MULTI-ASSET INVESTING
How to Harness Diversification

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THE LURE OF MULTI-ASSET STRATEGIES

While few agree on a definition, it's clear that diversification is the key concept underlying this growing set of investment approaches

Investors may search in vain for a clear and well-accepted definition of multi-asset investing. That's because some of the strategy's attraction is the myriad ways that managers interpret the phrase.

That said, multi-asset managers do agree on one thing: Diversification is king.

"Multi-asset strategies cast the net as wide as possible to get access to as broad a range of return drivers as possible within client constraints," said Johanna Kyrklund, global head of multi-asset investments at Schroders. "This means investing across asset classes and risk premia."

As investors seek to meet the challenge presented by today's complex global financial landscape, the sheer number of products and strategies available can seem daunting. At the same time, the once ubiquitous 60/40 asset allocation has long seemed too simple to meet the needs of institutions. Today, investors cast their nets very wide in search of return, but often find it difficult to keep up with fast-moving markets.

"Today investors have many more investment choices than they did 20 years ago," said Rui de Figueiredo, a managing director and chief investment officer of the solutions and multi-asset group at Morgan Stanley Investment Management. "The financial landscape is increasingly complex and this puts a governance burden on investors. Multi-asset investing allows investors to navigate that complexity and take advantage of it, without becoming overwhelmed by it."

For many, this can mean a true go-anywhere investment style.

"The wider your opportunity set of positive expected value positions, the higher the probability of success," said Justin Bourgette, a portfolio manager at Eaton Vance Management.

While multi-asset can mean everything from a traditional balanced fund to global tactical asset allocation or multifactor, David Millar, head of multi asset at Invesco, said his team believes in investing in ideas.

"It's macro-based investing with an unconstrained agenda that tries not to conform to definitions," he said. "We look across liquid, global markets, across geographies, sectors and currencies for good, long-term investment ideas." The aim is to create better and more enduring diversification.

Diversification is not a straightforward matter of allocating among asset classes. Of course, it is possible to get diversification that way. But de Figueiredo suggested that investors should also think about the other layers of diversification beyond simple asset class.

"There are securities within asset classes, sub-asset classes," he said. "There's geography across asset classes. We would also suggest thinking about fundamentally uncorrelated macroeconomic themes as well as the various types of factors that might be built into portfolios — growth vs. recession; inflation vs. deflation; various valuation environments."

Diversification is often identified through correlation. But "asset classes exhibit time-varying correlations" said Edward Campbell, a managing director and senior portfolio manager at QMA. In a crisis, for example, investors need return diversifiers, such as Treasuries or gold, which may not produce capital growth, but may dampen the downside risk."

SOMETHING EXTRA

Investors likely already have allocations to the traditional asset classes, including equities, fixed income and cash. "Multi-asset strategies need to do something extra for their portfolios," Millar said. "It has to be introducing something new."

This focus on research and identifying investment ideas that go beyond top-line asset allocation is a hallmark of many multi-asset strategies.

"Ours is a value-based approach," Bourgette said. "We allocate capital to undervalued risk premia across various asset classes and sectors with the goal of producing strong risk-adjusted returns over a full market cycle."

Managers also combine a range of methods to implement

The wider your opportunity set of positive expected value positions, the higher the probability of success.

Justin Bourgette | Portfolio manager | Eaton Vance Management

their investment ideas.

"Although the academic research says that asset allocation is the most significant determinant of returns," Morgan Stanley's de Figueiredo said, "you also need to add value through bottom-up security selection because that is where active managers can have the greatest impact." However, he also suggested that this division is suboptimal for investors. "Taking an integrated approach is the key to getting the most value."

TOP-DOWN OR BOTTOM-UP?

"We are agnostic about top-down or bottom-up approaches because at the end of the day, we are looking for 20 or 30 good long-term investment ideas that we can combine in a risk-managed portfolio to get diversification," Invesco's Millar said. "The freedom to get away from these definitions is what allows us to invest in the way that we do."

