Education

The growth of multi-asset investing (Part 1)

FTSE Russell

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Executive summary

Multi-asset investing has grown dramatically in popularity during the last decade. Together with passive investing, it is currently one of the fastest-growing segments of the global asset management business.

However, this segment of the market has been relatively underserved by benchmark providers historically. This is largely because the inherent diversity of multi-asset investment—whether by geography, asset class or strategy—presents numerous benchmarking challenges.

As a result, many multi-asset funds have operated without a formal benchmark or have relied on peer group approaches to benchmarking, despite the inherent limitations.

In this FTSE Russell *Insights*—the first in a two-part series—we summarize the growth of multi-asset investing and suggest some of the reasons for its rising popularity. We then explore the typical objectives of multi-asset funds and provide a categorization of such funds.

What is multi-asset investing?

Multi-asset investment strategies, also referred to as multi-asset solutions, typically combine asset classes with the objective of producing one or more specific investment outcomes, such as achieving long-term capital growth, improving risk-adjusted returns, generating income or matching a particular liability profile.

To achieve these objectives, multi-asset portfolios typically hold a diverse nature of underlying securities mixed with other assets. These may include equities, bonds, property, commodities and currencies, as well as unlisted assets, such as private equity, direct property holdings, loans and infrastructure. Multi-asset funds may also be relatively unconstrained when it comes to geographical exposure and the types of investment strategy permitted. For example, some multi-asset funds hold derivatives, enabling hedged or short positions.

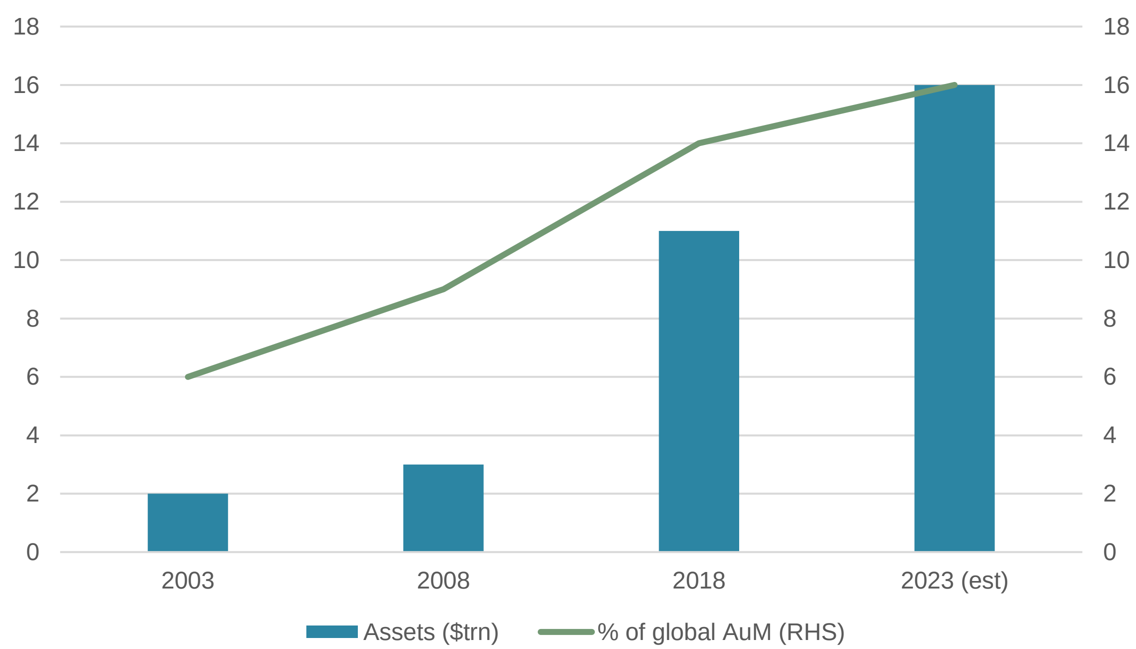
Assets in multi-asset funds

According to the Boston Consulting Group (BCG), a leading global consultancy firm, multi-asset funds, together with passive investments, have been the fastest-growing segments of the global asset management business during the last decade. The firm calculates that in 2018, multi-asset solutions represented $11 trillion of assets —a more than five-fold increase from $2 trillion in 2003. BCG define multi-asset as including target-dated, global asset allocation, flexible, income, liability-driven, and traditional balanced investment products.

