

Multi Asset Investing: A Hollow Box or a Better Building Block?

PAPERS Fall Forum

Adam Farstrup, CFA
Product Manager, Multi-Asset

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Schroder Investment Management North America Inc.
875 Third Avenue, New York, NY 10022
(212) 641-3800 www.schroders.com/us



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Defining success with clarity

What are the challenges?

- Investor needs are as great as they have ever been
- Capital market returns are muted
- Active returns have been mixed

- Increasing complexity and pressure of a low return environment leading to a rethinking of traditional portfolios
 - Asset allocation approach
 - Active vs. passive
 - Risk management

Complexity requires different building blocks as well as sophisticated risk management and portfolio construction

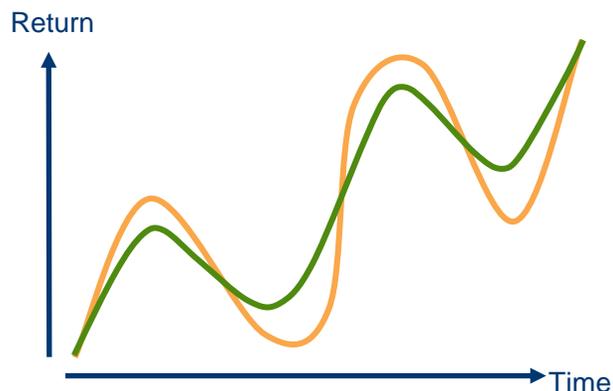
Agenda

- The importance of asset allocation
- You can eat risk adjusted returns
- Defining your objective matters, a lot!

The importance of asset allocation

Is this something new under the sun?

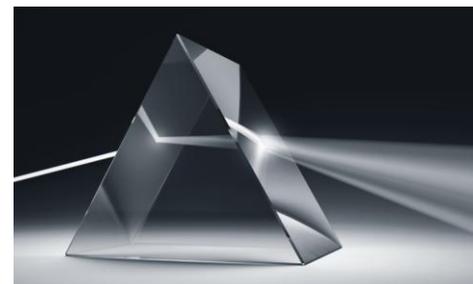
- Seminal Study – Determinants of Portfolio Performance



- Risk matters too – returns can not be understood in isolation

93.6%
of the variation in
plan returns is
explained by
investment policy

- Asset classes are false buckets – understand true sources of risk



Source: "Determinants of Portfolio Performance", *Financial Analysts Journal*, July/August 1986

I know it is important...

...but how do I do it?

You have some choices:

