BARRON'S

CLM Barron's Cover - Main

HD **What's Next for Healthcare --- From biotech to managed care, companies are focused on new challenges—and opportunities. What's at stake, and where to invest now.**

BY By Lauren R. Rublin

WC 6,536 words

PD 26 September 2022

SN Barron's

SC B

PG 20

LA English

LP

Thanks to vaccines, treatments, and preventive measures, the Covid crisis has eased, even if the pernicious virus persists. The pandemic's evolution gives healthcare companies a chance to focus on other issues, including drug-patent expirations, pricing pressures, regulatory changes, and deal making. For investors, a bear market in stocks adds another wrinkle—and an opportunity to snap up shares of the industry's most promising companies on the cheap.

This year, Barron's annual healthcare roundtable focuses on emerging themes across the industry, from the ability to "interrogate" biology with computational tools to the evolution of value-based care. The challenges are many, but the news is good, not only for innovative biotech and cash-rich pharmaceutical companies, but also for nimble managed-care providers and purveyors of much-needed medical devices and life-sciences tools.

TD

The roundtable, which took place in mid-September on Zoom, features four panelists: Jorge Conde, a general partner at the venture-capital firm Andreessen Horowitz; Ann Gallo, a healthcare portfolio manager at Wellington Management; Neal Kaufman, manager of Baron Capital's Baron Health Care fund (ticker: BHCFX), rated five stars by Morningstar; and Chris Schott, a healthcare analyst specializing in pharma stocks at J.P. Morgan.

An edited version of the conversation, including a look at the panelists' favorite stocks, follows.

Barron's: Postpandemic, what are the most important trends and emerging themes in your coverage areas? Ann, lead off, please.

Ann Gallo: I'm happy to do so. Utilization is an important driver of growth in healthcare. As more people schedule procedures, utilization is approaching prepandemic levels. We could see growth take off from current rates. This would be especially beneficial for healthcare-facility stocks hit hard by Covid, and many medical-device companies. That's a big, important theme.

Another important theme is the continued tension between the level of innovation in pharmaceuticals, biotech, and medical technology and our ability to pay for it. That has always been the catch. The transition to value-based healthcare is accelerating, and will have implications as we try to move from a world in which we're paying for volume to a world in which we're paying for the highest-quality care at a value sustainable to the system.

A third trend is digital healthcare. As companies embed digital tools in their operations, digital healthcare will become an important driver of growth and efficiency.

Chris, what is on your horizon?

Chris Schott: I'm focused on the innovation cycle we have seen. Can it continue? Covid demonstrated the value of the biopharma industry and what it can deliver in terms of vaccines and therapeutics. But what we are grappling with now, especially in my large-cap pharma coverage universe, are companies coming up on a large patent cycle.

Innovation is occurring in these companies' pipelines. We have hundreds of newly minted biotech companies, as well. In the next few years, as we pivot away from Covid, who will be the winners and losers? Which pharma companies have expanded that innovation across their portfolio to deal with the patent cycles they're facing? Which ones have to get more aggressive in business development and an external search for assets? And, can we support the number of biotech companies that came public in the past few years, or do we need to see consolidation?

Jorge, what is happening in your world?

Jorge Conde: It has been fascinating to see how robust early-stage innovation continues to be. If we are on the other side of the Covid pandemic, two things stand in stark relief.

One, technology—specifically, biotechnology—helped save the day. The ability to invent and develop Covid vaccines so quickly reflects the fact that biology is becoming increasingly programmable. And that means the innovation cycle is going to continue or, more likely, accelerate and compound. If we can program a messenger RNA vaccine for a spike protein, we likely can do it for many other things beyond infectious diseases.

The other realization, which Ann alluded to, is how broken the healthcare system is. We saw the cracks in the system during the Covid pandemic. We couldn't deliver essential services, testing, or necessary products. The need for innovation is more apparent than it has been in a long time.

A third thing that interests me is the environment for early-stage companies. It is a wonderful time to start a company because the technology is robust. The challenges of getting a company off the ground have been reduced dramatically. It is much easier to start a biotechnology company in 2022 than it was in 2002. And, there are deep pools of both public and private capital to help drive that innovation.

We'll return to the subject of financing, but first, let's hear from Neal.

Neal Kaufman: One thing we're focused on—and it isn't specific to healthcare—is: In a higher-inflation world, which companies have pricing power? Even if inflation starts to come down, it seems likely to be more of an issue than in the past. We are focused on companies that have the ability to raise prices to offset inflationary pressures.

Another theme is the use of technology to enable drug discovery. A lot of companies have come public in the past year or so that are focused on using artificial intelligence, computational platforms, or machine learning to speed the pace of drug discovery, at a lower cost and with an improved likelihood of success. There are plenty of private companies in this field, as well.

We are also focused on the development of blood-based early-cancer-detection tests. Illumina [ILMN] has entered this market through its ownership of Grail, although there are questions about whether it will have to divest Grail. Grail has a multicancer-screening blood test on the market; people can pay for it out-of-pocket. A host of other companies are working on single-cancer blood tests.

You run a diversified healthcare portfolio. Which industry subsectors look most attractive now?

Kaufman: Ann mentioned value-based healthcare, as opposed to volume-based. Many publicly traded, large-cap managed-care companies are involved in efforts to become more risk-based providers of healthcare as opposed to purely insurance companies. We have investments in Humana [HUM] and UnitedHealth Group [UNH]. Both are involved in this shift, either through ownership of primary-care clinics or a move into the home-care services space.

Outside healthcare services, we have historically liked the life-sciences tools subsector. Many companies in this area provide products and services to biotech and pharma companies. They have recurring revenue with high margins and good cash-flow characteristics. Unlike biotech companies that are purely product-driven and have clinical-event risk, many of the tools companies have more predictable business models. A lot of life-sciences tools companies benefited from Covid, so they have a bolus of Covid revenue starting to taper off. That is reflected in poor stock performance, year to date, but this remains an attractive area for long-term investments. A lot of these stocks are at valuation levels that haven't been seen in years, so there are plenty of investment opportunities.

Ann, same question: What are you prioritizing in your portfolios?

Gallo: Right now, 50% of the investible opportunity set within healthcare constitutes medical technologies and services, and 50% is in pharma and biotech. In our portfolios, over the past year, our biopharma exposure has been slightly skewed in favor of larger cap versus SMID [small- and mid-cap] names, relative to our historic positioning. Within medtech and services, our largest subsector bet is managed care, followed by medical devices and life-science tools companies.

The reason I recommend managed care is the attractive fundamental backdrop. Premium prices have been rising at, or slightly above, the trend in healthcare costs, and the feared bounceback in postpandemic procedure volumes is unlikely to happen due to capacity constraints in the system, including labor shortages. The Medicare Advantage market still provides attractive growth opportunities as the population ages and more people transition from traditional fee-for-services Medicare to managed Medicare run by the private sector. We see a relatively benign political and legislative environment for a while.

A big part of my investment process is to play subsectors off one another. Within healthcare services, there are probably 10 subsectors. We find a lot of correlation within subsectors, but not necessarily among them.

Our second-largest overweight is medical devices, and the third is life-science tools. The medical-device business was hit hard during Covid as people delayed elective procedures. We're starting to come out of that, and are seeing some stabilization in supply costs and supply-chain blockages.

At the same time, there is a ton of innovation. Boston Scientific [BSX], which we own, had a rocky couple of years during the pandemic, but now is generating above-market growth in all of its key divisions. It is positioned to grow broadly for some years into the future.

Where else do you see opportunity?

Gallo: Edwards Lifesciences [EW] manufactures medical devices focused on structural heart disease. It is exiting the pandemic with its leading TAVR (transaortic valve replacement) franchise well positioned for continued growth after the recent lull. Over the next decade, two newer and currently smaller markets, mitral and bicuspid valve repair, will join TAVR as important growth engines.

Abiomed [ABMD] is a name we've just started to get back into. The company's key product, the Impella pump, enables a patient's heart to rest and recover during cardiac failure and high-risk procedures by improving blood flow. Given the nonelective nature of these procedures, Abiomed's sales reps were among the few to have access to hospitals during the pandemic, enabling it to expanded its reach into new centers, while fortifying existing relationships.

Insulet [PODD], in the diabetes area, is another company we like. Its Omnipod 5 is the first and only tubeless automated insulin-delivery system on the market. When integrated with a continuous glucose monitor, it basically functions as an artificial pancreas.

What do you make of the efforts of tech giants such as Amazon.com [AMZN] and Apple [AAPL] to enter the healthcare market? Do they pose a threat to traditional healthcare companies?

Gallo: I've seen every generation of technology throw money at healthcare and then get out of the business. It is different now, especially for cloud-computing companies, because the move to value-based care will prevent information from remaining siloed. That said, companies outside the healthcare-services world often underestimate how dysfunctional and confusing healthcare is. Expertise is critical, and a lack of it has been a barrier to success.

Amazon announced about six years ago that it was getting into the drug-distribution business, but it was my conviction at the time that the advantages Amazon brings to consumers in other industries didn't exist within drug distribution. Years later, they have changed their approach.

Eventually, the tech behemoths will break in, but you don't need to be a tech company to leverage the advances in technology that we're seeing. The existing healthcare infrastructure companies will make a bigger impact with new technologies and AI. You can count on one hand the number of new entrants into healthcare services over the past 20 years that have a large, successful company to show for it.

Coming from Silicon Valley, Jorge, you must have thoughts about this.

Conde: Healthcare is hard. The system is complicated. But technology is coming, and it will increasingly transform the way we access healthcare in this country, the way we pay for it, the way it is delivered, and the way we experience it. Technology is giving existing providers superpowers, of a sort.

If you are a physician, there are powerful applications in which tools like AI can make you better at delivering care. For example, Bayesian Health's research-backed AI platform integrates every piece of available data to equip physicians with accurate and actionable clinical signals that empower them to diagnose, intervene, and deliver proactive, higher-quality care.

We are also focused on creating modern fintech rails for the healthcare system, whether to fix billing problems or create better price transparency or collect bills in systems operating at relatively low margins.

And, there is a lot of innovation happening in technologies to enable virtual first care, which will be an important catalyst in the shift to value-based care. Many companies in these areas are born with a technology-first approach to delivering what we would call full-stack care.

It has been a roller-coaster year for biotech stocks, which fell for many months, then recovered some, and are now sliding again. What caused the swings, and what might prompt investors to re-engage?

Schott: A lot of young biotech companies came public during the pandemic. There was excitement around innovation. Then, with interest rates going up and the economic outlook growing more challenging, there was a rerating of some of those businesses. Coming into the year, Big Pharma stocks were undervalued relative to the broader market. Pharma valuations have since normalized a bit, but there are still opportunities in the group.

Across the biopharma world, there are a lot of innovative companies now trading at valuations we haven't seen in a long time. There will probably be a great opportunity to re-engage with companies whose shares have fallen 30%, 40%, 50% in the past six to nine months.

Where do you see value in biotech?

Schott: Among companies in my coverage universe, we like Horizon Therapeutics [HZNP], which had one of the best product launches in that category with a drug called Tepezza for treatment of thyroid eye disease. The product went through a growth challenge this year, after going from zero to $2 billion in revenue in two years. We think the drug has more room to grow, and could generate $3.5 billion or $4 billion a year at the peak. The stock has fallen from around $120 to $60 in the past year, and now trades for less than 15 times earnings. Horizon made some acquisitions, and now has five or six drugs in Phase 2 development. At the current multiple, you're effectively getting the pipeline for free.

In large-cap biopharma, a lot of companies I follow are trading at 12 or 13 times earnings. They are harnessing some of the same technologies we are so excited about, and getting almost no credit for it. Names like AbbVie [ABBV] come to mind. The stock trades for 11 times earnings. The company will have an earnings trough in 2023, but from there will see healthy growth for a decade-plus.

Royalty Pharma [RPRX] buys up drug-sale royalties, providing an alternative source of capital for the industry. It offers a diversified way to invest in some of the innovation occurring at smaller companies. The stock is up about 3% year to date, but has not participated in the broader rerating we have seen with a number of the major pharma names.

Jorge, do you see bargains among broken initial public offerings?

Conde: The main opportunity is in areas where we are starting to see concrete proof that a new modality, a new form of medicine, can work. Gene editing is one such area. Companies such as Verve Therapeutics [VERV] and Intellia Therapeutics [NTLA] have been able to advance into clinical trials to bring these therapies closer to patients.

One reason we've seen such a pullback in shares of early-stage companies is that a lot of them went public as preclinical companies. It is hard for public investors to analyze them, absent proof points.

Was it a mistake for venture capitalists to push preclinical companies into the market?

Conde: These platform-based biotech companies require time and capital to fully develop. Historically, they got that capital by accessing public markets. Increasingly, we have deeper pools of private capital available. Innovative platform companies probably could benefit from staying private longer, building out their technology, and going public when they have demonstrated the value of their platforms. In the future, companies are likely to stay private for longer.

How will the abundance of private capital influence biotech?

Conde: Many groups have raised large funds, which by definition tend to be long duration. There is a lot of dry powder, and in the next five years, we expect to see a lot of it put into play. The market has gotten much deeper and more sophisticated. Some funds want to invest in tech-centric platforms. Some of these investors are large sovereign-wealth funds. There is a diversity of sources of capital. The key thing is to figure out the right time to access public capital.

Gallo: We participate in public and private markets. I have been surprised that we haven't seen more M&A [mergers and acquisitions], especially given the patent cliffs some pharma companies are facing. Is there anything you're seeing in private biotech, Jorge, that suggests this could be a route?

Conde: One reason we haven't seen more active M&A is because of the evaluation cycle; it takes a long time to figure out what the right price is. Also, in a crowded landscape, it is hard to figure out where the diamonds are.

Schott: I have always viewed my large-cap names, the buyers of many of these assets, as companies that, rightly or wrongly, would rather pay a premium for a best-in-class asset after it has been derisked, rather than buy an early-stage company on the cheap. But I, too, am surprised that there hasn't been more M&A, just because there is so much cash sitting on the sidelines in pharma, and investors generally have been supportive of companies deploying that capital.

We are starting to see more partnerships in cases where companies don't want to buy whole platforms, but rather work on particular assets. Maybe they make an equity investment in a company, and if the technology is as advertised, there is a second-step transaction a few years down the road.

Pharma companies are probably going to hit a tipping point in the next two years, as the reality of their impending patent cliffs sets in. Most of these companies have less than one times leverage and are generating tons of cash flow. At some point, it's going to be tempting to put that capital to work via acquisitions.

What is the outlook for pharma stocks generally?

Schott: There are two perpetual pushbacks: Pricing is uncertain and will get worse over time. And, how can companies sustain themselves, given patent cycles? On the latter, I am more optimistic than the market. Today, companies' internal pipelines are productive, and there are literally hundreds of companies that the Big Pharma companies can acquire or partner with.

On pricing, we've had multiple years in which net pricing was down, given increased rebates issued by healthcare systems. Most of us assume these companies will have to operate in an environment in which prices decline a couple of percent in perpetuity. Innovative companies that can reinvent themselves will get premiums, and others will get valued accordingly. It was probably easier to make a bullish call on the drug stocks a year ago, when they were trading at such a steep discount to the market. Today, it is more of a stock-picking market. Investors need to pick the companies that aren't getting credit for their pipeline, or have shown a sustainable innovation engine that you don't see elsewhere. We are fairly constructive on the group.

The Inflation Reduction Act contains several healthcare-related measures. How will they affect pharmaceutical companies?

Schott: There are three pieces regarding pharma. The Medicare Part D redesign, which caps seniors' out-of-pocket costs at $2,000 and creates a more predictable monthly expense for their medications, is something the industry has wanted. The benefit didn't really serve constituents well and will serve them much better when implemented in 2025.

The price-increase cap, which is tied to CPI, is neutral for pharma. The third part is selective drug-price negotiation. For most of our companies, this provision would initially clip prices in the final years before most drugs' patent expirations. It isn't hitting drugs early in their life cycle. The provision won't fully ramp up until after 2030. It reinforces the need for sustainable innovation, because if you stay static and have a big drug, the price eventually will be negotiated down by the government. I expect price negotiation to have a sub-5% impact on annual earnings per share for any given company.

Gallo: Chris, is there a risk that more drugs will be affected?

Schott: Larger drugs are going to be negotiated. By the time you get to the early 2030s, most drugs that generate more than 2% to 3% of companies' annual revenue and have been on the market nine to 13 years will get pulled into this list as it grows to 100-plus drugs. Again, this was fairly well anticipated, and it isn't the end of the world. We aren't going to global reference pricing, or other things that could have been implemented that would have been much more disruptive to earnings.

Gallo: What is fascinating about the price negotiation for select drugs is that potentially, for the first time ever, it gets to the real issue with drug pricing—the starting price of these drugs. Overall industrywide drug-price inflation has been in the low single digits for years. From an affordability standpoint, the bigger issue is that many drugs are initially launched at very high prices. Biologic drugs cost hundreds of thousands of dollars. They are highly effective for a small group of the population. This legislation is a blunt instrument, but it has the potential to get at this issue in the out years.

Chris, what are some of your top picks in Big Pharma?

Schott: Eli Lilly [LLY] is my kind of innovative pharma company. It isn't dealing with a patent cliff. Lilly is launching Mounjaro, to treat diabetes. It is a transformational asset. In the future, it will be launched to treat obesity. It could generate peak annual sales of $25 billion. This is a best-in-class diabetes medication. Patients lose more than 20% of their body weight. Over time, use of the drug will produce strong cardiovascular benefits. Payers might not want to pay for obesity medications, viewing obesity as a cosmetic market. We expect it to turn into a medical market.

Lilly's earnings could rise from about $8 a share this year to almost $30 by the end of the decade, and won't be done growing then. The patent cycle is mid-2030s and beyond. The company has invested consistently in its portfolio. It continues to work in several therapeutic areas. It has competitive advantages, including a best-in-class management team. At 38 times forward 12-month earnings, the stock trades at a premium to peers, but you can't find growth like this in other large-cap diversified pharma companies.

We also like AbbVie, a more controversial story.

How so?

Schott: AbbVie's patent protection on Humira will expire in 2023, and earnings will trough around the same time. The stock is trading for less than 12 times estimated trough earnings. Wall Street is focused on the patent cliff; we have been more focused on what happens after. AbbVie has multiple growth drivers. Looking past 2023, the top line is growing by mid- to high-single digits, and the bottom line is growing at a low-teens rate out to the early 2030s. The stock yields almost 4%. There is a strong argument for the stock to rerate as we go into 2023, and the Street has more visibility on trough earnings. AbbVie offers premium growth and an undervalued stock.

That's a good combination. Neal, what excites you in this market?

Kaufman: We like Bio-Techne [TECH], an $11 billion market-cap life-sciences-tools company. It has stable, organic growth and high margins, and can compound earnings over the long term. Its core business is selling proteins and antibodies for research use. Bio-Techne is a leading supplier of cytokines, a type of protein used in immunology research, a growing field.

The company has multiple growth drivers, including a platform technology that looks for cancer or transplant-rejection biomarkers in small extracellular vesicles called exosomes. Bio-Techne is a supplier to the cell- and gene-therapy market. It also has a protein-analysis business. Organic revenue growth has accelerated to the low- to midteens. The company is active in M&A, as well.

We think it can grow the business to $2 billion of revenue in the fiscal year ending on June 30, 2026. Assuming a 40% Ebitda [earnings before interest, taxes, depreciation, and amortization] margin, that's Ebitda of $800 million or more in the same fiscal year. Thermo Fisher Scientific [TMO] just paid 40 times Ebitda for a privately held competitor. Bio-Techne trades for 22 times the next calendar year's Ebitda. The stock could trade up to $600 a share in three to four years, versus around $300 today.

What else do you like?

Kaufman: Inspire Medical Systems [INSP] is a medical-device company with a roughly $5 billion market cap. It is focused on sleep apnea, a common disease in which the patient's airway is blocked during sleep; the patient wakes up throughout the night because of a lack of oxygen. This can lead to multiple health issues, such as stroke and cardiovascular issues, and higher healthcare costs. The first-line therapy is CPAP, but there is low patient compliance. Thus, there is a huge opportunity for better alternatives.

How large is the market?

Kaufman: Sleep apnea affects approximately 100 million people worldwide, and 17 million in the U.S. have moderate to severe sleep apnea. Inspire sells a small, implantable device that delivers electrical stimulation to the hypoglossal nerve, which moves the patient's tongue out of the air passageway while sleeping and allows more normal breathing to occur. The patient controls the system and can turn it on before going to sleep. The implant is done in a 90-minute outpatient procedure. It requires only two small incisions. Inspire has now secured broad insurance coverage for this device.

Inspire is targeting a market of approximately 500,000 patients in the U.S. Plus, there are international opportunities. This year, the company is going to sell roughly 15,000 devices, so there is a long runway for growth. The company could generate $360 million of revenue this year, up more than 50% year over year, despite the labor-shortage constraints in the medical-device market, with mid-80% gross margins.

This is an expensive stock on near-term numbers, but we see good long-term upside. Long term, if you assume just two implants per center per month at 2,500 centers in the U.S., at their average selling prices, combined with some international revenue, the company could be generating $1.5 billion to $2 billion of revenue at the end of the decade, with $700 million of Ebitda. It could be a $600 stock then, versus around $170 today.

Lastly, ICON [ICLR] has a market cap of roughly $16 billion. It is the second-largest CRO, or contract research organization. ICON provides outsourced drug-development and commercialization services to pharma and biotech. It is benefiting from growth in biopharma R&D spending and the trend toward outsourcing of clinical trials. Market share is shifting to large-scale providers like ICON as clinical trials become more complex and global. ICON has a long history of developing products and services embraced by customers. There has been concern about how the decline in biotech funding would flow through to their business, which has taken the stock down this year.

Is the concern warranted?

Kaufman: The concern is overblown, and ICON can still achieve its targets. Earnings will be up more than 20% in 2022, and the company could generate midteens or better earnings growth through 2025, with the possibility for acquisitions and share-repurchase activity.

Recent transactions in the CRO market have occurred at 20 times Ebitda. ICON trades for 14 times this year's expected Ebitda and less than 13 times next year's. On a price/earnings basis, the stock trades for 16.5 times this year's earnings and less than 15 times next year's. We expect ICON to earn roughly $18 to $20 a share in 2025, and think the business is worth 20 to 25 times earnings, which would get you to a $400 to $500 stock price in three years. The shares are trading below $200 today.

Let's get Ann's picks next.

Gallo: Insulet, which I mentioned, has a $17 billion market cap and is one of the leading diabetes-pump manufacturers. It shares the pump market with Medtronic [MDT] and Tandem Diabetes Care [TNDM]. Insulet is in the early days of commercially launching the Omnipod 5, which was cleared by the FDA in January, but was launched in only limited release until recently. Insulet is positioned to grow the market by taking share from MDI, or multiple daily injections. An added benefit of the Omnipod 5 is that it is sold through the pharmacy channel. This pay-as-you-go model lowers upfront costs for payers and consumers.

Is the launch of anti-obesity drugs a long-term risk for Insulet?

Gallo: Anti-obesity drugs are so early in their launch that they aren't likely to have much of an impact on the diabetes market for many years. The approach eventually might be one of partnering, using the pumps to monitor weight loss.

I mentioned Boston Scientific earlier; it has a $55 billion market cap. From the time Mike Mahoney took over as CEO in 2012 through 2019, Boston's execution was nearly flawless. The company experienced a couple of hiccups in 2019 and 2020, including the withdrawal of its transcatheter aortic valve system, Lotus Edge. Coming out of the pandemic, Boston Scientific is demonstrating a lot of traction: Endoscopy grew 6% in the latest quarter, and cardiovascular, 8%. In the next few years, we'll see a lot of innovation coming from both internal efforts and strategic M&A. We expect to see outsize growth and the return of predictability.

Tell us about the valuation.

Gallo: Boston Scientific now trades for 15 times Ebitda. I see upside to the company's valuation, as I do for a number of medical-device companies dragged down by delays in medical procedures during Covid. Boston Scientific could see margin expansion, an acceleration of earnings growth, and multiple expansion.

Next, UnitedHealth is one of the best-positioned healthcare services companies in the world. There is a lot of growth left in the Medicare Advantage and Medicaid markets. These companies—United, in particular—have the data, technologies, and explicit mandate from corporations and government to help manage healthcare costs. There is strong visibility on earnings and cash-flow generation.

The company's business is split 50/50 between its traditional managed-care business and its Optum division. UnitedHealth and Optum are examples of what I mentioned earlier: established healthcare companies that have successfully adopted some of the latest technologies to empower physicians to use data when treating patients. Optum also has a next-generation pharmaceuticals-services business that is looking to enhance the existing pharmacy benefit management, or PBM, model. And, it has a strong provider business—including the largest set of physicians, clinics, and ambulatory surgery centers in the country.

What does that mean for the stock?

Gallo: The stock has done well. On a P/E basis, it is trading a few points above the S&P 500 index. With a combination of earnings growth and multiple expansion, the stock could have 20% to 30% upside.

Lastly, I mentioned that Abiomed and Edwards are two interesting cardiovascular medical-device companies. There is a lot of growth coming from Edwards' TAVR market. Edwards and others are currently running numerous clinical trials whose publication over the next two to three years should drive the stock higher. Edwards' stock has pulled back substantially this year and now trades for 24 times Ebitda. While not cheap, I find the valuation compelling for a franchise leader with this growth profile.

Becton Dickinson [BDX] trades for a lower valuation. Its business is half medical supplies and half life-sciences tools and technologies. It offers both an attractive value proposition and a nice growth outlook. The company had some operational and execution missteps in recent years, but has taken care of them and is showing solid traction across its businesses. The stock sells for 14 times Ebitda.

Jorge, which companies, public or private, excite you?

Conde: What I am most excited about as an early-stage investor is the way that technology, and specifically engineering and computation, is transforming both life sciences and the healthcare system. In life sciences, we are getting tools and abilities to interrogate biology much more deeply than in the past, and therefore intervene in ways that we couldn't before. One of the biggest growth areas in the past decade-plus has been around DNA sequencing. The ability to quickly sequence the human genome reliably at low cost is an engineering marvel, and one of the most powerful engines our industry has had.

We recently invested in a private company, Ultima Genomics, that offers a step-change in building a new sequencing platform. The company has said it can already sequence human genomes for less than $100. As the price continues to fall, that opens up all kinds of interesting tools and applications.

On the intervention side, The Economist magazine recently published an article called "Gene Therapies Must Become Miracles of Medicine." It discusses the promise and challenges around potentially curative therapies like gene therapy. One of the biggest challenges is a limited ability to deliver genes into the body. When we try to dose gene therapies higher, we see all kinds of adverse events, including deaths. We are invested in Dyno Therapeutics, which is developing next-generation synthetic capsids.

Explain, please.

Conde: The most common way to deliver gene therapies is through viral vectors, which have evolved naturally. Dyno is using artificial intelligence to design synthetic AAV [adeno-associated virus] capsids, the viral delivery vehicles used in gene therapy that could do things natural capsids can't, like reach certain cells or evade the immune system. Instead of developing its own pipeline of products, Dyno wants to become the delivery infrastructure for all gene therapies. In effect, it is trying to become the FedEx for gene therapy. It is an early-stage company but already has partnerships with Novartis [NVS], Sarepta Therapeutics [SRPT], Roche Holding [RHHBY], and Astellas Pharma [ALPMY].

Shifting to therapeutics, we just discussed the new drug-pricing bill. We are investors in EQRx [EQRX], which is aiming to take a market- and technology-based approach to delivering lower-cost drugs for some of the highest-cost drug categories, including cancer. It has already demonstrated that it can develop a pipeline. It has licensed some promising compounds, and has several early-stage partnerships. And, instead of trying to commercialize drugs pushed toward physicians with a sales force, it is establishing a pull model with payers, whereby they guarantee access to high-quality drugs at dramatically lower prices. The company has developed what it calls a global buyer's club, and is on target to have something like 350 million covered lives with payers and health systems with which EQRx has MOUs [memorandums of understanding] in place by the end of this year. The question is: Can EQRx demonstrate that it can get these drugs approved more efficiently and quickly?

The company is trying to get Chinese-developed and tested drugs through the Food and Drug Administration, which doesn't seem to want to take China-only studies, at least in oncology. Does that damage the model?

Conde: They have multiple sources of compounds. Some are from China; others are licensed from U.S.-based companies, and others are in development through R&D partnerships. And, they are doing novel discovery programs in partnership with technology platform companies. There is a continuing dialogue with the FDA on how to get drugs approved when the data comes primarily from China. EQRx is making progress ex-U.S.

The stock has fallen about 50%. Why?

Conde: Mostly, because of the concerns you cited.

We are also investors in Komodo Health, which has built a software platform that injects data across the entire healthcare system. It has built what it calls a living Healthcare Map, covering north of 300 million interactions with the healthcare system. Komodo provides this data-analytics platform to life-sciences and healthcare-services companies to help inform decision making, identify where there is underdiagnosed disease burden, who prescribing physicians are for what class of drugs, and so forth. Komodo will be approaching more than $200 million in annual recurring revenue by the end of 2022, with software-like margins.

Finally, Devoted Health is a proprietary technology platform for the fastest growing, next-generation Medicare Advantage plans to deliver more efficient and effective care. It is an exciting area.

What impact will higher interest rates have on healthcare investing?

Schott: In my world of Big Pharma, there will be relatively limited impact.

Kaufman: The increase in rates has been reflected in stock prices. The biggest, most immediate impact is on the valuations of companies with long-duration cash flows that aren't yet here. Those stocks have borne the brunt of the market's downdraft in the past 18 months. If inflation remains a problem, companies with pricing power will benefit and be rewarded by the market.

Gallo: Most medical-device and life-sciences tools companies that operate with lower gross margins will have a tougher time passing on higher costs. I agree with Neal; it's in the stock prices. But this is the first time in my career when healthcare inflation is lower than overall inflation. It hasn't happened in decades. Also, managed-care companies hold a lot of cash in reserve, and their earnings will benefit, as rising rates will be a tailwind.

Jorge, we'll give you the last word.

Conde: As someone working on early-stage companies, we take a long-term view. The fever will break at some point. Innovation will continue, and the right ideas and teams will continue to get funded.

Thank you, everyone.

Write to Lauren R. Rublin at lauren.rublin@dowjones.com

IN i2569 : Biotechnology | i951 : Healthcare/Life Sciences | i257 : Pharmaceuticals | i3302 : Computers/Consumer Electronics | i330202 : Software | iaer : Aerospace/Defense | icnp : Consumer Goods | iconst : Construction | icph : Computer Hardware | idurhg : Durable Household Products | iint : Online Service Providers | itsp : Transportation/Logistics | i2572 : Vaccines | icomp : Computing | icre : Real Estate/Construction | idrugty : Specialized Drugs/Medications | iindstrls : Industrial Goods | itech : Technology

NS gbiot : Biotechnology | gimmu : Immunizations | c133 : Patents | ccat : Corporate/Industrial News | ghea : Health | gsci : Sciences/Humanities | ncolu : Columns | npag : Page One Stories | c151 : Earnings | c15 : Financial Performance | cgymtr : Intellectual Property Rights | cinprp : Industrial Property Rights | gbiol : Biology | gcat : Political/General News | gtrea : Medical Treatments/Procedures | ncat : Content Types | nfact : Factiva Filters | nfcpin : C&E Industry News Filter

IPD Barrons.com

IPC 4503.TO

PUB Dow Jones & Company, Inc.

AN Document B000000020220923ei9q000dx

BARRON'S

CLM Up & Down Wall Street

HD **The Fed Wants to Beat Back Inflation. It's Bad News for Investors.**

BY By Randall W. Forsyth

WC 1,061 words

PD 26 September 2022

SN Barron's

SC B

PG 7

LA English

LP

The aim of central banks in times like these often is described as achieving a soft landing, which conjures a picture of a gentle descent onto a broad runway. Central bankers' current task actually is more like the challenge of landing on an aircraft carrier. The pilot must bring the plane down onto a short flight deck, while the carrier is pitching at sea with shifting winds. To accomplish this, the aircraft has a hook that is supposed to swiftly halt it by catching a sturdy steel cable.

TD

Missing that cable might mean shooting off the bow and into the drink. But Lt. Randall John Forsyth of His Majesty's Royal Navy managed to land his Corsair during World War II despite missing that cable, which amounted to a monumental foul-up, he would relate with a rueful smile years later. Modern jet fighters fly at vastly higher velocities, however, and wouldn't have the margin of error that my dad's prop-engine plane did more than seven decades ago.

The Federal Reserve may be seen as a pilot trying to compensate for an errant landing approach by employing a steep descent and sharp deceleration. By rapidly raising its short-term interest rate target from virtually zero earlier this year, to 3%-3.25% this past week, via its latest sharp 75-basis-point hike, the central bank is attempting to bring down the inflation that it thought was transitory in 2021. (A basis point is 1/100th of a percentage point.)

More important than the latest increase, which mainly validated what was anticipated by federal-funds futures traders, was the Summary of Economic Projections from the Federal Open Market Committee. It predicted a relatively subdued outlook for growth and unemployment for next few years, with inflation eventually descending to near the central bank's 2% long-run target by 2024. To get there, however, will require significant further rate increases.

They will be enough, vowed Fed Chairman Jerome Powell, to wring out our four-decade-high inflation. The Fed's median fed-funds projections now are 4.40% by year-end and 4.60% by the end of 2023. That would put rates far above the ultralow ones that have prevailed since the 2007-09 financial crisis and keep them there.

Those were significant increases from the median projections in the previous SEP, released at the June FOMC meeting, of 100 and 80 basis points, respectively. The new projections also see the key rate ending 2024 at 3.9%. But while the individual panel members' projections for 2022 and 2023 were tightly bundled, their guesses for 2024—an eternity away in market time—ranged widely.

The old joke about economists is they have a decimal point in their forecasts just to show they have a sense of humor. Perhaps more telling than the numbers is Powell's desire to see positive real interest rates across the maturity spectrum; that is, above the rate of inflation. In his postmeeting press conference, he rattled off trailing three-, six-, and 12-month changes in the core personal consumption deflator (the Fed's favored inflation measure, which excludes food and energy prices): 4.8%, 4.5%, and 4.8%, respectively.

So, by implication, he wants to keep rates higher than the core PCE deflator, which the FOMC projected would recede from 4.5% by the end of 2022 to 3.1% by late 2023 and 2.3% by late 2024. The last would presumably amount to mission accomplished.

But getting there will require sluggish, below-trend economic growth and rising unemployment. The projection for this year's gross-domestic-product growth was slashed to just 0.2% (measured from fourth quarter to fourth quarter), versus 1.7% in June. That essentially means the GDP decline was concentrated into the first two quarters; the Atlanta Fed's GDPNow toolestimates third-quarter growth at a barely positive 0.3%. Next year's GDP growth rate is expected to recover to just 1.2%, and 2024's to 1.7%.

The unemployment rate is seen edging up to 3.8% by the end of 2022, and to 4.4% over the two following years. The June projections were 3.7%, 3.9%, and 4.1%.

Nomura North America's economics team considers those projections too optimistic. Notwithstanding Powell's admission that reducing inflation could involve some pain, they opine in a research note that the FOMC may be reluctant to forecast a recession, although the risks are tilted toward weaker growth and higher unemployment.

Evercore ISI tried to see the upside. Just as the Fed was too optimistic last year about continued growth and contained inflation, maybe the central bankers are too pessimistic this year, the firm muses in a client note. That said, while Evercore's proprietary gauges of the economy show slowing, the signals they're sending are probably still too strong for the Fed's liking.

On the latter score, Powell emphasized the still-robust labor market, with about two job openings for every unemployed person. The doleful calculus of bringing down core inflation, which is dominated by service costs, involves cutting jobs to slow the rate of pay gains. The reductions have begun in technology, with Meta Platforms (ticker: META) looking to cut expenses by 10%, in part through staff cuts, The Wall Street Journal reported this past week.

In sum, the Fed's policy approach will be asymmetrical, Julian Brigden, head of Macro Intelligence 2 Partners, said in an interview. Countering rising prices will take precedence, with Powell & Co. emulating the "opportunistic disinflation" approach of the Greenspan Fed of the 1990s.

For investors, that will mean further tightening of financial conditions.

With the S&P 500 threatening its June 16 low of 3666.77 Friday morning and more than 1,100 points below its Jan. 3 peak of 4796.56, sentiment already is bearish. The key message for investors: Don't look for the Fed to come to the rescue. The central bank's main concern now is for the economy to touch down safely on the carrier flight deck in rough seas.

As Dad used to say, good luck and happy landings.

Write to Randall W. Forsyth at randall.forsyth@barrons.com

NS ecat : Economic News | c1521 : Analysts' Comments/Recommendations | e11 : Economic Performance/Indicators | ncolu : Columns | npred : Economic Predictions/Forecasts | e1103 : Inflation Figures/Price Indices | ccat : Corporate/Industrial News | ncat : Content Types | nfact : Factiva Filters | nfce : C&E Exclusion Filter

IPD Barrons.com

IPC G/FED

PUB Dow Jones & Company, Inc.

AN Document B000000020220923ei9q00001

BARRON'S

HD **The Last Big Activist Still Standing --- Elliott Management is going after PayPal, Pinterest, and other stocks. Following its bets could prove costly.**

BY By Carleton English

WC 2,130 words

PD 26 September 2022

SN Barron's

SC B

PG 26

LA English

LP

For much of this year, PayPal Holdings stock couldn't find a floor. Not only did the payments company lose its pandemic luster, but it also lost credibility on Wall Street after cutting ambitious growth targets in February. Amid the selloff, PayPal's chief financial officer took a job at Walmart. Investors took off, too, sending the stock down 60% through mid-July.

But one investor, in particular, saw value and came equipped to orchestrate a turnaround in the stock: Elliott Management.

TD

Led by its longtime chief, Paul Singer, the $56 billion hedge fund amassed a nearly 2% stake in PayPal (ticker: PYPL) over the summer. As reports of Singer's involvement trickled out, PayPal shares popped9% and then rose another 12% when the company said it was engaged in "constructive and collaborative" talks with the hedge fund.

Singer, 78, isn't known for playing nice if he's rebuffed. A Harvard University–trained lawyer, he has led Elliott for more than four decades, developing a reputation for tenacious activism, tackling companies worldwide and even taking on an entire country over its debt. Worth $5.5 billion, according to Forbes, Singer is still highly involved in the fund, with co-CEO Jonathan Pollock. Managing partner Jesse Cohn oversees much of the firm's private equity and activism.

Few other hedge funds are targeting as many large and global companies. Fewer still are willing to fight for years if a company resists Singer's demands—from winning board seats to a wholesale firing of the management team or corporate breakup.

Yet investors who follow Elliott into a stock may be disappointed. Strip out the one-day pop in a stock when Elliott's involvement is disclosed, and, in aggregate, its activist picks haven't beaten the market, according to an analysis by Barron's.

For Elliott, that may not be a problem because the fund lives up to its name: It hedges risks in activist holdings both widely and narrowly, down to the business unit within a company that it is targeting. Those strategies aren't accessible to most investors.

Activist positions, moreover, only account for about 20% of the hedge fund; the rest consists of derivatives, debt securities, and other positions that aren't publicly disclosed. All of it together gives Elliot a leg up in activism. Investors who try to piggyback off its strategy should be wary.

As for Elliott's overall returns, they're a mixed bag. The hedge fund has gained an average 13.5% annualized since Singer founded the firm in 1977, according to people familiar with the fund. That beats the S&P 500 index's 11.6% return. Elliott has had only two losing years: 1998, when it lost 7% while the S&P 500 gained 28%, and 2008, when the fund lost 3% against a 37% market decline.

Elliott has done quite well this year. Through June 30, the hedge fund was up 5%, net of fees, against a 20% decline in the S&P 500.

But Elliott's performance hasn't been great over the past five years. The fund returned an annualized 9.7%, through June 30, compared with 11.3% for the S&P 500. In 2019, the fund returned 6.5%, trailing the market's 31.5% gain. Elliott also trailed the market in 2020 and 2021.

Advisors familiar with the fund, which has a $5 million minimum, say that investors aren't necessarily looking to knock the lights out with Elliott. Rather, they're seeking a true multi-strategy fund that can deliver returns noncorrelated to the broader market.

Cohn says avoiding losses is the first objective. "Elliott's core value is to preserve capital with no excuses and be skeptical," he said in an interview with Barron's.

Singer declined an interview.

Elliott's Activist Playbook

Led by Singer, Elliott is leaning into activism while many of his peers pull back. Bill Ackman, known for his short campaign against Herbalife Nutrition (HLF), said in March that his Pershing Square is officially out of activist short selling and will be taking a "quieter" approach to investing. Earlier this month, Third Point's Dan Loeb did an about-face on Walt Disney (DIS) after CEO Bob Chapek shot down Loeb's quasi-friendly nudge to split off ESPN.

In contrast, Elliott isn't backing down. The hedge fund, in the past year, has taken activist stakes in PayPal, Pinterest (PINS), Cardinal Health (CAH), Western Digital (WDC), Suncor Energy (SU), and Switch (SWCH). Globally, the hedge fund's targets include Swedish Match (SWMA.Sweden), Toshiba (6502.Japan), Willis Towers Watson (WTW), and Canadian National Railway (CNI).

Elliott is also using activism—gaining board seats and internal company knowledge—for buyouts. The hedge fund took the transport company Cubic private last year and has a buyout deal for Citrix Systems (CTXS). It took Athenahealthprivatewith Veritas Capital for $5.7 billion in 2018 and sold it to Bain Capital and Hellman & Friedman for $17 billion in February.

"The more effective we are in activism, the better that we can deploy those skills into acquiring companies," said Cohn. "The more we do in the private equity space, the more operational knowledge we build, and the more effective we can be as public-market players."

Overall, Elliott has launched 131 activist campaigns since 2015, according to data from investment advisory firm Lazard. That eclipses the sum of campaigns launched by the next three most active hedge funds: Starboard Value, Land & Buildings, and ValueAct Capital. Elliott has gained 95 board seats since 2015, lagging behind only Starboard with 125 seats over the same period, according to Lazard.

Elliott often starts out friendly but can quickly turn hostile; it has a reputation for latching on to companies or even entire countries like a pit bull. Singer tangled with giants like Athenahealth and steel company Arconic (ARNC). His hedge fund feuded with Argentina over its bonds for 15 years, even detaining an Argentine naval vessel at a port in Ghana as a pressure tactic. Elliott eventually settled with Buenos Aires, turning a $2.4 billion profit on a $115 million investment.

Partly in response to activists like Elliott, many companies have adopted defenses like share dilution provisions and other "poison pills" to thwart hostile actions. "It's no longer the early innings of activism," says Chris Couvelier, managing director at Lazard. "Even if your company hasn't been targeted, odds are you've got a director or member of management that has been affected by activism." Investors, meanwhile, are getting tired of headline-making proxy brawls. "Shareholders don't mind alternative ideas, but they want to evaluate them on their own merits," he adds.

Elliott's Activist Record

Whether Elliott enhances returns for shareholders—other than itself—is debatable.

Since 2018, the 76 activist stock positions publicly disclosed by Elliott have returned an average of 4.9% in the hedge fund's holding period, according to Bloomberg reports and data. That trails the S&P 500 by an average of 6.6 percentage points. Investors would have fared even worse if they'd missed the initial one-day gain, averaging 5.6%. Without it, Elliott's picks would have trailed the S&P 500 by 11.9%.

Elliott's stock returns are based on public filings and company disclosures. Some of its positions—particularly some foreign holdings—may not have been activist but rather arbitrage trades and hedges. Filtering out foreign holdings, the firm's U.S. activist holdings beat the S&P 500 by six percentage points. Investors who missed the first-day gain would have trailed by two points. Elliott declined to comment on Barron's findings.

A few recent examples exemplify the uneven performance. Western Digital surged 14.5% on the day that Elliott's stake was revealed in May. The company reached a settlement with Elliott a month later and agreed to explore a breakup—work it is still undertaking. Shares have since slid and trailed the S&P 500 by 27% since the disclosure of Elliott's stake.

Following Elliott into shares of SoftBank Group (9984.Japan) would also have been costly. Elliott amassed a $3 billion stake in the Japanese tech conglomerate, revealed in early 2020, and then lobbied management for more disclosures about its positions, among other demands. Initially, investors cheered, pushing up SoftBank stock by 7.3%. But Elliott abandoned efforts to exert pressure on SoftBank CEO Masayoshi Son and sold most of its stake in the company. SoftBank stock has trailed the S&P 500 by 10% since Elliott's stake was revealed.

Some companies targeted by Elliott say they don't view the hedge fund as an adversary. Elliott approachedthe data center Switch cordially, alerting management via a phone call that it acquired a stake and would like to talk. Switch President Thomas Morton was wary, but said in an interview that Elliott had "done its homework." Elliott and Switch were aligned in some goals, he added, including converting the company into a real estate investment trust. "We didn't think of them as an activist but as an additive investor," said Morton.

Other companies, perhaps wary of tangling with Elliott, appear willing to appease the firm. Elliott soughtfive seats on Cardinal's 11-person board in mid-August. Three weeks later, Cardinal agreed to add four directors backed by the hedge fund to its board. Cardinal also formed a committee to explore the company's strategy and improve financial performance, meeting some of Elliott's demands.

As for Pinterest, Elliott now has a 9% stake in the social-media and e-commerce site. The hedge fund wants to see the company accelerate efforts to monetize its base of 433 million monthly users—or put itself up for sale, according to a person familiar with Singer's demands. Both Elliott and Pinterest have said they're engaged in a "collaborative" dialogue. The fact that Elliott owns stakes in both PayPal and Pinterest has raised prospects of the hedge fund brokering a merger, though people close to both companies say a deal isn't on the table. A spokesman for Elliott denied it was pushing for a sale of Pinterest but declined to comment further.

Inside a $56 Billion War Chest

Fans of Elliott say it is misunderstood and unfairly maligned. Yes, it gets a lot of attention for hardball tactics in activist campaigns. But as a multi-asset fund, Elliott uses a range of instruments to achieve returns, including equity, debt, and derivatives. It also has the resources to fight for years in court, tackling bankrupt companies like Caesars Entertainment, and countries like Peru.

