Q&A-Delayed U.S. election result most significant risk; Equity-hedge strategies beyond Nov. 3 in place: AIA Group CIO Mark Konyn

Heightened equity market volatility extending beyond the U.S. presidential election is the most significant risk for investors, **Mark Konyn, AIA group chief investment officer in Hong Kong**, told the Reuters Global Markets Forum on Tuesday, September 29.

Konyn, who manages $221 billion worth of assets, said his fund had put in place hedges that protect investments in equities for a period well beyond the election on November 3.

"Where we have equity hedge strategies in place to protect the downside, we have extended the term until well after the election to avoid being caught out in this period of higher volatility," he said.

Following are edited excerpts from the conversation:

Q: How are you preparing your portfolio for a delayed or protracted result on November 3?

A: This seems to be the most significant risk considered by investors generally. We are looking at heightened volatility from now till after the election result is declared. This includes a period where the result may be challenged. However, our longer-term views are considered robust. Where we have equity hedge strategies in place to protect the downside, we have extended the term until well after the election to avoid being caught out in this period of higher vol. Our view maintains for a 75% U-shaped recovery and 25% L-shaped. We are confident that consumption in the U.S. continues along its recovery path, and that China's production capacity stays fully online.

Q: Would your equity hedge strategies contain going long on the VIX in some way?

A: We do not trade volatility directly, but instead look at strategies to protect the downside. These strategies have been asymmetric. Downside protection is expensive! And is likely to stay so for a while longer despite the VIX trading well below its elevated levels seen earlier in the year.

Q: In terms of your portfolio, what has changed, either because of election or the tech war?

A: We have benefited from spread widening early in the year and have positioned well for the equity recovery. We remain overweight equities and see the price recovery broadening out. We have shifted back to Asian credit from U.S. credits in the past quarter.

Q: Any particular sectors or markets that you'd like to highlight in your view? To get into, or stay away from?

A: Clearly those sectors particularly stressed by COVID-19 are a concern, and we do not see an immediate and sustained recovery here -- airlines, tourism ......

Q: Are you still invested in companies that benefit from COVID-19 or are you slowly increasing your exposure to companies where the recovery might help them bounce back?

A: The market leadership shown by tech is likely to sustain. In various portfolios we remain exposed to those companies that have benefited from the COVID-19 circumstances, but the case is becoming less compelling. Tech valuations are always high, but the leadership gives a significant advantage and we are under-estimating the long-term implications of COVID-19.

Q: How much of a downmove do you expect in the markets, specifically the S&P 500?

A: We see a significant downside move in the S&P as a low-risk outcome. Judging by market rotation and the amount of money looking to reallocate a short-term move, below 10% in a given two-to-three-week period is the norm. A major downside shock will be a lot more severe, but as I said, is a low risk outcome. By major downside shock, I am talking about >25% in a month. Businesses with cash, strong balance sheets and leading market positions will continue to perform.

Q: Are you moving to bounce-back stories yet or holding on?

A: Bounce-back is too early for the most stressed sectors, mainly driven by behaviours. Take airlines for example. Will business travel return to previous levels? If it does, it will take another 18 months. Tourism as well will take longer to recover.

Q: How does the USD play out in all these scenarios. The last week or so has seen some stability but most market players seem bearish on the dollar. Your thoughts?

A: Yes, the USD is a point of focus for many. The consensus is that the debase of the dollar will cause it to give up value. However, most recently we have seen the reverse; So, structurally weaker but cyclically robust. There is room for Asian currencies to move higher, given the RMB strength.

Q: Which Asian currencies, and how much higher are you expecting them to go? Also, around what level do see the dollar downmove being done?

A: Taiwan and India, for example (have room to go higher). It (dollar downmove) will be modest, (by around) 5%. Also, Thailand and Turkey are seeing external balances deteriorate.

Q: How much upside do you see from these 6.8 levels, especially now that policymakers may be pushing back against stronger yuan?

A: We see inflows into China over the next year and the advantage from a quick resumption of the industrial base as supportive. But the authorities will be mindful of it moving too fast and by too much. Expect a narrow range over 12 months of 4%-6% appreciation.

Q: Back in August, you had told us the Fed will be very reluctant for target rates to go negative. Have you revised your view after the Fed's change in inflation targetting at Jackson Hole? And what does that mean for yields?

A: No, I still hold this view – firmly. The AIT is support for 'lower for longer' and a way to allow inflation to exceed a hard limit without triggering expectations of a rate rise. Three more years at least of financial repression. I expect to see U.S. curve steepening, with short-term rates anchored. 10-year to move higher, above 1%, at least by the end of the Q1 2021. U.S. consumption is back or thereabouts to pre-crisis levels. A lot of focus is on the fiscal support measures in the U.S., clouded by the political posturing – 1 trillion, 1.5 trillion, 2 trillion? It will happen.

Q: So, you don't see the longer end U.S. yield curve sinking below 1%?

A: No. I would put a very low probability on this outcome.. to hit below 1% and stay there for any meaningful time is less than 5%.

Q: Any parting thoughts for us?

A: Stay constructive on risk assets.