Making a case for diversification

BY **PATHMA SUBRAMANIAM**

"Don't let how you feel about the markets overrule how you think about investing." This was the key takeaway from Hannah Anderson, global market strategist at JP Morgan Asset Management, for investors at the Standard Chartered Global Market Outlook Forum 2020.

Anderson, who is based in Hong Kong, emphasised that one of the biggest mistakes investors make is letting their emotions get in the way of investment decisions. "I am generally a pretty pessimistic person. I worry a lot about the world, politics, headlines and economic growth because I am an economist and these are the things we think about," she said.

But if she had allowed her investment portfolio to be determined by her general outlook and simply kept her assets in cash, only 2017 and 2018 would have been good years for her. "In every other year, I would have lost out," said Anderson.

She pointed out that if she had allowed her fears to drive how she invested, she would not attain her investment goals of saving for future education, retirement and buying a home. "So do not let how you feel about markets overrule how you think about investing. When we do that, we make really bad decisions."

In her presentation, "Balancing Hope & Fear: The Art of Creating All-weather Investment Portfolios", Anderson said diversification was important as it helped to offset the experience of market drawdowns, which instil a lot of fear. When a drawdown occurs, investors tend to step off their investment goals as they are driven to take money out of the markets and hold on to cash.

"So, if I put money in on Jan 1, 2019, and sold my holdings on Dec 21, I would have lost 11% of the value of my investment. But if I closed my eyes, did not open any of my statements and just checked again at the end of the year, my investments would have been up 16%," she said.

"This drawdown experience happens every year. On average, we are looking at a 20% drop in the value of your investment in one calendar year if you are invested in the MSCI AC Asia Pacific ex Japan Index. Having said that, the average calendar year return has been very positive. So, if I let these drawdowns scare me from putting money in the market, I will miss out on a lot."

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According to her presentation, the MSCI AC Asia Pacific ex Japan Index had seen positive annual returns in 20 of the last 32 years.

Anderson stressed that volatility affects all asset classes, not just equities. It is a common misconception that one needs nerves of steel to withstand the volatility in equity markets.

"But that is not true. You can also lose money in bonds. These are investment vehicles. It is possible that prices move to an extent that they do not make up for the income you get in these investment vehicles called fixed-income assets," she pointed out.

"The volatility [in bonds] is lower than in equities. The drawdowns are much smaller. But it is possible for fixed-income assets to go down in value."

Anderson also stressed the importance of diversification. "Not every type of fixed-income asset will behave like this at every point in time. In the same way, not every equity market will behave in the same way at the same time."

With the help of portfolio diversification, investors will be able to correct behavioural biases. "It helps make the experience, even when it is this dramatic, much more bearable," she said.

"The goal of diversification is to help you manage volatility, to smooth out that variation in your returns, so that your experience as an investor is a lot easier and you do not get as spooked. You do not let all of your fears derail your investment goals. You need to be as active in your diversification as you are in managing what you actually invested in." E

When behavioural biases affect investment returns

BY **KHAIRANI AFIFI NOORDIN**

Retail and institutional investors who do not remain invested may miss out on better returns, said David Wong, senior investment strategist and head of Asia business development (equities) at AllianceBernstein Hong Kong, at the Standard Chartered Global Market Outlook Forum 2020.

To illustrate his point, he recalled what happened early last year, when fear of a potential global recession caused many to move away from equities and riskier assets, resulting in a US$200 billion outflow from equity funds globally. "Despite this, the MSCI World Index was up 27% in 2019. There is now a lot of regret among investors," he said.

In his presentation, "Equity Investing: Are Behavioural Biases Holding Back Your Investment Returns?", Wong said three long-term problems may have kept investors from doing better with their investment portfolios.

The first was the lack of a long-term plan for their retirement. He pointed out that many investors in Asia had a short-termism behavioural bias, defined as an excessive focus on short-term results at the expense of long-term interests.

Many are also driven by a second behavioural bias — loss aversion. "As human beings, we do not like to lose. We have to do something to improve our financial returns. Yet, a study has shown that over a decade, the annualised return of a group with 21.5% monthly [stock] portfolio turnover is 11.4%," said Wong.

