The Frontier Line

Multi-asset manifesto

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About us

Frontier has been at the forefront of institutional investment advice in Australia for over 25 years and provides advice on $600 billion of assets across the superannuation, charity, public sector, insurance and university sectors.

Frontier's purpose is to empower our clients to advance prosperity for their beneficiaries through knowledge sharing, customisation, technology solutions and an alignment and focus unconstrained by product or manager conflict.

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Senior Consultant

Claire Casucci joined Frontier in 2018 and is now a Senior Consultant. Claire looks after a variety of superannuation, insurance and higher education clients, providing research, analysis and investment advice. Claire also undertakes manager and investment research, focussing on liquid alternative strategies. Prior to joining Frontier, Claire was a Senior Financial Advisor at ANZ Private in Adelaide, where she specialised in providing complex strategic and investment advice to high net worth individuals and families. Claire completed ANZ's Graduate Program and has also worked at ANZ in advice assurance, credit writing and transactional banking. Claire is a CFA charterholder, holds a Bachelor of Economics and Bachelor of Finance from the University of Adelaideand has an Advanced Diploma in Financial Services (Financial Planning) from Kaplan.

Background

Frontier's understanding of the multi-asset universe has accumulated and evolved over years of research. This paper reflects our current thinking and recent research of the sector, re-affirming the case for multi-asset investing and the role multi-asset strategies can play in portfolios.

Multi-asset strategies have been a mainstay of liquid alternative portfolios for many years. As other liquid alternative strategies have come into and out of favour, and subsequently into and out of portfolios, allocations to multi-asset strategies have often endured.

Multi-asset strategies, on the whole, have been 'true to label' and performed in line with expectations in a variety of market environments. Returns and volatility have been reliably in between those of equities and bonds, both in benign and stressed markets.

In addition, multi-asset strategies can serve different purposes for different investors. The same strategy may be used as a low-complexity diversifier by one investor, as a proxy for dynamic asset allocation (DAA) by another, or even as a strategic partnership by a sophisticated large investor. Larger, more sophisticated investors may build out their own set of sleeves, which effectively makes up a multi-asset offering. In addition, multi-asset strategies have often provided cheap access to liquidity during periods of market stress, providing investors with welcome flexibility to meet their need for extra cash at short notice.

However, multi-asset strategies are by no means generic, with a variety of portfolio construction and implementation choices available. Frontier prefers multi-asset strategies that seek to implement fundamentally-driven, top down, macro-themed views. Within that framework, we will consider a manager's philosophy and process, as well as the various choices they make in relation to implementation, responsible investment and fees. Frontier assesses managers and strategies on a case-by-case basis according to how well they justify and implement the choices available to them.

Manager selection ultimately depends on combining Frontier's assessment of the quality of a strategy, along with the needs and requirements of each investor.

Frontier continues to see merit in multi-asset strategies as a useful and multi-functional allocation within a broader portfolio.

Defining multi-asset

There are many interpretations in the market as to what constitutes a multi-asset strategy. Frontier has outlined a set of characteristics to define our approach to the asset class, as well as identifying managers that align with our preferences.

Frontier distinguishes multi-asset strategies as displaying the following characteristics:

Element	Characteristics
Description	Seeks to implement fundamentally-driven, top down, macro-themed views. Predominantly discretionary process (although the process may include some systematic elements).
SAA	No fixed SAA. Allocations are based on the manager's macro views and can vary considerably.
Return target	Will often be expressed as 'CPI-plus' or 'cash-plus'.
Risk target	Funds typically target a specific level of volatility and the level of this risk target is a key determinant of performance.
Fees	Low, relative to other alternative strategies.
Liquidity	Highly liquid, even in stressed markets.

Many strategies describe themselves as 'multi-asset', which can be confusing for investors who are trying to differentiate between a vast array of product choices to meet their specific need. The following terms are sometimes used interchangeably:

- multi-asset
- diversified
- multi-sector
- multi-strategy
- balanced/growth/conservative.

Frontier distinguishes between multi-asset strategies which have relatively unconstrained strategic asset allocations (SAAs) and express a manager's macro view, and traditional 'balanced' or 'diversified' portfolios which tend to have relatively fixed SAAs. Investors should always look carefully at the underlying features and characteristics of a strategy to ensure it meets expectations.

The spectrum of multi-asset strategies

Multi-asset strategies exist along a spectrum, although have some commonalities.

