Asset allocation and wealth creation

Meet financial goals and maximise wealth

HSBC
Asset Management

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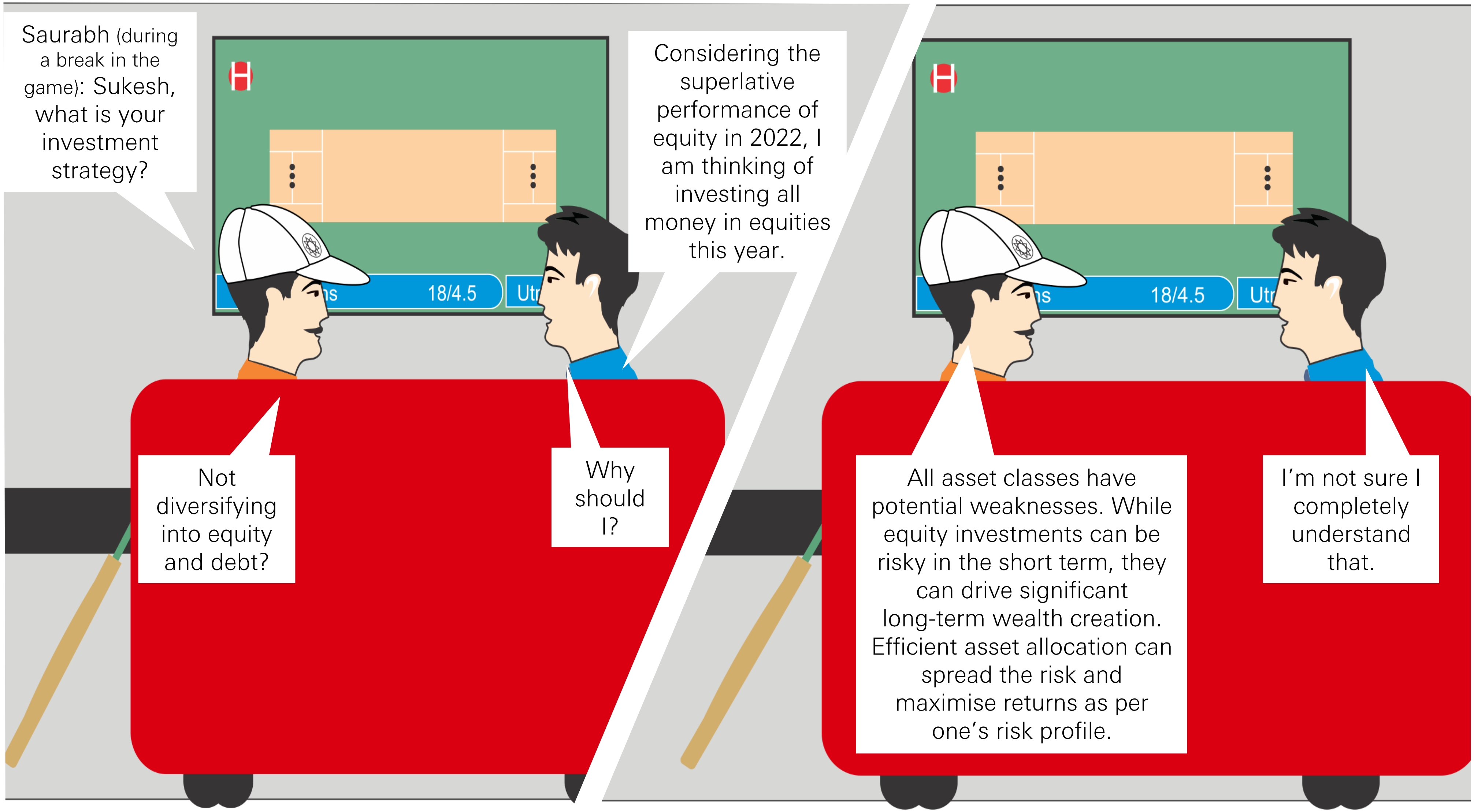
February 2022

