Multi-asset management in an absolute return environment

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As we all know, over the last decade the damage inflicted on UK defined benefit pension schemes by falling equity markets and declining interest rates was significant and served to highlight the potentially negative consequences associated with running an asset allocation policy that is poorly matched relative to liabilities. There was brief respite in mid-2007, but this was followed by more adverse market conditions and continual improvements in mortality which caused this brief return to healthier funding levels to all but disappear.

Strategic asset allocation

On the whole, pre the late 90s for most of the Local Government Pension Schemes, peer group benchmarking (WM Local Authority Survey) represented the norm in terms of devising asset structures for a scheme. The majority of scheme's assets were managed in 'balanced' funds with asset structures narrowly dispersed around the average allocation of all schemes. As a result, only a relatively small proportion of the overall return generated was attributable to tactical asset allocation (TAA).

From a long-term strategic perspective this asset structure actually served the average pension fund well during much of the 1980s and 1990s as equity markets enjoyed a sustained period of growth, outpacing liabilities. However, the seeds of today's problem were being sown even then. As equity market performance began to deteriorate and interest rates began to move lower, surpluses very rapidly turned to deficits. Whilst the simultaneous decline in equity markets and bond yields was unusual it was not unprecedented, and we did not witness a fundamental change in the inherent risk/return characteristics of each asset class. The asset structure of the average pension scheme performed in a way that was perfectly reasonable, given its intrinsic characteristics.

What next

It is now widely acknowledged that the efficient generation of returns involves managing a diverse set of investment strategies, within the framework of a scheme specific strategy, linked to liabilities.

Although the contribution to alpha (extra return) generation from TAA within balanced funds was historically relatively small, diversification away from balanced managers in pursuit of specialist managers has meant that for many schemes the opportunity to generate alpha from tactical asset allocation decisions has been lost.

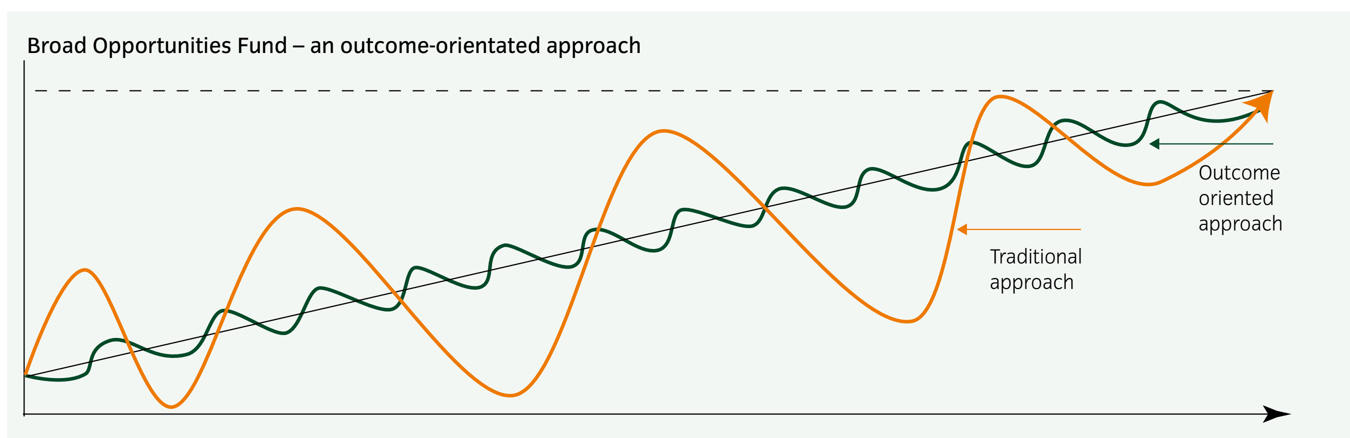
One way of capturing alpha from a combination of active management and TAA is to allocate a proportion of the scheme's overall strategy to funds with both active management exposure and dynamic asset allocation. These funds have the flexibility to shift exposure dynamically between sources of alpha and beta (market exposure) and can fit perfectly into the return-generating component of a scheme's overall strategy. They allow the investment manager to spend some of the scheme's risk budget in a more efficient way.

