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# Asset allocation at RBC Global Asset Management

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Asset allocation has always been a critical element of long-term investment success, and the immensely complex and rapidly evolving global markets necessitate an active approach to asset allocation to preserve and grow wealth. This process requires much more than simply maintaining static exposures to a broad range of traditional asset classes. To ensure that a portfolio can continue to meet the desired risk and return goals, the strategic asset mix must be kept up to date with the addition of new asset classes, regions and investment strategies. It is also just as important to review existing holdings and eliminate those with more limited long-term promise. In addition, making tactical adjustments around the strategic weights to reflect changes in the outlook for the economy and markets can be an important source of incremental returns over time.

## Disciplined and data-driven approach to asset allocation

At RBC Global Asset Management (RBC GAM), we have been building and managing balanced and multi-asset solutions for more than 35 years. With over $190 billion of assets managed within these types of programs, we are the largest provider in Canada and eighth largest globally.[1]

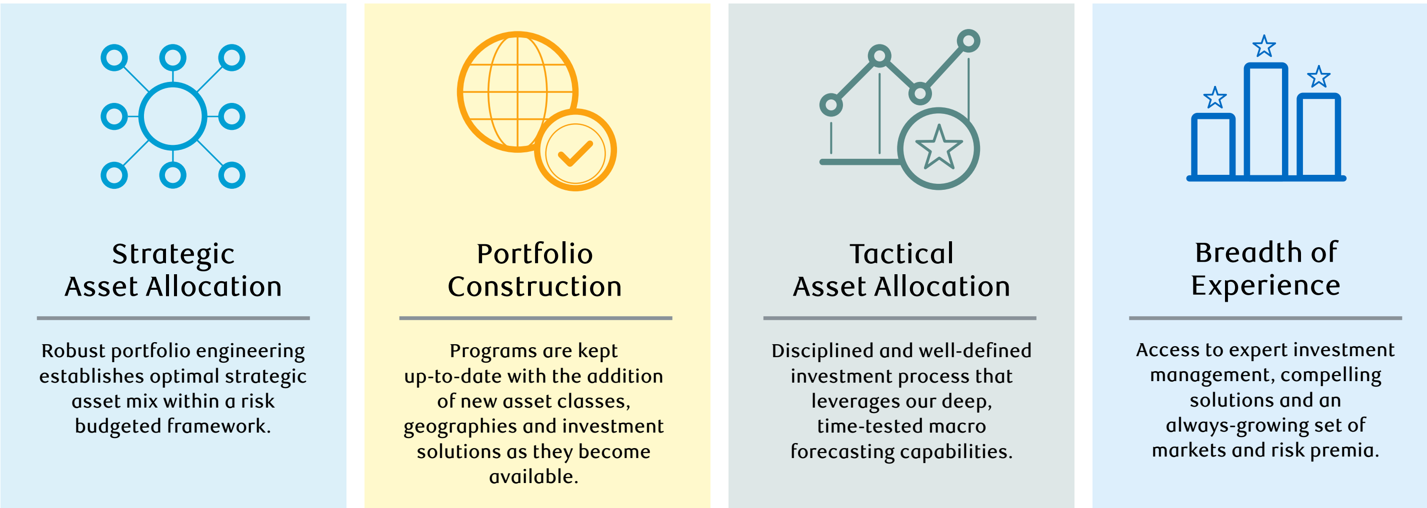
An important differentiator has been our approach to strategic and tactical asset allocation. A disciplined and data-driven investment approach, combined with access to a deep and broad set of investment options and extensive experience in global capital markets, has helped us to deliver competitive risk-adjusted returns for our clients over the long term (Exhibit 1).

