How to get the asset allocation mix right in modern portfolios

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The unprecedented access advisors have to investment securities today – from thousands of publicly traded companies to niche alternative investment products – creates an asset-allocation challenge: deciding how much to commit to each asset class to meet a client's objectives.

A starting point might include discussions about goals and preferences, such as growth versus income or capital preservation, or active versus passive approaches. But the implementation often moves beyond what to many is an outdated 60/40 model.

David Ferreira, portfolio manager at Harbourfront Wealth Management in Toronto, retains a 60 per cent growth and 40 per cent fixed-income framework. However, he allocates alternatives – investments that aren't exclusively public equities or bonds – within those buckets.

"Instead of using two asset classes to build portfolios, we use six, and they all have different attributes," he says.

His goal is to grow the portfolio's overall capital through a diverse set of return drivers while exposing a client's money to as little risk as needed to meet their goals.

Among the six categories, private equity contributes to capital growth while private credit can provide income. Real estate and infrastructure further broaden the investments available. Public equities serve their conventional role, delivering growth and capital gains. And public bonds provide stability or portfolio ballast as well as interest income.

Forward-looking return expectations and volatility inform the weightings, along with how the holdings behave or correlate to one another, Mr. Ferreira says. Liquidity sets another boundary. For money needed within five years, he generally favours little or no private-market exposure, which often faces stricter redemption rules.

In the Canadian market, all-in-one exchange-traded funds (ETFs) are becoming an increasingly easy answer to the asset-allocation challenge, particularly in smaller accounts, says Greg Gipson, managing director and head, ETFs, at CIBC Global Asset Management (CIBC GAM).

“Implementation, portfolio monitoring and rebalancing all become extremely efficient,” he says.

For example, Avantis CIBC Balanced Asset Allocation ETF CAGE-T combines actively managed underlying ETFs into a globally diversified 60/40 portfolio. It can anchor the core allocations of a portfolio, freeing an advisor or investor to adjust or add select satellite investments geared to excess growth, income or another objective.

CIBC GAM is far from alone among Canadian asset managers that have introduced low-cost all-in-one ETFs in recent years. Many are responding to the appetite for simplified, professionally managed solutions that are more cost-effective than traditional mutual funds and less laborious than individual security selection.

Mr. Gipson says advisors can devote the time saved on monitoring investments to more holistic financial and estate planning duties and client relationship building.

Professional management by experienced portfolio managers does carry a cost, but it’s one many advisors and investors are increasingly willing to pay. Actively managed ETFs now account for 35.7 per cent of total Canadian ETF assets under management.

Mr. Gipson describes CIBC Balanced Asset Allocation ETF as “active by design, but systematic in execution.” On the equity side, its underlying strategies favour companies with attractive valuations and strong profitability, adjusting as fundamentals change. The ETF’s management fee is 0.28 per cent, which is about 20 basis points higher than what a passive global equity index-tracking ETF would charge.

Mr. Ferreira sees room for inexpensive index exposures alongside differentiated active strategies. “If you want to own just the S&P 500 or the TSX, a passive ETF is a good way to do it.”

To help advisors optimize client portfolios, several major Canadian asset managers provide regular asset-allocation reports and model portfolio guides, including Fidelity Investments Canada ULC, BlackRock Inc. and BMO Global Asset Management (BMO GAM).

BMO GAM, for example, publishes a quarterly Macro Regime Model, with a balanced portfolio of BMO ETFs allocated tactically to equities, fixed income and alternatives. Its benchmark mix adheres approximately to weights of 60/30/10, respectively. The alternatives sleeve is tilted into areas such as gold, broad commodities and infrastructure ETFs as ways to provide less correlated returns and capital protection.

Such models help inform decision-making for other professional money managers as well. Mr. Ferreira supports a tactical asset mix that includes infrastructure to address persistent inflation he sees as remaining “sticky.” Overall, he says the tactical or short-term, reactive positioning in his portfolios represents roughly 20 per cent to 30 per cent of exposures at a given time.

His ultimate aim is diversification of returns across his six primary asset classes, which can support a client through the ups and downs of markets and economic cycles.

“We want asset classes and strategies that move in different directions for different reasons,” Mr. Ferreira says.

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