Inside the minds of Australia's most successful global investors – Part.1

James: When I was doing some background reading, knowing that we've got the two firms we've just talked about, complementary styles, that also means that there's a difference in approach and a difference in philosophy. How would you two see the divergence and the similarities between the way that you invest? My take was more of a deeper value contrarian focus from Platinum and Hamish from the recordings, and the reading I've done recently, I feel like I'm getting a sense that the quality of the business and the hurdles for that growth trajectory that the business is on, is a bit more paramount in your process.

Hamish: Yeah. We won't do contrarian deep value type investing. We tend to invest in super high quality. We do take, within that, we will take a contrarian position. Often your best ideas are contrarian, but they're not classically would be styled as the contrarian play. I think that's slightly different. I think Platinum is more diversified, in terms of it's the number of holdings. We tend to take very concentrated, single stock, specific type risk. Where Platinum takes less of that single stock type risk.

They would only end up with 7% of the portfolio in a single name. So the absolute concentration is different. We have obviously got expertise and things in different … we've been more US centric, they've been more Asian centric in their portfolios. I think they probably will be more classically in the value bent in terms, but everything comes to value. I find this misnomer about, they're probably more contrarian in the style than ... We're all looking at value at the end of the day. This concept of value investing is something is just, takes itself to one or the other. It's stupid.

Andrew: Well, I'm more and more abject to the label of value, because if you're not a value investor, then you're not investing. You're actually just speculating. Right? To us everything comes down to price, but value gets associated with low PEs, low price to book. You could have a low P and a low price to book and be terrible value, or you can actually be a very highly rated stock, and we think represent great value. I think-

Hamish: Exactly. When we bought Visa and MasterCard, there were 15 times earnings or something. We thought they were dirt, dirt cheap. But the value investor would say, well, they're never going to be low price to book, because they don't have any books.

Andrew: But they're good examples. We at the time were doing the work on those, because they were, at the time you're buying them, they're out of favour because of some of the regulatory changes going through. We do like to have that present, that sense that there's something concerning people about the company, but we do end up from time to time in the same stock. I think we're both in eBay and then PayPal, as it spun out-

James: I think you both are on Facebook at the moment?

Andrew: We've come to Facebook, we're all watching it very closely for a long time. Then hadn't acted on it, and we had the Cambridge Analytica initial selloff and bought it then, and then have bought it again after the-

Hamish: When we first got into Facebook was probably a year and a half earlier than that, when they gave a warning about that we're going to have less ad load and the market sold off dramatically. Ours was a bit of a contrarian entry point, Platinum just came to a contrarian point, it was another contrarian entry point, as well.

Andrew: But I think we do end up in some of the same stock some of the time, but we probably just are prepared to go ... What we would talk in terms of quality. Prepared to go down to more cyclical sort of stocks.

Hamish: Where we won't. We're just very strict on the quality-

James: Yeah. Yeah.

Hamish: We're not saying which is right or wrong. It's just a style.

Andrew: And it goes a bit to our lesser concentration. We always look at people who run very concentrated portfolios and first we would say, sometimes those strongest ideas are actually our worst. Right?

Andrew: You didn't identify ... If you could have such a strong view on it, you haven't identified what's making you uncomfortable. For us, we feel like you've got the good calls are the ones that are very uncomfortable. Not the ones that are easily done. We do prefer to have that broader spectrum of stocks. Having said that, it's still a relatively concentrated portfolio, by many people's standards.

James: The nature of the cyclicality of the businesses that you own, you need that bit of diversification just to cushion the ones that don't work out. Is that right?

Andrew: I think that you just don't have the high ... When you're investing at the very high-quality end of the spectrum, you can have greater certainty about the future outcomes. It's not for us, at the moment we own quite a lot of cyclical type businesses. That's where the market, we think, is throwing up the great opportunities. There have been other times where we've been completely at the other end of the spectrum, depending on what's going on in the markets and in the world.

James: Well, talking of markets and the world, there's the annual Christmas comes, people take a bit of a breather. It was also quite an interesting time with the Fed effectively doing an about turn on their policy and the narrative around that. People in the latter part of last year were factoring in continued steady rate hikes. They did an about face. How meaningful has that change in stance been for things like confidence and how you're viewing the trajectory for equities from here? Hamish, you can start with that, and Andrew, come on in.

