Multi-Asset = Multi-Risk? 5 Things To Consider - Seeking Alpha

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Tony Ash

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Barron's published an interesting cover story on multi-asset class income investing in the July 8, 2013 issue. It profiled the characteristics of this burgeoning product class and highlighted five mutual funds that have carved out large AUM and good performance. A table of returns in the article showed performance over 1- and 3-year horizons, but this time frame disguised the more recent disappointing performance results due to the recent increase in interest rates. With fears of increasing interest rates beginning to take hold, this product class filled with interest rate sensitive assets including bonds, TIPS, dividend stocks, preferred stocks, REITs, and energy MLPs could be positioned for periods of low or negative returns.

The Barron's article only made a passing reference to ETF products that also participate in this product class, indicating that only a few ETF products have been around more than three years with the Guggenhiem Multi-Asset Income fund (CVY) being the exception. Following below is a comparison of the five mutual fund products to other high profile ETF products and what the Barron's article did NOT say about how income-seeking investors should approach this asset class.

As seen from the table below, June 2013 was a disappointing month for the profiled multi-asset class income products and comparable ETF products. This was an environment where most asset classes produced negative returns and Treasury rates rose about 50 basis points. All of the funds and ETFs underperformed the Barclays U.S. Aggregate Bond Index AND the S&P 500 Index during June and they all tracked into negative return territory for the second quarter. Though some still produced positive returns for the first half of 2013, the potential for negative total returns from higher interest rates is clear.

Ticker	Product Name	June 2013	Second Quarter 2013	First Half 2013
BAICX	Blackrock Multi Asset	-2.16%	-1.02%	2.86%
FKINX	Franklin Income	-2.56%	-1.20%	4.30%
JNBAX	JPMorgan Income Builder	-2.63%	-1.31%	2.06%
DIFAX	MFS Diversified Income	-1.84%	-0.97%	3.03%
TIBAX	Thornburg Inv. Income	-2.48%	-0.95%	6.91%
CVY	Guggenheim Multi-Asset Income	-2.35%	-1.21%	8.98%
INKM	SPDR Income Allocation	-3.12%	-3.86%	-1.33%
IYLD	iShares Morningstar Multi Asset	-3.13%	-5.31%	-1.98%
	Barclays U.S. Aggregate Index	-1.55%	-2.33%	-2.45%
	S&P 500 Index	-1.34%	2.91%	13.83%

How should income-seeking investors approach this asset class? What things should they consider?

1. Using equity investments to generate income is "risky business"
Investors need to understand that this asset category uses risky equity-type assets to generate income and that losses could be large as demonstrated by returns during the Crisis in 2008. As shown from the table below, these funds in this asset category produced significant negative returns from -20% to -40%. Though these are sold as "income" strategies, the risks as shown by the standard deviation metrics in the table below are much higher than generic fixed income bond strategies (per the Barclays' Aggregate Index) and approach the risks of the S&P. A 4% income yield sounds good, but only when it is part of a "positive" total return story! It is the rare "income" investor who can withstand this kind of volatility. Ideally, the fund will have a stated approach that it takes to minimize drawdowns and demonstrates the risk management approach it uses to minimize downside risk.

Ticker	**Product Name**	**2008 Total Return**	**5-year Std. Deviation**
BAICX	Blackrock Multi Asset	N/A	10.57%
FKINX	Franklin Income	-30.50%	9.41%
JNBAX	JPMorgan Income Builder	-25.50%	12.46%
DIFAX	MFS Diversified Income	-20.41%	13.61%
TIBAX	Thornburg Inv. Income	-34.64%	14.97%
CVY	Guggenheim Multi-Asset Income	-40.89%	22.21%
INKM	SPDR Income Allocation	N/A	N/A
IYLD	iShares Morningstar Multi Asset	N/A	N/A
	Barclays U.S. Aggregate Index	+5.24%	3.81%
	S&P 500 Index	-37.00%	18.37%

2. Understand the buy/sell discipline
Fundamentals drive "what" to buy, but technicals drive "when" to buy. Managers need a discipline that is not driven by emotion, but is founded in a proven approach including both fundamental and technical aspects that has worked over various business cycles. A fundamental "value" approach is of no value if the story never gets realized or if the market never accepts the thesis, for example.

Also, in the face of recent historically low interest rates, it is clear that no fund manager has ever managed through this kind of business cycle. Understanding how and when a fund manager will buy or sell is a better way to match your individual risk tolerance to a fund. For example, sticking with a fund manager who is mandated to maintain a long term strategic target within narrow tolerance bands could be anathema for asset allocation funds where huge losses could result from long-only bond funds.

3. Need global focus
You don't need to be invested around the globe all of the time; in fact, you shouldn't be as is the case right now where technicals are pointing away from emerging markets. But, you need the flexibility to be there when the situation is warranted.

4. Tread cautiously with funds that use derivatives or leverage
Though derivatives can add significant benefits to hedge downside risk, they are expensive and can magnify volatility if mismanaged. Likewise, leverage can magnify losses if mismanaged.

5. Cash is your friend
Don't be afraid of funds holding cash as a tactical asset class. As a corollary to the use of derivatives and

leverage, cash is a simple hedge and provides a good cushion to weather market downturns. Additionally, cash used as a hedge doubles as a liquidity source to use for entry back into the market when warranted.

Despite all the good information that mutual funds are required to disclose, finding this information for a mutual fund is difficult. As we continue to enter the potential for a rising rate environment, "buyer beware" is the key credo. Understanding what you are getting is the first step to investment success and having faith in the investment process and adviser completes the story.

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