Benefits Of Total Return Strategies In Today's Financial Markets

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Managing investment portfolios requires balancing capital appreciation and capital preservation objectives. The traditional method of meeting those dual objectives involves careful diversification across asset classes in order to balance risk and return throughout multiple market cycles. However, in a period such as 2008, diversification across many traditional asset classes (stocks, bonds, commodities, REITs, among others) that most all suffered declines to some degree, neither met the objectives of capital appreciation or capital preservation. Additionally, while an investor may have outperformed a traditional benchmark on a relative basis, the portfolio may have suffered considerable losses on a total return basis.

The market environment of 2008 and potentially the market environment for months to come point to several important factors for consideration in the design and implementation of a successful investment strategy:

1. *The long-term benefits of traditional portfolio diversification methods don't shield investors from periods of significant stress.* In a market driven by fundamentals, diversification helps ensure that investors are not concentrating their positions. Market meltdowns push fundamentals to the sidelines, with a strong tendency for assets to cluster on the downside. Real economic drivers tend to have the same directional impact across asset classes. Equally important, global liquidity flows become more interconnected.

2. *Some risks can't be modeled.* Recent structural and regulatory forces have magnified the influence of global liquidity flows. Changes in margin requirements, short-selling restrictions, and the need to raise regulatory capital overwhelmed fundamentals in 2008 and traditional asset class distinctions in favor of liquidity needs. Another powerful factor has been the systemic unwinding of debt by consumers and businesses. None of these risks can be readily modeled. Hedge funds, with their flexible mandates and hyper-activity at the margin, only exacerbate the problem.

3. *The lines separating the historical non-correlated behavior of equities, debt instruments, commodities, REITS, and other traditional asset classes have blurred.* The economic drivers fueling the market turmoil in the fall of 2008 were a primary factor influencing returns. For instance, whether an investor owned equity or debt made little difference. The drivers that crushed stock prices also drove down prices in most sectors of the bond market, blunting traditional diversification benefits among these two primary asset classes.

The answer to this dilemma in today's market environment is to include "total" return funds in a portfolio otherwise diversified across traditional asset classes. Total return is frequently misinterpreted and popularly associated with hedge funds. A better way to think of total return is an investment approach that is agnostic about indexes and conventional descriptions. Under a total return mandate, these funds are concerned with finding the strongest risk/reward trade-off rather than meeting a rigid asset allocation requirement or managing a portfolio relative to an index based benchmark. Ultimately, the goal is a positive return in any market environment. Because total return funds behave differently than traditional asset classes, their inclusion in a portfolio enhances diversification and thus reduces overall volatility. By utilizing total return funds such as managed futures, long/short, and market neutral strategies coupled with opportunistic exposure to specific traditional asset classes, a portfolio can provide steadier, stable returns, even in adverse market environments.

For more information on how total return strategies can benefit your portfolio, call Mainstay Capital Management toll-free at 1-866-444-6246 to speak with an investment specialist.