Areas of commonality are typically across returns, risk and leverage. Whilst specific risk and return targets will vary according to each strategy, the outcomes can be broadly generalised as follows:

Returns

CPI or cash plus 4-6%.

Risk

Between bonds and equities.

Leverage

Unlevered (except via implementation choices like derivatives).

Each manager achieves these relatively similar risk/return profiles by structuring their strategies in different ways. Within multi-asset, we see a variety of portfolio construction choices across long-only, relative value only and a mix of the two.

- Long-only directional positions in assets, typically involving buying an index in an asset class a manager believes will perform well.
  - By being long-only, this exposes the portfolio to the market moves of the asset (or the asset class beta).
- Relative value trades only, which involves buying an investment in an asset class a manager believes will perform well and funding the position by selling an investment in an asset class it believes will perform poorly.
  - For example, if a manager believes oil prices will increase due to higher economic activity, it might buy the currency of an oil-producing country like Norway and sell that of an oil-importing country like South Korea. In doing this, it reduces the beta or overall market exposure for the asset class.
- A mix of directional and relative-value trades.

Portfolio construction considerations

Multi-asset strategies often fulfil roles within a broader portfolio. They typically aim to provide diversification to equities, as well as some growth potential.

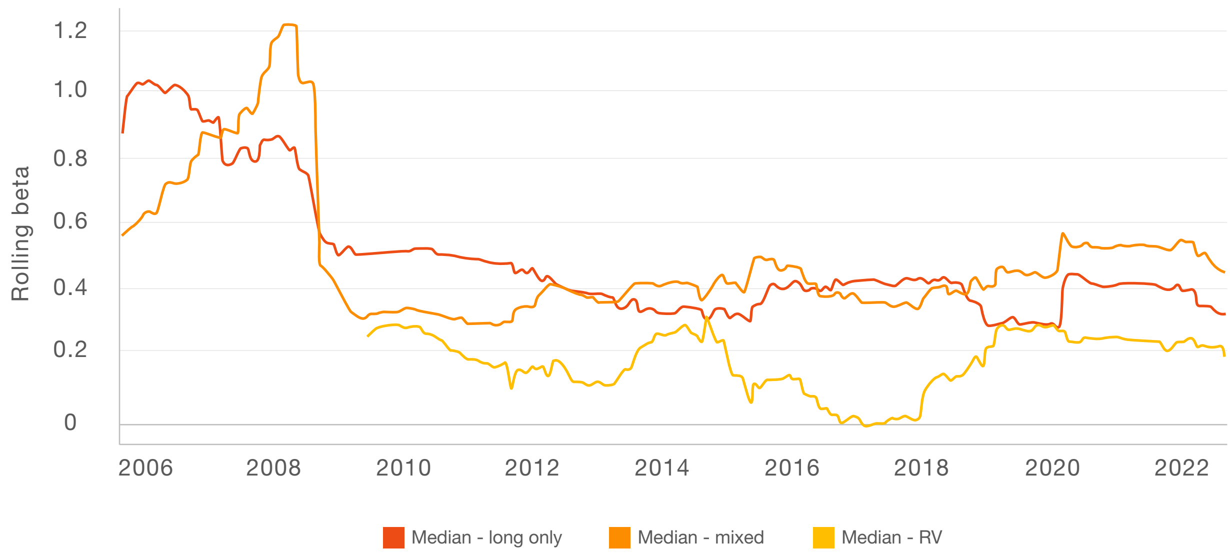
In addition, we have seen some investors use multi-asset strategies as a source of liquidity during periods of market stress. While it varies by manager, many multi-asset strategies have held their value during periods of equity drawdowns and provided flexibility to asset owners needing liquidity without crystallising significant losses. Depending on their implementation, multi-asset strategies can sometimes have lower transaction costs than other liquid defensive asset classes like core fixed income.

Frontier has created a heatmap of the key characteristics of multi-asset strategies (compared to equities and core fixed interest) that investors should consider when building their portfolios.

Strategy	Long term return expectations	Diversification (to equities)	Resilience	Liquidity	Fees
Multi-asset					
Equities					
Fixed income					

Within the multi-asset spectrum, we observe further differences between whether a strategy is long only, relative value only, or a mix of the two. Investors should consider whether they are seeking a more growth-oriented strategy or a more diversifying strategy. Relative value only strategies are likely to be more diversifying, whereas long only or mixed strategies are likely to be more growth-oriented.

