RBC Global Asset Management

Megatrends 2022

Turmoil fails to derail long-term investment trends

It's been a tumultuous year for investors. Near-term pressures such as stagflation and economic volatility have raised questions about investing in long-term megatrends. But climate change and technological advances remain major investment drivers, according to our new survey of 800 fund buyers, consultants and wealth managers.[1]

Introduction

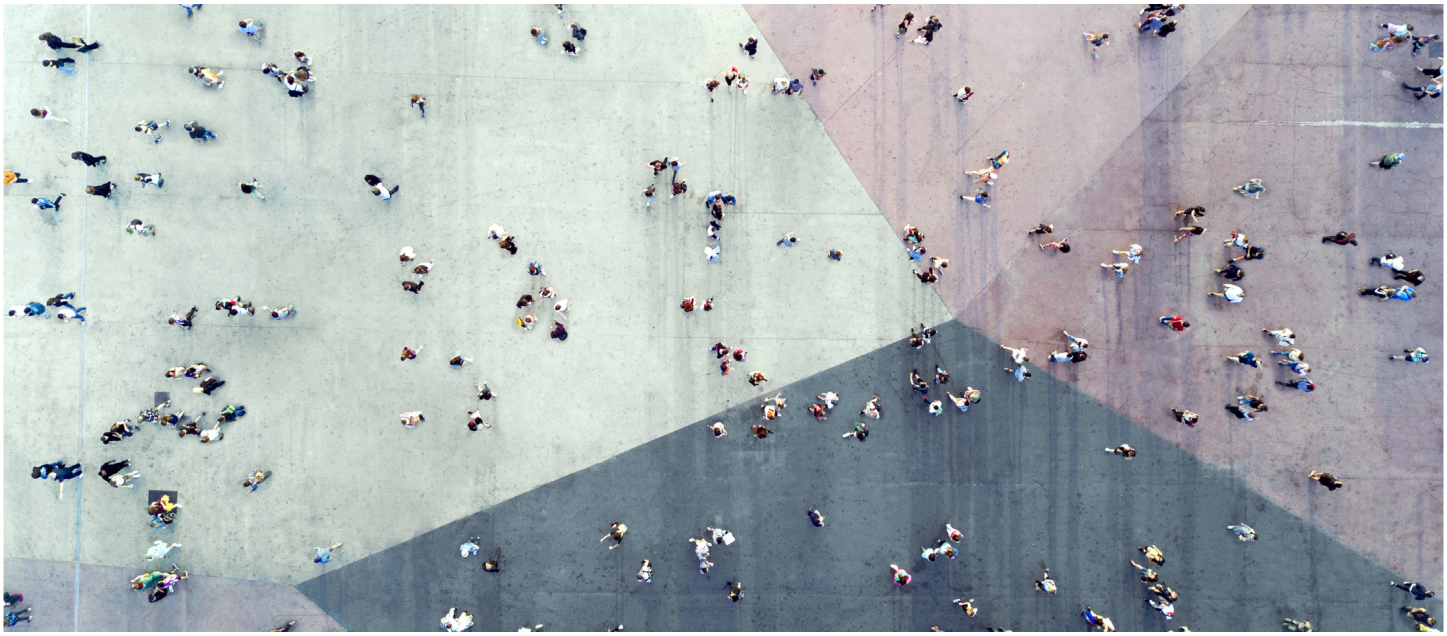
This year has been unprecedented. The Russian invasion of Ukraine has led to a major global supply chain shock that has triggered shortages of cooking oil, grain and – perhaps most significantly for the future of the world economy – energy, with many countries' dependence on Russian gas exposed. The scale of this crisis also reflects how many countries have not yet built sufficient renewable energy capacity.

Interviews with 800 fund buyers, consultants and wealth managers

Market	Number of interviews
US	200
UK	100
Germany	100
Switzerland	100
Nordics	100
Italy	100
Spain	100

Source: Fieldwork - September 1 to October 7, 2022.

"We have increased our panel of wholesale investors to 800, from just over 500 last year, and they span seven regions – the US, the UK, Germany, Switzerland, the Nordics (Sweden, Denmark, Finland and Norway), Italy and Spain."



