

## PRESERVING WEALTH IN UNCERTAIN TIMES

STRATEGIES TO ENSURE THAT ASSETS RETAIN THEIR PURCHASING POWER

By PRANAY GUPTA

**T**HREE factors have contributed to the fact that it is more difficult today than in the past to ensure that assets retain their purchasing power in times to

come:

- Global monetisation across currencies has debased the future value of paper assets
- Higher volatility in asset markets means that the traditional return sources such as the equity risk premium, duration or liquidity risk are much more suspect
- Low interest rates are leading to lower returns on assets today, and a likelihood that current loose monetary policy will lead to inflationary bubbles in the future – meaning that purchasing power of assets will decrease substantially at some point.

Therefore, the key question is how do we preserve asset values today (or insulate ourselves from asset volatility), while retaining the long-term potential for capital appreciation to hedge against future inflation? Below are some simple but powerful tools:

### • Define your risk tolerance as an asymmetric parameter

Defining what is the maximum percentage that you are prepared to lose at any point in time as an asymmetric risk parameter is critical to constructing a portfolio in volatile times.

### • Define return expectations in sync with your risk tolerance

All asset owners generally have an absolute return target based upon future liabilities, or a spread above a risk-free rate or inflation rate. However, this expectation must be in sync with the risk that one is prepared to take.

### • Diversify your portfolio by investment horizon

Uncertain periods such as now are characterised by investors having limited visibility on the near-term future, and a higher degree of confidence on the long term. The optimal way to capitalise on this is to divide assets into buckets of short duration and long duration, and select assets appropriately for each bucket.

### • There will be plenty of opportunities to buy ... don't be in a rush – and be contrarian

Volatility by definition means that asset prices will go up and down. In times of uncertainty, markets are driven by sentiment



LIMITED VISIBILITY

The optimal way to capitalise on uncertain periods is to divide assets into buckets of short duration and long duration

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and liquidity more than by fundamentals. Don't rush in with this pack; buy what you want when others are selling.

### • Don't chase after what has already appreciated

If an asset has appreciated substantially before you have had an opportunity to buy, don't chase it. Focus on what other assets you can look for.

So, in practical terms, what would one invest in today? Following our philosophy, we construct below two sub portfolios:

#### The short horizon sub-portfolio

Most Asian countries and companies have better control of their debt than their European and US counterparts. Buying and holding to maturity short-term Asian corporate and sovereign paper gives a pick-up in yield, with a high degree of certainty of principal repayment at maturity.

All the money that has been printed in the world over the past five years has no choice but to feed inflationary pressures at some point in the future, despite an economic slowdown. Inflation-linked bonds provide the cover that one needs when this happens.

The first country to enter the financial crisis was the US. Given that policy response has been swift and dramatic, it is likely that it will be the first out of the crisis as well. While we do not believe that the US economy is in a sustained economic recovery for the long term yet, the US equity rally

will persist for the first half of 2012. Exposure from investing in mainstream technology stocks which follow a global business cycle and are supported by US equity beta would capitalise on this expectation, but be sure to cash out at the first sign of trouble in the US.

#### The long horizon portfolio

When sentiment drives markets, the good and bad move together. When this happens to the downside, good companies become good investments. Be contrarian, as this is the opportune time to buy the best blue-chip companies and hold them for the long term.

In Europe, the trigger for this event will possibly be the break-up of the eurozone or a Greek default in 2012, where there will be good opportunities to buy all stocks in Europe which are globally exposed companies. In the US, the trigger will be in early 2013, when the new US leadership is forced to implement fiscal tightening which will inevitably undo the liquidity boom that US assets have enjoyed. Invest in companies which you know have leadership profiles in their industry, and will remain viable companies no matter what happens economically. Once started, a risk-aversion mindset is very difficult to undo in a short timeframe. The Singapore dollar will continue to be a favoured currency as a safe haven, and strong economic parameters can even lead to the Sing dollar achieving parity with the US dollar over the next three

to five years. Accumulating Sing dollars will stand a portfolio in good stead.

While the days of hectic yuan appreciation are over, it remains a currency which will appreciate at a steady pace, especially when one considers that alternative options are volatile or limited. Some exposure to the yuan is advisable.

#### What not to buy now

Gold, energy and other commodities have made a handsome profit, but if you happen to have been left out, this is not the time to jump on the bandwagon to buy them.

The solution to the Greek crisis is not the endgame in Europe, it is just the beginning. No matter what unfolds as the political solution in Europe, there is very little that can be done to prevent a severe liquidity crisis, a collapse in medium-term growth and either bailouts or dilution to all European financial institutions. The only thing to consider buying in Europe is what is not European.

We have an optimistic mindset towards the future, and believe that the world is not doomed economically as global markets are already half a decade into the crisis. However, if anything close to a deflationary or Japan-like scenario were to materialise, the only portfolio solution would be either a complete shift to tactical trading or a cash portfolio. ■

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