



## IMAP Independent Thought Podcast

### Episode 31: Goals-based Investing and the Implications on Portfolio Construction

Join **Emily Barlow (Perpetual Private)** accompanied by **Matt Walker (Dynamic Asset)** and **Alex Cousley (Russell Investments)** for an interesting conversation on goals based investing.

Key points covered are:

- A personalised approach to managing wealth
- Implications on portfolio construction
- The market outlook and more....

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#### Emily Barlow - Perpetual Private

Hello and welcome to Episode 31 of the IMAP Independent Thought podcast series. My name is Emily Barlow, and I am an Investment Director within Perpetual's Wealth Business and your podcast host.

Today I'm joined by Matt Walker and Alex Cousley. Matt is the managing director of Dynamic Asset, a managed goals-based investing service, and Alex is a director and senior investment strategist at Russell Investments, a global investment solutions provider.

In today's episode, we will be discussing goals-based investing, a personalised approach to managing wealth that aligns investment decisions with personal objectives.

We'll then dive into implications on portfolio construction, the market outlook, and how Matt and Alex are positioning their clients' portfolios in order to meet their objectives.

So Matt, if we could start off by explaining what goals-based investing is and how it differs from more traditional methods, which tend to be more benchmark specific or risk-based.

**Matt Walker - Dynamic Asset (01:19):**

Certainly goals-based investing fundamentally is a pretty simple and fundamental approach to matching up investment portfolios to clients underlying goals.

So when we talk to clients so my background is 30 plus years as a financial planner, and when we talked to clients one thing that became apparent to us is that a risk based or a risk profile type of solution didn't necessarily match up with their personal financial goals.

And so the industry has been trained on using risk profiling as a rationale for building a client's investment portfolio.

We took that back and applied goals-based investing to satisfy their particular needs rather than their risk tolerance. Of course, there might be a mismatch between risk tolerance and the actual numbers that are required to achieve their objectives, but that's part of the conversation then as a financial planner on, on how to bridge those gaps.

**Emily Barlow- Perpetual Wealth (02:25):**

Great, thanks Matt. Alex at Russell, you also adopt a goals based approach within your master trust, helping your members to track progress and take action to improve the probability of them achieving their goals.

Does your approach align with Matts?

**Alex Cousley - Russell Investments (02:40):**

It does indeed, so we use goal track, (as we call it within our master trust for our super members). And effectively we try and determine through questions and prompts what kind of retirement loss they would like to live with, and then we adjust the portfolio to match the best probability of hitting that outcome.

It does align in a way. I think the one big thing is that we obviously have a huge amount of members and so it's much less customised, but to the extent that we can build effectively a personal defined benefit scheme for each individual member, that's what we're really trying to do.

**Emily Barlow- Perpetual Wealth (03:13):**

Great. So that gives us a bit of an intro into the advice element of it. So if we move through into how that translates into investments and portfolio construction.

Matt, in terms of the objectives, when you think about the investment objectives that align to those goals, are you thinking in terms of cash or CPI plus or do you have a different approach?

**Matt Walker - Dynamic Asset (03:39):**

Well, we've found through practice that clients have all sorts of different objectives. Some of them might be financial, they want a certain rate of return, and that can be expressed as a simple rate of return or a cash plus or a CPI plus, whatever it may be.

Others had risk elements that they wanted to satisfy, so they might have a certain risk tolerance that they wanted to work within, and others also had cash-flow requirements.

A simple example being someone in retirement, drawing down on a pension, they just want money to turn up in their bank account on a regular basis, and satisfy their cash-flow needs.

So we found in practice that clients had different goals, different financial requirements, and so we designed dynamic asset different mandates to satisfy those different goals. And then you can use our portfolio construction tool to then blend those portfolios in any way, shape or form to satisfy different goals for each different entity.

**Matt Walker - Dynamic Asset (04:42):**

Then we match that back to what their requirements were or what their risk tolerance was.

So for example, we have three cash-flow based portfolios that allow people to satisfy the cash flows in years 1, 2, 3, 4, 5 and that matches up with their cash flow requirements for each particular entity. And then beyond that, it was whether or not they wanted to manage risk, or whether or not they wanted to target a return.

And again, through our portfolio construction tool, you can blend those in any way, shape or form to build a very client centric portfolio. And then that feeds into the underlying portfolios, which we manage through our managed account solution.

**Emily Barlow- Perpetual Wealth (05:26):**

Thanks. And Alex, what about you?

**Alex Cousley - Russell Investments (05:29):**

Yes, so for our master trust, we still have the risk based, growth, and conservative, and we blend them to try and get to that maximum goal.

So when you're young, it's similar to a life cycle, but a bit more personalised than that. So we try and put more in growth and that's really the way that we work it.

We do have cash and CPI plus portfolios, but that's a very different part of the business, more with advisors. So the master trust is very much that "risk space metric".

