UOB

Investment Insights

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Top 5 Questions Investors Would Want Answers To

Opening

Markets started 2019 on a positive note, with investors enjoying a strong run in global equities (**+11.9%**). The rapid recovery follows a **-13.31%** correction in equity markets in the fourth quarter of 2018. Though concerns over US-China trade tensions and Brexit remain, positive data and developments drove market optimism.

In this issue of Investment Insights, we address the top 5 questions that investors might have.

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Should you have any queries, please contact your UOB Banker for more information.

Q1. Is a diversified multi-asset strategy still relevant in a volatile market?

It is hard to predict the best performing asset class in any given year. Figure 1 above shows the calendar returns of different asset classes ranked by their performance. As seen in the table, there is no asset class that consistently tops the charts. For example, APAC ex Japan topped the chart in 2012 and 2017 but it was at the bottom in 2015 and 2018. Thus, maintaining a diversified portfolio allows an investor to capture returns from top performing asset classes and avoid being concentrated in the worst-performing asset.

When diversifying one's portfolio, a common blind spot is either taking too little risk or too much risk. One approach is to divide your wealth strategy into 2 components - core and tactical. Core strategies focus on safeguarding your existing assets and build future assets through appropriate risk management. Allocation to core strategies should form the bigger portion of your wealth portfolio. Tactical strategies, on the other hand, help to capture market opportunities to enhance your overall returns.

The multi asset strategy leverages on diversification with lower volatility, hence it sits within the core strategy allocation that can help to build assets and sustainable income stream for the future. Therefore, it can be an evergreen allocation in one's investment portfolio.

Figure 1: Investment returns of various asset classes.

												10-yrs ('09 - '18)	
2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	4Q '18	Ann. Ret.	Ann. Vol.
Global Bonds 4.8%	EM ex-Asia 91.3%	U.S. REITs 28.5%	U.S. REITs 8.7%	APAC ex-JP 22.6%	DM Equities 27.4%	U.S. REITs 30.4%	Asian Bonds 2.8%	EM ex-Asia 27.1%	APAC ex-JP 37.3%	Cash 1.8%	Global Bonds 1.2%	U.S. REITs 12.2%	EM ex-Asia 23.1%
Cash 1.8%	APAC ex-JP 73.7%	APAC ex-JP 18.4%	EMD 8.5%	Global Corp HY 18.9%	Global Corp HY 8.4%	Asian Bonds 8.3%	U.S. REITs 2.5%	Global Corp HY 14.0%	DM Equities 23.1%	Asian Bonds -0.8%	Asian Bonds 0.7%	Global Corp HY 11.1%	U.S. REITs 21.0%
Asian Bonds -9.8%	Global Corp HY 63.9%	EM ex-Asia 16.6%	Global Bonds 5.6%	EMD 18.5%	Diversified 5.6%	EMD 5.5%	EMD 1.2%	EMD 10.2%	EM ex-Asia 20.3%	Global Bonds -1.2%	Cash 0.6%	DM Equities 10.3%	APAC ex-JP 18.5%
EMD -10.9%	Diversified 41.0%	Global Corp HY 13.8%	Asian Bonds 4.1%	U.S. REITs 17.8%	APAC ex-JP 3.7%	DM Equities 5.5%	Cash 0.0%	U.S. REITs 8.6%	Diversified 17.0%	Global Corp HY -3.5%	EMD -1.2%	APAC ex-JP 10.2%	DM Equities 14.4%
Global Corp HY -27.9%	DM Equities 30.8%	Diversified 13.1%	Global Corp HY 2.6%	EM ex-Asia 17.0%	U.S. REITs 2.5%	Diversified 4.1%	DM Equities -0.3%	Diversified 8.3%	Global Corp HY 10.3%	U.S. REITs -4.6%	EM ex-Asia -1.9%	Diversified 8.6%	Diversified 10.1%
Diversified -27.9%	U.S. REITs 28.6%	DM Equities 12.3%	Cash 0.1%	DM Equities 16.5%	Cash 0.0%	APAC ex-JP 3.1%	Global Bonds -3.2%	DM Equities 8.2%	EMD 9.3%	EMD -4.6%	Global Corp HY -4.2%	EMD 7.8%	Global Corp HY 8.8%
U.S. REITs -38.0%	Asian Bonds 28.3%	EMD 12.0%	Diversified -2.4%	Diversified 15.9%	Asian Bonds -1.4%	Global Bonds 0.6%	Diversified -3.2%	APAC ex-JP 7.1%	Global Bonds 7.4%	Diversified -5.9%	Diversified -5.2%	Asian Bonds 7.5%	EMD 6.8%
DM Equities -40.3%	EMD 28.2%	Asian Bonds 10.6%	DM Equities -5.0%	Asian Bonds 14.3%	Global Bonds -2.6%	Global Corp HY 0.2%	Global Corp HY -4.9%	Asian Bonds 5.8%	Asian Bonds 5.8%	EM ex-Asia -6.9%	U.S. REITs -6.7%	EM ex-Asia 5.0%	Global Bonds 5.1%
APAC ex-JP -51.6%	Global Bonds 6.9%	Global Bonds 5.5%	APAC ex-JP -15.4%	Global Bonds 4.3%	EMD -6.6%	Cash 0.0%	APAC ex-JP -9.1%	Global Bonds 2.1%	U.S. REITs 5.1%	DM Equities -8.2%	APAC ex-JP -8.8%	Global Bonds 2.5%	Asian Bonds 4.7%
EM ex-Asia -57.2%	Cash 0.1%	Cash 0.1%	EM ex-Asia -21.2%	Cash 0.1%	EM ex-Asia -8.5%	EM ex-Asia -20.2%	EM ex-Asia -22.7%	Cash 0.3%	Cash 0.8%	APAC ex-JP -13.7%	DM Equities -13.3%	Cash 0.3%	Cash 0.2%

