

TRANSCRIPT: EPISODE 168

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[INTRODUCTION]

**Darius McDermott (DM):** Hello I'm Darius McDermott from FundCalibre and this is the Investing on the go podcast. I'm delighted to be able to bring you a podcast today with a new group – a new group from FundCalibre's perspective – but most certainly not a new group from a global investment perspective. Today we're talking to Capital Group and focusing on their New Perspective fund. I'm delighted to be joined by Chris Miles, who's Managing Director of the UK, and Steve Smith who's an Investment Director on the Capital Group New Perspective fund. Hi guys, how are you, good morning?

**Chris Miles (CM):** Good morning Darius, great to be here, thank you .

**Steve Smith (SS):** Morning Darius.

[INTERVIEW]

[0:40]

**DM:** Hi Steve, Hi Chris. Look, this is our first time discussing Capital Group with our audience and I think, as I know you pretty well now having spent a number of meetings with you over the years, this is an opportunity to introduce Capital Group. But from my perspective – and I don't mean to hone on the word New Perspective – my perspective, but Capital Group is quite different and you have a unique way to managing money. Maybe you could tell us a little bit more about the Capital Group approach and how it works please.

**CM:** Sure, yeah delighted to. And I mean Capital manage money in a very different way, as you say, Darius. And we use multiple managers to achieve our investment objectives for investors. And in simple terms, you know, why do we do that? We believe at the heart of our business it leads to better long-term outcomes for investors. And ever since our founding in 1931, we've been singularly focused on delivering these long-term durable outcomes for clients. And I think, you

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know, the experience all those years ago through the Great Depression, you know, it can be very difficult to deliver long term objectives for investors in multiple different environments. And I think there are two really important aspects to how we think about things.

First of all, we are underpinned by our private ownership. You know, it's quite unusual, I think in our industry for a business of our age, 91 years this year, to be privately owned. And particularly the size that we are. We are now entrusted with \$2.7 trillion of all active assets, which makes us the largest, all active asset manager in the world.

The second aspect as you say is how we manage money. And we do this through the capital system. This is where divide portfolios up amongst managers who have different approaches. And we also give a portion of the portfolio over to the analysts. So you have this nice balance between diversification from the different managers, but also very high conviction stock picks from the analysts. What that means for underlying investors is you get a much more consistent outcome over time.

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**DM:** And on this particular fund, you've actually got nine sort of different sleeves or whatever. So that that's eight portfolio managers and then a separate analyst pool. So it's sort of like nine contributing sleeves. Is that how it works?

**CM:** Yeah, I mean, effectively there are actually now nine managers and the analyst pool now. So, you know, what we found over time is that by bringing managers together who have slightly different approaches, they're all bound by the objective of the strategy and in the case of New Perspective, that is long term capital growth. And we have a huge benefit here through the stability of capital because, you know, on average, the nine managers in this portfolio have 24 years of experience just at Capital.

**DM:** Yeah.

**CM:** Again, these are massively long-term numbers. I mean, you don't hear that from organisations very often. So we have this benefit of seeing how those managers have invested over time. They then get behind the objective of long-term capital growth. And they look to deliver that in the way that they have found to be successful over almost two and a half decades of investing.

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Now it's not sort of organised chaos! One of the managers is ultimately responsible for the objective of the portfolio. And that is the principal investment officer who looks to ensure that the fund is, you know, correctly balanced and looking to achieve its objective. In the case of New Perspective, that is looking for companies on a global basis that have benefited from changing patterns of global trade, and what we identified back in the 1960s and 1970s, this fund was actually in, or the strategy I should say was incepted in 1973, was as a group of companies that we found that can really take advantage of changing patterns of global trade.

So typically we're looking for established multinationals here, as well as some exciting companies that we believe will be the multinationals of tomorrow. They tend to be very resilient companies but have also sort of got a proven track record in their home market that are starting to do things very excitingly on a global basis. And again, I think that's one of the benefits of having multiple managers because all of our investors are based around the world, bringing in different perspectives.

[4:57]

**DM:** So just looking then directly at New Perspectives, and we touched on some of these sort of large global champions. Some of the examples I see in there, Tesla, Microsoft, Amazon.. how do those individual managers then go about sourcing either those global champions or the future winners?

**SS:** So Chris mentioned that we're an active-only asset manager, right? We're paid to beat the global equity market return over the long term. And so that really starts, the way we do that is through company research, it really is at the heart of everything we do. It's the backbone of our investment culture. It's the backbone of our investment process. Now like some other world class active managers, sure, we have an army of analysts around the world. In fact, 80 analysts or so are feeding into New Perspective and they're combining the on the ground research with financial modeling to identify undervalued companies over the long term. But what really distinguishes our research and our ability to identify these companies that you mentioned Darius I think is a function of four things.