*"On average, 90 percent of the variability of returns and 100 percent of the absolute level of return is explained by asset allocation."*

Roger G. Ibbotson, Professor Emeritus in the Practice of Finance at the Yale School of Management

[1] Morningstar. As of August 31, 2023

## Exhibit 1: Disciplined and data-driven approach to asset allocation




Source: RBC GAM

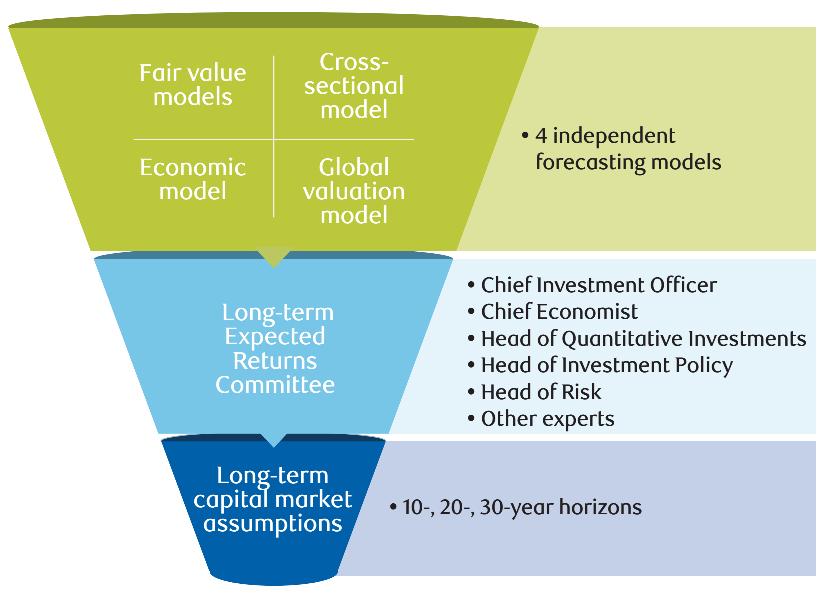
## Strategic asset allocation is the foundation of a well-constructed portfolio

Studies have shown that a key driver of long-term investment performance is the exposure that a portfolio has to individual asset classes over time. Holdings can include the major asset classes such as cash, fixed income, equities and alternatives; sub-asset classes such as government, investment-grade and high yield bonds within fixed income or exposure to various regions within equities. The strategic asset mix is designed to provide an investor with a solution that fits their individual risk tolerance and return goals based on an analysis of both historical and future expectations for asset-class returns, volatility and correlations. Our view is that the strategic asset mix is the benchmark, or neutral, allocation that anchors a portfolio through many business and investment cycles. It is the most important decision that an investor will make and will determine the bulk of returns over time.

## Our sophisticated approach to building solutions

As investment managers, we take a long-term view when building solutions. When establishing the strategic asset mix for a particular solution, we

## Exhibit 2: Multi-model approach for developing long-term capital market expectations




Source: RBC GAM

begin by looking at the historical results of the asset classes that we are considering for investment. While history is certainly a good guide to what might happen going forward, it is also important to establish long-term assumptions about future asset class returns, risk and correlation characteristics, and key economic and capital market variables (Exhibit 2).

We use a variety of independent forecasting models from our investment teams to provide a multi-faceted view across a wide range of asset classes when establishing our long-term capital markets assumptions. Each model employs forward-looking parameters in the context of historical results and empirical relationships to provide a long-term view on approximately 50 asset classes.

The results from the models are reviewed by the RBC GAM Long-Term Expected Returns Committee to arrive at a consensus forecast of future return expectations. The committee also examines asset classes that are not currently part of our solutions to assess their long-term effectiveness at generating returns and whether they are suitable additions to the portfolio construction process.

