Opportunities Emerge for Long-Term Investing Amidst a Volatile and Unpredictable Market

BY: **NICK CHAMIE**

From a global pandemic to the first foreign invasion in Europe since WWII, no one could have predicted the events that have thus far defined this decade – nor foreseen the seismic impact they would have on global markets and the economy at large.

After decades of relative global stability, it appears we're entering a new era where investors can no longer rely on the past as a predictor of the future. For example, after decades of low inflation and steadily declining interest rates, deglobalization, decarbonization, and shifting policy priorities will likely generate higher and more volatile inflation – and, therefore, higher interest rates – over the next decade.

To effectively navigate these trends, investors will need to dig deep into the implications and stay open to adopting new and innovative approaches to investment management.

Outlined below are a few key trends institutional investors should consider as they make investment decisions at the asset allocation and security selection levels.

Weathering Inflation

The COVID-19 pandemic and war in Ukraine severely disrupted the global economy and jeopardized the "low for long" era – a time characterized by relatively low growth, inflation, and interest rates. Looking ahead, even once the immediate fiscal and economic aftershocks of these events subside, inflation looks set to remain elevated and become more volatile than we have been accustomed to.

As the effects of the pandemic and the war in Ukraine continue to linger, deglobalization is becoming a crucial piece to consider within the portfolio puzzle. The rise in onshoring and "friend shoring" of goods and resources is shifting production to higher-cost regions, which could contribute to inflation. Politically popular "buy domestic" policies and those aimed at building domestic industries in strategic goods, resources, and technologies add fuel to the fire, spurring companies to potentially duplicate supply chains and shift production home.

Decarbonization efforts could provide additional inflationary tailwinds through various avenues, including via the substantial infrastructure-related investments required to facilitate the net-zero transition. These projects will boost the demand for various commodities crucial to the energy transition drive while their supply remains tight. Additionally, strategies to discourage investment in, and production from, fossil fuels (eg, imposition of carbon taxes) will likely exacerbate price pressures by making such energy sources scarcer

and more expensive.

High underlying inflation could also create a dynamic where central banks frequently need to slow growth to combat unwelcomed price pressures, leading to shorter economic cycles and increased volatility.

Deglobalization, decarbonization, and governments' anticipated growing use of policy will raise the likelihood of higher interest rates and yields for years to come.

From an investment perspective, these challenges present both risks and opportunities for investment managers. For instance, higher market volatility can widen the window of opportunity to take advantage of market dislocations. We are also seeing long-term investors consider greater exposure to inflation-sensitive assets, such as inflation-linked bonds, commodities, and real assets in their asset mixes.

A Shrinking World Could Grow Your Portfolio

Increased efforts to bring industry and production closer to home may not only increase inflation, but also the opportunity set for investors.

Notably, reshoring requires significant capital expenditure as it involves developing an entire manufacturing base that is more self-sufficient across the value chain. To adequately address these needs, both public and private markets will be called upon to finance and support the required capital expenditures, including infrastructure-related investments.

After more than 20 years of under-investment across domestic industries in the west, the coming decade appears poised for an investment boom; a stark contrast to the decades of globalization where efficiency (rather than security and domestic control) of production processes and supply chains were top priority. This downshift in international economic integration can be attributed to a variety of factors, including headwinds from increasingly protectionist policies, many of which are being enacted alongside a renewed focus on domestic employment and in response to rising global tensions.

While deglobalization will have many impacts on how investors design their strategies, it will not eliminate the need to maintain – and manage – foreign exposures. For instance, China is a market that is simply too large to ignore in a truly well-diversified portfolio. Holders of Chinese and Chinese-related assets should carefully manage risks stemming from broader geopolitical developments – such as China-US relations, Taiwanese independence, and Chinese domestic human rights issues – to ensure their country exposure aligns with their beliefs and clients' goals. Focusing on highly

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liquid investments in a market like China provides investors the ability to pivot if needed amidst a potentially fluid situation.

Driving Long-Term and Risk-Adjusted Returns with Private Assets

In recent years, many long-term investors have leaned into private markets to access the greater flexibility they offer when it comes to introducing strategic, operational, and capital structure improvements that can drive superior risk-adjusted returns. In turn, the options available to finance value creation strategies in private assets have exploded, with many investors and companies turning to private market-based financing over traditional bank-based sources. The net result has been an ever-expanding pool of investment capital seeking a similarly growing set of private market opportunities.

However, mere access to private assets isn't enough. To truly benefit from private market opportunities, investors must be large enough to not only enjoy economies of scale and related cost advantages, but also the better access to potential deals and origination opportunities available to larger investors. These benefits, combined with the ability to build dedicated operational expertise in a wider array of value-enhancement strategies, improve the potential for superior returns.

As the private investment market continues to grow, investors with appropriate resources and patience will have the opportunity to increase their exposure to these investments.

A New Era of Investing

Many of the market "assumptions" that investors have taken for granted over the past few decades appear to be fading in the current environment. On the economic front, the globalization and low inflation trends have been turned on their heads. Societal priorities have also shifted, with domestic concerns relating to issues such as inequality and climate change rising on the political agenda. These foundational shifts suggest that investors may find it increasingly difficult to rely on the past as a predictor of the future, effectively ushering in a new era of investing.

For investors, effectively navigating structural changes requires an elevated level of thought leadership and a willingness to adopt dynamic and innovative approaches to investment management. A flexible research-driven investment process not only helps make sense of the global trends sweeping economies and markets, but is also critical in building resilient portfolios in a changing world. BPM

Nick Chamie
is senior managing director of total portfolio and capital markets and chief strategist at IMCO.