

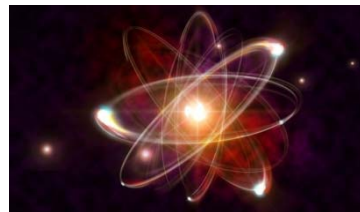
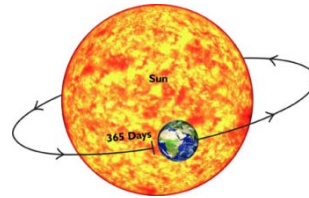
DGFs / Multi Asset Strategies – Still a Solution?

Oliver Kelly LCP Ireland



Solutions evolve

- Newtonian mechanics
- Special and General relativity
- Quantum mechanics



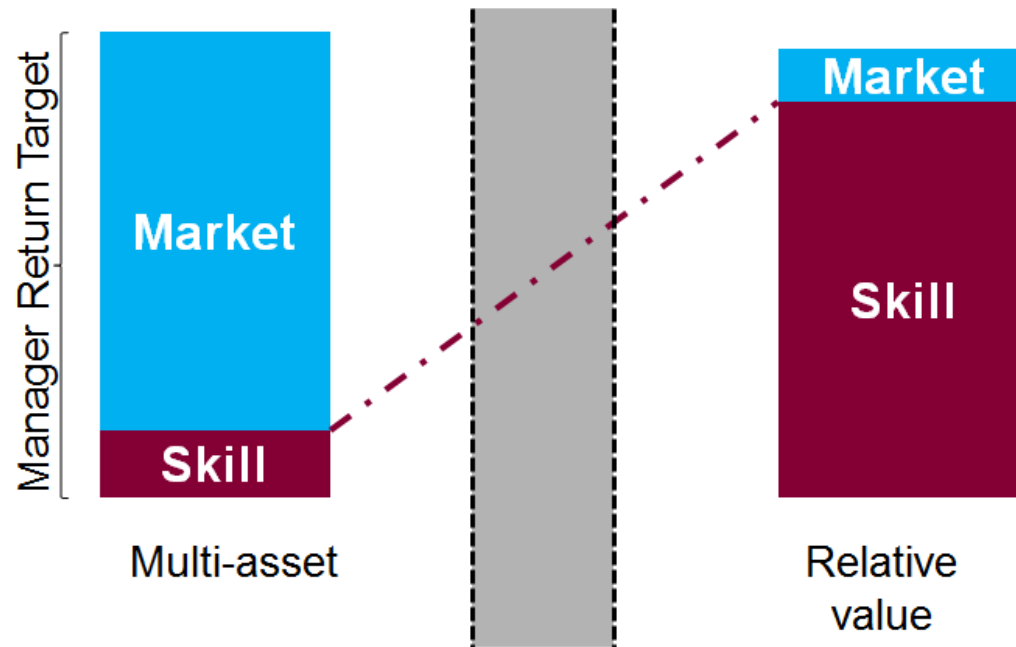
“I would rather have questions that can't be answered than answers that can't be questioned.”

— Richard Feynman

The Five Ws of DGFs

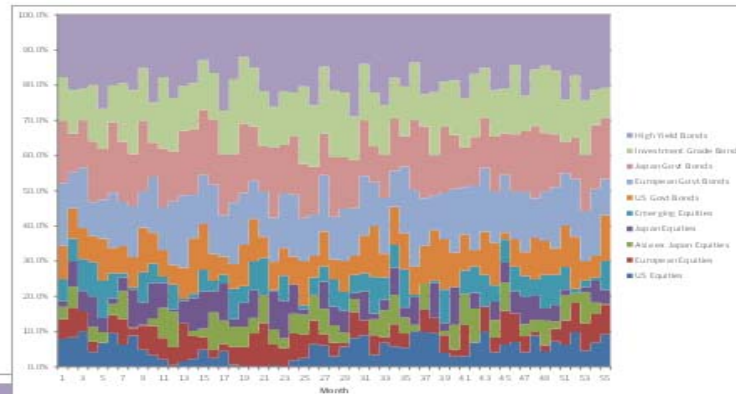
1. What are they?
2. Who is using them?
3. Where did they come from?
4. Why are trustees concerned now?
5. When should we still consider using them?

