Being on the right side of disruption

In mid-May, **Tell Media Group**, in cooperation with **Aberdeen Standard Investments**, **Janus Henderson** and **Jupiter**, invited Finnish investors to discuss equity investing. Tell Media Group founder **Niklas Tell** and FBNW editor **Janina Sibelius** moderated the roundtable.

By: Niklas Tell Photo: Christer Salling

To kick off the roundtable discussion, which was held at Hotel Kämp in central Helsinki on May 14, Niklas Tell observed that it was a good time to hold this discussion given recent activity in equity markets globally.

NIKLAS TELL: WE'VE HAD VERY GOOD EQUITY MARKETS FOR A LONG TIME, OF COURSE WITH SOME UPS AND DOWNS, BUT CAN EQUITIES CONTINUE TO PERFORM FROM HERE?

GEORGE CROWDY: "Broad equity markets have done very well for a decade but within that there has been a lot of dispersion. Some sectors have done significantly better than others and I consider disruption to be the word that best describes what has happened. I think it's misleading to only look at the headline numbers. There will always be interesting areas within equities where you can create performance. It will be all about being on the right side of that disruption going forward."

DALE MACLENNAN: "I think it's worth putting Q1 2019 returns into context by remembering the substantial de-rating that happened in equity markets in Q4. If you look at last year, it was actually a fairly weak period for risky assets and right now it's very much driven by sentiment and headlines such as the US-China trade deal and Brexit. Can it continue? We're still overweight and supportive of global equity markets on the back of supportive valuation levels, growth making a modest rebound on the back of fiscal support and a more dovish stance from central banks around the world."

ROSS TEVERSON: "Looking at emerging markets, I would like to echo George's comment on dispersion of returns. Even if equities in general have done well, you've had pockets in emerging and frontier markets that haven't participated at all. Returns in frontier markets, for example, have been modest for several years and at the same time frontier market companies have delivered good earnings. That means that valuation multiples are low and the same is true for many small-cap companies in emerging markets. That must present a long-term opportunity for stockpickers."

NIKLAS TELL: AS INVESTORS, DO YOU AGREE AND WHAT DOES IT MEAN FOR YOUR PORTFOLIOS?

PATRIK MORING: "We think that markets still have more room to grow. We discussed over lunch if a growth slowdown is worse than rising interest rates because of higher inflation. While both would be bad, I think that a growth slowdown would be preferable as we have very reactive central banks. We saw this last year when rates were going up at the wrong time. As investors, we're happy to be long risk at this point in time."

STEFAN BJÖRKMAN: "We've taken a strategic decision to be 100 per cent allocated to equity-type risk over the cycle. What we do take into consideration is how much leverage we should have and I think it's fair to say that this is not the time to have leverage in the portfolio. I think it's also a philosophical question. We want to be invested in profitable businesses or assets. What the price happens to be from day to day doesn't mean very much. It keeps us anchored. If you look too much on prices, you would have had plenty of opportunities to make the wrong decisions over the last 10 years."

JANINA SIBELIUS: WHAT ABOUT EXPOSURES TO DIFFERENT MARKETS? WHERE DO YOU SEE OPPORTUNITIES RIGHT NOW?

PATRIK MORING: "I think the US market is still the champion. However, Europe is starting to look attractive and this is the market where we have added to positions lately."

GEORGE CROWDY: "I completely agree with you on the US. It really is the only market where you have huge companies that are able to grow their top line at 10 to 20 per cent plus. It's on a completely different level when it comes to growth at scale."

DALE MACLENNAN: "A lot of people have called the top of the US market many times over the last couple of years and have gotten it wrong every time. I agree with the supportive sentiment towards Europe and we're overweight emerging markets right now. Also, when looking at economic growth, what we see is a synchronised growth moderation where US growth is converging with other major economies. We therefore think it's more important than ever to get your stockpicking right rather than choosing one country over another."

ROSS TEVERSON: "It's important to look at sectors as well rather than just geographies. If you look at IT hardware, you have stocks in emerging markets where valuations are well below their US peers but they're in the same supply chain and are driven by the same end demand factors. It's an opportunity to get exposure to strong structural growth without having to pay very much for it. There are interesting opportunities outside of the US as well."

LIPPO SUOMINEN: "We have very interesting markets and what we would prefer is, of course, very much dependant on the outcome of the trade discussions between China and the US. It's difficult to make a call on that today but

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LIPPO SUOMINEN
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Chief investment strategist at S-Bank & FIM. He joined the firm in September 2018 from Nordea where he held a similar position. He started his career at Tapiola Mutual Pension Insurance Company in 1998 where he worked as an investment assistant and portfolio manager.

