Vontobel

Megatrends

Transcending short-term noise to harvest long-term growth

April 2024

Marketing document for institutional investors in:
AT, CH, DE, ES, FR, GB, IT, LU, SE

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Foreword

Megatrends persist in shaping the landscape of the capital market, providing a foundation for guiding investment portfolios with a logical framework. These influential trends play a pivotal role in steering growth trajectories and reshaping profit dynamics. Noteworthy events, such as the UN Climate Change Conference (COP28), contribute to ***sustainable value creation,*** especially as the demand for solutions to withstand climate hazards rises amidst increasing climate damage. The ongoing conflicts in Israel / Gaza and Ukraine symbolize geopolitical fragmentation and the acceleration of a ***multipolar world.*** Shifting ***demographics*** impose constraints on the workforce, limiting the production and growth potential of countries. Lastly, the rise of AI is set to disrupt various sectors as ***technological convergence*** continues, unlocking tremendous productivity possibilities. Strategically harnessing these megatrends positions investors favorably to outperform static allocations.

Thematic investing witnessed a notable resurgence in 2023, bouncing back from a lackluster performance in the preceding year. Dominant themes, including AI and weight-loss, drove mega-cap outperformance. Shares of the largest 7 companies in the world exhibited significant appreciation, creating a substantial gap between market-weighted and equal-weighted indices. Companies tied to obesity drug (Glucagon-like Peptide 1), fueled by weight loss hopes, experienced a surge, with Novo Nordisk emerging as Europe’s largest company by market capitalization.

Anticipations point towards a slowdown in the global growth trajectory in 2024 and beyond. However, growth opportunities aligned with underlying drivers in structural themes position companies favorably. Lower interest rates may rekindle interest in smaller companies, and operating leverage is expected to take center stage in 2024, driven by high expectations for earnings growth. Increased volatility and dispersion suggest, in our opinion, the need for an active strategy in portfolio management.

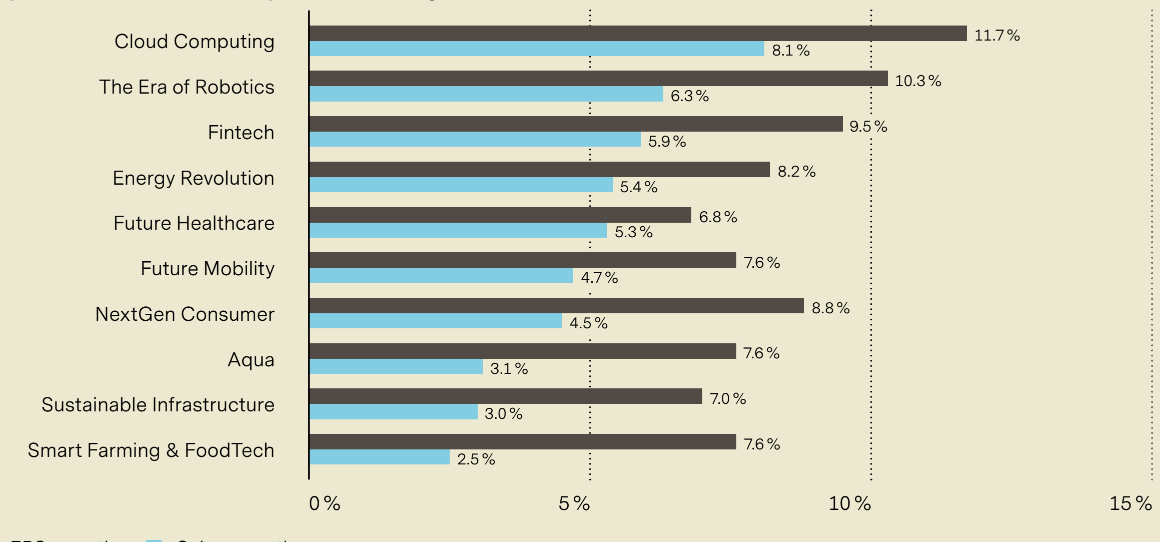
As we enter 2024, our preference in the context of the multi-thematic Vontobel Fund II—Megatrends leans towards overweighting themes with robust underlying drivers, such as Cloud Computing and Future Healthcare. We believe the challenges faced by the Energy Revolution theme in 2023 are behind us. However, caution is advised concerning themes with weakening demand trends, such as Future Mobility, given the apparent plateau in the demand for electric vehicles.

Daniel Maier

Head of Thematic Investing,
Impact and Thematics team,
Vontobel Conviction Equities

Structural themes offer pockets of growth

Expected sales / EPS compound annual growth rate (CAGR) for thematic stocks*



■ EPS growth ■ Sales growth

*measured by the average annual expected growth rate of companies in the Vontobel thematic universe over the next two years.
Sales / EPS growth is not an indicator of share price return.

Source: Vontobel, Bloomberg as of December 29th, 2023

Current thematic preferences (in the Vontobel Fund II – Megatrends)

Source: Vontobel, as of February 2024

Comments to current positioning

- GenAI to accelerate the role of software
- Data center growth fueled by advanced hardware needs
- CIOs name cyber security as top spending priority

- Medtech opportunities emerge as obesity drugs won't matter as much as priced in
- Patent cliff for large pharma will boost M&A in Biotech

- Utilities offer defensive exposure and benefit from lower yields
- Materials poised to benefit from energy transition

- Farmers appetite for new machinery investments pause
- Deflationary pressure on crop / fertilizer to continue

- Demand for electric vehicles could disappoint
- Lithium prices will likely not recover anytime soon

Source: Vontobel, as of February 29th, 2024

Aqua

US water infrastructure funding accelerating, reshoring trend to boost ultrapure water demand, digitalized smart water business growth will continue.

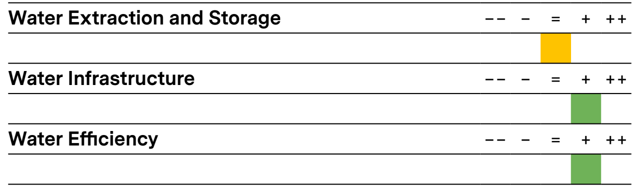
Summary
- US Infrastructure Investment and Jobs Act (IIJA) funding started to materialize in H2 2023 which was a tailwind for water-related industrial and IT companies.
- Higher interest rates and rising inflation costs were a headwind for water utilities and industrial stocks with high exposure to residential and agricultural irrigation systems.
- Federal and state funding, reshoring and onshoring subsidies and tax incentives will continue to act as catalysts for 2024 and beyond.
- Water utilities may rebound in 2024, if yields further decrease and the economy slips into a recession.

Review 2023
It was a positive year for all three water subthemes. The best performers were US and Canadian engineering services companies and US distributors of water and storm drainage products with strong pricing power. In principle, they benefited from record backlogs and strong order intakes as the IIJA funding related to water infrastructure has begun to materialize in H2 2023. On the negative side, some water-related companies with significant residential exposure faced headwinds due to lower demand and high inventory levels. Moreover, higher interest rates and rising cost inflation negatively impacted the performance of agricultural irrigation system providers and water utilities.

—
Thomas Trsan
Equity Analyst,
Impact and Thematics team,
Vontobel Conviction Equities

Outlook 2024
Companies in the Aqua theme will continue to benefit from the water infrastructure funding of the IIJA, the US Inflation Reduction Act, the CHIPS and Science Act and other legislations related to reshoring of new manufacturing plants in the US. Globally, we expect that water utility companies will increase their investments in digitalized smart meter technologies to improve revenue, cost and energy efficiencies.

Ultimately, we prefer companies involved in water infrastructure project engineering and design, water piping solutions, industrial (waste)water treatment and digitalized smart water networks solutions which provide significant efficiency gains and enhanced monitoring for water utilities.



Source: Vontobel, as of February 2024

Water Extraction and Storage
The hottest average temperature measured on earth in July 2023 increased the awareness of global warming and further exacerbates the water scarcity issue in many regions of this world. The increased water scarcity issue around the globe is a growth driver for more seawater desalination plants as an effective solution to increase fresh water supply. Therefore, we prefer reverse osmosis desalination equipment providers within this subtheme. Additionally, we are also positive on stormwater management solution providers diverting rain runoff or melted snow to designated areas that can absorb and filter the water in vegetated areas or ponds.

Water Infrastructure
The IIJA funding of 55 billion US dollars assigned to maintain and upgrade the US drinking water, wastewater and stormwater systems will further materialize this year. 15 billion US dollars will be assigned to replace lead pipes, causing health and water loss issues, to cheaper non-corrosive PVC pipes with an expected life of over 100 years, helping to reduce water loss by up to 40 percent. Furthermore, the general US reshoring and onshoring trend of new manufacturing facilities through various federal and state legislations will trigger increasing demand for ultrapure water with focus on the chip and pharma industry and industrial (waste)water treatment of other industries. Ultimately, we see industrial engineering services, water piping solutions companies and ultrapure water technology companies as beneficiaries. Furthermore, we are constructive on water utilities companies as we expect lower yields and they may provide diversification benefits in a potential hard landing recession scenario. Regarding residential water infrastructure, however, we remain cautious and expect further softening demand, particularly related to new build homes due to historically high mortgage rates and expected decreasing affordability.

Water Efficiency
We are confident that the increasing investment trend of water utilities for digitalized smart water networks solutions is here to stay in 2024. These solutions improve water leak detection and water loss prevention, monitor realtime water usage and enable more efficient billing, cost and revenue management. Growing population, climate change, and industrial contamination are some of the issues that cause water stress and impact water quality. Analytical testing to ensure water quality and safety is essential for health and the ecosystem.

Furthermore, we expect more stringent regulations in the US related to per- and polyfluoroalkyl substances (PFAS) in manufacturing in the next years. These "forever chemicals" are in waterproof outdoor clothing, non-stick pans, cleaning supplies, cosmetics, firefighting foams, food packaging, and electronics. They are persistent, bioaccumulative, toxic and therefore a health concern as they contaminate global drinking water resources. This is a growth driver for PFAS removal and treatment businesses as provided by, for example, Clean Harbors or water quality testing companies such as Agilent Technologies. Regarding agricultural irrigation systems, we see some continuing headwinds for the involved companies, as farmers currently shy away from new investments in this high interest rate environment with tightened lending conditions and higher equipment prices.

