

Why Multi-Asset?

The aim of investing is to achieve financial goals. These financial goals may be a required level of income or desired level of savings at retirement. To meet these goals, investment decisions need to be based on return ambitions, risk appetite and time horizon. The challenge is that financial markets are dynamic and experience both booms and busts. Most investors cannot rely on 'long-run average market returns' as they do not have an infinite time horizon. To achieve investment success over a specified horizon, asset allocation decisions must be made to address the delicate balance between delivering the return objective whilst not taking excessive market risk.

Multi-asset investing offers the ability to invest across an entire universe of asset classes globally, including equities, fixed income, commodities and cash. This can provide a high degree of diversification and potentially a better risk-adjusted return than a single asset class option, such as investing in fixed income or equities in isolation. Additionally, a multi-asset approach offers real-time risk insight as well as the ability and flexibility to adjust portfolio positions for prevailing market conditions.

[Multi-Asset Solutions Research Papers](#)

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 **First Sentier**
Investors



RISK FACTORS

This is a financial promotion for the First Sentier Multi-Asset strategy. This information is for professional clients only in the UK and EEA and elsewhere where lawful. Investing involves certain risks including:

The value of investments and any income from them may go down as well as up and are not guaranteed. Investors may get back significantly less than the original amount invested.

Currency risk: the Fund invests in assets which are denominated in other currencies; changes in exchange rates will affect the value of the Fund and could create losses. Currency control decisions made by governments could affect the value of the Fund's investments and could cause the Fund to defer or suspend redemptions of its shares.

Emerging market risk: Emerging markets tend to be more sensitive to economic and political conditions than developed markets. Other factors include greater liquidity risk, restrictions on investment or transfer of assets, failed/delayed settlement and difficulties valuing securities.

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Credit risk: the issuers of bonds or similar investments that the Fund buys may get into financial difficulty and may not pay income or repay capital to the Fund when due.

Interest rate risk: bond prices have an inverse relationship with interest rates such that when interest rates rise, bonds may fall in value. Rising interest rates may cause the value of your investment to fall.

Charges to capital risk: The fees and expenses may be charged against the capital property. Deducting expenses from capital reduces the potential for capital growth.

For a full description of the terms of investment and the risks please see the Prospectus and Key Investor Information Document for each Fund.

If you are in any doubt as to the suitability of our funds for your investment needs, please seek investment advice.

Over the last one hundred years, there have been large dispersions between returns of various asset classes. In general, equities have returned more than bonds, but with much higher volatility.

What is a Multi-Asset Investment?

The four main asset classes are equities, fixed income (bonds), commodities, and cash. Each asset class provides different investment characteristics which respond differently in any given market environment. Multi-asset investing is the process of allocating asset classes into one portfolio to maximise the probability of meeting investment goals.

What Can History Teach Us?

Modern portfolio theory started when Markowitz (1952, 1959) came up with his famous mean-variance optimisation of a portfolio by breaking it down into two factors: expected return and risk. The assumption, furthered by Tobin (1958), Sharpe (1964), Lintner (1965), and Mossin (1966), was that investors will want to minimise risk for any given level of expected return, but also that it is the portfolio risk that matters, and not the risk of each security. This means that investors will want to be compensated with higher returns for taking additional risk, or will expect to receive a lower return if they are risk averse.

Over the last one hundred years, there have been large dispersions between returns of various asset classes. In general, equities have returned more than bonds, but with much higher volatility.

For most investors, it is the real (inflation-adjusted) return that matters, as we want our investments to keep up with inflation and provide a return on top of that. Starting in 1920, the annual real returns and annual volatilities for some large asset classes are shown below:

Asset Characteristics: 1920 - 2020

Asset	Real Return	Volatility
US Equities	7.5	19.5
World Equities	5.9	17.9
US IG Credit	3.4	6.2
US Bonds	2.5	8.2
Global Gov't Bonds	2.0	8.2
Gold	2.0	21.5
US Cash	0.8	3.0
Commodities	-1.0	17.6

Local currency returns, numbers in %. Volatility is nominal.
 All data annualised to establish comparability. US CPI is used to deflate nominal returns to real returns.
 Global Gov't Bonds data starts in 1923, World Equities data starts in 1925.
 Sources: GFD, Bloomberg, First Sentier Investors, as at 31 December 2020.
 Past performance is not indicative of future performance.