Diversify your portfolio to mitigate risks and maximise rewards

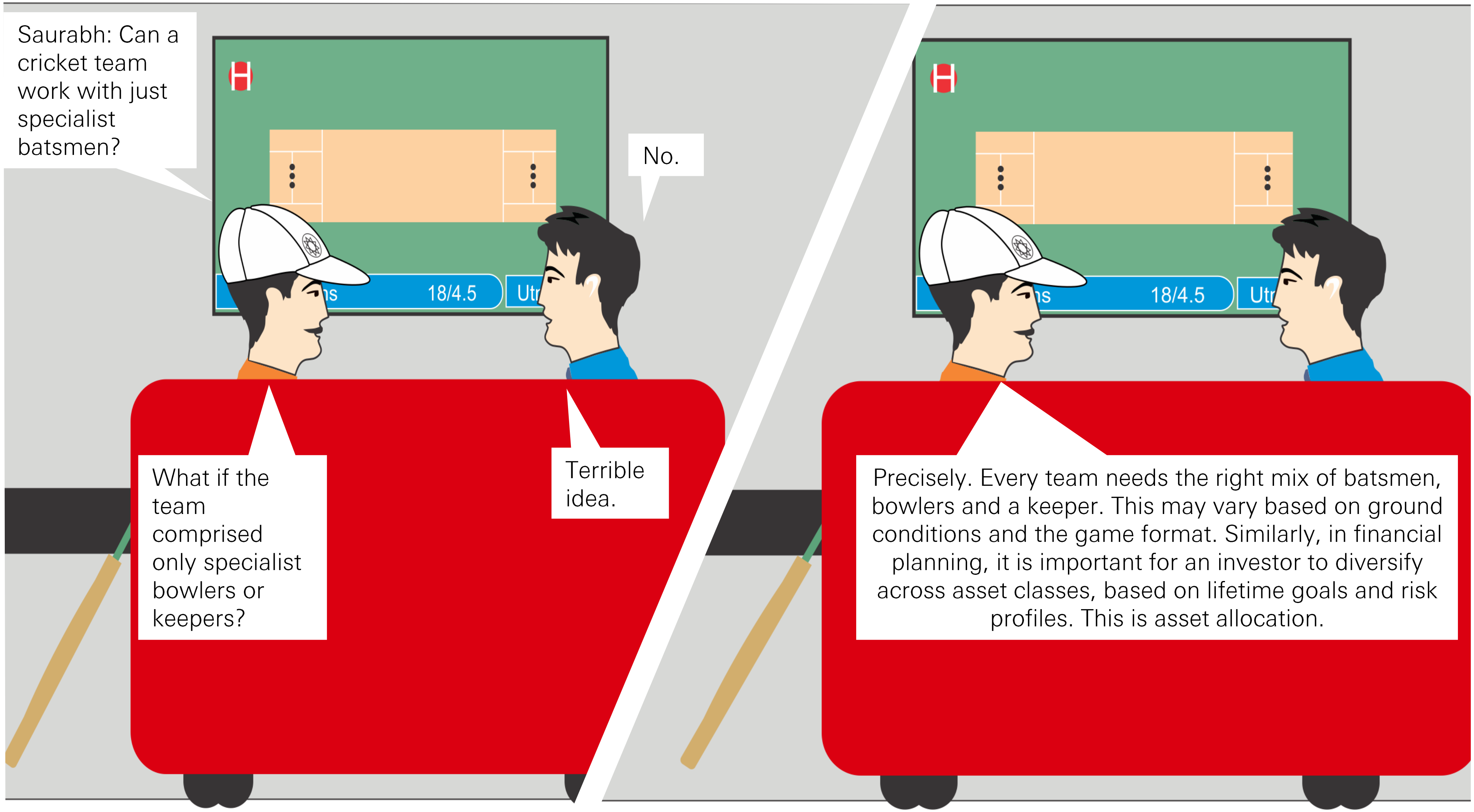
Saurabh and Sukesh are watching a cricket match when...



Past performance may or may not sustain and does not guarantee future performance.

Asset allocation is an imperative for successful financial planning

Diversify your portfolio akin to a winning cricket team



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What do the years gone by teach us?

