



SARASIN
& PARTNERS

Q1 2025
HOUSE REPORT

TRICKS OF THE TRADE

How history shows
us what to expect
from Trump's
new tariffs

- **Markets: Why 2024 was the year of the correction that never came**
- **Thematic investing: The thinking behind our investment process**
- **Private markets: How the sector became mainstream**

This document is intended for retail investors in South Africa only. You should not act or rely on this document but should contact your professional adviser.

INTRODUCTION



**STEPHEN
ROTHWELL**

EDITOR

Welcome to the latest edition of our House Report.

As we enter 2025, global markets are balancing optimism, after a year in which investors experienced strong returns, with the uncertainties and challenges presented by a new political landscape. Throughout last year, US technology stocks dominated global investment returns. The US remains the global economic powerhouse, propelled by technological innovation and resilient consumer demand, and US equities as a whole now constitute just shy of 70% of the MSCI All Country World Index. Trump's sweeping victory has given fresh impetus in the US to consumer confidence, economic growth, and equity market sentiment. However, as highlighted in Guy Monson's article in this edition of the Sarasin House Report, a disruptive new political backdrop, inflationary pressures, and rates remaining higher for longer, are just some of the risks investors face as we begin the year.

In his article, Guy gives more context on the 'correction that never was' with markets remaining remarkably resilient to a turbulent year for geopolitics and, of course, the new administration in Washington. Success in 2025, Guy suggests, will depend on vigilance, adaptability, and most importantly a 'willingness to seize opportunities amid the undoubted political noise'.

Like it or not, President Trump's policy on trade tariffs has set the economic agenda for the year. As Adam Hamilton explores in his article, the history of trade between nations has swung between co-operation and competition. From mercantilism in the 16th to 18th centuries, to Adam Smith's 'win-win' for nations' mutual prosperity, and now Trump's protectionism and tariff-based approach, Adam takes us on a journey through the evolving philosophy of how the world trades and looks at the potential investment winners and losers under the new regime.

Economic shifts help form the structural trends that shape our investment approach and, in his article, Colm Harney outlines how this underpins Sarasin's thematic investment philosophy. Also in this issue, Alastair Baker turns his attention to the rapid growth of the universe for investable private markets, which can sit alongside more traditional investments in public stock markets as part of a diversified portfolio.

For our clients within the charities sector, the beginning of a new year seems like a perfect place to explore some of the absolute and relative risks that trustees must contend with on a daily basis, as Melanie Roberts and Tom Lindsey explain in our Charity Focus article.

We hope you enjoy reading our team's insights and, as ever, we welcome your feedback and suggestions. Please get in touch at housereport@sarasin.co.uk.

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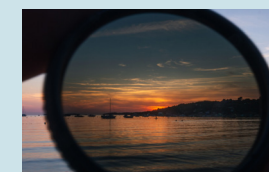


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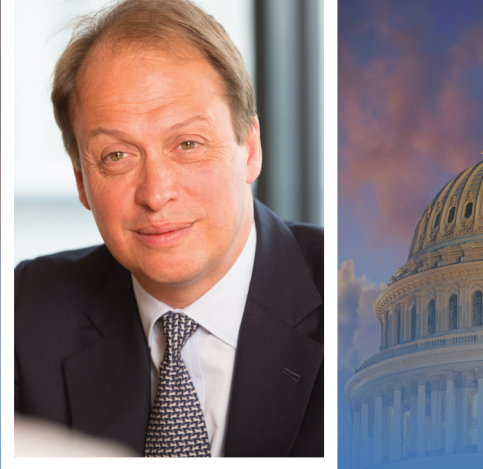


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GUY MONSON
CHIEF MARKET STRATEGIST
& SENIOR PARTNER

View from the Chief Market Strategist

THE CORRECTION THAT NEVER WAS

Key points

- Investors will remember 2024 as the year of the market correction that stubbornly refused to arrive – we were overweight equity and risk assets throughout the year.
- White House policy making will at times look chaotic, but on balance it is likely to be equity friendly.
- A key risk for markets in 2025 comes from bonds – the rise in yields over the last quarter has moved above our fair values in the US and UK.

Investors will remember 2024 as the year of the much-anticipated market correction that never arrived. Despite geopolitical turmoil in Europe and the Middle East, escalating trade tensions with China, and persistently sticky core inflation, every major equity market – barring Brazil – delivered positive returns. Even the Republican ‘clean sweep’ in Washington, which most saw as a potential source of uncertainty, was interpreted by markets as an opportunity for deregulation and pro-business policies.

At the heart of last year’s market rally lay the US, supercharged by the relentless momentum of the artificial intelligence (AI) boom. The Magnificent Seven tech giants’ continually exceeded profit expectations, and their earnings are forecast to grow robustly again in 2025. Unlike previous technology driven bull markets – whether the mainframe era of the 1960s, the PC revolution of the 1980s, or the dot-com bubble of the late 1990s – this rally is not built solely on inflated valuations. The margins of America’s tech titans now hover at an extraordinary 20%, underscoring the solid earnings and cash flows underpinning this bull run².

Against this backdrop, we maintained an overweight position in equities throughout 2024, with substantial exposure to AI beneficiaries through our Digitalisation and Automation themes. While we took profits selectively, our portfolios remain invested in six of the Magnificent Seven, with Tesla as the notable exception. For most equity mandates today, we remain close to market weight in the global technology sector.

Thin pickings elsewhere in markets

Beyond equities, returns across other asset classes were modest at best. Global bonds faced significant challenges, with yields rising sharply in Q4 as expectations for central bank interest rate cuts diminished. Markets now anticipate three fewer rate cuts in the US and four fewer in the UK by the end of 2025³ compared to forecasts from a year ago. Throughout much of last year, we maintained an underweight position in bonds. However, in Q4, we further reduced our exposure to corporate credit, where spreads had narrowed to near-historic lows.

Commodities offered little cheer either. Oil prices rose only modestly, despite significant supply risks stemming from wars in the Middle East and Russia. The standout performer was gold, rallying 28% in 2024⁴, driven by sustained purchases from emerging market central banks seeking to diversify their exposure to the dollar. While we have limited direct exposure to energy and industrial metals, our long-term positions in gold once again proved their worth.

