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KL CONNECTIONS

GameStop saga: why we need shorting

Argonaut's Barry Norris argues we would inevitably have a more dishonest stock market without short selling (page 2)

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PGIM Real Estate in UK Affordable Housing launch

PGIM Real Estate has launched its UK Affordable Housing Fund, with an initial capital raise of £190m from the Northern LGPS and Brunel Pension Partnership.

The open-ended income-focused UK Affordable Housing Fund targets a total return of 6-9% per annum, net of fees and costs, by investing in and developing affordable homes for working people and families across the UK. It is also able to leverage, giving it the potential to deploy up to £250m at launch. The fund is managed by an experienced team of professionals at PGIM Real Estate, including senior portfolio manager Paul Dennis-Jones and head of UK transactions Charles Crowe.

There has been a collapse in supply of UK affordable housing since the 1970s, with lack of affordability exacerbated by the end of local authority housebuilding. In 2018/19, just 57,000 affordable/social homes were built in England, versus an estimated annual need of 145,000.

Dennis-Jones comments: "There is a clear social need to be met in the affordable housing sector. Our deep global expertise in ESG, in combination with our long history of investing in this sector, means we are able to build safe and quality homes to meet social demand and deliver long-term investment performance."

GameStop: why we need shorting

Barry Norris
Argonaut

The meteoric rise of GameStop's stock earlier this year was widely celebrated as a kind of peasants' revolt of retail investors against hedge fund suits.

If short sellers could be broken on the wheel of a popular buying frenzy, then this would not only be symbolic of a redistribution of wealth, but also of power.

While this is a seductive narrative, unfortunately it is deeply flawed. Although the price of any asset can be manipulated in the short term, ultimately an investment made solely on price momentum requires incremental buyers at ever-higher prices. When inevitably these dry up – with no commensurate improvement in the company's trading prospects – then the stock will eventually collapse. Caveat emptor.

Short selling in a bull market is not an easy living. Although widely seen as malicious, in fact it only succeeds if an unpalatable truth is discovered.

"Short sellers often unmask fraudulent management, as well as poor business models"

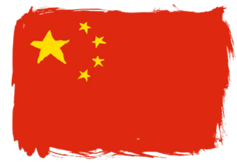
Short sellers often unmask fraudulent management, as well as exposing poor business models. Last year, the spectacular collapse of German payments company Wirecard was a direct result of painstaking research carried out by short sellers. NMC Healthcare in the UK was similarly exposed.

With the rest of the investment industry motivated solely by higher prices, without short sellers, these crimes may have never come to light. If there are no short sellers to play the role of market vigilante, we would inevitably have a more dishonest stock market. In the absence of shorts, capital would be allocated less efficiently, and economic growth would suffer over the long term.

The stock market should make capital raising easier for companies with better growth prospects and more difficult for the rest.

This time last year we witnessed the steepest falls in equity markets since 1929. This highlighted the folly of diversification through investment products solely dependent on rising prices. Without any ability for fund managers to hedge through short selling, fund buyers would be unfairly corralled into equity products reliant on upward market direction for returns.

China prospects in the Year of the Ox



Jane Andrews
BambuBlack

China presents many investment opportunities – particularly companies operating in the domestic market, which are beneficiaries of Xi Jinping's new 'domestic circulation' strategy.

The adoption of telemedicine has accelerated due to Covid-19, utilising the latest AI technology and the support of China's authorities. Coupled with a positive regulatory tailwind, this is an area of long-term secular growth relatively immune to the economic cycle.

For instance, Ping An Healthcare and Technology, the world's leading online healthcare platform, has revolutionised China's healthcare system, giving people access to doctors and medical advice more quickly than ever. During the Covid-19 outbreak, one billion people visited Good Doctor, Ping An's online medical portal.

"Ping An Healthcare and Technology has revolutionised China's healthcare system"

Charles Walsh
Mirabaud

At Mirabaud, our multi-thematic approach helps us identify and invest in the best structural growth opportunities across emerging markets.

