Emerging trends in portfolio advisory – a view from the MSCI experts

Alvin Lee, Executive Director and Head of Southeast Asia Client Coverage at MSCI addressed the audience at the Hubbis Investment Solutions Forum in Singapore to highlight key trends that MSCI – with its bird's eye view of the global financial markets and the Asian wealth management industry - is seeing in portfolio advisory.

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FOR MORE THAN 40 YEARS, MSCI's research-based indexes and analytics have helped the world's leading investors build and manage their portfolios. "Clients," Lee explained, "rely on our offerings for deeper insights into the drivers of performance and risk in their portfolios, broad asset class coverage and innovative research. Our line of products and services includes indexes, analytical models, data, real estate benchmarks and ESG research. We serve 99 of the top 100 largest global money managers.[1]"

Lee first explained that MSCI focuses on four areas of research,

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[1] Based on latest P&I AUM data and MSCI clients as of March 2018.

namely index, analytics, Environment, Social & Governance (ESG) research and real estate.

"On the index side," he elucidated, "I think most of those here today would have seen the recent inclusion of 226 Chinese A-share large caps into the MSCI Emerging Markets index. We have seen substantial volume linked to that through structured products, ETFs and, of course, underlying securities." But Lee explained that his focus at the event was more on analytics and ESG research. "There are four things I will mention we are doing to support the advisory process. These are looking at fund and portfolio robustness through a factor lens, market scenarios, structured products analysis and then, finally, impact and sustainability assessments."

MSCI updates older styles

Addressing the first of these - fund and portfolio assessment - Lee said that what the industry has seen for some years is the idea of looking at funds and putting them through 'Style Box', which he said was made popular by Morningstar.

The traditional style box, introduced 26 years ago, was a simple way to frame portfolio decisions along two dimensions, namely market capitalisation and style, in terms of value versus growth.

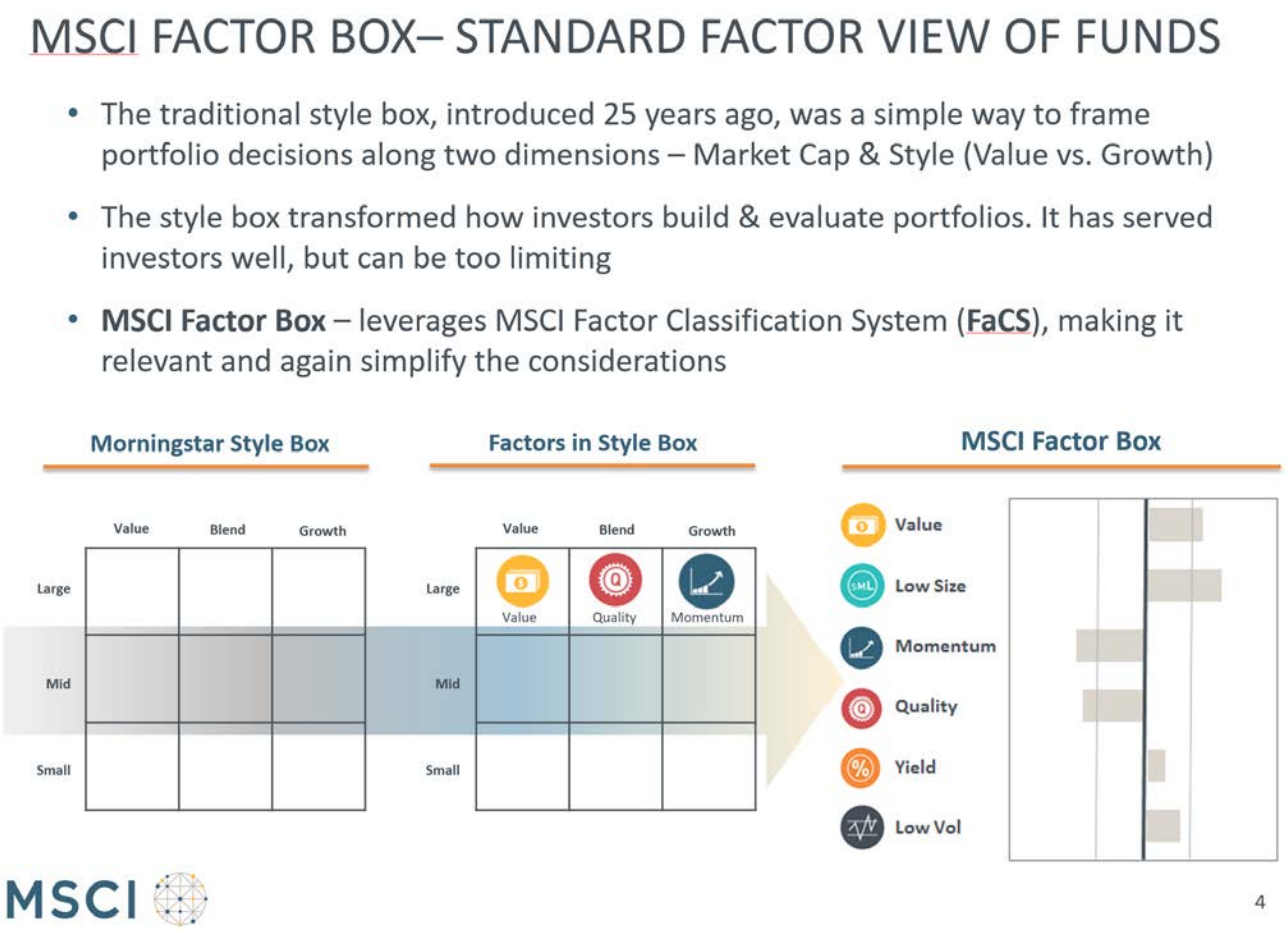
"The style box transformed how investors built and evaluated portfolios," Lee elucidated. "It has served investors well but can be too limiting. While that has been used for years, we are increasingly hearing interest about 'factors' related to 'smart beta' from more financial institutions and end clients." Accordingly, MSCI has worked on and launched what it has called the MSCI Factor Box, which leverages the innovative MSCI FaCS hierarchy.

