Gatekeepers gravitate to international equities, exit high yield

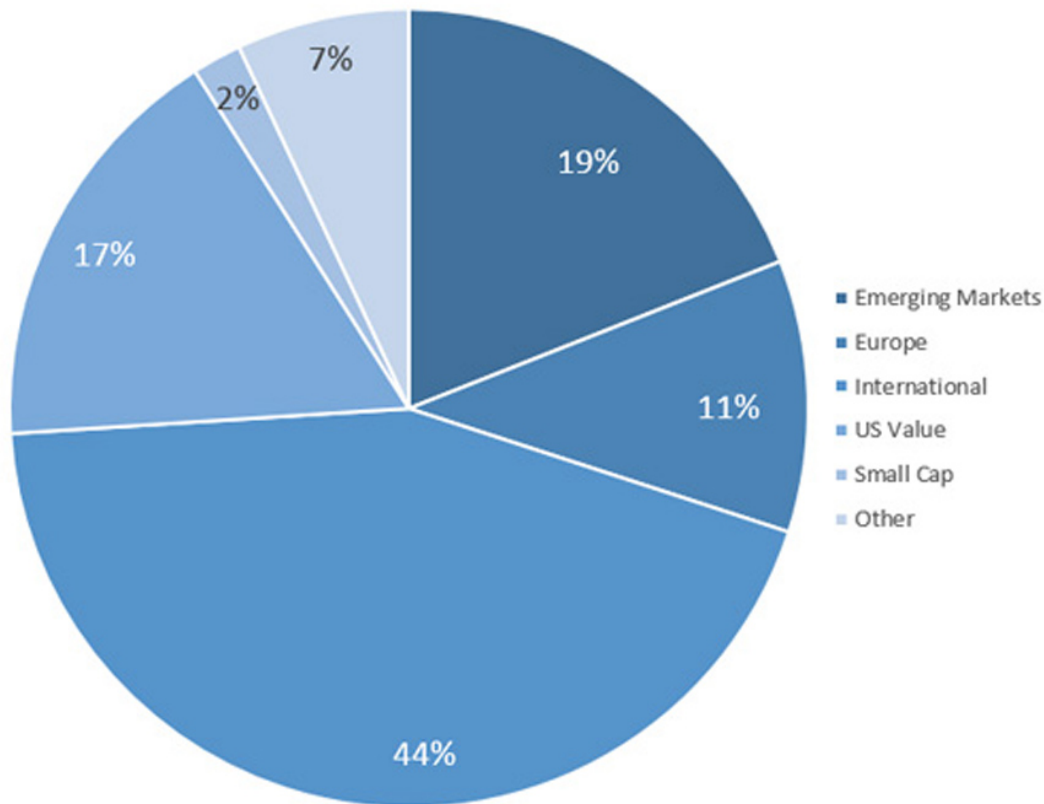
Andrew Jones / 24 October 2017, 13:18

Gatekeepers weigh in on where they're putting equity assets, what they're avoiding in fixed income and the catalyst of the next market correction at the Citywire Professional Buyer Retreat in Los Angeles, California

Gatekeepers plan to increase their allocations to international equities, reduce exposure to high yield and believe the next market correction could be triggered by weaker than expected earnings, according to a Citywire poll.

The survey results come from the Citywire Professional Buyer West Coast Retreat, which took place in Los Angeles, California on October 19 and 20.

In a live poll we asked 70 of the country's top due diligence analysts for their outlook for the next 12 months.



At the event, 44% of gatekeepers said they planned to increase their allocation to international equities over the next year, with a further 19% saying emerging markets and 11% saying specifically Europe.

Tim Clift (pictured below), chief investment strategist at Envestnet, said: ‘Europe is starting to move further into the growth phase and they’re still recovering from their recession so there is more potential upside there.’

‘Valuations are clearly the driver there when you look at the US, maybe they’re not overvalued but they’re getting more expensive.’

For international exposure, Clift said he liked the $11.8 billion Harding Loevner International Equity fund, which is managed by Citywire AA-rated Alexander Walsh and Ferrill Roll, as well as Bryan Lloyd and Patrick Todd.

The fund is ranked fourth out of 40 International Large Cap Growth funds tracked by Citywire for three-year total returns to the end of September. Over that time it was up 27% compared to the average International Large Cap Growth fund's 15.4%.

Ryan Kinkade, senior analyst at Franklin Templeton, said: ‘I think people are concerned about Fed rate increases and what that might do to equities in the US.’