- Traditional Mean-Variance Strategic Asset Allocation



- Static allocation in risk space



- Dynamic allocation

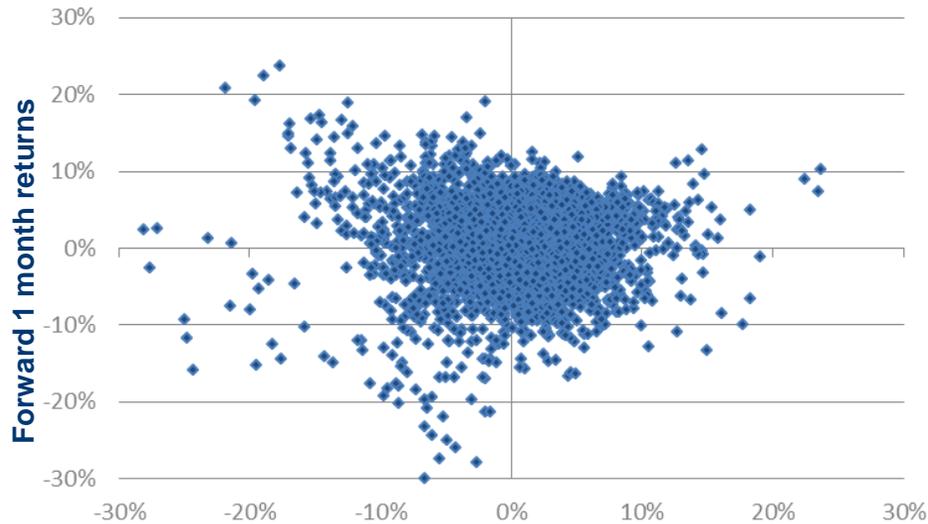


- Combination

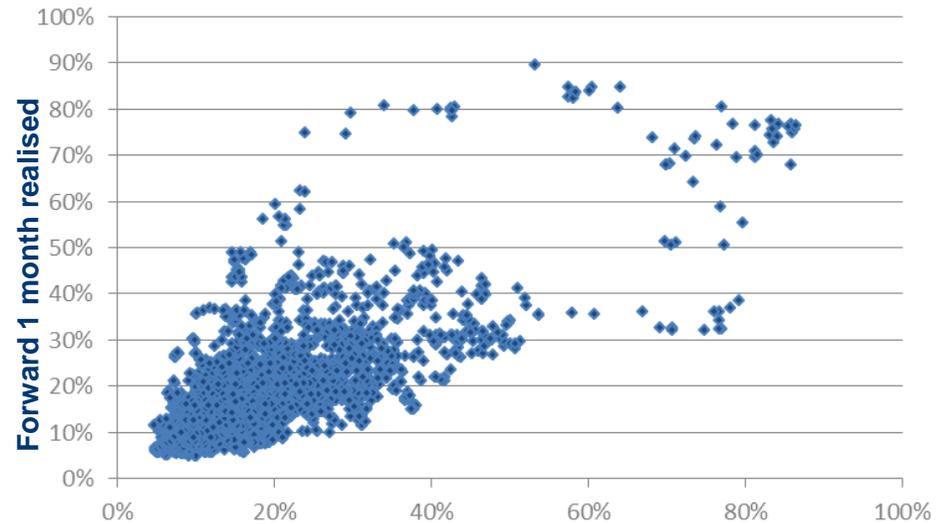
Dynamic asset allocation

Isn't that just market timing?

**S&P 500 Previous 1 month returns vs. forward 1 month returns
(Jan 1994 to Dec 2013)**



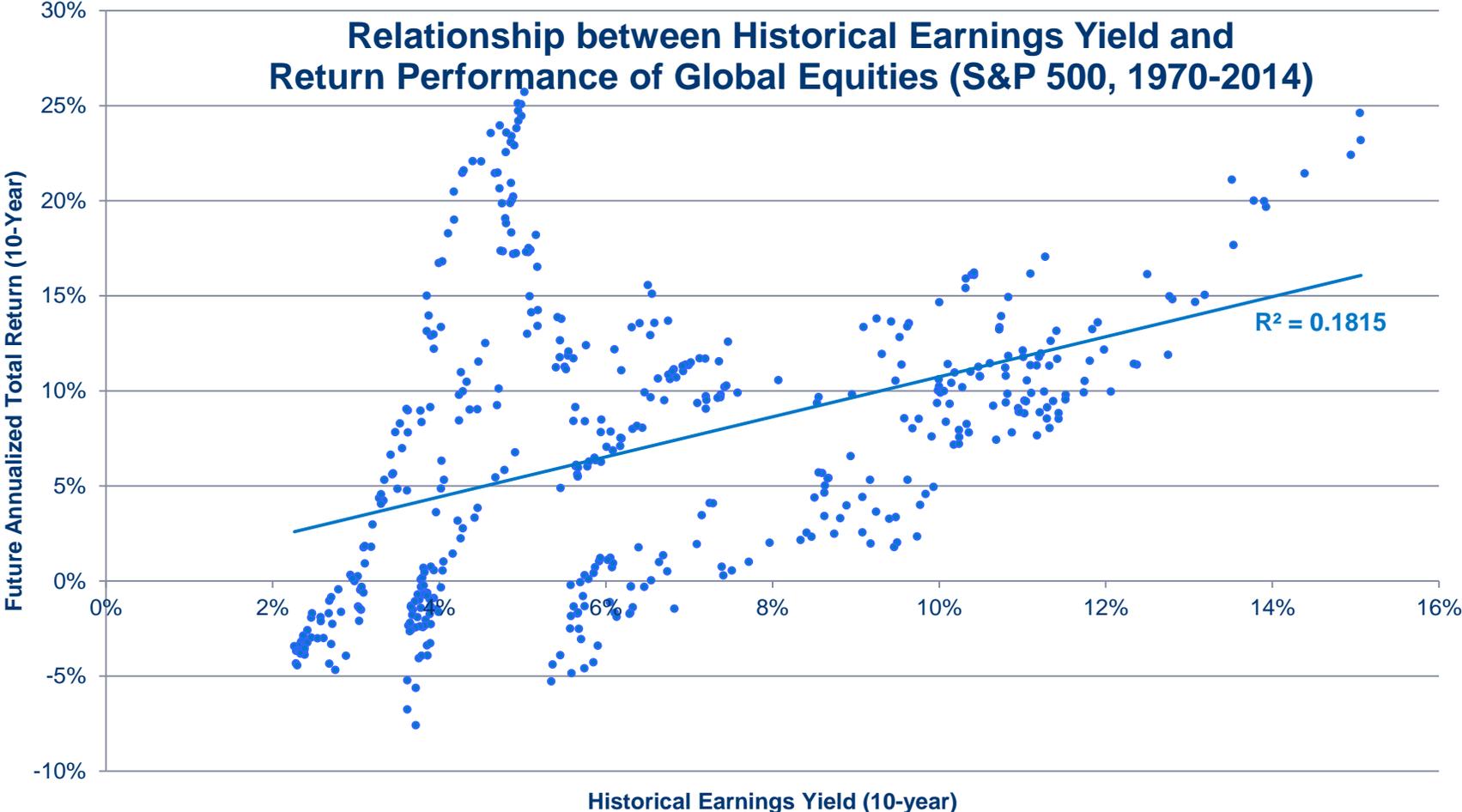
**S&P 500 Previous 1 month realised volatility vs.
forward 1 month realised (Jan 1994 to Dec 2013)**



