Speaker 0: Hello and welcome to Asset T V's Masterclass on US. Smaller companies in association with First Eagle Investments. I'm mark your host for the next 40 minutes or so, and we are looking at asset class. That's been some out of favour with investors in a world of mega caps. So is now the time to be looking at it, particularly if there are perhaps some

Speaker 0: problems going on in the underlying US economy. We're going to come to all of that in a minute, so let's get things underway. Um, we are joined in the studio today by Bill Hench. He is head of the small cap team and portfolio manager at First Eagle Investments and representing three umpires. We have Richard Rain Back Global head of fund research at E. F. G Asset Management. We're also joined

Speaker 0: in the studio by Ben Gutridge. He is director of model portfolio services at Invesco, and finally, we are joined today by Wayne Nut. He's fund manager at Premier

Speaker 0: Bill. He, uh can you first of all start by telling us a little bit about First Eagle Investments and a fund manager? What's the case for US? Smaller companies

Speaker 1: right now, sure. First Eagle. Uh, we are an asset management firm headquartered in New York, and we've got about 100 and 25 billion under management. We've been around for a long, long time, and, uh, we're very happy to be here today,

Speaker 0: so that's the group. But why US smaller companies now? Sure.

Speaker 1: So the reason why you'd want to invest in US smaller companies is because you can get paid for the risk. And, uh, when we say we get paid for the risk, that means we think when you invest in small caps uh, there are risks like liquidity, financial risk, uh, depth of management. Uh, and when you put those things into consideration, you could and should

Speaker 1: get better than S and P returns. Hopefully better than Russell 2000 returns. And if we do our job better than most of our competitors, so

Speaker 0: it's a small cap effect is is Is your your big believer

Speaker 1: in it? It's It's not only a small cap effect, it's a It's a history of these companies being able to produce returns that that are usually better

Speaker 1: than than what big companies can do over time. OK, thank you

Speaker 0: Well, Richard Rain. Could you tell us a little bit about how you run the money at at E f. G. In particular, how you think about allocating assets to US equities in the round? Absolutely. So I think the way we think of it is very similar to most fund managers. Um, so we we think in terms of benchmark relative allocations to each geographic region. So to use a kind of high level broad market view, So we use m CIA.

Speaker 0: Um, MS c I weight to the US right now is 60% almost dead on. So I mean, that sounds like quite a high figure. And we get a lot of questions on, you know, is is that too high? But, you know, you got to consider that the US is obviously a massive part of the of the global stock market. So, um, so I think 60% is quite a fair, neutral view. Um, and that you know, um, if if you're particularly bullish, then adding five or 6% or you know the same the other way wouldn't be too far out.

Speaker 0: OK, thank you very much. Uh, Ben gutridge get Can you tell us a little bit of how you think about US equities in particular that this, um, sort of between large caps has done so well in recent years. Well, over a decade and small cap. Well, I mean, I think that differentiation is sort of a nice compliment. Actually. You know that the large cap does have those, uh, dominated or certainly a big chunk of what we consider high quality businesses. You know, secular growth stories that might be able to weather

Speaker 0: something of a an uncertain period for the economy. But, uh, complementing that small caps, US, small caps, looking, let's say, sort of unusually cheap or a larger discount than normal to to large caps might be able to look through this period of uncertainty. You know, the market cycle market stock markets do tend to lead the economy. So if we get through this recession markets would we would get through the recession. But markets can move in advance of that, and that cheapness looks looks appealing. So, you know,

Speaker 0: I think large caps have really had it their way for a for a good number of years. But as I said that that uh that discount. That seems quite stark at the moment. Certainly. Very eye catching for for US small caps. A final, Um, we could you tell us a little bit about how you're running money at premier because I've been

Speaker 0: believe you're you're not just pure play on active. You're quite interested in passive investing as well. So there's probably a bit of a hurdle for active fund managers to get through before they potentially make it onto your by list. I think that's true. I mean, we we major majority of our funds are allocated to active managers. You know, we do believe in active management.

Speaker 0: Um, but we do use passive management where we think it's appropriate. I mean, I think I should say initially, we don't use A as a kind of benchmark starting place for our geographic allocations. Our geographic ratings are very different to a um you know, we've got a much more evaluation centred as allocation approach, which leads to geographic ratings that are very different to a Sometimes that works, sometimes it doesn't work. Um, but we're much more valuation driven in terms of active and passive, as I say, the majority of of of the multi management funds are actively,

Speaker 0: uh, fulfilled. But we do use passive at certain times. I think you know, the active passive debate is a very multifaceted one. And the the sort of things you want to think about are going to be, you know, very dependent on the kind of multi asset mandate you're running.

Speaker 0: Um, but I think if we think of two kind of, uh, specific examples, one obviously is cost. Um, you know, mandates a cost constraint these days. You may have a cost budget to deploy, but I think if you do have a cost budget to deploy, deploying it in smaller caps makes quite a bit of sense, actually. Um, not least because passives aren't that cheap in small cap, you know, the differential in cost is, is is is a lot less so if you've got a cost budget to deploy, small caps are probably not a bad place to deploy that budget.

