PORTFOLIO INSTITUTIONAL OCTOBER 2024

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US ELECTION:

THE DIS-UNITED STATES

PRIVATE EQUITY
Budget blues?

MARKET BROADENING
A universe of opportunity

WEST YORKSHIRE PENSION FUND
The call of nature

Issue No. 137 | www.portfolio-institutional.co.uk | Independent analysis for institutional investors

THE DIS-UNITED STATES

We are certain to see a familiar face sitting in the White House next year, but we are not certain who that person will be, giving investors much to ponder.

At the time of writing, pollsters are struggling to pick a clear winner ahead of next month's vote.

Will it be former US president Donald Trump or sitting vice president Kamala Harris? There is a cigarette paper between them in some swing states, with the lead seeming to change each time a new poll is published.

The uncertainty is fuelled by the candidates having wildly differing views on the economy and law and order. Foreign policy at a time of growing geopolitical risk is another area where the candidates cannot find common ground.

This month's cover story looks at the various scenarios and what they could mean for institutional investors. Our coverage starts on page 18.

This edition also looks at private equity and whether the first Labour Budget for 15 years could dampen any bullishness for the asset class. Read our view from page 26.

Another big topic is stewardship. It hit the headlines towards the end of last year when an investor group uncovered examples of misalignments between what asset owners want and how their managers vote. We take a look at how to fix the issue and what the industry could do to be more effective in changing corporate practices and policy (Page 36).

Elsewhere, with economic conditions supporting greater earnings growth, investors can now look beyond tech stocks when building a portfolio of growth assets. Our coverage of the new opportunities presenting themselves begins from page 42.

This edition also features Now Pensions' director of investment discussing his plans for the master trust, while the West Yorkshire Pension Fund's head of alternatives tells us about how its latest investment will protect and restore nature across the UK.

Finally, the *portfolio institutional* awards return in May following an eight-year absence. Find out from page 24 what you need to do to be crowned a winner.

We hope you enjoy this edition.

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IN THIS ISSUE

ASSET OWNERS SHIFT THEIR INVESTMENT FOCUS

Investor trends reveal a move towards riskier and digital assets, finds *Andrew Holt*.

Institutional investors are shifting their investment approaches on a couple of fronts, reveals new data.

Firstly, institutional investors are showing a shift for more risk assets, according to October's State Street Institutional Investor Risk Appetite index.

A prominent trend revealed in the index is the movement of investors from cash into equities, driven by lower interest rates and policy stimulus, which helped ease recession concerns.

"Think of it as a September smile: a strong start to the month for risk-taking, followed by a more defensive mid-month, and then a sharp recovery in sentiment towards month-end coincident to policy easing and economic stimulus from the Federal Reserve and the Chinese authorities," said Dwyfor Evans, head of macro strategy for the APAC region at State Street Global Markets.

This State Street measure gauges investor confidence and risk appetite by studying the buying and selling patterns of institutional investors.

The move into more risk is not without its challenges, notably the outcome of the US election and ongoing geopolitical risks, but this notion that policy easing has diminished recession risks is best highlighted by cyclical relative to defensive equity sector flows, which recovered in September to levels last seen in the first quarter of 2023.

The impact of China's extensive policy stimulus is still playing out, but cross-border equity flows into Chinese stocks rose to the top quintile in the immediate aftermath of the bigger-than-expected stimulus announcement.

Meanwhile, expectations on further Bank of Japan rate tightening saw a sharp reversal in Japanese yen flows with investors sitting on a top quartile overweight.

"This has cascaded more broadly in the region: all Asian emerging currencies bar the Chinese yuan sit on top quartile positioning levels, an indication of bullish bets on regional foreign exchange on expectations of further Fed easing and a softer US dollar," Dwyfor Evans added.

Policy adjustment

Developments during the summer seem to have helped in this regard.

Fed chairman Jay Powell soothed the market saying that the time had come for policy to adjust, sparking a rebound in risk as well as more constructive equity and foreign flows in August, leading to the Fed's half a percentage point cut in September.

It looks, based on this, that the Fed may well have pulled off its much discussed soft landing.

Although the picture could be more in the balance than such an assertion suggests. "We are now watching those flows closely to see if the sparks of more constructive risk sentiment will fire up a risk rally or if recessionary fears will turn them into ashes," added Marija Veitmane, head of equity strategy at State Street.

In early October, Powell suggested that the Fed would now revert to its usual quarter-point cut when it next meets in November, which is interestingly, just after the US presidential election.

But this is not all when it comes to institutional investor trends.

Digital momentum

In addition, there has been real momentum for investing in digital assets among institutional investors – something that was once down the pecking order of investors – according to hedge fund manager Nickel Digital Asset Management.

This study reveals that 80% of investors in the sector plan to increase their exposure in the coming year, reflecting a belief in the short- and long-term potential of digital assets.

The research, which surveyed institutional investors across the US, UK, Germany, Switzerland, Singapore, Brazil and the UAE, showed that two-thirds (67%) of respondents have already increased their digital asset holdings this year.

With these organisations collectively managing around $1.7trn (£1.3trn) in assets, their confidence in the sector is considerable, driven by what they view as attractive investment opportunities over the next 12 months and the next five years, with 98% of respondents viewing the sector as attractive during the next year and 32% rating it as "very attractive."

Looking further ahead, 97% believe digital assets will offer compelling investment opportunities over the next five years, with 44% describing them as "very attractive".

This long-term confidence underscores the growing role digital assets are expected to play in institutional portfolios.

This view is supported by Fidelity Digital Assets, which concluded in its own report that institutional investors "are still very much invested in digital assets" and believe they should be part of a portfolio. "The digital asset industry has proved remarkably resilient after facing significant headwinds in 2023 that rippled through the entire financial system," said Michael O'Reilly, president of Fidelity Digital Assets.

"Through it all, the core innovation and the underlying potential of digital assets never wavered. Perhaps more importantly, neither did the conviction of institutional investors."

Reilly added that this trend among institutional investors is not for those with short-term strategies. "Long-term institutional adoption is still on the rise, and it is built on a clear understanding of the core value propositions of digital assets, which we believe are here to stay," he said.

Alex Godfrey is investment director of Octopus Investments.

WE NEED TO TALK ABOUT CARBON OFFSETTING

Private capital is playing a crucial role in funding the decarbonisation solutions, renewables and nascent technologies that will be instrumental in powering our journey to net zero. But there's one major, outstanding piece of the puzzle missing: the emissions that can't be removed.

Radical innovation and the fulfilment of decarbonisation ambitions won't be enough to fully eradicate every level of emissions. That's the "net" in net zero – ensuring we offset hard-to-remove and truly residual emissions by removing carbon from the atmosphere.

Businesses and governments have set daunting decarbonisation targets, with many aiming to decarbonise 90% of their emissions. It's going to be hard to accomplish at scale, but it's actually the more straightforward part of the challenge.

The real difficulties surround the last 10% of emissions. Even the most optimistic innovation projections show us we can't completely decarbonise our supply chains – there will always be some level of residual emissions, which is why we have to look beyond decarbonisation as the sole solution and recognise the crucial role that offsetting will play in the journey to net zero.

Customers, shareholders and employees are holding companies to account over their net-zero targets. In turn, these companies are recognising the value of building a trusted brand, by doing the right thing for the planet.

Today, in the UK, 97% of FTSE 350 directors want to offset their business' carbon; with awareness of the role of offsetting sweeping the private sector, demand for carbon credits is building.

Carbon removal can happen through technology or through nature. But it's nature that offers the most efficient and low-cost model for sustainable removal – and carries added benefits, such as promoting biodiversity and water quality. Clearly, natural capital matters.

So far, conserving nature and generating carbon credits that actually deliver has proven to be a challenge. The nascent carbon credit market has faced harsh criticism, born of damning analysis by organisations including The Guardian.

Getting it wrong carries a corollary risk to businesses, in the form of greenwashing accusations. But the fact remains: offsetting is absolutely critical to reaching net zero – and the market is hungry for solutions.

While the supply of high-quality carbon credits is limited, demand is high, and with every new net-zero target set, the market size grows.

For investors, these dynamics are creating major opportunities as the structural fundamentals of the market drive price increases in carbon credits. Quality, credit-generating projects offer investors the chance to capture the growth in the natural capital economy.

Generating trusted carbon credits means ensuring the integrity of carbon removal projects, and setting global benchmarks on high quality. To meet the threshold of integrity, sure to deliver for companies, institutional investors and the planet, we believe the projects

underpinned by carbon credits need to deliver on a few key areas.

Among others, they need to be easily verified, by recognised, independent codes, with transparent reporting. Individual projects need to be tailored to the locality, with locally sourced, native trees and undertaken in collaboration with local communities. For the carbon credits to hold any value, there must also be certainty that removal of emissions wouldn't have occurred without their existence and sale.

Society is dependent on natural assets. Through natural capital, we apply an economic lens to global stocks of these assets, allowing us to place a value on nature restoration and conservation through the likes of carbon credits.

The world of natural capital is nascent, but it's the missing piece of the puzzle. To grow, it needs quality investment managers, working under the guidance of robust, independent frameworks, to help capital flow towards the right projects, and generating trustworthy carbon credits that actually represent meaningful steps towards net zero.

Octopus' natural capital strategy aims to generate trustworthy carbon credits through high-quality conservation and land management.

We are focused on restoring the UK's natural landscape to sequester carbon – a critical component of achieving net zero – and promote biodiversity. By combining robust investment management and best-in-class operators, we are set up to deliver.

SCALE ALONE WILL NOT LEAD TO MORE INVESTMENT IN THE UK, WARNS PLSA

Pension investment in productive assets should be made more attractive, says the pensions trade body. *Andrew Holt* reports.

Pension fund consolidation is not a silver bullet for driving investment into the UK, the Pensions and Lifetime Savings Association (PLSA) has concluded.

The government's Pensions Investment Review is exploring how the pension system can support investment in home-grown businesses, particularly in private markets.

At the heart of this is the government's consideration whether, and how, consolidating UK pension funds can increase investment in the UK.

The chancellor Rachel Reeves has expressed her wish for greater consolidation and scale in the UK pensions industry – citing the Canadian Maple 8 system as a model to possibly follow.

But in its response to the review's call for evidence, the PLSA offered a nuanced reply saying properly structured, a system with fewer, larger pension schemes has "the potential" to deliver more diverse capital allocation across private and public markets.

Based on PLSA member feedback, as assets under management reach £20bn, schemes can invest in a wider range of assets, including starting to co-invest in private markets – above this range schemes can invest directly and may increasingly use in-house investment teams.

Above roughly £100bn the advantages of additional scale are though rated as "incremental," the PLSA said.

Furthermore, and rather importantly, there is not, however, a direct causation between scale and inward UK investing, according to the PLSA.

"We agree with the government that larger pension funds are better able to undertake the complex and costly governance of managing private assets, which can have higher performance, albeit often at higher risk," said Nigel Peaple, chief policy counsel at the PLSA.

But Peaple added: "We support the government in taking measures to achieve greater scale in pension funds, where this is in the interest of scheme members, but scale alone will not result in higher investment in the UK."

Investment incentives

The PLSA's response, therefore, highlights a range of policy, regulatory and fiscal interventions aimed at attracting additional pension fund investment into UK assets.

These include, in broad terms, a stable policy context, a coherent industrial strategy, reform of barriers to UK investment, such as planning reform, and fiscal incentives for investment in the UK as compared to other countries.

Indeed, the PLSA has made 12 recommendations to the government for intervention, which it says will lead to higher investment – and crucially, in a wider range of assets.

A couple of these recommendations stand out. First is the suggestion that the government should provide fiscal and investment incentives, as in many other countries, for pension funds to invest in UK companies compared with non-UK.

The other is the importance of achieving policy certainty: setting out a clear plan for the UK economy, for example, by setting a strategy for key tasks like the green transition.

Robert McInroy, head of LGPS client consulting at Hymans Robertson, makes an additional point. "Investments in the UK should be driven primarily by the quality and suitability of the available investment opportunities," he said. "We trust the government will consider how it can make available such opportunities and increase the attractiveness as investments for the LGPS."

Go for growth

A more consolidated defined contribution (DC) market will be positive for economic growth if more investment flows to UK investments. Here Rachel Reeves has talked about growth being the central economic aim of the Labour government. "Growth is the challenge and investment is the solution," she said at the Labour conference in September. It has been mentioned by many investors that political and policy uncertainty, which has affected government decisions on infrastructure projects and the UK's approach to climate change, has sometimes made the case for investing in the UK less compelling.

The PLSA's position, in essence, is to support consolidation, but argues the best approach to raising investment in productive assets is to make them more attractive rather than compelling investment into certain sectors, which has been the approach of the last Conservative government and current Labour one.

For those wanting to see pension schemes invest more in UK growth assets, the structure of the market is already changing. The DC sector is consolidating rapidly and is expected to continue in this trend unabated.

Today, most DC savers, and the vast majority of DC assets, are managed by around a dozen large insurers offering group personal pensions and around 20 to 30 authorised master trusts.

Three of the largest master trusts already manage more than £25bn in assets each and a number of schemes have the operational aim to achieve scale of £100bn by 2030.

On its current trajectory Department for Work and Pensions analysis shows the master trust segment of the market is expected to manage £1.5trn in assets under management by 2035.

And putting UK pensions investment in context: they manage around £3trn of assets. A third is invested in the UK, with more than half of that loans to government and the remainder in a bonds, equities, private debt and property.

EUROPEAN ASSET BACKED SECURITIES – A MATURE AND ATTRACTIVE ASSET CLASS

Asset-backed securities (ABS) represent securities backed by specific collateral, with the largest sector being residential mortgages (RMBS). The European asset-backed securities market is large and diverse. At over €1 trillion it is comparable to the size of the European investment-grade corporate credit market.

