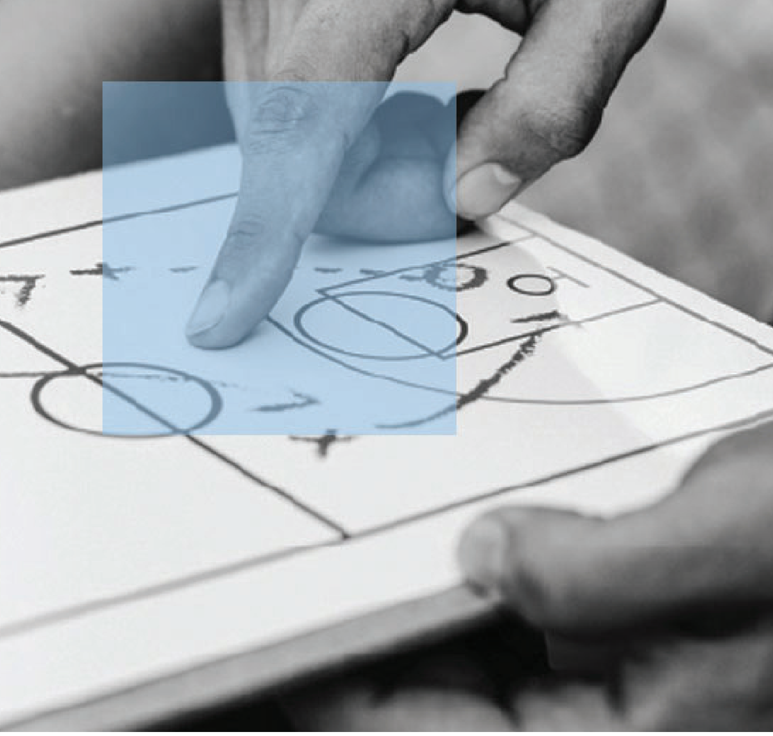


Your Next Move:
Should Tactical Allocation Strategies Play a Bigger Role in Portfolios?

Patrick Deniger
Product Manager

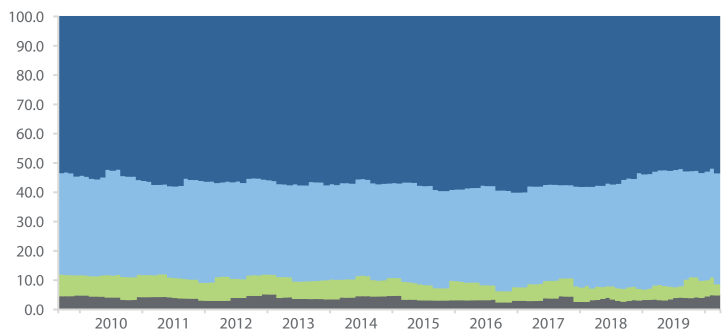
As markets struggle to find direction amidst the widespread economic and social impacts of the coronavirus (COVID-19), the abrupt correction of early 2020 and subsequent volatility serves as a useful juxtaposition to the previous decade that produced the longest and near calmest bull market in 100 years (average VIX for the decade was 16.86% vs. 82.69% at the peak of the COVID-19 initial shock).

This massive shift in market conditions also comes at a time when the world's foremost economists and analysts were already calling for dramatic rethinks in return profiles for many of the most common portfolio constructs, including allocation percentages and strategy utilization. Put simply, traditional mindsets and tactics (or lack thereof) were expected to be challenged moving forward — the rapid, unexpected onset of recession and uncertainty both punctuate a need for a fresh approach.

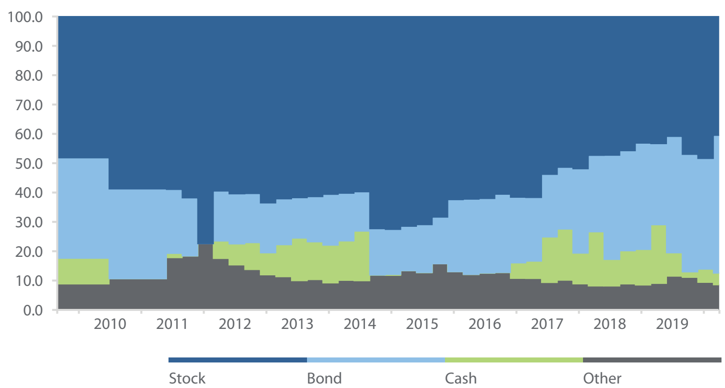
And though the longevity and somewhat muted volatility of the last decade's bull market was impressive, it was classified as one of the weakest economic recoveries, and this lack of pronounced expansion may be more indicative of the "new normal" of future growth periods. Looking beyond the effects of COVID-19, investors may have to consider lower return expectations and how a tactical, multi-asset portfolio can navigate the upcoming challenges of an inevitable recessionary period, while mitigating downside risk as much as possible.

The tactical approach is highly evident when you look back 10 years at Westwood versus our peers. While the typical multi-asset allocation remained stagnant, Westwood's Income Opportunity displayed much greater variations in allocations over the same period.

