Behind the Scenes of Solving for 2024

Disruptive Forces in Investing **December 12, 2023**

Anu Rajakumar: As we move into the final weeks of the year, we set our sights on what lies ahead in 2024. Today, we're going behind the scenes with one of the key contributors of the publication *Solving for 2024*, to understand the discussions and the debates that shaped the selection of the 10 key themes that Neuberger Berman believes will be prominent in the markets over the next 12 months. My name is Anu Rajakumar, and today I'm delighted to welcome to the show Shannon Saccocia, chief investment officer for Private Wealth, to discuss *Solving for 2024* and the topics raised from our recent virtual events. Shannon, thank you for joining me today.

Shannon Saccocia: Thank you for having me.

Anu: Now, Shannon, we've spoken about our *Solving for* publication at the end of each year. So this time around, I'd like to mix it up a bit and have you pull the curtain back. Tell us about the dialogue in the room as you and your fellow chief investment officers went about arriving at the 10 themes for 2024. And what are some of the key topics that really drove your discussions?

Shannon: It was an incredibly interesting experience for me. So I joined Neuberger Berman this year. So this is my first time going through the *Solving for* exercise. And I think one of the things when perhaps investors or clients read through these pieces, they often seem very top-down, very thematic. And I thought that what I wanted to do was talk a little bit about how we derived these themes, and that they're really derived from sort of the bottom up experience of all of our investment professionals here at Neuberger Berman.

So if you think about a top-down theme such as the consumer, obviously it's something that we experience on a day-to-day basis, we're always looking at, but it's seen through the lens of whether it's on our credit teams, our equity teams, putting together portfolios, thinking about trends around the corner. And one of the things that came out in the conversations was really that we were trying to synthesize all of these really micro economic variables, the things that we're hearing from companies on a day-to-day basis and pull those up into something that was thematic, that can act as an overlay in terms of incorporating all of these views.

So I think one of the things for people to really understand is that it's a lot less about a group of strategists in a room and coming up with things that are derived from some sort of intellectual silo. It's really about the things we're hearing on a day-to-day basis and synthesizing those and finding the commonalities between those that can help inform our investment process in 2024.

Anu: Obviously, you ended up finding those commonalities, and we found those 10 themes, but I imagine there was some debate in the selection process. What were some of the themes that were hotly debated? What were controversial? And were there any themes that were on the cusp of making it but just were the 11th or 12th theme that didn't quite get into the publication?

Shannon: Well, the value obviously coming from that bottom-up process is that all of our different teams, investment professionals, we're all looking at different variables and factors in terms of making those investment decisions. So when you bring people into a room, there are obviously going to be three or four things that they think are so important in terms of that process for them and in terms of them being able to identify risks and opportunities coming into the new year.

One of the things that's also hotly contested is that we're coming off such an extraordinary period where there isn't a lot of precedent, if you will, from a monetary perspective, from a fiscal perspective, from a market perspective. And so I think one of the things that was discussed was, "Is it different this time?" Are there things that we should be latching on to? Should we be going back to 2019 or even going back to 2005, 2006 or 1976 in some cases to think about what should be informing our thought process for next year?

So I think that was a big part of some of the debates was, "Are there things that are different this time because of this extraordinary period that we've come through?" There were also a lot of things that we talked about in 2022 and 2023 that didn't make the themes this year. And so if you think about China coming into this year, it was going to be the recovery in

China, the revival of the Chinese consumer, the reopening of the Chinese economy and how much that could impact not only what happens here in the United States where we sit today, but how it impacts the global economy, supply chain disruption. I don't see China in any of these 10 themes, and yet, it's such an important thing.

And then things like AI, how much of a productivity enhancement will that be? Could that help to alleviate the labor strain that we are experiencing? We have a demographic issue as it relates to that too, and we're not really talking about that. And then changes in the Japanese economy, things that the Bank of Japan is doing, the way that shareholder value is being derived and delivered in the Japanese equity market, for instance. These are all things that aren't incorporated into our 10 themes, but clearly could be as we pull back the layers of what could impact returns and opportunity next year.

So trying to talk about things that we think will be significant, but understanding that we could be in June or July of this year and say, "Wow, we really should have spent more time on geopolitical events" because it's become such a different world in these past six months.

Anu: Yeah, sure. You know, on that point about AI, which has been such a massive topic in 2023, I've heard folks say that in general, we tend to overestimate the impact of some of these massive themes in the short term and vastly underestimate them in the long term. So it doesn't mean that AI won't be a massive theme that we'll continue to see, but maybe the next 12 months, there are other things to really focus on.

