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**Getting 'active' in  
portfolios: a strategic  
guide for EMEA  
wealth**

# Executive summary

Profound changes are impacting the way institutions are building multi-asset portfolios in EMEA.

We see the Private Banking and Wealth Management industries transforming. Regulatory changes and profitability needs have triggered a centralisation of investment propositions – paving the way for the growth of discretionary portfolio management and fee-based solutions. In addition, we witness the rise of self-directed investing through digital channels and the rise and consolidation of independent financial advisers.

The magnitude and speed of change for the industry have been accelerated by the critical need to adapt to the post-pandemic investment environment of greater volatility, uncertainty and divergence in market performance. Gone are the days of ultra-low interest rates and low inflation, when ‘more or less every investment choice worked’, as equities and bonds often rallied together. Future return estimates above cash look less attractive. Our expectation is for structurally higher inflation and higher long-term rates. This is a new investment regime, which we believe is here to stay.<sup>1</sup>

The upshot? The bar has been reset, and it is much higher, calling for an urgent rethink of portfolio construction and asset allocation practices.

We believe this is the end of an era of simplistic, set-and-forget portfolios, where product selection was dominated by global and broad building blocks managed in silos.

In this new phase, we believe investors who want to stay competitive and take advantage of the investment regime to deliver long-term alpha to their clients should consider getting more ‘active’ in their portfolios by:

1. **Adopting** a more ‘dynamic’ approach to long-term portfolio construction, which includes more granular and nimble asset allocation delivered through a blend of index and active strategies, coupled with frequent risk monitoring and stress testing.
2. **Aiming** to be more active with index strategies and deliver alpha through flexible usage of index building blocks.
3. **Allocating** more to highly skilled active managers – for investors who have confidence in their ability to pick good managers to capture additional long-term alpha opportunities.

In this paper, we lay out the rationale behind our thesis, reflecting on recent BlackRock Investment Institute (BII) portfolio research results published in [‘Investment Perspectives: A bigger role for active strategies’](#) and their implications for EMEA Wealth investors.

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<sup>1</sup> For more on the new investment regime please refer to [Putting Money to Work: The road to opportunities](#).

# 1. Adopt a more dynamic approach

We believe that the post-pandemic era is characterised by increased macro and market volatility due to persistent supply constraints and major structural shifts, such as the low-carbon transition and demographic divergence. As a result, the steady growth and inflation of the Great Moderation, the four-decade period of largely stable economic activity and inflation, are unlikely to return. In the past, stocks and bonds experienced joint bull markets, but we do not expect this trend to continue. Instead, we believe that stocks' future excess returns over cash will be lower, due to persistent inflationary pressures and major structural shifts. This means that getting the portfolio asset mix right is more important than ever. See Figure 1, which shows the estimated impact of choosing to hold 20% more or less stocks than a hypothetical traditional portfolio mix (with 60% in stocks and 40% in bonds) – shown for illustrative purposes – during the Great Moderation (yellow lines) and the new regime (orange bars). We find the return impact – even with a different asset mix – is likely much lower than in the past. This is not about the starting point of a traditional portfolio being better or worse today – that will always depend on an investor's objectives. But changing the portfolio mix has a much greater impact today than it did in the past: those choices matter more. Our approach to portfolio construction has always accounted for uncertainty. We believe that in the post-pandemic era, considering the conviction of our strategic views for assets and incorporating uncertainty into them will be paramount to building more robust portfolios. It has become even more important to stress test assumptions and assess how portfolios may perform in different market scenarios.

Figure 2 illustrates that simple, set-and-forget approaches to portfolio construction are potentially not going to be as effective in the new regime. We believe that a dynamic investing approach that acts on insight and expertise more frequently even in single asset classes could be better rewarded. The chart shows monthly US equity returns in the old and new regimes under three scenarios: keeping the holdings unchanged (set-and-forget), yearly

