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Wealth managers keep calm and carry on

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Helen Avery | Tuesday, May 26, 2020

For wealthy clients, the Covid-19 crisis has afforded an opportunity to test the asset-allocation advice and lending capabilities of their wealth managers

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It is a wealth manager's nightmare. On May 5, data from UBS showed that investors were holding

cash with a value of around $4.7 trillion, an increase of more than $1 trillion in the space of eight weeks since the Covid-19 crisis started to accelerate in early March.

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Wealth managers know that the best thing clients can do in a downturn is stay invested, rebalance and ride it out – it's also better for wealth managers' profits when they do.

The current bout of volatility has been less financially painful for investors than some previous crises. For high net-worth clients, there wasn't a panic sell-off because a quick recovery was anticipated.

When news emerged of the spread of Covid-19 from China to Europe and the US, there was some movement into sovereign debt and gold, but then once it became a volatile market event, clients sought out more liquidity. But any panic was short lived.

"As soon as the central banks intervened, confidence returned," says Gilles Prince, chief investment officer for Switzerland at Edmond de Rothschild.

Prince says his firm's scenario was equity neutral going into the crisis: "We added some put options to the portfolio, so we were less impacted on the downside, but were also able to capture a significant part of the rebound."

Gilles Prince, Edmond de Rothschild

It was a quick rebound. On March 23 the S&P500 hit a bottom, with 30% wiped off 2019 gains. By May 21 it had rebounded from its lows by 24%.

What's more, the high level of client transactions occurring during March – particularly in Asia – meant that even while assets under management were falling, profits at wealth management firms were ticking along nicely.

By the end of the first quarter, UBS Global Wealth Management's AuM had dropped to $2.59 trillion from $2.9 trillion the previous quarter. Yet pre-tax profit was up 59% quarter on quarter and 41% year on year – largely driven by the high transaction volumes from Asia.

It was a similar story at Morgan Stanley, where wealth management client assets dropped to $2.4 trillion from $2.7 trillion. However, Morgan Stanley saw the wealth management division's pre-tax profit drop 11% year on year to $1.06 billion, but this was far less of a dip than in its asset management and institutional securities services businesses (the latter saw profits decline 40% year on year).

Credit Suisse International Wealth Management saw pre-tax profit rise by 3% year on year.

UBS Global Wealth Management's head of Americas investment strategy, Michael Crook, says his firm's approach has helped clients stay calm in the crisis. UBS GWM divides its clients' wealth into three buckets: short-term liquidity, for needs like those during a market shock or recession; longevity, the assets needed for their lifetime; and legacy assets.

"It means there wasn't really a panic during the market's abrupt downturn, because there is a comfort among clients that their lifestyles from a funding standpoint won't be impacted," he says. "If anything, they harvested their losses and took advantage of opportunities."

In the US, losses on sold securities can be used to offset a realized gain on another position as long as 31 days pass before re-buying the same position. Crook says it can add about 0.4% to a portfolio a year.

Josef Stadler, UBS GWM

For the mega-wealthy, it has been an entirely different crisis. Josef Stadler, head of the global family office at UBS GWM, oversees ultra-high net-worth clients for the firm – 1,500 to 2,000 individuals, with $450 billion in assets between them.

He says that during the crisis these clients have been less risk averse than others – indeed, quite the opposite.

“Had you said to people in October when the Dow was 28,000: ‘Would you enter the market?’ they would have said: ‘Sure, when the Dow drops to 24,000’,” says Stadler. “Now these types of clients would say when the Dow dropped to 18,000 that they wouldn’t want to get in, in case it drops to 12,000. Instead the mega-wealthy saw the market crash as an enormous opportunity and asked for billions of dollars in loans to be able to reinvest in liquid equities. The inbound request for balance-sheet support was a global phenomenon – and there’s more to come.”

There have still been opportunities to be had for the less wealthy.

At MBaer Merchant Bank, chief executive Michael Baer says his firm recommended Swiss franc dividend portfolios to its international clients.

“For a little while, people didn’t want to be exposed to the US and were looking at cash or gold. We said a portfolio would give you some yield and avoid the negative interest rates of cash.”

Swings

There have been plenty of things to avoid. During the peak of the market volatility in March and April, Stéphane Monier, private bank CIO at Lombard Odier says his firm reduced exposure to high-yield bonds and emerging market debt, as well as reducing exposure to oil and shale gas.

