

Transcript

The Ideas Exchange

Episode 22: Investment tips for declining markets - an ESG approach

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**Rory Cunningham (00:00):**

Welcome to The Ideas Exchange by ASX, connecting you with investment experts, market updates, and ideas. I'm Rory Cunningham, senior manager of investment products at ASX, and this is our regular podcast covering everything from investment trends through to different ways to invest using a variety of products.

**Disclaimer (00:18):**

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**Rory Cunningham (00:44):**

Hi everyone. Welcome to this month's episode of The Ideas Exchange. I'm your host, Rory Cunningham from ASX. In this episode, I have the pleasure of talking with our investment expert, Anthony Doyle. Anthony is head of investment strategy at Firetrail and a regular presenter at ASX Investor Day, and also writer for ASX Investor Update newsletter. Anthony has also recently launched an active ETF on ASX under the ticker of S3GO. That's S3G-O. Anthony, welcome to the podcast.

**Anthony Doyle (01:18):**

Cheers, Rory, a real honor to be with you today.

**Rory Cunningham (01:20):**

Yeah, good to see you again. So, Anthony, today we're going to be discussing everything global equities related and particularly the recent market volatility, and of course we're also going to talk about Firetrail's approach to investing, and you have a particular approach to ESG investing. But maybe do you want to kick us off, talk us through who you are, who Firetrail is as well?

**Anthony Doyle (01:42):**

Yeah, absolutely. So, Firetrail, as a business we've been going since 2018. There are 24 of us investment professionals that work for Firetrail, and you may be aware of our partner which is Pinnacle Investment, so also listed on the ASX. So,

the firm is majority owned by staff, 73 and a half percent owned by Firetrail employees with the remainder owned by Pinnacle. So, we're what is called one of Pinnacle's affiliates. So, we just concentrate fully on the investment management side of things and Pinnacle, our partners, they do all the back office distribution, HR, compliance, legal, so we can just focus on delivering investment performance for our clients.

Now, whilst we were launched in 2018, our pedigree is actually much longer than that. So, the team previously worked at Macquarie who I'm sure all your listeners are very familiar with. Many of us worked at Macquarie. Indeed, I worked with the team from '02 to '07, that long ago, and basically the managing director of Firetrail, Patrick Hodgins, he spent 26 years and one day at Macquarie, and he likes to say he loved all 26 years except for that one day where he told Macquarie that he was leaving, and the reason for that was the team enjoyed a lot of success at Macquarie, and in order to keep everyone together, it was best to forge our own path. Inevitably in this industry when you have a lot of success and employees are good and you find good investors, inevitably you find that the competition is not far away, and we're very fortunate that everyone has stayed and a lot of clients also joined us. So, today we have 6.2 billion Aussie in funds under management. So, we're a very midsize boutique I would suggest.

**Rory Cunningham (03:43):**

Cool. All right. Thank you for taking us through that background, Anthony. So, let's set the scene by talking about global equities and current market conditions. Now, prior to Firetrail, you were a macro guy, so I'm really interested in your perspective on what's happening in the markets. I just want to rattle off a couple of numbers and then help the audience get some understanding of the current market environment we find ourselves in. So, we're currently the 12th of October 2022. The S&P/ASX 200 index is down 12% year to date. The S&P 500 index as well as the MSCI world index is down about 25% year to date. The cash rate in Australia is currently sitting at 2.6% which is up from 0.10% in April. The US Fed are targeting 3 to 3.25% in terms of their interest rates, and we've seen recent interest rate rises around the world which arguably are some of the fastest we have ever seen. With that as the background, Anthony, what is going on?

