Arnerich Massena
Securing the Future Together

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Arnerich Massena Forecasts Investment Trends of 2020: Tectonic Shifts in the Investment Landscape

PORTLAND, Ore., Dec. 13, 2019 — Portland-based investment firm Arnerich Massena, an independent investment advisory firm specializing in private wealth management, endowment & foundation, retirement plan consulting services, and impact investing strategies, takes a look into 2020 to forecast some of the shifts and cultural changes that we think may affect the investment environment next year.

The firm's predictions are not meant to be investment recommendations, but provide an interesting look into the potential cultural changes that could affect the future investment landscape for everyone. "2020 is likely to bring significant changes, with an election, technological advances, and economic shifts," says co-CEO and co-CIO Bryan Shipley, CFA, CAIA. "Hopefully a heads-up into the possibilities will help investors as they think about navigating through the next 12 months."

Along with the publication of the 2020 Investment Trends, the firm also offers an accompanying podcast featuring firm principal and senior research analyst Arthur Coyne, CFA, and research analyst Melissa Liu in a deeper discussion of these trends and the company's thinking around them. Listen to the podcast on SoundCloud or YouTube.

Tectonic Shifts in the Investment Landscape: Investment Trends to Watch For in 2020

Last year, we saw the first trillion-dollar companies; this year, we saw the beginning of billion-dollar IPOs, better known as unicorns. Last year, we talked about robotics and machine learning; this year, we've jumped to 5G, the Internet of Things, and quantum computing. Global uncertainty remains elevated, with a continued trade war with China; massive protests across areas like Hong Kong, France, Chile, and Iraq; and a pivotal Presidential election coming up in the U.S. The landscape for investors has already changed over the last year; what can investors expect going into 2020?

Heading into 2020, we see a youthification happening across our culture, as the younger generations take control of the wealth, the political machine, and the economy. This will have wide-ranging impacts for investors. Technology, as well, is advancing exponentially, and the leaps we'll see in our digital landscape in 2020 are likely to eclipse 2019 changes. The changes extend not only to what we invest in, but to *how* we invest. Following are some of the shifts and cultural changes we think may affect the investment environment next year. Please note that we offer these predictions not as investment recommendations, but as an interesting look into the potential cultural changes that may affect the future investment landscape for everyone.

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Investing as political action

Investing has become part of the political sphere in several ways. As U.S. wealth transfers to the next generation, Millennials and Generation Z are looking toward investing as a way to identify with and broadcast their political and moral beliefs. They want to make a difference in the world, and recognize that one of the best ways to accomplish change is by putting their capital toward the things they care deeply about. We anticipate a growing interest in impact investing, gender-lens investing, responsible and ethical investing, and ESG investing as Millennials look to their portfolios to provide deeper meaning in their lives.

On the other side of the spectrum, politicians are using investors as leverage. The trade war with China, the sanctions on Russia and Middle Eastern countries — these are ways that U.S. politicians can leverage the potential for foreign investment to try to effect certain changes. Because few people want to engage in outright shooting wars, proxy financial wars are becoming the preferred method of creating geopolitical change. As global economic politicization spreads, so do the risks for investors, at least over the short term. Over the long term, we still think international and emerging markets offer significant opportunities, and we are focused on distributing risk across countries and geographic regions so that no portfolio is dependent on a single country's political climate.

New investment structures and the decline of the IPO

Public markets are clearly getting smaller; between 1997 and 2017, the number of stocks listed on U.S. stock exchanges declined by half (even though market cap increased). Many investors are looking to private markets to fill the gap, but not all investors have the ability to access private investments, nor to bear the illiquidity that comes with private equity and hedge fund investing. Enter interval funds, a type of publicly available closed-end fund that is not listed on an exchange and that periodically offers to repurchase a limited percentage of outstanding shares from its shareholders. Interval funds democratize private investments by making them accessible to a broader segment of investors.They often invest in income-producing strategies and offer investors access to less liquid investments in a vehicle similar to a mutual fund. Interval funds tend to have some liquidity constraints and redemption limitations, but are more liquid and have lower investment minimums than many private equity and alternative vehicles.

As the industry looks for ways to expand opportunities for investors, we are also likely to see some archaic structures beginning to go the way of the buggy whip. IPOs are one of those structures that appear to be in decline, as this last year has seen several high-profile IPOs stumble out of the gate (e.g. Uber, Lyft, WeWork). Direct listings may become an increasingly popular alternative to the IPO, as they eliminate the Wall Street middle men and offer greater efficiency to investors and owners alike. In a Direct Public Offering (DPO), the company offers existing shares (typically held by founders, key employees, early investors, and venture funds) to the public market rather than underwriting a new issue of stock, thus providing liquidity for those shareholders but not raising any new capital for the company. As such, DPOs currently benefit late-stage, venture-backed companies that do not need to raise new capital (generally because they are already profitable or have an established path to profitability after a recent private offering) but want to provide existing investors with liquidity without the traditional lock-ups that apply to many existing investors in a traditional IPO. While DPOs have been around for a long time, the new York Stock Exchange tweaked its listing rules to allow the recent Spotify DPO (which created a lot of buzz) and recently proposed additional rule changes that would allow companies to sell new shares in a DPO, raising new capital for the company. While the NYSE's proposal was just rejected by the Securities and Exchange Commission, the NYSE remains

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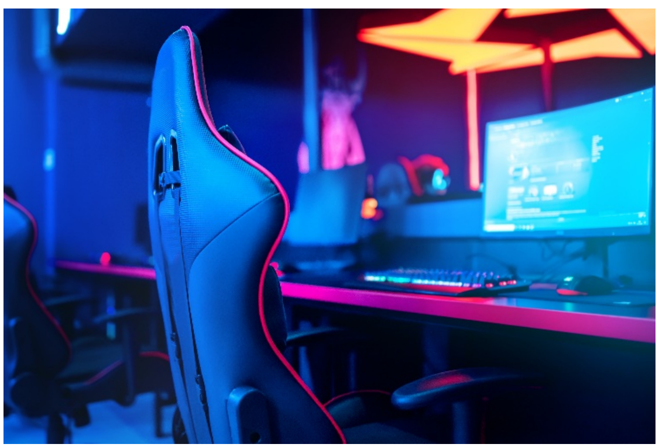
committed to evolving the DPO, and we believe potential benefits of DPOs will drive significant interest and substantive changes to how they are utilized in 2020 and the immediate future.