King dollar: The currency that still rules

Currency markets echoed the story of American exceptionalism. The dollar strengthened against all G10 currencies, bolstered both by robust economic growth (which is still running at around 2.5% annually⁵) and sustained capital flows into US assets. Surprisingly, sterling emerged as the second-best-performing major currency in 2024, despite the hostile reaction from business to Chancellor Reeves’ first budget. The UK currency has though moved sharply lower in the first days of 2025 and once again the issue is fiscal sustainability. In our UK balanced portfolios, we retain significant exposure to US dollars while currently hedging most of our euro positions.

The challenges for 2025

So, can markets deliver another year of US-led growth, or does the steady rise in global bond yields signal the start of a more fundamental shift in market leadership?

Let us consider the key risks and opportunities facing investors:

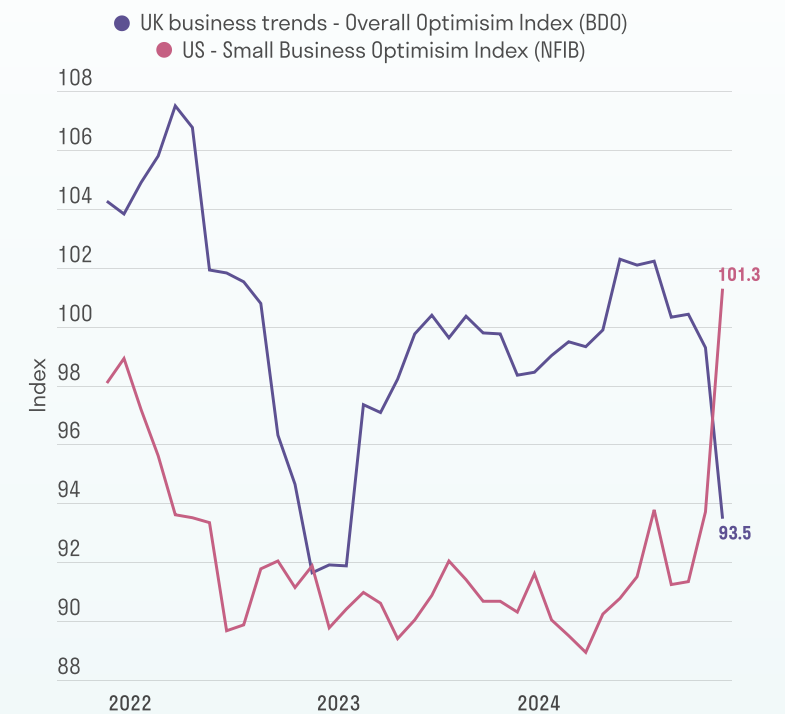
1. How disruptive will the new Trump White House be?

While details of President Trump’s economic agenda remain sparse, US markets are currently giving him the benefit of the doubt. Early signals suggest Wall Street’s confidence may be well-placed – so far, the picks for Trump’s economic team are notably mainstream. Kevin Hassett at the National Economic Council is expected to lead on tax policy, Scott Bessent at the Treasury is advocating a 3-3-3 agenda (3% GDP growth, a 3% budget deficit, and an additional three million barrels per day of energy equivalent production), while Howard Lutnick at Commerce has implied that tariffs might be ‘temporary and targeted.’

Tensions though loom on the horizon. Trump loyalists and MAGA believers, such as Stephen Miller, will have to face off against Silicon Valley figures like Elon Musk and Vivek Ramaswamy, now installed at the Department of Government Efficiency (DOGE). The potential for internal clashes on issues such as immigration and regulatory policy are already showing.

In summary though we see a Trump cabinet that has more strengths than weaknesses and is open to an agenda of deregulation, innovation and, yes, even government efficiency. Policy making will at times appear chaotic, but on balance it looks to be business and market friendly. Note the sharp divergence in US and UK business optimism since Trump’s election (see chart 1).

CHART 1 BUSINESS CONFIDENCE - A TALE OF TWO GOVERNMENTS



SOURCE: MACROBOND, 07.01.25

2. Will the US economy ever slow down?

The Federal Reserve’s rapid and aggressive rate hikes over the past two years have yet to deliver the slowdown many economists anticipated. A key factor lies in the structure of US consumer debt: over 70% of it is tied to mortgages⁶, with more than 90% of those loans locked in at 30-year fixed rates⁷. This insulation has blunted the impact of rising interest rates on household budgets, prolonging economic resilience. The implication is clear – interest rates may need to remain higher for longer, if the Federal reserve hopes to dampen spending meaningfully and bring core inflation back to target. Bond markets will be watching this closely hence our caution on global fixed interest.

3. How damaging are tariffs and immigration controls likely to be?

Trump’s proposed tariffs on imports from China, Mexico, and Canada threaten to raise costs for US manufacturers and consumers alike. Immigration restrictions, meanwhile, risk worsening labour shortages in critical industries such as construction, hospitality, and agriculture. Both policies are potentially inflationary. If tariffs are implemented gradually though, and with strategic intent, global growth should remain largely unscathed. However, the risk of hasty or politically motivated measures remains, so caution is needed across the most vulnerable markets (Mexico and China) and big exporters to the US, primarily in Europe.

THE CORRECTION THAT NEVER WAS

Guy Monson, Chief Market Strategist and Senior Partner



4. How fragile is the Chinese economy?

China's economy today is burdened with excess: millions of empty or unfinished apartment blocks, trillions of dollars in debt straining local governments and ballooning industrial production driving an export surge that is fanning trade tensions worldwide. China still has strengths: it dominates global manufacturing and has commanding positions in new technologies, such as electric vehicles and renewable energy. Policymakers have proven adept at handling past crises, and are readying bold new stimulus to support the economy. We continue to have very little direct exposure to Chinese assets – a more shareholder friendly environment and evidence that outright deflation can be avoided (e.g. rising bond yields), will be essential for us to reconsider our position.

5. Can the UK economy return to growth?

The UK started 2024 with a bang and ended with a whimper. The economy grew by a strong 0.7% in the first quarter and 0.5% in the second quarter but then stagnated in Q3 with only modest growth likely for Q4⁸. Indeed, the UK seems to be back where it was a year ago – with a lacklustre economy, ailing stock-market, and a government with sharply falling poll ratings. These are early days, but the government's stated commitment to growth clearly needs to be backed up with action, after a disappointing start for UK business. Key will be the behaviour of bond yields – with 30-year gilts now yielding more than 5%⁹ (for the first time since the mid-nineties), markets are sceptical. But there is hope, given that services dominate UK-US trade, the hit to output from Mr Trump's tariff agenda should be manageable and we still see UK GDP growth of 1.8% next year¹⁰ (behind the US but more than double estimates for the eurozone).

