Handelsbanken
Asset Management

Investment Outlook 2021

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From the outset, the economic shock caused by the COVID-19 crisis has been treated rather differently to a ‘normal recession’. Indeed, the reaction from leaders around the globe has been closer to what one might expect in response to a natural disaster. And this is entirely appropriate; the run-up to the pandemic bore little resemblance to the usual conditions foreshadowing a recession, the financial market reaction was swift but relatively short-lived, and the pathway out of the immediate crisis is clear and distinctly medical.

As we enter a new year, we believe that we are beyond the darkest days of the pandemic in both human and economic terms. The past 12 months have introduced extraordinary new stresses and strains, but the crisis has also been countered by unparalleled support from governments and central banks around the world. At the outset of 2020, central banks were already maintaining good levels of liquidity in the financial system and keeping interest rates low. That will now continue for much longer, but with government policymakers now definitively fighting alongside central bankers to support their economies. Put simply, the solutions to this crisis are likely to far outlast the crisis itself.

Our investment team discusses all of this, and more, in our first article – *What a difference a year makes* – overleaf. Meanwhile, we know that inflation is always a key concern for our customers, which we address in a short piece: *Inflation is still the thief who’d like to pick your pocket*. Another key player in the 2020 pantheon has been the US political scene. In *Political developments to watch out for in 2021*, we outline the landscape for US politics in 2021, as well as taking a look at changes at the helm in Japan, and the eternal Brexit saga.

Throughout 2020, our outlook has remained moderately risk-positive. Now, with a COVID-19 vaccine in distribution, signalling a very clear light at the end of the tunnel, we maintain this stance. In two further articles – *Investment strategy for the post-pandemic world* and *Thinking creatively about investment portfolios* – we assess how our investment strategy looks as we enter 2021, and outline some of the creative ingredients that go into our investment portfolios.

And finally, some of our customers might be wondering what the future holds for responsible investment, or thinking about what lies ahead for income-seeking investors. In our final two articles, *Is the future bright for sustainable assets*? and *The outlook for income investing – challenges and opportunities*, they may find the answers.

We wish you a safe and happy start to the new year, and a successful 2021.

Graham Bishop, Chief Investment Officer

What a difference a year makes

When we wrote our last annual Investment Outlook in late 2019, the outlook for the global economy was improving. Economic growth in most regions was anaemic, but central banks were in co-ordinated interest-rate-cutting mode. Governments were not seriously contemplating additional economic stimulus, but that did not stop central banks applying the usual pressure for them to do so. The world was being flooded with liquidity, and this was beginning to manifest in green shoots of economic recovery. There were hopes of a trade deal between the US and China, Brexit negotiations were supposedly progressing, and it looked vital for President Trump to keep the US economy on an even keel if he were to be re-elected a year later. All of this feels like a lifetime ago.

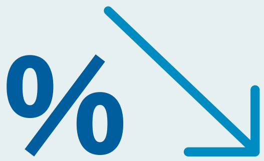
Suffice to say, 2020 was quite a year. The world experienced a seismic hit to economic activity due, of course, to a health crisis in the form of the global pandemic known as COVID-19.

For political and financial leaders around the world, the pandemic represented a natural disaster, and certainly both their responses, and the reactions of investors, consumers and businesses, have been closer to what we might expect following an earthquake rather than a recession. Indeed, the global financial crisis aside, recessions are normally caused by overly zealous central banks taking away the punch bowl (i.e. raising interest rates). Before the pandemic, the opposite was happening (interest rates were very low), which is important context to bear in mind.

Policymakers have come out swinging

The reaction of central banks and political leaders, faced with population lockdowns and widespread fear, was aggressive in pace and magnitude. They amped up their efforts, indicating that the lessons of the global financial crisis and ensuing recession had been learnt – the more that is done early on, the less is required later. Via wide-ranging government interventions to keep businesses afloat and households with an income, an even worse outcome has hopefully been avoided.

Interest rate cuts: lower by one percentage point



Central bank liquidity injections

Government support programmes

Debt is mounting

But, as readers will know, there is no free lunch: what is borrowed must be returned. Defaulting on the government debt incurred by COVID-19 support programmes is unpalatable for obvious reasons, so inflating it away in real terms or simply repaying it are the only two options left. The latter in particular poses a material issue for future generations, who might have to endure more onerous tax regimes. High debt burdens today have surprisingly low interest costs owing to extremely low interest rates, a relationship that may make central bankers think carefully before increasing interest rates in the future.

Inflation is performing a delicate balancing act

Inflationary forces affecting the global economy seem to be as great as the deflationary forces. On-shoring of production and massive economic stimulus by governments and central banks support the former; deficient demand and investment in technology (including automation) support the latter. The net result is likely to be more of the same, but the balance is delicate. Interestingly, the US Federal Reserve is now comfortable with maintaining very generous supportive policies even if it means that average inflation remains above its target range for a while. The direction of the inflation needle is something that we, and bond markets, are intently focused on.

Vaccines could offer a boost

These actions by policymakers, ahead of the first vaccine being rolled out in December, caused economic activity to bounce back swiftly, only to be met with additional lockdowns in the fourth quarter of 2020. We view this setback as temporary and the outlook for global economic growth in 2021 as positive, but stabilising, as time moves on. The release of vaccines, beginning with Pfizer's in the UK, are likely to give a positive boost to this trajectory, particularly if administered when the virus' reproductive rate is falling and herd immunity is easier to achieve.

We are all adjusting to a changed world

We believe the combination of targeted lockdowns, more effective transmission controls and continued policymaker support should make some semblance of normality achievable in 2021 and beyond. That is not to say that the outlook is entirely normal. Indeed, we are braced for periods of uncertainty if new virus clusters require remedial action. Confidence will take time to be restored and behaviours of all sorts of economic agents likely changed.

This matters for employment markets, as it is reasonable to assume that demand for work could shift over from hospitality, for example, to more digital sectors. Depending on the speed of this transition, government support programmes may need to be relied upon. If governments decide these programmes are overly expensive, temporary unemployment could easily become permanent unemployment. The risk of structurally higher unemployment remains a key concern.

The political outlook is relatively benign

There will likely be other features of a post-COVID-19 world. Businesses, burnt by their experiences earlier in 2020, may feel their supply chains are a vulnerability, so more production on-shoring may be in store. To a degree, this is what Trump wants, but the de-globalisation wave is likely to be partially offset by the election of Joe Biden, who seems keen to roll back the tariffs that Trump's executive orders put in place.

