

Invest Smartly

Multi Asset: Your Assets in Perfect Balance



Allianz 
Global Investors

Understand. Act.



Content

- 4 Your assets in perfect balance**
- 5 Navigational aid: asset classes under various economic scenarios**
- 6 Financial repression could last for years**
- 6 Smart risk**
- 6 Diversification can reduce risk without foregoing opportunities**
- 9 Individual risk profiles with multi-asset solutions**
- 10 Active & flexible management**
- 11 Multi-asset strategies for outwitting oneself**
- 11 Understand. Act.**

Imprint

Allianz Global Investors GmbH
Bockenheimer Landstr. 42 – 44
60323 Frankfurt am Main

Global Capital Markets & Thematic Research
Hans-Jörg Naumer (hjn)
Ann-Katrin Petersen (akp)
Stefan Scheurer (st)

Data origin – if not otherwise noted:
Thomson Reuters Datastream



Allianz Global Investors
www.twitter.com/AllianzGI_VIEW

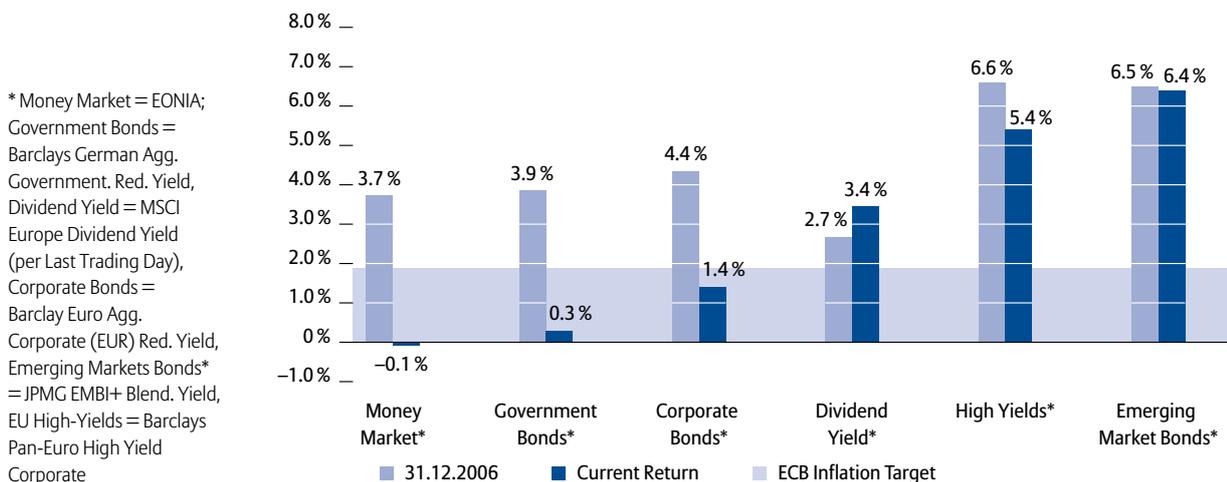
Your assets in perfect balance

Not taking risks is still the biggest risk for investors. Inflation tends to eat up the small returns which secure investments offer. Investors will therefore need to take balanced and well-considered risks in order to preserve their purchasing power and their wealth. Diversification is key right now – and multi asset strategies are an obvious solution.

The principle of “avoiding risk at any price” should not be used as a guideline for investments. Indeed, we are in a capital market environment of low real returns. To put it simply, interest on traditional types of investment can no longer compensate for inflation (see chart 1). Here, no government bond or fixed-term deposit will help as a stand-alone investment. The goal is to achieve a positive real return! This really should be the objective in any investment decision.

However, in the wake of the financial and debt crisis, investors appear to be uncertain: uncertain about which future economic scenario will materialize, what kind of investment is appropriate and when is the best time to invest. A navigational aid on the performance of asset classes under various economic scenarios could be helpful here.

