Investment Navigator
Asia Edition

Diversification is the Only Free Lunch: Alternatives in a Volatile Market

Key summary

- We expect market volatility to stay high. Instead of holding too much cash which offers negative real returns, investors should consider alternatives such as private equity, real estate, hedge funds, direct investments and structured products as satellite allocations to diversify and reduce overall portfolio volatility.
- We have seen the worst year-to-date performance for a 60% stock/40% bond portfolio since 1976. Alternatives generally show lower correlation with other asset classes. Investors can also take advantage of the current high volatility to invest in structured solutions with principal returned at maturity while capturing the upside potential.
- Most of the alternative investments require a longer-term horizon to benefit from market dislocations. They offer a premium over public securities at the expense of liquidity, and therefore, enhance investors' risk-adjusted portfolio returns in the long run.

Too many risks

The Russia/Ukraine conflicts, energy shock, high inflation, the hawkish Fed and potential aggressive tightening, China lockdowns and insufficient easing, supply chains disruptions, as well as rising stagflation and recession risks are the key investor concerns at present. Current volatility levels for different asset classes are much higher than their historic average (chart 1).

CHART 1: CURRENT VOLATILITY AT HIGH LEVELS

Volatility Index	Current level	1-year average	5-year average
VIX Index (stock market)	32	21	19
MOVE Index (bond market)	123	77	62
VXY Index (forex market)	10	7	7

Source: Bloomberg, BNP Paribas (WM), as of 6 May 2022. Past performance is not indicative of current or future performance.

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A US recession is NOT our base case scenario. Our forecasts for US GDP growth are 3.7% in 2022 and 2.5% in 2023. However, there is no quick fix to the issues mentioned above, and hence, we expect market volatility to stay high in the near term.

Why not holding large cash positions in times of uncertainty?

With deposit rates remain low while inflation is rising, cash is not king but a drag to long-term portfolio performance. Holding cash is an opportunity cost not even be able to beat inflation and keep the purchasing power, and hence, investors get a very negative return after inflation.

Alternatives as satellite allocations

We currently have an overall neutral stance on equities (downgraded from positive since February versus consensus) and fixed income (upgraded from negative recently) amid higher volatility and uncertainty. Therefore, it is important to build satellite allocations to alternative investments in order to diversify and lower overall portfolio volatility.

Some examples of alternative investments:

- Commodities
- Private equity
- Private real estate & REITs
- Hedge funds (long-short equity, global macro, event-driven, relative value strategies)
- Structured products
- Direct private investments

Why alternatives?

(1) **Low correlation with traditional asset classes:** Alternative investments tend to have lower correlation with traditional equity and fixed income asset classes (chart 2). Therefore, they are good diversification tools in a volatile market.

(2) **Benefit from market dislocations:** With a large cash pile and the ability to invest, improve and reposition companies, **private equity and real estate funds** can benefit from market dislocations with better valuations and points of entry.

