

# Frontier International

## Perspectives from Europe

Equities (Part one)

August 2024

# About Frontier

Frontier Advisors has been at the forefront of institutional investment advice in Australia for almost thirty years and provides advice on around \$700 billion of assets across the superannuation, charity, public sector, insurance and university sectors.

Our purpose is to empower our clients to advance prosperity for their beneficiaries through knowledge sharing, customisation, technology solutions and an alignment and focus unconstrained by product or manager conflict.



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James is the Head of Equities after joining Frontier in 2019 as a Senior Consultant within the Equities Research Team. He has more than 15 years equity markets experience, including direct equities experience. Most recently, he worked as a buy-side equity analyst at Prime Value Asset Management and prior to that he held senior manager research roles with Standard and Poor's and Aviva. He commenced his career as a financial analyst with Lincoln Indicators. James recently completed his Masters of Accounting at Monash University and also holds a Bachelor of Commerce from Melbourne University and Graduate Diplomas of Applied Finance and Financial Planning with FINSIA.



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Adrian joined Frontier in June 2019 and is a Senior Consultant working with a number of superannuation and insurance clients and is also member the Equities team. Adrian had previously worked at Lonsec for nearly eight years, where he was responsible for undertaking manager research in global and domestic equities and alternatives asset classes, with sector lead responsibilities for global equities and specialised domestic equities strategies. Prior to Lonsec, Adrian spent five years at IOOF where he held a number of roles including research, consulting and investment operations. Adrian holds a Bachelor of Commerce and a Bachelor of Information Systems from The University of Melbourne, is a CFA charterholder.

# Introduction

In this comprehensive research paper, we share insights from our recent European research trip. During this trip we met with 23 fund managers covering 29 strategies, as well as holding separate engagements with asset owners and our London-based research partner, Lane Clark & Peacock (LCP).

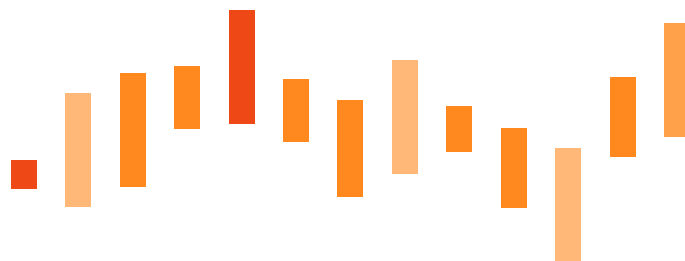
We travelled to three cities (London, Edinburgh and Copenhagen), with a dual focus on rated and client held strategies, while also progressing onsite due diligence on several new ideas. We expect this to lead to two new ratings in the second half of the year, specifically a listed impact strategy and a core strategy. We have observed more interest in publicly listed impact strategies, particularly among our non-super client base. Additionally, there is a demand for more fundamentally-managed core strategies, with moderate track error, particularly due to YFYS.

While we observed a number of themes during the trip, in this two-part paper, we share insights from two key themes that emerged from our fund manager and stakeholder discussions, which link back to Frontier's key strategy research themes, including evolving investment regimes, geopolitics and climate change.

In Part one, our primary trip topic extended our focus on the active management challenge of concentrated markets but more specifically, the underperformance of a broad cohort of quality growth managers more traditionally focussed on stable, long-term compounders trading at reasonable valuations. Whether coincidence or not, this underperforming cohort was overrepresented on this trip, which saw it emerge as a key theme.

The moderate growth peer group has faced less obvious style headwinds in recent years compared to other style cohorts, which are even further from the so-called 'magnificent seven' stocks. However, ultimately, many of these strategies have faced the same active management challenges in the wake of extreme market concentration; growth extrapolation; and elevated valuations. We explore some of the nuances of these quality growth strategies (including attributes of some of the stronger and weaker performers over this period), in conjunction with investment process observations. Looking forward, we reflect on the relevant attributes of 'quality' and those managers taking a more conservative approach to marrying up valuation and growth.

In Part two of this paper, we focus on geopolitical considerations from a European perspective, which was a key thematic at Frontier's recent client conference. We will be releasing part two in the upcoming weeks.



