# Looking for Aggressive Global Allocation?

## Don't Look to "Allocators"

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## OVERVIEW

Global equity investors typically have a choice when selecting managers or funds, between top-down allocators and bottom-up stock-pickers. Top-down ("TD") allocators generally make decisions on how to invest across countries and sectors and then pick stocks within those allocations. Bottom-up ("BU") stock-pickers generally select stocks they find attractive without any explicit commitment to country or sector exposure. Investors seeking managers who make significant allocation decisions might assume they should use top-down allocators.

However, I find that the implicit active country and sector exposures for funds using bottom-up managers have been more aggressive than all others, and that this tendency has increased over the past decade.

The 2022 bear market appears to have reinforced this effect. At year end 2022, bottom-up value funds' implicit active country and sector exposures had remained near the high levels they had been five and ten years earlier. But top-down allocators (for both value and growth) had reduced their active exposures significantly, as have bottom-up growth managers. **I conclude that for investors looking for managers to take aggressive active exposures, they might focus on bottom-up value funds, rather than the more apparently "obvious" approach of using a top-down allocator.**

## BACKGROUND

This article follows on from research on Active Share ("Another Use for Active Share—Understanding Portfolio Exposures"[i]). For that article, my co-authors and I broke out the impact

**Active Share Contribution ("ASC") is the amount of a fund's Active Share that can be directly attributed to the difference between a sector or country's portfolio weight and the equivalent index weight, in this case, the MSCI World Index.**

of country and sector aspects of Active Share for a sample of 46 global equity funds using Morningstar data. (More information on the universe and data in this article can be found in the Appendix.) Here, I use data from that study from the end of 2012 and 2017, along with current data for year end 2022, to show the evolution of the country and sector contributions to Active Share over a ten-year period.

My primary measure of these exposures is Active Share Contribution ("ASC"). This is the amount of a fund's Active Share that can be directly attributed to the difference between a sector or country's portfolio weight and the equivalent index weight, in this case, the MSCI World Index. Accordingly, ASC is a measure of how aggressively a fund's manager allocates its country or sector exposure.

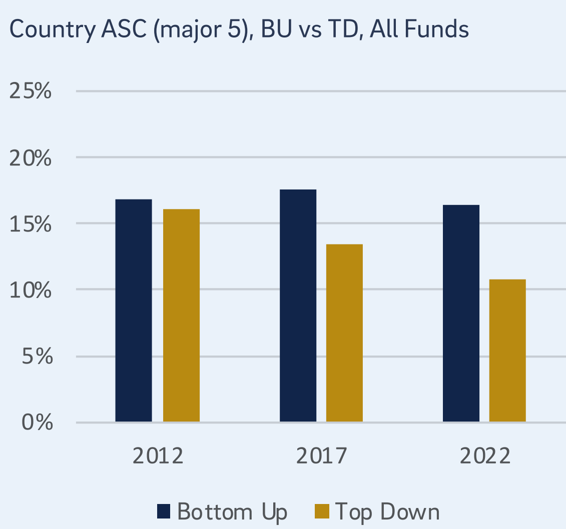
While I examine all eleven sectors, I have followed the practice of the academic paper and analyzed only five major active country exposures: the United States (typically by far the largest); Japan; the United Kingdom; France; and Germany. (The Appendix contains a note on active exposures to China and Russia over the decade.)


## RESEARCH FINDINGS

I found significant changes in ASC over the decade for both countries and sectors, particularly in the most recent five years, when ASC declined significantly for many funds.

