Mark Cormack:

Well, good morning and welcome to the Hyperion webinar on in the modern world, what sectors and narrow range of companies will be winners? My name is Mark Cormack and I'm a director with Pinnacle Investment. Pinnacle are equity partners and work alongside Hyperion to distribute their suite of Australian and global equity funds to the financial advisory marketplace.

Mark Cormack:

Today, I'm delighted today to be joined by Hyperion CIO, Mark Arnold, and Hyperion's deputy CIO, Jason Orthman. Just in terms of background, Hyperion have a 20 year track record of investing in equities with a concentrated benchmark unaware approach that only invests in the highest quality businesses. Hyperion defines quality investments as those with a high return on equity, low or no debt, and businesses that can deliver strong EPS growth through extremely strong competitive advantages.

Mark Cormack:

Normally in these webinars I'll talk about the investment benefits that Hyperion adds to client portfolios, but today I'm going to take a step back, because I think it's important to understand the fabric, so it's the building blocks, the DNA that really stands behind Hyperion as a business, and discuss their mission, values, and beliefs.

Mark Cormack:

Firstly, Hyperion is a business that is research driven. It's not marketing driven and you can see this by the pragmatic way the team has rolled out their global growth companies fund, even after many years of research before the fund even launched. The business from every aspect is evidence based. It's not about taking risk or blue sky investing which many others do. The whole focus for Hyperion is around delivering alpha for clients. This is the reason Hyperion exists.

Mark Cormack:

Another really differentiating point that Hyperion focus on is that they focus on investing for the long term. They think as business owners, not short term traders. This is especially important in a world that's focused on the next short term earnings numbers, which is really hard to predict. With Hyperion, it's a team approach. Sharing ideas, it's all about the collective outcome, not the individual. You'll also notice on this slide that Hyperion's funds under management has predominately been made from the compounding returns that our investors have received since inception, which is an endearment to the outstanding alpha driven approach the Hyperion team take.

Mark Cormack:

Hyperion's mission is to protect and grow and periods like the GFC and the current COVID-19 environment are great examples of how Hyperion has delivered outperformance in both up and down markets. This has been recognized by all the major research houses here in Australia, with Lonsec, Zenith, and Morningstar. With that, in May, Morningstar initiated coverage on the Hyperion global growth companies fund, and I thought I'd just briefly share some key comments from that report.

Mark Cormack:

"An impressive team, straightforward approach give it an edge in a very competitive peer group. A proven track record across two decades and Morningstar believes the style and skillset translates well into the larger global universe. The strategies assets size is relatively low in a global context, allowing the strategy to be nimble." And finally, "Performance has been stellar since the fund's 2014 launch, as the fund has nearly doubled its benchmark and peer average."

Mark Cormack:

Okay, enough from me. Turning to today's webinar, it will last around 30 minutes and all attendees do have the opportunity to ask questions on the questions tab on your screen. Without further ado, I'll hand you over to Mark Arnold, the Hyperion CIO, and Jason Orthman, deputy CIO, to take you through today's presentation. Thanks guys.

Mark Arnold:

Thanks Mark. Good morning, everyone. Just firstly, just to emphasize what Mark was saying, we really are all about protecting clients' capital and then growing that capital over long periods of time. We're very defensive in nature and you can see that through the outperformance during the GFC and also more recently, through the COVID-19 crisis. We protect capital by only investing in the highest quality businesses with the lowest fundamental risk, and lots of structural growth over long periods of time.

Mark Arnold:

We've been successfully doing that for 24 years now, protecting and growing capital for our clients, through very different and varied market conditions and economic conditions. In today's talk, there's five major topics we'll cover. Firstly, we'll revisit the shift from old to new economic frameworks. Secondly, we're going to look at the winners in this environment. Thirdly, we're going to look at the narrow set of companies that will take market share and while it'll only be a narrow set.

