SWISS RISK MANAGEMENT FIRM OF THE YEAR

- *Funds and Advisory at Barclays*

Ajay Jain, Head of Portfolio Engineering and Gil Platteau-Waldmeier, Head of Switzerland Sales, at Funds and Advisory at Barclays examine risk in investment.

Is there such a thing as a risk free investment?

Recent global events have proven that even large developed governments cannot always offer complete protection for investor money. The European Central Bank, the US Federal Reserve and a host of other central banks have taken action to prop up their economies and support the finances of national governments. Several countries have needed financial bailouts to stop them collapsing, as have a number of large international banks.

The pool of assets acceptable to many investors with a low risk tolerance is shrinking, as their perception of what assets are considered safe-haven or low risk has changed.

As a result of this, many investors have piled their money into assets considered to be safest, such as Treasuries, gold or German Bunds, which has significantly reduced returns. Yields on two-year German Bunds, for example, turned negative in 2012, meaning investors were effectively paying to invest in them.

Despite their risk aversion, institutional investors are moving into higher-yielding bonds, equities or commodities as they search for the returns they need to meet liabilities (e.g. pensions). This could previously be achieved via yields from ostensibly low-risk assets, but moving up the risk curve means added duration, credit and liquidity risks in exchange for potentially improved returns.

Addressing this downside risk is the bedrock of any sensible investment strategy and is even more relevant in today's world. Sustained healthy returns will be difficult to achieve if this isn't done correctly, as any short-term gains can be easily wiped out if markets turn.

There are a number of ways that portfolio managers can address risk. One of the most effective is diversification, or broadening the universe of investable assets to minimise impact if one or more assets fall in value. A typical diversification strategy will focus on mainstream assets, but hold positions in specific equities, commodities or currencies in order to mitigate downside. However, as we have seen, correlation breakdowns have become common during the last five years and traditional diversification methods no longer always suffice to preserve capital.

We believe that liquid alternative strategies based on global tactical asset allocation (GTAA) could provide a more efficient way of mitigating risk, provided that liquid instruments are being traded and that leverage is not used excessively. Portfolio managers will carefully choose which assets to allocate to on a monthly basis, depending on a range of fundamental and technical indicators. This type of regular rebalancing of portfolios means that there is more opportunity to identify uncorrelated returns with appropriate risk, as well as implementing swift measures to protect downside risk whenever required. More importantly, a liquid (GTAA) approach uses futures to allow portfolio managers to move into cash temporarily, should the need arise.

Furthermore, the ability to use shorts on liquid indices to mitigate risk works well when combined with long positions dictated by well tested methods. Many portfolio managers utilise short positions to take advantage of falling asset prices, however it can also be advantageous to use them for downside risk protection only, as and when necessary.

This approach to managing portfolios through tactical asset allocation has allowed Funds and Advisory at Barclays to post solid returns since inception during multiple crises and significant shifts in the global macro environment.

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