Structural Themes 2023

Sustainability
Increasing commitments to sustainability are shaping society by driving behavioural changes

Digital transformation
The impact of digital transformation on economic growth is significant

Fixing inequality
If climate change is the most pressing environmental and economic risk today, then inequality is the most pressing social concern

Rising geo-political tensions
Geo-political tensions have significant economic and social consequences

SALT
Funds Management

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Structural Themes 2023

Two years ago, as we were starting the process of building out Salt's global and diversified product range, we began by giving ourselves time to think about the world into which we were launching these products. We wanted to know not only what opportunities lay ahead, but also what challenges would need to be navigated.

That process led to the development of ten structural themes that helped inform the answer to our many questions, including which asset classes we wanted access to, which global managers thought about the future in much the same way as us and were already building solutions to fit, and what an optimal portfolio construction would look like.

Two years later, we thought it timely to review those themes, especially since the initial work was undertaken under the cloud of the global pandemic.

As you would expect given their structural nature, the themes remain much the same, though many have evolved over the last two years. Digital Transformation is now less about the shift to online shopping and work from home, and more about the opportunities and threats presented by AI. Russia's war in Ukraine means geo-political tensions have broadened from being a largely US-China issue.

The conclusions also are much the same. First and foremost, the world is a more challenging place in 2023. Heightened political tensions and rising political fragmentation have clear and obvious implication for growth, inflation, and markets.

Furthermore, the retreat of globalisation, challenging demographics and high and rising public debt levels all argue for lower growth, higher inflation, and shorter economic cycles in the period ahead. But it's not all bad news as digital transformation and the shift to more sustainable business practices, particularly in energy, provides plenty of opportunities for active investors.

Finally, we are delighted to be navigating the road ahead with two of the world's best asset managers in their respective asset classes: Morgan Stanley Investment Management as our partner for Global Equities and Bonds, and Cohen & Steers in the Real Asset classes of Global Listed Infrastructure and Property.

Bevan Graham, Economist
Greg Fleming, Head of Global Diversified Funds
July 2023

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This is seen in the global shift towards renewable and clean energy sources such as solar, wind, and hydroelectric power. Governments, businesses, and individuals are investing in sustainable energy infrastructure and technologies to reduce reliance on fossil fuels, decrease carbon emissions, and mitigate climate change.

Society is becoming more conscious of the ecological footprint associated with consumption and production patterns. There is an increased demand for eco-friendly products, ethical sourcing, and sustainable manufacturing practices. Consumers are increasingly prioritising sustainability in their purchasing decisions. They seek products and services that align with their values and contribute to a more sustainable future. Businesses are adapting by incorporating circular economy principles, reducing waste, and adopting sustainable supply chains.

Investors and financial institutions are recognising the importance of considering environmental, social, and governance (ESG) factors in investment decisions. There is a growing emphasis on investing in environmentally friendly projects and companies that demonstrate sustainable practices. This shift in investment patterns is channelling capital towards sustainable businesses, stimulating innovation, and driving economic growth in sectors aligned with sustainability goals.

Governments are enacting regulations and policies that encourage sustainable practices. These include carbon pricing mechanisms, emissions reduction targets, and incentives for renewable energy adoption. Such regulations create a level playing field, drive innovation, and provide clarity for businesses to align their strategies with sustainability objectives.

Embracing sustainability is not only necessary for addressing increasingly pressing environmental challenges but holds the key to unlocking significant economic potential. It stimulates innovation, creates new markets, fosters job creation, and enhances resilience in the face of climate change. By integrating sustainability into economic systems, societies can achieve long-term economic growth while safeguarding the planet for future generations.

Climate change and decarbonisation

The worlds efforts to replace fossil fuels with low carbon energy sources – the energy transition - is well underway. Solar and wind generation now account for over 10% of global power generation, up from effectively zero 10-years ago.

The transition is benefitting from increasing political support, regulatory changes, technological advancements, shifting consumer preferences and clear environmental benefits. As part of ongoing decarbonisation efforts, more than 70 countries globally have signed Net Zero pledges, accounting for around 76% of global emissions according to the United Nations.

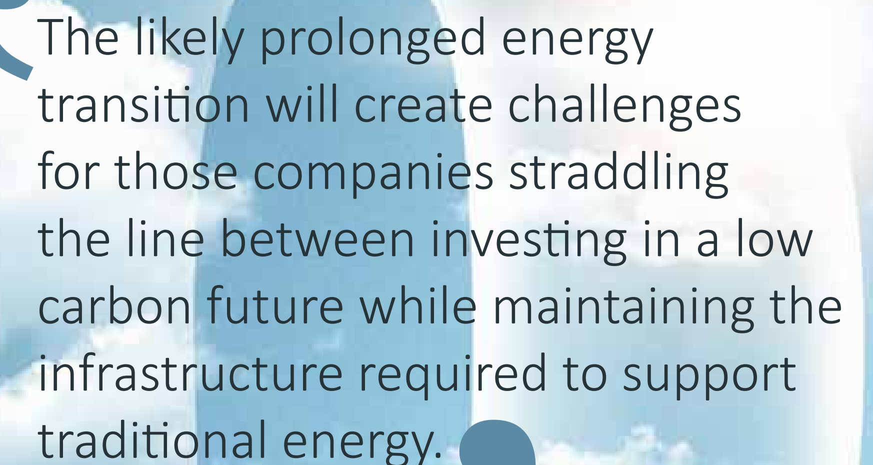
There are therefore an increasing number of infrastructure companies, particularly electric utilities, and renewable developers, that are beneficiaries of the commercial opportunities the transition offers.
The underlying manager of the Salt Sustainable Global Listed Infrastructure Fund, Cohen & Steers, believe that while good progress is being made, current ambitious timelines are unrealistic given grid-reliability and structural supply chain challenges.

This longer-than-anticipated transition will result in a longer useful life of conventional generation. Traditional energy sources such as oil and gas will continue to play a role for decades to come as a complete shift to Net Zero would be impractical for several reasons.