Speaker 0: Secondly, in terms of tracking error, if you are tracking our constraints, we're not particularly tracking our constraints. As I say, we have a valuation led approach. But if you are, um, tracking our constraint again, I think there's there's there's a good argument for deploying a tracking error budget in small caps, where I think you know, our performance of a benchmark index is perhaps a bit more achievable than it is compared to the kind of cap indices.

Speaker 0: And when you said that your asset allocation is valuation driven rather than picking off of a benchmark. So just out of interest, what's your US equity allocation? At the moment, it differs substantially by a mandate. So, for for us, our our our multi asset mandates are very unique,

Speaker 0: uh, that they're not just kind of risk targeted. We have income targeted mandates. We have other types of mandates, so the mandate is always the starting point for that. But I think if you were to have let let's put it in the context of 100% equity, hypothesis it over to 100% equity, you're probably talking about, you know, 15% maybe 20%.

Speaker 0: So you know, substantially less than than than an A benchmark. It's been higher than that in the past. It's been lower than that in the past, Um, and within that, we've got a reasonable waiting to, uh or at least in some mandates, some small cap exposure as well. Ok, thank you. Now I want to bring Bill right back in a second. But just before it is you're the three fund selectors on the panel. I want to get a just a thought for if you if you could each chance build one question or get him onto one topic, what would that be? Maybe that's a good way of unpacking this while we wait for some questions coming for our audience. So,

Speaker 0: uh, Richard, can I come to you on that first? What's what's a key topic? What issue? For you around your small cap at the moment? Absolutely. Yes. So I think one of the key topics is particularly for bills fund, which is kind of valuation driven. Um, you know, most value managers tend to look at discount to intrinsic value when they're looking at a company to purchase. Um, and there will be a catalyst that will get that company from,

Speaker 0: you know, in, um its current price to intrinsic value. I'd like to find out whether the current macro uncertainties we're seeing in the US have changed have made it more difficult to find that catalyst. OK, thank you. So that that's one topic there. Um, Ben, let's get one from you. Well, I mean, on the not too heroic assumption that we don't have financial meltdown then presumably US small caps can can do. OK, but you know what? What is the sort of base case?

Speaker 0: Very difficult. I know, uh, for how this financial challenges that we're seeing in regional banks sort of plays out. And what does that mean For the sort of US small cap trade and the,

Speaker 0: um, agility of US sort of smaller cap businesses. OK, thank you. And Wayne finally a topic for you. Yeah, I think always an interesting one for us is, um, the interplay between valuation and the quality in a in a process. Uh, you know, I think how you how you allow for quality factors in evaluation or value processes is is important. And and that's, uh that would be my one, I think. Ok, thank you. Well, let's start with the one in the middle. So, regional banks,

Speaker 0: what's obviously we've seen runs on a couple of them and and deposits moving very very quickly into some of the larger banks like JP. Morgan. What? How much further has that got to run? What does that do? Potentially to smaller companies? Sure.

Speaker 1: The answer is we don't know how How much more has to come. But it's important to remember that the the normal stress on the banking system has not been seen yet. Which is to say, bad loans. Um, other economic,

Speaker 1: uh, functions that normally happen at the end of a cycle. We haven't seen that yet, so we're really dealing with a different problem than we normally are right now. Uh, historically, uh, small companies borrow from banks when they need money, right? They don't have that,

Speaker 1: um, access to the capital markets that that bigger companies do. So it's very, very important that we have a an environment where credit is available. So to the extent that that is damaged, it it it makes it more difficult. Um, historically, uh, for us, uh, when credit gets tight, we we've normally seen our our companies tell us that we're paying more than we want for credit, but we're getting it. And our loan documents, which was to be, you know, 6 to 8 pages are now 16 to 20 pages.

Speaker 1: Uh, so it's there. You deal with it. Um, we in the past, uh, have been, you know, extremely sensitive during periods like this to to how much, uh, leverage our companies have. And to the extent we get, we can get a portfolio company with less leverage or no leverage at all. Uh, that's a benefit.

Speaker 0: And just on that point, about leverage. I mean, you give some idea of what you're looking at at the moment as you go back over the thesis on individual investments as you go back through the portfolio. What? What does, um,

Speaker 0: a sensible level of leverage look like? Well, it

Speaker 1: varies by industry, by sector and even by company. And with us being a value fund, we often have a lot of turnovers, turnarounds, and so what we're really looking on an individual basis is does the company have enough financial wherewithal to get through the period of time that it needs to turn themselves around? In other words, do they have enough cash flow? Would they generate enough cash flow? And secondly, we like to have companies that don't have any debt due,

Speaker 1: uh, in in the short term, and by short term, we prefer prefer not to see any big debt principal payments due in a year and a half two years. That's that's how we look at it. Uh, so we we we don't necessarily assign, uh uh

Speaker 1: uh, debt amounts of of or leverage amount, but it really depends on the individual company.

