Empire Life webinar – Exploring Growth Opportunities with the Empire Life Global Growth GIF
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PRESENTATION

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Thank you and good day everyone. I'm Paul Holba. I'm Senior Vice-President, Chief Investment Officer at Empire Life Investments. On behalf of everyone at Empire Life, I want to welcome you to our webinar Exploring Growth Opportunities with the Empire Life Global Growth GIF. Today's date is November the seventh, 2023, and I'm joined by David Mann, Senior Portfolio Manager and lead Manager of our new Empire Life Global Growth GIF. Dave will be walking us through the global trends and factors he sees affecting markets and introducing us to the investment process and makeup of this new fund at Empire Life. The Empire Life Global Growth GIF, which was recently launched alongside the new Empire Life Canoe Global Equity GIF, demonstrates our commitment to expanding the investment choices for you and your clients within our GIF segregated fund contracts. These funds give your clients exposure to growth-oriented companies that would not be found in our existing segregated funds, which have more of quality and value bias.

Going forward, you could expect to see new differentiated funds like these being added that will allow you to better diversify your client's investments across all market cycles. Now, in addition to providing you with more investment choices for better investment style, sector, and geographic diversification, these two new funds also demonstrate a new approach to launching funds within our segregated fund contracts. To ensure that we are providing you with the best-in-class investment funds to exist within our best in class segregated fund contract, we have begun partnering with leading investment managers to provide solutions that are differentiated, yet complimentary to those of the Empire Life Investments portfolio management team. This approach to our segregated fund family has one simple objective, providing you with the investment options you need to help your clients achieve their financial goals. Whether your client has short-term or long-term savings objectives, we want to have a solution that meets their needs, regardless of the markets, or what they may be doing. So, stay tuned for even more exciting new investment funds and product launches coming from Empire Life.

Now, before we move on, I do need to remind everyone that this presentation reflects the views of Empire Life as of the day published and is subject to change without notice. The information in this presentation is for general information purposes only, and is not to be construed as providing legal, tax, financial, or professional advice. The Empire Life Insurance Company and its affiliates assume no responsibility for any reliance on, or misuse, or omissions of the information contained in this document. Information obtained from, and based on, third-party sources are believed to be reliable, but accuracy cannot be guaranteed. Please seek professional advice before making any decisions. Now, we won't be taking any questions live on today's call, but we have reached out in advance for questions, and we'll address them as part of the presentation today.

The Q and A chat will be available, so please submit any questions you may have during the webinar and a member of our sales team will reach out afterwards and answer your questions directly. Now that all that's out of the way, let's start by me introducing David. David Mann is a Senior Portfolio Manager with Empire Life Investments, has more than a decade of investment industry experience focused primarily on international equities. He's a lead manager for several of our global funds and more specifically, the Empire Life Global Growth GIF, which we are here to talk about today.

David, the floor is all yours.

David Mann, CFA,
Senior Portfolio Manager

Thank you so much for the introduction, Paul. And today what I really want to do is go through three things. First, I'm going to give you an overview of our team and our growth-focused process. Then I'm going to talk about why you should include Global Growth products, and then lastly, I'm going to talk about fund composition.

Starting with the team and process. I co-manage the fund with Ashley Misquitta, who has more of a focus on US equity. So, our skillsets are very complimentary, and we're supported by two analysts, Neeraj Khosla, who focuses on international equities, and then Brendan Mick, who has more of a focus on US equities.

Moving on to our investment process, many of you are going to be familiar with this, but there are adjustments as you might expect, as it relates to a growth portfolio. So first off, what we do is we define our universe. We have market cap and liquidity requirements, and then we have leverage requirements as well, because we don't want to operate and invest in businesses that have a lot of leverage on their balance sheet. Here, as you might expect, we want companies that are going to grow. We want businesses that are going to outgrow their peers and outgrow global GDP.

