



# INSYNC OUTLOOK

SEPTEMBER 2018



## In Brief:

**The protected fund returned -1.03%.** After the cost of protection, for the month of September compared to +0.4% for the benchmark. **Year end of September the fund is up 21.17%**, after the cost of protection, versus the benchmark of 19.18%.

**The Long-Only** unprotected option posted -0.83% for the month.

**Positive contributors** for the month included Boston Scientific, Intuit, Stryker Corp, Visa and Twenty-First Century Fox. Main negative contributors were Heineken, S&P Global, Paypal, and Facebook.

**A booming US economy has driven US stocks and Treasury yields higher this quarter**, leaving US equities outperforming most of the other major markets. In September, US consumer confidence hit its highest level since 2000, while the monthly average of initial jobless claims fell to the lowest level since 1969. Wage growth rose to the highest level since 2009, supporting retail sales growth of over 7% year on year. Emerging markets continue to be volatile and performing poorly.

**The EM economies that are most reliant on external funding are finding the tightening in US monetary policy challenging.** As the Fed continues to raise rates and unwind its balance sheet, EM countries with large dollar-denominated debts and significant, or widening, current account or fiscal deficits may continue to struggle. Our experience shows that whilst problems often start small in emerging markets this typically leads to contagion across the whole emerging market complex. This time is no different.



## Currency and Options

The Fund continues to have no foreign currency hedging in place as Insync consider the main risks to the Australian dollar to be on the downside.

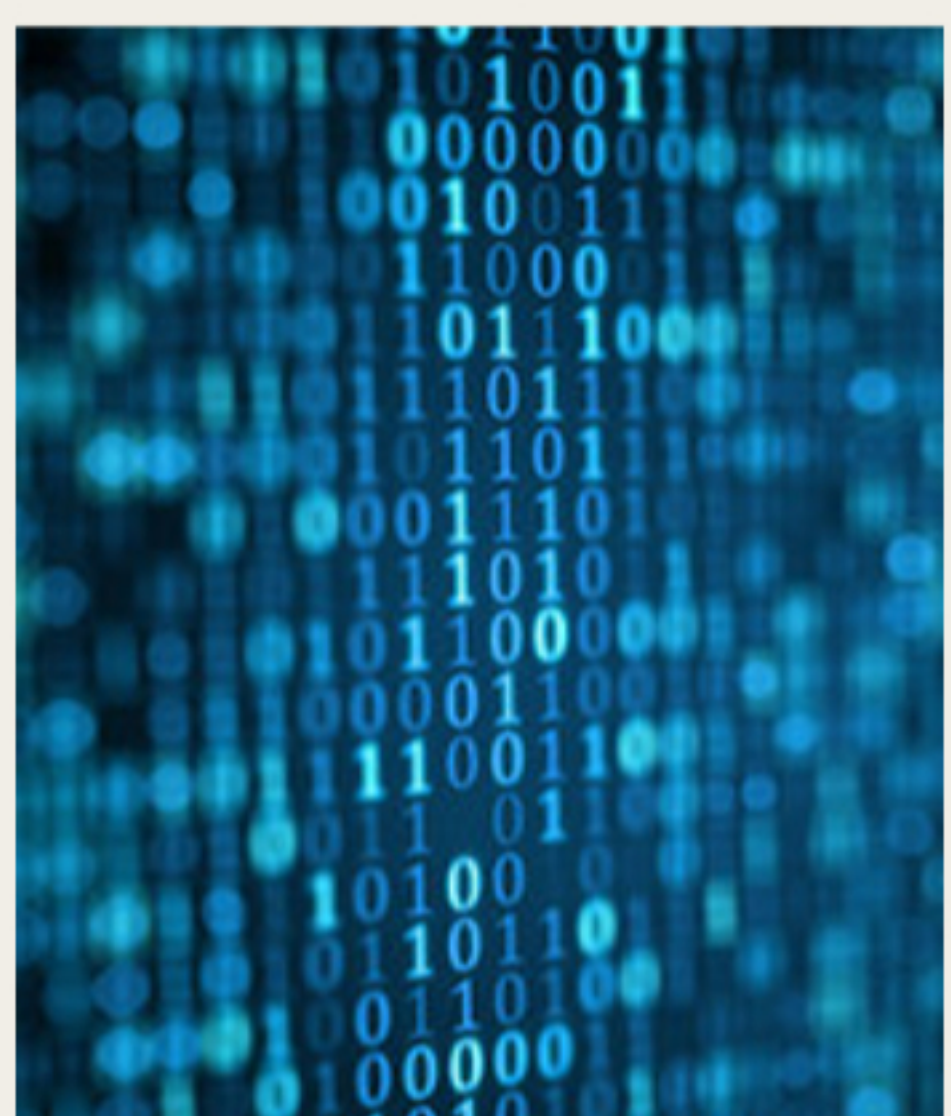
Insync continues to utilise 'out of the money' index put options to buffer sharp falls in equity markets for the protected option of the fund.

