

TRANSCRIPT: EPISODE 263

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[INTRODUCTION]

Staci West (SW): Welcome back to the 'Investing on the go' podcast brought to you by FundCalibre. We're focusing on an under-represented area of the market today: global mid caps. We consider recent difficulties - and potential - in the sector, and the significance of meeting management when vetting a holding.

Darius McDermott (DM): I'm Darius McDermott. Today, I'm joined by the Elite Radar fund abrdn [SICAV I] Global Mid-Cap [Equity] fund, fund manager, Anjli Shah. Good afternoon, Anjli.

Anjli Shah (AS): Hi Darius, how are you?

DM: I'm very well, thank you

[INTERVIEW]

DM: So, we don't often on our podcast talk about global mid-caps. I imagine you have a huge number of stocks to pick from and lots of geographies. So, let's see if we can't find some interesting investment areas. So, the fund's just gone through its third anniversary. What's been the highs and the lows for you?

AS: Yeah, so I'm really pleased to see the [abrdn SICAV I] Global Mid-Cap Equity fund, which launched in 22nd April 2020, reached its three year anniversary, and AUM has grown from 5 million dollars to close to 95 million dollars during this time. I think what's been particularly encouraging for me is that we've seen a number of the mid-cap stocks held in our portfolio, graduate into large-cap status. So, we can see the process of buying tomorrow's large-cap today, actually working in practice.

DM: Yeah. And I know 2022 was a more challenging year from a performance perspective. Was that in your mind just down to the style rotation that we saw in markets globally, or were there some mid-cap factors attached to that on top?

AS: So yes, unfortunately performance was challenged in 2022, but I think you have to take that holistically and look back at performance over the last few years. So, we saw very strong performance in 2020 and 2021, and last year we saw the X-ing out of some of those excess gains. Now what's interesting is that mid-caps and large-caps have both underperformed last year, so it's not just a mid-cap specific phenomenon, but within that we saw that mid-cap growth in particular was challenged. And the reason for that is because, you know, of course we've had much higher inflation prints from much of the developed world. And, as a result, central banks have been able to frontload their interest rate hikes - people having to adapt to those higher rate expectations and the magnitude of that at a much faster pace, so that led to a compression in the multiples of growth stocks in particular.

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But we're confident that investing in companies with quality growth and momentum characteristics will work going forward, particularly as we're more concerned about the global macroeconomic downturn. So, you know, we should see higher quality companies do better and much of that growth multiple compression or de-rating, now appears to be largely behind us so, valuations are looking much more supportive as well and we think that mid-caps have that bounce back ability effect, where they typically perform better in market recovery environments with the rebound happening faster than most people think.

DM: Yeah, it's interesting, I mean we always think when things are difficult that mid-caps will underperform, but you are saying in that sort of recovery phase is when you expect, you know, mid-caps to really outperform and you know, give some real portfolio zoom if you like, to give a real boom to the portfolio.

AS: Yeah, absolutely. So, I think, you know, certainly you would expect to see large-caps outperform prior to and at the start of a recession, given that people think their earnings come under less pressure. These are more mature, established companies and people are just generally more risk adverse. Those factors get turned on their head in recovery phases where mid-caps, because of their size are much more nimble; they're able to adapt to the changing environment around them, they're able to take advantage of what a growing economy has to offer. But actually, what we find is that mid-caps start outperforming large-caps soon after a recession has already started, and that's because markets are anticipating a macro economy recovery before it actually happens and markets move ahead of the macro.

DM: Well, that's right, markets always tend to lead rather than lag.

Now, I know we're going to talk about a couple of stock names, but also, I know that you are a low turnover investor: you want to be able to buy companies and run them as winners. I know you have a small cap team that maybe can bring some ideas into your fund. How has turnover been in the three years that you've run the fund and are there many names that have been in the fund since launch?

AS: Sure. So actually, a third of the global mid-cap portfolio is what we call small cap graduates. So, names that we have held in our small cap fund that have graduated into the mid cap index that we now hold in the mid cap fund. And actually, turnover is low, and we still have a number of stocks, about 18 stocks out of the current 44 stock portfolio - so about 40% - which were held in the portfolio at the time of launch, that are still held today. And I'm pleased to say that a number of these stocks have actually been our strongest contributors to performance and some of them have even graduated into large cap status now. So again, showing that process in action working of buying tomorrow's large-cap today

DM: As we're talking about running your winners, maybe we could talk about a couple of your top 10 stocks. Cadence [Design Systems, Inc.] was one I know you want to speak about and Moncler [S.p.A]. Maybe if you could tell the listeners what they do, firstly the products that they make, and then why you like them so much?