1. What are “DGFs”?

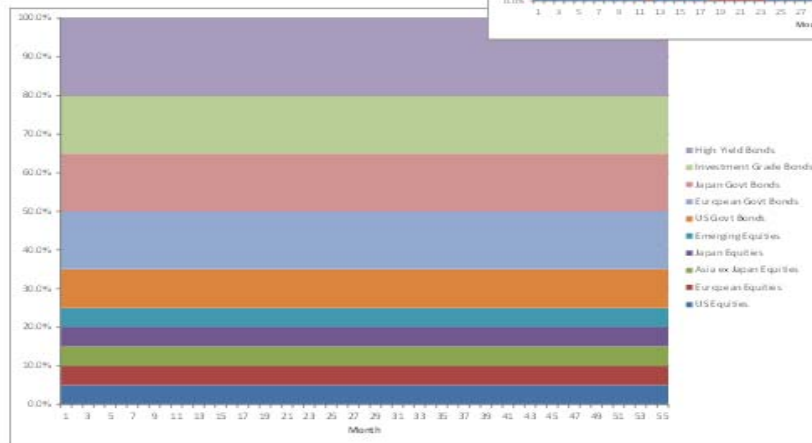


Traditional multi-asset “DGF”

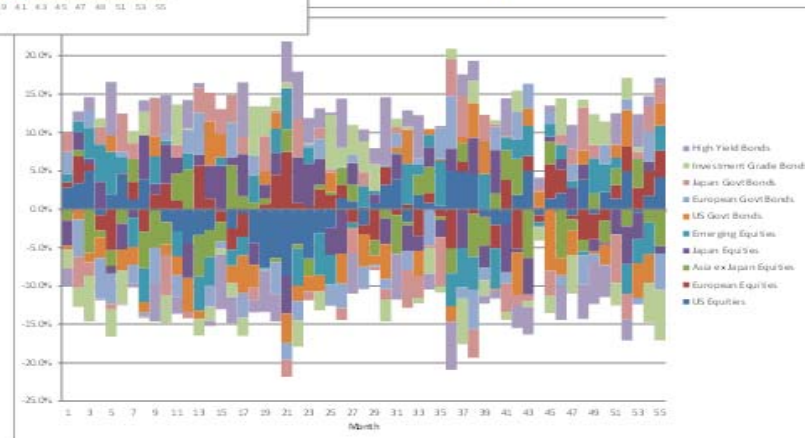
Full portfolio



Passive AA portfolio

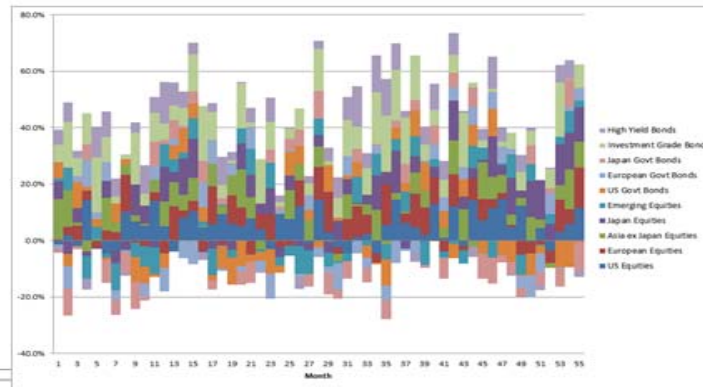


TAA portfolio

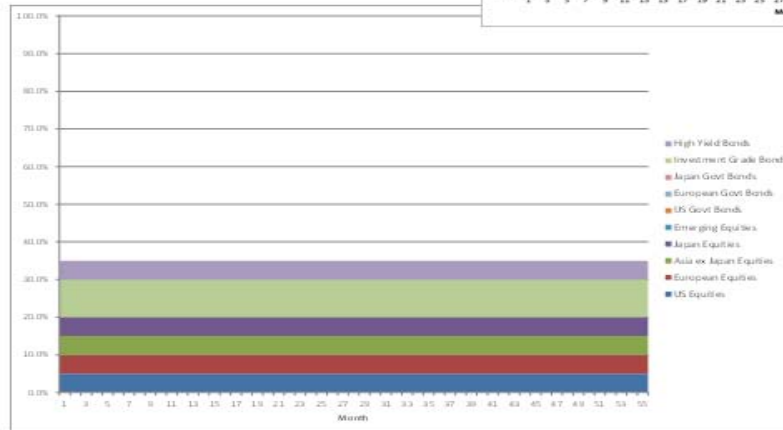


Relative value “DGF”