Source: J.P. Morgan Asset Management, Bloomberg Finance L.P., Dow Jones, FactSet, J.P. Morgan Economic Research, MSCI.

Notes:

- J.P. Morgan's "Diversified" portfolio assumes the following weights: 20% in Developed Market equities, 20% in Asia Pacific ex-JP equities, 5% in Emerging Market ex-Asia equities, 10% in the Emerging Market Debt, 10% in Global bonds, 10% in Global Corporate High Yield bonds, 15% in Asian bonds, 5% in US REITs and 5% in Cash.
- Diversified portfolio assumes annual rebalancing.
- All data represent total return in U.S. dollar terms for the stated period.
- 10-year total return data is used to calculate annualized returns (Ann. Ret.) and 10-year price return data is used to calculate annualized volatility (Ann. Vol.) and reflects the period 31/12/08 – 31/12/18.
- Past performance is not a reliable indicator of current and future results.
- Data reflect most recently available as of 31/12/18.

Q2. Should I hold cash in this investment climate? How much should I hold?

It is always prudent to set aside some cash for emergency needs. A common recommendation is to set aside six to nine months of living expenses to cater to your liquidity needs. Keeping an emergency fund minimises an investor's risk of converting investments into cash at unfavourable prices.

However, holding too much cash has hidden costs. In rising markets, a portfolio with too much cash over a long period of time can cause a drag on overall returns given the low returns of cash and the erosion of its value by inflation (see Figure 1). Conversely, keeping cash to be deployed when opportunities present themselves can be a sound strategy. A common pitfall, however, is not having the discipline to enter the market due to inertia. A more sustainable strategy could be setting up a disciplined rigour that invests the cash at regular intervals.

Q3. Will the US Federal Reserve Board (Fed) continue to hike rates in 2019?

The recent Fed meeting surprised many investors with a dovish stance and projecting no further rate hike this year. We are of the view that the Fed is done with the current rate hike cycle and no further rate hikes are expected in 2019 and 2020. There might be a possibility that the Fed may cut interest rates by 0.25% in 3Q 2020 if economic growth remains sluggish.

Q4. Chinese stocks have fallen significantly in 2018. Is this a good time to invest in China?

After falling **-12.4%** in 4Q 2018, optimism over a deal to ease the US-China trade war and a stable renminbi resulted in a strong **+21.9%** rally in China's stock market. In the short term, the strong momentum behind Chinese stocks is expected to continue as both countries have demonstrated ongoing progress and resolve in reaching an agreement. While there are concerns over China's slower growth of 6.0% to 6.5% for 2019 compared to 2018's 6.6%, the government has taken measures to support economic growth. Measures such as cutting the reserve requirement ratio (RRR) for banks to ensure sufficient liquidity and fiscal stimulus in the form of tax cuts and infrastructure spending have been put in place.

In the long term, investors cannot ignore the country's large domestic economy and fast-growing middle class that will be an important engine of growth. Additionally, China's US$3.55 billion artificial intelligence (AI) market, which grew 67% in 2017, is expected to continue to spur economic growth and improve productivity. As such, investing in China over the medium term may be rewarding given its long-term prospects. To mitigate volatility, investors can consider deploying combinations of the following strategies:

a) **No big allocation** – a good test of allocation size would be to ask yourself if you would lose sleep if its value halves.

b) **No big bets** – smaller amounts at higher frequencies to take advantage of better entry points when the market dips.

c) **Have an exit plan** – set a target return for review and have the discipline to consider the necessary actions when the target is met.

