Trend setters

We take a look at four mega-trends to future-proof your portfolio...

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Analysts:

Jo Groves
Jo@keplerpartners.com

We turned our attention to 'mega-trends' in the third week of our 2024 ISA event, with four fund managers talking about the exciting structural opportunities across the commodities, biotech, technology and infrastructure sectors.

We think investors taking a dynamic approach to capturing these mega-trends in their portfolios may well reap the rewards over the next decade and beyond.

The gateway to net zero

Evy Hambro, co-manager of **BlackRock World Mining (BRWM)**, kicked off proceedings with a deep dive into the commodities sector. The over-arching trend in this sector needs little introduction given the column inches dedicated to the wide-ranging transformation needed to meet net zero commitments by 2050.

Commodities will play a critical role in this transition to low-carbon energy, which will drive high demand over the next few decades. Evy highlighted the "scarily large" volume of materials required to support renewable energy systems, with offshore wind farms requiring 5 times the steel, and 3 times the copper, of their gas-based counterparts. Another mega-trend is the roll-out of AI which will be materials-intensive in areas such as data centres.

Evy also spoke about the production constraints to supplying the vast quantities of materials needed. More than 70% of the capital expenditure by the global mining sector over the last five years has been sustaining existing levels, not expansionary, which has led to low levels of inventories.

BRWM has increased its weighting to copper over the last few months, partly due to a lack of 'shovel-ready' projects, whilst profit-taking in other commodities with a weaker outlook. Evy continues to see valuations as "cheap" given the current level relative to long-term averages and the broader market.

That said, negative sentiment towards the re-opening of China has proved a headwind for commodities over the last year. There has also been a divergence of fortunes between gold miners and the underlying gold price, which Evy attributes to the capital expenditure needed to maintain production and invest in exploration, due to the relatively short lives of many gold mines.

Looking ahead, Evy believes that further clarity on the economic outlook for China could create the catalyst for an "explosive move" in commodity prices given current supply constraints. More broadly, the mega-trend of decarbonisation is likely to furnish the commodity sector with secular growth drivers for some time to come.

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Older, richer, sicker

Next up was the biotech sector, which is well-positioned to ride the demographic mega-trend of an ageing population. Further tailwinds include the forecast increase in healthcare expenditure among developing nations and the exponential rise in the prevalence of heart disease, cancer and Alzheimer's in the over-50s age group.

Ailsa Craig and Marek Poszepczynski, managers of **International Biotechnology Trust (IBT)**, joined us to talk through the opportunities in their sector. They noted that the number of new clinical trials has doubled over the last decade, with biotech companies at the forefront of new treatments such as cell-based, gene and RNA therapies, together with gene-editing.

Ailsa and Marek also spoke about the cyclical nature of the biotech sector, which tends to trade inversely to US interest rates. They believe the sector has just reached the 'equilibrium' stage with a sustained rise in valuations. There has been a clear increase in biotech equity financing in 2024, along with tentative signs that the IPO market may be re-opening. As a result, IBT has increased its exposure to smaller companies with the potential to deliver higher returns.

M&A activity continues to be a key feature of the biotech sector, with a forecast increase in the proportion of revenue at risk from patent expiries over the next five years. IBT has seen M&A deals for 23 portfolio companies since 2020, with the most recent being the $14 billion acquisition of schizophrenia drugmaker Karuna Therapeutics. The offer premia paid has been a significant driver of returns for investors in the sector.

Looking forward, Ailsa and Mark pointed to the importance of stock-picking in their investment process, including identifying companies targeting an unmet medical need which offer pricing power, financial strength and/or a monopoly position. They also apply a top-down overlay to manage risk, such as investing in a basket of companies in the same therapeutic areas and diversifying across the market cap and development stage spectrum.

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The octopus of digitalisation

The increasing digitalisation of our lives is arguably the most revolutionary of the current mega-trends, from driverless cars to connected medical devices. That said, it can be challenging for investors to position their portfolio to capture this mega-trend given the dominance (and current valuations) of the magnificent seven.

Michael Seidenberg, manager of **Alliance Technology Trust (ATT)**, talked through some of the underlying trends in the technology sector. The largest exposure in ATT's portfolio is currently AI and machine learning, with Michael predicting that fully-autonomous systems could approach human intelligence in the next 15 years. The trust also has a significant exposure to cybersecurity due to the need to protect the ever-growing quantity of data online, which should drive significant growth.

Michael also spoke about the strong and sustainable secular tailwinds in the cloud computing market, pointing to the forecast 45% cloud penetration of the enterprise IT stack by 2030 leaving plenty of scope for future growth. Cloud services have allowed companies to turn the fixed cost of infrastructure into a variable cost, as well as outsourcing innovation to third parties.

Technology valuations remain high but Michael believes these are supported by tangible earnings and cash flow. Although NVIDIA, Microsoft and Meta are ATT's top holdings, the trust is overweight mid and large-caps, and underweight mega-caps (relative to the Dow Jones World Technology Index). The trust benefits from a well-resourced research team based in San Francisco, near the innovation hub of Silicon Valley, which has borne fruit in terms of a five-year net asset total return of 154% (as at 19/03/2024).

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Infrastructure

With governments continuing to run deficits, private investors are playing a crucial role in funding infrastructure investments. One trust that is active in this area is **BBGI Global Infrastructure (BBGI)** and manager Duncan Ball presented at this week's event.

Duncan kicked off by noting some of the trust's core strengths, namely the stability of its cash flows and the consequent ability of the trust to pay a rising dividend. BBGI invests in availability-style assets. These are things like schools or hospitals, where revenues are paid so long as the facilities are available for use – as opposed to other infrastructure investments, like toll roads, whose revenues are dependent on how much they are used.

One of the key highlights is the trust's inflation-linkage, which is baked into the contracts BBGI forms with its counterparties. This has meant that over the last two years, higher than anticipated levels of inflation have actually benefitted the trust, resulting in increased cash flows.

Another key point that Duncan highlighted was the trust's exposure to higher rates. BBGI currently has 56 holdings, 55 of which have fixed-rate borrowings that have no refinancing risk. The managers have also hedged out a significant portion of the refinancing risk in the remaining investment.

One of the final points Duncan looked at was historical returns in infrastructure when trusts in the sector have traded at the levels they are at today. This is obviously not a guarantee of future returns but, as we noted in a recent article looking at BBGI, a lot of its attractive features do leave us wondering if there will be a rerating of the trust at some point.

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