As the world embraces the challenge of significantly reducing carbon emissions, we are faced with the collective need to rapidly increase the production of things such as solar panels and high-density batteries. China is a leader in these areas, and our energy transition theme – which includes the sub-themes of renewables and new energy vehicles – is dominated by innovative Chinese companies.

Chinese stocks are also highly visible within our emerging middle class theme. Given the sheer size of the populations in China and India, these countries – as they continue to develop – are likely to be the major source of the new global middle class.

"Our energy transition theme is dominated by innovative Chinese companies"

Hugo Robinson
Arisaig

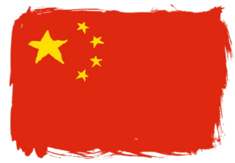
From a top-down perspective, China remains one of the most exciting emerging markets.

Numerous trends at play are tailor-made for our long-term investment strategy, which aims to capitalise on the growth of the emerging consumer – the shift from smokestack to knowledge economy, the rising importance of domestic consumption and the formation of increasingly dense networks of human capital.

If China is to become a consumer-oriented, technologically competitive country, it is hard to imagine this happening without a dynamic, innovative private tech sector. Digitalisation continues to open up exciting new opportunities, for example in education and healthcare, as well as in SaaS and the cloud. These 'dematerialised consumption' categories are a key focus for our research team.

"Numerous trends at play are tailor-made for our long-term investment strategy"

China prospects in the Year of the Ox



Juliana Hansveden
Nordea

China has performed exceptionally well in managing both the health and the economic impacts of the pandemic.

We expect the Chinese economy to deliver strong growth this year as it benefits from both cyclical and structural tailwinds – in areas such as industrial automation, electric vehicles and components and supply chain localisation.

In addition, Asia is now taking on the role of the new engine of global growth – with China the hub for trade in the region. The RCEP – Regional Comprehensive Economic Partnership – will bring Asia a step closer to becoming an integrated trading zone like the EU.

This trade deal will reduce economic frictions and, according to analysts, add $500bn annually to world trade.

"Asia is the engine of global growth – with China the hub for trade in the region."

Jacob Mitchell
Antipodes

China is focused on reducing city-based pollution, which means increasing usage of electric vehicles – which should account for 20% of vehicle sales by 2025.

While this target was reduced from an original 25%, it is still significant. China is the largest auto market globally, with more than 21 million new car sales per annum. With its target of 20%, China is looking to become the global leader in EVs and could account for as much as 40% of total global EV sales in 2025.

Additionally, solar has become increasingly competitive in China, as the all-in cost of solar greenfield capacity has approached that of coal without any subsidies. Further, the capital cost of solar equipment continues to fall. This could mean China's incremental power needs are met with solar rather than fossil fuels.

"China could account for as much as 40% of total global electric vehicle sales in 2025"

Damian Bird
Polen

With recent anti-China rhetoric in the US, many Chinese businesses have sought secondary listings in Hong Kong – such as Alibaba, NetEase, JD.com, Yum China and Huazhu Group.

Chinese businesses have been tapping US capital markets for approximately 20 years, and about 300 Chinese companies are currently listed in America. Over twenty years from September 2000, an equal-weighted basket of these companies would have returned an annualised figure of 21% in US dollar terms, assuming annual rebalancing. That works out as 45x your money over 20 years.

Until now, the average Chinese investor has been unable to participate in this wealth creation. With the retreat of these companies back to their home market, we think this balance is likely to shift.

"The average Chinese investor has been unable to participate in this wealth creation"

Gresham House Ventures adds to investment team

Gresham House Ventures has expanded its specialist team with the recruitment of experienced PE investor Rupesh Patel.

Patel joins as investment director across Gresham House Ventures' portfolio companies, which he will actively support to accelerate growth and build shareholder value. Most recently, Patel worked at Praesidian Capital, a transatlantic private equity and debt fund.

