Oreana
PORTFOLIO ADVISORY

Sustaining returns for the future: Oreana's 2021 Medium-Term Global Outlook

FEBRUARY 2021

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Executive Summary

The global economy entered recession in 2020. The Covid19 pandemic resulted in a sudden stop in global economic activity. Central banks cut policy rates aggressively and governments implemented fiscal support packages. Widespread lockdowns persisted through the year and investors looked forward to the fastest-developed vaccine in history. Through all of this, asset markets suffered a sharp correction before recovering rapidly.

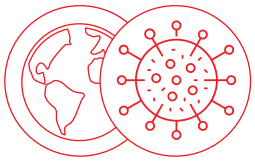
We recommended in 2020 that investors should prepare for a shock, review the resilience of their portfolios, and position to reduce surprises. Investors who did so experienced strong risk-adjusted returns over the year.

We think 2021 represents the start of a new economic cycle. The outlook, as ever, is uncertain. We know investing naturally involves taking on risk. We believe investing should focus on adding value through the medium-term. In 2021, we turn our focus to sustaining returns for the future.

Sustaining returns for the future means being aware of a range of plausible economic scenarios over the medium-term. And using those scenarios to stress portfolios to reduce unintended risks. Sustaining returns for the future also means identifying significant themes that will have a material impact on medium-term potential returns. Our 2021 Oreana Medium-Term Global Outlook considers these key themes and makes a range of recommendations that we expect will help deliver sustainable medium-term returns.

Implementing any of these recommendations is a good starting point for asset allocators and investors. Implementing all of them is challenging and likely to be part of a journey that could take some years. The Portfolio Advisory Service Team is available to help with that challenge, manage the risks and implement actions required to deliver future-proofed portfolios.

A review of economics and markets in 2020



Economic turmoil caused by a global pandemic

- ***A sharp, short contraction.*** Global growth entered recession in 2020 (Figure 1). The Covid19 pandemic spread rapidly throughout the world (Figure 2). Governments enforced economic lockdowns and self-isolation practices. The result was a sudden stop in economic activity.

  Major developed economies saw rising job losses in Q1 and Q2. The services sector was hit particularly hard. Global travel effectively ceased as governments tried to control the spread of the pandemic.

  Emerging markets suffered as cyclical parts of the economy including tourism stalled. China enforced a strict and widespread lockdown. China's economy contracted sharply in Q1. But China was quick to reopen and experienced a V-shaped recovery in parts of its economy. China ended 2020 with positive economic growth for the calendar year.

- ***Monetary policy was eased aggressively.*** Global central banks eased monetary policy aggressively to support the economy through the worst of the pandemic. The US Federal Reserve cut the Fed Funds rate quickly to 0.25% and implemented quantitative easing. The Fed also made commitments to buy corporate credit to ensure proper functioning of financial markets. Other major central banks followed with their own easing measures.

- ***Government support was critical for the recovery.*** Global governments were quick to implement fiscal support packages for their economies. The packages were typically large, broad and aimed at mitigating the impact of widespread job losses. Fiscal support packages helped to prevent major cuts in household incomes in developed economies including the US, UK, Europe and Australia. In some cases, several support packages were released. These measures were left in place longer than originally intended.

- ***Capital market outcomes recovered over the year.*** Despite the economic turmoil, most global equity markets ended 2020 higher. But equity markets suffered a brief, deep collapse in March as economic activity stopped (Figure 3). During the worst of the market volatility, credit and fixed interest markets seized up, yields surged higher, and credit spreads widened.

  The catalyst for the sharp recovery in equity markets was the combination of big declines in interest rates, significant fiscal policy support, and growing optimism that a vaccine could be quickly developed for Covid19. Earnings growth fell sharply but markets were willing to look through the collapse to an economic recovery over the medium-term.

Market returns in the context of our 2020 Medium-term Global Outlook

Our 2020 Medium-Term Global Outlook recommended focusing on portfolio resilience. Resilience is mitigating downside risks. But it is not just adopting a defensive bias. It includes participating in the upside.

We recommended this because we expected a recession to take place in 2020. We got that recession. But not for the reasons we expected.

This is important. Our portfolios were prepared for downside. But we were focusing on resilience. We were ready to participate in the upside post-recession.

In the scorecard in Figure 5, we have laid out the 4 recommendations and 10 actions from our 2020 Medium Term Outlook. The Commentary column provides the key concept from the Outlook.

We have assessed the actions against actual economic and market outcomes. We include some context from the discretionary (managed account) portfolios that we make available to clients in Australia and Hong Kong.

FIG 1: GLOBAL QUARTERLY GDP GROWTH SUFFERED A SHARP CONTRACTION IN EARLY 2020.

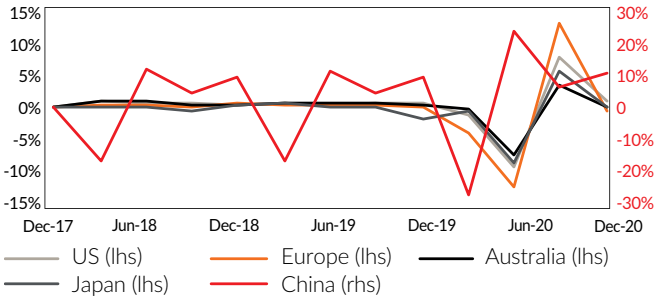


FIG 2: GLOBAL COVID19 CASES INCREASED RAPIDLY DESPITE WIDESPREAD LOCKDOWNS.

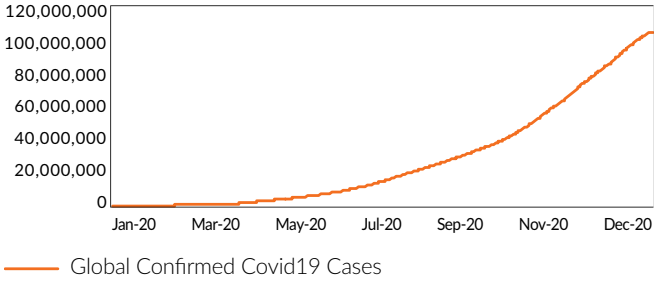


FIG 3: EQUITY MARKETS COLLAPSED BUT RECOVERED RAPIDLY OVER 2020 (REBASED TO 1 JAN 2020).

