



Growth Stocks Setting the Pace for Global Equities

Improved fundamentals and disruptive business models provide powerful tailwinds for growth stocks.

November 2019

KEY INSIGHTS

- Growth stocks have outperformed value stocks, driven by structural improvements in cash flow and earnings growth.
- Equity valuations appear attractive on a medium-term basis, but caution may be needed amid heightened near-term volatility.
- Global research platform can identify undiscovered growth stocks ripe for significant expansion.

Q. Global equity markets have bounced back strongly after a down year in 2018. What is your outlook on equities going forward?

We are still constructive on equities in the medium term. Currently, the S&P 500 Index's forward PE multiple is just under 17, which translates into an earnings yield of about 6% and current dividend yield of nearly 2%.¹ When you compare that against the backdrop of more than USD 15 trillion worth of negative-yielding bonds in the global market, the equity market valuation looks rather attractive on a medium-term basis versus other asset classes.²

There is a lot of bifurcation within the equity market, however. Growth stocks have meaningfully outperformed value stocks over the last decade, driven in large part by real cash flow growth and real earnings growth as opposed to

valuation multiples rerating. Importantly, this is different from the dot-com bubble, when valuations for growth stocks were coming just from multiples being rerated to reflect potential future earnings improvement.

Q. As you say, growth stocks have performed well in the past decade on the back of improving fundamentals. Do you think this is a structural change that will continue?

We do believe it is something that is quite structural. When you think about what is actually happening structurally within the growth segment of an index and the value segment, a lot of the growth stocks are actually disrupting the value stocks. Just look at a stock like Amazon disrupting traditional retail businesses or fintech disrupting banks to see how this is occurring today.



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Global Growth Equity Strategy

¹Source: Standard & Poor's (see Additional Disclosures). Data as of September 25, 2019.

²Source: Bloomberg Index Services Limited (see Additional Disclosures). Data as of September 25, 2019.

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Over the last decade, Amazon's total sales have grown more than eightfold.³ During that period, many retail stocks in the S&P 500 Index have actually had flat sales growth. To understand why Amazon performed so well as a stock, you have to look at how the operating performance of Amazon appears to have been much, much better than the average retail stock in the U.S. That is a structural change, and our view is that it is here to stay.

Having said that, growth stocks are often painted with just one brush, and that ignores the fact that there are also a lot of growth cyclicals in the market. Stocks in industrial automation and robotics that are linked to the industrial cycle, for example, have actually sold off meaningfully in the past year to the point where we see a lot of value.

It's also worth noting that there are still several undiscovered growth stocks that, in our view, are ripe for significant expansion in the coming years. This includes stocks like e-commerce providers Mercado Libre in Latin America and Sea in Asia and payment processor Stone in Brazil.

Q. The U.S.-China trade dispute has had a major impact on financial markets across asset classes. What is your view on the situation, and how are you positioned for a potential outcome?

The U.S.-China trade dispute has clearly had a significant impact on investor sentiment dating back to 2018. Where the situation goes from here in terms of getting to a resolution or whether there is further escalation really depends on politics and the rhetoric from both the U.S. and China. Initial negotiations on a trade resolution commenced some time ago, but there is a distinct possibility that

we may not actually have a trade deal at the end of all these talks.

As investors, we do not want to position our portfolio for just one outcome in such a binary event because of the inherent uncertainty of the situation. Instead, we are staying true to our investment process and are investing in durable, quality growth stocks at a reasonable price. We do recognize that the trade dispute could increase volatility in the near term, however, and have lowered our portfolio beta.

Q. If we are to enter a world of heightened volatility amid rising geopolitical concerns and slowing global economic growth, what is your approach to managing risk in the portfolio?

We use beta as one key indicator when we look at risk and are quite dynamic about it when thinking about portfolio positioning. For instance, we reduced the portfolio beta in 2018, and that served us really well during the fourth quarter when the market sold off. At that point, we started to see more attractive valuations and dialed the risk back up again, which helped our performance through most of 2019 to date, particularly during the first quarter. We have since lowered the beta again because we believe the market may be too complacent regarding the risks of the trade dispute.

While we have scaled back some risk, we have also not gone overly defensive, as we still think equities represent good value over the medium term, especially versus other asset classes, in the context of trillions of dollars of bonds in negative-yielding territory.

³ Source: Bloomberg Index Services Limited (see Additional Disclosures). Data as of September 25, 2019.

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