UK growth will likely trail behind the US yet remain ahead of the eurozone.

Conclusion: A year of delicate balance

As we enter 2025, markets stand at a crossroads between optimism and uncertainty. The US remains the global economic powerhouse, propelled by technological innovation and resilient consumer demand, while political risks under the new Trump administration are at least partially discounted. Europe, in contrast, faces a combination of political gridlock and subdued business confidence (although a possible ceasefire in Ukraine could change this meaningfully). Meanwhile, China's economy remains precariously balanced, as policymakers attempt to navigate a path through mounting debt, a troubled property sector, and industrial overcapacity.

This will be a year where we will need to tread carefully but will likely still continue to overweight global equities. Earnings and dividend growth look robust while global equity valuations outside of technology, still look attractive. Meanwhile a focus on the future winners from AI and digitalisation, will offer new opportunities across industries and markets.

Success then in 2025 then, will depend on vigilance across bond markets, adaptability over AI, and most importantly a willingness to seize opportunities amid the undoubted political noise.

¹ Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, Tesla

² Empirical Research Partners, December 2024

³ Macrobond, January 2025

⁴ Bloomberg, December 2024

⁵ Atlanta Fed GDP Now Forecast, January 2025

⁶ Statista, December 2024

⁷ Federal Reserve Bank of St Louis, February 2024

⁸ UK ONS data, December 2024

⁹ Bloomberg, January 2025

¹⁰ Sarasin forecast, January 2025

Economist outlook TALKING TARIFFS – THE HISTORY OF GLOBAL TRADE



ADAM HAMILTON
ECONOMIST

Trade has always been more than just a matter of swapping goods – it's a battleground for competing ideas about wealth, power, and national strategy. From the hoarding instincts of mercantilism to Adam Smith's invisible hand; and from David Ricardo's elegant theory of comparative advantage to Alexander Hamilton's industrial patriotism; trade theory has evolved alongside the fortunes of nations.

Today, as the Trump administration boldly embraces tariffs, the post-war consensus on free trade as a source of prosperity is rapidly unravelling. Before we explore the investment implications of this paradigm shift, let's quickly take a journey through time.

Mercantilism (16th to 18th centuries): The zero-sum mindset

For roughly 250 years following the rise of modern nation-states in the 1500s, wealth was measured not by productivity or innovation but by the accumulation of gold and silver. During this mercantilist era, trade was a ruthless, zero-sum competition. If one country grew richer, another must be getting poorer – or so the thinking went.

To stay on top, nations imposed heavy tariffs to curb imports and lavished subsidies on exports. Empires raced to secure exclusive access to resources and markets, with the state holding power to grant monopolies to trading giants like the British East India Company. For private capital, opportunities were narrow, often confined to risky ventures tied to political favouritism or military conquest.

Adam Smith (1723-1790): Win-win trade

Adam Smith flipped the zero-sum game of mercantilism on its head, arguing that trade isn't necessarily about one nation's gain at another's expense. Instead, trade can be a win-win, where nations can create mutual prosperity by focusing on what they do best.

At the heart of Smith's revolutionary thinking was the concept of absolute advantage. In his magnum opus, *The Wealth of Nations* (published in 1776), he urged nations to specialise in producing goods they could make most efficiently and trade for the rest. He laid the groundwork for modern capitalism and the global trade networks we rely on today. Although as we will find out, like all forms of competition, free trade is not a painless panacea; neither the costs of creative destruction nor the benefits of positive-sum trade were evenly shared.

Key points

- From mercantilism to 'absolute advantage' and 'comparative advantage', to 'infant industries' and protectionism, trade philosophy has evolved markedly over the decades.
- Today, as the Trump administration embraces tariffs, the post-war consensus on free trade as a source of prosperity is unravelling.
- As the US turns inward, the investment landscape will create many winners and losers.

TALKING TARIFFS – THE HISTORY OF GLOBAL TRADE

Adam Hamilton, Economist

David Ricardo (1772-1823): Playing to your comparative strengths

Building on Smith's ideas, David Ricardo, another British economist introduced his concept of comparative advantage in 1817. Ricardo's insight was deceptively simple but profoundly impactful: even if one nation is better at producing everything, it still makes sense to specialise in what it can produce at the lowest cost and trade for the rest.

Ricardo opened the floodgates for cross-border investments. Investors sought opportunities in industries that aligned with national strengths, such as Britain's world-leading textiles and America's agricultural exports in the 19th century.

Alexander Hamilton (1750s-1804): The protector of infant industries

Across the ocean, in the US, as a founding member of a new nation, Alexander Hamilton saw things differently. In 1791, he made a bold case for tariffs and subsidies to shield emerging domestic industries from foreign competition. While they came before Ricardo's insights outlined above, Hamilton's ideas took root to become highly influential throughout subsequent decades.

Hamilton's view was that young industries learn by doing and need support to grow strong enough to compete on the global stage – a strategy now famously known as the 'infant industry' argument. His vision became the cornerstone of US trade policy throughout the 19th century, inspiring nations like Japan and South Korea to use similar protectionist measures in the 20th century.

However, this approach comes with strings attached – protected markets are inherently inefficient, and prone to corruption and rent-seeking. In many cases it is still debatable if protectionism contributed to economic success, or whether the economic success happened despite that protectionism. Successfully producing and exporting goods is not a guarantee that this activity was economically worthwhile – as the experience of long-suffering shareholders in many Chinese export-oriented companies (or their international competitors) will tell you today.

A history of trading philosophies

Influential figures in international trade

16th to 18th centuries

Mercantilism

Wealth measured by the accumulation of gold and silver. Trade was ruthless with zero-sum competition. If one country grew richer, another must be getting poorer.



1772-1823

David Ricardo

Concept of comparative advantage in 1817 says even if one nation is better at producing everything, it still makes sense to specialise in what it can produce at the lowest cost and trade for the rest.



1723-1790

Adam Smith

The *Wealth of Nations* (published in 1776) argues that trade isn't necessarily about one nation's gain at another's expense. Instead, trade can be a win-win, where nations can create mutual prosperity by focusing on what they do best.



1750s-1804

Alexander Hamilton

In 1791, made a case for tariffs and subsidies to shield emerging domestic industries from foreign competition. The 'infant industry' argument says young industries need support to grow strong enough to compete on the global stage.



2017-NOW

'Trumpism'

Advocates trade barriers under the banner of "America First." President Trump thinks the US trade deficit is evidence of losing a trade war, particularly against China's surplus. However, this view oversimplifies economic realities.

