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Asian HNW Clients expected to significantly move towards Managed Investments

Nobody on planet earth yet knows the course of the pandemic, or fully understands the implications for government, corporate and personal finances. Although the equity and debt markets have recovered a considerable amount of ground they lost in the torrid market conditions of February and March, it is obvious that volatility will remain relatively high. Hubbis took the temperature of leading wealth management experts in the region in our weekly mini survey, to find out what they consider to be the next phase for Asia's wealthy investors, as the world struggles to escape the straitjacket of this pernicious virus, and also how the wealth management community might respond. There appears to be a strong consensus amongst these professionals in Asia that the tide should turn against HNW and UHNW clients' long preference for self-directed investing. But could that be simply wishful thinking on behalf of an industry that in the face of falling fees is increasingly eager to promote discretionary or managed investments, and advisory mandates?

Like the famed British weather, the outlook for global financial markets in the next year to 18 months is unpredictable. The experts we surveyed, while eschewing exact predictions for indices around the world, expect continued anxiety amongst investors, driven by record national and central bank borrowing, shockingly high unemployment, and falling consumption as individuals and companies hold on to whatever cash they have.

There will naturally be exceptions – for example online retailing, foods and staple products, Big Tech, big pharma, precious metals and so forth, but the world at large will continue to suffer. Moreover, the fallout could be frightening, as civil unrest and crime escalate, intimations of which we have already seen unfurling in the US and, in sympathy, across the globe. And geopolitical tensions, and trade wars could potentially turn even more lethal.

In face of all this, it is little surprise therefore that our survey respondents generally caution investors to hold on to invest with care, retain liquidity as a defence or as better opportunities unfurl, reduce leverage, and re-define then re-shape portfolios.

One concerned respondent pointed to the significant potential for global recession and a sharp correction in markets in the next 18 months, causing huge rises in unemployment in the US and in other major economies, as well as potentially exacerbating the US-China trade conflict. He warns that, even today, the trailing price earnings (PE) multiple stands at 22 in the US market, which is higher than its highest level in the 1960s.

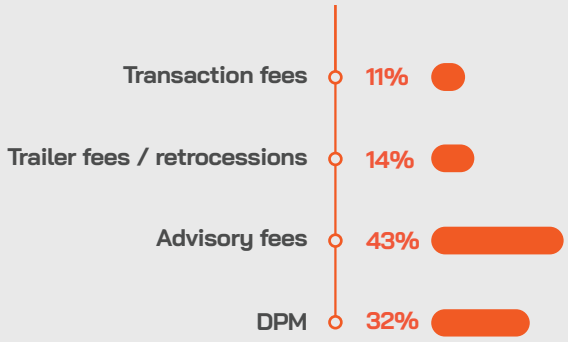
Leverage should decline further for well-disciplined investors, especially as risks become more apparent. One reply indicated that a V-shaped recovery is nigh on impossible. "The economic recovery will be slow," they commented, "and asset prices will surely adjust to reflect a far slower return to normality than most seem to expect."

"Much will depend on the election cycle in the US, the future of the EU

75% OF WEALTH MANAGEMENT PROVIDERS WILL EMPHASISE DPM AND ADVISORY, WHILE JUST 25% WILL FOCUS ON TRANSACTIONAL AND PRODUCT-RELATED FEE INCOME

75% of wealth management experts we canvassed evidently believe as providers they should be aiming to shift their Asian HNW and UHNW clients to discretionary portfolio management, managed accounts and advisory mandates, the latter being a fee-generating hybrid between DPM and self-directed investing. Will they succeed? The jury is still out, but this moment in time amidst an ongoing global pandemic that is creating huge anxiety and uncertainty is clearly a good opportunity to keep putting over the message as to why clients should put their trust in professionally managed or directed investment protocol. Are we as a result likely to see a shift in Asia away from the dominant self-directed investment approach of wealthy investors and a major growth in DPM, managed investments and advisory? Yes, very probably, but only time will tell the extent of such an evolution, and whether it actually becomes more of a revolution.

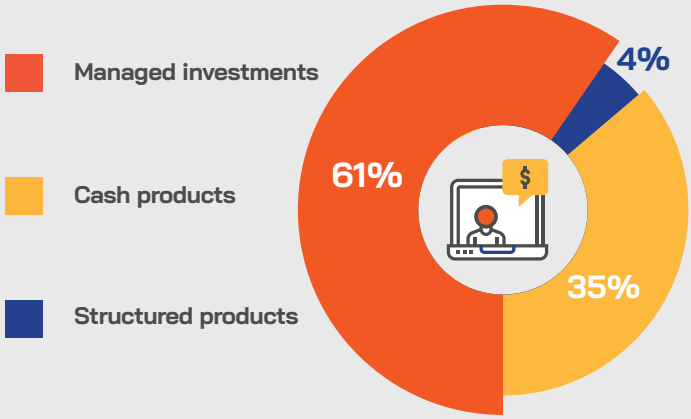
What will be your biggest focus going forward?



