Rothschild & Co
Wealth Management

Insights

American horizons: Politics, markets and trends

Autumn 2024

Contents

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Laurent Gagnebin

CEO, Rothschild & Co Bank AG

Running the long race…

As 2024 slowly draws to a close, it offers a moment to reflect on the events of the year and the enduring qualities that guide us through times of uncertainty—resilience, determination, and a long-term vision. These are qualities I've come to appreciate not only in our approach at Rothschild & Co, but also personally, being an avid marathon runner. The journey may be demanding, but the rewards come from perseverance and thoughtful preparation—principles that strongly mirror our investment philosophy.

This year, the United States has been at the centre of global attention. With the upcoming elections, we are reminded of how quickly the political and economic landscape can shift in such a pivotal economy. Now, more than ever, staying informed is crucial. The U.S. economy continues to shape global opportunities and challenges, underscoring the importance of sound, informed decision-making. As Benjamin Franklin wisely said, "Diligence is the mother of good luck" - a reminder that consistent effort and preparation are the foundations of success, especially in an unpredictable world.

In this edition, we explore the U.S. investment landscape from various angles, offering insights into key trends and developments. Our Chief Investment Officer shares his perspective on strategic opportunities and risk management in today's evolving market, while our Global Investment Strategist provides an in-depth analysis of the key developments shaping the U.S. economy and its continued influence on global markets.

You'll also gain perspective from our fixed income team on the outlook for U.S. fixed income markets. Additionally, our equity research team, fresh from their recent U.S. road trip, provides a unique view on key sectors. We further explore the potential of Industry 5.0 and present an insightful conversation with Christoph Besmer, the Swiss Trade Commissioner to the U.S., on the evolving relationship between the two nations. Finally, this issue includes an introduction to continuation funds.

On a broader scale, 2024 has also been a milestone year for Rothschild & Co, as we continue to expand our global presence with new offices in Dubai and Hamburg. This growth reflects our commitment to serving clients across key markets worldwide, and it allows us to offer deeper local knowledge paired with our global expertise.

Much like running a marathon, navigating the ever-changing landscape of global markets requires endurance, thoughtful pacing, and an unwavering focus on the finish line. We trust that this edition will equip you with valuable insights as you continue your investment journey, and we look forward to helping you stay the course toward your goals.

Warm regards,

Listen to the music

Kevin Gardiner
Global Investment Strategist

American soul-searching is not new. As its 47th presidency approaches, the mood seems especially febrile, but it is now half a century since Paul Simon borrowed an Old World melody to lament the "shattering" of New World dreams. Allen Ginsberg claimed famously to have seen the best minds of his generation "destroyed by madness" almost two decades before that – and he wasn't the first soul-searcher either. In the post-war literary world, "The Great American Novel" is not about a great America.

Nor has the rest of the world been slow to diagnose American faults. Its foreign policy has offended many, sometimes with good reason. We no longer wish or expect the U.S. to police the world. The "Washington Consensus" sits uneasily with a net government debt burden of 98%. America for many is synonymous with materialism, brashness, insularity, hubris.

All of which makes the continuing dominance of the U.S. economy and its capital markets the more remarkable. The U.S. still accounts for roughly 29% of global GDP, making it the biggest economy in nominal terms (compared to 19% and 16% for China and the eurozone respectively). China's economy is bigger in purchasing power parity (ppp) terms, but the U.S.'s drives the global business cycle.

Other countries are more prosperous on a per capita basis – notably, Switzerland and (recently) Ireland – but America's mix of size and productivity spreads general prosperity furthest.

For sure, the gains could have been distributed more fairly within the U.S.: some measures of median household real incomes have barely grown in recent years. But even if such measures accurately allow for the improved quality of goods and services (and there is an ongoing debate about this and other measurement issues), they ignore the fact that many more households are at such income levels nowadays.

The U.S. is not immune to the productivity angst overshadowing other developed economies in recent years, but it seems to have fared less badly than Europe in this respect – and there is a very active debate about measurement issues here too.

The Federal Reserve is by far the most influential central bank, and the yield on the 10-year U.S. Treasury note effectively provides the global "risk free" discount rate. U.S. Federal borrowing – and its ongoing mismanagement – is embarrassing, as noted; but the debt is usually willingly bought by investors who are not short of alternative borrowers to fund.

The U.S. dollar remains the biggest reserve currency, even as economists vie with one another in predicting its terminal decline. It will not – it cannot – be replaced by the renminbi as long as China maintains capital controls and runs a structural current account surplus. Nor does bitcoin pose a threat.

The U.S. stock market now comprises 65% of the widely-watched MSCI All Countries global index by market value. In total return terms, it has outperformed the rest of the world, in common currency terms, by roughly 200% since 2007. Much of this outperformance has reflected rising valuations: its price-to book ratio has doubled, while the rest of the world's is little changed. However, MSCI earnings per share have also outpaced those in the rest of the world, and U.S. Inc is markedly more profitable than its peers (its return on equity, RoE, is about 5-6 percentage points higher on average).

Strikingly, while U.S. nominal GDP growth has lagged behind China's nominal GDP growth (in USD) by roughly six percentage points annually since China's accession to the WTO at end 2021, U.S. MSCI earnings per share have outpaced those in China by two points annually.

The underlying drivers of this outperformance are unclear. A growing population has boosted growth overall, but can't easily explain per capita GDP. Its unified domestic market, its work ethic and culture must be playing a role – as of course must its open-ness to innovation in technology and working practices.

The U.S. model is often said to be one of undiluted free enterprise, but as the Mariana Mazzucato reminded us a few years back, the U.S. government has happily intervened on occasion to support research and development in

“We come in the age's most uncertain hours
And sing an American tune.”

– Paul Simon

healthcare, defence and indeed the internet. Nor is it afraid to challenge mergers and acquisitions if it believes they threaten national security and competitiveness (a tendency which long pre-dates the Trump administration).

Nothing grows to the sky, of course. The stock market's recent AI-led advance has been unusually narrow, and expectations about what Artificial Intelligence might reasonably be expected to deliver look a bit naïve. Arguably, the long period of U.S. tech-led outperformance casts a shadow over the wider case for global equity investing: it's looked not so much like "stocks for the long run" as "U.S. tech names for the long run".

At some stage the U.S. will fall from economic and financial grace, and perhaps for more prosaic reasons than the angst and political concerns noted above. As we have often noted, the political complexion of the occupant of the White House often matters less than does the evolving business cycle in driving the U.S. (and global) economy and markets, and at some stage the U.S. economy will likely stumble whoever is in office (we preview the presidential election more carefully elsewhere).

Calling the turn is not easy, however. Economists have talked about an imminent U.S. recession for most of the last two years, during which the economy has if anything grown a little more quickly than usual. The flipside of the bigger government deficit has been a healthy private sector financial surplus: there are few private sector excesses to be purged.

So as we enter the last quarter of 2024, then, it feels premature to be betting against the U.S. – just as it did when we entered the first. Indeed, for most of my working lifetime, global investors have ignored the U.S. at their peril. Listen to the music, read the literature – just don't sell the stock.

Note from the CIO

From politics to performance

Dr. Carlos Mejia
Chief Investment Officer

As we enter the final quarter of 2024, the United States remain a key focus for us. With the presidential elections approaching, the uncertainty surrounding the political landscape influences market behaviour. However, it's worth noting that this is not the first time we've faced such dynamics, and it certainly won't be the last. Historically, the S&P 500 tends to rise in the twelve months following an election, with the sole exception of 2001, when the dotcom bubble burst. The same trend holds true over the four-year duration of a presidential term: the S&P 500 (Chart 1) has almost always increased—eight times out of ten—during these terms, with notable exceptions during Hoover's presidency, Nixon-Ford, and both terms of George W. Bush.

