GMO Portfolio Strategist Vineta Salale on the Value of Active Strategies in the New and Challenging Era for Global Markets

Hubbis assembled an erudite panel of wealth management experts for our Digital Dialogue event on the rise of DPM in Asia. They discussed how they are adapting their business models to help produce more recurring and more predictable revenues, thereby swinging away from the vicissitudes of product-driven selling and to a more client-centric and also more stable business. The current environment of global geopolitical uncertainty, enhanced market volatility and shifting policy approaches from the West's central banks all appear to offer significant tailwinds for advisory and DPM propositions. Offering her views on today's very different investment environment compared to conditions prevailing since the global financial crisis of 2008-9, Vineta Salale, portfolio strategist with GMO's Focused Equity team, joined the panel to explain why selective active fund strategies can really help future proof private portfolios. She came armed with considerable experience - Vineta previously worked in GMO's client relationship management group, and prior to joining GMO in 2016, she worked for Towers Watson, her last role there as the Head of Global Bond Research. She currently works out of GMO's London office and has a very global perspective on these issues. We have distilled her observations and presented them as a summary Q&A report, as below.

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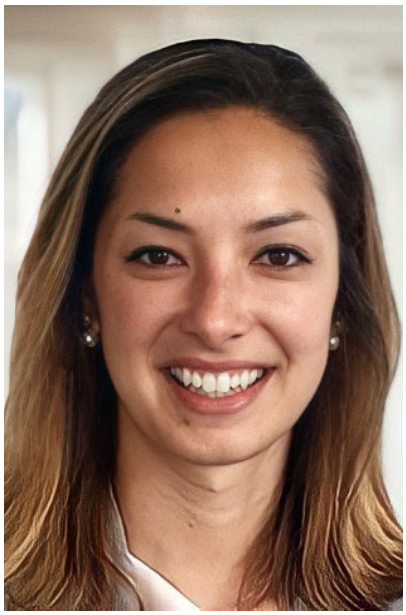

VINETA SALALE
GMO

"This is a really tricky market to navigate. Inflation is spiking. Commodity prices are going up. There are growing recessionary fears. There are serious concerns about earnings disappointments, particularly in US tech, but I think tech more generally around the world. And rates are rising. so all this means that some of the easy, typical ways to position portfolios, for example by taking on more fixed income, are very tough."

Vineta, what is your view on the role of active and passive strategies?

"GMO is an active manager, so let me declare that from the outset. Understandably, I am a proponent of active management, GMO's core multi-decade centre of expertise, and will articulate the case for the elevation of active strategies within advisory and DPM propositions. My view is this is one of the best times in recent history to be an active manager. Look at the performance this year – had you been passive, particularly in developed markets, you would be down double digits in terms of equities. That is a quite significant destruction of wealth. But as an active manager, GMO takes a valuation lens, and as such, we have a clear focus on the upside or downside of stocks and what a company can produce over the long term, hence a solid price target. In these types of volatile and bearish markets, it is really exciting for us, as we have clear views on valuations and how we can move in and out to achieve alpha.

Can you offer more detail on how you are positioning for downside protection and upside potential in this difficult current environment?

"Yes, for example, to put some sort of meat on those bones, we run a climate change strategy that has a significant exposure to clean energy. In the ETF space, there are well-known clean energy ETFs down over 40% since last year, whereas our active strategy is currently [May 18] up around 6% during the same period. If you just choose passive, and if you just use it in somewhat of a naïve approach, you are going to miss out on some returns that you can get from active management.

Secondly, this is a really tricky market to navigate. Inflation is spiking. Commodity prices are going up. There are growing recessionary fears. There are serious concerns about earnings disappointments, particularly in US tech, but I think tech more generally around the world. And rates are rising, so all this means that some of the easy, typical ways to position portfolios, for example by taking on more fixed income, are very tough. And central banks around the world are tightening.

In the face of all this, where can we go to find returns? Absolute return is one of the places that we see as being able to offer some diversification at least, albeit perhaps not necessarily downside protection. We think resource equities, because of their inflation hedging characteristics and because of their link to commodity prices, represent another interesting space. But the typical 60/40 portfolio is not going to work."

Can a greater focus on ESG help portfolios in general?

"There are so many different ways to define ESG and sustainability, so it's a very broad topic where, to some extent, you really have to sit down with the client and understand what they mean by ESG, what they mean by sustainability. But, with that caveat, we see more of the younger clients in the private wealth sector placing a much greater emphasis on sustainability, and that is resulting, for example, in a higher appetite for our climate change strategy. The demand is coming from the clients themselves, and the asset management industry must deliver the right strategies to satisfy that demand."

Is there any particular advice you want to offer the wealth management intermediaries or private investors currently?

"There is an understandable shift needed from growth to value. We actually have an absolute return strategy that is essentially long value, short expensive growth, and short tech; that has performed rather well so far this year. Another theme is resource equities because of the inflation linkage, and because of elevated commodity prices due to the demand-supply dynamics. And because of these factors and because of the geopolitical issues, commodity prices are more likely to stay high, at least for the short to medium term."

Finally, are there any other changes to your investment process or thinking that you might like to share here amidst these very challenging markets?

Jeremy Grantham is the well-known founder of GMO and has been talking for a long time about the bubble that the central banks have created, and he is still completely consistent in this, commenting that this bubble is bursting or has already burst. In the face of this phenomenon, we need to carefully re-think how to invest in this new and challenging environment. Diversification does help, but the traditional approaches to portfolio diversification may not work in this cycle." ■