4

Tactical Asset Allocation

The “Paradigm Shift” macro theme we highlighted last year involving structurally higher interest rates and volatile inflation is expected to remain in place. As such, we broadly recommend “Staying the Course”, with our 2024 Tactical Asset Allocation (TAA) and continue to position portfolios for an environment of heightened macro volatility.

Compared to our Strategic Asset Allocation benchmark (SAA), we began the year underweight interest rate duration (-2.5% Government Bonds, -2.5% TIPS) in favour of Cash/Short-Dated Bonds (+2.0%) and Absolute Return (+3.0%). However, we aim to move this cash overweight back into government bonds if 10-year US Treasury yields rise to a trigger level of c. 4.5%, or if a scenario of material economic growth deterioration appears more likely.

Given higher return expectations, we continue to favour income-generating assets including Liquid Credit (+3.0%) and Private Debt (+3.0%), although careful stock selection is necessary to guard against deteriorating credit fundamentals as coverage ratios have declined. We fund these overweight allocations from growth assets, with -2.0% underweight allocations to Global Equities, Private Equity (PE) and Venture Capital (VC). The below benchmark allocation to PE reflects the fact that it takes time to build out a mature, diversified allocation.

We continue to believe that long-term institutional investors should hold roughly 40% of their portfolio in private markets and recommend that clients continue to steadily maximise their allocation subject to their specific liquidity needs. We express this view by adding +1.0% to Buyouts in 2024 relative to last year.

Your capital is at risk, the value of investments may fall and rise and you may not get back the full amount you invested. Past performance is not indicative of future returns.

Partners Capital advises a wide range of clients, each with a bespoke portfolio catering to different objectives and constraints. To allow us to talk about asset allocation in more general terms, we reference a model portfolio that reflects our median client. All TAA changes discussed here reference this central policy portfolio for a large non-taxable institutional investor. The direction of these changes will be relevant to our taxable clients and those with different strategic benchmarks as well, but with different allocations depending on each client's tax situation, as discussed later in this chapter.

The model portfolio Strategic Asset Allocation (SAA) is optimised to maximise the return per unit of risk using our long-term market assumptions, constraining for the risk tolerance and liquidity needs of a typical client. Our Tactical Asset Allocation process considers the cyclical nature of financial markets and uses scenario analysis to best position the portfolio over the next 12-18 months.

One of our founding principles is that attempting to time the entry and exit from markets will generally lead to sub-par returns over the long run. Instead, we believe the best method for securing attractive returns over the business cycle involves setting an appropriate risk budget range using our Equivalent Net Equity Beta (ENEB) framework and allocating that risk across different types of market risk including equities, credit, interest rates and inflation. In this way, we aim to ensure that portfolios are well positioned for where we are in a cycle, remain diversified across return drivers and provide robust returns across the myriad macroeconomic scenarios that might unfold.

Summary of deviations from Strategic Asset Allocation in 2024

The 2024 TAA positions the portfolio for an environment of heightened macro volatility, particularly around the rate of change of key variables such as interest rates and inflation. The resulting portfolio is well positioned for our base case in which growth slows and inflation pressures gradually ease, while still offering a measure of protection against the possibility of a policy-error induced recession in the next 12-18 months if the lagged effects of monetary tightening do come to the fore. We aim to bias the portfolio in favour of income-producing assets to take advantage of higher interest rates, while maintaining well-sized allocations to those assets poised to benefit the most should growth continue to exceed expectations. Below we outline our rationale for positioning by asset class.

