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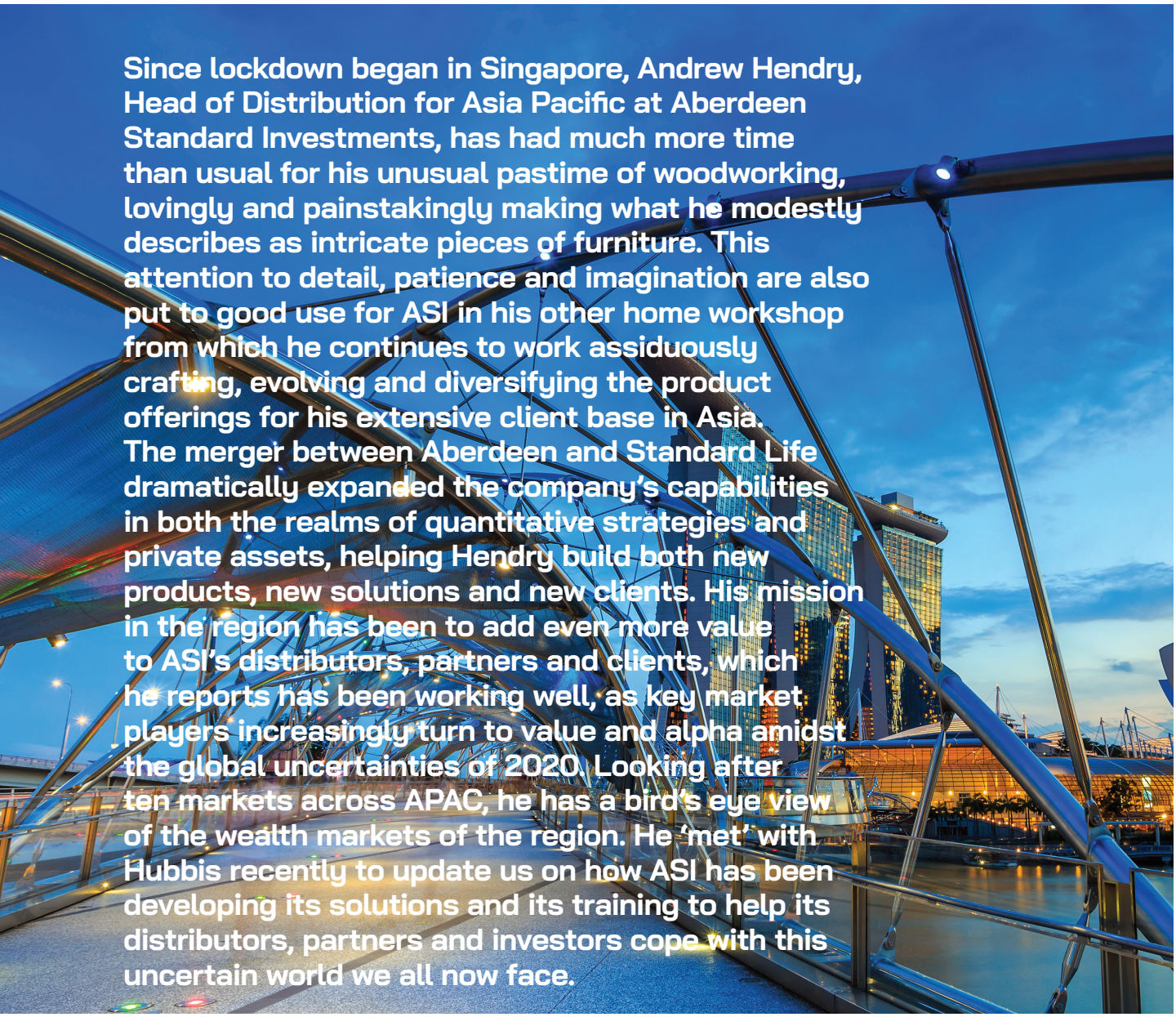
ASI's Andrew Hendry on Crafting the Right Investment Products for Challenging Times



