THE LONG READ

HOW INVESTMENTS CAN *ALWAYS* BE ON A BULL RUN

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CONTRARY TO POPULAR BELIEF, THERE IS A BULL MARKET AND A BEAR MARKET *COEXISTING* AT ANY POINT IN TIME — DEPENDING ON WHICH GEOGRAPHIES OR/AND ASSET CLASSES YOU ARE INVESTING IN. THE TRICK IS TO DIVERSIFY AT THE RIGHT TIME, AT THE RIGHT PLACE

As an investment professional, the question I face the most is some version of the following:

"What do you think of the market?"

"Where do you think the market is headed?"

"Will the market go up or down?"

My only answer is: "Which market are you talking about?"

Asking whether the market is going up or down is like asking whether a giant Ferris Wheel is going up or down. The direction for you depends on which passenger cab you are in. Now think of the investment universe as this giant wheel with each asset class being represented by a cab. At any time, certain asset classes are going up and some others are going down. Put another way, there is always a bull market somewhere in the world, even as there is a bear market elsewhere. The outcome for your investment portfolio depends on which passenger cab you are in.

Let us first understand what's meant by an asset class. The textbook definition is: An asset class is a grouping of investments that exhibit similar characteristics and are subject to the same laws and regulations.

Historically, the three main asset classes were equities (stocks), fixed income (bonds, fixed deposits, etc), and cash equivalent or money market instruments.

Today, there are many more: real estate, commodities, futures, options and other financial derivatives, cryptocurrencies etc. As you would notice, these include both physical assets like real estate as well as financial instruments.

While these are broad categories, they can be further divided by geography and other characteristics. For example, equities in Japan or South Korea may behave very differently from equities in the US. In fixed income, the categorisation is not just by geographies but also by credit rating and issuers (government bonds, investment grade bonds and non-investment grade bonds).

The first thing to remember is that 85 to 90 per cent of your investment returns are determined by your asset allocation — that is is the mix of various asset categories in your investment portfolio. Your choice of whether you are in US tech stocks or German real estate bonds will determine more of your investment returns rather than the *specific* choice of stocks and bonds.

This, in some ways, makes investment simpler as you do not have to look for the needle in the haystack in the form of the multibagger stock you can boast about. What you do need to do is to be in the right mix of investment categories or asset classes at the right time. According to Venkatram Mandalapu, CEO of NV Consultancy, "In a fast-paced market environment, some asset classes tend to outperform the other. To keep up, asset allocation is the answer to weathering any storm through the key concept of diversification."

A smart fund manager can create a permanent bull market in your portfolio. Which brings us back to the giant Ferris Wheel. If you can hop off the cab (asset class) going down and get onto to the one going up, your portfolio can be in a permanent uptrend.

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Venkatram Mandalapu

AVOID SCCARS AT ALL COSTS

"A Single Country, Single Currency, Single Asset Risk (SCCAR) exposure can SCAR you forever," says Shankar Sharma, vice chairperson, First Global (FG). Most of us think of investing only in our home countries and that too in a single asset class, usually equities. If you are from India or the UK, you might think of investing only in Indian equities or in shares listed on the London Stock Exchange. We have this bias due to sheer familiarity, but this can be very dangerous to your financial health because there can be long periods of time when a single market is not performing or is in a bear phase. You need tactical and dynamic asset allocation.

There is always a bull market and a bear market *coexisting* at any point in time — depending on which geographies or asset classes you are looking at. What this means is that certain categories of investments will be in a bear market *at exactly the same time*, some other categories will be in a bull market.

Let's go back a quarter of a century to the Asian crisis of the late 90s. This hit South Asia hard — from Taiwan, South Korea and Hong Kong to Thailand, Malaysia and Indonesia. Suddenly, the roaring Asian Tigers had a comeuppance, with both the stock market as well as the currencies crashing.

In dollar terms, all these markets were down 50 to 90 per cent within a year. This was a disaster few saw coming as the 90s were go-go years for these economies and many other developing economies wanted to emulate their success. This brought home very starkly the dangers of being exposed to a single market, even if it is a high-growth one.

However, the real story is that even as these Asian markets were in a tailspin, European equity markets were up over 25 per cent in that same year and US treasuries were up 20 per cent.

That is a pattern we will see repeated time and time again as a crash or a bear market in one geography or asset class is accompanied at the same time by other markets or assets going up. Most of us remember the 2000 tech crash well, when after the the first dot-com and tech boom, there was a major crash not just in Nasdaq but across US markets. US equity markets halved between March 2000 and October 2002. Even as this was happening, gold was up 14 per cent and both oil and US treasuries had good returns.

