Multi-asset solutions

Managing portfolios to let active managers shine

Managing a multi-asset portfolio can be a challenge, in part because such portfolios typically include multiple managers from different firms, all with varying degrees of flexibility within their stated mandates. In practice, few managers invest in a completely style-pure manner. In fact, some have broad mandates that allow a wide divergence from "what it says on the tin."

Our portfolio "look-through" process

To meet this challenge, the BMO Multi-Asset Solutions Team uses a "look-through" process to help ensure that the portfolio we implement accurately represents the asset classes, exposures and risk profile we intended. The process includes both quantitative and qualitative elements to help develop a comprehensive picture of each manager's tendencies. Below are some typical examples we seek to account for within our look-through process.

U.S. large-cap equity	International equity	U.S. core fixed income
• A manager may have significant mid-cap holdings, as high as 30% in some cases. • Potential result: sizable unintended mid-cap bias.	• A manager may be free to allocate to emerging markets, perhaps as much as 15%. • Potential result: unintended emerging-market bias.	• Some managers may allocate to "plus" sectors such as U.S. high yield or emerging-market debt. • Potential result: higher risk than intended for a fixed income allocation.

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Look-through process example: U.S. equities

The unintended exposures noted above illustrate how the risk profile of a multi-asset portfolio could be affected by an underlying manager's decisions. For example, two important components to evaluating the risk profile of a typical U.S. equity manager are allocations to small- or mid-cap equities and allocations to foreign stocks. We use historical positioning and detailed portfolio holdings to create our outlooks. Examples of the data we analyze follow below, using the Harbor Capital Appreciation Fund as the sample portfolio.

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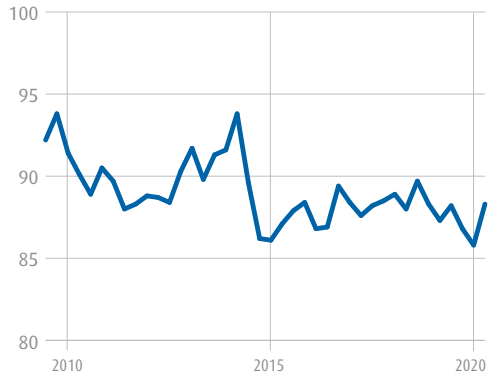
Large-cap exposure

Harbor Capital Appreciation Fund

Source: Morningstar Direct as of 3/31/2020

U.S. exposure

Harbor Capital Appreciation Fund



Source: Morningstar Direct as of 3/31/2020

The geographic allocation of a portfolio is a critical element of our look-through process. While the Harbor Capital Appreciation Fund has historically invested approximately 10% in foreign names, a closer look reveals 4.6% invested in emerging-market stocks, more specifically in China.

Name	Portfolio weighting %	Country
Shopify Inc A	1.26	CAN
Alibaba Group Holding Ltd ADR	3.62	CHN
Tencent Holdings Ltd	0.98	CHN
Kering SA	1.72	FRA
AstraZeneca PLC ADR	2.26	GBR

Source: Morningstar Direct as of 3/31/2020

Historical positioning and portfolio trends are important, but we also meet with our equity managers regularly to obtain qualitative support for our outlook. If a portfolio's positioning lacks consistency, a dialogue with the manager is often the best way to understand their intentions. We also discuss the alpha opportunities they expect over the next 12 months.

Look-through process example: Core fixed income

In addition to high-level beta components, we also regress returns against more granular factors. This process identifies significant drivers of returns for a portfolio and the magnitude of the exposure to these factors. We have found this factor-analysis process to be especially important within fixed income. For example, a core bond portfolio may show 100% in investment-grade securities. However, factor analysis may indicate 25% more credit exposure than the Bloomberg Barclays Aggregate Bond Index if the manager focuses on A and BBB bonds. Analysis may also indicate that the manager typically has about 15% less duration exposure than the Index. Therefore, to match the risk exposure of the Bloomberg Barclays Aggregate Bond Index, we may pair this manager with a longer-term Treasury ETF to reduce overall credit risk.