Since 1920, US Equities have returned 7.5% annually above the rate of inflation. This means that a \$100 investment, retaining the purchasing power in 1920, would have yielded \$143,110 over 101 years.¹ A corresponding investment in US Bonds, with only a return of 2.5% annually over inflation, would have returned only \$1,086.²

1. The investment in 1920 of \$100 would be worth \$1,973,667 at the end of 2020. Removing the impact of inflation over the period, it is the equivalent of \$143,210 in the purchasing power of 1920.

2. The investment in 1920 of \$100 would be worth \$16,341 at the end of 2020. Removing the impact of inflation over the period, it is the equivalent of \$1,186 in the purchasing power of 1920.

While long term returns are important, so is the volatility and potential loss incurred by an investment, within a shorter timeframe.

Looking at it like this, one can be forgiven for thinking, “why would I buy anything but equities?” Well, the answer is that investors have varying investment timeframes and goals. While long term returns are important, so is the volatility and potential loss incurred by an investment, within a shorter timeframe. If we drill into real returns per decade, and sort it by the best returning asset class at the top to the lowest at the bottom, it is clear that equities appear both at the top and the bottom, while fixed income is usually in the middle.

Yearly Real Returns (%)

1920s*	1930s	1940s	1950s	1960s	1970s	1980s	1990s	2000s	2010s	2020s [^]	
18.5	7.6	3.4	16.7	5.1	23.2	14.1	14.8	11.5	11.6	22.7	US Cash
15.9	7.6	0.5	16.6	4.4	2.9	11.8	8.8	6.3	8.1	16.8	US Bonds
7.1	6.3	-2.2	-0.2	1.5	-0.2	7.9	5.8	5.3	4.0	15.3	US Equities
7.0	6.0	-2.6	-0.4	0.2	-0.4	7.3	5.2	3.8	2.6	10.8	US IG Credit
6.6	2.7	-2.6	-0.6	0.1	-0.8	7.0	4.9	3.1	2.1	7.9	Commodities
4.9	2.5	-3.7	-1.6	-0.2	-0.9	3.8	2.0	0.2	1.6	7.7	World Equities
0.9	1.6	-4.6	-1.8	-2.2	-1.2	-6.8	-3.9	-2.2	-1.2	6.6	Global Gov't Bonds
-3.4	1.4	-7.9	-3.5	-2.4	-1.5	-7.6	-6.8	-3.4	-3.1	-0.8	Gold

Local currency returns, numbers in %.
 All data annualised to establish comparability. US CPI is used to deflate nominal returns to real returns.
 * Global Gov't Bonds data starts in 1923, World Equities data starts in 1925.
 ^ Contains 1 year (2020).
 Sources: GFD, Bloomberg, First Sentier Investors, as at 31 December 2020.
 Past performance is not indicative of future performance.

The boxes under the bold white line are where an asset class experienced negative real returns – one can see the importance of not relying on a single return driver. For example, while US Equities had real returns of 16.7% a year in the 1950s, the 1970s were marked by high inflation, eroding the value of investments in real terms and US Equities had annualised real returns of -1.5%.

World Equities presented throughout this article includes all countries, including the US. As an example, US represents approximately 56% of total market capitalisation of the MSCI All Countries World Index.³

Each investor has differing timeframes as they move through varying stages of life, though. If we zoom in on returns since 2006, an equally volatile picture emerges, but with different asset classes on top.

Asset Characteristics: 2006 - 2020

Asset	Real Return	Volatility
US Equities	7.8	16.5
Gold	7.7	15.8
World Equities	5.9	17.7
EM Equities	5.0	30.0
US IG Credit	4.2	5.9
US Bonds	2.6	7.9
Global Gov't Bonds	2.0	4.9
Commodities	0.0	16.1
US Cash	-0.7	1.6

Local currency returns, numbers in %. Volatility is nominal.
 All data annualised to establish comparability. US CPI is used to deflate nominal returns to real returns.
 Sources: GFD, Bloomberg, First Sentier Investors, as at 31 December 2020.
 Past performance is not indicative of future performance.

