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Brian Singer
head of dynamic
allocation strategies team
William Blair

Navigating a troop of gorillas

Global central banks are like a troop of 300-kilo gorillas harassing capital markets with their coordinated easy monetary policies. Their influence creates significant risks, but also reveals noteworthy opportunities, which William Blair is navigating with its Dynamic Diversified Allocation Fund.

Quantitative easing (QE) has helped the world out of a lot of holes, and perhaps none more so than the Global Financial Crisis. But it's also created some unintended consequences, according to Brian Singer, head of William Blair's dynamic allocation strategies team.

When the GFC hit in late-2008, about US$7 trillion was wiped from the US equity market and a further US$3.3 trillion was lost in home equity – almost one-fifth of world GDP at the time. In response, global central banks deployed economic stimulus strategies in the form of QE.

Almost immediately, the United States added nearly $2 trillion to the money supply and the European Central Bank implemented a strategy that ended only months ago.

Further, despite Australia's 27 years of uninterrupted growth, its economy is beginning to slow. With interest rates close to as low as they can get, those in the know are speculating the Reserve Bank of Australia may need to consider QE.

As we all know, quantitative easing works best in a low interest rate environment. And there have been few instances throughout history in which interest rates have been as low as in recent years.

"When central banks act with easing monetary policy to manipulate interest rates, it's the same thing as manipulating asset prices," Singer says.

"And we've seen this before. We saw it in the 80s; 90s; noughties; and now we are here in the 2010s."

Understanding this historical trend is important as Singer and his team navigate central bank activity via macro diversification.

In 2014 William Blair entered the Australian market, opening three of its funds up to institutional investors. One of those funds was the William Blair Dynamic Diversified Allocation Fund.

Through the fund, Singer and his team invest across 100 to 125 different equity markets, bond markets and currencies. The fund aims to achieve a return of CPI plus 5%.

The fund employs a game-theoretical framework and top-down dynamic asset allocation strategy that focuses on general price movements in various asset classes and currencies combined with bottom-up security selection.

Using a top-down approach, the dynamic allocation strategies team seeks to identify and exploit periodic discrepancies between fundamental values and market prices.

This is then complemented by the fund manager's traditional focus on bottom-up stock selection, with the secondary approach investing in six of William Blair's actively managed strategies: All Cap Growth, EM Growth, International Leaders, Small-Mid Cap Growth, Small Cap Growth, and Small Cap Value.

As a result, the team is able to assess strategic interactions of multiple world players; better understand negotiations and related investment implications; and vigorously increase or decrease portfolio risk exposures.

The fund is managed by the dynamic allocation strategies team, which operates with the belief that fundamental value exerts gravitational-like force on price, and acts as a beacon on which price converges over medium to longer term horizons.

While such horizons are typically too long to exclusively base a portfolio on, the team is still able to tilt the portfolio to take advantage of these valuation influences.

"This focus differentiates the dynamic allocation strategies team's philosophy from that of most other investors, who often miss these influences altogether as they focus exclusively on shorter-term anomalies," Singer says.

While the successful interpretation and navigation of these shorter-term influences is a critical element of the team's investment process, it does not disregard the underlying "tide" resulting from the pull of fundamental value.

As such, the team adds a top-down fundamental valuation-oriented capability to a portfolio that is designed to enhance performance through return improvement and risk navigation—seeking to capture compensated opportunities while mitigating uncompensated risks.

The team invests in more than 30 global currencies as a diversified source of alpha rather than a simple hedge, aiming to lower portfolio volatility.

It seems to work too, with the fund achieving an average return of 5.35% since inception[1].

"What we provide is macro diversification," Singer explains.

It's that macro diversification that helps the team navigate the very low-volatility, high-return environment created by central bank monetary easing policies.

The quote

We're not targeting a risk level; we're using the amount of risk that we need to use to take advantage of the opportunities.

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"What that does is create complacency among investors and leads investors to follow rules-based strategies. If we began to see a bear market emerge, what happens is those systematic and rules-based strategies will begin to unwind," Singer says.

So as investors do look to offload their investments, it becomes a matter of determining where the liquidity that is needed will exist in the marketplace.

In years gone by, investment banks have been the go-to. However, since the Volcker Rule came into effect in 2015 in the United States, investment banks can no longer provide that liquidity.

The Volcker Rule is a federal regulation that effectively prohibits US banks from using customer deposits for their own profit. It also limits banks in terms of the kinds of investments they can make. For example, they can't own, invest in, or sponsor hedge funds or private equity funds.

Now, in order to access the necessary liquidity, the transactions are going to high frequency traders.

"Circuit breakers, then, when they're introduced to the system during large market moves, prevent these high-frequency traders from seeing prices," Singer says.

"When that happens, they pull out of the market and the liquidity backstop that they would have provided disappears."

So, what does this mean for markets?

At the end of the day, it means that a market decline is likely to be steeper and sharper than would otherwise be the case, Singer says.

"In the current environment, it's important to have dry powder; to be able to step in, provide liquidity and take advantage of things that can be short-term in nature, but at the same time very large opportunities," Singer says.

When the opportunity set widens, William Blair looks to deploy more risk and, when it narrows, the fund manager reacts accordingly by deploying less risk.

"We're not targeting a risk level; we're using the amount of risk that we need to use to take advantage of the opportunities," Singer explains. **FS**

[1] As of 31 March 2019. Performance shown is net of fees. Fund inception date is 5 December 2013. Past performance should not be seen as an indication of future performance.