Chart 1: Returns of different asset classes



Past performance is not a reliable indicator of future results. Source: Datastream; Allianz Global Investors Capital Markets & Thematic Research, as of January 2016



Navigational aid: asset classes under various economic scenarios

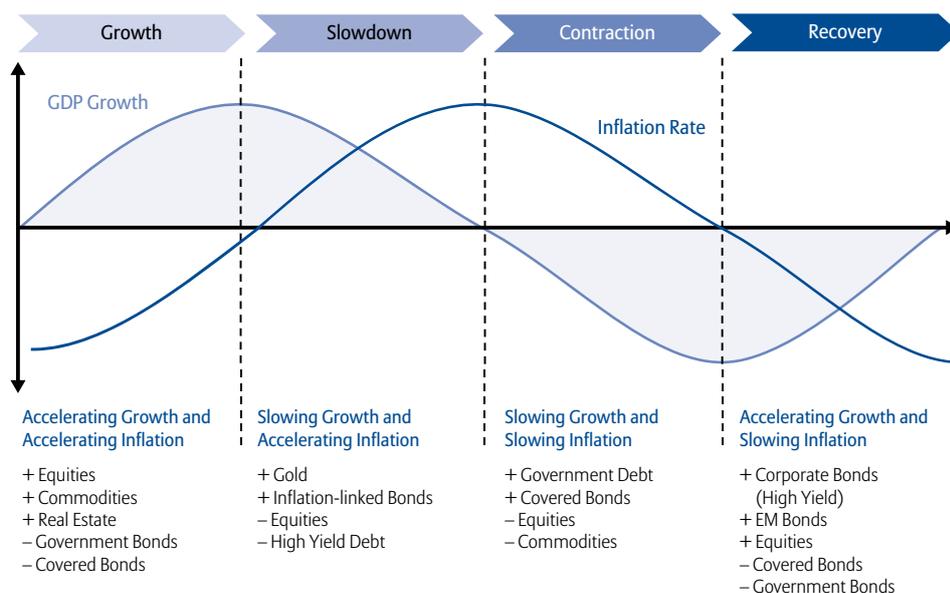
Real gross domestic product (GDP) and the inflation rate are significant variables of the real economy that reflect economic trends. Rather than the absolute value, it is often a dynamic view of these two variables that allows conclusions about earnings growth, yield curves etc. to be drawn, so they should also have major implications for the performance of various asset classes.

Our analysis, based on a historic comparison of asset class returns, as shown in Chart 2, indicates that the effect of the interplay between these forces is varied: for example, during a more mature economic recovery

with rising inflation, real assets such as equities, commodities and property performed well in most cases. However, given the expectation of an increasing interest-rate cycle, government bonds were the worst performers, even if spread segments such as high-yield and corporate bonds, as well as emerging market bonds, performed well. By contrast, during economic downturns, risky asset classes such as equities and commodities performed worse, especially during recessions. Government bonds, Pfandbriefe (covered bonds) and gold in most cases were seen as safe havens during such periods.

So much for the historical record. But what is the future outlook?

Chart 2: Growth and inflation



Source: Allianz Global Investors Capital Markets & Thematic Research; The hypothetical performance and simulations shown are for illustrative purposes only and do not represent actual performance; they are not a reliable indicator for future results.

Financial repression could last for years

The “cheap money policy” that followed the financial crisis and the debt crisis has had a substantial impact on the financial markets. The market environment is characterized by low nominal interest rates, in some cases combined with negative real returns. This is an environment in which countries can grow their way out of debt if economic growth outpaces the interest burden on public debt. As a result, it is likely that the low interest environment will persist for some time to come, with inflation likely to increase slightly. We refer to this combination of low interest policies and inflationary tendencies and/or expected inflation as “financial repression”.

If our forecast of moderate, but positive, inflation rates is correct, then asset classes that offer a hedge against inflation should perform well during a period of financial repression and artificially low real interest rates. These include real assets such as commodities and property, but also equities, which are particularly liquid. The latter, especially, should be broadly diversified geographically in order to take advantage of global growth opportunities. Alternative asset classes also look attractive. On the other hand, a lively imagination is necessary to see any significant yield potential in traditional government bonds over the long term, given already historically low interest rates. Instead, spread segments such as corporate bonds (either in the investment-grade or high-yield segment) and emerging market bonds, which still offer fairly attractive positive real returns, look more attractive. In this environment, paper money and fixed-term deposits are the least desirable.

