The pillars of a functioning economy: why are they so important?

By Mike Pinggera, head of Multi-Strategy team

The pillars of a functioning economy guide the positioning of the Sanlam Real Assets Fund. They include healthcare, housing, energy, water, transport and education: namely, the things that enable our economy to function properly.

Life expectancy in developed economies has increased significantly over the last few generations and today we have a growing and ageing population. In the article ‘Transforming World Atlas (March 2016)’ Bank of America Merrill Lynch estimates that the world’s silver generation (those aged 65 and older) will total 3.4 billion by 2050, outnumbering children under the age of 14 for the first time in human history. This means that across the world there will be fewer people of working age to support a larger population, who are either retired or approaching retirement.

A growing and ageing population creates stresses on both the economy and the pillars that support it. For example, around the world we are already seeing housing shortages; pollution and climate change; as well as pressures building on public healthcare spending.

While these stresses present long-term challenges for individuals and governments alike, they also create investment opportunities, and businesses across the globe are investing in real assets to fulfil the needs and requirements of bigger and more concentrated populations.

From wind farms to toll roads, we like real assets because they exhibit distinct and attractive characteristics. In a low but rising interest rate environment, they can provide predictable cash flows, a degree of inflation linkage and diversification away from traditional asset classes. There’s also much to be said for the prospect of capital preservation over the cycle and lower volatility. Finally, real assets can offer attractive yields, which means we are effectively being ‘paid to wait’ while these themes play out.

We filter down the investment universe by targeting real assets which exhibit lower economic sensitivity, stable and predictable cash flows, embedded inflation linkage (where possible) and a strong financial position. For example, a growing population and a slowdown in construction in the UK has limited the supply of housing at a time when demand is high. This has made it unaffordable for some to buy a property, which means the private rented sector (PRS) continues to grow. This trend is likely to persist for some time.

Water demand represents another theme in the portfolio. Urbanisation coupled with an expanding global population have created water shortages. Looking ahead, freshwater is likely to come under further pressure as a result of climate change and increased demand from agriculture and industry. This pick-up in urban growth has increased the amount of wastewater that is produced, which presents opportunities for treatment and recycling. This is a solution to meeting higher water demand in densely populated areas.

Finally, Bank of America Merrill Lynch cites that those aged 35 and under collectively account for 4.4 billion or 59% of the global population. This factor creates challenges and opportunities. For example, tech-savvy millennials who are looking for convenience have played a significant role in the rapid growth of e-commerce around the world – a trend that has placed retailers under pressure to meet new volume and delivery expectations. With this in mind, we invest in the large logistics facilities that are being developed to provide the infrastructure to handle the rise of e-commerce.

These are just some of the structural changes in demographics and populations that lie at the heart of our long-term investment themes, which in turn support the pillars of a functioning economy.

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