

# MARKET INSIGHTS

June 2021 Quarter

## THE UNANSWERED INFLATION QUESTION

Ashley Gardyne, Chief Investment Officer



*As inflationary pressures rise, many investors will ask what a sustained period of higher inflation may mean and what actions should be taken.*

Our portfolio companies continue to perform strongly, and we believe they have attractive long-term prospects. Against this backdrop, inflation is getting increasing airtime. Investors ask how long inflation might last, what risks it poses for investors, and what they should do about it.

These are important questions, and we have spent plenty of time thinking about them. The answers aren't straightforward, because predicting economic outcomes and market movements are fraught with difficulty.

### **No-one knows how long this inflation spike will last**

The recent spike in inflation is hard to ignore. Post-COVID supply chain pressures have resulted in low inventories and delays in consumers getting their hands on everyday items.

For example, have you tried buying furniture lately? Expect a 6-week to 6-month delay. Shipping and freight costs have spiked. And don't even mention lumber prices – up more than 100% since the depths of COVID. At an aggregate level, we see these pressures in the inflation data, and US headline inflation hit 5% in May.

Investors in bonds and term deposits will have a real problem on their hands if inflation stays high for a sustained period. So the key question is how long this current spate of inflation will last? Those who expect higher inflation to last argue that inflation causes inflation. Higher prices result in workers demanding pay rises, which businesses then pass on via higher prices. And around and around we go.

On the other hand, there is a real possibility that inflationary pressures will fade as COVID supply-chain disruptions diminish, and government support programmes disappear. This time next year, inflation may be in the rear-view mirror. We may be in an environment of low growth, low inflation, and low interest rates – just like much of the last decade.

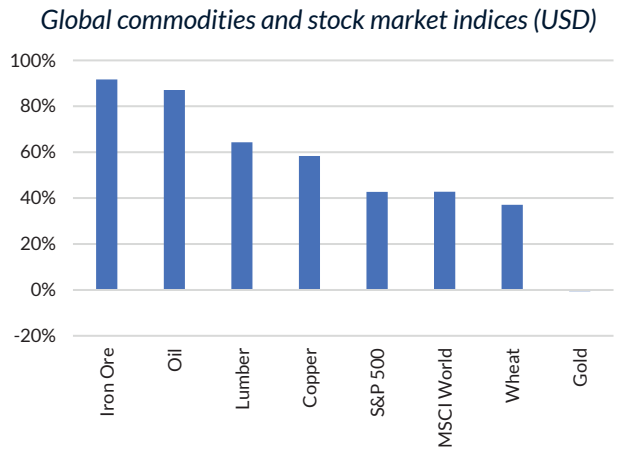
### **Inflation hedges don't always work as expected**

If you were an investor who, this time last year, saw inflation coming (and I'm not aware of anyone who made that call) what would you have done?

Many traditional macro investors would have suggested loading up on gold as an inflation hedge, expecting that a bout of inflation would push gold prices higher. If that was your trade – selling shares and buying gold – you would now be very disappointed. Over the last year gold is down 1%, while global shares are up over 40%, and many other commodities are up much more.

My point is that trying to invest based on macroeconomic forecasts is a tough game. Even if you guess the economic scenario right – and most can't – you still have to pick investments that will benefit from it. So basing investment decisions on macroeconomic factors is about as easy as predicting what the weather will be like this Christmas.

**Most major commodities and stock markets have outstripped gold meaningfully over the last year**



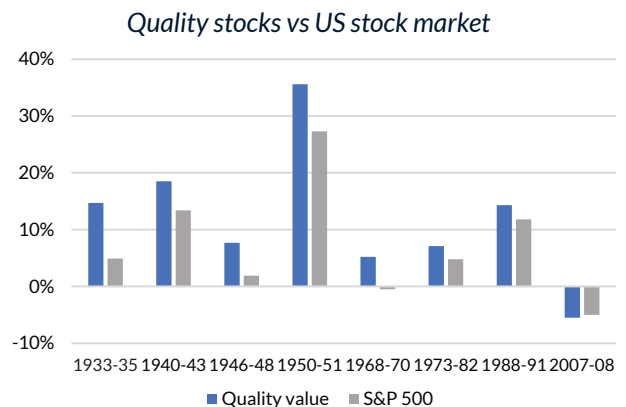
**Our investment approach helps manage inflation risks**

Those that have followed our investment approach for a while will know we don't try to predict the economic cycle. Our approach is to invest in high quality businesses with long growth runways, and we take care not to overpay. We believe this approach will help our clients build wealth over the long term, inflation or no inflation.

US fund manager GMO recently published an article on the types of share market investments that do best in inflationary environments. GMO studied the eight periods since 1933 when US inflation spiked above 5% for more than a year. They found that high quality businesses, bought reasonable valuations, outperformed the market in seven out of eight periods.

These companies outperformed the market by an average of 5% per annum and delivered an average annual return of 12% – even in periods of higher inflation.

**High quality US stocks outperformed the market by an average of 5% p.a. in seven inflationary periods since 1933**



Source: GMO

High quality businesses with sustainable competitive advantages – like Mastercard and Xero – tend to have more pricing power and wider margins. This allows them to better manage inflation and pass on rising costs.

Investing in well-managed and growing businesses is a sensible way to build wealth over the long term. This approach has done well through countless economic cycles, in periods of sustained inflation, and periods of low growth and low inflation.



Ashley Gardyne | Chief Investment Officer

## NEW ZEALAND EQUITIES

Sam Dickie, Senior Portfolio Manager



### To long-term investors, most market information is noise

*The market is easily distracted by short-term effects and confused by an ever-growing tide of data. The real skill is in filtering valuable information out of market noise – and using that information to guide a longer term view.*

Twenty years ago, information was scarce. So investors who could get the right information had a real advantage. Today, investors often have way too much market information. And to long-term investors like us, a lot of market information is just noise.

### Noisy times: Fisher & Paykel Healthcare, Xero, Auckland Airport

Three of our largest positions remind us not to get distracted by market noise. Fisher & Paykel Healthcare, Xero, and Auckland Airport all think long term. Recent market noise reminded us to do the same.

