Investors should continue to favour equities over fixed income

10 investment ideas for 2018

2018 is the Year of the Dog but it doesn't mean you have to bury your assets under the ground to save its value for later. Instead, unearth these investment ideas and learn the hacks on how to grow them.

The incoming year will not be as vibrant as 2017, said **Christian Nolting,** global chief investment officer and global head of DPM, Deutsche Bank Wealth Management. "Volatility will probably rise from current very low levels and risky asset prices may not rise as fast as they did in 2017," he said. "Domestic political risks remain in the US and Europe, as well as geopolitical risks around the world." But global economic growth, Nolting added, will continue to pick up, and will reach about 3.8% in 2018. "We remain broadly optimistic," he noted.

Hong Kong Business rounded up the most promising investment opportunities and listed some life hacks to guide investment decisions based on investor outlooks and conversations with industry experts and observers. These range from focusing on the potential of technology to provide solid returns to the importance of understanding diversity and balance in investments. The usual caveat applies, here at *Hong Kong Business* we don't have a crystal ball and merely gathered ideas from the experts. If we have a crystal ball, we'd give up publishing and just be professional investors. Nevertheless, here are 10 investment ideas to bark at in 2018.

1. Equities

Equities will continue to be a preferred investment option, according to **Ricky Tang**, product manager, multi-asset, Schroders, as the global market continue to stabilise and pile on the upward trajectory seen over the last 12 months, and giving plenty of reasons for stock investors to cheer for next year. "Equities remain our preferred asset class, which should continue to deliver positives returns in 2018," he said. "As equity valuations are not cheap, returns are likely to come from earnings growth rather than multiple expansions in the future."

Investors should continue to favour equities over fixed income, with equities expected to continue providing opportunities in 2018, even after this year's gains.

Nolting also shared that at a general level, investors should continue to favour equities over fixed income, with equities expected to continue providing opportunities in 2018, even after this year's gains. At the time of writing, for instance, the MSCI AC World had hit 68 record highs in 2017, the most on record.

"But earnings growth will be key, as price/earnings and other valuation multiples start to move down from elevated levels. With generally lower returns likely than in 2017, selectivity between sectors and between geographies will be important in 2018," the Deutsche Bank Wealth Management senior official reckoned.

Currently, earnings of global equities are expected to grow at 7% in 2018, with global financial services firm Credit Suisse also saying that the continuing bullish outlook of financial markets—particularly that of the US—will spill over to next year, for instance, S&P 500 will likely rise 13% by year-end 2018, according to the firm's latest market strategy report. This positive outlook on global equities growth, according to Tang, is supported by the strong cyclical environment of steady growth and subdued inflation pressure. "Within equities, we believe better opportunities lie in markets with cheaper valuation and stronger growth potential," he said.

This is echoed by **Arthur Kwong**, Asia Pacific head of equities for BNP Paribas Asset Management, particularly noting the well-performing Asian equities since January as a good condition for what's to come in the next 12 months, although a slight moderation is expected towards the end of the year. The cushioning factor is mainly driven by earnings revisions and currency appreciation, more so than higher valuations.

Dr. Jasslyn Yeo, global market strategist at J.P. Morgan Asset Management, said in a statement that whilst equity valuations are high, they expect these instruments to stay elevated for some time, with preference to cyclical and financial sectors.

2. Focus on technology

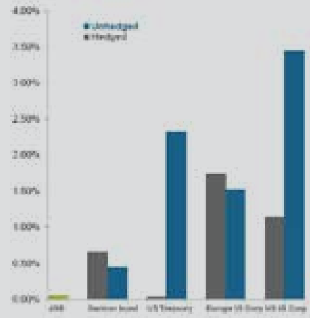
In this day and age where everything is and technology-driven, it is not a surprise that banking on technology—in stocks, shares, crowdfunding, etc.—continues to be a hot investment opportunity year in and year out.

Brendan Mullhern, global strategist for Newton Investment Management, said that sharing in the growth story of technology startups and groups that pushes the boundary of technology in the market space is an example of a smart investment decision.

"The potential disruption created by this trend creates great opportunities for new businesses and existing ones that adapt to the new openings," he said, adding that technologies should branch out beyond the consumer sector for it to reach its full (earnings) potential.