Smart risk

However, for investors with a long-term investment horizon, timing considerations should be secondary. Given the current volatility in the capital markets and the low-interest rate environment, a balanced portfolio structure is more crucial. To reduce investment risk, the investor needs to think about “smart risk”, in order to actively take advantage of opportunities on the one hand whilst exploiting the interplay of forces on the other. Here, the first step should be to achieve broad diversification, not only with individual equities, but also with different asset classes.

Diversification can reduce risk without foregoing opportunities

The bad news first: diversification, or the distribution of assets over different asset classes, does not protect against loss. But diversification does help avoid cluster risks in the portfolio. With securities and asset classes that are not fully correlated with one another, an investor can reduce the price fluctuations in his portfolio without reducing opportunities for returns by diversifying his assets (risk diversification effect). Diversification is the primary and simplest form of risk management.

In order to maximize the market risk premiums of different asset classes, in our view investors should distribute their money across multiple baskets. Over time, investment classes turn in varying performances. The best example is 2008, when the financial market crisis was peaking. That year, prices of government bonds issued by industrialized nations rose by an average of 18%, and gold by 8%, while equities, down

Multi-asset strategies

Multi-asset strategies involve diversifying across several asset classes, typically with equities from different geographic areas, bonds from different issuers with different credit ratings or money market securities, but in most cases also with other investments such as commodities, currencies or hedge funds. For example, multi-asset strategies may be implemented through asset management mandates.

40%, experienced their weakest year since the global economic crisis of 1931 (see chart 3).

The market recovery in 2009 was also quite mixed, with emerging market equities rising 73% and thereby outpacing other asset classes. Of course, investors needed to have nerves of steel.

But even supposedly safe government bonds and gold experience price fluctuations – as we have seen in the year 2013. From its peak, gold has lost up to 31% within 2013.

With a balanced mix of the most diverse asset classes and regions, investors can potentially be more confident. Let's assume that since 1 January 1998, an investor has been invested in a broadly diversified portfolio (the longest period for which data on all asset classes is available) comprising the following asset classes:

- 30% in government bonds of industrialized countries (15% Europe, 15% USA)
- 10% in government bonds from emerging economies

- 10% in investment-grade corporate bonds (5% Europe, 5% USA)
- 5% in global high-yield bonds
- 30% in equities (10% Europe, 10% North America, 10% Asia)
- 10% in commodities
- 5% in hedge funds

¹TMT = technology, media and telecommunications

A comparison of the historical performance of this sample multi asset solution with the twelve individual asset classes shows that an investor in this strategy would have earned a return of 149% and more than doubled his wealth in the period from the date of the assumed investment until the end of December 2014 (see Chart 4). Of course, it is impossible to simply extrapolate this performance for the future. And he would have done so despite the numerous crises, such as the Asia crisis, the TMT¹ bubble and the financial and euro debt crises that battered the capital markets. Equities, government bonds from industrialized countries and the basket of commodities performed less well. At the same time, investors' nerves were not so strained, as

Chart 3: A good mix – an overview of the performance of different asset classes

Comparison of yearly returns for different asset classes since 2000 (in % p.a.)

