Russell Investments

CLIENT FOCUS

The evolution of multi-asset

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Multi-asset investment products seem to be everywhere these days; a sign of their current appeal is that the label is being applied to all sorts of products, including a few that two years ago would more likely have been called "core plus fixed income" or "global equity."

As a multi-asset portfolio manager, I believe the increased interest is a natural response to the low-return environment we find ourselves in, and to investors' increased focus on specific outcomes such as improving funded status or meeting spending targets. Investors cannot afford to ignore sources of return, cannot afford to take risks they do not believe will be rewarded and must be as efficient as possible in the implementation of their strategies. Multi-asset investment products can help on all of these fronts.

DESIGN: GETTING EXPOSURE TO THE THINGS IN-BETWEEN

Three years ago, I presented to the Russell Investments Institutional Summit on the subject "making good on the promise of multi-asset investing."[1] This year, I was back to present on "the evolution of multi-asset." If truth be told, much of what I said three years ago still applies: the benefit of clear objectives, the importance of a total portfolio view and the need for a dynamic approach. But the products we launched in 2012 now have four years behind them, and the way the strategy is being managed in practice has evolved.

In terms of the design of multi-asset portfolios, true multi-asset is built on a foundation of a diverse range of exposures to assets and strategies, each of which plays a precise role in meeting a client's desired outcome. Some of these asset classes cannot easily fit into a traditional portfolio built from a series of asset classes or product sleeves, each selected by the asset owner. Most often, this is because some asset classes or exposures are not modeled in a typical set of long-term capital market assumptions, or because a quarterly investment committee meeting cycle does not allow enough time for new strategies to be properly researched or understood. The largest institutions not included, it's impossible to effectively select, track and manage separate exposures to the full range of return opportunities (e.g., exposures such as global infrastructure, global REITS, commodities, global high yield, bank loans, emerging market debt, volatility and currency – all of which now feature in our flagship U.S. multi-asset products). In a world with such a range of choices, getting the best thinking in strategic asset allocation into portfolios in a timely manner is a key benefit of the multi-asset approach.

[1] See "Making good on the promise of multi-asset investing" in the Q3 2013 edition of Communiqué.

Creating the structure is just the start. Each of these exposures ought to be managed dynamically (I'll return to that in a moment) and new exposures ought to be added over time. This type of broad diversification means that when one slice of the portfolio is dragging – as commodities did in the recent past – the exposure is not too large, and there are other parts of the portfolio that can carry you through.

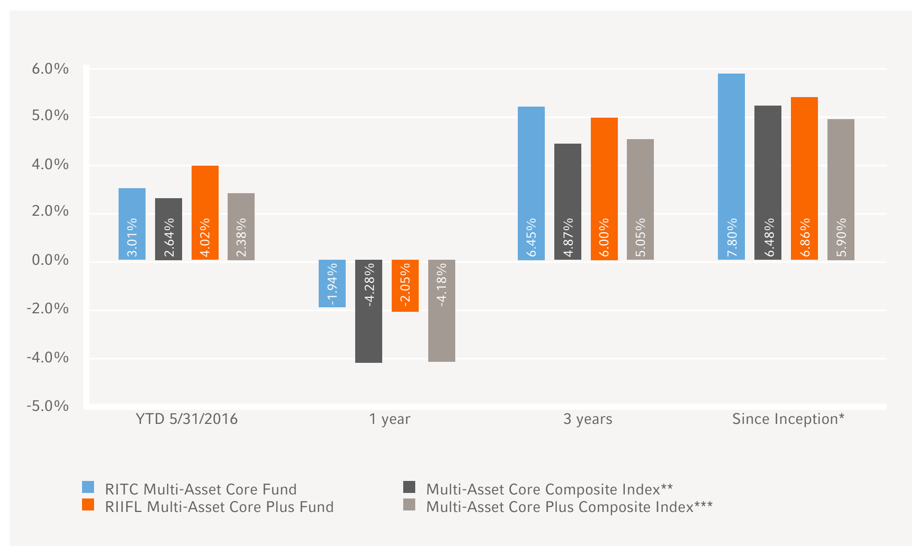
CONSTRUCT: GETTING THE BEST OF MANAGER RESEARCH

Having set the overall strategy, the portfolio needs to be built. As part of this "construct" phase, we look for the best available active management opportunities. Once again, to take advantage of the full breadth of what's available, it pays to take the multi-asset approach.

