



Staying the course

Our panellists share their top calls for asset allocation and risk exposures for 2016

2016 is shaping up to be a challenging year, as monetary policy diverges further and volatility is expected to remain elevated. We ask our panel of experts for their insights into investing and asset allocation this year.

Genevieve Cua: Please share with us your top calls for asset allocation and risk exposures this year, and why you hold those views.

John Woods: In fixed income, we remain broadly cautious as core yields are likely to rise further, although we expect corporate bonds to outperform. Floating rate notes are an alternative to global fixed rate issues and inflation-linked bonds as a portfolio hedge against acceleration of inflation. We think the key to extracting value from the high-yield sector is a carefully diversified selection of credit risks as global credit conditions tighten. Senior Loans, which are secured credits, offer a similar expected return through lower coupon and higher recovery rates in case of defaults. Convertible bonds are also an appealing source of yield and capital gain for the current cycle.

In Asia, we remain neutral on Asian hard currency bonds with a preference for selected investment grade Asian corporate credits, where credit spread tightening is likely to offset the potential negative impact of rising US Treasury yields.

We prefer equities over major asset classes, but returns may be limited as valuations are fair: global equities' P/E (price-to-earnings ratio) stands at 15x, P/B (price-to-book ratio) at 1.9x and dividend yield of almost 3 per cent. We believe an active tactical approach is necessary, seizing op-

portunities during setbacks and high volatility. The likely outperformers are regions with further unconventional monetary policies such as the eurozone and Swiss equities, and attractively valued Australian equities as the prospect for a stabilisation of commodities slowly improves.

In Emerging Markets (EM), we favour China, Taiwan, South Korea and Singapore. Investors may also look into Russia. Our preferred sectors are healthcare and technology and our preferred themes are Asian tourists, cash-rich corporates for stock buybacks, dividend growers and M&A.

In commodities, we remain neutral on valuation. But supply and capacity overhangs limit upside at least early in the year. Gold would be caught in states of flux due to the US Fed trajectory and US dollar (USD) trends. We believe active commodity strategies that take advantage of short-term movements should be well placed to deliver returns.

In forex, since the Fed started hiking, there may be some short-term consolidation of USD against the G-4 majors – euro (EUR), Swiss franc (CHF), pound sterling (GBP) and Japanese yen (JPY). This is due to temporary decoupling of interest rates and forex, as well as the overbought nature of the USD heading into the Fed hike. For investors that are substantially overweight in USD, particularly against the EUR or CHF, a temporary reduction in existing USD long positions is advisable.

Over the longer run, USD is expected to stay strong as the US economy recovers. Our tactical (three to six months) view on the USD is neutral versus EUR, CHF, bearish versus JPY. Asian currencies are expected to stay on the defensive, at least in the first half of 2016.

EM and Asian currencies are still lagging the selloff in the commodity complex, adding to the risks of carry and growth gap reduction. This anticipated weakness is also in

line with the recovery in the US economy, rising US interest rates and further weakening of the yuan post-Special Drawing Rights (SDR) inclusion announcement. Thus, we remain negative on most of the Asian currency block. The notable exception would be the Malaysian ringgit, where we see significant undervaluation offsetting the prevailing cyclical risks, leading to a neutral overall view.

Steve Brice: Looking forward, one thing we can be sure of is that the investment environment is not going to get easier in 2016. One key factor is the stage of the cycle the US economy is in. If you believe we are closer towards the end of the cycle, that is, close to a recession, then a defensive stance would be warranted.

We take a more constructive view. While we acknowledge that this cycle is already one of the longest on record, the US Federal Reserve is still focused on supporting growth rather than fighting inflation. Therefore, we believe we have at least 18 to 24 months of the US economic expansion remaining. We believe this can still be a good point of the cycle to be invested in risk assets such as global equities and US high yield bonds. As returns are normally negative in the last six to 12 months of any economic cycle, this means we are getting closer to the end of the equity bull market.

One key variable we intend to monitor is US inflation. We expect deflationary pressures to abate over the coming 12 months as the job market tightens and as oil prices eventually bottom. However, we do not expect inflation spiking anytime soon due to continued excess capacity elsewhere in the world. However, if inflation picks up briskly against expectations, this would be a significant headwind for risk assets as it would increase the pressure on the Fed to tighten monetary policy aggressively.

Within equities, we have a preference for euro area equities (currency-hedged) and Japanese equities. A continuation of stimulative European Central Bank (ECB) policies and a change in leadership from export-heavy sectors to those with a focus on domestic demand are expected to be among the key drivers of euro area markets in 2016. Valuations are elevated, but we expect earnings growth to drive equities going forward, instead of price earnings multiples expansion.

For Japan, following the yen-induced surge in corporate earnings since 2013, consensus expectations are for a more modest 11 per cent growth in 2016. While subdued in comparison to the 62 per cent growth recorded in 2013, it still represents the fastest growth among the large developed markets.

Valuations are still below long-term averages at 15x 12-month forecast earnings. Of potentially more importance than headline valuations is the trend in return on equity (ROE), which reflects the progress made on reform in the corporate sector. The current ROE is 8.8 per cent – above the long-term average of 8.2 per cent. Improving corporate governance and dividend payout ratios are also significant factors in our preference for Japanese equities.

Hou Wey Fook: The driver that will create market volatility in 2016 is the Fed rate hikes, on the back of a healthy US economy that has seen a steady drop in the unemployment rate. We believe that despite these rate hikes, US monetary policy as compared to past cycles will remain accommodative for a period of time. We see the economies of Europe and Japan stabilising, and China is transiting into a more sustainable growth path, albeit slower than before.