Source: Schroders, Bloomberg. S&P 500 Total Return Index used, Realised Volatility corresponds to annualised volatility of daily returns for the relevant period

Dynamic asset allocation

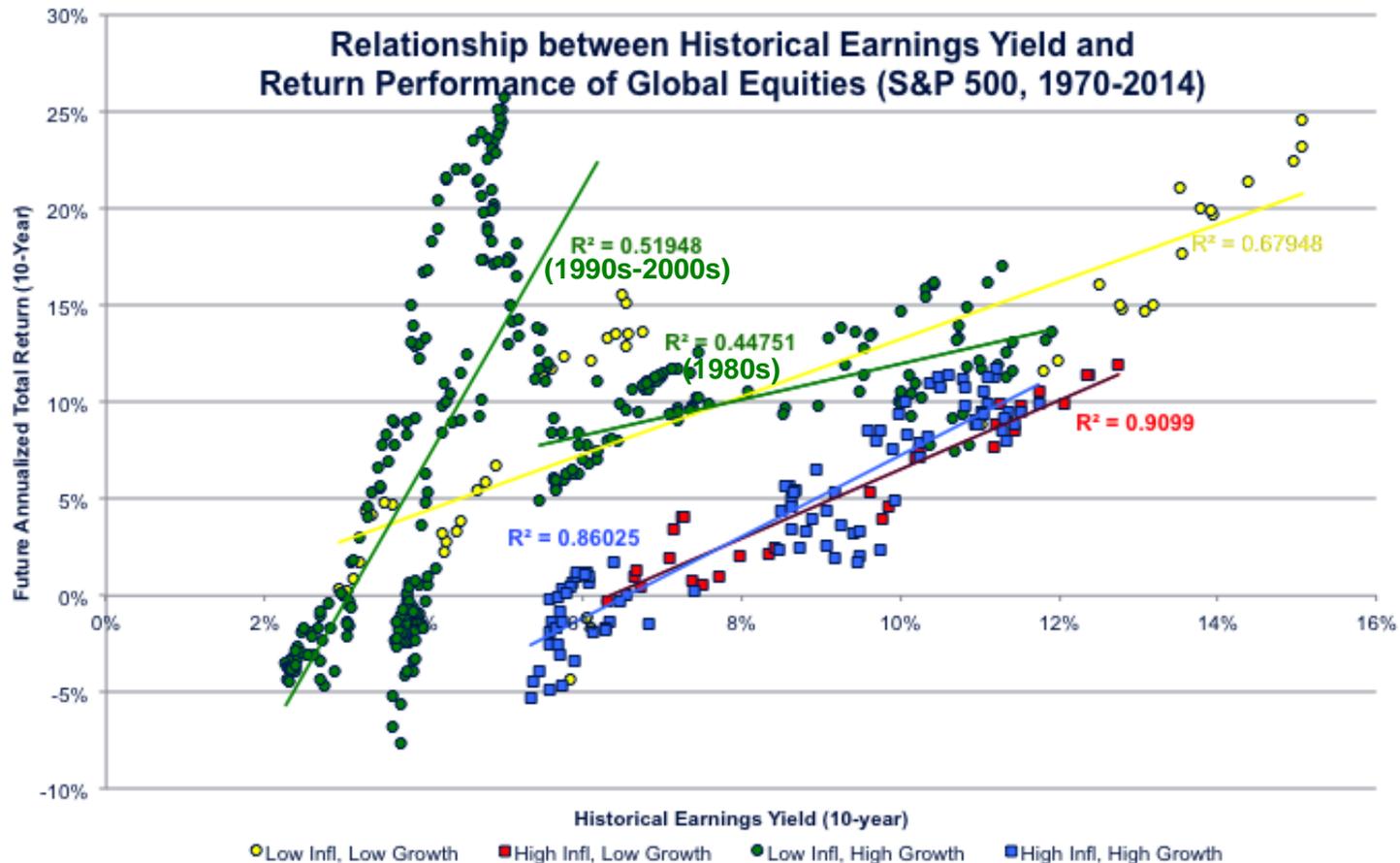
Does valuation matter?