## Carefully constructed portfolios

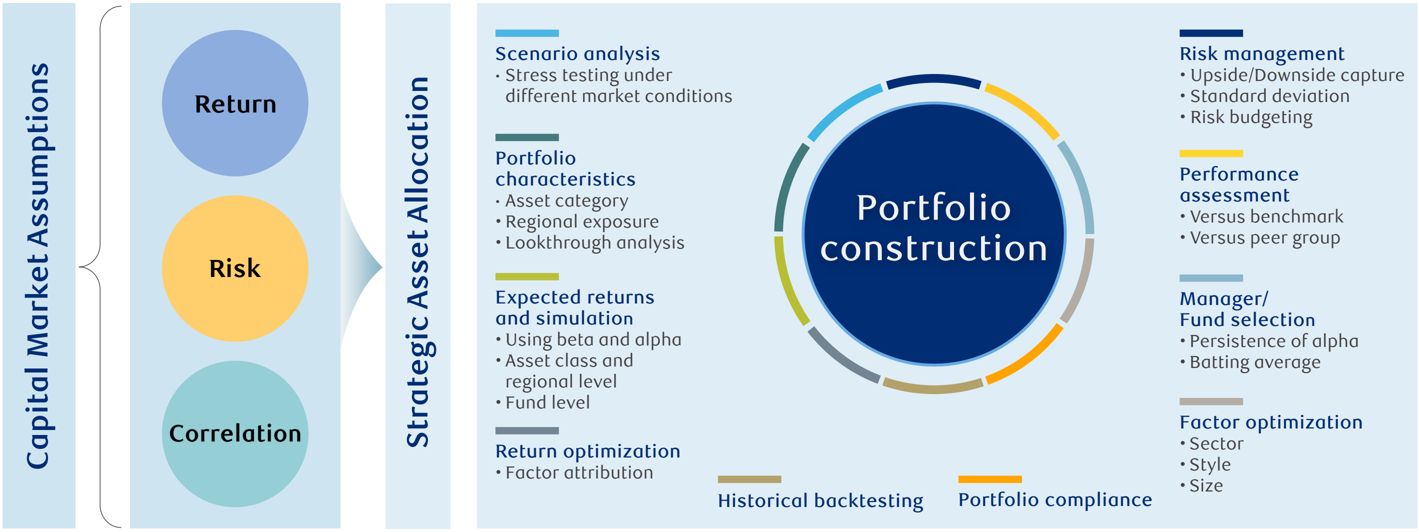
These long-term capital-markets assumptions feed directly into our portfolio-construction process (Exhibit 3). We have a team dedicated to establishing and reviewing the strategic asset mix for all of our balanced and multi-asset solutions. With an emphasis on capital preservation and consistency of returns, we use a rigorous and data-driven approach that blends asset classes to determine the strategic asset mix best suited to achieving the desired investment goal. This is an iterative process that looks at how the resulting portfolio can be expected to behave in terms of risk and return in a variety of market environments, both good and bad.

Once we have established the strategic asset mix, we shift our focus to portfolio construction, which involves selecting underlying strategies to include in the mix also known as fund fulfillment. This process includes:

- Identifying strategies that can provide strong and consistent performance over the long term
- Identify attractive, alpha-rich markets
- Measuring the persistence of fund manager skill
- Assessing whether the proposed strategy provides style and factor diversification
- Determining if the proposed strategy has available investment capacity

We then assemble a variety of options and rigorously test each proposed solution to see how they perform in different

### Exhibit 3: Portfolio construction




Source: RBC GAM

market conditions. The ultimate goal is to ensure that we build portfolios that can generate attractive returns while managing downside risk and drawdowns.

The final step is to apply a risk budget, which scales the amount of risk needed to achieve a desired expected return. We then seek to efficiently distribute the risk budget with careful consideration given to ensure that no single strategy or asset class accounts for too large a portion of the portfolio's risk budget. This approach helps to lower volatility.

## Strategic versus tactical asset allocation

Strategic and tactical asset allocation are distinct approaches used in portfolio management. While both methods aim to achieve superior risk-adjusted returns, they differ in their time horizon, investment considerations, inputs and level of flexibility. The key differentiating factor between the two is the frequency and magnitude of adjustments.

The strategic asset allocation forms the foundation of a portfolio and is focused on long-term objectives. It involves determining a target allocation across various asset classes based on an investor's risk tolerance, investment goals and time horizon.

