KL CONNECTIONS

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The goal is now a 'softish' landing

Neuberger Berman's Joe Amato expects continued volatility as investors tread for the bottom of this cyclical sell-off (page 2)

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Evenlode unveils philanthropic endeavour

Evenlode Investment has established the Evenlode Foundation, the philanthropic arm of the Oxfordshire-based independent manager.

The foundation aims to effect positive change and improve outcomes for individuals, communities, and the environment. It operates on three pillars – impact investing, charitable giving, and community support – and all activities are fully funded by the profits of Evenlode.

Innovation analyst Tom Weller says: "The foundation is developing a philanthropic, community-led portfolio of early-stage and not-for-profit organisations that address a diverse range of global challenges. Closer to home, the foundation will work with local charities, building long-term partnerships in its own community."

Portfolio manager Ben Peters adds: "The foundation is at the very essence of our purpose as a company. We focus on the sustainable growth of our investors' assets, but also empower our people to engage, collaborate and improve outcomes for the wider community.

"We believe investment can be a positive agent of change. Innovative asset-light business models, services and products that address entire value chains can provide solutions to the complex problems of social, environmental, and financial sustainability."

The goal is now a 'softish' landing

Joe Amato
Neuberger Berman

"We remain in a period of significant recalibration of risk-asset pricing"

Regardless of whether we get a hard or soft landing, we likely face a steep approach to the runway in trying to land this plane.

As investors adjust to an unappetising growth/inflation policy mix, we see two key questions. Are consumer and corporate fundamentals strong enough to absorb it? And has sentiment become bearish enough to create long-term value?

This month, Fed officials suggested its first 50bps rate hike in 20 years was likely to be followed by more, but a 75bps hike was not currently on the table. The goal now appears to be a 'softish' rather than a soft landing.

The bottom line is the Fed needs to increase rates to slow inflation, and we expect this will result in slower economic growth and pressure on earnings.

The steep run-up in real treasury yields has taken particularly large bites out of longer-duration growth stocks. Large-cap tech names are down 30-40% since the peaks near the end of last year. Also, there has been a dramatic re-evaluation of the more speculative corners of the market.

Against this, Q1 earnings were better than expectations. In particular, margins held up for most companies, reflecting an ability to pass on rising costs. This reflects the ongoing strength of consumer spending against a buoyant jobs market.

The market may have gotten ahead of itself in pricing for an imminent recession, which may provide the springboard for a rally over the coming months, especially in beaten-up growth stocks. That said, we continue to favour defensive, lower-beta stocks and sectors, and quality. While we do not think a US recession is a near-term risk, we do face a substantial inflationary slowdown. We recognise the possibility of a recession in 2023 is very real, though it is not our base case.

We remain in a period of significant recalibration of risk-asset pricing as the Fed, and other central banks, tightens financial conditions. As a result, there is likely to be continued volatility as investors tread for the bottom of this cyclical sell-off. We have yet to see the 'all clear' sign.

Energy surge does not dim renewables

Anu Narula
Mirabaud

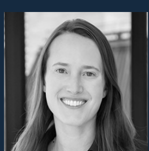
Renewable energy technologies now dominate the global market for new electricity generation capacity.

A record level of 260 gigawatts of renewables-based generation capacity was added globally in 2020, more than four times the capacity added from other sources. China alone is likely to account for almost half the global increase in renewable electricity generation.

The costs of renewable technologies have plummeted to the point new fossil-based electricity is no longer attractive.

Additionally, significant progress has been made in areas such as electric mobility, battery storage, digital technologies and AI. These are helping to solve the challenges presented by energy-intensive industries and sectors – like industrials, long-haul transport, shipping and aviation.

"260 gigawatts of renewables-based generation capacity was added globally in 2020"



Whitney Voûte
US Solar

One of the key players in the upcoming renewable era is solar.

In the US, where solar continues to be the cheapest form of new build generation across much of the country, the market is growing quickly. In 2021, a record 23.6 gigawatts of solar capacity was installed, bringing the total to 121.4 – enough to power 23.3 million American homes. As solar is the most cost-competitive source of energy production in much of the US, the Department of Energy sees it as a critical component of its clean energy shift – with estimates solar could reach 40% of electricity generation by 2035.

Additionally, solar in the US is often backed by long-term PPAs with investment grade offtakers, making it an ideal investment to deliver stable income with regular uplifts.