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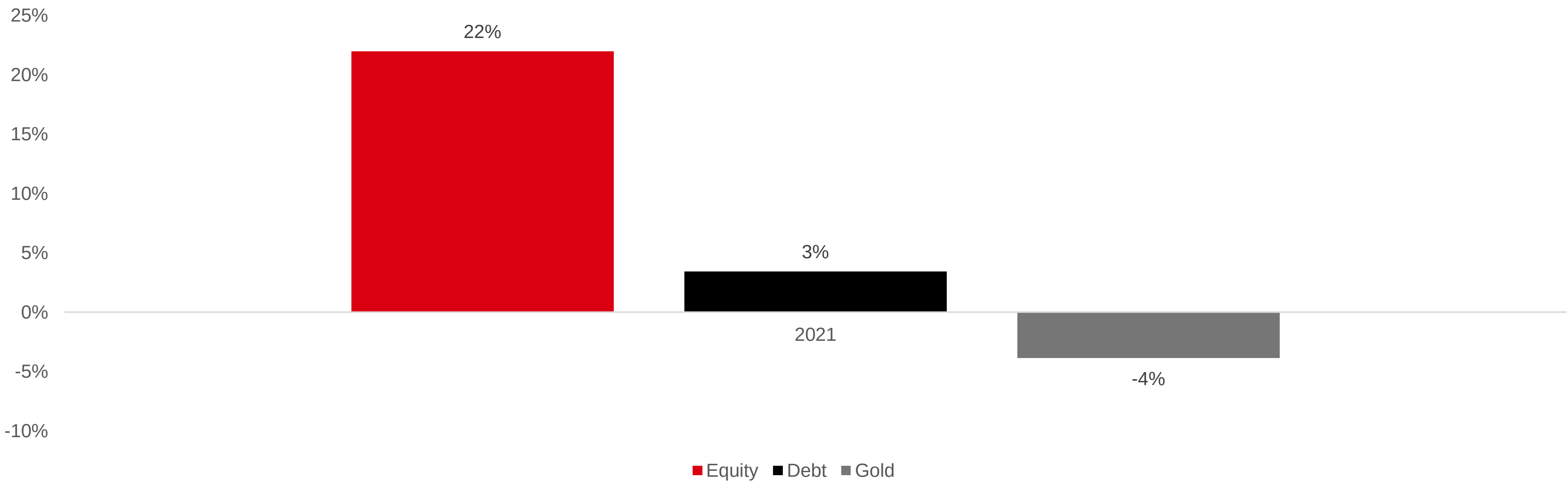
2021 was a less volatile year, in which equity was the top performer

- Equities delivered an impressive 22% return in calendar year 2021, the highest in the category since 2017
- The asset class was buoyed by upbeat macro data, measures taken to repair the pandemic-induced damage and positive global cues
- Debt ended up on second spot among major asset classes
- Gold gave negative returns after giving the highest return at 28% in 2020
- The asset class was weighed down by poor demand and weak fundamentals



Equity represented by S&P BSE SENSEX, debt by CRISIL Composite Bond Fund Index, and gold by MCX spot gold prices (PM) (per 10 gram)

Source: BSE, CRISIL Research

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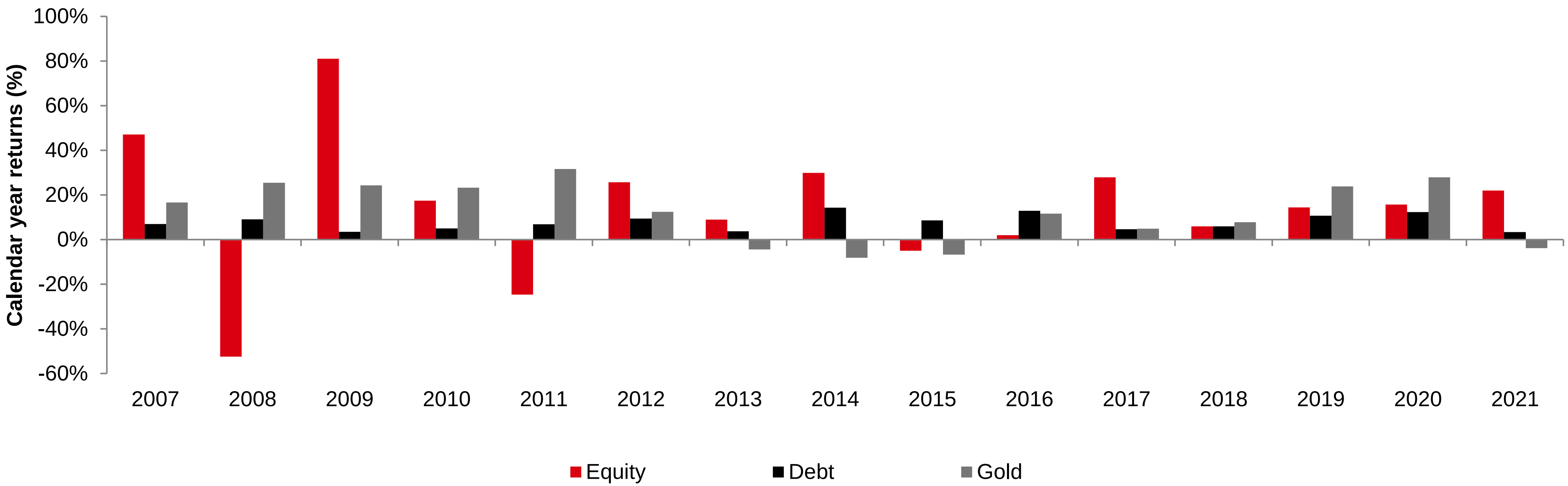
What does the performance history of asset classes indicate?

- Different asset classes outperform each other across different time periods

The best asset changes every year



Equity represented by S&P BSE Sensex, Debt by CRISIL Composite Bond Fund Index, and Gold by MCX spot gold prices (PM) (per 10 gram), Calendar Year Absolute Returns

Source: BSE, CRISIL Research, Data as at December 2021, Past performance may or may not sustain and does not guarantee future performance.

