

 Manulife Asset Management™

# Wealth *STYLES*

Third Quarter 2016

A large, stylized hand is shown holding a city skyline, including a prominent skyscraper and a clock tower, against a bright, hazy background. The hand is positioned as if presenting or supporting the city.

**Strategic  
& Tactical**  
asset allocation:  
Making a difference  
with human insight

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**W**e live in a competitive age with a clear trend: a move towards more computerisation, and artificial intelligence. But despite all this, “human nature” continues to fascinate and inspire.

Let's look at the Rio Olympics. The core premise of the event is systematic competition between nations. May the best athlete win. But what did we really see? Heart-warming stories about the athletes stole the spotlight from the chase for gold medals and world records.

Humanity possesses greater attributes and values than just sportsmanship and unity. Computers can enhance productivity and efficiency. But when it comes to investments, scientific analyses and pre-emptive positioning decisions still sometimes rely on human judgement. Financial technology (FinTech) and algorithmic trading can hardly replace this.

For the **Cover Story** of this revamped edition of WealthStyles, Sarah Lu from Manulife Asset Management (MAM) reveals how she, along with her team, remained calm and composed after the Brexit vote to cope with market surprises.

This issue's **Wealth Tips** discusses negative interest rates – a subject many of our readers are concerned about. Also, we present brand new insights into **Investment Psychology** with related anecdotes, as well as the usual **Investment Story**. Manulife Asset Management has also launched a WeChat account to better connect with clients. You can scan the QR code inside to enjoy the latest news on investment and wealth management direct to your smartphone.

As the world evolves, so must we. We now present you a new layout and design for easier reading. You can also enjoy new, more insightful content with enhanced depth and scope. Above all, we hope to remain your trusted partner in the increasingly complex world of wealth management and investment.

Enjoy reading and thank you for your continued support.

# Strategic and Tactical asset allocation: Making a difference with human insight



## Sarah Lu

Head of Asset Allocation,  
Portfolio Solutions Group, Asia,  
Manulife Asset Management

**I**n March this year, AlphaGo, a computer program developed by Google Deepmind to play the board game, “Go”, stunned the world with a victorious 4-1 win against 18-time world champion, Lee Sedol. While this sealed a landmark achievement for artificial intelligence (AI), it also sparked a debate whether computers may soon take over strategic decision-making in businesses and investments.

Sarah Lu, Head of Asset Allocation, Portfolio Solutions Group, Asia, Manulife Asset Management, pointed out how improved information flow and algorithmic trading in the asset management industry have sharpened market responsiveness to tumultuous world events over the past eight years.

The veteran, who has over 20 years of experience in portfolio management, enthused, “Especially in today's environment where the conventional buy and hold strategy alone is no longer adequate, strategic and tactical portfolio management plays a complementary role.”

Case in point: during the 2008 global financial crisis, to the European sovereign bond crisis broke out in 2011, then fast forward to 24 June this year, when Brexit unexpectedly happened, the British pound plunged more than 10 per cent in more than six hours. Sarah reminisces these tumultuous events in a very calm tone. The writer was curious enough to ask Sarah how she would describe herself. “Scientific” is the word that she came up with, without the slightest hesitation.

Although algorithmic trading had the edge in terms of responsiveness and speed, its creator – humans – will be steps ahead of computers as the human brain is capable of handling not just scientific and objective analysis, but also intellectual decision-making and in the case of trading, pre-emptive positioning.

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## Brexit: Think ahead and take pre-emptive positioning

She is convinced that while computers can execute preset instructions speedily, it cannot completely replace an innovative and professional investment team that continuously evaluates the markets. "By objectively analysing all possible scenarios in an ever-changing investment environment, anticipating the possible outcomes for each scenario, before positioning and placing trades that are one step ahead of trading programs."

In other words, although accuracy is important in decision-making, Sarah added, one has to compare the possible outcomes of each scenario before making the final judgement. Considering the ever-changing nature of the investment environment, in Sarah's view, a professional investment team that boasts innovation and continuous evaluation can hardly be replaced by computers.

"Take the recent Brexit referendum for example. Markets, including us, assumed that the UK would remain in the European Union, and had already adjusted for this outcome before the referendum, leaving little upside potential for equities. Any alternative scenario, such as Brexit, would have only led to more downside" said Sarah. With such a conviction, Sarah and her team of investment professionals decided to tweak the asset allocation by reducing stock holdings and switching to bonds and commodities on polling day, before the results were known.

