DECALIA

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INVESTMENT INSIGHTS

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A ROARING PET ECONOMY

EDITORIAL VIEW

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- In the Covid-world of the past 18 months, human bonding to pets has strengthened
- Globally the pet products/services market looks set to reach $350 billion by 2027
- Plenty of investment opportunities albeit not always pureplay and often expensive

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- *Omicron*, the new Covid variant, is a troublemaker but not a game-changer
- The stakes are high for the Fed as it begins to normalise its monetary policy
- Albeit more challenging, the macro backdrop remains supportive overall

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- Allocation – Pro-risk stance unchanged – still favouring equities over bonds
- Gold – More constructive view as a (double-edged) safe & real asset investment
- Forex – EUR downgraded on the back of a dovish ECB & deteriorating backdrop

EDITORIAL VIEW

A roaring pet economy

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- Globally the pet products/services market looks set to reach $350 billion by 2027
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Pet adoptions soared during the pandemic. Staved of social interactions, and with suddenly much more stay-at-home time, households were eager to take in new four-legged friends. Did you realise that there are today more pets than children in the US? And with that evolution comes ever-increasing spending on a range of products and services, which has now broadened to include natural pet food, animal healthcare insurance plans and pet-tech devices.

Worldwide, the pet products market should reach USD 232 billion this year, up 7.4% from the USD 216 billion of 2020. Over the next few years, industry analysts expect its pace of expansion to average 6%, meaning that it should hit USD 350 billion by 2027. And this is not just a matter of the pool of pets continuing to grow, their gradual “humanisation” is also driving a “premiumisation” of pet-related expenditures. In the US, almost half of pet owners currently spend as much on their pets as on themselves – paying attention to their diet (Millennials, as well as the Silver Generation, being particularly willing to pay premium prices for natural meals and treats) or forking out on veterinary care (as diagnostic and therapy choices expand).

As regards pet food, clearly the largest expense for pet owners, the market is dominated by two giants: Mars and Nestlé Purina. Other (all US) players, such as J.M. Smucker, Hill’s Pet Nutrition or General Mills, stand quite a way behind in terms of market share. From an investor point of view, however, none of these names provide pureplay exposure to the pet thematic.

If seeking more focused investments, better then to look to pet retailers. And more particularly the online segment, where most of the growth currently lies – for reasons that are quite obvious. Pet supplies are bulky, they are non-perishable, they are unlikely to be sent back and they are prone to reordering. Indeed, online sales of pet products have almost quadrupled since 2013, with a 51% jump just in 2020. Amongst the best positioned (and publicly traded) companies, we should mention Chewy in the US and Zooplus in Europe. The former, whose market cap is now just short of USD 30 billion, has developed a model that actually resembles that of software vendors: customers sign up for scheduled automatic deliveries and are rewarded with discounts. As for the latter, it is currently the subject of a bidding war between two private equity firms – willing to pay over EUR 3 billion.

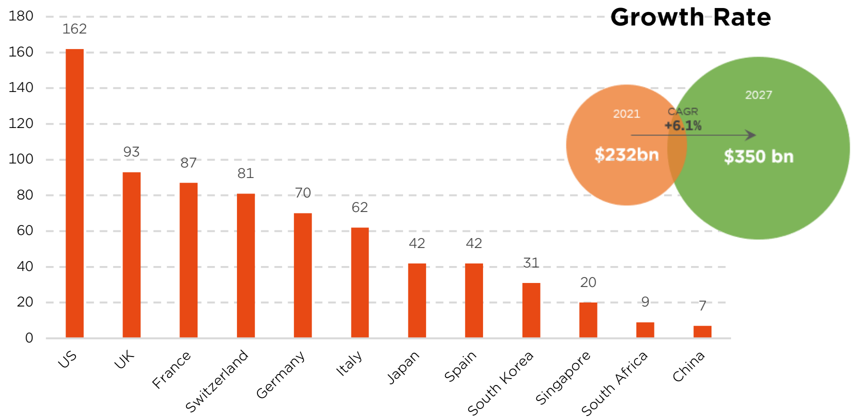
In the medical space too, one can uncover companies that are dedicated to pet care. Idexx Laboratories, Dechra Pharmaceuticals or Zoetis for instance develop medicines, vaccines and diagnostic services that are geared to animals – although their stocks (like those of the aforementioned online retailers) certainly do not come with a cheap price tag.

With Christmas just around the corner, anyone considering putting a new pet under the tree should perhaps have second thoughts. The benefits of human-animal interactions are several and undeniable, notably in terms of improved social attention, as well as mental and physical health. But owning a pet is also an (increasingly) expensive undertaking. Might buying pet-related stocks not be an interesting alternative?

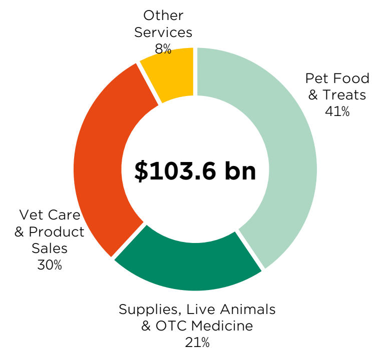
Written by Roberto Magnatantini, Lead Portfolio Manager of DECALIA Silver Generation & DECALIA Eternity

GRAPHS OF THE MONTH

Pet-care spending per person
(2019, in USD)



US Pet Industry Expenditures Breakdown (2020)



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GLOBAL STRATEGY

Covid-19 is not transitory unfortunately...

