Sponsored by:

Asset Management

ASIA'S DIVERGENT INVESTORS

The annual survey of the AI300 investors reveals a divergence in opinion when it comes to asset allocation

BY RICHARD MORROW

A shifting economic environment, including high asset valuations and rising interest rates, combined with a mounting trade war, have provided institutional investors with a need to reflect on their investment plans. *AsianInvestor*'s latest survey of Asia Pacific's leading asset owners reveals that they appear to be doing so, but there is an evident rift among the conclusions they are coming to.

The latest survey was based upon investors included in *AsianInvestor*'s annual AI300 list of the largest asset owners by portfolio size in the region, and is sponsored by Goldman Sachs Asset Management (GSAM). In total, 97 investors on the list responded to our questionnaire, which focused on their investment beliefs and plans.

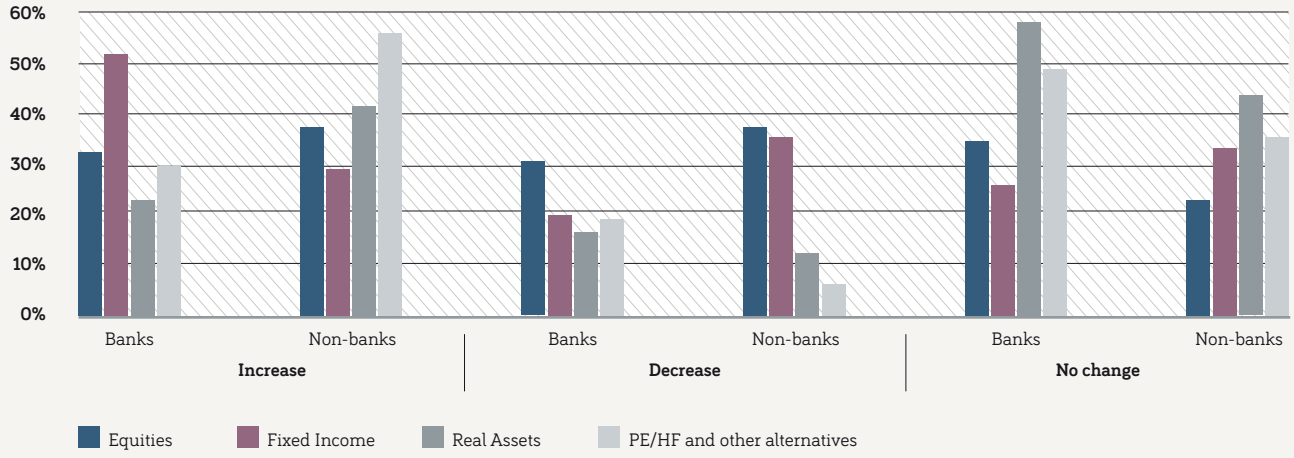
The respondents appear to have become more resolute in their investment plans, after being less focused in 2017. However, there is a bifurcation in their intentions.

Among non-bank respondents, for example, 38.3% say they intend to raise equity allocations over the next 12 to 24 months, but an equal amount would reduce this exposure. Similarly, while nearly 30% aim to raise their fixed income allocations, a slightly higher amount (36.2%) want to reduce this allocation.