Chart 1: Beta of multi-asset sub-strategies versus 60/40 portfolio



Source: Frontier, eVestment as at September 2022 (in USD).

Given the variety within the sector, it is important for investors to understand the characteristics of their chosen multi-asset strategy and whether that meets the investor's needs. Likewise, if combining two (or more) multi-asset strategies in a portfolio whether those strategies are diversifying to each other.

More than just 60/40

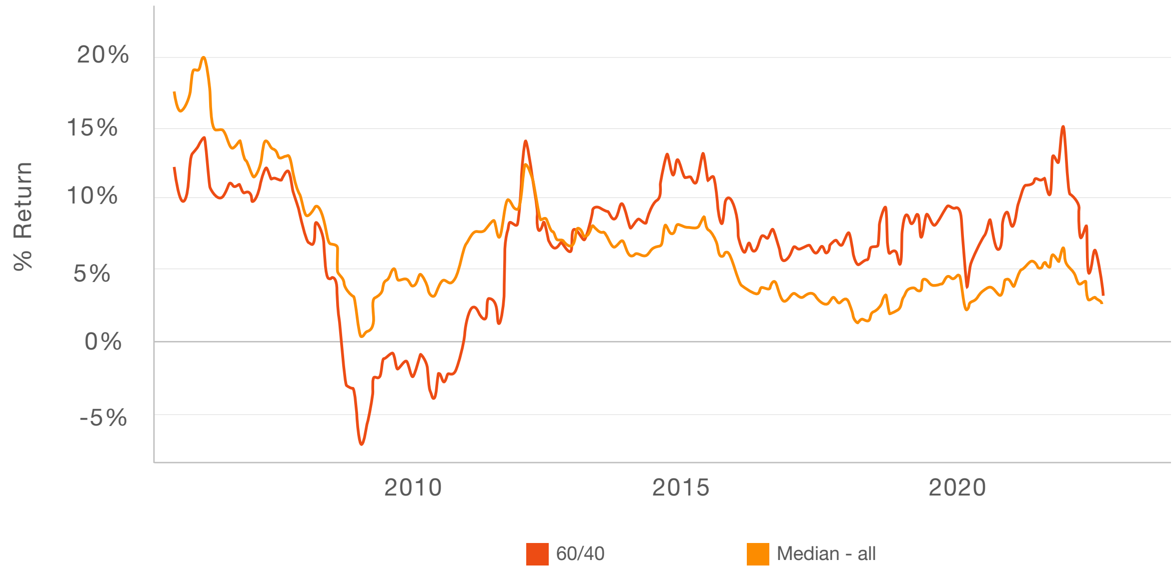
There is no single industry-accepted benchmark that covers multi-asset strategies.

Some benchmarks exist for relative value strategies, such as the Wilshire Liquid Alternative Relative Value Index, but Frontier has not identified a suitable benchmark for long-only or mixed multi-asset strategies. Benchmarks are particularly important for understanding how well a manager is performing against peers, so the lack of an industry standard benchmark means we need to find other ways to assess performance.

Industry convention often compares performance against a traditional 60/40 portfolio, and Frontier has adopted this approach as well. In addition, we maintain our own universe of managers to help us assess peer-relative performance.

Chart 2 shows the return of multi-asset managers can be persistently above or below a 60/40 benchmark for extended periods of time, often according to the strength of equity markets in a particular period.

