A multi-asset lens to future-proofing

A diversified multi-asset strategy can tackle shortcomings of investing in a single asset class, Conning Asia Pacific says

The concept of multi-asset investing seems increasingly well-suited to today's uncertain macro and market landscape.

Multi-asset strategies are designed to address the pitfalls of investing in silos. This is based on investors in different asset classes generally behaving differently under various market conditions over time.

In its simplest form, a traditional 60/40 portfolio comprising 60% allocation to equities and 40% to government bonds is widely considered to provide better risk-adjusted returns than a pure equity or pure bond portfolio, as the two asset classes typically do not move in tandem. This more balanced approach allows investors to capture the high-growth potential of stocks while also benefiting from the relatively stable income generation from bonds. The blend can also dampen overall portfolio volatility.

However, turbo-charged capital appreciation from 60/40 portfolios has also come from bonds as well as equities. Lower bond yields stemming from upward-moving bond prices have given a big boost to fixed income returns, especially over the past decade amid unprecedented stimulus measures from global central banks via quantitative easing programmes in the wake of the 2008/2009 global financial crisis and then the Covid-19 pandemic. Meanwhile, this wave of global liquidity has pushed equity valuations to near-record levels.

As a result, a rigid 60/40 portfolio can no longer provide the same potential level of investment return, given that global interest rates are already at ultra-low levels if not at zero or, in some cases, in negative territory. Bonds are also losing their key attribute of offering stability by providing downside protection to the portfolio. Indeed, today's market dynamics might even increase portfolio risk as the historical negative correlation between stocks and bonds breaks down.

Investors don't want to find themselves being forced to take on more risk to achieve their goals. At the same time, certain assets have become ever more important sources of diversification and return. These include:

- Emerging market equities for higher capital appreciation potential
- "Riskier" credit products as sources of yield
- Real assets such as commodities and real estate

The key is to be able to combine these and other asset classes and sub-asset classes into a well-diversified and

Chart 1: Asset class returns in past cycles, %

	Asian Financial Crisis	Dot Com Boom	Dot Com Bust	Post Dot Com Bull Market	Global Financial Crisis	QE Bull Market	Covid-19 Recession	Post Covid-19 Recovery
	Jun 97 – Sep 98	Oct 98 - Aug 00	Sep 00 – Dec 02	Jan 03 – Dec 07	Jan 08 – Mar 09	Apr 09 – Jan 20	Feb 20 – May 20	Jun 20 – Oct 21
Global Equities	-0.3	50	-39.7	137.2	-48	268.2	-7.9	50.4
US Equities	18.6	51.1	-41.3	85	-43.7	407.2	-4.5	56.6
EAFE Equities	-8.6	43.5	-38.3	172.4	-50.9	172.2	-12.2	40.6
EM Equities	-53	71.9	-27.4	388.2	-52.8	151.3	-11.8	41
Global Investment Grade	10.3	3.5	24.2	39.6	-11.5	88	-1.1	7.1
Global High Yield	0.2	5.3	-3.7	74.4	-24.4	210.1	-6.1	16.5
EM Investment Grade	-1.4	29.2	32	51.2	-5.2	119.4	-1.3	5.5
EM High Yield	-20.9	61.7	9.1	98.9	-16.4	189.1	-10.1	12.7
10-Yr US Treasuries	21	3.9	34.6	29.8	19.3	42.7	6.1	-3.7
Global REITs	-2.9	9.8	31	153.2	-58.9	389.8	-23.2	48.2
Gold	-11.1	-6.4	25.3	139.5	10.3	72.9	- 8.9	3.1
Commodities	-26.2	64.2	-4.9	100.2	-52.2	-35.3	-32	84.1

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Chart 2: Global equities and fixed income valuations elevated by historical standards

Equities	Forward 12M P/E Ratio	Percentile vs 15Y history
Global Equities	18.2	93%
US Equities	21.9	95%
EAFE Equities	15.3	89%
EM Equities	12.7	84%
Fixed Income	**Yield to Worst**	**Percentile vs 15Y history**
Global Government Bond	0.7%	86%
US Government Bond	1.1%	79%
Global IG Credit	1.8%	92%
Global HY Credit	4.7%	95%
EM USD Credit	4.3%	91%

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dynamically-managed global multi-asset strategy that suits investors' risk profiles and return expectations.

Creating the right portfolio balance

At Conning, we believe that this type of approach is an effective way to navigate today's challenging investment environment and, in turn, generate positive risk-adjusted returns for our clients.

The flexibility to invest not just across asset classes but also geographies allows investors to create well-rounded portfolios that can achieve multiple goals. These include capital preservation over periods of market turbulence, market upside when opportunities arise, and consistent control over portfolio volatility and drawdowns.