> "The reaction of central banks and political leaders, faced with population lockdowns and widespread fear, was aggressive in pace and magnitude. They amped up their efforts, indicating that the lessons of the global financial crisis and ensuing recession had been learnt - the more that is done early on, the less is required later."

Graham Bishop, Chief Investment Officer

President-elect Biden's victory also likely means a reasonable additional government support package, but a split Congress also means that it will probably be difficult to enact corporation tax hikes and/or capital gains tax hikes. This is one of the reasons why markets have taken the overall election results so well.

On this side of the Atlantic, the UK's retreat from the European mainland continues. At the time of writing, the country is on the precipice of a deal, but this statement could have applied at numerous points in recent history. COVID-19 likely trumps Brexit in terms of its wide-reaching impact, and those most affected by Brexit have now had some time to brace themselves. As a result, we do not believe that Brexit will prove to be the huge disruption it once might have been. Perhaps that is wishful thinking, but there are plenty more opportunities around the globe to keep us occupied.

> "On home shores, a Brexit resolution may be close, but the UK has other problems, including the size of its services sector - leaving us vulnerable to renewed lockdowns."
>
> Nikki Howes, Investment Associate

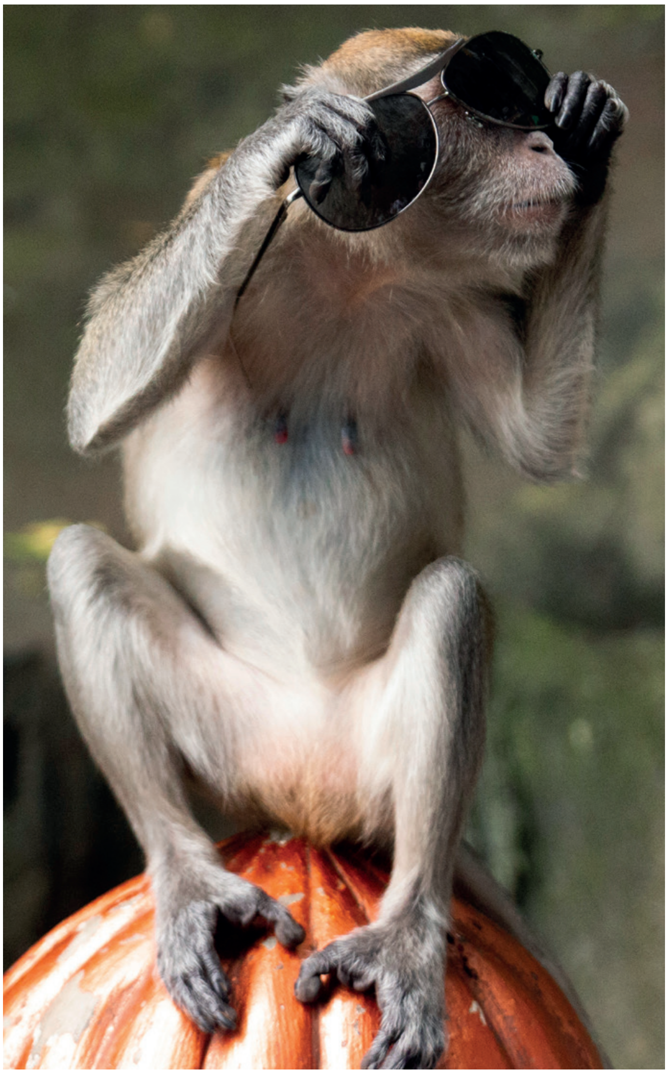
The big picture

- Management of the COVID-19 virus has improved since its emergence around a year ago. Vaccines are being rolled out, and lockdowns are more targeted. The global economy is recovering, with China leading the way. However, the pandemic has not yet left us, and can still impact business and consumer behaviour.
- On home shores, a Brexit resolution may be close, but the UK has other problems, including the size of its services sector (leaving us vulnerable to renewed lockdowns). As employment support schemes expire (e.g. furlough), we may also see the reality of job losses. Administering vaccines should help this picture.
- Clarity in US politics should support stock markets, and bring investors back into the market. Share prices should be further bolstered by traditional bond markets offering only very low yields, pushing investors into higher risk assets in search of financial returns.
- Corporate earnings are beginning to recover, and much more quickly than many had expected. Inventories across the world are also significantly depleted, meaning that restocking could be imminent, which would provide another boost for suppliers.
- Growth in the global money supply remains very strong, with ample liquidity in the financial system. More financial support from governments is likely on the way (in the US in particular) to supplement central bank support, but these costly programmes will not continue indefinitely. Inflation has proven hard to generate, and should remain low (see next article).

Inflation is still the thief who'd like to pick your pocket

The late Ronald Reagan, former US president, once said: "Inflation is as violent as a mugger, as frightening as an armed robber and as deadly as a hit man". He was absolutely right.

Inflation is the thief picking our pockets, and most of the time we don't even realise it. When inflation reaches double-digit levels (as in the 1970s), we can see the thief coming, though there is little to be done about it. But 2% inflation – deemed an acceptable (indeed, aspirational) norm by developed world central banks – is a thief we don't see coming, and can take half the contents of your pockets (50% of your capital) over the long run if nothing is done to stop the assault.



Which factors influence inflation?

Inflation is generally a function of three pressures:

1. **Expectations**

   Central banks do not believe that inflation will return to the target level of 2% until the end of 2021 in the UK, and 2023 in the US. We would note, though, that forecasting inflation is a thankless task, and central banks have a very poor history of predicting it with accuracy. From a market perspective, inflation-linked government bonds indicate that US inflation is not expected to return to 2% for the next 30 years.

2. **Demand variables**

   These include growth, unemployment, and the nearness of the economy to full capacity. Given the COVID-19 shock, there is likely to be limited pressure from these factors in the near future.

3. **Supply shocks**

   These include changes in relative import prices (via currency weakness) or changes in global supply chains. While the pandemic certainly impacted some supply chains, global corporations had already begun to diversify their production before its outbreak, in some cases leading to lower (disinflationary) rather than higher (inflationary) production costs.

Taken altogether, over the next few years, we expect low, but positive, inflation.

