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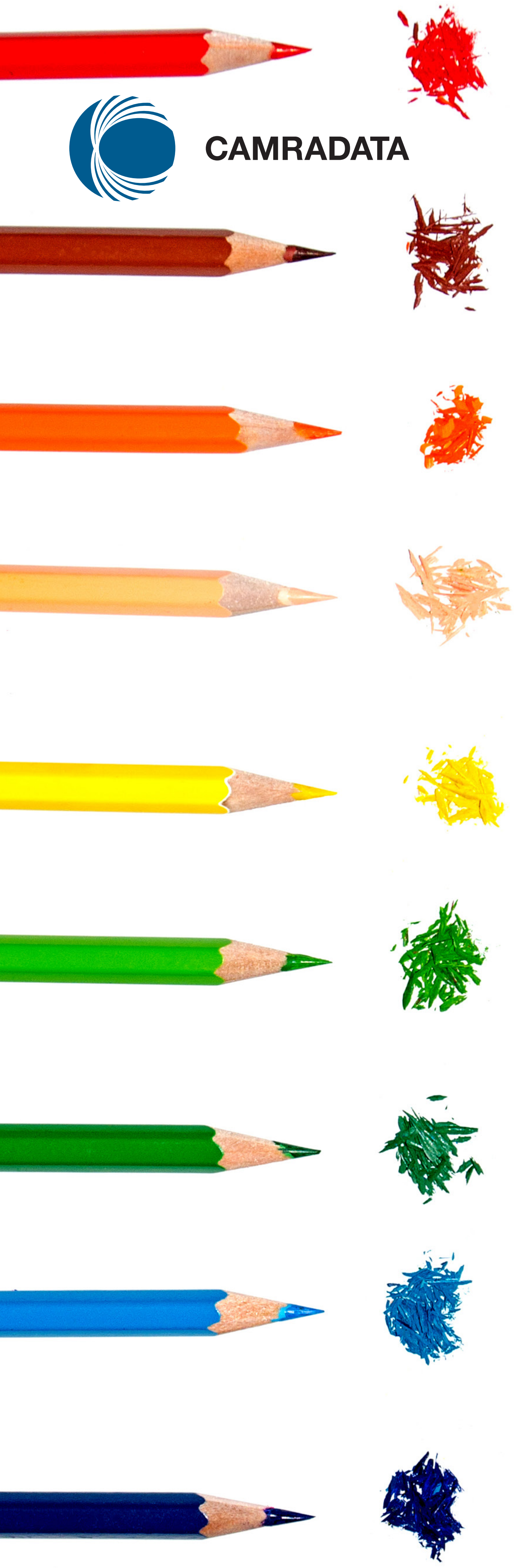

Multi Asset Roundtable

Not just for the sake of diversification

May 2019

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A Reminder About Our Aims

The mantra of low-growth and low yield has put asset managers under pressure in their quest to deliver performance and find new sources of alpha. This can lead to diversifying into new asset classes to deliver uncorrelated returns.

However, how easy is it to extend into new asset classes, as taking a multi-asset approach to investing is no easy task… the essence of a multi-asset portfolio is its ability to generate a diversified range of returns, but can this also be its Achilles heel as it may lead to increased correlation across asset classes?

Furthermore, the multi-asset category covers an array different approaches, from balanced strategies to diversified growth funds plus hedge-fund-like absolute return strategies which for some smaller schemes can be mystifying. Additionally, the use of more exotic asset classes over time, to seek this diversification could lead to increased risks and operational restrictions.

CAMRADATA's Multi Asset roundtable will seek to answer the crucial question as to whether active asset allocation and complex investment universes have had their day, or whether the best is yet to come.

> "The multi-asset category covers an array different approaches, from balanced strategies to diversified growth funds plus hedge-fund-like absolute return strategies which for some smaller schemes can be mystifying"

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Company Profile

Newton Investment Management is a London-based, global investment management firm, providing a focused range of investment strategies to public and private-sector DB and DC pension funds, corporations, charities and, via BNY Mellon, individuals.

