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SPECIAL EDITION

EUROPEAN INVESTOR SUMMIT 2023

RUGBY WORLD CUP FRANCE 2023

SOCIETE GENERALE Securities Services

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GETTING A HEAD START ON TOMORROW

After three fruitful editions, I am delighted to introduce **the fourth European Investor Summit, an event that has now become a landmark in the European investment world**. Each year I am pleased to see familiar faces and to welcome some new ones to this annual meeting of the key actors of the Investment Industry.

2023 is already an eventful year, with inflation hitting record highs, interest rates skyrocketing after being negative for quite some time, and the regional banking crises casting a shadow of doubt over international banks. Clearly **a new paradigm is taking hold in the investment world and all players might have to rethink their strategy**, from asset allocation to sustainability commitments.

And since 2023 also marks the upcoming Rugby World Cup in France, let's consider the values of this sport to guide us in facing the challenges of our industry: in this evolving scenario, there is obviously no room for a wait-and-see attitude… but precautions are in order. We should move step by step, taking the example of the rugby player entering the scrum: **Crouch, Bind, Set. Analyse the situation, take the time to embrace the challenges and anticipate their consequences for our businesses, before committing to a new strategy**.

This is precisely the raison d'être of the European Investor Summit: giving you the opportunity to **get a head start on tomorrow and to share these reflections with your peers**. I am proud once again of the impressive line-up of prominent speakers who have agreed to address the most pressing issues affecting our industry: macroeconomics, private markets, liquid alternatives, with ESG at the heart of each debate.

I would like to sincerely thank all participants to the 2023 European Investor Summit; I trust that you enjoyed the panels and keynotes. This magazine reflects the central topics discussed during the event, and I hope it will give you food for thought.

Yours sincerely,

GILDAS LE TREUT
Co-Head of Coverage, Marketing & Solutions
Societe Generale Securities Services

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IN COLLABORATION WITH euroclear

CORPORATE GOVERNANCE AND RESPONSIBLE BUSINESS CONDUCT FOR MORE SUSTAINABLE ECONOMIES

YOSHIKI TAKEUCHI
Deputy Secretary-General
OECD

The global economy relies on efficient, open and resilient markets to effectively allocate capital and stimulate innovation, productivity and growth. The private sector is indeed essential to global prosperity: across OECD countries, over 80% of workers are employed by the private sector[1], and businesses contribute 72% of GDP[2].

A CHALLENGING GLOBAL CONTEXT FOR INVESTORS

Investors play a very important role, by providing the capital businesses need to grow and create value. However, investors are sensitive to uncertainty, and the current economic and financial context is particularly challenging.

The recent market turmoil in both the United States and Europe has revealed weaknesses in financial markets and in regulatory and supervisory oversight of financial institutions. **We should remain vigilant, as risks across the global financial system have increased**. Bank failures and the higher cost of capital now faced by some banks could result in a further tightening of bank lending standards. This would weaken credit growth and economic activity.

Another issue of concern is the increasing stress in corporate debt markets. Corporate bond issuance decreased sharply in 2022 as borrowing costs surged, due to increasing inflation and tightening financial conditions.

With higher borrowing costs and a long-term growth in lower-grade issuance, significant amounts of relatively high-risk debt will need to be refinanced in less accommodative conditions than previously, with possible financial stability concerns.

DEVELOPMENTS IN ESG AND SUSTAINABILITY PRACTICES ACROSS FINANCIAL MARKETS

Investors and market participants are also increasingly focused on sustainability issues, including environmental, social and governance (ESG) issues. Indeed, beyond the near-term uncertainties, the global economy continues to face the triple challenges of climate change, biodiversity loss, and pollution. In addition to the existential threat to populations around the world, climate change is considered as a financially material risk for listed companies that make up 65% of global market capitalisation[3].

Action is urgently needed. Investors and financial markets can and should play a central role in the orderly reallocation of capital to support the transition to net zero. Thankfully, we are already seeing a rapid development of sustainable finance and ESG investment practices. Over the past decade, the use of ESG approaches to assess investment risks and opportunities, and drive investment decisions, has become a leading form of sustainable finance. As of 2021, portfolios influenced by ESG investing approaches, such as ESG Integration, exceeded $40 trillion in assets under management[4].

In parallel, stock exchanges across advanced and emerging market economies have increasingly called for disclosures of ESG factors, and more than 80% of the market capitalisation of listed companies has an ESG score by at least one prominent ESG rating provider[5]. And we are seeing a multiplication of pledges and target-setting across the corporate sector to address ESG risks.

OECD EFFORTS TO DRIVE BEST PRACTICES ON CORPORATE GOVERNANCE AND BUSINESS CONDUCT

In this context, it is crucial that standards for corporate governance and business conduct remain fit-for-purpose, to drive tangible climate action, and support the resilience and sustainability of financial markets and a healthy corporate sector. The OECD has two leading global standards in this space.

First, the G20/OECD Principles of Corporate Governance are the global standard on corporate governance, and are adhered to by all OECD, G20 and Financial Stability Board members, together representing over 90% of global GDP[6]. The Principles provide the global benchmark for corporate governance policies and practices that underpin the health of the corporate sector, and ultimately the wider global economy.

The Principles have been reviewed in light of the recent evolutions in capital markets and corporate governance policies, including the increasing attention devoted to sustainability issues, the growing role of institutional investors and the rise in ownership concentration. More broadly, the revision aims to improve corporate resilience and further facilitate companies' access to capital markets. This can contribute to greater financial stability, and to funding the emergence of innovative businesses that support the green and digital transitions.

The revised Principles include a new chapter focused on sustainability, to better reflect the growing challenges corporations face in managing climate-related and other sustainability opportunities and risks, and to offer guidance in this respect.

The second key standard, focused on responsible business conduct, is the OECD Guidelines for Multinational Enterprises. The Guidelines provide a framework for businesses to address the impacts of their operations on people and the planet, and to contribute to sustainable development throughout their value chains. The OECD is also reviewing the Guidelines, to provide updated recommendations for responsible business conduct in key areas such as climate change, biodiversity, technology, business integrity and supply chain due diligence. This also comes in the context of increasing expectations for due diligence and responsible business conduct around the world, as seen for example in regulatory initiatives in the European Union[7].

We are in the final stages of revising these two key global standards, which are due to be adopted by OECD Ministers in June, then endorsed by the G20 in the case of the Principles of Corporate Governance. Following the adoption, the OECD will continue to work closely with policymakers and regulators to ensure effective implementation around the world. We will also engage further with investors, boards of directors, stock exchanges and other industry stakeholders, to raise awareness and understanding of the changes.

