Asset allocation strategies for global market risks management

The wealth management market is full of variables. Grasp the opportunities and you may create even more wealth; mismanage the risks and you may suffer loss. No matter how much investment experience or knowledge an investor is equipped with, there is always a chance of making a loss when faced with risks. So how should we manage assets in order to lower risk and increase the chances of winning? It may be a good idea to find out about the investment strategy that are persistently adopted by high-net-worth individuals (HNWI).[1]

High-net-worth investors' five major assets

Capgemini Research Institute, the in-house think tank[2] of the renowned global business management consultancy Capgemini, has been publishing a World Wealth Report for 25 years. According to its latest

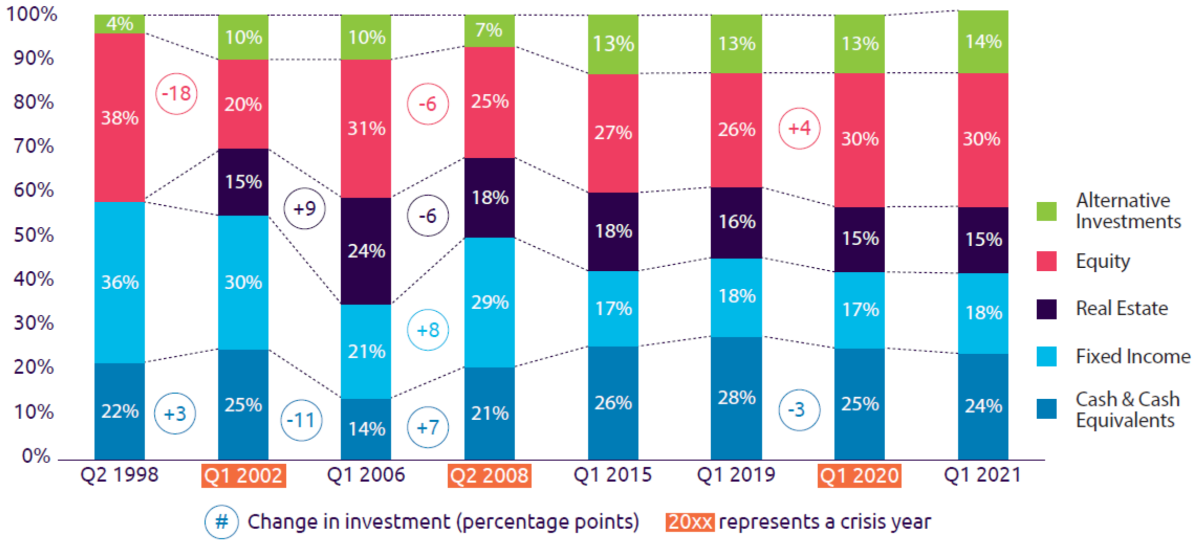
[1] https://www.capgemini.com/nl-nl/wp-content/uploads/sites/7/2020/07/World-Wealth-Report-WWR-2020.pdf
[2] https://www.capgemini.com/gb-en/research-institute/

Written and data source: The Money Coach, Mr. Alvin Lam

report, no matter how the market fluctuates, HNWIs always have five asset classes at the core of their wealth portfolios. They are:

Cash and cash equivalents	Fixed income	Real estate	Equity	Alternative investments

Allocation among these five assets is not fixed, but rather changes according to investors' sentiment. Percentages in Figure 1 show that over the past 20 years or so, among the HNWI respondents, equity took up 20-31% of their investments, followed by fixed income, at 17-30%. Cash and cash equivalents took up 14-28%, while real estate was 15-24%. Alternative investments had the smallest proportion, at 7-14%.



Note: "Real Estate" is included in "Alternative Investments" in 1998.