3. An index designed to track performance of large- and mid-cap global stocks across developed and emerging markets. Source: Bloomberg, as at 31 December 2020.

Twelve years on since the financial crisis of 2008 and the ensuing Great Recession, economies have largely recovered. Equities is still for the most part the better performer than bonds in multiple years, but it does reinforce the importance of owning multiple asset classes. Here are the ranked returns of the same asset classes as before, but on an annual basis.

It is clear that no single asset class consistently outperforms year after year and that return dispersions are large; thus diversification is the key to narrowing the return distribution on a portfolio level.

Yearly Real Returns (%)

2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
29.2	34.2	20.1	74.2	28.0	13.5	16.6	30.4	12.8	0.6	17.1	34.9	-0.1	28.5	22.7
20.0	25.8	13.3	29.9	27.6	11.0	14.5	25.5	10.8	0.5	9.7	22.0	-1.0	24.5	17.2
17.7	15.8	5.3	27.3	17.5	7.0	14.0	-1.4	10.0	0.5	9.5	19.3	-3.1	16.2	16.8
12.9	6.5	1.2	23.1	13.4	4.9	5.2	-3.7	4.7	-0.2	8.6	11.2	-3.5	16.2	15.3
10.7	6.2	-7.6	21.5	10.7	-0.8	2.7	-4.2	2.9	-0.7	5.1	5.8	-3.9	12.2	10.8
3.3	5.3	-23.8	5.0	7.1	-2.8	2.1	-4.5	-0.7	-1.4	0.7	5.2	-6.2	5.2	7.9
2.4	1.4	-37.1	-2.5	5.8	-7.7	1.0	-9.8	-2.5	-11.0	-0.6	0.2	-8.8	4.5	7.7
1.6	0.6	-40.4	-2.6	4.6	-13.1	-1.6	-9.9	-2.7	-15.2	-1.7	-1.3	-10.6	4.5	6.6
-0.3	0.4	-53.2	-12.1	-1.3	-20.5	-3.2	-29.1	-12.6	-15.8	-1.8	-2.1	-15.9	-0.1	-0.8

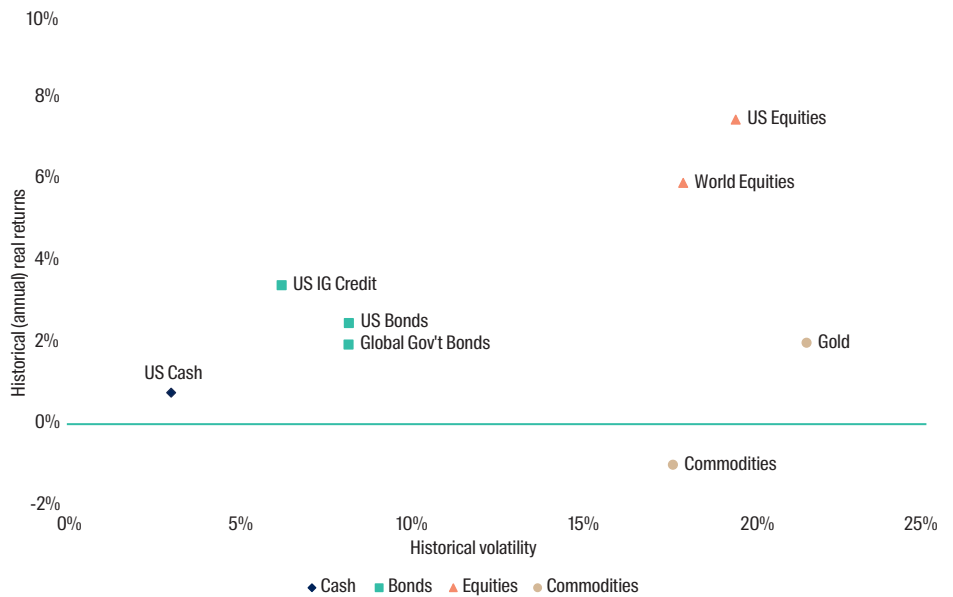
US Cash	US Bonds	US Equities	US IG Credit	Commodities	World Equities	Global Gov't Bonds	EM Equities	Gold
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Local currency returns, numbers in %.
 All data annualised to establish comparability. US CPI is used to deflate nominal returns to real returns.
 Sources: GFD, Bloomberg, First Sentier Investors, as at 31 December 2020.
 Past performance is not indicative of future performance.

