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China clouds beginning to clear

T. Rowe Price's Wenli Zheng believes circumventing China would be an error as its prospects continue to improve (page 2)

Gresham House Ventures invests £3.5m in fu3e.

Gresham House Ventures has made a £3.5m investment in fu3e., an adaptive management reporting software platform for the real estate sector.

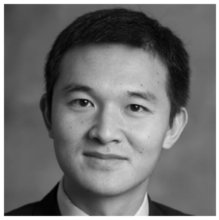
The fu3e. platform combines two leading digital products aimed at managing development risks and digitising management processes, and is designed to sit above and integrate with existing management reporting software solutions.

The investment will be used to accelerate product development, as well as sales and marketing growth. It follows a number of recent deals in the enterprise software space for Gresham House Ventures, including a £4m investment into Google Shopping optimisation platform Bidnamic in May.

James Hendry, associate director at Gresham House Ventures, says: "We believe fu3e. is well-positioned to emerge as a market leader, as the real estate sector increasingly embraces the potential of software to improve existing processes.

"We were immediately impressed by the fu3e. platform, which has clearly benefited from the management team's background in the industry. We believe the quality of management – combined with our software scaling expertise – will make this a highly effective partnership."

China clouds beginning to clear



Wenli Zheng
T. Rowe Price

"The dynamism, size, and depth of Chinese stock markets continue to excite us"

Chinese equity markets have endured a tough year. A confluence of factors has weighed on the market – including regulatory crackdowns, geopolitical tensions, the potential delisting of Chinese ADRs, an ongoing property sector downturn, and an outbreak of the omicron variant of Covid-19.

Some investors have even questioned the logic of investing in Chinese equities. However, we remain constructive, as we believe there are both cyclical and structural reasons why Chinese equities remain attractive for investors.

Firstly, it is important to not focus solely on GDP growth but instead on where China stands in its cycle. We believe the economy is currently passing through its trough and should begin to improve over the coming quarters.

In addition, we have already started to see a more positive tone on the regulatory front, but the market remains muted due to a combination of previous concerns and negative headlines. Some Chinese stocks are trading at one to two standard deviations below Western peers. History suggests these types of dislocations tend to provide longer-term opportunities.

The dynamism, size, and depth of Chinese stock markets continue to excite us. For example, high-end manufacturing is an area where we find ample opportunities.

While many companies are well positioned with strong competitive advantages, the near-term outlook has been clouded. First by rising input costs driven by the Ukraine conflict, then by supply chain disruptions from renewed lockdowns. Neither event alters our longer-term views on those businesses.

The pandemic will remain a headwind, but we also see it as a catalyst for accelerating industry consolidation. We have seen meaningful capacity reduction in sectors like hotels, restaurants, and furniture retail. Industry leaders are widening the advantage gap versus small peers. As the situation normalises, we could potentially see a stronger pricing cycle over the next couple of years with rising margins. It will require patience, but ultimately, we believe that we will potentially be rewarded with better returns.

BambuBlack adds experienced portfolio manager

BambuBlack, the Asia Pacific long-only equities boutique, has strengthened its investment team with the appointment of Pinakin Patel as portfolio manager.

Patel joins from Allianz Global Investors in Hong Kong, where he was an investment specialist. He has more than 29 years of experience in the Asia Pacific region, as both a portfolio manager and investment specialist – having worked at groups including JPMorgan, Gartmore and Newton.

Established by Jane Andrews in partnership with BennBridge in 2019, BambuBlack manages two strategies – the SVS BambuBlack Asia Ex-Japan All-Cap and SVS BambuBlack Asia Income & Growth. Andrews, who leads an investment team of three, has more than 30 years of sector experience, having previously worked at Smith & Williamson.

Andrews says: "As we continue to deepen client relationships and grow our funds, it is vital to have experienced professionals with local expertise. Pinakin brings both, so we are excited to have someone of his calibre join the business."

Patel adds: "I am excited to be joining the team at an important phase of the business' growth, as we look to unearth compelling opportunities across the region."

ECB policy pricing 'too aggressive'

Katharine Neiss
PGIM Fixed Income

"As rates rise, so does the risk the eurozone might fragment"

The ECB is set to raise its policy rate in July and September – leading it out of negative territory for the first time in more than a decade.

Most investors expected the broad contours of this near-term normalisation. But the ECB surprised many by essentially confirming a substantial 50bps rate increase in September – barring a significant weakening in the inflation outlook.

It remains an open question if the euro area economy can withstand interest rates significantly above 0%. The shock of Russia invading Ukraine has yet to feed through to the real economy. We expect further pressure on the economy in coming quarters as the boost from post-pandemic reopening fades, global growth slows, and tighter financial conditions continue to take hold.

We expect the ECB's policy rate to be capped at close to 1% one year from now – considerably lower than investors currently expect. In our view, current pricing of ECB policy is too aggressive.

Beyond obvious concerns about stagflation and tighter monetary policy, there are also questions surrounding financial stability. As interest rates rise, so does the risk the eurozone might fragment.

The ECB has not convinced investors it has a plan to deal with fragmentation risk as financial conditions tighten. Worse, the ECB suggested tighter financial conditions are desirable to reduce what it sees as excessive valuations in certain asset markets.

This view paints a dismal picture for risk assets. As long as the fight against inflation compromises the euro area's financial stability, risk premia are likely to widen. These include peripheral country bond spreads, corporate credit spreads and other risk premia.

