Adapting portfolios to the post-pandemic world

Desmond Tjiang, Managing Director, Senior Portfolio Manager, Conning Asia Pacific Limited

Conning is unique among the leading providers of economic modelling software in that it also manages large amounts of money for institutional investors across the globe.

Conning has been working closely with clients around Asia, to ensure their risk management processes have adapted effectively to the pandemic environment. Conning's long history of strong performance and deep understanding of insurance regulations across Asia have helped it meet and maintain its clients' objectives during the most turbulent of times.

The impact of Covid-19 on markets over the past 18 months has been dramatic. Coming as it did into an environment of already low rates, the pandemic affected not only asset values while spiking volatility, it increased the skewness of return distributions. This had many investors scrambling to to adjust their portfolios.

Now the focus is turning towards redefining investment strategies that can weather increased tail events in the longer term whilst still being positioned to take advantage of recovery.

Conning's vast experience in modelling capital markets and non-standard investments is enhanced by its proprietary and sophisticated risk modelling software. Conning focuses on achieving long term enterprise level objectives through thoughtful and robust investment strategies and seeks to provide stable growth and mitigate portfolio drawdown.

As a reflection of the unpredictable developments and uncertainty due to the global pandemic, Desmond Tjiang, Senior Portfolio Manager for Conning's Multi-Asset strategy observed that "2020 saw a substantial rise in market volatility levels and changing asset correlations. At Conning, our quantitative investment solutions capability has significantly helped us enrich our multi-asset investment process and risk control to navigate through this unusual period."

One of the key challenges clients faced in 2020 was when and where to reallocate risk, given the uncertainty due to the global pandemic. Tjiang said, "In addition to our macro scoring framework and country allocation model, Conning uses a blend of implied volatility and realised volatility as an ex-ante risk measure. This helps us incorporate our tactical asset allocation decision and allows our investment managers to detect early macro triggers and to make pro-active decisions, despite changing market conditions."

Conning's Tactical Asset Allocation (TAA) strategies are designed to integrate with the broader asset classes in the insurer's portfolio, so that the strategies support and enhance the insurer's strategic asset allocation. Conning's framework and modeling tools allow the automation of management reports, covering customised metrics such as the probability of requiring shareholder injections.

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

"With traditional relationships and correlations breaking apart from what has been observed historically, we have also introduced correlation shocks to quantify the risk of over or underestimating correlations in measuring tracking error," said Tjiang.

As an example, Conning's Risk Solutions' framework helped resolve a client's portfolio situation. A large Japanese insurer wanted to invest in overseas fixed income, despite being benchmarked against Japanese government bonds. Conning's proprietary framework allowed them to offer the insurer an asset allocation solution with awareness of the tracking risks against the JGBs, and translate this into a tailor-made investable portfolio.

Conning is unique among the leading providers of economic modelling software in that they also manage substantial amounts of money for institutional investors across the globe. Conning's GEMS® Economic Scenario Generator ("GEMS ESG") is a state-of-the-art multi-period, multi-currency stochastic simulation platform. GEMS ESG generates probabilistic distributions of possible future states of the global economy and financial markets, including the unexpected but plausible outcomes that are critical to assessing risk.

"The economic model calibrations combine the quantitative expertise of our financial engineers with the market views of investment professionals," said Tjiang. Conning constantly reviews and updates this methodology and in 2019, they launched GEMS Expert View Parameterization which is specifically designed to be in tune with the latest data and economic climate.

"The realistic and empirically validated economic dynamics of GEMS ESG provides clients a superior understanding of market risk and allows business models and investment strategies to be tested stochastically under a wide variety of economic conditions."

GEMS ESG generates a thorough and internally consistent set of financial, economic and macro-economic variables, including sovereign yields/bonds, corporate yields/bonds, multiple correlated common stock indices, alternative investment classes, mortgage-backed bonds and CMOs, U.S. 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.

The Global Multi Asset Balanced Strategy (MABS) is adaptable to different asset allocations. As asset allocation for insurers has changed in recent years, Conning has adapted the MABS approach to help deal with this.

