Interview with Monik Kotecha from Insync Fund Managers

06 May 2020 | Chris Gosselin, Australian Fund Monitors

We sat down with Monik Kotecha, Chief Investment Officer at Insync Fund Managers, to discuss the impacts of the COVID-19 pandemic on markets and the economy so far, what he expects the recovery to look like, whether that recovery may have already begun, and which sectors his team are focusing on primarily.

Chris Gosselin, Australian Fund Monitors

Monik, welcome to Australian Fund Monitors' Insights series of interviews. Firstly, can I ask you that given the volatility of the markets and the change as a result of COVID that the whole world's going through, has this changed the themes Insync has been focusing on?

Monik Kotecha, Insync Fund Managers

In terms of the themes post-COVID and pre-COVID, our observations are that the sector that has really been hurt through this crisis are the small and medium sized businesses, while the larger companies are benefiting. Quite often we're asked, 'has the market recovered too quickly, or has it fallen sufficiently hard?', which reflects the very deep economic concern we're going through at the moment.

Normally, when investors think about the market, they think about the economy. However, each are actually quite distinct. When you look at the S&P500, the top 40% are very large, robust companies like Amazon, Procter and Gamble, or Home Depot. Each of these companies are actually in a really strong financial shape, and have a strong competitive position. As such, if anything, post this crisis they're going to come out the other side even stronger. And those are the stocks that have actually already recovered. The ones that haven't recovered, that are still very depressed, are the ones that are very economically sensitive, with very poor balance sheets.

So coming back to your question around themes, our process has always been very much focused on buying really strong, highly profitable companies, with very strong balance sheets, quite often with net cash, generating huge amounts of cash flow and that have massive secular mega trends that they can grow into. As such we haven't actually had to change much in the portfolio. Yes, we've done a little bit, but the whole point about investing in secular mega trends is they tend to be less sensitive to the global GDP.

Chris Gosselin, Australian Fund Monitors

You mentioned being asked frequently whether markets had recovered too quickly, or whether they'd fallen far enough. What are your thoughts on that?

Monik Kotecha, Insync Fund Managers

Well the point I was trying to make was that the market has actually been quite rational. What makes up companies in the S&P500 is not the US economy. They are global companies, quite often with predictable recurring earnings, that are less sensitive to the GDP, and, as expected, they have recovered. These companies are going to come out stronger - they're definitely going to come out as survivors.

However, there are many companies that are not going to come out stronger, and these tend to be the much smaller companies. If you look at the S&P600 Small Cap Index, for example, it's now at five-year lows. So, I think the market has actually been very rational in the way that the recovery is unfolding so far.

Chris Gosselin, Australian Fund Monitors

Does that allow for the fact that we still don't know how we're going to come out of the current COVID-19 crisis?

So, are markets getting ahead of themselves in saying that this isn't going to be as bad as we might have imagined, or that prices have fallen enough?

Monik Kotecha, Insync Fund Managers

Well, there are number of observations: Firstly, the market tends to look ahead, so you shouldn't really look at the next six months, you should be looking forward 12, 18, 24 months. And if you look at the valuation of any business, the proper way to value a business, as this has always been the correct way, is using a discounted cashflow valuation (DCF). If you do a DCF on a quality growth business, then the next 12 to 24 months of earnings typically only represents less than 3% to 4% of the total valuation of the business. So, even if they lose the next 12 to 24 months of earnings, but they come out of it really strongly on the other side, it only has a small impact on the overall valuation of the business. So no, I don't think the market has got ahead of itself.

I think the other important point to always remember is just the sheer magnitude of the stimulus governments are providing. 6 trillion dollars has been put into the US economy alone, let alone the rest of the world. That compares to a US GDP of $20 trillion. So, a third of the economy has come through as stimulus. At the end of the day that not only provides a buffer in the immediate period, but over time has to find its way back into the economy, and into the market. So, while we're not saying there won't be more volatility ahead, we're relatively optimistic about the medium to long term future.

Chris Gosselin, Australian Fund Monitors

Would I be correct in saying you're probably not as optimistic about levels of government debt globally?

Monik Kotecha, Insync Fund Managers

Well, government debt has been an issue since 2009, and we've been consistently worrying about that so I'm not saying one should ignore the level of debt in the system. In fact, what the level of debt would suggest is that growth will continue to be very difficult going forward, as it has been for the last 10 years. As you know we've been operating in a low inflation, low growth environment and in a period of de-leveraging. Obviously that has an impact on suppressing the level of growth and inflation, and again that really favours the types of businesses that we own - quality growth companies that are able to grow faster than underlying GDP. So again from the way we look at it, that's certainly a positive construct,.