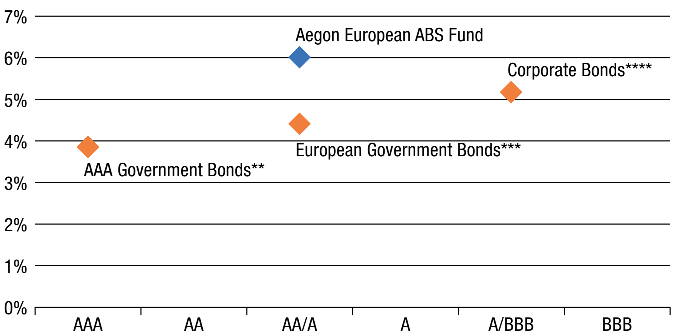
(Source for market size: AFME, Securitisation Data Report Q4 2023, Mar 2024).

Why European ABS and the advantages of investing in it?

An attractive yield

European securitised debt offers investors a structural spread-premium relative to fixed income assets with comparable levels of credit risk.

Yields of selected asset classes (in GBP)



Current yield*	
Currency	Spread
EUR	€ EURIBOR +158 bps
Hedged to GBP	£ SONIA +173bps
Hedged to USD	$ LIBOR +181 bps

1-year total return expectation*	
Currency	Total return
EUR	5.50% – 6.00%
Hedged to GBP	7.00% – 7.50%
Hedged to USD	7.25% – 7.75%

Source: Aegon Asset Management, Barclays, Bloomberg (as of 30 June 2024). All yields are in GBP and gross of fees. * Yields and Total Return Expectations with hedging to stated currency using 1-month FX forwards, ** Barclays Euro AAA Government Bond Index, *** Barclays Euro Aggregate Government Bond Index, **** Barclays Euro Aggregate Corporate Bond Index.

Low interest-rate sensitivity

Unlike conventional bonds with fixed coupons, the bulk of ABS bonds are floating-rate notes with a very short duration. This makes them less sensitive to interest rate changes.

Effective risk diversification

ABS offers exposure to direct consumer risk, which is complementary to sovereign and corporate exposure. ABS has a low, or even negative, correlation with many traditional asset classes.

Diverse exposure by geography and sector

ABS bonds offer exposure to a broad range of potential allocations across countries and sectors, including residential mortgages, consumer loans (credit card and auto), commercial mortgages and loans to corporations.

Diversifying credit exposure

At times of stress many similar asset classes tend to become highly correlated. While the ABS market is not immune to this type of stress, it does offer clients a degree of diversification compared to traditional fixed income markets. As global markets swing from risk-on and risk-off, investing in ABS can help to diversify fixed income exposure.

Access to the consumer

The cash-flows produced by ABS bonds are typically generated by the underlying consumers paying their mortgages, car loans and credit cards. These tend to follow a different cycle to sovereign and corporate markets, providing a different return profile.

European versus US and global ABS

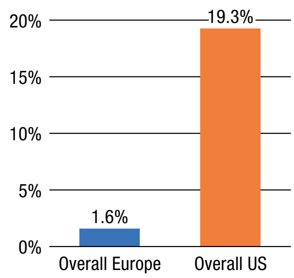
Contrary to its reputation, default rates on European ABS during the financial crisis were significantly lower than similarly rated corporate bonds.

Aggressive sub-prime mortgage lending practices and synthetic securitizations that led to large losses in the US were far less common in Europe.

Similarly, in the 10 years following the Financial Crisis, the default rates of European ABS were significantly less than the US, as illustrated in the chart on the right.

We believe that the fundamental differences between European and US ABS favour a regional approach managed by regional specialists.

Cumulative default rate of ABS bonds (2007 - 2014)



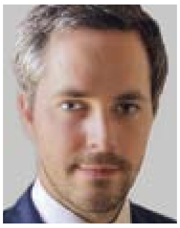
Source: S&P. 10 years to 31 Dec. 2017

ABS is a core capability of Aegon Asset Management

Highly Experienced	Deeply resourced team	AUM	ESG Integration
Investing in European ABS since 2001, and in US ABS since the late 1980s.	One of the largest dedicated ABS teams in Europe with 20+ experienced investment professionals.	Manage £15* billion in ABS globally, of which £9 billion is in European ABS.	Fully integrated in our ABS investment process.

*Source Aegon AM, as at 30 June 2024

PEOPLE MOVES



Our round up of the latest appointments among the UK's institutional investors starts with **Michael Airey**, who has been named as the new chief executive of **The Royal Mail Pension Plan**.

The scheme manages £10bn of assets for more than 123,000 members and was until June led by Richard Law-Deeks, who left after six years to join LGPS Central.

Airey (*pictured*) joined the scheme from Willis Towers Watson in 2016, serving as head of actuarial for five years. His other roles at the scheme have included spending the past year as head of funding and investment following the outsourcing of the CIO function to Blackrock.

Border to Coast has appointed **Tim Manuel** as its head of responsible investment.

He previously worked for Aon, where he helped pension schemes implement responsible investment strategies.

Manuel (*pictured*) replaces Jane Firth who retired six years after becoming the first head of responsible investment at what would become the UK's largest pension pool managing £52.3bn of assets for 11 partner funds.

Railpen, which manages the £34bn railways pension schemes, has welcomed **Busola Sodeinde** and **Sue Amies-King** to its board as independent non-executives.

Educational tech company founder Sodeinde is trustee governor of the Church Commissioners' audit and risk committee. She also chairs TR Property Investment Trust's audit committee and the Scout Association's people and culture committee.

Amies-King is a non-executive of Aviva Investors and Hastings Insurance. She also chairs their risk and conduct committees.

Also adding new faces to its board is the Pension Protection Fund. **Simon Gadd** and **Sonia Gogna** joined as non-executives in September bringing with them regulatory and risk expertise.

Gadd has more than 35 years of senior management experience earned through a variety of leadership roles at Legal & General, while Gogna gained pensions and investment experience at firms including Abrdn and Aon.

Finally, **Linda Whorlow** has joined **Legal & General**'s independent governance committee.

She succeeds Rachel Brougham, who has served on the committee since its inception in 2015.

Whorlow has more than three decades of workplace pensions experience and spent the past five years leading Aegon's workplace savings business.

CALENDAR

Topics for upcoming *portfolio institutional* events*

November
Factor investing roundtable

November
Real estate debt roundtable

March 2025
Private markets conference

May 2025
portfolio institutional Awards

*Subject to change

NOTICEBOARD

The West Yorkshire Pension Scheme has become a seed investor in a fund manager that seeks to earn a financial return from restoring and protecting nature across the UK.

The £20bn local government pension scheme invested an undisclosed sum for a minority stake in **Rebalance Earth**. The manager will invest in cutting flood and drought risks as well as improving the quality of drinking water among other biodiversity issues. For more details, read our ESG interview from page 32.

Meanwhile, **Nest**, the master trust managing £43bn of assets for a third of the UK's workforce, has formed a partnership with **Legal & General** and **PGGM Investment Management** to collectively invest up to £1bn on build-to-rent schemes across the UK. An initial £350m has been invested in the partnership.

Elsewhere, **Railpen** has bought 25% of **Verdis**, which collects waste from 6 million people across Denmark, Norway, Sweden and Finland. The company has inflation-linked contracts with local authorities, while half of its trucks are powered by electricity or biofuel.

The deal is part of the scheme's strategy of investing in essential infrastructure. Railpen's investment manager Tim Grimstone described the waste sector as "an essential service and building block of the circular economy".

People's Partnership, provider of The People's Pension, is to invest in private market assets. The £29.5bn master trust is developing the in-house capabilities to invest in infrastructure and real estate.

Pension Insurance Corporation, a defined benefit scheme insurer, has completed a £1.3bn buy-in of a retirement scheme for FTSE 250 sewing materials supplier Coats.

The deal guarantees the pensions of 18,000 members of the **Coats UK Pension Scheme**.

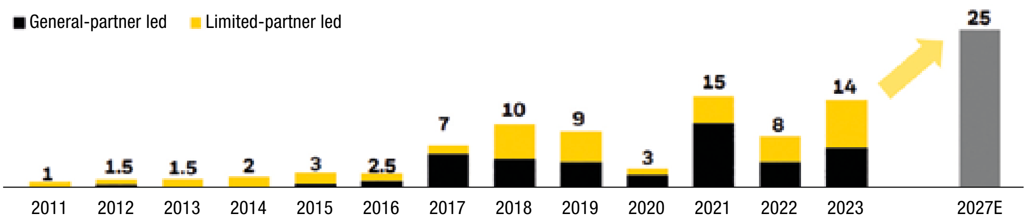
This is the scheme's second risk transfer following a £350m buy-in two years ago.

Just has completed a £42m full-scheme buy-in of Scottish Milk's retirement plan, the scheme sponsored by **First Milk**, a farmer-owned co-operative.

The deal secures the benefits of all 452 members, of which 292 are pensioners.

THE BIG PICTURE: ARE INFRASTRUCTURE SECONDARIES READY TO TAKE OFF?

Infrastructure secondary market transaction volume (USD billions)



Source: Preqin

Blackrock bullish on second-hand assets. *Mark Dunne* reports.

Secondaries are an under-valued but high-growth segment of the infrastructure market, the world's largest asset manager says.

Blackrock points to figures from Preqin that forecast the market could be worth $25bn (£18.6bn) by 2027, up from $14bn (£10.4bn) in 2023 (See chart).

Infrastructure offers institutional investors diversification, a recurring cash income, a hedge against inflation and comparatively high yields, but secondaries also provide liquid exposure to an illiquid asset class, given that private funds are typically structured as closed-ended vehicles.

A big part of the investment case is that no more than 2% of infrastructure assets under management are secondaries, making this an under-capitalised area of the market. Blackrock likens this to the size of private equity secondaries at the start of the century, which now account for 5% of that market (see chart).

It also made a comparison with the secondary real estate market almost 10 years ago, which now has a 3% market share. Blackrock believes that infrastructure secondary transactions are catching up.

Indeed, infrastructure funds are expected to double the value of their assets to almost $2trn (£1.5trn) by 2026, according to private markets adviser Campbell Lutyens, which would mean that prime funds are maturing.

With pricing typically based on historical valuations, assets can be bought at a discount to their net asset value. Indeed, in 2023 secondaries could be picked up at a 7% discount, on average, which slipped to 8% in the first half of this year.

And you can pick up a lot for your money. A report published by Blackrock – Infrastructure secondaries: Ready to take off? – says that the return on infrastructure secondaries was 11.7% last year.

Jérôme Leyvigne, head of secondaries and co-head of infrastructure in EMEA at Blackrock, said: "Infrastructure primaries of today are the secondaries of tomorrow."

He added that with secondaries only accounting for around 2% of all infrastructure assets under management, "buyer-friendly dynamics have been created, particularly for mid-size transactions which often fly under the radar".

Lauren Wilkinson is a senior policy researcher at the Pensions Policy Institute.

MEMBER OUTCOMES MUST REMAIN AT THE FOREFRONT OF THE PRODUCTIVE FINANCE DISCUSSION

Defined contribution (DC) investment strategies and the role they could play in UK productive finance continue to be a key focus under the new Labour government, building on the work of the previous government, including the Mansion House Compact.

There are potential benefits for DC members and the economy more broadly by investing in more diversified investment strategies that incorporate alternative asset classes and private markets. However, there are also potential barriers and trade-offs and it's vital that member outcomes continue to be at the forefront of decision-making.

Even before the Mansion House Compact and the current pension investment review, we have seen DC schemes tentatively exploring alternative asset classes beyond the traditional equity/bond split. Allocations to alternatives and private markets have been growing for a number of years now, albeit slowly and from a low starting point, demonstrating an increased focus on diversification in an evolving investment landscape.

More diverse portfolios, better risk management and better returns should deliver improved outcomes for members as DC asset allocation becomes more sophisticated. In addition to seeing their pensions yield better and more secure retirement incomes, DC members could also benefit from the societal improvements that successful investment in UK business should yield.

However, charges may rise with the higher costs associated with some asset classes and the cost of building sufficient expertise to invest in them effectively. This may be offset by the economies of scale and negotiating power of fewer, larger schemes, as we expect to see further consolidation and growth in the DC market.

Consolidation in DC will support and drive greater diversification of asset classes, but with this may come some additional costs for members and increased demands on governance bodies to ensure that new asset classes are understood.

While we expect to see allocation to alternatives and private markets growing in the coming years, it's unclear how much of this investment will be channelled into the UK economy specifically. There are potential societal benefits of mobilising the vast and rapidly growing pool of DC pension assets to stimulate the UK economy, but schemes need to ensure that there's also a strong case for it being in their members' best interests before making changes to investment strategy, otherwise we will see a growing tension between fiduciary duty and external pressures.

There are also concerns around whether there's a sufficient supply of quality UK productive finance investment opportunities. If we see a rapid shift in DC allocations to private markets, there's potential for a herding effect with providers all putting more money into private equity at the same time, which could have a detrimental effect on asset prices and returns.

We don't yet know the exact approach the government will take to encourage increased investment in UK productive finance. So far, very little has been ruled out, from lighter touch measures like disclosure requirements through to potential mandation. Even at the less prescriptive end of these potential policy levers, with disclosure requirements there's a risk that we could see less innovation in asset allocation as a result, as schemes tend towards the mean, and there's the potential it could have the opposite of the intended effect, a reduction in UK investment, if it becomes more evident that schemes that are overweight in allocation to UK assets are underperforming.

On the mandation end of the spectrum, any attempt to force providers to invest more heavily in certain asset classes presents a challenge to trustees' fiduciary duty and may be met with a considerable backlash. There could also be a tension with the regulators, both of whom place member outcomes at the forefront of their strategies and policy.

