



AGEING OF THE POPULATION: a longevity premium?



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What lessons can be drawn from the start of the year?

The year undeniably got off to a shaky start. Concerns about Chinese growth, bargain-basement commodity prices, and the Brexit outcome, just to mention a few, triggered steep volatility on all financial markets. This has been a challenging year, to say the least, in terms of visibility. While we had reasonably expected a further normalisation in US monetary policy, what actually happened was a clear status quo from the Fed, which sent interest rates to new all-time lows, particularly in Europe, where 10-year German sovereign paper is now trading at negative yields! And while international equity markets have achieved a slightly positive return in euros, they slumped several times before rallying, and investor confidence is still weak.

Equity markets are indeed performing surprisingly well, particularly in Europe, where a true cataclysm had been forecast after the Brexit outcome.

Yes, equity markets are now trading above their pre-Brexit levels. Within a few trading sessions, the markets had recovered from their shock after the late-June referendum. Brexit turned out to be a non-event on the markets. While we did see some direct fallout, like the freezing of some local real-estate funds, no one is able to say what impact Brexit will have on the European Union in the medium and long term. So caution is the by-word here.

What sectors benefited from this market environment?

Undeniably, commodity sectors like energy and basic materials, have outperformed the MSCI World by more than 10% as commodities prices, oil in particular, have stabilised at satisfactory levels. On the other end of the spectrum, financials have been undermined by falling interest rates, while pharma stocks have been hit by a wave of earnings downgrades over the past year.

But more than sectors, individual shares meeting investor needs have been sought out, i.e., deeply discounted shares for investors seeking yield and, of course, low-vol shares, which have drawn interest, due to the prevailing uncertainties.

Before getting into your performance so far this year, could you remind us briefly of your vision of the ageing of the population and how this issue is addressed in your funds?

We took an interest in this theme as far back as 2009, as we felt it was then the strongest societal trend and the most sustained on a global basis. By way of illustration, we often point out that the proportion of persons older than 65 within the global population will increase by at least 3% annually until 2040, compared to the 1% currently forecast for European growth. The financial stakes are easy to see.

We then examined the phenomenon through the prism of seniors' consumption by carefully analysing the behaviours of various segments of seniors, along with their needs. We used this quasi-sociological approach to precisely identify those sectors best-placed to benefit from these dynamics. We arrived at a well-diversified investment universe, including healthcare, asset management, and leisure, as well as the automotive, security and personal care sectors. We then employed strategies that are highly responsive to financial market dynamics in order to "amplify" the growth impact of the phenomenon.

We are now the clear global leader in the ageing theme, with more than €1.5 billion under management, which gives us greater confidence that our approach is the right one.

Your investment theme requires you to take very clear sector biases, with zero exposure to energy, commodities or utilities. How have you approached the current period?

Our investment universe is indeed designed to address seniors' consumption in the best way possible by identifying those companies that are well-placed to benefit from the global ageing trend. This diversified universe consists of more than 600 in eight different sectors. But, compared to the 1600 MSCI World stocks, entire swaths of the economy are obviously missing when compared to traditional equity indices. Our lack of exposure to sectors like energy, commodities and others has cost us. As a result, our universe has, for once, underperformed on the year to date. We have taken a hit from financials, as falling interest rates have undermined the business model of life insurance companies (banks are not part of our investment universe), but asset managers have held up rather well, as they have a different business model. The leisure sector has also disappointed, due to fears of an economic slowdown. However, within healthcare, we fortunately reduced our exposure to pharma stocks aggressively, and the healthcare equipment segment has been resilient.

What is your equity market outlook and stance?

The real issue now is the lack of visibility on the financial markets, and it is very hard to spot a solid medium- or long-term catalyst. As things currently stand, there are more questions than answers. Do the central banks still have a market impact? Just how healthy is the Chinese economy? What is the growth outlook for Europe? And so on and so forth. We have accordingly taken a cautious stance in favour of quality stocks with both a solid outlook for top-line and bottom-line growth and a defensive profile. Meanwhile, we are starting to wade back into pharma stocks, whose valuations, on the whole, are once again becoming attractive. Geographically, we prefer the United States, the fastest-growing region, and Europe over Japan, which we feel is in the midst of an economic transition. Most of all, we remain highly responsive in adjusting to market configurations.

In the longer term, we are still confident in the upside potential of our investment theme, which has performed well since its launch, more than six years ago. Based on our studies, the ageing of the global population is a down-to-earth phenomenon that is already equivalent in its extent to the US economy, and this trend will continue to gather force in the coming years.

Speaking of the longer term, there is a debate on the impact of the ageing of the population on the financial markets. Some experts believe this will lead to a reduction in savings and, hence, a decline in financial asset prices. Isn't that a direct risk to asset management?

True, theoretically, seniors dip into their savings during retirement to maintain equivalent living standards, i.e., they sell financial assets. As far back as 2010, proponents of this theory were forecasting a significant decline in overall savings in the United States, which would send interest rates up and undermine equity prices. In fact, savings have continued to expand since 2010. The reason for this is rather simple. The theory was based on the assumption that seniors would begin to reduce their savings at 65, which is the average retirement age. In fact, a closer look reveals that the biggest savers, i.e., the big income-earners (four fifths of the seniors' savings) retire far later, when they are 70 or 75, which automatically postpones the savings-reduction trend. Moreover, most savers secure their nest eggs as they approach retirement by moving them from risky assets, mainly equities, and into bonds. Once they are retired, they earn interest on their bonds. In fact, they don't truly start selling bonds until they are about 80. Another important point, especially in Europe, is that increasing lifespans is undermining the historical model of pay-go systems, which is dependent on the replacement ratio. Future retirees have to save more to offset the inevitable shortfall under the current system. Demand will also be driven by emerging market economies, where savings are expected to expand further in the coming years. All this shows that we still have some nice years ahead of us before this phenomenon truly comes into play.

In the meantime, many baby boomers who are now retiring will sell their shares and exert downward pressure?

Again, things are not linear. Selling is gradual. The closer you come to retirement, the more you will de-risk your portfolio by massively selling your equity holdings. But this has already been priced into the equity markets, given that the baby boomer generation is now retiring. In the longer term, society will have to find new ways of dealing with this trend, in particular to rebalance the replacement rate of the working population. There are several options, but postponing the retirement age looks inevitable, and that will once again push back the theoretical point of savings reduction, and so on.

For the moment, we are clearly in a new paradigm, and very low interest rates are raising real problems in returns on assets. Currently, in developed economies, equities are, on average, yielding more than government bonds, and this makes them a very reasonable way to boost returns on one's portfolio. When you add the silver economy's potential to the equation, we are confident that our investment strategy dedicated to this theme – through our Luxembourg SICAV CPR Invest Global Silver Age – is a must for long-term portfolios.

Ultimately, your approach may be considered a strategy that includes a longevity premium, a form of insurance against the financial risk incurred by longer lifespans?

Insurance a somewhat strong word, given that we offer no guarantee. This is still an equity investment, with all that implies in terms of risk. That being said, the theme can indeed be regarded as a way to hedge the longevity risk. In theory, the more that life expectancy expands, the greater the potential growth, and the expected returns on this strategy should rise. Anyone facing the expenses of ageing can find in our approach a way to offset in part the increased spending on seniors. So our strategy offers a long-term longevity premium and is attractive for institutions serving retirees, such as pension funds and insurance companies.

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