The tactical asset allocation, on the other hand, is a shorter-term and more dynamic approach. It involves adjusting the asset allocation based on market conditions, economic forecasts and valuation metrics. The tactical component allows portfolio managers to manage risk and take advantage of opportunities when investors may be mispricing asset classes after market fluctuations.

## Evolving our approach

Because the strategic asset mix takes a long-term view, changes are infrequent. We spend a lot of time thinking about our asset mix, and we are constantly looking for ways to improve investor outcomes by adjusting portfolios to bolster returns, improve income generation, manage volatility and provide portfolio stability as market conditions change. This constant attention and evolution have been key to the long-term success of our portfolios (Exhibit 4).

### Exhibit 4: Evolving the asset mix

**2010**
- Added Emerging Markets (EM) equities as a new asset class
- Broadened U.S. equity exposure by including the PH&N U.S. Multi-Style All-Cap Equity Fund

**2013**
- Expanded EM equity allocation to include dividend and small cap strategies
- Diversified core Canadian equity holdings

**2014**
- Further diversified fixed income exposure
- Added Quant equity strategies and a global equity focused fund
- Introduced separate allocations to Japanese equity and Asia-ex Japan strategies
- Lowered the neutral commitment to cash from 5% to 2%, moving the difference to bonds[2]

**2015/2016**
- Diversified U.S. equity exposure across market capitalization and style
- Added BlueBay Funds to increase exposure to global fixed income

**2018/2019**
- Added RBC European Mid-Cap Equity Fund to diversify European equity exposure
- Introduced ability to hedge foreign currency exposure
- Introduced an allocation to real estate with the addition of the RBC Canadian Core Real Estate Fund
- Added the RBC Emerging Markets Equity Focus Fund

**2020**
- Added an allocation to the RBC China Equity Fund
- Increased the neutral equity exposure from 55% to 60%[3]
- Introduced an allocation to liquid alternatives with the addition of the BlueBay Global Alternative Bond Fund
- Introduced new Tactical Sleeve to enhance tactical decisions through use of Futures and ETFs

**2021**
- Added the RBC Global Equity Leaders Fund

**2023**
- Added Infrastructure as a new asset class with addition of the RBC Global Infrastructure Fund LP

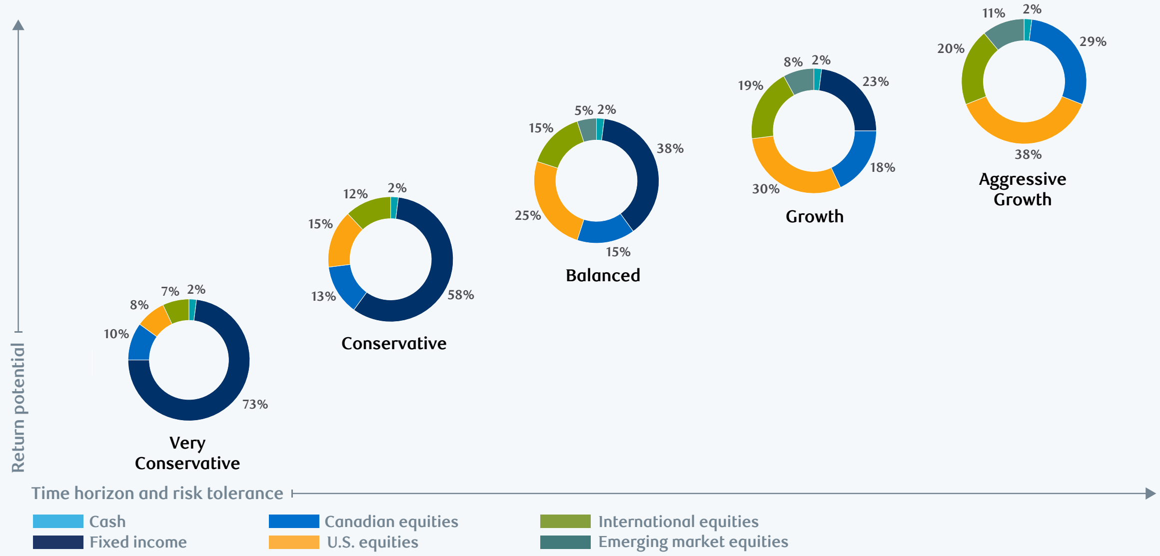
[2]Allocation for a global balanced investor. The total recommended allocation to cash and fixed income remains unchanged at 45%.
[3]In depth rationale for this change was covered in *Evolving Our Strategic Asset Mix*, a piece published on June 11, 2020.
Source: RBC GAM