[1] The fieldwork for this survey was conducted between 1st September and 12th October 2022 by research house Opinium Research on behalf of RBC BlueBay Asset Management. Views from 800 wholesale investors were canvassed across the UK (100 respondents), Germany (100 respondents), Italy (100 respondents), Switzerland (100 respondents), Spain (100 respondents), the Nordic countries (100 respondents), and the US (200 respondents).

Climate change and technology remain megatrends

What will be the main megatrends over the next 3-5 years?

- Climate change and scarce resources
- Technological advances
- Healthcare innovation
- Changing population demographics
- Change in macroeconomic paradigm
- Global polarization
- Maturing of emerging markets

Our 2022 Megatrends survey explores whether the themes we identified in our inaugural survey last year are enduring, or whether their influence on investment decisions has been replaced by newer concerns.

There is an overwhelming consensus (90%) that last year's main themes – climate change (60%), technological advances (59%) and healthcare innovation (36%) – will be the key trends that influence investment decisions over the next five years.

Higher inflation rates weighing on returns for at least 3-5 years is a concern for half the respondents. US investors are most pessimistic, with 59% expecting a drag on returns over five years, while 26% think it will go beyond six years. International wholesale investors mainly expect portfolio returns to hover in the 5-6% range during the period, with 39% of those surveyed taking that view.

Investors not moving off long-term plans

How does short-term volatility influence portfolio allocation in an environment where investors say they want to honor long-term strategic themes? One particular narrative for the past couple of years suggests that investors have sought shelter from the volatility of public markets by piling into private markets.

Our survey does not fully support that thesis.

Respondents are on average allocating 22% of their portfolios to private markets, and more than half (54%) either expect not to increase or even to decrease their holdings over the next 3-5 years. Of the remainder, only 14% forecast a significant increase. At the same time, just over half (56%) of respondents expect public markets to outperform private markets over the next 5-10 years.

Asked for their views on how the current market volatility will affect the investment case for public equities and fixed income, 46% of wholesale investors said it hasn't changed the case for investing in public markets, with the remaining respondents split equally between supporters and detractors.

The case for public markets is further strengthened by asset allocation priorities over the next three years. Equities and fixed income remain the primary allocation choices for 31% and 27% of respondents, respectively, ahead of other asset classes.

Similarly, the preferred investment approach by the majority of respondents (77%) is active over passive. This is perhaps reflective of investors' appreciation of the need to be nimble and not as tied to indices, allowing them to potentially shield more against the volatility of investing in public markets.

Global Results Executive Summary

Emerging markets (EM)

An overwhelming majority and more than last year (86% versus 83% in 2021) expect EMs to grow. All respondent markets are looking to capitalize on this, with more investors in the UK and Switzerland set to allocate funds in this area compared with last year. Within EMs, Asia (excluding China) continues to be considered the most investible with 59% of respondents agreeing, although China has increased by 5% in importance since 2021, up to 41%.

Future asset allocation

Market capitalization (42%) and sectors (40%) are the most commonly used filters for portfolio allocation, but that is likely to shift to earnings per share growth. For current and future fund selection preferences, there are likely to be global shifts towards small and mid-cap (30% to 33%) and large cap (40% to 42%) over the next three years, as well as to absolute return (33% to 37%) and value (28% to 33%).

Environmental, social & governance issues

Most international wholesale investors (57%) say that environmental, social & governance (ESG) issues are an important consideration. This is especially the case for US wholesale investors at 68%. The Russian invasion of Ukraine and concerns surrounding supply chains are driving the influence of ESG.

Private and public markets

Investors are allocating an average of 22% to private markets, with more than half (54%) of those surveyed expecting not to increase this over the next 3-5 years. Just over half (56%) of investors believe public markets will outperform private markets, and this view is held more strongly in the US market, at 70%.

Market outlook

International wholesale investors see climate change and technological advances as the key megatrends over the next five years, with most continuing to believe investing in megatrends will influence how capital is allocated. The majority predict that inflation will weigh on returns for up to 3-5 years and that the average rate of return will be 5-6% during that time.

