aperture investors

From The Desk of Peter Kraus

THE YEAR STARTS IN FEBRUARY

With 2024 now firmly in the rear-view mirror, the year was highlighted by the start of easing cycles across developed market central banks, strong equity outperformance (particularly by mega-cap stocks), and by volatile global geopolitics which included a historic number of significant elections across regions, many of which had unexpected results. In summary, the mixed signals emanating from last year, along with the significant anticipated upcoming changes make forecasting more difficult for 2025 than in recent years. However, I think that growth will be one of the most significant themes for the year, and overall, the direction of travel for growth in the US, Europe, and China will be positive. With the theme of economic growth in mind, I believe it will be vital to diversify investments as different segments of various asset classes have run their course or will likely underperform as the economic environment changes.

In the US, the positive growth trend will continue, given the change in leadership. The question of how much will largely be determined by the policies put in place by the new administration. There has been significant speculation (and subsequent market volatility) regarding upcoming changes to tariffs, taxes, and immigration; however, it is important to avoid any speculation until the policies are firmly in place and start to take shape.

Broadly, the promise of deregulation and lower taxes will be positive for US corporates, and so far, the market has responded positively to this, appearing to view it as an opportunity to support American growth. The average American consumer is in a better place than in previous years: unemployment is low, and consumer spending has remained relatively robust as a result. However, there is a divide between higher and lower earners, with the latter continuing to struggle amidst the higher costs of living, even though inflation has fallen significantly.

In Europe, there is still an overall positive trajectory for growth, but there are polarizing forces at play across the region. There is still political uncertainty in France and Germany which will create noise alongside the continuing tensions in Ukraine and the Middle East. Any further significant escalation or de-escalation in either region will have a significant effect on Europe and its supply lines.

Currently, the outlook for Chinese growth calls for a similar trend to that of 2024, however, the potential impact of new tariffs could greatly affect that. The announcement by Chinese officials in mid-December somewhat surprised global markets with the message that the Government will adjust its policy stance and acknowledged that monetary policy needed to be loosened. This also signaled that authorities were perhaps more concerned with the overall economic conditions in the country than previously disclosed. The degree to which the Chinese Government will need to step in, to further support the economy, remains to be seen but the messaging signaled that officials are likely to be cautious but supportive going forward.

Credit Outlook

When thinking about the overall credit asset class, a trend that has caught my attention is the increase of corporate credit risk exposure held by investors. Prior to the financial crisis in 2008, investors typically held direct corporate credit risk exposure with liquid bonds and indirect risk exposure to private credit via bank equity. With the significant growth of private credit over the last decade, investors are now holding significantly more direct corporate credit risk exposure, with far less liquidity, than ever before. Without robust diversification and thoughtful portfolio construction, this could present significant issues during the next market correction, whenever that may occur.

Additionally, I think it's likely that the Fed may be more cautious throughout 2025 and that rates (Secured Overnight Financing Rate "SOFR") may settle between 3.75-4.00% by the end of the year. Credit spreads have been near historical tight levels with relatively attractive yields, providing an interesting opportunity for credit investors should credit spreads continue to widen as expected.

However, valuations are also rich, so credit selection is critical for not only avoiding losses but for identifying credit opportunities with upside potential. Broadly, I believe that we will continue to see strong inflows into credit, however, it is likely to vary by region. There has been a divergence in rate outlooks between the US and Europe: US credit investors will be looking for shorter duration and floating rate opportunities while European investors will likely look for longer duration, which is in line with each of the respective environments.

It is clear investors will be forced to change their credit investment strategies from recent years when money market funds and passive credit investments presented opportunities for mid-single-digit returns and low-risk exposure. Investors will need to identify credit opportunities that can provide robust diversification within the asset class, specifically those that are not highly correlated to corporate credit and are in active investment strategies where there is a proven process and track record to evidence successful asset selection historically.

Equity Outlook

Following a strong bull market in the US in recent years, the equity outlook for 2025 is nuanced by region and market capitalization. In the US, the dominant performance of the S&P 500 over the last decade, including that of the Magnificent 7, has left many allocators overweight to US equities as the space has been viewed as a 'safe' bet. However, I think the stage is set for a significant shift to occur in the near future and for the growth differential between large caps and small/mid-caps to shift. The Magnificent 7 and other large caps started their growth trajectories during a low-interest rate period and continued to grow during a restrictive monetary environment, which negatively impacted small/mid-caps the most. It is unlikely that the Fed will need to return to a restrictive environment in the near-term, so conditions should allow smaller companies to borrow more and grow as a result. In particular, US consumer and technology sectors should be well supported for growth. However, I think that housing, financials, and healthcare may struggle in that environment. For financials, in particular, the steepness of the yield curve will have an impact on their ability to grow. Overall, I believe that there is still value in US large caps, but security selection will be essential to uncover value going forward. This idea is supported by low implied correlations across S&P 500, which underpin the need for single-stock selection as well as for active management in this environment[1].

The dominance of the US equity market has left investors under-allocated to international equities, which given the low beta in Europe and China in recent years, has not significantly hurt those investors. Specifically, European equities has been a difficult space in recent years, and it will be tough to argue that the region is poised for a higher growth environment in the near-term. That said, I believe there is an incredible opportunity in European equities and being underweight in international equities will cost investors in the future. Within European equities, it will be important to identify companies that are progressive in nature such as those that are looking to improve production methodologies, develop new products, and create cost efficiencies that will allow for acceleration beyond the growth rate of the broader market. Being able to identify and source these types of opportunities via active managers will be key to capturing the growth potential in Europe.

Closing

In summary, while the phrase 'we live in uncertain times' has been overused since the onset of Covid, I believe this is still a time of uncertainty, though, of course, for very different reasons. While the overall directionality of markets is positive, there is still a lot of room to maneuver within the market and many opportunities to be seized by discerning investors. At Aperture, we believe that the case for active management still exists, and investors will benefit from active portfolio management as they navigate forthcoming headwinds and tailwinds in 2025.

2024 was a pivotal year at Aperture in many ways. As a business, we have spent the year refining our product offerings to better align with investors' needs. Over the last several months, the Firm has been preparing for the launch of our newest strategies Litigation Finance and Structured Credit, which will be stewarded by two new seasoned portfolio managers, Luke Darkow and Vladimir Lemin, who we are honored to welcome to the Aperture team. We believe that these new strategies will help round out our credit platform and offer investors valuable diversification in their exposure to the credit universe. Alongside our credit offerings, we are equally enthusiastic about the opportunities for our equity strategies, which focus on bottom-up research in their respective markets, and which we believe are poised to perform well in the ever-changing market conditions we see ahead in 2025.

[1]Goldman Sachs Tactical Fund Flows Update, November 27, 2024.

I would like to thank our investors for their continued support. We greatly appreciate your partnership and look forward to continuing to work together in 2025.

Peter Kraus
Aperture Investors, Chairman and CEO

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