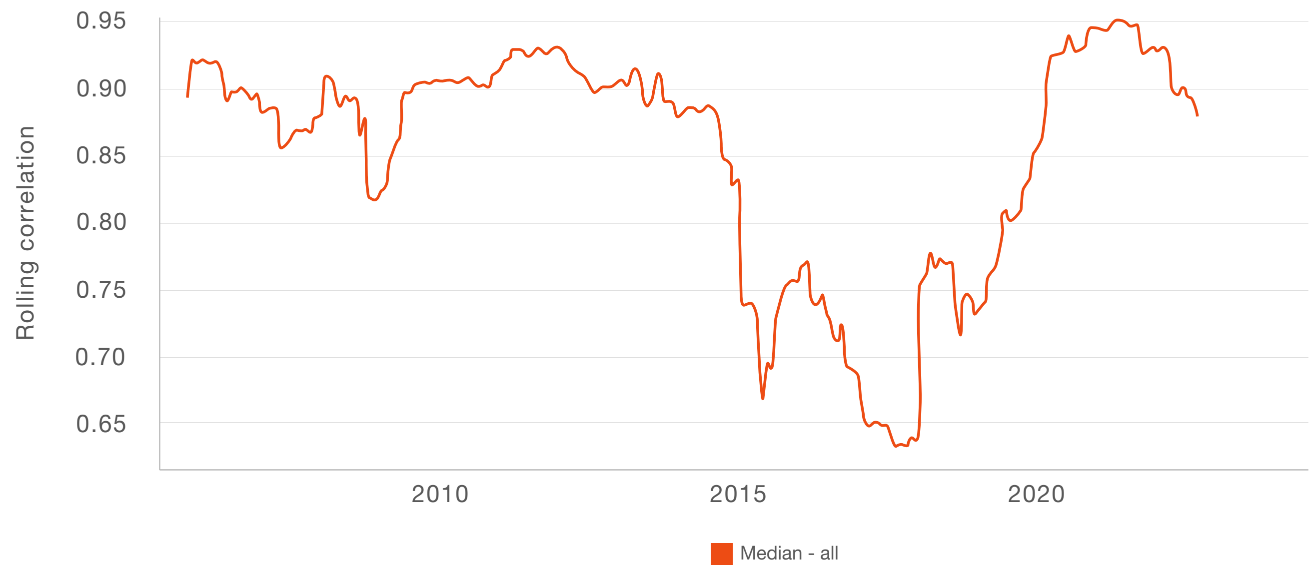
Chart 2: Three-year rolling returns of Frontier's multi-asset universe versus 60/40 portfolio



Source: Frontier, eVestment as at 30 September 2022, in USD. 60/40 portfolio comprises 60% MSCI World Net TR USDH and 40% Bloomberg Barclays Global Aggregate USDH.

However, Chart 3 shows the correlation between the multi-asset universe and 60/40 benchmark is usually very high and often >0.90.

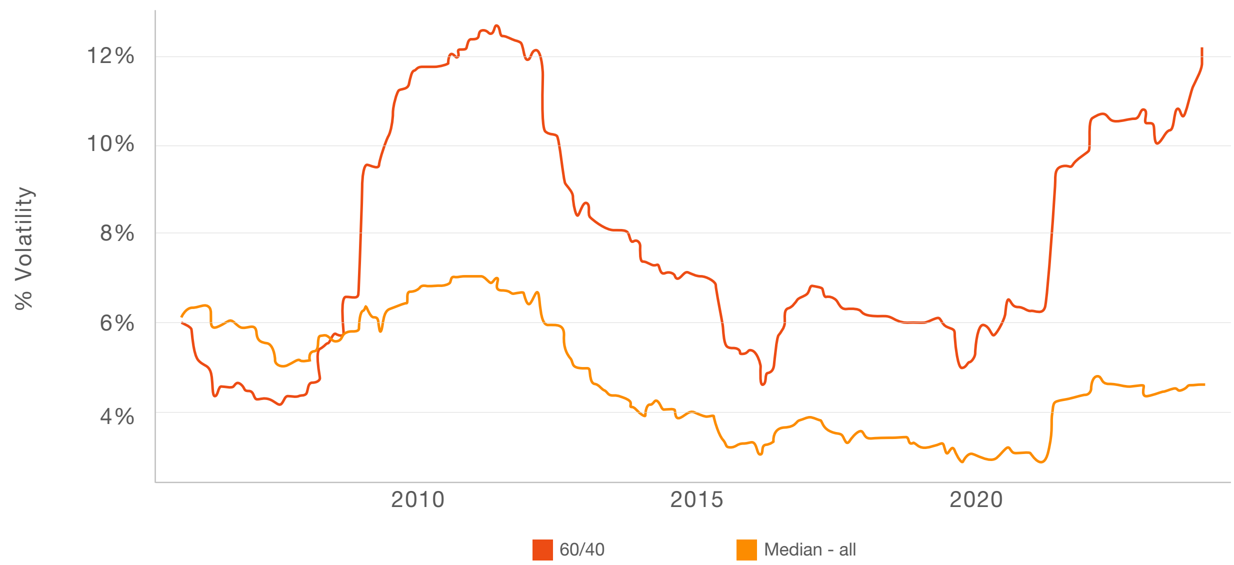
Chart 3: Three-year rolling correlation of Frontier's multi-asset universe versus 60/40 portfolio



Source: Frontier, eVestment as at 30 September 2022, in USD.

Chart 4 shows the volatility of a 60/40 portfolio compared to multi-asset managers. Over most time periods there is a meaningful reduction in volatility compared to a standard 60/40 portfolio. Multi-asset strategies usually have strong risk management and this has been demonstrated historically.

