VanEck®

PORTFOLIO COMPASS

Alternative Assets Outlook

June 2024

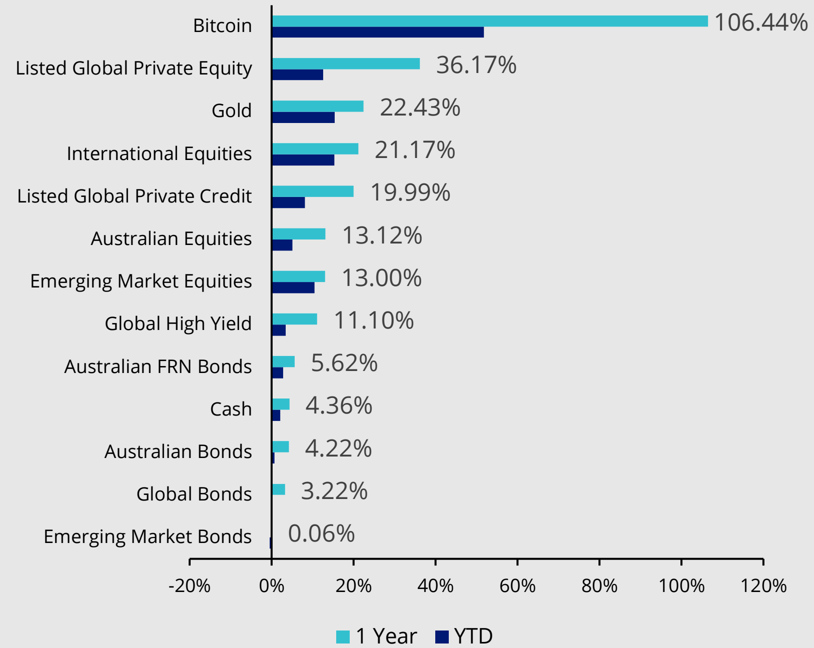
Executive summary

If the past 12 months taught investors anything, it's that being selective and diversified is key to riding the economic cycle. Had investors avoided risk assets on the back of many economists calling the "most anticipated recession" that never happened, they would have missed the stellar markets run led by listed alternative assets. The artificial intelligence boom also generated a frenzy across equity markets with the S&P 500 and the MSCI World ex Australia Index up more than 20 per cent.

Looking ahead, VanEck's 2024 Alternative Assets Outlook dissects our views on inflation, policy rates, economic growth and exogenous risks as more developed market central banks gear up for rate cuts with diverging paths. US Inflation will prove sticky, potentially delaying the first Federal Reserve cut until 2025 while the European Central Bank cut in June. On balance, a period of low global economic growth is likely with the US outpacing Europe.

Rate cut prospects and low economic growth environment should support the performance of riskier alternative asset classes. Gold plays an important role as a hedge against a potential flare up in geopolitical tensions and inflation.

Asset class performance as at 25 June 2024



Source: Bloomberg, 25 June 2023 to 25 June 2024, returns in Australian dollars. International Equities is MSCI World ex Australia Index, Australian Equities is S&P/ASX 200 Accumulation Index, Gold is Gold Spot US$/oz, Global Bonds is Bloomberg Global Aggregate Bond Hedged AUD Index, Cash is Bloomberg AusBond Bank Bill Index, Australian Bonds is Bloomberg AusBond Composite 0+ yrs Index, Emerging Market Bonds is 50% J.P. Morgan Emerging Market Bond Index Global Diversified Hedged AUD and 50% J.P. Morgan Government Bond-Emerging Market Index Global Diversified, Emerging Market Equities is MSCI Emerging Markets Index, Listed Global Private Equity is LPX50 Index, Listed Global Private Credit is LPX Listed Private Credit AUD Hedged Index, Australian FRN Bonds is Bloomberg Ausbond Credit 0+Yr FRN Index, Global High Yield is Bloomberg Global High Yield Index, Bitcoin is MarketVectorTM Bitcoin Benchmark Rate. Past performance is not a reliable indicator of future performance. You cannot invest in an Index.

Global macro views

US disinflation pace to slow

- Pace of inflation to slow as US services inflation remains elevated.

US rates higher for longer but volatility to normalise

- The market's optimism for two rate cuts in 2024 may be excessive.
- Prolonged rate pause should see interest rate volatility stabilise.

Europe commences rate cut cycle

- Headline inflation the lowest among developed markets.

Low economic growth globally

- US economic growth to outpace Europe.
- Many parts of Europe recovering from a recession.

Exogenous risks

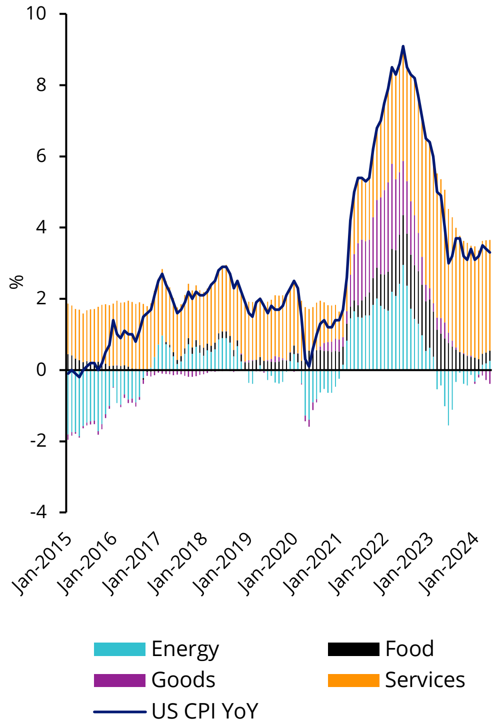
- Economic 'break' risk heightened in the wake of tightening.
- Geopolitical tension elevates risks of volatility.

Disinflation pace to slow

USA: Services inflation 'sticky'. Unemployment needs to reach NAIRU for services inflation to be at a manageable rate.

