2fold: Take Stock

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Centennial Asset Management

CAROLINE GURNEY: I'd like to begin by acknowledging the Traditional Owners of the land on which we meet today, and recognise their continuing connection to lands, waters and communities. We pay our respects to Elders past and present.

MATTHEW KIDMAN: A market allows anyone to participate. It's an open church. You can come into that market and do whatever you want. But you've got to bring yourself to it. You will have an advantage over anyone else. You've just got to find what your strength is.

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

I'm Caroline Gurney, the CEO of Future Generation. We're Australia's first listed investment group to deliver better returns for you while building better futures for young Australians, and we do this by harnessing the generosity of our top fund managers. So far, we've donated more than 75 million to not-for-profits, and that's because of people like Matthew Kidman, the principal and portfolio manager at Centennial Asset Management. Like all our fund managers, he charges zero management or performance fees for managing Future Generation money. Matthew also donates his time to Future Generation Australia by sitting on our investment committee on a no-fee basis.

He's in the studio with me today. So, Matt, hello. Welcome to our podcast.

MATTHEW KIDMAN: Thanks for having me.

CAROLINE GURNEY: Before we get into the heavy investment side of things, I want to ask you about your involvement with Future Generation Australia. You are one of the very first people to join our investment committee and also one of our first pro bono fund managers. How did that come about?

MATTHEW KIDMAN: Well, I think I was number three and Geoff, the creator, Geoff Wilson, who I've worked with for a number of years, had lined me up quite a bit earlier. He said, look, if we do this

Future Generation, I don't think it was even called Future Generation, will you come on the investment committee and I just said, sure, not knowing what was involved. And then one day he rang up and said, okay, you're on the committee. And I said, right, who else is? And it was him, Gabriel Radzyminski and me. And to be quite honest, we hadn't done this before. We were novices. And then Geoff said to me, well, the other thing you got to know is that we're managing some of the money at WAM and Gabriel's managing some of the money. So to make sure we're all conflicted, you've got to manage some of the money. You're happy to do that? So I went, okay, all right. And so that's where it started. It was pretty simple. And then since then, we've built out the investment committee. And it's got a completely different complexion now. It's a lot more sophisticated. We all know the industry well, but it is an A-class committee now, even with me on it.

CAROLINE GURNEY: Okay, so let's turn to markets. You were one of the very few fund managers last year to publicly call the start of the current bull market. You were right, of course, I should say. But what actually drove that conviction?

MATTHEW KIDMAN: Yeah, a little bit of luck in that. The way the markets are set up in my eyes was that we're probably running in the cycle slightly behind the US. And when I say slightly, it could be six months, but it's probably more like 12 months. The thing that spooked markets and forced the selloff in say 2021 through to 2022 was the emergence of inflation and how sticky it was. And of course, the Federal Reserve started to lift interest rates.

Now, the US got on top of that a bit earlier. They had a sharp spike in it, but they got on it early. And by about October, November 2022, the NASDAQ was the lead indicator. It bottomed and started to rally. And I thought that was quite interesting because we would run through the same cycle, we're slow to lift rates, we're a little bit behind in the cycle. And I thought at that stage, you could start thinking that markets had turned. Now, it always takes a couple of minutes, uh months to get through.

CAROLINE GURNEY: If only it was a couple of minutes.

MATTHEW KIDMAN: A couple of minutes, it is at bottoms. But you watch it quite closely day to day. And within a couple of months, it became obvious that the downtrend had broken and there was a different narrative going on in the US. So the Australian big cap market followed suit with a bit of a delay. The small caps where we spend most of our time was very slow to pick up. And I was saying by about the March, April, May period, I think the market's bottom, the trend is in, and it's all about rates levelling out, not necessarily going down, but stopping going up. And I've got to say, I was a bit early for small caps. It took a bit longer in Australia to play out the cycle, but that was the impetus for it.

CAROLINE GURNEY: So let's talk about bad situations driving investment opportunities. We've got two wars underway, a new cold war between China and the US. There's been a massive increase in defence spending globally. Are you seeing any opportunities there? And then I think we're going to go back to small caps.

MATTHEW KIDMAN: So there is. We talked about markets there briefly. And I think markets are in an uptrend now and will be for a while. And we're not in the very pointy end where things are out of control because not everything is lining up yet. I think that's down the track, but I think we're over the worst of it. So then you've got to go down and pick stocks. And on the face of it, things look pretty ordinary in the world, which is great, in one way because it keeps enough people negative about the world.