This is a particularly important aspect for investors in Hong Kong given its proximity to Shenzhen in mainland China—considered the Silicon Valley for hardware—where technology startups are blossoming out at a rapid pace. Such proximity offers an array of opportunity for investors to invest in promising technology businesses that are yet to hit the mainstream market, and for these startups to have a global exposure in the fast-paced environment of Hong Kong. "As the potential corporate applications of these innovations become clearer, there is broad scope for companies to reverse this trend [on focusing on the consumer sector]," Mulhern reckoned, citing companies including Microsoft, Cognizant, and SAP—all of

10Y Bond yields from a Japanese investor's perspective*



Source: Bloomberg Finance L.P., J.P. Morgan Asset Management.

Christian Nolting

Ricky Tang

Arthur Kwong

which provides enterprise technology and consulting services—could be a starting point for people looking for technology companies to invest in.

Nolting also added that there should be a keen interest and following on the tech industry in Asia that's ripping through silos and records every single year, given that majority of the hardware—and increasingly software—in today's tech markets are coming from the continent.

"We remain keen on technology and also on Asian emerging markets, in part due to its tech component—but economic fundamentals are also likely to support equity markets in this region too," he mentioned. "Asian equity markets seem likely to outperform most developed markets next year. We have an existing High Conviction Idea on Chinese equities."

3. Materials, industrials, and financials

Beyond technology, however, there lies several sectors that are making a comeback. **Robert Rountree,** global strategist, Eastspring Investments, shared that the long ignored cyclical sectors of materials, industrials, and financials are swinging back into favour, especially in Singapore where the finance industry remain robust and resilient amid movements in the global economy.

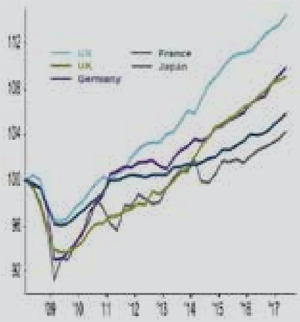
"Remove the technology stocks, which rallied strongly, and good to deep value is to be found elsewhere in both developed and emerging Asia including Japan," he said. "As valuations in these sectors are still mostly low, there is plenty of potential upside."

This bullish outlook for all three sectors have been steadily gaining ground over the last few quarters, although their strong performance remains overshadowed by trendier momentum on sectors like information technology. Bloomberg's Global Market Asia Index, for instance, shows significant year-to-date growth on financials at 18.48%, industrials at 23.61%, and materials at 25.85% for the rest of Asia.

4. Keeping an eye on emerging markets in Asia

Perhaps one of the most enduring economic stories over the past decade is the economic rise of developing Asia, and betting on this trend will remain to be a smart investment decision for 2018. Kwong shared that Asian equities have outperformed larger markets globally this year, particularly with the performance of China, South

Real GDP growth comparison



Source: FactSet, OECD, J.P. Morgan Asset Management.

EM currencies vs. U.S. dollar

Source: J.P. Morgan Asset Management.

Korea, and India.

Florence Tan, head of advisory – strategy & multichannel communications at Citi, shared that whilst uncertainty over the next US Federal Reserve Chairperson and faster than expected US rate hikes could lift market volatility, corrections in emerging markets can be viewed as opportunities given the robust global growth outlook and attractive valuations.

"Emerging market equities continue to trade near a record 40% valuation discount to the US," she said. "In Asia, 6.5% yields of local currency Indian bonds are among the most attractive in the region, supported by the country's longer term economic turnaround."

Mulhern, however, said that there is little guarantee that flows into emerging market assets over the last 18 months will stick around if global financial and economic conditions start to deteriorate, particularly next year. "It is likely that global growth and global financial conditions have peaked, which we believe warrants a reduction in emerging market assets over the next year," he said. "On fixed income, we have grown increasingly cautious during 2017 as corporate spreads have rallied to close to our 12-month targets. I don't think that we are likely becoming markedly more optimistic on this asset class in 2018," Nolting said, adding that there may obviously continue to be interesting areas in this asset class, particularly within emerging markets debt (which should benefit from a continued pick-up in economic growth combined with generally low levels of inflation), but this may not be the place to focus your investments in.