After we've identified our universe, it's time for idea generation, and there's really no single way to identify new ideas. We do it via discussions with our team, though, consistent management interviews, screening on Bloomberg and other tools. We all have a thirst for knowledge, so we read so, so much. But lastly, it is just our experience. So, as we've all been studying our respective markets for a lengthy period of time, we've become familiar with the different sectors, countries, and businesses which allows us to utilize that experience when it comes time for new ideas. And that's very handy because when we're analyzing the different businesses and industries, we already have a good foundation for doing that.

So, while we are being introduced to new companies all the time, a lot of it is just following up with investment ideas and themes that we're already familiar with. We love talking to management teams because that allows us to get a better understanding of how they see their business, their competitive positioning, and their growth opportunities. But needless to say, we do not rely on management to tell us the whole truth all the time, so we do our own analysis. In addition to speaking to management teams, we speak with analysts, expert networks, and then we have a whole host of data services that we use for proprietary research.

After we've done the analysis on a specific investment opportunity, we sometimes put it in the portfolio right away, but often put it on our watch list, where we look for a more attractive entry price or for fundamentals in the business to turn, to reflect things that we're looking for. And when it's on the watch list, it's no different than when it's in the portfolio because we're discussing our watch list, debating it, and we're ensuring that these specific businesses still merit being on our watch list, because when a company's on our watch list, we're covering it in a very similar manner to as if it's in the portfolio because we want to see if it could be an alternative to an existing portfolio opportunity.

The real difference though, when it comes to the Global Growth GIF, and let's say to Global Equity, is portfolio construction. In the Global Growth GIF, we're likely to have material sector over and underweights on a structural basis. So as one might expect we'll have very low, if any, exposure to low-growth sectors such as utilities, but much higher exposure to a sector such as information technology, where we see a better long-term growth trajectory. When constructing this fund, we're doing it in a manner, though, that's comparable to other funds in terms of our fundamental research. And for that reason, we expect turnover to be very comparable to other Empire Life Global Funds.

Onto our investment philosophy, and specifically our growth investment philosophy. We're still looking for high quality businesses, but we want them to be growth oriented. And there's a big spectrum of growth funds and growth businesses out there. So, what's really important for you to understand is that we're still looking for capital preservation. We're not looking for boom and bust kind of businesses, we're looking for businesses that have strong cash flows and healthy balance sheets, but happen to be growing faster than their peer set and faster than the economy. So, our approach is very, very simple and very similar to other funds where we're looking for bottom-up security selection. We want a margin of safety on our equities. We have a long-term time horizon. This is going to be a very high conviction fund, so there's going to be less names in the fund. And similar to our other funds, we don't rely on management or any external parties. We form our own opinions in the security selection process.

When looking at what businesses we're going to include in the portfolio, again, it's very similar. We want businesses with durable competitive advantages or a strong moat, which have long-term potential for growth and profitability. But something a little bit different that we look for is where many of these businesses are going to have disruptive potential. And when you think disruptive potential, you might think of a small, high-growth business, but it can be a large-cap, high-growth business such as Microsoft that was instrumental in introducing ChatGPT and generative AI. And very simply, we think that technology is going to have big disruptive potential. When analyzing the management team, there's no difference. We want management teams that are aligned with shareholders, that have a track record of capital allocation, and that have a track record of growing their businesses.

When it comes to growth, we are looking for a large and growing total addressable market, or TAM. If we compare two businesses, the first, I'll use Microsoft as an example of a large business with a growing TAM, and that is for simplicity, generative AI. I'll contrast that with a business that we own in the international portfolio, British American Tobacco, which is very well managed and has strong cash flows, but the growth trajectory for

tobacco is just not what it is for generative AI. And for that reason, this comes down to the security selection and inclusion in the portfolio. We have a substantial weight in Microsoft and no weight in British American Tobacco. That's not surprising because Microsoft has strong revenue growth and in an incessant focus on R and D, and that leads to a virtuous circle. The more you invest, as long as you're investing it wisely, you should be able to grow, which allows for more capital to invest back in R and D, which allows you to grow. So that's a virtuous circle of R and D.

