Wealth Management Leaders Survey Opportunities in the Global Markets

An eminent group of product gatekeepers gathered at the third panel discussion of the day at the Hubbis Asian Wealth Management Forum. Their mission was to consider how, after a year of considerable angst and volatility, wealth managers should position their clients to make money, but with resilient portfolios. They cast their discerning eyes over the mainstream global and Asian financial markets, they considered passive and active strategies, as well as reviewing opportunities in alternative assets ranging from private equity to gold and property. And they debated the rise of ESG and SRI principles, which are rapidly permeating more and more investment decisions.

These were the topics discussed:

- *What are the main investment themes and the products that will be most relevant in 2019?*
- *How has the investment environment changed in Asia from 2017 to 2019?*
- *How will you generate income in 2019?*
- *Understanding and managing risk after the volatility of 2018.*
- *How do you think the Asian equity market will perform in 2019?*
- *Do the fixed income and the credit markets have appeal today?*
- *Which way for the global equity markets?*
- *Is there an increasing interest in ESG?*
- *What is the outlook for emerging markets?*
- *Is Asia warming to index and ETF products?*
- *What levels of interest are there amongst private clients today in alternatives, private equity, hedge funds, infrastructure, or property?*

PANEL SPEAKERS

- **Thor Monsen**, Head of Hedge Funds, APAC, Citi Private Bank
- **Michael Levin**, Head of Asset Management, Asia Pacific, Credit Suisse Asset Management
- **Arjan de Boe**, Deputy Chief Executive, Head of MIS, Asia Market, Investments & Structuring, Indosuez Wealth Management
- **Angel Wu**, Managing Director, Head of Product Management Group, Bank of Singapore
- **Simon Godfrey**, Head of Products , EFG Bank
- **Matthew Chan**, Senior Consultant, Mercer

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THE KEY TAKEAWAYS

ESG and SRI rise to the top

Interestingly, the discussion began with the panel focusing on the remarkable rise to prominence of ESG and SRI investment principles, which increasingly inform many investment decisions in the mainstream and also alternative asset markets. One expert agreed that Asia has lagged behind in its adoption but reported that each year his bank holds a large Asia summit and whereas three years only one-third of participants said ESG was a key factor in decisions, this year's summit showed more than two-thirds adopting ESG.

Does ESG translate to outperformance?

As Asia grasps the nettle of ESG and as Asian governments, businesses and even pension funds gradually consider and adopt these principles, there is evidence from the global markets that investments with higher ESG ratings outperform. For ESG to become truly sustainable amongst Asian investors, this theory must prove itself.

Educated millennials embracing ESG

As more and more sons and daughters of wealthy Asians returns from overseas armed with high education and a close appreciation of the latest political and environment and geopolitical issues, there is a strong belief that they will drive the next phase of ESG adoption.

Opportunities open up

The volatility and other events of 2018 have opened value opportunities in investment grade credit and emerging market debt. The very strong economic conditions in Southeast Asia and in India open equity market opportunities.

Greater caution today

Nevertheless, the experience of 2018 has reminded investors of the need for prudence, especially as people comprehend that higher rates will constrain equity valuations and in cases negatively impact fixed income. But there are excellent openings, for example short-term investment grade debt today pays an attractive yield and a more dovish Fed gives a greater likelihood of fully realising that potential return.

China's equity valuations beckon

The negative sentiment towards onshore China has created valuations at just 11 to 12 times earnings for double-digit earnings growth, only three to four times dividend yield. What, asked one expert, is not to like about that with a longer-term perspective?

Hedge funds back in favour

A banker from a global name bank reported that net sales of hedge funds to the Asia client base had quadrupled over the last 18 months. The mission is to invest in markets through long-short and other hedge fund strategies that give market participation but without taking full volatility, without taking full downside risk.

Macro managers struggle for ideas

Macro managers have found it difficult to identify and sustain trends across asset classes. Trading-focused strategies have risen in prominence, compared with directional buy and hold approach. More dynamic management of portfolio risk is necessary.

Private equity rises, but...