Make America great again

The first Trump administration (2017-2021) shattered decades of free-trade orthodoxy, advocating trade barriers under the banner of 'America First.' President Trump thinks the US trade deficit is evidence of losing a 'trade war,' particularly against China's surplus. However, this view oversimplifies economic realities.

The US trade deficit is a sign US companies can't keep up with demand, including from the US government. Fix the government Budget deficit and the trade deficit will likely fix itself. In China, the trade surplus is a sign Chinese companies can't find buyers at home. Moreover, the US pays China for its imports not in gold, but in dollars, which of course are ultimately recycled back to the US and end up funding both government and consumer borrowing.

Yet Trump's policies resonated with voters, reflecting deeper discontent. Ricardo's free-trade model assumes that cheap imports – whether due to Chinese corporate subsidies or comparative advantage – are universally beneficial, but this ignores crucial factors. These are: the strategic importance of certain domestic industries, the social value of work for those in affected industries, and the uneven distribution of trade's gains and losses. Yes, there might be better ways than tariffs to make everyone feel like a winner from trade, but one way or another, tighter trade policy is coming.

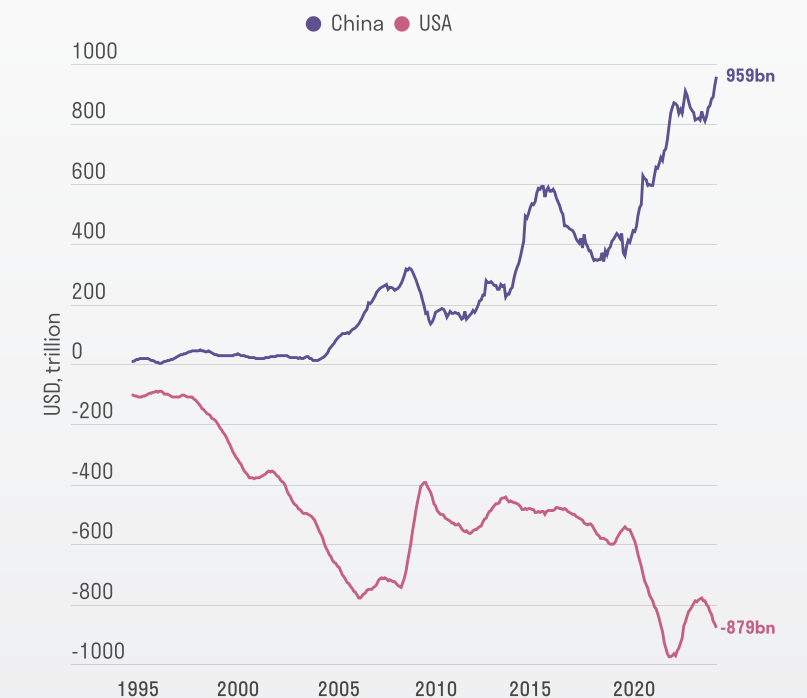
Investing in a transactional world

Protectionism redistributes gains from consumers to producers. In this case, the latter includes US workers and shareholders of US companies. As the US turns inward, the investment landscape is likely to create many winners and losers. At a high level:

Companies: Multinationals with complex foreign supply chains face pressure, while firms with large domestic markets and simpler operations are more resilient. National champions may see government support, though caution is advised in protected industries. Service companies are also likely to hold up relatively better – tariffs and quotas often hit goods harder than services.

Currencies: The US dollar is likely to strengthen. US exporters will be hurt by an increase in the value of the currency, even in the absence of trade retaliation.

CHART 1 TRADE BALANCES; CHINA VS US, 1995 - 2025



SOURCE: MACROBOND, 08.01.25

Volatility is likely to rise as currency markets will need to act as shock absorbers amid these disruptions. There is a growing risk of a devaluation of the Chinese renminbi which could wreak havoc for emerging markets currencies, the euro, and the yen.

Countries: Those that rely heavily on trade, especially those with large surpluses with the US like Germany, Mexico and Vietnam, are likely to feel the pinch as tariffs and restrictions ramp up. Australia and the UK could sidestep the initial shocks but may still get caught in the crossfire due to their close trading ties with targeted economies. 'Unaligned' economies like India and Singapore may fly under the radar and even step up as middlemen between competing trade blocs.

Gold: This could emerge as a strategic asset despite US growth exceptionalism and Trump's broader policy agenda. Growing sanctions in a Trump-led world will lead to shifts in financial flows as the search for 'safe assets' outside the reach of the US government increases.

Co-operation vs competition

Delving into our textbooks gives us fascinating historical insight into how these great minds have shaped economic thinking throughout the ages. The history of trade between nations has been a long, and sometimes bumpy, path with cycles between co-operation and competition.

In this sense, the protectionism and tariff-based approach under President Trump is nothing new, and with that in mind understanding that the pendulum is once again swinging towards competition underpins our dynamic approach to asset allocation in portfolios today.



COLM HARNEY

INVESTMENT STRATEGIST /
PORTFOLIO MANAGER

Strategist's View

WHY THEMATIC?

Key points

- Enduring structural trends – or themes – tend to be underappreciated by markets over the long term, and so create opportunities for disciplined investors.
- These opportunities arise from excessive short-termism by other market participants, driven by both institutional pressures and human behavioural biases.
- By integrating thematic research into all aspects of investing, Sarasin strives to mitigate biases, uncover opportunities, and address risks that could impact client outcomes.

At Sarasin & Partners we have long pioneered a global, thematic approach to investing. This thematic philosophy is encapsulated in our view that markets underappreciate the impact of structural trends. Here, we explain how that approach works.

Structural trends are long-term forces that shape behaviours, societies, industries, and even financial markets. They arise from innovations in technology, demographic shifts, changing consumer priorities, or global challenges like climate change and shifting geopolitical dynamics.

For example, longer life expectancies impact labour markets and healthcare spending, but also lead to different choices around education, urbanisation, family formation, and a range of associated spending decisions. Another example is the continued progress in the technology underpinning computer chips. Moore's Law has continued to deliver exponential improvements in the performance and cost of the basic building blocks of modern computers, leading to the rise of smartphones, e-commerce, cloud computing, and more recently breakthroughs in AI.

At Sarasin, we call these material, enduring trends 'themes'. We believe markets underappreciate the persistence of these themes, which gives rise to attractive investment opportunities.

