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Solutions

Aberdeen Standard Investments

Global risk mitigation: A prescription for volatility

Strategies that seek to provide downside equity protection without a significant cost in lower-volatility markets can prove valuable in times of economic stress. At ASI, we are continually developing innovative means of combating volatility.

Our global risk mitigation (GRM) strategy was designed with environments like the first quarter of 2020 in mind. GRM is a way to approach investments proactively, with risk top of mind. It is a custom, tailored solution that aims to provide a similar return profile to systematically buying equity puts for protection, but at a lower cost during benign markets.

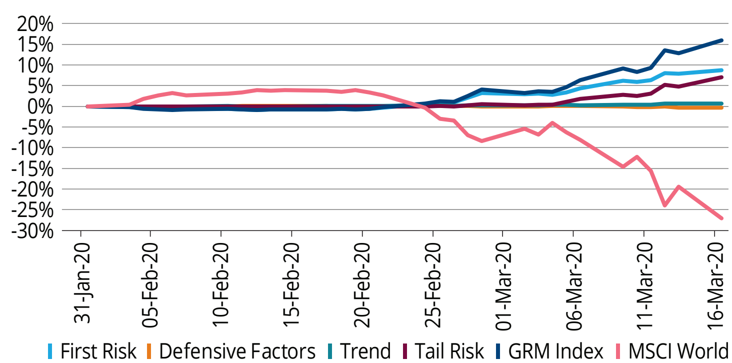
The strategy is made up of four separate segments, each of which plays a role in achieving the overall goal of the strategy:

Segment	Role	Includes strategies that…
First risk strategies	The first strategies to respond in a market shock	are expensive to hold in benign markets but very reactive to even small equity sell-offs
Defensive factors	Generate positive return over time to offset some of the cost of first risk	have risk premia factors with low and stable correlation to equities
Systematic trend following	Tactically provide additional positive returns	dynamically take directional exposure to various asset classes on the basis of recent price trends
Tail risk	Flat in most market environments, but with strong positive convexity during large sell-offs	typically start making profits once equities have already fallen 10-15%

Each category is actively managed, with weightings to 30+ underlying sub-components, which are frequently adjusted. The interaction of these four segments contributes to GRM's effectiveness.

Since July 31, 2019, BNP has created and run an index that we have managed. The chart below shows the breakdown of performance of each of these segments in the index, the index itself, and the MSCI World index, a proxy for global equities, for 2/1/20 through 3/16/20. While one cannot invest directly in an index, our GRM strategy will be managed in a similar manner to this index. As intended, the initial response was very much dominated by **first risk**. In the final days of February, once the market was down double digits, the **tail risk** allocation also kicked in and started performing. **Trend-following** strategies also contributed positively, thanks to exposure to rates and commodities. The **defensive factors** demonstrated their resilience in the face of market stress and are expected to provide a source of positive return to the index over time as markets stabilize (Chart 1).

Chart 1: Index Segments vs. GRM Index vs. MSCI



Source: BNP Paribas and Aberdeen Standard Investments, March 17, 2020. Category attribution is gross of rebalancing costs and had these costs and fees been included, results would be lower; GRM Index total return is net of all fees and costs. **PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.** For illustrative purposes only.

The aggregate result was a 16% total return over the six-week period while the MSCI global index returned -27%. There is also a version of the product that uses three times as much leverage that returned 48% over this timeframe. It should be noted, however, that the addition of leverage may increase risk. However, a strategy that produces this result can be an incredibly valuable component of a return-seeking portfolio for an investor that values stability in turbulent times.

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