Mark Arnold:

We'll look at why superior EPS growth is so important in terms of long term returns. And then finally, we'll look at how our three products are positioned in this post-COVID-19 world. Firstly, we'll go back to the old world, so in the six decades prior to the GFC, the world enjoyed very high levels of economic growth and that growth was driven by significant tailwinds. The tailwinds included young and growing populations, women entering the workforce for the first time and boosting productivity.

Mark Arnold:

At the beginning of this period, debt levels were very low in most economies so there was a gearing up over this six decade period where income and expenditure was brought forward as society geared up. That supercharged economic growth rates during that period. Also, there was a robust and growing middle class during the period. Confidence was generally high that the economic growth would continue. There was a commercialization of powerful machines, in combination with cheap fossil fuel based energy that really drove productivity, again.

Mark Arnold:

There was no talk of climate change or other sort of impediments to growth from natural resource constraints and disruption, and there were low levels of competition, and low levels of disruption generally. Post the GFC, we transitioned to a low growth disruptive world with significant headwinds. Population growth has been slowing consistently since the 1960s. You've got an ageing population problem in most major economies around the world. There's very high debt levels which will impede future growth.

Mark Arnold:

There's been rising wealth inequality in most countries around the world and the middle class has been hollowed out. There's natural resource constraints and disruption, particularly climate change. There's been a declining tailwind in terms of the move from higher interest to lower interest rates, so that trend has come to an end. That's no longer a tailwind. And there's increasing disruption through technology, better automation, better computers, better robots.

Mark Arnold:

Companies can achieve growth through two major sources. One is growth in the overall economic pie and the second is by taking market share. Most companies can access the first channel, so they can share in the growth, in the overall economic pie, but only elite businesses that have very strong competitive advantages and value propositions can access the second channel, in terms of consistently and structurally growing their market share over long periods of time.

Mark Arnold:

In a low growth world that we're facing, the first channel of growth no longer exists. Businesses that are reliant on the overall economy growing and those businesses taking their share of that growth are finding it very difficult in this world. The only real growth is for businesses that can take market share and as I said before, that's really the elite businesses that have very strong value propositions to offer. At the same time, the competitive dynamics of the world have changed.

Mark Arnold:

You can see on this chart, this is the profitability by decile for the stocks in the MSCI World Index. The relationship between the different deciles in terms of profitability or return on equity are prior to the internet coming into being, was fairly stable. But since the internet came into being in the 1990s, the elite businesses with the highest return on equity have enjoyed increasing returns on equity over time, whereas most of the other companies have actually experienced declining returns on equity.

Mark Arnold:

This is because power law distributions have really moved from regional areas to a global world. Power law distributions have always existed. It's always been the 80/20 type rule where the best businesses would take most of the share, and the movement from that regional based power law distribution to a globally based power law distribution has really adversely affected many businesses throughout the world. We don't see that this is going to change going forward, so it's really a disrupted world where the elite have taken more and more market share and most businesses have actually lost market share and they've really suffered lower margins and lower returns on equity as a result of losing market share.

Mark Arnold:

And as I said before, their one avenue of growth that used to exist in the old world, which was taking their share of the economic pie growing is no longer available to those businesses either.

Jason Orthman:

All right. Thanks Mark. When you look at a successful portfolio, you'll notice large weights in a collection of quality stocks and we've given some examples from the Hyperion Global Fund here, but the reality is structural winners are never obvious at the time. Only in hindsight. Whether that was Microsoft through the 1980s and the 1990s or Amazon through the 2000s, it actually wasn't that obvious at the time.

Jason Orthman:

If we look at some of these names in the slide, clearly Hyperion's owned some of these large mega cap tech leaders, although we made these purchases nearly six years ago. We do still own some of these names. We can highlight there the Amazons, the Facebooks, the Googles, Mastercards, Visas, but the interesting thing is up to 50 analysts would cover each of these large names.