CHART 2: ALTERNATIVES IN GENERAL HAVE RELATIVELY LOWER CORRELATION WITH TRADITIONAL EQUITY & FIXED INCOME

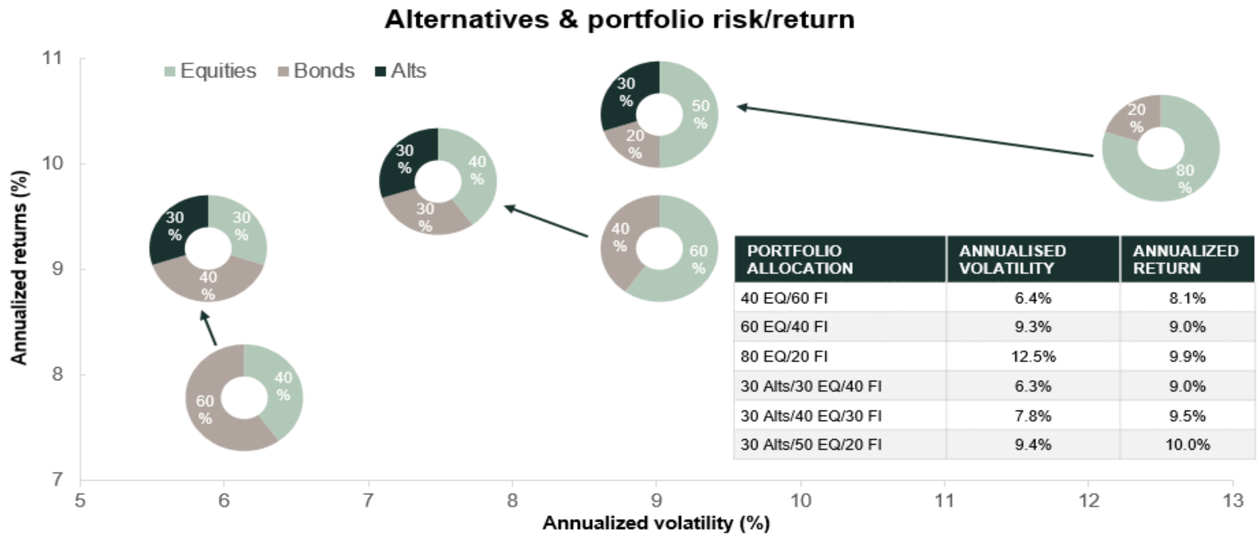
Correlations	Global equities	Global bonds
US private real estate	-0.2	-0.3
Europe private real estate	0.3	-0.2
US REITs	0.7	0.4
Hedge fund – global macro	0.4	0.2
Hedge fund – event driven	0.8	0.2
Commodities	0.4	0.1
Private Equity	0.8	-0.3

Source: Bloomberg, JPMorgan, BNP Paribas (WM), as of 6 May 2022. Note: Monthly data from May 2012 – May 2022. Past performance is not indicative of current or future performance.

They can also improve the companies' operations outside the eye of public markets with a longer-term time horizon. Investing in commercial real estate also offers inflation hedge as rents normally rise with inflation. Furthermore, private equity firms are active in themes including health-care, infrastructure, ESG and technology/metaverse that we favour.

Hedge funds are one of the tools that can be used to target market dislocations and hedge market risks. Post-pandemic recovery is providing numerous **event-driven opportunities** around corporate restructurings as well as other credit and corporate events. Furthermore, **macro hedge fund strategies** are benefiting from trends in currencies, rates and commodities. For many years, all central banks had the same monetary policy and were stuck at the zero or negative yields. Now, we have divergent trends with China easing while US and Europe tightening but at a different pace.

CHART 3: LONG-TERM RISK/RETURN IMPROVED SIGNIFICANTLY FOR PORTFOLIOS (WITH DIFFERENT EQUITY & FIXED INCOME MIX) WHEN 30% ALTERNATIVES (HEDGE FUNDS, REAL ESTATE & PRIVATE EQUITY) ARE ADDED



PORTFOLIO ALLOCATION	ANNUALISED VOLATILITY	ANNUALIZED RETURN
40 EQ/60 FI	6.4%	8.1%
60 EQ/40 FI	9.3%	9.0%
80 EQ/20 FI	12.5%	9.9%
30 Alts/30 EQ/40 FI	6.3%	9.0%
30 Alts/40 EQ/30 FI	7.8%	9.5%
30 Alts/50 EQ/20 FI	9.4%	10.0%

Source: JPMorgan Asset Management (data from 1989-2021), BNP Paribas (WM), as of 6 May 2022. Past performance is not indicative of current or future performance.

(3) Enhanced long-term portfolio risk-adjusted returns: Alternative investments help enhance investors' long-term risk and reward profile of their portfolios (chart 3). The potential premium that investors earn from alternatives over public stocks and bonds is the sacrifice of liquidity as many alternatives require a longer-term investment horizon.

(4) Monetize the volatility: We expect higher volatility to continue given the uncertainties of peak yields and inflation as well as their impact on growth. Investors can take advantage of periods of higher cross-asset volatility in bonds, equities, currencies and commodities to construct structured product solutions, such as principal returned at maturity solutions that limit the downside with upside potential.

CONCLUSION / STRATEGY:

- We expect market volatility to stay high in the short term given uncertainties over the Russia/Ukraine conflicts, energy shock, high inflation, the Fed's tightening path, pro-longed China lockdowns, supply chains disruptions, as well as rising stagflation and recession concerns.
- Instead of holding too much cash which offers negative real returns (after inflation), investors should consider alternatives such as private equity, private real estate, REITs, hedge funds, commodities, direct investments and structured products as satellite allocations in order to diversify and reduce overall portfolio volatility .
- Alternatives in general have lower correlation with traditional asset classes. Most of them require a longer-term investment horizon to benefit from market dislocations and offer a premium over public securities at the expense of liquidity. Therefore, they help enhance investors' risk-adjusted portfolio returns in the long run.