"Solar continues to be the cheapest form of new build generation across much of the US"

Ben Guest
Gresham House

As we transition towards net zero, there is a growing need to store the rising amounts of intermittently produced green energy.

While gas-fired power stations have traditionally had the role of balancing electrical power supply and demand, we must cut down on the use of fossil fuels. Batteries can undercut the higher balancing costs of gas and help keep electricity prices lower, in turn pricing gas generators off the system and eventually rendering them redundant.

Given the rapid ramp up of renewables in the UK, with new wind farms coming online in the middle of this decade, we see a short-term need of about 10GW of capacity by next year, with about 30GW required by the end of this decade – a huge growth opportunity for battery energy storage systems.

"Batteries can undercut the higher balancing costs of gas and help keep prices lower"

PGIM Real Estate enters new JV in UK hotels

PGIM Real Estate, on behalf of a value-add investment strategy, has entered into a joint venture with Madison Cairn, a newly formed division of Cairn Group, to target the recovering UK hotel sector.

The joint venture will seek to acquire, develop and reposition hotels in the UK, with a focus on domestic leisure demand, which has shown strong signs of post-pandemic recovery.

The team has already secured a strong pipeline of activity, with the joint venture's first investment in Brighton, one of the UK's most attractive hotel markets.

"At PGIM Real Estate, we have been investing in Brighton hotels since 2013 and have tracked this opportunity for some time. We are delighted to be working with the Madison Cairn team, which is one of the most experienced operators in the sector," head of UK transactions Charles Crowe says.

"We share conviction that the prospects for selected good-value domestic leisure markets have strengthened in light of recent events, and we look forward to expanding our venture soon in locations such as these."

PGIM Real Estate is the $209bn real estate business of PGIM. Cairn is an integrated investor, developer and operator in UK leisure, with a portfolio of 33 hotels.

Tech rout still has further to run

Richard Bernstein
Richard Bernstein Advisors

"Tech is still one of the most overvalued sectors in the market today"

After the last tech bubble, all the stories came true about how the internet would change the economy and business.

However, if you had bought Nasdaq Composite in December 1999, it would have taken you about 14 years to break even. So, we must separate out the story from valuations – in our view, technology is still one of the most overvalued sectors in the market today.

Long term market sentiment is based on three stages. When you start getting a bear market, people say it is temporary or transitory. Then you hear people talking about its bottoming. You will know it is over when people say it will never end.

When people attach permanence to a bear market or bad economic data, that is when your contrarian trigger should start wiggling. I do not think we have seen capitulation at all. How many times have we heard people talking about entry points back into tech? The Nasdaq Composite is down about 30% from its peak, but in 2000 it was down 75%. We are in the midst of it.

More broadly, it is hard to argue the Federal Reserve is even trying to slow the economy, let alone slow inflation. It is like shooting elephants with a pea shooter. The central bank is hunting, but how effective is it going to be? We have a long way to go before the Fed is literally fighting inflation.

Further, I do not think a recession is imminent. Eventually, we will have one because the Fed will panic and likely overtighten. But the odds of that happening in the next few months or even this year seem low to me.

If we are going to have a recession, this will be the most well-forecasted recession in my career. Usually, recessions surprise people – they bite people in the tush.

Mirabaud hires Juntunen as head of distribution

Mirabaud Asset Management has appointed experienced industry professional Liisa Juntunen as head of distribution.

In this newly created role, Juntunen will be responsible for client relations, business development, marketing, and product strategy across Europe. She is based in London and reports directly to Lionel Aeschlimann, CEO of Mirabaud Asset Management.

Juntunen has three decades of financial services experience, including at LGIM and AllianceBernstein. She joins from PGIM Quantitative Solutions, where she managed institutional business development in EMEA.

Aeschlimann comments: "We continue to invest in top talent, enabling us to provide our clients with high-conviction, innovative and sustainable investment solutions. Liisa's arrival as head of distribution will help us to further grow our business, expanding our client base in our core markets – across both institutional and wholesale."

Juntunen adds: "I am excited for the new challenge ahead of me at Mirabaud Asset Management. Its commitment to sustainable active management is very appealing to clients and something I am looking forward to help develop further."

Vincent Ropers
Wise

The bargain in biotech

The start of 2022 has been anything but plain sailing for investors.