"There will be no fresh water by 2040 if we keep doing what we are doing today."
Professor Benjamin Sovacool, Aarhus University, Denmark

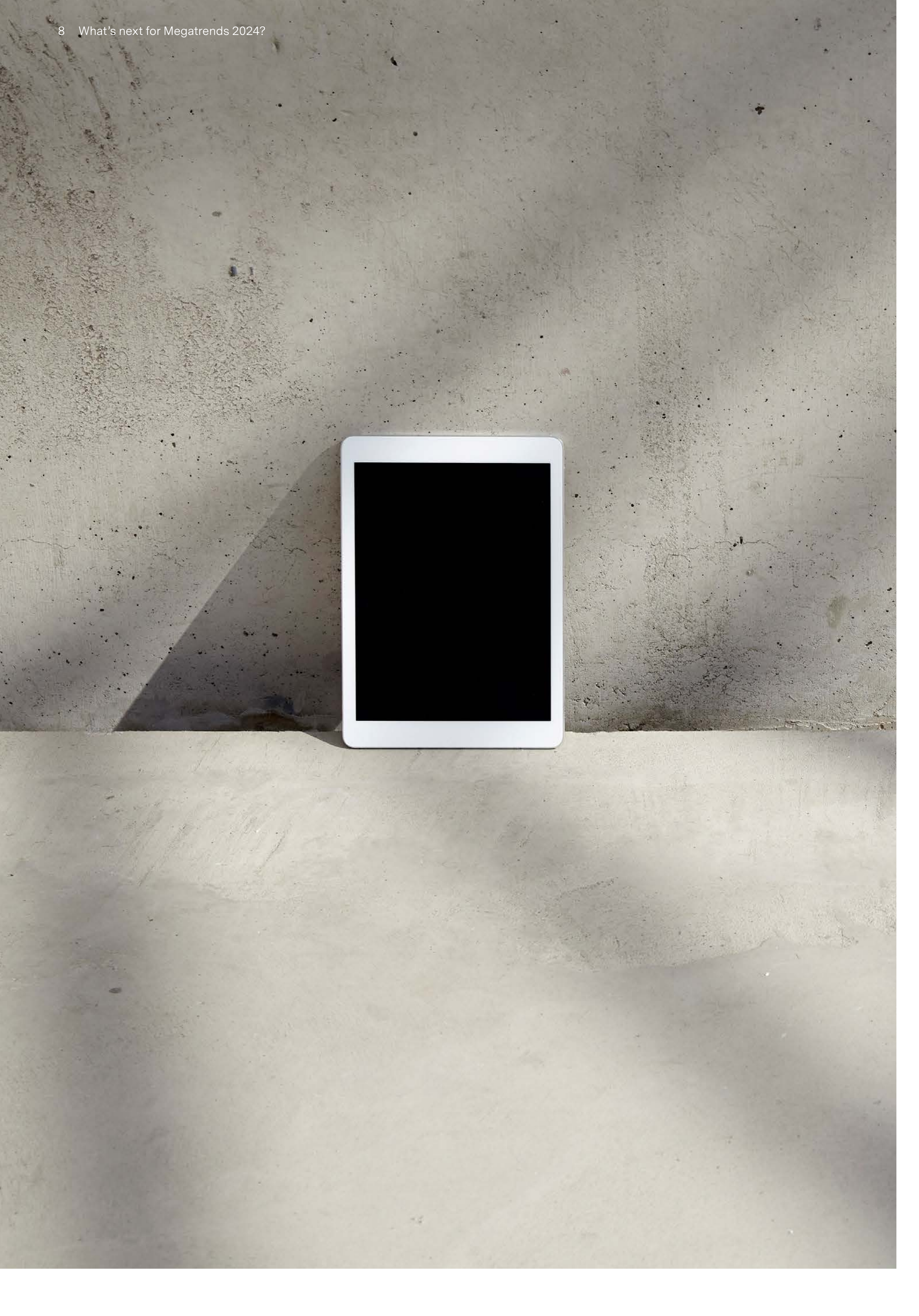
"1/3 of global fresh water running through pipes is lost due to leakage."
Liemberger and Wyatt

"Only 1 percent of global GDP p.a. until 2030 is required to solve the global water crisis."
World Resources Institute (WRI)

"USD 1 invested in water access and sanitation may generate 7 US dollars in returns."
World Bank

"Switching to 75 percent renewables would reduce water use by 47 percent by 2040."
International Energy Agency; Meldrum et al

"Training a ChatGPT-3 model consumed 700,000 liters of water in a month, equal to 5,000 showers … and at the same time, ChatGPT consumes half a liter of water for every 20 commands."
University of Colorado Riverside, University of Texas Arlington



Cloud Computing

Cloud Computing companies are well positioned to benefit from an AI supercycle.

Summary

- Cloud Computing thrived in 2023 with the rise of AI, driven by key players like Nvidia, Microsoft, Google and Amazon shaping the dominant landscape while fostering advancements in software adoption and next-generation data centers.
- Potential for Cloud Computing providers to monetize AI offerings through large language model (LLM) infrastructure and software development, leading to increased cloud capacity consumption.
- Increased demand for cyber security products due to sophisticated attacks influenced by geopolitical uncertainties.

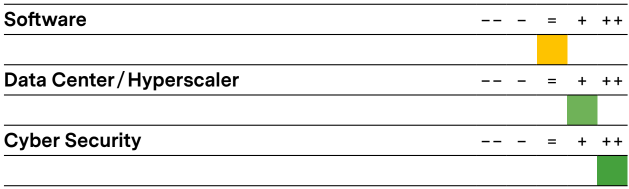
Review 2023

Cloud Computing emerged as a top investment theme in 2023, with the surge in AI bolstering investments in this domain, linking the dominant players—Nvidia, Microsoft, Google and Amazon—across both sectors. While the Magnificent 7 (Microsoft, Alphabet, Nvidia, Amazon, Tesla, Meta, Apple) led the way, other firms within the Cloud Computing sphere also excelled, driven by escalating software adoption amid labor shortages and increased expenses, necessitating streamlined processes and automation. Moreover, investments in next-generation data centers have not only benefited NVIDIA but also companies engaged in data storage, connectivity and related sectors.

—
Daniel Maier
Head of Thematic Investing,
Impact and Thematics team,
Vontobel Conviction Equities

Outlook 2024

We anticipate Cloud Computing to continue as a significant investment theme in 2024. While 2023 witnessed investments in AI-enabling infrastructure, 2024 will discern which companies can effectively capitalize on this opportunity of AI, particularly large language models, for substantial earnings. Generative AI can drive a new wave of innovations. NVIDIA's early success demonstrates this potential, yet major players like Microsoft (with OpenAI) and Google (leveraging LLMs such as Gemini and data ownership) have undertaken significant investments. However, we expect active investors to focus more attention on smaller companies, whose stock prices have lagged behind industry leaders Amazon, Alphabet and Microsoft. While IT spending trends overall could remain uneven in the near term, we are noticing a general stabilization. The cloud, and especially sub-categories like software, data centers and cyber security spending, continuously rank highly in Chief Information Officer spending priority surveys. Therefore, we remain positive with regard to the long-term power of Cloud Computing companies and believe 2024 will be a stock-pickers, market in this thematic area. IPOs and M&A should pick up in 2024, posting new opportunities for investors. While we do not expect a repeat of the explosive stock performance 2023 performance in Cloud Computing stocks and think individual stock selection will be more important, we are taking a balanced approach, seeing subthemes like software, data center and cyber security as most promising.



Source: Vontobel, as of February 2024

Software
"Software is eating the world, but AI is going to eat software," said NVIDIA founder Jensen Huang back in 2017. Now, six years later, there is a symbiotic relationship unfolding between cloud software and AI, manifesting as a new software stack. This stack comprises layers resembling different cloud software models: a foundational large language model (LLM) layer comparable to Infrastructure as a Service (IaaS), a ModelOps layer akin to Platform as a Service (PaaS), and an AI apps layer, much like Software as a Service (SaaS). AI features are becoming an integral component for all software solutions, fueling growth in this category. By 2027, it is projected that spending on AI-driven software will reach 81 billion US dollars, showing a compound annual growth rate of 190 percent.

This presents a significant business opportunity for cloud providers, whether they are major players, or smaller software companies. The shift from cost optimization to a growth cycle is expected to boost cloud spending by 1.2 – 1.3 times, driven by investments in LLM training, ModelOps and AI applications. The preference is for software categories like customer relationship management and infrastructure.

Cloud providers have multiple avenues to monetize AI offerings. The increasing use of LLM infrastructure and software code development around these models is paving the way for greater cloud capacity consumption. This evolution mirrors the early stages of cloud deployment, where companies outsourced internal hardware and labor costs. Notably, nearly 50 percent of surveyed cloud customers have extended the length of their contracts, signaling a shift towards longer-term cloud commitments.

Data Centers / Hyperscalers
AI's emergence is causing crucial shifts in data center architectures. Dedicated inference platforms from companies like NVIDIA, AMD and Intel are becoming essential due to the immense computing requirements of large-scale AI models like LLMs. The demand for acceleration across data processing, training, inference and post-processing stages is driving innovation across the entire AI workflow.

AI is seen as complementary to traditional data center and cloud computing. It is envisioned as a business model, relying on the existing logistical structure of traditional computing. AI infrastructure acts as a manufacturing base that sits atop the existing infrastructure, transforming raw data into valuable knowledge.

There is a surge in data center leasing, particularly led by hyperscalers, anticipating the demand for AI-driven workloads. The surge is predicted to lead to substantial capacity increases by 2027. This demand is driven by hyperscalers, AI-driven companies, large enterprises with extensive data, and sovereign entities utilizing AI for governmental operations.

However, this surge in demand is met with limitations on supply, causing data center pricing to rise consistently. Key constraints include available utility power, supply chain issues, and capital requirements. The scarcity of utility power, especially in larger markets preferred by hyperscalers, presents a significant hindrance to data center capacity growth.

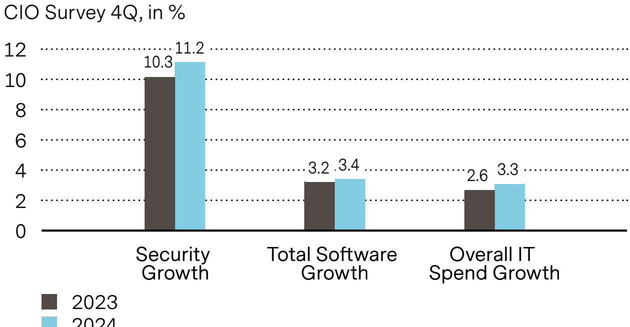
Addressing power procurement challenges will be crucial in the years ahead. Potential solutions range from on-site power generation to government-backed initiatives. Supply chain stress and the need for substantial investments in infrastructure remain pivotal challenges in keeping up with the escalating demand for data center capabilities.

