



**CAMRADATA**

# Global Equities Roundtable

Global Growth in Global Equities

**November 2019**



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## Introduction

Global equities remain the backbone of investment allocation for institutional investors, with over 90% of asset owners invested in global equity strategies, which provide a hunting ground for core holdings across the stock market.

According to the Investors Chronicle, a global equity fund should be at the 'heart of pretty much every investor's portfolio' – either as the core of a larger portfolio that also includes specialist funds, or a one stop shop for smaller pension schemes and start-up portfolios.

Many view global equities as being a diversifier or an opportunity to target faster growing regions in order to achieve better returns than they can locally. In addition to generating return, from a risk perspective, Vanguard reported that volatility was reduced by 40-50% with an allocation to global equities outside one's domestic market.

As the global equity markets rallied in the first months of 2019, following the shift in October and December last year, investing in equities in general and specifically global equities has presented opportunities. Indeed, according to Citywire Discovery data, global equities attracted the most money over the timeframe, which resulted in a €11.10 billion inflow into portfolios of Citywire-tracked managers.

Will global stocks continue to provide good opportunities and diversification for investors? What innovation can we expect to see in this sector going forwards, and will there be new considerations and approaches? What effect will the US and China trade tariffs have on the global markets?

CAMRADATA's Global Equity whitetable aims to look how and why global equities continue to be the pillar of an asset owners' asset allocation and how this will look for the future of investing.

“ Many view global equities as being a diversifier or an opportunity to target faster growing regions in order to achieve better returns than they can locally. ”

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## Sponsor

**Artemis Fund Managers Limited****Company Profile**

Independent and owner-managed, Artemis opened for business in 1997. Its aim was, and still is, exemplary investment performance and client service. All Artemis' staff share these two precepts – and the same flair and enthusiasm for fund management. Today, Artemis is a leading UK-based fund manager, offering a range of funds which invest in the UK, Europe, the US and around the world. As a dedicated, active investment house, we specialise in investment management for both retail and institutional investors.

The firm now manages some £28.5 billion\* across a range of funds, two investment trusts, a Sicav, a venture capital trust and both pooled and segregated institutional portfolios. A number of these funds are available to investors in continental Europe and Singapore. Artemis' fund managers invest in the funds that they and their colleagues manage. This has been a key tenet of Artemis' approach to investment since the firm started. It means that our fund managers' interests are directly aligned with those of our investors.

\*Source: Artemis as at 31 July 2019.

**Alex Illingworth****Fund Manager**

Alex manages the Artemis Global Select Fund and Mid Wynd International Investment Trust with Simon Edelsten and Rosanna Burcheri. After graduating from Durham, Alex began his career running global funds at Rothschild Asset Management. In 2003 he was appointed a director of global equity at Insight Investment, responsible for long-only, ethical and absolute return funds. He joined Artemis in 2011.

## Sponsor

**CQS New City Equity****Company Profile**

CQS is a credit-focused multi-strategy asset manager founded in 1999. Our firm's deep experience allows us to offer solutions for investors across a range of return objectives and risk appetites. CQS is an active asset manager with expertise across corporate capital structures including corporate credit, structured credit, asset backed securities, convertibles, loans and equities. We are committed to delivering performance and high levels of service to our investors.

CQS currently has \$17.8bn assets under management and has offices in London, New York, Hong Kong, Jersey and Sydney. Our investors include pension funds, insurance companies, sovereign wealth funds, fund of funds, endowments and foundations, and private banks.

**Raphael Pitoun****Portfolio Manager, CQS New City Global Equity Fund**

Raphael is the Portfolio Manager of the CQS New City Global Equity Fund.

He joined CQS in 2018 and is an equity specialist with close to 20 years' industry experience. He started his career as a sell side analyst covering the general retail sector for Dexia Securities in Paris before moving to a managerial position in the equity research department of Exane BNP Paribas. More recently, Raphael was Chief Investment Officer at Seilern Investment Management, as well as being portfolio manager of the equity funds Stryx World Growth and Stryx America, both of which received 5 star Morningstar and Lipper ratings.

Raphael graduated from Sciences Po Paris, holds a degree in economics from University La Sorbonne and also received a diploma from the Société Française des Analystes Financiers (SFAF).

Sponsor



Mackenzie Investments

Company Profile

Mackenzie Investments was founded in 1967 and is a leading diversified asset management solutions provider, headquartered in Toronto with investment teams in Boston, Dublin and Hong Kong. As part of IGM Financial Inc., a wholly owned subsidiary of Power Financial Corporation with a history dating back to 1925, Mackenzie benefits from the financial stability of a deep corporate structure while maintaining a boutique investment management profile.

Our distinct and experienced investment teams offer both fundamental and quantitative approaches with expertise across traditional and non-traditional asset classes, including alternatives, currency and multi-asset strategies.

