Equity outlook

'The economy is rapidly becoming sustainable and digital'

What do our equity portfolio managers expect in 2021 and beyond? We spoke to the fund managers of our small-cap, dividend and sustainable equity strategies and our Global Impact Pool to find our. Optimism reigns, especially over the longer term : as they say, 'We already hold tomorrow's winners in the portfolio.'

INTERVIEW WITH

Small caps–Jan Willem Berghuis
Dividend – Marius Bakker and Dimitri Willems
Sustainable Equity – Martijn Kleinbussink and Ivo Kuiper
Impact Pool – Marjoleine van der Peet

What do you see as the main themes for 2021 and beyond?

Ivo Kuiper (sustainable equity):
'All the innovation and creativity going on at companies is helping us make good progress towards meeting the challenges facing society. Europe has some highly ambitious climate goals but a lot still depends on their implementation. The question is how much courage the region displays in creating a more sustainable, greener economy over the next ten years.'

'Investors' ambitions should go beyond financial returns'

Marjoleine van der Peet (Global Impact Pool):
'I would add that 2021 will be a success if investors start thinking consciously about what they want to achieve. As part of that, it would be great if their ambitions go beyond financial returns. Sustainable investment is really taking off among our clients, partly because they can see that it's possible to do well. Some very clear themes are emerging, such as mitigating climate change. People want to see the impact their investments are having on the climate. It's possible to measure that impact, and Kempen does exactly that. And once you can measure your impact, you can start to manage it.'

Jan Willem Berghuis (small caps):
Investors always look a long way ahead. This past year has been extreme, with a small number of large caps dominating the markets. I expect this effect to lessen in 2021, creating more opportunities for small caps. A number of our holdings are performing very well while others are lagging behind, but that certainly

doesn't mean it's game over for the companies that are struggling. We apply a long horizon in our investment strategy. There's no doubt that small caps are often unloved in uncertain periods, yet it's precisely at these times that investors should take a look at them.

We made a few adjustments to our portfolio at the start of the year. For instance, we no longer hold any airline equities. We're positive about a US insurer that is clearly trading at below book value. We have lots of new ideas and have already increased our positions in a number of existing holdings. The value segment, which we hold a slight tilt towards, could undergo a sound recovery. I'm looking forward to less extreme markets and more opportunities to generate outperformance.'

Marius Bakker (dividend):
'The same goes for us. Part of the market seems cheap, even taking into account the recession we're either already in the midst of or that is on its way. For us as dividend investors, 2020 has been a terrible year. When the economy ground to a halt, many companies decided – or were forced – to suspend dividend payments. Quite rightly, at the start of the coronavirus crisis companies opted to ensure their survival and shield their broader stakeholders at the expense of payments to shareholders.

We're looking forward to the situation normalising somewhat in 2021 and to companies getting a better grip on the future, which should create capacity for a resumption of dividend payments. Whether that will happen as early as next year will depend on the individual firm, but many companies that have halted dividend payments want to restart them as soon as possible. Some financials that we invest in, for instance, were forced to suspend dividend payments by central banks, even though they were otherwise in good shape. We expect these firms to resume their dividend payments quickly. There was also a great deal of social and political pressure to cut dividends, especially on companies that have received state support.

More companies will undoubtedly get into difficulties. Resuming dividend payments would be great, but only if the company is in a position to do so. Orange, one of our holdings, is a good example: low leverage, a sound cash position, its business model is benefiting strongly from the trends in telecom use. Yet the French government still ordered it to halt payments. It slashed its dividend chiefly due to political motives. It would be great if the companies that are doing well are given the option of rewarding their stakeholders.'

Martijn Kleinbussink (sustainable equity):
'We believe that 2021 will be more of the same. And that companies will invest substantially in order to accelerate those two trends. Everyone quickly needs to become more digital and sustainable, as these areas have become so important. A lot of demand has been brought forward. The companies we're talking to are saying that they've already implemented the plans they had scheduled for 2025.

This is positive for our strategy: we already hold what we believe will be tomorrow's winners in the portfolio – companies that have been leading the way digitally and in terms of sustainability. We're more accustomed to looking ten years ahead, but I'm positive about 2021. This period is a validation of our choices. Companies have definitely started along the path towards progress. I can also see a role here for small-cap companies: they're often highly specialised and innovative. You can debate stakeholder value and whether you sometimes need to prioritise different interests with the companies in the dividend fund. There's a great deal of regulation on its way and this also needs to be taken into account.'

Some companies are doing brilliantly while others are really struggling, which seems to be a typical feature of this crisis. How do you view the opportunities in the market for next year?

Dimitri Willems (dividend):
'We're seeing things going to extremes. No recovery is being priced in at all for some companies, as if things will go badly for many years. But other firms are priced as if the pandemic has had absolutely no impact at all. It looks like an overreaction. If things start to normalise even a little bit, then 2021 could be a good year for our strategy as well. I view it rather like the resurrection of dividends. Many clients understand that perfectly well, luckily, and don't look purely at performance over the most recent period. What you need to explain as a fund manager is that a great deal has already been priced in, as if the recession will last at least ten years. This kind of exaggeration is unfortunately a typical market trait.'

'As a fund manager you need to explain that a great deal has already been priced in'

Martijn Kleinbussink (sustainable equity):
'We view the opportunities in the market differently. We're in the midst of two important transitions that need to take place within our generation, one to a digital economy and the other to a sustainable economy. Covid-19 seems to be accelerating both of these trends. For example, there's been a huge increase in the number of people working from home. As a result, our investment in Microsoft turned into a growth of nearly 90% a month. Another example is the Lonza Group, a Swiss medicine maker. It was already working on moving its supply chain from China to Europe on the principle that it's easier to make medicines where they're used. It's experiencing an enormous upturn in demand.'