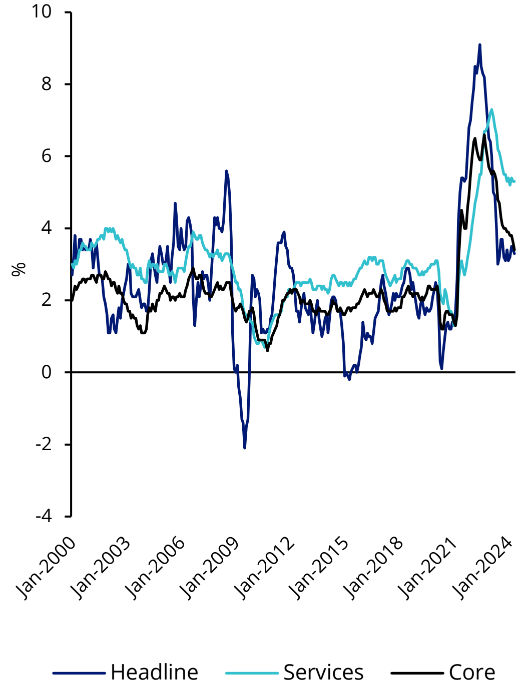
US CPI year on year contribution

Services contribution ~1.5x above pre-COVID trend



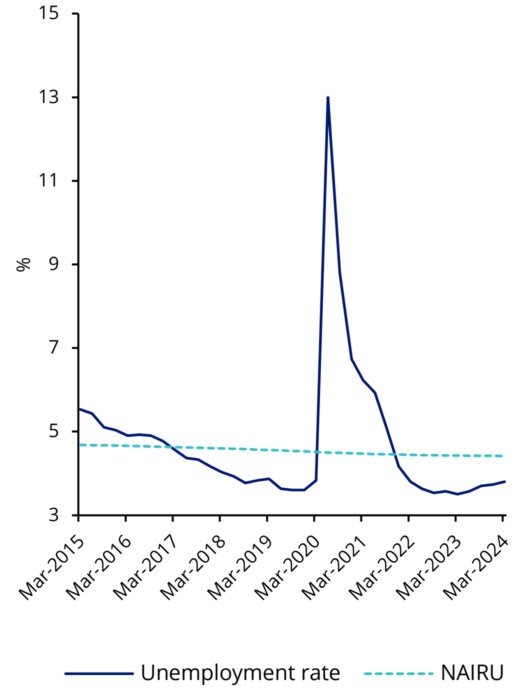
US CPI year on year

Slow burn to unwind services inflation



US unemployment rate

Slowly trending towards NAIRU



Non-Accelerating Inflation Rate of Unemployment (NAIRU) : Theoretical measure that indicates the lowest unemployment rate that can be sustained without causing wages growth and inflation (notably services) to rise unsustainably.

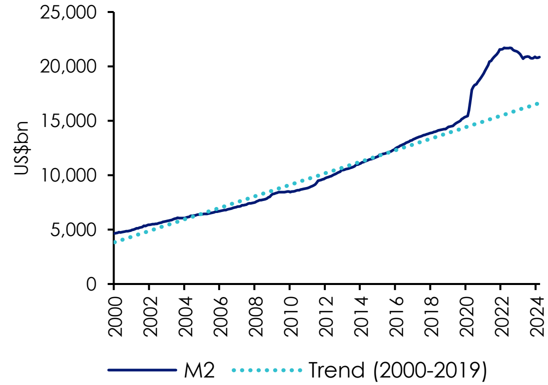
Source: Bureau of Labour Statistics. Federal Reserve Bank of St Louis. As at 12 June 2024.

Rates higher for longer but volatility to normalise

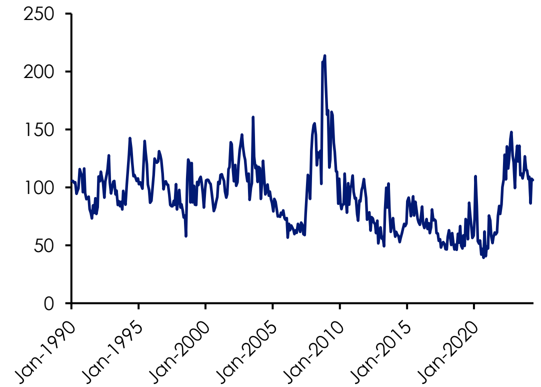
USA: The market's optimism for two rate cuts in 2024 may be excessive.

- Market is forecasting two rate cuts in December which may be premature for several reasons.
- Core inflation is above the Federal Reserve's target rate of 2%.
- Excess liquidity will continue to support economic growth and demand side inflationary pressures.
- Federal Reserve is unlikely to see core inflation sustainably below 2% in the near term barring a systemic crisis which reaffirms our tightening bias.
- Federal Reserve is reluctant to pre-emptively 'pivot'. Does not want a repeat of 1970s where a second inflation wave emerged.
- Prolonged period of rates on hold should see interest rate volatility subside. This will improve confidence in the assessment of valuations and therefore investment activity across public and private markets.

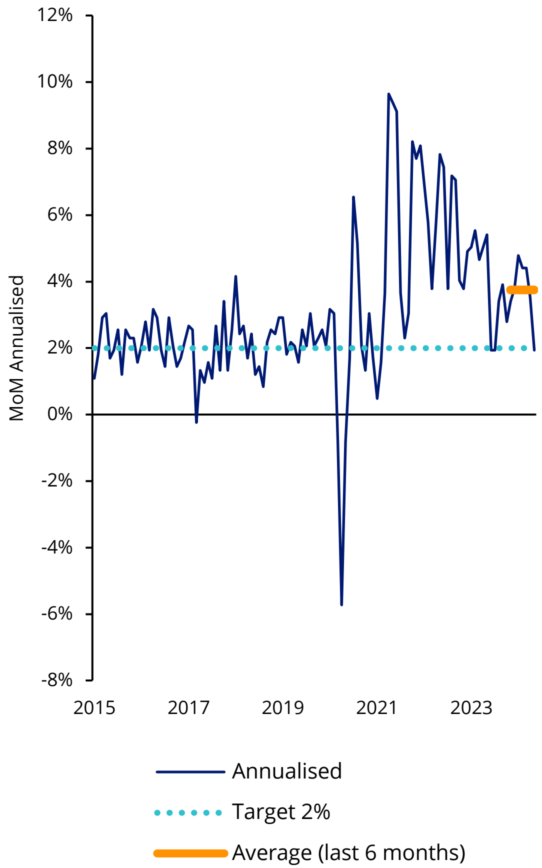
M2 money supply



US interest rate volatility



US core inflation MoM annualised



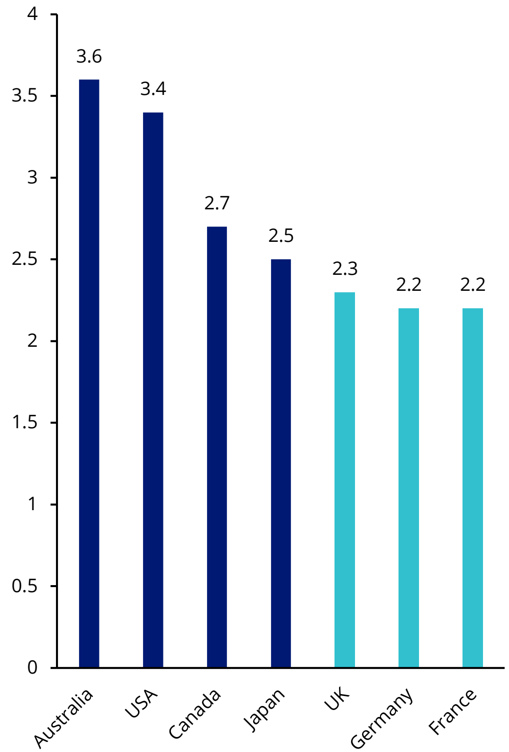
Source: US Interest rate volatility as ICE Move Index, Federal Reserve, as at 12 June 2024.

