Legg Mason Symposium focuses on future of investing

The role of hedge funds in investors’ portfolios, the exciting prospects for emerging markets and the drastic under-exposure to fixed income in Australian portfolios were the topics of conversation in the first panel discussion at a recent Legg Mason Investment Symposium in Melbourne.

Investment experts from four of the global asset manager’s stable of boutique investment shops put the case forward for each of their specialist asset classes.

Permal Group investment strategist Timothy Schuler urged delegates to think outside of benchmark-centric portfolio construction and consider the benefits of the uncorrelated returns offered by non-traditional strategies.

“People must think more holistically about their needs and allocations must be dynamic,” he said, adding that traditional portfolios can leave investors particularly exposed to sequencing risk as few strategies can provide returns during down markets.

“We don’t want pensioners’ birthdates to be the determining factor as to whether they eat cat food or caviar in retirement.”

In selecting hedge fund-like strategies for inclusion, Schuler had the following advice:

“Don’t just fill up your portfolio with managers who impress you and have good ideas, you must think about their role in the overall portfolio. Alternatives should be thought about as portfolio completion, capturing returns that may not be there from traditional assets,” he said.

“But one size does not fit all. Correlation and other statistics can give a false sense of comfort.”

Taking the stage next was Martin Currie investment director and head of global emerging markets Kim Catechis. He admitted developing economies had been tricky for investors over the last three years with dedicated equity funds reporting outflows of $25 billion in 2014. However, he believes that the emerging world was now in a new phase.

“In the decade 1994-2004 emerging markets were subcontractors for the rest of the developed world. Now we’re into a new age where emerging markets companies such as Samsung, are competitors themselves,” he said.

According to Catechis, reforms will be big driver of returns in emerging markets and singled out Mexico as an example where constitutional change was leading to genuinely exciting investment opportunities.

“The great thing about being an emerging markets economy is you don’t have to go through innovation and development of ideas, you just take an existing one off the shelf,” he finished.

Next up was Western Asset Management head of investments Anthony Kirkham. He said that even though global investors are preparing portfolios for a period of negative fixed income returns, he saw no reason for loose monetary policy to abate for some time yet.

“Even though the US has tapered stimulus, it’s still fighting to get interest rates off zero. Central banks around the world are still accommodative and continue to increase balance sheets. That is still likely to push bond yields near historically low levels.”

Over 200 advisers received a taste of what client portfolios could look like in the future as Legg Mason investment experts from across the globe descended on Melbourne for a symposium.

Legg Mason’s showcase event – which was designed in the aftermath of last year’s Financial System Inquiry – focused on helping advisers prepare for client issues that may become more prominent in the years ahead.

All-weather investing, single and multi-sector retirement income, as well as the future of asset classes themselves were the subject of three panel discussions, with Legg Mason investment professionals providing a range of opinions across asset classes.

But those expecting to hear a unified Legg Mason house view would have been surprised as Annalisa Clark, Head of Legg Mason Australia explains: “Legg Mason houses a range of independently operating affiliates and each brings their own unique viewpoint to the table. This event helped showcase the talent, diversity of opinion and depth of expertise across one of the largest funds management groups worldwide.”

The symposium included speakers from Brandywine and Western Asset in the fixed income space, Martin Currie (including Martin Currie Australia) covered equities, while alternatives specialist Permal looked at non-traditional assets. The investment topics were complemented with guest presenters Ian Irvine from the ASX who discussed the future of mFund investing, as well as Margot Cairnes, who presented a holistic description of change and thinking ahead.
Shift happens

In the information age, it is not the problems you see that are going to unsettle established businesses, but the ones you don’t. That was the powerful message put forward by thought leader and management consultant Margot Cairnes. “The real threats are the black swans – the unknown unknowns,” she said, highlighting Kodak as an example of a company which should serve as a warning to businesses today which fail to keep up with change. Cairnes explained that the digital information age was accelerating the pace of change in the modern world and heightening the risk for those that stand still, adding that the most complex problems facing the world have seemed to have no viable solution – human rights, conflict in the Middle East, terrorism, pollution.