Overview of our CIO Asset Allocation for May 2022

	Views Current	Views Prior	Constituents	We like	We avoid	Comments
EQUITIES	=	=	Markets	UK, Japan		■ We remain neutral overall on Equities (USA, Europe, EM) as we await further potential reduction in uncertainties (inflation, rising bond yields, monetary policies, war in Ukraine, energy crisis, China lockdown).
			Sectors	Healthcare, Semiconductors, Construction, Precious/battery metals		■ We continue to recommend a more defensive sector stance, biased towards quality dividend/dividend growth and buyback strategies.
			Styles/ Themes	Megatrend themes		■ **Inflation hedging & circular economy themes**
BONDS	=	=	Govies	US short-end Treasuries	Eurozone short-term govies	■ **We keep our 10-year US bond yield target at 2.5%.** ■ We are **neutral on US government bonds**.
			Segments	Emerging Markets Bonds (USD + local currency)		■ We are **neutral on US investment grade (IG) & high yield (HY)**. ■ We prefer **Rising Stars & Fallen Angels**.
CASH	=	=				
COMMO-DITIES	+	+		Gold & Base Metals		■ **Gold - positive**: gold to trade in the $1900-2100 range ■ **Oil - neutral**: Brent to stabilize in the $95-105 range at the end of 2022. ■ **Base metals –positive:** The super cycle is reinforced by the need to accelerate the energy transition & reduce dependence on Russia.
FOREX			EURUSD			Our 12-month target remains 1.12.
ALTERNATIVE				Real Estate; Private Equity; Macro & Event-driven Hedge Funds		We are neutral on Relative Value & Long/Short Equity, with a preference for Macro & Event Driven strategies.

Note: + Positve / = Neutral / - Negative

GDP & CPI Forecasts

		GDP (YoY%)			CPI (YoY%)		
		2021f	2022f	2023f	2021f	2022f	2023f
	Global	5.6	4.8	3.8	-	-	-
Developed	US	5.7	3.7	2.5	4.7	6.7	2.7
Developed	Japan	1.7	1.6	2.0	-0.2	1.5	1.1
Developed	Eurozone	5.3	2.8	2.7	2.6	6.8	3.4
Developed	UK	7.5	3.6	1.7	2.5	7.0	3.2
	Developing Asia	5.9	8.2	5.2	3.8	4.0	3.6
North Asia	China	7.7	4.5	5.5	0.9	2.1	2.7
North Asia	Hong Kong*	6.4	0.5	4.9	1.6	1.9	2.1
North Asia	South Korea	3.9	2.7	2.2	2.3	2.3	1.7
North Asia	Taiwan*	6.3	3.2	2.9	1.8	2.3	2.2
South Asia	India	8.1	9.5	7.3	5.1	6.3	5.2
South Asia	Indonesia	3.6	5.8	5.1	1.5	1.9	2.2
South Asia	Malaysia	2.6	4.7	5.1	2.3	1.7	1.9
South Asia	Philippines*	5.6	6.5	6.3	3.9	4.3	3.7
South Asia	Singapore*	7.6	4.0	2.9	2.3	3.5	2.0
South Asia	Thailand	1.2	3.6	4.0	1.1	1.1	1.1

Source: BNP Paribas Group Economic Research, BNP Paribas Global Markets forecasts as of 29 April 2022
** IMF data and forecasts as of 29 April 2022*

GROWTH

- Growth expectations declined in the previous month for three primary reasons: (1) Covid-19 lockdowns in China, (2) inflation causing disruption via supply chain and impacting purchasing power of consumers, and (3) ongoing geopolitical concerns.
- Presently, while GDP expectations have dropped, the probability of a recession rather than a slowdown this year is still low. In that regard, it is too early to forecast with high conviction for second half 2023.

INFLATION

- Global inflation forecasts have risen this year. A key variable will be the upcoming CPI figures in the US. Will there be any peaking of durable goods inflation as consumption shifts to services? How will the China supply chain issues act to distort the number once again?
- Barring new supply shocks, growth is slowing and the impact of base effects could create a peak in inflation rates in the US in the current quarter and in Europe later in the year. We forecast a slowdown in inflation but remaining above trend this year and next year.

