Quarterly Investment Outlook

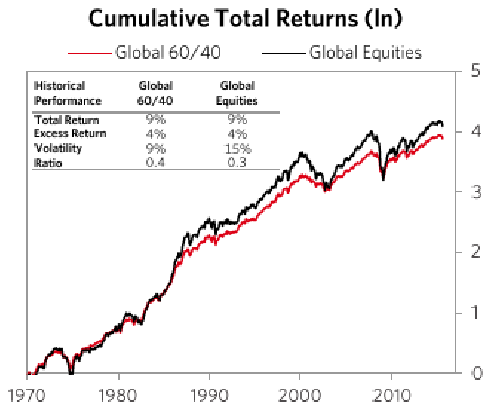
4th Quarter 2017 September 2017

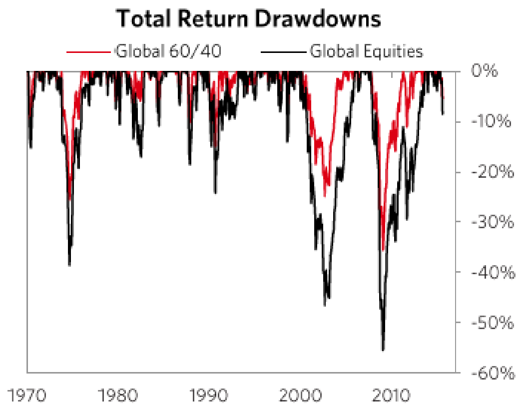
ameliora
WEALTH-MANAGEMENT

Advisor‘s Commentary

A typical balanced portfolio consists of 60% equities and 40% bonds. The idea behind the portfolio’s asset allocation is to diversify or minimize the overall portfolio risk. Conceptually, such a split between the two asset classes makes sense as equities are considered high risk, but also high reward, and bonds are viewed as lower risk instruments. Thus, the latter allocation should act like an offsetting buffer. However, with equities being three to four times more volatile than bonds, that split ratio does very little in terms of risk mitigation. In fact, the overall portfolio has over 90% correlation to its equity component implying that it will strongly mimic the developments of the equity markets. As such, in stressed financial environments, that 40% allocation to bonds will have marginal portfolio diversification effects.

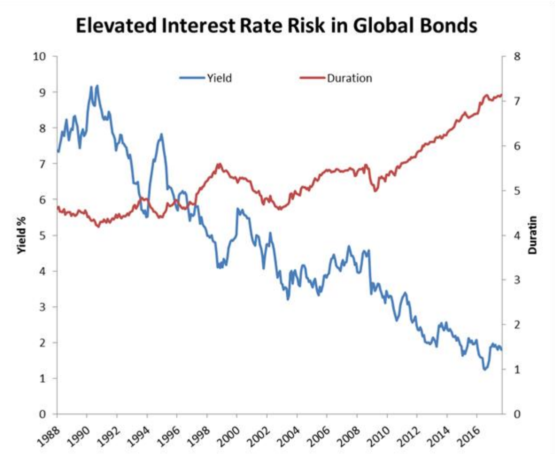
Why such a strategy has been labeled balanced is confusing as there is hardly any balance between the risk and return of the asset classes. Due to the tight correlation with equities, the strategy has pretty much delivered the same returns as the equity market – helped obviously by a +30 year bull market in bonds. It is true that the strategy has been less volatile, but in terms of risk adjusted returns, the difference is marginal.

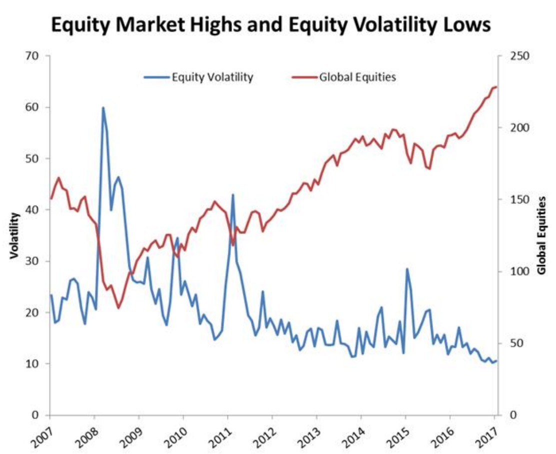




Sources: *Bridgewater Associates.*

Now, if we factor in where we are in the economic cycle and what prevailing asset prices are, this “balanced” investment strategy looks even more unbalanced. Global bond yields are now oscillating around 1.5% and equity market volatility is hovering at historic lows. If the market should witness an uptick in inflation, or expected inflation for that matter, both these two asset classes would move strongly and negatively in tandem. There would hardly be any diversification left as bond prices would fall and equities would rerate in anticipation of a changed economic climate. As a matter of fact, due to the extreme low interest rate levels and the long duration of the global bond markets the presumed risk mitigating properties of such a strategy is nonexistent.