Since lockdown began in Singapore, Andrew Hendry, Head of Distribution for Asia Pacific at Aberdeen Standard Investments, has had much more time than usual for his unusual pastime of woodworking, lovingly and painstakingly making what he modestly describes as intricate pieces of furniture. This attention to detail, patience and imagination are also put to good use for ASI in his other home workshop from which he continues to work assiduously crafting, evolving and diversifying the product offerings for his extensive client base in Asia. The merger between Aberdeen and Standard Life dramatically expanded the company's capabilities in both the realms of quantitative strategies and private assets, helping Hendry build both new products, new solutions and new clients. His mission in the region has been to add even more value to ASI's distributors, partners and clients, which he reports has been working well, as key market players increasingly turn to value and alpha amidst the global uncertainties of 2020. Looking after ten markets across APAC, he has a bird's eye view of the wealth markets of the region. He 'met' with Hubbis recently to update us on how ASI has been developing its solutions and its training to help its distributors, partners and investors cope with this uncertain world we all now face.

ANDREW HENDRY
Aberdeen Standard Investments

"We acknowledge that equity can be a volatile asset class. However, history shows that returns have compensated investors for taking on equity risk. When markets turn volatile, dividend-paying stocks offer investors an income as they wait for the markets to recover. One key factor is that dividend-paying stocks offer opportunities to capture both yield and capital growth. It's why we believe that a disciplined approach to managing a global equity portfolio will offer attractive risk-adjusted returns over the long term."

Where have we come from and where are we now?

The fixed income party's over. People have made relatively easy money over the past decade by being in fixed income, benefitting from that magic duality of decent yields plus incredibly low rates for employing leverage. But due to that ideal combination, investors have become quite lazy about asset allocation. But that all came to an end in February this year.

In terms of quantitative evidence, you can see that fixed maturity product (FMP) launches that used to be in the billions are now stretching to get one or two hundred million dollars as appetite has dropped away significantly due to the low yields now. And whereas before investors might instead of FMP gone for US high yield or other fixed income seeking yield, there is a major question now whether that's a good place now for money from a timeframe viewpoint.

Additionally, there is for the first time in ages the spectre of inflation, and certainly we see certain sovereign wealth fund clients starting to be concerned about that, as well as the central bankers.

In a July report, Mercer produced titled Beware of Deflation, the firm commented how the combination of events this year had led to a significant rise in short-term inflation estimates across the globe. Mercer reported that forecasts by leading investment banks and research firms see inflation in major economies, with the exception of China, falling by half in 2020 from 2019 levels, and in some cases, by even more. However, they reported that following unprecedented monetary and fiscal policy action, concerns have resurfaced regarding the possibility of a resulting increase in medium- to long-term inflation. And it is worth noting that even before the pandemic hit, the Fed had already been considering a shift to average inflation projections.

Add to this, there is much more persistent volatility, and combined with the uncertainties that we all see, investors, particularly individuals, have been redeeming equity exposures as they have been, quite naturally, somewhat frightened, so we saw redemptions from our funds, and despite the bounce in the markets, this has not been reversed.

All this means that the mentality must change, people need to reset their expectations, and then reset their portfolios.

Taking fixed income, is there a strategy you are promoting to manage inflation?

Inflation-linked bonds are a smart way to stay in fixed income and enhance returns in the event of inflation, which we believe is more likely than not to rear its head sooner or later. From our perspective in the institutional markets as well as wholesale markets we know for a fact people have not paid due attention to the potential for inflation. We concede that in certain European territories it is tough to make a case for impending inflation, but of course in Asia and indeed of course in certain countries in Latin America inflation is far more likely, in fact in China, wage inflation is phenomenal.

So, what does all of this mean directly for ASI's business and how are you adapting your products to the new normal and the anticipated environment?

I can answer that by referring to our work with an institutional client in the US. They are concerned about achieving long-term equity appreciation whilst hedging against dramatic downturns, so we created a global risk mitigation strategy which takes a whole number of components to essentially protect equity positions against dramatic downturns in the market and indeed even making more money as the market more aggressively collapses. I can report they are a very happy client as this strategy had been in place well before 2020.