Where investors put their money

- International wholesale investors expect North America (25%) and China (27%) to continue to record the biggest equity rally. However, this is down from 2021 (with North America at 30% and China at 32%) and there are signs of a shift towards Europe (Western Europe up 4% to 19% and Central and Eastern Europe up 5% to 9%).

- Nordic wholesale investors are the only ones using inflation-linked bonds (45%) as their primary hedge against the surging inflation risks. Internationally, this strategy comes fourth (38%) after increasing exposure to a fixed income asset class that trades well in this environment (46%), rebalancing asset allocation from equities to bonds (42%) and expanding allocation to private markets (39%). The latter is primarily driven by US investors (53%).

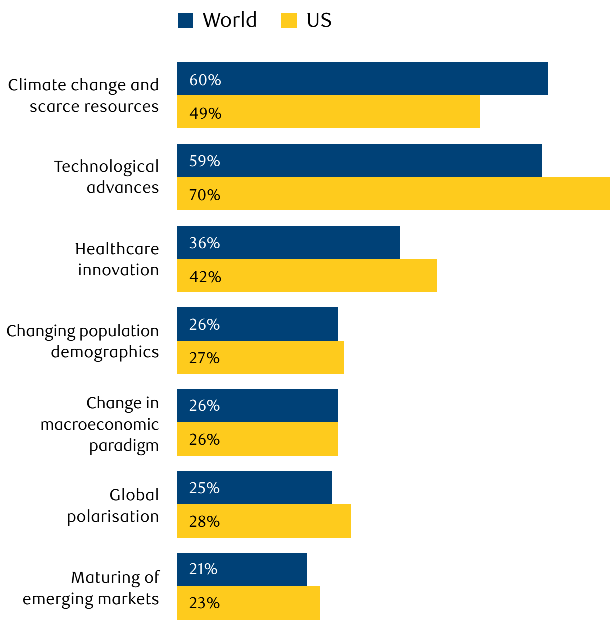
- Comparing findings from our 2021 survey versus 2022, there are likely to be shifts towards ESG factors within investments, and away from sustainable investing over the next three years in the UK (54% from 46% currently), Germany (49% from 44%) and Switzerland (52% from 47%). There are opposite moves towards sustainable investing in the Nordics (55% versus 39%), Italy (58% versus 49%) and Spain (46% versus 40%).

- China has remained largely separate from EM allocations (61% separate versus 39% part of the allocation). The biggest shift in the last year has been among German investors, with 48% now keeping China separate from EM allocations versus 52% last year.

US wholesale investor’s responses

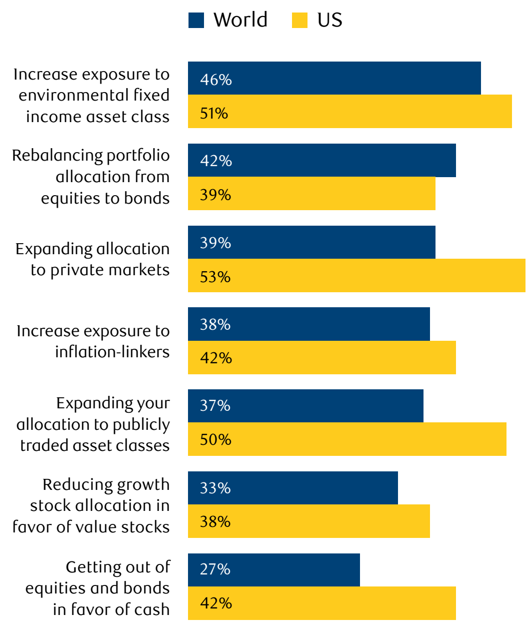
The vast majority of US wholesale investors (87%) consider megatrends to be important in deciding capital allocation over the next 3-5 years.

What will be the main megatrends over the next 3-5 years?



Source: RBC Global Asset Management and Opinium Research, October 2022.

How are you adjusting your asset allocation to benefit from rising interest rates?



Source: RBC Global Asset Management and Opinium Research, October 2022.