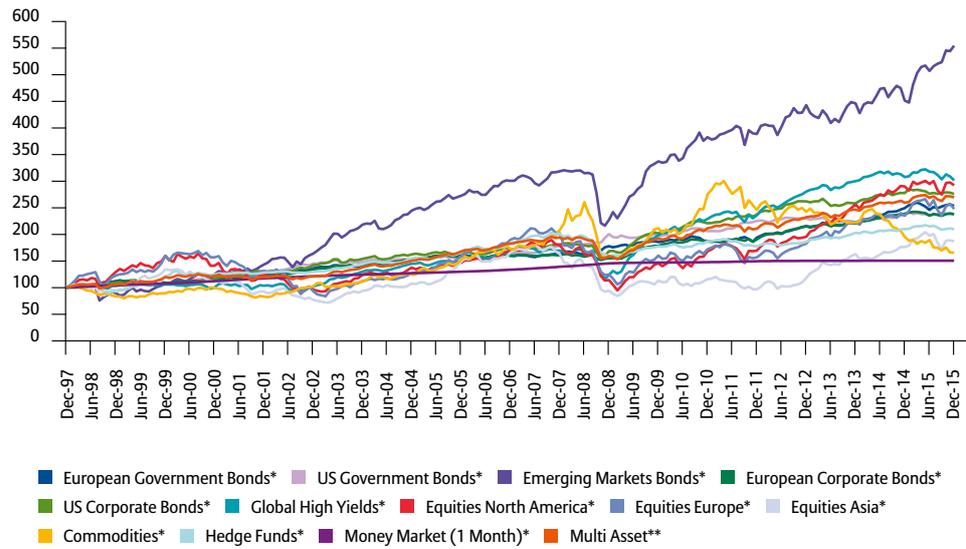
Rank	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
1	61.45	10.34	12.27	37.10	16.88	55.04	22.36	26.07	17.79	73.44	38.33	14.78	30.07	26.88	29.09	n.a.
2	22.16	6.93	5.23	30.02	12.65	44.88	20.18	22.60	8.45	32.55	27.48	12.09	18.09	26.68	20.17	12.86
3	10.04	6.87	1.29	15.76	9.12	34.81	18.60	19.76	1.55	24.19	23.47	10.81	16.81	20.51	17.46	12.76
4	9.28	4.60	0.16	7.42	8.26	27.59	10.74	18.86	-3.55	23.18	19.82	7.96	16.71	3.61	14.64	9.97
5	1.76	2.94	-2.52	4.54	3.69	27.36	3.16	3.17	-6.31	23.16	16.91	5.40	14.35	-4.22	11.85	8.78
6	0.15	1.97	-4.02	1.13	2.74	26.68	1.02	1.84	-33.88	22.61	15.76	3.69	9.36	-4.49	11.81	8.48
7	-1.93	-7.25	-20.24	0.43	2.18	21.83	-1.71	-0.06	-42.67	15.46	13.82	1.87	3.95	-6.49	7.40	7.19
8	-6.62	-15.26	-30.50	-1.46	1.49	11.74	-4.15	-3.20	-43.29	9.52	13.37	-7.51	3.67	-8.62	3.96	-0.25
9	-9.53	-17.75	-34.42	-4.74	-0.98	7.71	-5.23	-4.15	-44.78	1.13	11.75	-14.69	-0.26	-10.62	2.76	-4.87
10	-25.92	-28.93	-43.06	-4.79	-2.56	0.43	-24.69	-4.37	-50.76	-1.27	1.77	-15.44	-1.68	-30.48	-24.65	-26.10
AVG	6.08	-3.55	-11.58	8.54	5.35	25.81	4.03	8.05	-19.74	22.40	18.25	1.90	11.11	1.28	9.45	3.20

■ Equities Germany	■ Equities US	■ Equities EM	■ Government Bonds Advanced Economies
■ Equities Europe	■ Corporate Bonds	■ Real Estate (REITS)	■ Government Bonds Emerging Markets
■ Gold	■ Commodities (ex precious metals)		

Source: Datastream, Allianz GI Global Capital Markets and Thematic Research, Used Benchmarks: Germany: MSCI Germany TR, USA: MSCI USA TR, Equities Emerging Markets: MSCI EM TR, Equities Europe: MSCI Europe, Bonds Advanced Economies: JPM Global Govt. Bond Index TR, Bonds Emerging Markets: JPM EMBI Global Composite TR, Corporate Bonds: BofA ML Broad Corp. Index TR, Real Estate: Real Estate Price Index Germany Bulwien, Commodities (ex. precious metal): S&P GSCI Non. Precious Metals TR, Gold: € / fine ounce, all indices in USD (TR = Total Return Index, NAV = Net Asset Value), as of January 2016.

