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Private Clients and the Need to Adapt Investment Portfolios with a Proper Historical Perspective

Gary Dugan is Co-Founder and CEO of Singapore-based Global CIO Office, whose mission since opening its doors in October 2019 has been to elevate research, deal selection and advisory to institutional levels for smaller EAMs, or single-family and multi-family offices that need to upgrade product selection for their clients. The world has changed dramatically since he along with investment expert and co-founder Johan Jooste launched the firm, but their mission remains the same - to support the growing ranks of family offices and EAMs by providing outsourced investment ideas, portfolio analysis and research services driven by a deeper analysis of companies, a better understanding of sectoral and geographical trends and outlook, and a proper historical perspective that stretches back beyond the central bank liquidity bonanza unleashed since the global financial crisis. Hubbis had the opportunity to meet up with Dugan again recently, to hear what type of advice he and colleagues are offering clients today, and how they have been refining their approach to take into account the ongoing irrational exuberance despite rising inflationary and geopolitical risks, bloated mainstream market valuations and the risk of rising rates.

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Dugan opens by observing that despite the apparently very high valuations of fixed income and equities, both have been making money for investors, and most experts covering both asset classes report they are going with momentum rather than pricing parameters.

"They might say everything is hopelessly expensive," he says, "but they are running with the pack. However, at that point where things start to collapse around them, investors will not be protected because the bonds and equities will be falling at the same time, as happened in March of 2020, but this time it could be a multi-month, multi-quarter event and do some major damage. The March 2020 sell-off was sharp but brief and followed quickly by a major rally."

get their desired yields, and again there are major risks there. A major sell-down in bonds and with investors stuck in illiquid assets is a recipe for some major stress.

Dugan addresses the argument that investors who are under-invested are losing out on great opportunity. "My view is I think there's going to be a dramatic break with the trends of the past decade, during which markets have benefitted from the massive waves of new policy, massive liquidity being pumped in, seemingly ever-falling and even negative interest rates, and the ability for private clients, for example, to borrow money at 1%, invest and make money so easily. So, why wouldn't you leverage to the hilt?"

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Too much optimism, too much debt

He explains GCIO has been reviewing portfolios for clients and they see far too much leverage, so those investors are living in the hope that those asset classes will behave like they did for more than the past decade, but not like they would ordinarily behave in more normal environments. Another concern is that as people hunt for income, they increasingly migrate towards illiquid assets in order to

The elephant in the room

But he says the difference today is that inflation has resurfaced. "I won't argue that inflation will catapult to 10% annually, but even if it's 2%, that's up to the inflation target of most central banks, which in turn means there should be a normalising of interest rates, and that has not happened since the global financial crisis. Accordingly, we are at the greatest risk of a normalisation of monetary policy, the removal of the extremes of policymaking of the past decade plus."

He points to the UK as an example, where there are growing worries over inflation that has bubbled up to 3% and above, and he refers to the evolution of comments from the US Federal Research, shifting from their earlier stated position of inflation as transitory to a rather less forthright view. "The reality is that we are on a different direction of travel, we are going to see more inflation than the world bargained for, and that is partly because of huge amounts of money being spent in order to create inflation."

Fractious global relationships

Moreover, he observes that there has been a drive during recent years to question globalisation, and that has led to fractious trading relationships, broken supply lines, and other disruptions that might take years to fix. "In short, I am convinced, during the coming years, we will see more inflation than expected, and the knock-on effect on valuations could be significant, leading to a correction and much more modest returns in the future. That is certainly what we expect."

Dugan extends the line of thought then to the positioning of portfolios for this next phase. As he says, the wealth industry keeps moving forward, portfolios need fine tuning, we all need to keep invested to varying degrees and wisely, and there are indeed areas where risks are lower, and returns are available.

Seeking windows of opportunity

He focuses first on countries, pointing to Moscow's recent

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ranking in the top four cities of the world, and extrapolates to the Russian equity markets on a P/E multiple of about eight times forward and a yield of roughly 6% or 7%. He also points to the Middle East and even Latin America as offering great potential and reasonable entry valuations.