The outcome of the U.S. elections has the potential to impact everything from fiscal policies to international trade agreements, all of which can create volatility in the markets. However, it's also during these times of uncertainty that strategic investment opportunities can emerge. Our approach is to navigate these opportunities with a disciplined focus on risk management and a deep understanding of the broader economic trends at play.

Currently, we are closely monitoring several key areas:

1. Monetary policy and interest rates

Investors have been focused on inflation trends in developed markets for the past three years. Since the last significant inflation period in the 1970s and early 1980s, this has been a new experience for many. While it may be premature to declare victory, most central banks have started cutting interest rates, with the Federal Reserve (Fed) recently reducing rates by 50 basis points, benefiting from greater room for manoeuvre. Despite interest rates above 5% since May 2023, the U.S. economy has shown remarkable resilience, allowing the Fed more time to control inflation and aim for its 2% target. Many investors and economists now predict a soft landing, meaning the Fed has successfully cooled inflation while maintaining positive GDP growth. Chairman Jerome Powell recently indicated that the Fed's focus has shifted to supporting the labour market, expecting a slight rise in unemployment due to the lag from rate cuts. Consequently, the focus has moved from inflation to growth. While positioning for a soft landing is popular, it's important to remain vigilant for any economic indicators that could disrupt this scenario. U.S. assets are currently fairly valued, but negative economic data could lead to quick corrections, as seen in August and September 2024. These pullbacks can present worthwhile opportunities.

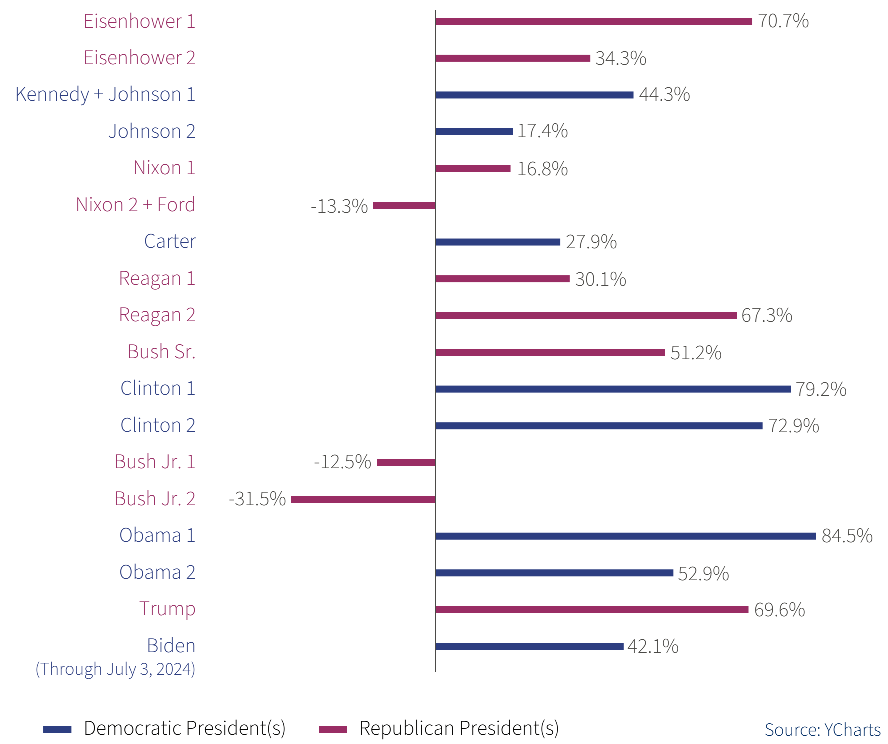
2. Sectoral impact

In the short term, during the three months following the election results between 1976 and 2021, the sectors that most frequently benefitted from a victory by either party were financials, energy, and telecoms in the case of a Democratic win, and manufacturing and materials for a Republican win. While these sectors may not align perfectly with those typically favoured by either party, their performance is likely more closely tied to the broader factors that usually influence market trends. Historical data from 1993 indicates that in the twelve months following election results, the sectors that perform best on average under a Democratic presidency are technology, consumer discretionary, and energy. In contrast, under a Republican presidency, materials, real estate, and energy tend to perform best. The sectors that underperform under a Democratic presidency include real estate, utilities, and consumer staples, whereas under a Republican presidency, the worst-performing sectors are communications services, utilities, and consumer staples (Chart 2.).

3. Geopolitical considerations

The U.S.'s position on the global stage, particularly in relation to trade and foreign policy, will

Chart 1: S&P 500 price change by presidential term



Source: YCharts

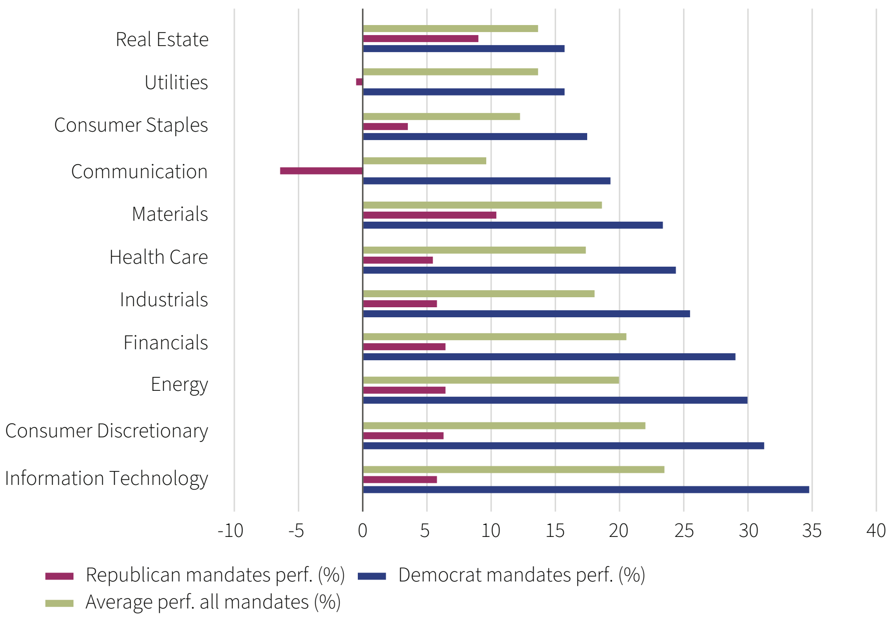
undoubtedly evolve with the new administration.

This might have significant implications for global supply chains and cross-border investments.

Our strategies are built on the foundation of diversification and flexibility. By remaining agile and informed, we aim to capture upside potential while safeguarding against downside risks. We continue to believe in the resilience of the U.S. economy and its markets, but we recognise that the road ahead may be uneven.

In this environment, staying informed and adapting to changing circumstances is crucial. We will continue to provide you with timely insights and recommendations to help navigate the complexities of the U.S. market in the months to come.

Chart 2: Average sector performance 1 year after start of mandate 1993-2020 (%)



What's on the horizon for U.S. fixed income investments?

Bastian Freitag
Head of Fixed Income Germany

Investors may find promising opportunities in the U.S. fixed income market as interest rates are continuing to decline. In this article, Bastian Freitag, Head of fixed income Germany, explores the implications of the rate cuts, the potential for solid returns from U.S. Treasuries, and the overall outlook for the fixed income landscape.

