crestone.


# Positioning for 2020

*Investing through volatility*

**SYMPOSIUM**

**OCTOBER 2019**

# OUR PANELLISTS

## THE HONOURABLE PETER COSTELLO AC

COMPANY DIRECTOR AND FORMER MEMBER OF PARLIAMENT

Peter served as Treasurer of the Commonwealth of Australia for just under 12 years from March 1996 to December 2007—the longest term in Australian history. He has served on the International Monetary Fund and the World Bank, and delivered 12 federal budgets, including 10 surpluses. During this period, Australia's sovereign credit rating was upgraded twice to its current AAA rating. As Australia's Federal Treasurer, he established the Future Fund and is now its Chairman and is also Chairman of the Nine Entertainment Corporation.

## SCOTT HASLEM

CHIEF INVESTMENT OFFICER
**CRESTONE WEALTH MANAGEMENT**

Scott has more than 20 years' experience in global financial markets and investment banking, providing economics research and investment strategy across equity, fixed income and alternatives markets. Prior to joining Crestone, he was Managing Director and Chief Economist for Australia and New Zealand at UBS. While at UBS he led a consistently top-rated economics team for more than 10 years, while being individually rated the number one broking economist for 10 of the past 11 years. Prior to joining UBS in 1998, he spent seven years working for the Reserve Bank of Australia, primarily in economic forecasting.

# Positioning for 2020

## *Investing through volatility*

### From Washington to Beijing, London to Hong Kong, and seemingly everywhere in between...Has the disruption of the geo-political status quo already sown the seeds of the cycle's end?

At our latest Symposium held in October 2019, **The Honourable Peter Costello AC** and Crestone Wealth Management's Chief Investment Officer, **Scott Haslem**, discussed the outlook for the global investment environment and its implications for Australia. They provided insights on what the disruption means for investments and how our clients can navigate through this complex environment.

The discussion was moderated by **Clark Morgan**, Vice Chairman and Head of Strategy and Development at Crestone Wealth Management.

### Key themes to emerge from the event were:

- **2020 is unlikely to be a 'set and forget' year for investors**, with late cycle challenges likely to persist. Monetary policy is now reaching its limits and various geo-political headwinds could be long-lived. The recent strong performance of traditional asset markets (bonds and equities), helped by historically low rates, is seen to be heightening the potential for risk-off events, though there is little visibility on timing.
- **Alternative investments (including private equity, hedge funds and private debt) remain important portfolio diversifiers**, especially later in the cycle and particularly when traditional asset valuations are elevated. At Crestone, we retain a modestly defensive portfolio position. This is expressed through an underweight in emerging market, European and UK equities. We are also underweight government bonds.
- **We believe global growth can stabilise and pick up next year**, and we are looking for opportunities to position portfolios less defensively. However, a focus on portfolio diversification, particularly through uncorrelated alternative assets is considered crucial. Given a likely sustained low interest rate environment, medium-term return expectations are likely to continue to face downward pressure.
- **Australia's record low interest rates are viewed to be somewhat at odds with a broader set of more positive fundamentals**. At Crestone, we are constructive on Australia and feel the economy could achieve growth of around 2.0-2.5% next year. In terms of the trade dispute between the US and China, it's the strength of the Chinese economy, not its trading position with the US, that really matters to us.

# STAYING DEFENSIVE, SEEKING OPPORTUNITIES

As we muddle our way through one of the longest economic cycles in history, many investors are asking where we are in the global growth cycle, and how they should be positioning portfolios for 2020. Central banks are struggling to lift growth, let alone keep inflation above 1%, while anti-trade and nationalistic governments dominate the landscape. Against this backdrop, how likely is it that a geo-political event will shunt us into a GFC-style recession?

### WE'RE REASONABLY CONSTRUCTIVE ON THE WORLD ECONOMY

**Scott Haslem**, Chief Investment Officer at Crestone Wealth Management, explained that, at Crestone, we're reasonably constructive on the world economy. We think growth can stabilise and pick up next year, but since August 2019 we've maintained a moderately defensive position, reflecting some concern near term that geo-political uncertainty has damaged the economic cycle. Currently, the International Monetary Fund, the OECD and World Bank all predict that growth will pick up next year after this year's slowdown, reflecting positive fundamentals like low inflation, low interest rates and tight jobs markets around the world.

