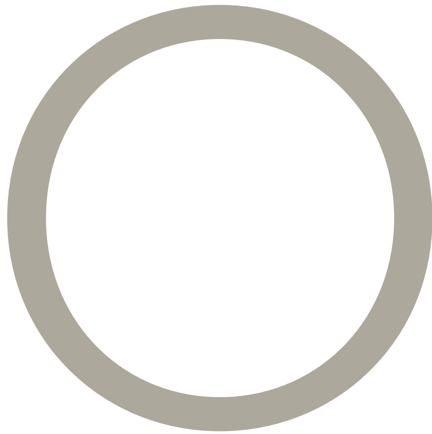
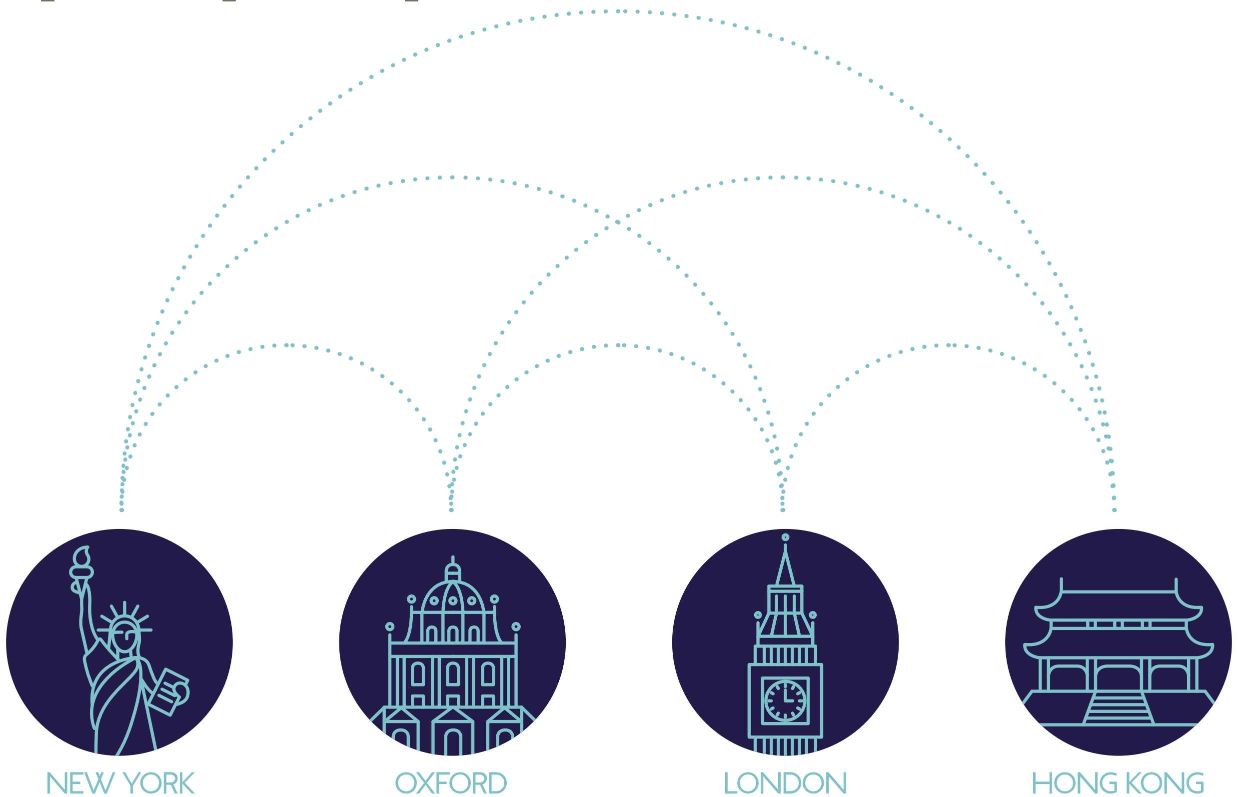


SIR JOHN TEMPLETON INVESTMENT ROUNDTABLE 2021

Global Video Conference | 10th November



JOHN TEMPLETON FOUNDATION | OXFORD METRICA

ABOUT OXFORD METRICA

Oxford Metrica is a strategic advisory firm, offering informed counsel to boards.
Our advisory services are anchored on evidence-based research in risk and financial performance.
Our work includes statistical analysis and index construction for banks and insurers, risk and performance analytics for asset managers, due diligence support in mergers and highly customised services for corporate boards.

