

Themes and Trends – June 2022

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.

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

Your Future Your Super tests

- APRA has delayed the rolling out of YFYS tests to all investment options, having so far limited the tests to default or MySuper options (where the majority of superannuation assets are currently held). This will be a relief to some funds who offer niche strategies or ESG options. According to a leading asset consultant, funds are concerned about how to balance their sustainability ambitions with the degree they can take tracking error risk due to the performance tests. Several industry participants have criticised the tests for not including some sort of risk measure such as a Sharpe ratio, this is particularly important for funds that have taken more conservative equity positions based on a more mature member profile.

What we are hearing

- June 30 performance results are beginning to be announced by super funds with many reporting a negative return for the first time in 9 years due to market declines across almost all asset classes. The median MySuper fund return for the year (as measured by Rainmaker) was -2.8%;
- Several funds have announced strategic partnerships with asset managers to provide bespoke solutions. An example of this is Hostplus Super becoming a cornerstone investor in global alternative manager, Apollo's Asia-Pacific Credit Strategy (US\$500mil of a target US\$1125 mil). Hostplus Super and Apollo have a longstanding relationship stretching back 13 years;
- Aware Super has followed in the footsteps of other funds such as CBUS and REST Super in pursuing greater efficiencies by establishing Aware Real Estate which will manage Aware's \$1.55bn property portfolio of office, retail and industrial assets;
- According to asset consultants and some funds, growth equities and emerging market equities are currently out of favour while quality and value equities and other asset classes such as credit and private markets are of greater interest. However, some investors with a contrarian risk appetite are conducting analysis on re-entry into quality growth, citing P/E's much closer now to historical levels than has been the case in recent years, in anticipation of a stabilisation and perhaps retracement in prices in these sub-asset classes;
- Furthermore, many investors believe we have hit peak margins in equities and this can only go one way, given rising interest costs and inflation hitting input costs. Only companies with strong franchises and the ability to pass costs onto consumers will be able to avoid margin compression. Some think this could provide further downside pressure on equities; but, a greater number believe this is mostly priced in;

- Since the February 2022 “sell off” in interest rates, investors have begun to steadily move back into duration assets. At the time of writing, this appears to have paid off for early movers;
- Similarly, contrarian investors have used the recent spread blow-out to increase credit allocations. This includes sub-investment grade credit; particularly, floating rate products such as leveraged loans and CLOs and private credit.

As mentioned in our last quarterly Themes and Trends, many investors (and consultants) have maintained a neutral weight relative to their credit strategic asset allocation benchmarks. We have been given indications more investors are likely to over-weight credit, although with a potential recession looming, many will prefer to rely on defensively oriented credit managers focused on tilting the portfolio to higher quality paper issued by companies with very defensible cashflows. Note, many investors expect the US recession to be relatively short and shallow so expectations of a spike in defaults are limited. Credit research and analysis is likely to be in high demand going forward given the increased dispersion of credit quality;

- With the “all in yield” of many high yield strategies approaching 10%, it is expected that fund flows into lower risk private credit strategies targeting 8-10% will slow until interest rates in this space adjust upwards on new issuance. This may be positive for high yield and higher risk private credit strategies;
- The crypto (or digital asset) bear market continued unabated including several high-profile collapses of crypto asset managers such as Three Arrows Capital and the bankruptcy of centralised finance (CeFi) lender, Celsius. This follows the collapse of the TerraUSD (UST) algorithmic stablecoin and its companion token, Luna.

Interestingly, these collapses have occurred in some form of centralised structure and, therefore, have only encouraged crypto participants as it reaffirms their belief in the inherent strength of decentralised finance. Going forward, it appears most leveraged investors have been washed out (another strength of the sector is that the level of leverage is easier to identify than CeFi) and sentiment may improve when the macro environment becomes clearer.

Merger update

- Consolidation in institutional super continues as Mercy Super announced it would be merging with HESTA, Christian Super announced it would merge with Australian Ethical Super, Australian Catholic Super Fund announced it would merge with Unisuper, and AvSuper announced it would merge with Commonwealth Superannuation Corporation. LGIAsuper (who recently merged with Energy Super and Suncorp super) has announced it is rebranding under the name “Brighter Super”. It appears that the future of 10-12 mega-funds within the next 5 or so years envisioned by some industry commentators is likely to come true.

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