Cash

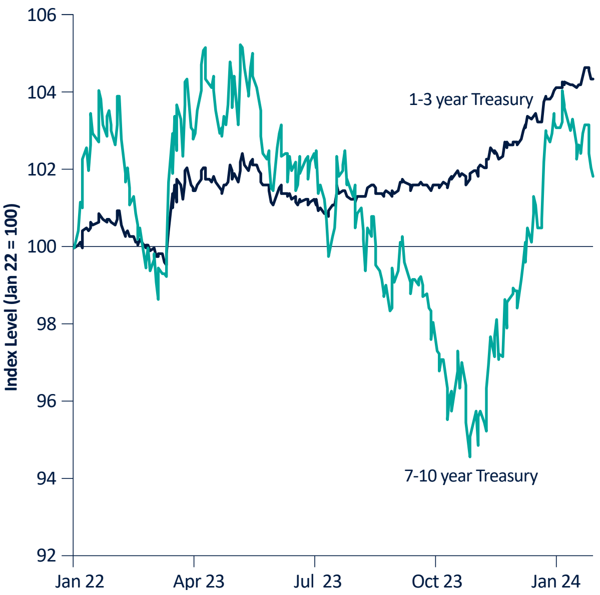
(Overweight moving to neutral): Cash typically has a limited investment role in an optimised long-term portfolio as it offers no risk premium for which we expect to be compensated, resulting in a low real return over time. However, with yield curves still inverted across most developed markets, cash yields remain competitive for now. Based on the yield of 1-year government bonds, a proxy for expected average cash yield over the next 12 months, we believe investors can expect to earn something close to 5.0% in USD and GBP and 3.5% in EUR on cash deposits in 2024, although this is a variable rate and subject to change. As of early 2024, we continue to recommend a +2.0% overweight position to cash and short-dated bonds, but we expect to reduce this allocation back to benchmark weight during the year in favour of longer duration bonds.

Government bonds

(Underweight moving towards neutral): We recommended below benchmark interest rate duration in 2023. This proved accretive as government bonds returned less than cash over the year and came with a great deal of volatility. As shown in Exhibit 1, the 1-3 year Treasury Index rose steadily over most of 2023 as it accrued interest, while the 7-10 year Treasury Index suffered a c.-10.0% peak-to-trough decline. We expect bond yields to remain volatile in 2024, but with the central bank hiking cycle coming to an end, we will look to add duration if the yield curve steepens via rising long-end rates. For example, if the 10-year US Treasury or UK Gilt yield were to rise to 4.5%, or the German Bund to 2.5%, we would recommend adding duration to portfolios. This will be contingent on our economic outlook at the time, and an assessment of the relative attractiveness of alternative uses for the capital (e.g., liquid Absolute Return managers).

Exhibit 1

The 1-3 year Treasury Index rose steadily in 2023 without the volatility of the longer duration assets



***Source:** Bloomberg*

Liquid Credit

(Overweight): Credit fundamentals are likely to deteriorate further over the course of the year as growth slows, and we anticipate a c. 4.0% default rate over the next 12 months, slightly above the long-term average of 3.2%. Refinancing risks are expected to be incremental and manageable, although a slower pace of rate cuts than is currently anticipated will challenge lower-rated credits. Against this backdrop, passive high-yield beta looks marginally expensive. However, other areas of Liquid Credit have not seen spreads tighten to the same extent and represent better value. Careful security selection will be key, but Opportunist/Event and Residential Mortgage Bonds offer attractive risk adjusted returns. CLOs also continue to offer a higher yield relative to limited underlying credit risk. The BB CLO Index starts the year with a yield-to-maturity of 12.0%, while BBB CLOs are yielding 8% with structural subordination that significantly reduces the possibility of impairment. We maintain a +3% overweight relative to benchmark to capitalise on these opportunities.

Private Debt

(Overweight): We recommend a 10.0% allocation to Private Debt, which is +3.0% above benchmark. The opportunity set is compelling, and clients should raise their allocation in 2024 if liquidity permits. We focus on Capital Solutions managers who can provide both public and private issuers with flexible financing for restructurings, business transformation and acquisitions, or as a replacement for highly dilutive equity financing where company valuations remain depressed. Constrained capital availability is creating a compelling opportunity set for Specialist Lenders in fields that require expert underwriting given the complicated collateral (e.g., healthcare, emerging technology or portfolio financing). There is also a material repricing taking place in Real Estate Lending, particularly Commercial Real Estate (CRE). Some $2.6T in US CRE-related loans mature over the next five years. US banks hold c.50.0% of CRE debt, and c.75.0% of that is concentrated in small/mid-sized banks. Banks are aggressively reducing lending activity in the face of increasing loan loss provisions, a trend that accelerated after the regional banking crisis in March last year. These market dynamics are creating attractive opportunities for senior and mezzanine lending specialists. We focus on more opportunistic transactions in an uncertain market environment via managers with proven sourcing advantages and the ability to manage assets where necessary.

