Shifting the Dial – How Should Asia's HNWIs Recalibrate Their Portfolios

A panel of experts assembled at the last group discussion of the Hubbis Investment Solutions Forum to ponder the optimal portfolio strategies for late 2019, in anticipation of 2020. There was plenty of healthy disagreement on all the key investment markets, and only one clear consensus, namely that the world remains an uncertain place, and returns will remain elusive.

These were the topics discussed:

- *What are the main investment themes and products that will be most relevant in 2H?*
- *How will you help clients shift mindset, investing style and portfolio holdings as the market transitions to a more volatile phase?*
- *How are you delivering performance? Managing risk?*
- *What Asian Markets offer the best value? What's your view on China?*
- *What is your current thinking about the role of fixed income and credit in HNW / UHNW clients' portfolios?*
- *What are the prospects for US dollar interest rates in the coming 12 months?*
- *Equity - where is best? Where is worst?*
- *What must be considered when investing in emerging markets?*
- *What's the role of structured products in 2H 2019?*
- *Any role for passive and index products?*
- *What's the role for private debt and alternatives within portfolios?*

PANEL SPEAKERS

- **Simon Godfrey**, Senior Vice President, Head of Products, EFG Bank
- **Michael Levin**, Head of Asset Management, Asia Pacific, Credit Suisse Asset Management
- **Jacky Tang**, Head of Portfolio Management Group Asia, Co-Head of Investment Strategy Group Asia, Goldman Sachs
- **Harold Kim**, Founder and Chief Executive Officer, Neo Risk Investment Advisors
- **Angel Wu**, Managing Director, Head of Product Management Group, Bank of Singapore

Link to Content Summary page
Link to Photos
Link to Event Homepage

hubbis

THE KEY TAKEAWAYS

Some are taking a glass half full approach

Some experts on the panel were fairly positive, with the discussion opening with one guest saying that the universe of fixed income is not so gloomy, especially outside the major developed markets, and particularly in Asia, and also using swap techniques. Meanwhile, he opined that investors are generally under-invested in equities - the equity risk premia are actually at attractive levels, especially for some markets in Asia such as China.

But, hold on a second, the US remains appealing

Another guest offered a rather different view, arguing that the US will enjoy plentiful inflows to equities next year, as the likelihood of a recession is modest, while the earnings cycle is again picking up, and the result should be that US equities are again leaders for the globe. Meanwhile, although EM equities are ostensibly offering better value, this expert worries about the fundamentals there, especially for China, where the "A" share will drop back and volatility rise.

Uncertainty persists, so risk must be dynamically managed

The near impossibility of predicting economic, financial or corporate fortunes means that investors must pay greater attention to greater dynamic management of the risks in their portfolios. And investors must focus on the medium to long-term, not the short-term.

Uncertainties are still there, but markets have discounted them

Another view came from an expert who noted that in fixed income investors should focus on limited credit exposures and shorter durations, while in equities many concerns, for example over trade wars, have been heavily discounted in the markets, offering value, especially in markets across Asia.

Take the tactical approach

A fellow panellist agreed, at least in part, arguing that investors must take a tactical view of markets, and remarking that equity valuations have returned to reasonable levels today, especially as the rates easing cycle continues, and there are good opportunities in dividend stocks, particularly in this Asia region.

Don't ignore climate risk

A guest highlighted the vital importance of climate risk and the growing impetus for regulators and the major investors to demand climate impact assessments and benchmarks. This all offers both risks for those recalcitrant companies and opportunities.

Are you getting enough return for your illiquidity?

While private assets - equity, debt, property - are increasingly in vogue in multi-asset portfolios, a guest questioned whether investors are earning enough return for the concomitant lack of liquidity, especially as prices are being driven up by the tsunami of money chasing opportunities.

GCC beckons as a new opportunity

The Gulf Cooperation Council Countries (GCC) were also mentioned, as they are being upgraded to Emerging Markets status in some of the major indices, creating a new type of EM opportunity.

India on the bounce

India today is back on the investment radar for EM buyers. Political stability, reduced inflation, and even with the tragedy in Saudi Arabia relatively moderate oil prices, accommodative monetary policy, rapid growth, the potential for margin expansion and therefore significant earnings growth, all add up to an interesting story.