#### We bought Fisher & Paykel Healthcare when the market over-reacted to news

Fisher & Paykel Healthcare's Optiflow technology became the global standard for treating COVID last year. Demand for Optiflow surged.

And for the last 15 months, the market has been desperately trying to pre-empt – and price – the end of that surge. The market thought it saw the end of the surge in May, when the company delivered weaker-than-expected results, and an uncertain short-term outlook.

The share price fell by 15%.

When we see a sharp drop in the share price of a portfolio stock, we go back to the reasons we invested in the company. We call that our thesis map.

To us, a key attraction of the company is its exceptionally long runway for growth. Around 50 million acute respiratory-illness patients a year would benefit from the Optiflow product. But Optiflow is currently treating less than 10 million. Investors who focus on a short-term, post-COVID slowdown in demand will miss out on that big runway for growth ahead.

We bought more Fisher & Paykel Healthcare stock when the market's knee-jerk reaction to short-term noise made the price attractive.

#### We raised Xero's target weight when the market got short-term jitters

In May, the market also punished Xero for reporting earnings below analysts' expectations. That's despite the company flagging that its approach to managing costs would deliver strong earnings in the first half of the year, and lower returns in the second half, as costs grew.

The sharp fall in Xero's share price – down by 23% at one point – reeked of short termism that missed the bigger picture.

Again, we went back to our thesis map. Xero's global penetration of its core cloud accounting business is less than 5%. We see no reason why that figure won't approach 100% in the years to come. Xero was deliberately growing costs in the business so that it could move along that exceptional growth runway.

We also noted that many of Xero's fundamentals are getting better, not worse. Subscriber growth was positive. Average revenue per user was only held back by a deliberate delay of price rises, given the COVID backdrop. Metrics like the ratio of customer life-time value to customer acquisition costs were strong, driven by good gross margins and lower churn. The pandemic made small business customers realise that a real time view on their cashflows is more critical than ever.

So we bought more Xero stock as the share price fell and upgraded our target weight. When we see an opportunity like this, we grab it with both hands.

#### **Auckland Airport investors looked to the long term despite negative news**

Negative news flow included the stop-start trans-Tasman bubble, the pending departure of CEO Adrian Littlewood, and near-term earnings downgrades. Enough to make any short-term bear lick their lips.

But the stock is flat versus where it started the June quarter, helped by news of a take-over bid for Sydney Airport. This is encouraging because it means investors are focusing on the long-term picture. We will travel again. And when you own a long-life, critical infrastructure asset, looking at the long-term picture is exactly the right thing to do.

#### **Other portfolio action**

##### **a2 Milk has rallied almost 40% from its intra-quarter lows**

Product pricing on key online platforms recovered from recent lows, and its sales rankings on major e-commerce platforms Tmall and JD.com are at similar levels to last year. There are also some signs that some of the old inventories are clearing out and being replaced by newer batches.

We have been expecting to see this recovery for some time, but want to see signs that the recovery will be sustained. These positives followed another disappointing earnings downgrade during the quarter and the unexpected departure of Peter Nathan, leader of the Asia-Pacific business.

##### **Mainfreight outperformed again and delivered a strong 2021 result**

Sales and profit growth accelerated strongly in the second half of the financial year, especially in Europe and the US. The company is continuing to 'fatten' its network, driving higher line-haul utilisation, and opening new warehouses – which helps win new customers.

The business is expanding geographically as new Air & Ocean freight-forwarding branches become profitable and grow the company's freight flows. Momentum has continued into the 2022 financial year.

We upgraded our target weight during the quarter. The business is executing well against its strategy and remains a high-conviction position.

##### **Infratil announced it was buying Pacific Radiology Group**

Pacific Radiology is New Zealand's largest provider of diagnostic imaging with 46 clinics and 90 radiologists. This is Infratil's second investment in diagnostic imaging, after acquiring Qscan late last year. The investment thesis is based on strong industry growth dynamics.

Once the proceeds are received from the sale of Tilt (expected 3 August), Infratil will be in a position to buy more companies in the Australasian diagnostic imaging industry.

**Vista continued to outperform as audiences return to cinemas**

Audiences are getting back into the cinema habit as studios release more blockbuster movies and vaccination rates increase.

We expect Vista's software-as-a-service (SaaS) project – with products hosted in the cloud, on a subscription basis – to be another earnings catalyst. Vista's SaaS product will launch later in 2021 with pilots at small customers. As larger customers sign up, SaaS products will deliver an uplift in recurring revenues and profit margins.

**Ryman Healthcare lost its CEO and we reduced our target weight**

The company announced that Gordon McLeod, a 14-year company veteran including almost five years as CEO, was resigning. We are disappointed with Gordon's departure. He has been an inspirational leader and leaves without a plan in place for a successor.

We reduced our target weight in Ryman during the quarter.

**NZ still underperforms global markets – but we continue to outperform**

Over the June quarter, New Zealand's share market was again one of the worst performing in developed countries. Four factors drove this poor performance. First, the economy underperformed. Second, 10-year bond rates nearly doubled. Third, the NZX50 has five times more defensives – companies sensitive to interest rates – than other global markets. Finally, few NZ shares are cyclical or reopening plays.

## AUSTRALIAN EQUITIES

Robbie Urquhart, Senior Portfolio Manager



*We know that many acquisitions fail to deliver value. We understand why Warren Buffett says he's 'much more inclined to cry than to smile' when he reads about one company buying another. But in rare cases – like Carsales' Trader Interactive deal – acquisitions can be a low risk way to grow when entering a new market.*

### Cheap borrowing sparked a boom in acquisitions in Australia

Low interest rates, bolstered by government and central bank stimulus, have given companies and investors a way to borrow heaps of cheap money.

This has spurred a boom in acquisitions that's underpinned the recent rally in the stock market. According to JP Morgan, there have been around 80 acquisitions on the ASX200 this year. At an average of A\$1.6bn, the total value of acquisitions is well ahead of recent years.

