

IPFOS Informatietafel  
25 November 2022

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Marketing communication



# Investing amidst rising inflation: key themes on the horizon



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# Agenda

## Highlights of 2022 and what to expect for 2023

- Looking back at 2022, where should you have focussed your investments and what should have been avoided?
- Outlook for 2023
- Which long-term trends are important?

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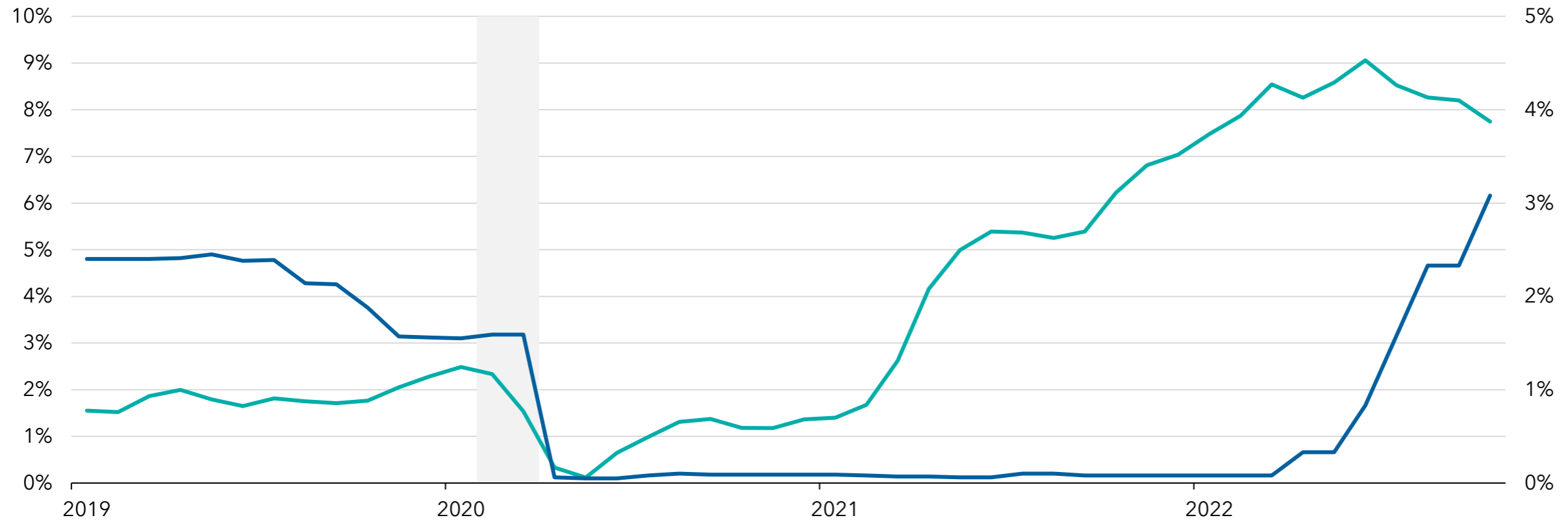
# Lessons from 2022

- Central banks can make mistakes
- Growth doesn't always outperform value
- Valuations are important
- Equities don't like inflation
- Active management is critical

# Central banks make mistakes

## US inflation and Fed Funds rate

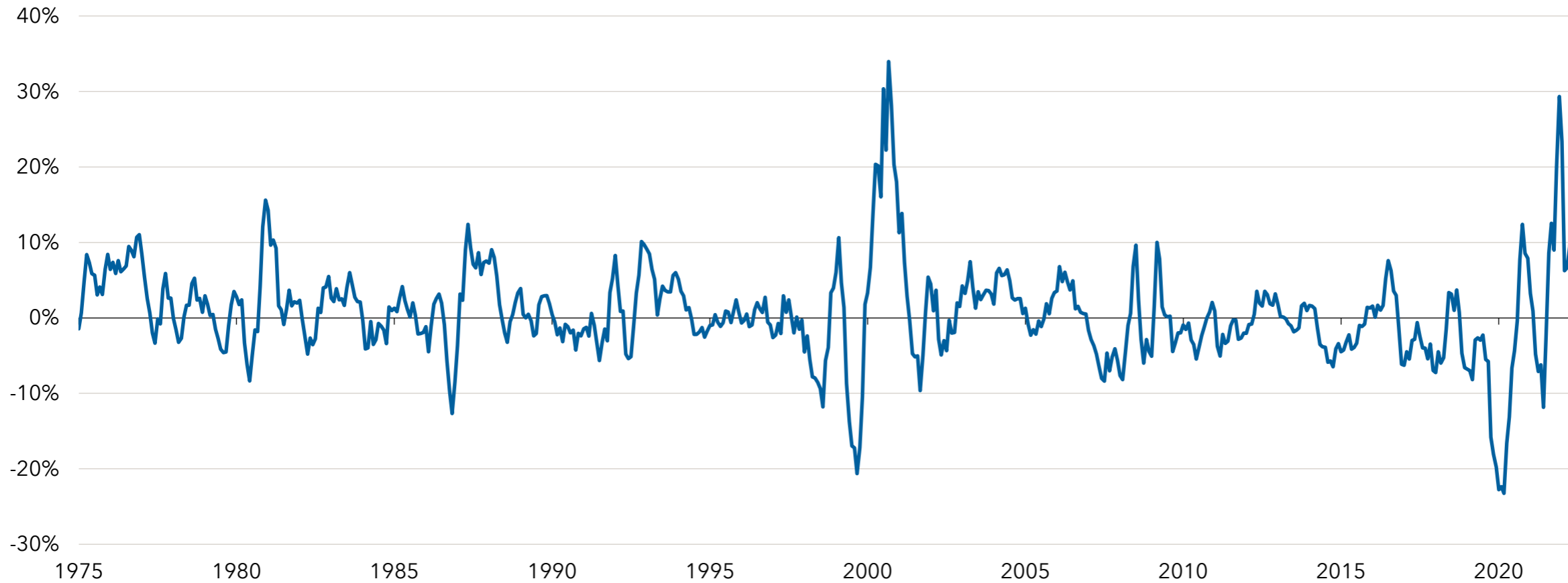
— CPI YoY change (LHS) — Fed Funds rate (RHS)



Data from 1 January 2019 to 31 October 2022. CPI: consumer price index. Source: Datastream