Gresham House Ventures has made more than 100 investments over the last decade, proactively supporting entrepreneurs to build businesses with long-term sustainable competitive advantages and to accelerate growth. Through a tried-and-tested process, the team has helped many leading venture capital and equity capital businesses scale up, notably in the innovative technology space.

Patel comments: "Gresham House Ventures has a rich heritage in identifying rapidly growing earlier stage companies. The Covid-19 pandemic continues to transform many industries, presenting an opportunity for disruptive entrepreneurial businesses across the UK. The team's combined experience and expertise is perfectly positioned to uncover the next generation of exciting businesses set to flourish in the post-Covid world."

How much is too much stimulus?

Joe Amato
Neuberger Berman

"US core retail sales jumped 6% month-on-month in January"

There is growing concern the coming US stimulus might be more than the economy needs.

Despite strong signs of improvement, the US government is acting as though the economy is still in a deep freeze. After putting $3trn under the stove back in May 2020 and another $900bn just two months ago, another stimulus package worth up to $1.9trn looks set to arrive by the middle of March – potentially followed by $2trn of additional infrastructure spending over the next decade.

US core retail sales jumped 6% month-on-month in January, far ahead of consensus forecasts of 1%.

Goldman Sachs estimates US households have accumulated some $1.5trn in excess savings over the past year, which could rise to $2.4trn by mid-year. By its reckoning, a fifth could be spent within 12 months, adding two full percentage points to US GDP growth on its own. January's retail sales suggest consumers have started spending already, buoyed by new year confidence and coronavirus vaccinations. A range of recent data indicates corporations are spending, too.

Are we about to add enormous fuel to a fire that is well on its way to heating up? The debate is certainly heated.

According to the Congressional Budget Office, inflation is forecast to rise gradually, averaging just 2.1% later in the decade, with the 10-year treasury yield rising sedately to 3.4% by 2031.

However, former Treasury Secretary Larry Summers, a noted fiscal dove in the aftermath of the GFC, has warned the coming stimulus threatens 'inflationary pressures of a kind we have not seen in a generation'.

Our own view is that inflation will pick up but fears of problematic inflation – sustained levels in the 3-4% range and beyond – are unwarranted.

Mirabaud global equity funds awarded SRI label

Mirabaud Asset Management has been awarded the SRI label for its two global equity funds – Sustainable Global Focus and Sustainable Global High Dividend.

The SRI label was created and is supported by the French Ministry of Finance. It follows a set of rigorous criteria to demonstrate the systematic and measurable integration of extra-financial and ESG analysis in investments. These two portfolios join Mirabaud's Sustainable Global Convertible Bond Fund in being awarded the SRI label.

Mirabaud's global equity team constructs high conviction portfolios via the identification of multiple global themes displaying strong long-term structural growth tailwinds. Each quality franchise added to the team's portfolios must also meet rigorous ESG criteria, which are fully integrated into the investment process. It involves both deep top-down and bottom-up company analysis, as well as active company engagement.

Anu Narula, head of global equities at Mirabaud, says: "It is great to receive this label in recognition of our robust ESG processes in our global equity franchise. As active, engaged managers, we believe there is no substitute for in-depth, bottom-up company research and ongoing active engagement with companies."

Scott Berg
T. Rowe Price

Boosting Asian exposure

Equity markets delivered extraordinary returns in 2020, but we expect the Covid on/Covid off trade to continue to flip-flop from here.

With US equities having performed so strongly, we have been looking for better value elsewhere. We have been increasing our exposure to Asia-Pacific and Europe.

The gravity of the world is moving towards Asia. It is where markets are deepening the most, where economies have been growing the fastest and where the most billionaires are now being created. It is where the most unpriced change can be found for investors.

While the EM growth premium has been decelerating for some time and collective earnings have been disappointing, many individual economies retain long-term advantages in relation to potential return generation from equities. Our preferred markets are India, Indonesia, the Philippines and Peru – while we also have high conviction in the Chinese consumer.