1. Renewable energy output is less reliable and more unpredictable. Weather patterns such as cloud cover or lack of wind impact the availability of renewables. This issue could be solved with some form of long-duration storage, but the technology is not there yet.
2. The retirement of substantial conventional power generation comes at a time of increasing energy demand from the electrification of transportation. In some areas adding one new electric vehicle is equivalent of adding two new houses to the grid. Utilities must strike a balance between decarbonisation and ensuring supply availability.
3. Metals are critical in renewable energy and battery storage construction. Reaching net zero would remove roughly 26 times more rare earth metals than we are using today. Furthermore, these scarce resources are often mined in regions that are geo-politically unstable including Russia and China.
4. Finding land appropriate for renewable energy production is challenging.
5. Politicians have generally demonstrated strong support for renewables, but that doesn't guarantee they will always act constructively. In the US we have seen the Biden administration maintain President Trump's stringent tariffs on imported solar panels.

The likely prolonged energy transition will create challenges for those companies straddling the line between investing in a low carbon future while maintaining the infrastructure required to support traditional energy. Investors therefore need to strike a delicate balance between investing for the future and appropriately valuing critical fossil-based infrastructure today.

In addition to the delayed transition, investors will also have to navigate risks and opportunities associated with climate change. Infrastructure companies will have to increase the resilience of their existing assets to extreme weather events.



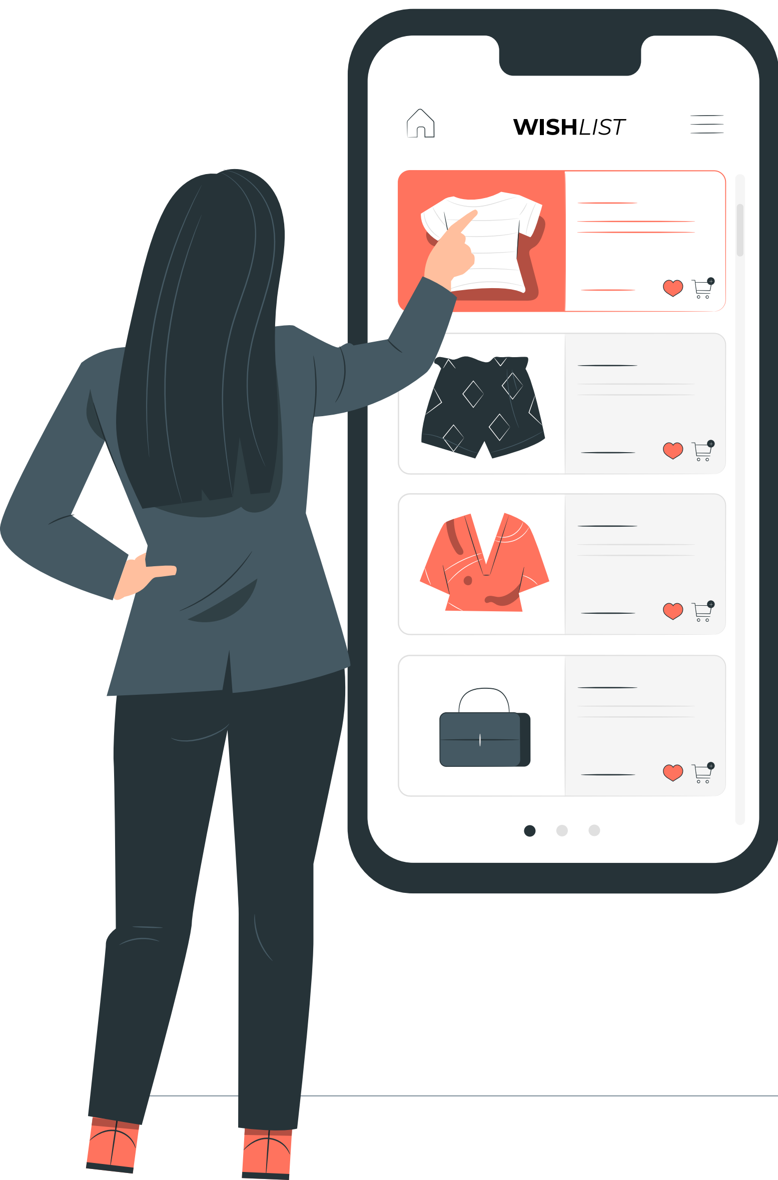
The likely prolonged energy transition will create challenges for those companies straddling the line between investing in a low carbon future while maintaining the infrastructure required to support traditional energy.

Changing consumer habits

According to the OECD, household spending accounts for an average 60% of gross domestic product around the world. Changing trends in consumer behaviours is therefore an essential consideration for the outlook of the global economy.

Furthermore, as society continues to evolve, consumers are increasingly mindful of the impact their choices have on the environment, society, and their own well-being. This has led to a notable shift in consumer preferences towards sustainability and ethical considerations.

One of the most prominent trends in consumer preferences is the growing emphasis on sustainability. People are actively looking for products and services that have a reduced carbon footprint, utilise renewable resources, and promote responsible production and consumption.