STEFAN BJÖRKMAN
Konstsamfundet
CEO of Föreningen Konstsamfundet, which he joined in October 2018 from a position as deputy CEO of the pension company Ilmarinen. Between 2014 and 2018 he was CEO of Etera, which in 2017 merged with Ilmarinen. Prior to working at Etera, he was deputy CEO and CFO of Aktia.

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> *– Stefan Björkman, Konstsamfundet*

assuming there will be a deal, we do like emerging markets. We recently had our EM manager in China and if we previously have discussed the 'Fed put', meaning that the Federal Reserve will bail us out, there's now discussions of a 'Chinese central bank put' and that they will save the country no matter what. One general question on emerging markets is, of course, why these companies have not participated in the rally to the extent most people expected. One explanation could be that in an era of 'bigger is better', we've seen many large companies moving into emerging markets to gain the benefits of the growth there. It's therefore not only EM companies that are benefitting."

NIKLAS TELL: IN TERMS OF FACTOR EXPOSURES, IS NOW FOR EXAMPLE A TIME TO CONSIDER HAVING A VALUE TILT?

STEFAN BJÖRKMAN: "I think the one thing in this chaotic world that is under-appreciated is good governance. If you look at companies with good corporate governance, they're usually more highly valued than companies with poor corporate governance. It's, of course, difficult to know what's what as companies that haven't sacrificed their growth options are not more highly valued than companies that show good numbers but have fewer future opportunities."

DALE MACLENNAN: "Trying to call a rotation from one factor to another is a fool's errand. For us it's about finding high quality companies and reasonable valuations, regardless of where in the cycle we are, especially when we are investing with a long-term time horizon."

GEORGE CROWDY: "I think it's important to differentiate between valuation and value. Low valuation companies are often the ones that are being disrupted by new market entrants and technologies, which make it very hard for investors to have confidence in the long-term value. Many low valuation businesses will turn out to be value traps. We believe that over the long term, growth will always generate the most value for investors."

ROSS TEVERSON: "Within emerging markets you can illustrate that by comparing Chinese banks to banks from other EM countries. Chinese banks typically trade at a P/E-multiple of five times future earnings. They have a low valuation for a reason. However, banks from other EM countries that also trade at a P/E-multiple of five have much stronger growth prospects. I don't think it's about value versus growth – it's about which of these lowly valued stocks also present a good long-term investment opportunity."

JANINA SIBELIUS: SO DOES THAT MEAN WE WILL SEE A RETURN OF STOCK-PICKING NOW?"

DALE MACLENNAN: "I certainly hope so and I think the other fund managers around the table would agree. It's a difficult question though as the influences that have been driving markets over the last ten years have been difficult for stockpickers to navigate."

STEFAN BJÖRKMAN: "You can, of course, also be a good or bad stockpicker. I think the judgement about the future is as difficult as it's always been but I really don't see any alternative to trying to find the best individual companies."

LIPPO SUOMINEN: "If we think about the bigger picture, we see that active funds are losing market share to have ETFs and index trackers and eventually something has to change in the market. In theory, you should have bigger opportunities when an increasingly large part of the market doesn't care about valuations. I don't know how long it will take and we're probably not there yet."

DALE MACLENNAN: "If we look at what's happening in markets, we do see that there are a lot of people that are trading on other information than you are as a stockpicker. Analysing the fundamentals of a company and buying at the right price is still key for long-term performance but the short-term movements of markets can be driven by other factors, such as sentiment or top-down macro views. Q4 last year was a good example of this, where equity markets de-rated aggressively on concerns about rising yields and trade war implications rather than meaningful change in earnings expectations."

GEORGE CROWDY: "But this short-term volatility is, of course, an opportunity for stockpickers."

DALE MACLENNAN: "I think one of the biggest challenges today is matching your investment time horizons with ever shorter client time horizons. Alignment of expectations are therefore very important."

STEFAN BJÖRKMAN: "I think another big-picture trend is that the younger generation is starting to act almost like foundations and returns are not the only thing that's important. You must also be able to stand for what the companies in your portfolio do. Money is not only money. An investment is also a statement. We've all seen the increased focus on ESG over the last couple of years from all parts of the industry."

DALE MACLENNAN: "The increased focus on ESG in the industry is very interesting because it's what we always have done when researching company fundamentals – it's essential when looking for quality companies. The difference now is that we also have to promote our ESG credentials more and prove that it's a fully integrated aspect of our investment process – from research through to stock selection and portfolio construction."

