What Is tactical asset allocation (TAA)?

If you are an equity investor, you might have been disheartened by the dismal performance of the market in the last few months. Even equity mutual funds and hybrid funds have borne the brunt of the market's wrath, sliding in value in a volatile market, with debt funds being one of the few schemes managing to escape largely unscathed. However, multi-asset funds and other mutual funds following a tactical asset allocation strategy would have been better poised to weather the storm, due to the fund manager's ability to steer the portfolio towards safer shores. If you are keen on knowing more about this strategy and making it a part of your investment portfolio, here is all you need to know.

What is tactical asset allocation?

The term tactical asset allocation or TAA indicates an active portfolio management strategy which enables fund managers to change asset allocations in an attempt to take advantage of, or safeguard from market trends or economic scenarios. For instance, a fund manager following the tactical asset allocation strategy would have shifted a large part of the corpus from equity and equity-linked securities to debt and money-market instruments to avoid the bloodbath in the equity market and ensure stable returns for investors. Therefore, TAA enables fund managers to adjust the underlying scheme's allocation to stocks, bonds, cash and other market-linked securities, in line with macroeconomic trends and market volatility, thus ensuring greater stability even in uncertain scenarios.

In simple terms, when a fund manager follows the tactical asset allocation strategy, their first focus is on asset allocation, with the selection of securities coming in at second place. Such fund managers keep an eye on the bigger picture, or macroeconomic trends and are of the opinion that asset allocation plays a greater role in portfolio returns than the actual selection of securities. Accordingly, their end goal is to adjust the portfolio in a way that a larger portion gets allocated to asset classes which are likely to perform better in a particular scenario. It is important to note that TAA is usually practiced in short-term market conditions, rather than as a long-term strategy. Let us now consider why you should opt for this strategy in your investment portfolio.

Reasons for tactical asset allocation

- *Capitalising on market opportunities:* Tactical asset allocation allows you to take advantage of short-term market opportunities. By making adjustments to your portfolio, based on current market conditions, you have the ability to potentially increase your returns. You can also limit your exposure to poorly performing assets, without altering the underlying strategy.
- *Risk management*: By adjusting your portfolio in line with market conditions, you can manage risk in an optimal manner

while potentially reducing the impact of market downturns, such as the one we are currently experiencing.

- *Adapting to evolving market scenarios:* If markets can be defined in one word, then they can be called volatile. Markets are constantly changing and tactical asset allocation allows you to adapt to these changes. This can be particularly useful in times of economic uncertainty or volatility.
- *Optimal flexibility:* Tactical asset allocation provides you with the flexibility to adjust your portfolio based on your current investment goals and risk tolerance, while also helping you navigate the uncertainties in the market.
- *Strategic diversification*: By investing in a variety of asset classes, you can achieve greater diversification and potentially reduce risk. Tactical asset allocation allows you to adjust your portfolio's asset allocation to achieve this diversification.

Tactical asset allocation within an asset class

While TAA is frequently used to manoeuvre between different asset classes, it is also possible to apply the strategy within a single asset class. Let us consider the example of equities to better understand this aspect. In this scenario, TAA within a single asset class would involve adjusting the allocation of different types of stocks based on short-term market conditions. For example, you may choose to adjust your allocation between growth and value stocks, or large cap and small cap stocks, based on your market outlook. You also have the ability to adjust your allocation between domestic and international stocks, in line with market trends and forecasts. Target asset allocation within a single asset class can be leveraged to potentially increase returns or manage risk.

Similarly, you can also undertake TAA in the form of percentages, if you wish to allocate your assets across multiple securities within a particular asset class. For instance, if your portfolio comprises of 40% equities, you can use TAA and divide it into 25% large-cap stocks, 30% mid-cap stocks, 20% small-cap stocks and 25% foreign stocks, in line with your personal investor profile. A similar approach can be utilised for debt asset allocation too, wherein you can divide your fixed income portfolio into government bonds, PSU bonds, AAA-rated corporate bonds, AA-rated corporate bonds and commercial papers.

Now that you have a clear understanding of tactical asset allocation, you may be in a better position to weather market volatility efficiently and work towards availing stabler returns in various scenarios.