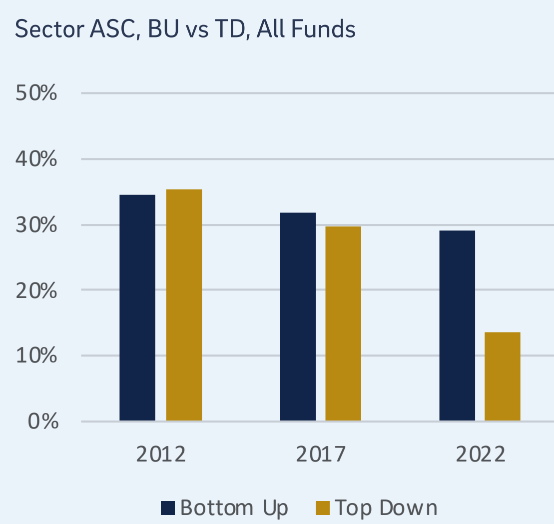
For both countries and sectors, ten years ago, BU and TD funds had similar ASC. By year end 2017, top-down ASC had dropped, and by year end 2022, both country and sector ASC were significantly lower for top-down funds than for bottom-up. See Exhibits 1a and 1b.

**EXHIBIT 1A | *Country* ASC Has Declined for TD Funds Between 2012 and 2022**




Source: Morningstar, Brandes Center

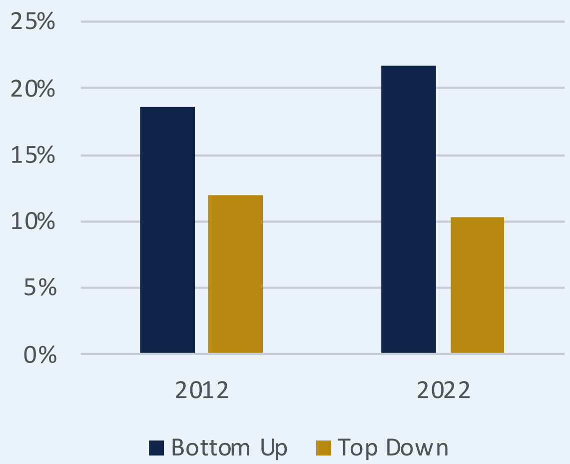
**EXHIBIT 1B | *Sector* ASC Has Declined for TD Funds Between 2012 and 2022**




Source: Morningstar, Brandes Center

**EXHIBIT 2A | For Value Funds' *Country* ASC, the Gap Between BU Funds and TD Funds Widened Between 2012 and 2022**

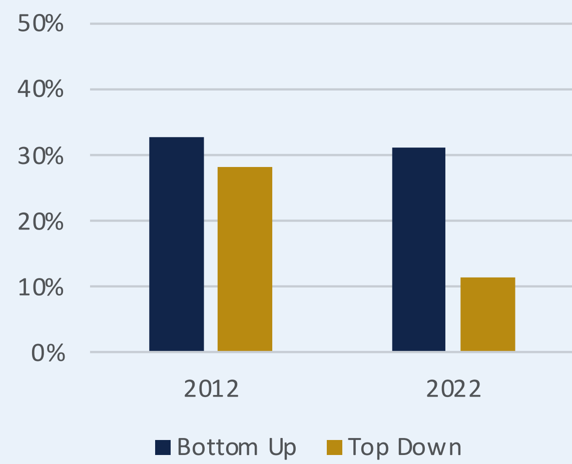
Country ASC (major 5), Value Funds, BU vs TD