We run a broad range of equity, fixed-income and multi-asset strategies, and have particular expertise in absolute-return, income-focused, high-conviction and sustainable investing. We use a global thematic approach to help achieve long-term perspective. Our themes inform both the rigorous fundamental analysis carried out by our experienced global research analysts, and the construction of portfolios designed to meet our clients' requirements. We consider environmental, social and governance issues in relation to every company in which we invest, in the belief that responsible investment is better investment.

www.newtonim.com

Andrew Warwick

Portfolio Manager, Real Return Team

Andy is one of the global portfolio managers of the Real Return strategy. Together with the other portfolio managers, Aron Pataki and Suzanne Hutchins, Andy is responsible for the final capital allocation decisions on the strategy. Andy started his career at Mercury Asset Management in 1993 as a unit trust dealer before joining the Quant & Derivatives team to focus on managing synthetic portfolios for clients and trading equity derivatives for the Firm. In 2006, Andy joined the multi-asset team at BlackRock where he was responsible for managing absolute and relative return mandates as well as the head of research specialising in equity thematic views and risk premia strategies.

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Royal London Asset Management

Company Profile

Royal London Asset Management is one of the UK's leading investment companies. RLAM has built a strong reputation as an innovative manager, investing across all major asset classes and delivering consistent long term outperformance. RLAM manages over £113 billion of assets (at 31/12/18), split between equities, fixed interest, multi asset investing, property and cash, with a market leading capability in Sustainable Investing. Products include funds and segregated accounts investing in government bonds, investment grade, high yield and unrated credit, equity income and equity growth across global developed markets, as well as UK property and cash and short-term money market instruments.

Trevor Greetham

Head of Multi Asset

Trevor Greetham is an investment strategist and fund manager with 25 years of experience. Prior to joining Royal London in 2015, Trevor was Asset Allocation Director for Fidelity Worldwide Investment, where he was responsible for implementing tactical investment decisions across a wide range of institutional and retail funds. From 1995 to 2005, Trevor was Director of Asset Allocation for Merrill Lynch, advising fund manager clients on their multi asset investment strategy. Trevor qualified as an actuary with UK life assurer Provident Mutual and has a Master of Arts in Mathematics from Cambridge University.

Participants

Steven Crane

Member Nominated Trustee

Steven has been a Member Nominated Trustee of a small defined benefit pension scheme since 2007, and Chair of Trustees since 2012. The scheme is open to new members and future accrual, and has maintained a funding surplus.

Also an active member of the Association of Member Nominated Trustees. Steven also has a degree in Philosophy, a masters degree in Industrial relations and an MBA.

Simon Woodacre

Senior Investment Research Analyst

Simon joined Buck in January 2017 and has 6 years industry experience. In his previous role Simon was an Associate at Pictet Asset Management.

In his role at Buck, Simon is the lead Multi-Asset Manager Researcher where he researches, monitors and rates a wide range of Multi-Asset funds for recommendation to clients. He also provides key insights, strategic thinking and analysis on the wider Multi-Asset investment universe.

Simon has passed Level II of the CFA Program; he also holds the IMC and graduated from the University of Southampton in 2011 with a 2:1 in Economics.

Participants

Mike Nixon

Pension Fund Manager

Mike is Head of Pensions for Leonardo, a manufacturer with major UK businesses in helicopters, electronics, defence and security systems. He is responsible for two medium sized DB schemes which remain open to future accrual as well as a DC scheme for new entrants that meets the Pension Quality Mark Plus standard. The schemes cover 7,000 employees supported by £2.5bn in assets.

He has over 30 years of industry experience, having previously worked for occupational schemes within the insurance sector. He holds professional qualifications from both the Chartered Insurance Institute and the Chartered Institute of Personnel and Development and is based in Yeovil, Somerset.

John Arthur

Senior Advisor

John Arthur was previously the Managing Director of Institutional Advisory Services and now acts as a Senior Adviser. He deals with all client issues for the team of Allenbridge Advisers including on-boarding new clients and monitoring Adviser performance. He has over 30 years' experience within the investment industry, working with both Corporate and Local Authority Pension Funds. He is a frequent speaker at conferences and seminars as well as taking responsibility for organising challenging speakers and events for the team of Allenbridge Advisers.

John has expert knowledge from working within one of the UK's largest defined benefit pension schemes as a member of the Senior Management Team. A career encompassing Head of International Equities and two years leading the relationship with the Scheme Trustees & Secretariat on all investment matters. He joined Allenbridge in 2012 and spent the last four years working with a number of pension clients, both LGPS and corporate as an Investment adviser and latterly as Managing Director of Allenbridge.