Jason Orthman:

Anyone could have purchased these businesses, but it seems like professional investors have really only been drifting to these names over the last couple of years. The question we propose is why. If we look through at some of the short term metrics at the time of purchase on this slide, you can probably see that the actual PEs have relatively limited value. If we look at the slide, Amazon making a purchase at 120 times earnings, or Facebook at 75 times earnings, this is not easy.

Jason Orthman:

Most people won't make these investments. You really need to do something more and actually look at the intrinsic value of these businesses and compare it to the share price. Even when you look at the lower PE names, the Mastercards and Visas, five to six years ago, you could have made investments in these businesses less than 20 times. But again, unless you've actually tried to make an estimate of their intrinsic value and the quality of their competitive positions, it's hard to do.

Jason Orthman:

If we go back to five or six years ago, you had all the talk about blockchain, Bitcoin, FinTech disruption, and so again, you might not make these investments. The meaning from this slide, in our view, is a lot of the short term industry metrics such as price to book, or EV to sales, or PE, doesn't actually have a lot of meaning in those metrics, and we need to look at a broader set of attributes. Mark, you want to talk through Microsoft and Amazon story?

Mark Arnold:

Yeah. Microsoft's an interesting case study. It's always been expensive. The average PE for Microsoft since it listed over 30 years ago has been above 30 times. That compares with the average PE for the MSCI World over that same period of time, of 16 times. If you were totally reliant on short term metrics in terms of making your investment decisions, you would have never bought Microsoft through the 33 year journey. You can see that over long periods of time, there's a close relationship between the sales per share, which has basically been organic growth primarily, and also the EPS of Microsoft.

Mark Arnold:

It's always been a highly rated business but if you actually look at the beginning price earnings ratio going back into the late 1980s, the stock initially sold on an average PE of around 25 times. Today, it sells on a PE of around 25 times as well, so the actual PE hasn't really changed over that 33 year period. All of that growth that you can see on this chart, which has been astronomical really, in terms of the returns, hasn't been driven by PE change at all.

Mark Arnold:

Really, the compound return, you can see, has been 24% per annum compared to the MSCI of 6%, around 6% per annum. And then similar story with Amazon. Gets a bit more extreme in terms of its earnings. For many years, Amazon didn't have any EPS, or was actually loss making, but it's always been really driven by an innovative culture, a very strong value proposition, and very large addressable markets. That's allowed Amazon to take substantial market share over a long period of time.

Mark Arnold:

You can see again, the dotted line is the sales per share and the relationship between sales per share and the share price has been very close, and also you do see that the EPS growth has ... The relationship between the EPS and the share price isn't as tight, but it has been a contributing factor in terms of the growth of the stock. Amazon's always had the philosophy that they'd focus on the long term, and they were prepared to invest heavily over the short term to achieve long term gains.

Mark Arnold:

That's really paid or resulted in superior returns for shareholders of Amazon. The average return per annum over the last 23 years has been 37% versus the benchmark of 5%.

Jason Orthman:

All right. If we shift it back to Australia, really the structural winners domestically weren't any more obvious than they were globally. If you look at the slide here, purchasing TechOne in the late 1990s or REA in the early 2000s, they were very different businesses. Even if you look back 5-10 years ago, REA was dismissed as a low quality website, not one of the most powerful networking effects the world has ever seen.

Jason Orthman:

If you bring it forward to some more current examples like WiseTech and Xero, they're not anymore obvious because there's no blueprint, there's no databases for these businesses. They are really the next blue chips and they're disrupting the incumbents. Along that journey, you will get short sellers targeting those stocks and I'm sure we'll see that again. As shareholders through that journey, you really compound a world of worry. You will make mistakes, until they've become the next established blue chips.

Jason Orthman:

If you just look at the metrics at the time of purchase. Again, to put it in context, really you can see through TechnologyOne, WiseTech, and Xero, there weren't any sense of historical or forecast PEs. These businesses were really coming into profitability and free cash flow, so it does require some extraordinary research, skill and conviction. Because of course, you don't want to be caught with concept stocks and it goes back to what Mark was saying earlier about protect and grow.