Europe commences rate cut cycle

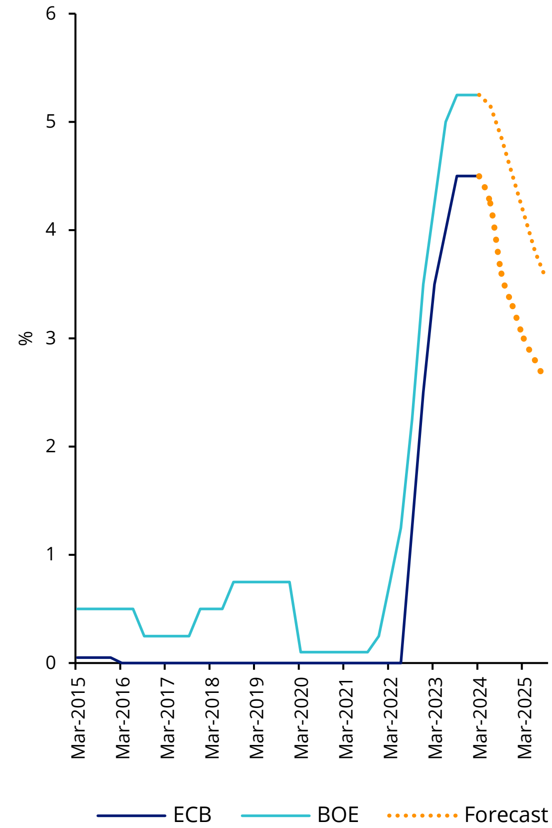
Europe: Inflation near central bank targets. ECB, Sweden and Switzerland have cut rates.

- European nations have seen inflation dramatically fall over the past 2 years and have the lowest year on year figures across developed markets.
- Sweden, Switzerland and European Central Bank have cut policy rates. Bank of England look increasingly likely to commence rate cuts in August.
- Early stage of rate cuts have historically been positive for both private and public market returns provided cuts are not in response to a significant economic downturn.

Inflation year on year



Central bank rate forecasts



Source: Bloomberg consensus, Federal Reserve, as at 31 May 2024.

Low economic growth globally

US economic growth to outpace Europe

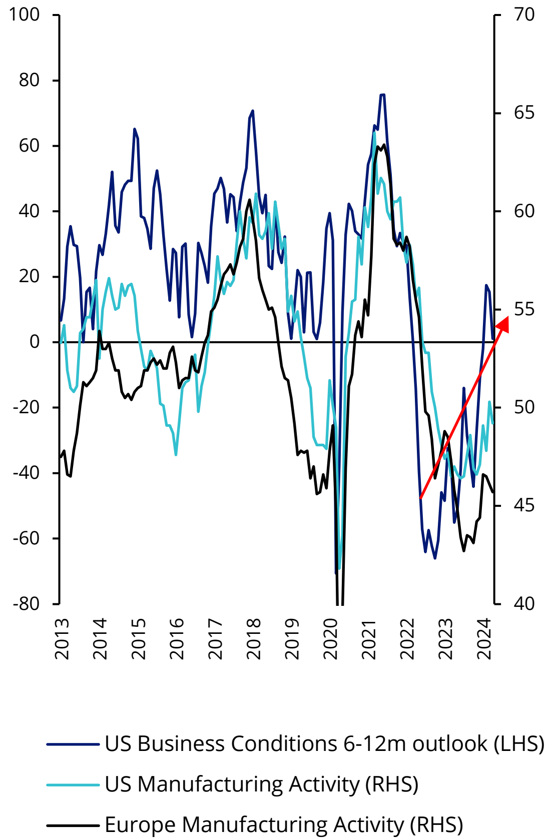
USA

- Massive fiscal stimulus initiated during COVID-19 will continue to support economic activity.
- Financial conditions are loose, encouraging business activity and capital expenditure.
- Business conditions and manufacturing activity improving on the prospect of rate cuts.

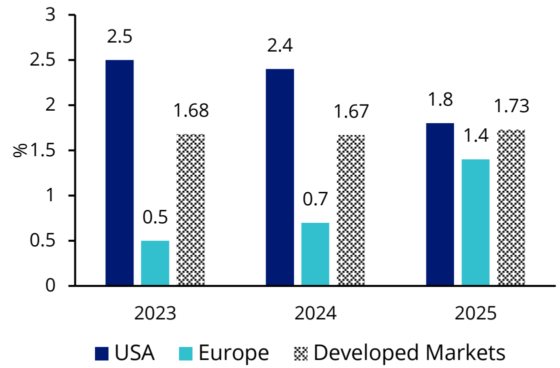
Europe

- Many parts of Europe are emerging from a recession.
- Manufacturing activity shows signs of improvement, but it has not yet fully transitioned into an expansionary phase.
- Rate cuts will help stimulate economic growth.

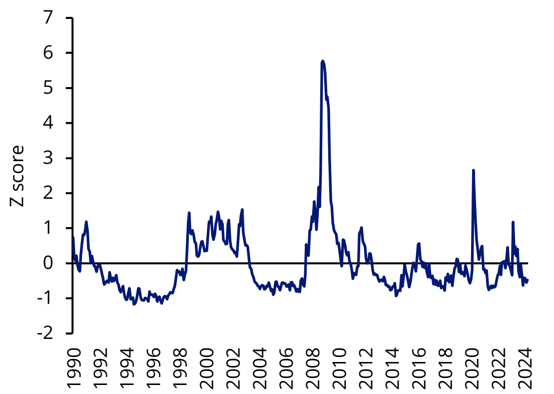
Business confidence and manufacturing activity



Real GDP growth consensus forecast



US financial conditions loose



Source: US financial conditions is Chicago Fed National Financial Conditions Index, ISM, Bloomberg consensus forecasts, as at 31 May 2024.

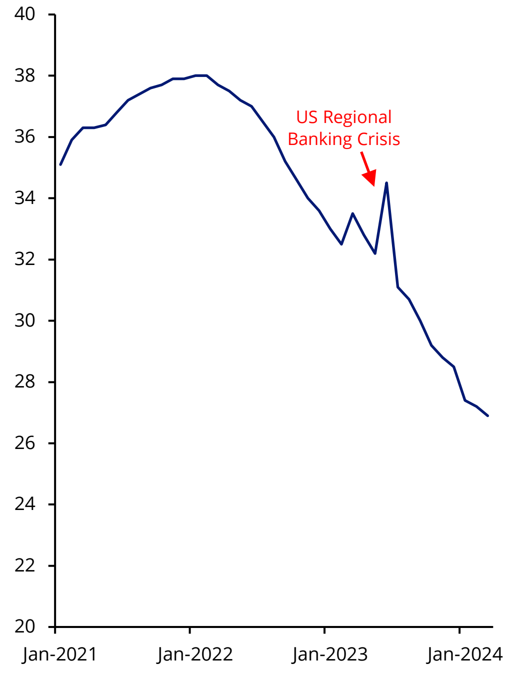
Exogenous risks

Watch out for economic 'breaks' and inflation shocks.