If every move is well thought out and pre-emptive positioning is achieved by analysing the potential upsides and downfalls, tradeoff decisions can be made decisively and promptly, ultimately improving the chances of getting it right.

While this concept applies to investing, the same can be said of life planning too.

## 24-hour active global asset management with a 400-strong team

In today's low interest rate and volatile environment, many investors are looking to diversify their portfolios to build resilience, but do not know how to. The end result: a "portfolio" which may consist of only a few blue-chip heavyweights and retail bonds.

However, by selecting the right vehicles, Sarah believes that investors can still achieve their wealth management objectives without taking matters into their own hands. "By entrusting their funds to us, investors can enjoy peace of mind, and focus on other important things in life," she believed.

As the helmswoman behind Manulife funds, Sarah has to target markets and assets with upside every day, adjusting investment weightings actively particularly during periods of the highly volatile conditions. Yet, despite such an intense daily workload, Sarah shows no sign of fatigue. It turns out that the secret behind it is adequate rest. She takes a break during weekends. In leisure time, she likes to travel around G7 countries and enjoy the finer things in life.

Sarah admitted that it would not be practicable to allocate the funds' assets all by herself, highlighting the importance of teamwork. "At Manulife, over 400 dedicated investment professionals around the globe monitor the markets round the clock. My team allocates assets from a top down perspective, some other investment teams use bottom-up approach to select individual stocks and bonds, and provide the latest views as well as market projections. All these are important catalysts for capturing investment potentials for our portfolios." Manulife Asset Management is currently supported by over 425 investment professionals<sup>1</sup>, all are highly experienced in managing a broad array of investment strategies.

<sup>1</sup> Source: Manulife Asset Management, 30 June 2016. The total number of investment professionals includes employees under Manulife Asset Management (Asia) and Manulife Teda Fund Management Co., Ltd. Manulife Teda Fund Management Co., Ltd is a joint venture between Manulife Financial (49%) and Northern International Trust Co., Ltd (51%).



**Anticipating**  
the possible outcomes  
for each scenario  
before positioning & placing trades that are  
**one step ahead**  
of trading programs

### Target risk funds: tailor-made asset allocation

Sarah believes it is impossible for individual investors to keep an eye on markets round the clock. Instead, they can enlist the help of professionals to select the right investment vehicles that suit their profile.

One example is target risk funds, which have been under the spotlight within the retail fund segment in recent years. As the name suggests, target risk funds invest within target risk parameters that are pegged to individuals risk tolerance. At Manulife, according to investor risk tolerance, we have divided into four categories, namely, capital conservative, managed growth, growth and growth plus.

Conservative funds are tailored for investors with shorter horizons and lower tolerance to volatility. At the other end of the spectrum, aggressive funds, which have higher weightings in stocks, may appeal to younger investors with longer horizons.<sup>2</sup>

According to Sarah, another advantage of target risk funds is that many of them offer diversified exposure, in terms of asset classes and markets – something which is difficult and costly to achieve in self-built portfolios.

“Apart from active funds, ETFs are also on our radar as they provide efficient access into non-traditional asset classes, with relative ease. For instance, when precious metals were our high conviction trade at the end of 2015, we invested in related ETFs and our funds generated gains,” said Sarah.

### Did you know? Target risk solutions

#### What are target risk solutions?

An average investor may not have a deep understanding of the risk-reward profile of each asset class, nor the concept of portfolio optimization. Instead, they are concerned with meeting their financial goals without having to take excessive risk. Target risk solutions are designed to invest within the target risk parameters that are linked to individuals’ risk tolerance. The portfolio manager will be responsible for finding the best investment opportunities within those risk parameters by a combination of tactical and strategic asset allocation.

#### Why target risk solutions?

Most investors here in Hong Kong have a diverse range of financial goals, be it funding a comfortable retirement, saving for our children’s education expenses, or simply meeting healthcare expenses.

However, despite ploughing their money into savings, Manulife’s research has shown that Hong Kong investors still face an aggregate shortfall of 2.5% per annum<sup>3</sup> in matching the growth rate of the costs of their five most-cited financial goals.

