Future Generation
INVESTMENT & SOCIAL RETURNS

2fold: Take Stock podcast

William Low, Nikko Asset Management

Caroline Gurney: I'd like to begin by acknowledging the traditional owners of the land on which we meet today and recognise their continuing connection to lands, waters and communities. We pay our respects to elders past and present.

William Low: The reality is you're only going to keep earning the right to have very high returns on capital if you look after all your stakeholders. If you deliver high returns at the expense of your customers, your suppliers, your employees, the environment or the society more broadly, you'll get found out. You'll get found out by social media, you'll get found out by asset owners and focus there is today in global markets.

So we've always felt our, basically, our search for future quality and the search for high ESG attributes are absolutely the same thing.

Caroline Gurney: Hello, and welcome to Take Stock, a podcast by Future Generation. In this series, we get a backstage pass into the minds of leading fund managers and work out how and why they make the stock choices they do.

I'm Caroline Gurney, the CEO of Future Generation. We're Australia's first listed investment company to deliver both social and investment returns by harnessing the generosity of our leading fund managers. So far, we've donated more than 75 million to not for profits. that improve the lives of young Australians.

And we can do this because of people like William Low from Nikko Asset Management. They charge zero performance and management fees for managing Future Generation's money. That means we can donate 1 percent of our assets to Australian charities. Will is here with me in the studio today, all the way from Edinburgh.

He's going to be my second Take Stock guest in a row, who's been from Edinburgh. Anyway, I'm not quite sure what's going on, but we're very lucky to have them. Will, welcome.

William Low: Well, thank you. Delighted to be here. Sydney, has to be said, one of my favourite places in the world.

Caroline Gurney: Ah, I love to hear that.

William Low: And nothing to do with the fact, it's slightly better weather at this time of year.

Caroline Gurney: But you've had a real well-earned trip though, from what you were saying. You've been to quite a few continents.

William Low: Indeed I have, but hey. That's part of the job and just seeing clients in various corners of the region, which has been good fun.

Caroline Gurney: I really want to start with artificial intelligence. I mean, it's really what everybody's talking about.

There's so much hype at the moment. I mean, for me, it's still very much in its infancy, but the valuations are staggering. So is this sector going to be another bubble? Or do you think that investors are still underestimating AI?

William Low: I think they're still underestimating AI. And there's a key reason why it doesn't look like just another bubble.

Yes, there's a level of expectation now being built into share prices. But there's real tangible evidence actually with the early stages of a major adoption wave, which is effectively an arms race for the big technology companies to adopt this new technology. If they don't, they're probably going to die.

And more importantly, you've got a bunch of other governments joining in, wanting to be involved in AI and not outsource that, dare I say it, to the US necessarily. And then finally, unfortunately, it's a literal arms race in certain corners of the world as well. So, very much AI is here to stay. I would add the differences are a little bit different this time as well, in that it's funded by companies who can afford to spend on it.

And they're getting real tangible benefits already. So this is not dream chasing hype bubbles, which can be seen in the past. It's certainly something a bit different.

Caroline Gurney: Will, you talked about sort of the arms race. And importantly, I think, as you said, companies now can afford to really go into artificial intelligence.

So in terms of your fund, how exposed are you to artificial intelligence? And how can Australian investors actually get access to it more?

William Low: We're exposed through a few holdings, of which obviously the largest would be NVIDIA, but we also own a range of other names that are either directly or indirectly exposed, from Synopsys, the software design company, or indeed Broadcom, which is another semiconductor company, to TSMC.

So there's a range of ways of playing AI, which you think is actually a great place, and exactly what we look for with our philosophy.

Caroline Gurney: And what proportion of your fund would artificial intelligence be? Like, what else are you exposed to?

William Low: We're exposed to many things that are far beyond just artificial intelligence.

So, for example, Microsoft. It's a part of what Microsoft does, but it's not the whole thing it does in any shape or form. So many companies are either directly benefiting to some degree from AI, or more importantly, some of them are using it to implement in their business to make it even better, more defensible.

The deeper and wider moat, where I would say Meta is a good example of that. So defining exactly which stocks and what proportion of portfolio is AI related. I think it may be a tough question. The better question might be, have you got the right businesses to grow compound up in a world where it's harder to deliver growth because central banks are trying to discourage it?

And you've got independent growth, which AI can be a good part. Actually, you've got something differentiated.

Caroline Gurney: And do you have healthcare and energy in your portfolio?

William Low: We don't necessarily have energy, but we've also got healthcare. So it's again, it's all about businesses that are going to do well in the future.

And to be fair, some of the healthcare names that we've owned had a tough time last year because essentially they had overhang of inventory following the burst of spending post COVID has had an echo of inventory build and therefore less demand. And they've been ignored by investors. Partly because they've had frustratingly lack of growth.

But I think that's now beginning to happen more and be evident. Actually, these great businesses have always grown compounded up are normalising some of their orders and growth. And really, this bit of a left behind companies like Danaher or Biotechni or Abbott, we own our portfolios, we think are all really good, place in that front.