After a decade of quantitative easing, yields have been pushed into negative, and often unknown, territory, resulting in a situation where government bonds provide virtually no return while still having considerable duration risk. In this situation, a number of investors have concluded that they can't simply allocate to a defensive asset, such as bonds, but that they have to take a different approach altogether.

Instead of a defensive asset that still offers some positive return in its own right, these investors look for an outright hedge to their equity exposures. They look for instruments that are explicitly negatively correlated with equities. Our Alternative Investment Strategies division at ASI has created an approach and they run a so-called 'risk mitigating' strategy that aims to achieve a correlation of -0.2 with equities.

"In terms of active versus passive, passive is going to rise consistently, but that does not mean active is not the place to be. The data has shown that this year USD200 billion of outflows from active managers and roughly commensurate amounts going into passive index funds, ETFs, which are so easy to access, there is no AML or KYC required, and they are deep and they are liquid and they are priced efficiently now, whereas in previous years that was actually a hindrance."

Having an explicit target for the strategy's correlation with equities gives investors the predictability they need to construct robust portfolios. We commit to that -0.2 target and we can be greater than that if we let the convexity in the portfolio run and increase the hedges as the market goes down. Having an explicit correlation target in place means the team will start to rebalance the portfolio once the portfolio starts to stray from it. This periodic rebalancing not only gives predictability, but also helps locking in gains.

As a result of this approach and its success, we have been building out the knowledge of this strategy with clients across APAC, and of course they are very receptive to such an approach. People's savings plans across APAC have been severely disrupted, due to market conditions and economic fragility, so people have in many cases drawn down from their pensions. This makes our mitigation strategy even more valuable, as the strategy allows such investors to remain invested, and to have the confidence to keep their money working.

We also have another strategy due for release this month in the form of our Global Dynamic Dividend strategy. The whole idea here is to achieve plain vanilla global equity exposure and with that targeting a monthly premium dividend yield plus potential capital growth. We just go around the world harvesting dividends from companies paying regular and special dividends. We have great expectations for this at a time when yields are so low and the search for income is so intense. This allows people to have equities as a core exposure again, to achieve a high income and to hedge themselves against inflation.

But can companies continue to pay out such dividends in this challenging environment?

Despite numerous companies delaying or cutting their dividends to ensure a sufficient capital buffer to counter the impact of the coronavirus pandemic, there remains a large, global universe of stocks that continue to pay out. The pandemic has affected industries and sectors differently. Some are better placed or able to adapt

than others. The dividends of companies operating in sectors such as technology, health care, consumer staples and materials have proved more resilient during this Covid-19 chapter than banks, insurers, automakers and property developers.

We analyse thousands of companies and have drawn up a buy-list of more than 1,100 stocks. We can see the companies best able to sustain their earnings and/or that have sufficient reserves to maintain dividend payouts. Despite a challenging market environment, there remains ample opportunity for investors to find companies able to continue paying dividends. And equity is one few asset classes where investors can still find attractive yields, especially important as trillions of debt now are negative yield and the global demographic shift of ageing societies equates to more people seeking income to fund their retirements. In Asia especially, we have seen strong demand for income funds, and we expect this trend to continue.

We acknowledge that equity can be a volatile asset class. However, history shows that returns have compensated investors for taking on equity risk. When markets turn volatile, dividend-paying stocks offer investors an income as they wait for the markets to recover. One key factor is that dividend-paying stocks offer opportunities to capture both yield and capital growth. It's why we believe that a disciplined approach to managing a global equity portfolio will offer attractive risk-adjusted returns over the long term.

We use various screens to alert us to companies that pay regular dividends or are about to pay a special dividend. In this way we are able to draw up a shortlist. We run screens weekly and study each opportunity in relation to all the dividend opportunities we could look to trade on. In this way we look to understand the full breadth of opportunities available.

But is there any underpinning to equity values in this forthcoming dividend strategy?

The choice of stocks will be driven by the usual ASI equity research approach- what is different is the dividend capture. The understandable concern is dividends coming down due to the economic fallout, however the facts address this issue: the bottom-line is that USD400 billion of dividends were paid out in just quarter 2 this year, and we project solid dividend returns ahead.