A corollary to this is that no market is in a permanent bull phase. For example, nowadays many investors think that you cannot go wrong buying US stocks, particularly Nasdaq ones. However there have been long periods of time when Nasdaq, i.e. US technology, has not been in a good asset class to be in. For example, over the entire period between 2003 and 2007, the returns from US equities were very, very tepid. In fact, Nasdaq did not reach its 2000 high right upto 2015!

Over the same time span, the emerging markets went up several times. The Emerging Market Index was up three and a half times. Brazil was up 10 times. Markets like India were up six to seven times. Oil tripled. Gold and commodities were up 130 to 150 per cent.

As always, bull and bear markets co-existed.

DO NOT PUT ALL EGGS IN ONE BASKET

In the last 10 years, prior to 2020, emerging markets were bearish while US markets were bullish. Overall, equities were in a bull market while commodities were in a bear market, till a few quarters ago when the commodity cycle began to turn. Oil and then metals began to turn towards prices that had not been seen for 10-15 years. More recently, food and other agri commodities are racing towards their highs of a decade ago.

So, like I was saying, bull and bear markets coexist. All the time. It only takes a deep understanding of markets to understand this. And exploit it. "To remain in a permanent bull market, asset allocation and percentage allocation plays a very important role. One of the assets will always have its run in any given point of time," says Charudutta Joshi, board member, Greenback Capital Limited.

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Charudutta Joshi

A fund manager who defines their investment universe very narrowly normally saying something like "I invest only in my circle of competence" really means that they invest within their comfort zone. That type of investment strategy or philosophy becomes a trap for you as an investor because that fund manager will do well when their type of securities are in a bull phase but when markets change — as they invariably will — your portfolio can underperform for years together. It is something like the fable of looking for your keys where there is light rather than where you are likely to find them. Fund managers that confine themselves to a narrow area are unlikely to be able to find you the keys to riches.

As Luis Freire, CIO & Managing Partner, BTA Wealth Management, puts it, "Diversification ensures that by not putting all your eggs in one basket you will not be creating an unwanted risk to your capital. Diversifying your investment portfolio is important because it keeps any part of your investment assets from being too heavily weighted towards one company or sector."

Clearly, the question to ask is: how good is an investment manager at the business of managing risk while continuing to generate returns?

LESSONS LEARNT OVER THE PANDEMIC

Allow me to give you some examples from our own experience. In India, in February last year, there were dangers looming up because of the virus. We immediately took protective action through our Tactical Insurance for Portfolio Protection strategy — TIPP Tech — which uses derivatives only for the purpose of hedging. And by buying government treasuries. This saved clients from a lot of damage in India as well as in global stock markets. From March-end 2020, we remained fully invested, riding the entire bull market.

However, from the month of October, we started to buy a matrix of put options, via TIPP again, which was hedging, at different points in time, different elements of our portfolios. Consequently, we kept capturing the upside that the markets gave us without running the risk of big losses.

On the global side, where there are far better risk management and investment options available, it is easily possible to diversify, across the world, into several uncorrelated asset classes, and individual stock positions; one can escape big meltdowns. The range of choices available — 13,000 stocks, hundreds of fixed income and Real Estate Investment Trust options, dozens of commodities etc — when combined together into a perfect portfolio can capture most of available upside, without endangering portfolio safety. And one can hedge each security, as well as a basket, too!

We moved away from our large American technology stocks positioning around August last year and increased our positions in emerging markets and commodities. As a result, we have had a very decent run even from the time that NASDAQ became wobbly, with a flat-lining of major stocks like Amazon, Netflix, Facebook, Microsoft (these stocks have done almost nothing since August 2020). Tactically, we left the ageing bull market in FAANG (Facebook, Amazon, Apple, Netflix and Google) stocks and exploited the younger bull market building up in other asset classes. And by tactically hedging portfolios through a combination of TIPP Tech and tightened stop losses, we almost ensure that even if there is a massive crash, there are no massive losses suffered.

WHAT SHOULD BE YOUR TAKEAWAY?

The best fund management and PMS services companies should be able to deliver this tactical risk management, that smoothens out your portfolio returns, by prevention of massive losses, thereby creating a near-permanent bull market in your portfolio.

If your choice of investment manager is right, you have solved your entire problem completely with regard to the management of your money/funds.

(Devina Mehra is co-founder of First Global, a global quantitative asset management group. The views expressed are entirely personal, and may not reflect those of the newspaper's.)

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Luis Freire