CAMRADATA

Investor Conference

Future-proof investing... mapping the way forward

29th November 2016

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Welcome to

CAMRADATA's Investor Conference

We have all been subjected to various attempts forecasting what Donald Trump's victory and the triggering of Artricle 50 following Brexit, will mean for the world as we know it.

But during this current period in history, it is imperative that we ignore all the caffeinated punditry and predictions pumped out in this nervy atmosphere – especially where investment is concerned.

The investable universe across world markets and time zones is vast. During today's Investor Conference, we aim to present some solid ideas for future proof investing to help you map the way forward.

Agenda

Venue

Painters' Hall, 9 Little Trinity Lane, London EC4V 2AD

Timing

08:30	**Registration and tea/coffee**
08.50	**Introduction -** Sean Thompson, Managing Director, CAMRADATA
09.00	**Orbis -** The High Price of "Safety"
09.30	**TH Real Estate -** Commercial Real Estate Debt – Predictable yield in volatile markets
10.00	**Redington -** Growth Portfolio Themes
10.30	**Break**
11.00	**Punter Southall Investment Consulting -** Asset Class Views for 2017
11.20	**First State Investments** - When Beta is not enough
11.50	**ShareAction -** Engaging on Climate Change: A focus on fossil fuel holdings
12.10	**New Capital funds by EFG Asset Management -** Global Macroeconomic Update
12.40	**Closing remarks**
12.45	**Christmas lunch**
15.00	**Finish**

Speaker

Bios

Daniel Murray

Global Head of Research

Daniel is Global Head of Research and Chief Economist at EFGAM. He was previously employed as a Director of Strategy at Russell Investments, before which he worked as a portfolio manager at Merrill Lynch Investment Managers. He began his career at Smithers & Co. Ltd. He has broad investment experience, having worked as an economist, strategist, asset allocator and portfolio manager with exposure to a broad range of markets, instruments and investment styles.

He has been a CFA charter holder since 2003. Daniel has a BSc Hons Degree in Economics, an MSc in Econometrics and Mathematical Economics and a PhD in Economics. He is a previous winner of the CFA UK Wincott Prize and was elected to the Board of CFA UK in 2014. He is also on the Editorial Advisory Board of the Global Commodities Applied Research Digest (GCARD) produced by the J.P. Morgan Center for Commodities at the University of Colorado Denver Business School.

Dan Brocklebank

Director and Head of UK

Dan Brocklebank is a Director and Head of UK at Orbis Investments. Having studied PPE at Brasenose College, Oxford he qualified as a Chartered Accountant with Arthur Andersen.

Bitten by the investing bug in the wake of the collapse of the dot com bubble, he joined Orbis Investments in 2002 as part of the investment team. Orbis currently manages approximately $30bn in a small number of primarily equity strategies globally. For the last 9 years Dan was responsible for Orbis' team of global industry analysts based in London. At the same time, he has worked with Orbis' institutional and retail customers to help them understand Orbis' long-term, fundamental and contrarian investment approach. Dan has a particular interest in Orbis' goal of making long-term investing simple and accessible to all and he is a Director of Orbis Access, Orbis' UK retail platform. He tweets under @OrbisDanB

Andrew Harman, CFA

Portfolio Manager, Multi Asset Solutions

Andrew Harman, CFA, joined First State Investments in 2008. He became a Portfolio Manager within the Multi-Asset Solutions team in 2010. Last year Andrew launched the flagship Diversified Growth Fund for the UK market which has had strong performance since inception. His responsibilities include research, market analysis and construction of proprietary investment models.

Andrew holds a Bachelor of Business (Banking and Finance) from Queensland University of Technology and a Graduate Certificate in Mathematics from the University of Technology, Sydney.

Clare James

Principal

Clare is a Principal at Punter Southall and has over 20 years' experience in the pensions industry acting as actuary and investment consultant to clients of DB and DC schemes ranging in size from a few £m to £4bn.

Clare currently holds a number of appointments providing investment consulting advice to trustees and corporate sponsors working with trustees in setting and implementing changes to their investment strategies. Current areas of focus include implementation of LDI solutions, achieving greater diversification, especially through the use of different diversified growth funds, and establishing "flight plans" for future de-risking with a view to achieving an ultimate objective of self-sufficiency or buyout.

Clare serves on the firm's Professional Affairs, Service Group, Defined Contribution (which she chairs) and Public Sector Committees. Clare also serves on the Association of Consulting Actuaries' Defined Contribution Sub-Committee. She takes a particular interest in developing DC governance solutions for clients with DC schemes looking to comply with the DC Code of Practice and regulatory requirements.

