New Private Markets

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NEWS & ANALYSIS

Factor rising inequality into asset allocation decisions, says IMCO

Inequality is starting to be recognised more broadly by investors as an emerging area of systemic risk; it should be on institutional investors' radars, according to the large Canadian investors' latest research paper.

IMCO, which invests C$77 billion ($53.6 billion; €52.1 billion) of Canadian public money, has identified rising inequality as an accelerating global theme with ripple effects that should shape asset allocation decisions.

"Widening disparities in income and wealth have stoked discontent with the 'hands off' market-oriented philosophy that has guided social and economic policy over the past several decades," the investor wrote in the latest version of its World View report.

Rising inequality can be seen reflected in trends such as deglobalisation, rising populism in politics, the "shedding of fiscal restraint", and antitrust efforts to stem the power of corporations globally, the report states: "Taken together, these trends can significantly alter the economic and social backdrop against which investment decisions are made."

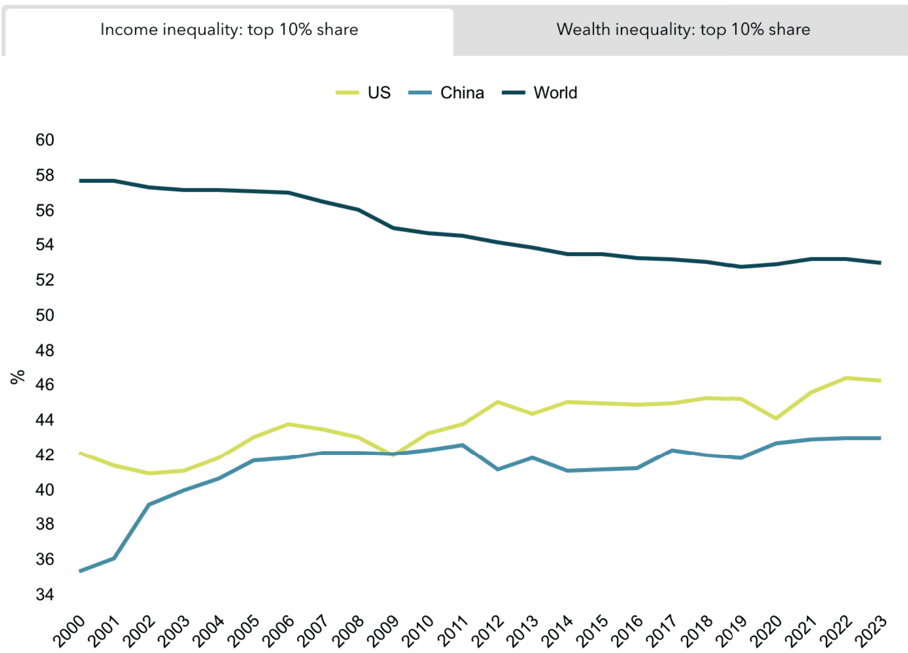
IMCO is a significant investor in private markets, with a total of 42 percent of is assets allocated to private equity, private debt, real estate and infrastructure, according to New Private Markets' data. It is a signatory to the Principles of Responsible Investment and has backed managers such as Brookfield Asset Management, Cinven and Ardian.

The investor creates its World View research to inform asset allocation decisions and to ensure the investor is exposing itself to the right tailwinds and mitigating its exposure to strong headwinds, Nick Chamie, IMCO's chief strategist and head of total portfolio and capital markets, told New Private Markets.

Data on global income and wealth inequality paints a mixed picture. More than half of global income (53.5 percent) went to the top 10 percent in 2023, according to the World Inequality Database, a resource funded by a mix of public and academic institutions. More than three quarters (77.7 percent) of the world's wealth is owned by the top 10 percent. These proportions have not changed dramatically since the turn of the

TOP HEAVY

The percentage of wealth and income captured by the top 10% of the population has increased in both China and the US, but not so across the world



Source: World Inequality Database

millennium – in fact both measures had fallen slightly. However, it is possible that the covid-19 pandemic and the resulting recession exacerbated inequality.

IMCO points to a number of factors it monitors, including available data on income and wealth disparities, rental costs vs home prices and indicators of social mobility. It also monitors second-order indicators, like protests and social attitudes to immigration. "Disparities in wealth, income and access to basic necessities are stoking societal demands for a political response to inequality-related issues," the report states.

"We feel inequality is one of the primary drivers behind deglobalisation and policy inflection," Chamie said. Waves created by accelerating inequality "are landing on the shores of other themes", like heightened volatility and unorthodox approaches to fiscal and monetary policy, he said.

Rising inequality has increased "stroke-of-the-pen risk", said Chamie, referring to unexpected and dramatic shifts in policy, often with the arrival of new government.

It has also spurred governments to rethink long-held attitudes to fiscal and monetary policy. "Orthodoxy over the last 40 years has been to keep fiscal deficits in check according to a particular rule, and then let your monetary policy be the active part of your economic management," said Chamie, "Well, that script has now been flipped. There is increasing demand for governments to ignore some of their previous fiscal orthodoxy and instead be more willing to loosen the reins, whether it be to address climate change, or domestic jobs or inequality."

When asked for an example of how the theme of accelerating inequality would flow through to asset allocation, Chamie pointed to inflationary risk: "As income inequality spurs on more demands for active fiscal policy, this can lead to more government spending, inflationary impulses. As a result, at the asset allocation level, we decided that inflation-linked bonds should be an important part of our fixed income allocation."

Wealth and income inequality is starting to be recognised more broadly by investors as an emerging area of systemic risk. It is a "great source of risk and missed opportunity" for the investment industry, said Brian Kernohan, chief sustainability officer for private markets at Manulife, speaking at New Private Market's Impact Investor Summit in 2023. "It limits productivity and innovation; it constrains consumer spending and growth; it creates political instability; and also acts a threat multiplier making other problems worse," he said.

"The private sector has for too long looked at itself as a dispassionate observer of these things," said Greg Shell, a managing partner at Goldman Sachs, last year. Shell leads the firm's Horizon Inclusive Growth Fund.

Steps are being taken to give investors more visibility over how their portfolios are exposed to inequality issues. The Taskforce on Inequality and Social-related Financial Disclosures was formally launched in 2024 to create a framework for inequality-related risks in the same way that TCFD and TNFD have for climate and nature. The initiative is supported by a broad group of organisations across the private and public sector, including the California Public Employees' Retirement System, Generation Investment Management and Manulife.

For some investors, providing solutions to the problem of increased inequality is a route to value creation. Social mobility, upskilling and financial inclusion all play an important role in mitigating inequality and have for a long time underpinned socially orientated impact investment strategies. There is also growing trend for employee ownership schemes among private equity-backed companies.

Decelerating trends

Elsewhere in IMCO's World View report, the investor notes that the momentum behind the theme of climate change and sustainability is slowing.

"It doesn't mean it is over," said Chamie, "It's part of the cycle around these trends that in one year can be racing ahead, and then the next they can decelerate a little. This is one of the areas where you might think that 'stroke-of-the-pen' risk might be higher in the immediate future," he said.

The investor also notes the current headwinds buffeting private markets, with slow deal volumes and the build-up of dry powder. However, "despite these cyclical speedbumps, the longer-term trend towards larger and deeper private markets remains well entrenched," the report notes.