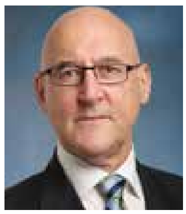
5. Keeping tabs on China

China's spectacular rise in becoming an economic powerhouse has tapered off, with growth continuing to average 6% to 7% over the last few years compared to 14.2% growth domestic product (GDP) growth rate a decade ago. However, experts are still saying that banking on Chinese industries and activities remains a smart investment decision to take, especially when it plays such a big role in the modern global economy.

"Increased rigour in risk mitigation ahead of top-leadership changes in Q4 are crucial for Beijing to preserve economic, social, and political stability," said Kwong. "Stability in China should allow for a stable year for Asian equity markets."

Tan also shared that the Chinese government's

Brendan Mulhern



Robert Rountree

Dr. Jasslyn Yeo

willingness to institute reforms and institutional changes have been showing results. "Key emerging markets including China has shown far more structural reform progress than many investors expected this year." This is something that Hong Kong, with its proximity—both geographical as well as cultural—to mainland China, can leverage and take advantage of.

6. Taking another look at Japan

Japan's lacklustre economic performance over the last couple of years after becoming a developed economy many decades ago may have erased it from the map of investment opportunities of investors. But Rountree shared that Japanese equities is providing a window of opportunity once again.

With investors still seemingly fixated on the success or otherwise of Abenomics, with the equity market falling and rallying on the ebbing and flowing of the confidence tide, Rountree said that investors are missing the tremendous improvements that are taking place at the corporate level—pushing Japanese companies to have some of the world's best cash earning yields.

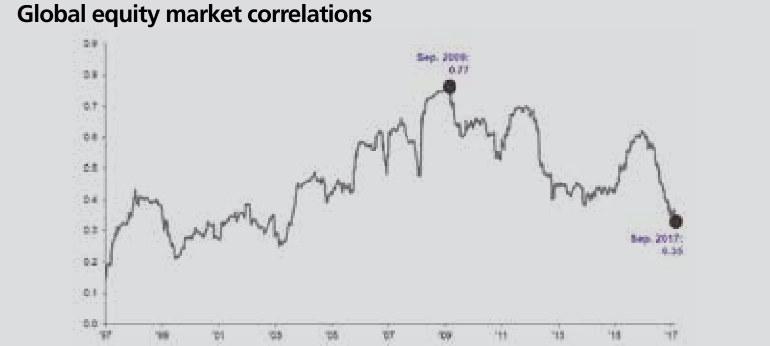
"Stronger cashflows are allowing Japanese companies to repay debt, raise dividends, and, more recently, to also embark on share buyback schemes," he said. "Japan was not immune from the run to safety fears that impacted the rest of the world several years ago. Thus, Japan's cyclicals look very attractive especially the financials. Unlike elsewhere, Japan's technology stocks still look attractively valued."

7. US$ to regain some shine

The US dollar was a mixed story in 2017. At the start of the year, there were reasonable expectations that the US dollar would make further gains on the back of a recovering US economy, further rate hikes from the US Federal Reserve, rising inflation, and President Trump's pro-growth policies. However, a combination of crowded dollar positioning, falling US inflation, a lack of pro-growth policies from the White House, and better global growth compared to the US economy has underpinned dollar weakness this year.

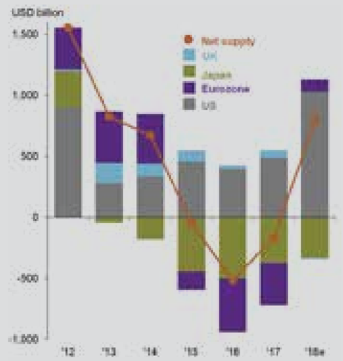
Coming from this position, Mulhern shared that going into 2018, there is a strong case that the dollar has scope to appreciate. "The decline of the trade-weighted dollar over the first three quarters of 2017 was the largest on record. On this basis alone, further declines are likely to

Global equity market correlations



Source: Factset, MSCI, Standard & Poors, J.P. Morgan Asset Management.

Global government bond net supply



Source: Copyright 2017 Morgan Stanley. 2017 and 2018 are estimates.

be limited," he said, adding that the US dollar is poised for further gains with global economic momentum likely to have peaked and the US Federal Reserve poised for further hikes. Nolting also mentioned that the U.S. dollar has recently recovered against the euro and yen and he thinks that further U.S. dollar strengthening is possible.