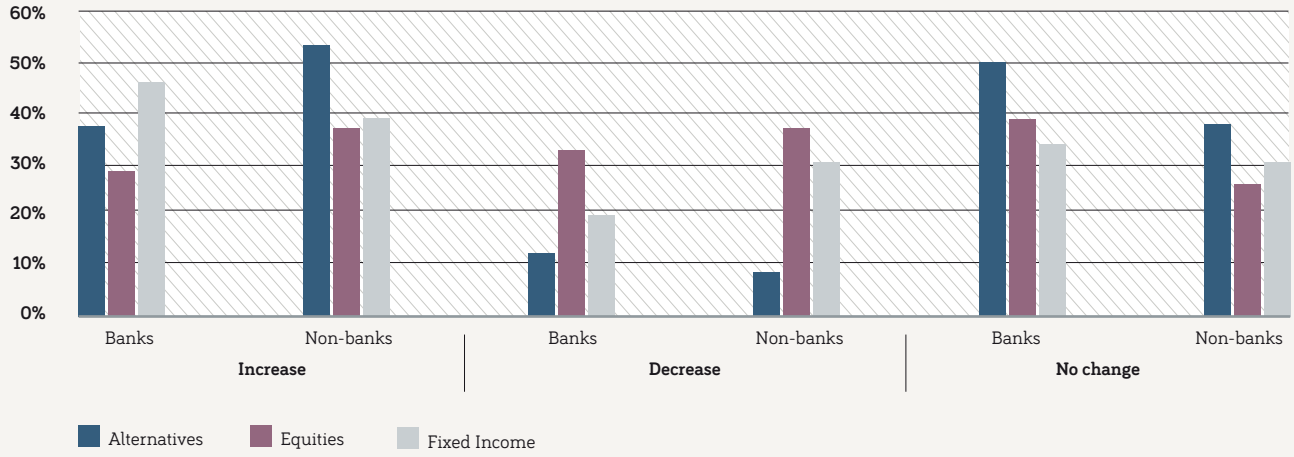
Bank respondents revealed a similarly disparate trend; 33.3% want to raise equities, but 31.3% are looking to cut such exposures. And while 53.1% want to add to fixed income, 20.4% intend to cut such investments – up from 10.5% in 2017.

Notably, the percentage of investors who wanted to keep exposures the same has also dropped. Non-bank investors looking to maintain current equity allocations fell from 40% in 2017 to 23.4% this year, while the percentage aiming to retain their fixed income investments slid from 36.1% in 2017 to 34%. Similarly, 35.4% of bank respondents wanted to keep equities the same this year, versus 44.7% in 2017. "The

HOW WILL YOUR OVERALL ASSET ALLOCATION CHANGE OVER THE NEXT 12-24 MONTHS?



WHAT CHANGES ARE YOU MOST LIKELY TO MAKE TO YOUR OVERSEAS ALLOCATION OVER THE NEXT 12-24 MONTHS?



survey reveals a bifurcation in views on the market; people are moving into distinct camps, with some believing the [US economic] cycle will hold for longer and others fearing it won't," said Tuan Lam, head of institutional business for Asia at GSAM.

"These investors appear to have stronger views now compared to where they were one year ago," he added. "Given where equity valuations have gone, some investors feel that they are too expensive today, whereas others believe that the global economy still has good fundamentals and think that market performance will last for a while longer."

LOCAL FOCUS

Lam said his conversations with clients reflected a branching in their investment views. Some feel risks are rising, and want to allocate away from overly risky assets such as equities. Others think there is more value to be found before conditions deteriorate.