We are committed to delivering strong investment performance and offering innovative, relevant solutions to our clients by drawing on the experience and unique perspectives gained over 40+ years in the institutional investment management business.

Participants



Alistair McKissack  
Senior Consultant

Alistair McKissack joined Aon’s Global Investment Manager Research Team in November 2016. In his role, Alistair researches equities and equity managers and provides advice and recommendations primarily on Global, Emerging Markets and UK equity managers.

Prior to joining Aon, Alistair worked for UK Consultants Hymans Robertson for 13 years where his responsibilities evolved from client consulting to a pure equity research role. Before moving into consulting Alistair worked for a number of years in portfolio management, principally managing domestic equity portfolios on behalf of pension fund clients at Columbia Threadneedle. Alistair qualified with a BA in Economics from Strathclyde University and is an Associate Member of the Society of Investment Professionals.



Darren McKiernan, CFA  
Senior Vice President, Portfolio Manager, Head of Team

Darren’s career in the investment industry began in 1995. Prior to joining Mackenzie Investments, he was Vice President and Lead Portfolio Manager of a major global dividend fund at a leading investment management company.

Before that, Darren was a co-manager at a global value-based investment firm, where he focused on U.S. equities.

Darren has a BComm (Hons.) from the University of Manitoba and is a CFA charterholder.



John Arthur  
Senior Advisor

John Arthur was previously the Managing Director of Institutional Advisory Services at Allenbridge and now acts as a Senior Adviser at MJ Hudson Allenbridge. He has over 35 years’ experience within the investment industry, working with both

Corporate and Local Authority Pension Funds. He is a frequent speaker at conferences and seminars and acts as Independent Investment Adviser to LGPS funds and government bodies as well as acting as an Independent Trustee for a Pension Fund

John has expert knowledge from working within one of the UK’s largest defined benefit pension schemes as a member of the Senior Management Team. A career encompassing Head of International Equities and two years leading the relationship with the Scheme Trustees & Secretariat on all investment matters. He joined Allenbridge in 2012 and spent the last seven years working with a number of pension clients, both LGPS and corporate as an Investment adviser and latterly as Managing Director of Allenbridge before becoming a Senior Adviser.

## Participants



**Tom Baird**  
Vice President, Manager Research

Tom works as a Vice President in the Manager Research Team and sits within the liquid markets segment. His primary focus is equity managers with both global and regional mandates. He has been heavily involved in the construction of preferred lists for global equity and sustainable equity managers.

Tom joined Redington in December 2017 having previously spent 4 years at Willis Towers Watson, where he researched both public and private equity managers, helping to lead the research on UK equities.

## Participants



**Brendan Maton**  
Freelance Journalist

A highly experienced financial journalist with an expansive network of contacts in the UK and across Europe. Brendan has written about pension schemes and national welfare systems from Finland to Greece for 18 years and understands the retirement savings industry in each European country.

Brendan has interviewed EU commissioners and national ministers; central bankers; pension scheme heads; insurance chief executives; chief investment officers; actuaries; union officials; professional and lay trustees. He worked at Financial Times Business for eight years, finally as editor-in-chief of all international pensions titles. Brendan has spent the last ten years as a freelancer for a number of publications, including Financial Times, Responsible Investor, Nordic region pensions news and IPE. He is also Chief webcast host for IPE.

Brendan has acted as conference chair for Financial News, the UK National Association of Pension Funds, Dutch Investment Professionals Association (VBA), Corestone, Insight Investment, Marcus Evans, Robeco Asset Management, Sustainable Asset Management (SAM), Towers Watson.



**Reza Mahmud**  
Senior Investment Consultant

Reza represents PwC's Investment Consulting business, advising institutional asset owners in the UK and globally on strategy, governance and implementation. He sits on PwC's multi-disciplinary investment committee (pensions, insurance, sovereign wealth funds, private wealth) and also their firm-wide ESG (Sustainable Investing) committee. Prior to PwC he was a multi-asset investment manager at Aviva Life and Pensions, and before that he served with Brunei's sovereign wealth fund as a portfolio manager and asset allocation analyst.

Reza has an LLB law degree from Exeter University and an Investment Management MSc from Cass Business School (City University). He also studied behavioural finance and investments at Harvard University, University of Chicago Graduate School of Business, and London Business School, and studied Psychology and Cognitive Science at Johns Hopkins University.

## Global Growth in Global Equities



**The CAMRADATA Global Equities panel began by putting this asset class into the context of strategic asset allocation. The consultants in the room, representing Aon, Redington, PwC and MJ Hudson Allenbridge, said that searches in the likes of private credit, infrastructure and Multi-Asset Credit were taking up more of their time than global equities.**

Alistair McKissack, a senior equity researcher at Aon, said this reflected derisking by mature DB schemes. Reza Mahmud, a senior investment consultant with PwC, said his clients globally were looking for income assets, as well as shifting to passive equities because of cost. Tom Baird, vice president in manager research at consultancy, Redington, said that fresh interest in equities was coming from the Wealth channel in the UK, but less so from DB pension schemes.

