

## What We Are Hearing From Asia-Pacific Investors: Five Themes for 2015

Over the past several months, it has been my privilege to visit many of PIMCO's clients throughout the Asia-Pacific region. Japan, Asia ex Japan, Australia and New Zealand together compose a large and diverse set of economies; still, we have observed five important common themes that have emerged among the region's investors:

1. A recognition of lower forward-looking returns,
2. A focus on multi-asset solutions,
3. A desire to look beyond traditional betas in both fixed income and equities,
4. A preference for income-oriented investment solutions and
5. An increased interest in harnessing the potential value of alternative investments.



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Mr. Mogelof is a managing director in the Hong Kong office and head of PIMCO Asia-Pacific, with responsibility for the firm's business throughout the region. In his previous roles, he was head of PIMCO's institutional business in the Americas and was global head of PIMCO Advisory. Mr. Mogelof is also a member of PIMCO's Inclusion and Diversity Committee and served on the board of directors of the PIMCO Foundation. Prior to joining PIMCO in 2003, Mr. Mogelof worked as a financial analyst in the investment banking division at Salomon Brothers Inc. and was also an associate at Jupiter Partners LLC, a private equity firm. He has 18 years of investment experience and holds an MBA from Harvard Business School. He received an undergraduate degree in mathematics and economics from Yale University.

As we head into 2015, PIMCO is prepared to address these themes, drawing upon our time-tested investment process that combines high-level macroeconomic views with thorough on-the-ground research.

### **Theme 1: Recognition of lower forward-looking returns**

As noted in PIMCO's December Cyclical Outlook, the markets have largely priced in the New Neutral reality of lower secular policy rates and lower market returns. The drop in oil prices may temporarily buoy some markets and hurt oil-producing economies, with an overall neutral to modestly positive impact on global growth. However, while this cyclical phenomenon plays out, the secular horizon still portends an environment where lower returns will be the rule rather than the exception.

We were privileged at our December Cyclical Forum to be joined by former U.S. Federal Reserve Chairman Dr. Ben Bernanke, who suggested that global central bankers are likely to remain focused on growth in the real economy in determining the course of monetary policy. Considering that growth is likely to remain measured and that therefore policy rates are likely to remain low, market returns are unlikely to be as ebullient as we have seen in recent years. In turn, this reduces the ability of traditional stock and bond returns to suffice as the engines of a modern investment portfolio.

### **Theme 2: A focus on multi-asset solutions**

We continue to see strong client interest in multi-asset solutions that transcend single asset classes to capitalize on a broad range of potential return drivers. Here in Asia-Pacific, these strategies may be particularly appealing to clients as first steps in deploying assets offshore, given the diversification and multi-sector accessibility they confer, as well as for clients seeking to move into higher-discretion, higher-return target strategies while limiting downside risk.

PIMCO offers a broad array of multi-asset solutions with long-term track records, including strategies with a real return orientation, strategies that express PIMCO's broad "best ideas" and strategies that integrate our absolute return offerings while explicitly managing downside risk.

### **Theme 3: Looking beyond traditional betas**

For decades, PIMCO has provided innovative solutions for enhancing traditional bond and stock betas. Client demand for these solutions has burgeoned in recent years, in light of both the limitations to traditional betas and the abilities of these "smart beta" and "liquid alternatives" solutions to help clients meet investment objectives.

In fixed income, PIMCO's unconstrained strategies seek to move beyond traditional fixed income returns and source alpha opportunities without the limitations of a benchmark. With the ability to modulate interest rate sensitivity and harness a global opportunity set, these strategies provide investors with valuable flexibility in the

face of a lower return environment. Similarly, strategies that seek to opportunistically isolate alpha sources in credit, mortgages and commodities can be powerful additions to a portfolio.

In equity space, PIMCO's StocksPLUS strategies, including the four-time winner of the U.S. Lipper Best Funds Group Large Company Equity award (2010, 2011, 2012, 2013), have been joined by a robust set of offerings in our Fundamental Index-based product suite. The latter strategies have grown from a collaboration with our partners at Research Affiliates, a pioneer in fundamental indexing. Because traditional market-capitalization-weighted indexes tend to overweight overpriced securities, fundamental indexes seek to structurally outperform traditional indexes by investing in securities that are underpriced relative to fundamentals and selling securities that are overpriced relative to fundamentals. PIMCO portfolio managers then add a layer of active fixed income management to this "smart beta" approach, presenting a compelling investment solution.