Figure 1: Global investors' allocation of five major assets

Source: Capgemini World Wealth Report 2021

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When the market sentiment is optimistic, aggressive assets can perform well, so equity can bring impressive income. But no one can tell when the market will take a U-turn. When the market is volatile, fixed income assets can bring stable income to meet essential outgoings. Since investment performance is usually cyclical, when an investment opportunity arises, investors may use cash to buy more of their preferred assets for a better chance of making a lucrative profit. Real estate and alternative investments provide additional investment options outside financial assets, but they take up a smaller proportion. Figure 1 illustrates the importance of balanced investing. To achieve better long-term gains like the HNWI investors do, we should learn to diversify assets, both in our mindset and in practice.

The “GROW” strategy for wealth management

If you want to understand your needs better as you invest and avoid following the crowd blindly, consider using the “GROW” model in planning and review.

“GROW” is an acronym for: “Goals”, “Reality”, “Options” and “Will”.

Goals

Before executing a plan, ask yourself what financial goal you would want to achieve at different stages of your life. Goals that are related to money must be tangible and can be measured by indicators. Otherwise it would be difficult to measure the progress.

Reality

Next, understand the limits around your individual circumstances and that of the investment environment. Don’t force yourself over your limit, and plan your defence strategy as you advance. It’s all about risk management: ask yourself whether you can deal with the worst-case scenario. If you don’t think through the reality as you start planning, the consequences could be disastrous.

Written and data source: The Money Coach, Mr. Alvin Lam

Options

Options of investment tools vary depending on individual objectives and circumstances.

In general, equities are aggressive assets. Investment in global stock markets can be made directly, or through funds or life insurance plans with savings element. Fixed income assets can generate stable income, such as investment grade bonds, annuities and life insurance policies with savings element. Regardless of the location, capital growth should always be the goal of real estate investment, because rental yield is not high.

Beyond traditional investment products, financial markets are always innovating. Investment opportunities and tools have emerged under today's virtual world concept. These are alternative investment tools that can be used to control risks.

Will

Once you have set your goal, you must follow on with perseverance and determination. Using different plans to achieve goals for different time frames will make it easier for the plans to be executed.

Deploying the GROW model for planning and review will certainly help investors increase their chances of achieving their goals

Understanding risks around "birth, old age, sickness and death"

Finally, don't forget about the importance of insurance as you allocate your assets. When it comes to risks about an individual and the family, they are very often concerned with birth, old age, sickness and death.

The "birth" of a new life comes with risks, and therefore the need for protection against illnesses the mother and child may suffer from during the pre- and post-natal periods. Population ageing is a global trend. To age gracefully and maintain a decent quality of life as life expectancy continues to rise, planning should begin as someone reaches middle age. This is what we refer to as "old age". Annuities have now become popular, as this type of financial product targets risks associated with longer life expectancy.

Written and data source: The Money Coach, Mr. Alvin Lam

No matter how careful you are or how close you watch your lifestyle, we all stand a chance for getting sick or being struck by an accident. Medical inflation has become a hot topic, and without suitable medical insurance, expenses related to “sickness” will continue to rise and eventually take a toll on the standard of living and wealth.

Some may think that as soon as they pass away, there is nothing for them to worry about anymore. But a pre-mature “death” with unfinished responsibilities will bring tremendous challenge to the lives and livelihoods of the surviving members of the family. Therefore, those with responsibilities and debts, especially breadwinners, must arrange sufficient life protection against the risk of pre-mature death.

In addition to helping manage risks, individual insurance products can also help increase the return of an investment portfolio while lowering overall investment risk.

Figure (2) uses the Efficient Frontier curve to show the change in expected return and risk after adding a life insurance policy with cash value to an investment portfolio. The Efficient Frontier theory was introduced by Nobel Laureate in Economic Sciences Harry M. Markowitz[3]. Investment always involves risk and return, and according to Markowitz, when an investor is faced with varying risk levels, there must be a set of portfolios that gives the maximum return for a given level of risk.

The theory points out that the Efficient Frontier curve is formed by investment portfolios that offer “the highest relative expected return for a defined level of risk” or “the lowest relative risk for a given level of expected return”.[4] Portfolios that sit right on the curve are in theory the optimal combinations. Meanwhile, a life insurance policy with cash value can shift the whole curve towards the left, effectively lowering risk and raising expected return.

