SAGE ADVISORY SERVICES

MSSB Prods Clients Back to Risk Investing

Morgan Stanley Smith Barney has unveiled a new campaign to help advisors combat the client mindset that since the market crash has parked a big share of assets in fixed income and cash-related products. The initiative – which aims to spur a return to investing in riskier products by touting the timeliness of low-volatility strategies – equips advisors with a slew of background materials and a roster of specific products.

The effort began back in May with a spotlight on 15 mutual funds across three styles, and soon will expand to separately managed accounts and possibly to exchange-traded funds or alternative investments after that. The styles in the push are covered call-options overlay, long-short and market neutral.

“The idea really is that clients have veered away from their long-term strategic asset allocation, because the market volatility has driven them more toward cash and short-term fixed income,” says **Joe D’Agostino**, a managing director who is point person for the initiative at Morgan Stanley Smith Barney. “But our global investment committee says that portfolios should be overweight in risk – it’s been the call since March or April of 2009 – in areas such as emerging markets, commodities and real estate. This would lessen the disconnect between clients and our global investment committee’s recommendations.”

D’Agostino cites a recent note penned by the wirehouse’s senior investment strategists – **Jeff Applegate, David Darst** and **Charles Reinhard** – that argues for upping risk: “At this juncture, our analysis suggests that risk assets – equities, corporate and emerging markets bonds, REITs, and commodities – remain attractive relative to safe-haven assets such as cash, sovereign debt, and inflation-linked securities. As a result, our asset allocation models remain positioned for a global expansion by overweighting global equities and alternative/absolute return investments while underweighting government bonds and cash.”

D’Agostino says the wirehouse – like most of the industry – saw flows to cash and fixed income products swell after the market crash. He says of the $1.5 trillion in assets that the brokerage oversees, it now sees about a quarter of the total in cash or related products, a historically high level.

“We expect interest rates to rise over the long term, and investors would lose out,” he adds. “Investors understand that cash paying 1.5% isn’t good enough.”

D’Agostino says the new initiative – already introduced to all of the wirehouse’s 18,000-plus advisors – has begun to bring assets back to the equity side of the fence, but he declines to share statistics about the movement.

And, he adds, “We have quite a ways to go.”

The focus on the three styles aims to ease investors back to the market with “managers who can deliver equity or equity-like returns with lower volatility,” D’Agostino says. “This is recognizing that it’s a volatile market. [These strategies] offer equity and stock exposure with hedging strategies that we think will resonate."

The three styles lean toward alternative investing approaches. Covered call strategies hedge equity holdings with call options that can do well in falling or flat markets. Long-short products combine long-only stock picks with selected short positions on securities expected to fall in value. And market neutral strategies also hold long and short positions, but typically in similar proportions in a bid to attack market risk.

D'Agostino says these products should also fit as a core ingredient of a long-term portfolio. While the campaign is set to migrate soon to SMA versions of the products, those would only include the covered call and market neutral strategies, not long-short products, D'Agostino says. He did not say whether it would be this year or next.

D'Agostino says the product list of mutual funds grew out of recommendations from the wirehouse's investment advisor research unit headed by **Glenn Regan**. All 15 of the mutual funds in the lineup outperformed the S&P 500 index in the first half of the year. But he declines to name any of the funds.

Regan's team will also help pick the SMA products that will be used in the initiative.

While the effort to steer clients toward riskier assets is sound, it may be tactically focused strategies that have more success drawing flows, say two executives at **Sage Advisory Services**, an asset manager based in Austin, Texas, that has $9 billion in assets overall, including around $500 million in tactical SMA strategies built with ETFs. The firm has seen a spike in assets in those SMAs, says **Michael Walton**, v.p. of marketing and product development for Sage.

Tactical products may fit more centrally in an asset allocation than alternative-style funds, Walton says. "Tactical could have a more meaningful place in a portfolio," he adds.

Tactical strategies also respond to concerns investors had about the inflexibility of traditional equity SMAs that didn't protect them in 2008, says **Rob Williams**, partner and head of research at Sage. "Advisors like the straightforwardness of tactical strategies, rather than having to explain the long-short or options strategies, which of course have their place," he adds.

The effort to spread information and recommendations for the covered call, long-short and market neutral strategies in Morgan Stanley Smith Barney's campaign has several prongs. The wirehouse put information on the internal research and product websites that advisors use. It also is disseminating it through its business development officers, the regional sales desks, and even through third-party manager wholesalers.

D'Agostino says it's unclear for now how the initiative may play out in relation to the unified managed account programs that the wirehouse is touting to clients, but he says that may come into better focus when the SMA side of the campaign begins.