Top Five Strategies by AUM - Model Asset Allocation
Time Period: 9/1/2009 to 3/31/2020



Westwood Management Corp Income Opportunity - Asset Allocation
Time Period: 9/1/2009 to 3/31/2020



Source: Morningstar Direct

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The Role of Tactical, Multi-Asset

Given the change in landscape and return expectations, investors may need to reassess legacy models and transition into more appropriate allocations to more accurately meet their investment goals. In other words, we may have to look deeper at portfolio behavior and how managers plan to deliver on strategy goals, gain advantage and achieve alpha. All these adjustments may have to occur sooner than later due to the fact that the U.S. economy was thrust into a recession in a matter of weeks, compared to what was expected to be at least a year or two of modest growth.

Heightened economic uncertainty and volatility (which typically equate to downside risk) may require asset allocators to consider strategies that promote a strong emphasis on loss limitations in bearish or sideways markets. The multi-asset category has proven to fit this profile, and, by design, invests across a broad spectrum of income-producing securities that can dampen volatility and provide an asymmetric return profile. Of course, not all multi-asset strategies are created equal. A properly executed multi-asset strategy should be a flexible, tactical approach that varies in composition to mitigate downside losses, while offering true risk diversification and decorrelation compared to other strategies within a portfolio.

A True Tactical Approach is Limited in the Marketplace

Multi-asset strategies should allow for a more dynamic collection of asset classes compared to a typical 60/40 equities and fixed income split. However, this is only a competitive advantage if the manager is truly tactical below the surface and dynamically changing their allocation based on market inefficiencies. The previous bull market allowed managers to ride a tide that lifted all boats, setting a top-down allocation across asset classes and letting the market take care of the rest. As the tide becomes rough, this technique could leave many investors overboard. In fact, looking at the allocation of the top five funds by AUM in the Institutional U.S. Tactical Asset Allocation category, their equally weighted allocation, over the past decade, exposes similar "set it and forget it" symptoms.

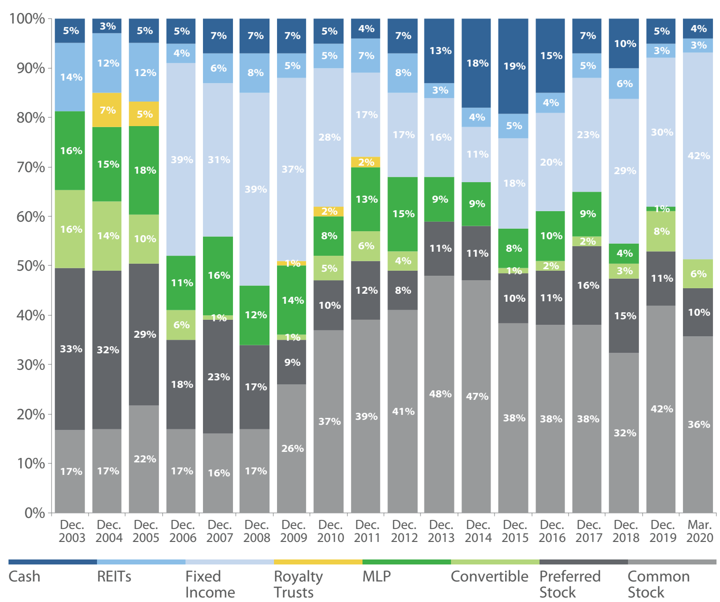
Westwood's tactical, multi-asset product has a more than 15-year track record of navigating challenging market environments through dynamically allocating across asset classes, including limiting losses in 2008 to only -6.68%.

An Opportune Time for Income Opportunity

Our evolved, tactical, multi-asset process aligns security selection with top-down macro views. We apply both bottom-up and top-down considerations as part of our process utilizing both fundamental and quantitative tools to evaluate macro, micro and technical conditions across a wide range of asset classes.

Designed for investors seeking the potential for conservative income, downside risk mitigation or tactical alpha allocation, the strategy utilizes a strict investment discipline focused on U.S. securities and a strategic exposure to fixed income, including a minimum average quality of investment grade. In terms of timing, you can see how the strategy evolves its holdings to best capitalize on opportunities in the marketplace. The chart below shows a more detailed view of our tactical approach, which, in a rapidly evolving market, allows investors to potentially capitalize on month-to-month variations in the pricing of different assets.

Income Opportunity Asset Allocation



Data as of March 31, 2020. Please note that each column may not add to 100% due to rounding. Allocations provided are based on a representative account that does not have any client-imposed restrictions. The representative account was selected by the firm because it was deemed to best represent this investment approach.

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Emphasis on Loss Limitation

Market imbalances require asset allocators to consider multi-asset strategies that have a strong emphasis on limiting large losses in down markets. The qualitative and quantitative assessment of absolute downside risk is paramount to outperforming over the long term and ensuring the reward justifies our risk when we invest. We perform periodic scenario analysis and stress tests on each strategy to ensure optimal return vs. risk portfolio structure. This is combined with quarterly risk meetings with our independent risk team to ensure appropriate positioning for client objectives and market risks.