Speaker 0: You want to come back out on that? Yeah. Just just pick up on that. So I mean, we see week in, week out in the press, you know, there's turmoil in the US regional banking sector within the smaller company space. Do you do you perceive that there's more reliance upon funding from those regional banks? And if so,

Speaker 0: does that? Is that a concern for you at all? It's

Speaker 1: definitely a concern. And it's not only the regional banks, but but banks that are even too small to be regional that that many of our companies, uh, borrow from. So it's something that is, you know, at the forefront of our thought every time we look at a company that has, uh, borrowings and we look at it, I think very, very differently than than if we were in small cap growth where they're borrowing for,

Speaker 1: uh, you know, to to to fund their growth. Our companies dealing with banks when they, when they're borrowing, uh, are principally just dealing with their everyday cash flow needs. Uh, so it's a concern. And it's, um, something that we're really in the in the beginning endings of, I think because we again haven't seen the normal stresses played out. This is this is stress being brought out by, you know, an unusual event, right? Where I I don't think most of us. I know. I wasn't,

Speaker 1: um, looking at that. That held to maturity as sort of the danger line on on banks.

Speaker 0: I mean, yes, you're right. It wasn't widely predicted. I certainly didn't predict it, but it was sort of understood that banks were sort of tightening their lending standards already. So I wonder, you know, CEO s CFO s were sort of preparing themselves for a

Speaker 0: more tricky credit sourcing environment. That actually, uh then the crisis comes. And maybe they're already or or slightly better prepared for it than they otherwise would have been.

Speaker 1: I I I think so. And I think we've had this discussion before in in in the years that we've known each other, that since since the financial crisis, many of our companies have have gotten, you know, gotten religion as far as as as, uh uh, being too levered. And in point of fact, you know, if if you talk to my analyst team, they'll they'll tell you that this is probably the

Speaker 1: best shape our balance sheets of the companies that we've invested in have been in, uh, in in years. Um, so many of our companies are are net cash. Uh, you know, many of them have no no debt at all. And, um, that's somewhat to do with with being more realistic about, uh, their ability to borrow. But also, it's it's just the the the change that's happening in small business. Many of the small businesses today,

Speaker 1: uh, are able to take advantage of things uh, that that bigger companies have been taking advantage of for a long time, whether it be outsourcing, manufacturing, outsourcing, back office, Uh, so many of those things that were, uh, uh that required lots of working capital or or investment have now become variable costs. Uh, and and with that, you need much less credit. Um, so we benefit from that as well. Do you have

Speaker 0: any, um, banks in the portfolio?

Speaker 1: We have a a small amount of banks, and And we had a small amount going in,

Speaker 1: uh, as value players. But when we look at banks, we like to buy banks when they've got lots and lots of reserves on their books. Uh, and with the zero interest rate environment that we've had for 15 years, um, there haven't been that many bad loans, and there haven't been that many reserves put on on bank balance sheets. So it was something that we were very, very light in. We did have, um, some exposure to some banks in Florida and Texas, where where the economy, uh, and and population growth have been terrific.

Speaker 1: Uh, but we cut back immediately. Uh, with the, uh, with the announcement by Silicon Valley Bank. Uh, we cut by bank positions, probably by half.

Speaker 0: I was just gonna ask, um do you Do you think that consolidation within the kind of small banks is a potential solution to the problems they're seeing? You know, on the one hand, we read that the US banking industry is very, very fragmented with thousands of banks. And then we read JP. Morgan just gets bigger and bigger, you know, Is there Is there a way out of this that involves consolidation amongst the smaller banks?

Speaker 1: My My guess is that it it'll continue to to be the the path that they take. Um, especially as as as some of the more profitable businesses continue to be, uh, taken away by by other financial by non banks. Uh, and and that's both in lending where you see more and more private lending and you've seen an explosion in private credit. Uh, as as those things which are very, very profitable, uh, get taken away,

Speaker 1: uh, from the traditional banks. Uh, I think it's inevitable that you'll see more consolidation and especially now, right there, any any time that there's an event such as this, uh, that that that drives consolidation.

Speaker 0: OK, well, well, second topic came up, uh, which I think you you talk about sort of the valuation and where that fits with with the macro. So give us a bit of a bit of a sense of where the US economy is at the moment. Um sorry. You're getting all the easy

Speaker 1: questions this morning. Where is the economy?

Speaker 0: Yeah, One word. One word answers only. And, um, you know how that's impacting on how you think about valuations and what?

Speaker 1: Sure, So? So things have clearly slowed. Uh, and and I don't think that's a surprise. Uh, and and it's natural, right? We we have. We've gone from zero to something, right to borrowing costs. Uh, we've also had this tremendous,

Speaker 1: um, change in where we are with inventories and and with expectations. So a lot of companies are just now getting things back to normal. Uh, post covid, uh, with supply chains and and and and ability to get product out the door. Um, but things have clearly clearly slowed, uh, and and we're seeing it mostly, I think, in the business to business. Uh, we haven't seen it as much in the consumer.

Speaker 1: Uh, employment is still strong, but I I think that's probably, uh I think we've we've already seen that. That that's not gonna maintain. I don't think these these unnaturally low unemployment rates are are gonna be with us for long. Um, I think we're getting back to normal.

