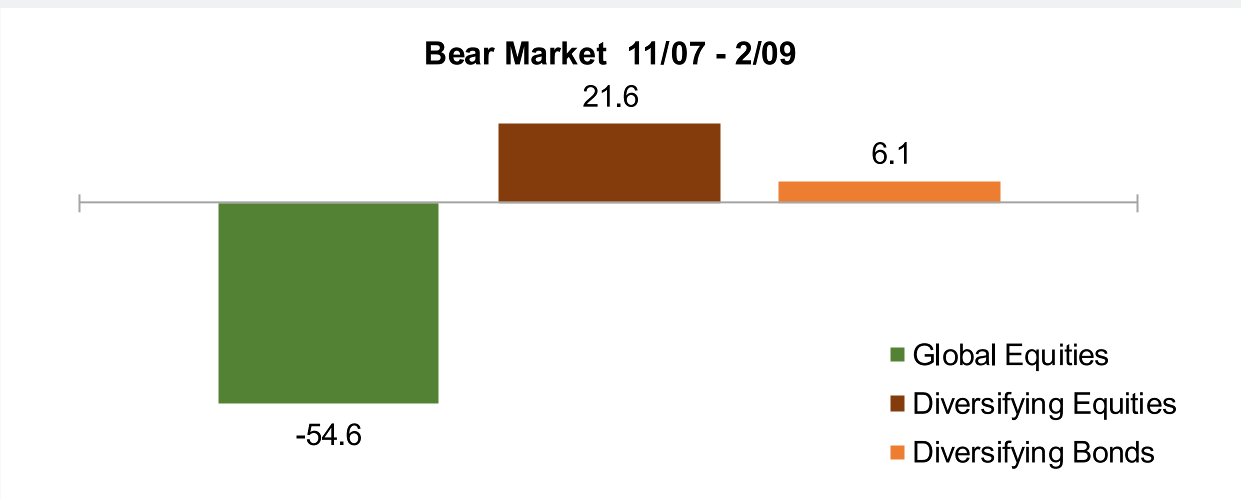
Building Ballast with Diversifying Strategies

The Investing Evolved framework focuses on diversification of asset classes and also strategies. One component of that framework is diversifying strategies, but what are they trying to diversify and what is their role in an Investing Evolved portfolio?

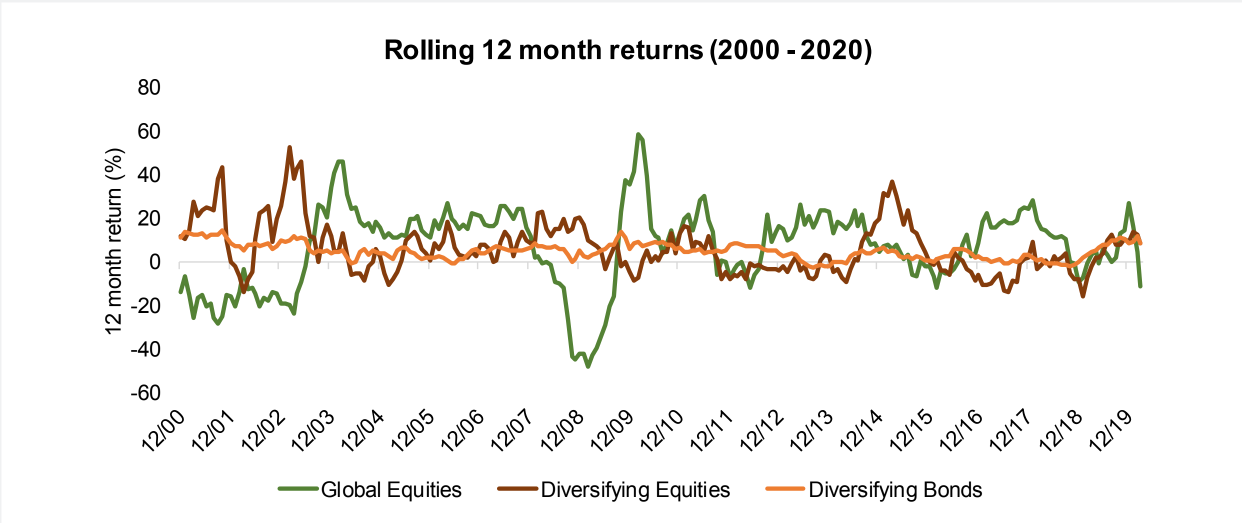
The biggest driver of portfolio returns over the long run is equities, and that comes with equity risk and greater swings in returns over shorter time periods. While core portfolios may contain some mix of fixed income to temper the portfolio's risk profile, diversifying strategies can provide ballast and complementary returns to the portfolio, especially during times of market stress.