Jason Orthman:

The one thing Hyperion will do is avoid any permanent loss of capital, so it really means in your investment framework, you need to be looking at more attributes than simply short term PEs.

Mark Arnold:

And RealEstate.com is a good example of the compounding effect that you get, and its tight relationship between the share price, the EPS per share, and the sales per share over long periods of time. REA's always been an expensive stock. You can see on the slide, their average PE's been 52 times over the period of time that it's been listed. The compound return for the stock has been close to 27% return compared to the benchmark return of about 8%.

Mark Arnold:

It's been pure fundamentally driven. It's really just the business has taken substantial market share. It's been a hundred bagger for Hyperion since we owned it. There's been heaps of value investors that have basically said that they'd never invest in it because it was too highly priced, and there's been heaps of short sellers as well that have destroyed capital for their clients by trying to short this stock over the years.

Mark Arnold:

And Xero's an earlier stage business that we think has got a very strong value proposition, and massive addressable market, and innovative culture, and again, the relationship and the fundamentals for this business, it's really sales per share have been driving the share price up. It's only just come into profitability, but we think over the longer term, the business will be highly profitable and will continue to take market share for many years. We think it's early days for Xero.

Jason Orthman:

Okay. If we look at Wotif as an example of a company that I guess didn't make it through that journey because it was acquired, whereas the REAs and the Seeks continued to compound up, there was a number of invaluable learnings, and one of the main issues was Wotif's inability or focus to reinvest in its business. It couldn't expand out of Australia.

Jason Orthman:

Managing a business for cost or to margin, we believe will ultimately lead to failure. The learnings are you need to innovate and invest heavily in R&D. You need to release new functionality, and new products, and you need to scale globally. These are some of the important attributes that Hyperion looks for in the business. If we move forward to the next slide, what Hyperion's effectively doing is backing progress and not betting against change.

Jason Orthman:

In our view, the majority of the market prefers the status quo and assumes market leadership or industries won't change. Big examples of these incumbent industries are traditional auto, traditional power, traditional oil industries, there seems to be a view that they will remain unchanged over the next decade. We're not willing to make that bet.

Jason Orthman:

To be fair, even in our view, Warren Buffett is effectively betting against change. But what Hyperion believes is because of that new economic framework that we identified and Mark talked to earlier, we don't think that's a sensible approach post GFC. MC, did you want to talk through the outcomes of investing in quality growth?

Mark Cormack:

Yeah look, as I mentioned in my introduction, Hyperion's Global Growth Companies Fund is now researched and rated by Morningstar, and when looking at the Morningstar direct analytics, the fund is rated number one out of 294 funds, in terms of versus the peer group, and over five years it shows that Hyperion's approach to investing and structural growth and delivering returns works.

Mark Cormack:

Not only that, but delivering the 4% per annum additional alpha over the next competitor, and delivering over 10.9% per annum alpha over the medium funds just shows how far ahead Hyperion's approach is. It's a similar story in Australian equities with Hyperion the number one in their Australian Growth Companies Fund over 20 years. Just showing that structural growth is a winner in both global and Australian equities.

Mark Cormack:

When I take into account I suppose the amount of risk that Hyperion has taken in order to deliver those returns and using standard deviation as a measure, Hyperion, if you have a look at the blue dot there on your screen, that blue diamond, Hyperion isn't taking much additional risk in order to generate those returns for investors. Now Mark, I was going to hand it back to you just to give the listeners some comments on returns and looking at value and growth and updating on how things have transpired in the COVID world.

Mark Arnold:

Thanks Mark. This is the Fama/French data. We've showing this chart before. When this line's going up, it means that value is outperforming, and you can see that over almost 100 years, value has outperformed, but the thing to notice is that all of that outperformance has really been in periods of strong nominal GDP growth, and for most of that period, it wasn't a disruptive world either.

