# Multi-Asset portfolios: positioning update

**John Husselbee is Head of the Liontrust Multi-Asset team**

**With the S&P 500 recently posting its worst first half of a year since 1970 and recession indicators flashing red, we are clearly in a challenging period for investment markets.**

**Inflation has now been rising for more than two years, with Covid simultaneously damaging global demand and driving a supply-side shock via shrinking workforces and clogged up production in many parts of the world. Huge bouts of quantitative easing and ultra-low interest rates, alongside other policies, were designed to boost demand, and where this ran into limited supply, the inevitable result was inflation. Russia's invasion of Ukraine, sparking energy price volatility, has only intensified the inflationary pressures.**

**A growing cost of living crisis has left many central banks battling to maintain a delicate balance between tighter policy and higher interest rates to curb inflation on one side and not tipping economies into recession on the other.**

**Rising inflation is proving toxic for investment markets, with equities, bonds and currencies all suffering enhanced volatility. While we have seen a pronounced value rotation over the last nine months, favouring markets such as the UK (which is skewed towards the energy and financial sectors), equities broadly have struggled, with anything in the long duration or growth camp hit by the prospect of higher rates. Fixed income, meanwhile, would usually be expected to provide defensive ballast during equity sell-offs but we are in a rare period of extreme stress during which normal asset class diversification has broken down; in some markets, notably the UK, bonds have not only correlated with equities, but their performance has been substantially worse.**

**Given this backdrop, it seems sensible to suggest the drivers of investment performance and risk could be very different over the next decade compared to the last 10 years, in which US equities (particularly a handful of mega cap technology names) came to dominate. We have therefore reviewed our WSS and MPS portfolios in the context of both higher inflation uncertainty and elevated volatility in equity and bond markets. Over the coming weeks, we will rebalance the portfolios through our annual strategic asset allocation (SAA) update, shifts to our tactical asset allocation (TAA) and changes to fund holdings, both in terms of the active/passive split and underlying managers. Here we set out the rationale for these moves.**

Taking SAA first, we completed our annual review during Q2 and began the usual gradual shift towards the new allocation. We produce low, medium and high-risk SAA allocations, equating to portfolios 3, 6 and 8 in our 1-10 range of risk profiles (1-8 on MPS). It is important to reiterate that moves are not tactical but rather how the data dictate we can best achieve our volatility targets. Like last year, headline changes are fairly small, and overall allocations to equities, bonds, cash and alternatives are broadly the same as in 2021.

Changes within equities reflect an increased return profile in developed versus emerging markets. This has meant a fall in allocations to UK, European and emerging markets equities (including small caps within the first two) and an increase in the US (including small caps), Japan and Asia. Elsewhere, developed market government bonds exposure fell again and high yield declined, while inflation-linked and emerging markets debt increased.

Following our most recent quarterly review, we have moved our TAA overall score down from four to three (on a scale from one to five, with five the most bullish) but would say we are actually more at 3.5. This reflects the fact that navigating higher inflation and volatility, as well as slowing growth, calls for slightly more defensive positioning. We feel risks to the downside are more prevalent, so the lower ranking is warranted.

At the headline level, we have reduced the magnitude of our active bets, cutting back equity exposure and tactically increasing cash to give us scope to re-enter markets when valuations are attractive. This also highlights our focus on suitability: the WSS and MPS portfolios are target risk and each one operates within a volatility band, so with risk spiking over recent month, taking some off the table ensures we remain within these limits and continue to meet our clients' risk profiles.

Looking at tactical changes in more detail, we have trimmed the tracking error and moved closer to the SAA (which is effectively our default asset allocation with no tactical calls) by lowering the equity overweight to neutral to reflect our more cautious positioning. We have cut risk further by lowering our exposure to equity beta-like assets such as convertibles, moving that money into our alternatives allocation (and upping that to overweight the SAA) via a position in the Liontrust Diversified Real Assets Fund (DRAF). We believe real assets should provide a differentiated return and income profile and, importantly given the backdrop, an element of inflation hedging.

We have also increased cash weightings from around 2% to 3-4%, offering both more protection against volatility and some dry powder to invest at opportunistic moments.

More broadly, we are also using this rebalance to alter the blend of active and passive funds across the portfolios, focusing on areas where we feel we can add the most value through selecting active managers. For UK and European equities, for example, we are moving to an overall 70%/30% split between active and passive funds, compared to 40% active/60% passive in the US.

Somewhat counterintuitively, overall passive exposure across the portfolios has increased (by an average of 1.9% for the Growth portfolios) as a result, but this means we are applying a consistent approach to active/passive splits across our full Multi-Asset range. We continue to believe that, post-corrections, markets should move beyond indiscriminate selling and focus more on what the earnings cycle is actually telling us and this is an environment where our favoured active managers can prove their worth in assessing how inflation is affecting companies and which are best placed to thrive. The change in the active/passive exposures means we are getting maximum benefit from areas where active managers can add maximum value.

While the passive exposures have modestly increased, we also remain selective in our active managers and, again, have taken this rebalance as an opportunity to make changes.

