Multi-Asset Portfolios

Case study

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Defaqto Case Study

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For further information please contact us on 0808 1000 804

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Introduction

Any advisory firm making decisions around outsourcing its investment proposition will almost certainly have undergone lengthy processes of segmenting its client base and analysing its own internal resources. Bearing in mind the significant amount of time many businesses will have spent on this groundwork, it is essential that the ultimate choice of outsourcing solution is based on a sound and quantifiable rationale.

When seeking to outsource their investment propositions, most advisers will look at two main options: discretionary solutions and multi-asset funds. Discretionary solutions are more bespoke in nature and may require investors to meet large minimum investments that typically range from £25,000 to £500,000. Multi-asset funds, however, usually have much lower minimums; often £1,000 or less, and generally have lower fees.

This case study presents:

- A framework for the analysis of the multi-asset fund universe
- An outline of the Defaqto approach to rating multi-asset funds with or without past track records, the latter being the case with the Goldman Sachs Wealthbuilder Multi-Asset Portfolios
- An overview and analysis of the new GS Wealthbuilder Multi-Asset Portfolios investment process and offering
- Under Defaqto’s Diamond Rating methodology for rating funds each of the three funds within the GS Wealthbuilder range currently receives a 4 Diamond rating.

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Understanding the universe of multi-asset funds

Identifying the appropriate strategy

Multi-asset funds come in various forms. Our ‘quadrant’ chart below offers a framework to help advisors identify the key investment characteristics and the positioning of each multi-asset class investment fund.

Defaqto’s framework focuses on four key themes:

1. Investment style
   - Return focused - Funds aim to achieve outperformance, either absolute or relative to a peer group or benchmark and normally with some risk control. These funds are useful if an investor is trying to achieve a certain level of growth over time or a particular goal in terms of amount of money.
   - Risk targeted - Fund ‘families’, a set of funds that still aims for good performance but each fund in the family operates within strict risk bands.

2. Management approach
   - Multi-asset funds can be either:
     - Single manager - One fund manager or team manages all the investments in the fund.
     - Multi-manager - Different fund managers are used for different asset classes.
   - Multi-manager funds may be either:
     - Fund of funds - The multi-asset manager is buying and selling all or part of its underlying funds.
     - Manager of managers - A mandate will be set up with the sub-fund manager and run on a segregated basis.
   - Multi-manager funds may also be either:
     - Fettered - The multi-asset fund manager can only use funds from elsewhere within its organisation.
     - Unfettered - Funds from any firm may be used.
3. Asset type

Multi-asset funds may be either:

- **Traditional asset funds** - Investments are long-only and in the ‘traditional’ asset classes of equities, bonds, cash and real estate.

- **Traditional and alternative asset funds** - Investments are a combination of traditional asset classes and ‘alternative’ assets, such as private equity and infrastructure.

4. Investment method

Finally, multi-asset funds can be either:

- **Active** - The underlying managers attempt to generate returns in excess of the stated benchmark/index.

- **Passive** - The underlying funds aim to track the benchmark/index.

- **Blend funds** - Significant positions are held in both active and passive funds. In the case of passive, the allocation between the passive funds will still be active.

Based on this framework, Defaqto classifies the GS Wealthbuilder Multi-Asset Portfolios as follows:

- Investment Style: Return focused
- Management Approach: Multi-manager, fund of funds, mainly fettered (with some use of external passive implementation)
- Asset Type: Traditional and alternative
- Investment Method: Blend with a bias to active (with the initial proportion of active funds being 80% for the Conservative Portfolio, 79% for the Balanced Portfolio and 72% for the Growth Portfolio)

The constitution of the GS Wealthbuilder Multi-Asset Portfolios is examined in more detail later in this document.
A Rating Framework for Selecting Multi-asset Funds

Defaqto has introduced Diamond Ratings to further help advisers and investors navigate the expanding fund universe by providing an independent assessment of where funds and fund families sit in the market.

In scoring multi-asset and other types of funds, we apply a Data Numeric Analysis (DNA) methodology, with each fund feature and performance attribute being scored from 1 to 5, whereby 5 indicates the best possible characteristic (top quintile) and 1 indicates the worst characteristic (bottom quintile).

The sum of the individual DNA scores across the range of fund features and performance attributes provides an overall DNA score, which we use to rank each fund within its respective universe.

Under our standard methodology for rating funds (which applies to those with more than two years of performance data), all funds would be rated on two different performance measures (in addition to the other fund features), with the weightings on each of these being doubled in order to give performance a higher impact on the overall rating.

**Subjective ratings**

For fund families with less than one year of performance history, we do not use performance data (if it exists at all) as we believe it would not be statistically significant. Instead, we rate the fund and underlying manager on a scale of 1 to 5 based on the following five aspects:

1. **Business:** Ownership stability, financial strength, ability to deal with business growth and key person risk.

2. **Staff quality:** Experience and skills of the team members - in particular the key decision-makers, team stability, how well the team are incentivised and staff turnover.