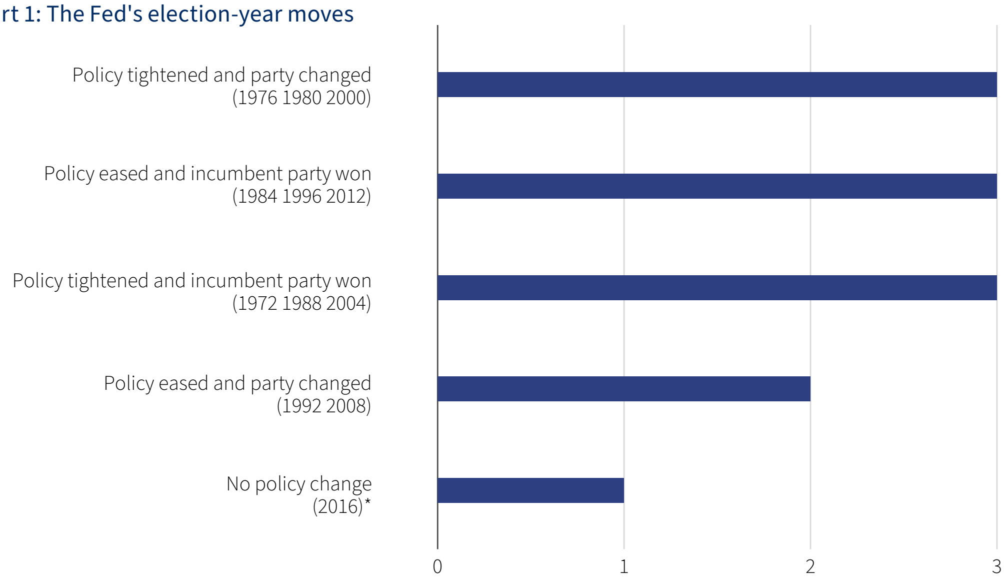
Understanding fixed income markets

Fixed income markets are the lifeblood of the global economy. Access to credit—essentially the ability to borrow money—has been pivotal in shaping society over the past 500 years and continues to drive economic and social progress today. In the last decade, these markets have become truly global. Despite regional differences due to local regulations, cultural variations, and a tendency for investors to focus locally, the global reach of major banks, asset managers, hedge funds, and corporations has expanded a market where capital flows seamlessly from lenders to borrowers. The USD 26.5 trillion U.S. Treasury market is the largest and most liquid in the world, with Treasury securities held by investors and central banks worldwide. This market is the primary tool through which the Federal Reserve implements monetary policy and the U.S. government raises funds. Yields on Treasuries represent the risk-free rate, against which global assets are priced.

U.S. fixed income markets in election years

In a recent speech at the Stanford Graduate School of Business, Fed Chair Jerome Powell stated that decisions made by the Federal Open Market Committee ("FOMC")[1] are taken "without consideration of short-term political matters." The data supports the chairman's claim. The Fed has adjusted its policy rate in 11 out of the 12 election cycles between 1972 and 2016. In some cases, these adjustments were relatively minor and took place early in

Chart 1: The Fed's election-year moves



*The Fed raised rates in December 2016, after the election.
Policy change describes net easing or tightening.

Source: Reuters

the calendar year, while in other instances, they occurred much closer to Election Day. There is little evidence to suggest that election cycles have influence interest rate policy in modern history – nor is there any evidence that cause and effect run in the other direction.

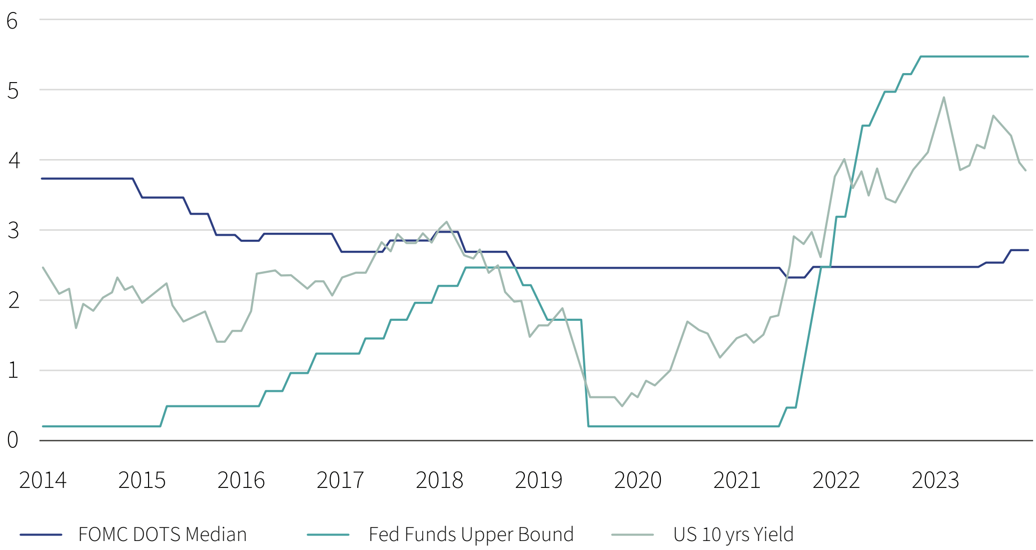
From an investment perspective, political noise may contribute to stock market volatility in the coming months, but its relevance in a portoflio context is likely overstated. Rather, the trajectory for both growth and inflation – and, in turn, their influence on interest rates - matter much more to bond (and stock) markets.

Indeed, in mid-September – undeterred by the pending Presidential race - the Federal Reserve lowered its main policy rate by 0.5% (50 basis points), bringing the target range to 4.75%–5.00%. This was the first time the Fed had cut U.S. interest rates since the early days of the pandemic in March 2020. Although the timing of the first U.S. rate cut was widely expected, the Fed opted for a more aggressive first cut - taking pre-emptive action before growth shows more obvious signs of cooling (Chart 1).

Risks, rate cuts, and the neutral interest rate

Chair Powell and the FOMC have indicated that risks to the economic outlook—both in terms of growth and the labour market—are now two-sided. While inflation remains a factor, the labour market has become increasingly significant in the Fed's decision-making process as the economy and inflation show signs of cooling. Further signs of labour market deceleration, such as reduced payrolls or a higher unemployment rate, could potentially prompt the Fed to consider further outsized 50 basis point rate cuts. However, we believe that market expectations for Fed cuts—over 100 basis points by the end of the year, including the September cut—are too high. The focus is shifting from the speed of rate cuts to the extent of these cuts. This discussion revolves around determining the neutral interest rate[2] for the Fed. The FOMC's median projection for the long-term 'neutral rate' is 2.75%, (Chart 2). We anticipate that the Fed may adjust rates back to this neutral level over time, but perhaps at a slower and more gradual pace than money markets are discounting ahead.