US Equities are highlighted here – there are many good years, but the volatility of returns is high. It is clear that no single asset class consistently outperforms year after year and that return dispersions are large; thus diversification is the key to narrowing the return distribution on a portfolio level.

Looking at historical long-term risk-return characteristics of various asset classes, they do fit loosely where we would expect according to theory – the higher the volatility, the higher the historical return (except Commodities).⁴

Historical Risk-Return Characteristics: 1920 - 2020



Real returns (i.e. adjusted for inflation) on the y-axis, historical volatility on the x-axis (i.e. not adjusted).
 All data annualised to establish comparability. US CPI is used to deflate nominal returns to real returns.
 Sources: GFD, Bloomberg, First Sentier Investors, as at 31 December 2020.
 Past performance is not indicative of future performance.

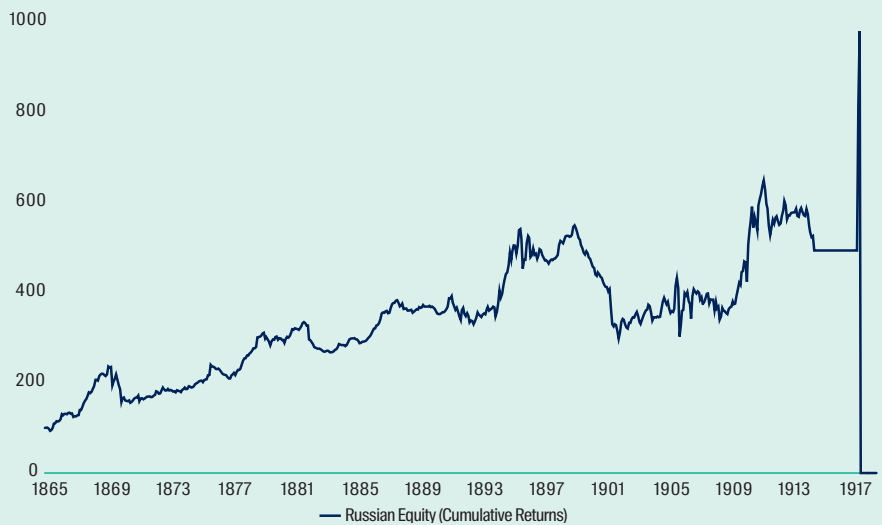
4. We have shown real returns here, but the picture is the same with nominal returns.

Survivorship Bias is Dangerous: Russia, 1917

Most financial analyses have taken the US as a starting point, because that is where the great majority of capital and universities are situated. The question becomes: is the US representative of the investible landscape today, and will it continue to be going forward? Probably not. US asset markets have been the best performer – both in nominal, real, and risk-adjusted returns – over the last hundred years. Using them as a base case means a heavy concentration of survivorship bias in an investor’s portfolio.

To make our point, we turn back in time. The following chart shows equity market returns in Russia from 1865 to 1917. Their stock market had had a good run for fifty years until it was closed in 1914 as World War I started. The Bolsheviks took power after the abdication of Emperor Nicholas II and re-opened the stock market, which experienced a brief rally before dropping to zero as every equity holder was expropriated. If you had your money in Russian equities in 1917, you would have lost everything.⁵ Complete disaster is not usually part of the distributions – but they should be. Making sure that an investor’s portfolio is truly diversified – and not just assuming that the past will represent the future – is paramount, as there is the risk that the equity markets that have done well are just the last man standing.

Equity Returns in the 52 Years Before the Russian Revolution



Local currency returns.
Sources: GFD, First Sentier Investors, as at 31 December 2020.
Past performance is not indicative of future performance.

5. The same was the case in Shanghai in 1949 after the communist takeover; all stocks were expropriated and became worthless.