It's quite likely that the hedge fund scores profits on its stakes that aren't available to piggybacking investors. The initial pop certainly helps Elliott. But Elliott mitigates its risks, partly by isolating a business unit within a company and hedging its exposure to the rest of the business or industry. While it looks as if Elliott is targeting a conglomerate like AT&T (T), for instance, it may be seeking a spinoff of the satellite business and would hedge its exposure to the telecom side.

"Elliott is probably the best hedging firm out there," says a person familiar with the fund. "They hedge down to the business line, as deep as they can, using any instrument they can find to take out the risks that don't relate to what they're trying to accomplish. They can do things that other activists can't, because they're not taking the same kind of risk."

With more than $50 billion in assets and 500 employees, Elliott towers over rivals like Third Point and Pershing Square. The fund's size enables it to borrow stock, for shorting positions, at ultra-low fees. Elliott can also hedge its exposures with custom-made instruments, such as credit-default swaps, at very low costs.

"Their size allows them to hedge more effectively so they can take riskier positions," said the person familiar with the fund. Moreover, Elliott relies on in-house industry experts who can push back against financial models, providing more insight into a company or sector that the numbers might suggest. "They are not resource constrained," said one advisor who regularly works with the firm.

At 78, Singer won't always lead the activist fights, though he seems to have built a firm with the resources to prevail. "We find value where we believe others have missed it," said Cohn. "I would say this is our type of market for finding opportunities."

Write to Carleton English at carleton.english@dowjones.com

CO xcmcrp : PayPal Holdings Inc | ellas : Elliott Capital Advisors, L.P. | ellmcz : Elliott Management Corporation

IN i8150105 : Consumer Lending | i8394 : Computer Services | ibnk : Banking/Credit | ifinal : Financial Services | ihedge : Hedge Funds | iinv : Investing/Securities | itech : Technology | iwealth : Private Banking/Wealth Management | i814 : Banking | i81501 : Credit Types/Services | i81502 : Trusts/Funds/Financial Vehicles | i831 : Financial Investment Services | ialtinv : Alternative Investments | ibcs : Business/Consumer Services | i83107 : Portfolio/Fund/Asset Management | ifmsoft : Financial Technology | impay : Mobile Payment Systems | iplastic : Electronic Payment Systems

NS m11 : Equity Markets | mcat : Commodity/Financial Market News | c173 : Financing Agreements | npag : Page One Stories | c151 : Earnings | reqris : Suggested Reading Investing/Securities | c15 : Financial Performance | c17 : Corporate Funding | ccat : Corporate/Industrial News | ncat : Content Types | nfact : Factiva Filters | nfce : C&E Exclusion Filter | nfcpin : C&E Industry News Filter | redit : Selection of Top Stories/Trends/Analysis | reqr : Suggested Reading Industry News

IPD Barrons.com

IPC 6502.TO

PUB Dow Jones & Company, Inc.

AN Document B000000020220923ei9q000jh

BARRON'S

HD **Markets Are Careening Toward Normal. What to Buy Now**

BY By Jack Hough

WC 1,041 words

PD 26 September 2022

SN Barron's

SC B

PG 9

LA English

LP

Stocks and bonds are tumbling. Housing has weakened. And I haven't heard a word about nonfungible cartoon monkey tokens in maybe three months. Strategists are now turning to truly bizarre assets—two I spoke with this past week recommended purchasing long-term Treasurys. One also said to favor shares of companies that generate cash, and he wasn't talking about Bitcoin mining.

TD

I don't want to set off a panic, but financial markets appear to be careening toward normal. If left unchecked, ordinary assets could soon reach price levels that imply adequate long-term returns.

The Federal Reserve is raising interest rates at the fastest pace in four decades to squash the hottest inflation in just as long. Already, its target for short-term rates is up to just over 3% from closer to zero at the beginning of the year. How high will it go? Higher than inflation, surely, but the inflation rate a year from now matters more than the one for the past year. The Cleveland Fed bakes up a year-ahead inflation prediction using swaps, surveys, and bond data for ingredients. Its latest reading is 4.2%.

Or we can just watch the dots. Fifteen years ago, the Fed started publishing a quarterly chart deck of economic predictions, and 10 years ago, it added a dot plot showing where its individual participants think rates are headed. The dots are "assessments of appropriate monetary policy," not predictions, the Fed likes to say. Good to know. The dots just shifted higher. The new midpoint prediction—I mean assessment—is that the fed-funds target will reach 4.5% to 4.75% by the end of next year.

The dots sent Wall Street into a fresh tizzy this past week. But really, they say we're moving toward normal, not away from it. The average monthly fed-funds rate in data going back to 1954 is 4.6%. Mortgage rates are turning more ordinary, too. The 30-year fixed rate recently spiked to 6.3%, versus 2.9% a year ago. But the average in data going back to 1971 is 7.8%.

What matters for investors is whether measures like these will shoot above long-term averages, and how much is already priced into stocks and bonds. The answers are unlikely, and maybe a lot.

"The economy probably won't be able to sustain that level of rates for any period of time," says Michael Darda, the chief economist and market strategist at MKM Partners, about the fed-funds rate potentially hitting 4.5% early next year. The dots agree. They suggest that after next year, the fed-funds rate will fall in 2024 and 2025, by a total of 1.75 percentage points.

Darda believes that it will happen faster; he sees inflation falling toward 2% in a year to a year and a half. "Some of these slower-moving, stickier measures are going to take longer to moderate," he says of things like wages and rents. "But they will moderate."

Darda recommends that investors buy the iShares 20+ Year Treasury Bond exchange-traded fund (ticker: TLT) and short gold. The ETF has lost 29% this year—about six points more than stocks—and its holdings have an average yield to maturity of 3.8%. It could rise in price if inflation moderates faster than expected. The gold side of the trade has to do with Darda's observation that although gold is called an inflation hedge, it has been a poor one, instead moving opposite real bond yields, or bond yields minus inflation.

So far this year, the yield on a five-year Treasury Inflation Protected Security has jumped from negative 1.6% to positive 1.5%. Gold should have tumbled, but it's down only slightly. Darda reckons it has to fall to $700 an ounce or lower, or real rates have to come back down. Gold recently fetched just over $1,670. Put it together, and if Darda is wrong about the Treasury side of his trade, he expects the other side to pay off from a gold crash.

Julian Emanuel, who leads the equities, derivatives, and quantitative strategies team at Evercore ISI, has turned bullish on the same Treasury fund. He recommends buying calls and selling puts. For investors who neither trade options nor sell short, another way to interpret both of these recommendations is that it's time to dip back into bonds.

"The 60/40 portfolio over the past two years has probably morphed into the 65/35 or the 70/30," Emanuel says of the traditional stock/bond split. "For the first time since 2019, there is value in longer-dated bonds."

As for stocks, what happens from here depends on whether we get a recession, says Emanuel. If not, stocks are likely near the bottom, but if so, there could be another leg down, he says.

Either way, he recommends value stocks with high free-cash yields and a record of returning plenty of cash to shareholders through dividends and stock buybacks. A recent screen for such companies turned up Bank of America (BAC); home builder Lennar (LEN); oil refiner Valero Energy (VLO); Comcast (CMCSA), the cable company; and Facebook owner Meta Platforms (META).

Now is a good time for old-economy stocks like those in the industrials, materials, energy, and banking sectors, says Graeme Forster, who runs international equity strategy for Orbis, an asset manager overseeing some $30 billion. When valuations for companies like these are low, their managers tend to underinvest, leading eventually to shortages, inflation, and rising interest rates, much as we're seeing now, says Graeme.

"You'll see old-economy businesses rerate upward, and new-economy businesses rerate downward," he adds. Among his favorite stocks are Shell (SHEL), which has a big energy-trading business that is in high demand amid global shortages, and Glencore (GLEN.UK), which produces and trades key metals and is profiting from solar and wind energy storage and the shift toward electric vehicles.

Write to Jack Hough at jack.hough@barrons.com. Follow him on Twitter and subscribe to his Barron's Streetwise podcast.

CO frbcl : Federal Reserve Bank of Cleveland

IN i1 : Energy

NS givsto : Personal Investments in Stocks | gpersi : Personal Investments | gcat : Political/General News | gpersf : Personal Finance

IPD Barrons.com

IPC BAC

PUB Dow Jones & Company, Inc.

AN Document B000000020220923ei9q000rt

BARRON'S

HD **Junk Yields Are Up. Time to Pounce? --- There's risk, of course. But the investment math is compelling.**

BY By Andrew Bary

WC 1,075 words

PD 26 September 2022

SN Barron's

SC B

PG 12

LA English

LP

High-yield bonds are finally living up to their name after the broad selloff in fixed-income markets this year.

Better known as junk, the $1.5 trillion sector looks appealing, as yields have risen to an average of 8.8% from 4.4% at the start of 2022, according to the ICE BofA US High Yield Index. Junk debt offers an alternative—or supplement—to stocks.

TD

Junk bonds aren't without risk. The ICE index had a negative total return of 12.6% in 2022 through this past Thursday, though that's better than the 20% decline (including dividends) of the S&P 500 index. And many investors understandably balk at buying debt of leveraged companies heading into a potential recession.

"Avoid junk bonds and junk equities," warned Ariel Investments' portfolio manager Rupal J. Bhansali, a Barron's Roundtable member, at MarketWatch's Best Ideas in Money conference on Thursday. "Risk assets" like junk, she said, aren't the place to be now.

A counterargument is that junk-bond math looks pretty good at current levels. The yield gap between junk debt and risk-free Treasuries has widened to five percentage points from three points at the start of 2022, based on the ICE index. Now, it would take a default rate of 8%, coupled with a bond recovery rate of just 40%, to effectively match the yield on Treasuries (8% times a loss rate of 60% is nearly 5%, the current spread of junk to Treasuries). The market overall appears to be in good shape, with the default rate running below 1%, although likely to head higher.

One underappreciated plus is that more than half of the market now consists of double-B-rated issues, the highest junk rating, from solid companies such as Charter Communications (ticker CHTR), Alcoa (AA), and Ford Motor Credit, the auto maker's finance arm. Just 10% of the market is in the most speculative triple-C category.

"Most companies should be able to withstand a soft recession. Companies took advantage of historically low rates to refinance debt and have padded their balance sheets with liquidity,' says Dan DeYoung, co-manager of the Columbia High Yield Bond fund (INEAX). "The lower interest burden coupled with pushing out near-term debt maturities have given most high-yield companies increased financial flexibility to navigate an economic slowdown."

The new-issue market is quiet as speculative companies balk at rates needed to attract investors. A high-profile financing for the leveraged buyout of software maker Citrix Systems (CTXS) was done recently at 10%. Royal Caribbean Group (RCL) sold $2 billion of debt on Thursday that included 9.25% bonds due in 2029. Other big junk deals waiting in the wings will finance the buyouts of Nielsen Holdings (NLSN) and Tenneco (TEN). Companies might not like those yields, but investors should.

Investors can play junk bonds through open-end mutual, closed-end, or exchange-traded funds, and individual issues. There is also another $1.5 trillion of so-called leveraged loans, which are privately issued senior obligations sold to institutional investors. That market also has funds and ETFs.

Many investors like the liquidity of junk ETFs, such as iShares $ iBoxx High Yield Corporate (HYG) and SPDR Bloomberg High Yield Bond (JNK), which hold some of the largest issues and yield about 8%. The VanEck Fallen Angel High Yield Bond ETF (ANGL), which buys corporate debt that was once investment grade, is an alternative that holds bonds from issuers like Las Vegas Sands (LVS) and Royal Caribbean. The fund's performance has bested the two larger junk ETFs in recent years.

There's a case to be made for active management in the junk market, where astute investors can add value. Closed-end junk funds offer higher yields than open-end funds and ETFs, thanks to leverage, which results in greater price volatility. "We believe there are great opportunities," says Eric Boughton, co-manager of Matisse Discounted Bond CEF Strategy (MDFIX), which buys discounted closed-end bond funds in many sectors, including junk and municipals.

He says junk yields are attractive and closed-end funds are a cheap way to play the sector because the average fund discount to net asset value is 9%, versus 5% in the past two years.

The BlackRock Corporate High Yield fund (HYT), the largest junk closed-end fund at $1.2 billion, trades around $9 a share, a 9% discount to net asset value. It yields over 10%. Nuveen Credit Strategies Income (JQC), which buys leveraged loans, trades around $5, a 14% discount to NAV, while yielding 9.5%.

Leveraged junk closed-end funds have negative returns in the high teens this year, but if the market rallies, they could rise smartly.

Even individual bonds look attractive. Columbia's DeYoung is partial to debt of American Airlines Group (AAL) and Uber Technologies (UBER). He favors a $3.5 billion issue from American backed by its AAdvantage program. Those 5.5% bonds due in 2026 now yield 8%. DeYoung says they're safe, given the value of the mileage program and its importance to American. Uber, the big ride-sharing company, was profitable by one measure in the second quarter, which lifted its stock by over 30%. Its 4.5% bonds due in 2029 yield about 7%.

It's not easy for retail investors to buy individual junk bonds, because many are issued as private placements under Rule 144A and available only to institutions (retail buyers can purchase some deals).

Barron's has written about the high yields of "busted" convertible bonds, often issued by formerly popular growth companies, such as Peloton Interactive (PTON), Wayfair (W), and MicroStrategy (MSTR). These trade at steep discounts to their face value and carry yields to maturity of 10% or more. Peloton's zero-coupon convertible due in 2026 trades for 67 cents on the dollar and yields 12%, while Wayfair's 0.625% issue due in 2025 fetches 70 cents and yields more than 12%. Bitcoin owner MicroStrategy's zero-coupon bond due in 2027 trades under 50 cents on the dollar and yields 18%. Most convertibles lack ratings and probably would be junk grade if they had them.

There is plenty to choose from now in the junk market.

Write to Andrew Bary at andrew.bary@barrons.com

CO ubrti : Uber Technologies Inc. | ubrib : Uber International B.V.

IN iextrfu : Exchange Traded Funds | i25 : Chemicals | ibnk : Banking/Credit | icnp : Consumer Goods | ifinal : Financial Services | iinv : Investing/Securities | i81502 : Trusts/Funds/Financial Vehicles | ibasicm : Basic Materials/Resources | iecom : E-commerce | iint : Online Service Providers | itech : Technology | itnsv : Sharing/On-demand Economy Services

NS npag : Page One Stories | cjunk : High-yield Corporate Bonds | reqrbc : Suggested Reading Banking/Credit | reqris : Suggested Reading Investing/Securities | c17 : Corporate Funding | c172 : Corporate Debt Instruments | cactio : Corporate Actions | ccat : Corporate/Industrial News | ncat : Content Types | nfact : Factiva Filters | nfcpin : C&E Industry News Filter | redit : Selection of Top Stories/Trends/Analysis | reqr : Suggested Reading Industry News

RE namz : North America | usa : United States

IPD Barrons.com

IPC AA

PUB Dow Jones & Company, Inc.

AN Document B000000020220923ei9q000m9

BARRON'S

CLM The Trader

HD **Mergers Might Be Getting Easier. Here Are the 'Arb' Stocks to Watch.**

BY By Nicholas Jasinski

WC 1,044 words

PD 26 September 2022

SN Barron's

SC B

PG 33

LA English

LP

UnitedHealth Group's $13 billion acquisition of health-tech firm Change Healthcare is a go, after a federal judge ruled against the Justice Department's antitrust challenge to the deal—and there are other merger deals that could get the green light in the months ahead.

TD

Change stock (ticker: CHNG) jumped some 7% this past Tuesday and Wednesday, to $27.21. That's a hair below the acquisition price of $27.75 per share in cash. The stock had traded largely between $20 and $24 since the deal was struck, reflecting investors' collective uncertainty about whether or not it would close. UnitedHealth (UNH) struck a deal with Change way back in January 2021 and the Biden administration sued to block the deal in February 2022.

Those who bought Change stock betting on the deal eventually closing can soon pocket the difference. It's an example of a strategy called merger arbitrage, which provides a yield opportunity that isn't correlated with the direction of the stock market or interest rates.

Most M&A targets see their share price quickly converge with the buyer's offer. For example, shares of insurer Alleghany (Y) were recently trading at around $842.85 per share, versus the all-cash acquisition price of $848.02 agreed with Berkshire Hathaway (BRK.A, BRK.B). That's a discount of less than 1% to the transaction value.

But when there's uncertainty surrounding a deal—possibly due to an antitrust challenge, concerns about financing, or major shareholder opposition—the target's shares may trade at a meaningful discount to the agreed-upon price. It leaves an opportunity for investors willing to take the risk that the deal will close.

Not all those risks are worth taking. The most high-profile merger arbitrage opportunity these days is in Twitter (TWTR), which is fighting in court to compel Elon Musk to purchase the social-media company for $54.20 a share, or about $44 billion. Twitter stock was trading at $41.60 on Wednesday, 30% below the deal price.

That's a tough one to handicap. Musk isn't your average buyer, and the risk to the stock is substantial should the deal fall through. Since the Tesla (TSLA) co-founder publicly disclosed a 9.2% stake in Twitter on April 4, the shares are up 6%—versus a 20% loss for the Nasdaq Composite and declines of 35% and 70% for social media rivals Meta Platforms (META) and Snap (SNAP). It's fair to say that Twitter stock would be a lot lower today if not for Musk's potential offer.

But there are still plenty of targets to look at. Other stocks trading at meaningful discounts to their agreed-upon deal prices include Tower Semiconductor (TSEM), due to be acquired by Intel (INTC); Black Knight (BKI), due to be acquired by Intercontinental Exchange (ICE); Tenneco (TEN), due to be acquired by funds associated with Apollo (APO); Rogers (ROG), due to be acquired by DuPont (DD); Tegna (TGNA), due to be acquired by Standard General; First Horizon (FHN), due to be acquired by TD Bank (TD); and PNM Resources (PNM, due to be acquired by Avangrid (AGR).

Three look particularly interesting. The largest deal waiting for a thumbs up or down from regulators is Microsoft's (MSFT) $68.7 billion bid for Activision Blizzard (ATVI), valued at $95 a share. That compares with Activision stock's $75.04 on Wednesday, a discount of almost 27%.

U.S. regulators are looking into the deal and it faces an antitrust probe in the U.K.Berkshire Hathaway's Warren Buffett is among the investors betting that the videogame maker's shares will close the gap. The conglomerate has increased its stake in Activision over the past year, to own some 68 million shares as of the end of the second quarter. Barron's recommended buying Activision in July.

Other merger-arbitrage opportunities today could include shares of VMware (VMW), which has agreed to be acquired by Broadcom (AVGO) for about $61 billion. The deal includes both a cash and a stock component: VMware shareholders can elect to receive $142.50 per share in cash, or 0.252 of a Broadcom share—worth about $124.25 on Wednesday. The terms of the transaction specify that about half will be paid in stock and half in cash, meaning that shareholders may not get their preferred allocation, but instead receive a prorated payment.

A 50/50 split would value the deal at about $133.37 per VMware share, or 19% above its recent $112.50. That's also a bet on Broadcom stock however—should the semiconductor firm's stock fall more, the expected deal value will decline too.

Another deal that's facing a potentially lengthy regulatory review is JetBlue Airways' (JBLU) $3.8 billion bid for low-cost carrier Spirit Airlines (SAVE). That's valued at $33.50 per share in cash—or almost 50% above Spirit stock's $22.40. The market appears skeptical that the deal will close. JetBlue shares have also halved since the bidding began.

Others are worth avoiding. Amazon (AMZN) has announced a pair of acquisitions this summer: robot vacuum maker iRobot (IRBT) and 1Life Healthcare (ONEM), the parent of healthcare provider One Medical. Big Tech companies in general have been under growing scrutiny from regulators and lawmakers, and the Federal Trade Commission has requested more information from Amazon regarding the One Medical deal. Nonetheless, both targets are trading within 5% of their offer prices.

Of course, investors don't have to do it all themselves. A number of funds use merger-arbitrage strategies, including the Arbitrage Fund (ARBFX), which has fallen 1.3% in 2022, the Merger Fund (MERFX), which has advanced 0.2%, and the BlackRock Event Driven Equity Fund (BALPX), which has dipped 0.8%. There's even an exchange-traded fund for that: The AltShares Merger Arbitrage ETF (ARB) which owns Alleghany, Twitter and Activision, has returned 2.8% in 2022.

Those might not be the most scintillating returns, but in a market like this, they don't have to be.

Write to Nicholas Jasinski at nicholas.jasinski@barrons.com

CO uhelc : UnitedHealth Group Incorporated

IN i82 : Insurance | i82002 : Life Insurance | i82003 : Non-life Insurance | ifinal : Financial Services | i8200301 : Health/Medical Insurance | ihmo : Health Maintenance Organizations | iprivhea : Private Health Insurance

NS c181 : Acquisitions/Mergers/Shareholdings | cacqu : Acquisitions/Mergers | cmerg : Mergers | c34 : Anti-Competition Issues | c13 : Regulation/Government Policy | cactio : Corporate Actions | ccat : Corporate/Industrial News | gpir : Politics/International Relations | ncolu : Columns | nrmf : Routine Market/Financial News | c18 : Ownership Changes | gcat : Political/General News | ncat : Content Types | nfact : Factiva Filters | nfce : C&E Exclusion Filter | nfcpin : C&E Industry News Filter | niwe : IWE Filter

IPD Barrons.com

IPC 508869.BY

PUB Dow Jones & Company, Inc.

AN Document B000000020220922ei9q00001

BARRON'S

CLM Income Investing

HD **5 Dividend Picks To Beat Inflation And Rising Rates**

BY By Lawrence C. Strauss

WC 1,053 words

PD 26 September 2022

SN Barron's

SC B

PG 29

LA English

LP

Dividend stocks are facing stiffer competition, thanks to a big spike in bond yields. A risk-free 10-Year Treasury note was recently yielding 3.7%, up from 1.63% at the start of 2021. That's well above the S&P 500 index's dividend yield of 1.76%, making bonds more attractive for income investors.

But this isn't the time to give up on dividends as an income source. A healthy payout stream can diversify income in your portfolio. And with consumer price inflation running at an 8.3% annualized clip, stocks with dividend growth can help your income stream hold up better than bonds with fixed interest.

TD

"Dividend growers really do protect you from rising rates and inflation because you are getting that growing income stream," says Thomas Huber, manager of the $19 billion T. Rowe Price Dividend Growth fund (ticker: PRDGX).

Despite the Federal Reserve's plans to keep raising interest rates and slow the economy in its fight against inflation, companies with resilient revenue are raising payouts. Even with earnings growth declining for those in the S&P 500, the index's overall payout should rise 10% this year, estimates Howard Silverblatt, senior index analyst at S&P Dow Jones Indices. That would mark the first double-digit increase in S&P 500 dividends since 2015.

Treasury inflation-protected bonds, or TIPS, meanwhile, aren't offering any protection. The iShares TIPS Bond exchange-traded fund (TIP) has lost 11% in 2022, including interest payments.

Stocks with rising dividends could also falter, of course. Target (TGT), for one, is a dividend "aristocrat," a company that has raised its dividend for at least 25 years. Target has hiked its payout for 51 consecutive years, including a 20% increase in June, to an annualized $3.60 a share, good for a 2.8% yield at the stock's recent price around $153.

But investors have punished the shares, pushing them down 34% this year. The retailer got caught with the wrong mix of inventory at a time of high inflation and changing consumer spending habits, says Michael Barclay, manager of the Columbia Dividend Income fund (LBSAX), which has lightened its position in Target.

A larger holding in the portfolio is Chevron (CVX). It yields 3.6% and has been a winner, gaining about 37%, with dividends included, this year.

Oil stocks won't fare well if global demand for the commodity slumps once the war in Ukraine winds down. A slowing global economy would also cool the outlook for crude. The Columbia fund's longtime manager, Barclay, thinks Chevron looks resilient, though. "They have been disciplined in their capital expenditure" spending, he says, adding that Chevron's diversified operations across the energy chain provide some stability.

Chevron hiked its quarterly dividend by 6% in January to $1.42 a share. It's annual payout is expected to hit $5.97 a share in 2023, up 5%, with a payout ratio at 35% of earnings.

More appealing for its yield is Philip Morris International (PM). Shares of the tobacco maker offer 5.2% and have notched a 3.7% total return this year. The company recently raised its quarterly payout by about 2%, or two cents, to $1.27 a share.

Philip Morris sells its products overseas, where declining tobacco use and regulation aren't as much of an overhang as in the U.S. Its IQOS heated tobacco device, sold abroad for now, brought in 29% of revenue last year. The company aims to nearly double that by 2025. "You are getting paid to wait with that 5% yield," says Huber, who owns the stock.

Investors shouldn't overlook stocks with low yields but rising payouts and solid core businesses, too.

Insurance brokerage Marsh & McLennan (MMC), for one, yields just 1.5%. But its dividend is growing at a good clip. The company boosted it in July by about 10%, to 59 cents a share, or $2.36 annualized.

Marsh doesn't have heavy capex needs, a big drain on cash for many industrial companies and those in other sectors. Barclay cites Marsh's steady revenue gains as supportive of the dividend, which is expected to rise. It will hit $2.45 in 2023, according to consensus estimates, with a payout ratio at a comfortable 33%.

Marsh's stock is down 9.6%, including dividends, this year. That's a good showing against the S&P 500 financials sector, off 17.7%. Marsh has proved resilient in recessions, growing earnings per share in all economic contractions going back to 1952, CEO Daniel Glaser told investors in July. Factors supporting its growth include inflation, which helps insurance pricing, and higher rates, which benefit its fiduciary income and profitability.

The beaten-down tech sector also has some attractive dividend stocks. One that Barclay likes is Microsoft (MSFT), a fund holding since 2004, when the software giant first started paying a dividend. True, Microsoft shares yield a meager 1.1%. But the payout has been climbing steadily, including a 10% hike this past week to 68 cents a quarter.

Most investors don't own Microsoft for its dividend, instead looking for it to provide capital gains from areas like videogames and enterprise software. The shares are off about 27% this year, largely matching the tech sector's slide. Still, Barclay likes the long-term setup. "When you step back and look at the earnings and cash flow, they continue to grow," he says.

Two more defensive picks to consider: Medical-device company Becton Dickinson (BDX) and health insurer Elevance Health (ELV). Huber likes both for their "defensive growth" business models, he says.

Becton, yielding 1.4%, is up a hair this year, including its dividends. The company hiked its quarterly payout by 5%, to 87 cents a share, late last year. Shareholders should get another increase later in 2022.

Elevance yields 1.1% but raised its quarterly by 13% this year, to $1.28 a share. At about $475, the stock goes for 15 times estimated 2023 earnings and has "room for multiple expansion," says Huber. Its dividend should expand, too, nothing to sneeze at in a downbeat market.

Write to Lawrence C. Strauss at lawrence.strauss@barrons.com

CO trpdgw : T. Rowe Price Dividend Growth | socal : Chevron Corporation

IN i1 : Energy | i13 : Crude Oil/Natural Gas Upstream Operations | ifinal : Financial Services | iinv : Investing/Securities | iretail : Retail | i64 : Retail/Wholesale | ifosfl : Fossil Fuels | i81502 : Trusts/Funds/Financial Vehicles | iioil : Integrated Oil/Gas

NS c15 : Financial Performance | c1512 : Dividends | cactio : Corporate Actions | ccat : Corporate/Industrial News | e11 : Economic Performance/Indicators | e1103 : Inflation Figures/Price Indices | ecat : Economic News | m11 : Equity Markets | mcat : Commodity/Financial Market News | ncolu : Columns | npred : Economic Predictions/Forecasts | c151 : Earnings | reqris : Suggested Reading Investing/Securities | ncat : Content Types | nfact : Factiva Filters | nfce : C&E Exclusion Filter | nfcpin : C&E Industry News Filter | redit : Selection of Top Stories/Trends/Analysis | reqr : Suggested Reading Industry News

IPD Barrons.com

IPC BDX

PUB Dow Jones & Company, Inc.

AN Document B000000020220923ei9q000xd

CLM	Barron's Cover - Main
HD	**Next on Netflix: Strange Things, Also Known as Ads --- Ads on new, cheaper tiers of Netflix and Disney+ pose competition for tech giants Google and Facebook, but will they boost the stocks? A look at potential winners and losers as the streaming battle heats up.**
BY	By Jack Hough
WC	2,202 words
PD	19 September 2022
SN	Barron's
SC	B
PG	18
LA	English
CY	

LP

PHOTO: Photo illustration by Barron's staff; (Squid Games) Dom Slike/Alamy

TD

"We'll be right back after these messages." The age-old commercial lead-in takes on new meaning at a time when a bounceback for Netflix and Walt Disney shares rests on the coming launch of ad-supported tiers for the two streaming leaders.

For Netflix (ticker: NFLX), the goal is to reverse subscriber losses with cheaper plans. For Disney+, it's to offset a recent acceleration in cable cord-cutting. Barron's laid out those concerns in a March cover story.

Much could go wrong in the near term for these companies and their rivals. A glut of advertising slots could push industry prices lower, especially if the economy weakens. Too many ads per hour could frustrate viewers. Too few could accelerate defections from full-price streaming tiers and cable.

Yet, if the television industry is successful, it could not only rekindle growth, but also pull back power that has been lost to the closed-off advertising economies of Google and Facebook.

"Connected television is what will bring down the walls of walled gardens," says Jeff Green, founder and CEO of Trade Desk (TTD), which competes with Alphabet as an ad-buying platform and has partnered with Disney in streaming advertising. He means that streaming can match the targeting power of online search and social media while making the emotional connection of video. "A banner ad has never made you cry," he says.

Trade Desk is poised to be a winner as more advertising dollars flow to streaming.

Microsoft (MSFT), a rising ad player, should benefit, as well. Roku (ROKU) could have better odds than its collapsed stock price suggests. Walt Disney (DIS) and Warner Bros. Discovery (WBD) will benefit from rich content engines. Netflix, meanwhile, faces plenty of risk. And across the industry, more consolidation appears inevitable.

Advertising already abounds on streaming. What is changing now is the scale. Netflix dominates viewership. Its users took in 1.3 trillion minutes of content during the most recent TV season, roughly from late last September to early May, according to Nielsen data by way of BofA Securities. That's nearly double the attention paid over the same period to CBS, the ratings leader in traditional TV, and five times that of the next-biggest streamer, Disney+.

Netflix just moved up the launch of its ad-supported service to November to beat Disney+ on Dec. 8. That means it will want to lock in advertisers by the end of this month. It's expected to start at an "ad load" of four minutes per content hour.

Jessica Reif Ehrlich, a media analyst at BofA, predicts what she calls silent price hikes in the form of a quick rise in ads for each hour. "There's no way it's going to stay at three, four, five minutes," she says. "Hopefully it won't be what we see on linear, which is unbearable."

The TV business is packed with jargon. Here's a quick glossary for investors. Linear means that movies and shows run at scheduled times, and can refer to either old-fashioned broadcast and cable, or to FAST, which stands for free ad-supported streaming television. FAST services skimp on content costs and pack in the ads, but users can't beat the price. Paramount Global (PARA) owns the FAST service Pluto TV; Comcast (CMCSA) has Xumo; and Fox (FOX) has Tubi.

The better-known streaming services, where users pay subscriptions to start shows when they want, are called SVODs, for subscription video on demand. When the cost is subsidized with ads, like the new Netflix and Disney+ tiers, they're called AVODs. Some FASTs dabble in AVOD, and vice versa, and both services compete for the same ad budgets.

That's the taxonomy. Here's the moneymaking: Ad revenue is determined by ad load, audience size, and CPM, or cost per mille, which is Latin for thousand, and refers to the price of reaching that many screens. Ads are sold ahead of time during so-called upfront negotiations in late spring and early summer, and last-minute in what's called the scatter market. TV companies use a carrot-and-stick approach to get early commitments, offering choice spots during upfronts, and warning of higher rates for those who wait for scatter.

To sum up the current state of TV advertising, upfronts were solid this year, but scatter has turned choppy. Also, to date, streaming has made most of its advertising inroads in scatter, whereas traditional television still rules the upfronts. That's bound to change.

Now for the question that matters most: Where will CPMs come in for Netflix? If they're high, it could provide cover for the entire industry to prosper. If they're low, Netflix will need a hefty ad load in a hurry, and it still might not make up for customers who trade down from full-price subscriptions. The whisper number is that the company is looking for $65. Some on Wall Street are whispering back: "Good luck."

Hulu is a veteran at selling streaming ads, and gets CPMs that are estimated in the $20s and low $30s. (Disney owns two-thirds of Hulu and will likely buy the rest from Comcast in 2024.) HBO Max is a top CPM draw, with rates pegged in the $40s. Nat Schindler, BofA's Netflix analyst, who is bearish on the stock, expects CPMs of $20 to $40. In one recent analysis, he calculated that Netflix could need $3.8 billion in yearly advertising revenue to make up for lost subscription fees, and will likely generate less than $1.8 billion to start.

Tim Nollen at Macquarie Research predicts that Netflix will secure CPMs of $50 by next year and $60 by 2025. By then, he sees the company bringing in $3.6 billion in U.S. and Canada advertising revenue, and $8.5 billion worldwide, or $2 billion more than the company would bring in without advertising. He recently upgraded the stock to Neutral.

Evercore ISI analyst Mark Mahaney upgraded Netflix to Outperform this past week. He sees $1 billion to $2 billion in incremental revenue by 2024—and 10 million more subscribers. A recent survey of "churned" or departed subscribers leads him to believe that 20% of them could return with a cheaper tier. Just how cheap it will be isn't yet known, but forecasts of $7 to $9 a month are common. The cheapest ad-free Netflix plan costs $9.99 a month, and the most popular one is $15.49. Disney recently priced its ad-supported Disney+ at $7.99 a month—the same price as the current ad-free service, which will soon move to $10.99.

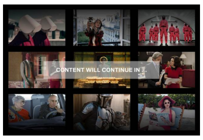


PHOTO: Illustration by Barron's Staff; Alamy (5); Netflix (2); Disney+ (2)

One factor that could weigh on Netflix's CPMs early on is that the company will offer little viewer information, which might have more to do with its abilities than privacy concerns. A partnership with Microsoft will help, eventually.

"The ink isn't even dry on the agreement," says Ratko Vidakovic, founder of AdProfs, an ad-technology consultant. "It's going to take a while for them to spin up the new advertising infrastructure that's going to allow them to offer more sophisticated ad targeting."

Traditional television has limited ability to target viewers with precision. The internet has plenty of ability, but it has long relied on technologies like tracking cookies that raise privacy concerns. Apple and Alphabet have cracked down on third-party cookies on their devices and software, and now advertisers are pondering a post-cookie world.

Meanwhile, streaming services have direct credit card relationships with customers, giving them valuable insights that could fetch top dollar from advertisers. What is needed is a way for advertisers to tailor their campaigns without Netflix sharing individual customer details or allowing outsiders to track Netflix users to other sites and advertise to them at lower cost.

One answer is called a data clean room, or software that allows collaboration without oversharing. Trade Desk is providing a data clean room for Disney. Microsoft, which just bought a programmatic advertising company called Xandr from AT&T, is believed to be doing something similar for Netflix. Microsoft declined to comment.

That could eventually make Netflix an advertising powerhouse. But there's plenty of risk for investors between now and then. Free cash flow for the company hasn't quite turned meaningfully and consistently positive. Content costs have soared—witness the more than $1 billion that Amazon.com is expected to spend on its new series loosely related to the Lord of the Rings books. Studios that once licensed shows cheaply are now hoarding them for their own streaming platforms.

Netflix has lost subscribers for two quarters running. The stock has rebounded 28% since the end of June in anticipation of a return to growth, versus 4% for the S&P 500 index. Meanwhile, the U.S. advertising industry turned in its weakest performance in two years in July, with spending falling 12.7% from a year earlier, according to research group Standard Media Index.

Without more growth soon, investors could begin second-guessing whether Netflix's projected $4.5 billion in free cash flow in 2025 is worth $97 billion in stock market value today. One wild card: Microsoft is believed to have offered Netflix a minimum revenue guarantee of perhaps $500 million to $1 billion to help win its advertising business.

For the legacy players, pay-TV subscriptions have fallen from a peak of more than 100 million in 2015 to about 82 million, and losses have lately been accelerating. But at least the remaining cash flows offer a bridge until streaming pays off. Disney, with a market value of about $205 billion, could top $10 billion in free cash flow in three years. Paramount, valued at $15 billion, is expected to generate at least $1 billion.

The cash cow of the group is Warner Bros. Discovery. It's valued at $31 billion and is seen generating nearly $4 billion in free cash this year and well over $9 billion in three years. Peacock owner Comcast earns far more from home cable connections, especially for broadband service, than from show business.

There have already been two big streaming deals this year. Discovery completed its purchase of AT&T's WarnerMedia, and Amazon closed on TV and movie studio MGM. Warner now says it will consolidate its HBO Max and Discovery+ streaming platforms to hold down costs. Paramount is considering the same for Showtime and Paramount+.

This past week, activist investor Daniel Loeb backed off his demand that Disney sell ESPN, tweeting about a "better understanding" of its potential. Loeb had argued that ESPN would be worth more to a company that would pursue gambling. Disney CEO Bob Chapek, asked at a recent company event whether ESPN is developing a gambling app, said, "We're working very hard on that."

Ehrlich at BofA and Nollen at Macquarie both favor Disney and Warner for their mix of must-haves like storied studios, live news, and sports rights. If Disney's price increase looks like a dare for subscribers to downgrade, there's a good reason. "Disney will probably make more on their AVOD platform than the SVOD," says Ehrlich.

Nollen is particularly bullish on Trade Desk. "Because they're neutral, because they've got great scale, great relationships, great ability to tie very targeted ads into all of these services, we think they're going to be one of the winners in this transition," he says.

Alicia Reese, a media analyst at Wedbush, recommends former highflier Roku, whose stock has collapsed by 78% in a year. It has a TV operating system that allows set owners to search for programs across their streaming apps, plus an AVOD called Roku TV. The company was hit by high exposure to the weakened scatter market, says Reese. But the market value is down to $9.4 billion, and the consensus view is that free cash flow will reach $500 million in three to four years.

Streaming commercials could prove effective enough to siphon spending to TV from online display ads in the years ahead, says Brett Gordon, who teaches marketing at Northwestern University's Kellogg School of Management.

At Trade Desk, CEO Green is eyeing a global ad budget approaching $1 trillion. "I want as much of that as possible," he says. And although his buying platform plays in websites, apps, podcasts, and more, he makes no secret of where he thinks the money is headed. "Connected television," he says, "is quickly becoming the most effective way to advertise on the planet at scale."

Write to Jack Hough at jack.hough@barrons.com. Follow him on Twitter and subscribe to his Barron's Streetwise podcast.

CO goog : Alphabet Inc. | netfli : Netflix, Inc. | onlnfr : Meta Platforms Inc.

IN imssoft : Streaming Services | i3302 : Computers/Consumer Electronics | i971 : Audiovisual Production | i97411 : Broadcasting | iadv : Advertising/Marketing/Public Relations | ibcs : Business/Consumer Services | icph : Computer Hardware | iint : Online Service Providers | itech : Technology | i8395465 : Multimedia Content Services | icomp : Computing | idistr : Media Content Distribution | imed : Media/Entertainment | i8395464 : Internet Search Engines | isocial : Social Media Platforms/Tools

NS c22 : New Products/Services | ccat : Corporate/Industrial News | gent : Arts/Entertainment | m11 : Equity Markets | ncolu : Columns | nimage : Images | npag : Page One Stories | cexpro : Products/Services | gcat : Political/General News | mcat : Commodity/Financial Market News | ncat : Content Types | nfact : Factiva Filters | nfce : C&E Exclusion Filter | nfcpin : C&E Industry News Filter

IPD Barrons.com

IPC AAPL

PUB Dow Jones & Company, Inc.

AN Document B000000020220916ei9j000dx

BARRON'S

HD **Forget a Fed Pivot. Rates Will Stay High As Inflation Persists.**

BY By Lisa Beilfuss

WC 1,069 words

PD 19 September 2022

SN Barron's

SC B

PG 29

LA English

LP

The latest consumer-inflation data helped firm up a new consensus around tougher interest-rate policy this year before the Federal Reserve flips in 2023. But Fed watchers might still be underestimating the inflation problem; they should bet on a rate plateau over a pivot.

When the Labor Department released its August consumer price index, it left little doubt that inflation is broad, sticky, and demand-driven. Consider that the Federal Reserve Bank of Cleveland's median CPI, which drops outliers to measure underlying inflation, rose a record 6.7% from its reading a year earlier. As Michael Ashton of Enduring Investments notes, about 70% of the components in the CPI increased at an annual pace greater than 6% last month. In the decade before the pandemic, that share was 10% or less.

TD

Economists and investors now expect bigger rate increases at each of the Fed's remaining three meetings this year, starting with at least a 0.75 percentage-point boost on Sept. 21, and ending with a policy rate of 4% to 4.5% by early next year. Yet, traders are still betting on a quick Fed pivot, CME data show, with about half a percentage point in rate cuts expected between next March and December.

This increasingly is folly. The latest CPI data undermine what has been the consensus view that the worst is over.

First, the drop in headline inflation reflected falling energy prices. But China's reopening from Covid lockdowns will boost oil demand, and RBC global energy strategist Michael Tran says that a host of variables—including the end of government strategic-reserve drawdowns—present upside risks to oil.

Second, the labor shortage will continue to drive prices of services higher.

Third, it will take about a year for early signs of cooling shelter prices to show up in inflation data, in which housing makes up a quarter to a third of major baskets. As Ashton of Enduring Investments points out, all it would take to match prior highs in the CPI, excluding food and energy, is a 0.4% rise in September from August. Last month, core prices rose 0.6% month over month.

One explanation for persistent Fed-pivot bets is the slowdown in the August producer price index that was reported a day after the CPI. The logic is that decelerating wholesale prices will flow through to consumers, auguring softer CPI prints. But that assumption is flawed.

But "let's talk about what is happening now, rather than what happened to the PPI last month," says Richard Farr, chief market strategist at Merion Capital.

It's futile to extrapolate from August PPI data when the prices for natural gas, diesel, corn, cotton, and lumber this month are up 124%, 107%, 37%, 24%, and 19%, respectively, from their levels a year earlier.

Another reason for persistent pivot expectations is the notion that more-aggressive monetary policy would conceivably bring about a faster and deeper recession. If economists at Deutsche Bank are right, and the Fed hikes to 5% by early next year, a deeper-than-expected downturn is inevitable. But it might not be so simple this time, given how fast inflation is running and because of its nature.

Vincent Deluard, director of global macro strategy at StoneX Financial, outlines several reasons why the Fed has no choice but to remain hawkish, at least through next year.

First, expectations for the central bank to cut rates next year reflect what he calls "immaculate disinflation," a scenario only possible if energy tabs keep falling. That is a tough bet, given that they currently are driven by geopolitics at least as much as by economics. Domestic supply is constrained, and reports suggest that the Biden administration may start refilling the strategic petroleum reserve sooner than anticipated.

Second, inflation isn't just sticky, but structural. A significant swath of workers are still missing from the labor force—and unfavorable demographics suggest that the problem isn't going away—while the transition to green energy requires more resources for similar output.

Third, persistent inflation begets higher inflation because the longer it lasts, the more it changes behaviors and expectations. That is playing out. Consider the 24% wage increase, and $11,000 immediate payout, for locomotive engineers and conductors in the deal announced this past week to avert a U.S. rail strike. And consider the record decline in bank deposits in the second quarter, a sign that households are leaving less money in the bank and spending it more quickly.

Fourth, Deluard predicts a rise in the velocity of money as inflation squeezes budgets, households keep less in the bank, and credit-card balances rise. For context, the velocity of money is the number of times a dollar is spent to buy goods and services per unit of time. Rising velocity means more transactions are occurring. Velocity plunged at the start of the pandemic as deposits surged and loans dropped, but there are early signs of a coming pickup, as inflation squeezes budgets and credit-card balances climb.

Even a small pickup in velocity at a time when the money supply is high could propel prices higher. Deluard says that such an advance would offset downward pressure on the money supply from the Fed's quantitative-tightening program.

Rising loan-to-deposit ratios illustrate Deluard's point. Deposits are falling, while loans are growing by double digits at the major banks, and Deluard calculates that a return to a pre-Covid loan-to-deposit ratio of 75% would require the issuance of about $2.5 trillion in new loans from the big four U.S. banks alone. The trend is better for small banks; Deluard notes that the loan-to-deposit ratio of the KBW Regional Banking Index (ticker: KRX) recovered to 77% in the latest quarter from a low of about 70%.

Sid Dinsdale, chairman of Pinnacle Bancorp, says his bank's loan-to-deposit ratio is finally starting to trend higher, rising to 69% from 66% last year, as rising interest rates are only cooling mortgage lending so far.

Says Dinsdale: "The sky is clear, but a storm will come at some point." The problem is that elevated inflation is part of the storm—and may remain, despite it.

Write to Lisa Beilfuss at lisa.beilfuss@barrons.com

CO frbcl : Federal Reserve Bank of Cleveland | fed : Board of Governors of the Federal Reserve System

NS e12 : Monetary Policy | e1103 : Inflation Figures/Price Indices | e11 : Economic Performance/Indicators | ecat : Economic News | ecpin : Consumer Price Index | npred : Economic Predictions/Forecasts | ncat : Content Types

IPD Barrons.com

IPC G/FED

PUB Dow Jones & Company, Inc.

AN Document B000000020220917ei9j0002t

BARRON'S

HD Work-From-Home Has Legs. The Office REITs Feel the Pain.

BY By Jack Hough

WC 1,091 words

PD 19 September 2022

SN Barron's

SC B

PG 11

LA English

LP

Get back to the office, say CEOs like Jamie Dimon and Elon Musk. I couldn't agree more. Exchanging ideas in person is the lifeblood of any thriving enterprise. Give me 50 hours in the big city any week—no, 60. Add 10 for commuting—that's quality audiobook time.

