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Private Bank CEO Advises HNWI investors to Ignore Market 'Noise'

Executive summary

Jean-Louis Nakamura, Chief investment officer, Asia-Pacific, and head of Hong Kong office for Lombard Odier group for Asia at Swiss private bank Lombard Odier spoke with Michael Stanhope, CEO of Hubbis, to enlighten investors on the perils of paying too much attention to peripheral noise in the market when making decisions regarding their portfolio. It is essential to focus instead upon diversification and risk to weather any short-term market storms caused by geopolitical upheaval and other extraneous events, even if they might seem dramatic at the time. Nakamura advised keeping a clear, non-emotional head when creating and maintaining an investment portfolio; and, better, he believes, side-step this issue completely by outsourcing to an asset manager to implement a discretionary portfolio management strategy instead.

JEAN-LOUIS NAKAMURA
Lombard Odier

JEAN-LOUIS KAMURA, CHIEF INVESTMENT OFFICER, ASIA-PACIFIC, and head of Hong Kong office for Lombard Odier group for Asia at Swiss private bank Lombard Odier spoke with Michael Stanhope, CEO of Hubbis, and enlightened investors on the perils of paying too much attention to 'noise' around the investment markets when making decisions regarding their portfolio.

Nakamura began by giving his definition of 'noise' in the market. "Noise is any piece of information which is not related to economic fundamentals that ultimately has little real effect on the markets and investments," he explained.

He noted that core developments would for example include earnings announcements and direction from companies, GDP data, inflation releases and projections, policies driven by central banks or governments, and so forth.

'Noise', on the other hand would include political or geopolitical developments and natural disasters. "These issues will not usually have any material, lasting impact upon policies or economies," elucidated Nakamura, "and most of the time they will have no persistent effect upon the markets and investments."

Investors urged to block out noise

Nakamura urged his fellow investors to ignore this noise, as it can lead to over-emotional decision-making. "It requires a lot of discipline to take a non-emotional approach to investment," he observed.

If investors fall victim to market noise, they can make mistakes. "Noise can force investors to become trapped in a situation where decision-making becomes harder," he said.

They can then be torn between staying put when moving would be a smarter choice, or even worse, panicking and taking the bold decision to protect their portfolio and disinvest, thereby losing either money, or opportunity, or both.

"Jumping ship is a typical mistake that investors who are overly sensitive to noise and emotions will face in the management of their own portfolios," warned Nakamura.

If in doubt, outsource

This jittery, destructive behaviour is one of the reasons a client should consider a Discretionary Portfolio Management (DPM) mandate, Nakamura suggested. "Outsourcing investments to a professional asset management team through a DPM mandate can reduce the emotional rollercoaster an investor can experience."

DPM must be conducted in an emotionless, detailed well-defined and clearly-explained way, and of course implemented with the strictest discipline.

"Focussing upon pure noise over the next 12 months," continued Nakamura, "for example information which has no fundamental implication in terms of growth or policies, such as geopolitical unrest, has a lot of scope to cause problems for the investor."

Events such as a resumption of tensions in North Korea, or between Russia and the US, or Italy becoming a serious threat once more within the Eurozone, have the potential to cause a great deal of this noise, which some investors will fall prey to believing will have major impacts for their portfolios.

"It is difficult to work out which noisy events will prevail in the coming months," explained Nakamura. "However, as long as they do not impact the path of economic growth or financial policy, they should not be weighted significantly in portfolio conduct."

What does a DPM mandate look like?

Nakamura then gave an example of a typical DPM mandate a client might have with Lombard Odier.

At Lombard Odier Asia Nakamura continued, "we exclusively propose core DPM portfolios with multi-asset strategies. This means we focus upon diversification within a set of both traditional and alternative asset classes."

This diversification means that in a DPM mandate held at Lombard Odier, there will be a mix of developing equities, emerging equities, credit, emerging debt, sovereign bonds and commodities.

"We do not allocate with regard to views of the market, but instead based upon their relative risk as measured today in the market," continued Nakamura.

This means that each time an asset class moves away from the others in terms of relative risk, exposure to this asset is reduced in favour of other assets. This keeps the proportion of risk across asset classes constant over time, and the total level of risk of the portfolio stable.

Watch that risk

"Since the start of the year, the only asset class that has significantly increased in risk is developed market equities," Nakamura stated.

"Because of this situation, our portfolios today have much less developed economy equities than they had six months ago," explained Nakamura.

"They have much more long duration sovereign bonds than they had six months ago, slightly less emerging equities and credit than six months ago. We are moving progressively towards safer assets, because today risky assets are much more significant than six months ago."