8. Diversify to EUR and CAD

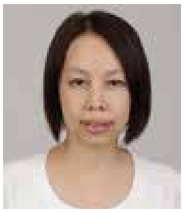
Despite the bullish outlook of Mulhern regarding the US dollar, Tan shared that the American currency has peaked, with Citi expecting it to move lower given the persistent current account and fiscal deficits and rising net external debt. Historically, multi-year rallies of the US dollar have also been driven by different factors—from a very strong US economy, a technology boom, to underperformance in economies elsewhere in the world—none of which is currently happening.

"Citi's preferred currencies in 2018 include the euro and the Canadian dollar," Tan said, explaining that the euro is expected to be supported by attractive valuations, a large current account surplus, and the cyclical recovery in the eurozone, whilst the Bank of Canada is expected to raise interest rates again given strong output and labour market activity.

9. On higher-yielding bonds

Although global central banks are talking about pulling back from the quantitative easing programs, the growth in liquidity is unlikely to reverse any time soon, according to Rountree. The US Federal Reserve has started to withdraw money as bonds on its portfolio mature but not only is the pace slow, but it has also signalled it will inject cash into the system again should it make a policy misstep. Where the US Federal Reserve goes, others will follow.

"The case for holding bonds for yield thus remains intact but that yield is to be found in the higher risk and longer duration bonds. On this basis, US high yields and Asian bonds (both local and US dollar) look attractive," he said. "Asian local bonds look attractive as the US dollar is expensive and should weaken on a longer-term trend basis. Rising interest rates, however, could generate spurts of US dollar strength which could provide buying opportunities for Asian local bonds."



Florence Tan

Yan Pu

10. Gunning for diversity/balance

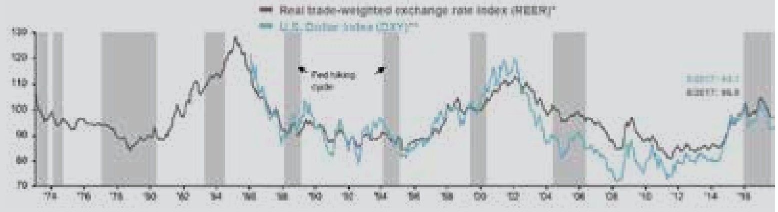
As with any investment opportunity and decision, there is a saying that we shouldn't put all our eggs in one basket. There is a need for diversity and balance on the kind of investment opportunity we're grabbing and balancing the risk that we're exposing ourselves into.

According to Rountree, with bond's long term rally finally petering out, investors have been running towards both higher risk bonds and equities in search of higher returns. "The trick is in balancing these two factors," he said, adding that in 2018, we should expect to see a further run into both higher risk and duration bonds—despite the possible rise in interest rates—and into equities. In terms of investment behaviour, **Yan Pu**, head of portfolio review for Asia at Vanguard Investments Hong Kong, shared four investment philosophies that would provide investors a better chance of success: set an investment goal; build a balanced portfolio; stay disciplined; and be mindful of the investment cost. "Vanguard believes that cost is one of the few controllable factors in today's dynamic market. Every penny you save in cost will eventually contribute to the return of your investment portfolio," she said. Pu shared that it is very important for investors to hold a global perspective despite their local bias, for example of investors in Hong Kong, and build a balanced portfolio that diversifies risk exposures appropriately.

Bonus: Sectors likely to silently make gains in 2018

As a bonus, we're adding some more sectors that may likely provide investment gains, according to Nolting. These are infrastructure, cybersecurity, global ageing, and millennials."These secular trend themes have done well year-to-date and are intended to complement shorter-term ideas in a portfolio. As recent cyberattacks have shown, cybersecurity is a rapidly growing problem which will demand substantial private and public spending to counter. Opportunities could also be provided by merger and acquisition activity in the cybersecurity sector as it grows and consolidates," he said. Nolting concluded by saying that infrastructure will also require major spending in the coming decades, particularly in the emerging markets. "Global ageing has impacts well beyond healthcare, for example, on insurance and other financial services. The spending patterns of millennials are already a focus for investors, given millennials' interest in consumer technology and lifestyle spending," he said.

US dollar performance



Source: FactSet, J.P. Morgan Asset Management; Bloomberg Finance L.P., U.S. Federal Reserve