To illustrate the threat posed by rapid change, Cairnes, who has represented Australia at World Economic Events around the world, drew the audience’s attention to numerous hard-hitting facts. “We are currently preparing kids for jobs that don’t yet exist, using technologies that haven’t been invented in order to solve problems we don’t even know are problems yet,” she said.

Among the most interesting facts were: one in five workers has been with their employer for less than a year while half of workers have been there for less than five years; it took 38 years for radio to reach an audience of 50 million, television took 13 years, the internet took just four and the iPhone took only three years; it is estimated that a week’s worth of New York Times today contains more information than a person was likely to come across in a lifetime in the 18th century. “Shift happens,” said Cairnes. “This level of change and network spawns problems.”

What’s the key to success in this environment? “Don’t be blinded by what you know,” concluded Cairnes. “Be open to life.”

Investing in non-traditional fixed income funds can help take the luck out of second-guessing interest rates because you can achieve positive results under a wider range of scenarios. That was the crux of a compelling argument put forward by Western Asset Management product manager for non-traditional strategies Joseph Filicetti and Permal Group portfolio manager and investment specialist Timothy Schuler. The problem facing fixed income investors is that the road forward still remains very uncertain. “We don’t know if rates will go up, when they will go up, by how much or for how long,” said Felicetti. “When they do go up it will be very difficult to not lose money if you are exposed to duration.”

“Non-traditional fixed income funds can off-set risk of interest rate exposure.” Products with the flexibility to swing portfolio duration are able to take advantage of the full opportunity set, Felicetti explained. “Non-traditional fixed income is also able to take a view on currency. There is an enormous opportunity from Abenomics to be short Japanese yen.” Schuler added that however much liquidity you pump into the banks via unconventional monetary policy, you can’t make them lend so the success of quantitative easing is far from assured. While most investors expect a Fed rate rise in 2015, he added that it would be unwise to rule any scenario out.

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Joseph Filicetti
Western Asset Management
How can mFunds change the future of investing?

The ASX’s new mFund initiative is squarely aimed at removing the administrative hurdles posed by managed funds and improving investors’ diversification to boot.

The mFund Settlement Service (mFund) allows investors to electronically apply for and redeem units in certain unlisted simple managed investment schemes through their authorised ASX broker in much the same way they would invest in shares.

ASX head of customer & business development Ian Irvine said momentum in the service has picked up over the last few months following the completion of a range of educational seminars for retail investors and advisors.

“We look forward to strengthening the ‘investment supermarket’ we are building for investors with the continued cooperation and commitment from our mFund foundation members in 2015,” he said.

Importantly, the mFund service does away with laborious paper forms and processes.

“The main benefit of mFund is that investors do not have to fill out a paper application form which can run to 16 pages. They also do not require direct investors to be identified for each transaction,” Irvine explained.

It is hoped the initiative can provide a huge opportunity for the million self-managed super fund trustees that account for a third of the assets in the superannuation system and if critical mass can be achieved then Irvine said the opportunity can be simply massive and the benefits will flow through to the advice community.

“SMSFs are forecasted to grow to $2 trillion by 2035, the number of trustees is expected to grow to 2.47 million and the average fund value will grow to $1.62 million from $1 million today.

“Investors are more open to taking advice in areas they are less comfortable so there will be a place for advisers to help.”

The mFunds initiative is currently supported by 24 product issuers with 75 funds. An extra 45 products are expected to come onto the scheme by end of June 2015.

So far seven external unit registries have joined, two managers do it in-house and three more will join by end June 2015.

A total of 12 brokers have committed to build IT to connect, with nine live now and one expected by end of March.

Numerous global asset classes have suffered significant falls in future income.

Reece Birtles
Martin Currie Australia

Income solutions for the future

Investors must face up to the fact that the income offered by traditional assets such as bonds and term deposits will not be as high in the future as they have been in the past, according to Western Asset Management head of investments Anthony Kirkham and Martin Currie Australia chief investment officer and portfolio manager Reece Birtles.

