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investing ON THE go

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[INTRODUCTION]

Staci West (SW): Welcome back to the Investing on the go podcast brought to you by FundCalibre. We discuss how rising global tensions and market volatility impact portfolio strategies while highlighting where investors can find value in today's challenging economic environment.

Joss Murphy (JM): I'm Joss Murphy, research analyst at FundCalibre. Today I've been joined by Ben Peters, manager of the Evenlode Global Income fund. Hi, Ben. How are you?

Ben Peters (BP): Yes, very well, thank you.

[INTERVIEW]

JM: Great to hear. Well, Ben, your recent commentary said that this fund is different by design from the wider market. So let's start there. What makes this fund different? What are you trying to achieve for investors?

BP: Yeah, with the Evenlode investment approach, and this applies to all the strategies we manage, but I'm talking about the global income strategy today. Really we're looking to deliver good total returns to our clients through time and for our income focused strategies that really is about delivering a growing income stream to our clients. And certain types of companies are able to do that.

So we look for companies where they generate a lot of cash, generate a lot of free cash flow from their operations and then can use some of that to pay a growing dividend through time. So that's really our focus and that leads us to invest in certain sectors and not invest in other sectors. So therefore the fund is quite different to the market and some of the sectors where we find companies that we think can consistently deliver dividend growth through time are, you'll find them in the fund.

So consumer goods, healthcare, information technology, an interesting one at the current time. Certain sort of business to business media companies, business services, et cetera. Where we don't find so many of these types of companies are in some quite big areas of the market. So energy, particularly oil and gas is one. Banking, insurance is another. And it's really important to say that we're not saying you can't make money investing in those companies at the right time, if you know what you're doing. It's just for our strategy and for our core aim of dividend growth we prefer to look elsewhere.

JM: Certainly makes sense. Ben, after consecutive days reaching all time highs, the US market fell earlier this week due to rising tensions in the Middle East. Do increased tensions and market volatility over the past few months worry you in this fund?

BP: I mean, I think that people should generally be worried about the tensions in the Middle East, and of course, war and outright war in the Middle East would be very undesirable for everybody. So I think as citizens we should be concerned. I think when it comes to a portfolio like the one that we are managing for our clients, you know, we're looking to insulate the portfolio from a very broad range of macroeconomic and geopolitical risks. So, you know, we think that the best thing we can do for our clients through time is execute our strategy. So invest in good businesses as we define them, let them compound over time. So reinvest in themselves and grow through time and sort of leave them to it really as long as the market valuations make sense?

And the best way for for us to do that with our approach really is to say, well, do we have a portfolio where there's relatively limited exposure to any one particular outcome? So that might be to do with the Middle East. It could be to do with, you know, the US/China trade tensions. And of course most companies are going to experience challenges along the way from any of these things. You know, we saw the supply chain disruption after Covid, for example. You know, the next thing in a year's time will be different to the things that have gone. But, you know, are these companies able to weather those storms and companies that generate lots of cash flow where their customers habitually buy their product is very key where they become either important to the sort of day-to-day operation of a business, or they're very important for a consumer and the consumer franchises, they're able to use their cash generating ability to deal with volatility in their operations. So that's really where we focus the Evenlode funds.

JM: As you alluded to earlier, you have a significant area of the portfolio dedicated to consumer staples. Is this area not on a downward trend with more people worried about the cost of living and less disposable income?

BP: Yeah, it's a really good question. And if you look at the sort of recent history of consumer goods, I mean, it's been very fundamentally affected by the pandemic. So, you know, when people are able to be out and about, they're gonna buy certain types of goods when they're locked in their houses and perhaps more worried about things like cleanliness. You know, we saw sales of things like Dettol go through the roof, you know, so things have changed quite a lot over the last four or five years because of the pandemic and then the effects of the pandemic in on supply chains. So we saw input cost inflation for these companies and that then had to be fed through in order that they maintain or recover their profit margin in rising costs to consumers. And that's clearly, you know, it's been very much in the news for obvious reasons.

What we're now seeing is that consumer goods companies are tailing off on those price increases. They put them through, they have recovered their margins, their cashflow that they had pre price of the pandemic in most cases. So they don't actually need to increase their prices unduly from now on. But as you say, you know, some of the stimulus that from the pandemic is starting to be, have been spent down and, you know, there are signs of a slowing economy. So what happens normally in that scenario is you see some trading down, most consumer goods companies have got what's called a price ladder so that people can stay within the products that they like, the brands they like in more extreme sort of downturns. Then people may sort of come out to the bottom of that and into private label. And you see that in some limited cases.

