Future Generation: Insights from the Investment Committee

Caroline Gurney and John Coombe

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CAROLINE GURNEY: Hello and welcome to Future Generation Insights from the Investment Committee (IC). I'm Caroline Gurney, CEO of Future Generation. Today I'm joined by John Coombe who is an Executive Director at Jana Investment Consulting. John is on the investment Boards of both Future Generation Australia (ASX: FGX) and Future Generation Global (ASX: FGG). He does that on a pro bono basis, which means shareholders get the benefit of his advice that he would normally be giving to superfund clients. All of the underlying fund managers, service providers, our Boards, the IC, provide their services on a pro bono basis. Other members of our Investment Committee include Geoff Wilson AO, our founder, as well as other well-known individuals from Morningstar, Lonsec, the founder of Zenith to name but a few. Their collective generosity allows the Future Generation Companies to generate investment returns for our shareholders, and also make a social investment in high impact not-for-profits. We give 1.0% of our assets to not-for-profit organisations that support children and youth at risk, and to the prevention and well-being of young people's mental health. So far Future Generation, both the Companies have donated $65.2 million, thanks to the ongoing support and generosity of people like John Coombe. So John, welcome. Thank you so much for spending time with us today.

JOHN COOMBE: Thank you, Caroline.

CAROLINE GURNEY: So tell me what is your day job? In your own words, what are you doing on a day to day basis?

JOHN COOMBE: Everybody askS me, especially my kids when I was at school, they were at school, and you had to do those presentations. But look, I have one of the best jobs in the world, Because I get to look at financial markets on a daily basis, I get to look at macro-economic trends that are happening, get to read and listen to the best minds, globally. We're in a very privileged position as the largest institutional consulting firm in Australia that, you know, all of the fund managers globally come and see us, all the domestic managers who want an institutional mandate, come and see us. So, I do get to speak to some of the, you know, the brightest and best investors in the world on a weekly, daily basis. So it's fantastic.

CAROLINE GURNEY: I think on the Investment Committee, we you know, we are very grateful for your expertise. But first of all, let's talk about markets. I have a number of questions from shareholders as well. So I'm going to be varying from those, because obviously, we do our webinars on a very regular basis. You know, it's a really extraordinary time at the moment. And history doesn't necessarily repeat, but it often rhymes. You know, the period that we're going through now, what does it actually remind you of? And can you help explain what is happening at the moment and how to navigate that volatility? What are you telling you superannuation clients?

JOHN COOMBE: Wow. I don't think there's anyone alive investing today, maybe Willow might be there, but who has ever been in a period like this. I think it's unique, right? And let me go back in history, probably after the Second World War, because I've read a lot of historical economic material, trying to get my mind around this. Some people have likened it to after World War Two, and there was a spurt of inflation, there was a lot of employment, etc. and, and governments were spending a lot particularly on, you know, people coming back from the war. But then you got to sort of throw in the 1970s, where you have an energy crisis and so you've got this energy spike caused by the Russian invasion of Ukraine. So it's a mix of those, but the world's completely different place to back then because manufacturing was on the up in the US manufacturing is sort of non-existent in the US, it's a service economy. And yet, we've got this inflation bout. If you really think about it, we started off the 2020s really low interest rates, booming stock markets, etc. Then we go into the pandemic, and suddenly, interest rates that we thought couldn't go any lower went lower, government expenditure just exploded. And suddenly we came out the other end when the vaccines came in, excess demand inflation, and suddenly central banks have had to reverse everything. And suddenly we've got interest rates, short term interest rates are four times higher than they were a year ago. Long-end interest rates are two times longer, and suddenly the stock market goes, Oh, hang on, we've got to adjust to this whole new regime. And so we've seen real, big declines. And in, some markets like NASDAQ, some stocks are down 80%. So it's a really unique point in history. And it'll be interesting when we go into 2023, when interest rates may be, what the markets do after that.

CAROLINE GURNEY: You mentioned obviously, that it's, it's an inflationary period, what are superannuation funds actually doing at the moment in this time? And how can we use that to give some lessons in a way to our investors?

JOHN COOMBE: Super funds are typically looking for investments that protect against inflation. So they've looked for assets that historically have provided inflation protection. So that's typically been property, adjustments in commercial rents, for inflation, infrastructure, although when we say that there is no real history about how infrastructure does perform, but we know that there's inflation protection there. Then they look at stock markets and go, well, what companies in the stock markets have typically delivered protection. And it's generally been the high quality names where they've got pricing power, etc. And so you've seen the investors looking at their mix of managers to make certain that they've got quality in their mix.

