

Big doesn't matter anymore

The region's private banking industry has been shaken by the global meltdown. Apart from seeing shrinking top lines and operating income, these banks have also lost customers. **Utpal Bhattacharya** speaks to bankers about the changing trends in the industry.

"There is a new investment product that is the cynosure of every investor these days, and that's a fixed deposit account," announces a private banker, tongue in cheek. He is right, except that it is not a new liability product, nor is he making a good commission out of booking fixed deposits compared to what he made selling collateralised debt obligations or CDOs, as they were glamorously called in their heydays.

This writer still remembers going to a press conference in 2006, where a local bank in Dubai was launching a debt instrument that paid a high single-digit coupon per annum. There was almost derision and disbelief among some of the invited investors that such a "lousy" offer was possible at a time when people went home richer by 20 per cent or more day-trading on equities and real estate.

The winning spree lasted a long time for many investors in the earlier part of the decade and also led them to throw all caution to the wind. When the downturn came, all those with the conviction that good times never end lost most of what they had made in four years, almost overnight.

Disaster struck, but not without warning. There were telltale signs everywhere for a long time before the financial Tsunami hit the shores of the GCC. However, most new millionaires and the young heirs of family businesses, who believed they were experts in investments, refused to heed the warnings. The investing environment was similar to one of winning bets in a casino, with the winners becoming ever

greedy. The result was that they paid the price and walked out of the market not only having lost their own equity, but also a lot of borrowed money.

Private banks that had hired a flood of people to service new millionaires and sell them myriad products, along with leverage and a promise of significant upsides, suddenly found out that they were not only losing revenue and credibility, but also their customers. There have been large retrenchments in a number of private banks in the region, especially in Dubai. Some of these banks moved their employees to other places as demand in Dubai was replaced by defaults.

"The market in the boom time was ruled by sheer greed. People were asking for and were promised returns of 20 per cent and more. That is always a recipe for disaster, which happened," says Rohit Walia, executive vice chairman and CEO of Sarasin Alpen.

Incidentally, Sarasin Alpen has been exceptional, claims Walia. In the last 18 months, the bank has not asked any employee to leave. In fact, the bank has been hiring almost every month in this period. It has also taken up more floor space in the Dubai International Financial Centre to accommodate its growing resources.

Not many have been as lucky as the conservative Swiss bank, but Walia argues that a bank's business has to be conservative in nature, as it primarily involves taking deposits and giving loans and operating on a spread of three to four per cent. If customers are promised high

double-digit returns on investment products, the business is building up significant risk for both the investor and the bank, he adds. But that's what happened to a number of banks, not only in the GCC, but also globally. The result was losses and pain once the downturn hit and the model of high leverage became unsustainable.

Risk aversion

Amir Sadr, head of Merrill Lynch Wealth Management for the Middle East, says that following the economic and financial crisis, clients are no longer as aggressive as they were before. But some of them are beginning to come back to the market now, trading and speculating, he adds.

"Certain clients are speculators and will be always speculators, but the vast majority are more risk averse today than they were 18 months ago," he notes.

Walia agrees. He says that although risk tolerance remains low even today, with cash and near cash preferred in many cases, there is greater willingness now to invest a proportion of assets in more volatile areas such as equities and commodities.

The reason is obvious, with global markets having bottomed out in the summer of 2009. Although markets have remained extremely volatile, there have been significant opportunities to make money, which some investors made, Walia says.

According to Walia, both equities and commodities offer exposure to the improving global economy today and both suffered terribly during the bear market of 2008. Even after a good year last year, equities and commodities are trading significantly below their

historic highs and both offer potentially attractive returns in the years ahead, he says.

"Although risk aversion remains high, we are recommending that clients consider increasing the risk profile of their portfolios in a measured and controlled way," adds Walia.

Walia says there are clearly two opportunities for regional clients. The first is to invest locally in the GCC equity markets, as the region lagged global emerging markets by a significant margin last year and is trading on an attractive valuation discount. The recovery in oil

revenues has provided the regional governments with the ability, and they have shown the willingness to increase spending to support economic growth, he points out.

The second area that Sarasin Alpen is recommending to its clients is the new "nifty fifty" of global blue-chip equities. These are well capitalised stocks that

have been overlooked and de-rated over the last two years that show powerful returns, risk, cash flow and yield characteristics and where future dividend growth is capable of outstripping inflation, Walia argues.

Asset allocation

Experts have said that post crisis, regional investors have turned inward, with their geographic preference being the GCC. The GCC is followed by India and China. Asset class preference has been real estate, fixed income and GCC equities. Capital guaranteed products have been in good demand, while oil and gas, industrial manufacturing and telecommunications have been a major industry preference.

Sadr says clients are currently looking at countries that are politically and economically stable.

Asia is a hot play now. Another trend that is particularly discernible after the crisis is a lot of investors globally returning to their local markets because that is the market they know best. The GCC investor has been no different and has focused on the Middle East and North Africa, apart from South Asia, Sadr adds.

Sadr also points out that things are beginning to change now, as new opportunities in the western markets are compelling some fund flows out of the region, although there is caution among investors due to hotspots like Greece.

"Investors are looking at certain parts of Europe, where there are signs of improvement; for example, in France and Germany. There is also the US, which is likely to lead the global recovery," he notes.

In terms of asset classes, cash continues to dominate, says Sadr. But when cash levels are high, clients are typically looking for yields. This is one of the reasons local currency deposits that offered high rates were welcome by customers and preferred against equity investing last year.