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SIR JOHN TEMPLETON INVESTMENT ROUNDTABLE 2021

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**The old order changeth,
yielding place to new ...
Lest one good custom
should corrupt the world.**

Alfred Lord Tennyson,
'Morte D'Arthur'

**In dreams begin
responsibilities**

W B Yeats
Poems, 1914

THE PARTICIPANTS

MODERATOR
Dr. Rory Knight, *Chairman*, Oxford Metrica & JTF IASC

GUEST KEYNOTE SPEAKER
Hanneke Smits, *CEO*, BNY Mellon Investment Management

PANEL OF INVESTMENT MANAGERS
Mark Baribeau, *Managing Director*, Jennison Associates
Damon Ficklin, *Head of Team*, *Portfolio Manager & Analyst*, Polen Capital
C.T. Fitzpatrick, *Founder*, Vulcan Value Partners

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Heather Templeton Dill, *President*, John Templeton Foundation
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Dr Andrew Serazin, *President*, Templeton World Charity Foundation

MEMBERS & TRUSTEES OF THE TEMPLETON PHILANTHROPIES

FOREWORD

Dr Rory Knight is Chairman of Oxford Metrica and chairs the Investment Advisory Committee of the John Templeton Foundation. He was formerly Dean of Templeton, Oxford University's business college. Prior to that Dr Knight was the vize-direktor at the Schweizerische Nationalbank (SNB) the Swiss central bank.

Sir John Templeton's wise words, 'Trouble is opportunity' ring truer than ever. At the moment there doesn't seem to be any shortage of trouble. Investing now is indeed a complicated, fast-changing place. We live in a world in which most major economies have been locked down for about eighteen months and yet stock markets are buoyant, if not ebullient. The MSCI ACWI Index is up 35% since February last year. Quite extraordinary!

Obviously, this situation is due in no small part to quantitative easing and the tons of money poured in by the Fed and central banks around the world in order to give government support to their economies. But one wonders how long this situation can last. The Federal Reserve has now gone beyond the $8.5 trillion mark. When we started these Roundtables, the number was just under $900 million. So, it is a strange time, and there is a feeling in the air that seismic change is now afoot.

Given the dire state of most real economies around the world, nearly all of which contracted in 2020, many claim that equities are a bubble about to burst. A more optimistic interpretation is that market judgements correctly predict a rebound in real economies as countries emerge from lockdown. The truth is that buoyant prices may reflect neither bubble nor rational pricing. The answer lies not at the aggregate but at the individual stock level. Generalizations about stock-markets are no longer valid in the post-Covid world. The old order is over, and grasping that fact will be crucial for all investors even passive index huggers.

As outlined in the first section of this report, five powerful and mutually reinforcing vectors are shaping this new order. The report then provides the views of Hanneke Smits on responsible investing, an area in which she has well-informed opinions and expertise. This is followed by presentations from CT Fitzpatrick, Damon Ficklin and Mark Baribeau covering respectively the impact of the pandemic, the possible return of inflation, the state of the Chinese economy and the great digital acceleration. As part of that acceleration coda is added on the current revolution in virtual currencies.

I offer this report in the hope that all readers will find its conclusions both timely and enlightening.

Dr Rory Knight
Chairman, Oxford Metrica

THE FIVE VECTORS OF CHANGE

Dr Rory Knight

1. GEOPOLITICAL CHANGE

Once investors could ride out macroeconomic factors. No longer. In future they will ignore them at their peril. Even before the pandemic serious fissures had opened in the geopolitical landscape, and these have widened significantly since. Prominent among these are the US-China tensions escalating from trade frictions to more ominous levels, and the rise in nationalism. The Biden administration may change the tone of US foreign policy but not its direction, which will continue to revolve around rivalry with China. China for its part is signalling a more insular approach with its so-called 'dual circulation' economy, privileging domestic consumption and technological autonomy whilst weaning itself off the dollar - which will continue to decline in significance as the world's reserve currency. It is inevitable that China will overtake the US far sooner than once expected. And international capital will correspondingly shift to China.

2. THE THREAT OF INFLATION

The world financial system was already fragile following the 2007 financial crisis, and with the pandemic is now markedly more fragile. Central bank balance sheets and government debt have spiraled as a result of the recent additional stimulus outlays needed to sustain lockdown. Meanwhile, interest rates remain more or less zero, with many long-term sovereign bond issues actually offering negative yields. Compensation for taking risk is therefore at an historic low.

Any jump now in interest rates could plunge the world economy into severe recession. A Catch 22 looms. If we navigate a successful path out of lockdown, winding down government debt and central bank balances will demand higher taxes and interest rates – which in turn will further dampen economic growth. Conversely, if recovery requires more years of lockdown and stimulus, this will simply push a bigger problem into the future. With a Keynesian in the White House it will be 'spend, spend, spend', and with a monetarist in the Federal Reserve it will be 'print, print, print' – the perfect formula for inflation. High inflation causes serious damage to society, eviscerating earnings and *in extremis* serious social unrest.

3. REGULATORY CHANGES

The pandemic has seen government interventions in economies reach unprecedented heights. These may take a decade to reduce, if ever. Politicians have enjoyed a corresponding windfall of power which they will be reluctant to relinquish, providing the perfect conditions for regulation to flourish. A particular area attracting regulatory attention will be social media. Regulating these behemoths which control global social media platforms has been on the agenda for some time. A regulatory crackdown in the US and EU will likely impact on the valuations of these companies - which ironically have been major contributors to the current equity market boom. Portfolios overweight in such companies are therefore likely to be at risk. Overall, the deadweight of increased regulation could well dampen growth. Fortunately technology may prove a counterweight.

