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'Pocket' investment themes can point in a profitable direction

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With the world's most significant stockmarket, the US S&P500, reaching new record highs, with zero interest rate policies continuing to nullify multi-asset-class return profiles, and with heightened volatility driven by greater global uncertainties than any time since the hyperinflation of the 1980s, private bankers and wealth advisers are seeking new and rewarding returns for their clients who have been running out of patience with paying pre-GFC era fees.

And this may go a long way towards explaining why over the past two quarters, "pocket" investment thematics have become all the rage.

Australian ultra high net worth investors have been briefed with their Asian, European and US peers, regardless of the fact that many of these specific pocket investments present additional complexities for Australians when foreign exchange, tax and anti-money laundering considerations are factored in.

A perfect example is the renewed global interest in Manhattan real estate assets.

With the recent completion of the New York Highline project — a 2.33km-long New York City linear park built in Manhattan on an elevated section of a disused New York Central Railroad spur called the West Side Line — a plethora of mega-high-end apartment projects have both broken soil and already sold 80 to 100 per cent off the plans, despite the fact that US real estate more generally continues to plateau.

The 520 W 28th Street building designed by architect ZahaHadid, which was mentioned in this column in June 2014, is weeks away from completion and has set new record highs for per footage pricing.

The reason such investments may be considered pocket and not asset bubbles, is that they generally are specific and not significant enough to be labelled asset or thematic bubbles, as were, for instance, credit default swaps leading up to the Great Recession.

Nonetheless their existence and popularity among UHNW private client advisers cannot be disputed, and it must be remembered that bankers are also in the business of lending and credit as much as they are wealth advisers as well.

The reason given for UHNW investing in Manhattan real estate assets usually comes back to low interest rates or ZIRP technical reasoning, but for Australian UHNW investors, the guidance of JPMorgan chief investment officer Richard Madigan has been heeded:

"While it's important to separate technical and fundamental market moves, every technical move has a fundamental spark."

The fundamental global search for yield has been exacerbated by:

• The economic shock from Brexit, which is forecast (and priced) to be large but mostly local (ie Britain), supporting a decline in broad asset volatility.

• Brexit ramifications through bond markets have been global, leading to an easing in monetary conditions across regions.

• The relative performance of financial assets, with financial stocks extending their decline and higher-yielding securities outperforming as investors chase any nominal income opportunity left.

• Evidence that wage and price inflation is rising, both in the US and Japan.

Specifically regarding the US, it is expected the S&P500 will continue to be range-bound during the remainder of this year and it is fair to expect a pullback of 5 per cent to 10 per cent, driven by rising policy uncertainty, unstable global growth and decelerating buybacks.

Certainly, according to Goldman Sachs, above-trend US GDP growth, a cautious Fed, and an earnings recovery will return the S&P500 to 2100 by year-end — it is about 2152 now — extending the flat market of the past two years.

They have been highlighting three investment strategies for an environment of slow economic growth, low interest rates, and rising uncertainty to three items:

1. US firms with above-average dividend yield and the fastest dividend growth.

2. American stocks with high domestic revenue exposure versus high international revenues.

3. A basket of US stocks with the highest prospective risk-adjusted returns.

But for sophisticated investors with more appetite for yield than risk-adjusted equity returns — whether they be on-market for as S&P500 or off-market, such as private equity or private placements — pocket niche investment plays have found a place within astute client portfolios.

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