estate and multi-asset strategies, and over 400* investment professionals (including what we believe to be one of Europe's largest credit research teams), we have the scale and expertise to offer tailored investment solutions across a wide range of risk and return requirements.

**As at 30 September 2018*

Wellington

Tracing our history to 1928, Wellington Management is one of the world's largest independent investment management firms. With over $1 trillion in assets under management as of 30 September 2018, we serve as a trusted investment adviser to more than 2,200 institutional clients and mutual fund sponsors in over 60 countries. Our comprehensive investment capabilities are built on the strength of rigorous, proprietary research and span nearly all segments of the global capital markets, including equity, fixed income, multi-asset, and alternative strategies. As a private partnership whose sole business is investment management, our long-term views and interests are aligned with those of our clients. Our commitment to investment excellence is evidenced by our significant presence and long-term track records in nearly all sectors of the global securities markets.

Company Profiles

Investec Asset Management

Our strategy at Investec Asset Management is simple. As a global specialist investment manager we want to assist people around the globe to enjoy their retirement and to preserve and grow wealth for future generations. We invest other people's money, not our own. At our core, we are focused on the long term, investing in people and relationships.

We offer investment strategies investing in global, UK and regional markets spanning, equities, fixed income, multi-asset and alternative asset classes. Our clients include wealth managers, financial advisers, individual investors, pension funds, central banks and sovereign wealth funds.

It all began in South Africa in 1991. Over 25 years later, we have grown to become a truly global company, managing more than £109 billion* on behalf of clients all over the world. We are proud of our journey from a start-up in an emerging market to a successful international business. This sets us apart from most of our peers.

Our business is still managed by our founding members. This has not only balanced stability with growth but has fostered a culture in which our people have the creative freedom to challenge the status quo and own and develop ideas to the benefit of our clients.

www.investecassetmanagement.com

**As at 3.09.18*

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Pensions Age

Pensions Age is the leading title targeting UK pension funds and their consultants. Published monthly in print since 1996, and daily online, we invest heavily in our circulation and content to ensure we are the clear market leading title. Our in-house editorial team of Francesca Fabrizi (Editor in Chief), Laura Blows (Editor), Natalie Tuck (Deputy Editor) Theo Andrew (Senior Reporter) and Jack Gray (Reporter) ensure we cover the latest news and topical industry issues to help our readers make the best informed decisions.

www.pensionsage.com is the leading website for pension funds, and we look to cover the breaking stories as they happen. With over 24,000 subscribers to our email newsletter service; we offer our readers an unrivalled service. At the core of this is high quality, news-breaking journalism combined with in-depth knowledge of the target market and heavy research into data.

Pensions Age also runs highly successful conferences, and the Pensions Age Awards.

We also publish *European Pensions*, which targets pensions funds across Europe in print, online and through regular newsletters, as well as running the European Pensions Awards and the Irish Pensions Awards. We also run an annual Nordics roundtable.

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