Article from

Risk & Rewards

August 2016
Issue 68

Asset Allocation Contest Update

By Jim Kosinski

The 2016 Investment Section Asset Allocation Contests are underway, with 50 Investment Section members entering 134 portfolios in the three contests, which began on May 1 and will continue through Sept. 30.

This year we decided to replace the traditional three objectives of highest return, lowest standard deviation and highest Sharpe ratio to try to encourage creating more interesting and realistic portfolios. Last year the highest return objective had brought in a number of portfolios that were 100 percent single asset, and rewarded lucky (or skilled?) market timing. The lowest standard deviation objective had brought in a lot of identical 20 percent cash, 80 percent bond portfolios. The Sharpe ratio objective was more interesting but still tended to reward very conservative portfolios.

The three objectives for this year's contests are: Portfolio Manager—Create Alpha, Portfolio Manager—Accumulation, and Drawdown. Participants were encouraged to enter a portfolio in each of the three contests, as the contrasts between the contests presented an opportunity to try diverse strategies.

The Portfolio Manager—Create Alpha contest is a variation on the highest return/highest Sharpe Ratio theme. A 60/40 (60 percent ACWI, 40 percent BND) benchmark portfolio was created, and the return of the participant portfolios will be compared to that of the benchmark portfolio scaled to have the same standard deviation. (We're defining "alpha" to be how far your return/standard deviation point plots above the Capital Market Line through the origin and the 60/40 portfolio.) This contest is intended to encourage diversification to reduce volatility, but using alpha rather than Sharpe ratio should also encourage riskier portfolios (for higher potential alpha), where a conservative portfolio might have an excellent Sharpe ratio but not much excess return. There are 46 entries in this contest.

The Portfolio Manager—Accumulation contest is a highest return contest, but with two twists. First, we assume additional funds come in on a monthly basis over the course of the contest, which allows for dollar-cost averaging into positions, or gradually adjusting allocations through time. Second, and maybe more significantly, on a monthly basis portfolios that have cumulatively underperformed the 60/40 benchmark by 5 percent are cut. The underperformance constraint is intended to encourage benchmark watching (like real life) and discourage concentrated bets. There are 43 entries in this contest.

The Drawdown contest is about managing a portfolio for a stream of income for as long as possible. Portfolios start with \$100,000, and \$1,000 is withdrawn each business day until the portfolio is exhausted (or until the end of the contest on Sept. 30). There are 45 entries in this contest.

In addition to changing the contest objectives, we also increased the number of exchange-traded funds (ETFs) available this year, from 10 to 20. Notable additions were high-yield bonds, small-cap stocks and long-dated Treasurys as well as some international bond funds. This also gives us a few more chances to have gains in our portfolios if the market is uncooperative again. (Last year only one of the 10 investment alternatives ended up positive for the contest … and that was short-duration bonds!)

A few observations on the contest entries:

- Thirty-nine of 50 participants entered all three contests; six entered two; five entered one.
- Over half of the portfolios (72 of 134) included four or more assets.
- Thirty-one of the 134 portfolios were single-asset, compared to 28 of 98 last year.

Notable asset allocation observations:

- We see a high allocation to alternative assets (gold, real estate, commodities), particularly gold. Alternative assets made up over 25 percent of the overall asset allocation.
- Most-used assets: gold (17.3 percent), S&P 500 (10.9 percent), high-yield bonds (7.3 percent), U.S. small-cap equities (7.1 percent), emerging market equities (6.1 percent)
- Least-used assets: TIPS (1.1 percent), global equities (1.4 percent), global equities ex-U.S. (1.5 percent), EAFE (2.2 percent), international small-cap equities (2.9 percent)

For the 39 participants who entered all three contests, we see noticeable shifts to the asset allocation across the three contests:

Contest	U.S. Stock	Intl Stock	U.S. Bonds	Intl Bonds	Cash	Alternatives
Alpha	22%	18%	21%	2%	9%	28%
Accumulation	28%	17%	17%	2%	4%	32%
Drawdown	27%	8%	30%	6%	8%	22%

The existence of the benchmark and the monthly portfolio review (with risk of being cut) does not seem to be discouraging risk-taking in the Accumulation contest. In fact, Accumulation sees higher allocations to U.S. stock and alternatives than Alpha. Drawdown, by contrast, has higher bond allocations than either of the others, with significantly less allocation to international stocks and alternatives.

As of May 18, the market is being almost as uncooperative as last year, with only three asset classes of 20 showing marginal gains thus far. There's still a lot of time until Sept. 30, though. Good luck to all our contest participants, and be watching for updates! ■

Jim Kosinski, FSA, CFA, MAAA, Ph.D., a member of the Investment Section Council, is VP Actuarial at Guggenheim Insurance in Indianapolis. He can be contacted at *Jim.Kosinski@guggenheiminsurance.com.*