POLEN | CAPITAL

iM Global Partner.

TIME TO CONCENTRATE: WHY FOCUSING ON A HANDFUL OF WINNING BUSINESSES CAN BOOST RETURNS AND MITIGATE RISK

Can you explain the Polen U.S. Focus Growth and Global Growth funds? How are they different?
Dan: The Large Company Growth team here in South Florida manages three different products: U.S. Focus Growth, Global Growth and International Growth, which is an ex-U.S. product. All three of these products are managed with the same investment philosophy and process, executed by the Large Company Growth team, and are available for investment as Separately Managed Accounts. The U.S. Focus Growth and Global Growth Funds are both available as UCITS as well. Each fund is concentrated in around 20-30 of the highest quality businesses and we have a long-term investment horizon, with an average holding period of five years. This allows us to generate returns through compounded earnings growth.

The differences between the U.S. Focus and Global Growth funds is primarily geographic. There's far more similarities than differences. The US focus fund is more than 90% US-based companies. For the global growth fund, which Damon and Jeff Mueller co-manage, they can go anywhere in the world to find the best companies. They, of course, have to think about country, currencies, government policies, etc., to manage a global fund, but they have a bias for globally competitive and globally dominant businesses, which are predominately earning in either US dollars or in a broad basket of currencies.

Growth has really outpaced value, especially since the global financial crisis. Do you see that continuing?
Damon: We're really careful about making market predictions as that is not what we do. But we would note that we think there is good reason for many growth companies to continue to perform well despite having significantly outperformed over the past many years. That's because it's earnings growth that drives returns and we believe many of these businesses continue to offer strong growth prospects. If you look at any index over a period of time, the vast majority of the returns come from earnings growth, and then of course dividends.

That should become even more apparent now that central banks are winding down monetary stimulus. As the liquidity tide that has lifted all boats recently recedes, we think earnings growth will be needed to drive returns from here. The companies we invest in grow their earnings at more than twice the rate of the S&P500 or any other market index. So we do believe that our growth companies can continue to outperform.

One thing that puts investors off growth companies are high valuations. What metrics do you use to value companies and be discerning?
Dan: We actually do use some traditional metrics like price-to-earnings, but the way we approach it is slightly different. To estimate the future returns that we will earn on an investment, we come up with a reasonable, if not conservative, estimate of what we think earnings will be in five years, we apply a reasonable multiple to those earnings and then discount that back to today. Fortunately, most of our companies are extremely stable companies so it's not too hard to predict, at least within a range, what their earnings are going to look like five years from now. The harder part is predicting what the price-to-earnings ratio is going to be five years from now.

But we never make assumptions that it will go up. We only assume they're going to be flat or down because most companies do see compression over time as growth slows. With any given investment we aim to earn at least a double-digit annualised return, while being positioned to earn even higher returns in the overall portfolio.

Both of the funds are very concentrated. This help you produce alpha?
Damon: Yes, we do believe that concentration is a big advantage. Taking meaningful positions allows the winners to really contribute and by concentrating in only the highest quality businesses we have been able to limit drawdowns in the past 30 years too. We've witnessed some big drawdowns over the years, and we can see very clearly the power of a concentrated, high quality portfolio.

We believe protecting capital during challenging periods is an important part of compounding capital over time. If you have significant losses, you need even more significant gains to recover, so capturing less of the downside can be just as important as picking winners. Fortunately, concentrating the way that we do, in only the highest quality companies, has allowed us to do well on both counts.

What companies do you look for? Where are you seeing the best opportunities?
Damon: The companies we look at must meet our strict criteria: extremely strong balance sheets, abundant free cash flow, ROE of 20% or greater, strong earnings per share growth, stable to improving margins and a shareholder-oriented management team.

Those factors really screen our universe down. By using those metrics, you find that there are more companies in certain industries than others. Tech is certainly one of them, as are healthcare and consumer stocks. This means we look nothing like an index, of course, and all our funds have very high active share. We do end up being tilted towards a handful of sectors. We're okay with that so long as we find superior companies.

DAN DAVIDOWITZ
Head of Large Company Growth Team
Focus Growth Portfolio Manager

DAMON FICKLIN
Portfolio Manager & Analyst
Focus and Global Growth Strategies

Both funds have performed well. How are investors using them?
Dan: Both funds have strong track records. We're happy that they've been acting as expected – and in line with our focus on earnings growth.

As to how clients use the portfolios, I would say it actually differs a bit in the US and outside the US. As expected most clients want upside participation and downside protection, especially now that we're nine years into a bull market.

However, for the US fund, and especially within the US, people are using us to complement their passive holdings – particularly because we're a high-quality manager, with high active share and offer something different. And both funds offer a highly concentrated approach that can give investors access to what we believe to be the best names in the US and across the world.

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