The shortsightedness of investing in silos

Why dynamic, holistic multi-asset investing matters

In this late stage of the economic cycle, the tectonic plates of financial markets are poised to shift, and investors will face increased volatility and uncertainty. Building inflationary pressures, rising recession risks, and historically low U.S. equity returns projected for the next decade are just some of the challenges at hand. These shifting sands serve as a warning sign telling investors to consider whether their investment strategy can ride out imminent market pressures and still deliver the outcomes required to achieve their objectives, both in the short and long term.

Most investors build their portfolios in a siloed fashion, meaning that the aggregate investment portfolio is composed of individual silos of single asset classes, each of which is optimized to outperform its respective benchmark. Russell Investments believes that in today's changing markets, it is no longer sufficient to allocate portfolios in this manner and evaluate success simply based on whether an asset class beats its benchmark.

Managing portfolios with a siloed approach, asset class by asset class, prevents investors from fully incorporating material improvements at the aggregate portfolio level, as what's best for the piece is not always best for the whole. For example, an individual equity manager and an individual fixed income manager will both select securities that they think can outperform a benchmark. Each manager, however, will only have a myopic view of the total portfolio, and won't necessarily be making investment decisions in light of what the other manager is doing. Let's say the fixed income manager believes that a strategic credit overweight makes sense, because this gives more room for issue selection than is possible in Treasuries. This credit bias works in the context of a portfolio with the objective of merely outperforming the fixed income benchmark. What if, at the same time, the equity manager sees significant opportunities in cyclical, high-beta sectors? This could lead to an overweight position in high-beta stocks in that part of the portfolio. Taken together, the fixed income and equity positions could create a significant bias at the total portfolio level towards a "risk-on" scenario. Even though it may be right for each segment, when all the positions are aggregated, the portfolio wouldn't end up with the best risk-reward structure.

This is why we believe investors need to look at their portfolios holistically—and consider applying an additional level of oversight on top of these managers. In this uncertain market environment, we think that setting a strategic asset allocation, hiring managers in silos, and letting them do good work simply isn't enough to deliver the returns most investors seek.

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Multi-asset portfolio management

At Russell Investments, we firmly believe in a simple, yet powerful, solution to this quandary: multi-asset investing. Multi-asset investing is an investment strategy that provides exposure to a globally diverse mix of asset classes and investing styles, which is dynamically managed by our team at the total portfolio level. This means that our portfolio managers are superimposing an additional layer of supervision and portfolio management expertise on top of the leading investment managers we have hired to play specific roles within the portfolio. Our teams are also providing daily, real-time portfolio management, thanks to our robust trading desk. By combining some of the world's best independent money managers and their underlying products into a single strategy, and implementing strategic decisions in real time, we bring our clients increased access to opportunities, greater transparency around risks and exposures, improved focus and flexibility, and enhanced diversification potential.

We use our multi-asset strategy as the growth engine of the portfolio because it is a more diversified way of seeking returns, with less predicted volatility. The broader scope of a multi-asset mandate allows investors to take the total portfolio view, looking across equity, fixed income, real assets, and other areas, to make the best risk-return tradeoffs. Multi-asset investing is also about making your portfolio greater than the sum of its parts, as it allows investors to look at the outcome they desire from their entire return-seeking portfolio and help ensure that they're positioned in aggregate to meet that outcome—in addition to holding individual managers accountable for hitting individual benchmarks. By approaching portfolio construction and risk management with a holistic multi-asset framework, it's easier to align your portfolio with your end goals. Doing this well will help you keep your portfolio true to its original design.

In fact, outcome-oriented multi-asset investing can provide a secure anchor for investment portfolios when the markets get swept away by volatility and uncertainty. This targeted approach gives investors visibility into the assets within their portfolios based on the roles they play (e.g., growth, risk reduction or diversification, return enhancement), rather than just the types of assets used. Using this roles-based framework allows for better, more integrated investment decision-making across the silos that would often arise in an asset-class-based framework. In fact, a roles-based approach affords investors the freedom and flexibility to make decisions between, rather than just within, strategy types. Within each general strategy type, some investments are liquid, others are illiquid; some are fixed income focused, others are focused solely on equities or real assets. Having the flexibility to rotate among these strategies and asset classes as new investment opportunities present themselves can better position your portfolio for success.