## Finding the right balance between risk and return

All investments carry some degree of risk. To earn a higher return, one must be willing to accept more risk, measured as the volatility of the return stream. Understanding this relationship is a fundamental part of investing. Choosing an appropriate blend of asset classes based on factors such as risk tolerance, time horizon and return expectations is key when determining the strategic asset mix.

### Blending asset classes to align with investor objectives

Five distinct investor profiles




Source: RBC GAM

Cash has historically been the safest asset class as measured by the degree of volatility, while equities have been among the riskiest. Fixed income tends to fall in between the two, providing higher income and potential returns than cash, but with less volatility than stocks. Therefore, the most risk-averse investor with the shortest time horizon would be at the far left of the risk-return spectrum with a higher allocation to cash and fixed income, while the investor with the longest time horizon and highest return goal would be positioned on the far right with a higher allocation to equities.

### Asset class characteristics

| | Risk level | Time horizon | Potential return |
|---|---|---|---|
| Stocks | High | Long term | High |
| Bonds | Moderate | Medium or Long term | Moderate |
| Cash | Low | Short term | Low |
| Alternatives | Varies | Long term | Varies |

Source: RBC GAM

While we have not added alternatives to the strategic asset mix, many of our solutions have exposure to the asset class. This includes strategies such as Real Estate, Mortgages, Infrastructure, Hedge Funds, Private Equity, and Private Credit. Each of these strategies can vary significantly in terms of their risk profile and potential return and, when compared to traditional asset classes, can have important differences in their liquidity profile. At RBC GAM, when allocating to alternatives in our multi-asset portfolios, we carefully consider the diversification benefits of the more traditional asset classes such as cash, bonds and stocks against the more limited liquidity that is often a characteristic of these types of investments.

Adjustments to our strategic neutral asset mix over the last decade reflect secular changes in the economy, changes in long-term expected returns, volatility and liquidity, and the availability of attractive new asset classes and investment solutions.

## Tactical asset allocation – incorporating our view on markets

A tactical approach to asset allocation involves adjusting exposures to asset classes above and below the strategic neutral weights based on shorter-term expectations for market movements or to reflect shifts in the relationship between risk and return. At RBC GAM, our portfolio management and research teams are always assessing the risks and opportunities in the global economy and markets, and developing expectations for a variety of indicators including interest rates, currencies, corporate profits, equity market valuations and financial market liquidity conditions – the critical elements of returns and volatility. Our process is designed to allow us to quickly reposition our portfolios to take advantage of opportunities as they arise. This includes the use of ETFs, futures and other derivative instruments which allow us to gain immediate access to markets, a critical tool in times of volatility.

*"An active approach to asset allocation is an important source of alpha in today's rapidly changing markets."*

Sarah Riopelle, Managing Director &
Senior Portfolio Manager, Investment Solutions,
RBC Global Asset Management

A key input of our tactical asset allocation process is a robust framework for macro forecasting. Over the years, we have developed sophisticated models and dashboards to aggregate the vast amounts of economic and market data available, and we use the data to interpret short- and medium-term changes in the economy, credit conditions, market fundamentals and technical indicators. We are constantly looking for innovative ways to enhance our macro forecasting tools so we can identify market trends that might prompt us to make changes to our tactical asset mix.