4. INNOVATION TO THE RESCUE?

Increasingly the world is driven by intellectual rather than financial capital or physical resources. Technological innovation hand-in-hand with favourable demographic trends helped keep inflation at bay over the millennium. The changes unleashed by the pandemic could well prove inflationary. Innovation, though, offers the prospect of keeping costs down through gains in productivity. Understanding how investments will be impacted by digital innovation will therefore be key. In particular, three overlapping areas of innovation will be critical to an inflation-free recovery: healthcare, artificial intelligence (AI) and cryptocurrencies.

Many believe that technology stocks valuations represent a price bubble. The evidence suggests the opposite. Technology stocks certainly benefited from the lockdown. The key question is whether these companies will continue to enjoy sustainable free cash flows in the future. Of course there are risks. A general downturn may cause tech stocks to tumble, regulation may rein in some of the large tech companies or there may be a swing away from growth to value investing placing such stocks under pressure. But the impact is likely to be transitory. Looking ahead to 2022 and beyond, pessimism may be misplaced. Generally, their values reflect markets' rational expectations of future growth. Those stocks with little debt and strong brands will continue to deliver value. Markets like humans are remarkably resilient and will inevitably bounce back

5. SOCIAL CHANGE

The fifth dimension in which there has been massive change, is the social one. Globalization lifted billions out of poverty but this has been at the cost of income and wealth inequalities within and between countries. Governments' responses to the 2007 crisis have exacerbated these gaps, with the rise in asset prices benefiting the wealthy while the poor suffered from austerity policies. The situation was already at a tipping point before the pandemic, which has further accelerated this process by at least a decade. The future will see far more strident demands for greater diversity, social justice and stronger environmental protection. We are already seeing this in movements like Black Lives Matter and the civil disobedience of climate activists. Environmental damage and climate have now become core corporate concerns, and investors are increasingly calling for responsible investing. Corporations which ignore these attitudes risk decline and obsolescence. This factor could also have a major impact on corporate returns, and investors should carefully consider their exposure to such tectonic changes.

DO GOOD, DO WELL: THE WORLD OF RESPONSIBLE INVESTING

Sir John's reflection that trouble is opportunity is indeed especially germane at this point. With controversy surrounding the playout of COP26, a whirlwind is gusting through society and business alike, shaking both corporations and the investment community at large. I want to talk about responsible investment and its opportunities and challenges in the investment landscape and, in particular its ambition to do good while doing well and to create both material and social health simultaneously. This is very much the movement of our time.

We as an organization have a history of being early adopters in applying responsible investment considerations to investment processes. But this has been accelerated by the pandemic, which has brought to the fore fundamental concerns about how society - the business community as well as governments - are addressing the environmental and social challenges of the day. We have witnessed the rise of the Black Lives Matter campaign and an increased urgency in the transition to a more sustainable economy. We believe all these movements are here to stay. The demand for collective action will endure as corporations are increasingly expected to focus on the triple Ps of *profit, people, and the planet*, and to move increasingly away from the shareholder primacy model to a stakeholder responsibility model.

In companies this takes many forms. Some companies are applying a CSR model using ESG metrics. Companies can look at how you apply specific sustainable business practices, or can go the whole hog by investing for impacts, thereby deprioritizing financial returns. But throughout all this spectrum there lies a recognition that business can drive positive change. Accepting this is the dominant issue for both the private sector, as well as the investment industry, and this has major implications for the cost of capital, operating costs, and gross revenue. We expect those issues to grow exponentially in importance for corporations and companies alike.

COP26 marked a pivotal point for the investment community because despite its inconclusiveness it helped spur what is the re-allocation of the capital urgently needed to transition towards net zero. Governments are committing increasing amounts of capital to environmental considerations, and there is equivalent pressure on the investment community, as stewards and allocators of capital. We estimate that some $90 trillion in new investment will be needed to meet the goals of net zero by 2050. That means about $3 to $4 trillion of investment or thereabouts each year between now and 2050 - though probably not in a linear fashion. And that annual figure represents an amount a hundred times greater than the inflows into climate-specific funds over the past five years!

Although there is a lot of talk about the flows needed to go into climate-specific funds that still leaves a big gap to be filled by action. The mobilization of capital is urgently needed to be addressed this decade in order to achieve global alignment between governments, regulators, asset managers, and corporations. So far the voluntary commitments and the pledges that have been made are in our view, insufficient and we believe that mandatory commitments together with greater consistency in reporting will be critical to achieving success.

Mandatory commitments would create a tipping point in accelerating the called for change in investment. Companies are beginning to embrace the social aspect of this mission, but to really kick-start the required investment, coordinated government policy is essential if the private sector is to find viable solutions within profitable revenue-generating frameworks.

