



# Strategic asset allocation

Preparing your portfolio for uncertainty

“  
Doubt is not a pleasant condition, but certainty is absurd.

– Voltaire  
”

## Being strategic is being prepared

When it comes to investing, the first and often most important step is making the trade-off between risk and return. What mix of asset classes best suit your needs, be they stocks, bonds, cash or hedge funds?

In this paper, we explain why we use strategic asset allocation to address uncertainty and risk. We summarise the work we do in preparing allocations and the importance of choosing the best fit for your needs.

## More things can happen than will happen

When contemplating all the external factors that can affect your investments, from the global economy, markets to policy, one simplifying truth is available: more things can happen than will happen. This is the nature of our reality.

No matter how you invest, future events will affect your wealth. Defining the nature of that exposure is the task of asset allocation.

So, if more things can happen than will happen, how do we approach the task of investing? One can invest time and resources in trying to better predict what will happen and invest to profit from that thesis. However, what happens if you're wrong? The strategic approach invests time and resources in trying to be prepared for a large number of eventualities.

## What happens if we're wrong?

Strategic asset allocation is inherently conservative. Here we seek to best position a portfolio for multiple possibilities. We answer the 'what happens if we're wrong?' question thousands of times with different scenarios. The result is we pick the best portfolio for the requirements under a wide variety of future circumstances.

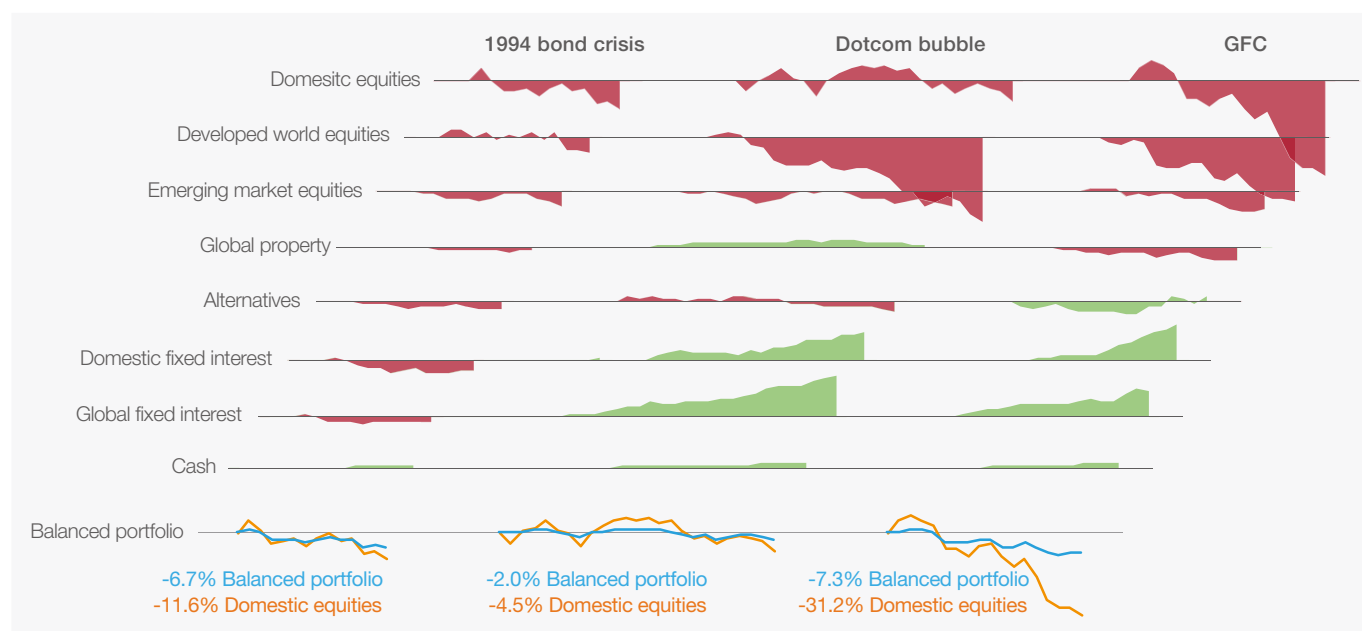
## What's the best position to take given uncertainty?

Our investment philosophy is to 'enable better investment decisions'. We do this by conducting evidence-based analysis, presenting the results succinctly and clearly, in order for you to work with your adviser to make the right decision for your needs. Strategic asset allocation is a perfect example; we do extensive analysis behind the scenes (see the next page) to produce a range of risk profiles from which you can work with your adviser to select the most appropriate for your needs.

