The Inside Network

Asset Allocation & Portfolio Construction *Symposium*

Summary report

9-11 October 2022
Noosa Heads QLD

Creating accountable credible portfolios.

Asset Allocation & Portfolio Construction Symposium 2022

It has become clear that investment returns will be challenging in the coming decade. The focus on intra-sector questions like value versus growth, energy or financials and duration versus credit obscures the larger decision on asset allocation and portfolio construction. Strategic asset allocation has long been appreciated as the major source of long-term returns, yet the growing dispersion of outcomes highlights the nuances and challenges of constructing portfolios that are suited to varying conditions.

Often taken as a guide to returns, asset allocation is much more about managing the level of risk for the underlying clients. The challenge is broader than standard volatility measures with the rise in illiquid allocations and private markets that don't lend themselves to such metrics muddying the waters. There are other structural risks that are likely to define the coming decade, ESG is an opportunity, but also a challenge, product proliferation such as SMAs, EFTs or ETMFs offers diverse options but potentially sit awkwardly with performance relative to the index. Further, the relevance of fixed income continues to be challenged, as does the definition of a defensive asset. 2022 has brought geopolitical tensions, regulation and technological developments to the forefront, which will also have to be navigated offering a new set of risks and returns.

The forum has consider if long entrenched methods and views remain valid, by discussing the most pressing opportunities and considerations for portfolio construction. Distinct building blocks towards a defensive component, a long-term growth allocation and opportunistic themes are framed by unique investment experts setting the challenge to convincing allocators of their approach to building individual portfolios.

In a first-of-its-kind event for the financial advice industry, the discussion was led by those at the coal face of the advice industry. Investment decision makers spanning private wealth, family office, and the IFA sector joined with asset consultants and institutional advisers to collaborate and seek real outcomes for clients.

ADVISORY COMMITTEE

Troy Armstrong
Koda Capital

Angela Ashton
Evergreen Consultants

Mathew Jeremy
Caravel Consulting Services

Jake Jodlowski
Atchison Consultants

Christian Ryan
Beulah Capital

Matthew Scholten
Scholten Collins McKissock

Scott Carmichael
Escala Partners

Damian Cilmi
Praemium

Lukasz de Pourbaix
Lonsec

Will Hamilton
Hamilton Wealth Partners

Luke Laretive
Seneca Financial Solutions

Peter Leggett
Arrow Private Wealth

Jeremy McPhail
FMD Financial

Aongus O'Gorman
Willis Towers Watson

Darien Reimann
Accord Financial Strategies

Vessela Tasker
Greenwood & Co

Dragana Timotijevic
AMP

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RUFFER

SeedSpace Venture Capital

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A snapshot

SESSION #1

Tim Hayes
Ned Davis Research

Rethinking asset allocation frameworks

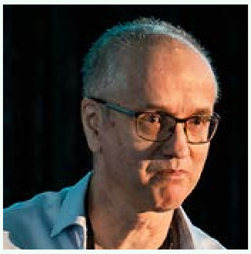
KEY POINTS

- The likely path of economic outcomes from this point is towards a more cyclical rather than secular pattern.
- Equity market performance during cyclical bear markets within secular bull markets has always been challenging, with this the likely position of the market today.
- Both sector and country weightings will be key to finding sources of alpha in asset allocation in the coming years.

LEARNING OUTCOMES

1. With the expected outcomes likely to be driven by more short-term factors including policy, the environment will be significantly different than the past.
2. Rather than focusing solely on the outcomes for the interest rate and inflation cycle, advisers must be considered other outcomes that will be relevant for portfolios.
3. Understanding the business cycle will be the most powerful determinant of success in the coming years.

SESSION #2



Steven Hail
Modern Money Lab

The future path of policy

KEY POINTS

- MML challenges the orthodoxy that suggests a straightforward relationship between unemployment, inflation and the economy.
- Monetary policy alone is an underwhelming policy approach, with fiscal policy significantly more powerful and implementable within the economy.
- The true power of a fiat currency lies in the ability of the domestic government to be able to tax and issue bonds in that currency.

