IMAP Independent Thought Podcast

Episode 49: Portfolio construction in the decade of uncertainty

Our host **Emily Barlow of (Evidentia Group)** is joined by **Ritesh Prasad (Colonial First State)** to discuss:

- How the CFS multi-asset team builds portfolios, and why it's "multi-asset" rather than "multi-manager" ?

- What five years of market, policy and geopolitical change means for portfolio construction ?

- How a risk lens shapes day-to-day portfolio construction, and how active, quant and passive tools are chosen across asset classes ?

- Whether concentration in index-driven markets should push passive and quant into a bigger core role, or give investors pause ?

Emily Barlow - (Evidentia Private): 00:17

Welcome back to the IMAP Independent Thought Series podcast. I'm **Emily Barlow from Evidentia Private**. And today we're talking multi-asset, investing and how portfolios are being built for an environment that feels a lot less predictable than it used to.

The past 5 years alone have delivered an inflation shock, a marked escalation in global conflict, a widely forecast recession that never arrived, and a 2nd Trp administration whose Liberation Day tariffs have reshaped trade and liquidity conditions. At the same time, equity markets have kept running hard with returns concentrated in a small number of mega caps. So, for advisors building resilient portfolios, that combination raises real questions about risk, positioning, and where active management still earns a place.

To help unpack this, I'm joined by **Ritesh Prasad, Portfolio Manager at CFS,** where he leads the design and management of their multi-asset SMA's. Ritesh, thank you so much for being here.

Ritesh Prasad - (CFS): 01:12

Great to be here, Emily.

Emily Barlow - (Evidentia Private): 01:14

Let's jump straight into it. Can you start by telling us how the CFS multi-asset team builds portfolios and why you describe the approach as multi-asset rather than multi-manager?

Ritesh Prasad - (CFS): 01:25

Sure. I hope to unpack what seems like a bit of a semantic difference. I joined the team probably two and a half years ago now, and it was really part of a transformation that the team was undergoing. We had Jonathan Armitage join 3 or 4 years ago now as CIO. Al Clark, who I work with in the multi-asset team, followed suit. And eventually I got hooked along for the journey as well. And aside from I suppose some of the personnel differences, the team has gone back to the drawing board a little bit and tried to reimagine what it means to be a multi-asset team, a true multi-asset team. And part of that has been, as I said, unpacking that gap between the traditional multi-manager difference and what we think about in terms of multi-asset.

To bring that to life a little bit, think about the portfolio construction toolkit as it existed 15 or 20 years ago. And in most cases, it was a combination of SAA, (strategic asset allocation), and it was really relying on the active managers to do quite a lot of the heavy lifting.
I suppose fast forward to today, and you've got Dynamic Asset Allocation (DDA), and in fact, the payoff from DAA increasing. When you just described an environment where there are a lot of moving parts, that's been part of the reason that set and forget probably doesn't work quite as well.

The other thing that we've done is expanded the toolkit so that we're not just relying on those active managers who, frankly, (well we'll unpack this a bit), but yes, they've struggled to add as much value in some cases in this environment as well. We have looked at the availability of things like smart beta enhance solutions in addition to the old black and white active versus passive dichotomy, and also things like derivatives to help with risk management. So that sort of encompasses the journey that the team's been on. And I think our identity is very much not just multi-manager, that's still part of what we do, but a much broader lens, which we sort of try to capture with that multi-asset label.

Emily Barlow - (Evidentia Private): 03:38

So, if we delve into specifically that navigating markets element of the portfolio construction piece, and as we've touched on already, a lot has been happening in recent years. Can you talk us through what this level of change has meant for your portfolios, and how you're thinking about that construction today?

Ritesh Prasad - (CFS): 03:57

Sure. And I think I'd start by contextualising the level of change as a genuine regime change. That's certainly the way we see it. Now it's hard to put a finger on exactly when the regime shift happens, but I think you could approximate it to the start of the decade because really it was a matter of weeks into the decade before we had COVID.

I'd suggest that was the one event that then changed everything. COVID was different in a number of ways. We'd gotten used to in decades prior, and when I say we policymakers had gotten used to dealing with market crises that were essentially demand side problems, the GFC being you know the most recent example. And they worked out, central bankers did, that you could just throw money at the problem if it was a demand side problem, sort of Keynesian approach. 2020 was a supply side problem. And I think in this case, throwing money at the problem using the old playbook unfortunately unleashed the medicine for this crisis created another problem, which we hadn't seen for a while, , which was inflation. You mentioned that in your intro as well. So that's a good example of how the landscape shifted. As part of that, we also saw the actors change.