Participants

Brendan McLean

Head of Manager Research

Brendan is Head of Manager Research and is responsible for recommending and monitoring investment managers across all asset classes. He joined Spence in 2017 and has gained many years of experience working at a variety of firms, including an investment consultancy and a family office. He studied Finance at the ICMA Centre, University of Reading.

Brendan Maton

Freelance Journalist

A highly experienced financial journalist with an expansive network of contacts in the UK and across Europe. Brendan has written about pension schemes and national welfare systems from Finland to Greece for 18 years and understands the retirement savings industry in each European country.

Brendan has interviewed EU commissioners and national ministers; central bankers; pension scheme heads; insurance chief executives; chief investment officers; actuaries; union officials; professional and lay trustees.He worked at Financial Times Business for eight years, finally as editor-in-chief of all international pensions titles. Brendan has spent the last ten years as a freelancer for a number of publications, including Financial Times, Responsible Investor, Nordic region pensions news and IPE. He is also Chief webcast host for IPE.

Brendan has acted as conference chair for Financial News, the UK National Association of Pension Funds, Dutch Investment Professionals Association (VBA), Corestone, Insight Investment, Marcus Evans, Robeco Asset Management, Sustainable Asset Management (SAM), Towers Watson.

Not just for the sake of diversification

It's been a tough few years for Diversified Growth Funds (DGFs). A long bull market in equities since the Global Financial Crisis has had clients wondering whether to keep faith with DGFs. A basic equity/bond allocation would seem to have done a better job than most, according to John Arthur, senior consultant at MJ Hudson Allenbridge, which advises pension schemes on investments.

> "In many UK pension funds, a DGF is the only bit of the investment that can be used to express asset allocation decisions in a timely fashion"

"Diversification has not worked these last five years," he says. "If you took a 100% equity/0% bond split; then just added 10% bonds each time, few DGFs would appear above the returns from any of these splits."

MJ Hudson Allenbridge has been a supporter of DGFs in the past. So is Arthur now discouraged? "No. The easy thing would be to dismiss them. Looking forward, I value diversification and in many UK pension funds, a DGF is the only bit of the investment that can be used to express asset allocation decisions in a timely fashion."

This is good news for Royal London Asset Management, which has a new DGF in the market managed by RLAM Head of Multi Asset, Trevor Greetham. The Multi Asset Strategies Fund (MAST) combines two complimentary sources of return, each with built-in risk control to limit downside. The core portfolio looks to capture the upside from a portfolio of liquid assets, reducing exposure during market turbulence. Independent tactical asset allocation strategies exploit short to medium term opportunities irrespective of market direction.

"Some DGFs offer market beta with pretty much static allocations. Others are market-neutral, with returns based only on manager skill. We are going straight down the middle," says Greetham. "Investors shouldn't have to choose between participating in rising markets and taking a more tactical approach when economic conditions deteriorate."

One notable feature of the disappointing period for DGFs in general was lower volatility. There have been moments of panic, notably the Eurozone crisis of 2013 and February and May 2017. The serious market losses at the back end of last year could, however, herald something more profound.

Simon Woodacre, multi-asset manager researcher at Buck, an adviser to pension funds, asked the DGF managers at the roundtable how their strategy would react in a market sell-off.

Greetham replied that MAST is ready for all kinds of weather because while the core portfolio will dial down exposure in worsening situations, the TAA element is still free to buy the dip. He gave the example of short-lived market panics. "You often find there are sudden plunges when everyone loses faith. We can buy at those times, as we did in December last year, if we think policymakers are going to intervene to turn things around."

Andy Warwick, co-manager of Newton's £16bn Real Return Fund, replied that it would not change its strategy and still look to preserve capital – Real Return was one of the only DGFs to deliver a positive return in 2018 and has never had a negative calendar year since inception. He broadly agreed with Greetham's prognosis for the years ahead. "Last year could be the beginning of the end of this financial regime," Warwick told the CAMRADATA panel. "That means a breakdown in correlations and an increase in volatility."

Newton's Real Return team, like many other multi-asset managers, has been on the end of criticism that recent performance has lagged equity markets. Newton has long made the case, however, that we have been living through strange times when central banks have fed the markets money and in doing so, distorted values. Tracker funds don't have to think about such profound matters as value. But lest we forget, one of the reasons DGFs came into being was the sore disappointment of pension funds who swapped active management for trackers in the very late 1990s only to be poorer once the tech bubble burst a few years later.