CAROLINE GURNEY: I've spoken to a number of our Future Generation fund managers, and there seems to be very much a sort of a mixture of patience, and the need to actually take advantage of this volatility. You know, this period, personally, I think, is great for stock pickers at the moment, because something that might have been too expensive is now probably in range. You've got to be careful of picking the right opportunity. But does this volatility also give, you know, mums and dads and others, opportunities?

JOHN COOMBE: Absolutely. And there's a great opportunity within our own fund where they're trading at discounts. But that is an opportunity, right? So you got to look around and go, well, what's trading at discounts the two underlying valuations and no LICs (Listed Investment Companies), some of the LICS are trading there, and we were one of those. So that is an opportunity. But in a general sense, I think investors need to be cautious because we may not be at the bottom yet, of this. We haven't had the earnings. We haven't seen markets and participants in markets, give warnings on earnings outlooks going forward. In inflationary periods, earnings get hit. Corporations have levered up their balance sheets. So by nature, interest rates are going to impact on their bottom line. Wages and salaries are rising, input costs are rising, and that has to impact on earnings at some point into the future. But for stock pickers, like our guys, that's a great opportunity to reposition portfolios. We have some managers who, you know, in January last year, I know one in particular, who turned over 40% of his portfolio to re-position from where he was to where he thought the markets were going. We've got others that were, you know, probably topping up on some of their better ideas, because the markets given them an opportunity to buy where they would didn't think they had it.

CAROLINE GURNEY: I think you've given me the perfect segue into Future Generation Australia. I mean, currently, the portfolio has 18 fantastic, boutique fund managers investing Australian equities, and we've got 21 funds there. That's a very diversified portfolio. Tell us a little bit about that diversification from an Investment Committee point of view.

JOHN COOMBE: Well, we have guidelines. So we've basically established that we want to protect our investors, particularly the mum and dad investors, from real downturns in markets. We've got some absolute managers, some market neutral managers, and some long-only, you know, real stock pickers because we've got a reasonably heavy weighting into managers that, you know, that are real stock pickers don't care about the index, just want to pick the best stocks and we have some balance in there. We've got some managers who basically aren't looking to shoot the lights out, you know, from month to month, year to year. I think we've got a really good mix of trying to protect for downturns, but also capturing a lot of the upside when it comes.

CAROLINE GURNEY: We talk about long equities, we talk about market neutral, we talk about absolute bias. why is it really important to have funds that work to this sort of investment style within our portfolio?

JOHN COOMBE: Again, I think you don't want to be caught in and we've seen that just recently in the last market downturn. If we'd followed the trend, and just had all growth managers, you know, we would have done quite well in the last two years, up until probably September last year, but it would have been horrendous year, this year, we'd be down under the market by 10 or so percent, right. So, because growth has fallen out of favour as interest rates have risen. That's why we have a mix. That's why we try to protect. We know that markets, on average rise, but we also know that they have big drawdowns. And so it's a matter of trying to have that real mix, I think, Caroline.

CAROLINE GURNEY: John, let's look at the performance of Future Generation Australia. How do you deal with negative performance?

JOHN COOMBE: Yeah, look, the last quarter has been good. But prior to that we had a tough period because we were overweight, small caps. And that sort of impacted the performance of small caps underperform, but in the last three months, that's turned around. We're pretty comfortable when you're looking the longer term numbers we're over well over three, five, and, and since inception. So it's just one of those things, you know, sometimes the markets treat us poorly. We've had other periods like this before, where the small caps have underperformed, and but they've bounced back, and we rely really on the stock picking ability of the managers.

CAROLINE GURNEY: But that seems to have corrected now in the last three months.

JOHN COOMBE: Yes, it does look like that, Caroline.

CAROLINE GURNEY: What do you think is unique about the Future Generation Australia portfolio?

JOHN COOMBE: The amount of stock specific risk in the portfolio is very unusual. From an institutional point of view, we look at a lot of institutional portfolios, there's nothing quite like our portfolio in terms of a) the number of stocks and yet the degree of stock specific risk or ability to outperform by holding those specific stocks, and it's really unique.

CAROLINE GURNEY: Let's turn now to Future Generation Global. In terms of global equities, there's a lot of underperformance across the board. What's happening globally?

JOHN COOMBE: Yeah. And Russia is the thing that's caused that. The Russian invasion of Ukraine took the markets by surprise, and the cutting off of energy, and the increase in energy prices.We were at I think $60 a barrel a year or so ago. We're near $100 today. And we've been over 100, the threat of cutting off supply to Europe, the impact on the European stock market, you've seen all of the trouble in Europe. You've seen the trouble in the UK. Part of it's their own making. But all of that is not predictable if you're a stock picker. So a lot of managers were underweight the energy companies because if you think about climate change, etc. You know, what's their future? And so, a lot of them were overweight, other parts of the market and really underweight that while those stocks just took off in the first half of the year, and so a lot of managers whether value or growth underperformed dramatically.

