Double disruption!

Mark Heslop, Richard Watts, Brinton Johns and Guy de Blonay discuss how Covid-19 has accelerated existing trends and how this ‘double disruption’ shapes the way they assess investment opportunities and risks.

‘Disruption' was a hot topic long before most of us had even heard the word 'coronavirus.' From geopolitical dislocations to the discourse about the relationship between business, society, and the environment, to the dramatic challenges to old business models from newer, technology-enabled players, the world was already rapidly changing. Then came the most serious global public health emergency in living memory. Here is how four of our fund managers approach this ‘double disruption’.

What are the key drivers of disruption in your markets?

As a small and mid-cap UK investor, digital innovation has been an important area for **Richard Watts** (Head of Strategy, UK Small & Mid Cap). IPOs for disruptive UK companies like RightMove and Just Eat provided an early hint of what was to come globally. In Richard’s view, the most exciting and innovative opportunities in the UK are private, unlisted companies that use technology to compete on a global scale. These businesses are led by aggressive price competitiveness, a big reason behind the muted inflation seen globally over the last decade, two trends he expects to continue. Richard also noted the strong ‘innovation ecosystem’ in the UK, from world-class universities to leading financial technology and e-commerce companies.

As European investor, Covid disruption has increased the potential of existing winning business models, said **Mark Heslop** (Fund Manager, European Growth). The Covid crisis has highlighted the value of digital solutions and in Europe a number of businesses have now adopted new technology to drive supply chain efficiencies as well as customer solutions. Companies like RELX or Experian, for example, show how proper investment in the right technology has enabled them to process vast amounts of data in order to provide better solutions and services for their customers. In Mark’s view, existing companies with strong management teams and business models that are prepared to invest in new technology and innovate can become even more resilient and cost competitive.

In **Brinton Johns’** (Co-founder and investor at NZS Capital, LLC) view, crises accelerate existing technological trends. Brinton said we are in the transition from the Industrial Age to the Information Age but only a very small part of the economy has yet made the shift to a digital mindset. He invests specifically through the lens of disruption and views events like Covid-19 as trend accelerators. Zoom is a good example. We’re all using Zoom now but even pre-Covid, Gartner, a leading IT consultant, had projected that 40% of all meetings would be held on video calls by 2022.[1]

[1] Source: Gartner, ‘Magic Quadrant for Meeting Solutions’, 5 September 2019

Guy de Blonay (Fund Manager, Global Equities) noted the huge shift in the Financials sector, his area of expertise. Five years ago, traditional banks and insurance companies were under siege from digital innovators providing fast services at cheaper prices. Millennials and Generation Z are big drivers of further digital disruption. Combined, they account for around 35% of total global income earned today. Gen Z's economic power is the fastest growing across all cohorts, at 10% of total global income today, projected to reach 27% by 2030, or \$33trn.[2] These new cohorts spend a lot of time online and the digital transformation will certainly continue rapidly post-Covid. Guys sees digital payments as a clear beneficiary of change, whereas sectors like alcohol, tobacco and car ownership are less in vogue for Millennials and Generation Z.

What do you look out for when identifying the 'winners' of disruption?

Richard Watts first looks at utility value – are they solving a real problem at a competitive price and attracting customers? Fintech companies are a clear example of providing a service, product or solution that customers really value. Secondly, Richard looks at whether the sector a business operates in is a large industry that is ripe for disruption and merger and acquisition potential. Thirdly, a strong management team with robust culture and entrepreneurial vision is key to ensure good ideas succeed. Finally, he watches out for the risk of the 'disruptors being the disrupted'.

Mark Heslop focuses on proven business models that can benefit from digital disruption and survive the increased threats and additional costs needed to meet those threats. He seeks companies that are able to differentiate their product offering in order to gain pricing power. In Mark's view, established businesses with barriers to entry that use technology to invest in closer relationships with their customers and provide differentiated solutions to their needs will be the winners of disruption.