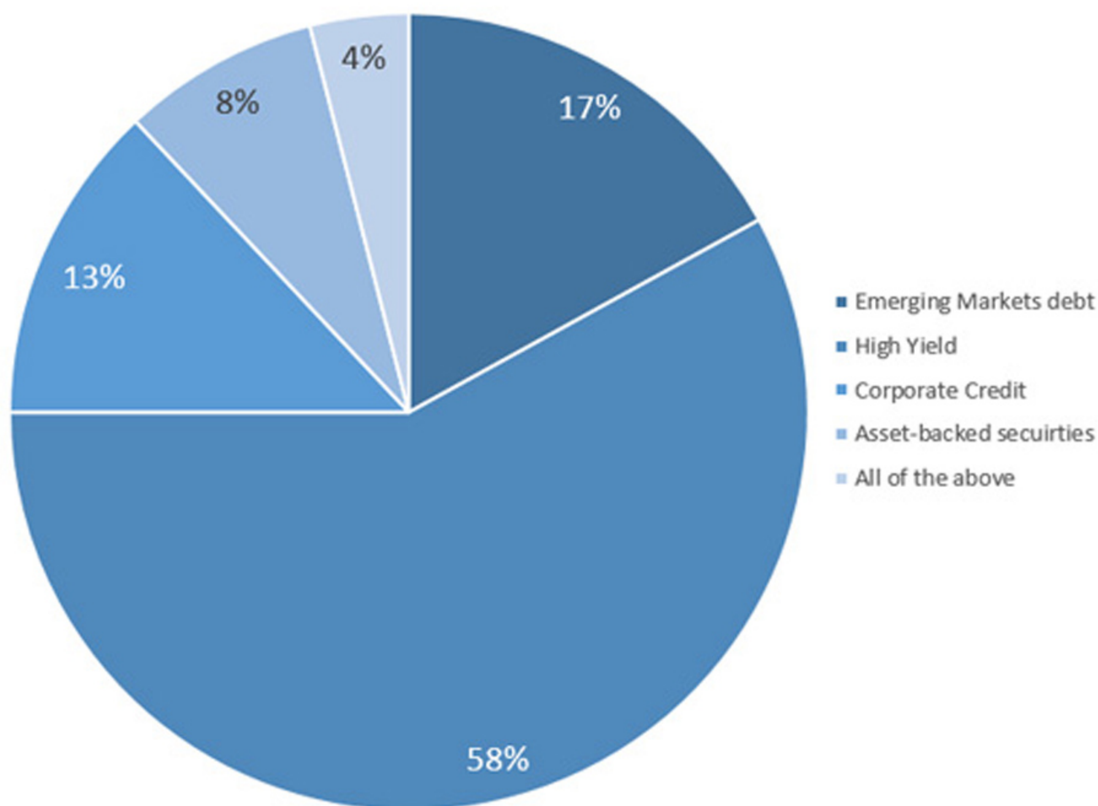
Aside from the Franklin Templeton international equity team, Kinkade said that he was quite impressed by Invesco’s quantitative equity team for its European expertise.

‘They are a very good quantitative, low volatility bent equity group,' he said.

Mark Sloss, chief executive of Regenerative Investment Strategies and a partner at RIA Wilde Capital Management, believes that investors will move towards international equities because the Trump euphoria has died down and European markets are looking a little more stable than they did earlier in the year.

‘I think a lot of asset allocators went long Trump and the US dollar in terms of pro-American business on the thought that there was going to be health reform and tax reform,' he said. 'Even if the rhetoric was a little ugly, the whole America First idea was bullish for America business,’ said Sloss.

‘It’s probably time to take a little bit of your winnings off the table and spread it around because Europe seems to be getting its act together, there’s been a little bit more political stability and more definition around some of the economies there like France and Germany.’



On the fixed income side, the majority of gatekeepers are planning to reduce exposure to high yield with 58% saying they planned to do so over the next 12 months.

Another 17% said they would reduce their weighting to emerging market debt.

‘High yield spreads and equities seem to be quite correlated so it’s a lot of the similar reasons why people are worried about equities right now,’ said Kinkade (pictured below).

‘It also has to do with interest rates because if treasury rates start to go higher, you may see borrowing costs [rise] for a lot of lower quality companies, that have had cheap access to money, [and they will] have to make tougher decisions about issuing high yield debt.’

Clift agreed with Kinkade.

