

New era for equities

✓ The time has come for equities to play a bigger role in investment portfolios

The tide is turning. The world is entering a new economic cycle – one which is characterised by massive intervention, both from central banks and governments. It will also usher in a new era for asset allocation.

At the core of it, we think that the wall of stimulus is suppressing the potential returns in fixed income. Today, to get positive real returns, investors need to be able to allocate more flexibly to risk assets.

That necessitates a big shift in their mindsets. Since 2009 global equities rallied some 180 per cent. But cumulative inflows into stock funds have been flat, according to EPFR data, with money piling into bonds instead. We think that balance of flows will change as investors realise that the equity market is a convenient way to hold a real asset and it gives them the best chance of growing the real value of their savings.

The most nimble are already making that shift. Norway's sovereign wealth fund, for example, now invests 70 per cent of its portfolio in global equities, having raised the cap from 60 per cent in 2009 and 40 per cent in 1998. We expect that others will follow.

Some are, of course, restricted by rules and regulation – be that imposed by their own statutes or by governments and watchdogs. Over the coming years and decades those rules may need to be reviewed and reconsidered if pension funds and insurers are to meet their liabilities.

Of course, given that investors have not been tempted into equities by record-setting rallies of recent years, you

may wonder – why are we so sure that they will make the shift now? Because negative real rates are now pervasive across the globe. Up until recently, you could still get positive real rates in the US, which has the biggest pool of capital in the world. Now, that is no longer the case, that capital may have no choice but to move elsewhere.

Golden opportunity

However, choosing the right equities is crucial, as we have seen all too clearly this year. Eight months into 2020, the UK equity market is down 22 per cent, while the S&P 500 index is up 11 per cent – that is a massive divergence of returns just based on country choice. The same is true for sectors: financials have underperformed technology by around 40 per cent.

We still see the benefits of investing in secular growth – those companies that are the driving force of human advancement, be that in technology, healthcare, or in sub-sectors such as mobile payments and transactions. Pricing may appear stretched after the recent rally, but their strong business models and dominate positions still make them attractive, especially when you can acquire them cheaply. Their balance sheet quality is crucial at this point in the cycle.

There are also potentially attractive opportunities in industries that are making the leap from the old economy to the new. Autos are one example, with strong investment in electric cars and the progress towards automated vehicles. Others include telecommunication infrastructure, which is the bedrock for 5G, and the technologies that aim to tackle the challenges of climate change



through greater resource efficiency.

Given the thirst for owning real assets, gold miners stand out because they have a strong margin relative to the price of gold. The gold in their mines is valued on their books at circa \$1,000 per ounce, while the current market value is double that. If bullion goes higher – which may well happen given the downward pressure on the dollar, the medium-term inflation risk and the wide-ranging scope for geopolitical wobbles from the US presidential election to Brexit – that disconnect becomes even more interesting.

Of course, there are still pockets of attractive opportunities in the fixed income market. One of those is Chinese government bonds, where positive real yields still prevail. Trading at a yield of just above 3 per cent, renminbi bonds offer investors a record 230 basis point pick-up over US Treasuries.

More broadly, whether the objective is to meet pension liabilities or build up savings for retirement, the scale of government intervention is likely to damage fiat currencies' role as a store of value. Focusing on real assets – including equities – can help mitigate those effects.



✎ **Written by Shaniel Ramjee, senior investment manager, multi asset, Pictet Asset Management**

In association with



PICTET
Asset Management