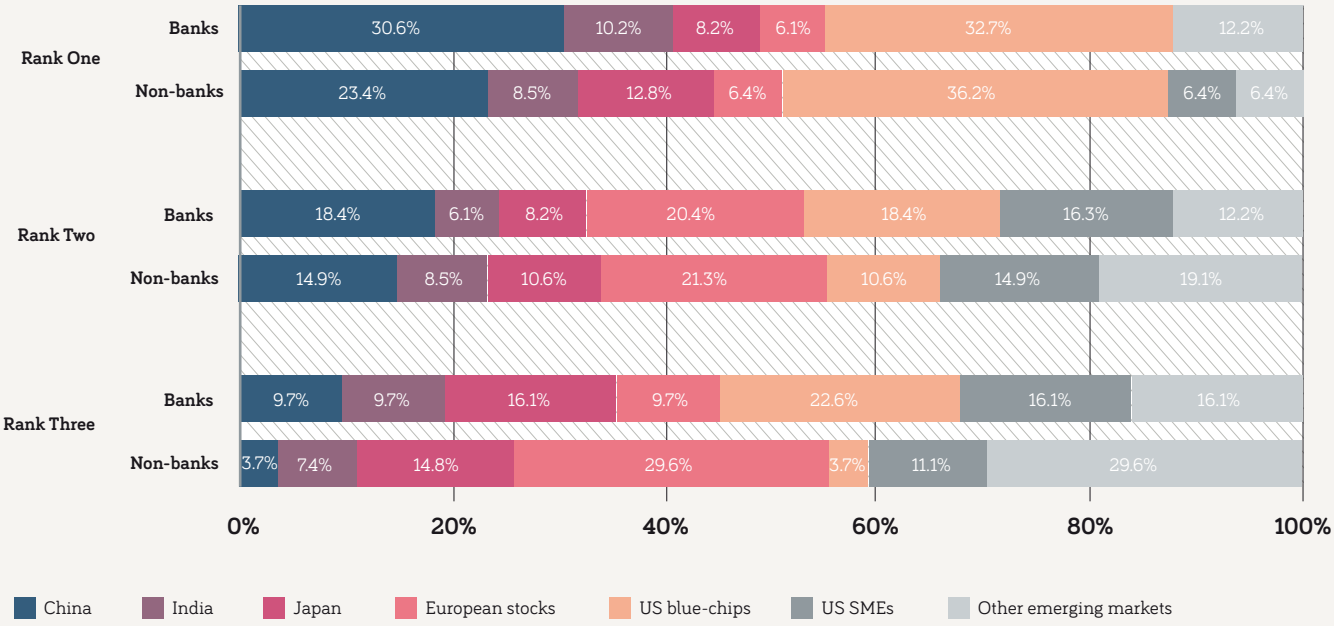
"Two years ago there was a general sense that we were in the late part of the [US] economic cycle. But now, to use a baseball analogy, some clients feel as if we are in the 9th innings of the game, but the game might have been extended to 12 innings," he noted.

The divergence in viewpoints is also becoming noticeable when it comes to investors' attitudes towards international investments.

Non-bank asset owners were split over whether to invest more into offshore equities; 37% say they want to do so, versus 41.7% last year, and another 37% are looking to cut their offshore stock exposures. Banks appear willing to raise offshore equities, although their overall desire is less pronounced: 28.6% want to raise such exposures this year, versus 23.7% in 2017.

There is more uniformity of investor views when it comes to alternatives, in an apparent recognition of the need to

WHERE WILL YOU LOOK FOR MORE EQUITY INVESTMENT RETURNS OVER THE NEXT YEAR?



INVESTORS' VIEWS ARE DIVERGING ON THE APPEAL OF EQUITIES

38.3% Of non-bank investors aim to raise equity holdings over one to two years, but the same percentage of investors intend to cut them

WHAT IS THE BIGGEST RISK TO YOUR INVESTMENT PORTFOLIO OVER THE NEXT 12 MONTHS?

	Rank 1		Rank 2		Rank 3	
	Banks	Non-banks	Banks	Non-banks	Banks	Non-banks
China and emerging market economies	36%	36.2%	12%	17%	14.3%	11.6%
Credit performance affected by sharp earnings	6%	6.4%	8%	6.4%	6.1%	N/A
Equity valuations remaining volatile	2%	10.6%	4%	12.8%	2%	7%
Expansion of international trade war	24%	27.7%	38%	21.3%	10.2%	18.6%
Global recession	12%	8.5%	12%	19.1%	20.4%	20.9%
Monetary policies	6%	4.3%	14%	8.5%	14.3%	23.3%
Politics/Geopolitics	10%	4.3%	10%	12.8%	20.4%	14%
Regulatory environment	4%	2.1%	2%	2.1%	12.2%	4.7%

maintain diverse portfolios. Over half (57.4%) of non-bank respondents want to raise allocations to private equity, hedge funds and other alternatives, while just 6.4% intend to cut such assets. Additionally, 53.3% want to raise overseas alternative investments, although this was a drop on the 66.7% who planned to do so in 2017. And 37.8% said they want to keep such allocations as they are. Alternatives remain an important part of institutional investors' portfolios. "Investors are continuing to focus on a wide range of alternatives as they look for incremental returns and enhanced diversification," said Lam.

CHIEF CONCERNS

The bifurcation in investors' views appears to be in response to broader changes in this year's overall macroeconomic environment.

