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What's driving demand for multi-asset indices?

A multi-asset approach that is nimble while targeting higher quality and more liquid assets is the priority for asset owners and managers as they look to tackle volatility and uncertainty for the rest of 2023, finds the latest poll by *AsianInvestor* and S&P Dow Jones Indices (S&P DJI).

By S&P Dow Jones Indices

Adapting to uncertain times

As macro, market and geopolitical headwinds continue to ebb and flow, several common asset allocation themes are shaping investment strategies across Asia. At the same time – accentuating the challenges for portfolio planning amid such an unpredictable outlook – investor opinion is divided on some key considerations.

For example, while long-term capital growth is expected to be the main driver for allocation decisions over the next six months, investors want to be flexible and active in their tactical asset selection.

Further, in eyeing multi-asset exposure, different allocators have different priorities. As they look to manage volatility and achieve absolute returns, their key considerations when selecting a multi-asset strategy range from its ability to stay aligned with the defined investment goal, to its track record, to its performance over the benchmark.

Yet in the search for consistent and attractive risk-adjusted returns during the rest of 2023, there is consensus in terms of a preference for high-quality fixed income, across global, Asian and US investment grade (IG) bonds. Investors also want to stay liquid, whether via alternatives or cash.

These were some of the exclusive insights from 101 senior executives at leading asset owners and investment managers in 11 markets across Asia, gathered in May and June 2023 by *AsianInvestor* in collaboration with S&P DJI. Respondents included insurance companies, public and private pension funds, sovereign wealth funds, government entities, endowments, family offices and asset managers – from Hong Kong, Taiwan, Australia, South Korea, Japan, Singapore, Thailand, Malaysia, Indonesia, the Philippines and India.

Key survey takeaways: investor sentiment at-a-glance

- Long-term capital growth is the main objective driving investors' allocation decisions for the rest of 2023.
- The majority (53%) of respondents expect IG bonds to provide the most reliable and consistent risk-adjusted returns this year.
- Absolute returns and managing volatility are the two dominant objectives for multi-asset exposure.
- Traditional macro factors pose the biggest investment risks for portfolios today, with respondents citing unprojected changes in interest rates, deeper recessions than expected, and persistently high inflation, as being of roughly equal concern.
- The two most important considerations for multi-asset exposure are staying aligned with a strategy's defined investment objective and the track record.
- For over half (56%) of investors, there is either a "medium" or "high" chance they will use more index-linked vehicles in the next six months.
- Disruptive technology is by far the most enticing megatrend for investors over the next 12 months.

Deploying capital with caution

The rollercoaster ride in interest rates, inflation and other macro dynamics that investors have endured over the last 12 to 18 months presents a range of potential pitfalls.

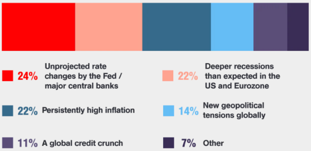
These are reflected by the key investment risks that survey respondents pinpointed for their current portfolios. Rather than any single factor, the three dominant fears are unprojected rate changes by the US Federal Reserve (Fed) and other major central banks, deeper recessions than expected in the US and Eurozone, and persistently high inflation.

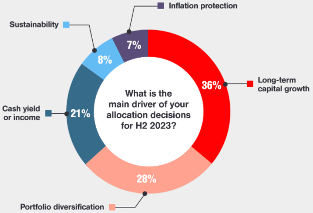
Despite hopes for more clarity when the Fed indicated in May a possible end to its year-long rate-hiking cycle, concerns have resurfaced after the hawkish pause signaled at its mid-June meeting.

Against the backdrop of such an uncertain and unpredictable environment, investors seem to be steering away from short-term positioning. Instead, long-term capital growth was the most popular driver of allocation decisions among Asian-based asset owners and managers for the second half of 2023, according to just over one-third (36%) of survey respondents.

To be prepared for all scenarios, portfolio diversification was also a key driver (28%), with cash yield or income also an important goal for some allocators (21%). Meanwhile, sustainability and strategies such as protection against inflation have become less of a priority.

What is the biggest investment risk for your portfolio today?





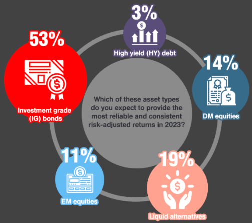
These trends broadly align with how S&P DJI sees investors responding globally. In particular, there is a shared view that any short-term rally is too hard to predict. Instead, investors want longer-term exposure, explained Priscilla Luk, managing director of research & design at the global index provider.

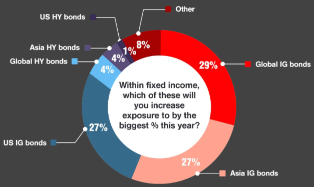
There is a lot of demand arising for diversification across asset classes, to reduce volatility," she added. "Investors are also keen to derive income from new sources.

Getting the multi-asset mix right

Given this mindset, there is a clear asset allocation trend among survey respondents towards looking for quality and liquidity.

In line with the more cautious and patient stance of those investors surveyed, the overwhelming majority (53%) believe IG bonds will give them the most reliable and consistent risk-adjusted returns overall this year.





Within this asset class, however, there are no clear geographic preferences. Global, Asian and US IG bonds each have a similar appeal, according to respondents.

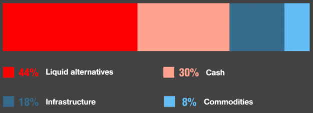
What this does indicate, however, is the general desire for higher quality fixed income. Although there might be a case building for selective high yield (HY) names in certain sectors and regions, appetite among investors for HY bonds remains limited.

The demand for high-quality fixed income syncs with the focus on liquidity, which is another key objective for many investors.