In summary, the integration of cloud and AI presents growth opportunities for cloud providers. However, AI's demands necessitate shifts in data center architecture and infrastructure, posing challenges in power procurement and supply chain constraints, requiring substantial investments to meet the burgeoning demands of the future.

Cyber Security
Cybercrime, if measured as an economy, would rank as the world's third-largest, with deepfake instances increasing 62 times in the last five years to 500,000. Cyberattacks cost 8 trillion US dollars globally in 2023 and increasing concerns about online safety surpassed fears of physical threats. As cybercrime increases in both frequency and sophistication, cyber security companies are experiencing heightened demand for their products.

Chart 1: Budget growth—Security vs. software vs. overall IT

CIO Survey 4Q, in %



Source: AlphaWise, Morgan Stanley. N=60 (US and EU data), as of January 2024

Geopolitical uncertainties across various global regions have led to a surge in these attacks, evident after events such as those in Ukraine and Israel. For instance, hackers allegedly attempted to designed to alert Israeli civilians about airstrikes, alongside reported attacks on Israel's missile defense system. While some companies have recognized the hacker threat and increased spending on cyber security, others have yet to invest adequately in protection measures. Anticipated growth is expected mainly in areas like SASE (Secure Access Service Edge), a technology delivering network and security controls as a cloud service directly to the point of connection, bypassing traditional data centers.

Energy Revolution

The light at the end of the tunnel with 2024 expected to be better than 2023.

Summary

- It has been a challenging year for energy transition companies, as oversupply, lower demand and higher interest rates pressured value creation in this investment theme.
- We are cautiously optimistic with regard to Transition metals and positive with regard to Renewable Production.
- The oversupply cycle in electrical equipment related to solar and battery is expected to persist, but should reach a trough during 2024.

Transition Materials	−−	−	=	+	++
				■	
Low Carbon Energy	**−−**	**−**	**=**	**+**	**++**
Natural Gas and LNG			■		
Hydrogen			■		
Renewable Energy	**−−**	**−**	**=**	**+**	**++**
Electrical Equipment			■		
Renewable Production				■	

Source: Vontobel, as of February 2024

Review 2023

2023 has proven to be exceptionally challenging for energy transition equities, with various segments facing headwinds that impacted their performance against the backdrop of a dynamic global market. All segments related to the energy transition, especially clean energy, exhibited varying degrees of underperformance, ranging from strong to severe, when compared to the global equity market.

—
Romain Hohl
Portfolio Manager,
Impact and Thematics team,
Vontobel Conviction Equities

The combination of Federal Reserve rate hikes, a robust US dollar, a less-than-anticipated reopening in China, and weak demand in Europe collectively created a difficult landscape for companies within the mining business.

Traditional energy and liquefied natural gas (LNG) players demonstrated resilience, benefiting from stable energy prices throughout 2023. However, companies in biofuels faced challenges due to the onset of an oversupply cycle for renewable diesel and sustainable aviation fuel. The hydrogen market presented a mixed picture, with pure-play green hydrogen companies facing challenges due to their high duration. In contrast, diversified industrial gas companies performed well in this complex environment.

The solar and battery equipment industry faced significant oversupply, while the wind industry awaited a pickup in orders and grappled with the execution of its low-quality backlog. On the other hand, demand for grid components and installation continued to gain momentum. The entire renewable energy value chain suffered setbacks, with renewable project development experiencing cost overruns due to inflation and higher financing costs. Despite challenges, lower yield at the end of the year helped the sectors to end the year slightly negative on absolute terms.

Outlook 2024

In the short term, we are not out of the woods yet. However, by being selective, we should be able to avoid a cyclical downturn for various industries within the energy transition, while riding up with those moving back to an upcycle. Whatever the macroeconomic scenario, 2024 should be better for the theme than 2023. Larger risks include a hard landing and the ongoing downturn in the Chinese property market. The US presidential election in 2024 should not be a risk for most companies but will certainly weigh on the sentiment.

Transition Materials

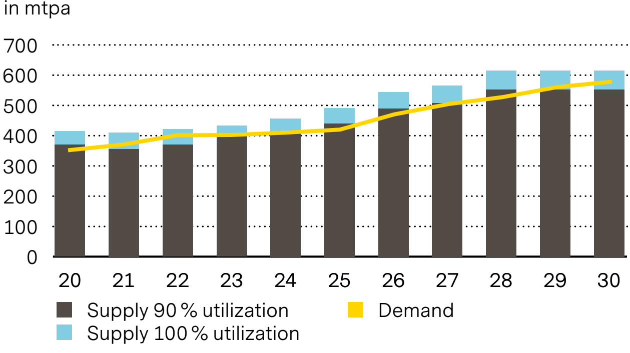
Approaching 2024 with cautious optimism, we observe macroeconomic headwinds shifting direction due to a weaker dollar, decreased bond yields, Federal Reserve interest rate reductions, robust demand in emerging markets, and sustained stability in China. Our preference remains with copper, aluminum, and steel over lithium, nickel, polysilicon, and rare earth metals, based on anticipated supply and demand dynamics in the market.

Low Carbon Energy: NG and LNG

Remaining cautiously neutral, we await an uptick in global gas (and oil) demand rather than relying solely on OPEC's current supply cuts to bolster our optimism in this sector. A cold winter could potentially prompt a reassessment, particularly as LNG supply is anticipated to be tight in 2024. Our preference lies with engineering energy firms, as we anticipate an upswing in the CAPEX cycle from integrated players over the next five years.

Chart 1: Supply and demand estimates for the LNG market

in mtpa



Source: Morgan Stanley Research estimates, as of November 2023

Low Carbon Energy: Hydrogen

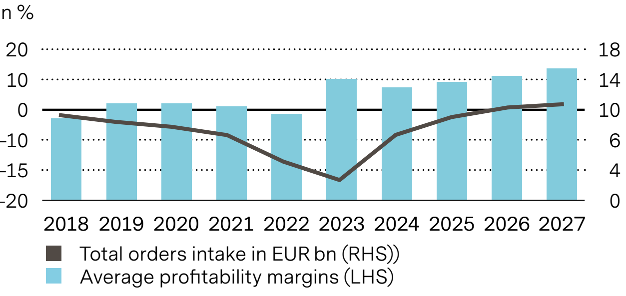
We continue to hold a neutral position, expressing positivity towards large industrial gas companies and OEMs due to their pricing power and the vast potential of new markets, particularly in Blue and Green Hydrogen. Conversely, we maintain a cautious stance towards smaller, specialized green hydrogen firms, given the prevailing pessimistic sentiment influenced by uncertainties surrounding clean hydrogen tax credits and the elevated costs associated with renewable electricity.

Renewable Energy: Electrical Equipment

Overall, the outlook is mixed. We anticipate continued challenges for the solar supply chain in 2024, with the need to address large inventory and oversupply issues to align with increasing demand. We foresee a trough in the first half of 2024, followed by a gradual recovery in the second half. Conversely, we anticipate a strengthening of momentum for wind turbine orders and improved margins as the backlog, characterized by lower quality, is fulfilled throughout 2024. However, our sentiment toward this segment remains negative for the next 12 months.

Chart 2: Western wind turbine manufacturers

in %



Source: Bloomberg, Vontobel Asset Management estimates, as of December 2023

In the battery sector, we observe an abundance of supply, potentially leading to a price war and subsequent margin pressure. We recommend favoring Tier 1 manufacturers with robust R&D capabilities. Our optimism hinges on an uptick in demand for electric vehicles to shift towards a more positive outlook.

Renewable Energy: Renewable Production

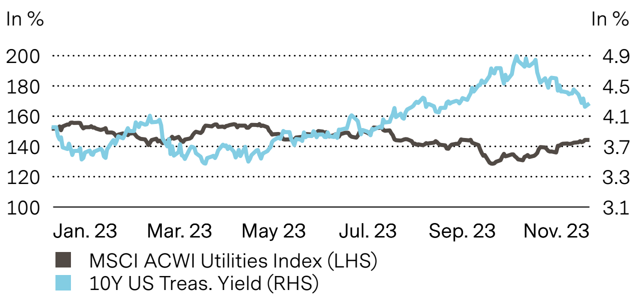
With interest rates appearing to have reached their peak, the risks associated with utilities stocks in the EU and US are tilted towards the upside.

In the medium to long term, we firmly believe that the evolving regulatory landscape across various countries regarding energy transition will materialize, serving as a catalyst for substantial investments in electricity networks. This investment will modernize grids and facilitate the energy transition and electrification process.

Chart 3: Negative correlation between US 10-year yield and utilities companies

In %

In %



Source: Bloomberg, MSCI, as of December 2023

Fintech

Opportunities in selective areas with companies generating sustainable value.

Summary
- Fintech stocks had a positive year in 2023 despite financial turmoil in the regional bank industry in spring.
- In 2024, we expect the fintech industry to continue its recovery. We are focusing on companies with compelling products and strong profitability.
- Given the increasing demands on banks' legacy technology from the adoption of new solutions and technology, we expect to see an increase in investment in innovative solutions for digital experiences, which should benefit fintech companies, with a particular focus on financial software. We are neutral in relation to payments and personal finance and cautious in relation to crypto-related companies given their strong performance in 2023.

Review 2023
Approaching 2023, the prospects for fintech companies did not look optimistic. The end of the easy-money pre-pandemic phase due to increasing interest rates and inflation made it harder for fintech companies to secure funding.

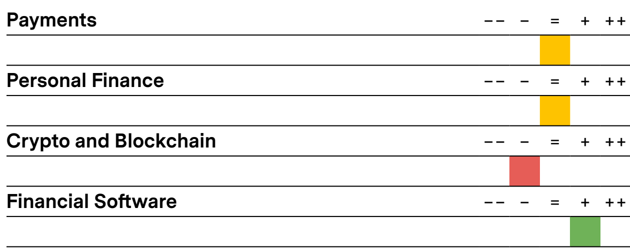
Regulatory bodies were exerting pressure on fintechs, especially those in the cryptocurrency sphere, to comply with more traditional customer verification protocols. Moreover, significant setbacks like the sudden downfall of Sam Bankman-Fried's FTX crypto exchange and the collapse of Silicon Valley Bank in March 2023, fueled investor unease, casting doubt on the future of fintech and prompting expectations of an impending market shakeout where only the most resilient would survive in the fiercely competitive landscape of entrepreneurial capitalism. Despite all headwinds, fintech companies posted a strong performance in 2023. Cryptocurrency companies posted the biggest gains on the back of strong bitcoin price development. Payment companies lagged due to weakening economic outlook. Financial software companies held up best. driven by the AI theme.