(1) OECD Report Government at a Glance 2021. See page 101, which reports that the public sector employs 17.9% of the workforce across OECD countries: https://www.oecd-ilibrary.org/deliver/1c258f55-en.pdf?itemId=/content/publication/1c258f55-en&mimeType=pdf **(2)** GDP = Gross Domestic Product. Source: McKinsey research (2017 data): https://www.mckinsey.com/capabilities/strategy-and-corporate-finance/our-insights/a-new-look-at-how-corporations-impact-the-economy-and-households **(3)** OECD report Climate Change and Corporate Governance 2022. See page 21. https://www.oecd-ilibrary.org/deliver/272d85c3-en.pdf?itemId=/content/publication/272d85c3-en&mimeType=pdf **(4)** Global Sustainable Investment Alliance review (2021): https://www.gsi-alliance.org/wp-content/uploads/2021/08/GSIR-20201.pdf **(5)** https://www.oecd.org/finance/ESG-investing-and-climate-transition-market-practices-issues-and-policy-considerations.pdf **(6)** Internal OECD calculation, as of 30.04.2023 **(7)** See for example the proposed Corporate Sustainability Due Diligence directive: https://commission.europa.eu/publications/proposal-directive-corporate-sustainability-due-diligence-and-annex_en

IN SEARCH OF A NEW EQUILIBRIUM

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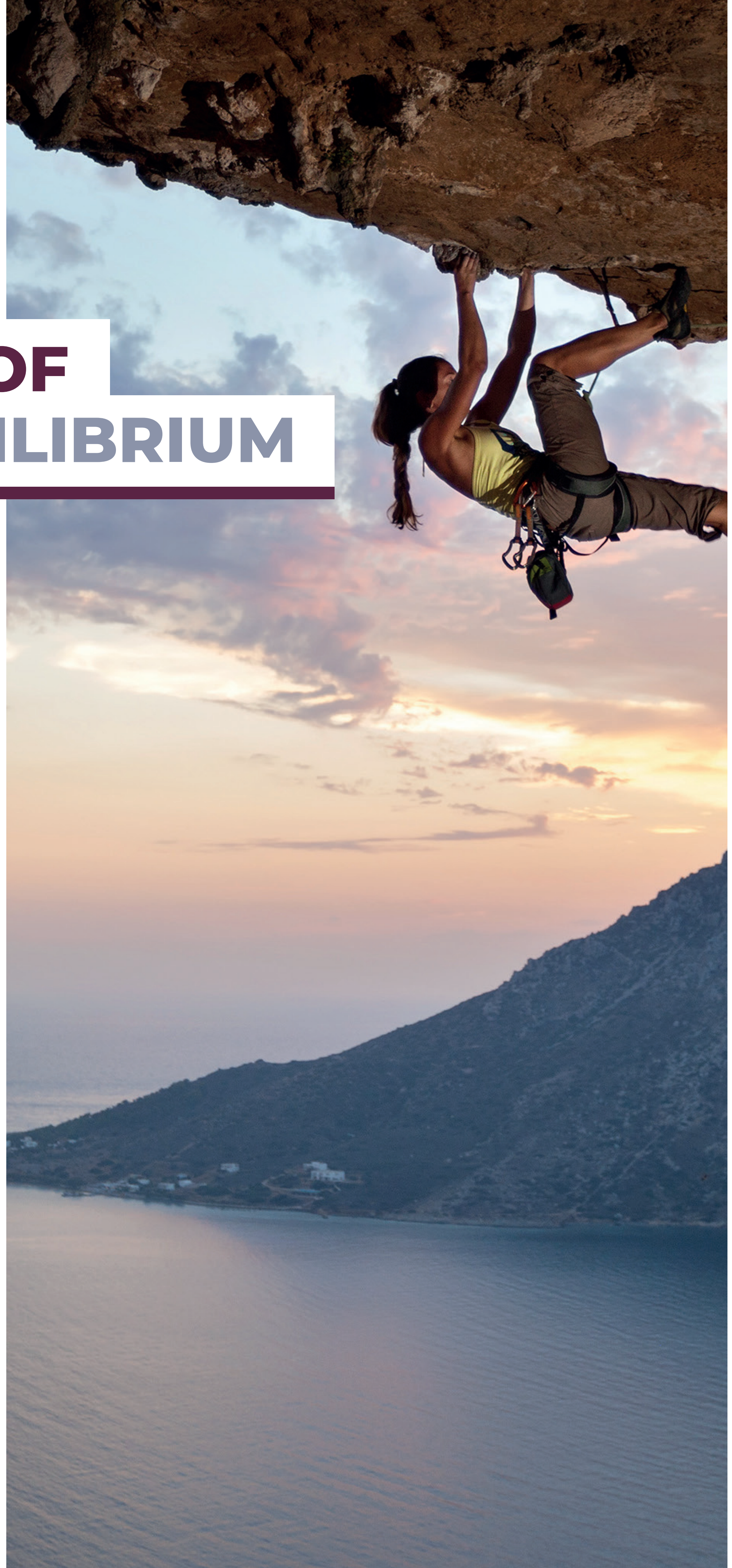
A month and a half on from the banking stress triggered by the failure of two US[1] banks and the difficulties encountered by Credit Suisse, the markets appear to have calmed down after the First Republic case was resolved with its acquisition by JP Morgan.

The main stock market indices are still trading at their highest levels of the year after a good earnings season. To see the impact of the financial stress episode, we need to look beyond the major stock market indices: in the US financial sector and on the bond market segment, where long-term interest rates have not returned to their start-of-the-year peaks.



On a more macroeconomic level, the April PMI[2] surveys show that the US and the euro zone are still experiencing strong expansion, entirely driven by **a new upturn in the services sector, while the manufacturing sector is still in decline**. In the euro zone, the gap between the two sectors is at an all-time high (more than 11 points)[3], so we think it is safe to assume that the two sectors will start converging again in the coming months. From a forward-looking perspective, the statistics show signs of a slowdown in the US economy with less favourable winds on household consumption, retail sales that are starting to slow down and the beginning of a retreat on open positions, although they remain historically high. The slowdown should thus intensify over coming quarters, given that the deterioration in credit conditions is expected to weigh on business investment.

US inflation, as measured by the consumer price index, fell slightly more than expected to 5.0% in March (vs. 6.0% in February), due to a significant base effect on energy prices, and is thus back to its May 2021 level. Underlying (or core) inflation is fairly stable, at 5.6% in March versus 5.5% in February[4] with the expected mechanisms: the easing of goods inflation has run out of steam for the time being and we will probably have to wait until the second quarter for services inflation, in particular via its housing component, to take over the driving down of inflation.