Speaker

Bios

Pete Drewienkiewicz

Head of Manager Research

Pete is head of manager research at Redington, leading a team of dedicated investment professionals responsible for the research, selection and monitoring of asset managers across both traditional and alternative asset classes. The manager research team covers a broad range of asset classes and strategies, with additional responsibility for implementing Redington's strategic asset allocation advice on behalf of clients. Pete is a member of Redington's Executive Committee and is also a voting member of Redington's Investment Committee.

Before joining Redington, Pete worked at Royal Bank of Canada where he initiated coverage of pensions and insurance clients in interest rate and inflation derivative products as well as gilts. Prior to this, he was an executive director responsible for sterling interest rate derivative sales at UBS. Pete began his career at Barclays Capital, providing hedging solutions for banks, building societies and project finance issuers across interest rates, FX and inflation.

Pete holds a BSc in Economics from the London School of Economics.

Juliet Phillips

Campaigns Manager

ShareAction is a UK-based responsible investment charity that advocates active stewardship on a range of environmental, social and governance (ESG) issues. Juliet leads on climate change related corporate engagements, with a focus on fossil fuel companies and banks. Through shareholder activism and coordinating collaborative investor engagement, Juliet works to promote best practices and raise the profile of ESG risks and opportunities within the investor community.

Juliet has a First Class MSc Political Theory from the London School of Economics, where she specialised in global justice and environmental governance.

Christoph Wagner

Director of Debt Strategies, Origination & Structuring

Christoph focuses on origination and structuring of commercial real estate debt. He has been active in the industry for over 17 years in Europe, and has experience in origination, underwriting and credit analysis, structuring and execution of loans, portfolio management, real estate structured finance, and asset management.

Before joining the business in 2014, Christoph was a Director at BlackRock, where he was responsible for originating, structuring and underwriting European commercial real estate loans for existing and prospective separate account mandates, including senior loans and high-yielding mezzanine debt investments. Prior to this, Christoph was at Barclays Capital where he was instrumental in establishing its European commercial real estate lending, securitisation and servicing platform. He led an origination team with a pan-European remit for on-balance sheet and capital markets lending. He has also worked at Morgan Stanley and started his career at McKinsey & Company in 1998, as a Management Consultant serving financial institutions with assignments including lending profitability reviews and M&A.

He holds an INSEAD MBA and a MSc in Engineering from RWTH Aachen, both awarded with distinction.

new capital
funds by
EFG Asset Management

> Our approach to fixed income investing can avoid some of the pitfalls of the traditional benchmark orientated approach, whilst seeking to enhance returns in this low interest rate environment

Written by

Michael Leithead, CFA
Head of Fixed Income

Why you should give credit to the creditor nations

The world has moved on over the last 20 years and the structure of the fixed income market has been slow to adapt to these changes.

We believe our approach to fixed income investing can avoid some of the pitfalls of the traditional benchmark orientated approach, whilst seeking to enhance returns in this low interest rate environment.

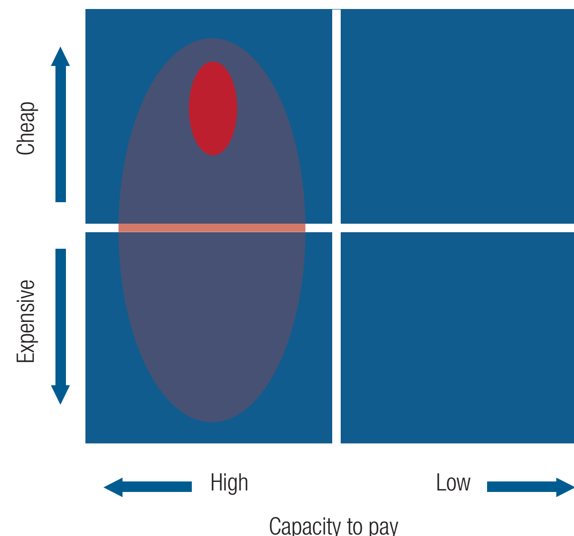
The New Capital Wealthy Nations Bond approach adopts two key differentiated views:

1. Firstly, we think of countries as a heterogeneous opportunity set based on their capacity to pay. We consider the world in terms of creditor and debtor nations. The historical view that the developed countries were the wealthiest, and developing countries were the poorest, no longer holds. These structural preconceptions can lead to mispricing of risk in fixed income markets.

2. The second, we believe that benchmark investing is suboptimal and an illogical approach when it comes to fixed income as benchmarks are skewed to the largest issuers of debt and therefore overweight more indebted nations. A strategy that constructs a portfolio based on benchmark exposure, potentially overlooks the best credit opportunities in favour of a riskier proposition.

Combining these two elements, our solution aims to avoid downside risks associated with nations that are dependent on foreign capital to repay their debts and focus on investing only where the reward justifies the risk. We believe that both our Net Foreign Asset approach and "value" style of investing offer a unique proposition which leads to a portfolio that has a number of benefits for investors. As such, rather than focusing on the entire global investment grade universe, we take a targeted approach, screening out countries which fall foul of our metrics and then concentrating on seeking the cheapest bonds in that universe. This leads to a portfolio solution which is unique from a geographical diversification process whilst seeking to improve the risk profile, without compromising returns.