Source: Schroders analysis, Shiller website

Dynamic asset allocation

Valuation matters within regimes



The relationship between valuation and return becomes clearer once grouped by regime

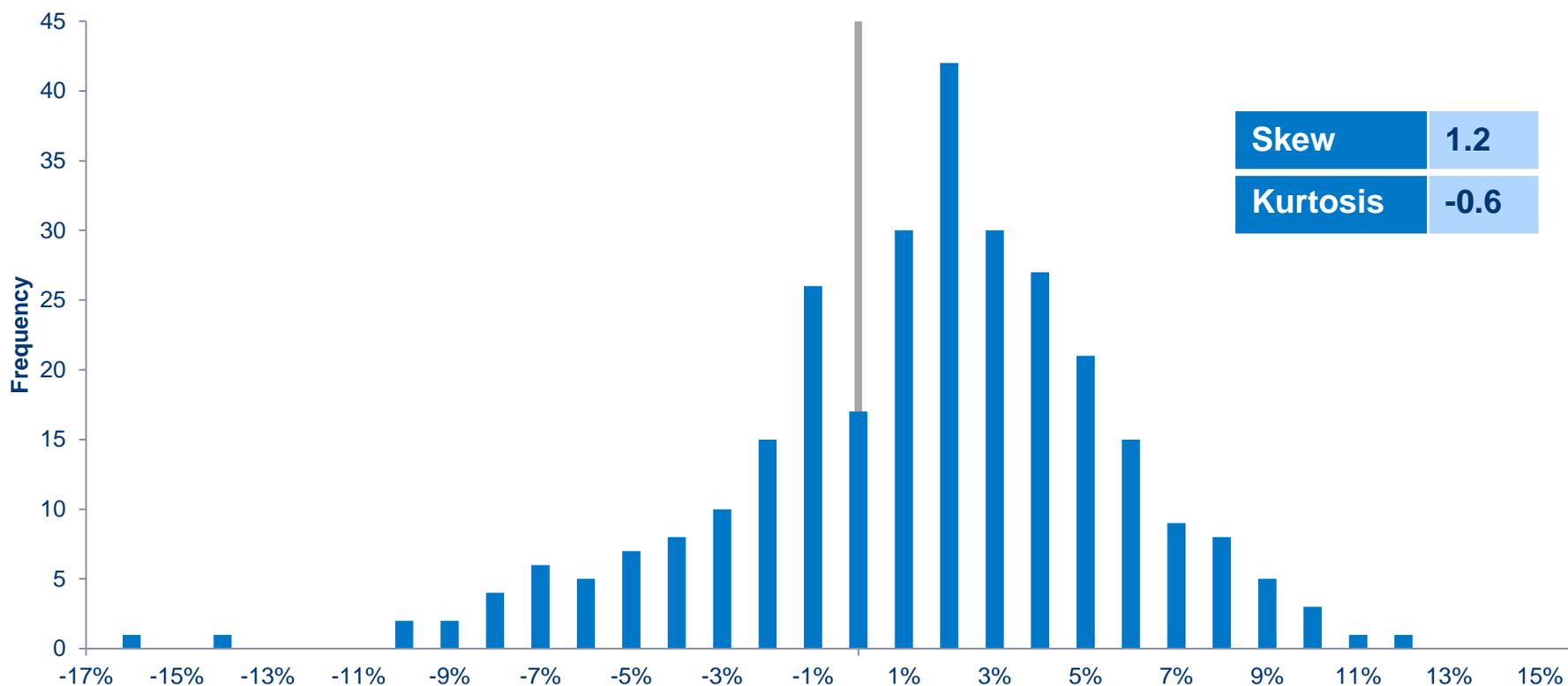
Source: Schroders analysis, Shiller website, NBER website