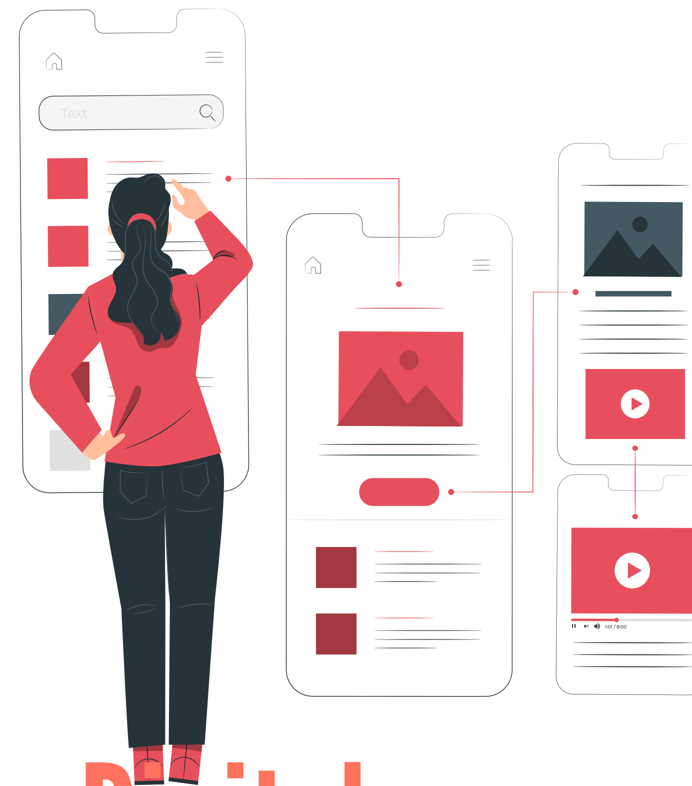


With advancements in technology, companies are able to gather vast amounts of data about consumer preferences and behaviour. This data is leveraged to offer tailored recommendations, personalised products, and customised services.

Ethical considerations are also playing a significant role in shaping consumer preferences. Consumers are now more aware of the social impact of their purchasing decisions. They are prioritising companies that exhibit ethical practices, such as fair trade, responsible sourcing, and support for social causes. Issues like labour rights, diversity and inclusion, and animal welfare are gaining increased attention, prompting consumers to choose products and services from companies that align with their values.

Consumers are actively seeking out products that align with their values and beliefs. They are making informed choices based on factors like sustainability, ethical sourcing, and social impact. This trend has given rise to a new wave of purpose-driven brands that prioritise social and environmental responsibility. Companies that can effectively communicate their values and demonstrate a genuine commitment to responsible practices are resonating strongly with this growing segment of conscious consumers.

The rise of e-commerce, mobile applications, and on-demand services has transformed the way consumers interact with businesses. Convenience has become a crucial factor influencing consumer decisions. Consumers expect seamless online shopping experiences, fast and reliable delivery services, and hassle-free customer support. Brands that can effectively leverage technology to provide convenient and efficient solutions are gaining a competitive edge.



Digital transformation

The impact of digital transformation on economic growth is significant. It drives productivity gains, enhances innovation, creates new business models and industries, and improves efficiency across sectors.

Digital technologies reduce barriers to entry, enable global trade, and enhance the competitiveness of economies. However, it is crucial to address challenges related to digital inclusion, cybersecurity, and ethical considerations to ensure that the benefits of digital transformation are shared widely and sustainably.

Digital transformation is reshaping industries and economies across the globe, with several key trends driving this transformation. Understanding these trends is essential to grasp their impact on economic growth:

1. As more individuals gain access to the internet, businesses can reach broader markets, and consumers can access a wide array of goods, services, and information. This connectivity facilitates e-commerce, remote work, and digital collaboration, boosting productivity.
2. Cloud computing enables businesses to store and process vast amounts of data efficiently. Combined with advanced data analytics, organizations can derive valuable insights and make data-driven decisions. This trend enhances operational efficiency, optimises resource allocation, and fosters innovation.
3. AI technologies are increasingly automating routine tasks and enhancing decision-making processes. Machine learning algorithms analyse large datasets to improve efficiency, accuracy, and personalisation across industries. Automation reduces costs, increases productivity, and enables businesses to focus on higher-value activities.
4. The Internet of Things (IoT) refers to the network of interconnected devices embedded with sensors and software. This technology facilitates the exchange of data and enables smart infrastructure, smart homes, and connected devices. The IoT enhances operational efficiency, enables predictive maintenance, and creates new business opportunities.
5. Digital platforms, such as e-commerce marketplaces, ride-sharing apps, and social media networks, have become integral parts of the digital economy. These platforms connect buyers and sellers, facilitate transactions, and create ecosystems that enable innovation and entrepreneurship. They foster economic growth by expanding market access, reducing transaction costs, and fostering competition.

The impact of digital transformation on economic growth is significant. It drives productivity gains, enhances innovation, creates new business models and industries, and improves efficiency across sectors. Digital technologies reduce barriers to entry, enable global trade, and enhance the competitiveness of economies. At the same time, however, it is crucial to address challenges related to digital inclusion, cybersecurity, and ethical considerations to ensure that the benefits of digital transformation are shared widely and sustainably.

Low productivity growth

Low productivity growth presents significant challenges and problems for economies and overall well-being. Low productivity growth hampers overall economic performance. When productivity fails to improve, it limits the ability of businesses to generate higher output within existing resources.

Stagnant output means stagnant wages. With limited improvements in productivity, businesses have less capacity to increase wages. This will result in reduced living standards for workers and increased pressure on politicians to fix the problem. We attribute much of the rise in political populism recently to voter frustration at the multi-decade stagnation in real (inflation adjusted) wage growth.

In a globalised world, low productivity growth puts economies at a disadvantage. Countries with higher productivity rates tend to have a competitive edge in international markets. When productivity growth lags, it becomes challenging for businesses to compete effectively, leading to a loss of market share and reduced export potential.

Slower productivity growth means lower tax revenues, making it harder to fund public services and invest in infrastructure. Governments are under increasing pressure to spend more, but public debt trajectories are already on an unsustainable trend higher.
Low productivity growth can impede innovation and technological advancement. When businesses struggle to improve productivity, they may have less incentive to invest in research and development, hindered by reduced profitability and limited resources. This stifles progress and the adoption of new technologies that could drive future growth.

There is no silver bullet to fixing low productivity growth. The solution requires getting a whole lot of little things right. Encouraging investment in research and development, promoting innovation, enhancing education and skills training are essential to boost productivity and foster sustained economic growth.