Global Investment Grade Bond Universe



1. Invest in the countries that have the greatest economic capacity to repay debts.
2. Focus on investing where there is value

How do we identify countries with capacity to pay? We measure them in terms of Net Foreign Assets (NFA)

The NFA position of a country is the total value of the assets that country owns abroad, minus the value of the domestic assets owned by foreigners. The NFA position of a country reflects the level of indebtedness of that country.

Countries with weak NFA positions are the most susceptible to the withdrawal of foreign capital and face more acute risks. In times of trouble, foreign investors may withdraw capital, resulting in higher cost of liquidity, currency depreciation and potentially higher interest rates.

The knock on effects can amplify the impact on the economy and present a greater risk of sovereign and corporate ratings downgrades, loss of investor confidence and other factors which impact investment returns.

Advantages of the NFA process

The outcome can be different to that of the more traditional metrics, which often has a number of flaws. Traditional metrics can overlook some of the key financial dynamics in evaluating capacity to repay debt.

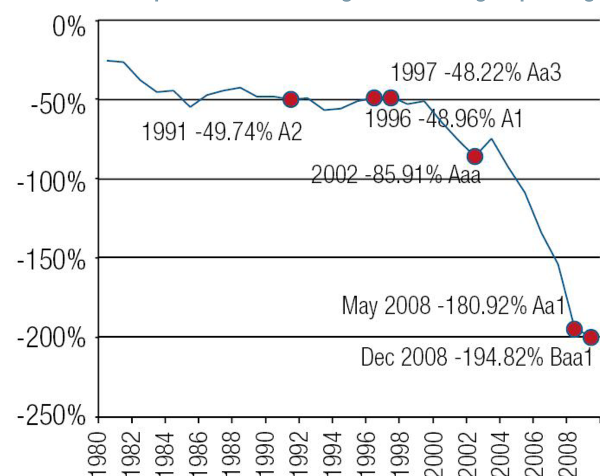
Country	Debt to GDP	NFA to GDP
Brazil	73.7%	-21.2%
Turkey	32.6%	-52.4%
Qatar	35.8%	217.8%
China	43.9%	12.6%
Indonesia	27.3%	-36.7%
Romania	39.5%	-52.0%

1. Assets as well as income can be utilized to repay debt. The NFA approach accounts for the net debt position of a country as well as the income with which to do this. Debt to GDP simply acknowledges income element.

2. There is too often a focus on one sector of the economy in isolation. The Debt/GDP ratio is typically applied only to the sovereign, ignoring the corporate and consumer sectors. If the last 10 years have demonstrated anything, it is that sovereigns have potential contingent liabilities from the consumer, financial and corporate sectors whilst an over levered sovereign can have a negative outcome for the credit profile of domestic players. The NFA approach includes all the sectors of the economy.

3. Finally, the stability of funding is important. The advantage of the NFA is that it identifies those countries that have a high dependence on foreign capital which may be more likely to create a funding gap as returning domestic savings fail to offset capital outflows. A lack of capital inflows can lead to currency depreciation, inflation and rising interest rates as capital becomes scarcer.

Iceland: NFA position weakening whilst rating improving



Our methodology is focused on achieving superior credit returns by avoiding overvalued, riskier credits.

Since the global financial crisis, there have been numerous examples of how the NFA approach has helped to avoid some of most acute financial risks. Iceland is one such example, a country which had less than 50% Debt to GDP in 2007 at a sovereign level, but whose financial system had geared itself to foreign capital.

The chart to the right clearly demonstrates how a focus only on growth and Debt to GDP led to the sovereign rating improving, whilst the NFA score was deteriorating.

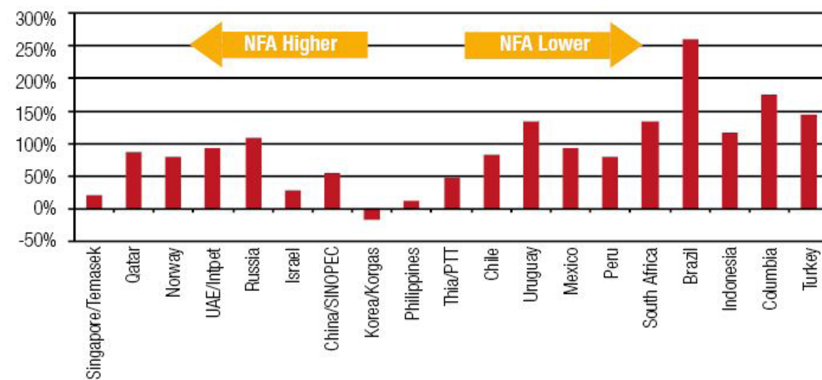
> If the last 10 years have demonstrated anything, it is that sovereigns have potential contingent liabilities from the consumer, financial and corporate sectors

> The ‘Taper Tantrum’ resulted in many EM currencies depreciating, and a greater sense of caution with regard to the fundamental risks from a credit perspective

The impact of the bailout of banks, collapsing currency and weakened domestic economy saw the sovereign rating freefall, impacting investor returns.