The concept behind such strategies is to actively manage beta alongside opportunistic alpha-generating elements to provide a smoother return profile. Most will be seeking to provide long run equity-style returns with materially lower volatility.

Such diversified multi-asset strategies should provide access to:

- Greater diversification of investment risk by broadening the investment universe to exploit a wider opportunity set.
- The potential liquidity premia embedded in illiquid assets.
- An improved and more dynamic mix of market exposure (beta) and active management risk (alpha).

An outcome-orientated approach



The combined output of our investment process is a smoothed investment returns profile – with better risk-adjusted returns and significantly improved downside protection than a traditional static or peer group-benchmarked balanced fund. We believe that this outcome-oriented investment approach should enable us to meet our clients' objectives over the course of the investment cycle.

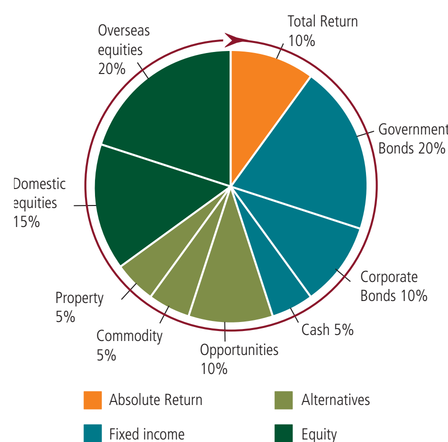
Investment scope

The fund's permitted investment ranges will be as follows:

	Min (%)	Max (%)
Equities	0	70
Fixed income	0	70
Total return (internal and external) investment vehicles	0	25
Cash	0	50
Commodities	0	10
Property	0	10
Opportunistic asset allocation	0	30

Dynamic tactical asset allocation

Illustration only: a typical asset allocation outlined:



The Insight Investment Broad Opportunities Fund

In order to address the demands of the return-seeking element of a schemes portfolio, Insight Investment has recently launched the Insight Broad Opportunities Fund (IBOF): a dynamic asset allocation vehicle with the flexibility to invest across a broad range of asset classes and strategies. The fund targets positive absolute performance of 3% over cash* per annum over the course of an investment cycle. Utilising a dynamic asset allocation strategy across a diverse range of asset classes, the fund is accessed via a combination of 'best of breed' funds (sourced both internally and externally), and cost-efficient market exposures.

The combined output of our investment process is a smoothed investment returns profile, with better risk-adjusted returns and significantly improved downside protection compared to a traditional or peer group benchmarked balanced fund. We believe that this approach should enable schemes to better meet their investment objectives over the course of a typical economic cycle.

IBOF invests in equity and fixed income, property, absolute return vehicles and "opportunistic" strategies which, together with variety of techniques, manages market exposure to create a highly diversified investment mix. The manager has the freedom to allocate between the asset classes with the aim of taking advantage of prevailing market conditions. The dynamic tactical asset allocation overlay incorporates wide allocation freedoms to allow the manager to exploit opportunities and manage downside risks.

Unlike some traditional return-seeking asset allocation approaches, IBOF is not dependent on return forecasts and correlation assumptions for different asset classes.

Five key reasons to invest:

- Actively managed fund – aims to provide smoother investment returns than a traditional balanced fund.
- Rigorous portfolio construction and investment process – to provide a dynamic asset allocation vehicle.
- Wide opportunity set – diversified at multiple levels by asset class, geography, manager and strategy.
- Access to external managers and Insight funds – for 'best in class' vehicles'.
- Robust portfolio monitoring and risk–control framework – to manage downside risk and reduce volatility.

To discuss your investment needs please contact:

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Important notes: Past performance is not a guide to future performance. The investment's value and any income deriving from it may fall as well as rise, as a result of market and currency fluctuations. You may not get back the amount originally invested. Unless otherwise stated, all data has been sourced from Insight Investment. All features described in this article are those current at the time of publication and may be changed in the future. This article is aimed at professional investors only. It is not designed for, and should not be used or relied upon by private investors.