Invesco

Transcript

When traditional asset classes move in tandem, building a diversified portfolio presents a challenge. **Duy Nguyen**, Portfolio Manager and CIO, Invesco Global Solutions Development & Implementation Team, explains how he will approach portfolio construction in 2018.

What are some of the key issues you expect investors to be confronting in 2018?

From my perspective, given the fact that I work with multi-asset, I think the big issue that clients that are building multi-asset portfolios are going to face is this notion of tepid return forecast for both the equity as well as the fixed income markets.

If you think about the last couple years from the equity perspective, you really have this strong equity rally and what that's done is really elevated valuations across the board. From a fixed income perspective, you know credit spreads are tight and even duration, you know, the rates have come up a little bit in the last year, but if you compare that versus last 25 years, it's still dramatically lower than history.

Then finally from a risk perspective, you have what we believe is going to be high volatility in the near future, we think volatility is going to come up. Now, the one benefit is we do think correlations are going stay compressed, which will lead to better diversification when you do a multi-asset framework.

Given these issues, what perspectives can you offer investors for navigating this environment?

If you look at our capital market assumptions there are clearly areas that we are more constructive, such as the euro zone, the U.K.

We think durations, that's what we should be afraid of as well, just given the volatility mix we're going to have. I think the most important thing that clients need to think about is when you do have tepid return forecasts, when you do have high volatility, the importance of diversification is elevated and the more you can better diversify your portfolio, the more uncorrelated sources of returns that you can inject in there, the more efficient your portfolio will be.

What are some potential blind spots that clients should watch out for in the coming year?

You think about, once again, the current market environment we've been in, I think it's very easy to get a focus on just what's happened and lose the context of the past. You've had really strong equity markets. What does that mean? It means diversification's been less important in the last nine years. We see this when we do analytics on our clients' portfolios, where we're starting to see credit creep into all their bets, we see equity in all their bets, because that's what really paid off. So if you're looking at the last five years, why would your fixed income not have credit in it? That's the best way to win, but what that does is it opens you up to not getting the diversification that you need.

In that same vein, I think that another asset class that's really out of favour is alternatives. Alternatives by definition give you diversification; they're uncorrelated to equities as well as fixed income. If you had any diversification, it was a penalizer for your overall performance, but if you think about where we're at now, if you think the last nine years is going to repeat itself, great, you don't need alternatives. If you think we're in a late expansion, early contraction, if that's your belief, then I think that's the one time where you really need uncorrelated sources of return. You need something that's going to provide you some defense versus episodic risks and that's what the role of alternatives is. And I think if we're good on alternatives, now would be the time to do it.

Recorded on October 31, 2017.