Hamish: Well, James, you're absolutely right. It was a massive back flip by the Fed at the end of January. I don't think many people are expecting the extent of the back flip. Obviously, very latter part of last year, financial conditions did tighten, but we had a big sell-off in markets, as well. I actually think Davos probably influenced with Dalio and others in Davos saying they're going too fast. They need to slow down. They're going to cause another recession. We're very worried about how late cycle we are.

Of course, we have Trump, who's out there, calling on the Fed. Then they come out, you're not only right. They back flipped in terms of suddenly inserting the word patient, and that was last year's, back in early 2016. This feels to me like 2016. They started tightening rates in December '15, and then the beginning of '16 they got spooked by China, really about their foreign currency reserves. They put any rate increases on pause for a period of time. The markets took that as a signal that low rates are here, and 2016 happened.

It eerily feels like 2016 again, but very importantly, they also mentioned the balance sheet. They haven't told us what they're going to do, but they said they may well change the pace of quantitative tightening, and indeed earlier, than previously had been anticipated. I think that's far more material in the news. Really, the punchbowl's been handed back to the markets. We've actually seen, if you look at flows around the world. Flows into EMs, flows into high yield and probably riskier areas of the market, there's been a very risk on trade, as in this party's going to continue.

Hamish: My warning to people here is none of us know what's going to happen. They've probably given us another six months before really knowing where it goes from here. Are we going to continue this very low inflation world and then the Fed can just continue this pause effectively on, without having to worry about inflation? I don't know. At the end of the day, we haven't really seen inflation yet. That doesn't mean it won't happen. It reminds me back of July 2007, this environment. The reason I'm picking July is because that's when Chuck Prince, who was the CEO of Citigroup, made his very famous statement.

He goes, "When the music's still playing, you've got to get up and dance. We're still dancing." And the way, what Powell has actually said is the music's still playing. I just think it's very risky to say, then, it's compulsory to dance. I think it's incredibly uncertain. It doesn't surprise me that the markets have reacted since January and into February, as they have. Look, some of this trade dispute may well get taken off the table. We don't know. China seems to have steadied its situation somewhat, and the Fed has said the punchbowl is back, and risk is back on.

Andrew: Yeah. I would agree with most of what ... with all that Hamish is saying, but I think the thing that's getting missed here all the time in all this analysis is we're focusing on US rates. We're focusing on the US economy. It's what we've done for the last 30 years, but China today, second largest economy, but it's the biggest market in any physical good you can think of, from shoes to planes, to trains. It's a huge market.

It is just, I think, very similar to 2016 in the sense that China had a huge tightening in monetary policy back then, caused by the capital outflows. What we saw a year ago was this financial reform, a huge tightening of availability of money. You can see it in Chinese interest rates. If I ask someone, where's the Chinese 10-year bond? Who's going to tell me? Right? Or short rates. Chinese bonds have gone from the 10-year yields have risen from a bit below three to around four and a half a year ago. The short rates have similarly gone above five.

We'd actually inverted the yield curve in China. They don't manage their monetary policy really in that fashion. It really reflects other things that are going on. Here we had an inverted yield curve in this economy. Guess what happened? It slowed, and it slowed in a way, in quite a different way, to what we've seen before. It's been in a much more of a consumer focused slow down, as some of that credit that was finding its way into that market, particularly through peer to peer lending, was taken away. What have we got now?

10-year yields in China are back down around three. Short rates are below three. We've got a fiscal ... Again, in China, one of the problems is transparency, but all of the policies, the best analysis that's out there suggests that we once again have a fiscal stimulus to the tune of about 3%. This time more through tax cuts than spending. I think the place ... We never do know what's going to come next, but in the way the systems of the world work, you would expect China is going to look a little bit better this year. We've taken away the US tightening, but again, we are late cycle in the US. Perhaps not so much in the rest of the world. It's an interesting set of circumstances we face this year.

James: You go to vote with your feet. Given the changes that have taken place over that 12-month period you've talked about with China's rates, what we've talked about happening in the US, have you dialled up the exposure in the portfolio? I know when we caught up last year, I think it was sitting around 80% exposure in your portfolio? Have you increased the risk that you're taking?

Andrew: No. What we've really done is change within that portfolio. As we've had the sell-off later in the year, there are some really great stocks, very cheap, particularly in the semi-conductor area. The one I like to highlight, we've often talked about Samsung. But Micron, it's one of the three players in DRAM, one of the five players in flash memory. The most incredible science at the heart of this company or these companies, a very now consolidated market. The same incentives aren't there to invest in capacity, in DRAM at least.

