

Future Generation Australia

Investment insights from pro bono fund managers Jun Bei Liu and Ben Griffiths

CAROLINE GURNEY: Hello, I'm Caroline Gurney, and I'm the Chief Executive Officer of Future Generation, a company that delivers bigger returns for you and better futures for young Australians. Over the past ten years, we've donated more than \$75 million to Australian not for profits, something we're all incredibly proud of. And we can do this because of leading fund managers like Ben Griffiths and Jun Bei Liu, who are with us today in the studio.

Welcome, Ben. Welcome, Jun Bei. Ben and Jun Bei both manage capital on behalf of Future Generation shareholders on a pro-bono basis. This means they actually waive all management and performance fees so that we can donate 1% of our assets to charity without compromising your investment returns.

So, Ben, first off, I'd really like to talk to you. You're a founding fund manager of Future Generation Australia, and you've been doing this for us now for ten years. Geoff Wilson AO, our Founder, asked you to do this, but it's been a long time. Why did you want to do it? Why is it so important to you?

BEN GRIFFITHS: It's such an important cause, the future of our youth and our younger population are paramount. It's particularly moving as a father, when I see young children or teenagers, adolescents in bad situations, challenging situations. When Geoff posed it to me and presented the proposal, it was all about raising money from managers and letting us do some work to try and improve the lot of some of these children that are having a tough time. Geoff's a particularly persuasive presenter, as you know. But it didn't take much to get me over the line. It's a magnificent cause.

CAROLINE GURNEY: Well, thank you so much for being with us for that time and also for your fantastic returns. And we are obviously invested in Eley Griffiths small companies fund and it's been a very tough time for small cap companies, but your fund has performed exceptionally well, increasing 16.7% over 12 months to June, which is more than 10% since inception. I'm really interested in how you've got to that performance and why you really believe in small caps. And congratulations on your returns.

BEN GRIFFITHS: Thanks, Caroline. Well, I mean, the journey is a big one, and it requires a lot of work. Jun Bei and I were talking about it before we came on, the amount of work that goes into just keeping a portfolio performing and keeping it spinning.

But we've had we've had some great fortune with some of their stock selections. We've been big believers in the market generally, the bull market advance that's been underway for two years, many won't recognize that, but it's two years. We've had a number of the listed managers, the NGIs, the GQG's, and the pinnacles of this world have been prominent in the portfolio.

We've also been reasonable bulls on the gold price, if you will, and the performance of Capricorn (ASX: CMM) and Genesis (ASX: GMD) have been two outstanding stocks, particularly Capricorn in the portfolio. So I really put it down to some very, very crafty stock selection, a belief that generally the market is wanting to go up, not down, making sure that we're committed, and then all the while maintaining what you'd expect such as quality filters, backing seasoned management teams, being on the right side of the earnings trajectory, which I think we are in each of those cases. And then having the conviction of your research and your view to back it in terms of portfolio expression. And that's what we've done. And I'll make it sound easy, but it's not that easy. And it's not just me. There's a whole team that are doing this work. But the numbers are particularly satisfying.

CAROLINE GURNEY: So, Jun Bei, you've also had very good performance as well. I'm interested in terms of what your view of the market is, but then also some stocks please.

JUN BEI: Absolutely. I'm so honoured to be here. First of all, thank you so much. Look, I think the share market at the moment is actually fantastic for active investing, as in, it's not about just buying ETF. You're going one direction or not. It's actually about picking bottoms, finding the good company to buy. And particularly at the time when other investors are a bit worried about something about that company.

So we are finding a lot of opportunity in the last 12 months in this share market, not just in the smaller end, we actually see across a larger end as well. You know, some of the names that we went early and really identifying the quality company and happy to be a bit more patient and one name for example is Goodman Group (ASX: GMG). While the interest rate was going higher, everyone's worried about the property trust, saying Goodman Group was one of the most expensive property companies. And we're selling it off and we saw the opportunity. This is a quality company, great execution, fantastic pipeline. Clearly, we didn't think about the data centre perspective, but we did see a lot of opportunity in this business, particularly when it was trading at the price as it is.

