UNCONVENTIONAL WISDOM

Unique investor insights from Wattle Partners

November 2021

The month that was…

- There is little doubt it felt like déjà vu for many when word of the new COVID-19 variant, Omicron, spread around the world at the end of November. The article in this issue was written almost immediately after the initial news and was quickly proven wrong. Yet as we speak, there remains at least two weeks before we will have a scientific understanding of whether our current vaccines can combat the mutation and similarly whether the symptoms are better or worse than expected. Despite being one of the most vaccinated populations in the world the threat of lockdowns likely lingers for many Australians.

- The impact of previous lockdowns was once again on show during November, with the Australian economy contracting by another 1.9 per cent as the worst of NSW and Victorian restrictions were in place. The contraction came despite a further $36 billion being poured into the economy via support packages. There are different takes on who is being impacted most by these events, with some suggesting lower and higher income groups are gaining more benefit from lower borrowing rates, stimulus and market gains. As has been the case, the so-called middle class tends to miss out. The lowlights of the result were the more than 20 per cent contraction in consumer spending on cafes and clothing, whilst the savings rate soared from 11 to 19 per cent in three short months. By the looks of the Melbourne CBD in recent weeks, the economy is quickly moving back to normal.

- The negative run of markets continued in November with most global indices falling as the realization that monetary policy would eventually normalise filtered through the market. The Federal Reserve's announcement that they would begin to taper bond purchases coincided with interest rate hikes in New Zealand and the abandonment of short-term curve control in Australia. As the article in this edition highlights, monetary policy remains historically loose despite the tapering and whilst bond rates spike immediately on the news, it has been far more muted than many predicted. Similarly, there was no correction or massive sell-off, in the market at least, even as inflation remained above expectations. More than ever, it remains a company by company and sector by sector proposition, with investors reminded that the index is just the sum of its parts, particularly the largest ones.

Sticking with this theme, the dispersion in the sector and stock returns on the S&P/ASX200 continues to grow as shown in the table below. After a stellar run benefitting from a surging global economy and underinvestment in supply, the energy sector fell into correction territory, down 8.4 per cent for the month. The outlook remains split, with some expecting decarbonization to lead to poor performances and others suggesting underinvestment will lead to a long-term bull market for fossil fuel. Financials were the other detractor, with CBA pulling the market lower. The weakness came despite a 20 per cent increase in profit with investors concerned about a weakening net interest margin. The abandonment of the Term Funding Facility by the RBA is sending the bank's cost of capital higher and may be a cap on profits. The highlights were materials, with lithium coming to the fore and signs of life emerging in the iron ore sector, as Chinese steel mills get set to ramp up once again. Healthcare also came to the fore with investors seeking more defensive earnings as volatility ensued.

Sector	November	Year
A-REIT	3.6%	14.3%
Communications	3.3%	23.4%
Cons. Discretionary	-0.5%	20.2%
Cons. Staples	3.6%	9.9%
Energy	-8.4%	-6.1%
Financials	-8.0%	12.9%
Healthcare	1.6%	4.1%
Industrials	0.5%	2.5%
IT	-3.6%	12.0%
Materials	5.8%	7.3%
Utilities	4.8%	-9.3%
Small Ords	-1.8%	13.3%

- Cryptocurrency has clearly moved into the mainstream in November, with a survey suggesting as many as half of young Australians had dabbled in the digital asset marketplace. November saw the launch, or flood, of a series of new ETFs linked to the burgeoning sector entering the market. Whilst the majority are either trading futures or investing in the companies involved in blockchain and associated uses, ETF Securities is set to launch a world-first spot market Bitcoin ETF before the year is out.

- Sticking with portfolio hedges and asymmetric returns, gold bullion is beginning to shine once again, with the asset class-leading most others in November. Digital assets are clearly still seen as risky, rather than as hedges, with gold seeing significant inflows as inflation in both the US, Europe and Australia remains well ahead of even the most pessimistic assumptions. The value of asymmetric returns remains as high as ever, with Australian investors also able to gain the benefit of a currency hedge should the US be forced to increase rates more quickly amid the expanding labour shortage.