More broadly, the 2013 Taper Tantrums provide another point of reference. Looking back at the expected Fed tightening in 2013, countries vulnerable to withdrawal of liquidity significantly underperformed. The ‘Taper Tantrum’ resulted in many EM currencies depreciating, and a greater sense of caution with regard to the fundamental risks from a credit perspective.

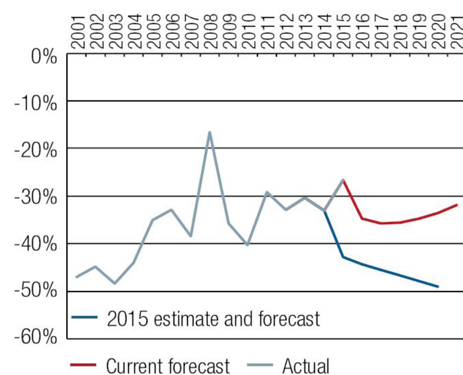
Since 2013, Emerging market spread changes have reflected creditor/debtor status. Change in credit spreads 3 yr

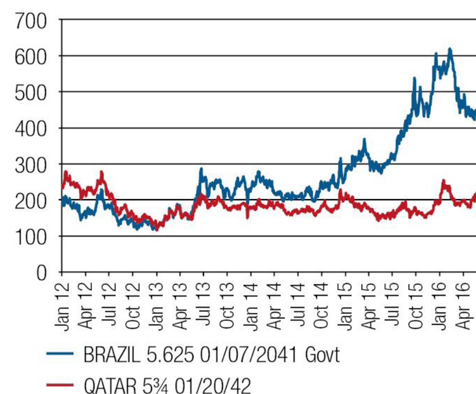


The bar chart opposite (below and to the left) shows those countries with a weak NFA score have encountered significantly greater credit spread widening compared to those countries with a stronger NFA position.

Examining past experience, market structures can lead to markets mispricing risk. An interesting historic example is Brazil vs Qatar. Although Qatar had a far superior NFA position and held a rating of Aa2, 6 notches better than Brazil, going into 2013, the market was pricing the risks associated with these credits equally. The question as to whether Qatar was undervalued or whether Brazil was overpriced is debatable, but in principal, rating agencies or market analysis was incorrect.

Whilst immediate fundamental risks did not concern investors in 2012, new developments in 2013 & 2015 led to capital outflows in Brazil which ultimately resulted in a loss of IG rating, currency depreciation and wider credit spreads, as shown in the chart to the right.





From an investment perspective, Qatar represented a value opportunity for its rating, whilst Brazil was arguably overvalued in 2013. In our view, there was little justification to own Brazil over Qatar with a medium term time horizon.

One off or where do value opportunities come from?

Expansionary central bank policy has created increased demand for bonds and lowered yields, resulting in investors moving down the credit quality curve in the search for greater income. This creates overvaluation of weaker issuers, leaving investors less well compensated for additional credit risk.

The inefficiencies go deeper. With the Fixed Income investment industry built on benchmark and regulatory constrained investing, often investors are forced into credits which are mispriced, whilst some of the best opportunities go neglected due to investment targets or risk constraints. Inefficiencies such as, home bias, benchmark weight constraints, ratings limitations and liability matching requirements throw up recurring opportunities which can be exploited by active managers.

What is value and what are the advantages?

Value investment is a well-known factor in equity investing, but not a concept that has been promoted by fixed income managers.

The style focuses only on bonds which offer greater credit compensation than their rating and maturity profile would suggest. By evaluating these opportunities, the portfolio benefits from a higher carry relative to its risk profile.

Equally, by analysing the fundamentals it is possible to identify whether those ideas have room for rerating, closing the discount to peers. Excess compensation from a spread perspective can contribute to capital returns, as well as the income component of returns.

Qatar exemplifies how a bond of superior quality can outperform a riskier bond such as Brazil based on the discount to its rating.

With income compensation limited by low interest rates, we believe that capital can have a much more pronounced impact on portfolio returns. It is more important than ever to have a strong valuation bias to investing.

Conclusion

With a low nominal growth environment for the foreseeable future, there will be winners and losers, both from a country and individual credit perspective.