Chart 2: FOMC's median projection



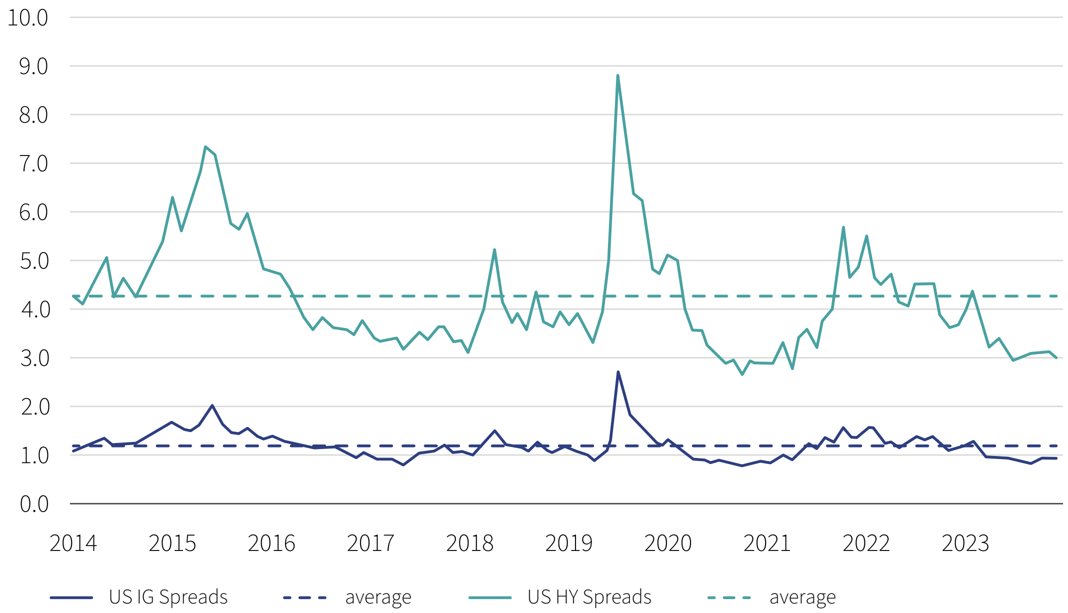
What to expect from U.S. fixed income markets?

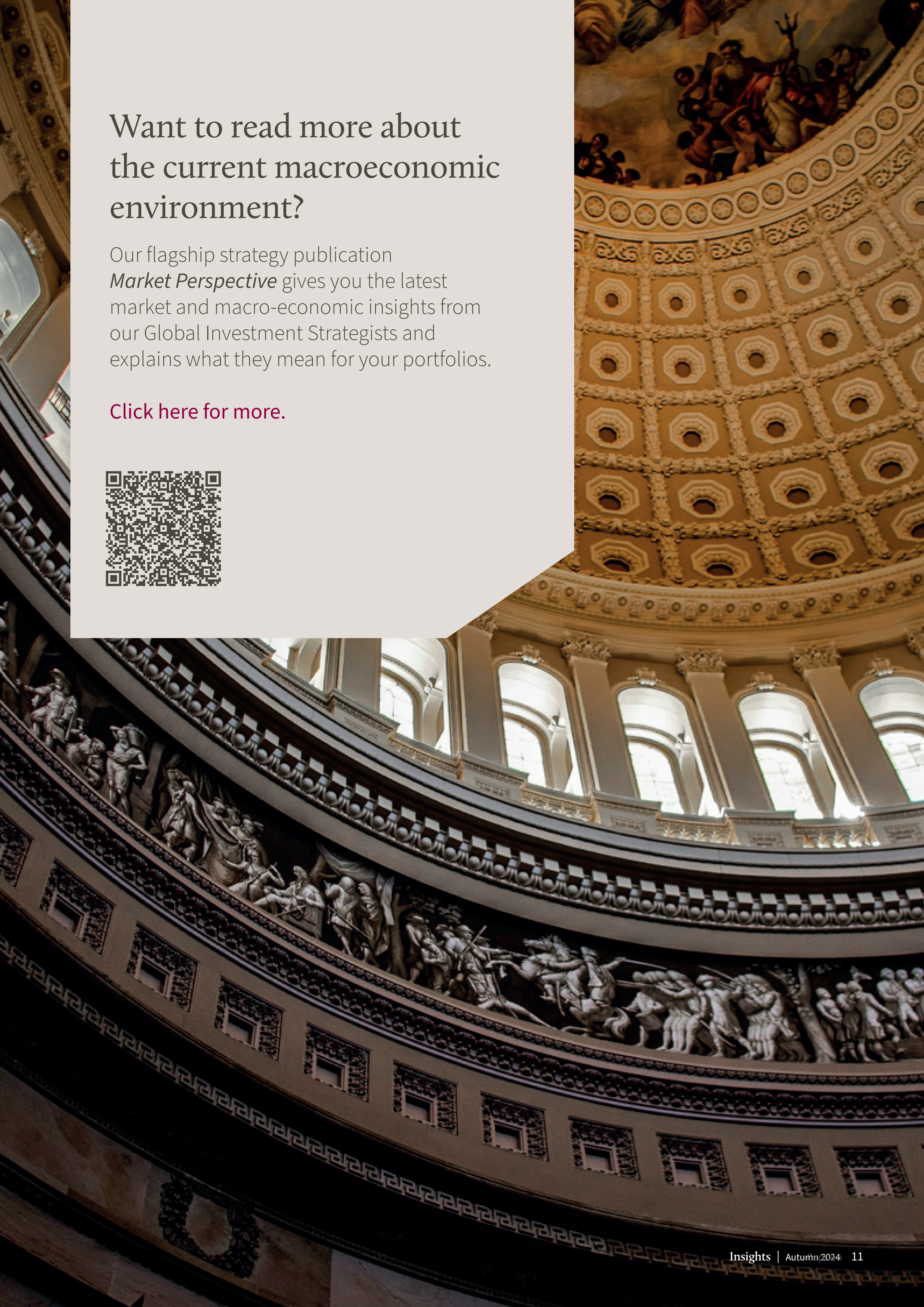
2024 has been another strong year for bonds, at least thus far, following a year of positive returns across the board in 2023. However, this has not been without its challenges, as it was only during the last two and a half months of 2023 that total returns moved into positive territory. U.S. yields have reverted to levels seen at the start of the year, but this time, rate cuts are not only anticipated. It is neither surprising nor unusual for Fed funds futures to price in a significant easing cycle. Rate cut expectations have been quite volatile: currently, futures are pricing in four 25 basis point cuts, compared to more than six at the beginning of the year and just one at the start of May. We maintain a bullish outlook on U.S. Treasuries. The dovish tone from Powell's Jackson Hole speech on 23 August and the latest FOMC minutes from 21 August have solidified market expectations for a shift in the interest rate cycle. Despite some pushback against early August market expectations of easing, Fed funds futures still indicate a cumulative easing of over 200 basis points[3] over the next twelve months. Historically, yields on longer-dated U.S. Treasuries have declined during easing cycles. Although we have seen some decrease in yields since summer, markets are pricing in Fed cuts too aggressively. This suggests that the path to lower yields in this cycle may not be straightforward and could be characterised by volatility. Nevertheless, we expect lower yields to remain the prevailing trend in the months ahead. In the credit markets, spreads are very tight and significantly narrower than the long-term average, suggesting they are priced for solid growth, a return to target inflation, and anticipated rate cuts. We do not foresee much widening of spreads unless a recession becomes imminent. However, further spread tightening at these levels seems unlikely. We favour duration risk over credit risk in the coming months. Given the current cyclical backdrop, we believe an up-in-quality approach is advantageous, which is why we continue to prefer government bonds over lower-quality credits (Chart 3).

With further interest rate cuts on the horizon and corporate profitability stabilising, there appears to be solid potential for continued gains in the coming months. As one of Bill Clinton's top advisers famously remarked, he'd like to be reincarnated as the bond market "because you can intimidate everyone." While volatility may be a feature of the path ahead, we are confident that the overall market environment presents promising opportunities for investors who remain attentive and strategic.