John Arthur, senior advisor at MJHudson Allenbridge, said searches were becoming more complex as clients looked not just for one manager but complementing styles. He added that illiquids were also gaining in popularity.

“Why are pension funds reducing equity exposure if equities have served pension funds well and they still need returns?” queried Alex Illingworth, manager of the Artemis Global Select Fund.

McKissack responded that equities have helped close deficits but the next logical step is for those funds to move to match or even buy out liabilities.

Raphael Pitoun, portfolio manager at CQS New City Equity pointed out the paradox of liquidity. Pitoun has just launched a global equity fund with daily liquidity but said he would be much more comfortable without this. “I would be happy with a three, five or seven-year lock-in. I would take no management fee: just a performance fee after that period. But in public equity [in contrast to private equity], if there is no liquidity, you won’t get any money.”

Given these tough conditions, how do long-only equity managers attract attention? Baird said he wants to see purity of style. “Give us your highest conviction stocks,” he said, before giving an example of what does not satisfy Redington: “We were seeing momentum managers with BP and Rio Tinto among their holdings. They were being held as beta/risk management plays.” Understandable for a strategy that does not want to be punished by unfavourable comparisons with the index. But Redington doesn’t

want to see asset managers “insuring” themselves in this way. It wants to be able to mix styles to suit clients’ needs and managers to stick to what they are good at – and that requires purity from third-party managers.

Those present, however, from Artemis, CQS New City Equity and Mackenzie, take more flexible approaches, which are intended to grow wealth over the full cycle. Darren McKiernan heads Toronto-based Mackenzie’s Global Core Equity Team. Core, sitting in the heart of the style box, permits a more dynamic approach to style bias. He said: “Any quality-focused strategy has been a good thing in the last few years. That being said, I have been trying consciously to move into Value in the last 12-18 months, which now makes up over one-third of the portfolio. For example, the strategy allows me the flexibility to own both SAP and Oracle, which sit on opposite sides of the Value spectrum.

McKiernan noted that performance-wise, even this measured move to Value has cost the strategy. Quality and Growth did not cede to Value last year or the first half of this year.

If a manager is conscious of the currents captured by style effects and wants to navigate between those currents, determining which metrics to apply as constants in the valuation process is critical. McKiernan said he uses a discount rate of 8% to value companies and has stuck with it for twenty years (when he first began managing money at an avowedly Value house).

Illingworth said McKiernan was right for two reasons. First, because 8% net of tax is what Artemis Global Select uses. Second, sticking to a rate makes for consistency “which keeps us honest and is related to cash – that can be forgotten amid a wash of other metrics.”

Mahmud noted that global interest rates for 2,000 years have been around 4%: “until recently fairly stable, almost like a law of physics,” commented Mahmud. McKiernan said: “Whatever the rates do, we won’t change the number. We also apply a 6% rate in Japan. But in an acknowledgment to how low rates are, we are a little more thoughtful about exiting positions as they approach our estimated intrinsic values based on what are admittedly conservative discounts.”

Like Mackenzie, Artemis Global Select is flexible in the stocks it owns because it wants to get clients through an entire economic cycle without deep losses. “We never lose sight of the real purpose of what we are doing, which is to grow people’s wealth,” said Illingworth.



“If a manager is conscious of the currents captured by style effects and wants to navigate between those currents, determining which metrics to apply as constants in the valuation process is critical.”

“Why are pension funds reducing equity exposure if equities have served pension funds well and they still need returns?”



“Building up a picture of the intrinsic value of any company is the work of active management.”

To help achieve this, a fundamental flexibility at Artemis is considering prospects’ asset value and cashflow value. Companies may be stronger in one than the other, which provides diversification in different market conditions. Artemis has been pivoting towards the former as the bull run in equity has lengthened.

Moreover, Illingworth does not slavishly employ simple accounting measures to inform his choices: “What is Value?” asks Illingworth. “All the textbooks start with Book Value. But what about intangibles? At Artemis we recreate the value of the business from Asset Value, ie what would it cost to make a competitor?”

This means taking a harder look at intangibles and devising a more accurate worth for them. On the fixed asset side adjustments also have to be made sometimes. For example, Artemis took the fields in Champagne owned by luxury goods manufacturer, LVMH, and put a price on that land of 130% Book Value. Likewise, Illingworth warns that just because a business has fixed assets, it does not follow that these spell high barriers to entry for competitors. He gives the example of 3G assets’ limited usefulness in the coming 5G world.

Building up a picture of the intrinsic value of any company is the work of active management. Pitoun and colleagues at CQS New City Equity build up a 50-page dossier on each target company as preparation. He warns that the figure for that value is nevertheless not constant. “You have to have some sense of where each company is in the investment cycle. Value makes sense for certain sectors with tangibles. But an entertainment provider like Live Nation – how do you capture its worth? They invest a lot in their business with new venues and relationships with talent.” Pitoun described his approach as “valuation conscious”.

