

Transcript

The Ideas Exchange

Episode 37: Key macro and market developments impacting global equities in 2024

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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 (00:19):

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Rory Cunningham (00:46):

Welcome to The Ideas Exchange. I'm your host, Rory Cunningham from ASX. Today, we welcome Vihari Ross is portfolio manager at Antipodes, and covers global equities. Vihari has a wealth of experience as a portfolio manager and specifically within global equities research. Vihari, thank you so much for joining us today.

Vihari Ross (01:06):

Thanks, Rory, for having me.

Rory Cunningham (01:07):

Before we get into it, Vihari, maybe do you just want to give our listeners a bit of background as to who Antipodes are and what your role involves with Antipodes.

Vihari Ross (01:15):

Absolutely. Antipodes is a fundamental active global equities manager. We're based here in Sydney, but we also have offices in the UK and in North America. We have both global long portfolios as well as global long-short portfolios. The long portfolio is available listed on the ASX under the ticker AGX1. That's an active ETF where investors can get access to portfolio of global stocks in a single trade, and there's no minimum investment. So you can trade AGX1 just like any normal share. That was launched over five years

ago, and it mirrors our longstanding global long only fund, which is based on our pragmatic value approach.

And pragmatic value really means paying the right price relative to a company's resilience and growth profile. And so our portfolio will feature quite high quality, high growth names like Microsoft, through to companies in the financial space and the commodities space as well. So you get that full spectrum of exposure to growth and resilience.

Rory Cunningham (02:22):

And can you talk us through the process to find those opportunities?

Vihari Ross (02:26):

Absolutely. So I think one of the key ways of identifying pragmatic value is understanding change. And I think change is one of those things that is a real constant in markets. But because markets are made up of humans that can become emotional, or extrapolate, or have fear and greed, the change can often be misconstrued.

So we tend to focus on identifying cyclical change, identifying structural change, as well as socio macro changes. And I think sometimes, what that means is that we can avoid those classic value traps where a stock that otherwise looks cheap is actually being disrupted and is therefore a trap, but also growth traps on the other side where if a business enters an exuberance phase in terms of its valuation, whether that's actually justified by structural change or whether it's going to actually have a shakeout and be a bit of a trap as well. So that's a key part of what we do. And when we pull all of that together, it's really about paying that right price relative to the growth profile that is available to us. It's what you're paying for and what are you getting in return.

And so as a result, we have a portfolio of about 60 companies that's truly eclectic, and truly global investment in the US, Europe, emerging markets, and all around the world really.

Rory Cunningham (03:49):

Okay, that's brilliant. Let's start with maybe a bit of the fear side of the equation. And what I mean by that is really around interest rates. Over the last couple of years, there's been record interest rate rises. And as we sit here today, in the US, the cash rate is about 5.3%. Inflation is at 3.1%, so it's come down quite materially from where it was at its highs. And the S&P is sitting at almost 5,000. So up around all time highs. In Australia, the cash rate is 4.35%. Inflation's 4.1%. So it seems to be a bit more under control as compared to last year. And the S&P ASX 200 index at all time highs around 7,600.

And as I mentioned, reserve and central banks around the world, the interest rate rises naturally have a flow on effects into equity markets, and there's so

much speculation about what the next 12 months look like, particularly in the US. So I'm wondering, can we breathe a collective sigh of relief that interest rate rises are over, or should we still tread with some caution about sticky inflation?

Vihari Ross (05:06):

Well, I think that's quite a broad-based question in terms of thinking about all the puts and takes when it comes to inflation. I think we have reached the peak of the hiking cycle and the sort of fear around that, that we saw in 2023. But we are seeing stickiness in the inflation level itself, particularly in the US. And a lot of that is driven by that services sector. Goods inflation has come well and truly down. That sort of Covid supply and demand constraints have come out of the base, but the services inflation has stayed high. And a lot of that is driven by what's called shelter in the technical term, which is rents and also something called owners equivalent rents, which is what people who own their homes think they can rent their house out for.

And that is actually remarkably sticky, and it's stayed high, and it's staying high because there is actually shortages in housing and there's lots of other reasons why that number is as high as it is.

So we might end up sort of being stuck at a slightly higher inflation level than what the market might expect. And that obviously has implications for interest rates, because as much as at the start of the year market was pricing in six rate cuts in the US, but that doesn't really gel very well with the fact that there's not going to be any recession. Typically, you don't see rate cuts when there's no recession. So I think we'd still think that at some point, the Fed will start bringing rates down in a sensible, gradual, careful way. But even in their most recent minutes, you saw that they're worried about doing it too fast and too quickly.

