

TRANSCRIPT: EPISODE 396

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[INTRODUCTION]

Staci West (SW): Welcome back to the Investing on the go podcast brought to you by FundCalibre. In this episode, we explore how markets behave through cycles of emotion, valuation, and disruption, and why long-term investing requires discipline when narratives shift quickly.

I'm Staci West and today I am joined by Nick Clay, manager of the TM Redwheel Global Equity Income fund. Nick, thanks for joining me today.

Nick Clay (NC): Thanks for having me.

[INTERVIEW]

SW: Now, I just wanted to start with a little bit briefly of a big picture. You have been investing since the early 90s, a period of time that has had crashes, booms, inflation shocks, pandemics, and pretty much everything in between. So what still surprises you about markets today? I mean, maybe it's nothing, maybe you're like, nothing surprises me, but what is it about markets today?

NC: Thanks for pointing out how old I am <laugh> and not how young everybody is. No, so what surprises me about the markets, I think really is you also, I get surprised by how the markets unable to learn <laugh>.

I mean, there's the famous quote that market learns in cycles, why it doesn't learn at all, just keeps making the same mistakes again and again. And that just ends up being entirely true. Yeah. And I think that's just because we're human beings. We're emotions govern what we do. I'm a different, you know, that's why we need disciplines in what we're doing on our strategy. It stop me being who I'm and those emotions, you know, lead to, you know, these excesses in interpretation of what's going on. So whether it's from greed aspect or from a fear aspect.

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And obviously right now it's, you know, it's more leaning towards greed, certainly, but what it means is you just get these great waves in markets. And I find that interesting because it happens again and again and again. And yet the market doesn't seem to be able to learn from that and work out to take a slightly more balanced view or to couch things in things that matter, like valuation and therefore reduce that volatility. And the only way that seems to happen is when we get external influences put upon markets to drive it in one direction, in a straight line. And that's the only way you sort of remove volatility from markets.

But the reality is that just creates yet another bubble or whatever, another excess and leads to greater volatility down the line. So I find that interesting that, you know, despite the fact we've been doing this forever and, you know, computers and algorithms and everything have been introduced into investing it doesn't seem to change the fact that human emotion still be, seem to be the largest driver of what goes on in markets. And I guess recognising that and trying to do something about that to counter that is what's key in trying to do something successful over the long term.

SW: Well, I mean, the reason I ask is because I saw something recently where you described markets as returning to normalcy, so what does normal actually look like then in 2026? I mean, you've talked about moving through cycles, investors behaviour, not really learning and kind of coming back to things. So what does normal today look like and maybe when you compare it to kind of a post global financial crisis type world that so many investors got used to?

NC: Yeah. I mean, and yeah almost many investors, I would say probably the majority investors have only known post-2008 investment backdrop. And that's been one where we have been swimming in excess liquidity permanently throughout that period. And that has implications. It has implications for risk what level of risk they would need to take implications for how people believe markets are gonna travel, which is upward only. And people believe that cycles have kind of been obliterated and they will not be cycles anymore because government central banks will just step in to make sure they never happen.

And I think that what we're starting to see now and of course what that's done is dampen down volatility over that period. You know, we've obviously had some spikes in that with COVID, et cetera, but generally the trend has been one of pretty low vol, and that certainly has been the case since COVID.

And what we mean by return to normality is when you step back and look at the long-term trends in markets. So going back to the 1950s on the S&P for example, you can see there are great periods where you have much higher levels of volatility in markets. It doesn't mean the markets go down, that's not what I'm saying. Markets can still go up during those periods or whatever, but they're just more volatile. And that we would argue is more normal. That is a more normal environment for equity investing.

Now, that's important. When things are going up in a straight line and there's no volatility, then you'll end up investing in a way where it's all about upside capture is can I beat the market on the way up because you've got no downside risks to have to think about. But when things are more volatile, then thinking about the downside, risks become far more important because that's just math, you know, the massive compounding a number over time, consistency in the number is far more powerful than volatility in that return path. And so we think that, you know, we're starting to see signs already of a return to more volatile markets.

We saw it obviously in 2025 with Liberation date. We are seeing it again this year with, obviously with what's going on in the Middle East. And that return to volatility means people need to think slightly differently. And given where we are in markets today, which I would argue is sort of peak confidence you

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know, got peak certainty of what's going on, what the outcome's gonna be, we've got markets all time highs by everything that's happening. I think that is just only increasing the risk and probability return to more volatile times. And of course that means downside capture becomes a more important element of a process and a way of generating a total return than just trying to get as rich as you possibly can by Monday. Which seems to be the way people think today.

