Big on themes

Our panellists highlight mega themes that will impact markets and how investors should position themselves to ride out the volatility

ILLUSTRATION: ISTOCK

Market volatility is par for the course in investments. Yet investing with a strategic view of mid to long-term themes that could drive markets may help investors to weather volatility and reap rewards. Our experts share their picks of Mega-Investment themes.

Genevieve Cua: Certain investment themes have been dominant over the recent decade, such as the commodities cycle, central banks' action and China. What themes do you expect to be dominant over the next five to 10 years and why?

Alvin Lee: The three key themes we think that are going to be relevant in the next five to 10 years are the China stock market, the US dollar and central bank policy actions. The Chinese economy has been a key contributor to global economy over the last 10 years with its high growth and outsized impact on the commodity market. In particular, incremental demand from China resulted in record high prices for commodities such as industrial metals, iron ore, coal and oil.

While the domestic economy has grown at a robust pace, the stock market continues to be poorly represented in all major indices. The MSCI and FTSE indices have a disproportionately low weighting in Chinese equities relative to the sheer size of its economy due to the lack of accessibility. Investment quota for foreign investors, capital controls and ownership issues have prevented the major indices from including more of the China-related companies in their widely followed indices.

We think this is set to change, as China continues on its path of financial and capital market reforms which will eventually lead to the proper inclusion of China-related listed companies in their indices. Although the inclusion will take place over a period of two to three years, the impact nonetheless will be very significant and will draw considerable interest and attention to China and Asia.

- The other key theme will be the US dollar which will remain the dominant reserve currency of the world. We think that the recovery of the US economy is understated. With the US Federal Reserve FOMC (Federal Open Market Committee) not raising interest rates as a pre-emptive measure to control the economy and inflation, the risk is that the US economic recovery will gather further steam and perhaps eventually trigger a series of faster than expected rate hikes down the road.

  The US domestic employment market is tightening and the housing market continues to be strong. An uncertain China growth trajectory and a low inflationary environment are key considerations for the Fed not raising interest rates at this juncture. We think this delay in rate hikes and a subsequent stronger US economy could lead to a stronger dollar trend over a prolonged period of time.
- The last important theme we think will prevail over the period is central bank policy actions. In recent years, all major central banks have been actively intervening in the currency market. This is in addition to unprecedented monetary actions by the FOMC, ECB (European Central Bank) and BOJ (Bank of Japan) which have brought their policy rates down to nearly zero. We think the eventual unwinding of such stimuli will likely lead to volatility, as financial markets are weaned off a period of prolonged low rates and easy money.

Marc Van de Walle: The issues that have been the dominant factors in the global economy are unlikely to change significantly:

- Central banks will remain key players in guiding the developed economies towards recovery and then trying to head off a serious inflation overshoot once that has happened. Their effectiveness will be key to financial market performance.
- China's sheer size means that it will demand attention. A key question is whether it can achieve a smooth transition to a slower, more sustainable growth path and gradually rebalance its economy towards more consumption, or whether it will have the typical uncomfortable hangover after a huge credit boom. This will have an influence on the speed at which it opens its capital markets, which, in turn, will determine when these can be included in major international indices.
- We should also watch how the spread of disruptive technologies affects incumbent industry players and unemployment. Perhaps these technologies can contribute to increasing productivity growth, which has been missing over the last decade. And productivity growth will be crucial as demographic problems will really start to bite across much of the developed world over the coming decade.
- Other themes include re-regulation versus de-regulation and its influence on the financial sector's profitability; "peak trade" or the end of globalisation; social inequality, political populism and global stability.

Bhaskar Laxminarayan: We believe that innovation will be a key determinant in the future growth of economies. We focus our attention on the Internet of Things, robotics, healthcare, transportation, Big Data, energy and new materials. While the determination of the timing of these events or the impact thereof on the real economy poses certain challenges, the potential players who can address these markets are a little easier to identify. This also leads to our core investment strategy of owning quality players with dominant market shares and a demonstrated ability to create shareholder value in these segments.

Genevieve: Given your choices of major themes, how should investors position themselves to benefit from the themes both in terms of maximising returns and mitigating risk?

Alvin: First, investors need to understand that the increased volatility will not just affect equity markets but will be felt in other asset classes going forward. The FX, commodity and fixed income markets will invariably see huge swings periodically, as the speed of capital flows will inflate and deflate asset bubbles globally.

The best protection investors can have is to diversify their investments and fully understand their own risk tolerance. Maybank Private Wealth has been promoting multi-asset and globally diversified funds to investors in the last two years, as we see the importance of a diversified portfolio.

Investors need to ascertain their downside risk tolerance, liquidity requirements and invest accordingly. Panic and fear are often exacerbated during times of heightened market volatility. Excessive and unwanted risks can be mitigated with a disciplined and sensible approach to investing.

Marc: A long-term investment strategy demands a well-diversified approach tailored to an individual's circumstances and risk tolerance, so it is hard to generalise. It also requires regular monitoring and updating, as a portfolio that is suitable for today's world might not be appropriate in a few years.

