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DAVID ROGERS
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Trade war ‘an opportunity’ for Loomis Sayles

Lee Rosenbaum in Melbourne on Monday. Picture: Aaron Francis

It may be daunting at times, but the US-China trade war that rattled markets again last month is providing buying opportunities says Loomis, Sayles & Co portfolio manager Lee Rosenbaum.

Boston-based Rosenbaum, who has an MBA from MIT and served as a lieutenant with the US Coast Guard before joining Loomis Sayles as a global equity analyst in 2008, co-manages the Global Equity Opportunities strategy and the Global Allocation Fund for the $US278bn ($410bn) fund manager.

“Historically we have used this kind of geopolitical event to make or add to existing investments where the business already has what we’re looking for,” Rosenbaum tells The Australian.

“These are what we call the three alpha drivers — quality companies that can then grow their intrinsic value over time, and importantly, we want them to be attractively valued.”

Benchmarked to the MSCI All-Country World index, the Global Equity Opportunities strategy actively and fully invests in an unconstrained “style-agnostic” and concentrated portfolio of 30-50 stocks.

As of July it was handily beating the index with an 11.5 per cent return per annum net of fees versus 7.5 per cent for the index since inception in 2004. The Australian version of the fund is off to a good start, returning 21.8 per cent versus 13.5 per cent for the index since inception in November.

“If you take Parker Hannifin — a US-domiciled global provider of industrial components for a range of end markets including the aerospace industry — that’s an example of the kind of stock in which we started a position when the trade war intensified a year ago,” Rosenbaum says.

The fund’s style-agnostic approach means growth is just one part of the overall value proposition.

“We own stocks that other investors would say are growth companies — like Amazon — and stocks that other people might call value companies — like Legal & General, a UK insurance company that’s trading at nine times earnings per share.”

The trade war has also helped create a “flight to safety” — turbocharged by central bank interest rate cuts that have helped drive bond yields down to record lows — in bond-like equities.

“For example, McCormick, a global spice company we have owned for a number of years — that was a very significant performer,” Rosenbaum says.

“In part because of their strategy, but also because the valuation got a little more rich, we used it as an opportunity to actually trim some capital out of that business but we still own it.”

While the foreign policy style of US President Donald Trump and the trade war the US has pursued with China may seem unprecedented, it’s one of a number of multi-year macro forces — like the European financial squeeze, Fed policy normalisation and China’s transition to a consumer-led economy — that have battered the price of global risk assets at times since the global financial crisis.

“We view the trade war like any type of major geopolitical issue and an opportunity for us to look for dislocations where the price of a stock today is different to where we think the long-term value is,” Rosenbaum says.

Founded as a fixed-income manager in 1926, Loomis Sayles now has 293 investment professionals across all the major asset classes and has been servicing institutional clients in Australia for more than 20 years. Moreover, it remains a research-focused and true-to-label active investor.

“If you take our investments in Legal & General in the UK or US home builder NVR, having the ability to tap the wealth of information from our credit analysts can be very helpful,” Rosenbaum says. “It gives us a 360-degree view of the company that we can drive through our process.”

Loomis Sayles is partnered with fellow Natixis Investment Managers affiliate Investors Mutual to offer the Loomis Sayles Global Equity Fund to the Australian retail market.

While it’s a global fund it doesn’t have any China-listed equities but does have significant Chinese exposure via investments in the likes of Alibaba and the pan-Asian insurer AIA.

It picked up Alibaba in the 2014 initial public offer and at one point built the stake up to a little over 7 per cent of the portfolio.

That was trimmed back significantly in early 2018 but the fund has subsequently used the weakness in the past year to top up its shareholding.

Some value-conscious fund managers struggle to justify holding high-PE stocks like Amazon, but Loomis Sayles looks entirely through the lens of discounted cash flow, rather than price to earnings. “The reason we like discounted cash flow is that compared to other approaches — like price-to-earnings or price-to-book ratio — it allows us to state our expectations and assumptions about the future of a business explicitly, rather than accepting embedded assumptions in a static multiple,” Rosenbaum says.

“We owe it to our clients to go that extra step. Earnings are subject to the vagaries of accounting but cash gets at the underlying economic power of a company, so we find a better measure to gauge creation of shareholder value is free cash flow.”

The discounted cash flow approach also allows for the recycling of capital throughout the portfolio independent of sectors of geographic regions, and allows the fund to take a long-term view.

“Portfolio turnover has been in the high 20 per cent range over three years, but more than half has come from our trims and adds of existing businesses,” Rosenbaum says.

“We are tending to own these companies for many years and a PE doesn’t allow us to have the long-term view we require.”

As well as the two co-portfolio managers, the fund has a dedicated team of three analysts and will be looking to hire additional analysts in coming months. But Rosenbaum says the global strategy — which now has $US5bn under management — has capacity to grow to $US25bn-$US30bn.