Absolute Return

(Overweight): One of our core investment themes is that the "Great Moderation" of the last decades is giving way to a period of heightened Macro Volatility. Specific segments of Absolute Return are likely to perform well in this environment, particularly Fundamental Equity Long/Short, Statistical Arbitrage and Fixed-Income Relative Value. We focus allocations on multi-strategy funds for cash efficiency and enhanced risk management, as well as strategy specialists to shape overall portfolio balance and to enhance returns. After a multi-year buildout, we believe our multi-manager Separately Managed Accounts (SMAs) are at sufficient scale to drive even greater benefits. These funds employ the same structural advantages of multi-manager platform funds but have better alignment and terms for investors. For example, unlike most external "platforms", our multi-manager SMAs only charge performance fees over the cash rate and allow investors to fully redeem within one quarter.

Public Equities

(Underweight): We reduce Hedged Equities by -2.0% relative to last year, taking it to benchmark weight. We maintain a -2.0% underweight allocation to Long Equities relative to the SAA benchmark. The underweight does not reflect an outright negative view on equities, but rather a relative preference for Liquid Credit and Private Debt where the contractual nature of the return is more certain, and Absolute Return where some strategies are likely to benefit from the current environment. Despite the reduction in allocation, we maintain an overall preference for Hedged Equities strategies compared to more directional strategies, given the ripe dispersion opportunity set within Emerging Technology, especially from Generative AI. Over the course of 2023 we have continued to evolve both our equities portfolio construction approach as well as our focus areas for manager sourcing and due diligence. We seek to build portfolios of strategies managed by a combination of generalist and specialist stock pickers that maintain an overall risk level similar to Global Equities and where regional or sector allocations are not the dominant drivers of relative risk and return.

Private Equity

(Continue building to max allocation): Clients should continue to steadily build out their private equity allocation, and we signal this with a +1.0% increase to Buyouts in the 2024 TAA. This leaves the model portfolio with a 21.0% allocation to PE (16.0% Buyouts, 5.0% VC) compared to the long-term strategic allocation of 25.0% that we believe most institutional portfolios should strive for (18.0% Buyouts, 7.0% VC). The TAA's below-benchmark allocation reflects the fact that it takes time to build out a mature, diversified allocation to Private Equity, and our average client remains underweight. Higher rates may handicap the industry's average return relative to those of the last decade, but we believe top quartile PE managers will continue to provide the highest long-term return of any asset class. Within Buyouts, we seek to partner with sector specialists and lower-middle market generalists with the ability to leverage sourcing and information advantages to acquire quality businesses at reasonable valuations and drive post-acquisition operational value-add (PAOVA) via revenue growth and margin improvement. We also aim to leverage our relationships with managers to source co-investments that can reduce management fees and carried interest expenses while concentrating capital in the sub-sectors in which they excel. Within Venture Capital allocations, we continue to expand exposure to early-stage investments which exhibit lower correlation with macroeconomic risks, as outcomes are dependent upon innovative technologies and product-market fit, rather than interest rates or the corporate earnings cycle.

Inflation-Linked Bonds

(Underweight): Our scenario analysis indicates that the return profile of ILBs is lacklustre relative to the alternatives. In a scenario of gradually moderating inflation, ILBs will provide a return similar to that of nominal bonds or Cash. In an upside inflation surprise, the Fed will keep policy tight to anchor inflation expectations, capping the change in breakeven rates as we have seen in the past two years. Real yields will rise by less than nominal yields, so ILBs will outperform nominal bonds, but they will still lag Cash and Absolute Return due to the impact of the long duration. However, in a downside scenario, inflation expectations typically fall sharply, which will results in a real yields falling by less than nominals. As such, ILBs will provide less downside protection than Government Bonds. On balance, this return profile has us maintaining a -2.5% underweight relative to benchmark, with a preference for Cash and Absolute Return managers.

Real Estate

(At weight): We maintain an 8.0% allocation to Real Estate, in line with the SAA benchmark. We favour a targeted investment strategy, focusing on Private Equity Real Estate (PERE) over core and core-plus strategies, due to more favourable acquisition valuations and value-add potential, especially given the current uncertainty in financing and valuation environment. In terms of sector exposure, we skew towards Industrials and Digital Infrastructure. We favour accessing Industrials through owner-operators executing a portfolio roll-up strategy in small (100-250K square feet) last-mile assets, as small assets continue to trade at a discount to large portfolio sales. In Digital Infrastructure, the rapid growth in data consumption driven by internet usage and cloud adoption is set to accelerate further due to AI adoption. While demand drivers are well understood, supply remains constrained due to challenges accessing appropriate sites with ability to secure the right zoning and access to sufficient power, creating compelling opportunities.

