Multi Asset Investing

Investing all your money in one type of asset might maximise your potential return over the long term. But it also maximises your risk. Take the stock market. Although equities have generally produced the best returns of any asset class over the long term, their performance has been uneven. Only a few years ago, for example, equities were suffering one of the worst bouts of falling prices – or so-called bear markets – in recent memory.

So no asset class comes with guarantees. And, of course, to achieve higher returns you need to take more risk. So there's a clear dilemma – where should you invest your money to maximise reward but minimise risk? Investing in equities alone, for example, might have the potential to reap high rewards but it's a high-risk strategy. For one thing, it means predicting a whole range of factors: company performance, merger and acquisition activity, the political backdrop, national and global economics and market sentiment. The list goes on. Forecasting the future is a risky business for the average investor.

Of course, at its simplest, reducing risk boils down to the age-old adage - don't put all your eggs in one basket. For investors, that means diversification, or spreading investments across a range of assets. That's the key to multi-asset investing.

Multi-asset funds have been available to retail investors since around 2002. As the name suggests, they invest in a variety of asset classes including equities, bonds, property, structured products and alternative assets such as hedge funds. That means that any underperformance from one asset class should be balanced by outperformance from another. In this guide, we have selected what we believe are the best multi-asset funds currently available.

Reducing investment risk is a clear advantage of multi-asset investing. But this diversified approach also reduces the volatility of investment returns. The chart below shows just how variable the returns from the main asset classes have been in recent years. Investing in several asset classes helps to 'smooth' returns, as the top-performing asset class today will not necessarily be the top performer tomorrow.

So the secret of successful investing is to have a well-diversified portfolio, investing in numerous asset classes, based on your own attitude to risk. In other words, to adopt a multi-asset approach.

<u>Historic Performance of Asset Classes</u>

1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Property	UK Equity	Resources	UK Bond	Resources	Global Equity	Resources	Resources	Property	Global Equity
Global Bond	Global Equity	Hedge Funds	Property	Global Bond	UK Equity	Property	UK Equity	UK Equity	Resources
UK Bond	Resources	Property	Global Bond	Property	Global Bond	Global Equity	Global Equity	Global Equity	Hedge Funds
Cash	Property	UK Equity	Cash	UK Bond	Hedge Funds	UK Equity	Property	Hedge Funds	UK Equity
Hedge Funds	Cash	Global Equity	Hedge Funds	Cash	Resources	Hedge Funds	Hedge Funds	Cash	Property
UK Equity	Hedge Funds	UK Bond	Resources	Hedge Funds	Property	Global Bond	UK Bond	UK Bond	Global Bond
Global Equity	UK Bond	Cash	UK Equity	Global Equity	UK Bond	Cash	Cash	Global Bond	Cash
Resources	Global Bond	Global Bond	Global Equity	UK Equity	Cash	UK Bond	Global Bond	Resources	UK Bond

Source: Lipper/Hindsight, 1 year annual performance to 1 October, total return. Indices used: UK Equity (FTSE All Share); Global Equity (MSCI All World ex UK); UK Bond (JPM UK GBI 5-7 Year); Global Bond (JPM Global GBI); Property (IPD UK Property Monthly); Hedge Funds (Credit Suisse/Tremont Hedge); Cash (LIBOR GBP 3 Month);

What is multi-asset investing?

Put simply, investment funds that take a multi-asset approach invest in a range of asset classes. Traditional investment funds typically invest in only one asset class such as equities, bonds, cash or property. And they usually invest only in a specific sector within that asset class, for example UK or overseas equities, or corporate bonds. Some funds – distribution funds for example – invest in two or three types of assets. We don't class these as true multi-asset funds though, because they only invest in a limited number of asset classes.

Before 2002, multi-asset investing was mainly the domain of large pension and institutional funds and a few very wealthy individuals. But around that time, well into the equity bear market, a number of industry experts and investors began to notice that the new-style funds investing in a range of assets – not just equities – were significantly outperforming the negative returns of equity-only funds.

This illustrates an important characteristic of multi-asset funds. As well as providing investors with potential capital growth and / or income, they seek to 'limit the downside', in other words, to limit the risk of losing part, or all, of the original capital outlay. Particularly in times of increasing market uncertainty, that gives them a distinct advantage over more traditional types of funds.

Choosing the right mix of assets in the right proportions – or asset allocation - is the key task of a multi-asset manager. In basic terms, that means creating a portfolio that balances investment risk by diversifying across the full range of asset classes. Each asset class has different levels of risk and return and so behaves differently in various market conditions. Significantly, it is the asset allocation within a fund – not the choice of underlying securities within an asset class – that has the largest impact on returns.