Investors are now struggling with fixed income, so this addresses income plus the spectre of inflation.

What does all of this mean to your distributors in this Asia-Pacific region and how are you reaching out to them and communicating the ASI strategies?

Firstly, for distributors it is a positive time in some respects, because they can really have things to talk about with the clients, and because there has been so much paralysis, this situation offers the opportunity of a call to action.

But due to the global conditions and the uncertain outlook, the advisors need to be more informed, especially about inflation, equities and so forth, as really it has been a whole generation of relationship managers out there who have really only been fixed income sellers from a mutual fund perspective. So, in many ways it is quite exciting for distributors.

As to how we support our distributors and partners, we work hard on education, training and other initiatives for their advisors, and we have expanded that as it is really important to refine what we're all saying about the products and to be relevant to distributors, so they in turn can be highly relevant to their clients. And we tailor the messages to the audience, of course, whether the end clients are HNWIs, UHNWIs, or perhaps retail or mass affluent. So, we as a firm are highly conscious of needing to modify how we help our distributors.

As to particular types of clients, of course the global private banks as distributors offer the biggest opportunity, due to their scale, so time spent with them is leveraged much more efficiently. But we also pay great attention to, for example, the retail universal banks across the region whether in Indonesia, or Thailand, and to the significant and growing independent wealth community, multifamily offices, and others.

We are very lucky on that front, because unlike many of our peers we actually have on the ground offices meaning our ability to connect easily, even face to face with them across APAC continues relatively well, whether it is teams sitting in Jakarta, Bangkok, Kuala Lumpur, Taipei or Australia.

We are also building out the discussions with insurance companies and tailoring the communication to the needs

of what could be hundreds of thousands of smaller investors connecting to those insurers through thousands of agents.

But whether bespoke strategies for HNW and UHNW clients, or perhaps simpler products for mass affluent investors, the fundamental benefits of what we're doing from an investment standpoint are the same.

In brief, where does ASI see that portfolios should be heading in the foreseeable future?

We see areas of structural growth in China, particularly as it relates to the increased spending power of the nation's burgeoning middle class. We believe higher disposable incomes will spur demand for health-care products, wealth management services and insurance. Structural growth drivers such as the adoption of cloud applications, 5G and artificial intelligence also remain intact. In addition, China's A-share market remains dominated by retail investors, who tend to be influenced more by prevailing sentiment and news headlines than companies' earnings prospects. This presents opportunities for investors to capitalise on stock mis-pricings. They can find companies in this market with strong footholds in their industries that are increasingly adopting international management practices and ESG principles.

In essence we are finding value in emerging market debt, in global linkers and private markets, specifically infrastructure and real estate. In terms of our outlook for equity markets, it is neutral. But you must be invested, you should not be underweight.

You have to be active nowadays, because while passive exposure to indices has worked pretty well over the last 10 years, it does not now, as the crisis has started to undermine the long-term sustainability of certain companies, meaning far greater selectivity is needed. The most extreme example is our small-cap strategy, which has outperformed the benchmark by 23.9% year to date.

Passive funds can't avoid weaker companies because they hold everything, good and bad. Asian markets as a whole are also a lot more inefficient than developed markets, partly because of their far lower level of analyst coverage and also due to the composition of investors in each market.

Active investors that focus on the strengths of companies' underlying fundamentals will be best placed to exploit these mispricing opportunities. Investors should analyse companies' balance sheets, debt maturities, cash flows and the long-term sustainability of their strategies. Considering risks and opportunities around environment, social and governance (ESG) factors will also be important. We have found management teams able to discuss key risks and how to mitigate them are the ones that have avoided blow-ups and created shareholder value.

Active management and owning quality remain the best way to mitigate risks. Quality companies with strong balance sheets, low levels of debt and competitive advantages will be better placed to sustain their earnings.

In short, we believe that active management is back on the top of the heap. For example, if you're going into China, head to our USD4 billion China A Share fund, where it is clearly paying off to be active there as opposed to passive. If you're going to emerging markets or you are going to European equities being active is paying off nowadays, and we have plenty of evidence to prove that.