As you said, there's two wars going on and there's still inflation about. So you've got to pick through what can benefit from these situations. And one of them definitely is defence spending, unfortunately, around the world. Post the Cold War thawing back in the 90s when the USSR disbanded, there was what they called a peace dividend. So there was more capital going back into productive capacity rather than into armaments built.

Unfortunately, we're back full cycle, it seems to me. Now symbolic of that, it was the war on the Ukraine. Even before that though, it started with the US through the Trump presidency, saying to the Europeans, if you want to stay in NATO, increase your spending and start contributing to this agreement. And that has flowed through globally as far as we can work out. The Australian government is trying to get its spending up. We've seen the August deal. Obviously, there's billions of dollars over many years. And unfortunately, it's filtered down into what I would call the Second Cold War, that in my lifetime, which is unfortunately China also starting to spend money or probably have done for quite a while in response. They can't be left behind. Now, we can't see that as obviously. It's a closed economy.

Where's the opportunity? There's some obvious ones at the small end. One that we've invested in over recent times is Drone Shield (ASX: DRO). New warfare depends a lot on drones. It's the eyes in the sky. And they also carry very little weapons and shoot from unusual places. It's totally different warfare. So, Drone Shield has systems that shoot these or protect you from these drones. And it's been around for a while, and it took a long time for it to get traction. But in recent times, it's taken off.

There's similar examples, other smaller companies like EOS (ASX: EOS), which provides military equipment at the small end. But I think where it's missing a little bit is Australia's productive capacity around steel. Now, it might not be obvious to Australians, but I went on a recent trip to China. And it was a terrific trip. Spent a week in China, hardly anyone goes anymore because it's been disassociated with Australia and the great Chinese miracles over. But there's still things going on. So one of the aspects that investors find hard to comprehend is why is the iron ore price, which is our biggest export, staying at an elevated level. Now, it's not at peak levels, but it's above long-term averages. And one of the reasons that's becoming obvious is that steel is going into armaments and defence in China, which is our biggest customers. And because of private enterprise, state-owned organisations up there, the government is in everything. So don't be surprised if iron ore stays at an elevated level and you do benefit from the big, and we all know, the BHPs, the Rios, it might not sit well with people, but that's where some of that steel is going. And it might be while other things come off like the property boom in China, there's an incremental gain on defence. And defence spending around the globe will require more steel as well. There's trions to be spent, unfortunately, as I said. It's not a great development, as you say, being disrupted. It's not productive, but there are some companies that make a lot of money out of it.

CAROLINE GURNEY: Actually, if we go back to China, I was really interested in the fact that you said that people aren't going there anymore to actually look at investment opportunities. So how are they finding out about them?

MATTHEW KIDMAN: Well, they're not going en masse. If you go back to 2000, just before the GFC and just after when the Chinese government stimulated enormously, you had to go to China at least once a year if you're an investor. Now, people are still going, but not in the way they used to.

So I think a lot of people rely on the macro data. And people actually, I was a bit surprised, people are actually mildly scared about going to China. So if you go to Shanghai, which has got a long history of a free trade port, obviously not these days, it's under the control of the Chinese government. Before COVID hit, 750,000 expats lived in Shanghai. That was the best estimate. During COVID, it got down to 100,000. And now that's about 200,000. So there's just not the communication between the expat community and the outside world, the government spending's closed off. It's all a bit more secretive again. So I would say most people aren't finding out about it.

There's still some very good stories there that you can benefit from. Things like A2 milk (ASX:A2M). So coming out of it, we spent the week up there and met a lot of people involved with infant formula, another bad scenario. Birth rates are way down in China, which is reflective of some of the things that are going on in the macro level, that the economy is slowed, property bust, no one's as confident. But sitting there amongst that birth rate drop is A2, which is gaining market share and doing really well. And there's a whole bunch of reasons for that. But you can still pick over the rubble and find things that are working in bad times or what you think is an adverse situation.

CAROLINE GURNEY: I find the whole Chinese sort of investing there just fascinating. But the other thing that I also wanted to talk about was artificial intelligence, because that is another huge theme that's driving markets. But how can Australian investors actually get exposure to that? And do you think that AI is going to be long term?