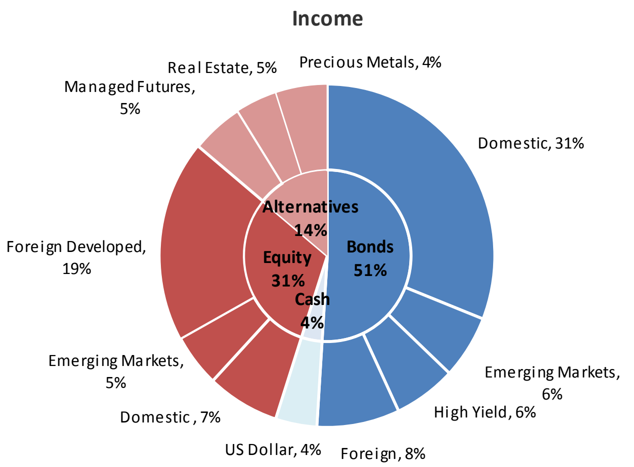


Sources: *Bloomberg, Ameliora Wealth mgmt.*

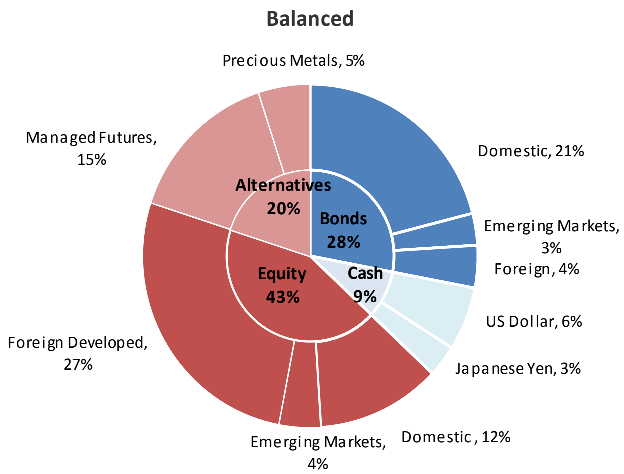
In our opinion, a balanced strategy should balance the risk and return characteristics of several asset classes. If anything is to be “balanced” it would mean that there is no dominate source of neither risk nor return inherent in the portfolio allocation. In addition, the strategy should dynamically be adjusted to the economic environment and respective asset prices to effectively capture the time variation in risk premia. Finally, the return expectations should be evaluated in the context of the overall diversification properties of the strategy. Having a wide allocation to several asset classes will over longer time horizons produce favorable risk adjusted returns, but might during certain periods underwhelm as risk capital is concentrated in just a few asset classes.

Our investment strategy allocations are shown below:

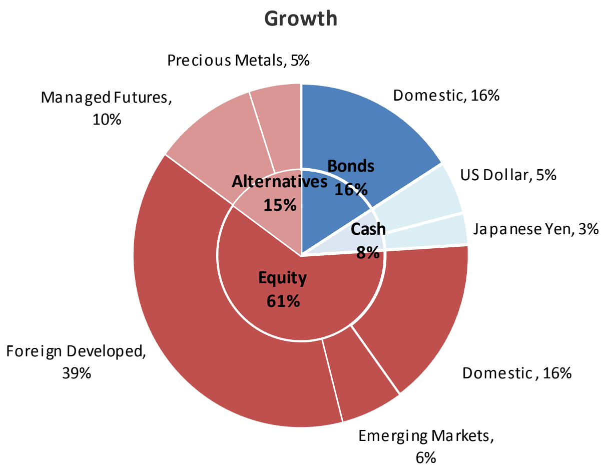
Asset Allocations



	Tactical Positioning Relative to Strategic Weights %	
	Income	Asset Class
		Cash
Bonds	-16	Domestic
	7	Emerging Markets
	5	High Yield
	-2	Foreign
Equity	-13	Domestic
	5	Emerging Markets
	7	Foreign Developed
Altern.	2	Managed Futures
	4	Precious Metals
	1	Real Estate



	Tactical Positioning Relative to Strategic Weights %	
	Balanced	Asset Class
	-2	Cash
Bonds	-10	Domestic
	5	Emerging Markets
		High Yield
	-6	Foreign
Equity	-15	Domestic
	8	Emerging Markets
	20	Foreign Developed
Altern.		Managed Futures
		Precious Metals
		Real Estate



	Tactical Positioning Relative to Strategic Weights %	
	Growth	Asset Class
	5	Cash
Bonds	-8	Domestic
		Emerging Markets
		High Yield
	-5	Foreign
Equity	-23	Domestic
	10	Emerging Markets
	20	Foreign Developed
Altern.	1	Managed Futures
		Precious Metals
		Real Estate

***Source**: Ameliora Wealth Management as of 1st September, 2017*

***Note**: Tactical asset allocations are subject to change without notice and represents investment strategies in USD. Tactical positions (over-/underweight) are deviations **from** strategic benchmark weights*

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