MORE THAN 60% OF RESPONDENTS SAY THEIR CLIENTS WILL BE FOCUSING ON MANAGED INVESTMENTS IN THE MONTHS AHEAD AND EXPECT MORE THAN ONE-THIRD OF CLIENTS TO ZOOM IN ON CASH PRODUCTS.

Run to cash is the adage in times of severe market or economic or geopolitical stress, and this is certainly a key finding in this situation. Similarly, it appears that the wealth management community is already seeing a shift towards managed investments, although there is a risk that this trend can reverse quickly, especially in Asia, if indices suddenly recover further, leading investors to rapidly forget the market traumas and return to some of their former investing misdemeanours.

In the next few months - are you seeing client interest swinging towards?



and the relationship between China and the rest of the world," another expert wrote. "We expect defaults in high yield bonds and there may be rotation in equity markets into undervalued sectors."

DE-GLOBALISATION? INFLATION?

Another warned that as de-globalisation adds to costs, economic growth in real terms will deteriorate further, especially as the rebuilding of supply chains will take time. He warned of an L-shaped recovery and a lost decade in real terms, whilst inflation and currency debasement will undermine many people as wage growth weakens.

The spectre of inflation also looms, and if the markets see the dangerous combination of inflation combined with falling or negative growth, a perfect storm might brew.

An interesting perspective came from one respondent who argued that the pandemic comes after a decade of misallocation of capital, driven by the world's leading central banks completely muddying the field of capital distribution, resulting in asset prices being severely mispriced.

NOTES OF HOPE

There were, nevertheless, some brighter tones out there. Some hope was held out by a respondent who argued that, rightly or wrongly, most risk assets will benefit from direct and indirect support from central banks and governments. Central bank balance sheets and the money supply continue to grow, leading to a rising disconnect between financial markets and the economy at large, exacerbated by the dominance of some strongly-performing, go-to giants in the indices, such as Big Tech.

And there were some considerably more optimistic replies that indicate the future is positive or even very positive. As the numerous national policy initiatives kick in to support and drive economic growth and asset prices, they believe that bond markets are likely to recover well, given lessons from the years after the global financial crisis, and US equity indices in particular are likely to remain robust, although one such expert warned that volatility will then strike back when policymakers later start debating the potential withdrawal of such efforts.

One common view was that markets will rally on vaccine hopes and slump as the world realises those are not the cure-all required. In the meantime, with the massive liquidity from the central banks and ongoing fiscal stimulus, some argue that markets are unlikely to drop to or below the lows seen in the worst of the February-March sell-off.

"The global response via fiscal and monetary stimulus is acting like a backstop to the economic crater effect prevalent amongst many developed and emerging economies," opined one respondent.

A CHANGE OF APPROACH?

We asked how in the face of this pandemic and its aftermath, the wealth management industry should position their clients. The findings here were rather consistent. Caution should rule investments, the experts generally maintain, arguing that many of the recovery assumptions are likely to be over-optimistic, and therefore that valuations are not duly reflecting such uncertainties.

Cash is king, equity positions should be carefully assessed and hedged, fixed income should gravitate almost exclusively to high-grade bonds, with caution about some sectors that will be most heavily impacted, such as travel and leisure. Leverage should be applied only very modestly, and precious metals, especially gold, should be core holdings.

Although some experts argued that for UHNW clients, higher leverage in the current conditions of low rates and lower asset prices could yield enhanced returns. Nevertheless, this is generally not considered a wise approach for any but the wealthiest private investors who can afford to assume more risk in return for potentially higher rewards.

Diversification and liquidity are essential, a careful focus on quality and long-term value must prevail, while professional-style asset allocation, discretionary management and managed portfolios will become even more valuable important.

Wealth managers, said one expert, face three core challenges - market volatility, operational risk, and increased reliance on digital channels. "We therefore have to deploy best practices to address client concerns and reduce the impulse to panic, especially via the increased role for DPM, enhance business continuity planning, intensify the push toward digital communication channels to bring the costs down, and prepare for consolidation across industry."

