

TACTICAL ASSET ALLOCATION (TAA)

What is Tactical Asset Allocation?

Having implemented the long term strategic asset allocation (SAA), advisers may also choose to “tilt” their client’s portfolios towards (or away from) specific asset classes, regions or sectors that they expect to outperform (or underperform) over shorter time periods.

This type of strategy, known as *Tactical Asset Allocation* (TAA), is a form of active management aimed at increasing returns, but which incurs additional portfolio risk.

In its most simple form, TAA involves selling investments in those asset classes expected to underperform and investing the proceeds into those expected to outperform.

For example, an investor who forecasts that international share markets will fare better than domestic markets in the near future might sell a portion of their Australian equities exposure (known as taking an *underweight* position) and invest the proceeds into international equities (an *overweight* position). If Australian shares do underperform international markets, this tactical position will add value to the overall portfolio, all else being equal.

Historical trends in TAA

TAA implementation in the past considered just the major asset classes (e.g. domestic and international shares, property, domestic and international bonds and cash) and shifted funds between each of these, based on expectations of relative short-term return, as per the previous example. However, this is a cumbersome approach to TAA, because research must be focused on a small number of very broad markets, rather than specialising on specific countries or regions where the adviser may have more skill or insight.

Therefore, there has been a recent trend towards more granular TAA, where individual regions, countries or industries are considered relative to one another and the portfolio adjusted accordingly. For example, instead of considering international equities as one broad asset class, the adviser looks at individual countries or regions and adjusts these targeted exposures, based on short-term return expectations. This enables the adviser to make active decisions and focus research on specific areas of expertise, thus making more efficient use of their investment skill.

To implement such a granular TAA strategy, the adviser needs to be able to construct a portfolio with exposures to specific markets, which can be adjusted quickly, simply and cost-effectively. In the past, constructing such a portfolio was complex, expensive and operationally difficult. This was especially true for clients with smaller account balances, where management fees and transaction costs were often higher, and access to appropriate instruments or strategies was limited, or even impossible.

How can TAA be implemented?

Because of the precise exposures that Exchange Traded Funds (ETFs) offer and their simplicity of transacting, they have become popular instruments globally for advisers and individual investors implementing TAA. ETFs offer market exposure to specific regions, countries and sectors, allowing focused tactical positions to be included into a portfolio simply, quickly and cost-effectively. The table shows some of the most popular exposures investors seek.

Exposure	Constituents	Example	Fees pa ¹
Regional emerging markets	Broad emerging economies including Brazil, Russia, India and China	iShares MSCI Emerging Markets	0.72%
China	25 of China’s largest companies	iShares FTSE/Xinhua China 25	0.74%
United States	Large cap US	iShares S&P 500	0.09%
Regional developed markets	Europe, Australasia and the Far East	iShares MSCI EAFE	0.34%
Global Healthcare	Global healthcare providers and manufacturers	iShares S&P Global Healthcare	0.48%

¹ Management costs: Total fund management fees and expenses as a percentage of average net assets, and is equivalent in calculation to the indirect cost ratio (‘ICR’) and the management expense ratio (‘MER’).

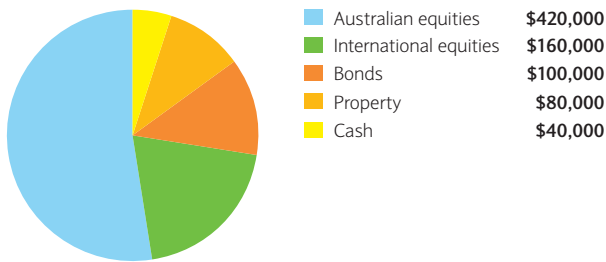
Client case study – Debbie and Ben

- **Age:** 30s
- **Portfolio:** 80% Australian, 20% International
- **Interests:** entertainment, cycling
- **Goal:** implement a tactical tilt to Asia

Meet Debbie and Ben

Debbie and Ben have a diversified portfolio, with 80% exposure to Australia and 20% broad international. Their financial adviser has suggested a short-term tilt towards Asia to capture the potential outperformance of this region in the next six months.

Debbie and Ben's portfolio



Factors important to their decision:

- **Timing:** they want to get in and out within a six month timeframe
- **Diversification:** not knowing the market intimately, they would like broad exposure
- **Transparency:** they want to know exactly what they are investing in

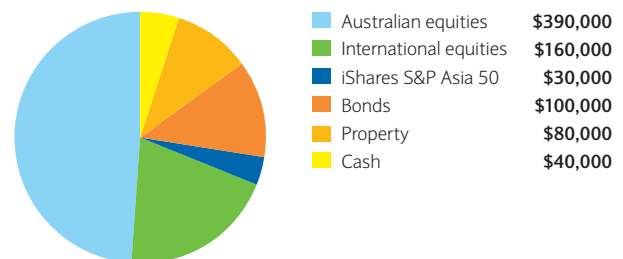
Working with a financial adviser

Their adviser schedules a meeting to discuss the investment into Asia. After examining the opportunity, Debbie and Ben want to proceed with broad exposure to Asia, through a transparent vehicle they can get into and out of quickly.

Knowing they want a transparent investment, their adviser recommends the iShares S&P Asia 50 ETF (ASX: IAA), which publishes holdings daily on iShares.com.au. To implement the tactical tilt, their adviser proposes that they sell Australian equities and match the dollar amount with the investment they wish to make into Asia. The adviser also explains that because ETFs trade on the ASX, by purchasing the iShares ETF and selling the Australian equities on the same day Debbie and Ben remain fully invested throughout the transaction.

Debbie and Ben agree to allocate \$30,000, and their adviser executes the above TAA trades in the standard ASX T+3 settlement cycle.

Debbie and Ben's new TAA



The outcome

Good for the client:

- ✓ They like the broad Asian market diversification provided by the iShares ETF.
- ✓ They like the trading flexibility, and ability to get into and out of Asia when they want to
- ✓ They know exactly what they own at all times, enabling them to monitor their investment

Good for the adviser:

- ✓ Client is happy and was invested at all times with the T+3 settlement cycle
- ✓ Greater control over the portfolio's risks, costs and transparency.
- ✓ Differentiated the business by recommending best investment products

For more information visit [iShares.com.au](https://www.ishares.com.au) or call 1300 iShares (1300 474 2737)

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