Ageing populations and rising dependency ratios

The trend towards ageing populations and rising dependency ratios is already well established amongst the older developed countries and some key emerging economies, most notably China. This will only continue, impacting economic growth, labour markets, healthcare systems, and social welfare programs.

The dependency ratio, which compares the number of non-working individuals (such as school-age children) to the working-age population, increases as the population ages. A higher dependency ratio can strain an economy's ability to meet its citizens demand for goods and services, especially when combined with low productivity growth.

Japan has often been held up as the poster child for the theory that ageing populations are deflationary. We disagree. With a smaller workforce, moribund productivity, and increased demand for skilled labour, wage pressures will rise. Employers may need to offer higher wages to attract and retain workers, especially in sectors facing labour shortages. These wage pressures will feed into generalised inflation as businesses pass on higher labour costs to consumers.

In the early stages of its ageing process, Japan benefitted from policy settings that meant China's aspirations were to be the "factory of the world", producing ever cheaper goods for the global market. China's aspirations are now quite different, focussing on common prosperity and self-sufficiency. That means China role as a major global disinflationary force is coming to an end.

Japan's low inflation problem is more a product of its wage setting environment than its age profile. With respect to fiscal policy, as the proportion of elderly individuals increases, governments face rising healthcare and pension costs.

This necessitates adjustments in taxation, retirement ages, and social security systems, especially as economic growth slows due to a shrinking workforce. This will require innovative policies to sustain public finances and support intergenerational equity.

Looking more broadly around the world there are several other factors to consider:

1. Africa is expected to experience substantial population growth, with United Nations estimates suggesting that it will be home to a significant portion of the global population by 2100. This growth poses both opportunities and challenges for the continent, including the need for increased investment in education, healthcare, and infrastructure.
2. Urbanisation is set to continue at a rapid pace. More people are expected to migrate to cities, seeking better economic opportunities and improved living standards. This trend will put pressure on urban infrastructure, housing, transportation, and environmental sustainability.
3. Climate change and environmental degradation will influence demographic trends, leading to population displacement, resource scarcity, and increased vulnerability to natural disasters. Addressing these challenges will require sustainable development practices and policies to mitigate their effects.

Rising geo-political tensions

Geo-political tensions continue to rise. Two years ago, our primary concern was ongoing tension between the United States and China as both vied for global economic and political supremacy. Since then, Russia has invaded Ukraine in a conflict that is now well into its second year. This has led to further factionalism and fragmentation.

Geo-political tensions have significant economic and social consequences. They disrupt global trade, hinder investment flows, contribute to currency volatility, impact commodity prices, undermine confidence, and hinder international cooperation. These consequences can result in reduced economic growth, job losses, higher costs for businesses, and increased uncertainty in financial markets.

When countries engage in trade wars, impose tariffs, or enact trade barriers, it creates uncertainty and hampers the flow of goods and services across borders. Trade disruptions can lead to higher prices for consumers, reduced market access for businesses, and decreased efficiency in supply chains. This, in turn, can hinder economic growth, stall job creation, and weaken the competitiveness of industries that rely on global trade.

Uncertainty and instability in the geopolitical landscape make investors cautious and reluctant to commit capital to regions or countries experiencing conflicts. Foreign direct investment (FDI) may decline, which can have detrimental effects on economic development, technological transfer, and job creation. Furthermore, investors may redirect their funds to safer havens, causing capital flight and increased volatility in financial markets.

As we have seen in the Russia/Ukraine conflict, geopolitical tensions can have spillover effects on commodity prices. Disruptions in major commodity-producing regions due to conflicts or geopolitical unrest can lead to supply shocks and increased prices. Higher commodity prices can have a domino effect on various sectors, affecting production costs, input prices, and ultimately impacting consumers through higher prices for goods and services.

Furthermore, rising geopolitical tensions can disrupt global cooperation on critical issues such as climate change, cybersecurity, or public health. Collaborative efforts among nations are essential to addressing these challenges effectively. When geopolitical tensions rise, cooperation may falter, impeding progress in finding global solutions and potentially exacerbating economic and social problems.

Globalisation in retreat

Since the end of World War II, rising trade flows has been a significant contributor to global growth, lower inflation, and the reduction of inequality *between* countries. However, it has undoubtedly contributed to greater inequality *within* countries.

The aftermath of the Global Financial Crisis saw peak dissatisfaction with stagnant real income growth in western democracies, rising inequality (both income and wealth) and poor job security.

These were all seen as the outcomes of Thatcher/Reagan-style polices that promised the trickle-down benefits of a free-market orthodoxy that embraced deregulation, privatisation, globalisation and lower taxes. For most, the promised rewards proved nothing but illusory.

Memories that no longer stretch back to the chaotic, interventionist 1970's means the obvious answer to the dissatisfaction with the status quo is regulation, nationalisation, protectionism and higher taxes.

The public policy failure is not globalisation per se. The failure has been government's inadequacy in designing and implementing education and skills development programs to assist those displaced by globalisation to find new career paths.

Nevertheless, global trade flows peaked at the time of the Global Financial Crisis in 2008 as populist politician have been delighted to capture the change in mood. From that time the trade liberalisation agenda initially stalled and then went backwards as China turned inwards, the UK voted for Brexit and the United States adopted a "Make America Great Again" agenda.

The COVID pandemic has added momentum to the reversal, reinforcing concerns that global supply chains have gone too far. Many businesses are now reassessing whether sourcing goods at a cheaper price from far away might be inferior to more expensive goods closer to home. Rising geo-political tensions are also hampering trade and investment flows.

Restrictive policies may discourage foreign direct investment (FDI) as investors become uncertain about market access and trade conditions. Reduced FDI can hinder technological transfer, limit job creation, and hamper economic development. Moreover, deglobalisation can trigger capital flight, as investors seek more favourable investment environments in other countries.

Deglobalisation will have significant economic consequences. It disrupts trade flows, hampers supply chains, reduces economies of scale, hinders investment and capital flows, and undermines international cooperation.