You can eat risk adjusted returns

Normal distribution of market returns

Returns are not normal!

Distribution of S&P 500 Monthly Total Return
Jan 1990 - Aug 2014

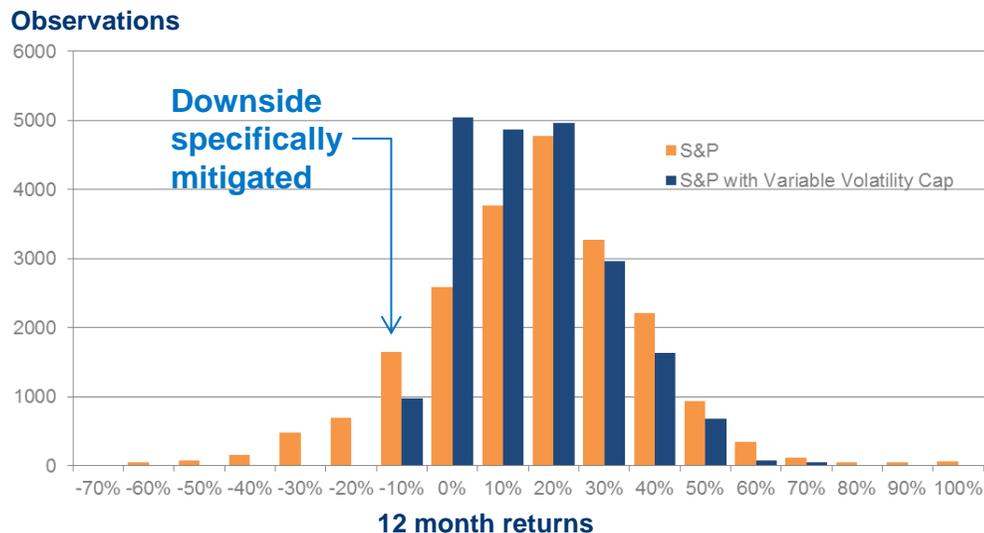


Source: Bloomberg, Schroders

You can eat risk adjusted returns

Choose the right risk

Distribution of annual returns 1928 – 2013



- For most investors, risk is not volatility but risk of loss
- Risk of loss can be measured in absolute terms, relative to a asset benchmark or a liability benchmark
- Loss aversion tends to rise after losses occur

Risk characteristics: 1928 – 2013

	Average return*	Standard deviation	CVaR (observed)	2008 return
Uncapped	9.76%	19.18%	-36.54%	-37.00%
Variable Volatility Cap	9.98%	10.74%	-9.14%	-8.76%