**Anthony Doyle (04:45):**

Rory, all the tough questions. 2022 will definitely not be a vintage year for equity markets, whether it's the domestic exchange or the global markets as well. So, I mean, you have to remember what an extraordinary time we've lived through these last few years with the pandemic, lockdowns, economies grinding to a halt, central banks cutting rates to zero basically, record lows, government stepping in and fiscally spending in terms of support measures and injecting huge amounts of cash into their economies just to get us through that very difficult period until the vaccines were found. So, subsequently, we've had an extraordinary few years, and certainly no one really knew what was going to happen and no one really could anticipate what the implications were of these emergency measures, both on the interest rate side, but also the government spending side.

Now, with 2020 hindsight, we do know that they were highly inflationary and we've seen unemployment rates plunge around the world to record low levels,

wages increase in many parts of the world, including the United States, UK, and subsequently central banks are working very, very hard to deal with double-digit inflation, and the RBA is also there as well, expecting inflation to rise to as high as seven and a half percent in Q4 of this year.

So, with that in mind, markets hate uncertainty. The world is always uncertain. Throw in a war as well in the middle of that, and you've got a recipe for down markets, and that's what we've experienced this year. So, a difficult 12 months, even longer for investors, and what you've seen as interest rates have risen, it's been the tech sector predominantly that's been hit hardest, and the global tech names like Alphabet, Meta, which used to be known as Facebook, Amazon, particularly hard hit. So, equity markets down around the world.

So, there's still great uncertainty, as you say, where we sit today. There's been a lot of speculation that central banks may start to slow down the pace of interest rate hikes globally. We've seen that from the RBA last week or the first Tuesday of October when there was only a quarter of a percent interest rate hike rather than the half a percent that markets had been expecting. But certainly, what we're seeing around the world is still some very strong economic indicators, suggesting that central banks are going to continue to be raising interest rates for the remainder of this year. So, a lot of uncertainty, markets hate it, and certainly it's been a difficult environment for investors.

**Rory Cunningham (07:29):**

And so, then from the bottom up, you and your colleagues spend a lot of time talking to companies. What is it generally that you're finding when you talk to CEOs of listed companies in Australia or around the world?

**Anthony Doyle (07:42):**

So, the first six months of this year, there was a lot of hope that inflation was not going to be a permanent feature, and I think that actually what we're seeing is inflation is more sticky than what had originally been anticipated, and markets have woken up to that. And certainly, in terms of the global businesses that we talk to, they're reporting higher labor costs, higher input costs via their supply chains, but they are also reporting that those supply chains that were so impacted by COVID, they are starting to ease some of those constraints and some of those restrictions. So, whilst the first few months or six months of this year really concerns about how high interest rates will go, the last few months have really been dominated by, well, central banks aren't going to stop until inflation is under control and inflation is unlikely to be under control until we see a global recession.

So, the focus now is are we going to enter into a recession and how deep will that recession be, and the companies we talk to are certainly indicating to us that they're seeing a slowdown which is to be expected given that when economies reopened, consumers, not only are global consumers but of course Australian consumers as well, there's been record spending. So, we have this dichotomy at the moment that consumer confidence and sentiment is very low, but the economic indicators like retail sales, still very, very strong.

**Rory Cunningham (09:07):**

Okay. When you talk to the investor side of the equation and also financial advisors, what do you think is important for retail investors, financial advisors to keep in mind when trying to invest in this current market?

**Anthony Doyle (09:21):**

Yeah, Rory, I mean, I have lots of conversations with advisors and investors, as you know, at the ASX Investor Days, and I've been doing the ASX Investor Day since 2019. So, we've seen a full cycle, you and I, together.

**Rory Cunningham (09:35):**

Yeah.

**Anthony Doyle (09:36):**

And one thing that is really interesting and that you'll often hear is preaching the benefits of diversification, absolutely, and having a diversified, not having all your eggs in one basket, that old investment cliché. But one thing I find extraordinary, and it's more on the behavioral side is that when you talk to investors and you talk about some of the opportunities that we're finding at the moment in equity markets, you'll often articulate that when you are investing in equity markets, they are risky. They don't always go up, as I'm sure listeners understand. Indeed, you expect there to be losses. On average, one out of every seven years historically has seen a down market, and you preach and you talk about having a long-term investment time horizon.