MATTHEW KIDMAN: I think AI is probably going to go through something like this. So it's been around for a long time, artificial intelligence helping certain organisations. But what would change the game completely for everyone was about a year and a half ago now, maybe a little bit under, was the open AI platform. And we know chat GPT. So it basically became accessible to everyone, this great system. Not unlike, I would think, the internet in the late 90s. But before that, it was tied up among certain companies and people, and well, it went to an open platform. And that was great. So not only were companies trying to get hold of it, but the general public was. And great change in any social economic comes from the people. When the people vote, and it doesn't have to be at the ballot box, it can be with their feet, things change. So all of a sudden, when we had chat GPT, who was talking about it? It was people at work. It was people at socials. I've used this. How incredible is the idea of speech with it? We used it for a whole variety of reasons. And all of a sudden, every company in the US and then to the rest of the world were asked by investors and asked by everyone, how are you using AI? So in the US, it's a bit more obvious because they're building AI. They're the ones who are delivering it to us in the main. In Australia, it's not so obvious to everyone, even though every company will be affected by AI as we try and become more productive. How do you get exposure to it?

In Australia, there's still some ways. There's the data centres, because AI requires a lot more data and requires a lot more power. So these data centres that we're getting built, mainly around cloud originally, offsite with all your capacity going offsite rather than at your own place of work. So we've been an investor in Macquarie Technologies (ASX: MAQ), that's been one. Obviously, next EC (NYSE: EC) is the other big listed player here, but the Big App Ender, another buyer, is something like

Goodman Group (ASX: GMG), who pivoted away just from being an industrial property play to building and owning data centres, which is part of their growth. That's the big end. The other parts that you can do on data centres is another small company we've had called SKS Technologies (ASX:SKS). Used to be called Stokes. They're commercial electricians, effectively. They wire big buildings. Used to be office towers. It might have been industrial sites, schools, hospitals. Now they're wiring data centres, and that's been a great investment. So there's a few of those. And I think as time goes on, AI will infiltrate everything. And you're going to have to ask that, if you're not doing it, then you're behind. Will they be pure players in AI for us? No. But there will be companies that benefit from it. And I would suggest that there'll be some software companies that do exist in Australia that do play a role that we haven't discovered yet that will come forward in time.

CAROLINE GURNEY: Excellent. So one of the other things I want to talk about is a bull market, which you mentioned earlier. You have said before that we're on the last leg of a generational bull run. So what do you actually mean by that? And how much further do we have to let that run?

MATTHEW KIDMAN: So what we talked about at the top of the conversation was what's happening now. So in 2021 and 2022, we came off that high that was exploded out of COVID, where there was a lot of stimulus from governments, and it wasn't as bad as what everyone thought. And there was a lot of capital around. Come the end of 2021, November, I think it was, the Federal Reserve started to increase interest rates and they changed the whole game. All of a sudden, capital wasn't free anymore. So you had to put back. That turned things down over a period of about nine months in the US and a little bit longer here as we talked about earlier. That is a cycle within the cycle I'm talking about. The structural bull market that was more of a cyclical component started in 2009 at the bottom of the GFC and still exists today. If you look at it, there's been blips. There was the COVID blip, it bounced back pretty quickly. We had that correction that we talked about there in 2021-22. And we had, right at the start of it, we had the European debt crisis in the early teens, 2011-12 around there.

But we've gone in one direction. So the way I look at it, if you go back in time, there's been several multi-decade bull markets. It was after the Second World War, probably about late 40s, 49-50, went through to 66. Then the American market went sideways for 16 years. And that was the bear market. Then from 82 through to the peak in the tech boom, 18 years. And it went straight up, and I think it delivered a return of about a thousand percent. From 2000, we had the tech crash, a rally, then the GFC. That was the next bear market that lasted just under 10 years. And we've been in the next bull market.

So now we sit here, we're at 15 years. We've been going up quite steadily with a couple of those small blips that we talked about, or quick blips. They weren't small when you went through them. They were quite tough, but they didn't break the market down on any permanent basis.