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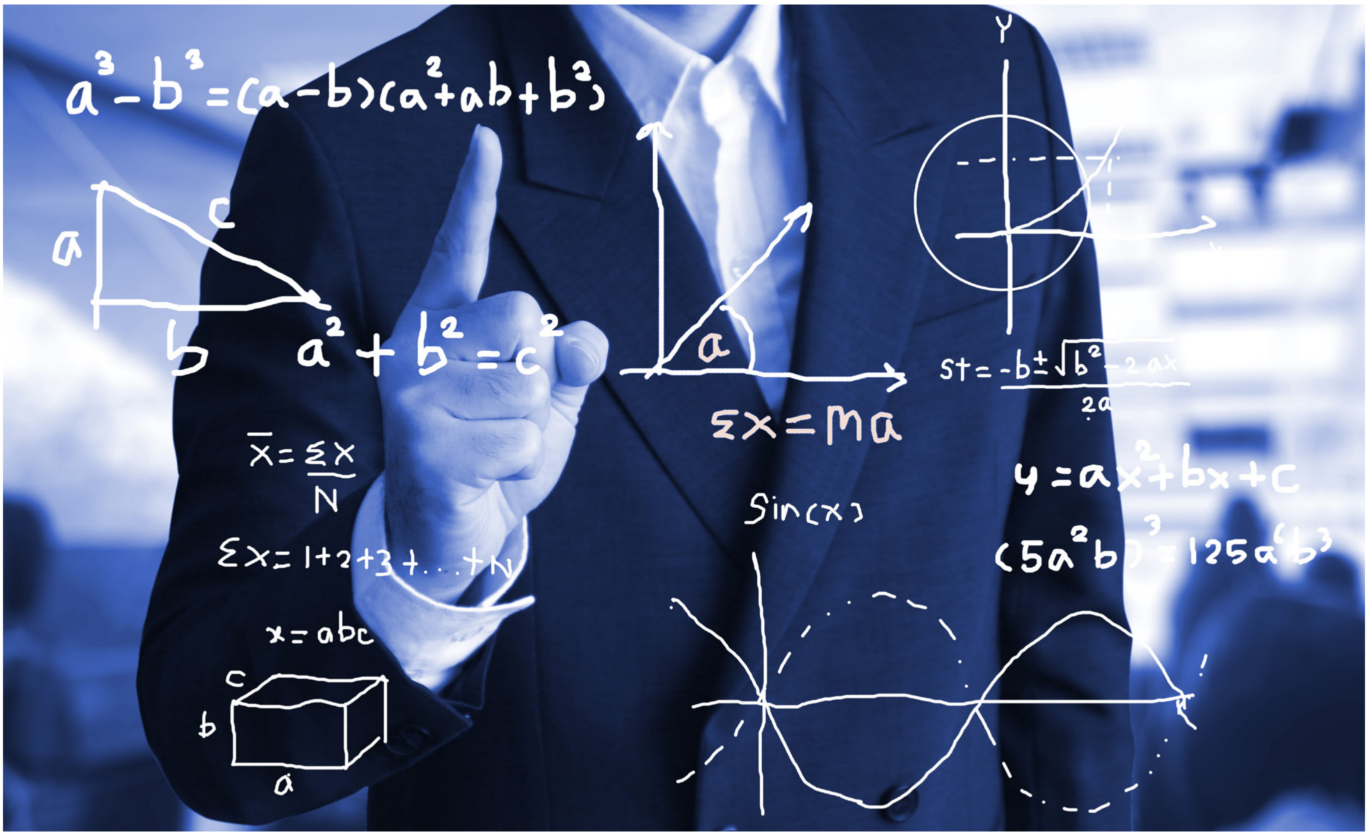

"Due to the disruption to economic and financial markets caused by the global pandemic, we are currently in a very low-yielding environment with much shortened market cycles, to a matter of quarters if not months," said Desmond Tjiang.

"More insurers are facing the question of where to allocate assets, given the mounting yield pressure amid low rates. As such, we believe there is higher demand from insurers for strategies that focus on Dynamic Asset Allocation and Tactical Asset Allocation, without introducing significant skews on the overall strategic asset allocation over time."

These strategies from Conning can capture the shorter cycle alpha more efficiently without distorting their longer-term asset allocation, he added.

"The biggest challenge in dealing with this strategy is forming and sizing the DAA/TAA views. Conning's multi-asset investment approach aims to overcome these challenges by supplementing views with a data-driven and systematic macro process that can react faster, as well as sizing our positions appropriately using risk-based portfolio construction tools, to adapt to changing volatility and correlation dynamics."

Conning's Global MABS seeks to generate stable absolute total returns with low volatility across market cycles. With a dynamic asset allocation framework driven by an asset allocation committee and a predictive asset allocation model, the firm captures the most attractive return opportunities at the right time.

Conning believes that the combination of a diversified strategy that generates attractive returns and low volatility would be a strong proposition. Conning's MABS strategy was designed to distribute predictable, smoothed monthly income to the tune of 3-5% per annum. The MABS has delivered attractive risk-adjusted returns and demonstrated successful upside/downside participation since inception. Returns outperform individual asset classes as well as a neutral multi asset balanced benchmark.

MABS is also capable of replicating individual asset class income generation. Since inception (August 2014) it has delivered a return of 63.99% (gross of fees), with an annualised performance of 8.02% against a customised benchmark of 6.05%, as of December 31, 2020*.

The global pandemic has significantly affected everyone's approach to investing in financial markets, with the attendant increase in volatility and shifts in correlation. Conning's software have adapted to this change by using a blend of implied and realised volatility and incorporating correlation shocks, to make the portfolios more robust. Conning's enhanced quantitative solutions and asset allocation model, based on macro and volatility indexing, allow them to provide clients with further clarity on investment strategy, despite changing regional and cross-asset variances.

Whether clients contract Conning to perform objective-oriented fund management or financial analysis on their behalf, or use the systems themselves for their internal modeling, they benefit from the depth of Conning's professional expertise. The fact that Conning is one of the leading insurance asset management companies in the world is a unique advantage that helps them model better representations of real world phenomena, especially when adapting the global experience to Asia.

**Past performance is not indicative of future results.*

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