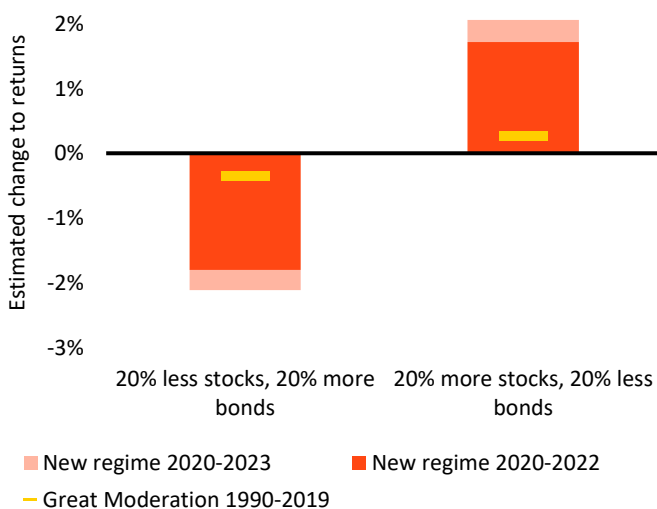
reviews and semi-annual reviews. The reviews allow the investor to optimise the hypothetical portfolio for returns, diversification and risk, with perfect foresight of equity sector returns. Acting on this hypothetical ability more frequently would have yielded greater rewards since 2020 than in the four years prior. Even if we exclude 2023, when a few mega cap tech stocks strongly contributed to overall US equity returns, we find the same results. The orange bars, representing a simple, static approach of buying and holding, are much lower than the yellow and green bars. This suggests that not only good insight, but also timely action, would have resulted in greater rewards than fixed strategies since 2020. This hypothetical exercise highlights how skill and insight may be better rewarded in the new regime, and this is why we believe that investment expertise is likely to give portfolios an edge.

Evolving portfolio construction practices in this new environment, to move beyond the fixed allocation approach could offer EMEA Private Banks and Wealth managers new commercial opportunities to deliver better and more consistent portfolio outcomes to clients and potentially avoid regulatory challenges related to the MiFID suitability mapping.

To be successful in this new regime, we advocate the following shifts in portfolio construction practices:

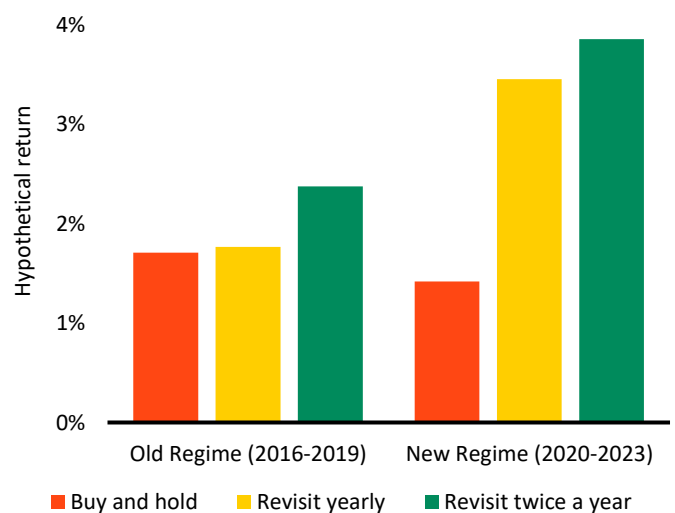
- **Adopting a more dynamic approach** to asset allocation, with frequent reviews
- **Putting in place more adaptable implementation choices** that give an ability to quickly and efficiently adjust portfolio exposures to act on good insight
- **Continuously monitoring risk and stress testing portfolio outcomes**
- **Educating end investors focusing on the outcome**, not the product.

**Figure 1: asset allocation choices matter even more**



For illustrative purposes only. These do not represent actual portfolios and do not constitute investment advice. Source: BlackRock Investment Institute with data from LSEG Datastream and Morningstar. Returns data as of September 2023. Index proxies: MSCI AC World for equities and the Bloomberg Global Aggregate Index for bonds. We use the actual returns for both indexes using Refinitiv data to estimate portfolio returns.

**Figure 2: greater rewards for a more dynamic approach**



Past performance is not a reliable indicator of future performance. Index returns do not account for fees. It is not possible to invest directly in an index. Source: BlackRock Investment Institute, MSCI with data from Bloomberg, December 2023. This analysis uses historical returns and has been conducted with the benefit of hindsight. Future returns may vary and these results may not be the same other asset classes. It does not consider potential transaction costs that may detract from returns. It also does not represent an actual portfolio and is shown for illustrative purposes only.