"Everywhere other than Australia, labour markets are tight. That's good for consumer spending; that's good for wage growth. The other positive is interest rates are low, which means consumers and businesses are paying less on their debt, and that's also good for spending."

On the flip side, **Haslem** explained that industrial activity and export volumes have fallen across the world over the past nine months. Businesses are concerned about the outlook, driven significantly by geo-politics, particularly the trade dispute between the US and China, but also uncertainties surrounding the Middle East, Brexit and Hong Kong. **Haslem** explained that he is a little more constructive on Australia and believes the economy can achieve growth of around 2.0-2.5%, reflecting recent policy easing and a stabilisation in housing. However, Australia lacks the breadth of sectors and earnings growth that we can find offshore.

### OUR POSITIONING IS STILL MODERATELY DEFENSIVE

Although bonds and equities are not cheap, there are still opportunities out there, particularly offshore and in alternative assets. He noted that 2020 is unlikely to be a 'set and forget' year for investors, stressing the importance of staying invested.

**Haslem** explained that Crestone is currently moderately underweight equities, expressed through emerging markets and Europe, which are the most materially impacted economies as far as the trade dispute is concerned, particularly given their exposure to the slowdown in industrial activity and exports. At Crestone, we are also underweight the UK due to Brexit uncertainty. While neutral in Australia, there is concern about the weak earnings outlook compared to elsewhere.

"Australia has only 18% of the entire market telling us we have a long-term return over 10%. Every other market has a quarter to a half of their equity market with medium-term earnings growth expectations over 10%."

Crestone is also underweight government bonds but sees value in alternatives. "We continue to focus on those more uncorrelated, non-traditional assets like private equity and hedge funds that can actually deliver a more stable return, particularly through the later stages of the cycle."

SCOTT HASLEM
CHIEF INVESTMENT OFFICER
**CRESTONE WEALTH MANAGEMENT**

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# WHERE IS THE INVESTMENT WORLD HEADING?

In 2018, there was talk of global markets normalising; interest rates were going up and the global economy looked like it was on the mend. What happened in 2019? And what does the future look like for the world and Australia in 2020?

### HOW IS THE TRADE DISPUTE LIKELY TO AFFECT AUSTRALIA?

**The Honourable Peter Costello AC** feels that what we're seeing play out between the US and China is a strategic rivalry that will continue for decades. What is taking place is a re-ordering of the world order where a new superpower is emerging. He feels that it is short-sighted of markets to react to the latest news emerging from the dispute, as this is a rivalry that will go on for quite some time.

**Costello** highlighted that Australia's trade with China has not been affected in relation to iron ore and metallurgical coal, which is what really counts. In contrast to the US, Australia has a trade surplus with China. From Australia's perspective, it's the strength of China's economy, not the Chinese trade position with the US, that really matters to us.

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COMPANY DIRECTOR AND FORMER MEMBER OF PARLIAMENT

*"Over the long term, real wage growth can only be justified by increasing productivity."*

### IS INFLATION REALLY TOO LOW IN AUSTRALIA?

**Costello** referred to recent commentary from central bankers that inflation is too low, citing the Reserve Bank of Australia's (RBA) recent comments that in Australia we need to lift inflation to 2% from its current level of 1.6%. **Costello** feels the RBA and the US Federal Reserve should not feel pressure to increase inflation but acknowledged the concern about the lack of real wage growth throughout the developed world. He feels that contributing to this phenomenon of low wage growth is a sense of people feeling precarious in their employment.

"They watch technological change go through their workplace, and they know their jobs can disappear easily. They feel precarious. They feel they can't go for wage increases."

A second factor contributing to the absence of real wage growth is a lack of productivity. "Over the long term, real wage growth can only be justified by increasing productivity."

### THE IMPORTANCE OF A PRODUCTIVITY AGENDA

With the cash rate now at 0.75%, **Costello** feels that monetary policy has run its course in Australia, and fears that recent interest rate cuts have perhaps reduced confidence rather than added to it. He stressed the importance of working on a productivity agenda in Australia, highlighting the need to address the extent of regulation currently seen in the market place.

"We are much more regulated than we were 10 years ago. We all know the Australian equity market is dominated by banks. There's enormous regulation on banks coming out of the royal commission."

