Discussing different equity investment styles

In late April, Tell Media Group, in cooperation with **American Century Investments**, **Baillie Gifford** and **Lazard Assets Management**, organised a roundtable discussion at Hotel d'Angleterre in Copenhagen, focusing on equity style exposures. Tell Media Group founder Niklas Tell and Nordic Fund Selection Journal editor Caroline Liinanki moderated the discussion.

By: **Niklas Tell** Photo: **Christer Salling**

The discussion started out with Caroline Liinanki asking Ebbe Matthiesen about PensionDanmark's investment philosophy for equities and what the portfolio look like in terms of styles and themes.

EBBE MATTHIESEN: "We've been in a transition period over the last year where the direction of travel has been towards a lower tracking error in the overall portfolio. There are, of course, many drivers behind that but one is the concentration in the market and specifically the weight of the magnificent seven. We've tried in the past to balance growth and value tilts in the portfolio and that has been a challenge and today we don't have any factor tilts in our equity portfolio."

NIKLAS TELL: ALLAN, WHAT ARE YOU HEARING WHEN WORKING WITH YOUR CLIENTS IN TERMS OF THEIR EQUITY PORTFOLIO STRUCTURE?

ALLAN LORENTZEN: "Most of our clients are small institutions and here we have more of a say in the approach they take. When we talk to larger clients, we typically see that it's either/or. Either they have portfolios that are completely factor driven or not at all. But it's really difficult to find investors that are good at calling the right time for being growth or value. When we work with smaller institutions, we simply try to find good quality managers and that could be a value manager or a growth manager. Then we try to establish a pool of managers with a low correlation in the alpha generation, which should give us a stable, long-term alpha generating portfolio."

NIKLAS TELL: AS PORTFOLIO MANAGERS, IS THIS SIMILAR TO WHAT YOU HEAR WHEN YOU TALK TO INVESTORS?

DAVID BYRNS: "We have run our value strategy with the same philosophy and process for some 30 years where the aim is to find quality value companies. We're simply aiming to invest in the best businesses we can find and we're looking to buy them when they're cheap. We typically see that clients pair us with other managers that have different risk factors and use us for our alpha generation abilities, so that could be a growth strategy to create more of an overall core exposure."

STEWART HOGG: "The strategy that I'm aligned with is very concentrated and when it was launched back in 2004, it was a very different proposition. This form of high conviction investing is probably more common now. The strategy is designed to be a return generating machine over the longer term but you will have to accept that it will come with volatility. We don't agree that high tracking error is high risk – especially when you know the companies deeply and you operate on a five to 10 year time horizon."

STEPHEN TONG: "If you look at the portfolios of the managers represented around this table, I don't think we have any stocks in common. Each of us will select stocks that we think will outperform based on the style we follow. If we stick to what we say we do, you would be able to combine the strategies together and gain both outperformance and diversification. Our clients typically mix different styles."

NIKLAS TELL: IS THERE A RISK THAT YOU DILUTE THE BENEFITS WHEN YOU COMBINE DIFFERENT STYLES IN ONE PORTFOLIO?

ALLAN LORENTZEN: "At some point you, of course, risk buying the index but I think you would be far away from that if you blend the three managers around the table today."

EBBE MATTHIESEN: "Coming back to my starting point, I think it's fair to say that with the development of the magnificent seven driving performance, it has been challenging for active managers. One way to get around that is to buy the seven according to the index and then have an equal weight of the rest and evaluate external managers against that second bucket. At the end of the day, it comes down to your tracking-error budget and right-sizing your bets with external managers. If something happens in an external mandate, we should be able to keep that manager."

STEWART HOGG: "One of the things we talk about a lot internally is optimism and being long term. This mindset is important as it helps battle against our inherent human tendencies of loss aversion. Most investors spend too much time trying to ensure bad things don't happen but it's inevitable – company progress is rarely in a straight line. As a manager of a growth strategy, your returns in the long term will be determined by the things that go very, very right. It's determined by the stocks that multiply many times over. I think it's wrong to focus too much on the current state of the market and the magnificent seven. That's backward looking. These companies have performed very well historically to be where they are today and the right thing – which we did – was invest in them five or 10 years ago. What is more important today is understanding what can be a tailwind for certain companies going forward and ensure we invest in them now."

NIKLAS TELL: IS THE HOLDING PERIOD SIMILAR ACROSS VARIOUS STYLES OR ARE THERE DIFFERENCES?