Caroline Gurney: I know that investors are actually looking at a price rate cut, that's what everybody would really like. But a lot of people are actually saying that's not going to happen because of, inflation needs to be more under control. You've got Jamie Diamond. We've had Phil Lowe, who is the the former governor of the Reserve Bank in Australia, and he just agreed to be our Future Generation Australia chair.

And they're saying that rates might still need to go up. What are you expecting from interest rates and inflation?

William Low: We don't pretend we're the big bond forecasters, we're equity stock pickers. But what we would observe would be there's a bit of a yin and yang there. There's some disinflationary forces are pretty clear from supply chains, inventory build, some weaker growth, and indeed technology at one side, but actually you've also got a cycle this time very different.

You've got a cycle where actually there's not been mass layoffs, fully employed, still got wage inflation, commodities bottoming and such energy now picking up. So you've got, it's difficult to predict exactly what the path of inflation is. And I guess our best guess would be. At this stage of the cycle, probably continue to assume higher for longer will be the norm until proven otherwise.

Caroline Gurney: Nikko is obviously a Japanese asset manager, and the most legendary stock picker of all, Warren Buffett has been very bullish on Japan in recent years. Do you have a view on Japan?

William Low: Not a strict view in Japan other than it's easy to observe there's obviously a bit of a change in policy. And also there's the ongoing structural change in Japan where companies in terms of the degree to which they've looked after shareholders as compared to other stakeholders has probably been less focused on stakeholders, would be polite way of putting it, and but gradually that is changing, so there's generally an improvement in the return on capital. But the reason I highlight, in terms of what it means for the type of companies we pick, we're really focused on companies that have to be attaining and sustaining very high returns on capital over the long term, and many of the companies in Japan are starting from very low returns of capital to getting slightly better, which means they don't necessarily meet the key philosophy that we're looking for.

Caroline Gurney: Let's turn to China. Its economic recovery has disappointed. Do you think that we're going to see lower but more sustainable growth from China? What's your view there?

William Low: Sustainable is a harder one to predict. The lower the answer would be yes. I think the challenge that China's got it feels like the debt deflationary bind that many other economies have gone through is following that road map we've seen elsewhere, of which Japan is born.

The biggest one would highlight. We've been thinking that for a while, and hence it's very difficult to see significant growth. There will be attempts to liquefy no doubt at the margin, maybe more fiscal expense to try and engender growth and let that little bubble or particularly large bubble deflate rather slowly, which is exactly the same roadmap, dare I say it.

We've seen in almost every other developed economy and in the country where you need to ensure everyone is always employed or fed, I would suggest even more likely that you'll let it go down smoothly. So subdued growth would be the norm, would be my expectation.

Caroline Gurney: I haven't heard that one before. Subdued growth. I like that.

William Low: I'm trying to be polite.

Caroline Gurney: I'm really fascinated how you actually choose a stock. So how do you go about choosing a stock?

William Low: There's two things. One is you want to know exactly what type of company you look for. So I mentioned previously that attain and sustain high returns on capital. So the path of returns is really important for us.

Combined with some future quality pillars, strong management, franchise, balance sheet, and a sensible valuation. So you start with the quality principles. You focus with some really good research team. Focus trying to find those ideas around the world. And then to find them into portfolios is just as important.

Lots of great ideas, but how do you find the best? How do you weight them properly? So you've got to have a very well designed process that embraces team culture and an organised way of ranking, comparing them to make sure only the best ideas get into the portfolio, which is really what we've been doing for the last 13 years.

Caroline Gurney: You run a high conviction fund, roughly 40 to 60 stocks. Would you mind talking through one stock that you've picked and, and the process behind that and why you believe it's going to be there for the long term?

William Low: Okay. Yes. We, between 40 and 50 low 40s consistently over the last decade and longer biggest current active weight in our portfolios is the way we would measure it would be Netflix is a great example of what we really look for companies that go on a unique journey of improvement.

And for example, Netflix changing its pricing model last year in short lent to more net revenue growth. Due to the change in subscribers, number paying, add in the advertising model, and you end up with a franchise that is the leading streamer, the best content, more profitable, and in an industry where every one of its competitors are struggling to make any money at all.

So you're basically the strongest getting stronger and clearly be the long term winner. And it took a while, I think, for investors to wake up to that reality that Netflix had become a much better platform and higher growth animal than it was before.

Caroline Gurney: And it was also quite controversial at the time in terms of their pricing strategy.

I remember reading a lot about it, but when they did, I mean, obviously, as you say, it's had a great result for them.

William Low: But I think you're spot-on, controversy is great because at the end of day, the best ideas have always got wrinkles on them. The best companies, if they look perfect and everybody can enunciate exactly why a company is brilliant, the chance are everyone's already exposed to it.

And to be honest, if you want to make a very high return, you ideally need a lot of buyers who need to change their mind and controversy is sometimes a good starting point.