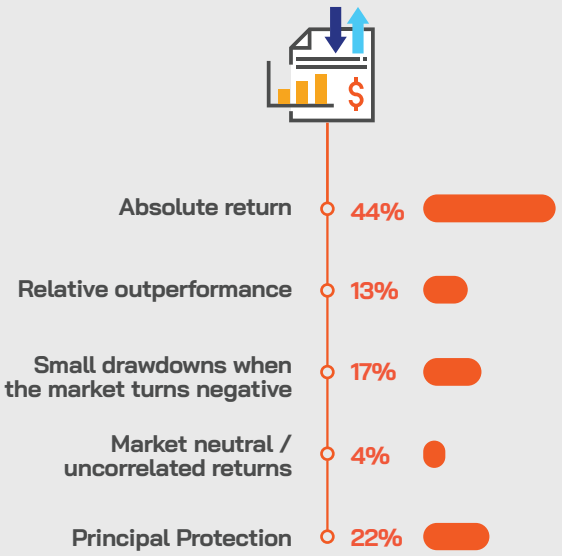
INSTITUTIONAL-STYLE STRATEGIES

A valuable perspective came in a reply that noted how loss aversion means that clients may not be brave enough to take positions when there have been sharp falls and volatility. "Wealth managers should try to stop clients going from pillar to post, but to invest across a variety of professionally-managed investment strategies, that protect assets on the one hand and access deep-value opportunities when they become available," they advised.

TWO-THIRDS OF ASIA'S HNW AND UHNW CLIENTS ARE EXPECTED TO AIM FOR ABSOLUTE RETURN ALIGNED WITH PRINCIPAL PROTECTION FROM THEIR MANAGED INVESTMENT STRATEGIES

Absolute return strategies are fine, but as experts highlighted in a recent Hubbis investment products and solutions webinar, the return targets must now be adjusted for the new world we are entering.

What are the key objectives for clients looking to actively managed funds or solutions?



One reply highlighted how in their view strategic allocation is less relevant than tactical calls right now. "Our approach is one of firstly reviewing the client's strategy, to see whether it is appropriate for a volatile environment," came one view. "And then we must make sure that clients really understand what they are invested in and why. And we are promoting DPM and Managed Fund solutions. I am concerned, however that while clients and RMs are ready to take the right approaches, the banks are still pushing products and seeking to maximise revenues from clients."

HANDING CONTROL TO THE EXPERTS?

There has been a very gradual shift towards DPM as a long-term structural trend, and if the whole managed investments sector can prove their value and resilience, then there is considerable hope for growth of AUM away from self-directed investing.

Managed portfolios and managed solutions were evidently of greater interest to clients after the Lehman crisis, and this appears to be the case again now. Bankers report that after the global financial crisis, discretionary in Asia went from a roughly 2% penetration to about 10%, and they now anticipate a second wave in Asia that will further propel the region towards norms now prevalent in Europe and the US, where fewer and fewer investors want to self-manage their portfolios.

But will this materialise? In the aftermath of the GFC, the financial sector's recovery, state-sponsored as it was, and the massive QE programme aligned to ever lower interest rates, catapulted valuations ever upwards for years. But this crisis is another phenomenon entirely, so only time will tell the full ramifications.

A key, as always, is whether Asian clients are more ready now to pay regular fees for the fund managers to manage their accounts. A half-way house of course can be seen as advisory and managed accounts, which offer the investors a somewhat more tactile approach, while leaving the daily curation of strategies to external parties.

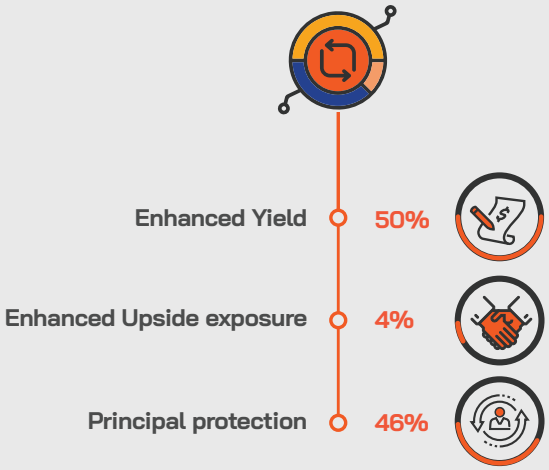
Accordingly, many believe clients will increasingly appreciate discussions and adherence around strategic portfolio allocation, and that more will be willing to pay for independent and good quality advice wherein each client portfolio is managed in accordance with his/her risk profile and requirements.

While the bounce in the markets worldwide might muddy the waters, there is a strong hope and expectation that investors will focus more on portfolio resilience, DPM, and the professionalisation of the overall approach to HNW and UHNW investing.

96% ARE HOPING FOR ENHANCED YIELD AND PRINCIPAL PROTECTION, OR BOTH, FROM THEIR STRUCTURED INVESTMENTS

Principal protection has, unsurprisingly, also become a higher priority for investors, given the recent events. Yield is ever more important both as risk assets in the form of equity become less popular and also as interest rates continue to fall, increasingly into negative territory.