## Digitisation Megatrend: Unstoppable and highly disruptive

Perhaps the single most important thing we think about is the potential for technology to disrupt industries and erode franchises and moats, not just within the technology industry itself but across all the sectors we invest in. Whilst this has been occurring for centuries, it is now the staggering speed at which it occurs that is the big driver of why disruption is so much in focus when investing.

**Digitalisation is a megatrend that is influencing the building of future society.** Digital refers to the broad wave of enterprise technology aimed at 'the creation of new business models and processes by integrating technology with the physical world. When studying companies (in various industries) in detail, we notice that "digital companies" differ from "traditional companies" in the way they are managed and governed. Speed is built into the company's DNA to quickly respond to new customer demand, competition or trends.

The question is often how to minimize existing bureaucracy to allow for innovation and creativity in product units working close to customers. Too much bureaucracy, processes and control will have the opposite effect. However, "traditional companies" have been built in a different, predictable and slow, market condition, one where productivity, stability and control are the starting point for decision making processes. When the "traditional companies" clash the digital market with "digital companies" the outcome is uncertain. In fact, many "traditional companies" may well not survive the digital revolution because they simply cannot handle the speed of change.



## Digitisation: Exponential growth

Global digital transformation market is expected to grow from US\$445 Bn in 2017 to US\$2.3 Tn by 2025.

A CAGR of 24.3% from 2018 and 2025.



## A close shave: Disruptive example in action.

The rapid speed in change can be found in the razor industry. It was characterised by a highly stable market for decades with a clear market leader in **Gillette** (bought by Procter & Gamble for US\$54bn in 1995). This was until **Dollar Shave Club and Harry's** came on the scene in 2011 and 2013 respectively. Dollar Shave Club introduced a subscription model for razors to the world in 2012 with a slapstick YouTube video, in which he railed against high-price blades and deadpanned: "Our blades are f—ing great."

This led to substantial price drops and market share loss to the leader in the razor category, Procter & Gamble, ceding circa 16%+ market share over a 6 year period. By 2015, Dollar Shave Club was the number-one online razor company with a 52.4% share of the market, compared with Gillette's 21.2%. **Many traditional companies, that were labelled enduring companies because of their history** (Gillette was founded in 1901), are being rapidly disrupted and struggling to adapt to the tidal wave of disruption that digitisation is creating.



**A Portfolio Beneficiary:** Accenture is benefitting from the rapid increase in spend that companies are having to make to digitally transform their business. Accenture is a global professional services company, providing a broad range of services and solutions in strategy, consulting, digital, technology and operations. Their importance as a critical business partner is reflected in the fact they serve more than three-quarters of the Fortune Global 500 and 95 of the top 100. Their top 100 clients have been with them for at least five years, and 98 have been clients for 10 years or more. In common with existing holdings in the fund it has a high return on invested capital clearly benefitting from a global megatrend.

## Our Core Approach

All in all we remain positive on our stock holdings of highly profitable companies that will continue benefiting from global Megatrends® despite trade wars and rate rises. Our valuation approach, which seeks to capture the long-term growth of these companies, continues to show a valuation discount. We focus on investing in quality growing companies with a long 'runway of growth' that are less sensitive to the fluctuations of the global economy. Should markets continue to perform, the portfolio of stocks will participate in the rally. Importantly, if the market suffers a significant correction then we have our downside strategy in place for those in the protected option.

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