Furthermore, DGFs earned a good reputation for successful navigation through their first real test, the Global Financial Crisis of 2008-9. Looking ahead, Warwick believes that policymakers have recognised that QE is becoming less and less effective as a tool to stimulate the economy and therefore they would be forced to come up with alternative / more radical tools (e.g. modern monetary theory). He does not believe that China, for example, has the wherewithal to make good on all the indebtedness in its economy. In Western democracies, governments acknowledge populist wishes not to see State support for financial markets. So instead he sees the focus falling on fiscal.

"One of the reasons DGFs came into being was the sore disappointment of pension funds who swapped active management for trackers in the very late 1990s only to be poorer once the tech bubble burst a few years later"

Warwick warns, however, that this new mood could take another five years to play out. The onus thus falls back onto consultants to help clients decide which type of DGF might help them in the future. Arthur noted that the universe has expanded from fewer than 20 funds ten years ago to almost one hundred today. Woodacre listed some of the sub-categories: static allocation (reminiscent of the old Balanced Funds); market directional; absolute return; outcome-orientated.

For Buck clients there was broad disappointment from DGFs in 2018. One of the biggest concerns in all this, according to Woodacre, was some Absolute Return funds losing money in the fourth quarter of 2018 when they were supposed to protect. This begged the question about their process. Have they lost their way? He said that in the current environment long/short absolute return strategies had not really worked and nor had some of the protective optionality to reduce losses.

> "The universe has expanded from fewer than 20 funds ten years ago to almost one hundred today"

The panel thus homed in on the difficulty of understanding all the moving parts and their relative contribution to dynamic multi-asset strategies. Greetham asked the consultants if they received sufficient attribution data from managers.

Woodacre said that the Absolute Return managers produced huge spreadsheets of attribution but this didn't necessarily tell you everything you wanted to know. He said for some market-directional managers there was the issue that they had over-delivered: what in the strategy caused that?

Arthur said that the truth was that consultancies do not have the resources to analyse the entire DGF market thoroughly. "We have to rely in part on good communication with the managers," he said.

Brendan McLean, head of manager research with Spence and Partners, a pension fund consultancy, said that the data was often not as granular as he would like, especially for those DGFs specialising in fast-moving Tactical Asset Allocation.
McLean said that he concentrated on a handful of strategies. "If there are any doubts in my mind about a strategy, then I exclude it because I can't take unnecessary risks with client money."

Woodacre said that Buck typically won't look at a strategy without a three-year track record unless a team can demonstrate the same integral strategy at a previous firm.
What's the asset owners' perspective? Mike Nixon is head of pensions at Leonardo, manufacturer of defence electronics and helicopters, which has two DB schemes closed to accrual and one open DC scheme.

All three have been managed using dynamic allocation but via a fiduciary manager, with a track record of 14 years. Nixon said the trustees had learned to trust the manager over time. "We as trustees do not have any special expertise in making detailed asset allocation decisions or selecting underlying managers but can make a real difference at the strategic level."

He said the board were kept up-to-speed by numerous benchmarks, including long-term liability and short-term static asset benchmarks as well as peer comparisons. But the test that really mattered, according to Nixon, was the three-year scheme valuation because that is when everything comes together. He added that the DB schemes have really benefitted this century from interest and inflation-hedging of the liabilities. But he agreed with Arthur's earlier point that that leaves dynamic allocation as a key route to building a surplus; and for DC members getting them above-inflation returns. This last point, to earn real returns in DC, is a top priority for Leonardo in pensions.

Steven Crane is a trustee for a small, open DB pension scheme. His trust board's experience of DGFs has been less comfortable: four have been hired and fired in under seven years. The scheme is onto its fifth and sixth, having diverted some growth assets into a pooled fund for private assets. At the CAMRADATA roundtable, Crane acknowledged the asset managers' belief that economic conditions may well be changing. "We are wary of pulling the trigger now. I have some sympathy with more than one manager we have had because of the conditions," he said. His criticism was that some DGFs focused too much on diversification and should instead have been more dynamic, for example by tracking the equity market when that made sense. The scheme's sponsor's priority is to have low volatility, low risk return streams.

