DWS chief preaches new tools, models

Hensler says traditional investment strategies no longer cut it in these changing times

By Mark Bruno
February 15, 2009 6:01 am ET

As clients continue to question the merits of traditional investment approaches, Philipp Hensler, chairman and chief executive of DWS Investments Distributors Inc., is prepping his firm to arm financial advisers with a new way of thinking.

Rather than relying on classical diversified-portfolio models or conventional buy-and-hold approaches, he said, advisers should take a very specific cue from the institutional investment community: Stop structuring portfolios that aim simply to accumulate as much as possible, and start matching clients' assets to their future liabilities.

"All of the tools and models that we have been relying on for decades have been looking backwards. We have been building portfolios under the fundamental assumption that the future will be exactly like the past," Mr. Hensler said in an interview in his New York office last week.

'WORLD HAS CHANGED'

"But we need to consider just how dramatically the world has changed and what advisers now need to do to meet the changes in their clients' needs for the next five to 10 years and beyond," he said.


Philipp Hensler: "We need to consider just how dramatically the world has changed."arnoldadler.com

It is a case that Mr. Hensler and his team of 75 wholesalers are now pitching to advisers across the country, as nearly every piece of clients' portfolios have taken massive hits during the past 18 months. Advisers, he added, are looking for ways to preserve their clients' assets and generate more-predictable returns.

After the technology bubble burst early in the decade, however, many institutional investors began using asset-to-liability matching strategies to insulate their portfolio from severe swings.

This approach often calls for institutional investors such as large pension plans to dial down their exposure to traditional equities. In exchange, they add less volatile, longer-duration fixed-income instruments and more-exotic products such as swap overlays that are aligned with investors' long-term financial needs and risks.

Although this may reduce the potential for returns, the core concept behind such an approach is to take as much market risk off the table as possible while preserving and producing enough money to cover all of an investor's future financial obligations.

"It's the type of approach that should certainly be incorporated into an individual portfolio," said Kay Lynn Mahue, managing partner at The Botsford Financial Group in Atlanta, who added that her firm has been building more-risk-managed portfolios around clients' lifestyle needs since 2001. "There's definitely been an accelerated interest in it."

Bing Waldert, associate director of research at Boston-based consulting firm Cerulli Associates Inc., echoed her sentiments.

"Retail investors often look at a lot of the techniques used in the institutional world to see what could be applied in the own portfolios, but asset-to-liability matching could be the one that has the most appeal right now," he said.

And with good reason: Institutions that had an asset-to-liability matching program in place broke even last year, according to a study released this month by investment consulting firm Watson Wyatt Worldwide Inc. of Washington. Those with more-typical asset allocations, meanwhile, saw the value of their portfolios decline by more than 25% last year.

RETAIL INVESTORS

Such results are sure to get the attention of retail investors, and Mr. Hensler said that he and his team are attempting to get advisers to focus more on the specific liabilities or "realities" that could threaten their clients' portfolios over the long term — and invest more of their assets in lockstep with these obligations.

Retail investors' liabilities include the long-term risks associated with lower market returns, rising health care costs, inflation, longer life spans and interest rate volatility. Mr. Hensler said that there are a number of options that advisers could use to model a portfolio around these types of client liabilities without having to rely on many of the complex products employed by large pension plans.

He said that retail investors could use more fixed-income and Treasury inflation protected securities funds to gain easy access to an insulated portfolio. But they can also tap into a range of structured products, in particular structured notes, to obtain more-predictable returns across multiple asset classes.

For instance, DWS and its wholesalers are pushing the use of M-Notes — a relatively new type of structured product that is, not coincidentally, manufactured by the investment-banking arm of Deutsche Bank AG of Frankfurt, Germany, DWS' parent company.

With these types of products, the structured note is designed to offer a client an opportunity to get returns in either bear or bull markets. It is also structured to protect the investors' principal at the same time.

The note could be tied to a specific equity index, such as the Standard & Poor's 500 stock index, and would have specific predetermined performance "barriers."

When the note matures, the investor's return is based on where the index finishes within these barriers; if the barrier was 10%, for example, and the S&P 500 was up 8% at maturity, the investor would get an 8% return. At the same time, if the S&P 500 finished down 8%, the investor would still get an 8% return.

DOWNSIDE PROTECTION

If the performance of the index falls outside this barrier, however — say the S&P 500 was up or down 15% at the note's maturity — the investor gets only his or her principal returned. So it essentially offers an opportunity for a good deal of downside protection but limited opportunities in very bullish markets.

It could be several years before many advisers rely on these products as the "basic building blocks" of an asset-to-liability matching portfolio, Mr. Hensler conceded, but said that the broad concepts appear to be resonating with some advisers already.

"It may not prove to be appropriate for every client, but securing a client's assets should always be an adviser's top priority," said Robert Wander, a planner at Wander Financial Services in New York. "And it's clear we all need to start exploring strategies beyond just the traditional approaches."

E-mail Mark Bruno at mbruno@investmentnews.com.