- The Job Maker package was central to the Federal Government's effort to boost the economy out of the pandemic, and both it and the mining sector have paid off. Corporate profits were 4.2 per cent higher in the September quarter boosted by both sectors. Among the highlights were building product supplier CSR, which delivered a 30 per cent increase in profit and James Hardie, which saw double-digit sales growth as stuck at home people around the world doubled down on renovations and rebuilds.

- Corporate activity remains at record levels, with a long list of IPOs joining the market but a clear reduction in quality. More listings are struggling to keep up with initial valuations hurting growth-focused investors. Globally, the trend is similar with both Johnson & Johnson and Toshiba, two of the most well-known companies in the world following GE in announcing their intention to break up their complex conglomerate business models. We are also seeing a massive divergence between quality and momentum, with global semiconductor leader NVIDIA delivering record sales and profit growth despite supply shortages, whilst the likes of Zoom and Peloton struggled to sustain COVID growth rates.

Model Portfolio Update

- Investment Committee -

Index	Index Points - October	Index Points - November	Performance 1 Month	Performance 1 Year
S&P/ASX 200	7332.2	7239.8	-1.2%	9.7%
All Ordinaries	7629.7	7562.5	-1.0%	10.9%
US Dow Jones	33843.9	34483.7	-3.7%	16.4%
US S&P 500	4605.4	4567.0	-0.8%	26.1%
Hang Seng (HK)	25377.2	23475.3	-7.5%	-10.9%
FTSE 100 (UK)	7237.6	7059.5	-2.5%	12.7%
Nikkei 225	28892.7	27821.7	-3.7%	5.3%

Top 5 Performers	1 Month	Bottom 5 Performers	1 Month
Nanuk New World Fund	8.4%	Commonwealth Bank o	-11.0%
BHP Group	7.6%	Challenger Financial	-6.9%
Woolworths	7.2%	ANZ Banking Group	-5.1%
Telstra Corporation	6.5%	Ramsay Healthcare	-5.1%
Gold	5.4%	Origin Energy	-5.0%

Diversification and portfolio construction continues to pay off for the Wattle Partners Model Portfolio, with the decision to reduce growth asset exposure in the previous quarter proving well-timed as volatility increased in November. Performance across the asset classes remains mixed, with global equities once again taking the mantle of the top performer, followed by both defensive and growth alternatives, which posted positive returns. Looking at the portfolio more closely, cash allocations remain a drag forcing more investments into fixed income and defensive alternatives including credit and property. The fixed-income holdings experienced a slight sell-off, as the prudential regulator increased pressure on balance sheets at the same time that the tapering of bond purchases in the US and Australia forced bond yields slightly higher. That said, the portfolio continues to carry very limited duration risk, many it is somewhat protected from interest rate increases and able to deliver stronger income as rates rise.

The defensive alternatives sector outperformed with gold and global commercial real estate seeing strong growth. Higher than anticipated inflation, bond tapering and a weaker AUD all contributed to a rally in the gold price to their highest point in several months. Similarly, institutional-grade commercial property continues to recover as cities around the world return to normal.

Within domestic equities, the financial sector gave back recent gains, with the Commonwealth Bank among the worst hit, down over 10 per cent. The key driver was a weaker than expected profit result and concerns about tighter margins as the property market slows. Challenger and ANZ shared a similar fate but on the positive side, the materials and mining allocations performed well. BHP has recommenced its strong performance as Chinese steel mill curbs are seen to be reducing, which is seeing demand for iron ore surge once again. Woolworths and Telstra were also outperforming as both attracted defensive investors amid an increase in volatility. Every investment in the global equity allocation posted a positive return, with the sustainably focused Nanuk New World Fund the standout. Investments in technology and data providers including Wolters Kluwer and Accton, which supports digital networking solutions, and a value bias drove the fund higher. The Asia tilt within portfolios also paid dividends, as the Cooper Fund delivered a strong positive performance amid unexpected resilience in the Chinese economy. Munro's focus on quality growth leaders including Amazon and Microsoft is also benefitted from a rush to mega cap amid a more uncertain outlook.