I'm now going to move on and talk about why Global Growth, why include a growth fund in your investments? So here you can see going back 10 years, the MSCI World in green versus the MSCI World Growth in blue. For many of the years, they seem to track one another, but really as interest rates started to decline, the growth segment of the market started to massively outperform the rest of the MSCI World. With rates as high as they are, you might be asking, "Is this still an opportunity for growth or should we be all in value now because rates are higher?" And the firm answer from our perspective is to have a diversified mix, including growth. Who knows what's going to happen in the future, but I have a hard time thinking that rates are going to increase at the same level that they have. And from a balance of probability perspective, I would say they are going to be lower over the next several years versus higher. Even under a scenario with stable rates though, there are some fantastic growth-oriented businesses that have a place in anyone's portfolio.

This is one of my favorite slides in the presentation because it speaks to R and D. So, what we've done here is we've looked at the R and D sales ratio, on the left-hand side, for all companies in the Vanguard Growth ETF. And then we've taken those companies out from the S&P 500, so you can see in green on the left-hand side, the S&P R and D ratio, kind of excluding those growth companies. And you can see over the past decade, again, the R and D sales ratio for the growth businesses started at a higher level of sales, four and a half percent-ish, and they've continued to trend up. Over that same time, the R and D to sales profile of those other businesses has remained roughly flat.

Turning to the right hand side, you can see that they started at roughly the same level of R and D spend, but again, as they compound the sales growth and that higher investment into R and D, the cumulative R and D spend is now magnitudes higher for those growth businesses compared to their non-growth counterparts. And as you'll see, these types of businesses that are investing in it, investing in R and D, have outgrown the peer group.

If we switch to looking at R and D GDP on a country level, as a Canadian, I'm really disappointed by this. And that R and D to GDP as a percentage of GDP has really stayed flat in Canada for the past 20-plus years. Contrast that with China, where we've seen big companies like Alibaba and Tencent come out, Korea, that has produced Samsung and LG, and the United States where we don't need to talk about Facebook, Google, Amazon, et cetera. I challenge anyone to think of a growth business that's achieved global scale on a sustainable basis coming out of Canada. I'm hopeful that this is going to change, but history suggests this is unlikely. And very quickly, talking to portfolio construction, we have no Canadian businesses in the growth fund. Not to say that we won't in the future, but we don't right now.

Here you can see, and these are all constituents of the Global Growth Fund. You can see Apple, Amazon, Microsoft, MasterCard, Sony, Google, these are household names. Many of us use their products every day, even if we don't think we do. Sony doesn't just make TVs and the PlayStation, they make microchips that go into phones, computers, et cetera. The one name here that probably is not a household name is Novo Nordisk, and it's a pharmaceutical company that has its history really in diabetes. Several years ago, they were investing healthy levels into R and D, but that really ticked up over the past few years. And that ticked up because they saw opportunities for some of their key drugs to grow beyond diabetes. Again, so Novo Nordisk, their TAM, or total addressable market, was diabetes, but they unlocked the global obesity market through two drugs, Ozempic and Wegovy. And those are drugs that you're probably familiar with. They're advertised widely.

And what they've done is they've allowed Novo Nordisk to address an unmet need. So specifically in the United States, there's a lot of obesity, and these drugs, they're really appetite suppressants. They can safely reduce an individual's body mass index. And because of the efficacy of this drug, again, it's unlocked a whole market that was not in existence just a few years ago. They also have early mover advantage, and the market is likely to be a duopoly.

Turning to more of a global macro level, a country that we think is going to be a driver for global growth globally is India. So here you can see a GDP rank going back to 2000, where India was ranked 13th. Fast forward to 2021, and India is now fifth in global GDP, and that's likely to march higher. Because of intricacies of the Indian market, it's not easy for global businesses to have access to that market directly. So, it's absolutely critical that you're getting what we call local champions in the Indian market. It's complex to navigate from a political environment, since there's many states. So, we find that over time local companies tend to win out, and we have a few investments in the Global Growth Fund right now with a hundred percent exposure to India, and that should grow over time.