[1] Committee within the Fed that is charged under United States law with overseeing the nation's open market operations.
[2] The neutral rate of interest is the inflation-adjusted interest rate that supports full employment and stable inflation. Though not directly observable, it is estimated by policymakers to guide monetary policy, with ongoing debate suggesting it may be higher than previously assumed, implying a more stimulative stance.
[3] Bloomberg WIRP.

Chart 3: Historical development of U.S. spreads





Want to read more about the current macroeconomic environment?

Our flagship strategy publication *Market Perspective* gives you the latest market and macro-economic insights from our Global Investment Strategists and explains what they mean for your portfolios.

Click here for more.

Building bridges:

An interview about Swiss-American business and investment opportunities

Christoph Besmer

Christoph Besmer is a seasoned international business professional with over 20 years of experience. He currently serves as Switzerland's Trade Commissioner and Head of Investment Promotion in the U.S., having joined the Swiss Business Hub USA after co-founding a foreign direct investment consulting firm. Previously, he led U.S. efforts for the Greater Zurich Area investment promotion agency and worked with humanitarian organizations. He has also developed start-ups in both Europe and the U.S. Christoph holds a M.A. from Georgetown University's School of Foreign Service and graduated magna cum laude in Business Administration from the University of Southern California (USC). His blend of Swiss precision and American entrepreneurial spirit defines his approach to cross-cultural business challenges.

Despite their vast difference in size, Switzerland and the United States share a long-standing, deep-rooted history. In the aftermath of the American Civil War, thousands of Swiss citizens celebrated the Union's victory, reflecting a strong sense of solidarity. In 1865, 20,000 Swiss men signed a condolence letter mourning the death of Abraham Lincoln — an extraordinary gesture at a time when national identity was still forming, and signing petitions was far less convenient than today. Canton Aargau's government addressed the U.S. as "our great sister republic across the ocean," a sentiment echoed by the U.S. ambassador, who praised Switzerland's unwavering friendship toward its "larger sister republic."

In this interview, Christoph Besmer, Switzerland's Trade Commissioner and Head of Investment Promotion in the United States, shares his insights on the evolving Swiss-American relationship, offers a unique perspective on cross-cultural business interactions, and discusses the key factors shaping the future of economic collaboration between the two nations.

How would you describe the current state of the U.S.-Switzerland relationship?

It is safe to say that the relationship of the two "sister republics" has remained stable and based on mutual trust in recent years, despite occasional disagreements on global economic policies and tax regulations. The U.S. values Switzerland's role as a neutral mediator in international conflicts. Both countries share common values and strong economic ties, continually benefiting from their partnership. Switzerland ranks as the seventh-largest foreign direct investor in the U.S., with investments exceeding USD 330 billion. Notably, since 2021, the U.S. has been Switzerland's most important trading partner.

How do you think the perception of Switzerland in the U.S. has changed over the years?

I think that the perception of Switzerland in the U.S. has evolved significantly over time, although perception is relative and influenced by the background and experience of the person asked. In the early 20th century, Switzerland was primarily viewed through the lens of its neutrality, especially during the two World Wars. While Americans respected Switzerland's neutral stance, there was also a degree of scepticism, especially given the U.S.'s more active role and the unfamiliarity of neutrality to many

Americans. After World War II, Switzerland's neutrality became more of an asset in the eyes of the United States. During the Cold War, Switzerland started to play a key role as a trusted mediator in international disputes and as a protecting power of U.S. interests in countries lacking American diplomatic representation, such as Cuba and Iran. This solidified Switzerland's reputation as a reliable and stable partner in global diplomacy.

We all know how Switzerland's financial sector has had a complex impact on its image in the U.S., with banking secrecy laws drawing criticism related to tax evasion and even Nazi gold. Today, while Switzerland is viewed as a transparent and cooperative financial hub, some stereotypes of the Swiss banker and secret accounts still persist.

What factors attract U.S. companies to invest in Switzerland?

The Swiss Business Hub USA is tasked with speaking to executives of U.S. companies who have a potential interest in international expansion and/or in restructuring and optimizing their global set up. Switzerland is one of the world's leading locations and top positions in international rankings testify to this. Switzerland is not an inexpensive country, but a potential investor has to weigh various factors when evaluating a location. There are numerous good reasons to locate a business in Switzerland: Chiefly, cutting-edge innovation and technology, a liberal economic system, political stability, close links with foreign markets, excellent education and healthcare systems, an outstanding infrastructure, a high standard of living, and a competitive tax system provide a strong mix of hard and soft location factors. There is a strong local ecosystem available to tap into in key industries where both countries excel, such as health, finance, digital worlds and food tech, among many others.

Conversely, what motivates Swiss companies to invest in the U.S.? Are there specific sectors where Swiss investment in the United States is increasing?

The United States offers access to a huge domestic consumer market for Swiss companies. The country has a population of over 330 million, providing Swiss companies with vast opportunities to expand their customer base. The business cultures are similar, and the U.S. economy is stable, developed, and offers all the important parameters for successful investments and growth opportunities. That said, there are also challenges Swiss companies face, such as the ongoing lack of specialist staff and high turnover rate and governmental red tape.

The United States remains a key leader in innovation, particularly in sectors like information technology, and biotechnology. Quite a few Swiss companies enter the U.S. market through mergers and acquisitions or joint ventures, allowing them to quickly establish a presence and tap into established distribution networks and customer bases. It is therefore no surprise that Swiss businesses with a stronger presence in the United States tend to achieve greater growth in revenue overall and higher profit margins than their competitors.

With the upcoming U.S. elections on the horizon, what do you anticipate as potential changes in U.S. foreign policy that could affect Swiss interests?

I am no expert in this, but I am quite certain that no matter who wins the election, the strong and positive relationship between the countries will remain. Geopolitical uncertainties are likely to have a significant but unpredictable impact, regardless of whether a Democrat or Republican occupies the White House, which will also lead to a greater focus on reshoring. The economic and political ties are very strong. As with any new incoming administration, there are likely to be some changes that may impact specific aspects of the bilateral relationship (there might be new tariffs, more complex regulations in a specific industry etc.). Economic policies, financial regulations, diplomatic priorities, environmental commitments, and immigration policies are all areas where shifts in U.S. leadership could have some impact on the bilateral relations. Nevertheless, the deep-rooted ties between the two countries will ensure continuity and cooperation, regardless of the change in administration.

What are some of the biggest lessons you've learned about cross-cultural business interactions between Switzerland and the U.S.?

It is a truism that the Swiss tend to underpromise and overdeliver, while Americans tend to be fantastic at selling. Americans, generally speaking, favour a direct communication style, getting straight to the point. Opinions are often expressed openly. On the other hand, the Swiss way of communicating is generally more reserved and formal. Professionals tend to avoid direct confrontation. Although a bit simplified, I think it holds true that the American business culture encourages innovation and risk-taking. Failure is often seen as a learning opportunity, and there is a strong entrepreneurial spirit. This can lead to a dynamic and fast-moving business environment where new ideas are quickly tested and implemented. If something does not work, try something new. Our business culture is generally more risk averse. There is a preference for stability, reliability, and long-term planning. Innovation is definitely valued, but it is approached in a more cautious fashion, with a strong emphasis on quality and precision. In business meetings, it is important to understand the underlying currents in cross-cultural communication. For a Swiss entrepreneur meeting with an American, it helps to have someone, it is helpful to have somebody in the room that understands "American" and the verbal and non-verbal cues.

Looking ahead, what emerging trends or opportunities do you foresee for Swiss businesses in the U.S. market?