# Growth doesn't always outperform

Rolling 6-month relative returns of MSCI World Value vs. MSCI World Growth

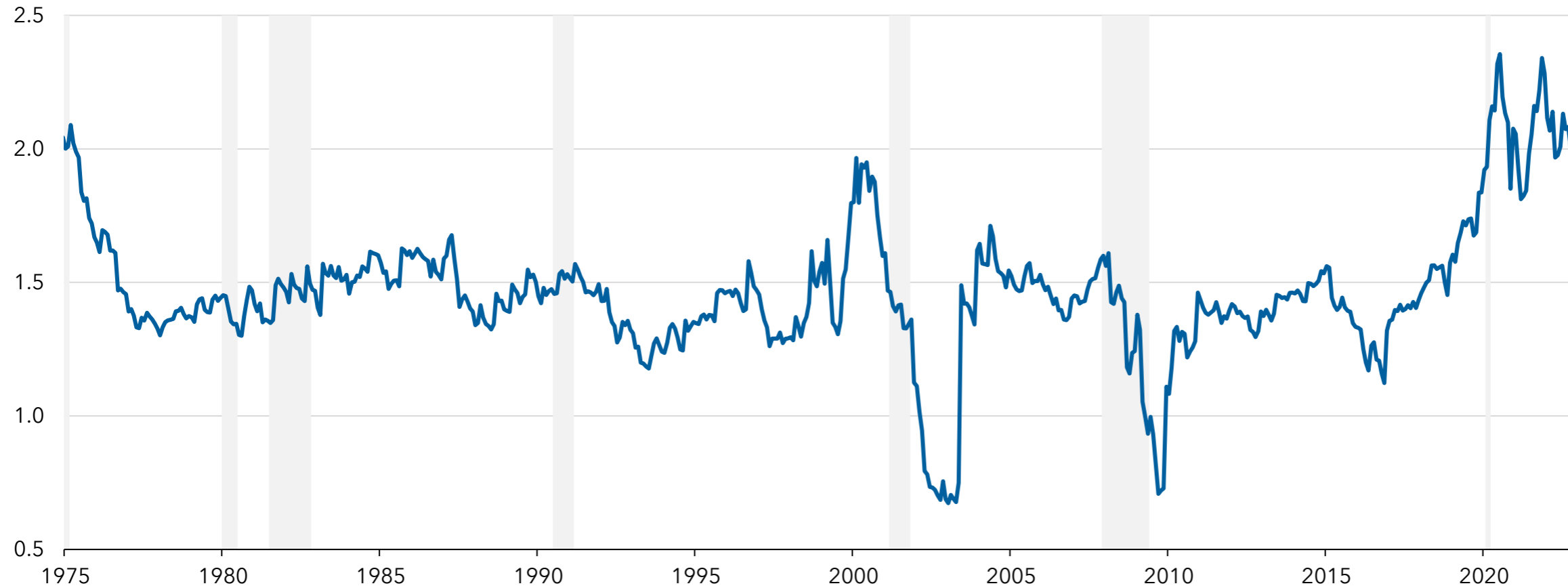


**Past results are not a guarantee of future results.**

Data from 31 December 1974 to 30 September 2022. Chart shows rolling 6-month relative return of MSCI World Value index versus MSCI World Growth index (with net dividends reinvested) in US\$ terms, calculated on a geometric basis. Source: Datastream

# Valuations are important

Relative Price/Earnings ratios of MSCI World Growth vs MSCI World Value



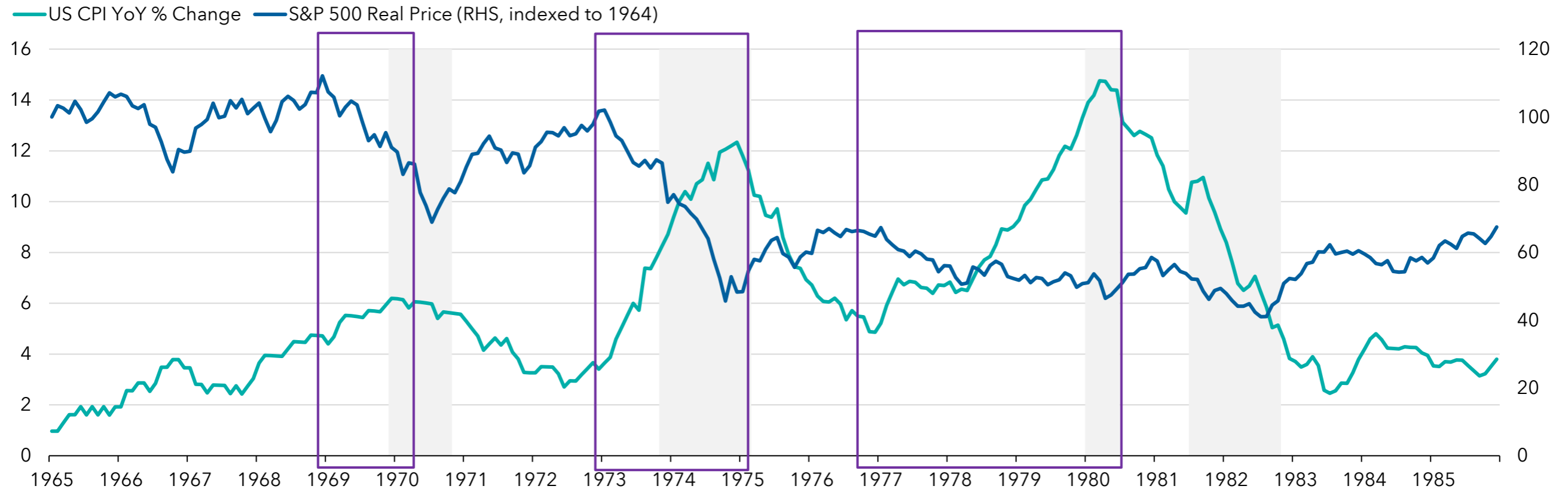
**Past results are not a guarantee of future results.**

