> While people didn't feel the urgency to change their ways of doing things and investing before [the pandemic], they feel it now. If you don't change your business model or investing method, you will be left behind.
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> › ***Danny Wong, CEO of Areca Capital Sdn Bhd***

Rethinking risk in the new normal

The Covid-19 pandemic has caused major disruptions to businesses and economies and ushered in a new normal around the world. Remote working, the penetration of technology into all industries and a low interest rate environment are just some of the characteristics of this time.

However, some have observed that the markets and economy were already heading in this direction before the pandemic. In fact, the health crisis only served to accelerate these trends, says Danny Wong, CEO of Areca Capital Sdn Bhd.

"The pandemic forced governments to come up with stimulus programmes and central banks to cut interest rates, which were already low, to support the growth of the market. A low interest rate environment affects fund flows, as depositing money in a bank to earn passive income is no longer a viable option for investors," says Wong.

Interest rates may never go back to where they were previously, he adds. That is because countries with huge populations like China and India may begin to see their growth rates stabilise going forward, thus resulting in generally lower interest rates across the world.

"That is due to the emerging wealth in these countries. When this happens, they will struggle to sustain the kind of growth they have now ... When their economic growth stabilises and they are more advanced, the inflation experienced by the people might not be as high as well. Consequently, their interest rates will come down," says Wong. This could also occur in Malaysia as the country progresses towards advanced emerging market status, he adds.

To adapt to the new normal, Malaysians must change their way of investing as well as their mindset on retirement planning.

"While people didn't feel the urgency to change their ways of doing things and investing before, they feel it now. If you don't change your business model or investing method, you will be left behind," says Wong.

This is especially important for retirees and those who are about to retire. They might have relied on fixed deposits (FD) to fund their retirement, but with the FD rates mostly below 2% per annum now, they can no longer afford to do so. "If your retirement portfolio model is based on FD returns of 3% to 4% per annum, your portfolio will suffer if you continue to use the model. Your savings may not last that long and you may have to compromise your standard of living during your retirement."

In this new normal, retirees and pre-retirees must make sure they have a diversified portfolio that covers bonds, equities, properties and other asset classes. While FDs used to make up a huge portion of retirees' portfolios, this must change going forward.

"The new regime has forced everyone to rethink the way we do our investments and look at our long-term plans. Everyone is forced to look at alternatives and re-educate themselves. We are also helping senior citizens learn about the options available. It's inevitable that everyone needs to come out of their comfort zone," says Edward Iskandar Toh, chief investment officer of Areca.

"We are trying to change retirees' perception and tell them that being idle in their investments is actually detrimental and not necessarily safe. We are being shepherded into an environment where you have to be more active in making investments."

DON'T BE SCARED OF EQUITIES

Being more active in investing and creating a diversified portfolio would also require investing in equities, which retirees often think of as a risky asset class. However, not taking on additional risks to invest in this asset class is actually riskier, as the lower returns from FDs could threaten one's retirement plans.

"The risk of staying in FDs is high, as it may not support your standard of living if the interest rates keep going down. You must then find a new strategy and think about how you can optimise your risk-reward ratio," says Wong.

"Conventionally, people may think of equities as risky, but, in fact, it is not so if you plan your portfolio well. Having equities may increase your overall returns and the overall risk can be optimised."

In other words, retirees must change their understanding of risk. Typically, people think assets that are liquid and allow you to withdraw your investments without affecting your capital are safe, such as FDs and bonds. Meanwhile, asset classes like equities that experience price fluctuations are risky.

"That's the wrong concept ... You are actually risking your living standard if you outlive your savings. If you have sufficient time to invest, putting your money in FD is a big risk [because you're compromising your retirement portfolio returns] compared to investing in equities [which can perform over time]," says Wong.

One aspect that retirees should understand is that their portfolios have a longer time horizon than they think, especially if they plan to leave the wealth to the next generation.

"Your wealth lasts longer than you expect, so you should plan according to that duration," says Wong. With a longer timeline in place, investors can take more risks and benefit from cycles in the economy, he adds.

"When you have three months, the asset class has less time to perform. But in 10 years, you can experience mini cycles, and the asset class usually has enough time to perform. For instance, the equity cycle used to be every 10 years but now it's shorter. With more time, you can recover from any crisis."

Investors might experience volatility in the short term, but over the long run, their assets should grow alongside the economy, he adds.

The asset allocation of each portfolio depends on the individual's preferences, goals and time horizon. Take, for example, an investor who wants to double his wealth in 10 years in order to fund his retirement for 30 years. After taking into consideration his risk preferences and life situation, his adviser estimates that he needs a 7.2% per annum return to reach this goal.