### SO, WHAT DOES THIS MEAN FOR INVESTMENTS?

While equity markets have delivered strong returns this year, **Costello** stressed the need for investors to diversify and invest in assets not correlated to equities. "You might get low returns, you might even get negative returns because, if it's not correlated, it could be going down in this market. But you've got some padding. So, if things normalise, you've got some diversification to rely on."

# QUESTIONS FROM THE AUDIENCE

**The Future Fund has a target return of CPI+4-5%. If we're going into a lower interest rate environment, is there a possibility that this target return will be adjusted?**

**Costello** acknowledged that it will be challenging to achieve the CPI+4-5% target consistently in the future. The Future Fund did reduce its target in 2017 by around 0.5% and may need to adjust it again in the future if necessary.

"What happens is the equity markets take off and everyone says '4% is very easy, anyone can get 4% now'. But my point is that these equity markets are very unusual and when things normalise, you would expect equity markets to normalise."

**How do you integrate environmental, social and corporate governance (ESG) considerations from a strategic asset allocation perspective?**

In many inter-generational reports, there are stories of Baby Boomers passing on large transfers of cash to the younger generation, which has a broader social view of how it wants to invest that money for good. **Haslem** explained that Crestone has evidenced this behaviour, with many of its clients and its clients' children wanting to invest in a socially responsible way. This includes the entire spectrum of responsible investing from ESG, to ethical investing, right through to sustainable and impact investing.

**Haslem** explained how the Crestone Investment team spends a lot of time making sure it can populate its strategic asset allocation with managers across all asset classes from a socially responsible perspective.

"The main thing to understand is that it's not an asset class—it's basically a belief structure. And if you have that belief structure, you want it to come across all of your assets. So, we spend a lot of time making sure we can do that for our clients, so we can really align our clients' values with their investment portfolios."

**It's been 28 years since Australia had a recession. How important is population growth for economic growth?**

With 28 years of uninterrupted economic growth, **Costello** explained that Australia holds the record for the longest period of economic growth among developed countries. However, if you break that down per capita (growth per person), he explained that we have actually had two or three recessions.

This has just been masked by a very fast-growing population by developed world standards, which has been important to overall economic growth. Yet, while population growth has been good for the overall economy, he explained that this has put enormous pressure on infrastructure—particularly in Sydney and Melbourne where the majority of migrants choose to live.

**Haslem** commented that while both sides of politics understand the value of strong migration for supporting 'headline' economic growth, Australia's history of migration had been a vital contributor in delivering less of an ageing demographic issue than many other countries (like China) were experiencing. Key to this has been Australia's focus on ensuring strong skilled migration flows.

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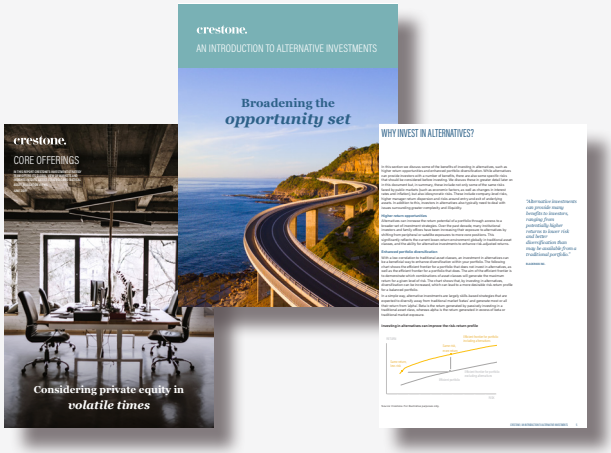
# Broadening

## *the opportunity set*

When it comes to selecting the best alternative investments for your portfolio, your Crestone investment adviser can help identify the best combination of investments for your situation at any point in time.

Our specialist alternatives team takes the hard work and complexity out of investing in alternatives and can provide access to a growing list of alternative investments. In addition, you can benefit from access to bespoke solutions in hedge funds, real assets and private markets.

To learn more about how we can help you, or to evaluate your current portfolio positioning, please contact your investment adviser.




To read more about how investing in alternatives can enhance diversification in your portfolio and provide potentially higher returns, please visit crestone.com.au/news

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