Video Transcript - HSBC Global Asset Management

Investment Outlook 2020: The age of uncertainty

Alternatives Outlook

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While both bond and equity markets moved higher, over the year there was significant volatility throughout. Amidst the ebbs and flows, alternatives served as a useful diversification tool.

Looking at hedge funds for instance, the chart shows that the largest monthly drawdown for the industry, HFRI Index, was less than one-fifth of the largest monthly decline for developed market equities. Within hedge funds, risk-on and risk-off strategies contributed relatively equally to performance in 2019.

Now, given the uncertainty and downside risks of the current macro environment, we generally favor risk-off strategies going forward. More particularly, multi-strategy and market-neutral strategies for their specific focus on downside risk management, diversified sources of returns, and market neutrality.

In real estate, the impact of e-commerce is continuing to pressure lower quality retail properties. However, this shift in consumer behavior is creating opportunities in logistics and warehousing properties to facilitate rapid fulfilment of online purchases.

Considering that very low interest rates across developed markets are expected to continue, the search for yield should also continue to support property markets. Listed property currently offers yields over 125 basis points higher than global equity dividend yields, and over 300 basis points higher than developed market bond yields. Despite recent outperformance, we continue to favor listed property over direct property in most markets, where we believe higher long-run returns are available without the cost associated with physical property ownership.

Various factors are pressuring yields in infrastructure debt, including excess demand in the U.S., where many deals are oversubscribed. In our view, this dynamic places added emphasis on an intelligent approach to credit, with specialist analysis required to determine the right opportunities with adequate risk mitigation. Regionally, we think Asia offers some of the better opportunities today.

Increasingly, sustainability has become a primary factor when we consider an asset, as it will have a significant impact on its long-term cash flows. There continue to be opportunities in renewable energy. While conversely, we generally prefer to avoid segments potentially at risk such as fossil fuels.

Looking at private markets as we progress through late cycle dynamics, we have observed that managers appear better prepared for a downturn than in the past due to more discipline in purchase price and target companies. A notable development is that private markets are becoming an increasingly important player in credit markets, with a significant shift from banks to private lending in Europe over the last few years. We expect this trend to continue globally due to banking regulations and efficiency gains from this approach.

As we progress into 2020 with stressed valuation in some markets, we think that investors must pay particular attention to the steps that can add value in the investment process in alternatives. Diversification, of course, but first and foremost, manager selection, asset allocation and portfolio construction.

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