April 2020

InFocus

Aberdeen Standard Small Companies Fund

Key features

Consistent long-term outperformance with high downside protection	Bias to quality stocks with underappreciated potential for compounding returns	We favour fundamentally strong businesses with low correlation to one another

"We believe investing in quality works, given that the market systematically underestimates the sustainability of returns from high-quality companies."

Michelle Lopez
Head of Australian Equities, Aberdeen Standard Investments

1. Market outlook

The COVID-19 pandemic has spurred a truly coordinated effort by the Reserve Bank of Australia, government and regulators to keep the economy and capital markets solvent and in a position to recover once the disease has been brought under control.

The RBA slashed interest rates to a record low of 0.25% to support employment and economic activity. At the same time, the federal government launched the largest fiscal stimulus this country has seen in 50 years – at 10% of national GDP, or $192 billion and counting. State governments also unveiled stimulus packages worth $15 billion to date. It underlines how materially lower government debt is in Australia than other markets, providing it with enviable firepower. In addition, China – Australia's largest trading partner – is in good shape owing to its effective response to COVID-19. Chinese authorities prioritised timely liquidity management and targeted fiscal measures to support sectors under most strain. Australia is well placed to benefit from this fiscal support as the Chinese government shifts focus to reinforcing its economy. Rising consumer wealth in China remains supportive of demand for high-quality products in which Australasia has a unique selling point. We remain wary of the impact on holdings directly exposed to consumption, travel and education. But, as always, we aim to look beyond volatility and accumulate positions in quality companies with strong management teams, healthy balance sheets and upbeat earnings prospects. They tend to be more resilient during market turmoil. We view volatility as an opportunity to invest in fundamentally strong stocks whose share prices have been unfairly beaten down. Among companies best placed to sustain growth will be those that own their intellectual property or provide services to improve productivity (see InFocus: Healthcare; Consumer Staples).

InFocus: Health Care
Fisher & Paykel Healthcare

The medical equipment manufacturer invests heavily in research and development to protect its intellectual property, helping it to generate consistent revenue growth.

Aberdeen Standard Investments

Its respiratory-care products are entrenched in hospitals worldwide, proving essential during the COVID-19 pandemic amid the scramble for ventilators and associated equipment at intensive care units. At the same time, recurring sales of its homecare products to aid breathing disorders and sleep broaden the firm's revenue base.

InFocus: Consumer Staples
Delegat Group

A New Zealand company that produces and sells premium wine domestically and globally, with North America as its largest market. Brands include Oyster Bay and Barossa Valley. We see plenty of room for future growth from its continued investment in vines and vineyards, increasing distribution into the US and a concerted push into China.

2. Benefits of being active

We work to build a portfolio of businesses with low correlation to one another. Of course, sector representation against a benchmark can be misleading. We are overweight in financial and real estate sectors, for example, but we don't invest in banks, or in companies highly leveraged to residential property prices. Our exposures are highly diversified. In financials (see InFocus: Financials), we invest across wealth management platform providers, an insurance broker, an asset manager, a private health insurer and a stock exchange. Our real estate exposures similarly span commercial warehousing, petrol stations and property developers. Our largest overweight is in information technology. Still, we only invest in IT companies that own their intellectual property. In many cases they have disrupted their industries to strengthen their market share (see InFocus: Information Technology). Separately, our largest underweight is to materials, given our difficulty in finding high-quality businesses in this market segment. Many are single asset or single mine companies with very volatile cash flows and high operating risk. We do invest in mining services firms Lycopodium and Monadelphous, but they have diversified earnings and their share prices aren't as closely tied to volatile commodity prices as mining firms themselves. We recently initiated a position in gold miner Saracen Mineral Holdings. We view its growth profile as attractive, together with its strong balance sheet and experienced yet nimble management team.

InFocus: Financials
NZX

The firm runs the stock exchange at the core of New Zealand's financial markets. It facilitates capital-raising, secondary trading and securities settlement. It also operates a passive fund management business and a wealth technology platform, providing income diversity and complementary growth. It adds up to an attractively defensive business with a predictable earnings stream. Increased trading during market uncertainty – such as during COVID-19 – enhances the company's profitability.

InFocus: Information Technology
Appen

A global leader in developing machine-learning datasets for mobile devices, digital assistants, vehicles, law enforcement, search, social media, ecommerce and consumer electronics. One key competitive advantage is scale as it covers more than 130 countries and 180 languages. With a strong balance sheet and recurring revenues, it is well placed to leverage on structural tailwinds for data usage and artificial intelligence that look set to persist for years.

3. Process of outperformance

Our active investment process has enabled us to deliver an annualised outperformance of more than 800 basis points a year against the benchmark over the past decade (see performance table below). We look to explit market inefficiencies based on our own research and analysis. Company fundamentals drive stock prices, yet are often priced inefficiently. We believe investing in quality works, given that the market systematically underestimates the sustainability of returns from high-quality companies. These firms have fewer tail risks and a greater margin of safety. Their earnings also tend to be more resilient, leaving them better placed to navigate market uncertainties and capitalise on opportunities to create value. We incorporate environment, social and government (ESG) factors into our investment process both as a way to manage downside risk and as a source of alpha. We have ESG analysts in our team, supported by a centralised ESG function. We actively engage company managements to drive corporate improvements, protecting and enhancing the value of our clients' investments.

Our heaviest overweight is to IT stocks, but we are very selective. We look for IT companies whose products are already embedded in organisations, making them difficult to replace. We also favour firms with competitive advantages they can sustain or strengthen; that have large addressable markets, at home and abroad; and that own their intellectual property. We work in sector pods across our global investment team, discussing factors such as scale, intellectual property and barriers to entry to understand what drivers a business is subject to. We have an overweight to REITs, which have held up exceptionally well over the past year. That is not just a function of the record low-rate environment, but also because these are typically defensive assets that derive income from long-term leases with anchor tenants including the likes of Woolworths, Coles, Bunnings and DHL.

10 year performance (p.a.)

	Gross	Net
Fund	12.90%	11.50%
Benchmark	4.38%	4.38%
Relative	8.52%	7.12%

Source: Aberdeen Standard Investments, end Feb 20.
Performance figures are calculated using end-of-month exit prices, reflect the annual reinvestment of distributions and make no allowance for tax.
Past performance is not a reliable indicator of future results.

Contact us

Client Services Team

Telephone:
1800 636 888 or +61 2 9950 2853 if calling from outside Australia

Email: client.service.aust@aberdeenstandard.com
www.aberdeenstandard.com.au

Important Information

Visit us online
aberdeenstandard.com.au

AU-070420-114146-3

Aberdeen Standard Investments