In particular, bank and non-bank respondents both register a marked level of concern about the impact of both China and emerging markets on their investments (36% and 36.2%, respectively). Both sets of investors are also alarmed by the escalating trade war between the US and other nations, with 24% and 27.7% of respective bank and non-bank investors pointing to this as a paramount worry.

GSAM's Lam noted that these two concerns are linked. China is the main target of the US's increasing trade protectionism, and the impact of the latter's tariffs could slow its economy.

"The ongoing issue of the trade war naturally connects China and the US and it also has a big emerging markets component," he said. "The key issue for our clients is that it's hard to see a resolution to the trade war, at least in the near future. That is increasing investment uncertainty.

"We're not seeing many clients make large changes in their SAA (strategic asset allocation), which makes sense since SAAs are meant for longer term time horizons, but we are seeing many clients focus on being more nimble and tactical within their asset class allocations," he said.

Lam noted that another frequently-cited factor on investors' minds has been rising US interest rates.

Expectations for US interest rates remain fairly broad-based and consistent.

> "SOME CLIENTS FEEL AS IF WE ARE IN THE 9TH INNINGS, BUT THE GAME MIGHT HAVE BEEN EXTENDED TO 12 INNINGS"
>
> Tuan Lam,
> Goldman Sachs, Asset Management

When asked where the 10-year US Treasury yield would be a year from now, 41.7% of bank respondents and 36.2% of non-banks expect it to be over 3%. This sits well with general market expectations, with most anticipating a further 25 basis point rate hike in 2018, and up to another three increases during 2019.

FIXED INCOME FORECASTS

Rising rate expectations have led investors to begin changing their preferred fixed income strategies. Interestingly, non-bank respondents were drawn to the idea of duration management, with 42.6% signalling this as their top area of potential investment returns. This could well be a sign of their interest in extending their average bond maturities, in an attempt to gain more yield.

UNDERSTANDING BIG DATA

43.5%

of non-bank investors are incorporating big data or algorithmic investing into their plans

Bank investors are also fairly interested in duration management, although it only comprised 26% of votes. Meanwhile 20% said they don't intend to look to change their bond investing strategies at all, versus 13.2% last year. Evidently some respondents feel they may have the right strategy – or at least that shifting could do more harm than good.

Respondents were also asked what specific types of fixed income allocation they favoured, which revealed a marked interest in US and European investment grade bonds.

Non-bank investors placed this asset as their overall favourite (24.4%). Non-banks preferred emerging market debt (22.9%) and bank loans (18.8%), the latter of which is one of two new categories for this question.

"The interest in US and European investment grade bonds continues to be strong from certain client segments in the region given recent volatility in emerging market debt," said Lam. "In addition, certain Asian clients still want to buy

KEY TAKEAWAYS

MORE CERTAINTY
Bank and non-bank investors have become more certain in their attitudes towards equity and fixed income investing for the future, compared to 2017, with fewer numbers aiming to leave their current allocations unchanged

DIVERGENT INVESTING
Investors' views on the markets have polarised; more asset owners intend to increase equity or fixed income investments, but more aim to decrease such exposures too

KEY INVESTING CONCERNS
Investors are most concerned their returns will be affected by China and emerging markets, plus an expanding trade war. The two may well be linked

DURATION MANAGEMENT
Non-bank investors favour managing fixed income duration to improve returns, probably because of a view on rising US interest rates

EQUITY EXTREMES
Equity investors favoured China to gain returns, along with US blue-chips, marking a barbell approach to equity risk

NEW INVESTING APPROACHES
Investors are increasingly utilising big data and algorithmic investing into their plans, as well as applying environmental, social and governance principles

and hold long duration assets, which are liquid and of a high quality."

EQUITY DIVERGENCE

The opinion of survey participants in the equity space was far less concise.

When we asked investors where they felt S&P 500 index returns would be in a year's time, they were defensive. A total of 49% of banks and 53.3% of non-bank investors felt it would yield between zero percent and 5%. A smaller number (32.7% and 28.9%, respectively) were a little more optimistic, pinning their hopes on a return of 6% to 10%.

