Video Transcript

In conversation
HSBC's Annabel Spring talks investing with Rob Lovelace

Filmed on 27 February 2023

Annabel Spring
So, Rob, You've been investing for 37 years. I think you've probably seen more than your fair share of bear markets. So looking at last year: geopolitical tension, inflation, rising interest rates. What's your outlook for 2023?

Rob Lovelace
When we look at the markets, we tend to think about that long-term perspective. And we get focused on an individual year, but what's happening right now really is part of a longer story. We're at the end of a very long bull market, and it's been one of the least-liked bull markets that I can ever remember.

You know, everyone kept waiting for the bear market to come. And we're about a year now into the more formal bear market. And bear markets that are associated with recessions tend to be longer.

This is, believe it or not, about the midpoint. That's been typical of prior bear markets that you saw in '69, in the TMT crisis in '99, and that you saw in the great financial crisis as well. All of those align very similarly in terms of how long they've lasted, how far they went down.

But really, the recession needs to begin. The stock market is a leading indicator. It doesn't lag what's happening; it's anticipating what's coming in the future. So right now, there's hope that it'll be a soft landing. You're hearing all these discussions about how the economy is going to look. But in essence, what's happening now is probably a bit of false hope, because we are really just starting to see the negative earnings come through.

We're really just starting to see companies taking action to prepare for this longer, slower economic situation. And so I would expect to see that bottoming three, four or five months from now. But then it's going to be a real sustained bottom. You mentioned geopolitical and other aspects, though. There's always these wild cards.

Considering how bad things are right now, there are probably fewer downside risks on the geopolitical side, believe it or not. On the economy, there are definitely policy issues that could go wrong.

But overall, again, it's playing to script. Keep the faith. We should see that bottoming sometime this year when the recession begins. It's not going to feel great, but that'll actually be the moment that we begin to build for hopefully another decade of bull markets.

Annabel
I think that's really an interesting thesis, and there's a lot in there that I really agree with. I do think , though, there are some lessons learned for investors, and some of the things that we're talking about, diversification, you know, whether it's global diversification, whether it's sectoral diversification or, particularly for this round, asset class diversification.

You know, if you look at the classic 60/40 mix between equities and bonds, that's been the worst year for people holding that mix since 1937,[1] which is astounding. So stretching out our asset classes – equity, bonds, obviously high-quality bonds in markets like this, but also into alternatives.

I think what we really need to focus on is making sure that we learned the lessons of diversification.

But I want to come back to one thing that you said, which is, you know, geopolitical uncertainty. And there's been a lot of commentary about that, plus the lessons of COVID and the sort of – the supply shock challenges. What do you think is happening in globalisation, and how do you think investors can take advantage of any changes that you might see there – or maybe any risks?

Rob
I think people get overly focused on whether we're increasing or decreasing globalisation. I hear a lot of conversations about that. We have a particular

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[1] Source: Leuthold Group, November 2022

strategy where we think about globalisation as a theme. So it's on my mind all the time. And what I've learned is, it's always just shifting. So right now we're seeing the compression of physical trade, but we continue to see the expansion of digital trade.

So all we know for sure, as you described, is with the conflict in Ukraine, with what's happening with China, people are definitely looking at reforming, redesigning their supply chains. And shocks from COVID and other things reminded us that maybe they were too fragile and we need more redundancy. So there is more onshoring or at least moving manufacturing closer to final markets.

But if you're a global company, which most of the companies that we tend to look at and invest in now are multinational companies, they don't really look at the world that way. They are looking at how they need to design their structures based on laws and regulations.

One other example I would highlight is there is so much manufacturing in China that even with the intent of shifting it somewhere else, there aren't that many other places to move it in the short term.

Most of Southeast Asia is pretty well booked. Mexico is booming right now. They can't even manufacture the space to be able to do other manufacturing. So it's a very interesting time where everyone knows where it's going over the long term. But the ability to make short-term shifts are really difficult to pull off.

Annabel
So I'm curious, you know, you are quite famous for your system in terms of how you find companies. So how do you find those companies and how do you analyse them? How do you keep your long-term perspective, and how do you manage that in your selection process?

Rob
Well, I think one of the things that makes Capital different is this multiple manager system we have: the Capital System. Others have multiple manager systems, but we've really developed something over the last five decades that is different. At its core, we're similar. We have a lot of analysts that are out visiting companies and they're getting to know them well.

Key to that, though, is people tend to come to Capital and stay here. Like myself in my fourth decade. That's not uncommon here. And so our analysts and our portfolio managers are able to build relationships and really get to know companies, because when you're investing for the long term, you're investing less in what the company is reporting today and all that short-term noise.

You're actually investing more in people, because it's people and the decisions they're going to make about an acquisition you haven't even thought of yet. It's that combination of short-term awareness, long-term relationships, and this focus on making sure we're getting it done over the longer periods and compensating our people for that.

Annabel
The other thing that's changing; you hit on people, and I wanted to just focus on that aspect for a second because there's a lot of trends happening with people.

People are looking for a much more equitable opportunity set, much more inclusion, whether that's flexible working – that's important to employees, to corporates, to investors. How do you look at trends like that and social trends, whether that's ESG, etcetera, through the Capital lens? How do you get into that with corporates and what difference does that make in terms of your investments?

Rob
I think I would start in terms of a focus on diversity, equity and inclusion, and in a related sense to the environment, social and governance issues. But I think it starts with us. And so one of the things we're lucky about at Capital, is our Capital System with multiple managers needs to have different approaches for it to work.

If everyone's managing money the same way, it looks just like a star system. So we actually understood decades ago the importance of having people from different backgrounds, with different life experiences coming to bear on a portfolio, so that we have these balanced and strong outcomes. From that platform we can then look at our investments.

We can then look at other companies and say, we know it matters. This isn't an academic debate. We know where it matters. We know it matters on boards of directors. We know it matters in senior leadership. We know it matters at the top all the way through the organisation. Because if it's not there and believed in the top, it won't go through the entire organisation.

And it's not the be all, end all. But to my earlier comments about long-term focus, it begins to add up over time. It's not a determining factor in the short term, but it adds a resiliency, and it adds a wisdom to a company that we think matters.

And I'd put ESG – environmental, social and governance – in kind of the same category. It's usually not enough to be the key driver of a company, but if they're thinking about it, that usually means they've got a good strategic planning exercise. If they're thinking about climate, it really doesn't matter what their view is; the point is they're doing the exercises and that shows me they're actually thinking what their business is going to look like five, ten or 15 years from now.

Annabel
Thank you so much for joining us. I really appreciate the time.

Rob
Well, I'm honored. It's been a delight, Annabel. And thank you very much.