Mark Arnold:

So, market share changes were pretty mild and slow moving. In that sort of environment, a strong growth environment with not much competition and not much disruption, value as a style works quite well, because as we, in those previous slides where we spoke about the two sources of revenue, one being share of economic growth in the economic pie, and the other one market share, in a high growth environment, most businesses do well because they can share in the growth in the economic pie, and they're the sorts of businesses that tend to sell on average, or below average PE.

Mark Arnold:

They're the sorts of stocks that value investors invest in, but on this chart, you can see that during periods of contraction or low nominal GDP growth, value's always underperformed, so value's never protected investors during difficult economic times. We've updated this chart for the COVID-19 crisis and can see that the value has continued to underperform during this crisis, as it has during every other crisis through this almost 100 year period.

Mark Arnold:

As we've explained, we don't see the environment changing. We're not going back to a high growth world, and we're not going back to a benign, non-competitive world, because the internet's here to stay, and that will drive ongoing disruption and market share change.

Mark Arnold:

And then again, just looking at the same data, looking at global equities over the last 10 years, you can see that growth has substantially outperformed value, and then again with Australian equities as well. Because the previous data that we've showed was just the US market for the Fama/French data. Again, this is just reinforcing the same story. We think that there may be short periods of outperformance of value in the future, but that would be we think very short, and it'd just be during a cyclical bounce.

Mark Arnold:

But longer term, because of this low growth environment that we're permanently in, it's very unlikely that value is going to outperform as a style over an extended period of time.

Jason Orthman:

If you take a long term approach rather than a trading approach, the reality is equity markets have always been driven higher by a narrow number of winners. This is actually very normal despite the perception through at least mainstream media. If we again, look at the data over the last 100 years in the US stock market, the excess returns relative to treasury bills produced from US equities from 1926 to 2016 has been extremely narrow.

Jason Orthman:

You can replicate this across over developed markets including Australia, New Zealand, and the UK. You can see the best performing 4% of all listed companies in history have explained the entire excess return of the US stock market since 1926. The two charts on this slide effectively show you how those excess returns have been driven by only 1000 out of 25,000 historically listed US companies.

Jason Orthman:

If you take that even further, out of those 1000 companies that have driven all those returns over the last 100 years, it's really only a few hundred that have done all the heavy lifting. This is really important to understand if you want to be a long term investor and compound returns rather than simply being a trader. But if we try and think about where to from here, we believe post in a COVID-19 environment, we're not going back to the high growth levels that have existed pre-GFC, and back to normal post-COVID-19 really means back to the same problems that we've faced previously. Just with additional debt burdens. The index won't generate you any meaningful growth either.

Jason Orthman:

We've been trying to find some examples or structural themes where we do believe you'll get some growth post-COVID-19. One area is the shift to modern software. The one thing COVID-19 has shown everyone is that we need flexible, adaptable organizations, firms that can actually allow their staff to work remotely. Simply, this requires modern, agile, highly functional software, and it needs to be delivered appropriately.

Jason Orthman:

In our view, despite the prevalence of on-premise legacy software, that will no longer be accepted by staff and organizations going forward. Mark, did you want to talk through another example, post-COVID-19?

Mark Arnold:

We think that the shift to a low carbon energy and transport world was happening anyway, but we think COVID-19 has accelerated change across a whole range of products and services. We think that it'll definitely be accelerating the change to low carbon energy sources and also low carbon transportation. The awareness is a big factor, also a crisis really forces people to think about value propositions and the awareness of the level of pollution that was in most major capital cities as a result of cars being on the roads and most of the cars being internal combustion engine cars, producing a lot of pollution, we think that that awareness will help to accelerate.

Mark Arnold:

But the main driver is really cheaper batteries, cheaper renewable energy generation. It's been ongoing and moving at double digit rates year after year. That will be the main driver that COVID-19 has helped to increase awareness.

