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Harvard goes multi-asset

If you've followed the news, you've seen that over the last few months, my alma mater, Harvard University, has gone through several changes at their endowment—the largest academic endowment in the world. After years of middling returns and a well below peer return of (gasp!) 8% last year, Harvard has brought in a new CEO of the Harvard Management Company. His first change: to move from a portfolio of asset class sleeves to a generalist investment model in which all members of the investment team take ownership of the entire portfolio. **We see this approach clearly as multi-asset.**

I'm glad to see this, for Harvard's sake (and the endowment's beneficiaries). They're seeing an investment light while others, in my opinion, are still wandering in the shadows. Because, somewhere along the way, the asset management industry and many asset owners lost their focus. Maybe it was the massive returns from equities and bonds prior to the financial crises that lulled so many of us to sleep. Maybe it was the rise in style boxes and investment consultants (where Russell Investments, by the way, has been a leader). But, somewhere, the focus moved away from solving client challenges, closing funding gaps or creating enough wealth to sustainably live in retirement. The focus moved toward beating intricate benchmarks or combinations of benchmarks—that was how success was defined. But everyone who looked at account balances or custody statements in 2008 can tell you that being down -28% versus a composite index down -30% was not success.

In this business, we sometimes overthink things. Some institutional investors are beginning to realize that the complexities of their investment programs and misaligned incentives lead to "unintended consequences," to quote Narv Narvekar, the new Harvard endowment CEO. In his *State of HMC* letter, Narvekar recently said: "Portfolio managers conducted research

and analysis and executed investment decisions within their respective asset class independent of the rest of the portfolio, sometimes creating both gaps in the portfolio and unnecessary duplication. This model also created an overemphasis on individual asset class benchmarks. Overall, I believe the silo approach did not lead to the best investment thinking for a major endowment."

We couldn't agree more.

In 37 years of providing outsourced chief investment officer (OCIO) services, Russell Investments has experienced many ups and downs and lessons learned to make ourselves better. As the adage says, *You have a choice: You can get better or get worse, but you cannot stay the same*. Coming out of the Global Financial Crisis, there were many lessons learned. One of the biggest lessons was that benchmarks are not outcomes. And, portfolios managed with a silo approach, asset class by asset class, can lead to significant principal-agency problems. Put another way, sometimes what is best for the part is not best for the whole of the portfolio.

For example, near the end of every big cycle there is a search for yield. And it's natural for bond portfolio managers (PMs) to gravitate toward, or at least keep, exposure to high yield bonds. At the same time, equity PMs might have an inclination to seek out growth opportunities among the scarce companies that can organically grow as the economy slows down. Both decisions are logical with asset class PMs seeking to manage risks, but the combination could be deadly. Care is needed to manage which risks are worth taking holistically.

With this in mind, Russell Investments expanded our Multi-Asset team globally, building it up further to over 75 people, as a key part of our team of more than 250 investment professionals*. We focused even more on our risk systems and execution services in order to expand our ability to take a total-portfolio approach. We strategically broke down the silos in our regional and asset-class-based investment teams to a single, globally integrated investment team. The investments we have focused on with clients have become less benchmark-focused and more outcome-oriented. We aim to solve a specific challenge rather than trying, bucket-by-bucket, to fill out a portfolio.

This **total portfolio perspective** allows cross-asset-class tradeoffs for finding the best opportunity in the marketplace, but it also helps ensure that risks are managed holistically. For example, with the fall in energy prices in 2016, high yield bonds, the Canadian dollar, the commodities asset class, Canadian equity markets and the energy sector were all hit. By focusing on the risk *across* these assets, we created portfolios designed to limit drawdowns. But we were also able to search out the opportunity within high-yield bonds during the selloff, with the intention of creating significant gains in client portfolios when things stabilized.

Eight years ago, we realized the limits of sleeve-based strategies. It's affirming to see Harvard following the same path. We hope the rest of the OCIO providers and the asset management community come around as well.

*As of June 30, 2017, Russell Investments employs 282 investment professionals.

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