There are many opportunities for Swiss companies in the United States, spanning sectors such as healthcare, green technology, digitalization, advanced manufacturing, food and beverage, luxury goods, and sustainable mobility, among others. By leveraging the Swiss strengths in quality, precision, and innovation, Swiss companies can successfully navigate these emerging trends. Any company entering the U.S. market has to be aware that while opportunities are vast, the competition is tough and that it has to be viewed as a priority and with a long-term vision.

Pioneering innovation: SpaceX, private American spacecraft manufacturer (Kennedy Space Center)

Equity Research

Diary of an equity research road trip:

Uncovering insights in America's financial heartlands

Embarking on an insightful journey across the United States of America, our equity research team recently explored the latest market trends and engaged with industry leaders. Over the course of two weeks we, Beat Keiser, Portfolio Manager and Head of Equities, and David Windisch, Portfolio Manager and Equity Analyst, travelled to the tech hubs of San Francisco and Silicon Valley. These research trips are invaluable, providing the team with a unique opportunity to connect with industry peers and insiders while gaining a deeper understanding of the culture and strategies of the companies we invest in. These personal interactions offer rich insights that often elude financial reports, earnings calls, or third-party analyses. Here's a diary of our journey, capturing the professional insights and memorable moments that made this trip both productive and impactful.

Beat Keiser
Portfolio Manager and
Head of Equities

David Windisch
Portfolio Manager
and Equity Analyst

Monday, 2nd September 2024

The work fun commenced as we touched down in San Francisco, where the weather was pleasantly mild, albeit ever-changing in classic San Francisco style. This time of year, the city isn't overflowing with tourists, making it an ideal setting for our meetings with experts and companies. One of our first meetings was with the new CFO of Visa, Chris Suh, at their impressive new offices in the Mission Rock district, overlooking the Pacific Ocean and the San Francisco Giants' baseball stadium (Photo 1). With a market capitalisation of USD 550 billion, Visa ranks among the most valuable companies globally. Over the past decade, its share price has increased five-fold. We believe that Visa, much like its main competitor Mastercard, has strong long-term prospects. The key reason for this is the potential for further card penetration. Even in a country like the U.S., where approximately 80% of adults own at least one credit card, there is still considerable room for increased usage. For example, mobile wallets and tap-to-pay functions can further enhance credit card utilisation. In fact, the revenue of the credit card issuing industry in the U.S. is projected to reach approximately USD 160.3 billion in 2024.[1]
Other countries and regions are even less advanced in this regard, meaning the global shift from cash to card payments continues. Card payments are simply more efficient, if not safer and more convenient, than carrying cash. Following our meeting, we felt assured that Visa is set to remain a key player in the payments industry.

We also consulted with a former senior manager from Fair Isaac Corporation (FICO), a leading company that enhances financial freedom through its credit scoring services. FICO's credit scores are crucial for assessing consumer creditworthiness, which lenders, such as banks rely upon to approve mortgages, auto loans, and credit cards. Notably, these essential scores are very cost-effective, providing FICO with significant pricing power. Additionally, FICO offers a software platform that helps businesses detect fraud and manage customer relationships, among other functions. This enables companies to make better decisions, driving growth, profitability, and customer satisfaction. 95% of the largest U.S. financial institutions are FICO clients, and the company has sold more than USD 100 billion credit scores since its inception. The company also asserts that three-quarters of all home loan originations make use of the information provided by its scores and reports. FICO also maintains a fraud protection service used to safeguard more than 2.5 billion credit cards. Furthermore, it is facing competition from only one smaller player.

Thursday, 5th September 2024

We headed to San José, the heart of Silicon Valley. The city's appearance felt somewhat unremarkable, and could have been anywhere in the warmer regions of the U.S.. Silicon Valley remains the cradle of computing, encompassing everything from hardware to software and housing most major tech companies. Our schedule was packed with meetings with experts and companies, but we still found time to visit the Intel Museum, where we had fun donning bunny suits (Photo 2) as a playful nod to semiconductor manufacturing.

We spent time with Cadence, a leading provider of semiconductor design software, and Intuit, which offers comprehensive software solutions for small businesses, including bookkeeping, human resources, payroll, and taxes. Additionally, we spoke with a former senior engineer from KLA, renowned for its advanced semiconductor inspection tools, and Intuitive Surgical, which develops and markets surgical robots like the "da Vinci" system to enhance clinical outcomes through minimally invasive surgery. Visiting these companies first hand gave us valuable insights and a deeper understanding of their operations. Overall, we are optimistic about KLA and Intuitive Surgical due to their strong competitive positions in their respective industries, corporate culture, and future potential.

We also stopped by the offices of VAT, the Swiss company renowned as a world leader in high-performance vacuum valves and systems, serving numerous semiconductor equipment manufacturers in Silicon Valley. Approximately 500 Swiss companies operate in the United States, and VAT stands out as a prime example of Swiss success in this market. On a lighter note, we spotted Tesla's much-anticipated Cybertruck (Photo 3) and couldn't help but think it's not quite living up to the hype!

Monday, 9th September 2024

After a weekend spent catching up on sleep and recovering from travel-related ailments (no photos of that, fortunately), we dived into what is arguably the largest tech conference in the world, Goldman Sachs's Communacopia + Technology conference. Over three and a half days, the event featured more than 250 companies, 150 presentations, and thousands of investor participants. The line up was top notch, including Marc Benioff, CEO and founder of Salesforce—who were hosting their own gargantuan Dreamforce conference the following week. Other luminaries included Bill McDermott, CEO of ServiceNow; Wendell Huang, CFO of TSMC; and Chris Suh, CFO of Visa, whom we had met the previous week. Even a 7:15 am session with none other than Jensen Huang, CEO of NVIDIA, was fully packed including the overflow room. Jensen was interviewed by Goldman Sachs' own CEO, David Solomon, who tried to match Jensen's signature motorcycle jacket style with a business-casual tech outfit. Interestingly, traditional suits were scarce at the conference, but indoor temperatures felt more Alaska than California! Note to self: bring ski wear next year. Throughout the conference, we participated in nearly ten group meetings with companies and attended around 30 on-stage presentations. The overall mood was unmistakably

Photo 1: David Windisch (left) and Beat Keiser (right)


Photo 2: Visit to the Intel Museum


Photo 3: Beat Keiser in the Cybertruck

[1] IBISWorld: Credit Card Issuing in the US - Market Research Report, January 2024.

American, marked by the optimism and innovation of Silicon Valley, particularly regarding advancements in AI and their transformative applications. This spirit of entrepreneurship and possibility was palpable throughout our journey. While there are questions about the future trajectory of the U.S. and global economy, as well as the timing of a recovery in the semiconductor industry, the tech sector remains resilient and optimistic, undeterred by political noise. We are excited about the promising developments the future may hold.

Thursday, 12th September 2024

As the conference concluded, we were happy to board a plane home, eager to report back on all we had heard and seen.

Reflections and regrets

One thing we missed out on was experiencing Waymo, the autonomous ride-hailing service that's been making waves. Despite our best efforts, we couldn't activate the Waymo app due to restrictions linked to our Swiss phone numbers. It's said to be an amazing service, and we hope that our next visit to the U.S. will include a chance to try it out—so we'll definitely be back.

Overall, our trip was a blend of professional growth and cultural experiences, providing valuable insights into companies that are shaping the future. From the bustling streets of San Francisco to the innovation hubs of Silicon Valley, it was an adventure that reaffirmed the dynamic nature of the industries we cover. We look forward to leveraging these insights to better serve our clients and can't wait for the next journey. Until then, cheers to the land of opportunity!

