CS INVESTMENT MANAGERS

VIEW FROM THE SQUARE

August 2020

A New Paradigm

Over the last century, each decade has been synonymous with an environment that has typified that period – a paradigm. From the great depression of the 1930's, to the war time period of the 40's. The 70's saw high inflation and low growth, whereas the 80's were the reverse of that. Markets adjust to these environments accordingly. The most recent decade has been typified by quantitative easing, lifting most assets. And it is this very act that is likely to have a significant bearing on this decade – effectively lowering the expected return for traditional asset classes. Investors therefore need to look elsewhere for returns and that is a core reason we see a renaissance in the value of active management.

The developed world finds itself almost entirely at record low (in some cases negative) interest rates, thanks to the aggressive policy action by central banks over the last decade and more recently as a result of COVID-19. This has had a knock-on effect of boosting asset prices, even though the underlying economic environment remains challenging at best.

We strongly believe that the traditional asset allocation structure, whilst still forming an important element of portfolios, will not be the one best placed to weather the next ten years. Take UK Government bonds for example – the yield at the end of August of the UK 10-year government bond was close to 0.3%. This means that investors buying these assets (formerly a popular way of providing some protection in portfolios) will receive a paltry total return of just over 3% over a decade. Take into account inflation and investors are guaranteeing a real loss on their money, if held until maturity. A passive approach is committed to buying such assets, whereas as active managers, we have the ability to select other assets, where returns can be more attractive, and it does not necessarily need to be at the cost of greater risk. Portfolio balance can be achieved by blending assets that compliment one another in varying environments – gold is a classic example of an equity compliment. Whilst gold and equities are volatile assets, their drivers are often different – gold will tend to fare well in a risk off environment, whilst stocks will struggle – however collectively, we believe that both assets will deliver solid returns over the long-term.

Other assets considered are that of absolute return funds – these collective investments are well diversified and have the potential to do well in varying market conditions. The severe falls in stocks in March this year was a true test for such strategies and winners have emerged. We favour those absolute return funds that we believe will deliver solid long-term returns, but with low correlation to equity and bond markets.

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