Investors question traditional investment beliefs in the wake of COVID-19

Key points

- *Fundamental investment beliefs remain in place such as the merits of diversification and the importance of liquidity.*
- *But investors are now questioning their sources of returns, defensive asset classes, and overall growth/risk positioning.*
- *Inflation remains a risk factor in the long-term.*

The fallout from the coronavirus pandemic has prompted investors to question traditional investment beliefs about sources of returns, defensive asset classes, and overall growth/risk positioning.

Caresuper Chief Investment Officer, Suzanne Branton, said fundamental changes to fiscal spending, deglobalisation, geopolitics, taxation, and the specific nature of the widespread recession sparked by the pandemic, provided good reasons to treat the next decade as a new regime.

"It's always very scary when people say things like that, but I think there are some reasons to think it will be different," she said during a Frontier conference session on portfolio implications flowing from the COVID-19 pandemic.

"Overall, what we're looking at here is a whole lot of uncertainty with a whole lot of liquidity and it's a very interesting environment. The overarching angle in my mind is what we're dealing with here is an incredibly wide range of potential outcomes."

This will likely result in a "high amplitude cycle" across economies and markets, with the path of the economic recovery far from certain.

Frontier Advisors Director of Consulting, Kim Bowater, said certain investment truths remain in place such as the merits of diversification, liquidity, exploiting competitive advantages, focusing on secular change, sustainability, cost management, and strategy implementation.

But investors may need to question their traditional sources of returns given rates are set to be lower for longer, and the role of defensive assets such as bonds. Investors will need to be flexible as new information comes to light and re-assess how portfolios are constructed.

"I think there is a clear issue with lower risk portfolios – things like conservative options – portfolios tend to have a larger exposure to bonds and cash," Bowater said.

Inflation still a factor to consider

While huge fiscal and monetary stimulus will have a disinflationary effect for some time, investors are also considering how to protect their portfolios against a potential rise in inflation.

"If you go into an inflationary environment, you want something like an inflation-linker, or something like commodities, but it's very hard to find any single asset that's going to perform well in both of those environments," NZ Super Chief Investment Officer, Stephen Gilmore, said.

Bowater said inflation is a longer-term risk factor. 'We should be thinking about inflation-linked bonds, looking at other ways to get inflation protection, and be aware there is inflation protection in things like real assets."

Key questions the panellists answered

- *(10.20m) With central banks anchoring key rates at all-time lows, will that limit the downside protection of fixed income assets?*
- *(17.15m) If central banks keep rates low for an extended period, what does that mean for inflation?*
- *(24.15m) What are your views on the expected risk of asset classes when constructing portfolios in this environment?*
- *(37.35m) If defensive assets are not going to deliver what they historically have, is diversification within growth assets going to be impacted by more volatility in this environment?*
- *(41.40m) What role will infrastructure and property play in a portfolio given liquidity demands and ongoing low interest rates?*