Jason Orthman:

We've included some stock examples now where Hyperion believes we'll outperform over the long term, post-COVID-19. All these businesses are proven market leaders that have huge structural tailwinds that we believe will last for decades. If we go through the Global Growth Companies Fund, there's some examples there. Amazon is one that we've discussed. Through Australian growth, ResMed is a healthcare business that we believe will outperform over a long period of time.

Jason Orthman:

Then, if we move into the small cap fund, things like Pushpay we believe have the attributes that we're after. If we can get this stock selection broadly right, this collection of businesses will drive the EPS of the portfolios up at high double digit levels, and ultimately the returns will follow. We can see here over the next few slides that the dotted green line, which is the earnings per share of the Australian Growth Companies Fund, has led the black line or the unit price up over a long period of time.

Jason Orthman:

If we move forward to the next slide, you can see this for the Hyperion Small Growth Companies Fund as well. Again, the dotted green line is the EPS of the small cap fund, which has driven that black line up, which is the unit price. To put in context, the dotted blue line is the EPS of the Small Ords Index which has drifted sideways, and the red line, the market has followed that. Again, if we move to the final example around EPS, this is for the Global Growth Companies Fund which is rolling into the six year track record, again, the dotted green line being the EPS has correlated pretty closely with the actual black line of the unit price.

Jason Orthman:

That dotted green line of the EPS of the Hyperion funds versus the dotted blue of the indexes, that gap there has really been the long term alpha that Hyperion's been able to achieve. MC, you want to talk through how this actually translates to returns?

Mark Cormack:

Yeah look, and I think ultimately, performance is what matters, and Hyperion have been able to deliver some outstanding performance across the Hyperion Small Growth Companies Fund, the Aussie Growth

Companies Fund, and the Global Growth Companies Fund. While the short term performance numbers have been exceptional, Hyperion will always point their investors to the long term track record they have delivering alpha.

Mark Cormack:

Since inception, Hyperion's Global Growth Companies Fund has outperformed by over 7% per annum. The Australian Growth Companies Fund has outperformed by over 3% per annum, and Small Growth Companies Fund has outperformed by over 8% per annum. Obviously, all substantially outperforming the index. Mark, I know you want to take listeners through the internal rate of returns in the funds as they stand at the moment.

Mark Arnold:

Yeah. We think the return outlook for all three products is very attractive at the moment. The IRRs for all three products are higher than what they were pre-COVID-19. The Australian product, the Australian large cap and the small cap products have projected returns of around 12 or 13% pre-COVID-19. They're now sitting at 16-17% before fees, and the global fund pre-COVID-19, the projected return was sitting around 15%. That's moved up to 20%.

Mark Arnold:

We think in a low return world, a low growth, a low return world, then double digit returns are pretty attractive.

Mark Cormack:

Excellent. Thanks guys. Always great to get your views on the market and as we covered today, the narrow range of sectors and companies that'll be winners in the modern world. Look, most advisors are familiar with Hyperion's Australian equity funds, in terms of performance, but advisors do often ask me how Hyperion's Global Growth Companies Fund does compare to the major players, in terms of fees and performance. You can see here on the screen, it's very compelling in terms of their 70 basis point management fee.

Mark Cormack:

It's one of the cheapest versus some of the major competitors, and as I mentioned, it has certainly delivered some solid returns over the last five years. Whilst listeners have got the opportunity to submit questions, I had been lucky enough today to be given the greenlight to share some of the insights and analytics from a group called Foresight Analytics who provide some in depth data and analysis to institutional investors such as super funds.

Mark Cormack:

I'm quite cognizant some of these charts are fairly heavy, but whilst people submit their questions, I'm just going to go through a couple of things that came out of this really detailed deck. This chart you'll see here on your screen shows in green the growth metrics that the businesses put together, in terms of Foresight Analytics. They're looking at growth metrics such as sales growth, forecast growth, forecast earnings growth, and you can see here, Hyperion provides access to investing in companies that have very strong structural growth attributes.