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THE PROMISE AND PITFALLS OF PRIVATE MARKETS

Private markets have seen huge growth over the past two decades, going from a relatively niche part of the industry to a dominant asset class. McKinsey's private markets report[1] set the size of the industry at more than $13trn (£9.9trn) in June 2023 up from around $3trn (£2.5trn) in 2012.

There are many reasons for this growth: the dis-intermediation of banks as capital providers post-2008, the reach for yield in the zero interest rates era, the sale of state infrastructure assets and the tendency of companies to stay private longer. Some of it is a push from fund managers and consultants to retain higher fee products and services in the face of large-scale moves to passive management in listed markets.

Private markets aren't a coherent asset class, they are a grouping of private equity, venture capital, infrastructure equity, real estate equity and private debt, which all have different characteristics.

Private markets bring the promise of investing in a new hot wave of startups or being one of a small group of investors in a lucrative infrastructure deal. But the reduction in transparency can lead to a host of issues that can cancel out those opportunities if investors are not careful.

One issue has always been that fees charged by managers can eat up all of the additional advantage of the underlying assets and this is not appreciated as much as it should be. The traditional fee models in some parts of the private markets need to change.

The so-called illiquidity premium is not a given and is hard to pin down in practice. The future expected returns of private markets assets – like all financial markets – are not knowable to any degree of certainty and any analysis of the benefits of private markets to members depends heavily on the assumptions chosen.

Even when looking at actual returns data, the practice of focusing on the frequently misleading internal rate of return can give investors the wrong impression. Some academics believe data shows that the global buyout market has not outperformed listed equities since about 2005[2&3]. Private markets are frequently put on a pedestal that isn't deserved. On the other hand private equity founders have become staggeringly wealthy – 22 of the *Fortune* 400 list in 2021 came from the private markets industry. There is plenty of money to be made selling and running private markets funds, nothing inherently wrong with that, but are they sharing the returns fairly with their investors. This was a concern that held us back from signing the Mansion House Compact.

As they grow, large-scale asset owners are able to address this by designing their own programs, utilising in-house teams and making the most of direct deals and co-investments to access private markets in a way that leaves a fair share of economics in the hands of their members, but this takes scale as we have seen in the Australian and Canadian pension markets.

For our part, as we are looking ahead to being £50bn in a few short years, we are now approaching sufficient scale to do this efficiently as are some other UK master trusts. Our custodian model also gives us the flexibility to structure these investments in the best way for the underlying assets, rather than being limited to funds that are frequently structured sub-optimally so they can be held on platforms.

We are advancing work with commercial asset managers as well as asset owner peers with a view to putting top-class proposals in front of our trustees at the right time, to allocate a portion of our assets to private markets in a way that will deliver value to members' pensions and allow us to preserve our low charging structure.

The way we look at these investments is as a hurdle rate to the global listed markets. We know we can get our members exposure to global listed markets for low fees, so to put real value into the hands of members we need to do better than this after fees. We also want to see asset owners being a stronger and more influential force collaborating together, rather than competing against each other

Such investments could represent billions of pounds of new growth capital invested into UK infrastructure and real estate, among other things. Perhaps building the wind farms, batteries and data centres of the future?

1) Global Private Markets Review 2024 | McKinsey
2) An Inconvenient Fact: Private Equity Returns & The Billionaire Factory by Ludovic Phalippou 2020
3) "Patient Capital" Josh Lerner, Victoria Ivashina

Design and production
portfolio Verlag

Printed in the UK by
Stephens & George

Subscription rates
UK £300 (9 issues),
Single issue price: £35
Overseas €350 (9 issues),
Single issue price: €40

Subscriptions
Claudia Ajagbe
c.ajagbe@portfolio-verlag.com

ISSN: 2045-3833

INTERVIEW – MARTYN JAMES

"It is my responsibility to help keep the good news coming."

The director of investment talks to *Andrew Holt* about his priorities, working with an in-house fund manager, his passion for DC and the importance of taking risks.

How have your first five months in the role been?

It is going well. There has been a lot to do. The teams are great. I have enjoyed working with the trustees and Cardano, the in-house fund manager. As I have got to know the investment solution, it has exceeded my expectation. I love the flexibility the platform provides and the investment changes that were made just a few months before I joined. It is a great place to start from.

What have you identified as your priorities?

A key priority is how I work with Cardano. It is making sure that works successfully. Now Pensions relies on Cardano for ideas to build the master trust portfolio and implement that successfully.

My role here is to provide the investment expertise from a defined contribution (DC) master trust perspective. So understanding the market, what competitors are doing, understanding the solutions out there, understanding any outliers in our portfolio – and then contributing my own ideas.

Cardano has a great reputation as an investment manager and adviser for asset owners, but when it comes to the DC master trust portfolios I can challenge with my specific DC experience on behalf of Now Pensions, its trustees and the members.

So my priority is working together, building that relationship so I can challenge them, come up with my own ideas and we can develop the portfolio together. It has been a good start.

Has there been any difference of opinion or conflict?

Not really. For example, when I came in I wanted to understand where the scheme was on private markets, something that is hot on the agenda. There has been a lot of debate around that portfolio over the summer. But it has been more collaboration, rather than any conflict. We all bring different ideas to the table and it is coming to a clear vision. We intend to invest in private markets in 2025.

So having Cardano is a strong aspect of the investment working?

It is a good advantage to the master trust having an in-house fund manager. There is then a good alignment between the fund manager and the trustees and the trustees can have a greater influence on the portfolio. Those portfolios managed by Cardano are segregated and separate, rather than pooled fund investments. If you have third-party fund managers, they manage those, but there is not the direct alignment that you have with an in-house fund manager.

How then does the relationship with Cardano differ from an outsourced chief investment officer arrangement?

Where it is slightly different is the separation of the two roles: I am not selecting and building my own in-house investment team or the investments. That is effectively the role of Cardano. I am the director of investment and have ultimate responsibility for the investment strategy proposed to the trustees and ensuring effective implementation.

Why have you made the move from being a consultant to being at the coal face as an investor?

My career at Mercer was quite varied and it wasn't as simple as being a consultant. That is what I trained to be. But in 2014 I fully committed my career to the DC market. I was one of the leaders at Mercer that set up a UK DC business. I was a leader heavily involved in the evolution of the business into new areas like master trusts, rather than one that was just involved in consulting. So the move into this role is not as stark as it may first appear. As I have been specialising in DC for many years.

You touched on it, but what skills do you bring to your new role?

As well as my knowledge of the UK DC investment market, it is that passion for DC investment solutions and improving investment outcomes for the members. My role is not just about helping to create the solution with Cardano, it is also about going out and talking to the market – which I love doing. It is about good communication.

I have a deep experience in the market. At Mercer I spent 18 months in Australia and over two years in Latin America where there are some large and mature DC master trusts. I saw glimpses into the future for the UK master trust market.

So with that Australian experience, there is much discussion about Australian superfunds being the model for the UK. Do you agree?

There are lessons to learn in terms of what scale can achieve. The scale Australia has built in superfunds can allow the creation of better investment propositions. One where you can make investments in the real economy and private markets and deliver better returns net of fees for members. So with consolidation of assets in the UK market you can do better things for members in terms of investment solutions.

At Now Pensions, we have the scale to begin making private markets investments and intend on making an investment to the asset class in 2025.

So you agree with Rachel Reeves, as she wants to create more scale within the pension fund industry.

There are two parts to what she says: the scale piece and then the greater investment into the UK economy. On the first, I believe it is the right way to go. And if you get to the scale, you are able to do the more interesting investments at better price points: invest in private markets, infrastructure, private equity and property. This should then increase long-term returns for members.

The trickier bit is whether those type of assets are invested in the UK, which is a separate question. That is a more complicated answer. Trustees have a fiduciary duty to select the right investments for the best outcomes and that may or may not mean investment in the UK. However, you can understand why Rachel Reeves wants to use pension funds in these investments.

Going back to you, what has been the biggest challenge in your new role?

It is linked to the priorities: making sure I understand our stakeholders. We have an experienced trustee board who are passionate about responsible investing and real world impact. So it is making sure I'm aligned to their views and policies. Like any master trust we have a lot of stakeholders to understand and manage appropriately.

You joined at a crucial time for the scheme: it has surpassed £4bn in assets under management and seen the introduction of a series of enhancements. What do you see as your most important responsibility?

It went up to more than £5bn in assets over the summer, so an exciting milestone. And because of the investment returns and contributions we could soon be hitting £6bn. The inflows are pretty large. With that size it is an interesting time. What I want to focus on is building upon the recent changes to the portfolio at the start of the year. My responsibility is to make sure the asset allocation, and the strategy being designed, continues to be appropriate for the master trust market and our members. We want a high conviction portfolio for our members but to make sure we are not a massive outlier compared to our peers.

That is where my knowledge of the market comes in. But I want to know what others [in the market] are up to. Since our new strategy came in at the start of the year we have performed strongly. So it is my responsibility to help keep the good news coming.

> **Real-world influence is the piece that is the most exciting to me.**

How then would you sum up your investment philosophy?

The philosophy is we, and the trustees, have three 'Rs' that underpin our investments and are important to our members: return, risk and real-world impact.

In return and risk, this is obviously the concern for every master trust. How we think about it is we want to be heavily invested in growth-type assets to drive strong returns but still have diversification to have some protection in adverse market environments. We are targeting inflation plus 3.5% over the long term.

Most of our portfolio consists of equities: with a 75% allocation in listed equities managed by Cardano directly. We do want some diversifying assets in there, so we have 15% in bonds, that is sustainable bonds and investment-grade credit also managed by Cardano directly.

We also have 10% in alternatives: gold, industrial metals, carbon credits and high yield is another part implemented through derivatives. Some of the positions have gone extremely well this year.

The real-world influence is the piece that is the most exciting to me. It is also somewhat to do with the structure I mentioned at the start. As we have a segregated portfolio for global equity managed by an in-house manager, it allows the trustees to have more influence and have that real-world impact.

A key part of it is stewardship, where we use our role as a shareholder to influence the companies we invest in through engagement and voting, to improve the world we live in. For example, for companies to reduce their carbon footprint in line with the net-zero by 2050 target and become more sustainable and address other social issues. So the trustees can have a real-world impact, creating a better society for our members and every-one else in the future. But to have that without sacrificing our returns, indeed we believe that this focus reduces systematic risks and should help improve long-term returns.

This can mean, in some cases, removing stocks from the portfolio if we believe the companies aren't adapting to a net-zero by 2050 target. But we would prefer to engage and influence – it is a powerful part of the portfolio, which makes a real-world difference.

What are your targets for net zero?

As is typical for a master trust, we are committed to net zero by 2050 and committed to 50% carbon reduction by 2030 based on 2019 levels. We also have other targets: net-zero deforestation by 2030, and water neutrality by 2030. So we have these clear goals but we want to achieve them whilst making a real-world impact.

We don't want to simply decarbonise the portfolio, which we could do today, because that would not make a real-world impact. We want to move at a pace that aligns with the world's efforts to reach net-zero by 2050, which is the Paris-alignment objective. We will, however, disinvest stocks that do not have a credible plan for the journey to net-zero by 2050.

Although what we prefer to do is that if organisations are carbon intensive today but they have a credible plan, we will support them through engagements with them and voting with them. We also collaborate with other investors on key engagement initiatives. And I believe it is making a difference for our members.

You also have a commitment to other ESG issues, specifically the living wage, gender equality and climate change. How do these translate into your investment approach?

This is part of our stewardship of the assets that are held directly and managed by Cardano. Cardano is strong on stewardship, but it was the trustees who decided that we should focus on those three key areas on behalf of our members.

As a consequence Cardano will focus on those areas for engagement and voting and monitor them closely on behalf of the trustees

Overall, 75% of the portfolio has to align with the trustee's responsible investment approach, and we are more than 75% in that measure.

Has the inflationary environment impacted on your investments?

It is an important measure given our target for the portfolio is inflation-plus 3.5%. So in a high inflation environment it means the target can be harder to achieve in the short term.

On the other hand, as the investment strategy has a high allocation to equities and our performance over the last 12 months, when inflation has been high, has been extremely strong, we have outperformed our inflation-linked target quite comfortably. Historically, equities have shown they are more than capable to outperform inflation over longer time periods.

Do you see the economic and geopolitical outlook shaping your investments?

We are seeing a lot of risks, especially geopolitical risk, and we have to keep an eye on that and see how it progresses. But at the same time we need to look through that noise. Our central view is that we are seeing some stronger economic growth coming through and with interest rates coming down it is generally a positive environment for growth assets. And as a disciplined long-term investor, we try to avoid second guessing events that may or may not happen.

What are your objectives as director of investment over the coming years?

Looking at changes over the coming months, the private markets piece is going to be the most important, which is targeted at a 5% allocation, which is meaningful but not large. The allocation may increase over time.

My objective, generally, is to challenge Cardano if there is anything missing within the portfolio. For example, asset classes we should invest in or changes to the strategic allocation.

Over the longer term I want to make sure the three 'Rs' make a difference. The return part is important to member outcomes. I want to make sure, year-on-year, we are delivering consistently good returns for our members and we are the right pension provider for them.

And I love the trustees focus on real-world impact: I want to ensure we deliver on that too on behalf of our members over the long term.

What has been the biggest lessons of your career?

I have had a varied career and the biggest lesson I have learnt is to keep it exciting, maybe sometimes take a risk, and that has served me well.