But...the central banks are out of bullets

The final word went to an expert who pondered the state of central bank operations, expressing concerns that the world is in a new and worrying phase. With negative rates on supposedly risk-free assets and the potential for risks or bubbles to escalate, the world's central banks appear to have no more bullets left to stave off crises, which could mean rising spreads and rising default rates.

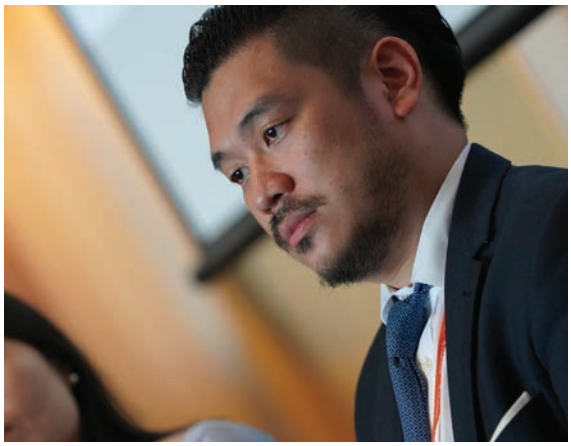
MICHAEL LEVIN
Credit Suisse Asset Management

"**PEOPLE ARE OVERREACTING ON THE FIXED INCOME SIDE** and probably under-invested on the equity side," began one private banking expert, in a statement that offered some cause for optimism amongst the delegates. "There are low yields, and tight spreads as a result of accommodative monetary policy, but fixed income outside the major markets, especially Asia, is appealing, for example senior secured bank loans swapped with floating rate paper and collecting some very appealing yields - default rates over the last 12 months have been almost zero. Real estate also offers predictable sources of yield, and the rental rates may even benefit from inflationary pressures and because of some of the economic challenges there hasn't been a lot of development, so there is lack supply."

He added that people appear rather too willing to accept any incremental risk for incremental yield but are perhaps not being sufficiently compensated.

Swapping in Asia

"Asia is the best market," he noted, "as you can capture yields approaching 6% for an average investment grade portfolio with a pretty moderate duration and floating rate. LIBOR is about 2.14%, and you compare that to the five-year yield which is about 1.75% and we actually get a yield pickup for reducing the risk and any way to reduce risk and capture incremental yield should be taken, all day long."



JACKY TANG
Goldman Sachs

SIMON GODFREY
EFG Bank

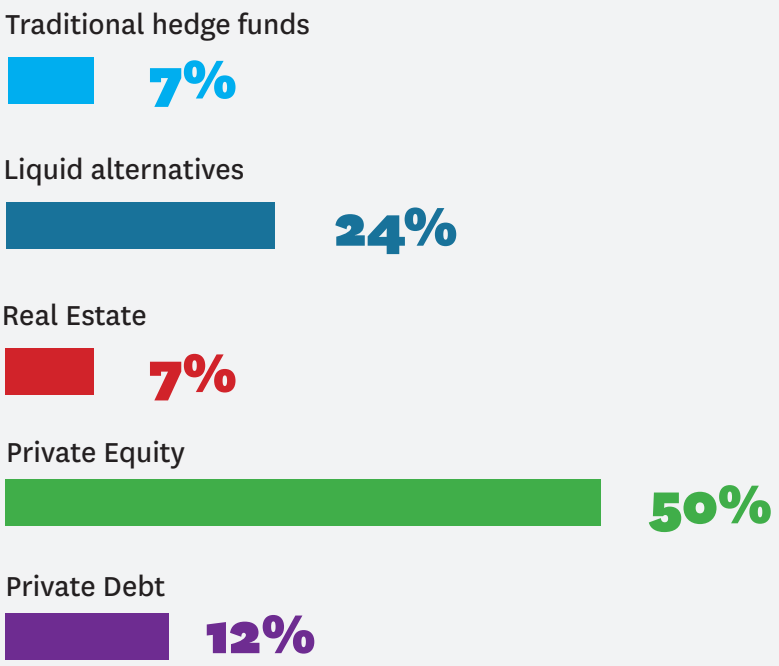
He then noted that his view is the equity risk premium is actually at very attractive levels, especially some markets in Asia such as China. "One can assemble a pretty compelling portfolio with a 10 times PE roughly, a 3.5% dividend yield and with 20% ROE. That's something that investors should be doing all day and not worry so much about volatility."