In the euro zone, total inflation fell sharply to 7.0% in April versus 8.5% in February[5] due to substantial base effects on energy prices, while core inflation remains high at 5.6% (vs. 5.7%)[4]. Indeed, the first easing of inflation for manufactured goods at the beginning of 2022 is unable to offset the renewed rise in services, which weigh much more in the household basket and whose evolution is very similar to that of wages in the euro zone, currently around 5% year to year[4].

To summarise, total inflation is falling on both sides of the Atlantic, notably thanks to the base effects of energy prices, but core inflation remains stubbornly high. It is therefore services inflation, which is most closely linked to wage dynamics, that central banks will be monitoring to guide their monetary policies during the second half of the year. Within this context, the Fed (Federal Reserve System) is unlikely to change its key lending rates after early May's hike. We also believe that **the three interest rate cuts expected by the market by the end of the year are exaggerated**. The US central bank will wait until it is convinced the core inflation index will continue to fall before easing its monetary policy. Otherwise, the US recession in the second half of the year would have to be violent, due to the accumulation of numerous rapid rate increases and the tightening of credit conditions resulting from the shock wave on regional banks. If that were to be the case, we find US equities far too high and at multiples unable to absorb this kind of bad news.

In Europe, the European Central Bank should continue to raise its key lending rates once or twice between now and the summer before stabilising and, like the Fed, remaining in restrictive territory to see core inflation decline during the second half of the year.

Long rates should not fall significantly in our main scenario. Having in mind a longer investment horizon, **the necessary global energy transformation could become a growth opportunity** that would allow us to enter a long growth cycle and thus see nominal growth, inflation, and short and long rates remain high for a substantial period of time (inflation higher than the central banks' target being a less painful aid to reducing government debt than tax increases or public spending cuts).

From our point of view, we have thus undoubtedly changed the regime for the absolute level of interest rates, thereby restoring the status of the money market and investment grade assets, two asset classes that had markedly lost their appeal in the previous decade. **The asset allocations of major investors will therefore inevitably change**, leading to a future rebalancing with those that were previously favoured. Last but not least, this new interest rate equilibrium will also probably go hand in hand with a shift in the correlation matrices between stocks and bonds, similar to what we experienced in the early 2000s, once again modifying the construction of many asset allocations and portfolios.

(1) United States. **(2)** Purchasing Manager Index. **(3)** Source: HCOB S&P Global, data as of May 9, 2023. **(4)** Source: Bureau of Labor Statistics, data as of May 9, 2023. **(5)** Source: Eurostat, data as of May 9, 2023

MANAGING SHORT-TERM HEADWINDS, PREPARING FOR LONG-TERM OPPORTUNITIES: CHALLENGES AND OPPORTUNITIES IN PRIVATE MARKETS

PETER VELDMAN

Deputy Group Head of Fund Operations

EQT Group

Over the past decade, private markets investors have benefitted from a Goldilocks scenario that has its roots in the global financial crisis and Madoff saga. But since last year, this has been countered by three headwinds: inflation, higher interest rates and geopolitical uncertainty. However, we believe that the long-term prospects for private capital remain promising.

STATE OF THE MARKET

The impact of inflation, higher interest rates and geopolitical uncertainty has been well covered over recent months. That said, **we think the green shoots of a more promising market are beginning to show themselves**, especially in relation to financing and deal activity.

As with previous cycles, starting in 2022 we saw the quality of syndicated loans deteriorate while covenants reduced, resulting in an inventory of unsellable loans at various banks that then retreated from financing deals. Understandably, tighter availability of financing dampened deal flow in 2022, but sellers did not immediately respond to this new reality and as a result bid and ask gaps grew significantly.

That said, we are beginning to see that banks are ready to selectively provide finance in certain sectors. Credit funds, which began to play a more active role in deals when banks stepped back, are still sitting on huge piles of dry powder and so also remain active. Taken together, this means bid and ask spreads are beginning to close and investment opportunities are on the rise.

LONG-TERM OPPORTUNITIES

It would be remiss to declare that the headwinds we have faced in recent months are coming to an end, even though conditions are promising. But while we at EQT are always aware of the short term, our horizons are inherently long-term. **And in the long term, we think the trends remain promising**.

Research shows that the assets managed by **private markets firms are expected to surpass USD 23 trillion by the end of 2027**, up from USD 14 trillion at the end of 2021[1]. There are several drivers of this growth, including the fact that investing in private markets delivers diversification benefits away from more volatile public markets and that as companies stay private for longer, private markets investing offers an opportunity to support companies during the period in which they enjoy a greater share of their growth.

POSITIONING FOR SUCCESS

We believe that capitalising on these trends requires certain characteristics. The industry is becoming more global as investment opportunities appear across the world. This was a key driver of our decision to combine with BPEA[2], which brought together one of the world's leading private markets firms, EQT, with the third largest in Asia, BPEA. As a result, **EQT is now active in countries representing 80%[3] of global GDP[4]**. We believe global scale and the access, network, and shared learnings this stimulates will be vital going forward.

We also believe it is important to take a thematic approach and invest with conviction in long-term trends. Simply put, **at EQT we make good companies in great industries even better**. We have a distinct way of doing this: we empower decision-making at the highest level of the companies in which we invest, we bring in industry veterans from our global network of advisors to support the management team and we help our portfolio companies become even more successful and resilient by connecting them to our experience in improving operational, digital, and sustainable performance.

Finally, we think values will be a key driver of performance. For three decades, at EQT we've invested in a way that maximises returns while also benefitting society. **We believe doing good is good business** – it's not an either-or proposition. We make long-term investment decisions based on these values, while striving to be the most reputable investor and owner. In doing so, we position companies to succeed beyond EQT's ownership period. For example, last year we took the largest fleet of iconic yellow school buses in North America and are investing in 30,000 fully electric vehicles, creating better health for our children and better outcomes for the planet.

SHORT-TERM HEADWINDS, LONG-TERM OPPORTUNITIES

To conclude, we believe that EQT is well positioned today and for the future. While we stay humble, laser focused on performance and very selective when it comes to deals, we are preparing for markets to re-open further in the future and by making sure that we have the best talent in the industry supported by great values and a strong culture.

(1) Preqin (Oct 2022) https://www.preqin.com/future **(2)** Baring Private Equity Asia. **(3)** 2021 nominal GDP estimate; Source: Macroeconomics indicators EIU via SNL as of Feb 2022. https://eqtgroup.com/news/2023/eqt-ab-s-annual-and-sustainability-report-for-2022-published/ page 11 footnote 3 of the EQT AB Annual Report. **(4)** Gross domestic product.

MODERNISING PRIVATE MARKET FUNDS: THE EUROCLEAR AND GOJI PARTNERSHIP

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Private market funds have been growing in popularity over the past decade, offering institutional and high-net-worth investors access to alternative investments and diversified portfolios. The demand for access to these funds is increasing, and this trend is set to continue.