Q5. Will the United Kingdom (UK) leave the European Union (EU) without a deal?

At the time of writing (22 March 2019), the UK Parliament has requested an extension of Brexit till 30 June 2019, but the EU has only approved an extension till 12 April 2019, with the possibility of a further extension till 22 May 2019 should the UK Parliament agree to Theresa May's Brexit deal. The best case will be a swift approval of May's Brexit deal, which will provide certainty to investors. This is unlikely as May's deal has been voted down twice with no significant changes in between. The worst case will be a no-deal Brexit where the UK leaves the EU without any agreement in place. This is also unlikely as the UK will rather ask for a longer extension than to risk this outcome. Our base case is an extension where the UK government goes back to renegotiate terms with the EU, thus prolonging the uncertainty. Not knowing how the outcome will be, European markets will likely see increased volatility in the coming months as both sides struggle to find common ground.

Market Outlook and Strategies ▶▶

Economic Drivers

Global growth	The IMF forecasts global GDP growth to slow to **3.5% in 2019**[1] **from 3.7% in 2018**, on par with the average growth rate from 2012 to 2016. However, slower growth does not equate to a recession in 2019.
Inflation and central bank	Central banks have adopted a dovish tone. The Fed and ECB will not be hiking rates in 2019, while the BoJ will likely stay accomodative for the foreseeable future.
Corporate earnings	In 2019, strong personal consumption supported by a healthy jobs market should continue to drive the **positive trend** in corporate profits. Global earnings growth is expected to rise around **8% in both 2019 and 2020**.

Risks

Rising US protectionism	The US could impose more tariffs on Chinese products in 2019. **Continued trade woes** will hit Asian economies that are plugged into global value chains. Higher import prices could raise costs and lower profit margins.
Central bank policy missteps	Inflation continues to rise amidst a tight labour market. The heightened risk of **inflation overshoot** could prompt central banks to increase rates aggressively. Conversely, if central banks are **overly-aggressive in tightening** monetary policy without high inflation, the excessive reduction in liquidity could suffocate economic growth.
Political risks	Prime Minster May's Brexit plan has yet to gain acceptance among UK MPs. However, there is increasing consideration given to extending Brexit beyond 29 March 2019, and possibly a second referendum. As a result, financial markets could see increasing volatility as politicians continue to bicker.

[1] World Economic Outlook, IMF, January 2019

High Conviction Strategies

Conviction	Key Proposition	Risks
Global Quality Equities	Global quality equities tend to outperform broad equity markets over longer investment cycles.	Relatively expensive valuations could increase the probability of short-term corrections. However, the quality companies tend to better weather the economic slowdown, limiting the likelihood of large corrections in quality stocks.
Emerging Market Equities	Broad EM equities are supported by stronger fundamentals and attractive valuations.	An unexpected surge in USD strength could cause a retreat from EM equities, as seen in the Turkey situation last year. A worsening of US-China trade tensions could also lead to higher market volatility.
US Financial Equities	Attractive valuations and higher earnings due to rate hikes.	An escalation in the US-China trade war will hurt global growth. US banks will feel the impact directly. Increase in regulatory pressure on certain wayward banks that have been alleged of criminall wrongdoing (e.g. money laundering) will pose idiosyncratic risks.

Megatrend Strategies

Conviction	Key Proposition	Risks
Global Healthcare Equities	Healthcare is a structural growth story driven by long-term growth in an aging global population. In the medium-term, we expect drug approvals and an increase in M&A activity to be catalysts for a sector re-rating.	Policy uncertainty could weigh on sentiment for the sector. Concerns over drug pricing could place pharmaceutical companies under closer scrutiny in the near-term. This risk will likely be mitigated in the long-term as a growing silver segment should contribute to stronger increase in demand.
Chinese Equities	Chinese equities are underowned by global investors, and provide a good risk-reward and diversification benefits.	A US-China trade war remains a key risk in the near term. Negotiations are likely to be long-drawn, but both sides have shown commitment in reaching a deal sooner rather than later. Financial deleveraging could continue to put pressure on growth and lead to higher risks of policy missteps.
AI & Innovation-Driven Companies	Artificial Intelligence (AI) has the ability to drive multi-fold increases in productivity by utilising big data and powerful computing hardware to accurately and reliably solve real-world problems with little human input.	Policy and regulatory uncertainty is a key risk to watch for. As AI permeates more and more into people's daily lives, questions about safeguarding individual privacy and appropriate use of such tools will surface. Regulators may step up efforts to curb the uses and applications, while differing standards from various countries can create barriers to universal adoption.

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