Quarterly Investment Outlook

1st Quarter 2020 December 2019

ameliora
WEALTH-MANAGEMENT

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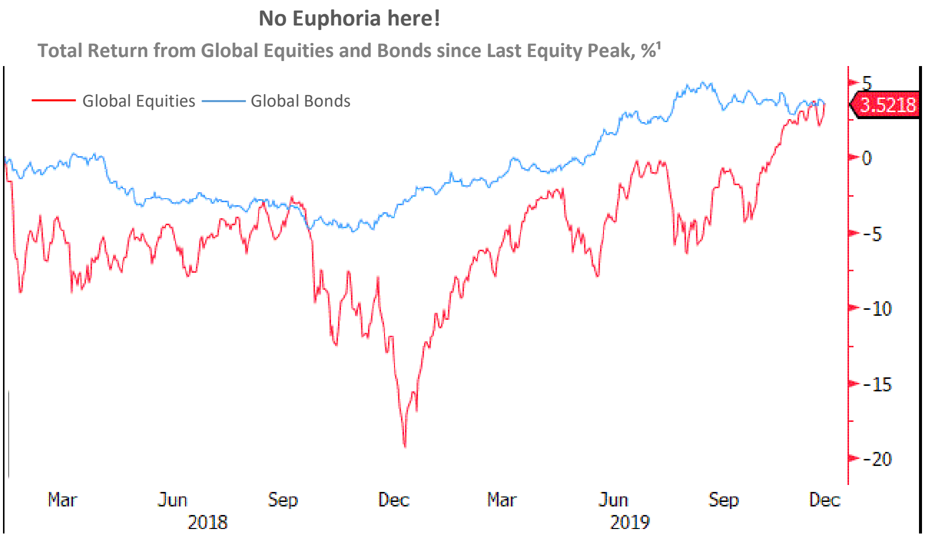
Advisor's Commentary

December 13th, 2019

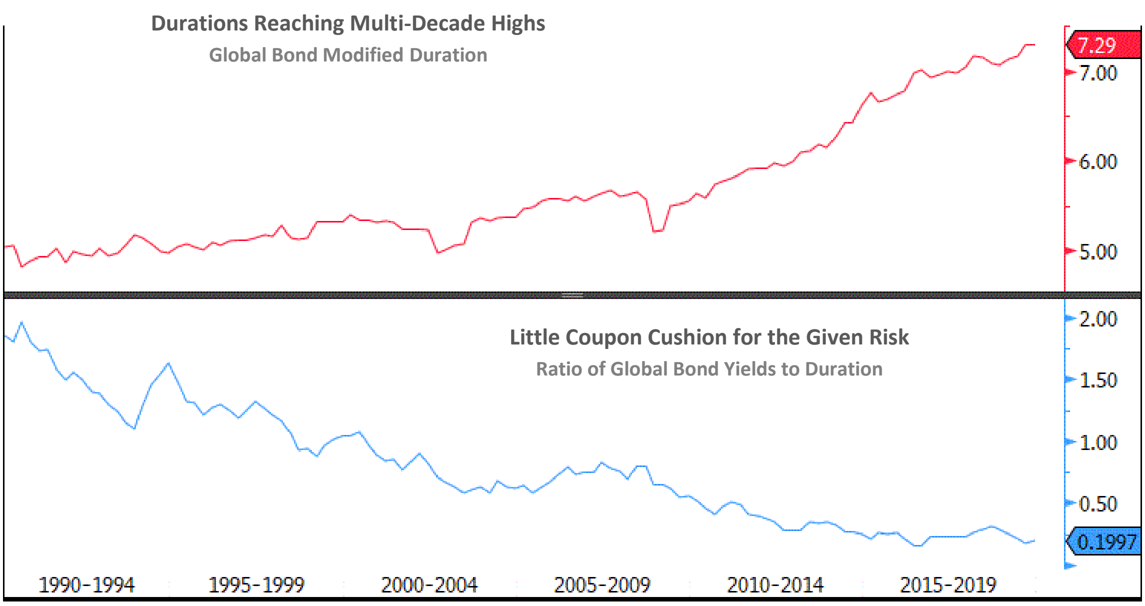
As we head in to the festive season, we can look back on a most joyous 2019. Calendar year performances for most asset classes look strong and positive. Safe haven and risk assets alike have pushed higher so far this year, the last one of this decade. An investor couldn't had wished for more during the upcoming Holidays! However, arbitrary performance measures such as calendar years mask the unpleasant events of previous years. Although the global equity rally this year looks impressive with a close to 23% return, it has only marginally trounced the previous peak recorded in late January of last year. The annualized return since then has been slightly below 2%, or a meager total return of 3.5%. That is identical to the return of global bonds over the same timeframe. Considering the relative higher risk associated with equities, the risk adjusted return has been undisputedly dismal during this period.



