Future Generation
INVESTMENT & SOCIAL RETURNS

Investment Committee Insights with John Coombe

JANA Investment Advisers

CAROLINE GURNEY: Hi, I'm Caroline Gurney, the Chief Executive Officer of Future Generation, and with me in the studio today is John Coombe. John is the Executive Director of JANA Investment Advisers. He advises some of Australia's biggest super funds on how to invest their money. John is also on the Investment Committee for both Future Generation Australia (ASX: FGX), and Future Generation Global (ASX: FGG). He's here today to give us an update on the Future Generation Australia investment portfolio. So John, welcome. Thanks very much for being in the studio today.

JOHN COOMBE: Thanks for inviting me, Caroline. It feels like our annual get together.

CAROLINE GURNEY: So my very first question is, the Investment Committee of Future Generation Australia is primarily responsible for managing the company's investment portfolio on behalf of shareholders. I really want to start by asking you about the portfolio construction. When you're putting together a Future Generation Australia portfolio, what are you actually looking to deliver for investors?

JOHN COOMBE: Well, we want to match the market, but more importantly we want to do it with volatility that's a little bit lower than the market. One of the things, and given the shareholder base, is that we like to think about protecting in negative markets. To be blunt, we look at it over a five-year period, and we really want to match or beat the S&P/ASX 300. We want to deliver really strong, positive returns to shareholders.

CAROLINE GURNEY: And with the fund managers that we're investing in, we like them to be boutique with skin in the game.

JOHN COOMBE: History tells us that boutique managers generally outperform, particularly when they are a startup. They've got things to prove. We get a lot of new boutiques that come to us and ask, but we do want to have a history, we want to see that the principals involved have delivered strong returns, probably in their previous job. It’s very interesting, but you want proof points. We're not just going to give money out to some of the boutiques that aren't proven. We do want to see that they've got a track record.

CAROLINE GURNEY: And they need to have that sort of performance, that long term performance over time.

JOHN COOMBE: They’ve got to be additive to our portfolio, too. So as you know, we've got three or four buckets that we look at, and they've got to fit into our broader scheme of how we mix the portfolio, from long buys to long shorts, to absolute returns, etc. So it's got to fit into our structure as well.

CAROLINE GURNEY: Let's look at that. We're very lucky with JANA because they work pro-bono for Future Generation Australia, and we see the portfolio having uniquely active characteristics. And I remember when you were in the Investment Committee, and you talked about that and how unusual that was. Can you explain to us what that means and explain where the underlying fund managers are actually invested.

JOHN COOMBE: Given the number of different strategies that we have in the portfolio, it’s well over 12, and we've got absolute bias, we've got long short, we've got long only. You would think that we would in a risk sense be very much like the index. But when we ran the analysis through our risk analysis tools, my young analysts said to me, “John is this possible that you can have such a big tracking error against the benchmark with this many managers and with this style?”

To give you an example, if you look at the active share now - let me explain what active share is. Active share is where you take the pluses and minuses of your weight against the weight of the stock in the index, and you add it all up. You don't subtract one from the other. You add it all up. Now we have an active share somewhere in the sixties right now for most institutional clients that we manage. If the active share is in the twenties to thirties, we think that's good.

CAROLINE GURNEY: So why does that benefit our investors?

JOHN COOMBE: Because it shows that we've got a lot of active stock pickers in there and they're picking in the sectors where they think there is a lot of added value. If you look at our market split, we're very underweight in the top ten, we're very underweight in the top 50 actually, but we're super overweight in mid-caps and small caps and we have a fair weighting in micro caps as well. So, it just shows that those stock pickers have an ability to analyse the companies, given their style of how they're investing, but analyse the companies and put the right amount of weight into the stocks that they like. And that's generated seriously positive returns for us over the longer term, which is very pleasing. And that's what we want. We did have a hard time in the last 12 months, two years, when small caps were underperforming. But we kept up. Especially with the small cap index, we were outperforming it by a lot. And that was basically because we had good stock pickers.

