Income Webcast Series #1
Hunt for income under the current volatile market

Transcription

Recorded on 15 May 2020

Presentation

00:00:01 Moderator
Good morning everyone, my name is Andson Tsang from the Sales and Marketing department of Allianz Global Investors and I am the moderator today. A very warm welcome to all of you.

We have been seeing significant volatility in global investment markets in recent months. In order to identify some investments, a deeper look at particular fixed income sectors is even more critical and also to benefit from their attractive yields. Of course, AllianzGI has devoted ourselves to be your best investment partner, especially in income investment strategies.

To help you and also your clients to hunt for income, for the webcast we invited Mona Mahajan, our US Investment Strategist, to share about how AllianzGI interpret the current situation and the macroeconomic impact of COVID-19, global monetary policies and fixed income markets, as well as forward-looking updates on fixed income investing.

A bit of background of Mona: she is also a Portfolio Manager with AllianzGI, she has more than 17 years of experience in the financial services industry spanning portfolio management, global market strategy, public and private equity, emerging market, thought leadership and client relationship management.

For the webcast, Mona will share the presentation in the first half an hour. If you have any questions, please use the online QA column and we will cover as many questions as we can in the QA session later.

So now, without further ado, let's pass the time to Mona to share her view on how the pandemic will change the economic and market landscape.

00:01:51 Mona Mahajan
Great! Thank you so much Andson for that generous introduction. And welcome everyone, I certainly hope everyone is staying safe and healthy during this time, you know this is certainly a health crisis first and a market and economic crisis second. So, what I thought I'd do is first perhaps go through broadly some of our positioning conclusions up front, and then perhaps take us through some of the health crisis updates themselves, the market and economic implications and really how to think about sector positioning in a post-COVID environment.

So looking at slide 2 here, certainly we are now entering what we are calling a new phase in this economic cycle – The Reopening, not only here in the US but in global economies. Certainly, still some uncertainty remains on what lies on the other side of this reopening process, but we suggest positioning with both offence and defence in this market.

Looking at the slide, just quickly reviewing our key highlights:

One, the Tech sector broadly could continue to remain a market leader. Tech is likely to remain in a secular uptrend in a post-coronavirus world; consumers globally continue to use more stay-at-home and work-from-home technology, both across software and hardware.

Number two, convertible bonds and fallen angels in fixed income broadly could offer opportunities. You know, keep in mind in the fixed income space, there are both offence and defence – defensive plays within that. We think convertible bonds and areas like fallen angels in the high-yield space do offer attractive opportunities at this point in the cycle.

Third, start thinking about the laggards. There have certainly been some sectors, including cyclical sectors like financials, parts of energy and of course the travel and leisure complex that have been suffering during this crisis. But many companies will survive and eventually thrive and so they offer some of the most compelling risk/reward opportunities today.

And then fourth, keep maintaining the defence as well. In this case we look to consumer staples and healthcare particularly. These have traditionally been defensive sectors but in the post-coronavirus environment, we believe they could offer long-term secular growth opportunities as well, not only from basic healthcare and food needs, but also to medical therapies and vaccinations, which we will be discussing as well.

So turning to slide 3, up to 15 May we have over 4 million cases of coronavirus globally. In fact, total cases in the US have surpassed any other country now; over 1.4 million cases in total. Interestingly, the US is followed by several European economies, including Spain, Italy, UK, Germany and France. And also of note, China has now fallen to number 11 on this list. So certainly, perhaps the first to get into this crisis and now, perhaps the first to re-emerge from this crisis.

Turning to slide 4, as we discussed one of the most headline-making news in the US and globally, is really the reopening of the economy. Currently over 40 states in the US have now lifted social distancing restrictions in some form, including my own state of New Jersey, but clearly there have been over, about 42 states now, interestingly more than half the states but only about one-third of the GDP. This is because much of the reopening process is occurring in the middle of the country. It is really the coast, both the East coast and the West coast, where a lot of economic and financial activity occurs. So, what are we watching as we are thinking about the reopening? We're turning to slide 5 here.