DAVID BYRNS: "As value investors, we see our long-term time horizon and holding period as an advantage. The companies that we're investing in are going through a tough period – that's why we can buy them at an attractive valuation. Taking a longer-term view can help us see through whatever might be causing a security to be mispriced and gives us enough time for these companies to revert back to their more normal state and that's when the alpha is generated. What's interesting is that often times, it doesn't take nearly as long as we – or the investors that have given up on the stock – expect for the business to recover."

STEPHEN TONG: "We're quality investors and we do have a long-term investment horizon. We invest in a very specific type of quality company -- what we call compounders. These are companies with a high return on capital today that we think they can continue to deliver that return while at the same time re-invest in the business. That will drive higher cash flows, which in turn will drive share price development. You want to find these companies today, understand their

PARTICIPANTS

- **EBBE MATTHIESEN**
  Senior portfolio manager, PensionDanmark
- **ALLAN LORENTZEN**
  Managing partner at Jentzen & Partners
- **DAVID BYRNS**
  Portfolio manager and senior investment analyst, American Century Investments
- **STEWART HOGG**
  Investment specialist director, Baillie Gifford
- **STEPHEN TONG**
  Director, portfolio manager/analyst, Lazard Asset Management

EBBE MATTHIESEN
Senior portfolio manager at the Danish pension company PensionDanmark focusing on global equities. Before joining PensionDanmark in 2018, he was an analyst at Danske Bank for more than six years. He has also worked as a consultant at PwC in Copenhagen.

ALLAN LORENTZEN
Managing partner at the investment consultancy Jentzen & Partners since 2015. He is also an external associate professor at the institute of finance at Copenhagen Business School. He previously spent some 10 years at Danske Bank, his last position being first vice president & head of advisory services.

competitive advantages and hold them for a long time, letting the compounding work to your benefit."

STEWART HOGG: "A lot of academic research shows that the secret sauce to success is a long-term time horizon, being truly different from the benchmark – so a high active share – and reasonable fees. It's not necessarily about whether you are value, growth or quality because you could have that secret sauce in all three strategies."

CAROLINE LIINANKI: SO WOULD YOU SAY THAT LABELS ARE NOT THAT IMPORTANT?

ALLAN LORENTZEN: "To us, it's not important at all. But indirectly we will search for different types of managers. I think it would be unlikely that we would find three growth managers that are different enough for us. I think the correlation between them would be too high."

DAVID BYRNS: "As value investors, we're typically looking where others are not and today we're finding value in traditionally defensive areas of the market. What's worked recently has been higher beta areas like technology and industrials. Today we're seeing that sectors such as consumer staples, healthcare and utilities are trading at heavily discounted valuations and that's a great starting point. We're not sure what the catalyst will be that brings these areas back in favour but I think we will be looking back a couple of years from now and see that these sectors had a nice period ahead of them and that – in hindsight – right now is a great time to be boring and invest in what have traditionally been the more defensive areas of the market."

NIKLAS TELL: ARE THERE MISCONCEPTION OUT THERE WHEN IT COMES TO THE DEFINITIONS OF VALUE, GROWTH AND QUALITY?

STEWART HOGG: "We would disagree with the market's definition of growth. The market tends to identify value as short-term value and define growth as short-term momentum. If you're investing over a very long period of time, like we are, that's a different type of growth. It's transformational in nature and can last for decades. I should also say that there are shades of value, growth and quality in what we do. Our core focus is identifying growth but we want our companies to be financially strong and self-financing and we believe they are materially undervalued."

STEPHEN TONG: "There are different definitions of quality, which must make it difficult for investors. I think what matters is that the holdings and the portfolio activities match the investment philosophy. As an investor, you should be able to look at the portfolio and find that it makes sense."

DAVID BYRNS: "On the value side, I think people understand what it is – I'm just not sure they believe it works any more. Over the last 30 years that we've been managing value style portfolios, value has gone in and out of favour and the style is out of favour right now. From a contrarian point of view, that's a good thing because it's at these points in time – when sentiment towards our style is at very low levels – that we typically see things turn around for us."

NIKLAS TELL: "WHAT ARE SOME OF THE CHALLENGES LINKED SPECIFICALLY TO THESE DIFFERENT STYLES?