But when we go through a difficult period of market volatility and some of those numbers that you've just mentioned, double-digit losses, all of a sudden investors' time horizons go from being a long-term time horizon, they collapse to what's going to happen in the next two months, what's going to happen in the next month. And what you find in the global marketplace is the interaction of investors that have long term-time horizon, short-term time horizon, levered players that are trying to make a quick buck, and certainly the best thing that investors can do is refocus their time horizon to the long-term time horizon. And if you think about the ASX 200, if any investor that has invested in the ASX 200, including dividends, so their total returns with a five-year time horizon, they have had a positive experience since 1979.

And so, if you extend your time horizon out to longer periods, you're placing the odds in your favor that you have a positive return experience, and that's one thing that I think investors, particularly at times like these, have to really remember because it's difficult. It is difficult to invest at a time when markets are declining and investors want to time the markets.

But we often say at Fire Trial, some of the best investors we've ever come across is the great Aussie homeowner, and the reason for that is they take a long-term time horizon. If it's your own house and you saw the price of that house printed on the newspaper every day and you had newspaper headlines screaming at you that it's going to fall, you might think about selling. But certainly being an illiquid asset class and of course you have to live somewhere, you enter into a house purchase with a long-term time horizon, what you've found is that Australian investors, in terms of their main asset being their home or an investment property, they've done very, very well out of it, and I think that the same approach should be taken when investing in companies and the equity market.

**Rory Cunningham (12:25):**

Okay, great. Thank you for that background. Some really interesting points there for investors to take away I think. Let's switch tax now and take a look at

how you invest at Firetrail. So, can you talk us through your investment approach and then also talk about your philosophy in regards to ESG investing in particular?

**Anthony Doyle (12:45):**

Yeah, Rory, so we are what is known as an active investment manager. So, our belief is that we can outperform an index exposure. So, typically, what you'll find is that active investment managers, relative to say passive or index investors, we don't invest in every single company on the stock exchange. We want to identify those companies that will outperform the market over time, over that long-term time horizon, and our investment process involves a lot of bottom up groundwork. We are only looking to invest in 25 to 35 companies within our portfolio. The reason for that is we want to maximize the potential to outperform, and we want to maximize our ability to engage with companies and put them on the right path.

Our investment approach is what's called high conviction. So, we do a lot of fundamental analysis. On average, our analysts do 200 hours of research on every single company before they're even proposed to the team to enter into the portfolio, so around six weeks of work. They only cover between five or six companies. We don't have to find a plethora of companies to invest in, just 25 to 35 of the very best opportunities. So, we build a high conviction portfolio. It's concentrated. Certainly when you think about say the ASX 200, by its very nature has 200 companies. We only invest in 25. The MSCI world index which is a global equity index has around 1500 companies in it. So, we aren't beholden. We're very aware of what the index contains, but we are agnostic in terms of our own positions that we take within our portfolio.

So, we think this is the best way to invest capital, invest your hard-earned savings in the equity market which has traditionally been a fantastic bedrock for Australian investors to meet their long-term investment and savings goals, and we've been running money or investing money in this way for over 20 years, and historically we've shown that this is a good way to deliver long-term investment performance for our clients.

**Rory Cunningham (15:03):**

Okay. So, that's your approach to a high conviction investment philosophy. Now, just touching on ESG for a bit, so obviously there's many different shades of green when it comes to ESG investing. How do you approach it and why?

**Anthony Doyle (15:19):**

Yeah, so the Firetrail is three global opportunities fund. It's high conviction, it's concentrated as I mentioned, but we also have a sustainable edge when we are looking for companies to invest in. So, as you mentioned, ESG, environmental, social, and governance, a lot of investors, their eyes glaze over. But certainly when you talk about the impact that you can have as an investor in solving some of the world's most difficult challenges that we face today, I think certainly a lot more interest is gained. A lot of the ambivalence that I see towards sustainable or ESG style of investing is just as you say, there's so many options and which one is right for me, and there's a lot of confusion out there. Do I focus on ESG integration which is where I'm incorporating ESG into my investment process? Do I focus on engagement, working with companies to improve them? Do I focus on excluding bad companies? Do I focus on just

companies that only emit low levels of carbon? Do I focus on companies that have the best gender equality scores?