If inflation is set to remain low, why should we worry?

Inflation may remain at ostensibly benign levels, but interest rates will stay ultra-low too. This means that the return on cash after inflation and taxation is locked in negative territory for investors. This is unlikely to change: central banks have already told us that if inflation does pick up, they will raise interest rates much more slowly than in the past (if at all), letting the thief rifle through our pockets for longer.

For customers looking to maintain the purchasing power of their capital, and ideally grow it over and above inflation in the long term, a global, multi asset class investment approach could be the optimum solution. This approach is able to pull on a multitude of levers to produce returns over the long run for a given level of risk.

As we bid 2020 farewell (and many would bid it good riddance), it is worth remembering that a global pandemic is not the only significant development travelling with us into the new year. Across the globe, change is underway in some of the highest political spheres.

Political developments to watch out for in 2021

A volatile landscape for a new US president

From the bitter accusations of foul play to the long shadow of COVID-19, the most recent race for the White House is sure to live long in our memories. Since 2008, the US has held seven federal elections – comprising presidential elections and intervening elections for Congress (the US government). On seven of these eight occasions, US voters have transferred power to the opposition party, either by switching the White House resident or repointing the balance of power in Congress. Such a period of political volatility has not been witnessed in the US for over a century.

Unusually slow economic and income growth have fuelled inequality and polarised the US population. The highest voter turnout in more than 100 years delivered Biden a record-breaking victory, but also gave Trump more votes than anyone but Biden has ever received (and more than he himself received in 2016). So, Joe Biden will enter the White House in January 2021, and remain there for at least four years. But more than 70 million US voters opted for Trump, and many of them feel very strongly about both the result and the outgoing president himself. All else being equal, don't be too surprised to see Trump (Donald, or one of his sons) in the 2024 race.

What's more, Biden enters his presidency without a majority in the Senate (a majority could materialise in the Georgia run-off election on 5th January, although history is on the side of the Republicans here). This is very rare for an incoming president – it has happened just three times since the 1880s. The Democrat's erstwhile majority in the House of Representatives is now also razor thin to boot, which could have profound implications for how far Biden can push his election manifesto.

The US economy needs more financial support from the government, but much of Biden's spending proposals hinged on tax hikes for the wealthy and a reversal of the corporation tax cuts enacted by Trump. Without a Senate majority, Biden probably cannot raise (or spend) as much as he had previously hoped.

This could be a perversely constructive scenario for financial markets. A limit on Biden's ambitions could reduce new strains on the US budget deficit, and lower the new debt issued by the US Treasury. Fresh, large-scale Treasury issuance could have had knock-on effects on bond markets, including an unwelcome rise in bond yields. This would have meant a higher cost of borrowing for businesses and consumers, at a time when fostering economic revival is absolutely vital.

In stock markets, share prices received a major boost from Trump's corporate tax cuts, particularly in the technology sector. Businesses would be happy to hold on to these. Tech firms will also welcome the Biden-Harris administration more generally. There have long been calls for more regulation in the sector, including stricter competition laws, but both Biden and Harris are perceived as close to this industry. It is worth noting that technology is a key theme within our portfolios.

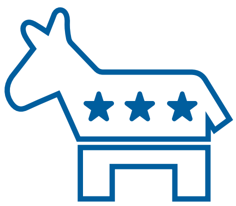
In 2020, Trump received the second most votes ever cast for a presidential candidate. In any other year, he would have won, and set a new record.

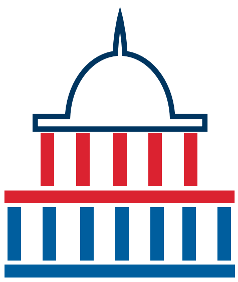
TOTAL VOTES RECEIVED IN A PRESIDENTIAL ELECTION (RANKED)

1. 2020 BIDEN 80,063,589 VOTES
2. 2020 TRUMP 73,904,195 VOTES
3. 2008 OBAMA 69, 498, 516 VOTES

This set up of White House and Congress has not been see for over a century

DEMOCRATIC PRESIDENT





REPUBLICAN-CONTROLLED SENATE (UPPER HOUSE)

DEMOCRAT-CONTROLLED HOUSE (LOWER HOUSE)

This outcome was last seen in the 1884 election

Source: Wikipedia

> “The eyes of the world will now be on Suga to see if he continues Abe’s economic approach. Dubbed ‘Abenomics’, Abe’s policies were aimed at ending the persistent deflationary pressures plaguing Japan for decades.”
>
> David Absolon, Investment Director

Can we expect continuity from Japan’s new prime minister?

Overshadowed on the international stage by the US contest, Japan was also the site of a leadership election in 2020.

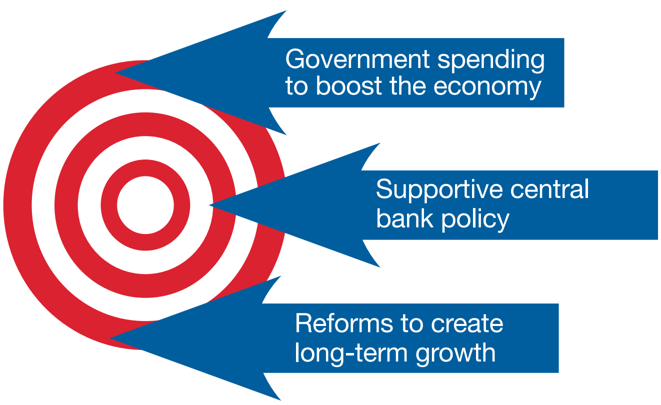
At the end of August, Shinzo Abe – Japan’s longest-serving prime minister – was forced to resign on the grounds of ill health. This prompted an election to select a new leader from Abe’s party to serve out the remaining prime ministerial term. Chief Cabinet Secretary Yoshihide Suga won easily.

The eyes of the world will now be on Suga to see if he continues Abe’s economic approach. Dubbed ‘Abenomics’, Abe’s policies were aimed at ending the persistent deflationary pressures plaguing Japan for decades. Abenomics centred on three ‘arrows’ – ultra-supportive central bank policy from the Bank of Japan; flexible financial support from the government; and a growth-oriented reformist approach to industrial policy. While the Bank of Japan has delivered on the first arrow, the other two arrows have made less progress than envisaged.