One thing we follow closely is the IHME (Institute for Health Metrics and Evaluation) model, which is used by the White House and the administration as well. That helps predict where each country and where each state is in its viral curve. In the US, the model indicates that the curve likely peaked on 30 April, with now a total death toll projected to be about 137,000. Now keep in mind this is up pretty substantially from the 72,000-death estimate just a couple of weeks ago. According to the modelling team, that change in projection is because of the increase in mobility we have seen in the country as states reopen. This chart on the right which you see indicates that New York, which was largely considered the epicentre of the crisis here in the US, is also thought to have peaked on 9 April with an estimated death toll of 32,000 now. So, you know, about 25% of the total projected deaths in the US will come from New York alone. So, while states like New York and New Jersey do continue to show flattening, many states are still showing increasing viral curves. So we'll certainly continue to monitor the direction of the virus and the estimated death toll but particularly now as states and economies globally begin to reopen.

And of course, the other thing we're monitoring, on slide 6 you'll see here, a list of potential therapies and a list of potential vaccinations. As you might have seen in the headlines, there have been multiple medical therapies continued to be tested: Gilead/Remdesivir has garnered a lot of attention in the press lately. It was actually granted what's called Emergency Use Authorization by the FDA (Food and Drug Administration) just in the week of 4 May, meaning it can be prescribed even though the drug is still undergoing trials. Now keep in mind, this drug is most useful for those with the severe illness and thus far can only be administered through IV. But in addition to the Remdesivir, you're also seeing hydroxychloroquine being tested, convalescent plasma treatment, which uses the antibodies of those who've recovered – really the goal overall is to have a therapy or a set of therapies in place by the summer, ahead of any potential second wave of infections in the Fall season. Now, vaccination, which would be a more all-encompassing solution, will still likely not be in place for another 12 to 24 months, although we have heard from President Trump, just on 9 May, that he is quote "hopeful" that a vaccine would be available by year end 2020. In addition to therapies, that will really help round out a toolkit to help fight the virus.

Now, turning to slide 7 here. So while the health crisis may be stabilising and perhaps even improving, the economic damage from the forced quarantines continues here in the US. You know just this morning we had another jobless claims figure come in – 2.8 million. That brings the 8-week total jobless claim figures to an unprecedented 35 and a half million people, likely bringing the unemployment rate in the US close to 25%.

Now, keep in mind on 8 May we also got a Non-Farm Payrolls report for the month of April, which showed a slightly better than expected change in payrolls – negative 20.5 million versus the expectation of negative 21.3. But what's interesting to note in the April jobs report, as indicated on the slide here, is that roughly 78% of those that are newly unemployed believe that it's temporary, so perhaps they have been furloughed, and that gave some hope that perhaps some portion – perhaps over 50% – of these job losses will be coming back as the economy starts to re-open.

The other thing to note here and you will see it on this chart on the left is that, while the job losses have been quite devastating here in the US, the direction of travel has been improving. So, the peak of the jobless claims was in mid-April (6.6 million) – we've steadily been coming down since then. And so you know, markets do pay attention to that second derivative, and so that has certainly perhaps supported some of the market move we've seen since the 23 March lows.

Now, what is the government doing to mitigate some of these job losses? Well, you can see on the right hand side, I'll summarise, you know certainly part of the $2 trillion CARES stimulus, there was a $350 billion allocation by the Federal government to the Payroll Protection Program and that's a programme which gives small business loans that are forgiven if employers choose to keep employees on the payroll. And then of course in mid-April, Congress passed an additional $484 billion stimulus; $310 billion of that was earmarked for more PPP (Paycheck Protection Program), so that would bring the total PPP to 660 billion. And then of course, there has been increased chatter around a potential infrastructure package, you know that has been talked about by both parties and perhaps would be included in the next or the round after stimulus. That would be a bill centred on rebuilding the nation's infrastructure including roads, highways, bridges, tunnels but importantly could provide many needed jobs to those who had been part of the depleted services sector. However, such a programme again would require bipartisan support in Congress, but something we'll be watching for as well.

So turning to slide 8, now really focusing on some of the market implications of what we've seen happening in the markets and certainly what a difference a year makes. The chart on the left here shows 2019 returns by sector and the chart on the right shows 2020 returns by sector year-to-date. Clearly, in 2019 the S&P was in fact up nearly 30% driven by that Technology sector – up nearly 48%. Also interesting to note, the value sectors including financials and industrials were starting to make a comeback in the second half of 2019. That was really driven by this narrative that perhaps global growth was starting to stabilise and even pick up.