Status of individual asset classes

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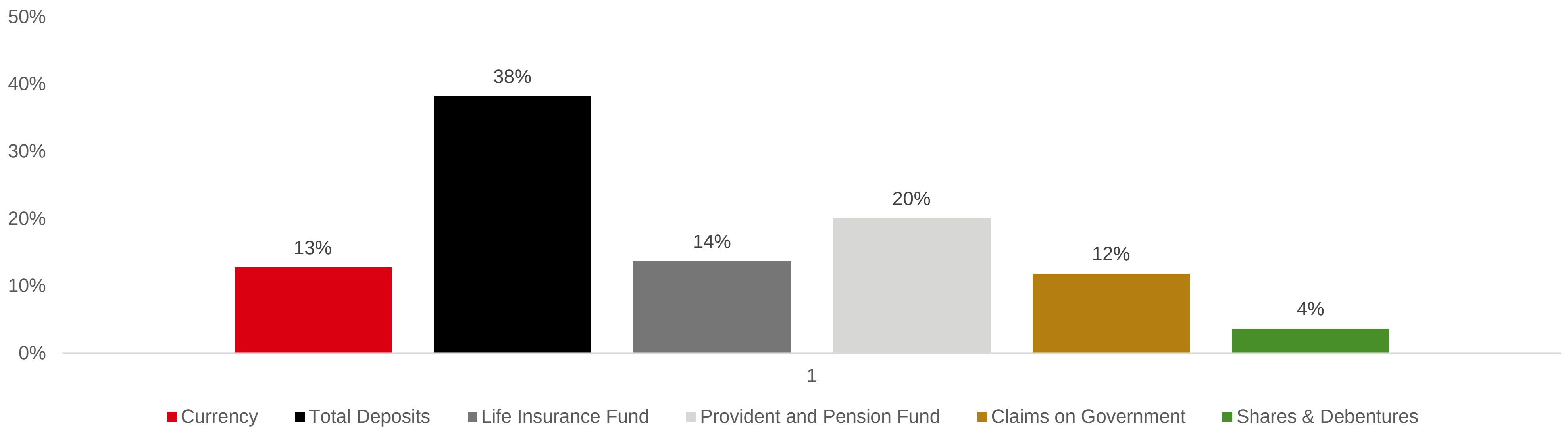
Indians have a traditional bias for the fixed income category

- Traditionally, Indians have favoured debt investments, primarily bank fixed deposits
- Post office savings schemes and provident funds (public and employee) follow closely in popularity
- The higher preference for fixed-income instruments is reflected in India's household savings data
  - Deposits and cash account for ~40% of the total gross financial savings of an average Indian household

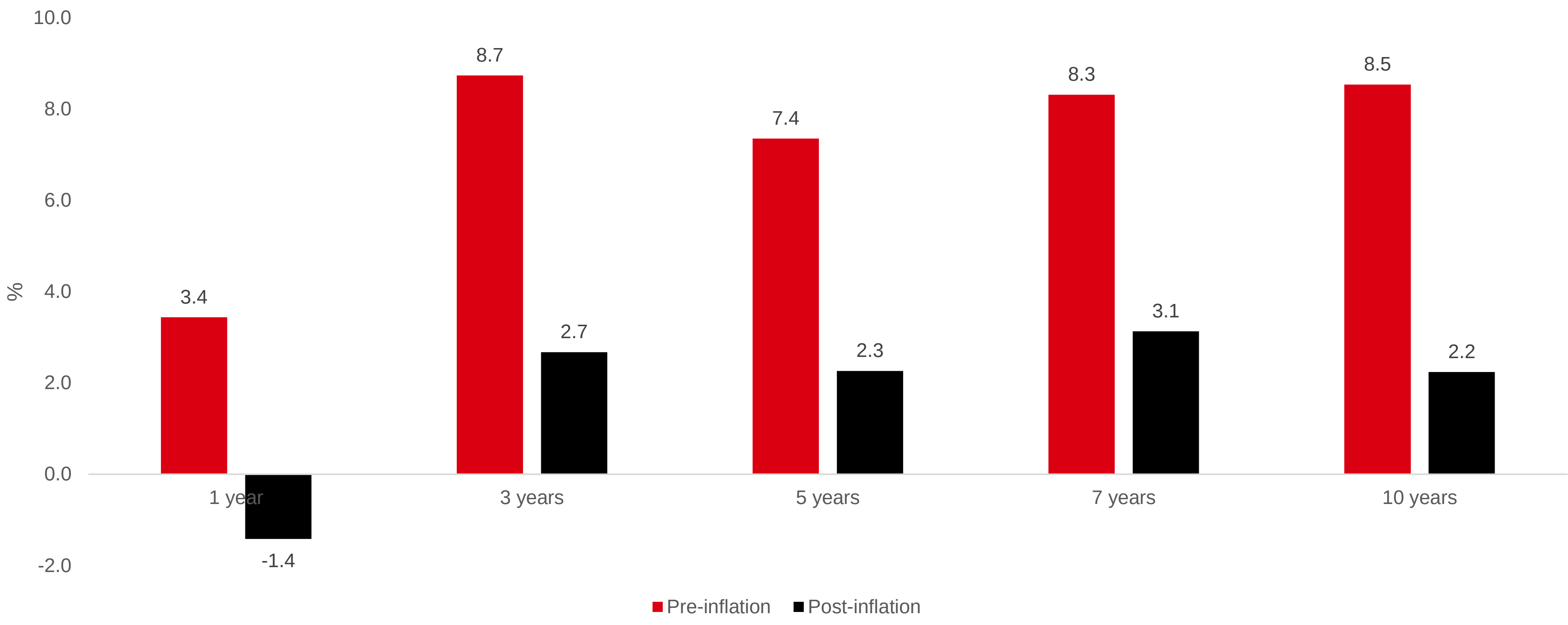
Components of household financial savings