So we saw a substantial amount of opportunity and we took a position and as the market then recognized this growth pipeline as well as the data centre is certainly adding additional shine. But this is how we find the opportunity. The Australian market, I think the current environment is fantastic for both long side and the short side as well, because there's quite a lot of companies who are expensive, trading an expensive valuation and then we find there's problems with earnings, or the economy might be a little bit tough for some of their forecasts.

And that's where we find the short opportunity. So in terms of the market, we're pretty positive. The Australian market, we think, even though it's done well and by next month things are actually looking pretty good. You know, August, the reporting season is going to mark the low of, say, the retailers and

others because consumers are slowing down. But I do think with the tax cut as well as with the prospect of an interest rate cut, it's going to make things a little bit better for the Australian economy. China's holding up okay. Look, it's recovering slowly, but all of that together, make the Australian economy reasonably resilient. That is pretty good.

CAROLINE GURNEY: Excellent. That's really good to hear. We're lucky, and thank you very much because your performance has actually contributed to us, in the last 12 months to 31 May, to actually get 12.1%. And we're very pleased with that, especially I think, because we do have that sort of small companies and sort of micro companies as well. So I'm really interested in in terms of you, Ben, what do you think the outlook for small companies is going to continue to be and with your fund, how are you positioning it? Because everybody is saying that small caps are going to continue to grow. Is that your opinion?

BEN GRIFFITHS: I would agree with Jun Bei's sentiments. The Australian share market, the broader market, is at all-time highs. You wouldn't know that. It doesn't seem to be talked about much in the papers, but we're at all-time highs and in step with other markets. The small cap market has enjoyed or had enjoyed a really impressive rally out of the October lows last year, and that really came down to the trajectory of interest rates. And when, Fed President Chairman Powell came out and gave the market a verbal cut that was literally putting the market on blue flame and small caps, rallied globally. It's interesting because small companies have been pinned down in an earnings downgrade cycle for the last two years. Right now, there's a number of companies have come out and updated, basically, many of them negatively and some positively, but many negatively.

We think this is the last throes of the downgrade cycle. And I think what has caused some angst for investors has really been the deferral of any interest rate easing. And the fortunes of small company investing is pinned heavily to the direction of interest rates. And we're all set beginning of this year for six rate cuts in America. We're going to get one if we're lucky. Likewise, in Australia, it feels like the next rate easing won't be until March quarter of next year, despite the fact that most of our trading banks are saying there'll be something in 2024. So, we feel particularly comfortable about small companies right now.

We look to the valuations as well. The valuations are sitting at about, the small ordinaries, small industrials versus the big cap industrials that are there in about a 7% discount. And so you're getting small caps slightly cheaper. People say to me, "oh but they're not at 20% discount to where they were during COVID," but I think the way to look at the discount is that the discount tells you that confidence levels have risen, that people aren't demanding a discount to place small companies. They think the prospects are strong. It's not just us that think the prospects are strong. Look at the amount of corporate activity.

There've been about 35 to 40 takeover bids last time I checked for Australian small caps since October. So both international and local suitors are actually out looking and buying and bidding for these assets. So I see that and I say, well, that's confirmation that corporates see value and I know portfolio managers like ourselves see value, and furthermore, I like the way in which good slices of equity have been raised since October. If you've got a sick market or a market that's not on good underpinnings, you can't raise a billion dollars like Infratil (ASX:IFT) did the other day.

So the underpinnings are strong. The confidence is there. It's not uniform. As Jun Bei mentioned, there's opportunities for shorters and for people who want to play for the long side, but the opportunities are there. We apply quality filters. We've got a very disciplined process. We like to weed out companies whose fundamentals are questionable, and we like to look at their portfolio. We think we're well-positioned going forward and we'll use the August reporting season as well as an opportunity just to critically assess have we got the portfolio position right for the next 12 months.

CAROLINE GURNEY: Jun Bei do you actually agree with what Ben's been talking about there in terms of your investment focus, especially in that smaller companies area?