Omicron shakes the market

- Drew Meredith -

Magellan Financial Group (ASX: MFG) and its founder Hamish Douglass have been a lightning rod for investors, analysts and the media in recent months. After over a decade of outperformance, Magellan's flagship global fund came back to earth, with Douglass' unwillingness to chase returns in 'value' stocks seeing the fund underperform.

Combine that with the decision to invest in up-and-coming investment bank Barrenjoey and the unfortunate events around the ANT Financial IPO, and it couldn't get worse for the group. More recently, fast-growing but similarly performing global manager, GQG Partners (ASX: GQG) has seemed to attract funds away from the group.

Then came Friday, when the first rumblings of 'another' mutation of the coronavirus, dubbed "Omicron" by the WHO, saw significant volatility re-enter the market. Among the hardest hit were the most popular "value" and "recovery" plays, into which a growing list of fund managers had been flooding in the pursuit of short-term returns.

Few may remember, given the short-term focus of the market, that Douglass warned about this on several occasions in the last 12 months, something we covered here.

The concept of mutations has been raised in almost every major Magellan update since the beginning of 2021, with Douglass derided at one point for appearing to be spending more time on virology (the study of viruses) than on effectively managing his underperforming portfolio.

Are the tables about to turn? As initial news about the mutation emanated from South Africa on Friday, the market tanked, but with a particular focus. Many of the most popular and widely held stocks suffered significant sell-offs, including Flight Centre, Qantas, Oil Search and Pilbara Minerals.

Such is the nature of extended bull markets, with this one now over a decade old. Naturally, some excess creeps into markets. The last 12 months alone have seen a flood of new managers, in everything ranging from small to large-caps, technology to resources, private equity and venture capital, launching their own strategies after periods of significant and strong performance.

In many cases, they have delivered exceptional returns, albeit on a short-term basis, during a period dominated by momentum. But as always, you only really know the quality of risk and funds management when times get tough. Historical returns are built over many years, not just a few.

As usual, an initial bout of volatility saw a flood back to 'quality'. Previously unloved sectors, including utilities and healthcare, which couldn't find a buyer for the last 12 months, were immediately back in demand. Interestingly, Bitcoin also fell around 8 per cent on the day, as it appears many newer investors see it as a risk asset, rather than a hedge like gold bullion, which rallied strongly.

Moving back to Magellan, Douglass had flagged his preference to focus on building a 'resilient' portfolio that was prepared for both inflationary environments, but also unlikely to see the selloff that came should a mutation eventuate. The initial signs are somewhat positive in this regard, with the likes of Microsoft, Netflix and even Alibaba outperforming the broader market.

Of course, only time will tell how long this sell-off lasts and if the latest COVID mutation is particularly dangerous.

Is Alibaba set to soar?

- Investment Committee -

Alibaba (NYSE: BABA) is typically described as China's Amazon, but it is so much more. Anyone undertaking a true analysis of the business would likely need to include Alphabet, PayPal, Microsoft and potentially even Intel in their comparison to US technology giants.

The company and its distinguished founder, Jack Ma, have been somewhat of a lightning rod for the global investment media and portfolio managers alike. Following a poorly timed decision to 'pop his head out of the sand,' Ma has seen the rug pulled from under his booming ANT Financial business.

There is a long list of well-known fund managers calling China 'uninvestable,' yet the most common and relevant saying in the market remains 'buy when there is blood in the streets', and there likely couldn't be more blood than what has been seen in 2021.

One of the biggest reasons why most global growth managers are avoiding China today is because they have historically been 'dabblers' in the region. That is, China formed only a small part of their portfolio when the unique culture demands a concentrated and focused approach to the region.

Take the ANT Financial story for instance, where the IPO was pulled at the last minute and Jack Ma was blamed for speaking out on political issues. A closer look at the business highlighted the fact that the company had become so important to China, providing about 20 per cent of all consumer debt, on an unsecured basis, that the government may well have thought ANT was too big to fail. In fact, the business was being run with no capital requirements, despite being a significantly important lender.