*Average annual compounded return

Source: Schroders, Bloomberg. Daily data from 31 December 1928 to 31 December 2013. For illustration only. Performance shown is past performance based on a simulation. Indices used are the S&P 500 (Dividend Adjusted) (December 1928 – January 1988), S&P 500 Total Return (January 1988 – December 2013). 12 month rolling volatility. CVaR is Conditional Value at Risk

From asset classes to risk premia

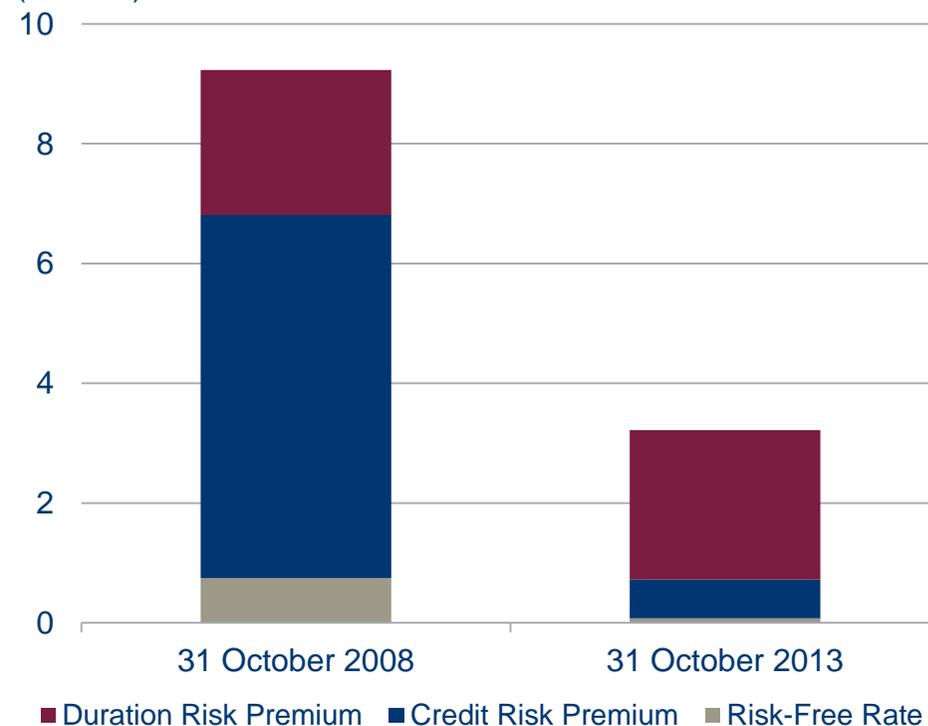
Understanding risk and return drivers

- **Risk premium:** expected return for assuming a source of risk
- **Risk premia:** building blocks of asset classes
- **Asset classes:** composed of one or more risk premia

Breaking an asset class down into risk premia

Example: US investment grade credit

(Yield %)



Source: Schroders, Datastream, 31 October 2013. US investment grade credit is represented by the BofA Merrill Lynch US Corporate Index. Shown for illustrative purposes only and should not be viewed as a recommendation to buy/sell.