Arthur asked the managers how they fit the valuation into the thesis? “You are buying into a business model,” he remarked.

Pitoun’s reponse was that conventional accounting metrics are inadequate for understanding business models of the modern era. “The economic profile of the company is totally different from accounting,” he said. “We are looking at the long-term economic cashflows of the company. The only change in accounting principles in the last hundred years has been the recognition of goodwill. Multiples don’t make sense if you accept this thesis.”

McKiernan agreed. “How do you capitalise R&D spend, for example?” He said there were plenty of financial models out there offering managers “the security of false precision” but



the overwhelmingly important decision is: what is the business going to look like in ten years? “No model is going to reach that answer alone. But we are looking for businesses with competitive advantages; durable economics. There aren’t a lot of them in the world. What multiple we pay for a business is of minor consequence if we don’t get the big picture right. This is tough to answer – there are big global trends.”

On the risks to maintaining investment beliefs, Arthur noted that successful managers could be tempted after a number of years of good performance to dial down risk, reduce trading activity and broaden holdings. Or he saw evidence of managers lowering their valuation targets in order to boost growth late in a cycle.

Illingworth said that Artemis’s discipline had cost it in terms of performance in recent times. “We would have been better off not being valuation-conscious.” But late in the cycle, defensiveness is on the managers’ mind. Illingworth noted that his team’s own money was invested in the strategy they run. So what does protection for a long-only manager look like? Illingworth gave the example of Sumitomo Forestry, with 85% of book value in tangible assets, 8.5x P/E and 2.5% yield. He said this kind of stock would hold up over a more difficult environment.

In contrast, Artemis Global Select has held barely any Western banks and non-precious metal miners in its history. Among the FANGS, only Amazon currently merits inclusion. McKiernan was similarly concerned about balance sheets. “Our best performers have been stock exchanges which, unlike banks, have very little balance-sheet risk!” He said that managing money was ultimately a “black and white” endeavour with performance being the ultimate arbiter. Rightly or wrongly, it is understood that four consecutive quarters of really bad performance and you are out.

Arthur accepted this summary. “Our job as consultants is to coach clients through bouts underperformance if our view of the manager has not changed. Returns are the only factual numbers that the clients get, all else is subjective and so they struggle even with a short period of underperformance.”

But other consultants followed Baird and expressed wariness of style drift (distinctive from style rotation, which can be defended as premeditated). McKissack said he was concerned when he heard equity managers talking about carrying “insurance” in their portfolio. “That’s the client and consultants’ job,” he said. “Managers ought to be high-conviction, not thinking about overall risk when it is likely the institutional asset owners have diversification through exposure to different managers and asset classes.” Mahmud added that style drift was a key risk because under pressure, some portfolio managers’ behaviours start to change. Arthur added that he did not believe a house could fundamentally change its style or run two styles convincingly. “I think style is a deeply-held



“Managers ought to be high-conviction, not thinking about overall risk when it is likely the institutional asset owners have diversification through exposure to different managers and asset classes.”



conviction, akin to religion belief,” he said.

McKiernan’s defence was pragmatic: “As long as we can show a long-term track record, clients tend to give us a bit more leeway. Though 2017 and 2018 were our worst two years, we were only just below the market so our longer term performance stayed intact, and we were able to hold onto clients.”

Then McKissack admitted that even global consultancies like Aon have to work hard to maintain as much balance as possible for clients when a style is persistently out of favour. Fiduciary managers have more scope to rotate managers but in reality rotation is relatively infrequent.

Pitoun then asked the panel to take a step back and review what causes market performance. He cited recent research by the University of Arizona that only a limited number of constituents drive the stock market. “In the US, 50 stocks have made 40% of the value creation over the last 100 years,” he said. “Ninety-six per cent of companies destroyed value. We need to focus on the 4% as a reflection of economic profit in the real world.”

At an average 25 holdings, Pitoun’s strategy is concentrated into fewer stocks than the other two managers. “I look at a few sectors,” he said. “Our business is research, not portfolio management.”

Only the foothills are green

The conversation turned to Environmental, Social and Governance (ESG) criteria, which all the consultants recognised as a growing theme for their clients. The difficulty with growing themes is that universal standards are hard to implement. Thus far, the asset management industry has been guided far more by principles than unambiguous regulation. McKissack noted that impact investing was far more easy to measure on a standalone social project basis than across an entire business, especially a multinational with numerous lines of business and tens of thousands of suppliers.

Mahmud said that the quality of ESG data still has lots of room to improve, plus in seeking to evaluate its significance as a factor in company performance, there was a risk of correlation with other rewarded factors. Baird said that ESG scores by third-party providers can be manipulated by companies. “After a century of global accounting principles, we are still in the foothills when it comes to ESG reporting,” commented Illingworth.

