ASSET ALLOCATION

ASSET ALLOCATION WITHIN SCOTTISH WIDOWS’ MULTI-ASSET FUND RANGE

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AN EXPERIENCED TEAM

GAVIN STEWART

Prior to joining Scottish Widows in 2010, Gavin was chief executive of Ignis Asset Management (previously known as Resolution Asset Management). An actuary by profession, he has a wide range of experience within the financial services industry, including roles at AEGON, Prudential and Scottish Amicable. As head of the Asset Allocation Team, he has responsibility for the investment strategy of all funds within the Insurance division of Lloyds Banking Group.

TIM BUTCHER

Tim joined the team in 2015 and has over 30 years’ experience of working within bond markets, half of which was spent undertaking fundamental and relative value assessment of corporate bonds at Scottish Widows Investment Partnership. His background also includes researching emerging market bonds at Nomura during the Asian crisis. He has been a member of the Association of British Insurers (ABI) bond committee for 15 years.

STEVEN MILLAR

Steven has 13 years’ experience working within financial services, with this time being split between a range of firms and a breadth of different positions. For the past five years his focus has been on fund analysis and large scale complex transitions, in particular the medium-term asset allocation trades carried out by the Asset Allocation Team. Steven joined Scottish Widows in 2016 and more recently the Asset Allocation Team in 2018.

BRIAN MCCREADY

Prior to joining Scottish Widows in 2015, Brian worked for 12 years at Mercer, where he was responsible for advising on the full range of investment consulting areas to institutional clients. He also undertook investment manager research and was a member of Mercer’s specialist Defined Contribution consulting group.

ROSS MCFARLANE

Ross joined Scottish Widows in 2015, having spent nearly 30 years working in equity markets – as an analyst and direct portfolio manager, and also a manager of multi-manager funds, which included a role in manager selection. Through positions at Ignis Asset Management, Murray Johnstone and Russell Investments, Ross has experience of investing in almost every equity market, including emerging markets.
A TWO LEVEL PROCESS

ENSURING THAT OUR MULTI-ASSET FUNDS HAVE APPROPRIATE ASSET ALLOCATION IS VITAL AND SOMETHING THAT WE PAY GREAT ATTENTION TO. FOR ALL THESE FUNDS, WE UNDERTAKE ASSET ALLOCATION AT TWO PRINCIPAL LEVELS: 1) LONG-TERM STRATEGIC AND 2) MEDIUM-TERM ‘HOUSE VIEW’.

Long-term strategic asset allocation is the main determinant of the performance of our Multi-Asset Funds, in accordance with their long-term nature. However, we also look to identify significant medium-term market opportunities in addition to the long-term strategic asset allocation framework. By reflecting these within the portfolios, we aim to create additional value.

The two levels at which we undertake asset allocation are described in more detail below:

1. LONG-TERM STRATEGIC ASSET ALLOCATION

At the inception of a Multi-Asset Fund, we determine its risk profile based on the investors it’s intended to serve and the description of the Fund. The purpose of long-term strategic asset allocation is to determine the optimal mix of asset classes for that risk profile, based upon the modelled returns of those asset classes over the long term. We also take into account the range of asset classes that the Fund can invest in and our view of customer expectations. For PIA and GIS specifically, we factor in our core commitment to using passive investment funds as the main vehicles for implementation, recognising their positioning as low cost solutions.

We aim to undertake a periodic review (indicatively every 1 – 2 years) of the long-term strategic asset allocation within our Multi-Asset Funds. The purpose of this review is to refine the asset allocation, with the aim of improving projected returns, while ensuring that the Funds retain their intended risk profile. A key component of this is reviewing the assumptions made as to the long-term returns of the different asset classes – these are key elements of judgement and we’ll start with independent assumptions and discuss possible changes to these where our internal view may be different. We’ll also aim to manage changes within a modest overall level of change as we’re very conscious of the cost of turnover within a Fund and the impact that this can have on investment returns.

Any recommendations from our periodic reviews are considered based on a framework agreed by our Unit-Linked Investment Management Committee (ULIM). ULIM’s role is to ensure that appropriate consideration and oversight is given to Fund changes as part of its remit of overseeing the governance of all Unit-Linked Funds within the Insurance division of Lloyds Banking Group. We communicate externally the results of strategic asset allocation reviews through our website.

2. MEDIUM-TERM ‘HOUSE VIEW’ ASSET ALLOCATION

While the strategic asset allocation reflects a long-term view, medium-term asset allocation involves making adjustments to the weights of individual asset classes within a Fund based on the expected medium-term performance of those asset classes. We generally consider the medium term as indicatively 18 months to 5 years.

Taking a medium-term view on top of the strategic asset allocation allows us to adjust the asset allocation within our Funds. Our aim is to add value to the Funds by reflecting our current views of the relative value and attractiveness of asset classes. The process by which we do this is described in more detail in the next section.

The diagram below illustrates our two-stage asset allocation process. As an efficient method of implementation, we apply changes at both stages through adjusting the portfolio benchmark.
WHILE WE AIM TO REVIEW THE LONG-TERM STRATEGIC ASSET ALLOCATION WITHIN OUR FUNDS ON A PERIODIC BASIS, OUR MEDIUM-TERM ASSET ALLOCATION POSITIONS ARE ESSENTIALLY UNDER CONTINUOUS REVIEW, AS ILLUSTRATED BY THE DIAGRAM BELOW.