—
Daniel Maier
Head of Thematic Investing,
Impact and Thematics team,
Vontobel Conviction Equities

Outlook 2024
In essence, the scenario unfolding for fintech in 2024 reflects a reintroduction to sobering market realities due to the resurgence of higher interest rates, inflation, and increased scrutiny from investors. This environment no longer sustains speculative ventures or risky investments, highlighting the necessity for fintech solutions with compelling product narratives, distinctiveness from competitors, a defined market niche, and, critically, a viable path toward profitability.

The altered landscape has instigated significant reconfiguration and innovation within the market. Some fintech companies, faced with overly competitive consumer markets, are shifting focus towards enterprise or business-to-business services. Others are racing to incorporate generative artificial intelligence (AI) capabilities into their offerings or devising entirely new AI-driven products. Collaborations between fintech and established financial institutions are proving successful in mitigating the risks of independent operation.

Undoubtedly, some of the excess in the fintech space has dissipated over recent years. Yet, those fintech grounded in strong fundamentals—like any robust business model—are navigating the challenges adeptly and have multiple reasons for optimism as they progress into 2024.



Source: Vontobel, as of February 2024

Payments

Despite substantial disruption and the digitalization of financial services in recent decades, the payments sector continues to exhibit compelling long-term growth trends. Persistent innovation acts as a driving force behind this growth. There exists a substantial opportunity to expand digital payments penetration, especially considering that approximately 6.1 trillion US dollars worth of consumer purchases globally (excluding China) still rely on cash, and the scale of B2B manual payment methods surpasses those many times over.

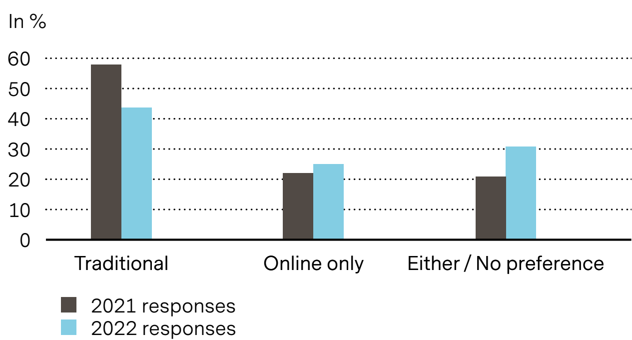
The group benefits from the shift to digital payments, particularly in international markets, although there is a wide variation among providers who have entered these markets. E-commerce expenditure patterns seem to have steadied, but certain competitive pricing factors have influenced changes in market share. Understanding whether this shift is temporary or a lasting change is crucial. The total volume of payments directly relates to consumer resilience and the spending habits of consumers.

Personal Finance

Personal finance applications should continue to see increased interest from consumers as many try to cope with their financial matters in a more efficient and digitalized way. Fintech applications facilitate personal finance matters considerably, leading to a better oversight of personal finances, which is particularly critical in a time when many people are coping with a higher cost of living and financial distress. In some areas of the world, where access to financial services is limited, we are observing fintech offerings becoming the first choice for managing financial matters such as banking, investing, lending, taxes or real estate. According to McKinsey, roughly 73 percent of global interactions with banks are currently conducted via digital channels. Additionally, on a global scale, retail consumers now hold a similar level of satisfaction and trust in fintech companies as they do in traditional incumbent banks. Increased demand should bode well for companies that offer digital access to online banking, loans, credit cards and mortgages and apps that facilitate tax filings, real estate transactions or taking out insurance policies.

Chart 1: Consumer preference for Neobanks over traditional banks has increased since 2021

In %



Source: Jefferies, survey responses: n=~1700., as of September 2022

Crypto and Blockchain
Cryptocurrencies had a strong comeback in 2023 with Bitcoin up more than 170 percent. Several things sparked euphoria in this area. Discussions between Blackrock and other ETF providers with the SEC around a potential Bitcoin ETF launch in 2024 has created noise. Hopes are that an ETF will facilitate investment in this asset class, which could spark interest from a wider audience of asset allocators that have yet seen hurdles for investing in cryptocurrencies.

Another area of interest is asset tokenization. Asset tokenization involves digitizing real assets by transforming them into digital tokens on a blockchain. Given the increasing interest in alternative and private assets, we anticipate a rapid acceleration of the asset tokenization trend in the coming year. This trend facilitates the democratization of investment in illiquid assets, making them accessible to a wider audience. Moreover, wider acceptance of central bank digital currencies (CBDCs) is gaining traction. CBDCs are logical in terms of financial inclusion for markets with limited access to banking services. However, we approach their extensive adoption in developed nations with caution due to persistent reservations from all stakeholders. Overall, we are more cautious with regard to stocks related to crypto and blockchain as many have seen strong share price improvements in 2023.

Financial Software
We anticipate that the overall demand environment for financial technology names will be solid in 2024 as financial institutions look to technology to both improve revenue (such as banks upgrading their platforms to increase net deposit growth) or drive efficiencies (such as moving certain workloads to the cloud). Given the increasing demands on banks' legacy technology from the adoption of new solutions and technology, we expect to see an increase in investment in innovative solutions for digital experiences. Celent, a research company focused on financial institutions, estimated that global IT spending by financial institutions will increase 5.0 percent year over year in FY24 and 5.4 percent in FY25, driven by the underlying need for digital transformation, product innovation, legacy modernization and cloud migration. Enterprise software applications that facilitate financial management and accounting, expense management, human resource management, and compliance and legal also are well positioned.

Future Healthcare

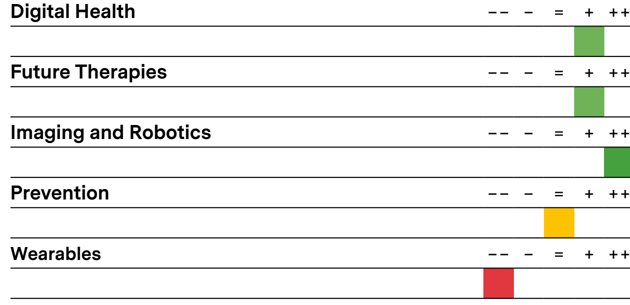
In 2024, healthcare will thrive on breakthroughs, AI revolution and reshaping the industry's future with innovation and resilience.

Summary
- Healthcare stocks had varying performances last year, with Novo Nordisk rising to the top of the market capitalization hierarchy in Europe due to the success of its GLP-1 drugs.
- In contrast, biotech companies faced challenges that were exacerbated by rising interest rates. This dichotomy highlighted the divergent developments within the healthcare sector and prompted investors to strategically capitalize on these dynamics to find advantageous opportunities.
- Global healthcare in 2024 will undergo transformative shifts driven by AI, breakthrough treatments and medtech innovation.
- Advances in Alzheimer's and obesity treatments, coupled with the rise of AI, are setting the course for a dynamic future for the healthcare sector.
- The positive outlook for medtech emphasizes the need for companies to prioritize innovation, compliance and sustainability for lasting success.

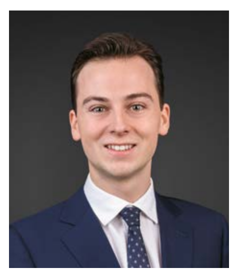
Review 2023
In 2023, heightened investor interest in artificial intelligence drove robust returns in the technology and communication sectors. Concurrently, the enthusiasm for weight-loss drugs played a pivotal role in boosting returns within the healthcare sector, benefiting companies in this space. However, healthcare equipment manufacturers—particularly those serving the diabetes market, such as insuline pump producers—faced losses due to concerns about the potential impact of weight loss drugs on diabetes device demand.

Increased healthcare utilization emerged as a positive trend, with patients resuming postponed surgeries and treatments, leading to gains for healthcare facilities and medical device manufacturers. Nevertheless, managed-care health insurers experienced a decline in stock value. Despite these dynamics, the healthcare sector faced challenges in garnering investor interest, contrary to its typical defensive reputation. Investors, preferring aggressive investments, particularly in megacap growth stocks linked to artificial intelligence, contributed to the overall underperformance of the healthcare sector in 2023.

Outlook 2024
In 2024, the global healthcare sector stands at a pivotal juncture, marked by transformative forces such as innovation, sustainability, social care integration, cost management and workforce adaptation. Artificial intelligence (AI) and machine learning are poised to revolutionize healthcare by addressing inequities and enhancing efficiency in administration, diagnosis, treatment and patient care. Building trust in, and mitigating bias against technology, are crucial for successful integration.



Source: Vontobel, as of February 2024



—
Luca Berger
Equity Analyst,
Impact and Thematics team,
Vontobel Conviction Equities

Another theme for 2024 is the impact of patent expirations on large pharmaceutical companies' revenues. With many pharma companies facing patent cliffs, that could erode billions of revenues, we can see a positive case for mergers and acquisitions. Biotech companies with attractive pipeline drugs could become takeover targets.

Breakthroughs and the future of healthcare
Projected statistics indicating a doubling of Alzheimer’s cases among older Americans by 2023 underscore the urgency for medical breakthroughs. The approval of Lecanemab offers a tangible solution to slow the progression of Alzheimer’s, while Phase 3 trials of Donanemab show promise in early-stage treatment. Genomics research is driving advancements in obesity treatments, with Novo Nordisk’s Ozempic and Wegovy, along with Eli Lilly’s Zepbound and Mounjaro, leading the way with a collective market capitalization nearing 1 trillion US dollars. This marks a significant shift in the landscape of diabetes and obesity treatment, impacting the prescription drug market and offering substantial opportunities for investors.

AI revolutionizing healthcare
The United States faces a demographic shift with the milestone of Peak 65, indicating a historic reversal where the population aged 65 and above exceeds those under 15. Advances in combating obesity contribute to increased life expectancy, necessitating innovations in healthcare. The convergence of neuroscience, genomics, biotech and AI is poised to revolutionize the sector. AI models are deciphering extensive health datasets, and the AI healthcare market, valued at 9 billion US dollars in 2022, is forecast to reach 188 billion US dollars by 2031.