Chart 4: Rolling three-year volatility of Frontier's multi-asset universe versus 60/40 portfolio

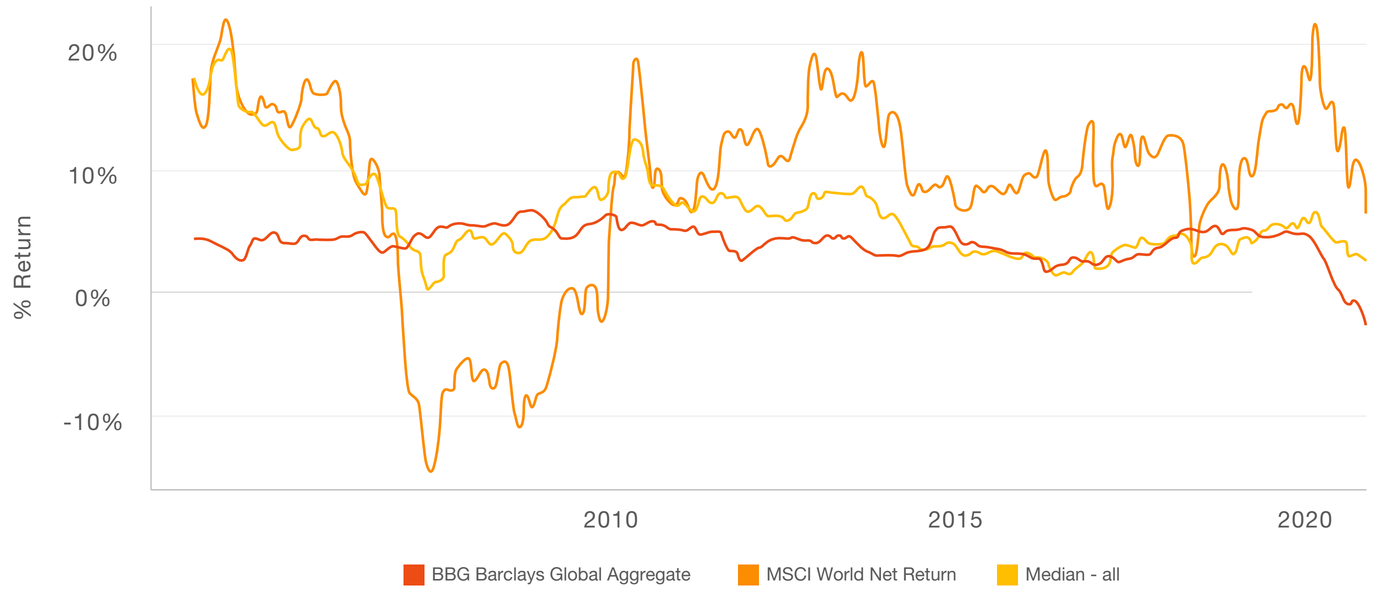


Source: Frontier, eVestment as at September 2022.

Performance

Over time, multi-asset strategies have typically delivered a return between that of equities and bonds.

Chart 5: Three-year rolling returns of Frontier's multi-asset universe, equities and bonds



Source: Frontier, eVestment as at 30 September 2022, in USD. Equities are MSCI World Net TR USDH and bonds are Barclays Global Aggregate USDH.