- *Omicron*, the new Covid variant, is a troublemaker but not a game-changer
- The stakes are high for the Fed as it begins to normalise its monetary policy
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It ain't over til it's over. More than 20 months after financial markets were first hit by pandemic concerns, a new Covid variant (Omicron) triggered a substantial sell-off... on Black Friday. It is too early to assess precisely how this development could impact the macro backdrop, although we acknowledge that it has clearly instilled a dose of uncertainty in our "pre-Omicron" scenario depicted below.

While European economic momentum is currently moderating, after two consecutive quarters of very strong growth and on the back of recent restrictions, US economic surprises have turned positive again and Chinese growth is showing tentative signs of stabilisation. As a result, we expect above-trend growth to continue to prevail next year in DM, though shifting to a lower gear and possibly of a choppier nature.

As far as inflation is concerned, we remain in the "transitory" camp but acknowledge that the current spike, especially in the US, is too big to ignore and may trigger unwelcome side-effects via expectations. We cannot even rule out a further increase over the next 6 months, because of unfavourable base effects, current upward price pressures due to ongoing supply-chain issues, higher energy prices or rising "shelter" prices.

Moreover, part of the supply chain issues have been related to... exceptionally strong demand for durable goods, given (also exceptionally) accommodative policies in lockdown times. As the distortions due to the pandemic and resulting policies fade away, demand for durable goods should moderate, supply-chain issues ease and, hence, price indices move back closer to central bank targets. Even though inflation is likely to be structurally higher going forward, especially in comparison to the last decade, it will not be high enough in our view to be considered disruptive for the economy and markets.

Monetary policies have remained very accommodative thus far, although central banks in DM have now prepared investors for an initial form of normalisation, to begin soon. The main challenge for central banks, and hence a risk that investors will closely monitor, will be to deliver the right dose of tightening, at the right pace, carefully balancing risks on both the growth and inflation fronts.

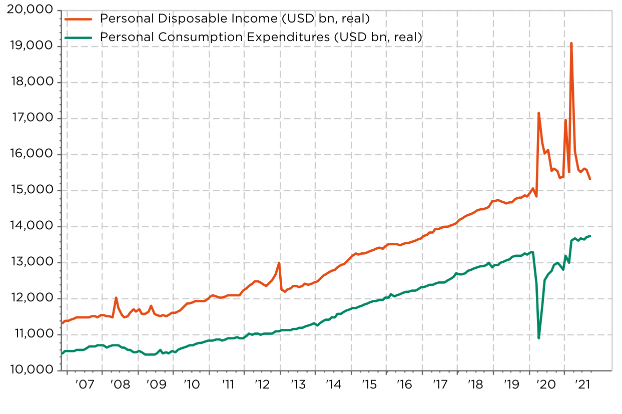
All told, our central macro scenario has not been altered so far, still supportive overall for equities (and real assets) vs. fixed income/cash. Moreover, remarkable buy-the-dip market forces, combined with a slowly improving global health situation, resilient economic momentum, vigorous earnings growth, easing valuation multiples, still-low interest rates, and a not-so-complacent investor positioning, all support our positive stance. Admittedly, the vast majority of asset valuations leave little margin of safety but, given our current macro scenario and as long as financial repression persists, only equities – alongside real assets – offer positive real return expectations today.

Speaking of financial repression and excessive valuations in some part of the markets, and especially beyond (cryptos, art, watches, housing, you name it...), we are again turning more constructive on gold. It stands to benefit either from its safe haven status in the event of a sharp correction of those bubbly assets or from another increase in inflation expectations.

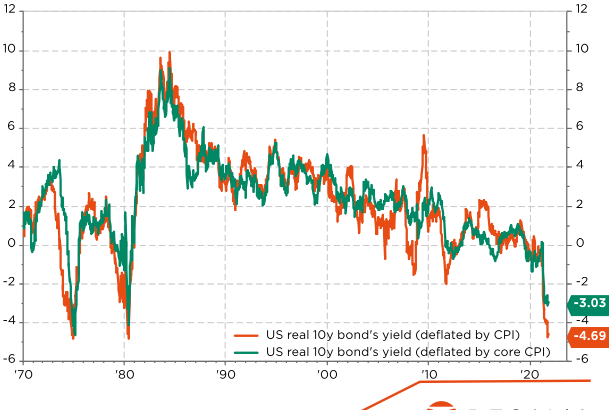
On a final note, our allocation grid now reflects a tactically negative stance on EUR. The single currency is facing several headwinds: a very dovish ECB, a deterioration in the pandemic and weakening economic momentum. In all other major asset classes, our positioning is unchanged.

Written by Fabrizio Quirighetti, CIO, Head of multi-asset and fixed income strategies

Too much cash chasing few goods & no services in the US



Financial repression has intensified of late
US 10-year government bond yield minus US inflation



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External sources include: Refinitiv Datastream, Bloomberg, FactSet, The Economist, Global Market Insights, American Pet Products Association

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