

Value in being boring

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For professional investors only



Why use multi-asset solutions in today's complex markets

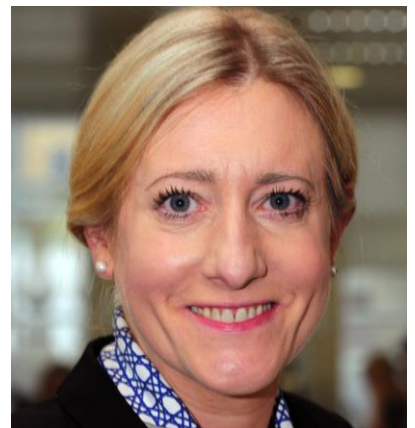
William of Ockham was right. The 14th century friar, scholastic philosopher and the author of the Ockham's Razor, a problem-solving principle, famously stated that "plurality must never be posited without necessity". He gave precedence to simplicity, meaning that of two competing theories, the simpler explanation is preferred.

Complex solutions to solve basic problems

The asset management industry aims to serve the best interests of investors who want to generate a return on their capital. We have a fiduciary responsibility for our clients' money and we take this role very seriously.

However, the industry sometimes has a habit of building more and more complex solutions to solve the basic problem of how to generate a return, not always operating in the spirit of William of Ockham. Some of these complex products have been blamed for their contribution to the Global Financial Crisis, with the securitisation of sub-prime mortgages attracting particular attention over the 10 years since the crisis started.

Furthermore, the interconnected nature of the global economy and the evolution of trading and settlement systems enables market participants to use a wider range of strategies and investment products. This has led to the maturation of previously more exotic asset classes, such as emerging markets debt in local currency, and has enabled retail investors to trade in financial instruments previously exclusively available to large institutional clients, such as OTC derivatives¹.



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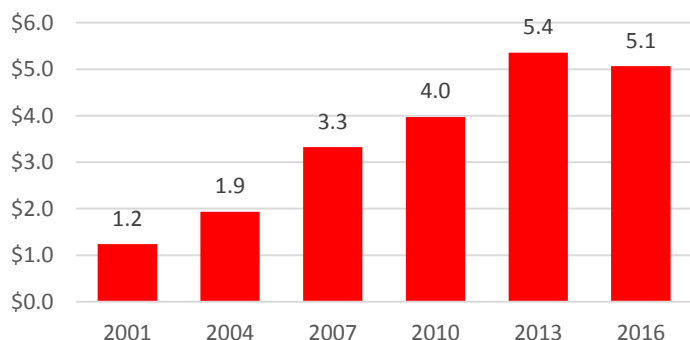


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An integrated global economy

For an example of how the global economy has become more integrated, we can look at data from the Bank for International Settlements. This indicates that trading in foreign exchange markets averaged USD5.1 trillion per day in April 2016 (a 4.25-fold increase from 2001), and suggests that the world's 2016 GDP, measured by the World Bank to be USD75.5 trillion², is being traded on FX markets every 15 days³.

Total Daily FX Volume (USD trillions)



Source: Bank for International Settlements as at April 2016.

Of course, market evolution and improved efficiency also offer opportunities, through increased availability of investment choices.

But at the same time and in particular for retail and wholesale investors, the investment world looks like a very complicated place with lots of plurality being posited by actors within the global financial marketplace.

The myriad choices offered to retail investors makes it nigh on impossible for the average client 'to see the wood through the trees' and identify the best asset allocation in advance. The temptation being to either add a bit of everything to their portfolios, or to buy the latest fad, without fully understanding the investment being purchased and how it may, or may not, contribute towards meeting their objectives.

So what does this all mean for investors just looking to generate a return on their money?

There is value in being boring.

The impact of regulation

An active asset allocation strategy, with appropriate global diversification, can provide investors with compelling risk adjusted returns on their money. Portfolios should be constructed with consideration to the long term expected return patterns for each asset class, with any speculation on short term trends limited to smaller tactical tilts.

Asset managers should construct portfolios which are appropriate for the level of risk end investors are willing and able to take.

¹ Source: Bank for International Settlements, Monetary and Economic Department, Statistical release: OTC derivatives statistics at end-June 2015 – http://www.bis.org/publ/otc_hy1511.pdf

² Source: The World Bank – <https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?end=2016&start=2008>

³ Source: Bank for International Settlements, Monetary and Economic Department, Triennial, Central Bank Survey Foreign exchange turnover in April 2016 – <https://www.bis.org/publ/rpfx16fx.pdf>

The assets used to fulfil this portfolio should only be included if they are fully understood and sufficiently liquid, contribute to the portfolio's overall risk/return profile and can be accessed in a cost-efficient manner. It is imperative to understand what drives the investment's return and what situations could cause the investment to fail.

Regulation is moving in this direction, with MiFID II building on the rules which were implemented through MiFID in 2007. In the UK, Mifid II has considerably expanded the scope and spirit of the transparency requirements introduced by the Retail Distribution Review (RDR).

For example, under the new rules, clients must be told, both pre- and post-sale, about any costs related to an investment. Mifid II has increased the requirement for regular client reporting as well as the frequency with which clients must be updated on the performance of their investment.

In light of the financial crisis and considering developments in the trading environment since 2007, new rules and regulation have been designed with the aim of making financial markets more efficient, resilient and transparent.

In particular, the due diligence standards required to distribute complex products will be increased and complex products will be unavailable for sale in execution-only channels. The increased costs and risks associated with managing a mix of complicated products may drive demand from distributors for simpler, packaged solutions.

How can multi-asset help?

As an example, when appropriately constructed, multi-asset solutions are perfectly placed to deliver to these requirements, providing a simple 'all in one box' solution for clients to meet their investment objectives.

Multi-asset solutions can deliver global diversification in a simple, transparent structure which is easy to understand.

Investing, by definition, is long term. Complex strategies may work in the short term, but this makes them suitable for speculation rather than as a core investment in a long term strategy. As the modern William of Ockham may well have said: keep it simple, stupid.

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