Data from 31 December 1974 to 31 October 2022. Source: Datastream



# In the US, the evidence suggests equities are not a great inflation hedge in the short-term...

## US inflation and real equity prices

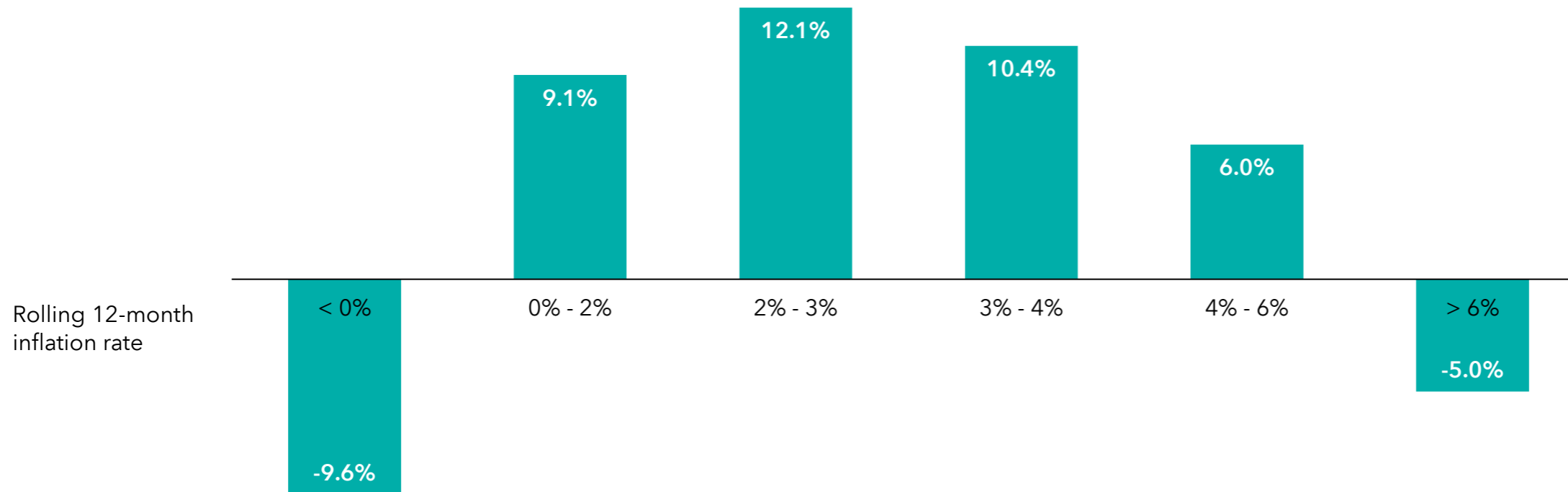


**Past results are not a guarantee of future results.**

Data from 1 January 1965 to 31 December 1985 in USD terms. US CPI: United States Consumer Price Index. YoY: year-on-year. S&P 500 Real Price is the level of the S&P 500 index adjusted for the level of CPI and indexed to the start of the period. Source: Datastream

# ...and similar for global equities

Annualised real returns for global equities at different US inflation rates (1970 - 2022)



**Past results are not a guarantee of future results.**

Data from 1 January 1970 to 31 July 2022. All returns are inflation-adjusted real returns in USD terms. Global equity returns represented by MSCI World to 30 September 2011 and thereafter MSCI ACWI. Inflation rates are defined by the rolling 12-month returns of the Ibbotson Associates SBBI US Inflation Index. Source: Capital Group, Morningstar, MSCI

# Why have equities not typically been a great inflation hedge in the short term?

## **Two main reasons:**

- Effect of rising rates on valuations
- Effect of rising rates on interest charges

## **...but two more subtle ones:**

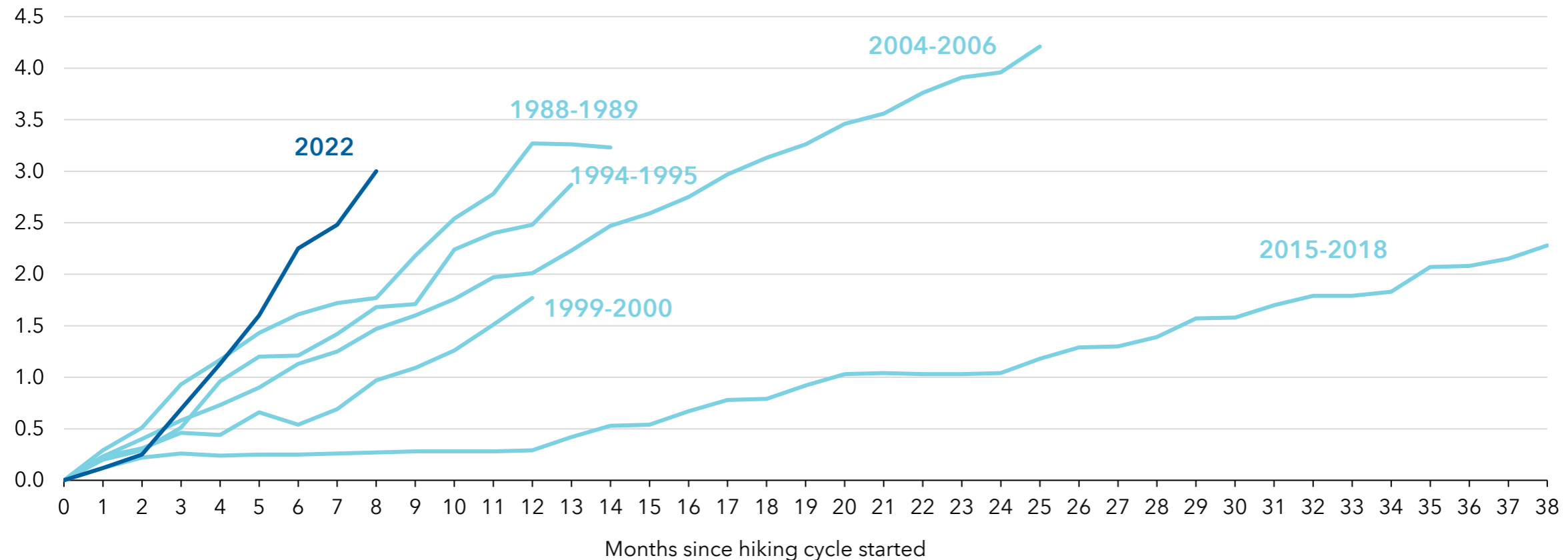
- Cost of goods sold understated, especially if Historical Cost Accounting is used
- Depreciation understated

## **Effects**

- Overstated earnings leads to higher cash taxes
- Negative impact on free cash flow