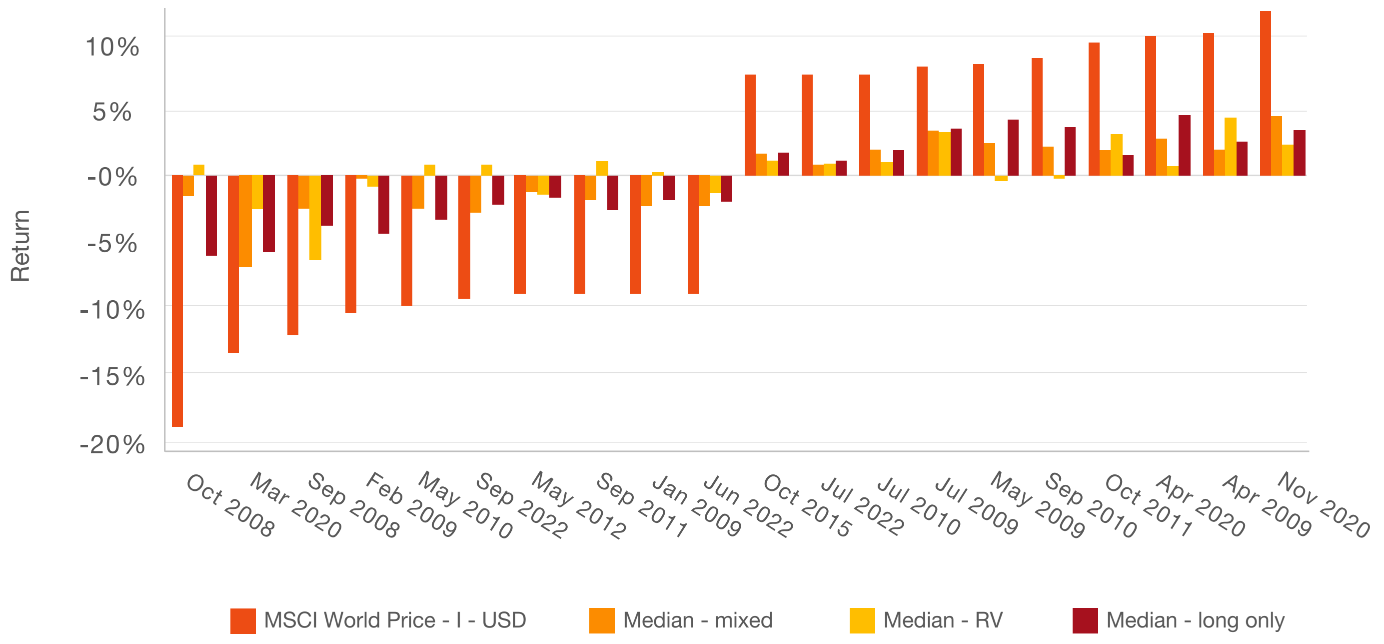
There was a period of depressed returns from around 2015 - March 2020, where the macro-economic environment was not supportive of multi-asset strategies. During that period, equities looked expensive and multi-asset managers were usually more bearish and therefore did not benefit from the continued late-cycle rise in markets that extended to the COVID-19 market crash.

These performance dynamics were explored in [Frontier Line 162: Relative Value Multi-Asset Hit Rate Analysis.]

In falling equity markets, multi-asset strategies have tended to hold their values relatively well. Returns for multi-asset strategies in the ten worst months for equities are often fairly resilient (Chart 6), with relative value strategies in particular sometimes delivering small positive returns.

Conversely, multi-asset strategies will have lower upside capture in months when equity markets are particularly strong.

Chart 6: Best and worst 10 months of MSCI World versus multi-asset



Source: Frontier, eVestment from 1 July 2006 to 30 September 2022, in USD.

Throughout 2022, performance for multi-asset strategies has been challenged. With almost every asset class delivering negative returns, there have been few places to hide and most multi-asset managers have not been able to deliver positive returns. In addition, the spike in inflation has made it difficult for strategies to achieve their CPI-linked performance targets. This is likely to persist in the short term, although should resolve in the medium term once the inflation spike settles. Based on our conversations with managers, they retain conviction their CPI-linked performance objectives remain achievable in the medium-long term and there will be sufficient opportunities for them to deliver on expectations.

Frontier's view is a more 'normal' economic environment, where market volatility is not artificially dampened by significant policy support, should be conducive to the application of fundamental skill-based strategies like discretionary multi-asset.

Different things for different investors

The same multi-asset strategy may be deployed by different types of investors for different reasons.

Low complexity liquid alternative allocation

For investors with smaller portfolios which are unlikely to have dedicated internal investment staff, multi-asset strategies are often the most appropriate liquid alternative solution.

Multi-asset strategies are arguably the most straightforward liquid alternative strategy available. They are intuitively easy to understand thanks to their clear linkage from macroeconomic view to implementation. There are no ‘black box’ algorithms to trust or interpret, and thus the transparency of multi-asset strategies is also appealing.

Multi-asset strategies are popular with investors that prefer low cost, low complexity, liquid strategies that are expected to provide some diversification from equities and returns between equities and bonds.

Proxy for dynamic asset allocation

Not all asset owners are equipped or structured to be able to manage their own DAA process, but would nonetheless like to implement some short-medium term market views in their portfolio. Investing in a multi-asset strategy can provide dynamic exposure to a manager’s market views, and deliver the nimbleness that investors are seeking, without the burden of managing and implementing a DAA process.