Equities

POSITIVE NEUTRAL NEGATIVE

OVERALL GLOBAL: NEUTRAL

Positive	Neutral	Negative
COUNTRY		
UK Japan Emerging Mkt	Eurozone US	-
SECTOR		
Healthcare Financials	Energy Comms. Materials Industrials Consu. Sta. Utilities Real Estate Technology Consu. Discre.	

OVERALL ASIA: POSITIVE

Positive	Neutral	Negative
COUNTRY		
China Singapore South Korea Indonesia	Taiwan India, Thailand Malaysia Philippines	-
SECTOR		
Comms. Consu. Discre. Consu. Sta. Healthcare Technology	Energy Industrials Materials Real Estate Utilities	Financials

- We remain neutral in global equities that we had downgraded earlier than consensus since February 2022.
- Rising inflation, interest rates and the strong dollar create near-term caution for global equities. The key will be the pace of interest rate rises and the peak of inflation. Growth slowdown means overweight defensives and quality stocks.
- We continue to favour communications, consumer discretionary and staples, healthcare, and technology in Asia.
- The key will be ongoing fiscal and monetary loosening in China which has greater urgency given the Covid-19 lockdowns in China.
- Two overweights are working in Asia: Singapore +8.6% and Indonesia +14% year-to-date.

		1-month (%)	YTD (%)	2021 (%)	Forward PE (x)	Trailing PB (x)	Dividend Yield (%) 2022f	EPS Growth (%) 2022f	EPS Growth (%) 2023f	ROE (%) 2022f
Developed	US	-5.7	-10.9	25.2	19.3	4.4	1.9	9.8	9.8	22.9
Developed	Japan	-2.7	-5.1	11.4	12.7	1.5	2.2	44.8	5.7	9.1
Developed	Eurozone	-2.9	-12.0	20.1	12.9	1.6	3.1	9.3	7.4	11.1
Developed	UK	0.2	3.7	15.0	11.1	1.8	3.7	13.6	1.4	11.1
	Asia Ex-Japan	-7.5	-15.1	-6.4	12.2	1.6	2.6	11.3	12.0	11.7
North Asia	China	-8.5	-21.2	-22.7	10.3	1.3	3.1	15.6	15.2	11.2
North Asia	China A-shares	-4.9	-18.7	-5.2	14.1	2.4	1.9	17.5	13.8	11.4
North Asia	Hong Kong	-4.8	-6.6	-5.9	14.3	1.2	3.3	14.2	14.2	8.7
North Asia	South Korea	-4.4	-12.3	-1.6	9.1	1.1	2.3	2.4	10.9	14.1
North Asia	Taiwan	-8.3	-11.4	21.6	12.7	2.5	2.7	6.3	2.4	20.6
South Asia	India	0.2	0.1	27.3	21.3	3.7	1.2	20.1	14.1	15.1
South Asia	Indonesia	4.6	14.0	1.5	15.6	2.7	3.1	18.7	8.6	16.0
South Asia	Malaysia	0.4	1.7	-7.3	14.8	1.6	3.9	-5.7	13.0	10.2
South Asia	Philippines	-4.4	-1.6	0.9	16.6	1.9	1.5	18.1	21.6	8.3
South Asia	Singapore	-7.3	8.6	4.4	17.5	1.5	3.8	20.8	21.6	8.9
South Asia	Thailand	-2.1	0.7	7.1	17.6	2.1	2.7	15.4	12.0	9.4

Source: MSCI indices in local currency terms, Bloomberg, Datastream, BNP Paribas (WM), as of 29 April 2022

Fixed Income

POSITIVE NEUTRAL NEGATIVE

OVERALL GLOBAL: NEUTRAL		
Positive	Neutral	Negative
EMD (LC) EMD (HC) Short-term UST	US IG High Yield Long-term UST	-

OVERALL ASIA (USD): NEUTRAL		
Positive	Neutral	Negative
Hong Kong Indonesia	India Philippines South Korea China	-

