Asset Management: Scope for New Direction in Asia

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Firstly, let me state that in terms of global investors, institutional asset managers and owners now do not just come from the West and developed economies, they also come from Asia. These include Singapore’s GIC and Temasek Holdings, China’s CIC and National Social Security Fund, Korea’s KIC, and Abu Dhabi’s ADIA. Hence, while the global investment funds are looking to Asia, particularly India, Indonesia and China, for investment opportunities, there is also a new breed of highly-sophisticated institutional players, with large pools of sovereign capital, originating from Asia. I.e., it’s a two-way traffic system when it comes to investment flows!

That being said, for both retail and institutional investors, transparency, liquidity and tail risk management have become paramount concerns when making investments locally and abroad. When one couples that with equity risk premiums compressing around the world, there really is a need for new and innovative ideas, approaches, and products for investing. Before I go there, let me address what should be keeping us awake given the realities of the real economy:

a. Indebted nations in the West and the ongoing Greek Tragedy (Greece Lightning, Greece is the word) call it what you may;
b. The US still hasn’t shaken off its housing and unemployment woes;
c. Central banks are printing money like there’s no tomorrow given the various shapes and forms of quantitative easing. If I recall my Macro 101, this could lead to higher inflation;
d. Unresolved geopolitical and war risks in the Middle East that will continue to keep the price of oil high;
e. Unfavorable demographic trends in parts of Asia, which I argue will compress the equity premium further and create a looming retirement savings problem, especially for those pinning their hope that equity markets will help support them in their golden years – there has to be some relationship between the support/dependency ratio and long-term equity risk premium;

Addressing the Eurozone crisis in particular, it is appropriate to ask what the impact on Asia will be. My view is that given that most of Asia ex Japan is still recording robust growth rates, public and private savings rates continue to be high, and domestic consumption, investment and intra-regional trade continue to grow and drive the regional economies, Asia’s vulnerability to any European (or for that matter, US) slowdown will be limited and benign. If anything, the export-oriented manufacturing industries and regions will take somewhat of a hit, but that’s it. There’ll also be a flight of risk capital from Asia to their home countries so as to repair their default-affected banks’ balance sheets. Some also worry that the Middle Kingdom may come apart due to its domestic debt problem and/or asset and property prices deflating. Nevertheless, we are comforted in the knowledge that China’s economy is a highly-managed process. That is, the Chinese government will work hard to ensure that there is no hard landing in either of these sectors, and the expectation is that if there indeed is any slowdown, it would be gradual and it would happen in an orderly fashion.

Note: Support Ratio is the proportion of population economically dependent on the working population.
The next question is where and how should one be investing?

a. The need for the separation of “alpha” (pure excess returns that is uncorrelated with the market return) and “beta” (the market return itself), and the attendant management fees that funds charge for such services. In a recent paper out of MIT, researchers highlight that high market systematic risk has been an effective precursor to heightened tail risk. So what should one be doing in the face of this research finding, and the changing and challenging macroeconomic and regulatory climates? Hedging out systematic risk. In other words seek out good alpha managers. Additionally, be wary not to pay aggressively in asset management fees for either alpha or beta! India has taken a step in the right direction here by barring entry, exit and deferred sales charges (a.k.a. “loads”) from the fees that unit trusts and mutual funds can charge.

b. The aging population, increasing dependency ratio, and the “hope for the best” retirement products sold on financial shelf stores today cry out for a totally new and innovative way of thinking about lifecycle savings and investing for retirement. Simplicity, transparency and guarantees are key; rocket science and the management of uncertainty should be left to the financial manufacturers, and not ordinary investors. As a consequence, a partnership between the government, the sell-side (bankers, structurers), and the buy side (asset managers) is needed to make all of this work for the benefit of investors. For a start, financial manufacturers, i.e., the asset managers, need the basic building blocks – inflation-indexed bonds. With the existence of inflation-linkers, pension funds and other asset managers can begin to offer a broad suite of inflation-indexed products, ranging from retirement life annuities to inflation-linked insurance policies that are properly guaranteed. This will certainly improve the functioning of national pension systems, and hence the welfare of retirees. Again, India is taking a step in the right direction here by weighing the reintroduction of inflation-indexed bonds.

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