His practical advice to asset owners and asset managers is thus not to try to satisfy themselves that every practice of every company has or can undergo effective ESG analysis. “You have to draw the line somewhere or else you will get lost in the forest of data”, he said. “Looking at everything does not contextualise it. The important point is to outline the metrics you think matter and integrate them into analysis.”

As a counter-example, he spoke about airports, which Artemis no longer holds. “Politics matter much more in Europe nowadays, more than hitherto. Airports are subsidized by visas and rates; plane fuel is not taxed. But airports will get caught up in green politics and biases may change.”

Pitoun pursued Mahmud’s point: “ESG is not data. There are many providers of such data but the quality is horrible. One financial institution, for example, offers ESG data profiles on 18,000 companies; 15,000 of the profiles include estimates.” Instead, he insisted that investigation into ESG issues, like other elements of company analysis, has to be conducted by the asset manager itself. Pitoun believed that Social issues were the least researched and required the most background research.

He gave as an example Rollins, a pest control business in the US. “It’s an industry with typically high turnover of staff. Rollins has worked hard to keep its turnover low by offering the right kind of perks. Staff retention has fed through to client retention.”

The panel then discussed Alphabet, Google’s parent, which has an ownership that concentrates power in the hands of the two founders. This might be a red flag for some investors. For Pitoun, on the other hand, it signalled long-termism. “Compared with Facebook, Alphabet has hired good managers with discipline in terms of financial investment; and it is very client orientated,” he said.

McKissack said that social media companies generally are going to have to spend more on the policing of content, directly or indirectly. Which led onto a disagreement over Tencent, Chinese social media giant and one of ten largest companies in the world by market capitalisation. Artemis Global Select exited the stock after the announcement that online gaming by children would be curtailed by regulation in China. For Mackenzie, however, the network economics Tencent enjoys make it worthwhile holding.

The CAMRADATA global equities roundtable finished with a manager asking a tough question of his own. McKiernan asked the four consultants whether they had ever mandated an asset manager with above-average ESG metrics but bad investment performance. McKissack said the answer was no, but worth clarifying that there is still a school of thought which regards consideration of ESG risks as an exclusionary approach which restricts a manager’s opportunity set and can lead to poorer performance. Current thinking, at least for active managers, has moved on and Aon would want to mandate a manager that has evidenced good performance and takes full account of ESG risks in their process... “and such managers are out there,” concluded McKissack.



“ Looking at everything does not contextualise it. The important point is to outline the metrics you think matter and integrate them into analysis. ”

“ After a century of global accounting principles, we are still in the foothills when it comes to ESG reporting. ”

# Investing through the cycle: The need for a diverse portfolio and versatile valuation toolkit



“ Investing guidelines that work well in a bull market may have erroneously come to be considered appropriate for all market conditions. ”

When students of financial history look back at past cycles they often chortle at the excesses – the madness of crowds – described. From the tulip bubble to TMT, from banks lending without assessing risks through to the mass selling of equities at the worst possible moment. Those students then think ‘I won’t make those mistakes’.

The current bull market in global equities is now in its tenth year. One must be mindful that such an uninterrupted upward run may have let indiscipline creep in. Investing guidelines that work well in a bull market may have erroneously come to be considered appropriate for all market conditions.

In our opinion there are a number of such principles that are worth looking at with a critical eye, several of which featured in our roundtable discussion.

### Turnover

Taking the most contentious of these principles first, we think it bizarre to adopt a blanket negative attitude towards the regular buying and selling of shares. At its simplest, buying more shares when they are cheap and taking profits when a share price is ahead of itself enhances performance. The trouble is that you have to believe you have found an active fund manager skilled in identifying cheap and expensive shares...

If you have, they should be able to demonstrate that their skill exceeds in value their charges and the cost of dealing. From that point of view, any manager understands the costs of buying and selling shares and will rationally minimize turnover to avoid these costs weighing on the performance of the fund. We believe that successful active management requires some degree of portfolio turnover.

### 'Our favourite holding period is forever'

This point follows from the last, but there is one further implication. Any selection of investments will, over the long run, see some rising much more than others. This will necessarily mean that the distribution of risk becomes more and more lopsided over time, with a portfolio becoming increasingly dominated by the most successful investments. These often end up being the most overvalued investments in the latter stages of a bull run.

### A focussed portfolio performs better than a diversified one

Now, this statement is true *if and only if* the focussed portfolio only contains successful stocks. As the bull market continues, even poorly selected stocks detract little from performance, so active managers can become over-confident. They can confuse a bull market with investment genius – everything they buy goes up, even if only a little.

When markets turn, however, the mathematics works the other way: one’s successes compensate little for the capital losses in one’s worst stocks.

