Intelligent Investing

KINNELL & CO

Capturing Long Term Trends

The best way to protect and grow investment capital is to identify and gain exposure to profitable long term trends at a sensible price for that exposure. A key aspect is identifying long term trends that are profitable and likely to remain so for many years to come. This can be achieved with discipline and critical thinking but is more difficult than it sounds.

A couple of major trends in the twentieth century were the growth of car manufacturing and the boom in air travel. Both did not exist in 1900 but by 2000 were major industries. However, as we know for investors in these industries the results were very poor due to a mix of huge competition, high labour costs, low margins, and protected markets. A great trend identified was a poor investment because of a lack of consistent profitability. At present, we have many technology companies “worth” billions of dollars with no profitability and varied paths to potential profitability. The prize, of course, is identifying the next Google, Amazon, or Facebook but most of the new contenders will fail to deliver on the billions of dollars of hope invested in them. Avoiding trends that are well established and likely to continue to be poor for investors is also important to protect investors capital. Despite share markets having a great run the past few years the traditional US Department Store retailers like JC Penney, Macy’s and Kohls have been hammered as their business models are challenged by the growth of online retailing. Avoiding negative trends like this is relatively easy but what about making a positive investment return? To do that we need to identify profitable trends and gain exposure to them in a sensible way.

Recently I read yet another article about the economic rise of China and India. For the historians amongst you, you may recall that around 1800 China and India were each about one-quarter of the global economy. The West industrialised first and we have outpaced the East but that mega trend is rapidly ending as the major population centres of the world catch up to our living standards. In a few short years’ India and China will be back roughly where they were in 1800 as a share of the world economy. India’s middle class is growing strongly and estimated to be close to 300m people (the entire US population currently stands at 320m). Investing into rapidly developing countries though can be fraught with risk, due to developing regulatory systems, and different cultural and political norms. If you invest directly you risk losing your capital – think Indonesia ‘nationalising’ a mining joint venture, Vietnam after the US lost the war, Venezuela nationalising almost everything in recent years, or Eastern Europe being nationalised by the Soviet Union in the late 1940’s. We want exposure to the mega trend of growth for the Asian century but not exposure to a large capital loss.

When we invest in US listed global multinational companies we look at where a company’s earnings come from. Many major multinationals generate 30-50% of their earnings outside the US. This provides access to faster growing economies in Asia but also less risk as those companies are already very profitable in their home Western markets. Procter & Gamble generates around 60% of its earnings outside the US with around 30% from emerging markets. This provides access to faster economic growth but also diversifies risk for an investor. Multinationals that still have a viable growth runway via Asia and other emerging markets offer a sound pathway to increasing profits without the direct risks of trying to invest in companies solely focussed in the emerging economies. Next time we’ll take a detailed look closer to home at Ryman Healthcare and how it continues to ride the ageing population trend - where might they be in 10 years’ time?

The companies mentioned above are examples of the types of quality companies in the sectors discussed. This should not be construed to be personalised advice nor a recommendation to invest in these companies. Please contact Kinnell & Co. regarding how best to take advantage of the trends listed above.

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