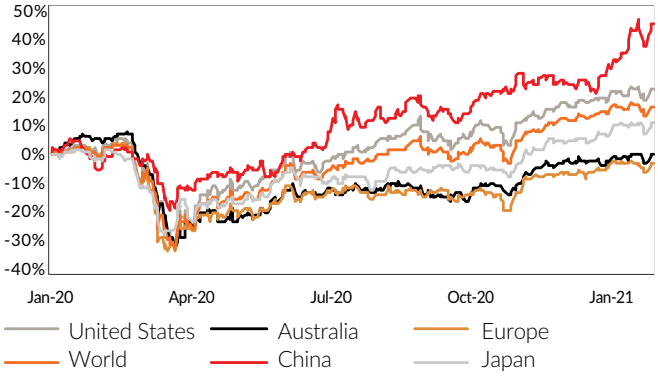


FIG 4: RETURNS WERE HIGH ACROSS MOST ASSET CLASSES IN 2020.

	1 yr (%)	3 yr (% p.a.)	5 yr (% p.a.)
US Cash	0.5%	1.6%	1.3%
Investment grade gov't bonds	9.5%	4.8%	4.7%
Global corporate bonds	10.4%	5.9%	6.2%
Developed world equities	14.1%	8.5%	10.1%
Emerging market equities	15.8%	3.7%	10.2%
Alternatives	11.7%	5.5%	6.1%

Source: Bloomberg LP, Oreana Financial Services

2020: We improved resilience and reduced surprises

Our 2020 Medium-Term Global Outlook provided a clear set of recommendations that were very useful for portfolio allocators and investors through 2020.

Implementing each of the recommendations was challenging. But implementing all of them was transformative for portfolio returns in 2020.

We were able to protect on the downside. Our reduced allocation to equities in early 2020 meant that performance was cushioned in the March drawdown.

Importantly, the Medium-Term Global Outlook recommendations meant we were ready to reallocate to equities during the upside.

In a year that contained significant challenges for asset allocators, our 2020 Medium-Term Global Outlook provided a roadmap that helped improve resilience, reduce surprises, and deliver strong risk-adjusted returns.

FIG 5: SCORECARD FOR OUR 2020 MEDIUM-TERM GLOBAL OUTLOOK.

Medium-Term Outlook view	Commentary	Assessment
	Improve portfolio diversity	
Review exposure to risky assets	Reducing equity exposure but not removing it could improve portfolio resilience.	Our lower allocation to equities in March resulted in a smaller drawdown relative to the market.
Review exposure within asset classes	Small but meaningful adjustments to investment grade credit allocations could improve resilience.	We reduced most of our exposure to corporate credit in late-2019 and allocated to high quality sovereign debt. This provided considerable support during early 2020.
Consider alternatives within the portfolio	Alternatives with lower risk could enhance resilience during market turbulence.	Our defensive alternatives had limited correlation with equity markets even during March, helping to cushion portfolio drawdowns.
	Review portfolio risks	
Identify and manage liquidity risks	Specific asset classes including credit can become illiquid and subject to volatile price shifts lower.	We had almost no exposure to high yield corporate debt, which became very illiquid in March 2020.
Use scenarios to qualify resilience	Building a range of scenarios to stress the portfolio can lead to more resilient portfolios.	Our scenario analysis helped us identify a better economic outlook from April, allowing us to add risk and participate in the upside.
	Dynamically manage macro exposures	
Be wary of conditional correlation.	Lower quality bonds do not provide downside protection. Focus on sovereign bonds to improve portfolio resilience.	Our fixed income allocations were largely to sovereign bonds. These assets were important in protecting on the downside in early 2020.
Reduce risk now to increase later.	Reduce equity risk now, to increase exposure at better valuations.	We started to increase allocations to equities from mid-March 2020, moving to a significant overweight position from June.
	Reconsider manager selection	
Be discerning in alternative exposure.	Some alternatives can improve portfolio resilience during market cycles.	We avoided major blowouts from our alternatives, with many delivering positive returns through February, March and April.
Don't forget fixed income.	Portfolio resilience can by improved by allocating across alternative credit and sovereign debt strategies.	Our alternative credit and sovereign debt allocations were important in preventing large drawdowns, providing a strong base to reallocate to equities.
Be style aware.	Blending different styles appropriately can improve resilience during challenging markets.	Our focus on quality equities in early 2020 was helpful in March. We moved to a value bias in August, capturing some of the rotation from growth that took place in Q4 2020.

A review of Australia in 2020

Recovery delayed, but not indefinitely.

- ***A short, sharp recession with a gradual recovery.*** GDP growth collapsed in Q2 as the Australian economy was largely shutdown. Interstate and international travel all but ceased, and the services sector struggled with the impact of widespread lockdowns.
- ***The RBA and the government provided powerful economic support.*** The RBA quickly cut the cash rate to 0.25% and delivered further cuts to 0.10% through the year. The RBA also started quantitative easing, adding further support to the banking system. The government provided significant fiscal support that helped to cushion the impact on household incomes. But extended lockdowns meant the recovery was somewhat weaker than other developed economies.
- ***House prices recovered as monetary policy worked through the system.*** The RBA's rate cuts supported a recovery in house prices that defied most forecasts for a house price collapse.
- ***Australian equities recovered after March.*** Australian equity prices fell in March but began a gradual recovery to end the year largely unchanged in terms of price. Government bond yields were lower, reflecting the lower cash rate. The AUD – which weakened during the worst of the Covid19 pandemic, appreciated rapidly to end the year higher versus the USD.

FIG 1: THE UNEMPLOYMENT RATE SURGED AS AUSTRALIA ENTERED A SHORT, SHARP RECESSION.

FIG 2: THE RBA CUT RATES AS INFLATION REMAINED BELOW THE 2%-3% TARGET RANGE.