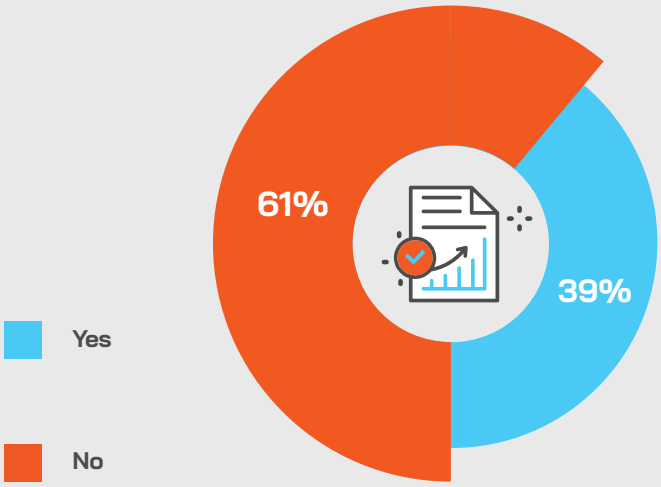
What aspect of structured investments is currently most appealing to clients today?



61% OF HNW CLIENTS ARE UNLIKELY TO RAISE LEVERAGE IN THEIR EQUITY HOLDINGS

61% see reduced leverage ahead in the world of equity holdings amongst Asia's wealthy. Leverage, if very carefully controlled and structured, can certainly enhance returns, but it can also exacerbate problems in difficult conditions, as witnessed first-hand by many of our market sources during February and March. Not only can margin calls force investors to sell anything they have that will sell – and these are often the more liquid, better-quality holdings – but it can then force those same investors into retreat just as markets rebound, meaning they suffer a double-hit of realised losses compounded by de facto opportunity losses as well.

Post COVID-19 will wealthy investors in Asia increase leverage in their equity portfolios?



SUSTAINING RELEVANCE AND REVENUES

Many argue that this crisis has brought about a sudden and structural change in all aspects of our lives and that investing is going to be fundamentally different. More alpha, less beta, greater differentiation between winners and losers, the ability to see beyond QE-enhanced credit and artificial support, and a more risk-management centric approach, all these factors are essential.

In a recent webinar, we asked the audience if client interest was swinging towards active or passive strategies. The result was that some 60% said active was gaining sway. Had that question had been asked, as it was many times, in the pre-Covid-19 world of wealth management, the categoric reply would have been that alpha had lost its way, while passive strategies had won the heart and minds of investors.

This was largely because in the decade past there was a rising global tide of valuations, almost all assets rise around the world. However, there appears little doubt that investors will need to be far more selective in terms of asset classes, sectors, and geographies in the foreseeable future, as there will be far greater performance divergence throughout economies, sectors, and corporations.

In the clement market conditions of recent years, too many investors have eschewed risk management and portfolio resilience in favour of chasing easy returns. Paying up for downside protection is now back on the table, as the reality is that those defences are needed in good conditions as investors know how rapidly good times can turn bad.

To help sustain their relevance and fee revenues, the experts we polled in this survey reported they will be taking a variety of initiatives. These will include shifting clients towards estate and succession planning and using life insurance solutions for succession planning and risk mitigation. Others focused on the enhanced visibility and value of high-quality advice in a more volatile, less predictable world. And one reply remarked how fees, which have been under pressure for several years, will stabilise and possibly recover in a more complex, less one-directional market environment.

ALL EYES ON RISK VS RETURN

"Investment management should be a natural consequence of proper discovery of client risk-return objectives (a process that is rarer than most people might think)," said one respondent. "The crafting and refinement of investment policy

for each client is more important than the implementation because the latter is well-understood by the industry, but the former is not. Firms who can engage clients in the right way, instead of some vague promise of excess return (over what exactly, we must often wonder?), will stay relevant and maintain their fee income."

"To remain relevant," came another opinion, "banks must do much more than respond to the post-crisis shifts in policy and regulation; they also need to be astute in anticipating and responding to the other forces, meaning they must anticipate the risks and opportunities that the megatrends will create, respond in smart ways, and adapt to the resulting changes in the industry landscape. A key priority in the short to-medium term will be staying on top of the migration of 'banking' activities beyond the traditional banking sector, in other words going digital, cutting costs down and becoming less reliant on the traditional way of selling."