However, the current lack of market infrastructure and widely adopted technology results in:

- Distributors unable to digitally get access to private market funds.
- Asset managers offering a poor investor experience and not being able to scale to meet demand.
- Costs and entry ticket to invest in private market funds are high, limiting the diversification to a broader investor base.

In response to these challenges, **Euroclear has acquired Goji to modernise and facilitate access to private market funds**. The collaboration aims to streamline trading and custody, increase accessibility and reduce the overall cost of access. In this article, we will delve into the challenges facing the private market, the benefits of open-architecture market infrastructure and our vision for the industry.

CHALLENGES AND OPPORTUNITIES IN PRIVATE ASSETS MARKETS

Over the past decade, fund managers in private capital have been experiencing higher demand for their funds than ever before, as investors seek out strong returns and portfolio diversification. After the pandemic, private markets have bounced back and experienced growth across the board. In June 2022, total private markets assets under management (AuM) reached $11.7 trillion, with AuM growing annually at a rate of nearly 20% since 2017[1]. This growth was seen in all asset classes, and particularly in private equity.

Oliver Wyman[2] reports that allocations to private funds from high-net-worth individuals (HNWIs) are expected to increase by 5% by 2025. This 5% increase represents $1.5trn AuM or a $21bn revenue opportunity for the market.

While structures such as the European Long-Term Investment Fund (ELTIF) provide the framework, the industry lacks homogenised technological infrastructure to support the increased demand. To successfully tap this, market infrastructure needs to evolve, with scalability and connectivity at the core.

ADVANTAGES OF OPEN-ARCHITECTURE MARKET INFRASTRUCTURE

Euroclear is introducing a no-conflict, open-architecture market infrastructure, bringing together technology-enabled solutions and network of investors and assets managers. This unique combination will facilitate low-friction access to private assets, increase efficiencies and support growth. Euroclear will also offer nominee solutions, which enable the aggregation of smaller positions into a single subscription into a given fund.

Distributors will be able to connect to a large universe of private funds, through a single point of entry, increasing the opportunities of investment available to their underlying investors.

- **Asset managers will be able to offer digital access to private funds to new and existing investors, unlocking more capital and improving the experience of their investors.**
- Institutional Investors will gain access to a wider range of private funds at reduced costs.
- Individual investors will gain access to private funds, where historically access may have been barred due to high entry points.

THE PARTNERSHIP

Euroclear's extensive experience, operating €37.3 trillion assets on behalf of over 2,000 clients globally connecting to more than 2,500 fund management companies[3], positions it well to expand its offering. The acquisition of Goji, a leading London-based provider of digital access and technology-enabled solutions to private market funds, will allow the group to expand its footprint into private markets, building upon its recent successful acquisition of the MFEX funds distribution platform.

Together, Goji and Euroclear are taking the opportunity to shape the future of the fund industry. By streamlining processes and connecting the private funds universe digitally, Euroclear and Goji will bring about the digital era of private markets, underpinned by secure and scalable solutions, trusted by the industry at large and vital to unlocking capital.

(1) https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/mckinseys-private-markets-annual-review **(2)** https://www.oliverwyman.com/content/dam/oliver-wyman/v2/publications/2020/jul/2020-Global-Wealth-Management-Report-After-the-Storm.pdf **(3)** Source: MFEX internal figures, data as of 28/02/2023.

THE FUTURE OF ASSET MANAGEMENT: REINVENTING THE WHEEL OR STAYING STILL?

PETER KRAUS
Chairman and CEO
Aperture Investors

Over the past decade, the asset management industry experienced rapid growth, largely due to equity markets. The S&P 500[1] averaged a 10% annualised return over the past 90 years, ~7.5% (2001-21) and ~16.5% (2011-21). In the ten years ending 2022, inclusive of last year's challenges, the index averaged 12.7%, almost 30% above the 90-year trend[2].

Over the last decade, declining U.S[3]. Treasury rates have made long duration investments very attractive, but also ensured future capital gains from duration would be a challenge until the Fed normalised interest rates. Last year certainly proved this. The hunt for yield drove credit spreads in public markets to low levels. Private credit markets offered additional spread in exchange for low levels of liquidity. For many investors, an additional 50 basis points of yield when cash paid almost nothing was a lot more attractive before cash started yielding almost 5%[4]. Low base yields, high returns for equities levered with low-cost capital and high returns for growth companies enhanced by low inflation all worked to shape the asset management industry we operate in today.

Global AUM[5] grew over 8% annually from 2011 to 2021[6]. Although exemplary, the net flows have not been. Revenues driven by net flows offset by fee pressure provided almost no growth in revenues for the industry.

Passive and alternatives' share of global AUM grew from 21% in 2005 to 40% in 2021. Their share of the fee wallet grew from 33% to 51%, with passive topping out at only 15% of the total fee budget in 2021. Alternatives' share in absolute dollars is almost 90% of the active manager share. These numbers demonstrate that the percentage of AUM and wallet share of fees for traditional asset managers have persistently and dramatically declined.

The cause of the decline is simple: **only a minority of active managers have delivered outperformance, net of fees, over a full market cycle**. The effect is that allocators will continue to move money away from traditional managers until their value proposition changes or the results of the other products become less attractive.

Given the investing environment of the last decade, allocators sought to mute the volatility of public securities, which sped the growth of private capital pools. These pools offer smoothed returns, enabling more leverage without reporting increased volatility. Investors received higher returns for surrendering flexibility and liquidity; a seemingly "free lunch".

However, the holdings in these private vehicles are similar to those in public vehicles, but such levered assets should result in greater economic volatility. The fees paid to managers who oversee, originate and sell these assets are also materially greater than those charged in public vehicles. Therefore, the increased leverage must produce a gross return high enough to cover these fees. Assuming it does, the investor still owns a riskier asset owing to the leverage. It begs the question: **have investors correctly measured the additional compensation necessary for accepting the increased economic return?**

Consider, for a moment, the past ten years of economic activity, the macroeconomic trends, the inflection point we face in treasury yields and the allocation of assets by investors to passive and alternatives moving away from traditional areas. What do we think the next ten years will look like? Of course, we don't know, and broad predictions are interesting but hard, so I will attempt at the unambiguous risk of being very wrong.

There is a wide diversity of alternative manager businesses including hedge funds, private equity, real estate, venture, infrastructure, commodities, private debt and liquid alternatives. Hedge funds have not been, and I believe likely won't be, a growing asset class. I expect the growth of private equity will slow, reflecting the inability to maintain its torrid pace, the challenge of producing acceptable returns at increasing size, the impact of weaker returns across growth equity, headwinds caused by higher borrowing costs and, finally, a much smaller venture world reflecting fewer attractive opportunities with slower crystallisations.