Even after accounting for the effect of market movements, multi-asset has shown strong growth. Expressed as a percentage of total worldwide assets under management (AUM), this category of funds now has a 14% market share, up from 6% in 2003.

Within the asset management sector, only passive investment funds and products have accumulated assets at a faster rate than multi-asset funds over the last decade and a half; BCG estimates that the assets in passive funds have grown from $3T in 2003 to $14T in 2018. The growth in the multi-asset and passive fund categories has come largely at the expense of traditional active funds, which have seen a shrinking market share over the period.

Exhibit 1. The rise of multi-asset funds



Source: Boston Consulting Group, Global Asset Management 2019. Multi-asset fund category includes target-dated, global asset allocation, flexible, income, liability-driven, and traditional balanced investments.

Why is multi-asset investing growing in popularity?

Structural changes in the asset management market and the evolution of investment theory have helped contribute to the rising popularity of multi-asset investing.

First, there's the continuing shift from active to passive management, both in the form of segregated, index-based investment mandates and of index-tracking mutual funds and exchange-traded funds (ETFs). This shift has enabled investors to gain access to a wider spectrum of asset classes relatively easily and at low cost. As a result, the range of passive investment options in asset sectors that were traditionally the preserve of active managers—such as emerging market debt, commodities, real estate or infrastructure—have expanded greatly during the last two decades.

Secondly, investors increasingly construct portfolios using risk premia, rather than asset classes, as the main portfolio building blocks. This trend reflects the growing consensus that factor risk premia, whether in equities or other asset classes, generate the lion's share of long-term investment returns[1].

A popular past approach to multi-asset investing might have emphasized a 60-40% split (for example) between equities and bonds as a strategic asset allocation target. But today, investors tend to incorporate a broader range of systematic risk strategies, and target the associated risk premia, within their long-term asset allocation. This has furthered managers' capabilities to extend diversification considerations across additional risk spectrums, other than the traditional asset class range.

A third contributing factor to the growth of multi-asset approaches is that investors now commonly express their strategy in terms of desired outcomes. For example, an outcome might be to produce a specific risk-adjusted or absolute return target, to reduce volatility, generate income or meet a particular liability profile. A multi-asset strategy can then be developed to help meet this outcome, utilizing a diverse range of allocations to various asset-classes or risk premia.

The growing popularity of outcome-oriented investing since the 2008/09 financial crisis also reflects the prolonged period of low interest rates as seen since the crisis—a shift that has overturned some long-held investment assumptions. Other secular trends, like demographic changes, have also focused asset allocators' attention on the need to produce specific investment outcomes, particularly within the market for investment solutions catering to pension funds.

[1] See "Evaluation of Active Management of the Norwegian Government Pension Fund – Global," Ang, Goetzman and Schaefer, December 2009, for an influential statement of this investment philosophy.

Common objectives of multi-asset funds

The investment objectives pursued by multi-asset solutions are diverse and can often be multifaceted. The table below provides a brief overview of some of the most common ones; it should be noted that funds/strategies can, and often do, seek to pursue several of these in combination.

Exhibit 2.

Type	Stylized example objective	Description
Diversification	*"Provide broad diversified exposure to a range of asset class betas"*	A common goal of multi-asset strategies is to seek to provide a level of diversification to investors. Classically, diversification was considered across geographies and asset classes, but increasingly macro and even asset-class-specific risk premia are also considered. While diversification can be achieved utilizing either static allocations (e.g. 60/40) or allocations that vary relative to market-size, many funds overlay a strategic and/or tactical asset allocation framework which accounts for their capital markets assumptions.
Long term capital growth	*"Generate long term capital growth"*	Another common objective, often linked to and accompanying that of diversification, is to deliver stable long-term growth in capital value, perhaps over a stated timeframe.
Absolute return	*"Deliver returns in excess of 3% over a given period"*	Some funds stated aim is to earn a target absolute return (often measured over a cash rate of CPI) in all market environments, over a given time horizon
Income	*"Deliver regular income of at least 2%"*	Increasingly popular in times of low developed market bond yields, these strategies that seek to earn a stable income across multiple asset classes, while potentially benefiting from natural diversification effects.
Target date	*"Allocate capital in accordance with a typical 2035 retiree's glide path"*	Growing increasingly popular among retail investors, particularly those within Defined Contribution (DC) schemes, these fund types seek to allocate capital according to given glide path across time, mimicking the aging of a "typical" investor with that retirement date.
Target risk	*"Maintain realized portfolio volatility in the 8-10% range"*	Targeting a maximum realized level of risk—measured by either volatility, drawdown or similar—and/or targeting to maintain these metrics within a stated range is also common. A variant of this strategy is to seek to control *contributions* to overall portfolio risk; equalizing these across asset classes is known as risk parity.
Liability relative	*e.g. reductions in funding ratio volatility*	Commonly, liability-relative strategies (such as the popular LDI portfolios common in DB pensions and life insurers) will utilize multiple asset classes to best reflect the multitude of risk factors present in the liabilities they seek to replicate.

