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Investor behaviour in a time of financial market crisis

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Introduction

Investments held within managed accounts can include direct domestic and increasingly international equities, directly held fixed interest securities, listed investment companies (LICs), model portfolios, managed funds including exchange-traded products (ETPs) and exchange traded funds (ETFs) and cash term deposits.

Given that the essence of managed accounts is their ability to assemble direct equities and fixed interest securities into model portfolios, a subtle challenge for retail wealth management groups is demonstrating how they make their investment decisions and administer these model portfolios differently to how they oversee regular managed funds.

This paper looks at investor behaviour in a time of financial markets crisis.

Investor behaviour during March quarter

The extreme market volatility observed in the months of the March 2020 quarter provided observers with a rare opportunity to examine the behaviour of investors in a time of financial markets crisis.

With the spread of COVID-19 across the world in the first quarter, financial markets were sent into a period of extreme volatility, with some of the largest single-day falls and rises in history.

Normally in a bear market a rise in volatility is caused by sharp downwards price movements and sudden price rises rather than a long, drawn out process where prices fall gradually over time. Price rises in bull markets are normally much slower, with a commensurate reduction in volatility. As the old saying goes, 'Bull markets take the stairs up, bear markets take the elevator down.'

March was characterised both by sharp falls in prices and equally sharp rises in price. This volatility was caused by the fact that there was no clear consensus on what the pandemic would mean to future economic activity, profits of companies and the ability of corporate borrowers to repay debt.

To provide context, Table 1 shows the monthly changes to key financial markets variables over the quarter, ranked from the largest falls to highest returns. Figure 1 shows the average absolute daily price changes over rolling one-month periods (this is equivalent to volatility). It can be seen for an important variable such as Australian equities that the average daily price change increased seven times from around 0.6% per day in January to 4.1% p.a. at the end of March.

Over the quarter, Australian listed property suffered the greatest loss (34%), while gold in Australian dollar terms had the highest return (19%).

Assets managed through the Australian ETP market as a whole went down in the quarter. At the beginning of the quarter, it managed $61.5 billion and three months later managed $56.9 billion, a loss of 8%.

Investors, however, continued to allocate assets to ETPs with net flows of $3.8 billion. Without these flows, the loss of assets under management would have been closer to 14%. Net flows in March were lower than recent averages, but still positive.

But assets under management and flows only tell part of the story. In the most volatile month (March) traded value spiked to more than 2.5 times that seen in February. The ratio of traded value to net flows increased even more. In January, the ratio was 2.7 ($1.9 billion net flows versus $5.1 billion traded value). In February, it nearly doubled to 4.7 ($1.5 billion versus $7.2 billion). In March, it was 51 ($350 million versus $17.8 billion). This demonstrates just how active ETP investors were in repositioning their portfolios during an extremely turbulent month.

Table 1: Financial market variables

	Jan-20	Feb-20	Mar-20	March quarter
ASX 200 - Listed Prop.	6.4%	-4.9%	-35.1%	-34.4%
ASX 200 Accum.	5.0%	-7.7%	-20.7%	-23.1%
MSCI AC hedged	-0.6%	-7.6%	-12.8%	-19.9%
USD/AUD	-4.8%	-3.7%	-5.1%	-12.9%
MSCI AC unhedged	3.9%	-4.5%	-8.8%	-9.6%
Gold USD	4.7%	-0.2%	-0.7%	3.8%
Bloomber Barclays Aust.	3.3%	1.2%	-0.1%	4.4%
Gold AUD	10.0%	3.6%	4.7%	19.3%

Source: FactSet

Normally when liquidity increases, the cost of buying and selling ETPs would decrease. In March something different occurred with the traded value-weighted spread nearly tripling from 0.12% in February to 0.31%. There were two reasons for this. Firstly, products that historically had wider spreads experienced higher turnover. Secondly, products with tight spreads had to trade at wider spreads because of the volatility in the market.

The most active areas of Australia's ETP market in the March quarter were Australian equities, international equities, gold and fixed interest. Previously minor product categories—such as bear and bull funds, which multiply price changes in underlying indices by a rough factor of two—were particularly prominent in terms of funds flow and traded value.

Australian equities

Australian equities strategies, which include listed property, suffered the greatest negative returns over the month of March. It was therefore interesting to see that these strategies had the highest level of net funds flow ($1.2 billion) and the highest traded value ($8.8 billion). Investors were clearly looking to pick up assets they believed were at bargain prices, reallocating portfolios or just trading the volatility.