Chart 4: Multi asset strategies help to increase your returns and calm your nerves

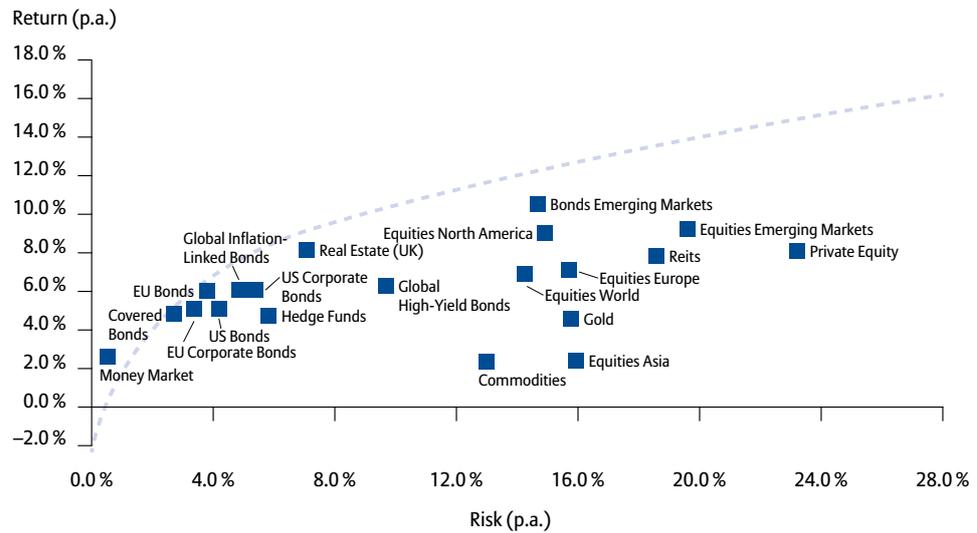
Development of asset classes and multi-asset strategy since the end of 1997 (31.12.1997 = 100)



*Used Benchmarks: European Government Bonds: BOFA ML EMU DRCT GVT; US Government Bonds: BOFA ML US TRSY / AGCY MSTRAAA(\$) - TOT RETURN IND; Emerging Markets Bonds: JPM EMBI+ BRADY BROAD - TOT RETURN IND; European Corporate Bonds: BOFA ML EMU CORP. - TOT RETURN IND; US Corporate Bonds: BOFA ML US CORP MSTR (\$) - TOT RETURN IND; Global High Yields: BOFA ML GLB HY - TOT RETURN IND; Equities North America: MSCI NORTH AMERICA - TOT RETURN IND; Equities Europe: MSCI EUROPE - TOT RETURN IND; Equities Asia: MSCI PACIFIC - TOT RETURN IND; Commodities: TR Equal Weight CCI - PRICE INDEX; Hedge Funds: HFRI FOF: DIVERSIFIED - TOT RETURN IND; Money Market (1 Month): BOFA ML EURO LIBOR 1M AVG (E) - TOT RETURN IND; all Indices in local currencies and total return ** Multi Asset: = Mix of 15% European Government Bonds + 15% US Government Bonds + 10% Emerging Markets Bonds + 5% European Corp. Bonds + 5% US Corp. Bonds + 5% Global High Yields + 10% European Equities + 10% US Equities + 10% Asian Equities + 10% Commodities + 5% Hedge Funds. Source: Datastream, Allianz GI Global Capital Markets and Thematic Research, as of January 2016; Past performance is not a reliable indicator of future results

Chart 5: Returns and volatility of different asset classes

Comparison of asset class returns and volatility (Jan. 1993 to Dec. 2015, % p.a.)



Used Benchmarks: European Government Bonds = BOFA ML EMU DRCT GVT; US Government Bonds = BOFA ML US TRSY / AGCY MSTRAAA(\$); Emerging Markets Bonds = JPM EMBI+ BRADY BROAD; Global inflation linked Bonds = BARCLAYS GLB INFL WORLD; Covered Bonds = CGBI EBIG COLLJUMBO PFAND. 3-7Y; European Corporate Bonds = BOFA ML EMU CORP.; US Corporate Bonds = BOFA ML US CORP MSTR (\$); Global High Yields = BOFA ML GLB HY; US High Yields = BOFA ML HY US CRP DF RED INTBND (\$); Equities World = MSCI WORLD; Equities North America = MSCI NORTH AMERICA; Equities Europe = MSCI EUROPE; Equities Asia = MSCI PACIFIC; Equities Emerging Markets = MSCI EM; Commodities = TR Equal Weight CCI; Gold = Gold Bullion LBM U\$/Troy Ounce; Reits = EMU-DS Real Estate; Real Estate (UK) = UK IPD; Hedge Funds = HFRI FOF: DIVERSIFIED; Money Market(1 Month) = BOFA ML EURO LIBOR 1M AVG (E); Private Equity = LPX 50 E; all Indices in local currencies and total return, Source: Datastream, Allianz GI Global Capital Markets and Thematic Research, as of January 2016; Past performance is not a reliable indicator of future results

the price fluctuations for this balanced portfolio were several times lower than for government bonds from emerging economies, commodities or equities. Active asset class weightings and securities selection should help to increase the potential return even further.