Broadly speaking, asset allocation can be broken down into two areas: strategy and tactics.

Strategic Asset Allocation

Strategic asset allocation is just that - the long-term strategy the fund manager follows based on an analysis of the long-term returns of the various asset classes. The manager blends a range of asset classes to create a portfolio that fits the risk profile of their fund.

Tactical Asset Allocation

Tactical asset allocation enables a fund manager to make short-term, tactical deviations from their long-term strategic allocation in order to enhance potential returns. Managers use these short-term tactics to take advantage of changes in market conditions and economic events, while still adhering to the long-term strategy of their fund.

Once short-term tactical positioning has achieved its aims, the strategy reverts to the strategic asset allocation until the manager sees another tactical opportunity. The balance between strategic and tactical asset allocation often depends on the risk profile of the fund. Some managers will have considerable flexibility in varying from their strategic allocation, while others may only allow themselves a few percentage point movement either side.

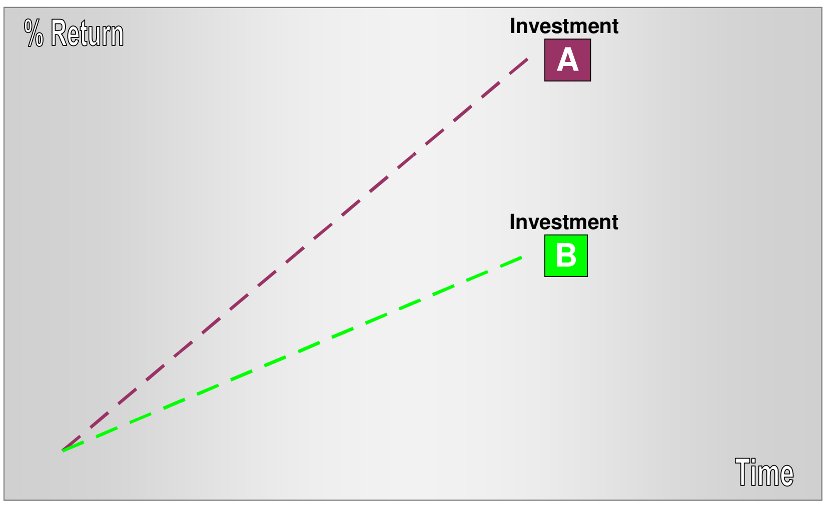
The asset-allocation decisions of multi-asset-fund managers should produce consistent medium to long-term returns, while protecting against potentially declining markets, and reducing volatility.

Limiting volatility

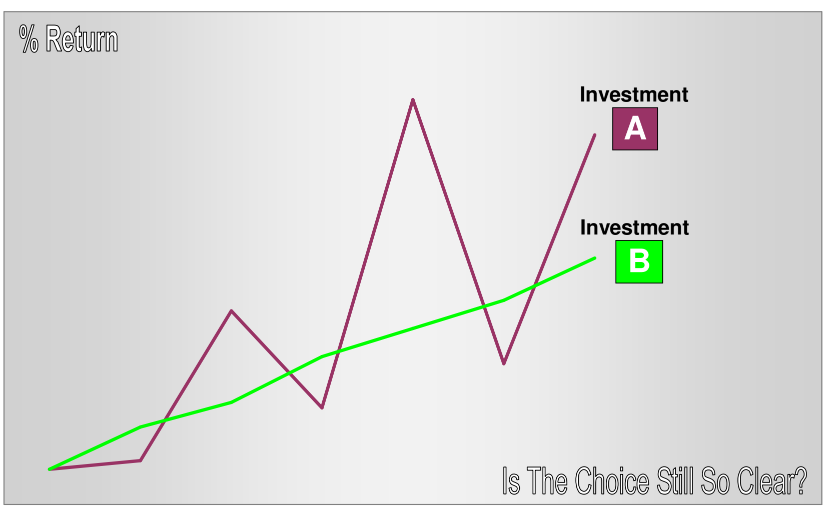
Limiting volatility is fundamental to multi-asset investing.

Let's look at equities again. Although they have historically provided excellent returns over the long term, equity investors have had to weather the characteristic volatility of the stock market. Standard deviation is often used to measure volatility. In simple terms this measures the risk of an investment over a certain period.

As an investor, you need to consider whether the ultimate potential return is the key factor in your investment decision. If you view return as paramount, a portfolio like A in the example below might prove appropriate.



However, if you were able to see how the gains in Investment A were achieved – in other words, the volatility of returns over time – you might prefer Investment B.