> "Some DGFs focused too much on diversification and should instead have been more dynamic, for example by tracking the equity market when that made sense"

Greetham suggested that to smooth out returns, investors must have a sense of where we are in the cycle and allocate accordingly [this is not the simplistic seven-year business cycle of yore]. Early in his career, Greetham came up with the notion of an Investment Clock linking asset returns to the business cycle, with growth and inflation indicators to tell the time. In 2019, Greetham observes we are entering a record eleventh-year of continuous expansion in the US economy but the slump in oil prices late in 2018 has taken inflation out of the system again. Growth could surprise positively this year but recession risks are rising, in his view, with the interest-sensitive US housing market suffering after two years of rate hikes from the Federal Reserve. All in all, storm clouds are brewing. Greetham suspects that many investors haven't figured out how they will cope in choppier markets. He says RLAM's approach to active management tends to add more value in bear markets than in bull markets.

Arthur agreed that Tactical Asset Allocation tends to do well in times of market dislocation when managers can build high conviction that many assets are mispriced. His concern was that markets can spend many years close to fair value when it is difficult to add value via TAA; yet managers tend to continue to allocate between asset classes based on a lower level of conviction rather than waiting for the next period of market stress. But MAST has the other source of return, the broader beta exposure coming from what he calls risk premium strategies. Greetham says he does not want to do TAA solely and lever up like a Risk Parity strategy when markets are quiet when there's an obvious complementary source of return to be had at these times from a long-only portfolio.

> "Investors should think twice about any DGF offering returns of 7-9% going forward. Because if policymakers are not prepared to spend big, to stimulate markets again, then those kind of returns will be hard to find"

Warwick said investors should think twice about any DGF offering returns of 7-9% going forward. Because if policymakers are not prepared to spend big, to stimulate markets again, then those kind of returns will be hard to find. The underlying economy is not itself demonstrating enough signs of strength to encourage investors. Warwick noted for example that Germany's growth in 2018 was at a five-year low. Downgrades of forecast earnings are plentiful. The US yield curve has inverted – a characteristic portent of recession. But while bondholders seem to have taken note, shareholders seem to have put their faith in the ongoing largesse of central bankers.

Newton's framework for evaluating markets this decade - Crisis, Response, Improvement, Complacency – remains a useful guide in this context. Some policymakers such as the ECB are still managing some QE by the back door while even the US has paused on rate hikes. But Warwick's belief is that such responses, which have driven much of the last ten years' returns cannot last. "The bigger the bubble, the bigger the bust," he concludes.

UPCOMING ROUNDTABLE DISCUSSIONS

22nd May 2019 - Multi-Asset Credit
10th June 2019 - Private Credit/Debt
13th June 2019 - Insurance
19th June 2019 - DC

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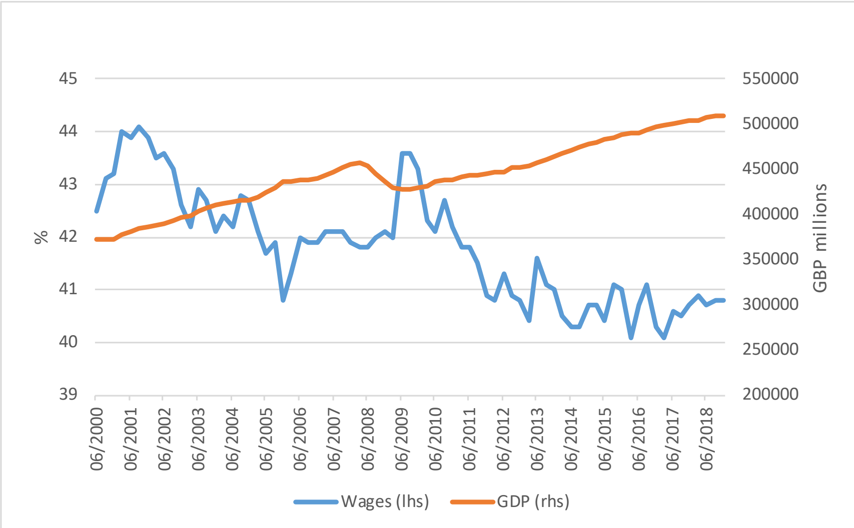
Recent political events across much of the developed world have signalled an end to the policy consensus that has existed for most of the last 30 years. The free-market liberalism which took hold in the US and UK in the early 1980s, and subsequently across much of the developed and emerging world, heralded a period of economic stability and globalisation, which has been characterised by the free movement of capital, labour and trade.

Globalisation has, in aggregate, led to economic gains, and has created many winners. A wide range of developing economies have benefited from increased trade, with countries such as China exporting cheaper goods to the West, resulting in millions being lifted out of poverty and the emergence of a growing middle class. Consumers in developed markets have also gained from cheaper, imported products and from increased choice and competition.