Brinton Johns noted that in an environment where information flows freely, the impact of technological transparency on businesses, both old and new, is huge. To take an everyday example, Apple's operating profit peaked in fiscal year 2015.[3] While Apple's share price has risen since then, largely due to share buybacks, the pace of their technological innovation has stalled. In contrast, Microsoft is a large business that has remained an innovator, pointing to the success of their Cloud technology. He added that companies that produce value for stakeholders, the environment and society – where each of these players can win – will be best placed for the future.

Guy de Blonay added that in the Financials sector, while there are plenty of exciting new disruptive digital start-ups, partly thanks to the abundance of capital due to the low interest rate environment, the huge capital behind big global banks should not be ignored – they have the revenues to invest heavily into new technologies.

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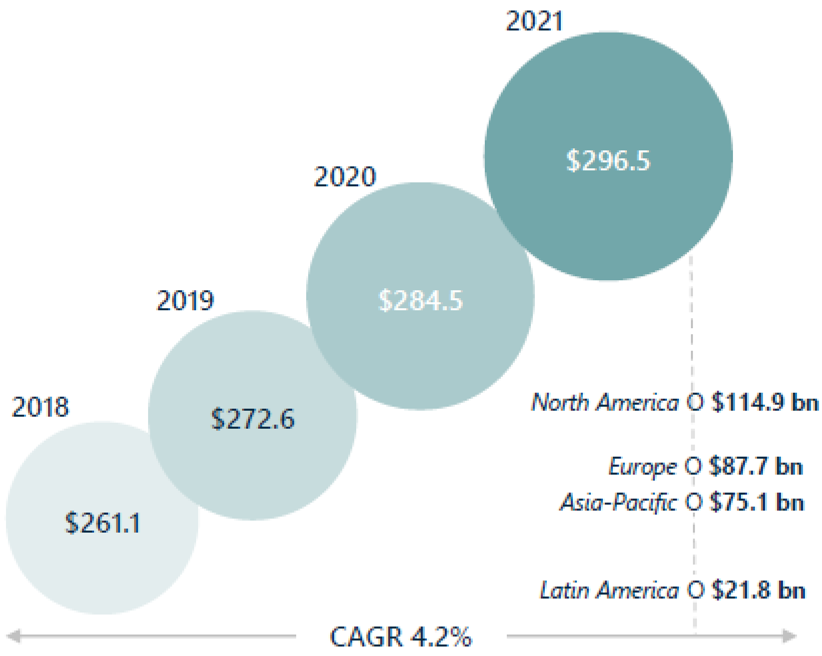
[2] Source: Bank of America Global Research, 'OK Zoomer', 10 November 2020
[3] Source: Bloomberg

Technology spending by banks



Source: www.celent.com as at March 2018.

How does climate change affect your investment approach?

Mark Heslop said that the urgency of climate change further increases existential challenges to businesses, as well their cost burden as they are required to cut their carbon emissions. European companies have an edge here given changing consumer behaviour and the fact that governments in the region have arguably been much more on the front foot in developing solutions to climate change – for example, driving energy and buildings efficiencies within their economy. Mark looks for companies that are innovative in this area and that have differentiated products that will give them pricing power over time.

Brinton Johns said he looks for companies that provide more value than they take. Providing value solely to stakeholders is no longer good enough and companies that also offer value to society and the planet are essential. Companies and management teams that understand this will be the ones to survive, and those that do not, ignore it at their peril.

Guy de Blonay added that the move to digital payments and financial technology plays a big part in adding value to society by helping governments to better tackle tax evasion and money laundering while also helping to reduce carbon emissions.

Richard Watts said that small and mid-cap companies in the UK don't always get ESG right quickly enough given the increased challenges they face as fast-growing companies. That's why he says it's important to understand the mindset and culture when investing in these smaller companies, looking out for management teams that understand the scale and problem of climate change and who seek to do social good.

Jupiter and NZS Capital entered into a strategic partnership in Q1 2020 with Jupiter providing trading, operational and distribution support to NZS.