From asset classes to risk premia

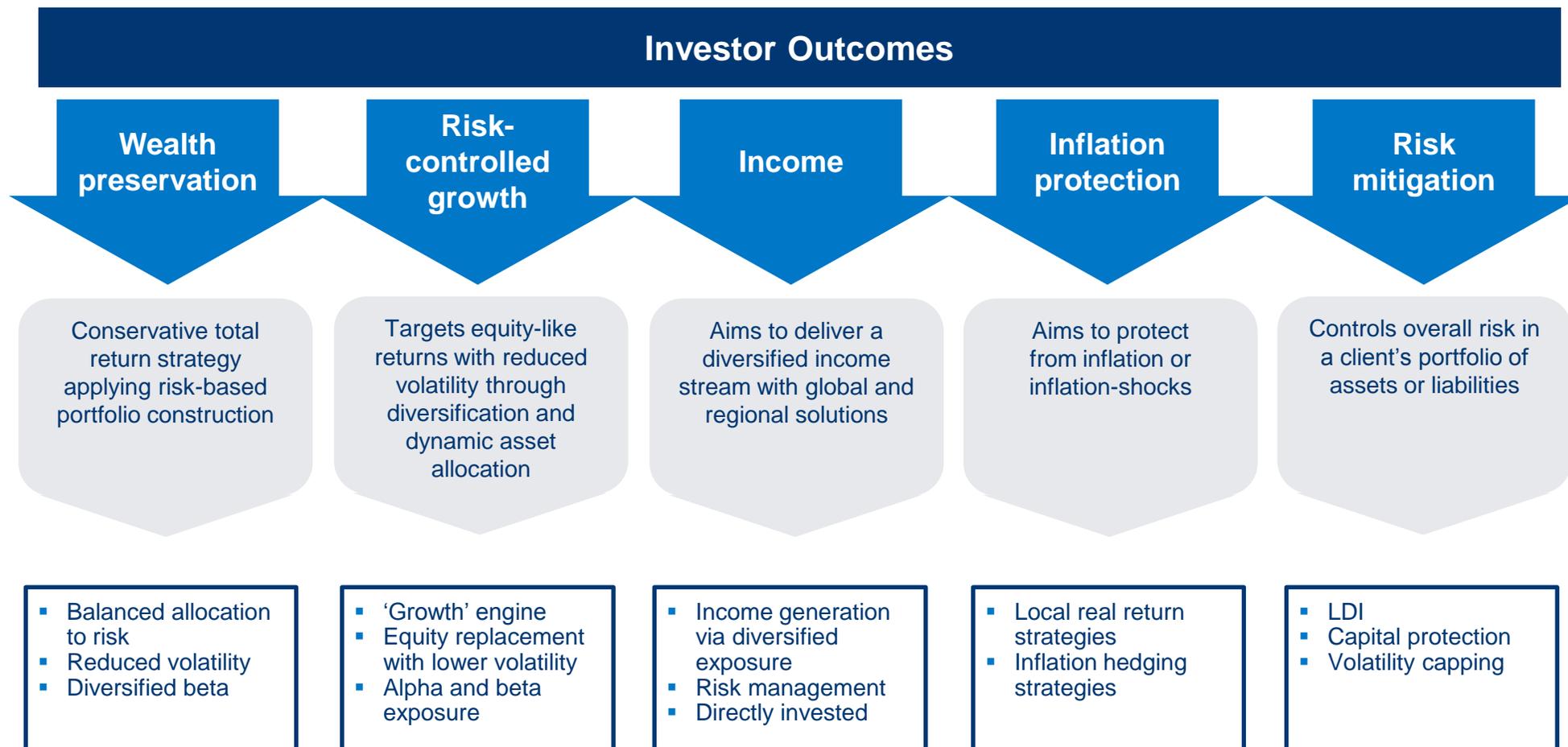
How we organise our research

Duration	Growth	Inflation	Strategies				
Term Matthias Scheiber London	Credit Urs Duss Zurich	Equity Johanna Kyrklund London	Commodities Alastair Baker London	Inflation Philip Chandler New York	Strategies David King London	Currency Patrick Brenner Hong Kong	Volatility Aymeric Forest London
Team of 12	Team of 10	Team of 10	Team of 9	Team of 4	Team of 11	Team of 11	Team of 10
Developed markets	Investment Grade	Developed markets	Agriculture	Commodities	Size	Global FX Carry	Volatility
Emerging markets	High Yield	Emerging markets	Energy	Breakeven inflation	Value	EM FX Carry	
TIPS		Equity value	Ind. Metals		Trend		
		Equity size	Gold		Volatility		
					Carry		

Source: Schroders, as of 31 July 2014. For illustration only. Some professionals are members of two risk premia groups. Team numbers include team leader.

Asking the right question

What is your objective



Source: Schroders. The Multi-Asset team has expressed its own views and opinions and these may change.

Conclusion

- Re-examine your asset allocation approach, ensure your objectives and true-risk tolerances are reflected
- If you have defined risk correctly, risk adjusted returns matter. Maximize your objective adjusted for the right risk!
- “If you don’t know where you are going, you might wind up somewhere else.”
– *Yogi Berra*

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(212) 641-3800