> "Middle-class workers have seen their pay stagnate for years, often with the perceived threat of jobs being exported to the developing world"

However, there have been losers too. Most notably, many jobs in developed economies have been lost and transferred to lower-cost countries. In other cases, middle-class workers have seen their pay stagnate for years, often with the perceived threat of jobs being exported to the developing world. Workers have also faced the challenge of technological disruption, with many traditional jobs at risk in sectors such as retail as businesses move online. Such an environment has led to wage deflation. Taking the UK as an example, the chart below highlights that, while the country's GDP has risen over the last 20 years, wages have fallen in real terms, with average wages lower than they were 20 years ago.

UK wages as percentage of GDP vs nominal GDP



Source: Bloomberg, Office of National Statistics, Newton, February 2019

In the US, while unemployment may be at its lowest rate for 50 years, the low-paid nature of numerous positions means that many individuals are struggling to make ends meet. According to the US Census Bureau, over 50% of under-18s live in a household receiving welfare payments.[1] This is reflected by data which shows that the US corporate sector's share of gross value added (measured by after-tax profits) has risen to record highs over the last 20 years, while employee compensation's share has significantly declined.[2]

The crisis effect

The aftermath of the 2008 global financial crisis has reinforced the trends which had already been developing over the previous two decades. Extraordinarily loose monetary policy such as quantitative easing has driven asset prices higher. However, this price inflation has been concentrated in financial assets, and so those people with assets have seen their wealth inflated, while those without such assets have seen them become often unaffordable.

1 Source: US Census Bureau, 2017
2 Source: Bloomberg, CPA London, March 2019

With the great bulk of financial assets owned by the few (a study suggests that 84% of US stock-market wealth is owned by 10% of the population[3]), the result has been an increase in inequality.

In addition, while profits have soared once again, wages have stayed low and public services have been cut, while governments have made little headway in tackling the effects of longer-term structural challenges facing their economies, such as the debt mountain, ageing demographics, and technological disruption. With austerity a near-permanent feature in recent years for many countries, it is perhaps unsurprising that more extreme politics have begun to attract growing support.

A new 'post-globalisation' era?

A series of events over the last five years have defined the continuing surge in populist movements. One of these was the election of Donald Trump as US president, and his administration's subsequent protectionist policies which have included the trade dispute with China. However, the majority of these developments, such as the UK's Brexit vote and the recent 'gilets jaunes' protests on the streets of France, have taken place in Europe, where the overall populist vote share has risen from 7% in 1998 to over 25% in 2018.[4]

Such developments indicate to us that we may be entering a new 'post-globalisation' era, which is likely to look very from different from the previous 30 years. In particular, history suggests that populist policies result in fiscal expansion, as governments are forced to consider radical new means of empowering their citizens. This can lead to inflationary pressures, higher debt (leading to higher bond yields) and, ultimately, an economic slowdown, as occurred in the UK in the 1970s.

> "History suggests that populist policies result in fiscal expansion, as governments are forced to consider radical new means of empowering their citizens"

From an investment perspective, this new era is likely to be very different from the previous 30 years. The global economic uncertainty index indicates that such uncertainty is now higher than at the height of the global financial crisis,[5] and, with the potential for further populist developments, it is likely that volatility will remain elevated. Furthermore, correlations between equities and bonds may continue to break down. Historically, this relationship has tended to see bonds perform better when equity markets have taken a dive, and vice versa, acting as an important diversifier for multi-asset portfolios. However, in a more inflationary environment, there is potential for both asset classes to be weaker: inflation will naturally eat into fixed-income returns, but rising yields can also make the stocks of those companies with higher debt look less attractive compared with 'safer' securities. In such an environment, 'growth' stocks, which have driven much of the stock-market gains over recent years, may be less favoured, with 'value' equities making a comeback.

While the stimulus of recent years may have helped a rising tide to raise all boats, we believe we may now be entering a financial regime that is very different from the world we have become used to. In seeking to navigate this uncertain environment, we believe the importance of an active, flexible portfolio, with an eye to capital preservation, is likely to come to the fore.