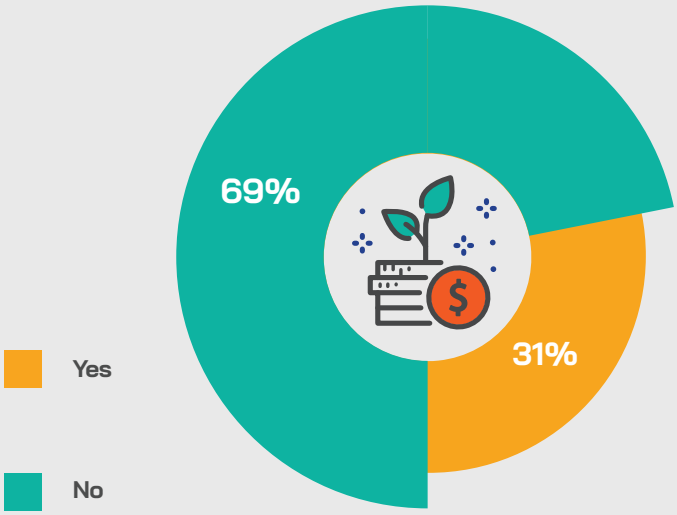
Another respondent concurred, adding that although people still want to talk to people, robo-advisory will increase in prominence and technology solutions will play a larger role.

There is little doubt from the replies that a more holistic approach to the clientele is required, with several replies espousing open communication, regular and consistent connection to multiple generations of the clients' families, a rigorous focus on quality advice, a forward-thinking approach to holistic wealth solutions, and the abstinence from product pushing. ■

AND 69% OF CLIENTS ARE UNLIKELY TO INCREASE LEVERAGE IN THEIR FIXED INCOME HOLDINGS

An even more convincing story appears in relation to fixed income holdings, although as debt is generally less volatile historically, it appears our market experts believe a reasonably significant portion of the wealth clients in Asia will continue to apply leverage in the foreseeable future. That view might, of course, change if there is a dramatic fall-off in credit quality as the clouds clear in the post-pandemic world. And in any case, our industry discussions indicate at this stage that investors will be more generally cautious than they have been for some years.

Post Covid-19 will wealthy investors in Asia increase leverage in their fixed income portfolios?



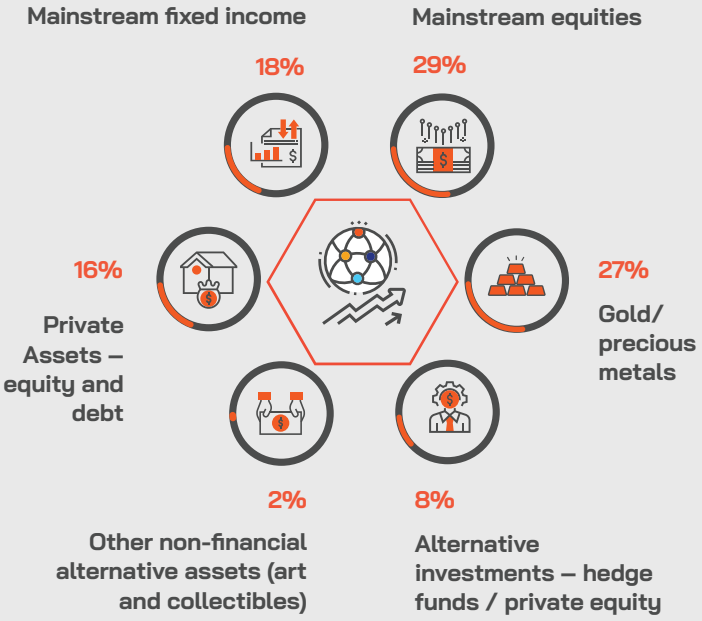
CONCLUSION

Time will tell exactly to what extent the pandemic has accelerated the wealth management industry's race towards DPM, managed investment and advisory. The consensus from the survey is that this will not be a false dawn this time. However, precisely how strong the sun will shine and how bright the future will be for a significant boost to the thrust for recurring revenues remains to be seen.

ONLY 47% EXPECT MAINSTREAM PUBLIC MARKET EQUITY AND FIXED INCOME INVESTMENTS TO SEE INCREASED DEMAND

The big winner here is clearly gold as 27% of those we canvassed expect demand for gold, that defensive, go-to investment, to rise, while more investors are also favouring private markets and alternative investments. Public market equity, the benchmark risk asset, is likely to be relatively less in favour as risk assets diminish as a percentage of well-constructed investment portfolios. These findings are in line with the anticipated de-risking of portfolios in the post-pandemic world, at least until a much clearer picture of the shape and time-frame of the anticipated economic recovery emerges.