# We've just witnessed one of the steepest rate hikes in recent history

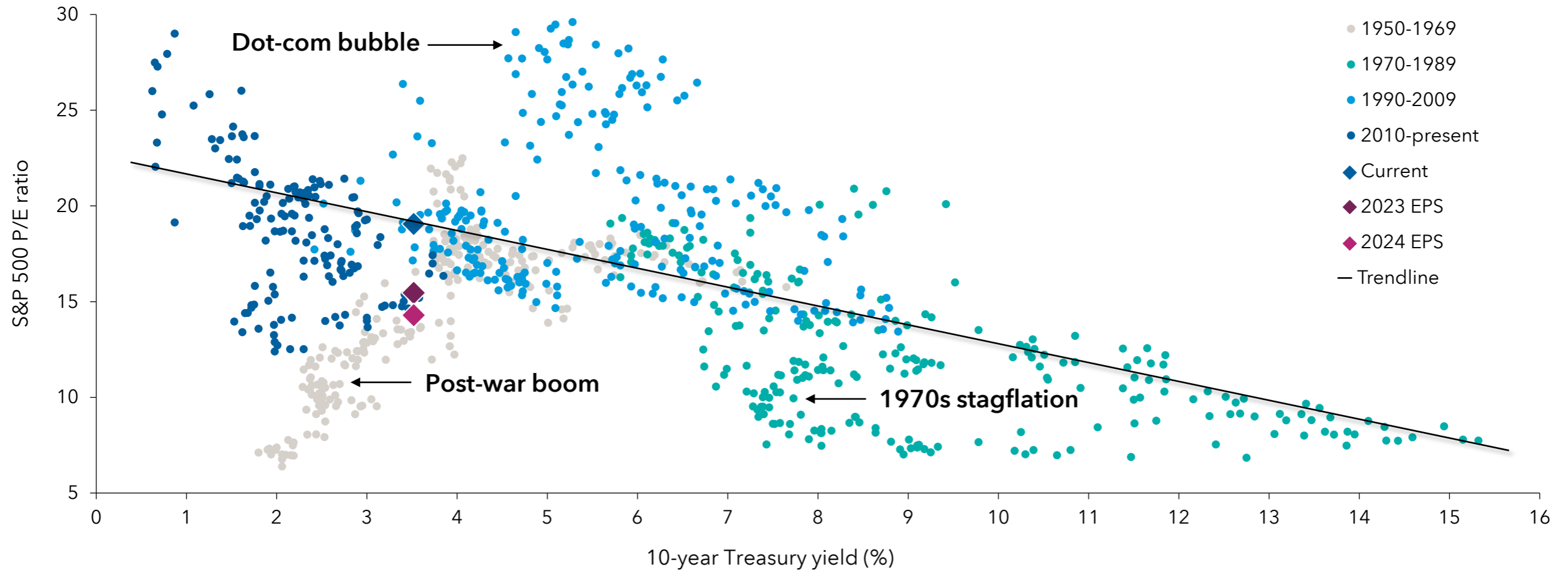
Cumulative percentage point increase in Effective Fed Funds rate



Data from 29 February 1988 to 31 October 2022. Sources: Federal Reserve Bank of St. Louis, Forbes. Fed: US Federal Reserve.

# What levels of interest rates might be problematic?

Interest rates have been supportive of equity valuations



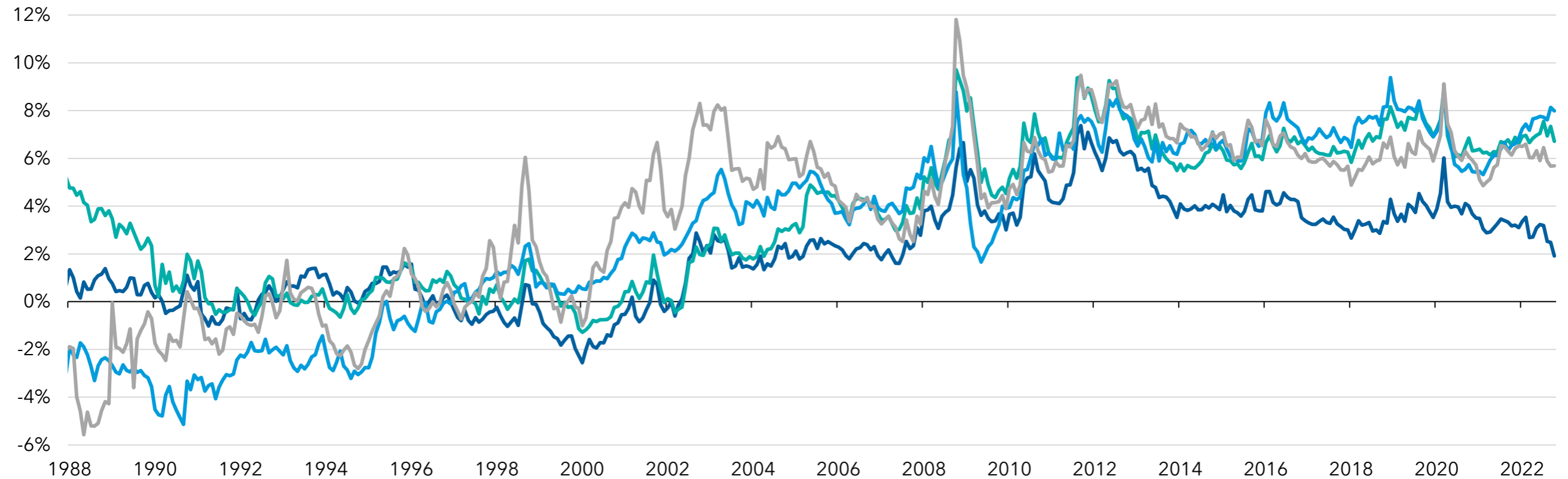
**Past results are not a guarantee of future results.**

As at 30 September 2022. Dots represent monthly data from 1 January 1950 to 30 September 2022. Sources: Capital Group, US Federal Reserve, S&P Dow Jones Indices LLC, IBES. P/E: price-to-earnings.