AS: Sure. So, first of all, Cadence is a US-listed company that is a provider of computational software tools that are used to design and test cutting edge semiconductors.

DM: And we know there's lots of requirements for semiconductors in the world!

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AS: Absolutely, yeah, exactly. So, you know, the growth drivers here relate to the fact that there's a growing use case for semiconductors and also they're getting more and more complex because of [DM: Smaller aren't they? You have to do better, more with them.] Absolutely. They're tiny, needs faster and higher throughput, better power. So, those are the structural drivers at play and the electronic design automation industry plays a critical role within the semiconductor industry. So, simply put, they help to minimise design errors. It's an industry with very high barriers to entry; so, you know, it takes years of training for an engineer to actually learn how to use these tools. And they're deeply integrated into the semi-value chain. So, as a result, revenues are very sticky. Customers are very sticky. So, Cadence actually has 90% of revenues which are recurring in nature. So, that really provides you with a lot of visibility. And this is a company that has consistently beaten expectations, raised guidance, and delivered strong returns.

DM: And how, because from a large-cap point of view, there has been some real winners: NVIDIA [Corporation] up 200% or something or thereabouts, approximately year to date - is Cadence up that type of amount or is there still plenty of juice in that semiconductor story from the mid-cap point of view?

AS: Yeah, so Cadence has actually been one of the strongest performers in our portfolio, year to date. And [it's] gone up very strongly because, as we are seeing this demand for AI coming through, [with] more and more people talking about it, AI needs semiconductor chips [DM: Of course it does, that's what it's about!] And you know, something like Cadence is at the middle of companies that are these kind of platform companies like NVIDIA, but also systems company like Apple, which are increasingly designing their own semiconductors to drive differentiation. So, they're absolutely a beneficiary of the AI trend. And actually, when I met the CFO in London just last week, what was really interesting to me is that he said to me, 'when you take computational software and apply it to data, that's AI. We've been doing that for the last 35 years'.

DM: So, some long history in AI.

AS: Absolutely! Before it was called AI, before the new buzzwords.

DM: Absolutely. And maybe if you could then tell us a bit about Moncler [S.p.A], which is another strong performing stock for you.

AS: Sure. So, something very different. So, Moncler is an Italian-listed company that is a luxury brand with a focus on outerwear, so, famous for their alpine down jackets. So, I can see both of us in summertime at the moment, [we'd] be very trendy in our Moncler jackets were we to wear them. But you know, this is a company that has [a] consistent track record of delivery. It's got one of the best margins in the luxury sector and growth here is driven by 1) growing brand awareness and this kind of exclusivity around the brand, but the continued retail store rollout, particularly in the Asian market, pushing into new categories, so things like knitwear for example. And also, the recent deal that they've done with Stone Island, which is targeting a younger audience. And this is a company that has continued to deliver very strong sales momentum, so even in Q1, they had very strong sales in China and the US and they're also launching products to coincide with their 70th anniversary this year.

DM: And meeting management of these types of companies must be important. I know you are a bottom-up stock picker, so you care about companies and their growth and their revenue and their valuations and their momentum. Yet you must have to meet lots of management. How do you sort of try to work out what good management looks like or is that something that you just grow into over time and get a feel for, is this another 'art not science'?

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AS: Yeah, that's a great question and I do really think it is an art rather than a science. I think first of all, it's always important to meet management before you invest in these companies, to hear them articulate how they think about their own strategy, their vision and their plans for getting there. And often you're looking for softer things as well - so, you know, how does the CEO interact with the CFO? Is he completely speaking over him or is he allowing other people to shine for example? Yeah, so you know, there's all these kind of softer attributes that come from meeting management. You also get a feel for whether someone comes across as relatively well thought-out or conservative in nature. And I think it's important to get a feel for the individuals because at the end of the day they're the ones running the company.

DM: Yeah. And I guess, I mean we're talking global mid caps, we're not talking tiny companies. We would expect management to have a certain skill towards investor relationships or to be polished and or all those sorts of things. So, I suppose actually meeting them and doing the nitty gritty and getting familiar with them over time must add some values too.