Even so, some strategies failed.

Crook at UBS says “Selling equities in order to time for buying on the downside just didn’t work as the swings were so fast. Similarly, for managed futures, the sell-off and recovery were too fast for the trend to align.”

Unsurprisingly, structured notes have seen high demand.

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>
> \- Michael Crook, UBS

David Bailin, chief investment officer for Citi Private Bank, says: "We've done 70% of what we did in the whole of 2019 in just the first five months of this year. Among the most popular are those that create equity exposure and limit downside risk, and those that create yield by selling volatility."

Certain sectors have also proven themselves.

Steven Bates, head of investment products and fund selection at Credit Suisse, says: "At the end of April when global stock markets were still down about 10%, the Nasdaq was up, driven by the digital service providers, online video and audio solutions, as well as the well-known technology giants."

Steven Bates, Credit Suisse

As at Edmond de Rothschild, Monier says Lombard Odier also put in protection in the form of put options on equity indices. It also kept its allocation of 6% in gold.

"We also increased our allocation to investment grade credit as the spreads have widened and these investments are now supported by central banks' asset purchasing programmes," says Monier. "The yield is attractive versus cash."

Indeed, gold is likely to prove popular for some time.

Prince at Edmond de Rothschild says: "There are a lot of supporting factors around gold, such as negative yields, currency debasements and a weaker dollar as we get into

recovery mode.

“In general, a 60:40 portfolio needs to be rethought in this low interest-rate environment; including other asset classes, like gold, can make them more robust.”

It’s a point that is repeated by Bates: diversification is key during times of uncertainty.

“Those that have been diversified and have stayed invested have fared better,” he says. “I’ve been through four crises, and that’s never changed. Diversification is the best hedge.”

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> \- Steven Bates, Credit Suisse

However, investor sentiment is becoming more measured as many countries enter recovery and questions around a second wave of infection remain. Uncertainty means that cash holdings increase.

“It is important to say that the first quarter is not representative of the rest of the year,” says Stadler.

“It was a unique period of time that we will likely not see again. There’s a little reluctance now – not everyone’s convinced there won’t be a second sell-off.”

He says he expects clients to favour liquidity for the next six to 12 months.

Strategies

Citi has built a second wave Covid-19 outbreak in the fourth quarter into its models and is factoring country responses to this current wave into expectations of where that contagion is likely to be worse, says Bailin.

It is perhaps now that advice is particularly important. Had investors stayed diversified, invested with some put options, they probably could have ridden out March and April relatively unscathed.

The challenge is, of course, that no one knows what is coming in the six months ahead, especially as there is no precedent for this type of crisis.

Stéphane Monier, Lombard Odier

Lombard Odier, Monier says, is planning for various scenarios, ranging from optimistic to pessimistic, and offering different strategies for clients based on their own expectations.

“We cannot know which of these scenarios it will be,” he says, “but we are using big data to try and help us navigate them.”

Prince says Edmond de Rothschild is cautious on equities and underweight in them.

“The market has been a little too optimistic; the more earnings are released, the more the sentiment is turning negative. We’re also a little concerned about tensions between China and the US. We think a consolidation is due in the short term. Large-cap growth stocks remain the preferred safe option.”

However, at Citi, Bailin seems more bullish, pointing out that consumer confidence remains intact.

“It is usually recommended to rebalance from equity exposure for the year and buy fixed income, but we will be suggesting the opposite come June,” he says.

There are opportunities for investors, he adds, as emerging market valuations fall.

“The Brazilian ETF [exchange-traded fund], for example, is trading at levels approaching those of 2005, lower than the last recession. That’s an extraordinary discount. There’s good yield too. The dividend yield on the Mexican ETF is 4.4%, for Brazil it’s 5.5%.”

He points out that Asia offers similar opportunities, as it appears to be recovering earlier than the rest of the world.

“Already Chinese auto sales are back to volumes pre-Covid 19, for example,” he says.

Generally, wealth managers say they are nervous about emerging markets, however.

“I hate to say it,” says one, “but this has shown once again that for all the talk about the excitement of emerging markets, the US always rebounds quicker in these crises, it is always liquid and there’s always a price. It continues to be a safe harbour.”

> In the case of a crisis the US Federal Reserve is quicker to respond than central banks in other parts of the world. That was the case in the great financial crisis and has been the case this time
>
> - Stephane Monier, Lombard Odier

Monier too believes that the US is favoured over emerging markets – although not those in Asia.