You know, one of the themes was the awkward age for ESG and obviously, that's a little bit controversial in itself. Different jurisdictions around the world care about that theme more or less. Talk a little about that one as well.

Shannon: Well, we had a theme about ESG last year as well in *Solving for 2023.* And so we really wanted to talk about, I think, the transition of the way that investors are thinking about ESG and incorporating that into portfolios. And one of the things that's important, I think, for investors to take away about ESG is that while the moniker itself may denote different things for different types of investors, the premise that we are in a world where sustainability, and you can talk about that from a financial perspective or from a resource perspective, sustainability is something that's in focus.

And so while, for instance, my fellow CIO, Niall O'Sullivan, could talk about it in EMEA, where he acts in the multi-asset capacity there, he can talk about that from a pragmatism perspective that many portfolio allocators there are looking at this in terms of this is a real threat/risk/opportunity, and therefore, we should be paying attention to it. Here in the United States, I think we really look at it in terms of what are the financial implications, if you will, of not looking at things like sustainability and incorporating them into your process.

And so as we move forward, I actually think that this is going to be a wider aperture than just this ESG moniker, and that people, from an investment perspective, whether you're an institutional allocator or a private client, are going to start to internalize, you know, not thinking about sustainability is actually the risk, rather than it's a potential opportunity in a future state.

Anu: Absolutely, I totally agree with that. And I think it was you in the publication who did say that investors are becoming, as you said, more pragmatic, more solutions-oriented, and really understanding and differentiating between sustainability impact and ESG integration. Now, Neuberger held two virtual events on November 16th related to the solving themes. Now, one of those was geared towards institutional investors, and the other one, which you had a central role in, was geared towards private wealth clients.

Now, obviously, both of those virtual events covered many of the same topics, but one interesting difference that I noticed was in the audience polling. In both virtual events, the audience was asked which asset class they thought had the biggest opportunity in 2024. The institutional audience picked fixed income while the private wealth audience picked equities. And in both cases, I'll know that private markets came in as a close second, but I wanted to get some of your thoughts on that. Why the difference?

Shannon: I think it's a difference of experience, if you will, or perhaps desired outcomes from those two different client bases. So from a private client perspective, if you look back over the last decade plus, it has been very challenging to deliver the returns, if you will, that are required, especially if you are pulling money out of a portfolio, if you're attempting to meet your living standard with your portfolio, from the fixed income side of the equation.

And so I think the premise that equities will do better next year is, number one, based on the fact that many of our clients look at equities as the opportunity that combines both the potential for income generation as well as that capital appreciation, being able to have principal grow in excess of an inflation rate that is now obviously higher than what we've been experiencing. We also hear a lot from private clients and talk to private clients a lot about the opportunity of seeing rates come down and the impact on valuations. And so I think that is very much paramount in their mind.

On the institutional side, fixed income is seen as a tool, not just for return generation or income generation, but the potential to act as collateral, if you will, for different types of liabilities, to think about a longer term structure in perpetuity to potentially fund, from a maturity perspective, capital calls on the private market side. So I think it's just a difference in terms of, yes, the opportunity set is actually attractive for potentially both equities and fixed income next year. I think it's just the way that portfolios are built and constructed and the desired outcomes from that portfolios that probably informed that decision from a polling perspective.

Anu: Yeah, those are terrific points to make. You know, just continuing on that theme of opportunities, another one of the common sentiments that was in the publication was this focus on quality. It was noted in every asset class, equities, fixed income, alternatives. Tell us about why that's something investors really need to focus on in 2024.

Shannon: Going back to the period prior to the pandemic, whether it's from a credit perspective or an equity perspective, and particularly on the corporate side-- but this isn't, you know, just for corporations, it's for governments as well --there was such a low bar in terms of being able to borrow, in terms of being able to access liquidity and capital. And therefore, the decisions around capital allocation, the decisions on taking on additional debt, the decisions on buying back stock in the marketplace for instance, that was all sort of easier, if you will, than it is in this current environment.

And so when we talk about quality, whether it's in equities or in credit, you're thinking about things like free cash flow, you're thinking about the strength of the balance sheet, the ability to tap the capital markets, sustainability from a competitive advantage perspective. All of those things are more important in a higher rate, higher cost environment.

And you and I can sit here and we can talk about what we expect inflation and interest rates to be at the end of 2024. That's not really the exercise. We certainly know that they're going to be higher still than the pre-pandemic period. And so that emphasis on quality is really about sustainability at both the government and corporate level. And how do you engineer sustainability? You have a margin of safety, you have a cushion, you have some latitude and flexibility to meet head-on what challenges could come from, you know, exogenous shocks in the world that we're living in.