CAROLINE GURNEY: We have talked about diversification the Future Generation Global portfolio is diversified, but it hasn't performed as well as we would have expected. Obviously we don't have that much in terms of energy stocks out there, but why else hasn't it performed?

JOHN COOMBE: I think some of our absolute return managers and our long-short managers have haven't done as well as we would have hoped. And we've been quite disappointed in some of that their performance and that's part of the reason why we're doing a little bit of restructuring at the Investment Committee.

CAROLINE GURNEY: So the Investment Committee has been meeting incredibly regularly. How are you rebalancing the portfolio?

JOHN COOMBE: We're adding more managers, we're down-weighing some of the managers that we've been very disappointed in, and we're improving what we think the mix of management going forward. We're going to reduce our risk across the portfolio and I think we're introducing some really, really, really interesting managers. Some of those managers or managers that we have in Future Generation Australia, who have moved into the global space, and we're taking advantage of our knowledge of them and the way they've run their assets here in Australia. So we're basically looking to introduce those guys in a way to dampen down the volatility and improve our net returns into the future.

CAROLINEG GURNEY: We now have 14 Boutique fund managers in the portfolio. And obviously, we've just introduced Plato, Lanyon, Vinva, and Holowesko. Tell us about those because Vinva is from Future Generations Australia's portfolio. So Plato and Vinva, I mean, they're sort of quant. Why is that going to be good for the portfolio?

JOHN COOMBE: It will dampen down our volatility, because it'll give us more stocks, basically across the portfolio. They're more index aware as quants are, but that doesn't stop them picking stocks or, you know, moving the portfolio around, it just basically means that they're more risk control. They take a little bit of the risk out in terms of sector bets, and country allocations and that's a good thing for the portfolio. It gives us a more rounded portfolio. So I think really good managers there who we've had really good experiences with.

CAROLINE GURNEY: Tell us a little bit about Holowesko and Lanyon as well, because obviously, Lanyon is also in the Future Generation portfolio.

JOHN COOMBE: Lanyon's unique in a sense, because they're very concentrated portfolio, but with a value valuate or true valuation bias, we've probably lacked that in the portfolio have probably had a little bit too much growth in the portfolio. So the introduction of him into the portfolio is going to be quite interesting. From our perspective, we put them in at a modest way, because it's a new strategy. Mark Holowesko used to be the head of Franklin Templeton, way back in the late 90s, early 2000s. He was one of the reasons why in the tech wreck, Franklin Templeton did so well. And Mark decided, after those that he would go out and start his own funds. He's been a very successful investor in long short portfolio for, you know, 20 years. I think we're just so fortunate that Mark wants to give back to Australia. And he's happy to be a manager in the line-up. It was really inspiring. When we did the interview with him that that was really one of his big focuses was that he wanted to give back to the Australian community. Because Australia's been really good to him. He's had long standing relationships with some of our clients. He has performed, as you would expect for a long biased absolute manager, he's done particularly well over a very, very long period of time.

CAROLINE GURNEY: How is this going to have a long term impact in our portfolio?

JOHN COOMBE: I think we balance up our growth value exposures. And I think when bringing yourselves to be more like FGX in construction. We've got more diversification across managers, more stock picking. We're not as reliant on one or two of the managers and I think that's a really good thing. And I think, you know, we're just re-positioning to improve the outperformance going forward, and to be more robust in market downturns, I think we were pretty disappointed in the last 12 months that we didn't perform better given that we've got absolute bias managers there and long short managers.

CAROLINE GURNEY: There obviously has been a fair bit of change in the last six months in the portfolio. So how is this actually going to affect the stock composition?

JOHN COOMBE: We will just have more stocks. And I think we probably may, in our next newsletter come out and talk about how it looks going forward in terms of our allocation to the various sectors, you know, with energy, etc, etc, countries. that might be some information that our investors would be really, really interested in. If you look at any of our global competitors, who, multi manager, their dividend yields probably 1% or something like that at most. We've ensured that we're going to pay a reasonable dividend to investors, who need to basically live off the dividend, and also having a profit reserve helps.

CAROLINE GURNEY: So tell me, you're an investor in both of these companies. Why do you invest in both of them? And how does it play within your portfolio?

JOHN COOMBE: So it sits in my self-managed superannuation fund. And it really plays a sort of core role in my Aussie equities and global equities, portfolios because of two things. One, they're very diverse, and they're quite different to me just going out and picking one particular manager, so I'll get a spread of managers and the dividend yield's Fantastic. And so, you know, fully Frank give you like, that is really helpful. I might retire soon, maybe, maybe not!

CAROLINE GURNEY: As long as on the Investment Committee, but thank you very much, John, for your time. Thank you.

JOHN COOMBE: Thank you, Caroline.