## Communicating our macro views

The RBC GAM Investment Strategy Committee (RISC) is responsible for developing and communicating the firm's outlook for the economy and investment environment. The Committee takes a longer-term view of the economy and markets and develops detailed economic and capital market forecasts that guide the firm's tactical asset mix decisions. Chaired by our Chief Investment Officer, the Committee consists of senior investment professionals drawn globally from across RBC GAM in the areas of economics, currencies, fixed income, equities, derivatives, quantitative investments investment policy and asset allocation (Exhibit 5). With industry experience averaging almost three decades, the committee members assess geopolitics, fiscal and monetary conditions, projected economic growth and inflation, as well as the expected course of interest rates, major currencies, corporate profits, valuations and stock prices.

Important guidance is provided by the Committee's regional equity specialists (North America, Europe, Asia, Emerging Markets), the Global Fixed Income & Currencies Advisory Committee and the Global Equity Advisory Committee. The Global Fixed Income & Currencies Advisory Committee is made up of senior members from the Global Fixed Income & Currencies team, as well as the Chief Economist, and is responsible for developing the outlook and forecasts for interest rates, economic growth and inflation. The Global Equity Advisory Committee and RISC's regional equity specialists, consisting of senior professionals covering global equity regions, develop the outlook and forecasts for equities including sector and geographic views.