Private equity investment allocation is on the increase, although there is so much money chasing deals across the globe that it is difficult to find the right opportunities.

Illiquidity premium turns to discount

There is a real danger that with so much global and now Asian money chasing private equity, the illiquidity premium that prevailed for such investments is now turning into an illiquidity discount. Caution is advised.

THE DISCUSSION BEGAN WITH IMPACT INVESTING and ESG, with the Chair noting while perhaps Asia lags Europe and the US in its adoption, there is rising interest and especially amongst the millennials.

"For several years already, we have included ESG ratings in our client statements for both individual securities, as well as at portfolio level," reported a senior banker. "And we have a big Asia summit each year where ESG often features prominently. Three years ago, during a summit, we asked the clients whether or not ESG credentials play any role in their investment decisions, and about one-third of the clients said yes. Two weeks ago, the same question was met with a two-thirds 'yes' response. The mindset, as you can see, is really changing, even in Asia."

Asia embracing ESG

He added that, for example, the Chinese regulators had now asked listed companies to start reporting on ESG. "Clients are nowadays afraid to miss out on securities with high ESG ratings, whereas before they were less focused," he remarked. "If you look at the European and the US equity markets, you can see that since 2014 high ESG securities outperformed the lower rated ones."

The representative of another global bank agreed that he is seeing a similar pattern. "A few years ago, everyone had to have an ESG policy in order to qualify for, let's say, pension RPs, with ESG factors for example determining

MATTHEW CHAN
Mercer

SIMON GODFREY
EFG Bank

whether that fund could invest in such as a coal mine. Nowadays, however, ESG is driving more investment decisions because of the economic realities both on the liability side of the environmental, as well as the importance and value in driving the social and governance sides and investors are leading this."

He acknowledged the impetus had come from Europe and that the US has followed, but even in Asia yield leading organisations like the Singapore government investment fund have started to include climate change indices in some of their benchmarks.

"I think probably the only way that the trend towards ESG is sustainable is when people believe that it translates into enhanced returns, and I think this is happening, with ESG investing translating into better outcomes for clients."

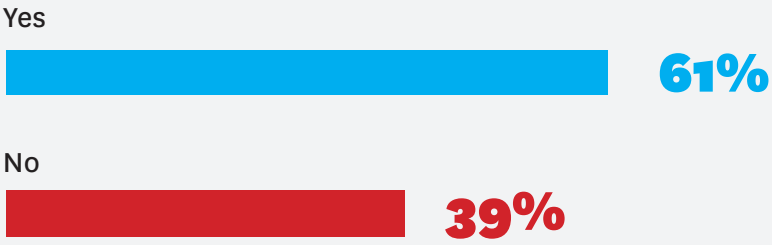
ANGEL WU
Bank of Singapore

More ESG opportunities

Another perspective came from a banker who noted that much of the impetus in Europe is from the government levels, while in Asia this is not likely to follow through in the foreseeable future. However, he said that there is powerful momentum in practical manifestations, for example the Hong Kong green bond market is performing well, there is a strong impetus to food standards and security, and there are more and more initiatives taking place, and required in the future, as well as more educated Asians returning from overseas and focusing on these huge issues.

The discussion shifted to market conditions and the outlook. "We are at a pivotal point in market cycles at the moment," a senior private banker observed. "There is volatility, and uncertainty, so we need to either be cautious or reverse these trends. But there are opportunities, for example yields on debt have risen sharply and there is real value now in places like investment grade credit, and emerging market debt. On the equity side we certainly see

ARE YOUR CLIENTS MUCH MORE INTERESTED IN ESG TODAY?



Source: Asian Wealth Management Forum 2019 - Hong Kong

some very interesting opportunities in this part of the world, for example we are seeing very strong economic conditions in Southeast Asia and in India for example."

Opportunities open up

Another view came from a senior panellist who argued that there is greater prudence and sensibility now, rather than the 'cognitive dissonance' [mental discomfort due to the holding of two or more contradictory beliefs] of early 2018 when we had low rates and tight credit spreads, alongside elevated equity market valuations, and when we had readily adopted the thesis that declining interest rates would drive asset prices higher and support both equity and fixed income. It then took time for people to accept the core, which is the rising rates will constrain equity valuations and negatively impact fixed income."

