WWW.KL-COMMUNICATIONS.COM AUG-SEP 21

KL CONNECTIONS

Don't lose sight of bigger picture in China

Antipodes Partners' Sunny Bangia believes regulatory risk in Chinese tech is already priced into the equity market (page 2)

PGIM launches NextGeneration equity strategy

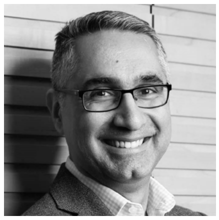
PGIM has bolstered its equity UCITS offering with the launch of the PGIM Jennison NextGeneration Opportunities Fund.

Managed by Jennison Associates, PGIM's active equity manager, the fund targets underappreciated high-growth opportunities within the global small and mid-cap space. It has exposure to a range of innovative industries within the next generation economy – such as digital payments, e-commerce platforms, and cloud computing.

It is run by an experienced team at Jennison, led by global small and mid-cap manager John Donnelly, and head of global equity Mark Baribeau. The focus on small and mid-sized stocks complements PGIM's existing equity suite – including Baribeau's top performing PGIM Jennison Global Equity Opportunities and PGIM Jennison Emerging Markets Equity funds.

Donnelly comments: "At Jennison, we look to discover the high-growth companies of tomorrow. As growth becomes harder to find, our active approach seeks to invest early in a company's life cycle to capture a long runway of compounded returns. Our strategy allows investors to tap into opportunities not realised or appreciated by the broader investment community, while delivering long-term risk adjusted returns."

Focus on bigger picture in China



Sunny Bangia
Antipodes Partners

"I feel strongly that Beijing is not anti-private enterprise"

Uncertainty is never good for short-term sentiment, but for the long-term investor, it can often present buying opportunities. This is the case when it comes to Chinese equities today.

In terms of China's economy, credit growth has slowed, and economic activity is decelerating at a faster pace than in the US and Europe. Indeed, policymakers are tightening, which is a logical thing to do in an economy that has emerged from the Covid-19 crisis stronger than most. Investors should not overlook the fact these measures leave policymakers with the firepower to loosen at will in the future.

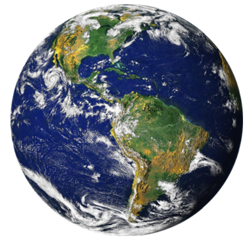
When it comes to regulatory risk, particularly in tech, the intense investor focus will pass in time. There is no question regulators have acted in a blunt fashion recently, and there have been implications for entrepreneurs. But investors must ask themselves, are the policies unreasonable? Is it unusual for regulators globally to regulate lenders, protect consumers from anti-monopolistic behaviour or have concerns around data security?

I feel strongly that Beijing is not anti-private enterprise and leaders understand the nation's economic growth is dependent on a vibrant private sector. High-profile internet businesses, such as those that have materially de-rated, are an essential part of this, providing solutions to the everyday lives of consumers.

While it is clear China ultimately wants its leading companies to be accessible to domestic investors via listings in Hong Kong or the mainland, this does not impact fundamentals or prevent investment from abroad. Valuations of Chinese tech, compared to similar businesses in the US over a long period, would imply any additional regulatory risk in China is well priced in.

The waves of prosperity that have transformed China's domestic consumption over the past three decades and delivered long-term investors exceptional returns have not been without shorter-term volatility. The coming decade will be no different. While the emergence of risk factors should never be overlooked, it should not cause long-term investors to lose sight of the bigger picture.

EU unveils bold climate plan



Harry Granqvist
Nordea

The Fit for 55 policy package could prove to be the most significant climate intervention we have seen.

Yet, given a 55% reduction in emissions by 2030 will almost certainly not be sufficient for limiting global warming to 1.5°C, it is especially critical the announced policy measures are effective and deliver the intended decarbonisation effects.

It is imperative the EU gets this right, because in the run-up to the COP26 climate summit, the world urgently needs advanced economies to lead by example.

This will be key to ensure a speedy phase-out of both direct and indirect subsidies for fossil fuels, but also to create a favourable fiscal and investment environment for companies that provide alternatives and climate solutions within energy, industry, buildings and land use.

"In the run-up to COP26, the world urgently needs advanced economies to lead by example"

Ben McEwen
Sarasin & Partners

The European Commission's package of proposals to make the EU's climate, energy, land use, transport and taxation policies fit for reducing net greenhouse gas emissions by at least 55% by 2030, compared to 1990 levels, is extremely important and welcome.

This provides investors with increased visibility around the policy frameworks that will deliver the deep decarbonisation needed in Europe. While there remain questions to disentangle in future years, this set of proposals makes clear the current emissions profile of the continent will no longer be tolerated.