Negative yields and the search for alternatives

In 2019, the global supply of negative-yielding debt — bonds that pay their holders back less than their original purchase price upon maturity — rose to more than $17 trillion.[1] As this once-unthinkable phenomenon has become commonplace (over a quarter of global investment-grade bonds were paying negative yields as of September 2019), bond investors will need to be thoughtful about their bond strategies in 2020.

While U.S. bonds are not generally in this camp (yet) and are still delivering a positive nominal yield, many are likely to fail to preserve purchasing power after inflation. We expect that alternative income strategies, such as hedge funds, private debt, and the above-mentioned interval funds, may increase in popularity with investors and contribute to positive long-term return and diversification. We also foresee an uptick in currency exchange rate volatility in 2020 as negative yields drive investors to rethink their currency allocations.



The digital revolution

Technology is clearly growing at an unbelievably rapid pace, and the investment landscape will see new impacts in the New Year. As the 5G rollout launches across the globe and the Internet of Things becomes visible on the horizon, people will be inhabiting a world as digital as it is real. In many ways, our digital and physical landscapes are merging into a single seamless reality. eSports is a great example of this; eSports refers to competitive video gaming where video gamers compete in a public arena for prizes and titles. This has quickly become a billion-dollar industry with an audience estimated in the hundreds of millions and continuing to grow rapidly. The investment opportunities span streaming platforms, advertising, media rights, merchandising, etc. We anticipate that 2020 will bring an expansion of investment opportunities in the digital space in previously unimagined ways, such as quantum computing and artificial intelligence.

With the digital revolution comes a greater need for cybersecurity, and this rapidly expanding industry offers investors significant growth potential. Cybercriminals are keeping up with the times, and new methods for preserving privacy and information security are becoming a necessity. The data breaches didn't slow down after the Experian hack in 2017: in 2019, Facebook experienced a breach of 540 million users' data, and First American Insurance discovered that it had exposed 885 million financial records on public servers. In addition to the danger from cybercriminals, advertisers are working hard to collect ever more granular data for targeted messaging. And we are willingly supplying ever more data via new channels like our home assistants, televisions, security systems, and even electrical meters, all of which are constantly listening to us and tracking us. All that sensitive data goes somewhere, and the need to keep it out of the wrong hands will become ever more critical.

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Going rural

The last decade has seen explosive growth in U.S. cities, particularly the coastal cities. The areas between cities and in the rural heartland have been largely overlooked during this busy urban growth period. But as cities become saturated and plagued with high costs of living, rural communities are beginning to look like attractive areas for investment. Rural businesses, with lower overhead costs, may become an area of growth for investors to consider. Rural areas will also require attention to bring energy efficiency technology and even basic technology services to out-of-the-way places. This may become an excellent opportunity for investors seeking to make a demonstrable impact with their assets.

China

China, the world's largest exporter and most populous nation, will definitely be in the headlines in 2020. Relaxed regulations have been opening the Chinese market, inviting more foreign investment, and concerted efforts to eliminate corruption and intellectual property theft make investment more accessible and attractive for U.S. investors. The Belt and Road Initiative could create massive improvements in Chinese infrastructure and connectivity with the rest of Asia and Europe. On the other side of the coin, China is still plagued with political strife, particularly as the Hong Kong protests and trade war continue, and American investors need to ensure that overseas investments are adequately diversified.

The return of fundamentals

In 2018, more than 80% of companies going public in the U.S. lost money in the 12 months leading up to their IPO. In 2019, we saw Uber and Lyft IPO go through an IPO and almost immediately drop precipitously in value, while WeWork actually withdrew its IPO due to its massive decline in value. We've written for several years about the steep price to earnings ratios among the largest companies in the S&P 500. Market exuberance has helped to support the longest bull market in U.S. history, but fundamentals really do matter, and the losses from the IPO and unicorn debacles serve as a potent reminder of this. We believe that 2020 will bring with it a return to fundamentals, as investors refocus on seeking companies that have strong profit margins, excellent governance, quality management, strategic direction, a long-term value proposition, and demonstrated market share. After all, unicorns really are mythical creatures.

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2020 Elections

No discussion of 2020 would be complete without mentioning the 2020 U.S. elections, which are bound to play a role in the investment landscape next year. Several proposals being floated by presidential hopefuls would greatly alter the financial playing field, such as universal basic income (UBI), a wealth tax, and Medicare for all. There's no way to foresee the outcome, but we suggest that investors prepare by enlisting the assistance of their advisor(s) to help navigate the potential volatility of a political transition.

With the speed at which global change occurs growing ever more rapid, the tectonic plates under the investment landscape are constantly shifting. 2020 will be another year of change, with technological leaps, potential electoral shifts, and transformation in how we participate via private investment. As always, we wish all investors a Happy New Year; may your portfolio strategy be thoughtful and disciplined in the coming year!

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