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Discretionary **M**anagement **S**ervices, LLC

GTAA Investment Process Insight: "Supercycles"

By Tom Woolwine, President, March 2014

In the first phase of our GTAA investment process, we set our global asset allocation policy. After establishing goals/objectives and defining benchmark targets/ranges for client portfolios, the portfolio management team evaluates economic and market conditions. They rely on DeMarche's strategic forecast developed by the Asset Allocation Committee. This incorporates proprietary "supercycle" analysis which identifies differences in the interaction and performance between asset classes.

DeMarche defines a "supercycle" as a series of bull-to-bear market cycles that oscillate around a longer-term pattern of improving and slowing rates of economic growth. Correlations between U.S. large cap stocks and other primary asset classes also change based on the cycle. Typically one or more key underlying demographic factors are manifesting themselves in market behavior. DeMarche research has identified two supercycle types in the U.S., which we describe as "high growth" and "moderate growth." There have been six supercycles since 1900 (three high growth, three moderate growth). We have been in the current moderate growth supercycle since 2000 and some of the strategic implications for asset allocation decisions are:

- Lower returns for the stock market in the near term
- P/Es constrained/trend below long-term average
- GDP growth below long-term average
- Volatility of risky asset classes likely higher
- Correlations of risky assets trend higher
- Illiquid asset classes more likely to see crisis

Past supercycle durations have ranged from 12 to 20 years. This supercycle has not yet resolved the impact of high levels of consumer and fiscal debts, nor demographic challenges from aging populations.

The conventional approach to asset allocation policy uses inputs based upon longer-term history. Typical models assume normalized average future outcomes in equilibrium state. In contrast, Dynamic investment policy can allow consideration of strategic expectations (3-5 years) in concert with long-term secular traits. We recommend clients rebalance within policy framework more often and restructure as supercycles change. The DMS GTAA service provides the means to implement those recommendations.

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