This, albeit straightforward, example illustrates the importance of considering the risk/reward trade-off when investing – one of the core principles of multi-asset investing.

What types of assets are used?

We generally categorise asset classes into four distinct groups: equities, corporate bonds, property and cash. Of course, the multi-asset fund manager will utilise all of these asset classes at some point. In addition, however, the manager can also access a range of other asset classes and financial instruments to improve fund diversification and produce steady but competitive growth over the long term.

The main assets used by multi-assets funds are listed below, although not every fund uses all of the assets and financial instruments in this list.

Cash:

- Cash includes bank and building society accounts, certificates of deposit, treasury bills and money market funds.
- Cash-based investments have low risk and volatility.
- However, over the long term, the real capital value of cash can be eroded by inflation.

Equities:

- Over the long-term, equities have generally produced the higher returns when compared to other asset classes.
- Equity investments can have two main benefits – capital appreciation and dividend payments.
- Equity prices fluctuate because of a range of factors, including company performance, merger and acquisition activity, the political backdrop, national and international economics and market sentiment.

Fixed-interest securities (Bonds):

- Bonds are effectively loans to a government or company in return for interest and repayment of the capital at a future date.
- Government bonds are traditionally considered the safest type of bond because the government guarantees the investment. UK government bonds are more commonly known as gilts.
- Government bonds historically produce lower returns than corporate bonds, but are lower risk.
- A bond's capital value is determined by demand, which is driven by the level of interest paid by the bond compared with prevailing interest rates and by the credit-worthiness of the issuer.

Property:

- This category includes investment in commercial and residential (real estate) property, either directly (bricks and mortar) or through shares or units in investment funds.
- Property offers rental income and the potential for capital growth.
- Historically, capital returns from property are higher than those from bonds, but carry a higher level of volatility and risk. Rental income is generally slightly lower than the income yield paid on corporate bonds.
- This asset class (particularly commercial property) tends to be negatively correlated with equities and bonds. This means that property can still increase in value when equity and bond markets are falling (and vice versa)

Structured Products:

- These are synthetic instruments designed to reduce the risk associated with, but still benefit from the performance of, a particular asset class. Such instruments are usually linked to an index representing a composite of that asset type, for example the FTSE 100 Index for equities or even an index of commodity or property prices.
- Structured products generally consist of two components - an element of capital protection and/or an ‘at-risk’ element, which offers the performance potential.
- The capital repayment at maturity may be less than the original investment depending on market performance.
- A minimum-return structured product normally guarantees repayment of the investor’s capital but any growth depends on the performance of the underlying stock market(s) or index to which the product is aligned to.
- Providers of structured products enter into agreements with other financial institutions to provide security against the negative return of the chosen index; if they cannot meet their obligations, investors may lose all or part of their investment.

Hedge Funds:

- Like structured products, hedge funds are not strictly an asset class but a type of investment product that can include many asset classes.
- In general, hedge-fund managers seek out situations where investments appear to be wrongly priced in order to make returns i.e. they believe a stock is either too cheap, or too expensive. They aim to produce positive returns in all types of market environments.
- Controlling risk is a key attraction of investing in hedge funds.
- Hedge funds can ‘go long’, for example buying an asset in the expectation that its price will rise over the long term. However, unlike unit trust and OEIC funds, they can also ‘sell short’. For example, a hedge fund might sell shares that it does not yet own in the knowledge that, if the price falls, those shares can be purchased at a later date in order to make a return.

Glossary of Terms

Absolute return funds
These funds seek to preserve investors’ capital and to achieve consistently positive returns. They are generally measured against cash, so are therefore deemed to have an 'absolute' performance benchmark.

Alternative assets

Alternative assets are investments outside of the traditional three asset classes of bonds, equities and cash. Hedge funds are one of the more common examples. However, they can also include investments such as derivates or commodities.

Collective investment schemes

These are funds that pool investors’ money and invest on their behalf, either in investment trusts or unit trusts.

Correlation

In investment terms, correlation refers to the extent to which the prices of asset classes or securities move in the same direction. Assets with prices that usually move in opposite directions are 'negatively correlated'.

Distribution funds

In distribution funds, a large portion of the portfolio is usually invested in fixed-interest securities like gilts and corporate bonds to provide a stable income from the investment. The other main component of the portfolio is often income-bearing equities, which provide the potential for capital growth as well as additional income.

Fixed-income securities

These include government, supranational and corporate bonds, other income-producing debt securities and bank certificates of deposit due in more than one year. They generally constitute a promise by the borrower (the issuer of the security or a bank) to pay the investor a specified amount of interest and to return the principal on a specified date.