Source: Morningstar, Brandes Center

**EXHIBIT 2B | For Value Funds' *Sector* ASC, the Gap Between BU Funds and TD Funds Widened Between 2012 and 2022**

Sector ASC, Value Funds, BU vs TD

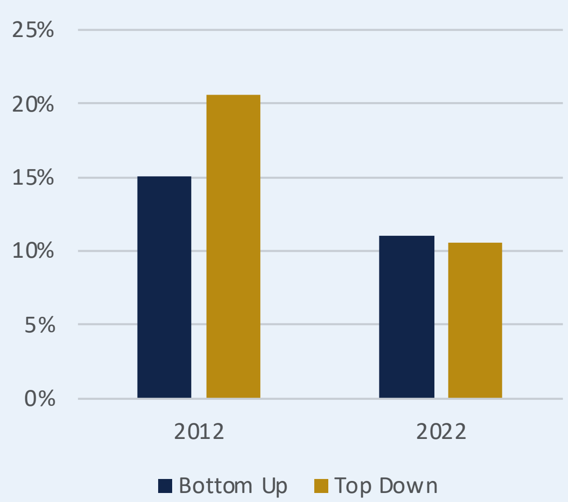



Source: Morningstar, Brandes Center

Among growth funds, ASC levels declined over the decade for both bottom-up and top-down funds, with most of the decline occurring in the most recent five years. I note that the trend was much more pronounced for the top-down subset. For example, sector ASC for TD growth funds was 44% in 2012, then declined to 34% in 2017 and down again to 15% by 2022.

**EXHIBIT 3A | *Country* ASC for BU and TD Growth Funds Fell Between 2012 and 2022**

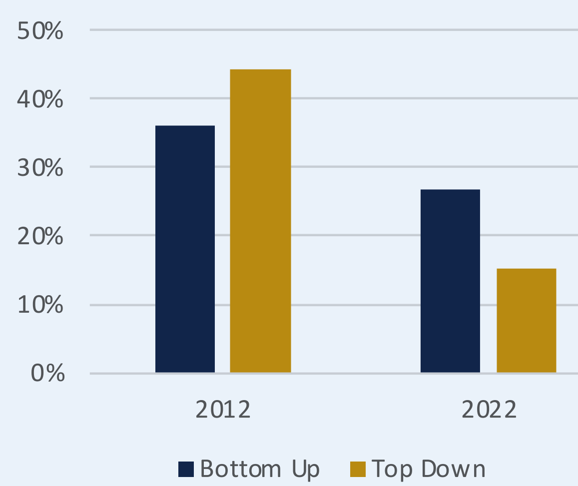
Country ASC (major 5), Growth Funds, BU vs TD




Source: Morningstar, Brandes Center

**EXHIBIT 3B | *Sector* ASC for BU and TD Growth Funds Fell Between 2012 and 2022**

Sector ASC, Growth Funds, BU vs TD




Source: Morningstar, Brandes Center

The sector ASC declines over the full period (regardless of which subset) were spread across sectors. This reflected not just a drop in exposure to one or two large sectors, but appears to be an "across-the-board" reduction. In contrast, for country ASC, the declines for growth funds were largely the result of taking a less active exposure to the United States. Value funds generally maintained or increased their underweight in the United States resulting in continuing high country ASC.

Notably, top-down growth funds were among the most aggressive allocators in 2012 vs. being among the least aggressive ten years later.

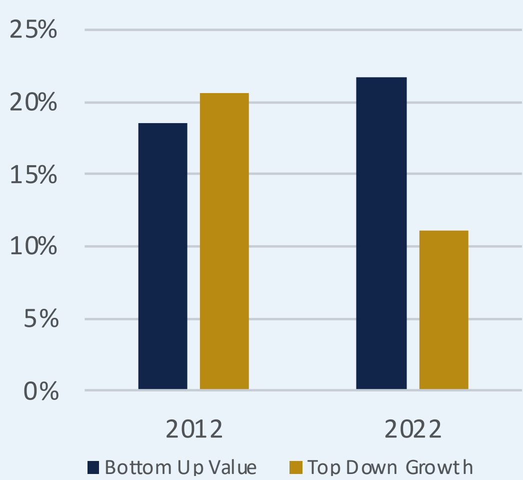
## CONCLUSION

Top-down allocators make explicit decisions on country and sector weights. The data shows that their allocation decisions have become significantly less aggressive over the past decade, for both country and sector allocations.

Allocations by bottom-up managers are implicit, driven by where they see the most attractive stock opportunities. Over the decade, and in particular for bottom-up ***value*** managers, these implicit allocation decisions have become more aggressive. Exhibit 4 contrasts the extremes of this change, comparing bottom-up value with top-down growth managers, and showing how their positioning changed over the decade.