Why themes are overlooked

Despite their transformative power, structural trends or themes are consistently underestimated by financial markets. According to efficient market theory, prices should reflect all available information, reacting only to unexpected developments. However, behavioural and institutional factors mean markets often fail to price in these themes for years, or even decades.

Institutional pressures: Short-termism in asset management

The structure of the asset management industry inherently incentivises short-termism. Professional managers are agents acting on behalf of clients, their principals, who typically evaluate performance on quarterly or annual timescales. This focus on short-term results leads managers to prioritise identifying short-term market inefficiencies or attempting to outperform peers by predicting near-term company performance, rather than focusing

on longer-term opportunities. These pressures are reinforced by the quarterly earnings cycle, where corporate reporting often aligns with investors' near-term priorities, further obscuring the visibility of enduring themes in financial markets. This well-studied phenomenon is called the principal-agent problem, defined as a 'conflict in priorities between the owner of an asset and the person to whom control of the asset has been delegated'¹.

Conventional investment wisdom also plays a role. Traditional approaches emphasise a narrow focus on fundamental analysis of individual companies, often assuming that themes will 'cancel out' over time. As a result, many investors concentrate on short-term forecasts while conservatively assuming that growth and profitability will steadily decline over longer periods, when in fact the empirical evidence suggests that this is not the case².

Behavioural challenges: Cognitive biases in decision making

Behavioural science reveals that cognitive biases often prevent investors from recognising and acting on themes. For example:

- **Anchoring bias:** Investors may rely too heavily on historical averages, leading to slow adaptation to new trends.
- **Confirmation bias:** Investors often overweight evidence supporting their existing beliefs while dismissing contradictory information.
- **Substitution bias:** Confronted with complex questions about long-term trends, investors may simplify their analysis, focusing instead on shorter-term, more tangible opportunities.

These biases encourage a collective focus on short-term market drivers, leaving enduring themes under-researched and undervalued.

Structural trends in action: Thematic investing

At Sarasin & Partners, thematic investing involves understanding long-term structural trends and counteracting the inherent biases toward short-termism. As an independent partnership, our structure aligns our time horizon with that of our clients, enabling us to take a truly long-term perspective. This alignment allows us to focus on delivering sustainable value over decades, rather than succumbing to the pressures of quarterly or annual performance targets.

We also structure our internal philosophy and processes explicitly to recognise and mitigate the incentives, conventional wisdom, and behavioural biases that drive short-termism. By embedding a disciplined focus on themes into every stage of our investment process, we ensure that our approach consistently reflects long-term opportunities. This philosophy is not limited to

one aspect of investing but is deeply integrated across our research, asset allocation, and security selection processes. Below, we outline two key areas where this thematic approach adds value:

1. **Equity selection:** A deep understanding of the major global themes is required to accurately estimate the true intrinsic value of companies, and forms the core of our thematic equity research process. For example, major technology companies like Amazon, Apple, and Microsoft were long recognised as profitable and growing, but few investors accurately gauged the strength and persistence of the digitalisation tailwinds driving their success. As these themes played out, the companies' share prices rose in line with their underappreciated growth.
2. **Active asset allocation:** Thematic research also enhances asset allocation decisions by providing insights into the themes influencing economic variables like inflation, interest rates, and GDP growth. These are important drivers of long-term asset class performance.

A dynamic approach to themes

It's important to note that themes and their under-appreciation do not last forever. Economies and societies have self-correcting mechanisms, and the conditions fostering transformative trends eventually change. Similarly, companies benefiting from structural growth will face competitive pressures that limit returns over time.

Markets also tend to overcorrect, often moving from underestimating themes to overvaluing them just as they begin to reverse. As a result, thematic portfolios should not be purely 'buy and hold' with minimal turnover. An active investment approach, that continually reassesses market expectations and adjusts portfolios accordingly, is critical for sustained long-term success.

At Sarasin & Partners, we are committed to identifying and capitalising on enduring themes to deliver long-term value to our clients. By integrating thematic research into all aspects of investing, we strive to mitigate biases, uncover opportunities, and address risks that could impact client outcomes. Alongside our focus on responsible investment, this thematic approach is central to our mission of securing tomorrow.

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¹ <https://www.investopedia.com/terms/p/principal-agent-problem.asp>

² <https://www.unpri.org/download?ac=4215>, UNPRI 2017

WHY THEMATIC?