While there may be short-term benefits for certain sectors or industries, the long-term implications of deglobalisation can lead to reduced economic growth, higher inflation, limited market access, and increased uncertainty. Striking a balance between supporting domestic industries and promoting global economic integration is crucial for fostering sustainable and inclusive growth in a rapidly changing global landscape.

Unsustainable fiscal policy

In many countries fiscal sustainability is being challenged by already high and rising debt levels along with ever-increasing calls on Governments to meet an ever-rising list of challenges including meeting Net-Zero 2050 decarbonisation commitments, closing infrastructure deficits and building back stronger when existing infrastructure fails during extreme weather events, and closing inequality gaps.

The challenge for politicians is to meet these challenges within the constraints of maintaining prudent levels of debt and a globally competitive, growth enhancing tax system, not to mention frequent calls for tax cuts.

Making this all fit into an affordable, coherent, and sensible long-term fiscal plan is becoming increasingly difficult. Former UK Prime Minister Liz Truss found this out to her detriment. Financial markets will take a dim view of fiscal plans that simply don't add up.

Furthermore, this pressure is coming while ageing populations are already threatening the quality of healthcare provision and challenging commitments to pension entitlements.

Higher interest rates are also raising debt servicing costs as interest rates return to more sustainable levels. The days of forgivingly-low interest rates have passed, and the willingness of investors to keep financing those governments who lack credible plans to fix their fiscal problems can diminish, leading to even higher debt servicing costs as bond yields become inflated by rising country risk premia.

That was the lesson learned by many emerging markets since the 1990s, and it should not be lost on developed economies, particularly those like New Zealand, which depend on offshore capital investment flows.

It is crucial to avoid the vicious circle of higher government debt being issued and rolled over at ever-higher interest yields, as that can become a potent threat to both investment returns and to the provision of public services. As more money is allocated towards interest payments, it leaves less room for investment in other critical areas such as infrastructure, education, healthcare, and innovation. This can lead to a decline in productivity and competitiveness, hindering long-term economic growth.

The unsustainable trend of increasing public debt levels carries significant economic implications. It burdens government finances, raises borrowing costs, fuels inflation, dampens investor confidence, and exposes nations to financial vulnerabilities. Addressing this issue requires a comprehensive approach that combines prudent fiscal policies, structural reforms, and responsible debt management strategies to ensure sustainable economic growth and stability.

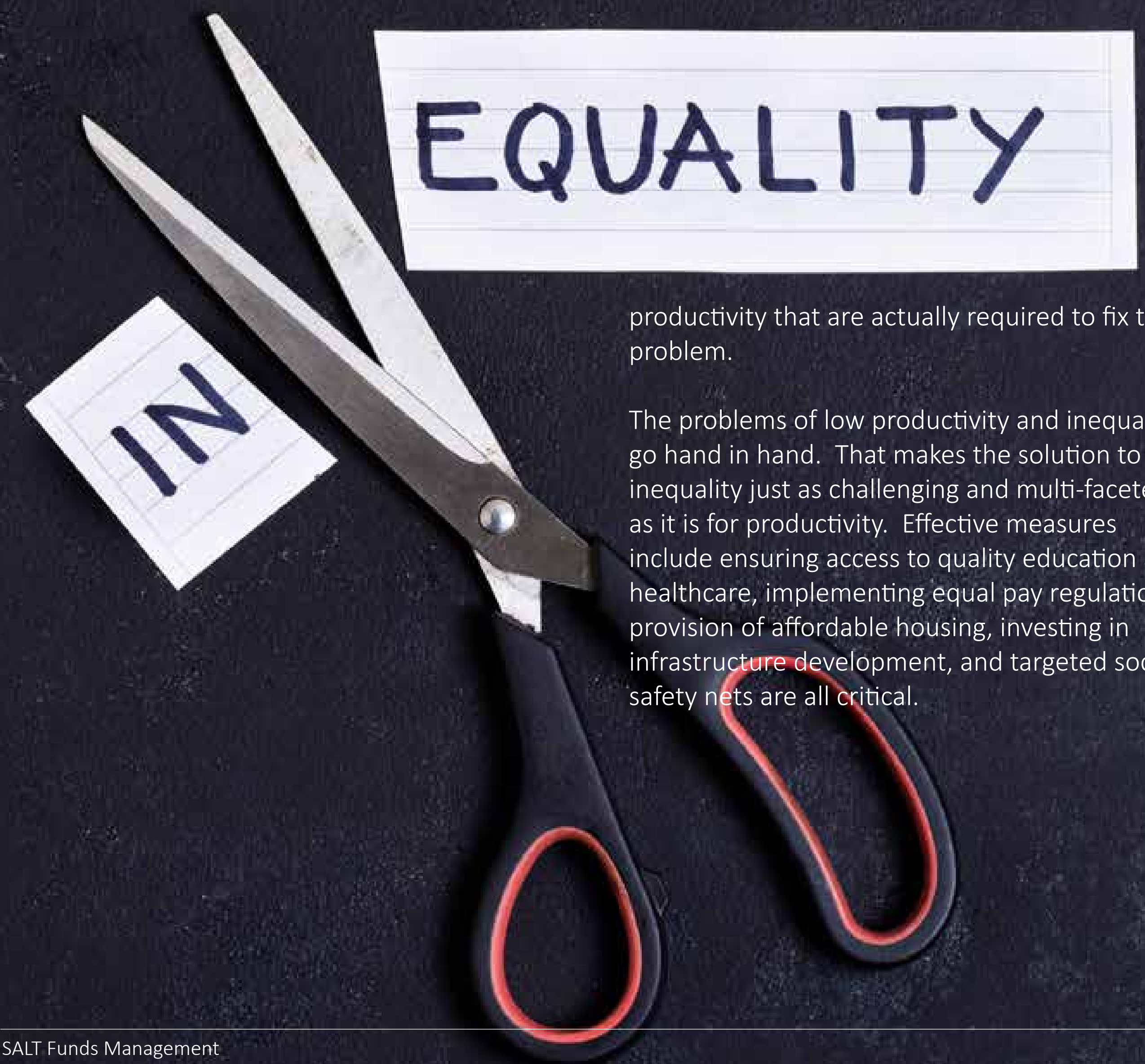
Fixing inequality

If climate change is the most pressing environmental and economic risk today, then inequality is the most pressing social concern. The consequences of rising inequality extend beyond mere social justice issues and can significantly impact the economic and political landscape.