AS: Yeah absolutely. And I think, you know, a lot of mid-cap companies still have a kind of 'founder on' element or the family may be involved in some way, or the management team themselves are significant shareholders in the company. So, I think that alignment of interest is important again, so actually, meeting the management of these companies is important.

DM: Now, I want to just, if we could, finish on a couple of parts of idea-generation - we'll come to small-cap graduates, I know we've touched on that briefly - in-house proprietary tool called the Matrix, which looks for earnings growth and momentum amongst a couple of the factors. Where are you seeing an increase from the idea generation, from the Matrix? Is it again stock specific or are there any geographies for instance, I know you talked about a Chinese cosmetic company - is that the type of thing that's typically being thrown out at the moment?

AS: Yeah, so the Matrix is a dynamic tool which is all rating stocks relative to each other as part of the wider universe. The matrix basically has 13 factors, and the largest weightings are given to earnings, momentum, quality, and growth. And the reason earnings momentum is given such a large weighting is because when you do back testing of the Matrix, it actually reveals that earnings momentum is the most predictive factor of future performance. I think what's interesting is when you look at the Matrix right now and the ideas that are coming through - particularly those kind of top quintile names - they're not concentrated in any one geography or any one sector. It is actually quite [a] broad base.

You know, I think there's certainly a debate for some people around whether we're going to see Asian or emerging market stocks do particularly well, given that, you know, these countries have inflation that are closer to the target range, their central banks are near or already at the end of their hiking cycle, and that contrasts to some of the developed markets. And whether that provides more opportunities for those Asian EM stocks and, you know, certainly one of the names that you mentioned, Proya Cosmetics [Co., Ltd.] in China, is a stock that we bought in the portfolio in Q1 2023. And it was a name that was screening well on our Matrix. And the reason for that is because they've continued to reveal results that have beaten expectations, seen positive earnings revisions. So, for those that are not familiar with Proya, this is a company that specialises in cosmetics, so particularly skincare, for mass market Chinese domestic audience. And this is a company that is growing because of premiumisation, expanding from being a single product to a collection, and really kind of going after the younger demographic in those Tier One and Tier Two cities. And it's a high-quality company that's continued to beat expectations.

DM: And then maybe lastly, one small-cap graduate. I know the mid-cap team that you work with obviously works very closely with the geographical small-cap teams and global small-cap teams within Aberdeen

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Standard, so, is there one exciting small-cap graduate you'd like to highlight maybe and tell us why you think it could go on to be a larger company?

AS: Yeah, sure. So, they've actually got a few examples of this, so it's hard to pinpoint exactly just one, but I think one of the examples that really stand out to me is a US-listed company called Insulet [Corporation]. So, this is a manufacturer of tubeless insulin pumps. So, we bought this stock in our global small cap fund back in, I think it was 2016/17 as a small-cap. And it's continued to outperform, be a really strong performer. And the reason for that is they've increased their penetration rate amongst diabetics, which unfortunately as we know, is a growing population size, to do with lifestyle and diet factors - I say that as I've just eaten some chocolate <laugh> - and you know, so there not only is a growing demographic, but this company has really helped to broaden access and reimbursement, so their device is available through the pharmacy channel in the US, so eliminates the upfront cost associated with getting the device. So, this is a name that has then graduated into mid-cap status, and we bought in the global mid cap fund at the time of inception. And again, this is a name that's continued to do well. It's actually now just launched its first automated insulin delivery system called Omnipod® 5, which is if you like, a step closer to an artificial pancreas and you know, helping to target Type 2 diabetics as well, which is an even larger population size. [DM: Yeah, even larger market, yeah.] Exactly. So, this is a name that is basically on the cusp of becoming a large cap now. So, you know, that is a example of a stock that's gone from small to mid to now potentially going into large-cap status.

DM: Anjli, thank you very much for running us through your fund, the abrdn [SICAV I] Global Mid-Cap fund.

SW: With limited funds specifically targeting the expanding mid-cap space, the abrdn [SICAV I] Global Mid-Cap Equity fund stands out due to its strong credentials. For investors seeking pure exposure to a high-quality growth portfolio comprising medium-sized companies, this fund presents a highly competitive choice. For more information on the abrdn [SICAV I] Global Mid-Cap Equity fund visit fundcalibre.com – and don't forget to subscribe to the Investing on the go podcast, available wherever you get your podcasts.