Exhibit 2 summarises our recommended 2024 TAA for a non-taxable investor and contrasts it with both the SAA and the 2023 TAA. We have modified versions of the TAA for our US, UK and other taxpaying clients with changes that move in a similar direction. A more detailed summary of our views of each asset class is provided in the asset class sections of this publication.

Exhibit 2
Changes in Tactical Asset Allocation

Asset Class	SAA	2024 TAA	Difference vs. SAA	Difference vs. 2023 TAA	Notes
Cash	1.0%	1.0%	—	-2.0%	• Continue to favour Cash/short-maturity bonds for now, but add duration if the yield curve steepens. • Review trigger of 4.5% on 10-year Treasury and Gilt, or 2.5% on German Bund. Contingent on economic outlook and relative attractiveness of alternatives at the time.
Government Bonds	5.0%	4.5%	-0.5%	2.0%	
Liquid Credit	2.0%	5.0%	3.0%	—	• Structured Credit, Opportunist/Event and Residential Mortgage Bonds offer attractive risk adjusted returns. • Passive High Yield and Loans appear marginally expensive with below average spread over Treasuries despite rising default rate.
Private Debt	7.0%	10.0%	3.0%	1.0%	• Increase Private Debt allocation further if liquidity permits. Focus on "capital solutions" and specialists in fields that require expert underwriting (e.g., healthcare, emerging technology or portfolio financing).
Absolute Return	12.0%	15.0%	3.0%	—	• Higher macro volatility and stock market dispersion offer strong "cash-plus" return opportunities. • Allocate to multi-strategy funds for cash efficiency and enhanced risk management, as well as strategy specialists to shape overall portfolio balance and to enhance returns.
Hedged Equities	5.0%	5.0%	—	-2.0%	• Reduce allocation back to benchmark. We maintain an overall preference for Hedged Equities strategies compared to more directional strategies, given the ripe dispersion opportunity set within Emerging Technology especially from Generative AI.
Long Equities	30.0%	28.0%	-2.0%	—	• Underweight allocation reflects relative preference for income-generating lending strategies such as Liquid Credit and Private Debt. • Within equities, we maintain a balanced mix of factors, as well as regional and sectoral exposures.
Private Equity	18.0%	16.0%	-2.0%	1.0%	• Particularly high conviction in buyout managers that possess an ability to "buy complexity" and drive post-acquisition value creation. • Below benchmark allocation reflects the fact that it takes time to build a mature, diversified allocation to Private Equity. Continue to build to max allocation contingent on individual liquidity constraints.
Venture Capital	7.0%	5.0%	-2.0%	—	• Continue to build out VC allocations with focus on early stage as we have developed strong access and relationships to several top tier established and emerging managers in the asset class.
Inflation-Linked Bonds	5.0%	2.5%	-2.5%	—	• Near-term return outlook for ILBs is modest relative to the alternatives. • Skew allocation towards front end of the curve which is more responsive to near-term inflationary pressures.
Real Estate	8.0%	8.0%	—	—	• Focus on PERE managers due to favourable acquisition valuations and value-add potential – i.e., "buy-upgrade-sell". • Bias towards industrial (vacancies below 5.0% in most major markets) and digital infrastructure (surge in demand from AI adoption)
Total	**100%**	**100%**	—	—	
ENEB	66%	63%	-3.0%	0.0%	
Illiquid Assets	40%	39%	-1.0%	2.0%	

Source: *Partners Capital*

Portfolio Duration

Exhibit 3 below shows the portfolio-weighted duration resulting from allocations to Government Bonds, Credit, Private Debt and Inflation-Linked Bonds. It does not include other asset classes such as Property and Growth Equities because the statistical relationship between these asset classes and interest rates is less consistent. For US investors, if we reach the trigger to add 2% to government bonds from cash as discussed above, the weighted duration of the TAA will roughly match that of the SAA. GBP portfolios will have a duration of 1 year vs. 1.3 years for the benchmark and EUR investors will have 0.7 years duration vs. 0.9 years for the benchmark. This difference largely reflects the long market duration both Government Bonds and Inflation-linked Bonds in the UK and Europe compared to the US.