Still there? Sorry—sometimes management reads the first few lines. Between us, I'm following a standard hybrid plan of high-output isolation mixed with strategic visibility. On the busiest work days, I roll out of bed and straight into business slippers, avoiding human contact at all costs. On office days, I do a bit of extra noisemaking to leave the impression that I was there for longer. Squeaky shoes and jingly pocket change help.

TD

Office REIT yields of around 7.5% speak volumes about work-from-home expectations. That's more than double the average payout for other types of real estate investment trusts. The market is saying that payment cuts are coming, suggesting that occupancy levels aren't going to bounce back to former levels soon.

"If we don't see signs of organic growth bottoming in the next 18 months, we think dividend cuts may be back on the table to preserve capital and reduce leverage," wrote Morgan Stanley analyst Ronald Kamden this past week.

Office REITs have fallen harder than the rest of the group this year, and the average big one goes for just seven times next year's projected funds from operations. That's half the broader REIT average. Before Covid, the discount was 12%. Office landlord incomes are getting a lift from a bounceback in variable fees on things like parking, but vacancies have crept higher. REITs with New York City exposure enjoyed occupancy percentages in the mid-to-high 90s a few years ago. Now they're in the high 80s to low 90s.

Kamden reckons that nearly all the office REITs he covers will post lower funds from operations next year. Cash balances will help, but if landlords want to preserve cash, many will need to raise outside capital. Kamden is bullish on an office REIT called Highwoods Properties (ticker: HIW), which yields 6.7% and operates in Sun Belt markets with lower exposure to work-from-homers. But he recently reiterated bearish calls on New York heavyweight Vornado Realty Trust (VNO), which pays 8%, and the smaller Office Properties Income Trust (OPI), with exposure to Washington, D.C.; Chicago; Atlanta; and Silicon Valley. It pays 13%.

There are better income opportunities, including outside of REITs. The market strategists at Morgan Stanley expect dividend stocks in general to outperform as inflation eventually comes down from peak levels. They recently ran a screen for promising ones, then asked the firm's industry analysts which to prefer. Some of the picks are expected to pay more than 4% in dividends next year while providing total returns over 30%. Be reasonably confident in the first number but only prayerful about the second.

On that list are Ohio utility FirstEnergy (FE), which for now yields 3.8%; drugmaker AbbVie (ABBV), 3.9%; East Coast banker Citizens Financial Group (CFG), 4.5%; and wheeze facilitator Philip Morris International (PM), 5.4%.

As for the future of offices, economists say a labor shortage has shifted power to wage-earners, who want better work-life balance. They must be talking about younger ones. As a Gen-Xer, I'm motivated more by traditional business values, like greed and insecurity. I expect to gradually make more frequent trips to the office. For now, if anyone important is looking for me, you just heard me jingling into a meeting, and it sounded important.

Let me turn to something tangentially related to this week's cover story: how to charge customers for sitting through advertising. Last week in this space I mentioned Apple's (AAPL) yearly iPhone presentation. It's free, of course. Cupertino could learn a thing or two by looking south, to Anaheim, where Walt Disney (DIS) just held a typically biennial event called D23 Expo.

Tickets were $89 for one day, $229 for all three. Choice seating ran $899. Buyers had to belong to a fan club called D23, after Disney's founding year of 1923, at gold level, which costs $99.99 a year. And they had to hurry, because expo tickets sold out in July. These lucky few—well, enough to pack the Anaheim Convention Center, which can hold 7,500—got to hear about things like minor ride enhancements and new character greetings. For example, the Star Wars land will soon have a Mandalorian walking around with an animatronic Grogu (baby Yoda to non-sticklers).

I mention this because I just returned from my first Disney World trip since before the pandemic. By now you might have heard that ticket prices have soared, and there's a new upcharge for something called Genie+ to avoid punishing ride waits, plus another for something called Individual Lightning Lanes on rides too popular to be part of Genie+. Availability can run out. Effectively at 7 a.m. there's a new show called Parents Frantically Poking Smartphones to Buy Privileged Access to Slinky Dog Dash.

It's hard to quantify true Mickeyflation, because some previous freebies are gone, like the bus from the airport. But I'd guess that my costs were up 40%, fun was down 20%, and the kids were 15% whinier. That last one is on me—they turned feral from too much screen time during the pandemic.

All of this has done wonders for Disney's park operating margins, but grumbling customers have taken to switching CEO Bob Chapek's last name to Paycheck. I'm watching for signs of waning demand, but not seeing them yet. And the fact that so many paid so much for so little at the D23 Expo gives me confidence in the cash flows.

But I'm vacationing closer to home from now on, not least because airline travel has come to resemble a porta-potty visit—sometimes necessary, but never good. I've got my eye on Bushkill Falls, which they call the Niagara of Pennsylvania. Park entrance is $15, and there's a $3 charge for a trail map, but no lightning lanes, so long as the weather holds.

Write to Jack Hough at jack.hough@barrons.com. Follow him on Twitter and subscribe to his Barron's Streetwise podcast.

IN i1 : Energy | ibnk : Banking/Credit | iinv : Investing/Securities | ifinal : Financial Services

NS gpersi : Personal Investments | gtcom : Telecommuting | gbal : Work-Life Balance | gcat : Political/General News | gjob : General Labor Issues | glife : Living/Lifestyle | gpersf : Personal Finance

RE usa : United States | namz : North America

IPD Barrons.com

IPC AAPL

PUB Dow Jones & Company, Inc.

AN Document B000000020220916ei9j000gp

BARRON'S

SE Special

HD **An Independent Advisor for You --- As the advisor industry explodes, investors face a wealth of choices**

BY By Steve Garmhausen

WC 1,931 words

PD 19 September 2022

SN Barron's

SC B

PG S2

LA English

LP

Until the 1990s, massive Wall Street brokerage firms all but owned the market for investment advice. But amid growing demand for investment guidance and financial planning, big-name firms such as Morgan Stanley and Merrill Lynch now have some serious competition.

Independent advisors, often working within registered investment advisor, or RIA, firms, are multiplying at a breakneck pace. From 2012 to 2021, the number of such firms in the U.S. increased 41%, to nearly 15,000.

TD

"There's a bull market for advice," says David Canter, president of Bluespring Wealth Partners and a longtime leader in the financial advisory field. "And that's backed up by the fact that the number of independent advisors just continues to grow."

As the industry matures, some very large players are emerging. The biggest, Santa Clara, Calif.–based Edelman Financial Engines, manages some $290 billion in 1.6 million accounts for clients across the country. Creative Planning, based in Overland Park, Kan., manages $134 billion in about 165,000 accounts. Mariner, also in Overland Park, boasts $55 billion in approximately 90,000 accounts.

As firms have clamored for market share and the economies of scale that come from growth, a robust mergers-and-acquisitions market has evolved. Indeed, the number of acquisitions within the industry has increased for eight straight years. Last year saw 242 deals, according to consultancy DeVoe & Co. This year's activity is on track to surpass that record.

The industry's evolution means that investors seeking to work with an independent firm now have a plethora of options. Firms vary based on the kind of client they're best at serving, the list of services they offer, how they invest, how they charge for their services, and more. Learning the landscape can help you narrow down a list of firms you would like to work with and find a good fit with an advisor.

The two rankings in this special report focus on independent advisors. Our Top 100 RIA Firms ranking, now in its seventh year, is based on both qualitative and quantitative criteria, including the assets a firm manages and the revenue those assets generate, its regulatory record, staffing levels and diversity, technology spending, and succession planning. Our ranking of top individual advisors uses a similar set of quantitative criteria. Qualitative factors include the advisors' experience, advanced degrees and industry designations, the composition of their teams, and, of course, their compliance records.

Independent RIA firms are distinct from Wall Street wirehouses—Merrill Lynch, Morgan Stanley, UBS, and Wells Fargo, which together employ more than 50,000 advisors. Often affiliated with banks, wirehouses have massive wealth management units with stock-brokerage roots. At the end of 2021, Morgan Stanley reported having $4.93 trillion in total client assets, dwarfing even Edelman Financial Engines' $290 billion.

A key point that independent RIAs often promote is that they are legally bound by a fiduciary standard, meaning they owe clients an ongoing duty of loyalty and care covering all aspects of their relationship. In contrast, financial professionals working under brokerage regulations at wirehouses and smaller brokerage firms are bound by what is generally seen as a less rigorous standard of care known as Regulation Best Interest. Things can get confusing, however, because in addition to brokerage accounts, wirehouses offer fee-based wealth management accounts that are subject to the same fiduciary standard governing independent RIAs.

Indie Appeal

The universe of independent RIA firms contains a variety of service models. The most common one is the full-service wealth management model, which includes investment advice and financial planning. These firms' value proposition is essentially that they can assign price tags to your life goals—retirement, college funding, and so on—and, by identifying how much you need to save and how it should be invested, position you to reach those goals. Full-service firms can review your insurance coverage and help you fill gaps.

Other firms limit their services to investing. Whitefish, Mont.–based Stack Financial Management manages stock portfolios only, and has a strong record of doing so. Wellesley Asset Management, in Wellesley, Mass., specializes even further, running portfolios of convertible bonds. It has boosted its assets under management from $100 million in 2008 to more than $3 billion today.

Firms that offer only financial planning are less common, but they make sense for clients who prefer to consult with a professional and then invest on their own, or who don't have much to invest but need sound financial advice. Planning-only advisors often charge an hourly rate, which makes them accessible to those who don't yet have the levels of investment capital that full-service advisors often require. Some offer a subscription model, with fees ranging from $50 to $500 per month depending on the level of service and support provided. However they charge, planning-only advisors can provide a second opinion on investments and advice on key decisions such as when to retire and file for Social Security, and how to draw down retirement accounts.

Niche Services

As the independent-advisor industry has matured, specialty practices have sprung up. For example, some practices specialize in serving LGBTQ+ clients, whose distinct needs often include funding adoption and other forms of family creation. Many advisors are experts in serving employees of a specific industry or even a specific employer. Mainstay Capital Management, in Grand Blanc, Mich., is a classic example: 75% of its clients work, or worked, at General Motors. Led by David Kudla, himself a former GM executive, Mainstay advisors are intimately familiar with the company's compensation and benefits.

"When an advisor serves your niche—assuming they're a good planner and investor, that their fees are appropriate, and so on—that's an absolute plus from our point of view," says Doug Black, founder of SpringReef, an advisor search firm for very wealthy families and institutions.

It might seem misguided to talk about serving women as a specialty, since they make up 51% of the population. But the investment-advice industry has long been dominated by men, who have often geared their communication to male clients, even when working with married couples. Luma Wealth Advisors, in Cleveland, takes a different tack. It is one of a growing number of firms that are run by women and are built to serve primarily women. Luma focuses on widows, divorcées, business owners, and other women with net worths of $2 million to $25 million.

Research has shown that women place significant value on empathy when choosing an advisor, so the firm has made empathy a cornerstone of its culture: The trait is a key factor in hiring decisions and even factors into compensation decisions.

Luma and other RIA firms that cater to women aren't just filling a perceived gap in the advice industry; they're also positioning themselves to gain business from a segment of the population that's poised to get a lot richer. Over the next four decades, women will inherit a projected $28.7 trillion, according to a study by New York Life Investments.

On Target?

Another way to view the independent-advisor landscape is through the lens of their target client. A swath of firms focus on the so-called mass-affluent population—households with no more than $1 million or $2 million of investible assets. Edelman Financial Engines is a good example. Hourly planners tend to serve this clientele, as do robo-advisors, which offer automated investment services and often provide access to a human advisor for an additional fee.

The vast majority of full-service independent firms target households with $1 million to $10 million to invest. They typically provide planning and investment management and charge a fee that equates to about 1% of assets under management. In some cases, these midtier firms offer "concierge services," such as paying bills and balancing checkbooks.

For so-called ultrahigh-net-worth clients, those with at least $10 million to invest, private wealth managers and family offices provide much more high-end service, including access to private investments. More emphasis is placed on estate planning, philanthropy, and tax management. These firms provide concierge services of a higher order—running payroll for household employees, for instance—and if you need to buy a yacht, aircraft, or other big-ticket toy, they've got you covered.

It's a good idea to work with a firm where your wealth level doesn't make you an outlier, says Black. If you're far wealthier than your firm's typical client, your advisor probably doesn't have much experience in serving your needs, and might not have access to high-end investments like private equity and hedge funds. If you're smaller, you're likely to get less attention—unless, that is, you have a clear path to wealth, such as employee stock options.

"You want to work with an advisor who has clients that look and feel just like you," says Black. Advisor firms commonly segment their clients according to their profitability—referring to them as "A," "B," and "C" clients. Not surprisingly, clients with bigger accounts tend to get more attention. For instance, if there's dramatic movement in the markets, advisors will often reach out to clients in the order of their account sizes, Black says.

While the assets-under-management, or AUM, fee is usually the dominant compensation model, even at the very high end, different arrangements are gradually becoming more common. Firms serving the very wealthy have started to offer retainer arrangements, with a flat annual fee based on the complexity of the client's needs. Advisors like these arrangements because they're a way to get paid for work beyond the investment portfolio, from advice on real estate holdings to the financial education of heirs.

Atlanta-based Balentine rolled out a retainer option in 2017. It works with clients to understand their situation and goals, then proposes a scope of services and specifies what they will cost. The agreement must be renewed annually.

Such an approach eliminates real or perceived conflicts of interest on advisors' part. If an advisor is paid purely based on the size of the client's investment portfolio, it might be tempting to advise the client to deploy risky strategies in hopes of rapidly growing the portfolio (meme stocks, anyone?). While no reputable advisor would do that, the AUM model provides an incentive to do so.

Navigating Fees

Some firms offer a blend of fee types. Savant Capital, in Rockford, Ill., charges hourly fees or retainer fees for tax and accounting services, and an asset-based fee for traditional planning and investing services.

For a closer look at firms that serve clients of different wealth levels, read our interviews with executives from Edelman Financial Engines, Altair Advisers, and MAI Capital Management, which offer insight into each firm's service model.

When selecting an advisor, it's wise to do your research carefully. Select four firms that have a clean regulatory history, serve clients like you, charge reasonable fees, have a reputation for good service, and can demonstrate proven investment capabilities, Black suggests. Let them make their pitch to you, then choose two finalists and ask deeper questions before making your choice. This is a good approach, regardless of where you fall on the wealth spectrum, Black says. "If they want you to entrust your life savings to them, they need to earn it," he says.

Email: rankings@barrons.com

IN i831 : Financial Investment Services | i83108 : Investment Advice/Research Services | i814 : Banking | ibnk : Banking/Credit | ifinal : Financial Services | iinv : Investing/Securities | iwealth : Private Banking/Wealth Management

NS gpersf : Personal Finance | ccat : Corporate/Industrial News | ciprof : Industry Profiles | cdom : Markets/Marketing | gcat : Political/General News

RE namz : North America | usa : United States

IPD SNRTOPINDIEADVISORS

IPC GM

PUB Dow Jones & Company, Inc.

AN Document B000000020220916ei9j0008d

BARRON'S

CLM Mutual Fund Profile

HD **A Relentless Focus on Growth**

BY By Debbie Carlson

WC 1,007 words

PD 19 September 2022

SN Barron's

SC B

PG 23

LA English

LP

Mid-cap companies are usually defined as having a market capitalization of $2 billion to $10 billion, but Amy Zhang prefers to measure by revenue instead.

As the portfolio manager of the $475 million Alger Mid Cap Focus fund (ticker: AFOZX), Zhang looks for smaller mid-cap companies—those with revenue of $500 million to $1 billion—that generate strong free cash flow and operate in a field large enough to allow them to take market share. That enables shareholders to benefit from compounding as the company grows. "To use a baseball analogy, these companies are in the third or fourth inning," she says.

TD

A no-load fund, Mid Cap Focus' three-year annualized return of 14.9% puts it in the top 10% of its peers, handily beating the mid-cap growth category and the Russell Midcap Growth index, net of the 0.68% annual fee. It is sold largely through financial advisors and has an investment minimum of $500,000. Mid Cap Focus A shares (ALOAX), which are the same investment, are now available for a $1,000 minimum and a 0.96% fee at brokerages such as Charles Schwab and Fidelity. There is a 5.25% initial fee.

The fund has lagged behind the index in the past year, as value stocks have held up better in a down market than growth stocks. But Zhang is sticking to her guns, buying beaten-up tech stocks that she regards as bargains.

Her differentiated investing approach comes from 20 years of managing both small- and mid-cap growth strategies, including 13 years co-managing the Morningstar gold-medalist Brown Capital Management Small Company fund (BCSIX). She joined Alger in 2015 to launch Alger Small Cap Focus (AGOZX), and in 2019 launched the four-star, Morningstar silver-medalist Mid Cap Focus fund.

Zhang seeks firms with business models that produce durable revenue growth with earnings visibility, such as subscription models or companies that supply critical components. She wants firms that can grab share and maintain an advantage with time-saving or problem-solving products.

"These firms are valuable and differentiated; they can have pricing power, which is very fitting in this market," she says.

Strong managers are key, and Zhang looks for a "sort of yin and yang," meaning firms that have a visionary CEO and a chief financial officer focused on profitability, to balance growth and profitability. She shies away from companies that aren't focused or don't have an efficient sales strategy.

Mid Cap Focus is a high-concentration portfolio of about 50 names, and Zhang prefers to hold companies for three to five years, using intrinsic value as one reason to buy or sell. The three years since she launched Mid-Cap Focus have been volatile, leading to significantly more turnover than she'd like—as much as 250% last year.

After Mid Cap Focus returned nearly 85% in 2020, she sold several highflying names, including user-authentication company Okta (OKTA) and videoconferencing firm Zoom Video Communications (ZM), noting that "they really overshot their valuations." Mounting inflation and the Federal Reserve's interest-rate-raising campaign prompted other sales.

The current market cycle favoring value is hitting Mid Cap Focus' year-to-date and one-year returns, down 28% and 33%, respectively. The fund is in the bottom 10% versus peers and is lagging behind the index.

Another reason for the fund's weak performance is a slight overweight in technology versus peers and the index this year. Zhang describes it as an opportunistic move as she looks to "find the gems in the rubble" of this year's tech selloff. She says several tech firms remain high-quality companies as their multiples contracted.

One of the companies Zhang bought during the tech rout earlier this year was CrowdStrike Holdings (CRWD), re-establishing a position in the cybersecurity firm after taking profits in late 2021. The first-quarter tech selloff made the firm attractive again from a long-term perspective, she says.

She considers CrowdStrike an emerging leader in the enterprise endpoint security market, an end-user device security system. CrowdStrike is taking market share from companies such as Qualcomm (QCOM) and McAfee, she says. The cloud-based system is different than competitors' offerings, since once customers buy the system they often add additional services, creating durable revenue streams. "It's both a high-unit-growth and expansion-of-wallet share," she says.

Another recent tech addition is payroll-service provider Paylocity Holding (PCTY). It competes against the likes of Automatic Data Processing (ADP) and Paychex (PAYX) and currently has about 33,000 customers—compared with one million combined for ADP and Paychex, she notes. It is also expanding into human-capital management. Zhang hopes that Paylocity can be a long-term compounder, noting that it increased business during the pandemic.

A number of the companies that Mid Cap Focus owns have pricing power, which should mitigate inflation pressure. One example is Heico (HEI), a company with two business units: a replacement-parts supplier for aircraft, and one for electronics for niche applications in aerospace and defense. As a Federal Aviation Administration–approved third-party parts supplier, Heico makes parts 20% to 40% cheaper than original-equipment manufacturers and is the largest in its category. FAA-approved aftermarket-parts suppliers represent only 3% to 4% of the commercial aerospace aftermarket, providing a long runway for growth, she says.

After the volatility of recent years, Zhang feels the portfolio is set up well. The companies she owns have strong balance sheets and little need to tap capital markets for funding, shielding them from higher rates.

"I feel very good about the next one to three-plus years. I think most of the bad news regarding rates are priced in," she says. "Even smaller companies can grow in a rising-rate environment, when you have the strong balance sheets where you can be self-funded and you have some truly idiosyncratic drivers."

Email: editors@barrons.com

IN i8150211 : Mutual Funds | ibnk : Banking/Credit | iinv : Investing/Securities | i81502 : Trusts/Funds/Financial Vehicles | ifinal : Financial Services

NS c15 : Financial Performance | c181 : Acquisitions/Mergers/Shareholdings | c25 : Information Technology | c313 : Market Share | cacqu : Acquisitions/Mergers | cactio : Corporate Actions | ccat : Corporate/Industrial News | gpersi : Personal Investments | ncolu : Columns | npeo : People Profiles | c151 : Earnings | c18 : Ownership Changes | cdom : Markets/Marketing | gcat : Political/General News | gpersf : Personal Finance | ncat : Content Types | nfact : Factiva Filters | nfcpex : C&E Executive News Filter | nfcpin : C&E Industry News Filter

IPD Barrons.com

IPC ADP

PUB Dow Jones & Company, Inc.

AN Document B000000020220916ei9j00002

BARRON'S

CLM Interview

HD **Long Live the Dollar, and Other Currency Calls**

BY By Reshma Kapadia

WC 1,814 words

PD 19 September 2022

SN Barron's

SC B

PG 26

LA English

LP

Jens Nordvig grew up in Denmark when the country was facing bankruptcy. In the fifth grade, he started researching how a nation could find itself in such a precarious financial position, eventually giving his classmates a presentation on government and external debt.

Nordvig eventually became an economist, and later, co-head of global currency research at Goldman Sachs and a strategist at Nomura. He drew on these experiences, and a fascination with macroeconomic policy, to found Exante Data, a New York–based firm that analyzes data to help institutional investors navigate global markets. He is the firm's CEO.

TD

Some clients balked at Nordvig's prediction that the European Central Bank would turn hawkish and lift interest rates meaningfully. But that call, reiterated during the year, now looks prescient, after the ECB's historic 0.75 percentage point rate hike and indications that it will tighten further to tame inflation. Energy prices in Europe have soared since Russia's invasion of Ukraine and Moscow's halt of gas supplies to a major European pipeline.

Macroeconomic developments play out in currency markets, one of Exante's specialties. Currencies have had an especially volatile year, with the U.S. Dollar Index rising 14% and the euro and yen falling to two-decade lows. Barron's spoke recently with Nordvig about why markets might be in for more pain, why it's too early to bargain-hunt in fixed income, and why the dollar is on track for its best year ever. An edited version of our conversation follows.

Barron's: Let's start with your big- picture view on the global economy.

Jens Nordvig: It's a whole new macroeconomic regime. If we have inflation, central banks can't have easy policy; their job is to be tight. Everyone grew used to an absence of inflation for 20 to 30 years. Now, we have inflation. Everyone thought the worst was over. Then, we got a reading on the U.S. consumer price index [up 8.3% in August from the year-earlier level] that showed it's not.

We just saw the biggest equity-market move ever on an economic data point after the release of the August CPI: a four-standard-deviation move [the Dow Jones industrials fell 1,300 points Tuesday]. People can't get used to this idea that inflation won't last for a couple of months, but rather a couple of years. The August CPI data showed that even if gas prices are coming down and commodities have turned lower, goods prices still rose. Inflation is broad-based.

What is the biggest risk now for markets and the economy?

That the Federal Reserve keeps going, and lifts interest rates further. Even after the August CPI, the market is pricing in expectations that the Fed will pivot and cut rates later next year. What if the Fed must continue to move rates higher next year? That will be a total shocker [for the markets].

Should investors brace for more dramatic moves?

We aren't going back to 2019 anytime soon. Every time the economy was in a bit of trouble, there were emergency facilities and zero rates and backstops. This time, we may have some bankruptcies. There are no monetary-policy safety nets. Investors might not want just to be [long] equity or credit. Maybe they want a lot of cash. You can buy Treasury bills yielding 3% without fees. In fixed income, you don't want to get in too early. Wait until we have had a dramatic repricing of the market, following the moves by the Fed—probably next year. When will it be time to dive into European and U.S. stocks? When you think the monetary-policy tightening cycle has run its course. In the U.S., we need to see core inflation come down. Inflation likely will moderate but stay above target, so we will see some fist-fighting within the Fed.

How high does the Fed need to boost interest rates?

We won't see 75-basis-point [hikes] forever, but there may be a scenario in which the Fed hikes rates aggressively this year, and then next year does a bunch of 25 basis-point hikes. [A basis point is 1/100th of a percentage point.] That's not priced in.

What is the path ahead for the ECB?

Europe has probably had the biggest energy shock ever—bigger than in the 1970s. Europe's energy bill has jumped from 3% of gross domestic product to 8% very quickly, and that has taken the euro down.

The ECB will have to tighten aggressively because the inflation problem is so big—and not just with energy, but also wage inflation picking up. The dovish camp within the ECB that essentially drove policy has lost its credibility. Different people are setting the agenda. [German economist and hawkish ECB board member] Isabel Schnabel is now the de facto leader. The ECB is probably going to be more decisive than people thought.

How do you see Europe managing the energy crisis?

How quickly they can get alternative suppliers up and running, and how well they can manage saving the correct industries [such as energy producers], will be important in determining whether this is a huge crisis for a year or a multiyear crisis. Since the supply-and-demand balance is so tight, any extra accident that disrupts supply will have a much bigger impact [than usual].

There are a lot of moving parts, including how cold the winter is and when the French nuclear industry kicks in after a hard time this summer with a heat wave. What happens militarily will be important, too. We have had dramatic developments around Ukraine that give [Russian President Vladimir] Putin less leverage. If he is losing territory quickly, it makes a cease-fire with conditions that Ukraine can accept more possible.

How would markets react to a cease-fire?

That's not our central case, but it has become more likely. Energy prices would ease and the euro would rally. But that's more for 2023 than in the near term. It is hard to imagine [energy] prices collapsing, unless Russia starts supplying gas again. It may do that next year, but it is hard to imagine it would do so this winter. For the next six months, Europe will have a tricky situation.

Yet, you aren't as gloomy about Europe as some others are. Why?

[Negative] sentiment was so extreme that more positive scenarios should also be considered. The fact that Ukraine is doing better militarily is a positive. Europe's policy initiatives to cap prices, for example, are a positive.

There are positive developments from a bad starting point. Something breaking the right way in Europe has more probability now, but that isn't the case for China. We recently recommended that clients book profits on long dollar trades versus a basket of currencies, but still recommend going long dollars versus the Chinese yuan.

Can the dollar continue its move higher?

This could be the biggest year ever for the dollar, bigger than the move in 2001, and there is a chance it beats its 1980s performance. There are so many things supportive of the dollar: monetary policy, the view that the U.S. economy can take more hikes than the market thought, and the U.S. becoming a big energy exporter. Typically, the dollar collapsed when energy prices went higher. That has been flipped on its head, now that the U.S. is going to be the biggest supplier of energy [gas] to Europe.

China's currency, on the other hand, has declined sharply this year. How bad is the situation in China?

China has one of the biggest bubbles in the world in its real estate market, which is imploding. That is a multiyear problem. The banks aren't going to go under because they are mostly state-owned enterprises and will be backstopped. But it's terrible for growth because the economy depended on the housing sector and construction.

On top of that, they have a Covid drag and [there are questions] about whether it turns into a social and political crisis. China had been growing for so long that it didn't have a test of what happens if growth is zero—or negative. [Chinese leader Xi Jinping] isn't going to get kicked out, but maybe there are more diverse voices that create political uncertainty.

China's policy makers have been reluctant to take on more debt needed for a massive stimulus push. Will they eventually give in to help the economy recover?

They overstimulated for so long and had such excessive credit growth and overbuilding that there's not much they can do. They have to provide wholesale transfers [of money] to consumers. I don't think people realize how big of a structural shift is going on around China. One important indicator is foreign direct investment, which has collapsed. That tends to be a slow-moving variable, not a one-quarter type thing—but the shift tells you that multinationals are feeling overexposed to China.

Investors are also worried about a structural shift toward deglobalization. Would that threaten the dollar's dominance?

People have predicted the dollar's demise every year—for the past 40 years. Can you really have proper competition to the dollar from these other currencies, when their issuers have such severe problems? China still has a closed capital account and controlled equity market; it doesn't have free allocation of capital, and its growth engine is collapsing. Europe [is facing] the biggest energy crisis it has seen.

Saudi Arabia has bought more U.S. equities in the past three months than ever before. Why? They want to have a return on assets. Are they going to get it in China? No. Russia? Nope. If Saudi Arabia can see that Russia is going to lose [in Ukraine], they will gravitate back to the euro and dollar [for oil transactions]. There's nothing in what I see that points to any challenge to the U.S. dollar.

What is your most contrarian call right now?

Some emerging markets are safer than the [old] havens. There is a perception that when the U.S. dollar is strong, some emerging markets are in serious trouble. We are seeing the opposite. In the latest month of further dollar strength, the only currencies not weakening are Latin American. LatAm [policy makers] didn't do experimental monetary policy, and started hiking rates when they sniffed inflation, and it's helping. It's an example of how everything is different this cycle. Places to look include Mexico, Indonesia, maybe South Africa, and Brazil.

Thanks, Jens.

Write to Reshma Kapadia at reshma.kapadia@barrons.com

CO eurcb : European Central Bank

NS e12 : Monetary Policy | e1102 : Money Supply Figures | e1201 : Central Bank Intervention | e52 : Euro Zone/Currency | ecat : Economic News | gpersf : Personal Finance | gpersi : Personal Investments | m13 : Money/Currency Markets | m131 : Money Markets | m132 : Foreign Exchange Markets | mcuop : Currency Options | mforx : Forex Derivatives | ncolu : Columns | nitv : Interviews | e11 : Economic Performance/Indicators | gcat : Political/General News | m15 : Derivative Securities | mcat : Commodity/Financial Market News | ncat : Content Types | nfact : Factiva Filters | nfce : C&E Exclusion Filter | nfcpex : C&E Executive News Filter

RE namz : North America | usa : United States

IPD Barrons.com

IPC G/FED

PUB Dow Jones & Company, Inc.

AN Document B000000020220916ei9j0005l

BARRON'S

CLM Market View

HD **Market View**

WC 1,020 words

PD 19 September 2022

SN Barron's

SC B

PG 41

LA English

LP

This commentary was issued recently by money managers, research firms, and market newsletter writers and has been edited by Barron's.

The Poor(er) U.S. Consumers

TD

The Week in 60 Seconds Wells Fargo Sept. 16: The Fed released U.S. household balance-sheet statistics for the June quarter, and as we forecasted three months ago, a drop in equity values drove a $6 trillion (4.1%) decline in aggregate net worth, to $144 trillion. This was the largest quarterly decline in net worth since the onset of Covid (1Q20: -5.1%), and before that, the financial crisis (4Q08: -5.0%).

Equities fell 17%, from $38.4 trillion, and to only 19.7% of total assets (Q1-end: 22.8%). The 19.7% is the lowest since 2Q20. The decline in equities was only slightly offset by rising real estate values. Cash ticked slightly lower ($18.52 trillion vs. $18.65 trillion), the first decline since 2Q19.

Shrinking household balance sheets, the draw-down of excess savings, and the reliance on revolving credit suggest that the American consumer is running on fumes. A recession by the first half of 2023 may be inevitable.

Christopher P. Harvey, Gary S. Liebowitz, Anna Han

Big Chill in Housing

Commentary & Analysis Maria Fiorini Ramirez Inc. Sept. 14: For the week ended on Sept. 9, overall mortgage applications fell by a week-to-week 1.2% after easing by 0.8% in the preceding span. Applications for home purchase inched up by 0.2% after ebbing by 0.7% in the prior week. Applications for refinancing purposes dropped by 4.2% after declining by 1.1% in the previous week.

While week-to-week movements in these data can be affected by seasonal-adjustment difficulties, it is nonetheless clear that the downward trend continues for home-purchase applications. Refi applications, meanwhile, continue to decline, while mortgage rates have resumed rising.

The purchase index, after having rebounded for some time, dropped sharply in February and briefly stabilized in March; since then, it has been sinking further. A combination of substantially higher mortgage rates and a steep run-up in house prices is having a significant negative effect on demand. The refi index shows an even starker picture, with soaring mortgage rates having a chilling effect on demand for mortgage refinancing.

Joshua Shapiro

Please Listen to the Fed!

Weekly Technical Review Macro Tides Sept. 13: Wall Street has been consistently wrong about what the FOMC [Federal Open Market Committee] would do, despite being told repeatedly by FOMC members what they planned. In March, the FOMC said it would increase the funds rate expeditiously to neutral last spring and, in recent weeks, that an increase to 3.75% to 4.25% was likely. Fed Chairman Jerome Powell's Jackson Hole speech was a wake-up call, but Wall Street has continued to harbor the bullish illusion that the FOMC will be cutting rates next year. The latest consumer-price-index miss relative to CPI forecasts was a jolt, since the Street has been overfocused on inflation easing as the basis for its dovish posture. The FOMC is now far more likely to increase the funds rate by 0.75 [percentage point] at the Sept. 21 meeting than the 0.50 that I thought was possible...

The FOMC members have referenced the "extreme" tightness in the labor market for months, but investors have not been listening. Sooner or later, Wall Street will experience another narrative adjustment when the FOMC's messaging about the need to create more slack in the labor market, and an attendant increase in the unemployment rate to 5% or higher, sink in.

Jim Welsh

Don't Buy the Plunge

The Lancz Letter Lancz Global Sept. 13: Why are [we] not more positive on the stock and bond markets, especially after prices plunged through most of 2022? Typically, we would be buyers into weakness, but one year ago, our research saw the highest level of risk being taken by investors since the late 1990s. [It] was a pivotal time when investors didn't understand the amount of risk they were taking, nor the degree of risk in bonds or those 60/40 stock/bond allocated portfolios. The Russia/Ukraine conflict made our energy overweight pay off even more quickly than we expected, but other sectors will struggle from this rising interest rate and high inflationary environment. Earnings will struggle in most other sectors, so the latest plunge in valuations is not yet as appealing in the current scenario as it would have been typically. In other words, if earnings decline while many balance sheets have deteriorated, then current price/earnings ratios will need to be adjusted. It is more critical than ever to be selective, as there will be more losers than winners.

Alan B. Lancz

The Case for Europe

Commentary Advisors Capital Management Sept. 12: Europe's short-term challenges don't change the long-term fundamentals for most of Europe's companies, and even the short-term impact will be muted for many. Many larger companies, especially, don't depend solely on Europe's near-term economic fundamentals. There are several global leaders based in Europe, but with majority exposure to other parts of the world. Our holdings include worldwide industry juggernauts in such areas as food products; luxury consumer goods; semiconductor fabrication equipment; chemicals, food, and fragrance ingredients; industrial automation tools and services; 3-D design software; and biotechnology therapeutic solutions. A few of these lack meaningful competitors from the U.S. or anywhere else in the world. Those that do face competition currently enjoy a competitive edge due to the cheap euro...

European stock valuations are beyond compelling—some would say stupid cheap. The relative price-to-book ratio shows Europe's valuation at 44% of the U.S. When this ratio moved below 70% in late 2001, considered cheap at the time, European stocks outperformed U.S. stocks by 166% over the next seven years.

David Ruff

To be considered for this section, material, with the author's name and address, should be sent to MarketWatch@barrons.com.

CO fed : Board of Governors of the Federal Reserve System

NS ccat : Corporate/Industrial News | ciprof : Industry Profiles | ncolu : Columns | cdom : Markets/Marketing | ncat : Content Types

RE namz : North America | usa : United States

IPD Barrons.com

IPC G/FED

PUB Dow Jones & Company, Inc.

AN Document B000000020220916ei9j000m9

BARRON'S

HD **Amerco: Invisible Stock, Familiar Brand --- U-Haul's parent has thriving truck-rental and self-storage operations, but its shares are sputtering. Why they could move up by 50% or more.**

BY By Andrew Bary

WC 1,014 words

PD 19 September 2022

SN Barron's

SC B

PG 22

LA English

LP

Few companies are as dominant as U-Haul, which is virtually synonymous with rental trucks used by do-it-yourself movers. And few companies are as anonymous as Amerco, U-Haul's parent.

But if investors look at Amerco closely, they'll find a lot to like. U-Haul has a nearly impregnable market position, with nearly 10 times the number of rental locations as Penske, one of its top rivals. Amerco also has quietly built a large self-storage business to complement its rental operations, and that value doesn't appear to be reflected in its stock price. Amerco shares (ticker: UHAL), which are off 29% this year to $515, look inexpensive, fetching just nine times the earnings of $57 a share in its fiscal year that ended in March.

TD

Amerco, however, can't get Wall Street's attention. There are no profit estimates for the current fiscal year because there is virtually no analyst coverage of the stock, despite its $10 billion market value.

The company, led by its strong-willed chairman and president, Joe Shoen, doesn't cater to the investment community. It pays a minuscule, sub-1% dividend, doesn't buy back stock, provides limited financial disclosure, and refuses to change its nondescript name to U-Haul, which could raise its profile.

No one can force any changes. The Shoen family controls the company, owning more than half of the stock. A trust controlled by Joe Shoen and his brother Mark owns a 43% stake. Amerco fans say that, capital management aside, Joe Shoen, 73, has ably managed a great business over more than 35 years at the helm. A cost-conscious leader, he earned $1 million last year, modest by CEO standards.

"Amerco is one of the great businesses that is completely unknown on Wall Street. The brand is ubiquitous," says Steve Galbraith, chief investment officer at Kindred Capital Advisors, a Norwalk, Conn., investment manager that owns the stock. He thinks the shares are worth 50% more than their current price—not outlandish, given that they peaked last November at $769.

Others are even more bullish. "Amerco should trade slightly above the market multiple, given the consistency of the business and how little competition it has," says Bill Smead, co-manager of the Smead Value fund (SMVLX). At a market multiple, the stock would trade near $1,000.

It's hard to overstate just how dominant U-Haul is. The company says that one in five Americans move each year and that 75% of moves are "do-it-yourself." There are no data on truck-rental market share, but it's believed that U-Haul has more than 50%. Rivals include Penske and Avis Budget Group (CAR). U-Haul rents trucks and trailers (which are towed behind vehicles) at more than 23,000 U.S. locations.

U-Haul does little advertising, in large part because its trucks and trailers are rolling billboards for its services. It prices rentals on local demand. Reflecting the migration from California, a three-day truck rental from Los Angeles to Phoenix later this month costs $566, while the reverse trip is only $199. All told, the truck-rental business' revenue has grown at a 9% annual rate over the past decade.

U-Haul's self-storage business also is impressive. The industry has exploded in the past decade, and leaders like Public Storage (PSA) have generated outsize returns. "The American public's ability to accumulate junk is unbelievable, and people are incredibly bad about purging," Smead says.

Sales from U-Haul's storage operation have grown at a 16.5% clip over the past decade; its footprint has quadrupled to about 50 million square feet. Amerco has been building self-storage facilities at most of its more than 2,000 company-owned rental sites because people often find that they have unneeded stuff when they move. The company spent $1 billion on the business in its fiscal 2022.

Based on the valuations of companies like Life Storage (LSI), Galbraith thinks U-Haul's self-storage unit, which generates about $700 million in annual revenue, could be worth most of Amerco's market value. So, investors aren't paying much for the truck-rental operation, which produces most of its $5.7 billion in annual sales. Given the strength of Amerco's business, Galbraith and Smead believe that, if the Shoen family ever wants to sell, Berkshire Hathaway (BRK.B) would be an interested buyer.

After net income nearly doubled in fiscal 2022, to $1.1 billion, some investors wondered if Amerco was "overearning." But profits in the June quarter, at $17 a share, were little changed from the year-earlier level. One investor beef is Amerco's refusal to offer a regular dividend, which Galbraith says limits its pool of potential investors. He thinks it can afford to pay out $10 annually—a 2% yield. Its periodic dividends—characterized as specials—totaled just $1.50 in the past year.

Craig Inman, a portfolio manager at Artisan Partners, praises Shoen and his team, but also thinks Amerco should boost its payout. One option would be a mix of a regular dividend and a variable one tied to profits–a combination becoming more common.

On conference calls, Shoen has been noncommittal on dividends. As for repurchasing stock, he told Barron's in an email, "While there are economic calculations that support a buyback, our general attitude is to reinvest in the business so that we can better serve customers." Asked about the gap between Amerco's intrinsic value and stock price, Shoen replied, "There is no action that is off the table. I believe we can do better to communicate with investors and are attempting to do so."

Shareholders might politely applaud that effort. But buybacks and fatter dividends probably would get a standing ovation.

Write to Andrew Bary at andrew.bary@barrons.com

CO uhauii : U-Haul International Inc | amnv : Amerco Inc

IN i84803 : Truck/Trailer Rental/Leasing | ibcs : Business/Consumer Services | ibnk : Banking/Credit | iinv : Investing/Securities | i84 : Rental/Leasing Services | iautlsg : Vehicle Rental/Leasing | ifinal : Financial Services

NS c15 : Financial Performance | ccat : Corporate/Industrial News | npag : Page One Stories | reqbcs : Suggested Reading Business/Consumer Services | reqrbc : Suggested Reading Banking/Credit | reqris : Suggested Reading Investing/Securities | ncat : Content Types | nfact : Factiva Filters | nfcpin : C&E Industry News Filter | redit : Selection of Top Stories/Trends/Analysis | reqr : Suggested Reading Industry News

RE usca : California | namz : North America | usa : United States | usw : Western U.S.

IPD Barrons.com

IPC BRKA

PUB Dow Jones & Company, Inc.

AN Document B000000020220916ei9j000jh

BARRON'S

HD **Newmont Stock Is Too Cheap to Ignore. It's Time to Buy. --- The only gold stock in the S&P 500 is a hedge against uncertainty with a 5% dividend yield. The shares could have an upside of 20%.**

BY By Nicholas Jasinski

WC 1,034 words

PD 19 September 2022

SN Barron's

SC B

PG 14

LA English

LP

Gold has lost its shine of late, but gold producer Newmont might be a diamond in the rough.

It certainly hasn't been easy being a gold miner lately. As a commodity producer, you're worth as much as what you sell, and the price of gold has been sliding since it topped $2,000 an ounce in early March as Russia's invasion of Ukraine spooked markets. Then, the Federal Reserve started raising interest rates, sending the U.S. dollar higher, and it has been all downhill since then, with gold tumbling 19%, to $1,665.

TD

Gold's slide has hit Newmont (ticker: NEM) hard, with the stock down more than 50% from its April high to $42.40, its lowest price since March 2020, when gold was $1,500 an ounce.

The company has also been hurt by the same inflationary pressures affecting practically every business this year. A pair of worse-than-expected quarterly results contributed to the sharp decline in Newmont stock since April. In the second quarter, reported in July, management cited higher prices for labor, diesel fuel and other energy, and raw materials used for mining and processing gold. The company raised its all-in sustaining costs to $1,150 per ounce, from $1,050. That was a larger increase than many of Newmont's competitors at the time. Shares dropped 13% after the report.

Still, it may be time to buy Newmont stock. The dollar, up 14% in 2022, is unlikely to rise forever, and owning gold would provide a hedge in the case of mean reversion, or potential geopolitical and economic tremors. Newmont continues to increase its production of the precious metal, and its stock looks cheap. It also carries a 5.2% dividend yield, which means that investors can get paid to wait.

"Recent underperformance marks an attractive entry point for a low-risk gold producer delivering volume growth," writes Goldman Sachs analyst Emily Chieng.

Of course, everything starts with the price of gold—and lately the metal has been under considerable pressure. Higher interest rates tend to make gold, an asset that doesn't offer any yield, less attractive. It's also priced in dollars, so as the dollar rises, gold is worth fewer dollars. But a reversal in either of those two trends could send gold prices shooting higher.

"Gold has exceptional medium-term fundamentals," says Thomas Kertsos, manager of the First Eagle Gold fund. "We have record global debt levels; an equal amount of geopolitical, economic, and financial uncertainty; and now an energy crisis and a potential food crisis on the horizon."

Newmont may be the safest way to bet on a gold revival. It bulked up in 2019 via its acquisition of Goldcorp, gaining new mines, people, and other assets. Its industry-leading scale qualifies the company for the S&P 500, and it remains the only gold stock in the index. That makes it the default for generalist investors and gives it a boost from index-fund ownership, while a generous dividend makes it a target for income funds. It also operates in generally less risky regions than many other gold miners, with close to 70% of its assets in North America and Australia.

Its nearly 100 million ounces of reserves towers over all of its peers but one. Newmont produces some six million ounces of gold annually, and smaller quantities of other metals including silver, copper, lead, and zinc. Sales were $12.4 billion over the past four quarters, with net income of $1.9 billion and free cash flow of $1.8 billion.

"The assets are there, the management is good, and it's by far the biggest gold company, so it's what most people look at," says Caesar Bryan, manager of the Gabelli Gold fund.

Those assets are on sale right now. The stock trades for 0.95 times its net asset value, according to Gabelli analyst Christopher Mancini, versus a typical premium of 30% to 50% for gold miners in general. He believes that shares should go for 1.2 times NAV, or $52. UBS analyst Cleve Rueckert calculates a $50 price target, based on a 7.5 times multiple of enterprise value to forward earnings before interest, taxes, depreciation, and amortization, or Ebitda—which would be close to the stock's historical average. It currently trades at 5.8 times. Goldman's Chieng uses a mix of both valuation multiples and calculates a $53 fair value.

All three targets represent roughly 20% upside before Newmont's dividend yield of more than 5%.

The dividend has been a focus of investor worries lately, but Rueckert believes that the concerns are unfounded. The company's dividend formula consists of a $1 per share base dividend annually, and a variable payment on top of that tied to 40% to 60% of free cash flow at a gold price above $1,200 an ounce. That's currently an additional $1.20 per share annually, based on management's estimate of a $1,800 gold price, with the company re-evaluating the payout whenever the price moves by $300 in either direction.

Rueckert models sufficient cash flow in the coming years for the company to maintain the current payout while investing in new projects and mines. He notes that the current $1.20 payout is much closer to 40% of free cash flow than 60%, while Newmont's balance-sheet strength gives it additional flexibility. (Net debt to Ebitda was just 0.3 times at the end of the second quarter.) Its dividend yield above 5% should put a floor under the stock.