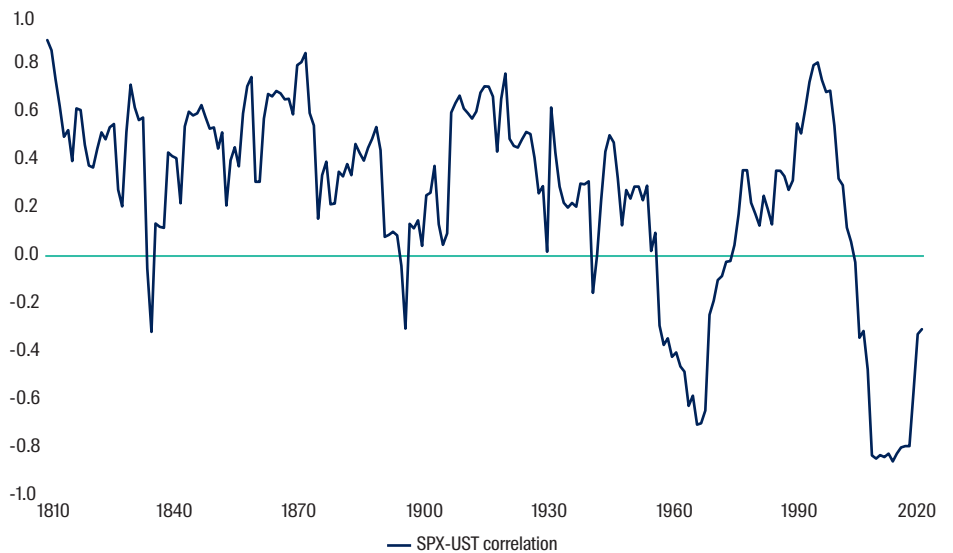
Correlations are dynamic and change over time.

If correlations change, a static portfolio is vulnerable.

Assumptions and Correlations Matter

To build portfolios in the Markowitz sense, many assumptions are needed. The most important ones are for expected returns, volatilities, and the covariance between assets – whether they will hold, or how they will be different.⁶ Markowitz (1952, 1959) asset allocation theory assumes returns, volatilities and correlations are stable, but this is not how the real-world works. Correlations are dynamic and change over time. This is illustrated in the chart below which depicts the correlation between equities and bonds. It has ranged from -0.86 to 0.90 on a rolling 10-year rolling basis for the US. Throughout most of history, US Bonds and US Equities were positively correlated, meaning that they moved up or down together. The last 20 years, in that regard, is an anomaly, as bonds and equities have been negatively correlated (when equities go down, bonds go up). This made it somewhat easier to be diversified, as a 60% equity and 40% bond portfolio performed well on a risk-adjusted basis. If correlations change, a static portfolio is vulnerable.

10-year Rolling Correlation, Yearly Returns



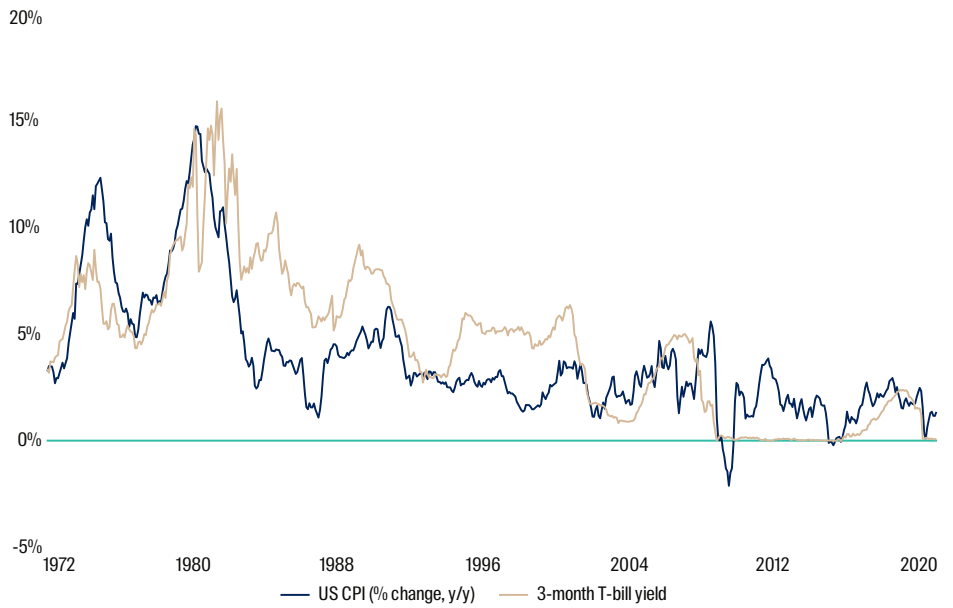
Sources: GFD, Bloomberg, First Sentier Investors, as at 31 December 2020. Past performance is not indicative of future performance.