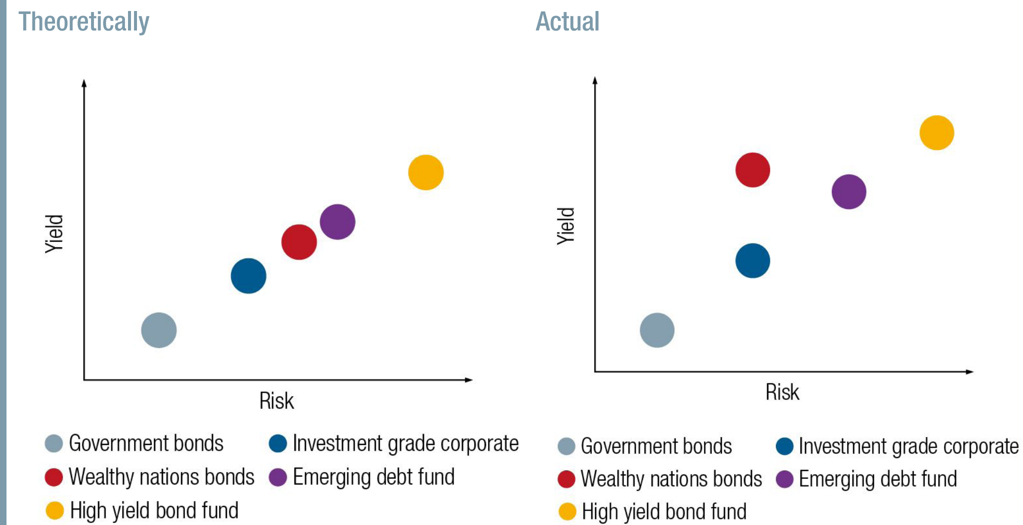
The danger lies in highly leveraged countries that will be susceptible to any withdrawal of foreign capital without the counterbalance of external savings.

Structural inefficiencies result in credits issued in some of the wealthiest countries still offering attractive yields.

Investors willing to ignore benchmark weights can exploit these opportunities and enhance yield relative to their defined risk parameters, allowing them to construct portfolios with a superior risk/reward profiles.

> With income compensation limited by low interest rates, we believe that capital can have a much more pronounced impact on portfolio returns

“Higher yields without compromising credit quality”



The New Capital Wealthy Nations Bond strategy offers the following key attributes:

- Exposure to countries that are considered "Wealthy" from a Net Foreign Asset position
- Higher yields without compromising credit quality
- Investment grade exposure managed for macroeconomic factors
- A superior risk/reward profile to a traditional Fixed Income portfolio

	Wealthy Nations Bond Fund	Merrill Lynch US Corporate Bond 7-10yrs Index	Merrill Lynch US Treasury Note 7-10yrs Index	EMBIG Diversified	EMBIG Diversified IG
Duration	7.76	7.31	7.65	6.86	7.93
Average rating	A2	A3	AAA	Ba1	Baa1
Realised vol since inception	4.02%	4.97%	6.16%	4.61%	4.38%
Realised vol last yr	3.09%	4.41%	5.69%	4.47%	4.19%
Average yield (%)	**3.76**	**3.21**	**1.39**	**5.06**	**3.47**

CAMRADATA's Assisted Searches

For institutional investors with very specific manager search requirements, we run assisted searches on their behalf. This service is free of charge for institutional investors.

“CAMRADATA Assisted Search added a new dimension to our tender process. We were able to narrow the field in terms of the service we were after and gain interest from a wide range of market participants. A bonus was the help we received in coordinating a presentation day and providing a central neutral location at which to meet.”

Peter Beaumont, Finance Director, Cornish Mutual

Below highlights just some of the asset classes CAMRADATA Assisted Searches have covered over the past quarter:

Passive UK Government Fixed Income

Emerging Market Equities

Euro Corporate Bond Funds

Fixed Income SRI

Global Equities SRI

Emerging Market Small Cap Equities

UK Equities SRI

Multi Sector Fixed Income

Active UK Government Fixed Income

If you would like us to carry out an assisted search, please contact us now

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First State Investments

> As we approach the end of 2016, global markets continue to be dominated by macroeconomic themes

Written by

Andrew Harman, CFA
Portfolio Manager, Multi Asset Solutions

When Beta is not enough

Given the current climate of low returns and rock bottom interest rates, we must dynamically combine beta and alpha drivers in a portfolio to meet investors' objectives

With lower growth and lower inflation characterising our forward-looking economic climate, the biggest challenge for investors will be to allocate capital in this period of foreseeable lower investment returns and low-to-negative interest rates. That said, we continue to believe that fundamental valuations will ultimately assert themselves and be the most important driver of returns.

Economic climate

As we approach the end of 2016, global markets continue to be dominated by macroeconomic themes. Looking ahead the UK is facing myriad trade negotiations with 27 individual nations, while Europe itself goes through its own identity crisis. Against this economic backdrop we have seen some equity markets at all-time highs and global bond valuations at historically high levels.