CAROLINE GURNEY: Our Future Generation Australia investment portfolio performance is 16.1% for the past 12 months to 31 May 2024, which I think is very much talking to exactly what you said.

JOHN COOMBE: Break that down Caroline. The small caps underperformed by 6%, and I tell you I'm super overweight in small caps, and yet we outperform. It's got to come down to really good stock

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picking. Doesn't it?

CAROLINE GURNEY: Undoubtedly. I mean, that's why we've picked these boutique fund managers. Would you mind just talking about some of the returns in the portfolio? For example, five managers have more than 20%. Can you explain that sort of diversification of our portfolio a bit more.

JOHN COOMBE: I think what's really interesting, if you look at the style of the managers that delivered those outperformances, it wasn't that they were all big growth managers and they were all in growth stocks, there was some who had just the mid-caps and they delivered over 20%. There were long short managers that delivered over 20%. What do we mean by long short, for all of our listeners, we mean managers who can go into long stocks they really like, but if they find a stock that they don't like and they think it's overpriced, they can go out and buy it and sell it in the market and short it. So those styles of managers in particular have done quite well for us over the last 12 months. And it's really interesting when we've looked at our portfolio construction, we've basically decided in the last 12 months that we don't really need the market neutral style managers.

So these are guys who go long short, and they have no exposure to the underlying equity market. We think that's just too negative for our investors. And so, we've eliminated that out of the portfolio. Look, it was only 4%, so, it wasn't a big portion of the portfolio, but it was a drag on performance at times. And we thought, is that delivering what we really wanted to deliver to the shareholders?

CAROLINE GURNEY: But I think it's also indicative of the fact that you're managing the portfolio on a very regular basis and making sure we get that sort of volatility less in the market as well. We're always talking about inflation, we're talking about, are we going to go into a recession? And it's been a very tough couple of years.

JOHN COOMBE: You wouldn't believe that if you looked at the stock market returns, you just quoted 16.1%, and yet we're in a cost-of-living crisis. It just shows you the resilience of companies to adjust their earnings profiles, cut costs where they have to, build out into other markets where they need to. We do think that it's going to be tough, but there is a resilience in earnings out there in the world and it is feeding into the Australian companies. Companies with overseas earnings are doing quite well. So, there's the translation effect because the currencies weak. There's a whole lot of factors that are going to make the Australian market, we think, be reasonably okay into the next 12 months or so.

Assuming inflation does come under control, you would anticipate that there will be a drop in interest rates. That is very supportive to the stock market given that companies are growing their earnings consistently. So in the longer term, that's why you buy stocks. You buy it because they grow their earnings, they pay out more in dividends. And we deliver a fully franked dividend to our investors.

CAROLINE GURNEY: We do indeed. Now it's been a challenging period for small caps, but do you actually look at the portfolio and think, right, we need to take a tilt now to larger companies, or are you going to stay exactly where you're at? Are you happy with the structure and how the fund managers are performing?

JOHN COOMBE: The Investment Committee, we had a really big discussion about this in the last six months and we have moved to lift our weighting in the top part of the market a little bit. Not a lot, but just a fraction. We've taken some of that absolute bias money and put it into managers who manage more in the top part of the market than the bottom part.

It's not that we don't have faith in the small cap part of the market, but when the economy's going through a tough time, it's generally the large caps that have got more resilience, they've got overseas. You look at BHP (ASX: BHP), all of their earnings are coming from offshore sales. I mean Rio (ASX: RIO), very similar. So, we tend to think about those issues and think about the positioning of the portfolio. But in the longer term we will be structurally overweight mids and smalls because that's where the growth in the market comes from. That is where the Australian stock market has historically come from, and we want to capture that for investors.

CAROLINE GURNEY: Excellent. Thank you so much John. Thank you very much for your time and the work you do, and I look forward to our hopefully next three-month chat.

CAROLINE GURNEY: We hope you enjoyed today's video. 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 Australian not-for-profit organisations. You can be part of this and gain investment returns while contributing to improving the lives of young Australians. For more information please visit our website, www.futuregeninvest.com.au.

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