Very few saw outcomes that were much better than this. Given the record-breaking valuations of the index until early October, this hesitance is understandable.

However, investors were similarly cautious in 2017 – 46.2% of bank investors and 44.3% of non-bank respondents believed there would be a less than 5% return – but the S&P 500 offered nearly 15% from the beginning of August 2017 until the end of July this year.

"If you compare these results to previous years, there's a bit more weight on the zero to five percent returns level," Lam said. "Given where equity valuations were at the time of this survey, it would have been harder for investors to have high conviction that we would see another 10% over the next year."

> "IT'S HARD TO SEE A RESOLUTION TO THE TRADE WAR, AT LEAST IN THE NEAR FUTURE. THAT IS INCREASING INVESTMENT UNCERTAINTY"
>
> Tuan Lam,
> Goldman Sachs, Asset Management

ENGAGING WITH ESG

61.7%

of non-bank investors are using ESG principles in some manner to invest their assets

The marked volatility in US stock markets on October 10 and 11 underpin the uncertainty of their performance. After racking up record historical gains until late September, the S&P 500 fell six days in a row from October 3. It dropped 3.29% on October 10, and then another 2.06% the following day.

Investors sent somewhat mixed signals when it came to which stock investments they prefer. China, the largest regional economy, gained a decent level of support, with 30.6% of banks and 23.4% of non-banks choosing the country's volatile equities as a top choice to seek more returns. US blue-chips also fared well, garnering interest from 32.7% of bank participants and 36.2% from non-bank respondents.

The mixture of investor preferences could point to the relatively low valuations of Chinese stocks, following a poor 2018 to date, combined with the resilience of US companies at a time when the world's largest economy continues to enjoy robust growth.

The interest in Chinese equity was also noteworthy among investors considering how best to invest into the country.

Over half of bank respondents (57.4%) and almost half of non-banks (45.7%) said they favour stocks when it comes to investing into the country. This seems a sensible point, given the relative maturity of the country's stock market. Similarly, the interest in its large and growing fixed income market was also unsurprising.

However, private equity and hedge funds are also proving popular with investors into China; 36.2% of banks like these alternative investment avenues, and 28.3% of non-banks support them too.

ALTERNATIVES INTEREST

Those asset classes fall into the catch-all of alternatives, an area that has gained demand across Asia with institutional investors.

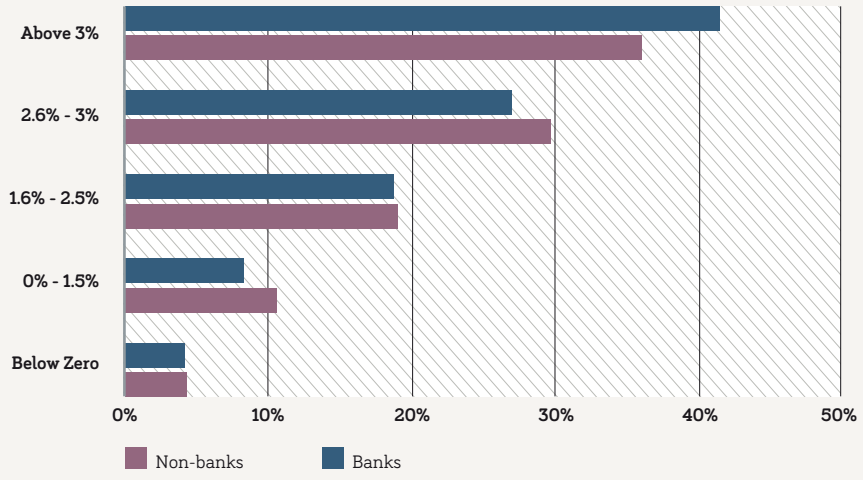
However, this year's survey highlighted some variances of investor preference within this category compared to last year. Most notably, energy and commodities have gained more favour (24% of banks and 21.7% of non-banks, respectively).