Hong Kong investors on average hold more than 45%<sup>3</sup> of their financial assets in cash deposits, which are known to yield insignificant returns. This is a worrying trend, as the value of this huge amount of cash holdings is, in reality, being eroded by even a small amount of inflation over time.

To address this, target risk solutions aim to take the complexity out of investing for investors’ financial goals.



<sup>2</sup> Investment involves risk. No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment

<sup>3</sup> Source: Aging Asia – One step forward, half a step back: Meeting financial goals in Asia, June 2015. Manulife Asset Management.

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## When investing, heads always win

Like it or not, emotions often play a major role in investment decisions. One common mistake, especially for novice investors, is to let emotions rule when making investment decisions. This can often result in a setback when it comes to returns.

The chart shows the various stages of emotional responses an investor may experience over a typical market cycle, as the value of his investment portfolio rises and falls<sup>1</sup>.



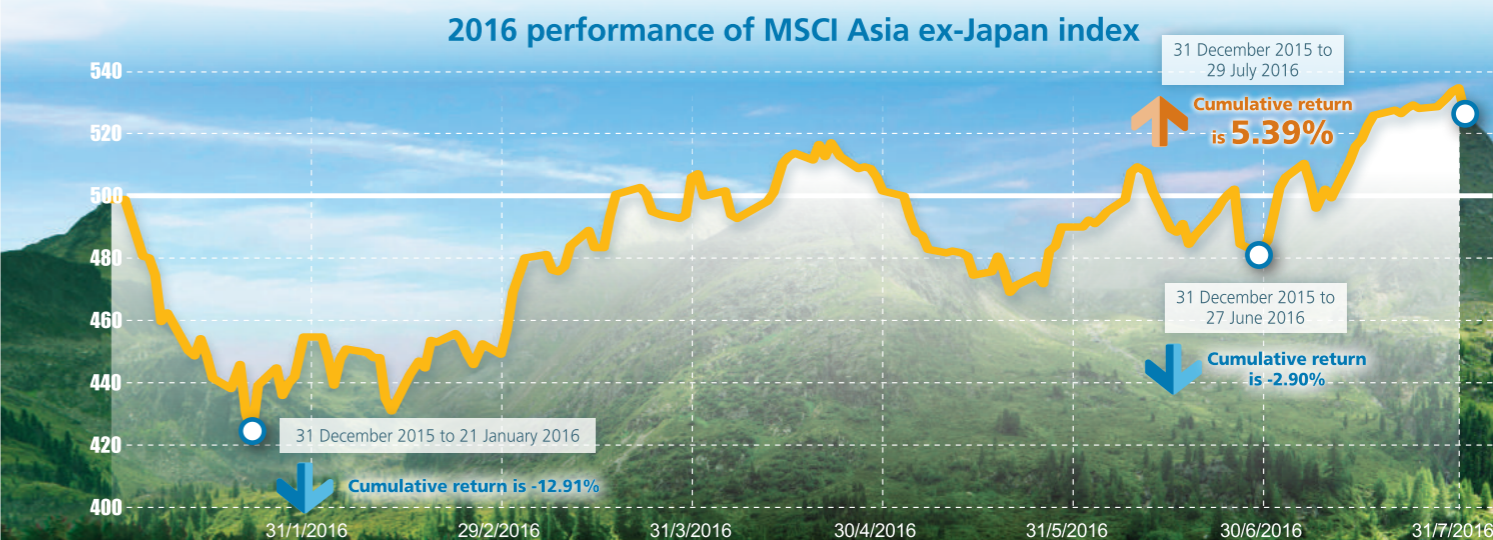
Indeed, financial markets have experienced a great deal of volatility so far this year – which means it is difficult not to be overcome by emotions such as fear and greed. So, what is an investor to do against such a backdrop?

By keeping a cool head, focusing on long-term view and avoiding rash decisions, an investor can avoid selling low, and instead make potentially attractive gains on his portfolio over the long term.

Take for instance an investor who purchased a portfolio based on the MSCI AC Asia ex-Japan index at end-2015. As prices plummeted in late-January this year, had he sold his holdings then, he would have seen a drastic loss of about 13%.

And should he have sold the same holdings right after the Brexit referendum results were announced in June, the investor would have suffered a loss of around 3%.

In contrast, by staying focused on the portfolio and holding on to his investments throughout this period, his accumulative returns for the first seven months this year would have exceeded 5%.<sup>2</sup> In a scenario characterised by low growth, low inflation and low interest rates, this would have constituted a noteworthy return.



