The next 30 years

Bo Knudsen | C WorldWide Asset Management | 08 February 2018

1987 was another interesting year. Not just because of the new songs from Depeche Mode – a British band that still tours the world. More because the countries of the world came together on a very serious environmental threat – a hole in the ozone layer that grew in size with potentially devastating consequences. This was described in the Brundtland report and the world agreed and backed the Montreal Protocol on Substances that Deplete the Ozone Layer, with the purpose of reducing harmful substances that since have created positive change.

Today, 30 years later, the fundamental story is the same. Fear of survival is a timeless factor of motivation and a reason to act. Concerns include general health, the environment and hence our planet, when it becomes clear that there are serious threats that could influence the quality of our daily lives. Some 195 countries (194 now that Trump has pulled out) came together recently to reduce C02 emissions in the Paris Agreement to counter global warming.

Things change and yet they stay the same. In ancient times, there were worries and health issues coming from indoor wood fires. Megacities around the world now struggle to give citizens the fundamental right of breathing clean air. The theme of protecting the environment and finding better energy solutions will also be relevant for the next 30 years - certainty in an uncertain world.

It can be easier to predict long-term themes than to predict the next few months. This certainty is very helpful for the long-term, fundamental investor as it is possible – via equity ownership in strategically well positioned companies – to participate and prosper from this knowledge. There will likely be companies benefitting from the need for alternative energy and energy efficiency that will multiply in size. The world's biggest problems are also the world's biggest business opportunities.

Even though deep understanding of a company's business model and competitive environment is a necessity for a successful stock picker, the devil is not always in the detail. The difficult part is understanding the long-term trajectory and staying on course, when the sirens are tempting you to change and a deviation away from the long-term trends due to a short-term "wind of change". It is about getting the big picture right and staying the course. That said, it is naturally crucial to understand if there is a significant change in the environment that alters the investment rationale of an equity investment and then to act on it. This White Paper describes and exemplifies strategic stock picking by describing three additional identified themes.

EXPERIENCES

Life is the sum of your experiences

Thirty years ago, the world enjoyed music. Thirty years from now, music will still be an important part of our daily lives (and maybe Depeche Mode will still tour the world in a digital version in 2047). That which entertains draws our attention and we are willing to pay for it. "Experiences" is a rather broad term to cover this very important area where human beings are going to spend more time and money for decades to come. Technology is a facilitator. Technology has proven to be a tool that brings people together. The Facebook platform is a practical tool that brings people together and the fact is that Facebook becomes a convenient gateway to overall connectivity – a gateway to the internet. It is a fact that there is a chance of being recognised, confirmed and respected as a human being by being on social media. The core is the experiences and the feelings generated from it, that makes you pay with time and money spent – not the technology.

It is likely that the future will bring more spare time and even easier access to experiences - experiences that we seek to capture and share. There are nuances in how people perceive and more can be expected of our senses involved in these experiences going forward with the visual sense still being the most important. This leads to the following three headlines of long-term pockets of stronger growth than global GDP for the coming decades:

1. **Content**
   Traditional media, online media, gaming, live entertainment
2. **Travelling and hospitality**
   The good life – curiosity
3. **Aspirational products**
   See me - confirm me

URBANISATION

Cities scale. At this stage, the benefits of scale for a city have no limits. Big cities like Shanghai, London and New York continue to grow even at their stages of development. Why? The rule of 15 is a reflection of the fundamental dynamics of city growth. A city of 10 million people only needs 85% of the roads, pipes and wirings compared to the sum of two cities with five million people each, thus saving 15% of key infrastructure needs. The number of ideas measured in patents, in crime incidents, and the wealth per individual is 15% higher in cities of 10 million people versus patents, crime and wealth per individual in the two five million people cities, on average. These numbers are coming out of research from the Santa Fe Institute and are a consequence of connectivity and network effects in cities. Cities will scale over the next 30 years because of these network effects, and it is likely that megacities will emerge with populations of 30, 40 and 50 million. China is working on a long-term plan (Diamond Five Metropolitan Areas) where the Shanghai-Hangzhou-Nanjing area is interlinked and will eventually house 63 million people.

If done intelligently, urbanisation will support overall growth in an efficient and more suitable way, and massive urbanisation will melt together with energy efficiency and be more sustainable with positive effects on the overall health of the planet. Think big – think megacities.

With cities getting bigger and smarter, there are opportunities for companies exposed to:

1. **Cities growing higher, wider and more intelligent**
   Soft and hard infrastructure (elevators), public transportation, design/planning
2. **Creation of social connectivity**
   Connecting in the urban jungle on/off line (the 21st century cafe), activities, the neighbourhood platform
3. **Solving problems of higher levels of crime, stress and waste in cities**
   Security, surveillance, recycling, going green

INDIA

The pattern of the growth of India over the next 30 years is likely to replicate what happened in China over the last 30 years. Despite the fundamental political and cultural differences between India and China, there are very important similarities. Strong leadership in both countries share the goal of broader prosperity and progress. Societies evolve in an environment of trust to institutions, and corruption is a key structural obstacle for growth in a nation. Both countries try to reduce the levels of corruption. Both countries use technology to increase efficiency and improve governance structures. There is a hunger for a better life in these two vast countries with a strong entrepreneurial spirit.