Nevertheless, Suga inherits an economy which has made some headway, and has handled the COVID-19 pandemic better than most nations (despite Japan’s ageing population). He now has 12 months remaining in his term in which to cement his position and aim for re-election. Suga is expected to continue in some of the spirit of Abenomics, but – perhaps more sensibly than his predecessor – he will focus on structural reforms around regional banks, and more competitive pricing in digital markets. This could help the underlying economic growth of the Japanese economy.

We would note that financial markets in Japan are very closely tied to fluctuations in the global economy. If (as we believe) we see something of a global economic revival in 2021, this is a region which should stand to benefit, and receive increased investor attention.

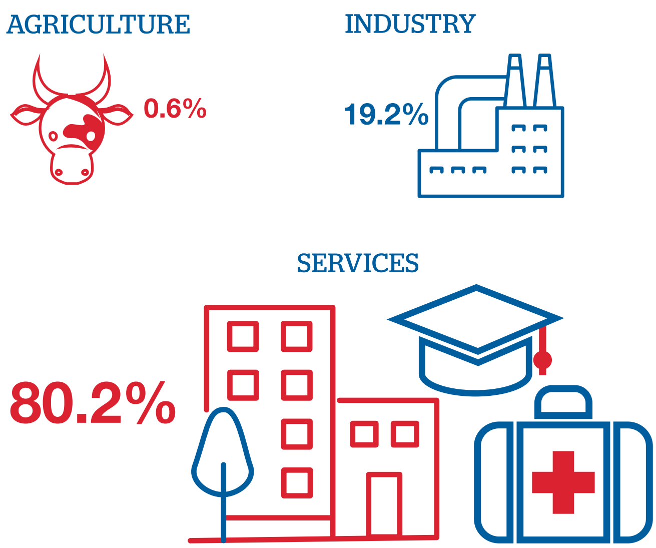
Abenomics three arrows (in simple terms)



The never-ending Brexit story nears the end of a chapter

Brexit took a back seat for much of 2020, as the COVID-19 pandemic took the wheel. However, at the time of writing, it has returned as a key talking point. Talks have already been pushed beyond a number of previous informal deadlines, and the transition period is due to conclude imminently. Our prediction, albeit not without reservations, is that an extremely loose and light deal is likely to materialise at the eleventh hour, with the most contentious issues deferred until another day.

Composition of the UK economy:



Source: Office for National Statistics - most recent estimates

The UK economy has been hit exceptionally hard by the pandemic, in large part due to its reliance on the services sector (rather than manufacturing). The road to recovery will be a long and winding one. The Bank of England will need to maintain its extremely accommodative stance, with interest rates nailed to the floor, and perhaps a return to cash injections into the financial system. Meanwhile, the UK government would surely like to begin winding down furlough schemes and addressing the burden on national finances caused by the pandemic (likely via tax rises on the middle class). However, until there is clear evidence of an economic recovery unfolding, that wish will have to wait.

For now, we remain cautious about UK assets, and maintain an ‘underweight’ position in the UK stock market and UK commercial property within our investment portfolios. Our exposure to sterling as a currency is light relative to where we have been in the past. With limited visibility on the UK economy’s trajectory from here, this is unlikely to change in the near term.

Investment strategy for the post-pandemic world

Alexandros Michailidis / Shutterstock.com

As we enter a new year, and stand on the cusp of a post-pandemic world, it is natural to consider what this means for our investment strategy.

Big portfolio decisions

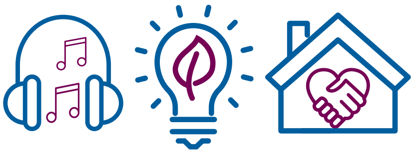
The events of 2020 did not remove our moderately pro-risk view of the world, and we feel relatively positive about the outlook for the pandemic, the economy, and financial markets from here. In many ways the reaction to 2020 was akin to that of a natural disaster, hence knee-jerk recessions and unprecedented policy stimulus. We retain our conviction in our chosen themes and assets, and manage risks carefully and opportunistically.

For the time being, given the balance of factors in play, we are holding overall portfolio risk levels steady. This means maintaining our slight overweight to those assets intended to drive financial returns versus those designed to diversify portfolio risk. We have good variety amongst our diversifiers themselves, as we recognise that government bonds may not smooth the journey in the way they once did.

While there is now light at the end of the tunnel, the pandemic has not yet left us, and is still very capable of affecting many types of human behaviour, including consumer choices. News of a vaccine has been widely welcomed, but when government support programmes around the world (like the UK's furlough scheme) roll away, the true impact of this economic shock will come into focus.

But although the economic scars left behind by the pandemic will be long-lasting, many of the economic support mechanisms set in motion by governments and central banks throughout 2020, are also likely to be here for the long haul. This is welcome news for a recovering world, and for investment markets.

WE ALSO HAVE HIGH CONVICTION IN OUR MORE CREATIVE PORTFOLIO POSITIONS



SUCH AS OUR HOLDINGS IN MUSIC ROYALTIES RENEWABLE ENERGY AND SOCIAL HOUSING

“While there is now light at the end of the tunnel, the pandemic has not yet left us, and is still very capable of affecting many types of human behaviour, including consumer choices.”

Ben Matthews, Investment Manager

President Biden, technology and healthcare

Among our stock market holdings, we continue to favour key themes including technology and healthcare. There had been concerns that a Biden presidency could spell bad news for these areas due to increased regulation and taxation, but will these come to pass?

Greater regulation, via competition law, has long been perceived as a particular area of vulnerability for big tech firms. However, in reality, bringing ‘antitrust’ cases against these businesses would be incredibly challenging. Indeed, large tech firms are not actually monopolies in the traditional sense – for example, Facebook gives away its services for free, and Google allows businesses to set the prices for its advertising (via bids). The reality of a post-pandemic world is also that governments are increasingly reliant on technology and technological solutions to keep the economic recovery going.

Even so, tech businesses were a major beneficiary of the corporation tax cuts introduced by Trump early on in his presidency, and would be disproportionately affected by their undoing. But a return to higher tax rates would be unhelpful for US businesses and stock markets in general, meaning that Biden would need to move very carefully, and (perhaps more crucially) he is unlikely to have the support in Congress to enact such changes.