Multi-asset strategies can make up a part of a portfolio or encompass the entire portfolio. "If you think of the broader asset allocation in a multi-asset class portfolio, then that portfolio should include both alternative and traditional asset classes," Campbell said. And importantly, the portfolio should be constructed using a robust framework balancing return and risk with forward-looking capital market assumptions.

In the aftermath of the financial crisis, Campbell continued, that exercise showed that investors would get double-digit returns on equities, assuming that earnings and valuations would return to trend over 10 years. But today, he said, "We only see 6% or 6.5% expected returns on equities." This is an important example of the idea that expected returns are time-varying.

Multi-asset investing provides investors with the ability to be more dynamic and holistic in their investing behavior. "You ignore one of the tools in the toolbox if you fix a static asset allocation and then try to generate alpha," de Figueiredo said.

Since the financial crisis, asset class correlations have been elevated and that changes the risk-reward picture for multi-asset investing, leading managers to a risk-on, risk-off market behavior that has been the defining characteristic of recent markets. But that is changing, so multi-asset investing provides a framework for recognizing and reacting to the shift from a high correlation to a low correlation environment, or vice versa.

Multi-asset investing also takes advantage of a wide range of approaches — long-only, long-short, asset allocation, security selection and importantly, relative return — to construct positions.

"Relative return ideas are crucial to our strategies," de Figueiredo said. "One, because they give you the ability to decide how you want to allocate your risk and two, how you are going to control that risk. It allows for a more nuanced point of view."

Diversification obviously isn't a new concept, but the crying need for it was brought home to investors after the financial crisis took hold. The sharp drawdown in equity markets showed investors their portfolios were not as diversified as they thought.

"What you want in your portfolio is diversification not only to different asset classes, but also to exposure to different risk factors like inflation, illiquidity, economic growth," said QMA's Campbell. This kind of diversification can reduce volatility and improve risk-adjusted performance.

This multidimensional aspect of diversification is emphasized by multi-asset managers, though often using slightly different language, making it difficult for investors to compare managers.

"You need to look not just at asset classes but also at the underlying drivers of return," Eaton Vance's Bourgette said. For example, an investor with high-yield exposure in 2014 to a U.S. shale producer and emerging market sovereign debt, might think that was diversified. "But," Bourgette said, "if you actually understand how the underlying cash flows are generated, you would see that both are exposed to very similar risk factors."

Beyond offering the benefits of deep diversification, a multi-asset manager can deploy capital more efficiently than traditional managers. Rather than having both bank loan and high-yield managers — possibly both having the same name in a portfolio — in the lineup, a multi-asset manager will identify that company as attractive and then "determine where to be positioned in the capital structure most efficiently," Bourgette said.

In today's era of low yields, investors are concerned about what comes next.

"We have clients asking if there is any way to protect gains and limit downside risk, even though many asset classes have continued to perform well for far longer than anticipated," Invesco's Millar said.

10-20%
Recommended allocation to multi-asset strategies

Again, the answer relates to diversification. Multi-asset strategies can be go-anywhere, or more narrow in scope. QMA offers a multi-asset real assets strategy that uses a benchmark of one-third commodities, one-third real estate and one-third Treasury inflation-protected securities, but also invests in master-limited partnerships and global infrastructure.

"It's an actively managed strategy that seeks to provide attractive risk-adjusted performance relative to the benchmark while also offering inflation protection," Campbell said. It could be used by investors with a specific bucket for inflation protection.

The idea that each cycle is both the same and different is an important element of the argument for using multi-asset

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managers. Multi-asset managers focus on the future, although they don't discount lessons learned from the past. This is most apparent in their approaches to risk management.

"We think risk management is multi-faceted," Bourgette said. "It's not relying just on a [value-at-risk] model, which is backward-looking, because correlations change over time." When there is low volatility in the markets, a VAR model will encourage investors to take on more risk, more tracking error and more leverage, which may not be appropriate.

HIGHER HURDLE RATE

"We try to think both about risk and the potential path or distribution of return streams," he continued. "So we look for a period of stress, when volatility and correlations increase, and try to weight those more in a forward-looking view of risk." It gives, he contended, a higher hurdle rate for wanting to take a risk, as well as a margin of safety in case things go wrong.