Speaker 1: Um that being said the the country sometimes feels like we're I I sometimes feel like I live in two different countries and I'm not making a political statement here, But I think if you if you look at places like New York uh, Chicago, San Francisco, uh, it's clearly different than if you go down south and you and you and you're in Nashville or or or Charlotte or Austin. Uh, there's been a tremendous move, um, of the population and businesses down to those places, uh, lower taxes, less regulatory issues.

Speaker 1: Uh, and and it is it's stunning, sometimes to to get off a plane and and and, uh, and see the, uh, the differences overall I think the economy is is is fine. I think I think we're we're We're always subject to

Speaker 1: to sort of left field events like we had with Silicon Valley Bank and and if there's another one out there, I'm sure none of us are gonna guess which one it is. And if we do, it'll just be luck. That we guess what, What, What, what? That uh, what that issue is. But right now, I I I I think What what's helping us is that we don't have any sort of hangover in in housing inventory. Uh, our auto

Speaker 1: inventories don't seem, uh, out of whack. Uh, if you look at the commodities year over year, uh, they seem to be, uh, far from hitting highs. So, uh, those things that normally come and sting you when things slow down aren't there, So so, you know, if we do have the dreaded recession that we've all been talking about for forever, I guess it seems, um, you know, perhaps we we're lucky and and and we skate through it.

Speaker 0: I wanted to pick up this point you make about the fact it's applying almost in the US is an economy. It's a series of economies. You're in a federal system, people can alter tax rates. Um, if you look at the portfolio, uh, do you find it's got a geographic or tilt within the US? Now that it didn't have

Speaker 1: it has tilted more toward the Southeast and Southwestern states than, uh than in the past. Um, and we've seen more and more companies move to Texas, move to Florida.

Speaker 1: Uh, and and the portfolio reflects that, uh, I think we had a much, I think, 10 years ago, 15 years ago, we had much bigger, uh, representation in in in places like California, and that's clearly shifting, and I expect it will continue. So,

Speaker 0: Richard, have you got to follow up on that around just around that valuation point? Yeah. So on the on the valuation point, So I mean, I mean, what I'm quite keen to find out is if the the recent debacle we're seeing in the US around the banking system has has that caused, I guess your price targets to be met more quickly. So when you say this this this stock will go from a to B, is it Is it getting to be in a quicker time frame or is it

Speaker 0: or is it taking much, much, much longer than you? And you just have to stop that quite stale for longer. How how does that play out? We

Speaker 1: haven't had a, uh we haven't had as much, uh, rotation. I think in in our portfolio as as as we normally like. And that's because we have seen this sort of

Speaker 1: stagnation and and a lot of pricing and and and things of that nature and And right now, I think we're We're finally getting to to a point where I start to feel pretty good about things, because we we're starting to sort of discount the same bad news over and over again, right, Which is kind of silly. Uh, but you're also starting to see when there's bad news, which is anticipated is announced. Maybe not the reaction that we thought liquidity has dried up a little bit.

Speaker 1: Um, all the all the sort of signs of a of a bottoming in our market are are starting to appear, um, and and for us, you know, that's paramount, right? The the the only thing we can control is is what we pay for for merchandise for stocks. Uh, and and traditionally, when we've been able to pay prices, we want we we we come out ok, doesn't mean we can't go down, right? And and and as my mentor taught me, there's no such thing as too low in small cap. Right?

Speaker 1: Um, but usually when we get this during the get the opportunity to pay prices that we like that we think are are quote unquote cheap. Um and we do that on an individual basis that basis, uh, we we tend to do OK,

Speaker 0: so, yeah, if I could just follow up on on the on the bottom outside. Um, do you have a view on, um, on kind of earnings trends in small caps, we've seen small cap earnings expectations deteriorate quicker than large caps over the last, you know, 234

Speaker 0: months. Um, obviously, it's a bit like how long has been a string, but, you know, if we do see an economic slowdown, it has that process finished. Is it? Is there much further to go? Alternative. Is the valuation discounted? You know, much more of

Speaker 1: that. I I I think on cyclicals you you'll see the numbers come down. Probably significantly. Uh, as we bought them out there, um, you know, we don't do a lot of sector work. We do individual company work. I think on a lot of our companies, we we're either at the bottom or or or or pretty near outside the ones

Speaker 1: um, we don't have much in the way of of of banks in the portfolio. So I I not really, uh, able to give you a pretty good look on that, um, you know, it it it's it's very odd because everyone was very excited about the banks for a long time because we were finally getting a net interest margin right from zero to something, and then it caused a lot of excitement. Um uh, but you really have to look name by name to to to really get an appreciation of of what's happening.

Speaker 1: Um, there are some sectors where where things are very, very good and and some way they're not. And and that's and that's normal. And that's how it should be. You know, I think I think for for years we've gotten used to this. This sort of everything's either great or horrible and and and based on artificial interest rates and injecting trillions of dollars into the economy. So So as we pull away from that,

Speaker 1: uh, people like myself and and and pretty much all I think active managers can can can sort of go back to to doing what we're paid to do, which is differentiate those things that we think we can make good returns on versus those things that we that we can't, um,

Speaker 0: just sort of wanted to latch on to the

Speaker 0: your comment about unemployment being sort of unusually low, and you don't think that will persist? I mean, not an unreasonable comment to make. I mean, but you're making that based on experience or because you go out and see so many company managements. Are you getting the sense? I mean, obviously not gonna tell you we're gonna sack loads of people. But you you you getting the sense that,

Speaker 0: uh, employees are sort of losing, losing their bargaining power and and maybe a bit of a shift back.