## 2. Aim to be more active with index strategies

Historically, portfolio builders have put significant emphasis and resources into selecting investment products. For decades, we witnessed a siloed approach to portfolio construction, where asset allocation was separate to product implementation, and investors stuck to false dichotomies, such as index vs. active strategies and public vs. private markets. For example, index funds such as exchange traded funds (ETFs) were considered by some investors to be ‘passive’ exposures and ‘cheap beta’ building blocks. Alongside those, we had ‘active’ exposures, dedicated to alpha-seeking managers selected to deliver the desired above-benchmark returns for the entire multi-asset portfolio. Inefficiency in terms of fee budget allocations and shortcomings related to potential unintended tilts between the target and actual portfolios were an inevitable consequence. Such inefficiencies rarely came to light, however, as decades-long bull markets in equities and fixed income meant that almost any investment choice worked.

In EMEA, in the years following the global financial crisis, we saw a gradual change in portfolio construction practices. With new regulation and shifts in client demand came a greater focus on value for money and increasing scrutiny on the products used to meet client objectives. Transparency of traditional fee structures started changing revenue models. Technology started enabling new competition in the form of ‘robo’ advisers and digital offerings that delivered simple, cost-efficient portfolio solutions. We started seeing higher adoption of index strategies, as investors continued to decouple key drivers of portfolio returns. Investors have been increasingly recognising the value of viewing the investment universe through a ‘whole portfolio’ lens, and expressing long-term market and factor choices through index vehicles, while deploying excess fee budget to acquire alpha excellence from managers skilled in timing exposures and security selection.

Since the pandemic, we have entered yet another phase, one characterised by the new investment regime, that is turbocharging the evolution of such portfolio construction practices. As we outlined in the previous section, we believe that in this new era, portfolios’ alpha needs to be delivered through more dynamic asset allocation choices implemented through more granular exposures, characterised by the blurring of lines across strategies and markets, and where investors are measured by end clients against a higher performance bar – which calls for transformative innovation. We believe that in this new environment, there could be nothing ‘passive’ about implementing a multi-asset portfolio and that indexing should play an even bigger role in portfolio construction, to:

- fuel the need for adaptable and dynamic portfolio implementation;
- introduce precise, nimble, cost-efficient and highly liquid and flexible building blocks;
- and free up budget for highly skilled alpha-seeking managers able to further contribute to the portfolio alpha, if investors have confidence in their ability to pick good managers (see more on the role of alpha-seeking managers in the next section).

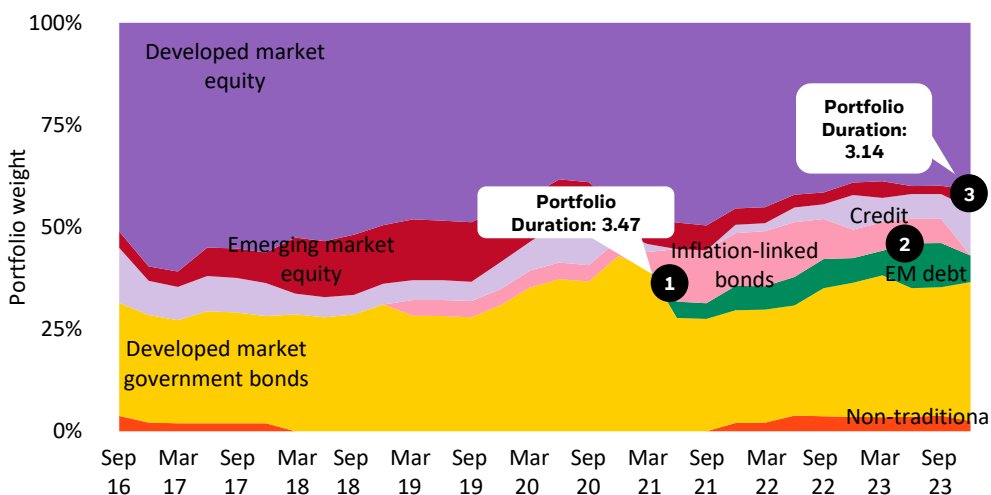
An active approach to indexing could allow investors to exploit their skill in timing markets and their ability to consistently pick exposure to the right sectors, regions and styles. The portfolio implementation example below captures an extreme case of the role that indexing can play. We illustrate a fully indexed model expressed through granular ETF building blocks across equities and fixed income, regions, sectors, factors and themes, targeting a moderate risk profile. We use this example not to discount the role of alpha-seeking funds, but rather to bring to life the concept of being dynamic with index exposures, through an efficient investment vehicle such as an ETF, that allows for liquidity and flexibility. We illustrate that:

- a risk-targeted, quarterly asset allocation review approach allows for a more dynamic adjustment to exposures, delivering consistent experience for clients for the desired risk appetite in an evolving macro environment – see point 1;
- working with a broad and granular range of ETFs has allowed the portfolio to materially change at times when the new investment environment has presented challenges or opportunities – see points 2 and 3.