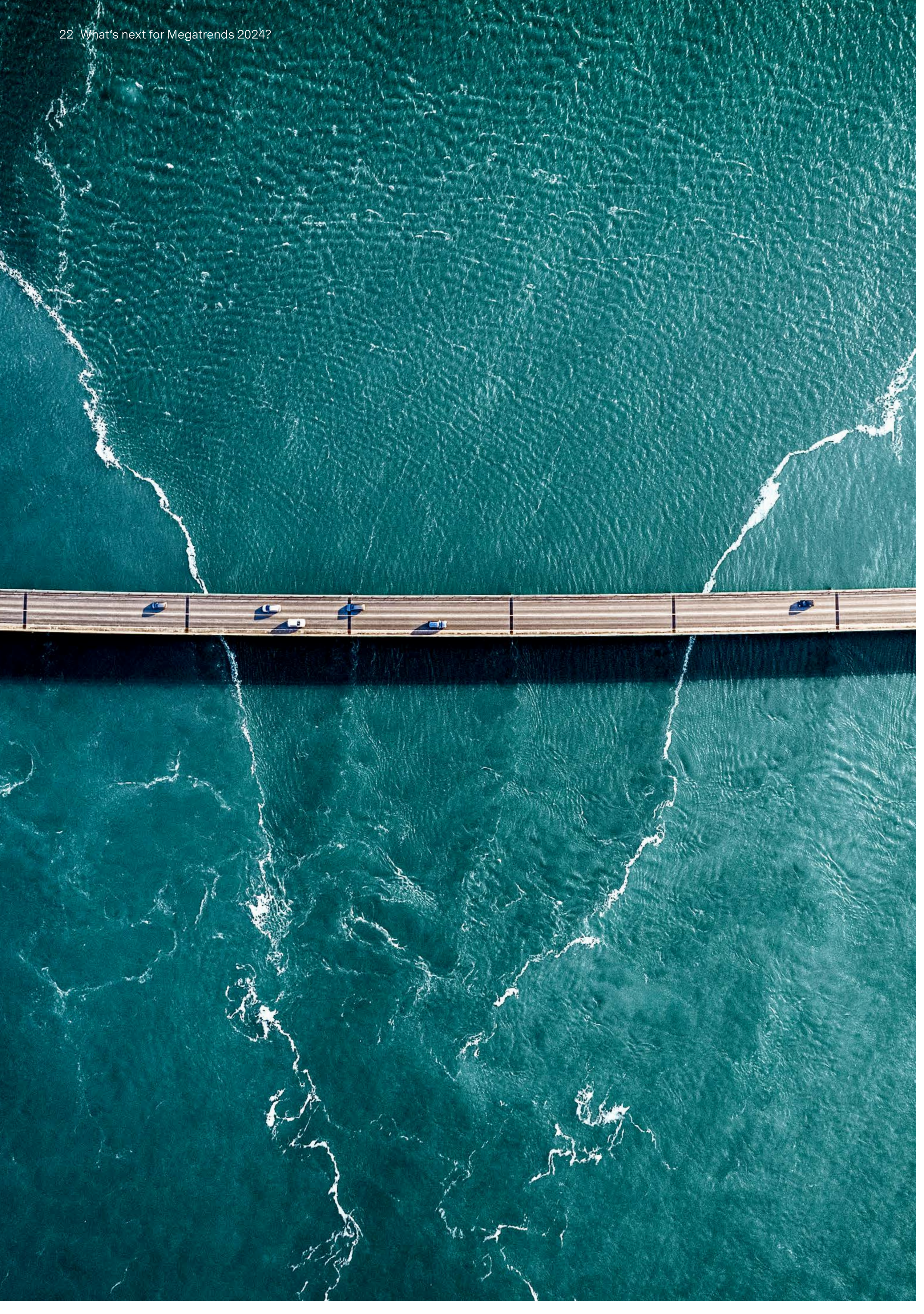
AI’s profound impact extends to brain and gene mapping, accelerating neural pathway tracing processes and facilitating detailed mapping of the human brain. In drug discovery, generative artificial intelligence (genAI) techniques are anticipated to reduce time and costs for biotech companies significantly. The advent of genAI promises enhanced efficiency in medtech, from clinical activity monitoring systems to diagnostic test interpretation and product manufacturing. GenAI is expected to revolutionize product development, aiding automated tools in designing treatments and expediting time to market for physical products.

Despite being in the early stages, genAI is considered a long-term tailwind for medtech. Proper utilization promises more time for healthcare providers to focus on high-value tasks, reduced cost and time burdens in hospitals and, ultimately, improved patient outcomes. Resistance to AI adoption, rather than AI itself, is anticipated to be the primary obstacle affecting companies in the medtech space.

Positive outlook on medtech
The global outlook for the medtech and medical device industry in 2024 and beyond is positive, surpassing pre-pandemic levels with continuous growth and improved margins. Drivers include an aging population, increased healthcare access and technological advancements fostering innovation and investment. China emerges as a growth hub for digital dentistry, and diagnostics firms are expected to rebound from declining Covid-19 test kit revenue. Despite regional variations in medtech investment downturns, the overall industry remains robust, urging companies to prioritize innovation.

Rare disease diagnostics and treatment	Virtual nursing assistance	Fraud detection
Cyber security	Gene editing	AI robot-assisted surgery
Health monitoring and wearables	Personalized healthcare plans	Cancer research
Dosage error reduction	Medical diagnosis	Drug development

Source: World Economic Forum, "Scaling Smart Solutions with AI in Health: Unlocking Impact on High-Potential Use Cases", BlackRock. For Illustrative Purposes Only.



Future Mobility

Slowing electric vehicle sales growth and excess chip inventories, regulatory support on Advanced Driver Assistance Systems (ADAS) and connectivity, positive shared mobility trend could persist.

Summary

- 2023 was a year of record sales in electric vehicles (EVs) supported by China via no commute restrictions in large cities and the US via tax credits of the Inflation Reduction Act.
- In the second half of 2023 miners and battery producers struggled with decreased margins as EV sales growth slowed.
- In 2024, headwinds in EV sales will persist, but a possible recovery could take place in 2H24 driven by new models and improving affordability.
- ADAS and connectivity will continue to get regulatory support promoting net-zero emissions targets and road safety.
- Shared mobility's strong growth will most likely persist in 2024, including in a hard landing recession scenario.

Review 2023

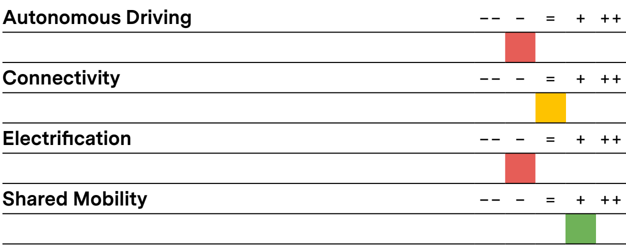
It was quite a positive year for many companies involved in future mobility despite the rising inflation and increasing interest rates environment in Western countries. Among the best performers were some smaller Chinese EV manufacturers thanks to strong sales and strategic partnerships with a large automaker. The global EV leader Tesla also excelled in terms of performance, mainly driven by strong vehicle delivery growth in the US supported by IRA tax credit benefits. Semiconductor companies involved in car electrification, ADAS / autonomous driving and vehicle connectivity also had an excellent year driven by revenue growth and as a result of several new strategic partnerships with car producers were announced.

Furthermore, the growth in shared mobility continued to accelerate. The leading ride hailing company Uber was one of the strongest performing large cap stocks this year and succeeded in becoming profitable. Negative performers were lithium mining and battery manufacturing companies. They suffered from depressed lithium prices driven by the slowdown in EV sales starting in the Western countries in 2H23 when interest rates rose and lending conditions tightened.

Outlook 2024

We expect a challenging year for the theme dependent on the severity and length of a potential recession. A recession would mostly affect car sales, lithium miners and battery manufacturers as they may suffer from sluggish sales and falling prices. It will also be interesting to see if the ambitious sales expansion of the largest Chinese EV producers will gain traction in Europe this year, intensifying the competition.

Furthermore, we expect that the strong growth of the shared mobility theme, as an affordable alternative to owning a vehicle, will continue this year—even in a recessionary scenario—and further drive the structural sharing economy trend.



Source: Vontobel, as of February 2024

Thomas Trsan
Equity Analyst,
Impact and Thematics team,
Vontobel Conviction Equities

Autonomous Driving
ADAS (Advanced Driver Assistance Systems) will likely benefit from a stronger global push for safer and more sustainable transportation through regulatory support. In 2024, we expect a stronger consumer preference shift toward vehicles equipped with ADAS features such as adaptive cruise control, collision warning, parking assistance, head-up display, etc., which are seen as essential for modern driving. This will convince car producers to integrate ADAS into a broader range of vehicle models. We expect several new strategic partnerships, acquisitions and collaborations of chip companies, auto parts suppliers and car producers, seizing the opportunities of technological innovation in ADAS and autonomous driving. However, excess inventories of chips, which are the result of over-ordering to mitigate the Covid-related supply chain issue of chip shortages, pose a downside risk.

Connectivity
This year, we may experience the expansion of 5G connectivity, which will enable technological progress in the transportation industry, such as improved safety, optimized route planning and traffic management. Moreover, it will also strengthen the development of smart cities where vehicles communicate with urban infrastructure. This could comprise smart traffic lights that optimize traffic flow or smart parking guidance systems that contribute to reducing traffic congestion and carbon emissions.

Furthermore, fleet management solutions should benefit from increasing investments by trucking companies. They are faced with the current challenges of rising costs and economic instability, with an increase in fraud, safety concerns and skilled labor shortages. Therefore, they acknowledge that updated technology with AI and operational efficiencies are among the top opportunities for physical operations in 2024. The advantages of these advanced technologies range from better asset and vehicle tracking, more accurate decision making and expense planning, among others.

Electrification
We believe that in 2024 new vehicle models, generally lower EV vehicle prices and expanding charging coverage will help to support EV growth. EV price cuts will continue to be triggered by falling lithium prices, lower battery costs and by increasing competition. This is good news for consumers in terms of affordability, but bad news for lithium miners, battery manufacturers and EV producers in terms of potential margin contraction. EV giants, such as BYD and Tesla, may be more resilient, whereas smaller producers may suffer more due to scalability, profitability and financing issues. Battery manufacturers will step up research and development of solid state and sodium batteries to achieve productivity gains with new technologies by applying cheaper materials.