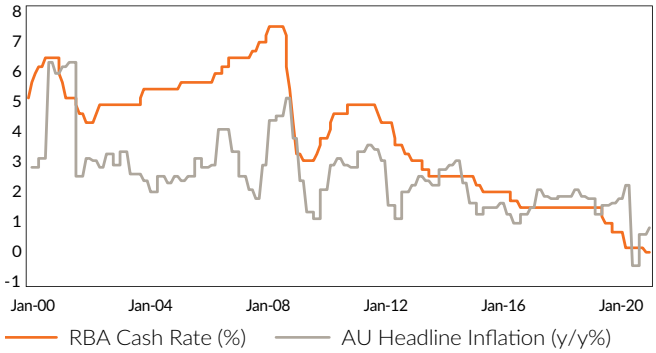


FIG 3: HOUSE PRICES RECOVERED AS MONETARY POLICY WORKED THROUGH THE SYSTEM.

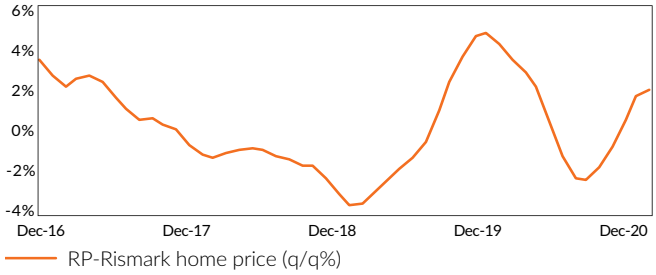
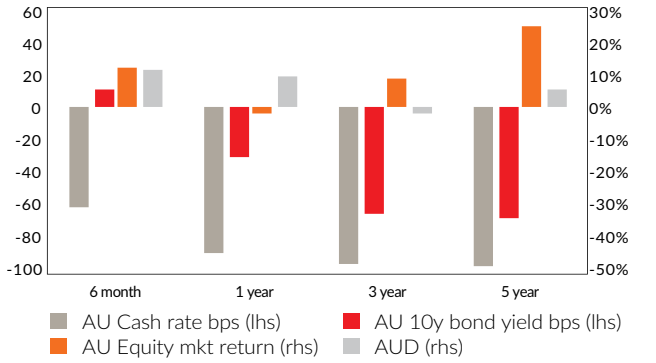
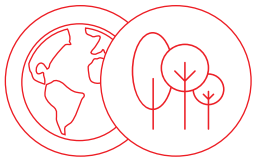


FIG 4: BOND YIELDS DECLINED WHILE EQUITY MARKETS AND THE AUD RECOVERED SHARPLY.



Source: Bloomberg LP, Oreana Financial Services

Our medium-term economic and market outlook



Sustaining returns for the future

Our focus on the medium-term over the short term means that we spend less time on trying to forecast near-term outcomes. Nonetheless, our 2020 Medium-Term Global Outlook made a series of recommendations which if implemented, would have been transformative for portfolios through 2020. Our discretionary and managed accounts,[1] currently available in Australia and Hong Kong, experienced strong risk-adjusted returns in 2020 as we followed our own recommendations.

Now, in 2021, we review our medium-term outlook having experienced a recession as expected in 2020. We turn our focus to sustaining the strong return profile we achieved in 2020 over the medium-term.

Our outlook is for a low volatility, accommodative monetary policy environment where economic activity and inflation normalize. There are risks to this view. But we think this is an environment where tailwinds persist for risk-adjusted returns on growth assets.

Our 2021 Medium-Term Global Outlook considers a range of key issues that will be important for investors to sustain the strong returns were on offer in 2020. Continuing the focus of our 2020 Medium-Term Global Outlook, these areas have associated actions that we believe will help build portfolio resilience.

These are a summary of the issues and actions we believe will be most valuable to investors in achieving their medium-term investment objectives. Our Portfolio Advisory Service (PAS) considers portfolio construction and governance through an even broader set of lenses.

We believe that adopting the PAS service and its expertise, governance budget and real-time management will be the most efficient method to improve risk-adjusted outcomes. But carefully considering the key issues and implementing some of the actions will still be beneficial for investors looking to sustain returns for the future.

Setting the scene: the start of a new cycle	• Equity beta will be rewarded • Remain invested through short term volatility • Be wary of costly insurance/vol protection strategies in a low vol environment
Use scenarios to manage surprises	• Understand exposures to downside and upside risks • Use scenario and stress test results to review diversification • Contact the Portfolio Advisory Service for assistance with implementing a clear scenario and stress test process
Searching for yield in a low-rate environment	• Focus on the objective • Focus on manager selection • Consider alternative credit
The growth of China	• Make China exposure a conscious decision, not an unintended omission • Use active management where possible
Integrate sustainable investing	• Start with beliefs • Embrace the journey • Contact the Portfolio Advisory Service for our Whitepaper Sustainable investing: Key concepts, trends and developments.

1. Performance reports of our discretionary and managed accounts in HK and Australia are available on request.

1 Setting the scene: the start of a new cycle

The start of a new cycle

The global economy entered a deep, brief recession in 2020. Central banks and governments responded quickly and forcefully to support the economy through the sudden stop in activity. In our view the swift response prevented a deeper, more extended crisis.

Accommodative policy for years to come

The monetary policy support released by global central banks has pushed nominal and real interest rates to record lows.

We expect the US Fed and other central banks including the Reserve Bank of Australia, the Bank of England, the European Central Bank and the Bank of Japan will leave rates at or near current low levels for several years to come. We think the risk is skewed towards policy rates at or near zero percent for five or more years (Figure 1). We expect quantitative easing will remain a feature too.

Central banks will be encouraged to do this because low rates will support real economic activity and jobs creation. Low rates will also support wealth and asset inflation. But we expect structural issues including low household income growth, aging populations and improving productivity will leave actual inflation at the lower end of most central banks' policy ranges (Figure 2).

An asset reflationary environment

Record low interest rates and ample liquidity pushes investors out the risk curve in search of yield and returns. That has supported equity markets so far during the recovery (Figure 3).

We anticipate these tailwinds to persist over the next five years. Low policy rates, relatively low bond yields, a steepening yield curve and a supportive macroeconomic environment will all support equity valuations.

Return to a lower volatility environment

The pandemic-related bear market correction that ended in March 2020 represented a bout of market volatility that ended almost a decade of relatively low market volatility.

We expect financial repression – with interest rates below inflation for the next five years – will return the market to the very low volatility environment we experienced between 2012 and 2018 (Figure 4).