But actually, you know, most of the consumer goods companies that we follow are seeing that that's not really happening, but they are seeing some, you know some change in consumer behaviour, but not so to the point where they're sort of leaving their products entirely. So they are actually seeing now starting to see volume growth. So they're selling more products rather than the sort of price driven growth that they saw. And in sort of last year and the year before in response to the input cost inflation.

JM: So where do you see the best opportunities today then?

BP: Yeah, well, it's really where the Evenlode Global Income portfolio is positioned. So the biggest sector is consumer goods. It's pretty diversified under that. So we've got anything from sort of day-to-day essentials from a company like Unilever or P&G through to luxury goods in LVMH, sort of via L'Oreal and cosmetics, if you like. So it's pretty diversified, but actually that's a sector where we do see good value. We see steady growth. It is a sector where we get a bit more yield today. So you are looking at yields of typically 3% to 4% in that sector but with some pretty steady returns under the bonnet there.

Healthcare is another area where we see good value. And that's a similar sort of dynamic in terms of being quite, I suppose, "defensive" in its characteristics as in not very exposed to the economic cycle, but where we also see good valuations. And I think that the valuations there are good partly because of what you mentioned in terms of the underlying consumer dynamic at the moment, which, you know, the market tends to worry about a bit. But for long term patient investors, that presents an opportunity.

Healthcare actually, I think has been sort of held back in terms of market returns by the fallout from the pandemic where some companies, they performed extremely well for obvious reasons in the pandemic being, you know, like a medical testing company like Quest Diagnostics or something. There was an obvious benefit to running a lab in Covid, but that revenue has come off and the market tends not to like it when it sees a shorter term negative performance, even if it's sort of bringing it back to the pre pandemic normal, which is what we think is happening. So healthcare is certainly an area where we see value.

And then one of the bigger areas for us is what gets called as industrials, but for us it's really business service companies. And in there you find companies more like business to business media companies like Rex Bolters Clear and also outside of that sector we've got some information technology companies. So we do hold Microsoft for example, but that's a holding where it's performed very well in the market. You know, sure we'll talk about artificial intelligence, but you know, it's been deemed to be a beneficiary of that trend. We still think it looks decent value, but it's not as interesting as it was when the share price was that much lower. So, you know, we have sort of paid that position size back to reflect the fact that the valuation is okay, but it's not as exciting as it was.

JM: And just going back to AI there, Ben, no podcast seems to be complete without the mention of it. You have, as you said, a holding in Microsoft, which I believe is invested heavily in data centre capacity to serve demand of AI. [**BP:** Yeah.] Is this an opportunity for the business?

BP: Well, it certainly is, and I think that when it comes to artificial intelligence, I mean, it's an amazing technology, isn't it? I mean, if we are sitting in doing this podcast in 20 years time, we will be using artificial intelligence tools absolutely, no doubt. And the way that we're using them, I would imagine we can't even conceive of right now, you know? So, you know, I think that the future is bright for AI. I think that there is a near term opportunity for some companies, but Microsoft is investing very heavily, as you say. So we're actually looking at that, and there's a sort of a bit of a shift in its business model, so it's now spending a lot more on capital expenditure. So, you know, buying AI chips, it's buying data centre capacity, as you say.

I think that for Microsoft itself, you know, it can choose to do that. If it doesn't see the customer demand, then it can slow that down very easily. So that bit, it is turn off and audible but we are watching the total expenditure there because it does cost money. And I think this is the main thing around artificial intelligence. It’s certainly there, it's a very useful technology probably. I think that actually the monetisation of that technology remains to be seen how that exactly happens. Just like in the early days of the internet, it took a while for people to figure out exactly what the business models were that were gonna make money. I think it's gonna be exactly the same with with artificial intelligence, you know, it will be monetised, there will be some very, very useful applications that come out of it. But we are in the early stages of that.

JM: You seem very excited about the prospects of AI. Is this a wider theme in the portfolio currently, or something you're watching closely as a potential for the future?

BP: Yeah, I mean, I think it's an exciting technology and I think that the, you know, I used to be a scientist, I'm a bit of a bit of a nerd at heart. You know, it's an exciting technology, but I think it, the focus in the market is on companies like Microsoft. Nvidia, of course, you know, that's gone rapidly to $3 trillion valuation very famously. So in AI chips that is interesting. We just had the news that Open AI, the Chat GPT makers, that just raised a record amount, that's a record valuation for a private company is latest fundraising round. So there's obviously lots of excitement in certain companies in the market, but I think that the real interest will be when companies start making AI driven tools for use on the ground. And we see that in the portfolio.