And of course, looking to 2020 with the onset of the coronavirus pandemic, we did see markets fall 34% from 19 February to 23 March. Notably, we've recovered quite nicely, in fact up nearly 30% from the lows as of 8 May. And you can see here what's really been driving that move while nearly all sectors are in the red but Technology is the one of eleven sectors that remains in the green. And interesting to note, within Technology, there are 3 sub-sectors – Software, Semis and Hardware – only one of them, Software, is up nicely, up over 6% year-to-date. Interesting to note on the other side of this spectrum at the bottom there, we're seeing the value sectors once again lagging in 2020, so areas like energy, financials, industrials, still very much in bear market territory. Now keep in mind as we go through this reopening process, these cyclical type sectors are the ones that may start performing well, particularly if the market believes in this story of reopening and economic stabilisation, so we'll be watching that closely as well.

Looking at slide 9, you know from a global perspective it's certainly interesting to note as well how the performance is playing out year-to-date. And on the left hand side here we see equity performance and on the right hand side we see sovereign bond performance year-to-date. Perhaps one of the key takeaways is that the US broadly still remains a flight-to-safety asset class really across equities and bonds.

From an equity perspective, the S&P500 is now second in performance only to the Chinese Shanghai Index which again has been driven by really the Chinese story, being the first to come into the pandemic and really doing a nice job of coming out of it. Interesting to note at the bottom of that equity list we still see several EM and European economies still in bear market territory or close to bear market territory.

Now on the right hand side you can see the sovereign bond performances and clearly you know the US Treasury market has been the flight-to-safety asset class of choice in the bond market. Keep in mind that US Treasury yields, even now at 65 basis points or so, are relatively attractive to some of the European and even Japanese counterparts which could be flat or even negative. So that's been an interesting trend year -to-date as well.

And then turning to slide 10, just thinking about earnings season, keep in mind, we're now over 70% through with S&P earnings for Q1. Estimates have come down quite substantially; S&P earnings for 2020 are now projected to be down -20% year-on-year, this is well below the -4% estimate just on 31 March of this year. You know we believe estimates are now starting to reflect reality and certainly in line with our view of down -20% to -25% year on year. Now on a quarterly basis you can see the most downside to growth is clearly expected in Q2. So Q1 is expected to down about -14%; Q2 down -41%, followed by Q3 of -23% and Q4 of 11%. So keep in mind, while there's chatter of markets perhaps pricing in a V-shaped recovery, in fact earnings estimates remain quite modest even for Q3 and Q4 of this year.

And then looking at slide 11, so beyond 2020, what could S&P earnings really look like? Well it's interesting to think about it from the perspective of what the market might be pricing in. You know currently the S&P is around the 2,900 or high 2,800 levels, which you can see highlighted in the yellow here in this box. That prices in roughly $170 of EPS and a 17 times multiple. Now keep in mind the 2019 earnings was about 165, so what this is pricing in is a 2-3% growth outlook from 2019 and using a somewhat conservative 17 times multiple. You know we think this may be reasonable for a more steady-state earnings estimate, perhaps 2021 or even 2022, but in any case markets do tend to be forward looking and we're starting to see some of that getting priced back in as we are undertaking the reopening process.

Looking at slide 12, the other part of the story that's helped drive the market quite nicely over the last few weeks, and what's really been different this time versus other downturns, is really the speed and size of the monetary and fiscal response. And now this slide has a lot of language on it, I won't go through it in full detail – but you know needless to say we now see the full force of monetary and fiscal stimulus being unleashed to combat the virus. We've seen dramatic responses from both the Fed (Federal Reserve) and the Federal government which total about $9 trillion thus far (or about 40% of GDP). The breakdown is roughly $6 trillion from the Fed and $3 trillion from fiscal stimulus programmes. You know it's interesting that the Fed in particular has really delivered in this crisis; not only in its speed but in the innovation in its solutions. Of course, we've seen rates come back down to the zero bound, QE purchases increase indefinitely but some of the other tools implemented by the Fed include a commitment to buy municipal bonds, to buy high-yield and investment grade bonds and ETFs and of course to buy the PPP and the CARES loans that have been produced by the Federal government. So you know, clearly what the Fed has done has had a positive impact on both the equity and bond markets and we'll see that going forward as well.