The strategic portfolio is unlikely to be the best performer in any one period. It is designed to preserve wealth in crises and participate in good times and in so doing, provide long-term capital growth at an acceptable level of volatility

An analysis of three historic stress scenarios illustrates the power of being prepared, strategic and diversified. A balanced portfolio made up of a diversified mix of major asset classes is observed through the 1994 Bond crisis, the Dotcom bubble and the Global Financial Crisis (GFC). In each instance, the balanced portfolio weathered the period better than a domestic equity portfolio. It preserved more wealth and did so in a less volatile manner.

Figure 1 – Stress testing†



*Note: Simulated past performance is likely to be impacted by selection and survivorship bias. Potentially overstating the expected returns and understating the expected volatility of returns.*

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# What it takes to be prepared

## Passive decision support

We conduct extensive analysis to present you with a choice of portfolios.

We do the homework of preparing the best mix of investments across the risk spectrum. We have a variety of risk profiles, each with distinct risk and return expectations. Each designed to be the best mix of assets for a variety of market conditions. Here's some of what we do:

### Establish expectations

We define our expectations for long-term returns and volatility for each asset class, using long-term historic datasets and forecast insights. We combine these using a conservative statistical process. We respect the varying certainty in forecasts and the limited usefulness of past performance.

Figure 2 – Asset class expectations\*

Asset class	10 year range	Correlation
Australian Equities		
International Equities		
Global Bonds		
Domestic Bonds		
Global Property		
Growth Alternatives		

### Analyse the investment mix

We analyse the investment mix to determine the mix of assets best suited to deliver under thousands of scenarios that can happen. We do this using the below.

- **Constraints** – we make very limited use of constraints (setting minimum or maximum exposures to asset classes). When used extensively they tend to define the answer rather than allow the analysis to yield insight.
- **Resampling** – Asking ‘what if we’re wrong in our expectations?’ we re-run the analysis for thousands of subtle and extreme variations. For each scenario, we calculate the best suite of portfolios for each level of risk.

From this analysis, we distill a range of portfolios best suited to perform under the thousands of scenarios that can happen. So you are well placed for the one that will happen, whatever that may be.

Figure 3\*

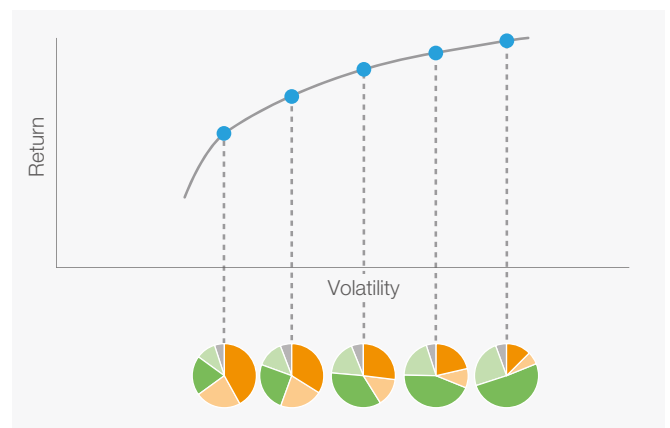


### Strategic allocation

Select strategic asset allocation aligned to the risk profiles, by:

- aligning investment objectives, recommended investment timeframe, the likelihood and extent of losses, to our risk profiles.
- stress testing – we strike a balance between timeframe, objective and risk by observing portfolio performance under thousands of stress-test scenarios.

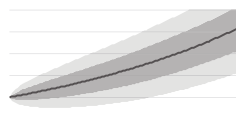
Figure 4^



### Review and maintain

Designed to be long-term, we expect allocation changes to occur gradually and infrequently. We review estimates annually, with significant changes only expected if there is a structural change in the market. Here we balance the cost of making a change (taxes, trading expenses) against our level of confidence in a better investment mix being available.

## Definitions



This variation of the sparkline sets out to convey the estimated return as well as its dispersion, or uncertainty, around that expectation.



This symbolises the degree to which return properties of two assets are alike. We use this as an intuitive visualisation of correlation. Complete overlap indicates that two assets move in lock-step. Separation indicates movement is unrelated. While distant separation indicates that two assets move in the opposite direction.

† Source: MWM Research, Morningstar, December 2019.

‡ Illustrative only. Source: MWM Research.

\* Illustrative only. Source: MWM Research.

^ Illustrative only. Source: MWM Research.

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