The surge in the number and variety of ETFs now available means that investors can build portfolios in more innovative ways than ever. For example, we see the emergence of active ETFs, further blurring the lines between index and active implementation options, offering potentially enhanced return and diversification opportunities. ETFs are now providing a wider range of exposures, allowing investors to access individual countries, sectors, style factors, themes and structural trends such as the low-carbon transition. This increased breadth and granularity also enables the targeting of specific portfolio outcomes. The precision of ETFs, combined with their liquidity and adaptability across various asset classes, enables an effective expression of portfolio views. This is particularly important in a highly unpredictable environment.

### Figure 3: a hands-on-the-wheel approach to navigate market uncertainty

Illustration using a fully indexed moderate risk profile



#### 1 Jun 2021

Increased US and European inflation linked bonds **when supply-driven inflation started rising globally.**

#### 2 Jun 2023

Adjusting to the **new regime by applying selectivity** through European quality dividend equities and EM debt for their relatively attractive yields.

#### 3 Dec 2023

Maintaining **risk-on stance** as market volatility continued to moderate. Within fixed income, **diversifying government bond** allocation.

For illustrative purposes only. This information is not intended as a recommendation to invest in any particular asset class or strategy or as a promise - or even estimate - of future performance. Source: Blackrock, as of 31 December 2023.

### 3. Allocate more to highly skilled active managers

As we have established, the new regime of heightened macro and market volatility rewards an ‘active’ portfolio approach, with dynamic indexing helping to quickly evolve portfolio allocations and freeing up fee budget. In this section, we argue that for investors able to consistently pick skilled fund managers, we think alpha-seeking strategies could play an even bigger role in portfolios today. Why? Greater macro uncertainty has fuelled dispersion in some markets – for example, the range of US stock returns has grown markedly from 6.5% on average between 2010-2019 to 7.7% since 2020.<sup>2</sup> This means there are more opportunities for skilled managers to find and deliver above-benchmark returns in US equities that can’t be explained by static exposures to macro factors and equity style factors. As recently illustrated by Bill in [Investment perspectives - A bigger role for active strategies](#), professional managers as a group have not become more skilled at delivering active returns overall – however the investment environment has become more conducive for highly skilled managers to deliver greater active returns.

Looking at a broad universe of equity, fixed income and hedge fund managers, Bill’s research finds that active returns for developed market equity and hedge fund managers have been more dispersed in the post-pandemic era. Although we don’t see a similar magnitude of alpha dispersion in fixed income in the new regime, historically, information ratios – a risk-adjusted measure of active returns – have been higher in fixed income than in equities, suggesting that active risk is generally more efficiently rewarded in fixed income. This is one reason why we see attractive alpha opportunities in high-quality European credit, for example.

We illustrate the potential need for more alpha-seeking managers alongside beta in portfolios with a hypothetical example (Figure 4). Again, we start with a snapshot of a fully indexed multi-asset portfolio (the first bar), like the one outlined in the previous section, optimised for 8% expected risk. We estimate around 5% real/above-inflation annualised expected return for this portfolio, coming from static macro and equity style factors – or what we call beta return, leveraging BlackRock’s [Capital Market Assumptions](#).

If an investor needs to generate approximately 1% additional real return with this portfolio, they can either:

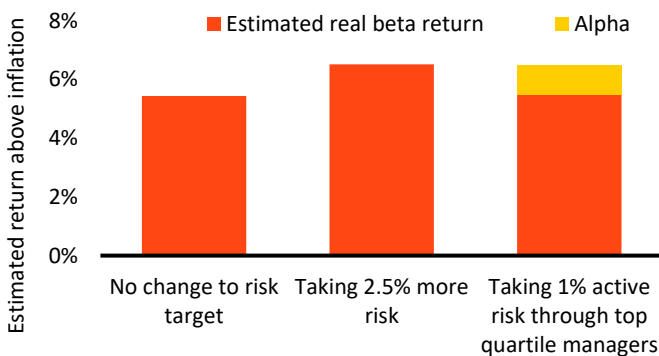
- remain fully indexed and take 2.5% more equity risk by changing the asset class mix to boost the real beta return estimate (the second bar);

- or allocate more to carefully selected, top-quartile active managers, introducing 1% active risk while keeping broad beta risk unchanged (the third bar).