- Risk of an economic 'break' heightened in wake of the tightening cycle.
- Central banks will be swift to address but likely turn to targeted measures before policy rate adjustments. Inflation is too high and central banks don't want to risk triggering another wave of inflation. The Federal Reserve implemented target liquidity measures following the US regional banking crisis last year.
- Geopolitical tension elevates risks of inflation shocks. Natural gas prices spiked following Russia invasion of Ukraine.
- The latest concern is the Rea Sea Crisis which has resulted in ships that would normally pass between Saudi Arabia and Egypt to instead go all the way around Africa to get to Asia. The outcome has seen shipping prices jump 4 times. When shipping prices spiked following COVID-19, it took 6-12 months to be passed on to consumers via goods prices. We could see this again in the second half of 2024.

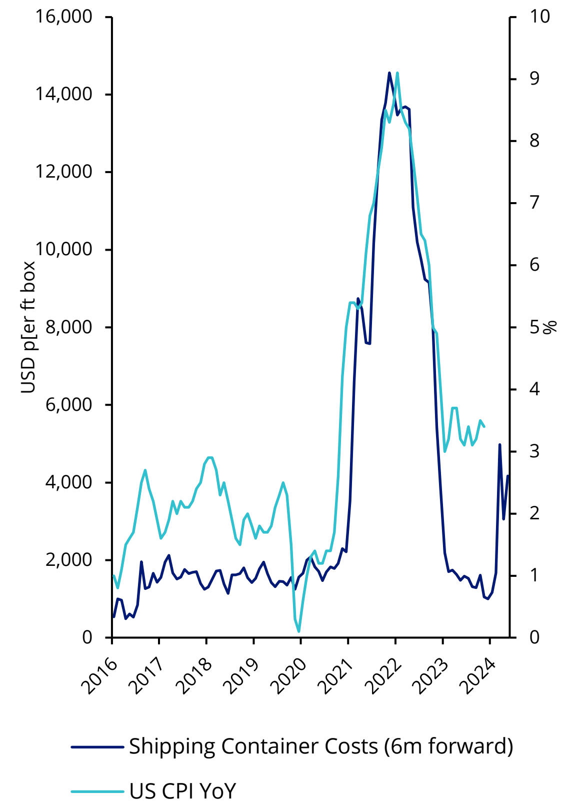
Fed balance sheet - % of GDP

Targeted liquidity following US regional banking crisis



Shipping costs versus US CPI YoY

Shipping costs surged following Red Sea Crisis



Source: Federal Reserve, Shipping Container Costs (6m forward) is WCI Shanghai to Rotterdam Container Freight Benchmark Rate per 40 Foot box, Bloomberg, 31 May 2024.

Alternative Asset Class Views

Global listed private credit

- Yield premium relative to high yield.
- Accelerating demand from asset owners.

Global listed private equity

- Firms under significant pressure to deploy the accumulated record levels of dry powder.
- Valuations compelling. Historically outperformed listed equities when trading at a discount to book value.

Gold

- Portfolio diversifier. Low correlation to traditional asset classes.
- Hedge against rising geopolitical tensions, market shocks and sticky inflation.

Bitcoin

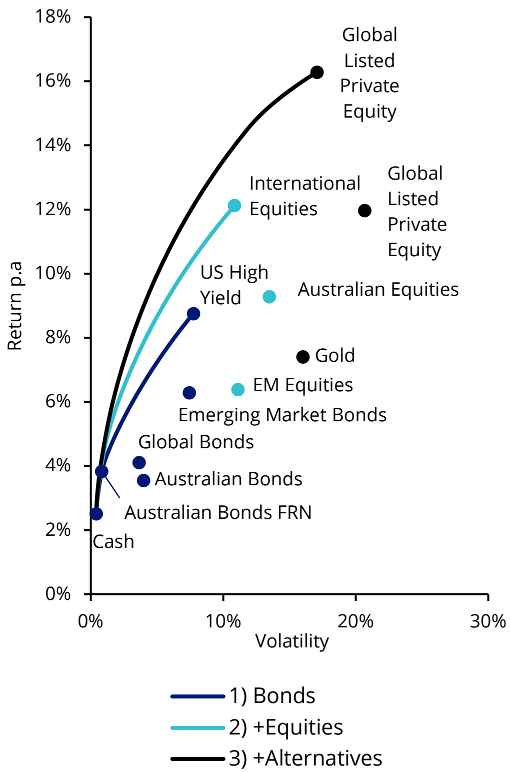
- Institutional adoption accelerating.
- Limited supply and halving process price growth catalysts.

Alternatives

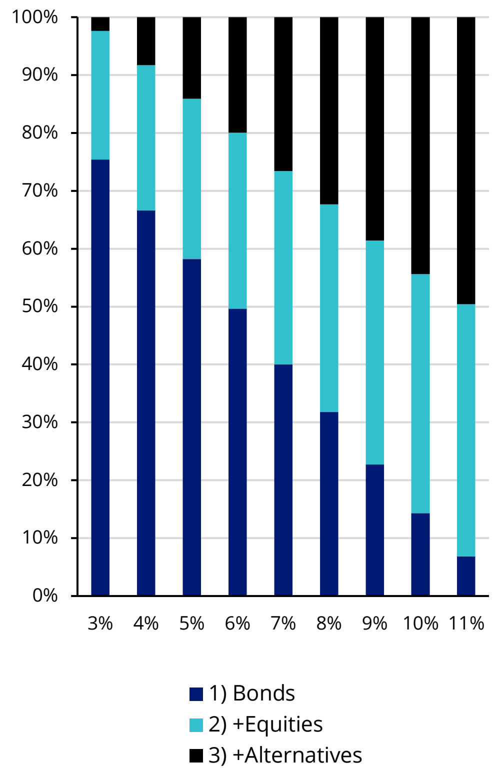
Alternatives historically enhanced return versus risk profile when paired with traditional asset classes.

Efficient frontier portfolio: 15 years

Alternatives historically enhanced profile



Allocation by target volatility



Positioning

- The efficient frontier shows the optimal portfolio that offers the highest expected return for a given level of risk. The allocations are determined based on the historical performance of respective asset classes.
- The results show exposure to alternative asset classes such as private equity, private debt and gold would have historically enhanced the return profile for the same target risk relative to a equity and bond portfolio only.
- The optimal allocation to alternative assets increases with associated risk appetite.