Such a backdrop is usually favourable for risk assets of equities and corporate bonds for the longer term. However, the headwind from rising interest rates will usher in short-term market uncertainty. Our 2016 roadmap for the US stock market is that it will trade in a broad range with higher volatility – not dissimilar to the 1994-96 period when rates rose. Equity markets in the rest of the world would likely exhibit similar characteristics given the strong influence the US market traditionally has on them.

2016 is likely to be a year where “alpha” returns are more important than “beta” returns. Simply put, “alpha” is ideas-specific returns while “beta” is the return from the general market performance. Although we are of the view that markets will end the year higher, we think it is unlikely – given the backdrop of rising rates – that market indices will register strong absolute performances.

Therefore, strategies that can extract alpha are the best ways to enhance portfolio returns. Investors can integrate a number of alpha strategies, namely, investing in specific themes and strategies within the equity asset class; in the

“yield carry” theme within bonds; and in non-correlated hedge funds.

We seek stocks of companies that demonstrate strong competitive advantage either through their use or production of new innovative technologies. For example, we like companies that are spearheading innovative sectors in Big Data and analytics, robotics, energy and environmental systems, financial services innovation, medicine and neuroscience, among many others. In a world of technology changes and globalisation, innovation has been a key success factor for many companies that have consistently generated excess shareholder returns. Therefore, investing in them provides opportunity for alpha returns.

We like EM high yield bonds over low risk investment grade bonds and cash deposits. We expect the compression of yield spreads to offset the drag from higher Treasury bond yields. Past market cycles suggest that each time rates started to rise, yield spread compression took place. Thus, the “yield carry” strategy from holding a diversified portfolio of well-researched emerging market credits is likely to produce superior returns over low risk government bonds.

Selling optionality is another way to extract additional returns versus a buy-and-hold strategy. Given our market roadmap of a “broad trading range with higher volatility” for 2016, we believe portfolios can benefit from generating premium income via selling covered call options on stocks held in the portfolio that are viewed to be trading below their fair values. Investing in non-correlated strategies, namely hedge funds, is an important strategy to enhance risk-return characteristic of a portfolio as well as to add alpha returns.

We like hedge funds with good long-term track records in strategies such as long-short equity, global macro and multi-strategy. We are also keen on “unconstrained” bond funds in which the mandate allows for a wider opportunity set and flexibility for the manager to express a negative view on rates through active management of duration, yield curve and currencies.

On asset allocation, we upgrade EM high yield bonds to overweight, while holding underweight in developed market investment grade bonds. On equities, we maintain a neutral weight position with Europe as our preferred market. Negative interest rates in many parts of Europe and the ECB’s readiness to extend its quantitative easing programme would act as strong tailwinds for the market. We upgrade Asia to a neutral weighting after being underweight in the last three years. Valuations have now become compelling relative to developed markets.

Matthew Colebrook: Our house view remains that we are in a “fragile equilibrium” of low growth, low inflation and low medium-term asset class returns. Inflation remains

subdued in advanced economies and across Asia and, if anything, deflation risks are in the ascendant. While we foresee modest global equity returns for the long term, it remains our conviction that investors are much better off investing in this asset class rather than in government bonds and cash.

We believe the outlook for Europe has improved, and growth should continue to pick up, supported by accommodative monetary policy. Corporates have benefited from a weaker currency and low commodity prices, and we envision the net positive impact of these factors should continue to support European equities.

Within EM, we have a preference for Asia ex-Japan equities, based on their stronger fundamentals and attractive valuations, which have fallen to levels last seen during the global financial crisis. It’s hard to argue that the region’s fundamentals justify such low valuations. Asia ex-Japan has generally benefited from a strong reform agenda which has tackled a myriad of issues, such as financial and agricultural reform, improved governance and labour market improvements. These are especially visible on a country level, in markets such as India and China.

Our clear preference on a sector level is for cyclical stocks, as they look to be the most attractive from a profitability and valuation perspective; these stocks have yet to realise their full potential. However, in light of the ongoing volatility, we believe investors should remain truly diversified.

In terms of fixed income opportunities, we think returns will be very similar to what we have seen in 2015, with low to mid single-digit returns across bond segments. We continue to prefer Europe and Asia, which are more resilient and supported by economic stability or even a soft acceleration, in our view. On the other hand, we remain cautious on the US, particularly US government bonds, which may suffer from the Fed’s rate hike cycle.

There are of course many risks to the outlook as well. Unlike in 2015 when deflation was looming, market expectations may lean towards a scenario of more synchronised demand globally, with the US accelerating, Europe picking up, Asia – and China in particular – stabilising, and Latin America coming out of a very disappointing 2015.

In this scenario, the Fed will be under greater pressure to raise rates. Emerging countries also present significant risk, and we will continue to monitor their structural adjustment. We will be paying close attention to the risk of a credit tightening within EM corporates in particular. Over the past few years, EM corporates have been relying heavily on US dollar liquidity and the new rate cycle will make their life more difficult in that respect. Overall, we expect 2016 to be another very busy year on fixed income markets. ■

THE BUSINESS TIMES’ WEALTH ROUNDTABLE

Genevieve Cua, BT Wealth Editor poses questions to wealth experts for their advice on investment strategies.



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Steve Brice is Standard Chartered Bank Chief Investment Strategist, Group Wealth Management. Steve is an expert on the world economy

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Hou Wey Fook is Bank of Singapore Chief Investment Officer and Managing Director. Wey Fook, a CFA, has 28 years’ experience in managing

portfolios across asset classes of equities, bonds, mutual funds and hedge funds. He enjoys golf and reading.



Matthew Colebrook is HSBC Singapore Head of Retail Banking and Wealth Management. Matthew has over 28 years of experience in the

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