Colm Harney, Investment Strategist / Portfolio Manager

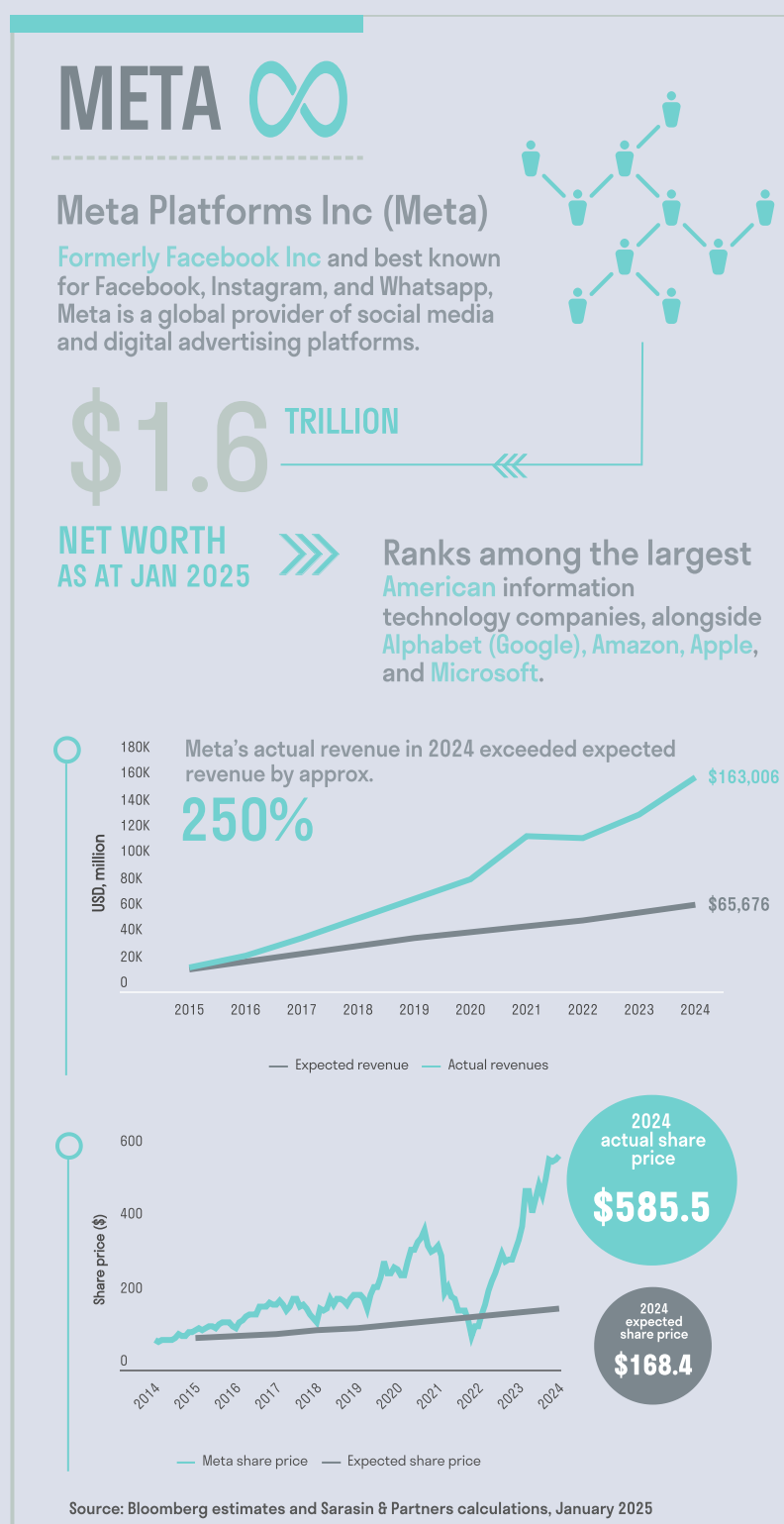
Case study: Meta, December 2014

In December 2014, Meta - which at that time traded as Facebook - traded on over 40x expected earnings, and was generally considered a relatively expensive, high-growth stock.

Its strong market position underpinned confidence that Meta would continue to benefit from its core tailwind or theme - the growth in digital advertising as marketing spend continued to steadily shift online from offline. However, it was priced for a steady fade in growth down from above 30% in the upcoming two years, to 10% annual growth over the longer-term.

In reality, revenue growth averaged exactly 30% over the subsequent decade as the thematic tailwind from digital advertising proved very durable, and the company successfully maintained a strong market position. As a result, while the valuation multiple faded from c.40x earnings to closer to 20x, the share price increased by 700% over the decade, significantly outperforming both the expectations of investors and wider stock market indices.

All data: Bloomberg estimates and Sarasin & Partners calculations, January 2025



Investment Focus ALTERNATIVE THINKING

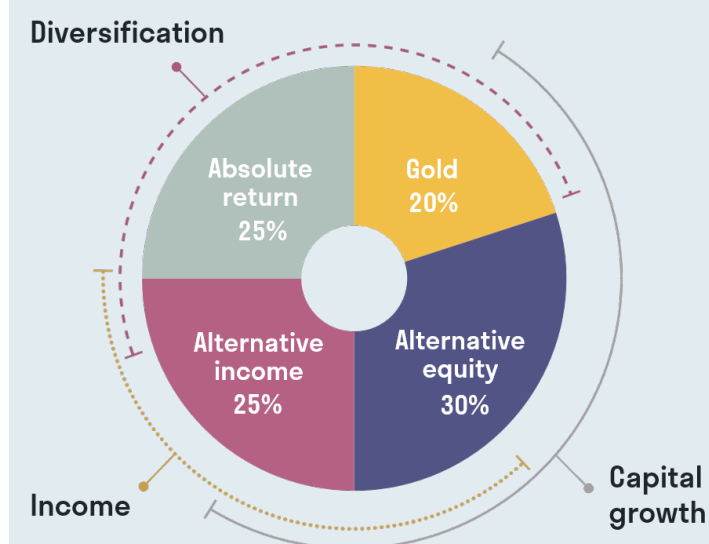


ALASTAIR BAKER
PORTFOLIO MANAGER

The use of alternative assets to improve portfolio diversification and to provide a source of uncorrelated returns has been a longstanding feature of Sarasin & Partners multi-asset portfolios.

The illustration below sets out our principles for investing in alternatives along with the typical exposures to the different strategies within the investable universe. We continuously review our approach to alternatives exposure to make best use of the available investment opportunities and to find the most efficient means of accessing them. The latter point is especially important in relation to the rapidly growing pool of investment opportunities not quoted on public exchanges, collectively now known as private markets assets, which are set to play an increasingly important role within our alternatives exposure for multi-asset portfolios.

FIGURE 1 TYPICAL OBJECTIVES AND EXPOSURE OF A SARASIN ALTERNATIVES PORTFOLIO



OUR PRINCIPLES FOR INVESTING:

- 1 Superior returns vs bonds
- 2 Differentiated exposures
- 3 Diversified returns

Key points

- Private markets have become a mainstream and material segment of the investment universe, with these markets now growing at a faster rate than public markets.
- Funding for the private markets eco-system is now much deeper and more extensive, as regulation in public markets drives investment capital towards private markets.
- History suggests that an allocation to private markets has the potential to enhance returns for long-term investment portfolios. For those with an appropriately long-term investment horizon, we believe that an allocation to private markets alongside public markets exposure should be given serious consideration.

ALTERNATIVE THINKING

Alastair Baker, Portfolio Manager

The rise of private markets

McKinsey estimates that private markets were valued at approximately \$13.1trn as at 30 June 2023, having grown at an annual rate of 20% since 2018¹. Private markets cover a wide range of investments such as private equity, private debt and venture capital, and have a long history.

Regulation can have a meaningful impact on how financial markets operate. For example, the regulatory response to the 2008 global financial crisis has led to a safer banking system where stringent rules attempt to ensure banks are not taking excessive risk and have sufficient capital to withstand a large economic shock. This strategy has successfully helped the banking sector to navigate both the impact of the global pandemic and an abrupt change in interest rate policy following the subsequent inflationary shock.

However, with banks now having less flexibility to hold a wide range of investments, many opportunities have either failed to secure funding or had to find other sources of capital to support them, creating an opportunity for long-term investors to fill the void. Companies and their management teams have also increasingly chosen to fund their growth from the private markets rather than by an Initial Public Offering (IPO) with the associated burden of regulatory, reporting and governance costs. These changes in financial regulation, combined with the increased accessibility of private markets and a broadened investment opportunity set, have caused substantial growth over the last 15 years. In addition, private markets investments have delivered strong returns which have attracted large capital inflows.