The US markets beckon

Another guest offered a rather different view. "We think the US should be the place where you will see more inflows next year," he said. "We see the chances of recession as modest, and we see the fundamentals as actually pretty good with even the earnings cycle picking up, and we think that the US fundamentally should give some support to the overall global equity market. We also think that the EM valuation today is much more attractive than the US, but at the same time we are also worried

HAROLD KIM
Neo Risk Investment Advisors

WHICH ALTERNATIVES SEGMENT IS MOST INTERESTING FOR YOUR CLIENTS IN 3Q19?



Source: Investment Solutions Forum 2019 - Hong Kong

about the fundamentals of some EM markets, and especially Chinese companies, where we think that not so many Chinese companies offer comfort when looking at the balance sheet and their P&L, so I am not sure next year the 'A' share market will continue to do as well as this year, and there will be more volatility to come."

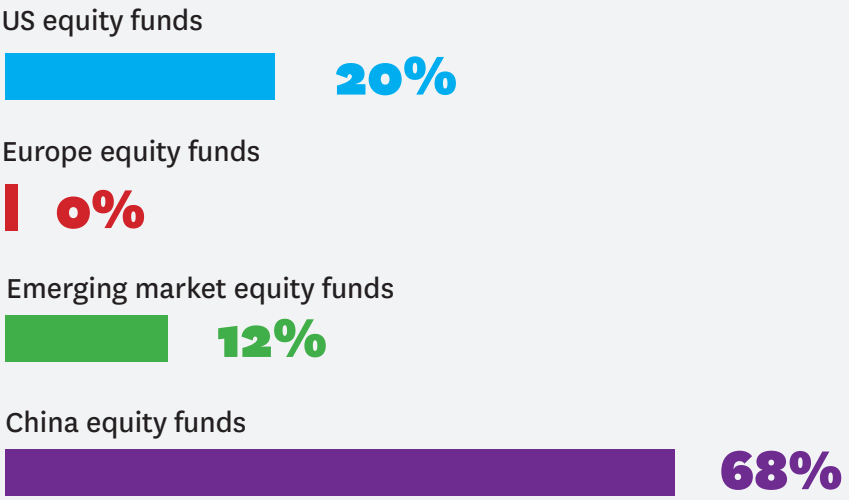
Focus on risks

An expert highlighted his wariness of shorter-term views and explained how he tries to focus on a 10-year horizon. "People who try to predict where rates were going through this year got it all wrong, and people who tried to predict where equities were going last year got it all wrong," he reported. "So we should focus on longer-term trends, for example, the rise of China's institutional investor presence, the low likelihood of the low rate environment reversing itself over the next two or three years, but as typically the correlation between rates and equity means that you want a little bit of both in your portfolio, with the weighting dependent on your views and risk appetite."

"There is too much cash around," came another opinion, "and investors need predictable sources of yield, so we see there is preference for limited credit exposure, and a preference for an investment grade blend with high yield and shorter duration. And as to equities, a lot of the concerns about trade wars have been heavily discounted in the markets, so the question now is whether or not valuations are attractive, and earnings growth is going to be reasonable. I think yes, certainly for Asian equities."

ANGEL WU
Bank of Singapore

WHICH FUNDS WILL EXPERIENCE THE MOST INFLOWS IN IN 2020?



Source: Investment Solutions Forum 2019 - Hong Kong

Stay in, but underweight equities

A different view came from another expert who said they are firmly underweight equity at this point. "We think that you should stay invested," he commented, "but with a strategic asset allocation, and underweight equity."

"I firmly believe that it is incredibly hard to predict where the markets are going, equity or fixed income," so we advise having a balanced portfolio and managing risk actively," said another panellist. "We believe risk is little bit more predictable than return."

Another expert reported that his firm likes to advise clients in a very strategic long-term way, but clients also need to anticipate what will happen over the short term.