<sup>1</sup> John Hancock, 2016.

<sup>2</sup> Source: Bloomberg, data as of 31 July, 2016, price returns in base currencies.

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# Four Banks to Rule Them All

Mention 'central bank' and more often than not, the US Federal Reserve (Fed) comes to mind. However, most investors often forget that there are actually three other major central banks that play equally important roles in dictating movements in global financial markets: the European Central Bank (ECB), Bank of England (BoE) and Bank of Japan (BoJ).

Collectively known as G4, these banks have come into particular prominence in an era dominated by buzzwords such as 'negative interest rates' and 'quantitative easing'.

Today, we look a closer look at these banks and dish out some deserving accolades.

## US Federal Reserve, European Central Bank, Bank of England and Bank of Japan, collectively know as "G4", play significant roles to global financial markets

### Most aggressive: BoE

Since the global financial crisis in September 2008, the BoE has been the most active in cutting interest rates to stimulate the economy. The benchmark rate has fallen from 5% at that time to the current rate of 0.25%, equivalent to a total reduction of 475 basis points.

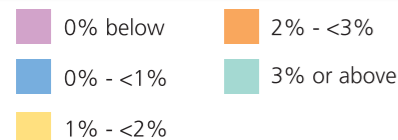
Compare this to the ECB and the Fed, where over the past seven years or so, cumulative interest rate cuts were 425 and 175 basis points respectively.<sup>5</sup>

### Most diligent: BoE

In 2016, BoE held 11 board meetings, the highest among the G4. However, from 2017 onwards, the BoE will reduce the number of board meetings to match the three other major central banks with 8 meetings a year, at intervals of around six weeks.

Interestingly, the BoJ often has board meetings around the same dates as the Fed; meetings of the two banks are generally only a few days apart and sometimes even on the same day.<sup>3</sup>

### 10-year local currency government bond yields<sup>4</sup>



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### Deepest dive: ECB

As the first among the G4 to opt for negative interest rates, the ECB first cut deposit facility interest rates (the interest rate on excess reserves deposited by banks in central banks) to below zero in June 2014. The rate was cut further on three occasions, to -0.4%, the lowest among the four regions.

Denmark was the first country to implement negative interest rates in 2012.<sup>3</sup> Japan began implementing negative interest rates in January this year, with excess reserves interest rates standing at 0.1%.

### Biggest lineup: ECB

Contrary to belief, interest rate adjustments are not decided at the sole discretion of presidents or chairpersons of central banks, but rather by committee members through voting. By examining the voting results, we can actually have an idea of the size of a policy committee.

The ECB has the largest committee with a total of 25 members, consisting of six members of the Executive Board and 19 governors of national central banks of Euro area countries.

The BoE and BoJ have the smallest committees as they consist of only nine members each, including the president of the bank.<sup>3</sup>

### Most generous: BoJ

In April 2013, the BoJ implemented quantitative and qualitative easing (QQE), as part of its proactive measures to stimulate the Japanese economy and combat deflation.<sup>1</sup>

Since the measures, Japan's monetary base has grown over 1.6 times to 432 trillion yen as at end-June this year. To put this amount into context, it is nearly 766 times the initial budget for the upcoming 2020 Olympics to be held in Tokyo.<sup>2</sup>

Total assets bought by the BoJ under the measures have also exceeded the quantitative easing measures by the Fed, ECB and BoE.<sup>3</sup>

These measures have seen a mixed bag of results, however; over the three years of QQE, Japan's economy has experienced its fair share of ups and downs.

Nevertheless, this year's first quarter GDP grew 1.9% year-on-year, while inflation was positive between June 2013 and as of February 2016.<sup>3</sup>

<sup>1</sup> Quantitative and qualitative measures include increasing annual assets bought to 80 trillion Yen, focusing on longer-term government bonds to combat deflation and reach the 2% inflation target. BoJ also purchases other assets, including exchange traded funds (ETFs) and Japan real estate investment trusts (J-REITs).

<sup>2</sup> Source: Official website of the 2020 Tokyo Olympics

<sup>3</sup> Source: Websites of the US Federal Reserve, European Central Bank, Bank of England and Bank of Japan; Bloomberg, 29 July, 2016

<sup>4</sup> Source: Bloomberg, 30 August, 2016

<sup>5</sup> Source: Bloomberg, 18 August, 2016

# Negative Interest Rates what do they mean for you



Earlier this year in January, the Bank of Japan announced a levy on bank deposits from banks, making Japan the first country in Asia with a negative interest rate regime.

