POLAR CAPITAL

Q&A with Andrew Holliman, Lead Fund Manager, Polar Capital North American Fund

Finding compounding opportunities across the world's greatest stock market

Q: Gary Corcoran (Head of Corporate Communications and Content): How has the market concentration that has dominated the US market recently impacted how you run your portfolio?

A: Andrew Holliman (Lead Fund Manager, Polar Capital North American Fund): It has been a big feature of market dynamics in recent times. For the past several years, but particularly this year, we have had record market concentration levels – on some data we have seen, going back 160 years. That change in concentration can be frustrating for an active manager because it is mathematically harder to keep up. However, we are very much committed to taking an active approach to fund management. By that I mean we focus on companies based on their merits, first and foremost, not on their size.

There are a few reasons for that. First, it makes sense to focus on the ultimate drivers of the investment, which we think are what a business can compound at in the long term, but also the price you pay for it is more important than the size of the business by market cap. To us that just makes sense. Second is a key plus point about being an investment manager in the US market – the breadth and the choice you have. We have over 1,500 companies that we can invest in from a liquidity perspective. It makes sense to fish in that larger pond and it means you are going to have greater access to more opportunities that can have good growth prospects or are trading at attractive valuations. Finally, it provides a greater diversity of companies with long-term value drivers so you are not dependent on one or two themes.

Q: GC: We are seeing signs of softening in the US economy. How is that affecting the business environment you are investing in?

A: AH: We have seen some signs of softening, particularly in the past few months. We have seen the low-end consumer really starting to struggle. Perhaps that is just an accumulation of the inflation we have seen in the past few years, of higher interest rates and maybe running out of fiscal stimulus? We have seen some weakness in the commercial real estate market and weak housing activity, which is again related to higher interest rates – which went from very low to very high levels. More recently we have seen weaker commodity prices as well. That has a bit of an impact on some of the businesses we are investing in, but it is not something we are worried about structurally. It is just the natural ebbs and flows of the economy and possibly the result of where we have been in terms of the prior environment, going from a very low-rate environment to a very high-rate environment. At least we are probably at the right end of that directionally, so even though we may be seeing one or two companies facing a few higher headwinds, we are still very confident about the portfolio's progression.

We think this year that, again, it will compound business value around a double-digit level. By that we mean a combination of either earnings per share growth or cashflow per share growth plus dividends. That is continuing the trend achieved over time: since the launch of the Polar Capital North American Fund nearly 13 years ago, it has compounded business value at c11% per annum, which is far in excess of the benchmark and the average company in the US[1]. We are still very confident that will continue in the short term, but also in the long term. To put that in context, if you do that and achieve that compound annual growth rate, that is a tripling of business value over 10 years and about an eight-fold increase over 20 years. We think if the portfolio continues to do that from the current attractive valuation levels the portfolio is at, then that should result in attractive returns for shareholders, both from an absolute perspective and against the benchmark over the long term.

Past performance is not indicative or a guarantee of future returns.
Source: Bloomberg and Polar Capital, December 2023. **1.** Business Compounding calculated as the difference between Fund (or Index) change in NAV less the change in the Fund (or Index) weighted mean forward 4Q PE ratio over the equivalent period. Fund NAV grossed up to adjust for annual OCF charges plus cash drag from launch. Data is provided for illustrative purposes. All opinions and estimates constitute the best judgment of Polar Capital as of the date hereof, but are subject to change without notice, and do not necessarily represent the views of Polar Capital. Forecasts contained herein are for illustrative purposes only and does not constitute advice or a recommendation.

Q: GC: One topic you obviously cannot avoid is the US election. How have you reacted to all the noise of the past few months and how important is it to you who wins?

A: AH: The noise is fascinating, but we do not react to it because we are focused on the businesses we are investing in. I think it is going to be a fascinating election and it is probably too close to call. It is interesting that you have an incumbent party against an ex-president. Markets do not like uncertainty but in this case they are not really getting anything they have not seen before. Certainly, when we speak to the businesses we invest in or other businesses, they might not be enthused about the election but they are not greatly worried.

There are a couple of things that we are looking at, though. Donald Trump is maybe putting more emphasis on tax reductions and lower spending; and the Democrats and Kamala Harris are perhaps focusing on increased taxes and higher spending, particularly on corporate tax rates. Harris would like to increase the domestic corporate tax rate to 28% and Trump would like to lower it. That will have an impact on the value of businesses over the long term, but we do not think it will be a significant one and the portfolio is not skewed one way or the other.

Of course, the other big difference or talking point is tariffs. Trump is much more – although some think a little more – aggressive than the first time around on tariffs. He has been talking about some pretty draconian tariffs. Then again, the Democrats have also not exactly been supportive of globalisation in the past few years. That kind of environment is not necessarily good for global economic growth and not good for all businesses, but for some domestic businesses it is probably pretty supportive. One feature of the US political system, however, is there are lots of checks and balances – you often get a balanced Congress, for example – so you do not really get too many surprises in terms of big policy changes.

The final and most important thing is that this will be the seventh presidential election in my career and I cannot think of many or any of the businesses we have invested in – or certainly not the biggest winners or even the biggest losers – which have been shaped by who has been in the White House at that time. That again gives us some confidence that this election should not keep us awake at night. In general, a feature of the US market is that most businesses are immune from politics.

Q: GC: Where are the most immediate opportunities? And can you give us an idea of your longer-term outlook?

A: AH: We continue to find opportunities all over the market, across different industries and the market-cap spectrum. That is one of the beauties of the US market and, related to that, we are seeing different drivers of compounding of businesses as well. So we are investing in companies that have great opportunities to expand organically and reinvest in their own business and are growing their top line at a very attractive rate. An obvious example would be Amazon, which everybody knows about, but there are also less obvious ones such as Interactive Brokers, which is disrupting the online brokerage market on a global basis. We think these could compound for a very long time at high rates.

We are also investing in businesses that have terrific records of growing by expanding through acquisitions. One example of that is Constellation Software – which has been in the portfolio for five years – which we think has perhaps the best capital allocation record of any business we have seen, whether it be in North America or the rest of world. We think it has an ability to reinvest at attractive rates for many, many years to come.

We are also seeing opportunities to invest in businesses where the value creation is coming from capital return, whether it be buybacks or dividends. A recent example there is Lowe's, the home improvement business, which has returned 7% of its market cap per annum to shareholders in the past five years.

While in recent years, a lot of the plaudits have gone to a select band of very large companies, and deservedly so, we think there are some great opportunities outside those companies and we think it is very important that investors get access to those businesses.

Finally, I would say we like the appealing compounding potential of the businesses we have access to, but we can invest in the businesses that have an attractive valuation. We take a holistic approach to valuation and do not think everything should be looked at from a multiple perspective, but we can get access to the attractive compounding potential of these businesses at appealing valuations. If you look at the aggregate valuation, the portfolio trades at about mid-teens earnings and free cashflow on a forward basis. We do not think earnings multiples are everything but, given the compounding potential of the portfolio, we think that is an indication that it is very well set for future attractive returns.

Andrew Holliman

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Find out more

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