"These are examples of the value that is available around the world, but in different areas," he says. "They exhibit improving stability, low P/E multiples, robust growth, and they are asset rich, and particularly when it comes to commodities. Additionally, there you can find governments with the lowest debt to GDP ratios. Yes, their markets suffer lower liquidity, but that I think will change. And relatively some of these countries are more appealing now – for example, Russia has been somewhat ostracised, but would that not be better to invest there than in China with all the unforeseen changes? I concede these are smaller opportunities than for example buying into the liquid and giant US markets, but they do represent opportunities."

Private debt beckons, but you need staying power

As to bonds, he says it is more difficult. "I believe there are however opportunities in the private debt market, so for example here in Singapore you can buy into SME debt offering yields of 12% to 15% through private debt funds. In the UK, a credit card has an annualised rate of return to the bank of around about 50% for any debt that's outstanding, so there is income out there, you just need to find ways of getting to it."

Greater access to more opportunities

He reports that accessing such opportunities is easier than it was before, with funds available offering 7% to 9% returns, and the risks are low as the returns will likely be boosted by the macroeconomic environment he projects ahead. Accordingly, investors should consider heading to the explicitly illiquid markets that today offer some cashflows in terms of monthly or quarterly payouts. "I personally think it is better to accept the illiquidity of such private assets than the market risks of assets that are exceedingly expensive," he states.

Another fascinating sub-sector of the investment markets, one that has become more in focus in recent times, is tokenisation, which will allow investors to buy other asset classes in a more liquid form. "We have seen that with some of the private debt deals, and this caters to assets that are short supply but rising demand, so I do think this segment will become more regularised and more standardised for inclusion in a typical portfolio."

Gold might just stage another major rally

He also shines a spotlight on gold, commenting that a major risk ahead is the crisis of confidence in the US dollar, what he refers to as the 'end of Rome moment' for the US economy. "It would not only show a lack of confidence in the biggest economy in the world, but it would create even more inflation, which basically takes us back to the crisis created after Bretton Woods failed and Nixon took the US dollar off the gold standard," he says. "This kind of stuff does happen, and it typically does happen at a geopolitical crisis, which the US has faced recently, and will continue to face. So, gold, which for many people is a rather marginal asset of late, I think will become a core asset as well."

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Don't maintain tunnel vision

As to particular advice on portfolio formation, Dugan says the first exercise is to apply normal risk management parameters looking back over several decades of data, not extrapolating only firm the past decade since the GFC. Only then can they understand the true risk they are taking. "Look at high yield bonds, for example, which have only ever gone up in recent history, never down," he remarks. "But in reality, investors could lose 15% or more if they assessed these risks properly."

Secondly, he advises against mixing up income and capital gain. "If you were to ask someone their return expectations on high yield bonds, they might say of 7% or 9%, but actually they yield perhaps only 3.5%, and the reality is spreads will not likely compress further leading to the bond prices rising. That is because we are now seeing interest rates rising or more likely to rise across the globe."

Challenge your hypotheses

In short, Dugan advises challenging the prevailing assumptions and properly assessing the potential returns on each asset class in the portfolio in order to work out how much downside risk they really have built in. "The result of many such exercises is the realisation that the investor has an inappropriate amount of risk, exacerbated through leverage. By way of example, I reviewed a portfolio of a wealthy client who had taken on so much leverage that a 15% correction in high yield bond prices would wipe out half the portfolio. And like so many, they say, well I was never told that, I can't believe I am risking half my invested wealth on the possibility of what would be considered a normal setback in the markets."

Playing the long game

He closes the discussion by reiterating that we are today in a very different environment from that before the pandemic hit, and that preconceptions of portfolio management and allocation for the HNW and UHNW community in Asia need to be rapidly reviewed and updated. "History tells us much about markets and risks as well as returns," he says. "My advice right now is look back well beyond the 2008/9 global financial crisis and incorporate risk assessments that are more proven over many decades. Historical trends are seldom wrong." ■

Global CIO Office – In Sync with The Needs of Asia's IAM Community

High-profile veteran banker Gary Dugan and long-time financial markets expert Johan Jooste are respectively CEO and MD of The Global CIO Office. They joined forces to launch The Global CIO Office in Singapore in the second half of 2019. Their mission is to provide outsourced investment ideas and research services to IAMs/EAMs and multi-family offices, as well as single-family offices.