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[3] https://www.cfainstitute.org/en/research/financial-analysts-journal/2017/harry-m-markowitz-profile-of-an-industry-leader

[4] https://www.investopedia.com/terms/e/efficientfrontier.asp#:~:text=The%20efficient%20frontier%20is%20the,for%20the%20level%20of%20risk

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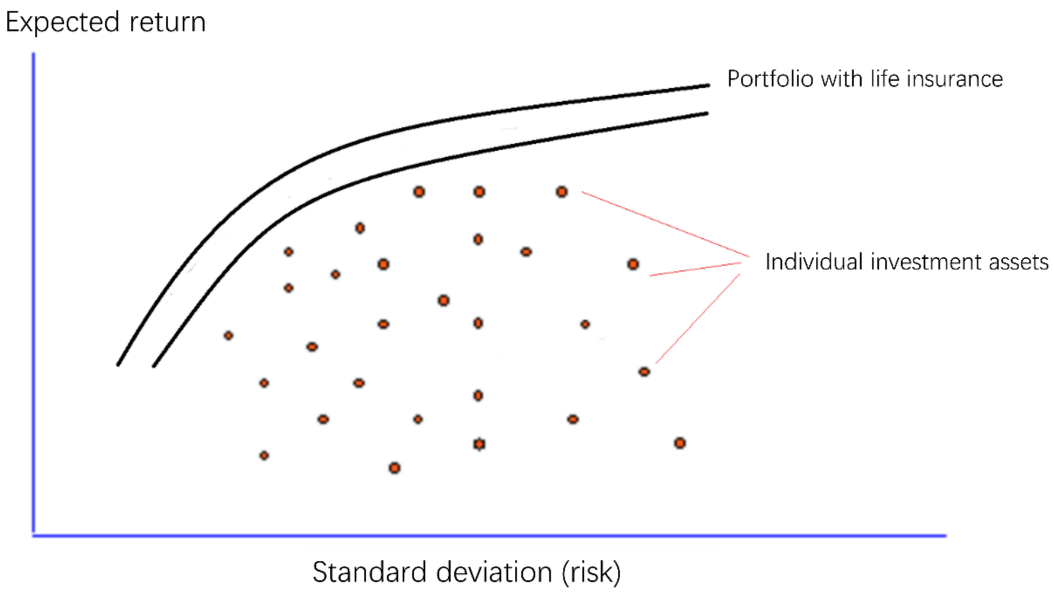

Figure 2: Effect of life insurance on the Efficient Frontier
Source: A book on money management "Four buckets of gold: Learn to invest speedily"

An investment consulting subsidiary of the funds analysis agency Morningstar has been commissioned to conduct a research that has led to the finding that allocating life insurance with savings element to an investment portfolio may increase the expected return while lowering risk.

In that research, the team set up two investment portfolios: a hybrid assets portfolio consisting of fixed income and equities, and another hybrid assets portfolio with some of its fixed income proportion replaced by life insurance. The proportion of equities remained the same across the two portfolios. It was found that when the ratio of cash value of the life insurance against total assets increased to 20%, the expected return of the overall investment portfolio increased by 0.26%, while the risk went down by 0.45%. You can find out more about this research in the book "Four buckets of gold: Learn to invest speedily".

The research shows that when we choose our investment tools, we cannot simply aim at high return, believing that only high return can bring maximum profit. The truth is, appropriately adding some tools that bring stable income to the portfolio will potentially bring even higher expected return and lower risk. This is an important effect of diversification.

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Conclusion

Using the GROW model to plan and review investment portfolios, taking out insurance protection against risks surrounding different stages of birth, old age, sickness and death, and appropriately allocating your capital to the five main asset classes according to what you can afford, coupled with discipline and reviews, even in an everchanging global market, it is still possible to increase your chances of achieving your goals in life.

Written and data source: The Money Coach, Mr. Alvin Lam