What we haven't seen is the blow-off period. And every bull market will have a blow-off period because that's where the excesses are built in. People are talking about valuations now, but what you want to see is strange behaviour. Typically, it's associated with quite a lot of debt coming into the market. I don't see that yet. Now, AI that we talked about earlier, there was definitely a boom in that. It's come off a little bit. It's not as buoyant as it was in terms of how people talked about it, say at the end of last year. But the overall market is still fairly sane in how they're thinking about it. I would think that we're probably grinding up, and at some stage, we'll have a period of 18 months, two years, where things go a little bit crazy. And people will start borrowing money to buy shares. We've seen blips of that, as I said AI, before that crypto. We haven't hit that period yet. So I think we might have three or four good years left, and then we've all got to get ready for maybe a bear market post that, because that's what history tells you. I hope that explains it. That's the structural component. They're the long-term trends that happen.

CAROLINE GURNEY: I'm not sure whether to be excited or depressed from that, to be honest.

MATTHEW KIDMAN: Well, same as me, you've lived through the 2000 to 2009 temp period. And there, like we went through earlier, there are places you can still make money. You've just got to work out where, but the market itself is not going to be the one that gets you through. You're going to have to decide where to put your money.

CAROLINE GURNEY: Let's think about mums and dads as investors, and they're already grappling with the cost of the living crisis that we're going through. And we know that a lot of retail investors didn't actually come back into the market after the GFC, because as you could describe it was once bitten and twice shy. So have they now missed out on that opportunity to get ahead? And is this really just going to increase that divide between those that have and those that haven't? Because if you're saying it's got another couple of years, where do they invest? What do they look to do?

MATTHEW KIDMAN: I think a couple might be at the smaller end. As I said, I think it's three or four years before, and it could be longer. But we haven't seen that erratic behaviour that I'm talking about. That's when people have got to be able, and unfortunately for mums and dads, investors who don't watch every day, probably don't see it. The signs aren't as obvious. And when you're in the professional game like me, you've got a different conundrum. You start to see it, but you know the market's still going to go up for a while.

So how do you play it? You see silly behaviour, but you can't necessarily jump off. You can't get off the boat. You've got to play it because there'll be a year or so where everyone says, your investors, say, hey, the market's up 40%. What are you guys doing? And all your money goes out and then it rolls over. We've all been through that. Now, I think there's still a good opportunity. I think in our market, the obvious place is the smaller end of the market because there was probably a period from 2000 to the GFC at least, 2008, 2009, where small caps performed really well, and maybe even longer if you go back prior to that, where you probably got low double-digit returns. Now, the reason you can do that is because small companies in theory can grow quicker than big companies. They're not as stable. They're more volatile and they're more fragile to downturns, but you can get there. Now, if you go in the last decade, we've got a return, including dividends of about 4% to 5% from small caps. It's about half what it used to be.

So that's been through a cyclical low. I see a lot of promise and we've talked about it before in terms of what we want, but I'm quite optimistic about it. We're at the top of the interest rate cycle. Now, I'm not calling for a lot of cuts coming soon, but we're going to get tax cuts in July, in Australia. We will probably get interest rate cuts, maybe the end of this year. I know everyone's talking about mid-25, but they're going to come because the economy is definitely slowing. Since Easter, the economy has come off the boil. Every company we speak to is saying it's tougher. Now, that sounds terrible and it is in the short run, but it means that the reserve bank inflation will follow. It will come down and it will get a 2 in front of it at some stage. That will mean the reserve bank can cut.

Now, markets never follow the earning cycle or the economy, follow the interest rate cycle. At that point, there's a whole bunch of sectors that have not participated in recent times. I put into that camp retailers. They've been on the nose and in small caps, retailers are a big component of it.

I think the numbers I've seen quoted, companies associated with the consumer and their spend, not only retailers, but car dealerships and the like, the housing market, where in the end, the consumer buys the product, is about 60-65% of that market. We might see a low in that at some stage. The other part is the finance companies, the non-bank finance companies, are all trading below book value, which has all been typically a really good place. Property companies, not doing so well.

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We've got one called Cedar Woods (ASX: CWP), a little one out of Perth. It trades at below its book value, well-managed, balance sheet is getting better. We see great opportunity for that and it will turn when the interest rate cycle turns, and that's where you want to be. I think there's opportunities with companies that people actually understand, not companies that sound good, but it'll be things like a retailer that you've been and shopped in, which is kind of nice. I think that's where the valuation is compelling. It just needs the right environment to get them going.

CAROLINE GURNEY: With your view on interest rates, how does that also influence your view of the Australian economy as a whole?