Table 2: Australian equities product variables ranked on March net flows ($m)

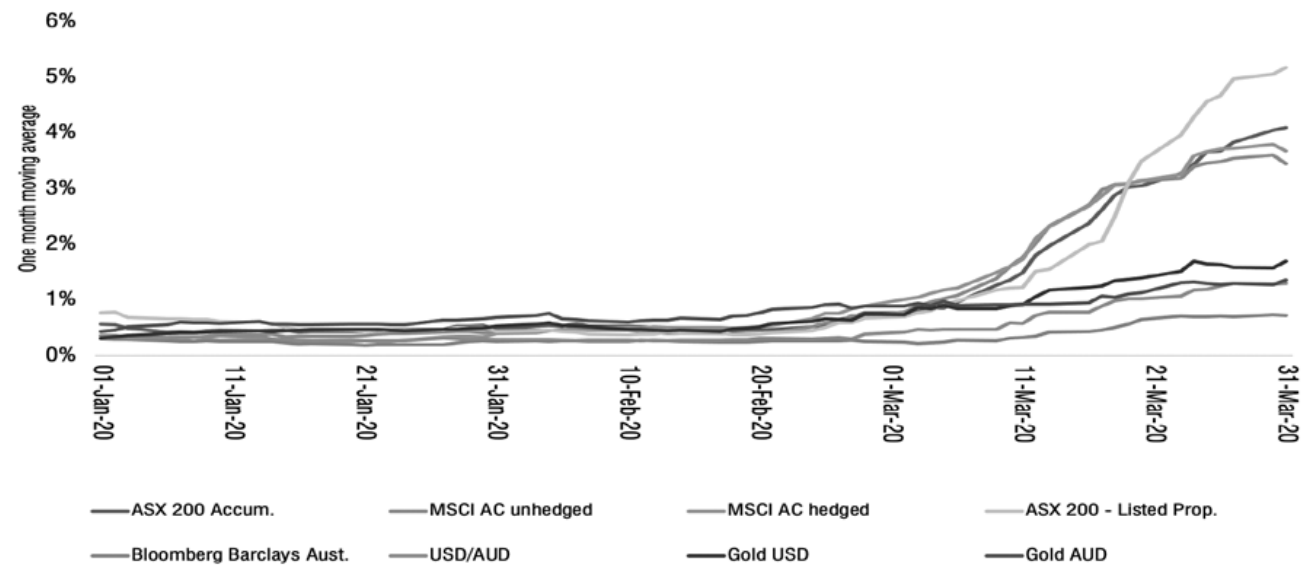
Name	FUM	FUM change	Net flows	Traded value	Rank
Vanguard Aust Shares Index	$4,199	-$417	$538	$1,617	1
SPDR 200 Fund	$3,095	-$408	$283	$1,372	2
Betashares Australia 200 ETF	$613	-$42	$99	$534	3
BetaShares Aust Eq Strong Bear	$366	$159	$85	$1,964	4
BetaShares Geared Aust Equity	$109	$20	$61	$515	5
BetaShares Aust Top 20 Eq Yld Max	$227	-$66	-$8	$33	49
BetaShares Aust Div Harvester	$127	-$27	-$17	$28	50
SPDR S&P/ASX 200 List Prop	$398	-$278	-$24	$68	51
VanEck Vectors Aust Res	$42	-$41	-$25	$29	52
iShares S&P/ASX 200	$1,582	-$494	-$69	$979	53

Source: ASX, Rainmaker

The quote

The equities bear market resulted in a huge increase in traded value.

Figure 1: Moving average daily price changes



Source: FactSet, Rainmaker

The quote

Despite market turmoil, net funds flows were positive both in the March quarter and the month of March.

Table 2 shows the top and bottom five Australian equities strategies based on their net flows in March. The top three products are similar to each other, in that they are based on market cap-weighted indices with low management fees and tight spreads.

Positions 4 and 5, however, are completely different. The BetaShares Australian Equities Strong Bear Fund makes money when the Australian shares index falls (at a ratio of around 2 to 1). It was one of the few products to increase in assets under management in March and had positive net flows. It had the highest traded value of any product in March at nearly $2 billion. This was for a fund that had just over $200 million at the beginning of the month. The ratio of traded value to assets was 9.5, which is another way of saying the turnover of the product was nearly 10 times in one month. The next two products with the highest traded value to assets ratio were the BetaShares Geared Australian Equities Fund and the BetaShares US Equity Strong Bear Fund, with ratios of 8.8 and 4.7 respectively.

While these products are great for hedging portfolios so that investors do not have to sell long-term holdings that may have embedded capital gains, it looks fairly apparent that investors were using their magnified effect to trade volatility for short-term gain. When prices on underlying indices were changing at an average of 4% a day in March, this means the average change in price of these products would have been around 8% a day. It is also likely that products based on Australian indices would only have been available to trade in Australia. International investors probably contributed to the elevated levels of traded value in the Australian-based products.

The largest net flows occurred in plain vanilla products based on market cap indices: Vanguard Australian Shares Index, SPDR 200 Fund and BetaShares Australia 200. These also had a high amount of traded value historically.

During March the asset-weighted spread of Australian equities strategies increased to 0.2% from 0.08% in February.

International equities

In the March quarter there was a 10 percentage point difference between currency unhedged returns and currency hedged returns (–10% versus -20%). The currency hedged returns are reflective of local currency returns, while currency unhedged takes into account changes in the exchange rate of the Australian dollar versus those local currencies.