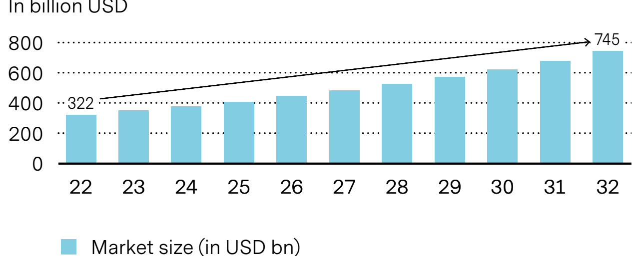
Furthermore, we are constructive in relation to equipment manufacturers for EV charging infrastructure in 2024, which enjoy regulatory support for promoting carbon emission-free transportation linked to net-zero targets in the respective regions and countries. As an example, there are charging agreements among major car manufacturers in the US to support increased EV adoption (i.e., Tesla opening parts of its Supercharger network to other EV customers, including those of Ford, General Motors and Rivian).

Shared Mobility
We believe that the strong shared mobility trend could persist in 2024. From carpooling and car sharing to rental cars, shared bicycles and e-scooters, consumers are increasingly seeking means of transport that are sustainable, cost-effective and efficient. The increased use of EVs as taxis is also gaining traction in emerging countries such as India, evidenced by the start-up BluSmart, an electric taxi operator in New Delhi and Bengaluru, or Tata Power EV Charging Solutions, which collaborates with the car-sharing platform Zoomcar to leverage EV deployment in India and to drive sustainable mobility growth.

Another key factor is the expansion of robotaxis as mobility-as-a-service contributors are planning new launches in US cities such as Miami, Atlanta and San Diego in 2024. Baidu Apollo Go plans to expand its autonomous ride hailing services from Beijing to 65 additional Chinese cities by 2025.

Electric take-off and landing (EVTOL) could emerge as an attractive new area of transportation. While companies in this ecosytem are still in the early stages with no commercial operations, we see great interest in shared air mobility.

Chart 1: Shared Mobility expected to double by 2032
In billion USD



Source: Precedence Research, as of November 2023

NextGen Consumer

Resilient consumer landscape amid global economic uncertainties.

Summary
- Consumer staple stocks faced underperformance in 2023 due to inflation concerns, weak global economic conditions and geopolitical tensions.
- Positive signs emerge with easing inflation, peaking interest rates and robust employment, suggesting a potential turnaround in consumer sentiment.
- E-commerce trends are expected to continue in 2024, driven by factors such as improved services and changing consumer spending habits.

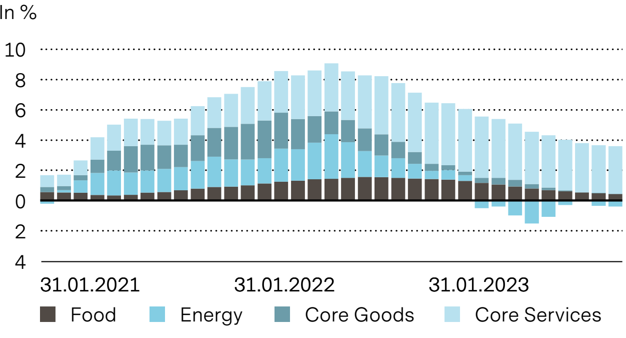
In 2023, concerns about inflationary pressures impacting consumers and affecting volumes in the consumer staples sector were compounded by higher interest rates and geopolitical tensions in the Middle East. Despite these challenges, positive signs have emerged as inflationary pressures ease, the interest rate cycle approaches its peak, and employment remains robust. Consumer behavior has shifted due to higher interest rates, signaling a departure from the easy availability of cheap credit over the last decade. The conclusion of Covid subsidies and the resumption of student debt payments in the US has reduced savings, yet consumers in the US continue to spend. Credit card spending is at an all-time high, despite an average credit card rate exceeding 20 percent (see chart 1).

—
Luca Berger
Equity Analyst,
Impact and Thematics team,
Vontobel Conviction Equities

For consumer staples companies, organic sales growth has been driven by price increases, compensating for lower volumes amid consumer caution. While concerns about the long-term impact of new obesity drugs have affected the spirits sector, food retail has exceeded expectations. Food retail's resilience is attributed to surprising strength and effective savings programs, even in a fiercely competitive environment favoring market share gains by discounters. Looking ahead, there is an expectation that volumes in the consumer staples space will likely improve next year, with no widespread deflation anticipated due to persistent inflationary pressures in specific areas.

Chart 1: US Consumer Price Index Year over Year

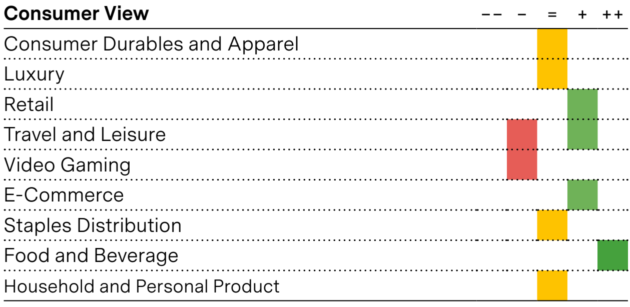
In %



Source: Bloomberg, as of December 2023

Consumer macro view

The economic outlook is mixed, with GDP forecasts rising for 2023 but anticipating modest growth in 2024. Interest rates have surged, potentially nearing their peak impact on consumers. Confidence is easing post-Covid, yet employment remains robust. Inventories are normalizing after Covid disruptions, and wage growth is surpassing inflation. Corporate input costs are easing, hinting at a period of moderate price increases rather than deflation, accompanied by recovering demand.



Source: Vontobel, as of February 2024

In the world of Food & Beverage, shifting demand dynamics and uncertainties in the macroeconomic landscape have led to reconsiderations of overly optimistic revenue forecasts in early 2023. Regional differences play a significant role, emphasizing the need for a bottom-up approach in 2024. Despite concerns about obesity drugs affecting food demand, cost environments—especially for brewers—are improving and the overall impact on diversified food companies is expected to be minimal. In the Retail sector, rapid decreases in inflation on key items like raw materials, transportation and energy are allowing for effective cost management in 2024, with the exception of rents and salaries. While the market is expected to be generally price competitive, certain categories, such as fashion and electronics, may experience a demand recovery driven by positive real wage growth. High-ticket categories, however, may face subdued demand due to tough comparisons after robust pandemic-era sales. Household & Personal Product companies, having experienced above-average revenue growth and improved profit margins in 2023, are now anticipating slower sales growth in the future. Despite this, there is an expectation of accelerating gross margin improvements, and the benefits may be reinvested in commercial initiatives to stimulate volume growth. The key theme for Luxury in 2024 is the normalization in revenue growth, particularly in H1, driven by developed market consumers. While Chinese offshore consumption remains strong, companies are prioritizing brand investment, leading to expected margin reductions. The sector has pulled back, but caution is advised. Demand normalization is evident among American, European and Japanese luxury consumers, while China’s growth outlook appears favorable, supported by travel. Pricing tailwinds and a mix of new products at higher price points offer opportunities. Despite challenges, luxury spending from the American consumer has remained above 2019 levels since 1H20. Chinese luxury demand outperformed expectations in 2023, with a forecast 10 percent growth in 2024.

Apparel sees a positive shift after a focus on reducing excess inventories in 2023. Brands and retailers, cautiously planning expansions in 2024, are showing positive order trends, increased spending and revived store plans. Abating cost challenges, especially transportation and input costs, could pave the way for improved gross margins, making 2024 a potentially more normalized year. In the Travel & Leisure sector, solid lodging demand driven by leisure recovery contrasts with structurally below-2019 business demand. International demand faces challenges due to tensions in the Middle East, and investors are wary of average room rate trends in an uncertain macro environment, resulting in a negative outlook for the sector. Data from Bank of America shows a decrease in consumer spending on airlines and lodging, signaling a shift away from travel spending. This change in behavior is expected to drive positive trends for the e-commerce sector in the coming year.

Cautious in relation to Video Gaming sector:
In 2024, the video game industry may face challenges due to weakened consumer sentiment, leading gamers to stick with familiar franchises. Valuations across the industry are expected to remain uneven. Notable games include Assassin’s Creed Codename Red, Star Wars Outlaws and updates to sports franchises. A tepid consumer environment in the first half of the year may drive gamers toward established franchises. Despite economic challenges, global gaming revenue is projected to expand by low to mid-single digits in 2024, with potential reacceleration in 2025. Key franchises like EA FC, Madden, Grand Theft Auto Online, NBA 2K and Assassin’s Creed are expected to see similar engagement growth. Ubisoft in the spotlight with with releases like Assassin’s Creed Codename Red, Star Wars Outlaws and others. Electronic Arts may refresh sports franchises and potentially release EA Sports College Football. Take-Two is likely to update NBA 2K and WWE 2K, with attention on Grand Theft Auto VI in 2025. Microsoft’s 2024 activities may reveal plans for Activision Blizzard’s properties. Chinese companies may enter console gaming in 2024 with titles like Black Myth: Wukong. Generative AI in-game development is expected to accelerate in 2024–25, enhancing non-player character interactions, ingame assets and level designs. This technology is seen as a tool for expediting development rather than a key to a game’s success. The use of generative AI is expected to significantly increase in gaming from 2025.

Robotics

Cautious overall outlook, with positivity for artificial intelligence and negativity for factory automation.

Summary

- Very strong performance in 2023 supported by semiconductors and the hype surrounding AI.
- Cautious outlook for robotics stocks in 2024 due to macroeconomic uncertainties, slowing order books, and higher valuation ratios.
- We favor the artificial intelligence segment driven by robust AI software performance, with anticipated growth in revenue and EPS, stable margins, and potential benefits from lower yields.

Source: Vontobel, as of February 2024

Review 2022

The performance of stocks associated with the robotics theme was positive in 2023. Despite facing challenges from increased inflation and higher interest rates, the excitement generated by the ChatGPT announcement and the anticipated secondary impact on demand for semiconductors and artificial intelligence software outweighed the negative effects of inflation. Industrial automation stocks faced increased challenges during the year due to rising interest rates, which elevated the cost of their capital expenditures. Additionally, the proximity of their book-to-bill ratio to 1 indicates a slowdown in order momentum.