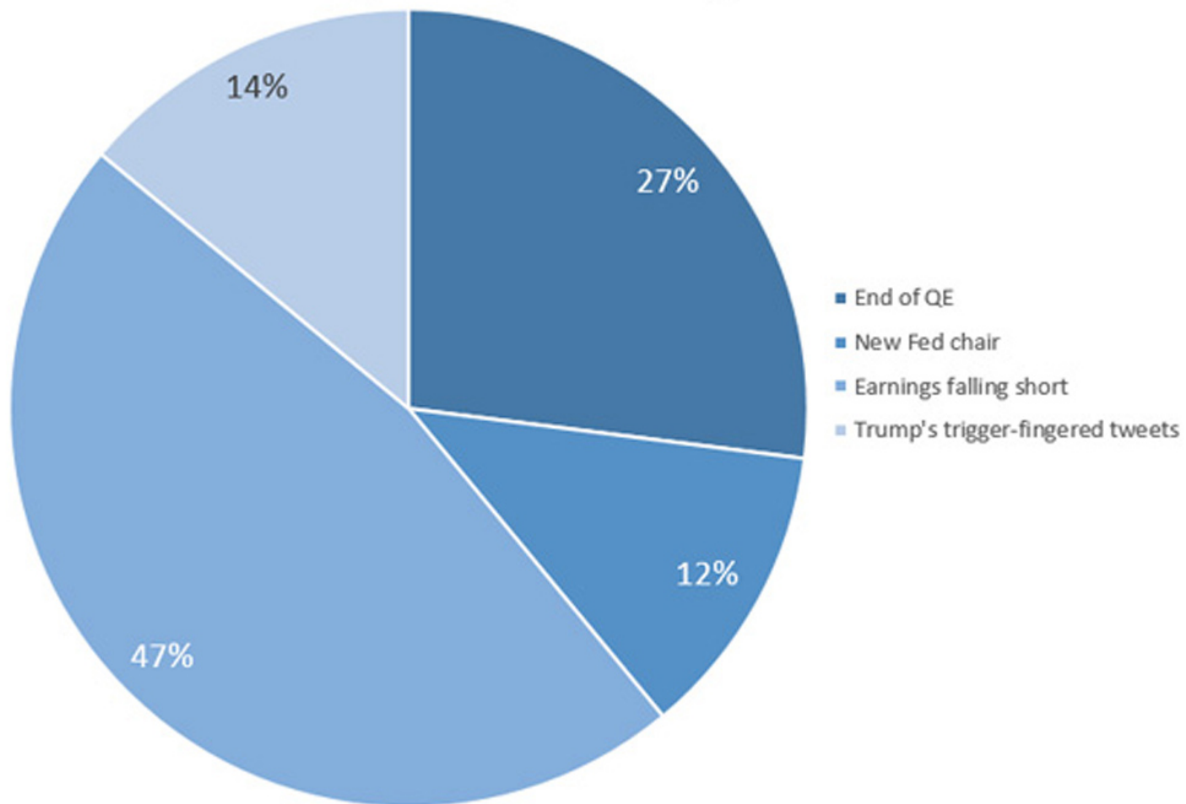
‘Valuations are high and high yield tends to have a higher correlation with equities so you’re doubling down on equities if you’re adding on that your [in the] fixed income space,’ he said.

‘There is also interest rate sensitivity in high yield and people are trying to steer clear of interest rate sensitive investments.’

Sloss believes that the credit risk associated with high yield exceeds the reward so investors have been taking a closer look at it how necessary an allocation to the sector is.

‘Spreads are probably a little too tight for comfort and I’ve certainly heard a lot of asset managers saying that the spreads that you’re getting on high yield are not sufficient to compensate you for the incremental risks that you’re taking,’ he said.

‘I think there’s just enough nervousness about fixed income in general and then you compound it with the additional credit risks that come with high yield and it’s at least enough to take a very healthy look at it.’



Almost halve of all the gatekeepers, 47%, believe that the number one catalyst for a market correction in the near future is weaker than expected earnings.

‘When you have all of this non-fundamental stuff going on that, at any other time, should’ve broken the market but didn’t, people think that it would have to be something really fundamental,’ said Sloss (pictured below).

‘You have to look at internal mechanisms of the market that might trigger it, so it makes sense that most think missing on earnings would be a reason for people to pause and say maybe the equity market is overvalued.’

Sloss said he was not sure the catalyst for the next market correction would be missing on earnings, adding that it could be something more structural like a liquidity issue or technology problem.

For Clift, said some corporates might struggle without support from the Fed.

‘They (the Fed) are finally out of the picture so the big concern is if companies can continue to beat estimates that are becoming harder to beat going forward and it’s hard to figure out where that growth is going to come from,’ he said.

Kinkade agreed.

‘I think people are aware of the easy money corporations have had and everyone is well aware of the theme of financial engineering, companies buying back stock and maybe or maybe not propping up earnings figures through creative accounting,’ he said.

‘I think that’s a diminishing return and companies can only do that for so long.’