"All you really need for the stock to recover is for the gold price to stay flat," Rueckert says.

With Newmont, investors get a solid option on a higher gold price in a high-quality company—with a steady stream of income in the meantime.

Write to Nicholas Jasinski at nicholas.jasinski@barrons.com

CO newmnt : Newmont Corporation

IN imet : Mining/Quarrying | i211 : Metal Ore Mining | i2112 : Silver Ore Mining | i22 : Primary Metals | i224 : Non-ferrous Metals | ibasicm : Basic Materials/Resources | igoldm : Gold Ore Mining | infmore : Non-ferrous Metal Ore Mining

NS npag : Page One Stories | ncat : Content Types

RE namz : North America | usa : United States

IPD Barrons.com

IPC G/FED

PUB Dow Jones & Company, Inc.

AN Document B000000020220916ei9j000b7

BARRON'S

CLM Technology Trader

HD **Why Have Tech Deals Gone Away? Start With Leery Investors.**

BY By Eric J. Savitz

WC 1,063 words

PD 19 September 2022

SN Barron's

SC B

PG 28

LA English

LP

Last week, in the middle of the four-day Goldman Sachs tech conference at the Palace Hotel in San Francisco, four of the firm's tech bankers took to the stage to discuss the state of its deal business. Basically, they were there to explain why they hadn't been doing anything. "And that's why I'm short Goldman," one fund manager whispered to me in the middle of the session.

TD

In the June quarter, Goldman's investment-banking revenue was down 41% from a year ago. And the company reportedly is planninga round of job cuts. That's only logical: The deal market is closed, and for that you can blame a combination of falling stock prices, rising interest rates, an uncertain economic environment, and a distinct lack of consensus among potential buyers and sellers on how deals should be valued.

The easiest bit to explain is the lack of initial public offerings. With tech valuations down sharply since the market peak in November, interest rates still rising, and investors becoming more risk averse, the appetite for new issues is nonexistent. Buyers aren't interested, and potential issuers have no desire to sell stock into a market where valuations are still declining and the economy is sagging. While there are a slew of venture-backed and private-equity financed companies that would love to tap the public markets, they are going to have to sit tight.

The light mergers-and-acquisitions market is a little more surprising. There is plenty of cash in private-equity funds, and there have been a handful of tech buyouts in recent months: In August, Vista Equity Partners inked an $8.4 billion deal to buy tax-compliance software company Avalara (ticker: AVLR), and Ping Identity (PING) snared a $2.8 billion bid from Thoma Bravo. But otherwise, the market has been eerily somnolent. One reason is the higher cost of capital. These are leveraged buyouts, and rising interest rates raise the bar on required returns.

Strategic buyers have different issues: They need to convince shareholders that using capital to make acquisitions is a good idea in the middle of an economic downturn. They also have to convince skeptical sellers—and their boards—that the valuations they saw at the market peak last fall are, in fact, gone forever. Barry O'Brien, head of tech M&A at Goldman, said during the session that buyers and sellers have never been further apart on how to set deal prices. He noted that while buyers want to be opportunistic, they also worry how shareholders will react.

That's a valid concern. Early Thursday, right on cue, Adobe (ADBE) unveiled a deal to buy the collaborative design-tool provider Figma for $20 billion in cash and stock. Adobe's own entry in the space failed to gain traction; Figma shores up a weak spot. But the market hated the deal, slashing Adobe's stock price by 17%, reducing the company's market cap by $30 billion. Ouch.

There are at least four reasons the Street is irritated. One, the deal is alarmingly pricey: Adobe expects Figma to exit 2022 with $400 million in run-rate revenue, putting the valuation at a lofty 50 times sales (100 times, if you use 2022 actual sales). Two, Adobe says it will take three years after closing before the deal adds to non-GAAP profits. Three, Adobe needs to come up with $10 billion in cash to close the deal, which will mean a much slower pace of stock buybacks. And four, while Adobe raves that the Figma deal will be "transformative," the Street sees it as a defensive move. Writes Bernstein analyst Mark Moerdler, "This was an acquisition driven by need and not opportunity."

Oracle (ORCL) offers another example. The enterprise-software company's shares are down about 30% since the announcement late last year of a $28 billion deal for health IT company Cerner. Oracle viewed the deal as a fantastic opportunity to become a major player in health IT, but investors have yet to be fully convinced. The deal also slowed an aggressive stock-repurchase program, and elevated Oracle's debt position.

Last week, Oracle announced its first earnings report that fully reflected the Cerner deal—and it had a big impact. On a currency-adjusted basis, Oracle had 23% revenue growth in the quarter to $11.4 billion, more than 12% of that from Cerner. Backing out Cerner, Oracle still grew 8%.

I'd argue that the biggest news was Oracle'scontinued progress on its shift to the cloud. CEO Safra Catz sees the company's cloud-based software and infrastructure businesses driving double-digit revenue and profit growth from here. Valuation is undemanding, at 12 times forward profits versus 21 times for Microsoft (MSFT) and 28 times for Salesforce (CRM). Skepticism about the Oracle story remains high. But I see opportunity knocking, giving investors a chance to buy an improving story on the cheap.

One of the great investor debates over the next 12 months will be what happens to Apple (APPL) shares, which will depend on demand for the iPhone 14that launched on Friday. Morgan Stanley analyst Erik Woodring wrote in a research note that lead times for preorders suggest that the cycle is starting "stronger than expected," with a particularly long wait for the top-of-the line iPhone 14 Pro Max. He reports that both China and U.S. demand is "much better than feared" given macroeconomic concerns.

But the early read isn't the full story. Bernstein analyst Toni Sacconaghi thinks the Street's December-quarter estimates are too low, but he also believes estimates for the September 2023 fiscal year are too high. He's looking for total fiscal 2023 revenue growth of just 1% growth, on a 3% to 4% decline in iPhone revenue.

Writes Sacconaghi: "We worry that Apple was a pandemic beneficiary, whose fortunes could revert, particularly in China, and forecast that iPhone upgrade rates will slow following two strong years of sales." Sacconaghi also thinks iPhone 14 could trigger "a negative mix shift away from Pro offerings," and adds that "Apple is not immune to economic weakness."

Time to start thinking about iPhone 15.

Write to Eric J. Savitz at eric.savitz@barrons.com

IN itech : Technology

NS cacqu : Acquisitions/Mergers | c181 : Acquisitions/Mergers/Shareholdings | cactio : Corporate Actions | ccat : Corporate/Industrial News | ncolu : Columns | c18 : Ownership Changes | ncat : Content Types | nfact : Factiva Filters | nfcpin : C&E Industry News Filter

RE namz : North America | usa : United States

IPD Barrons.com

IPC AAPL

PUB Dow Jones & Company, Inc.

AN Document B000000020220917ei9j0002v

BARRON'S

HD Inside President Biden's Crypto Crackdown --- A flurry of White House reports outline a much tougher approach to crypto regulation. The industry is already fighting back.

BY By Joe Light

WC 1,368 words

PD 19 September 2022

SN Barron's

SC B

PG 16

LA English

LP

PHOTO: Illustration by Barron's Staff; Dreamstime (2)

TD

The White House wants to bring law and order to crypto. Its plans are starting to take shape.

Backed by an executive order, the White House released a set of reports this week on the administration's plans to regulate the industry. While encouraging innovation—including the potential development of a Federal Reserve–backed "digital dollar"—the reports urge regulators such as the Securities and Exchange Commission and Commodity Futures Trading Commission to "aggressively pursue investigations and enforcement actions," the White House said.

The reports followed a blistering missive from the White House earlier this month on the climate impact of crypto mining, which uses massive amounts of electricity to process transactions, primarily for Bitcoin.

For crypto companies and investors, it looks like another pivotal moment. And like all things in crypto, the regulatory push is fueling more controversy and uncertainty over whether Washington will figure out how to establish rules without breaking the industry's back.

"It's clear that there's a lot of work the Biden administration wants to do," says Owen Tedford, an analyst for Beacon Policy Advisors, a Washington, D.C.–based policy research firm.

Despite its antigovernment roots, the industry is seeking regulation, albeit on its own terms. The thinking is that a legal framework for tokens and trading platforms will attract more mainstream users along with institutional pools of capital, such as pension funds.

The industry also needs to restore credibility, given its recent blowups. The bankruptcies of major crypto firms like Celsius Network, Voyager Digital, and Three Arrows Capital helped wipe out $2 trillion in the token market, undermining crypto's appeal to institutional investors and putting pressure on lawmakers to come up with consumer protections.

"The industry is very supportive of consumer protections and investor protections being put in place," says Brett Quick, head of government affairs for the Crypto Council for Innovation, a trade group whose members include Coinbase Global (ticker: COIN) and venture-capital firm Andreessen Horowitz.

Political momentum to regulate crypto is clearly building. Along with the White House push, bipartisan bills in Congress could settle longstanding issues, such as which tokens qualify as securities and which agencies should be in charge of oversight.

At stake are rules for exchanges such as Coinbase, investment firms like Grayscale Investments, and miners such as Riot Blockchain (RIOT) and Marathon Digital Holdings (MARA). Token issuers and companies backing decentralized-finance networks are on edge because they may come under more scrutiny from agencies empowered to carry out the president's orders.

At the same time, crypto's critics see the regulatory momentum as a Pyrrhic victory. Some consumer advocates view the White House's initiatives as a back door for crypto to deepen its ties to the financial system. And they worry that more regulation will only expand the appeal to retail investors, paving the way for more investors to lose money in tokens and crypto-related companies.

"Now, you can have a crash where trillions of dollars vanish in months but the systemic implications are zero," says Dennis Kelleher, CEO of Better Markets, a Wall Street watchdog that has become a big crypto critic. "That won't happen if the industry is connected to the core of the banking and financial system."

The White House climate report on crypto illustrates the administration's hurdles. Mining operations, running computers 24/7, consume up to 1.7% of U.S. electricity, while crypto activity overall pumps up to 0.8% of U.S.-based greenhouse-gas emissions into the atmosphere, the report says. None of that is compatible with the administration's goals of cutting emissions by up to 52% by 2030.

So, what to do about it? The White House floated several actions the EPA and Energy Department could take. The most draconian would ban proof- of-work mining—the process the Bitcoin network uses. Other major blockchains, such as Ethereum, have switchedto less energy-intensive systems, making Bitcoin an outlier.

But a mining ban is also the least realistic solution; mining would simply shift to other countries. And a potential ban already has the industry vowing legal challenges. "The White House is on questionable legal ground if they were to ever attempt to ban Bitcoin mining," tweeted Lee Bratcher, president of the Texas Blockchain Council, a trade group representing crypto-mining interests in the state.

That's just a small facet of the administration's challenges. Friday's reports detailed crypto's threats to consumers, financial stability, and the tools the government uses to combat illicit finance. One report even said the Department of Labor should investigate the fiduciary conduct of 401(k)-plan sponsors that offer crypto as an investment—a swipe at Fidelity Investments, which aims to offer Bitcoin in retirement plans it administers. Fidelity said it views its crypto product "as a responsible solution to meet the demands of mainstream interest."

For many crypto companies, regulation is now viewed as a necessity. Crypto emerged among libertarians averse to government intervention; many proclaimed blockchain technology resistant to "censorship" and other forms of control. Yet the bulk of its financing now comes from venture capital and banks that believe regulation will bolster crypto valuations. Oversight is inevitable, given the size of the token market, at $1 trillion, and economic interests in crypto from Wall Street to Silicon Valley.

The industry has built a powerful lobbying force and is flooding pro-crypto candidates with contributions. The Blockchain Association, a trade group, unveiled a new political-action committee this past week. Coinbase CEO Brian Armstrong also said this past week that the company had integrated "crypto policy efforts right into our app," including ratings for politicians on a crypto-friendliness scale. Though his political concerns go beyond crypto, FTX founder Sam Bankman-Fried said recently that he could spend $1 billion on the 2024 election.

The industry sees Congress as the key to winning favorable rules. That's in part because it will likely require a law to settle perhaps the most contentious issue: which tokens should fall under oversight of the SEC.

SEC Chair Gary Gensler, who has brought several enforcement actions against crypto companies, said in a Senate Banking hearing Thursday that he believes the "vast majority" of tokens are securities under the agency's jurisdiction and that exchanges ought to be registered.

But putting the SEC in charge of crypto is far from a done deal. The Senate agriculture committee is considering a bill that would put the bulk of crypto under the watch of the CFTC, which the industry sees as a lighter regulator. Crypto backers implored the committee this week to add provisions to the law that would define most cryptos as commodities, which would take away much of the SEC's enforcement and rule-making power.

With the November midterm elections looming, the bill has little time to become law this year. But the industry thinks it could advance in 2023, no matter which party controls Congress. "The agencies have done about all they can, and we really need Congress to step in," says Blockchain Association executive director Kristin Smith.

While regulatory momentum builds, investors in crypto stocks have more immediate worries. Bitcoin is trading just below $20,000, down 72% from its November high. Mining companies may be less worried about a ban on their operations than staying afloat amid a long crypto winter that has wiped out profits and put some miners on the brink of insolvency.

Exchanges are also ailing. Coinbase stock is down 70% this year. "The biggest fear for Coinbase isn't regulation, but natural causes of death: compressing fees, overhiring, and less-engaged investors who got burned and are deterred from playing again," says Mizuho Securities analyst Dan Dolev.

For now, the industry might just be hoping to get through this downturn while convincing Congress to protect it from a regulatory wave that the White House is trying to build.

Write to Joe Light at joe.light@barrons.com

CO seexc : US Securities and Exchange Commission

NS c13 : Regulation/Government Policy | ccat : Corporate/Industrial News | ciprof : Industry Profiles | nimage : Images | cdom : Markets/Marketing | ncat : Content Types | nfact : Factiva Filters | nfcpin : C&E Industry News Filter

RE usa : United States | namz : North America | usdc : Washington DC | uss : Southern U.S.

IPD Barrons.com

IPC ASHRW.XX

PUB Dow Jones & Company, Inc.

AN Document B000000020220916ei9j000b9

BARRON'S

HD **Forget China. These Markets Are Better Bets. --- Emerging markets now sell at a big discount. India, Indonesia, and Brazil offer fast growth and attractive assets. How to invest.**

BY By Reshma Kapadia

WC 1,644 words

PD 19 September 2022

SN Barron's

SC B

PG 20

LA English

CY

LP

Rising interest rates in the U.S. and Europe, a strengthening dollar, and a volatile market that makes investors risk-averse are usually bad news for emerging markets. But a few of them are holding up relatively well and poised to outperform developed markets.

Emerging markets have run into trouble in the past when the Federal Reserve raised interest rates. Countries that borrowed heavily in dollars face rising debt burdens and a weaker currency to try to finance them. Capital tends to flee to safer shores as yields rise elsewhere, further tightening financial conditions and exacerbating the pain.

TD

That is still the reality for a handful of troubled emerging markets, including Turkey, Colombia, and South Africa. But as Barron's reported earlier this year, more emerging markets this time around are in better shape.

Strong demand for oil and metals like copper and nickel is helping commodity producers, including Indonesia. Emerging market central bankers, such as those in Brazil, have been earlier and more proactive in fighting inflation than the Fed. Structural trends—including tensions between the U.S. and China and the war in Ukraine—benefit countries such as India and Indonesia.

The MSCI Emerging Markets index, at 10.5 times next year's earnings, is cheaper than the 14 times it has averaged since 2010. With the pandemic, emerging markets have traded at their cheapest valuation versus developed markets since the global financial crisis. Part of the discount stems from the long list of troubles plaguing China—which accounts for almost a third of the MSCI index—as it grapples with a property slump and zero-Covid approach that has locked down millions of people in major cities.

Optimists hope that China will continue to introduce more stimulus and ease up on its Covid lockdowns after October's 20th Party Congress, when top leadership is selected—moves needed for Chinese stocks to recover meaningfully.

But some emerging markets are already attractive. Brazil, India, and Indonesia are primed to outperform, as their economic situations offer an attractive counter to the challenges facing the U.S. and China.

While the U.S. and European markets are just now feeling the sting from higher prices, Brazil ended last year as one of the worst-performing markets as the country battled double-digit inflation. Corporate earnings took a hit.

Brazil's central bank raised interest rates over the past 18 months from 2% in early 2021 to 13.75%. That has put it far ahead of its U.S. and European counterparts and closer to the end of its rate hike cycle, with possible cuts coming later this year or next.

That would set up valuations to recover, while U.S. and European valuations are weighed down by rising rates, says Todd McClone, co-manager of the William Blair Emerging Markets Growth fund (ticker: WBEIX), which has been buying more stocks recently in Brazil.

One way to tap into Brazil's improving outlook is through Brazil's stock exchange operator, Brasil Bolsa Balcão (B3SA3.Brazil). "As rates go down, equities should bounce, and there will be more secondary and initial public offerings," McClone says. "Brazil is unique in that it has a private-equity culture, so we could get more IPOs."

As Brazil's outlook improves, GQG Partners Chairman and Chief Investment Officer Rajiv Jain favors energy, materials, and financial companies, including oil giant Petrobras (PBR) and Banco Bradesco (BBD). The bank trades at 6.6 times 2023 earnings and generates a 16% return on equity. Jain thinks it can pay more than a 7% dividend yield.

"There's a fear of nonperforming loans because of higher rates, but [the sector] is not coming from a period of crazy lending in this cycle like it did in 2013 to 2014," Jain says. Such loans "will rise but not spike," he predicts.

Brazil's presidential election in October could inject volatility. The leftist candidate, former president Luiz Inácio Lula da Silva, is expected to edge out President Jair Bolsonaro. At current prices, the market is already bracing for a Lula victory. An upset by Bolsonaro would offer markets a boost, McClone says.

Longer term, the country stands to benefit from the energy transition. Brazil is known as a major oil producer. More surprising is that roughly 85% of its installed power-generation capacity is renewable, including hydro and wind—the highest of the Group of 20 nations, according to TS Lombard.

Indonesia is also well positioned for strong commodity demand, especially as countries scramble for alternatives to Russia's nickel and oil. Demand for its metals and palm oil has contributed to a record current-account surplus, helping to keep the rupiah relatively strong. Its resources position it well for the long term, with many of them needed for green-energy products.

The short-run bull case for Indonesia is that the economy is reopening as Covid restrictions are eased. Retailers are in the sweet spot for a recovery, says Laura Geritz, co-manager of the Rondure New World fund (RNWOX), which is overweight Indonesia with companies like Ace Hardware Indonesia (ACES.Indonesia).

While Indonesia is among the best-performing markets so far this year, McClone, who has a heftier allocation to the country than peers, still sees potential, noting that Indonesian companies are expected to generate 30% earnings growth in the coming year. McClone's fund owns companies such as Bank Rakyat Indonesia (BKRKY), a microfinance lender with a 30% return on equity, and United Tractors (UNTR.Indonesia), which sells equipment for coal mining, which is seeing increased demand in the wake of disruptions created by the war in Ukraine.

Indonesia and India are also well positioned to take market share in the global supply chain from China as U.S.-China tensions increase and companies look to diversify production, especially in areas like technology, medical equipment, and high-end manufacturing.

If there's an emerging market that fund managers see as taking China's role in the asset class, it is India, which Capital Economics says is on track to becoming the world's third-largest economy by 2030. Foreign investors have been net buyers of stocks in India in recent months.

While China is struggling to get out of its economic rut, India is emerging from a decadelong malaise, following years of tackling a debt crisis and short-term pain from major structural reforms—among them tax reform and demonetization, which invalidated 85% of the currency in circulation overnight in 2016 in a bid to crack down on tax evasion and corruption.

India's corporate and bank balance sheets are in their healthiest condition in almost a decade. The changes that took a while to digest are now collectively "repowering India," says Justin Leverenz, manager of the Invesco Developing Markets fund, which has a fifth of its portfolio in India.

He points to a wave of digitization and formalization of swaths of India's informal economy. India is also at the cusp of a housing and credit growth recovery—a marked contrast to China, which is reeling from a property market bust.

William Blair's McClone is finding opportunities in HDFC Bank (HDB), which he describes as the JPMorgan Chase of India, as well as tile company Kajaria Ceramics (KJC.India) and property developers including Oberoi Realty (OBER.India), which is well positioned for a housing recovery.

India is one of the pricier parts of emerging markets. It is also an energy importer, needing roughly 1.1 billion barrels of oil a year. While energy prices have eased off their highs, McClone says a $10 increase in oil prices would hurt its fiscal situation and hamper its expected economic growth, which the International Monetary Fund forecast at 7.4% economic growth this year.

While roughly 5% of its energy needs came from Russia before the war in Ukraine, that has climbed to 20%—and that oil is priced at roughly a 20% discount, McClone says. Policy makers are also helping to buffer its currency by tapping $50 billion of its reserves. Further weakness is a risk, but India still has roughly $560 billion in its reserves.

India, Indonesia, and Brazil combined account for less than a quarter of the broader emerging markets index. Some active funds have higher allocations, including Jain's GQG Partners Emerging Markets Equity fund (GQGPX), which has a quarter of assets in India, 18% in Brazil, and almost 2% in Indonesia. McClone's William Blair Emerging Markets Growth fund has 21% in India, 6% in Indonesia, and 5.6% in Brazil.

Other funds with strong track records and bigger exposure to at least two of the three markets include Rondure New World, which has 17% allocated in India, 8% in Indonesia, and 3% in Brazil, and Touchstone Sands Capital Emerging Markets Growth (TSMGX), which has 11% allocated in Brazil, almost 31% in India, and 3% in Indonesia. Fidelity Emerging Markets Discovery (FEDAX) has about 9% allocated in Brazil, 19% in India, and 4.5% in Indonesia, according to Morningstar Direct.

Given the sharp moves in currencies, with the yen and euro falling to multidecade lows versus the dollar, Jain says he sees more macroeconomic risk in developed markets like Japan and Europe that are grappling with high levels of leverage, less fiscal discipline, and anemic growth prospects than emerging markets like India, Indonesia, and Brazil.

While emerging markets are far from immune to the jitters hitting the U.S. and other markets, some of these countries are going against the trends playing out in the U.S. and Europe. That is a good reason to take a closer look.

Write to Reshma Kapadia at reshma.kapadia@barrons.com

CO imonf : International Monetary Fund

NS npag : Page One Stories | ncat : Content Types

RE devgcoz : Emerging Market Countries | braz : Brazil | asiaz : Asia | china : China | easiaz : Eastern Asia | india : India | indon : Indonesia | lamz : Latin America | namz : North America | samz : South America | seasiaz : Southeast Asia | usa : United States | apacz : Asia Pacific | bric : BRICS Countries | chinaz : Greater China | dvpcoz : Developing Economies | indsubz : Indian Subcontinent | sasiaz : Southern Asia

IPD Barrons.com

IPC 500180.BY

PUB Dow Jones & Company, Inc.

AN Document B000000020220916ei9j000b5

BARRON'S

CLM Income Investing

HD **Short-Term Bonds Yield 4%. Why They Could Beat Cash.**

BY By Lawrence C. Strauss

WC 1,152 words

PD 19 September 2022

SN Barron's

SC B

PG 25

LA English

LP

Until recently, short-term bonds were a yield wasteland: A two-year Treasury note yielded 0.21% a year ago and just 1% in January. Today, the yield is over 3.8% and could soon touch 4%, thanks in good measure to the Federal Reserve's aggressive interest-rate-hiking campaign.

The Fed's work—trying to cool down the economy and tame persistently high inflation—isn't close to finishing. Rates are expected to keep rising into early 2023. Typically, that would pressure bond prices, which move inversely to yields.

TD

But this could be a good entry point for short-term bonds: They may not fall much more, and yields are now high enough to withstand some price pressure. "We are actually comfortable owning the front end of the yield curve here," says Bob Miller, head of Americas fundamental fixed income at BlackRock.

Granted, this a wacky timefor bonds. The yield curve is now inverted: Most short-term bonds yield more than long-term notes, such as the 30-year Treasury at 3.47%. The upshot is that investors aren't being compensated for holding long-term bonds. Quite the contrary: Yields are lower, and duration risk—or sensitivity to rates—is higher at the long end.

Short-term funds have racked up losses this year. The iShares 1-3 Year Treasury Bond exchange-traded fund (ticker: SHY), a proxy for Treasuries, is down 3.85%, after interest.

Yet some analysts think that short-term yields may now be close to pricing in the remainder of the Fed's rate increases. With yields at nearly 4%, there's far more of an income cushion against price declines. Investors may also scoop up a bit more income than with cash proxies like money-market funds, now yielding about 2%.

"When you have a 3.75% yield, that's much more manageable," says Cary Fitzgerald, head of short-duration fixed income at J.P. Morgan Asset Management.

The risk still out there is the "terminal" federal-funds rate—the point at which the Fed pauses its increases.

Currently in a range from 2.25% to 2.5%, the fed-funds rate is expected to rise sharplyfrom here. The futures market sees a 75% chance of a three-quarter point hike when Fed officials meet this coming week. Another rate hike is expected in November, putting the rate around 4% in December.

The futures market is expecting the fed-funds rate to peak at 4.4% in the first quarter, following a consumer price inflation reading that came in much hotterthan expected in August.

Terminal rates of 4.75% or even 5% aren't impossible, however, under a range of scenarios: Inflation stays hot, the war in Ukraine continues to disrupt energy prices, or supply chains don't get back to normal, exerting more upward pressure on prices. "Really, what it comes down to is what the average fed-funds rate will be for the next two years," says Fitzgerald.

The bond math does seem favorable for short-term notes. At a duration of two years, for instance, the two-year Treasury note would lose 40 basis points, or 0.4% in price, for another 20 basis point rate increase by the Fed. (A basis point is 1/100th of a percentage point.) Even if the Fed were to raise rates by another 175 basis points, the bonds could generate positive returns over their lifetime.

Inflation data aren't predictable, of course, but some bond managers say the market has largely priced in a terminal fed-funds rate. BlackRock's Miller thinks the two-year Treasury's yield embeds the rate peaking around 4.3% in the first quarter of 2023. "The two-year note looks like a reasonable asset," he says. "Is it screamingly cheap? No. But it's no longer ridiculously rich like it was a year ago."

Tom Tzitzouris, head of fixed-income research at Strategas, says short-term yields are also now in the terminal ballpark. If that's the case, he adds, "you're basically going to clip your coupons in two-year Treasuries because the market has already priced in the tightening."

Opportunities in shorter-term bonds aren't confined to Treasuries. John Bellows, a portfolio manager at Western Asset Management, likes investment-grade corporate debt, which features both a yield component and some income from the credit risk embedded in the bonds.

"We have a widening in credit spreads at the very front of the curve," he says. The spread on one- to three-year investment-grade corporates was recently about 75 basis points over corresponding Treasuries, putting yields in the neighborhood of 4.5%. "Over a three-year period, there is a lot of potential total return," he says.

Mark Freeman, chief investment officer at Socorro Asset Management, also likes short-term corporate debt. "With risk-free rates in the 3.75% range and high-quality corporates yielding in the 4.25% to 4.75% range, it's not a bad place to be in a volatile investment environment," he says.

Various mutual funds and ETFs offer exposure to the shorter end of the yield curve. For pure Treasuries, the $26 billion iShares 1-3 Year Treasury Bond ETF offers broad diversification at a low fee. It has an SEC yield of 3.31% and an expense ratio of 0.15%.

For corporate bond exposure, consider the $43 billion Vanguard Short-Term Corporate Bond ETF (VCSH), an index fund covering the broad market. It sports an SEC yield of 4.22% and an expense ratio of 0.04%. The fund is down 5.85% this year, after interest payments, trailing 78% of peers. But its razor-thin expense ratio has helped push it ahead of nearly 90% of rivals over the past 10 years, according to Morningstar. Its holdings as of July 31 included debt issued by blue-chip names such as JPMorgan Chase (JPM), Bank of America (BAC), and Goldman Sachs Group (GS).

Among the short-term investment-grade bonds that Freeman holds in client portfolios is one issued by Home Depot (HD) that matures in 2025 and has a yield to maturity of 4.25%. Freeman cites the retailer's "dominant market share, loyal customer base, and forward-thinking executive management team."

Also in his portfolio is a Phillips 66 (PSX) bond with a yield to maturity of 4.5%, and a bond issued by Target (TGT) maturing in 2025 with a yield to maturity of 4.2%.

Assuming the Fed doesn't get much more hawkish, this rate cycle should peter out in six months or less. As these yields show, the short end of the curve doesn't always equate to the short end of the stick.

Write to Lawrence C. Strauss at lawrence.strauss@barrons.com

CO fed : Board of Governors of the Federal Reserve System

NS e1102 : Money Supply Figures | e52 : Euro Zone/Currency | ecat : Economic News | gpersf : Personal Finance | gpersi : Personal Investments | m13 : Money/Currency Markets | m131 : Money Markets | m132 : Foreign Exchange Markets | mcuop : Currency Options | mforx : Forex Derivatives | ncolu : Columns | ccat : Corporate/Industrial News | ginvbn : Personal Investments in Bonds | e11 : Economic Performance/Indicators | gcat : Political/General News | gfxiin : Fixed Income Investing | m15 : Derivative Securities | mcat : Commodity/Financial Market News | ncat : Content Types | nfact : Factiva Filters | nfce : C&E Exclusion Filter

IPD Barrons.com

IPC BAC

PUB Dow Jones & Company, Inc.

AN Document B000000020220916ei9j000b8

BARRON'S

CLM Barron's Cover - Main

HD **How Bitcoin Bombed in El Salvador --- The first country to adopt Bitcoin as a legal currency is now grappling with the aftermath. What it means for digital payments.**

BY By Sabrina Escobar
WC 2,976 words
PD 12 September 2022
SN Barron's
SC B
PG 18
LA English

LP

Dominga de Jesus accepts payments in Bitcoin at his flavored ice cart on the beach.
PHOTO: Photograph by Fred Ramos for Barron's

TD

For those who believe in Bitcoin, El Salvador looks like a crypto paradise. It's one of the few places in the world where you can use Bitcoin to buy a Coke or cerveza on the beach. In theory, you can pay rent in Bitcoin, buy a house, pay off a credit card, or send a payment to a Mayan pottery vendor in the local market.

Yet El Salvador is far from a crypto lover's dream. Instead, it has turned into a cautionary tale of what happens when a country adopts a cryptocurrency, tries to weave it into its economy, and rebrands itself as a tech-friendly haven: It isn't working as advertised.

Barron's visited El Salvador to gauge Bitcoin's impact a year after the country passed a law that established the crypto as a legal currency. El Salvador made history when its 41-year-old president, Nayib Bukele, signed the Bitcoin Law last September, becoming the first country to fully legalize the crypto for domestic use. Banks, businesses, and merchants of all sizes have since been required to accept it, alongside the country's other official currency, the U.S. dollar.

By almost all measures, Bitcoin appears to be doing more harm than good. The government has plowed scarce resources into the crypto and related projects, its fiscal health has deteriorated as Bitcoin crashed, and hardly anyone uses it outside a few pockets in the capital and crypto-friendly beach spot.

"The Bitcoin experiment is working as well as one might have expected—which is not too well," says economist Eswar Prasad, professor of trade policy at Cornell University.

Salvadoran Congresswoman Claudia Ortiz PHOTO: Photograph by Fred Ramos for Barron's

The crypto collapse hasn't helped. Losing more than 70% since last November, Bitcoin has shed about $1.5 trillion in value, wiping out many investors and fueling a selloffin the broader crypto market. Along the way, it has drawn the wrath of governments, notably China, that have come to view it as a subversivethreat to their monetary control and a profligate consumer of electricity due to the steep energy toll of crypto "mining."

In El Salvador, the crypto still has its boosters, notably Bukele, a Twitter-loving millennial who heralded it as an economic savior. "We must break with the paradigms of the past," he said when announcing the Bitcoin Law. "El Salvador has the right to move toward the first world."

One year later, critics say, Bitcoin has been little more than a distraction from deep-seated economic problems and a mechanism for Bukele's increasingly authoritarian rule. Indeed, it has been a divisive force, causing street protests and fear of reprisals to anyone who criticizes it—including residents of a fishing village who may be forcibly relocated by a government-backed "Bitcoin City."

"It's either the biggest failure or the biggest con," said Claudia Ortiz, an opposition member of congress in El Salvador and one of the dwindling opponents of Bukele.

Bitcoin's Bad Timing

On a macro level, the country's embrace of Bitcoin has taken a toll. Bukele inherited a highly indebted nation when he won the presidency in 2019. The situation worsened as the pandemic hit and the government ramped up spending. Debt grew from 71% of gross domestic product in 2020 to 85% at the end of 2021.

As the debt load rose, Bukele started buying Bitcoin and legalized the crypto, complicating the country's financial profile with creditors and pushing up its sovereign bond yields. A lack of hard currency is now raising alarms over two $800 million government bonds, maturing in January 2023 and 2025. The country had raised only $560 million to repay bondholders as of July, according to finance minister Alejandro Zelaya, who acknowledged that repaying the entire debt would be "almost impossible."

The 2023 bond trades at 90 cents on the dollar with a 37% yield to maturity. The 2025 bond trades at 51 cents, yielding 39%. Both reflect market skepticism about the country's debt profile and make it prohibitively expensive to issue more bonds.

Bitcoin or Bust: Despite a crash in its price, crypto still has its fans in El Salvador. PHOTO: Photograph by Fred Ramos for Barron's

Former government officials see more fiscal trouble ahead. "With international markets closed, I don't see how it's possible for the country to pay upcoming bonds with the resources of the domestic market," says Carlos Acevedo, a former president of El Salvador's Central Bank and now an independent consultant and economist.

Confidence in Bukele spending the government's revenue wisely is also being undermined by his crypto plans. They have included doling out at least $250 million on "digital infrastructure," according to estimates from opposition leaders. Those funds have gone to things like a government-backed digital wallet—distributed to adult citizens and preloaded with a $30 bonus in Bitcoin. The money also went to setting up more than 200 Bitcoin ATMs, and a $150 million "Bitcoin trust" to ensure convertibility between the crypto and the dollar.

Bukele widened the fiscal hole. While the government refuses to disclose its Bitcoin holdings or spending, Bukele's tweets indicate that he bought 2,381 Bitcoins for the treasury, costing about $107 million. As prices slid, Bukele repeatedly tweeted that he "bought the dip." The strategyappears to have lost tens of millions of dollars, based on falling prices for the crypto and Bukele's tweets.

That isn't fatal for a country with an $8 billion annual budget. But it has rankled opponents. "This is like gambling with the public money of a poor and indebted country," said Ortiz. "A country that needs those resources now can't afford to wait for them to gain value in an undetermined amount of time," she said at her office, a small space tucked away in the congressional building, grouped with other Bukele opponents.

Turning El Salvador into a Bitcoin ATM has also rattled lenders like the International Monetary Fund. The government applied for a loan package from the IMF in 2020 and was negotiating a $1.3 billion agreement when Bukele signed the Bitcoin Law. Talks have broken down, partly due to the IMF's concerns about the crypto's destabilizing effect. "A program with the IMF would have to address all major economic vulnerabilities," the fund said in a statement to Barron's. "These include those related to the adoption of Bitcoin as legal tender."

Bitcoin's Next Generation: Students at the Ignacio Pacheco Castro School take a class in Bitcoin. PHOTO: Photographs by Fred Ramos for Barron's

Bukele appears intent on turning the country into a global hub for Bitcoiners—from miners to crypto tourists. This past November—when the crypto was trading at peak prices around $68,000—he unveiled plans to issue Bitcoin-backed bonds, designed to fund the construction of an oceanside "Bitcoin City" nestled at the base of the Conchagua volcano. The city will be a tax haven for crypto investors, free of income, property, and procurement taxes, Bukele said. The country also aims to lure crypto miners—who use huge amounts of electricity to process transactions—by generating geothermal electricity from the volcano.

Yet the bonds, scheduled to be issued this past March, have been postponed. The country is doing some crypto mining—partially powered by geothermal energy from a pre-existing plant. But development of a volcano-powered Bitcoin City is nowhere in sight in the tropical forest. The volcano isn't even a viable geothermal reservoir, says Carlos Martinez, an electrical engineer who works at the University of El Salvador.

Bukele's promise of using Bitcoin to bank the unbanked and catapult the country into the digital era remains unfulfilled. Beyond a few pockets on the coast, a tiny sliver of people are using crypto—no surprise, perhaps, in a country where even apps like PayPal's Venmo service aren't widespread. More than four million people downloaded the wallet, called

Chivo—Salvadoran slang for cool. A $30 bonus preloaded in Bitcoin was no doubt enticing in a country where the minimum wage is $13 a day.

Yet only 20% of Salvadorans used the app after spending the bonus, according to one recent study. Nearly 92% of small and medium-size businesses said Bitcoin has been immaterial for them. "Bitcoin is absolutely irrelevant for the country," says Luis Membreño, a Salvadoran economist and critic of the Bitcoin Law, who lives in exile out of fear of government persecution.

Students using bitcoin to buy lunch. PHOTO: Photograph by Fred Ramos for Barron's

The country continues to grapple with gangs, poverty, and rising unemployment. If Bitcoin is having an impact, critics say, it's within a parallel world of crypto-tourists, techies, and well-connected elites.

Bukele declined interview requests, and a government spokesperson declined to make any officials available for this article.

A Bitcoin Surfer's Paradise

To see Bitcoin in action, it helps to hit the beach. Specifically, El Zonte, an area that has been nicknamed "Bitcoin Beach" by crypto enthusiasts because it's one of the few places where the crypto is readily accepted.

There, you might meet Wilfredo Urias, a 28-year-old surfer who started his own surfing school, in part thanks to profits he made from trading Bitcoin. Urias bought his first $100 of Bitcoin in 2020, promptly turned it into $500 as prices soared and then continued to trade and profit, eventually making enough to buy 12 surfboards and hire instructors—some who want to get paid in the crypto. Bitcoin has been "very beneficial" for El Zonte, he said, as an ocean breeze ruffled his hair and surfers dotted the black sand beach.

Urias' story isn't representative of much of the country. Few merchants or stores that Barron's encountered were equipped with the QR code readers necessary to process a transaction. Nor do they see much reason to go through the hassle.

"Tourists don't shop; they just come to sight-see," said a vendor in a local market, explaining why she didn't take Bitcoin as a payment.

Crypto Mining in a Tropical Forest: The Berlin geothermal plant is powering a small Bitcoin-mining operation. PHOTO: Photograph by Fred Ramos for Barron's

Some vendors say they lost sales because of hacks in the digital wallets. A beach vendor selling baskets in El Zonte said he had been locked out of his wallet due to a hacking alert and couldn't access the funds or take more Bitcoin payments. "It's better to keep using cash than virtual money," he said. "I'm not getting into that again."

Bitcoin complicates even 1980s technology, like using an ATM. Bitcoin ATMs convert a traditional currency into Bitcoin, stored in a digital wallet. But they are slow; it took six hours for a $20 Bitcoin deposit to show up in our Chivo wallet. A government subsidy covered the transaction fee, usually steep at a Bitcoin ATM. When we tried to buy snacks, however, the money was nearly useless; only three merchants out of 10 that we met would accept payment in Bitcoin.

There is some crypto development in the capital. Companies that have set up shop include Strike, Bitrefill, and Binance. At a weekly meetup of Bitcoiners in a swanky bar, attendees swapped ideas for apps and exchanged tips for obtaining residency permits, buying property, or investing.

"If you're somebody who has Bitcoin and fiat money, you're in these worlds that don't mix. Here, the two worlds have merged," said Dallas Rushing, a California-based app developer, visiting as a crypto tourist.

Bitcoin investors are interested in buying property, said William Velasco, co-founder of a real estate brokerage. "We've noticed an influx of foreigners from nationalities that we never thought would invest here," he said.

Nonprofits, meanwhile, are trying to teach students to use crypto. A nonprofit called My First Bitcoin holds classes across the country. Bitcoin could propel the country into the digital economy, said Napoleón Osorio, an instructor who had just returned from a class on Bitcoin at a school in Apaneca, a rural town in the coffee-bean-growing highlands. But foisting the crypto on the population was akin to a "technological coup," he added, and it will take much education, time, and technological investment to catch on.

Hugo Guevara, a community leader in La Criba. PHOTO: Photograph by Fred Ramos for Barron's

Outside of crypto circles, Bitcoin has scant discernible impact. On a recent Friday in the town of Conchagua, where the future "Bitcoin City" is planned, street vendors were setting up shop, milling around, and swatting flies while waiting for the shopping crowd. Few could conjecture what the future city would look like. Even fewer were familiar with how to use Bitcoin.

Local officials aren't sure what to make of "Bitcoin City." Oscar Parada, the mayor of the neighboring city of La Unión, said he doesn't know when or where the development would start, adding that carving out the infrastructure would be a challenge. Parada, a member of Bukele's New Ideas party, said he hasn't been focused on Bitcoin. "Right now, I don't think it's necessary, but medium or long term, it will be," he said.

One community feeling the impact is La Criba, a poor fishing village near the Conchagua volcano that has also been targeted for development of the "Bitcoin City." More than 50 families live there, making a humble living through fishing and agriculture. Residents are under pressure to sell their land—often at a steep discount—as developers look to transform the region into a crypto destination.

"We live on standby," said Hugo Guevara, 61, a resident and community leader of La Criba. Guevara gestures at the small, rundown cement houses with aluminum roofs nestled between the sand and lush mangrove trees. "We live like this because we can't build anything better, out of fear that we'll be evicted tomorrow."

The Promise of Digital Money

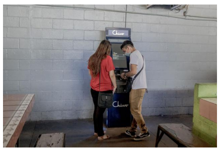
One could argue that El Salvador was never a great proving ground for Bitcoin. Internet penetration is just 50%, and commerce is largely conducted in cash or credit cards backed by hard dollars.

Bitcoin might have a better shot in countries without a stable currency or financial system, where hyperinflation can be corrosive and people fear for access to their savings. El Salvador has none of that. It has used the dollar as official currency since 2001, posing steep hurdles to any rival, let alone something as baffling as Bitcoin—a 13-year-old set of software rules with no intrinsic value, existing solely as code on computers worldwide.

As for whether more countries follow in El Salvador's path—the great hope of Bitcoin lovers—that is looking less likely. The Central African Republic madeBitcoin legal currency in April, but the country's top court is putting up roadblocks to its use.

Opposition to Bitcoin from organizations such as the IMF, the World Bank, and international bond markets will likely deter other governments. Crypto also remains a conduit for money-laundering and evading government sanctions. And the environmental toll of mining—spewing out country-size carbon emissions each year—makes it controversial for any country, especially as other types of crypto have moved beyond Bitcoin's energy-intensive system for processing transactions.

Even if Bitcoin were more stable, traceable, and eco-friendly, its technology wasn't designed to scale up for an entire country. Its blockchain handles seven transactions per second, compared with 24,000 for Visa's card network. An add-on "Lightning" network can process Bitcoin transactions faster, but that adds more complexity to the system, and it doesn't address the high underlying fees and congestion on the original blockchain, where all transactions are recorded.



Part of El Salvador's $250 million budget for digital infrastructure was spent to set up 200 Bitcoin ATMs. PHOTO: Photograph by Fred Ramos for Barron's

"There's a cautionary tale here about the inability of Bitcoin to meet the needs of even a tiny country," said David Yermack, a finance professor at New York University.

None of this should be viewed as an indictment of digital money or peer-to-peer transactions through apps. In Kenya, a mobile app allows people to deposit traditional currency on accounts stored on cellphones and transferred via text messages. For international remittances, or money transfers, a central bank digital currency, or CBDC, could cut fees compared with commercial services like Western Union. That would have big benefits in countries like El Salvador where a quarter of gross domestic product comes from remittances.

Indeed, the future of tokenized money is far more likely to be a CBDC or stablecoin—privately issued tokens backed, in most cases, by a hard currency like the dollar. China is well on its way to tokenizing its currency. In the Bahamas, the "sand dollar," a digital version of its currency, can be loaded on a smartphone app and used at resorts or anywhere cash is taken. The U.S. is studyingCBDCs, along with dozens of other countries.

Perhaps the best outcome of El Salvador's Bitcoin experiment may be its failure. "If the law had been successful, Bitcoin's drop would have been a catastrophe," said Acevedo, the former central banker. "The Bitcoin Law's failure has saved us."

Write to Sabrina Escobar at sabrina.escobar@barrons.com

CO imonf : International Monetary Fund

IN	ivicu : Virtual Currencies/Cryptocurrencies | i831 : Financial Investment Services | i8394 : Computer Services | ifinal : Financial Services | itech : Technology | iinv : Investing/Securities | ibcs : Business/Consumer Services | ibnk : Banking/Credit | ifmsoft : Financial Technology
NS	gcat : Political/General News | mcryp : Cryptocurrency Markets | m13 : Money/Currency Markets | m132 : Foreign Exchange Markets | ncolu : Columns | nimage : Images | npag : Page One Stories | reqris : Suggested Reading Investing/Securities | mcat : Commodity/Financial Market News | ncat : Content Types | nfact : Factiva Filters | nfce : C&E Exclusion Filter | redit : Selection of Top Stories/Trends/Analysis | reqr : Suggested Reading Industry News
RE	elsal : El Salvador | camz : Central America | lamz : Latin America | dvpcoz : Developing Economies
IPD	Barrons.com
IPC	I/BKS
PUB	Dow Jones & Company, Inc.
AN	Document B000000020220909ei9c000jh

BARRON'S

HD **Social Insecurity --- Millennials are convinced that Social Security will vanish by the time they retire. The reality is less dire, but big changes are looming.**

BY By Elizabeth O'Brien

WC 2,005 words

PD 12 September 2022

SN Barron's

SC B

PG 23

LA English

LP

Will Bowron doesn't give much thought to retirement. The 32-year-old from Birmingham, Ala., is busy with his job at his family's coffee and tea roaster, his wife and young child, and a side career writing crime fiction.