GEORGE CROWDY: "I think you have two ways in which to think about ESG. The first is to look at companies bottom up to understand their governance and how they manage and consider their environmental and social risks and opportunities. The second is to take a top-down view and invest in companies providing solutions to long-term environmental and social challenges. By taking both a top-down and bottom-up approach to ESG we're able to find attractive secular growth opportunities in this time of disruption and politically led markets."

NIKLAS TELL: WHAT ARE THE MAIN CHALLENGES WHEN IT COMES TO ESG? IS IT THE COMMUNICATION AROUND ESG AND THE FACT THAT ASSET MANAGERS NOW MUST BE ABLE TO PROVE WHAT THEY'RE DOING?

PATRIK MORING
OP
Strategist and portfolio manager for macro and equities at OP Financial Group. Prior to taking on his current role in 2013, he was an investment director and asset manager in other parts of the OP group.

GEORGE CROWDY
Janus Henderson Investors
Investment manager for Janus Henderson's global sustainable equity and global responsible managed strategies. He joined the firm in 2010 and was promoted to an analyst role on the global equities team in 2013 before becoming an investment manager in 2016.

DALE MACLENNAN: "I think one of the main challenges is cutting through the noise now that everyone if claiming that they've integrating ESG. We need to be able to both articulate what we do and how our ESG analysis is impacting our investment decisions as well as to prove it to fund selectors that are obviously looking for evidence."

STEFAN BJÖRKMAN: "For me, ESG is first and foremost about the 'G'. If you don't have the G, then the rest will not fall into place. Also, governance is a function of culture and the culture of an organisation is not something that will change rapidly. The really hard stuff is the culture and this is finally coming to investing. It goes deep. Look at the Nordic banks. The penalty for bad governance has been harsh and we've only seen the beginning. We've entered into a time where the penalty for bad governance is coming and it's coming quickly. It's a new environment. Some five years ago, you could get away with it."

ROSS TEVERSON: "I totally agree with Stefan that if governance work, then the environmental and social parts tend to follow. Also, even if fund managers are talking a lot about ESG, I do think that there are much more to be done on governance. Wherever possible, we like to speak to the chairman and an independent director in companies that we invest in. There are too many occasions where the conversations start with the chairman or director saying that they normally don't speak with investors. While engagement may be common in developed markets, it has a long way to go in emerging markets."

GEORGE CROWDY: "I think that the 'S' in ESG is probably the most under-appreciated area by investors. Most investors can articulate what good governance and environmental risk management looks like. But identifying a company with good corporate culture, which is often the key driver of long-term innovation and growth, is where you can really add value as an active fund manager."

LIPPO SUOMINEN: "I think it's important to remember that there's not one 'ESG'. It means something slightly different to all of us and the difficulty is in understanding the differences. The increased focus on ESG is, of course, a good thing – both due to the fact that we're helping to save the world as we put increasing pressure on companies but also in that it helps us make better investments. However, when everyone if focusing on one issue at the same time, there's the risk for a hype. We saw it in the IT bubble at the end of the 1990s when stocks were able to increase their valuations simply by issuing a statement that included the word 'internet'. We must therefore be careful and not just buy on headlines but do our analysis also on companies that say they are the most sustainable company in the world."

PATRIK MORING: "One of the challenges for us as investors is that it's hard to get in-depth information on what the ESG criteria are for different asset managers or index providers. For someone, it's about excluding some companies and for someone else, it's very focused on governance factors."

ROSS TEVERSON: "I think one problem is that many ESG-ratings are based on available facts and disclosures. If fund selectors are in doubt, I think the best thing is to look at case studies and discuss with the fund manager to really understand what he or she is doing. It has to be more sophisticated than just looking at the ratio of independent board members."

STEFAN BJÖRKMAN: "I would like to look back and make a comparison to what we have seen in industry over the years. In the 1980s, we had a focus on 'quality' and it was about avoiding waste – basically to do more with less or do it right the first time. Then in 1990s, the industry focused on 'lean' and that was basically about not wasting time on meaningless things. I would say that ESG could be seen as a gauge of what waste-trail a company is leaving on society and if you can find a company that can do something with less waste, it's probably more valuable. Also, the penalty for leaving a waste-trail on society is bigger and comes quicker today."

ROUNDTABLE – EQUITIES, HELSINKI

NIKLAS TELL: WHERE DO YOU DRAW THE LINE ON WHAT YOU CAN INVEST IN FROM AN ESG PERSPECTIVE? EVEN IF YOU HAVE GOOD ARGUMENTS FOR HAVING INVESTED, THERE'S ALSO A HEADLINE RISK FROM OWNING SOMETHING THAT MAY REQUIRE EXPLANATIONS TO MEDIA OR CLIENTS?

PATRIK MORING: "It's always at the back of your mind and being a major player in the market, we're one of the first places where media will look. You simply can't be caught with something questionable and it of course affects your investment decisions."