So, it is obviously person by person. People's values are different, and society's standards evolve over time and change over time. But more often than not, sustainable investing, the critique is that you give something up investing in that way. The critique is that if I am an ESG investor, I can't outperform the index because I'm excluding some companies that may outperform, and the critique is that ESG investing, it's a risk. But from our perspective, we did over two and a half years of research before launching our fund, S3GO, and we think that sustainable investing is an investment opportunity, one of the greatest investment opportunities of our lifetimes, and increasingly, more and more funds are investing with some form of ESG or sustainable lens in mind.

So, what we found in our research was there's an overreliance on rules. There's too many rules. So, if you're a high carbon emitter, you're penalized. If you're a low carbon emitter, you typically score better. If you're a large company, you typically score better because you can work with these external rating agencies to improve your score. And what we're looking for in our fund are companies that are contributing to positive change along one of four positive change themes, which is are they contributing to positive change in health and wellbeing, innovation and equality, are they having positive change in terms of climate impact or a sustainable world. So, four positive change themes, and we're identifying companies that are misunderstood or are just overlooked by the general investor market base. So, what we do is invest in these companies early on. We avoid those companies or we don't invest predominantly in those companies that have very, very high ESG scores as they're already recognized by the market as ESG leaders and subsequently they have a very expensive valuations. So, we're looking at companies that are the future leaders of tomorrow in positive change.

Now, when the market wakes up to the contribution these companies are making to the world, and certainly their growing earnings that they are likely to deliver over time, then what we'll see is that these companies will earn a higher valuation in the marketplace, and that represents investment performance for clients. So, the typical type of company that we look for, they share sustainable characteristics which is where S3 comes from. They're the three sustainable characteristics that we look for in every company. Two are financial and one is ESG related. So, the two financial metrics are they need to be sustainable in terms of their business models. So, sustainable business models that are delivering sustainable earnings within the next five years, and they are contributing to sustainable positive change, and those characteristics are so powerful. That's why we launched the name, that's why we named the fund after them, the Fire Trial, S3 Global Opportunities Fund. So, we believe that you give absolutely nothing up investing in this way globally, and certainly we think you should be part of the solution, rather than investing in those companies that are causing part of the problem.

**Rory Cunningham (20:00):**

Okay. Like most people, love a stock story. It helps bring the investment process, the investment approach to life. I have seen some of the companies that are in your fund, as you said, between sort of 25 to 30 companies you're invested in, and I'll be the first to put my hand up, I didn't recognize a lot of the names in there, so I'm really interested to hear about the stock stories for those

companies that you're invested in. So, perhaps could you take us through some of the companies that the fund invests in and investment thesis behind those investments?

**Anthony Doyle (20:34):**

Yeah, sure, Rory. I know you always love a good stock tip and I have been recommending to you S3GO, so hopefully you'll stop hassling me for those stock tips. But in terms of global equity funds, more often than not, they are overweight the mega cap tech names, like those names I mentioned earlier, and as you say, our fund is very, very different. There is no one investing in this way in Australia. So, when you invest in S3GO, it's a very different global equity portfolio to what you'll typically get in an active ETF or a passive ETF. So, some of the holdings in the portfolio today, you mentioned one of them which I presented at the Investor Day which is Weyerhaeuser, for those that weren't lucky enough to get there in Brisbane, Melbourne, or Sydney.

**Rory Cunningham (21:28):**

And just a quick plug, we are holding Investor Day again in November. So, for any listeners, please feel free to go to the ASX website and register. Back to you, Anthony.