MATTHEW KIDMAN: The Australian economy now is in slowdown mode. The mining sector is still going okay. If you go to Perth, which is the hub in Western Australia, the hub of the mining sector, the economy is going very strongly. It's running. Parts of Queensland are doing quite well, but they've obviously got, I hate to say, coal mines there still, and a lot of other mining, copper, Mount Isa, there's a lot of activity. They're doing okay. The big states of New South Wales and Victoria, especially Victoria are struggling, and that's where you're getting the depressed numbers with the consumer. They need some relief, but I'm quite hopeful that the softness there will lead to some relief on inflation, eventually. It's slow moving, but I think we'll get it down. So once you start getting interest rate cuts, like I said before, follow the interest rate cycle and it will come through. That's what history tells you. So I'm pretty bullish. We've hit a bottom in the market since being led by tech, but I think it can spread over time. It's been a bit slower than what I thought. I know you gave me the pat on the back saying you picked the bottom in the market, but I think that we're going through the very tough period. The bite on interest rates took a bit longer. We went through the fiscal cliff in Australia. Everyone said, well, that didn't do much. I think it's starting to impact now, everybody we speak to is saying things have slowed enough to be noticeable. And if we can get those interest rate cuts, things will pick up in 12 months time after that, but you can't wait until then. You've got to go earlier.

CAROLINE GURNEY: Let's look at what's happening in the US. We're going to have the election in November. Are you watching that? And how do you think it will play out in Australia? If at all?

MATTHEW KIDMAN: How can you not watch it? Two old guys going.

CAROLINE GURNEY: Fascinating. It really is. Every day there's something new.

MATTHEW KIDMAN: Something new. And everyone says that the Americans aren't interested, which is quite strange because there is something at stake here in terms of something far beyond economics and financial markets, which is two very stark positions about a whole range of subjects and institutions and how they should be run. But I think from a financial point of view, it's in an unusual situation where you've got two former presidents running, one that sits in the White House today and one that was the previous four years.

Not in my lifetime has that happened. So there's not a mystery to the markets anymore. There's no great indecision around that. We know what you're going to get. If Trump gets in, the market should respond very well in the sense that he has said the first thing that his administration will do, is extend the tax cuts that he put in previously. So, as we know with Trump, anything that he did is the best. And therefore, that's easy for him to extend. And I don't think he gets much pushback. Tax cuts normally get through, whether they can fund them or not is not in the question. It's whether they can convince them. I think that will happen. And so, people will respond to that. There'll be less regulation around business and so on. But at the same time, if Biden gets in, it's more of the same. It's not a big shift.

So, I think we all watch, but not from a financial market point of view. Where I'd be more sceptical is probably the out years of that presidential term, three or four years down the track when we get to the back end. I think that probably matches with that cyclone running. And a couple of things around that could happen. I hate to say it, but everything that Donald Trump touches breaks eventually, whether it be friendships, marriages, businesses. And eventually COVID was his undoing and his handling of that last time. And the other side is, Biden is old and you're really voting for the administration rather than the individual to get you through, which is fine. It's happened before, Reagan had bad dementia. So, when he gets old, he might not be able to last the term. So the back end of their presidencies are what you're probably more worried about. In the first instance, I think markets are very comfortable because the reason I said, they've seen both before. It's not a mystery.

CAROLINE GURNEY: Okay, so let's go on to you as an investor. I mean, you're predominantly a small cap investor, but you've always had a lot of flexibility within your fund. You can go to cash, you can turn to the larger end of the market. Where are you at the moment? And what is your view for the next sort of 6 to 12 months on small cap companies?

MATTHEW KIDMAN: When rates went up, we did two things to protect ourselves, two main things anyway, was to take on a bit more cash. So we'll always run with a bit of cash. We never gear. It's too much risk. None of the businesses we're involved in are too big to fail. There's no use leveraging up. You've got enough risk without leverage.

So we took more cash on, and for a period during 2022, we were probably at the end of 21 and start of 22, cash tables were close to 40%. And we probably took the remainder of the portfolio. Half of that portfolio went into the top 50 companies. They were the better, stronger companies at the time and responded well because they're just more robust businesses, bigger, more developed franchises. There's not as much risk around it. So come that period I was talking about, we saw the bottom in the US market into 23 in Australia, we started to unwind that. We started to invest more. So today, we're mainly back in small caps and some micro caps as well.

