Allocation d'actifs la métamorphose

Confronté à des marchés asiatiques extrêmement volatils, Pranay Gupta, praticien des marchés depuis 25 ans, remet en question les fondements de l'allocation d'actifs traditionnelle, égratignant au passage une industrie qui pense davantage à son confort relatif qu'au besoin de rendements absolus de sa clientèle.

Pourquoi utiliser une seule méthode et un seul horizon de temps lorsqu'il s'agit d'allouer ses actifs? Les définitions traditionnelles du risque et de la prime de risque sont-elles cohérentes dans un univers composé de diverses classes d'actifs? Les processus d'investissements mis en œuvre tiennent-ils compte des risques réels auxquels sont exposés les portefeuilles? Peut-on véritablement distinguer la chance du savoir-faire lors de l'évaluation des performances d'une stratégie? Pour quelles raisons la gestion d'actifs évolue-t-elle des stratégies multi-actifs vers les solutions multi-actifs? C'est à toutes ces questions ainsi qu'à la proposition de réponses concrètes que s'est attelé Pranay Gupta dans son récent ouvrage intitulé «Multi-Asset Investing: a practitioner's framework»[1]. De passage à Genève, il répond à nos questions dans l'entretien qui suit.

Investnews: You argue that the relentless quest for alpha has made allocation an "under-appreciated" skill. This is quite surprising since every asset manager knows that 80% of the performance of a portfolio comes from allocation. How do you explain this contradiction?

Pranay Gupta: Indeed, as you say, Finance 101 tells us that 80% of the risk and returns of a portfolio come from asset allocation. But allocation is a difficult game – there is lower breadth, allocation is not done to tangible assets and asset classes are very volatile (in aggregate). Given that all intermediaries are driven by commercial objectives, perforce this investment problem has taken a back seat compared to the easier game of managing a relative return portfolio of stocks or bonds.

In the relative return game the portfolio manager has a larger breadth of assets, he has the touch and feel of what is being forecasted, and most importantly, the investment decision relates to only a fraction of the total portfolio volatility (as the manager is only interested in asset weights relative to the market benchmark, rather than the total weight).

Hence the industry has structured itself for delivering relative return, not absolute return, and the asset allocation problem has been relegated to creating a long term strategic portfolio for an institutional investor or a 60/40 portfolio for an individual. This has been complemented by investment banks where, since the majority of revenues are often derived from IPOs for individual companies, research teams are focused on delivering company research, not allocation research. This however defeats the basic purpose that all asset owners want absolute return, not market relative return.

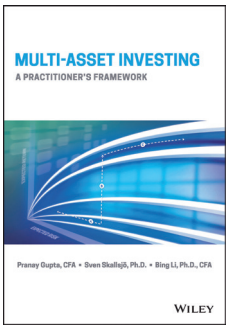
When you say allocation is an under-innovated skill, what do you mean?

Over the last decades, as the financial industry focused on stock and bond selection in managing assets, the brightest brains have devoted their energy to finding new and innovative ways to do it. This has led to a plethora of innovations in stock and bond selection techniques, portfolio management styles, risk modelling and optimization for single asset security portfolios.

On the other hand, allocation as an investment skill is confined to being researched by a fraction of the people in investment banks, asset management or asset owner groups. Further, this is often done at a long horizon, where the necessity to innovate has been less, given that reconciliation of actual results versus forecasts is seldom done. This has naturally led to a lower resource and a lower innovation in this area.

During the last 25 years, we have seen many «innovations» but very few have really worked. Decorrelation, once a panacea, used to vanish during crises. Is it still worth using such a tool?

It is an accepted fact that diversification of assets increases during times of crises. This is driven by the behavioral aspects of investors de-risking in times of uncertainty, and this human nature is unlikely to change. However, this does not mean that correlation is not relevant; it just means you need to work harder to find it. Therein lies the basic challenge for allocation research. We have become used to thinking of the world neatly as equities and bonds, and perhaps there are other ways to define allocation buckets, where diversification can still be harnessed.



Volatility is widely used as a risk measure, but we know that it has no real relevance for the investor. There were discussions to use semi variance or other metrics such as the Treynor ratio. But these attempts seem to have been abandoned. Why?

Volatility has one big advantage – it is easy to understand and simple to implement. Asymmetric or full distribution risk measures are more difficult mathematically, more difficult to assimilate and more difficult to implement for products. I agree with you that by doing this, we are often missing the wood for the trees. Risk is not normal or dual sided in a distribution, practically or behaviorally. Further, none of these measures capture intra-horizon risk of an asset, which is the real risk for an investor.

Risk-based allocation seems to be the new fad. Does it really work?

Risk and return are two sides of the same coin. There is no free money: if you need return, you need to take commensurate risk. It therefore is incomprehensible to me why the allocation world has focused all its attention on return allocation (ie: what we call asset allocation today, where expected asset class returns are the basic input). To that extent risk based allocation is not a fad, it is a basic requirement without which the allocation process is incomplete.

Having said that, the fad of using the label of risk allocation as an all-encompassing panacea, is grossly incorrect. This is basically a technique which still requires investment and forecasting skill; it is not the solution in itself.

Moreover, the asset managers and private banks that propose risk parity as the allocation method for delivering absolute return to clients, are using this label as a marketing gimmick for commercial objectives, rather than helping the client achieve their portfolio objectives. I have seen instances where risk parity is justified as an appropriate allocation method based on quantitative back-tests. But one needs to take these with a pinch of salt. Not only are the periods of these back-tests suited to prove the argument, but often managers misrepresent the benchmark of a standard 60/40 portfolio to be 60% bonds and 40% equities, because the proof wouldn't work if they actually used the correct definition of 60% equities and 40% bonds. This is tantamount to intellectual fraud.