All the headlines around regulatory crackdowns have sent the Alibaba price down more than 50 per cent since October 2020, meaning it now trades on a forward price-earnings (P/E) ratio of just 15 times 2020 forecast earnings. That is a full 25 per cent cheaper than the S&P500. This is despite the fact that the company through its Taobao and Tmall e-commerce businesses still controls close to 50 per cent of the market in China.

The group has more than 1.2 billion annual active users and has been growing revenue at a rate exceeding 30 per cent for several years. While many compare Alibaba to Amazon, its business model is more akin to those of eBay and Google, such that it is able to generate significantly higher margins by delivering advertising and ranking, rather than just product sales.

Put the e-commerce business to the side and Alibaba becomes even more interesting. The group owns similar business lines in Europe and Asia, with AliExpress the most popular app in Russia.

After founding Alibaba Cloud around 11 years ago, the group has now reached critical mass, turning a profit for the first time while still growing above 50 per cent a year as the digitalisation trend spreads throughout Asia. This has placed it third in the world behind Amazon and Microsoft in the cloud computing stakes.

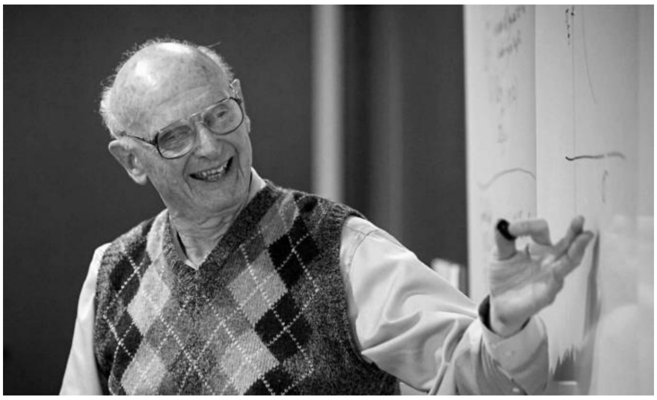
As is typically the case with winner-takes-all technology companies, Alibaba has recently launched its own semiconductor chips that will be used within its cloud business, further insulating the business from the growing semiconductor shortage and potentially opening up a new business line.

Such has been the underperformance that renowned value investor Charlie Munger has nearly doubled his investment in Alibaba over the last 12 months. And why not? Investment research platform Gurufocus suggests with free cash flow of US$45 billion in 2025 and based on a comparable multiple of 25 times, the company could join Tesla as the next trillion-dollar company.

WATTLE PARTNERS

Uncovering the 40/60

- Drew Meredith -



40/60, 60/40 or 30/70. The term is among the most spoken about by financial advisers and other industry experts. At present, the focus of the discussion is on why the 40/60 portfolio is "broken," yet we rarely take a step back and think about it in its own right.

The term refers to the "construction" of an investment or retirement portfolio. In most cases, outside of the US, the first number refers to the allocation of a portfolio into low-risk assets, primarily bonds, and the second into growth assets, primarily shares. Ultimately, it speaks to asset allocation among available investments.

This isn't a new concept, but in my experience as a financial adviser, portfolio construction and asset allocation are not front of mind for most self-directed investors. In fact, they rarely garner a mention and are low on the priority list.

Historically, the concept of a 40/60 portfolio is grounded in the concept of Modern Portfolio Theory and the idea of diversification. A 40/60 portfolio is said to offer the best of both worlds, being the ability to grow your capital through a significant allocation to shares, but also, with the ability to dampen volatility through a sizeable investment in high-quality bonds.

Ultimately, the strategy is predicated on achieving the best possible return on your money, without taking more risk than is appropriate for someone in your circumstances. As is commonly the case, risk refers to the volatility in the value of your portfolio, not the permanent loss of capital.

And this is where most people get lost. At its core, investment theory suggests that if you take more risk in growth assets, you should be rewarded with higher returns. But recent history has shown this isn't always the case. In fact, those with larger allocations to bonds have tended to significantly outperform in a falling interest rate environment.