Another area that we think is going to be a driver of global growth is the energy transition. Here you can see a graph of electricity generation going back to 2000. What really stands out, up until 2010 really, is that wind and solar did not exist. So, it was largely fossil fuels and wind and solar. And what's emerged over the past 10 to 12 years is wind and solar, and we're not there yet in terms of having a structural supply of wind and solar on a sustainable basis. The higher interest rate picture has

resulted in some complications, I would say. So, the business model is still being sorted out, but as a result of that, there's a lot of investment going on. And that investment is going to drive growth not just in the end market of wind and solar power generation, but the entire supply chain below it.

And this here, this just focuses on energy transition from a generation perspective, but the clear peer is EVs, electronic vehicles. And all of the investment that is going into that market by the legacy OEMs such as GM, Ford and Volkswagen, but also newer companies like Rivian, and the obvious one being Tesla. And they are spending billions and billions of dollars to try and cement market share in the EV market. Also, not just companies are spending money, but again here in Canada, we want to have our place in the EV market, so our governments are giving big subsidies to make sure that we have good exposure to EVs, specifically on the power side, with batteries.

It really wouldn't be a growth presentation if we didn't talk about generative AI. It's still such a new concept, but it's having a lot of impact. And this is, we think, comparable in potential impact to the arrival of the internet. So, I'm not saying it's going to be the internet of the future, but the impact it can have could be similar to the internet. We don't yet know all of the areas that GenAI is going to touch. Some of the early opportunities though, are in semiconductor investment because you can't train AI without specific GPUs or general processing units. And there's a few companies, namely NVIDIA, that are highly levered to that. But it's not just NVIDIA, its capital equipment dedicated to semiconductors that will benefit because again, you need to make these chips. And there's very, very few companies that can do this, and coincidentally, they have a high market share, healthy balance sheets, and very strong cash flows.

Other opportunities are corporate efficiencies, and I'll combine the second and third point, extracting data from data pools. And a great example is a business that we own called RELX, and RELX is really, at its core, an information services business. They have data sets in the form of scientific journals, data that's used for insurance underwriters, but specifically here, they have a tool called LexisNexis, that is now called LexisAI, that's used by lawyers to really track case law over time. And they have a database of, I don't know how many thousands of pieces of case law. And what that will allow lawyers to do is to use GenAI. RELX is going to have a dedicated one for their data sets that will have access to that private data. They're going to use that data to increase their efficiency in writing new case law writing. I'm not a lawyer, but doing what they do, and kind of I would say, supplementing, or in some cases replacing, lawyers in certain elements of the legal profession.

So, again, it's very early. It's not being used as of yet, but it will be a high-growth market. It's not without its risks though, like any technology. And two of the ones that we've identified are intellectual property risk and job displacement risk. So again, RELX is a great example of that because they have their proprietary database, LexisAI, and they need to ensure that they are protecting that IP. If they're not, any web scraper can come along and get access to that data. But we've met with management, talked with experts, and we have a high conviction that they're able to protect their IP. And on job displacement, we just want to be on the right side of it, ensuring that the businesses that we invest in are disrupting and not becoming disrupted.

This here is really, it's my second favorite slide in the presentation because it really speaks to the concept of diversification. So here you can see three-year rolling returns versus the MSCI World Index- its excess return versus the MSCI World. The blue line is excess return of the Growth factor versus the World, and the green line is excess return of the Value factor, or the Value index, versus the World. You can see, as you might think, they behave in very opposite manners. I'll fast forward and talk about the period starting at the COVID time, whereby just as COVID happened, central banks, globally, didn't know what to do. They thought there was going to be a growth scare, so they cut rates materially. As they cut rates simultaneously, what was happening was people were staying at home, and as people were staying at home, you were shopping at home using Amazon more, using Google more for web search, et cetera. So those businesses were accelerating.