Investors, particularly institutional investors such as pension funds, know all about balancing the return and risk.

"Pension funds often face challenging and somewhat conflicting objectives," Morgan Stanley's de Figueiredo said.

> We are often targeting the same outcome as hedge funds – cash plus 5% – but multi-asset strategies are simpler and lower cost.
>
> Johanna Kyrklund
> Global head of multi-asset investments
> Schroders

"How do they improve their long-term funding situation — that's an alpha question. But how can they also minimize the worst-case funding outcome? You can't do that with equities."

Multi-asset management allows pension investors to meet both those objectives at the same time.

"Thou shalt not market time" is an oft-repeated cardinal rule for investors. It's an easy rule to follow when investors are enjoying double-digit returns on both their stock and bond portfolios. But when markets tighten and returns grow scarce, the penchant to market time emerges. Multi-asset strategies can be a strong antidote.

"Now investors can see the value of having more dynamic tactical allocations, assuming that they can find an investment firm that has a solid investment process," QMA's Campbell said. "We actively research and monitor secular and cyclical developments for evidence of factors that may not have been important in the past but might be critical to securing stronger risk-adjusted returns in the future."

However, not all investors necessarily need dynamic asset allocation.

"If you have a 20-year investment horizon, you may not need to focus on multi-asset strategies," Schroders' Kyrklund said. "These strategies come into play for investors who value a smoother path of return." She defined that as those with a three- to five-year time horizon. "With a 20-year time horizon, you can sit through all the volatility that the market throws at you."

Kyrklund cites two trends that feed into this shorter time horizon. First, many defined benefit plans have matured and simply have shorter time horizons. Also, she said, "our industry often suggests that defined contribution investors should ignore volatility. For an investor in his or her 50s, a big drawdown has a disproportionate impact on their future retirement." Multi-asset strategies can play a role in mitigating that risk.

"We have typically achieved our returns with very low volatility recently, mainly because volatility has been suppressed," she added. "Over the next 10 years, I would expect volatility to increase from 5% to 6%, up to 8% to 10%."

As multi-asset investing moves more fully into the mainstream, it is beginning to usurp the diversification role of hedge funds and other alternatives.

"We are often targeting the same outcome as hedge funds — cash plus 5% — but multi-asset strategies are simpler and lower cost," Kyrklund said. "We've demystified the process and we are very blatant about using beta to generate return. So we price ourselves a lot more cheaply."

All investors are looking for ways to increase returns and in a growing number of cases, that can mean focusing on fees.

"While hedge funds still use fairly aggressive fee structures, we are in a world with very low forward-looking returns across numerous asset classes," said Eaton Vance's Bourgette. "That means that more of the expected returns are getting eaten up by those fees."

For investors searching for cheaper and more transparent alternative sources of return than hedge funds, multi-asset investing can offer a lower fee burden, said de Figueiredo. But he cautioned that multi-asset strategies aren't necessarily replacements for hedge funds; both can have a place in portfolios.

Consultants are beginning to view multi-asset strategies differently, acknowledging that although they may provide hedge fund or equity-like returns, the method of achieving these returns is altogether different.

NOT A HEDGE FUND

"We see some consultants developing multi-asset strategy buckets, although this can be a problem as there isn't an agreed definition," Invesco's Millar said. "We are actively communicating with consultants about the differences."

What's more, alternative allocations have been disappointing for some investors, and "that's caused some investors to rethink how they are seeking diversification and low correlations," Millar said. "Institutional multi-asset funds can offer transparency, liquidity, lower fees and the ability to daily price, which can be important for defined contribution plans." He also pointed to the way that many multi-asset strategies aim to provide a more consistent return stream over time.

Although some investors take a multi-asset approach to their entire portfolio, most make a specific allocation to the strategies. However, it isn't enough to just dip a toe in the water. In fact, an allocation of at least 15% most likely is needed, Millar said, "to make any meaningful difference at the portfolio level."

Schroders' Kyrklund said that many larger investors tend to allocate between 10% and 20% of their portfolio to multi-asset strategies. "These are the kind of allocations that may have been made to opportunistic hedge fund strategies in the past," she said.