Private debt faces an interesting refinancing cycle. **Since the meteoric rise in this activity engendered by the GFC[7] and regulatory actions affecting bank lending, there has not been a proper credit cycle**. As a result, there is no reliable data on credit defaults and on losses for this period. How private credit performs over the next few years will determine its long-term future growth trajectory. Commercial banks may reclaim some of this market segment as JP Morgan has announced its intentions[8].

I believe allocators will adjust to more effectively balance liquidity and locking up capital for lengthy periods to generate returns. Private credit, high yield, CLOs[9], and bank-driven lending will coexist. I suspect there will be continued growth in niche businesses that can aggregate $10 to $30 billion in specialised areas and charge primarily for performance rather than asset size.

This activity, in the aggregate, will become a larger part of the asset management industry. Scale businesses such as passive, low-fee, low-return, low-risk or essentially enhanced index businesses like ETFs[10] or actively managed portfolios with low tracking error will benefit from consolidation. Fee pressure for them will be offset by scale, squeezing out smaller players.

Large organisations may shift from performance-based business models to asset accumulation engines and client service models. Their franchise value will be organised around brand recognition, distribution prowess, cost efficiencies and client service. They will look more like wealth management and/or service- or solution-based organisations versus alpha engines.

The movement to passive should continue. The simple reason is alpha is hard to achieve, and the more money managed, the harder it is to deliver. Traditional asset management will unlikely be able to reverse this trend until it shrinks much more and manages far less money. Companies will react strategically as they have by buying or building passive or alternative businesses, but that won't arrest the trends we've seen in the core business. Some managers will migrate to different incentive systems where those models primarily charge for measurable performance. This will help restrict the capacity of capital they manage, allowing them to improve the probability they can outperform. **Allocators will have to come to grips with the fact that more and more of their capital will be run passively**. To achieve better-than-index returns, they will need to be willing to allocate to capacity-constrained managers whose principal financial incentives are to perform.

(1) Standard & Poor's. **(2)** Bloomberg, Dimensional. **(3)** United States. **(4)** US treasury. **(5)** Global assets under management. **(6)** BCG. **(7)** Global Financial crisis. **(8)** Bloomberg. **(9)** Collateralised loan obligations. **(10)** Exchange Traded Funds.

WHY HEDGE FUNDS ARE PARTICULARLY ATTRACTIVE NOW

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ALLOCATORS ARE FACING TOUGH CHALLENGES

With core inflation slow to normalise, central banks are constrained in their ability to ease their policy at a time of elevated liquidity stress and deteriorating credit conditions. As a result, **carry trade should remain volatile and confined to government bonds and Investment Grade**.

Multiple opposing forces are making it challenging to sequence the path of the global economy, albeit increasingly tilted to the downside. With investors pricing rapid inflation normalisation, faster monetary easing and no recession, **cyclical assets remain vulnerable**. Portfolios' **risk management is also challenging** amid unstable cross-asset relationships and with the threat of additional liquidity shocks. Structurally **greater risks from geopolitics** and politics are unusually impactful for fiscal policies, regulations, trade flows, corporate operations and thus for markets and allocations. Meanwhile, investors do not want to miss **carry opportunities** and are seeking to benefit from uneven regional stories and other **decoupling segments**. While keeping **positive optionality**, they are looking for **protection** in case of a hard landing.

We contend that **hedge funds respond to most of these challenges for 3 main reasons**.

3 REASONS WHY HEDGE FUNDS ARE A PARTICULARLY GOOD FIT IN THIS ENVIRONMENT

1. Hedge funds provide good protection in an inflationary environment

Hedge funds are dynamically arbitraging inflation.

Surging inflation means more volatility, active central banks, valuation dislocations, i.e. more opportunities. It helps **hedge funds remain resilient in inflationary episodes**. They usually outperform traditional assets, thanks to uneven strategies' sensitivity to inflation.

They then tend to perform even better when inflation normalises. Past the inflation peak, multiple convergence trades open up, highly profitable for hedge funds, as economies gradually return to their equilibrium and as investors' focus shifts from inflation and rates to economic growth.

As they are **structurally long cash**, hedge funds also tend to benefit from higher rates.

2. We believe hedge funds' capacity to generate alpha has increased

■ Above-par volatility regime likely to persist, an optimal equilibrium for hedge funds

Volatility is a decisive factor in setting an allocation's risk level and targets with major implications for alpha generation.

Secular trends suggest the volatility regime will remain above par, due to structurally higher geopolitical and social risks, stalling globalisation and a more multipolar world, and shorter economic cycles. The challenges and cost of climate change, as well as several disruptions that will change the nature and structure of work, would also support volatility.

Our **volatility regime models**, which track both short-term and long-term volatility drivers, **suggests the same**.

This regime is **optimal for hedge funds**, providing room for frequent market timing opportunities.

■ Alpha generators in high demand amid growing alpha potential

Above-par inflation, below-par growth, shorter economic cycles, but also new sets of opportunities might be in store in the next phase of the cycle. Amid lower potential growth and milder traditional assets' risk/reward, **alpha generators will be in high demand**.

The surge in alpha since the pandemic might only be at its beginning. Following a decade of low interest rates and massive liquidity injections during the pandemic, **shrinking liquidity and higher rates are a game changer**. Increasing economic and asset differentiation will create more macro and micro **relative opportunities**. Assets will **trade closer to their fundamentals** as investors' focus shifts from monetary decisions to countries' economic situations and issuers' quality of business models. Meanwhile, growing attention to idiosyncratic developments would give more space **for thematic allocation, diversifying the sources of alpha**. Finally, an above-par volatility regime would provide **greater arbitrage potential and more frequent tactical opportunities**.

3. Hedge funds provide sustainable diversification in a portfolio in the current environment

■ Resiliency in periods of macro uncertainty

Thanks to highly diversified and dynamic cross-asset exposures; the use of shorts; as well as a focus on arbitrage and relative value, hedge funds show **resiliency when growth is weak**.

■ Hedge funds are one of the few diversifying assets

The return of inflation uncertainty and stagflation risk have broken the Goldilocks negative equity/bond return correlation regime that prevailed over the last two decades.

Following record high equity/bond return correlations in 2022, the balance of forces suggests a more neutral relationship going forward. Portfolios' **risk management challenges thus remain live**, while the equity/bond relationship remains unstable and poorly reliable.

The menu of diversifying assets is limited. Amongst gold, options, cash, safe-haven and real assets that all come with strings attached, hedge funds look particularly appealing.

Hedge funds show little sensitivity to traditional assets as they operate in most market segments, favour relative arbitrage with short exposures, and are dynamic in their market timing. Importantly, with an adequate rotation of strategies along the economic cycle, **hedge funds provide durable diversification**.

For all these reasons, we think having hedge funds in a portfolio adds value.