What are the implications for my portfolio?

Our outlook is one for solid economic growth, accommodative policy and low volatility. In this environment, we think the following implications are important for portfolios.

1. ***Equity beta will be rewarded:*** We expect the next five years will deliver solid equity returns. We recommend investors carefully consider different geographical and style exposures to deliver outperformance.
2. ***Remain invested through short term volatility:*** Periods of short-term volatility could feel particularly painful given the otherwise positive outlook. We recommend focusing on the medium-term prospects for solid returns and remaining invested.
3. ***Be wary of costly insurance/vol protection strategies in a low vol environment:*** It is tempting to look for downside protection with big payoffs if equities fall dramatically. We expect strategies that primarily use short vol strategies to harvest vol premium, or to hedge equities, will deliver disappointing returns over the next five years.

FIG 1: POLICY RATE (%) ARE LOW AND ARE LIKELY TO REMAIN LOW FOR A LONG PERIOD.

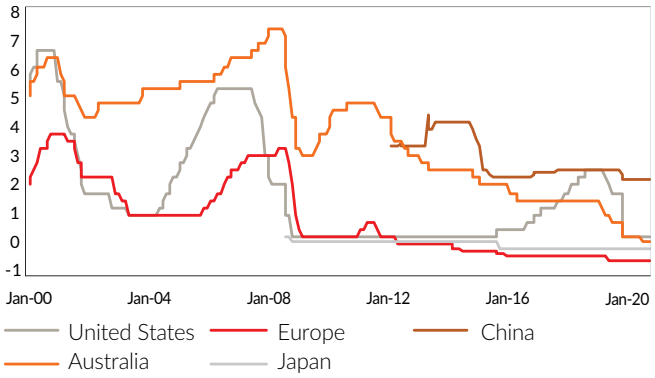


FIG 2: WE EXPECT GLOBAL INFLATION TO REMAIN LOW RELATIVE TO HISTORY.

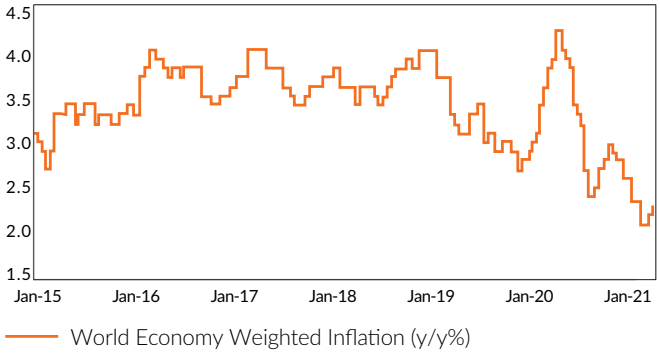


FIG 3: PE RATIOS ARE ELEVATED AS INVESTORS HAVE MOVED OUT THE RISK SPECTRUM TO EQUITIES.

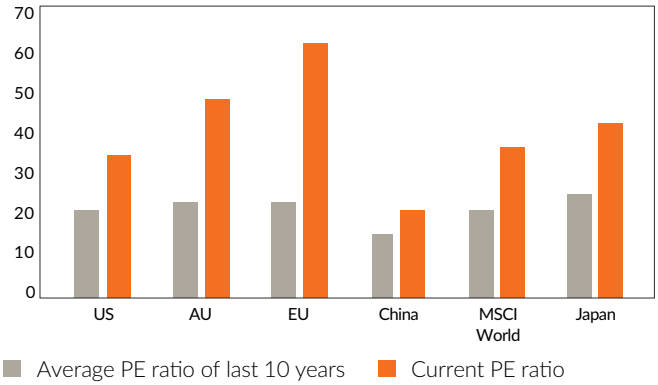
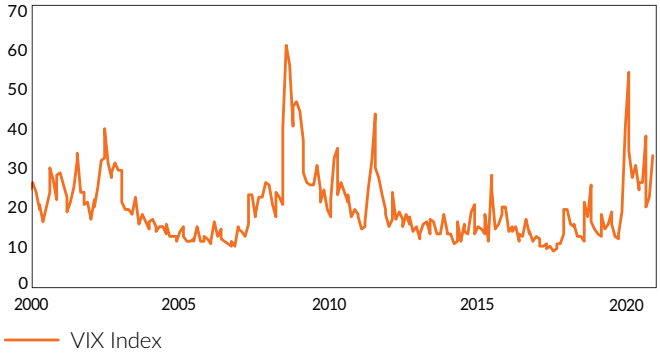


FIG 4: VOLATILITY (MEASURED BY THE VIX INDEX) REMAINS ELEVATED BUT WELL BELOW THE PEAKS OF THE PANDEMIC.



Source: Bloomberg LP, Oreana Financial Services

2 Use scenarios to manage surprises

Embrace uncertainty

In the previous section, 'Setting the scene', we detailed our outlook for a low rate, low vol, reflationary environment. This is our *modal* outlook – the outcome to which we attach the highest likelihood.

But we acknowledge there are a wide range of plausible outcomes over the next five years. Some of these are related to the set of monetary and fiscal responses that were used to support the economy through Covid19. Other scenarios could be driven by exogenous geopolitical events. Each of these scenarios could occur with a range of probabilities.

The outlook remains uncertain because we are at the start of a new economic cycle. We have a strong background in stress testing and scenario analysis. Our analysis gives us a richer insight into the investment outlook. We use this to assess the range of investment outcomes and build resilience within our portfolios.

Three plausible scenarios

We have considered three scenarios around our modal outlook to estimate a range of impacts on asset prices. Table 1 shows the implications of these scenarios on economic outcomes and asset prices.

1. ***Technology boom:*** An accelerating pace of technological progress increases productivity and long-term growth potential. That puts downwards pressure on inflation.
2. ***Inflationary shock:*** Central bank and government stimulus through 2020 leads to an inflation shock. Policy is tightened too fast by concerned central banks, leading to a recession in the medium-term.
3. ***US-China trade war:*** US and China relations sour. The Phase One trade deal is ended. Trade slows and tariffs are reintroduced. This leads to slower growth and higher inflation in the medium-term.