MARTYN JAMES' CV

April 2024 – present
Director of Investment
Now Pensions

October 2007 – October 2019 / November 2022 – December 2023
Senior investment consultant/partner in DC & Financial Wellness and Investments
Mercer

October 2019 – June 2022
Wealth (Pensions and Investments) leader LatAm
Mercer

January 2014 – October 2019
Client leader/leadership team in DC & Financial Wellness
Mercer

October 2007 – December 2013
London unit head/team leader
Mercer

January 2006 – July 2007
Consultant
Mercer (Australia)

July 2001 – December 2005
Analyst
Mercer

US ELECTION:
THE DIS-UNITED STATES

Buckle up for the US presidential election. *Andrew Holt* looks at what it could mean for investors.

November's US presidential election takes place in a country that is in one of the most divided periods in its 248-year history.

Such division creates uncertainty on so many levels. It also means the election is too close to call, which, from an investor's perspective, presents numerous scenarios to consider. It looks like a labyrinth of uncertainty and major risk.

"This is going to be a knife fight in a phone booth. It is going to be an incredibly close election," says Libby Cantrill, head of US public policy at Pimco.

For Ross Barr, senior investment strategist at Cardano, the US election is a key risk event. Assessing the situation, he says: "Harris is now the favourite in the prediction markets, overtaking Trump. In reality, we have gone back to when Biden and Trump were neck and neck only a few months ago. This will be a tight contest, dependent on a handful of swing states."

Given the tightness of the contest, Barr raises the obvious problem for investors. "It will be difficult for markets to price until the event itself, allowing events such as the [September] first Fed cut to have more importance on a shorter-term basis," he says.

"However, we have also observed that the 'Trump trade' has been faded by the market and in our view this may provide some opportunities in terms of effective hedges for the election," Barr adds.

Fall and rise

One study examines the investment trends leading up to and after a US presidential election, with a focus on the close-run affairs. Research Affiliates studied the 24 US elections since 1928 and revealed that stocks in the S&P 500 tended to fall in the run-up to a close election, then surge in the final week of the campaign before continuing their upswing, although with a greater amount of volatility, after the election.

The study noted that in the lead-up to an election, growth and value stocks tend to exhibit a similar performance. Whereas after the election, value stocks tend to bounce back when Republicans move into the White House, while growth stocks typically rebound when the keys are handed to the Democrats.

And assessing the impact on investments and the president in office, Morningstar looked at S&P 500 returns over a 50-year period. It found that since 1953, $1,000 invested when a Democrat became president, sold when a Republican took office, then reinvested when a Democrat returned resulted in $62,000. A different strategy – only investing when a Republican is in the White House – only grew to $27,000.

However, and this is good news for long-term institutional investors, doing nothing and leaving the $1,000 where it was for the duration would have reaped investors $1.7m by the end of 2023.

> **Investors often welcome a divided government because, perhaps perversely, it diminishes uncertainty.**
>
> Stephen Dover, Franklin Templeton

Divided government

Looking at scenarios that could result from the outcome of the election, and one connected with the divided US electorate, is a truly divided government, with the presidency going one way and the House of Representatives and Senate going or holding another.

Looking at the house and senate: out of the 435 seats available, current consensus forecast points to 206 being allocated to Democrats, 207 to Republicans with 22 seats being a toss-up – out of which nine are Democratic seats and 13 Republican, according to analysis from Deutsche Bank.

Coming down to the Senate, 34 out of the 100 seats are up for re-election. Currently, the Democrats control the Senate by 51 to 49 and 28 of the Democrat and 38 of the Republican seats are not up for re-election.

"The base expectation is for a divided government with 50-50 odds for a Trump-Harris victory," says Deepak Puri, Americas chief investment officer at Deutsche Bank.

This, paradoxically, might not be a bad result for investment risk and returns. "Investors often welcome a divided government because, perhaps perversely, it diminishes uncertainty," says Stephen Dover, chief market strategist and head of the Franklin Templeton Institute.

"The scope for sweeping legislative changes to tax laws or regulatory policy is constrained by the need for compromise," Dover adds. "The status quo persists, allowing firms and investors to make decisions without having to consider major fiscal or regulatory policy shifts."

Dover makes another positive point about the divisions between lawmakers. "Divided government can even permit deficit reduction, as occurred from 1994 to 2000 and again from 2010 to 2016. Bond investors, therefore, may have grounds for welcoming it as an avenue to reduce deficit and debt burdens," he says.

The one area of potential concern under a divided government, however, resides in political default risk, Dover says. "Government shutdowns and the potential for the treasury to miss interest payments on the national debt have been a concern when impasses led to an inability to increase the US debt ceiling."

It should be noted that in all such cases since the mid-1990s, those near misses – but including US debt downgrades – have occurred with a Democrat in the White House and a Republican majority in the House of Representatives.

Democrats, thus far, have not engaged in similar political negotiating tactics under circumstances where they controlled the House of Representatives under a Republican president. "The implication is that default risk would be higher in divided government with Harris as president," Dover says.

Changing dynamics

One of the reasons we are where we are with a tight election is there has been a shift in the presidential race. There is no doubt that in recent months the dynamics of the US presidential election, as well as the outcomes for control of the US Senate and House of Representatives, have shifted.

The decision in July by president Joe Biden to withdraw his candidacy in favour of vice president Kamala Harris has seemingly changed the trajectory of the presidential race, or, at the very least upset the momentum Trump seemed to have towards heading into the White House.

Polls have indicated tighter races across all levels of elected government. Initial polling and moves in political futures markets indicate that vice president Harris won the September 10 debate against former president Trump.

But it remains premature to know whether the result was enough to firmly entrench her as the frontrunner. In this context, one has to remember in 2016 Trump was considered to have lost all three of his debates with Hilary Clinton, but of course went on to win the presidency.

The Trump risk

And when it comes to risk associated with the US election, there is none bigger than the concern about Trump himself. One big issue, among many, is that Trump will not accept a peaceful transition if he loses. This happened in 2020, with disturbing consequences. If Trump loses in November, will we see it again?

"This is a sign of a democracy in crisis, and the potential for this outcome to be manipulated and lead to more division is something we all should be paying a great deal of attention to," says Ian Bremmer, president of Eurasia, a political risk consultancy.

Although when Trump took this approach after the 2020 presidential election, which led to the storming of the Capitol Building in Washington, the Dow, the S&P 500 and Nasdaq all closed on record highs on January 6. This though was the result of an upbeat economic outlook post-Covid, and possibly a nod to a Democratic Party victory.

There could also be said to be Kamala Harris risk. Questions still abound about what she believes in. Is she a leftist masquerading as a centrist, or is she an outright opportunist given that she seems to have discarded most of her beliefs from just a few years ago? Which raises an obvious question: what type of president would she be? Such uncertainty is not good for markets and investors.

Don't panic

But in assessing the returns of stocks during presidential election years, Mark Peterson, director of market and portfolio insights at Blackrock, says there is no reason to panic.

That is because, on average, stocks have risen 11.6% during presidential election years since 1926, slightly better than the market's average 10.3% return in all years.

Drilling down further, he reveals that stocks tend to follow a pattern during presidential election years: sluggish in the first half, followed by a big second half. Historically, the third quarter has delivered the strongest returns, with an average return of 6.2%.

"Many Americans have strong feelings – and genuine concerns – about politics, but history suggests that presidential election years tend to be pretty good for stocks, especially in the second half of the year," Peterson says.

In other words, what happens in Washington DC largely stays in Washington DC.

There's no guarantee the market will follow the historic election year pattern in 2024, given the divisive nature of the election. But Peterson is positive about the future picture. He therefore

I generally think politics is overrated in terms of its impact on markets.

Stephen Parker, JP Morgan Private Bank

The sharp shift in the polls over the past two months is a reminder that a lot can still change.

Stephen Dover, Franklin Templeton

recommends investors should "tune out the political noise".

Although outsized market moves can sometimes present tactical investment opportunities near to, and in the aftermath of elections, says Peterson's colleague, Blackrock portfolio manager Tom Becker.

"In the run-up to elections, we sometimes observe a more muted asset price response to growth or inflation data," he says. "Though it is hard to know for sure, some sub-sets of investors may be more cautious to express active views based on fundamentals in the run-up to elections."

But what about after the noise has subsided and the election has been held? "In the aftermath of elections or referenda, we have sometimes observed large asset price moves that feel outsized relative to the potential impact on fundamentals. It is not uncommon for these market moves to be sentiment-driven over-reactions," Becker says.

Comparisons in uncertainty

Looking at other major political events as a potential guide to the US election, especially those that were uncertain or unknown, the Brexit referendum in 2016 is an example of a national vote that catalysed large global asset price moves, Becker says.

Leading up to the vote, uncertainty about the outcome was high. Consistent with its general approach to binary risk of this nature, Blackrock did not position portfolios for either outcome. "However, in the hours after results became clear, Japanese equities sold off sharply, declining -7% in the overnight session," Becker says.

"Viewing this as an overreaction, particularly given the limited economic linkages between the UK and Japan, we took advantage of the opportunity to tactically buy Japanese equities at attractive prices," he adds.

A few months later, in the run-up to the 2016 US presidential election, Blackrock had an insight that US growth and inflation data were improving but the market was not fully pricing in these macro developments. "We viewed the impending event risk as a potential reason for that disconnect," Becker says.

"By maintaining short US bond positions, founded on the growth and inflation data rather than any view on the election, we were rewarded with the swift repricing that occurred immediately in the aftermath of the election," Becker adds.

More recently, leading up to the Taiwanese election in January of this year, the asset manager observed evidence in flows data that investors were taking with risk ahead of the election.

"However, we had a positive outlook on earnings growth prospects of listed Taiwanese companies," Becker says. "With an expectation that less uncertainty following the election – regardless of the outcome – could bring investors back and drive market prices higher we utilised this opportunity for a tactical, active investment in Taiwanese equities."

Politics is overrated

It is though, a re-occurring theme among many investors that politics and elections have little impact on shaping investments. A point made by Stephen Parker, head of specialised strategies at JP Morgan Private Bank. "I generally think politics is overrated in terms of its impact on markets," he says.

"And trying to make any meaningful changes to your portfolio is a difficult game. You have to predict who is going to win and then predict how markets will react," Parker adds. "It is an opportunity, as an investor, to stay disciplined and stick to a plan. The biggest risk is with those [investors] thinking about making drastic changes to their portfolios in anticipation of the election. Historically, this has led to bad outcomes."

Stephen Dover agrees with such a view. "Despite shifts in polls and other indicators, our primary investment conclusion remains unchanged. Investors should stay focused on long-term objectives and not overact to US politics and election outcomes," he says.

In this way, politics is a big circus that investors are not clownish enough to participate in. "Markets have thrived, paused, corrected and rebounded under Republican and Democratic presidencies, as well as under various constellations of power in Congress," Dover says.

"The broad contours of the stock, bond and even currency returns are typically dictated by fundamentals determined outside the sphere of politics."

Ready for regulation

This does not mean there are no concerns for investors. It is more of a case of the devil is in the detail. "The more important consideration for equity investors is regulatory action, which resides chiefly with the president," Dover says.

A point shared by Wei Li, global chief investment strategist at the Blackrock Investment Institute. “A Trump win could mean some deregulation, including the rolling back of regulation for banking in particular. Big tech may still be a target for bipartisan anti-trust measures,” she says.

“By contrast, a Harris win could reshape the healthcare landscape through expanded Medicare or drug price caps.”

There are other takes on this theme from the Harris and Trump camps. “Harris and the Democrats are apt to push for greater regulation of fossil fuel energy and the pharmaceutical industry, that is further caps on prescription drug pricing, while promoting alternative energy,” Dover says. “The opposite would be true in a Trump presidency.

“Accordingly, we think those sectors are likely to react more to the presidential outcome than the broader market,” he adds.

Risk and reward

So what in this more focused picture could a Harris victory mean for the market? “Anti-trust policy is worth watching,” Dover says. “The Biden administration has taken a tougher stance against large capitalisation technology companies, led by Federal Trade Commission chair Lina Khan. A Harris administration could also pursue that approach.”

There are other aspects to a Harris presidency, says Deutsche Bank’s Deepak Puri. “Overall, the Harris-Walz ticket is based on creating a ‘care’ economy from day one and extending many of Biden’s Build Back Better plan initiatives.”

And in the same way, what could a Trump victory mean for the market? “The wildcard for the dollar and capital markets would be a Trump victory followed by the imposition of large, across the board tariffs,” Dover says.

“If countered by other countries, the risk of trade wars could push up risk premiums, leading to sharp falls in equity markets and a surge into traditional safe-haven currencies – Swiss franc, Japanese yen – or gold and crypto-currencies.”

Looking at what to expect from a Trump presidency, Puri also adds: “The Trump-Vance ticket is expected to create stricter control on illegal immigration, use deregulation and focus on imposing tariffs to maintain domestic competitiveness.”

Another point Puri identifies about a Trump presidency is a possible unpredictable Fed policy shift with Jay Powell potentially being replaced, which could create huge uncertainty for investors.

Of course the only certainty about this election is its uncertainty. And we are likely to see more twists and turns before election day. “The sharp shift in the polls over the past two months is a reminder that a lot can still change. Relatively few voters may remain undecided, but US elections – at all levels – are often decided by swings in relatively few votes in just a few states,” Dover says.

This is a good point. The outcomes of the 2016 and 2020 presidential elections hinged on less than a million votes cast in six key swing states – out of about 150 million votes cast. The swing states are now Arizona, Georgia, Michigan, Nevada, North Carolina, Pennsylvania and Wisconsin. It is here where the election will be won and lost. It remains too close to call in all of them.

An indication of this, are the numbers, as they currently stand in each of the swing states. In Nevada, Michigan, Wisconsin and Pennsylvania Harris is up, but only between a mere 0.2% in Nevada and 1.7% in Michigan. Trump is up 1.6% in Arizona and 1.7% in Georgia with North Carolina tied.