In the Income portfolios, we are replacing Redwheel Enhanced Income with JOHCM UK Dynamic. While the deep-value RWC fund has performed well in the recent rotation, this comes after several years of weaker returns. We have concluded that the team's concentrated strategy, investing in deeply discounted companies and not necessarily needing to see a catalyst for potential re-rating, carries too much risk of either mistakes or falling into value traps in declining industries, especially with the speed of disruption, innovation and transition we see now.

In contrast, JOHCM UK Dynamic is more diversified, with strict sector limits around portfolio construction, investing in around 50 companies versus RWC's 25 to 30. While the sector framework and identification of a catalyst for change result in a 'value-lite' style, this mindset leads to a more diversified portfolio, which is arguably more open to opportunities in recovering and/or undervalued companies. Performance has been more consistent, although it should be noted there is a difference in yield, with RWC more income focused and using a covered call strategy to enhance this whereas JOHCM UK Dynamic has a total return objective. At the time of writing, the three-year average 12-month yield on JOHCM UK Dynamic is 3.8% versus 5.6% on RWC Enhanced Income.

We believe higher yields can often be prevalent in mature industries finding it difficult to grow and ultimately favour value managers looking for mispriced quality through catalysts as opposed to those focusing on getting in at the bottom.

In the Growth portfolios, we are replacing Man GLG Continental Europe with BlackRock European Dynamic and AXA Framlington US Growth with AB American Growth.

These two European funds are similar so this move is more a case of rationalisation, bringing our Multi-Asset Portfolios and Funds closer together, as opposed to concerns with the strategy. In essence, both pursue a high-

quality approach but BlackRock European Dynamic is backed by a larger team and has a more flexible strategy, with a high-quality backbone but the capacity to rotate into value when the opportunity exists.

Our move to the AB American Growth Fund is another example of rationalisation as the AXA Framlington fund has performed well. Again, both look to uncover persistent growth opportunities but AB American Growth tends to be a little more concentrated and adopts a purer growth style, which we believe is viable given the US market composition – although it should be blended with a more core or value-biased proposition.

While market and economic conditions are clearly difficult at present, our core view remains that the best antidote to short-term volatility is a resolute focus on long-term outcomes and we see little to be gained by aggressive trading in the current environment. That said, we always build our portfolios from the perspective of preparation rather than reaction and are confident the changes we are making will help us to deliver on suitability and contribute towards meeting long-term outcomes for our clients.

Key Risks & Disclaimer: **Past performance is not a guide to future performance. The value of an investment and the income generated from it can fall as well as rise and is not guaranteed. You may get back less than you originally invested**. The issue of units/shares in Liontrust Funds may be subject to an initial charge, which will have an impact on the realisable value of the investment, particularly in the short term. Investments should always be considered as long term. This document is issued by Liontrust Fund Partners LLP (2 Savoy Court, London WC2R 0EZ), authorised and regulated in the UK by the Financial Conduct Authority (FRN 518165) to undertake regulated investment business. Some of the Funds and Model Portfolios managed by the Multi-Asset Team have exposure to foreign currencies and may be subject to fluctuations in value due to movements in exchange rates. The majority of the Funds and Model Portfolios invest in Fixed Income securities indirectly through collective investment schemes. The value of fixed income securities will fall if the issuer is unable to repay its debt or has its credit rating reduced. Generally, the higher the perceived credit risk of the issuer, the higher the rate of interest. Bond markets may be subject to reduced liquidity. Some Funds may have exposure to property via collective investment schemes. Property funds may be more difficult to value objectively so may be incorrectly priced, and may at times be harder to sell. This could lead to reduced liquidity in the Fund. Some Funds and Model Portfolios also invest in non-mainstream (alternative) assets indirectly through collective investment schemes. During periods of stressed market conditions non-mainstream (alternative) assets may be difficult to sell at a fair price, which may cause prices to fluctuate more sharply. **This is a marketing communication.** Before making an investment, you should read the relevant Prospectus and the Key Investor Information Document (KIID), which provide full product details including investment charges and risks. These documents can be obtained, free of charge, from www.liontrust.co.uk or direct from Liontrust. Always research your own investments and if you are not a professional investor please consult a regulated financial adviser regarding the suitability of such an investment for you and your personal circumstances. This should not be construed as advice for investment in any product or security mentioned, an offer to buy or sell units/shares of Funds mentioned, or a solicitation to purchase securities in any company or investment product. Examples of stocks are provided for general information only to demonstrate our investment philosophy. The investment being promoted is for units in a fund, not directly in the underlying assets. It contains information and analysis that is believed to be accurate at the time of publication, but is subject to change without notice. Whilst care has been taken in compiling the content of this document, no representation or warranty, express or implied, is made by Liontrust as to its accuracy or completeness, including for external sources (which may have been used) which have not been verified. It should not be copied, forwarded, reproduced, divulged or otherwise distributed in any form whether by way of fax, email, oral or otherwise, in whole or in part without the express and prior written consent of Liontrust. 22/522