Fundamental Flash

Positioning your Portfolio in a Downturn

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Preface

As investors brace for further volatility in a market downturn and whispers of a recession grow louder, many might be wondering how they should position their portfolio to ride out the turbulence. Anton Tan, Senior Director, Product, Wealth & Advisory shares why it is important that investors stick with quality, but more importantly keep a cool head and stay calm.

Recession Whispers…

Technically a recession constitutes 2 consecutive quarters of negative growth. To confirm if the economy is in recession, paradoxically we actually have to wait until it has already happened which would of course be too late by then.

Our best guess is that we are already in a recession as the COVID-19 pandemic forces a global shutdown of economies in an unprecedented scale.

But in the investment realm, this is actually secondary because asset prices have already moved ahead and priced-in any recessionary risks. If you look at global equity markets especially from the peak-to-trough, it has plunged by over 30% and has mainly stayed range-bound.

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In the fixed income space which tends to be able to predict or price-in a recession quicker, we have seen a sharp widening of credits spreads which indicate stress. For investment grade (IG) bonds, credits spreads have widened by over 400 bps. The typical spread for IG bonds should range just between 200-300 bps.

Within the high yield (HY) segment it has surpassed 1000 bps, though we see some normalisation since global central banks like the US Federal Reserve injecting stimulus and providing liquidity.

As a team, we have been closely monitoring the COVID-19 pandemic and the daily change in infection rates. We can certainly expect a higher rate as testing is ramped-up especially in the US which has begun to acknowledge the severity of the situation. It will be important to see a peak of infection levels in order for markets and the economy to recover.

The impact on the economy will be significant as this is a global phenomenon. It is necessary to gauge the impact this would have the on the balance sheets of businesses and corporates. But, it is crucial that we do not see this turning into a systemic risk that could impact the balance sheet of banks.

Any risks of the coronavirus being prolonged coronavirus could lead to businesses suffering permanent loss in their balance sheets.

Tilt Towards Quality

If liquidity is crucial especially for investors who have retired or are approaching retirement, we believe that it appropriate for them to reduce exposure in equities. There is still little clarity on outlook and what impact the coronavirus would have on the real economy. So, the prudent thing to do may be to estimate the worst.

This might forego some future upside, but is ideal to help preserve and protect capital. Within fixed income, conservative investors should tilt their allocation IG bonds and avoid HY.

For investors who sit in the middle of the risk-profile spectrum and want some equity exposure, an important question they need to ask themselves is if they can stomach the volatility for the next 3-5 years. If the answer is yes, then investors should average down and split your investment into a few tranches to ease your way into the market.

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