Although some investors use multi-asset as a substitute for hedge fund or other alternative strategies, other investors view these allocations as diversifying the more traditional asset classes.

"We see investors funding multi-asset strategies from both equity and bond buckets because they view the strategies as hybrids," said Eaton Vance's Bourgette. "And it's relatively easy to decompose the strategy into equity beta and credit beta." •

THE DIVERSITY of DIVERSIFICATION

Multi-asset managers may embrace similar rhetoric when describing their strategies, but the differences become apparent in the implementation

Money managers use different approaches to identify the many dimensions of diversification. Some rely on a combination of qualitative and quantitative research that can result in thematic investment ideas. Others start firmly in the quantitative camp, identifying factors they expect to outperform.

This diversity can lead to very different approaches to implementing investment ideas, using a range of techniques to build portfolios. Some managers use a combination of active and passive while others focus more specifically on adding alpha through active management.

What today's multi-asset investing isn't, is static. Dynamic asset allocation tends to be synonymous or at least very closely aligned with tactical asset allocation, though that phrase has fallen out of favor in recent years. Simply put, both refer to altering a portfolio's asset allocation opportunistically based on short-term views.

For some, dynamic changes presuppose a strategic benchmark. For QMA, dynamic movements are based on quantitative tools that rank asset classes by fundamental factors and use macroeconomic analysis to determine positioning. "We then use forward-looking risk models to help us determine position sizes," said Edward Campbell, a managing director and senior portfolio manager at the firm.

FACTOR-BASED STRATEGIES

Factor-based strategies have become more popular in recent years and play a significant part in many multi-asset strategies. Although the concepts underlying this approach have been around for more than a decade, investors are only just becoming more familiar with the nuances of factor investing.

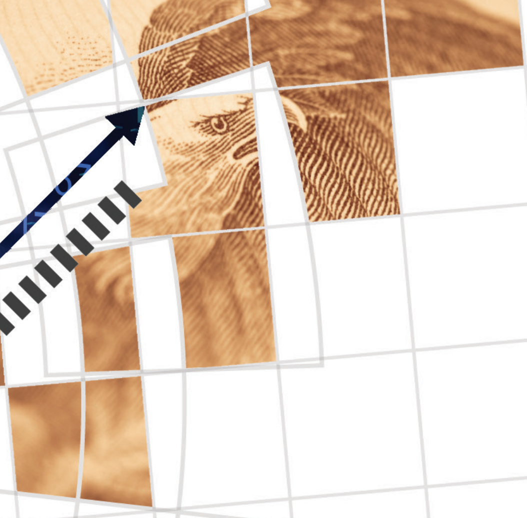
"We have an open mind when it comes to multi-factor investing," said David Millar, head of multi asset at Invesco. "But we know that the end investor or plan sponsor needs to understand the concept of multifactor risk." Equity and interest-rate risk are, of course, the biggest factors in many portfolios, but investors should be familiar with other factors that can be harnessed for return.

Understanding factors is an important element of the new multi-asset investing because many managers consider that viewing a portfolio through the lens of factors provides another layer of potential diversification. While equity and interest-rate risk are both the most well-known and most easily accessed factors, others now play a considerable role in multi-asset portfolios.

For example, many managers focus on valuations, but as Justin Bourgette, portfolio manager at Eaton Vance Management, said, "We don't have a crystal ball. We look for various economic scenarios that will offer an asymmetric payoff or asset classes that offer skew to one side or the other."

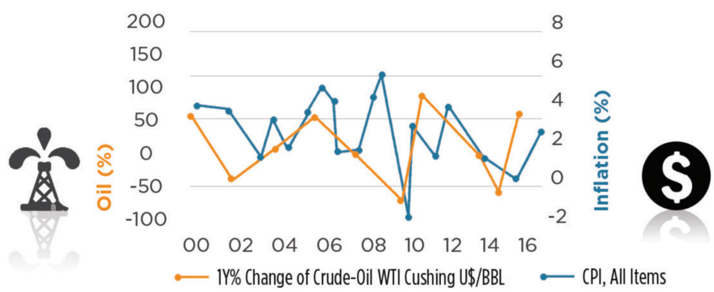
"During the financial crisis, high-yield bonds were trading at significant spreads over Treasuries and that is the exact time that a value-at-risk model would suggest derisking," he continued. Under any economic scenario, even taking spreads another standard deviation wider, past their widest historical spreads, "you would and did still generate positive returns over a one- to three-year time horizon. So that's a fat pitch."