So I think that's something that is very relevant to markets. It's something that everybody's watching. We are sort of not out of the woods when it comes to how that's going to go.

And there's also so many other puts and takes around government spending going on this year. It's an election year. You're going to see more spending taking place. It's really about what flavour of spending you're going to get, whether it be Trump or Biden. Is it going to be more around decarbonisation or is it going to be tax cuts? Either way, there's going to be spending going on. And sort of interesting what you said about the collective sigh of relief, because high interest rates actually don't affect everybody equally. And it's only about a third of people who have mortgages that are very much impacted and getting crunched by this high rate scenario.

But there's the other third of people who own their own homes outright and are net savers. They've probably don't feel that way at all about high rates.

They're in fact spending more than ever, as we've seen in the data. Meanwhile, the renters are actually really seeing the impact, believe it or not, because people who have mortgages are pushing that increase in cost onto the rental market. Those people also typically may have credit card debt or auto loans, which are also floating rate. So it isn't... For those people certainly would be a collective sigh of relief. But for a lot of other parts of the economy, who frankly they've been carrying the economy over the last 12 months, they may feel quite differently about that rate cycle.

Rory Cunningham (08:08):

Yeah, well it's interesting when you consider retirees and where they're going to put their capital. We had Gemma Dale on this podcast last year talking about exactly this. All of a sudden, investors have choice as to where they allocate their capital. And I know even if I reflect on my own parents, they're quite happy now to put their capital in term deposits that are getting them 5%. So absolutely, I hear what you're saying when inflation and high interest rates impacts different segments of the economy and the consumer base.

Vihari Ross (08:43):

Yeah, I think the other thing that springs to mind when you talk about that is not all economies are dealing with inflation in the same way as well. So again, we have a truly global perspective. That perspective I just gave you was very relevant to the US, very relevant to Australia, and the UK. But we've also got inflation coming down in a material way, rates coming down, and have already started to move down in a lot of emerging markets like Latin America. And that's actually very supportive of the consumer environment in those sorts of regions.

You've got deflation in China meanwhile, and there's sort of stimulus that needs to happen there. So not all markets are created equal when it comes to this thing that everybody focuses on to such a big extent.

Rory Cunningham (09:26):

Yeah. Let's stay at that macro level, because as a global equities manager, you are looking obviously across the world. What are some of those key macro and market developments that you saw as 2023 drew to a close?

Vihari Ross (09:40):

I think one of the biggest things that we've really observed in the last 12 months, particularly in 2023, was that extreme market concentration that you saw. At the end of last year, that Magnificent 7 of stocks. Apple, Microsoft, Alphabet, Amazon, Meta, Nvidia, and Tesla, they made up 25% of the US index. That's an extraordinary level of concentration of market cap in so few names. Literally 493 other stocks are making up 75% of that market cap.

So it doesn't happen very often, that type of extreme. It's actually the most extreme since the dot-com era. And to put it into context, you've got such a narrow... Those seven stocks generated almost 100% performance last year, and the rest of the S&P was up only 6%. I'm not necessarily saying that this is the same as that dot-com era, because in the case of that Magnificent 7, there's actually quite a bit of dispersion amongst them.

But generally speaking, it's been backed by strong operating results as well. And that's very different to say dot-com where there was a lot of no earnings backing some of those valuations. But nonetheless, that was something where we saw. What we're expecting to see now is for that to start to broaden out. We saw that start to happen at the end of last year, fueled by that expectation of lower rates coming into 2024. But we might start to see divergence there, not only with that broader based section of stocks start to perform better based on their operating performance of course, but also more divergence among the Mag 7 itself. They've been talked about as this single entity cohort, but actually if you think about it, there's a lot of differences in how they're performing.

Even this year, you've seen Apple down year to date, you've seen Tesla down more than 20% year to date, and that's been based on operating results really and expectations versus the growth you're ultimately going to get, which is central to our philosophy. But of course, you've continued to see strong results from companies like Microsoft, Meta, and Nvidia more recently as well. So that's one element.

The other thing I think is really topical for 2024 is that nearly half the world's population is going to the polls in terms of elections. They could prove quite important for markets this year. There's a lot of talk about it in the lead up and what the implications of that might be, which can create some volatility. It might impact the geopolitical environment, particularly in the US, depending on who gets in.

And I think the topics that come up over and over again when thinking about it are things like national security, relocalisation, bringing manufacturing back home, security around energy and the sourcing of energy. And obviously things like Taiwan and those types of dynamics come into play.

I think that the end result of all of that debate and thinking, it goes back to the point I made earlier, which is the likelihood of more spending at that government level. Maybe it's America first, maybe it's about being more conciliatory to the rest of the globe. But either way, the sort of net result is probably more spending, which may well be supportive of markets.

