

## Strategies that benefit from volatility

While 2019 proved a buoyant year for all financial markets, the first weeks of 2020 have proved volatile. Asian investors who remember previous corrections are looking for sophisticated strategies fit for all market conditions.

Financial markets proved unpredictably buoyant in 2019. Although the fog of US-China trade frictions hung over them, and economic growth faltered, both equities and bonds ended the year far higher than they started it.

The MSCI AC Asia ex Japan Index climbed almost a fifth (18.17%).<sup>1</sup> Unusually, bonds also rallied, with US 10-year Treasury bond yields falling from 3.2% in October 2018 – when the US Federal Reserve was still raising interest rates – to 1.84% in early January 2020.<sup>2</sup>

Synchronised weakening in economic activity across the globe led the US Fed and other central banks to perform a policy U-turn in the first half of the year after the Fed cut rates twice in 2019. And, the European Central Bank controversially restarted quantitative easing.

Looser monetary conditions have proved a balm for financial markets, although volatility has returned in early 2020 as the rapid spread of the coronavirus in China has sparked fears over what was already expected to be a muted recovery in economic growth. Indeed, the World Bank's most recent forecasts see global GDP growth picking up from 2.4% last year

to 2.5%.<sup>3</sup> Even so, valuations in equity and bond markets remain relatively high, with the economic cycle ageing and trade friction undermining business confidence. This raises the possibility that still more market volatility could be around the corner.

An uptick in volatility could present rich pickings for long-short equity strategies, also known as “extended alpha”. With their focus on fundamental stock picking, they benefit as companies' fortunes diverge. Unsettled markets trigger price dislocations, creating investment opportunities for the stock pickers who run these funds. They can navigate market volatility, through short selling and altering gross exposure to equities.

At the same time, the principle behind extended alpha funds is that your gains will be more closely linked to the difference between the best and worst performing stocks than the market's performance – and so less susceptible to volatility.

### Matching long and short exposures

Over the last decade when low-cost beta strategies in the form of exchange-traded funds have become popular, long-short



strategies have continued to offer investors a highly effective way to source alpha. The managers behind these funds have ratcheted beta and alpha exposure up or down, depending on the market outlook and clients' risk appetites.

At Columbia Threadneedle Investments, we have a range of extended alpha strategies. We meet companies and conduct fundamental research, using our trusted stock picking approach that relies on Porter's Five Forces as a key tool to assess the pricing power of companies for our long positions. High-quality companies with strong pricing power can compound their earnings yields powerfully over time, generating outsized gains.

Most of the strategies' short books are made up of relative pair trades, which are expected to underperform the corresponding long holdings in the same sector. The portfolios also have short positions where events such as disappointing earnings, competitive product launches etc. are expected to trigger price falls.

### Fine tuning market exposure

But not all extended alpha strategies are the same. Investors can choose between strategies that share the same investment approach, yet offer different levels of risk. The typical extended alpha strategy offers equity-like levels of market risk, while market-neutral funds are designed to offer absolute, or cash-plus, returns. This results from varying net market exposures: an extended alpha strategy might range from 90% to 110% and market neutral from -10% to +50%.

Taken together, the two strategies offer a unique combination that enriches the wealth manager's opportunity set, particularly in current market conditions.

The scarcity and appeal of high-alpha equity portfolios has increased with the rise of passive funds, making a strong case for long-short equity with high-alpha potential. These strategies allow for a full range of market exposures, and they can be used separately or combined to fine tune client portfolios.

### Demand for sophisticated strategies

While the mood in Asian markets has lifted in 2019 and 2020, the equity market rout of 2018 is not long ago. That was the worst year in a decade for China's equity market – the Shanghai composite index fell by almost a quarter, or 24.6%,<sup>4</sup> unsettled by the trade war and a slowdown in growth.

That has resulted in many Asian investors looking for sophisticated strategies able to benefit, rather than suffer, from volatility.