Hanneke Smits is CEO of BNY Mellon Investment Management and a member of BNY Mellon's Executive Committee. With nearly 30 years of investment experience, Hanneke was previously CEO of Newton Investment Management, a BNY Mellon Investment Management firm, from 2016 to 2020. Prior to Newton, she served on the Executive Committee at private equity firm Adams Street Partners from 2001 to 2014, having been Chief Investment Officer from 2008 to 2014. She joined Adams Street in 1997 to build out its global investment capabilities, and successfully launched its presence in Europe and Asia. Before joining Adams Street, she was an investment manager at Pantheon Ventures, and worked for Philips China Hong Kong Group. Hanneke is a member of The Investment Association's board, the trade body that represents UK investment managers, and serves as Chair of Impetus, a venture philanthropy organization which backs charities to transform the lives of disadvantaged young people. As part of her role with Impetus, she is Trustee of the Education Endowment Foundation (EEF), founded in 2011 by The Sutton Trust in partnership with Impetus. Hanneke was also a Non-Executive Director to the Court of the Bank of England, and a co-founder and first Chair of Level 20, a not-for-profit organization set up in 2015 to inspire women to join and succeed in the private equity industry. Originally from the Netherlands, Hanneke has a BBA from Nijenrode University and an MBA from the London Business School.

What did COP26 actually achieve? Several positive developments have emerged, for example the pledges concerning deforestation and the pledge to cut methane emissions by 35%, and getting around half of the world's polluters to sign up to those pledges is very encouraging but it is still not enough. While it is good to see China and India making their pledges, we do not know the impact of their commitments beyond 2050 - in China's case beyond 2060, and in India's case beyond 2070. Nor do we know what the impacts of their deadlines will be on other countries' abilities or on the world's ability as a whole to actually achieve a net zero target. We really need to achieve the target of 2050 by 2030, and that poses some very urgent challenges. Pledges are welcome but limited in that they are voluntary. We have seen this before. We saw it in Paris. Pledges can be broken, and we believe it is time to inject more detail into enforcement and reporting.

Against this backdrop it is little wonder that responsible investment is starting to dominate thinking in the investment community. Responsible investment is no longer something 'nice to have' – an extra, merely offering a parallel track for the top investment organizations and corporates – but something to be fundamentally embedded in *all* the investment decisions of corporations, governments and asset managers. The focus must shift from simply mitigating risk to establishing the key imperatives underpinning future growth.

The role of stewardship of capital will therefore change profoundly, and businesses will have to focus on delivering sustainable models, because, if they do not, they will cease to be attractive to customers, employees and ultimately investors. Increasingly investments will be expected to deliver the dual benefits of financial returns and a positive impact on society - which I described earlier as doing well by doing good.

We are already seeing this starting to happen. Responsible investment assets under management are on the increase. As of 2020 there was about $35 trillion committed to responsible investing, and we think this figure will hit about $50 trillion by 2025 – or about a third of global AUM. Now, that will involve many different things. While responsible investing is growing it is probably still not enough to meet the gap described earlier. These inflows are still a trickle compared to what is needed. They will involve not only exclusionary investing and spending on infrastructure but also some truly 'dark green' investing.

Are current ESG models no more than a distracting bubble? With increasing flows mainly going into recognized responsible investment champions is there not a risk of overcrowding? And are the models themselves sufficient? A lot of investors rely on external providers for ESG data and scores. These identify a small number of responsible investments, the best-in-class investments, which then attract a disproportionate proportion of the inflows, not only creating risks of overcrowding but also risk directing flows away from sectors desperately needing investment to achieve the necessary transitions.

We need to see greater focus by investors on identifying companies that are not simply best-in-class today, but which are transitioning to align with a lower carbon world and need the capital to support that transition. Forward-looking investment management firms are beginning to move away from simply making low carbon investments to investing in companies that are engaged in wholescale transitioning. It is also important to focus on those sectors that are quite difficult to decarbonize

but which urgently need to transition, not just energy but chemicals and construction to name just a few.

Challenges remain. There is a lack of consistency in global regulation regarding policy and related metrics, and without standardization of data and quality control, it is a bit of a free-for-all. We think it very important for regulators to guide industry agreements that highlight the ultimate benefit for end-investors. End-investors need consistency in reporting to give them the confidence to invest in products and investment vehicles. Regulators need, firstly to standardize international disclosure requirements. Secondly, we need to see greater consistency in the ESG data and transparency identified in company filings. Finally, it will be important to harmonize the responsible investment terminology used by issuers and investment advisors.

Nevertheless some in the investment community are not sitting on their hands waiting for policymakers and regulators to act. The most forward-looking asset managers have recognized the information and data gaps, are anticipating the changes that are needed and actively trying to fill the gaps by seeking out best-in-class sources.

We firmly believe that bringing about the necessary transition will involve *engagement* rather than divestment. Divestment has grabbed the headlines recently, but in our view it is important to engage first and see if you can *influence* change in issues vital to the creation ultimately of long-term value for clients. We think true value can be achieved by avoiding crowding into those companies simply identified as champions and instead focus on the transformation of business models leading to long-term value creation. This does not apply solely to equity investing, which tends to dominate headlines, but also stewardship in fixed-income markets.

The pandemic has brought all these issues into sharper focus. They present nonetheless tremendous opportunities for the asset management industry if it is prepared to satisfy the demands of increasingly aware clients who want to see their personal values reflected in their portfolios. It is also going to create opportunities for asset managers to navigate these large and quite disruptive changes relative to returns and risk premia which are vital to 'greening' the world economy. The most successful will be those who embrace change, who on the basis of a deeper understanding of developments in economic and market conditions and create new business models that forge closer links between clients' changing perceptions and investment decisions.