Identify and manage portfolio risks

We think economic risks are skewed to the upside. But identifying and managing portfolio risks is an important element of managing surprises and building portfolio resilience. A well-specified set of scenarios can also help stress test portfolios and identify areas of risk. And that can help identify areas where diversification could be important in protecting portfolios against a range of outcomes.

How can I use scenarios to improve outcomes?

1. ***Understand exposures to downside and upside risks:*** Use your scenarios to stress test your portfolio against negative and positive economic and asset price outcomes.
2. ***Use scenario and stress test results to review diversification:*** The range of potential outcomes over the next five years is wide. We think a well implemented stress test analysis across a range of scenarios can help improve portfolio diversification.
3. ***Contact the Portfolio Advisory Service for assistance with implementing a clear scenario and stress test process.***

Source: Bloomberg LP, Oreana Financial Services

TABLE 1: SCENARIOS HELP SET OUT PLAUSIBLE ECONOMIC AND ASSET MARKET OUTCOMES.

Scenario	Base Scenario	Inflationary shock	Technology boom	US-China trade war
GDP	A short, sharp economic recovery followed by a normalized recovery.	An improved economic recovery in the next 24 months followed by a policy-error led recession.	A strong recovery in the next 24 months and improved medium- and long-term growth potential.	The economic recovery stalls and gives way to a lower growth environment.
Inflation	Inflation slowly picks up with a medium-term recovery.	Inflation surges in the next 24 months as liquidity and QE drives a strong reflationary environment.	Inflation recovers gradually to be around but just below central bank targets.	Inflation recovers gradually but gives way to higher inflationary pressures as trade reduces and tariffs increase.
Monetary Policy	Rates remain at or near zero for around five years with extensive quantitative easing.	Central banks are forced to hike sooner and more aggressively than they would otherwise like.	Rates remain at or near zero for around five years with extensive quantitative easing.	Rates are cut in some cases to negative with monetization of sovereign debt.
		Medium-term market impact		
Equity Markets	Medium-term average annual returns are above historic averages.	Medium-term average annual returns are below historic averages, with losses backloaded over a five-year period.	Medium-term average annual returns are considerably above historic averages.	Medium-term average annual returns are somewhat below historic averages with losses frontloaded over a five-year period.
Sovereign debt	US Treasury yields remain low relative to history but drift higher.	US Treasury yields surge higher as central banks hike too soon.	US Treasury yields remain low relative to history but drift higher.	US Treasury yields remain low with low policy rates.
Corporate Credit	Credit spreads narrowing gradually with improving economy.	Credit spreads widen suddenly, and defaults increase as indebted companies struggle with higher interest rates.	Credit spreads tighten to levels well below historic averages.	Credit spreads briefly widen but narrow to historically tight levels as central banks monetize debt.

Red: Expected returns are worse than the modal outlook over the medium-term.

Orange: Expected returns are broadly in line with the modal outlook over the medium-term.

Green: Expected returns are better than the modal outlook over the medium-term.

3 Reaching for yield in a low-rate environment

Lower for longer is here to stay

Global central banks have cut policy rates to near or below zero percent in 2020. We expect this low-rate environment is going to be a feature of the next five years. In this low cash-rate environment, we expect investors will continue to reach out the risk spectrum to higher-yielding investments. This will be a tailwind for equities. But it presents a challenge for the fixed interest sleeve of portfolios.

The investor's dilemma

Low central bank policy rates have reduced income and potential return for fixed interest investments.

The collapse in yields has presented a dilemma for investors. Investors need to choose between the safety and diversification of investment grade and sovereign bonds on one hand, or the income and return from lower quality sub-investment grade (or high yield) bonds and higher risk, on the other. The difficulty is compounded by the deteriorating quality of investment grade corporate bonds. More than half of the investment grade universe is now rated BBB, the lowest investment grade rating.

Alpha generation is difficult

High yield bonds are a market that is broad, under-researched and with market inefficiencies. These characteristics should leave the market open to alpha generation. But evidence suggests that many strategies struggle to outperform the index. We expect this to continue over the coming five-year period.

Alternative credit

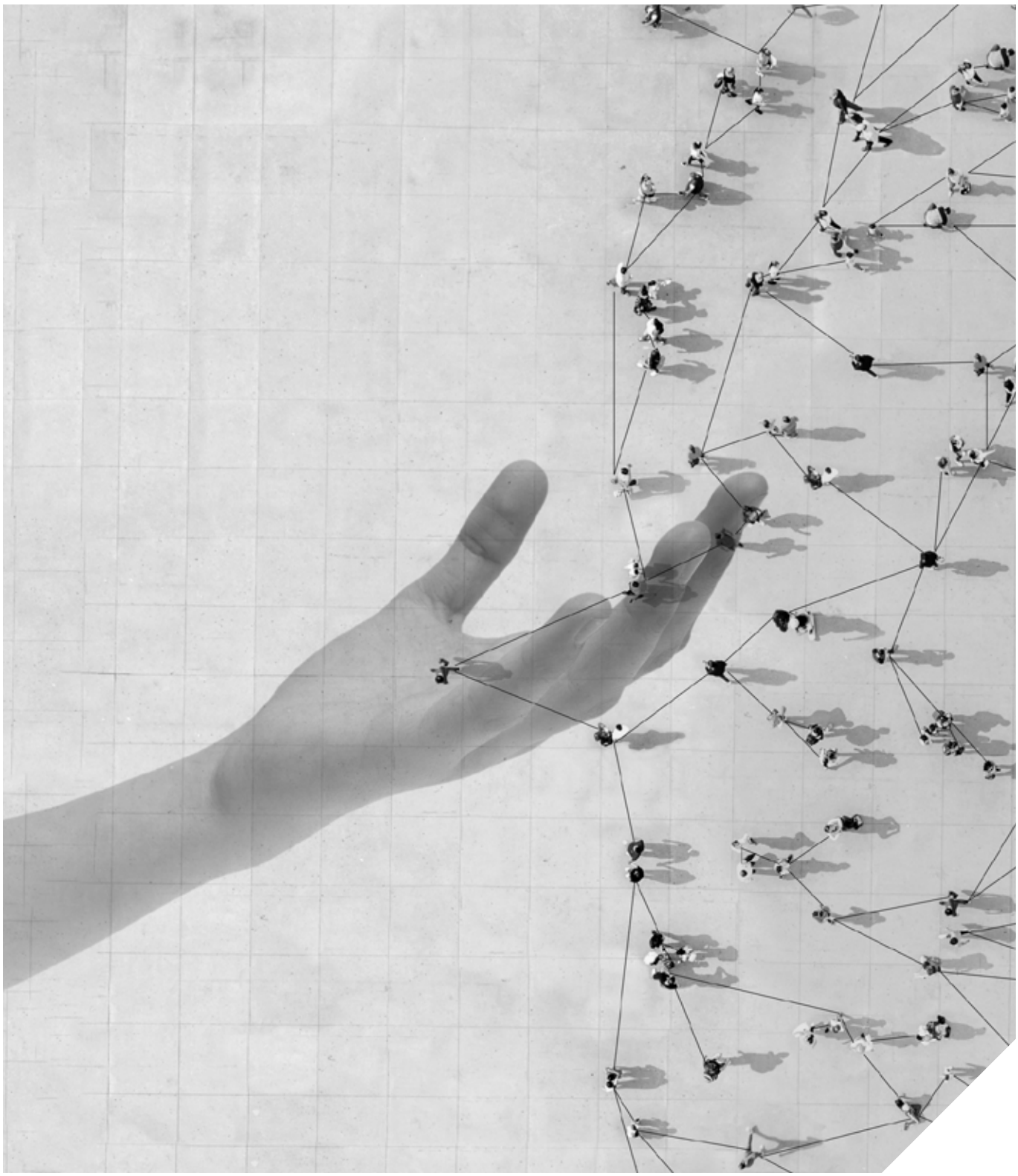
Alternative credit markets can provide access to niche parts of the credit universe. These markets include emerging market debt, direct and private credit, and bank loans, among others. These became more readily available after regulatory and technology changes following the great recession in 2008. These markets can offer ample opportunity for alpha generation. We expect these markets will become increasingly sought after over the next five years as investors reach for reliable sources of income. But the liquidity profile and specialist nature of these require an enhanced level of expertise and due diligence to avoid capital losses.