It can be important to understand the nature of return drivers when thinking through true diversification. "If you have an equity portfolio and you add high-yield bonds, you aren't truly diversifying your portfolio in terms of exposure to different factor risks because both are highly leveraged to growth in the economy," Campbell said.



> The founding philosophy of multi-asset investing is unconstrained but risk-managed with the aim of a decent long-term return.
>
> David Millar | Head of multi asset | Invesco

Inflation: Has One Key Driver (Oil) Bottomed?



Source: Thomson Reuters Datastream, QMA. As of 12/31/2016

When it comes to translating ideas into action, some managers focus specifically on combining alpha and beta, often using passive strategies to access cheap beta. Others, often with a total return focus, want to corral alpha, leaving beta to the other parts of an investor's portfolio.

RELATIVE COST

"The relative cost of passive vs. active will be a crucial question for implementation," said Rui de Figueiredo, a managing director and chief investment officer of the solutions and multi-asset group at Morgan Stanley Investment Management. When it's difficult to generate alpha, then passive is the right option. In other cases, he continued, "given where we want to be allocated, we will look to the best use of active management at the security selection level and allocate to that as an additional source of excess return."

Implementation comes after the asset allocation decision. "Is it with futures? Is it through an ETF?" asked Bourgette. "If we want generic market exposure to fairly liquid markets, then it's a fairly cheap way to replicate that portfolio," he said of ETFs. But not all ETFs are created equal and Bourgette avoids those that are not designed correctly for his purpose, as some are really trading tools.

Sometimes only active management will do the job. "Accessing credit in any form typically requires an active approach," said Johanna Kyrklund, global head of multi-asset investments at Schroders.

Many multi-asset strategies approach diversification through multiple avenues. Implementation can be key as managers look not just to traditional long-only positions, but also shorting, relative trades, futures and indexes. "The founding philosophy of multi-asset investing is unconstrained but risk-managed with the aim of a decent long-term return," Millar said.

This objective is important when considering both different implementation approaches and the lack of constraint in terms of asset classes used.

"When investor risk appetite is high — for instance, in the late 1990s — the correlations among risky assets tend to be low," QMA's Campbell said. "In a lower-risk-appetite regime, such as the one we've had since the financial crisis, you tend to have more risk-on, risk-off trading." This is a time when investors need more return diversifiers, which include assets such as Treasuries, gold and Treasury inflation-protected securities, which may not produce capital growth but may dampen downside risk.

The time frame is one lens through which to understand the implementation framework of a multi-asset manager.

"We take a medium-term view," Kyrklund said.

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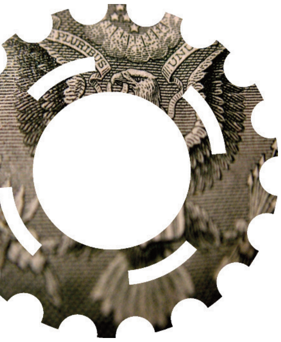


"But you can see significant oscillation over shorter time periods driven by shifts in the probability of risk scenarios." That is particularly true, she said, in today's environment of heightened political risk, which may require more tactical adjustments.

"We work to a three-year view when we add an idea to our portfolio," Invesco's Millar said. "But that three-year view can come to fruition in three weeks, depending on political, economic or market factors. So we don't hold onto investments for holding's sake, but we tend to expect to harvest our ideas over a two- or three-year time horizon."

Others remain more firmly in the longer-term camp.

"We seek to add value from long-term asset allocation based on realistic expectations of asset performance," Eaton Vance's Bourgette said. "But we also rely on our equity and credit analysts for bottom-up security selection."