Source: RBI, Data as of FY20

Debt may not offer adequate inflation-adjusted returns

Inflation tends to erode returns from fixed-income instruments, resulting in low real returns (post-inflation) in the hands of the investor



Debt represented by CRISIL Composite Bond Fund Index, inflation by average of annual CPI-IW inflation.

Data as of December 31, 2021

Source: Labourbureau.nic.in, CRISIL Research

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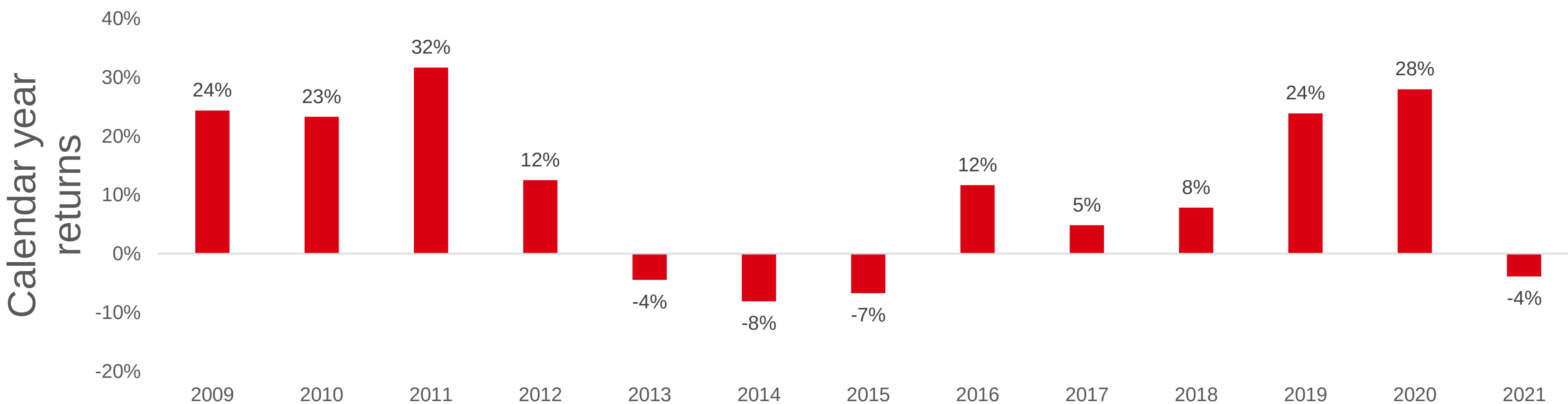
Gold, commodities, and real estate are fluctuating and risky

- Gold: Allocate in moderation
  - While this asset class tends to have a positive growth trajectory in the long term, it is prone to short-term fluctuations
  - Investors should invest in gold in moderation, primarily for portfolio diversification and as a hedge against economic slowdown/recession
- Real estate: Tough to call, has significant risks
  - Project delays
  - Title issues
  - Illiquid investment
  - Varied returns
- Commodities: Regulations still evolving

Gold – fluctuating returns, potential hedge against economic slowdown or recession



Gold represented by gold by MCX spot gold prices (PM) (per 10 gram)