That said, from a tactical perspective, there are a few issues that occupy us at the moment. Firstly, how to be positioned in a world where the US is set to embark on a slow, but lengthy tightening cycle. This pushes us away from low yielding investment grade bonds and towards higher yielding bonds or equities.

Secondly, we ask ourselves the question of when to rebalance away from developed market equities and

THE BUSINESS TIMES' WEALTH ROUNDTABLE

Genevieve Cua, BT Wealth Editor poses questions to wealth experts for their insights on Mega-Investment themes.

Alvin Lee is *Maybank Head of Regional Private Wealth.* Alvin has over 23 years of banking experience across wealth management, corporate, consumer banking and treasury, with specialisations in product and risk management across several markets spanning Asia, Europe, Africa and the Middle East. Alvin is president and honorary treasurer of the Raffles Rugby Union. He is also board member of Rugby Singapore Pte Ltd, the special vehicle that manages the Singapore leg of the World Rugby 7s.

Marc Van de Walle is *Bank of Singapore Global Head of Products.* Marc has responsibility for the product platform on which all wealth management solutions are built. He has responsibility over the bank's investment strategy, research, discretionary portfolio management, trading advisory, wealth planning and trust services. Marc is an avid golfer and skier. He also has a keen interest in wine.

Bhaskar Laxminarayan is *Pictet Wealth Management Chief Investment Officer – Asia.* Bhaskar is responsible for investment strategy for Pictet's private banking business in Asia. He is an avid reader of a wide range of genres and topics. He also enjoys photography and is a dedicated foodie.

ROUNDTABLE

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> **Marc Van de Walle, Global Head of Products, Bank of Singapore**

towards emerging markets. Valuations are starting to look attractive in emerging markets, but we are still troubled by the individual problems of some countries as well as their vulnerability to higher US interest rates and the slowing Chinese economy. More convincing signs of stabilisation in China could be the turning point.

The era of low volatility is probably drawing to an end as US monetary policy settings start to normalise and that means that investors need to be particularly aware of the typical behavioural finance traps that can damage returns. Reading Daniel Kahneman’s excellent book Thinking, Fast and Slow is a good place to start.

Investing in technological change is challenging, partly because most of the benefits tend to accrue to the consumers, but also because it is so hard to spot winners. This is where strong, unbiased research becomes really important.

Bhaskar: Clearly a diversified portfolio is the way to go. As we mentioned earlier, while predicting the success of themes in a particular time period remains challenging, having a portfolio mix reflecting these trends would be a good approach to mitigate risk while remaining exposed to these opportunities.

Genevieve: What risks do you think global and Asian markets are most vulnerable to in the near to mid-term that are not currently adequately anticipated by markets?

Alvin: The financial markets have been reacting to possible global recessionary fears, as well as hard landing scenarios in China and other emerging market economies. Deflation concerns and further monetary easing from major central banks have also been widely discussed. So the only elephant left in the room is geopolitical risk. Any sustained escalation of tensions in the South China Sea or the Middle East are some examples of such risks.

Marc: The markets seem to have spent too much time focusing on risks in recent years, as seen by the high proportion of cash held by many investors – even though that guarantees them negative inflation-adjusted returns in a world of zero interest rates. In fact, markets have been worried about policy tightening by the Federal Reserve ever since former chairman Ben Bernanke caused the taper tantrum back in mid-2013. We are concerned that US interest rates could rise faster than the market expects, which could generate some stresses, but the basic idea that US rates are heading higher is not going to surprise anyone.

Another concern is that profits in the US account for an unusually large share of national income. If labour markets continue to tighten, then at some point we could see workers regaining some lost ground, and profit margins could be squeezed, which would not be good news when equity market valuations are already fairly stretched.

Closer to home, we wonder whether China can successfully stabilise growth and rebalance its economy. The history of countries that have seen similarly rapid credit expansions is a very unhappy one, so a smooth transition will require remarkably adept policymaking. The consequences of an abrupt growth shock could be severe both inside the country and across the region, and confidence in the policymakers has been undermined by recent policy missteps.

Bhaskar: Lack of demand remains a key risk all around. The low momentum growth recovery that we are witnessing at a global level does not augur well for an improvement in earnings cycle and valuations don’t offer support for negative surprises.

Genevieve: Investors may explore alternative assets such as private equity (PE) as a way to harvest more returns despite the illiquidity. What types of exposures in the PE space do you see as most promising with a mid to long-term view?

Marc: The nature of private equity is that there will always be interesting opportunities. From a top-down perspective, the energy and real estate sectors, particularly in Europe, appear promising. Private debt is also generating interest, as bank lending is stymied due to regulatory reasons. However, private equity deals depend largely on bottom-up deal sourcing and due diligence, and depending on their ground presence, skilled managers should be able to identify attractive opportunities regardless of geographies or sectors.

At Bank of Singapore, we have an open architecture platform, providing our clients with access to best-in-class managers globally through a diverse selection of private equity funds. We prefer managers with experience across cycles, and undertake a top-down macro view as well as a bottom-up manager specific analysis in evaluating opportunities for our clients.

Bhaskar: We are big believers in private equity. This becomes even more relevant in an era where public market returns are going to trend lower than they have in the past. We prefer the more mature part of the private equity cycle as against angel or early stage investing. W