We've mentioned a few names earlier. And we're quite positive about small caps in the future. So the large caps, probably only the 50% of the equity exposure we had is probably down now to 10%. The investment side, we're back up to a much smaller cash position, which is probably our average, 15%. I would expect we'll continue to back small caps and as the market gets a bit clearer, especially if we get talk of interest rate cuts, we will go to a 95% long position. And we see opportunities and we're given some sectors there that are on the nose at the moment.

There's retail, there's non-bank financials, there's property companies. And that overlays with stuff we already like. As I said, I've given you some names over, we've been big in A2 Milk. There's another little company, a finance company called Generation Development (ASX: GDG). And it fits into what you said before. There's superannuation changes coming. Quite aggressive changes from the Labor government around taxation for higher balances and superannuation that we've all talked about. They'll be legislated in July. That seems like a negative to everyone in terms of investments.

But there is a company called Generation Development that specialises in non-super, but tax enhanced products. And that is a place that we're in. That's a small cap. It's growing at 30%.

There's an idea that it's going through the cycle. It doesn't need a booming economy to get there because other things are at work. But as time goes on, the economy and the market is going to help you as the cycle goes back in our favour instead of against us. And so those other sectors come into play. And I'd be hopeful the next two or three years are very good years for small caps.

Now, if you sat me here in three months time, it could change. But if you ask me today, which you have, that's how I feel about markets. I think we can have a decent period. The only thing I would say is that once you get to that strange behaviour period it can come in all different varieties. And maybe when it happens, we can come back and talk about some of the strange things that are happening. I don't see it quite yet. So yeah, I'm quite bullish on the next few years.

CAROLINE GURNEY: Excellent. Because obviously, Future Generation Australia is heavily weighted towards small cap companies. You are, as I said before, on the investment committee. I'm really interested in you talking about what drives our performance. And when you look at the collection of fund managers we have, I'm not asking you to comment directly on each and every one of them. But how do you look at the portfolio construction that we have, Future Generation Australia. And how has it evolved over time? And what do you think of it now?

MATTHEW KIDMAN: I think we've had some really good learnings in what works and what doesn't. The first thing is, and that makes sense, is that generally you want to back funds that are in the market and participating the whole time. In other words, markets go up over time. So you don't want to be too scared or too hedged. There will be a period, as I said before, that maybe that comes in the vogue, and we've got flexibility around that. But you want to be in funds that are continually searching for the best investments they can find. Active funds that can find, as we talked about, hopefully we can find a few other people can, rather than playing company or funds that are trying to hedge their way through. It doesn't tend to work through the cycle. So we've learned that.

Obviously, we've got a good exposure to small caps. And there's several reasons for that. But over time, as I said, we've been through a pretty tough period with small caps. Over time, that area delivers the best outperformance, we think. And the history tells you Australian small cap managers, compared and mid cap managers, compared to everyone else around the world, is a real outlier. Everyone comes to Australia from the international and said, well, how come these small cap guys outperform their index? And I think it's because they've got flexibility within their indexes and that they can pick companies, and they can go overweight.

Now, it doesn't work always, but it works most of the time. So I think they're the people you want, who are out there hunting for the best possible investments. And we will assess all the managers. And at times we've had to change a few. It's rare because we know most of them. But that's the way the world works. Not everyone can stay on top producing great results the whole time. But I think we've got a terrific collection. We've got great insights.

The other thing is we know most of the people who run that money and how they go about it. And in recent times, as I said, Future Generation has put together, I think, a terrific investment committee. And with those people coming on board, it's become a much more industrialised way of looking at things. Not only have you got the overlay of the likes of Geoff and Gabriel and myself, who know all the managers, you're starting to get data points and exposures around industries and so on, that we can see now through the data. And we work with them, and we talk to them about it, and we understand why, and we have the funds come in and present to us and we get a good feel for it. So, it really feels like we've got a grip on who we've gotten, what they're doing and why you want to be there. It's improved a lot, I think, over time.

CAROLINE GURNEY: So, you're obviously a top performing fund manager, but you also write books. I think you've written three.

MATTHEW KIDMAN: Previously. I think I've helped write three and I've written one myself.

CAROLINE GURNEY: Right. Well, obviously we're coming up to our 10-year anniversary, so maybe we could do like a Future Generation - that would actually be a good book, I think, in terms of going through what Future Generation has done and all of our fund managers. But let's go on. So in addition to being a very good fund manager, you've written three books with other people, but you've done one on your own. So when I look at Australia, I don't see a lot of literature about fund managers top performing, what drives the industry, unlike the US. So what are you reading? Where do you get your investment ideas from? Is it sort of wires or is it just looking through lots and lots of different data points?