### We did not weep when Carsales bought 49% of Trader Interactive in May

In the main, we agree with Mr Buffett's view that many acquisitions fail to deliver value. We prefer companies that can grow earnings under their own steam – by selling more goods and services, to more customers, year after year. We are sceptical of companies that grow mainly by buying other businesses. Buying a profitable business will increase overall earnings, but often fails to create value for shareholders – especially if the buyer pays too high a price.

But we didn't feel the prickle of tears when Carsales, a core portfolio company, bought 49% of Trader Interactive in May for A\$800m. Trader Interactive owns a number of leading online classified advertising websites in the US. Each website has a speciality, from recreational vehicles (campervans), commercial trucks, powersports (jet skis and snowmobiles), to industrial equipment.

This was a sizeable acquisition for Carsales, and we took part in a \$600m equity raising that helped fund the deal.

We support the Trader Interactive deal for four reasons. First, Carsales has not grown earnings mainly by acquisition. In Australia, its largest market, it has grown the number of customers, and adverts placed – and raised prices – year after year. The company is thoughtful about how it allocates free cash flow. It has reinvested profits into improving its website, and the value the site delivers to customers.

### Category-leading websites have a strong competitive advantage

Second, Carsales knows that the category leader in an online classified advertising business has a strong competitive advantage. Category leaders benefit from a virtuous circle. Customers looking to buy a vehicle visit the leading website because that's where the most for-sale vehicles are. Buyers get to browse the biggest range of models on the category leader's site. And sellers want to advertise on the site because that's where the buyers are.

Competitors have found it very difficult to derail this virtuous circle. And this is part of our investment thesis for Carsales: a strong, durable market position.

Because category leaders are so hard to unseat, it makes sense for Carsales to buy the category leader in a new territory. Buying the leader is arguably less risky than making a big investment in wooing buyers and sellers to a new site with no track record.

### **Carsales has a proven track record with category leaders in new territories**

Third, Carsales has successfully expanded into new countries by acquiring shares in category leaders. Years ago, Carsales used this playbook to enter South Korea, where it bought into Encar, and Brazil by buying into Webmotors. Today, both territories contribute to Carsales' profits, and Encar makes up over 15% of its pre-tax earnings.

Fourth, Trader Interactive opens up a new territory for future earnings growth and extends Carsales' growth runway. And trading in a new territory diversifies Carsales' earnings base, making it less reliant on the Australian market.

Many an investment banker is burning the midnight oil right now, looking for acquisitions to pitch to ambitious CEOs. Not all of these acquisitions will create value for shareholders. But sometimes an acquisition is the low risk way to grow a business.

### **Resmed made us smile as Philips' mis-step boosted growth potential**

Most of our portfolio companies delivered positive returns in the last three months. Only Credit Corp and Limeade saw their A\$ share prices fall, and neither company has had any notable negative changes.

Our best performing company, Resmed, rose +30% in A\$ in the period. A voluntary recall of sleep and respiratory care products by Philips, its main competitor, helped Resmed move ahead.

Philips discovered that some components were a health risk, and may have to replace or repair 3– 4 million devices. The company will need to devote valuable production capacity to the recall rather than making products for new customers. This gives Resmed a large opportunity to take market share from Philips.

### **High-growth stocks rose as the global economy edges back towards 'normal'**

Our higher growing companies delivered strong returns in the period. These stocks include PWR Holdings (+23.8%), REA Group (+19.3%), SEEK (+17.0%), and Audinate (+15.7%).

The underlying business environment for these companies will continue to improve as the global economy edges towards 'normal'. Less market anxiety about inflation helped lift the stock prices of higher growth companies. The investment rationale for this is that if interest rates edge lower, analysts apply a lower discount to future cash flows, and this drives up valuations.

### **Bank stocks rose as their earnings outlook improved**

Our Australian bank shareholdings also did well: ANZ (+2.5%), CBA (+16.0%), NAB (+3.2%), and Westpac (+8.2%).

All four banks gave positive earnings updates to the market. The banks noted that credit impairments are improving, as fewer customers struggle to repay loans, and were positive about future earnings. The banks also increased dividend payments, which has been well received by the market.

## SELECT INTERNATIONAL EQUITIES

Ashley Gardyne, Senior Portfolio Manager



### Boring proves beautiful in global markets, with large technology companies driving performance in Q2

*Global markets outperformed our domestic market in Q2, with travel snapping back and a strong economic recovery in the US and Europe. This cyclical upswing – and a strong performance from Alphabet and Facebook – delivered another strong quarter.*

Our international portfolio had a busy Q2. We exited three small portfolio holdings to make way for a new company, NVR, Inc, which we discuss below. The earnings season delivered good news for our technology holdings, which helped drive our market outperformance.

The US, UK, and Europe are enjoying economic recovery thanks to their world-leading vaccine rollouts. In the US, 93% of those aged 65+, and 60% of 18–64-year-olds, have had at least one dose of the vaccine. Success with vaccines, combined with government stimulus measures, has driven strong consumption growth. Consumer spending has returned to pre-COVID levels and even domestic travel is returning to previous heights.

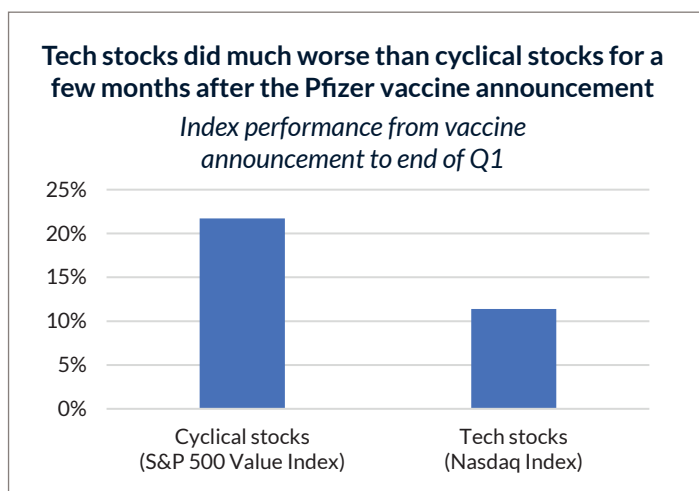
The US stock market led markets higher, returning 8.2% for the quarter. European markets gained 5.4%, while emerging markets climbed 4.6%.