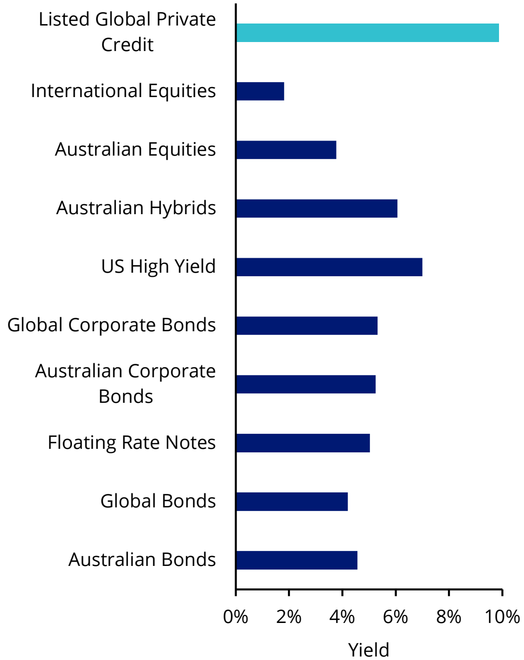
Source: Bloomberg, 1 January 2009 to 31 December 2023. returns in Australian dollars. International Equities is MSCI World ex Australia Index, Australian Equities is S&P/ASX 200 Accumulation Index, Gold is Gold Spot US$/oz, Global Bonds is Bloomberg Global Aggregate Bond Hedged AUD Index, Cash is Bloomberg AusBond Bank Bill Index, Australian Bonds is Bloomberg AusBond Composite 0+ yrs Index, Emerging Market Bonds is 50% J.P. Morgan Emerging Market Bond Index Global Diversified Hedged AUD and 50% J.P. Morgan Government Bond-Emerging Market Index Global Diversified, Emerging Market Equities is MSCI Emerging Markets Index, Listed Global Private Equity is LPX50 Index, Listed Global Private Credit is LPX Listed Private Credit AUD Hedged Index, Australian FRN Bonds is Bloomberg Ausbond Credit 0+Yr FRN Index, Global High Yield is Bloomberg Global High Yield Index. Past performance is not a reliable indicator of future performance. You cannot invest in an index.

Global listed private credit

Yield premium and fundamentals favourable relative to high yield.

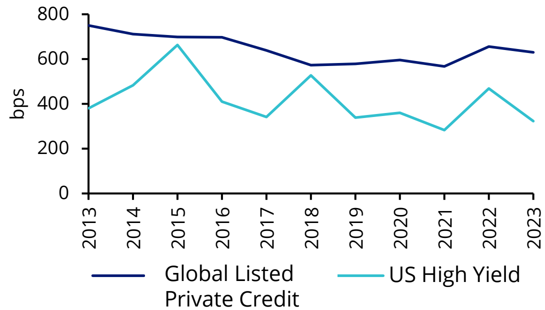
Yield

Global listed private credit +3% pickup relative to high yield



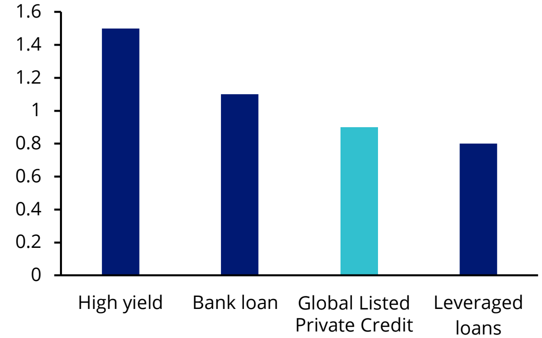
Credit spread

Global listed private credit compressed less than high yield



US 10 year average default rate

Global listed private credit lower than high yield



Positioning

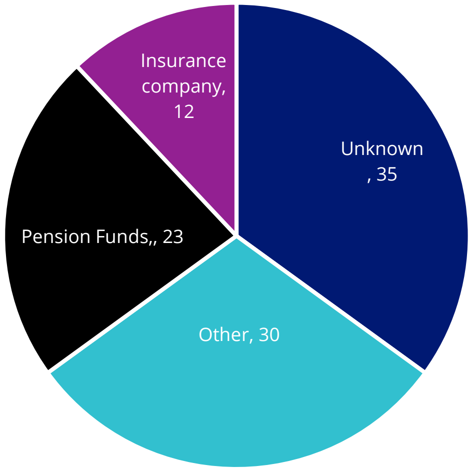
- Global listed private credit offers an attractive opportunity compared to US high yield.
- Provides a yield pickup of approximately 3%.
- In contrast, the 10-year default rate for US high yield is higher than that of private credit.
- Additionally, US high yield credit spreads have narrowed significantly over the past 18 months, potentially leaving investors undercompensated for the associated risk.
- Global listed private credit, on the other hand, has not experienced the same credit spread compression, making it a relative value proposition.

Source: Bloomberg, IMF, as at 31 May 2024. You cannot invest in an index. Past performance is not a reliable indicator of future performance. Yield is either yield to maturity or dividend yield. Yield to Maturity (YTM) is the estimated annual rate of return that would be received if the fund's current securities were all held to their maturity and all coupons and principal were made as contracted. YTM does not account for fees or taxes. YTM is not a forecast, and is not a guarantee of, the future return of the fund which will vary from time to time. Dividend Yield is the weighted average of each portfolio security's distributed income during the prior twelve months before management costs. If applicable it does not include franking credits. Indices used: Global Bonds – Barclays Global Aggregate Bond Index A$ Hedged; Australian Bonds – Bloomberg AusBond Composite 0+ Yr Index; Floating Rate Notes - Bloomberg AusBond Credit FRN 0+ Yr Index; International Equities – MSCI World ex Australia Index; US High Yield – Bloomberg US High Yield (AUD Hedged); Australian Equities – S&P/ASX 200 Accumulation Index; Australian Hybrids is Solactive Australian Hybrid Securities Index, Global Listed Private Credit – LPX Listed Private Credit Index AUD Hedged, Australian Corporate Bonds – Bloomberg AusBond Credit 0+ Yr Index, Global Corporate Bonds - Bloomberg Global Aggregate Corporate Bond Index (AUD Hedged).

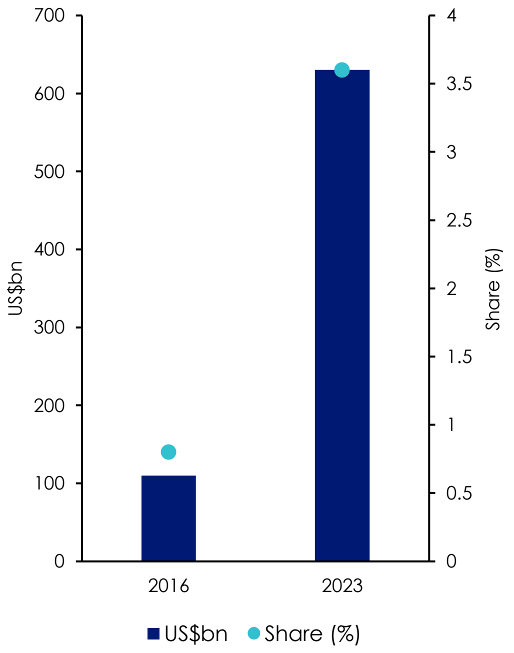
Global listed private credit

Accelerating demand from asset owners.

US private credit investment share



US investment in private credit by pension funds and insurance firms



Positioning

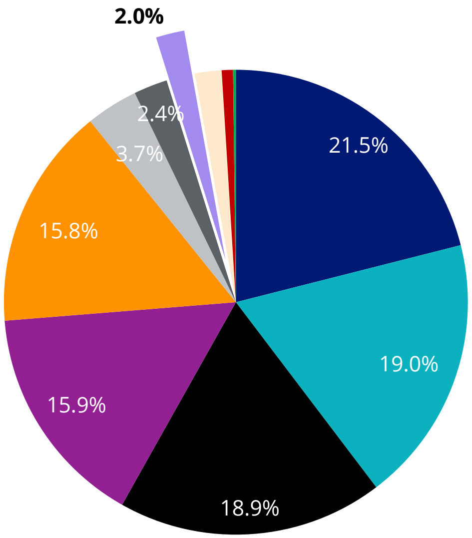
- Private credit is gaining prominence among asset owners as a well-established asset class, driven by a surge in demand.
- Private credit AUM held by asset owners has increased six-fold over the past 7 years.
- Investors are attracted by the higher return versus risk profile compared to traditional asset classes, diversification benefits and for potential protection against rising rates as most loans are floating.
- 35% of private credit outstanding is held by asset owners.