However, instead of encouraging the Japanese to move their monies out of the bank and start a spending spree, the unexpected happened; safes were sold out across the nation<sup>1</sup>! The negative interest rate policy had ironically backfired.

In an environment of sub-zero negative interest rates, retired persons and savers are affected. Is it true that cash is king, and the best way to store money is to stash it in a safe?

What used to be an unconventional monetary policy may now be turning into a new normal. Apart from Japan, economies currently with a negative interest rate policy include the eurozone, Switzerland, Sweden and Denmark.

In fact, Denmark was one of the earliest adopters of the policy, having started negative interest rates almost four years ago. Interestingly, borrowing money from Danish banks now allows one to earn money!

When a mortgage is taken out, the bank pays the borrower every quarter, instead of the borrower paying interest. This phenomenon has, of course, resulted in the local population taking out loans and going on a property-buying spree<sup>2</sup>.

It may be easy to think that negative interest rates are irrelevant to Hong Kong, but its effects are slowly starting to be felt here.

Some major banks have recently amended their terms of service, and are

charging negative interest rates for large deposits in Euro, Japanese Yen and Danish Krone placed by professional or corporate clients – which means these clients need to pay interest for their deposits!

If negative interest rates persist, banks may even begin to charge their retail clients a fee for holding their cash, although this is unlikely in the near term.

**For retirees, holdings of cash may reduce investment risk, but it is quite difficult to generate consistent income to fund retirement needs.**

## Foreign deposit rates in Hong Kong head south

Interest rates of foreign currency time deposits in Hong Kong are not what they used to be (see table). A six-month time deposit of over one million Australian Dollar or New Zealand Dollar now earns only around 0.5% interest per annum! It should also be noted that exchange rates have fluctuated greatly due to Brexit and interest income may be insufficient to cover the loss of falling exchange rates.

One positive outcome from negative rates is the surge in demand for wealth management services in countries such as Denmark<sup>2</sup>.

With concerns that a negative interest rate environment will continuously shrink the value of their money in the bank, and push up the prices of property and other assets amidst stagnant wages, investors recognise the importance of preserving the value of their cash assets. One way is to cast their sights wider and

- further by looking for investments that generate higher returns.
- In an era of not just low interest rates, but also low economic growth and low inflation, the flow of global capital has readjusted. This means that investors should readjust their mindsets and take active steps to manage their wealth.

### Consider suitable income-generating products





For retirees, holdings of cash may reduce investment risk, but it is quite difficult to generate consistent income to fund retirement needs.

Therefore, investors should consult professional expertise and, after carefully




considering risks and returns, make better use of their wealth and consider suitable income-generating products.

After all, it is one's responsibility to manage wealth wisely, lest it slips through the fingers.

## 6-month time deposit rates reference

|                           |  Hong Kong dollar |  US dollar |  Euro |  British pound |
|---------------------------|--|---|--|---|
| <b>HSBC</b>               | 0.05% p.a.<br>Minimum balance ≥ 10,000   | 0.01% p.a.<br>Minimum balance ≥ 500,000   | 0.001% p.a.<br>Minimum balance ≥ 2,000   | 0.2% p.a.<br>Minimum balance ≥ 500,000  |
| <b>Hang Seng</b>          | 0.05% p.a.<br>Minimum balance ≥ 10,000   | 0.1% p.a.<br>Minimum balance ≥ 500,000  | 0.01% p.a.<br>Minimum balance ≥ 1,000  | 0.15% p.a.<br>Minimum balance ≥ 500,000   |
| <b>BOC HK</b>             | 0.05% p.a.<br>Minimum balance ≥ 100,000  | 0.08% p.a.<br>Minimum balance ≥ 50,000  | 0.001% p.a.  | 0.15% p.a.  |
| <b>Standard Chartered</b> | 0.05% p.a.<br>Minimum balance ≥ 1 million  | 0.08% p.a.<br>Minimum balance ≥ 500,000   | 0.01% p.a.<br>Minimum balance ≥ 2,000  | 0.13% p.a.<br>Minimum balance ≥ 50,000  |