DAVID BYRNS: "It's psychologically tough to be a value investor. In theory, it seems easy to just buy stocks that are trading at discounted valuations but in practice it's much harder than that. Typically, the businesses we invest in are going through something bad that has driven a mispricing. Headlines are bad. Sentiment is bad. Many investors have given up. You have to have a disciplined process in place to take advantage of those mispricing and be greedy when others are fearful (and vice versa)."

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>
> *– Ebbe Matthiesen, PensionDanmark*

STEWART HOGG: "Our investment thesis is very much grounded in the future and at times the market finds it hard to put a value on something it can't see. The market therefore focuses on the next quarter and set price targets three to six months ahead. We think about the future, five or 10 years from now, and over those time horizons, it's no longer so much a quantitative endeavour. What we do is much more qualitative where the intangibles of the investment case become more important. The culture of the business is vitally important for the future growth. One example of a current holding where the market is sceptical is Moderna, which of course was very popular during the Covid pandemic. We purchased the company before the pandemic as we think it's a potential disruptor in healthcare. Their mRNA technology was proven at scale during the pandemic and we think Moderna could become a significantly larger company as it creates innovative therapies to tackle a wide array of disease. It will not happen next month, though. You must be patient."

NIKLAS TELL: DO YOU EVALUATE MANAGERS DIFFERENTLY DEPENDING ON THE STYLE EXPOSURE?

EBBE MATTHIESEN: "So we have a quality, a growth and a value manager around the table but you had to go all the way to Kansas to find a value manager. There are not that many around any longer. If I was to gain exposure to value, I think it would be brave to just buy into the value factor, for example through an ETF. I really think you need to look into the companies that sit in the value basket because some of them you would rather avoid. I think you need to go with an experienced active manager if you're looking to get that exposure."

ALLAN LORENTZEN: "I wouldn't say there is too big of a difference in how we evaluate different managers. What we're looking for is managers that are doing what they say they're doing and are sticking to that. If I were to find one difference it might be that when we evaluate growth managers, we look a little bit more on why the manager would be able to spot new ideas and future winners."

NIKLAS TELL: WOULD IT BE FAIR TO SAY THAT A VALUE MANAGER CREATES VALUE WHEN HE OR SHE BUYS A COMPANY, WHILE A GROWTH MANAGER CREATES VALUE WHEN HE OR SHE EVENTUALLY SELLS THE COMPANY?

ROUNDTABLE – EQUITY STYLE EXPOSURES

DAVID BYRNS
Portfolio manager and senior investment analyst at American Century Investments, where he co-manages the US value, global quality value and global sustainable value strategies and provides fundamental research and analysis for all strategies managed by the quality value team. He has been a member of this team since joining American Century Investments in 2014.

STEWART HOGG
Investment specialist for long-term global growth, one of Baillie Gifford's most concentrated equity strategies with a focus on transformational payoffs. He has worked for the asset manager for more than 15 years.

STEPHEN TONG
Director, portfolio manager/analyst at Lazard Asset Management, supporting global quality equity strategies. Prior to joining Lazard in 2018, he was a senior equity product specialist at HSBC Global Asset Management. Before that, he has also worked at Vontobel Asset Management and AllianceBernstein as a Portfolio Manager and Director of Research.

STEWART HOGG: "We work on the premise that a company that we buy will look significantly different and more valuable on a five to 10 year basis. Our core message is that if we get a few of them right, that's what will be driving your returns. But that company progress takes time – you need to be patient."

ALLAN LORENTZEN: "One of the most difficult things as a selector is when one of the managers you have selected is underperforming. Say that they are sticking to their philosophy – for how many consecutive quarters should I stay patient?"

DAVID BYRNS: "Over time, we've seen different styles being in or out of favour for extended periods of time so I think you need to evaluate any active manager on a multi-year time frame."

STEPHEN TONG: "I would echo that. Quality companies are not immune from headwinds – be that macro headwinds or company specific challenges. I don't think any company is. However, as long as we can demonstrate that we're following the philosophy and can explain the headwinds, then you can make the decision if you have the patience or not. We need to demonstrate to you through data that we're right to have conviction in the companies we own."

NIKLAS TELL: I GUESS IT ALSO COMES DOWN TO WHAT YOU SAID EBBE IN THE BEGINNING ABOUT SIZING YOUR MANDATES CORRECTLY.