Individual risk profiles with multi-asset solutions

However, tactical advice should play a secondary role when planning for retirement or other long-term investments. We believe investments should focus on personal objectives and needs, and not primarily on the market environment. As part of a strategic asset allocation, practically any desired risk/reward ratio can be replicated to match the investor's individual risk profile, thanks to the broad spectrum of assets available. With a conservative strategy, lower-risk, fixed-income securities are more likely to dominate. A higher reward strategy will usually focus more on equities or other investments offering a higher potential return.

Here too, a look at the past may be helpful. While it is true that one cannot determine the future trends of capital markets from the

past, historical observations can offer useful guidance when applied in conjunction with insight gained from portfolio theory. Chart 5 shows the risk/reward profile for various asset classes in different geographic areas over the last 20 years. It is quite clear that both risks and returns were lower in the money market than for government bonds and that in most cases, both parameters were lower for corporate bonds than for equities.

Since 1994, emerging market equities, in particular, have seen high levels of both fluctuation and returns. This confirms the findings of portfolio theory: generating higher returns and/or positive real returns in the current low-interest rate environment requires investment in higher-risk securities without losing sight of the advantages of broad diversification. The chart also clearly shows that failing to diversify a portfolio can cause exposure to unnecessarily high levels of risk. Thus an investor who, for example, held only Asian equities over the time period shown could have significantly reduced his risk and/or increased his potential return if he had spread his assets out more broadly. The benefits of the diversification effect can thus be exploited in the real world as well.



Active & flexible management

In a complex world, broadly diversifying assets across the most diverse range of asset classes and a targeted tactical change in the portfolio are important components of a solution to reduce risk in a structured investment process. As part of a strategic alignment of multi-asset strategies, portfolio risks should also be fine-tuned by making tactical changes. During periods when markets are highly volatile, losses can best be avoided or at least limited (if so specified by the specific approach) through a possible shift from higher-risk assets into more stable segments and securities.

It may also help to differentiate, not only with different asset classes, but also with investment styles and regions. For example, mixing

- emerging markets and shorter duration corporate bonds (especially high-yield bonds) may help to reduce a bond portfolio's vulnerability to movements in interest rates;
- high dividend shares in the equity portfolio may increase the return (dividend) in order to cushion downturns and reduce volatility;
- commodities, such as gold, may improve diversification and reduce overall risk.

In addition, a market environment characterized by higher price fluctuations (volatility), in particular, may lead to

inefficiencies (anomalies). Anomalies are not necessarily negative per se; they may also provide investment opportunities that can be actively exploited. This includes stock picking – the targeted selection of specific shares based on fundamentals.

But what if virtually all asset classes point in only one direction: downward (phases that were seen in the wake of Lehman's bankruptcy at the end of 2008 or the euro crisis in August 2011)?

One way out of this situation is to adopt dynamic risk management approaches that are intended to limit losses and/or secure risk capital without excessively reducing upside potential. These approaches generate the desired target profile using rule-based allocation adjustments (e.g. equity weightings) over time. As a rule, correspondingly liquid (and thus cost-efficient) derivatives are used to adjust the allocation. These instruments (futures, options, etc.) can be used to cushion against market risks and also to hedge against extreme risks, for example, through the targeted purchase of options.

Multi-asset solutions offer the triad of diversification, active and flexible capital investment and risk management (see chart 6). Particularly those investors who do not want to continually keep an eye on the markets are often grateful for such a solution.



Chart 6: Dynamic Multi-Asset Solutions for the Investment Process



Source: Allianz Global Investors

Multi-asset strategies for outwitting oneself

Investors often react emotionally and irrationally, according to experts in behavioural finance. For example, investors often have limited visibility due to inadequate information. The window, or rather the window frame, through which they observe the world of investments is simply not big enough to provide a view of all the necessary information, investment alternatives or contradictory facts. In addition, they often exhibit a home bias – a preference for securities from companies in their own country. The result: they lack diversification and ignore better alternatives.