Rory Cunningham (13:02):

Thanks, Vihari. You did mention emerging markets. So I'm wondering from a macro perspective, what are you seeing in those markets and countries?

Vihari Ross (13:09):

Yeah, so I think emerging markets are a really interesting and fruitful place for us to find investment opportunities at the moment. A lot of emerging markets, because of the turmoil of what happened to a lot of these economies through Covid and the aftermath of that, you're seeing some really compelling valuation opportunities.

So we have some significant exposure to Latin America, be it particularly Brazil and Mexico, and also China as well. And what you're seeing on the Latin American side of things is a scenario where these markets are trading on trough multiples relative to their history. And therefore, there's an opportunity to buy stocks that are actually relatively defensive. They're relatively high quality and have growth potential at significant discounts to their historical valuations. So that's what we're seeing in Brazil. We're seeing that in Mexico as well.

China is a different story. With China, it's a really interesting market in the sense that it's trading on a 20-year trough multiple. A lot of foreign investors have found it too hard or there's too much fear around it. I think what you're seeing is that classic market risk premium come into that market. Many, many stocks now look very cheap, but of course you have to be circumspect about what the circumstances are that have created that fear.

It's interesting that the Chinese government was willing to curtail their property sector and something you'd never, ever in a million years see a western government do to their property sector. And the reason for that is because of the blowback on obviously economic growth but also on consumer sentiment. So you've seen that impact. In China, you've had the property developers who were crossing those red lines, get pulled into line, have the access to their funding pulled and stuff like that. And I think what we're now seeing is a surplus of inventory. That's going to take a while to come out in the wash in terms of it being part of the base of China GDP, and then for that economy to grow again from that base. But the rest of the economy continues to get strong support.

I think one of the things that we are doing in China in terms of our exposure is being quite surgical about where we will go, where we will invest. So we have a number of the internet names. We've got companies like Alibaba and Baidu, Tencent, they're all doing buybacks. Alibaba's buying back 8% of its stock. It's a remarkably large number. It's still very cash generative. It's growing. It's a national champion. We have a company like [inaudible 00:15:50], which is the Oracle SAP equivalent of China. Again, a national champion growing rapidly, and it has a structural growth tailwind behind it. It's not dependent on what the Chinese property sector is doing, what the Chinese consumer is doing.

We also have exposure to companies like Galaxy, which is the Macau gaming play. It's interesting, because Macau gaming has recovered to more than 20% above the pre-Covid level whilst for example, travel to the US hasn't recovered.

So it's really about being considered about where the opportunities are and where the recovery actually has been in China, rather than blankly buying China as a group. And I think as the Chinese government ultimately brings stimulus back into the economy, I think they've been a bit reticent to do it because once you've taken that step of giving someone a crack on the knuckles, you didn't want to... I think there was a little bit of concern about, "Well, we can't bail them out now because we were the ones who created this problem."

But you are starting to see gradual change in that thought process. You're seeing stimulus now come back into that economy, and you're actually seeing foreign investors start to return to the market as well. So we do think there's some interesting opportunities there. But again, be surgical.

Rory Cunningham (17:07):

Okay. So in light of the macro environment, US emerging markets, how are you actually positioning your portfolio?

Vihari Ross (17:15):

So the portfolio is positioned across three key pillars. We tend to have an exposure to the mature cyclical bucket we would call that. That tends to be high quality domestic champions. We also have an exposure across financials, both developed and emerging market. And also, a cohort of what we would call global cyclical. So that's really playing into this dynamic of in a lower rate environment and continued buoyancy in economies like the US, it's actually a ripe for these global cyclicals to inflect output. So that's companies in the fertilizer space, in the chemical space, in the auto space. They're all trading at significant discounts because of that uncertainty that we've had around rates and the trajectory of the economy. And those, we expect to do well in that benign economic scenario with lower rates.

We also have an exposure to defensives. We're still conscious of a lot of tail risks sitting within markets around the world, particularly that market concentration risk. But more broadly, that includes companies like Tesco, Diageo, businesses that are dominant in their spheres, and again, generate a lot of cash and are trading at compelling valuations.

And also in the healthcare space. So that's an area that's had a lot of attention, particularly in 2023, in particular in that diabetes drug space. But these companies we have, we have American Sanofi, they have big immunology businesses. There's big tailwinds behind that space unfortunately. As people get older, the propensity to get cancer goes up, and there's a lot of

innovation happening in that space. They also have things like pet care and vaccines, which are quite defensive in nature as well. And again, they're trading on quite compelling valuations, particularly in comparison to those diabetes champions.

