

Market Insight

Including alternatives strategies in a portfolio can help to improve performance whilst reducing risk

The Portfolio Research & Consulting Group at Natixis Global Asset Management provides fully independent analyses of private and institutional investor portfolios, identifying sources of performance, risk concentration and diversification. In doing so, the group has highlighted the major contribution of alternative strategies.

Key takeaways

- The Portfolio Research & Consulting Group offers a completely free and personalized service, independent of the services offered by the sales and fund management teams.
- The Durable Portfolio Construction© approach is based on a number of principles, including the prioritization of risk management, improved diversification and the implementation of alternative investment strategies.
- Overlaying similar types of investment exposure is not synonymous with diversification.
- Alternative strategies may contribute additional sources of performance whilst reducing a portfolio's average risk.

The role of a portfolio constructed for the long term is to remain invested whatever the market conditions. In the current market environment, investors tend to overreact when faced with volatility peaks and make decisions that are not in the best interest of their long-term investment targets. Against this background, Natixis Global Asset Management creates solutions which help investors to construct durable portfolios (Durable Portfolio Construction© – DPC). This approach is based on a number of principles, including the prioritisation of risk management, improved diversification and the implementation of alternative investment strategies. Taking account of risks upstream of portfolio construction is truly the cornerstone of Natixis Global Asset Management's investment philosophy. Risks must be considered as starting points for investments, rather than consequences of investment decisions.

Overlaying similar types of investment exposure is not synonymous with diversification

This is why the Portfolio Research & Consulting Group established by our firm in the US in 2011, then in London in 2013, has the very specific role of providing in-depth portfolio analysis for investors, be they private or institutional



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(financial advisors, private banks, family offices, but also increasingly, retirement funds, insurance companies and pension funds). Its aim is not to make investment recommendations, but to study portfolio composition from the joint perspective of risk management and diversification, thus identifying risk concentration, analysing underlying securities and funds, applying stress tests and ranking the various performance contributors. Often the real degree of diversification in a portfolio is not as expected. Combining several funds, which aim to generate alpha in the same asset classes, leads to an overlay of similar exposures (e.g., in French small- and mid-caps) and not increased diversification. Similarly, an institutional portfolio often exhibits risk well below that of its benchmark (in terms of VaR or maximum drawdown): excessive caution, indicating incomplete appreciation of the sources of performance.

With a variety of academic and professional profiles, from risk management, fund management and quantitative analysis backgrounds, the thirty-six professionals making up the Portfolio Research & Consulting Group team (25 in Boston and 11 in London) offer a completely free and personalised service, independent of the services offered by the sales and fund management teams of the company's affiliated asset managers. They aim to clarify investment processes for clients, so that investors can freely and in full confidence share their views on the impact of including securities, structured products, derivatives, currencies, ETF and competitor funds in their portfolios with these experts. Ultimately, this analysis either validates or invalidates investors' beliefs about their risk exposure

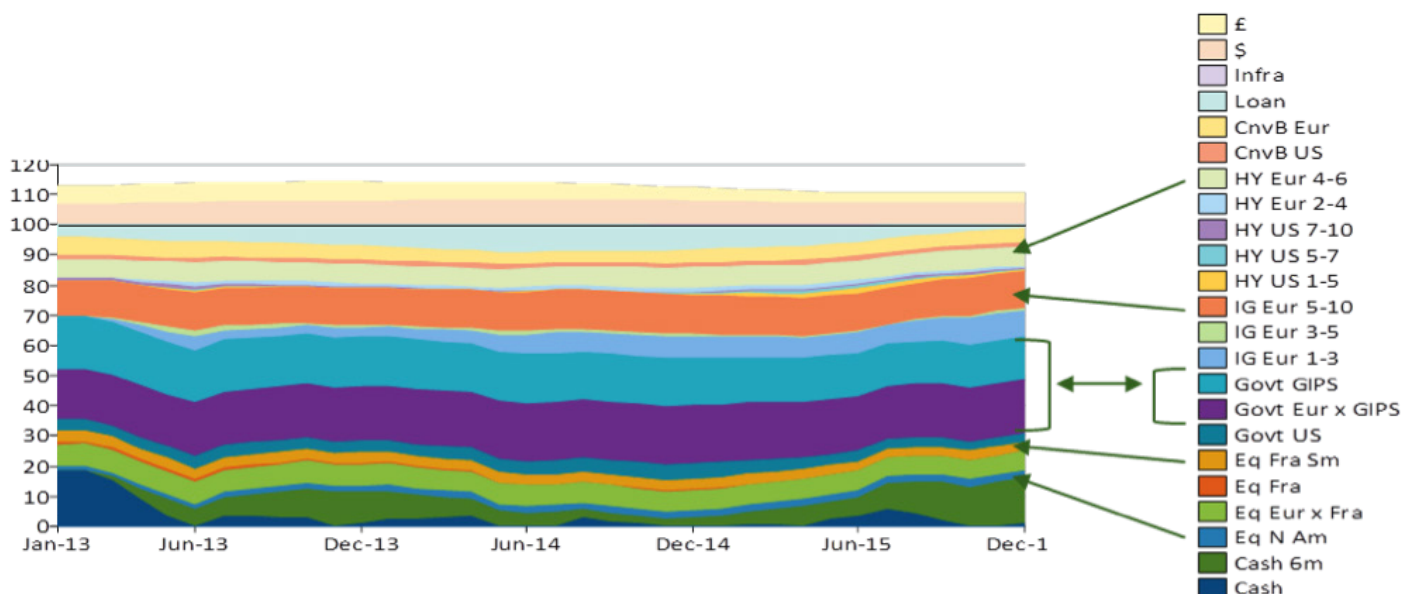
while revealing the truth about the sources of performance in a portfolio. This analysis can also be made in the context of the regulatory (Solvency II) and accounting constraints of certain institutions.