6. For a look at how we deal with these issues, see First Sentier Investors (2013), Strategic Asset Allocation.

Most theory is, in fact, time sensitive - it often works during a specific time period, which creates the need to be dynamic as the economic climate changes.

Most theory is, in fact, time sensitive – it often works during a specific time period, which creates the need to be dynamic as the economic climate changes. To deliver a return over inflation, it is important to know what assets protect against rising inflation. Fama and Schwert (1977) broke inflation down into expected and unexpected inflation. They found that expected inflation can be hedged by buying T-bills and bonds, while unexpected inflation is harder to protect against with liquid assets (inflation-linked bonds are now available, but they have their specific risks⁷). Fama and Schwert looked at 1953-71 for the US. Extending on that, while it seems like there may be a historical relationship between the year-on-year change in the US Consumer Price Index (CPI) and the yield on US Treasury bills since the 1970s, it is faint and a robust conclusion cannot be drawn upon. Relying on the fact that ‘it has been thusly for fifty years’ is a dangerous thing, as we saw with US housing prices in the 2000s. Fama and Schwert’s results held only for a particular time and country, which is not uncommon; investors need to be flexible in their asset allocation as a consequence.

US Inflation and Cash Return



Sources: Datastream, First Sentier Investors, as at 31 December 2020. Past performance is not indicative of future performance.

7. Specific inflation-linked bonds risks may include the performance profile in a period of deflation or interest rate rises, potential trading complexities, liquidity as well as taxation treatment.

When investing, it is important to consider the long-term fundamentals. Short-term optimism surrounding potential growth can last many years before ultimately dissipating and reversing.

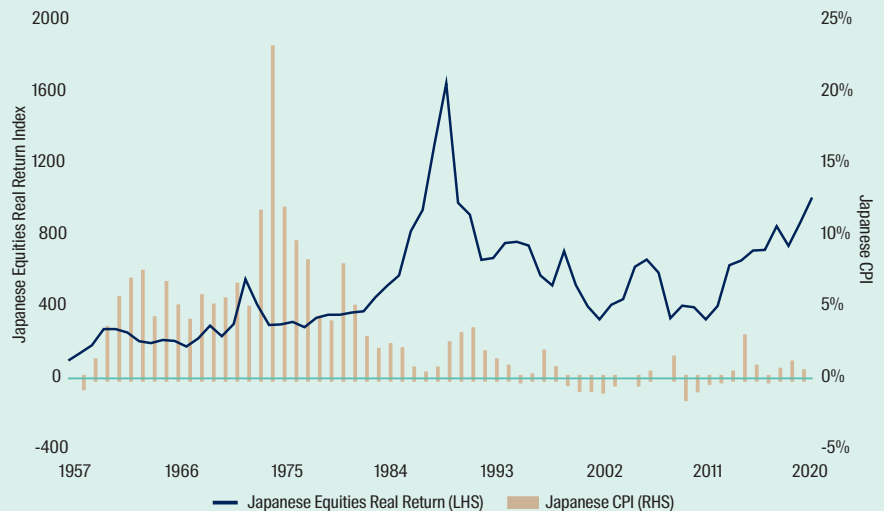
Three Lost Decades: Japan, 1992

Japan experienced a period of boom in the early 1980s which saw asset prices appreciate greatly, both in nominal and real terms. In the second half of the 1980s, asset prices doubled and even tripled in a matter of a few years, prompted by easy credit, rampant speculation and a lax monetary authority. But from the late 1980s, prices started stagnating and eventually collapsed. This asset bubble burst set in a period of economic stagnation and price deflation, leading to the 1990s being referred to as the 'Lost Decade' in Japan. One could argue that Japan has lost three decades so far. The Japanese economy began to recover a few times though none were a meaningful reprieve.