But when he does get around to thinking about his future, Bowron doesn't imagine Social Security being any part of it. He has seen the headlines that the program's $2.8 trillion retirement trust fund will become depleted in 2034, decades before he plans to retire. "The math doesn't work out," Bowron says.

TD

"Right now, all of this money that everyone is paying is going to the baby boomers, who are spending it to enjoy their lives, which is fine," says Bowron, who published his debut novel, Vigilant, this past spring. "But it's spent money. It's not money that we'll inherit."

Bowron is like millions of other Americans—millennials, mostly—who figure that Social Security will meet only a fraction of their retirement needs, if that. Nearly half of millennials, typically defined as those between the ages 26 and 41, agreed with the statement, "I will not get a dime of the Social Security benefits I have earned," according to a 2022 poll from the Nationwide Retirement Institute, versus 30% of Gen Xers and 15% of baby boomers.

And given the rapid aging of the population, their pessimism is understandable: For many decades, there were more than three workers paying FICA taxes for each beneficiary, but that number has fallen to 2.8 and is expected to decline to 2.3 by 2035.

Still, younger workers who expect the pension system developed during the Great Depression to be completely defunct by the time they reach retirement are probably overstating the case. While Social Security's trustees project that the Old-Age and Survivors Insurance Trust Fund will run out of money in 12 years—the program paid out more than it took in for the first time last year—it faces insolvency, not bankruptcy. Unless Congress acts before that date, benefits will be reduced by 23%, with payroll taxes continuing to fund the remaining 77% of scheduled benefits, according to the most recent Social Security trustees report.

If no additional moves to raise funds or reduce benefits are taken, that cut would gradually grow to 26% by 2095, according to a report by the Congressional Research Service. (It's worth noting that Social Security has two trust funds, one that pays retirement benefits and a much smaller one that pays disability benefits; though they're often referred to together, this article focuses on the larger Old-Age and Survivors Insurance Trust.)

That level of reduction could be catastrophic for the roughly one-quarter of recipients who rely on Social Security for at least 90% of their income, according to the Center on Budget and Policy Priorities. For all but the most affluent beneficiaries, it would cause some degree of hardship. While Congress is likely to step in before such a scenario would come to pass, the program still faces serious challenges, and retirement savers should brace for some degree of benefit cuts, higher taxes, or other changes for the first time in 40 years.

Kilolo Kijakazi, acting commissioner of the Social Security Administration, declined Barron's request for an interview, but did provide a statement: "It is important to strengthen Social Security for future generations," she said, adding that the program will affect 66 million beneficiaries this year. "The trustees recommend that lawmakers address the projected trust-fund shortfalls in a timely way in order to phase in necessary changes gradually."

Addressing the Shortfall

So, what is actually going to happen—and when? That's the $2.8 trillion question.

While the executive branch can nudge lawmakers toward action, it's ultimately up to the legislative branch to pass a law that will shore up the program.

The chances of Congress failing to do so are remote, experts say, given how many older voters derive some or all of their retirement income from the program. Social Security isn't called the third rail of American politics for nothing. "It's extremely unlikely that Congress will go, 'Eh, c'est la vie,' " says Aron Szapiro, head of retirement studies and public policy at Morningstar. After all, retirees are known as a powerful voting bloc—and they don't look favorably on lawmakers who threaten their financial security.

Nevertheless, some observers aren't writing off that possibility, considering gridlock in Washington. "It no longer feels out of the question that we get to 2034 and it actually does go into depletion," says Mike Piper, a certified public accountant who runs the Open Social Security claiming calculator.

If a fix were easy, it would have happened by now. Instead, tackling the shortfall will necessitate a degree of compromise that is rarely seen on Capitol Hill. Social Security can't be addressed through reconciliation, the method by which the Senate can pass certain legislation with a simple majority, without the threat of filibuster. And it will involve solutions that won't be an easy sell for many American households.

Lawmakers could raise taxes to increase inflows, cut benefits to slow outflows, raise the retirement age, or some combination. They might also look to infuse some general revenue into the program, either through a loan or a one-time transfer that would add to the country's debt, says Kathleen Romig, director of Social Security and Disability Policy at the Center on Budget and Policy Priorities. Since benefit cuts and tax increases are usually phased in over time, the longer Congress waits to act, the more likely it will need to add general revenue to raise quick money and plug the shortfall, Romig says.

On the revenue side, Congress could increase the rate of the FICA tax, the payroll tax that funds Social Security and Medicare; the 12.4% that goes to Social Security is split equally between employers and employees. Lawmakers could also subject more income to the tax—the current cap is $147,000 for 2022. President Joe Biden has pledged not to raise taxes on anyone making under $400,000, so one bill to expand the program, sponsored by Rep. John Larson (D., Conn.), proposes reinstating the Social Security tax at incomes above that amount. Politicians could also subject 100% of benefits to federal income tax, instead of the current 85% above certain income levels.

On the benefit side, Congress could increase the full retirement age, the age at which you receive 100% of the benefits you're entitled to. One proposal would lift the full retirement age from 67 to 69. Although it doesn't always register as a benefit reduction, raising the full retirement age by two years results in a 13% lifetime benefit cut regardless of when a recipient claims, Romig says.

That's one of the fixes that lawmakers settled on in 1983, the last time the trust fund faced depletion. In a deal brokered by the Democratic Speaker of the House Tip O'Neill and Republican Sen. Bob Dole, President Ronald Reagan signed a law that gradually increased the full retirement age to 67 from 65. The change was so incremental that it's just coming to fruition now, with today's 62-year-olds the first to have a full retirement age of 67. (The 1983 deal also accelerated a previously scheduled payroll-tax rate increase and for the first time made some Social Security benefits subject to federal income tax, among other adjustments.)

Think of Social Security as a house built in the mid-1930s, Romig says. It's structurally sound, but the plumbing is on its last legs and will need repair for the house to be functional for the long haul.

Making a Backup Plan

Any changes to the program's benefits will almost certainly exempt current beneficiaries. Those who doubt this need only picture the backlash that lawmakers would face if they cut seniors' paychecks: advocacy groups and political challengers would fill the airwaves with images of older Americans lining up for food pantry donations or sitting down to meals of crackers and canned tuna. It didn't come to that in 1983 because Congress did act; the major players back then understood the stakes and the uproar they'd face if benefit checks were suddenly cut in value, says Eugene Steuerle, co-founder of the Urban-Brookings Tax Policy Center and a former deputy assistant secretary of the Treasury for tax analysis.

Any changes to Social Security are also unlikely to affect people within about 10 years from retirement. Lawmakers will want to give workers time to adjust their retirement plans accordingly. Assuming Congress waits a decade or so to act, an educated guess would be that anyone who is currently 45 and up probably doesn't have to fear cuts, and will most likely proceed through retirement with benefits as currently structured.

Piper, 38, is already making adjustments. He is conservatively planning for a 23% benefit cut in his personal retirement projections, and he's saving more to make up the difference. He hasn't ruled out buying an annuity, but he says it's too early to do any concrete planning around such a purchase. "Who knows what products will be available many years from now?"

For those who want savings targets, a 35-year-old earning $100,000 a year today would need to save an additional, inflation-adjusted $33 a week over the course of his or her career to make up for a 20% lifetime reduction in Social Security benefits, according to a report by HealthView Services, which provides retirement healthcare cost data and planning tools for the financial services industry. The calculation assumes a typical employer 401(k) match, 6% annual returns during their working years, and 5% annual returns during their retirement years, which begin at age 67.

Some planners run projections without Social Security, just to see where their clients would stand on their own. "The younger the client, the more often they'll say, 'Let's not include it in the plan,' " says Steven B. Goldstein, vice president and private chief financial officer at oXYGen Financial. Better not count on something they don't expect to get.

Jake Northrup, a financial planner and founder of Experience Your Wealth in Bristol, R.I., uses his young clients' current Social Security benefit estimate in their future models. "Assuming this won't grow in the future is a very conservative assumption," he says. After all, your Social Security benefit is calculated based on your top 35 earning years, and many of his clients are still in their 30s—as is Northrup himself.

Younger people are more motivated by financial independence than traditional retirement anyway, Northrup says. They're not envisioning punching out of a company job at age 65; they're building the kind of career where they can mix travel and entrepreneurship, and work on their own terms for as long as they please. Whatever form it takes, Social Security will be a supporting player at best. "You control what you can control," Northrup says.

For Bowron, the Alabama millennial, that means recalibrating his expectations about what his retirement will look like—and hoping that the money he has saved in his 401(k), his stake in the family business, and any royalties from his books will be enough to sustain his postwork years when the time comes.

While many boomers are retiring by 65 and traveling the world, his generation might retire at 75 and go fishing close to home, he says. "I don't think the retirement the people are enjoying now is what will be around in 30 years."

Write to Elizabeth O'Brien at elizabeth.obrien@barrons.com

NS gretir : Retirement Planning | gcoho : Generational Cohorts | npag : Page One Stories | gcat : Political/General News | gcom : Society/Community | gpersf : Personal Finance | ncat : Content Types

IPD SNRRETIREMENT

IPC G/SSA

PUB Dow Jones & Company, Inc.

AN Document B000000020220909ei9c000b5

BARRON'S

CLM Interview

HD **Getting a Grip On Quantitative Tightening**

BY By Lisa Beilfuss

WC 1,895 words

PD 12 September 2022

SN Barron's

SC B

PG 30

LA English

LP

The Federal Reserve now owns about a third of both the Treasury and mortgage-backed-securities markets as a result of its emergency asset-buying to prop up the U.S. economy during the Covid-19 pandemic. Two years of so-called quantitative easing doubled the central bank's balance sheet to $9 trillion, equivalent to roughly 40% of the nation's gross domestic product. By adding so much liquidity to the financial system, the Fed helped fuel significant gains in the stock, bond, and housing markets, and other investment assets.

TD

Now, with inflation rampant, the Fed is unwinding this liquidity via a process known as quantitative tightening, or QT. In June, the central bank started to shrink its portfolio by letting up to $30 billion of Treasuries and $17.5 billion of mortgage-backed securities, or MBS, roll off its balance sheet, or mature without reinvesting the proceeds. The amount will double this month and effectively kicks in Sept. 15, as Treasuries are redeemed midmonth and at the end of the month.

QT is as ambitious as its impact is uncertain. At full-throttle, the pace of balance-sheet tightening will be much more aggressive than in the past, and come at a time when interest rates are rising quickly. What could go wrong? Potentially, a lot, suggests Joseph Wang, a former trader on the Fed's open-market desk and author of the Fed Guy blog and Central Banking 101. Wang explains what's at stake in the edited conversation that follows.

Barron's: How will quantitative tightening unfold, and how will accelerated redemptions affect the market?

Joseph Wang: When the economy wasn't doing well, QE put downward pressure on interest rates and increased liquidity in the financial system. Now the Fed wants to tighten financial conditions. QT increases the amount of Treasuries available to investors while also reducing their cash holdings. Mechanically, the U.S. Treasury issues new debt to an investor and uses the issuance proceeds to repay the Treasuries held by the Fed. The Fed receives that cash and then simply cancels it—the opposite of what happened during QE, when the Fed created cash out of thin air.

When you're increasing the supply of bonds into a market that isn't very liquid, and when the marginal buyer is changing as the Fed steps back, you're going to get volatility. Markets haven't priced in just what that means. We will likely see higher fixed-income yields. Higher yields affect equities in a few ways. There is the portfolio-rebalancing impact, whereby losses on the bond side of a portfolio would prompt an investor to sell some equities to rebalance. QT also reverses the risk-on effect of QE, which occurred when many investors looking for yield moved into riskier assets or longer-dated Treasury bonds.

This is happening at a time when Treasury issuance is high. Why does that matter?

Market pricing is determined by supply and demand, and in the coming years, there is going to be a tremendous supply of Treasuries coming from two sources. One, there are the budget deficits the U.S. government is running. While the deficit will shrink a little this year compared to last, the Congressional Budget Office says the trajectory is basically a trillion dollars a year of Treasury issuance for the foreseeable future. The second source of additional supply is QT. Together, these will increase the supply of Treasuries to historically high levels of around $1.5 trillion this year and next. Before Covid, net supply was about $500 billion.

On the demand side, the marginal buyer is changing as the Fed extricates itself from the Treasury and mortgage markets. The hedge funds aren't there. The Fed isn't there. And the banks aren't there. We won't have to go through a phase of price discovery. Keep in mind the context: Treasury-market liquidity is weak right now. There is some fragility, and it will likely be stressed as QT ramps up.

Speaking of the marginal buyer, who will fill the void as the Fed steps back? Can these markets function without the Fed?

I'm not sure who the new buyer will be, which is why I think there could be significant volatility in interest rates. But new buyers can be manufactured through policy. One way is through a Treasury buyback program, where the Treasury becomes a large buyer of Treasuries. The Treasury department recently floated this idea. Another way that new buying by banks could be encouraged is through regulation changes, wherein regulators reduce the capital requirements of banks, thus encouraging them to buy more government debt.

But the point is that if issuance is growing by a trillion dollars a year, it's hard to say that there will ever be enough marginal buyers. We are locked in a world where there will always be QE, because the Fed will have to ultimately become the buyer again. The growth in Treasury issuance is faster than the market can handle by itself.

Consider that over the past 20 years, the amount of Treasuries outstanding has more than tripled, but the average daily volume in the cash market has grown far slower. That is inherently unstable. It's like a stadium that keeps getting larger while the number of exits remain the same. When a lot of people need to get out, as happened in March 2020, then the market has issues.

Fed officials say they don't know much about how QT will play out. Why is that?

The way that QT plays out will depend on moving parts, and a lot of it is beyond the Fed's control. First, there is the uncertainty around what the Treasury issues. It could issue lots of longer-dated Treasuries, which the market will have more difficulty digesting, or more shorter-dated Treasury bills, which the market can more easily digest. Depending on what the Treasury is doing, the market may have to digest a lot more duration, which would be disruptive in a Treasury market where liquidity is already thin.

Where liquidity comes out is also beyond the Fed's control. When the Treasury issues new securities, they can either be purchased by cash investors, like banks, or levered investors, like hedge funds. When they're purchased by levered investors, the money that goes to fund them most likely comes out of the Fed's reverse repo facility, or RRP, an overnight lending program that you can think of as excess liquidity in the financial system.

If the newly issued Treasuries are purchased by levered investors, that results in draining liquidity that the financial system doesn't really need, so the impact is neutral. But if the newly issued securities are purchased by cash investors, someone is taking money out of the bank and using it to purchase Treasuries to repay the Fed. In that case the banking sector loses liquidity, which can be disruptive, because it's possible that someone, somewhere is dependent on that liquidity. That is what happened in September 2019 when the repo market seized up and the Fed had to add more reserves.

It seems you are worried that something will break again. Why?

It's impossible for the Fed to know how the liquidity will be drained out of the financial system. But we can look at who is buying today, and buying is almost all coming from the banking system, as opposed to parties such as hedge funds. The RRP has been steady at around $2 trillion since the beginning of the year. So it seems like QT is going to be draining liquidity out of the banking sector rather than the RRP.

That is the opposite of what the Fed wants. Officials have assumed they could ramp up the pace of QT aggressively, because they see a lot of liquidity parked in the RRP. What they may not understand is that how liquidity gets drained is beyond their control. And at the moment, as noted, it is coming out of the banking system.

Fed Chairman Jerome Powell said in July that QT would last between two and 2½ years. That suggests the Fed's balance sheet will shrink by about $2.5 trillion. Is that a realistic assumption?

The Fed thinks of QT as being limited by how much liquidity the banks need to operate well. They feel that the balance sheet could drop by around $2.5 trillion, and it would be fine. But remember, the Fed doesn't have a lot of control over how the liquidity is drained. It seems they want the banking sector to have above $2 trillion in reserves. Right now, the banking sector has about $3 trillion. The only way QT can proceed as currently forecast is to ensure that the liquidity is drawn more evenly out of the financial system—meaning more liquidity coming out of the RPP versus the banking sector. If the Fed can't find a way to achieve that balance, it might have to stop early. But there are ways that they can make this work.

What are they?

There are two primary solutions to the problem of too much liquidity draining from the banking sector while a lot remains in the RRP. First, the Fed can do what it did in the fall of 2019 and start buying a lot of Treasury bills. From the Fed's perspective, purchasing bills isn't the same as QE. They are basically exchanging short-dated assets for reserves, which are also short-dated assets, intentionally adding reserves into the system without affecting interest rates.

Second, and more likely, the Fed could work with the Treasury. If the Treasury conducts buybacks by issuing shorter-dated bills and uses the proceeds to purchase longer-dated coupons, it would move liquidity out of the RRP and into the banking system because the Treasury bills would be purchased by money-market funds with money held in the RRP. The sellers of the coupons to the Treasury would then be depositing the funds in a commercial bank. Moving money from the RRP to the banking system would allow the Fed to proceed with QT without having to worry about liquidity in the banking system falling by too much.

Will the Fed wind up selling mortgage-backed securities?

Its plan is to roll off a maximum of $35 billion a month in agency mortgages, but it estimates that it will only be able to do about $25 billion a month. Unlike with Treasuries, whose principal all gets paid on the maturity date, mortgage loans can be prepaid. For example, if someone who owns a home refinances, they take out a new loan to repay an old loan. In selling a house, they might using the proceeds to repay the mortgage. That all slows as mortgage rates rise.

Selling MBS is another tool the Fed has to tighten financial conditions, but it doesn't seem like they want to deploy it. In the past few months, the housing market has softened significantly. I would imagine they want to see how this plays out before further tightening financial conditions in housing.

Thanks, Joseph.

Write to Lisa Beilfuss at lisa.beilfuss@barrons.com

CO fed : Board of Governors of the Federal Reserve System

IN ibnk : Banking/Credit | ifinal : Financial Services

NS ecat : Economic News | e1201 : Central Bank Intervention | e12 : Monetary Policy | gvbod : Government Bodies | gvtre : Finance/Treasury Department | ncolu : Columns | nitv : Interviews | gcat : Political/General News | gpir : Politics/International Relations | gpol : Domestic Politics | gvexe : Executive Branch | ncat : Content Types | nfact : Factiva Filters | nfcpex : C&E Executive News Filter

RE namz : North America | usa : United States

IPD Barrons.com

IPC G/FDL

PUB Dow Jones & Company, Inc.

AN Document B000000020220910ei9c00001

BARRON'S

CLM Funds

HD **ESG Sector ETFs Could Be Volatile. What to Do Instead.**

BY By Debbie Carlson

WC 1,023 words

PD 12 September 2022

SN Barron's

SC B

PG 27

LA English

LP

Hot money has come to sustainable investing.

Despite lagging behind the market in the first half of 2022, investors in sustainable funds weren't more likely to ditch their holdings versus their traditional-investing counterparts. But one area was more susceptible to turnover: sector exchange-traded funds.

TD

These funds, which focus on a narrow slice of the market, have seen persistent outflows over the past year, especially clean-energy sector funds. They skyrocketed in price amid surging demand in 2020, only to crumble in 2021 and the first half of 2022. Clearly, at least some investors were chasing returns in these funds.

In the one-year period ended June 30, the bulk of sustainable-sector equity net outflows was concentrated in clean-energy and other ETFs, according to Refinitiv Lipper Research data. There were net inflows into sustainable-sector mutual funds and sustainable U.S. diversified ETFs and mutual funds.

Return-chasing is unusual in sustainable investing because a hallmark of the style is that investors own funds that reflect their values and are more likely to tolerate extended underperformance. That happened during the 2008-09 crash, when socially responsible investors—as the style was called then—generally rode out the S&P 500's drop and rebound, says Tom Roseen, head of Refinitiv Lipper Research.

But a lot has changed since 2008. Socially responsible investing is no longer the purview of faith-driven investors or others with strong moral convictions who insist on mutual funds that shun alcohol, tobacco, firearms, and oil stocks. It's now dominated by environmental, social, and governance, or ESG, investing, in which third-party rating firms score companies on certain criteria to create best-in-class rankings. ESG funds might even include odd bedfellows, such as oil companies with a diverse workforce.

One example of how flows shifted in clean-energy funds was the Invesco Solar ETF (ticker: TAN), which saw assets under management rise from $418 million in early 2020 to peak at $5.2 billion in early 2021 after rising 233% in 2020. From 2021 through May 2022, assets fell to $1.79 billion as prices retreated, although as of early September assets are at $2.9 billion.

The sector equity subgroup represents a smaller part of sustainable investing, and Roseen wonders if this is a sign of a different investor in this space who might more readily follow market twists and turns, especially with the rise of ETFs and ESG's additional focus on return. "Who has been gravitating toward this? Are they as committed as the old socially responsible investors?" he asks.

Some newer ESG-minded investors may hop in and out of ETFs, but the style is designed as a long-term core holding through market cycles, financial advisors say. Sustainable investing focuses on big-picture trends, such as energy transition, that could take a decade or more to play out, which doesn't lend itself to quick trading. Investors who do use sustainable-sector equity ETFs should limit them to a small part of their portfolio, they say.

"We think about constructing portfolios that reflect a sustainable economy," says Garvin Jabusch, chief investment officer of Green Alpha Advisors and co-manager of the $300 million Shelton Green Alpha fund (NEXTX). "I always tell people, if you're thinking about a time frame of less than five years, we're probably not the right strategy for you."

Rene Reyna, head of thematic and specialty product strategy at Invesco, says thematic funds like the solar ETF allow investors to take advantage of market moves. Invesco has some of the oldest thematic and sector equity ETFs in the sustainable and ESG space. He says the firm sees two types of investors: those who are allocate part or all of their portfolios to ESG and are staying the course, and those who are using ETFs opportunistically.

"There is interest or demand for exposures outside just your general core-type holdings. I don't want to say it's hot money, because that's not necessarily the case," Reyna says. "But I would say that a lot of thematic opportunity sets are designed to be more secular themes."

Tim Hughes, managing director of Wealthspire in Reston, Va., customizes investing strategies for clients interested in both traditional and sustainable investing. He says the firm tries to manage client expectations about sustainable investing, explaining that their portfolios could underperform if they don't own certain market sectors.

Similarly, Peter Krull, CEO of Earth Equity Advisors, a sustainability-focused financial planner in Asheville, N.C., explains to clients that this style is skewed toward growth and will underperform when value dominates the market cycle, as it does now. Hughes and Krull say their clients haven't expressed worries about sustainable investing's underperformance this year.

For investors who want sustainable funds with diversified holdings and good, long-term track records, both advisors recommend mutual funds for the main part of a portfolio. Hughes uses Calvert US Large Cap Core Responsible Index (CSXAX), Calvert International Responsible Index (CDHAX) and Boston Walden Trust Small Cap (BOSOX). Krull uses Shelton Green Alpha and Brown Advisory Sustainable Growth (BIAWX).

Although sector funds are volatile, Krull says they can play a small part in a sustainable portfolio. His firm uses the First Trust Nasdaq Clean Edge Green Energy Index ETF (QCLN), which he limits to about 5% to 6% of total assets in a moderately aggressive portfolio. "Just be aware that it's going to move not just with the whims of the market, but also the political aspect as well," Krull says.

The current market action and flows are a reminder that market cycles matter, as does knowing what's inside a fund. Sustainable investors who avoid investing in certain sectors or industries will underperform when those areas rally, Roseen says. Despite the drubbing sustainable investing is taking now, he says, "I think over the long haul, we're going end up with at least similar returns on the responsible side" as in traditional investing.

Email: editors@barrons.com

IN iresinv : Sustainable Investment | iextrfu : Exchange Traded Funds | i81502 : Trusts/Funds/Financial Vehicles | i8150211 : Mutual Funds | ibnk : Banking/Credit | ifinal : Financial Services | iinv : Investing/Securities | ialtinv : Alternative Investments

NS cesg : Environmental/Social/Governance | cenvire : Corporate Environmental Responsibility | ccat : Corporate/Industrial News | gpersi : Personal Investments | ncolu : Columns | gcat : Political/General News | gpersf : Personal Finance | ncat : Content Types

IPD Barrons.com

IPC I/EXT

PUB Dow Jones & Company, Inc.

AN Document B000000020220909ei9c0005l

BARRON'S

CLM Income Investing

HD **How to Get a 6% Yield And Profit From Rising Interest Rates**

BY By Lawrence C. Strauss

WC 1,016 words

PD 12 September 2022

SN Barron's

SC B

PG 28

LA English

LP

Amid a historic selloff in bonds, the leveraged-loan sector is acting like a sanctuary. With the bond market overall down11% this year, including interest payments, leveraged loans are acquitting themselves well, with a loss of 1.3%, including interest.

The sector could still be a winner compared to traditional fixed income, given its average 7.5% yield and link to rising interest rates. But it will have to overcome some mounting headwinds.

TD

The sector's strength doesn't arise from the quality of its credit. Leveraged loans are often issued to highly indebted companies with "junk" credit ratings. Banks and other financial firms make the loans, which are then sold to investors in public markets.

The main reason they're doing well is their high floating rates. Interest on the loans typically resets every three months, pegged to benchmarks like the London interbank offered rate. The three-month Libor was recently at 3.2%. Loan yields right now typically add another three to 5.5 points, as you'd find in the securities held by Paul Massaro, longtime manager of the $4.6 billion T. Rowe Price Floating Rate fund (ticker: PRFRX).

Loan yields are lower than those on junk bonds, averaging 8.4%, but they're well above the 3.4% investment-grade average, according to the Bloomberg U.S. Aggregate Bond Index.

With the fed-funds rate inching higher, benchmarks like Libor will adjust up, quickly boosting loan yields. "As the Fed has hiked this year, our base rate has been rising, giving us additional compensation," says Massaro.

Another nice feature: The loans expire quicker than long-term debt. They typically mature in six or seven years, though they can be acquired on the secondary market with even shorter effective maturities. That provides a cushion against the "duration" risk in traditional fixed income, whereby bonds with longer terms fall sharply in price as market yields rise.

"Loans hold a unique place in the landscape of fixed income, with a combination of competitive yields and low duration," says Massaro.

So what's not to like? For one thing, defaults. If the economy falls into a recession, the floating-rate sector could get crushed. So far, the default rate looks quite low, though it is heading up. The rate was 1.3% in August, up from 1% in July and 0.6% at the end of 2021. The average since 2007 in nonrecessionary periods is 1.7%. With recessions taken into account, the overall rate jumps to 2.5%.

Loan defaults are "still very benign overall," says Eric Rosenthal, senior director in the leveraged finance group at Fitch Ratings.

Loan investors do have some protections over bond holders. Bank loans, which are secured by the issuer's assets, are usually at the top of a company's capital structure, with first-lien status. In a bankruptcy, the holders of loans would get paid ahead of high-yield-bond or equity owners.

Still, a long or deep recession would be a killer, as would a selloff in junky assets. During the financial crisis in 2008, the Morningstar LSTA US Leveraged Loan Index declined nearly 30%, though it rebounded the next year, returning 52%. More recently, in March of 2020 as the pandemic began, that index lost 12%.

The loan index has been showing strength lately, rallying a bit over the summer and adding price gains to the sector on top of interest.

A low-cost play is the $9.3 billion iShares Floating Rate Bond exchange-traded fund (FLOT). Its total return is about flat this year. The ETF has a 30-day SEC yield of 2.7% and an expense ratio of 0.15%.

Paul Olmsted, a research analyst at Morningstar who covers fixed-income strategies, favors actively managed funds over index funds. Deep-dive credit research can pay off in a climate with a rising default rate, he says. "You can't avoid defaults, but you can minimize them. That's what you pay for with active management."

Both T. Rowe Price and Eaton Vance have lots of experience in the space, he observes. He recommends T. Rowe Price Floating Rate, which is down 1.5% this year. It yields 5.8% and ranks in the top 10% of its Morningstar peer group, year to date. And its 10-year annualized return of 3.25% puts it in the top quarter in that period.

Massaro says he isn't that worried about rising defaults, pointing out that many companies in the loan universe refinanced debt when rates were lower and pushed out debt maturities.

As of July 31, the fund was tilted toward financials, airlines, healthcare, and broadcasting companies.

One of its top holdings is HUB International, a private insurance brokerage. The loan held by the fund expires in 2025 and has a coupon of 5.95%. Given the price of the loan, its yield to maturity is 7.4%. The insurance-brokerage industry has "been very resilient through a lot of different economic cycles," Massaro says.

The fund chief also likes some loans in the software sector, including holdings like Epicor Software. Its loan, maturing in 2027, has a yield to maturity of 7.25%.

Another option is the $7.8 billion Eaton Vance Floating-Rate Advantage fund (EIFAX), which recently had a distribution rate of 6.6%. It has underperformed this year, but its 10-year annualized return of 3.9% ranks in the top 2% of peers.

The performance of these funds hinges on whether the U.S. avoids a recession as the Fed hikes rates to fight inflation. If defaults don't spike much as rates keep rising, bank loans should continue to be near the head of the class among bond categories.

Loan prices "could go lower and be cheaper," says Andrew Sveen, head of floating-rate loans at Eaton Vance, but "their intrinsic value is clearly higher than the current level."

Write to Lawrence C. Strauss at lawrence.strauss@barrons.com

NS e1202 : Interest Rates | clever : Leveraged Loans | ccat : Corporate/Industrial News | e12 : Monetary Policy | ecat : Economic News | ncolu : Columns | c17 : Corporate Funding | ncat : Content Types | nfact : Factiva Filters | nfcpin : C&E Industry News Filter

IPD Barrons.com

IPC N/CNW

PUB Dow Jones & Company, Inc.

AN Document B000000020220909ei9c000dx

BARRON'S

HD **How Europe's Energy Crisis May Play Out --- Energy bills are soaring for families and companies, all but assuring a recession. Stocks could fall another 15% before the economy settles.**

BY By Avi Salzman
WC 1,596 words
PD 12 September 2022
SN Barron's
SC B
PG 14
LA English

LP

The energy crunch in Europe escalated into a full-blown crisis this past week after Vladimir Putin cut off the pipeline that supplies a third of the natural gas that Russia sends to Europe. Natural-gas prices soared 30% at one point, and Goldman Sachs analysts projected that Europeans will see their monthly energy bills triple this winter to an average of 500 euros, or almost $500, per family at the peak.

When the worst of it hits, utility bills could account for 15% of European gross domestic product, crowding out other kinds of spending and investment. Goldman warns that the repercussions "will be even deeper than the 1970s oil crisis."

TD

Europe is now on the verge of recession, if not already in one, and the worst looks yet to come. Graham Secker, Morgan Stanley's chief European equity strategist, expects an imminent recession in Europe that will pull earnings growth into negative territory next year. Result: Europe's stocks, already off 14% this year, could well fall another 15%, Secker says.

Plenty of investors have already headed for the doors. Withdrawals from European exchange-traded funds last month hit the highest level since the Brexit panic of 2016, BlackRock reported.

European policy makers, initially slow to respond, have snapped into action, but they have few easy options. The European Central Bank has the near-impossible task of dampening inflation while avoiding a deep recession. The ECB raised interest rates by 0.75 percentage points on Thursday, its largest hike ever, and ECB President Christine Lagarde warned of a "really dark downside scenario."

Countries are reducing power use, mostly through voluntary measures. Thermostats in Spanish office buildings were turned above 80 degrees last month. The lights that normally illuminate Berlin's famed Brandenburg Gate have gone dark. European Union energy ministers are considering mandatory electricity limits and caps on Russian energy prices, among other measures.

Hundreds of billions of dollars in government support—potentially exceeding Covid bailouts—will soften the blow of high prices. Germany has already authorized €65 billion to help households, and the United Kingdom capped household gas and electric bills at 2,500 pounds sterling ($2,898) a year for the next two years.

The lifeline being extended to households and small businesses may not save larger firms, however. Many are already reeling.

"If there are any shortages, it's going to be on the industrial side," says Jack Ablin, chief investment officer at Chicago-based Cresset Capital. While natural gas is used to produce electricity and heat homes, it's also a key input for industrial plants.

The metals industry is facing a "life or death winter" after electricity and gas costs soared over 10 times last year's levels, a group of chief executives wrote in a letter asking the European Parliament for emergency aid. The products they make sell for less than the cost of keeping the plant running, they argued. Half of the EU's zinc and aluminum production has already been halted. "We know from experience that once a plant is closed, it very often becomes a permanent situation."

Government bailouts are likely to soften the pain, but not eliminate it. "You're talking about a ballpark of over €1 trillion of extra energy costs for people," Secker says. "Governments will try to socialize some of that with fiscal support. They're not going to have the ability to do all of it. The number's too big." Politically tricky decisions on rationing energy use could still be ahead.

As the crisis deepens, analyst estimates of corporate earnings could well prove too rosy. Analysts on average expect 17% growth in European earnings this year and 2% next year, Secker says. By comparison, Morgan Stanley sees 12% growth this year and a 10% contraction in 2023.

The MSCI Europe Index, which contains companies from 15 countries, is now trading at 11.5 times expected earnings, below its historical average of 13.5. Secker sees that dropping to 10 as stocks flag in coming months.

To understand why the outlook is so bleak, it helps to look at how the European power crisis came to be.

The problems actually began more than a year ago. Natural-gas prices in Europe had already more than quadrupled on a year-over-year basis as of last September. Demand had risen as Covid lockdowns waned, and supplies were slow to catch up. In addition, a cold prior winter had depleted the amount of gas in storage.

Russia's invasion of Ukraine in February vastly exacerbated the problem, because buying Russian energy meant funding Russia's war. Oil prices have been volatile since the war began, but the impact on natural gas is a bigger deal. Europe relies on gas for about a quarter of its needs, from heating to electricity to industrial production. In some countries, it makes up much more. Italy, now the "sick man of Europe," relies on gas for 40% of its energy. Europe needs to import most of its natural gas because it has limited capacity to produce it.

Russia provided Europe with 40% of its natural gas before the war. For years, cheap Russian gas powered the economies of countries such as Germany, which was directly linked to Russian supply via the Nord Stream 1 pipeline that runs under the Baltic Sea. Germany was on the brink of doubling its imports from Russia through a new pipeline called Nord Stream 2 when the war broke out.

The war turned the energy crisis into a political one, too. European sanctions against Russia initially spared most energy sources, but European countries began to transition away from Russia regardless. And Russia accelerated the process, ratcheting down the amount of gas it sent through pipelines. The announcement from Russia's state-controlled energy giant Gazprom that Nord Stream 1 needed maintenance and wouldn't come back on is the latest blow; analysts think it's likely the pipeline stays off through the winter. Europe now gets just 9% of its gas from Russia.

The crisis has been particularly acute because other sources of power have underperformed. Droughts have left rivers at a trickle, reducing hydropower by 26%. And a larger-than-usual number of nuclear plants, particularly in France, have been shut down for maintenance this summer. An increase in solar power has taken up some of the slack, but Europe remains undersupplied heading into the winter.

Russia says that Europe started the economic war by imposing sanctions, and sealed its own fate this winter. "We will not supply gas, oil, coal, heating oil. We will not supply anything," Putin said at a forum in Vladivostok on Wednesday.

There are some positive developments, though, that should give Europeans hope for the next few months. Natural gas spiked briefly above $100 per million British thermal units on Aug. 26 just ahead of the Nord Stream shutdown—six times recent historical levels—but that price didn't hold. By shutting off Nord Stream 1, Putin has now played his most powerful card and prices have still retreated to $60.

"In terms of power-price hikes, we've probably seen the worst," says Deepa Venkateswaran, a Bernstein utilities analyst. Months of preparation have paid off. Europe vowed to fill its storage tanks to 80% capacity by the end of October, and has already hit 82%, giving it several months of spare capacity. And record cargoes of American liquefied natural gas have been making their way to Europe to fill the gaps. Venkateswaran expects French nuclear plants to come back on-line in coming weeks. Gavekal Research's Cedric Gemehl thinks "the shortage is unlikely to prove catastrophic."

Still, the crisis has upended power markets and put the entire electrical system in jeopardy. An executive at Norwegian utility Equinor says that utilities could be on the hook for as much as €1.5 trillion worth of margin calls, and Finland warned of a "Lehman moment" in power markets. Utilities that sell power to traders and to one another use the futures market to hedge. When prices rise, they face margin calls. Some countries have already announced bailouts. Venkateswaran doesn't expect those margin calls to be anything like the collapse of Lehman Brothers, however, because it's driven by a sudden spike in prices, not speculation. "It's contained within the energy system probably," she says.

In all, it could take months for the crisis to play out and stocks to settle. Ablin is sitting in cash, waiting for more clarity on interest rates. When the Federal Reserve's cycle of tightening rates slows down, he expects that the euro will rise against the dollar and open up a buying opportunity in European stocks. At that point, he'll start buying names that pay stable and growing dividends, like the stocks in the First Trust S&P International Dividend Aristocrats ETF (ticker: FID). Among the European names in that index are financial company Allianz (ALIZY) and pharmaceutical giant Novartis (NVS).

"What appeals to me is you're dealing with very high-quality companies," he says. "Their balance sheets can withstand a pretty ugly quarter. Management has been dedicated to maintaining and growing their dividend. And, as a result of that, they're going to do whatever they can to manage their cash flow."

Write to Avi Salzman at avi.salzman@barrons.com

IN i1 : Energy

NS ecat : Economic News | c13 : Regulation/Government Policy | ccat : Corporate/Industrial News | e1201 : Central Bank Intervention | e51 : Trade/External Payments | gesanc : International Sanctions | gpir : Politics/International Relations | gtrade : Trade Barriers/Restrictions | npag : Page One Stories | e12 : Monetary Policy | gcat : Political/General News | gdip : International Relations | ncat : Content Types | nfact : Factiva Filters | nfcpin : C&E Industry News Filter

RE eurz : Europe | asiaz : Asia | easiaz : Eastern Asia | russ : Russia | ussrz : CIS Countries | apacz : Asia Pacific | bric : BRICS Countries | devgcoz : Emerging Market Countries | dvpcoz : Developing Economies | eeurz : Central/Eastern Europe

IPD Barrons.com

IPC BLK

PUB Dow Jones & Company, Inc.

AN Document B000000020220909ei9c000m9

BARRON'S

HD **Plants Need Nitrogen. Ammonia Needs Gas. Result: Fertilizer Arb.**

BY By Jack Hough

WC 1,020 words

PD 12 September 2022

SN Barron's

SC B

PG 9

LA English

LP

Apple launched new iPhones and watches this past week, but let me start with something more exciting: fertilizer arbitrage.

Profits for North American fertilizer companies have exploded higher, and the reason has to do with the war in Ukraine, and a century-old manure workaround that today feeds the planet.

TD

See, plants need many elements to thrive, and none is more important than nitrogen, which forms proteins, and thus tissue, for all living things. Air is mostly nitrogen, but farming depends on more-reactive nitrogen compounds, like ammonia, made from nitrogen and hydrogen. Dung is filled with the stuff, luckily enough. But if we relied just on manure for fertilizer, the planet would only be able to support a population of maybe four billion, tops. On Nov. 15, we're projected to hit eight billion.

The extra four billion owe their existence to a German chemist named Fritz Haber who spent World War I developing two things of decidedly mixed benefit to humanity: chemical weapons and a process for making ammonia from air, using hydrogen gas, pressure, and a catalyst. Today, it's estimated that half of the nitrogen atoms in the body of an average developed-world resident once passed through a chemical plant using the Haber process. The world turns out more than 170 million metric tons of ammonia per year, mostly by using natural gas for the hydrogen.

See where this is going? Russia has shut off Europe's natural-gas supply, and since gas isn't easily shipped overseas, the price in Europe is many times the U.S. price.

Gas makes up about three-quarters of the cost of fertilizer, so European plants have simply shut down, leaving North American ones to supply the market. One price index for various manufactured nitrogen fertilizers has gained 168% since the end of 2019. And fertilizer is easy to ship, especially as a nitrogen compound called urea, which comes in granules.

Revenue for CF Industries Holdings (ticker: CF), a U.S. fertilizer pure play, is expected to be up 158% from 2019, even though the company shut down some of its European manufacturing. And earnings per share have multiplied some nine times to a projected $18 and change this year.

CF shares are up 139% since the end of 2019. They trade at less than six times this year's projected earnings. Investors are cautious because earnings are broadly expected to peak this year, and no one knows how quickly they will come down. The low estimate has CF earning about $7 a share next year. The high estimate is over $22.

Meanwhile, the war in Ukraine has also cut into grain production there, raising prices for corn and other crops. Farmers elsewhere are scrambling to raise output, which means they will need more fertilizer. And the natural-gas disruption in Europe appears unlikely to abate soon. "That is going to keep the nitrogen complex relatively supported," says Chris Lawson, the head of fertilizers at CRU Group, a commodity consultancy.

Fertilizer demand is seasonal, with volumes picking up late in the year. Joshua Spector, who covers fertilizer stocks for UBS, expects prices to push higher over the next three to six months. He predicts 25% stock upside for CF, 27% for a smaller player called LSB Industries (LXU), and 20% for a Canadian company called Nutrien (NTR).

That last one has less natural-gas exposure than the others. Nutrien specializes in potash, or potassium fertilizer, which gets its name from an early manufacturing process involving wood ash and pots, but these days is produced largely from mined salts. Belarus is a big player, but its output has been hit by sanctions, leaving Canada and others to fill the supply gap.

On to Apple (AAPL). This past week, it introduced a new crop of iPhones that were so little changed from last year's phones that the watches stole the show. There, the big news was a new $799, tank-size Ultra model with a choice of three bands for Alpine climbers, endurance runners, and deep-sea divers. My favorite feature is the 86-decibel distress siren that can be heard from 200 yards away—otherwise known as well within yelling range. I suppose that if a remote wilderness accident left me both immobile and mute, yet able to work my watch, and somehow within a five-iron distance of the nearest rescuer, it would be nice to have options.

I'm in the market for an Apple Watch, as it turns out, but I settled for the mainstream model for $529. The biggest new feature in the watch is a temperature tracker for ovulation. I have no immediate plans to ovulate, but again, it's nice to have options.

I can't remember the last Apple launch that wowed me, but I'm happy enough with the software ecosystem, and I use my gadgets constantly. So, I shell out every three years or so for a new handset, watch, and earbuds, plus $30 a month for a service bundle that includes cloud storage, music, and streaming video.

Wedbush Securities estimates that there are now a billion iPhones worldwide, 240 million of which are at least 3.5 years old, which I guess explains why EPS is expected to continue creeping higher by single-digit percentages in the years ahead.

But Apple shares already trade at an ambitious 23 times forward earnings estimates, and about 80% of analysts already say to buy them. The bull case on Apple from here calls for a burst of rosy sentiment. For example, Bank of America Securities sees 18% upside, in part because it argues that the shares deserve a valuation of 29 times its earnings estimates for calendar 2023.

Something about all of that bullishness, the wobbly economy, and Apple's ho-hum launch day leaves me wondering whether I should have paid up for the distress siren.

Write to Jack Hough at jack.hough@barrons.com. Follow him on Twitter and subscribe to his Barron's Streetwise podcast.

IN i2513 : Fertilizers | i25 : Chemicals | i3302 : Computers/Consumer Electronics | i3441 : Telecommunications Equipment | ibasicm : Basic Materials/Resources | icellph : Cell/Mobile/Smart Phones | icph : Computer Hardware | iint : Online Service Providers | itech : Technology | i2567 : Industrial Gases | i34411 : Mobile Communications Devices | i3454 : Personal Electronics | iagro : Agrochemicals | icomp : Computing | ielec : Consumer Electronics | ihandaps : Handheld Electronic Devices

NS c151 : Earnings | c22 : New Products/Services | ccat : Corporate/Industrial News | gpersi : Personal Investments | reqrch : Suggested Reading Chemicals | c15 : Financial Performance | cexpro : Products/Services | gcat : Political/General News | gpersf : Personal Finance | ncat : Content Types | nfact : Factiva Filters | nfcpin : C&E Industry News Filter | redit : Selection of Top Stories/Trends/Analysis | reqr : Suggested Reading Industry News

RE eurz : Europe | namz : North America | usa : United States

IPD Barrons.com

IPC AAPL

PUB Dow Jones & Company, Inc.

AN Document B000000020220910ei9c0005l

BARRON'S

CLM Up & Down Wall Street

HD **A Housing Bubble and Kim Kardashian: More Troubling News for Markets**

BY By Randall W. Forsyth

WC 1,211 words

PD 12 September 2022

SN Barron's

SC B

PG 6

LA English

LP

Can there be a better sign of a market top than when celebrities pile into it? Especially celebs whose main talent is to appeal to the public's tastes, or lack thereof. While they might be acutely attuned to what's happening in fashion, music, or the movies, they can be late in latching onto financial trends to which their sole connection is an insatiable desire to wring as much money as possible from the zeitgeist.

All of which is brought to mind by news that Kim Kardashian is launching a new private-equity venture. Truth be told, I don't know what she or the rest of her reality-show family is famous for, other than for being famous. But Kim has leveraged her millions of followers on social media to become a huge entrepreneur, with interests ranging from women's undergarments to faux meat. That indeed is a talent not to be discounted.

TD

Her entry into private equity recalls other celebrities' forays into financial spheres just ahead of those markets' top ticks. Most recently, all manner of celebs plunged into cryptocurrencies, most notably actor Matt Damon, who touted Crypto.com in a now-infamous Super Bowl ad in which he intoned how "fortune favors the brave."

Doug Kass, the head of Seabreeze Partners—who flagged the prevalence of cryptocurrency ads at the time—further pointed out in an email this past week how other worthies, from rapper 50 Cent to quarterback Aaron Rodgers to New York City Mayor Eric Adams, took their paychecks in crypto. In case you need to be reminded, Bitcoin traded Thursday at around $19,200, less than half its quote on Super Sunday in February and a mere 72% below its peak last November.

Private equity hasn't suffered big losses. But, according to a Sept. 8 note from Citi Research's quantitative global macro strategy group, private asset prices tend to lag those of the publicly traded markets, which are quoted second by second on screens. Weakness in public equity markets portend lower private-asset valuations, according to the report.