"This year's survey suggests stronger interest in energy and commodities," he admitted. "This might be a result of some investors looking to rebuild their energy or commodities allocations following the adjustments they had made when we saw lots of volatility in 2016 and 2017."

Infrastructure also remains a strong area of interest among non-banks in particular, with 32.6% choosing this as their top choice.

"We are still seeing a lot of interest in diversifying into this asset class, although it remains one where it is

WHERE DO YOU THINK NOMINAL 10-YEAR US TREASURY RATES WILL BE IN 12 MONTHS' TIME?



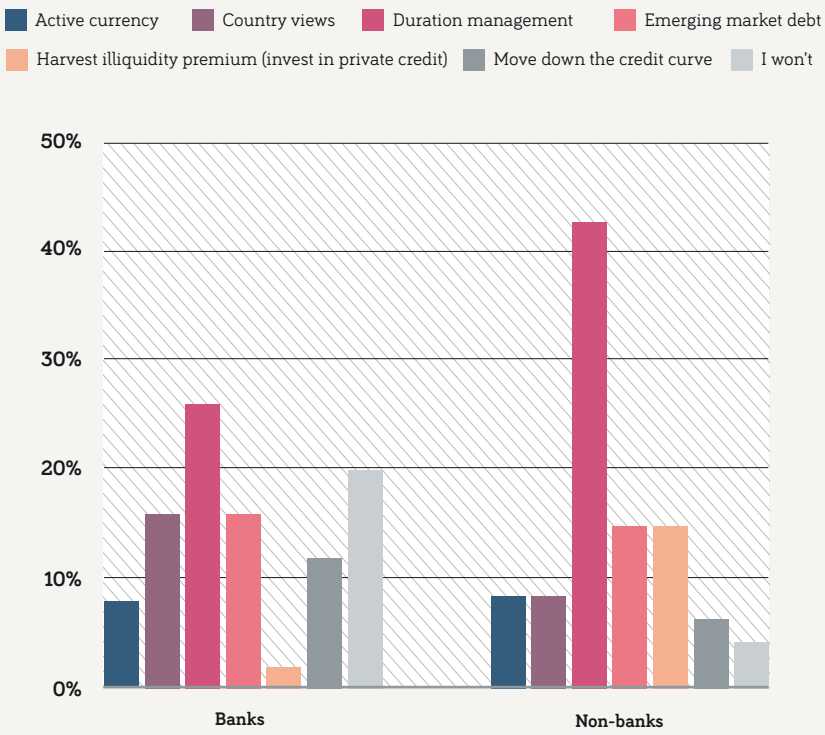
WHICH ALTERNATIVE ASSET CLASSES DO YOU FIND MOST APPEALING?

	Rank 1		Rank 2		Rank 3	
	Banks	Non-banks	Banks	Non-banks	Banks	Non-banks
Energy and commodities	24%	21.7%	22%	2.2%	6.5%	8.8%
Hedge funds	14%	13%	6.0%	6.5%	12.9%	5.9%
Infrastructure	14%	32.6%	22%	17.4%	19.4%	29.4%
Private credit	10%	2.2%	8.0%	26.1%	16.1%	8.8%
Private equity	16%	19.6%	20%	17.4%	6.5%	14.7%
Real estate	8%	4.3%	12%	28.3%	22.6%	23.5%
Structured finance	14%	6.5%	10%	2.2%	16.1%	8.8%

INVESTORS ALSO HOLD HIGHLY DIVERGENT OPINIONS ON THE APPEAL OF FIXED INCOME

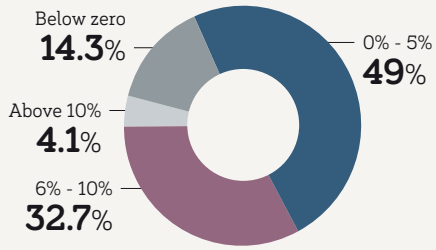
53.1% of banks want to add more fixed income over one to two years but 20.4% are looking to cut fixed income exposures

WHERE WILL YOU LOOK FOR MORE FIXED INCOME INVESTMENT RETURNS OVER THE NEXT YEAR?