MATTHEW KIDMAN: I'm going to disappoint you here. I don't think I've read an investment book probably for seven or eight years. And there is a reason behind that. And the last book I wrote, which was the one by myself, was called “Bulls, Bears and a Croupier”. Catchy name. And I remember the whole process. I kept sitting up night after night talking to my wife, Susie, saying, there's got to be something with Bulls Bears, Bulls Bears. And then she goes, I'm going to bed, this is on a Saturday night. And I'm sitting up and I thought, I've got this story about this guy who was a croupier. Bulls Bears and a Croupier, that kind of ring. And so, I went and woke her up and said, I've got it - “Bulls Bears and a Croupier.” And she goes, “you woke me up for that?”. So that didn't go down well. So that's what you go through with a book.

But what I conclude, and the reason for doing that book primarily was that at WAM, which if we had at that point, thousands of investors, it used to be hundreds, but it was thousands. And they'd ask us questions all the time. And a lot of them repeated over time, but there were new ones. And I thought, well, how can I answer those questions as best as I can without saying this is the question, this is the answer. Let's go through examples. And I thought that was quite an interesting process because what I learned, I think I ended up writing a chapter on it, is that a market allows anyone to participate. It's an open church. You can come into that market and do whatever you want. But you've got to bring yourself to it. You will have an advantage over anyone else. You've just got to find what your strength is.

So people who say this, where they come unstuck is if they read about someone, whether that be a Buffett, who's obviously an unbelievable investor over a long time and try and replicate that, it doesn't work. It's like anything. It's like writing. You can't copy someone else's writing. It's just, there's a creative element to it. So I kind of concluded, what's the way I invest? And sometimes that gives me shocks in the sense that there's new things that come along. Like I don't really understand crypto. I acknowledge it, but I don't understand how it works. But it is a form of investment and asset class. That's fine. I'm not fighting against it and saying it's stupid. I just don't know how to play it. But you've got to work out where are you strong, and what do you know, and what do you bring to a market?

And after reading many, many investment books, I found that I gather my information and think a certain way. So where do I get my ideas from and how? It's all to do with conversations. Strangely, I've written books, and it's the written word, and I do read stuff. But by far a greater strength for me is having conversations like this. I take the view that everyone in the world knows something I don't, and that I've just got to work out what that is. And normally it comes with just a normal conversation. I talk about this in the book, that you'll be talking to someone, and you'll ask the simple question, what do you do? And then if you can make the link, it might lead to something on the investment side. The last two weekends, I've met two people I've never met before through someone else, and they've given me two investment ideas because they know about something I don't. And I went, oh, okay, you're in that industry. And what do you think? And the people in the industry know a lot more than you do. I'm a generalist. So that's probably my strongest point, to keep a broad network, keep getting information. And then when you know someone, you can go back to them.

How does that work? Well, something that Geoff Wilson taught me - share information. Don't just suck it because people won't keep giving it to you. Offer them something. And if you share information, then everyone's happy. It's a good relationship. You get on. Everyone feels good about it.

CAROLINE GURNEY: That's very much a Geoff thing to say. So I'm going to ask you, how do you select a stock? Tell us.

MATTHEW KIDMAN: Yes. So like everyone else, you can get the information that everyone else can. What's its market value? What industry is it in? How much does it trade? So that will determine how big you can get in the investment. Then you go about the process of unpicking its financials. And then you go about the process of interviewing the people and trying to work out how they think about their company. And so, you do all that groundwork.

We do that every day of the week, those things. But then how do you go about picking a company to invest in? Now, the thing about Centennial is that we do not follow an index. I know we do small caps, but we do not follow an index. So that means that we don't say, here's the 40 companies in an index. We're going to invest in all of them. All we're going to do is decide which ones were going to be overweight in their percentage in the index or underweight. We don't do that. We just go from the company straight up.

So then you've got to work out what is going to change the value of that company in the eyes of the market. You've got to have market sense. What is going to trigger? And years ago, at WAM we talked about catalysts, and you can say that, or you can say a defining moment or a change. Something that lights the share up. And so, you've got to have the knowledge. So if it doesn't, if there's something wrong with the management that you've discovered, if the balance sheet is fragile, if the cash flow is not there, there's a lot of things to knock out. But if all of those tick off and then you go, okay, we've looked at this, there's something changing in that industry.

