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## Look for Value in True Growth or Solid Dividends

- **Good economic data encourages risk taking**
- **Persistent low interest rates help sectors beyond tech**
- **Watch for a re-rating of emerging markets**
- **After a wobble, REITS are finding their feet and are still good value**
- **The life of a CIO is never easy**

There was little in the economic data last week to encourage any significant profit-taking in risk assets. Economic data around the world continues to point to a good rebound in activity. In Asia, mainland China and Taiwan posted strong export growth with much of northern Asia showing sustained and broader recovery. Industrial production for July in the euro area rose +9.0% month-on-month, in the US by 3.8%. There are concerns about the lack of agreement on a new fiscal package in the United States however the markets happy to assume that something will be agreed eventually, in the range of \$1.0trillion - \$2.5 trillion.

### **Low interest rates justify a re-rating of growth stocks not 'non-growth' stocks**

We have stood firm in our belief that accommodating monetary policy will underwrite an ongoing rally in risk assets. But there is a limit. We do not agree with those commentators that portray low-interest rates as warranting an ever-higher P/E for the market. The reason that stocks can rise when interest rates drop is on the crucial assumption that you still believe that companies will achieve the same level of projected long-term growth targets. But the reason that you have lower interest rates is that the world is struggling to reach those historic levels of growth and therefore they get a helping hand of easy money from the central bank.

If anything, the COVID19 crisis has muddied the water in respect of future long-term growth estimates. As companies struggle to hit the analyst earnings estimates, it's easy to put up a defence that the setback is due to the COVID crisis. But in truth, many companies were struggling well before the crisis hit. The western world nominal growth has been on a declining trend for some years. In the US companies have only achieved their earnings forecasts through a combination of tax cuts (funded by every higher US debt to GDP) and share buybacks, funded by ever-higher levels of corporate debt.

**Over the longer term, we completely accept very low interest rates are a boon for true growth stocks such as tech companies, but we should not forget emerging markets.** Emerging markets have real growth underpinned by demographics and productivity growth. COVI19 should materially undermine neither of these latter factors over the longer term.

The other sectors that can hold onto a re-rating are the dividend payers with staying power. **We are keeping REITS in our line of sight.** In a COVID19 world, the sector has got badly beaten up. While there are the horror stories in the retail sector, there are still many tenants paying their rents often helped by government hand out. In any case, we are talking about one-two maybe three-year dip but not a structural change. Even current problems in the retail sector may be transitory In an interesting development Simon Property the largest owner of shopping malls in the US is in talks with Amazon to lease space in shopping malls for Amazon to build out fulfilment centres.

**REIT valuations are very supportive of the sector.** Historically REITs have traded at a two percentage point yield premium to the US 10-year government bond yield they are currently closer to 400bps. Indeed the spread is at its highest ever other than the period 2008/09.

Also, there is the longer-term argument that illiquid investments, including real estate, could end up being a much larger percentage of institutional portfolios in the future. Brookfield an infrastructure company, so slightly biased, believe the allocation to alternatives including real estate, could rise from 25% to 60% of an institutional portfolio in the future.

**For your average domestic stock in your average developed country, low-interest rates do not solve for the intractable problem of low real and likely nominal growth.** Ageing populations may lead to structurally higher savings rates, particularly given the issues of failing pensions funds (see later comments) and unfunded social benefit schemes. Also, note that even younger people are showing less of a penchant for credit. Younger generations are understood to feel more comfortable with payment cards not credit cards.

As CIOs, we have always had a soft spot for our fellow professionals. In recent months we have looked out for the CIO of CALPERS, one of the worlds' largest pension funds. Last week Ben Meng resigned from his role after less than two years in the job. While there is still some conjecture about the circumstances behind his resignation Ben has faced some significant challenges in his short tenure. Those challenges reflect the serial problem for most pension funds in the western world, namely how do you hit an unrealistic investment return to meet the massive (often) unfunded liabilities of the fund. Last year the pension fund decided to leverage its portfolio by 20% to try and achieve its required rate of return of 7%. Jeff had also faced criticism from state officials that he was investing in Chinese stocks. It beggar's belief that anyone can think the Calpers fund can even attempt to achieve such elevated expected returns by not investing in the largest emerging country and the second-largest country by GDP in the world.

The challenges to the western pension fund are very evident also in the UK. The [FT reports](#) that the Universities Superannuation scheme is due to announce that its funding deficit widened to £12.9 billion at the end of March, from £5.4 billion a year ago. Employees' and employers' contributions are already 30.7% of employees' salaries. The fund has indicated that contributions may have to rise by 50% to cover the deficit. Such maths is not just the domain of UK universities but many defined benefit schemes in the western world.

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