It is though important for Puri that investors stay focused amidst the din of all the election coverage. “While short-term volatility is common in markets leading up to election season, it is important to separate the noise from the long-term drivers of equity market performance which depend on sound fundamentals,” he says.

“Retrospectively, stock markets appear rather unimpressed in the medium term by who moves into the White House, which confirms the old stock market wisdom that political bourses do have short legs.”

And he adds that although meaningful tactical calls can be undertaken, investment portfolios should be constructed to outlast an election cycle. “In most cases, a well-diversified, multi-asset portfolio is the best way to navigate political and macro-economic events and investment strategy should continue to be tailored towards personal timelines, liquidity needs and risk tolerance levels,” Puri says.

But at the same time, the most divided election could cast a shadow of uncertainty over the investor and political landscape for some time. “US politics has been, and remains, closely divided. It is therefore still too soon to draw firm conclusions regarding the outcome in political or market terms,” Dover says.

This is going to be a knife fight in a phone booth. It is going to be an incredibly close election.

Libby Cantrill, Pimco

THE *PORTFOLIO INSTITUTIONAL* AWARDS: TIME TO SHINE

Andrew Holt introduces the *portfolio institutional* awards, giving an insight into each category and what the judges will be looking for. Potential entrants should read on.

The portfolio institutional awards have opened for nominations and entries. The awards will be held next year in the Banking Hall, in the City of London on May 15. Between now and the deadline on February 23, investors have an opportunity to enter.

These awards are unique, in that they are given only to asset owners for excellence in seven specific categories, with the focus being on an effective investment strategy and successful investment outcomes in each.

Albeit, each category is based on a specific criteria, which entrants are advised to follow carefully when making their submission.

But while the awards are focused only on asset owners, asset managers can play their part by entering an asset owner for excellence. Entrants can enter more than one category.

The seven categories are: Best pension scheme under £1bn; best pension scheme over £1bn; best DC pension scheme; best charity/foundation/endowment; best responsible investment; best risk management and best local authority pension scheme.

The judging process is completely independent, with a carefully selected group of industry experts chosen to assess, and then select, each category winner. A submission questionnaire has been created with the judges for each of the respective award categories.

It is the submission questionnaire that determines the winner for each category. So the effective completion of the questionnaire is vitally important.

Here is a useful guide for entrants to consider before putting together their respective entry.

Best pensions

The first two categories: best pension scheme under £1bn and best pension scheme over £1bn, strike at the heart of institutional investment during the past 18 months or so. Pensions funds have faced a number of challenges over this period of time.

The focus of these two awards are on these sized pension schemes and their effective approach to investment management. The judges will assess each scheme on its merits, considering their size, type and status.

Examples relevant in support of an entry include: the effective planning and execution of the investment strategy, appropriate cost control, strong governance, the effective use of advisers, managers and other third parties, as well as any potential innovation within the scheme's investment approach.

Entrants will have to ensure they supply judges with detailed and well-argued examples of all of these. It has been a challenging time for pension schemes, and we look forward to hearing from schemes on how they have risen to these challenges.

DC pensions

The best DC pension scheme is an award at the forefront of where the industry is going. Not only is it a guide to the trajectory of the pensions industry, but also an insight into how schemes are addressing this challenge. Again, the award will be focused on investment management.

Many DC pension schemes use LDI, so how they survived the LDI turmoil could be a key point of focus as well dealing with the market and longevity issues. Examples of effective forward planning and cost control will therefore be needed to impress judges.

The judges will assess each scheme on its merits, taking account of its size, type and status.

Examples relevant in support of an entry include: the effective planning and execution of the investment strategy, appropriate cost control, strong governance, the effective use of advisers, managers and other third parties and potential innovation within the scheme's investment approach.

Best charity/foundation/endowment

This category includes registered charities, philanthropic funds, educational endowments, family foundations and long-term investment assets held by not-for-profit organisations. The focus of this award, again, is on investment management.

Examples relevant in support of an entry include: objects of the organisation and its mission, the investment philosophy and how this determines investment strategy, the effectiveness of portfolio management, planning, risk management, cost control, governance, roles of investment committee members, advisers, managers and third parties and indicators of success and of innovation.

Charities are seldom given the credit they deserve, especially when it comes to successful investment, so this is an exciting occasion for charities to shine.

Best responsible investment

The best responsible investment (RI) award is very much the zeitgeist award. No institutional investor is without some form of responsible investment. Therefore this category could well be a fascinating insight into the numerous approaches investors are taking to the issue of responsible investment.

Furthermore, the focus of the award is on RI in investment management by an asset owner. RI can include ethical, social/impact and sustainable investment.

The jury recognises that RI is an ever-evolving approach and will therefore welcome submissions relating to the growing role of RI within an organisation and/or new and novel RI approaches.

Examples relevant in support of an entry include: the articulation of the motivations and investment beliefs behind the RI strategy, effective planning and execution of RI, strong governance, effective use of advisers, managers and other third parties, the use of innovation, as well as clear and concise reporting against the RI objectives.

Best risk management

The best risk management award can be seen in comparison something of the meat and drink award, as no investor can get by without having effective risk management.

The focus of this award is on the philosophy, qualitative process and implementation of risk management within a pension scheme. The jury will assess the risk management processes of each participating scheme, as defined by the risk management philosophy, risk identification, measurement and reporting and the actual risk management carried out.

Schemes can offer examples of how their risk management practices have worked, as well as risk management innovations undertaken.

The choice of risk models and solutions will need to be highlighted, as well as the implementation of the process, and, of course, the overall success of the risk management approach.

Best local authority pension scheme

The best local authority pension scheme is a new award, looking at the unique nature of local pension schemes and how local authority pensions undertake their investments for their local stakeholders while working within the LGPS system. Judges will assess investment approaches and those that standout.

Like the main pensions awards this award focuses heavily on investment, and the successful implementation of the scheme's investment policy and philosophy, risk tolerances, use of innovation and strong governance.

The portfolio institutional awards promise to be a great celebration of all that is good within institutional investment. We encourage all institutional investors to look through the list of categories and identify where their strengths lie and enter the appropriate category.

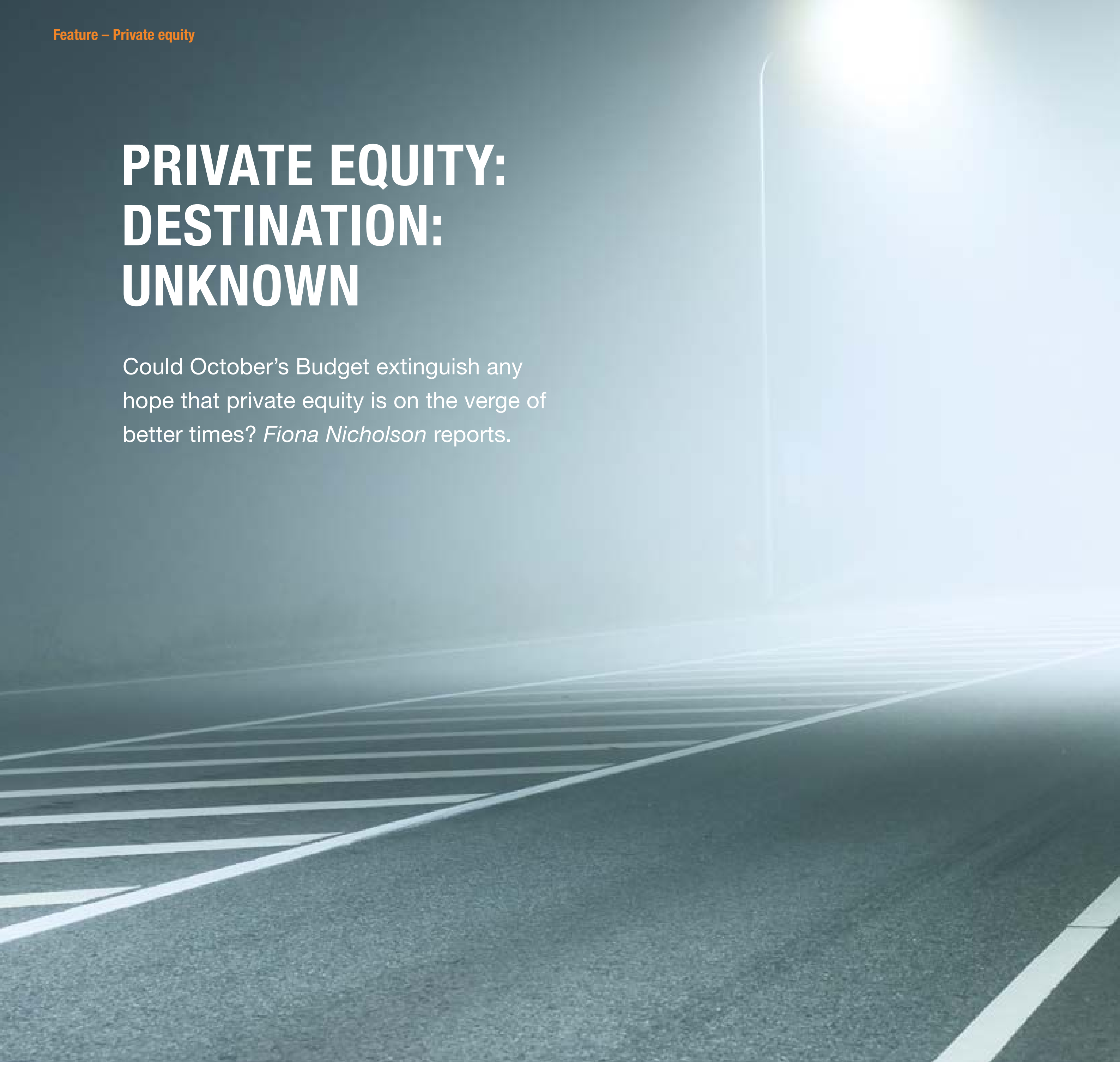
Best of all, all nominees along with the judges, are invited to the portfolio institutional awards gala dinner on May 15, which promises to be a great evening.

All information on the awards can be found at: awards.portfolio-institutional.co.uk. Please do not hesitate to contact us if you have any questions.

THE *PORTFOLIO INSTITUTIONAL* AWARDS CATEGORIES

- Best 2024 Scheme Under £1bn
- Best Pension Scheme Over £1bn
- Best DC Pension Scheme
- Best Charity/Foundation/Endowment
- Best Responsible Investment
- Best Risk Management
- Best Local Authority Pension Scheme

PORTFOLIO INSTITUTIONAL AWARDS 2025



PRIVATE EQUITY: DESTINATION: UNKNOWN

Could October's Budget extinguish any hope that private equity is on the verge of better times? *Fiona Nicholson* reports.

The UK's private-equity sector has been buffeted by the significant economic, political and geopolitical events of the past few years.

A global pandemic; Brexit; war in Ukraine and the Middle East; political changes in the leadership of the previous government; the exact economic trajectory of the new government; and a prolonged period of rising interest rates and inflation have all created uncertainty.

Grant Thornton's report on private equity in the first half of the year observes that "the last 12 to 18 months have been volatile". The firm continues to note that "the market is still cautious, and transactions are taking a long time to close".

Other research shows that fewer deals are being done. A KPMG UK mergers and acquisitions study published in July, revealed that the volume of private-equity deals during the first half of the year totalled 656 – down 20% in comparison with the same period of last year, when 822 were recorded.

But an improvement is anticipated: "There are signs that market conditions are settling down, with a new government in place providing much-needed stability," says Humza Khan, director and head of private-equity coverage at Grant Thornton.

"Inflation is falling and, although still high, rates have peaked, which means valuations are stabilising," he adds. "Deals are picking up and overall volume looks set to increase in late Q3 and Q4."

Pete Terry, partner and head of private equity at the firm, takes a similar view. "Now that we've passed through the general election, we're going to have more deals, although the effect

will probably be delayed. Some that would have closed in Q3 were paused by the political uncertainty, and we are likely to see them close in Q4.

"Markets are upbeat and there are signs that interest rates will be cut," he adds. "Political stability looks set for the next few years and Labour has repeatedly committed to prioritising growth."

KPMG also foresees better times. Alex Hartley, head of private equity and London M&A, says: "Looking ahead to the remainder of 2024, after a prolonged period of uncertainty, investors will now be looking at the UK as a more stable environment for investing into new businesses and realising portfolio assets.

"The focus on deploying capital is here to stay, as many private-equity firms are sitting on significant amounts of dry powder," he adds.

"Ultimately, the foundations needed for dealmaking have improved over the last few months, and we expect activity levels will continue to rise in the second half of 2024."

A more positive mood is reflected by tax advisers, which is evident in RSM's private-equity outlook for the second half of the year. "The corporate-transactions landscape is showing promising signs of revival, supported by a growing confidence among sellers and buyers," the report states.

It also states improvements in, and more certainty around key economic influences, for example falling inflation, the definitive election outcome, the drop in interest rates and the prospect of improved GDP growth in 2025 is helping provide much more confidence in the financial projections of companies.

"While we may not revisit the frenetic pace of the period immediately post the pandemic where ultra-low interest rates, exuberance and historically high economic growth buoyed activity, 2024 Q4 and 2025 are poised for a marked improvement from the first half of the year," notes the report.

The bull is back

Also pointing to buoyant levels of confidence within the sector is Ilja Hauerhof, director of quantamental research and solutions for private markets at S&P Global Ratings. "Our research shows that stable public markets are the secret to private-equity optimism," he says.

"Our natural language processing analysis of statements made by executives of 28 publicly traded private-equity firms during first-quarter 2024 earnings calls revealed a significant rebound in private-equity confidence.

"Despite a challenging M&A landscape and slower fundraising environment, private-equity executives' sentiment surged to its second-highest level in more than 13 years – or 57 earnings seasons," Hauerhof adds.