Source: CRISIL Research, Data as December 2021

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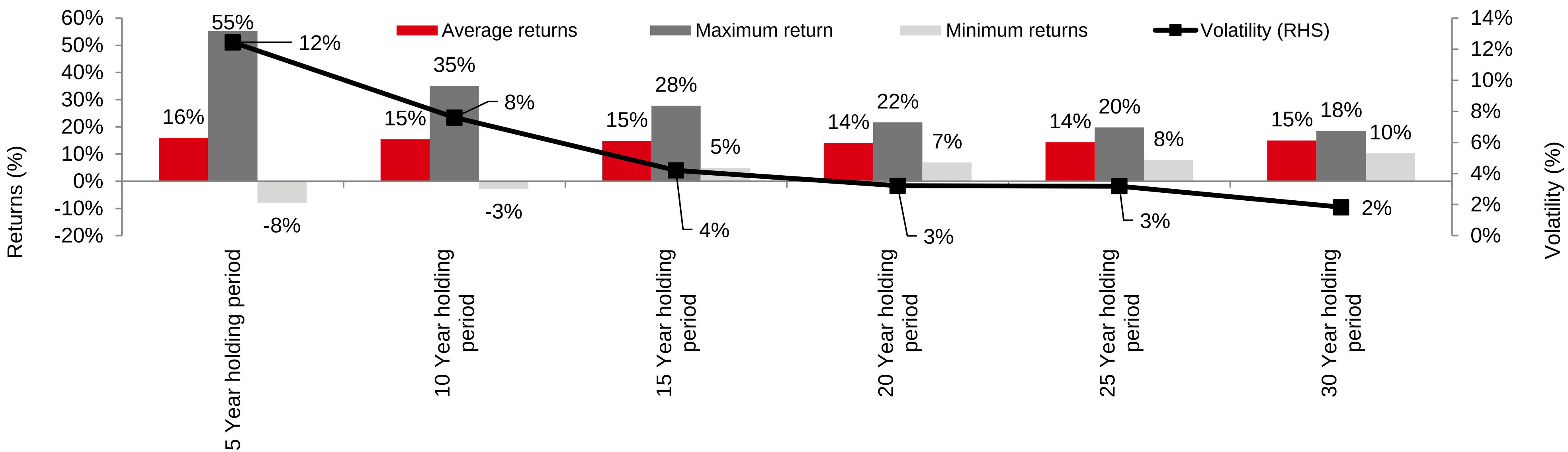
Equity – volatile in the short-term, but has attractive long-term potential

- While equity is a good investment option for a young as well as other types of investors, the asset class is beneficial over the long term
- Equity is exposed to volatility in the short term
- As evident from the returns distribution chart below, the percentage of positive returns increases as the investment horizon increases
- Similarly, the holding period returns chart shows there are no negative returns for an investment period of above 15 years
- Another benefit of long-term investing is that volatility decreases with an increase in the investment horizon

Holding period returns



Average annualised returns on a daily rolling basis since inception (1979) of S&P BSE Sensex considered across various holding periods

Source: BSE, CRISIL Research, Data as of December 31, 2021

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Investor approach

Asset allocation – The key factor

- Allocating funds solely to a single asset class is not prudent as it may not garner efficient inflation- and risk-adjusted returns
- Different levels of correlation among different asset classes provide the portfolio with an effective hedge
- The basic premise of asset allocation is to spread risk from higher-risk to lower-risk asset classes, and maximise risk-adjusted returns based on the risk profile
- Asset allocation is an investment strategy to determine how much of one's portfolio is to be invested in different asset classes, depending on one's risk-taking ability and financial goals
- Further, allocation is not only between asset classes but also within an asset class
  - Equity sub-asset allocation based on market cap (large, mid- and small cap) and sector or theme
  - Debt sub-asset allocation based on maturity (short- and long-term)
- Asset allocation can help meet financial goals and maximise wealth

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Asset allocation reduces volatility, provides better risk-adjusted returns

- To test the benefit of asset allocation, we compared the returns, volatility and risk-adjusted returns under individual asset classes -- equity, debt and gold -- with those under asset allocation combination of the three classes (in a ratio of 40:40:20, respectively) since 2007
- The asset allocation combination fares well on all the three parameters – returns, volatility and risk-adjusted returns

Asset allocation versus solitary asset-class performance

	Equity (100%)	Debt (100%)	Gold (100%)	Equity (40%) / Debt (40%) / Gold (20%)
Returns	10.26%	7.76%	11.65%	10.38%
Volatility	22.00%	2.80%	15.00%	9.32%
Risk-adjusted returns	0.19	0.62	0.38	0.47

Equity represented by Nifty 50, debt represented by CRISIL Composite Bond Fund Index, and gold represented by MCX spot gold prices (PM) (per 10 gram)
Source: NSE, CRISIL Research Analysis done for illustration purposes only; asset allocation will vary based on the individual's risk-return profile and investment horizon
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Goal-based asset allocation