### Strong tech earnings boosted our fund’s performance

Our Select International Equity Fund had another quarter of solid performance, gaining 9.0%, above the 7.3% delivered by our global benchmark.

Our performance is partly due to our large holdings in Alphabet and Facebook, which both reported good earnings results and saw their share prices surge in the quarter.

This surge is a real change from the previous two quarters, when large cap technology stocks generally performed poorly, behind cyclical companies that soared from the excitement of economic reopening. The chart highlights how much technology stocks underperformed cyclical stocks after the Pfizer vaccine announcement in November 2020. This result reversed in Q2 of 2021.





High quality growth companies have struggled so far in 2021. While the underperforming technology sector weighed on our portfolio, strong performances from a handful of companies — including Signature Bank — helped us outperform the market in the first quarter.

### **Alphabet's profits soared**

Alphabet (+18%), including Google and YouTube, saw its profits soar in Q1 of 2021. Its core search and advertising products continued to benefit as more people searched online for goods and services, a behaviour that grew during lockdown. Revenue rose 34% to \$55.3 billion, thanks partly to YouTube's revenue growing nearly 50% compared to the previous year.

Google Cloud Platform's revenue increased 56%, faster than its two larger competitors, Amazon Web Services and Microsoft Azure. Google Cloud also significantly reduced its losses as its recent investments started to bear fruit, and its Cloud business grew.

### **Facebook smashed revenue estimates**

Facebook (+18%) reported even better earnings, smashing revenue estimates by more than 10% and earnings per share estimates by more than 40%. Its advertising sales grew a remarkable 46% to \$25.4 billion. Limiting expense growth to 25% helped the company's operating income nearly double to \$11.4 billion. We still see a lot of growth ahead for Facebook as it expands its commerce and payments initiatives in Instagram, Facebook, and WhatsApp.

### **Digital advertising will continue to grow strongly**

We expect another decade of strong growth in digital advertising. More advertising will move from traditional media like TV advertising, and companies will spend increasing proportions of their marketing budget on digital platforms. In a digital world, retailers no longer need physical shopfronts to attract customers. Instead, retailers pay businesses like Alphabet (Google and YouTube), Facebook (including Instagram), and Amazon to help them find customers.

## **Many other holdings supported our portfolio gains**

### **Gartner reported strong earnings across the board**

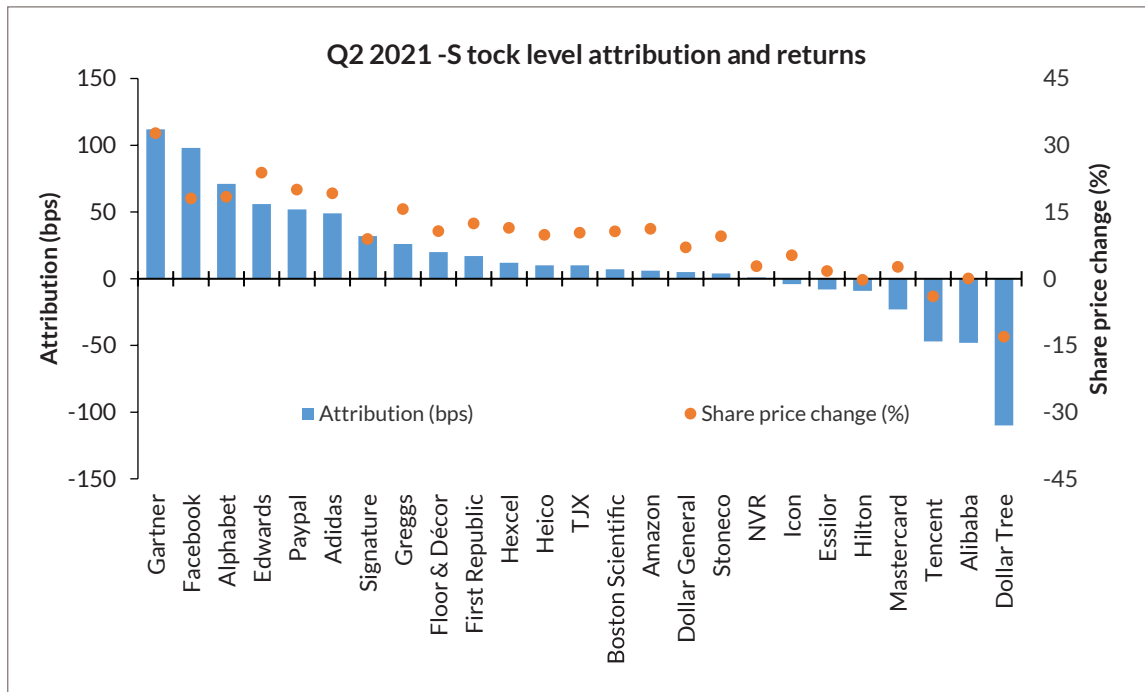
Gartner (+33%), a research and advisory company that we added during the 2020 COVID sell-off, reported strong earnings across all its three segments (research, consulting and events). The company's corporate IT research is proving increasingly valuable in a world of accelerating digitisation trends. These trends, and Gartner's strong execution, led it to raise its full-year earnings guidance by over 20%, excluding the growth when in-person conferences resume later this year. We have recently increased our holding in the company because our confidence in the company continues to build. We believe Gartner can continue to grow rapidly in IT research while expanding into other business verticals like marketing, finance and HR.

### **Edwards Lifesciences was a standout performer**

Edwards Lifesciences (+24%), a heart valve manufacturer, was another standout performer in the quarter. As with other medical device players, the strong vaccination roll-out in developed markets has driven optimism for a second-half recovery in surgical procedures. Edwards Lifesciences reported better than expected Q1 revenue and we expect momentum to continue growing throughout the year as patients return to hospitals for treatment.