Outlook 2024

Following a strong performance in 2023, we are adopting a more cautious stance regarding the outlook for robotics stocks in 2024. The expected decline in inflation and potential rate cuts should provide support for the share prices of robotics stocks. However, the presence of macroeconomic uncertainties and slowing order books-coupled with a higher valuation ratio for industrial and technology companies compared to the previous year, represent a significant headwind. In the event of a favorable Goldilocks scenario where conditions are optimal, the robotic theme becomes particularly compelling for exposure in 2024. We take an overall neutral view on this thematic area.

—
Romain Hohl
Portfolio Manager,
Impact and Thematics team,
Vontobel Conviction Equities

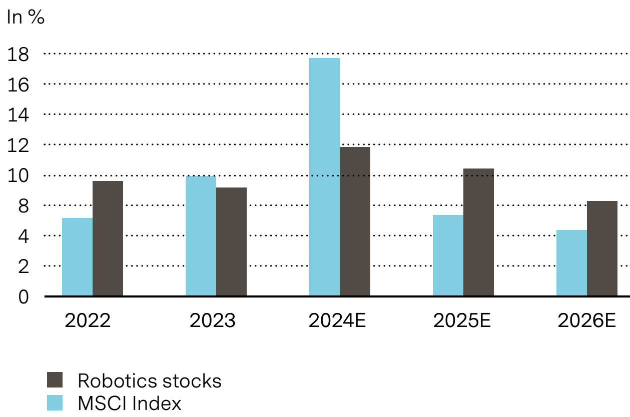
Artificial Intelligence

We hold a positive outlook on the Artificial Intelligence segment, primarily fueled by the robust performance of AI software. Anticipated strong revenue and EPS growth, coupled with stable margins for the next year, contribute to our optimism. Moreover, many of these companies are poised to benefit from lower yields.

Looking ahead, the long-term prospect is promising, driven by the substantial cost savings derived from automating white-collar tasks through AI. The efficiencies gained are expected to outweigh the costs associated with the AI software itself, thereby stimulating increased demand.

Chart 1: EPS growth (weighted median)

In %



Source: Vontobel, Bloomberg, as of December 2023

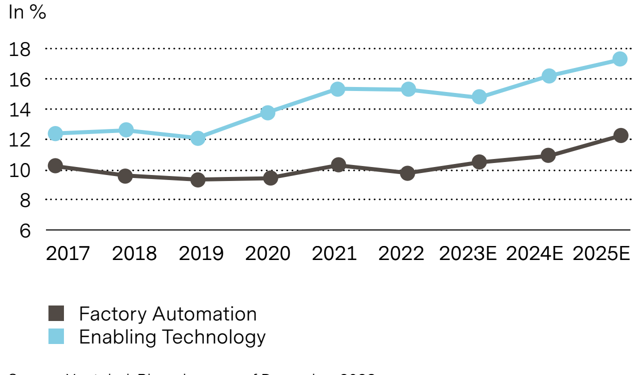
Factory Automation

Our outlook is pessimistic for the pure Factory Automation segment in the upcoming year. Capital-intensive companies, particularly in the industrial sector, are expected to face challenges in the current high-interest-rate environment, and a significant decrease is needed to make a substantial impact. Furthermore, an imminent peak in margins is expected and the impact of price costs is likely to become more pronounced.

Despite these challenges, within the current context of deglobalization and reshoring trends, automation remains crucial for maintaining cost competitiveness. The issues related to inflation are also drawing attention to the labor shortage, with robots potentially able to play a significant role in addressing these demographic concerns.

Chart 2: operating margins in our robotic universe

In %



Source: Vontobel, Bloomberg, as of December 2023

Enabling Technology
We are taking a neutral standpoint with regard to enabling technologies, especially within the semiconductor sector. Companies involved in semiconductor equipment are expected to face challenges in achieving significant upward movement, primarily due to their high valuation and diminished capital expenditures from semiconductor foundries. On another front, signs are emerging of a slowdown in both orders and sales momentum for other automation components and equipment in the coming year, aligning with our cautious outlook on this segment.

Looking ahead into the long term, enabling technologies assume a crucial role in fostering technological advancements. This impact extends beyond robotics firms, reaching into the broader universe of stocks that are becoming increasingly interconnected.

Smart Farming and FoodTech

High crop inventories and supply growth lead to further price deflation. Weakening food demand most likely in a hard landing scenario.

Summary
- 2023 was a year of depressed prices in agricultural commodities, fertilizers and pesticides.
- Rising interest rates, tightened lending conditions and a stronger US dollar contracted consumer demand.
- Farmers' biggest concerns for 2024 remain higher input costs followed by rising interest rates and lower crop/livestock prices.
- 74 percent of farmers would currently shy away from large farm investments (i.e., buildings and machinery) due to rising interest rates, tighter lending standards and higher prices.[1]
- Market consolidation in crop processing and paper packaging sector is expected for 2024.

Review 2023
The year continued with falling prices in agricultural commodities, such as wheat, corn and soybeans, and crop chemicals, such as pesticides and fertilizers. Consumer demand eroded as affordability took its toll after record price levels in the previous two years triggered by droughts, diseases and the war in Ukraine.

The US Federal Reserve's tightened lending conditions, interest rate hikes and a stronger US dollar were further headwinds for food commodities. As a consequence, it lowered farmers' incomes in 2023 in combination with higher input cost inflation and lower government payments driven by less disaster assistance.

Crop chemicals companies were negatively impacted by plunging nitrogen, potash and phosphate prices. Crop processing companies suffered from falling commodity prices and deteriorating crush margins. Agricultural equipment companies in the machinery and irrigation field faced headwinds caused by rising interest rates and tightening lending standards. The bright spots this year were:
1. Protein nutrition producers with a strong brand recognition and
2. Animal health companies profiting from increased veterinary spend per visit, mainly driven by diagnostics and preventive care.

Outlook 2024
It is expected to be a year of high crop inventories and widened supply with El Niño weather conditions in the Americas that are favorable for crops, which may cool agricultural commodity prices further. There will also be vast fertilizer supplies, which will minimize the risk of higher input cost shocks. These developments will generally deteriorate the pricing power of upstream agricultural producers. For 2024, with lower net farm income we expect a decrease in large farm investments such as agricultural equipment and new farm buildings.

For downstream agricultural companies such as food and fuel producers, lower crop prices are a cost relief, but their pricing power may weaken due to increasing recession risks triggering lower food demand of price-sensitive consumers. Crop processors should benefit from higher global supply of grains and oilseeds.

—
Thomas Trsan
Equity Analyst,
Impact and Thematics team,
Vontobel Conviction Equities

[1] Purdue Center for Commercial Agriculture, Producer Survey, November 2023

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Digital Agriculture		■			
Crop, Plant and Animal Health		■			
Controlled-Environment Agriculture		■			
Food Technology			■		
Post-Farming Supply Chain				■	

Source: Vontobel, as of February 2024

Digital Agriculture
The US Department of Agriculture (USDA) forecasts an inflation-adjusted 20 percent net farm income decrease in 2023 compared to the previous, record-breaking year of 2022. The main drivers are weaker commodity prices, higher input cost inflation and lower government payments. Farmers' current concerns about rising interest rates, tightened lending standards and price increases in agricultural equipment will lead to negative sales growth in 2024, which outlooks from leading companies like Deere[1] and Trimble[1] imply.

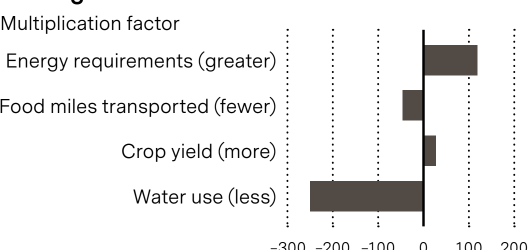
Crop, Plant and Animal Health
Rising inventories of major crops, followed by El Niño conditions boosting output, will continue the downward pressure on crop prices along the agriculture supply chain in 2024. This usually implies an earnings pressure on crop chemicals, seeds and livestock feed companies. The animal health sector expects a resilient veterinary spend across every segment and accelerated growth in livestock for 2024, after the segment returned to growth last year.

Controlled-Environment Agriculture (CEA)
Norwegian salmon farming companies may expect increasing harvest growth driven by good productivity in 2024. Furthermore, headwinds are expected due to lower demand from China for seafood. These developments may lead to a negative impact on salmon prices during the first half of 2024. In addition, a potential recession in Europe and the US would slow down consumption.

Higher interest rates, higher energy costs, and recession concerns dampened the hope for growth and improving profitability in vertical / indoor farming companies and led to some bankruptcies in 2023, as occurred with the US company AppHarvest[1], which we have never been invested in.

Chart 1: Vertical farming vs. traditional open field farming

Multiplication factor



Source: ScienceDirect, Bank of America, as of November 2023

Food Technology
Falling crop prices is a tailwind for food ingredient firms which cater to fast moving consumer goods (FMCG) companies. However, these consumer staples companies continue to suffer from inventory destocking and are therefore postponing purchases from food ingredient companies. Moreover, as recession risks are elevated, retailers are planning discounts to revive consumer demand. The bright spot for growth in 2024 may be in pet food, which started to recover in the second half of 2023.

Current trends in the food ingredients space are enhanced taste solutions to remove calories from consumers' diets and the use of the stevia plant for advanced sugar reduction solutions. We continue to see opportunities in these companies.

[1] Examples of companies

Post-Farming Supply Chain

The crop processing sector, which aggregates and trades crops, will benefit from larger crop yields and lower crop prices. They will boost asset utilization with lower cash requirements for hedging. It increases the competitiveness of their product prices for the oil, fuel and food ingredients they sell. We expect more market consolidation in the crop processing sector, as triggered by the most recent merger plans of Bunge and Viterra to form an agricultural trading powerhouse.

Sustainable packaging, especially paperboard, may face some risks of further box-price cuts due to some signs of weaknesses in food demand. This is already witnessed by discount efforts at large packaged-food companies such as Glanbia[1] and Nestlé[1]. Market consolidation is observed in the sector, with the recently announced merger of Smurfit Kappa and WestRock to become the global market leader in the paper packaging business.