Chris Gosselin, Australian Fund Monitors

Going back to themes, can you provide an indication of which themes you might have adjusted, or moved into as a result of the crisis?

Monik Kotecha, Insync Fund Managers

As you know we invest in mega trend themes that tend to be very long term in nature. These are typically very significant, because the driving forces behind them are unstoppable, and they tend to be less sensitive to global GDP generally. Having said that, we have made some modifications to the portfolio.

Clearly travel has experienced a significant crisis. We believe travel will come back - if you go back over time, the amount spent on travel experiences over the last decade has been growing significantly faster than GDP, whereas the amount spent on material goods has been less than GDP. That's a secular trend; consumers want to spend on entertainment, on leisure, and on travel. Our research indicates that consumers will be really keen to get out of the lock down, and get back on the road.

Interestingly, when you look at cruise bookings in the US, the level of 2021 bookings are actually higher than they were in 2019. So, we're still very positive on the travel theme. Having said that, one of our investments was in Amadeus. Their revenues are derived from airline ticketing, reservations and seat choices, and they receive a "clip" of the ticket cost. We believe that they will probably take a little bit longer to recover, so we've reduced our exposure to the travel megatrend and sold out of Amadeus.

On the buy side there are a couple of interesting observations. One is that the move to the cashless society is now accelerating. However, even within that space you really need to be quite discerning. In this period when social distancing may last for longer and actually become part of the accepted norm, the drive towards online and contactless payment is going to accelerate. We know that the online penetration, which is still only 9% of total retail spending, has accelerated and will continue to increase at a rapid rate. As such we expect the contactless payment space will increase at a faster rate than physical card spending, hence our exposure to PayPal and Apple. So, while that's a trend that was already very strong, we believe it will accelerate.

A relatively new trend, and again it is an outcome of the pandemic, is a drive to become healthier. There is research that shows that the people most at risk of the virus are not only the old, but also the ones who are overweight. The trend towards health and wellbeing is definitely accelerating, along with the trend towards immunisation. People want to exercise, but they want to look good. We previously had a long-term investment in Adidas, which we sold for valuation reasons, but as this trend is starting to accelerate we've invested into Adidas again.

Chris Gosselin, Australian Fund Monitors

Monik, as always your insight into global thematics are very interesting. Thank you very much for your time, and we look forward to getting further updates from you in the future.

Monik Kotecha

Chief Investment Officer, Insync Fund Managers

Monik Kotecha has 25 years of funds management experience in international and Australian equity markets, including 15 years of managing top-quartile performing portfolios. He has worked in London, New York and Sydney. He spent over 7 years as a Senior Portfolio Manager at Investors Mutual Limited, 5 years with BT Funds Management Limited, and 3 years with the Abu Dhabi Investment Authority.

Monik was a Senior Portfolio Manager of the Australian Share Fund at Investors Mutual Limited and a key member of the Investment Team which was awarded Fund Manager of the Year Australian Equities in 2002 and 2003 by Money Management. Prior to this Monik was the lead portfolio manager for over 5 years at BT Funds Management Limited on a number of international equity funds and was a member of the asset allocation team. Monik spent the first few years in funds management as a Pan European Equity analyst at the Abu Dhabi Investment Authority in London.

Management Company Overview

Established in July 2009 by Monik Kotecha, Chief Investment Officer, Insync is an independently owned global equity specialist based in Sydney, Australia.

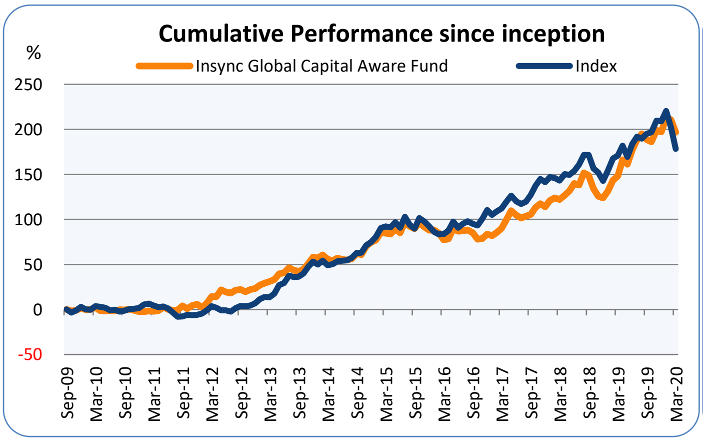
Insync believes that investing with a strong focus on capital preservation will lead to superior relative and absolute returns over time. They do this through conservative stock selection from a select pool of exceptional global companies and by actively managing market risk and currency risk.