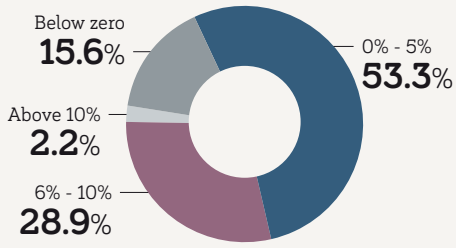


WHAT DO YOU THINK THE S&P500 EQUITY RETURNS WILL BE IN THE NEXT 12 MONTHS?

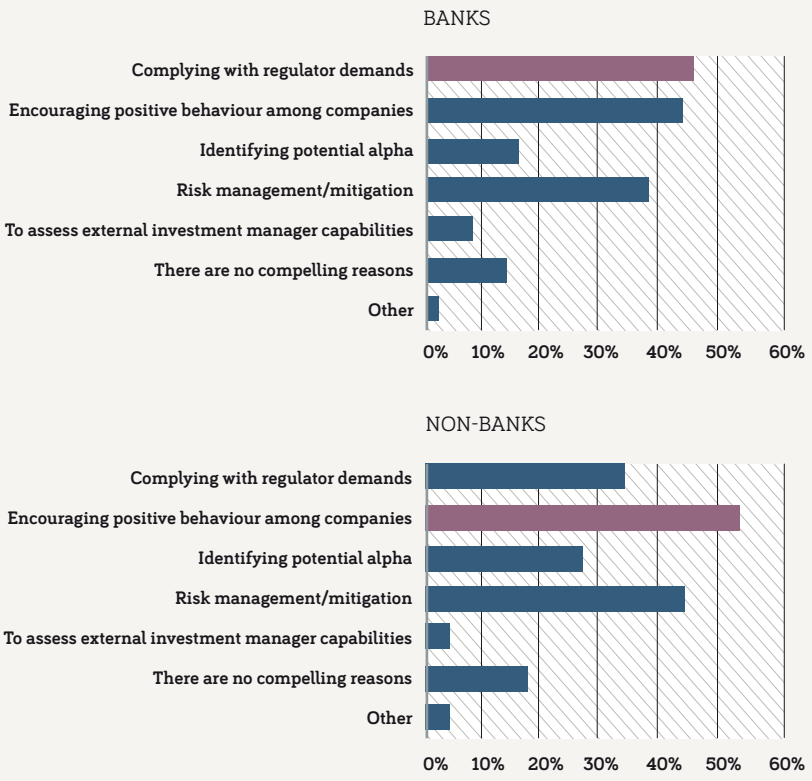
BANKS



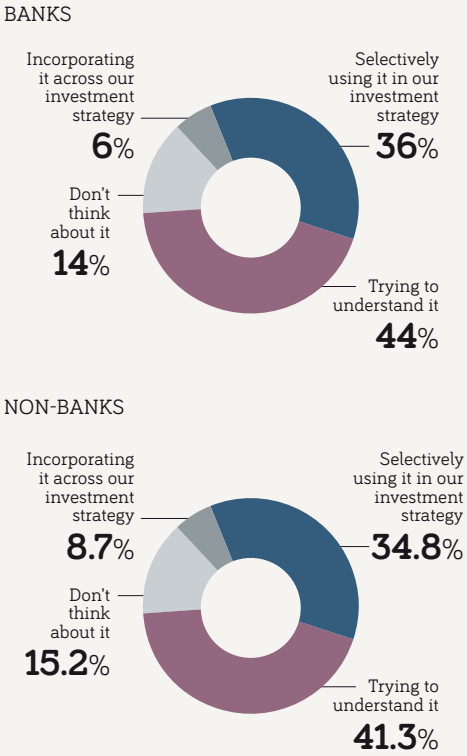
NON-BANKS



WHAT ARE THE TOP REASONS TO INCORPORATE ESG PRINCIPLES INTO YOUR INVESTMENT STRATEGY?



HOW IMPORTANT IS BIG DATA AND ALGORITHMIC INVESTING TO YOUR INVESTMENT STRATEGY?



