ALLIANCEBERNSTEIN®

FIVE QUESTIONS FOR THREE YEARS

# AB CONCENTRATED GLOBAL GROWTH

Equity markets have been through plenty of challenges in the three years since AllianceBernstein launched its Concentrated Global Growth managed portfolio in Australia. In this Q&A, **CIO Mark Phelps** explains how he's steering the portfolio through tricky conditions in 2019.

## Q: THE OUTLOOK FOR INTEREST RATES HAS CHANGED MARKEDLY SINCE THE END OF 2018: THEN, RATES WERE RISING IN THE US; NOW, THE US FEDERAL RESERVE AND OTHER MAJOR CENTRAL BANKS ARE CUTTING RATES. HOW HAS THIS AFFECTED PORTFOLIO PERFORMANCE, AND WHAT RISKS AND OPPORTUNITIES DO FALLING RATES CREATE FOR THE PORTFOLIO?

It's hard to remember a period when the interest rate cycle has changed so markedly so quickly. Underlying all the Federal's Reserves considerations is the current state of the US economy, and on most measures that is still doing reasonably well, although growth has slowed from the 3% level seen in 2018, to somewhere around 1.5% to 2% currently. This slowdown was the main factor behind the recent cut in US interest rates, reversing the increase in the fourth quarter last year. As growth has slowed, concerns over a recession have increased, and the US yield curve has inverted, often a sign of a pending recession, albeit a 'necessary but not sufficient' condition for that to happen.

However, another critical factor is the ongoing trade tension between the US and China. Tariff increases and threats to block technology transfers have unsettled investors and have made it difficult for companies to invest, given the uncertain background. We have also seen significant increases and decreases in inventories as companies have tried to get ahead of tariff increases, further clouding the economic picture.

At the company level we have primarily avoided investments directly impacted by tariff increases and we have reduced our exposure to some stocks that could be caught up in trade wars, where they were already trading at fair value. Looking ahead we do not see a major recession coming, although in a low growth environment we will see some quarters where growth could be zero or even very modestly negative. We do think monetary conditions will remain very accommodative, and we may well see a further cut in US interest rates in the near future. Here so much hinges on a trade resolution. If we get one I think growth will be reasonable in 2019 and 2020; if we do not get one then a recession is more likely. Bottom line, in a world of low growth we are very focused on identifying those companies that have their own growth drivers, believing this is the way to generate positive returns going forward.


**Mark Phelps**

Mark Phelps is Chief Investment Officer of Concentrated Global Growth. Prior to joining AB in December 2013, he was president and managing director of Global Investments at W.P. Stewart & Co. From September 2008 to June 2013, Phelps also served as W.P. Stewart's chief executive officer. He originally joined W.P. Stewart & Co. (Europe) in February 2005 as a global portfolio manager. Prior to that, Phelps held senior positions with the Kleinwort Benson/Dresdner Bank organization in London and San Francisco, most recently serving as CIO for Global Equities at Dresdner RCM in San Francisco. He holds a BA (Hons) in economics from the University of York and completed graduate studies at the Royal Military Academy Sandhurst. Phelps served in the British Army from 1981 to 1984, achieving the rank of Captain.


**IN A LOW GROWTH WORLD WE FOCUS ON COMPANIES THAT HAVE THEIR OWN GROWTH DRIVERS**

# FIVE QUESTIONS FOR THREE YEARS

### Q: MANY INVESTORS ARE WORRIED ABOUT EARNINGS GROWTH. HOW DO YOU VIEW THE THREATS TO GLOBAL PROFITS?

Earnings are facing many hurdles, including the escalating US-China trade war, and fears of a global economic slowdown. But the outlook itself may not be as bad as widely perceived. It's true that the pace of earnings growth is slowing—particularly in the US, as the boost from last year's tax reform fades. Yet companies are generally still increasing profits across most sectors globally, which is a positive environment for stocks. We expect global earnings growth in 2019 to range between 5% and 8%. So growth is slowing but not disappearing, and the balance between the US and other markets should be supportive of a more consistent return across markets[1].

### Q: WE HAVE RECENTLY SEEN VOLATILITY COME BACK TO MARKETS. HOW ARE YOU POSITIONING YOUR PORTFOLIO TO WITHSTAND OR TAKE ADVANTAGE OF MORE VOLATILE MARKETS?

Volatility is not necessarily a bad thing; it is really a fact of life in markets. In recent years, investors have become accustomed to exceptionally low levels of volatility; and, in many ways, the return of volatility implies that normal conditions are beginning to return to markets after a decade of support from exceptionally loose monetary policy globally. In fact, historically, equity markets correct by 10% on average about every eight months—as they did in February and October of 2018[1].