How can I manage fixed interest in a low-rate environment?

1. ***Focus on the objective:*** Fixed interest allocations should have clear objectives within a portfolio. It is important to identify that objective and allocate accordingly. High quality sovereign bonds will continue to have a role for downside protection, for example. But they may struggle to achieve a high-income objective.

2. ***Focus on manager selection:*** Manager selection will be increasingly important for generating alpha in a low-rate environment. This is particularly true as investors move out the risk spectrum to high yield credit.

3. ***Consider alternative credit:*** Alternative credit is a growing universe. It can offer higher yield with low historic volatility. But investing requires strong due diligence capabilities to avoid capital losses. ***Contact the Portfolio Advisory Service for assistance with reviewing alternative credit strategies.***



4 The growth of China

The opportunity: diversification and alpha

China has the second largest economy in the world. China's economy managed to grow in 2020 despite the impact of the Covid19 pandemic. China also has the second largest global equity market and fixed income market. Chinese stocks outperformed global equities in 2020. We think China will be an increasingly important source of equity and fixed interest diversification and alpha for investors over the medium-term.

What has changed?

China has liberalized its capital markets relatively quickly. The timeline opposite shows some key milestones (Figure 1). That liberalization has increased access to investors. But foreign investors only hold about 3% of the Chinese A-share market and 2.4% of the nation's bond market . Foreign ownership of Chinese government bonds has grown significantly since the opening of the market, but still only reached 9.2% by late 2020.

China has been included in key global equity benchmark indexes since the introduction and expansion of the HK-Shanghai and HK-Shenzhen Stock Connect programs. Similarly, major global bond indexes now include RMB-denominated government and policy bank securities.

As of August 2020, China A and H shares, plus Taiwan, comprised more than 50% of the MSCI Emerging Market index (Figure 2). We expect that exposure will increase as MSCI increases the inclusion weight of China A from 20%.

Why is this important?

We observe China has higher excess returns as volatility remains elevated. Global participation is low – because many investors have avoided exposure and many traditional EM managers lack sufficient expertise to skillfully navigate China's equity markets.

We expect this to change as Chinese assets become larger components of passive indexes and as accessibility continues to improve. We think these assets will offer important diversification and alpha opportunities for investors.

Investors that have no exposure to China will be taking a significant active risk relative to the benchmark. For many investors, that will mean rethinking their China strategy.

How can I gain access to the growth of China?

1. ***Make China exposure a conscious decision, not an unintended omission:*** A zero percent exposure may be appropriate for some investors, particularly those with lower risk profiles. For others, zero exposure is a big active bet that could forego significant alpha generation. We think this decision should be made within a clear governance and investment framework.

2. ***Use active management where possible:*** China's asset markets are ripe for alpha generation. Local experience and language barriers are important in consistently generating excess returns. Where possible, we recommend using active management to benefit from this alpha generation. ***Contact the Portfolio Advisory Service for assistance with reviewing Chinese asset strategies.***

FIG 2: MSCI EMERGING MARKET INDEX WEIGHTS, AUGUST 2020.

