A New Reality for Investors Demands a More Active Approach

Five key investment themes that advisors should consider for their clients.

After a decade of mega-cap, technology-oriented companies leading the markets during an era of easy money, there's a new, more challenging reality setting in for investors.

Long-term bull markets, like the 11-year one that stretched from 2009 to 2020, are the exception, not the norm, for stock markets going back over a century. Traditionally, investors haven't been able to rely on outsized returns from simply buying, holding and forgetting a market-weighted index fund skewed to mostly big-tech names. As The Wall Street Journal put it in an article late last year, a combination of higher-than-normal inflation, higher interest rates, and worries of a potential recession "have created new winners and losers in the stock market."[1]

For investors, this may mean turning to portfolio managers who have a focus on capital appreciation through the bottom-up selection of the stocks and bonds of companies that exercise balance-sheet discipline and have generated earnings growth. Other portfolio managers may seek attractive investment opportunities in companies that have generated strong dividends for shareholders in the past. Such investments may perform relatively well should markets fail to keep pace with the last great bull market.

5 Investment Themes to Keep an Eye On

According to several of Capital Group's portfolio managers and investment analysts, several major shifts in markets have uncovered some key investment themes worth considering in this new reality. We highlight five of the more prominent ones here, along with specific Capital Group active exchange-traded funds (ETFs) that embrace these themes.

1. Dividend Decade

Investing in dividend-oriented stocks may have made less sense during an era of high-flying tech stocks that paid little to no dividends. But in the new reality, boring can be beautiful. Indeed, dividend stocks can shine at times when the Federal Reserve, as part of its inflation-fighting efforts, is loath to lower short-term interest rates.[2] The managers of Capital Group Dividend Value ETF (CGDV) seek to deliver consistent income that exceeds the average yield of the S&P 500 Index. Many of the companies in this portfolio have experienced slower growth than tech companies, but possess strong cash flows which allow them to pay—and at times increase—their dividends.

2. New Growth

When investing in growth stocks, portfolio managers must seek to identify which companies are fundamentally challenged and which ones have attractive growth prospects at reasonable valuations. The managers of Capital Group Growth ETF (CGGR) understand this distinction. The fund takes a flexible and wide-ranging approach to growth investing: The best opportunities may be found in developing industries such as electric vehicles, turnaround situations where valuations may be out of line

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with expectations, or even in non-U.S. companies that are either industry leaders or providers of innovative products or services.

Nearly 1 in 3 financial advisors said they plan a shift to active ETFs in the next six months. When asked why, they cited their flexibility and ability to adapt to a changing market environment.

3. Golden Age of Health Care

Innovation is ultimately what can drive long-term value creation across industries. And innovation is arguably at an all-time high in the health care sector. It's no surprise that health care comprises a large weighting in the Capital Group Global Growth Equity ETF (CGGO), as of June 30, 2023. The fund's managers, including Roz Hongsaranagon, are particularly bullish on pharmaceutical and biotech companies with innovative pipelines priced at attractive valuations, as well as opportunities for value-based primary care. "We may be in the early innings of a new innovative cycle for the sector," she says.

4. Core Bond Strength

As The Wall Street Journal wrote in an April 2023 story, "After more than a decade of uninspiring returns, bonds have started to pay out real money."[3] And strong income opportunities, combined with the potential for an economic slowdown, could make a portfolio of core bonds the star of an investment portfolio. Capital Group Core Plus Income ETF (CGCP) invests across the fixed-income spectrum to seek current income and total return consistent with the goal of preserving capital.

5. A Comeback in Credit

After the bond market experienced a rout in 2022, income opportunities in fixed-income sectors have become more attractive. The bond sectors that Capital Group U.S. Multi-Sector Income ETF (CGMS) highlights may be fertile ground for investors to pursue above-average income. Indeed, yields for higher-income sectors such as investment grade (rated BBB/Baa and above), high yield and securitized debt may offer attractive entry points for long-term investors.

Fortifying Portfolios With Active ETFs

In this new market reality, some advisors may be rethinking portfolio strategy to achieve particular goals, such as consolidating fund selection, increasing international exposure and replacing more passive investments with ETFs offering active management.