"In essence," Lee clarified, "FaCS, which stands for MSCI Factor Classification Standard, enables the measurement of a fund's exposure to value, low size, momentum, quality, yield, and low volatility, which are common style factors investors want to assess. With this MSCI is providing to the market the ability to look at any particular fund through a different prism - it is effectively an innovation on the traditional style box that is relevant to contemporary trends and practical to use."

Get stressed for lower stress

Lee then moved on to look at stress testing and scenario analysis. This means reviewing the potential impact of a particular market shock on a client's portfolio, gaining insight to the portfolio's robustness, and assessing possible behaviour across multiple scenarios.

He highlighted one particular possible scenario, namely a potential US-China trade war. "How



do you translate that high-level concern into some specific forecast and assess the potential market impact?" Lee mused.

"That is where it is important to have access to macroeconomic models and risk models where you translate the high-level scenario into possible GDP and inflation shocks resulting from trade-related impacts. Finally, which is, of course, most relevant for your wealth management clients, how does that impact the markets? With analytics, one can model the moderate to extreme scenarios across multiple asset classes."

Lee moved on to broader scenario analysis. "This is all about checking the robustness of your clients' portfolios," he explained. "You can assess multiple scenarios and their potential impacts to your client's portfolio and check how rate hikes, policy events which can shock growth and inflation expectations, and so forth translate into different manifestations in the market. This helps portfolio analysis and rebalancing decisions."

Lee then highlighted MSCI's analytics that provide insights into structured products. "In this segment, MSCI can help clients and advisers understand the implicit exposures through to the underlying reference securities, bringing clarity to the overall composition of their portfolios."

ESG – a hot topic

Lee closed his talk with reference to impact and sustainability, which he described as one of the 'hottest topics' in the market currently. "Institutions and individuals, especially millennials, are highly focused on ESG nowadays and this is a trend we see expanding as the trend moves mass market. Again, MSCI provides research and analytical tools for assessing the ESG risks of funds and portfolios, as well as develops investable ESG indices."

Lee summarised his talk as follows. "I will leave you with four key thoughts on research ideas to support your advisory process. The first is the MSCI Factor Box for analysing funds and unit trusts. Second is scenario analysis to enrich your conversations with clients. Third is delving more deeply into structured products used within portfolios, including their underlying exposures. Finally, building and understanding portfolios in the context of impact and sustainability." ■