**Anthony Doyle (21:37):**

Yes, good little ad in there, Rory. Cheers. So, Weyerhaeuser is a boring old timber REIT, domicile in the United States, listed on the New York Stock Exchange, over a hundred years old. But our question is, well, is it a boring old timber REIT? So, in terms of Weyerhaeuser, it is the largest private land owner of forests in the United States. It owns 11 million acres of forests in the US and has long leases on 14 million acres of forests in Canada. So, you're talking about a land size two and a half times the size of Tasmania. So, they're private assets, and you can guess what they do with those assets. They cut some trees down every year, some forest down every year, and they produce lumber and timber, a sustainable building material, and certainly what you'll find is far fewer carbon emissions than say concrete or steel.

But in terms of its assets, it plants far more trees than it cuts down every year. So, it plants around 150 million trees a year, and they've been doing it for a very long time. So, Weyerhaeuser, first and foremost, what you'll find at Firetrail is we like to cut through the noise of the day-to-day headlines and truly focus on what matters for companies, the two or three things that are really going to drive earnings over the next three to five years. So, for Weyerhaeuser, certainly it's the lumber price, given that's its dominant business. So, the lumber price has been hammered. It's been really volatile in terms of it appreciated markedly to around \$1,600 after COVID. As I'm sure many listeners understand, Americans were similar in terms of going out and renovating, and they've also had a house price boom, like Australia as well. So, strong demand for lumber. That's subsequently declined with the slowdown in US economic growth, but the lumber price still remains above its long-term average of \$200. So, it's sitting around \$400 today.

So, that's a positive catalyst for Weyerhaeuser earnings, but again, we're taking that five-year view. But the second really exciting opportunity for Weyerhaeuser is the ability to sell carbon credits into the US carbon market on those assets. So, all those trees suck in 35 million tons of carbon a year. We

think Weyerhaeuser is the largest, or we believe Weyerhaeuser is the largest natural carbon sink that you can get access to on any listed market in the world. Weyerhaeuser are exploring this opportunity. It's one that we've spoken to company management about. We are working with them on sharing what is best practice in Europe where the carbon market is far more developed.

But to give you an indication, the current carbon price in the US is around \$12 a ton, and it's a fact that if we are to reach net zero, our ambitious net zero targets, then companies will have to offset some of their emissions, and we expect increasingly US companies to commit to a net zero future as they come under pressure from either regulations but also their customers. So, as companies continue to look to reduce their carbon footprint, they may offset those emissions by owning a carbon credit on one of Weyerhaeuser's forests. Now, interestingly, our analysis suggests that when the carbon price, currently \$12, gets to \$25 a ton in the United States, Weyerhaeuser has this interesting choice to make as we believe that it will actually be more beneficial for Weyerhaeuser to keep the trees in the ground and sell carbon credits rather than to cut them down every year, and you can imagine what happens to the lumber price if all of a sudden Weyerhaeuser stops cutting down forests and starts selling carbon credits.

So, it's an interesting play on two markets. So, when I say it's a boring old timber REIT, well, certainly there's this exciting new business opportunity that Weyerhaeuser are exploring, and that's why Weyerhaeuser but also another company in the fund, Ryanair, they're two ways that we can get exposure to a rising carbon price in the United States which should represent long-term investment performance for the fund as well.

**Rory Cunningham (26:01):**

Fantastic. So, you're telling me that money can grow on trees.

**Anthony Doyle (26:04):**

Are you stealing my jokes there, Rory? Yeah, certainly. So, that's one of them, and of course I've got 26. How long have we got, a few hours? So, do you want another one?

**Rory Cunningham (26:14):**

Yeah, maybe European based.

**Anthony Doyle (26:16):**

European based, okay. So, one interesting company that is a growth company is Hello Fresh. So, domiciled in Germany, and I'm sure many listeners are familiar with Hello Fresh.

**Rory Cunningham (26:28):**

Yep, certainly am.