Indeed, we feel that the lack of a Democrat ‘clean sweep’ (winning the White House plus both houses of government) is likely to limit any extreme sweeping changes in either technology or healthcare. What’s more, Biden’s plans to expand the Affordable Healthcare Act could also actively benefit the healthcare sector, particularly as the nation recovers from one of the worst COVID-19 experiences globally.

Assessing geography and size

Our strategies never consider whole regions as homogenous markets; when we allocate investments to a particular geography, we take care to consider the specific factors impacting each part of that market. For example, at the time of writing, we have a relatively low allocation to the larger stocks in the UK equity market – rather, we have a relative preference for the shares of small and mid-sized companies. The growth potential of these companies is enviable and in vogue when the global business cycle experiences a setback.

We also favour emerging markets, and our allocation to this incredibly diverse group naturally includes preferences for opportunities in specific countries. We have long-held positions in the onshore Chinese stock market, as well as positions in the bond markets of specific emerging economies.

One good example is the Indian bond market, where both government and corporate bonds can offer attractive returns in a world of incredibly low bond yields. For example, 10-year Indian government bonds have a nominal yield of around 6%; generous yields like this can provide a cushion to manage any currency volatility. Further, around 90% of the Indian bond market is owned by domestic (rather than international) investors, which lowers the risk of large numbers fleeing the market in the event of any turbulence.

Getting creative

We also have high conviction in our more creative portfolio positions, such as our holdings in music royalties, renewable energy, social housing, and non-traditional lending. Market moves in these areas appear uncorrelated to those in wider financial markets, leading to attractive variety among the assets we hold for the purpose of generating returns as well as those used to diversify risk. As alluded to earlier, it is important to get creative amongst diversifiers too. Bond yields at extremely low levels hardly make for compelling investments. Hence we own gold, have exposure to the Japanese yen, and ‘tail risk’ hedging strategies (specialist products designed to protect against sharp, dramatic market falls).

In the next article – Thinking creatively about investment portfolios – we discuss some of the tools we use to create diversity within our portfolios through non-traditional assets.

Thinking creatively about investment portfolios

The core philosophy behind our portfolios is the idea of diversification, and our multi asset approach means that we include both traditional and alternative asset types within our portfolios.

We believe that this kind of diversification has the potential to help long-term returns in two ways:

1. **Managing portfolio risks**

   We all know the old saying 'don't put all your eggs in one basket'. Our portfolios contain a range of investments which do different things at different times.

2. **Enhancing portfolio returns**

   By accessing opportunities outside of the traditional investment universe, we look to find attractive financial returns.

One way to address this is by expanding the range of opportunities available, and our multi asset mandate allows us to do this. Here we consider some examples of diversification within our portfolios.

Example 1.

Traditional real assets: commercial property

Investing across a broad range of commercial property assets, generally in the three primary sectors: industrial, office and retail.

Commercial property has long been a core component of multi asset portfolios, offering investors the kinds of yields normally associated with bonds (through rental streams) and the kind of potential gains normally associated with shares (through capital growth). Over the last few years, however, returns from commercial property, particularly in the UK, have been mixed at best. Some sectors, such as high street retail and shopping centres, have suffered significantly as consumer activity has shifted increasingly towards online retail. However, areas such as industrial property have benefitted from increased demand for warehouse and logistics centres to allow online retailers to manage and expand their supply and delivery chains. We have been increasingly selective in the UK commercial property space, taking account of these trends. At the same time, we have expanded our property investment universe to include other 'alternative' sectors that we believe present attractive risk/reward dynamics.

Alternative real assets: renewable infrastructure

Like commercial property, this involves investment in a real 'bricks and mortar' asset, but the focus is on renewable energy generation assets, such as wind plants and solar photovoltaic farms.

Renewable energy production has expanded significantly in recent decades, driven by falling production costs and an international push to decarbonise economies and mitigate climate change. Buying a renewable energy asset, such as a wind farm, involves the payment of a fixed price today in exchange for future revenues earned through the electricity generated by the asset. Revenues are typically a mix of government subsidies and/or long-dated fixed contracts with large utility companies. This provides investors with access to stable, inflation-linked returns. In addition, future revenues from renewable energy projects are generally not determined by the direction of financial markets or the wider economy, but by idiosyncratic factors such as the weather, future power prices and changes in government policies. This can provide diversification benefits within a broader portfolio.

As with any investment, however, this space is not without risks. Some technologies, such as wind farms, may be very weather dependent – therefore, ensuring exposure to the right assets, backed by strong operating histories, is important. Other risks involve volatility in future power prices, loss of government support and too much investment capital flowing into the space, pushing down returns.

Example 2.

Traditional fixed income: corporate bonds

Debt issued by companies in public markets. Owners of corporate bonds (i.e. the lenders) earn a rate of interest for lending to the underlying business, set at a level which reflects the credit risk of the borrower.

Interest rates have fallen pretty much across the globe over the last decade or so, and the average yield on corporate bonds has followed suit. This means that lenders now earn less than previously for lending out their money. Whilst we do continue to hold corporate bonds, through exposure to both the investment grade and high yield space, we have also selectively expanded our fixed income universe to ensure that we are capturing as much of the broader opportunity set as possible.

Alternative fixed income: infrastructure- and real estate-backed direct lending

Instead of lending to publicly-listed companies, these specialist lending strategies are focused on making loans against assets, e.g. infrastructure projects such as wind farms, real estate assets such as commercial property, or intellectual property rights such as pharmaceutical royalties.

As these strategies are slightly more specialist and may be more illiquid than their public debt counterparts, lenders can earn an attractive yield from these investments. Loans are often backed by projects or assets that have long-term, recurring cash flows, creating attractive diversification in an investment portfolio. Risks must be taken into account – for example, we generally have to look to active managers (who rely on their skill in selecting specific investments) to gain access to this space, so conducting thorough due diligence to ensure that they have the right credit selection and risk management processes in place is paramount.

RENEWABLE INFRASTRUCTURE

THE FOCUS IS ON RENEWABLE ENERGY GENERATION ASSETS, SUCH AS WIND PLANTS AND SOLAR PHOTOVOLTAIC FARMS

Example 3.

Traditional diversifiers: government bonds

Holding government bonds has long been a key tenet of a diversified portfolio, with government bonds typically included to provide protection during periods of stock market stress.