First of all, our analysts are career analysts. So they are covering the same sectors or industries if you like for their entire careers. Often for many decades, it means they become absolute experts in their field of coverage. Secondly, our analysts are investment analysts. They are not just recommenders of ideas. They are not just researchers. They are investors as Chris said, they're part of the money management process. We're asking each of these analysts to invest in a very, very

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small number of their highest conviction ideas in their industry, or sub-industry that they're responsible for. And so having these career analysts that often cover sectors for their entire careers, having them be actual investors themselves, we think leads to better investment outcomes, which is why around one fifth of News Perspectives' assets are managed by the investment analyst in what we call the research portfolio.

I also think longevity is really important as well. The average tenure of our analysts is longer than the industry average. So having these very well regarded investment analysts that are experts in their field of coverage, that are investors themselves, that happen to work for the world's largest active only equity manager, means we often get unparalleled access to company management, but right, we are not just meeting top company management. We meet the various layers. We go out, we meet the customers, the suppliers, the creditors, the competitors of the companies we're researching to really get a complete picture of a company's strengths, its weaknesses, the opportunities and threats.

And then just my final point would be, I think the integration of our equity research with our fixed income analysis with our macro and political research really is important - that ability to connect the dots and get a complete picture before analysing is really important.

[7:46]

**DM:** Now look, before we get on to talk about a few stocks and how the fund is looking into 2022, when I think of this fund that I've seen the bubble chart that you present so well, it's sort of today's champions but future champions as well. And it's a blend of that sort of, you know, big global leaders winners today, but also the up and coming ones. And I know you like to get them in to the portfolio reasonably early. How do I suppose you think differently about the sort of the future champions versus the global champions and how does that sort of play out?

**SS:** Sure. Now that's a great question and it really does get to the heart of New Perspectives. So Chris mentioned, what is New Perspective doing? It's investing in transformational change, right? And Chris said that transformational change primarily being driven by change in patterns of global trade, economic and political relationships, but also these multi-generational secular shifts in the global economy. So New Perspective is purposefully seeking companies that are driving and actually thriving on long term change. And within that broad global universe, we think that there is this powerful subset of companies that are well positioned to capture those long term opportunities. And they are, as you've mentioned Darius, multinational companies.

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Just a quick history, sort of a little bit of history, and then I'll directly answer your question, but you know, our observation, when we launched New Perspective, back in the seventies, like Chris said, was we felt that multinationals would be well positioned to deal with change, well positioned to deal with an increasingly complex world due to their flexibility, their resilience, their adaptability. And we felt that these types of companies would be able to generate stronger and more consistent returns compared to the broader global market, because, you know, they can do well in a variety of different market environments. Importantly, that view has not changed today. Even if the companies that we're investing in today is different to 20, 30, 40 years ago.

So what is New Perspective doing? It's investing in a spectrum, and this is the key word Darius, it's investing in a spectrum of multinational companies, from those early-stage multinationals, which we've defined as sort of potential future global champions. You know, what are they? These are typically, you know, your small to medium sized, fast growing companies. Think of these as companies that have achieved, what we call escape velocity. So companies that have successfully expanded beyond their domestic markets and are starting to be embraced by foreign markets. They often have disruptive business models or technologies. They often have innovative goods and services. We try to identify companies that have large and expanding total addressable markets. We want to try and find companies with low penetration rates and ideally big competitive moats, because if we can get those characteristics, these types of companies can offer extraordinarily long earnings growth runways, right? And we're talking decades here Darius, we're not talking a couple of years.

And then we're investing all the way up along the spectrum all the way up to the established multinational champions of today. And I actually think some of the established multinational champions of today have some of the characteristics that I just mentioned, you know, disruptive business models and technologies, the big markets, the growing markets, the low penetration, et cetera, but what they also offer is resilience. You know, these companies offer the strength of balance sheet, access to credit when you need it. The diversified sources of revenues by product, by geography, et cetera. They have the scale. They also have the experienced management teams to weather storms and the different types of environments.

So what you're really getting, I think with New Perspective is in a nutshell, we are trying to deliver our underlying clients, a portfolio of current and potential future global champions, right. And historically Darius, what that has done, investing across that spectrum successfully, has allowed New Perspective to capture the upside as markets are rising, but at the same time offer some relative resilience in down markets, right. Some downside protection.