Dynamic management

To meet your objectives in today's uncertain markets, we also believe that you need to be able to manage your investment program dynamically. Investors must incorporate investment strategies that may offer incremental return opportunities, are designed to avoid uncompensated risks, and better ensure the efficient implementation of manager changes, trades, and adjustments to their portfolios.

By dynamic management, we mean capitalizing on short-term market dislocations to enhance returns and manage risks—so that, in the long run, these short-term shifts don't derail your strategic investing objectives. To achieve this, portfolio managers need to have daily, real-time trading capabilities, and may use tactical tools such as overlays, currency management, dynamic hedging, and calculated overweights or underweights to specific assets. As market conditions, underlying managers, and organizational circumstances change, dynamically managing a multi-asset portfolio allows investors to access new return sources opportunistically, while simultaneously managing risks as they arise.

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In our experience, we have found that silo-based investing doesn't provide investors with the flexibility to dynamically manage their assets. Because silo-focused investors are tied to rigid, segregated mandates, they are unable to consider key risks and exposures at the total portfolio level. One example of how we have successfully implemented holistic dynamic management for our clients is illustrated by our multi-asset strategy positioning in late 2018, when global equities were under considerable pressure. Our equity replacement strategy, with an underweight to U.S. equities and an overweight to cash, contributed 105 basis points to our multi-asset portfolios.[1] Entering the quarter, we implemented option protection and rolled option strategies that are designed to help us participate in the upside while protecting from the downside of market movements. These served us well going into year-end—when listed equity, alternatives, and credit markets sold off, our portfolios were well protected against the drawdown and were well positioned to outperform their custom benchmark.

Dynamic management requires portfolio managers to have access to the daily, security-level holdings of every manager in the portfolio, understand the aggregate positioning of the portfolio, and apply tools at the total portfolio level to manage these exposures accordingly.

As market volatility picked up towards the end of the year, we marginally increased risk by over 6% but continued to manage well below long-term strategic levels. Moreover, our portfolios were rewarded during the period for maintaining underweights to U.S. equities in favor of overweights to Europe ex-UK and emerging market equities, as U.S. equities saw their worst December performance since 1931. Thanks to these tactical tilts, our multi-asset strategy was able to achieve a total of 111 basis points in excess return over its custom benchmark.[1]

Considering that a multi-asset strategy may have multiple active decisions in place at any given time, the benefits can go a long way in pursuit of long-term total portfolio return objectives. The takeaway is that dynamic management is not only complex and requires specialist implementation resources and vigilance, but also has to be approached at the total portfolio level, with transparency and risk managed all the way to the individual security level. This means that while many firms can bolt on a cash overlay or currency product, dynamic management is seamlessly incorporated into the fabric of the portfolio. It requires portfolio managers to have access to the daily, security-level holdings of every manager in the portfolio, understand the aggregate positioning of the portfolio, and apply tools at the total portfolio level to manage these exposures accordingly. With a siloed approach, taking these nimble, tactical positions on specific market issues would be difficult, not to mention costly.

Why multi-asset?

With shifting market forces on the horizon, a narrow, silo-based perspective obscures transparency and can ultimately constrain your portfolio's ability to deliver the returns you need to meet your broader objectives. At Russell Investments, we have found that a holistic, roles-based investing approach, and the flexibility to take timely, short-term bets on market issues, can better position your investment program to achieve your desired investment outcomes in the long run. We believe this is critical to reaping incremental returns and saving valuable dollars in a volatile, uncertain market environment.

If you are not investing at the total portfolio level and incorporating dynamic tactics into your portfolio, you are missing out on an opportunity to improve your chances of meeting your goals, whether it's hitting a spending target, improving funded status, or maintaining your credit rating. This is why multi-asset investing matters. Mastering multi-asset—or working with a seasoned investment provider that specializes in multi-asset strategies—can help you survive and thrive in today's uncertain, volatile markets.

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[1] Gross of fees, for the 4Q18 period ending December 31, 2018. Results are quoted at strategy level; individual products' performance may differ. For illustrative purposes only. Past performance is no guarantee of future results.

About Russell Investments

Russell Investments is a global asset manager with a unique set of capabilities that we believe is essential to managing your total portfolio and to meeting your desired outcome. At Russell Investments, we stand with you, whether you're an institutional investor, a financial adviser, or an individual guided by an advisor's personalized advice. We believe the best way to reach your desired outcomes is with a multi-asset approach that combines: asset allocation, capital markets insights, factor exposures, manager research and portfolio implementation.

For more information

Call Russell Investments at **800-426-8506** or

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