"Meanwhile, the group with 0.2% monthly portfolio turnover achieved an annualised return of 18.6% over the same period. In other words, being trigger happy [with your portfolio] does not help you build your wealth."

He pointed out that many investors flee to what they perceive as "safe assets" such as bonds when there is negative news in the market. However, the valuations of stock and bonds have reversed over the last 30 years while US equities have experienced the best consistent earnings growth over the last decade.

"Valuations in equity markets look high because bond yields are at an all-time low. Actually, there is a very large gap between stock and bond yields. It can be seen when comparing the earnings yield of the S&P 500 with yields of the 10-year US Treasuries over the course of the past three decades," said Wong.

Recently, there were concerns in the market about the perceived overvaluation of US equities. He said these concerns and other risks related to developed market equities were overblown. "The S&P 500's annualised return from 2010 to 2019 is 13.6%. By comparison, the annualised return of the MSCI Emerging Markets Index is only 4% (in US dollar terms) over the same period.

> Being trigger happy with your portfolio does not help you build your wealth.
> > ***Wong***

"We in Asia have this perception that we should allocate more to companies in Asia as the region's GDP growth is higher. Actually, we find that consistent growth companies that can maintain a high level of profitability with less cyclicality and more stability are in markets like the US and Europe."

Wong recommended that investors deploy the QSP (quality, stability and price) strategy, which is described as evergreen and will work in different market cycles. With this strategy, investors include companies with a sustainable competitive advantage as well as those with less volatility in their portfolios to gain profit and mitigate risks of downside volatility.

"Investors should also be very disciplined and selective about the price they pay for these companies, especially on a free cash flow yield basis. This strategy blends different factors that lead to outperformance relative to the market. Quality stocks provide upmarket capture. That is the big focus of what investors get when they buy consistently profitable franchises. Stability gives them that downside protection for peace of mind," he said. E

EMs poised to benefit from potentially weaker US dollar

BY **KHAIRANI AFIFI NOORDIN**

A possible softening in the greenback, resulting from a rebound in global growth and quantitative easing in the US, may benefit emerging markets (EMs) this year, said Affin Hwang Asset Management Bhd (AHAM) managing director Teng Chee Wai at the Standard Chartered Global Market Outlook Forum 2020.

He added that there could be a window of opportunity when the US dollar weakens, which could give equity markets in EMs a boost. "When the US dollar is strong, money flows out of EMs and into US dollar asset classes, largely into S&P indices and US government bonds. If the US dollar weakens, people look for opportunities in EMs and Europe."

In his presentation, "Asian Economic Outlook: Why Now is the Time to Invest Closer to Home", Teng said market observers can now see the first signs of green shoots in the global economy, as a result of accommodative monetary policies. "We have seen very early signs of a turnaround globally in some leading indicators, including strength in production numbers and increasing liquidity. We have also seen China implement some modest stimulus policies for its financial markets.

"These can be considered early signs. Things are not getting worse globally as far as economic conditions are concerned. While they are not growing rapidly, markets are at an all-time high in response to this turnaround. To me, this is basically a reflection of a world where there is a lot of liquidity. It does not give investors time to sit around and ponder. Time is money!"

The improving global economic outlook and easing trade tensions between the US and China have led to an increase in the valuations of Asian equities. However, these are still seen as generally inexpensive compared with their regional peers, said Teng.

"One piece of good news is that investors globally are still underweight on EMs. I have not seen major calls to overweight the market. Generally, the funds are tilted to developed markets. In fact, I hear a lot of people talking about exposure to Europe as they are expecting the euro to strengthen. In Europe, there are a lot of deep cyclical companies that will benefit from a turnaround in the economic cycle," he added.

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Southeast Asia is still ignored by global investors, who are focusing their attention on India and North Asian markets such as Taiwan, South Korea and mainland China. The only market in Southeast Asia that has managed to attract investors is Indonesia, due to its progress and reform potential, said Teng.