[1] Global Equities = MSCI ACWI Net Total Return USD Index. Global Bonds = Bloomberg Barclays Global Aggregate Total Return Index Value Unhedged USD. Start date 26.01.2018

So does this imply that global bonds have a relatively better value proposition, particularly with regards to risk? Not really. While equities exhibit significantly higher price volatility, and subsequently higher expected return, bonds' risk is mostly embedded in their duration, a relationship between their coupon income and respective maturity tenor. It is a sensitivity measure of bond prices to changes in yield - the higher the duration, the higher the bond price risk. So for any one percent change in yields, the bond price is expected to move by the magnitude of the duration measure. And as bond yields have fallen to historic lows of about 1.5%, after a multi-decade long global bond rally (assisted with massive international monetary stimuli), durations have been pushed to historic highs to over 7 (really high).

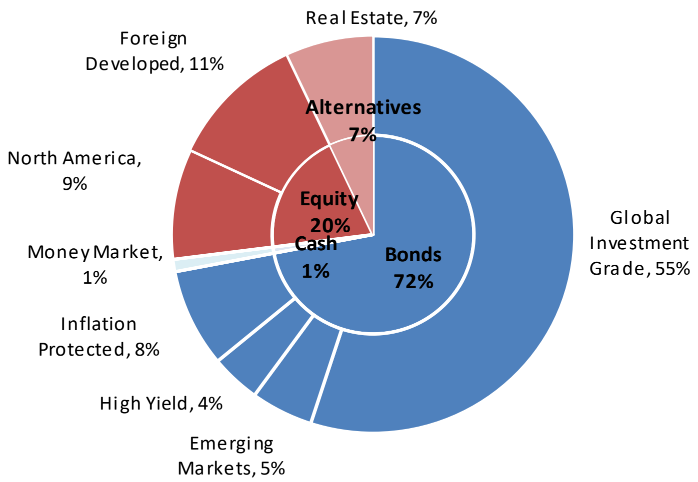
The relationship between yields and duration is so compressed that there is hardly any income cushion left should interest rates just modestly tick higher. To illustrate the current "risk adjusted" return, we simply look at a ratio of prevailing yields over the associated duration. This gives us an indication of the inherent bond risk where we can deduce that, currently, it is skewed negatively compared to its history. This particular situation also stems from the current flat yield curve structure. The term premium, the additional yield required for holding longer dated bonds, is marginal as both the short end and the long end of the curve offer similar yields. As such, by extending duration, i.e. increasing potential bond price volatility for the approximate same coupon income as shorter dated bonds, only increases risk and lowers risk adjusted returns. Although this calendar year has recorded an impressive 6% return for global bonds so far, it only takes a 1% increase in yields to wipe out a whole year's worth of fixed income performance.

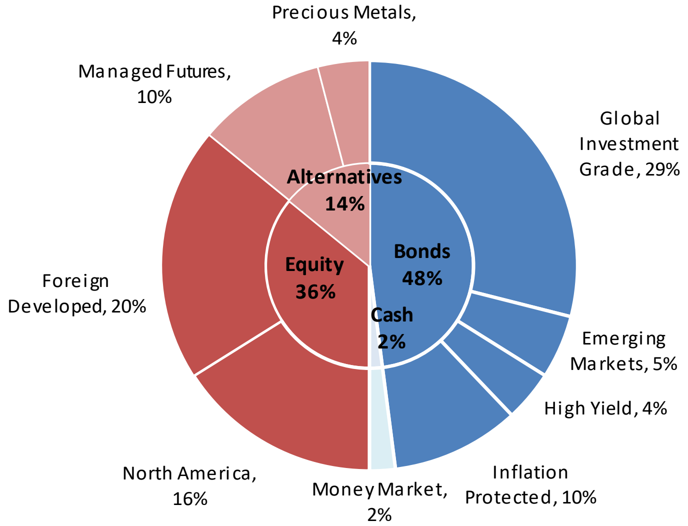


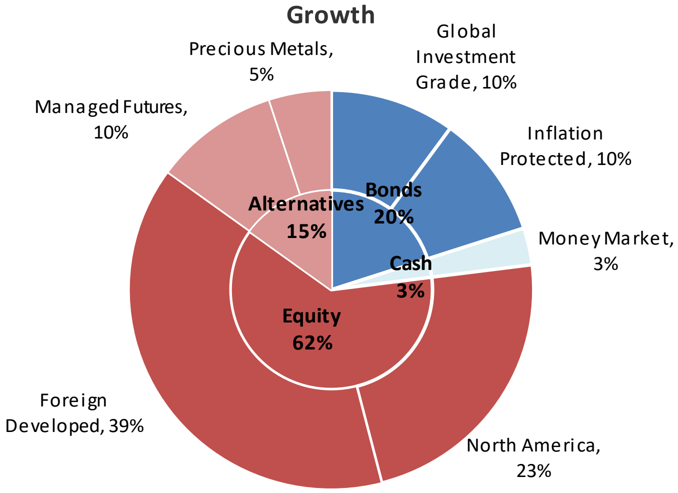
Sources: Bloomberg, LP

Asset Allocations

December 13th, 2019







***Source**: Ameliora Wealth Management as of 1st December, 2019. Asset allocation weights are subject to change without notice and represents investment strategies in USD*

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