EXPECT GREATER INVESTMENT RISK APPETITE AS GLOBAL GROWTH SPUTTERS ALONG

The 4th Asia Investment Management Summit for Insurance revealed a hazy outlook for global growth and the likelihood of insurers revamping their investment portfolios to accommodate more risk-taking.

By Ridwan Abbas

Deflationary pressures pose the biggest threat to global growth compared to inflation and will guide monetary policies moving forward, said Dr Brian Murray, Chief Economist of the AIA Group, at the 4th Asia Investment Management Summit for Insurance held in Hong Kong last November.

Dr Brian Murray

"I think we have been fighting the wrong war looking at inflation, looking ahead deflation is threatening and it's harder to get rid of than inflation," he said.

"Inflation hasn't happened despite the QE, and deflation has not been only the result of oil prices collapsing because deflation had happened even before oil prices collapsed. While it did play a part, deflation was fundamentally the result of a liquidity trap and the lack of demand rather than the collapse of one specific commodity price," he added.

Deflation could also have a significant impact on the insurance industry, as previously seen in Japan where insurers lost a lot of money on the securities they held, said Dr Murray.

"Deflation in the late 1990s wiped out a significant portion of the Japanese insurance industry because of the effect of negative carry on their books, which is why deflation is a bigger threat to the financial system than inflation."

Fed hike likely in Dec

Turning to US monetary policy, Dr Murray rightly predicted during the conference that the US Federal Reserve would hike interest rates in a one-off move at its meeting in December, mainly due to political factors.

However, he said it would be a mistake for the Fed to tighten given low inflation in the US and the country's weak labour force participation rate – which stands at a 38-year low – despite the unemployment rate coming down to 5%.

Dr Murray added: "Most importantly, it would be a mistake because the US raising rates at a time when EU, Japan and China are loosening means the stronger dollar will affect US export competitiveness and slow down economic growth which has been tepid."

Spectre of debt hangs over global economy

On the topic of asset allocation and the amount of risk to take, investors are currently dealing with a "fragile equilibrium" as the global economy finds itself in between severe stagnation and a strong demand-driven recovery – whereby there is just enough demand relative to supply leading to a mix of low growth and low inflation, said Mr Denis Gould, Chief Investment Officer, Multi Asset and Wealth, HSBC Global Asset Management.

Mr Denis Gould

However, this balance is a fragile one and there is a likelihood for the global economy to tilt towards the stagnation scenario, he said.

"This would mean there's still too much debt in the world, it's just shifted from the private to public sector, and this will put a drag on growth for years to come akin to the Japanese scenario.

He added: "Such an environment will support developed market government bonds, but yields won't really be going much lower, and it will be bad for emerging market equities - so these are the kind of things we're monitoring to see how much risk we should take."

Valuation of insurers on the high side

Turning to the topic of investing in the insurance industry, Avicennia Capital's Group CEO Alexander Ankel, said excess capital in the industry is driving steep valuations on M&A deals amongst insurers.

Mr Alexander Ankel

He cited examples such as Nippon Life's 20% acquisition of Indonesia's Asuransi Sequis Life at 13.3x price to book ratio, and also the high bancassurance fees like the US$1.2 billion which Manulife paid for exclusive distribution rights with DBS Bank.

"A deal is between a willing buyer and a willing seller but valuations are tough out there," said Mr Ankel.

Avicennia Capital is the insurance investment arm of Malaysia's sovereign wealth fund – Khazanah Holdings – and was formed two years ago. It currently owns two insurance businesses in Malaysia and one in Turkey.

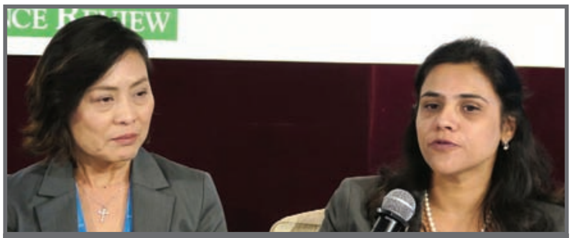
On investments in the insurance space, Mr Ankel believes markets such as India and Southeast Asia represent considerable opportunities for investors.

"Based on our assessment, there are approximately 93 insurers who would be available for either potential full sale or in markets where ownership isn't limited like in Thailand, at least a larger investment in the company."

Ms Sally Yim, Vice President & Senior Credit Officer, Moody's Investor Service said there remains opportunities to acquire bank-linked insurance assets as the banks evaluate the prospect of divesting and focusing on bancassurance related activity.

Ms Sally Yim

She also sees the momentum for cross-border deals to be sustained; and for the next wave of M&A to move away from the life sector and looking at non-life targets.



Ms Judy Vas and Ms Ritu Arora

Regulations to play big role

Greater regulatory oversight has been a constant in recent times and the number of regulations for financial institutions will only increase going forward, said Ms Judy Vas, Regulatory Leader, Financial Services (Asia Pacific) at EY during a regulatory panel discussion.

She noted that Asian regulators are not keen to lead the way; instead being happy to observe what policymakers in the West do and learn from their experiences. Hence, the time lag that occurs as a result could be viewed as a positive thing for financial services companies in Asia.

Ms Vas also anticipated an increase in regulations for non-financial risk such as consumer protection and anti-money laundering.

Taking on more risk

Among other things, the acceleration of regulations could be attributed to the re-evaluation of risk on the part of the market as well as regulators, said Mr Paul Sandhu, Head of Risk & Capital Management Solutions (Asia Pacific) at Cathay Conning Asset Management.

Mr Paul Sandhu

Ms Ritu Arora, Founding Member & Chief Investment Officer, Canara HSBC Oriental Bank of Commerce Life Insurance Company, said the entire market's risk appetite is being challenged and insurers have had to become more aggressive in their investment approach in order to generate the same level of returns.

This is due to the anaemic global outlook with US growth too weak to pull other nations along. She also added that balance sheet stress will become evident if demand does not pick up in the near future.

Hence to generate the same returns, substantial risk is being taken by investors, with insurance companies in particular becoming more inclined to consider opportunities in the more unconventional asset classes such as REITS, real estate and derivatives.

At present, there is a misalignment in terms of the market's risk appetite and that of regulators, added Mr Sandhu. He felt that once this gap is closed, then insurers will approach alternative asset classes in a much bolder way than at present.

And given the propensity to consider non-conventional assets, Mr Sandhu expects regulators to place greater focus on risk management going forward.

When China sneezes...

Recent stock market volatility in China has undoubtedly caused jitters amongst market participants and regulators the world over. However, it will not have a material impact on China's sovereign and corporate credit quality, said Dr Michael Taylor, Managing Director & Chief Credit Officer, Asia Pacific, Moody's Investors Service.

Dr Michael Taylor

He noted most Chinese companies do not rely heavily on equity financing, instead preferring to use debt.

Nonetheless, the challenges associated with the structural rebalancing of the Chinese economy have become more prominent since mid-2015, as the government seeks to restructure the economy on a more sustainable path while sustaining employment - thus highlighting the trade-off between growth and stability.

And despite having come out with a larger than expected policy response, the government still has room for further stimulus measures, said Dr Taylor. However, he added China's debt levels continue to rise as a percentage of GDP.

The two-day conference organised by *Asia Insurance Review* was sponsored by Avicennia Capital and HSBC Global Asset Management.