Using alternative strategies to contribute additional sources of performance whilst reducing a portfolio's average risk

With data accumulated from five years worth of analyses of a large number of portfolios from across the world (more than 4,500 in 2015 globally), the Portfolio Research & Consulting Group is able to make highly astute and contextualised comparisons between portfolios, while ranking the analysed elements. This process highlights the paramount importance of including non-traditional strategies, either

liquid or illiquid, which can generate additional sources of performance whilst reducing the portfolio's average risk. Comparisons of the weightings of the various positions in a portfolio can highlight extremely disproportionate contributions to performance and risk (as the chart below shows).

Identifying the sources of performance of a typical institutional portfolio with the RBSA technique



Source : Natixis Global Asset Management. Analysis of a typical institutional portfolio between January 2013 and December 2015.

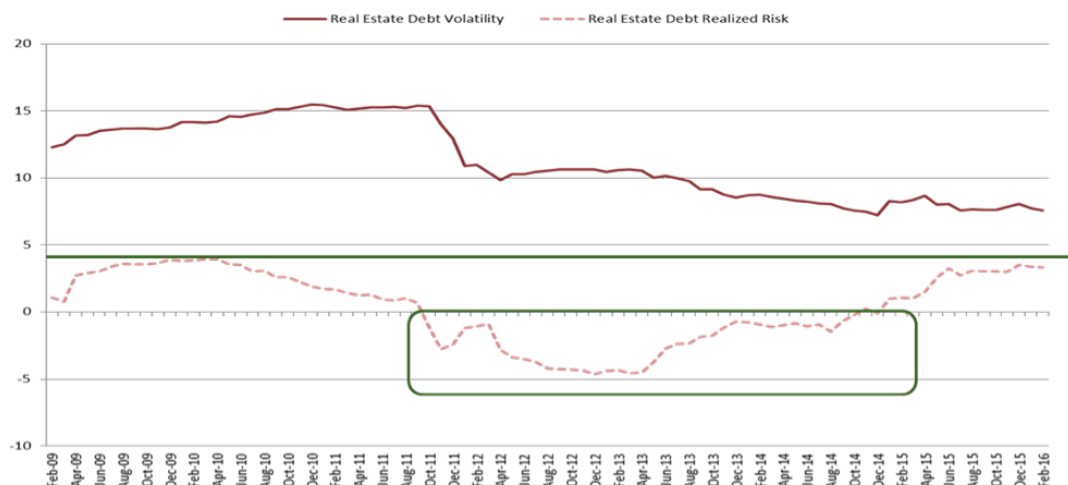
Our research shows that an institutional portfolio's risk/return profile may be significantly improved by the addition of certain constituents, which may appear to be very volatile, but are actually only moderately so in the context of the portfolio, because of their weak correlation with the other portfolio

constituents. Performance can thus be improved, without the addition of risk, despite the volatility of the asset class.

This is typically the case with Commercial Real Estate Debt, as the chart below illustrates. Although Commercial Real Estate Debt's volatility

peaked to more than 15% on its own, when added to a typical institutional portfolio, its consistently low correlation with the institutional portfolio since 2006 means that the strategy would have even reduced the portfolio's overall risk between August 2011 to February 2015.

36 Month Rolling Realized Risk
February 1, 2009 - February 29, 2016



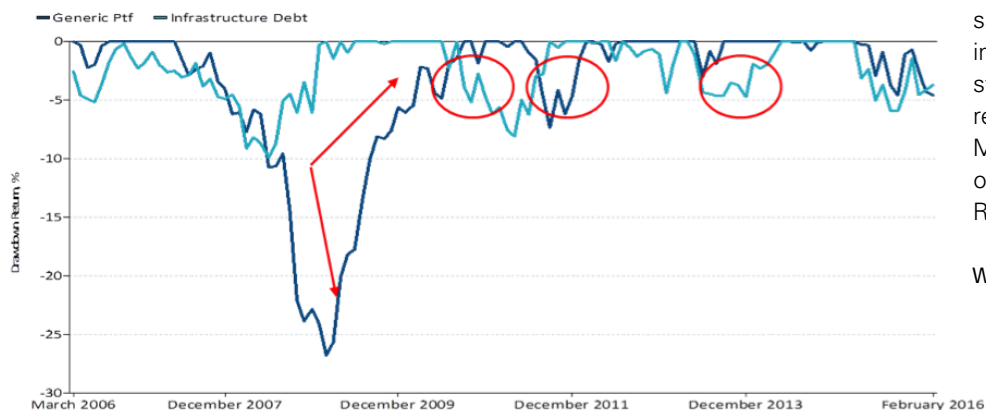
Source : Natixis Global Asset Management. Based on the analysis of a typical institutional portfolio between February 2006 and March 2016, with Real Estate Debt represented by the DJ Global Select Real Estate Securities Corporate Bond Index.

Finally, the addition of non-traditional strategies may reduce the extent and length of pronounced market falls (see chart below). For example,

infrastructure debt tends to move in opposite direction to the typical institutional portfolio when the latter drops quickly in value.

Non-traditional illiquid strategies may add value to institutional portfolios, making them more robust over the medium term.

March 1, 2006 - February 29, 2016



No two institutional portfolios are the same, and there is a lot of dispersion in the performance of non-traditional strategies. Professional investors can reach out to their Natixis Global Asset Management contact to get an analysis of their portfolio by the Portfolio Research & Consulting Group.

Written on 28 May 2015, updated on 21 April 2016.

Source : Natixis Global Asset Management, March 2016. Infrastructure Debt represented by the MS Global Bond Infrastructure GR EUR.

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Past performance is no guarantee of future results.

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