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## **GTAA - An Efficient Investment Discipline**

By: Richard Urwin

In recent years, GTAA (Global Tactical Asset Allocation) has become one of the more attractive **investment** opportunities to have emerged in the market. The strategy is increasingly finding its place as an established product in many portfolios as it offers a distinctive **investment** opportunity.

There are four features that distinguish GTAA portfolios.

First, the opportunity set is global. The potential range of **investments** includes bond, equity, and currency markets for which liquid derivative markets exist, which tends to be the larger and more developed capital markets.

Second, implementation exclusively through the derivatives markets means that the cost of delivering the strategy is very low, making it particularly efficient when compared to strategies using physical or cash related instruments.

Third, GTAA is an absolute return oriented strategy with no explicit asset-based benchmark. The performance hurdle is typically a return in excess of cash. The use of derivatives enables relative value trades to be scaled appropriately and the ability to short assets which can add a further dimension to the return potential.

GTAA alpha can be derived from varying asset exposures over time and, more importantly, by market selection within each asset class. While market timing is a legitimate source of return in a GTAA strategy, we would not expect it to be dominant. Market selection within each asset class is likely to provide more durable alpha.

### **Generate Signals**

Fourth, the GTAA investment process maintains a quantitative bias. Quantitative models are often used to generate signals. Sophisticated portfolio construction then allows these signals to be combined in an effective way, notably, by delivering an appropriate distribution of risk in the portfolio and not allowing performance to be dominated by misscaled large bets.

Quantitative investment styles should not be seen as eliminating judgment from the investment process. Substantial thought is involved in the construction of these models. In our view, a successful GTAA model should be based chiefly on fundamental factors such as valuation and the cyclical drivers of market returns. We do not believe it is necessary to import insights from quantum physics to add value in this area. The returns from a range of fundamental factors have low correlations, allowing significant diversification of return sources and providing the opportunity for consistent alpha.

This process can be of potential interest to a wide range of investment funds. Significant alpha can be harvested from this disciplined investment process. Global investment flows are still dominated by benchmark-driven investors and, therefore, there exists considerable capacity in the GTAA space. Large flows from retail investors are primarily driven by performance or by investment committees making decisions by consensus, which are often slow moving and unable to capitalize on exploitable market opportunities. By contrast, GTAA, though disciplined, offers this flexibility.

### **Appealing Characteristics**

Furthermore, GTAA alpha has three appealing characteristics. It is diversified, incremental, and consistent. Research suggests that over the course of a market cycle, GTAA alpha has had a very low correlation with returns from a range of conventional asset class returns. Over shorter time horizons, somewhat higher correlations may be evident – for example, if a long equity exposure was

maintained during a bull market. However, the risk devoted to such a bet should not dominate the portfolio's return and a successful short exposure in a declining market could be significant in delivering a lower market correlation over time.

In our experience, the GTAA strategy can be utilized in one of two ways. It can be employed as a low risk, incremental return overlay sitting above a portfolio. Alternatively, the strategy can take on more risk to generate higher returns by delivering a significant enhancement to cash in the portfolio, if this cash is used as margin to support a higher notional investment. The precise risk level chosen can be easily calibrated to an investor's targeted risk level and there is flexibility in the asset set employed – for example, whether to include or exclude currency.

Global interest in the GTAA strategy has significantly increased over time. GTAA seeks consistent returns with low correlation to traditional asset classes. As fund structures have become more complex, the use of asset allocation as an investment discipline has eased. GTAA offers a direct way to reinstate it. ■

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