EBBE MATTHIESEN: "Absolutely. We've had challenging market for a number of years now with a lot of things happening from a macro perspective. It creates a need for managers that both understand what's happening right now and are able to understand what the longer term effects will be."

CAROLINE LIINANKI: WHAT DOES THAT MEAN MORE SPECIFICALLY FOR YOUR INVESTMENT APPROACH?

EBBE MATTHIESEN: "It's of course tricky because you're asking a lot from your managers. I think you need to allow your managers to work on a longer time horizon because you don't want to exit at the wrong time. That's why the sizing of mandates is important."

NIKLAS TELL: YOU HAVE ALL TALKED ABOUT THE IMPORTANCE OF PATIENCE AND BEING LONG-TERM. HOW AND WHERE DOES SUSTAINABILITY COME INTO PLAY FOR YOU?

STEWART HOGG: "I think it comes down to time horizon. If you hold a company for three to six months, then ESG and sustainability factors don't matter to you because they don't influence over that time horizon. If you hold a company for five to 10 years, then ESG is all that matters. It's about the governance of the company. Do you have confidence in who's running it and will society at large allow that company to grow and prosper over time?"

STEPHEN TONG: "Our investment philosophy is all about return on capital and there are both ESG opportunities and risks that can affect company profitability. So we naturally need to be mindful and incorporate that into our fundamental research."

DAVID BYRNS: "The world is going to change from an environmental perspective and we have an energy transition going on and that will shape and change the investment landscape. We've actually just launched a strategy with an explicit sustainability focus that focuses on companies that are transitioning their business models to a more sustainable place and we firmly believe that there's alpha to be found there. There are many different belief structures when it comes to sustainability but one viewpoint that we've found unifying is that more sustainable businesses are more valuable. So if we can invest in companies that are improving their sustainability in an economically rational manner, we can share in the value that's created for all stakeholders during that business model's transition."

NIKLAS TELL: FROM AN INVESTOR POINT OF VIEW, WOULD YOU SAY THAT INVESTORS ARE HAPPY TO BE ON THE TRANSITION JOURNEY OR ARE THEY FEARFUL OF HOLDING COMPANIES THAT ARE NOT SUSTAINABLE ENOUGH TODAY?

ALLAN LORENTZEN: "The honest answer would be that our clients are less concerned about ESG compared to larger institutions. The reputational risk is much greater for a large institution because they can lose clients and assets if they end up on the front page for the wrong reasons. Our clients don't face that same risk."

EBBE MATTHIESEN: "I think there are some obvious industries that you don't want to be invested in and coal is one. It becomes more tricky when it comes to oil. If you only look at exposure, as a portfolio manager, you would be inclined to avoid companies like Equinor and Shell, which invest in green energy, because it gives less focused oil exposure. Also, the expected return on these investments may be lower than on their oil business. On the other hand, there's a long-term futureproofing of the business model in the gradual transition to green energy that can add value in the long run, and which we as a pension fund want to support when it can be combined with competitive returns. Therefore, I think you need to be pragmatic because the world will run on oil for some time to come. Yes, we have an ongoing transition but it will take time and money."

NIKLAS TELL: AS WE'RE APPROACHING THE END OF THIS DISCUSSION, ARE THERE ANY ADDITIONAL POINTS YOU WOULD LIKE TO BRING UP?

EBBE MATTHIESEN: "We can always talk about AI. One of my colleagues just had a meeting with an asset manager on AI and they had been doing backtests on how a large language model would operate as an asset manager. The backtests showed that all models outperformed greatly. However, typically when you see results like that there's something wrong but it would be interesting to hear from the asset managers here how you think AI will impact your business."

STEWART HOGG: "We've been experimenting with it across our business because research shows that some 20 per cent of knowledge workers' time is spent on searching and gathering information. Large language models can be effective in helping with that and I think that will have an impact on every business around the world – not only asset management. I would, however, be very hesitant to use a large language model for investing because it has been trained on the average of all human knowledge and that's a bad starting position. We want to produce a return different to the index, so we want our inputs to be differentiated, not the average."

DAVID BYRNS: "The fun thing about being a value manager is that we get to look at areas that others are not. I think one thing that can be overlooked right now is the energy intensity of AI. For example, over the last 10 years, electricity demand was flat in the US but if the projections for AI comes to fruition then electricity usage should compound by 3 per cent annually. Could my boring utility companies that trade at a record discount to the market end up being beneficiaries of AI? I think so."