At COP26 the main attention was on climate change. But social issues and addressing social inequalities will also be key, demanding a recalibration of behavior, culture and expectations within society. We have no doubt that the financial services industry and in particular the asset management industry can, has to be and will, act a force driving the necessary recalibration.

"In China one has difficulty getting past the G in ESG"

"History suggests inflation will ultimately re-surface but businesses have a much bigger, richer and stronger foundation from which to grow"

"In emerging markets digitization has now become mission-critical"

"ESGs are not just about the environment but all sorts of things such as access and democratization of services and technology can play an important role in sustainability"

"Cryptocurrencies demand a decentralised but interdependent system. Paradoxically smart regulation itself will be one of the key ingredients"

VIEWPOINTS...

"The deadweight of increased regulation could well dampen growth"

"A whirlwind is gusting through society and business alike, shaking both corporations and the investment community at large"

"Responsible investment is no longer something 'nice to have'. Clients want their personal values reflected in their portfolios"

"Current ESGs not only create overcrowding but risk directing flows away from sectors desperately needing investment"

"Investment managers' skill set needs radical readjustment. Transition will involve *engagement* rather than divestment."

"The gradient of difficulty in China has become more severe. China's innovation engine there is being killed"

DEBATE

Thanking the keynote speaker, Dr Knight commented that her presentation had been a real eye-opener. 'In it you mentioned mandatory pledges. As you said, at COP26 we simply saw voluntary arrangements. At what level should these be mandated? Are we talking about governments committing themselves internationally or governments generating regulation and imposing these on corporations nationally?'

'It is a complicated question,' Smits replied. 'We think that governments will need firstly to collaborate and coordinate in establishing an overall international framework, which will then obviously, need to be rolled out nationally in order to achieve consistency in defining these commitments and in reporting. A number of pledges have already been made - a net zero pledge, a reduction in methane pledge, a deforestation pledge, just to name but three, but there is not much detail provided as to how companies are going to achieve those goals and the basis on which they report on progress to meet these pledges. So, how are you actually going to compare what looks good from an investment perspective? We therefore think it would be helpful if there were a framework aligned by governments around the world, and then implemented on a national level.'

Dr. Knight posed another question with a slightly sharper edge to it. 'You highlighted the lack of coordination and harmonization in terminology. Are you implying corporations do not know what they should be doing, and need standardization imposed on them because governments know better than they? Or are you saying that on an individual level the skill set required by an investment manager needs radical readjustment? How do you set about achieving either of these while we still do not have a harmonized and standardized terminology?'

'What I suspect a lot of asset managers are doing, including our firm and some of our partners and competitors,' said Smits, 'is creating their own rating systems. If you look at the data that's coming from the external data providers, they are inconsistent, so that, in order to form a clearer view, investment managers often mandate their own teams to develop rating systems by which to assess companies and decide whether an engagement plan with a company is needed to support or encourage it to develop a transition plan. This is where asset managers can help fill in the gaps. Such engagement creates opportunities for them, but obviously rests on a huge amount of individual judgement. Ultimately, the task for the end-investor, will be to compare their different approaches and their ability or inability to meet these challenges.'

'Certainly very challenging times lie ahead given the $90 trillion you believe is required to achieve net zero,' Dr. Knight commented. 'Personally you are in a unique position in that you are not only in charge of individual responsible investment decisions but also a member of the senior management of a very large publicly-listed corporation. So you have to tackle issues from both angles. Do you find this a challenge?'

Smits saw no conflict between commercial and responsible investment decisions. 'As a corporation BNY Mellon is publicly-listed company and is obviously assessed according to ESGs, but it is also very important we aspire to the same values and standards by which, from an investment management perspective, we judge companies. We believe there is a strong match between the pursuit of investment management business and the sort of corporations in which we invest.'

THE CHANGING INVESTMENT LANDSCAPE

SURVIVORS AND SUCCESSES: THE PANDEMIC SHAKEOUT

Dr Knight asked C.T. Fitzpatrick if, and how, his experiences during the pandemic had informed and changed the way in which his company approached investment.

'Comparing the world before the pandemic hit' Fitzpatrick replied, 'and the world of now, we would certainly describe what happened as a greater than 'three standard deviation' event. It really surprised us that a few of the companies that we had always felt like could withstand pretty much anything all of a sudden found that they might not be able to maintain the stability of their value in the course of the pandemic.

Thankfully, there were only a handful of them, but there were some amazing businesses that we ended up getting out of that in years past, in say the great financial recession or 9/11, we would have been getting into. Instead, we found ourselves considering other businesses on our radar that had potentially very promising futures in which others were beginning to invest heavily but which we just thought were not yet ripe for investment. They were not ready for primetime, if you like.

