

March 16th, 2017

Russell Investments,

## Multi-asset investing: the importance of seeking to manage the downside



By: Rob Balkema

Multi-asset investing is currently a hot topic in our industry. An increasingly wide range of investors want the dynamic allocation and broad diversification attributes that a well-managed multi-asset portfolio can provide. Many investors also want to ensure their multi-asset fund uses skilled money managers and strategies in every asset class, to seek to generate the extra performance that is so vital in a world of low returns. But fewer investors appreciate the importance of downside protection - the range of techniques designed to reduce the probability and magnitude of losses in a portfolio.

Why is this key for clients seeking consistent portfolio growth? Because big losses are hard to recover from! For example, if a client's portfolio suffers a -30% drop in value, a 43% rise will be needed to get the portfolio back to its starting point. That's where a multi-asset approach that also emphasizes managing downside risk is so valuable, even if they don't protect against all losses or guarantee a profit.

To explain why, let's recollect Aesop's fable about the race between the tortoise and the hare. In the original story, the tortoise beat the hare by being more consistent. In a multi-asset portfolio context, two hypothetical portfolios are racing:

- One has a lower average annual arithmetic return (runs slower) but is well diversified and so exhibits lower volatility. Let's call this one *multi-asset*.
- The other has a higher average arithmetic return (runs faster) but is concentrated in a single asset class, higher volatility portfolio. Let's call this one *equities*.

Because the hypothetical, lower volatility multi-asset tortoise has fewer and/or shallower setbacks to recover from, its lower average returns can compound more smoothly to achieve an equivalent geometric return to the higher volatility portfolio.

The setback penalty for the higher volatility portfolio is known as 'volatility drag.' And that's why the multi-asset tortoise has a good chance of matching or beating the equity hare over one or more full market cycles, all other things equal.

Why is this such a big deal for investors? Because many investors can't stomach market downturns and turn to cash. And individuals approaching or post-retirement can't afford big losses.

In fact, the impact of volatility on a client's portfolio becomes more adverse once the client starts making cash withdrawals. Imagine what happens if a retired client's portfolio suffers that -30% fall, and maybe that timing coincides with the client needing to buy a new car, or finance expensive medical treatment? The client may have to withdraw cash from their retirement portfolio at the worst possible time. Even if the portfolio subsequently enjoyed strong returns, it may *never get back to its starting level within the retiree's lifetime!*

The impact of withdrawals on portfolio performance is known as *cash-flow drag* - and certainly among baby boomers, it's becoming a more relevant consideration. Viewed from a cash-flow drag lens, the slower but more consistent multi-asset portfolio may start to look like a much more compelling investment option than the faster but more volatile equity hare.

## The bottom line

For investors who have the most money on the table that they are ever going to have, a big stumble at this point could be crippling. That's why it's so important for investors now to look at downside risk in a different way, to start focusing on wealth preservation in the here and now, and to get away from an exclusive focus on long-run average rates of return.

In a nutshell, that's why managing downside risk is one of the key ingredients of an effective multi-asset strategy. We believe these core ingredients *comprise broad diversification, skilled money managers in every asset class and strategy, and dynamic management* - and last but not least, downside protection. Such an approach can't protect against all losses or guarantee a profit, but it may help reduce the probability and magnitude of losses in a portfolio.

---

### Disclosures:

These views are subject to change at any time based upon market or other conditions and are current as of the date at the top of the page. The information, analysis, and opinions expressed herein are for general information only and are not intended to provide specific advice or recommendations for any individual or entity.

This material is not an offer, solicitation or recommendation to purchase any security.

Forecasting represents predictions of market prices and/or volume patterns utilizing varying analytical data. It is not representative of a projection of the stock market, or of any specific investment.

Nothing contained in this material is intended to constitute legal, tax, securities or investment advice, nor an opinion regarding the appropriateness of any investment, nor a solicitation of any type.

Please remember that all investments carry some level of risk, including the potential loss of principal invested. They do not typically grow at an even rate of return and may experience negative growth. As with any type of portfolio structuring, attempting to reduce risk and increase return could, at certain times, unintentionally reduce returns.

The general information contained in this publication should not be acted upon without obtaining specific legal, tax and investment advice from a licensed professional.

The information, analysis and opinions expressed herein are for general information only and are not intended to provide specific advice or recommendations for any individual entity.

Russell Investments' ownership is composed of a majority stake held by funds managed by TA Associates with minority stakes held by funds managed by Reverence Capital Partners and Russell Investments' management.

Frank Russell Company is the owner of the Russell trademarks contained in this material and all trademark rights related to the Russell trademarks, which the members of the Russell Investments group of companies are permitted to use under license from Frank Russell Company. The members of the Russell Investments group of companies are not affiliated in any manner with Frank Russell Company or any entity operating under the "FTSE RUSSELL" brand.

The Russell logo is a trademark and service mark of Russell Investments.

Copyright © Russell Investments Group, LLC 2017. All rights reserved. This material is proprietary and may not be reproduced, transferred, or distributed in any form without prior written permission from Russell Investments. It is delivered on an "as is" basis without warranty.

**Russell Investments Financial Services, LLC, member FINRA ([www.finra.org](http://www.finra.org)), part of Russell Investments.**

## Disclosures

---

Russell Investments does not control, endorse or accept responsibility for content, services, security or privacy on third-party sites.

Nothing contained in this material is intended to constitute legal, tax, securities, or investment advice, nor an opinion regarding the appropriateness of any investment, nor a solicitation of any type. The general information contained in this publication should not be acted upon without obtaining specific legal, tax, and investment advice from a licensed professional.

Please remember that all investments carry some level of risk, including the potential loss of principal invested. They do not typically grow at an even rate of return and may experience negative growth.

Russell Investments' ownership is composed of a majority stake held by funds managed by TA Associates with minority stakes held by funds managed by Reverence Capital Partners and Russell Investments' management.

Frank Russell Company is the owner of the Russell trademarks contained in this material and all trademark rights related to the Russell trademarks, which the members of the Russell Investments group of companies are permitted to use under license from Frank Russell Company. The members of the Russell Investments group of companies are not affiliated in any manner with Frank Russell Company or any entity operating under the "FTSE RUSSELL" brand.

The Russell logo is a trademark and service mark of Russell Investments.

Copyright © Russell Investments Group, LLC 2016. All rights reserved. This material is proprietary and may not be reproduced, transferred, or distributed in any form without prior written permission from Russell Investments. It is delivered on an "as is" basis without warranty.

**Russell Investments Financial Services, LLC, member FINRA ([www.finra.org](http://www.finra.org)), part of Russell Investments.**

Not FDIC Insured • May Lose Value • No Bank Guarantee

[Read this post on our blog: https://blog.helpingadvisors.com/2017/03/16/multi-asset-investing-importance-seeking-manage-downside/](https://blog.helpingadvisors.com/2017/03/16/multi-asset-investing-importance-seeking-manage-downside/)