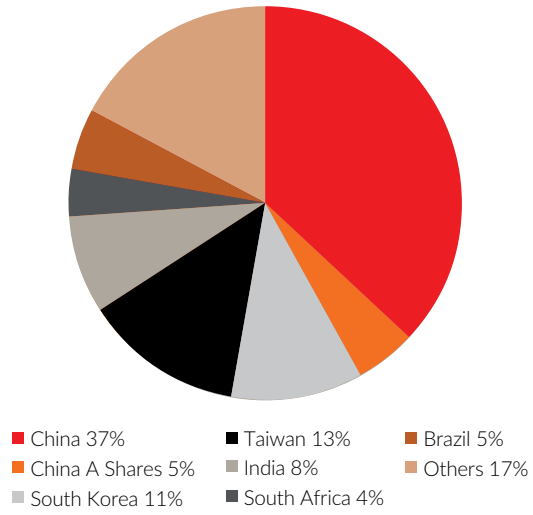
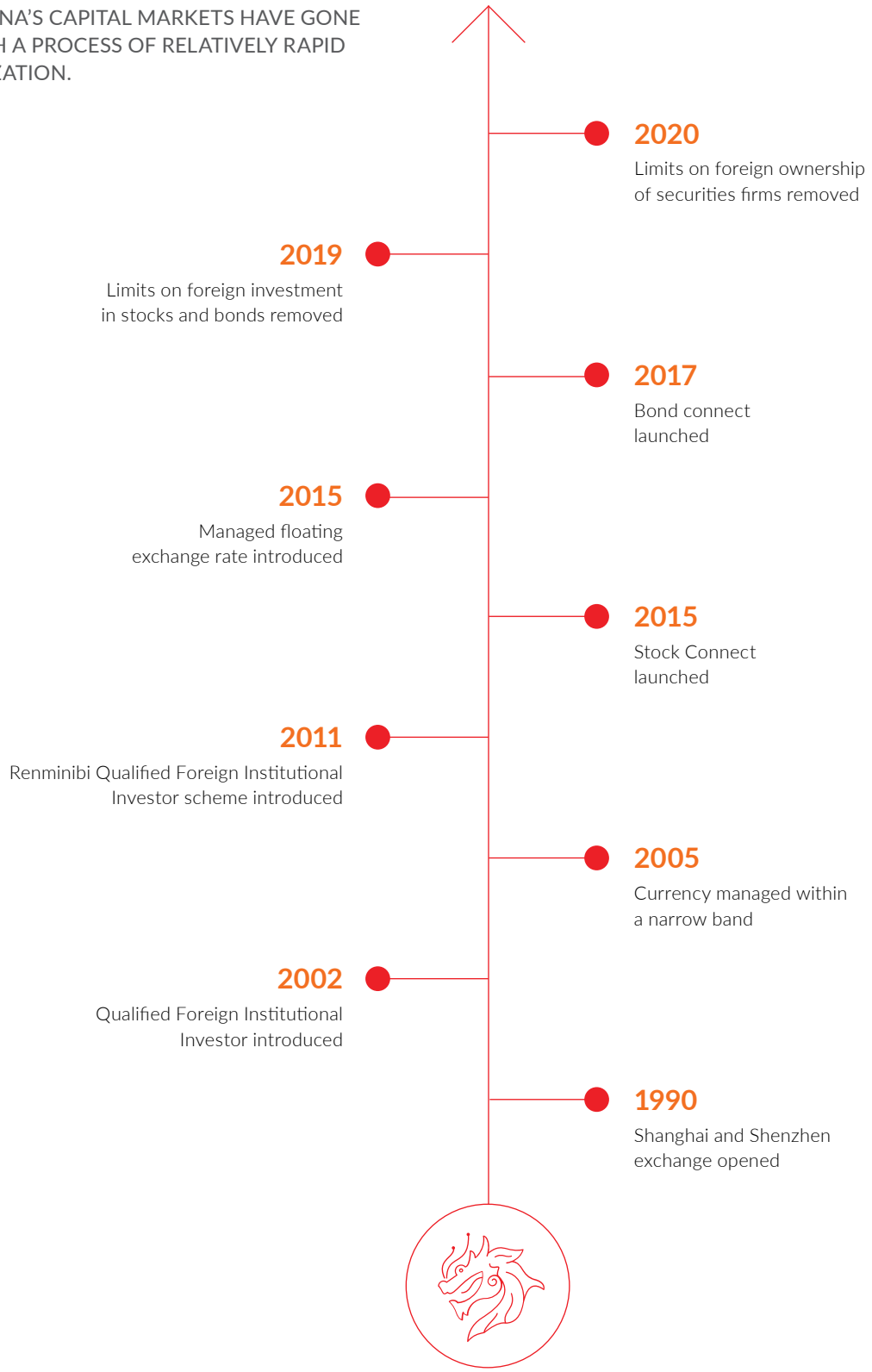


FIG 1: CHINA'S CAPITAL MARKETS HAVE GONE THROUGH A PROCESS OF RELATIVELY RAPID LIBERALIZATION.



Source: Bloomberg LP, Oreana Financial Services

5 Integrate sustainable investment

Sustainable investing is important, and will grow in importance

Sustainable investing has grown rapidly in recent years. A growing number of the largest asset owners and institutional investors globally have embraced Environmental, Social and Governance (ESG) investing approaches. But demand for sustainable investing is also evident across the global financial ecosystem including retail wealth management. We expect this trend to continue.

Rapid growth in sustainable investing will continue

According to the US SIF foundation, more than USD17 trillion was invested in the US alone in 2020, an increase of 42 percent from USD12 trillion in 2018. ESG funds attracted extremely large net inflows between April and June 2020, exceeding the combined total for the previous 5 years. This rapid growth reflects the growing realization that sustainable investing is a source of alpha. We expect that an investment process that is sustainable investing-aware, and increasingly integrates sustainable factors, will outperform one that doesn't over the medium- to long-term.

Investor demand and regulatory push are key drivers in the medium-term

Sustainable investing growth has been led by investor demand, regulatory pressure, and a growing understanding of the long-term alpha potential from sustainable investing. From an investment perspective, we expect consideration of sustainable investing will become part of the fiduciary duty owed to asset owners. Asset managers and investors who do not incorporate ESG into their investment processes will need to explain why they don't see ESG as a portfolio risk or investment opportunity.

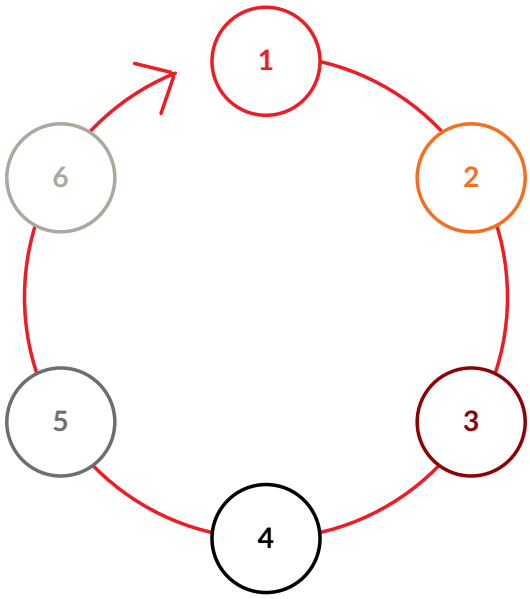
Implementation is a journey that should begin now

Integrating sustainable investing, and sustainability metrics, into the investment process is challenging. It has proven challenging for large institutional investors and asset owners as well as retail investors. This involves deeply integrating sustainability across all the steps that make up an investment and governance framework. We think this is an important process to begin now. That process will deliver benefits that will continue to accrue over the medium- and longer-term. Figure 1 shows some suggestions on how this can begin.