The themes dominating the economic climate as we see them are:

Central bank policy: Lower global inflation had already been dampening the trajectory of the expected interest rate rises in the US, but the Brexit decision only diffuses what little inflation was starting to come through. The Bank of Japan, the European Central Bank and likely the Bank of England are set on easing monetary policy further via extended quantitative easing programmes. As a result, global yields are expected to stay low, if not negative for longer.

Negative interest rates (NIRs): The total value of government bonds trading at negative yields has swelled to greater than $13trn. The countries that introduced such a phenomenon have done so under the premise of increasing inflation and/or stabilising their currency. There are side-effects to adopting this policy, such as margin pressures on banks as, to date, they have avoided passing on NIRs to their retail customers. Even lower rates may see banks increase their lending rates, which is a form of tightening; the exact opposite of the central banks' objectives. An additional hazard of NIRs is that they encourage increased risk-taking in the search for 'positive' yields.

Rebalancing the Chinese economy: China's transition to a more consumer-led economy will remain hampered by structural problems (high debt, inefficient state-owned enterprises). In this context, the 'official' headline growth rate is expected to land somewhere between 6-7% in 2016. This has largely been discounted into markets but the greater unknown is the pace of depreciation of the Chinese yuan. This only adds to the deflationary trend.

Energy prices: Despite some recent recovery in the oil price, the basic economic principle of demand and supply is still very much in force. Irrespective of demand, the world's largest oil producers seem intent on drowning us in 'black gold' with no regard for the implication on price levels. There are benefits to those nations that are net importers of oil, but the downward pressure on global inflation is affecting everyone.

Brexit: Article 50 of the Lisbon treaty has not yet been invoked. However, that has not prevented market consensus economic growth forecasts being revised down throughout Europe, particularly in the UK. The extent to which these factors play out will be an evolving process that should remove some uncertainty for the markets over time.

Investment process

Within our investment process we have two building blocks. The first, which we call Neutral Asset Allocation (NAA), sets longer-term asset allocations. The second, which we call Dynamic Asset Allocation (DAA), allows us to exploit short-term opportunities in markets.

The NAA allocations are based on our view of the global economic climate, prevailing market conditions, valuations of financial assets and political and market risks. We use the economic climate assumptions within our set of proprietary stochastic simulation models to determine forward-looking risk premia and expected returns.

Our DAA process, on the other hand, takes into account the shorter-term market dynamics to deliver additional returns and abate portfolio risks, such as tail events. This part of our investment process, which includes our investment signals and qualitative overlay, is formally reviewed each week and looks at (among other things) markets and fundamental data to take advantage of possible dislocations.

Multi-asset investments

Given the current market conditions and outlook, especially in a low return environment, to meet investors objectives there is a need to dynamically combine beta and alpha drivers in a portfolio.

> Given the current market conditions and outlook, especially in a low return environment, to meet investors objectives there is a need to dynamically combine beta and alpha drivers in a portfolio

2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
25.6	15.6	32.7	14.0	57.5	15.2	9.8	15.7	28.9	9.8	2.1
20.8	14.4	9.1	-8.3	30.0	12.6	5.3	15.7	18.7	6.0	1.1
15.8	11.8	7.4	-14.2	27.3	11.6	4.5	15.6	7.4	4.8	0.8
6.5	7.2	7.3	-26.4	25.7	10.0	4.4	11.1	0.1	3.2	-1.3
2.8	6.7	4.7	-28.3	19.2	9.0	-1.2	10.0	-1.2	2.5	-3.8
2.7	3.1	4.0	-38.7	13.5	6.0	-2.2	2.2	-3.0	0.7	-4.6
-3.0	-15.1	2.2	-46.5	-3.7	5.9	-5.5	0.1	-3.4	-33.1	-32.9

- US Treasuries
- IG Credit
- HY Credit
- EM Debt
- FTSE 100
- MSCI World
- S&P GSCI

As shown in the table above there are significant fluctuations in returns across the individual asset categories; and the returns on offer in any one year such as 2015. A multi-asset portfolio that can invest in asset classes such as equities, bonds and commodities provides our clients with superior investment opportunities and diversification. Having the flexibility to invest within, and across, the investment categories to generate alpha through long and short positions is critical to us delivering on our investment objective.

FUNDAMENTAL LONG-TERM CONTRARIAN

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The high price of "safety"

At a time when many stockmarkets in the developed world appear fully valued, we would argue that minimising losses is more important than maximising gains. That's not to say that attractive investment ideas cannot be found in global equities, but it does mean that investors must be even more vigilant than usual when assessing risk.

The problem is that many investors define "risk" in terms of short-term volatility or the risk of differing from a benchmark (tracking error). We believe this is misguided. Our focus at Orbis has always been on avoiding permanent loss of capital. We will happily tolerate periods of short-term volatility and underperformance—indeed we have long recognised that those are inevitable when you run a portfolio that's different to the indices—but it's the risk of losing our clients' money that keeps us awake at night.