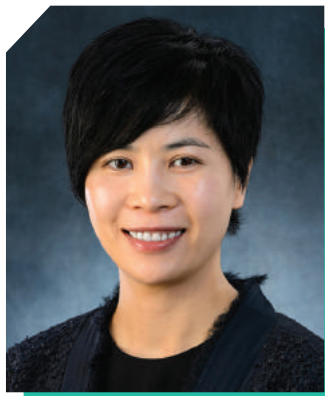
|                           |  Australian dollar |  New Zealand dollar |  Canadian dollar |
|---------------------------|---|--|---|
| <b>HSBC</b>               | 0.45% p.a.<br>Minimum balance ≥ 1 million   | 0.55% p.a.<br>Minimum balance ≥ 1 million  | 0.15% p.a.<br>Minimum balance ≥ 1 million   |
| <b>Hang Seng</b>          | 0.5% p.a.<br>Minimum balance ≥ 1 million  | 0.6% p.a.<br>Minimum balance ≥ 1 million   | 0.25% p.a.<br>Minimum balance ≥ 2 million   |
| <b>BOC HK</b>             | 0.4% p.a.   | 0.5% p.a.  | 0.1% p.a.   |
| <b>Standard Chartered</b> | 0.5% p.a.<br>Minimum balance ≥ 100,000  | 0.6% p.a.<br>Minimum balance ≥ 1 million   | 0.05% p.a.<br>Minimum balance ≥ 100,000   |

Source: Major banks in Hong Kong, as of 30 August, 2016. Information is for reference only.

<sup>1</sup> Wall Street Journal, 22 February, 2016: "Japanese Seeking a Place to Stash Cash Start Snapping Up Safes."

<sup>2</sup> Wall Street Journal, 14 April, 2016: "Negative Rates Around the World: How One Danish Couple Gets Paid Interest on Their Mortgage."

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**Paula Chan**  
Senior Portfolio Manager, Fixed Income,  
Manulife Asset Management

## Award news

**C**ongratulations to Paula Chan, Senior Portfolio Manager, Fixed Income, Manulife Asset Management, for being named among the "Most Astute Investors in Local Currency Bonds"<sup>1</sup> in The Asset's Benchmark research survey for the eighth consecutive year (2009 to 2016)!

Paula is recognised for qualities befitting of a well-rounded industry elite: credit and market knowledge, trading skill, and investment decision-making acumen. She was nominated for this title by nearly 500 top-rated professionals including analysts, economists and strategists, as well as Asian local currency bonds salespeople and traders.

Paula is responsible for the Manulife Asset Management's Hong Kong dollar and renminbi bond portfolios. She has over 17 years of fixed income experience. Paula also oversees fixed income investments in Taiwan and liaises with the firm's onshore China joint ventures, Manulife TEDA and Manulife Sinochem\*, to ensure comprehensive coverage of the Greater China bond market.

<sup>1</sup> Source: The Asset Benchmark research survey, August 2016. In the first half of 2016, nearly 500 top-rated professionals were invited to nominate the ten most Astute investors, based on their knowledge of the credits and markets, trading skill and acumen in making investment decisions. As such the ranking also includes investors who are not included in absolute return or performance assessments. The nominations collected are subject to two weightings: the first according to the rank in the nomination form and the second determined by the rating of the individual casting the vote. The latter is determined according to the annual survey of investors.

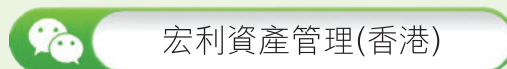
\* Manulife-Sinochem Life Insurance Co. Ltd is a joint venture company between Manulife (International) Limited (51%) and the Sinochem Finance Co. Ltd. (core member of the Sinochem Group (49%)). Manulife TEDA Fund Management Co. Ltd is a joint venture between Manulife Financial (49%) and Northern International Trust Co. Ltd (51%).

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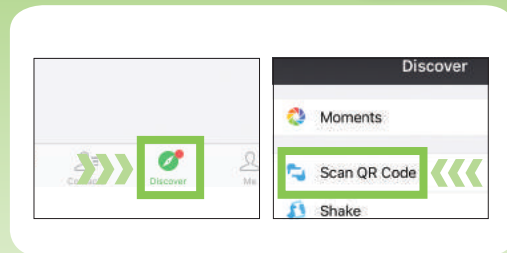
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