Rising inequality hinders productivity and innovation. When a significant portion of the population lacks access to quality education, healthcare, and other resources, their potential contributions to the workforce and the economy remain underutilised. As a result, valuable talents and skills go untapped, hindering innovation, technological advancement, and overall productivity levels.

It can also fuel political unrest and instability. When a significant portion of the population feels left behind and excluded from economic opportunities, social discontent rises, leading to political polarisation and a loss of faith in the existing political system. This can manifest in the form of populist movements, social protests, and heightened political volatility, which in turn undermines policy effectiveness, investor confidence, and overall political stability.

Indeed, closing the inequality gap will lead to ongoing calls for fiscal policy intervention including more progressive tax systems and the creation of new taxes such as a wealth tax, all solutions that will hamper the economic growth and higher productivity that are actually required to fix the problem.



The problems of low productivity and inequality go hand in hand. That makes the solution to inequality just as challenging and multi-faceted as it is for productivity. Effective measures include ensuring access to quality education and healthcare, implementing equal pay regulations, provision of affordable housing, investing in infrastructure development, and targeted social safety nets are all critical.

Investment implications

The macro-economic implications of our structural themes are:

1) likely lower economic growth in the period ahead;
2) higher inflation;
3) higher interest rates;
4) shorter economic cycles than we have become used to in the post Global Financial Crisis period; and
5) greater geo-political tension.

These are all new features which need a reflection in portfolio-building. The market implications are:

1) a challenge to the sources of real returns;
2) higher costs for leveraged (debt-funded) investing;
3) rapid swings in sentiment; and
4) fast deployment of ad hoc stabilisation measures when crises do break out.

In our view, it is not enough to argue that "in the longer term, market returns will revert to their historical norms." Rather, we think some fundamental shifts have occurred, not least in the volatility level an investor needs to be comfortable with to reasonably expect a given returns target. In the years from 1980-2020, a portfolio holding 60% in equities and 40% in bonds functioned well. Equities racked up strong cumulative gains, especially when dividends are re-invested, and took care of capital growth aspirations. These capital gains were not substantially eroded by inflation, which remained well-contained.

Bonds, during that period, provided portfolio ballast by gaining value during equity market shocks or times of stress. This mix could be "dialled up" to 75% equities and 25% bonds, for investors with stronger tolerance for the volatile return patches. But, even a "Balanced" ratio of 60:40 historically delivered an annualised nominal return as at the end of 2022 of just above 6% for the decade. Many analysts looking forward ten years expect balanced returns tracking a bit lower – in the 5% to 6% annualised range, before adjusting for inflation.

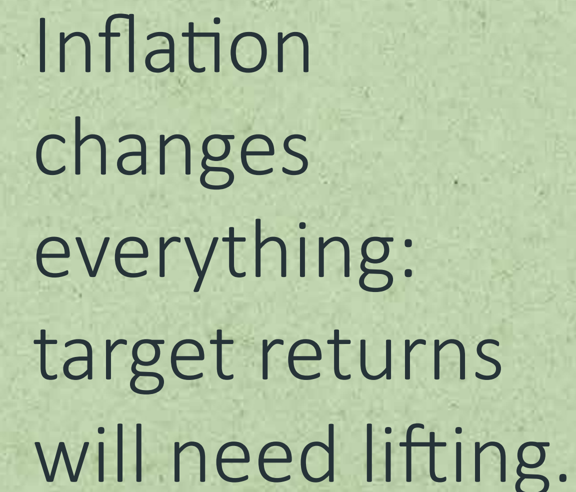
For "Growth" portfolios with 75% or more in Equities, the nominal return (conservatively estimated on a forward-looking basis) could reach 7% per annum, but after forecast inflation is deducted, that expected return would shrink to (at best) around 5% per annum, on average.

These are the four key implications for portfolio architecture:

1) Investments should be planned to perform even if inflation remains a concern;
2) A systematic process furthering sustained investment in Structural Themes is vital;
3) Volatility is an opportunity to shift investments into harder-to-find, undervalued assets; and
4) Demographics and population aging both strongly influence investment opportunities and define investors and clients' critical time horizons for wealth accumulation and draw-down phasing.

Inflation changes everything: target returns will need lifting.

Higher multi-year inflation, sustaining elevated interest rates, both suppresses and re-directs economic activity, by increasing the market cost of capital. This makes investment in new projects more problematic, as the rate of minimum



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expected return from any given investment (hurdle rate) moves up. In turn, more demanding hurdle rates for financing capital spending can act as a productivity-supressing force and thus compound the problem of low productivity growth, as discussed above.

Although that sounds grim, there are offsetting trends that may short-circuit some of the drivers of a low productivity, high-cost economic trap. Firstly, certain forms of Information Technology innovation can kick-start productivity gains without requiring large up-front capital investment. This is partly due to the nature of the technology and partly due to the manner of its delivery.

Opportunities from convergence points of Medical Care, IT and Artificial Intelligence

Our identification of this clustering of future Structural Trends around a given investable entity or sector leads to Salt portfolio toward holdings that embody the drivers of future need and demand. For instance, we have identified medical technology companies which embrace new digital technologies for treatment, monitoring, medication management and diagnostics.

Such firms even deploy Augmented Reality technologies for demonstration, training and engagement with clients. The Software as a Service (SaaS) subscription revenue sub-theme thus even affects the specialised field of clinical care technology. In the bigger picture, this can help relieve overburdened public social services funders (especially when coupled with better-targeted insurance provision, another crucial and investable global trend.)