Expected Returns from 2024 TAA

In Exhibit 4 we summarise our 2024 return forecasts by asset class for our downside, base case and upside scenarios, as well as the long-term return that we expect to earn over the next 10 years. The short-term returns are for the 12-months starting 31 January 2024. In the base case, to which we assign a 60.0% probability, we expect the model portfolio TAA to produce a return of c. 9.0%. The heightened uncertainty puts an unusually wide error band around this. Specifically, in a lagged recession, we anticipate a decline of c.-10.0%, while in the upside scenario of a no landing, the portfolio is expected to rise c.14.0% - both scenarios are assigned a probability of 20%. Over a 10-year investment horizon, over which the benefit of diversification plays more of a role via active rebalancing, we expect the portfolio to deliver returns closer to c.+9.0% p.a.

Exhibit 3

Estimated look-through portfolio duration exposure by client currency

Asset Class	SAA	TAA	US		UK		Europe	
			Default Benchmark	Duration	Default Benchmark	Duration	Default Benchmark	Duration
Government Bonds	5.0%	4.5%	Barclays Treasury 5-10 Years TR	6.2	FTSE A British Govt All Stocks TR	8.8	Citigroup EMU GBI TR	7.3
Liquid Credit - IG	0.0%	0.0%	Barclays US Corporate BBB	6.7	Barclays Global Corporate BBB TR LC	5.8	Barclays Global Corporate BBB TR LC	5.8
Liquid Credit - HY	2.0%	5.0%	Barclays U.S. Corporate High Yield TR	3.2	50/50 Barclays Global HY / CS Leveraged Loan	1.7	50/50 Barclays Global HY / CS Leveraged Loan	1.7
Private Debt	7.0%	10.0%	Partners Capital Private Debt Vehicle	1.3	Partners Capital Private Debt Vehicle	1.3	Partners Capital Private Debt Vehicle	1.3
Inflation-Linked Bonds	5.0%	2.5%	Barclays U.S. TIPS TR	5.5	FTSE A (Index-Linked) British Govt All Stocks TR	15.1	Barclays Euro Govt Inflation Linked TR EUR	8.1
SAA Weighted Duration				**0.7**		**1.3**		**0.9**
TAA Weighted Duration				**0.7**		**1.0**		**0.7**
Duration Gap				**0.0**		**-0.3**		**-0.2**

Source: *Barclays, Bloomberg, Partners Capital*

Exhibit 4

Expected 12-month returns by scenario (starting 31 Jan 2024, includes alpha and beta assumptions)

Asset Class	Allocations			Short-Term, Scenario Specific Forecast (Inc. Alpha)				10-year Return Forecast (inc. alpha)
	2023 SAA	2024 TAA	Deviation	Downside (20%)	Base Case (60%)	Upside (20%)	Expected Value	
Cash	1.0%	1.0%	—	4.0%	5.0%	5.5%	**4.9%**	**4.0%**
Fixed Income	5.0%	4.5%	-0.5%	11.1%	3.3%	-4.6%	**3.3%**	**4.3%**
Liquid Credit	2.0%	5.0%	3.0%	-6.6%	7.3%	8.0%	**4.7%**	**7.0%**
Private Debt	7.0%	10.0%	3.0%	-5.1%	8.8%	9.5%	**6.2%**	**9.5%**
Absolute Return	12.0%	15.0%	3.0%	2.7%	7.9%	9.3%	**7.1%**	**7.3%**
Hedged Equities	5.0%	5.0%	—	-7.5%	8.3%	13.4%	**6.1%**	**7.5%**
Long Equities	30.0%	28.0%	-2.0%	-19.1%	9.0%	18.8%	**5.4%**	**8.0%**
Private Equity	18.0%	16.0%	-2.0%	-16.1%	11.5%	21.3%	**8.0%**	**11.5%**
Venture Capital	7.0%	5.0%	-2.0%	-17.4%	12.9%	23.6%	**9.0%**	**13.5%**
Inflation-Linked Bonds	5.0%	2.5%	-2.5%	4.0%	5.0%	2.5%	**4.3%**	**4.3%**
Commodities	0.0%	0.0%	—	-20.0%	4.0%	10.0%	**0.4%**	**4.5%**
Private Equity Real Estate	8.0%	8.0%	—	-7.0%	9.0%	11.5%	**6.3%**	**10.5%**
SAA	**100%**			**-10.1%**	**9.0%**	**14.6%**	**6.3%**	**9.1%**
TAA		**100%**		**-9.6%**	**8.9%**	**14.2%**	**6.3%**	**9.1%**