ANALYSE

When considering the medium-term asset allocation within our Funds, the Asset Allocation Team analyse many factors in order to form a view on the relative attractiveness of the asset classes available to them. Essentially they are asking themselves whether any available asset class is significantly undervalued, relative to other asset classes and relative to its own history, and whether as such it is an attractive investment proposition for the medium term. The main points to highlight here are ‘significant’ and ‘medium term’. The team are not looking to exploit small, short-term anomalies within markets. The identified opportunity has to be sufficiently substantial in order for them to implement a change.

DISCUSS

The Asset Allocation Team all work together at our main office in Edinburgh and therefore the practice of analysing and discussing asset classes takes place daily. Individuals have different areas of focus and specialist expertise but ideas can come from any one of the team. Ideas may be generated from our own analysis, from the work of external commentators, from Lloyds Banking Group economists, or from one of the investment management firms that we use to manage our underlying funds, of which there are over 20. Where an idea comes from an external source, it will also be analysed by the Asset Allocation Team before being taken further.

Every two weeks, the team meet to have a more structured discussion about how their views are evolving and about any developments within markets. If the team believe that they may want to make a change to a medium-term asset allocation position, either by implementing a new position or closing an existing one, the relevant members of the team will hold an additional meeting in order to discuss this further. Any decision they make will be presented to our Insurance Investment Strategy Committee (IISC).

APPROVE

IISC comprises of some of the most senior members of the Insurance division of Lloyds Banking Group. Its approval must be given before any recommendations made by the Asset Allocation Team can be implemented within our Funds. This approval will either be specifically in respect of a particular idea or through IISC applying a strategy that gives flexibility for certain decisions within pre-defined parameters. Therefore where an idea is within a previously agreed strategy, it can be implemented without further IISC approval.

IMPLEMENT

Once IISC have approved a medium-term asset allocation recommendation, it then forms part of our ‘house view’. There follows a process to consider whether that view should be applied to a given Fund, taking into account the underlying investments of that Fund and its risk profile. The physical implementation of any changes is undertaken by our Fund Mandate Team. They issue the instructions to our underlying managers and monitor delivery by them.
KEY DIFFERENCES BETWEEN OUR ORIGINAL PENSION PROPOSITIONS (PIA AND GIS) AND OUR PREMIER PENSION PROPOSITIONS (PPIA AND PGIS)

While our two-level asset allocation process applies to both our original pension lifestyling propositions (PIA and GIS) and to our Premier lifestyling propositions (PPIA and PGIS), the way in which it manifests itself depends upon the nature and range of the underlying assets within each proposition. Therefore PIA and GIS, which invest in a relatively low number of asset classes, will inevitably be subject to fewer asset allocation changes than PPIA and PGIS, or our other Multi-Asset Funds, which invest in a greater number of asset classes.

Most of the Funds within our Premier propositions also benefit from a third level of asset allocation, which we would describe as shorter-term tactical asset allocation (TAA). TAA involves adjusting the current asset allocation within a Fund in order to capture shorter-term relative value opportunities in markets. We do not undertake TAA directly within Premier, but instead invest in Scottish Widows Global Tactical Asset Allocation (GTAA) 1 Fund, which is a TAA fund managed on our behalf by Aberdeen Standard Investments. The reason that we invest in a TAA fund rather than undertaking TAA transactions directly is that it reduces transaction costs since the underlying assets are not being bought and sold. This method also reduces the need to hold cash in a Fund in order to facilitate transactions, and therefore the risk that this cash will reduce performance returns.

RETIREMENT PORTFOLIO FUNDS

The latest additions to our Multi-Asset range are the Retirement Portfolio Funds, which were launched in February 2018. These four innovative funds are specifically designed to meet the needs of Drawdown customers. They are designed to reduce the risk of investment losses during periods of significant volatility for equities and help a pension pot last longer. While they don’t guarantee against losses, extensive future simulations and back-testing indicate that the funds’ Dynamic Volatility Management process could have a significant and positive impact during key equity market downturns. This is particularly relevant in relation to the early years of taking withdrawals, because sequence of returns risk could potentially have a devastating impact on a client’s retirement fund.

THE USE OF DERIVATIVES AS A METHOD OF IMPLEMENTING ASSET ALLOCATION DECISIONS

We regularly use derivatives within the majority of our Multi-Asset Funds. The exceptions are the Funds within PIA and GIS, where our commitment to a simple, low cost approach generally precludes the use of derivatives other than in exceptional circumstances. Derivatives can be used within portfolios for a variety of purposes, of which asset allocation is only one. Where we use derivatives for this purpose, it is because it is a more efficient method of implementing an asset allocation decision than buying or selling the underlying asset. For example, by using a derivative rather than investing in the underlying asset, we may free up capital to invest elsewhere. Alternatively, it may be cheaper to buy a derivative than to buy the underlying asset.

In all cases where we use derivatives, we do so within the strict risk parameters of each Fund. Indeed, another reason for us using derivatives may be to reduce risk within a Fund, for example to protect a Fund from extreme falls in certain equity markets.

FIND OUT MORE

IF YOU’D LIKE MORE INFORMATION ON OUR INVESTMENT PROPOSITION SPEAK TO YOUR USUAL CONTACT OR VISIT OUR ADVISER EXTRANET.

www.scottishwidows.co.uk/extranet