We've talked about a few of them already. Drone Shield, they had good technology. They were quite a good leader in what they did. They were negotiating with companies in the Middle East, mainly the Saudis, could not win a contract. They sat there and needed to raise money three or four times. It did not work. It was a good idea that everyone bought until the numbers didn't appear. The stock went down. And then guess what? A couple of wars have broken out and it's just taken off. They're in demand. There's the catalyst. Now, whether that sustains, I don't know, but we did talk about budgets globally going up for defence. Maybe it does. So we've got to monitor that. It could be the next catalyst. It could be we leave, but there's something changed in that.

So that's how I look at a company. You've got to be across, and most of the time we're knocking out companies. No, no, it doesn't work. It's got a bad balance sheet. The management didn't do what they said they were going to or there's something strange about the way they look at the world. The cash flow is terrible. They're capitalising costs. They're doing accounting tricks. We look at all that. That's what we spend. But then you've just got to work out what is the catalyst for this company to go higher, because we don't have to own a company. We've got to find a reason to buy it. And so that's what we do.

I say, well, that's the kind of magic formula just to get a bit of mystery in there. Everyone knows something about a company, probably more than I do, but you try and pick, and you don't get them all right. I always say to our investors, if we get 50% of our calls right, you buy us because we're underperforming. If we're getting 70%, you sell us because we're hitting it out of the park. It's not going to stay at that average. But if you can get in the low 60s, the way we construct our portfolios will deliver you the returns, which we say to everyone is 13% to 15% gross through a cycle, I consider three years. And if we can deliver that on an annual basis, some years worse, some years better, but over three years, then that's what we will deliver. And so, to date that's kind of worked. That's how we do it.

CAROLINE GURNEY: So Matthew, well, thank you very much for talking to me. I could listen to you talk about markets for hours.

MATTHEW KIDMAN: I can see you yawning, which no one else can. So I'm not sure about that.

CAROLINE GURNEY: I so didn't do that. But I suppose finally, my last question, you've always been such a huge supporter of Future Generation and that's something we are very thankful of. Why do you do it and why do you think it's so important to have an organisation, a listed investment company like this?

MATTHEW KIDMAN: I've been asked a few times over the years why that's the case. And a couple of reasons. We joked about Geoff saying, come on, you get on board. And I knew about it for a long time what he was trying to achieve. He talked about it for years. What can we do? And he found this structure. And it's just a great structure in the first instance that it can grow over time, and it can support - you ask any of the not-for-profits that it supports, and the one I'm involved on in FutureGen is the domestic one, where it supports kids. And so whichever not-for-profit, charity, whatever tag you want to put on it, they will say the best thing about this is we get money every year from you guys. We don't have to go and rattle the can, which is so exhausting and so hard to do and start from scratch every year. Terrific model, just a great model, and it can grow over time. As Geoff said, and as you've said, we can grow it gradually over time and grow more money and there's been 70 odd million out of FutureGen Australia there already paid out. That's one thing.

The other thing is for me, I've been involved in quite a few not-for-profits, supportive groups over time and you put a lot of effort in, but at some stage it finishes. And it's quite exhausting. You put everything into it, and you've done a certain amount of work, but then for whatever reason, it finishes. FutureGen goes on. And I'm going to be blatantly honest here. It's easy. You make it really easy for us to contribute because we want to, but it makes it so easy for us to say, yep, we can give you capacity. Obviously, there's parameters around that with how much money you manage and so on, but we can do that, and we do it every day and the money goes out and the causes are good.

So the combination, everyone should be doing something that helps the rest of society and you've got to find the best way to do that, and this is just a very simple, easy way to support it and it's a good course.

CAROLINE GURNEY: Matthew, I've really enjoyed talking to you and getting an insight into your investment process. Thank you so much for your time today and for all the work you and Centennial Asset Management do to ensure Future Generation keep on giving.

We hope you enjoyed today's episode. Please join the Future Generation family, Australia's first listed investment company to provide investment and social returns. We are proud to have given more than $75 million to not-for-profits in Australia. You can be part of this and gain investment returns while contributing to improving the lives of young Australians. For more information, please go to our website, www.futuregeninvest.com.au. Thank you.

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