SW: You mentioned obviously the downside capture and at the very top, we talked about discipline and importance of process. So this fund has a sell discipline, which means that you can be a forced seller at extremes, which is something that we have talked about before. But has this discipline been tested further in the last, say, six months? And, you know, if so, is there any examples that you can maybe give us of where this has happened?

NC: So we haven't had to sell anything via the yields discipline. IE sell discipline being that we have to sell everything that yields less than the market, primarily because the market keeps going up to all time highs. And so it keeps driving down the yield of the market, and we're a mighty 1.5% today on MSCI world is our yield hurdle. So basically, yeah, the hurdle that we have to go below is just getting lower and lower.

However, having said that, things have gone up a lot. And therefore from a pure valuation point of view we have had to sell some things. And the way we think about valuation is we think of the range of outcomes for the cash flow of our company. And that creates a fan, you know, a sort of range of what could happen. And we want to discount that back to today as an 8% discount rate because that is the very long term return on equity markets and what you're trying to beat. And then see if that fan of outcomes when it's discounted back to today's skew in our favour and of your risk rewards in our favour, or if it's all skewed to the downside and it's asymmetrically skewed against you, and then you wanna sell.

And that is what happened to the fan of outcomes for Cisco Systems where we got to a point at the, towards the end of last year, beginning of this year, where that fan of outcomes was effectively saying to us that in almost all circumstances you weren't gonna make any money out of Cisco anymore. And so therefore we sold it and recycled it into something else.

Now, you know, when we think about that and then we look at, well, what were, you know, what had happened to Cisco? Well, since 2024, Cisco's share price has gone up 120% since August 2024 to today. If you look at what's happened to its earnings forecasts for 2026 and 2027, so the earnings we're expecting to come they've gone up a mighty 9% over that period. So it's in a pretty sharp rerating in the stock. We're up to 34 times PE as low as a 3% free cashflow yield on the stock. And we're all about seven times sales. Now, you know, if you are an uber bull, you would go, well, it's got a long time to go yet, because look what it peaks at in 2000 when it was got nonsense in the tech bubble. But if you look at the last 10 years, that its peak valuation has been on for 10 years now, what that's effectively saying to you is that Cisco Systems can change its business, that it's going to become a higher margin, maybe higher growth business structurally into the future. And yet there's precious evidence. So that's the case. It's not that Cisco's a bad company, it's just we don't think has the ability to have a complete step change in its gross trajectory or its margin trajectory, and yet that is what the share price is kind of demanding it has to do now from here. And so we're perfectly happy to sell that when that fan becomes asymmetrically spates us, despite the fact, you know, these fans become asymmetrically screwed against you because everyone's now in love with that company.

You know, everyone is in love with semi's companies, everyone's in love with everything to do with AI. And that's why you need the disciplines and the system in our process to say, yeah, if the fans become like that, well then we just rotate it into something else in the portfolio, despite the fact everyone in the world is telling you that's a stupid thing to do. You should just run these things to the moon.

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SW: Well, let's talk about the income side then of the fund for a little bit. You mentioned the yield there. So income investing has had a strange few years. We've had dividend cuts during COVID, we've had inflation reshaping expectations of many, many companies. So what does a reliable income mean today for you?

NC: We think a reliable income from our companies. The way we phrase it is to say that our companies can suffer. And what we mean by that is they can suffer the range of outcomes that we could potentially, you know, face.

And the two big things there is a return of inflation and that inflation is structurally higher than it has been for the last 10, 15 years. And therefore, do they have a business that can cope with that? Do they have a business that has got pricing pressure, power? Is it a business that, you know, sells stuff that you're gonna have to keep buying in respect of how high the price goes or you buy it because the price isn't a really a relevant consideration or it's just a legal requirement? And I, things like insurance, for example, where you have no choice but to keep buying your car insurance or they are businesses that can suffer in a recession. And therefore have a defensive characteristic attached to them.

And being able to suffer, having business models which are able to do that should enable them to survive in volatile environments too. And what that should ultimately should mean is that they are able to continue to generate and grow their cashflow over time. And if they can do that, then they should be able to continue to grow their dividend. Now, if they can genuinely really suffer particularly in an inflation environment, which is the, you know, the really hard one for everybody then they should be able to actually grow their dividend faster or in line with inflation, which should be able to compensate our plants in a real sense for what's going on.