Clearly ASI is a proponent of alpha, but can you give us more insight into the world of alpha, beta, smart beta right now from your perspective?

Smart beta has a big question mark hanging over it, because last year and the year before large players in the 'quant' strategies had a very bad time. A lot of the factors used in constructing smart beta strategies simply failed, and the numbers were hundreds of basis points behind the standard benchmarks.

In terms of active versus passive, passive is going to rise consistently, but that does not mean active is not the place to be. The data has shown that this year USD200 billion of outflows from active managers and roughly commensurate amounts going into passive index funds, ETFs, which are so easy to access, there is no AML or KYC required, and they are deep and they are liquid and they are priced efficiently now, whereas in previous years that was actually a hindrance.

So, I am not a detractor of passive if applied properly. But active strategies are ideal for alpha generation, and that is where we are seeing good progress this year, despite a bad year overall. Our numbers show active performance offering a compelling performance increment for the past three years

in fact. Even if it is only perhaps 60 basis point outperformance on average for each year, when compounded up, it is a great story.

In short, I think that's where you will continue to see this bifurcation with continued heavy use of passive, particularly in areas where you cannot deliver sustained alpha and then the selection of active managers and strategies in areas where we can truly deliver value.

So, you don't see the world of passive as the great enemy for ASI?

No. As an industry, flight or fight. Yes, passive is currently eating into active managers' share, but on the flip side if you look at the global exposure of individuals to long term savings activities, whether it's mutual funds, pension funds, insurance, whatever it is, is people just don't save enough. We see the pensions gap in the UK and in Europe and of course that is now the same and increasing across Asia, where the demographics, especially in China, show ageing demographics accelerating rapidly, meaning the total pie must increase somehow.

We agree that for certain areas it is better to just go passive and not overthink it. But then in certain other areas you need to go active because the materiality of the uptick in performance behoves you to do it so if you're an advisor worth their salt, or an end client.

In short, the global population has more than enough room at the table for passive and active players and, by the way, we are actually in the ETF business. We have a whole range of precious metal ETFs and they have been selling like hotcakes as you can imagine since folks have been enthusiastic about gold and palladium this year.

What are your key priorities for the year ahead, whatever that might bring amidst the ongoing pandemic?

Hendry: Fundamentally we want to evolve the conversation with distributors, so that hopefully the end clients out there, the individuals, are at least on the curve if not a little bit ahead of it. That is the fundamental thing that we're focusing on and the teams are focusing across Asia-Pacific.

The second piece is that as a firm we are boosting our digital capabilities, focusing on digital wealth discussions with our distributors, not in competition but to support them. We have some great platforms in the UK, such as Wrap, Elevate and Parmenion that support advisors in finding solutions for their clients. These platforms and the technology behind them have proven how we can increase advisor's efficiency at generating recurring revenues in the face of regulatory changes and simultaneously deliver the actual returns which the end client targeted. There are a lot of risk-return models out there but few have a public track record of a decade and over USD10 billion in client assets as proof positive of delivering what clients and advisors need.

Finally, is ASI now firing on all cylinders in APAC?

Yes. Since the 2017 merger of Standard Life and Aberdeen Asset Management we now offer a far wider array of products, expertise, talent and reach. Aberdeen was always really well known as a very active emerging equities firm, especially for Southeast Asia and broader Asia-Pacific. And Standard Life brought in a wide array of opportunities within multi-asset and the private markets area, including private equity, infrastructure and real estate.

The merged company now has a vast quantitative strategies business, whether smart beta, index or enhanced index, with some USD5 billion in that area. The firm is the first in the world to launch an active quant strategy with artificial intelligence as part of the investment process.

In short, we are a very different and a considerably more expansive proposition for our clients than we could offer before. We have the same history of expertise and quality as when we were just Aberdeen or Standard Life, but we have developed significantly from the organisation that people knew two or more years ago. We have a lot to offer, and our distributors and partners are seeing that on a daily basis. Markets and economies are in turmoil, but ASI is making headway in all the right areas. ■