S&P DOLDRUMS

68.9% Over two-thirds of non-bank investors see the S&P 500 offering a return of less than 5% for the coming year

IF YOU ARE INVESTING INTO INFRASTRUCTURE ASSETS, WHAT ARE YOUR PREFERRED MEANS OF DOING SO?

	Rank 1		Rank 2		Rank 3	
	Banks	Non-banks	Banks	Non-banks	Banks	Non-banks
Co-investments	16%	30.2%	12%	16.3%	9.1%	5.3%
Infrastructure funds	34%	37.2%	14%	14%	22.7%	10.5%
Mezzanine tranche financing	2%	9.3%	26%	23.3%	4.5%	15.8%
Municipal bonds	10%	4.7%	10%	14%	13.6%	5.3%
Public equity investments	6%	7%	16%	11.6%	40.9%	26.3%
Senior debt financing	32%	11.6%	22%	20.9%	9.1%	36.8%

difficult to find quality opportunities," said Lam. "We also noticed that some investors are seeing US municipal bonds as a potential substitute for infrastructure debt."

Pension funds and, increasingly, insurance companies are looking to co-invest into infrastructure-linked projects, preferring their collateral-backed structures. Indeed, 30.2% of non-banks say co-investments are their favoured infrastructure route, versus 16% of banks. Meanwhile 34% of banks prioritise infrastructure funds, versus 37.2% of non-banks.

When it comes to private debt, both sets of investors are in broad agreement: senior bank loans are the preferred form of entry. Lam said this makes sense, as such loans typically are floating rate, which can be helpful in a rising rate environment. However, he admitted to being surprised at the overall lower interest in private debt suggested within this year's survey.

"Many investors have built up significant private debt exposures over the past few years and might be reaching their maximum allocations; that might explain the lower level of interest in investing more," said Lam. "Some private investors might also be more concerned about the compressing yields or rising valuations within the asset class."

EVALUATING ESG

This year *AsianInvestor* also asked AI300 respondents about their level of engagement in environmental, social and governance (ESG) principles when it comes to investing.

These considerations are meant to encourage investors to better monitor their exposure to pollutive industries, or companies that have scant regard for corporate governance or shareholder rights. To date, Asian investors have been less eager to embrace ESG than those in Europe.

The good news for the environment is that interest among Asian investors appears to be rising. "We are seeing more interest among Korean investors in ESG, as well as those in Australia, Singapore and some in Taiwan," said Lam. "Clients are becoming more sophisticated on this topic after an awareness push over the last few years. We are now advising a number of clients on how to best holistically introduce ESG into their portfolios."

His observation is largely supported by our survey findings. All-told, 36.7% of banks and 23.4% of non-banks said they are looking at how best to introduce ESG into their investment portfolios, whereas 51% of the former and 61.7% of the latter are either investing into ESG via specific mandates or incorporating the principles across their portfolios already. It appears the concepts are gaining a serious undertaking among most regional investors. Investors identify different reasons for this focus. Over half (52.2%) of non-banks prioritise getting companies in which they invest to do better, while 43.5% also point to risk management or mitigation. Among banks, the need to comply with regulator demands stands tallest (46.9%), followed by a desire to encourage good corporate behaviour.

The growing willingness of investors to engage with ESG is a positive development. Asia is facing more pollution due to urbanisation and many companies need to improve their corporate governance. The desire of this fast-growing region's biggest asset owners to expect better governance as they invest can only be a positive.

DURATION FOCUS

42.6%

of non-bank investors are looking to duration management to raise fixed income returns

WHICH CHINESE ASSETS MOST APPEAL TO YOU OVER THE NEXT THREE YEARS?

	Banks	Non-banks
Equities	57.4%	45.7%
Fixed income	40.4%	43.5%
Wealth products	17%	4.3%
Real estate	14.9%	13%
Private equity/hedge funds	36.2%	28.3%
Other	2.1%	N/A

HOW IMPORTANT ARE ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) PRINCIPLES FOR YOUR INVESTMENT STRATEGY?