

Go for growth or value in a global upturn?

THE GREAT DEBATE



GROWTH

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As the current bull market enters its sixth year, investors may wonder where to find growth in a maturing bull market. Valuations are richer than they were a year ago, but interesting growth opportunities still abound globally.

It is critical to never abandon valuation discipline. It can be tempting to try to capture 100 per cent upside in a strong bull market, but doing so can result in a portfolio of over-valued stocks that materially underperforms when the next downturn hits.

Investors can mitigate this risk by investing in franchises – firms with a combination of moat-like features protecting them from competitor encroachment, such as leading market share, material intellectual property, a defensible brand and/or a low-cost advantage. Once identified, it is

important to buy franchises at reasonable valuations.

Finally, stocks follow profits. Regardless of the macro environment, if you can find where profits are likely to accelerate, you can find good growth opportunities. The following are several powerful global trends that have the potential to contribute to profit acceleration for well-positioned firms for some time.

Industrial process innovation: In emerging markets, wage inflation is driving up labour costs. In developed markets, consumers are demanding increased safety and quality. These factors, combined with a dearth of trained labour, are contributing to an increased use of smart industrial robots and automation – a new industrial revolution – as firms aim to increase quality, precision and output in a scalable manner while managing labour costs. For example Sweden's Hexagon is a provider of design, measurement and visualisation technologies used to increase productivity and speed design engineering.

Biopharmaceutical innovation: Massive gains in the understanding of human genetics has shifted the biopharmaceutical industry towards increased development of new drugs that are often more effective, more targeted and less toxic. To reduce the 'binary event' risk that a firm's only pipeline drug doesn't get approved, consider firms with a strong current product cycle and a pipeline supporting additional waves of growth behind it. Regeneron Pharmaceuticals has a leading vision-loss treatment drug in Eylea and a pipeline of promising therapies for high cholesterol, allergic diseases and rheumatoid arthritis.

Mobile internet: The proliferation of 'smart' devices is making cheap and powerful handheld computing commonplace. Internet mobility is reordering a number of traditional industries including retail and

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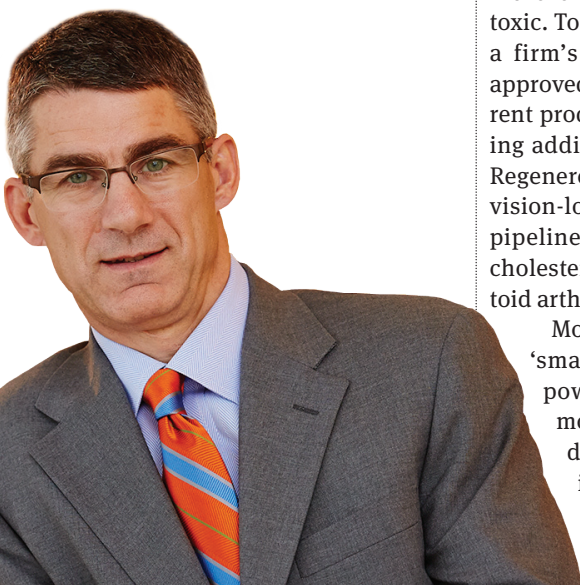
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media. Even business software has changed as firms shift to on-demand, flexible cloud-based software. Firms with exposure to this trend include Baidu, China's leading internet search provider, which is focused on monetizing its mobile platform and increasing user engagement.

Golden age of natural gas: Technological gains in horizontal drilling and hydraulic fracturing has made extraction of hydrocarbons from unconventional sources economical, causing an energy renaissance in much of North America. IEnova, Mexico's largest private pipeline operator, has assets strategically located near and interconnected to the US market, and it could benefit as Mexican energy reforms opens that market to private investment for the first time in over seven decades.

The rise of emerging market consumers: Emerging market incomes are rising, and a newly emerging middle class is demanding more and higher quality goods and services and increasingly spending on leisure activities. Great Wall Motor Co – China's largest SUV manufacturer – has enjoyed particularly fat profit margins as Chinese consumers mimic US demand for 'bigger-is-better' vehicles.

Identifying strong franchises at reasonable valuations on the cusp of a profit-acceleration cycle can help investors find profitable growth where ever it occurs globally. ●



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