So yes, Microsoft is an example. They're delivering the sort of the tools to be able to enable people to make applications. But if you look at companies like Volta, Crew and Rex, which are for those not familiar with the companies, they service sort of professional services like legal accountancy, healthcare professionals with data and analytics. And that's an obvious area where, you know, you could see sort of discoverability, search ability that sort of thing, you know, summarising thousands upon thousands of legal documents in a way that, you know, no human could. I think that's an obvious use case.

But I say, you know, the real interest will be when the use case comes along that none of us have thought of. And we'll be like, wow, how did we ever do without that? Just like we think about things like social media now, but we didn't think about it, you know, 20 years ago when Facebook was in its infancy or whatever. So, you know, I think that the theme is definitely there. Experian in the world of credit scoring and credit referencing, you know, there isn't any company that which is not going to be using in some way AI tools and another obvious use cases in marketing and creating marketing campaigns. So it'll be there but it's actually the sort of coalface the applications that we really, really interesting in time.

JM: It definitely is a fascinating topic and a lot to be discovered. Ben, this is a high conviction defensive, quality led portfolio, which has been out of favour in the market in the past few years. How have you continued through this?

BP: Yeah, I think running a strategy which is different to the market, you know sometimes the strategy is going to outperform in market terms. So the market participants, whoever they are, other investors, short term traders, whatever, it's going to go with the flow. And then sometimes conversely, the excitement is going to be elsewhere. And if you look at the last few years you know, on the back of Russia's invasion of Ukraine, oil and gas was very strong. If you look more recently, financials, particularly banks and insurers have been very strong. And you've had the sort of AI kind of enthusiasm on top of that, of which we do have some exposure. But you know, it's been fair to say there's been some very, very big movers in the market there that we haven't owned.

So how do we sort of deal with that? Well, first of all, I think it's important that we understand that's going to happen ahead of time and understand why it is that we invest in this way and because it's good for you know, putting, we have to stay risk. This is equity investment and one doesn't get a return without risk, but we manage that risk and we think that by doing that, we can execute this through thick and thin for the long term, thinking about, you know, the returns that are not just the ones that have just happened, but the ones that are to come and the ones that are to come over a long period of time. So, you know, making sure that the underlying economics of the businesses make sense is really, really important.

Are these companies growing? Are they dealing with the volatility that there is in the world? There's always something going on. Are the cash flows coming through? Is the dividend growth coming through? Asking really basic question for our strategies. Is the dividend growing and is that backed by solid business fundamentals, solid business performance?

And we do evolve the portfolios through trying to manage valuation risk in the market as well. And sometimes we change our minds on companies where we feel like the investment case has changed. That might be due to some news flow or maybe we've done some more research. But, we are always open-minded about companies, but as long as we've done that work, we can see the performance going through in the companies and then ultimately for very importantly for our income strategies, the dividend is growing, then that's the thing. They're the things that we can control. And that's what we do. And we understand that when, say banks are outperforming, that's going to be a headwind to our relative performance.

JM: And finally, what is your outlook for global equity income as we look further ahead to 2025 and beyond?

BP: Well, I think that a lot of the kind of discussion you see in the media and the headlines and things is about the general market level. And generally, equities look quite expensive globally. I mean, this is particularly driven by the US and the US is such a big market these days that one can't ignore it. But underneath the headlines, actually, there are a lot of companies, really good companies where they've got great competitive positions, they generate their cash flow, they have got good customer propositions and they're trading at pretty reasonable prices. And clearly we are positioning the global income portfolio, even a global income portfolio in those types of businesses at those market valuations. And actually, there's plenty to go out there. So whilst, you know, you will see lots of headlines about the general market level looking a bit expensive, if you dig below that, there's plenty to plenty of companies where they are really good, they are gonna certainly be here in, you know, 10 or 15 years time doing their thing for their customers.

And you can buy those cash flows you're gonna get if you own those companies at a pretty reasonable price right now. So I don't really know what's gonna happen, sort of looking into 2025 and beyond. Of course, I don't have a crystal ball any more than you do. But I think that if I'm thinking about my own savings invested in this fund - which they are - and I think about what the future for these businesses is and how they're performing right now, it stacks up. So that makes me feel pretty good about equity investing as long as you're sort of doing it diligently and doing it sensibly.

JM: Ben, thank you very much for your time today.

BP: Pleasure. Good to be here.

SW: Managers Ben Peters and Chris Elliott believe the market fundamentally underestimates the value of high-quality businesses because of its obsession with short-term events. This fund aims to balance the income received today with future dividend growth. To learn more about the IFSL Evenlode Global Income fund please visit fundcalibre.com