		Total Return (%)			Yield-to-Worst (%)
		1-Month	YTD	2021	
Asia	Asia USD Bond	-2.6	-8.8	-1.7	4.9
	Asia Local Currency Bond	-5.0	-8.7	-7.0	4.3
	China	-1.8	-8.5	-4.6	5.7
	Hong Kong	-2.2	-7.8	0.8	4.3
	India	-3.1	-7.5	3.2	5.7
	Indonesia	-5.3	-11.4	0.8	4.7
	Singapore	-2.1	-7.8	0.5	3.9
	South Korea	-1.3	-5.8	-0.3	3.5
	Philippines	-4.7	-11.3	-0.1	4.5
Other Regions	US 10-year Treasuries	-2.8	-8.3	-3.0	2.9
	US Investment Grades (IG)	-3.3	-9.0	-1.5	3.4
	US High Yield (HY)	-3.1	-7.8	5.3	6.9
	Emerging Market USD Bond	-2.5	-9.2	-2.8	5.9

Source: Barclays indices, Bloomberg, BNP Paribas (WM) as of 29 April 2022

US Treasury 12-month Yield Targets (%)	2Y	5Y	10Y	30Y
	2.25	2.4	2.50	2.6

- **The Federal Reserve meeting in May was moderately dovish raising rates by 50 bps.** The Fed will kick off quantitative tightening in June at an initial pace of USD 47.5 bn, increasing to USD 95 bn after three months. Chair Powell acknowledged the inflation risks in the press conference, but noting that a 75bp hike is not something the FOMC is actively considering and signaling that more 50bp hikes are likely in the near term.
- **We expect the Fed to front-load the rate hikes this year with another 50bp hike in the June meeting and 25bp hike in each of the remaining four meetings with policy rate ending at 2.5% by end-2022.** We expect only a 25bp hike in 2023 with the terminal rate at 2.75%.
- **Our 12-month targets are 2.50% for the US 10-year treasury yield and 2.25% for the US 2-year treasury yield.**
- We remain **positive on Indonesia** credit as Indonesian economy gains momentum on further reopening.
- We still **see value in Hong Kong names** where most of them have demonstrated resilience in bond price despite concerns on China policy risk and Fed rate hikes. This is primarily mitigated by their largely non-China asset portfolios and relatively short duration.

Forex & Commodities

POSITIVE NEUTRAL NEGATIVE

12-MONTH FOREX VIEW

Positive	Neutral	Negative
JPY EUR THB NZD AUD GBP MYR CAD SGD	TWD CNY IDR HKD KRW	USD INR PHP

COMMODITIES

Positive	Neutral	Negative
Gold Base metal	Oil	-

King Dollar: During April, currency weakness was broader with most currencies falling versus the dollar. The trigger was the uber weakness in the Yen. The Bank of Japan reaffirmed its commitment to unlimited purchases of Japanese government bonds and yield curve control. This eventually led to weakness in the Renminbi and other Asian currencies such as the Malaysian Ringgit, given the trade competitiveness with Japan.

In addition, the dollar strength was catalysed by the May FOMC meeting as traders bet on further dollar appreciation. We adjusted lower our forecasts for CNH, JPY, and other currencies after the recent weakness. However, in the medium term, not in the short-term, there could be some upside in selected pairs vs. the dollar.

GOLD weakened during April as higher real yields impacted the appetite for precious metals. With gold not paying a coupon and 2-year Treasury yields rising, all this added to the pressure on gold. However, we prefer gold as a portfolio hedge. For **the next 12-month, we expect gold to trade in the $1900-2100 range.** Investors can consider to **accumulate gradually on weakness.**

OIL was range-bound during the month. Supply concerns remain as a portion of Russian crude goes without buyers and Europe is contemplating an end to oil purchases from Russia over a period of time. Our price on fundamentals is **$95 - $105**.

BASE METALS were weaker during the month. We remain positive as inventories are low. There is also a need to accelerate the energy transition to reduce dependence on Russian oil and gas, and increase defense spending. **Short-term, supply risks have led to high-risk premia, so accumulate selectively on weakness.**

Forex Forecasts

		Spot	3-month		12-month	
		As of 29 Apr 2022	View	Target	View	Target
Developed	USD Index*	103.62	-	100.5	-	97.3
	Japan	131.0	+	124	+	120
	Eurozone	1.052	+	1.08	+	1.12
	UK	1.244	+	1.29	+	1.37
	Australia	0.708	+	0.73	+	0.76
	New Zealand	0.650	+	0.68	+	0.70
	Canada	1.284	+	1.25	+	1.25
Asia Ex-Japan	China	6.612	=	6.60	=	6.50
	Hong Kong*	7.846	=	7.83	=	7.83
	South Korea*	1,272	=	1,235	=	1,240
	Taiwan*	29.52	=	29.4	=	29.5
	India	76.49	=	76.0	-	78.0
	Indonesia*	14,497	=	14,300	=	14,700
	Malaysia*	4.363	+	4.15	+	4.11
	Philippines*	52.29	=	53.2	-	54.1
	Singapore*	1.388	+	1.33	+	1.31
	Thailand*	34.45	=	34.20	+	33.00