"In the case of a crisis, the US Federal Reserve is quicker to respond than central banks in other parts of the world," he says. "That was the case in the great financial crisis and has been the case this time."

He also points out that the sector distribution is more favourable in the US than in Europe for the post-Covid future.

"For example, the weight of the IT sector and healthcare sector are bigger in the US than in Europe. There are also good IT companies in Asia, China and South Korea," says Monier.

Bailin is more of a contrarian. He points outs that there's been a bifurcation of performance between defensive stocks such as healthcare and technology doing well and cyclical stocks of small to medium-sized firms doing less so.

Now the market has rebounded it's time for clients to buy the cyclicals – "those will generate alpha over the next two years," he says.

David Bailin, Citi Private Bank

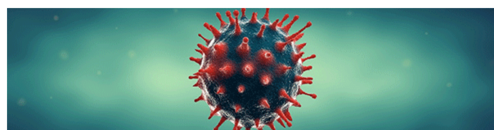
In credit, Crook says there are opportunities now that equity markets have recovered: "Higher yielding fixed income, investment grade credit, US dollar-denominated emerging market sovereign bonds and Treasuries and highly-rated muni bonds all look compelling from a value perspective."

With regards to long-term views, wealth managers are keen to point out that the trends they had already anticipated remain – they have just been accelerated. Healthcare, automation, digitalization and consumer preferences for firms with good environmental, social and governance (ESG) commitments are all popular strategies.

Prince mentions subscription-based companies in the digital sector and robotization as supply chains need to be reorganized. He says that the quality bias inherent in ESG has meant that ESG funds have done well during the crisis.

"Also, I think investors will be less keen on investing in firms that are borrowing for share buybacks, or those that with vast supply chains where commodities are sourced far from where they are sold," he says. "It's possible a change in sentiment will happen as a result of Covid-19."

Bates also mentions ESG: "Eighty percent of our own and selected third-party ESG funds have outperformed the market over this period. And we'd expect that to continue."



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Credit Suisse created a UN Sustainable Development Goal aligned-fund with a third-party provider during 2019 that looks at the goal of responsible consumption and production.

"Now we see that we've been consuming more than we needed to, traveling more than we needed to, that theme has even more resonance," adds Bates.

Monier makes the point that investing sustainably automatically creates a style bias towards quality and growth: "Over the last few years, quality growth has outperformed and value stocks have been underperforming. Will there be a reversion? We don't think so. The uncertainty around the pandemic will only make quality growth more appropriate."

He also highlights China as a separate region: "China's share of global GDP is close to 20% yet it's not reflected in any benchmark, so we are looking to invest more in sectors there, such as tech and healthcare."

Consolidation

While wealth managers may be breathing a sigh of relief that their clients' wealth so far remains stable, there is a sense that this upcoming period will be more testing. The Covid-19 crisis has afforded many of the leading wealth managers the ability to gain market share – and it's all to lose if their advice proves to be wrong.

Monier says his firm "quickly developed the possibility to open accounts digitally" to capture the strong inflows it has been receiving.

UBS took in $11.6 billion in net new assets in the first quarter.

“The fact that we were able to help clients whose other banks were running out of capacity has meant a deepening of relationships and an increase in our market share,” says Stadler.

Philipp Wehle, Credit Suisse

Credit Suisse’s International Wealth Management division took in SFr3.7billion ($3.8 billion) in private banking net new assets. Philipp Wehle, chief executive of the division, says he expects an increase in market share to continue.

“When lockdown began, the management team came together, and we said we wanted to be as close as possible to our clients to understand how we could support their needs during this difficult time,” he says, “that now is the time to deepen the relationship. We’ve seen movements of clients to us and expect more to come on the back of the crisis.”

For many wealth managers lockdown has also provided them with the perfect opportunity to deepen relationships with clients.

“The average length of our client conversations is longer and there’s an ability to really share information because clients have more time and they are being more transparent,” says Bailin at Citi.

“The next call is on the hour or half hour, so there’s time to hear about their personal experiences as well as going into detail about their portfolios. It’s good for us as our relationship with them grows – and it’s also good for their portfolios.”

Bailin thinks the experiences of clients during this crisis could lead to consolidation of market share: “I would guess that clients will have fewer banking relationships. They want fewer, deeper relationships. During these periods you realize who is with you.”

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