Multi-asset strategies can help investors to outsmart themselves – easily and automatically.

Understand. Act.

In this low-interest rate environment, we believe the biggest risk is not taking any risk at all. When making investment decisions, “smart risk” is crucial. Multi-asset solutions can be considered an attractive form of investment because, thanks to the broad spectrum of investment opportunities and the flexible use of trends, investors can take advantage of numerous opportunities for returns worldwide whilst simultaneously achieving a balanced risk structure for their investments. This is a form of “autopilot” that helps investors to reduce risks without foregoing opportunities for returns.

Dennis Nacken

Further Publications of Global Capital Markets & Thematic Research

Active Management

- "It's the economy, stupid!"
- The Changing Nature of Equity Markets and the Need for More Active Management
- Harvesting risk premium in equity investing
- Active Management
- Active Share: The Parts Are Worth More Than The Whole

Financial Repression

- Shrinking mountains of debt
- QE Monitor
- Between a flood of liquidity and a drought on the government bond markets
- Liquidity – The Underestimated Risk
- Macroprudential policy – necessary, but not a panacea

Strategy and Investment

- Equities – the "new safe option" for portfolios?
- Capital Markets Monthly
- Dividends instead of low interest rates
- Is easy monetary policy fuelling new economic imbalances and credit bubbles?

Alternatives

- The Case for Alternatives
- Volatility as an Asset Class
- The Long and Short of Volatility Investing
- Market-neutral equity strategies – Generating returns throughout the market cycle
- Benefiting from Merger Arbitrage

Capital Accumulation – Riskmanagement – Multi Asset

- Smart risk with multi-asset solutions
- Sustainably accumulating wealth and capital income
- Strategic Asset Allocation in Times of Financial Repression

Behavioral Finance

- Behavioral Risk – Outsmart yourself!
- Reining in Lack of Investor Discipline: The Ulysses Strategy
- Behavioral Finance – Two Minds at work
- Behavioral Finance and the Post-Retirement Crisis

All our publications, analysis and studies can be found on the following webpage:
<http://www.allianzglobalinvestors.com>



Investing involves risk. The value of an investment and the income from it will fluctuate and investors may not get back the principal invested. Past performance is not indicative of future performance. This is a marketing communication. It is for informational purposes only. This material does not constitute investment advice or a recommendation to buy, sell or hold any security and shall not be deemed an offer to sell or a solicitation of an offer to buy any security.

The views and opinions expressed herein, which are subject to change without notice, are those of the issuer or its affiliated companies at the time of publication. Certain data used are derived from various sources believed to be reliable, but the accuracy or completeness of the data is not guaranteed and no liability is assumed for any direct or consequential losses arising from their use. The duplication, publication, extraction or transmission of the contents, irrespective of the form, is not permitted.

This material has not been reviewed by any regulatory authorities. In mainland China, it is used only as supporting material to the offshore investment products offered by commercial banks under the Qualified Domestic Institutional Investors scheme pursuant to applicable rules and regulations.

This material is being distributed by the following Allianz Global Investors companies: Allianz Global Investors U.S. LLC, an investment adviser registered with the U.S. Securities and Exchange Commission (SEC); Allianz Global Investors GmbH, an investment company in Germany, authorized by the German Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin); Allianz Global Investors Asia Pacific Ltd., licensed by the Hong Kong Securities and Futures Commission; Allianz Global Investors Singapore Ltd., regulated by the Monetary Authority of Singapore [Company Registration No. 199907169Z]; and Allianz Global Investors Japan Co., Ltd., registered in Japan as a Financial Instruments Business Operator; Allianz Global Investors Korea Ltd., licensed by the Korea Financial Services Commission; and Allianz Global Investors Taiwan Ltd., licensed by Financial Supervisory Commission in Taiwan.

www.allianzglobalinvestors.com

Allianz Global Investors GmbH
Bockenheimer Landstr. 42–44
60323 Frankfurt am Main

February 2016

