

# FROM THE CIO

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## TO ROTATE OR NOT?

Why we are still emphasizing a pro-growth bias in our longer duration PE-oriented portfolios

## ECONOMIC VIBRANCY

The US as the leading economic engine pulling the global economy out of its pandemic slump and turning it into a post-pandemic boom

## ABUNDANCE OF LIQUIDITY

Private equity strategies as a primary beneficiary of Bounce created by aggressive global monetary policy

## VALUATIONS

There seem to be few places for capital to earn some plausible upside in returns other than equities

## INNOVATION AND FERTILITY FOR NEW COMPANY ECOSYSTEM

What is different today versus past periods of optimism around technology and new company formation

Economies are now at different stages of reopening which is correspondent to the degree to which local populations have become vaccinated and/or new COVID-19 cases have abated. This is contributing to shortages of certain goods that were disrupted by manufacturing shutdowns during 2020 and hence price pressures are evident in certain areas (especially home building).

Stock markets have maintained an upward tilt, but leadership has rotated towards value stocks or economically-sensitive areas and commodities showing the most robust rebounds relative to other areas.

In fixed income markets, rates have risen putting pressure on the performance of safe haven fixed income-oriented assets. Credit spreads have tightened.

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Previously, David served as the CIO at Falcon Private Bank Ltd. Before that, he was the founding member and Managing Director at AIG Global Investment Corp.'s Alternative Investments. David brings over 35 years of experience and expertise in focused alternative investment programs in both capital and private markets.

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In order to give our readers a **quick overview and our opinion of the material issues on the minds of capital allocators** we are highlighting them below:

### 1 TO ROTATE OR NOT?

Last quarter we described our views that a rise in rates was not going to be a cause for us to reduce our focus and emphasis on equities. We recognize the tactical shift in stock leadership towards cyclicals but still are emphasizing a pro-growth bias in our longer duration PE-oriented portfolios.

#### Allocation to cyclicals as a tactical opportunity

We would describe an allocation to cyclicals as a tactical opportunity and have increased exposure to certain procyclical themes in selective emerging markets for our outsourced-CIO clients, where such tactical allocations can be made quickly and reversed later.

#### PE-focused growth and innovation strategies with a long-term edge

But, for our longer-term PE-focused strategies, we still believe that growth- and innovation-driven themes will still have the edge in the long run.

### 2 ECONOMIC VIBRANCY

There is no doubt that consumers and companies are in a sort of catch-up demand execution mode. This is especially evident in the US where vaccinations are ahead of the rest of the world in terms of the number of doses distributed, and therefore consumer confidence is very robust.

#### US leading economic engine as a result of vaccination speed

We would see the US as the leading economic engine pulling the global economy out of its pandemic

slump and turning it into a post-pandemic boom. Other countries are likely to follow this pattern of post-pandemic recovery.

### 3 ABUNDANCE OF LIQUIDITY

One of the byproducts of the pandemic was an abundance of liquidity that was created by global monetary policy.

#### Sharp rebound in illiquid asset pricing

This aggressive policy response has created an unprecedented degree of liquidity that has led to the sharp rebound in asset prices especially those that were illiquid.

#### Significant dry powder for later-stage growth strategies

Private equity strategies were a primary beneficiary of such liquidity induced bounce and this was especially evident in the speed of "up round valuations" for later-stage growth deals. There still is an abundance of dry powder in later-stage growth strategies and this recovery is most easily appreciated by the rapid reversal of fortunes of Softbank which two years ago was suffering from several high-profile unicorn failures. Now, the robust recovery in valuations of private and public company growth deals has led Softbank, and many other PE investors for that matter.

### 4 VALUATIONS

As a result of the liquidity infusion across the board, valuations for most financial assets from equities to fixed income are at high levels from a historic perspective. This is leading many "nay sayers" to call for either "tops" or at least a "pause" to further rapid appreciation in equity prices.

### Few return opportunities beyond equities

We see conditions more likely that it is a pause but not a “top” as there are few places for capital to earn some plausible upside in returns other than equities. The one argument that we are empathetic to is that this excess liquidity is now being absorbed by consumers and companies as spending rather than having capital flow directly into the financial markets.

### Excess liquidity to contribute to earnings and growth

In effect, the surplus liquidity gets spent by consumers or corporate R&D or capex or share repurchases. One should note however that all of these uses of capital should contribute to earnings strength and growth.