In the final panel session of the Legg Mason Investment Symposium Birtles and Kirkham shared their view of what income portfolios may look like in the future.

The bottom line is that retirees are likely to have to take more risk.

“Following zero interest rate policies, numerous global asset classes have suffered significant falls in future income,” said Birtles.

“Current yields across numerous asset classes shows that achieving satisfactory income is going to be difficult without considering non-traditional asset classes. Retiree investors cannot move to 80% defensive assets with no inflation protection and meet their needs.

“Income biased Australian shares and real assets can provide significantly higher yields and even offer growth in income stream along-side company profits and capital growth.”

With as much of a third of self-managed super fund investors’ portfolios locked away in term deposits, Kirkham said falling interest rates and over exposure to equities are likely to pose a significant threat to investors.
Brandywine: More stimulus ahead

Deflationary pressure won’t last long because central banks will continue to flood the global financial system with liquidity.

That was the opinion of Brandywine director of global macro research Francis Scotland who kicked off the symposium by giving a snapshot of global markets and the economic forces driving them.

Having left behind the snow and ice of his native Montreal for his first trip to Australia, Scotland explained that while 2014 ended on a deflationary note, there was no need to fear a meltdown in global price indices for long.

“Some of the market stabilisation mechanisms that took place in the final stages of 2014, combined with stimulus activity should bring in inflationary conditions that will create a more balanced system. This will be beneficial to risk assets,” he said.

According to the macro-economic expert, the impact of monetary policy in emerging markets is being over-looked as all eyes have been on Janet Yellen and the Federal Reserve.

“The most interesting source of deflation has been in the emerging world. On a GDP-weighted basis, short-term interest rates have been rising in the emerging world while G7 has declined,” he said.

“Over the last 18 months the aggregate GDP-weighted interest movement globally has been up – the world has been tightening.”

As a result, Scotland anticipates central banks to respond to deflationary pressure with more stimulus measures. This has already been seen in India and Indonesia.

Pete Pennicott

Practice principal and financial planner, Pekada

Generally at these events you are hearing about a single manager, strategy and point of view, and so it was refreshing to get access to equity, macro, alternatives and fixed income in one session.

There were some really useful insights that I can take back to our clients’ investment strategies, namely reinforcing that we need to consider outcome orientated strategies based on our client’s needs. Satisfying those needs is ultimately what drives our advice, and the portfolio construction decisions form an important supporting role in this. It is definitely a case of one size does not fit all.

Hearing first hand from the people in charge of these investment strategies helped to gain greater clarity to the underlying strategy and process. Greater clarity provides me with more confidence to ensure that we have the right strategy mix in place for our clients.

Anna-Louise Brown

Financial planner, Blue Print Advisors

What I really found valuable was that it touched on bigger pictures and macroeconomics. There’s been more complex themes, which I enjoy because it expands your knowledge rather than just being another self-congratulatory industry event.

It’s definitely been educational. I couldn’t say there’s been one presentation which stood out as better than the rest because there’s been a little bit of everything and I’ve taken something from every single one.

Because there’s been so much change in the industry I’m very, very open to new ideas at the moment. I’m already very client focused but I’m questioning the best way to structure my portfolios. I want to be more and more reliant on professional managers rather than doing it myself, therefore choosing those professional managers becomes more and more important. This event has helped my understanding in that regard.

Ash McAuliffe

Managing director, McAuliffe Wealth Management

Investment trends and the economic landscape change rapidly, however, what our clients expect from us does not. They trust us to have our finger on the pulse, and hearing directly from local and international experts is the best way to keep current.

Reece Birles’ presentation on income solutions highlighted the volatility in term deposit returns. We consider term deposits to be defensive and stable, however Reece pointed out that income from deposits have displayed more volatility over the past 12 years than the ASX200.

This is the perfect illustration of the changing environment, where we have some defensive assets behaving more like growth assets, and some growth assets, such as infrastructure, serving as defensive income producers. This makes portfolio construction more challenging because traditional asset allocation benchmarks are less relevant.