Walia points out that there have not been many takers of international bonds recently, despite the fact that they are low-risk assets and appeal to certain clients.

He explains: "Substantial new bond issuance, low yields and the risk of rating downgrades to countries such as the UK and the US, not to mention Greece, means that we are not experiencing the kind of interest we used to. The fear that governments will try to inflate their way out of their debt crisis is also proving a deterrent for clients."

Need for transparency

There have been some interesting trends coming out of the crisis, as high net worth investors are no longer going by big names like



Amir Sadr

Wealth protection becomes a priority

Gary Dugan, chief investment officer of private banking at Emirates NBD, responds to questions from **MONEYworks** on private banking and investments.

What sort of demand do you see from customers post-crisis?

The demands on us from clients are different from the past. In the past, private banking clients in the region were mostly interested in short-term trading opportunities and higher risk assets and products. Things have changed. Clients are asking us to protect their wealth and advise them on developments in the regional and global economy. Hence, we are showing our clients conservative investment solutions with a bias to cash and bonds.

What sort of innovative products does Emirates NBD offer its customers, especially being home grown and familiar with the market and culture?

We are offering a wide range of products that are invested in the local markets – bonds, equities and sukuku. We are also seeking to offer clients international selective products that are based on what we believe to be the growth industries of energy, technology and green issues.

Is there a major difference between the local and expat customer?

The major differences between local and expat customers are currency risk and the global perspective. It is less natural for an expat client to want to invest in the local markets. Expats tend to invest more globally, often focused on the markets they will retire to. For example, a UK expat will want some of their assets invested in the UK financial markets and they will be concerned about the negative impact on their future wealth from a major appreciation of sterling against dollar.

What about risk appetite?

We find that our clients have remained quite cautious about the outlook. Clients

have continued to keep large cash balances. More recently, we have seen some appetite for investing in bond markets. Some of the recent local bond issues that have been priced on six per cent plus yields have tempted some investors to switch some of their cash into bonds. A small number of investors have invested globally in equity markets to take advantage of the recent strength of the markets.

Can you describe the international investment scenario versus local?

In the near term, the outlook looks better for the international markets. Longer term, we believe the local markets have considerable upside. In the near term, the international markets can look forward to already well-established growth. The rapid recovery of the economies of Asia and the US has provided a very positive backdrop to their financial markets. We would not be surprised to see the international developed markets deliver a further 10 per cent plus returns by the end of the year. The local markets need to see a return of confidence in the local economies to show any significant returns for investors in the near term. With oil prices likely to remain high and global growth strong, it is only a matter of time before growth in the local economies starts to accelerate. More confidence in regional growth will bring stronger flows of capital into the region and good returns from the local financial markets.

Is Emirates NBD planning to introduce any new product in the private banking space?

In the next few months, we intend to introduce a comprehensive wealth-planning tool that will enable us to build a purposeful set of investment



Gary Dugan

proposals for a client's needs. We also aim to introduce long-term savings plans that provide a client with significant flexibility over the investments they can choose and aims to minimise the risk a client needs to take in order to hit their investment return goals. In the near term, we are focused on bringing the clients investments that offer a high level of income yield with some capital gain.

How is the Emirates NBD offering different?

We are differentiating ourselves by offering advice, not product push. Our aim is to offer a comprehensive service of advice that has at its heart providing the client with a strategic asset allocation that matches their long-term needs. A balanced portfolio that serves the client well in the full range of economic conditions is something that will build their wealth solidly over the longer term. We are investing in having one of the strongest teams of research and advice professionals that combines local knowledge with international experience. We are well equipped with the latest software data and best-in-class thinking for private banking client needs. We aim to have a full team of investment professionals based here in the UAE able to provide advice face-to-face, not on a quick phone call from New York or London.

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they used to before. Undoubtedly, there has been a loss of credibility for banks, as investors lost a lot of money after being promised windfall profits. These investors are now even questioning the basis of research of the banks, disclose bankers.

Sadr says the entire private banking and wealth management industry has changed in the past year or so. And banks have to work very hard on the trust deficit of clients.

“When we were in a bull market, clients would buy our ideas and the markets and the portfolios would go up. It was a lot easier those days. But today, clients are questioning all aspects of our industry and relationship,” Sadr adds.

Bankers say that clients are also now questioning the jurisdictions and the platforms and are extremely concerned about the safety of their assets. They are checking on the custodian and the regulatory aspects, which they left to

bankers and advisers in the past. All these are forcing more transparency into the industry.

“Transparency is absolutely critical now. And right now, we as a bank are taking our customers through a process of being completely transparent about all aspects of their accounts,” discloses Sadr.

Private clients are also asking questions about the fees and other costs. In fact, bankers say that the days of hidden fees are coming to an end. Pricing has to become more transparent if clients are to be retained, as clients are no longer loyal to any particular organisation. They are looking for the best value for their money and great service.

Walia cannot agree more. He says that clients are seeking much more from their banks now than before the crisis. Especially with banks having retrenched staff in large



Rohit Walia

numbers, clients have to speak to different relationship managers, which is not always the best position to be in.

In the GCC region, where high net worth individuals control about US\$1.4 trillion in wealth, private banking has to be

about consistency and stability in the future, say bankers. But increasingly smaller players will get into the market space with service and consistency compared to the past, when larger banks won clients hands down.

“Private banking is going to be all about consistency and track record in the future. Clients want stability, both at the banks and with the people they deal with. It was always important, but now it has become even more important, with clients having lost so much money and trust. And big will not matter anymore, as clients will look for a sound and stable bank to bank with,” notes Walia.

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