Generating income: Multi-Asset as a solution

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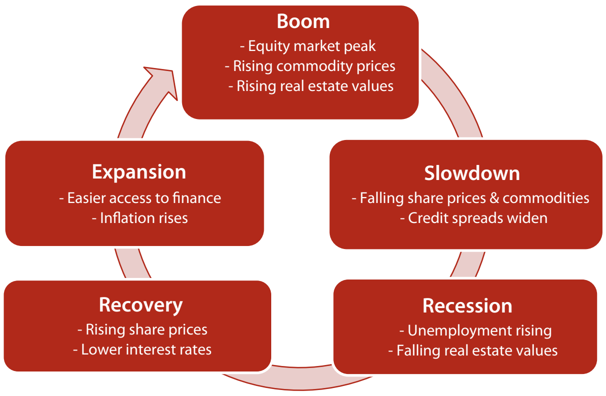
MULTI-ASSET BECOMING MAINSTREAM

Following the 2008 financial crisis, the asset management industry in Europe was characterised by a big increase in assets under management labelled as "Multi-Assets". 2015 was again a "bumper" year in terms of net sales for these strategies (Multi-Asset being an investment strategy and not an asset class in itself) with an annual increase of 22.8% in total net assets across Europe[1]. Multi-Asset strategies have become relevant in most European countries and we believe that this trend is here to stay.

The reasons behind the success of Multi-Asset strategies are manifold, trying to respond to different issues, whether related to market fundamentals (lower returns and yields, across asset classes), risk management (to avoid maximum drawdowns, contain volatility and/or reduce tail risks) or investment (flexibility, to capture different market opportunities).

Importantly, it also responds to some investors' preferences: a smoother investment journey and some level of protection in falling markets, a rebalancing between riskier equities or to safer fixed income instruments, achieving real returns but with volatility lower than global equities or wanting positive returns regardless of market direction (absolute return).



Source: Generali Investments Europe S.p.A. Società di gestione del risparmio

Whatever the reason, economic cycles do impact the performance of the main asset classes – as illustrated in the chart above – while outperforming asset classes constantly change within those cycles!

Diversifying via uncorrelated (or less correlated) sources of performances is, for Generali Investments, key to targeting and achieving medium/long term investment goals. Furthermore, efficient allocation becomes even more relevant with our current regime of low yields, lower returns and higher volatility.

Allocating across so many different asset classes therefore requires specific expertise and skills.

ASSET ALLOCATION AS THE CORNERSTONE

Asset allocation relies primarily on Strategic Asset Allocation (SAA), which defines a portfolio's neutral allocation, i.e. its long term exposures and structural biases.

The following are among the most common approaches in the Multi-Asset space:

Risk Parity Allocations

The allocation is based on risk budgets instead of nominal weights, balancing the risk exposures to avoid any implicit risk biases at the SAA level. This approach is agnostic, considering that equities and bonds have the same risk/reward ratio in the long run, with the allocation moving dynamically, along with asset classes' risks.

Constant Mix Allocations

It is based on setting the long term sensitivity to economic growth through a defined weight in equities and it keeps a constant exposure to equity markets. As a consequence, the allocation's risk can vary significantly from time to time: a systematic rebalancing back to the constant mix level provides a mean reverting feature.

Income focused Allocations

The purpose is to provide a combination of attractive income levels and capital growth potential through a diversified multi-asset investment universe, hence multiplying the sources of yield. The strategy can use carry strategies to deliver solid yields and attractive risk-adjusted returns. The income generation should be distinct from the asset allocation.

MULTI-ASSET INCOME STRATEGY: THE WAY FORWARD

At a time when yields are at an all-time low and volatility is back on the agenda, proposing an efficient alternative way to harvest yields, without concentrating market risks in one single asset class is paramount for investors.

Our purpose is indeed to provide a combination of attractive income levels and capital growth potential through a diversified multi-asset investment universe, hence multiplying the sources of yield. The strategy uses carry strategies to aim to deliver solid yields and attractive risk-adjusted returns.

When constructing such an income focused strategy, we believe that income generation has to be dissociated from the allocation process. Indeed, we initially design a robust asset allocation process to provide capital appreciation with a solid risk/return profile over the long run. We then typically aim to generate an income of 4% to 5% (this target is not guaranteed), through dividends, coupons and option premia, without influencing the above allocation process.

Finally, in our opinion, Tactical Asset Allocation (TAA), on a weekly or monthly frequency, may deliver sound returns over time.

At Generali Investments, we think that generating income through a Multi-Asset investment strategy is the way forward for investors interested in diversifying their sources of yields while also seeking capital growth, controlling their level of volatility, reducing asset class specific risks and therefore limiting maximum drawdowns.

It indeed offers the necessary flexibility to benefit from attractive opportunities in an asset class or region, without taking unwanted and unnecessary concentration risk: sound portfolio construction & diversification, dynamic asset allocation and on-going management of risks are, in our opinion, all key to a smooth investment journey to generate income.

FOOTNOTE
1 Source: FundRadar, December 2015

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