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MEDIA RELEASE

Inoculating markets from economic influenza

Investing in a post-COVID world

Economic uncertainty existed before the COVID-19 pandemic, but investment performance depends on more than economic fundamentals, according to GSFM and its fund manager partners Payden & Rygel, Munro Partners and Redpoint Investment Management.

Stephen Miller, investment strategist at GSFM, says investing uncertainty is elevated, not just as a result of the COVID-19 pandemic, but also because of other pre-existing economic issues.

"Trade-wars, deglobalisation and re-regulation, dysfunctional politics, cyber-wars, climate change, inequality, and 'oligopolistic privilege' were already playing out in the global economy, and COVID-19 has intensely exacerbated uncertainty.

"However, monetary policy is exhausted and is no longer an appropriate tool to deal with these challenges. Fiscal policy will need to do the heavy lifting, but it needs to be intelligently crafted. The world is at an inflection point when it comes to policy with tectonic shifts in the offing not just on the macro front but also on the regulatory front. The focus on these areas is likely to intensify into the November US elections.

"Investors too, are at a crossroads. Bond yields are at historic lows, and while listed equities are not cheap there is a lot happening below the surface. FAANGs are booming while others like autos, advertising, energy, regional banks, hotels and airlines are languishing.

"Tectonic policy shifts can alter the relationship between asset prices. There is a suggestion that as government bond yields approach zero, they might not be as effective diversifiers for riskier assets in a multi-asset portfolio.

"For investors, this signals a need to diversify portfolios away from 'vanilla' beta to other assets – including gold, absolute and unconstrained bond strategies, and active equities including long / short and hedge funds."

Eric Souders, director with Payden & Rygel, agrees that absolute and unconstrained bond strategies will increasingly come to the fore, especially as bond markets are buffeted by more than just the impact of macro-economic policies.

"The bond market is an evolving ecosystem driven by structural change and technological disruption.

"Unlike equities, fixed income does not trade on an exchange, but rather over-the-counter, through a broker dealer community that facilitates all transactions. Heightened regulation in recent years has permanently impacted broker dealer capacity. Consequently, reliance on the broker dealer community for liquidity purposes is challenged in many environments.

“The development of the Trade Reporting and Compliance Engine (TRACE) has led to greater pricing transparency. At the same time, the fixed income market largely uses matrix pricing given the scope of asset classes and underlying securities.

“The result is fixed income liquidity has become more fragile, with prices periodically dislocating well beyond fair value. This dynamic can impact entire asset classes, particularly during extraordinary periods like COVID-19.

“The liquidity shock in March was evident as liquidity collapsed even in the most liquid areas such as US Treasuries, as transaction costs increased from a handful of basis points to roughly 100 basis points. In addition, high-quality credit areas such as AAA-rated U.S. Collateralized Loan Obligations experienced temporary price decline that materially overshot fundamental fair value. This was exacerbated by leverage being unwound, lack of broker dealer balance sheet, and matrix pricing.

“In these instances, it is critical that investors remain patient, work to separate liquidity from credit impairment through sound fundamental research, and take advantage of buying opportunities in a multi-asset bond portfolio.”

Munro Partners chief investment officer, Nick Griffin, says if there has been one consequence of COVID-19 that everyone can agree upon, it is the way it has accelerated the take-up of technology.

“Digital enterprise is a sector that continues to show promise – along with e-commerce and digital payments – all sectors that are set to be beneficiaries of the COVID-19 pandemic.

“To capitalise on this view we have pushed portfolio exposure higher in key areas of interest such as Digital Enterprise, Digital Payments, eCommerce and Innovative Health. Many of our key portfolio holdings are now strongly positioned to accelerate their market share dramatically as disruption speed, social distancing and the need to test the population becomes more prevalent.

“Over the medium to long term it is far more important to correctly identify an area of structural growth and the companies set to benefit from that growth, than to try to predict the direction of the economy or market. With so many areas of disruption occurring at once post COVID-19, the opportunities for investors will bear this out.

“E-commerce, for instance, has been on a growth trajectory for some time already, and this crisis means the shift will happen even faster. From that point of view, Amazon and Alibaba are two names that are set to benefit.

“While a slowdown in commerce during the pandemic means that payments overall will take a hit this year, ultimately the shift to digital will also only accelerate. PayPal is set to be a beneficiary in this space.”

Meanwhile, Redpoint Investment Management’s CEO, Max Cappetta, says globally and locally the COVID-19 “bounce” in equity markets has been spectacular.

“Our experience from March 2009 was that a bounce would come, but it has been sooner and sharper than many expected.

“Government and central bank support has fuelled a price rebound which is now at odds with the uncertainty of our COVID economy. Valuations are now stretched, and there are similarities to the late 1990s – with a few important differences. Equity markets remain attractive to cash starved investors seeking income and to those seeking growth.

"In this environment, improving investor outcomes through stock selection should become more important. Active management is usually more effective in periods of increased uncertainty, and it is hard to find an environment more uncertain than now.

"Other issues that will be firmly in investor's sights during the next decade are the tax costs of investing as well as embedding principles for responsible investment and a heightened consideration for how companies are managing their ESG risks.

"These are important issues and they can't be properly addressed by simply owning a handful of single factor smart beta ETFs. There are multiple investing objectives to be met, that will demand professional advice to educate and inform investors."

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GSFM was established in July 2007 as a subsidiary of the Grant Samuel Group. In November 2016 CI Financial Corp (CI) purchased an 80 per cent stake in the business. CI is a diversified wealth management firm with fee-earning assets of CAD $179.2 billion (as of 30 June 2020

). GSFM specialises in marketing funds managed by high calibre local and international managers to Australian and New Zealand institutional and Australian retail investors.

Since 2007, GSFM has formed alliances with following investment managers to distribute investment products to Australian and New Zealand clients:

- *New York based Epoch Investment Partners, Inc.*
- *Tribeca Investment Partners, a successful Australian boutique manager*
- *Payden & Rygel, a Los Angeles based independent investment management firm*
- *Munro Partners, an independent global equity manager*
- *London-based Man Group plc*
- *Toronto and Boston based Cambridge Global Asset Management*
- *Redpoint Investment Management, a boutique equities manager based in Sydney*

GSFM represents approximately $16.7 billion funds under management (as at 30 June 2020). For more information about GSFM please visit the website: www.gsfm.com.au