

*Beyond Convention:*

# The Evolution Of Active Management In Investment Solutions

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## INVESTMENT



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investment programs.

Investors continued to benefit from extended bull cycles in the 1980s and 1990s. The bull cycle survived the overshoot in tech when that bubble burst rather abruptly in the early 2000s. You can argue that it even survived the Global Financial Crisis (GFC) in 2008, as central banks aggressively lowered yields and forced equities higher. The resulting regulatory change has certainly altered the financial playing field and brought about change to the types and the behaviours of players.

Eight years beyond the GFC, things are changing. The era of central banks easing monetary policy is likely over. Economic management is shifting towards government fiscal policy. In the 'new normal' since 2008, developed market interest rates have gone towards zero and below, while correlations between traditional asset classes are increasingly elevated. Growth is gravitating back towards the developed markets from the emerging world, but at reduced levels of GDP growth and with much higher volatility than we have been accustomed to.

### Augment The Prediction

So let's augment the prediction of what will create success looking forward. Current projections of expected market returns are typically low relative to the last 30 years. Many investors have concluded the old 'active versus passive' debate by seeking to approximate market returns via indexing or smart beta strategies, where there is an abundant supply of index funds or ETFs to satisfy needs. Should these lower return projections prove correct, then it's unlikely investors will be able to offset reduced asset performance by simply squeezing fees.

We take a more progressive position on 'active management' investment solutions and also take cues from the success of the so-called 'Canada model.' This refers to the world-renowned approach developed by public pension plans at the federal and provincial levels, wherein the

Canada model embraces a diverse portfolio of traditional and alternative asset classes, both liquid and illiquid. The model allocates capital to where there is the highest return on risk, relying increasingly on manager skill to shape returns.

The challenge we are undertaking is to make some of these risk-focused investment solutions and vehicles available to the larger institutional investor community. In this realm, we embrace the opportunities presented by 'liquid alternatives,' which can include derivatives instruments such as forwards, futures, options, swaps, etcetera, used to structure exposures that will achieve the desired risk and return outcomes. These instruments give investors access to some of the deepest, most liquid, and often most transparent markets globally, including access to alternative risk premia as a source of positive returns. From this perspective, active management means taking advantage of all available investment opportunities in the pursuit of a defined investment outcome. The outcome will typically be expressed in terms of both return and risk. Strategies that employ this approach carry names such as 'multi-asset growth,' 'diversified growth,' and 'targeted return,' among others.

Critical to the success of these active management solutions is the manager's ability to access discrete investment opportunities that don't fit the norm and to combine this access with skill in such a way as to generate a stable risk and reward profile over time, a profile that has little correlation to the traditional asset classes that the investor might be exposed to elsewhere. If the manager is truly skilled and experienced, this provides the flexibility for custom-built active management solutions that meet the needs and risk appetites of a variety of different investors.

### Embrace Alternatives

Concluding these thoughts, it strikes me that institutional investors that benefit from a longer time horizon will increasingly move away from convention

**A**s I write this thought piece, the news media is still announcing a U.S. President-elect Donald Trump, an event that likely ushers in a new and very different era of political leadership for the nation that boasts the world's largest economy. Markets are already reacting with increased volatility, a typical reflection of their dislike of uncertainty. With the Brexit vote still fresh, one cannot help but feel that this latest development will simply compound the already precarious state of capital markets.

These issues add fuel to my belief and prediction that what will generate success for investors over the coming 10 or more years will likely be different from what worked over the last 20 or 30.

### 'Black Monday'

My memories of joining the industry in the mid-1980s remain vivid. I started my career at an independent, London (UK)-based merchant bank with a global outlook and a robust business in balanced portfolio management. Within 18 months of joining, 'Black Monday' occurred on October 19, 1987. That day the Dow Jones Industrial Average (DJIA) in the U.S. fell 23 per cent. Despite the savagery of this downturn, markets quickly regained their poise, the DJIA recovered all of the loss by the end of that same year and reached new all-time highs less than two years later. Because the time from 'crash to recovery' was relatively short, there was little impact to the conventional design of institutional

and choose to embrace alternative investing in their pursuit of a desired level of reward and risk, and reduced volatility. This suggests that illiquid alternative investments – such as private equity, real estate, and infrastructure – will hold sustained appeal and will increasingly be

complemented with active management solutions employing liquid alternatives.

There appears to be a growing body of opinion, perhaps even conviction, that what has worked for institutional investors over the last 30 years, in the process becoming convention, is not likely to repeat over the

next 10 years or more. By keeping an open mind to newer active management solutions, investors will position themselves for continued success. Let skilled investors manage the risks and returns for you. Don't leave it to central bankers and government policy makers. **BPM**