**EXHIBIT 4A | *Country* ASC for Value BU Funds Increased Between 2012 and 2022, while Falling Significantly for Growth TD Funds**

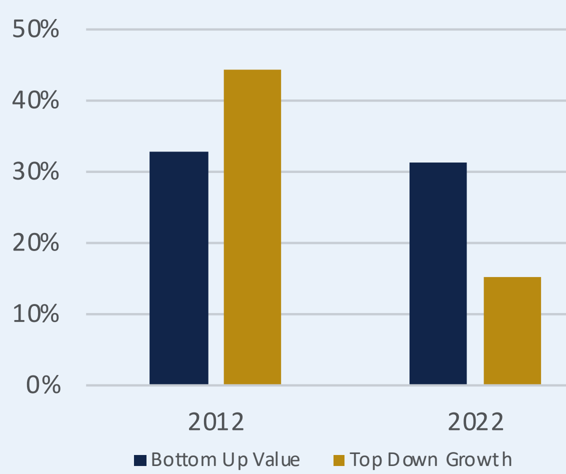
Country ASC (major 5), Value BU vs Growth TD




Source: Morningstar, Brandes Center

**EXHIBIT 4B | *Sector* ASC for Value BU Funds was Stable Between 2012 and 2022, while Falling Significantly for Growth TD Funds**

Sector ASC, Value BU vs Growth TD




Source: Morningstar, Brandes Center

I BELIEVE THERE ARE TWO “TAKEAWAYS” FOR INVESTORS:

- → Those seeking managers taking aggressive allocations now, should consider bottom-up value managers.
- → Those looking to their top-down managers to make aggressive allocations should carefully monitor the active allocation decisions of these funds in the future. Are today’s “low aggression” allocations just a cyclical pause? Or will top-down managers continue this way for an extended period, raising the question of why invest in an “allocating” fund that doesn’t?

## APPENDIX

**Source Data:**

The original academic research paper used data for 46 funds, and I used the same peer group. I found that 12 funds have closed, merged or changed mandate since 2017, leaving 34 funds available for this study. I divided these into “bottom-up” and “top-down” sub-groups, based on the managers’ own description of their investment process in published documents (for example, prospectuses or other publicly available sources). Managers with processes that included both top-down and bottom-up aspects were placed in the top-down category. Consequently, this study included 20 bottom-up and 14 top-down managers. Value and growth style categories were sourced from Morningstar. There were 5 funds in the Blend category, and these were included in the Growth subset for this study.

At time of writing, 7 of the 34 funds had not yet published country and sector allocations for December 31, 2022, and data for November 30, 2022 was used instead. In the author’s opinion, the difference was likely immaterial in impact on the conclusions of this article.

**A Geopolitical Note: China and Russia**

Given the geopolitical issues with China and Russia over the decade, it might be useful to check if there was any material impact on funds’ active exposure to these two countries over the decade. As neither is in the MSCI World Index benchmark used for this article, any exposure to these countries contributes to Active Share. The short answer is no: ASC from China and Russia was not significant. In 2012, the average ASC for each country was only 0.1%. By 2022, with its markets inaccessible, the Russia ASC had dropped to zero. China’s ASC had increased over the decade but remained small: 0.5% on average for bottom-up funds, 0.8% for top-down.

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[i] Elimelakh, Simon, Barry Gillman and Geoffrey Warren. The Journal of Investing. October 2020, 29 (6) 7-22; DOI: https://doi.org/10.3905/joi.2020.1.149

[ii] Martijn Cremers and Antii Petajisto introduced Active Share in the following research paper: Cremers, K. J. Martijn and Petajisto, Antti, How Active is Your Fund Manager? A New Measure That Predicts Performance (March 31, 2009). AFA 2007 Chicago Meetings Paper, EFA 2007 Ljubljana Meetings Paper, Yale ICF Working Paper No. 06-14, Available at SSRN: https://ssrn.com/abstract=891719 or http://dx.doi.org/10.2139/ssrn.891719

The authors wrote that Active Share "...represents the share of portfolio holdings that differ from the benchmark index holdings."

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