Kim's entrance into the rarefied world of private equity may be about as propitiously timed as Barbra Streisand's furious pursuit of initial public offerings at the height of dot-com mania in 1999. (Babs told Fortune back then that she had quadrupled her money in America Online shares, but averred that she didn't pretend to be a maven "like the guy in Barron's last week who can analyze all the companies and so forth.")

If private markets do get marked down one to two quarters after the public ones, as Citi says they have historically, that points to similar trouble for the former. I wouldn't shed any tears for Kim K. or any other A-lister able to get past the velvet ropes into private-equity funds. None are apt to be prowling dollar stores in search of ramen noodles, even if their PE holdings go to zero.

For us hoi polloi, however, the drop in asset markets may be painful. Household net worth has soared as never before in the past two years, writes Stephanie Pomboy in her latest MacroMavens missive. Pumped up by Federal Reserve expansionary policies, the public's wealth in equities and residential real estate has ballooned, relative to the economy, even faster and more furiously than during the housing bubble of the 2000s and the dot-com daffiness of the 1990s. When those values get marked down, the impact on consumer spending won't be pretty, she concludes.

Households' net worth has exploded by $39 trillion during the two-year Covid stimulus span, or by 158%, relative to U.S. gross domestic product. In comparison, it rose by 98% of GDP during the housing bubble's two hottest years and 79% during the dot-com boom.

"Thanks to the Fed's serial reflations, asset prices are now the tail wagging the dog of the U.S. economy. Where they go, growth inexorably follows," she observes. While Pomboy points out that she doesn't favor the Fed explicitly targeting asset prices, she adds that ignoring their role in the economy "is pure folly."

The effects of the correction in asset prices are becoming apparent. "The speed and magnitude of the decline in housing activity we've witnessed just over the last few months blows the housing bubble bust out of the water," she writes. Existing home sales are down 27% from their peak and 25% this year alone. New home sales are faring worse, off 50% and 40%, respectively. Meanwhile, the number of new homes under construction—some 1.7 million—tops that in the previous housing bubble.

Consumers' lost housing wealth is likely to hit their confidence at a time when inflation is eroding their real incomes. Pomboy cites economists' estimates that a dollar drop in housing values translates to about a 40-cent cut in consumption—about four times the impact of a $1 decline in stocks.

On the latter score, "between Robinhood, Reddit, Davy Day Traders and Apes, U.S. household exposure to equities is now the highest on record," Pomboy observes. Given the enormity of this bubble, its deflation should have an equally unprecedented impact on consumer demand.

Following the dot-com collapse, nominal spending growth slowed to an annual rate of 1.7% from 9.0%. After the housing bust, spending shrank at a 3.4% yearly pace, down from a positive 5.9%. If those episodes are prologue, nominal outlays would slow from the current 8.7% annual clip to about 1.7%. And taking annual inflation of 8% into account would produce an outright contraction in real spending.

Pomboy finds a couple of tidbits of good news in the drop in household net worth. She hypothesizes that the Great Resignation owed much to asset-value inflation, which became not just a supplement to labor income but a substitute for it. With house and stock prices down this year, some 786,000 folks reentered the labor force in August alone, she observes.

As asset values have rolled over in past cycles, consumer prices have tended to follow, she adds. The dot-com plunge cut the consumer price index's rise to 1.1% a year from 3.7%, while the financial crisis that followed the housing bust dropped CPI to negative 2.1% from positive 5.6%. But deflating asset bubbles can be dicey, especially when there's the possibility of a recession and total U.S. debt equals 274% of GDP, more than twice the 135% it stood at when Paul Volcker headed the Fed and slayed the inflation dragon in the early 1980s.

Assuming that the current Fed successfully manages the deflation of a $39 trillion bubble (which she doubts), Pomboy says it "would be a nail-biting exercise." Even for the flawlessly manicured Kim Kardashians of the world.

Corrections & Amplifications

Bitcoin traded on Thursday at around $19,200, 72% below its peak last November. An earlier version of this column incorrectly said it had declined by 77% since its peak.

Write to Randall W. Forsyth at randall.forsyth@barrons.com

IN ivicu : Virtual Currencies/Cryptocurrencies | i831 : Financial Investment Services | i8394 : Computer Services | itech : Technology | ibcs : Business/Consumer Services | ibnk : Banking/Credit | ifinal : Financial Services | ifmsoft : Financial Technology | iinv : Investing/Securities

NS c1521 : Analysts' Comments/Recommendations | ecat : Economic News | gcele : Celebrities | gent : Arts/Entertainment | glife : Living/Lifestyle | gmovie : Movies | ncolu : Columns | ccat : Corporate/Industrial News | gcat : Political/General News | ncat : Content Types | nfact : Factiva Filters | nfce : C&E Exclusion Filter

RE namz : North America | usa : United States

IPD Barrons.com

IPC G/FED

PUB Dow Jones & Company, Inc.

AN Document B000000020220910ei9c000b5

BARRON'S

HD **No Pain, No Gain: Tracking the Cost of a 2% Inflation Target**

BY By Lisa Beilfuss

WC 1,057 words

PD 5 September 2022

SN Barron's

SC B

PG 25

LA English

LP

When Federal Reserve Chairman Jerome Powell said that tightening monetary policy will bring "some pain" to households and businesses, he pushed back on the idea that the central bank would flinch in its inflation fight. But how much pain is the Fed willing to inflict before it has no choice but to raise its inflation target?

To quantify the amount of economic damage from the current tightening cycle—where rate hikes work on a lag of about a year, inflation is both supply and demand driven, and balance-sheet tightening is about to ramp up—Barron's spoke with Joe Brusuelas, RSM's chief economist. To estimate how high unemployment must rise to bring inflation back to the Fed's 2% target, Brusuelas puts a new twist on an old, and increasingly controversial, idea and concludes that the number of job losses might be higher than policy makers and investors appreciate.

TD

At the heart of the current policy debate is the so-called sacrifice ratio, which Brusuelas says matters for the first time in 40 years. The ratio represents the trade-off between price stability and the economic growth that policy makers must give up to achieve it. More technically, it's an estimate of the slope of the Phillips curve.

Named for New Zealand economist A.W. Phillips, the curve reflects the inverse relationship between unemployment and wage growth and connects the Fed's dual mandates: price stability and maximum employment. The logic is that employers have to raise wages to attract workers when unemployment is low, boosting overall inflation, and vice versa. Many economists and policy makers declared the Phillips curve dead after the prepandemic stretch of ultralow unemployment failed to drive wages or inflation higher. But the postpandemic's rapid rise in wages as labor remained tight has resurrected the curve.

Jefferies chief economist Aneta Markowska says that the Phillips curve is back with a vengeance and suggests that the labor market will set a floor for inflation around 4%, although others argue that the curve should remain buried insofar as it affects policy decisions.

To advance the debate, Brusuelas created a supply-augmented Phillips curve to make it more relevant for today's economy and policy decisions, including using RSM supply-chain data with variables such as inflation expectations and the unemployment rate. He says that without controlling for supply-chain deficits during the pandemic, the Phillips curve shows significant downside biases and helps explain why so many failed to predict how elevated inflation would become. By contrast, he says his supply-augmented curve tracks actual inflation levels significantly better before and through the pandemic.

Using his curve, Brusuelas arrives at two sets of sacrifice ratios. Getting the Fed's preferred inflation metric, the personal consumption expenditure, or PCE, to 2%, he says will cost 5.3 million jobs and result in an unemployment rate of 6.7%. The PCE rose 6.3% in July from a year earlier. In its latest summary of economic projections, the Fed estimated the jobless rate would rise to just 3.9% this year and 4.1% in 2023 from a current 3.7%.

In his July press conference, Powell acknowledged that while the Fed targets the PCE, the public focuses more on the consumer price index, or CPI. "The difference really is because the CPI has higher weights on things like food, gasoline, motor vehicles, and housing than the PCE index does," he said. "Given the importance in the public eye of CPI, we are calling it out and noticing it."

The point: To the extent that inflation expectations drive inflation, which central bankers tend to believe, policy making can't altogether dismiss the CPI. The CPI rose 8.5% in July from a year earlier. To get it down to 2%, Brusuelas estimates that some six million job will have to be lost and the unemployment rate will rise to 7.1%.

This column has long argued that the Fed may have no choice but to lift its inflation target. Brusuelas agrees. "We don't think 2% in the near term is a reality-based option," he says, given the amount of economic carnage it would require. He believes the Fed will engage in what he calls "opportunistic reflation" and raise the inflation target to 3%. Hitting that target in the PCE would require a loss of 1.7 million jobs and a rise in unemployment to 4.6%, he says, while to get the CPI there would take 3.5 million jobs and a 5.6% jobless rate. Fed officials have said they remain committed to 2% inflation.

Some central bankers and economists have said that the historically high number of job vacancies will serve as a cushion and limit job losses because firms would pull job listings before they start laying off workers. But Alex Domash, an economist and research fellow at Harvard University, says the argument that the Fed can bring down inflation through clearing job vacancies alone is "unreasonably optimistic and is not based on the historical evidence."

All of this will take time, but not necessarily that much time. Jeffries' Markowska estimates there are some 1.5 million workers who can still be brought back into the workforce, and she predicts it will take the next four to five months to burn through that slack. "This means that by the end of the year, there will be no one left to hire," and employment growth will become constrained by the growth rate in the working-age population, which translates to about 50,000 net new workers a month, she says.

She adds that we have more job openings at a given level of unemployment because the jobless either aren't qualified for available jobs, or live too far from employment and are unable or unwilling to move, amounting to a structural shortage of labor that reinforces a steeper Phillips curve. The upshot: higher wages and inflation pressure.

The question for policy makers is no longer whether there will be pain in bringing inflation down to an acceptable level, but what that level is—and how many millions of jobs will be sacrificed to reach it.

Write to Lisa Beilfuss at lisa.beilfuss@barrons.com

CO fed : Board of Governors of the Federal Reserve System

NS e1116 : Employment/Unemployment Figures | e1103 : Inflation Figures/Price Indices | e12 : Monetary Policy | ecat : Economic News | e11 : Economic Performance/Indicators | npred : Economic Predictions/Forecasts | ncat : Content Types

IPD Barrons.com

IPC G/FED

PUB Dow Jones & Company, Inc.

AN Document B000000020220902ei950008e

BARRON'S

CLM Up & Down Wall Street

HD **Facebook Changed the World. Why the Stock Stopped Working.**

BY By Alex Eule
WC 1,119 words
PD 5 September 2022
SN Barron's
SC B
PG 7
LA English

LP

Social media may be the most influential innovation of the 21st century. In 2022, if an event doesn't make it to a social feed, it never really happened, like the tree that falls in a forest with no around to hear it.

But 20 years after Friendster kick-started the industry, something else has become clear about social media: It isn't a particularly good business. Based on traditional accounting metrics, Snapchat parent Snap (ticker: SNAP) has never made a full-year profit. Twitter (TWTR) has just two profitable years to show for its near decade as a public company. Pinterest (PINS) finally made money in 2021, but Wall Street forecasts a return to losses this year.

TD

For much of its existence, the industry's struggles were masked by Facebook's dominance. Facebook.com became a human operating system. It was a brilliant idea that was perfectly executed. It couldn't help but make money. But in retrospect, Facebook wasn't all that different from a fad diet. It made everyone feel good; then it made us feel guilty. And finally, it mostly stopped working.

This past week, Facebook's smaller rival Snap said it was cutting 20% of its workforce, or roughly 1,200 jobs, while canceling noncore projects such as its flying selfie camera known as the Pixy.

"We must now face the consequences of our lower revenue growth and adapt to the market environment," wrote Snap co-founder and CEO Evan Spiegel in a letter to employees.

Meanwhile, Twitter's future is tied up in a Delaware courtroom, where it will try to force Elon Musk to complete his purchase of the company, even as he regularly disparages the business itself.

Most of Wall Street has been caught flat-footed by social media's struggles. But not everyone. Back in 2017, Brian Wieser at Pivotal Research downgraded Facebook's stock, making him just one of two analysts with a Sell rating on the shares.

"With every passing year, digital advertising is closer to a point where the market is saturated," Wieser wrote in his downgrade note in July 2017.

At the time, Facebook traded at $172. The stock—under its new Meta Platforms (META) name—closed on Friday at $160, meaning that investors who bought Facebook shares five years ago, and held on, have lost money. Over that same period, you would have been better off owning IBM (IBM), which has itself been dead money but at least paid a dividend. Procter & Gamble (PG), Ford Motor (F), and McDonald's (MCD) are among the stocks that have easily outpaced Facebook's five-year price appreciation.

I spoke to Wieser this past week about what everyone got wrong and what lessons we can learn from the miscalculations.

"What I think much of Wall Street and, frankly, most of the companies themselves missed is that they are fundamentally advertising businesses," Wieser says.

Social-media companies became just one more example of start-ups claiming that technology could alter the basics of business. Think WeWork in real estate, Teladoc Health (TDOC) in medicine, and Peloton Interactive (PTON) in fitness. As we've learned over the past year, market realities eventually still trump technology.

Wieser says his edge covering Facebook was his experience at an advertising agency before he went to work on Wall Street. He never lost sight of the fact that advertising revenue over time grows roughly in line with gross domestic product adjusted for inflation. That means growth rates close to 5%. "Investors' expectations for the durability of 20% or 30% growth rates were unrealistic and unsustainable," he says.

Meanwhile, social-media companies tended to buy into their own marketing. Across Silicon Valley, Wieser says, "they don't necessarily care or care to understand about advertising. They succeed in spite of themselves in advertising."

When Snap went public in 2017, the company labeled itself a "camera company" in the first line of its prospectus. That description still tops the company's annual report, even though the same document declares, "We generate substantially all of our revenue from advertising."

Wieser left Wall Street in 2019 and now serves as global president of Business Intelligence for WPP's (WPP) ad buyer GroupM. While Meta stock continues to fall, analysts have clung to the notion that it remains a disruptive force. Forty of the 56 analysts covering Meta still rate the stock at Buy or its equivalent, according to FactSet. There are still just two Sells. The average price target is $221, more than 35% above current levels.

Rosenblatt Securities analyst Barton Crockett has one of the 14 Hold ratings, but he's just one of three analysts who carries a price target below Meta's current price. His $156 target implies downside of 2.5%.

"For much of social media, we're going through a painful but inevitable, and ultimately healthy, process of transforming from juggernaut to business," Crockett says. "And what we're seeing are various stages of denial, and ultimately acceptance, of the inevitability."

Snap's cost-cutting announcement this past week—and the cancellation of its Pixy flying camera—was its "juggernaut to business moment," Crockett says. "They're focusing on what's important, where they can feel strongly that they get a return."

Meta, on the other hand, is still thinking like a juggernaut that can overcome economics through scale. Today, Facebook reaches roughly three billion people, but user growth has stalled.

Crockett says the company's metaverse ambitions—at the expense of its advertising reality—"is emblematic of refusal to accept and live with who you are, which is a business."

Social-media believers might point to TikTok as the next new thing. But TikTok is another advertising business that's no more likely to bend the long-term curve of ad spending.

There's already indication that TikTok's emphasis on short-term videos, while addictive to users, might not convert all that well to ad dollars. In a recent report titled "Has TikTok Ruined the Internet?" Bernstein analysts note that TikTok generates two-tenths of a cent for every user minute spent in the U.S. versus 1.4 cents for Facebook and half a cent for YouTube.

"No one likes change, but in internet, it's evolve or die," write the Bernstein analysts. "But what if there's something more deprecatory taking place ruining advertiser economics, creator art, and consumer attention spans along the way...all desperate for that next 15-second hit?"

Bernstein says "stay tuned" for the answer, but I think we already know what happens next.

Write to Alex Eule at alex.eule@barrons.com

CO fjfvpl : Snap Inc | gdsicz : Pinterest, Inc. | onlnfr : Meta Platforms Inc.

IN i3302 : Computers/Consumer Electronics | icph : Computer Hardware | iint : Online Service Providers | itech : Technology | icomp : Computing | imed : Media/Entertainment | isocial : Social Media Platforms/Tools

NS credun : Lay-offs/Redundancies | gweb : Social Media | c151 : Earnings | c1521 : Analysts' Comments/Recommendations | c42 : Labor/Personnel | ccat : Corporate/Industrial News | glife : Living/Lifestyle | ncolu : Columns | c152 : Earnings Projections | c15 : Financial Performance | gcat :

Political/General News | ncat : Content Types | nfact : Factiva Filters | nfce : C&E Exclusion Filter | nfcpin : C&E Industry News Filter

RE namz : North America | usa : United States

IPD Barrons.com

IPC F

PUB Dow Jones & Company, Inc.

AN Document B000000020220903ei950008d

BARRON'S

HD **It Looks Like a Messy Fall for Markets. How to Navigate The Risks --- Wall Street strategists are sharply divided on the outlook for the S&P 500. No matter, there are plenty of bargains in stocks and bonds.**

BY By Nicholas Jasinski

WC 2,600 words

PD 5 September 2022

SN Barron's

SC B

PG 18

LA English

LP

If 2022 were to end tomorrow, or the day after, it would enter the books as a dismal one for investors. The Dow Jones Industrial Average is down 13% year to date, the S&P 500 index is off 17%, and the once-bubbly Nasdaq Composite is nursing a loss of 25%.

The selling could continue into the fall and beyond, given the panoply of factors eating at investor confidence and returns. Inflation is stubbornly high, the Federal Reserve is determined to raise interest rates to cool it, and the world is an even more hostile place now than at the start of the year.

TD

Yet, this year's turmoil also offers opportunity: Stocks are cheaper than they have been in a long time, and shares of companies with competitive business models, healthy balance sheets, and steady cash flows beckon. The fixed-income market offers even more from which to choose, with numerous categories sporting their highest yields in years. It is tempting to focus on macroeconomic forces that have depressed stocks and lifted bond yields in the first eight months of the year, and many Wall Street strategists do. But investors who pick their spots well could benefit from the prevailing negative trends.

Barron's recently canvassed eight Wall Street strategists to get their read on the investment outlook for the rest of the year. While the average target among the group puts the S&P 500 at 4185 at year end, up 6% from recent levels, individual estimates range from 3600 to 4800. That's an unusually large span with four months remaining in the year, and reflects widely divergent views on the strength of the economy and corporate earnings, and the Fed's determination to fight inflation.

Some strategists, like Ed Yardeni, proprietor of Yardeni Research, see more of a muted recession than a full-blown economic contraction. "If we're going to have a recession, it could be very shallow," he says. "Or, it could be a rolling recession that hits different sectors at different times, like we arguably saw in the mid-1980s."

U.S. gross domestic product contracted at an annualized 1.6% in the first quarter and 0.6% in the second, but underlying trends don't suggest the economy is in a recession. "When I look at the underlying dynamics [of the economy], be it corporates, be it households and consumers, the real economy doesn't look so bad outside of inflation," says Sonal Desai, chief investment officer of Franklin Templeton Fixed Income and a member of Barron's Roundtable.

Desai sees little evidence of a broad slowdown in economic activity—at least not yet—and says the coming year could bring more of a zero-growth, stagnant economy than a meaningfully shrinking one. Strength in the job market and consumer balance sheets have much to do with that, even though inflation is taking a bite out of incomes: Annual inflation of 8.3% is equivalent to lopping off one month of a worker's annual salary, and savings will last only so long.

For stock market bulls, a potential peak in inflation is enough to get excited about the market's prospects. Should inflation continue to decline, investors could look ahead to the eventual end of the Fed's tightening cycle and expect less economic and earnings damage.

J.P. Morgan's chief U.S. equity strategist, Dubravko Lakos-Bujas, has a year-end S&P 500 target of 4800, reflecting a 20% gain from here, and a record high. He doesn't expect a global recession and sees inflation easing as commodity prices decline and other pressures fade. He notes that people are underinvested: As of late August, funds' relative exposure to the stock market was lower than 90% of historical readings. Alongside corporate share buybacks, he expects to see daily inflows into equities of several billion dollars a day over the next few months, lifting indexes.

Wells Fargo's head of equity strategy, Christopher Harvey, sees the economy and earnings holding up in the second half of 2022, before a potentially more challenging 2023. He doesn't expect the Fed to get more hawkish, and thinks the pressure on stock multiples from rising bond yields is largely played out.

"We've seen the top on yields, the Fed is going to decelerate, and the fundamentals aren't as bad as feared," says Harvey. "The places where we have begun to see some negative revisions and margin compression have been more so on the growth side. And that's where we already saw that big derating in the first half of this year. Let's not forget, this was the worst first half in over 50 years. A lot of the bad news is already priced in, and it wouldn't be surprising to see a bounce."

Harvey has maintained his 4715 year-end target for the S&P 500 all year. He recommends a growth-at-a-reasonable-price tilt, emphasizing quality in a potentially rockier economy next year. He's bullish on the more media- and technology-leaning areas of communication services—as opposed to telecom—and bearish on software and retail stocks. Harvey also recommends creating a so-called barbell portfolio with more-defensive companies, namely in food, beverage, and tobacco. The Invesco Dynamic Food & Beverage exchange-traded fund (ticker: PBJ) is one way to execute this idea.

Among market sectors, energy stocks have a lot of fans for the remainder of this year. Elevated oil and gas prices look likely to stick—not at $120-a-barrel oil but comfortably above the cost of production. Energy companies are harvesting profits, paying down debt, and spending more responsibly than in the past. Shareholders will continue to benefit, strategists say—energy is far and away the best-performing sector in the S&P 500 in 2022, up 41%. The Energy Select Sector SPDR ETF (XLE) provides broad exposure to the sector and yields 4.2% in dividends annually, while the iShares U.S. Oil & Gas Exploration & Production ETF (IEO) is more concentrated in the upstream subsector.

Healthcare is another popular recommendation among investment strategists. The sector is increasingly tech-focused, with enviable secular growth characteristics. But it doesn't trade for an overly pricey valuation multiple, perhaps due to concerns about government legislation, including a drug-price negotiation program in the just-passed Inflation Reduction Act.

"Healthcare provides some protection against an ailing economy, and you don't have to overpay," says Mike Wilson, chief investment officer and chief U.S. equity strategist at Morgan Stanley. "Outside of biotech, it's underowned, I think, because there's still concern around the government coming in with a heavy hand on pricing."

The Health Care Select Sector SPDR ETF (XLV) includes all S&P 500 stocks in the sector. The iShares U.S. Healthcare Providers ETF (IHF) is more focused on insurers and providers, which have a pent-up-demand tailwind postpandemic—rather than pharma companies or medical-device makers.

Wilson has a June 2023 target of 3900 for the S&P 500, down 2% from recent levels. He's worried about earnings, which reached a record high in the second quarter. "While the Fed is still raising rates, that's not going to be the main driver of equity prices from here," Wilson says, "The valuation damage from rates going up, that's not really the issue. The issue now is that earnings are going to come down a lot."

Wilson expects Wall Street analysts to reduce their earnings estimates in the coming months, dragging down stock prices. That process began with second-quarter reporting season, and he notes that earnings-revision cycles tend to last for three or four quarters. The fall conference-call season and third-quarter results could be the catalyst for downward revisions, if management teams offer gloomy forecasts or reduce guidance. That's also an opportunity to separate winners from losers.

"Where the first-half selloff was just a blunt instrument that hurt all stock valuations, it becomes more idiosyncratic from here," Wilson says. "Stocks can separate themselves depending on which companies can operate better in this environment…but we're bearish on the index level over the next three to six months."

Wilson is focused on some of the least flashy but most stable sectors of the market: utilities, real estate, and healthcare. His recommended underweights are consumer-discretionary stocks and cyclical areas of technology, including semiconductors and hardware firms.

Like Wilson, Savita Subramanian, BofA Securities' head of U.S. equity and quantitative strategy, sees plenty of room for earnings estimates to come down. "Consensus estimates are far too optimistic," she says. "Consensus is forecasting 8% growth next year, and we think that it's going to be probably more like minus 8%. This is consistent with our view that there's going to be a recession."

Subramanian, who has a target price of 3600 on the S&P 500, advises looking for companies that are inexpensive based on their ratio of enterprise value to free cash flow. That approach emphasizes businesses that can best continue to generate cash despite rising cost pressures and without reliance on too much debt, which is getting more expensive.

"As you move into the later stages of an economic cycle, you've got inflation and the Fed tightening," says Subramanian. "Maybe earnings hold up OK, maybe sales hold up. But free cash flow starts to become scarce because companies are forced to spend on higher costs, capital expenditure, or higher interest on their debt."

Screening for companies that are cheap based on enterprise value to free cash flow yields mostly energy companies in the S&P 500, including Exxon Mobil (XOM), Chevron (CVX), Marathon Petroleum (MPC), and EOG Resources (EOG). Pharma companies such as Pfizer (PFE) and Moderna (MRNA) are other examples, as are Dow (DOW) and LyondellBasell Industries (LYB), in chemicals. The Pacer US Cash Cows 100 ETF (COWZ) includes a basket of Russell 1000 companies that meet similar criteria.

Subramanian's sector picks have a value tilt, and include energy, financials, healthcare, and consumer staples. But she says there may be some opportunities in profitable growth companies that have sold off this year; many tech names have lost 50% or more, and could appeal to those with a longer-term investment horizon. PayPal Holdings (PYPL), Adobe (ADBE), and Salesforce (CRM), for instance, have positive free cash flow and are down at least 33% in 2022.

Gargi Chaudhuri, head of iShares investment strategy for the Americas at BlackRock, recommends another way to add a quality tilt to your portfolio: the iShares Core High Dividend ETF (HDV), which yields about 2.3%. Top holdings include Exxon Mobil, Johnson & Johnson (JNJ), and Verizon Communications (VZ).

For fixed-income investors, it's a new era: The asset class is generating income after a lengthy drought. The S&P U.S. Treasury Bond index has declined 8.5% this year, U.S. investment-grade corporate bonds have lost 14%, and mortgage-back securities have slid 9%. But that has lifted yields, which move inversely to a bond's price.

Nuveen's chief investment officer of global fixed income, Anders Persson, believes that most of the damage in higher-quality areas of the bond market, such as Treasuries and investment-grade corporate bonds, is done, while high-yield bonds and other riskier categories may have more downside. He doesn't see any screaming bargains and stresses a focus on income generation and diversification.

"It's not going to be a beta market," Persson says. "It's more of an alpha market, where you have to really do your work as an active manager, looking for those industries and names that can hold up best."

He points to the TIAA-CREF Core Plus Bond fund (TIBFX), which yields 3.4% and includes a variety of fixed-income assets such as U.S. and foreign sovereign debt, investment-grade and high-yield corporate bonds, preferred stock, and asset and mortgage-backed securities.

Persson singles out the Nuveen Preferred Securities and Income fund (NPSRX), with a 5.7% yield. It includes preferred shares from mainly banks and other financial institutions with strong underlying credit quality helped by heightened regulations since the 2008-09 financial crisis. Persson also likes the Nuveen Floating Rate Income fund (NFRIX), lower in credit quality but with a yield of 5.2%. The loan portfolio's floating rates provide some insulation from a rising-rate environment, although the risk of defaults in an adverse economy is greater.

Desai similarly recommends the Franklin Income fund (FKIQX), which is about half in traditional bonds and the rest in dividend-paying stocks, preferreds, and convertibles. The fund has a yield of 5.2%.

Not much movement is expected in the long end of the Treasury curve for the remainder of this year. Strategists generally see the 10-year yield remaining range-bound and finishing 2022 around 3.00% or slightly higher, versus today's 3.26%.

Strategists see the Fed raising interest rates by another 100 to 125 basis points (a basis point is one-hundredth of a percentage point) over its remaining three meetings this year. That would take the federal-funds rate target range to 3.50%-3.75% at year end. In 2023, the benchmark rate could rise a bit more. Then the Fed might pause. None of the strategists with whom Barron's spoke see the Fed cutting rates early next year, as futures markets had been pricing in before Fed Chairman Jerome Powell's Jackson Hole speech on Aug. 26.

Addressing the central bank's annual economic policy symposium in Wyoming, Powell emphasized that inflation fighting is the No. 1 priority, and that some economic pain would be required. That means slower or potentially negative real GDP growth and an increase in the unemployment rate, currently 3.7%. Markets will test the Fed's resolve once job losses begin to pick up, Desai says.

"Historically, people have always said 'don't fight the Fed,' " she says. "This time around, everyone wants to fight the Fed."

That will be a recipe for more volatility in stock and bond markets. BlackRock's Chaudhuri expects the S&P 500 to land at 3800 by year end, after a volatile stretch. She recommends staying invested to take advantage of sharp rallies that might occur.

Chaudhuri cites iShares MSCI USA Min Vol Factor ETF (USMV) as one way to insulate a portfolio from greater volatility. Its top holdings include Eli Lilly (LLY), Microsoft (MSFT), Accenture (ACN), and T-Mobile US (TMUS).

One thing to worry about this fall is quantitative tightening, or QT, by which the Fed shrinks its balance sheet and drains liquidity from the financial system. "People are underestimating the impact of liquidity risk to the market and the real economy [due to QT]," Wilson says. "Just like quantitative easing was like grease to the engine, QT is more like a wrench in the engine."

Rising rates, more volatility, and engine wrenches don't sound like a recipe for the large gains investors saw in the past two years. But judicious stock-picking and smart fixed-income investments could go a long way to avoiding the season's biggest risks.

Write to Nicholas Jasinski at nicholas.jasinski@barrons.com

CO fed : Board of Governors of the Federal Reserve System

IN i1 : Energy | i82 : Insurance | icnp : Consumer Goods | ifinal : Financial Services

NS m11 : Equity Markets | mcat : Commodity/Financial Market News | npag : Page One Stories | ncat : Content Types | nfact : Factiva Filters | nfce : C&E Exclusion Filter

RE namz : North America | usa : United States

IPD Barrons.com

IPC ACN

PUB Dow Jones & Company, Inc.

AN Document B000000020220902ei95000dx

BARRON'S

CLM Barron's Cover - Main

HD **Labor Pains --- The hope that the worker shortage would vanish as Covid fades into the background hasn't—and won't—come to pass. Instead, the U.S. is on track for a permanent labor crunch, one with root causes that go far deeper than the pandemic.**

BY By Megan Cassella

WC 2,201 words

PD 5 September 2022

SN Barron's

SC B

PG 14

LA English

LP

In the summer of 2020, Mike Zaffaroni, the owner of Liberty Landscape Supply in Jacksonville, Fla., needed to start staffing up to fulfill a pair of contracts to plant trees around the city. At first the hiring went relatively smoothly, but as fall approached, things started to change: A growing number of candidates were failing to make it to their scheduled interviews. He would sometimes expect 10 people, but only one would show. "It's one of the most alarming things I've seen in my working career," he says.

In the two years since, Zaffaroni has raised his starting wages by nearly 40%. He expanded his benefits program, shortened his interview process, and began considering a broader pool of workers, including those with limited experience or a spotty work history. But none of it has been enough: His 112-person company still has 19 current openings and few prospects to fill them.

TD

Now, Zaffaroni is applying for a set of visas that would allow him to hire 10 foreign temporary workers next year—a first for his 15-year-old business. "I really think that's the only way to solve the problem in the short term," Zaffaroni says. "Because I don't know that we're going to pull a whole bunch of workers back into the workforce."

As the labor market settles into a postpandemic normal, Zaffaroni is among millions of employers across the country still bending over backward to try to hire from a pool of workers that appears increasingly dry. In July alone, U.S. companies posted 11.2 million job openings for a market that has just six million unemployed workers to fill them, a vast disconnect that has been trending wider for more than a year. For all of the Great Resignation talk, the workforce has already surpassed its pre-Covid size—but the economy has continued to grow in the meantime, creating fresh waves of unquenchable demand.

Now, the hiring challenges that many expected would fade as the worst of the Covid shocks dissipated look less like a passing trend and more like a new reality. Economists warn that the U.S. is staring down what will become one of the biggest economic challenges of the next several decades: a permanent—or at least deeply entrenched—labor shortage. At its worst, the depleted workforce could sandbag productivity and economic growth, hinder the Federal Reserve's efforts to tame inflation, and even threaten the nation's status as a global superpower.

"I think a lot of companies are still like, 'We've got to make it through this little blip,' " says Ron Hetrick, a senior labor economist with Lightcast who led a 2021 economic report on the forthcoming workforce challenges called "The Demographic Drought." "And I'm like, 'Blip? Are you kidding?' "

Average annual growth of the U.S. prime working-age population is projected to slow sharply to just 0.2% over the next three decades, down from 1% average annual growth over the past 40 years. By 2100, as much as two-thirds of the country could be out of the workforce and financially dependent on the remaining one-third, according to an estimate from Hetrick and his co-authors. For companies, persistent labor shortages mean hobbled growth, and for consumers, fewer high-touch services and 24-hour or next-day options.

"It's not just a matter of having to do more with less," says Zaffaroni, the landscape-supply company owner. "It's having less, and doing less, and productivity actually dropping because you don't have those resources."

The concern that the U.S. would one day run short on workers has been circulating for decades, as economists braced for baby boomers to begin retiring around 2010. As far back as 2001, the Federal Reserve Bank of Boston organized a conference focused entirely on the economic impact of demographic change, which included research that found the country would need a 40% jump in labor productivity by the mid-2030s just to maintain then-current living standards.

But since those early warnings, two phenomena have emerged, seemingly tailor-made to take the situation from bad to worse. The first was that net immigration began to fall, peaking in 2016 before entering a slide it has yet to recover from, eating away at the usual influx of both highly educated scientists and engineers and manual laborers.

A handful of factors drove the decline. U.S. border enforcement increased at the same time that economic development in Mexico and Central America meant that fewer people there were looking to leave the region, says Giovanni Peri, a labor economist with the University of California, Davis. A shift in immigration policy and rhetoric under President Donald Trump—including lower caps on refugees and a litany of attacks on the H-1B visa program, which provides green cards for highly skilled workers—also contributed.

Then came Covid. As the pandemic drove up the death rate and dragged down the birthrate, it inflamed the pre-existing demographic trends: From July 2020 to July 2021, the U.S. population grew just 0.12%, according to an analysis of U.S. Census Bureau data by demographer and Brookings Institution senior fellow William Frey—the lowest annual rate since World War I.

The virus also hit the workforce on other fronts: Kansas City Fed researchers estimate there were 2.1 million "excess" retirements during the pandemic, meaning those above the expected trend. And as more Americans have stayed home for reasons ranging from long Covid to caretaking responsibilities, the labor-force participation rate has dropped from 63.4% just before the pandemic to 62.4% in August, the Department of Labor said on Friday; the agency forecasts that the rate will slide to 60.4% by the end of this decade.

Covid exacerbated the immigration problem, too. The combination of closed borders and shutdowns at U.S. consulates overseas led to massive visa backlogs that remain today, pushing net migration to its lowest level in decades. Peri's research found that by the end of 2021, there were roughly two million fewer working-age immigrants in the U.S. than there would have been had prepandemic trends continued, half of which would have been in highly educated science, technology, engineering, and math, or STEM, fields.

"When we look at the trend lines, and the difficulty that we're going to have getting the workforce participation rate back to where it was even prepandemic—the demographic trends and the shortfalls in legal immigration—we think all of that kind of points to this being a long-term challenge for the American economy," says Neil Bradley, chief policy officer with the U.S. Chamber of Commerce.

The Chamber is among a growing chorus of major businesses, lobbying groups, and economists calling on lawmakers to take steps to ease the labor crisis, with proposals for comprehensive child-care, federal investments in job training and reskilling, and a host of other policies. But some of the loudest calls are for Congress to find ways to boost legal immigration, either by raising the annual cap on temporary work visas or passing wholesale reforms to offer more pathways into the U.S.

Immigration has been thrust to the forefront because many employers see it as the most efficient way to increase the pool of workers quickly and substantially. (Efforts to increase the domestic birthrate, for example, would be of little help to them for another 20 or so years.) Foreign-born workers also play an outsize role in specific industries that, without substantial policy changes, could face a crisis in the coming years.

Take healthcare. As of 2018, immigrants constituted 17% of the overall U.S. workforce but 38% of home health aides, according to the Migration Policy Institute. And the Bureau of Labor Statistics sees the home health-aide industry growing by 33% from 2020 to 2030—a spike driven by the aging population. Already, however, the healthcare and social-assistance industry has nearly two million unfilled jobs and, at 8.8%, one of the highest rates of open jobs anywhere in the economy.

"You have not only a retiring population, but a retiring population that really needs advanced services…that an immigrant typically fills," says Hetrick, the "Demographic Drought" economist. "They're just not there, at the time when we probably need them more than ever."

Construction is another sore spot. In July, there were 375,000 job openings in the industry for 359,000 unemployed construction workers, Department of Labor data show. And that's poised to balloon: McKinsey estimates that the Bipartisan Infrastructure Law, which Congress passed in November, could create 300,000 to 600,000 new jobs a year for the next decade. Failing to meet that demand will hold back progress on modernizing the country's infrastructure—which the Biden administration has argued is necessary for easing supply-chain issues—and on replenishing the U.S. housing supply, where lack of availability is keeping rent and shelter costs elevated.

But the situation is perhaps most damaging in STEM professions because of the impact that innovation has on U.S. productivity and broader economic growth—and because of the way foreign-born workers dominate these fields. Immigrant students receive more than half of all master's degrees and 44% of all doctorates in STEM fields, the Congressional Research Service found in 2019. And despite headlines about tech layoffs or hiring freezes, the industry remains desperate for skilled workers: On the job-search site Indeed, postings in software development alone are up 92% since February 2020, while listings in industrial, civil, and electrical engineering are all up roughly 80% during the same period. Overall, the Department of Labor estimates that the STEM sector will need 1.1 million additional workers by 2030.

Leaving these positions vacant hurts more than just the tech industry. Peri cited research out of the University of California, Berkeley, that finds that every new job in high-skill fields, including STEM, creates 2.5 more jobs for the local economy. "From an economic point of view, this is the driver of American productivity," he says. "The shortages in this group will generate, eventually, smaller economic growth for everybody else."

Opening the immigration spigots would require significant action from Congress on an issue that lawmakers have failed to address in a comprehensive way since 1986, when President Ronald Reagan granted amnesty to nearly three million people. Since then, President Barack Obama used executive power in 2012 to offer work permits and renewable deportation deferrals to undocumented immigrants who arrived in the U.S. as children. But the last attempt at broad reform came in 2013, when the Senate's "Gang of Eight" passed a sweeping bill that died in the Republican-led House.

In the absence of wholesale reform, advocacy groups are pushing for a piecemeal approach, including creating a pathway to citizenship for undocumented workers, raising visa caps on a temporary basis, and better securing the border, in part to win participation from lawmakers focused on illegal immigration. They're forming alliances and pressing Congress to make progress on immigration, working to make an economic case on an issue that has become a political third rail.

In the interim, some companies that rely on immigrant labor are taking their own steps to lure workers. Meat processor Tyson Foods (ticker: TSN), which made headlines early in the pandemic when it was forced to close several plants due to Covid-19 outbreaks, has 120,000 U.S. employees who hail from 160 different countries and speak 50 different languages. Some are permanently in the U.S., while others are on temporary work visas.

Over the past year, Tyson has spent an additional roughly $500 million on wage increases and bonuses for its front-line workers; the company says its average hourly pay is now more than $18, or $24 including benefits. But it isn't just about wages: To increase the availability of workers, the company also helps employees with child-care, housing, and transportation. It has programs to pay for employees' education, offers immigration-related legal services, and provides free medical care at its own health centers. And it holds regular conversations with elected officials on ways to update the country's immigration system and provide pathways to citizenship.

"Pay and benefits are still at the top of the list, but in my view, they're table stakes," says Hector Gonzalez, Tyson's head of labor and team-member relations. "Employers have to go beyond that."

But there is a limit to just how much help the company can provide to workers who need things like permanent work authorization that only Congress could provide, says Gonzalez: "We can't do it alone."

Nicholas Jasinski contributed reporting to this article.

Write to Megan Cassella at megan.cassella@dowjones.com

IN icnp : Consumer Goods

NS gjob : General Labor Issues | e11 : Economic Performance/Indicators | ecat : Economic News | gcrim : Crime/Legal Action | gillim : Illegal Immigration | gimm : Human Migration | gout : Outbreaks/Epidemics | gpir : Politics/International Relations | ncolu : Columns | npag : Page One Stories | npred : Economic Predictions/Forecasts | nstacs : Statistics | gcat : Political/General News | ghea : Health | gmed : Medical Conditions | gspox : Infectious Diseases | ncat : Content Types

RE namz : North America | nz : New Zealand | usa : United States | apacz : Asia Pacific | ausnz : Australia/Oceania

IPD Barrons.com

IPC G/FED

PUB Dow Jones & Company, Inc.

AN Document B000000020220902ei95000gq

BARRON'S

CLM Interview

HD **Don't Fight the Fed—or Fall in Love With Apple**

BY By Eric J. Savitz

WC 1,830 words

PD 5 September 2022

SN Barron's

SC B

PG 26

LA English

LP

Dan Niles thinks the stock market is headed lower. Maybe a lot lower.

A Stanford University–trained electrical engineer who once worked at the old minicomputer giant Digital Equipment, Niles has focused on tech stocks for more than 30 years, initially as a sell-side analyst at Robertson Stephens and Lehman Brothers. He moved to the buy side in 2004, and now runs the Satori Fund, a tech-focused hedge fund. It is in the black for the year, despite the Nasdaq Composite's 23% loss, due to nimble trading and some smart short sales.

TD

Niles came into the year bearish, and his worries have only deepened. He thinks we're headed for a recession, and sees the S&P 500 index bottoming around 3,000—down 25% from here—or maybe lower. He details his grim view—and shares a few stock picks—in the edited interview below.

Barron's: Dan, when we talked in late December about the outlook for 2022, you told me that your top pick was cash. "It will be a tough year for anything in tech," you said. That was spot-on, but after the selloff we've seen, why are you still bearish?

Dan Niles: Coming into the year, we were focused on two things. The first was, we didn't want to fight the Fed. And the second was, we didn't want to fight the fundamentals. Coming into this year, our expectation was that the market would be down at least 20%. In May, we revised that forecast to down 30% to 50%, peak to trough, by sometime in 2023.

We thought inflation would pick up, and that, as a result, the Fed would be more aggressive than others were anticipating. Structurally, three things were in place to make inflation run hotter. The labor market had tightened, with the number of job openings, relative to the number of unemployed, at a record level. The second piece was commodity inflation. After the 2008-09 recession, people didn't invest in capacity for commodities such as coal, oil, and copper. Our view was that if demand was going to be stronger than expected, commodity prices would rise. The final piece was that we thought the housing market, with record-low interest rates, would be very strong.

How does your inflation outlook inform your worries about corporate fundamentals and stock valuations?

What does higher inflation do? It drives down corporate earnings—and stock multiples.

From mid-June through mid-August, the Nasdaq Composite surged 20%. And then Federal Reserve Chairman Jerome Powell popped the bubble. Were people just deluded?

Earlier this year, I looked at all the bear markets since 1920. Every time, you get sharp rallies. You lost 49% of your money, peak to trough, in the tech bubble in 2001, and 57% in the recession of 2008-09. In both cases, you had five rallies in the S&P 500 of 18% to 21% on the way to the bottom. In the Great Depression, you had five rallies of more than 25% between the crash in September 1929 and the bottom in June 1932, on your way to losing 86% of your money. So, the summer really was nothing special. People thought, "Earnings estimates have come down enough; things should be fine." But they're not.

Some of the media commentary after Powell's speech focused on the drop in oil and other commodity prices, retailers' excess inventories, and softening housing prices. Critics asserted that the Fed is being too hawkish.

That's why Powell said in his speech that the Fed will likely have to leave rates higher for longer than most people have anticipated. In the 1970s, the Fed not once, but twice, started cutting rates too early, just as inflation showed the first signs of coming down. That's why Powell said, we've made this mistake before, and we're not going to do it again, and stressed that we're going to go through some pain. He has seen this picture before.

What about the bulls' assertion that inflation is already easing?

About 70% of the U.S. economy is tied to services. Labor is two-thirds of costs for the average corporation. Only 10% is tied to the supply chain, and 10% is energy costs. The only way to deal with inflation is to drive unemployment higher.

Since November, we've had a huge downdraft in tech stocks. What would make them attractive again?

The S&P 500 trades for about 20 times trailing earnings. If you look back at 70 years of history, when the consumer price index has been above 3%, the trailing price/earnings ratio, on average, has been 15 times. That's a pretty big drop from where we are today. And when the CPI has been above 5%, the average P/E has been 12 times. The last CPI report was 8.5%, and we're trading at 20 times. This seems unsustainable.

But some stocks are already down 70% or 80%.

I always like to ask investors: When a stock is down 90%, how much downside remains?

And, of course, the answer is 100%. Not 10%.

Right. It can always go to zero. I read recently that about 5,000 internet companies, both public and private, went bankrupt in the 2001 and 2002 downturn. We haven't seen that yet. But with rates going up, the economy slowing down, and balance sheets for some of these companies where they are, you are going to see bankruptcies pick up in 2023.

Let's talk about specific stocks. Two of your picks are large-cap retail bets, which some people might find surprising.

We're bullish on Walmart [ticker: WMT] and Amazon.com [AMZN]. Look back at the last recession. Walmart shares rallied 18% in 2008 in a year in which the S&P 500 declined 38%. The company gained market share. If you listen to Walmart's earnings calls, management talks about the fact that consumers are trading down. You've got more high-end consumers shopping in Walmart. And the company seems to be getting its inventory issues under control.

Amazon's valuation isn't nearly as low as Walmart's, and you've seen growth slow from 44% in the March 2021 quarter to 7% in the June 2022 quarter. But, like Walmart, they are going to gain market share during a recession. Keep in mind that I don't own these stocks in a vacuum—I have them paired against a basket of shorts of online and offline retailers. But the bottom line is that Walmart and Amazon are going to take retail market share from everybody else.

On the other hand, you're worried about the advertising market. What concerns you?

If you go back to the 2008-09 period, ad revenues dropped more than 20% in two years. At that point, the internet was 12% of the overall ad market. Now, digital is two-thirds of all ad spending. In an advertising recession, which we're likely to have next year, companies reliant on digital advertising can't escape; they're just too big.