The impact on public markets

Private markets are still small compared to public: global equities represented by the MSCI All Country World Index have a market capitalisation of \$98trn and bond markets represented by the Bloomberg Global Aggregate Index are valued at \$66trn as at 31 December 2024. However, since 2018 these indices have grown in size at a rate of only 6% per annum, significantly below that of private markets².

This is having a marked impact on public exchanges, with companies staying private for much longer: the median age at which a company becomes listed had risen from six years in the 1980s to 11 years by 2021. Between 1980 and 2000 there were 6,500 Initial Public Offerings (IPOs) in the US, but from 2001 to 2022 there have been less than 3000³. Databricks, an AI and data analytics business, raised \$10bn in December, the largest single private markets fund raising of 2024; according to Databricks, investors tendered double that figure. This is not just a story about capital-light companies such as software providers. Take Elon Musk's rocket-launching SpaceX business as a prime example. SpaceX is a privately funded company with a valuation of c. \$350bn at its last funding round in November when it raised an extra \$1.25bn⁴. To set that in context, AstraZeneca, the largest company listed on the London Stock Exchange, has a market capitalisation of around \$200bn and had a weight of 8% in the FTSE 100 at the end of December 2024⁵.

Most private companies are much smaller than SpaceX, of course, and the majority of activity is in a valuation range of \$100m to \$10bn. We can see the impact of this within the UK market where last year 88 companies delisted from the London Stock Exchange, with a major driver being acquisitions by private equity firms; by contrast, only 18 new firms were listed in the UK via IPOs⁶.

Evolving our approach

Traditionally, the wealth management sector has gained access to private markets opportunities via closed-ended quoted vehicles such as investment trusts. While these vehicles offer a degree of liquidity in normal market conditions, dealing conditions can also deteriorate rapidly. Closed-ended vehicles holding unquoted assets typically trade at very significant discounts to their published net asset values when there are more sellers than buyers for their shares in the market. Hence it is important for us to explore other avenues for accessing private investment markets.

Taking a more illiquid approach can be advantageous for genuinely long-term investors. In periods of economic change and market volatility, the long-term capital funding model of these vehicles remains in place, allowing them to take advantage of attractive valuation opportunities thrown up by short-term fluctuations in market sentiment. We are developing a range of solutions specifically designed to provide tailored access to global private markets opportunities under the leadership of our highly experienced Sarasin Bread Street team (more detail to follow in the next issue).

We expect private markets to continue to grow in size and importance. The inclusion of unlisted private assets within an investment portfolio's allocation to alternatives can significantly enhance longer term risk-adjusted returns, as many leading academic institutions and charitable endowments have been able to demonstrate in recent years. The challenge for us now is to develop suitable means of accessing the exciting opportunities available in unquoted markets for private investors and charities.

¹ <https://www.mckinsey.com/industries/private-capital/our-insights/mckinseys-private-markets-annual-review>

² Bloomberg and Sarasin & Partners calculations, January 2025

³ <https://www.nasdaq.com/articles/as-companies-stay-private-longer-advisors-need-access-to-private-markets>

⁴ <https://www.bloomberg.com/news/articles/2024-12-10/spacex-share-sale-is-said-to-value-company-at-about-350-billion>

⁵ Bloomberg and Sarasin & Partners calculations, January 2025

⁶ <https://www.ft.com/content/aef053ce-c94d-4a72-8dce-bdbf56dd67e1>



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Charity Focus

MANAGING RISK THROUGH DISTINCT LENSES

Key points

- Fundamental to investing is the understanding that taking measured and calculated risk is a necessary function of generating attractive returns.
- Inflation risk, withdrawal risk, reputational risk, and investment risk are all important considerations for charity trustees.
- Sarasin & Partners looks at investment risk through the lenses of absolute and relative risk.

As an investment manager, managing risk is always front of mind in how we at Sarasin & Partners serve our clients. Here we outline our thought processes in how we balance different risks, to maximise the possibility of the best outcomes for our clients.

At its core, 'risk' relates to the probability, severity and frequency of an adverse outcome or event occurring. The management of risk is therefore centred on the reduction of related uncertainty and the creation of an environment where it can be adopted and harnessed in a controlled manner. One of the fundamental tenets of investing is the notion that taking measured and calculated risk is a necessary function of generating attractive investment returns.

We are frequently asked by charity trustees how best to consider investment risk when managing charity portfolios. Ultimately, we recognise that risk takes different forms for different organisations and that each charity will naturally have its specific areas of focus.

In its broadest sense, risk to most charities will encompass:

- **Inflation risk** – the concept that capital and spending power can both be eroded by rising prices.
- **Spending/withdrawal risk** – the risk that returns generated are ultimately insufficient to fund a charity's mission or operations.
- **Reputational risk** – owning assets that contradict an organisation's objectives to the detriment of a charity's reputation and standing.
- **Investment risk** – a measure of an organisation's tolerance for capital volatility and capacity for loss.

To assess a charity's risk profile, investment managers will typically refer to common risk metrics. While these often provide useful historical context and a helpful guide when building investment strategies, at Sarasin & Partners we tend to view investment risk through two distinct lenses.

The first is absolute risk, the risk of a decline in values in **absolute** terms resulting in absolute loss of capital in extremis. Secondly, **relative** risk, which is a measure of the variability of returns when compared to a composite benchmark and/or a peer group comparator.

Absolute risk

Industry established measures of investment risk include: volatility (standard deviation); maximum annual drawdown (a measure of the magnitude of peak to trough paper losses (i.e. unrealised), typically over 12-month rolling periods); and value at risk or VaR (an indication of a typical paper loss in normal market conditions, excluding the most extreme outcomes). While these are instructive, like performance records, they are inherently backward looking.

Caution is needed when extrapolating historic trends into the future, as it is possible that the next economic or market crisis could take a different shape to that experienced previously.

Similarly, while it is worthwhile taking time to understand an organisation's capacity to tolerate variability in capital values (which is what the three risk measures above seek to illustrate), these risks are only brought into relief if they are crystallised through forced asset sales at the worst possible moment. We have long advocated that, when taking on investment risk, the best protection against loss in absolute terms is through robust strategic planning. An organisation's investments have to be managed in keeping with its liabilities, expected future cashflows and spending requirements.