### **Theme 4: Income-oriented solutions**

Our clients' increasing focus on income-oriented solutions is supported by both demographic trends and market realities. An aging global population naturally focuses on steady sources of income, and uncertainty about long-term market returns augments investor focus on income generation in the near term.

PIMCO's Income strategy is managed by our Group CIO, Dan Ivascyn, and managing director Alfred Murata. Last year, Dan and Alfred were jointly recognized as 2013 Morningstar Fixed-Income Fund Managers of the Year (U.S.). Investors continue to utilize this strategy in pursuit of income without sacrificing a strong risk management focus.

Another income-generation-focused strategy that has attracted interest from investors in Asia-Pacific is the Capital Securities strategy. This strategy blends macroeconomic analysis with rigorous credit research to identify securities that may outperform bank equities and traditional high yield bonds.

### **Theme 5: Exploring alternatives**

PIMCO's alternatives strategies target high returns while aiming to reduce portfolio volatility by focusing on uncorrelated sources of alpha.

We have seen a broad array of approaches to alternatives in Asia-Pacific: Some investors favor direct investments in hedge funds and/or private equity strategies, some prefer fund-of-funds approaches and some primarily seek co-investment opportunities. PIMCO currently offers hedge fund strategies (global macro, relative value, commodity) and private equity strategies (opportunistic real estate and opportunistic credit). We plan to grow this important business to target opportunities that our alternatives portfolio management team identifies, and serve increasing client demand for these solutions. We look forward to continuing the dialogue on this important opportunity set in the coming months.

The above list is by no means exhaustive, but it does represent what many Asia-Pacific investors are prioritizing in 2015.

In closing, let me express my gratitude for the time our clients have taken to share their investment needs and priorities; these exchanges enable PIMCO to serve investors more effectively. We stand ready to support our clients however we can, and we wish you a happy, healthy and prosperous 2015.

**Past performance is not a guarantee or a reliable indicator of future results. All investments** contain risk and may lose value. **Absolute return** portfolios may not fully participate in strong positive market rallies. Investing in the **bond market** is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. The value of most bonds and bond strategies are impacted by changes in interest rates. Bonds and bond strategies with longer durations tend to be more sensitive and volatile than those with shorter durations; bond prices generally fall as interest rates rise, and the current low interest rate environment increases this risk. Current reductions in bond counterparty capacity may contribute to decreased market liquidity and increased price volatility. Bond investments may be worth more or less than the original cost when redeemed. **Equities** may decline in value due to both real and perceived general market, economic and industry conditions. **Investing in foreign-denominated and/or -domiciled securities may involve heightened risk due to currency fluctuations, and economic and political risks, which may be enhanced in emerging markets. Commodities** contain heightened risk, including market, political, regulatory and natural conditions, and may not be suitable for all investors. **Mortgage- and asset-backed securities** may be sensitive to changes in interest rates, subject to early repayment risk, and while generally supported by a government, government-agency or private guarantor, there is no assurance that the guarantor will meet its obligations. **High yield, lower-rated securities** involve greater risk than higher-rated securities; portfolios that invest in them may be subject to greater levels of credit and liquidity risk than portfolios that do not. Derivatives may involve certain costs and risks, such as liquidity, interest rate, market, credit, management and the risk that a position could not be closed when most advantageous. Investing in derivatives could lose more than the amount invested.

Smart beta refers to a benchmark designed to deliver a better risk and return trade-off than conventional market cap weighted indices. PIMCO's liquid alternative strategies are without the principal lock-ups of traditional private equity funds and hedge funds and include separate accounts whose holdings can be liquidated at a client's request subject to current market conditions, mutual funds that can be liquidated at NAV on a daily basis and ETFs that can be liquidated on the secondary market under normal market conditions. There is no guarantee that a security will be able to be liquidated in a timely fashion or when it would be most advantageous to do so.

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The Morningstar Fixed Income Fund Manager of the Year award (2013) is based on the strength of the manager, performance, strategy and firm's stewardship. Morningstar named Dan Ivascyn and Alfred Murata the 2013 Fixed Income Manager of the Year (US). The Lipper Fund Best Group over 3 Years Large Equity award (2013) recognizes funds that have delivered consistently strong risk-adjusted performance, relative to peers

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