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Why We Choose Strategic Allocation: A Research-Based Approach

In 1986, Brinson, Hood, and Beebower famously identified asset allocation as being responsible for the lion's share of performance variability between "passively" and "actively" managed portfolios. Ever since, controversy among institutional investors regarding the relative value of strategic versus tactical allocation has continued unabated.

In this piece, we discuss the merits of strategic versus tactical asset allocation and analyze the historic returns of professional allocators, measuring each of these approaches to determine which holds more promise for long-term outperformance. Our findings suggest that strategic allocators have enjoyed the advantage, both in simple returns and on a risk-adjusted basis across most time periods.

What do we mean by Strategic and Tactical Allocation?

Tactical managers actively shift portfolio allocations on a set frequency or ad hoc basis based on near-term projections of asset class performance. Allocation shifts may be between asset classes, such as equity, fixed income, cash, or real assets, investment styles like value and growth, market cap weightings, or regions. Since shifts are often near-term or temporary, some critics say tactical managers are attempting to time the market.

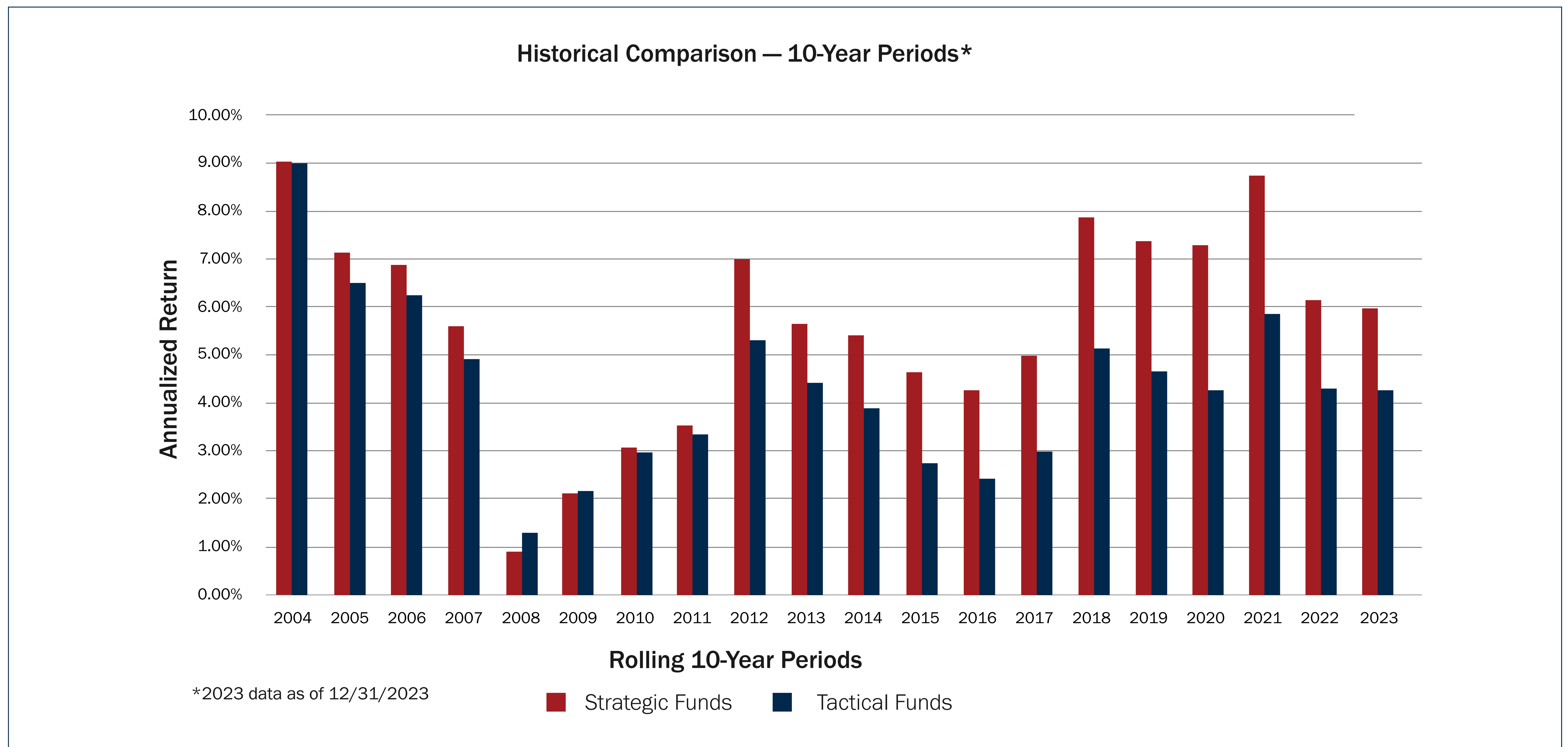
In contrast, strategic managers develop a long-term asset allocation based on capital market returns and long-term economic views and maintain this allocation across multiple market cycles. Managers who pursue a strategic asset allocation approach typically define a longer list of asset classes, each with a target and a high/low range. They do not make short-term or near-term adjustments to the asset class targets. Rather, they rebalance each individual asset class back to the previously determined target.