In the first half of 2023, Capital Group's ETF sales specialists and portfolio consultants have observed that advisors are using the Capital Group Core Plus Income ETF (CGCP) because of its broad exposure to various bond categories. This active ETF may be an effective substitute to holding several narrow index or actively managed funds that seek the same outcome. This move to a single ETF also allows bond asset allocation decisions to be passed from the advisor to experienced bond portfolio managers.

Other advisors seeking active management are using Capital Group Dividend Value ETF (CGDV) and Capital Group Global Growth Equity ETF (CGGO) as replacements for investments that seek to track indexes such as Russell 1000 Value and MSCI EAFE. And advisors seeking more international exposure find that Capital Group International Focus Equity ETF (CGXU) and CGGO may be an effective solution for gaining exposure to non-U.S. developed and emerging markets without needing to monitor individual exposures to certain regions.

Advisors who turn to Capital Group's active ETFs may take comfort in knowing each fund is run by a team of seasoned portfolio managers instead of just one manager. Known as The Capital System™, this multimanager approach generates a portfolio of high-conviction investment ideas. Instead of one portfolio manager building a well-diversified portfolio single-handedly, a fund's investments emerge from the highest-conviction ideas of a group of experienced investors, each responsible for their sleeve of the portfolio.

In an investment environment filled with a new set of winners and losers, certain active ETFs seem well positioned to pursue the opportunities. Findings from a recent survey of more than 500 financial advisors conducted by WSJ Intelligence indicate that advisors understand how active ETFs can help in navigating less reliable bull markets. Nearly 1 in 3 said they plan a shift to active ETFs in the next six months. And when asked why, they cited their flexibility and ability to adapt to a changing market environment.[4]

Sources:

1. Singh, Hardika, "Stock Picking Makes a Comeback in Market Turbulence," The Wall Street Journal, Dec. 20, 2022.

2. Huang, Vicky Ge, "Interest-Rate Concerns Push Investors Into Dividend-Paying Stock," The Wall Street Journal, Feb. 24, 2023.

3. Pinsker, Joe, "People Are Investing in Bonds Again—Once They Figure Them Out," The Wall Street Journal, April 14, 2023.

4. Capital Group ETF – Financial Advisor Study," WSJ Intelligence, June 2023. (Study was in the field June 7-20, 2023, receiving 554 total respondents.)

Disclosures

Investors should carefully consider investment objectives, risks, charges and expenses. This and other important information is contained in the fund prospectuses and summary prospectuses, which can be obtained from a financial professional and should be read carefully before investing.

Capital Group exchange-traded funds (ETFs) are actively managed and do not seek to replicate a specific index. ETFs are bought and sold through an exchange at the then current market price, not net asset value (NAV), and are not individually redeemed from the fund. Shares may trade at a premium or discount to their NAV when traded on an exchange. Brokerage commissions will reduce returns. There can be no guarantee that an active market for ETFs will develop or be maintained, or that the ETF's listing will continue or remain unchanged.

As nondiversified funds, Capital Group ETFs have the ability to invest a larger percentage of assets in securities of individual issuers than a diversified fund. As a result, a single issuer could adversely affect a fund's results more than if the fund invested a smaller percentage of assets in securities of that issuer. Refer to the applicable prospectus for details.

For CGGO, CGXU, CGCP and CGMS, investing outside the United States involves risks, such as currency fluctuations, periods of illiquidity and price volatility. These risks may be heightened in connection with investments in developing countries.

For CGCP and CGMS, lower rated bonds are subject to greater fluctuations in value and risk of loss of income and principal than higher rated bonds. The return of principal for bond funds and for funds with significant underlying bond holdings is not guaranteed. Fund shares are subject to the same interest rate, inflation and credit risks associated with the underlying bond holdings. The use of derivatives involves a variety of risks, which may be different from, or greater than, the risks associated with investing in traditional securities, such as stocks and bonds. Investments in mortgage-related securities involve additional risks, such as prepayment risk.

Bond ratings, which typically range from AAA/Aaa (highest) to D (lowest), are assigned by credit rating agencies such as Standard & Poor's, Moody's and/or Fitch, as an indication of an issuer's creditworthiness.

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