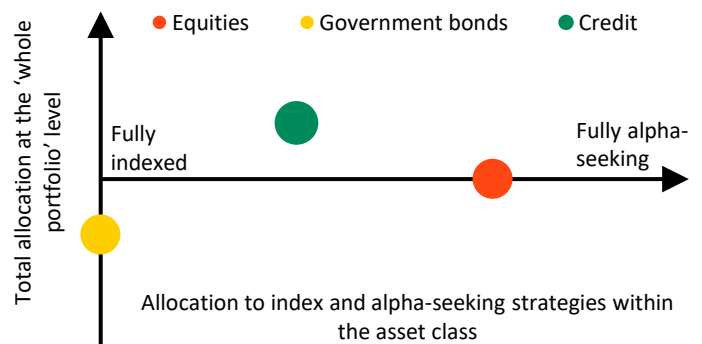
While this example shows that in the current environment, we see a greater role for alpha-seeking managers in portfolios for investors who are looking to target higher levels of real return without significantly increasing portfolio beta risk, there are several key considerations to highlight:

- The role of beta – or the broad macro and style factor exposures – continues to be a key driver of the portfolio. It is important to separate this source of return from any alpha-seeking manager’s excess return relative to a benchmark to understand the returns an investor pays for with alpha-seeking funds. Investors need to ensure portfolio factor exposures are deliberate, diversified and scaled though continuous risk monitoring and stress testing for different market scenarios.
- Alpha-seeking managers impact the whole portfolio (see Figure 5). We see a role for both index and alpha-seeking strategies to build portfolios fit for the future. Starting with the fully indexed portfolio, we allow for a portfolio optimisation where the choice of index or alpha-seeking vehicle influences the asset’s weight in the portfolio. Due to the higher alpha opportunity in equities, we see higher allocation to alpha-seeking managers there. The efficient alpha opportunity in credit makes the asset class relatively more attractive and results in a blended implementation choice, and an overweight, at the expense of a reduction of the fully indexed government bond exposure. This illustrates how asset allocation preferences can shift based on our views on alpha and its efficiency and magnitude – as well as the choice between indexed and alpha-seeking exposures within asset classes.
- Costs matter. For example, product fees cut into returns and can reduce or, in some cases, eliminate the alpha an investor receives. In addition, manager selection and monitoring could amount to significant governance costs. For instance, if we examine the number of top-quartile funds in the European Global Large Cap Growth Equity in Morningstar over the last three years, we find that out of 634 funds, around 101 funds (16%) have top-quartile performance.<sup>3</sup> If we extend this analysis to a five-year period, the number of top-quartile funds is close to 65 funds (10%), highlighting the importance of consistent active manager selections.

**Figure 4: taking more risk or using more top-quartile alpha-seeking strategies**



**Figure 5: alpha-seeking managers impact the whole portfolio**



**This information is not intended as a recommendation to invest in any particular asset class or strategy or as a promise - or even estimate - of future performance.** Source: BlackRock Investment Institute, January 2024. Notes: We assume the following median fees: 0.6% for equities, 0.225% for government bonds, and investment grade credit, 0.45% for sub investment grade credit and 2.75% for private markets. This visual representation is for illustrative purposes only and do not represent an actual portfolio. Regression analysis is backwards-looking with the benefit of hindsight and complex – it may not reliably predict the future relationship between manager performance and market conditions. Expert judgement from a manager research team on an individual fund managers could bring better clarity on how they performed. In-depth and practical manager research can improve on econometric techniques and analysis, like regressions, to build a better picture of how a fund manager might perform in the future.

<sup>2,3</sup> For more on this analysis please refer to Appendix.



## Conclusion

In this paper, we have sought to demonstrate why simple, set-and-forget approaches to combining stocks and fixed income may not be effective portfolio construction strategies going forward. We expect lower real returns across public markets, which makes the portfolio asset class mix matter even more. An investing approach that frequently acts on insight and expertise could be better rewarded in this new environment. Evolving portfolio construction practices offers an opportunity for EMEA Private Banks and Wealth Managers to capture new commercial opportunities and deliver consistency in portfolio outcomes, in our view.