To do so, the investor can allocate some money to asset classes that are liquid and can provide average returns of between 5% and 10%, which could be a mixture of different asset classes, including fixed income and equities.

"He can depend on fund management services for the rest by allocating [funds] into unit trust funds and exchange-traded funds. The investor might think that land is a scarcity, so he wants to invest in landed properties, for the long run. That is an illiquid asset but it has less correlation with the other asset classes. He can also have some foreign currency and gold exposure," says Wong.

Should retirees focus on income-generating assets like bond funds? It depends on their investment profile and timeline, says Toh, adding that even equities can generate regular income for investors.

"Whatever asset class that we go into, we can cater to some form of liquidity. We can structure the investments in a way that you can also gain cash flow from investing in equities by doing regular deductions," says Toh.

Ultimately, retirees must understand that relying on passive income from FDs is not necessarily safe. In the new normal, one must be more active and diversify into other asset classes. If not, retirees are actually risking their future standard of living. "Even the Employees Provident Fund has one third of their portfolio in equities, even though they are a retirement fund. They know that if they are not exposed to this asset class, they cannot get 5% to 6% returns, which is difficult to get even in this [current] environment," says Wong.

LET THE PROFESSIONALS DO IT

Retirement is a time for relaxation and for one to indulge in hobbies and interests. However, some retirees become preoccupied with managing their investment portfolios and tracking the markets every day.

"We have limited time, but there is new technology, new investment opportunities and new business models coming up all the time. As a retiree, you want to spend time doing what you missed out on during your working days. If you spend it being as busy as you were before, are you foregoing your dreams of retirement?" says Wong.

Instead, retirees can rely on professionals and outsource this responsibility to wealth advisers.

"They key is to let the professionals do the heavy lifting for you so you don't get bogged down by the small details. Leverage the expertise of others ... It's like you appointing a tax adviser to manage your taxes, which you are not familiar with," says Wong. The cost of paying for such services is worth it, he adds.

"At the end of the day, ask how much return you can get from this service and how much risk you have to take, instead of fixating on the cost."

In addition, wealth management services do not just touch on investment portfolios. It also covers estate planning.

"How do you plan to pass down your wealth? This is very important for retirees and those about to retire to consider. Wealth management includes things like setting up your trust, which is a better method than just having a will. It can help you plan ahead for rainy days," says Wong.

For instance, he has a client who owns a business. During the Movement Control Order, the client's business was impacted and he was worried that it would also threaten his family's wealth and investments.

"His business risk is an equity risk. How can he prevent this risk from affecting other assets in his portfolio, including his savings and emergency funds? How does he protect everything? Wealth planning can address these questions and use tools like trusts to protect his assets, so he doesn't lose his hard-earned money because of sudden events," says Wong.

On the other hand, there is an increasing number of fintech services in the market to help Malaysians save and invest. While this is useful, such services still cannot provide the high quality and personalised treatment that a wealth adviser can provide, Wong observes.

For instance, instead of relying on a set of 10 questions distributed by a machine to determine one's risk profile and preferences, an adviser can talk to the client and understand his or her goals and changing life situations along the way.

In comparison, a machine that asks investors 10 questions and then classifies them under a certain risk profile category may not be able to capture their exact situations and will require constant updating, adds Wong.

"The whole wealth management industry is impacted by two trends. One is the automation of processes and standardisation of products, while the other is customisation. These two will co-exist, and neither could be the perfect way," says Wong.

While advisers can provide personalised services, technology can be used to make the process more efficient and convenient. This is what Areca capitalises on.

"We need a hybrid model. For instance, you can use a machine to select stocks for you but you will still need to key in your parameters. But if you have limited time or you don't have the expertise, you need a professional to guide you. This is the high-touch approach that we use," says Wong.

"We are putting quite a lot of effort into our internal fintech processes to complement our high-touch service, which we think is necessary. We believe in high tech and high touch."

At this time, Areca is increasing its focus on wealth management. It does not want to just manage investments for its clients but also, protect their assets, so they can be passed on to the next generation. The company wants to educate its clients on the importance of wealth planning, especially in this new normal.

"Each of us spends 30 to 40 years working. But a lot of us neglect wealth planning and think that at the end of our working life, you can just put your legs up and relax without doing any prior planning. We're here to help you start the conversation and ensure that your planning doesn't only start at retirement. It must begin earlier to ensure that you and your family can enjoy the fruits of your labour going forward," says Toh.