

A new way to allocate investment capital in Wealth Management

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Rethinking the IPS: shifting from traditional Asset Allocation to Strategy Allocation in Wealth Management

For decades, Strategic Asset Allocation (SAA), complemented by Tactical Asset Allocation (TAA), has served as the bedrock of the Investment Policy Statement (IPS) in Wealth Management. When onboarding High-Net-Worth (HNW) clients and family offices, wealth managers traditionally use this framework to define return objectives, risk tolerance and portfolio constraints.

However, as private markets evolve and client needs become increasingly complex, this traditional framework is showing its limitations. Most notably, it imposes rigid constraints that prevent wealth managers from efficiently expressing market views or even utilizing advanced financial instruments.

To better serve private clients, there is a growing paradigm shift from the rigid SAA/TAA framework toward a more dynamic **Strategy Allocation model**. This modern approach allows wealth managers to develop a more adaptable IPS - one that empowers them to fully leverage the precision and flexibility of sophisticated investment vehicles.

The bottlenecks of the traditional IPS framework

When an IPS is built strictly around SAA, it is fundamentally anchored to the long term. It assigns fixed percentage weights to traditional asset classes (for example: 60% Equities and 40% Fixed Income) to achieve targeted expected returns (in the long run).

The flaw in this approach is its heavy reliance on unpredictable, forward-looking variables—specifically, long-term average returns, volatilities and correlations. When subjected to Mean-Variance Optimization, the resulting client portfolio becomes hypersensitive to even minor shifts in the return assumptions (though there are ways to mitigate this).

To compensate for this rigidity, wealth managers use TAA to express shorter-term directional views. Yet, within a traditional IPS, TAA is tightly bound by strict drift limits around the SAA baseline. While it serves as the active management valve, it inevitably forces a reversion to the original SAA targets. This creates significant practical and psychological friction in private wealth management:

- **The rebalancing dilemma:** in a strongly trending market, strict IPS rebalancing parameters force managers to prematurely trim a client's winners, capping gains while an uptrend is still intact.
- **Behavioral friction:** conversely, it requires the psychological discipline—often a hard sell to a nervous client—to buy into an asset class while it is actively falling.

There is a clear need for an alternative framework to manage private wealth more effectively. Enter the Strategy Allocation model, an approach much better calibrated to the integration of modern private markets and structured products.

Modernizing the IPS: The Strategy Allocation model

Instead of confining a client's portfolio strictly by asset class, modern wealth managers are redesigning the **IPS to focus on the underlying maximum risk and the type of strategies being deployed**. Building on this philosophy, a modern Strategy-Based IPS typically categorizes investments into four core buckets:

1. **(Bi-)Directional Strategies:** growth engines designed to capture market trends and illiquidity. Three levels of liquidity might be considered such as “highly liquid”, “liquid” and “illiquid”. A separate liquidity pool that is not part of a broader strategy should also be maintained.
2. **Non-Directional Strategies:** yield-optimization and specialized absolute return engines.
3. **Diversified Strategies:** self-risk-managing, all-weather approaches.
4. **Anti-Shocks:** a dedicated risk-control bucket focused strictly on wealth preservation and tail-risk hedging.

The first three categories form the portfolio's "active return" engine. Because market risk primarily stems from the directional and non-directional buckets, the **Anti-Shock** bucket acts as the portfolio's crucial defense mechanism.

Structuring an IPS this way makes it easier to align the portfolio with the investor's actual objectives and liquidity events, rather than arbitrary benchmark constraints. Crucially, the wealth manager's true market views take center stage and tailored use of derivatives can be applied with greater nuance and flexibility.

Example of implementation within a Strategy-Based IPS: the (bi-)directional strategies case

For the bi-directional active, return-seeking portion of the portfolio, wealth managers can utilize an **optimizer based on maximizing the Calmar Ratio in particular**, with the capacity to unlock highly bespoke approaches from the liquid and **highly liquid** segments. The latter refers essentially to the use of futures markets that can easily implement a short exposure. With the Calmar Ratio ($\text{Average Annual Return} \div \text{Maximum Drawdown}$), the focus is on the Maximum Drawdown (the biggest percentage loss) - a risk measure much more appropriate than the common (standard) volatility. For the user, it means targeting either an annual return or a Maximum Drawdown. These targets exhibit greater stability over time, significantly reducing the need for frequent rebalancing.

Conclusion

By transitioning the IPS from a rigid matrix of asset classes to a dynamic Strategy Allocation model, wealth managers can break free from the limitations of traditional rebalancing. This modern framework aligns perfectly with the use of new strategies – considering a larger palette of vehicles and allowing advisors to build highly resilient, customized portfolios that directly target the return and risk dimensions while enabling them to effectively implement market views. This topic will be addressed during the Progressive Wealth Management course taking place this December.

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