There is a term called—“The Fog of War”. It means the large uncertainty experienced in military operations during a war. Hence, the use of the word “fog”—which clouds judgment in such scenarios. The current Covid-19 pandemic has also been termed as a ‘silent war’ by various heads of states. It has truly been an unprecedented or black swan event, and created large amount of uncertainty in the short to medium term. To add to that, there have been several recent events that have not been seen in a long time or never been seen before. Some of these are:

- Oil prices turning negative intermittently.
- Due to lock-down, US unemployment touching levels (of ~15% in April) last seen post the end of the Great Depression era.
- Due to the stringent lockdown in India, unemployment rate spiked to record high of 27% in early May as per data from CMIE—implying ~12 crore jobs lost already.
- International agencies project the worst global recession in 2020, since the Great Depression era. India’s GDP projected to grow at a flatish rate, and some even expect GDP to contract in FY21, which would make it the worst GDP growth rate in India since late 1970s. However, a healthy recovery in GDP growth expected in India and globally, the following year.
- Global bond yields (of several developed countries in Europe & Japan) falling sharply and turning negative. US yields have also fallen sharply and short-term treasury yields now approaching closer to negative territory.

Of course, there is quite a bit of uncertainty on how these projections pan out, as this is still a developing situation, and lot of moving parts or variables are involved. The sharp spike in unemployment rates may also soften to some extent once the economy opens-up, but not likely to go back to pre-pandemic levels anytime soon. As a result of the severe economic stress and a health crisis, governments around the world have announced record-high economic stimulus packages to deal with the Covid-19 pandemic. India too recently announced a mega economic stimulus package of Rs 20 trillion (or 10% of India’s GDP).

The importance of asset allocation in times of uncertainty/volatility
In times of uncertainty or market volatility asset allocation approach of investing gains favour. Asset allocation means diversifying into different asset classes (of various risk profiles), as per underlying risk profile and investment horizon of the investor. Different asset classes provide varying returns over different time periods/years (from large negative returns in some years to large positive returns in some years). This is highlighted in the table below.
It would be prudent to have a mix of different asset classes in your portfolio, to diversify risk (as per investor’s profile). Asset allocation should also be reviewed/re-balanced from time to time, depending on market conditions/movement and outlook.

**How ULIPs can help in managing your asset allocation**

ULIPs can be an effective tool in planning your asset allocation, as there are various types of funds available to investors like equity funds (large-cap, mid-cap, index), debt funds, liquid funds and even asset allocation funds (mix of equity & debt). One of the biggest advantages of ULIPs is that the investor can switch between various fund options without any capital gains tax incidence, and can switch as many times—without any additional charges or any exit load. This helps an investor to plan their asset allocation in a more efficient and tax-friendly manner, and this tax advantage is not available in other competing investment products.

We also recommend that investors can use a goal-based approach to asset allocation. Suppose one has a 10-year investment goal; since the investment horizon is longer—the investor can start off with higher allocation to equities and gradually start reducing equity allocation and switching to debt/liquid fund, as they approach the maturity term of their policy. This will help to protect the wealth created from investing in equities over the long term (in case of a market downturn) before maturity of the policy—and help the investor in meeting their investment goal. Novice investors, who find it difficult to choose their asset allocation mix can also consider an Asset Allocation Fund in volatile times, where the debt-equity mix changes, depending on fund’s manager’s market outlook.

**Conclusion:**

The Indian and global markets have seen a sharp correction due to Covid-19 pandemic (Nifty 50 index was down ~39% from the peak at one point), followed by a swift partial recovery. With the market correction, valuations had turned quite attractive, and the risk-reward / margin of safety for equities also became more favourable. Therefore, we have been advising long-term investors to gradually deploy money in equities & increase their equity exposure (as per their risk profile). Historical data shows that
investment made in challenging times (or market downturns) have been quite rewarding for investors over the medium to long term.

However, as we know, it's difficult to predict the bottom & top of markets accurately. We may see some more short-term market volatility if Covid-19 cases continues to escalate; and past major market downturns have usually seen 2-4 waves of correction—followed by market recovery.

Therefore, in these times of uncertainty, it might be prudent for investors to use an asset allocation approach in investing, and diversify their portfolio. As famed investor, Sir John Templeton had once said -- “The only investors who shouldn’t diversify are those who are right 100% of the time.”

Disclaimer: “The opinion expressed by the Author in this article is his personal opinion and readers are advised to seek independent financial advice before taking any investment decisions”.