It is well-known that rising health care costs have contributed upward pressure on Developed Market inflation, beginning well before the Covid pandemic. Because Health Care is a complex sector with medical devices and services companies distinct from pharmaceuticals and biotech enterprises, careful active stock selection is required. Well-chosen Health firms often display more robust earnings pathways.

A concrete example is the IT and medical device innovation driving digital health care delivery and thereby boosting efficiencies and productivity in the increasingly important chronic patient management parts of the global hospital and clinical services industry. Improving and streamlining medical care intersects with several Structural Trends: Digital Transformation, Aging Populations, Changing Consumer Habits and Unsustainable Fiscal Polies and even mitigating Inequality are all pertinent.

Secondly, non-inflationary growth can be boosted through the global evolution of an environmental sustainability programme. This is particularly pertinent in the energy and transportation industries. At present, volatile fossil-fuel based energy sources can impact inflation, and with geopolitical risk high, non-sustainable industries can sap resources without creating efficiency. By contrast, renewable energy and associated industries in transition will provide much greater predictability in energy costs, which helps resource allocation.

Watching for "Rates of Positive Change."

In such ways, building timely investor exposures to positive emerging trends is facilitated by keeping a close watch on companies that display a superior rate of change on the path to achieving their Environmental, Social, Governance and Sustainability goals. A good example is the Transformation imperative in utilities enterprises. The key drivers of improvement and corporate "self-transformation" here include adoption of renewable energy, energy storage and green hydrogen tech and supporting carbon capture and storage.

In healthcare, positive change markers can be seen in practices minimising waste and polluting by-products or in developing more collaborative socially-beneficial management styles – whether in new pharma research or care pathway transformation. These improvements may progress fitfully at times, but they will not reverse direction.

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Structural Trends also affect the sources of portfolio risk.

As well as opening up new sources of investment returns, the trends discussed also have many implications for the other side of portfolio management: keeping overall risk in check. Risk to an investor's portfolio can arise from losing purchasing power due to inflation, permanently losing accumulated investment gains due to corporate malfeasance or errors of judgment or suffering curtailed choices in retirement due to a mismatch between the investor's individual needs and the timing of the payback from a particular investment holding. Such dangers are presently elevated and all the dimensions of risk, not just security price volatility, should be considered going forward this decade.

More volatility means more cycles, providing greater opportunity to add value through more frequent sector and factor rotation. The length of each stage of the economic cycle is not fixed, and recent cycles have been shorter than in the past. At the same time, associated market pricing trends have also changed. Long, smooth rising (or falling) asset price phases are less frequent, while choppy range trading and amplified bursts of optimism or pessimism are now a major market feature that requires recognition. There are now too frequent reversals of investor confidence (probably amplified by pervasive social media) to rely wholly on allowing risk statistics to form acceptable averages over multi-year periods. Rather, managers need to balance adequate commitment to longer-term asset class dynamics with the "jumpiness" of large numbers of short-term traders- whether human of computerised- who can cause sharp price reversals that at times obscure robust underlying trends.

A more challenging and volatile economic environment argues for greater active management.

The volatility of most markets has risen in recent years, and previous "smoothing operations" by governments seeking to buttress sentiment may not be easily repeatable. This means that an active approach to scrutinising risks and judging their severity and whether they are transitory or permanent is ever more important.

The future likely holds a more challenging environment for equities and bonds alike, but one ripe for active investors. Some equity sectors will perform better than others at different points in the cycle. These turning points need to be actively identified and reflected in portfolios ahead of time, which cannot be achieved passively. Certain bond maturities will be more or less vulnerable to inflation and credit risk movements, which can erode capital over the medium-term.

Active managers can tilt the investment portfolio toward the more robust or under-valued securities and away from the more fragile or expensive ones. In 2022, for example, we kept bond exposure to a minimum, but lifted it in our diversified funds at the beginning of 2023 by means of our new, Sustainability-themed Global Fixed Income fund.

A new approach, as not all bonds are alike

Now that we are more comfortable with lifting bond exposures, we have taken an innovative path. Rather than simply following the common practice of buying an index-based fixed income selection containing many thousand individual bonds (for international fixed interest) or a domestic bond vehicle containing rather too few separate securities for diversification benefits, we re-designed the bond building block of Salt portfolios and offer the solution as a stand-alone wholesale portfolio component.

Along with our investment partners at Morgan Stanley Investment Management, we have launched a fund which combines a comprehensive approach to sustainability with an active, flexible approach to fixed income investing by identifying the best ideas within the global fixed income universe. Salt's Sustainable Global Fixed Interest Opportunities Fund reduces exposure to material ESG risks through restriction screening of controversial sectors.

The Fund also tilts the portfolio in favour of the 80% strongest sustainability performers across the debt securities of corporates, by sub- sector, and of sovereigns, and contributes to positive outcomes based on key sustainability themes, with a particular focus on low carbon intensity.

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Central bank interest rate cuts are likely to remain highly problematic, with inflation elevated and activity levels not yet plunging. So, segments of the non-Sovereign fixed income market are better-suited to immediate economic conditions and have different drivers of their total returns to government debt securities'. The bond selection in our new fund aligns with Structural Themes and introduces a clean method for providing local investors access to specialised and sustainable areas of the Fixed Income universe.

Sovereign (government) bonds have traditionally been a go-to refuge for investors in periods of market disruption, but these securities will continue to be challenged by higher inflation and rising debt levels.

This means that investors need to look further than Sovereign debt to offset equity risks or to diversify their funds in a way that helps lift the investment returns received for bearing a higher level of volatility. Timely exposure to a well-diversified credit, securitised and agency-linked portfolio in addition to Sovereigns can be expanded or contracted as the cycle permits, as well as building up an exposure to "green" and sustainability-aligned bonds to capture the benefits of the transition to a greener planet. This transition will need to continue for some decades more, and therefore the bonds issued to finance the huge changes underway in many aspects of industry, transport, energy, and consumption are becoming long-term income investments of a type not previously accessible.

