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JH Explorer in Japan: sustainability and digitalisation

Japan is renowned for its rich history, idyllic landscape and one-of-a-kind inventions. Aaron Scully, Global Sustainable Equities Portfolio Manager at Janus Henderson Investors, took a trip to Japan to learn more about the companies that operate there as well as its economic and political climate. These were his key findings.

1. Sustainability is becoming ubiquitous

The idea of sustainability is not new to Japan; the ancient concept of “Mottainai” – to respect and not waste resources – has sustainability embedded into Japanese culture. According to the UN’s Sustainable Development Report Japan ranks 19th out of 193 Member States in terms of its progress towards achieving the Sustainable Development Goals, putting it among the top countries in Asia with regards to sustainability. Indeed, Japan has become a leader in championing sustainability efforts in Asia with many of its policies and initiatives in line with the 2030 Agenda for Sustainable Development.

It should perhaps have been no surprise then to be greeted by a billboard promoting sustainable innovation at Tokyo’s Haneda Airport and to come across an advert for Climate Group’s EP100 initiative on a TV in the back of a taxi. In my short time there it became clear that sustainability is a key focus for Japanese policy.

2. Japanese companies are finding it increasingly more difficult to find workers

Japan has the highest proportion of elderly citizens of any country in the world, which puts a great deal of pressure on its labor force. This reality has been exacerbated by the measures imposed at the onset of the COVID pandemic, which saw a decrease in foreign workers and a smaller portion of the labor force return to work after restrictions were lifted. Difficulty finding workers was a common theme in the company meetings that I attended, with many management teams expressing that this could limit their ability to grow over the medium and long term.

Digitalisation can offer a solution to labour shortages in many cases by filling critical but often mundane roles. Doing so enables companies to

realise efficiencies and creates space for more meaningful roles that are more appealing to workers. But while this may be a good solution, the Japanese economy is currently behind the curve when it comes to digitalisation relative to the rest of the Western world.

The good news for investors is that companies which offer automation and business solution services are well placed to benefit from this theme as the need for digitalisation increases. These businesses could include tools which support business operations such as TechnoPro, a technology-focused staffing and services company, or cloud computing tools such as those provided by Rakus, a cloud services provider for small and medium-sized enterprises (SMEs). Digitalisation also allows for companies to utilize data-driven insights to better understand customers, identify inefficiencies and improve existing functions, which should ultimately provide benefits for all stakeholders.

3. Japanese companies are moving operations away from China

It became apparent upon meeting many Japanese companies that they are becoming more aggressive in their intentions to decouple from China. This was evident in the fact that some of the companies that I met with are choosing to

build manufacturing capacity outside of China and ensuring that critical technology is far from Chinese shores. While the extent of any threat that China poses to Japan is up for debate, these actions clearly signal plans to take back control of strategically important industries and operations.

It should be noted that Japan is not alone in these efforts. Companies across Europe and North America have begun reshoring operations and supply chains as the weaknesses associated with globalisation have become a reality over the past two years. Interestingly, we have seen many developed world policymakers put sustainability at the core of policies intended to rebuild a sustainable and digital economy. In a policy speech by Japanese Prime Minister Fumio Kishida, the intended post-COVID growth strategy “will work to resolve social issues, including digitalisation, climate change, economic security and science, technology and innovation”.

As the sun sets over an era of globalisation, we expect that the new environment – where economic security goes hand in hand with digitalisation and sustainability – will offer plenty of opportunities for investors globally.

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FANG bite back – but will they lose their edge?

TAM Europe Asset Management explores the question.

Unlike humans, almost all snakes with fangs can regrow these when they get damaged or knocked out. In 2023, this innocuous example of reptilian Darwinism is apparently now shared with the S&P 500.

After a shocking 2022 for growth stocks, the first quarter of this year will go down as one of the most potent rallies in the history of growth investing, particularly for the small clutch of mega cap stocks known as FANG. Much like snakes, the S&P 500 has managed to regrow these potent growth stocks back into the spotlight this year. But how has this happened?

Let us take a look at the numbers. By subtracting the performance of tech stocks from the S&P 500’s overall performance, we can see the index is up 3.5% in Q1 2023 – not bad all things considered.

However, if you were to carve out FANG stocks alone – Facebook (Meta), Amazon, Netflix and Google – you will find they are up 35%, producing x10 returns on the index in just three months. This is more akin to a casino than a stock market.

The impact for those who manage diversified portfolios has been that, even if you had allocated a reasonable amount to US equities in 2023, you would still have underperformed if you were not overweight to these specific stocks. Therefore, as we prepare for a potential recession, the market’s takeaway from this rally is: “big is best” – or so that is the story doing the rounds.

Fanning the flames

The recent banking panic in the US and Europe has done little to halt the rally – if anything, it only added fuel to the flames. The resulting market narrative was that, in order to prevent a total disaster hitting from the US financial system, central banks were likely to cut rates before the end of the year. As one might expect, this triggered the massive buying of growth stocks.