Source: BNP Paribas (WM) as of 29 April 2022
**BNP Paribas Global Markets forecast as of 29 April 2022*

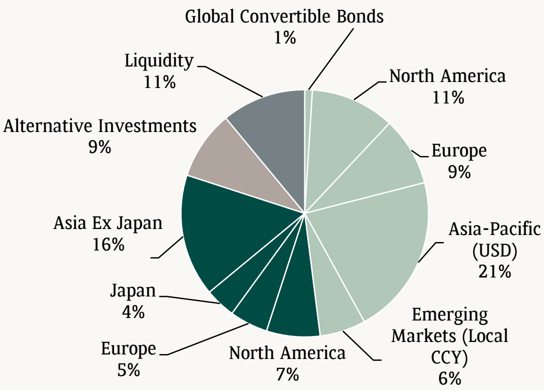
Note: + Positve / = Neutral / - Negative

Strategic & Tactical Asset Allocation

OUR TACTICAL ASSET ALLOCATION IS BASED ON OUR CIO'S ASSET ALLOCATION VIEWS. CHANGES ARE REFLECTED IN THIS MONTH'S TACTICAL ALLOCATION.

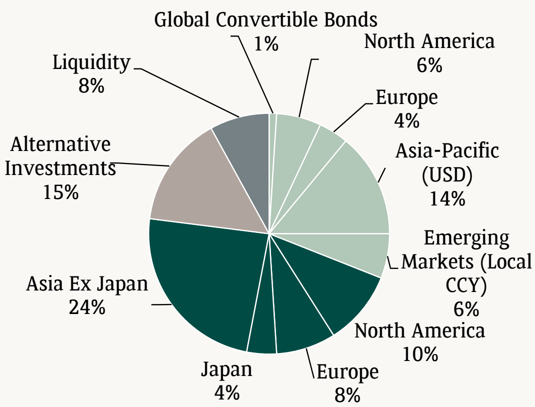
INVESTMENT PROFILE: BALANCED

	STRATEGIC ASSET ALLOCATION		TACTICAL POSITIONING		THIS MONTH'S TACTICAL ASSET ALLOCATION
FIXED INCOME	50%	+	-2%	→	48%
EQUITIES	30%		2%		32%
ALTERNATIVES	10%		-1%		9%
LIQUIDITY	10%		1%		11%



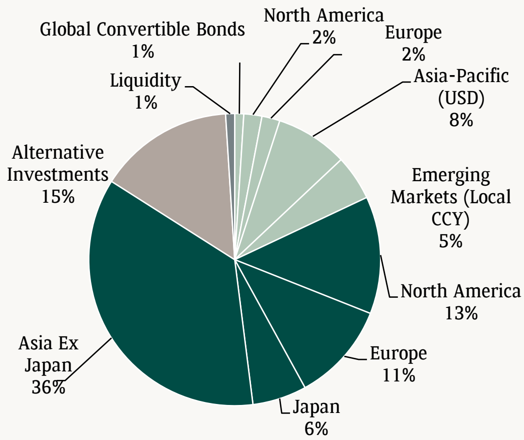
INVESTMENT PROFILE: DYNAMIC

	STRATEGIC ASSET ALLOCATION		TACTICAL POSITIONING		THIS MONTH'S TACTICAL ASSET ALLOCATION
FIXED INCOME	35%	+	-4%	→	31%
EQUITIES	45%		1%		46%
ALTERNATIVES	15%		-		15%
LIQUIDITY	5%		3%		8%



INVESTMENT PROFILE: VERY DYNAMIC

	STRATEGIC ASSET ALLOCATION		TACTICAL POSITIONING		THIS MONTH'S TACTICAL ASSET ALLOCATION
FIXED INCOME	20%	+	-2%	→	18%
EQUITIES	65%		1%		66%
ALTERNATIVES	15%		-		15%
LIQUIDITY	0%		1%		1%



Source: MyAdvisory, as of 5 May 2022
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