I keep talking about value *stability* because that is the most important factor for us. Value *growth* is great, but you have got to have stable value as a foundation upon which to build growth. Companies that consume capital really don't meet that criteria. In the pandemic we saw a number of businesses on the negative side of that equation, but there were others on the right side where we had we had evidence that their business models would work. We thought their success would play out over, say, five years, but in fact it played out over six to nine months and that created a lot of opportunities for us by being agile. As value investors, we found ourselves in a situation where everything was discounted and so we said, 'Well okay, let's get into all these great discounted companies now. '

Which companies are clearly going to benefit in a post-Covid world, and which are going to be hurt? Technology - the digital acceleration - will definitely be a factor. We identified some beneficiaries - companies that already had strong business models and were on the way to becoming even stronger and other businesses where we had needed proof and then got it. As a result we were able to make some pretty big shifts in our portfolio.

I think Sir John always has had it right, and like him we at Vulcan love volatility, because, if you are focused upon businesses that have stable values, volatility creates opportunities. So, the extreme volatility created by the pandemic opened extraordinary opportunities for long-term investors, and our portfolio is more reflective of those kind of businesses than it was pre-pandemic.'

CHINA: BEWARE THE DRAGON

China led the post-Covid global bounce-back in equities, Dr Knight commented, ending 2020 as one of the world's leading market performers. Although tensions between China and the United States heightened, their impact on equity market performance was more than offset by China's ability to deal with the pandemic, enabling it to take the lead internationally in lifting lockdown measures and opening up its economy. Demand in China not been limited to the three growth sectors particularly favoured during the pandemic - the internet, e-commerce and healthcare - but also includes two other sectors likely to outperform:

domestic consumption and financials. This is underpinned by the increasing purchasing power of China's middle-class, a cohort roughly double the US population. Retail investors in China, classified as 'affluent' or 'mass affluent', is expected to more than double by 2030. China's wealth management industry is therefore poised for tremendous growth over the next decade.

Chinese markets then have offered great opportunities to find and exploit undervalued stocks and generate alpha returns. However, investing in Chinese markets demands clear, carefully crafted strategies. Chinese equity markets are highly liquid and involve a substantial proportion of institutional investors. Many international investors are hesitant to allocate capital to the mainland markets due to their lower levels of transparency, restrictions on international ownership, rules on eligibility and other regulatory concerns. 'Are these concerns that worry you?' Dr Knight asked Damon Ficklin. 'Recent examples of China's intervention - almost the expropriations of a number of assets – are they just an aberration or something that we should expect to normalise?'

'As global investors we at Polen Capital have had to think hard about these issues,' Ficklin replied. 'Since the inception of our firm's global strategy about seven years ago we have maintained significant positions in both Tencent and Alibaba. We thought they were outstanding businesses and indeed we still think that they are outstanding businesses.

But when the after-school tutoring segment of the market in China – a $100 billion industry - was essentially erased thanks in the middle of this year because of regulatory changes, that spurred a lot of debate about the investment climate in China and what regulation might mean for other segments, either technology or more broadly. The gradient of difficulty has become more severe, and our judgement of the ability of the companies we are accepting to be high quality candidates for our global portfolio more stringent. As a result our expectations for growth in China have probably damped down as a result.

From our point of view, we can - and we do - go anywhere in the world, but if we are going to embrace the country, currency, policy, or other risks that relate to a specific geographic investment, then we think we should be paid for that. There should at least be strong enough underlying fundamentals in its businesses to overcome those headwinds, and valuation should appropriately reflect that. We have to be certain that we can get to a mid-teen growth number that will driving mid-teens returns over time.

From our point of view the easiest way to drive our outcome for our clients and the safest way is the best way. You don't get any extra brownie points in this business for exposing yourself to unnecessary degrees of difficulty, and so we concluded, as we looked across the global opportunity set in the middle of the year, that although we still think Tencent and Alibaba are great businesses, frankly we could get the same results in much easier ways through other businesses and have oriented ourselves towards them.'

'So, are you saying that you have actually disinvested from China? asked Dr Knight. 'We have,' Ficklin confirmed. 'We have actually been overweight there since the inception of our global strategy until midyear. By this point, we have zero direct exposure. We still invest in other businesses in the broader Asian market that themselves have significant exposure in China but we have no direct exposure at this moment.'

Turning to Mark Baribeau Dr. Knight asked whether his firm had also disinvested from China. 'Yes, we agree with Polen Capital on that. The investment landscape in China has shifted dramatically to the negative side. Business model stability is in question for most internet and technology companies in China, and, in view of that, we began exiting from them in last December last year when the Ant Financial IPO was pulled. That was our trigger to sell, and we have continued to do so as the year has gone on. By now we have zero direct exposure, to China, and that has not been easy as we have been investing there since 2007. But China is a different universe now, which it is sad, because the innovation engine there is being killed, and, outside of the United States, it had been the most innovative country in the world when it came to entrepreneurs tackling fundamental problems and creating really strong business models. This reversion should not to be underestimated in terms of its negative impact for China longer-term.'