# Equity risk premia by region

## Equity risk premia

— United States — Europe — Japan — Emerging Markets

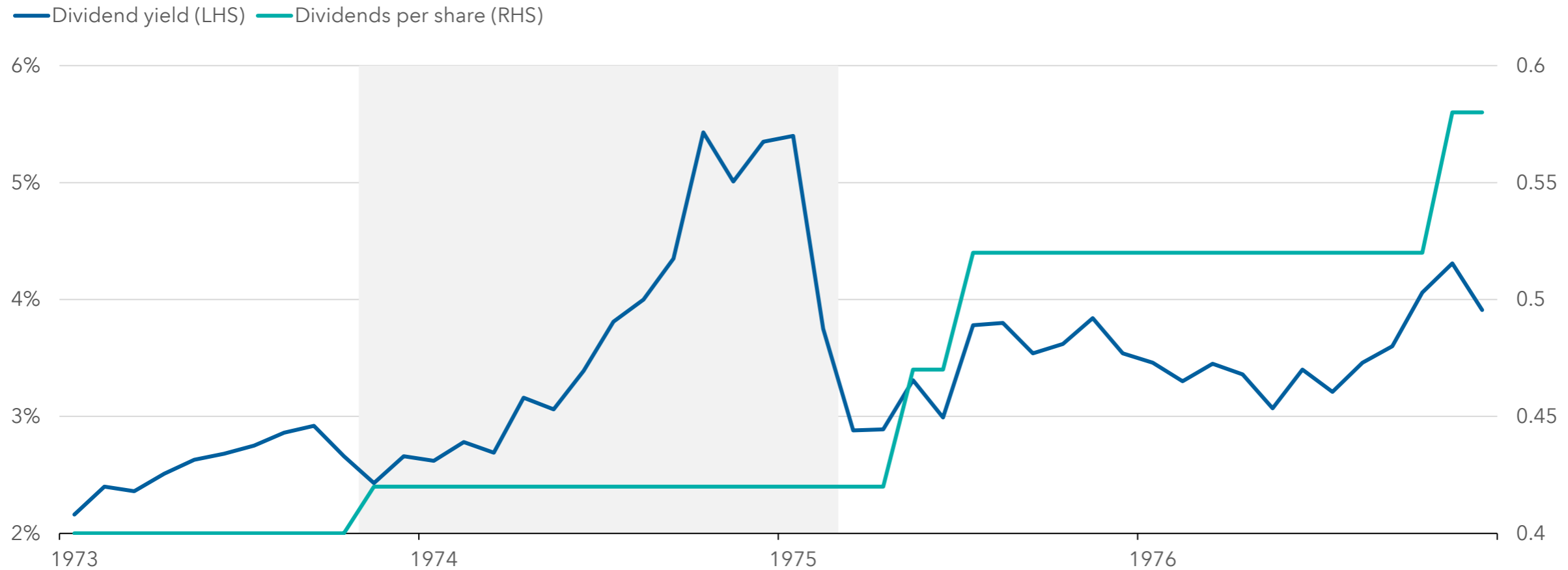


**Past results are not a guarantee of future results.**

Data from 31 January 1987 to 31 October 2022, based on S&P 500 index, MSCI Europe index, MSCI Japan index, and MSCI Emerging Markets index. Source: Datastream

# The 'Doomsday Machine'

## Glaxo SmithKline dividend yield and DPS

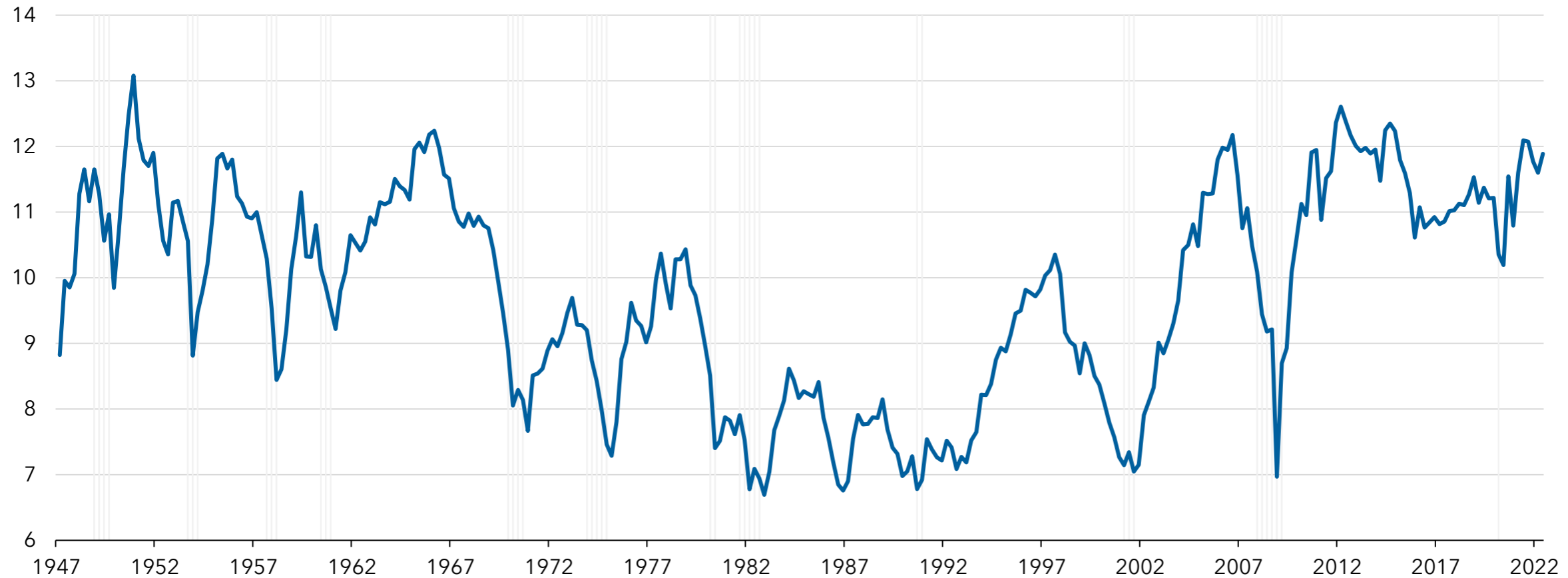


**Past results are not a guarantee of future results.**

Data from 1 January 1973 to 31 December 1976 in USD terms. DPS: dividends per share. Source: Datastream

