Future Generation: Investment Insights

Caroline Gurney and Ben Griffiths – Eley Griffiths Group

CAROLINE GURNEY: Hello and welcome to Future Generation Investment Insights. My name is Caroline Gurney and I'm the CEO of the Future Generation Companies, which are Australia's first listed investment companies to deliver both investment and social returns. Today, I'm thrilled to be joined by Ben Griffiths. Ben is the Co-Founder, Managing Director and Portfolio Manager of Eley Griffiths Group, and a highly respected veteran of the funds management industry. Eley Griffiths is a leading Australian investment management company that specialises in small and emerging companies and like all of our fund managers, they do that on a pro bono basis, which means they don't charge any management or performance fees to our shareholders. This allows us to donate 1% of our assets to not-for-profit organisations that support Australian children and youth at risk. So far, Future Generation Australia (ASX: FGX) has donated more than $32 million and that is thanks to fund managers like Ben. Ben, thank you so much for being with us today. We're really appreciative.

BEN GRIFFITHS: Great. Fantastic to be here, Caroline.

CAROLINE GURNEY: Ben, you founded Eley Griffiths with your friend and obviously somebody that you respect highly, 30 plus years ago, and you've become experts in your area. The question I really want to kick off with is what is your outlook for the next six to 12 months?

BEN GRIFFITHS: It's an interesting question Caroline and one that I'm getting asked quite a bit. Not surprising given the market volatility. Investors need to take note that the Australian share market is sitting nicely on a support line that projects out of the COVID lock downs back in March 2020. So, that is what you see as an investor. That's what markets are made of. Of uptrends and downtrends but uptrends in this case. But unfortunately the complication that arises is there are a number of cross currents right now that are having a direct bearing on confidence. Citigroup came out with a great note this morning talking about how the storm continues, but so does the global growth. And I think that mostly underscores the fact that whilst there is volatility also, there is some movement in stock prices. There's also a growth impulse that's occurring. Why is that happening? Well, simply, central banks have hiked rates and quite aggressively over the last 12 to 15 months. And there is now the great belief that the tightening cycle, the hiking cycle, is near an end. And that is positive and I think stocks are sensing that that's where we're at. Now the outlook is a little bit cloudy. Hence the storm analogy. I'd look at what's happening in China, where the tail winds that we're looking for probably aren't coming through the quality of that recovery is not quite clear. I think central banks have done their bit and that's a positive. The fact they've done their bit and they're close to the conclusion of their hiking campaign.

And the final thing is that investors should be relieved about and comforted about the fact that credit markets are somewhat behaving. They are trading at where you would expect normal settings to be. So credit conditions are benign to basically normal, rather than being challenging or restrictive. And that's positive for stocks. Investors shouldn't be investing unless credit conditions are broadly, broadly supportive, and we have a broadly supportive credit environment. So the outlook is not without challenge, but I think the outlook is positive for stocks.

CAROLINE GURNEY: In terms of your business you've specialised in small caps and you have a really good understanding of that area of the market. We all know that small caps haven't done very well compared to many others in the market. What's your view on small caps going forward? And when do you think that swing will happen?

BEN GRIFFITHS: Sure, and that's another very valid question. Look, small companies like their bigger cap brothers are sitting on the same support line that projects out from the COVID lows back in March of 2020. That's a bullish thing to see that. But I think the outlook for small caps, investors should be considering divergent performances from stocks. Not every small cap will perform well. And we've seen in recent days, the consumer stocks, the consumer facing names which are principally the retailers who have direct exposure to discretionary spending from households, they're doing a bit tough, and I'd expect the environment for that group of stocks to be challenged. On the flip side, I think there's been enormous interest in resources names and select resource names. I think interests will remain elevated. And when I'm talking resource stocks, I'm talking about the likes of the battery minerals names, the uranium names, and even the gold miners. The Australian dollar gold price is plus or minus $3,000 an ounce. That's very positive for the Australian gold miners. So I think they'll perform well. I think the market is about to swing into a defensive mode given the storm conditions I just mentioned a minute ago. So stocks that have defensive attributes, that is, attributes where they'll be able to defend against the cycle, I think will start to perform well. And Ridley (ASX: RIC) is a name that I'd quote there, which is the stock feed producer that is a well-managed industrial business, we're very defensive attributes. And the other area that we think the other sector, or sub sector of the small cap universe, would be those structural growth names companies that have very, very strong business models, who would have a very diversified or exposed to growth areas or they're getting growth when growth is going to be hard. To come by names like Tourism Assets (ASX: TLA) and Lovisa (ASX: LOV) are two names that immediately spring to mind.

CAROLINE GURNEY: That's good because our shareholders love stock tips. Before we go any further, because I'm really interested in some of the areas you're talking about, we've got reporting season coming up in August. Are you seeing those same themes and how do you think earnings are going to hold up?

BEN GRIFFITHS: Well, I think those themes that I just mentioned will be, I guess magnified and there'll be great deal of focus on those precise buckets. The confession season, which tends to precede the reporting season, is where we are now and we've had a number of retail companies come out and advise that trading has become difficult, that people aren't turning up to stores shoppers aren't fronting even sales. In the case of Baby Bunting (ASX: BBN), sales aren't performing like they used to perform. So I think that environment with the consumer will be difficult and continue to be tough, and I think the confession season has highlighted that retailers will be doing it tough. Normally when the confession season is busy and disruptive and volatile as we've had, that tends to plant the seed for a difficult reporting season where the mood of investors is bad or negative. The responses to the market tend to be heavy handed. So I would think that the confession season tells me there's going to be some volatility coming up. I'd also expect that greater attention than normal will be paid to company CEOs with their outlook statements and how they're foreseeing the next 6 to 12 months. Any developing trends, trends in pricing trends in margin degradation. In the case of contractors, are clients paying their bills more slowly. Banks are getting a bit tough on lending and making it hard to fund. If you're involved in the homebuilding industry, how are you, how your customers performing, how the bank's going with funding. So all those sorts of signals I think will be particularly closely scrutinized due to during the season. It should be, it will be volatile. I think of the recent weeks' trading performances. Trying to go by, but we've been there before. We know that you're getting good reporting services and you get challenging, but I just think this one's going to be it's going to be a little bit tougher.