In addition to managers, investors also have time frames. Carry is an interesting factor. Income-focused investors need to remember that higher-yielding assets tend to outperform lower-yielding assets over time, said Campbell.

Most investors considering multi-asset strategies want to achieve superior returns, often with less volatility than a comparable equity portfolio. But managers caution that they need to remember what the alternatives are.

A more traditional balanced portfolio might not provide a return of 4% to 5% that many multi-asset managers target over a three-year period. "You shouldn't expect a return from a passive 60/40 portfolio to exceed 4% or 5% from where we stand today," said QMA's Campbell. That 60/40 portfolio is likely to come with significant volatility in returns as well.

For all that diversification is the watchword of multi-asset investing, managers caution that too much emphasis on creating true diversification can draw attention away from the usual objective — providing a return on investment.

Diversification is not an end in itself, said Schroders' Kyrklund. "It's a means to an end. A starting point. You need to focus on making adjustments to the asset allocation, taking into account valuation and the cycle." •

How to Pick a Multi-Asset Manager

As the name implies, a multi-asset manager must exhibit a range of abilities. To wit: a depth of skill in major asset classes and a significant research capability. But perhaps the most critical element that an investor should look for is a dedicated multi-asset resource within the firm.

Managers suggest that investors consider what portion of a firm's resources is allocated to pure multi-asset activities.

"First, you need people who are truly objective across asset classes," said Johanna Kyrklund, global head of multi-asset investments at Schroders. "You can't be objective about the asset class you are managing so you really need dedicated multi-asset resources with no allegiance to asset classes," she said.

"Experience counts," added David Millar, head of multi asset at Invesco. "We have a defined philosophy, a group of managers that have worked together for many years, an unconstrained research agenda and importantly, a sophisticated platform to implement the strategy."

In terms of implementation, a key skill in multi-asset investing is to have a global infrastructure and capability to deliver the strategy, which is becoming more important, he said.

Justin Bourgette, a portfolio manager at Eaton Vance Management, said having a manager who has run the strategy over a complete market cycle is critical.

"If you haven't seen a manager through a full cycle, how can you know that they are actually going to be able to mitigate risk?" he asked. "And you need to make sure your manager stays within their core competency as a firm." He pointed out that Eaton Vance doesn't have expertise in private debt, for instance, so that's not part of the firm's multi-asset portfolios.

Managing over market cycles requires that an organization can evaluate and operate in a set of diverse and varied markets, and has the ability to move capital around dynamically in response to opportunities.

OUTSIDE MANAGERS

At times, a multi-asset manager may use outside managers to round out its offering. In that case, a rigorous vetting process is necessary.

"We want to know if a manager can add value on a stand-alone basis," said Rui de Figueiredo, a managing director and chief investment officer of the solutions and multi-asset group at Morgan Stanley Investment Management. "But in the case of using an external manager in a multi-asset portfolio, we want to understand the level of differentiation that they bring and if it's attractive relative to cost."

"Having access to all the pieces internally often works best," said Edward Campbell, managing director and senior portfolio manager at QMA. "It's easier to coordinate trading and ensure that you spend no unwanted time in cash." It's also easier to see aggregate exposures in real time.

"When you decide to bring in outside managers, you need the separate and distinct capability of manager search and selection," he said.

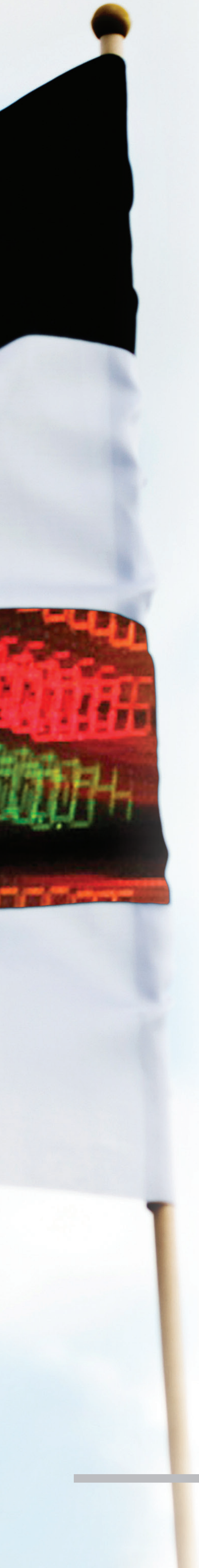
Above all, flexibility, in different contexts, is paramount.