### Investment risk is represented by volatility (beta)

Unfortunately, many investors are now educated in fundamental analysis using a theory called the Capital Asset Pricing Model (CAPM). We agree with the core principles of this model – that an equity can be valued by comparing its cashflows with bond coupons, but the future cashflows should be discounted for the extra risk of an equity compared with a sovereign bond.

Maybe for lack of any more immediate way of assessing the risk of investing in a commercial enterprise, CAPM then uses the ‘equity risk premium’ multiplied by an individual stock’s ‘beta’ as the discount rate premium for each equity. (For those interested in these things, the equity risk premium is a number generally picked out the air from historic data of equity outperformance of bonds. Beta is the ratio of an individual stock’s covariance with the variance of the equity market as a whole. Neither of these figures may actually represent what risk one is taking with one’s capital owning a share...).

Furthermore, betas seem unhelpful in practice. Bloomberg on 24 September 2019 quoted the raw beta of Thomas Cook at -0.7. This indicated a stock well-placed to bring balance to a portfolio by rising when the wider market falls. Unfortunately instead of balancing a portfolio as the theory would suggest, it went bust. Clearly, this raw beta uses the last couple of years of historic share-price movements. That figure did not identify Thomas Cook as an equity where investors were taking higher-than-average capital risk – something that the theory would say was indicated by a positive number over 1.

Similarly, among the ‘highest beta’ stocks in the UK index is Prudential (beta 1.47), a business which has chugged along pretty solidly since 1826. Rated as much less risky (lower-beta) is an investment such as SSE Group (beta 0.49) which was created in 1998 from the merger of Scotland’s hydro-electric stations and the Southern electricity billing and generating assets, including gas and coal power stations.

### Having a long-term perspective means volatility matters less

This belief may have resulted in some over-confidence. During the market wobbles in the second half of 2018, a number of funds fell rather more than the market. Markets then rebounded sharply in the first quarter of 2019. Some managers therefore argued that the best policy was to hold one’s nerve. So maybe the volatility should be ignored?

Unfortunately, the rebound has not always made up for the losses: a number of portfolios which suffered badly in the falls lagged the rise.

### Our approach

In the Artemis Global Select Fund, we value investments against both their future cashflows and against their asset values as described in the published balance sheet. As the bull market matures, it makes sense to us to be prudent. Our hope is to protect the capital gains we have accrued by increasing our weighting in more asset-backed stocks and by trimming holdings in higher-growth companies when we believe markets may have become over-excited.

As has been seen in many equity market cycles, growth stocks will generally lead investment returns provided they do not start from excessive valuations. Also some low-growth companies can make fine investments if their valuation is truly bargain-basement. Finally, growth stocks tend to perform during the core years of an equity market run, while the lower-rated stocks tend to hold up better during market sell-offs.

By bringing a better balance to our portfolio we hope to achieve strong returns when market conditions are fair and not to give up those gains too easily – even if markets conditions should sour. This is the way that we believe one ends up with the best real returns for our investors over the long run.

“ As the bull market matures, it makes sense to us to be prudent... we value investments against both their future cashflows and against their asset values as described in the published balance sheet. ”



Written by  
Simon Edelsten  
  
Fund manager, Artemis Global Select Fund



## Our Global Select hunters' *diverse* strategy helps them to skirt storms.

AS ANY PILOT will tell you, four engines are better than two. Get trouble in one – or even two – and there are still enough to carry you home. A similar philosophy informs our Global Select hunters' strategy. As the name suggests, the trio – Simon Edelsten, Alex Illingworth

and Rosanna Burcher – are highly selective in their approach. Hunting only the 'best of breed'. Yet they also believe in diversity, with no one stock typically making up more than 3% of the portfolio. Some might see this as a defensive mindset, but in the hunters' view it's simply enhancing the balance between risk and return. Enabling them to maintain a high active share in the face of localised squalls. The overall result has been top quartile Profits bagged since launch. Further proof, if proof be needed, that spreading the risk pays. In the long haul.

Performance (%)	Since launch <sup>1</sup>	5 years	3 years
Artemis Global Select	178.1	106.0	47.1
Benchmark	144.7	78.3	39.9
Sector Average	124.6	71.4	37.3
Quartile	1	1	1
Risk/return ratio vs peers	2nd decile	1st decile	2nd quartile

<sup>1</sup>Since launch data from 16 June 2011. Source: Lipper Limited, class I GBP accumulation units, mid to mid in sterling to 30 August 2019. From 4 February 2019, this fund changed from a dual-priced to single-priced basis; historic performance is unaffected. All figures show total returns with dividends reinvested. Benchmark is MSCI AC World NR GBP. Sector is IA Global NR.



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## Innovation Compounders

One of the most widely written about topics in investment management over the last twenty years is the rise of index investing. There is a growing recognition that most companies listed on the stock market are not worth investing in. A famous study from the University of Arizona makes this point perfectly: In the US stock market over the last 90 years, 96% of listed stocks performed less well than the risk free rate. Conversely, the totality of the wealth generated on the US stock market over the last 90 years was created by just 4% of US listed companies.