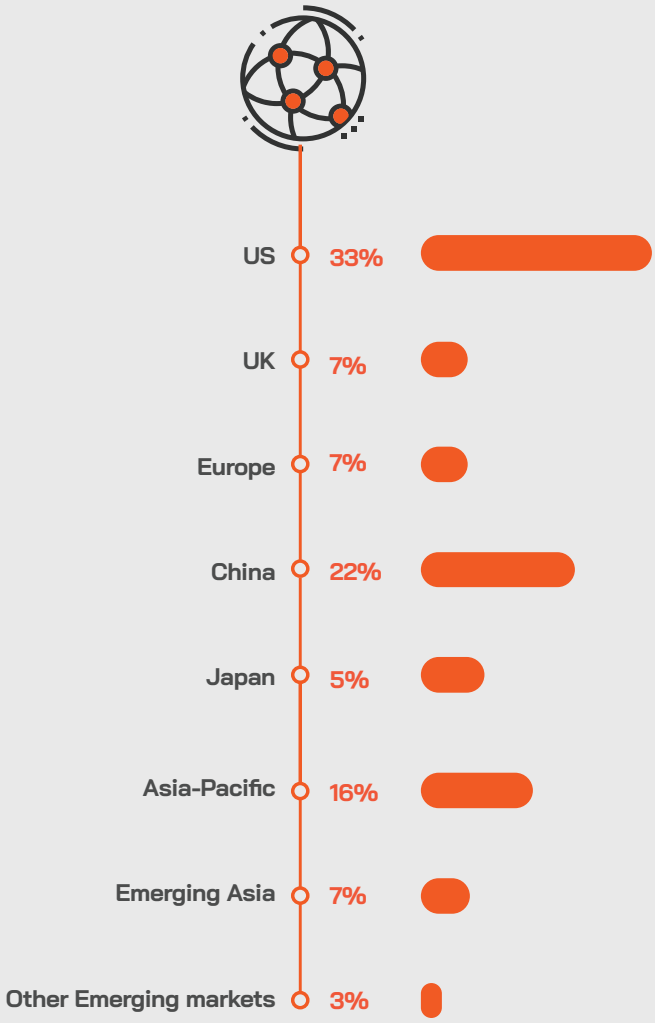
As the world's financial markets move past the initial shock of the global pandemic, which investments are likely to see greater demand for foreseeable future?

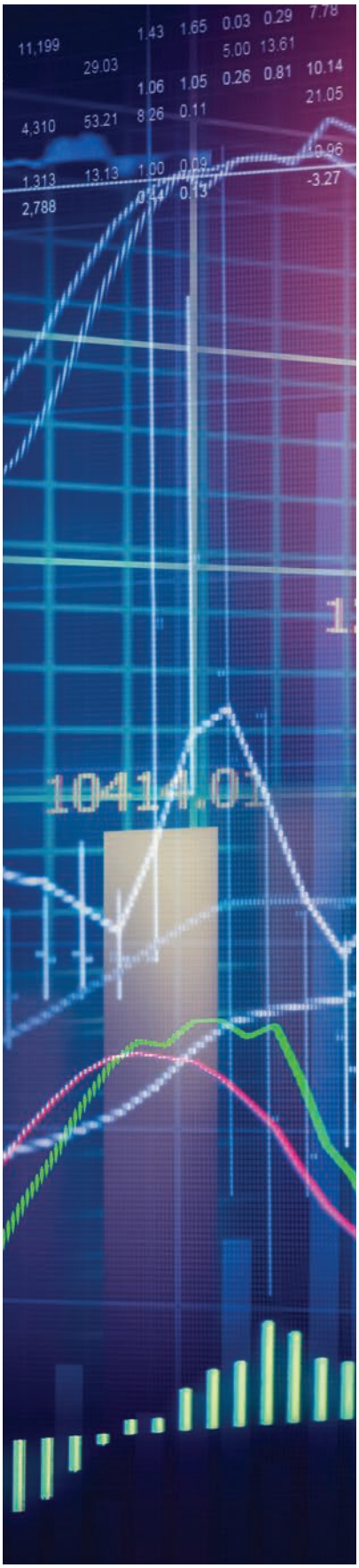


THE US REMAINS THE CAPITAL MARKET OF CHOICE, WHILE CHINA APPEARS TO BE A CLEAR WINNER IN ASIA

Amongst HNW investors in Asia, there appears to be a clear continuing preference for the scale and depth of the US equity markets, while China's star has clearly risen, at least in terms of investment outlook, as investors see their tough controls on the virus have, at least ostensibly, paid dividends. It is certainly the case that Asia Pacific as a whole will remain core to the portfolios of Asian investors, as 51% of those we surveyed expect investment as a whole across the region to steadily recover and rise.

Which markets and regions will be in greatest demand for equity investments?