"Flexibility is the one [characteristic] that's understated in the industry," de Figueiredo said. "That is flexibility to go anywhere, ability to consider a broad range of opportunities, asset classes, themes and so on. But it's also the flexibility to customize the portfolio, in terms of types of risk and how to be complementary to an investor's other holdings." •

SEPARATING THE JUDGMENT CALL

Setting an objective, having a goal — these are integral elements of investment policy. All investors need to know what outcome they want from a money manager. Boards and investment committees are well-versed in benchmark setting, blended benchmarks and even absolute return targets. Yet multi-asset managers can pose a challenge, as they often don't fit neatly into one box.

So investors would be well-advised to separate the judgment call — has the manager achieved the outcome required



— from the process of constructing and managing a multi-asset portfolio. The outcome could be a specific return or income target. Or it could be an allocation designed to mitigate risk across the whole portfolio. It could involve beating a blended, bespoke benchmark. How the manager gets to the required outcome, and how the investor monitors this performance, may look quite different than in more traditional approaches.

For some managers, it is important to overemphasize this focus on outcomes. Many investors and consultants have been focused on tracking error.

"The key is not to use a comparator as your starting point for portfolio construction because the whole point is that we are trying to deliver something that is much more flexible," said Johanna Kyrklund, global head of multi-asset investments at Schroders. However, she is happy to provide market information to help investors understand how outcomes have been achieved.

"We prefer not to be constrained by a market benchmark," added Justin Bourgette, a portfolio manager at Eaton Vance Management.

But since many consultants care about this kind of performance measure, more multi-asset managers are willing to be measured in this way if additional bogeys, such as peer groups and risk-adjusted returns, are also used. There are others, too.

"Maximum drawdown is an important metric," said Edward Campbell, a managing director and senior portfolio manager at QMA. So given the 50% or more drawdowns that investors saw after the financial crisis or the dot-com bubble, investors will want to know what any multi-asset portfolio's maximum drawdown could be.

CASH-PLUS OBJECTIVES

Rui de Figueiredo, managing director and chief investment officer of the solutions and multi-asset group at Morgan Stanley Investment Management, said: "Cash-plus objectives give us a very clear steer on performance, as long as the time horizon is long enough."

With flexibility paramount, many multi-asset managers operate within a range of constraints.

"On a benchmark-driven allocation, investors want to know whether the manager is controlling risk in the expected way," de Figueiredo said. "And how is the manager generating performance. Is it through dynamic allocation or implementation?"

"We do have clients that are focused on limiting downside risk," he continued. "So that is yet another way to focus the benchmark."

Understanding how a strategy works is imperative in multi-asset investing.

"It's important that we have clients with similar philosophies and time horizons to us," said Eaton Vance's Bourgette. "We add value by understanding return drivers or the historical supply side of returns, and making realistic, though not always popular, expectations of asset performance."

In addition, client perspectives can change depending on the market environment, so managers need to be flexible in adapting to client needs.

"People's utility functions shift depending on the market environment," Kyrklund said. "In a difficult market environment, clients will want you to lose as little money as possible; when the market is going up, they want you to capture as much of the upside as possible. Managers need to empathize with their clients."

Often, multi-asset strategies have very clear targets. For instance, David Millar, head of multi asset at Invesco, points to the strategy's gross target of cash plus 5% over a three-year period, with less than half the volatility of global equity markets over that same period.

> Most portfolios in the absolute return space tend to target a certain level of volatility.
>
> Edward Campbell
> Managing director and senior portfolio manager
> QMA

"I think a Sharpe ratio is also helpful in considering performance, as providers may have different ways of articulating their target," he said. "The point is that returns are always important, but the amount of risk is equally important."