### **Dollar Tree's earnings fell short, but we remain optimistic**

Several of our holdings did not do well, most notably Dollar Tree (-13%), the US discount retailer. Their earnings fell below market expectations because of higher-than-predicted freight costs. But we consider high freight costs a temporary issue and remain optimistic around the company's future. Its Dollar Tree stores, which until recently only sold items for \$1, has introduced \$3- and \$5-items. This should increase sales per store and could greatly improve profit margins. The turnaround at its Family Dollar stores also continues to progress well with store renovations. Finally, the new Dollar Tree- Family Dollar store combination provides a meaningful sales uplift.



### Leading US homebuilder NVR joins our portfolio

NVR, Inc is not just the fourth largest homebuilder in the US, they also have an exemplary growth record. We believe their unique business model gives them a strong advantage over less efficient competitors.

First, unlike most homebuilders, which are also land developers, NVR only builds homes. By using options to control land, they have the right to buy land just when they need it – without obligation, and not before they are ready.

Second, NVR differentiates itself from peers by pre-fabricating frames, roofs and staircases in one of its eight manufacturing facilities, saving time and cost. Their competitors still mainly build on site.

NVR’s asset-light business model, pre-fabrication, and local economies of scale allow them to enjoy higher returns on invested capital than their peers, and grow steadily with less reinvestment. With NVR’s approximately 2% market share in a highly fragmented industry, we see potential for years of market share gains and growth.

Third, and perhaps most importantly, we’re optimistic because we’re impressed by what NVR has managed to do in the last 20 years despite a bleak housing market.

Researching the US housing market is eye-opening as a Kiwi. Instead of the go-go boom we’ve experienced, most Americans steered clear of the housing market until the last 12 months. The US housing crisis that started in 2006 nearly collapsed the US and global banking systems. The doom and gloom kept homebuilders away, resulting in a significant under-build of homes in the US over the last 10 years – perhaps 5.5 million homes under.

Yet NVR took market share, grew, and created value for shareholders. Their business model and management’s execution has proven the test of time, as the chart shows. They have delivered shareholders a 20% a year return despite a terrible housing market.

NVR’s CEO, Paul Saville, has been with the company for over 20 years and steered the ship through the GFC. He has plenty of skin in the game, with over US\$500m worth of shares the company.

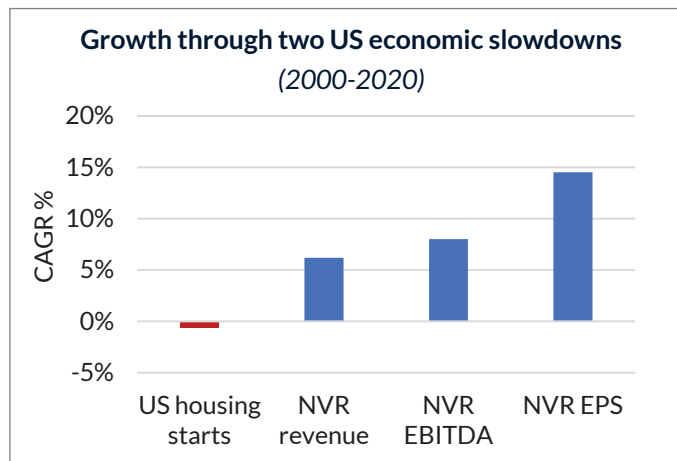
### Three small positions funded our NVR purchase

We exited three positions during the quarter so we could buy NVR.

The first was TJX Companies, a leading off-price retailer in the US. We have invested in TJX for more than three years and it has delivered a great result for our investors. While we believe the company should continue to take market share thanks to its scale and unique value proposition, we are concerned about their profit margins. The off-price business model is very labour intensive, especially in the supply chain with manual sorting, picking, and packing. A strong post-COVID rebound in TJX’s share price, combined with a higher probability of wage inflation crimping its margins, led us to take our profits and reinvest the funds elsewhere.

We also exited our position in Heico. We added this aftermarket aerospace supplier to our portfolio when it declined 50% during COVID and we thought the market was overly pessimistic about the company’s earnings outlook. With a large part of its revenue tied to air travel, Heico’s share price has benefited from the economic reopening and now trades at pre-COVID levels, despite a full recovery in air travel being a couple of years away. We think this is overly optimistic and believe we could use the capital better – like for NVR.

Lastly, we exited our position in optical product manufacturer and retailer, EssilorLuxottica. We invested in the company in 2017 when Essilor and Luxottica were merging. The merger created a vertically integrated industry leader, with significant synergy benefits. This largely played out and shares are now at all-time highs.



## NEW ZEALAND CASH AND FIXED INTEREST

David McLeish, Senior Portfolio Manager



### The folly of the forecast

There is something quite romantic about the future. But its mystery can also be deeply discomfoting, challenging our need for control. And it is this longing for control that has sparked our love affair with prediction.

In financial circles, central banks are well known for their predictions, often forecasting interest rates many years into the future. And it is their economic 'mana' that often turns these forecasts into widely accepted beliefs.

But as their projection for higher interest rates again become consensus, it might be worthwhile considering the practice and practicalities of prediction.

### Humans are hopeless romantics

Most of us already know how terrible humans are at prediction. Research suggests this has to do with how much we want the predictions to come true. The more we want something, the more we believe it's likely to happen. Understandably, this connection is most strong when we predict our own future behaviour. This is because of our tendency for over-optimism and over-confidence in our predicting capabilities.

### Those who know, don't predict; those who predict, don't know

Studies also suggest that 'experts' are not much better at prediction than the general public. The forecasting inability of economists has been the subject of numerous studies. But again, we tend to hold what these gurus say in higher regard, without much consideration for their track-record or ulterior motives.

