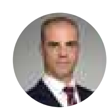
After a prolonged period of relative tranquility, global equity markets experienced a rollercoaster ride of volatility in the first quarter of 2018. How are managers coping with these ups and downs, and do they expect equity markets to level out soon?

Finding creative and proactive solutions

Juan-Manuel Aronna
RBC Wealth Management
Singapore

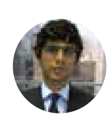


We prepared our clients early for the return of volatility. Last May, we structured a global equity fixed income portfolio with a volatility cap. It was extremely well received. The value was clear when volatility spiked and the protection feature kicked in.

We have to be creative because we're in an environment where you can find both bonds and equities moving in the same direction, as we saw in February.

Another way to limit volatility is through non-traditional asset classes. Having between 15% and 20% of a portfolio in precious metals and hedge funds is sufficient to provide meaningful diversification value. We also have exposure to gold and silver. The managers we're using include Franklin Templeton, NeubergerBerman, Legg Mason Brandywine, Standard Life and BlueBay.

We're also advising clients to focus on long-term structural investment themes such as artificial intelligence, disruptive technologies, urbanisation and ageing populations. When you're in the early stage of megatrends like these, sell-offs become great buying opportunities. Picking the winners and avoiding the losers is of course not straightforward, but we have solutions to mitigate the risks.



Andrea Ciaccio
AZ Investment Management
Hong Kong

Hard times for asset allocation

The return of volatility may foreshadow a transition to a new market regime and points towards a particularly challenging time for asset allocation. Simply put, during a 'phase transition' what has worked until that moment ceases to work, or continues to do so but in a more erratic fashion, while what has not worked continues not to work until the new market regime sets in.

In the current context, it is easy to identify the former with growth – in big tech in particular – and the latter with value. Regardless of how that battle will eventually conclude, we are of the opinion that financials will benefit from improving fundamentals in the new reality of higher rates. Accordingly, we have maintained a sizeable allocation to the **BlackRock World Financials** fund since Q4 of 2017.

In addition, we think that it may be the right time to invest beyond the indices' big names and momentum stocks. We're looking to do that by increasing allocations to active managers whose returns are driven by more idiosyncratic positions, rather than broader sector trends or themes. One such fund that we added to our portfolio during Q1 of 2018 is the **Wells Fargo US Select**.

Don't jump the gun

The first quarter saw a sudden shift in market sentiment – from optimism in January to extreme caution in February and March – on the back of a potentially more hawkish Federal Reserve and growing concern about a global trade war. But before jumping the gun and concluding that the nine-year bull has turned into a bear, let's look closely at the fundamentals.

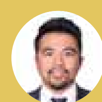
First, while equities have experienced a meaningful correction during the recent turbulence, credit markets are resilient. This is reflected in stable corporate yield spreads, which point to a continued low default rate environment.

Second, bear markets have historically taken place during periods of recession. Today, the world is enjoying synchronised growth, and the corporate earnings outlook is upbeat. And finally, even with growing trade tensions between the US and China, our base case is for an eventual resolution.

We stay constructive on risk assets in equities and corporate bonds, even though it is likely that the days of low volatility are behind us.

We believe that a targeted and long-term investment approach is paramount. Gaining exposure to income-generating assets is essential to ensure portfolio resilience, so we're staying with BBB/BB-rated corporate bonds and Asia dividend equities. In our portfolios, we like Asia and global technology stocks given the longer-term tailwinds at their backs. We are also positioned in high-quality companies in the global financials and consumer discretionary sectors, as well as European companies that are beneficiaries of a robust domestic recovery in Europe. For portfolios that are underinvested, we recommend adding exposure to these themes.

Alvin Poh
Bank of Singapore
Singapore



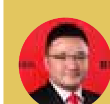
The new normal

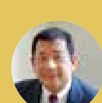
The Bank of Singapore has held the view for some time that higher market volatility will be the new normal. To help clients navigate this volatility, the Bank has recommended an allocation to hedge funds of 14%. While it is tempting to be fixated on volatility, we also believe that investors should not overlook investment opportunities that will reap returns over the longer term.

We have been advocating unconstrained fixed income strategies such as the **H2O Adagio** and **H2O Multibonds** funds. These funds, which have been available to our clients since 2015, have generated returns of 4.9% and 21.5% respectively to the end of April this year. In hedge funds, the case for an event-driven strategy is strong, as corporate activity remains high. In this environment, good managers such as Third Point can take advantage of a wider opportunity set.

Tapping into investment opportunities offered by big data and artificial intelligence is also an area of focus for us. Beyond investing in pure play technology companies who are obvious beneficiaries, utilising technology and big data within an investment management context can afford investors an information edge. The **Goldman Sachs Global CORE Equity Portfolio** exemplifies this opportunity. The fund has consistently outperformed the MSCI World index across various time periods, even in a volatile first quarter.

Frank Lee
DBS Bank
Hong Kong





Arnulfo de Pala
Trilake Partners
Singapore

Looking beyond volatility

While many market participants look at volatility as a source of alpha or a potential hedging strategy, we view historical and implied volatility as a measure of market sentiment and not much more beyond that. We could glean some insight from it, but we don't particularly see any strategic value in trading in it. It's like focusing on your weight gain instead of the reasons why you gained the weight.

Cboe Volatility Index (VIX)-related ETFs don't correspond with the VIX all that well. We have had some small exposure to managed volatility futures through some hedge funds, but those are usually in conjunction with complementary trend-following strategies. Our strategic asset allocation is driven by long-term capital market expectations including volatility, but we do allow ourselves to adjust for any short-term convictions or deviations from those long-term expectations. While equity has long been the source of volatility in portfolios, we've felt that it was compensated over the long term. We couldn't say the same thing about fixed income going forward and we have continually pared that part of our asset allocation over the past one-and-a-half years. We do not foresee making directional calls on volatility or doing volatility trades, but we will most likely further increase optionality and insurance in our portfolios. ■

The Verdict

As market volatility becomes the new normal, we asked wealth managers about their key strategies for handling this rollercoaster ride.

RBC Wealth Management prepared its clients early for the return of volatility. Last May, it structured a global equity and fixed income portfolio with a volatility cap, Juan-Manuel Aronna explains.

Meanwhile, AZ Investment Management is of the opinion that financials will benefit from improving fundamentals in the new reality of higher rates, Andrea Ciaccio says.

DBS' Frank Lee adds that gaining exposure to income-generating assets is essential to ensure portfolio resilience. He recommends sticking with BBB/BB-rated corporate bonds and Asia dividend equities.

The Bank of Singapore, on the other hand, has recommended a 14% allocation to hedge funds to help clients navigate the volatility, Alvin Poh explains. Trilake Partners has taken a different route though, using some small exposures to managed volatility futures in conjunction with complementary trend-following strategies, Arnulfo De Pala says.

Audrey Raj
Editor, Citywire