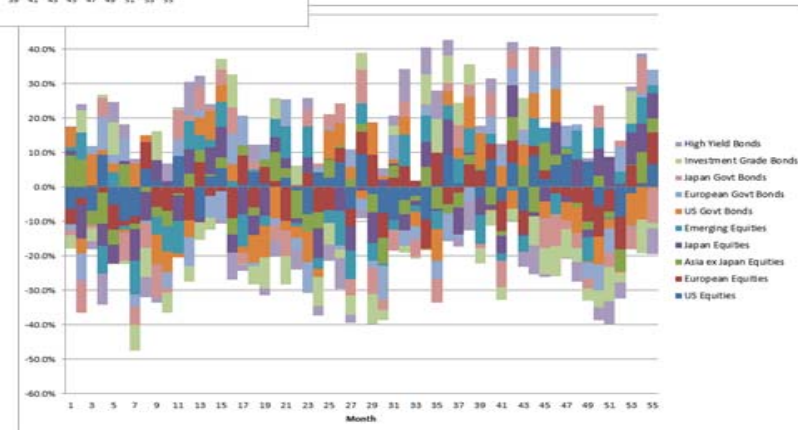
Full portfolio



Passive AA portfolio



TAA portfolio



2. Who is typically using DGFs?

- DC scheme members who may have a cautious attitude to investment risk or to decrease fund volatility
- DB schemes seeking to reduce equity risk or diversify, or those which are unwilling or unable to invest in matching bonds

3. Where did they come from?

- Balanced products popular until c2000
- Interest was building in DGFs prior to the Global Financial Crisis (“GFC”). However the GFC galvanised interest.
- Many DGF’s preserved or almost preserved capital through 2008
- Many also re-risked in 2009 to produce strong returns in the rebound
- Risk was well controlled at less than half of equity

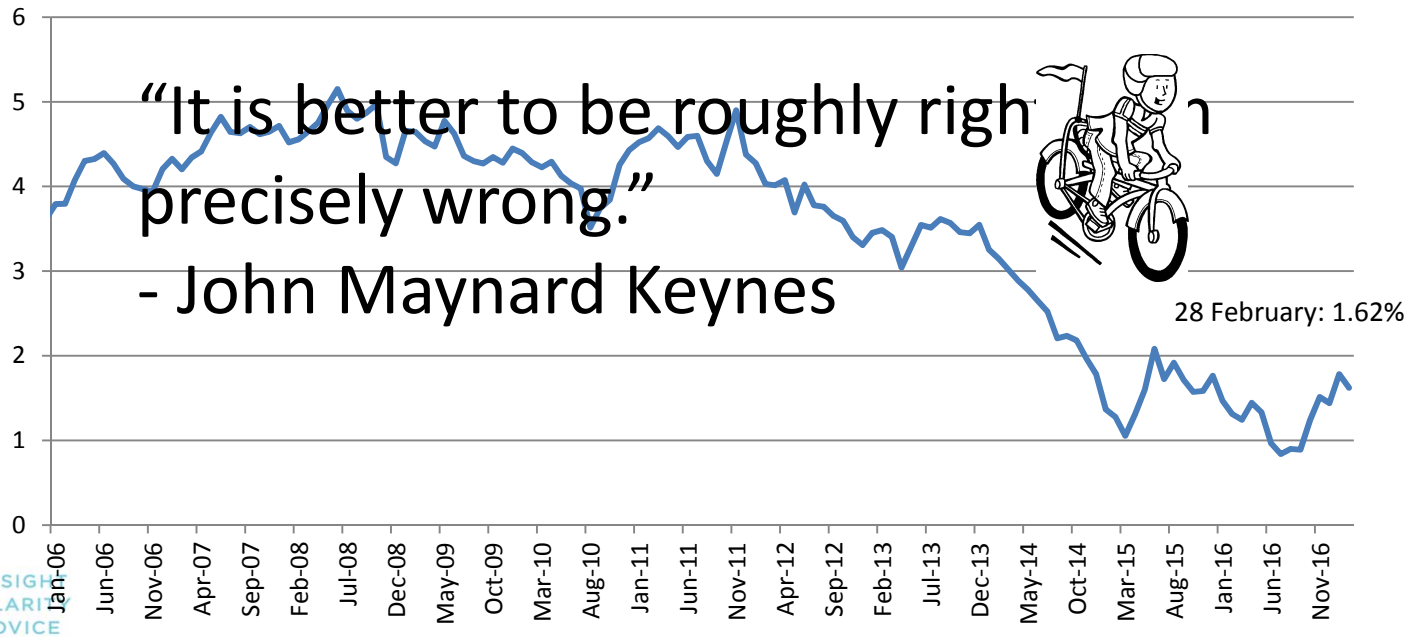


4. Why are trustees concerned now?

- Recent returns have been below target
- Will the next market crisis resemble the last?
- Do DGF managers still have the “tools” to control risk?
- Are they too big and inflexible now?
- Can we achieve the same results with lower costs?