Europe also now looks more attractive. Although it does not offer the breadth of high-growth opportunities the US or China can offer, there are a number of change-driven stocks we feel confident about in a world marked by improvement – especially from spring 2021 onward. Key for us at this point in the equity cycle is the ability to find profits growth, as this remains the most powerful driver of stock prices over the long term.

"The gravity of the world is moving towards Asia"

Esmé van Herwijnen
EdenTree

Oil companies must act

Major oil companies have long known about their impact on global warming and can no longer avoid engaging with the subject.

Shell and BP have both announced long-term transition plans, with the aim to achieve zero carbon emissions by 2050. However, these commitments are contradictory to other activities in the sector. The targets set do not seem to put an end to any new exploration and production (E&P), and both BP and Shell leave room for further E&P in longer-term plans – even though BP, when launching its latest energy outlook, did announce a reduction in E&P.

Further E&P is not compatible with the goals of the Paris Agreement, given research shows that burning all current reserves exceeds our carbon budget.

The sector relies too much on mitigation, technology and adaptation to reduce overall emissions impacts over the next two to three decades, rather than a comprehensive transition to a low carbon energy environment away from fossil fuel exploitation.

In addition, despite green marketing campaigns and noble ambitions, the sector continues its lobbying activities against climate policies. According to InfluenceMap, an NGO monitoring lobbying expenditures, the five largest listed oil and gas companies – BP, Shell, ExxonMobil, Chevron and Total – spend approximately $200m a year on climate lobbying.

"Further E&P is not compatible with the Paris Agreement"

Why we avoid quasi sovereigns

Thede Rüst
Nordea

"Even though we avoid quasi sovereigns, it is an exciting time to be an ESG-focused investor in EM corporate debt"

Quasi sovereigns, bonds issued by fully state-owned companies, account for a substantial slice of the emerging markets (EM) fixed income markets.

In fact, three of the five largest EM corporate debt issuers are fully state owned. To many investors, this segment of the market is a way to enjoy a level of safety similar to sovereign bonds, but with a higher yield.

However, despite fully state-owned companies representing about 20% of our benchmark, we avoid this area of the market as we believe fully state-owned companies can pose an ESG risk.

Fully state-owned companies in EM are often less efficient and frequently run with political objectives threatening commercial goals. Since key management usually gets nominated by the government, incentives for long-term business planning are low. Additionally, the lack of independent oversight makes fully state-owned companies prone to corruption.

In theory, fully state-owned companies enjoy one consolation for all this interference – the state will step in as the lender of last resort. Ratings agencies subscribe to this view and give ratings based on this assumption. There is rarely an explicit guarantee, but ratings agencies see it as an implicit one.

Indeed, cases of debt restructurings for fully state-owned companies are rare. However, for an increasing amount of fully state-owned companies, investors could start questioning this – which may decouple spreads for individual issuers from the respective government bonds in the future. Increasing leverage on sovereign balance sheets might amplify this.

Another crucial reason why we currently do not invest in fully state-owned companies is the fact many have low levels of non-financial disclosure.

Even though we avoid quasi sovereigns, it is an exciting time to be an ESG-focused investor in EM corporate debt. Since the beginning of 2020, we have been complementing our ESG-focused EM sovereign bond portfolio in Nordea's Emerging Stars Bond strategy with the addition of corporate bonds.

Financials make up the largest sector among privately-owned corporates. While we place the same ESG demands on financials as we do on non-financial corporates, we also have a strong preference for signatories of the Principles for Responsible Banking – of which Nordea is a founding signatory. Banks in this category include Mexico's BBVA Bancomer and Colombia's Bancolombia.

We are also enthusiastic about recent developments in ESG-related bond issuances. While green, social and sustainable bond issuance has grown rapidly, we recently saw the first issuance of a sustainability-linked bond from an EM issuer. Brazil's Suzano, the world's largest pulp and paper producer, issued a bond in September linking the coupon rate to greenhouse gas emission targets. It has paid off for Suzano, with the bond trading with a lower spread than its conventional bonds.