Investing in a low yield world

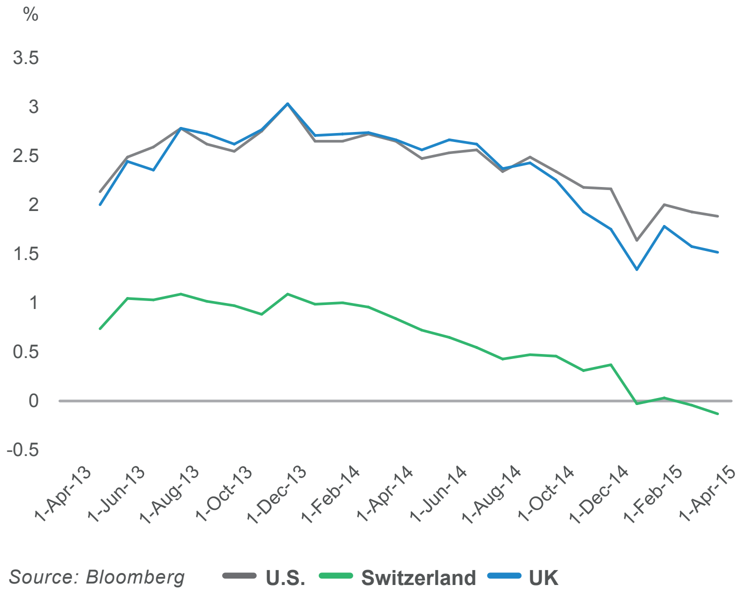
"The first rule is not to lose money. The second rule is not to forget the first rule."
Warren Buffet

In what is without a doubt a historical landmark, the Swiss Central Bank auctioned 10-year sovereign bonds with a negative yield on 8 April 2015 (Figure 1). This is probably the first time investors actually paid for a government to take their money for such a long period. In addition, many euro zone government bonds are trading at negative yields; the German government previously sold 2-year and 5-year bonds at auction with negative yields. The yield on the 30 year US Treasury bond is at the lowest level in the history of the United States (2.44%)!

The flight of investors to the bond market – which has driven bond yields down across the developed world economies – is mainly driven by fears of deflation and the European Central Bank's 1 trillion euro bond purchase scheme launched last month is accelerating the process. The Brookings-FT TIGER index, a set of composite indexes that track the global recovery confirms that the world economy is characterized by stagnant low growth, risks of deflation, and weak consumer and business confidence. Given this outlook, expectations for an interest rate hike by the Central Banks are very low (either in Europe or in the US).

For investors, the practical significance of the low yield fixed income world is that they need to look for returns in other markets. As indicated by the performance of the MSCI world index (EUR) in Figure 2, the global equity markets are in their 5th year of robust positive growth and while fears of a "correction" are growing, specific segments of the equity universe represent great diversification tools and income generating opportunities. One such segment is the dividend paying large caps in both the US and Europe, and the easiest and safest way to access this opportunity is through exchange-traded funds (ETFs) that invest in a large number of such stocks across countries and industries.

Figure 1 **10-Year Government Bond Yields**



Source: Bloomberg

By always maintaining a diversified portfolio of investments, investors can avoid unnecessary exposure to (investment specific) non-systematic risk and achieve higher returns for the same level of risk. Efficient diversification at a global scale takes diligent research, disciplined monitoring and rebalancing and efficient execution. For most investors, this level of protection through extensive diversification is almost impossible to achieve due to size and access constraints and costs.

At Emergo Wealth, we developed a range of globally diversified investment portfolios that enable people to achieve their financial goals in a way that is consistent with their individual risk appetite. The portfolios are diversified based on risk factor analysis, rather than just asset class. We look at what economically is driving the return in each asset class and in each product and we use maximum drawdown as a key metric for manager selection. Risk mitigation is achieved through the investment in high quality assets and through a dynamic search for negatively correlated assets. The LifeGoals Investments portfolios offer retail investors easy access to comprehensive risk-adjusted strategies that meet their individual goals. The portfolios offer supreme value to investors by following a tax-efficient asset allocation strategy, by utilising cost-efficient products, like ETFs, and by always maintaining the proper allocation through disciplined rebalancing.

Figure 2 **MSCI - All Cap World Index**

Source: MSCI

Emergo Wealth Research Department

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