And if you look at, you know, UK inflation over the last five years since we've been at Redwheel is 5%. If you look at what the dividend distribution in sterling has done on the strategy over that period, it's grown as a cagr of 10.7% over that period. So you can see that the companies are able to be able to suffer and are able to grow their cash flows faster. And, you know, and that's during a period of pretty elevated inflation on historical standards for the UK of around 5%.

And one ultimately we think is going to be the bad job we're gonna face. Because, you know, we think inflation is the only way out of the debt situation for all governments. So we think inflation is the most probable outcome we face is elevated inflation for a long period of time. And so that's what we look for when we say reliable income is, can our companies suffer? Can they continue to grow the cash rate? Therefore, can the dividend carry on beating inflation? There's a growth at a great rate that compensates our clients.

SW: You had joined me about a year ago on this podcast, maybe slightly less than that actually, and we had a strong debate, let's say, on US exceptionalism and mean reversion. So now that I have you back, I'm curious if since then, have markets moved in a way that's further reinforced that view, or has it been challenged? What's happened?

NC: So it's oscillated, I would say it started to go down the view that American exceptionalism has been taken too far. That began with Liberation Day sort of Q1 of last year. And then it started to reassert itself a bit actually in the second half of last year. But the dollar remained fairly under pressure. As we caught to the turn of this year in 2026, it was really starting to assert itself.

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And I mean, I find this interesting going back to the first question about learning, I think, I mean, how the market flips on a six months. So, you know, the beginning of this year we had concerns about capital and how the inflation that we were seeing or the challenge of energy to produce all of that, the inflation we were starting to see in the supply chain of AI and how we are gonna cope with that, the ultimate end demand, was it gonna be high enough to justify all this investment? And when might it all happen, is it still a long time into the future?

And of course at this point, you know, American exceptionalism was starting to stumble a little bit and elsewhere was becoming a more favourable base mainly on valuations. And then we had the war. And then of course the war has, you know, it's increased the cost of everything. It's increased the cost of energy, it's increased the cost of heating, which is pushing up chip prices. Memberships continue to go up. You know, some of the major buyers of AI might need to spend their money on something else like rebuilding some of their energy infrastructure yields across the curve have all gone up. So long duration cashflow should be discounted at a high yield, so worth less today. And yet what's happened there is US exceptionalism has returned and tech has gone to the moon and AI euphoria has returned.

So despite the fact everything we were worried about in January and February has actually got worse incrementally where now far more confident that we're completely right and everything's gonna be wonderful. And again, it's this sort of emotions that plays in markets. So the war, ironically, even though, you know, America sort of instigated the beginning of it they are seen as the one by the market that the least impacted by it, and therefore it's splendid isolation, it's everybody else's problem, not their problem. And therefore people have gone back to have gone back to America initially as a bit of a safe haven, which made sense because it was profit taking and the things they'd already done well, gold, et cetera.

But now since, particularly since the end of March you have seen the sentiment swing right back again to semiconductors and AI and all things to do with AI utopia trade. And that has been driving, you know, anything related to it, to insane valuations. I mean, I think I saw yesterday that Intel is up 100% in a month or something like that. And the semiconductors index up 65, 70% since the March 30 lows.

And again, what's interesting about that is that the PE on semiconductors hasn't moved. So everyone would go, you know, it's gone up a lot, but it doesn't matter. It's no more expensive than it used to be. It's on the same PE because the earnings have gone up a lot. And so there's totally justified what's happened, but when you look at the price of sales that has gone up about 65-70% IE your revenue not grown, your revenue assumptions have not changed, but your earnings assumptions have dramatically gone up. Now, what that means is the market's saying that the margins of these companies are gonna dramatically be higher. And what they're trying to say to you is that particularly in semis that because of the, you know, shortage of supply and massive demand, they've got permanent pricing power and therefore can earn these permanent higher margins forever. And they're structural.

Again, going back to the first question about learning in industries is semiconductors is a cyclical industry. It's always been a cyclical industry, and yet now the market's going, no, no. It's a structural growth market and it's a structural growth industry. These margins are permanently high forever, and that's what justifies the share price movements. And yet we work in a capitalist society. So I mean, unless the capitalist world has stopped, you know, we'll attract more and more capital to this, which is what commoditises it, which brings it down, which makes it cyclical. And so we think here we are again, you know, making the same emotional mistakes of believing something to be permanent forever, when it's unlikely to be so.

SW: And you were significantly underweight the US last time. **[NC:** yeah] Is that still the case?