And so when we think about market technicals, what are some signals that we're looking for? I've outlined 3 here that could be interesting on slide 13. So in addition to a very impressive retracement off the market lows, there are a few other signs too.

One, we look at the volatility index or the VIX, which is also known as the Fear Index. This has really come down from peak levels; it reached an all-time high in March of 83 and is now hovering in the mid-30s range, perhaps indicating that peak fear may be behind us.

The second signal we're looking at is the sector rotation, you know clearly as we were entering this crisis, there was a rotation into the bond proxy, very defensive sectors like Utilities and REITs. More recently the markets have been driven by two main growth or secular growth areas: Technology and Healthcare. What we'll be watching for next is if we can see any rotation into the cyclical sectors. As we noted earlier that would indicate a real belief in the reopening story.

And then thirdly, you know spreads in both investment-grade and high-yield corporate bonds have tightened quite a bit from recent widening spikes and that's been supported by the massive stimulus from the Fed. And we've also seen new issuance in the investment-grade market really start to recover in the US as well. So all of these factors may be part of a bottoming process where we believe perhaps the large portion of the down-move may be behind us. We certainly don't believe we will retest any lows going forward and perhaps, you know, any pullbacks in the future could be opportunities for positioning.

So looking at slide 14, just to highlight in graph form the spreads on both investment-grade and high-yield bonds, you can see really they spiked wider as the pandemic hit but since the Fed intervention in March we've seen both IG (investment grade) and high-yield spread come down. They still remain elevated versus pre-crisis tightening/tight levels which could provide an opportunity going forward.

On slide 15, in this backdrop you know we've also seen yields continue to remain soft and we talked about not only the Fed but it's really central banks globally that continue to remain in easing mode. So we see on the left hand side here yields on major economy sovereign bonds have been trending lower. And then on the right hand side you see negative-yielding debt globally remains elevated still.

So in that backdrop, how do we think about positioning, in fixed income in particular? Well you know we outline here 3 phases of the economic cycle: the early stage when growth rebounds – and we think we're perhaps entering this early-stage rebound, and then there's the mid-to-late stage and then there's really the recession stage, which you know obviously we have seen quite dramatically and swiftly during this crisis. So as we're kind of exiting recession and entering the early growth stages we would consider a barbell approach to fixed income as we talked about early on. On one hand of that barbell, we continue to like some of the defensive asset classes – like Treasuries, like high quality investment-grade – but we also prefer areas that have increased yield profiles, like select areas of high yield, including fallen angels, convertible bonds and even Asian high-yield would be in this category.

So looking at slide 17, this really outlines this barbell approach that we would use to really think about positioning in the fixed income space. You can see on the left hand side the treasury bonds, the US dollar assets and high quality investment-grade make up a defensive portfolio. And then on the right hand side, select US high yield, convertible bonds and Asian high yield would really make up our more offensive fixed income portfolio. And so this really provides a good balance in terms of if you enter a risk-on or a risk-off environment, you're protected on the downside and participate in the upside as well.

And then finally, on slide 18, how do we think about what a post-coronavirus or post-COVID-19 world looks like? And we really think about the sectors that may benefit, really across asset classes from this gradual reopening phase and as we continue to live with the virus and get through it.

And so some of the sectors I'll highlight here: one, the rise of food delivery and online retail. Now of course, Amazon sticks out right away as a name in this space but really any player that can efficiently offer retail and food delivery services may be a winner here.

Of course, Technology is a space that we highlighted up front, but there are several trends that we would like to participate in that really cater to a more stay-at-home world. There's enhanced Wi-Fi services and of course the emerging 5G space but there's a whole complex around e-gaming, video conferencing and remote education, all likely to see secular uptrends. And then of course corporations will need better cloud computing and enhanced cybersecurity solutions, especially with a more work-from-home workforce.

In the Healthcare space we see several fundamental shifts that we could participate in as well: tele-medicine, the need for medical equipment, testing devices and testing services. And then of course, the pharmaceutical players who are involved in the medical therapies and vaccination, all will be critical going forward as well.