3. **Philosophy:** Are there unique characteristics about the manager’s beliefs and philosophy? Can they be translated into ‘alpha’? If so, in what type(s) of market are they likely to do well?

4. **Process:** Is the manager’s approach to asset allocation and portfolio construction clear, understandable and consistent with the manager’s investment philosophy? How does the manager research and select funds? How does the manager analyse and manage risk? What is the sell discipline?

5. **Research capability:** Level and type of resource - in particular the size of the research team.

The ratings for the above are derived from at least one detailed and structured on-site meeting with the fund manager. The rating weights are scaled down, by a factor of four fifths, so that the effect on the overall rating of the five criteria listed above is the same as that of the two performance measures used to rate funds under the standard methodology.

We may also look at quantitative information if, for example, a strategy similar to the proposition has been managed elsewhere in the business.
Additional Features

Our Diamond Rating scoring methodology - both standard and for new funds - also takes into account the following additional features:

- Fund size
- Group assets under management (AUM)
- Manager tenure
- Number of distribution partners
- Size of minimum single investment
- Initial fund charge
- Ongoing fund charge

The attribution of the overall Diamond Rating is shown in the chart opposite. In this chart ‘minimum single investment’ and ‘number of distribution partners’ are grouped into ‘accessibility’. ‘Tenure’, ‘fund size’ and ‘group AUM’ are grouped into ‘other manager features’.

Diamond Rating attribution

- Charges: 18.2%
- Accessibility: 18.2%
- Other manager features: 36.4%
- Quant or subjective ratings: 27.3%
Goldman Sachs multi-asset fund offering

This case study considers the GS Wealthbuilder Multi-Asset Portfolios and their potential suitability as a multi-asset solution for clients.

Classification of the GS Wealthbuilder Multi-Asset Portfolios within the Defaqto Multi-asset Fund Framework

The GS Wealthbuilder Multi-Asset Portfolios offer a range of three distinct solutions that reflect different return and risk orientations. Investors can select which solution best suits their long-term investment objectives.

<table>
<thead>
<tr>
<th>Portfolio</th>
<th>Rationale</th>
<th>Gross Expected Return</th>
<th>Expected Volatility</th>
</tr>
</thead>
<tbody>
<tr>
<td>GS Wealthbuilder</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Conservative</td>
<td>Objective: Capital preservation</td>
<td>5.6%</td>
<td>6%</td>
</tr>
<tr>
<td></td>
<td>Investor Type: Willing to assume lower levels of risk, aims to primarily preserve capital, while seeking opportunities for capital growth.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balanced</td>
<td>Objective: Moderate capital appreciation</td>
<td>6.7%</td>
<td>9%</td>
</tr>
<tr>
<td></td>
<td>Investor Type: Willing to assume additional risk, seeks a balance between capital preservation and capital growth over the medium- to long-term.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Growth</td>
<td>Objective: Notable growth of capital</td>
<td>7.6%</td>
<td>12%</td>
</tr>
<tr>
<td></td>
<td>Investor Type: Willing to assume higher levels of risk in the search for significant capital appreciation over the long-term.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Business background

Goldman Sachs Asset Management (GSAM) has been providing discretionary investment services since 1989, with over £560 billion in assets under management and more than 1,900 professionals based in 32 locations around the world (as of March 2014). GSAM offers access to a diverse range of asset classes including fixed income, equities and alternatives.

The GS Wealthbuilder Multi-Asset team

The GS Wealthbuilder Multi-Asset Portfolios are managed by GSAM’s multi-asset investment team, Global Portfolio Solutions (GPS). GPS consists of more than 70 members dedicated to constructing and managing over £15 billion in global multi-asset solutions (as of March 2014). The team has been managing multi-asset portfolios for nearly 20 years, and senior investors average over 20 years of investment experience. Raymond Chan and David Copsey of GPS are the lead portfolio managers responsible for managing the GS Wealthbuilder Multi-Asset Portfolios, and additional oversight is provided by Neill Nuttall, Co-chief investment officer of GSAM’s multi-asset investment team, and Kathryn Koch, head of the GPS international business.
The GS Wealthbuilder Multi-Asset Portfolios’ investment philosophy and process

The GS Wealthbuilder investment philosophy, consistent with that of all GPS multi-asset solutions, is rooted in three core tenets:

- **Diversify for the long run**: A well-diversified portfolio across multiple sources of return, investment style, and investment horizons maximises the likelihood of achieving investment objectives over the long run.

- **Active management matters**: Markets are not always efficient, presenting both opportunities and risks. Exploiting these inefficiencies through security selection, tactical allocation across asset classes, or risk management strategies can make a significant difference in achieving client objectives.

- **Risk is necessary to generate investment returns**: Risk is an input to, rather than an output from, the investment process and therefore must be identified, measured and managed systematically.