In today's environment, central banks have driven yields down in an attempt to force investors and savers to put their money to work in the real economy. Human nature has not cooperated. Instead of spending more, people are saving more. Instead of investing in growth, companies are using financial engineering to pay out more cash to their income-starved investors. And instead of shifting capital toward productive investments that would stimulate the economy, markets have merely redefined what is "safe" and what "safe" is worth.

> "In today's environment, central banks have driven yields down in an attempt to force investors and savers to put their money to work in the real economy. Human nature has not cooperated"

Cereals, candy, soy sauce

In the process, a flood of cash has transformed mundane companies into stockmarket darlings. These include makers of breakfast cereals, candy bars, and soy sauce, along with traditional stalwarts such as electric utilities and telecom service providers. In our view, one of the greatest risks looming in global equities today is the high price that is being paid for the apparent safety that shares of these relatively predictable businesses seem to offer. Make no mistake: these are excellent businesses that have stood the test of time. But every asset has a price at which competing opportunities can be found that will produce a portfolio with a more desirable balance of reward and risk. At a high enough price, "safe" companies can actually be dangerous investments.

	Price to earnings (2017 estimates)*	Revenue growth per annum**
Kellogg	19	4%
Nestle	20	2%
Kikkoman	28	1%

Data as of 31 October 2016
Source: Datastream, Orbis. *Consensus earnings estimates for 31 December 2017 for Kellogg and Nestle; March 2018 estimate used for Kikkoman. **Annualised growth in revenue per share, in local currency, for 10 years to last reporting year-end: March 2016 for Kikkoman and December 2015 for Kellogg and Nestle.

Written by

Dan Brocklebank
Director and Head of UK

But it also creates an opportunity. Shares of cyclical businesses have been so neglected in this environment that the valuation gap relative to their less volatile peers is near a historical extreme. Autos and banks come to mind as examples of just two areas in which we've recently found compelling investments.

Extreme pessimism in autos

In the case of autos, there are all the usual reasons to dislike the stocks such as uncertainty about consumer confidence and overall economic activity. But the current environment presents an even bigger question mark in the form of massive technological disruption. This is reducing future earnings visibility at a time when investors are placing an unusually high premium on certainty, thus pushing auto sector valuations to attractive relative and absolute levels.

We don't claim to have special insights on the future of the automobile. However, it is not clear to us that these technological developments such as electric cars or driverless vehicles are unambiguously negative for carmakers. These companies are very cognisant of the disruption risk and many, notably Nissan, are investing heavily in these same technologies. The one thing we can say with certainty is that investor pessimism toward the sector is well above average. As we have seen throughout our firm's 26-year history, it's quite often times like these that present the greatest contrarian opportunities.

"Cocktail party stocks"

If investors are pessimistic about owning automobile shares, they are simply appalled at the idea of owning banks. We often call shares of companies in this situation "cocktail party stocks"—as in the kind most would be embarrassed to admit owning in polite company. Few areas of the market today fit that definition better than banks.

The post-global financial crisis era has been suffocating for bankers and shareholders alike, with a constant flow of investigations, massive fines, and punitive regulations that have crushed profitability. No longer pillars of their communities, bankers have become better known in the vernacular as "banksters".

> "The post-global financial crisis era has been suffocating for bankers and shareholders alike, with a constant flow of investigations, massive fines, and punitive regulations that have crushed profitability"

But the story you won't see in the headlines is that many bank management teams, most of them new, have been working hard to improve their businesses. Despite significant headwinds, many banks have stabilised profitability by simplifying their structures, eliminating lower-return businesses and locations, and generally cutting fat. But with price-to-book multiples less than 1 and price-to-earnings ratios below 10, the market is not pricing in much, if any, further improvement. It's as if the market can't seem to stop fighting the old battles of global financial meltdown and regulatory, legal and interest rate headwinds, along with fresh fears of recession, credit bubbles, and credit card competition.

This is exactly the type of mismatch between perception and reality that we like to see. It has enabled us to find an increasing number of banks whose share prices are failing to give them proper credit for the improvements they've made.

We recognise that ideas about old-fashioned carmakers and banks won't make you the life of your next cocktail party, but we very much believe that these areas contain investments that will be worth telling your friends about someday. Then again, at that point the real opportunity may lie in unloved consumer staples shares and bond proxies. One can dream.

AssetVIEW AWARDS 2017

24 February 2017
Gherkin, St Mary's Axe, London

Over 30 Awards to be presented

Only a few weeks remain before the 2017 Asset View Awards will be decided.

Unlike many industry awards, we do not engage a judging panel to decide who wins. Instead, we apply the CAMRADATA Independent Quantitative 'IQ' scores and rankings to determine the exceptional funds.