But as risk-adjusted performance dispersion is and will be wider then, you'll need to be selective.

We believe Amundi Asset Management can help investors with the appropriate fund selection expertise that we have developed for more than 25 years.

CUTTING THROUGH THE HYPE: A REALISTIC ASSESSMENT OF SUSTAINABILITY

MASJA ZANDBERGEN

Head of Sustainability Integration

Robeco

It was Winston Churchill who said: "A pessimist sees the difficulty in every opportunity; an optimist sees the opportunity in every difficulty." I used to be firmly in the optimist category. Problem? Face it head on! Something wrong with the system? Change it from the inside! But what has been achieved so far when it comes to sustainable development? I am slowly becoming more pessimistic, and here's why.

First, take climate change. Despite efforts to move to cleaner technologies in producing energy, and despite a global pandemic that caused global emissions to go down for one year, CO_2 emissions are back at pre-Covid levels. The carbon intensity of our economies has decreased but, due to economic growth, emissions are still increasing.

The Intergovernmental Panel on Climate Change (IPCC) report that was released last year states: "We are not on track in tackling global warming – despite having the tools and know-how[1]. With the right leadership, the world can avoid dangerous climate change."

That leadership was somewhat lacking at the COP27 climate summit in late 2022. The summit did deliver a few wins, including plans to create a fund for developing countries to finance decarbonisation, but was disappointing overall. Climate policies still fall short. If all plans are met, the summit leaves us heading for 2.5 °C of global warming. And since the plans have not been met to date, why should they now?

MIXED PICTURE ON THE SDGS

Looking beyond climate change to a broader set of Sustainable Development Goals (SDGs) through the lens of the United Nations (UN) SDGs, there is a mixed picture. The 17 goals ranging from eradicating poverty and inequality to building the infrastructure for a sustainable future were established in 2015 and are supposed to be achieved by 2030.

At half-time, we're still nowhere near meeting them, and indeed progress actually went backwards during Covid. The headway made since 2015 has been too slow, and **no country is on track to achieve the goals by 2030**[2].

What is now particularly worrying are the negative trends on the environmentally focused SDGs. If we do not address climate change and halt the loss of biodiversity embodied in three of the goals, it is unlikely that we will achieve any of the other SDGs, given that **all social systems depend on the natural environment**.

And there are contradictions between the goals. For example, solving SDG 2 to end hunger and ensure year-round access to safe and nutritious food will be difficult to achieve while also simultaneously solving SDG 15. This seeks to ensure the conservation, restoration and sustainable use of forests, wetlands and drylands – growing more food makes this much less likely.

WE NEED EXTERNAL COSTS TO BE PRICED BETTER

So, should we therefore be downhearted? In recent years, the financial sector has woken up to 'sustainability', and focused on integrating financially material ESG factors into portfolios, to make better-informed investment decisions. That's now in the mainstream and is highly positive.

However, there are two issues with this. The Intergovernmental Panel on Climate Change (IPCC) mentions in its report that climate risk remains underpriced in financial markets, and this also goes for other ESG externalities such as the loss of biodiversity, poor labour conditions, poor governance and poor community relations.

This could be solved by better global regulation, which puts a price on these issues and makes sure that investors and corporates internalise these external costs. If not, then while ESG integration will still help to make better investment decisions, it would not directly benefit sustainable development.

MOVING TO IMPACT INVESTING

What the investment community is doing now is **trying to find a way to go beyond standard ESG integration and move towards impact investing**, creating structures that can fund the trillions of dollars in investments needed. A start was made at COP27 with the creation of a loss and damage fund by wealthier countries, but this still needs to be made operational.

Green, social and sustainability-linked bonds are also good instruments for large investors to create an impact on the ground. While this looks promising, only a very small part of all assets under management goes to directly funding (corporate) projects that help sustainable development, so we're not there yet either.

MY GLASS IS STILL HALF FULL

It is good to let my pessimistic self out for a change, however I have to note that we, as investors, companies and governments, are still trying to construct the tools capable of making our global practices more sustainable. **It is time now to start allocating our resources and focus on building those tools**, and to shift away from the hype of campaigns, reassuring rhetoric and the creation of unreachable goals and targets. And whereas COP27 left us heading for 2.5 °C of global warming, five years ago, we were heading for 4 °C.

So, to end with another quote from Churchill: "For myself, I am an optimist – it does not seem to be much use to be anything else."

(1) https://www.robeco.com/en-int/insights/2022/04/ipcc-warns-were-not-on-track-to-limit-global-warming-despite-having-the-tools-and-know-how **(2)** https://www.robeco.com/en-int/insights/2022/08/the-sdgs-at-half-time-we-need-to-score-with-more-goals

FIVE SUSTAINABLE INVESTMENT TRENDS TO WATCH

LLOYD MCALLISTER
Head of Sustainable Investment
Carmignac

The pandemic, war, persistent environmental degradation and inequality mean that the role of sustainability in business and investment has never been higher profile. In addition, ESG and sustainable investment have found themselves to be the subject of healthy debate too. Against this backdrop, Lloyd McAllister, head of sustainable investment at Carmignac, outlines five themes that he predicts are likely to dominate the sustainable investment narrative over the next year.

A SHIFT FROM COMMITMENTS TO DELIVERY

A lack of progress on global emissions reductions will move the climate discussion from long-term targets to delivery and a focus on innovation and technology solutions. Delivery was given a shot in the arm thanks to the Ukraine war highlighting the weakness of energy systems vulnerable to geopolitical risks. Consequently, **emphasis will turn to scalable technology that can support the transition** and renewables growth will continue to outpace expectations. We expect the rush of long-term emission reduction targets to slow and become caveated with dependencies on regulators setting explicit rules and consumers buying lower emissions products and services, as the reality of delivery becomes clear. We also expect brown-to-green transitions to face greater scrutiny but will ultimately become more accepted as the duration and complexity of the energy transition becomes better understood by asset owners.

The uncapped tax incentives within the Inflation Reduction Act in the United States (US) will drive faster adoption of clean tech in the US, and we expect further regulation and activity from central banks and European Union (EU) regulators, in particular highlighting the EU's Carbon Border Adjustment Mechanism.

Why it matters: We expect a shift in expectations from long and medium-term "talking" metrics such as science-based decarbonisation targets to a focus on capital and operational expenditure that enables the delivery of these targets. With much green tech still nascent and unproven, financial incentives can provide a catalyst for companies to invest in laggard transition sectors such as cement, steel, aviation, shipping and food. Innovation in climate technologies will provide opportunities for investors looking to align portfolios with the energy transition.