### Investment objective

There are many ways to try to deliver stock market returns. Some might even look at the 96% of underperformers as their share prices move up and down during their lifetime as a listed entity. Others, with increasing popularity, look for specific growth themes and create baskets of stocks which have a common secular trend. Our view is different, but we believe it to be a common sense approach – namely to identify the 4% that are the long term wealth creators. And among the 4%, the Holy Grail for us is to select a few dozen companies. In the above mentioned study approximately 50 companies generated 40% of the wealth creation – and so by finding these companies, with a disciplined approach, we believe will deliver exceptional and sustainable returns above benchmark over the long term.

### Research process

The question is how we do that? Valuation is a crucial point but comes at the end of our process. Often, a low valuation reflects a standard or mediocre business which is unlikely to be one of the gems we are after. Our approach is to look at the business first and study it over a long period of time. The research process, which is close to the process adopted by private equity investors, seeks to identify that the business has unique characteristics. We turn every stone to find the right companies - but that's not enough - we also need to target the right type of companies – and the most exceptional companies have many common characteristics such as: i) the focus on a particular mission for clients; ii) top notch corporate governance; and iii) excellent balance sheet.

### Brand

But even then, there is a debate among the tenants of the quality growth strategy. On the one hand, some investors would only invest in companies with a strong brand. For them, a brand is the cause of a good business. It is true that when looking at the list of successful companies and great wealth creators over the last ninety years, some of them have a strong brand but it is not the majority. We actually think that taste fragmentation, price transparency and decreasing barriers to entry - particularly in consumer goods – will reduce the list of companies to a minimum which only succeed through branding and marketing spending.

### Innovation

We are not focused on brands but on innovation. We think that particular types of companies which manage to deliver a constant flow of new and added value products and services to their clients are the ones to look at. Some companies manage to launch a blockbuster product which results in fame and growth for a few years, but that's not the type of innovative companies we look for. The ones that deserve our investors' money are recurring innovators that have deep knowledge of their market and an excellent track record of selling products their clients are happy to pay for. We segment these types of companies - what we call the innovative compounders - into four different groups:

- Innovation hub – companies which capitalise on their knowledge of their clients, their distribution capabilities and logistics to sell recurring innovation in new products and services;

- Innovation monopoly - these companies account for the vast majority of research and development spending and innovation flow in their respective niche markets;

- Innovation enabler - companies which help their clients to innovate – for example, simulation software or IT specialised consulting;

- Value chain disruptor - companies which approach their market differently – the innovation is in the business model.

Most of the exceptional companies which generated substantial returns in the past belong to one of these groups. We find the strategy particularly relevant these days as the general lack of pricing power can only be offset by value and innovation. No quantitative approach or factor investing will help to find these companies, only a methodological process combined with a lot of patience.

“ No quantitative approach or factor investing will help to find these companies, only a brain-based and methodological process as well as a lot of patience. ”

“ We turn every stone to find the right companies - but that's not enough - we also need to target the right type of companies – and the most exceptional companies have many common characteristics ”



Written by  
Raphael Pitoun

Portfolio Manager, CQS New City  
Global Equity Fund

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# CQS New City Global Equity Fund

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equity portfolio.**

“We look to invest in a small number of corporate stars which deliver a constant flow of innovation, empowering their customers and generating significant pricing power.

We are not interested in brands or trends, but in long term leaders in specific industries.”

**Raphael Pitoun**  
Fund Portfolio Manager

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The fundamental investment process pursued by Darren McKiernan, head of the Global Core Equity team at Mackenzie Investments, is simple to articulate.

“It’s a pretty straightforward approach,” says McKiernan, who has been with the Canadian firm, which has €98 billion of assets under management, since 2013. We’re looking for great business models from around the world.”

But simple can be hard to achieve. Finding those great business models and achieving 18% year-to-date performance, as the Mackenzie Global Core Equity strategy has in 2019, takes graft, especially when there is no sector, geographic or style bias to fall back on.

“It can be challenging for consultants because it’s tough to put us into a style box,” says McKiernan. “We’re not growth investors; we’re not value investors. We’re looking for great businesses at either end of that continuum.”

The strategy’s style agnosticism is perhaps particularly arresting. It finds opportunity in what could be considered Growth and Value securities. For instance, it owns SAP and Oracle, Tencent and Sony, Moody’s and Hannover Re.

Industrial gases and alcoholic beverages are examples of “advantaged industries” where McKiernan finds multiple opportunities to invest. He uses the term “compounder companies” to describe the kinds of businesses he is seeking.

“We’re looking for businesses that have consistent, high or expanding return on invested capital and certainly companies that have above-average free cash flow conversion for their respective industry,” he says.