Sometimes a multi-asset fund may have more than one stated objective. For example, a goal of providing diversified exposure to asset classes may be combined with a secondary objective, such as constraining volatility or downside risk. The objectives defined in multi-asset funds' prospectuses and factsheets may also be subject to pre-specified targets and constraints.

Types of multi-asset funds

Understanding the objectives of a strategy or fund is vitally important as a first step towards considering how best it should be categorized, and ultimately how its performance should be benchmarked. For this reason, FTSE Russell has developed an in-house categorization of common multi-asset strategies that reflects the inherent diversity of this category of investment. It also seeks to identify commonalities in approach among funds with minor differences in their stated objectives.

Benchmarking approaches for each common category of multi-asset funds can then be considered, alongside likely requirements for tailoring the approach to suit the nuances of a given strategy (e.g. certain constraints or secondary objectives) via index customization.

The six multi-asset fund categories in the following table—asset allocation, absolute return, income generation, target date, risk-based, and liability-driven—cover the primary objectives we have identified as the most common among multi-asset funds. This is not by any means a complete or exhaustive list; however, this approach sets the foundations for the development of a benchmarking approach for multi-asset strategies and funds.

Exhibit 3. FTSE Russell's multi-asset fund categorization

	Primary Objective	FTSE Russell Category	Indexing / Benchmarking
1	**Diversification**	Asset allocation	Broad market multi-asset benchmarks can be developed to measure the returns to a diversified, market value weighted broad market approach, providing a measure of public market betas, weighted either statically or at market weight.
2	**Long Term Capital Growth**		
3	**Generate a given income**	Income generation	A range of cross asset income generation indexes could be developed, utilizing various income producing asset classes that typically achieve more stable income generation and wider diversification benefits (equities, bonds, REITS, cash etc). Can use either indexes (composite approach) or securities (bottom-up approach) as primary inputs, with various options on objective rules-based allocation mechanisms.
4	**Target a specific retirement date**	Target date	Target date indexes move allocations between asset classes (represented by indexes) along a pre-defined glide path.
5	**Deliver managed volatility**	Risk based	Index strategies that seek a target realized volatility, target risk contribution per asset class, and/or target realized downside over a given period. There are various methods of achieving this in a rules-based methodology, some of which require index provider capital markets assumptions, and some of which do not.
6	**Deliver an absolute return**	Absolute return	Cash indexes can utilize an appropriate performance measure, however alternative absolute return benchmark approaches could involve indexes that seek to combine various low-correlation risk premia across asset classes.
7	**Match liability profile**	Liability driven	Naturally tailored/custom due to the dependence on a specific liability profile; however, some "aggregate" LDI-based benchmarks are possible, utilizing an aggregate and representative, but nonetheless, hypothetical liability profiles.

Benchmarking challenges

Given the inherent diversity of the sector, no categorization of multi-asset funds is likely to be exhaustive. However, the process of highlighting common objectives among such funds offers a first step towards developing a comprehensive range of benchmarking solutions for an area of the funds market that has traditionally been underserved by index providers.

In the second part of this series we will outline some of the challenges involved in benchmarking multi-asset investment strategies. We will also summarize some recent feedback from our clients with regards to current standards of benchmark provision in this area. We will then describe some of the future product development steps that are likely to be necessary to address the needs highlighted by our clients.

About FTSE Russell

FTSE Russell is a leading global provider of benchmarks, analytics and data solutions with multi-asset capabilities, offering a precise view of the markets relevant to any investment process. For over 30 years, leading asset owners, asset managers, ETF providers and investment banks have chosen FTSE Russell indexes to benchmark their investment performance and create investment funds, ETFs, structured products and index-based derivatives. FTSE Russell indexes also provide clients with tools for performance benchmarking, asset allocation, investment strategy analysis and risk management.

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