In my opinion, if the banking crisis was caused by high interest rates, then they would be cut. However, if these failures were due to poor investment decisions by the directors of these banks, it is likely that central bankers remain unfazed – not wanting to address a banking issue that does not affect the wider economy.

This casts doubt on the narrative that rates will be coming down by the end of the year. While there are clearly opportunities for active

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2023: Navigating volatility in uncertain times

With Will Bartleet, Chief Investment Officer, Pacific Asset Management.



Introduction: Calm markets amidst turmoil

Headlines of bank failures hardly seem like the backdrop to calm markets, and yet the first quarter scorecard for 2023 shows both bonds and equities were positive. Under the surface, things are not quite what they seem: the issues with the banking sector are unlikely to spiral out of control in the short term but are likely to weigh on growth in the long term. And whilst major equity indices have been rising, some of the more economically sensitive areas of the market, such as small companies and cyclical sectors, haven't participated in the rally, suggesting a less bullish picture. Macroeconomic data also appears inconsistent, with stronger data for US retail sales and progress on inflation conflicting with weakening hiring intentions and lower new orders confidence for smaller businesses.

The liquidity crunch and banking sector woes

"The key narrative for the first quarter was the liquidity crunch which emerged within the banking sector," says Will Bartleet. The failure of Silicon Valley Bank (SVB) and Signature Bank in the US triggered concerns among depositors and shook confidence globally. SVB's unique set of risk management failures, including a concentrated base of depositors and lack of interest risk hedging, led to its downfall and prompted deposit flight from perceived weak banks.

Regulators swiftly intervened, assuring depositors and implementing a bank term funding program to ensure liquidity for banks facing similar asset problems. However, the long-term consequences of the banking liquidity crisis are likely to hinder credit availability, as banks become less willing to make loans to different parts of the economy.

Conclusion: navigating uncertain waters

In conclusion, despite the relatively calm market conditions during the first quarter, concerns arise regarding the long-term credit provision by banks. This potential lowering of growth trajectory could impact major economies, including the US. Bartleet emphasizes the importance of positioning portfolios across diversified asset classes and strategies to cushion potential equity market downturns.

"Economic slowdowns also tend to present long-term opportunities, which we aim to capitalize on," states Bartleet. Trades such as TIPS and curve steepeners offer positive performance potential with limited correlation to equity markets.

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Implications for the global economy

"While the failure of smaller banks may not matter in isolation, the cumulative impact of their lending is not to be understated," warns Bartleet. Smaller banks in the US provide a significant portion of commercial and industrial lending, commercial real estate lending, and residential real estate lending. The decrease in loan provisions is expected to hit GDP and increase the likelihood of a global recession.

Portfolio positioning: a defensive stance

Given the evolving market conditions, portfolio positioning has shifted towards a more defensive stance. "While remaining underweight fixed income and avoiding exposure to the riskiest areas of credit markets, the focus has shifted to inflation-linked bonds in both the US and the UK," Bartleet explains. These bonds offer protection from a potential growth slowdown, as their duration component tends to rally during weak economic periods. Additionally, the inherent inflation protection they provide becomes valuable if central banks fail to rein in post-COVID inflationary pressures.

Another strategic move has been to increase positions linked to the shape of the US Treasury yield curve. The US 2-10 Curve Steeper strategy takes long positions on 2-year government bonds and short positions on US 10-year bonds, matching the duration risk of each exposure. The shape of the yield curve serves as a reliable early warning indicator for recessions, and at the end of a cycle when growth slows significantly when the curve starts to shift higher.

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managers to generate some alpha, tremors in the US financial system do not spell out the foundations for a strong market rally.

Where does the market go from here?

Despite our thinking that this market might have gotten ahead of itself, there is scope for growth stocks to be chased even higher as we continue through 2023. Why? Because recession and rates reign supreme when it comes to market volatility.

If we see all the elements of inflation coming back towards 0% and a smidgen of soft economic data, we will see people making the inevitable inference that we have achieved "immaculate disinflation", – and boost growth back into a bull market.

We already got a taste of this in 2023. The danger to jumping on this bandwagon and riding off to the races once again is that this very rosy scenario has already been priced into the market – in other words, the horse has already bolted. This is not a

call for switching into a portfolio of cheap value stocks, but it is certainly a cautionary note about doubling down on the current strength of these mega cap growth stocks.

If inflation remains sticky, central banks will want to keep rates higher for longer. This should erode the strength of this growth rally and begin degrading many businesses in the global economy which were built to survive on interest rates at sub 2% – aptly coined "zombie" companies.

The deeper risk is that, if economic weakness does come through in global economies whilst inflation remains stubbornly high, central bankers will face a dilemma – keep rates high to kill inflation or cut them to stimulate the economy as it slows, yet run the risk of inflation surging back like it did in the 1970s.

Make no mistake, the rally thus far has priced in a 2023 road map in which inflation slows steadily, with a little economic slowdown. This forms a perfect scenario for central bankers to slowly cut rates and stimulate a slowing economy without running the risk of sparking inflation. That is the playbook as it currently stands and, even as I write this, economic data is starting to pull the shine off that trade.

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