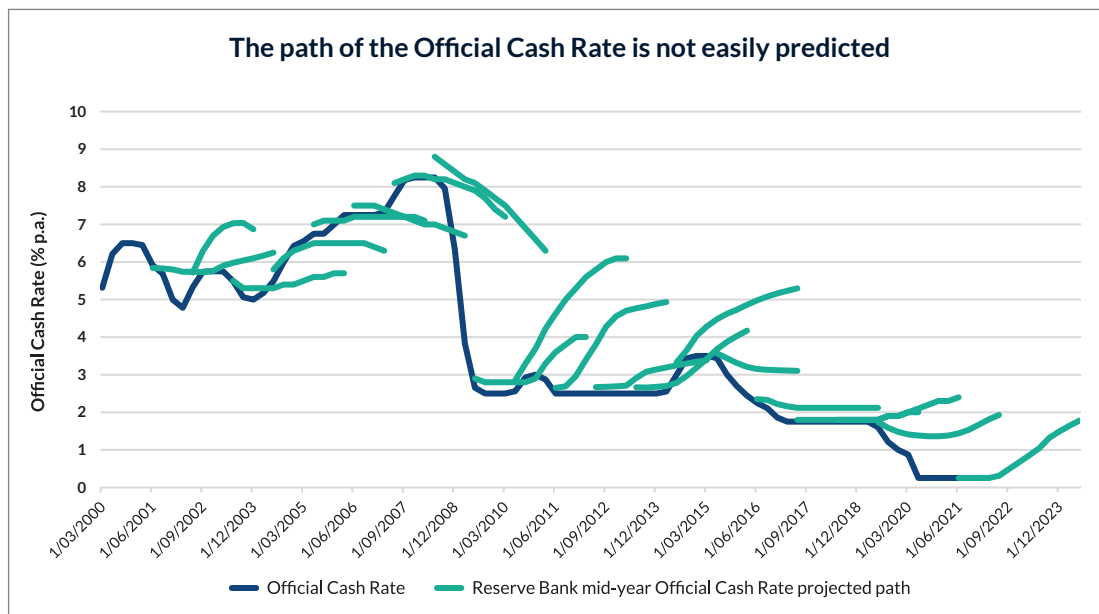
It is in the murky world of monetary policy where all these dynamics come together in one place.

### Fool me once, shame on you. Fool me twice, shame on me. Fool me thrice, shame on both of us

In May, the Reserve Bank of New Zealand caused quite a stir when, in their Monetary Policy Statement, they projected the Official Cash Rate rising by 1.5% over the next three years.

They set this overnight interest rate, so again very few question their projections. Therefore the markets response was, dare I say it, predictable. Investors moved quickly to reduce their bond holdings because they know if rising interest rates are coming this will push down the value of fixed income assets like these.

But I wonder if the reaction would have been any different if this latest prediction had been delivered alongside the previous mid-year predictions the Bank has made? (which the chart below shows):



Source: Bloomberg, Fisher Funds

The Reserve Bank modified its approach during the pandemic. So, there was no mid-year Official Cash Rate projection in 2020.

## Be careful when you follow the masses. Sometimes the ‘M’ is silent

The trouble is not that people make predictions. The trouble is that others blindly follow them without much thought for their likely accuracy or the consequences that come from reacting to them.

For example, investors who sold their New Zealand bonds and parked the funds on call in the bank when the Reserve Bank made a similar forecast in 2010 would have missed out on around 30% returns between then and now. Similarly, when the Bank began raising interest rates in 2014, some borrowers rushed to lock in their 7%, 4-year mortgage rates – only to see mortgage rates 1% lower just a year later.

## Focus on the short term and look at the facts

Listening to and considering a wide range of opinions will undoubtedly improve decision-making. But it always pays to add a healthy dose of scepticism.

Better still, rather than attempting to make accurate long-term predictions, we think you’re better off focusing on the near-term and dealing with facts as often as possible. For example, we have found that an astute assessment of the current economic environment is far more valuable than any forecast when deciding on the right mix of assets to hold in an investment portfolio.

Knowing what you don’t know is important. But knowing that others don’t know either is just as important. As Mark Twain once famously said, “It ain’t what you don’t know that gets you into trouble. It’s what you know for certain that just ain’t so”.

# PROPERTY AND INFRASTRUCTURE

Sam Dickie, Senior Portfolio Manager



## Growth infrastructure: a different way of thinking

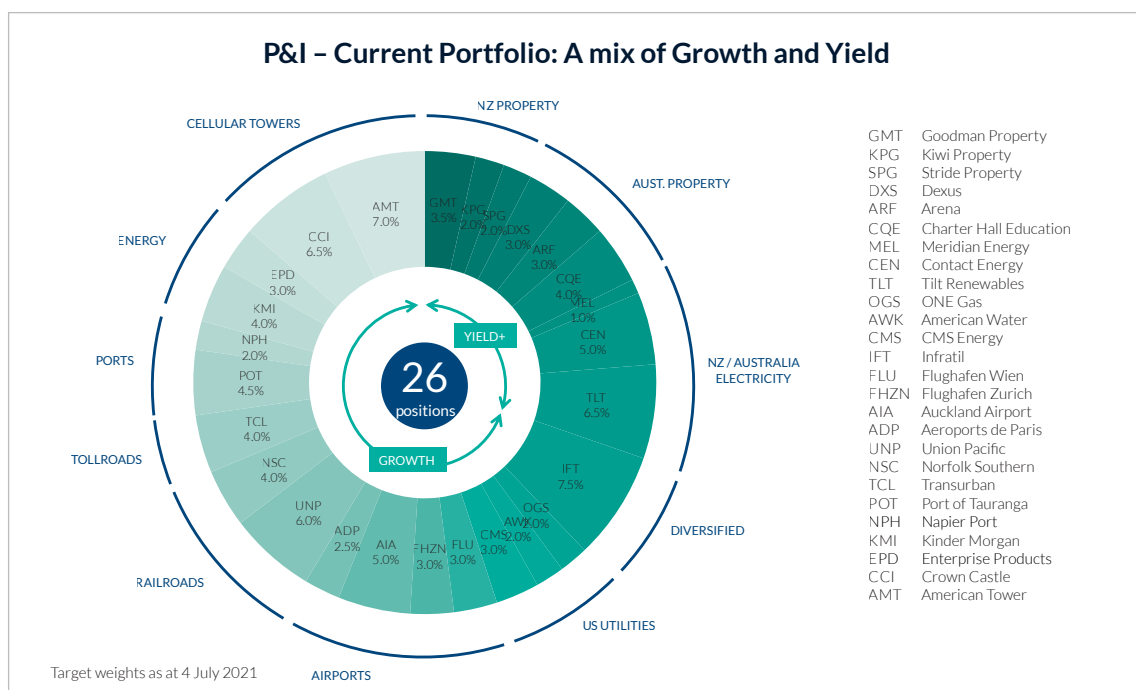
Conventional wisdom says infrastructure means low growth 'backbone' assets. We have a different view, a belief in a rare but not mythical beast: growth infrastructure. Growth infrastructure means predictable – and a useful rate of growth.