At the same time, for commodities, people didn't know what oil consumption was going to be. So, the former group of businesses are all growth businesses, Amazon, Google, et cetera. Whereas the energy businesses such as Chevron, ExxonMobil, et cetera, are value businesses. So, you had two forces driving that growth factor up and two forces kind of driving the value factor down. So, there was a massive dispersion in factor performance.

So, if one had a portfolio of all growth, it would've worked out really well at the start of COVID. However, the performance got to extremes, and as there was a vaccine and, more importantly, inflation and central banks had to react, there was a big divergence in factors, whereby value massively outperformed growth. So, what this goes to show, is that different factors are going to behave differently in different market environments, and I think it just makes sense, from a diversification perspective, to have exposure to both areas of the market, no different from when we're constructing portfolios. We don't have just one or two companies in the portfolio. We have a variety of businesses that we think will do well over time but also have diversified exposure.

I'm now going to compare two of our funds, the Empire Global Growth Fund on the left, compared to the Global Equity Fund. And we've just selected a few metrics for each respective fund to really show that they are very differentiated. The return on equity to start is 55, 56% in Global Growth versus 19% in Global Equity. And this is largely a mixed thing, where businesses such as Google, I'll use them as an example, sure, they have a lot of data centers, but the rest of their business is largely

capital light, in that they operate in somewhat of a software model in areas of their business. So, they just don't have that same level of invested capital as, let's say, an oil business does, where they need to go and explore for new oil all the time. And then once they have that oil, they need to extract it. So, it's just a much higher invested capital business.

So, by having lower exposure to high invested capital, or to low invested capital businesses, naturally the Global Growth Fund is going to have a higher return on equity. The beta is actually somewhat similar between the funds, and the outcome is a little surprising to me, but nonetheless, it speaks to the company model diversification that we have in the Global Growth Fund, and that they're not all levered to a single thing. Sure, a lot of it will be levered to information technology, but within that, there's a whole host of businesses with different end-market exposure. The dividend yield is much lower on Global Growth versus Global Equity. And this again, really speaks to R and D and growth opportunity, and that when a company has a dollar of cashflow, they really have two choices. Do they pay it out to shareholders, or do they reinvest it in the business?

If you pay it out to shareholders in the form of dividends or buybacks, that is going to reduce, likely, your long-term growth potential compared to a company that's retaining all their earnings and investing it wisely. So, it's really no surprise to see the dividend yield being close to 110, 120 basis points lower in the Growth Fund versus the Global Equity Fund. The price to earnings ratio, it should also be no surprise, is materially higher in the Global Growth Fund, and that's largely because higher growth businesses have often come with a higher PE ratio. And you don't need to take my word that we're investing in higher growth businesses, you can see it here in the long-term growth earnings estimates for the individual companies in the growth fund. And when you roll it up into the fund, you can see the fund has long-term earnings growth expectations of 17%.

As you can see in both funds, and this speaks to our investment philosophy, is that we're not benchmarkers, we have very high active share versus the MSCI World, but the Global Growth has slightly higher active share, or a slightly higher off benchmark versus Global Equity. As I spoke to before, it's much higher, and we have conviction in all our companies, but we just have bigger weight in businesses like Microsoft and Amazon in the Global Growth Fund than we do to the Global Equity Fund. So, there's roughly 37 stocks in Global Growth versus over a hundred in Global Equity. And what our data team is able to extract from Morningstar is that 64% of the businesses in the Global Growth Fund are classified as growth, versus only 29% in Global Equity. And not to belabor the point, but Morningstar has a score that they assign each portfolio value versus growth. Anything over 200 is growth, and with a score of 260, the Empire Life Global Growth Gift is strongly in growth territory.

Again, just to speak to the differences in portfolio construction, you can see the Empire Life Global Equity in green versus Global Growth in blue. And here you can just see the differences in exposure by sector and by geography. And here I'm just really going to focus on sector because I think that's what matters most, and that you can see the substantial overweight, or more exposure, that the growth fund has to information technology, and that is offset by no exposure to typical lower growth sectors like staples, materials, real estate and utilities.