Our analysis suggests this shift in policy significantly expedites the risks of those firms needing to decarbonise, as well as increases opportunities for those participating in emissions mitigation solutions.

"This makes clear the current emissions profile of the continent will no longer be tolerated"

Joe Mares
Trium

The centrepiece of the EU's Fit for 55 plan is the expansion of the Emissions Trading Scheme, a system that effectively charges companies for the cost of polluting.

In essence, Brussels' objective is to force faster decarbonisation by allocating fewer permits, driving the price of carbon up. It is hard to overstate how much of a big deal this is for high-emitting sectors.

Carbon prices are now being set at a level required to transform European industry. The EU regulation will have far-reaching consequences for industries and high-emitting stocks.

On the other hand, the scheme will act as a strong tailwind for those that have set in place decarbonisation plans – and thus have a first-mover competitive advantage.

"It is hard to overstate how much of a big deal this is for high-emitting sectors"

KL CONNECTIONS

Gresham House to acquire Mobeus VCTs

Gresham House has agreed to acquire the Venture Capital Trust (VCT) business of Mobeus Equity Partners.

The deal, which is expected to be completed over the coming weeks, comprises four VCT contracts – Mobeus Income & Growth VCT, Mobeus Income & Growth 2 VCT, Mobeus Income & Growth 4 VCT and The Income & Growth VCT. The acquisition will see Gresham House become a leading player in the VCT market, with about £850m of assets across its range.

The Mobeus VCTs' focus on unquoted companies and emphasis on total return is highly complementary to Gresham House's existing Baronsmead VCTs, which invest in unlisted and public companies to deliver consistent dividends.

Gresham House CEO Tony Dalwood comments: "The high-quality and experienced Mobeus VCT team is culturally aligned with us at Gresham House, and the Mobeus VCTs' strong brand and long-term performance also provide a close fit with Gresham House's reputation for governance, fund performance and investment culture.

"As the VCT segment continues to consolidate, this deal enhances our combined reach amid what we believe is a period of rising demand for early-stage growth capital."

Evergrande is not a Lehman event

Rob Drijkoningen
Neuberger Berman

Since July, Evergrande bonds have been pricing in near-certain default and Chinese banks have been reducing exposure – now just about 20bps of system loans.

Bondholders and bank creditors will likely face a long restructuring process, with uncertain recovery prospects due to the sheer size of Evergrande and complexities of its capital structure – including hidden liabilities.

While banks and bondholders will face a significant haircut – in light of the government's typical tolerance for losses to well-off investors and business owners – authorities will be quicker to ensure social stability and act to protect homebuyers, SME suppliers and employment.

We do not expect a reversal of policy to allow developers to re-lever, but we foresee measures to stabilise property sales and ease working capital funding, to ensure properties under construction can be delivered to homebuyers.

Regarding financial markets, risks of Lehman-type financial contagion are limited, even if all Evergrande debt gets written down to zero. This is because Chinese banks have limited exposure to Evergrande and have reduced property developer loan exposure to 7%. However, the outlook for national property sales is also bleak, in what is supposed to be a seasonally strong September and October.

Weak demand could spill over into commodities, as property typically accounts for about 40% of steel demand and about 8% of copper demand. As a result, construction halts will lead to weaker commodity prices.

Across our EMD and multi-sector strategies, we do not have any Evergrande exposure and remain defensive in the Chinese high yield property names we own. Opportunities will arise in property from this situation – but not yet.

"Bondholders will likely face a long restructuring process"

Nordea raises €900m for first Trill Impact fund

Trill Impact, an independent private investments firm backed by Nordea Asset Management, has closed €900m in commitments for its inaugural impact mid-market buyout fund.

Trill was founded in 2019 by Jan Ståhlberg with the backing of Nordea. Today, it is one of the largest dedicated impact investment houses in Europe, with more than €1bn of AUM within its private equity and microfinance investment advisory strategies.

Through its strategic partnership, Trill teams up with Nordea's award-winning responsible investments team, as well as Nordea's global investor relations and fundraising teams.

"Our longstanding mission has been to provide returns with responsibility," Nordea Asset Management CEO Nils Bolmstrand comments.

"This is very much what drove our venture with Trill Impact – joining our respective forces to offer investors world-class private equity and ESG expertise, as well as the opportunity to participate in the change they want to see in the world.

"We are thrilled to see many prominent investors have recognised the value of this partnership and believe that this inaugural success paves the way for future growth of the Trill Impact offering."