Those of us who were around in the aftermath of the GFC will remember Ben Bernanke, sort of on the cover of Time magazine. It was a decade post the GFC where the central bank has really ruled the world. This decade it's been a case of the governments of the world saying, “hold my beer”. And we've really seen that in the form of fiscal policy being far more dominant in terms of being a key driver than monetary policy has been.

The third thing I'd layer on to this has been the market participants themselves. We've seen more money going into passive, more money going to systematic strategies, a new breed of a new generation of retail investors who who've seen nothing but buy the dip work. These forces have sort of conspired to change the behavior of markets as well.

And one thing we would point to is that the velocity of markets has increased. The GFC took circa 18 months to go from the top to the bottom, and then we saw COVID in record time. we had a bear market in two weeks, followed by an equally violent recovery.

And then in recent years, you mentioned Liberation Day, the unit of measurements now shrunk to days. You can get a 20% decline in two or three days. So that months to weeks to days really charts or plots the way that markets have changed. And we felt the process has had to has had to mirror the amount of change we've seen in markets.

Emily Barlow - (Evidentia Private): 06:46

I think that takes us to a nice segue on risk and how you think about allocating to risk within the portfolio and how that lens shapes the construction process day to day, given the fact that we're seeing a lot more risk come through in much shorter periods of time.

Ritesh Prasad - (CFS): 07:05

I think you did a great job in calling out earlier on the non-recession, the recession that didn't happen. And if I could start there, it was a really good reminder that there is a gap between markets and economies. And we've perhaps placed a lot of reliance previously on concepts like the economic cycle. And I think we all remember everyone pointing to the yield curve, invert inverting and saying, well, you know, like clockwork, we'll have a recession in in next months. That was confounding. And I think if you were paying attention at the time, a lot of textbook wisdom at the time was sort of had to be thrown out the window.

The thing that explains the difference between the textbook view of the world, in our view, is partly policy and liquidity. We were staring into the abyss, we were staring into the worst recession since World War II when the world shut down during COVID, and yet weeks later, we were in a rip-roaring bull market. The fiscal policy response that I mentioned is part of that. and so I think we need to sort of be mindful of that lesson. Markets aren't the same thing as economies, and when it comes to risk, , you know, we've also gotten this your future, your super element in the room here. So strategies or payoff profiles that might have been palatable previously. And I don't want to pick on value here, but you know, that's probably one that's familiar advisors will be familiar with, where you might need to endure years of pain before you see a payoff, and that payoff might be relatively brief or short-lived.

In today's world, that's probably not an optimal profile, notwithstanding the fact that at the end of the journey you might end up with alpha, but your future, your super, just puts a different complexion on risk. And then the third thing I'd touch on is you know, we've done well to get this far without mentioning Trump, but he sort of ratcheted this up.

Emily Barlow - (Evidentia Private): 09:09

Oh, I touched on him straight away though, didn't I?

Ritesh Prasad - (CFS): 09:11

Yes, you did. Maybe it was my selective hearing, we're almost sick of him, right? But I think that in what in the chaos that he's unleashed, it sort of rendered the traditional asset class labels and style or factor frameworks a little bit unable to keep up with the shape-shifting nature of risk. Tariffs are a really good example. You pick his favourite toy, but it can transform on a whim from tariffs levelled certain countries to tariffs levelled or exemptions being given on certain sectors. How do you ensure that a portfolio is resilient when the risk itself is shapeshifting? I think it's a really key question that we've been wrestling with as a team too.

Emily Barlow - (Evidentia Private): 09:58

And the Trump one's an interesting one, right? Because now everyone just ignores him because everyone asses that he's going to chicken out and whatever he says isn't going to play through. So, if any of that does start to stick, I think that will be a bit of a shock for markets.

Ritesh Prasad - (CFS): 10:12

I think it's a really timely point to raise, though, because we've seen this Iran conflict, which we need to remember this is actually the first time this decade we've seen the combination of a supply side shock, like the oil price shock that he sort of created, and Trump being in charge. So, we have seen, if you like, man-made crises. You mentioned Liberation Day being one of those. And what those situations featured was the ability to solve that crisis at the stroke of a pen or a tweet.