The asset price bubble had devastating effects on the Japanese economy. To date, the Japanese economy still feels the effects of the bubble era, with stocks nowhere near the highs of 1989. The Japanese Nikkei Index subsequently loss 40% within one year, 60% in three, and 80% within 13 years. Not only has there been practically no inflation since early 1990s, but investing in Japanese equities post the 1980s peak would have delivered negative real returns for multiple decades.

When investing, it is important to consider the long-term fundamentals. Short-term optimism surrounding potential growth can last many years before ultimately dissipating and reversing. Japan is an example where equities can stretch for long periods without providing investors with an increase in real capital – exemplifying the need for diversification across and within assets classes to achieve an investment objective.

Japanese Inflation and Equity Market Real Price Returns



Local currency real price returns normalised to 100 at the end of 1957 and excluding any dividend reinvestments. Sources: Bloomberg, Datastream, First Sentier Investors, as at 31 December 2020. Past performance is not indicative of future performance.

How to Build Portfolios?

Finally, how do we estimate expected returns? Fixed income instruments have yield-to-maturities, but for equities it becomes more complicated. A large part of financial theory (and financial products developed) is built on the fact that equities and bonds are good offsets; or in Markowitz' terms that the covariance between the two is low (or negative, during periods of turmoil). The last 40 years have seen an amazing bond rally as yields have come down, but what if that changes? Forward looking estimates need to take this into account, for both returns and correlations.

For volatility, the longer the history, the better – historical data needs to have been through all kinds of economic scenarios. Investors who did not have the Great Depression in their dataset have, for example, been at an enormous disadvantage for the last 15 years. The biggest risk for investors is that they do not meet their investment objective, but it is also important to have a risk management framework that takes all of the above factors into account to build a truly flexible, dynamic and well-diversified portfolios – without hidden risks.⁸

First Sentier Investors Multi-Asset Solutions

Our multi-asset investing approach is designed to provide risk/return benefits that are not typically achievable by investing in a single asset class. We build multi-asset portfolios with a risk/return profile to meet individual investment needs such as a real return (return above inflation), with a focus on preserving capital, and generating growth over the long-term.

Our investment solutions range across the continuum of styles demanded by our clients, from more traditional asset allocation, through the investment spectrum to benchmark-unconstrained, absolute-return strategies.

The First Sentier Investors Multi-Asset Solutions team has the capability to provide sophisticated, customised and practicable asset allocation solutions that take into account underlying client liabilities, investment goals, risk perception and tolerance.

Our objective-based multi-asset strategies, which seek to overcome the limitations inherent in a traditional balanced approach, are defined by the following characteristics:

- **Flexible and dynamic:** A flexible investment process, which can dynamically allocate to market beta and alpha opportunities. Our process has the flexibility to scale-up the risk allocation to alpha positions if market returns are not providing sufficient risk/return opportunities, or scale down the alpha positions if risk is deemed excessive.⁹

We strive to understand and narrow the distribution of investment outcomes. We seek to balance the trade-off between upside potential (meeting our investment objectives) and downside risk (what can stop us from meeting these objectives), which we believe can generate consistent results.

- **Discretionary portfolio construction, not 'fund wrapping':** We invest in the most efficient investment instruments, physical or derivative, based on the desired risk/return exposures. This can include First Sentier Investors' portfolios where appropriate.

- **Qualitative investment ideas, quantitatively verified, and qualitatively implemented:** Our investment process utilises our qualitative insights and investment ideas, and verifies them through quantitative techniques. Given the breadth and scope of the investable universe, there is a need for quantitative rigour, which plays an important role in counteracting cognitive biases and ensuring that the process can be repeated over time.

8. Including, but not limited to, regime shifts, stress testing, Value-at-Risk (VaR) and volatility, economic factor analysis, and shifts in correlations, market betas, and Fama-French factors.

9. In First Sentier Investors (2014) we show how our Dynamic Asset Allocation process works.

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