Speaker 1: Definitely. Um, it So we own about 250 companies, and and we've probably had close to 200 of them report thus far this quarter. And and the difference in in those companies talking about hiring or expanding versus a year ago or or or even nine months ago is is is dramatic. Um,

Speaker 1: I I rarely hear on on any of our con conference calls about hiring. So if I can combine that with with what's happening in the announcements with the bigger companies, it's hard to have any faith in those weekly unemployment numbers which which are adjusted for for birth and death rates and and other things like that. Um, fiction. Right? So, uh, my my suspicion is that that that'll come through because that's that's real time data, right? We're we're talking to these companies every day.

Speaker 1: Uh, and and generally, if smaller companies aren't adding, uh, that that's a pretty good indication of of of what the national picture looks like. And again, you know, that's more normalisation happening.

Speaker 0: But I mean, so sorry, the like that. That sounds like a pretty bad news story, doesn't it? You know, job losses and and therefore small cats can't deal with that. But, I mean, we would you presumably you would be saying that valuations are a long way

Speaker 0: prepared to reflect that, uh, more, more, more troubling

Speaker 1: news. You bet and and and I don't. And it is troubling, and it's it's it's never good to to lose a job. But three point, whatever the number was less was 37. I think, uh, is unnaturally low, uh, unsustainable. Um, and not normal. And And therefore,

Speaker 1: um, I I think it's not giving us AAA real picture of of of what? The eco? How the economy should function.

Speaker 0: Um, Bill you're talking a lot about valuation, and you know, it's great to get in great value, but at some point that share price has got to go up for you to be able to crystallise that game. What? What's the attitude of US domestic investors to small cap? What do the institutions think of it at the moment? And if things are tougher than you're hoping, is there a danger that a huge amount of money comes out of, you know, existing mutual funds? And and actually, you know this You're sitting on a lot of deferred success?

Speaker 1: Sure. So we we've actually been been busier than normal. Um, these these a lot of these names, uh, and and and, you know, point of fact, the index last year that the Russell was down, I think 20%. The Russell value is probably down about 14.5. Um, traditionally, this is when bigger institutions really start to take a look at at at these types of situations and and and retail has been extremely busy as well. Uh, everybody loves a bargain, right? Americans love a bargain. We love a sale. And and that's what we've got. We've we've got a part of the market.

Speaker 1: Um, that has not performed.

Speaker 1: Uh, and we're also in a part of the market that traditionally does exceptionally well after recessions. Uh, and and that's what what people are looking at, and that's what draws the interest. Is there a risk in in in that? In that, I mean, you bet there always is.

Speaker 0: OK, now I want to move on to the third topic. So, Wayne, could you just remind me we were talking about valuation quality. So you guys just give us a bit of a recap around that as an issue, and then we'll we'll we'll bring Bill back in. Yeah, sure. I think, um, you know, in some, in some ways, um, you know, valuation can be a proxy for low quality. So I think with any value strategy, it's important to, you know, philtre out low quality.

Speaker 0: Um, so you're not buying the value trap essentially. So I think that's my my question. How do you, uh how do you guard against value traps and and look at quality and how it interplay with valuation? Sure,

Speaker 1: I I'd like to have a better answer, but I don't we we can avoid value traps. Uh, we get them every year. Uh, as much experience as we have, we we're going to make mistakes. Uh, what we do to to to to lessen the, uh,

Speaker 1: the pain of that is is is to act pretty quickly and and as I tell people, we usually panic first, right? So So when we discover we're in one of those we we we try to get out as quickly as we can, and and and with as as little harm as possible, you you can't avoid it. You know, it's it's it's part of the process. You know, we're constantly looking at at these names that that that are going through issues, uh, that, uh, that we hope are temporary, and sometimes they're not.

Speaker 1: Um, And when we make those mistakes and they they become value traps, we we do our best to get out. But you can't avoid them.

Speaker 0: And And how? Because you mentioned that you've got 250 stocks in the portfolio. Um,

Speaker 0: doesn't that mean you're potentially exposed to a lot of value traps? If you had 60 stocks, you'd have potentially far

Speaker 1: fewer, but we're also exposed to 250 things that could be just outstanding return operations. So, um,

Speaker 1: historically, what has happened is that most of these things tend to work out over time. Every year we get a handful of disasters, right value traps and all sorts of other different things. Every year we get a handful of names that just,

Speaker 1: you know, knock the knock the lights out, right. Uh, but those two extremes balance each other out. It. It's the rest of the portfolio that drives our performance over time. And it is over time. You know, the most things that we buy take a year and a half two years to work out. Um, so it's a it's It's a It's a a process, uh, that uses time, uh, as a as a as an aid to to our success.

Speaker 1: Um, but you're constantly, constantly going to get things that are worse and things that are better. Uh, and, uh, that's why we tend to this portfolio every day.