Institutional investors' interest in private equity remains solid too, according to Preqin's investor outlook for the second half of the year. Its survey of institutional investors revealed that alternative assets are still viewed as a key element in portfolios, mainly for diversification and return enhancement, as well as for lowering volatility. Furthermore, the research found that institutions are planning to invest even more in private equity, private debt and infrastructure.

The survey also demonstrated respondents' satisfaction with private equity: 68% reported that it had met their expectations during the past year – representing a four percentage-point increase.

Furthermore, Preqin's survey identified that investors continue to be upbeat about the short-term outlook. The percentage of respondents expecting a drop in performance over the next 12 months has halved for the second year in a row to 12%. On the other hand, the percentage of investors anticipating an improvement in private-equity performance in the year ahead has shot up to 45%, from 26% in June 2023.

The survey also indicated that almost half (46%) of respondents plan to maintain their allocation to private equity. Slightly fewer (42%) said they intend to increase it in the longer term.

Shakeups on the horizon?

But there may be more headwinds on the way. While it is early days for assessing the impact of the new government on the sector, chancellor Rachel Reeves unveils her first Budget on 30 October – and there are rumblings of potential shakeups that could affect private-equity and institutional investors.

These were referenced in a speech that Reeves delivered in 2021 at Labour's annual conference, when she was shadow chancellor. She signalled her intent, should the Labour Party come to power, to hone in on carried interest, specifically with regard to the tax 'loophole' which allows private-equity fund managers to pay a reduced amount of tax on their performance-related share of profits. Carried interest attracts capital-gains tax (CGT) rates (28% for higher-rate taxpayers), which are a considerably lower amount than income-tax rates (up to 45% in England, Wales and Northern Ireland, and up to 48% in Scotland).

> **"The focus on deploying capital is here to stay, as many private-equity firms are sitting on significant amounts of dry powder.**
>
> Alex Hartley, KPMG

A paper published in July, *The trillion dollar bonus of private capital fund managers* by Ludovic Phalippou, a professor of financial economics at the University of Oxford – Said Business School, found that carry has exceeded more than $1tn (£749bn) during the past 25 years.

In her 2021 speech, Reeves stated: "Private-equity bosses who strip the assets of British businesses pay a lower rate of tax on their bonuses than workers do on their wages. That is indefensible so we will abolish it."

The new government has not forgotten this vow. At least, in principle. In the Labour Party manifesto, it stated that £565m could be saved from closing the loophole. Then, at the end of July, only a few weeks after Labour formed a government, Reeves announced its commitment to take action. The first stage took the form of a "call for evidence" on the tax treatment of carried interest. Meetings with stakeholders were offered as part of the consultation, which closed on 30 August. The next announcement is due to be made in the Budget.

Taking this course of action could have ramifications: firing financial shots over the bows of the City could result in returned fire, such as proposing to take their business elsewhere.

Commenting on the potential impact of the new government on private equity, Jeremy Over, partner at law firm Moore Barlow, says: "In its manifesto, the Labour Party stated it would be hardening rules around private equity providers in relation to being able to claim capital-gains tax on carried interest payments. If this comes into effect, it could certainly impact the private-equity market, and whether some private equity houses decide to continue investing in the UK or look to invest in more tax-friendly jurisdictions."

Reflecting on the potential shake ups that might emerge in the Budget, which could affect private equity and institutional investors, Over says: "The Labour government is widely expected to review CGT because the party ruled out changes to income tax, VAT and national insurance in its manifesto.

"This could affect private equity by obstructing deal flow and impacting the willingness of people to sell their companies and go through an exit event, which would potentially reduce the number of investment opportunities for private-equity providers."

Alignment with growth?

The Labour Party's plan for financial services, published in January, stated that a Labour government's "defining economic mission" would be "to revive strong economic growth", but this may not be compatible with their other aims.

Over says: "It's important to note that Labour has consistently said that growth is a core part of its political agenda; if that is the case, it's difficult to see how that can be reconciled with aligning CGT rates with income-tax rates because that could negatively impact growth in a number of ways. It could discourage entrepreneurs from starting new businesses, leading to less wealth creation and fewer jobs from which the government can generate income tax and national insurance.

"To make their growth plan work, any changes to CGT must be aligned with their growth agenda. For example, they could consider making business asset disposal relief more generous, while at the same time raising the headline rates of CGT, encouraging entrepreneurs to create and grow businesses."

The high interest-rate environment has affected confidence in the market and the willingness of private-equity houses to invest, and that's why the Budget will be a critical milestone.

Jeremy Over, Moore Barlow

Lacking confidence

Although, looking at how the Labour government has approached other issues that it took a strong line in opposition, like the status of non-doms, which have been watered down in government, could well mean private equity firms and investors should not be too concerned about what the government will do.

Considering other factors affecting the private-equity sector, Over points to one area that has held investment back is the interest-rate environment. As many private-equity deals are based around leveraged finance, and if the cost of debt is higher, it makes it more challenging for private-equity providers to successfully structure a deal compared to when the cost of debt is cheaper.

"The high interest-rate environment has affected confidence in the market and the willingness of private-equity houses to invest, and that's why the Budget will be a critical milestone," Over adds.

Returning to the politics, Over says: "Labour has a huge majority with a huge amount of power, so it will be interesting to see what measures are announced, not least because Reeves is an economist by trade, so she should know better than anyone what levers to pull to generate the growth agenda that Labour has put a lot of political capital behind."

In the meantime, Over sees encouraging signs in the market. "While we wait for the Budget, there's a lot of anticipation, but there remains a considerable amount of capital to deploy within the marketplace, and private-equity providers will always be under pressure from their investors to deploy that capital."

This, Over says, "can only be a positive, and the market should be heartened by the fact that there's a lot of money out there just waiting to invest.

"It will be absolutely critical to ensure that the Budget lands well," he adds. "This is a new Labour government and the markets are watching it very carefully."

In conclusion, Over says: "The opportunity is that if the Budget can land well with well-thought-out measures, it will send out the message that Britain is open for business and that the government is truly committed to growing the economy. But for this to happen, they can't be too punitive on wealth creators."

pi ESG CLUB

Stewardship is core to sustainable asset strategies, but having a lot of ground to cover and rising misalignments between asset owners and their managers make the task harder. This month's ESG Club looks at how stewardship could be more effective.

Members

INDUSTRY BODIES IN CALL TO ACTION ON BIODIVERSITY

Investors need a robust escalation strategy to engage with nature, says report. *Andrew Holt* takes a look.

Responsible investment campaigner Share Action and the UN Environment Programme World Conservation Monitoring Centre (UNEP-WCMC) have launched a guide on how investors can strengthen their approach to protect some of the world's most important biodiversity-rich areas.

The guidance identifies the critical role investors need to play to help stop, and even reverse, biodiversity loss through their investment policies, capital allocation and portfolio stewardship processes – and amounts to something of a call to action for institutional investors on biodiversity.

It focuses on the particular approach needed when investing in or near areas that have been designated as protected by governments, due to their rich biodiversity.

These include areas such as the Central Amazon Conservation Complex and the River Dee in the UK.

It describes practical steps investors should take to incorporate protected areas into their environmental and social risk management processes, establish clear expectations for investee companies and follow escalation strategies where expectations have not been met.

Key recommendations for investors include assessing and mitigating biodiversity impacts across portfolios, but also recognising the additional importance of protected areas.

Investors should also assess if any assets or sites within their portfolios intersect with, or are adjacent to, protected areas.

Share Action and UNEP-WCMC say investors should therefore "set ambitious targets" to ensure that all assets within protected areas are only engaged in activities that align with the management plan or designation of the respective protected area.

Escalation and engagement

Investors should also have an escalation strategy that covers biodiversity engagement priorities. Escalation policies should also consider the "possibility of divestment" if biodiversity risks are not addressed, noted the guidance.

Alexandra Pinzon, head of biodiversity at Share Action, said: "We know investors are not doing enough to adapt their investment policies to tackle the destruction of important ecosystems in protected areas."

And she added: "To address the global extinction crisis and unprecedented decline of nature, investors must recognise the vital role of protected areas as a tool for biodiversity conservation and strengthen their investment policies and engagement with companies accordingly."

A number of reports and supranational bodies have warned of the dangers of not addressing biodiversity risks.

For example, a study by the United Nations Environment Programme: State of Finance for Nature 2023, estimates that around 37% of species will be threatened or extinct by 2100.

And the loss of biodiversity is listed in the top five global risks in terms of impact to the global and financial system by the World Economic Forum, a Geneva-based think tank.

Research from S&P Global Sustainable has also shown "that about 70% of companies in the S&P Global 1200 have at least one asset in a protected area", further highlighting that investors need to look at their investment policies, capital allocation and portfolio stewardship processes in addressing biodiversity.

"We need to see investors use the huge power they wield to reduce their nature-related risks and impacts, especially on internationally recognised areas of importance for biodiversity conservation," Pinzon added.

This, she said, would also be beneficial for investors, as the regulatory shifts required to deliver the ambitions of the Global Biodiversity Framework result in more stringent biodiversity protections and the expansion of protected areas, which could lead to stranded assets, reputational damage and other financial consequences.

Room for improvement

Over the last few years, Share Action has monitored the responsible investment policies and performance of the world's largest asset managers, assessing the ambition and transparency of their approaches to responsible investment, including policies to protect vital biodiversity.

The campaigner's latest benchmarking reports have shown room for improvement in the way asset managers and insurers protect against risk towards protected areas as well as their own financial returns.

They revealed that 64 asset managers and 50 insurers assessed by Share Action lack clear evidence of policies to manage risks associated to protected areas.

UNEP-WCMC is a global centre focused on addressing biodiversity and nature's contribution to society and the economy and operates as a collaboration between the United Nations Environment Programme and the UK conservation charity WCMC.

Neville Ash, director of UNEP-WCMC, said: "Asset managers and asset owners can drive positive impacts for nature through their investment decisions. For example, when they engage with companies and exercise their voting rights, they can be influential in ensuring that businesses respect and help manage protected area networks."

He therefore said the guidance helps to lay out the steps investors should take to reduce their risk associated with protected areas and drive positive change.

ESG INTERVIEW – DARRAN WARD

Rebalancing the Earth

The head of alternatives talks to *Andrew Holt* about West Yorkshire Pension Fund's pioneering investment in natural capital.

Your investment in Rebalance Earth, a boutique fund manager focused on natural capital, is unique. Why did you make that investment?

Last year we began updating our investment strategy, which resulted in a 5% allocation to alternatives across public and private markets.

Our alternatives mandate aims to provide the long-term, risk-adjusted and uncorrelated returns you would expect from a portfolio of alternatives. But it also prioritises our investment beliefs around climate solutions, sustainable cities and innovation, with a focus on regional and UK opportunities.

We have therefore been analysing many opportunities from venture, tech and life sciences through to residential, infrastructure and natural capital assets.

Within natural capital, we are particularly interested in nature-based solutions and Rebalance Earth's focus on nature as infrastructure struck a real chord with us. It combines uncorrelated long-term returns, innovation and a strategy targeting climate action, solutions and resilient cities, communities and companies.

Given the expertise and experience of the founders at Rebalance Earth, the scalable market opportunity and our strategic alignment, we explored the potential for direct investment in the company.

How long did it take to complete this investment?

We first spoke to Rebalance Earth back in 2023. As with all our private market transactions, we carry out in-depth analysis and financial, operational and legal due diligence alongside as wide an array of meetings with industry experts and potential stakeholders as possible – which, inevitably takes time.

Were there any stumbling blocks along the way?

There were certainly no major stumbling blocks or disagreements. We kept a regular, open dialogue throughout.

We had strong long-term alignment from the start, which I believe was essential and prevented any major stumbling blocks.

The investment specifically focuses on five problem areas within the ecosystem. Why they are important?

The key ecosystem problems many UK businesses face are flooding, drought, water quality, biodiversity and carbon. Flooding is a huge problem in the UK, costing businesses on average £82,000 a year and is only going in one direction.

Yet despite this, we also remain at risk of drought due to our built environment and degraded soils. Our rivers and coastlines are polluted and our biodiversity is depleted. Since 1970 we have lost 76% of our freshwater species and 69% of our wildlife. And we need to drawdown a huge amount of CO_2 from the atmosphere to limit climate change.

There are many other ecosystem problems, but we believe these five present the largest risk for UK businesses and impor-

tantly present the greatest incentive for businesses and investors to contribute towards nature-based solutions.

Are some of these five problems more important than others?

They are all important. And it's essential we work to solve all these issues, and many others, and not just in the UK. That said, flooding presents the clear and present danger for the greatest number of businesses in the UK.

The Environment Agency estimates that 185,000 commercial properties are at risk of flooding, as well as 1.85 million homes and 5 million people. That's a huge problem and a material risk that we urgently need to address.

Why is natural capital as an investment theme so important?

Very simply, nature underpins everything. It's the air we breathe, the water we drink and the food we eat, but it is also the global economy that our pensions rely upon.

Natural capital is critical in providing food, health and protection for human capital together with the natural resources and protection for produced capital, with all three forms of capital key to the global economy.

The issue is that we are depleting one form of capital, which in my mind makes the whole thing unsustainable. This is largely due to not paying for nature's ecosystem services adequately and not valuing natural capital correctly.

Closing the nature finance gap is arguably one of the key challenges of our time – estimated globally at around $150bn to $440bn per year. Regulations, markets and businesses are rapidly changing, and we see nature-based solutions as having a huge role to play addressing climate mitigation, adaptation and resilience, and therefore we see the whole sector as an incredible opportunity.

You have also said that natural capital is a business-critical infrastructure investment. What do you mean by that?

We have meaningful investments in business-critical infrastructure across our public and private markets portfolios, which provide us with long-term, stable cashflows, diversification and inflation protection. We see green infrastructure and grey infrastructure as providing essential services to society and businesses.