## 5 INNOVATION AND THE FERTILITY FOR NEW COMPANY ECOSYSTEM

One of the great questions we face from our clients is:

“What is different today versus other periods of time in the past when there was a sentiment of optimism around technology and new company formation?”

### Leaps in innovation as drivers of economic advancement and growth since the middle ages

There is a pattern of economic advancement and acceleration of growth that almost always corresponds to or traces back to some leap in innovation. There typically is an exponential degree of new companies formed and new technology born from the development of a critical type of technology. Think of the invention of the printing press in 1450 by a German exile living in Strasbourg, France.

### From Gutenberg’s printing press to the art and architecture of the Renaissance

Initially, the printing press and book publications were centered in the German-speaking regions, including Switzerland. Later (ca. 50 years), Venice, Italy, emerged as the epicenter for book publication. It was the perfection of the roman typeface and the approach to create a mass market for pocket editions that led to the Italian Renaissance. The quest for knowledge and the large humanist movement emanating in Italian cities such as Venice and Florence led to significant creativity and wealth formation. The vibrancy of this is still evident today in these cities which remain full of art and architecture reminiscent of this time. All of this originated from proliferation of knowledge and the technology that enabled its dissemination was the printing press.



### The end of thought monopolies

It was also that after this period from 1450-1800 that led to enormous transformation of societies, the collapse of many monarchies throughout Europe later on, and the “bust-up” of the monopoly power previously held by the Catholic Church via the Reformation. This new mentality led many people to question the status quo and it ignited a new degree of liberty and freedom for people around the world. Wealth created led to venture funded exploration of the oceans and the discovery of new continents.

### Knowledge transforms societies and broadly advances standard of living

Entire populations who were previously oppressed during the Middle Ages were transformed and freed. After the printing press and with increasing literacy rates, economies that expanded knowledge and applied this knowledge to new products, services and culture advanced their standard of living. Of course all of these freedoms and advancements were not uniformly shared but certainly for those countries who accumulated the wealth and applied such technological advances it became the differential factor for living standards of countries.

### Inventions continue to improve quality of life centuries later

Similarly, the invention of the combustion engine, the application and use of electricity, refrigeration, radio the television etc. all were catalysts for the spawning of a whole array of related new applications that improved the quality of life for society. Like in the period after the Renaissance, the unevenness and the pace of change also created societal tensions which triggered wars, by those countries and population segments who were being left behind in these broad advances in economic wealth.

### Today, connectivity and access to information are as transformative as the printing press

Today the penetration of mobile phones and the accessibility of information/knowledge will have the same significant transformative impact on society that the invention of the printing press had over the following 200 years after it was invented.

### Speed of change increasing on a global scale

Unlike then, speed of change will be faster and on a global scale. We see the pace of digital innovation, software, automation, space exploration, drug discovery, etc. all accelerating and we believe that it will foster decades of innovation and the creation of new companies and industries.

Unlike the past when these innovations were funded by local patrons or wealthy families (like royal families and wealthy merchant families like the Medici's), today the global support and ecosystem for company formation is stronger and more diffused around the world than ever before in human history.

### Technological advancement to drive productivity in light of demographic challenges

Every government around the world knows that the key to economic prosperity is to create a fertile ecosystem for innovation and technological advancement. This is due to many factors but one that is recognized today is that for the first time in human history the world population growth is stalling. Fewer babies are being born and most developed nations are facing a significant decline in the ratio of their working population proportional to those not working (aged and young). China just relaxed its one child policy and now is encouraging families to have three children! This demographic condition is putting significant pressure on the ability of countries to grow their top line GDP which is essential to support increasing and widening government debt and deficits. One of the only ways to combat this top line growth challenge is to improve productivity by fostering technological advancement so that a country can produce more with less.

This is in our opinion why governments are being forced to run unprecedented fiscal policies funded by extraordinary money printing, and adopt policies that are friendly to technology development like automation and robotics and other forms of productivity driven innovation.

Countries, which increase taxes and punish entrepreneurs and innovation, will lose out to those that create and foster environments favorable to entrepreneurs who are willing to take risk and create new innovative companies.

### The risk of being of the wrong side of the digital divide

Accordingly, we continue to see more risk by being on the wrong side of the digital divide and would rather be on the change-driven side. This is the big picture and why through our PE- investment strategies, we support funding and advancement of entrepreneurial led innovation.

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