In this new environment, we believe that indexing should play an even bigger role in portfolio construction, allowing for adaptable and dynamic implementation, to free up budget for highly skilled alpha-seeking managers. An active approach to indexing would allow investors to exploit their skill in timing markets and picking the right macro and factor exposures. ETFs offer the breadth and granularity of building blocks needed to enable an effective expression of portfolio views in a highly unpredictable environment.

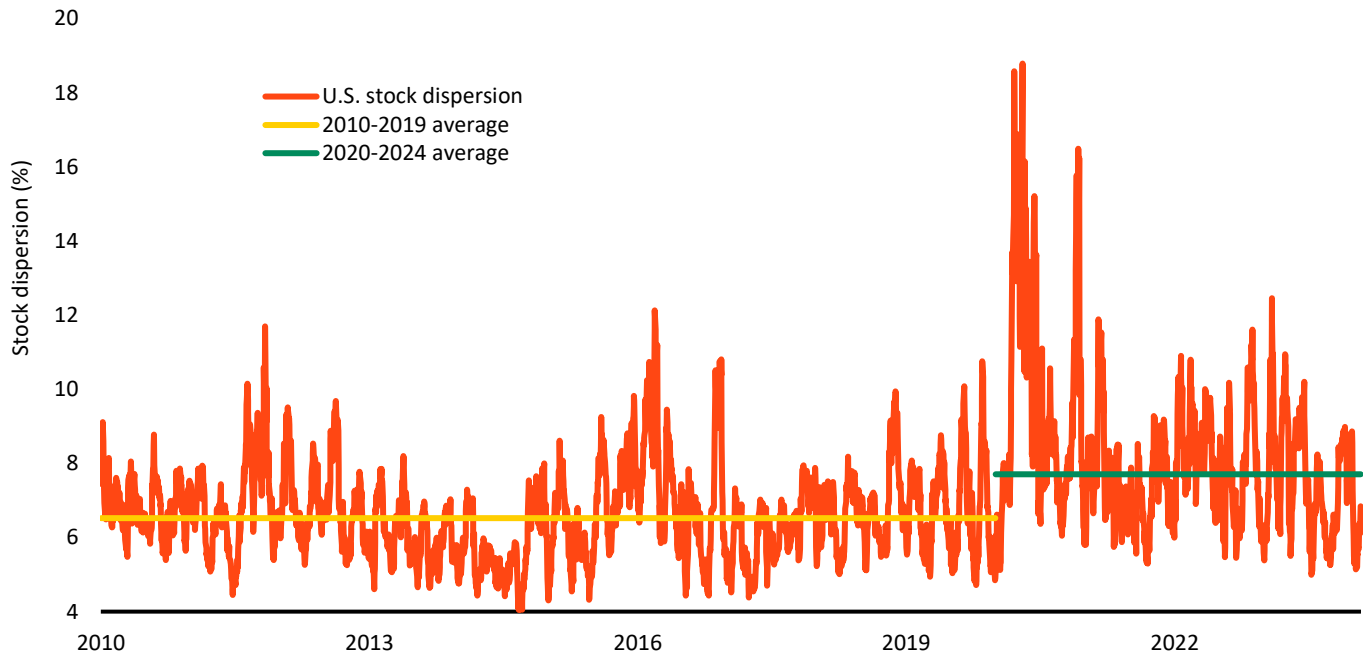
For investors able to consistently pick skilled managers, and able to afford the associated governance costs, alpha-seeking strategies could play a bigger role in portfolios today due to greater macro uncertainty fuelling dispersion in some markets. We believe allocating to alpha-seeking managers should not be done in silos, but rather alongside indexing, to ultimately inform the overall portfolio asset allocation choices, enhance a portfolio's alpha and meet the higher performance bar set by clients.

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# Appendix

## 1. Dispersion of US stock market (S&P 500) returns, 2010-2024



Past performance is not a reliable indicator of current or future results, and index returns do not account for fees. It is not possible to invest directly in an index. Source: BlackRock Investment Institute, with data from LSEG Datastream, February 2024. Notes: The chart shows the dispersion in S&P 500 monthly stock returns on a daily basis and the median level of dispersion from July 2010 after the global financial crisis through 2019, and from 2020 through 31 January 2024.

## 2. Top-quartile funds in the Morningstar European Global Large Cap Growth Equity category over three and five years

Fund Category	Total number funds in study	3Y 1st Quartile	5Y 1st Quartile
EAA Fund Global Large-Cap Growth Equity	634	101	65

Source: Morningstar Direct, as of 29 February 2024.

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