## Exhibit 5: RISC Committee members

**Dan Chornous, CFA (Chair)**
Chief Investment Officer

**Soo Boo Cheah, MBA, CFA**
Managing Director & Senior Portfolio Manager, Global Fixed Income & Currencies

**Dagmara Fijalkowski, MBA, CFA**
Managing Director, Senior Portfolio Manager & Head of Global Fixed Income & Currencies

**Stu Kedwell, CFA**
Managing Director, Senior Portfolio Manager & Co-Head of North American Equities

**Eric Lascelles**
Managing Director & Chief Economist

**Scott Lysakowski, CFA**
Managing Director & Senior Portfolio Manager, Head of Canadian Equities (Vancouver)

**Hanif Mamdani**
Managing Director & Head of Alternative Investments

**Bryan Mascoe, CFA**
Managing Director & Senior Portfolio Manager, Fixed Income (Vancouver)

**Sarah Riopelle, CFA**
Managing Director & Senior Portfolio Manager, Investment Solutions

**Martin Paleczny, CFA**
Managing Director & Senior Portfolio Manager, Asset Allocation & Derivatives

**Kristian Sawkins, CFA**
Managing Director & Senior Portfolio Manager, Fixed Income (Vancouver)

**Jaco Van der Walt, DCom**
Managing Director & Global Head of Quantitative Research & Investment

**Milos Vukovic, CFA**
Managing Director & Head of Investment Policy

**Brad Willock, CFA**
Managing Director & Senior Portfolio Manager, North American Equities

**14** Investment Strategy Committee members

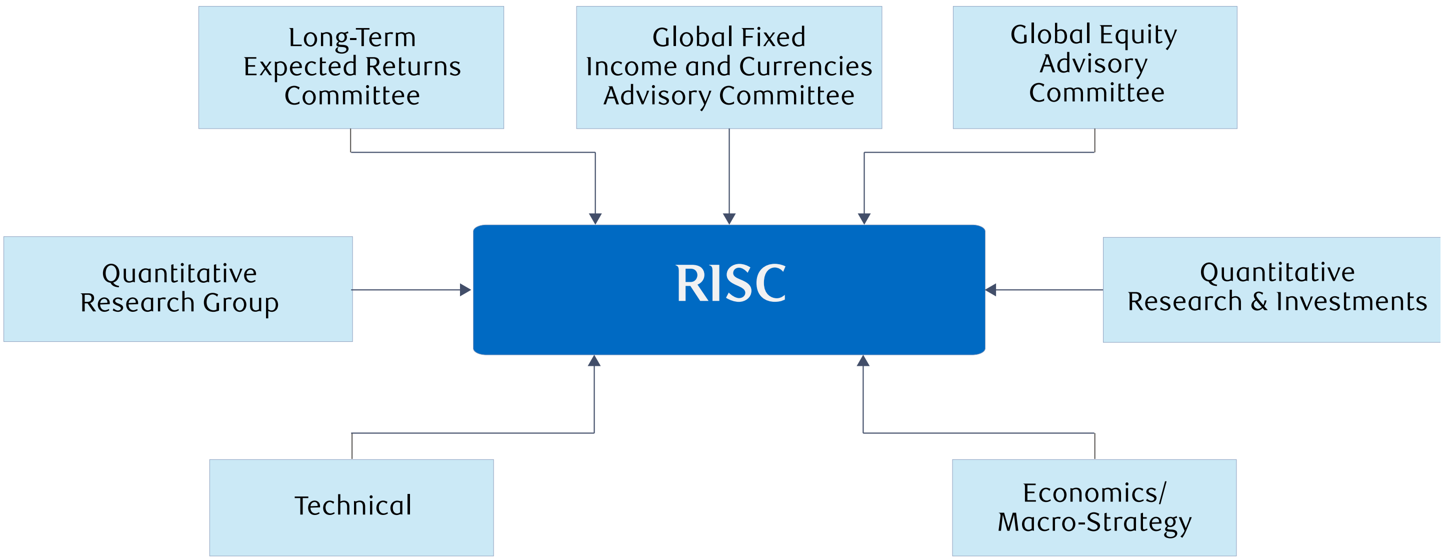
**23.7 years** Average firm experience

**29.3 years** Average industry tenure

Our up-to-date view is published quarterly in *The Global Investment Outlook* here.

RISC and the supporting advisory committees gather formally on a quarterly basis, but also meet monthly and on an ad hoc basis, to discuss changes in the economy and markets and consider their impact on our outlook and positioning. These meetings are a key element of our asset allocation process and provide a forum to share views, challenge forecasts and assess current conditions to determine whether adjustments are required. Our collaborative, team-based approach allows us to fully leverage the breadth of expertise and diversity of thought that exist at RBC GAM and ensures that the latest views of our investment specialists are reflected in each asset allocation decision (Exhibit 6).

### Exhibit 6: Key committees supporting RBC GAM Investment Strategy Committee (RISC)




Source: RBC GAM

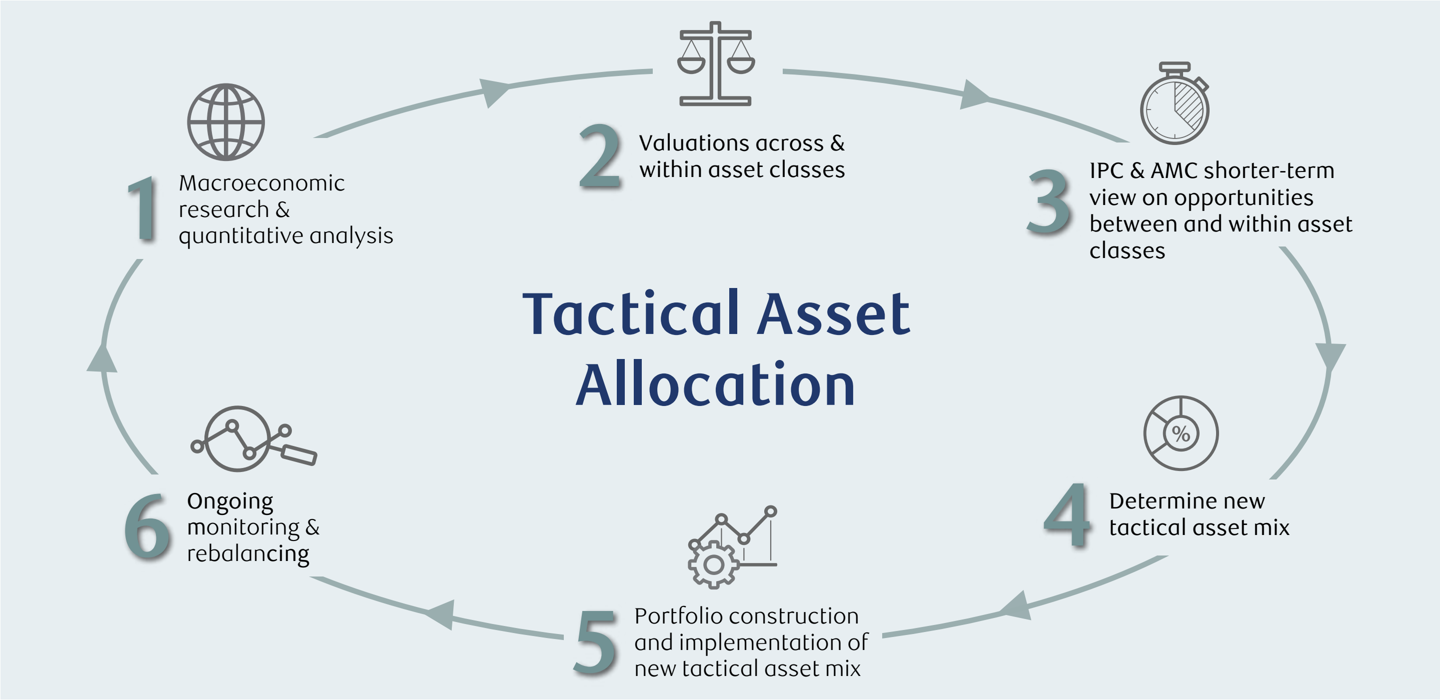
## Implementing our tactical view in the portfolios