How can I start integrating sustainable investment into my investment and governance process?

1. ***Start with beliefs:*** This could focus in on specific sustainable investing types – ESG investing, or social or green investing, for example – or it could identify types of assets that need to be excluded from the portfolio based on certain ESG characteristics.
2. ***Embrace the journey:*** We expect integrating sustainable investing across portfolios will take time. But the journey is important to begin. We expect investors that embrace the journey now will achieve better risk-adjusted returns over the medium- to long-term, and where applicable, will be able to more clearly show they are fulfilling their fiduciary duty.
3. ***Contact the Portfolio Advisory Service for our whitepaper* Sustainable investing: Key concepts, trends and developments. *We can assist with beginning the sustainable investment journey.***

FIG 1: IT IS TIME TO START INTEGRATING SUSTAINABLE INVESTING WITHIN THE INVESTMENT PROCESS.



1 **Mission**

Identify sustainable beliefs.

Incorporate sustainability into investment objectives.

2 **Portfolio construction**

Identify the impact of long-term sustainability risks on capital market return and risk assumptions.

Select benchmarks that measure the success of sustainable strategies.

3 **Manager Selection**

Review and monitor a strategy's sustainable beliefs and integration.

Implement through beta or alpha.

Review performance relative to suitable sustainable benchmarks.

4 **Asset allocation**

Negative or positive screening of assets.

5 **Investment committee**

Manage reputational and regulatory risk.

6 **Monitoring and reporting**

Review and report on success relative to financial and non-financial objectives.

Conclusion

At the Portfolio Advisory Service, we believe investing should focus on adding value through the medium-term, while being aware of short-term outcomes. Our 2020 Medium-term Global Outlook: Review resilience and reduce surprises set out a range of concrete recommendations that proved transformative for portfolios through 2020. Similarly, in 2021, our Medium-Term Global Outlook: Sustaining returns for the future focuses on five key themes that are important and implementable. Implementing any of these is a good starting point for asset allocators and investors. Implementing all of them is challenging and likely to be part of a journey that could take some years.

Our focus on the medium-term over the short term means that we spend less time on trying to forecast near-term outcomes. Our focus is always on delivering great risk-adjusted returns within a clear governance framework and investment process. 2020 represented a particularly strong year for investment returns as our medium-term outlook played out quickly. But we stress that these 2021 themes are intended to help investors sustain returns for the future.

We make fourteen recommendations across the following five themes for the next five years:

1. Setting the scene: the start of a new cycle
2. Use scenarios to manage surprises
3. Reaching for yield in a low-rate environment
4. The growth of China, and
5. Integrate sustainable investment.

The Covid19 virus in 2020 was unexpected. We expect portfolios that embraced our 2020 suggestion of reviewing resilience and reducing surprises will have achieved better investment returns with lower volatility. For us and the investors that embraced our recommendations, the focus must turn to sustaining returns over the future. The Portfolio Advisory Service Team is available to help with that challenge, manage the risks and implement actions required to deliver future-proofed portfolios.

For further information, please contact your Oreana Financial Services affiliated Advisor or one of the following:

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Isaac is the global CIO for Oreana. He is responsible for Oreana's capital markets research, portfolio construction and asset allocation. Isaac works across Australia and Asia to deliver great investment outcomes to institutional and retail clients.

Isaac has significant experience in the financial sector with a career spanning across central banking, risk management, asset allocation and investment consulting in major firms in Australia, the UK and Hong Kong.

Prior to joining Oreana, Isaac worked at Willis Towers Watson as the Head of Capital Markets Research in the Asia-Pacific. Other prior roles include Chief Economist at NSW Treasury Corporation, and Manager, Economic Risk at Lloyds Banking Group, the largest retail bank in Britain. Isaac started his career at the Reserve Bank of Australia.

Isaac holds a PhD in Economics from the University of Sydney in NSW, Australia. Isaac has also studied at the University of Oxford in the UK and the University of Tasmania in Australia. Isaac is a Certified Investment Management Analyst® holder through the Investment and Wealth Institute.™

About Oreana Portfolio Advisory Service

The Portfolio Advisory Service (PAS) delivers institutional grade investment and portfolio management solutions for clients across Asia and Australia. The team have extensive experience providing investment services to retail and high net worth clients, family offices and institutional investors.

The PAS employs a flexible, comprehensive framework and repeatable processes. Our solutions are backed by expertise and thought leadership across the entire investment process.

Our broad range of solutions include:

Managed accounts We have a range of Separately Managed Accounts (SMAs) and Managed Discretionary Accounts (MDAs) available in Australia and Hong Kong across a range of investment platforms. These have delivered strong risk-adjusted returns for our clients through a challenging investment period.

Investment governance We are thought leaders and experts in investment governance and best practice stewardship. The PAS provides investment governance reviews, investment committee documentation and can participate in investment committees.

Advisory solutions Our broad expertise and institutional background mean we can provide a range of bespoke advisory solutions for clients. This includes portfolio construction and asset allocation, stress testing and scenario analysis, communications and capital market research, and Approved Product List management.

Manager research Shane Hawke is one of the leading manager researchers in Australia with more than 20 years of experience across research, advice, and portfolio construction. The PAS team can leverage this to provide strategy review and recommendations across a wide range of asset classes.

Sustainable investing advice We expect sustainable investing will be a growing issue for investors globally. The PAS is available to help with implementing sustainable investing into your advice practice, portfolio or investment processes and frameworks.

The PAS provides governance, expertise, and clear, efficient investment solutions with its powerful investment engine. We align ourselves with your investment needs and objectives. We aim to be your trusted partner through your investing journey.

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