Source: IMF

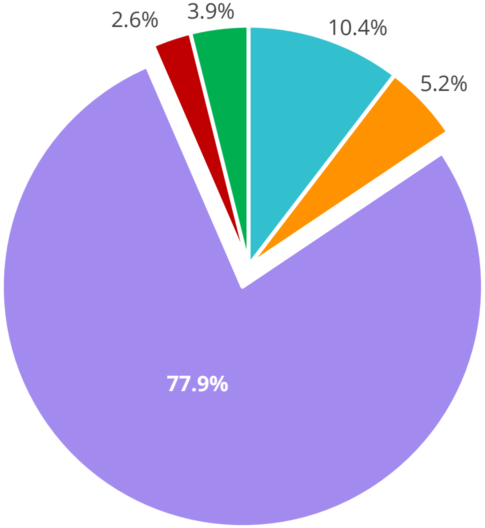
Global listed private credit

Global exposure offers superior sector diversification relative to Australian private credit.

Global private credit sector breakdown



Australian private credit sector breakdown



Industrials
Financials
Information Technology
Consumer Discretionary
Health Care
Consumer Staples
Energy
Real Estate
Materials
Telecommunication Services
Utilities
Other

Positioning

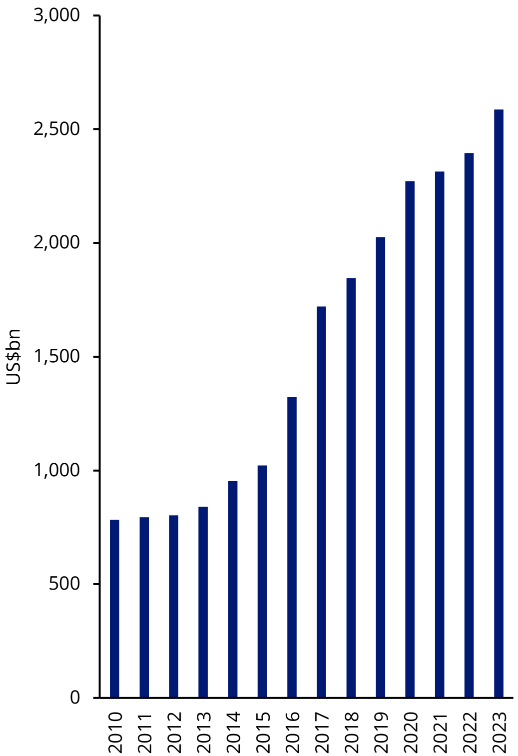
- Global listed private credit has been pivotal in scaling up technology infrastructure and enhancing workflow efficiencies while allowing business owners to retain equity stakes.
- Global listed private credit primarily serves service-based industries.
- Australian private credit funds typically provide concentrated exposure to real estate.
- Insolvencies in the property and construction sector are rising, adding to the risk of loan defaults. ASIC, the Australian corporate regulator reported that 28% of business collapses in 2023 were in the building and construction industry.

Source: LPX, Australian private credit manager, as at 30 April 2024.

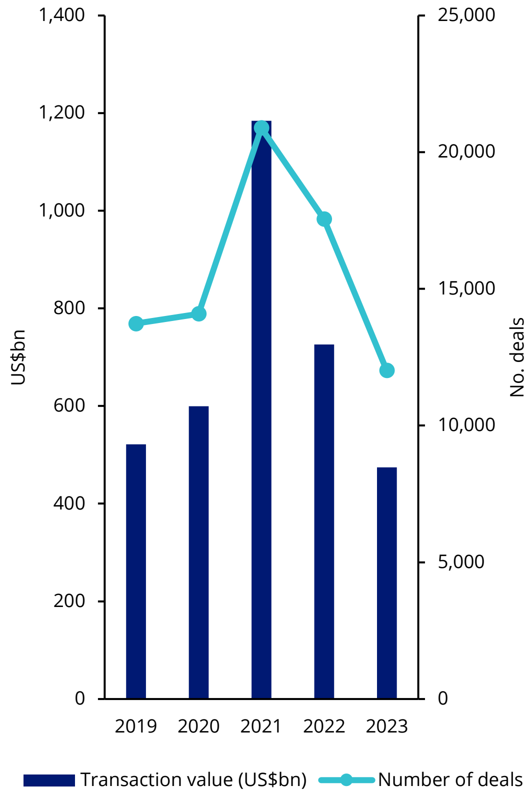
Global listed private equity

Private equity firms under significant pressure to deploy the accumulated record levels of dry powder.

Global private equity dry powder



Global private equity transactions and deals



Positioning

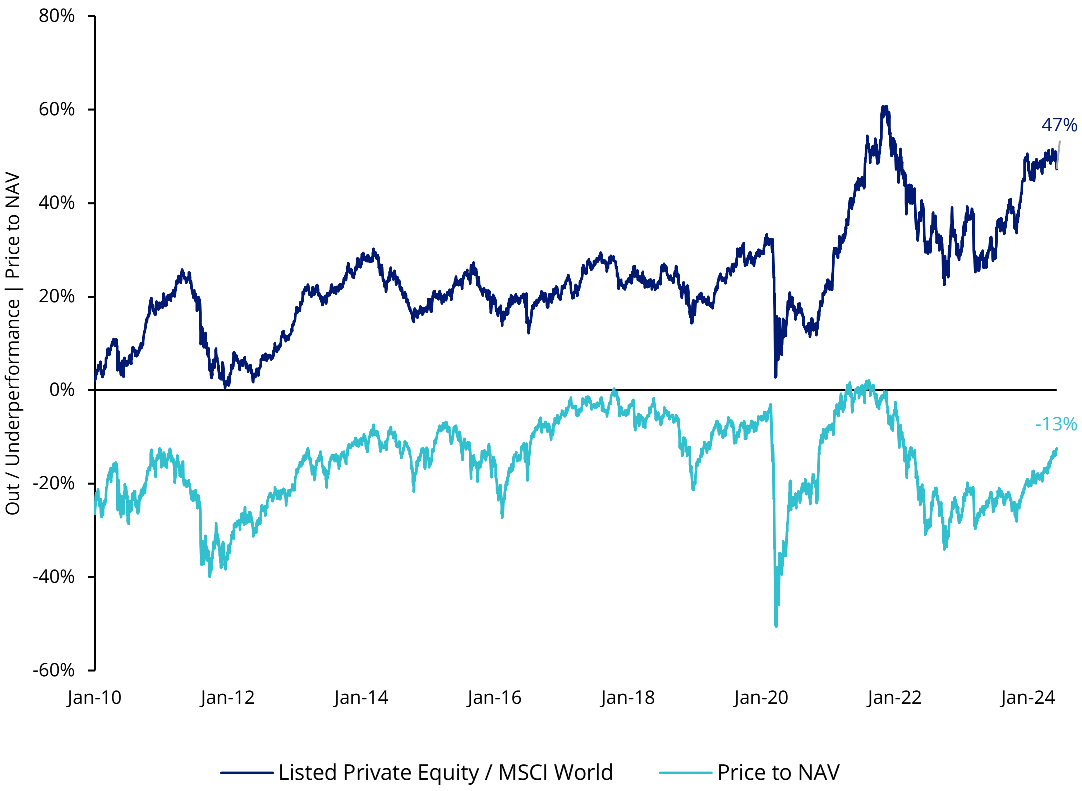
- We forecast activity in the private equity market to accelerate.
- We are at the end of the rate hike cycle. Rates should stabilise, improving confidence in the assessment of valuations and therefore investment activity.
- Firms are under significant pressure to deploy the accumulated record levels of dry powder.
- In terms of sectors, we expect to see most activity happening across technology, media, and telecom (TMT), as firms seek to capitalise on the Artificial Intelligence (AI) revolution. Restructuring of distressed assets will likely pick up as select businesses struggle in a rates higher for longer environment.