CAROLINE GURNEY: Can I just ask you, we said you've had 30 years of experience. Have you seen this before and seen a sort of, come through?

BEN GRIFFITHS: I've seen I've seen this conditions many times before. I have the welts on my back to prove it. But one thing you know is good businesses with good management teams have invariably managed their cost basis down ahead of or on the on the cusp of a revenue decline. So, the margins are preserved. You'll see some pretty sensible decisions from sensible management teams. And I think a lot of them have been fortifying their businesses anyway, preparing for the regime of higher rates and higher interest expenses and so on. So I think we've already seen some good behaviours. We're going to learn who has actually been preparing for tough conditions. This is part and parcel of equity investing. It's especially germane that the small end where companies tare, you know that they are less, less ably resourced in many cases versus their bigger counterparts. It's a bit more work to be done at the smaller end. And they tend to be in the main exposed to more cyclical type businesses, where you are going to get tossed around by the economy, but it's all part of it's what I signed up for, Caroline.

CAROLINE GURNEY: I'm also really interested in your thoughts on inflation. I mean, that's what we're all talking about. It feels in a way that we haven't managed to get it as under control as everybody thought we would. So, what's your view on inflation? You know, how long is it going to take to get under control? And are we going to be at that 2% mark?

BEN GRIFFITHS: Yeah, well, it's been a long time between drinks for the market to have to grapple with inflation. We've had all of a sudden, we've had a very sudden surge in over the last 12 months or so, or maybe even a bit longer, 15 months, and inflation tends to be a glacial thing. It's hard to eradicate. It takes a long time. I think central banks around the world have used perhaps the blunt instrument of all, and that's the cost of money. That's interest rate settings. They've done that. But there's a transmission mechanism from tightening rates to seeing the multiplier effects in the economy. It's up to 12 months. So we need to be a bit patient to see whether in fact the rapid fire hikes and interest rates have actually achieved what they set out to do. It does feel, if you look at some of the International US stat, that the inflation numbers we're seeing have probably peaked. Maybe we have a bit more structural inflation in the system going forward. Various central banks have got targets and objectives where they want to get inflation to. Whether they succeed remains to be seen. But I think we haven't beaten that into submission. But I think central banks of the world are kind of on top of it. Now a little bit of inflation is also a good thing because that enables pricing power and corporates can put price increases through and that's the beginning of margin improvement. So a little bit of inflation is a good thing. There will be exacerbating features, like we've just seen with the minimum wage increase and potential knock on effects that higher salaries will put through on cost structures and so on. But inflation is, that's the phenomenon we're dealing with at the moment. It's a phenomenon that central banks I think have reacted to appropriately. We just spent a bit of time to see whether we are in fact done and that the tightening works of the central banks globally is near an end. I think equities, as I mentioned in my first point, equities sense that the tightening regime is just about done and that's why stocks are rallying.

CAROLINE GURNEY: You are a small cap specialist and as you know, Future Generation Australia is predominantly small caps. Is there anything else we should be telling our shareholders that you know, we haven't discussed now?

BEN GRIFFITHS: I think in trying markets and difficult markets, volatile markets, it is very easy for investors to lose their nerve and panic and investing is a long term game. Investors need to remember that. And then investors need to look at opportunities. When the markets under pressure, when good businesses get oversold, when good stocks fall out of favour. They should be thinking about the long run and look to buy those businesses that are well managed, that have got robust business models, that have got sustainable earning streams, and that are conservatively funded. I think investors need to focus through the long term lens and the market. The market will always be here. The market will have good times and bad. It's the yin and yang of stocks. That's how the markets work. And this is must not lose sight of that. So, stay the course would be my suggestion.

CAROLINE GURNEY: Thank you so much, Ben. I can see why you are one of our fund managers with Future Generation Australia. So finally, why is being a pro bono fund manager with FGX so important to you?

BEN GRIFFITHS: Well, it's important because I'm one of the founding managers. Geoff Wilson knocked on the door and asked for support and we were there for him. I think it's important. Being involved in Future Generation is important for a couple of reasons. But none more important than knowing that what we're doing is actually making a difference. There were only a handful of charities when we, when Geoff first set sail. I think there's now 10 charities in the stable. They're all doing the most magnificent work, and it's just so satisfying. It's one thing to get stocks, right? Get the portfolio on the right side of the benchmark and do the job you're paid to do. It's another thing to know that in a small way you're making a contribution to the ongoing funding and success of some of those charities. I mean, I have a soft spot for the Diabetes Kids Fund, which I know is an important part of Future Gen. I love the work they do. I see their annual reports each year and I love the programs that they set course on. So it's just great. It's very satisfying. To know that we're making a difference.

CAROLINE GURNEY: Ben, thank you so much, not only for sharing your insights today, but also for being a pro bono fund manager from the very beginning and managing shareholders money for Future Generation Australia. As you know, Future Generation has a very diversified portfolio because we have different managers with different investment styles. And it's really because of all of your expertise that Future Generation continues to deliver long term performance for our shareholders. So thank you very much.