Marjoleine van der Peet (Global Impact Pool):
'In our fund we invest much earlier in the chain than, for example, the companies in which Sustainable Equity invests. They aren't listed on the stock market either. Listed companies often ultimately buy up our companies; that's part of the exit strategy. We're also seeing that trend towards a sustainable economy. For instance, we invest in a company called Vericool. It's developed a sustainable alternative to expanded polystyrene foam that is biodegradable and manufactured without the use of oil products. We're happy to invest in that. Listed companies are now showing more interest in these kinds of things too. They're investing in the same companies as us or buying them up. There could be more acquisitions in 2021, as long as companies continue to hold a significant amount of cash and don't start just monitoring their costs.'

Jan Willem Berghuis (small caps):
'The small-cap segment will probably experience a large number of acquisitions in 2021; at the moment we're only seeing a few. In October, one of our holdings received an unsolicited bid that was 64% above its market price. We agree that the digital and sustainable transitions are two extremely important trends. If you look at our portfolio you can see that reflected in companies like Abercrombie & Fitch: 50% of its sales are now conducted online and that has helped prop up its results over the past couple of quarters, despite some of its shops being closed. The wheat is currently being separated from the chaff. It'll quickly become obvious over the next three years which companies haven't succeeded in making the digital or sustainable transition.'

The world is facing three big issues: Covid-19, the US presidential elections and Brexit. How are these factors affecting your investment decisions?

Ivo Kuiper (sustainable equity):

'The Covid-19 pandemic has naturally had an enormous impact, not just on the economy but also on society. Just think of people's mental health. I do worry about that for the next year. The situation is having an enormous impact on who we are and what we do.

In economic terms, the present situation could indeed act as a trigger for the creation of a more sustainable and digital economy. For the companies in our portfolio these changes will lead to lots opportunities. The role of governments shouldn't be underestimated either. They need to display courage for the transitions to take place. They mustn't rein in spending in panic or try to save the old economy at any price. You can see a difference in the support packages that are currently being provided: in Europe, businesses are receiving support and people's jobs are being preserved. In the US they're quicker to make people redundant, but then they're given income support.'

Marjoleine van de Peet (Global Impact Pool):

'Early in the lockdown we phoned the managers of the companies we invest in and asked them: how much cash do you have, how long can you hold out? And, luckily, they were all in good shape. They have enough cash on their balance sheets to keep them going until well into next year and there's enough support if they require more cash.

The longer this pandemic continues, the greater the impact on the economy. In our fund we aren't invested in companies on the front line that were hit very hard, such as hotels and gyms, nor are we exposed to the second line really. We invest a lot in sectors that are in fact profiting from the pandemic. As an example, we hold a chain of pharmacies that has almost doubled its revenue. So our healthcare portfolio is doing extremely well.

The first US presidential debate, apart from being largely uninspiring, was notable for both sides making statements on sustainability. That sustainability is in the spotlight is positive in my opinion. I think that Joe Biden will offer greater support to the sustainable transition than Donald Trump. The natural disasters that we've seen recently, such as the tragic wildfires in California, are also bringing home the facts to the American people. I hope that this translates into action in the very near future. That would be wonderful.'

Are you worried about the potential consequences of Brexit?

Marius Bakker (dividend):

'The US elections are reasonably binary: it'll either be Trump or Biden. But Brexit is so wide-ranging, and affects so many countries. The array of outcomes is vast and it's hard to predict the impact. Quite apart from the fact that it probably isn't a good idea, the UK's departure from the EU will probably cause volatility in the short term. In the long term it's hard to say. What we do as investors is to diversify, so that a poor outcome doesn't affect our entire portfolio. Some of it has already been priced in. And in many cases companies are listed in the UK but earn their money across the world.'

Jan Willem Berghuis (small caps):
'Our portfolio contains companies from the UK, but they operate globally and just happen to be listed in the UK. We're cautious about companies that depend mainly on the UK economy. Because the issue has been going on for so long, it's almost last year's news. We do have a lot of clients in the UK, including for our fiduciary business, so we continue to monitor the situation closely.'

OUR FUNDS

Small caps

Small caps are smaller listed companies. The definition 'small cap' is based on the market value of a listed company. At Kempen, a company must have a market value of EUR 100 million to EUR 5 billion to be included in one of our small-cap funds.

Sustainable Equity

When selecting companies for our Sustainable Equity strategy we initially examine their quality. Valuations are of course also important, but only in the second instance. ESG criteria form a major and integral part of our company analysis. Here we use our experience and knowledge of each sector to look beyond the short-term cash cows, and we also examine how we can profit from the difference between a company's market value and the intrinsic value we identify.

Global Impact Pool

This strategy invests in impact funds that make a positive contribution to society and the environment. We also expect each of our impact investments to make a positive financial return, fully integrate ESG criteria and contribute to at least one of the United Nations Sustainable Development Goals. The strategy spreads its investments across various asset classes, mainly in private markets.

Dividend

We seek to invest in attractive companies with strong capital discipline from the large universe of firms that distribute high dividends each year. In doing so we follow some clear guidelines: each holding should have approximately the same weight in our portfolio and its dividend yield should exceed a minimum threshold: 2.5% for our European strategy and 3% for our global strategy.

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