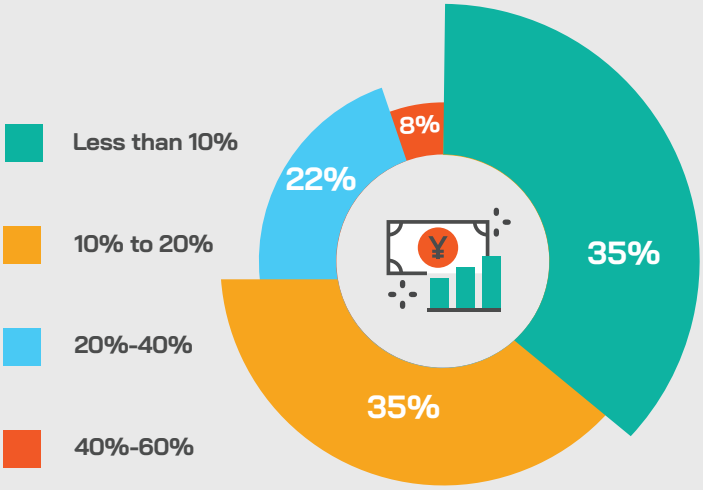


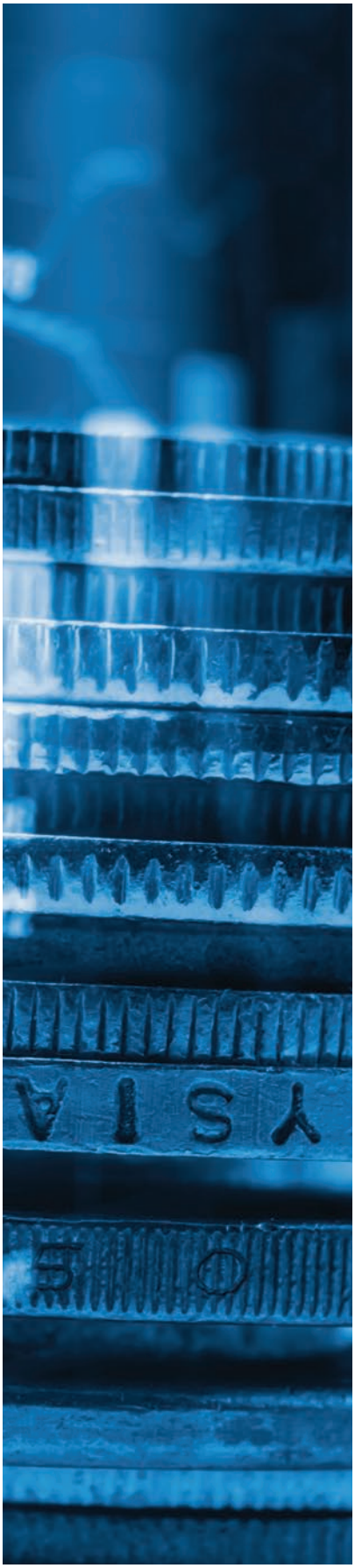


57% OF RESPONDENTS REPORT THAT WEALTHY ASIAN INVESTORS SHOULD ALLOCATE BETWEEN 10% AND 40% OF THEIR PORTFOLIOS TO PRIVATE AND ALTERNATIVE INVESTMENTS

In times of excessive volatility, illiquid, long-term investments such as private equity, private debt and other such assets are shielded from dramatic price fluctuations. There has been a growing trend towards greater allocation of investment portfolios - especially for the upper end of the HNW segment and of course the UHNW market – in recent years, with most market practitioners complaining that their core problem was securing investments rather than locating demand for such assets. Our Survey again highlights how private assets will continue to take a win a growing role in shaping the portfolios of Asia's wealthy.

How much of their portfolios should Asia's wealthier investors allocate to private and alternative investments away from the mainstream public financial markets?

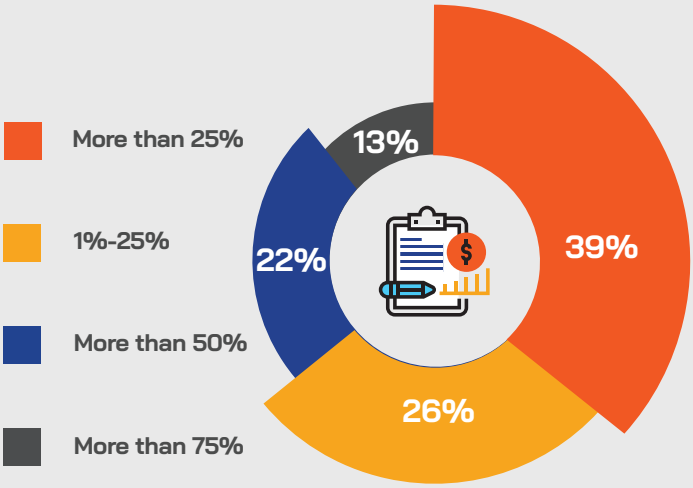




74% BELIEVE ESG COMPLIANT INVESTMENTS SHOULD REPRESENT MORE THAN 25% OF ANY PORTFOLIO AND 34% MORE THAN 50%

61% think ESG compliant assets should dominate between 25% to 75% of investment portfolios. What is ESG investing? We will not delve into the technicalities here, but it is predicated on the view that a robust focus on selection via ESG filtering principles curates the most transparent and best-managed companies into investment portfolios, and those corporations exhibit lower balance-sheet vulnerability, higher quality of revenues, better liquidity, lower volatility, greater conservatism, a more robust approach to capital and dividends, and that all these factors ultimately lead to outperformance. There is no doubt that the Survey results indicate the industry believes that interest in ESG will continue to rise.