Mark Cormack:

From that perspective, that's the green bars there you can see on your screen. In terms of the blue bars, they're value factors. At Hyperion, you can see there ranks poorly on short term value factors, and whilst finally on the right hand side there you can see on your screen, the purple bars show Hyperion have very strong quality bias, by investing in companies that have very high profit margins and high return on equity. These aren't speculative businesses in the portfolio.

Mark Cormack:

You can see really how Hyperion fits in a portfolio context with that strong growth metric and very strong quality metric. Just in terms of some of the other analysis Foresight Analytics did, next slide shows Hyperion's performance has been and whilst it doesn't outperform all the time, it shows that Hyperion has outperformed well over 60% of times in both up and down markets. This really reiterates that growth and defensive characteristics are the Hyperion approach.

Mark Cormack:

And then on the next slide, you can see the analysis on this slide goes on to explain that over half of Hyperion's outperformance that they've been able to deliver cannot be explained by simply looking at a common investment metric, or a factor like return on equity. It comes down to the skill of the fund manager, their process, their approach, and their proprietary IP.

Mark Cormack:

As I said, these slides are very detailed and we're happy to go through with any investors, with them in more detail. And finally, the final slide shows how different Hyperion is with competitors when looking at a holdings based analysis. Whilst many people often make the comment to me that Hyperion's like Magellan, the research shows that Hyperion is around 70% different to Magellan, and over 85% different to the global equity peer group, meaning that Hyperion blends very well with virtually every other global equity manager in the market, and the index.

Mark Cormack:

My point with these charts is that investing with Hyperion, you're accessing not only a unique portfolio, but a portfolio that's very different to competitors, and a portfolio that's outperformed in both up and down markets, and provides that combination of growth and protection. Okay, guys, we have had a number of questions come in while I have been going through some of that analysis, and as I mentioned, that analysis and data is by Foresight Analytics who provide analysis to Australian super funds in the institutional market.

Mark Cormack:

Okay, guys. Let me kick off with some of the questions that have come in. Why doesn't value protect in difficult conditions when it focuses on low PE stocks?

Mark Arnold:

Well, it doesn't protect because in a really low growth, disruptive world, it doesn't protect capital because the businesses that tend to sell on those lower PEs have higher fundamental risk. They're more reliant on economic growth. They're more reliant on a status quo situation where there's no disruption, there's no real material changes in market share. So, even though the PE's lower, the risk is actually higher in the fundamental sense, because the businesses are lower quality.

Mark Cormack:

Okay. Another question, probably more on PE. Why don't you buy low PE stocks in high growth potential markets like developing markets?

Mark Arnold:

We think you're going up the risk curve when you go into emerging markets. You need to make sure that you're compensated for that extra risk. We just think that the risk of most emerging markets economies is substantially higher than what you get in developed markets. They're just less robust economies, and we think in the low growth world, emerging markets will suffer more than the developed markets in that competitive environment. Because most emerging markets really don't have a solid consumer base.

Mark Arnold:

They're more export driven and if you've got a situation where growth is low, it makes it more difficult for those economies to perform. It's our view that most emerging markets will never emerge and become developed markets and that includes China.

Mark Cormack:

There is a question come in specifically on China and a couple of companies there, Alibaba and Tencent. Any views there?

Jason Orthman:

Yeah, well Alibaba we took the opportunity through COVID-19 to add that to the global portfolio. That's a business we have been following since 2014, but the internal rate of return has increased over the last few years. When you look at its VIE structure, the revenue's from about 18% contribution. Tencent it's more like 50-60%, so Tencent is on Hyperion's global bench, but Alibaba made sense when we can actually get across some of those governance issues, the internal rate of return increased significantly in our view, and it's still a great business. Although, unfortunately still reliant on that Chinese economy, so you're never going to be a leading weight in the Hyperion portfolio.