Consider the example of the money manager we hired following a period of performance, which saw it underperform its market benchmark by 80%! That sort of concentrated risk and extreme volatility can be too much to bear if you're looking at that line item in isolation, or even if you're looking at the slice of the portfolio it comprises (this was a global equity

By approaching portfolio construction and risk management with a total portfolio view, it is possible to gain better alignment between the portfolio and the end goals being pursued:

Figure 1: Russell Investments Multi-Asset Fund performance (as of May 31, 2016)



The RITC Multi-Asset Core Fund is a fund of the Russell Investments Trust Company Commingled Employee Benefit Funds Trust; it is not a mutual fund.

The RIIFL Multi-Asset Core Plus Fund is a fund of the Russell Investments Institutional Funds, LLC; it is a private placement. This is not a mutual fund.

*Inception for RITC Multi-Asset Core Fund is 4/1/2012. Inception for RIIFL Multi-Asset Core Plus Fund is 2/28/2013.

**The Russell Investments Multi-Asset Composite Benchmark consists of 75% Russell World Cap Index 50% Hedged, 5.0% Bloomberg Commodities Index, 5.0% FTSE EPRA/NAREIT Developed Real Estate Index(Net), 5% S&P Global Infrastructure Index, 7% Barclays US Aggregate Bond Index and 3% Barclays US 1-3 Month Treasury Bill Index.

***The Russell Investments Multi-Asset Core Plus Fund Composite Benchmark consists of: 75% Russell Global Index 50% Hedged, 4% Bloomberg Commodity Index Total Return (USD), 4% FTSE EPRA/NAREIT Developed Real Estate Index (Net), 4% S&P Global Infrastructure Index Net (USD), 5% BofAML Global High Yield 2% Constrained Index TR USDH, 5% JP Morgan Emerging Market Bond Index Global (USD) and 3% Barclays U.S. 1-3 Month Treasury Bill Index.

Performance shown is gross of fees. Fees will reduce the overall performance of the funds. Indexes are unmanaged and cannot be invested in directly. Past performance is not indicative of future results.

manager). But multi-asset's holistic view means that we allocate risk at the total fund level, not asset-class-by-asset-class. So we were able to hire the manager knowing that its risk is diversified elsewhere in the portfolio – and the early results have paid off handsomely to date.

By approaching portfolio construction and risk management with a total portfolio view, it is possible to gain better alignment between the portfolio and the end goals being pursued: What's best for the total portfolio is not necessarily the same as what's best if each part is being managed independently.

MANAGE: BEING DYNAMIC ACROSS AND WITHIN ASSET CLASSES

The strength of the case for each strategy and each asset class fluctuates over time, and the multi-asset approach allows for dynamic portfolio management not only within asset classes, but also across them. (See the article later in this issue of Communiqué for more on how Russell Investments approaches dynamic portfolio management.)

For example, in early 2016, we took the view that exposure to high-yield credit (corporate-issued bonds) was more attractively priced than exposure to the stock of those same corporations (equity). So, at the margin, we preferred exposure to corporations' debt than to its equity. Timely and precise changes to a portfolio such as this can add up to significant value-added over time.

Behind a fully-developed multi-asset approach, there needs to be a world class implementation capability. Credit exposure, for example, can be expensive to trade if insufficient attention is paid to how positions are built and managed. The dizzying choice of trading instruments available to today's investor includes not only physical securities and derivatives such as futures, but also more complex exposures such as options or other complex derivatives. Each can play a role in the essential task of cost-effective implementation.

CONCLUSION: A STRENGTHENING CASE

So, with the ever-growing complexity and ever-widening range of choices available to institutional investors, we believe that the case for multi-asset management will continue to strengthen in the coming years.

When I first started presenting the case for multi-asset to U.S. clients in 2011 and 2012, our flagship U.S. multi-asset funds had only recently been launched, and had no live track record to point to. This year, I was able to show not only a track record that was above the benchmark (as of 5/31/2016,) but one which chalked up positive contributions from each of the design-construct-manage elements around which we have built our process. (See performance details at end of this article.)

I expect that this sector will continue to evolve in the years to come, for example, through ever-greater customization to particular goals such as a growing focus (for pension plan investors) on "surplus space" results.

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