Can multi-asset funds protect you from market shocks?

Risk management in the current volatile environment

EXECUTIVE SUMMARY

Dynamically managed and with a focus on risk, multi-asset funds can help you mitigate the impact of market shocks. We believe the strategies in our multi-asset process help us steer a course through volatile times.

Multi-asset funds may not give you full immunity from market shocks, but some may be able to help you mitigate them through skilful management.

Multi-asset best practice competencies

Multi-asset funds have become increasingly popular among investors who want to focus on a specific objective rather than on beating a stock-market benchmark. However, meeting objectives becomes harder when markets have low yields and high risks.

Multi-asset funds may not give you full immunity from market shocks, but some may be able to help you mitigate them through skilful management. We believe that requires a number of key competencies:

1. A **robust investment process** that can help navigate changes in market values, business conditions and investor sentiment
2. Thorough preparation for risk events through **thoughtful portfolio diversification**
3. **Real-time monitoring** of the portfolio and markets
4. **Comprehensive risk analysis** at the total portfolio level and constant re-evaluation of risk/reward pay-offs
5. **Expert trading skills** to implement new ideas quickly and cost-effectively.

At Russell Investments, we have developed industry best practice in each of the above five competencies to provide robust multi-asset portfolios that deliver client objectives.

Risk mitigation strategies – the background

Global risks have been on the rise for some time. The first step in risk mitigation is to assess the probability and likely impact of each risk factor. Our investment process currently reflects a sober evaluation, based on our three assessment factors – cycle, value, and sentiment (CVS):

- Business **Cycle**: Our research shows that global growth is on a modest trajectory, with a potential for a stronger economic performance outside of the US.
- Market **Valuation**: Most developed markets are expensively valued. An expensive market is, by definition, a risky market and prone to shocks.
- Investor **Sentiment**: Markets have been very bullish until recently, bordering on euphoria. However, there are now signs of nervousness and investors taking profits.

It's easy to get swept up in mentality of the crowd and underestimate the risks. Uncertain conditions mean it makes sense for our strategists to look at three scenarios for 2018, rather than preparing for only one outcome:

- Our core (central) view which our strategists believe is the most likely scenario is that share markets can push higher over the first part of the year, before facing more challenging conditions later in 2018 as markets factor-in rising risks of a 2019 recession, i.e. a central scenario of a relatively flat year for global growth that's stronger in Europe, Japan and emerging markets, and
- A downside scenario where a mistake by the Fed could trigger a recession,
- An upside scenario where markets continue to move higher and investors enter a stage of euphoria where they borrow money to participate in a market rally.

2018 Multi-asset positioning

In light of our dual objectives of cushioning portfolios from market corrections while participating in upside growth under these possible scenarios, we have chosen to position portfolios via the following alternatives to equities:

1. **Commodities.** At this late stage of the market cycle, we prefer to gain risk exposure through commodities rather than traditional equities. This is because commodities benefit from ongoing economic growth, while being less correlated to the traditional equity risk premium. In addition, exposure to gold can also provide portfolio diversification if markets do sell-off.
2. **Local currency emerging markets debt (EMD).** Following strong rallies in high yield credit in recent years, local currency EMD offers a more attractive yield, and stands to benefit from stronger fundamentals in emerging market economies.
3. **Volatility strategies.** These allow us to increase defensive portfolio positioning if market fluctuations become more pronounced.
4. **Options.** We favour the use of options due to their flexible and different payoffs compared to buying or selling equities outright. These help us to manage our portfolios in terms of capturing upside gains, while cushioning against downside risks.
5. **Floating rate credit:** This allows us to gain exposure to instruments such as bank loans, which help to provide income but have little sensitivity to rising interest rates compared to traditional bonds.

Risk mitigation strategies – in future

We believe that uncertainty will continue to linger in markets for the foreseeable future. Against that background, at Russell Investments, we aim to rely on the same key competencies, and to exploit the same three key attributes:

- **Dynamic allocation**, moving quickly to capture opportunities to add value as they arise.
- **Thoughtful diversification**, combining asset classes in which we have conviction to diversify risk and seek to generate consistent returns.
- **Downside risk management**, using a variety of techniques and derivative strategies, both to hedge against big falls and to increase our risk exposures at levels we believe are attractive.

ABOUT RUSSELL INVESTMENTS

Russell Investments, a global asset manager, is one of only a few firms that offers actively managed multi-asset portfolios and services that include advice, investments and implementation. Russell Investments stands with institutional investors, financial advisers and individuals working with their advisers—using the firm's core capabilities that extend across capital market insights, manager research, asset allocation, portfolio implementation and factor exposures— to help each achieve their desired investment outcomes. The firm has AUD$379 billion in assets under management (as of 31/12//2017).

FOR MORE INFORMATION

Call your Russell Investments client representative on **+61 9229 5111** or visit www.russellinvestments.com.au for more details.

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