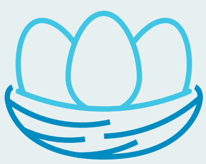
Government bonds have historically performed well during periods of economic stress due to reactive interest rate cuts during recessionary periods (this is beneficial for bonds as their prices and interest rates are inversely related), and in nervous market environments, when investors often move towards these typical ‘safe-haven’ asset types. However, as interest rates have systematically fallen over the last decade, the protection power of government bonds looks challenged. With starting yields already very low – even zero or negative in some cases (meaning bond holders are effectively paying to lend out their capital if they hold these bonds to maturity) – there is increasing concern about how much of a performance cushion government bonds will provide in future crises.

Alternative diversifiers: gold

As multi asset investors, we hold a range of assets in portfolios that we believe can help to provide protection during periods of market stress when other risk assets may all come under pressure.

> “While past performance is not a reliable guide to future performance, gold has a long history of strength during periods of economic and financial stress.”
>
> Charu Lahiri, Investment Manager

This encompasses a wide range of assets that we believe can serve as portfolio hedges, including a position in gold. While past performance is not a reliable guide to future performance, gold has a long history of strength during periods of economic and financial stress, and is a relatively low cost asset to hold. Given the finite supply of this precious metal, it can also serve as a store of value in an environment where central banks pumping liquidity into the financial system is putting pressure on the value of fiat currencies (i.e. not backed by commodities like gold).



WE ALL KNOW THE OLD SAYING ‘DON’T PUT ALL YOUR EGGS IN ONE BASKET’

OUR PORTFOLIOS CONTAIN A RANGE OF INVESTMENTS WHICH DO DIFFERENT THINGS AT DIFFERENT TIMES

Is the future bright for sustainable assets?

Recent years have provided fertile ground for sustainable assets to perform. Even more recently, consumer activity and investor priorities have actively supported sustainable assets during the COVID-19 pandemic, as a glance at the share-price performance of sustainable businesses demonstrates. But, as customers no doubt tire of hearing, past returns are no guide to future performance. Where will sustainable assets go from here?

Happily for sustainable investors, a number of factors are set to bolster sustainable assets, and many of these are relatively new influences. While the road ahead will not always be easy, overall we see a very supportive landscape emerging.

The political environment is right

Governments often exhibit herd behaviour, and right now the herd is on the move. Following the UK's commitment to reaching net zero emissions by 2050, France, Denmark, New Zealand and Japan have made matching pledges. Even China – currently the world's biggest polluter – has committed to net zero emissions by 2060. Importantly, the incoming US president – Joe Biden – has also pledged to take his country back into the Paris Agreement (abandoned during President Trump's time in office) and is aiming for net zero by 2050 too.

What's more, this is an issue with reach across much of the political spectrum: political parties traditionally unconcerned by such 'green' externalities are now also talking earnestly about sustainability. Notably, a Conservative government committed the UK to a net zero emissions target.

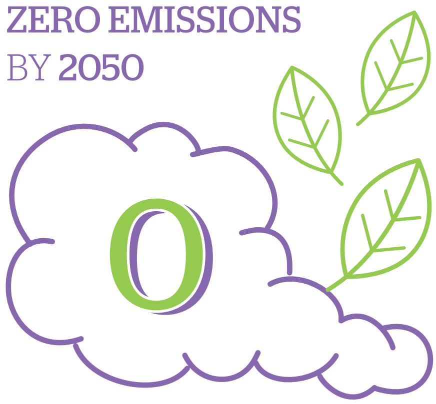
Policies are starting to catch up

In the UK, the government intends to double the amount of renewable energy it subsidises in 2021, including onshore wind and solar power. A surge in wind power helped to break records for green energy generation in the UK in 2020. Chancellor Sunak has also announced that the UK government will issue its first green bonds in 2021 in an effort to meet growing investor demand for sustainable assets.

Meanwhile, the European Commission is committed to an action plan for financing sustainable growth. Its action plan seeks to reorient the flow of capital towards sustainable investment, better integrate sustainability factors into the way investments are rated and researched, and foster a transparent and long-term approach to financial and economic activity. The EU is also considering a tax on imported goods which reflects the level of carbon dioxide emissions created via their production. There has been widespread international interest in this notion, including from President-elect Joe Biden.

At present, the US is the world's second largest polluter, and significant US policy change will be needed in order to meet the net zero 2050 target. Encouragingly, Biden's election manifesto included an outline for a 'Green New Deal'. While promises in the build up to an election cannot always be relied upon, this was a prominent part of Biden's campaign, and a cornerstone of his proposed policy approach. Stating that the US urgently needed to 'embrace greater ambition' on climate change, Biden drew a link between the health of the US economy and that of the environment.

THE **UK'S** COMMITMENT TO REACHING **NET ZERO EMISSIONS** BY **2050**



The private sector is ready for change

In 2019, Business Roundtable (a not-for-profit association of private sector CEOs) issued a statement redefining the purpose of a corporation. They stated that businesses should work for the benefit of all their stakeholders, including not only shareholders but also customers, employees, suppliers, and local communities. This latter point included a specific commitment to respecting both people and environment, and embracing more sustainable business practices.

This is a growing trend in evidence among business leadership. In 2020, BlackRock CEO Larry Fink wrote a letter to CEOs outlining how the investment risks posed by climate change will accelerate a significant reallocation of investor capital. He noted that this will have profound repercussions for risk assessments and asset pricing globally.

This private sector change is broadly being driven by two factors. First, it is increasingly understood that sustainability is ‘the right thing to do’. In one high profile example, Microsoft has committed to being ‘carbon-negative’ by 2030, and will include the carbon impact of not only its own direct emissions but also those of its supply chains within its assessments.