# Longer term, however, equities are a great hedge against inflation. But why?

US corporate profits as a % of GDP

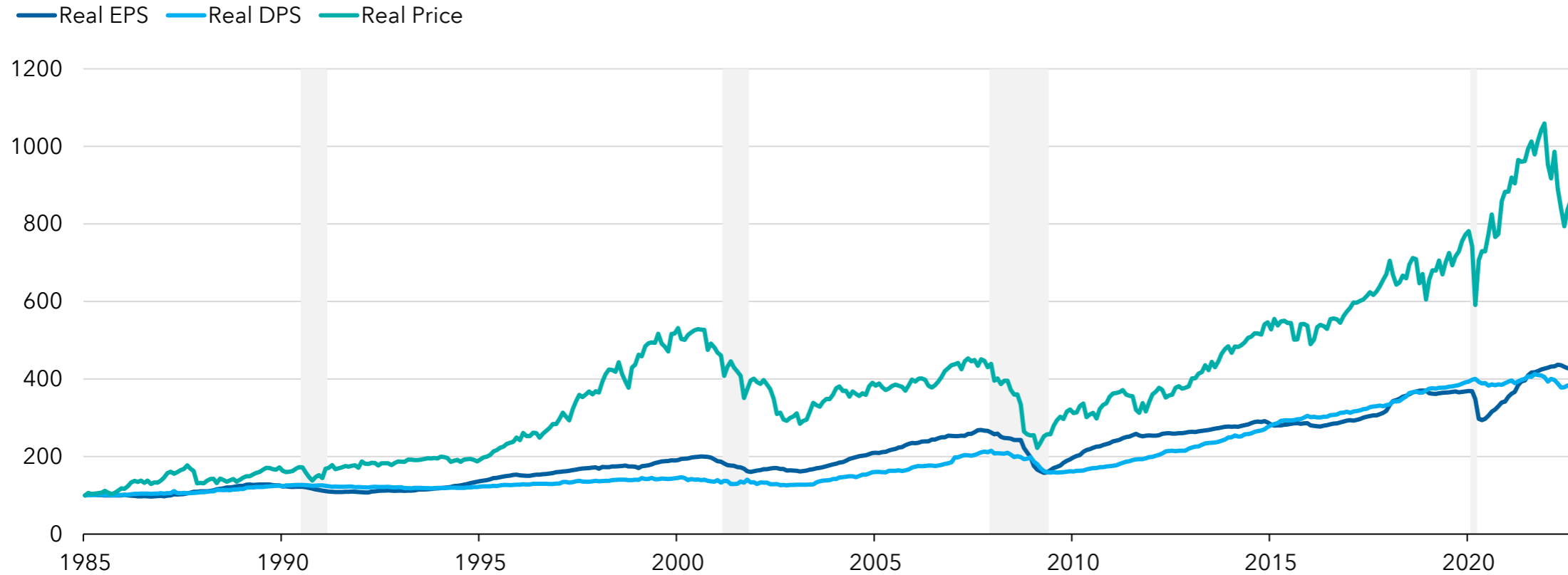


Data from 1 January 1947 to 30 June 2022. GDP: gross domestic product. Source: Datastream



# So, earnings + dividends beat inflation

US equity real earnings, dividends and equity prices (indexed to 1985)

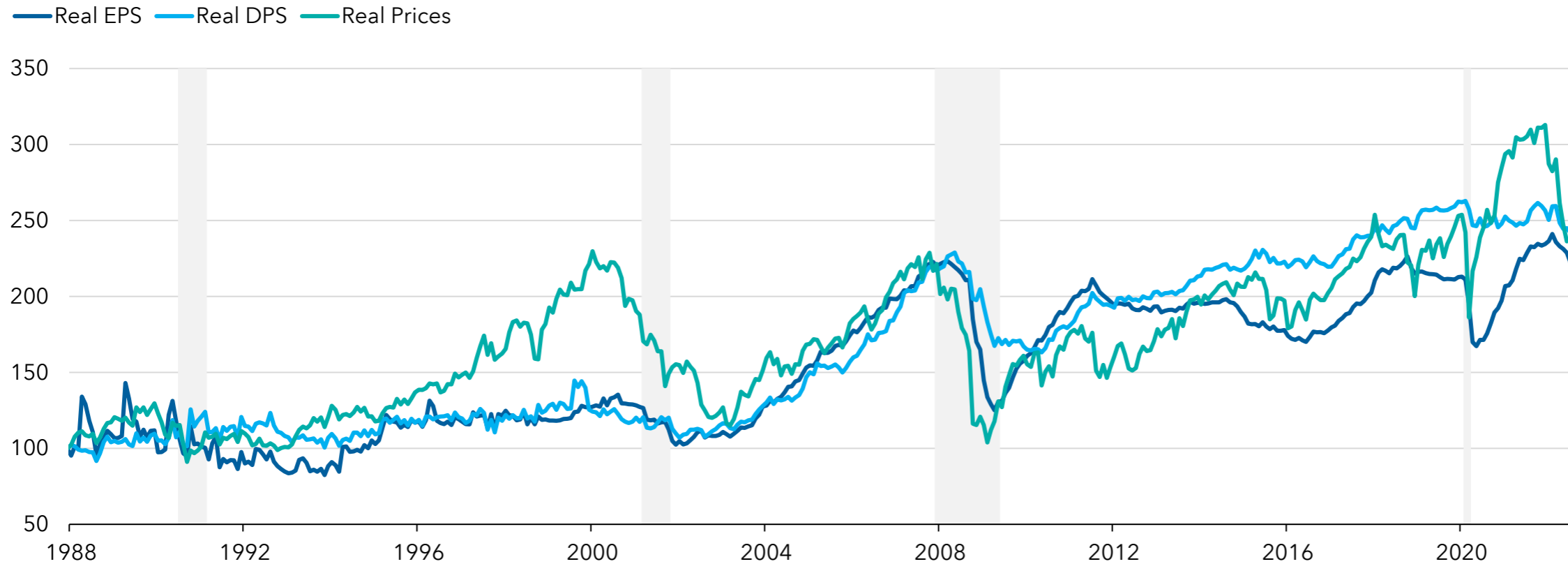


**Past results are not a guarantee of future results.**

Data from 31 January 1985 to 30 September 2022, based on the S&P 500 index in USD terms. Real EPS (earnings per share), based on IBES forward 12-month estimates, and DPS (dividends per share) adjusted for US CPI. Source: Datastream

# ...and it's truly global too

## Global real earnings, dividends and equity prices (indexed to 1988)



**Past results are not a guarantee of future results.**

Data from 31 January 1985 to 30 September 2022, based on the MSCI ACWI index in USD terms. Real EPS (earnings per share), based on IBES forward 12-month estimates, and DPS (dividends per share) adjusted for US CPI. Source: Datastream

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# Market outlook

- We are living through a pivotal time marked by geopolitical realignment and the end of a 40-year period of declining interest rates.
- It is likely that new equity market leadership will form over the next cycle ...
- ... but it does not mean 'growth investing' is dead.
- Corporate earnings likely to be a bigger driver of equity markets going forwards - a welcome return to fundamentals.
- Equity markets could be less one-dimensional and not driven by a small set of stocks, or growth vs. value, or US vs. non-US.
- Some regions may experience 'healthy recessions' while others could suffer bigger contractions driven by negative supply shocks.