At a more granular level, absolute loss can also encompass the loss of capital in a single individual investment. While no investment manager would ever set out to lose money, unfortunately this is a very real risk when managing investment capital. A charity investor's greatest protection in this regard is to scrutinise a potential or existing investment manager's process. In particular, a thorough understanding of the prior track record, security selection process, depth of resource and ex-ante risk controls should be sought.

Liquidity risk (the ease with which an asset or security can be sold) is especially important in this context, particularly if an investment manager is seeking to invest in smaller companies or less liquid markets. Attention should be paid to position sizing in these sorts of investments. Experienced managers will likely have self-imposed ownership limits in smaller companies and collective investments such as investment trusts, where in periods of market stress liquidity can sometimes be constrained.

At Sarasin & Partners, our process tends to focus attention on areas in which we believe the probability of success is higher. Businesses that display 'quality' characteristics typically create more enduring and sustainable value for shareholders. These characteristics include: high return: higher returns on invested capital, sustained competitive advantages expressed through higher and more persistent margins, competent management teams with strong and transparent governance, coupled with lower, or well understood, environmental, social and governance (ESG) risks.

Conversely, we recognise the threats posed by uncertainty and opacity. Businesses that are overly exposed to the business cycle, exogenous factors such as commodity prices or government funding streams, or those which are especially sensitive to interest rates, all represent

potentially more uncertain and therefore higher risk investments. Where we invest in collectives, such as investment trusts, we impose a maximum ownership limit of 10% of the shares in free float, but in practice exposure is often closer to 5%. We typically restrict ourselves to trusts that are greater than £1bn in market capitalisation. When investing in direct equities, the vast majority of the companies on our buy list are larger than \$5bn. This protects us in times of market stress and allows us to be nimble if our investment thesis changes at short notice.

Relative risk

Most charity investors, regardless of experience, suffer to a greater or lesser extent from 'loss aversion' – the phenomenon where a real or potential loss is perceived as psychologically or emotionally significant than an equivalent gain. For this reason, absolute risk will often be the overriding focus. However, given the increasing sophistication of many charity investment committees, relative risk – the performance of an investment portfolio relative to a pre-agreed comparative benchmark – is increasingly under scrutiny. Put another way, trustees will assess the opportunity cost that occurs as the result of an investment manager's decisions and actions.

Over the long-term, most charitable organisations with investment reserves are, understandably, concerned with achieving a 'real' return objective i.e. generating a given level of return ahead of inflation. This is typically to fund grant programmes, charitable expenditure or operations, while growing the capital base such that the spending power of the assets is maintained. However, we also encourage clients to measure their investment performance over a wide range of time periods against a composite index-based benchmark and an appropriate peer-group comparator.

The measurement and assessment of relative risk, when compared to an index-based composite benchmark can be fraught with complexity. Composite benchmarks typically exist to compare the performance of an active fund manager against a group of composite indices, gross of costs. This is to see whether or not value has been added through stock selection (the identification of specific companies and investments) and tactical asset allocation (expressing a view on certain asset classes vs a pre-agreed 'neutral' position). However, the very composition of modern capital markets has resulted in these comparators containing inherent and unexpected risks in and of themselves.

First of all, there is the selection of benchmark constituents. By way of example, measuring global equity performance against the MSCI World benchmark index, which excludes emerging markets, as opposed to the MSCI All Countries World Index (ACWI), which includes them, would have yielded markedly different results over the past decade. The latter has underperformed the former by over 20% over the ten years to 31 December 2024, as emerging markets have lagged their developed market equivalents¹. While the pattern may not necessarily repeat over the years ahead, and the vast majority of our clients use the broadest measure of global equities available, understanding

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Thomas Lindsey, Business Partner, Charities,
Melanie Roberts, Partner, Head of Charities

the reasons behind the disparity in the performance of comparable indices, and any resulting under- or out-performance of that comparator, is crucial.

Then, there is the composition of modern stock markets and the level of concentration risk inherent within them. The US now represents over 66% of global stock market capitalisation, as measured in dollar terms via the MSCI ACWI. The next largest single market is Japan at 4.8%, followed by the UK at 3.1%. The entire UK equity market is now smaller than individual companies such as Apple (4.9% / \$3.8tn), Nvidia (4.3% / \$3.3tn) and Microsoft (3.8% / \$3.0tn). Similarly, Amazon represents roughly 2.7% of the global index, comparable to that of the entire Chinese stock market (2.7%)².

Concentration isn't a new phenomenon but the size and dominance of US technology businesses has resulted in a challenging backdrop for global investors used to relying on global indices for diversification.

This, of course, only paints part of the picture. Advocates of US exceptionalism would point to recent headlines underscoring the exodus of UK businesses from domestic stock markets in favour of the US. According to the London Stock Exchange Group, in 2024 alone, a total of 88 companies delisted or transferred their primary listing from London's main market with only 18 new listings taking their place³. With the US market acting as such a powerful pull for global business, it could be argued that geography, based on a company's listing, is losing its effectiveness as a measure of diversification.

One solution for sceptics could be to focus attention on equally weighted indices, which normalise the size of these behemoths. However, doing so could significantly impact returns, as we have been reporting to clients throughout the past 18 months. Regardless of your perspective, charity investors must be aware of these nuances when considering relative risk.

At Sarasin & Partners, we believe that the skewing of geographies and the sectoral imbalances in certain stock markets call for a more holistic approach to diversification and risk management. While many institutional investment managers focus on factor risks – identifying certain styles that may be responsible or explain the returns generated over a particular time period – we still believe that taking a thematic approach to investing ensures that portfolios are well exposed to the trends that are likely to generate superior returns over the medium to long term.

Of course, understanding positioning relative to benchmark indices and geographies is important for the purposes of effective portfolio construction, but country listings are increasingly becoming an inefficient way to build and diversify portfolios on a standalone basis.

The fact that some index constituents are now so large that isolating relative risk from absolute risk has become nigh on impossible, means that investors must increasingly challenge a manager's process and seek justification for individual investment decisions.

A bespoke approach

We understand that every charity encounters different risks at different times, and a bespoke approach to managing these challenges is critical. For this reason, at Sarasin & Partners we work with our clients on a discretionary basis, where we have the opportunity to add value through our strategic expertise and unique approach to risk management and portfolio construction.

¹ Source: Bloomberg (MSCI ACWI (Net Total Return) vs MSCI World (Net Total Return)), 31 December 2024

² Source: MSCI, 31 December 2024

³ <https://www.ft.com/content/aeef053ce-c94d-4a72-8dce-bdbf56dd67e1>

IMPORTANT INFORMATION

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