Each multi-asset strategy has its own preferred time horizon for its investing views, usually ranging from a few months, to a few years. Investors seeking a DAA proxy should invest in a multi-asset manager whose philosophy and time horizon agrees with their own preferences.

However, a single multi-asset manager will likely hold a small proportion of an investor’s total SAA and the collective impact, while positive, is likely incremental as opposed to a large collective DAA tilt.

Strategic partnership

Large asset owners prepared to commit significant capital (typically a minimum of USD500m to USD1b) may enjoy the sharing of intellectual property that comes from investing in a multi-asset strategy. In the case of a strategic partnership, the relationship with the manager may reside with the internal strategy team as they seek to benefit from the investment insights shared by the manager.

Frontier explored strategic partnerships in Frontier Line 104 in 2015.

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Responsible investment

Based on our observations within the liquid alternative manager landscape, multi-asset strategies tend to have the greatest scope to integrate and implement ESG considerations relative to their liquid alternative peers.

ESG integration can be achieved via:

- single securities
- ESG-aligned indices and futures
- using derivatives to back out exposure to undesirable holdings.

Frontier does not necessarily have a preferred implementation approach for responsible investment. We will evaluate each manager's method and justification for its choice on a case-by-case basis. In general, if a manager has a sound reasoning for taking a particular route and then implements it effectively, Frontier will assess it favourably. Individual investors may also have their preferred approach which will influence strategy selection.

Single securities

Managers that implement via single securities have the greatest scope to conduct fundamental ESG research at a company level and select securities that meet specific responsible investment objectives, such as exclusions or positive screens.

ESG-aligned indices

Multi-asset managers can use ESG-aligned indices to implement their strategies, instead of standard indices.

There are a growing number of ESG-aligned indices that meet the different needs of investors with responsible investment concerns. For example, MSCI has a variety of equity and fixed income indices that cater to climate change, low carbon and faith-based needs.

Whilst ESG-aligned indices and futures can appear to be a neat solution at first glance, their key issue is they tend to be much more thinly traded than standard versions. As liquidity is a key appeal of multi-asset strategies, this lack of liquidity from ESG-aligned indices is a drawback and Frontier's observation is implementation using ESG-aligned indices is infrequent. This implementation choice may grow in popularity as the ESG-aligned index market matures and deepens.

Using derivatives to create a more ESG-aligned proxy

Some managers address the liquidity issues of ESG-aligned indices by instead investing in standard indices, then using derivatives to effectively back out exposure to undesirable holdings. Some managers argue this method allows them to even create a net short exposure to undesirable holdings, as opposed to just a zero exposure.

Implementation

Multi-asset managers implement their portfolios in a variety of ways.

Indeed, a single manager may use multiple implementation methods depending on the asset class or theme they are trying to implement. Typical implementation choices we see in multi-asset strategies are:

Method	Benefits	Considerations
Indices and futures	Standard indices are cost-effective and highly liquid.	Standard indices may not meet responsible investment needs.
Derivatives	Allows for targeted and tailored exposures.	May require funding during periods of market stress.
Single securities	Ability to target specific characteristics.	Individual securities may not capture beta of asset classes or themes.
Baskets of securities	Ability to target specific characteristics, but broad enough to capture the beta of asset classes or themes.	Idiosyncratic behaviour (dispersion) of selected stocks may reduce efficacy of the basket.
Internal managed funds	Allows security selection by sector specialists. Usually fee rebates apply to avoid doubling up on fees.	Internal products may not be best of breed, or may not have gone through thorough due diligence.
External managed funds	Provide access to asset classes or themes the manager may not cover internally. Allows security selection by sector specialists.	Need to pay fees to external manager. Less control over operational aspects of investee external fund (e.g. liquidity). Less look-through compared to internal managers.

There is no single 'correct' implementation method. When assessing implementation, Frontier considers whether the chosen method adequately expresses the desired asset class or theme and whether the manager has the appropriate expertise to execute their chosen implementation.

Frontier's preference is that the implementation method chosen should aim to capture the beta of an asset class or theme. As such, we are cautious of strategies that are fully or substantially implemented via single securities. Where implementation is via single securities, a large part of our due diligence is spent ascertaining whether securities are selected on a top-down or bottom-up basis. Multi-asset strategies that are effectively bottom-up security selection of equity and credit names are not our preference, given their overlap with investors' existing dedicated equity and credit allocations.