Stay in and consider overweight equities

"That means we tend to have a more tactical view of markets," he explained, "and we do feel that equity valuations have come back a lot from where they were a year ago, so we don't see equities as being overvalued today. We also feel there is still some potential with the fact it will continue to be in an easing cycle and therefore without confirmation that there is a recession or deep recession scenario we do feel there are still some opportunities there. We see rotation towards value. We like dividend yielding stocks and especially in this Asia region. It is a good time to diversify towards value in equities, but we don't see much potential in fixed income, to be honest."

An expert highlighted climate risk, which they said will overshadow ESG in the next years to come, for several key reasons. Because of climate change, climate risk has become a tangible risk, with the exposure of USD2 billion per year expected to increase to USD1 trillion per year by 2025 onwards. Only one-third of this risk is insured. Regulators are now asking larger companies to disclose on climate-related risk as soon as 2020.

Climate the hot topic

Most importantly the climate risk is beyond physical damage - the social and economic impact will put our society in distress by 2030 onwards, and the young generations are very much aware of climate-related risk, hence they will be asking for products related to a cleaner environment, better health, more sustainable and affordable food, a more sustainable society.

"I believe only a handful of companies are starting to truly realise the real impact of climate risk on their bottom line," they commented. "The bad news is that it is very difficult to predict climate risk. The good news is that investors are starting to realise that this is a risk that they can no longer afford to ignore."

"THE BAD NEWS IS THAT IT IS VERY DIFFICULT TO PREDICT CLIMATE RISK. THE GOOD NEWS IS THAT INVESTORS ARE STARTING TO REALISE THAT THIS IS A RISK THAT THEY CAN NO LONGER AFFORD TO IGNORE."

An expert turned to alternatives, such as private equity and particularly private debt, which has attracted a lot of capital of late. He said the question is whether investors are being sufficiently compensated with an illiquidity premium.

The absence of mark to market is perceived by many as an absence of risk, but too much money flowing into this area results in too much leverage to produce higher returns, because prices have risen. "This actually is a pretty bad recipe," he commented.

Another guest reported that their firm's model portfolio offers a roughly 10% allocation to private equity, around 5% to private credit, and 10% to both traditional hedge funds and liquid alternatives. I don't really see that investors are looking for very high returns, but they are focussed on the volatility part or the risk part."

A guest countered that view with the opinion that the trade wars will be resolved sooner rather than later, and aligned to MSCI inclusion, there will be stronger inflows to Chinese stocks from foreign institutional buyers.

Is the US insulated?

The discussion drew towards a close as a guest commented that the world appears to be focusing on geopolitical and climate change connected to trade tensions, and resulting in a thrust towards de-globalisation, and populism.

"Weighing up the many factors," he said, "the US is actually reasonably well insulated, particularly when you have monetary stimulus, fiscal stimulus and increasing tax cuts with full employment, making it very hard to see a recession environment. OK, valuations are a little bit rich at 18 times, but you have rates again being cut and supportive."

Think about the GCC and India

The Gulf Cooperation Council Countries (GCC) were also mentioned, as they are being upgraded to Emerging Markets status in some of the major indices, creating a new type of EM opportunity. GCC countries are oil-exporting, with currencies pegged to the dollar, high foreign currency reserves and very low debt-to-GDP. Momentum investing into GCC stock markets has proven to be quite lucrative for traditional EM investors, said one guest.

Another expert mentioned India. "Political stability, reduced inflation, and even with the tragedy in Saudi Arabia relatively moderate oil prices, accommodative monetary policy, rapid growth, the potential for margin expansion and therefore significant earnings growth, it is all a good story that people don't talk about much," he stated. "On the equity side and fixed income side you have risk free rates of about 6.6% in India, the Rupee is relatively stable at 71, so I think India is a good focus for tomorrow."

Central banks are spent forces

The final word went to a concerned observer who said that there are major worries out there. "We are concerned about the longer-term impact of persistent friction between the US and China, in other words becoming an economic cold war and the battle for technology dominance. And another concern is the trap of low or negative interest rates on various asset classes and the potential for risks or bubbles to build, yet without policy tools any longer available to redress them, leading to worries over whether the lower yields and lower default rates in corporate credit are both sustainable." ■