We also have an important part given that change framework that we employ in our portfolio construction. We have a cohort of companies that are exposed to favourable structural change. So that includes things like the monetization of cloud and AI, as well as the energy transition. And it's important for us to identify those shifts, but also find pragmatic value ways of playing those shifts as well, rather than seeking to jump on a structural change bandwagon and overpaying.

So to bring that together, the portfolio overall has 60 securities across those three pillars being mature and cyclical type companies, structural change winners, as well as the defensive cohort of companies as well. So you have a truly global portfolio with businesses listed all around the world. But again, with that pragmatic value approach to finding compelling valuations relative to the growth that we're going to get.

Rory Cunningham (20:15):

Okay. And so what sectors then are you focused on at the moment and why?

Vihari Ross (20:20):

So I think one of the big themes is AI, and that's not going anywhere. We're at the early stage of what the investment in AI will look like, what the monetization of AI will look like. But what we can see is that it ties in very much so with that transition to the cloud and the incumbents who are already well positioned in that space. If you think about the biggest users, or buyers rather of graphic post-processing units from Nvidia, they're actually the big tech companies. 75% of their sales are coming from those big tech companies and from China.

So you've got this real capital deployment that's taken place ahead of time, before the monetization's happened. It's sort of interesting because the market's very interested in this thematic. We have exposure to that in a number of ways. We have the shift to the cloud, obviously, that's still to happen and is still ongoing for companies like Amazon and Microsoft. But we also have an investment in Oracle.

I think that's a really interesting one. It's a business that a lot of investors wrote off a decade ago. But I think the incumbency advantage really comes to the fore for a company like Oracle.

I think a lot of the cloud transition, if you think about it, has already happened in the consumer facing side. We've already got Apple Music or Spotify. We've got Netflix, we use Microsoft applications on the cloud. But

the transition hasn't taken place in the same way, in the less exciting part. In the infrastructure, the ERP, that's still to take place.

And as that shift happens, the market opportunity of that is enormous, and it's going to generate growth of 15 to 20% per annum. And we look at Oracle that was maybe a little bit slower to move. They've got banks, and hospitals, and so on, conservative risk averse enterprises that are using their software. They don't want to rock the boat when it comes to making that transition themselves. So you've got this real advantage in being the incumbent provider.

The Oracle Cloud Infrastructure business is growing up now at more than 50% per annum. And as they augment that baseline infrastructure with software and platform capabilities, they're getting three to five times the value from those customers. So it's profitability creative as they make that shift. And you've got a business as a result that's growing at 10 to 15% per annum and trading at a discount to the S&P at 20 times. So that's a real pragmatic value way of playing thematic that is actually pretty well known and the market is generally pretty exuberant about, but they're actually not necessarily looking at some of these obvious winners simply because they might be operating in a less, less exciting part of that transition.

And then another sector we're really focused on is the energy transition. Again, this is an area that's had a lot of time and attention. What you're really seeing here is a confluence of circumstances that have come together to make it a reality right now. It's something where we've had consumer acceptance of climate change, we've got governments putting spending and regulation behind it as well. You've had a big change in technology capabilities in terms of actually being able to decarbonize in a way that's economically viable.

So this is something that's a multi-decade investment cycle that we're looking to invest behind as well. In the developed world, it's estimated it's going to be 2 to 3% of GDP per annum for the next decade.

And there's a lot of different ways you can play that. You can do energy efficiency, you can do abatement, you can use sustainable forestry and things like that. But when it comes to efficiency, it's quite broad based. Efficiency is less on the cutting edge. It's really about putting insulation into your home. It's about using energy efficient air conditioning and reusing materials. But because of that, it's actually quite broad based as well.

And to give you an example, in places like France, you can imagine all the buildings are all higgledy-piggledy and so on. To actually put insulation into that, it's actually quite a difficult thing to do. It requires certain injectable technology and things like that, and that's going triple the renovation rate, because 90% of buildings have to be retrofitted.

And there companies like Saint-Gobain that we have an investment in. It's French-based building materials company. And you might think, "That's a bit dull." But the reality is looking forward, it's a business that has better growth, better profitability than it had in the past because of this sustainability tailwind that sits behind it. And interestingly, because of high mortgage rates, it's a stock that's been sold down because it's attached. The market's sort of missing the point that it's attached to this building materials type scenario, when really it's a sustainability company.

So there's pragmatic value ways of playing these bigger structural trend thematics. And that's really what we're looking for when it comes to our picks within the portfolio.

