The Macro Research Desk

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The global equity bull is not dead yet

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Global markets continue to face uncertainty after the Dow Jones witnessed its third-largest one-day points drop in history late last week. Although markets corrected towards the end of last week, Asian markets experienced another dip on Monday and Saudi Arabia's market slumped significantly, based on fears that US President Trump may enforce sanctions on the kingdom following the disappearance of a prominent journalist. However, in Momentum Investments' view, local investors need to keep perspective about the current equity market sell-off, as global equity markets have not yet exited bull territory.

Although volatility is always an integral part of investment markets, volatility particularly increases during late-cycle bull market periods, when contracting global liquidity becomes less asset-price friendly and bear-market signals start to emerge. In this regard, global equity markets are approaching their decade-long anniversary (the bottom of the market was in March 2009 after the Global Financial Crisis).

Having said this, bull markets don't typically die of old age (i.e. they don't end just because they have been in place for a long time), they normally come to an end once interest rate rises have been severe enough to constrain company profits through their negative economic growth effect, as well as their detrimental effect on equity valuations. (Money increasingly flows from equities to interest-bearing investments as interest rates rise.)

In Momentum Investments' opinion, this is, however, not yet the case. A US recession only looks likely by 2020 at the earliest, as US high-yield spreads, lending standards and default rates are not rising and real policy rates are still too low to really strangle the economy and corporate profits.

We therefore need to keep perspective about the current equity market sell-off. Emotive words like "crash", "turmoil" or "bear market" are often used to attract readership, but are not appropriate yet. A bear market is typically (rightly or wrongly) defined as a 20% price fall from a peak. In this regard, the technology-laden US Nasdaq Index is off less than 10% from its peak in August 2018 (and still up around 6% for the year to date), while the broader US S&P 500 is down about 7% since its September 2018 peak (but up 2% in 2018). Also, highlighting absolute point drops in ever-rising indices is mathematically disingenuous (although they make for sensationalist headlines) – the law of big numbers dictates that percentage changes should be used to compare the magnitude of drops over time (for example an equivalent drop of 5% when the Nasdaq is at levels of 5 000 or 500 would amount to 250 and 25 points respectively). In this regard, while the 4.1% drop in the Nasdaq on 10 October 2018 is significant and doesn't happen very often, it isn't that rare either – the Nasdaq had similar or higher daily drops on almost 70 occasions in the past 25 years.

The best defence for investors against volatility or asset class drawdown risk is to have a well-diversified investment portfolio. Exposure to a wide range of investments, including traditional asset classes (like local and global equities, bonds, cash and property) and alternative investments (like private equity, hedge funds, commodities and infrastructure) should enhance the robustness of overall investment returns regardless of market conditions, as asset classes can behave very differently under the same set of circumstances.

A rational investment approach should be followed during times of uncertainty. For example, Momentum Investments' outcome-based investing philosophy should clearly show its superiority during periods of increased market volatility or stress. A major benefit of this approach is its ability to straddle the full universe of portfolio management alternatives to take advantage of diversification across multi-asset-class capabilities (taking advantage of traditional and alternative premias), multi-strategies (exploring the return drivers within each asset class) and multi-mandates (choosing the most suitable investment manager for each strategy).

The philosophy lends itself to take advantage of multiple investment characteristics by traversing a multi-mandate approach, which can include single investment managers (using existing superior in-house skills), a multi-mandate strategy (using the best available skill sets where these are not available in house), passive investing (little cost leakage when returns are low) and active management (enhanced alpha-generating ability when asset correlations are low and dispersions high).

Where appropriate, Momentum Investments also has downside protection strategies in place to limit the effect of market drawdowns on overall portfolio returns. As such, Momentum Investments views outcome-based investing as a superior strategy to navigate inherently volatile investment markets over any investment horizon, by not only providing investors with an enhanced probability of attaining their ultimate investment goals, but also by striving for a smoother and less-stressful voyage to the destination.

Of course, Momentum Investments always remains on the lookout for potentially lucrative investment opportunities that may arise from excessive asset-price weakness that are not justified by fundamentals. The company uses these opportunities to add tactical or strategic exposures to portfolios if justified by an appropriate improvement of the risk-reward ratio, with the aim to increase long-term portfolio outcomes for its clients.

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