We continue to like China as an asset class here, which we've mentioned a couple of times, particularly as the rates of the virus continue to fall and remain relatively stable, but also China is still largely a manufacturing and industrial sector economy – easier to implement social distancing in that format, certainly more so than the US where it's really a services-driven economy.

And then of course we're considering certain market dislocations, so the sectors that may have been priced to distressed levels but will likely survive after the crisis subsides. And we talked about perhaps certain airlines, perhaps certain areas of energy, in the fixed income space, we look for fallen angels and convertible bonds. And so these are areas that offer very compelling risk/rewards at these levels.

And then finally, we believe active management is really a must as we navigate this crisis, there will certainly be companies that win and lose through this downturn across asset classes. And index or passive strategies, which are OK for certain environments, now may expose investors to potential underperformance, even potential defaults. So therefore, you know we really do think it's critical to make some active bets, as we navigate and re-emerge from this global pandemic.

You know overall, we continue to believe that, longer-term, the health of the US economy will not be fundamentally derailed. Society will move forward, albeit with much more caution and awareness around health and safety. But when we do stabilise, we will actually be in an environment where asset prices and valuations have potentially come down and those investors, like us, who had been looking for more attractive risk/reward opportunities, will benefit.

And so with that, I'm happy to pause here, answer any questions. I'm also happy to connect with anyone on LinkedIn and thank you so much. Stay safe everyone.

Q&A

00:26:35 Moderator

Thank you Mona, thanks a lot. We actually have received quite a lot of questions from our audience, maybe we can take a few questions. There are a few questions asking about the economy of the US. So, what is your outlook on the US economy as you gradually reopen in the second half this year and also what could drive a stronger recovery?

00:27:00 Mona Mahajan

It's a great question. So clearly when we look on a quarterly basis, Q2, like we saw in earnings forecasts, will be the hardest hit in terms of economic growth, down perhaps 30-40%. But we do see a gradual stabilisation in the second half of the year. You know what could lead to stronger upside? Well there's upside risk if perhaps, we do see additional therapies or in an ideal case, a vaccination being approved. This could be a game changer and really help improve confidence going forward.

You know the second thing that could improve confidence generally is if the unemployment picture does stabilise and get much better. And you know we talked about how many of the jobs may be furloughed and perhaps will come back once we re-open. So we'll be watching both those trends very carefully.

You know on the other side of course we'll also be watching to see if the reopening process leads to any sort of second wave of infections. We've been watching the Asian economies quite closely and they've been doing thus far a pretty good job in making sure they don't see second waves. We started to hear a little bit about that but it seems like they're all pretty contained – well contained. And we're entering in the US the summer months, which certainly helps when you're dealing with a respiratory virus. And so, I think we'll be looking for both upside and downside but, generally speaking, the second half of 2020 we should see improving trends, particularly versus the Q2.

00:28:42 Moderator

Even though it seems we are optimistic about the improving trend in the second half this year, if we look at the latest weekly jobless claims that you mentioned earlier, it's already close to 3 million so it's still worse than the expectations. So, are we going to see more ugly data in the coming months?

00:29:05 Mona Mahajan

I think certainly from the unemployment perspective and as we talked about and showed in that graph earlier, the data is, on an absolute level, quite devastating – quite ugly, as you mentioned. Even the 3 million today has been really unprecedented versus historical periods. That being said, you know as we have been talking about, the trend has been generally improving so we went from mid-April from 6.6 million, then went down to 5.8, 4.5, 3.3 to 3 and then 2.8. So I think hopefully we'll continue to see the stabilisation in these figures. And of course, you know I think most of the people that have been let go, it occurred during the month of March and April and now going forward hopefully we see this trend stabilise and eventually start to reverse. So, yes we will certainly continue to see soft data but from an unemployment and jobless perspective we have probably seen the worst behind us.

00:30:14 Moderator

Another question from the client is about government policy. Do you expect more policy support from the US Fed and also from the fiscal side? If yes, what kinds of support will they be?