Turning to CT Fitzpatrick Dr. Knight asked if his firm was also pulling out of China. 'The short answer is we've never been there,' Fitzpatrick responded. 'We looked at Chinese companies and admired their business models and wanted to invest, but we were never able to get past the 'G' – the 'governance' - in ESG in China. When you consider the ownership forms in which you would have to accept such as variable interest entities, VIEs - which people do not talk enough about - it is never clear what you really legally own an asset, and that is problematic. For that reason China has always been a redline for us.'

'Dancing with - riding and taming - the Chinese dragon has always been a roller-coaster ride,' Dr Knight concluded. 'As we enter 2022 several factors will determine China's attractiveness to international investors. US-China relations are once again centre-stage, and negotiations between the Biden Administration and China will be pivotal. While China's focus on opening up its equity markets to international investors and encouraging domestic ownership of Chinese stocks will up drive demand and boost equity prices, monetary policy will also be key to equity market performance, especially how both the Fed and Chinese policy-makers tackle possible inflation – and this is an issue to which I would now like to turn.'

THE SPECTRE OF INFLATION

Investors worldwide are currently wringing their hands over the threat of inflation, commented Dr Knight. 'Doomsayers argue that if central banks further loosen policy they risk double-digit inflation along with stagflation. Conversely, if they raise rates, they will trigger a debt crisis-driven recession. So you are damned either which way.

'So is inflation a real threat? My own view is that at the moment it is not, and the reason for that is that the world economy is nowhere near its full capacity, although it almost certainly will be over the longer term. As long as China grows and is prepared to fund US and European monetary expansion and debt, inflation will be manageable. A far greater danger currently lies in fears of inflation rather than in inflation itself.

That said, there are genuine reasons to be deeply concerned about inflation over the longer-term. Ever since the 2007 financial crisis central banks and governments have embarked on a series of unparalleled experiments in monetary expansion. Such global entanglement of fiscal and monetary policy on such a scale in the last decade and a half has been truly exceptional. We are told the experiment is temporary and will eventually reverse. However, history has yet to pass judgement. Should

monetised debt continue to grow at anything like the current pace – and it promises to do so at least in the near term – history suggests inflation will ultimately re-surface. That would be a profound change, reversing some forty years of deflationary demographic and technological trends. 'So is it a case of "jam today, inflation tomorrow"? Dr Knight asked the participants.

'Regarding inflation, there are a lot of structural challenges right now in terms of workforce availability and the ability to move goods through supply chain, things we have taken for granted until now,' Ficklin replied. 'But the pandemic threw a further wrench into the situation. There are certain aspects of inflation now that I think are likely temporal, but the interesting thing about inflation is that the longer it lasts, the more the inflation expectation become embedded. Fortunately, we at Polen do not need to know what exactly the inflation picture will be. If you are managing a commoditized business and the cost of doing business goes up you are very likely not going to be able to raise price because you are resource-intensive, or because of labour unavailability or other factors. That is the essence of a commoditized business. If you raise your prices, somebody is going to go to your customer or your competitor rather than you. So, broadly speaking inflation is generally is a bad thing for a commoditized, undifferentiated business resulting in either lower sale or margin compression or some combination of the two.

Our approach is to buy and own what we think are the highest quality sustainable growth companies in the world, those which are offering differentiated products and services, and real added value. As that one of that class of company we really do not see much concern from an inflation point of view. There might be pockets of impact if, say, a company like Starbucks is raising wages, or Amazon raised wages to hire hundreds of thousands of people during the busy fourth quarter season. But those are exceptional circumstances, and if you look at the kind of companies we own, they are really not resource-intensive and therefore can wield pricing power. So we do not feel inflation will be a challenge in those sorts of businesses. In fact, I think a sustainable, high quality growth portfolio is the best way to offset the impacts of inflation over time.'

THE GREAT DIGITAL ACCELERATION

'Technology, and especially the accelerating pace of digitalization that is taking place, I know are areas of particular interest to you,' said Dr. Knight, turning to Mark Baribeau. 'But are they sustainable at their current rates of pace? And what are the investment implications?'

'The digital transformation of the economy is one of the most exciting trends in the marketplace today,' Baribeau replied. 'It comes in two pieces. Firstly there is the consumer piece where both the big branded companies, the global multi-nationals and smaller entrepreneurs starting new brands and products, want to go directly to their consumers. They are seeking to bypass traditional distribution and to own the relationship with the customer – to control the engagement, control their inventories, and most importantly to be able to move product around the world in a very dynamic fashion to wherever demand may be growing. The only way to do that is to build omni-channel distribution. That is typical e-commerce - good, old-fashioned bricks and mortar, but *via* one's own outlets and boutiques. Some companies are very far along in making that direct-to-consumer transformation, and it really defines winners as opposed to losers. You can see it in services as well as products of course, video streamers like Netflix or similar companies.

Tesla occupies the same disruptive area. Tesla represents a direct-to-consumer business model. It is really significant that such a trillion-dollar upstart in the automotive industry should go direct-to-consumer. If you want to buy a $100,000 Tesla, you buy it online. There is no dealership. So, it controls the relationship with the customer and pockets the margin. The biggest area of transformation over the next five years will be the global automobile industry because it is such a huge industry. It will undergo really wrenching change with the move to electrification, to autonomous driving, and shared mobility.

