

THE BENEFITS OF VARIABLE BETA STRATEGIES

By David Schofield

The return of volatility has meant portfolio responsiveness needs to improve in the new market dynamics. Variable beta strategies provide greater resilience and can help contribute toward achieving long-term outcomes.

Risk and return assumptions are key to strategic asset allocation, but they are often static and leave investors with unchecked downside risk.

While it may be necessary to maintain a static strategic allocation, it would be prudent to incorporate more beta flexibility within the equity portion as a means of adapting to market regimes. This approach potentially reduces risk without changing the return profile, improves compounding and can encourage more disciplined savings behavior.

Variable beta strategies attempt to do just that. These strategies adapt automatically to risk regimes in order to protect on the downside and participate in the upside.

This approach can be incorporated into an asset allocation in two different ways:

1. reduce total portfolio volatility while maintaining equity exposure.
2. maintain total portfolio volatility while increasing equity exposure.

We illustrate the benefits of adding a variable beta strategy to an asset allocation model within a target-date investment strategy. Target-date strategies are popular in defined contribution plans, but are limited by their static assumptions. These assumptions often ignore the impact of equity drawdowns.

Our goal is to reduce portfolio volatility while matching the equity exposure of the Base Case.

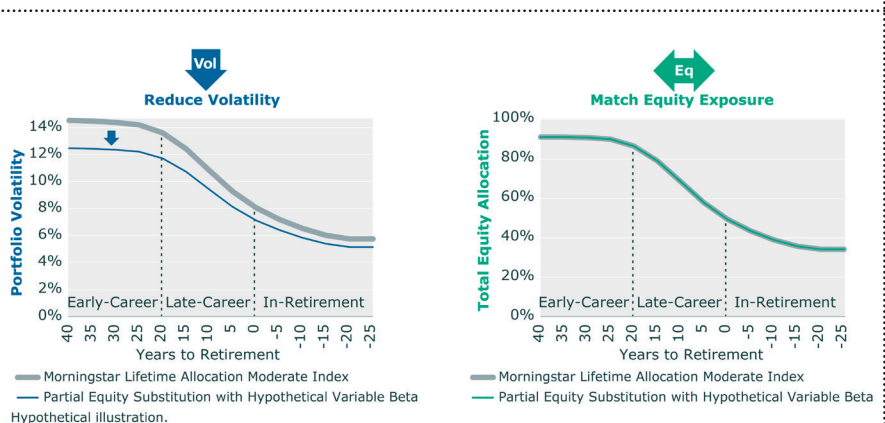
Our analysis uses the Morningstar Lifetime Allocation Moderate Index as a 'Base Case', a robust benchmark for target-date strategies. We create two alternative glide

path models by substituting part of the equity allocation with a hypothetical variable beta strategy.

REDUCE VOLATILITY

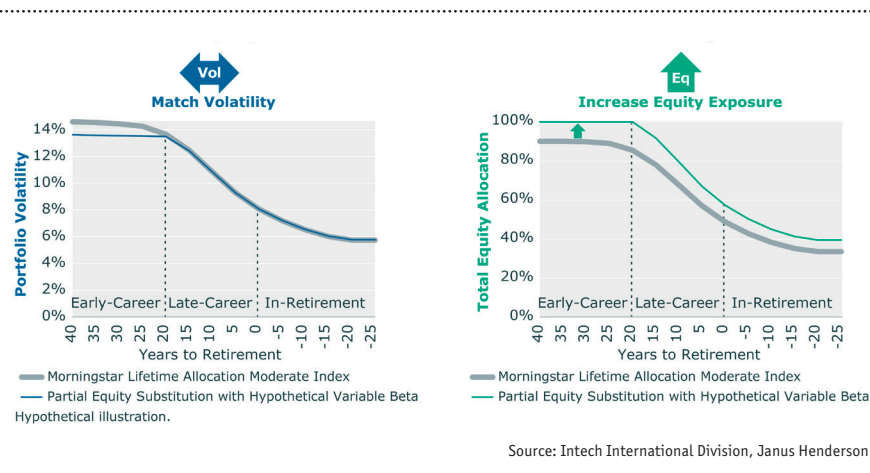
In the first case, we simulate the 'Reduce Volatility' (RV) model by substituting 1/3 of the equity portion with a hypothetical variable beta strategy. Our goal is to reduce portfolio volatility while matching the equity exposure of the Base Case. The impact is illustrated in Figure 1. It shows a reduction in volatility throughout the glide path while maintaining the same overall equity exposure.