Source: S&P Global Market Intelligence

Global listed private equity

Valuations compelling. Historically outperformed listed equities when trading at a discount to book value.

Global listed private equity Price to NAV versus cumulative performance of listed private equity relative to MSCI World



Positioning

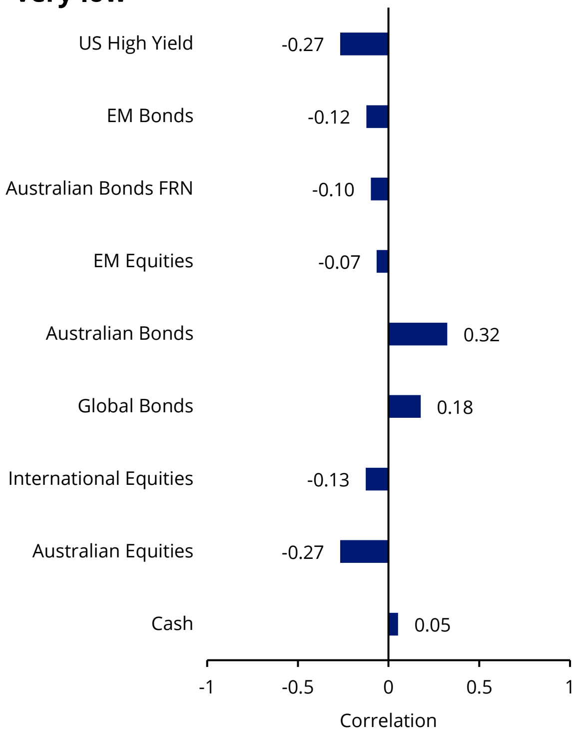
- Global listed private equity has been trading at a discount to book value since 2021. To capitalise on the discount, private equity managers have announced share buybacks, saying to the market that they perceive listed prices to be undervalued.
- Double discounting has also played out where private equity firms have sold portfolio companies at a premium to book value. Examples include HgCapital Trust selling GGW Group at a 40% premium and Apax Global selling Healthium Medtech at a 29% premium.
- LPX research found listed private equity outperformed listed equities in 18 out of the past 22 years (~80% of cases) where private equity was trading at a discount.

Source: LPX, Bloomberg. Data to 5 June 2024. Listed private equity as represented by LPX Listed Private Credit Index AUD Hedged. You cannot invest in an index. Past performance is not indicative of future performance.

Gold

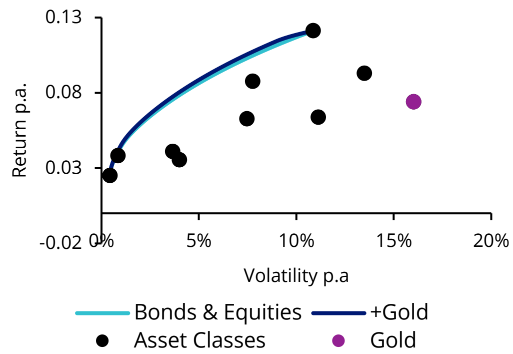
Yield premium and fundamentals favourable relative to high yield.

Correlation to gold performance very low

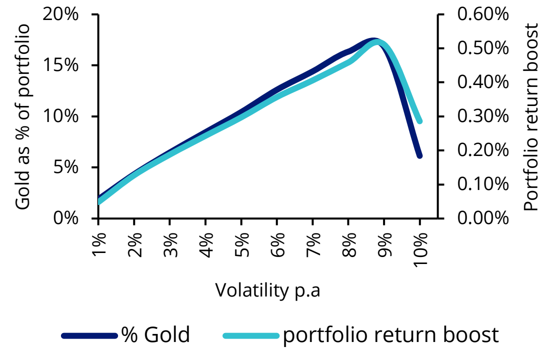


Efficient frontier portfolio: 15 years

Gold inclusion boosts return for same target volatility



Gold allocation by target volatility



Positioning

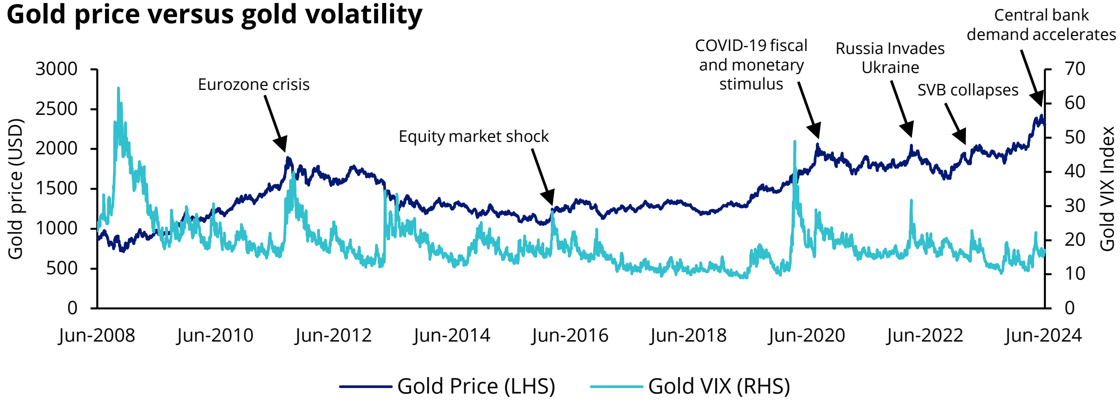
- Gold inclusion in a traditional bond and equity investment portfolio has historically enhanced returns by up to 0.5% p.a. for the same level of risk.
- Gold performance has a low correlation with traditional asset classes which decreases portfolio volatility.
- Optimal gold allocation as a percentage of the total investment portfolio reaches a maximum 17% as determined by the efficient frontier model.