LIPPO SUOMINEN: "Everyone has to balance what they do and this is why we still have exclusions."

ROSS TEVERSON: "But doesn't it depend if you can actually explain it or not? If there's a company that will help a country in its energy transition, that must be fine – even if it is a company in the oil and gas sector?"

LIPPO SUOMINEN: "As I said before, it's about drawing the line somewhere and in that case it might be that I miss out on an investment opportunity."

STEFAN BJÖRKMAN: "Unfortunately, the bandwidth for explaining is getting narrower and for a general portfolio, I don't know if I would like to take the risk."

NIKLAS TELL: IF WE MOVE AWAY FROM ESG AND INTO THE QUESTION OF GETTING EXPOSURE TO GLOBAL EQUITIES, DO YOU DO GLOBAL MANDATES OR DO YOU PREFER TO FIND REGIONAL SPECIALISTS?

PATRIK MORING: "We prefer a regional approach as we would like to keep the control of the exposure we get."

STEFAN BJÖRKMAN: "For us, it very much depends on what we're looking for. We have a core portfolio and from time to time, we ask ourselves what the best diversifiers would be. If we find that it's automotive and forestry, then automotive could be a European exposure and forestry would be a global exposure."

NIKLAS TELL: YESTERDAY, WE HAD RENEWED FEARS OVER A TRADE-WAR BETWEEN CHINA AND THE US, WHICH IS ONE OF THE LATEST GEOPOLITICAL EVENTS OVER RECENT YEARS. ARE EMERGING MARKETS IN GENERAL THE HARDEST HIT EQUITY MARKET BY THESE?

ROSS TEVERSON: "I think it's hard to say. I think emerging markets have had their fair share of geopolitical events over the last couple of years. We've had a lot of elections in emerging markets last year and coming into this year. One good thing is that these are now behind us and we can look forward to more stability on the domestic political front. On the US-China trade issue, it was disappointing that Trump and his administration didn't reach an agreement. Our base case is, however, that a deal will come into place. The question is how long it will take."

DALE MACLENNAN: "Also, even if the US and China do come to an agreement on trade terms, I think this is only the opening salvo between these two super-powers. There's more to come. One thing that we've

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DALE MACLENNAN
Aberdeen Standard Investments
Head of equity investment specialists at Aberdeen Standard Investments. He works closely with the company's active equity division to support its commercial growth and development. He joined Standard Life Investments in 2002, having previously worked at Scottish Widows Investment Partnership and the WM Company.

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> *– Lippo Suominen, S-Bank & FIM*

developed over the last five years is an ability to scenario test the risk footprints of our equity portfolios to certain significant macro or geopolitical events to get a more granular understanding of the risks you have in your portfolios."

NIKLAS TELL: WE HAVE TALKED A LOT ABOUT ESG AND TRUMP. LOOKING AHEAD, ARE THOSE STILL THE MAIN RISKS TO NAVIGATE OR IS THERE ANYTHING ELSE OUT THERE THAT KEEPS YOU AWAKE AT NIGHT?

STEFAN BJÖRKMAN: "Well, technology has not gone away. Disruptions from new technologies are still in their infancy."

DALE MACLENNAN: "And central bank policy is another factor that we still need to keep an eye on."

LIPPO SUOMINEN: "To put it in simple terms, if you think there will be a recession in the US next year, then you should sell equities. If not, then you should keep them and live through the volatility. The economic cycle will, of course, turn at some point and that was the fear last autumn. The risk is, of course, still there."

GEORGE CROWDY: "I agree with Stefan on this one. Many industries are still very early in their adoption of technology and companies that are not thinking far enough ahead about the impact technology will have on their industry will likely be long-term losers."

ROSS TEVERSON: "We've talked very little about debt today and that should not be forgotten. There are very high levels of debt in many places and one reason why we don't own any Chinese banks is that we're not comfortable with the way asset quality will develop if growth slows. China has a very high level of debt to GDP given where it is in the development phase. In general, I think we need to focus more on balance sheets – both on a sovereign level and also for corporates."

NIKLAS TELL: ANY FINAL THOUGHTS?

STEFAN BJÖRKMAN: "We have talked a lot about challenges and the negatives but I think it's important not to forget that there are a lot of positives as well."

LIPPO SUOMINEN: "I agree. Given the level of interest rates, we don't even need companies to grow their profits – it's good enough as it is to be positive on equities. Overall, if you look back over the last 10 years, this has probably been the most unloved equity rally of all times. Cycles usually turns when everyone is too positive and there's euphoria but we haven't had that this time around. That's probably one reason for why this equity rally has continued for this long."