Real asset classes remain effective medium-term inflation hedges.

More broadly, portfolios are expected to benefit from increased exposures to asset classes that will perform well during periods of low growth and higher inflation, including global listed property and global listed infrastructure. These assets tend to earn fairly predictable cashflows over a known investment horizon, whether measured in quarters or years. They have high sensitivity to interest rate levels, but over timeframes greater than five years, their performance tends to be more driven by fundamental structural trends in the global and local economy.

The continuing rise of East Asian consumers, India's emergence as a more business-friendly market, the city-building happening through the forward-looking states in the Middle East, and even reconstruction and "building back better" plans in regions affected by war or climate disasters all show the intersections of these Structural Trends with new or rapidly-evolving investment opportunities. However, geopolitical risks taken when directly investing into Emerging Market securities have to be weighed very carefully.

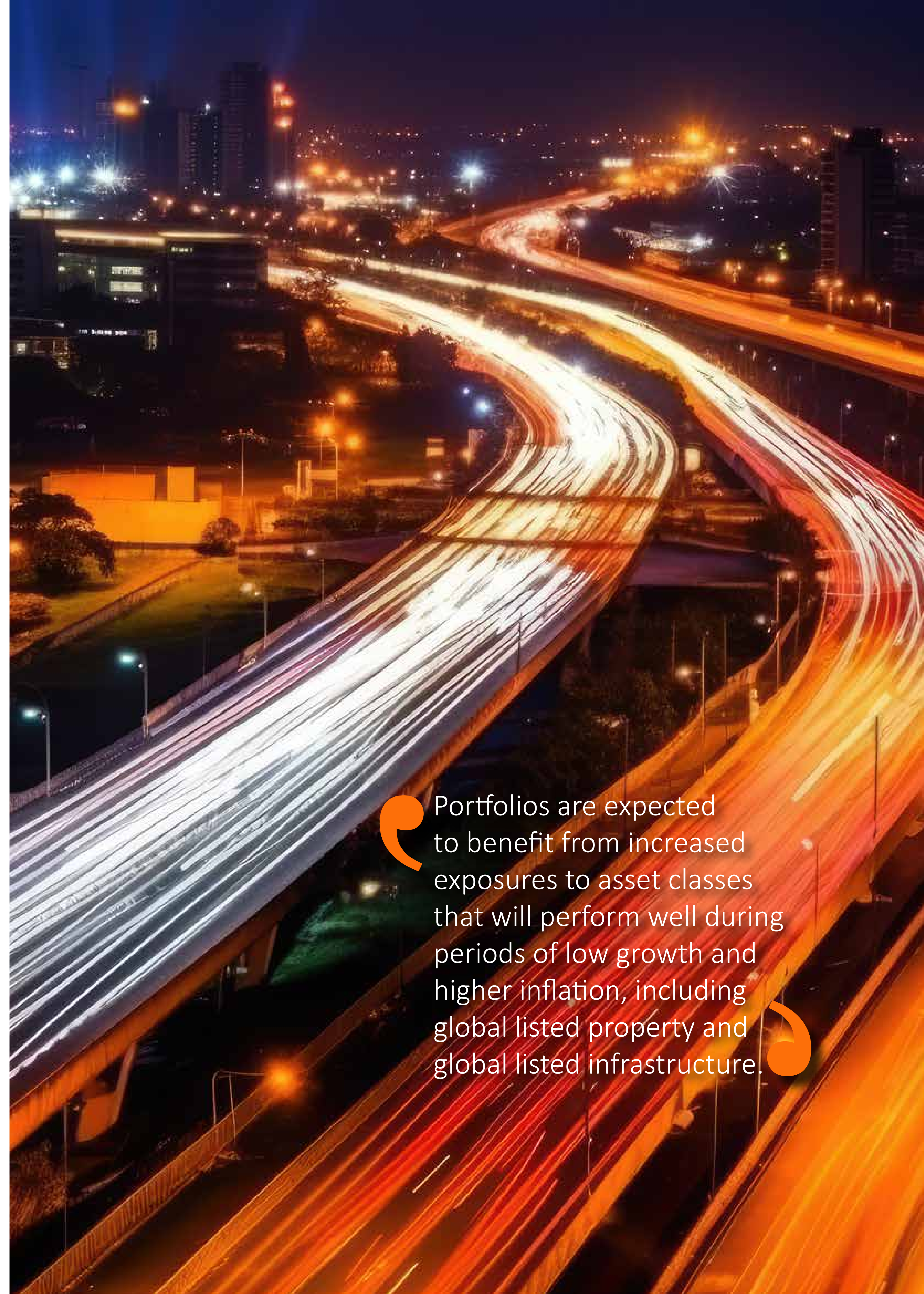
Adapting to a new investment era

While many of the Structural Trends may appear worrying or disorienting, the best response is never to bury one's head in the statistical sands or to deny that they are underway. Rather, it is to engage with all available information and to sift through the emerging opportunity sets with elevated diligence and constructiveness. All historical periods have eventually seen "structural breaks," as technologies and demographics force societies past critical tipping points. Our current period in history sees environmental forces adding to the pressure for societal and economic adaptation.

An investment manager who constructs portfolios with these perspectives at the core of their decision-making can potentially achieve a great deal on behalf of their clients. At Salt, this is our commitment.

An integrated approach to Structural Themes, such as ours, is more effective than the often-observed, piece-meal approach which seizes upon investment novelties for a short while and then moves on.

Ultimately in history, and equally within investment portfolios, timely decisions often become self-sustaining. Pioneers progressively find the consensus of other investors catches up with their views when those early perceptions prove validated. That is why we consider it vital to look at these Structural Themes in detail, and to re-visit and test them and their suppositions. We look forward to posting regular further updates as our Themes continue to evolve, explaining the themes-based investment ideas and strategies in progress reports.



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