This is the key issue that every investor, from the endowment and pension funds to SMSF trustees, faces today. With bonds yielding as little as 1.6 per cent a year, they are almost guaranteed to deliver a negative return as interest rates eventually increase. Given this represents 40 per cent of the 'portfolio,' this is bound to hurt returns. In some cases, analysts are predicting that the long-term returns from a 40/60 portfolio may be as low as 2.2 per cent a year for the next decade.

It is for this reason that many experts are pushing for a change in the 40/60 portfolio construction. At the core of this argument is the inclusion of a broader range of asset classes, including anything from credit, high-yield or junk bonds, private equity, infrastructure and hedge funds, in the pursuit of returns.

But clearly, this complicates matters even further. On the one hand, how does one gain access to, and assess, these without broad-based indices to compare? On the other, what is the appropriate allocation to each sub-asset-class?

As always, I personally stress the need for a detailed Investment Policy document for every person managing capital, their own or others, to assist in guiding these decisions.

Watching the smart money - Buffett's latest moves

Berkshire Hathaway (NYSE: BRK) continued its busy year, with management clearly "cleaning-up" its expanding portfolio of investments. As readers will know, the Warren Buffett-led group doesn't always 'do what it says,' with Berkshire focused on active management and in many cases taking full ownership of businesses ranging from railroads to insurance companies.

The September quarter saw Berkshire facing some difficult comparables, with overall earnings (which reflect Berkshire's fluctuating equity investments) falling by 60 per cent in the September quarter, year-on-year, to $10.3 billion.

On an operating basis, the result was significantly better, with operating income coming in at US$6.47 billion, up 18 per cent from US$5.48 billion a year ago.

The cash cow of the business has long been the insurance underwriting business, which Buffett himself confirms is central to the ability to hold such a diverse array of listed and unlisted investments. Insurance premiums must be invested to deliver returns, but offer a constant flow of cash, not unlike an Australian pension fund.

The cash-cow status has been somewhat muted in 2021, with the group seeing a tripling of its losses to US$784 million as a number of natural disasters saw a spike in insurance claims.

As of the end of 30 September, the company held some US$311 billion in equity investments and a ballooning cash balance of US$149 billion which is still looking for a home. Buffett's 'value' focus combined with a booming merger and acquisition market has made it difficult to find appropriate investments to deploy this cash, or perhaps Buffett is waiting for another crash?

According to regulatory findings, this quarter has been all about trimming and cleaning-up Berkshire's direct equity portfolio, with allocations to the financials and healthcare sectors reduced.

Management confirmed that its holdings in Visa (NYSE: V) and Mastercard (NYSE: MC) had been reduced following a strong 12-month period for both companies and well in advance of Amazon's decision this week to ban payments from the latter in the UK.

In the healthcare space, holdings in pharmaceutical businesses AbbVie (NYSE: ABBV) and Bristol Myers Squibb (NYSE: BMY) were reduced significantly after a sharp sell-off in October amid concerns about increasing drug prices. The most interesting new addition to the portfolio was Royalty Pharma (NYSE: RPRX) which seeks partnerships with late-stage drug-trial hopefuls and supports them in moving to commercialisation.

Naturally, as a traditional value investor, the holding in oil and gas company Chevron (NYSE: CVX) was increased while tiling retailer and manufacturer Floor and Décor (NYSE: CVX) was a new addition. So, what can Australian investors take from this insight, and are there any companies they should be considering in Australia?

On a high level, Wesfarmers (ASX: WES) stands out, with the company in the process of taking over Australian Pharmaceutical Industries (ASX: API) while also owning the largest DIY and home renovation chain in the form of Bunnings. Metcash (ASX: MTS) has maintained operations, albeit smaller, in the tool and hardware business. Clearly Berkshire has some confidence in the ability for the surge in residential and commercial construction to continue.

Inflation hyperbole

- Jamie Nemtsas -

'Inflation risk is real'. 'Federal Reserve turns hawkish'. 'Tapering to begin in November'.

