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INSIGHTS

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Economic Cycles Keep Multi-Assets Evergreen

Economic cycles are pretty much a fact of life, however much governments try to tame them. There are funds that can thrive on these cycles – they are called multi-asset funds.

Any investor knows, economies (and markets) do not move in straight lines.

As a result, there are times when one wants to be in equities. At others, in bonds. When, for example, the cycle moves from Stage 2 (Recovering) in the chart below to Stage 3 (Overheating), the asset of choice will likely be equities. The question is "Which equity?" Regional? Country? Sector?

As the cycle moves from Stage 4 (Stagnating) to Stage 1 (Base building), bonds will likely move into favour. Yield curve issues come into focus accompanied by questions such as "Should I be in Investment Grade or High Yield bonds?".

Today we seem to be near the trough of a cycle

The global economy looks to be bottoming; we look to be well into Stage 1 poised for Stage 2. Investors are increasingly asking "Is it time to switch from bonds to equities?" This is when the argument for multi-asset funds is at its strongest.

The global economy seems to be healing despite whirling Eurozone and associated fallout fears.

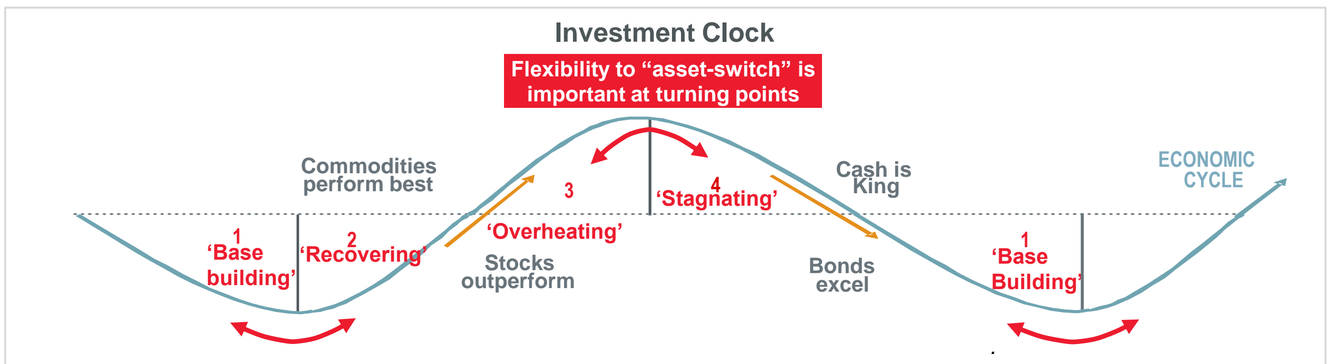
During early 2013, growth forecasts, especially in Asia, nudged higher[1]. Even in Europe, the falling growth forecasts that characterized much of 2012, ended despite resurgent UK growth concerns.

Better, but still spotty, US data has been sufficient to drive the US equity market to post-crisis highs. At the same time, US credits have generally held up despite easing Treasury prices and fears of a "big rotation" from bonds into equities. The global economies seem to be headed towards the bottom of the stylized economic cycle below.

As the cycle turns, think "Multi-Asset"

At such points in the cycle, possessing the flexibility to move between asset classes is paramount. These are times when switching can make the difference between profit or loss. And the timing of such moves becomes critical.

As we move from Stage 1 to Stage 2, from bonds into equities, questions like "How much?" and "When?" quickly come to the forefront. In our interactions with investors today, many are clearly grappling with such a dilemma.



Source: Eastspring Investments (Singapore) Limited. The Investment Clock cannot anticipate external influences that may affect economic conditions.

This time it "really is different" and it could be.

What differentiates this recovery is the on-going role of the US Federal Reserve Board.

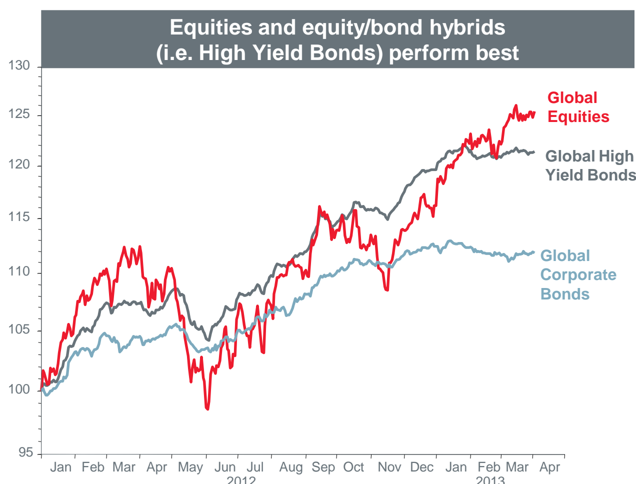
As is well broadcast, the Fed intends to keep US (and thus most global) rates low until US unemployment falls to 6½%[2]. Simply extending the downward trend in unemployment suggests that rates will not rise until mid 2014. But our US colleagues believe that while US growth is healing, it is slow. US rates, they believe, could stay low until 2016 ***at least*** (our emphasis).

This situation immediately throws up an investor conundrum.

- Low growth and low interest rates, which stay low until 2016 (or possibly beyond), have historically been good for high yield bonds.
- But an improving economy is generally better for profits and thus equities.

So what is it to be? High yield bonds? Equities? A mixture of both? If so, how much? Clearly, this is where multi-asset funds can shine.

This conundrum was amply demonstrated in 2012 when both equities and high yield bonds produced broadly similar returns. Investors did not know which way to jump; they jumped onto both. The chart below illustrates this clearly.



The data has been rebased to January 1, 2012 = 100.

In the final analysis, high yield bonds probably gave the better risk adjusted return even though equities did marginally better.

Today's investment picture is complicated.

Good equity value is increasingly evident as confidence in the profit forecasts rises.

China and Indian valuations are bouncing along their lows despite last year's rallies. US equity valuations remain below their long-term trend. Even European equities look to have discounted a lot of bad news.

Credits could still rally further (while rates stay low) despite looking expensive on most measures. But they won't be low forever. One day the Fed will raise rates. When that day comes, investors will not want to be in bonds!

Since 1990, the Fed has undergone three tightening cycles. Each time, US bonds sold off with yields rising 40% or more[3]. That is a big sell-off.

Getting one's timing right in adapting to these changes is crucial in investing successfully.

Many bond investors, for example, lost heavily for several years, arguing that already expensive Treasuries could not get more expensive. They did.

Multi-asset funds do the chewing for you.

"Yes", it is true that an investor could make their own decisions. And yes it is true that the investment picture is frequently complicated.

It is certainly not easy.

At times such as today, asset choice and timing gain in importance; a multi-asset fund can lighten an investor's decision load.

After all, there is no harm in having an asset allocation professional on the home team.

Source: MSCI Global Equity index and Barclays Capital Global Corporate and High Yield indices, 1 Jan 2012 - 3 April 2013 from DataStream. All indices are in USD and are total returns.

Source :
1.Consensus Forecasts, April 8, 2013

2.Financial Times, December 13, 2012

3.Source: US Federal Reserve Board and the US Bureau of Labor Statistics from Datastream as at March 28, 2013.

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