Q4 2023 Commentary

2023 began with the continued discussion around inflation and consequent Federal Reserve interest rate hikes, reopening of the Chinese economy post a stringent COVID lockdown and one of the warmest January months on record. This year, as asset managers we witnessed significant geo-political and macroeconomic developments that both impacted the Nia portfolio and the global financial market at large. Events such as the growing calls for an energy transition, the novel wave of generative artificial intelligence and their ethical implications, and questions of employee welfare arising from multiple workers' strikes were all reminders of the significance of Nia's investment thesis and solution themes. Against the backdrop of extended market losses in 2022, we heard several fellow analysts and investors anticipate a recession or a further economic downturn in 2023. While this prediction did not play out, the market remained volatile through catalysts such as the surging interest in Artificial Intelligence(AI) and its potential to introduce disruptions across sectors, the impact of heightened interest rates on the housing market, finance and consumer spending and lingering disruptions in the supply chain post COVID. One such event was the banking crisis that was narrowly averted in March wherein three banks "failed" in quick succession. Another impact of rising interest rates occurred in the housing market where sharply rising mortgage rates as well as higher prices (as a result of fewer homes on the market) pushed many prospective buyers out of the market. This kind of volatility in the housing market disproportionately affects low-income households many of whom belong to communities of color. Platforms like Zillow, a Nia portfolio company, help such consumers with access to information including property data and financing assistance. Housing data and transparency in rental markets will become even more important in the near future as extreme climate events such as fires and flooding continue to impact housing and immigration patterns and influence property evaluations.

2023 brought a spotlight on collective bargaining and workers' welfare with multiple union strikes across professions including health workers, teachers, actors and writers as well as automobile workers. Through December 20th, there were approximately 405 strikes in the US. The demands for each of these strikes echoed common themes such as wage improvements and the impact of AI automation on the employee base. This latter concern has been reaffirmed right at the beginning of 2024 with certain companies initiating AI induced layoffs. Since inception, Nia has maintained focus on employee welfare and growth as a key component of a company's performance. This past year has proven the importance of this metric and Nia will continue to monitor and engage with companies on the same.

Speaking of AI, during 2023, both consumers and investors rode a wave of positivity for advances in the technology, specifically large language learning models such as Chat GPT. Tech companies rushed in to meet the burgeoning curiosity of investors and the term “AI” was mentioned 177 times in the Q2 2023 earning calls of all S&P 500 companies. Mega Cap tech companies began projecting either the uses of generative AI in their products or internal functions while cloud and data center operators began boosting capacity to host AI servers. In what has been compared to the dot com bubble of the early 2000’s, specific companies known as the Magnificent 7 (Apple, Alphabet, Microsoft, Tesla, Nvidia, Meta and Amazon) sharply increased in stock price and valuation through the year, largely based on the promise of generative AI. The market narrowed to almost historic levels with the equal weighted S&P 500 index underperforming the S&P 500 itself by 12% in 2023. According to Bloomberg, as of December the top 10 companies in the S&P 500 were worth as much as the bottom 415. As investors increasingly relied on this small concentration of companies for financial returns, a bet against positions in these companies essentially became a bet against the market. The advent of generative AI, however, poses some serious questions with regard to ethics, sustainability and geopolitics. AI algorithms designed by humans require diverse teams to correctly identify and mitigate inherent biases. While there is some debate on the exact number, a Forbes article claims that only 12% of AI researchers globally are women. This lack of representation of gender and people of color behind the scene of what is arguably one of the most important technological advances in a decade, is concerning and can contribute to inherent flaws in the technology itself. Nia’s commitment to racial justice and gender equality primary questions when approaching potential AI companies for the portfolio. In addition to diversity challenges, the design and execution of generative AI requires higher degrees of computing power which in turn leads to higher emissions. Lastly, this development has added another layer to the technology stand-off between China and the USA. With semiconductor chips and cloud capacity emerging as key tools, the US has been employing the use of regulation such as the CHIPS act to encourage domestic production of semiconductor chips and reduce reliance on China for the same. Each of these factors have played an important role in Nia’s analysis of the generative AI wave and will continue to do so in the coming year.