Also, TikTok is taking market share from other social-media companies, like Meta Platforms (META) and Snap (SNAP). And Netflix [NFLX] is launching an ad-supported tier. Those are dollars that would have gone to others. Apple [AAPL], as much as it talks about privacy, is seeing its ad business take off. You can short those ad-supported companies against an Amazon long.

What is your thinking on Apple?

We're long right now. Over the past decade, the stock outperformed 60% of the time in the weeks leading up to product launches. But our plan is to sell and go short after the iPhone 14 launch on Sept. 7. That reflects where we think the economy is going, what will likely be high price points for the new phones, and the fact that you're starting to see high-end consumer spending weaken. I have a hard time believing Apple's revenue growth will accelerate from the 2% they reported in the June quarter to the 5% range, which some analysts are expecting for next year.

Dan, you've stayed bullish on the gambling sector. Why?

We own Penn Entertainment [PENN] and DraftKings [DKNG]. In the last recession, revenue from the Las Vegas strip fell 20%. But Penn Entertainment, which owns regional casinos and race tracks, was down only 5% in that period. I expect them to hang in a lot better. We own DraftKings because of online sports betting. About 20 states have legalized online betting, and we think California will follow. Both companies are down about 75% from their highs. Draft-Kings should grow revenue this year by 60%, and compound at 40% over the next three years. It is one of the last markets to go digital.

You've been dabbling in Intel [INTC].

That's true, although I have my position hedged against other chip shorts. Intel, at one point, was considered unassailable. They did everything they could to shoot themselves in the head, falling behind on manufacturing, missing product launch dates over and over again, and losing market share to Advanced Micro Devices [AMD]. They are going to lose more market share next year to AMD. People have them returning to double-digit earnings-per-share growth next year; they'll be lucky if earnings are flat. But with new CEO Pat Gelsinger, they have an engineer back in charge. They have a great CFO in Dave Zinsner, who just came aboard from Micron Technology [MU]. And the stock trades at 13 times earnings.

The key for Intel is getting their contract chip-making business going. But won't that take lots of time and money?

Yes. But they just signed on a major foundry customer in MediaTek [2454.Taiwan], a large Taiwanese chip company. If they can find another large customer, the stock could be a better performer.

The wild card is China's testy relationship with Taiwan.

One of the risks we saw coming into this year was Russia invading Ukraine, which is what happened. Another we cited was China's reunification with Taiwan, which we still think will happen in the next five years. The day you hear that China is moving on Taiwan, you are going to see Intel rally 10% or 20%. This is a geopolitical hedge.

You could see at least one other major company commit to Intel's fabs before year end. And at some point, you could see Apple, which is so reliant on Taiwan Semiconductor [TSM], strike a relationship with Intel. Intel is probably the most hated large-cap semiconductor company, but at this multiple, it's an interesting idea.

Thanks, Dan.

Write to Eric J. Savitz at eric.savitz@barrons.com

IN icnp : Consumer Goods | ifurn : Furniture | iretail : Retail | itsp : Transportation/Logistics | i64 : Retail/Wholesale

NS ecat : Economic News | c151 : Earnings | c25 : Information Technology | ccat : Corporate/Industrial News | ncolu : Columns | nitv : Interviews | c312 : Corporate/Industry Exports | reqrre : Suggested Reading Retail | c15 : Financial Performance | cdom : Markets/Marketing | ncat : Content Types | nfact : Factiva Filters | nfcpex : C&E Executive News Filter | nfcpin : C&E Industry News Filter | redit : Selection of Top Stories/Trends/Analysis | reqr : Suggested Reading Industry News

RE usa : United States | namz : North America

IPD Barrons.com

IPC 2330.TW

PUB Dow Jones & Company, Inc.

AN Document B000000020220902ei950002u

BARRON'S

CLM Mutual Fund Profile

HD **Humans Make Calls At This Quant Firm**

BY By Lewis Braham

WC 1,067 words

PD 5 September 2022

SN Barron's

SC B

PG 21

LA English

LP

Long before there were exchange-traded funds using fancy computer algorithms to pick value or momentum stocks, John Montgomery was doing quantitative investing. When the now 67-year-old MIT-trained engineer founded Bridgeway Capital Management in 1993, he already had a fondness and facility for number crunching that most other managers lacked at the time.

The world has changed, but Houston-based Bridgeway hasn't lost its numerical edge. Perhaps its best fund embraces the factors most beloved by quants and financial academics, value and small-caps.

TD

The $504 million Bridgeway Small-Cap Value (ticker: BRSVX) has dominated its peer group, besting 99% of funds in Morningstar's Small Value Category in the past five years with a 14.9% annualized return, and 97% of them in the past 10 years with a 12.6% return. Its 0.92% expense ratio is below the category's 1.10% average.

Montgomery didn't start out on Wall Street. In the 1980s, he was a transit engineer, helping the Houston bus and rail system run on time. He went to Harvard and earned his M.B.A. in 1985. There, he fell in love with the factor investment models of famed academics Eugene Fama and Kenneth French. "I was like, 'Oh my gosh, you can use numbers and statistics to do this stuff,' " Montgomery says. " 'This is awesome.' "

Even so, quant investing remained a "hobby" until Montgomery founded Bridgeway. He recognized in 1993 that computers could do more cheaply what human analysts at bigger firms did, so he could compete with them on fees. Today, Bridgeway manages $4.5 billion.

Co-managers Elena Khoziaeva, 45, who is also Bridgeway's head of U.S. equity, and Michael Whipple, 53, help Montgomery run Bridgeway these days. Both have accounting backgrounds. Khoziaeva's journey began in Belarus, where she wanted to study international relations. She wound up in accounting as an undergrad and liked it enough to continue studying it while pursuing her M.B.A. at the University of Houston after moving to the U.S. Being in Houston and interested in finance, she says, "Bridgeway found me and I found Bridgeway." While in school, she worked as an executive assistant/analyst there in 1998, and became a full-time analyst in 1999 when she graduated.

The accounting classes proved invaluable. "It definitely helped a lot in number-crunching and understanding the data. Because it's one thing to enter all the data in the computer, but another to know which kind of variables we're looking for and what is happening behind the numbers in financial statements," she says. As for Whipple, he was a practicing certified public accountant for years before getting his M.B.A. from the University of Chicago in 2002, after which he joined Bridgeway.

While most computerized factor ETFs follow strict algorithmic rules for picking stocks, the key to being a successful "human" quant in 2022 is learning how to adapt as the academic research on finance evolves. "All of the [factor] definitions are going through ongoing review and monitoring here," Khoziaeva says. "We keep looking at academic papers." Even so, the team moves cautiously before changing models. It tests research on new metrics that seem promising, combining each metric with existing quant models to see if it improves returns without increasing risk.

Over the years, the team has updated its definition of value stocks in the fund. It has moved beyond the old Fama-French price-to-book value model, which focuses on hard assets such as factories and doesn't capture intangible ones, such as patents at drug companies. It also has incorporated new factors like quality and sentiment, which includes price momentum. High-quality stocks with consistent earnings are usually more expensive than value ones. Yet, despite paying up for certain stocks, the fund has maintained some of the lowest valuation stats in its fund category, with a portfolio average price/earnings ratio of only 6.7 versus the Small Value category's 10.1 average, according to Morningstar.

A big reason for the lower valuations is the fund's willingness to buy smaller, often overlooked companies. The average Small Value fund has only 5.0% in microcaps versus Bridgeway's 63.5%, according to Morningstar. Though microcaps tend to be volatile, the fund has experienced less downside risk than its peers in recent years, losing 35.5% in the January-March 2020 crash versus its rivals' 37.0%.

A stock like Teekay Tankers (TNK) illustrates Bridgeway's more nuanced approach toward value. Bridgeway bought shares of the oil transport company in the first quarter of this year. At the time, Teekay's earnings and cash flows were negative, making it impossible to value it based on price/earnings or price-to-cash flow ratios, Khoziaeva says. However, Bridgeway's "deep value" model also considers companies' sales, and the team identified it as a top pick.

"In the value and quality components, there are multiple individual models," Khoziaeva says. "So, diversification comes not only from [the individual factors]. It also comes from the individual models that are run independently within each [factor]."

Typically, 70% of the fund is devoted to small-cap value stocks and 30% to those that fit into in the quality and sentiment categories, although the latter are still companies found in the fund's Russell 2000 Value Index benchmark. In the second quarter, the team purchased Agree Realty (ADC), a retail real estate investment trust in the Russell benchmark, which was too expensive for Bridgeway's strictest value models. As of June 30, the stock had a 40 P/E ratio compared with 9.5 for the Russell 2000 Value, Khoziaeva says. But Bridgeway's quality model liked the stock's strong earnings per share. Agree's profit margins have topped 35% for several years.

Another second-quarter addition in the sentiment factor category is Otter Tail (OTTR), a conglomerate that includes an electric utility and a plastics manufacturing operation. It surely has price momentum, up 19.0% in the past three months.

The team is currently working on new factor research, examining the performance characteristics of environmental, social, and governance metrics. But like every quant tweak at Bridgeway, no metric will be added until it has been vetted by humans.

Email: editors@barrons.com

IN i81502 : Trusts/Funds/Financial Vehicles | ifinal : Financial Services | iinv : Investing/Securities

NS ccat : Corporate/Industrial News | ncolu : Columns | npeo : People Profiles | ncat : Content Types | nfact : Factiva Filters | nfcpex : C&E Executive News Filter

RE houst : Houston | namz : North America | usa : United States | uss : Southern U.S. | ustx : Texas

IPD Barrons.com

IPC ADC

PUB Dow Jones & Company, Inc.

AN Document B000000020220902ei95000b5

BARRON'S

HD Target Is A Bargain, Despite Its Troubles --- After a tumble, the stock seems to reflect all the bad news. A fat dividend and "sticky" customer base burnish the retailer's allure.

BY By Teresa Rivas

WC 1,063 words

PD 5 September 2022

SN Barron's

SC B

PG 12

LA English

LP

Fashion is fickle, even for trend-friendly Target. But the trend might get friendlier for the stock as it looks to put 2022 behind it.

It seems everything that could go wrong for Target (ticker: TGT) has gone wrong this year. Supply-chain problems caused the company to order too many items that consumers no longer want, like clothing and furniture, leading it to slash prices to move inventory.

TD

Target was forced to cut its guidance, not once, but twice, and a recent earnings miss added to the pain. What's more, shoppers—no longer flush with cash and pressured by rising prices—are spending less on stuff and more on food, an area where Target lacks the scale of competitors such as Walmart (WMT).

But with Target's shares down 29% in 2022, compared with the S&P 500 index's 18% decline, a lot of the bad news is already reflected in the price of Target stock. At the same time, there's still a lot to like about the big retailer, from its growing market share to its ever-expanding dividend.

Yes, things have gone from bad to worse as Target aggressively discounts overstocked merchandise, but now its shares look like a bargain—but a bargain, it must be cautioned, best suited for investors comfortable with a bumpy road to redemption.

Target's fiscal second-quarter earnings, which were released on Aug. 17, were disappointing. The company reported a profit of 39 cents a share, missing forecasts of 72 cents, but the bigger disappointment might have been that it wasn't worse. Many investors "think [that Target] missed an opportunity to reset a lower bar," says UBS analyst Michael Lasser, and instead will have to lower its guidance again in the near future. Analysts expect it to earn $8.16 this year, down from $13.56 in fiscal 2021.

Target's results have been bad enough to make even some long-term investors in its shares a bit nervous.

Longtime Target owner Bill Smead, chief investment officer of Smead Capital Management, calls the Minneapolis-based retailer a "wonderful company with as sticky a customer base as there is." He sees it in "the sweet spot" for the millions of millennials who are forming new households and families. Still, he thinks that it makes sense to buy Target on any dips that send it from a recent $165 back into a range around the $140s and $150s, and incrementally from there, depending on an investor's time horizon and risk tolerance.

Everyone would like to wait for a better price, but those don't always present themselves. And while the stock could fall further, buying it now might be the way to go.

"I think you've already seen the bottom in the stock, and 12 months from now, I think you have a better chance of this being up 20% than down another 20%," says Max Wasserman, founder of Miramar Capital, which recently was adding to its Target holdings. He thinks the shares could be back above $200 next year: "That's not a bold call. It's growing earnings, and its dividend is great." The stock yields 2.6%.

Wasserman is right about the earnings. Even at $8.16, Target is still making almost $2 a share more than it did in 2019, before Covid hit. Moreover, the retailer's sales are setting records, its dividend has risen, and its returns on equity and assets—which climbed to 50.9% and 13.2%, respectively, last year—are meaningfully higher than they were in the prepandemic period.

Target's market share expanded by $9 billion in 2020 alone, and with the store-traffic trend still positive and sales expected to climb 3.5% year over year, to a record $110 billion in fiscal 2022, Target continues to outpace the competition, including in downturn-resistant categories—such as food and beverage and essentials and beauty, whose sales were both up by double-digit percentages in the first quarter.

And while consensus estimates for this year and next have come down significantly in recent months, analysts still expect earnings per share to rebound more than 45% in fiscal 2023, which ends in January 2024, from this year's lows, to $11.97. That would mark Target's second-most profitable fiscal year ever, behind only fiscal 2021, during which it earned $13.56.

Of course, with worries about a slowing economy and persistently high inflation, investors aren't sure those estimates won't decline further.

Their fears might be overdone.

Wells Fargo analyst Edward Kelly, who recently upgraded Target to Overweight from Equal Weight, believes that the expectations for next year's profits among buy-side analysts are about $11, below even the sell-side average close to $12. Kelly, however, thinks that Target can earn an above-consensus $12.70 in fiscal 2023, and he argues that this year's margin issues are temporary. "Target has shown resilience in mild consumer recessions," he writes. "Management is making the right decisions to address the challenges at retail," boosting his confidence in Target's "recovery potential." His $195 price target is 18% above Friday's close of $164.60.

But even at the consensus, Target shares look cheap, or at least cheaper than those of its closest competitors. Right now, they trade at 14.4 times expected 12-month forward earnings. That's below the S&P 500's projected 16.8 times and Target's own 10-year average of 15.9 times. Target also changes hands at a 33% discount to Walmart's 21.4 times, when historically the discount has been 15%.

While Walmart has had problems of its own, its larger amount of grocery sales have helped insulate it better from the inventory problems both companies have faced, and it has weathered past economic downturns well. At some point, the trend will reverse, and Target could be left looking like the more attractive of the two.

Target's missteps won't last forever. It's time to start adding its shares to your shopping cart.

Write to Teresa Rivas at teresa.rivas@barrons.com

CO dayhud : Target Corporation

IN i64 : Retail/Wholesale | i654 : Specialty Retailing | iretail : Retail | i656 : Mixed Retailing | i6560002 : Department Stores

NS c15 : Financial Performance | c151 : Earnings | c1512 : Dividends | c181 : Acquisitions/Mergers/Shareholdings | cacqu : Acquisitions/Mergers | cactio : Corporate Actions | ccat : Corporate/Industrial News | npag : Page One Stories | reqrre : Suggested Reading Retail | c18 : Ownership Changes | ncat : Content Types | nfact : Factiva Filters | nfce : C&E Exclusion Filter | nfcpin : C&E Industry News Filter | redit : Selection of Top Stories/Trends/Analysis | reqr : Suggested Reading Industry News

IPD Barrons.com

IPC I/RTB

PUB Dow Jones & Company, Inc.

AN Document B000000020220902ei95000xd

BARRON'S

CLM Follow-Up

HD **A New Study Casts Doubt on a Paid-for-Order-Flow "Problem" --- A paper analyzing 85,000 trades finds the best pricing at an order-flow broker**

BY By Bill Alpert

WC 1,268 words

PD 29 August 2022

SN Barron's

SC B

PG 15

LA English

LP

Critics of retail brokers like Robinhood Markets condemn those companies for routing customers' orders to market makers like Citadel Securities in exchange for payments. Gary Gensler, the chair of the Securities and Exchange Commission, has suggested banning those payments for order flow, arguing that those customers must be getting worse pricing on their stock trades.

The suspicion is that greater payments to brokers must be offset by less favorable execution prices. But that isn't what a new study finds.

TD

In an Aug. 13

working paper, five finance professors analyzed 85,000 stock trades they made through five leading retail brokers. They did get significantly different pricing through different brokers for identical orders to buy or sell at the current market price.

But their best pricing came from a broker that takes payment for order flow, namely TD Ameritrade, now a unit of Charles Schwab (ticker: SCHW). Fidelity, which takes no order payments, got worse prices on the professors' trades than did TD Ameritrade. And its prices were no better than those from the E*Trade unit of Morgan Stanley (MS), which does take payments. Robinhood, which used revenue from order-flow payments to subsidize the industry's first commission-free trading, delivered middle-of-the-pack pricing. Interactive Brokers (IBKR) ranked last in the execution pricing of the professors' orders.

In 2020, TD Ameritrade got $1.15 billion in order flow payments, or some 20% of its revenue. Robinhood got 72% of revenue from such payments in 2020, while E*Trade got 14%.

"There's no relationship in our data between paid order flow and price execution," says Chris Schwarz, a finance professor at the University of California-Irvine, who wrote the paper with his colleague Philippe Jorion, UC-Davis professor Brad Barber, Washington University professor Xing Huang, and UC-Berkeley's Terry Odean.

Since most retail brokers have followed Robinhood's lead in cutting commissions to zero, the cost difference between them today is mainly a matter of how good a price they get on the orders they send for execution at a stock exchange or off-exchange market maker. In the last decade, the brokers have sent a growing portion of their clients' buy and sell orders to be executed at market makers like Virtu Financial (VIRT) and Citadel Securities.

The benefit to clients is that the market makers give better pricing on a particular stock than the figures quoted on stock exchanges—by executing trades at prices inside of the quoted spread. The result is that retail traders get slightly more per share when selling, and pay slightly less when buying.

With no price improvement, a person buying a stock would pay the offer price at the high end of the quoted spread, while a seller would receive the bid at the bottom end. The best price a trader can expect to get is the midpoint of that spread, but how often that happens varies.

The professors write that they were astonished at the size of the execution-price differences among the various brokers. Sixty-nine percent of the trades executed for Ameritrade were at the midpoint of the quoted spread—meaning the customer effectively got the transaction done without the market maker taking a cut—compared with 16% in the Interactive Broker Pro account.

Among the stocks in the study, the average spread between the bid and offer quotes was 16.8 cents, a range with a midpoint of 8.4 cents. On average, Ameritrade achieved a price improvement of 47% of that spread, meaning sellers got a price 7.8 cents above the quoted bid, while buyers paid 7.8 cents below the offer, figures that are all quite near the midpoint. The comparable figure for the Interactive Broker Pro account was 19%, for an average saving of 2.8 cents.

Fidelity and E*trade each averaged price improvement of around 35%, while the figure for Robinhood was 27%.

"U.S. retail traders are really being well treated—better than in any market in the world," says Jason Clague, who heads trading operations at Schwab, Ameritrade's parent. "The last decade has been a steady drumbeat of constantly improving retail trading outcomes." A recent white paper from Schwab notes that the spreads it obtained on U.S. retail trades have narrowed by 67% in the last 15 years, when compared with the spreads quoted on exchanges.

Fidelity notes that it is the only retail broker that reports its execution performance under a standard that was developed by the industry, but then shirked by other brokers. "We support data driven research on execution quality and have consistently called for greater transparency in retail execution quality to allow investors to determine what broker is best for them," said a Fidelity spokesperson. "We encourage other industry participants to provide a full breadth of execution quality statistics for investors' benefit."

Interactive Brokers, Robinhood, E*Trade, and Virtu didn't immediately provide comments. The SEC declined to comment.

While the study casts doubt on payment for order flow as an explanation for different levels of price-improvement by brokers, what does explain the better prices obtained by some brokers? One explanation may be the differences between different brokers' customers. Along with individual investors, Fidelity also handles accounts for family offices and investment advisors. Interactive Brokers courts savvy, active traders. And Robinhood customers have been shown to trade in herds under the influence of social media.

"The level of price improvement will vary by broker or stocks depending on a number of factors, including the nature of the order flow and types of orders, says Gregg Berman, who heads up market analytics at Citadel Securities. "The paper recognizes the significant price improvement we and other wholesalers provide to retail investors as we compete for broker flow."

Schwarz and his co-authors took great pains to send the same stock trades simultaneously to the five brokers. They traded more than 128 different stocks, across a range of market capitalization, liquidity, and volatility, while making sure to include the retail favorites Tesla (TSLA), Apple (AAPL), Nvidia (NVDA), AMC Entertainment Holdings (AMC), Nio (NIO), Aurora Cannabis (ACB), Bank of America (BAC), Exxon Mobil (XON), Alphabet (GOOGL), and Visa (V).

The professors funded the trading themselves, at considerable cost. Each day-trading account required a minimum balance of $25,000, and the professors' in-and-out trades occurred in the six months between December 2021 and June 2022, when stocks were plunging. "We lost tens of thousands of dollars," says Schwarz.

Funding constraints limited the professors' trades to a few shares per order, on average. That makes their findings hard to extrapolate to the treatment traders can expect on larger orders.

Expensive, self-funded experiments shouldn't be needed to compare the execution prices at brokers and market makers, say the professors. The SEC should standardize disclosure of execution performance data, they argue, but the relevant rules haven't been updated in years. Among other things, the rules take no account of odd-lot orders of less than 100 shares, which now comprise over two-thirds of retail trades.

"It's a study that I wish I had done," says Georgetown University finance professor James Angel, who wasn't involved in the research. "Different brokers do different jobs in execution quality. These differences are not driven solely by payment for order flow."

Write to Bill Alpert at william.alpert@barrons.com

CO obhiqc : Robinhood Markets Inc. | citadv : Citadel LLC | seexc : US Securities and Exchange Commission

IN i831 : Financial Investment Services | ibnk : Banking/Credit | ihedge : Hedge Funds | iinv : Investing/Securities | iwealth : Private Banking/Wealth Management | i814 : Banking | i81502 : Trusts/Funds/Financial Vehicles | ialtinv : Alternative Investments | ifinal : Financial Services | i83102 : Security Brokering/Dealing

NS ccat : Corporate/Industrial News | ncolu : Columns | reqrbc : Suggested Reading Banking/Credit | reqris : Suggested Reading Investing/Securities | ncat : Content Types | redit : Selection of Top Stories/Trends/Analysis | reqr : Suggested Reading Industry News

RE namz : North America | usa : United States

IPD Barrons.com

IPC AAPL

PUB Dow Jones & Company, Inc.

AN Document B000000020220826ei8t000gr

BARRON'S

CLM Barron's Cover - Main

HD **Water Worries --- The scarcity of water is rapidly emerging as a global threat that could disrupt businesses, crimp profits, and jeopardize growth. The scarcity of fresh water is rapidly emerging as a global threat that could disrupt businesses, crimp profits, and jeopardize growth**

BY By Lauren Foster

WC 2,171 words

PD 29 August 2022

SN Barron's

SC B

PG 16

LA English

LP

When Bob Seawright moved to San Diego 27 years ago, the only thought he gave to water was about the glistening swimming pool in his backyard. These days, water—or the lack of it—is a fact of daily life. Seawright has twice been forced to evacuate his home in the suburb of Rancho Bernardo due to the threat of wildfires. And the lush vegetation that once adorned the surrounding landscape has given way to dirt, hardy ground cover, and rocks.

"We have changed all of the shrubbery and ground cover to make it much more 'water wise,' " says Seawright, chief investment officer of Madison Avenue Securities, and one of the 90 million Americans living under drought conditions.

TD

The American lawn might be the most obvious casualty of the nation's depleted water supply, but growing water scarcity, whether caused by drought, contamination, or deteriorating infrastructure, extends to every facet of our lives: the clothes we wear, the food and beverages we consume, the cars we drive, and the search engines and electronic devices we rely on.

Nor are investment portfolios immune. Water scarcity is emerging as a threat that could heighten business disruptions, crimp profits, and jeopardize growth—especially in thirsty industries such as agriculture, fashion, computer-chip making, and data centers.

Poor water stewardship carries the added risk of reputational damage, as regulators crack down on waste and environmental issues grow in importance. At the same time, companies that address water issues offer new investment opportunities.

"Investors who fail to incorporate water risk into their portfolios risk significant future underperformance," says Thomas Schumann, creator of the TSC Water Security Index Family, a series of three regional equity benchmark indexes that measure the performance of large-capitalization stocks, weighted by their exposure to water risk. The U.S. and euro zone indexes were launched in January 2021, and a global index will arrive early next year.

The risk methodology looks at factors such as water utilization and policies to assess whether a company is a good steward of its water resources. Companies with lower risk are overweighted, while those with higher risk are underweighted.

Water metrics—such as the amount withdrawn and the volume consumed—are valuable tools for investors to gauge the dangers related to the natural resource, according to Sustainalytics, which is owned by Morningstar (ticker: MORN). In a March report, "Water-Related Risks and Challenges," the firm notes that just one in 10 companies reports information on water usage.

One way investors can analyze water risk—which includes scarcity, quality, and the threat of floods—in their investment portfolios is via the Investor Water Toolkit, created by sustainability nonprofit Ceres.

In most developed counties, access to H20 is as easy as turning on a tap. But just 3% of the Earth's water is fresh, according to the U.S. Bureau of Reclamation. About 2.5% is locked up in glaciers, the polar ice caps, the atmosphere, and soil, or is highly polluted or lies too far below the surface to be extracted affordably. So, just 0.5% of the available supply is fresh, and severe droughts threaten even that.

A United Nations report, "Drought in Numbers, 2022," notes that since 2000, the number and duration of droughts has risen by 29%, compared with those in the two previous decades, and that from 1998 to 2017 droughts caused global economic losses of roughly $124 billion.

In the U.S., the problem is especially acute in the West, where the 1,450-mile-long Colorado River, which provides water to 40 million people and more than five million acres of agricultural land, has fallen to record-low levels. Its two enormous reservoirs, Lake Mead and Lake Powell, are below 30% of capacity, exposing sunken boats and even human skeletal remains.

The federal government recently announced new mandatory water cuts and asked states to come up with a plan to save the river. Starting in 2023, Arizona will lose about 21% of its allotted annual supply of river water; Nevada, 8%; and Mexico, 7%.

As the Earth's water resources shrink, the planet is getting thirstier.

A McKinsey analysis predicts that, by 2030, global demand will outstrip supply by 40%. The nonprofit World Resources Institute has an even grimmer forecast: It projects that the gap will be 56% by the end of this decade.

Much of that demand comes from companies that produce the goods for daily life.

While estimates vary, FoodPrint, a project of Grace Communications Foundation, says it takes 1,800 gallons of water, on average, to produce a pound of beef, and 240 gallons to manufacture a cellphone. Nearly 800 gallons are used to turn out a pair of Levi's 501 jeans, according to the company. Levi Strauss (LEVI) launched a water stewardship program in 2011. It says that as of the end of 2020, two-thirds of its products were made using its water-saving finishing techniques or in facilities that meet its water recycle-and-reuse guidelines.

The biggest water hog is agriculture, which accounts for about 70% of global water withdrawals globally, according to the World Bank. Other thirsty sectors include apparel, energy, chemicals, pharmaceuticals, and mining. A report from nonprofit CDP found that the potential financial impacts of water risks are far greater than the costs of addressing them. In 2020, companies reported maximum financial impacts of water risks at $301 billion—more than five times higher than the $55 billion associated with mitigating them.

Tesla (TSLA) recently faced water-related hurdles at its electric-vehicle factory near Berlin. The plant was supposed to open in July 2021 but ran into bureaucratic challenges and resistance from locals worried that the factory—which may use up to 1.4 million cubic meters of water a year—would strain the area's water supply, which comes from local surface and groundwater sources. This supply has been shrinking for several years, due to prolonged drought, climate change, and overuse.

Tesla CEO Elon Musk laughed off a reporter's question about water usage when he visited the plant in August 2021. "This region has so much water; look around you," he said. "[There's] water everywhere here. Does this seem like a desert to you?"

But a peek below the surface told a different story.

Jay Famiglietti, director of the Global Institute for Water Security at the University of Saskatchewan in Canada, has been analyzing NASA satellite data for the past two decades, as part of his continuing research.

When asked to look in detail at Germany for a public television series there on water, Famiglietti used measurements from NASA's Gravity Recovery and Climate Experiment, which tracks changes in Earth's gravity field primarily caused by the movement of water over and through the planet's surface. He found that the country has been losing 2.4 cubic kilometers of water annually for the past 20 years, probably due to factors such as drought and overuse of groundwater. That's about 1.3 times the capacity of Lake Mead, the largest reservoir in the U.S.

The Tesla factory opened in March. Local officials said the auto maker could start production, on the condition that the plant meets environmental-impact requirements, including those related to air pollution and water usage.

Water scarcity is already showing up as a liability for companies and investors via stranded assets—plants, pipelines, and mines whose value has been written down due to water issues. A recent report from nonprofits CDP and Planet Tracker found that $13.5 billion in assets are already stranded and another $2 billion are at risk.

One company acutely aware of the intensity of its water usage is U.S. chip giant Intel (INTC), whose main U.S. manufacturing facilities are in Arizona, New Mexico, and Oregon. The Arizona and New Mexico sites are in areas experiencing high water stress, based on the World Research Institute's 2021 Aqueduct Water Risk Atlas, a mapping tool that helps companies, investors, governments, and other users understand where and how water risks and opportunities are emerging worldwide.

To understand why water is a top concern, one need look no further than the crisis facing the states that rely on the Colorado River. Amid this parched backdrop sits Chandler, Ariz., home to two of Intel's manufacturing campuses and 12,000 of its employees. A fabrication factory, or "fab," for making semiconductors requires vast quantities of water to operate, from the "ultrapure" water needed to prevent impurities from damaging the chips, to the water for cooling and facilities. According to Intel's latest Corporate Social Responsibility report, the Ocotillo campus in Chandler used about 15,800 megaliters of water in 2021, or about 4.2 billion gallons.

Todd Brady, Intel's chief sustainability officer, tells Barron's that ultrapure water, which has had as many of the impurities removed as possible, accounts for the largest share of the water used by the company. Chips and their pathways are built up in layers and, between manufacturing steps, must be washed to remove solvents and debris from the layer completed previously.

Water is also needed in semiconductor manufacturing facilities for purposes such as cooling and removing pollutants from the air. "Water is used in most applications," notes Brady, adding that the company uses about 14 billion gallons of fresh water a year.

Intel is trying to conserve water in its operations, collaborating on initiatives with local communities through water-restoration projects, and using technology to help others reinvent how they use the resource. The chip maker has set a goal of being "water positive"—restoring more freshwater to its local watersheds than it consumes—by 2030.

When Brady started at Intel in the mid-1990s, it took about two gallons of water to create one gallon of ultrapure water—50% efficiency. Today, it takes about 1.1 gallons of water to produce one gallon of ultrapure water, he says. The company has found ways to reuse water, and has funded more than 30 projects to restore it to local watersheds.

Brady says that, over the past 10 years, Intel's conservation efforts saved about 44 billion gallons, enough to supply about 400,000 U.S. homes for a year. "[Water scarcity] is something that we've been working on for a very long time, and we're very mindful of and continue to evaluate our risk," Brady adds.

Intel's sustainability efforts are paying off: The company topped the 2022 list of Barron's 100 most sustainable companies, created by Calvert Research and Management.

Tesla also pays attention to water risk. In its recently released 2021 Impact Report, the company acknowledges that "water is becoming increasingly scarce as the climate changes," which is why Tesla is reducing its usage throughout its operations "as much as possible."

In August, the electric-car manufacturer asked the Shanghai government for help in dealing with a severe drought in Sichuan province that has affected hydroelectric power production there, forcing some manufacturers to close plants. Tesla didn't respond to requests for comment.

When it comes to climate risk, water has garnered much less attention among investors than greenhouse-gas emissions. That appears to be changing.

Famiglietti of the Global Institute for Water Security says that "increasingly severe flooding and drought, melting glaciers and permafrost, groundwater depletion, and increasing water scarcity" are happening far more rapidly than climate models predicted.

Investors are waking up to the risks. The Securities and Exchange Commission's proposed climate disclosure rule, expected later this year, could require companies to disclose material risks if their facilities are located in regions of "high or extremely high water stress." The potential rule has elicited objections from companies that argue that it lacks clarity and would be costly to follow.

In August, Ceres launched the Valuing Water Finance Initiative, with 64 investment firms that collectively manage $9.8 trillion in assets. The initiative is intended to push some of the world's "biggest corporate water users and polluters" to consider water as a financial risk.

Addressing the world's growing water shortage—and its investment implications—will take more than glossy sustainability reports. It will require a collective effort across many sectors of society. Will Sarni, CEO of the Future of Water Fund, a venture fund that focuses on the Colorado River Basin, sees a silver lining. "Water scarcity drives innovation, which drives investment opportunities," he observes.

Competition for water will grow more intense over time. And companies that safeguard the long-term availability of clean water—and investors who recognize water scarcity as a material business risk—will be better positioned to weather the dry years.

Write to Lauren Foster at lauren.foster@barrons.com

IN icnp : Consumer Goods | ifurn : Furniture

NS gdroug : Drought | gnrsca : Natural Resource Scarcity | c151 : Earnings | e11 : Economic Performance/Indicators | ecat : Economic News | genv : Natural Environment | gntdis : Natural Disasters/Catastrophes | ncolu : Columns | npag : Page One Stories | npred : Economic Predictions/Forecasts | cpshrt : Product Shortage | c15 : Financial Performance | c21 : Output/Production | ccat : Corporate/Industrial News | cexpro : Products/Services | gcat : Political/General News | gdis : Disasters/Accidents | grisk : Risk News | gwea : Weather | ncat : Content Types | nfact : Factiva Filters | nfcpin : C&E Industry News Filter

RE usa : United States | namz : North America

IPD Barrons.com

IPC G/NSA

PUB Dow Jones & Company, Inc.

AN Document B000000020220826ei8t0008d

BARRON'S

HD **Powell's Policy Point: Inflation Must Be Beat, And It Won't Be Pretty**

BY By Lisa Beilfuss

WC 1,100 words

PD 29 August 2022

SN Barron's

SC B

PG 12

LA English

LP

When Federal Reserve Chairman Jerome Powell spoke Friday at the central bank's annual symposium in Jackson Hole, Wyo., he didn't say anything exactly new. But in reinforcing his commitment to restoring price stability, the chairman sounded more resolute than he had in other recent public appearances. "Today, my remarks will be shorter, my focus narrower, and my message more direct," he said, opening a speech that would last only minutes, mostly stick to the importance of the inflation fight, and highlight how his job is only getting harder.

TD

"Price stability is the responsibility of the Federal Reserve and serves as the bedrock of our economy. Without price stability, the economy does not work for anyone," Powell said, noting that higher interest rates, slower growth, and softer labor markets are the "unfortunate costs of reducing inflation" and will "bring some pain to households and businesses."

Strategists agreed that Powell was forceful. In weighing the two legs of the dual mandate—inflation and economic growth—the Fed will decidedly come down in favor of reducing inflation, says Cliff Hodge, chief investment officer at Cornerstone Wealth. "Powell can't come right out and say that the Fed is fine walking us right into recession in order to crush inflation, but that is what this messaging unequivocally implies."

Yet Powell is only starting to convince markets that he will do whatever it takes to beat inflation. Chris Zaccarelli, chief investment officer at Independent Advisor Alliance, says a market fully expecting the Fed to follow through on its pledge would be down at least 20% this year. After Friday's fall of 2.5% in the S&P 500, the index is off 14% in 2022. At the same time, traders on Friday shifted bets toward a half-point hike in September and away from a third consecutive three-quarter-point increase.

Aside from having to fight markets that have been fighting the Fed—with summer stock market rallies helping to ease the very financial conditions the central bank is trying to tighten—Powell has two particular forces working against him.

First, there is the job market.

In a report this past week, Piper Sandler economist Jake Oubina highlighted growing concerns over labor-force growth. He says that many positive postcrisis labor-force participation trends have sputtered and, in some cases, reversed. Prime-age participation has stalled at a level about 600,000 workers short of the pre-Covid tally. And the number of Americans not in the labor force who don't want a job rose to 19.9 million from 19.5 million over June and July; that's above the pre-Covid trend of about 19.1 million. In addition, the improvement in the labor-force participation rate among lower-skilled workers recently rolled over, Oubina observes.

Long Covid, or lingering negative effects of the virus, might explain some of the labor-supply problem. Oubina notes that the number of people out of the labor force because of disability is about one million above pre-Covid levels. A new report by Katie Bach at the Brookings Institution finds that around 16 million working-age Americans now have long Covid. Of those, Bach says, two million to four million are out of work, due to the condition. If the labor market is a main transmission mechanism of Fed policy, an acutely short labor supply complicates the picture and may mean labor demand must cool more than appreciated to take pressure off wages and prices.

The second force working against the Fed is fiscal policy.

President Joe Biden's student-debt forgiveness plan has ignited an economic debate, alongside a political one. Analysts at the University of Pennsylvania's Penn Wharton Budget Model say the plan will cost roughly $500 billion over a 10-year budget window. Relative to current law, (assuming that the interest moratorium that has been extended until the end of the year does end), the program will add about 0.2 to 0.3 of a percentage point to inflation, says Jason Furman, economics professor at Harvard University and head of former President Barack Obama's Council of Economic Advisers.

Melissa Kearney, an economics professor at the University of Maryland, says the debt-forgiveness policy will, by design, result in millions of households having more discretionary income. "That is a boost to demand and thus pushes in the direction of rising prices," she says, adding that this will drive up the cost of higher education and loans going forward. She notes that Biden's announcement mentioned that the immediate forgiveness will be paired with more generous forgiveness terms on future loans, which "essentially subsidizes the very sector whose ballooning pricing got so many people into this predicament." And it means that even more people will take out loans in the future, she says, further pushing up the costs of higher education.

In normal times, Furman's estimate wouldn't seem very significant and Kearney's points would be cause for longer-term concern, but not necessarily for losing sleep. Given how high inflation is now, however, it's a step in the wrong direction that undermines the central bank's efforts to cool demand and cure inflation.

The Fed does have something working in its favor, and it is the data. The latest indications of cooling prices came Friday, when the personal consumption expenditure index declined from its level a month earlier, slipping to a 6.3% year-over-year pace from 6.8% in June. The core versions, which back out food and energy and represent the Fed's favorite inflation measures, also moved in the right direction. From a year earlier, the core PCE fell to 4.6% from 4.8%, still well above the 2% target, but not nearly as elevated as the consumer price index. Separately on Friday, the University of Michigan revised its latest gauges of inflation expectations slightly lower, to 4.8% for the next year and 2.9% over the next five to 10 years. Powell says that the recent inflation cool-down is welcome, but not enough.

At this point, the forces working against the Fed outweigh those moving in the right direction. They are all the more reasons to believe Powell when he says that failing to fix inflation isn't an option, and they are reasons to believe policy might be even more painful than it would otherwise have to be.

Write to Lisa Beilfuss at lisa.beilfuss@barrons.com

CO fed : Board of Governors of the Federal Reserve System

NS ecat : Economic News | e11 : Economic Performance/Indicators | npred : Economic Predictions/Forecasts | e1103 : Inflation Figures/Price Indices | ncat : Content Types

RE usa : United States | uswy : Wyoming | namz : North America | usw : Western U.S.

IPD Barrons.com

IPC G/FED

PUB Dow Jones & Company, Inc.

AN Document B000000020220826ei8t000ul

BARRON'S

CLM Up & Down Wall Street

HD **Why Apple Might Push Deeper Into Sports Streaming**

BY By Eric J. Savitz

WC 1,101 words

PD 29 August 2022

SN Barron's

SC B

PG 8

LA English

LP

Recently, I discovered, to my horror, that my wife and I have 10 streaming-video subscriptions—and I might be undercounting. I stopped paying for cable service years ago, and largely avoid watching old-school, ad-supported commercial TV unless I'm binging on cable news. Still, I never know what to watch. So, when I spy something intriguing on a service I'm not already getting—Ooh, look! Killing Eve on AMC+! —I tend to succumb. Cha-ching.

Turns out that I have plenty of company. Nielsen this month disclosed that U.S. streaming in July passed cable viewership for the first time, with 34.8% of total viewing hours, versus 34.4% for cable, and a paltry 21.6% for broadcast TV. The news spurred media analyst Michael Nathanson, co-founder of research boutique MoffettNathanson, to dive deeper. What he found should alarm the entire TV business, cablers and broadcasters alike.

TD

Among other things, Nathanson discovered that broadcast viewership among 18- to 49-year-olds in July was down 39% from the level a year earlier. That's shocking, although he concedes that the comparison was tough. July 2021 featured both the first week of the Tokyo Olympics and late-ending NBA and NHL playoff games. Even more disturbing than ice hockey in July, in Nathanson's view, is that broadcasting's loss wasn't cable's gain. Cable viewing hours that month fell by 18%.

Nathanson warns that cable networks' ad sales will remain under pressure as viewership shrinks. The cablers and broadcasters also face the imminent arrival of serious new competition for advertising dollars, as Netflix (NFLX) plots the debut of an ad-supported subscription tier for early 2023. For years, Anthony Wood, the CEO of Roku (ROKU), has been saying that all content, including ads, eventually will be streamed. His prophecy now seems inevitable.

Nathanson's firm has Neutral ratings on most content providers, including Netflix, Warner Bros. Discovery (WBD), Disney (DIS), and AMC Networks (AMCX). And it has Sells on Paramount Global (PARA) and Roku. Nathanson's sole Buy in the group is Fox (FOX), which he says wisely sold its entertainment assets to Disney, and now focuses on sports and news, where viewer interest in ad-supported TV remains. Fox is also the group's only member without a subscription-based streaming service (no, you can't count Fox Nation), avoiding a segment in which competition is fierce and differentiation challenging. (Fox and Barron's parent, News Corp (NWSA), share common ownership.)

Nathanson actually thinks the cable bundle can be saved…if it's stripped to its essence—again, sports and news. He thinks the U.S. audience for pay TV will keep shrinking, from about 80 million households to 60 million over the next four or five years, with the remaining subscribers mainly hard-core sports fans.

But the cable audience could be even smaller if more sports shift to streaming. One wild card is what happens to NFL Sunday Ticket, which lets football fans watch out-of-market Sunday afternoon games. DirecTV has had the rights to Sunday Ticket since 1994, but that deal runs out after the coming season. There's an intense bidding war to take control of the service, with bidders reportedly including Apple (AAPL), Amazon.com (AMZN), Alphabet (GOOGL), and Disney.

Apple has the deepest pockets. It has been aggressively seeking sports programming to boost Apple TV+. The company already streams Friday night Major League Baseball games, and recently secured rights to Major League Soccer matches.

As Evercore ISI analyst Amit Daryanani points out in a research note, DirecTV pays $1.5 billion a year for Sunday Ticket. He expects the price to jump to at least $2.5 billion for Apple (or whomever wins). The analyst thinks Apple could boost the number of Sunday Ticket subscribers well beyond the current two million, but adds that "there is no real plan for the service to be stand-alone profitable."

That seems pretty evident. Daryanani notes that if Apple sticks with the current subscription price—$300 for the season—it would need to quadruple the subscriber base to eight million to break even. True, Apple has a structural advantage over DirecTV; you don't need a satellite dish for Apple TV+. But the average NFL game in 2021 had 17 million viewers, and the number of people who want to watch out-of-town games is likely a lot lower than that; eight million might be a stretch. DirecTV lost money on Sunday Ticket, using it to boost its subscriber base. Apple might take the same approach.

One bold option, Daryanani proposes, would be for Apple to roll Sunday Ticket into Apple TV+, which costs $4.99 a month, for no extra charge. If you assume a four-month season, at that rate Apple would need 125 million incremental subscribers to break even on the NFL package. Tim Cook & Co. can't possibly count on that; 112 million people watched the 2022 Super Bowl broadcast on NBC. But Apple this year will have net income of about $100 billion; if anyone can afford this kind of loss-leader, it's the iPhone maker.

The notion of giving away Sunday Ticket has other merits. It would make Apple TV+ a must-have for football fans, who might then stick around to watch shows like Ted Lasso, For All Mankind, and Severance. It would be a gut punch for other streamers. And it might eventually entice more buyers to choose Macs, iPads, AirPods, iPhones, and other Apple gear, and attract more subscribers for other Apple services.

"Sports are one of the last holdouts of the world of scheduled content with market appeal and significant advertising potential," Daryanani observes. "We think Apple pushing deeper into sports makes a lot of sense in terms of driving subs to TV+, while also differentiating it from its peers in an increasingly crowded market."

Oh, and one more thing, as Steve Jobs used to say: Apple holds its annual fall product launch event on Sept. 7, presumably to debut the iPhone 14. One day later, the 2022 NFL season starts. Commissioner Roger Goodell has said the league will announce a new Sunday Ticket partner in the fall. Apple's launch is about a week earlier than it has been in most years, for no obvious reason. I have no idea what will happen, but I suggest tuning in.

Write to Eric J. Savitz at eric.savitz@barrons.com

CO applc : Apple Inc.

IN icph : Computer Hardware | itech : Technology | i3302 : Computers/Consumer Electronics | icomp : Computing

NS c1521 : Analysts' Comments/Recommendations | gent : Arts/Entertainment | gtvrad : Television/Radio | ncolu : Columns | c151 : Earnings | c15 : Financial Performance | ccat : Corporate/Industrial News | gcat : Political/General News | ncat : Content Types | nfact : Factiva Filters | nfce : C&E Exclusion Filter | nfcpin : C&E Industry News Filter

RE namz : North America | usa : United States

IPD Barrons.com

IPC AAPL

PUB Dow Jones & Company, Inc.

AN Document B000000020220826ei8t000jh

HD **Wringing Profits From Water --- With climate change, pollution, and population growth, this often overlooked industry has mushroomed in importance. Here are six stocks to consider.**

BY By Al Root

WC 1,042 words

PD 29 August 2022

SN Barron's

SC B

PG 19

LA English

LP

Water is harder to pump than crude oil. It's harder to invest in, too.

