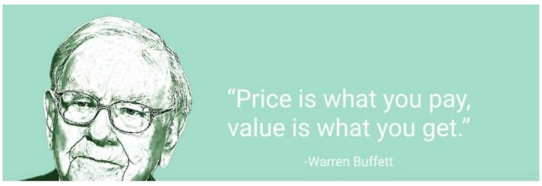
APOLLO
APOLLO MULTI ASSET

Once in a generation opportunity



The first half of 2024 has once again seen the accelerating leadership of the mega cap US "tech" stocks, with Nvidia remaining the poster child of AI euphoria. The performance of these few names has led the US indices up to all-time highs and rarely have we seen so few stocks dominating index returns. Many market participants are calling for the broadening out of equity returns into other regions and sectors supported by the resilience of solid earnings growth, the increasing likelihood of interest rate cuts and as investor positioning shifts away from the over-exuberance of the mega cap US tech companies. However, we do not advocate chasing this last hurrah in such a narrow section of the market, instead we favour positioning in those companies and sectors which have been left behind and offer exceptionally compelling long term opportunities.

- **Prices are at once in a lifetime levels.** The chart below is vital to understanding the portfolio strategy that we are following on your clients' behalf. It clearly illustrates that over the longer term, there is a direct and undeniable correlation between the price you pay for a stock (as measured here by Price to Earnings ratio) and the subsequent returns. Simply put, the lower the ratio the better the long-term return. As a result, our portfolios typically have equity market exposure as far to the left of the chart as possible, with many of our managers having portfolios as shown in the circle.

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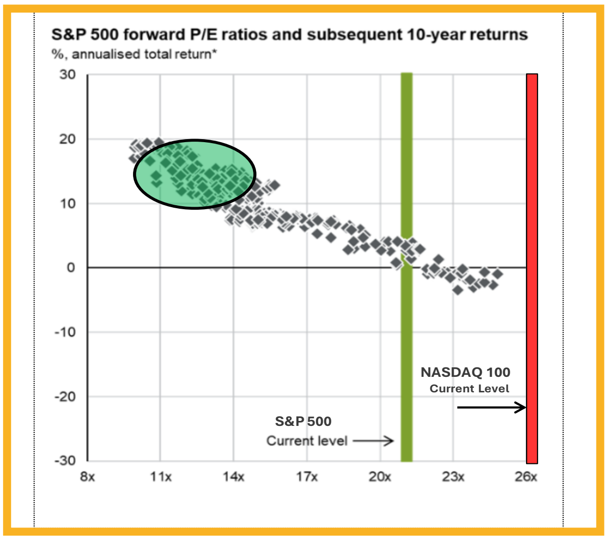


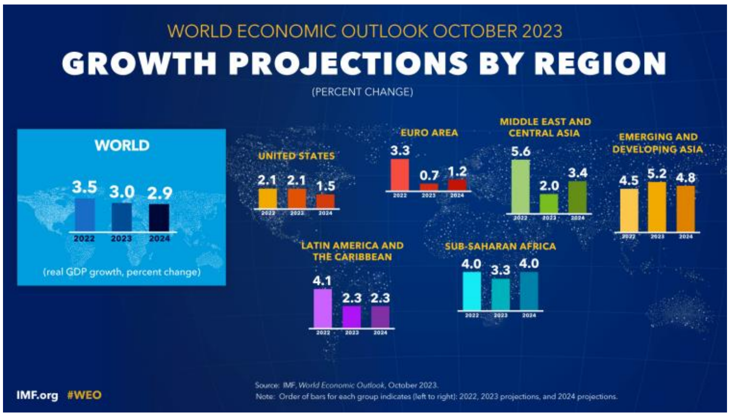
- To further put this into context, the tech heavy NASDAQ 100 index, currently has a forward PE ratio of 26 (Source: Bloomberg 05/07/2024) , thereby setting an extraordinarily high barrier for investors to receive strong and consistent returns over the next few years.

- This strongly suggests that over the longer run we will be rewarded with superior gains. We do not know how long investors will favour the expensive technology companies in the US, but we believe it is a very compelling strategy to buy overlooked, cheap, high quality companies with strong earnings growth at this time. The recent focus on the US tech sector has opened up many opportunities which in our view offer significant return potential for the patient investor.