Which is better?

To answer this question, Mason tracked the long-term performance of investment managers who share a common investment objective but pursue this objective with different allocation strategies.

Morningstar tracks the results of mutual funds by investment objective as well as by how funds approach allocation, whether strategic or tactical. Using Morningstar's historical return data, we first selected funds

with an “income and capital appreciation” objective. Then, we compared the performance of funds focused on tactical allocation with those using strategic allocation over a series of rolling 10-year periods ending in each year from 2004 to 2023. The results are shown in the chart below.

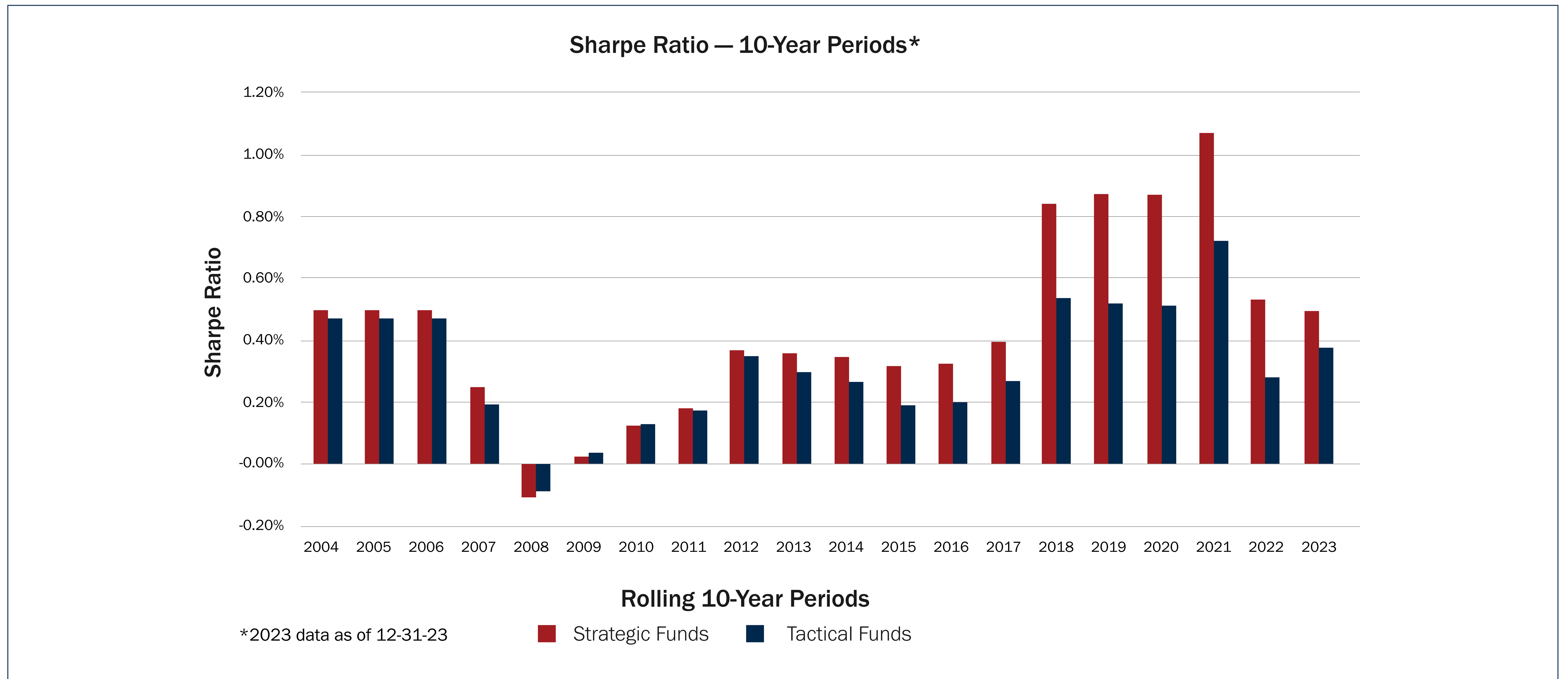


A strategic approach wins on absolute performance over long time-periods

In all but two years since 2004, strategic managers have posted higher returns than those employing a tactical approach. And since 2012, this outperformance has been significant.

Risk-adjusted returns also favor strategic allocation

To determine whether strategic allocation also enjoyed a performance advantage on a risk-adjusted basis, we reviewed our sample set of income and capital appreciation funds using Sharpe ratios, which measure how much excess return an investor receives for accepting the volatility associated with holding a riskier asset. We found that strategic allocators again came out on top for most periods tested.



Results hold true across multiple investment objectives

Finally, to test whether strategic allocation might also exhibit a return advantage in other investment objectives, we looked at strategic and tactically allocated funds in Morningstar's growth, growth and income, income, asset allocation, and balanced categories. We found that for the vast majority of time periods, strategic allocators outperformed their tactical counterparts in these categories on both a trailing performance and a Sharpe ratio basis as well.

While timing the market may be tempting, we believe our analysis determined that over the long-term, making tactical shifts to your portfolio based on short-term predictions may lead to worse outcomes. We believe that institutional investors are rewarded for being patient investors. At Mason, we emphasize strategic allocation for our clients' portfolios.

For information about Mason's Institutional Services and our research on strategic versus tactical investment strategies, please contact Will Thorpe or visit our website.