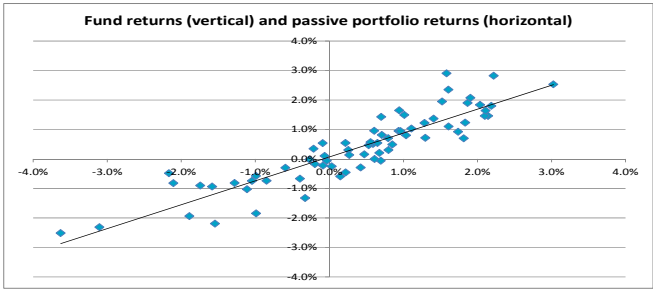
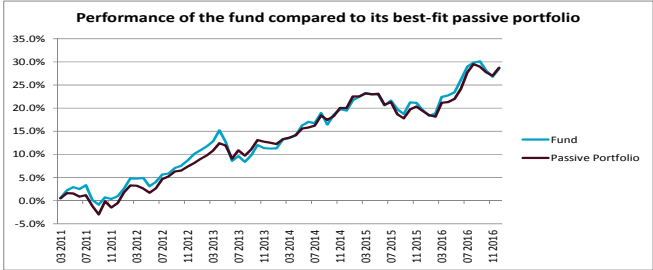
2006 - 2017

Merrill Lynch EMU 10+ Year Bond Index

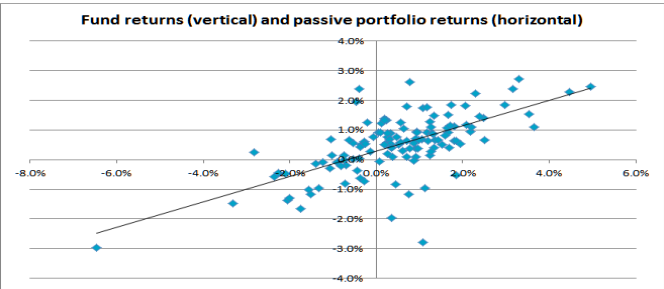
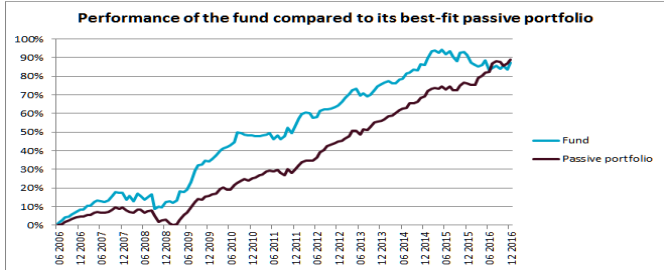


Fund returns vs best-fit passive portfolio

Multi-asset



Relative Value



Attribution analysis

Total Return = Passive portfolio + TAA portfolio

(We assume that the correlation between the passive portfolio and the TAA portfolio is zero)

Attribution analysis

We use the **passive portfolios'** weights to each asset class to calculate the expected returns and risk of each fund using LCP's long term asset class return assumptions.

Asset class	Multi-asset	Relative Value
Expected return (pa)	3.6%	3.0%
Risk (standard deviation)	6.8%	4.5%

The expected returns fall short of the managers' targets – the shortfall must come from the TAA portfolio

Attribution analysis

		Multi-asset	Relative Value
Return	Expected return of passive portfolio	3.6%	3.0%
	Target return (total return per annum)	5.3%	6.8%
	Return required from TAA	1.7%	3.8%
Risk	Risk of passive portfolio	6.8%	4.5%
	Target risk (volatility)	7.0%	6.0%

- Returns from TAA are required to supplement the passive portfolio returns in order to reach the target.
- We believe that the returns required from the TAA portfolio are not achievable within the volatility targets
- It is, therefore, unlikely the funds will achieve their stated return targets over the long-term

5. When should we still consider using DGFs?

- Should we be changing horses midstream?
- They may serve a role to protect capital values from a future market crash. How much risk can your scheme tolerate?
- Analyse and limit reliance on “skill” to achieve strategic targets across the performance portfolio.
- Are there other alternatives available to supplement DGFs?

Future solutions

DC solutions to consider

- White labelling and blending of active DGF managers
 - Multi-asset and relative value managers
- Lower cost “passive” multi-asset with explicit tactical overlay if preferred
- Market trend to add alternatives into DC portfolios in addition to DGF exposure

Future solutions

DB solutions to consider

- Consider alternatives in conjunction with DGFs
 - Infrastructure, private credit, long lease property etc.
- Blend of DGF managers and approaches
 - Using scale or by using an investment platform
- Lower cost “passive” multi-asset

“If I have seen further than others, it is by standing upon the shoulders of giants.”

- Isaac Newton

Scope

This document is a visual aid to complement an oral presentation and does not constitute our written professional advice.

Written advice about any matters discussed should always be sought in order to clarify the data relied upon, assumptions, conclusions and recommendations.

While this document does not represent our advice, nevertheless it should not be passed to any third party without our formal written agreement.

Lane Clark & Peacock Ireland Ltd (2017)