Written by

Andy Warwick

Portfolio Manager,
Real Return Team

Important information

3 Household wealth trends in the United States, 1962 to 2016: Has middle class wealth recovered?, Edward N Wolff, National Bureau of Economic Research working paper 24085, November 2017

4 https://www.theguardian.com/world/ng-interactive/2018/nov/20/revealed-one-in-four-europeans-vote-populist

5 Source: http://www.policyuncertainty.com/, March 2019

GROWING FUTURES

We believe perspective is crucial in seeking to achieve investment objectives for our clients. We think the investment landscape is shaped over the long term by a number of key trends, and we use a range of global themes to help try to shut out the distraction of short-term market 'noise' and identify the structural areas of opportunity and risk in financial markets.

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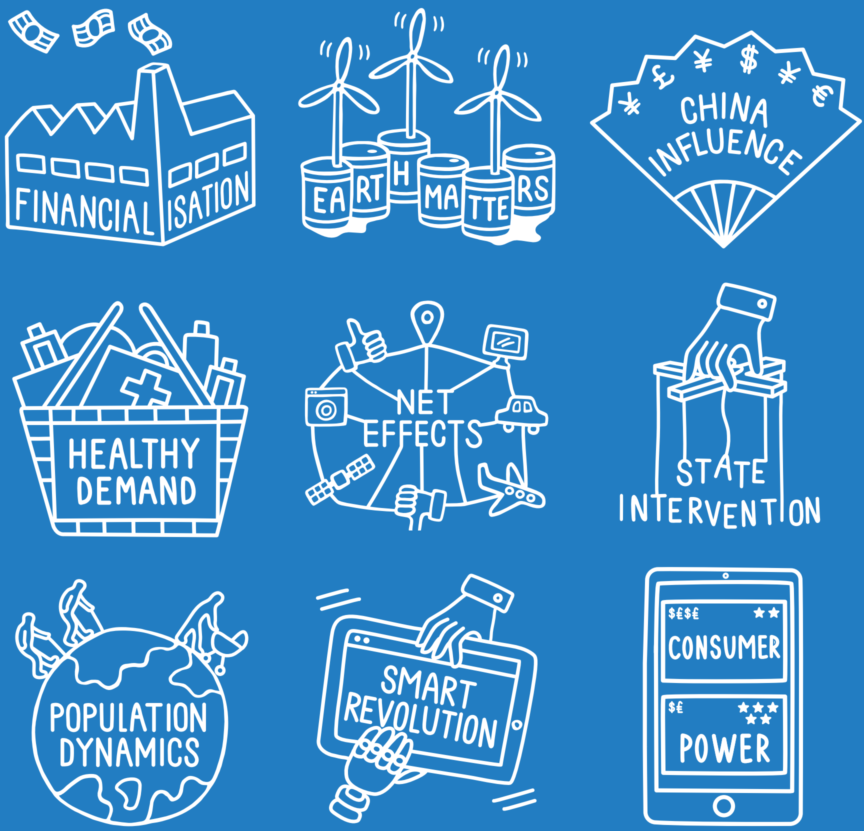

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Stock market volatility is a common feature late in the business cycle but institutional investors shouldn't have to choose between funds offering participation in rising markets and those taking a safety first attitude when economic conditions deteriorate. Royal London's Multi Asset Strategies Fund (MAST) offers a flexible approach, designed to capture market upside in the good times through an efficient mix of liquid assets while limiting downside risk by shifting towards more tactical, market neutral strategies during periods of financial market turbulence.

Most institutions need to generate positive real returns over a long investment horizon but also want to minimise losses over the shorter term. A wide array of diversified growth funds (DGFs) have launched over the last decade to cater to these requirements. Most fit into one of two broad categories: Strategic DGFs, which invest across a wide range of asset classes and rely primarily on diversification to reduce risk, and absolute return funds, which generate returns through a portfolio of individual relative value trades.

The sector has fallen out of favour in recent years after some high profile absolute return funds delivered flat or negative returns against a backdrop of rising stock markets while failing to protect capital adequately when volatility rose in 2018. Meanwhile, less complex strategic DGFs have performed relatively well but few have explicit strategies in place to deal with the more challenging market conditions that undoubtedly lie ahead.

As of June 2019 this will be the longest expansion in the US economy since the 1850s but recession risks are starting to emerge. We expect to see further bouts of market turbulence like those we experienced last year. This marks a significant change in the investment regime. Company shares tend to post lower returns and suffer larger peak to trough losses during periods of above average volatility (table 1).