For example, after IG bonds, more survey respondents expect to get reliable and consistent risk-adjusted returns in 2023 from liquid alternatives (19%) than they do from equities, either in developed markets (14%) or emerging economies (11%).

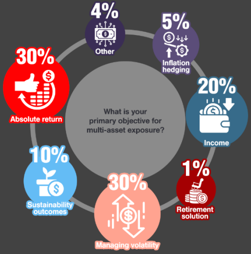
Besides equities and fixed income, liquid alternatives, at 44%, were also by far the most likely asset class that survey respondents said they will add to a multi-asset portfolio. Cash is second, at 30%, reinforcing the desire for liquidity.

Besides equities and fixed income, which of these asset classes are you most likely to add to a multi-asset portfolio?



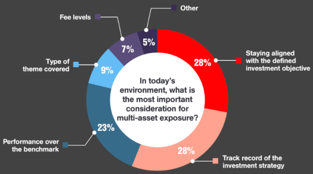
Investors also have specific intentions for their multi-asset exposure. The two primary objectives for survey respondents were absolute return (30%) and managing volatility (30%).

To find ways to deal with so much market turbulence within the trading day, S&P DJI has seen increasing interest among investors in intra-day volatility control indices. "We are launching a lot more intra-day rebalancing indices, which react faster to market movement and seek to more accurately control volatility within a trading day," said Luk.

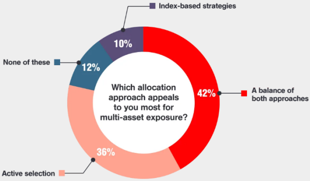


More broadly for investors looking at their multi-asset exposure, survey respondents said today's environment has sharpened their attention on specific considerations.

Three of the most frequently cited decision-making criteria were: staying aligned with the defined investment objective (28%); the track record of the investment strategy (28%); and performance over the benchmark (23%).



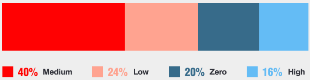
Making multi-asset pay



Another notable trend for investors in the survey was the appetite for index-linked strategies over the next six months.

More than half (56%) of respondents said they are likely to use more of these vehicles, split between either a "medium" (40%) or "high" (16%) chance.

How likely are you to use more index-linked vehicles/strategies over the next 6 months?



Today's market environment makes it more effective to use indexes for multi-asset portfolios.

More specifically, rather than pursue diversification, which has driven multi-asset allocations in the past, the aim now is to reduce risk by controlling volatility or generating steady income. "This is why a lot of rules-based indices are emerging, to dynamically allocate weightings across different asset classes," Luk explained. "This is cost effective and there is no need for switching as investors don't need to make active decisions like they would in a bull market."

Ultimately, in the absence of strong convictions by the majority of investors for the time being, their objective with multi-asset strategies is to deliver a targeted, income-focused outcome.

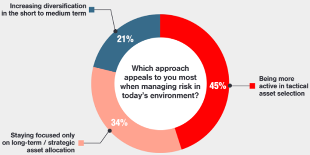
S&P DJI has seen increasing evidence of this through appetite for equity exposure but with a bond-like component, which tallies with the more cautious view among investors of limited upside potential available for the foreseeable future. "This is leading to a rise in demand for covered call strategies," explained Luk, "where investors are comfortable with forfeiting some upside but collecting a premium from the call option."

To achieve this, a growing number of investors are using passive investment products which track the covered call indices. "For example, the Dow Jones US Dividend 100 7% Premium Covered Call Index is designed to measure the performance of a long position in the Dow Jones US Dividend 100 Index and a short position in a standard listed S&P 500 monthly call, targeting a 7% annual yield from the option premium," added Luk.

At the same time, being more bespoke brings with it a need for some active selection. Survey respondents agreed, with a balance of active allocation and index-based strategies the most popular approach for multi-asset exposure.

This is also the case based on the approach that appeals most to surveyed investors when managing risk in today's environment.

The findings showed a clear preference towards them being more active in tactical asset selection (45%), with a smaller number opting to look to strategic asset allocation (34%). In general, increasing diversification in the short to medium term wasn't a priority for most investors (21%).

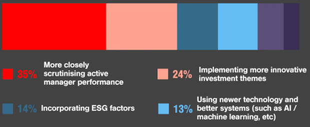


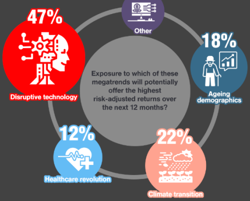
Finding a compelling theme

To complement investors' multi-asset approach to their portfolios, they are also honing-in on certain themes they believe will deliver outperformance over the next 12 months.

Based on survey respondents, disruptive technology (47%) was the megatrend with the greatest potential to offer the highest risk-adjusted returns during this timeframe – more than climate change (22%) and ageing demographics (18%).

Which of the following is most likely to help you enhance returns in today's volatile environment?





🟪 9% Seeking co-investments with other investors

🟪 5% Other

"For market participants seeking exposure to certain themes such as artificial intelligence, there are a growing number of multi-asset index solutions with a thematic equity component," added Luk.

This corresponds with the view of around a quarter of investors (24%), who said that implementing more innovative investment themes was the most likely way for them to enhance returns in today's volatile environment – second to efforts to more closely scrutinise active manager performance (35%).

Inevitably, environmental, social and governance (ESG) factors are part of another key investment trend that S&P DJI is seeing in the multi-asset space.

For example, the S&P ESG Global Macro Series measures the performance of a multi-asset strategy with sustainability-themed equity components and a risk control overlay. "The S&P ESG Global Macro Index dynamically allocates to equities and fixed income across three regions based on economic and market trend signals," said Luk.

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