These were the headlines that followed Federal Open Market Committee member Randal Quarles' speech at a conference this week. Yet the headlines once again highlight the risk of confirmation bias that afflicts even the most objective, professional investors.

While the headlines were true, and Quarles did support a decision to start reducing The Fed's massive bond purchasing program in November, they missed a significant amount of discussion and commentary about what has actually been occurring in the economy.

In a wide-ranging speech, Quarles offered insights into the FOMC's decades of experience, and both the issues and opportunities that are arising as a result. At present, he suggested, "supply bottlenecks and labour shortages.... are camouflaging continued strong underlying demand," but this does not of itself lead to the inflation outbreak that we all fear.

There is a growing list of expert hedge fund investors, billionaires and economists suggesting that the Federal Reserve is 'behind the curve,' and not doing enough to avoid a disastrous economic outcome. The speech directly targeted this cohort, with Quarles stating he doesn't believe the Fed is behind the curve for three key reasons: "most of the biggest drivers of the very high current inflation rates will ease in coming quarters; some measures of underlying inflation pressures are less worrisome, and longer-term inflation expectations are anchored, at least for now."

Looking beyond the headline figures, he reiterated that "the inflation we have experienced so far has been very unusual, and largely related to supply constraints associated both with production and distribution problems related to COVID and with a demand shock arising from the unprecedented and rapid reopening of the economy."

Clearly, this is not an unexpected result following a global pandemic the likes of which have not seen for several decades, and not once in the careers of those managing money or pontificating about economies today. Referring to the "trimmed mean" measure of inflation, which systematically removes prices that are increasing or decreasing at 'abnormally large rates', the true inflation rate may well be as low as 2 per cent. This once again highlights the importance of policymakers seeking to 'look-through' the short-term data towards the longer-term trend, something that is very difficult for market participants to do.

The concept of "transitory" inflation remains misinterpreted, with many believing transitory must mean "short-lived," when it actually refers to the source of said inflation. That said, if inflation remains high for too long, it may impact inflation expectations, which then impact wage growth. But ultimately the dilemma faced by the Federal Reserve is likely clear to everyone:

"Demand, augmented by unprecedented fiscal stimulus, has been outstripping a temporarily disrupted supply, leading to high inflation. But the fundamental productive capacity of our economy as it existed just before COVID—and, thus, the ability to satisfy that demand without inflation—remains largely as it was," said Quarles. That likely suggests a return to below-trend growth after this is all over.

Quarles reiterated that regardless of the ultimate inflation result, the Federal Reserve is as confident as ever that it "has the framework and tools" to address inflation.

Tricks of the trade – defining tracking error

- Drew Meredith -

There is no shortage of investment ideas available to self-directed investors, nor any lack of 'fool-proof' money-making strategies. The level of certainty with which most investment ideas are delivered to the masses belies the inherent complexity of markets. In this environment, the more tools that any investor has at their disposal the better.

The role of a financial adviser involves acting as something of a 'filter' between the many new and existing investment ideas, and those families that have entrusted us with guiding the investment of their life savings. In over a decade of experience, I have seen almost everything and learned a lot, but one of the most powerful tools I have picked up is 'tracking error'.

The 'passive versus active' debate has dominated headlines since the introduction of the "index fund" by Vanguard many decades ago. But the most commonly used statistics do a disservice to the discussion, as they give no consideration to how active the active managers actually are.

The concept of 'tracking error' is among the most straightforward ways to measure the 'activeness,' for lack of a better word, of the manager, exchange-traded fund or listed investment company you are buying. Put simply, tracking error is the difference between the movements in the price of a portfolio of investments, a fund for instance, and the movement in the price of the benchmark or index which it seeks to outperform.

It is measured using a standard deviation approach and is among the most accessible data for every fund manager to measure and provide to investors. An index fund, which has the sole purpose of tracking the underlying index, should have a tracking error of close to zero; yet this is not always the case. A truly actively managed fund will have a tracking error upward of 1 per cent to 2 per cent.