It's at the centre of every exciting technology, whether it's Facebook or it's autonomous vehicles. You can buy it at book value. They're promising to buy back a quarter of their stock at the lows. Now, the stocks have had a good bounce off there, but it was extraordinary value in a lot of these cyclical tech areas.

What we were doing is more going, okay well, we've been progressively leaving positions in other parts of tech, which we think not particularly expensive, but didn't offer that same sort of opportunities. Whether that was Alibaba in China, or we've been selling down and are out of PayPal, which we still think they're great companies and they have lots of opportunities, but we thought this represented a lot more. The market exposure is similar to what we had. A little bit lower than that 80% at the moment, but a lot of movements underlying the surface.

James: Hamish, similar style question for you. In that period in the last quarter of 2018, there was a big draw down, particularly in the US index. It's bounced back, but you were carrying 18% also cash, at that time. With that kind of dislocation in the market or short-term drawdown, did you find some compelling ideas? Did you feel pressed to put some money to work, given some of the changes we talked about at the macro level as well, with rates and the punchbowl being served back up?

Hamish: Yeah. At the margin, at the end of the day. Why I said at the margin, there was a whole series of things that we were looking at. Frankly, January ran very strongly. We are less than ... We got up to 20% cash. We had less than that. We're probably at around 16% cash. Slightly less than that. We've deployed some cash. Don't forget we're super, super high quality. We tend not to play the technology cyclicals, for instance. I'm not critical at all, but that's not in our quality filter of what we play, but a number of things had sold off very dramatically. I'm not going to tell people what we bought.

There has been some trading within the portfolio, as we saw as well. Some things we were buying, then they ran past our price limits where we feel comfortable in this market.

James: Yeah. 16% and cash, and Andrew, that relatively ... Below 80%, that tells me that despite some opportunities coming up at the stock specific level, you're both still relatively cautious and circumspect about the outlook from where we are in markets. Is that a fair summation?

Andrew: I struggle a bit with drawing that conclusion from our positioning, because to me the positioning comes about the opportunities in the stocks. I'm extraordinarily excited about the opportunities in our stocks. To me, in the world we're in, and I'm talking a long term, not the next 12 months, I think as a portfolio positioning thing, you want to run through time with cash of probably 15% because opportunities arise.

If you don't have cash, you're not going to be able to take advantage of it. I don't even see that as being particularly ... I think there's lots of issues that will come out of left field and hurt markets over the next five years, but in the meantime, we're buying the stocks we want to buy, have a few interesting short ideas, and it's not a statement about-

James: It's not reflective of a broader view or a market level view.

Andrew: No. It generally isn't. It's very interesting because most people would take our positions being very cautious on markets. I would actually ... I don't think a 12-month view on markets is of great value from anyone. I certainly don't think I have great insight into that. Because of the sort of things we're talking about with this illiquidity and whatever, my best guess is markets are probably going higher this year, until the next problem arises.

James: Let's talk about one of the major differences that people attribute to the two firms and how you position, and they often see Magellan as a bit of a proxy or exposure more to US markets and Platinum with a specialty in Asia. A question has come through from some of our readers saying, where do you want to place your bets? US versus Asia. There's been this period of really strong US leadership, more recently Asian markets had a challenging time. How do you think about that country and that geographic allocation, and where you see the opportunities within those different markets? Hamish, the bias towards the States?

Hamish: Well, first of all I would say there is just a huge misunderstanding about what we do that is based towards the US. It's domiciled to the United States, without a doubt. It's 70% of our portfolio is domiciled to the United States. But the vast majority of those businesses are very large multinational businesses. We have very, very little cyclical exposure in the United States, where we're taking a US view on the US economy, dramatically outperforming.

Actually, we've sold down most of what we would call our US domestic style exposure in a portfolio. We've got businesses, the example I often give is Nestle is a Swiss company and it's got 2% of its sales in Switzerland, but it has nearly 35% of its sales in the United States of America.

We don't own Coca Cola at the moment for various reasons, but Coca Cola's a kind of quintessential American company, and it has a bit over 20% of its business coming out of the United States. Everyone would say that if you own Coke that you've got a US bet on, and if you own Nestle you may have a European bet on. It's just complete nonsense at the end of the day.