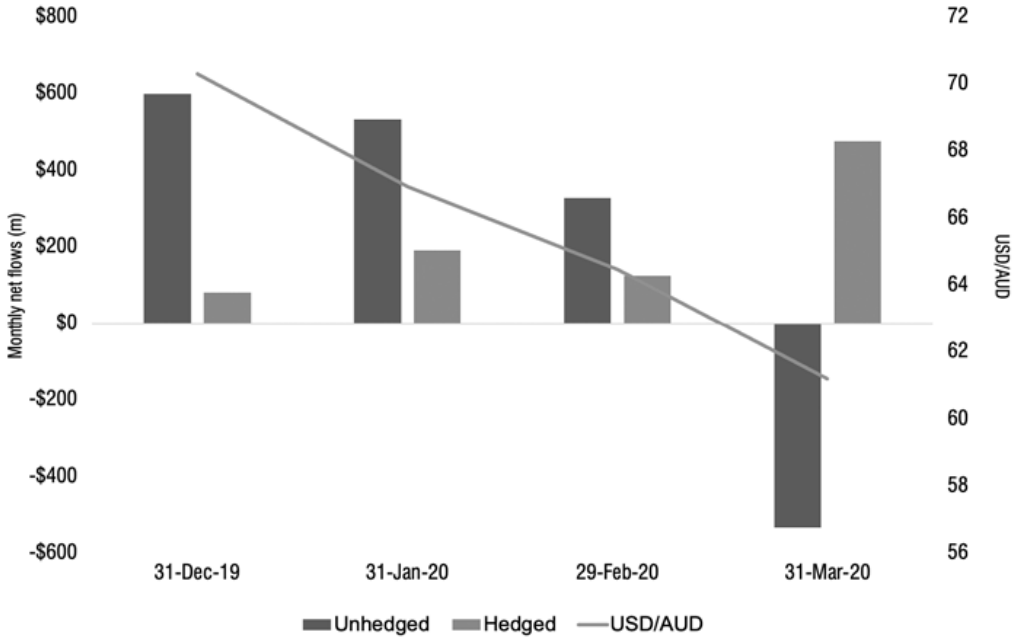
When a currency depreciates, an unhedged position makes more money than a hedged position, with the opposite being true when a currency appreciates.

In this situation, the Australian dollar depreciated in each of the three months of the March quarter, falling from around 70 US cents to around 61 US cents, a drop of around 12%.

While the Australian dollar was falling, net flows to unhedged international products continued to be positive. Flows were also positive to hedged products (a much smaller proportion of the total universe) although at a much lower flow rate.

The situation changed dramatically in the month of March, however, with large outflows from unhedged products ($533 million) being nearly completely offset by positive net flows into hedged products ($476 million). This happened at the very time that the Australian dollar reached its low point against the US dollar.

Figure 2: Net flows, hedged versus unhedged international equities



Source: ASX, Rainmaker

This showed some canny repositioning on the part of investors (assuming the sellers of unhedged and buyers of hedged products were the same entities), particularly if the Australian dollar goes on to appreciate.

Table 3 shows that the top five products in terms of net flows in March were all hedged, while the bottom five were unhedged. Interestingly, the product capturing the second highest flows, the iShares S&P500 Hedged, captured nearly the whole of the outflows from the product with the highest outflows, the iShares S&P500 Unhedged.

Table 3: International equities product variables ranked on March net flow ($m)

Name	FUM	FUM change	Net flows	Traded value	Rank
BetaShares US Eq Strong Bear (H)	$226	$85	$60	$662	1
iShares Core S&P 500	$3,030	-$347	-$156	$555	2
Vanguard MSCI Index Int	$2,012	-$193	-$32	$346	3
Vanguard US Total Market	$1,677	-$192	-$45	$323	4
Magellan Global Equities	$1,614	-$103	-$31	$266	5
ETFS S&P Biotech ETF	$8	$0	$0	$1	93
BetaShares Legg Mason EM Fund	$10	-$1	$0	$1	94
AMP Capital/BetaShares Global Prop Sec	$22	-$4	$0	$1	95
Morningstar International Shares Active ETF	$10	-$1	$0	$0	96
iShares MSCI Taiwan	$0	$0	$0	$0	97

Source: ASX, Rainmaker

It is also interesting to note that the product with the third highest net flows (more than doubling its assets under management) was a hedged energy company fund. Investors there are clearly looking for a bounce in both the Australian dollar and energy prices.

Note also the product with the highest traded value was the BetaShares US Equities Strong Bear Fund (hedged). This was not as great as the Australian version at $662 million, but still three times its assets. This gives weight to the theory that international investors were involved in the Australian-focused product.

In international equities strategies, the traded value-weighted spread increased from 0.19% in February to 0.53% in March.

Commodities

Gold came into its own in the March quarter with the price rising strongly throughout the quarter in Australian dollar terms.

The traded value of all commodities products increased by a factor of six over the quarter, from $166 million (on assets of $1.9 billion) to $1 billion on assets of $2.5 billion in March. Monthly net flows increased fivefold from $48 million in January to $257 million in March. The largest product in this asset class was ETFS Physical Gold with 65% of total assets. **FS**

The quote

Volatility across asset classes rose dramatically in March.