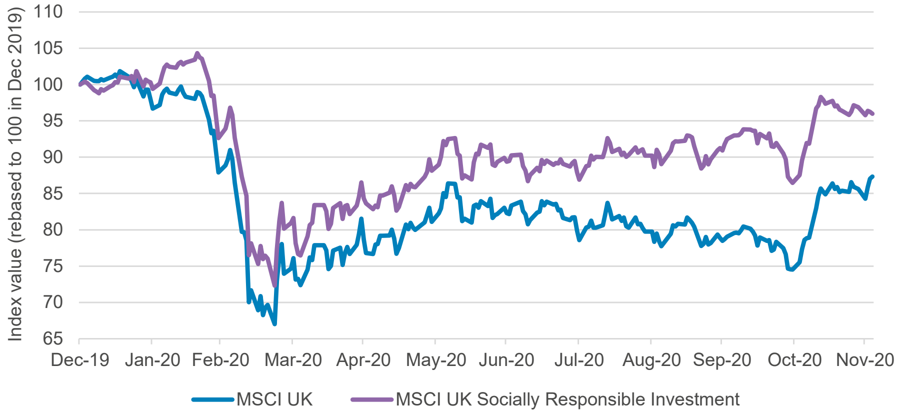
Second, businesses need a social licence to operate, meaning that a sustainable approach now makes good business sense. Even corporate giants with relatively poor past reputations for sustainability and ethics are publicly moving towards more responsible conduct. In the beverage industry, Coca-Cola is using recycled material in its plastic bottles, and is calling for reforms to increase recovery and recycling rates for reusable plastic. In the mining sector, when Rio Tinto presided over the destruction of Aboriginal caves dating back 46,000 years in order to extract the iron ore beneath them, it cost the CEO his job and many directors their bonuses.

Good behaviour is being rewarded

Once relatively niche and low on the political agenda, political commitment to sustainability is increasingly being rewarded in the voting booth. Climate change does still remain a divisive issue in those areas negatively affected by progress (e.g. US states where employment relies heavily on the traditional energy sector), but sustainability is increasingly a political vote winner elsewhere.

A supportive landscape for sustainable share prices

Performance of broader UK shares (MSCI UK) versus socially responsible UK shares (MSCI UK Socially Responsible Investment)



Past performance is not a reliable indicator of future results.

Source MSCI / FactSet

Meanwhile in the private sector, action is also being rewarded. With its range of electric vehicles, Tesla has shifted the automotive landscape and been rewarded handsomely for it, becoming the highest valued car maker in history. In the food industry, fast-growing plant-based business Beyond Meat is aiming to accelerate the shift towards sustainable eating habits and new meat substitutes. Closer to home, Danish power company Ørsted has transitioned its entire business model within the space of just a few years, shifting to a focus on renewable solutions, and is now a leader in the field.

In the past, living sustainably was a personal choice rather than a broader societal issue, but this is no longer the case. It is likely that none of these companies would merit their share-price performances based on traditional growth metrics, but investors are rewarding sustainable credentials and voting for change with their wallets.

> “Even corporate giants with relatively poor past reputations for sustainability and ethics are publically moving towards more responsible conduct.”
>
> Matt Toms, Investment Manager

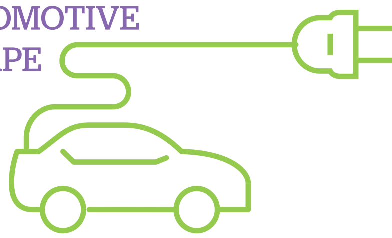
COCA-COLA HAS BEGUN USING **RECYCLED MATERIAL** IN ITS **PLASTIC BOTTLES**

What next for sustainable assets?

Quite simply, there is no turning back from here. Politicians and businesses are committed irrevocably to improving their sustainability, and while we are still at a relatively early stage in the journey, the road only leads forwards.

It is important to remember that corporate and political scandals/errors are never 100% avoidable, even when sustainability and responsibility hold the spotlight. However, taken altogether, shifting priorities spell good news for sustainable approaches to politics, business and investment, and should support the performance of sustainable assets over the long term.

WITH ITS RANGE OF **ELECTRIC VEHICLES, TESLA** HAS SHIFTED THE **AUTOMOTIVE LANDSCAPE**



The outlook for income investing – challenges and opportunities

Drawing a sustainable income from your assets, whilst also enjoying growth in your portfolio's capital over time, has historically been a relatively achievable investment goal. However, if the past few years have been a bitter pill to swallow for income-seeking investors, then 2020 has served as a rather unwelcome cherry on top.

The economic crash in March 2020 spawned the most extreme cuts to global dividends in history. In this unparalleled environment, many businesses were placed under intense regulatory and political pressure to abort their payouts to shareholders. Fortunately for investors reliant on an income from their portfolios, we believe there are more palatable times ahead.

Changing investor preferences have penalised dividend-paying stocks

Since early 2018, significant shifts in investor preferences has meant that the prices of high-yielding shares have struggled to keep pace with other segments of the stock market.

This is at least partly because investors have been very willing to pay handsomely for shares in 'growth' businesses in a low-growth world. 'Growth' businesses are those deemed to have greater predictability in their earnings (such as consumer staples) or greater potential for future growth (often technology businesses), and they rarely return cash to shareholders in the form of dividend payments.

At the other end of the spectrum, shares in 'value' companies (often telecommunications, utilities, energy and financial businesses) are much more likely to offer high dividend payouts, but have been comparatively unloved by investors. This lack of interest has held back the market price of 'value' shares, while those of 'growth' businesses have soared. In addition, Brexit-related fatigue among international investors has impacted the traditionally high-dividend-paying UK stock market, further penalising the assets held by income investors.

Bond markets have faced challenges of their own

Meanwhile in mainstream bond markets, yields have been pushing lower, with investors needing little incentive to invest in these traditional income sources. In turn, traditional bonds have therefore offered exceptionally good capital gains for those already invested, but present a rather lacklustre prospect for income seekers looking to invest.

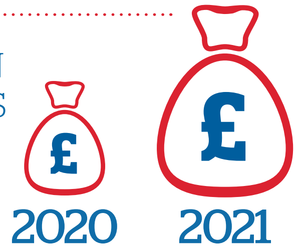
Compounding the struggles of income investors in bond markets, a vast global wave of negative-yielding debt (where investors effectively pay to lend out their money if they hold such bonds to maturity) reached record-breaking levels of around $17 trillion in 2019. This raises serious questions about the future income prospects of bond-based portfolios.

Will 2021 witness the return of dividend payments?

In the face of significant pressure, even companies very much able to fund their pre-existing dividend commitments were strong-armed (explicitly or implicitly) into holding them back during the pandemic crisis. This was especially true of banks, whose balance sheets have improved greatly since the global financial crisis more than a decade ago. Despite most banks now generating sufficient cash flows to cover dividend payments comfortably, global regulators compelled them to suspend dividend payments, prioritising the needs of local economies over shareholders.