Finally, a discussion about 2023 is incomplete without touching on the consistently rising temperatures and changing weather patterns across the world. The European Union’s Copernicus Climate Change service confirmed that not only was 2023 the hottest year on record for Earth but also that every month since June 2023 has been the hottest month on record. The extreme gravity of these statistics don’t seem to have sunk in just yet with major climate conferences like the COP28 dithering on commitments to divesting from fossil fuels. What does this mean for the market? The unfortunate circumstances leading to conflict and war between Israel-Palestine as well as Russia-Ukraine has led to spikes in oil prices, arising out of uncertainty regarding oil supply routes. To exacerbate the issue at hand, the recent increases in interest rates negatively impacted clean energy stocks which play a crucial role in the transition to a sustainable economy. The cost of capital and financing has risen both for the companies themselves as well as for residential consumers of solar technology who largely rely on loans to set up solar installations at home. These increasing costs translated into reduced margins and elevated inventory for the clean energy industry as well as reduced residential demand. This in turn, led to outflows of funds from these renewable stocks.

However, the big picture discussion around the importance of renewable energy and divestment from fossil fuels continues with the state of California paving the way. California legislators passed a bill mandating businesses with annual revenue over 1 billion dollars to start disclosing their greenhouse gas emissions by 2026. While California often leads the US, we foresee other states following with similar mandates. Nia continues its practice of encouraging all portfolio companies to disclose their carbon emissions as well as set emissions reduction targets and strategies to reach net neutral carbon levels. As such, Nia portfolio companies are well positioned for compliance and perhaps even ahead of the curve, for when such mandates come into play.

Financial performance in Q4

For Q4, the portfolio's top performers sector wise were Finance, Consumer Non-Cyclicals and Industrials. Against the backdrop of a pause in interest rate hikes by the Federal Reserve and the possibility of rate cuts starting in the first half of 2024, the U.S. stock market rallied during October 2023. Our finance and banking holdings benefitted from this pause in hikes which directly impacts interest rate spreads. Our only banking name in the portfolio reported growth in deposits while multiple portfolio names within the sector reported improved yields. Within consumer non-cyclicals, multiple holdings including those in e-learning, nutrition and furnishing reported improved demand and reaffirmed or raised full year 2023 outlook. Within industrials, wind turbine manufacturer Vestas reported improved demand through Q4 with an influx of orders at the end of the year. Other renewable names in the portfolio which have been experiencing volatility due to interest rate increases, rebounded to a certain extent. The portfolio's bottom performing sectors were led by healthcare followed by business services and consumer cyclicals. Despite generally being a defensive sector, healthcare overall lagged broader benchmarks during the quarter. Certain healthcare names within the portfolio are continuing to experience a COVID revenue decline and are currently in the process of re-prioritizing their product pipelines and business strategy. The portfolio is currently underweight compared to the bench for both business services and consumer cyclicals.

Outlook for 2024

One of the key elements to look out for in 2024 is geopolitical risk and opportunity as citizens of more than 60 countries go to the polls. Electoral results across the world will have implications for climate financing as well as technological developments and financing. An example is of recently elected Argentinian president Javier Milei who has stated that his government will neither attempt to fight climate change nor sustainably regulate the oil and gas industry. Climate financing, particularly for non solar clean energy sources such as wind energy, is still reliant upon government aid to a certain extent and elected officials who do not consider global warming a priority, can prove to be a short term headwind to the industry. In the U.S., benefits of the Inflation Reduction Act such as tax credits for electric vehicles and federal financial aid for carbon capture and storage technologies hang in the electoral balance, particularly against the backdrop of the 2023 concentrated yet loud political opposition to "ESG investing".

With Federal interest rates and inflation induced volatility at play, it will be imperative to monitor rate sensitive sectors and focus on names that are prioritizing cash flow and earnings growth. In the specific case of renewable energy, companies will need to prioritize improvements in pricing strategies, booking out project pipelines and manage debt. More innovation will be required to address the challenge of continuing disruptions in climate patterns. If borrowing costs start declining as anticipated, this could be a tailwind to such innovations. Finally, Nia will be keeping an eye on valuations of all technology/communication/infrastructure companies both within the portfolio and for potential opportunities to add to the portfolio as companies begin reporting progress on generative AI development and its contribution to margins and prices begin to adjust to the same.

making if the account held actual client capital. Actual client accounts in this strategy are managed by the Nia investment team based on the model portfolio, yet the actual composition and performance of these accounts may differ from those of the model portfolio due to differences in the timing and prices of trades, and the identity and weightings of securities holdings. Performance information is sourced by Orion.