He continued, theorising that there are currently interesting and active relatively easy investment opportunities. "Although not without volatility risk, rising rates and a flattening of the curve presents a gift as the short end of the curve offers investment grade yields of 4% to 5% yield, and even 5% to 6% blended average investment grade portfolio with a two- to three-year duration. In short, all of a sudden short-term investment grade pays a reasonable yield and a more dovish Fed versus hawkish at the beginning of the last year gives greater likelihood of fully realising that potential return."

Debt offers returns, selectively

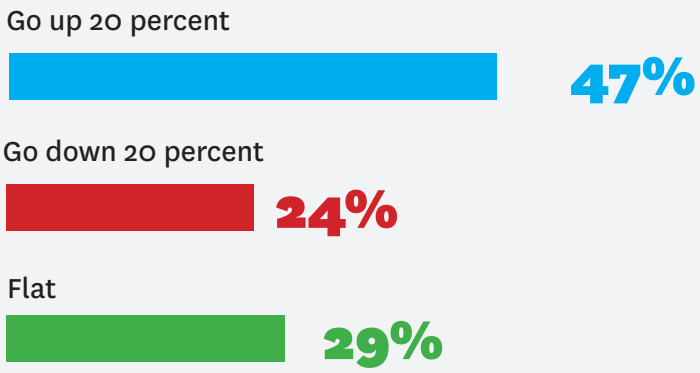
He also added that in Asia investors can pick up floating rate bank loans at 50 to 75 basis points in investment grade and 100 to 200 basis points in non-investment grade; they can build a portfolio of Asian fixed income on 7% to 8% returns, in US dollars at the 3-1/2 year duration. "In short," he reported, "there are some real gifts on the table."

"IN SHORT," HE REPORTED, "THERE ARE SOME REAL GIFTS ON THE TABLE."

He moved on to the equity market to observe that the safe and seemingly comfortable areas such as developed market equities are stretched, so advised caution there, but China, he said, seems to be another gift. "The negative sentiment towards onshore China has created valuations at just 11 to 12 times earnings for double digit earnings growth, just three to four times dividend yield, so what is not to like about that with a longer-term perspective?"

Another expert agreed that fixed income was appealing, and said their clients are very keen on high yield. "We see a lot of interest in something called the unconstrained bond fund, with investors not

WHAT WILL ASIAN EQUITY MARKETS DO IN 2019?



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caring so much whether they are in long duration, short duration or where the market is, as long as it generates yield in an all-weather environment."

China's low valuations

This same panellist turned to equities, agreeing that China remains a very long-term theme. "Our Asian investors like to focus more on Asia, in particular China, and like to accumulate even in down markets. And as to ESG, we are seeing more family offices in the region enquiring about this, so it is a trend developing here."

Hedging your bets

Another perspective came from a big-name private bank who reported that net sales of hedge funds to the Asia client base had quadrupled over the last 18 months. "This is typical offshore, Cayman, hedge fund structures, as well as a small flow in some liquid alternatives like UCITs."

He explained that the bank talk about these ideas to clients starting with the overall top-down view. "We think we are at the late stage of the equity and credit cycle," he commented, "and so do most of our clients, who are sitting on too much cash because they are concerned about where we are in the cycle. Accordingly, if we talk about ideas where the downside risk is less, that gives them more comfort to deploy capital and invest into markets through long-short strategies and other hedge fund strategies that give market participation but without taking full volatility, without taking full downside risk."

THOR MONSEN
Citi Private Bank

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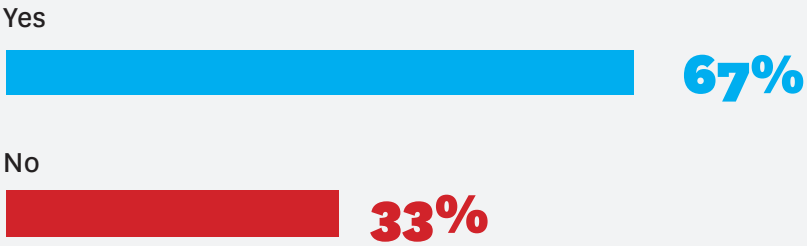
WILL YOUR CLIENTS BUY MORE ETFS IN 2019?



