The Guiding Lights

It starts and ends with risk

With a foundation in advising institutional investors, Atchison's investment philosophy begins and ends with risk. Risk, but more importantly, ensuring every risk that clients are exposed to is being compensated, is at the core of our decision-making framework.

Atchison's obsession with risk is supported by our extensive experience in providing approved product list (APL) monitoring and reporting that meets APRA's prudential standards for major financial institutions and trustees. This demands a need to look beyond headline risks like volatility, by assessing portfolios at multiple levels, including styles, sectors, themes, and economic factors.

Among the most common uncompensated risks come from inherent style biases, such as size, income or low-quality companies, currency, and sector weightings. We understand that what truly matters to clients is the value of their capital, not financial ratios.

Asset allocation is the primary driver of returns

There is no shortage of academic research showing that asset allocation and similarly beta selection, drive most returns over the long-term. Central to the success of an asset allocation focused approach, is the comfort and objectivity it affords to assist in supporting informed, rather than emotional decisions during periods of market stress.

Share or manager selection may be more exciting than considering more complex issues like asset allocation, both strategic and dynamic, but as much as 90 per cent of return will be determined by the selection and management of beta.

As fiduciaries of capital, Atchison seeks to build portfolios that are resilient to all market conditions, and able to produce regardless of the backdrop. With this in mind, we leverage both long-term strategic, and shorter-term dynamic asset allocation decisions, and take a more granular view on asset class selection.

Active management can smooth the ride

The world as we know it has shifted significantly in recent years, with a multi-decade tailwind of falling interest rates reversing, resulting in a 'normalisation' of market conditions. Despite the significant shift, much of the investment world continues to construct portfolios for a low interest rate environment.

With the headwind of a higher cost of capital and greater divergence of returns, we must assess the risk that the 'average' market return alone may not be enough to deliver on objectives. History has shown that 'true' active management can both reduce volatility and deliver better risk-adjusted returns if utilised well.

Most importantly, active management can add true diversification to portfolios and mitigate the impact of significant market events. Central to this benefit is a focus on identifying and paying only for those active managers that have high ‘active share’ or differentiate from the index, while ensuring any ‘cancellation effects’ of duplicated or reversed holdings are limited.

Rebalance – but automate it

Given the increasing divergence of the global economy and markets, there are significant opportunities to improve returns by making ‘tactical’ or medium-term allocations to more attractive sectors, asset classes, countries, and styles. These ‘dynamic’ decisions can add significantly to returns but it is important to ensure that changes are being made within an objective framework.

It is our view that every holding within a portfolio must be able to have a real impact on returns. Thus, we apply several simple rules, including minimum holding sizes, along with the timing and quantum of rebalancing, importantly, these rules are systematic, and require little input nor risk of human error.

Similarly, where portfolios perform strongly, we are advocates of regular rebalancing at the asset allocation and investment level. Rebalancing ensures the portfolio remains aligned with your risk profile and can navigate varying market conditions, but also ensures you are always ‘buying low and selling high’.

Liquidity is your friend

Liquidity or the ability to cash in an investment in a short period of time is one of the most vexed questions in investment markets. Institutional investors with ‘sticky’ capital have sought to leverage the ‘illiquidity’ premium to boost returns, however, the changing economic and investment environment is challenging this approach.

While illiquidity can support higher returns and more patient capital, it must always be considered against its cost, and the objectives of the end investor. Given the inherent focus on managing retirement capital, Atchison’s are acutely aware of the need to maintain liquidity not only for income requirements, but also to allow for efficient rebalancing and risk management.

Within core portfolios and considering the fast-moving nature of asset valuations amid a higher interest rate environment, liquidity is currently at a premium and adds significant optionality through the ability to deploy capital more quickly.

Trust in mean reversion

Extending on the importance of rebalancing at an investment and asset class level, Atchison are advocates in the power and long-term expectation of mean reversion. That is, that over time, most markets, including credit, fixed income, and equities, will revert to the long-term trend of ‘mean’ level of returns and valuation.

All too common are the examples of short-term events, whether thematic or policy-driven, being extrapolated into long-term structural trends and thus reflected quickly in portfolios. The only way through which a resilient portfolio can be built, is by ensuring that we are not ‘betting everything on the base case’ which is regularly proven wrong.

With mean reversion at the forefront, we seek to identify and benefit from relative valuation differentials between asset classes, sectors, and styles, ensuring we do not confuse structural for cyclical changes. Despite this, short-term momentum will regularly test the will power of investors.

Costs matter

Over the long-term, in the pursuit of CPI plus objective returns, trading and related costs can have a significant influence on returns. On the one hand, we seek to ensure investors are getting ‘bang for their buck’ by only using active managers that a truly different, we also seek to negotiate discounts to ‘off the shelf’ fund fees.

On the other hand, trading costs and taxation implications can be a real drag on performance. Investing is a truly long-term strategy, hence central to our approach is the commitment to not over trade nor seek to make changes for the sake of change.

A key example is the common practice of switching last year’s top performing fund for this year’s bottom performer, which does little more than add to trading costs and volatility. Every investment added to our portfolios has a reason to be there, and with a focus on long-term compounding, Atchison seeks to ensure portfolio turnover is kept to a minimum unless something significantly changes.

Always have an exit strategy

Too often investment markets and even institutional investment decisions are driven by emotions. The data and risk-driven basis on which our investment approach is constructed is focused on building and executing repeatable processes that can be monitored and implemented while removing the risk of human error or emotion.

We believe that dynamic asset allocation and investment selection can add to returns, but that every decision must have a framework and exit strategy. This is required whether the investment goes right or wrong and is subject to significant rigour and back testing.

The key behind this approach is removing emotion from as many decisions as possible and forcing the need to reconsider every investment within any portfolio daily.