**Emily Barlow- Perpetual Wealth (05:56):**

And I assume when you translate that into portfolio construction, that you are doing that more traditionally from a strategic asset allocation approach, Alex?

**Alex Cousley - Russell Investments (06:08):**

Yes. We do a strategic asset allocation. We review that every six months and then on top of that, every day we have portfolio managers in Sydney and I sit alongside them, and we look and make sure that if there any tactical opportunities that we should be looking at, and just making sure that the portfolio is in a sound position for the outlook.

**Emily Barlow- Perpetual Wealth (06:25):**

And how big are those tactical positions that you might take in those portfolios?

**Alex Cousley - Russell Investments (06:29):**

They're generally quite modest without conviction, we tend to think the tactical is not where we should be spending most of our risk. We prefer SAA and stock selection that we get through our fund managers.

But you know, for example, we have got positions in currency, maybe 2%. We can go overweight credit inequities at the height of the covid panic. We're about 4.5% to 5% overweight. So we can move, but it tends to be a bit more modest compared to the SAA risks that we take.

**Emily Barlow- Perpetual Wealth (06:56):**

And how are you positioning portfolios at the moment given the current environment?

**Alex Cousley - Russell Investments (07:01):**

Yes it's a very interesting environment for us right now. There are two things that we think are appropriate. We think that we're very close to our SAA weight on equities.

We know that there is a bit of economic uncertainty. We know that equities are probably on the wrong side of VA fair value in the United States, but you know, there is still some positive stories coming out of the United States.

Where we think there is actually an opportunity from an SAA and actually on TAA as well, is in government bonds and duration. We think that it provides firstly, a nice buffer if we're wrong about recession risk.

And if recession occurs, we think that government bonds will perform quite well. And secondly, as we move through the year, we do expect that government bonds play the role that we've been used to, in terms of a diversifier to that equity book. And so that 60/40 portfolio idea we think is going to be alive and well through this year,

**Emily Barlow- Perpetual Wealth (07:49):**

This year. So does that mean you are underweight alternatives?

**Alex Cousley - Russell Investments (07:52):**

We're underweight cash and we're underweight high yield credit. So high yield credit is the one area of risk that we think is overly optimistic in terms of pricing the outlook.

We think there's a 35% recession probability this year or the next 12 months. Our measures on high yield credit suggest that it's pricing at 10%. And so there's really not that risk reward opportunity in high yield.

**Emily Barlow- Perpetual Wealth (08:13):**

Private credit is a pretty hot topic at the moment. Is that something that you invest in in your portfolios?

**Alex Cousley - Russell Investments (08:18):**

We do. So we have a couple of Australian managers and a European manager. We have quite a strong research manager research team globally for private credit and private assets. And so it is an area that we have got what we believe are very high conviction managers.

**Emily Barlow- Perpetual Wealth (08:33):**

Thanks. And Matt, you've got a very different approach in terms of objective setting. So does that translate into a different approach when it comes to portfolio construction?

**Matt Walker - Dynamic Asset (08:44):**

It does. At Dynamic Asset, we believe in holding investments in our portfolio that we believe will help achieve our mandates. If they don't, we don't see any reason to hold them.

Now, what that means is that we don't have any "set and forget" strategic asset allocation, nor do we concern ourselves with SAA type benchmarks. Our only goal in investing and with the investments that we choose is, will they satisfy the mandates?

Now that gets more complicated when you delve into it from a portfolio construction perspective and what goes with what and how it all fits together. But at a singular level, we have very broad mandates.

We are very dynamic in how we apply those mandates. If we don't believe an asset class has a perspective outlook, we simply won't use it at all in our portfolios. Now, that can lead to very large swings in what people would normally refer to as SAA, but again, our concern is not what SAA does or what risk profile benchmarks are being used, because they don't relate to the clients.

**Matt Walker - Dynamic Asset (09:53):**

Clients in my 30 years of being a financial advisor never came to me and said, can I please have a risk profile portfolio? They came to us and said, I want a certain rate of return in order to be able to meet my retirement objectives.

So dynamic asset allocation portfolios that we run tend to be very broad in their asset allocation ranges and dynamic because we only include what we think is relevant. And so that leads us to being very different to well any SAA type of manager which is generally most of the market because, again that's what traditionally we've been brought up with and educated to use and is most prominent in the market.

But you can see other managers such as the future fund or endowment funds over in the US and so forth, they take a much more similar approach to what we do because their mandate is not to satisfy our risk tolerance is to achieve a particular outcome.

**Matt Walker - Dynamic Asset (10:54):**

That's particularly relevant at this particular time because we believe that the investment cycle has changed over the last 30 or 40 years.