Nature can serve as green infrastructure by proving cost effective and sustainable solutions for water management, disaster risk reduction and climate regulation, often outperforming grey infrastructure on cost and outcomes.

And in return, we believe green infrastructure can provide those long-term, stable, inflation-linked cashflows that institutional investors are looking for.

Where exactly does this investment fit into your investment beliefs?

As part of our overarching investment strategy statement, we have identified three sustainable development goal themes as being of particular focus: climate action and solutions; sustainable cities and communities; and economic growth and innovation.

We are looking to integrate these themes into our reporting and asset allocation process across the whole West Yorkshire Pension Fund portfolio over time, subject to improvements in methodology and data collection. But more immediately, we have expanded our alternatives mandate allocation to 5% of the fund, across public and private markets, to focus on opportunities addressing these key themes, and in particular across natural capital, infrastructure, living sectors, such as affordable housing, and venture growth with a strong emphasis on UK, regional and local place-based investments.

Whilst this won't always be the case, this partnership with Rebalance Earth fits across all three of our belief themes, with our direct equity investment in a UK early-stage company supporting 'UK growth' and Rebalance Earth's mission to use innovative, nature-based solutions to enable more resilient cities and communities whilst actively improving nature and the climate.

So how much will be allocated in total to this investment?

We have allocated 5% of the total fund to alternatives within the strategic asset allocation.

But decisions on tactical allocation and single-line investments are dynamic and fluid.

We have invested a relatively small amount of direct equity into Rebalance Earth – relative, that is, to our £20bn of total assets – and we will be hoping to commit more as a cornerstone investor to their initial Darwin fund, once launched subject to due diligence, alongside other investments in natural capital and beyond.

> **Flooding presents the clear and present danger for the greatest number of businesses in the UK.**

Will you be looking to increase this?

Potentially, yes, as a limited partner in the Darwin fund, subject to further analysis and due diligence.

Do you have any further innovative investments like this in the pipeline?

Yes, we are discussing other direct and co-invest opportunities that are similarly aligned with our beliefs, vision and long-term risk-return objectives across natural capital, infrastructure, real estate and venture growth in the UK.

Do you think other big asset owners may follow your example?

That's for other asset owners to decide. We are fortunate to be of the right size, to have the strategy which emphasises UK alternative opportunities and importantly to have the in-house capabilities to carry out such direct investments with senior leadership and committee support.

We would like to do more and we are open to joint ventures with other similarly aligned large asset owners.

Does this place West Yorkshire Pension Fund as a pioneer within ESG investment?

The LGPS as a whole should be proud of its role in this space, due to its size, influence and commitment to ESG, responsible investment and net-zero pledges. We are proud to be part of that network and are keen to lead and share our knowledge and experience where we can.

As an engaged asset owner, with significant size and influence, West Yorkshire Pension Fund has long recognised the importance of the ESG characteristics of individual companies.

We are proud signatories of the Stewardship Code, have published our Task Force on Climate-Related Financial Disclosures report and have mapped our carbon emissions for the past five years. But importantly, we recognise that we and the companies we invest in need to do more, and will do more to ensure our pensioners have a world worth living in.

WEST YORKSHIRE PENSION FUND AND NATURAL CAPITAL

In September the West Yorkshire Pension Fund, which is part of the £60bn-plus Northern LGPS pool alongside the local authority pension schemes of Greater Manchester and Merseyside, made what is viewed as a pioneering investment in Rebalance Earth, the UK's first boutique fund manager entirely focused on nature as an investable asset class.

Rebalance Earth finances nature as infrastructure, which provides climate adaptation and resilience for companies, communities and cities across the UK. Rebalance Earth's strategy is to make a clear business case for companies to pay for nature restoration in their local areas.

This approach not only benefits the environment but also increases companies' operational resilience through nature-as-a-service contracts. These contracts function as long-term offtake agreements, generating stable cashflows that offer attractive risk-adjusted returns for investors.

During the next decade, Rebalance Earth aims to mobilise more than £10bn towards restoring nature across the UK.

BRANCHING INTO SUSTAINABLE TIMBERLAND INVESTMENT

BNP Paribas Asset Management takes a look at the investment case for timberland.

Forestry: an unrecognised economic force

Forests cover more than 4 billion hectares or around 30% of the Earth's land area and are composed of naturally regenerating forests and planted forests. These natural systems provide many goods and services, primarily timber but also products which contribute to human health and well-being – including food, medicinal plants and raw materials for pharmaceutical products – and outdoor recreation and culture, such as sports and tourism.

Aside from being a source of natural capital, the forest sector employs more than 33 million people, 1% of global jobs.

Forests also provide important environmental services like air and water purification, soil protection, nutrient recycling, carbon sequestration and climate regulation. And they are one of the most important harbours of biodiversity, providing a natural habitat for a vast range of animals, plants and other living organisms.

Despite pledges by world leaders to end deforestation by 2030, natural forests remain threatened by deforestation – in 2022 an area the size of Denmark was lost.

However, commercial timber plantations – known as timberland – are starting to play a more productive economic and environmental role.

Growing demand for sustainable supply

Timberland plantations only account for around 3% of the world's forest area yet produce a third of global industrial timber. What's more, commercial timberland is forecast to take up a much larger share of global wood production, with the FAO forecasting global demand for timber will increase by 37% to 60% between 2020 and 2050.

This heightened demand stems from multiple drivers, including world population growth, urbanisation, an increase in per capita income, the availability of wood, and product and technological developments. In addition, consumers are also increasingly demanding that wood be certified as sustainably produced, meaning it needs to be responsibly sourced and authenticated. These more stringent environmental regulations should further propel the supply of timber towards timberland plantations.

Fostering climate and biodiversity solutions

Sustainably managed timberland also offers a tangible way for investors to contribute positively to climate change adaptation and/or mitigation, as well as meeting several of the UN's Sustainable Development Goals.

Managed forests can play an important role in battling climate change. Firstly, they have the potential to reduce greenhouse gas emissions through the prevention of deforestation and forest degradation. Secondly, forest management and restoration can maintain or enhance forests' role as carbon sinks. Finally, greater carbon storage over the long term can be facilitated by the greater use of sustainable wood products and emissions can be avoided through the substitution of emissions-intensive materials.

Activities related to forest restoration, afforestation and reforestation alone could offer more than a third of the response options needed by 2030 to prevent an increase in global temperatures exceeding the 2C threshold set out in the Paris Agreement.

A climate and nature-positive investment option

For investors looking to increase their exposure to greener investments in low-carbon, climate-aligned areas, sustainable forestry offers a palpable and readily available opportunity with an investible universe of around $200bn (£153bn).

Timberland is particularly suited to institutional investors, as its duration characteristics match the long-term liabilities arising from pension funds' and insurers' obligations. However, investment is not without risk. Market risks include the volatility of timber pricing; physical risks involve factors that can affect the volume and quality of timber, such as fire, storms, drought, insects and disease; while regulatory/legal and policy risks can arise from changes made to land use regulations, environmental laws, green certifications or tax codes that may have potentially adverse effects on timberland's investment returns.

These risks can largely be mitigated through portfolio diversification across geographies, species of tree, age classes, products and end markets.

A natural capital solution for a changing world

The positive trend by macro-economic factors – population growth, increase in per capita income, green transition – alongside its role as a natural climate solution and its attractive investment attributes mean sustainable forestry presents a compelling opportunity for investors.

STEWARDSHIP: RULES OF ENGAGEMENT

Investing in a company is only the first step in creating your desired portfolio, but the journey is far from smooth. *Mark Dunne* reports.

Investing with purpose is not easy. Institutional investors looking to build a more sustainable world and reduce inequality need to be resilient.

It could take years to change a corporate's operating practices to make your portfolio greener and fairer while creating long-term shareholder value. This is where investment managers play a key role through dialogue with a corporate's leadership and voting on an asset owner's behalf.

When it comes to stewardship, Brunel Pension Partnership's asset managers are its "first line of defence", says Brunel's head of stewardship, Vaishnavi Ravishankar. They are responsible for all of the pool's portfolio risks and engage on its behalf.

Brunel, which manages around £37bn of assets on behalf of 10 local government pension schemes in the South and Southwest of England, lists climate change, biodiversity and human rights as its top responsible investment priorities. The pool also wants its managers to focus on tax fairness, the circular economy and cybersecurity as well as diversity, equity and inclusion.

These systemic risks became priorities following discussions with its member schemes. Brunel now works closely with its investment managers to make sure these issues are considered when managing the assets.

"Our expectations are the floor, not the ceiling," Ravishankar says. This approach provides asset managers with the flexibility to employ various analytics and frameworks to meet the pool's expectations.

Different strokes

When it comes to how best to approach stewardship and engagement, there is no one-size-fits all model. It differs across asset classes and also depends on the investment style of the asset manager. "There is no single answer to what is good stewardship," says Michael Marks, head of stewardship and responsible investment integration at Legal & General Investment Management (LGIM).

The approach for an active equity investor is different to that of an active fixed income investor, which is different to a private equity investor, which is different to an index investor.

"In private markets, if you own a significant holding in a company then you have greater influence over its management," Marks says.

But stewardship is more important to index investors. "They cannot choose whether to own a company or not," Marks says. "Therefore engagement is the tool to help improve the long-term returns of the portfolio.

"If you are an index investor who thinks like a universal owner, you are looking to raise market standards across the board," he adds. "If you are an active boutique, you are looking at raising the performance of the individual company."

Stewardship is not easy but worth the effort when compared with what could be achieved. "If engagement is carried out effectively, it can be a powerful stimulator of change in company practices," Ravishankar says.

But the path to success is not straightforward and so requires resilience. "It's important to acknowledge that engagement progress can never be linear, and it often takes time to bear fruit," Ravishankar says.

Investors, therefore, need to understand the underlying process. For example, what's the theory of change? What escalation pathways are under consideration? When will they be used, and within which timeframes?

Getting round the table

One of the repeated concerns with stewardship is that asset managers may not be aligned with the wishes of asset owners when implementing climate stewardship on their behalf.

LGIM has six core investment stewardship themes when managing its clients' capital: climate, nature, people, governance, health and digitisation. Whether they build a greener world is not necessarily the main focus of the engagements they conduct on behalf of their clients; but generating long-term outcomes is and this may deliver a greener world, Marks says.

To examine the issue, an investor group was formed. Late last year, a review by the UK Asset Owner Roundtable, which counts Border to Coast, Brunel, Nest and USS among its members, found that such concerns are credible.

"The roundtable brought these sides together and we ended up having quite a constructive conversation," Ravishankar says. "There was an acknowledgement that a gap existed, and there was willingness from both sides to look at possible solutions.

"One of the key messages from asset managers is they want investors to have a collective voice when it comes to expectations around climate stewardship, because they were seeing a divergence in terms of their clients' views around this issue," she adds.

In response, a number of asset owners are putting together a statement on what they expect from managers in terms of climate stewardship. "We've taken this feedback on board," Ravishankar says.

Evolutionary times

All of this comes at a time when stewardship is going through a "phase of disruption", says Leanne Clements, head of responsible investment at People's Partnership, which provides The People's Pension.

The stewardship proposition has traditionally been led by fund managers, but Clements believes that could be changing. "What I'm seeing lately is a shift where asset owners are starting to rise in terms of their voice," she adds. "You're seeing evidence of that through the new stewardship propositions that are being presented by fund managers."

It's not just about individual asset owners. Disruptors also include the Taskforce on Pension Scheme Voting Implementation.

"Seven years ago, no fund manager was willing to talk about it. Well, today the landscape is an entirely different world, and it's creating a lot of disruption," Clements says.

"A lot of people are complaining about that, but I welcome it," she adds. "It's a necessary evolution to where we need to be as a demand-led industry with the owners of capital at the top of the chain driving what they need from their fund managers."

A targeted approach

In April, Clements said the days of "tea and cake engagement" have gone. Instead, she wants fund managers to adopt a targeted approach "routed in a robust theory of change", where limited resources are used as effectively as possible. This will include executing robust voting escalation strategies.

Yet it is too early to say if the message is getting through. "It's a work in progress," Clements says.

"It's just about consistently sending that signal through the monitoring program.

"Rome wasn't built in a day when it comes to these things," she adds.

Clements hopes that a targeted approach to stewardship will eventually be rooted in responsible investment policies and become part of monitoring programs.

"It is early days, but I can see a positive evolution with respect to it.

"It is not something where you can snap your fingers and it's going to happen overnight, but the conversations are happening. It's just a matter of embedding them into the processes. So let's talk [about this] in three years," she adds.

Let's work together

Another challenge with stewardship is that there's a lot of ground to cover. "Where we are failing is we are spread too thin," Clements says.

The answer, she adds, is to be clear with investment managers on the targeted areas you want them to focus on.

"With that spirit in mind, I'd love to get all of the key asset owners in a room and do a big mapping exercise of the barriers to the sustainable financial system to identify key focus areas where we could achieve maximum impact," Clements says.

"Then we need another mapping exercise of the industry, of who's doing what and where with respect to those focus areas, to see if there are any gaps."

The third phase is to identify leads within each focus area, depending on the skillsets of the asset owners. Then establish

Our expectations are the floor, not the ceiling.

Vaishnavi Ravishankar, Brunel Pension Partnership

> **There is no single answer to what is good stewardship.**
>
> Michael Marks, Legal & General Investment Management

a working group for each focus area. "This is a case study to highlight what we need to do, which is sharing the workload," Clements says.

Asset owners engaging in targeted areas include the Church of England Pensions Board's work to improve environmental and social standards in the mining industry and Railpen's engagement on dual-class shares.

"We need more of these focal points and more people leading, like they are," she adds. "We will achieve much more maximum impact, as opposed to us all working in silos and spreading ourselves too thin."