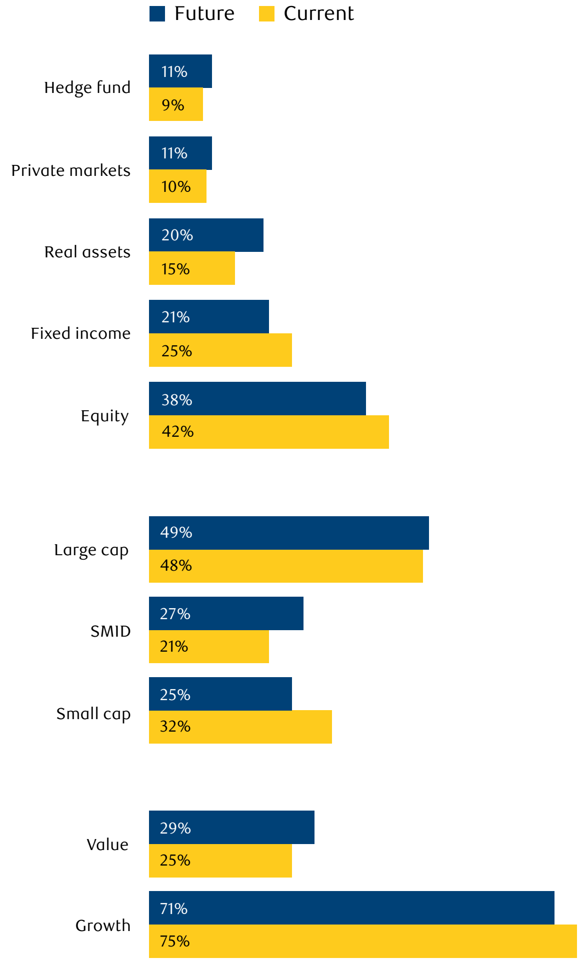
Investors in the world’s largest economy firmly back public markets, with 70% (versus 56% internationally) of them expecting public markets to outperform private ones.

They are currently allocating 25% of capital on average (versus 22% internationally) to private markets, with more than half of them (55%) either planning not to increase or to reduce it over the next 3-5 years. They are the most pessimistic about inflation weighing on returns (59%, with the international average at 50%) over the same period.

Unlike most of their counterparts in other regions, their primary focus from an asset allocation perspective, in order to benefit from EM growth, is Central and Eastern Europe (58%), ahead of Asia and China (49% and 30%, respectively).

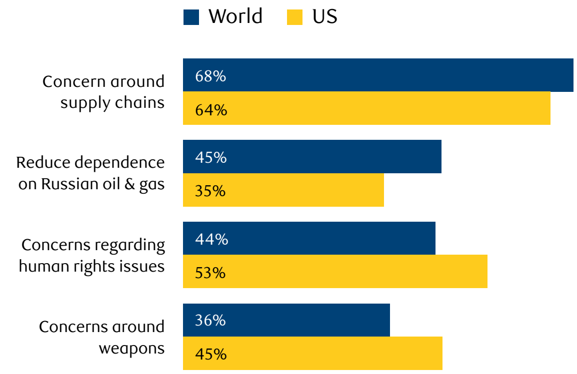
Market capitalization and sectors are the most-used investment filters for US investors (both 40%), but they see that shifting to sectors (75%) and earnings per share growth (69%) in the future. For current and future fund selection preferences, US investors plan to shift more assets towards SMID (27% in the future versus 21% currently) and value (29% in the future versus 25%). However, investors expect to continue to favor large cap growth.

Current and future fund selection preferences



Source: RBC Global Asset Management and Opinium Research, October 2022.

What are the factors driving this greater interest in ESG?



Source: RBC Global Asset Management and Opinium Research, October 2022.

Investors in the US are most likely to consider ESG factors as important (68%), with the Russian invasion of Ukraine and concerns about supply chains having a great deal of influence in driving interest in ESG factors (80%). Almost half of those (47%) who don't profess an increase in interest say they are driven by the outperformance of sectors traditionally not considered to be ESG-friendly.

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