Ours, because of the nature of very market leading firms like Google and Facebook and Apple and Nestle and others, they're operating everywhere, as in Visa or MasterCard. Some of them may not have businesses in China, like Visa or MasterCard don't have businesses in China, but then we've got Starbucks, which is a big business that is 60% of its future growth is probably going to be driven by their Chinese business over the next decade.

In no way are we, sometimes we haven't expressed a view of a particular economic zone where we may be buying banks in a particular area of the world or a more cyclical bank, a kind of cyclicals or other things, some retailers we may have already, domestic retailers, because we're taking an economic view.

But we've got a very neutral economic view in the portfolio, notwithstanding we've got this big domicile view at the moment. We don't tend to have a lot of what we call economically cyclically things in the portfolio. That may well be a difference where we are at the moment, but this whole US, non-US, and also this thing that the US market is more expensive than other markets around the world.

If you look at the S&P 500's, average price earnings multiple ... Yes, it looks more expensive, but if you look at the underlying sectors of the market, and you compare similar companies in America, we just had Micron which is a US company, but its PE multiple is incredibly low.

And they've bought that over maybe some other memory businesses as well, because there's that US one. They sell the memory all around the world. Even though, and Andrew's … not taking a US view on that. That's a US company.

When you look around, some of the big, within sectors, some of the cheaper ones are actually the ones listed in America. It's just the American actually index is far more skewed now to very large technology, which trade at high multiples as a whole. Therefore, this whole thing, these commentators about ... Markets simply are just not that inefficient.

Andrew: That's absolutely correct. I think we've missed ... We've always thought the way you want to look at the world, and it's' the way our teams are set up, is they're industry specialists. You can't do Micron without knowing Samsung, Hynix, Sandisk, the lot. You can't do Sanofi without knowing what Merck is doing in the US. This is exactly the case that the US is expensive, because of these large tech stocks. There is some difference. I think the US banks are generally a lot more expensive than banks around the world, but then conditions for banks have been much better in the US.

Hamish: I would actually say if you actually look at the big US banks, and you look at their average price multiples compared to the non-Chinese large banks in the world, the multiples are very, very similar at the moment.

Andrew: They probably are.

Hamish: If you adjust them for the return on equity, their price to books probably for the right return on equity, is probably not that far out. The US was ... They've come off quite a bit lately-

Andrew: Yes. I'm not following them that closely, but I think some of the banks exposed to eastern Europe, which is a really healthy environment. We're talking of stocks that have got growing loan books and on book value, and seven times earnings. Or you can go to somewhere, a stressed economy like Italy, and get the great bank Intesa, and they're paying out all their earnings and getting a 10% yield. Now, it's not the most exciting investment, because if that's all you're going to get, I wouldn't own it.

You need some economic growth to make it a sensible investment, but anyway. They're probably, I'm looking at particular banks rather than the ... yes, the large European banks are pretty dull, I think or are in line. It is this thing, it's not about the geography in most cases. Yes, there will be domestic US business, domestic Chinese businesses. There all facing their own factors. It is really about we need to be looking at the world on an industry basis.

Hamish: That's why we are global investors, and true global investors would look at the world that way.

James: What do you think are some of the really exciting long-term global industries that you think have got this multi-year growth cycle ahead of them? Where are you seeing the really strong tailwinds, that really attract you longer term picture at the moment, if we take a positive view on a particular industry that you think is ... regardless of the economic backdrop, is really going to be a major player over the next 5 or 10 years?

Hamish: Well, if I picked one big one that we're still in very early stages, I would put Cloud computing. The shift of computing power in the world and there are going to be very, very few huge infrastructure players in the world with the deep capability. Outside of China, we probably have three very large-scale players now in the world. Amazon with AWS obviously is one. Number two is sitting in Azure, which is owned by Microsoft, and three in the world is Google Cloud, obviously owned by Alphabet.

We're at a very, very early stage, probably in a trillion-dollar addressable market. If you look over the next decade, that's going to be a massive industry to get into that, and of course it's participation in that, and we may hear something on semi-conductors and other things, how to participate that.

But I think in the industry of the future of this shift of computational power to the Cloud, and even things like driverless cars and things. That's all going to be powered by ultimately Cloud based technology and then you've got the chips and you've got the software and everything that goes into that.

