Be an optimist

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Sustainable equities

The path of least resistance is up

One of the indisputable truths about investing is that the past is certain, but the future is all probabilities. Hindsight is a wonderful thing, as the saying goes. It seems obvious now that there would be no recession in 2023 in the US, due to high levels of government expenditure and strong wealth effects from property and share prices within large parts of the consumer economy. Yet, at the end of 2022 a recession was viewed as inevitable. At the end of 2023 similar concerns over economic growth were also well founded, but incorrect. Why do forecasters have such pessimism when reality teaches them otherwise?

Part of the answer to this question is behavioural. Losses impact us much harder than gains, so it is rational that human nature seeks to protect us from them. Caution is often viewed as wise, whereas optimism is viewed as reckless. Another reason is a failure to understand base rate probabilities – essentially what is the probability of an event in any given year. If we look at past occurrences, the probability of a recession in any given year is about 15%. Using the same approach, the probability of the US stock market being down in any given year is approximately 25%. In summary, the most likely path in any given year is rising economic growth and share prices. The path of least resistance is up.

Atoms, bytes and genes

Another reason for optimism is the high level of innovation we are currently seeing in the global economy. This can be best summarised with the concept of atoms, bytes and genes. In theory everything in existence is one of these. Atoms represent the physical world, bytes the digital, and genes the natural world. In my opinion, if we can understand trends in these three areas, we should be able to understand everything.

The physical world is undergoing a once in a generation investment boom, led by reshoring (as overseas manufacturing is moved back home for geopolitical reasons), decarbonisation and the need to build out data centres to support the increased use of artificial intelligence. The digital world is also seeing an unusual level of growth as cloud computing combined with generative AI becomes more pervasive. Not to be left behind, in the natural world new treatments are being created for diseases such as Alzheimer's and obesity. Any one of atoms, bytes and genes could be enough to drive economic growth but all three together are a powerful tailwind that could exist for many years to come. I think that sustainable investing is a great way to invest in all three of these areas.

When we add base rate probabilities to a high level of innovation it seems to us the potential for 2025 to be another good year for equity investors is high.

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Always something to worry about

Investors are worriers. No matter how good investment returns are, or how positive the outlook is, there is always a sense of impending negative news. This does have some degree of rationality about it. The world looked a good place on 10 September, 2001, economic growth was strong in early 2007, and in January 2020 hardly anyone had heard of Covid. Within a short space of time, we saw a terrorist attack, financial crisis and the global economy largely shut down.

Although each of these events was traumatic in their own unique way, none had a permanent impact on investment markets – and for long-term investors, these were ultimately an opportunity to save for future needs at a more favourable price. Worrying is often not a profitable experience.

That said, it does pay to be aware of risks that may occur in the year ahead. It seems reasonable to expect tensions between China and the US will increase. This could be in several forms, from trade tariffs to disputes over geographical regions. There is also a risk that inflation will come back again, a function of economic growth being stronger than expected at a time of economic stimulus. Were this to occur, interest rates would have to increase again, whereas expectations currently are they will fall. Concerns around fiscal deficits are also valid. The level of borrowing being proposed by major economies such as the US is unprecedented, and no one knows how debt markets will respond to this. If debt levels are seen to be too high, bond yields will rise, making the situation of funding government expenditure plans even more difficult.

Don't worry, be happy

One of my favourite sayings is if you want to be a successful journalist, be a pessimist; if you want to be a successful investor, be an optimist. This is not to say that investments can only go up – they clearly do not in some years – but it is to say that generally over the long term, societies improve, economies grow, innovation thrives and optimism wins. Whilst we expect 2025 to have unforeseen challenges, we also think it is a great time to be a long-term investor with more opportunities today than ever before. As always, we choose to be optimistic about sustainable investing and equity markets generally.

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