The views expressed by RISC directly influence the work of the RBC GAM Investment Policy Committee (IPC) and the PH&N Asset Mix Committee (AMC). These committees are responsible for determining the tactical asset mix for all RBC and PH&N balanced and multi-asset solutions totaling approximately $190 billion in client assets. Both IPC and AMC meet regularly to review market events, performance and investment strategy. Most of the members of IPC and AMC also sit on RISC to ensure continuity and consistency. IPC and AMC determine the appropriate tactical asset mix for a Global Balanced Investor and we use proprietary algorithms designed to transmit that view across our balanced and multi-asset solutions, ensuring that the tilts for asset mix and regional exposures are consistent across all portfolios, while adhering to each fund's strategic neutral position.

## Marginal gains approach: making small, measured moves over time

Our tactical asset mix decisions also incorporate a risk-budgeting approach to determine the size of adjustments around the strategic weights. We have conducted extensive research to determine how much of the risk budget should be allocated to tactical asset allocation decisions and concluded that our approach of making measured tactical changes around the strategic weight over time is appropriate for achieving our goal of adding alpha (i.e. additional investment returns versus the benchmark) over the long term. Changes to the tactical asset mix that are too frequent or that move the funds too far from the strategic neutral positions can add significant volatility without a commensurate increase in returns.

## Tactical asset allocation




Source: RBC GAM

*"We don't need to hit home runs every time. By hitting singles and doubles, we can achieve our goal with lower volatility in returns."*

Dan Chornous, Chief Investment Officer
RBC Global Asset Management

### The value of ongoing active management

Daily market movements can cause portfolios to drift away from the targeted tactical weights. Constant monitoring of positions is necessary to ensure that each fund remains appropriately positioned. We have a robust process in place to manage and monitor drift, and to rebalance portfolios as required, sometimes on a daily basis. In addition, we constantly track a variety of performance and risk statistics to ensure that we are always aware of and comfortable with the risks that we are taking and of the potential impact on the performance of the funds under our care.

### Putting it all together

In our view, investment success comes from following a disciplined investment strategy through all market cycles. Having clear investment objectives, a disciplined data-driven process and adherence to a risk budget when managing the asset mix should ultimately help our clients meet their investment goals. This discipline is embedded in all aspects of our investment management process and is a key element in delivering solid investment performance.

Asset allocation at RBC GAM harnesses the latest thinking and experience of our firm's leaders in every asset class. Decades of honing our expertise in building and managing balanced and multi-asset solutions has certainly taught us humility, but we are proud of the track record that we have built, consistently adding value over the long term.

## Disclosure

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