Speaker 0: But if you look back at the value traps over time, are there any patterns in them? You know, actually, you just got your timing wrong, but it wasn't a company that went bust, or I'm just interested

Speaker 1: in all sorts of things happen. Right? Um, it could be execution issues. It could be,

Speaker 1: uh, the company fixing itself at a at a at a point in time where the where the market doesn't care about that type of stock. Right. So So maybe you bought a chemical company, and they've they've done their best to get rid of their all their low margin products, and they've now only got really good high margin products. But they are at a time where the economy is turning around, and and so no one wants chemicals

Speaker 1: companies. Right? So So you did all the right things, right? You bought a company with these great great valuation metrics. You had a management team that that did and executed perfectly. But the timing is wrong. So you lose it, you know? And then and then you also run into problems, you know, And and no matter how many times that this happens, I I seem to get caught doing the same thing, but,

Speaker 1: uh, you know, you'll see a company that's getting out of one business and entering, You know, another business and they'll tell you, You know, our old business is going to fall off by 10 or 15% and our new business is gonna grow 30 40%. You say this is terrific, you know, and and what happens? You know, the old business falls off 50% and the new business gets delayed. So So these things happen. It's it's part of the the risk. And it's also another reason why I own 250 names instead of 60 because you never know

Speaker 1: which ones are gonna are gonna work and which ones aren't gonna work, right? Uh, and no matter how smart you think you are, no matter how much research you do, no matter how great you think the management team is or the product is, uh, you're just subject to things that you can't control. And if you don't believe me, ask the people who owned all those small banks in the US. They'll tell you things happen that you just never expect.

Speaker 0: Yeah, just to pick up on the research side of things. So, you know, it's no secret that developed countries across the world are battling with inflation now,

Speaker 0: is it? your perception that, you know, smaller companies are more. I guess price in elastic they can They can pass on the impact of inflation onto their consumers. Or is this something that you stress tested and you're conscious of is a significant risk in your portfolio.

Speaker 1: Sure. So, um, traditionally, small, small cap value has been, uh, one of the best performers during inflation. Every time,

Speaker 1: Um, most of our companies have passed on. Uh uh uh. Price increases. I think we're at the time now where where we're getting near the end to that, Uh, I think on a lot of consumer companies, uh, we're clearly at the end of that, Uh, some of the business, uh, business to business type enterprises are still having shortages, and they've got a little bit more power, right? That so So many companies are limited to one or two suppliers. Right? Uh, so there's a little more pricing power there, but on the consumer side, I think it's

Speaker 1: it it it's rough to, uh or or I think it's a stretch to think that we're we're still in this, uh, environment where we could push things through. And we've had, uh, more than more than a couple. Uh, companies report in the last couple of days and talk about we We we think we've reached sort of peak pricing. Um, but inflation for small companies, it it tends to be pretty good.

Speaker 1: Uh, in in that. You know, by definition, you're getting more for your your goods or services, right? Your prices are higher now, your margins might be by clipped, right, because you're also paying more for input costs. But your gross dollars, your gross profit dollars are increasing. And that's what our companies get valued on. You know, our our companies tend not to get multiple compression or expansion based on on on what the 10 year is, right? So So it's rare that that we'll have a small cap company make $2 this year and then $3 next year and see the price go down because the multiple contracted,

Speaker 1: usually with small companies. If you make $2 this year and $3 next year, you're gonna get a higher stock price. You're not going to be subject to that same, uh, type of effect that happens in bigger companies.

Speaker 1: Thank you. Yeah,

Speaker 0: sure. I mean, I guess it. It might be one of the questions that sort of levelled at you, most other than, like, how do you remain looking so young is like, Why have you got, uh why have you got so many stocks in your portfolio, you know, is is you sort of touched on. It helps dampen the impact of those things that go wrong, but also sort of might dampen the impact of those things that go right. So, you know,

Speaker 0: I if you can get us a little bit more excited about a portfolio that has 250 stocks in it,

Speaker 1: So So first and foremost, it's something it it's it's It's a key part of our strategy and and and a key part of why it works. Uh, I'd love to do this with 50 names. The problem is, I could never figure out ahead of time which 50 are gonna work and and and which 50 are not going to work? Right?

Speaker 1: Um but there are other reasons. So we use a lot of names because it's really one of the two best ways we think to address risk, uh, the other being keep the portfolio cheap, uh, but spreading out, uh, the risk, Uh, in an environment where liquidity isn't always great and you know, in in the point we're in right now isn't isn't

Speaker 1: is is is less than great, right? It's It's tough. Right now. Liquidity is tough, so we like the ability to, uh, to not have an impact on the market. Uh, we like to move in very, very small steps. We slowly work into names over time, and we slowly work out. And having that many names allows us to do that. Uh, and we've always managed a fairly large amount of money, so that's very, very helpful. But the key, the key thing Benn is that

Speaker 1: is that you know, you just with small companies things that that are annoyances to big companies to small companies can can be fatal. Right?