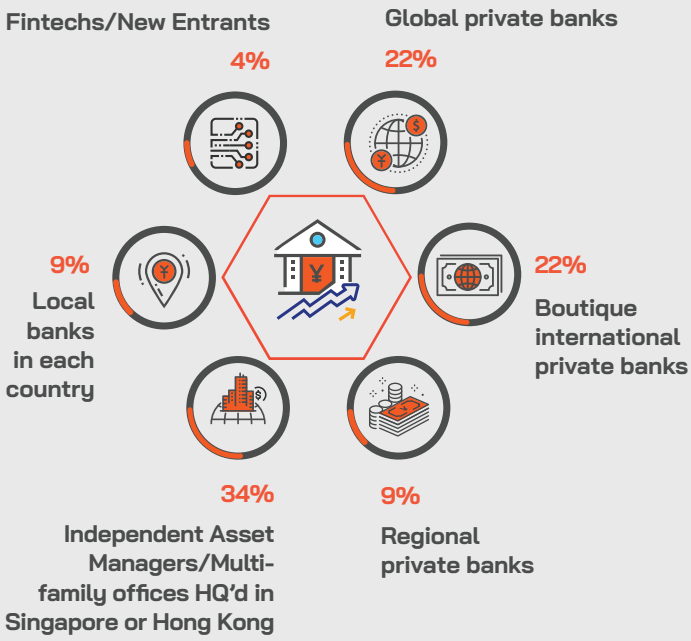
What percentage of ESG compliant investments should be in a well-designed portfolio?

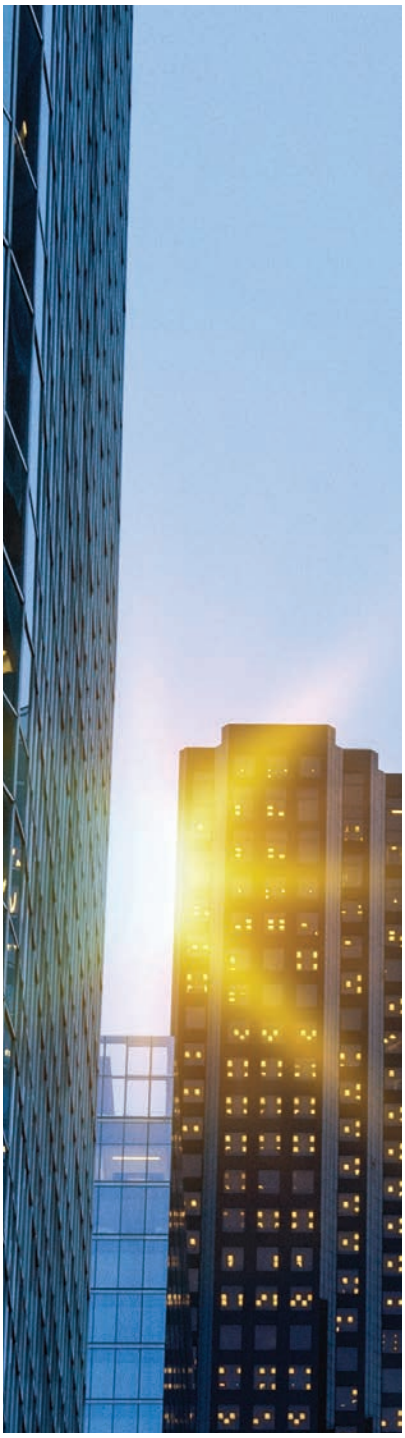


ONLY 22% OF RESPONDENTS THINK THAT THE GLOBAL PRIVATE BANKS ARE BEST POSITIONED TO OFFER THE BEST INVESTMENT SOLUTIONS AND SERVICES IN ASIA

It appears that the independent asset management community is faring well in the battle with global brand-name private banks for HNW and UHNW investor clients, with the approach of the boutique international private banks also apparently increasingly well appreciated by the market.

Which type of wealth management institutions are best placed to offer the best investment solutions and services to Asia's HNW/UHNW investors?





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