LEARNING OUTCOMES

1. Modern monetary theory is more relevant than ever, and broadly being tested or implemented in most major economies.
2. Traditional monetary policy is an inefficient approach to managing inflation or growth, ultimately contributing to perverse effects that reverse gains.
3. Budget deficits by their nature are not deficits, the government doesn't need funding, resources must be allocated to efficient uses of capital.

SESSION #3

Alex Lennard
Ruffer

Navigating regime shifts

KEY POINTS

- The multi-decade tailwind of interest rates and the benefits of globalisation are being reversed, but how far remains the major question.
- The result of this reversal will be significantly higher volatility in inflation and interest rate markets, the reverse of recent years, and by no means a straight line.
- Central bank actions, while welcomed by many, represent the single most underappreciated risk today compared to inflation and geopolitics.

LEARNING OUTCOMES

1. An environment of volatile inflation, as opposed to higher or lower levels, requires a more active and flexible investment approach as different asset classes will suit varying environments.
2. The events in the UK in October represent a warning for the future, with unexpected events likely to challenge the status quo as liquidity is quickly removed from the system.
3. Central to delivering long-term return objectives will be the protection of risk on the downside, with the ability to shift from defensive to aggressive key to this.

SESSION #4

Glen Foster
Atrium Investment Management

Michael Houghton
Lucerne Investment Partners

Stephen Goode
Tactical Global Management

Smoothing the journey

KEY POINTS

- The current approach to risk within portfolios is deficient, and must be reconsidered in light of an increasingly volatile environment.
- Volatility management and mitigation can assist in reducing the probability of emotionally driven errors that result in poor investment outcomes.
- Risk must be considered from multiple perspectives, with rebalancing and the use of overlays central to dampening equity beta.

LEARNING OUTCOMES

1. With the investment environment changing, advisers must spread their focus beyond returns, giving greater consideration to volatility and risk management.
2. The greatest challenge to delivering on client objectives is in navigating risk, but a deeper consideration must be given to the true source of risks within assets.
3. Diversification across and within alternative asset classes can be an invaluable source of non-correlated returns.

SESSION #5

Anthony Kirkman
Western Asset Management

Duration - The resurrection

KEY POINTS

- A broad selloff in both bond and equity markets, during a period of positive correlation, has opened the opportunity for fixed income once again.
- The performance of the global bond markets in 2022, is significantly worse than at nearly every point in modern history.
- There are growing signs of weaker growth and sentiment, pointing to a significant risk of a recession.

LEARNING OUTCOMES

1. After a significant increase in interest rates and bond yields, the traditional diversification benefits of long duration fixed income are beginning to return.
2. With markets continuing to price aggressive rate hikes despite changing signals, any moderation will be beneficial to longer duration bonds.
3. Repricing of corporate spreads has opened an opportunity to benefit from both higher yields and repricing should economy conditions turn out better than forecast.

SESSION #6

Chris Bedingfield
Quay Global Investors

What if?

KEY POINTS

- While the performance of listed property has been challenging in 2022, divergence has grown between jurisdictions, sectors and individual properties.
- Office trends globally and domestically continue to improve, with stronger attendance combined with growing leasing activity.
- The drivers of inflation, primarily supply side, are beginning to reverse, opening up a diverse range of opportunities for long-term investors.

LEARNING OUTCOMES

1. Aggressive inflation and interest rate assumptions currently priced into markets offer an attractive opportunity amid signs of a reversal in recent trends.
2. Factors outside of interest rate movements drive the majority of asset class performance, with supply a bigger threat to the property market than demand.
3. With much of the attention paid to the 1970s, the 1940s standout as a more appropriate comparison for the outlook for inflation.

SESSION #7

Adam Grotzinger
Neuberger Berman

Go anywhere, be nimble

KEY POINTS

- The risk of a financial accident continues to grow, with high yields and reducing liquidity, advisers must be wary and diversified.
- Defaults are being aggressively priced into high yield bond markets at higher levels than GFC experience, the sector now offers opportunities.
- Potential impact of higher interest costs on corporate balance sheets is overstated with a significant amount of loans not set to mature until 2027 and beyond.