On Liberation Day, we saw the tariffs could be reversed or delayed or extended. All the power was in his hands. Iran's a different beast in that they found the Strait of Hormuz difficult to control. And even if they do manage to get something like a war under control, it's very hard to save definitively achieve victory. I mean, the Ukraine conflict's still going on, and people forget the ‘73 crisis, it took the Secretary of State of the time, Henry Kissinger, 4 months to negotiate with Iran to end the oil embargo.

So, these things take longer than I think the market might have been suspecting. And they've gotten used to, as you point out, almost looking through what they consider noise and taking the view that, well, it's just bluster and he can he can solve this via a tweet.

This situation is different, particularly once the inflation journey has escaped, being a supply-side type of crisis. And we do think he's sort of playing with fire, particularly this close to a midterm election.

Emily Barlow - (Evidentia Private): 11:57

So, if we move now from geopolitics into implementation, and we've seen a lot of institutional and retail investors lean more heavily on passive and quant approaches.

There’re two questions I have linked to that.

Firstly, how do you decide which tool to use where and why one asset class or sub asset class might call for different approaches versus another?

And the second is around that concentration that we're seeing in in index markets, given the level that they've now been adopted. Does that cause you any concerns?

Ritesh Prasad - (CFS): 12:32

Sure. So, I think the first thing to say is when we think about active versus passive, it's important not to forget, the elephant in the room - the 90% that we're all familiar with, which is the asset allocation lever. So, we do try to use that lever meaningfully, and that I know most listeners will be thinking immediately that means dynamic asset allocation.

But I think what's underrated is just being purposeful about it in the first place. We did see it in 2022 where you had our index funds outperforming competitors' index funds due to what seemed like pretty minor change differences in asset allocation, a little bit more real assets, a little bit less global bonds. But we recognized that defensive assets weren't defensive, traditional defensive assets weren't defensive in the face of inflation.

So, we do think about being purposeful with the asset allocation as well as being dynamic.

But then to take the next step down to your point and look at the building blocks themselves, point one I've already raised, which is we do see the world in terms of black, white, and grey now. So, it's not just the bookends of active versus passive, but you've got this secret source, if you like, of smart beta or enhanced strategies. And the reason they're important is they sort of break the link between the old view that passive equals cheap and active equals expensive.

You can have fairly active index or rules-based solutions that aren't cap weighted, so they're systematic, therefore the cost is low, but they can move the dial meaningfully from a performance and a risk perspective. So that I think is a really important part of the toolkit. To get to how we then go around the grounds in a portfolio and think about what the right tool for the job is, I'd say it's a combination of research that our team's done, and I suppose looking out the window at the prevailing conditions and the subcurrents of the markets.

An example of a more sort of set-in-stone view that our team has reached has been in Australian equities. We've run the numbers over the last 10 years or more and found that if you looked at the top 20 stocks in particular, most active managers in the large cap space struggle to consistently add value after fees in that particular market segment. So, we've sort of taken that finding and from an implementation perspective, have tried to have a passive approach with large cap, meaning take that fee saving and spend that elsewhere in the portfolio where we think the payoff is more attractive.

A more tactical example would be emerging markets, and this is a really live one for us. We're thinking about making some changes in the portfolio in response to this. , we've all heard about the Magnificent 7 in the US ad nausea over the last few years. It turns out this year we've seen the emergence of sort of a Mag 3 in the emerging markets. So, this is Taiwan Semiconductor, Samsung, and SK Hynix, 2 of those are Korean stocks, and they've really driven the emerging markets returns “year to date” to the point where those 3 stocks now occupy more of the emerging markets index than China does.

And that was meant to be a broadening trade, so we're trying to get away from the Mag 7 and diversify in places like value and small cap in emerging markets, this has been a pretty unhelpful development. So now we are looking at how we might change the emerging markets exposure in some of some of our funds to maintain what we think is an attractive beta but not be quite so exposed to the concentration risk that you just mentioned.

Emily Barlow - (Evidentia Private): 16:26

Although I guess good if you've been in there and ridden the high of those 3 stocks, but certainly the thematic of tech, you're now not getting away from tech in emerging markets either, are you? So, you've got similar return drivers in developed and emerging markets, which the diversification is not necessarily that helpful.