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Very happy Darius to give you a couple of examples should you wish of maybe one of each in those sort of polar regions?

**DM:** Why not Steve, yeah please, please why don't you.

**SS:** And I'll be brief. But I think SEA Limited, I think is an example of a potential future global champion. New Perspectives has owned it since late 2019. We first bought it when the market cap was less than \$20 billion. Look it up today, it's multiples of that number already. What is it? It's an internet and mobile platform. We think it's in the sweet spot of the digital transformational shift. At the moment it's operating primarily in Southeast Asia, but it is starting to successfully expand across a number of different emerging markets. The business units are structured as follows, a very profitable online gaming business, a loss making but rapidly growing eCommerce business. That's got a lot of growth potential that's really benefiting from the rising penetration of internet within the emerging markets. And then it has this really interesting, but nascent, very early stage FinTech business that again, we think offers potentially significant upside optionality. It's at the moment providing a variety of payment services and loans to different corporations and individuals. So that would be an example of one of these I think potential future multinational champions.

And then if you look at the top twenty positions Darius, I would argue that there's a number of the more established multinational champions of today, a Microsoft, maybe an ASML, which is the world's largest semiconductor equipment manufacturer, or maybe a company like AstraZeneca, one of the leading healthcare organisations. So you're getting a real mix.

[13:33]

**DM:** Right. Thanks, Steve. Appreciate it. Look, it would be remiss of me not to touch on Tesla, which is, I believe the fund's largest holding, also one of the most well-known companies, but also one of the most well-known stocks and a fantastic 2020, but it's also well-known because of its founder. Let's talk a little bit about Tesla, if we may. How do you look at Tesla from a fund perspective? I appreciate it may well be included because it's been nominated by a number of the nine managers and the analysts, but how do you look at Tesla? It's a very controversial and interesting stock.

**SS:** Sure. And I, you know, and I also get the question is Tesla sort of what is Tesla? Is it a potential future champion or is it a current champion sort of, how do you think about it like that? Maybe just a quick bit of background Darius, because look, we've gotta talk about Tesla. You correctly say it's the biggest position in the fund, but actually it hasn't always been the biggest position. We first

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initiated the Tesla position in 2014. One of the portfolio managers owned it in 2014 and the fund has owned it ever since. Back then in 2014, the market cap was less than \$30 billion, today it's part of the \$1 trillion market cap club. So over the time that New Perspective has owned it, the market cap's gone up nearly 40%. And it's the biggest position in the portfolio today because of price increase. Okay. Not because of consistent buying over a number of years, it's primarily, it grew to be the biggest because of the share price appreciation, especially in the last couple of years.

I would argue and I'll get onto sort of the broad thesis, but you know, when people say, is it a current or future global champion? I actually think the answer Darius is it's neither. I mentioned the fact that we're investing across a spectrum of multinational companies, right. And that's really important. I think Tesla is on, is along the spectrum. It's not either of the polar ends. You know, why do I say that? You know, on the one hand, it's a \$1 trillion market cap company, really big, it generates tens of billions of revenues, very big, half of its revenues now come from outside of its domestic US market, suggesting that Tesla has, if you like, successfully expanded globally, right into other countries, like a lot of established multinationals do.

But then on the other hand, you know, it, you could argue that Tesla's market cap is actually very small compared to the underlying markets that it's sector disrupting. And what are they? Autos and energy. You could argue that although Tesla dominates the global EV market, you know, it has just over 20% market share, actually the EV market's very nascent, it's in its early stages, you know, global EV penetration Darius is what roughly today, I think 5% to 6% of the total market. But, you know, as of 2020, low single digits maybe 2% to 3%. So I think from a size perspective, it feels like Tesla is one of these, if you like current global multinational champions, but from a potential growth perspective, it feels like more like an early stage multinational with a lot of potential upside optionality. So hence I say, it's actually not at either end of the spectrum, it's probably somewhere along that spectrum.

Do you want me to touch upon the thesis just briefly without getting into too much detail?

**DM:** Yeah, I think it's such an interesting stock that might add some value. Sure Steve, yes please.

**SS:** Sure. I'll just sort of give like four key bullet points. The first would be that the owners of Tesla in New Perspective think that it is a secular disruptor, right? First of all, in the auto market, we are suddenly the owners of New Perspective are modeling potentially a very attractive runway of electric vehicle revenue over the last decade. You know, we think that Tesla is a pure electric vehicle company. It is vertically integrated, that is giving Tesla a number of structural advantages in our humble opinion, over a number of these legacy automakers. We also think that Tesla's

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technological lead is widening because of its unique electric only architecture that is really important, right. You know, electric vehicles is a software issue or a software problem to solve, the internal combustible engine is a hardware solution. And they're completely different skill sets, what are required to create an electric vehicle are completely different to an internal combustible engine. Think of it as software versus hardware.