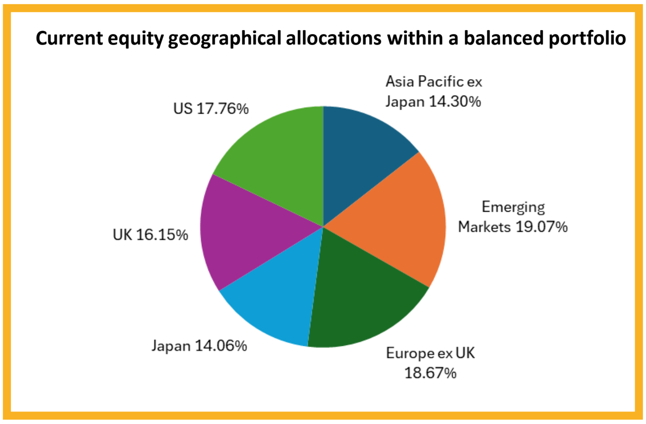
> *Determining when an investment trend has run its course is more of an art than a science. While we love the productivity-enhancing possibilities that artificial intelligence (AI) offers, the AI phenomenon has many of the hallmarks of an inflating bubble. There are big bucks chasing the AI dream. New kings of industry have been crowned. And the hyperbole is flowing.*
>
> Ed Yardeni, Yardeni Research 04/07/24

Exciting opportunities, themes and tailwinds

- **Geographically spread** in regions and countries which are at the turning point of their economic cycle and beneficiaries of falling interest rates and the dollar weakening as US interest rates come down. Countries in emerging markets and Asia can again be supported by structural growth trends underpinning the long-term investment case. Many economies and markets outside of the US have been fairly stagnant or performed poorly over the last 18 months as the effects of tighter monetary policy has worked through. The chart below from the IMF highlights that while global growth is expected to be at similar levels in 2025, there seems to be a change in leadership for where the growth will come from. We are particularly concerned for the US where a new presidential cycle will be underway and the debate will focus on the budget deficit, expiring tax cuts and the US debt ceiling.

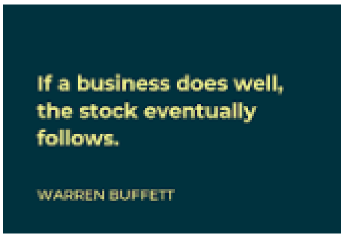


Source: IMF.org October 2023



Source FE Analytics and Apollo MAM 05.07.24

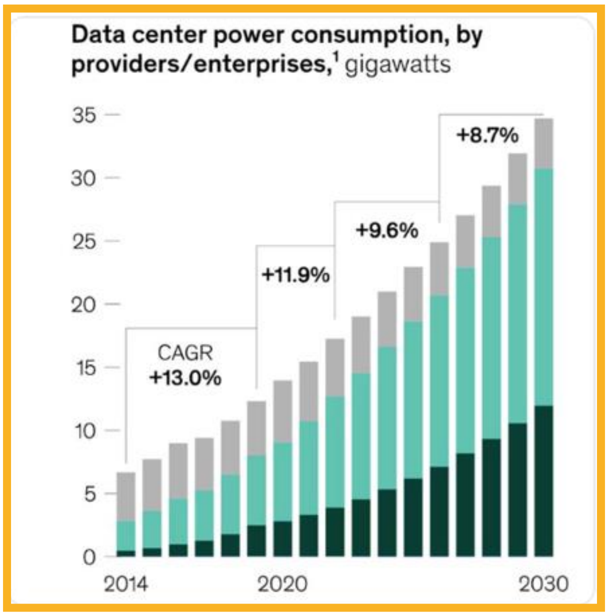
- **Sectoral diversification** in real world industries generating good cash flow and earnings. Our sectors are supported by buybacks and dividends to enhance shareholder returns and currently are on very cheap valuations offering significant upside. The outperformance of mega cap tech companies has drawn significant capital away from other areas of the market and economy. However, while we don't advocate chasing who might be the winners or losers in the AI tech battle, the potential for artificial intelligence to enhance the earnings potential for many businesses over time can be found in many of our underlying themes. **Healthcare** is a long-term global growth theme with ageing populations in developed markets and growing access to better quality healthcare in emerging markets. It is a sector with a number of sub-sectors to cherry pick value opportunities away from some of the over-hyped themes such as wonder weight loss drugs. New product cycles are looking to support strong revenue growth and the potential for AI to drive innovation could have a significant impact on these companies.



