ANGELES' MICHAEL ROSEN INTERVIEW WITH INSTITUTIONAL INVESTORS "NOW WHAT DO WE DO?" - PART TWO

Michael Rosen, Angeles Investments' Chief Investment Officer, is participating in a three-part interview for Institutional Investors Network's series, "Now What Do We Do?"

Institutional Investor Network is an investors only forum that includes discussions, white papers, trends and analysis for investors by investors. Part Two: *Michael Rosen Has Seen The New Normal and It Features Lots of Problems for Investors* can be accessed below or here. Note access to II Network does require registration.

Institutional Investor NETWORK

MICHAEL ROSEN HAS SEEN THE NEW NORMAL AND IT FEATURES LOTS OF PROBLEMS FOR INVESTORS

Figuring out the post-pandemic "new normal" has become a favored parlor game among those sheltering at home. So far, many people seem to agree that the working from home experiment is likely to lead to more of that in the future, and some say movie theaters may well be doomed. But investment consultant Michael Rosen, the managing partner and CIO at Angeles Investments, a firm focused on providing Outsourced CIO services, says there's less attention being paid to critical macroeconomic and financial consequences.

Never mind what happens to shopping malls or restaurants, he says, "On the higher level, I see a much lower level of economic growth." One reason may well be that households have become "more concerned about their jobs and savings, so savings rates may go up. That means less money for consumption, so slower growth." He adds that the increased level of government debt may well limit new investments by government and private sector institutions. The devotees of Modern Monetary Theory aren't worried, but the traditional argument is that all this borrowing has to be inflationary.

With less consumption and investment, he goes on, "It's not just that returns for investors come down because there are fewer growth opportunities." Slower growth raises questions about wealth and inequality, a concern which have risen for the last few years, "but what we've seen here exacerbates that gap," Rosen says.

Low returns also mean an accelerating emphasis on cost savings at many companies "which increases automation – "A trend we've already seen occur," he says. As companies seek to replace workers with automation, that also contributes to wealth inequity, and threatens a political backlash.
Yet another implication of slower growth may be "there's an anti-globalization mood – which I think was already in the works – but it gets accelerated," Rosen predicts. ?

What does all this mean for financial markets? For bonds, it's all about interest rates. And Rosen argues, "In a world where growth is slower," interest rates will be low. I think central banks will keep costs low for an extended period of time."

That raises questions about allocations to bonds, he says. “Historically, most investors have had an asset allocation for 60/40, equities and fixed income, now maybe 70/30, bonds,” Rosen says. Core investment grade bonds have played a role to dampen volatility, diversify and to prove a steady level of income. But if interest rates are in the basement, “I am questioning the role of core high grade bonds in any portfolio. With yields at very low levels, at 1% yields, there’s not a lot of income to be generated.”

There may also be less diversification benefits and volatility dampening from high-grade bonds than have historically existed. But if bonds don’t do that job, “How do you diversify and mitigate volatility in the portfolio, where the options are few, and what does that mean for investors?” he asks.

As for equities, slow growth means limited nourishment for growth stock buyers, who need the prospect of rising earnings, or for value investors, who are purchasing the discounted present value of future earnings.

So where does that leave investors? The biggest problem may be for pension funds and insurance companies which “are the two big investors that have asset/liability questions, whereas endowments and foundation typically don’t think about liabilities; they think about a spending rate.” Insurance companies, by regulation, and pension funds, by actuarial standards, have distinct liabilities that they manage the assets to.

Lower for longer “has implications for the funded status of pension funds,” Rosen notes. Their assumed rates of return need to be low, and their actual returns well be as well. But that makes it particularly difficult for “pension funds that are underfunded. If they can’t grow their way out of their underfunded status, they will have to make contributions or cut benefits. Thus, the financial outlook “has massive implication on the asset side, but also on the funded side as well,” he says.

There’s way more than that reshaping the investment world, Rosen argues. What happens to real estate if more people work at home instead of offices and if there are fewer retail stores and restaurants? What happens to private credit and distressed debt if the recession is long and deep? Rosen says what happens to economic growth rates and interest rates and to stocks and bonds is enough to ponder right now.

Angeles Investments is an independent and privately-owned investment advisory firm located in Santa Monica, CA and New York City. Angeles provides investment and wealth management services to institutional clients and families and individuals (e.g., endowments, foundations, pension plans, trusts and private family clients).

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