The same cannot be said for Malaysia, which was one of the worst-performing markets in Asia last year. The FBM KLCI was at a four-year low, with a loss of 7.6% for the year to Dec 16, 2019. By comparison, equity markets in Taiwan, Japan and Singapore gained 18.1%, 16.4% and 4.1% respectively during the period.

"Corporate earnings have been disappointing. This year, expectations of corporate earnings are between 4% and 6%. Let's see if this can be delivered," said Teng.

Against this backdrop, where can investors deploy their money in Malaysia? He said AHAM is currently focusing on banks, plantation companies and those that will benefit from the trade tensions such as plastic product manufacturers.

"Banks are cheap and they are cyclical in nature. Today, nobody likes them because they do not talk about growth. Like it or not, they are linked to the economic cycle.

"The multiplier effect will kick in once the economic activities start to pick up, which will benefit investors. It is worth mentioning that banks do pay good dividends — some at about 5%, which is higher than typical fixed deposit rates."

Meanwhile, crude palm oil prices surged to their highest level in nearly three years at RM3,025 per tonne at the end of last year. This is positive for the sector, considering that the base cost is about RM1,600 per tonne, said Teng.

"The other thing to note is that there are no more new plantations in Malaysia and Indonesia. This means the supply of palm oil will stabilise from the current oversupply over the next 10 to 15 years," he added. E

Low yields to persist

BY **PATHMA SUBRAMANIAM**

Fixed-income instruments made some positive strides in 2019 but may not do as well in 2020, said Karen Chen, senior product specialist at Allianz Global Investors Hong Kong, at the Standard Chartered Global Market Outlook Forum 2020.

"Last year was fantastic. About 50% of the returns [from bonds] came from the fall in interest rates versus historical averages. [The bond market's performance] exceeded expectations last year. We think it is highly unlikely [to repeat the feat this year] because the US Federal Reserve is now holding back [on raising interest rates]. Generally speaking, the whole world will have a very low-yield kind of environment," Chen said in her presentation, "Income Investing: Where Should Investors Turn for Yield in a 'Lower for Longer' Paradigm?".

She pointed out that the Fed had stressed that its monetary policy would be data dependent. Interest rates would probably stay where they were after the previous round of cuts in September last year, she added.

"The majority of the Federal Reserve Bank governors think interest rates will rise higher and may tighten at some point in time. But what the market thinks is also important and it is pricing in one more cut this year," she said.

"If we look at 2019, the Fed had been very hawkish and stood firm on its rate hike expectations. But the market told the central bank that cuts were necessary. And the market won."

Chen said central banks around the world were in an "easing" phase. "The European Central Bank (ECB) and Bank of Japan (BoJ) are already in negative territory."

Bond prices and interest rates have an inverse relationship — as interest rates rise, bond prices fall, and vice versa. Also, the longer the maturity of the bond, the more it will fluctuate in relation to interest rates.

Apart from fiscal policies, geopolitical risks — most predominantly the US-China trade dispute — are bound to continue impacting the financial markets, said Chen. "More importantly, what are corporations going to do? Will they still spend money? We are starting to see many corporations move their operations out of China. In that case, which countries are benefitting?

"Will this kind of business spending spill over into the service part of the economy? So far, we have not seen that happen yet."

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> > *Chen*

She added that the markets also has to deal with the impact of Brexit and everything that is going on in Europe and the Middle East. "These are constant risks throughout the year."

Seeing that the interest rates set by the ECB and BoJ are already in negative territory, investors should be looking elsewhere for positive-yielding debt, said Chen. "Any sensible investor in Europe and Japan will be going out of the country and looking for positive-yielding debt. So, that is another force pressuring yields down in the positive-yielding world such as the US, which is the largest and strongest developed market. We are seeing a lot of flows into US bonds, hence yields remain very low, and some of the Asian bonds as well."

In the hunt for yield, investors will have to venture a little out of sovereign bonds, she said. "To beat inflation, you need to go further out to credit quality. Emerging-market debt will definitely give you a lot more yield potential. But yield does not equal returns. So, investors need to be mindful." E