The complexities facing investors (and asset managers)

Long gone are the days when asset managers became famous for managing balanced funds comprising 60% equities and 40% fixed income.

Florbela Yates, Head of Equilibrium

Nowadays asset managers managing balanced funds need to have asset allocation skills across multiple asset classes, and both local and offshore.

Beating the peer-group over any period requires an understanding of the peer-group holdings, which can now range from 0% to 45% outside of South Africa, include components of passive investments as well as active, and even have instances where the local asset manager outsources components to other teams.

So how exactly do investors pick the most suitable investment for their need? I believe that there are three factors that investors and their financial advisors need to consider.

The first is their investment time horizon. If they are investing for a particular event (for example to buy a house, pay for school fees or to provide an income in retirement) then the time horizon helps to determine how long they have and how much they need to save to get there. The second factor to consider is risk. This is a complicated topic in that risk can be broken down further into the ability to take risk and the willingness to do so. An investor who is worried about market volatility may be defined as an investor with a low risk tolerance (or willingness) but if he has insufficient capital and a short time horizon, he may need to take a bigger risk to grow his investment capital. In defining risk, the investor and their financial advisor needs to define what he sees as risk. Is risk the ability to not fund a specific event or is risk to that investor the possibility of losing capital over a particular period?

The third factor is the actual benchmark or outcome. Investors who can determine their unique outcomes will be better placed to choose an investment that specifically aims to achieve those goals. For example, an investor drawing an income, might want to ensure that they don't lose any capital over a rolling 12-month period and that they are able to draw down 5% of capital every year. And an investor investing towards retirement may want maximum capital growth and benchmark their investment against inflation (CPI) to ensure that their capital is growing in real terms. One of the main reasons that Discretionary Fund Managers (DFMs) have gained traction both locally and internationally is their ability to understand the need for a greater link between investor needs and asset manager outcomes.

By appointing a DFM to build portfolios that are linked to an investor outcome rather than some arbitrary index or peer benchmark, a DFM can better track how an investor's portfolio is performing to get them to their desired outcome. This allows DFMs to construct portfolios differently. They are not restrained to selecting asset managers across the entire asset class portfolio but can rather find specialists in different asset classes. The DFM now becomes responsible for determining the appropriate asset class combination based on the particular investor needs and can appoint underlying fund managers who specialise in a particular asset class.

The DFM therefore requires the skill to evaluate whether or not an asset manager has asset allocation skills (and is able to take on a broader investment horizon) or single asset class skills as well as their ability to manage an asset class holistically (locally and offshore). And it goes further, to sourcing different investment strategies from different domiciles around the world. This evolution in portfolio management has led to much greater complexity in portfolio construction and management.

Some considerations include which asset classes to source locally or offshore, which should be actively managed or sourced passively and which strategies (eg value, earnings momentum, quality) should be sourced. In addition, they need to determine the breadth of the mandates to allocate to underlying asset managers. While this trend has led to portfolio benchmarks becoming much more closely aligned to investor needs it's a lot more complex and requires investors and financial advisors to select a partner that understands the complexities and can help navigate both risks and outcomes over the relevant time horizons. Equilibrium has a proven track record in running advice-led, investor-linked portfolios for investors. For more information, please visit **www.eqinvest.co.za.** ■

Florbela Yates is the head of Equilibrium in the Momentum Metropolitan group. Equilibrium is an independent discretionary fund manager that partners with financial advisors to help them enable their advice outcomes. Equilibrium brings balance to an advice practice by delivering services and investment solutions to help clients achieve their defined investment goals.