28th October 2020

Multi-asset passive funds: a question of design

- As "relative risk" strategies multi-asset passive funds experienced similar drawdown in the COVID crisis
- Their recoveries, however, are differentiated
- Strategic design parameters – such as global or UK equity bias – as well as any tactical asset allocation decisions have been key

What do we mean by "Relative Risk" strategies

We refer to asset-weighted multi-asset strategies with clearly defined equity allocations "relative risk" strategies. Why? Because as their asset weightings are relatively stable, their risk will fluctuate relative to equity risk, which is itself dynamic. The alternative to this approach is "target risk" strategies, where the asset weightings fluctuate to target a stable portfolio risk. The vast majority of risk profiled multi-asset portfolio and multi-asset funds are relative risk strategies, where risk can be defined as % equity exposure.

Nowhere to hide

The sudden severity of the COVID-related market downturn mean that the impact on "relative risk" strategies was similar. Broadly speaking, they took ~60% of the drawdown in global equities. A traditional asset-weighted approach can reduce beta to global equity, but not necessarily reduce correlation. In this respect, there was nowhere to hide for traditional relative risk multi-asset funds whose asset allocation is relatively stable.

Fig.1. YTD Performance of "balanced" multi-asset passive funds

Source: Elston research, Bloomberg data. Total returns from end December 2019 to 28th October 2020

What is visible, however, is the differing shape of recoveries. And this was predominantly a function of:

- Strategic design parameters (e.g. UK or Global Equity bias)
- Any tactical asset allocation decisions made

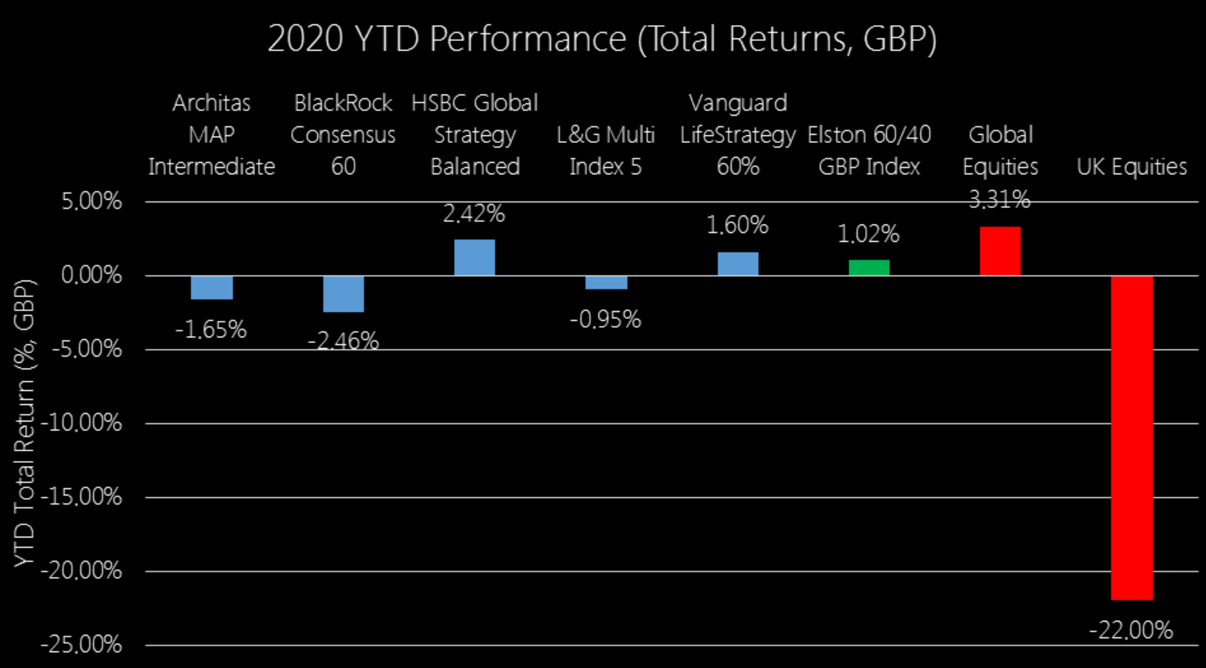
As outlined previously, home equity bias is irrational and has penalised UK investors, and this is now a key distinguishing feature between multi-asset funds.

