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How multi-asset funds can hedge against geopolitics

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Guide to Multi-Asset investing

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With geopolitical tensions on the rise across the globe, be it Brexit, a breakdown in US-Sino relations, or something else, investors are likely to rush to protect their portfolios.

Amid this landscape, several investors have turned to multi-asset funds as a one-stop shop to reduce their exposure to volatility.

But what is it about multi-asset funds that can help investors mitigate geopolitical uncertainty?

Diversify against political uncertainty

Several in the industry note that multi-asset funds are often the most popular way to diversify returns.

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Alan Chan, chartered financial planner and director at IFS Wealth and Pensions: "A multi-asset fund often provides global diversification from a range of assets, hence political uncertainty associated with one country may only form a small part of the overall portfolio."

He cites that while recent volatility caused by Brexit may have caused investor woes, but this could often only constitute 20 per cent of an overall portfolio with remaining allocation spread to equities globally, including US, Europe, Asia and emerging markets.

Gareth Deacon, portfolio manager at Blackfinch Wealth, says: "Enabling a provider to utilise its risk budget across asset classes allows for much more dynamic portfolio management, with the ability to both produce positive returns and protect capital on the downside."

He explains this level of freedom for investment managers, while retaining a level of independent oversight, allows active managers to avoid areas that may pose risks to investors, whether geographic, asset class or sector specific.

"This freedom is invaluable in times of political and economic uncertainty," adds Mr Deacon.

Danny Knight, investment director at Quilter stresses multi-asset funds are able to react in real time to market conditions or political changes as they often possess futures or trackers.

Mr Knight says: “For instance, in the current market volatility produced by Brexit a multi-asset fund is able to make quick changes and utilise currency hedging to hedge currency exposure and holding level.”

He highlights that this is not possible through other structures such as: adviser run model portfolios, outsourced model portfolios, discretionary managers and unitised fund structures.

Multiple asset classes

Multi-asset funds can curtail geopolitical risk because the risk is usually spread across many investments, according to experts.

Mr Deacon confirms: “By spreading an investment across a range of asset classes, investors can minimise their exposure to systematic (market) risk.”

He adds: “By understanding the correlations between asset classes as markets move through economic cycles, multi-asset managers can manage volatility and reposition a portfolio as conditions dictate."

Mr Chan says: “A multi-asset fund provides diversification for the investor as the underlying portfolio contains a spread of investments including equities, property, bonds and cash. In other words, the fund is designed as a single solution for investors.”

David Bebb, chartered financial planner at Pannells Financial Planning notes because fund managers are institutional investors, they can get access to investments that an ordinary retail investor cannot.

He adds: “A multi-asset fund can offer access to asset classes otherwise unobtainable, so the fund manager also has day-to-day control of the fund, and can act quickly should a tactical move needed to be made.”

Thierry Michel, multi-asset portfolio manager at TOBAM agrees that multiple asset classes combined in a risk-based portfolio protect against uncertainty.

“By renouncing to views, macro or otherwise, and focusing on risk and correlation, the resulting portfolio is by nature less sensitive to unexpected moves.”

Mr Michel adds: “This requires a robust estimation of the dependencies between assets, and naturally optimisation of the portfolio.”

But what role do alternative assets have to play in multi-asset funds?

Alternative assets

Mr Chan says multi-asset funds guard against illiquidity by providing a spread of investments and avoiding large exposure to illiquid assets such as property or unquoted stocks.

But Nathan Harris, chartered financial planner at Lothbury Group says alternative assets have a pivotal role to play in multi-asset funds as they tend to be less correlated to each other.

“So by having more uncorrelated assets you are able to be on the efficient frontier and offer better returns to investors,” he says.

The efficient frontier is a curve showing the optimal portfolios that offer the highest expected return for a defined level of risk or the least risk for an expected level of return.

Portfolios that fall below the efficient frontier tend to be less optimal while portfolios that fall to the right of the efficient frontier are also sub-optimal as they pose greater risk for the same expected level of return.

He says investors are typically adding property, insurance and infrastructure funds to portfolios.

Mr Harris says his advice company had spoken to The Foresight Real Global infrastructure fund to assess how a government led by Labour party leader Jeremy Corbyn pan out, should there be a general election in the next few months.

The Labour opposition has pledged to nationalise key infrastructure areas, such as energy, water and railworks which could reduce the rate of return from stocks in that sector.

“We are quite likely to see large losses for those who have invested in infrastructure, but I suspect that would spread to all shares under a Corbyn government.”

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