# Investing in an age of uncertainty

At Antipodes, we believe the biggest risk to your clients' portfolios is overexposure to expensive growth.

When considering this risk, most will immediately think about exposure to growth-style funds, but overexposure can materialise in ways you may not fully appreciate.

Consider the passive index. Given software and internet alone have grown to account for 10% of the index, this represents an area of risk.

The last time this was the case was the tech bubble. As global growth slows, we caution against paying any price for growth and quality. Instead we need to look for structural growth opportunities in less obvious parts of the market.

Another major area of risk that must not be overlooked is overexposure to the US economy.

At the beginning of July, the US economic expansion became the longest since the Civil War and the longest bull market on record. It's been a bull market characterised by quantitative easing, buybacks, disruption, credit growth and record low interest rates. Certainly, in recent times, the US economy has been the last bastion of growth in a world where growth has become scarce.

## Can the US accelerate from here?

US Industrial data is showing signs of weakness and the US is already running a fiscal deficit of more than 4% of GDP. With the potential for much greater fiscal flexibility elsewhere in the world we think the US economy will be relatively weaker than the other major economic blocs.

We see the domestic facing part of the US market particularly vulnerable as the tailwind of stimulus fades and competition, facilitated by low interest rates, continues to heat up.

We do own many great US businesses like Microsoft, Merck and Facebook, to name a few, but what these all have in common is they are global businesses, not dependent upon the domestic economy to grow. What are we avoiding? Businesses that have been a beneficiary of stimulus.

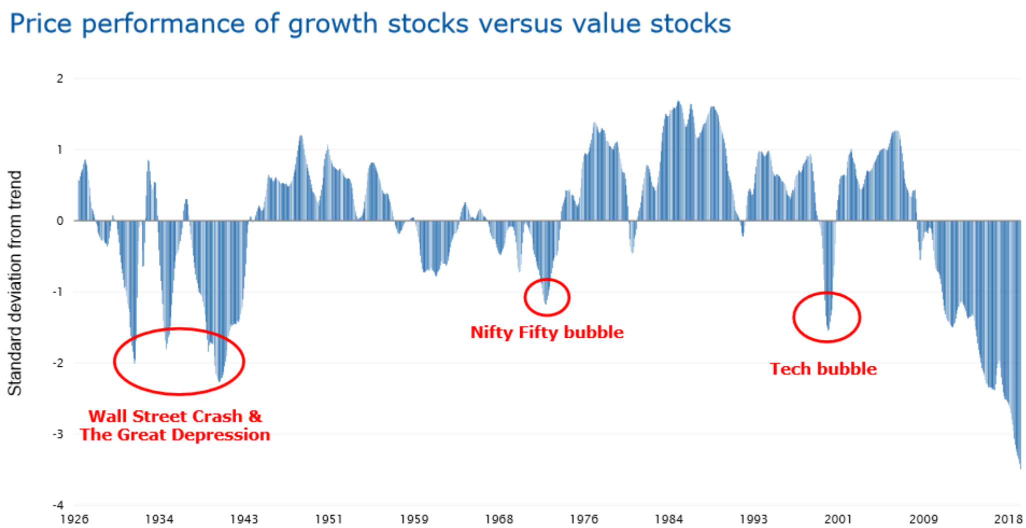
Remember, the US is now running a fiscal deficit of more than 4% of GDP – a point worth repeating as this degree of stimulus would typically be seen in a time of war or deep recession, not at a time of full employment. The effects of this stimulus are fading and we see other tailwinds becoming headwinds.

Many domestic facing businesses have taken advantage of a prolonged low interest rate environment to borrow money to buy back stock and pay dividends, not invest in their own businesses.

At the same time this low interest rate environment has facilitated a venture capital funding boom into disruption, leading to greater competition in many parts of the domestic market. It's worth remembering that 25% of the index is invested in these expensive domestic businesses in the US, so investing in the passive index might be more volatile than you think.

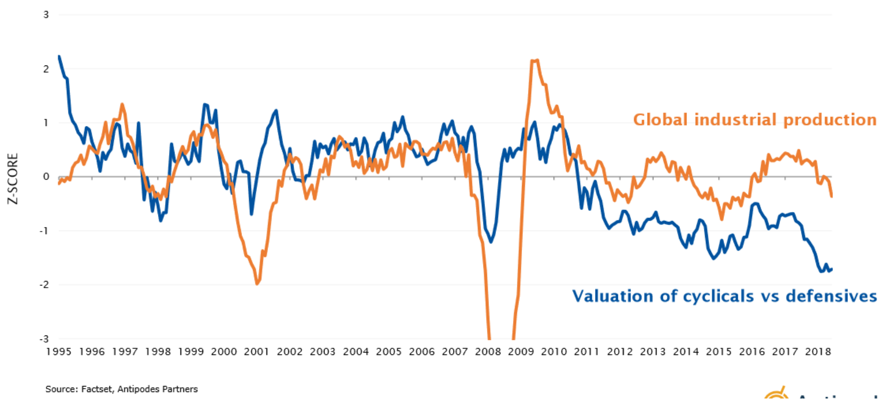
At Antipodes we favour quality consumer franchises in Asia and Europe; these are businesses that aren't trading on premium valuations and aren't under the threat of disruption. Examples include Ping An, Yum China, ING Bank.

The chart below shows just how extreme the price performance of growth stocks relative to value stocks has become. In fact, it's never been more extreme over the last 100 years, which includes previous stock market events such as the Great Depression, the Nifty Fifty Bubble and more recently the Tech Bubble. Record low interest rates are driving up the value of growth stocks to ever more extreme levels.




Source: Antipodes, Fama French. The chart is based on Fama French data where value is defined as the cheapest 30% of stocks on P/B, PE, P/CF, dividend yield, and growth the most expensive 30% of stocks.

As the market has herded into growth and quality at any price, cyclical stocks have never been cheaper.




Source: Factset, Antipodes Partners

On one hand we have increasingly attractive valuations of cyclical stocks, but on the other we are cognisant of a backdrop of potentially slowing economic activity.

So how do we balance this? Rather than buying cyclicals just because they are cheap or because we are convinced the cycle can extend further, we are looking for cyclical businesses that are attractively priced and have a structural growth story.

The structural growth story means these companies are not dependent upon the economic cycle to grow.

## Managing risk

At Antipodes we're managing the risks of overexposure to expensive growth and overexposure to the US economy by looking for growth and quality in less obvious parts of the market and adding cheaper expressions of growth and quality to the portfolio.

We're also being selective. We're wary of owning cheap stocks that risk being permanently impaired by competition and wary of owning disruptors that won't stand the test of time.

It's a multi-layered approach to managing risk.

At the foundation it begins with good stock selection - owning good quality businesses that provide multiple ways of winning.

At the portfolio level we look for uncorrelated sources of alpha and use our macro observations to feed into the margin of safety we require to own a stock.

And finally, around the edges, we look for cheap insurance to protect the portfolio against rare events.