

The road map to success

by Stephen Nguyen, CFA

Defining success is not straight forward, achieving it is even more difficult, so it is imperative to have a detailed and thorough plan. Success might be reaching your savings goals of buying a house, funding your children's education or retiring at a certain age. The journey may be long or short depending on the nature of the goal, but one's experience of that journey is of great importance. Research shows that the smoother the journey, the more likely one will see it through and there is nothing more damaging to achieving one's financial goals than giving up halfway through the journey.

In order to achieve your goals, first and foremost they need to be clearly defined and appropriately aligned. Traditionally, the investment management industry has tended to focus more on benchmarks than on client objectives. This can result in mismatches between clients' needs and the outcomes they experience. The conventional balanced benchmark was the popular 60/40 benchmark (a combination of 60% equities and 40% bonds). This is not a bad starting point and has worked well through the great bull market in bonds. However, given where markets are today, with the US equity market currently sitting at an all-time high and sovereign bond yields hovering near zero, and in many instances negative, it is questionable whether this simple portfolio design can deliver sufficient returns for investors in the future. At today's historically low yield levels, bonds offer significantly less protection and diversification benefit compared to the past. In this new low rate environment, the traditional 'balanced' portfolio may no longer be balanced. Investors need to look outside the box for additional tools and search beyond traditional investments in area such as alternatives, credit, convertibles, real assets and precious metals.

A simple balanced portfolio is likely to face return and diversification headwinds as mentioned above, so we think the better approach is to have a carefully constructed strategic asset allocation (SAA), investing in a wide range of asset classes, designed to meet clients' specific outcomes. The focus should be on outcomes rather than benchmarks. Clients need more meaningful and detailed outcomes aligned to their needs.

We spend a lot of time deriving the optimal SAA for our clients. Our optimisation is multi-faceted and goes beyond simply maximising returns for a given amount of risk. We include a wider range of asset classes in our SAA's to increase the naturally occurring diversification benefits. We consider how those asset classes behave in combination with one another. We assess not only the probability of achieving the return target over the investor's time horizon, but also the extent of any shortfall versus this target in the majority of adverse scenarios. We then look at the likely range of returns over shorter time periods, such as 12 months. We pay attention not only to the outcomes but also to the path of returns.

Based on these optimisation metrics, we then generate thousands, sometimes millions, of possible portfolio combinations, by varying the weights of one asset class over another. Unfortunately, there is no simple equation which tells us which portfolio will deliver the best outcomes on our key optimisation metrics, so instead we combine the team's years of experience with the help of our quantitative calculations to arrive at the optimal SAA.

Rather than a simple conventional 'balanced' approach of holding an allocation between equities and bonds, the extensive work and output of our SAA process allows us to have more sophisticated tools and a better starting point to begin the journey with our clients.

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Market Focus

- » A mixed picture as global equities returned 0.4% last week
- » Global deaths from Covid-19 surpass 800K
- » Brent crude fell 1.0% ending the week at \$44.4 a barrel
- » Gold fell -0.2% to end the week at \$1940.5 an ounce

US

- » The Trump administration is said to be mulling the possibility of issuing an emergency use authorisation before the U.S. presidential election for a coronavirus vaccine being developed by AstraZeneca and Oxford University
- » President Trump praised China's purchases of corn, beef and soybeans, while Peter Navarro, the Director of the Office of Trade and Manufacturing Policy, said that the Phase One deal reached with China was on track
- » The US investment grade bond market has seen 2020 issuance hit a new record of \$1.34tn, and surpassing 2017's full year total with four months left to run
- » US equities rose 0.8% last week with the major gauge hitting record intraday and closing highs last Tuesday. This was the fourth straight week of positive returns

Europe

- » German Chancellor Angela Merkel has ruled out any further loosening of virus containment measures after a doubling in the number of daily cases in the last three weeks. Finance minister Olaf Scholz has proposed extending the country's job support scheme from 12 to 24 months
- » European equities fell 0.6% last week against a backdrop of an uptick in the number of corona-virus cases across the region
- » Eurozone preliminary composite PMI's for August fell to 51.6 from 54.9 in July. The drop was led by a flattening in services, as manufacturing performed better

UK

- » A big upward surprise in the UK's CPI reading, which came in at +1.0% in July (vs. +0.6% expected), whilst core CPI also surprised to the upside at +1.8%
- » U.K. government debt has topped £2 trillion for the first time which means debt is now above total economic output
- » The flash composite PMI reading for August rose to 60.3 from 57 in July. The consensus was for 56.9. The services measure advanced to 60.1 from 56.5. The manufacturing PMI reached 55.3 vs 53.3 in July while services moved up to 60.1 from 56.5
- » Despite these positive readings, U.K. equities fell -1.4% last week