For skilled, long-term investors, volatility often provides opportunities, and does not necessarily reduce returns. We are not trying to time markets but are happy to hold cash of up to 10% to find attractive entry points in stocks of high quality companies with solid long-term fundamentals.

### Q: WHAT TYPES OF COMPANIES ARE YOU LOOKING FOR IN THE CURRENT MARKET ENVIRONMENT?

As we look beyond 2019, we are carefully scrutinising input cost inflation to avoid companies that may deliver negative earnings surprises. Companies with strong pricing power could potentially offset inflationary pressures, so this is factored strongly into our models. That said, the best investing strategy is to find great secular growth businesses that can deliver growth in almost any environment. And the correction in late 2018 gave us the opportunity to modestly reposition our portfolio toward the most predictable growers at reasonable prices.

Our investing philosophy aims to target companies that have the potential to generate earnings growth of 10% or more per year over the next five years. Even in the best of times, very few companies can do this—but those that do, tend to outperform the market over time. In today's market, we believe that identifying companies with the potential to deliver consistent earnings growth amid trade tensions and continued uncertainty in global equity markets is a recipe for long-term success.

In the long run, we continue to believe our portfolio can generate returns broadly in line with the earnings growth achieved. In that respect, if the journey is going to be a positive one, how we get there shouldn't matter, so long as we are able to stay the course. Volatility is rising, but that can be an opportunity as well as a challenge.

**VOLATILITY IS RISING, BUT THAT CAN BE AN OPPORTUNITY AS WELL AS A CHALLENGE.**

# FIVE QUESTIONS FOR THREE YEARS

### Q: HAS ANYTHING CHANGED IN THE WAY YOU MANAGE THE PORTFOLIO OVER THE LAST FIVE YEARS?

The world around us has changed dramatically in the last three years. But when markets get a bit crazy, it's all the more important to stay disciplined as investors.

To find companies that can grow earnings consistently over time, we still look for superior businesses, typically industry leaders with predictable, recurring revenue streams. People often ask me: what do you mean by "high quality growth"? For us, it's all about finding companies with strong management, volume growth drivers, dominant franchises and high barriers to entry. We prefer businesses with low cyclicality, low customer concentration and low regulatory risk. To qualify for our portfolio, companies must demonstrate an ability to maintain capital discipline, as indicated by strong balance sheets.

Our team's approach is based on years of experience, developed well before the AB Concentrated Global Growth Managed Portfolio was launched in Australia. Yet we're always fine-tuning our investment process and risk management tools as the markets change. And the essence of our goal remains the same: to tap into sources of underappreciated growth potential in a small number of select companies that we believe can deliver long-term returns for our clients through changing markets.

**WHEN MARKETS GET A BIT CRAZY, IT'S IMPORTANT TO STAY DISCIPLINED.**

### MARK'S FIVE TOP STOCK PICKS

**Microsoft (US)** – the tech giant continues to benefit from the company's pivot to the cloud when Satya Nadella took over as CEO a few years ago. Office 365 is driving strong growth in both users but also services taken, and as a service offers a much more stable subscription service, rather than a one-off purchase. Azure, Microsoft's system that hosts companies cloud data, is also growing dramatically as companies outsource their data management.

**Abbot Laboratories (US)**—manufacturer of a range of healthcare products including diagnostics, nutrition, pharmaceuticals and medical technologies. Each franchise enjoys unique investment themes that contribute to durable growth and diversified revenues for the group. A strong management team underpins the company's strategic advantages and earnings growth potential.

**Treasury Wine Estates (Australia)**—formerly the wine division of international brewing company Foster's Group, this company has a global winemaking and distribution business. Treasury has also penetrated China, a rapidly growing strategic market, where competition is relatively scarce.

**AliBaba (China)** — the internet company continues to see strong growth in sales for its online market places TMall and Taobao and has over a 50% market share of China's on-line retail market. The company is also seeing strong sales growth in its cloud computing business. Its financial services arm, Ant Financial, is also growing rapidly as Chinese consumers look to increase their use of credit, as well as buy financial savings products.

**Eurofins Scientific SE (Belgium)**—an international group of laboratories headquartered in Brussels, providing testing and support services to various industries and governments. The company specialises in lab testing for food companies and pharmaceuticals. The food industry is a niche market where we believe Eurofins has a first-mover advantage with large manufacturers.

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[1]Source: Bloomberg, S&P and AllianceBernstein (AB)

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