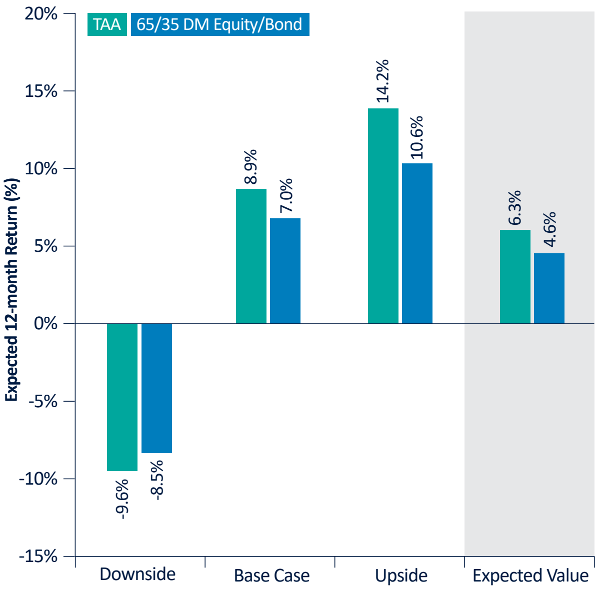
Note: *Short-term assumptions are for the 12-months starting 31 January 2024*
Source: *Partners Capital analysis*

Hypothetical return expectations do not represent actual trading and are based on simulations with forward looking assumptions, which have inherent limitations. No representation is being made that any investor will or is likely to achieve returns similar to those shown. Such forecasts are not a reliable indicator of future performance.

These portfolio return assumptions compare favourably to the expected return of a 65/35 mix of Developed Market Equities and Government Bonds. The respective returns are shown in Exhibit 5. We expect our 2024 TAA portfolio to outperform a 65/35 equity/bond index by nearly 2.0% in the base case and c. 3.5% in the upside case but will likely lag a 65/35 benchmark by c. -1.0% in recession due to the lower bond allocation. Relative to the SAA, the 2024 TAA is more defensively positioned, a result of the skew into yielding assets from growth sensitive equities. Essentially, the distribution of expected returns for the TAA has thinner tails than that of the SAA, meaning it has a higher probability of achieving our central expectation of c. 9.0%, and lower probability of an extreme positive or negative outcome.

Exhibit 5

Portfolio returns by scenario, Partners Capital TAA vs. a 65/35 Equity/Bond benchmark



Source: *Partners Capital*

Sub-asset class positioning

Within each asset class, we favour particular strategies or sub-asset classes. The asset class summaries at the end of this publication provide more detail on sub-strategy attractiveness and our strategic priorities for each asset class. Exhibit 6 below summarises our sub-asset class skews across each asset class.