Goal-based asset allocation to achieve specific goals

- A goal-based approach involves investing to achieve specific goals (small, medium and long-term) by allocating money to different asset classes in sync with one's risk capacity and time horizon
- Let us take the hypothetical case of a young professional
  - His/ her priorities across different time horizons are captured in the table below. Based on those, he/she can allocate funds across asset classes

	Short term	Medium term	Long term
Want	Goal – Buying a car Investment objective – Stability Asset allocation – Moderately conservative	Goal – Buying a vacation home Investment objective – Stability and growth Asset allocation – Moderately aggressive	Goals – Foreign vacation, estate planning Investment objective – Growth Asset allocation – Aggressive
Need	Goals – Child care, down-payment on home Investment objective – Stability Asset allocation – Conservative	Goals – Children's education, parent care in old-age Investment objectives – Stability and growth Asset allocation – Moderate	Goals – Retirement, children's marriage Investment objective – Growth Asset allocation – Moderately aggressive

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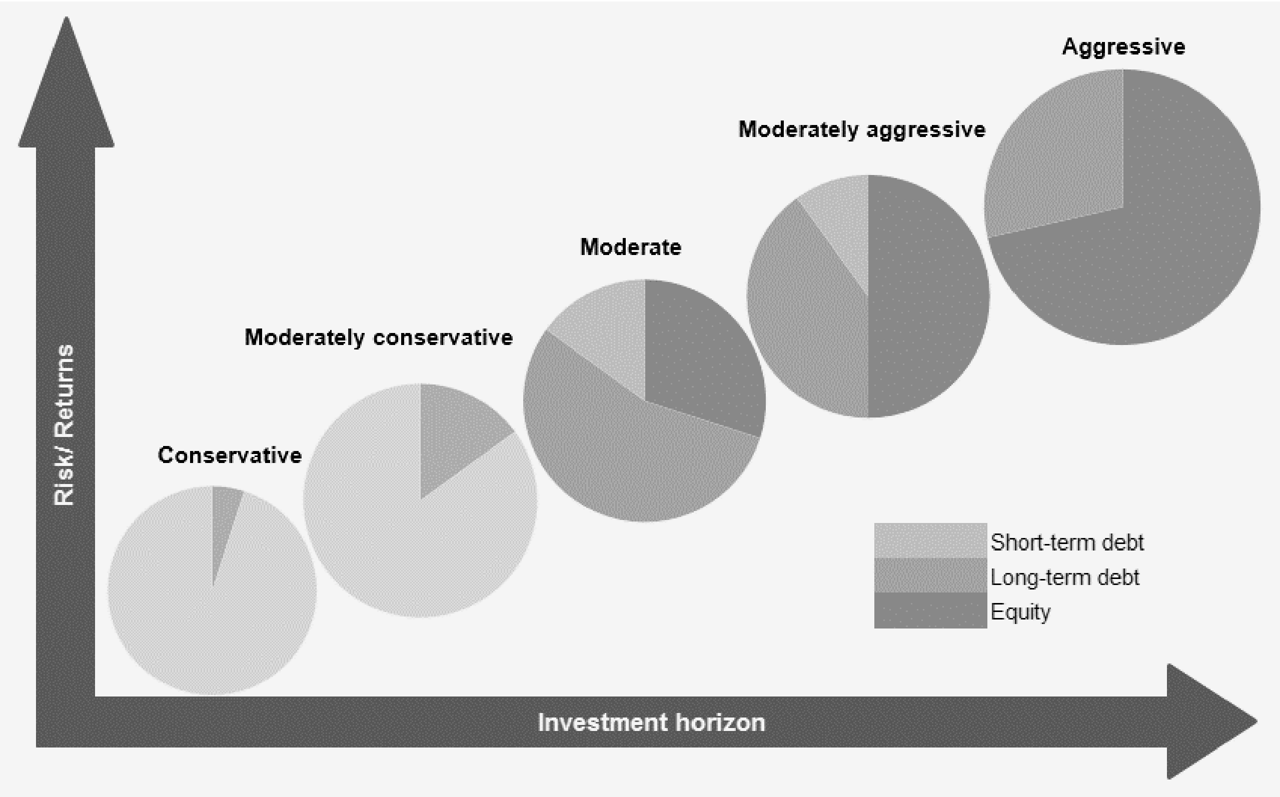
Risk profiling to evaluate risk-taking capacity

Asset allocation based on risk profile

- Risk profiling involves investors assessing themselves on various parameters to evaluate their risk-taking capacity, and accordingly allocating money to different asset classes
  - Risk profiling is usually undertaken via a formal questionnaire-based process where investors answer questions that probe their goals, risk-taking capacity and suitability



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Seek professional help for asset allocation