In a strategy that has an average turnover of less than 25% and an average holding period of over five years, the long-term view is crucial. It’s comparatively easy to find businesses that have the desired characteristics today; the crucial question is how sustainable that is.

“We’re looking for those long-duration businesses,” says McKiernan. “That’s the hardest part of our job. We spend the most time on thinking about those competitive advantages, those moats, which in turn allows for the companies to compound its revenues and cash flows over the long term.”

Often advantaged industries are present in several countries. This is the case, for example, with financial exchanges and semi-conductor manufacturers.

“We own six stock exchanges, and there are reasons for that,” says McKiernan. “They’re phenomenal businesses whether they are in Japan, Europe, the US or Brazil. Financial exchanges by and large benefit from the same scale and unit economics no matter what jurisdiction they reside.”

Sometimes, the team identifies a long-term theme that presents opportunities throughout the value chain. An example is global air travel. Again, the selection is international, with the fund owning a Spanish airport, French and US jet engine manufacturers and a US reservations system.

“They’re all levered to global air travel, which has grown at two times GDP for 30 years,” says McKiernan.

However, this does not mean that the strategy is blind to geography and sectors. As lead portfolio manager, it is McKiernan’s job to make sure the strategy does not get unbalanced.

“Given the nature of the strategy and its goal to generate what we consider to be fairly consistent risk-adjusted returns, it’s my job to make sure it doesn’t become a technology strategy or a Japan fund. We obviously have different exposures compared to the benchmark, but we are conscious that it doesn’t get too tilted in any one direction,” he says.

And, while McKiernan believes that “great businesses don’t have any geography”, as a long-term investor, he is very aware of how the balance of global economic power is shifting from North America to Asia. This means paying more attention to the latter, and more specifically to China.

“We’ve started spending more time in this market over the last few years, and I suspect that will continue,” says McKiernan. “The reason is quite simple. It’s the world’s second largest economy and on its way to number one and it is just now entering global benchmarks.”

Several Chinese stocks have already joined the 50-80 stocks in which the strategy typically invests (the current number is 76). The team also maintains a “compounder watch list” of around 400 stocks. This is a watchlist of businesses with compounder characteristics that it monitors closely. Typically, these companies have some identifiable competitive advantage such as unique intellectual property, hard-to-replace assets, or offer valued products and services that present customers with high switching costs. The result is a collection of businesses that generate relatively predictable, high-return economics.

This can enable the team to take advantage of entry opportunities caused by valuation dips. An example is Equifax, which the strategy invested in after the cyber-security breach a couple of years ago. After the breach, the stock was off over 30% in a couple of days.

“We were able to make a decision quickly because it was on our ‘compounder’ list,” says McKiernan. “Even although we didn’t own it, we continued to follow it, still met with management when we had the opportunity, and we were able to be nimble enough to take advantage of the stock price fall after the data breach.”

Often, McKiernan, who came into the investment industry in 1995 and started working on global strategies in 1997, has been following the businesses on the “compounder” list for many years. He had, for example, owned Equifax along with other credit bureau operators previously, though the post-data breach purchase was the first time the Global Core Equity strategy had bought it.

That depth of team experience is part of what the Global Core Equity strategy offers. The “compounder” list has been curated and optimized for the best part of 15 years, and the team of six that are involved in the strategy keeps that job going. The team is organised by geography, but within that all the team members are generalists.

“We travel together a lot, and there’s definitely cross-pollination of ideas,” McKiernan says. “What we’re doing when we’re on the road is determining if there are companies we could potentially put on the ‘compounder’ watchlist and almost more importantly if there are companies that deserve to come off.”

Although it is under constant curation, the watchlist doesn’t change much. This chimes with the strategy’s low turnover and the team’s focus on those hard-to-find compounder companies with great brands, regulatory advantages or some other edge.

“Finding great businesses that fit the description of what we’re looking for – highly competitive businesses with great cash flow conversion – and where we have the conviction that the business is going to look similar ten years from now to how it does today is hard,” says McKiernan.

As to the future, the fact he is going to spend an increasing amount of time working out of their Hong Kong office says it all. Helped by an analyst from Beijing and another already based in Hong Kong, McKiernan is determined to expand their knowledge base on this huge market which, despite the current geopolitical uncertainty, is going to become a bigger part of global benchmarks over time.

“The ability to generate alpha is going to increasingly come from places like China,” he says. “For global generalist managers like our team, being able to demonstrate capability in stock selection in that part of the world we think is going to be a differentiator,” he says.

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Written by  
Darren McKiernan

Senior Vice President, Portfolio  
Manager, Head of Team

# High-quality compounders

# Proven investment discipline

# High conviction decision-making

Global Markets Expertise.  
That's better together

Mackenzie's Global Core Equity team has a long history of proven expertise in navigating global markets. Working together, our team applies a disciplined institutionalized strategy that identifies high-quality, compounder companies in seeking to deliver strong, risk-adjusted returns.

**Contact us to learn more.**

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