#### Sources:

1. Source: MSCI.
2. Source: FT.com, 7 November, 2019.
3. Slow growth, policy challenges; World Bank Group; January 2020.
4. Chinese markets' 2018 performance was their worst in a decade, CNBC, 31 December 2018.

To find out more visit  
**COLUMBIATHREADNEEDLE.COM**



**Important information: For investment professionals only, not to be relied upon by private investors.** This material in this publication is for information only and does not constitute an offer or solicitation of an order to buy or sell any securities or other financial instruments to anyone in any jurisdiction in which such offer is not authorised, or to provide investment advice or services. Offerings may be made only on the basis of the information disclosed in the relevant offering documents and the terms and conditions under the relevant application forms. Investment involves risk. Your capital is at risk. You are advised to exercise caution in relation to this material. Please refer to the relevant offering documents for details and the risk factors. Past performance is not a guide to future performance. The value of investments and any income is not guaranteed and can go down as well as up and may be affected by exchange rate fluctuations. This means that an investor may not get back the amount invested. The research and analysis included in this publication have been produced by Columbia Threadneedle Investments for its own investment management activities, may have been acted upon prior to publication and is made available here incidentally. Any opinions expressed are made as at the date of publication but are subject to change without notice and should not be seen as investment advice. Information obtained from external sources is believed to be reliable but its accuracy or completeness cannot be guaranteed. The mention of any specific shares or bonds should not be taken as a recommendation to deal. This document includes forward looking statements, including projections of future economic and financial conditions. None of Columbia Threadneedle Investments, its directors, officers or employees make any representation, warranty, guarantee, or other assurance that any of these forward looking statements will prove to be accurate. This document may not be reproduced in any form or passed on to any third party in whole or in parts without the express written permission of Columbia Threadneedle Investments. This document is not investment, legal, tax, or accounting advice. Investors should consult with their own professional advisors for advice on any investment, legal, tax, or accounting issues relating an investment with Columbia Threadneedle Investments. This document and its contents have not been reviewed by any regulatory authority.

Issued by Threadneedle Investments Singapore (Pte.) Limited ["TIS"], ARBN 600 027 414. TIS is exempt from the requirement to hold an Australian financial services licence under the Corporations Act and relies on Class Order 03/1102 in marketing and providing financial services to Australian wholesale clients as defined in Section 761G of the Corporations Act 2001. TIS is regulated in Singapore (Registration number: 201101559W) by the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289), which differ from Australian laws.

Issued by Threadneedle Investments Singapore (Pte.) Limited, 3 Killiney Road, #07-07, Winsland House 1, Singapore 239519, which is regulated in Singapore by the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289). Registration number: 201101559W. This advertisement has not been reviewed by the Monetary Authority of Singapore.

Issued by Threadneedle Portfolio Services Hong Kong Limited 天利投資管理香港有限公司. Unit 3004, Two Exchange Square, 8 Connaught Place, Hong Kong, which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 regulated activities (CE:AQA779). Registered in Hong Kong under the Companies Ordinance (Chapter 622), No. 1173058.

Issued by Threadneedle Asset Management Limited (TAML). Registered in England and Wales, Registered No. 573204, Cannon Place, 78 Cannon Street, London EC4N 6AG, United Kingdom. Authorised and regulated in the UK by the Financial Conduct Authority. TAML is not licensed in Switzerland and may only provide investment management services on a cross-border basis. This document is distributed by Columbia Threadneedle Investments (ME) Limited, which is regulated by the Dubai Financial Services Authority (DFSA). For Distributors: This document is intended to provide distributors with information about Group products and services and is not for further distribution. For Institutional Clients: The information in this document is not intended as financial advice and is only intended for persons with appropriate investment knowledge and who meet the regulatory criteria to be classified as a Professional Client or Marketing Counterparties and no other Person should act upon it. **Columbia Threadneedle Investments is the global brand name of the Columbia and Threadneedle group of companies.**  
**columbiathreadneedle.com** Issued 01.20 | Valid to 07.20 | J30191 | 2938480