Source: Bloomberg, 1 January 2009 to 31 December 2023. returns in Australian dollars. International Equities is MSCI World ex Australia Index, Australian Equities is S&P/ASX 200 Accumulation Index, Gold is Gold Spot US$/oz, Global Bonds is Bloomberg Global Aggregate Bond Hedged AUD Index, Cash is Bloomberg AusBond Bank Bill Index, Australian Bonds is Bloomberg AusBond Composite 0+ yrs Index, Emerging Market Bonds is 50% J.P. Morgan Emerging Market Bond Index Global Diversified Hedged AUD and 50% J.P. Morgan Government Bond-Emerging Market Index Global Diversified, Emerging Market Equities is MSCI Emerging Markets Index, Listed Global Private Equity is LPX50 Index, Listed Global Private Credit is LPX Listed Private Credit AUD Hedged Index, Australian FRN Bonds is Bloomberg Ausbond Credit 0+Yr FRN Index, Global High Yield is Bloomberg Global High Yield Index. You cannot invest in an index. Past performance is not indicative of future performance.

Gold

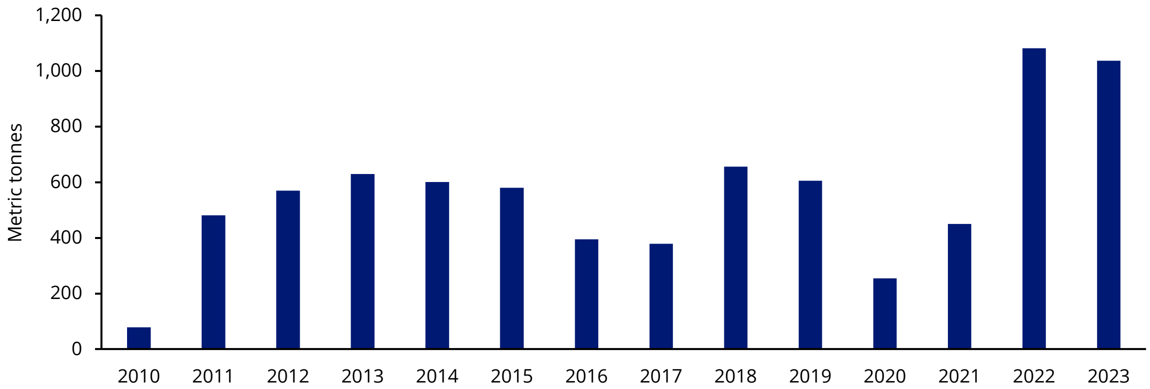
Gold is considered a safe haven asset.
Effective hedge against rising geopolitical tensions, market shocks and inflation.

Gold price versus gold volatility



Central bank gold net purchases

Demand has accelerated over the past 2 years



Positioning

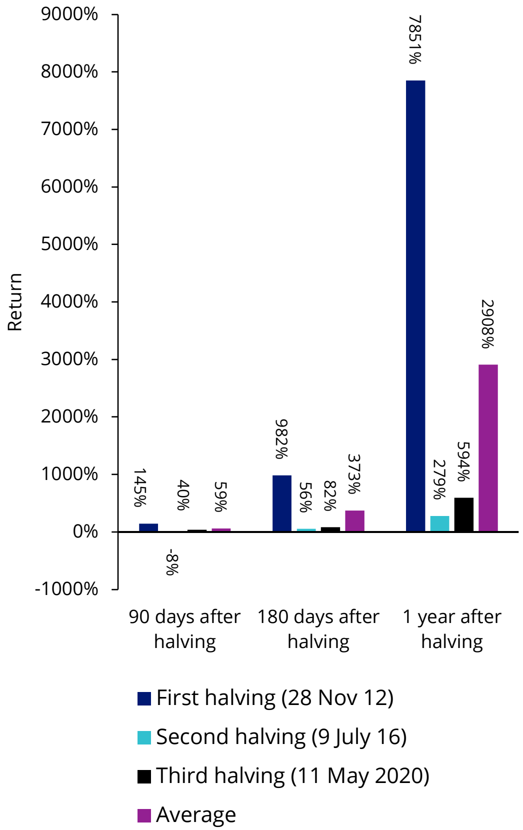
- Gold is considered a safe haven asset. Price typically increases during periods of rising geopolitical tensions, market shocks and inflation.
- Central banks have increased their gold purchases as part of their efforts to diversify reserves. These purchases accounted for approximately 20% of the total global gold demand in 2023, contributing to the recent surge in gold prices.
- Weaker economic growth, sticky inflation and escalating geopolitical tensions could all be catalysts for a gold rally.

Source: Bloomberg, World Gold Council. Past performance is not indicative of future performance.

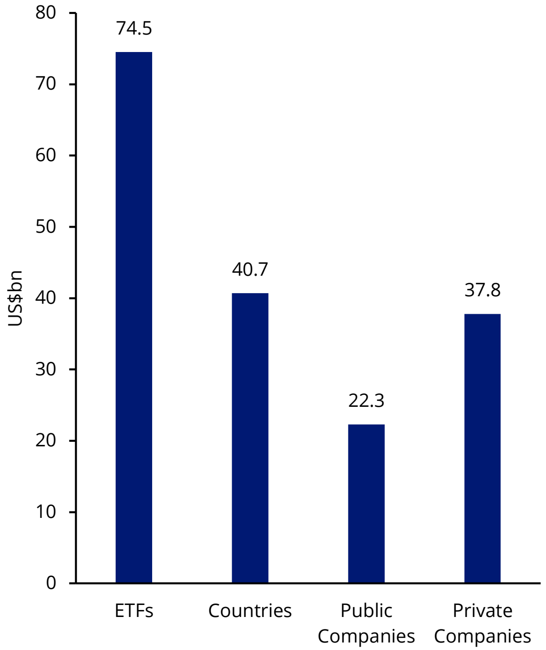
Bitcoin

Institutional adoption accelerating. Limited supply and halving process price growth catalysts.

Bitcoin halvings typically associated with explosive returns



BTC holdings



Positioning

- Bitcoin interest among institutional investors has accelerated. Hedge funds and asset management firms are increasingly recognising bitcoin's potential as a store of value and as a portfolio diversifier. Approximately US$175bn worth of bitcoin is held by ETFs, countries, public and private companies.
- Ease of access has expanded. Merchants and businesses are accepting bitcoin as a form of payment and infrastructure has been built to make it more convenient for the average person to use. The development of user-friendly wallets, exchanges, and marketplaces has removed the technical barriers to entry that existed in bitcoin's early years.
- There is a maximum of 21 billion bitcoin in existence. Scarcity of supply increases price volatility. Historically, the price of bitcoin has rallied leading up to and following a halving which roughly occurs every 4 years. Halvings increase the difficulty of mining bitcoin, thereby reducing the number of newly discovered coins added to circulation.

Source: Bloomberg, Buybitcoinworldwide, as at 31 March 2024. Past performance is not indicative of future performance.

Contact us

vaneck.com.au
info@vaneck.com.au
+61 2 8038 3300

VanEck-Australia
VanEck_Au
VanEckAus
VanEckAustralia

Any views expressed are opinions of the author at the time of writing and is not a recommendation to act.