Speaker 1: Um, losing you're losing credit, right? Or losing a bank or, you know, we're big, big companies. We have multiple banks that will lend the money. You know, our companies might not have that many relations, Uh, you know, single product issues or or key? Uh uh, customers. You know, customer concentration. All these things make make investing in small companies. Riskier, right? And that's why we think you should get the premium. So having the ability to to to spread our bets. Amongst many, many companies,

Speaker 1: it is a lot more work than than than than you know than otherwise. But also it's it's key to it's key to, um it's key to the risk.

Speaker 0: Sorry. Yeah, So I just ask them In the in sort of the immediate post pandemic period, we saw a massive valuation expansion amongst the the kind of small cap growth stocks. A lot of IP OS, you know, with not no earnings at all in some cases, um, obviously, a lot of those stocks have fallen very far. I appreciate being a value manager. They don't naturally fall into your universe, But have any of them fallen into your universe? Given the way that they've the valuations, come back so much or are they still, you know, way out of where you'd consider relevant for a value universe?

Speaker 1: To a large extent, they haven't come come into our universe. And the last time we really, uh, were sort of blessed with a with an onslaught of growth stocks at really, really cheap prices was was was was post covid. And it was more on the consumer side, uh, much, much less so than the, uh than tech side. But a lot of those companies are are still growing at at at, you know, pretty impressive rates. And and they're still a little bit, uh, expensive for for people like us.

Speaker 0: OK,

Speaker 0: can I get a thought from you all? As as as fund selectors of where you are on the Value and Growth. Um, I mean, I take it obviously you've got different portfolios that you're running for clients, so I'm sure it will vary a little bit between us, but, um uh, be Let's start with you. What? What? How how do you try and blend them in portfolios of styles And do you do you have a bit of a tilt to one over the other at the moment? Well, we certainly try to blend it. Uh, we don't want to sort of swing for it on on the style call, but, uh, if pushed under questioning,

Speaker 0: uh, we would sort of say the we probably sort of passed, you know, peak inflation. Um, think we sort of heading into a bit of a downturn that suggests the bond yield would move a a little lower. That supports sort of longer duration, higher quality assets. So that, um that that does sort of, uh,

Speaker 0: encourage you to have more sort of US large cap. But the most recent move the the very recent move, is actually to sort of add a little bit more to US small cap on that valuation, uh, appeal We do are starting to think that markets might move ahead of this sort of recessionary phase. And, uh, actually, you know, small caps do recover well in a a recession, but actually they move after a recession. But actually they start moving in the recession.

Speaker 0: Uh, because you said markets do tend to move a little bit ahead of the economic cycle. So, like modest overweight to US like large cap. And and as I said at the start of the meeting, that the small cap valuation, I think, is a nice combination there, but but in terms of value growth, you you are sort of a tilt to load

Speaker 0: growth. Would that be? The scale and weight of the portfolio is is balance towards higher quality growth, but the marginal move. Sorry to be moving away from there to sort of more more sort of small cap per play. No, no, thank you. I just want to make sure we got it. Absolutely right. Um, Richard, how? How about you? Where are you in this sort of value versus growth, So I say, quite similar. I mean, if you look at our house for over the last decade, it's been quite growth,

Speaker 0: and and that's worked for, you know, for for most of the last 10 years. Um, I think we took it off at the right time and kind of tempered that at at almost the right time. And I think now we're in the same sort of bed as Ben described here, so we're kind of in a very, very growth to if we were pushed on that. But the focus on quality companies, we're talking about companies that can pass on the impact of inflation. They can weather the downturn. So we're not, you know, not buying into the sort of, you know, high growth, potential, low carbon earning type type companies.

Speaker 0: But does it worry, Richard, that pretty much everyone will say that you know, everybody in a downturn says we want to be able to pass the cost of inflation. We want to be able to grow the business. I mean, how many of

Speaker 0: being a bit unfair? But how many stocks are there out there that can do it? And if everyone's piling into them

Speaker 0: very much, Yeah. No, it's It's It's a fair question. I mean, it's, um you know, if if if if everyone buys into the same, the same part of the market is there a bubble is a fair question, and unfortunately, I can't answer, OK, All right. And, uh, thank you. And finally, Wayne, from from your perspective, where are you on that sort of mix of value and growth. So we're digit and tactical. Yeah, we're fairly you know, I think you would compare our to to from from yours, I think we'd be pretty clearly in the value camp. Um,

Speaker 0: you know, I think our view would be that the US mayor cap stocks are in a in a what is like to be a multi-year evaluation compression phase. Having rallied up so strongly for a number of years before that I do accept that in the short term, you know that that if if we're right and there is a multi evaluation decompression amongst the mayor caps, it's not going to be in a straight line. And as we see periods of cyclical weakness, with bond yields going down, that could well support them in the medium in the short term. And maybe we're seeing a bit of that at the moment.

Speaker 0: Um, but still, we've got a pretty clear value slant. We've gone into a couple of areas of growth. We, um we added back US biotech, um, around the middle of last year, you know, we think sentiments, you know, may have changed. AM and A is picking up. So there are areas of growth we like, but in terms of the mayor caps, although I can see the appeal in the short term when bond yields go down, we think, you know, they're still still a bit too expensive for us.