This philosophy is anchored in the belief that asset allocation is the main driver of investment returns for multi-asset strategies over the long term. In line with this is the need to nimbly adjust portfolio construction according to changes in global and local economic cycles and market environments.

To achieve this, a proprietary macro scorecard, volatility gauge and sentiment tracker can be used for asset allocation.

- **Macro scorecard** – this uses a combination of global growth, inflation, liquidity and policy indicators as inputs. These allow asset managers to assess macroeconomic conditions at the time and the corresponding appropriate allocation to risk assets, supported by back-testing of return and volatility profiles of different asset classes under various macroeconomic conditions.
- **Volatility gauge and market sentiment indicators** – these complement the macro scorecard to keep track and take advantage of potential asset mispricing to drive final tactical asset allocation decisions.

Quantitative and qualitative mix

Adapting the quantitative investment approach enables extensive data coverage. The data is processed objectively to create information and to draw insights.

Portfolio managers like Conning can continuously evaluate and enhance these quantitative inputs, processes and outputs. The advantage of this quantitative process is that it typically does not have portfolio manager oversight.

Beyond the traditional country/region and sector overweight/underweight concept, multi-asset investing can only be relevant in today's investment backdrop if it factors in the growing thematic focus that has accelerated notably since the pandemic began.

Long-term, sustainable investment framework

In response to these far-reaching and transformational shifts, asset management firms tend to approach global companies at the security selection level by categorising them into growth lifecycle categories.

Through this lens, companies with a superior growth runway and attractive profitability can be distinguished from the mediocre – and declining – ones. This enables a more concrete process in selecting core holdings in the portfolio construction process.

Understanding companies from a growth lifecycle angle also provides asset managers a perspective beyond the traditional country, region and sector boundaries, allowing better tracking, measuring and managing exposure to each category according to changes in market cycles over time.

To cater to a new investment climate, Conning's Allocation Optimizer™ software uses stochastic optimisation, integrating asset-liability interaction, regulatory requirements, accounting standards and internal investment constraints to assist clients in establishing a risk-adjusted optimisation of their portfolios.

With traditional asset risk profiles and correlations transitioning from what we have observed historically, Conning also uses dynamic correlation processes to quantify the risk of over or under-estimating correlations in measuring tracking error.

Conning's GEMS® Economic Scenario Generator (GEMS ESG) is a state-of-the-art multi-period, multi-currency stochastic simulation platform. It generates a thorough and internally consistent set of financial, economic and macroeconomic variables – including sovereign yields/bonds, corporate yields/bonds, multiple correlated common stock indices, alternative investment classes, mortgage-backed bonds and CMOs, US municipal bonds, real estate, actual and expected multiple inflation indices, nominal and real GDP growth rate, foreign exchange and unemployment rates, as well as a rich set of derivatives on interest rates, equity, inflation and foreign exchange.

As asset allocation for insurers has changed in recent years, Conning has adapted a multi-asset approach to help deal with this.

Chart 3: Conning's forward-looking global asset allocation bias

Cross-Asset Allocation		Short Term (1-3 Months)	Medium Term (6-12 Months)
Equities		+	+
Fixed Income	Gov/TIPs	-	-
	Credit IG	-	-
	Credit HY	=	=
Cash		=	=

Equities (Regions) - Medium Term (6-12 Months)

North America	Europe	Japan	Asia	EMEA	Latam
+	+	=	-	-	-

Fixed Income (Currencies) - Medium Term (6-12 Months)

	USD	European Ccy	JPY	EM External	EM Local
Gov/TIPs	-	-	-		=
Credit IG	-	-		+	
Credit HY	=	=		+	

+ Overweight = Neutral - Underweight

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Adapting to new investment realities

Ultimately, multi-asset strategies enable investors to capitalise on evolving trends via the blend of different securities.

For instance, years of technological advancements have been compressed into months as the world's population strives to adapt to new dynamics shaping how people live, work and consume, including e-commerce, online education and digital transformation of the workplace. The pandemic has also been a wake-up call in terms of the urgency to significantly boost investments into medical and biotechnology innovation in order to be prepared for the next pandemic.

In addition, an ageing global population demands better healthcare infrastructure and equipment, while advancements in artificial intelligence, automation and robotics are necessary to replace a shrinking labour force.

Climate change and environmental protection are additional hot topics as governments around the world commit to a more sustainable future. This enables themes such as electrical vehicles and renewable energy to thrive while putting fossil fuels and other highly polluting industries in less favourable positions.

As these and other windows of opportunity emerge, capturing their return potential relies on the type of balanced, diversified and well-managed strategy that multi-asset investing can deliver, if done right.