We've had falling interest rates, falling inflation, and that's been positive for growth assets. We think we're near the bottom of that cycle and, and possibly on the way back up, it really depends on topical issues like inflation at the moment.

But if interest rates don't have much further go down and or they could possibly go up, then that tailwind for growth assets is much more challenged. So you need to be a little more dynamic, a little more active in how you seek your alpha or do your TAA or whatever you want to call it.

Setting and forgetting we believe is going to be reasonably challenged in the next five to 10 years. It might work for 3, 4, 5 years, whatever it may be, but overall we think the next decade or so is going to be very difficult for a 60/40 portfolio to achieve the meaningful objectives that they've seen over the last 10, 20, 30 years.

So you have to be different if you want to achieve a result in a different environment.

**Emily Barlow- Perpetual Wealth (11:59):**

Great. So we've started to touch on outlook and we'll definitely come back to that, but there were a couple of points you've made that I'd like to delve into a little bit more deeply. The first, you've mentioned dynamic quite a lot. So I'm interested to know how big are the positions you are making? So how often and how much are you moving the portfolios that you invest in?

**Matt Walker - Dynamic Asset (12:21):**

We're mindful of transaction costs, turnover, CGT, and so forth. So we have to balance out all those things, but we review our portfolios daily and we could transact on any particular day.

There are periods where we generally have more activity than less. So it depends upon the circumstances at the time but we'll make changes whenever we deem them necessary. And that could be at any time.

**Emily Barlow- Perpetual Wealth (12:48):**

So in terms of the actual sizing of the position, are we talking 2 to 5%, 10 plus percent or could it be anywhere between that sort of scale?

**Matt Walker - Dynamic Asset (13:02):**

Because our philosophy is orientated towards delivering clients the portfolios that they need to meet their goals. We're not concerned about corporate risk, if you will, insofar as we don't care about deviating from the benchmark. And as such, our mandates are very broad.

So our position changes can be very broad. People talk about TAA allocations being 2 to 5% different to SAA, whatever it may be. We might be a hundred percent different. So we might not include any equities in the portfolio if we didn't believe that was appropriate. Or any property or any fixed interest, whatever it may be.

At this particular point in time today, we're fairly underweight property for example we're about 80% under our neutral weight, if you will. We're also very overweight alternatives and real assets. In that regard, some of our portfolios include up to 50% to 60% alternatives, which you simply won't find in a retail type of offering.

**Emily Barlow- Perpetual Wealth (14:10):**

And alternatives is a pretty broad topic. So what would you deem or what alternatives are you investing in in your client portfolio?

**Matt Walker - Dynamic Asset (14:19):**

Well, you're right there. Alternatives is a very broad church. In fact, if you look at the investible world, it makes up the majority of the investible world.

So from that perspective, we consider alternatives to be anything other than the traditional financial assets of equities and fixed interest and cash. So that might include different types of hedge fund strategies, the long shorts, the market neutrals, the arbitrage type funds.

It might include things like private equity and credit, which everybody is familiar with and talking about these days. It also includes things like precious metals, commodities anything that is outside the realm of what most people would consider to be a traditional asset.

**Emily Barlow- Perpetual Wealth (15:12):**

And you mentioned that there are certain asset classes that you might not use at all. Is there anything that you are avoiding completely at the moment

**Matt Walker - Dynamic Asset (15:22):**

In the US market, we are completely avoiding traditional financial US assets. It's not to say banks, but just traditional indices if you will. We do hold exposure to US equities but very selectively and usually expressing what we believe is an underlying asset class or thematic.

So we might have for example gold, oil or copper, those types of assets expressed through either US stocks, or listed US ETFs, whatever it may be. And so we're not invested in the US equities in any meaningful way. We're not invested into property in any meaningful way.

We're a bit underweight infrastructure in some of our longer duration funds. We're fairly short on fixed interest so from that point of view, it depends upon the mandate because as I said, we run different mandates and so each mandate will select the assets that are most appropriate, but there could be different mixes to satisfy the different outcomes.

**Emily Barlow- Perpetual Wealth (16:37):**

So the magnificent seven is something that's been very topical and obviously very large US stocks. And perhaps something your clients have been asking about is, is that an area that you've also avoided or, or something you've made an exception for?

**Matt Walker - Dynamic Asset (16:53):**

No, we have avoided the magnificent seven and that was to our detriment last November and December, when risk rallied on the back of Powell's comments and so forth.

We've seen a bit of softening into this year, but a recent rally again on the back of the recent rally, we actually started shorting the NASDAQ in some of our portfolios, not necessarily big, as we think it go down, but because we believe that they're priced for perfection, they're about as good as they can get.

Therefore, we consider the upside and downside risk to be asymmetric more downside than upside. And so we're using a short on the NASDAQ from a portfolio risk management perspective more than we are making a bet that the NASDAQ's going to fall.