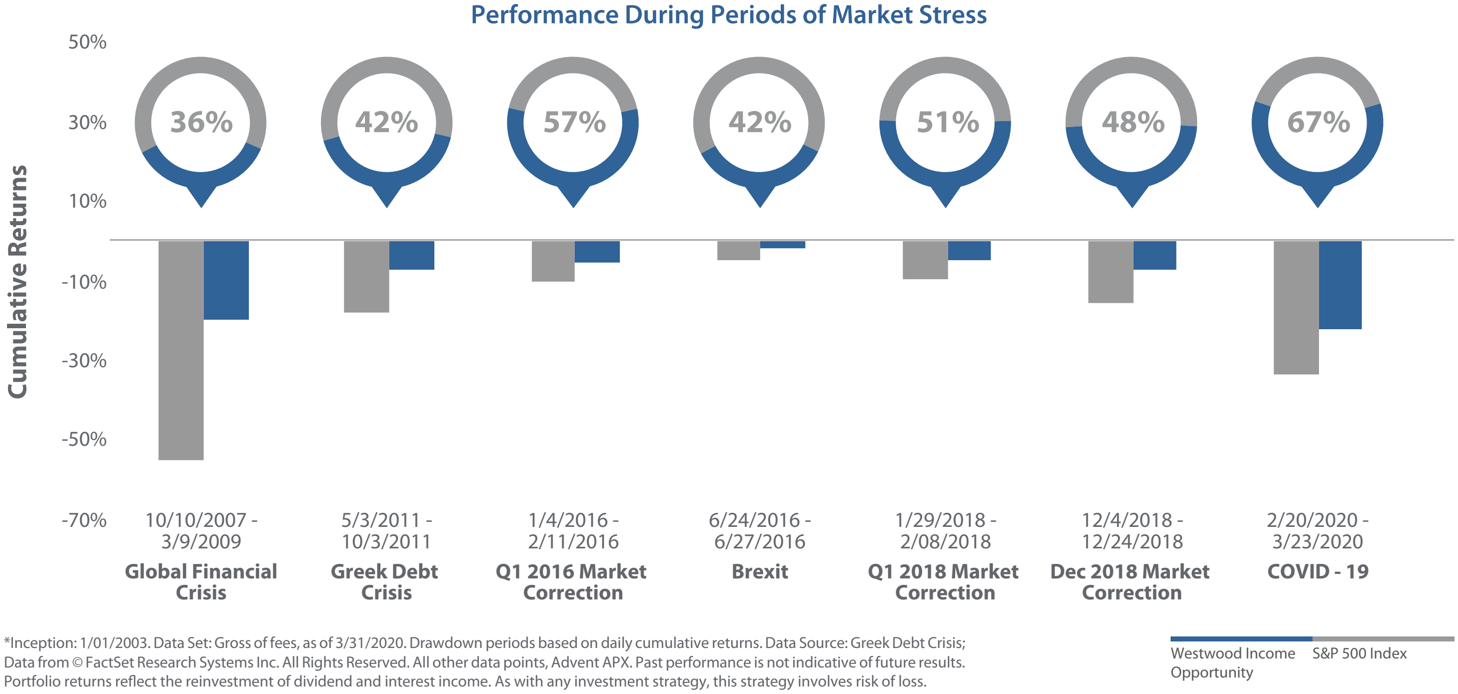
Team-Based Approach

Our formalized multi-asset team is focused on idea generation and fundamental research across five portfolio managers with an average of 25 years of experience, supported by three analysts. Additionally, the team collaborates with Westwood's U.S. Value investment team and Emerging Markets investment team to help enhance our equity research and our global views. Ideas and strategies are vetted by the team as a whole to help ensure risks are properly assessed, while increasing the chances of capturing the most favorable opportunities.

The Bottom Line

Bottom-up, multi-asset investing can bring something very powerful and unique to a portfolio in the current environment. Many portfolios today have increasingly more exposure to top-down diversification or macro exposure as indexing has proliferated in investor portfolios. In an environment where index volatility increases across asset classes and correlations go to one, outperformance becomes a function of avoiding losses in the worst stock indices vs. adding higher-quality stocks. A flexible, bottom-up, multi-asset approach that can sync the asset allocation process to the stock selection process may help investors in 2020.

Performance During Periods of Market Stress



*Inception: 1/01/2003. Data Set: Gross of fees, as of 3/31/2020. Drawdown periods based on daily cumulative returns. Data Source: Greek Debt Crisis; Data from © FactSet Research Systems Inc. All Rights Reserved. All other data points, Advent APX. Past performance is not indicative of future results. Portfolio returns reflect the reinvestment of dividend and interest income. As with any investment strategy, this strategy involves risk of loss.

Sources: https://www.cbpp.org/research/economy/chart-book-tracking-the-post-great-recession-economy
https://www.investmentweek.co.uk/news/4014573/multi-asset-delivers-impressive-capital-preservation-testing-q1-bfinance/page/2