Speaker 0: Bill, you've been running US smaller companies with this valuation style for a number of years. Um, but I guess for the last decade it's been a period where everyone's wanted back of caps. Growth's been going, you know, I mean, there hasn't been a price to money. It's been pretty much free. Um, as this world shifts and changes, do you think in the round there's anything that fund buyers investors have forgotten that they, you know, lesson they should dust off because you've

Speaker 0: sort of think, Well, if you were around in the nineties or the early two thousands, you might have a very different take on where the world is and what's happening. Well,

Speaker 1: I I you know, I don't know if they've forgotten it, but but we're being reminded every day. But we have interest rates now, and we have inflation, and and those two things are are meaningful to to impact, uh, or or to to our performance and everybody else's. And, um,

Speaker 1: you know, if you look at every recession save for what happened post covid, uh, you know, small cap value has has has done what you needed to do right, which is to give you excess return. And and hopefully they'll remember that. Ok,

Speaker 0: well, I think we've got about five minutes left to go, so I'm gonna ask uh uh, each of our fund select. So they got a quick final question for you, Bill. So it's a sort of a minute or two. Answer piece. Um,

Speaker 0: Wayne, can I come to you on that first? Yeah. Um, I think, um, you mentioned management quality earlier, and I think I'd ask whether you need to look for different attributes in management in small caps compared to large caps.

Speaker 1: Sure, you you You usually look for them to do to be able to do quite a few things, right? So, you know, it's it's common for us to to meet senior people who not only are good managers, but they're good sales people. Uh, they're good at product selection. Uh, they wear many hats. Uh, and and that's important, especially with turnarounds. Uh, and and And what we've discovered sometimes the hard way is that when we do lose a key person like that, we found out not only were they the the great CEO, but they were their best sales person, too. And, uh

Speaker 1: so So that's it's key to have a lot, a lot of different talents. I think

Speaker 0: if I think about value, I'd sort of think that the trade is like long financial short Tech. But that's not quite what we see in your portfolio, is it?

Speaker 1: Could you? So So on the on the financials again, you know, we'll buy them when? When? They've got lots and lots of reserves. And that's always been the key to to good performance for us in small banks.

Speaker 1: Um, tech is is a it's It's such a huge industry, right? And and and our tech and and small cap and and specifically with with with, uh, with our fund is mostly glorified capital goods. Right. Uh, and and, uh, they have these wonderful attributes of of having most of them have no debt, lots of excess cash.

Speaker 1: Uh, and you're in a period now where they're thought of as not having a lot of really good growth, right? Uh, but as, uh, I think as we as we sort of bottom here and and as people start to look through a recession, uh, companies in our in our tech world will start to see better unit volumes, which is what really, uh, drives our our performance of our companies.

Speaker 1: Uh, and that's why that works for us. So better unit volumes at a little bit better margin goes a long way towards towards looking more like growth companies, which, which is usually our exit point.

Speaker 0: Thank you, Richard. Yes. So one statement we hear quite or question we get quite frequently is is it the right time to buy into small cups? And that seems to

Speaker 0: but But to me, that seems to be quite a generalist sort of question. You you You're Categorising. You know, 7.5 1000 companies globally in into one sweeping statement. I mean, is it you know, is it, um I guess what I'm asking is right now is is it the right time to view it as that or or or to view it as a stock? Pickers markets. And you can have value by buying the best of the best rather than buying Broad based.

Speaker 1: There's a great little research firm called Fury Research Partners, and they do a

Speaker 1: great work on small cap. And they they point out, this is the cheapest that small caps have been versus, uh, big caps on a PE basis ever. Um, so timing wise, I I That always helps to have that in in your in your in your back pocket with with us. You know, we think in terms of cycles, not in terms of today or or next month or even next quarter. Right?

Speaker 1: Uh, and and And any time again, As as I stress, you know, when when we get to pay the the prices that we think are are are are good or cheap. Uh, we we we feel good about about this, this market, and and with that in mind that, you know, all we can do is control that part. Right? Uh, and and, um, do things look cloudy? Now, you bet. Right Is is it is it awful to have the the Fed contracting money supply? You bet.

Speaker 1: Uh, but all these things will pass, and and And we think that, you know, we're probably at the latter stages of fed activity. Uh, and and And once that abates, uh, we think we could be in pretty good shape.

Speaker 0: I think we're pretty much out of time. I just There was one quick question I wanted to ask you, Bill, which is where If you look at where the earnings for your portfolio come from, how much of it is domestic US and how much of it is global, but just just given.

Speaker 1: So, in general, our indexes are about 80% of the revenues are about, uh, domestic in our portfolio, which tends to tends to skew a little bit smaller in market cap. It's

Speaker 1: It's a couple of percentage points higher than that, right? So mid mid to low eighties. Yeah,

Speaker 0: OK, we have to leave it there. Thank you so much for watching. Do stay with us. We've got some information coming up in just a second on how you can potentially use this as part of your structured learning. Just reminds me to thank our fantastic panellists here in the studio in London. Bill Hench, Richard Rain back Ben Gutridge and Wayne Nut from all of us. Here. Thank you for watching goodbye for now.