**Anthony Doyle (26:29):**

In terms of ordering meals and cooking them at home, I haven't actually used it, but I know a lot of people that have, so I do have to sign up, but my analysts tell me that certainly in terms of the younger demographic, the young, I sound like an old guy now, don't I, younger demographic are certainly, but also I know for



instance, my mum's ordered a few meals and things like that as well. So, they're a global business now. Indeed, most of the revenue for Hello Fresh actually comes from the United States.

Now, Hello Fresh was a huge COVID winner globally, and the share price had run up significantly, but COVID winners have been hit hard, and particularly COVID winners that are domiciled in Europe. So, we think that the market is penalizing Hello Fresh too significantly, given that the majority of its revenues are offshore and indeed the fall in the euro relative to the dollar. So, euro is now actually gone through parity with the dollar. \$1 represents more value than the euro today. That's actually benefited Hello Fresh's revenues as most of its revenues come from the US and are US dollar domicile.

So, with that in mind, Hello Fresh from a sustainable perspective, you may not be aware of this, but typically between 30 to 50% of fresh food is thrown away from a supermarket like a Woolies or a Coles. Hello Fresh has virtually no wastage as they send obviously you the meals to cook and the exact right amount of ingredients and things like that as well. So, they're having a positive impact from that perspective. They're contributing to positive change. They're working very well with their supply chains. They're treat their staff, their customers very well as well. And that's one company, a growth company in the portfolio that we think stands to benefit over the course of the next five years from consumer trends, moving from going to the supermarket and determining what I want to eat, to the convenience of having those ingredients delivered to your door.

**Rory Cunningham (28:44):**

Perfect, thank you. Thank you for taking us through those stock stories. I think that helps bring it to life for listeners. So, as we kind of wrap up here, are there any closing points that you'd like to make?

**Anthony Doyle (28:55):**

Yeah. So, we think S3GO, as I mentioned, we want to be part of the solution to many of the challenges the world faces today. So, we're building a portfolio of companies that is very unique. It's a portfolio of companies that you may not have heard of, so you stand to benefit from a diversification perspective, but we also want investors to be patient. So, if you're looking for short-term quick fix returns, this wouldn't be the fund for you. If you're looking for that medium-term time horizon where we have that time period to outperform to allow the positive change cycle to progress and occur, if you're looking for a fund where we take that high conviction approach where we work very closely with the companies that we invest in, where we get to understand them intimately, and importantly, contribute to a better world rather than causing problems in the world, then this may be a fund that could be appropriate for you.

I mean, ultimately, we are very aligned with clients in the fund. We all invest in the fund ourselves. As I mentioned, our firm is majority owned by the staff, and certainly we believe this is a fund that investors can be proud to own within their portfolio. So, it sits very well if you are looking for exposure to a basket of global companies in one simple trade via the ASX. Rest assured, day in, day out, we are doing the work. We are often having conversations on the weekends. We're back in the office five days a week. We're very, very passionate about what we do. So, certainly, this is a fund that we'll give you that exposure to what is a fantastic asset class. It's a very volatile time at the moment, but we're

finding significant opportunities, and really we think that now is a better time to invest than certainly the go-go days of 2021, certainly if you're looking for some really, really strong performance over the medium to long term.

**Rory Cunningham (31:04):**

Great. Thanks, Anthony. I'd also encourage anyone that's listening today to go onto the Firetrail website and look at the content that you have there. Follow Anthony on LinkedIn. You're a prolific poster, always great information coming through. And of course, a plug for ASX. Come to ASX Investor Day or subscribe to the Investor Update newsletter to learn more about these types of things. So, Anthony, thanks again for your time. We always appreciate the time that you do give us at ASX. So, yeah, very insightful as always.

**Anthony Doyle (31:36):**

Cheers, Rory. Thank you.

**Investor Day (31:38):**

Visit the ASX website, [asx.com.au](http://asx.com.au), and register for the next Investor Day, our premier education event, providing timely marketing insights and ideas from a range of industry experts.