JUN BEI: In terms of the size of my investment, I do think in the smaller end there's a lot more opportunity because 12 months ago the large cap pretty much outperformed the mini cap. And up until end of last year. And it does make some of the quality companies at the time much more expensive, bigger companies, much more expensive, even though the earnings momentum is slowing down. And some of the examples I would use, such as Woolworths (ASX: WOW) and Coles (ASX: COL), earnings that started to slow down and the earnings pretty much peaked last year. But at one point they were very expensive compared to some of the smaller companies where the growth is actually now just gradually on the way up. And I think the prospect of an interest rate cut and others in the economy not doing as bad as we previously feared, it certainly makes the medium to smaller end much more interesting where we can find opportunity.

We do find that with the flexibility in our portfolio that we can go to wherever the opportunity leads us. But that's of course not to say the large cap may not be an opportunity. But the large cap is very much sector driven.

Today everyone's buying banks and selling resources. In three months they may well come back, but they are much more macro driven. Is China growth coming back and others. Whereas the smaller companies, mid-cap companies, it's more company driven. You know what is happening with the micro economy and who's beneficiary and they can take advantage of it.

Another thing I want to touch on is the thematic now playing through the market, AI is a huge one in the last 12 months, and in Australia there it is limited opportunity for play. But I think we just have to start thinking about the flow on effect of the AI. It's not a bubble, it now has real applications across almost every sector, every company is talking about what they can do with it. Prices are clearly a little bit high because of the chip price but it's coming off. So we think that is real. And AI chip is one way to play this data centre. And then we flow on to maybe it's a PC replacement cycle, the PC maker, the PC seller and then the utility. So there's a lot of opportunities in those thematic, I do think investors can't sort of ignore, because they're real, they're probably cross-decade megatrends that needs to be right on those waves. And then the smaller end is where you do see quite a lot of opportunities coming through.

CAROLINE GURNEY: So following on from what you just said in terms of investors don't perhaps see that in terms of the smaller companies. So what needs to happen for investors to get more comfortable with investing in the small caps in the market? Over to you Ben.

BEN GRIFFITHS: Well what you need is animal spirits to be onside. And right now I think the typical investors are a little subdued. We need a good hit of FOMO to bring a lot of investors out of their torpor, which is how I'd describe it right now.

But you certainly need the obvious things. You need evidence, and you need to see interest rates starting to get cut. You need to see indications from the central banks. And we've seen the Bank of Canada and we've seen the Swiss cut rates and hold on to the ECB. But we need to see the beginning of a committed campaign of interest rate easing. And that'll happen if inflation falls away, old growth starts to ease off, but we don't see a collapse in earnings growth. The forecast S&P 500 earnings for next year would suggest there's no great growth slump coming, we're probably in the teeth of the soft landing. And I think that's been overdone. But I think that's a reality. We're in the teeth of a soft landing. So investors want to see confirmation that we are going to get cuts.

I think what they also want to see, and call me a cynic, I've been around so long, the man on the street, desperately wants to see a successful IPO. And we haven't had many of those. It's been a couple of years since the IPO cycle chimed in. And it's been even longer since we've had a nice, well-performing, strong performing IPO.

From my experience, and I look back at when Virtux Health (ASX: VRT) floated, when Wise Tech (ASX: WTC) floated, they were emblematic stocks that marked the beginning of a revival of investor interest. We haven't had that. So I think we need a bit of that. We need a bit of FOMO. We need some confirmation that rates are on the retreat, and we don't want to see any, to Jun Bei's earlier comments, we don't want to see any collapse in earnings. The reporting says you want to see things generally in hand. The management are at the tiller and doing a good job.

So that's not too much to ask. But I think that's what we need to see for markets to continue to trade to new highs. Again, I make the point, we are at new highs in the small ordinaries. The small cap stocks are not at all-time highs, but good chunks of the Australian share market is. So we just need a little bit more FOMO.

CAROLINE GURNEY: I like that. So can I just ask both of you, what's your outlook in terms of the RBA and what they're going to do?

JUN BEI: Look my view is that I think the cut is coming March quarter. There is a possibility, I would say 20% probability of it being this year, but I think the majority is probably next year just given that's probably what we're looking for in the US as well.