Exhibit 6

Partners Capital sub-asset class positioning

Asset Class	Most Negative	Negative	Neutral	Positive	Most Positive
Cash, Fixed Income, Inflation-Linked Bonds, Gold, Commodities		— Inflation-Linked Bonds — Commodities	— German Bunds — UK Gilts — US Treasuries — Gold	— Cash (incl. low-duration government bonds)	
Liquid Credit	— Consumer Lending	— High Yield Bonds — IG Munis	— Leveraged Loans — Short Duration High Yield — EM LC/USD Bonds	— Commercial Real Estate Credit — Short Duration Lending — Asset-Backed Lending — Structured Credit	— Opportunistic/ Event Driven — Residential Mortgage Bonds
Private Debt and Uncorrelated Strategies	— EM Direct Lending	— Insurance — Life Settlements — Mezzanine Lending	— Royalties — Real Estate Lending — CLO Equity and Debt — Litigation Funding	— MM Direct Lending — Asset-backed Lending — Drug Trial Financing	— Capital Solutions — Specialty Lending (tech, healthcare)
Absolute Return		— Risk Premia — Reinsurance — Broad Event-Driven	— Convertible Arbitrage — Macro/Trading — Managed Futures/ CTA	— Fixed Income RV — Fundamental ELS (risk-managed)	— Statistical Arbitrage — Merger Arbitrage
Public Equities		— Traditional Generalists — Mid-Net Long/Short	— US Small Cap — Global EM	— Equity Market Neutral — Emerging Tech — Energy Transition — Japan	— Risk-Managed Beta-1 — Life Sciences
Buyouts	— Emerging Markets (ex-Asia)	— Large Cap Buyouts — Distressed/ Turnaround — Asia Buyouts	— Growth Equity — Secondaries	— Sector Specialist Buyouts — US Buyouts — European Buyouts	— Lower Mid-Market Buyouts — Complex Situations Buyouts — Co-Investment
Venture Capital	— China	— Late-Stage — Deep Tech	— Europe — Consumer Tech — Life Sciences	— US — Enterprise Software	— Early-Stage
Real Estate	— Office — Emerging Markets	— Hospitality — Retail	— Core-Plus Property — Multifamily — Infrastructure — REITs	— Industrial/Logistics	— Opportunistic (incl. Capital Solutions and Loans) — Digital Infrastructure

Source: *Partners Capital*

Partners Capital are not tax advisors. Tax treatment will depend on the individual circumstances of each client and is subject to change. You should consult your own tax advisor to understand the tax treatment of a product or investment.

Taxable Client Asset Allocation

All changes discussed above reference our central benchmark policy portfolio for a large non-taxable institutional investor denominated in USD. While some of these changes are relevant to our taxable clients as well, special consideration must be given to each client's tax situation and the nature of the underlying investment strategies in the portfolio.

For our tax paying clients, our goal is to maximize expected after-tax returns from a multi-asset class portfolio with a relatively high level of certainty. To do this, we have developed the following four Golden Rules of Tax-Efficient Investing:

1. Increase portfolio risk to reflect the dampening effects of taxation
2. Allocate across asset classes based on after-tax returns, volatility and correlations
3. Select asset managers based on a range of after-tax expected returns
4. Utilise tax efficient structures

The practical implications of the above golden rules will vary depending on the underlying investors status, location and objectives.

US Taxpayers: We believe the key drivers of post-tax relative performance outcomes are 1) relative tax-efficiency of active manager beta exposure (compared to its passive benchmark) and 2) expected alpha.

We believe active strategies may have a tax profile that is more punitive than passive alternatives. We calculate a 'breakeven alpha hurdle' to determine the level of pre-tax alpha necessary to outperform a manager's passive beta on an after-tax (both federal and state) basis. We then prioritise asset classes and strategies where our pre-tax manager alpha expectation is ahead of the breakeven hurdle.

Furthermore, we emphasise that investors maximise their illiquidity budgets within portfolio constraints, primarily to Private Equity and Private Equity Real Estate, given tax efficiency, illiquidity premium and alpha potential. We also recommend increasing allocations to asset classes, sub-strategies and managers with high Information Ratio and low 'breakeven alpha hurdles' relative to forward-looking alpha.

Within Credit, we recommend taxable investors focus primarily on passive strategies or opportunistic Private Debt where the illiquidity premium and potential for manager alpha is higher. In Long Equities, we target a core allocation to tax-managed and traditional passive strategies with complementary exposure to selective active managers that are benchmark aware and/or low cost. We are highly selective on Hedged Equites strategies and prioritise high total returning Absolute Return as the core alpha driver of the liquid portfolio.

UK Taxpayers: Unlike some other European tax regimes, the UK taxes capital gains, dividends and income differently. Strategies appropriate for non-taxpaying entities such as charitable endowments may not be appropriate for a tax-paying investor and vice versa. For UK taxpayers, as with the US taxpayers' portfolios, we believe the allocation should be skewed toward equities given capital gains tax treatment combined with a good menu of reporting status funds. We believe Absolute Return hedge funds should also receive a high allocation as they provide better after-tax returns than Fixed Income where we can find funds with reporting status or for truly exceptional performers where we don't mind paying the tax.

If you would like further information on optimising your portfolio for after-tax returns, there are whitepapers on this subject available on our website.