Water, believe it or not, is denser than crude oil, which makes transporting it a feat. In fact, while energy is a sector, water is an amalgamation of 17 subsectors, according to RBC Capital Markets analyst Deane Dray, including water treatment, valves, pumps, filtration, desalinization, and metering.

TD

Water, for all of its importance to life, is also a much smaller business than oil. Dray, who has presented at United Nations water conferences, estimates the size of the global water business at about $655 billion a year, a fraction of the roughly $3 trillion worth of crude oil consumed around the globe each year.

Still, drought, climate change, population growth, and a focus on environment, social, and corporate governance investing make water a perpetually intriguing sector for investors. The trick, Dray explains, is to invest in water businesses with the best technology and not just interchangeable items.

"The world is awash in commodity water products: pipes, pumps, and valves," Dray says. "The emphasis should be on smart water systems."

But there's room for water utilities, too, says Jay Rhame, portfolio manager for the Virtus Reaves Utilities exchange-traded fund (ticker: UTES), who points to their stability as a main selling point. Exhibit No. 1: York Water (YORW), a small utility in Pennsylvania that has paid dividends continuously since 1816. Its streak is believed to be the longest in U.S. history.

With a $620 million market capitalization, York might not be appropriate for every portfolio. The six stocks discussed on this page, however, deserve a closer look.

American Water Works

Investors like water utilities for their stability, and American Water Works (AWK) is as stable as they come. The company is expected to grow earnings at an 8% annual rate for the next three years, after increasing them by 8% a year over the past decade.

That consistency has earned American Water Works a price/earnings ratio of 32 times, in line with its three-year average. It's not hard to see why. Everyone needs water, and just about everyone pays their water bill. What's more, utilities are allowed to earn a return on fixing and replacing pipes. Rhame says that makes projecting their results relatively easy. The stock pays a dividend of 1.7%.

Danaher

Danaher (DHR) isn't a pure-play water company, but it is a technology provider with a strong market position, says Dray, who estimates that 10% of its sales are directly related to water. "I have been in water plants on five continents, and they all use Danaher water test systems," he adds.

Danaher stock trades for about 26 times estimated 2023 earnings, a small discount to its average of 28 times over the past few years. The company is expected to boost earnings at an annual rate of about

7% for the coming three years, but that might be conservative. It has historically grown profits at an average annual rate around 12%.

Essential Utilities

Essential Utilities (WTRG), based in Bryn Mawr, Pa., isn't a pure play—it also delivers natural gas to customers—-and that makes it a little less stable than American Water Works. Its historical results are still impressive "It's a really well run water utility," says Rhame,

Essential Utilities earnings have grown at a 9% annual clip for the past decade, and should increase at just under 8% a year on average for the next three years. Essential Utilities' stock trades for about 27 times next year's expected earnings, in line with its recent history, though not as high as American Water, due to its gas business. The shares have about a 2.3% dividend yield.

Evoqua Water Technologies

Pittsburgh's Evoqua (AQUA) cleans water for more than 38,000 customers in industries including electronics, manufacturing, and even water parks. The stock isn't cheap. It trades for 37 times 2023 earnings, a premium to its three-year average of 35. But earnings are expected to grow by 15% a year over the next three years, up from 10% over the past few years.

Evoqua is also one of the few companies with ways of removing "forever" chemicals, or PFAS, from water, which could be a billion-dollar business if the federal government designates them as hazardous substances. Dray rates the shares Outperform and has a $44 target for the stock, up some 15% from recent levels.

Mueller Water Products

Atlanta-based Mueller Water Products(MWA) makes fire hydrants and has one of the largest installed bases of iron-gate valves, used to stop the flow of water in mains or garden hoses, in the U.S.

Mueller's profits are cyclical and can rise and fall with the economy. The stock dropped 10% after the company missed fiscal third-quarter earnings in August, a development it blamed on inflation and supply-chain pressure. Seaport Global analyst Water Liptak believes that the decline is an opportunity.

Earnings are expected to advance at about 13% annually for the next couple of years. At 17.5 times 2023 earnings, Mueller trades at a small discount to its three-year P/E of 18.3 times.

Xylem

Leaky pipes are a big problem. The average age of a water main in the U.S. is roughly 45 years. And Rye Brook, N.Y.–based Xylem (XYL) is here to solve it. If a utility has a leaky water main, Xylem can detect and diagnose the problem remotely. About 35% of the company's sales come from digital products, and that should get closer to 50% by mid-decade, says Alec Lucas, an analyst at ETF provider Global X.

Xylem stock trades for about 30 times estimated 2023 earnings, well above the S&P 500's 17. But earnings are expected to grow at an annual rate of 25% for the next three years. The digital products, which have better profit margins, help boost earnings growth, says Lucas.

Write to Al Root at allen.root@dowjones.com

IN i1 : Energy | icnp : Consumer Goods | iconst : Construction | icre : Real Estate/Construction

NS c151 : Earnings | gclimt : Climate Change | gdemog : Demographics | genv : Natural Environment | gqual : Environmental Pollution | npag : Page One Stories | c15 : Financial Performance | ccat : Corporate/Industrial News | gcat : Political/General News | gcom : Society/Community | gglobe : Global/World Issues | ncat : Content Types | nfact : Factiva Filters | nfcpin : C&E Industry News Filter

RE usa : United States | namz : North America

IPD Barrons.com

IPC AQUA

PUB Dow Jones & Company, Inc.

AN Document B000000020220826ei8t000gq

BARRON'S

HD Why Alcoa Could Win The Aluminum Wars --- With strong finances, a potential breakthrough technology, low operating costs, and a cheap stock, the old-line manufacturer is forging ahead

BY By Andrew Bary

WC 1,013 words

PD 29 August 2022

SN Barron's

SC B

PG 13

LA English

LP

The outlook for aluminum is brightening, and so are the prospects for Alcoa, probably the best pure play on the versatile and light metal—and a cheap one.

Alcoa stock (ticker: AA) looks like a bargain, trading at a level that doesn't reflect its issuer's favorable operating costs, improved balance sheet, increased shareholder returns, and one of the industry's lowest carbon footprints. And investors are ignoring a potentially breakthrough technology Alcoa is developing that could eliminate carbon emissions from the aluminum smelting process.

TD

Jefferies analyst Chris LaFemina has called Alcoa's Elysis smelting project, a joint venture with Anglo-Australian Rio Tinto (RIO), a potential "game changer" that would position Alcoa as a "truly green aluminum producer." Alcoa is using the process on a small scale and aims to prove it at the commercial level in coming years.

Alcoa shares, at about $56, are down 43% from $98, reached in March before aluminum prices fell nearly 40% to about $2,400 a metric ton, or $1.09 a pound. The stock trades for just over seven times projected 2022 earnings of $7.68 a share and has a similar estimated 2023 price/earnings ratio.

"Alcoa is inexpensive," says Timna Tanners, an analyst at Wolfe Research. "It has an advantaged cost position and isn't getting much credit for its green initiatives." She has an Outperform rating and price target of $62.

While based in Pittsburgh, Alcoa has the vast bulk of its operations outside the U.S. It mines bauxite, an aluminum ore, mainly in Australia. It uses that to make alumina, an intermediate product, and then refines alumina into aluminum at smelters globally, including a 120-year-old facility in Massena, N.Y. Alcoa separated its aluminum-product business into Arconic (ARNC) in 2016 and now is focused on making alumina and aluminum.

Aluminum is still made in the same electricity-intensive process that Alcoa founder Charles Hall developed in the late 19th century. Alcoa benefits because some 80% of its electricity comes from renewable sources, most relatively cheap, carbon-free hydropower. Its production emissions—about five tons of carbon per metric ton of aluminum—are a third of the industry average of 15 tons because many rivals rely on coal-generated power. That's increasingly important, as many Alcoa customers, including Apple (AAPL), focus on carbon footprints. Alcoa's overall costs are in the bottom half of the industry.

Aluminum is used widely. It's in cars, planes, packaging, wiring, and wind- and solar-power components. Used instead of heavier metals and plastic, it improves vehicles' mileage and is recyclable. It can offer the strength of steel with a third of the weight. Ford Motor's (F) top-selling F-150 pickup has an aluminum body.

"Aluminum is vital for the ongoing transition to build the electric vehicles and renewable-energy infrastructure the world will need to transition to a low-carbon future," said CEO Roy Harvey on Alcoa's earnings conference call in July. Citing an industry trade group forecast, he said demand could rise 80% by 2050, off a 2018 base.

China plays an oversize role in the aluminum market, accounting for over half of global demand and production.

In an Apple podcast this year, Eric Mandelblatt, who runs Soroban Capital Partners, an investment firm that owns Alcoa stock, said China had "destroyed" the aluminum market by vastly expanding electricity-powered smelters in the past 20 years, to take advantage of its large coal reserves.

Aluminum prices have averaged less than $2,000 per metric ton in the past decade, and are now no higher than they were in 1989. The bull case is that China is getting more eco-conscious and vows to cap its smelting capacity at 45 million metric tons annually, versus about 40 million now. Global production capacity is 69 million. Alcoa makes about two million tons a year.

"Nobody is taking the handoff," Mandelblatt said on the podcast, referring to construction of new smelters. That could tighten the supply/demand balance in the coming decade. High power prices in Europe and elsewhere already have idled one to two million metric tons of aluminum capacity. Alcoa CEO Harvey said on the July conference call that 10% to 20% of global capacity is uneconomic.

When Mandelblatt, who declined to comment to Barron's, spoke in February, aluminum was at $3,200 a ton—it peaked this year at $3,900—which would let Alcoa earn $12 to $13 a share annually. At $5,000 a ton, which he termed a dream scenario, Alcoa's EPS could jump to nearly $30.

He also saw the possibility in the next decade that Western countries could levy a carbon tax of perhaps $100 a ton on "dirty" aluminum made by China and other countries. That would benefit Alcoa, especially if its new smelting technology proves out.

Alcoa has used its strong earnings recently to bolster its balance sheet. It has just $299 million of net debt, against a $10 billion market value, and total obligations, including pensions and retiree healthcare, of $1.2 billion, versus $3.4 billion at year-end 2020.

Alcoa pays a 10-cent quarterly dividend and bought back $350 million of stock—about 3% of its shares outstanding—in 2022's first half.

"We have substantially strengthened the balance sheet and have made great headway on improving our portfolio," Alcoa Chief Financial Officer William Oplinger told Barron's in an email. "As a cost-focused, pure-play aluminum company, we are well positioned to capitalize on the growing demand for aluminum."

There are caveats, including a weak Chinese property market that's cutting demand for aluminum. But with its low-carbon footprint, sturdy balance sheet, and potential breakthrough technology, Alcoa has both the metal and mettle to be a long-term winner.

Write to Andrew Bary at andrew.bary@barrons.com

CO aupnew : Alcoa Corp.

IN i2245 : Aluminum | i22 : Primary Metals | i224 : Non-ferrous Metals | ibasicm : Basic Materials/Resources

NS c24 : Capacity/Facilities | m142 : Metals Markets | ccat : Corporate/Industrial News | npag : Page One Stories | malum : Aluminium Markets | m14 : Commodity Markets | mcat : Commodity/Financial Market News | mnonfr : Non-ferrous Metals Markets | ncat : Content Types | nfact : Factiva Filters | nfce : C&E Exclusion Filter

IPD Barrons.com

IPC AA

PUB Dow Jones & Company, Inc.

AN Document B000000020220826ei8t000dx

BARRON'S

CLM Technology Trader

HD **Nvidia Has Had a Rough Year. Why It Could Get Worse.**

BY By Tae Kim

WC 1,011 words

PD 29 August 2022

SN Barron's

SC B

PG 25

LA English

LP

Nvidia, the most valuable U.S. semiconductor company, is in a big rut. This week, the chip maker cut its guidance versus analysts' estimates for the third consecutive time over the past three months, blaming a softening economic environment and a sharp slowdown in demand for its gaming graphics cards.

While some investors are hopeful for a quick turnaround, I'm skeptical. Nvidia (ticker: NVDA) is facing multiple threats, including rising competition, an unsustainable pricing structure, and a potential crypto used-card glut that will be difficult to overcome.

TD

On Wednesday, Nvidia gave a forecast for the October quarter that was significantly below expectations, projecting a revenue range with a midpoint of $5.9 billion, compared with the $6.9 billion consensus. The weak outlook came after Nvidia

preannounced another miss earlier this monthwhen it said it would report $6.7 billion in revenue for the July quarter, versus its $8.1 billion guidance in May.

Barron's readers shouldn't be surprised by Nvidia's recent stumbles. In April, we cautioned investors about the company's deteriorating fundamentals, citing rising gaming inventories at retailers, elevated pricing, and exposure to cryptocurrency mining—all risks that came to fruition. In the ensuing months, the vast majority of Wall Street analysts missed the air pocket in demand for Nvidia products, the shares tumbled, and it went from consistently growing revenue at 50% year-over-year rate to forecasting a 17% year-over-year revenue decline in just two quarters.

On the earnings call this past week, Nvidia management said both product pricing and the number of units sold fell dramatically during the quarter. Nvidia's stock pared its initial losses and closed up 4%, to $179.13, in trading on Thursday. The shares are still down about 40% this year.

The same analysts who had a Buy rating on Nvidia shares during its drop this year aren't giving up yet. They now believe financial earnings estimates have been fully derisked, predicting that new Nvidia products, expected to launch soon, will boost its performance.

But the bulls are overlooking a number of significant risks. First, the negative aftereffects of the crypto bust are ongoing. To recap, Nvidia's gaming cards have been used primarily to mine Ethereum, the second-largest cryptocurrency by market capitalization. While mining demand has already sputtered this year as digital-currency prices have fallen, the biggest shoe still hasn't dropped.

Ethereum is expected to migrate as soon as September from a so-called proof-of-work model to proof-of-stake, negating the need for graphics card-based mining. As we have warned, when that occurs, billions of dollars of Nvidia cards may flood used marketplaces, creating a glut. Wedbush estimates that Ethereum mining may have accounted for $800 million of the company's quarterly revenue over the past year and half, totaling about $4.8 billion.

Second, Nvidia's profitability may get crunched as pricing falls to more normal levels. During the past couple of years, the company feasted on unprecedented demand for higher-priced cards that sold for

$1,200 to $2,000, driven by the crypto boom. That is now history. Pricing and demand will need to come down to a normal non-crypto-driven level of $800 and below, hurting its profit margins.

Veteran industry analyst Jon Peddie, who presciently told Barron's in April that demand for higher-priced cards would disappear, remains adamant that Nvidia's elevated pricing is unsustainable. He adds that Advanced Micro Devices' (AMD) next-generation graphics cards, expected later this year, will be more price competitive and gain share thanks to its innovative "chiplet" architecture.

That could be a game changer. A new era of competition from AMD might be the biggest unappreciated risk for Nvidia. None of a half-dozen notes from Nvidia analysts I read this week mentioned AMD as a threat, despite the fact that AMD has gone on record that its coming lineup of cards, code-named RDNA 3, will offer more than a 50% improvement in performance-per-watt versus the prior generation. A more efficient design will enable AMD to gain a manufacturing cost advantage over Nvidia.

In an interview with Barron's, Nvidia Chief Financial Officer Colette Kress says the company is "unable to quantify" the negative demand impact from crypto miners and the eventual Ethereum proof-of-stake transition. When asked if pricing for the current generation Ampere cards is sustainable for the next one, she says Nvidia will look at market conditions at launch to set pricing. On the potential for stronger competition from AMD, Kress says that while efficiency is important, Nvidia's cards have a stronger brand with gamers and dominate rankings for the most-used cards on gaming services. She also expresses confidence that partnerships with game publishers and Nvidia's more advanced software will help it to beat the competition.

While Kress may have some points, I agree with Peddie that AMD will take business from Nvidia.

The setup is eerily reminiscent of four years ago, when this column was bullish on a similar performance-per-watt advantage, at the time, for AMD's Rome server processor against dominant market leader Intel (INTC). AMD went on a multiyear rampage fueled by Rome, quintupling its stock price and surpassing Intel in market value.

It could happen again, this time in gaming cards against Nvidia. Better price-to-performance products are everything in tech.

Finally, even after its share price stumble this year, Nvidia's valuation looks expensive, as its earnings estimates have also tumbled. The chip maker now trades at 48 times expected per-share earnings for the next four quarters, which is nosebleed territory for a company expected to show negative growth for the immediate future.

Ultimately, given the risks, it is too early to get optimistic over a Nvidia turnaround. The worst is likely yet to come for the chip king.

Write to Tae Kim at tae.kim@barrons.com

CO nvdcrp : NVIDIA Corporation

IN ivicu : Virtual Currencies/Cryptocurrencies | i34531 : Semiconductors | i831 : Financial Investment Services | i8394 : Computer Services | icnp : Consumer Goods | ifinal : Financial Services | ifurn : Furniture | iindele : Industrial Electronics | iindstrls : Industrial Goods | itech : Technology | ibcs : Business/Consumer Services | iinv : Investing/Securities | ibnk : Banking/Credit | ifmsoft : Financial Technology | iintcir : Integrated Circuits | ividbd : Graphics Integrated Circuits

NS c15 : Financial Performance | c151 : Earnings | c1522 : Share Price Movement/Disruptions | ccat : Corporate/Industrial News | ncolu : Columns | reqbcs : Suggested Reading Business/Consumer Services | reqris : Suggested Reading Investing/Securities | ncat : Content Types | nfact : Factiva Filters | nfce : C&E Exclusion Filter | nfcpin : C&E Industry News Filter | redit : Selection of Top Stories/Trends/Analysis | reqr : Suggested Reading Industry News

RE namz : North America | usa : United States

IPD Barrons.com

IPC AMD

PUB Dow Jones & Company, Inc.

AN Document B000000020220826ei8t0005l

BARRON'S

HD **Suddenly, It's T-Mobile at The Top of Telecom --- The former wireless also-ran merged with Sprint and rode the transition to 5G as Verizon and AT&T struggled. The best is ahead.**

BY By Nicholas Jasinski

WC 1,315 words

PD 29 August 2022

SN Barron's

SC B

PG 14

LA English

LP

It used to be Verizon Communication's world, but wireless now belongs to T-Mobile US—and its stock will continue to benefit.

Verizon (ticker: VZ) was the undisputed winner of the 4G era, investing heavily in its network infrastructure and wireless spectrum licenses to build the nation's best service. Subscriber gains and premium pricing were the spoils. AT&T (T) was hot on its heels, allowing management to splurge on a since-reversed foray into the media industry. T-Mobile (TMUS) and Sprint were laggards, without the scale to compete with bigger players, and forced to rely on discounted pricing to attract consumers to subpar networks.

TD

A lot has changed as the world has moved on to 5G. Nearly 2½ years removed from its acquisition of Sprint, T-Mobile's business is humming. The once-upstart wireless carrier is winning plaudits for its 5G network and gaining market share, helped by industry-low pricing for its mobile plans. Shareholders will benefit, too, as T-Mobile finishes the most costly stretch of its Sprint integration and gets ready to direct surplus cash flow toward buying back a significant portion of its shares.

Barron's recommended buying T-Mobile stock in January 2020, and the shares have gained 84% since then, versus a 34% return for the S&P 500. The stock has returned 25% just this year—and more gains lie ahead.

It's difficult to overstate how much the shift to 5G has changed the competitive balance of the U.S. wireless business. The industry is in the early innings of a transition to next-generation networks, which deliver faster speeds and better performance in crowded areas than earlier technologies through the use of more antennas, additional higher-frequency airwaves, and greater network efficiencies.

The move has put T-Mobile in the pole position. T-Mobile's merger with Sprint, which closed in April 2020, has given the company an enviable portfolio of wireless-spectrum licenses in the sweet spot for 5G. The greater operational, network, and customer-base scale of the merged company means deeper pockets and more ammo for capital expenditures in the network. T-Mobile now has well over 100 million subscribers, leapfrogging AT&T. Its midband-spectrum network covered 235 million Americans at the end of June. And it's committing almost $14 billion to capital expenditures this year—less than rivals but more than double its premerger rate.

Unlike AT&T and Verizon, T-Mobile has managed to do all this without raising prices—and it has continued to see growth in average revenue per user, or ARPU. That's a function of customers choosing T-Mobile's pricier tiers with more features, suggesting it's attracting higher-value subscribers. It means T-Mobile can expand profit margins in coming years—from some 4% this year—approaching Verizon and AT&T, which have midteens margins.

Nowhere was T-Mobile's advantage more clear than during second-quarter earnings season. T-Mobiletrounced its rivals, adding an industry-leading net 1.7 million postpaid customers—an all-important metric for wireless companies that refers to customers who pay a monthly bill—and beating Wall Street estimates on several key metrics. Management raised guidance across the board.

Verizon, meanwhile, barely matched expectations, lost postpaid phone subscribers, and cut its guidance for the second quarter in a row. AT&T saw strong subscriber additions but weak free cash flow, as it spent on promotions to drive growth. It also cut full-year free cash flow guidance.

"T-Mobile delivered by far the cleanest quarter of the Big Three, with management continuing to execute on all fronts," wrote Morgan Stanley's Simon Flannery, who called T-Mobile stock his top pick after the reports.

Of course, a lot of this shift is already reflected in the shares. While T-Mobile stock has held its value over the past 12 months, near $147, Verizon is down 21% over the past year, to around $43.50 per share—levels last seen in 2017. AT&T has slid 8% over the past year, to around $18. T-Mobile stock goes for just under 10 times enterprise value to next year's Ebitda, versus around 7.5 times for its two rivals.

Nor are Verizon and AT&T sitting still. Both are also spending heavily on 5G, though both are at a spectrum-license disadvantage. They were top spenders in last year's C-band auction, bidding a combined nearly $70 billion. That midband spectrum will be a key part of their 5G networks, but it's only beginning to become available this year and next. Meanwhile, independent analytics companies have consistently rated T-Mobile's 5G network ahead of Verizon's or AT&T's.

Verizon management is confident that the full launch of the C-band spectrum and additional densification of their higher-frequency mmWave network will close the 5G performance gap with T-Mobile. At the end of June, Verizon said it had 135 million Americans covered by C-band, rising to at least 175 million by year end. "We have a path to a very, very strong network performance," Verizon CFO Matt Ellis said on the company's second-quarter earnings call in late July.

Others, like veteran telecom analyst Craig Moffett, aren't so sure. "Verizon has a history of excellence in their network operations, so it's certainly not something that one should dismiss out of hand," he says. "But the physics are on T-Mobile's side."

T-Mobile also has an attractive starting point on its side. Supported by its 5G lead, management is focused on growing market share in rural areas and among business customers, where T-Mobile and Sprint have historically lagged behind Verizon and AT&T. There's a long runway for subscriber growth there: Management expects T-Mobile's share of rural and business customers to rise to 20% by 2025, from the low teens and high single digits, respectively.

But the biggest boost to profit growth might come from simply doing nothing. T-Mobile management said in July that they expect to be done with the Sprint network integration by the end of September—versus a previous goal of the end of 2022. That has been the costliest portion of the acquisition integration, involving shifting cell sites from one network to the other, shutting down duplicative ones, and transitioning former Sprint subscribers to the T-Mobile network. Merger-related costs were almost $1.7 billion in the second quarter alone.

Once those costs are in the rearview mirror, T-Mobile's increased customer scale and rising ARPU will flow through to free cash flow—opening the way for a massive share-buyback program that could be announced later this year.

Deutsche Telekom (DTEGY) owns 48.4% of shares, with SoftBank (9434.Japan) holding 3%. The remaining 48.6% of T-Mobile's tradable market capitalization is roughly $90 billion, versus a potential $60 billion buyback program over four years, per management guidance. That's huge. Retiring two-thirds of the stock's float will dramatically increase earnings per share. As a result, Wall Street analysts expect T-Mobile's earnings to grow fourfold, from $2.41 in 2021 to $11.54 in 2025. Verizon's and AT&T's earnings per share are expected to be essentially flat from 2021 through 2025, according to FactSet.

So, forget T-Mobile's slight valuation premium over peers or its recent run. They barely begin to reflect its vastly superior growth trajectory and buyback plans. T-Mobile remains an investor's best bet in telecom.

Write to Nicholas Jasinski at nicholas.jasinski@barrons.com

CO belatt : Verizon Communications Inc. | dbptel : Deutsche Telekom AG | sbcatt : AT&T Inc. | unitel : Sprint Corp. | vcestr : T-Mobile US Inc.

IN i7902202 : Mobile Telecommunications | i7902 : Telecommunication Services | i3302 : Computers/Consumer Electronics | i79022 : Wireless Telecommunications Services | icph : Computer Hardware | iint : Online Service Providers | imed : Media/Entertainment | icomp : Computing | itech : Technology

NS ccat : Corporate/Industrial News | ccfd : Corporate Financial Difficulty | c181 : Acquisitions/Mergers/Shareholdings | cactio : Corporate Actions | npag : Page One Stories | cmerg : Mergers | c18 : Ownership Changes | cacqu : Acquisitions/Mergers | ncat : Content Types | nfact : Factiva Filters | nfcpin : C&E Industry News Filter

IPD Barrons.com

IPC DTE.XE

PUB Dow Jones & Company, Inc.

AN Document B000000020220826ei8t000b5

BARRON'S

CLM Interview

HD **As Europe Reels, This Pro Sees Bargains**

BY By Lauren Foster

WC 1,796 words

PD 29 August 2022

SN Barron's

SC B

PG 26

LA English

LP

Gloom has descended on Europe. The United Kingdom's inflation rate has hit double digits, and Germany's is getting close. The euro is flagging, recently dipping below parity with the U.S. dollar. With Russia squeezing the supplies of natural gas to the region, the winter heating season is apt to be a brutal one. It is all raising concerns that Europe may be headed for a deep recession.

But Matt Burdett, who helps run international equity and global income strategies at Thornburg Investment Management, sees big opportunities in Europe. He says it's important to look beyond the headlines, to dig deeper to understand what is really going on. "Knowledge is comfort," he says.

TD

Burdett joined Thornburg in 2010 after an earlier career as a medicinal chemist at Sunesis Pharmaceuticals and a stint as an investment banker, focused mainly on biotech. He worked at Pimco as a senior vice president and portfolio manager from 2011 to 2015, and then rejoined Thornburg.

He is a co-portfolio manager on three Thornburg funds, including the firm's $11 billion flagship strategy, Thornburg Investment Income Builder fund (ticker: TIBIX), which he has co-managed since 2018.

Investment Income Builder, which invests internationally in both stocks and bonds, has consistently beaten its peers. So far this year, it's down 8.6%, versus a 10.7% loss for Morningstar's Global Allocation category. Though it is less exposed to stocks than many funds in that group, it has handily topped the category average over stretches of one, three, and five years. Over the past 10 years, it has returned an average of 6.5% a year, outpacing 92% of its peers.

Burdett says the fund is designed to solve a problem: "The problem is income and growing income over time." The portfolio is 80% global dividend-paying stocks; 13% bonds, mostly BBB-rated or below-investment-grade corporate credit alongside securitized debt; with the balance in cash. Domestic equities are 30% of the portfolio, versus 54% for international equities.

Barron's recently spoke with Burdett about why he believes now is the right time to invest in Europe and where he is finding value. An edited version of the conversation follows.

Barron's: So, what do you like about Europe, given all of the troubles?

Matt Burdett: We are income-focused, and dividend yields are much more attractive outside the U.S. Europe, specifically, is a very attractive yield market. I don't think of Europe as all the same, or all of the companies in Europe as the same. It's really more about finding value. In some cases, a company just happens to be domiciled there, but their business is global. So, there are many examples in the portfolio of companies that are domiciled in Europe but have very global businesses.

What's a good example?

Roche Holding [RHHBY] is a company we've owned for more than 10 years. It's based in Switzerland, but more than half of its sales comes from the U.S. So, it's not as simple as just looking at the domicile of a company and then computing it as a European company. It's more complicated than that. Roche's dividend yield is about 3% in Swiss francs.

The negative backdrop today creates opportunity. Our view is that we can buy companies that we think are going to be long-term winners at more attractive relative values. Everything's about relative value. We still think there's great value in Europe.

Where are some of the best values right now?

TotalEnergies [TTE] is a French-listed oil major that is benefiting from the energy crisis, as it has the second-largest LNG [liquefied natural gas] business in the world, second only to Shell [SHEL]. Even if the Russia-Ukraine situation were to resolve tomorrow, and I'm not saying that it will, but if it did, things would not go back to the way they were. We think TotalEnergies is excellent value—it's half the valuation of Exxon Mobil [XOM].

That does sound cheap.

If you look at consensus estimates, the price/earnings multiple is roughly four times forward earnings. So, a low multiple. What we tend to look at is enterprise value to Ebitda [earnings before interest, taxes, depreciation, and amortization], which is going to factor in the market capitalization and the net debt that the company would have. Ebitda is a better proxy for cash flow. And so that valuation is 2.4 times, which is very low. Exxon Mobil is 4.2 times, so TotalEnergies is more than 40% cheaper.

You've held it since 2017, and it's your biggest position today. How bright is its future?

We've intentionally made it our largest position and think there's great value there. The capital allocation is reasonable and disciplined, and so we feel good about it. TotalEnergies' dividend yield is 5.6%, based on Bloomberg consensus estimates for calendar-year 2023.

But we're also well aware of the fact that if there is a meaningful recession in Europe, that's usually not good for oil prices and gas prices. But right now, we feel that given the supply-demand balance and the geopolitical tension, there's probably some support for these commodities, at least in the near to medium term.

You just mentioned the elephant in the room. Do you expect a recession in Europe?

I think the consensus is that there will be a recession. The question is, how severe will it be? I think the main lever is how high energy prices will go, in particular gas. We don't really come up with recession scenarios. What we try to do is look at the individual companies and the sensitivity of their earnings to different environments. A lot of people have concluded that you can't own Europe, given the negative outlook, but investing in companies really depends on the key drivers of the businesses you own. Mass fear is an opportunity. You have to dig around to find where that true value lies.

Where else do you see value?

Orange [ORAN] is the fund's No. 2 holding. We've owned it since 2016 and think it's an undervalued telecommunications company. It's what we would call a consistent earner. This is a business where the earnings stream doesn't vary very much throughout an economic cycle. People don't usually cancel their phone and internet service, even in hard times.

Orange is present in a lot of countries. France is the home country, where they have the leading market share in both mobile services and fixed broadband—internet service and TV service. What we like about Orange is that they've been investing heavily in fiber deployment in all of their geographies, but mainly in France. They're coming off of the heavy investment this year. So, starting next year, you'll see a material inflection in the free cash flow they can generate, and usually when that happens, it tends to be a good time for a digital infrastructure company, which is really what this company is.

Another reason that we like Orange, and why we bought more during the pandemic, is because the pandemic showed us how important digital connectivity is. You saw all kinds of stocks like Zoom Video Communications [ZM], and all of these other highflying names, move materially higher. But the core digital infrastructure that a company like Orange owns is really the critical backbone. If that's not there, nothing works.

What do the numbers look like?

If you look at the forward P/E, it's roughly nine times earnings. The enterprise value to Ebitda is about 5.2, which is probably a more relevant metric to look at. When the free cash flow inflects higher next year, which we expect will happen, that's an attractive point for other investors to get more involved in the stock. It's a well-run business and has controllable levers to create value. Orange's dividend yield is 7.1% in euros, based on consensus 2023 estimates.

Let's pivot to U.S. stocks. Pfizer [PFE] is in your top 10. Why do you like the stock?

We first bought Pfizer in 2010 and have increased our position meaningfully over the past couple of quarters on the grounds that it's a consistent earner and very attractively valued. We could not have asked for a better delivery from the company than what we saw during Covid with the vaccine and now with the antiviral Paxlovid.

The stock is trading at 9.5 times next year's earnings, and 7.5 times this year's earnings, and the earnings estimates are going down simply because the Covid vaccine sales are expected to go down.

Our view is that the Covid business is probably more durable than people expect. We think Covid probably ends up being like the flu. Is there going to be the same amount of demand for the vaccines as there was early on? No. But there are other levers to pull. When Pfizer first started selling the vaccine, they were not selling it at what would be a typical commercial vaccine price. So, even though volumes might fall, price can make up for some of that, and that would be true for Paxlovid, as well.

And, more importantly, they have a lot of stuff going on in the pipeline. They have built up, and are continuing to build, large amounts of cash, which allows them to acquire other assets and help them grow. This stock is helping us meet our income needs, with a dividend yield of nearly 4% and growing.

Which sectors do you like the most and the least?

Our largest overweight is financials because that's the sector where we think the best value is going to be. A lot of people think that if a recession is coming, you can't possibly own financials. We think the conditions are somewhat different than, say, before the [2008-09] financial crisis, when capital ratios were much lower. Our financials holdings are fairly diverse. We have some U.S. financials, such as CME Group [CME]. We also own some European insurance companies and banks. We think BNP Paribas [BNPQY] is still very good value and probably a winner in the European banking sector.

Our biggest underweight is information technology. The primary reason is simply because a lot of that sector doesn't pay income. Alphabet [GOOGL] doesn't pay a dividend. Meta Platforms [META] doesn't, either.

Thanks, Matt.

Write to Lauren Foster at lauren.foster@barrons.com

CO snisph : Viracta Therapeutics Inc.

IN i1 : Energy | i2569 : Biotechnology | i257 : Pharmaceuticals | i41 : Food/Beverages | i951 : Healthcare/Life Sciences | icnp : Consumer Goods | ibioph : Biopharmaceuticals

NS ccat : Corporate/Industrial News | ncolu : Columns | nitv : Interviews | reqbio : Suggested Reading Biotechnology | ncat : Content Types | nfact : Factiva Filters | nfcpex : C&E Executive News Filter | redit : Selection of Top Stories/Trends/Analysis | reqr : Suggested Reading Industry News

RE eurz : Europe | namz : North America | usa : United States

IPD Barrons.com

IPC BBG.XX

PUB Dow Jones & Company, Inc.

AN Document B000000020220826ei8t00002

BARRON'S

HD New York City's Sky-High Views Spit Out Cash, Luring REITs --- The observation decks atop celebrated skyscrapers are so profitable that real estate investment trusts and other institutional money have taken notice

BY By William McCormack

WC 1,118 words

PD 29 August 2022

SN Barron's

SC B

PG 20

LA English

LP

It's the ultimate New York experience: standing on the observation deck of a skyscraper and gazing out upon the city that never sleeps. And it wouldn't be New York unless you had to pay for the experience—a lot.

The attractions and experiences built around the best views in the Big Apple are getting more elaborate as skyscrapers try to outdo each other. And institutional money is wading into the fray, drawn by the steady cash flow produced by observation towers.

TD

During a vacation to New York City in July, Bernhard Posch of Austria, his wife, and their two daughters headed to Rockefeller Center in Midtown, where they strolled through a short exhibition and boarded an elevator that whisked them 67 stories up to the viewing floors.

"It's just gorgeous," Posch said, staring out at Central Park on a cloudless afternoon. "I think it's one of the best views you get all over the world." His family paid dearly for that view, with tickets to Top of the Rock starting at $40 for adults and $34 for children.

Tourists, particularly international visitors like Posch, have raced back to New York this summer after the pandemic kept them away. They have new options to take in the sweeping vistas. A decade ago, Rockefeller Center and the Empire State Building hosted the city's most prominent observation decks. Three new competitors have joined them.

One World Observatory, atop the Freedom Tower downtown and managed by the private hospitality company Legends, opened in 2015. More recently, the Edge observation deck in Hudson Yards and the SUMMIT deck atop the new $3.2 billion One Vanderbilt skyscraper have soared into the space. Standard daytime adult tickets range from $38 to $44 at all five Manhattan decks. Premium tickets that come with perks like glass elevator rides, glasses of Champagne, and expedited entry can cost between $63 and $113—and the sky is the limit for special packages like observation deck marriage proposals.

KKR (ticker: KKR), the private-equity firm, paid a reported $500 million last fall to acquire a majority stake in Edge from Related, the company behind much of the recent development of Hudson Yards west of Midtown Manhattan.

Billy Butcher, chief operating officer of KKR's global real estate business, said the firm sees "the growth of the market, as well as the recovery of tourism, contributing to strong early performance" for its investment.

"The biggest thing that stands out from all these other folks who have come in is the fact that now lenders and investors recognize these are institutional-grade investment assets," said Tony Malkin, chairman and chief executive officer of Empire State Realty Trust (ESRT), which owns the Empire State Building. He thinks investors had previously applied too low an earnings multiple to the observatory, which is creeping back toward the roughly $100 million in net operating income it generated before the pandemic, when about 4 million visitors bought tickets each year.

The Empire State's observation deck started drawing in hefty sums almost as soon as the building opened in 1931. Even during the Great Depression, the observatory brought in $1 million each year with $1 tickets (equivalent to $22 in today's dollars), according to Robert Slayton's Empire Statesman: The Rise and Redemption of Al Smith.

Top of the Rock, which is owned by developer Tishman Speyer, hosted about 3 million visitors a year pre-Covid, Tishman's Head of Rockefeller Center EB Kelly said.

Meanwhile, real estate investment trust SL Green (SLG), which operates SUMMIT at One Vanderbilt, expects $20 million to $25 million in observatory net operating income this year and 1.85 million to 2.15 million yearly visitors when its new business stabilizes in 2024. KKR and Legends declined to comment on the performance of their decks.

Malkin said the Empire State Building, as a publicly registered partnership, had broken out its observatory revenue since his family purchased the building in 1961. But analysts say the broader market didn't fully catch on until ESRT, which reports its observation visitation and financials quarterly, went public in 2013.

"Empire State Realty did a good job educating the market on how resilient [its observatory] has been," John Kim, managing director for U.S. Real Estate research at BMO Capital Markets.

Observatories are entering the spotlight as REITs try to cut their reliance on office buildings, a trend that Kim says the pandemic accelerated. SL Green and Vornado Realty Trust (VNO) are hoping to get casino licenses for Manhattan. Real estate investment trust Boston Properties (BXP) is constructing "View Boston" atop the city's 52-story Prudential Tower.

In New York, operators are eager to collect intel on their competitors. SL Green Executive Vice President Robert Schiffer said he has traveled to competitors' decks a handful of times each. He visits solo, and he doesn't wear his suit. Empire State CEO Malkin said the company has posted its own employees at competitors' entrances to count visitors.

Decks are pulling out all the stops to differentiate themselves. At Edge in Hudson Yards, customers can strap into a harness and travel up an outdoor staircase 1,200 feet above the ground. One World offers prix fixe dining at its restaurant and a private event space that starts at $25,000 or $30,000, says deck managing director Delfin Ortiz.

The Empire State Building offers a VIP proposal package for $1,000 per couple, and its owner completed a $165 million "reimagination" of the observatory in 2019, adding a 10,000-square-foot museum and other upgrades. Kelly says Tishman Speyer expects to start construction later this year on new additions at Top of the Rock—a former executive at Universal Studios is helping with attraction development.

When SL Green researched global observation decks while considering SUMMIT, it calculated numbers like Tokyo's observatory saturation rate that suggested New York had room for more, Schiffer said. Almost one in three visitors to Tokyo visit—at least one deck in the city, he said; at the time, the figure in NYC was only around one in seven.

"The pie does not appear fixed for the observatory business," said Daniel Ismail, a senior analyst at Green Street, a real estate analytics firm. "There is likely a pool of people who do want to go to an observatory but the addition of the new observatories, particularly in different locations, can grow it."

Write to editors@barrons.com

IN icre : Real Estate/Construction | ireest : Real Estate | i81502 : Trusts/Funds/Financial Vehicles | ifinal : Financial Services | iinv : Investing/Securities

NS ccat : Corporate/Industrial News

RE usny : New York State | nyc : New York City | usa : United States | namz : North America | use : Northeast U.S.

IPD Barrons.com

IPC AAPL

PUB Dow Jones & Company, Inc.

AN Document B000000020220826ei8t00004

BARRON'S

CLM Funds

HD **SEC Could Take Aim At Fat 12b-1 Fees Paid By Fund Investors**

BY By Lewis Braham

WC 1,012 words

PD 29 August 2022

SN Barron's

SC B

PG 22

LA English

CY

LP

Chances are mutual fund managers collectively shuddered when President Joe Biden chose Gary Gensler to chair the Securities and Exchange Commission. Gensler is the co-author of The Great Mutual Fund Trap, a book detailing fee abuses and conflicts of interest in the fund industry. In 2004, he testified before Congress that certain fund fees should be curtailed or abolished.

Some of the industry's fears have been realized. This March, the SEC issued a report of its 2022 "examination priorities" for registered investment advisors (RIAs) and broker-dealers. Among the stated concerns were RIAs' use of funds with 12b-1 marketing and distribution fees for clients. The SEC has also aggressively pursued some recent enforcement actions against RIAs related to such fees, and it's possible the regulator may ultimately eliminate the fee.

TD

The SEC created Rule 12b-1 permitting the fee in 1980 to help the mutual fund industry defray distribution costs. The fee is often used to compensate commission-based brokers, providing an incentive to hold on to a fund after they have already sold it to a client and received their commission—called a front-end load. With the $157 billion American Funds Washington Mutual Investors fund (ticker: AWSHX), for example, there is a 5.75% commission to buy the fund and a continuing annual 12b-1 fee of 0.25% to compensate advisors—on top of 0.22% for the management fee and 0.09% for other expenses.

Despite the fund industry's original claims that the 12b-1 would ultimately save investors money by creating "economies of scale" for large funds, critics say that hasn't been the case. Gensler testified before Congress in 2004: "The evidence clearly shows that funds with 12b-1 plans simply have higher expense ratios and poorer performance than non 12b-1 funds. The time has come to look seriously at repealing rule 12b-1."

Now Gensler has the power to do that.

"It's definitely a Democratic majority [in the SEC] right now," says Amy Lynch, a former SEC examiner and president of consulting firm FrontLine Compliance. "If Chairman Gensler wants something, he's going to get it." Lynch points out that according to its public agenda, the SEC will publish a proposed rule on "fund fee disclosure and reform" sometime in October. If the 12b-1 fee is to be repealed, it would likely happen then.

Yet Lynch isn't sure Gensler will kill it. "He's already fighting the [financial services] industry on a lot of other proposals that he's released over the past year," she says. "I think at this point, [the SEC] has to decide what battles they want to fight." She thinks additional restrictions on how 12b-1s can be used and additional disclosure required to use them is more likely than outright repeal. The SEC didn't respond to a request for comment.

One of the primary conflicts of interest addressed by SEC's enforcement actions involve dual-registered advisors. In a 2019 study called "The Worst of Both Worlds? Dual-Registered Investment Advisers," Nicole Boyson, a professor of finance at Northeastern University, wrote how 12b-1s influence "dual-registered" advisors who operated as both commission-based brokers and RIAs.

As fiduciaries, RIAs have a higher regulatory burden than commission-based brokers, requiring them to put their clients' financial interests before their own. Most RIAs charge a percentage of assets under management, historically 1%, instead of commissions, so they're not supposed to favor a load fund over a no-load one. But Boyson found that dual-registered advisors still favored higher-cost 12b-1 funds for their RIA account clients. Even though those funds didn't charge an upfront commission, the 12b-1 fee would still compensate the advisor by 0.25% of assets a year.

"If I'm a registered investment advisor, and I typically charge 1%, I'm going to, almost all the time, use funds that have a 12b-1 fee, so that I'm effectively getting paid 1.25%—1% directly from the client, and 0.25% indirectly from the client," says Boyson.

Yet much has changed in the fund industry since Gensler's 2004 testimony. According to the Investment Company Institute, a fund trade group, 89% of gross sales of mutual funds went to no-load funds without 12b-1 fees in 2021, compared with 46% in 2000. There's been a dramatic shift toward low-cost index funds and away from commission-based brokers.

Still, that doesn't mean funds are now conflict-free. In fact, in some ways, eliminating 12b-1s could make things worse. "12b-1s introduce a level of transparency that is not present with share classes that have other kinds of revenue sharing," says Aron Szapiro, head of retirement studies and public policy at Morningstar.

"Revenue sharing" is a more-generalized form of compensation fund managers pay for distribution that includes 12b-1s but can also include far-less-transparent payments. Often, for instance, fund advisory companies pay brokers out of their profits for favorable treatment instead of directly from an individual fund's expense ratio.

Szapiro calls funds with no 12b-1s but other revenue-sharing agreements "semi-bundled." Such funds can still be high-fee ones, but the reason is largely invisible, as there is no standardized disclosure for such arrangements. So while Edward Jones discloses it received $98.7 million from American Funds in revenue sharing in 2020, for example, Morgan Stanley doesn't provide specific numbers for each fund family.

Assets in semi-bundled funds have grown from $10.1 trillion in January 2018 to $12.6 trillion in June 2022, while assets in funds "bundled" with 12b-1s shrank from $3.6 trillion to $3.2 trillion.

Much like that old Whac-A-Mole game, every time the SEC brings the mallet of regulation down on an unsavory fee, a new one pops up someplace else.

Email: editors@barrons.com

CO seexc : US Securities and Exchange Commission

IN i8150211 : Mutual Funds | ibnk : Banking/Credit | iinv : Investing/Securities | i81502 : Trusts/Funds/Financial Vehicles | ifinal : Financial Services

NS c13 : Regulation/Government Policy | c314 : Pricing/Prices | ccat : Corporate/Industrial News | gpersi : Personal Investments | gpir : Politics/International Relations | gpol : Domestic Politics | ncolu : Columns | c31 : Marketing | cdom : Markets/Marketing | gcat : Political/General News | gpersf : Personal Finance | ncat : Content Types | nfact : Factiva Filters | nfcpin : C&E Industry News Filter

RE usa : United States | namz : North America

IPD Barrons.com

IPC G/SEC

PUB Dow Jones & Company, Inc.

AN Document B000000020220826ei8t000gs

Search Summary

Text	wc>1000
Date	In the last month
Source	Barron's
Author	All Authors
Company	All Companies

Subject	All Subjects
Industry	All Industries
Region	All Regions
Language	English
Results Found	47
Timestamp	28 September 2022 12:20