Anu: Yeah, totally. And I think as investors become more discerning, more selective, it's just really important to have that focus. Again, whether you're looking at various asset classes, you know, alternatives are obviously always an area of intrigue and I'm sure much discussion. What are some areas of the alternatives market that you think are particularly important, especially for private wealth clients that you're speaking to?

Shannon: Alternatives were historically, you know, 20 years ago, they were primarily a tool utilized by institutions or institutional like private clients and families. And they really required not only a significant amount of capital, they also required a level of sophistication and understanding that really wasn't something that either private clients were looking to do on their own, or many advisors from an advisory perspective feel comfortable talking about.

But two things have happened: number one, the world has shifted in terms of how capital and working capital in particular are delivered to businesses, are delivered to those that need it. Much of that happened in the public markets historically, much of that happened through traditional financing, through larger banks, for instance and you know, for small businesses and through regional banks. That has really come out of the marketplace. And we also have seen the rise of companies staying private longer being backed by private equity, if you will.

And so the need for other forms of liquidity have really driven the growth of the private market. And so when private clients think about how do they potentially participate in innovation, in growth, in backing some of these companies, it's no longer an opportunity to do that to the same extent in the public markets. I mean, just look at the small cap universe, how much smaller that is. A lot of that is private, right? And that's really when you want to get involved with some of these companies is before they get large.

And so I think the way that private clients are looking at this, and the way that we're trying to educate them to look at this is that if you want access to the full economy, part of your allocation does need to be within the private markets.

Anu: Yeah. And maybe just to that extent, how are you going about that education process? What are some of the things that you and your team really like to focus on?

Shannon: One of the things is just having people understand that shift in the dynamics of the market. The second thing is really understanding what types of risks are you taking on? There are different risks in terms of whether you're on the credit side of the equation or on the equity side of the equation. How early stage or late stage are you in equities? How diversified are you in those investments? Are you coming into a diversified fund of funds product? Are you coming in within a co-investment vehicle? And then understanding the liquidity of that.

So I think trying to see that intersection of the market opportunity and some of the strategies that fit for private clients is part of that education process as well. It's like the "So what?" is so important in the private client space because for many private clients, this is new to them and we want to make sure they have as full and understanding as possible before they commit to this type of strategy.

Anu: Yep, absolutely. And it sounds like you're really committed to making sure that you are on that education journey with them and a resource. What are some of the other areas of the investment opportunity set that you are personally most intrigued by in 2024?

Shannon: Yeah, so I'll talk about this from an NB Private Wealth perspective in particular, right? Because we're thinking about it in terms of we have clients who potentially have maybe a shorter term time horizon than we do on the institutional side, but we also have clients who are looking, you know, from an experience perspective, they're often benchmarking to something like the S&P 500. So, a very broad market index. And as we know, you know, there's been a lot of concentration in the performance of that index.

What we do think is going to be paramount in 2024 is understanding that there's going to be dispersion. And so when we think about dispersion, we think about opportunities that are outside of maybe what's performed best this year, which is a small part of the technology universe has really boosted returns from an equity perspective. Looking at small cap companies here in the US in particular have not participated, but offer-- particularly if we don't expect a severe economic contraction, potentially have some opportunity to participate out of what could be kind of a slowdown in the first half of the year.

You talked about quality earlier. Those quality companies are available, whether you're talking about value or growth. Quality is really going to be much more important than, you know, I think sectors or style in terms of determining what we would be interested in. Municipal bonds, there's attractive tax equivalent yields that are available. And for private clients, we have to factor tax into that.

And then on the credit side, the ability to allocate across sectors to be able to allocate across asset types. That dispersion is not just going to be in the equity market. There's going to be a lot of dispersion, particularly on the credit side. And so looking at flexible options within multi-sector credit, that allows us to tap where the investment professionals here are making those decisions about what's most attractive from a risk and return perspective and being able to incorporate that into a portfolio rather than us trying to make those decisions like on an asset class by asset class sector by sector basis.

Anu: And when you say multi-sector credit, are you thinking about this just from the public side or is it the spectrum of public and private?

Shannon: I think it's both. I think you really need to consider both when you're thinking about that allocation, but there are opportunities even on the public side in multi-sector credit, just given some of this dispersion that we anticipate. One of the things we talked about in the *Solving for 2024* piece was that we think some of the default risk will be more idiosyncratic that lends itself to flexibility in terms of looking across credit opportunities.