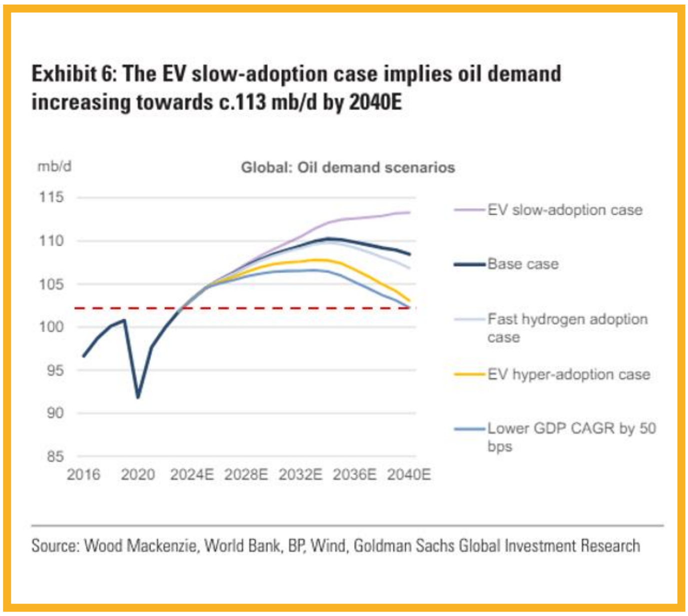
Stable businesses such as **insurance** offer good upside at current levels, supported by rising premiums and structural global demand for the products. Rising frequency and severity of risks from climate change to cybercrime has intensified the need for insurance from corporates. Supportive demographics in Asia and emerging markets are driving demand for personal insurance cover from great home ownership, personal protection and health insurance.

Unloved and under-invested industries such as **energy and mining**, are supported by growing demand from the technological evolution and the drive for a more sustainable future. Current price levels and earnings expectations are incredibly low and offer significant upside. In the case of mining, there has been a number of headwinds, particularly due to the sector being seen as a proxy for Chinese growth and also due to ESG factors. Nevertheless, any increase in demand could see a sharp move higher. With the crumbling infrastructure in the west, the roll out of the electricity grid in many parts of the East and the ongoing energy transition, we believe that the sector is facing much more demand growth than has been removed from the collapse of Chinese real estate. In addition, there has been a dislocation with company share price moves and the price of the underlying resources.

Energy is a key theme within our portfolios. Despite the ongoing strength of the oil price (solidly above $80pb) and there being very little sign of a collapse in demand or a rapid expansion of production, analysts still believe that the energy sector will see declining revenue in the next two years. This seems particularly at odds with the expected energy demand for key growth industries. Below are charts highlighting firstly the energy demand for data centres growing from 17GW in 2022 to 35GW by 2030, growth of 10% a year as highlighted below (Source: McKinsey Consulting 2023). Secondly, the differing scenarios of oil demand depending on the speed of the adoption of electric vehicles, showing clearly in all scenarios a pick up in oil demand in the near term. With such a pessimistic outlook from analysts, even a small beat on earnings numbers will see a strong run in the already historically cheap, under owned and unloved sector. The sector is currently giving back more money to shareholders than it is investing which is unprecedented versus history and illustrates how much capital discipline now exists in what was historically a very un-shareholder friendly sector.



Source: McKinsey Consulting 2023



Source: Goldman Sachs Research June 2024

- Broad exposure to the **full market cap spectrum**. The advance of the mega tech companies has diverted capital away from the **small and mid cap** companies in recent years. At Apollo, we are increasingly excited about UK small and mid cap companies. They have been largely ignored by the investment community for a long period of time, are at exceptionally attractive price levels and while managements are supporting share prices through buybacks, external buyers are finally emerging. These companies are now trading at historic low valuations and yet are positioned very well for the changing macro environment and falling interest rates. This area of the market has already begun to see M&A activity internationally from the bigger companies and also interest from private markets. These are all signals that prices are too low and a sharp re-rating could occur imminently.