Caroline Gurney: With a high conviction fund, if you pick correctly, you can definitely hit it out of the ballpark. But the opposite is also true. How risky is a concentrated approach and what do you do to mitigate that?

William Low: Risk? We've got 40 holdings. And is that a lot? No, I don't think it's a lot at all in terms of it's sufficient to give you and really capture the very key philosophy But in a diversified way, you know, we've got a range of companies that we're invested across geographies and sectors So we're not dependent on just one individual gamble factor, whatever you want to call it.

You're getting our ability as a team to pick a range of ideas that meet our philosophy. And 40 stocks we found historically very much can deliver that and deliver quite significant high returns over the long term.

Caroline Gurney: And you have a lot of turnover in your team and in your portfolio. How do you know when to sell? What are the things you look for and you see, and then you decide to actually sell that particular company?

William Low: Well, first of all, there's no change in teams. That's an easy one in terms of change. But when it comes to the portfolio, we do embrace the fact, two things, over time of owning great companies, you don't have every one right.

You will make mistakes in a 40 stock portfolio, whatever number you've got, you need to embrace that fact and actually when you made a mistake, admit it as early as you can so you can redeploy in something better. So that's one of the things that we do as a team and why we've got what we call our specific ranking tool to help identify either companies that were wrong to begin with.

Or indeed of a performance so well, there's actually less upside, and they're the things that really drive what we do and changes in the portfolio, which has been round about 30 percent per annum over the last five years or so or longer. So proportionate turnover to keep redeploying, and I would stress in a world where valuations and in terms of key drivers are changing all the time.

Caroline Gurney: You're known for your future quality investing philosophy. What does that mean in practical terms? Is it something that an everyday investor could do?

William Low: Well, an everyday investor can buy historical quality. We live in a world where data and computing power is pretty easy to come by. So knowing who were the great companies of the past, you Anybody could do, to be honest.

But what we challenge ourselves with, we get excited in terms of what we do is trying to work at which companies in five years' time or longer will still be great or even better have gone a journey of improvement to become great companies. That's where the higher returns are. And that's what is harder to replicate.

If you don't have the right philosophy focus and great talent working together as a team. To me, they're the essential ingredients. If others can do that, or individually, well great, but that's what we, what we've delivered and exactly why, you know, your fund, such as ours, embraces what we provide for the overall strategy.

Caroline Gurney: I know you're not involved in this, but obviously you launched a global green bond fund late last year. How does ESG figure in your process?

William Low: It's relatively simple. If we want to buy a great franchise, you know, with a great management team that earns very high returns on capital, the reality is you're only going to keep earning the right to have very high returns on capital.

If you look after all your stakeholders. If you deliver high returns at the expense of your customers, your suppliers, your employees, the environment or the society more broadly, you'll get found out. You'll get found out by social media. You'll get found out by asset owners and focus there is today in global markets.

So we've always felt our busy, our search for future quality and the search for high ESG attributes are absolutely the same thing.

Caroline Gurney: We have more than 60 elections coming up around the world, and we've got US, we have India, we have the UK, we have Indonesia, and obviously European

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Parliament. Do you think this is going to impact your investing in any way, or is it something you've already sort of factored into your planning? Your global approach?

William Low: Well, factoring in, we suggest we've got amazing predictive power in terms of the red and blue debate in the United States or indeed elsewhere. And I think we'd be liars. And I think our own experience, having been through things such as Brexit and so on, trying to predict such events is not an easy one.

Very true. I would suggest being observers around about politics because it can have significant change, but by its very nature of politics, not always predictable. So I think we wait and watch. More often than not, it means very little. Great companies flourish irrespective of the politics, but sometimes politics can change ways to make that more difficult.

If it happens, we'll address it with that new information when it comes along.

Caroline Gurney: And were you given a great piece of advice when you started your career, and what was it, and have you lived by it?

William Low: Oh, there's a good question there. I'm not sure what the advice that brought me into this industry was particularly clear, given I didn't know what I was going to do.

I did a degree in geology. Where most people were losing the jobs, never mind employing. So I randomly find my way into being the first graduate trainee at a company called the Needham Fan Managers in Edinburgh, and the first person they'd ever interviewed. So in terms of advice of what to say or ask, but neither side knew what to do in terms of questions to ask or how I answered them.

But I'm not sure of what I would particularly highlight to, maybe I'll come back to you on that.

Caroline Gurney: Well, thank you very much Will, I've really appreciated your time, and thank you very much for being one of our managers.

William Low: Absolutely delighted, and I think it's been a great cause.

Caroline Gurney: And a safe trip home.

William Low: Okay, thank you.

Caroline Gurney: We hope you enjoyed today's episode. Please join the Future Generation family, Australia's first listed investment companies to provide investment and social returns. We are proud to have given more than 75 million to Australian not for profits. You can be part of this and gain investment returns while contributing to improve the lives of young Australians.

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