"Farmers must increase their food production by 70 percent by 2025 to cater to the growing population."
High Level Expert Forum—How to Feed the World 2050

"About 735 million people face hunger and 2.4 billion people lack regular access to enough food."
UN Food and Agriculture Organization

"Only 1 percent of global GDP p.a. until 2030 is required to solve the global water crisis."
World Resources Institute (WRI)

"The food that is lost (14 percent from harvest) and wasted (17 percent of food at retail and consumer level) could feed 1.26 billion hungry people every year."
UN Food and Agriculture Organization, 2019

"Sustainable farming uses up to 56 percent less energy per crop unit produced, generates 64 percent fewer greenhouse gas emissions and produces more significant levels of biodiversity compared to conventional farming."
The Agrotech Daily, 2022

Sustainable Infrastructure

Regional infrastructure and net zero stimulus programs will further materialize, headwinds in residential and agriculture may continue.

Summary

- 2023 was a good year for infrastructure companies involved in electricity, roads and bridges, water, low-carbon energy and senior housing.
- Residential, agricultural and renewable infrastructure had a challenging year of rising interest rates and rising cost inflation.
- Infrastructure funding and tax incentives in the US and Europe will further materialize in 2024.
- We prefer infrastructure themes related to roads and bridges, electricity, 5G communication, data centers and water. The least preferred are residential and commercial properties and agriculture and forestry, which are suffering from high interest rates and rising cost inflation.

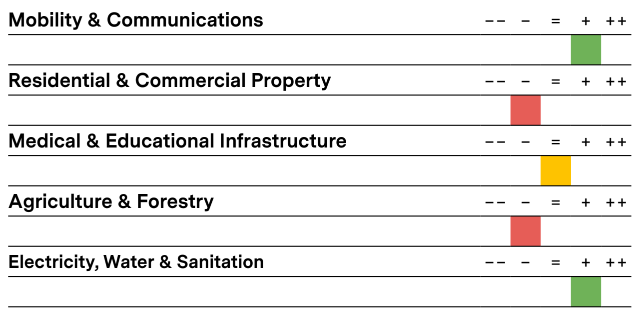
Review 2023

2023 was a mixed year for infrastructure companies. US Infrastructure Investment and Jobs Act funding and US Inflation Reduction Act tax incentives began to materialize in H2 2023. This resulted in a strong performance of infrastructure companies involved in road and bridges, transmission, distribution and power, data centers, non-residential infrastructure, and senior housing. Renewable energy production-related utilities and agricultural machinery companies had a challenging year with financing costs as a headwind in a rising interest rate and cost inflation environment.

—
Thomas Trsan
Equity Analyst,
Impact and Thematics team,
Vontobel Conviction Equities

Outlook 2024

The funding and tax incentives of US infrastructure programs and the REPowerEU and European Green Deal Industrial Plan will materialize. We expect that the best-positioned infrastructure companies are to be found in the road and bridges, power grid, 5G communication and data centers, and water segments. Furthermore, utilities and real estate investment trust companies may benefit from a potential decreasing yield environment this year. Companies that may continue to face some headwinds are in the agricultural and forest machinery segment and the ones with a high exposure to residential construction, as long as lending rates remain high and lending conditions tightened.



Source: Vontobel, as of February 2024

Mobility and Communications

This subtheme will continue to mainly benefit from the US Infrastructure Investment and Jobs Act in 2024 as most of the funding is related to road building, bridges, freight and passenger rail, broadband, public transportation, airports, and highway & pedestrian safety. Therefore, we prefer companies involved in roads and bridges, 5G communication and data centers. With regard to electric vehicles (EV) charging infrastructure companies, we are taking a more cautious view as they are more sensitive to recession and deteriorating consumer sentiment, which would imply a continuing slowdown in EV sales.

Residential and Commercial Property

In a probable recession scenario in 2024, companies with a large exposure to residential and commercial property (e.g., construction machinery, industrial real estate investment trusts) will continue to face headwinds as demand may continue to fall in a high mortgage rate environment and a potential bubble in the commercial real estate sector. With regard to US homebuilders, companies with a strong balance sheet could surprise positively, as in 2023, if mortgage rates continue their downward trend.

Medical and Educational Infrastructure

Life science real estate companies could profit from a continuing recovery trend. Furthermore, companies may continue to benefit from the strong senior housing market fueled by demographic trends and increasing occupancy rates. Student housing companies may continue to experience high rental and occupancy growth.

Agriculture and Forestry

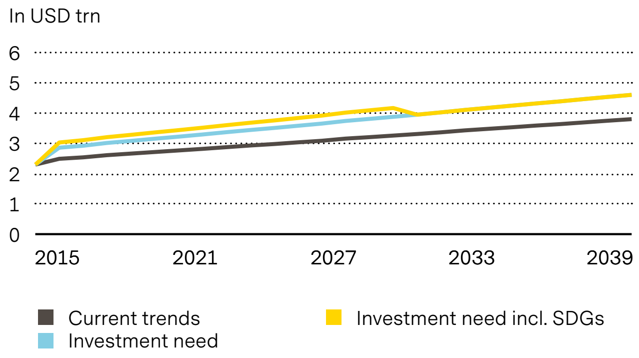
The US Department of Agriculture (USDA) expects net farm income (adjusted for inflation) to fall 20 percent year over year in 2023. Weaker commodity prices, higher input cost inflation and lower government payments related to disaster assistance were the reasons for this. 74 percent of farmers currently see this as a bad time for making large farming investments (i.e., buildings and machinery) due to rising interest rates, tighter lending standards and higher prices. Furthermore, forest product companies became more confident that the US housing market may have bottomed out, which would be a positive sign for increasing demand of wood products.

Electricity, Water and Sanitation

This subtheme will continue to benefit from funding from the US Infrastructure Investment and Jobs Act for energy, power and power-grid infrastructure, and water and wastewater infrastructure. Additional catalysts are tax credits from the US Inflation Reduction Act in the area of clean energy, including grid and energy storage technologies.

Chart 1: The USD 15trn global infrastructure investment gap by 2040

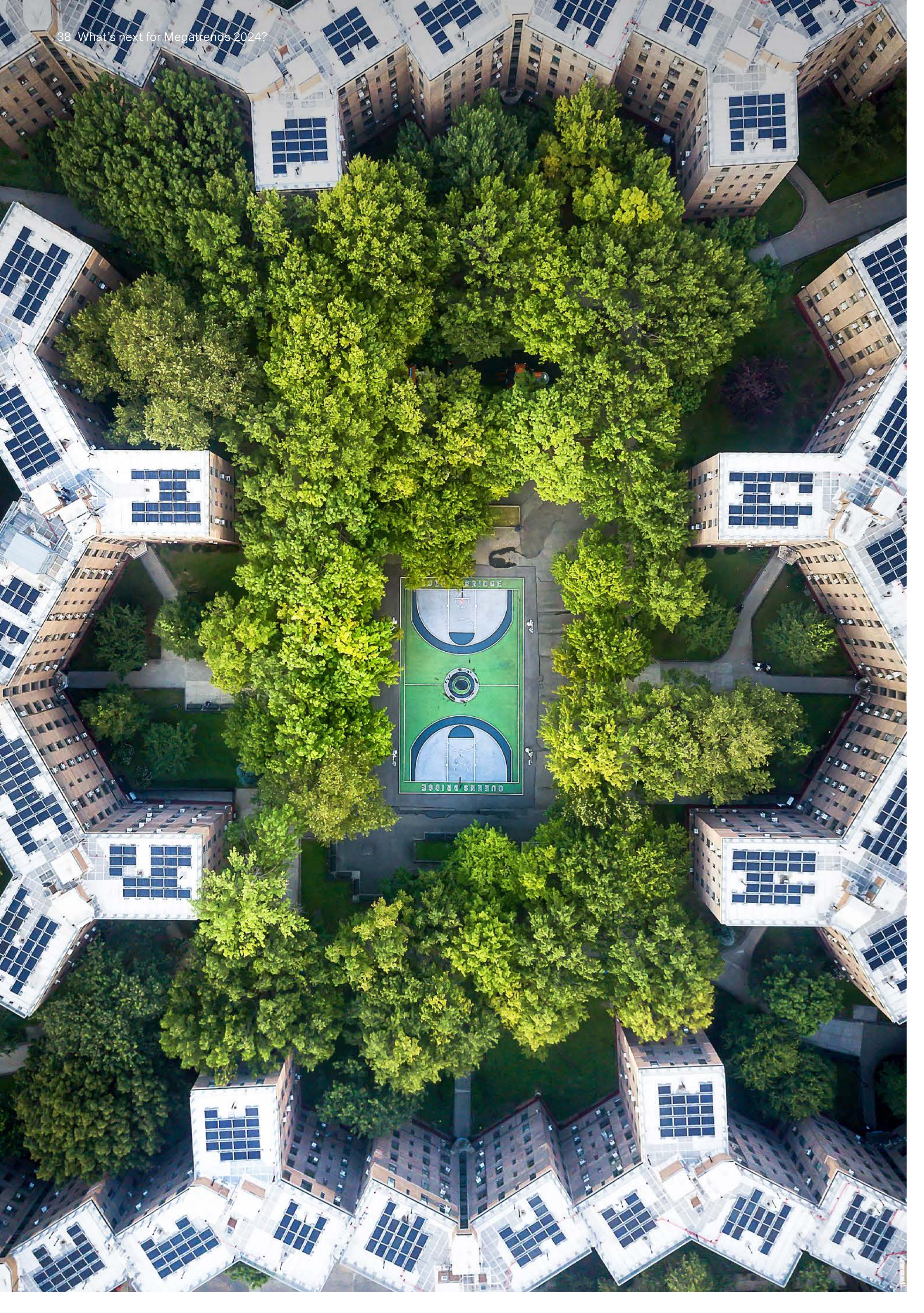
In USD trn



Sources: Global Infrastructure Hub, SDG includes the additional investment needed for countries that have not yet met the SDGs, as of April 2019

Driving forces for infrastructure investments

- Demographic changes
- Technology shift
- Increasing regulation
- Sustainable transition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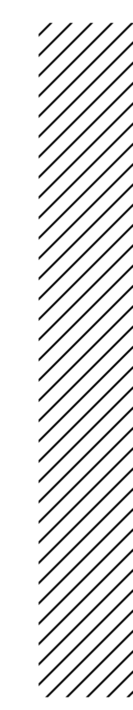

Vontobel Asset Management AG
Gotthardstrasse 43
8022 Zurich
Switzerland

vontobel.com/am