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Asset Allocation: Strategic Versus Active

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Snapshot

- Strategic and active allocation approaches have traditionally been differentiated in terms of time horizon.
- In our view, it is more accurate to think of strategic as permanent and active as temporary.
- We believe that harvesting the benefits of both can improve investors' chances of success, regardless of their investment time horizons.

When it comes to asset allocation, strategic and active approaches have traditionally been differentiated in terms of time horizon. For instance, strategic positions may be said to employ a 5-to-10-year time horizon, while active positions may be thought to last for less than one year. There is a grain of truth to these characterizations, yet it leads some investors to believe that having a shorter investment time horizon means they should exclusively emphasize active asset allocation.

A more accurate framework

Strategic Asset Allocation	Active Asset Allocation
Strategic allocation positions can be thought of as ***permanent*** (or at least very durable).	Tactical allocation positions can be thought of as ***temporary***. We expect them to be unwound at some point.
They make up the core positions, designed to produce well-diversified, efficient portfolios for any time horizon and risk/return objective.	They are composed of a small number of ad hoc positions expected to marginally enhance the return or lower the risk of a strategic portfolio.
Selection is based on how we believe different asset classes will impact the risk and return characteristics of a portfolio—not based on a more speculative view of near-term performance.	Selection is based on perceived market dislocations or inefficiencies, informed by contemporaneous and evolving market views; positions are sized modestly to preserve the strategic portfolio's risk characteristics.

Why framing matters

We think of strategic holdings as core positions crucial to maintaining well-diversified, efficient portfolios that are well-balanced and likely to offer high risk-adjusted returns. Meanwhile, active allocation positions are applied on top of strategic portfolios (where appropriate). Our approach to strategic asset allocation is therefore neither based on temporary market (or asset class) views, nor is it dependent on having a longer-term investment time horizon. It is an effort to tilt the odds in our favor at every horizon in an uncertain world. Active asset allocation can be used to enhance the returns or lower the risk of a strategic portfolio, but we keep those tilts modest so as not to overwhelm the underlying characteristics of the portfolio.

Nothing can guarantee success when investing in risky assets over any finite period—but we are confident that harvesting the benefits of both strategic and active asset allocation can meaningfully improve investors' chances of success, regardless of their investment time horizons. It is our hope that a better understanding of the critical differences between strategic and active allocation will help investors stay disciplined when faced with the inescapable risks and uncertainties of investing in financial markets.

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