> "Investors shouldn't have to choose between participating in rising markets and taking a more market-neutral approach when economic conditions deteriorate"

Table 1: US stock market risk and return classified by volaility regime

	Below Average Volatility	Above Average Volatility	All Periods
Average Return	13.4%	6.3%	10.9%
Volatility	12%	23%	17%
Efficiency (return per unit of risk)	1.1	0.3	0.6
Maximum peak to trough loss	-15%	-55%	-55%
Percentage of Time	64%	36%	100%

Source: RLAM; DataStream US total market equity index from 9 October 1973 to 21 March 2019. Past performance is not a reliable indicator of future results. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.

This observation is central to the downside risk mitigation process we employ in our Multi Asset Strategies fund (MAST), launched in November 2018 in collaboration with an institutional investor. The fund builds on the research-led investment process we apply on over £65 billion of assets managed for our parent company and a wide range of third party investors, and aims to counter some of the perceived shortcomings of DGFs.

MAST seeks to generate an average annualised return of four per cent in excess of cash on a rolling five year basis by investing in a diversified portfolio of liquid assets, while managing volatility and downside risk. It operates on an unconstrained basis, so we are able to reduce or remove exposure to risky assets when we deem it necessary to protect capital.

The fund exploits two complementary sources of return, each with in-built risk control. The core portfolio aims to generate steady risk-adjusted returns by investing in an efficient asset mix. Over the long term, every asset class should offer a premium over the risk free rate to compensate for its volatility. We operate risk premium strategies within a pre-set risk budget, scaling back exposure to risky assets when volatility rises above an acceptable level in order to limit losses during periods of market stress.

Tactical asset allocation strategies are designed to exploit short to medium opportunities irrespective of market direction. They build on the core portfolio and operate within a separate risk budget to limit downside risk when markets do not behave as we expect. Our disciplined, model-based approach has a good long-term track record and performed particularly well in the last financial crisis. At its core is our proprietary Investment Clock (www.investmentclock.co.uk), which links asset class returns to the global business cycle. Market leadership passes from one asset class to another as the world economy expands and contracts or the inflation backdrop changes. Investors often miss turning points, leading to a mispricing of assets that we seek to take advantage of.

Our approach to tactical asset allocation adds most value going into and around recessions when downside risk is at its highest. As such we expect it to work well alongside risk premium strategies designed to add more value in bull markets.

A common criticism of volatility managed strategies is that they reduce exposure to stocks after a correction, leaving investors locked in cash as markets recover. Our approach allows us to take part in these rallies using the separate risk budget we allocate to tactical positions.

The benefits of this approach were in evidence almost immediately after the fund launched. A sharp rise in market volatility into year-end forced us to make a temporary but small reduction in the weight of equities in the risk premium portfolio. However, we were still free to back our tactical convictions and we bought the dip in markets, maintaining an above average exposure to stocks and benefitting from the subsequent sharp recovery.

Our model-based framework allows us to simulate positions we would have taken in MAST since the early 1990s. This analysis suggests MAST would have beaten cash by more than five percent a year since 1995 gross of fees with maximum peak to trough losses of less than ten percent. During this period, MAST would have captured about half of the upside from stocks over calendar quarters when they rose. However, a combination of downside risk control and a positive tactical asset allocation impact suggest that on average MAST would have moved sideways over calendar quarters when stocks fell (table 2).

"Our disciplined, model-based approach has a good long-term track record and performed particularly well in the last financial crisis"

Table 2: Capturing upside with limited downside

1995 Q2 to 2018 Q1	Quarters when Stocks Rose	Quarters when Stocks Fell	Average Quarter
FTSE All World (£)	5.9%	-7.6%	2.1%
Risk Premium Strategies	2.4%	-1.0%	1.5%
Tactical Asset Allocation	0.7%	1.1%	0.8%
RLAM MAST	3.1%	0.0%	2.3%
% Time	73%	27%	100%

Source: RLAM and Datastream. RLAM, for illustrative purposes only. The above table contains simulated performance data. Simulated performance data is not a guide to past or future performance. The returns implied in the above are gross of fees and transaction costs which would have had the effect of reducing the actual returns that may have been received.

Written by

Trevor Greetham,
Head of Multi Asset

We are acutely aware there is no guarantee that we can achieve the same results in the future. However, we have an experienced team and what we believe is a sensible and transparent investment process well suited to the more uncertain conditions we are likely to face over the next few years. A disciplined approach that thinks carefully about downside risk at every stage of the investment process will be more important than ever.

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