A really important point and especially for our thesis Darius is Tesla's not just an electric vehicle manufacturer. You know, there is this growing in-house energy storage and battery sale business. We think that that could become incredibly important in the future and be a significant driver of revenues and profits going forward. I think my final point...

**DM:** So...

**SS:** Yeah, go ahead.

**DM:** So I was just going to say, so not just a car company then.

**SS:** Absolutely not. At the moment people obviously think it's just a car company. You know, those that know a bit more about it will see this small nascent energy storage and battery sale business. But we certainly the analyst and portfolio managers that own Tesla within New Perspective, and it is a divisive stock even internally, Darius. Okay, let's be clear, but there is certainly a view amongst some of our investors that the energy storage and battery sell business could be very important, both from a revenue and profitability point of view.

The other point I should just mentioned is again, the growing contribution of potentially high margin software subscription revenues, right? You buy a Tesla, you then want to pay to have the full self-driving kit that will cost, I don't know, anywhere between \$60 and \$100 per month, each month, recurring revenues, high margins.

**DM:** A nice subscription revenue model.

**SS:** You got it.

**DM:** As well as other parts of the business.



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SS: You got it.

[19:37]

**DM:** So look finally then maybe if we could just wrap up. As we sit here in January 2022, we've touched on the global champions and the sort of the growing champions. Does the fund have any sort of positioning looking out, is there any sort of sector overweights or underweights that we think might be interesting to the audience, just as we close out today?

**SS:** Sure. Let's talk about the positioning and I'll answer it Darius in a slightly different way to sort of just overweight and underweight, I'll try and paint a picture that hopefully resonates with our listeners. So, first of all, you know, New Perspective, it is a core but flexible global equity strategy. By design we deliberately want it to be well balanced as you know, we're not trying to base New Perspective positioning on a small number of top-down binary outcomes. Okay, we are deliberately being well balanced and we're also investing for the long term. So we're not trying to, or what we're trying to do is look through any short term noise and volatility.

But so how's the portfolio positioned? This is how I'm framing it and thinking about it. If I look at the portfolio holistically, you're getting access to secular growth and cyclical growth, both of which are underpinned by this core set if you like of broad, stable, foundational investments, you know, the secular growth is coming from selected digital enablers. The digital disruptors is coming from selected electric vehicle manufacturers and various suppliers within the value chain there and certain transformational healthcare companies. But then you've also got this, what I would call cyclical more economically sensitive growth, selected financials. We own some travel and aviation companies, some leisure and hospitality companies, we're investing in consumption stocks, especially those that are positively are positively based on the emerging market mass affluent consumer. There's a number of construction-related companies that should benefit from the rebound in infrastructure as well.

And then that secular and cyclical growth, as I said, is underpinned by a core set of broad stable foundational investments. Think of these as some steady compounds, some of the subscription based revenue based models. Think of these as companies that are drivers of long-term trends in manufacturing and logistics. So various if you like factory automation and industrial robotics companies, we're investing in some of the drivers of long-term sustainability, both from an environmental but also a wellness point of view. So you're getting a nice blend of secular and cyclical growth underpinned by these core foundational stable investments.

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My final comment Darius, I can't, we can't really have a podcast without talking about inflation, right, given how important it is. When I look within the investments in New Perspective, I do see good exposure to a number of companies that arguably could hold up well in an inflationary environment. There are a number of companies that we think have good pricing power to help offset some of the inflationary pressures. A couple of examples would be companies offering staple like services. Services we can't live without. I would put Netflix in there. You've seen they've raised prices a number of times over the last five or six years, yet subscription keeps on going up.

We're investing in companies with superior products, the durable brands, especially those luxury goods manufacturers that have their inelastic demand and restricted supply. We're also really focusing on companies that have strong competitive positions operating in rational industries with high barriers to entry. The semiconductor businesses are a good example there. And the semiconductor equipment manufacturers are nice examples. So that's really how I'm thinking about the positioning of the portfolio at the moment Darius.

**DM:** Steve, thank you very much, that's been really detailed and thanks for actually coming on and talking about some stocks and some themes. So listen, thank you very much to Chris and to Steve. Simple message from me. If you do like the Investing on the go podcast, please do subscribe to listen to both our back issues and future issues. And if you would like more information on the Capital Group New Perspective fund, please do visit [fundcalibre.com](http://fundcalibre.com)