LEARNING OUTCOMES

1. With greater volatility expected, investors will likely need to be more active, diversified and tactical to protect capital and achieve objective fixed income returns.
2. After the selloff, high quality bonds are government debt appear 'cheap' offering repricing opportunities and a true source of diversification.
3. Opportunities are emerging within both high quality and high yield, with investors rewarded by long duration positions, but diversification will be key.

SESSION #9

Cathryn Lyall
Seed Space Venture Capital

Jeremy Hastings
Hutly

Tom Blinksell
T-shirt Ventures

Anto Joseph
Stropro

Pacific Pitch Night

KEY POINTS

- Despite short-term pressure, technology remains a key driver of innovation throughout the economy and warrants a position in portfolios.
- The key to success and reducing risk within venture capital and private markets is via specialisation and focusing on a narrow area of expertise.
- Financial services is a sector that remains ripe for disruption, removing historical bottlenecks and improving user experience.

LEARNING OUTCOMES

1. Hutly's unique property contracting platform is improve the ability to do business in an historically administratively driven environment.
2. Stropro has built an alternative investment platform bringing structured products from institutions direct to advisers and consumers.
3. T-shirt is improving the communication between government and private sources to drive efficiency in the NDIS rollout.

SESSION #1

Joe Millward
Epsilon Direct Lending

In search of security

KEY POINTS

- The corporate lending market, being loans backed by all assets of a company, is a growing sector as banks continue to retreat.
- With most loans privately negotiated, security and quality of lenders can be controlled supporting secure and consistent income.
- Origination and operational due diligence are more important than ever as the economic cycle shifts.

LEARNING OUTCOMES

1. Deteriorating appetite from traditional banks combined with a significant and growing addressable market offers significant income opportunities for investors.
2. Due diligence when lending in private markets is essential, experience is invaluable when operating in private markets.
3. The floating rate, shorter duration nature of private credit is set to remain a portfolio diversifier amid greater volatility.

SESSION #2

Graeme Shaw
Orbis Investments

Thinking differently about portfolio construction

KEY POINTS

- Both asset allocation and security selection contribute significantly to returns over the long-term, how they are applied is the biggest difference.
- Traditional investment assumptions rely on forecasts, which have proven to be consistently and significantly wrong.
- Even the most experienced, knowledgeable experts have been proven unable to accurately forecast even short-term events.

LEARNING OUTCOMES

1. Given the inaccuracy of forecasts, advisers must consider and invest for multiple outcomes from markets and portfolios.
2. Accepting the fact that no one can forecast the future, advisers should consider contrarian positions to have the opportunity to outperform.
3. Asset allocation, security selection, dynamic portfolio changes will all be required to deliver performance in a more challenging environment.

SESSION #4

Stephen Quance
Invesco

Rethinking the core

KEY POINTS

- The performance of the 40/60 model portfolio in the last cycle is unprecedented and at the peak of any point in history.
- Diversification benefits of traditional fixed income have been challenged by the reliance on duration. Advisers must seek diversification through additional factors.
- After cost performance, ESG and implementation efficiency are key drivers of the popularity of factor investing from an institutional perspective.

LEARNING OUTCOMES

1. Historically bonds and equities have exhibited positive correlation more than not, challenging the diversification experience of the last decade.
2. ESG considerations standout as a key factor when constructing fixed income and equity allocations, but flexibility of data source is key to measure these issues.
3. Defensive fixed income factors including low experience volatility and currency offer rare diversifying benefits in a challenging environment.

SESSION #5

Rob da Silva
SQM Research

Lincoln Smith
Albourne Partners

Hiring and firing

KEY POINTS

- Style drift should be a key consideration of investors in the current environment having historically been a precursor for poor outcomes.
- Knowing when to fire managers is as important as hiring but must be considered separate to the context of short-term performance.
- The rise of passive is pressuring larger managers, while greenwashing is becoming a target of the regulator.

LEARNING OUTCOMES

1. Increasing volatility within equity markets is exacerbating both the risks and opportunities of style drift, advisers must be cognisant of this challenge.
2. Key reasons to justify manager selection changes include significant outflows, major corporate events, and style drift or 'misrepresentation'.
3. Alternative asset classes standout among the current opportunity set while being significantly underweight in most portfolios.

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