Rory Cunningham (25:36):

Now you've been very kind with us, and you've shared a fair few stocks that are in the portfolio already. But nothing does bring it to life like stock stories. So do you have one to two stock stories that you'd be willing to share with us?

Vihari Ross (25:49):

Absolutely. So I've got two. One is really quite an exciting one, which people will be quite familiar with. That's Meta. Meta is a business that, people actually misjudge how much this business is benefiting from AI. One of the best things that ever happened to them many years ago was when Apple stopped sharing data with them. Stock obviously got smashed at the time, but that meant that they had to pivot, they had to invest in their own capabilities in terms of monitoring the behaviour of users.

And it's not something that they haven't done. They've always had to proactively monitor their platform, and take content off, and do all of that type of thing. But this really forced them to invest behind how to best monetize the eyeballs that are on all of their family of apps.

So you've got a business now that if you look at actually the amount of capital expenditure that's been put into graphic processing units, Nvidia, one of the biggest customers, as big as Microsoft has actually been Meta. And they are now monetizing their family of app platform in an accelerated way thanks to that investment that's been put into place. They're doing Meta AI in terms of generative chatbots, potential to take a little bit of that search volume off of Google there as well. You've got a business that in that family of apps environment is now growing its revenues from a volume point of view at close to 20%.

And if you adjust for the Reality Labs investments, you're paying a high teens multiple, which is discount again to the S&P, for a business that's growing rapidly and is really one of the best place to monetize AI from here on in, in a

really practical way. It's really, again, getting more yield and return out of your existing business. So I think that the conviction we can have around that trajectory is really strong as well.

And then because we are a truly global portfolio, another example I have is one in emerging markets. Brazil is a really interesting market. It's one that was really impacted by Covid. They were in recession for four years before Covid happened. And then Covid happened and inflation went through the roof. Interest rates went through the roof. The consumer was very negatively impacted by that. We're on the other side of that now. Interest rates have already been cut about three times in Brazil. They're on their way down. Consumer confidence is improving. People's ability to borrow is improving. Unemployment is coming down. So you've got this real cyclical recovery. And remember, this is part of our change framework. We're looking for these cyclical opportunities around the world, and we have a business there that we've invested in called Sendas Distribuidora. It's actually just a cash and carry grocery business. It's maybe, again, a little bit on the boring side, but what's not boring at all is the growth rates coming out of this business as part of participating in that consumer recovery. They actually bought a competitor's store network just at the wrong time, when those interest rates started to really accelerate up.

But what they're doing now is that they've closed them and then they're reopening them, having refurbished them. They're opening them at three times the level of sales that they bought them for. And they're also rolling out stores across Brazil.

So they're getting 13% revenue growth per annum. And then at the same time, their profits are growing at more than 20%, because they're getting a huge cashflow uplift as these stores reopen. And interest rates are coming down. So that debt burden's coming down rapidly for them as well. So you're getting really strong profit growth, and you're paying eight and a half times for that stock.

And to give you a comparison there, we always look to try and put our valuations into context with what's going on in the rest of the world. People might be really familiar with Costco, that's a business-

Rory Cunningham (29:52):

Yes, we've seen the lines.

Vihari Ross (29:53):

Everybody's been there. Most people have been there, let's say, maybe not everybody, if you can be bothered with the lines. But as much as people might want to enjoy shopping there, to actually buy the stock, you've actually got to pay 40 times multiple. And that's an equivalent business to what these guys are doing and they're executing remarkably well. And again, you're

participating in this recovery in Brazil, but you're doing it in a really quite defensive, high quality way. It's not that we have to go down that risk curve to participate. So that's another example that I have for you.

But if I was to only pick one stock, then the stock I would choose is AGX1. And that's our listed on the ASX portfolio, long-only global portfolio. It'll give investors 60 global securities from all around the world, playing into a number of really interesting thematics around the cyclical opportunities around the world, structural opportunities around the world. As well as really high quality defensive businesses at compelling valuations. So that's my pick for you today.

Rory Cunningham (30:56):

Brilliant. I love a plug right at the end there. And what I'd strongly encourage to any of our listeners here is to go to the Antipodes website. I think as you've got a sense from our discussion here, there's some really exciting names in the portfolio, but also Vihari, I've obviously watched some of the educational videos that yourself and the team put up there. It is a great opportunity really to learn what's happening around the world, to understand how businesses work, and hopefully also find great investment opportunities through AGX1. So Vihari, I suppose, thank you for joining us today.

Vihari Ross (31:33):

Thanks so much, Rory. It was really great to come along.

Rory Cunningham (31:35):

And thank you to all of our listeners. We look forward to tuning in next month on The Ideas Exchange.

CEO Connect (31:41):

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