Self-driving car in San Francisco

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U.S. Robo-manufacturing gearing up

Eunice Harbeke
Investment and
Portfolio Adviser

The U.S. is making significant strides to reclaim its leadership in manufacturing through strategic government investments. In this article, Eunice Harbeke, an Investment and Portfolio Adviser, explores the evolving ecosystem and highlights why this transformation is creating promising opportunities for investors, particularly in automation, AI, and advanced manufacturing sectors.

The United States, once a global leader in manufacturing, saw its position overtaken by China in 2010. However, recent supply chain disruptions and other exposed vulnerabilities have prompted the U.S. to take action to reclaim leadership. In response, the U.S. government has implemented strategic measures to strengthen domestic production by fostering a favorable ecosystem for businesses. The commitment to innovation and revitalisation is evident and despite some initial challenges, incentives are proving effective, capital is flowing into key sectors, and the competitive landscape is shifting. With this momentum, the business environment is primed for further advancements, and industries such as automation and robotics stand out as key beneficiaries of this transformative shift.

"Made in America", "Buy in America"

Three laws play a central role in restoring the competitiveness of U.S. manufacturing: the Inflation Reduction Act (IRA, 2022), the Chips and Science Act (C&SA, 2022), and the Infrastructure Investment and Jobs Act (IIJA, 2021). Together, this legislation not only lays the foundation for the development of automation but also paves the way for further advancements, such as the integration of artificial intelligence into manufacturing. Collectively, these laws allocate a total of USD 1.8 trillion in capital spending, with a significant portion directed toward supporting automation and robotics. But there is much more. The IRA, C&SA, and IIJA also create opportunities for construction projects, investments in production equipment, and the recruitment of a skilled workforce. These laws further focus on innovation in high-tech sectors, including electrical manufacturing and the semiconductor industry, which are considered vital to national security. Additionally, they encourage local production by offering tax incentives for goods containing more than 55% domestic content. Ultimately, these measures aim to usher the U.S. economy into a new era of industrialisation, reinforcing its position as a global leader in advanced manufacturing.

Robotics and humanoids in the U.S. Industry

In a global context, the U.S. is anticipated to account for the majority of the revenue expected in the robotics market in 2024[1][2], resulting in a significant boost in productivity[3]. Looking ahead, society has an increasing projection about robots having cognitive capabilities allowing them to perform repetitive but complex tasks autonomously. This transformation is expected to significantly impact industries such as automotive, electronics and heavy machinery industries among others.

The direction is clear and the goal of robots working autonomously in U.S. factories is captivating, but there are still some challenges questioning the speed at which the end goal will be achieved. In fact, the development of this type of automated processes using robots powered by artificial intelligence (the so called "humanoids") needs to be deployed on a cost-effective and meaningful scale before it becomes profitable and commercially attractive. Currently, manufacturing outside the U.S. continues to be considered due to lower labor costs and ongoing shortages of skilled workers domestically.

Nevertheless, artificial intelligence and machine learning are evolving quickly, and they are already playing an important role in shaping the future and enhancing the quality of the robot market in the U.S. Industry.

The U.S. is forecasted to generate the highest revenue in the robotics market in 2024, with an expected value of

$784.6bn

"The United States remains a global leader in AI research and development, cultivating a dynamic ecosystem ideal for tech professionals, entrepreneurs, and researchers. The nation's innovative spirit is showcased by numerous startups and tech giants, all advancing the frontiers of artificial intelligence, robotics, and digital transformation."

Top countries leading AI development, wokewaves, October 2024.

[1] Statista: Robotics - Worldwide, October 2024. ; Robotics Industry Report, May 2024.
[2] 2024 Manufacturing Robotics. United States and Global Perspective, Industry Report June 2024
[3] Fortune: Finance - Productivity: Robots and AI, February 2024.

How the ecosystem is getting ready for more

There are interesting examples of organisations across the country working to modernise U.S. manufacturing through technology. Behind the scenes, these organisations aim to build partnerships and bridges between businesses, individuals, and government agencies, all focused on the common goal of regional leadership in manufacturing.

Furthermore, they are dedicated to developing and deploying robotic technology in various U.S. regions by bringing together universities, government agencies, small start-ups, entrepreneurs, and even the creativity of younger students, all committed to advancing innovation in robotics.

An opportunity for investors

Governments worldwide are considering robotics to boost innovation, productivity, and competitiveness. In the United States, major government investments are being strategically combined with private capital to drive the next wave of industrial innovation.

While the broad adoption of robotics and humanoids in the U.S. industry may take time, and much progress is still needed, this enormous infusion of capital and talent is already creating interesting investment opportunities for forward-looking investors.

DEEP DIVE

Industry 5.0

Industry 5.0, through AI, robotics, and big data, is set to revolutionise production, boost efficiency, and redefine customer experiences. Building on Industry 4.0, this phase encourages deeper human-machine collaboration, making businesses more agile, innovative, and sustainable. Early adopters are already reaping benefits, highlighting the central role of AI-driven transformation in future industrial success. In this article, we explore how these developments are shaping manufacturing and how businesses can seize the opportunities they present.

Continuation funds

Insights into a dynamic asset class

Sara McDonald
Private Markets Sales and Distribution Director

In recent years, there has been a noticeable increase in the number of continuation funds launched by private equity sponsors, aiming to address a longstanding issue: the inherent time constraints of the private equity business model often leading to exits from investments before their full potential for development and value enhancement has been realised. This is particularly relevant during periods of limited alternative investment options, such as extended low-interest-rate environments, where many investors seek longer-term capital opportunities.

In the following article, Sara McDonald explains the significance of this trend and its implications for investors.

What is a continuation fund?
A continuation fund is a private equity vehicle designed to extend the holding period of one or more assets from an existing fund that has reached or is approaching the end of its lifecycle. The primary purpose of a continuation fund is to allow fund managers (general partners or "GPs") to maintain control over promising assets while providing liquidity options to existing investors (limited partners or "LPs") who may wish to exit.

Some historical context

Continuation funds emerged in the wake of the 2008 global financial crisis when many private equity funds found themselves holding assets longer than expected due to the challenging exit environment. Initially regarded as a niche solution, they have since evolved into a mainstream element of the broader private equity secondary market. The concept gained traction as both GPs and LPs recognised its potential benefits: GPs could continue to manage and enhance high-performing assets that required more time to realise their full value, while LPs had the option to either cash out or reinvest in the new vehicle.

Growth trends and market size

The use of continuation funds has seen significant growth over the past decade:

- The total volume of GP-led secondary transactions, which mainly consist of continuation funds, increased from just USD 9 billion in 2015 to over USD 51 billion in 2023.[1]
- Continuation funds now account for a substantial portion of the overall secondary market.
- In 2023, GP-led transactions made up 45% of the market, with continuation funds representing 88% of this transaction value.[2]

The COVID-19 pandemic further accelerated the adoption of continuation funds. The market volatility and economic uncertainty during this period made it challenging to achieve favourable exits through traditional means. Continuation funds provided GPs with the opportunity to retain high-quality assets for longer, with the expectation of a post-pandemic recovery to maximise value.

