

Talkin' 'Bout My Generation | December 2017

“Children now love luxury. They have bad manners, contempt for authority, disrespect their elders, and love talking instead of exercise.”

Socrates

It is every generation's prerogative to opine on and decry the ones that follow. But instead of shaking their fists and complaining about Millennials, the wiser grey-haired executives are preoccupied with understanding how to market to and manage them. As Canada's and America's largest living cohort comes of age, so too rises their relevance as producers, consumers, and investors.

It is estimated that by 2020 Millennials will represent 50% of the global workforce and have a net worth in the ballpark of \$19-21 trillion, having doubled assets since 2015. They will not only benefit from increased earnings but also from a wave of inheritances, as the majority of managed wealth currently resides with those over the age of 60. So as time goes on, it will be increasingly important for financial institutions, asset managers, and investors to understand how this generation will put their money to work.

And perhaps the best starting point is to look at how they are currently managing their nest egg.

Despite carrying hefty debt burdens, Millennials are good at saving. But reports suggest that the vast majority of them do not hold equities, preferring physical assets and cash. Much of this has been attributed to the Great Recession. Not only were many of them entering a terribly difficult job market, but they were also scarred from watching their parents and grandparents suffer losses in 2008. As a result, they are reluctant to put their hard-earned savings at risk.

A report released by Merrill Edge suggests that the crisis also created mistrust in the financial system amongst Millennials and an underlying feeling that they are better off relying on their efforts, leading to most of them managing their own wealth. But rather than being aggressive youngsters, 85% of them say that they 'play-it-safe,' with 46% claiming they are more conservative than their parents.

While they may be risk-averse, the first digital generation is unquestionably more comfortable with technology and algorithmic portfolio management. This has led to Robo-advisors managing hundreds of billions of dollars, a number that is expected to snowball in the coming years. As an example, the Canadian start-up Wealthsimple has accumulated over \$1bn in assets under management in less than three years.

Another trend amongst the young 'punks' is the move towards socially responsible and impact investing. According to research from Deloitte, almost two-thirds of Millennials are not only concerned about the state of the world but also feel obliged to do something about it. This has been one of the factors behind the tremendous growth in sustainable investing, with 1 in every 5 dollars invested in Canada and the US falling under this umbrella.

Just as Boomers reshaped the world to fit their needs and desires, bringing us 'sex, drugs and rock 'n' roll,' so too will the Millennials profoundly change business and culture to conform with their values and biases. And whether or not the older folks are ready to pass on the baton, the Millennials will be grabbing it with both hands and leaving their mark on all aspects of society. It is, therefore, very worthwhile to try and understand them and the future they are creating.

The Fund

Fortunately, the credit markets made it onto the ‘nice’ list, and were gifted an invite to participate in the ‘Santa Claus rally.’ With new issue supply ending mid-month, dealer inventories were drawn down leading to a modest performance in credit. With this final grind tighter, 2017 saw corporate spreads lower by 27bps in Canada and 29bps in the US. This performance was in spite of record corporate new issuance of C\$116 billion, with the slack from lighter bank supply picked up by foreign companies such as Apple and Pepsi.

As can be expected, there was little in the way of trading activity and opportunities in December. Over the month we added to our FRN positions and exited some hedges which had been creating a mild drag on performance. The carry earned and spread tightening generated a return of 50bps in December.

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2017	1.73%	1.30%	0.44%	1.03%	(0.22%)	0.53%	0.94%	(0.09%)	0.70%	0.83%	0.45%	0.50%	8.46%
2016	0.19%	1.49%	5.32%	3.51%	0.60%	0.54%	1.73%	1.63%	1.01%	1.86%	1.60%	1.62%	23.15%
2015	-	2.29%	2.51%	1.27%	2.46%	0.25%	0.73%	(0.25%)	1.68%	1.71%	1.37%	0.87%	15.86%

The Algonquin Debt Strategies Fund LP was launched on February 2, 2015. Monthly returns are based on 'Series 1 X Founder's Class' NAV as calculated by SGGG Fund Services Inc. and are shown in Canadian dollars, net of all fees and expenses.

Credit

Near-term momentum remains bullish as dealer inventories are light, and there seems to be a slow start to new deals. Tailwinds at the moment are rising yields and US tax reform. In rising rate environments, portfolio managers favour corporate over government debt, as the higher coupon helps offset losses when yields rise. The tax changes south of the border make it less desirable for some corporations to borrow money since not all interest payments are tax deductible. Furthermore, companies may repatriate foreign cash reserves to be used for capital expenditures, stock repurchases, and M&A.

Although the macroeconomic conditions and corporate fundamentals are constructive for credit, we remain a little cautious given that spreads are at the tighter end of the range and are patiently waiting for opportunities.

Rates

It appears that 2018 will be the year of interest rate normalization. Most countries are experiencing robust economic and employment growth. Fiscal stimulus in the US comes with unemployment at 4%, while in Canada significant minimum wage increases in Alberta and Ontario could be passed on to consumers. Although inflation has not yet climbed, there is a growing unease that perhaps it will do so this year.

Central banks will have little choice but to continue hiking and scaling back on quantitative easing. As such, rates should continue to rise in the coming months. The only question is by how much. For Boomers who might still remember (if they can) 13% mortgages, 4-5% is still ridiculously low, while it could be a shock for Millennials who have more experience with sub 3% mortgages. Needless to say, we will keep the portfolio's interest rate risk tightly hedged.



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