M A C R O E C O N O M I C S

Exploring Macroeconomic Sensitivities

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Forecasting economic and market conditions is no easy task. More-confident investors pick a particular macroeconomic (macro) view and construct a portfolio that aims to excel in the chosen environment. Investors more humble about their forecasting ability may prefer to construct diversified portfolios that are robust across a variety of macro environments. But in order to construct their portfolios, both types of investors need to understand how various investments have fared in different macro conditions.

"Risk-based investing" can mean different things to different investors, but the common feature is the emphasis on improved risk diversification. While many investors identify risks primarily as asset-class exposures, others may look at underlying macroeconomic exposures (such as inflation sensitivity). The difficulty with the latter approach is that macroeconomic factors are not directly investable.

In this paper, we study the sensitivity of traditional asset classes and dynamic strategies to different macroeconomic environments (growth, inflation, real yields, volatility and illiquidity). We identify environments that are particularly challenging for investors, and find evidence that dynamic systematic strategies, known as style premia, have meaningfully less macro exposure than do asset classes. We also show how diversification reduces portfolios' macro risk exposures.

Since investors cannot be certain of the future economic environment, they should try to prepare their portfolios for any eventuality. Just as a portfolio's performance can be made more robust through better risk diversification across investable return sources, we believe it can also be improved by more balanced macro exposures.

be relied on in making an investment or other decision. There can be no assurance that an investment strategy will be successful. Historic market trends are not reliable indicators of actual future market behavior or future performance of any particular investment which may differ materially, and should not be relied upon as such. Diversification does not eliminate the risk of experiencing investment losses.

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