CAROLINE GURNEY: There's so much noise out there. How do you manage to concentrate on just your portfolio and the stocks that you've chosen with everything going on? I mean, you've talked about AI, you've talked about various other thematics. How do you concentrate on just your portfolio?

BEN GRIFFITHS: There's a simple answer to that. Stop watching share prices every day. If you've got the conviction of your portfolio and you've done the work and model the business up, then stocks don't need to have their hand held every waking minute. If you're confident, done the work, these stocks should look after themselves. If a stock gets hit for one reason or another and you're still confident, then you buy more of it. That's how we fund money.

So we tend to ignore the noise. There's always going to be noise, whether it's the front page of the newspaper or whether it's just scuttlebutt or whether it's just some terrible price action in the market, a share price vandalize, and we'll take advantage of that. But we try to cut out the noise because it doesn't do any good. It creates nervous energy and it just doesn't add to the value for unit holders.

JUN BEI: Look, I think for me is that it's like running a business. Beginning of the year or the quarter, you kind of you make a decision about what risk that you want to take. Am I comfortable with, China is going to tracking as it is. Am I comfortable with interest rates expected to go lower, market maybe a bit too bullish or bearish. Am I comfortable to take a risk that, I think the Australian economy is doing as I expect. So you make a decision about all of that and then we track our portfolio based, our exposure based on what our decision is.

We think the economy is going this way and these are our domestic, say, retailers. These are exposures. We think the economy may become a little bit softer and this August reporting season, might be a bit soggy. So what we do is that we perhaps don't over own too many of those retailers. We wait until the price weakness has come to us, and then we'll be able to build to our full position.

So we make those strategic allocations of different buckets, if you like, of what we want to have exposure to and eliminate everything else. So, I don't want to take currency risk, I don't want to take size risk, I want to make sure it's reasonably neutral, large versus small. A reason being is that I'm not sure if the market, you need the animal spirit to come back for the small to do better than large.

So I don't want to take that risk. So I sort of manage all my exposure to all of these buckets and really go down to what I know best. I know this company, I know that company in our time, my entry, and I'm very comfortable with those. I can sleep at night, but everything else, I'm not taking any extra beat on.

BEN GRIFFITHS: Caroline can I just add on that, we are big shareholders in Afterpay (ASX: APT) and if we reacted to every piece of AFR gossip or columnist carry on, or every senate inquiry or asset inquiry or small claims, consumer claims tribunal allegations, if we reacted to any one of those pieces of scaremongering, as it turns out, we would have been out of that stock and not held onto it. So that's a great example of backing conviction and staying with it. And Afterpay was peppered with noise for its listed life.

CAROLINE GURNEY: You are incredibly good fund managers. So finally, what is the best piece of investment advice you've ever received?

JUN BEI: Best piece of investment advice, I think for me, is knowing to be pragmatic about my position every day. Knowing when to sell rather than holding onto losers. So I think that's something that I always feel is very important, and do not sell my winner way too early. I think that's been incredible for many years. I look at the companies within my portfolio range. Some of the best performers is the company I held for years and years and years. Through all of the ups and downs, absolutely. So, you know, when it's down a little bit, maybe you can tell. So this is how we see a lot of those investments.

CAROLINE GURNEY: Excellent. Thank you, Ben.

BEN GRIFFITHS: My late grandmother was a feisty businesswoman, and she was quite an astute, albeit small investor. And she imparted upon my father and myself that in stock markets, her exact quote was, "in matters of finance, one must be patient." And I think Jun Bei has teased a bit of that out in her comments, as I did with not reacting to the noise and the static and only carrying on. Conviction of your belief. And the big money is made by sitting in positions and letting the position deliver great returns.

If the investment thesis changes, you might step off. But more or less you sit with positions. You buy on bad days, and you sit there. So I think it's patience that is the key to success in any investing, particularly so in stocks.

CAROLINE GURNEY: Excellent. Jun Bei Liu, Ben Griffiths, thank you both very much. And I think that

holds through for Future Generation Australia, it's a long-term investment. Thank you for all your support.

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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