LONG TECH, SHORT OIL WON'T CUT THE MUSTARD

It was easy to appear sustainable in the post-crisis era of easy money that generously rewarded growth. This led to the typical long-tech short-energy portfolio becoming the blueprint for sustainability due to its low level of easily measurable negative externalities such as carbon emissions, alongside positive exposure to cutting-edge technology that was improving people's lives. We believe this somewhat superficial approach will cease to work going forwards, due to **higher asset owner expectations, regulation and a different market environment**.

Why it matters: We expect portfolios marketed as having sustainable characteristics to clearly demonstrate what client-alignment, additionality or outcomes they are delivering and the extent to which ESG is considered from a financial and non-financial perspective. In addition, we expect the need to show positive engagement outcomes will become a base requirement, rather than a nice to have.

EVOLVING EXPECTATIONS OF FIDUCIARY DUTY AND MATERIALITY

There is a growing shift in defining fiduciary duty from shareholder wealth to shareholder welfare accompanied by the rise of stakeholder capitalism. This means **asset owners are increasingly expecting asset managers to consider the concept of double materiality** whereby both the consequences of environmental and social issues on a company's performance, as well as the company's impact on the environment and society, are both considered material.

Why it matters: We expect clients and regulators to talk about ESG issues that appear less relevant to a company's valuation in the short term but are material to long-term asset owner decision making.

POLITICISATION

ESG has been attacked in the US by politicians from both sides of the aisle. For the right, ESG represents a political cabal that is distorting markets and dangerously removing finance from crucial industries such as energy and defence. For the left, ESG is the latest game cooked up by Wall Street to extract higher fees using greenwashing. While the arguments often misrepresent, oversimplify or are overly reductionist, **the critique of ESG as it becomes more mainstream will force higher quality approaches and transparency**, which we view as positive. While political noise often misrepresents ESG, we expect these arguments will remain a source of news flow, thereby creating confusion for clients. Thus asset managers must be crystal clear regarding their investment philosophy and approach.

Why it matters: We hope that there will be a growing recognition that individual or groups of asset managers have some, but not unlimited, ability to deliver system-wide ESG goals and that regulators need to step up.

THE RESURGENCE OF THE DEGROWTH NARRATIVE

The two dominant economic theories in sustainability either focus on degrowth or green growth. Green growth believes that it is possible to grow traditional metrics like Gross Domestic Product (GDP) while reaching acceptable global pollution and living standards. Degrowth believes that resource consumption needs to fall to enable society to live within an ecologic ceiling. Throughout 2022, **the degrowth narrative became more prominent due to the perceived ineffectiveness of green growth**. Unless absolute global pollution begins to trend down, the degrowth narrative will likely begin to slowly permeate into broader economic debate and policymaking. Companies with high exposure to commonly perceived "over-consumption" issues, i.e. fast fashion and single-use plastic, can expect to draw increased attention from regulators, consumers and clients.

Why it matters: To date, governments have focused policy on the need for companies to quantify their emissions, but wider acceptance of the degrowth theory could result in a more interventionist stance. This could have a profound effect on the long-term financial outlook of the most in-focus sectors.

AUTHORS' BIOGRAPHIES


GILDAS LE TREUT - Co-Head of Coverage, Marketing & Solutions
Societe Generale Securities Services

Gildas Le Treut is appointed Co-Head of Coverage, Marketing & Solutions in September 2021. He joined SGSS as Head of Sales and Relationship Management in May 2018 after 11 years at ABN Amro Clearing. Since 2007, he has been successively Managing Director of the branch in France (Fortis Bank Nederland), Global Head of Product & Network Management and Global Director of Prime Services. He has developed ABN AMRO Clearing franchise for institutional investors, banks, asset managers and hedge funds. He started his career in 1996 at BNP Paribas Securities Services in the equity clearing team where he occupied various positions before being promoted as Sales & Relationship Manager for Continental Europe. Gildas Le Treut has a Master's degree in Bank & Finance from Sorbonne University.


YOSHIKI TAKEUCHI - Deputy Secretary-General - **OECD**

Mr. Yoshiki Takeuchi was appointed Deputy Secretary-General in November 2021. His portfolio includes the strategic direction of the OECD policy on Employment, Labour and Social affairs, Education, Skills, Well-being, Inclusion, Sustainability and Equal Opportunities, Financial and Enterprise Affairs along with the Centre for Entrepreneurship, SMEs, Regions and Cities. He also represents the OECD at the Financial Stability Board and guides OECD work with the Asia-Pacific region. Mr. Takeuchi has had a distinguished career over nearly four decades at the Japanese Ministry of Finance. Prior to joining the OECD, he served as Special Advisor to Japan's Minister of Finance. He was Vice-Minister for International Affairs (2019-2020), Director-General of the International Bureau (2016-2019) and has held other senior positions including as Deputy Minister in many international fora such as G7, G20, IDA and International Monetary and Finance Committee. Mr. Takeuchi has a wealth of experience in the field of international economy and finance. He worked closely with international organisations including the IMF, the World Bank, the Asian Development Bank and other regional development institutions. He also led Japan's G20 Presidency finance team with a particular focus on digital taxation, quality infrastructure investment, capital flow management and global imbalances. Mr Takeuchi holds a B.A. in Law from University of Tokyo, a MPhil in Economics from University of Oxford and conducted research at Chatham House.


ERIC BERTRAND - Deputy Managing Director, Chief Invesment Officer
Ofi Invest Asset Management

Eric Bertrand is Deputy Managing Director, CIO of Ofi Invest Asset Management (resulting from the merger of OFI Asset Management and Abeille Asset Management). He joined OFI Asset Management as Head of Fixed Income and Multi-Asset Strategies in january 2016. Prior to joining OFI AM, Eric Bertrand had worked at CPR AM since 1994. His first role was as a Money-Market Portfolio Manager and Trader then a Bond, Fixed Income and Credit Manager, before being appointed Head of Fixed Income Management in 2000. He was subsequently promoted to Deputy Chief Investment Officer and Head of Fixed Income and Credit Management. Eric Bertrand started his career as an actuary at Comptoir des Entrepreneurs. Eric graduated as an actuary from ISFA (Institut de Science Financière et d'Assurances).


PETER VELDMAN - Deputy Group Head of Fund Operations - **EQT Group**

Peter has studied Business Economics at the UVA in Amsterdam. After his graduation, he started his career at the Dutch Central Bank and continued at ABN AMRO where he was a senior trader followed by Cyrte Investments and Ownership Capital where he was the COO. Peter joined EQT in 2014 as Managing Director in the Amsterdam GP office, where he was responsible for the Dutch-based Funds. In 2017 Peter relocated together with his wife and 2 teenage boys to Luxembourg where he became the Head of Fund Management, taking full responsibility of the EQT Fund Management platform. In 2019 he took on the role of Deputy Group Head of Fund Operations that next to Luxembourg, has (legacy) locations in Guernsey, London, Stockholm, New York, Singapore and Amsterdam. Currently, around 180 of EQT's FTE's are part of the Fund Operations organisation.