Anu: Absolutely. Now final question for you, Shannon. We've covered lots in this episode, and *Solving* obviously has 10 themes that we go into it in a lot of detail. But, just for today, what are the three key points that you want our audience to take away from this year's solving campaign?

Shannon: If you look at the macro themes that we discussed, I think the underpinning of a lot of them is that monetary policy as a tool is blunt and it typically is slow. So, I think about it in terms of trying to move an LNG tanker versus sailing in the America's Cup, right? There are times to move and certainly you can pivot that, but it takes some time. And so the transmission of monetary policy, a lot of people are using the term 'higher for longer', but there really are implications where a lot of what has happened over the last year in terms of central bank policy globally is still going to transmit through the economy. And so looking for that second and third derivative is incredibly important when you're thinking about investments.

We talk a lot about risk and some of the themes, I think, as you read through them, are really identifying the risk. But on the flip side of every risk is an opportunity. So, not all companies, not all countries are going to be equal in terms of their ability to navigate. And so that dispersion should be the expectation, but it also creates the opportunity for-- potentially for alpha generation. And I think back to the first question you asked me, you know, that fundamental micro analysis, that's where we start to see the benefit.

And then private markets, as I mentioned, increasingly important to the functioning of the economy. They're a critical compliment to what happens in the public markets. And so when investing through that lens, you have to combine public and private to really capture and widen your aperture in terms of the opportunity set.

Anu: Excellent. That was wonderful way to end the episode. But Shannon, I can't let you go without a bonus question. And so as I was thinking about what to ask you, I was reflecting on the question that I ask members of my team every year. I asked 'em to look ahead and respond to a couple of questions to help drive efficiencies and synergies in the coming year. So, I'm going to ask you questions that are similar in spirit, but I want you to base your answers off of your life outside of the office. So, got to learn a little bit more about Shannon. So, in 2024, in your personal life, what is something that you would like to do less of and what is something that you would like to do more of in the coming year?

Shannon: There's a fallacy in terms of loneliness, and I think that frequent interaction is the fallacy that the more that you're seeing people and spending time with people that it can cure loneliness. Loneliness is a huge concern in our society. And so I think focusing on genuine interaction and limiting the amount of interaction you have to interactions where you think they will-- the proverbial 'fill your cup', as we say in my house, I think is an important one as we look at this general problem of we're all very busy and so being much more prescriptive and thoughtful about how we're spending our time from a social perspective.

Anu: It's almost like a focus on quality interactions.

Shannon: Exactly.

Anu: That's lovely. And is there anything that you'd like to do more of hobbies or interests or anything like that in 2024?

Shannon: I love to travel. And so as we've seen over the past several months, there has continued to be a lot of people who are like me out there traveling.

Anu: Travel is back.

Shannon: It's absolutely back. One of the things that I really value about travel is that we read a lot of economic data and we digest things, but being out in different geographies, being in a community, looking at “What are other consumers doing? What are travelers doing?” I'm the super nerd, right? So I'm counting the number of containers that are sitting at a dock and seeing what that implies potentially for the global economy.

But just being out of your intellectual bubble, if you will, and understanding that sometimes there are deviations or differences between what we're reading in a strategy report and what's really happening on the ground. So I'm very much excited to get back out there on a more regular basis.

Anu: Yeah, I love that you're doing micro research while you're on vacation, that is a real commitment to your job.

Shannon: My family loves it as well. I can tell you.

Anu: Well, we talked about so many things today that were important from the importance of quality in investments across asset classes, the implications of “higher for longer”, and really just how we synthesize these bottom-up views into key themes. Finding those commonalities between our CIOs to come to the 10 themes for 2024.

For our listeners, there are so many more topics that you can dive into in our publication. So if you haven't seen it yet, encourage our listeners to go to nb.com to download it and read at your convenience. And I'll also mention that at the end of every *Solving for* publication, we do a scorecard on how we did in the previous publication in the anticipated themes, see how they turned out, which is always, as you said, a humbling experience, right? But Shannon, it's been great having you and we wish you and your team and your family a happy New Year.

Shannon: Thank you so much.

Anu: And to our listeners, thank you for tuning into Neuberger Berman's *Disruptive Forces in Investing* podcast this year. We wish you all an enjoyable holiday season and look forward to more insightful episodes in 2024. And as always, if you've enjoyed what you've heard today on *Disruptive Forces*, you can subscribe to the show via Apple Podcasts, Google Podcast, or Spotify, or you can visit our website, nb.com/disruptive forces for previous episodes, as well as more information about our firm and offerings.