Diversifying strategies should be thought of as the risk management tool to help diversify equity risk in a portfolio. They seek to dilute the equity risk during times of market stress and seek to provide a degree of return, or "crisis alpha" during those times.



Source: Zephyr Style Advisor, AssetMark

Diversifying strategies are the components of the portfolio that can allow for higher equity exposure in parts of the portfolio, however, there is a cost to them that can also limit returns over the long run. Think of them like insurance – something you're glad to have when the accident or natural disaster hits but an opportunity cost over the long-term. Another way to think about diversifying strategies is that they are like seatbelts in a car – they can hinder your movement in the car but you're very glad you're wearing them when the crash happens.



Source: Zephyr Style Advisor, AssetMark

So, if we accept we should have some exposure to diversifying strategies, how do we think about building that part of the portfolio? Instead of trying to find a catch-all to do everything, one train of thought is to focus on the goals of the client portfolio and either tilt toward that strategy or use a diversified mix of building blocks.

We think there are four different building blocks within the diversifying space;

Return

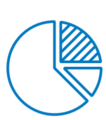
Emphasis is on providing a total return through the use of credit sectors beyond investment-grade bonds

Income

Emphasis is on providing a consistent and higher level of income through inclusion of higher-yielding sectors and asset classes

Preservation

Emphasis is on providing a steady return from investments in higher-quality bonds



Diversification

Emphasis is on providing a differentiated return source that is uncorrelated to traditional markets

The other factor that we need to account for is the type of bond exposures that our core manager is taking, to make sure we don't build a portfolio that is overloaded in one specific area. For example, multi-asset income strategists tend to tilt toward the higher yielding sectors like high yield, so we may not want to lean heavily into the strategies that emphasize income within the diversifying space.

Strategists within our diversifying category have biases toward one of these four key themes, or may emphasize a couple, which can help with the selection of which strategy to use when building out the ballast in the portfolio. Below are the AssetMark strategists grouped by these themes that gives some broad guidance. Note that the strategies don't squarely fit into each theme, we have classified where we see them fit best based upon their approach.

Return

Beaumont Decathlon Aspect- Conservative

- Selects 10 ETFs based on their return potential over the subsequent trading period. Can hold up to 30% equities

Dorsey Wright Tactical Fixed Income

- Uses relative momentum to drive investment decisions across 6 key sectors. Can hold up to 60% in credit risk sectors

Income

BlackRock Risk Focused Income

- Seeks to maximize yield for the level of risk with a macro overlay signal to identify whether to hold credit risk sectors

PIMCO Tactical Income

- Seeks to maximize yield for the level of risk through use of an optimizer that leverages fundamental macro top-down views

Return & Income

Clark Capital Fixed Income (Taxable & Tax-exempt)

- Actively managed portfolio of individual securities focused on credit selection

DoubleLine® Capital Low Volatility

- Actively managed portfolio using global macro viewpoints to drive sector positioning and active credit selection

Nuveen Municipal

- Actively managed portfolio of individual securities focused on credit selection within the municipal market

Preservation

High Credit Quality Laddered portfolios (Savos, Eaton Vance)

- A laddered portfolio of individual securities while focusing on higher quality credits.

Benchmark-sensitive portfolios (Savos duration-based portfolios)

- Systematic approach to maintain a portfolio that tracks closely to the benchmark (which tends to have a high degree of Treasury bond exposure)

Diversification

JPMorgan Absolute Return

- Flexible strategy focusing on low volatility outcome by investing across multiple sources of return - equities, fixed income and alternatives.

Neuberger Berman US Equity Index PutWrite

- Provides exposure to differentiated risk factor and can have high impact on returns due to higher volatility.

Savos Preservation Strategy

- Flexible strategy that includes alternatives and differentiated sources of return alongside less interest rate risk.

Managed Futures (ASG, Altegris, AQR)

- Low correlation with equities and high impact on returns due to higher volatility. Can also have low correlation with bonds.

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