We would like to wish all asset managers good luck and we look forward to welcoming the winners to the Gherkin on 24th February 2017.

TH Real Estate

Financing

The real estate finance sector continues to evolve into a more diverse market place, with a broader spectrum of lenders offering new alternatives to borrowers.

What does the future spell for real estate?

Find out in our A-Z guide to investing in Tomorrow's World real estate:
threalestate.com/tomorrows-world/a-z

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TH Real Estate

Commercial real estate debt investment makes a comeback

TH Real Estate, a global real estate fund manager, looks at commercial real estate debt investment opportunities in Europe and how this may fit into investors' portfolios.

In the years prior to 2007, a significant expansion of real estate debt occurred globally, especially in Europe and the UK. This was driven by lenders providing unprecedented leverage at historically low loan margins and operating under an "originate-to-distribute" model that transfers transaction risk to third party investors. By mid-2007 the ability to securitise or syndicate commercial real estate loans evaporated in the UK primary market, and secondary market volumes slowed considerably. Bank lenders were left with low-yielding, over-leveraged property loans to manage.

Since then, the bank-lending market has faced tightened economic and regulatory pressures affecting capital ratio requirements, leverage ratio limitations, legacy asset concentration, rating agency, and investment analysts' and investors' requirements, thereby reducing banks' appetite for balance sheet exposure. These factors have caused many global banks to reduce the loans being offered.

Historically, banks have provided the majority of debt finance globally. According to Morgan Stanley Research, in 2012 banks and bank-related lending comprised 90-95% of the market in Europe and the UK. Asia-Pacific has a similar reliance on banking finance at 75-80%, while the US is at 55-57.5%. In contrast, more recent research from De Montfort University (2015) shows that 25% of new CRE loan origination in the UK has come from non-bank lenders.

Institutional investors, on the other hand, are increasingly seeking a better risk-return profile with higher, stable yields. Against the economic backdrop of reduced debt supply and the low-yield capital market conditions, capital markets and non-bank lenders have begun to play a major role in supplying finance for real estate debt.

This has brought about renewed and continued interest in commercial real estate (CRE) debt as an attractive and competitive investment asset class, especially in the UK. Global investors have greater accessibility to high quality commercial real estate assets for medium and long-term yield.

CRE debt, a loan secured by a mortgage on commercial real estate property, is in many aspects similar to a fixed-income, bond-like investment as tenants support quarterly interest payments. It can be tailored to match the risk-return profile of investors.

The case for CRE debt

CRE debt has the potential to generate handsome and predictable returns, and depending on how loans are structured can absorb significant income and property market volatility which makes it an attractive investment. The net rental income generated by the property is typically higher than the debt servicing requirements and the value of the property is higher than the loan amount. In short, the very nature of CRE debt is conservative and it has a defensive risk-profile.

The scope and diversity of investment options is another positive and attractive feature of the asset class. Investors can construct their portfolio based on traditional real estate parameters, collateral asset types, jurisdictions and the related currency, as well as the locations.

"Against the economic backdrop of reduced debt supply and the low-yield capital market conditions, capital markets and non-bank lenders have begun to play a major role in supplying finance for real estate debt"

Written by

Christoph Wagner
Director of Debt Strategies, Origination & Structuring

TH Real Estate

> The UK has a stable commercial real estate profile, aided by a liquid, transparent market place, a creditor-friendly jurisdiction and a well-understood legal framework

CRE debt generally offers comprehensive security packages which help protect investors' control of assets in case of distress and potential enforcement. Investors then have the flexibility to implement asset management plans, or liquidate and monetise the assets and recover their investment.

While a debt investment remains stable for longer during periods of property value declines, it is still sensitive to significant corrections and these can also lead to return reductions. If property value and rental income increase, the debt will not participate in the increased returns that direct real estate investment would provide in this scenario.

The case for the UK

The UK has a stable commercial real estate profile, aided by a liquid, transparent market place, a creditor-friendly jurisdiction and a well-understood legal framework. The UK is also the largest real estate and real estate finance market in Europe, with transactions typically structured on five year loans and commensurately frequent refinancing.

The underlying market size, quantum of transactions and financings possible in each jurisdiction, makes the UK the most active European jurisdiction and provides an attractive and executable investment strategy for performing investment CRE loans in the current state of relative market pricing.

For enhanced returns, lending against strong secondary and regional assets in the UK is an attractive opportunity to take advantage of the credit supply and demand mismatch between debt providers and borrowers.

There are risks and uncertainty around economic growth, global political stability and rise in interest rates, with expected volatility in the market. Bearing that in mind, investors can see the appeal of core-like and higher returns available from the financing of quality secondary and regional assets, where the secured debt investor is in a priority protected position in the capital repayment order.

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