The GS Wealthbuilder investment process focuses on achieving portfolio objectives as outlined in the following steps:

1. **Diversified Strategic Asset Allocation**
2. **Dynamic Tactical Asset Allocation & Security Selection**
3. **Portfolio Construction and Implementation**

On-going risk management
Step 1 - Strategic Asset Allocation (SAA)

The GS Wealthbuilder Multi-Asset team views strategic asset allocation as the primary driver of portfolio performance with a goal to create an overall diversified portfolio that maximises the likelihood of achieving portfolio goals. In pursuit of diversification (spreading of risk), GSAM has developed a proprietary asset allocation approach that:

- Aims to access the widest investment universe possible: The team takes a global approach and focuses on finding sources of return beyond traditional bonds and equities. This approach results in the inclusion of asset classes that are under-represented in a market capitalisation weighted portfolio, thus increasing the potential to improve the overall diversification of a portfolio and generate additional returns.

- Allocates risk, not capital: The team’s approach to constructing a portfolio is based on the amount of risk specific to each investment rather than on a monetary amount. GSAM also takes into account the relative behaviour of each asset class.

- Provides an understanding of the key risk drivers: GSAM has developed a set of ‘risk factors’ that aim to provide a greater insight into the drivers of portfolio and asset class returns. The team uses seven distinct factors: equity, emerging markets, interest rates, credit, commodities, currency and volatility. This approach provides greater diversification of risk as asset classes may be driven by a number of risk factors; for example, some of the risk factors driving high yield bonds are credit and interest rates.

As a result of this approach, the GS Wealthbuilder Multi-Asset Portfolios have the following strategic asset allocations:
Step 2 - Tactical Asset Allocation (TAA)

While the GS Wealthbuilder Multi-Asset team believes that markets are fairly efficient, it is aware that economic cycles and market uncertainty can result in materially different returns and mispricing across asset classes over the short-term (six weeks to one year). As a result, the team conducts in-depth quantitative, qualitative and technical analyses focused on identifying short-term opportunities and risks on the horizon and adjusts the portfolio allocations to reflect these views. The views fit into three categories:

<table>
<thead>
<tr>
<th>Category</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Macroeconomic</td>
<td>Underweight US government bonds because of the reduction in quantitative easing by the US Federal Reserve and expected rise in interest rates</td>
</tr>
<tr>
<td>Valuation</td>
<td>Overweight European equities because of perceived undervaluation versus other regional markets</td>
</tr>
<tr>
<td>Hedging</td>
<td>Hedge duration of high yield bonds in anticipation of the rise of global interest rates</td>
</tr>
</tbody>
</table>

When uncovering potential market dislocations, the GS Wealthbuilder team utilises inputs from various parts of Goldman Sachs as well as external sources. The team looks at what the market is pricing in, identifies differing views, and assesses the associated risk and alternative ways of analysing the opportunity. Tactical shifts may be utilised for risk management as well as return-seeking purposes.
Risk management
At the portfolio level, the GSAM risk management approach incorporates the following:

- Understanding of portfolio and market risk exposures. The use of advanced risk management systems provides the portfolio management team with access to a range of risk analytics, external real-time market data and analyses to understand risk from many different angles. Stress tests and scenario analyses are used to identify how portfolios may have performed in different macroeconomic environments.

- Close monitoring of portfolios on a daily basis and measurement of risks such as currency, liquidity and inflation risk. Stress testing is carried out to improve awareness of potential downside risks.

- Effective mitigation of identified risks. The team employs proprietary risk management strategies and tactical hedges with the goal of dampening portfolio drawdowns and managing volatility.

Risk management is further enhanced and supported at the divisional and firm levels.

Comparing the GS Wealthbuilder Multi-Asset Portfolios with other multi-asset funds

The Goldman Sachs Wealthbuilder Multi-Asset Portfolios have just been launched and, as a result, the funds do not have a performance history. As previously referenced, Defaqto scores such funds based on a set of qualitative factors.

The GS Wealthbuilder Multi-Asset Portfolios have been compared to other funds in the following categories:

- Multi-Manager Mixed Investment 0-35% Shares universe for the Conservative Portfolio
- Multi-Manager Mixed Investment 20-60% Shares universe for the Balanced Portfolio
- Multi-Manager Mixed Investment 40-85% Shares universe for the Growth Portfolio

Under the Defaqto Diamond Rating process, each of the three funds currently are attributed an overall 4 Diamond Rating (out of a possible 5).

They score very favourably on the five subjective measures related to the overall business, staff quality, investment philosophy, process and research capability. Also within this total rating, the GS Wealthbuilder Multi-Asset Portfolios are attributed a score of 5 for minimum initial investment and charges, both initial and ongoing.
As an independent research provider, Defaqto will continue to provide insights into new investment strategies. The Goldman Sachs Wealthbuilder Multi-Asset Portfolios are one example of a return-focused, multi-asset fund range that seeks to meet clients’ specific objectives. Based on review of the strategy, we believe the key strengths of this offering include:

- A large and experienced investment team supported by Goldman Sachs’ resources
- A sound investment philosophy and process
- A robust risk management framework
- Very favourable fees, with no initial charge and a total expense ratio of between 1% - 1.2% (for the R clean share class)
Get in touch

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