Institutional clients appreciate the exceptional level of service and attention Mason's credentialed professionals provide, our flexible approach, and the range of options offered.

Get personalized attention from a team that understands your organization.

Connect with an institutional consultant.

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- Allocation—50% to 70% Equity Funds in allocation categories seek to provide both income and capital appreciation by primarily investing in multiple asset classes, including stocks, bonds, and cash. These moderate strategies seek to balance preservation of capital with appreciation. They typically expect volatility similar to a strategic equity exposure between 50% and 70%. Category Group Index: Morningstar Mod Tgt Risk TR USD Category Index: Morningstar Mod Tgt Risk TR USD Morningstar Index: Morningstar Mod Tgt Risk TR USD
- Tactical Allocation portfolios seek to provide capital appreciation and income by actively shifting allocations across investments. These portfolios have material shifts across equity regions, and bond sectors on a frequent basis. To qualify for the tactical allocation category, the fund must have minimum exposures of 10% in bonds and 20% in equity. Next, the fund must historically demonstrate material shifts in sector or regional allocations either through a gradual shift during three years or through a series of material shifts on a quarterly basis. Within a three-year period, typically the average quarterly changes between equity regions and bond sectors exceeds 15% or the difference between the maximum and minimum exposure to a single equity region or bond sector exceeds 50%. Category Group Index: Morningstar Mod Tgt Risk TR USD Category Index: Morningstar Mod Agg Tgt Risk TR USD Morningstar Index: Morningstar Mod Tgt Risk TR USD
- In addition to allocation reference points such as "Allocation – 50% to 70% Equity" and "Tactical Allocation," another way in which Morningstar categorizes funds is by their "fund objective." Examples include growth, growth and income, income, asset allocation, and balanced, among others. In this presentation, we analyzed the trailing performance, standard deviation, and Sharpe ratios of funds in the "Allocation – 50% to 70% Equity" and the "Tactical Allocation" reference points with each of these fund objectives.

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