Mark Cormack:

Okay, guys. Another question. Why don't you simply just buy a basket of high revenue growth stocks?

Jason Orthman:

Yeah, well in our view, we think it's been supported by research over time that many losers you get through that approach won't make it up for the few winners. As we discussed, most growth companies are really concept stocks or momentum stocks that actually fade out or burn out over time. This leads to a permanent loss of capital and Hyperion's initial go, initial role is to actually protect. It comes back to that protect and grow.

Jason Orthman:

Growth investing is just as difficult as traditional value investing, but I guess our observation is Hyperion's added a quality and valuation overlay to growth which means we're a lot more discerning, and you really need to pick those growth companies where their sales and earnings will persist over time, which is actually pretty tricky to do.

Mark Cormack:

Okay. Another question around PEs. How do you have the courage to buy high PEs or stocks with no PE?

Jason Orthman:

I guess part of that comes back to our track record and the confidence that our process can distinguish between exceptional businesses and just your average or above average business. We think this is one of the inefficiencies we exploit in the market. It really comes back to assessing the quality first, and then also actually trying to work out what the intrinsic value is.

Jason Orthman:

Not next week, but in 10 years' time. With the confidence to buy those businesses that are moving into profitability and free cash flows, when the quality's there, and when we can actually have a reasonable of its intrinsic value. If we put the small universe of companies through our process, we believe we've got the quality and valuation overlay to get more right than wrong.

Mark Cormack:

Okay, last question, because we are running out of time. Why are you convinced we are in a new economic framework and that traditional ways of investing such as value are no longer applicable?

Mark Arnold:

Well, just through the studies that we've done. The period of six decades prior to the GFC was a very unusual period. That's a period that value investing really dominated and outperformed dramatically. But we think that that was an aberration. If you actually look back thousands of years, there was very little growth in the global economy prior to the first industrial revolution, and then it was really supercharged during the second industrial revolution, particularly from the period from 1950 up until the GFC.

Mark Arnold:

We just think that everyone assumed that high growth was normal and sustainable, but we think in actual fact, it was temporary and unsustainable. We think it's very unlikely that we'll go back to that high growth environment. Sure, there'll be short periods of stronger economic growth, but they won't be sustained, and value investing, because they invest in average and below average type businesses, and are highly reliant on economic growth rates being high and the world staying stable and not having disruption and market share changes, we think it's pretty unlikely that the value style of investing will work in the future.

Mark Cormack:

Won't work in the future, yeah. Okay, guys. That is all we have time for today. Many thanks for the questions that came in. We have been overloaded and we will get back to any unanswered questions via the Pinnacle distribution team. Just a couple brief updates and a reminder, after being closed for five years, the Hyperion Australian Growth Companies Fund is now fully open to the retail market.

Mark Cormack:

Just on access, whilst Hyperion's Australian funds, the Australian equity funds are widely available throughout the market, as I've mentioned previously, Hyperion's Global Growth Companies Fund does have more limited access on APLs and platforms, so if you want Hyperion's Global Growth Companies Fund available on your preferred platform or APL, we certainly do want to and need to hear from you, so please let us know so we can do some work with the platforms or the dealer research teams to make the fund available.

Mark Cormack:

The information that Mark and Jason provided and spoke about today has been supported by a number of the academic research papers that the team have written over the last two years, and I know Mark and Jason are working on some new research papers to be released in the coming months, looking at why passive investing won't work, looking at value during the COVID period, the economic framework, and exploiting inefficiencies, and expanding on structural growth winners. Stay tuned for those over the coming months.

Mark Cormack:

We will be making this webinar available on the Hyperion Asset Management website, which is www.Hyperion.com.au, and they'll be available later today. If you have further questions or inquiries, please don't hesitate to contact your local representative from the Pinnacle distribution team. We'd certainly like to thank everyone for their attendance today. We look forward to catching up with you on our next webinar or one on one meeting if you want more detail. Thank you very much for your time today and have a great day.

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