Infrastructure assets are traditionally seen as largely regulated, low-growth assets with predictable revenue streams. Assets like utilities, low-growth toll roads and property. Assets that would have historically been considered the 'backbone of the economy'.

But at Fisher Funds, we see infrastructure differently. We focus on growth infrastructure because quality- growth companies create more value over the long term. On the one hand, investing in growth infrastructure companies protects your downside because cashflows are predictable and sustainable, even in an economic downturn. On the other hand, such companies can grow significantly faster than typical 'backbone' assets.

## We strive to offer investors a healthy balance of yield and growth

The portfolio is currently split between 65% growth infrastructure and property, 30% yield or backbone type assets, and 5% cash. Growth infrastructure is weighted higher than over the past four years because we believe growth assets will continue to do well as the economy recovers from COVID. We will monitor their performance and switch gears between growth and yield assets as appropriate, which we can do as active fund managers.



## US cellular towers are the ultimate example of growth infrastructure

When we are hunting for growth infrastructure, we like following mega trends. One of the most prominent mega trends currently in our portfolio is data proliferation.

### Ericsson predicts that global mobile data traffic will grow five-fold by 2026

Smartphones use 42x more data than legacy mobile phones. A 3-minute video uses six hundred times more data than an email. The world is hungrier for data with increasingly data-intensive smartphone applications and the internet of things (IOT), which connects more devices to the internet. Around 10 billion devices already connected to the internet, and the World Economic Forum forecasts that number to explode to a breathtaking one trillion devices by 2030!

### Cellular tower companies have wide moats

Communications infrastructure providers American Tower and Crown Castle sell space on their cellular towers to mobile phone companies like AT&T, which in turn sell connectivity to data-hungry consumers. American Tower and Crown Castle are in an enviable position. They own 82,000 of the 130,000 cellular towers in the US. Their market share is unlikely to diminish soon because only 1,000–2,000 towers can be built each year, thanks to consenting requirements. People don't want a new cell tower in their back yard. Mobile phone companies can't switch providers easily – imagine the cost of moving all of your telecommunications equipment between towers.

Perhaps even more important, mobile phone companies may have less choice between cellular tower companies soon. The effective coverage of a cellular tower shrinks as data usage climbs. The higher frequency ranges that enable people to use more data rapidly have a much lower range. This means that mobile phone companies may well need to use all the towers they can. Cellular tower companies' moats will inevitably grow wider. Having the law of physics on your side is great!

### Investing in cellular tower companies gives us the best of both worlds

By investing in American Tower and Crown Castle, we enjoy the downside protection of traditional infrastructure because cellular tower leases typically have increases of 3% per year, meaning income grows over time regardless of new business activity.

But we are more likely to get our growth infrastructure upside because mobile phone companies need to add more and more equipment to towers to satisfy their customers' insatiable demand for data. Cellular tower companies' earnings grow around 10% per year, significantly higher than traditional infrastructure companies.

## Other news on companies in the portfolio

### Auckland Airport investors looked to the long term despite negative news

Negative news flow included the stop-start trans-Tasman bubble, the pending departure of CEO Adrian Littlewood, and near-term earnings downgrades. Enough to make any short-term bear lick their lips.

But the stock is flat versus where it started the June quarter, helped by news of a take-over bid for Sydney Airport. This is encouraging because it means investors are focusing on the long-term picture. We will travel again. And when you own a long-life, critical infrastructure asset, looking at the long-term picture is exactly the right thing to do.

### Contact Energy is operating well

Contact Energy hosted an investor day during the quarter, including a tour of its Tauhara geothermal site, which is ahead of its construction schedule. The company is partnering with Meridian on initiatives to replace current electricity demand from the Tiwai aluminium smelter, which may shut after 2024. Overall, the investor day reassured investors that Contact is operating well and has a sound 4+ year growth plan.