Source: Asian Wealth Management Forum 2019 - Hong Kong

Macro stories struggle

Meanwhile, he noted also that the macro managers have found it difficult to identify and sustain trends across asset classes, so following macro has resulted in underperformance. "I think what we're talking about here is more trading-focused strategies, not the directional buy and hold approach, something a little bit more dynamic, actively managing the overall risk of your portfolio and that should enable you to navigate more volatile markets better than traditional investments."

He added that his bank's presentation on ESG is investing with purpose. "It is a big deal for us," he stated, "because one of the core themes for 2019 is ESG as we are seeing our clients asking for it. And we do a lot of work with our next generation client who are very aware of how the family wealth is invested and they are very receptive to these ideas around ESG."

If looking for trends, here is ESG again

Another expert concurred with this view, adding that there are a lot of papers and discussions showing that doing SRI or ESG, if properly managed, can deliver excess alpha to clients. "And governance is a major issue when funds and pension funds assess whether the company is worth buying or not." Nevertheless, he would like to see more interest shown in mainstream markets such as Hong Kong, which lags even markets such as Taiwan, where pension funds are grasping the concept.

"It will become as a mainstream in Asia as it is in Europe and US as well," came another voice. "On January 29 in the US, 18 large institutional investors representing USD6.5 trillion in investment asked the six largest fast food chains in the US what they are going to do about reducing the impact of their supply chain. It was an open letter so these six companies have no choice but to come up with specific plans to address these issues, if not, investors might pull back."

Private equity appeals, but deals elusive

The discussion turned to key investment ideas that had not yet been covered. Private equity was the first to pop up, with a banker reporting that the activity had migrated from Europe to the point that at least half of its core investments are now in Asia. "Our challenge at the moment is client advertising is growing so fast that it is very difficult to match this with actual investments to match the kind of the goals we set." Another expert agreed, adding that an estimated USD0.5 trillion of money raised globally for private equity remains uninvested.

MICHAEL LEVIN
Credit Suisse Asset Management

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Another expert agreed, noting that private equity had been a core offering at their bank for more than six years. "The commonality of the deals is that they are very specific, for example, real estate in Asia, such as hotels or perhaps logistics projects, or it could be a strategy that buys minority stakes in other private equity companies. Demand remains very high for private equity, but at the same time we are mindful about being very late stage in this asset cycle, so we avoid high leverage, which is something people are getting a little bit too carried away at this stage of the cycle. We think we must be very careful about what we are choosing now."

Watch out for a paradigm shift

"Yes," said another panellist, "tread with caution, as the illiquidity premium that we have lived with for so many decades is now turning into an

illiquidity discount because of the demand from investors. Increased volatility [in the mainstream markets] is translating to people preferring assets without mark to market volatility, so I want to highlight the risk there particularly in private credit where you have $2 trillion raised, often promising very significant yields, double digit net IRRs and there is simply a lack of availability. So, be very cautious, and I should add it is about manager selection as well."

Tactical ideas

A final few comments adding that there is also interest in multi-asset and gold. On gold he observed that it was a tactical holding, because the dollar is quite strong at the moment, and gold also offers a tail risk hedge. Another expert reported that his personal portfolio construction was half cash and half ETFs, the latter diversified equities from APAC, the US, and Europe.

And the final word went to a private banker who highlighted distressed situations in emerging markets. "We will see more of these opportunities going forward rather than fewer, and if you can identify the right manager to pick the right bonds that are trading at $0.75 on the dollar or cheaper, with solid due diligence, the returns can be pretty spectacular. But he also added that clients who invest in this sector must be ultra-HNW type clients, some with an average wealth of USD250 million or more. ■