The return of a multi-asset portfolio depends on whether the investing is long-only or long-short, and whether leverage is used.

"Most portfolios in the absolute return space tend to target a certain level of volatility," said QMA's Campbell. His firm's global macro strategy targets a portfolio volatility of between 6% and 10%, with an absolute return objective of Treasury bills plus 4% to 6%, and a maximum gross exposure of four times levered.

"We believe the most important thing is to have the freedom to vary the asset types and asset classes that we access, as well as the ways in which we implement ideas," said Millar. "We are able to change implementation along the way. All of this is necessary to ensure enduring diversification."

This type of attitude probably accounts for the move away from holding managers to benchmark-driven performance measures. "We've seen the most growth in recent years in outcome-oriented multi-asset portfolios," said Schroders' Kyrklund. More specifically, she said, this means those strategies with a cash-plus return target as opposed to benchmark-relative performance. •

Finding Opportunities TODAY

Multi-asset managers are bullish. But then, as they often possess the ability to invest across asset classes, geographies and investment themes, multi-asset managers are rarely without positive prospects. That's the beauty of the approach.

Many multi-asset managers look for investment ideas that will play out over two to three years, but even they are finding that in the current environment, it requires some fancy footwork to keep up with the political, economic and financial challenges in the markets.

One economic variable that all are keeping in close view is inflation. One of the trickiest issues of recent times, inflation seems to be reappearing after a prolonged absence. Managers are watching carefully to see what effect potential U.S. infrastructure spending and changes in tax policy might have.

"Inflation is a big issue," said Rui de Figueiredo, a managing director and chief investment officer of the solutions and multi-asset group at Morgan Stanley Investment Management. "And expected returns are low. So we are positioning portfolios to be nimble in responding to potential spikes in volatility. On the spectrum of risk and return, we are much more active than usual. This is partly because we feel that U.S. equity valuations are quite elevated, with the expectations of the Trump presidency already baked in."

Taking an active approach is important at this point in the cycle. While pursuing some new ideas, managers are mindful of potential pitfalls.

"In years past we focused on investing in the beneficiaries of quantitative easing," said Johanna Kyrklund, global head of multi-asset investments at Schroders. "But we felt that the theme had run its course by the beginning of this year."

Now the firm is following up on areas that lagged the QE trend and focusing on areas that offer better value. These include emerging market risk.

However, given issues such as heightened political risk, Kyrklund acknowledged that the firm has some hedges in place to help navigate some of the volatility it sees ahead. "Overall, we see opportunities in cheaper asset classes so we don't have a pervasive return problem for now," she said.

"We have 26 ideas in our portfolio today," said David Millar, head of multi asset at Invesco. "We are spread across the map, with exposure to traditional asset types as well as other ideas. We have a wide array of currency ideas in the portfolio at the moment: long the [U.S.] dollar vs. the euro, long the ruble vs. the Canadian dollar. And at these low volatility levels, we are long volatility in some equity markets because we believe that volatility will come back into those markets."

Risk, which in some cases is represented by volatility, is one issue that divides managers.

"We're reasonably positive on risk assets," said Edward Campbell, a managing director and senior portfolio manager at QMA. "We're still overweight equities, though they are somewhat pricey. While valuation is a good predictor of longer-term returns, it's really not a great predictor of shorter-term ones."

He said QMA has been moving equity exposure from the U.S. to Japan and Europe because of a perception that these markets have more potential to re-rate upwards.

At Eaton Vance Management, portfolio manager Justin Bourgette and his team are derisking portfolios.

"While we think there could be some positives out of the new U.S. administration, particularly on the regulatory front," he said, "we question the idea that increased fiscal spending will increase long-term structural economic growth. Empirically, when government becomes a larger part of the economy, growth has slowed."

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>
> Rui de Figueiredo
> Managing director and CIO
> Solutions and Multi-asset Group
> Morgan Stanley Investment Management

Bourgette also sees some value in collateralized loan obligations, particularly in relation to high-yield, "but only if you do the credit work, understand the deal structure and the underlying economic exposures." Partly this is because of the additional call protection offered by loans in the short term. •

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