We doubt that anyone actually looks forward to their annual physical. But, amidst all the undignified prodding and tut-tutting, there is surely a certain degree of comfort that comes from the chance to take stock and, to some degree, hit the restart button.

Well, in a similar vein (no pun intended), your portfolio can also benefit from an annual checkup. And, as you adopt a physician’s mindset, look in particular for the potential to sensibly use any year-end adjustments that you might be undertaking to consider new themes and strategies, with an eye on improving your portfolio’s overall health. We’ll give a few suggestions about how those could look below.

Three Themes to Consider

Once an investor has decided to make any year-end adjustments to their portfolio, it’s critical to use this opportunity to better align their holdings with their current investment objectives and market views. And, in the interest of offering a few ideas in this respect, we would like to briefly present three prevailing global themes that could be worth considering.

Strategic Beta

The chances are that you’ve been hearing about strategic (or smart) beta for some time now - perhaps year end portfolio changes could be the catalyst to dip your toes in the water. What are these approaches - and why are they worth thinking about. Well, the topic is obviously a vast one (and here at Deutsche Asset Management we have a swath of resources if you are interested) but, put simply, these strategies attempt to outperform market capitalization based approaches by weighting stocks differently.

Specifically, they will normally have one or more “factors”, or characteristics of stocks, such as their size, their risk, or their relative cheapness, which have been proven to outperform over time. A detailed discussion is beyond the scope of this short piece but, if you are thinking of going down this road, then here are three helpful directions.

First, identify the factors that are convincing to you. This will obviously depend on the burden of proof that you need, but we would suggest at least two things - looking at long-run risk adjusted returns to ensure that they have indeed been superior, and ensuring that there is a valid intuition or explanation for any factors that you are considering.

Second, take a very close and careful look at the construction methodology. Make sure that it’s explicit, logical, comprehensible and explainable. This ought to involve a number of detailed conversations with those offering such funds to ensure that you fully understand their suite.

Finally, look at performance and price. We suggest this comes last because a fixation on a fund’s expense ratio risks clouding the more important first two steps that we have outlined.
A Rising Rate Environment

For those worried that any possible rate hike from the Fed this fall may be just a precursor of more tightening to come, there are a couple of areas that are worth your consideration - interest rate hedged bond funds, and international bond funds.

The first of these strategies lowers the duration of a normal bond fund, perhaps by selling Treasury futures to target a lower (or zero) duration. That means a strong degree of insulation for the funds from interest rate risk while retaining the credit profiles of their underlying bonds.

International bond funds are also worth consideration as a means to diversify away from the US yield curve. At his Jackson Hole speech last summer, the Bank of England governor, Mark Carney, spoke about the effectively uncorrelated nature of global inflation. To us that was quite interesting because it suggests that, despite recent QE moves from some of the major developed central banks resulting in one way moves in rates, there will eventually be a return to the domestic-oriented inflation fighting, that is more familiar territory. And, given Carney’s comments, that ought to mean global yield curves moving in an uncorrelated manner. It’s this diversifying potential that make international bonds worth a look.

But one word of warning. If you do switch some of your holdings across to international bonds, it’s critical in our view that you hedge out your currency risk. The lower volatility that’s typical of bonds has the potential to get swamped out if FX risk is retained.

Real Assets

The last theme that we’d like to discuss is real assets, tangible investments such as infrastructure and real estate that sometimes struggle for the same recognition conferred upon their financial asset counterparts. And, again, in the spirit of pushing your portfolio towards full health, we can think of three reasons why these may provide a tonic:

— Inflation Mitigation - Real assets have tended to offer relatively robust performance during periods of above-average inflation. The last print for Personal Consumption Expenditure (the Fed’s preferred measure of inflation) was 1.7% versus 2015 numbers that were consistently below 1.5%.

— Diversification - Real assets can, through their regulatory framework, or via relatively inelastic demand, benefit from pricing mechanisms that lower their correlations to equities. As such, even small additions could help to improve overall portfolio characteristics.

— Income Potential - In this world of low yields, investors are understandably still on the hunt for assets that might provide higher income. With that in mind, it may be worth taking a look at some of the relatively higher dividend yields that real estate and infrastructure have paid when compared to the S&P 500 Index.

Conclusions

For any investors who are using this time of year to give their portfolios a physical, we would suggest trying a few lifestyle changes that are aligned with today’s key investment and macro themes. We’ve highlighted factor investing, interest rate hedged bonds, international bonds, and real assets. We hope they might provide the fillip of a financial flu shot when jabbed into any ailing portfolios.
Beta measures a security’s sensitivity to the movements of the fund’s benchmark or the market as a whole. A beta of greater than one indicates more volatility than the benchmark or market, while a beta of less than one indicates less volatility. The dividend yield is the dividend that a company pays out each year divided by its share price. A future is a financial contract obligating a buyer to purchase an asset (or a seller to sell an asset) at a predetermined future date and price. Duration is a measure of the sensitivity of the price of a fixed-income investment to a change in interest rates and is calculated on the basis of present value, yield, coupon, final maturity and call features. Quantitative easing (QE) is the introduction of new money into the money supply by a central bank. The S&P 500 Index tracks the performance of 500 leading U.S. stocks and is widely considered representative of the U.S. equity market. The yield curve is a graphical representation of how yields on bonds of different maturities compare. Normally, yield curves slant up, as bonds with longer maturities typically offer higher yields than short-term bonds.

Diversification does not eliminate the risk of experiencing investment loss.

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