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Michael O'Dea
head of multi-asset,
Perpetual Investments

In 2014, Perpetual Investments scored a major coup: it recruited the former head of investment and implemented consulting at JANA, Michael O'Dea, to its fold.

Prior to joining Perpetual, O'Dea spent 13 years at JANA in a variety of roles including being the head of the absolute return research team.

That experience plays well into his current role as head of multi-asset at Perpetual, where his goal is to figure out that fine balance between investor expectations on returns given the associated risks of those returns.

This week, we invite you to find out what multi-asset investing mean for O'Dea and his team and, in particular, how their thinking shapes the running of the Perpetual Diversified Real Return Fund.

Having delivered 8.1% return per annum as at December 31, 2016 (based on five-year net performance), the diversified real return fund exceeded its target by a wide margin.

And as the oft-quoted phrase in the industry goes, "you can't eat relative returns." The focus to deliver 'real returns' in this case makes this fund primer a must-read.

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Multi-assets: Regular returns with little sacrifice

Greek philosopher Aristotle observed that the whole is greater than the sum of its parts. This goes to the heart of the Perpetual Diversified Real Return Fund's four quadrant approach to portfolio construction. The philosophy behind each quadrant combines to achieve a precise balance between minimising risk and achieving a targeted level of return.

With the freedom to move decisively between asset classes, the team behind the Perpetual Diversified Real Return Fund dynamically manages the portfolio, aiming to deliver consistent, inflation-beating returns and keep volatility in check. The four quadrants (see Figure 1) that underpin the fund's construction are designed to identify investments that contribute to on objective of CPI + 5% p.a.* at low levels of volatility.

Here's how the process works:

1. Inflation protection - what will protect from inflation over five years?

A sustained period of high inflation is one of the most serious risks facing investors. It can have a two-fold impact on wealth: When the cost of living increases the future value of an investor's money diminishes; and many assets, such as equities and bonds, fall in both real and nominal value when inflation is high.

Given these risks, the investments we consider in this quadrant are those that will help protect the fund from inflation over a period of five years. These investments may include inflation linked bonds, commodities, and property where rental increases are explicitly linked to inflation.

2. Return seeking – What has a high probability of meeting a return of inflation + 5% p.a.*?

This is the 'engine room' of the portfolio. We look for the most attractively priced investment opportunities across asset classes, markets and geographies. We are not constrained by fixed allocation ranges which means we have the flexibility to actively shift the investment exposures to capture the best opportunities – wherever they are found.

From an extensive range of investment opportunities, we build a highly selective portfolio of diversifying opportunities that satisfy an expected return greater than inflation + 5% p.a. over a rolling five-year period, before tax and fees. The types of assets we may invest in within this quadrant include Australian or global equities, infrastructure debt, emerging market debt or equities and bank loans.

3. Does the investment add the potential for uncorrelated returns?

Uncorrelated returns diversify a portfolio because they are not linked to the general movement of the overall stock market. In the past, investors could diversify by investing in cash and bonds at positive real rates. But this is no longer viable because of historically low interest rates.

What we look for are investment opportunities typically overlooked by traditional balanced fund investors. Sometimes they don't fall neatly into asset classes – they may include relative value investments, currency holdings or skill-based sources of return such as market neutral equities.

4. Downside protection - What will protect the portfolio in terms of market stress?

Our approach seeks to lower risk and protect capital because the fund is focused on managing overall volatility. Having an inherent bias towards loss prevention means our portfolios are designed to act as shock absorbers when markets fall.

One way we protect on the downside is to explicitly manage valuation risk – that is, avoiding investing in expensive asset classes in the first place. But we are aware this approach can lead to investing large amounts in cash when valuations are unattractive. To counter this we not only tactically increase our allocation to fixed income and hold cash when appropriate, we may also implement explicit portfolio protection.

We rotate our protection strategies according to what is likely to be most effective at any point in time. These strategies include put options, gold, bonds or cash.

About Perpetual

Perpetual's disciplined approach to identifying high-quality, attractively valued investment opportunities for our investors – irrespective of the security or asset class – is what has set us apart for generations. As one of Australia's most highly regarded and awarded investment managers, Perpetual manages money across a range of asset classes, including Australian and global equities, multi-asset strategies, as well as credit and fixed income.

The quote

The portfolio is designed daily with the right mix of assets to deliver the return objective at lower levels of risk.

More information

To find out more about the Perpetual Diversified Real Return Fund, visit: www.perpetualrealreturn.com.au, contact our Adviser Services team on 1800 062 725 or speak to your Perpetual Business Development Manager today. FS

*Over rolling 5 year periods, before tax and fees.

Watch the video on www.fsitv.com

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Figure 1: Four quadrant portfolio construction