Investment Centre
a part of MONEY MANAGEMENT

Balanced funds ‘flying blind’ in their allocations

25 May 2020

Balanced funds are “flying blind” as their positioning to assets like infrastructure is failing to provide defensiveness during sharp market downturns, according to Cor Capital.

By Laura Dew

Balanced funds are “flying blind” as their positioning to assets like infrastructure is failing to provide defensiveness during sharp market downturns, according to Cor Capital.

Some balanced funds had seen drawdowns of between 15%-20% in the first quarter of 2020 which exceeded the risk appetite of many balanced risk investors, the firm said.

A key reason for this was because there had been a trend in recent years to move away from governments bonds into other types of alternative assets like infrastructure, credit and property.

Cor Capital investment manager, Tom Rachcoff, said: “But when the market downturn hit in late February, these assets were far more closely correlated to growth assets than they believed. Airports, commercial property, and corporate credit are linked to gross domestic product expectations as the global shutdown has graphically exposed.

“It means many traditional ‘balanced funds’ held between 60% and 80% exposure to growth assets, when their belief would have been that their exposure was much lower. It’s little wonder they were shocked in March at their portfolios’ growth risk exposures.

“At this junction, this is particularly concerning given the bleak global economic outlook and the fact that a sustained and deep recession is a real possibility. Portfolios tilting toward high levels of growth asset risk may be flying blind into a serious headwind.”

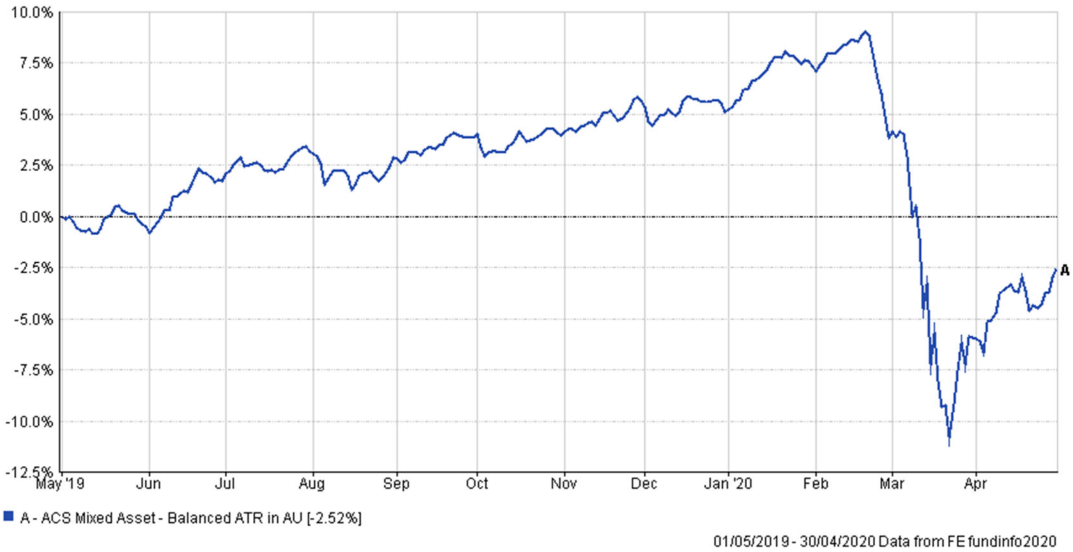
Rachcoff said it was important for investors to build an “all-weather” portfolio which would perform like a balanced fund in rising markets but like cash and gold when there was a market downturn.

“The premise of such a strategy is built on the belief that it is extremely difficult to forecast asset class returns; and that the most robust portfolio possible will be diversified based upon fundamental economic drivers for all environments. It is the antithesis of what is usually considered ‘diversification’, especially in the superannuation industry,” he said.

“You see a lot of portfolios that are supposed to be ‘diversified,’ but they’re really 70% growth – like ‘balanced’ super funds. Even if they’re rebalancing, they’re just rebalancing from growth to growth. Every time we have a major systemic event – it happened in the Global Financial Crisis, and it has happened again – we see the correlations of the assets in a balanced fund go to one, and there’s no defence for that.”

According to FE Analytics data, within the Australian Core Strategies universe, the average balanced fund lost 2.5% over the year to 30 April, 2020.

Performance of mixed asset balanced sector over one year to 30 April 2020



https://investmentcentre.moneymanagement.com.au/news/7464654/balanced-funds-flying-blind-in-their-allocations