In a low interest rates world, managing bonds can be a tough challenge. ETFs are not really a solution since they tend to overweight the biggest debtors. Is the only solution to sit on your bonds until maturity?

Indeed ETFs are not the solution precisely because fixed income indices overweight indebted issuers. Hence active techniques are required. However, often in the realm of active asset management, where relative return is the primary objective, the risk of a rise in short term interest rates becomes a significant determinant of what bonds to buy, as it creates interest rate risk for bonds. However, if the client has a medium term investment horizon, I would propose that holding bonds to maturity is an elegant solution. Firstly, it insulates the client from volatility caused by interest rate risk, and secondly, it enables him to exploit the increase in yield and lower transaction costs with the longer duration.

Can you talk about your own experience in managing multi-asset portfolios?

My path to managing multi-asset portfolios has been non-standard. In general, most multi-asset managers come from a top down economic background where they use macro skills to allocate assets. I originally started managing Asian equity portfolios in Singapore. As fate would have it however, over the course of my career I got to complement this with managing Japanese equities from Tokyo, European equities from London, US equities from New York, Hedge funds from London and Emerging market debt from

Hong Kong. Further, I also got the opportunity to work as a fundamental top down macro strategist and a quantitative portfolio manager. So I arrived as a multi-asset portfolio manager equipped with a more holistic approach of blending top-down and bottom up, fundamental and quantitative and asset class and factors.
Further, having managed assets for a wide range of clients from insurance companies, sovereign wealth funds, endowments, corporate pensions and high net worth individuals, I realized that the investment objective of all asset owners is basically the same – absolute or inflation adjusted absolute return; it is not relative market return. As such, I have focused my attention in attempting to deliver this, with the knowledge that allocation is the main source of portfolio risk and return.

Can you explain your composite time horizon based approach and show how it compares to more traditional asset allocations?

Another concept, that all of us have been taught, is that we must look at any fund investment for at least a medium time horizon. So we are told by asset managers to hold unit trusts for 3-5 years, we are told that policy portfolios for institutions should be for 3-5 years and we are told that we should look at retirement funds for a long horizon. There are several flaws in this approach.
Firstly, it is a mathematical fact that as you lengthen your investment horizon, the probability of intra-horizon drawdowns increases. As it stands today, modern portfolio theory doesn't cater for this risk as the standard measures of risk don't accommodate this measurement. Practically however, both individuals and institutions face this as a real risk. Hence investment horizon of an investment has to be calibrated such that the intra-horizon risk threshold for the investor is not breached. Secondly, when we define an investment horizon, the tendency is to hold all assets for a roughly similar horizon. This prevents time diversification from being harvested in the portfolio. Finally, we believe that investment goals are independent of the horizon – ie: we define a horizon as x years and we define goals as income, growth, etc., but we never relate the two.
In a composite time-horizon based investment solution, we relate each component of an investment goal to a horizon, and structure the portfolio at these multiple horizons. This enables us to deliver a more stable portfolio, where the portfolio composition is actually based on the objectives of a client. For example, if you have an income requirement and a long time horizon, rather than investing in high dividend equities and a bond fund, I would propose a composite of securities across the capital structure (equities, preferred shares and debt) where the income is stable, the volatility is reduced due to the multi-asset structure and the fixed income component is devoid of interest rate risk as the bonds are held to maturity. The implication of this is to challenge the conventional wisdom that a 60/40 balanced portfolio is the right solution as a diversified investment.

Why don't we all invest in passive instruments such as ETFs and let one asset manager make the asset allocation?

Firstly, let me dispel the notion that all ETFs are cheap. That is not true across the board. Internationally, very often asset managers charge similar fees for ETFs as are charged by active managers; however they use the label just because investors seem to believe that any product with an ETF at the end of its name is inexpensive.
Secondly, let me also dispel the notion that has been created by many that ETFs are low risk. They are not. In fact if you simply plot a distribution of returns of say the S&P500 US Equity index ETF and a US equity long-short manager, you will conclude that the long-short manager in fact has a far lower volatility and a far lower drawdown that the ETF.
As such, ETFs should be viewed simply as implementation vehicles and not an investment strategy in itself.
With regard to choosing one manager to do allocations, that can be risky. No investment process, including allocation can have a perfect hit ratio. So there are always benefits in choosing more than one manager to do an allocation for any portfolio.

If I do choose more than one manager to do the allocation, then how do I select the asset allocation I will actually implement?

The current method of investing is that you do allocation into equities-bonds first and then for each asset class choose multiple managers. So you end up not diversifying the beta allocation, but diversifying the alpha of active management. I am proposing that you divide your assets first into buckets of types of asset allocation (done by different methods – say traditional allocation, risk allocation, factor allocation, sector allocation etc.) Now for these buckets you choose a different manager. For traditional allocation you will need active managers, for some other kinds like risk allocation you will need futures of ETFs, for sector allocation you will need global sector funds etc. This way, you actually diversify the decision that matters most (allocation). You can still harness alpha where possible, but it's not that important in the big picture. This incidentally also makes the active-passive decision a bit obsolete, because in some allocation methods, you will need to invest passively.

1 - «Multi-asset investing - A practitioner's framework», Pranay Gupta, Sven Skallsjö, Bing Li

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