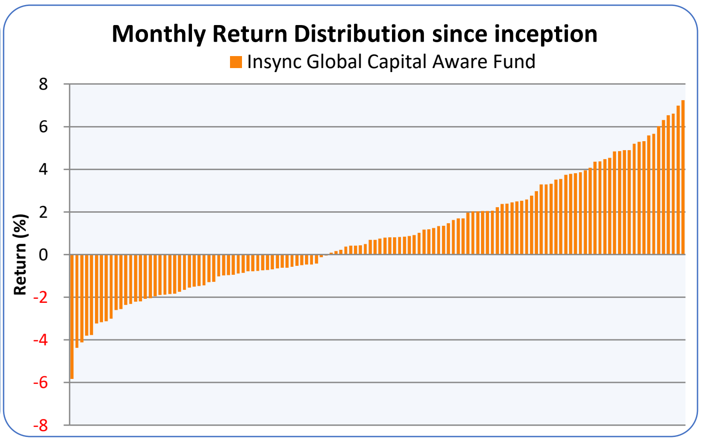
Insync sets itself two objectives: to deliver a positive return at least 2% above the Australian cash rate each year, and to outperform the global equity benchmark by at least 3% on a rolling 3 year basis.

They look for large, high quality companies that can consistently grow their dividends and earn high returns on invested capital. Such companies are often in industries under-represented in Australia. If the shares of those companies are attractively priced they become candidates for inclusion in Insync's funds.

Insync Global Capital Aware Fund (view profile)

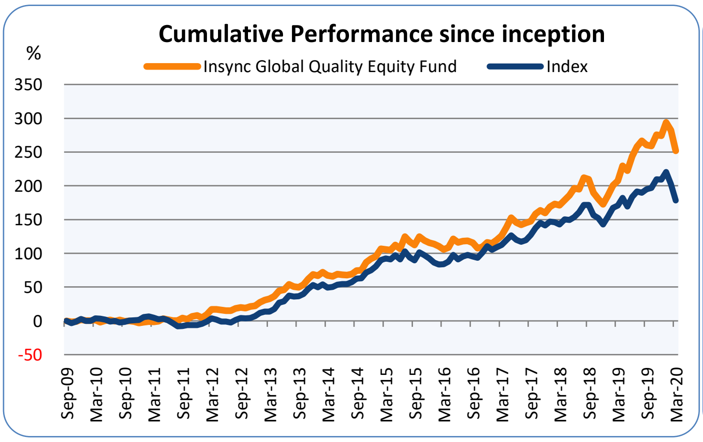
Strategy:	Equity Long	**Fund Inception Date:**	October 2009
Discretionary/Quantitative:	Discretionary	**FUM (millions):**	AU$34.15m
Investment Style:	Mega cap, dividend growth stocks, index put protection	**Investor Type:**	Wholesale & Retail
Fund Geographic Mandate:	Global	**Minimum Investment:**	AU$10,000
Fund Domicile:	Australia	**Management Fee:**	1.30%
Status:	Open	**Performance Fee:**	Nil

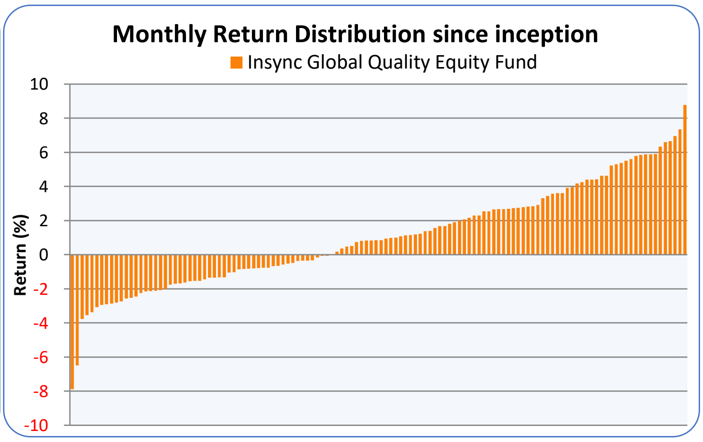




Insync Global Quality Equity Fund (view profile)

Strategy:	Equity Long	**Fund Inception Date:**	July 2018
Discretionary/Quantitative:	Discretionary	**FUM:**	AU$12.49m
Investment Style:	Mega cap, quality focus, no index put protection	**Investor Type:**	Wholesale & Retail
Fund Geographic Mandate:	Global	**Minimum Investment:**	AU$10,000
Fund Domicile:	Australia	**Management Fee:**	0.98%
Status:	Open	**Performance Fee:**	Nil





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