**Past results are not a guarantee of future results.**

As at 30 June 2022. PMs: portfolio managers.

# Market leaders before and after bear markets are rarely the same

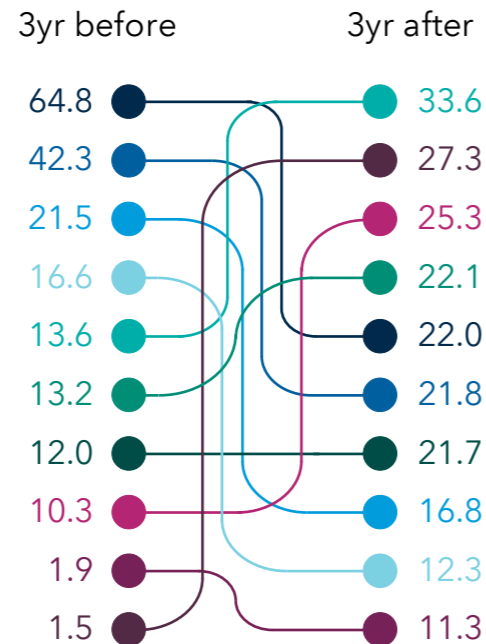
## MSCI World returns - 3 years before and after bear markets

### Bear market

### Tech bubble bursting

31 Mar 2000 to 30 Sep 2002

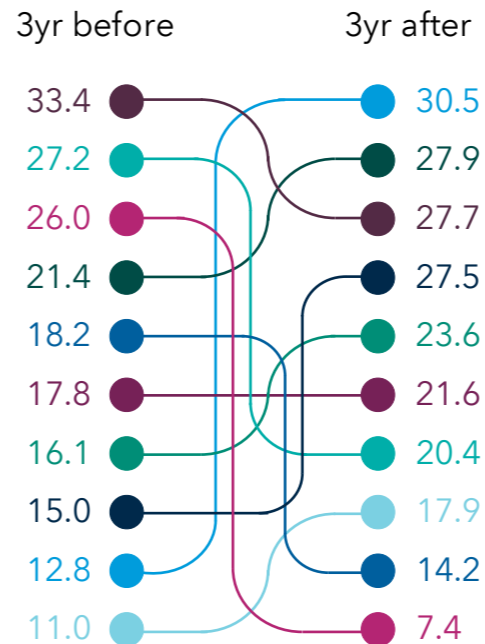
Returns (% p.a.)



### Global financial crisis

31 Oct 2007 to 28 Feb 2009

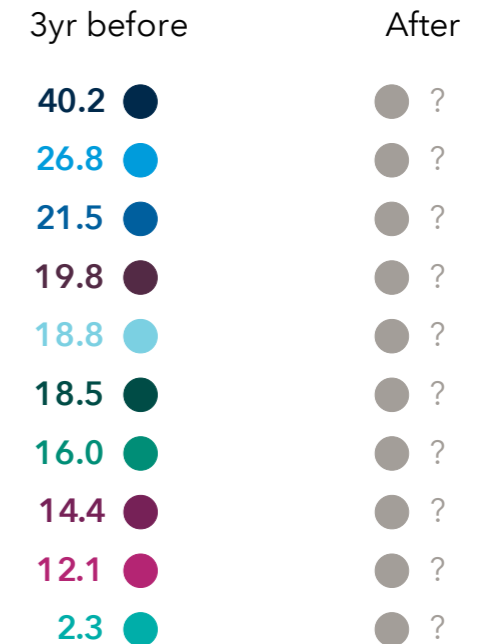
Returns (% p.a.)



### Current market

31 Dec 2021 to ?

Returns (% p.a.)



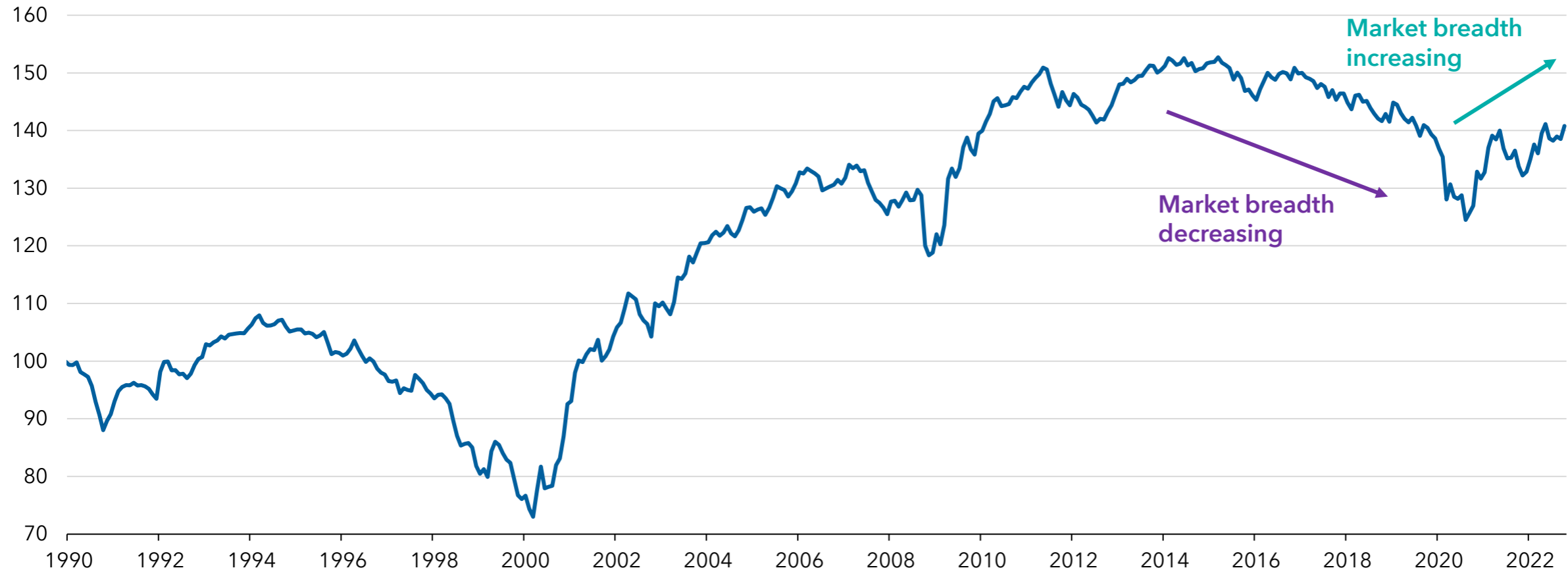
### Past results are not a guarantee of future results.