While heightened geopolitical and macroeconomic uncertainty has naturally led investors to pivot towards defensive assets, this environment may unearth attractive opportunities in a number of high growth sectors with strong value prospects.

For discerning investors able to act opportunistically, the healthcare and biotechnology sectors seem particularly compelling. Both spaces appear to have been unjustifiably punished post the Covid-19 rebound and look particularly attractive both from an absolute and relative valuation standpoint. Moreover, the sectors are underpinned by structural long-term growth drivers.

The biotech sector in particular has rarely been cheaper. In fact, about 16% of the businesses in the NASDAQ Biotechnology Index are trading at negative enterprise values.

Prior to the Russian invasion, we added to our holding in International Biotechnology Trust, a specialist investor in both quoted and unquoted biotech innovators across the globe.

Specialist expertise is critical to truly gauge whether a business with perplexing scientific fundamentals is fairly priced by the market, and the portfolio managers at International Biotechnology Trust draw from their extensive scientific backgrounds when analysing businesses.

"The biotech sector has rarely been cheaper"

Barry Norris
Argonaut

Return of the 1970s

It is currently an investment myth that central banks in the early 1970s let inflation get out of control through loose monetary policy.

In fact, up until mid-1974 – when the FTSE ALL Share Index had already crashed 70% from its 1973 peak – the UK had positive real interest rates, in stark contrast to today.

Even over the entire decade of the 1970s, monetary policy was stricter than it is today, with 9.3% average base rates, 12.5% RPI and negative real rates of just 3.1%. In the US during the 1970s, the average Fed funds rate was 7.3% versus inflation at 7.1%. There was also no money printing QE in the 1970s.

The 2020s is shaping up to be an inflationary decade on a par with the 1970s. While the energy/commodity shock has been mild to date, real interest rates have entered unprecedented negative levels in the US and are approaching the extremes witnessed following the UK stock market crash of 1973-75.

Although central banks can control aggregate demand, they can do nothing about supply bottlenecks. This will continue to be pervasive without capital formation in 'old economy' sectors which may, in fact, be discouraged by higher nominal interest rates.

The only long-term cure for high commodity prices is a sustainable bull market in commodities, where companies are encouraged again to re-invest in new supply.

"Central banks can do nothing about supply bottlenecks"

Still too early to add credit risk

Ken Orchard
T. Rowe Price

"The outlook for credit has deteriorated since we reduced our exposure a few months ago"

If we rewind to the beginning of the year, credit spreads were incredibly tight by historical standards, while growth was shaky and central banks were about to start tightening monetary policy to tackle inflation.

Noting these factors, we saw a real prospect of spread widening – which led us to cut our exposure to credit risk in our international and global multi-sector bond portfolios.

Spreads have since widened over the past four months, and corporate debt is now trading more cheaply than it was in January. In ordinary times, this might be regarded as a signal to add credit back to the portfolio. But we are not living through ordinary times.

Despite cheaper valuations, now is not a good time to add credit back to our portfolios. In our view, the outlook for credit has deteriorated since we reduced our exposure to the asset class a few months ago. There are two main reasons for this.

First, the global growth outlook has declined since Russia invaded Ukraine and Covid-19 cases surged in China, and second, central banks seem even more determined to tighten policy to keep inflation under control.

This combination of weak growth and tighter monetary policy means there is little reason to believe a sustained credit rally is possible.

History tells us sustainable rallies in credit have been preceded by an actual or anticipated easing of monetary policy. Whenever credit spreads have widened over the past 30 years, the peak in spreads has almost always been immediately preceded by a rally in five-year US treasury yields.

This typically happened because spreads widened due to concerns about economic growth, and the usual response of central banks to growth concerns is to ease monetary policy – which creates the conditions for a credit rally. But this has not been happening this time. Central banks are clearly so concerned about inflation that yields continue to climb.

So, the current period sticks out like a sore thumb compared with previous peaks in credit spreads.

While it is not an absolute rule treasury yields must rally before you can add credit risk to a portfolio, there is no reason to believe credit can rally while central banks remain so determined to tighten financial conditions.

If a major slowdown in the coming months causes markets to become jittery and spreads to widen further, we might be able to identify an 'investable bottom' in credit spreads. However, if growth does not slow enough to get inflation forecasts down and central banks continue to hike, spreads may continue to be volatile for some time with no clear sign that the peak has been reached.

If this happens, it could be some time before we are ready to add credit risk back to our portfolios.