Oreana
PORTFOLIO ADVISORY

Portfolio Advisory Insights

Feb 2021

The start of a new cycle

The global economy entered a deep, brief recession in 2020. Central banks and governments responded quickly and forcefully to support the economy through the sudden stop in activity. In our view the swift response prevented a deeper, more extended crisis.

Our focus on the medium-term over the short term means that we spend less time on trying to forecast near-term outcomes. Nonetheless, our 2020 Medium-Term Global Outlook made a series of recommendations which if implemented, would have been transformative for portfolios through 2020. Our discretionary and managed accounts, currently available in Australia and Hong Kong, experienced strong risk-adjusted returns in 2020 as we followed our own recommendations.

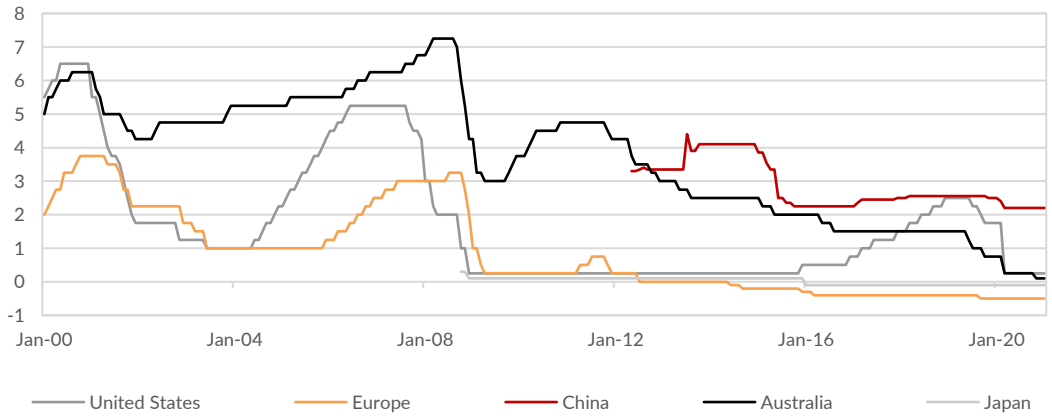
Now, in 2021, we have reviewed our medium-term outlook having experienced a recession as expected in 2020. We turn our focus to sustaining the strong return profile we achieved in 2020 over the medium-term.

Our 2021 Medium-Term Global Outlook considers a range of key issues that will be important for investors to sustain the strong returns were on offer in 2020. Continuing the focus of our 2020 Medium-Term Global Outlook, these areas have associated actions that we believe will help build portfolio resilience. The 2021 Medium-Term Global Outlook will be available in late-February. Below, we share some key thoughts around the medium-term outlook.

Accommodative policy for years to come.

The monetary policy support released by global central banks has pushed nominal and real interest rates to record lows (Fig 1).

Fig 1: Policy rates (%) are low and are likely to remain low for a long period.



We expect the US Fed and other central banks including the Reserve Bank of Australia, the Bank of England, the European Central Bank and the Bank of Japan will leave rates at or near current low levels for several years to come. We think the risk is skewed towards policy rates

at or near zero percent for five or more years. We expect quantitative easing will remain a feature too.

Central banks will be encouraged to do this because low rates will support real economic activity and jobs creation. Low rates will also support wealth and asset inflation. But we expect structural issues including low household income growth, aging populations and improving productivity will leave actual inflation at the lower end of most central banks' policy ranges.

An asset reflationary environment.

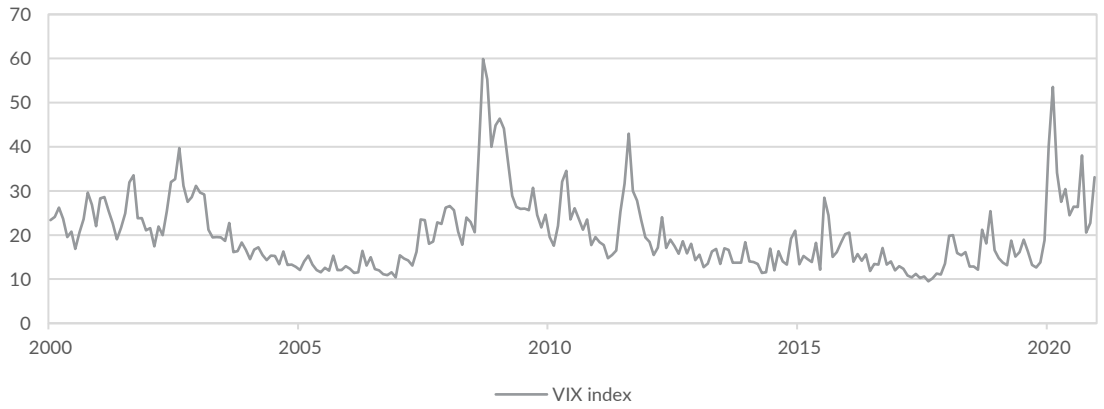
Record low interest rates and ample liquidity pushes investors out the risk curve in search of yield and returns. That has supported equity markets so far during the recovery.

We anticipate these tailwinds to persist over the next five years. Low policy rates, relatively low bond yields, a steepening yield curve and a supportive macroeconomic environment will all support equity valuations.

Return to a lower volatility environment.

The pandemic-related bear market correction that ended in March 2020 represented a bout of market volatility that ended almost a decade of relatively low market volatility (Fig 2).

Fig 2: Volatility (measured by the VIX index) is elevated but below the peaks of the pandemic.



We expect financial repression – with interest rates below inflation for the next five years – will return the market to the very low volatility environment we experienced between 2012 and 2018.

What are the implications for my portfolio?

Our outlook is one for solid economic growth, accommodative policy and low volatility. In this environment, we think the following implications are important for portfolios.

Equity beta will be rewarded: We expect the next five years will deliver solid equity returns. We recommend investors carefully consider different geographical and style exposures to deliver outperformance.

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Remain invested through short term volatility: Periods of short-term volatility could feel particularly painful given the otherwise positive outlook. We recommend focusing on the medium-term prospects for solid returns and remaining invested.

Be wary of costly insurance/vol protection strategies in a low vol environment: It is tempting to look for downside protection with big payoffs if equities fall dramatically. We expect strategies that primarily use short vol strategies to harvest vol premium, or to hedge equities, will deliver disappointing returns over the next five years.

Sustaining returns for the future.

Looking ahead through 2021 and beyond, we are focussed on continuing to deliver great outcomes for investors in our portfolios. We will continue to be transparent and share our views. Our flagship Medium-term Global Outlook will be released later this month, and sets out our key recommendations for investors looking to sustain returns in the future.

Reach out to our Portfolio Advisory Service to find out how we can assist you with managing your investment challenges.

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