What this means is that the fund has performed significantly differently from the index, both positively and negatively. Referring back to the active vs. passive debate, it clearly doesn't make sense to include 'actively' managed funds that have tracking errors of less than 1 per cent in any debate.

There are many uses of tracking error, but ultimately it is to determine if a fund manager is doing what it said it would. By evaluating the historical tracking error of a fund, you can get an idea of how far the manager has been willing to differ from the index in the past, and thus how far it is likely to differ in the future. It really answers the perennial question, 'why pay an active manager if you are just getting index performance?'

Managers are acutely aware of tracking error, particularly when they start to receive significant institutional mandates from pension funds and the like. These sorts of investors have every possible opportunity in front of them, hence every manager is easily replaceable if they underperform; this tends to lead to lower tracking error and benchmark performance in the larger active funds.

One of the more common uses of the tracking error measure is to build a core-satellite type allocation to, say, domestic equities. The 'core' portion of the portfolio would be a very low-cost index fund with nearly zero tracking error. The satellite is then used to invest in truly active managers with significant tracking errors, who are really seeking to move the dial in terms of returns and the implementation of their fundamental analysis.

Ultimately, if a manager is delivering low average returns and has a large tracking error, you are most likely better off in an index fund.

Munro doubles down on climate

- Jamie Nemtsas -

Munro Partners this month announced the launch of a new 'climate' dedicated equity strategy. After successfully navigating the taper tantrum, Trump election and the pandemic, CIO Nick Griffin has identified what Munro believes is a $30 trillion opportunity and split its climate "area of interest" out of the Global Growth Fund.

The strategy will invest in between 15 and 25 companies that are judged as leaders in the world's transition towards net-zero carbon emissions. Clean energy, energy efficiency, clean transport and the circular economy will all form part of the climate "sleeve," which had grown to 18 per cent of their core strategies given the fast-expanding opportunity set.

While Griffin and Munro have made a reputation from identifying the leaders in the "winner takes most" nature of technology markets, he notes that the range of winners will likely be vastly broader in the new decarbonised world. For instance, based on the growing number of net-zero targets, by both corporates and governments, forecasts suggest about 20 times more wind farms need to be built than what is in existence today; there are only three companies that can do this.

Yet just like Amazon (NASDAQ: AMZN) or Apple (NASDAQ: AAPL) in their early days, investors seem obsessed with supply chain and inflation issues and are unable to look beyond the short-term to see the "structural growth" opportunity afforded by the likes of Vestas (CPH: VWS). The recent rotation back into end-of-lockdown winners, such as commodities and financials, which Griffin expects to fade next year, means that the "majority of holdings (in the Climate Fund) trade at multiples well below the alternatives," but particularly loss-making technology companies.

The launch news was delivered as part of a quarterly update in which Munro confirmed that it had reached $6 billion in assets under management and would be reducing the fee on its long-only global strategy to just 0.7 per cent. The strong performance since inception, Griffin said, was driven solely by the fact that the strategy invests in companies that are growing earnings, with share prices ultimately following the profitability of a company over the long term.

In summarising Munro's approach to picking winners, it is all about "looking for companies that can double in five years," both in terms of earnings and share price, and it is for this reason that the fund maintains a zero weighting to China. While short-term underperformance can be expected in a momentum-driven market, Griffin expects "structural growers" to move back into focus in 2022 as fiscal and monetary support wane.

Commenting on the latter, he was more circumspect than many outspoken experts, suggesting that the hysteria around bond rate increases is overstated, with rates ultimately capped by the level of indebtedness of governments. There is a "level of certainty" that rates will stay low for the foreseeable future, between 1 to 3 per cent, somewhat proven by the fact that despite every reason to have moved higher, the US 10-year yield remains stuck below 2 per cent.

