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Q&A- Energy best place to "hide" from potential recession; renewables difficult investments: Michael Rosen, Angeles Investments

The odds of a U.S. economic recession are increasing as the Federal Reserve is forced to take a more hawkish policy path due to inflation, **Michael Rosen, chief investment officer at Angeles Investments** told the Reuters Global Markets Forum on Tuesday, March 15.

"Commodities, energy are the places to hide. Perhaps dividend stocks that can increase dividends at least at the pace of inflation," he said.

Meanwhile, he sees green energy plays as difficult investments given lower returns on capital and volatility in renewable stocks, despite the sector's favorable long-term outlook.

Following are edited excerpts from the conversation:

Q: To start, could you tell us what you're expecting from tomorrow's Fed meeting?

A: They will raise the Fed funds rate by 25 bps. The Ukraine war took 50 bps off the table. But the Fed is significantly behind the curve and will have to tighten a lot more than they want to. The war only exacerbates inflation pressures, which exist because the Fed has allowed monetary policy to be too loose. So they have a lot of catching up to do, which will be politically challenging as the economy slows.

Q: So is the risk of a Fed-induced recession strongly on the table, in your view?

A: A recession is still unlikely in the next twelve months, but the odds have increased over the next two to three years because the Fed has allowed inflation to get out of control and will have to tighten much more than they hope to.

Q: Is it time to turn back to traditional safe havens - gold, bonds, etc?

A: Bonds? No! Certificates of confiscation (as we said in the 70s). Commodities, energy are the places to hide. Perhaps dividend stocks that can increase dividends at least at the pace of inflation.

Q: On energy, do you prefer to invest directly or in energy stocks, etc.? Any particular names you like if so?

A: I'd focus on the domestic producers who have seemingly embraced the concept of earning a return on capital greater than the cost of capital. That's a change from a few years ago. These companies are and will be very cash flow positive.

Q: Oil's been quite volatile in the last week, has this changed your view at all? And what role do you think renewables should play in a portfolio?

A: But the there are other domestic beneficiaries. Natural gas is insanely expensive in Europe, ten times in the U.S. Liquid natural gas will continue to grow, but low gas also favors domestic producers of fertilizers and chemicals, for example.

Now, renewables. The challenge has been returns on capital. Demand in rising, for sure, and our policies are way behind in promoting a green transition, but it's coming. But renewables have been a tough place to make money as an investor because companies are not earning their cost of capital. Also, the stocks are extremely volatile. So for now, equities are a trade, not an investment. On the private side, the challenge is earning an acceptable rate of return. That has largely been absent. So, overall, the renewable space has not been particularly favourable for investors, despite long-term growth prospects that are strong.

Q: Would you be able to offer some colour on potential implications of US freezing Russian central bank assets? Some press reports noted Middle East moving to adopt Yuan. What do you think about the effects on U.S. Dollar's reserve currency status?

A: Great, important question. The dollar has been the most potent weapon the US has versus Russia. There is no question that China, and others, would like to see an end to the dollar reserve status, but there is no currency that can realistically replace it. For the yuan to become the world reserve currency requires China giving up control and running current account deficits. I don't see that happening. It may very well encourage the formation of a non-USD bloc: China, Russia, Iran. But there is little chance that most of the world will move away from the dollar.

Q: What might need to happen in order for China to start running current account deficits?

A: Not going to happen. China wants the yuan to be a more global currency but does not want to give up control. Can't have both. Which is why the yuan will not replace the USD.

Q: Do you expect U.S. equities to outperform this year as opposed to more cyclical and value linked European market, or emerging markets?

A: We had been moving to an underweight in the U.S. earlier in the year as we saw better prospects and cheaper valuations in Europe and EM. But the war impacts Europe directly, and the odds of recession in Europe are far higher than in the US. Consequently, we are back to a small U.S. overweight.

Q: Do any EMs still look attractive from a valuation perspective, or has the war thrown too much uncertainty into the mix?

A: There is a shortage of energy and other commodities. Those countries that are net exporters will benefit. Brazil, for example. Not EM, but think Australia, Canada too.