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NC: Until April and then April's been hard because we can't own all these overvalued tech stocks. You know, technologies, our biggest underweight we can't own them. And that's fine. So I mean, yeah, so probably upfront, you know, if AI utopia is right and we are going to have a step change in company productivity and we are going to be able to earn far higher margins in all industries than we've ever been able to do in the past because of what AI can do for us at the same time is not destroy the employment base and make everybody unemployed then that is utopia. You know, we're all gonna be far, far wealthier companies gonna be far, far more profitable far more reductive and therefore be able to do incredible things and no one's gonna suffer from it.

If that is the case and that is the outcome, then this strategy is not gonna be the strategy for you. You know, you want our outgrow probably a Nasdaq ETF or something because it's difficult with the concentration for anybody to get anywhere listed. However, if that happens, not to be the outcome, if there's any kind of difference from that, if it turns out in a different way. And don't get me wrong, our working assumption is that AI is adopted by anyone and everybody but we think it's adopted by everyone and anybody because it commoditises, not because we're all gonna pay an absolute fortune for it. But it that it will be everywhere and it will be incredibly disruptive and for businesses which might have been quality in the past, but might not be quite so today but it won't be quite as smooth as it's wonderful and everything is great and that any kind of disruption from that, whether it be whoever the winners happen to be.

I mean, you look at the top 10 companies today, and they're 40 plus percent of the S&P, the top 10 companies for the last four decades have never been more than 20% of the S&P. We are twice as confident today that we know who the winners are gonna be than we've ever been in the past at a period where we've got probably the largest disruption happening ever in our lifetime in terms of speed. And effectively they're spending a trillion dollars a year to try and make this disrupt everything.

So we've got the most uncertain outgoing yet we are the most confident we know who's gonna win that. That just seems to be smacks of complacency in my eyes rather than you have absolute certainty about what's gonna happen in the future. And so if you, if there's anything different happens <laugh> and the outcome changes, then you might want to think about having a little bit of this as well as your ETF.

SW: Well, I did actually wanna finish with quality because, again, you had written that we are moving beyond this 'quality at any price'. So for a long time, investors were told that they had to pay up for quality companies, and we're now in a world where that trade off between the quality and price is maybe mattering a little bit more again. So what is that change that you are seeing that's kind of signalling that we're moving beyond this phase? And then, but also, what should we then be focusing on? What should investors be focusing on?

NC: So it is the disruption. You know, AI is going to bring disruption to a lot of what have been previously very high quality businesses because of the moats around their business. And yet a lot of those moats are genuinely now gonna be challenged. And that means that having gone through a very good period up until about the start of 2025, where quality had done very well for, you know, decades or so, and got to the point where you just buy quality at any price that isn't the case anymore. Because the thing about valuation is valuation is the expectation of what that company has to deliver. And when it's very high, they have to deliver incredible things. And when everything's smooth and perfect and nothing's going wrong, then companies have an ability to do that.

When things become more difficult, obviously then it, you know, the chances of disappointing go up and then you're on a very high valuation, chances are you're gonna become pretty volatile on your share price. You could lose a lot of money too. And, and AI disruption is certainly gonna bring that. And to companies

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where, you know, previously, for example, having very large databases was seen as your moat, but those databases were ultimately public. It historically it was borderline impossible time-wise and cost-wise to replicate those databases. That is not the case anymore. And so there will be businesses out there, which we have historically thought of as almost Teflon, and that isn't gonna be the case anymore.

However, having said that in the way that the market is now coming to grips with that and deciding that there are these businesses at peril in true market fashion, we keep going back to the first question. In true market fashion everybody gets told with the same brush. And so that is going to provide some opportunities.

And we've gone from expensive quality companies to now quality companies, which are looking very good value. And dare I say it, I mean, I was a presentation not that long ago and a value investor was presenting and I put up my portfolio and you went, oh wow, portfolios are quite similar. This the first time we've been able to buy these companies because they're on value, you know, measurements. So some of these quality companies have underperform so much, they're actually coming into a value universe. And, and so that is gonna present opportunities, but you're gonna have to be pretty active in turn to select the ones which you feel have the requisite characteristics to be able to survive the disruption coming.

What that means, going back to this being able to suffer as a company, what that means is do they have the ability to adopt AI into their business for their clients without the competitors coming in and undermining them, taking their business away or putting in credible price pressure upon them. And so what are those characteristics you're looking for?