Hywel Franklin
Mirabaud

Germany is going green

After almost 16 years with Angela Merkel as chancellor, it is not an exaggeration to say Germany's election marks a significant turning point for the biggest economy in Europe.

Even before July's catastrophic floods in the Northern Rhineland, green issues were near the top of the political agenda. All parties, other than the far-right AfD, supported the Paris Agreement's target of limiting global warming to 1.5 degrees Celsius – although critics claim these plans do not go far enough. The prominence of green questions in the election debates has been heartening. As a major manufacturer with a huge auto industry, Germany faces a big strategic challenge in greening its industries.

"Germany faces a big challenge in greening its industries"

Germany's cybersecurity strategy was also a point of contention in the election. As both our professional and personal lives move online, protecting the integrity of our digital communications has become a significant strategic priority for governments worldwide. Our funds have significant exposure to this growing sector.

Germany's famous Mittelstand complex of small-to-medium-sized companies, which pursue global dominance in high-value manufacturing niches, is in the sweet spot for both our Discovery Europe and Discovery Europe ex-UK funds. This has led us to make the country our most significant national overweight in both strategies.

Archibald Ciganer
T. Rowe Price

Japan reform to continue

Japanese Prime Minister Yoshihide Suga, Shinzo Abe's successor, announced he is stepping down earlier this month. Suga had been struggling in the polls because of the delayed vaccination programme and the decision to hold the Olympics.

Despite his exit, the LDP – the party of Abe and Suga – remains very much in control, with the opposition in disarray. In addition, public support for the reforms we want to see, such as those known as 'Abenomics', remains strong.

Japanese equities are cheap and as the country catches up with vaccinations, which it is, we believe the market will re-rate.

Over the medium term, Japan is one of, if not the most, open and cyclical markets. It is closely aligned to the global economy, and as the economy recovers post-pandemic, Japan's corporates will benefit from this recovery more than other regions and markets.

"Despite Suga's exit, the LDP remains firmly in control"

Longer-term, while scepticism on corporate governance improvement remains, we are still strong believers. With improvements, returns will increase and further attract foreign investors – which are currently underweight.

From a portfolio perspective, we are excited by the digital opportunity in Japan. Japan is a global manufacturing leader, but woefully lags in digital technology – the government has realised this and wants to catch up. We have identified and invested in a number of companies benefitting from this significant opportunity.

Biotech aiding the ageing world

Ailsa Craig
International Biotechnology Trust

"The healthcare sector has outperformed the wider market for at least the last 25 years"

Despite the devastating effects of Covid-19, infectious diseases are no longer a major cause of death. Due to advances in medicine, life expectancy across the world has vastly improved – reaching 72.6 years in 2019, compared to just 66.3 at the turn of the century.

While the growth in ageing populations is undoubtedly positive, old age naturally predisposes humans to diseases. After the age of 50, biological wear and tear begins to take a toll on the human body, requiring increased consumption of healthcare resources. Cancer, cardiovascular diseases, and dementia are ailments commonly associated with age, which all require drug-based treatments.

Under growing pressure from an ageing global population, the healthcare sector has continued to innovate. In particular, the increasing use of platform technologies in the biotechnology space is powering a higher pace of scientific development.

By compiling data and discoveries relating to different molecules, platforms offer a systematic method of leveraging prior knowledge. Platform technologies have been used to generate therapies addressing multiple disease types – for example, the use of RNA technology for vaccines, rare diseases and cancer. This has led to an uptick in clinical trials, and a greater number of drugs being approved for use. For instance, the US FDA approved 53 new chemical entities in 2020, compared to 20 in 2016.

Driven by rising demand from ageing populations and continuous innovation in biotech, the healthcare sector has outperformed the wider market for at least the last 25 years – and we expect these forces to remain in place over the long term.

By investing in companies at different stages in the innovation cycle, we aim to capture the immense potential growth on offer, while seeking to mitigate the risks related to drug approval. We have a proportion of the trust in dependable profitable companies, another segment in higher-risk development stage companies, and the final percentage in revenue growth opportunities – companies with an approved and launched product not yet turning a profit.

In terms of an ageing world, the next health epidemic requiring urgent attention is dementia. It has been difficult to discover effective drugs to combat this impairment, due to poor understanding of the biological underlying causes. However, after decades of industry research, we have seen the first approval of a drug aimed at combatting Alzheimer's from Biogen – one of our profitable portfolio holdings.

Oncology is another area disproportionately affecting older people, which is witnessing strong growth. This is driven by a better scientific understanding of the biology and pathology of cancers. We are seeing advances in treatments addressing individual cancers in a patient-specific way, which companies such as Seagen, Amgen, Mirati and Incyte are addressing.