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Biden advisor joins PGIM Fixed Income

PGIM Fixed Income has named Daleep Singh as chief global economist and head of global macroeconomic research.

Singh joins PGIM Fixed Income from the White House, where he was US deputy national security advisor for international economics and deputy director of the National Economic Council. In this capacity, he served as President Joe Biden's top international economics advisor. He also served as the president's representative at the G7, G20, and APEC.

Prior to joining the Biden administration, Singh was executive vice president and head of the markets group at the New York Fed.

"As one of the world's leading experts on economic policy matters, Daleep has provided extensive experience and insight at the highest levels of government. Adding an expert of this calibre to our team is fundamental to helping our managers navigate the increasingly complex macro and geopolitical forces driving financial markets," Gregory Peters, co-CIO for PGIM Fixed Income, says.

"His expertise will be instrumental in continuing to provide leading economic and sovereign research, as well as thought leadership. We look forward to the impact he will have on our organisation and the investment outcomes for our clients."

Hywel Franklin
Mirabaud

ESG efforts overlooked

Smaller companies are generally less-well researched, which means their innovation and focus around ESG may be overlooked by the broader market.

These companies also have less resources compared with large-cap peers and often struggle with completing ESG and climate-data disclosures. This provides active managers with an advantage, because uncovering the true extent of a smaller company's focus on sustainability often requires a visit to the business, alongside strong engagement with senior management.

Through our bottom-up research, and travel to all corners of Europe, we have seen first-hand many examples of small and medium sized companies leading the way in the important area of ESG.

Furthermore, as so much emphasis is placed on the 'E' of the 'ESG' – there is usually more information available on environment and governance factors, and information on social factors can be relatively scarce.

However, from our perspective, small and mid-sized companies play an important societal role. For example, this area of the market plays a vital part in the provision of employment, supplying two out of three jobs in the EU and Switzerland. They support highly localised economies in Europe through the creation of local jobs, leading to value creation for local households.

"Information on social factors can be scarce"

Daniel Dolan
iMGP - Dolan McEniry

Strong credit entry point

In credit markets, irrational exuberance seems to have been replaced by irrational pessimism.

This is good news for active, long-term investors seeking high-quality assets at an attractive entry point.

Credit risk does still lurk, but overall credit quality appears strong. If the Fed continues to raise rates, some experts have suggested the economy could slow and the possibility of a recession exists. If this were to occur, economists have suggested the Fed would again be put in a position where it must stimulate the economy. We believe yields and spreads are as attractive as they have been in three years, barring the pandemic sell-off.

The key to our credit analysis is an evaluation of free cash flow – in our opinion, companies that generate it well and allocate it wisely make the strongest case for enduring value. The more prosaic the business, the more comfortable we feel in our ability to analyse its prospects.

Across the investment grade spectrum, we are now picking up quality names trading between 175-200bps over treasuries. In the high yield space, we have been able to take advantage of yields approaching 7%.

If you go back to periods where there have been extreme credit events, such as the taper tantrum or financial crisis, credit quality overall was much lower. In our opinion, the quality of credit in our portfolios remains strong today.

"We believe yields and spreads are attractive"

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Infrastructure's lead role in ESG

Jeremy Anagnos
Nordea

"Infrastructure is uniquely positioned to benefit from global sustainability initiatives"

Over the last several years, no other theme has seen such asset growth as ESG.

We expect the market to continue to rise, with the overwhelming majority of investors interested in sustainability and integrating ESG into their portfolios. The coming shift in asset allocation should not be underestimated.

Infrastructure is uniquely positioned to lead and financially benefit from global sustainability initiatives. Electric utility companies are at the forefront of net-zero action – as these groups are installing solar modules, constructing wind turbines and upgrading transmission lines to charge EVs and convert our heating to electricity. Meanwhile, these same utilities are pushing aggressively to shutter high-carbon, fossil-based generating stations.

Water utilities upgrade antiquated lead pipes and filter waste to provide clean drinking water. In telecommuting and edge computing, data centres and cell towers reduce Scope 3 emissions and optimise logistics, while rails and roads invest to lower the need for long-haul trucking – producing 75% less greenhouse gas in the process – and to reduce congestion.

Because of these investments, infrastructure companies should grow cash flows substantially and sustainably. Over the next two decades, we expect over $100trn in investments across the utility, water, digital infrastructure and transport sectors.

Given infrastructure's central role in achieving global sustainability goals, it is unfortunate major ESG funds allocate so little to the asset class. All in, the top 20 global ESG funds have only 5% exposure to companies leading environmental stewardship and energy transition, while they have a 33% exposure to tech and communications services.

This is a clear shortcoming for investors who wish to prioritise climate change, as the companies in listed infrastructure are leading industries that are spending half of every dollar on decarbonisation over the next several decades.

When we put aside broad ESG strategies, and examine ESG and clean tech ETFs, we find a larger exposure to energy transition, but also a concentration to businesses with uncertain futures. The more popular ETFs have roughly 50% exposure to solar installers, manufacturers, wind turbines and clean EVs – which have a history of booms and busts.

By contrast, listed infrastructure companies either have long-term contracts or regulated rates of return, which provide stability to cash flows. Cyclical clean tech tends to make money on energy transition only once, with each sale of a car or solar panel, whereas listed infrastructure will earn on a renewable asset for years. Tesla and the module makers might be the hares in an energy transition race, but infrastructure is the tortoise – it is the steady and secure way to invest in energy transition while offering an attractive and growing income.