However, notwithstanding another big economic shock, we do expect dividend payments to resume in the relatively near future, creating a pickup in income flows. Since so many businesses were in a position to pay their dividends even in 2020, the dividend picture has the potential to be much better in 2021. Company earnings news in the first few months of 2021 will be closely watched.

SINCE SO MANY BUSINESSES WERE IN A POSITION TO PAY THEIR DIVIDENDS EVEN IN 2020, **THE DIVIDEND PICTURE HAS THE POTENTIAL TO BE MUCH BETTER IN 2021.**



Uncovering income opportunities will require flexibility and selectivity

But even as we prepare to enter what will hopefully be a much better period for investors reliant on drawing an income from their portfolio, a selective approach will remain key. For one thing, a number of big dividend payers, particularly in the traditional energy sector, had been overpaying their dividends for some time, in some cases borrowing funds (by issuing debt) in order to maintain dividend payouts to shareholders. This was unsustainable, particularly given lower oil prices and a need to reinvest in their businesses to position for greener energy. In the aftermath of the economic and stock market fall, a number of notable companies in this sector did take action, resetting dividend policies to much lower levels.

Further, while dividend payments will broadly return in most instances, the other challenges facing income investors (outlined at the outset of this article) have not evaporated. We believe that investors looking for income in 2021 will need all the flexibility they can get. This makes a truly multi asset approach – focused on sustainable income, portfolio growth and capital protection – more valid than ever.

Income managers need to be more creative than ever before

We think that a multi asset approach means not only being creative with traditional income-providing asset types like bonds and dividend-paying shares, but also looking to alternative sources of income elsewhere in the vast investment universe. Within our own portfolios, in specific areas like healthcare royalties and infrastructure project debt, robust underlying business models have allowed dividends to be delivered to investors as expected, despite the economic shock. The range of products available to income managers is expanding, giving those with a multi asset remit greater freedom and flexibility to create more balanced portfolios.

Put simply, as we look to the future for income investing, an investment approach that includes as many asset types as possible, will allow managers much more room to manoeuvre than a single asset approach (e.g. a portfolio focused solely on bonds or shares). Most importantly, this flexibility has the potential to serve income investors well across a range of financial market conditions.

Can a multi asset approach help to manage risk for income investors?

Income investors have to face risks on multiple fronts, not only securing an appropriate level of income, but also managing wider factors like volatility in their income stream and inflation (the real value of income could fall as the cost of living rises).

Another key consideration is the risk to the investment capital itself: if the core capital of a portfolio is damaged, then it becomes more challenging to generate a robust level of income, no matter how sound your investment decisions thereafter.

In building an income-oriented total return solution, multi asset investors have the ability to deploy traditional investments alongside a diverse range of other specialist and alternative holdings. With the flexibility to switch between asset types and geographies, this can help to smooth the journey for income-seeking investors.

In combatting such a broad range of risks to both income and capital, though, diversification is crucial. Spreading the opportunity of reward and the possibility of loss is key to many investment styles, but arguably it is nowhere more important than in investing for income.

> “We believe that investors looking for income in 2021 will need all the flexibility they can get. This makes a truly multi asset approach – focused on sustainable income, portfolio growth and capital protection – more valid than ever.”
>
> Jaisal Pastakia, Investment Manager

Key investment terms

Active management	Where the fund manager uses their expertise to pick investments to achieve the fund's objectives rather than copy the investments in a market index.
Assets	Anything having commercial or exchange value that is owned by a business, institution or individual.
Balance sheet	A summary of a company or institution's financial position, made up of assets, liabilities and (where applicable) shares.
Bond (government or corporate)	An investment in the debt of a government or corporation, where investors receive a fixed rate of interest over a specified time period, at the end of which the initial amount is repaid.
Capital investment	Funds used by a company to further its business objectives, which could include the acquisition of assets such as property, manufacturing plants, or machinery.
Capital markets	The area of the financial system concerned with raising capital via shares, bonds, and other long-term assets.
Developed economy/market	Well-established economies with a high degree of industrialisation, standard of living and security.
Dividend	A share of profits which a company pays out regularly (typically annually) to its shareholders.
Diversification	Holding different types of assets in a portfolio to spread the risk.
Emerging economy or market	Countries that are progressing toward becoming advanced, usually shown by some development in financial markets, the existence of some form of stock exchange and a regulatory body.
Exposure	The proportion of a fund invested in a particular asset type, bond, sector/region, usually expressed as a percentage of the overall portfolio.
Fixed income	A sector of investments which offer fixed rates of interest over a specified time period, at the end of which the initial amount is repaid. This may include government bonds and corporate debt.
Hedging	A method of reducing unnecessary or unintended risk on a portfolio.
Index	A representative portfolio of assets which helps to track market trends and performance.
Inflation	The rate at which the price of goods and services rises.
Multi asset	Investment across different types of assets such as company shares, bonds, property or cash.
Quantitative easing	The introduction of new money into the money supply by a central bank.
Recession	A period of economic decline, technically defined as two consecutive quarters of negative growth.
Risk	The level of risk in a portfolio is essentially the probability for loss.
Risk management	The activities a manager undertakes in an effort to limit the risk of losses in a fund.
Sector	An investment category used to define the primary business of a company, such as technology, energy, or healthcare.
Share/stock	A stake representing part ownership of a company.
Volatility	The degree to which the price of a given asset, or price levels of a given market, rapidly changes. The higher the volatility, the riskier the asset/market tends to be.
Yield	The income from an investment, usually stated as a percentage of the value of that investment.

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Wealth Briefing European Awards 2019

Winner: Best Fund Manager
Winner: Change Management Process/Best Implementation of a Technology Solution
Shortlisted: Most Promising New Entrant (Sustainable)

Financial Services Forum Innovation Awards 2019

Winner: Customer Loyalty
Highly Commended: Customer Interaction and User Experience

Investment Week Sustainable and ESG Investment Awards 2018

Shortlisted: Best New Entrant - Services

Citywire Investment Performance Awards 2018

Shortlisted: Best Medium Firm

Investment Week Fund Services Awards 2018

Shortlisted: Best Technology Solution (small to medium firm)

FE Trustnet Alpha Manager Ratings 2018

Winners: David Absolon, Scott Ingham, Michael Stanes

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Past performance is not a reliable indicator of future results.

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