Most people would agree that corruption at the highest levels in India has reduced dramatically since Modi took over and with hard working, tech conscious politicians driving growth forward. Three specific initiatives are creating a very solid foundation for more growth and less corruption in India:

1. Biometric banking and financial inclusion;
2. Housing for all; and,
3. Simpler online based tax system (General Sales Tax).

Two-thirds of the population in India is under 35 years old and the average age of the first home buyer is 38 years, according to the housing finance company HDFC. Financial penetration is low. Meeting a group of female microfinance borrowers in Delhi is a reminder of the good and important role of banking - greasing the wheels of growth and giving entrepreneurs the means to realise the dream of opening up a business. The financial inclusion project is an important foundation for growth in India.

Urbanisation there will continue and move a further 100 million people (32% to 40% urbanisation rate) to the cities over the next 15 years. The number of people in the working population continues to grow and this number will surpass the working population in China within the next 10 years. India's Gross Domestic Product (GDP) is one fifth the size of China's and level with the GDP of France today, with a population that is more than 20 times bigger. That will change.

India will become the third largest economy in the world again, joining the top three with China and the United States as the biggest economies in the world, over the coming decades. This is not reflected in market indices today. HDFC has a similar market capitalisation to Nordea, which serves a market with 100% mortgage penetration and a population of 25 million in the Nordic region. India has 9% mortgage penetration and 1.2 billion people. Benchmarking to the future rather than the past should guide investors to a markedly higher exposure to India.

STRATEGIC STOCKPICKING - LASTING INVESTMENTS

A list of companies that have been around for centuries is dominated by businesses exposed to timeless products and services that are still highly relevant today. The fascinating list is dominated by hotels, breweries and restaurants with mostly Japanese and European companies. Sean's Bar near the River Shannon in Ireland is one unlisted example – probably dating back to year 900 A.D., according to the Guinness World Book of Records. Companies providing products and services for basic consumption needs are lasting investments and a relevant hunting ground for strategic stock picking. A number of the big market cap companies of our time cater to basic needs and were established in the late 19th century. Companies like Johnson & Johnson, Nestle, Proctor & Gamble, Anheuser Busch and Coca Cola are more than 120 years old and still strategically well positioned.

Increased access to information and cross border trade, combined with accelerated technology shifts, has led to a more competitive environment across most sectors. The so-called technology sector dominates the top of the market indices today. An investor has to be very selective here, again depending on the strategic positioning of the individual company, the thematic long-term picture, and the actual nature of the product or the service that the company provides. Both

Microsoft and SAP have turned 40 and it has been rewarding to follow them for a decade or more, despite the technological changes impacting them.

The car sector has faced big changes over the last 100 years and the next 30 years are probably going to be even more dramatic. It is hard to identify who the winner will be in this capex intensive industry and, at this stage, where a fundamental shift to electrification takes place, strategic stock picking risk is high.

Dividends are an important part and a long-term driver for returns in stocks. Aside from the obvious fact that dividends are the direct cash flow for the stock investor, experience and academic studies reveal that dividends have a disciplinary effect on how cash flow is being reinvested in the company – the capital allocation dimension. Having a bias towards disciplined capital allocators really matters for a truly long-term investor. Sustainability and growth in dividends are more important than a high dividend. Some sectors and companies need to have a high dividend to be able to attract capital. The high dividend can be an illusion if the company does not generate the underlying returns on capital and growth that creates the cash for the cash dividend. Investing in growth could also mean participating in companies that do not pay a dividend because the long-term business opportunity needs capital in order to build a strong strategic position.

Investing in growth in a more aggressive way could also involve investing in smaller companies to get maximum exposure. In the earlier part of the evolution of a theme, there might only be smaller companies available. Equally, at a later stage in the life of a theme, there could be a strong smaller contender that would be interesting. The risk is typically higher in the smaller and mid cap segment and hence this must be taken into overall consideration.

If a company wants to have a long life, it needs to behave and be a good and responsible citizen. The last few years have institutionalised this with the concept of SRI (Socially Responsible Investment) and ESG (Environmental, Social, Governance). The world is now more precise about this area than ever before, supporting overall thematic developments. It is important to take the strategic view on ESG issues. When engaging with companies, it makes most sense to have disciplined follow-up on ESG issues and focus on understanding and eventually debating the strategic plans for the company, instead of putting pressure on management to live up to short-term earnings numbers on a quarterly basis.

One belief is that the right management team is more aligned and will make better decisions in a strategic environment.

There are themes and stocks that last for decades. In a world that thinks more short-term, there is another direction - thinking longer-term - to find companies which grow markedly and sustainably bigger over time. Short-term benchmarking and performance measurement can act as a serious constraint for strong risk-adjusted return generation. Benchmarking to what the world is going to look like in the long-term changes mindset and has direct portfolio construction consequences. It focuses on what is essential. And, it is simpler to make decisions in the longer term mindset as opposed to having to optimise both short-term and long-term views at the same time.

Einstein expressed that "we must learn to differentiate clearly the fundamentally important, that which is really basic, from what is dispensable, and to turn aside from everything else, from the multitude of things, which clutter up the mind and divert it from the essential".

In its purest form, this is strategic investment. Whether the investment horizon is three to five years, 10 years or even 30 years, it is likely investors will benefit from taking a generational perspective, by thinking about the universe of themes and stocks for generations to come. Even though the sirens tempt towards short-term thinking, another perspective is to stay on course for the benefit of longer-term investment.

Portfolio Construction Forum

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