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Finding growth in a low-growth world

The world is becoming an increasingly winner-takes-all environment – investing into high-quality businesses with global addressable markets is essential for long-term success. Super funds reviewing their equity investment approaches may find opportunities in both local and global markets, although the shape of the recoveries will vary by market, writes MARK ARNOLD.

Since the GFC, global economic growth has been weak, particularly across the developed world, and this is a trend which we expect to continue long after the COVID-19 crisis.

The world economy is facing numerous structural headwinds including high levels of debt, ageing populations, rising wealth inequality, technological disruption, and environmental disruption brought about through climate change. Globalisation has also made the world a much more competitive arena.

COVID-19 did not create these headwinds, but it will exacerbate most of them and their effects. For this reason, we continue to hold the view that a growth-based investment style will continue to outperform value investing and other investment approaches in the decade to come.

Out with the old in with the new

The *value* investing approach relies heavily on investing in discounted average businesses that are trading below their perceived intrinsic value, but which are reliant on a strong economy to grow. It stands to reason that in a global economy which is no longer growing, such companies will underperform.

The only other way to grow earnings is to take market share away from competitors and therefore, we focus on *growth* companies which do precisely this. These companies are characterised by their strong revenues and profits which allow them to grow at rates well above the overall benchmark – this is especially true in economic downturns.

We favour modern and technology-enabled businesses because we believe old-world companies and old-world drivers of growth—including those companies with business models that are reliant on fossil fuels for their value propositions—will no longer be effective in delivering above benchmark returns over the next decade.

In our view, technology continues to be the key driver of growth and change, and we seek to leverage the key themes which we believe will deliver alpha. Among these are the shift from traditional media to online/digital media, the move from cash to electronic payments (which has accelerated during COVID-19), the transition to sustainable energy and transport, and the digital transformation of the workplace.

Looking at the current market recovery, we can see that it has been technology-led with the NASDAQ recovering more than 40 per cent from its lows compared with approximately 36 per cent on the S&P500 and 27 per cent for the ASX200 (at the time of writing on 27 May 2020).

Picking the winners

The companies we believe are set to dominate are those with strong value propositions, sustainable competitive advantages, a large and growing addressable market, strong positive free cash flows, high levels of R&D investment, low levels of debt and a talented management team with a long-term focus and skin in the game.

Technology disrupters like Amazon, Facebook and Google are just some of the most recognisable names but there are various others, both abroad and in Australia, which show potential and which we believe will outperform the broader market in the long-term.

Local but global

Our investment thesis is long-term in nature and focused on fundamental quality. Regardless of changing market conditions, we continue to invest only in the highest quality companies that we believe have the best potential to outperform for shareholders.

Within the Australian market, we particularly like healthcare and technology stocks and our portfolios have a significant international tilt with many of the businesses including CSL, ResMed and Xero having diversified and global revenue streams with large addressable markets. We believe modern businesses like these, that invest in R&D and technology, will not only strongly recover but will significantly outperform over the long run as they take market share from competitors.

Compared with international equity markets, Australia has a high concentration of large and traditional financial and resource-focused businesses. This means we have a far more limited investment universe to choose from, especially when we screen out banks which we believe are vulnerable to technological disruption, and that energy and resources are in structural decline or lack the earnings predictability we required. As a result, we currently have no exposure to oil or gas and our exposure to the banking sector remains low within the overall portfolio.

The long view

Ultimately, super fund investment teams need to take a long-term view on the intrinsic value of a company to determine if it is expensive or not. While some *value* companies may look cheap compared to *growth* companies on a short-term PE multiple, we believe many of these old-world businesses will continue to be disrupted in a low-growth world.