00:30:31 Mona Mahajan

Yes, I think we do expect more, certainly from the fiscal side and we heard from Jerome Powell earlier this week, who is also urging Congress to come together and produce more fiscal stimulus. I think the initial fiscal stimulus was meant to be a bridge to the economy until about the end of May, which we're approaching in the next couple weeks. I think the additional fiscal stimulus will be in the range, in total between another $2 to $4 trillion and that'll largely be focused on, helping state and local government. Keep in mind, state and local governments in the US support things like public schools, like hospitals, even some of the social security and safety net programmes. And so they have certainly been hit by the loss in revenues from this pandemic and so I think Congress will need to support those state and local governments.

We also see more funding towards testing, you know hopefully the government comes up with a more comprehensive approach to testing so that's another area. And then longer term, as we mentioned earlier there is perhaps hope around an infrastructure bill. I think that would be a nice way to improve the infrastructure of the economy, support some of those industrial companies that have really lagged during this market rally and then of course provide many needed jobs, especially to those in the services sector so look out for those sets of fiscal stimulus going forward.

00:32:02 Moderator

Besides the US economy seeing declines, they are also interested in the US Presidential election. So what's your view on the US Presidential election and also how will that election impact the markets?

00:32:19 Mona Mahajan

Yes, absolutely. It's a very interesting time because in more normal scenarios a lot of the focus of the headline and the news would be around the Presidential election, which is coming up on 2 November, but now I think we're looking at more, obviously, pandemic and coronavirus related headlines which has put the election cycle kind of in second position.

That being said, historically speaking, the Presidential election, especially for an incumbent President, is usually decided by the state of the economy. And so if in the next quarter we do start to see potential stabilisation, economic upturn certainly versus what we saw in Q2, that could be supportive for a second Donald Trump presidency. If not, if we start to see the reverse with perhaps a second wave of infections or more shutdowns, then we may actually look to Joe Biden as the potential candidate.

You know keep in mind, when you look at the betting odds right now, when we look at sites like "predictit", President Trump is still in the lead by some margin – not very large but I think it's 49 to 44% versus Joe Biden. Joe Biden thus far has been relatively quiet. He's letting the President kind of take the forefront here, especially during this crisis and thus far has really not made any sort of major announcements for policy, even his Vice-Presidential candidate, and so we'll wait to hear on how that plays out and what he comes up with.

Certainly the Healthcare sector in particular has benefited from Joe Biden beating Bernie Sanders on the Democratic side, there was some worry that if Bernie Sanders was the nominee for the Democrats, he would really push the "MediCare for all" type platform. And since he has dropped out of the race, the Healthcare sector has actually steadily stabilised since that. So that's one sector we'll certainly have an eye out on. Certainly, Technology and Financials are the other ones as both candidates have looked to maybe break up Big Tech or roll back – Joe Biden has certainly talked about rolling back - some of the tax cuts.

00:34:46 Moderator

Let's change the focus to views on asset class. I think China, it seems to be another area of interest of our clients. So, you mentioned during your presentation, China, as an asset class, the outlook for China is very promising and also if we look at the performance of the China stock market, it has been outperforming other markets – the major markets in the world. But at the same time there is also some news about decoupling between China and the US. So, what's your view on that and how far does it impact the de-globalisation post-COVID-19 and also the investment outlook for China?

00:35:33 Mona Mahajan

Yes, certainly. You know clearly the US-China relationship has been in the spotlight during this pandemic as well. And it's interesting because I think just in the week of 4 May, both parts – or both sides – negotiating teams for the trade deal had come together and done a call – a conference call – and they both came out saying that in fact the phase 1 trade deal was intact and they're hopeful that it can be carried through as planned this year.

But interestingly President Trump came out later and talked about the Chinese relationship not being as solid as he had hoped. And I think perhaps what we tend to see, especially now as we're heading towards this election season, that President Trump and the administration in general tends to talk more about anti-China or China rhetoric in general – de-globalisation – it plays well to President Trump's base and certain parts of the population, but when it comes to actual action like you know potentially increasing tariffs again or banning certain companies from doing business etc, we have not yet seen that. And so in some ways it tends to be more rhetoric to support his – President Trump's – potential election bid than actual action. That being said, I do think that you know given what's happened in terms of supply chain disruption from the pandemic, there will be perhaps more of a push for more local supply chains, just as a matter of practicality. To get intermediate goods from one country to another now has just become more complicated. And so this really does speak to perhaps something that will accelerate this trend towards de-globalisation. So you know that being said, it will be perhaps more local supply chains but we also then on the other side have to think about what that means for pricing and inflation as well. So, something we're watching going forward, especially now as we're starting to reopen again. I'm hopeful that supply chains will become a priority for global economies.