This bodes well for the outlook of fast-growing technology companies, but particularly Tesla (NASDAQ: TSLA), which he admits is the only highly priced company in the climate portfolio. Answering questions on the true valuation of the company, he compared it to Apple, in the fact that Apple dominated both the hardware and software categories, not one or the other like many other businesses do. Tesla is "exactly the same," owning the largest market share of EV sales, which itself is a fast-growing sector, but also having designed and built a technology platform that is years ahead of its competitors. The key is identifying the 90 per cent margin income streams that Apple achieved, which may well see a US$3 trillion valuation for Tesla.

Concluding, Griffin flagged the lack of certainty around the re-nomination of Jerome Powell as Chair of the Federal Reserve as "one of the most under-appreciated risks" in the market today. Given the current state of markets, this could see a "major change," which may well be disruptive.

BNPL gets hotter and hotter

- The Silver Mongoose -

Since our last note on BNPL, there has been even more frenzied activity in the partnership and acquisition game involving BNPL players and Payment Technology platforms. Here is a summary of the past 2 months:

- In August Sezzle, a USA based BNPL player inked a $30m investment round with Discovery (aka Diners Club) to cement a "partner" program that introduces Discover's merchants to Sezzle increasing its footprint to small and medium businesses and in return Sezzle will market Discover's card products to its customers to upsell them into a credit card product set.

- In August the partnership between Amazon and Affirm was announced. From the details that have emerged Amazon will now start offering BNPL payment terms alongside regular credit options as a way of driving more online sales for its merchants across the Amazon platform.

- In August the much-hyped Square purchase of Afterpay was announced but other moves mean that much of its significance at the time may be overshadowed.

- In September PayPal not only launched its new super App but it announced it was buying a Japanese BNPL operator Paidy for $2.7b cash to build out its Japanese footprint and to enhance its BNPL skill set. Paidy has excellent machine learning technology that assesses the creditworthiness of a consumer in seconds and then guarantees payment to the merchant. Thus, enabling PayPal to bypass many of the toxic debt issues confronting other BNPL operators.

- In October Klarna and Stripe inked a partnership agreement to offer Klarna's BNPL services to Stripe's 3 million online merchants globally.

- In October Klarna acquired Inspireock an online travel planner in the USA to enable it to offer shopping and payment technology for travel agents and merchants in the USA.

- In October Klarna participated in a $100m funding round of Billie a German fintech that powers BNPL B2B payments as opposed to consumer focused BNPL.

This ongoing frenzy in the BNPL space points to the potential seismic shift occurring when tech and BNPL players combine. Klarna's transactions in particular herald a significant shift as it will now be able to offer a B2B platform integrated with an e-commerce platform delivering the B2B players end-user consumers. That has not been possible till now for any BNPL player and positions it directly in the consumer banking space but without the bank's legacy IT systems.

The potential for the dis-intermediation of the traditional banking relationships is now clearly apparent. The increasing pace of partnerships and acquisitions in the BNPL space must be putting pressure on banks. They need to have realistic strategies and products to enable them to respond to the new BNPL partnerships that have the potential to unpick their relationships with both consumers and merchants. Part of this will have to involve Banks restructuring their fee streams from both groups which will put pressure on the fee cash cow associated with payments and consumer credit.

The more it becomes apparent to both merchants and customers that there are viable alternatives that can link them then the banking inertia that has protected banking high street players for so long may be about to be overcome. Such is the speed of these partnerships that even technology fintech focussed banks like Barclays in the UK and Capital One in the USA that were launching their own BNPL products as a defensive strategy may find it is too little too late.

Finally, this spate of partnerships and mergers also poses challenges for those BNPL players yet to forge technology payment platform partnerships. For them, it may be too late, and their exit/demise may be a matter of time.

Market Thinkers

- Jamie Nemtsas -

Our Market Thinkers series has come to an end after exciting sessions focused on retirement. We will be continuing this theme in 2022 and beyond and welcome your thoughts on potential topics both including and outside investment circles.

Each of our episodes is available here:

- Apple Podcasts
- Whooshka

Updates from Wattle

We welcome Kimora Diep to the team full-time after finishing her studies. Kimora will be supporting the rest of the team, in both advice, administration and implementation roles.

Finally, young Flynn Meredith has turned six months, an exciting time for all involved.