IMA fund categories

The Investment Managers' Association categorises funds into over thirty sectors to help investors compare funds with similar characteristics. The sector categories are broadly divided into funds that aim to provide an 'income' and those designed to provide 'growth'.

Investment trust

This is a limited company with a fixed share capital whose shares are listed on a stock exchange and whose capital is invested in stocks and shares.

LIBOR

The London Inter Bank Offered Rate is the rate of interest at which banks lend money to each other - in effect, the 'wholesale' price of cash rather than the 'retail price' (the rate at which banks charge consumers to borrow money).

Money-market instruments

These are short-term debt instruments with high liquidity, and include Treasury bills, commercial paper and certificates of deposit.

OEICs

Open-Ended Investment Companies are a type of collective investment that combines elements of both unit trusts and investment trusts. An OEIC works in a similar way to a unit trust, except an OEIC is legally constituted as a limited company, so that investors buy shares, rather than units.

Short selling

Short selling is the selling of a security that the seller does not own. Short sellers expect the price of the security to fall, enabling them to 'buy it back' at a lower price than the price at which they sold short, thereby making a profit.

Standard deviation

Standard deviation measures how much a set of data varies from its average. It is a common way of measuring and comparing the volatility (hence risk) of investment funds since it illustrates how much a fund's return deviates from its expected normal returns. The higher a fund's standard deviation, the higher its volatility.

Unit trust

A unit trust is an open-ended collective investment trust vehicle, where investors' monies are pooled into a single fund managed by investment professionals.

UCITs

These are collective investment funds that can be sold across EU borders in accordance with EU legislation on 'Undertakings for Collective Investment in Tradable Securities'.

Warrants

Warrants give the holder the right, but not the obligation, to buy shares at a pre-determined price within a set period. Buying the shares is called 'exercising' the warrant. A warrant is normally issued with a bond, but the owner may trade the bond and the warrant separately.

Appendix: Important Information

Past performance is not a guide to future returns and may not be repeated.

This guide was prepared by Chartwell Group Limited using sources believed to be reliable and accurate. The information in this guide is correct at the time of writing and we cannot and will not be held liable for any changes or differences to the published information within this guide that subsequently cannot be changed. This guide represents our opinions, which reflect our judgment at the time of writing.

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This publication contains product-specific details only and unless we have complete up-to-date written details of your financial circumstances and requirements we cannot and will not offer any opinion as to the suitability of any investment for any client. Any response to this publication will therefore be on the basis that client-specific advice has not been given. These investments are not suitable for everyone. If you have any doubt about whether they are suitable, you should obtain expert advice.

Ensure you obtain and read the literature

Before you consider purchasing any of the products mentioned, it is essential that you obtain, read, and fully understand the Terms of Business and Key Features/Simplified Prospectus relating to the specific products(s) in which you are interested, as each have different risk levels and some are more volatile then others dependent on where and how they are invested. They also set out the risks, charges, cancellation rights and terms of the investment. Do not invest unless you have read this information.

Important notes

It is important to always bear in mind that any stock market and equity-linked investment carries risk. Investments in these, as well as other forms of investment are subject to market and economic forces and can go down in value as well as up. Investment in the stock market, whether directly or indirectly, should not be considered as suitable for short-term investment.

Overseas investments

You should also bear in mind that exchange-rate fluctuations may cause the value of overseas investments to fall as well as rise.

Taxation

Levels and bases of, and reliefs from, taxation are subject to change. Please read the product prospectus carefully to ensure you understand how the investment product is taxed and how this may affect your personal tax position.

Property funds

Some funds invest in property and land. This can be difficult to sell – so you may not be able to sell/cash in this investment when you want. The value of property is generally a matter of valuer's opinion rather than fact.

Fixed Interest Securities / Corporate Bonds

Where a fund has holdings in fixed-interest securities, these are likely to be impacted by changes in interest rates and/or inflationary expectations. Where the main objective of the fund is to provide an *income, the level of income is not guaranteed and can fluctuate up or down. Non-investment-grade bonds are contained in some funds. These bonds bring an increased risk of default on repayment, which translates into a risk that the capital value of the fund will be affected.*

Fluctuating Income

Where an investment is described as likely to yield income, or as being suitable for an investor who wants an income from his/her investments, you should bear in mind that income from investments may fluctuate and part of the capital may be used to pay that income. Investments in the stock market, either directly or indirectly are not short-term investments and should only be made with money with which you can afford to take a risk, as there is risk with all stock-market-linked investments.