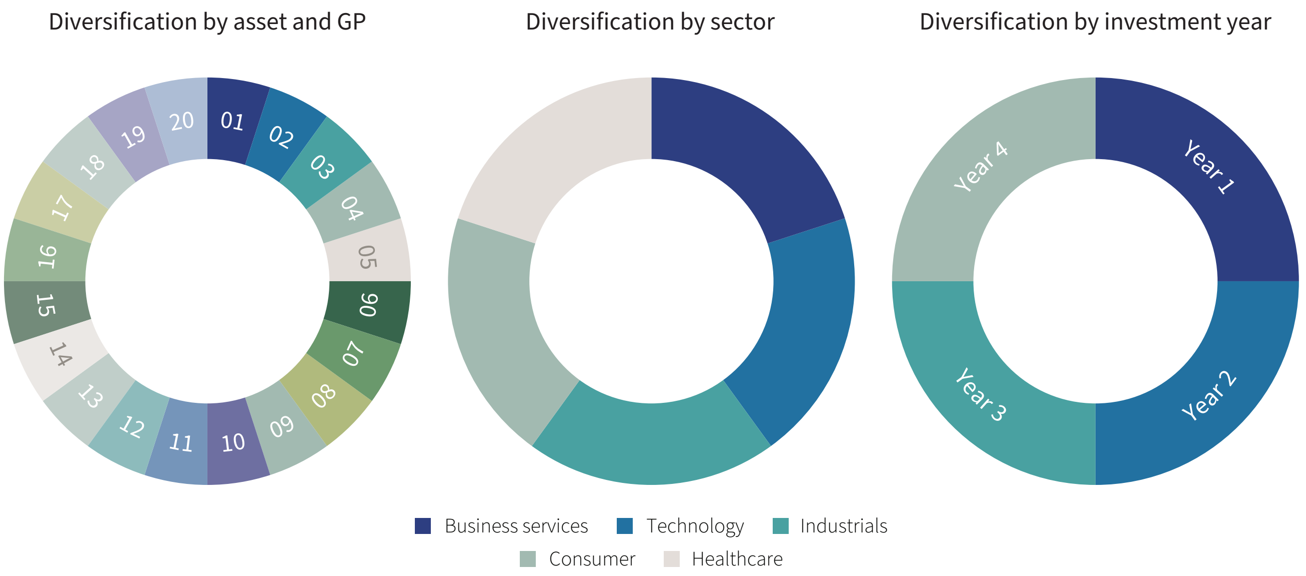
How do continuation funds operate?

The process of establishing a continuation fund involves several key steps. Initially, the GP identifies one or more assets from an existing fund that have further potential for value creation. A new vehicle, known as the continuation fund, is then set up to acquire these assets from the existing fund. An independent valuation is typically conducted to determine a fair price for the assets. Existing LPs are given the option to either sell their pro-rata share of the assets and exit, roll their interest into the new continuation fund, or choose a combination of both. The continuation fund raises capital from new investors, often secondary funds, to purchase the assets and potentially provide additional capital to support the growth of the portfolio companies. Once the assets are transferred to the continuation fund, the proceeds are distributed to the selling LPs. The GP continues to manage the assets within the new vehicle, usually with a reset of the fund’s economics to better align the interests of the GP and LPs. For example, carried interest is generally calculated based on the current net asset value (NAV) at the time the continuation fund is established, rather than from the initial investment cost. This method incentivises the GP to generate returns above the new NAV.

"Today, GPs face a market-wide challenge: they are expected by their LPs to perform exits in order to distribute regular cash proceeds, yet they are often reluctant to let go of trophy assets. Sourcing high-quality companies at fair prices within reasonable timeframes has indeed become increasingly difficult, as the competitive landscape in the buyout market continues to intensify. By setting up a Single-Asset Continuation Vehicle, GPs can extend their value creation journey with the company while also offering liquidity to their fund LPs. The adoption of Single-Asset Continuation Vehicles has grown significantly in recent years (accounting for over 20% of the total secondary market), underscoring a cultural shift as GPs increasingly implement alternative strategies to traditional straight sales. Five Arrows Single Asset (FASA) intends to leverage the broad network of the Five Arrows multi-strategy platform to curate the best single-asset continuation opportunities and build a portfolio of 12 to 15 small and mid-cap assets in its core sectors: Software & Data, Healthcare & Education, and Business Services."

Olivier Baron, Managing Director, Five Arrows Strategic Assets (FASA)

Chart 1: Continuation funds – diversification benefits (illustrative portfolio)



Risk mitigation and return potential

One concern raised regarding continuation funds is the perceived concentration risk, as they often involve a select subset of assets, or even a single asset. However, this view tends to arise from grouping GP-led transactions with traditional LP secondary investments and overlooks how risk can be mitigated through a structured diversification approach. A continuation fund strategy can, for instance, include interests in 20 to 30 different companies. According to portfolio theory, a well-diversified portfolio of around 20 to 30 stocks can significantly reduce risk, achieving what is known as statistical diversification. This same principle can be applied to continuation funds, addressing concerns about over-concentration in a single asset. Additionally, continuation fund portfolios are further diversified across general partners, sectors, and vintages, introducing extra layers of non-correlation, which further reduces risk (Chart 1).

Careful asset selection in continuation funds helps mitigate risk, allowing investors to hand-pick exposures at the company level from high-quality opportunities. Portfolios can be positioned to withstand higher rates and include less cyclically exposed assets, further enhancing risk management. A key element of risk mitigation is the strong alignment between GPs and investors. While some argue that continuation funds create a conflict of interest, as sponsors are effectively selling assets to themselves, a well-structured fund ensures GP alignment, improving its risk-adjusted return profile. As the market has matured, it has become common for GPs to roll 100% of crystallised proceeds into the new continuation fund, often adding personal capital and investing from their latest fund, validating pricing, alignment, and potential upside.

Short duration profile

A key feature of continuation funds is their shorter investment horizon, typically set for three to four years, which is notably less than the duration of traditional buyout investments. This shorter timeframe is further supported by the careful construction of continuation fund portfolios. In the current macroeconomic climate, investors can position their portfolios to ensure that the underlying assets are less reliant on long-term economic cycles, thereby contributing to the reduced investment duration. The advantage of being able to "hit the ground running" with GP-led deals benefits investors not just at the end of the holding period but also helps mitigate the J-curve from the outset. Value creation can be driven by several factors, including EBITDA growth, cash flow generation, multiple expansion, and, in some instances, purchasing at a discount to NAV. GP-led transactions are typically marketed based on a reference date, with the period between this and closing stretching up to 9 to 12 months.During this time, well-performing assets may experience EBITDA growth and cash flow generation, which, alongside any mergers or acquisitions, could lead to multiple expansion. In certain cases, continuation funds may acquire assets at a discount to NAV, depending on market conditions, as they provide a quicker and more certain liquidity option compared to other exit routes. This can result in the equity value of an asset exceeding the purchase price, leading to an early increase in valuation shortly after the initial investment.

Continuation funds in private equity

Continuation funds have become an essential component of the private equity industry, offering a range of benefits. They provide portfolio management flexibility, enabling general partners to optimise the timing and strategy for exiting individual assets. These funds also attract new investors to established private equity assets, broadening the investor base. Additionally, they align with long-term value creation by supporting investment strategies that may take longer to fully reach their potential. Continuation funds also offer a liquidity solution for LPs, allowing them to access liquidity in a controlled manner. Furthermore, they help the private equity sector adapt to evolving market conditions and longer holding periods for certain assets.

Looking forward

Continuation funds are a distinct asset class with their own advantages and are set for strong growth in the coming years. As more capital is dedicated to these funds, experienced GP-led investors are likely to find attractive opportunities to build high-quality, well-aligned continuation fund portfolios.

[1] NCPERS: General Partner (GP)–Led Secondaries, September 2023.
[2] Secondaries Investor: Secondaries market records second-biggest year ever, January 2024.

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