Drivers of performance

Successful Investing takes time, discipline and patience.

WARREN BUFFETT

Equity

- Long term investors – short term underperformance in market euphoria
- **Prices for many high quality and growing companies are at once in a lifetime levels** both relatively to the US and absolutely to earnings potential as the economic cycle turns.
- Many economies and markets have been stagnant the last 18 months as the effects of tighter monetary policy has worked through but this is changing
- Economic cycle turning, falling interest rates, inflation normalizing
- Weakening data, uncertainty over elections, debt problems and tax cuts look likely to hamper optimism for the US the US next year
- Any signs of US retail/passive investors **shifting allocations** away from mega cap tech will see outsized gains in many areas as the prices currently being paid are cheap
- M&A is picking up, signs that prices are too low for attractive businesses
- Market **performers will broaden out** and the price discrepancy will normalize over time
- The significant leadership of the Nasdaq versus the MSCI World for the past 15 years and the extreme market valuation suggests there are many opportunities to generate attractive returns for investors outside of the tech sector.

Source: FE Analytics 14.08.98 – 03.07.24

Absolute Return

- Basket of funds aimed at generating **cash plus returns** regardless of whether markets are rising or falling, although a positive return is not guaranteed. Absolute return funds have a different investment objective to relative return equity or fixed income funds and use derivatives to manage the risk and return profile. These funds use a number of strategies, including “short” positions which allow a profit to be made if the value of a stock or index fall, to diverse their risk and provide protection. These funds aim to generate a steady rate of return with low volatility

Fixed Interest

- UK and European government bonds – should provide uncorrelated returns if the market is more volatile
- Offering **decent yields** currently and upside in the price as interest rates are lowered by central banks

Property

- Impacted by the speed of interest rate increases as the cost of borrowing fed through to this sector
- Yields of 7% and above are available in many sectors
- Rental growth remains positive for those sectors that have secular growth tailwinds
- Sector specific exposure to supermarkets, healthcare centres and last mile logistics i.e. warehouses storing goods delivered by Amazon for example
- Strong stable business models, **dividend growth,** price paid for these shares is at a discount to the asset values

What happens next?

The soft-landing scenario seems to have become consensus during 2024, in that the Federal Reserve in the US has potentially orchestrated inflation to fall and yet maintain reasonable levels of growth in the US economy. While the rate cut story in the US has been swamped more recently with political noise around the upcoming elections, there most likely will be cuts in the next 6 months as either inflation cools to a reasonable level or the economy starts to slow down. We may not see a technical recession due to the government spending, and this will allow the US central bank to cut at its own pace.

The outlook for the US economy in 2025 is where our main concerns lie, the new presidential cycle will be underway and the debate will focus on the budget deficit, expiring tax cuts and the US debt ceiling which puts upwards pressure on yields. So while there may be short term opportunities in US equities and Treasuries, we would rather position in areas outside of the US which we believe are also beneficiaries of falling US interest rates, supply chains normalising and inflation subsiding, and most importantly, are already near the bottom of their economic cycle with forecast growth in GDP for next year. Global Central banks can continue to cut rates without fear of importing inflation, and with lower financing costs and transaction costs on goods & resources priced in USD can stimulate global activity. This in our mind reinforces our optimism for quality value companies in stable sectors, small and mid cap companies, commodities & energy, emerging markets and Asia.

APOLLO MUTLI ASSET MANAGEMENT

Founded in 2008 with two of the first multi asset funds in the UK, Apollo has a proven track record of building strong, lasting relationships with clients and financial planners alike. After the launch of the first funds, Apollo quickly adapted to the growth in platform-based portfolios with the launch of the risk graded, platform-based portfolio range called Athena. In the subsequent years, due to client demand, we have continued to innovate and have launched a range of multi asset Passive+ portfolios, an ESG solution and a DFM range of portfolios.

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