00:37:51 Moderator

Another question I have on hand is – as you mentioned in your presentation, equity and credit may offer some investment opportunities at this stage. Does it mean a mixed asset approach will be better for investors in the post-pandemic world?

00:38:10 Mona Mahajan

Yes, I'd say absolutely. Certainly you know this will depend on your risk profile and risk appetite, but we would certainly advocate for a balanced or blended portfolio. And now, as equities have had quite a nice move upwards, credit becomes more interesting, especially since the Fed is in there supporting credit assets and as we've seen in some of the graphs spreads have come down, but they're not yet back down to pre-crisis levels, which offers some opportunities as well. So there's certainly ways to position in credit that we've talked about. We would balance that with an equity portfolio that certainly gives some exposure to what we like in a post-COVID world but also some exposure to some more defensive sectors as well. So, this theme of barbell approach, or balance, applies to both equity and credit and we would certainly advocate for a mix of both, perhaps at this point slightly favouring credit more versus equity.

00:39:16 Moderator

Since we're running out of time, maybe let's answer the final question for the day. Mona you just mentioned about the barbell approach, this question is also asking about – in terms of the investment approach to hunt for income, it seems it's not appropriate to take much duration risk in this ultra-low yield environment. On the other hand, we are also exposed to credit risk due to the damage on the economy. So selecting high-yield seems to be the way out to hunt for income. And how about the short duration credit?

00:39:54 Mona Mahajan

Yes you know I think the key here is to have active management. We certainly still like our short duration credit portfolios. We think if you're active and pick the right sectors, the right credits, the right corporations, you can do quite well from a yield perspective. You know I think for duration at this point, with 10-year Treasury yields for example down at 65 basis points, the downside to that is still not too high and so we're looking certainly to reduce our duration exposure.

So we certainly like what you mentioned here, both short-dated credit and then of course high yield to hunt for income. And the combination of that could be quite powerful, especially when yields globally, sovereign yields are quite low, in some cases zero or negative, and even the dividend strategies are still tentative given that some companies are now starting to cut dividends. So we certainly prefer the approach that you noted in terms of both high yield and short-dated credit.

00:41:05 Moderator

Thanks so much Mona for joining us and also sharing your valuable insight today.

For questions that were not answered, we will provide written responses together with the summarised transcript for the webcast today and share with you later.

Before closing, I would like to invite you to fill in the online survey form to give us valuable feedback and also comments about the webcast. In the near future we will launch a series of digital and virtual programmes and bring you forward-looking investment insights. Stay tuned.

So, that's the end of the webcast today. Once again, thanks Mona for being our guest. Hope we can speak to you soon, later this year. And thank you so much to all our clients for joining to the webcast. Have a great weekend.

Q&A — Unanswered questions during the webcast

Question

Would like to know your thoughts on the US banking sector.

Answer

We think the US banking sector has come into this coronavirus crisis in much stronger shape than it was coming into the 2008 financial crisis. Bank leverage has come down, reserve levels remain substantial, and balance sheets are generally solid. Banks have also played an important role in supporting PPP loans during this crisis. However, keep in mind the low rate environment is not too positive for bank loan margins. Currently, our preference is to get exposure to the US banks through preferred fixed income securities, which are higher-yielding and can offer exposure to the strongest bank balance sheets.

Question

What will trigger the Fed to implement negative interest policy? If the US rate turn negative, what fixed income strategy will look like?

Answer

We generally believe that Jerome Powell has been pretty consistent and clear that he does not prefer taking the US Fed funds rate below zero. The Fed has also seen the evidence from Europe and Japan – negative rate policies have not promoted growth or inflation, and may cause some market distortions. So our view broadly is that the Fed will utilise other tools first (expanding current vehicles, taking on more QE, etc) rather than push rates negative.