- Investors may not have the wherewithal to manage their money and allocate assets across asset classes
- Professional management is a viable option
- Investments can be routed through mutual funds
- Benefits of mutual funds
  - Professional management – A dedicated team helps better analyse investment opportunities in the market
  - Research and credit function – An independent research and credit function aids investment
  - Focused risk management – Imperative to manage inherent risks in asset classes

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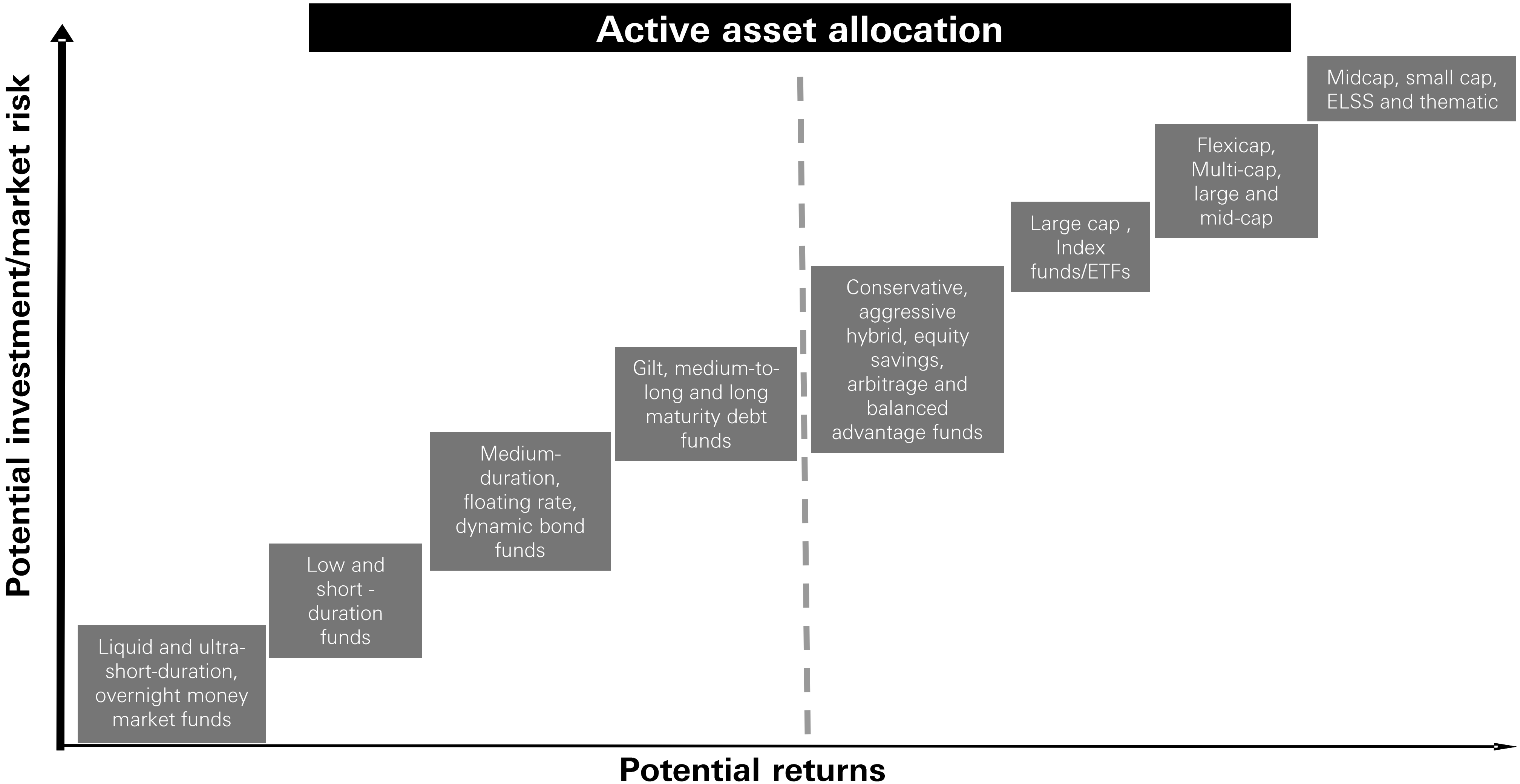
Mutual funds – Easy risk profile-based investing

- Mutual funds offer a variety of funds in each asset class, and investors can choose funds based on their risk-return objectives and time horizons



Note: For debt funds, potential risk involved indicates interest rate risk and is not an indicator of credit risk. Select fund categories are listed in the above chart. Investment horizon given above is only indicative and gives a general idea on an ideal investment period

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Takeaways

Asset allocation impact

- Reduces volatility
- Encourages stable investor behaviour and potentially provides better results
- Rebalancing – A key supporting factor

Asset allocation is an excellent tool to address volatility in investment markets

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