Although now only two years old, they are already in a very different global environment to that in which the firm was first imagined; however, they believe the premise for creating The Global CIO Office has been reinforced by the events of 2020 and 2021 so far, and they are optimistic they will find an even more robust client demand as the world's asset markets are now set to demonstrate much greater divergence of performance than seen for many years past.

The Global CIO Office brand operates under the umbrella of Purple Asset Management, which is owned by the UK's Fry Group and the Independent Strategy Group, who backed the pair as shareholders, offering both funding and resource.

The GCIO Office team looks after HNW and UHNW segments mostly, building its clientele through the provision of high-grade outsourced Chief Investment Officer services for external asset managers and wealth management businesses. This encompasses both advisory and bespoke discretionary portfolio management, investment due diligence, strategic asset allocation and market and product advice and research.

The GCIO Office has as its core mission the elevation of research, product selection and advisory to institutional levels for those smaller EAMs, or single- and multi-family offices that need to upgrade product selection, filter out better deals and boost the quality of advice for their end-clients, generally very wealthy global and Asian individuals or families.

They aim to offer their services at a competitive level to the costs that would be borne if the entire investment function was taken in-house by a family office or small wealth manager. "We have done case studies for prospects where we have shown that we can potentially cut the overall costs of a firm's investment team by around 50%," remarks Dugan. However, he also offers the caveat that the intention is not to necessarily to take over the entire investment function of the firms they speak to, rather to complement their key resources.

A source of price competitiveness is derived from the myriad of technological advances which are now available to the wealth management industry. For larger firms that lack the institutional nimbleness required to assimilate technology into workflow quickly, this is a threat. To smaller firms with leaner organisational structures, it is a great opportunity.

A further element favouring smaller entities is the lower headcount requirement to achieve the same level of service. Smaller firms do not suffer from the requirement to be a "one-stop-shop", delivering a whole suite of services that can be expensive to maintain and deliver low margins.

The GCIO Office looks to both these avenues for cost savings that are built into the pricing model, but without compromising on quality. Such an approach allows for the creation of a strong network of external providers for essential items such as risk and attribution reporting on client portfolios and the use of an expert network to assist in due diligence of specialised investment strategies, to name but two. The approach also allows for costs to be focused very clearly on the specific service being provided, allowing the GCIO to achieve a high degree of scalability.

As such, the firm's approach and its services are likely to see an even greater interest in the post-coronavirus world, as financial markets are no longer likely to be floating on a rising tide of optimism. Accordingly, cost effective research, analysis, and a more refined judgement are likely to be more rigorously sought and applied.

Whatever the precise lie of the land ahead, one of the firm's missions is to ensure institutional quality due diligence on private debt, private equity and VC. "There is a gap in the market for greater professionalisation of this segment and the heavy use of technology such as AI, as there is plenty of supply of opportunities, plenty of demand, so we must efficiently filter the best for the clients," Dugan explains. "There are limited resources for family offices and wealthy investors to rigorously assess and compare deals, so we want to be the go-to source of due diligence and independent advice. Often the only institutional advice is from the company promoting the deal."

Another priority is to broaden the firm's geographic horizons. "Singapore," he says, "is an excellent base from which to expand and offers an edge in terms of reputation and perceived quality, but we also recognise we want to build on our connections into Hong Kong, and the Middle East. Of course, this will have to wait for the virus to abate, but it is core to our vision of the future."

The third, somewhat more esoteric mission is to reshape asset allocation. "We have to re-think the whole approach," Dugan says. "After the global financial crisis and the collapse in government bond yields post-Covid, there has been a lot of talk about the old portfolio approach being defunct, hence we see new horizons where illiquid assets are used more heavily in portfolios, with such opportunities needing far more in-depth due diligence coupled with the use of technology. We would like to be seen as go-to-resource for family offices to enhance their ability to cope with this emerging trend," says Dugan.

Dugan believes that in positive or adverse conditions, there is no substitute for experience. "We do believe that our collective experience of markets is an important resource for clients to tap into. Our experience allows us to control our emotions and deal with each challenge put in front of us for the benefit of the client."