This is what Clements sees as the way forward for the industry. There is a lot of work to be done here so more owners of capital will have to get involved. "It can't just be asset owners like Railpen, Church of England Pensions Board and Brunel carrying the load of addressing systemic challenges in responsible investment."

But this is not only about large asset owners. Those with limited responsible investment resource could also play a part. "The important role for them is to just lend their AUM [assets under management]," Clements says.

"So if there is any initiative coming out in which we need to exert influence through AUM, they can lend their AUM."

Ravishankar welcomes the idea of sharing the workload among asset owners. "From a point of efficiency, it's a no brainer," she says. "It enables significant progress."

Artificial support

Another area of progress within stewardship is the increasing use of artificial intelligence (AI). Brunel is using AI to improve the efficiency of its stewardship functions. "It's important to move with the times and embrace technology where we can," Ravishankar says.

So far, the pool has used AI to refresh and monitor the implementation of its voting guidelines, which, she says, "reduces time and effort".

"It also enables us to stay ahead of the game through picking up new issues and themes that maybe other asset owners or managers are working on.

"That's the direction of travel we expect in the coming years," Ravishankar says.

And it's a direction LGIM is taking. For instance, to build an accurate picture of a company's carbon emissions, data across thousands of pages from various company and sector reports needs to be digested.

"We use AI to trawl the internet for the data and categorise it to help inform our decisions," Marks says.

Time to say goodbye?

If all of innovations and approaches to stewardship mentioned throughout this article fail to produce the desired outcome, investors could always end their exposure to such companies.

But for Ravishankar, divestment does not mean that stewardship has failed. It is just one of the many tools in the stewardship toolbox.

"It is not appropriate to use [divestment] at the drop of a hat," she says. "Like any other lever, we use it deliberately and cautiously, particularly when other stewardship options haven't quite worked."

It is an issue on which asset owners and asset managers agree. "Divestment in its own right, is not an outcome," Marks says, adding that the threat of exiting an investment can be a powerful motivator.

If companies are not making enough progress on improving their operations or are refusing to take engagement with LGIM seriously, they could find themselves on the divestment list, which is published yearly.

"The publicity that goes alongside that is another tool in the stewardship armoury that helps engage companies," Marks says.

"We've had occasions where we have published the list and within 24 hours a company we have struggled to engage with have come to us asking what they have to do to come off of our divestment list.

"If you're not owning the company, you can't drive change," he adds. "So we believe in engagement rather than divestment, but as a tool it is powerful."

And it needs to be powerful. Change is needed in a world facing systemic threats such as climate change and nature loss alongside growing inequality. But this is not going to be easy, making the call for greater co-operation between asset owners, their managers and the companies they invest in appears a credible strategy.

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MARKET BROADENING: A NEW UNIVERSE

After being heavily concentrated on tech stocks the market is broadening out, bringing with it a host of opportunities, finds *Andrew Holt.*

One of the big investment themes for next year and beyond is going to be the broadening of the market. It is a trend that emerged during the summer as tech stocks were sold off, during what is being seen as a July rotation, and has resulted in a move away from a concentration on tech stocks to a market broadening where a wider range of stocks come into play.

The benefits are potentially numerous, with the central belief being that when the market is broadening, an increasing number of stocks are rallying and economic conditions will support earnings growth and profitability, creating the possibility of greater opportunities for investors along the way.

All the signs are, due in part to this rotation, that stocks appear to be heading deep into 2024 with a powerful tailwind and brighter outlook.

Wei Li, global chief investment strategist at Blackrock, sees a clear broadening trend. She says that looking back on 2024, all sectors beat expectations for second quarter earnings, driving this broad margin expansion.

“Looking ahead, we are expecting broad based earnings growth over the next 12 months with the gap between tech and the rest narrowing – a departure from the concentrated market up ‘til now,” Li says.

Matt Britzman, senior equity analyst at Hargreaves Lansdown, said this market shift is a positive for the market and investors. “The broadening out from big tech, which was priced for perfection, looks like a positive step for the market’s long-term health.”

Innovation broadening

For Rahul Bhushan, managing director of ARK Invest Europe, a thematic-focused asset manager, the outlook points very much to market broadening, beyond just market changes.

“As the economic outlook stabilises, borrowing costs decline, inflation ticks lower and oil prices either remain stable or fall further due to the current hydrocarbon glut, the market setup is primed for a broadening beyond the ‘magnificent seven’ to the ongoing S&P 493 rally and even further out to innovation equities and thematic sectors,” he says.

This creates a scenario for investment opportunities. Bhushan believes market broadening creates a prime environment for future-focused industries like artificial intelligence (AI), genomics and clean energy, which are positioned to benefit from increased capital flow and investment.

“For instance, global AI spending is projected to reach $500bn by 2024, reflecting a compound annual growth rate of 20%,” Bhushan says. “Renewables are forecasted to account for 90% of global electricity capacity growth by 2025.

“These trends underscore the opportune entry point to long-term secular themes and ETFs that are poised for significant expansion,” he adds.

Although Liz Ann Sonders, chief investment officer at Charles Schwab, says what we have is a tale of two markets: resilience at the index level, but weakness at the individual stock level. Using Nasdaq as an example, at the index level drawdown has been 7%, but at an individual stock level that has been 38%.

"That is a hell of a lot of churn and rotation under the surface," she says. This presents a more complex way of viewing the market changes.

It does though make investor choices a little clearer: investors should opt for "high-quality" stocks in the broadening environment, Sonders says. "We have been focused on things like strong balance sheets, strong cashflows and high interest coverage. These are the things that matter," she says. "There is a bias [higher] up the cap spectrum. But even within the small cap indexes there is a huge performance differential using a quality demarcation."

Sector rallies

But given the nature of market broadening it is axiomatic that a range of investments could well benefit within the market. Value stocks, for example, are trading at a discount on price-to-earnings and include sectors such as financials and industrials. And some investors believe rallies in these sectors, as well as small caps, could go further.

There is no doubt that July's broadened stock rally brought into view the market's small-cap segment. That same month, the Russell 2000 index of smaller stocks saw its largest outperformance over mega caps in decades, returning more than 10%, while the Nasdaq-100 index lost 1.6%.

Currently, at 15.1 times forward earnings, the small-cap benchmark is trading at a discount to its long-term average and the S&P 500's forward price-earnings ratio of 20.4 times.

"We believe that a multi-factor approach to small caps, which we consider to be an attractive asset class, should be represented in diversified portfolios," says Dina Ting, Franklin Templeton's head of global index portfolio management.

And stocks with value traits – which emphasise holdings that are inexpensive relative to their fundamentals – have underperformed in recent months and in the year-to-date through August 8, not only within the small-cap but also for the mid-cap segment.

But that is not the full story. Zoom out further and we see the Russell 2000 Value index has outperformed the Russell 2000 Growth index over the past 25 years by 1.82% on an annualised basis.

"In our opinion, anchoring quality-tilted stocks, marked by profitable companies with capital efficiency and momentum, together with value and low-volatility factors can hedge against risks," Ting says.

Mid-cap appeal

In addition, there are other areas investors should be investigating, some that have been overlooked, Ting says. "The market rotation away from mega-cap stocks has fuelled attention to the often-overlooked, mid-cap segment and led to a preference for interest-rate-sensitive small-cap stocks following indications from the US Federal Reserve over lower borrowing costs to come," she says.

"The broadening out from big tech, which was priced for perfection, looks like a positive step for the market's long-term health.

Matt Britzman, Hargreaves Lansdown

Yet despite the attractive risk/reward profile of mid-caps, which usually feature more established customer bases and brands than their smaller-cap peers, investors tend to be under-allocated to the segment, Ting says. To put this in perspective, investments in large-cap funds and exchange-traded funds are about nine times greater than those in mid-cap funds and ETFs.

And US mid-cap stocks – as measured by the S&P MidCap 400 index – have outperformed their large-cap – as measured by the S&P 500 index – and small-cap – as measured by the S&P Small Cap 600 index – counterparts over the past three decades.

"In our analysis, many mid-sized companies hit the so-called 'sweet spot' in that they feature a lower risk profile than small caps and faster growth prospects than large caps," Ting says.

Exposure to mid-cap indexes also offers the added benefit of diversification. At the end of July, technology sector holdings comprised 29% of the Russell 1000 index compared to just 13% in the Russell Midcap index. And while, when you look closer, utility companies were the best performers – an 18% total return for the mid-cap index – they held the smallest sector weighting within large-cap benchmarks.

"Beyond the market-cap criteria, we believe that multi-factor strategies can target allocation and pursue stronger risk-adjusted returns for a smoother ride over the long term compared to traditional market-cap-based indexing," Ting adds.

And she noted that in her view, a forward-looking, rules-based index design that analyses individual stock exposure against a well-vetted mix of factors – quality, value, momentum and low volatility – can serve as a middle ground between active and passive management. "The process may provide exposure to high-quality companies at a reasonable price, while also potentially avoiding value traps," she says.

Niche opportunities

And opportunities exist in different geographical regions as the market broadening shapes markets across the globe. "We do find opportunities in some niche areas outside the United States," says Philip Straehl, Americas chief investment officer at Morningstar Wealth.

These, he adds, include some emerging markets, especially Chinese technology stocks. For Straehl, such stocks held up better during the recent volatility. He also points to positions in quality European stocks.

Yet at the same time, Straehl offers a different take on the more upbeat picture of market broadening, saying there is a case for taking a more defensive approach. "We had started to build more defensive ballast in our portfolio," he says, pointing to defensive plays like consumer staples and real estate investment trusts as being the investments of choice in such a positioning.

And the shift to market broadening is not without its challenges. "The re-rating, or increasing share prices, of industries is broadening and rolling through the global equity markets," says Chris Buchbinder, an equity portfolio manager at Capital Group. "But with re-rating comes higher valuations, so as active investors we must be wary of groups of stocks associated with market trends and focus on the prospects of individual companies to deliver top-line growth."

Global hunt

It does, therefore, Buchbinder believes, make sense to think globally "in the hunt for companies with dominant market positions and strong potential demand for their offerings".

Market broadening therefore presents an interesting picture for Buchbinder, as different factors have to be considered. "While US stock markets are likely to do well, they likely will not be the only source of superior returns. But with questions lingering over inflation, rates and global trade, selective investing will be critical," he says.

For Buchbinder the situation means investors should ultimately look at the opportunities outside of the US. "The seven leading contributors in 2023 within the MSCI EAFE index, a broad measure of developed markets in Europe and Asia, have outpaced their US-based cohort since the beginning of 2022, rising more than 40%," he says.

Although he also focuses on investors looking to exploit the situation in the here and now. "For investors seeking income, technology, aerospace and energy companies have been introducing or increasing dividends," he says.

At the same time, he also notes the broadening market offers positive economic fundamentals that will underpin the whole investor outlook. "We expect solid economic growth for the remainder of this year and through 2025," Buchbinder says. "This will likely lead to an environment of expanding earnings growth across industries and sectors.

"This, in turn should lead to a broadening market rally, as profit growth is a primary driver of returns."

Good rally

What has been interesting during all of this is the market had continued its solid rally with the S&P 500 gaining 19% year-to-date with reinvested dividends, contributing to a total return of 61% since the market bottom in 2022.

As has been the trend, much of this performance has been driven by large cap technology stocks over the past 18 months, but the broadening market scenario shows solid signs that other parts of the market are boosting the picture as well.

It possibly does highlight the important truism that while investing trends may come and go, it comes down to something of the tried and true principles of investing that enable investors to grow their portfolios and achieve their financial goals over years, as well as decades.

Looking forward, Straehl offers such solid long-termist investor advice, despite the changing nature of the market. "Keep your eye on the long term and don't overreact to short-term news," he says. "If anything, use it as an opportunity to buy assets that might have fallen more than what the fundamentals justify." A point shared by Cathie Wood, ARK Invest's chief investment officer. "We encourage investors to reassess portfolio concentration risk and consider ways to diversify exposure," she says. The market may change, but the central tenets of successful investing do not.

The re-rating, or increasing share prices, of industries is broadening and rolling through the global equity markets.

Chris Buchbinder, Capital Group

THE FINAL COUNTDOWN

74%

The local government pension schemes who invest in social infrastructure for its risk-return profile and diversification.

Source: Octopus Investments & Mallow Street

$1.74trn

The expected underlying global dividends for this year after the forecast was upgraded by 6.4%.

Source: Janus Henderson

33%

The capital raised through secondary fundraisings on the Alternative Investment Market fell by a third to £1.18bn in the year to the end of August.

Source: UHY Hacker Young

$10.1bn

The venture capital raised by UK startups in the first eight months of the year through 673 deals – 14.8% more than in the same period in 2023, despite volume falling by 16%.

Source: Global Data

€19.9bn

The estimated inflows into ETFs promoted in Europe during August, beating the €17bn 12-month average and sending assets under management to a record €1.87trn.

Source: London Stock Exchange Group

53%

More than half of FTSE 350 boards are sceptical that the City can reverse the net de-listing trend during the next five years.

Source: The Chartered Governance Institute UK & Ireland

£2,000

The price of an ounce of gold hit a record high in late September on heightened tensions in the Middle East and rising expectations of rate cuts by the Fed. The value of gold has jumped 23% so far this year.

Source: The Royal Mint

$2trn

The increase in the global debt pile during the first half of the year, driven by the US and China, bringing the total to $312trn.

Source: The Institute of International Finance

99%

Almost all defined benefit scheme trustees have found the pace of new regulation challenging in the past year with 38% reporting that ESG rules are the most complex to implement.

Source: TPT Retirement Solutions

Quote of the Month

“It is my responsibility to help keep the good news coming.”

Martyn James, Now Pensions