We've been in some ones that have still got very long tailwinds. We've been in payments for a long period of time. There's still this massive shift, global consumption expenditure probably grows at 6%, but these big payment networks are probably growing at around 12, PayPals a bit faster, but Visa and MasterCard because you've still got this massive shift out of payments of cash and check.

When you have something delivered online, when is the last time you paid cash on delivery? Or a check on delivery? All that is, everything that's going online has to be paid digitally. Now, in the world. That is still, even though it's been going on, that has got a very long tailwind.

The big emerging one that I think is just massive in terms of scale, I would probably put the shift to the Cloud. There's all sorts of different ways. You could be into software. Software as a service. You can be their infrastructure providers. You could probably be in the semi-conductor space.

James: Could you give me, I'll come to you in just a second, Andrew. Give me an example of ... Often people like to say, so what's changing? What's a new piece of technology, or what's being enabled by Cloud computing that really captures your imagination? I imagine you meet with these big companies that you're talking about, and they're working on projects out the side. What are some of the things that you've seen when you've been out researching these companies and understanding their capabilities that have really blown your mind in terms of change with how we're going to be living and interacting in the world?

Hamish: Well, I think we're just seeing at a very simple sense in ... Now we're worrying about cybersecurity and security to everything. These big Cloud providers can provide much better security for the future than we can provide by investing in our own systems on premise because they can be automatically patched, for instance. A lot of these cyber attacks that have happened have attacked from very large companies with on premise software that simply forgot to patch, or it's very, if you operate in 80 countries in the world, it's very, very hard to continuously patch all your different software and everything, on the basis.

They're very practical examples, but of course, once you shift of that model and you get software as a service, and you shift to that, you're then in a very annuities style business. I think powered by the Cloud, you're going to see the Internet of Things, of course where we're going to get massive amounts of connected devices all through our homes.

You look at your photos on your phones at the moment. Every photo, they're all stored in the Cloud. There are various things happening in your life every single day. Ultimately, we will get to a world, I believe, of driverless cars. I think they'll start as taxi fleets. I think personal driverless cars are a long way out from where we're sitting today, but there's shifts there and the impact it's going to have on people, is going to be absolutely immense. We're right at the 1.0 of what the shift of the Cloud means for business models and just how we do things in our day to day lives.

James: Do you get excited by the same challenge?

Andrew: Well, I mean, absolutely. The sort of Cloud is enabling all sorts of interesting things, even within software. That issue of security, for example, interesting company. We don't own it. It's pretty well loved is Zscaler which is using a Cloud based solution to provide security for companies around their existing systems. It's a very, very clever solution. I think it was been adopted, it's either Siemens or GE who are using it. There are these amazing companies coming out of nowhere, because of it. Quite extraordinary, but there's lots of elements to the excitement that's out there, whether it's artificial intelligence, which autonomous vehicles is probably one of the most interesting elements of that.

Even it doesn't have to be fully autonomous, but what the features you get on a high-end BMW or Audi or Merc as they come down through the range of vehicles, electric vehicles, renewables, lots of interesting things going on, there. Then another area is biotech where you've got some extraordinary science at the moment coming up with all sorts of potential solutions for human health.

James: What's an example of a step change in that part of the world?

Andrew: Look. It is honestly, we've got Bianca Ogden who came out of research labs at J&J and is worth an interview on her own to do justice to any of those ideas. Really, it's one of the areas where laypeople really struggle to explain anything well, but we've seen ... It's quite been a popular idea in the last year or two, but gene editing or whatever, to try and change people's response to our own genetic response.

James: Susceptibility to disease.

Andrew: There's a huge area. There are all these different things that are ... And again, we're the contrarian, but the other thing we love is where there's change going on, because to us it's where you can't extrapolate. If you can say, here's this company. It's grown 5% forever, and it's going to keep growing at 5% forever. Well, if it does, it's probably the case everyone has a pretty good sense of that, but wherever there's technology and change going on.

I mean, as an example, people are very bearish about the auto companies for a whole range of reasons. Autonomous, the costs of going electric, which is being forced on them by both the European and Chinese regulators. It's been a massive cycle, we're at the end of the cycle, and we probably are, but it's when you change products that you create the opportunity for the good companies to make money.

I think there's a very good chance that the boring old car companies, particularly a BMW or a Daimler are going to make a lot of money out of selling electric vehicles, and there becomes the upgrade cycle.

Well, I've got my current BMW, but now there's one with hybrid electric, or it's got more autonomous features, or whatever. These kind of changes drive opportunities.