DAVID GENN - CEO - **Goji**

David Genn is the CEO of Goji, an investment platform technology provider based in London, UK. Goji's mission is to improve investor access to private funds. Goji develops, implements and operates private markets technology and services, and provides the infrastructure to give investors a digital investment journey. In December 2022, Goji was acquired subject to regulatory approval by Euroclear, the global provider of Financial Markets Infrastructure, to build market-neutral infrastructure that will bring straight-through processing to private funds.


PHILIPPE LAURENSY - Managing Director and Head of Group Strategy, Product Management, and Innovation - **Euroclear Group**

Philippe Laurensy is a Managing Director and Head of Group Strategy, Product Management, and Innovation for the Euroclear Group. He is a member of the Euroclear Extended Management Committee, and Non-Executive Director for MFEX and Greenomy. Previously, he headed the Commercial Division and was responsible for Sales, Marketing and relationships with customers across the Euroclear group.


PETER KRAUS - Chairman and CEO - **Aperture Investors**

Peter Kraus is the Chairman and CEO of Aperture Investors. For over four decades, Peter has worked at major financial institutions including Goldman Sachs, Merrill Lynch, and most recently at AllianceBernstein (AB) where he served as Chairman and CEO, successfully leading the firm's turnaround after the crisis in 2008. Throughout his career, Peter has been a vocal proponent of pay-for-performance compensation models and the need for trust between active managers and their clients. After years of watching diminishing returns and increasing outflows, he concluded that a disruptive idea like performance-linked fees would only be successful in an entirely new firm, one built from scratch with client performance as its primary objective. That's why Peter teamed up with Generali to launch Aperture in 2018. Peter serves on the boards of multiple organisations including CalArts and the Capital Markets Institute of Third Way, and is the co-founder of The Kraus Family Foundation, a non-profit that supports public art and emerging artists. He is also the Chairman of Marstone, a leading independent digital wealth management platform. Peter received his B.A. in economics from Trinity College and his M.B.A. from NYU Stern School of Business. He and his wife Jill are avid collectors of contemporary art and enjoy spending time at their home in Dutchess County where they commission outdoor artwork.


BERNADETTE BUSQUERE - European Head of Hedge Fund Research
Amundi Asset Management

Bernadette Busquere Arnal joined Amundi Asset Management in January 2022 as European Head of Hedge Fund Research. Prior to joining Amundi, Bernadette spent 15 years of her career at Societe Generale, starting in April 2006 as Portfolio Manager of an Equity Long Short Fund at SGAM Alternative Investments until 2010 when she joined Lyxor Asset Management as a Portfolio Manager of several quantitative equity strategies. Bernadette joined the Hedge Fund Selection team at Lyxor in 2013 and was appointed European of Hedge Fund Research in 2020. Prior to joining Societe Generale, Bernadette was Equity Sales at ABN AMRO Securities from 2002-2006 in Paris and had held numerous positions in the Investment Banking Department of the bank from 1998 to 2002. Bernadette holds a Master of Science in Accounting and Finance from the University of Birmingham (UK) and a Master's Degree in Company Finance from the University of Assas (Paris).


JEAN-BAPTISTE BERTHON - Senior Cross-Asset Strategist - **Amundi Institute**

Jean-Baptiste Berthon is a senior Cross-Asset Strategist at Amundi Institute. He started his career in 2000 at SG Cowen in the US Economic Research team, before joining Lyxor AM as a fund of hedge funds manager and allocation strategist. He then joined J.P. Morgan where he became head of alternative investment in the Structured Fund Management unit. Before returning to Lyxor AM in the Cross-Asset Strategy team, he co-founded at T.S.A.F. a desk dedicated to the intermediation and analysis of illiquid hedge funds traded on the secondary market.


MASJA ZANDBERGEN - Head of Sustainability Integration - **Robeco**

Masja Zandbergen is Head of Sustainability Integration and responsible for coordinating ESG integration across asset classes. Previously, she has been working as a portfolio manager equities, managing European portfolios and a global fund aimed at young investors. Since 2003 she also specialised in Sustainability Investing. Prior to joining Robeco, Masja had roles as Portfolio Manager and Responsible Investment Specialist at her own company and Head of Equity at Syntrus Achmea. She started her career at Robeco in 1997 and rejoined Robeco in 2015. Masja holds a Master's in Econometrics from Erasmus University Rotterdam and is a CEFA Charterholder. In 2022 she was named one of Financial News' Fifty Most Influential in Sustainable Finance.


LLOYD MCALLISTER - Head of Sustainable Investment - **Carmignac**

Lloyd is Head of Sustainable Investment at Carmignac and a member of Carmignac's strategic development committee. Lloyd joined the business in December 2022 from Newton Investment Management. Lloyd worked at Newton IM from 2018, latterly as Head of ESG Research, responsible for setting and implementing the firm's responsible investment philosophy and research process. Prior to Newton IM, Lloyd was a Sustainability Consulting Manager at KPMG LLP. He is a qualified accountant and started his career in financial services in 2009.

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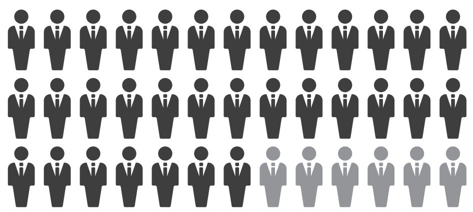

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Source: SGSS internal report - data as of 31.03.2023

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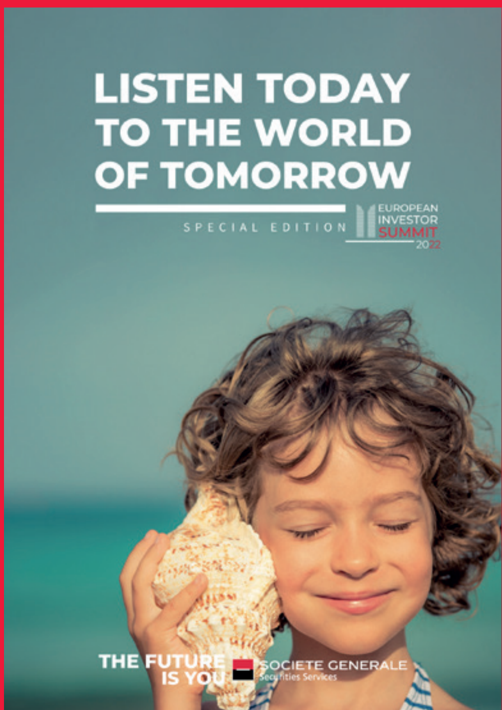

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