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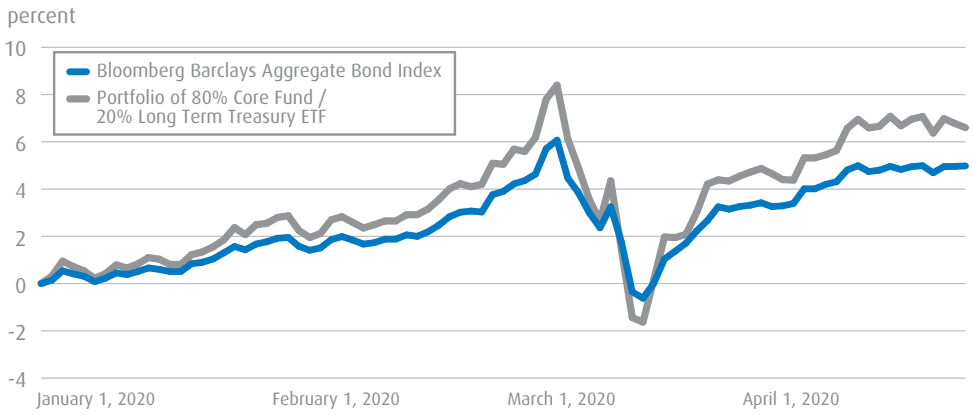
The example below shows how we might create a solution with risk similar to the Bloomberg Barclays Aggregate Bond Index while maintaining the core bond manager's ability to pick credits and shift credit exposure as opportunities arise.

Cumulative returns



Source: Bloomberg LP

Factor analysis was particularly important in the first quarter of 2020 when credit markets sold off sharply following the outbreak of COVID-19. The chart below separates the Bloomberg Barclays Aggregate Bond Index into duration and credit components. The duration component performed quite well in the first quarter as Treasury rates plummeted, while the credit component performed poorly as spreads widened. Understanding how a fixed income portfolio derives its returns is crucial during market drawdowns, when duration typically outperforms credit.

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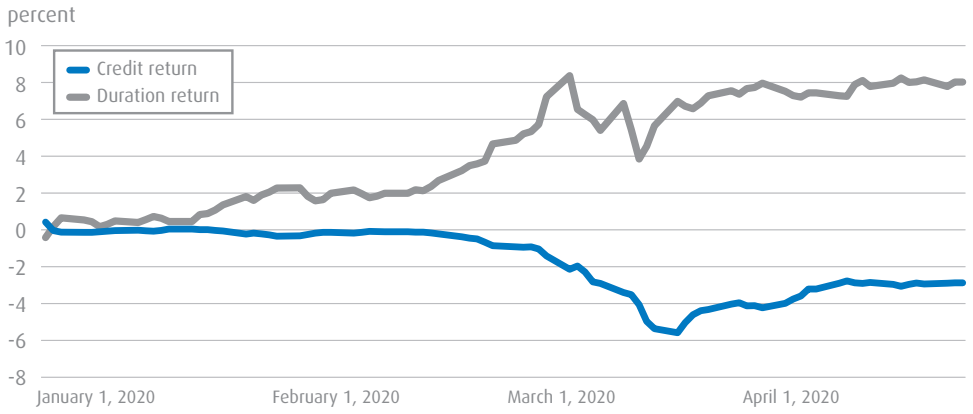
Bloomberg Barclays Bond Index component returns



Source: Bloomberg LP

These examples demonstrate the importance of factor analysis, but qualitative understanding is crucial to our fixed income allocations as well. Given the lack of consistent, reportable portfolio detail in global databases, regular interactions with our fixed income managers help us to understand their tendencies, current positioning and outlook for opportunities.

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The portfolio we get is the one we ordered

We formally analyze each manager's positioning and update our assumptions periodically while maintaining the flexibility to adjust these assumptions if and when a manager changes their approach. Given our strong working knowledge of our managers and regular meetings with them, we believe we can understand how they will generally be positioned over the next 12 months. This process helps us ensure that all the exposures in our multi-asset portfolios are both understood and reflective of our intentions.

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