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Manager selection

With so many strategies that call themselves 'multi-asset', or consider themselves to be 'multi-asset', manager selection can be a minefield.

Frontier is frequently assessing the universe of multi-asset strategies available to investors.

We use the framework outlined in this paper to ascertain whether a particular strategy meets our definition of a multi-asset strategy, and whether it aligns with our preferred approach of seeking to implement top-down, fundamentally-driven, macro views.

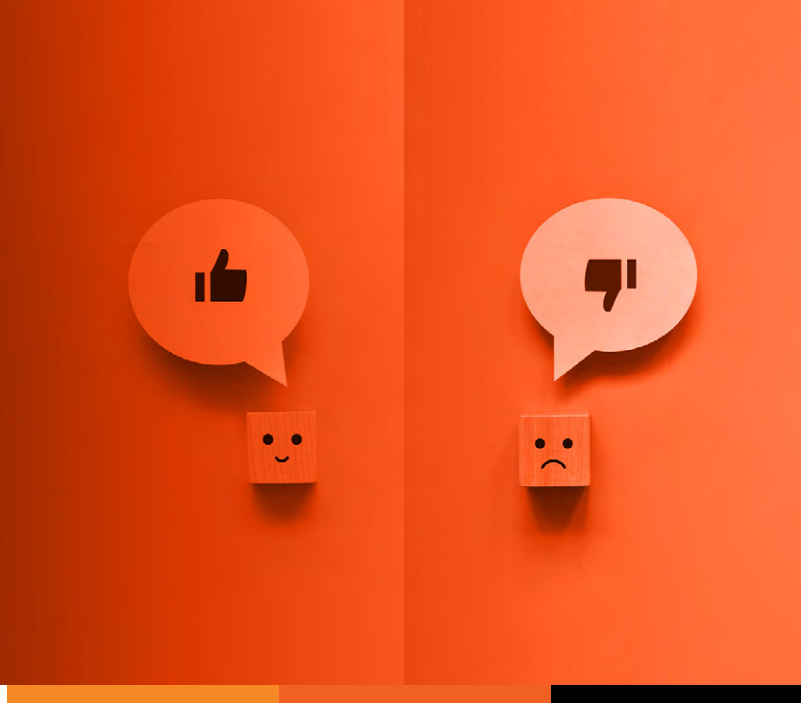
Frontier can then assess the quality of a manager and strategy according to our standard due diligence process, which covers:

1. Business management
2. People, culture & environment
3. Investment philosophy & process
4. ESG approach
5. Performance
6. Value for money (fees)

There are many choices available to multi-asset managers within their philosophy and process, often with no single 'right' way to do things. Part of our due diligence process is to understand *why* managers do things the way they do, and assess *how well* they do it.

Assessing a manager and strategy often takes multiple meetings over a period of months, or even years. Frontier makes this accumulated knowledge and deep research available to our clients, matching it with our understanding of a client's needs and objectives to recommend an appropriate solution.

The final word



Multi-asset strategies have been a reliable component of liquid alternative allocations for many years, delivering 'true to label' performance over a variety of market environments.

Multi-asset strategies can be a valuable addition to many investors' portfolios, particularly those requiring low complexity and a stepping stone into building an alternatives allocation. Their ability to fulfil many different roles in a portfolio makes them attractive to a diverse range of investors, both small and large.

While we see challenges with meeting CPI-linked performance objectives in the short term given the recent spike in inflation, the managers we speak to retain conviction in their ability to meet their return objectives over the medium-long term. We believe that a more 'normal' environment, without significant central bank support distorting markets, should be more conducive to skill-based fundamental strategies like multi-asset.

At Frontier, we are continually growing and evolving our understanding of multi-asset strategies. We apply our years of accumulated knowledge and research to help investors determine whether multi-asset strategies could fit within their portfolio, and which managers and strategies would best meet their particular needs.

Want to learn more?

Please reach out to Frontier if you have any questions or visit frontieradvisors.com.au for more information.

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Frontier is one of Australia's leading asset consultants. We offer a range of services and solutions to some of the nation's largest institutional investors including superannuation funds, charities, government / sovereign wealth funds and universities. Our services range from asset allocation and portfolio configuration advice, through to fund manager research and rating, investment auditing and assurance, quantitative modelling and analysis and general investment consulting advice. We have been providing investment advice to clients since 1994. Our advice is fully independent of product, manager, or broker conflicts which means our focus is firmly on tailoring optimal solutions and opportunities for our clients.

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