Figure 1: Reduce Volatility (RV) Model: Reduce Volatility and match equity exposure



Source: Intech International Division, Janus Henderson

Figure 2: Match Volatility (MV) Model: Match Volatility and increase equity exposure



Source: Intech International Division, Janus Henderson

MATCH VOLATILITY

In our second case (Figure 2) we simulate the ‘Match Volatility’ (MV) model by matching the total portfolio volatility but increasing the equity exposure.

To understand the impact of a variable beta strategy, we examine the cumulative wealth differences between the three models over the 20 years ending 31/12/2018.

During the early-career phase, participants have a high allocation to equities. The rationale is that younger participants have more time to regain any losses. Mitigating losses during this phase helps improve compounding over this early phase. At the end of this period, accumulated wealth for the RV model is 4.9% higher than the Base Case. Wealth for the MV case is 9.8% higher.

In most glide paths equity exposure falls significantly during the late-

career stage. Here downside protection becomes increasingly critical. Mitigating losses is especially important during the years before retirement, when large losses can dramatically reduce retirement wealth. A variable beta strategy can help in this stage by reducing such drawdowns. During this period, the RV model generates 12.9% more wealth and the MV model generates 16.8% more than the Base Case model.

Finally, during retirement, participants are expected to withdraw capital but doing so in down markets damages portfolio longevity. Furthermore, as people are living longer in retirement, maintaining growth potential from equity exposure is vital. During this period, wealth for the RV and MV models are 11.7% and 17.0% higher than the Base Case, respectively.

Losses also affect contribution behavior – even in target-date strategies. Anxiety during market

downturns impacts contributions as participants abandon their investment strategies at the worst of times. Using variable beta strategies can help here by mitigating the impact that equity losses have on a portfolio. In Figure 3 we observe that both models protect on the downside. The RV model exhibited lower drawdowns in recent periods than the Base Case and MV models. During recovery periods, variable beta strategies attempt to keep up with rising equity markets by systematically increasing beta.

Variable beta strategies adapt to equity risk regimes within existing allocation approaches. By using such strategies, investors can make their strategic asset allocation models more dynamic without changing their long-term assumptions. «

This article was written by David Schofield, President, Intech International Division at Janus Henderson.

Important information
 This article is intended solely for the use of professionals, defined as Eligible Counterparties or Professional Clients, and is not for general public distribution.
 Past performance is not a guide to future performance. The value of an investment and the income from it can fall as well as rise and investors may not get back the amount originally invested. There is no assurance the stated objective(s) will be met. Nothing in this article is intended to or should be construed as advice. This document is not a recommendation to sell, purchase or hold any investment.
 There is no assurance that the investment process will consistently lead to successful investing. Any risk management process discussed includes an effort to monitor and manage risk which should not be confused with and does not imply low risk or the ability to control certain risk factors.
 Various account minimums or other eligibility qualifications apply depending on the investment strategy, vehicle or investor jurisdiction. We may record telephone calls for our mutual protection, to improve customer service and for regulatory record keeping purposes.
 Issued in Europe by Janus Henderson Investors. Janus Henderson Investors is the name under which investment products and services are provided by Janus Capital International Limited (reg no. 3594615), Henderson Global Investors Limited (reg. no. 906355), Henderson Investment Funds Limited (reg. no. 2678531), AlphaGen Capital Limited (reg. no. 962757), Henderson Equity Partners Limited (reg. no. 2606646), (each registered in England and Wales at 201 Bishopsgate, London EC2M 3AE and regulated by the Financial Conduct Authority) and Henderson Management S.A. (reg. no. B22848 at 2 Rue de Bitbourg, L-1273, Luxembourg and regulated by the Commission de Surveillance du Secteur Financier). Investment management services may be provided together with participating affiliates in other regions.
 Intech Investment Management LLC is a subsidiary of Janus Capital International Limited and may serve as a sub-advisor on certain products.
 Janus Henderson, Janus, Henderson, Perkins, Intech, Alphagen, VelocityShares, Knowledge, Shared and Knowledge Labs are trademarks of Janus Henderson Group plc or one of its subsidiaries.

Figure 3: Drawdown and recovery comparison for all three models

	Tech Bubble		Financial Crisis		2015 - 2016	
	Drawdown	Recovery	Drawdown	Recovery	Drawdown	Recovery
Base Case	-30.0%	73.5%	-47.4%	86.4%	-10.9%	14.4%
RV Case	-21.6%	76.5%	-40.3%	74.8%	-7.9%	13.7%
MV Case	-26.3%	80.8%	-43.4%	78.3%	-8.2%	14.2%

Hypothetical illustration.

The results shown are hypothetical based on data that is currently available. Actual results are not guaranteed and may differ materially

Source: Intech International Division, Janus Henderson