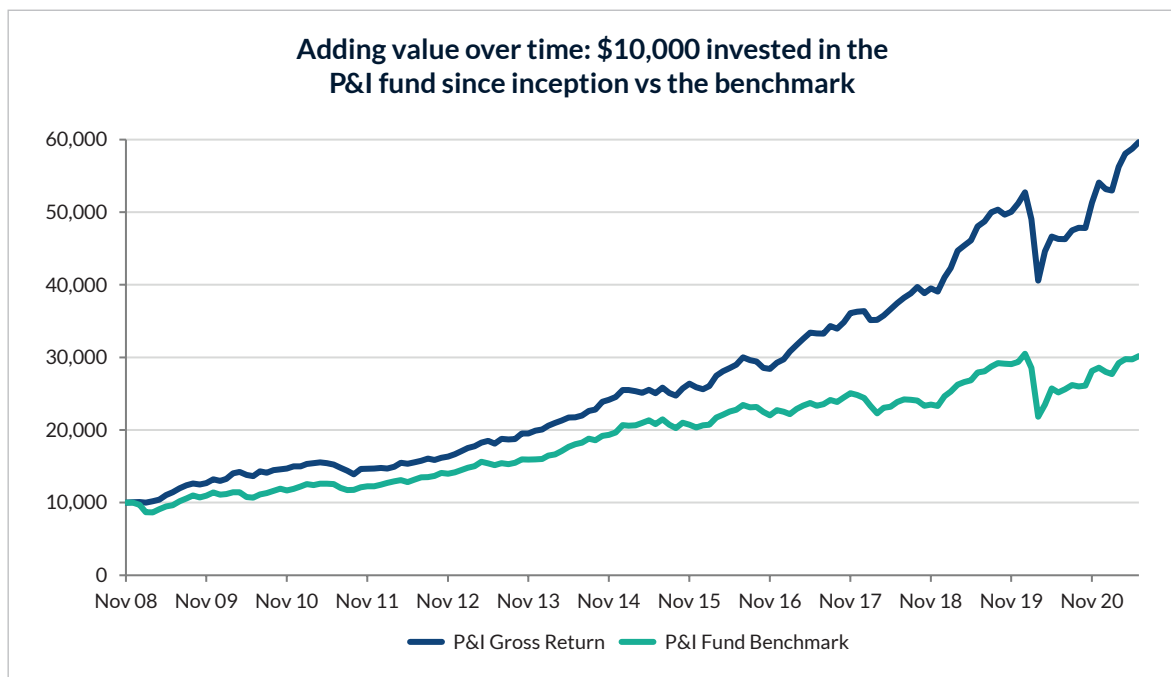
**Infratil announced it was buying Pacific Radiology Group**

Pacific Radiology is New Zealand’s largest provider of diagnostic imaging with 46 clinics and 90 radiologists. This is Infratil’s second investment in diagnostic imaging, after acquiring Qscan late last year. The investment thesis is based on strong industry growth dynamics.

Once the proceeds are received from the sale of Tilt (expected 3 August), Infratil will be in a position to buy more companies in the Australasian diagnostic imaging industry.

**High quality risk-adjusted returns**

Our P&I fund offers a lower risk alternative to global equity funds and should be considered as part of any diversified portfolio. Our fund’s returns have historically been less volatile than global equity funds. While our fund’s returns have been slightly lower, it has returned more for the same risk when you consider the relative risks of infrastructure and equity funds. – and we’ve done better than the benchmark too.





# MARKET MOVEMENTS

As at 30 June 2021

Stock Markets*	Closing Values	Changes over:			
		1 Mth	3 Mths	6 Mths	12 Mths
		%	%	%	%
S&P Developed LargeMidCap - (Local Curr)	1149	2.1	7.5	14.4	37.5
S&P Developed LargeMidCap (\$NZ)	N/A	2.1	3.4	13.1	21.6
S&P Global LargeMidCap (\$NZ)	N/A	5.5	7.6	15.8	28.5
USA - S & P 500	8943	2.3	8.5	15.3	40.8
USA - Nasdaq	17246	5.5	9.7	12.9	45.2
Japan - Topix	3071	1.2	-0.3	8.9	27.3
UK - FTSE100	6848	0.4	5.7	10.9	18.0
Germany - DAX	15531	0.7	3.5	13.2	26.2
France - CAC40	18450	1.2	9.1	19.5	35.5
HK - Hang Seng	87461	-0.6	2.7	7.4	21.6
Australia - S & P 300	82367	2.3	8.5	13.0	28.5
NZ-S&P/NZX 50 Gross Index (inc imp credits)	15532	2.8	0.9	-3.0	11.2
NZ-S&P/NZX 50 Gross Index (excl imp credits)	12655	2.7	0.7	-3.3	10.5
Market Volatility - VIX	15.8	-5.5	-18.4	-30.4	-48.0

New Zealand Property		%	%	%	%
S&P/NZX All Real Estate (inc imp credits)	1953.5	2.9	2.4	-1.8	21.1
S&P/NZX All Real Estate (exc imp credits)	1853.5	2.8	2.2	-2.1	20.4

Ten Year Bonds	%	Yield Changes			
USA	1.45	-0.13	-0.29	0.52	0.79
Japan	0.06	-0.02	-0.03	0.04	0.04
United Kingdom	0.71	-0.08	-0.11	0.52	0.57
Australia	1.53	-0.12	-0.26	0.56	0.67
New Zealand	1.76	-0.03	-0.05	0.77	0.84

90-Day Interest Rates	%	Yield Changes			
USA	0.05	0.04	0.02	-0.04	-0.11
Japan	0.06	-0.01	-0.01	-0.02	-0.01
United Kingdom	0.08	0.00	-0.01	0.05	-0.06
Australia	0.03	0.00	0.00	0.02	-0.07
New Zealand	0.35	0.02	0.00	0.08	0.05

Bond Indices	Closing Values	Changes over:			
		1 Mth %	3 Mths %	6 Mths %	12 Mths %
S&P/NZX Bank Bills 90-Day	735.30	0.03	0.09	0.16	0.31
S&P/NZX NZ Government Bond Index	1871	0.45	0.21	-3.22	-3.60
Barclays Capital Global Aggregate Index (Hedged NZD)	N/A	0.52	1.01	-1.50	0.02

Hedge Funds & Commodities		%	%	%	%
HFRX Global Hedge Fund Index (USD)	1432	0.4	2.4	3.7	12.0
DJ-UBS Commodity Index Total Return	202	1.9	13.3	21.1	45.6
Gold (US\$/ounce)	1770.80	-6.9	3.3	-6.5	-1.2
Oil (US\$/barrel)	75.13	8.3	18.3	46.7	80.4

Currencies		%	%	%	%
NZD / USD	0.6987	-4.0	-0.2	-3.0	8.5
NZD / EUR	0.5892	-1.0	-1.1	0.1	2.8
NZD / GBP	0.5058	-1.2	-0.4	-4.0	-2.9
NZD / AUD	0.9307	-1.0	1.2	-0.2	-0.5
NZD / YEN	77.55	-2.6	0.2	4.3	11.7
Trade Weighted Index	73.74	-2.3	-0.2	-0.7	3.0

\*Total Return Indices. Indices are net of offshore tax.  
Source: Thomson Reuters Datastream

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