Here you can see the top 10 for the Global Growth and Global Equity, and this is a very, very powerful slide in that on the left hand side you can see eight out of the 10 are large growth, and many of them are those businesses that I spoke to before, being Microsoft, MasterCard, Apple, and ASML. And for those that don't know, ASML makes capital equipment, or semiconductor equipment, that allows microchips to be made globally. And then you can contrast that on the right-hand side where we have healthcare businesses such as Elevance, a great business, just not high growth. Same thing can be said for Chubb, a fantastic insurance business, just not high growth, and an energy business such as EOG. So just a different way, again, of seeing the different composition of these two funds.

Here you can see, and this is from a historical basis, and I'm going to go very quickly through this, how it pays to have, in our mind, from the diversification perspective, some Global Growth and then more core funds like a Global Equity. In different environments, the funds behave differently. On a year-to-date basis, and this is specific in the US, and this relates to Magnificent Seven and some other equities, growth has massively outperformed value. So again, it pays to have a portfolio like this in your asset mix. Lastly, in terms of fund composition, before I get to some individual highlights, some ideas, you can see the top 10 here. And then on the right-hand side, we show just the MSCI World exposure to different sectors in green versus the Global Growth Fund where you can see big overweight in technology and consumer discretionary.

I'm going to wrap up by highlighting two investment ideas that we've included in the portfolio. The first being Lam Research, which is a US specialized equipment company that's used to make semiconductors. What's happened over the years is that getting semiconductors has gone from hard to very hard, and Lam is an enabler of this process, and they enable semiconductor chips to be made. And as the complexity increases, so do barriers to entry and Lam, as a function of their incessant R and D focus and their market share, they'll be able to grow cyclically, but they'll be able to grow many years into the future. That competitive advantage not only enables that growth trajectory, but also high margins and returns. They generate a lot of cashflow, and as a result of that cashflow and market share, they're able to have both very strong growth, but also give a little bit back to shareholders.

The last company I'm going to highlight is IndiaMART, and we talked about the ascension of India's GDP relative to global GDP and the necessity to have a local player. IndiaMART is a B2B business, in that it's an online marketplace that allows a customer to look nationwide for suppliers. This contrasts with the previous way of looking locally and having to go to industrial malls with different booths set up, and there was a lot of friction in that. So, it's really a marketplace like AutoTrader or anything else, but more of a B2B focus, and they're going to benefit massively from increased internet penetration at higher speeds and the shift to organized trade for more of a cash-based untaxable environment. They have very, very strong market shares. It's a CapEx light model that leads to very high free cashflow generation and a very healthy balance sheet. And I think our growth expectations are actually modest at 15 to 20%. I think they'll be able to outgrow that over the next five years.

So, what I've done here is given a summary of why you should include a growth-focused fund in one's asset mix, how we at Empire Life think about growth, and then we've highlighted a few company examples. I'd like to thank everybody for your time and your continued support, and I'm going to pass it back to Paul.

Paul Holba, CFA
Senior Vice-President and Chief Investment Officer

Great, thank you David. And just thanks very much, great oversight of our process. This does conclude our webinar today. Again, thanks to David for your insights and introduction to this new and exciting investment solution.

Now, the investment team continues to find investment opportunities across all market cycles, and you can stay informed on the team's activities through our Empire Life Investments blog, where we have our Emblem portfolios and asset allocation updates. We have videos that feature members of the team, and our recent insight into growth versus value investing. If you do have any questions on today's webinar, or any of our industry leading product choices, please contact a member of our sales team. They would be so happy to hear from you and help you out.

Watch your inbox within the next few days for an email. We'll include a replay of today's webinar that you can share with colleagues who may have missed it. We're also going to include several resources to support you with selling the Empire Life Global Growth GIF and the Empire Life Canoe Global Equity GIF. This, and many other great resources, can be found, again, on our advisor site to empire.ca/advisor. And with that, I wish you all a wonderful day, and thank you so much for your support and for joining us here today.

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