The other piece in the technological digital revolution has to do with the enablers themselves - operations like retail operating systems that are cloud-based or in digital payments. These include big companies like Shopify or Audien in the Netherlands. They need a superior technology stack to ensure all their commerce proceeds in the most frictionless manner. In them we see the digital transformation of the enterprise itself, which is largely being driven by the shift to cloud-based computing. We see that in the huge amounts of data workloads being shifted to, say, Amazon AWS or Alibaba Cloud. Their numbers are very robust and accelerated faster even in the last quarter.

But the truly exciting parts of the great digital acceleration are the applications that are being put on top of all those data workloads, all of them cloud-based, in areas like unified communications such as Zoom, in security, infrastructure management for businesses and in workflow automation. These productivity enhancing measures allow companies or organizations to be more nimble and flexible in terms of their allocations of resources and at the same time be state-of-the art in terms of their applications sets, their information technology stacks.

These then are the big trends transforming markets today. And the pandemic accelerated all of these processes. The cutting edge question for markets this year is whether this big boost in demand for e-commerce and cloud-based applications was a one-time event or will fall back to a more normal rate. Our own view is that, having accelerated the implementation of many of these trends already were underway, businesses now have a much bigger, richer and stronger foundation from which to grow, one that is going to be far more powerful from a profitability perspective.'

'But are such returns going to be sustainable as we settle down into a post-Covid world?' Dr Knight asked again. 'And, reverting to Hanneke Smits' keynote presentation, do you think the rapid change in technology is going to help with regard to sustainability?'

'You're always going to look company by company, Baribeau responded. 'Some got ahead of themselves during the pandemic. They simply benefited from a bubble in demand that was not sustainable. Others built solid foundations on the basis of successful business model that they had evolved pre-pandemic and so they got even more lucky during the pandemic. Instead of being negatively affected, the pandemic actually accelerated demand for their products and services. And that demand remains very sustainable, because they were benefiting from it pre-pandemic and now are taking it a step further. The market has tried to be conservative about extrapolating the numbers, but, if you look at the consensus estimates for these types of businesses, they are not at all unrealistic.

The situation regarding sustainability is interesting. ESG actually has different metrics. They are not just about the environment but all sorts of things such as access and democratization of services. And technology is certainly paving the way for the democratization or access to financial services in emerging markets. It did so in China through WeChat Pay and Alipay. It is doing so in Latin America at a massive pace right now, where it is going to disrupt their traditional banking systems, which have done such a poor job of getting services to people in those regions. By charging high fees and providing poor service, they have created openings for non-traditional financial competitors, ones using technology on an internet platform, to come in and take over their payment systems. There has been explosive growth there in developments like digital wallets and other digital banking products. So, technology can play an important role in sustainability, not just in obvious ways by making things more productive and cleaner, but by improving access, coming up with new solutions offering greater convenience and generally enriching people's lives. In emerging markets digitization has now become mission-critical.'

THE CRYPTOCURRENCIES EXPLOSION

A hugely salient feature of the changing investment landscape has been the increasing adoption and impact of virtual currencies, a development extensively analysed by the Roundtable's Chairman Dr Knight although not specifically addressed in this Roundtable. The launch of Bitcoin in 2008 was the catalyst to the development of a decentralised autonomous system. There are now more than eight thousand bitcoins and tokens in circulation and 491 organised crypto-exchanges and platforms worth trillions of dollars. The burgeoning of additional coins, tokens and non-fungible tokens (NFTs) has allowed the evolution of new digital products, markets and services which in turn are providing more efficient financial services to a wider group of consumers.

The fast-moving technological progress and bewildering array of new firms, products and markets raises considerable challenges for regulators. There are inevitable tensions as incumbent dominant market players call for protective regulation under the guise of protecting consumers, and governments intervene simply in order to retain control. Most regulators are seeking to strike a balance between allowing innovation and protecting consumers. This is a delicate task as well-intentioned regulation is more than able to unintentionally stifle innovation.

'The future of digital finance demands a decentralised but interdependent system,' Dr Knight concludes. 'It would be sensible to begin the process of policy setting by defining the key features of the ecosystem that will ensure its success. Paradoxically, smart regulation is itself one of the key ingredients, as regulatory certainty is necessary to encourage participation by investors and consumers without whom the new industry will migrate to other more conducive jurisdictions.'

ROUNDTABLE TOP STOCK SELECTIONS FOR 2022

Dr Knight drew proceedings to a close by asking participants which companies they thought would do best over the next year between the present and the 10th November 2022.

Participants' selections included some well-known names such as Microsoft and Mastercard but there were surprises. Another chose Sea Limited, a Southeast Asian company headquartered in Singapore. 'It is the dominant player in e-commerce in Southeast Asia and growing also in Latin America and Eastern Europe,' he said. 'E-commerce penetration rates in those regions are very low compared to China or other developed markets, so they enjoy a huge opportunity. In addition they have a very able executive management team and a strong record in terms of battling very competitive markets and winning.'

NOTES

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