The Covid-19 pandemic has accelerated structural trends and triggered fiscal and monetary policies on an unprecedented scale. As a result, the low interest rate, low-growth and low inflation environment will persist. Investors need to access opportunities that will generate more attractive returns, without compromising the risk that they are willing – and able – to take.

The crisis has profound implications for portfolio returns. Ten-year government bond yields in developed markets, for example, are now trading at historically low levels (see chart 1). For this reason, we are implementing a series of changes to the strategic asset allocation (SAA) approach that we use to structure our clients’ portfolios. This takes account of central banks’ interest rate commitments and asset purchase programmes, as well as government fiscal stimulus injections to support their economies and infrastructure projects.

Our SAA, regularly reviewed, aims to enhance portfolios’ performance by improving the quality of our estimates and the robustness of our construction and asset allocation tools. This approach is fundamental to successfully investing a multi-asset portfolio over a full business cycle.

1. All developed market rates are trading sideways since the Covid crisis

<table>
<thead>
<tr>
<th>10-year yields, in %</th>
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</thead>
<tbody>
<tr>
<td>01.16</td>
</tr>
<tr>
<td>US</td>
</tr>
<tr>
<td>Germany</td>
</tr>
<tr>
<td>Japan</td>
</tr>
<tr>
<td>Switzerland</td>
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</tbody>
</table>

Source: Bloomberg

Key takeaways

- The pandemic has changed the investment landscape with unprecedented fiscal and monetary support
- Our newly updated strategic asset allocation reflects the new economic and geopolitical environment
- Investors need to look beyond their traditional portfolio allocations to capture returns
- Three areas – a standalone China allocation, thematic value and private markets – offer growth and investment opportunities.

Important information: Please read the important information at the end of the document.
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Data as of 24 August 2020 unless otherwise stated.
Lombard Odier · CIO Viewpoint · 24 August 2020
Specifically, we see three major asset allocation themes driving investment decisions: treating China as a stand-alone investment, thematic investments targeting specific trends and private markets to capture otherwise hard-to-access value. Each has a role to play in building resilient and reactive portfolios.

**Stand-alone China allocation**

China’s management of the Covid-19 crisis allowed its economy, now the world’s second largest, to recover more rapidly than many other nations. The Chinese economy now represents 16% of gross domestic product globally. However, this is not yet reflected in the world’s financial markets. China is in the process of being added to a number of benchmarks and currently accounts for just 5% of the world’s equity markets (see chart 2) and 5.3% of the value of the Bloomberg Aggregate Global Bond Index, for example.

We believe that the time has come for investors to make a specific portfolio allocation to this enormous, and growing, market.

China is implementing structural reforms aimed at re-shaping its economy and reinforcing its geopolitical leadership. As the country evolves into a domestic-driven, service-led economy with technology champions, it is creating growth and investment opportunities, including more focus on sustainability. The country is also opening its economy to align with global capital markets, transforming the investment landscape for domestic savers and encouraging foreign inflows. China is already home to two of the ten-largest companies in the world by market value, Alibaba Group and Tencent.

Geopolitical competition between the US and China seem certain to continue, whoever sits in the White House in January 2021. If mutual suspicions and rivalry do persist, we believe that it is possible that the world’s only two superpowers will diverge as they seek separate solutions to technological problems.

This possibility reinforces our conviction that a stand-alone portfolio allocation to Chinese assets, rather than a broad exposure to China through traditional emerging markets benchmarks, will soon be both logical and essential.

**Capturing thematic value**

The Covid-19 pandemic is one of a series of global structural changes including demography, climate change and digitalisation. These ‘megatrends’ are profoundly affecting our societies, landscapes and economies.

These trends present both risks and opportunities. It is only by looking beyond a traditional geographic or sectorial approach that we can take advantage of themes. In recent months, we have focused on climate change and companies transitioning towards a cleaner economy. However, the Covid-19 pandemic has also underlined the need to address supply chain bottlenecks, the most important actors in the virtual economy and demands for more inclusive societies.

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2. **Treating China as a stand-alone allocation in client portfolios to reflect the nation’s economic and geopolitical weight**

<table>
<thead>
<tr>
<th>Current share of global GDP – 2020</th>
<th>Composition of global stock market</th>
</tr>
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<tbody>
<tr>
<td><strong>World Bank - 07/01/2020</strong></td>
<td><strong>MSCI ACWI - 31/07/2020</strong></td>
</tr>
</tbody>
</table>

**China**16%  
US 25%  
China 16%  
Japan 6%  
Germany 5%  
France 3%  
Italy 2%  
Russia 2%  
Brazil 2%  
Others 33%  

**China**5%  
US 58%  
Japan 6%  
Germany 2%  
China 5%  
UK 4%  
Brazil 1%  
India 1%  
Italy 1%  
Russia 0%  
Others 19%

Sources: World Bank, MSCI
In addition, the European Union’s recovery plan, which focuses on greener mobility, hydrogen energy and the transition to a ‘Clean, Lean, Inclusive and Circular’ (CLIC) economy, will drive evolution. While regulations and consumers have jointly pushed this package, the EU’s ‘Green Deal’ will generate private-sector solutions, facilitating a transition that can offer future investment returns.

**Broadening investment horizons**

This is one example of governments around the world increasing spending on, or sponsoring, infrastructure projects. From public health and more sustainable transport networks to communications technologies, many sectors are either transitioning to greener solutions, or creating new technologies to respond to the climatic challenges that we face.

As a result, investors will need to be more open minded and look beyond their traditional allocations when searching for opportunities.

Increasingly, many large private firms are relying on private venture capital, before floating on public markets. While there are still opportunities to invest in companies in the public markets, much of the value creation can be captured by private market investors, including through venture capital funds. These also offer opportunities in companies that are developing technological advances to disrupt more traditional industries.

Finally, in the search for alternative sources of yield, we are adding a real estate component to all of our portfolios and extending the duration of our exposure to sovereign debt. In addition, we are adjusting portfolios to increase their exposure to international assets, and away from the traditional home-market bias that can undermine performance. We also add a strategic exposure to gold to increase diversification and as a hedge, within our portfolios.

By actively broadening our investment opportunities, we can build attractive returns into our clients’ portfolios while adapting their investments to an evolving world. We are positioning clients’ portfolios today for the investment opportunities of tomorrow, all without increasing risk nor compromising on quality.
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