Ritesh Prasad - (CFS): 16:44

Correct.

Emily Barlow - (Evidentia Private): 16:45

I think that gives us a good segue into positioning more broadly. And what I was interested to discuss with you is you know, you mentioned that we've gone into a regime shift as of the beginning of the decade. At what point does a regime look different enough that it should meaningfully change your investment style rather than just the tilts that you're putting on your portfolios?

Ritesh Prasad - (CFS): 17:12

Well, I think we've seen a few vignettes this decade that I think qualify as being significant enough. We’ve talked about the increased step change in the speed of markets. I think that's a meaningful change. We've seen the levels of concentration you've referenced sort of reaching not at a sector level, unprecedented levels, because we have had similar technology booms.

You'd have to go back to the railroads. I think as at 1900, roughly half of the UK and the US indices were railroads, but the stock concentration has certainly been very high.

That's probably meaningful enough to warrant a change in approach, particularly if you're relying on active managers running concentrated portfolios that have any sort of valuation lens to them, though the decks really stacked against those sorts of approaches, being able to navigate this environment.

And the 3rd I've also called out is when you have, (and I won't name them), but a well-known index provider's conservative fund returning a more negative return than the so-called high-risk fund, or then you know something's broken there in the traditional portfolio lens as well. So, I'd suggest there's plenty of evidence to point out that we've entered to a different environment because asset classes or managers or styles are just behaving badly or differently to our expectations.

Emily Barlow - (Evidentia Private): 18:44

We’ve touched on a little bit about styles and investment implementation, but in terms of the market today, what other positions do you have on in terms of your portfolios given the level of uncertainty?

Ritesh Prasad - (CFS): 18:57

And so, this is probably a great opportunity for me to invoke my risk colleagues, and try to bring to life what we think is a bit of a secret weapon in our team that's helped us navigate the last couple of years. And in fact, CFS has come out with some fairly industry-leading performance, which is which is meritorious given it's been a difficult asset allocation environment, and I'd point to this risk, institutional grade risk lens that we have.

Most advisors' eyes glaze over when you start talking about risk. So, I've tried to bring it to life by using the analogy of a dragonfly. The dragonfly's calling card of the animal kingdom is that it's got the best vision. And the secret there is it's actually got 30 lenses or multiple lenses in each eye. So, it can look at something from slightly different angles, which helps triangulate better. And I guess that's a good analogy for what we try to do with our risk system.

Having multiple lenses on a portfolio and recognising that your stock standard views of sector, of region, and of style may not be the most consequential ones. Concentration is a great example. That probably wasn't part of the standard way you "slice and dice" a portfolio you know 5 or 10 years ago, that's become really meaningful recently.

The one we're paying attention to right now is there's an interesting tug of war beneath the surface. So if you like the index level, it looks pretty calm, but the swimming duck's legs are playing out in this tug of war between months that have been really favorable for active managers, and months that have been favorable for more passive strategies because we have seen an unwind of that concentration and of the Mag 7's dominance. in fact, last year only 2 of the Mag 7 outperformed the SP 500. So, we think they very much are yesterday's story,

Iran sort of saw a return to the Mag 7, because investors perceived that as being relatively safe and insulated from the oil impact. But we've seen that tug of war again come in favour of what we're calling a more dispersed market. So, volatility can manifest itself in two ways. The GFC saw everything go to one, correlations go to one. But if you go one crisis before and look at the dot-com era, and I was in high school, I'll confess, I wasn't watching this day by day, but the older heads in our team reliably informed me that what you saw in that environment was an environment where the index was actually quite stable, but you saw these huge sort of 5% swings at the stock level.

So, you do need the magnifying glass to be able to see those subcurrents, but we think that's a really relevant theme right now, and we're trying to position portfolios for, I suppose, our base case being a broadening, we're a higher dispersion environment than yesterday.

Emily Barlow - (Evidentia Private): 21:59

Well, Retish, I think that's everything that we've got time for today. Thank you so much for joining me. I mean, I think today's conversation is a really good reminder that resilient portfolios are built from a combination of using the right tools and carefully managing your risk budget.
So, thanks also to everyone for listening today. And also, if you enjoyed today's episode, please do share it with your colleagues and your network. And we look forward to having you join us next time.

Ritesh Prasad - (CFS): 22:27

Thanks, Emily.

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