

Themes and Trends – September 2018

The following comments are based on our discussions with investors and investment managers over the last quarter. We have referred to investors in the comments below but, in most instances, investors will be working closely with their consultants and you can infer that a reference to one is a reference to the other also.

Although US economic data continues to be strong (and the US equity market continued to rise in the September quarter), some investors question the sustainability of US growth (arguably being driven by company and personal tax cuts) and anticipate this could start to drop off meaningfully in a year or two. Ordinarily, strong growth would buoy US trading partners and be very positive for emerging market countries. However, the above concerns and the ongoing US/China trade war tensions, and fears this could escalate to other countries, exacerbate investor concerns.

Argentina and Turkey's economic woes have also contributed to emerging markets more broadly being unloved over the last couple of quarters. Although commentators point out that high levels of inflation, debt and deficits are common elements to these countries, the general cautious sentiment regarding emerging market equities and debt is likely to pervade for some time.

Themes and Trends we have identified since our previous quarterly update are as follows:

- Investors continue to have strong interest in absolute return approaches, reflecting the beta that has already been had from long-only benchmark aware approaches since the GFC and ongoing concerns about current market valuations.

However, some long-only 'roads less travelled' are attracting attention such as land registry offices, build-to-rent property (as opposed to build to sell); additionally, the resurgence of interest in venture capital seems to be continuing;

- After sitting on the sidelines throughout 2017 and early 2018 awaiting a better entry point, the sell-off in emerging market debt has started to pique the interest of investors recognising that value is more attractive relative to 12 months ago and compared to certain sub-sectors of developed market corporate credit. However, there are still significant concerns over whether the USD will continue to rise on the back of more tax cuts and the problems mentioned above in countries like Argentina (and Uruguay), Turkey and Indonesia. Local currency and blended debt sovereign strategies with significant flexibility to invest in other sub-asset classes such as Hard currency, Frontier debt and perhaps cash are likely to be favoured approaches;
- The trend to increasingly active asset allocation continues with more funds internalising capabilities and processes, enabling them to move more quickly and with the input of a broader range of expertise across asset classes. This does not necessarily require internalisation of direct portfolio management skills, which may well not be the preferred approach, given this trend explicitly recognises that more active return is derived from asset allocation than stock selection;
- ASIC have been quite critical of the lack of diversification of self-managed super fund investors and particularly in relation to those SMSFs that have primarily been utilised as holding vehicles for residential property investments.

Reflecting this, SMSF investors have been increasingly diversifying portfolios into international equities over the last 6 and 12 months. These investors have in the past

often favoured Australian blue-chip stocks and residential property. Recently they have been seeking additional return from international exposures via listed products, such as ETFs, or direct exposures to well known 'growth' names such as the FANGS: Facebook, Amazon, Apple, Netflix, Alphabet (Google).

Independent wealth firms, particularly those catering to the high and ultra-high net worth segments of the market, have built solid research capabilities in international equities and are also making available to their clients an increasingly broad and diverse range of managers and products and are assisting them to diversify their portfolios. In doing so these firms are differentiating themselves from each other and, more importantly, from the aligned advisory and planning firms from which they have often evolved;

- Investors are increasingly questioning fund managers on gender diversity within their organisations; they are asking less gender diverse managers why they do not have more women in key senior roles and what steps are being taken to rectify the imbalance. Specifically, investors will expect to see more women in substantive *investment* roles;
- Speaking at the AIST ASI 2018 Conference in September, Gary Weaven of IFM Investors strongly encouraged Australian Governments to cooperate more closely with Australian superannuation funds on major infrastructure projects.

At \$2.7 trillion and growing strongly, the potential for Australia's superannuation savings pool to fund Australia's infrastructure destiny is enormous.

Weaven makes the point, as others have before, that Governments can work harder and more collaboratively to structure projects suitable to the needs of superannuation funds and their members. State and Federal Governments have frequently seen the primary objective of the tender process as short-term revenue maximisation. Bidders must price aggressively and either set their return expectations lower than they might otherwise have been or charge higher prices to their customers (i.e. mostly Australian consumers). Currently, many Australian supers are finding Australian infrastructure too keenly priced to provide an attractive return, so they are either looking for more obscure and less well understood assets which still offer value (e.g. land registry offices) or they are looking further afield and investing in the infrastructure of other countries.

If Governments structure and price projects in such a way that they (the Governments) are sufficiently compensated for their development efforts and at the same time the supers are presented with an attractive (but not outsized) risk/return proposition that can be a win-win for all parties – including the end consumer; and

- The number of MySuper funds utilising lifecycle approaches rather than defaulting to a static growth or balanced exposure is increasing. The logic of such approaches being that as members age, their investments are gradually de-risked to protect their balance approaching retirement. When the superannuation system was in its infancy, it was important for members to be invested for as long as possible in assets anticipated to achieve the highest returns to maximise savings at retirement (even though they would not necessarily be enough to sustain them in retirement). However, as the superannuation system approaches maturity (in theory most Australians are now spending their entire working lives accruing super), members should have ridden out several investment cycles and, again in theory, have balances sufficient to meet their expectations in retirement.

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