

Blending managers: From style diversification to scenario diversification – a new framework for adviser portfolio design

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The limits of traditional diversification

For decades, portfolio construction has been anchored in style diversification: growth versus value, local versus global, defensive versus cyclical. Yet markets do not operate in styles; they operate in scenarios: inflationary spikes, liquidity droughts, policy reversals, or exuberant risk rallies. But scenarios often defy the stylistic boundaries that advisers rely on.

Today's challenge is not simply to hold a variety of managers, but to ensure that each one performs a role in distinct market conditions. Diversification by scenario is not about holding more funds — it's about holding funds that respond differently when markets change regime.

The market scenario framework

Every investment portfolio ultimately faces four dominant regimes:

1. **Calm and Range-Bound Markets** – Low volatility, narrow leadership, income strategies thrive.
2. **Expanding Bull Markets** – Broad participation, growth bias rewarded.
3. **Volatility Spikes/Corrections** – Correlations converge, liquidity vanishes, behaviour dominates.
4. **Prolonged Bear Markets** – Capital preservation, cash flow stability, and psychological resilience determine outcomes.

Each of these environments rewards a different type of manager. Instead of blending by factor exposure, advisers can design portfolios that breathe — each sleeve contributing to defense or growth as regimes evolve.

Manager archetypes across scenarios

Table “Diversification for all market scenarios” recognises that no single manager excels in all regimes — *resilience comes from complementarity, not duplication.*

Diversification for All Market Scenarios

Strategy	Key Attributes	Falling Market (Inc. Large Market Falls)	Volatile Market	Stable Market	Rising Market
Diversify risk – Conservative/Growth Mix	Relies on correlation spread across asset classes	Unfavorable – Correlation often rises in crisis	Unfavorable – Capital losses	Favorable	Favorable
Occasional Protection via Predictions	Requires accurate timing to be effective	Unfavorable – Exposed if wrong	Unpredictable – Gains/Losses	Favorable	Favorable (May be Capped)
Protection Always in Place – Absolute Return (Cyrostat)	Non-correlated beta with embedded put protection; thrives on volatility	Very favorable (Class A), favorable (Class B)	Favorable (Class A), very favorable (Class B)	Less Favorable (Lower Return)	Favorable (Mitigated Upside)

Table is a simple matrix showing four market regimes and three manager archetypes:

- Growth/Beta managers
- Income/Option managers
- Risk-Managed/Defensive managers

From style to scenario diversification

This framework reframes diversification from a static mix of styles to a dynamic alignment of roles. Each manager type contributes differently:

- **Growth/Beta managers** capture long-term compounding in expansion phases.
- **Income/Option managers** provide cash flow stability and smoother participation during moderate volatility.
- **Risk-Managed/Defensive** managers preserve capital, control drawdowns, and support reinvestment capacity after stress events.

By understanding the interplay between these archetypes, advisers can construct portfolios that retain intent across regimes, instead of relying on luck or timing.

Behavioural Implications – Matching Strategy to Investor Psychology

Loss aversion peaks when portfolios are in withdrawal mode. Sequencing risk converts volatility into permanent capital loss. In that stage of the investor lifecycle, protection is not optional — it is structural.

Scenario diversification helps advisers map the investor's emotional cycle to the market cycle:

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|-----------------------|--------------------------|-------------------------|
| - Accumulation | → volatility tolerance | → growth exposure |
| - Transition | → anxiety rising | → balanced exposure |
| - Retirement | → loss aversion dominant | → structural protection |

Conclusion – designing portfolios that breathe

Traditional diversification assumes markets move linearly. They don't — they pulse. Scenario diversification accepts that every market environment has its own winner, and that true portfolio mastery lies in anticipating the shift between them.

“The future of portfolio design lies not in choosing the best manager — but in blending the right ones for the next scenario.”

Closing reflection:

For advisers seeking to evolve beyond static model portfolios, scenario-based blending offers a way to integrate structure, psychology, and performance — transforming diversification into design.

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