**Emily Barlow- Perpetual Wealth (17:38):**

So you've got a pretty diverse remit when it comes to investments, a pretty broad remit in terms of the asset allocations and you can swing, you mentioned, all the way up to a hundred percent on a particular asset class.

How do you benchmark that for your clients in terms of what's added value, whether or not you're achieving your objectives or whether or not a decision you you've made has been detrimental from a portfolio perspective?

**Matt Walker - Dynamic Asset (18:05):**

Well, we have the usual portfolio manager risk reward modeling and attribution reporting and so forth so we can see what is working, what's not working and we can overlay that with our macro thoughts on why that might be the case and whether or not it's worth holding in the environment.

Overall though, we don't pay attention to benchmarks because they're not relevant to our portfolios benchmarks in the traditional sense of what is Australian equities doing or what international equities are doing or what is a balanced profile doing because again, we found through 30 years of working with clients at the retail level, no one ever came in and said, "I want my retirement to depend upon how the ASX is going to do".

They came in and said, my family wants to retire with certain amount of money in the bank and therefore that's what I want to try and achieve.

**Matt Walker - Dynamic Asset (18:57):**

They never say, depending upon the ASX or the MSCI or anything like that. So those types of benchmarks are irrelevant when you look at trying to get an absolute return outcome such as you do with say the future fund or the endowment funds that I've mentioned you need to be more dynamic.

You need to be more selective. You can't just afford to put something in, because a portfolio construction based on efficient market hypothesis, which is based on the last 20 years as you need to hold that certain percentage of assets.

So the fundamental breakdown when you think about it is that the last 30 years have been different to what the next 20 or 30 years might be. Building a portfolio based on the maths applying to the last 20 years might not actually be relevant. So that's why we don't necessarily track those types of benchmarks, but we very definitely track the underlying investments, how they contribute and what risk we're getting out of that.

**Emily Barlow- Perpetual Wealth (20:01):**

Alex, I imagine you do track benchmarks on this and you're probably a bit more peer aware in terms of your performance monitoring. I'm just interested in if you have anything to add on the benchmarking perspective or anything else that Matt's commented on?

**Alex Cousley - Russell Investments (20:17):**

Yeah, we are benchmark aware, and in terms of attribution, we think about the different levels as well. So, we look at the SAA attribution, so how much did the SAA add relative to a benchmark of peers as well as what did the TAA add relative to the SAA?

So, it's kind of that layered process to make sure that each level of the process is working the way that we would like it to work. You know, any to that line of we want more SAA risks than TAA risks, we want more stock selection than either of the two. So, making sure that they align with each other.

I think the other thing to note is from the SAA perspective, the way that we build it is not just based on backward looking information. We look at where coherence matrices are likely to land, where we're going in the economic regime.

I know we're going to talk about this soon but it's much more than just looking at what the historical returns and the coherence has been, and mapping that forward. It's much more forward looking.

**Emily Barlow- Perpetual Wealth (21:09):**

Well, you've already started mentioning forward looking, so let's dive into that now. We are looking at an environment now, where interest rates are likely to stay higher for longer. How is that impacting your portfolio positioning and what are you underweight and overweight and perhaps what are you focused on particularly closely at the moment right now? And Alex, if we start with you on that one?

**Alex Cousley - Russell Investments (21:33):**

Yeah, sure. I think it's worth just looking at where we've come from.

So last year as a house we thought recession risk was more likely than not. And I think over the last four months in particular, we've been encouraged by both the disinflation trends that have been going over the last 12 months as well as the fact that the US is kind of doing what Australia is doing in terms of the labor market re-balancing on immigration.

So that recession risk has been reducing, which we think is an encouraging environment. Nevertheless, we think that duration, (as I mentioned earlier), is still a pretty attractive place to put some money. It gives you that nice profile that absents a big shock in inflation, (which we don't think is likely), there's not a great deal of upside to the US tenure at 450.

**Alex Cousley - Russell Investments (22:15):**

On the flip side, if we're right that soft landing or perhaps recession occurs, there's quite a bit of downside to those yields.

We mentioned, I mentioned high yield. We don't think high yield's an attractive place that just the risk reward is not there. And the other part is that we think emerging market equities is actually looking quite attractive right now. It's one of those areas that people have been excited for a long time about valuations, but we're starting to see some life out of the Chinese economy starting to see signs of life out of Korea, and Taiwan.

If that continues, (which we think it will), that's a pretty attractive opportunity. So that's one area that we think is actually becoming a bit more green in a sea of orange.

**Emily Barlow- Perpetual Wealth (22:52):**

We've covered quite a vast array in terms of two quite different approaches to investment settings and portfolio construction as well as portfolio positioning, both now, but looking forward into the future.

Thank you so much both for your time today and to our listeners, we hope you can join us next time for what I'm sure will be another great discussion. Thank you.

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