As at 30 September 2022. Annualised returns shown are in the three years prior to and after the bear market period shown. Based on MSCI World index in US\$ terms with net dividends reinvested.

Sources: Capital Group, MSCI

# Market leaders are becoming less concentrated

Ratio of S&P 500 Equal-Weighted index to S&P 500 index



**Past results are not a guarantee of future results.**

Data from 31 December 1989 to 31 October 2022. Based on S&P 500 total return index in USD terms. Source: Datastream.

# In a higher inflation environment, which types of companies might be on the shopping list?

## **Types of equities to consider:**

- Dividend growers
- Quality
- Small/mid caps

## **Some themes:**

- Energy transition (which includes some metals)
- Infrastructure & building efficiency
- Confluence of personalised medicine, big data & AI
- Pricing power (not low margins or high leverage)

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# A new market environment presents new opportunities



Companies engaged in the accelerated energy transition and electrification of the power grid



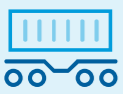
Beneficiaries of the changing nature of globalisation and supply-chain reconfiguration



Increasing emphasis on efficiency and automation of buildings and infrastructure



Increasing confidence in the ability of selected pharmaceutical companies' drug pipelines



Beneficiaries of improved long-term supply and demand characteristics in commodities



Companies with strong pricing power in the context of higher underlying labour/input costs

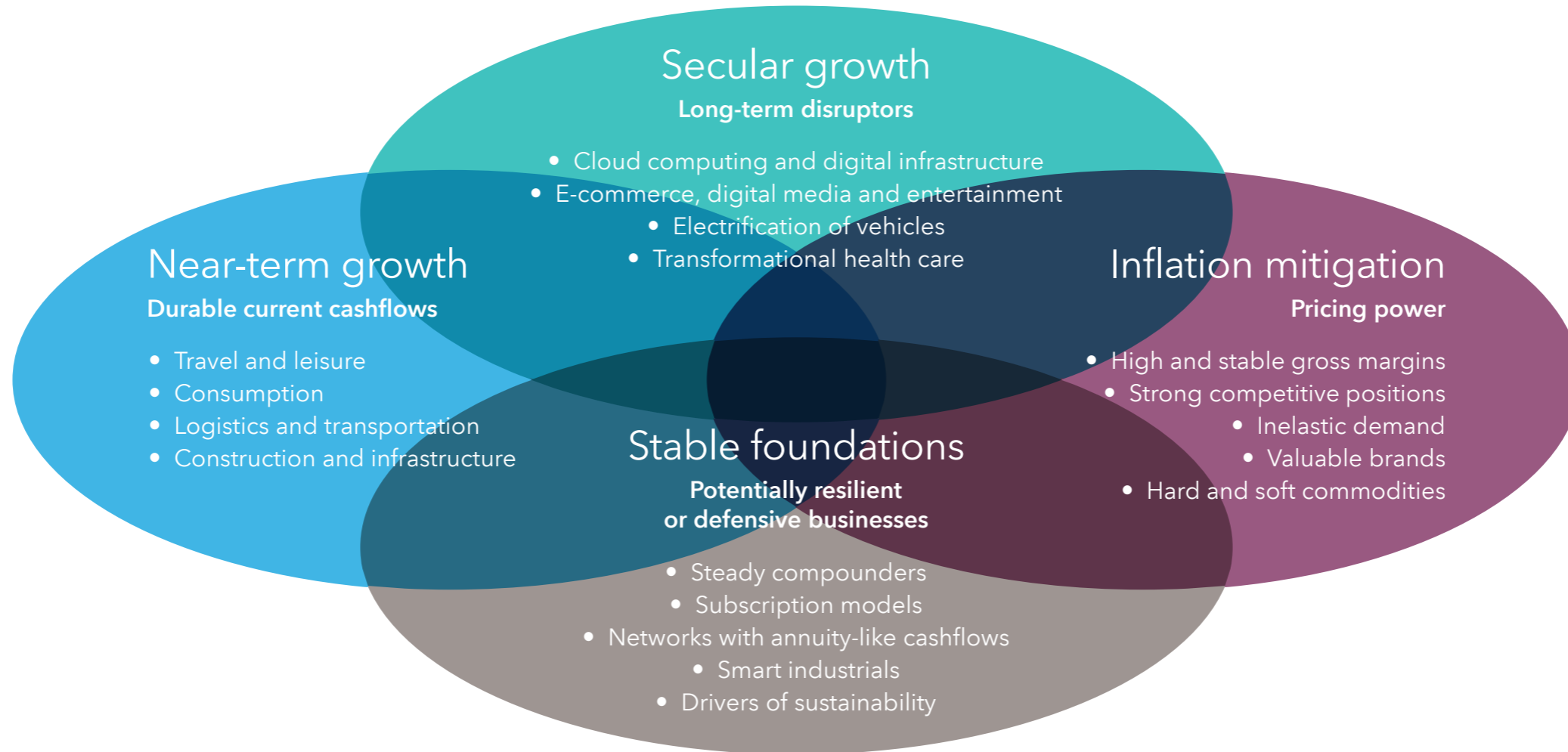


Growth companies with profits and cashflows today supporting long-term valuations



Companies with potentially durable and resilient earnings in a slower growth environment

# Seeking to capture long-term opportunities with a truly diverse approach



As at 30 September 2022.

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