FRANKLIN TEMPLETON

April 07, 2021

Secular Tailwinds Prevail Across Market Cycles

With global equities trading near record highs, many investors are questioning the potential for continued gains going forward. Franklin Equity Group's Matt Moberg believes we are still experiencing a rich backdrop to invest in innovation as many discrete advancements are becoming economically viable in the economy today.

Over the long term, we believe innovation drives wealth creation in the economy and that investing in innovation offers a high probability of outperforming the market over a full cycle—approximately three to five years. However, in practice, our time horizons for investment are often much longer. Even after the strong performance of the past year, we continue to think we are experiencing a very rich backdrop to invest in innovation as many discrete advancements are becoming economically viable in the economy today.

In the short term, markets can move based on a countless number of fears, concerns, quantitative buying or selling, or many other factors. Recently, we've seen some shifts in market leadership towards value-oriented and cyclical names in the wake of the pandemic nearing an end. Even with these shifts, we continue to see opportunities across many high-growth companies and believe the discounted cash flow methodology is the best way to determine a company's intrinsic value. It differs from standard multiples, which do not incorporate growth. For example, a high price-to-earnings ratio (P/E) doesn't mean a company is expensive, nor does a low P/E ratio mean a company is cheap.

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We find that market participants often underestimate the duration of growth that innovative companies can generate; rather than seeing profits competed away in short order, many of them grow and generate excess profits for very long periods of time. Their pace of growth may also be underestimated over both short- and longer-term periods. Within discounted cash flow (DCF) models, these assumptions of duration and pace are key variables which, independently and combined, can have a profound effect on an assessment of a company's value. Our differentiated research approach seeks to foster the discovery of unrecognised value even in stocks which might otherwise appear expensive. We believe the cyclically oriented market shift we see today is a natural result of investing over a cycle. And we assert that innovators will be rewarded as they find new products, new methods and new advancements that will solve some of our biggest problems and make our lives better.

It's clear to us that the impact of COVID-19 will leave an indelible mark on consumer behaviour. Over the next year, live entertainment and travel should start to come back—maybe not to pre-pandemic levels initially, but the inflection point is coming, and the direction is positive. Other consumer shifts over the past year are likely to be more permanent. In the early days of COVID-19, 27% of global consumers started shopping online for the first time1 and our best guess is many of those customers had a positive experience. This contributed to increased investment in related industries like logistics, online payments and web services as companies adapted their business models to the new environment.

The genomics space continues to be a key area of innovation advancement. Genomics and gene sequencing were major contributors to finding therapies and vaccines for this virus. Now, we have not only fast-tracked therapies, but we have also built distribution and manufacturing capabilities that could make genomic advancements easier to implement in the economy in the future. All investments we have noted here are foundational; while demand certainly accelerated, we believe both adoption and the addressable market size can continue to grow over time.

Perhaps a half a century ago, when we started investing in innovation, most of the change happened in California's Silicon Valley, primarily in the semiconductor and aerospace and defense industries of the economy. Even just 25 years ago, a portfolio invested in innovation was likely to primarily be a collection of companies based out of Silicon Valley. As we look at the landscape today, innovation has clearly gone global, and we see centers of excellence across the world. Tremendous advancements are coming out of China, Japan, Taiwan, Israel, Western Europe and Latin America, and each are developing differentiated expertise. Our research team aims to take advantage of the emerging innovation we see.

Looking ahead, it's difficult to see how these trends in innovation will slow down. However, impacts driven by individual country regulation or delays in new advancements due to technical requirements are possible. These are areas where we believe active investing and a generalist view can add value to the investing process.

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