We look at summary YTD performance of selected multi-asset passive funds, relative to our Elston 60/40 GBP Index, Global Equities and UK Equities.

At +2.42%, HSBC Global Strategy Balanced has delivered strongest return YTD, outperforming the Elston 60/40 GBP Index by 1.40ppt

At -2.46%, BlackRock Consensus 60 has delivered weakest return YTD, underperforming the Elston 60/40 GBP Index by -3.48ppt

Fig.2. 2020 YTD Performance



Source: Elston research, Bloomberg data. Year to date as at 28/10/20. Total Returns in GBP terms. Global Equities represented by SSAC. UK Equities represented by ISF.

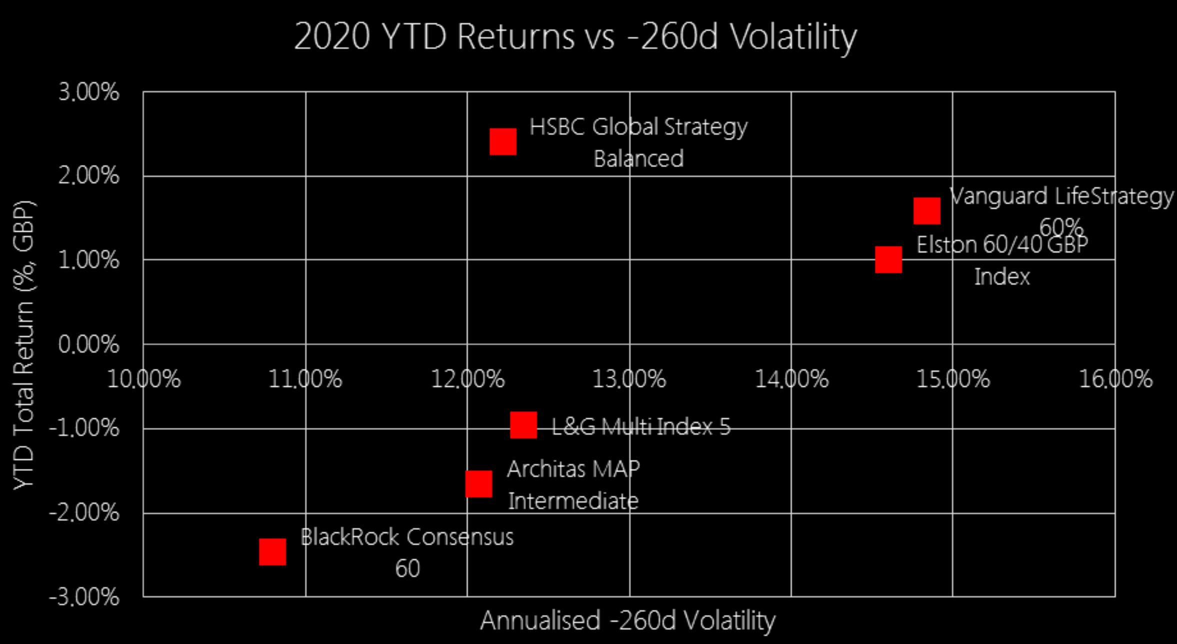
Risk-adjusted returns

For risk-adjusted returns, we compare YTD performance to the 260 day rolling volatility. On this basis, HSBC Global Strategy Balanced has delivered best risk-adjusted returns.

On a risk-adjusted basis, HSBC Global Strategy Balanced delivered positive YTD returns and +1.40ppt outperformance relative to the Elston 60/40 GBP Index with approximately 84% of the volatility of the Elston 60/40 GBP Index.

By contrast Vanguard LifeStrategy 60% Equity delivered positive YTD returns nd +0.58%ppt outperformance relative to the Elston 60/40 GBP Index with 102% of the volatility of the Elston 60/40 GBP Index.

Fig.3. Risk-adjusted returns



Source: Elston research, Bloomberg data, as at 28/10/20 Total Returns in GBP terms

Summary

Based on this analysis

1. Relative risk strategies can be defined by their equity allocation
2. Whilst the COVID shock impacted relative risk strategies similarly, their recovery paths are differentiated
3. UK vs Global bias with respect to, primarily equities is a key differentiator

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