Rest of the World/Asia

- » Japanese equities fell -1.2% last week. The country saw its largest economic contraction on record with a drop in GDP of -7.8% in Q2. The Tankan manufacturers sentiment index increased to -33 in August from -44 in July
- » Chinese equities rose +2.2% after some positive signals in US-China trade tensions such as the postponement of the U.S.'s six month trade review
- » Turkey's central bank left its benchmark interest rate unchanged at 8.25% despite the recent underperformance of the lira

Asset Class / Region	Currency	Cumulative returns			
		Week ending 21 August	Month to date	YTD 2020	12 months
Developed Markets Equities					
United States	USD	0.8%	3.9%	6.1%	17.7%
United Kingdom	GBP	-1.4%	2.2%	-19.8%	-15.4%
Continental Europe	EUR	-0.6%	2.7%	-7.3%	1.7%
Japan	JPY	-1.2%	7.2%	-5.5%	9.9%
Asia Pacific (ex Japan)	USD	0.1%	2.2%	3.6%	16.7%
Australia	AUD	-0.1%	3.3%	-7.0%	-2.6%
Global	USD	0.4%	3.9%	2.6%	13.9%
Emerging Markets Equities					
Emerging Europe	USD	-4.4%	1.2%	-22.0%	-7.9%
Emerging Asia	USD	0.3%	1.9%	7.9%	24.2%
Emerging Latin America	USD	-3.1%	-5.4%	-32.1%	-23.4%
BRICs	USD	1.1%	1.7%	3.1%	17.6%
China	USD	2.2%	3.0%	16.7%	33.1%
MENA countries	USD	2.0%	5.2%	-10.5%	-9.5%
South Africa	USD	0.6%	-1.4%	-20.8%	-10.3%
India	USD	1.5%	2.7%	-10.5%	0.2%
Global emerging markets	USD	-0.1%	1.3%	-0.5%	13.7%
Bonds					
US Treasuries	USD	0.5%	-0.8%	9.7%	8.3%
US Treasuries (inflation protected)	USD	0.6%	0.1%	9.2%	9.3%
US Corporate (investment grade)	USD	0.3%	-0.9%	7.5%	8.6%
US High Yield	USD	0.1%	0.2%	0.8%	4.4%
UK Gilts	GBP	0.3%	-2.0%	8.1%	4.3%
UK Corporate (investment grade)	GBP	0.3%	-0.4%	4.8%	5.0%
Euro Government Bonds	EUR	0.6%	0.1%	3.3%	0.5%
Euro Corporate (investment grade)	EUR	0.4%	0.5%	0.8%	-0.3%
Euro High Yield	EUR	0.1%	1.1%	-2.5%	-0.2%
Japanese Government	JPY	0.0%	-0.5%	-1.2%	-3.4%
Australian Government	AUD	0.3%	-0.1%	4.3%	1.8%
Global Government Bonds	USD	0.4%	-0.7%	7.3%	5.7%
Global Bonds	USD	0.2%	-0.5%	6.6%	6.2%
Global Convertible Bonds	USD	0.2%	1.1%	11.1%	16.9%
Emerging Market Bonds	USD	-0.3%	0.6%	3.7%	6.9%

Source: Bloomberg. Past performance is not indicative of future returns.

Asset Class / Region	Currency	Cumulative returns			
		Week ending 21 August	Month to date	YTD 2020	12 months
Property					
US Property Securities	USD	-0.4%	-0.4%	-16.0%	-13.9%
Australian Property Securities	AUD	0.7%	4.8%	-18.7%	-21.5%
Asia Property Securities	USD	0.3%	4.5%	-15.9%	-10.9%
Global Property Securities	USD	0.2%	1.8%	-15.8%	-10.8%
Currencies					
Euro	USD	-0.6%	-0.2%	4.8%	6.0%
UK Pound Sterling	USD	-0.2%	-0.2%	-1.4%	7.7%
Japanese Yen	USD	0.6%	0.0%	2.6%	0.6%
Australian Dollar	USD	-0.3%	0.0%	1.8%	5.2%
South African Rand	USD	1.3%	-0.8%	-18.5%	-11.4%
Swiss Franc	USD	-0.5%	0.0%	5.8%	7.3%
Chinese Yuan	USD	0.4%	0.8%	0.6%	2.1%
Commodities & Alternatives					
Commodities	USD	0.9%	4.9%	-17.9%	-11.1%
Agricultural Commodities	USD	1.6%	2.9%	-5.1%	4.6%
Oil	USD	-1.0%	2.4%	-32.8%	-26.5%
Gold	USD	-0.2%	-1.8%	27.4%	28.8%
Hedge funds	USD	0.2%	0.9%	1.1%	4.5%

Source: Bloomberg. Past performance is not indicative of future returns.

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