So for example, we bought recently Amadeus in the portfolio that provides all the flight systems to the airline industries. They tend, tend to use one of these systems so they don't use 200, so therefore trying 201 isn't that bigger cost. And we might as well try and see what happens and it's a coder in a beanie hat and headphones, and they can do it differently if it's one system and it runs your whole business. And it's so important that if you don't have it right, your planes don't get off the ground, et cetera, your ability to take the risk on something completely new is probably quite low. And so therefore it gives ams the opportunity to adopt AI into assistance for its clients and move forward. It has the ability to suffer that disruptive transition that's gonna go through as pretty much industry's gonna do. And those are the kind of things we feel can throw up some value today, but that valuation gonna are gonna,

SW: And finally, I mean we've kept coming back to this in initial first question but I do wanna try and just come back to it one more time. You mentioned markets going through cycles, but also investor behaviour and emotions during those times and how you kind of can forget or block out. And we did talk about it with global financial crisis, that there's probably quite a few investors that are still mentally emotionally anchored in this low-rate, high liquidity world that you've talked about. But then as we've discussed in this podcast, you know, there's a new regime coming through and things are changing and the cycle is changing.

And so what would you kind of say to investors of what are you focusing on long term with your experience of going through - we won't mention the length of time - but what would you say that they should be focusing on? What are you looking at when you're talking about long-term investing today with that kind of understanding that there's such an anchor in our behaviour and what we've gone through and how cycles move as we talked about at the top of the interview?

How would you just bring that together to where we are today and you know, are people kind of adapting or understanding this new regime or era that we might find ourselves in?

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NC: So my oldest son is doing this GCSEs as we speak, and I think he's got history this week and history is what you should go and have a look at.

SW: My least favourite subject! <Laugh>

NC: So go back longer than 2008. Go back as far as you possibly can. And lots of very clever people have done this thankfully for us. And so you can just go and read what they've done. And what it teaches you is that things can be wildly different from the environment we've been in for the since the financial crisis effectively. And that actually that period of time is in that really that longer time when you put it in the fullness of time. And therefore to think what were to happen, were we to come outta those situations? And why might we come out of our current situation?

And this could bring, it sort of circles me back to inflation seems like the most probable outcome we're gonna have to face because it's the only way to get out the debt situation the governments find themselves in. But you know, when I speak in presentations and I say, you know, in the 1970s interest rates peaked at 18% or whatever it was in America. I mean, I literally see everybody look at their phones and go, he's obviously lying. And they go to Google to check that this is the case.

SW: They need to fact check you

NC: Yeah, I mean people literally kind of going, that's just made up. That's rubbish. Because obviously the immediate emotion is, well, interest rates could never go to 18% today because obviously the world would be kaput. And a lot of things would suffer in that environment. And so it's trying to think about the possible range of outcomes and not be anchored to just repeating what's happened in the past in the recent past to just guide you, which is what everybody does.

As I think we said last time, the most dangerous investment tool everybody has is a ruler and they just put it on the trend and that's the trend that's gonna be there forever. And that's what everybody does. And so I would say go back and look and then what you find when you go back and look is that what makes up your total returns over time oscillates and it goes through these big cycles and it, and it's based upon the starting valuations in markets.

So when valuations are cheap, then your next 10 years of returns tend to be really good and they're also driven by the capital, by everything going up. And of course then as we talked about earlier, that means you need to invest in that way, you know, read kind of thing, try and make as much money on the upside. But when things are expensive, which is where we are today, when things are expensive, then your next 10 year returns tend to be much harder to come by lower. And the majority of it is made up by the compounding of an income. And so your total return is made up by the capital, the things going up and the compounding of your income now.

And nobody talks about compounding income because it's all about rich, rich, rich. And so, you know, reminding people that that is a meaningful part and driver of your total returns over the long term. And given where we're starting today, probabilistically likely to be a large driver of your total returns for the next 10 years.

So having something that focuses up on that puts it at the heart of what they do, we think becomes a quite a relevant thing for clients going forward for the next 10 years. But it's only when you look back in history that

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you can actually see that if you look back to the last 10 years, then it's all about, let's see what we can make on Monday.

SW: Well Nick, that was incredibly interesting as always. So thank you so much.

NC: Thank you for having me on

SW: And I look forward to our next discussion once again. [**NC:** Yeah] But thanks for joining me.

NC: Thanks Staci. Thanks very much. Cheerio.

SW: Nick Clay is a highly experienced manager and the investment strategy on the fund is well proven. It has a true contrarian nature backed up by a logical and disciplined philosophy. To learn more about the TM Redwheel Global Equity Income fund please visit fundcalibre.com and don't forget to subscribe to the Investing on the go podcast, available wherever you get your podcasts.