# Compounders and the underperformance of quality growth?

Buoyant market returns and a narrow cohort of market winners since 2022 has been a boon for passive funds, high growth managers and many risk-controlled quants. However, prevailing conditions have also proved a headwind for most other active, fundamental managers, including quality-biased and more moderate growth style managers. Rising market concentration has coincided with strong momentum in emerging themes, driven by powerful new catalysts for AI and the explosive demand for weight loss drugs. This momentum has been led by the outperformance of the magnificent seven and increasingly Nvidia, as well as key GLP-1 weight loss stocks, Novo Nordisk and Eli Lilly.

These growth themes have driven a strong alpha recovery in the performance of long-duration growth managers that were most impacted by the rise in interest rates and PE de-rating of 2022. However, more moderate growth managers, including those with a quality bias have generally struggled alongside other active management styles in the ensuing 18 months. A growing number of these managers have faced difficulty purchasing or continuing to own the market's largest stocks on valuation grounds. This includes the more moderate

quality-focussed managers, typically looking for more stable compounders with predictable earnings and fade rates, which has made today's market darlings prohibitively expensive. In some cases, the resulting underperformance extends well beyond the prevailing market conditions of the past few years.

## Quality growth underperformance

Table 1 shows the median and quartile alphas of a curated quality growth cohort, which has underperformed the benchmark before fees over both one- and three-year periods to June 2024. FY24 was a very challenging 12-month period for active management for most style cohorts (with the exception of high growth and core/quantitative), compounded by a particularly poor June quarter for alpha. That being said, moderate growth underperformance was more modest over the one-year period (unlike defensive and value cohorts). Alpha is much stronger over the longer-term five-year period. We have recently released our FY24 paper on active management outcomes describing the drivers of this underperformance across the various style cohorts.

**Table 1:** Quality growth cohort quartile alpha (June 2024)

Gross (June 24)	Alpha one year	Alpha three-years p.a.	Alpha five-years p.a.
Median	-3.4%	-0.1%	0.6%
Max	18.5%	9.3%	6.4%
Min	-20.4%	-5.4%	-5.7%
Upper quartile	-0.2%	1.5%	2.4%
Bottom quartile	-10.5%	-2.0%	-0.9%

Source: eVestment, Frontier Advisors

We observed strategies employing a more dynamic and broader approach to quality have generally performed better in recent years. This includes managers with broader definitions around quality and durability, which includes exposure to more industrial cyclical compounders but even commodity stocks in some cases, where they see similar high barriers to entry emerging in a decarbonising economy. Although for most other quality growth managers (Australian equity managers aside), commodity exposure is incongruous with predictability and minimising downside capture.

Outperforming managers have also been selective long-term holders of the magnificent seven stocks as the epitome of quality compounders able to ‘beat the long-term fade’, in comparison to others dismissing high top-line growth rates as unsustainable, and on that basis, expensive. While their underlying assumptions differ, in both cases we observe valuation sensitivity, at least relative to a narrower focus on just quality metrics. These more flexible approaches include both fundamentally driven managers and quantitative strategies that rethink traditional quality definitions. The quants have also benefitted from more limited common factor active risk due to generally tighter active sector and country constraints.

Despite the underperformance, in most cases we take comfort that these active, quality-focussed managers are thinking about how quality will evolve overtime and what business models are truly durable (i.e. forward-looking quality) and importantly, what to pay for that quality. It’s yet to be determined whether a more conservative and traditional approach to defining quality yields bigger dividends moving forward, while providing superior downside protection. However, we’ve noticed the better performing quality growth managers are starting to favour (at least at the margin) more traditional quality hunting grounds, including more ‘stable’ growers and defensives. This looks to be an outworking of valuation extremes at the top end of the market and/or general scepticism that such a narrow number of stocks can continue to drive market performance. Although it remains to be seen whether this results in more correlated performance outcomes within this broadly defined quality cohort (given more common sector tilts), or the opposite, with more diversified stock selection (i.e. less overlap).

Frontier’s proprietary peer set alphas (median) over the one and five-year periods to June 2024 are quite telling. The five-year horizon includes periods very conducive to both growth and value, albeit value’s time in the sun was shorter-lived. It’s not surprising that core investments have performed best over the last five years. Quant managers have especially excelled since the ‘quant winter’ of 2018-2020, as they were less affected by underperforming sectors and regions, particularly US tech.

The last year has certainly been a strong period for high growth, but core has also performed in alpha terms. However, the defensive cohort has been the clear underperformer over both the one- and five-year periods. Given the strong downside capture (i.e. capital preservation) of this loosely defined cohort of quality growth funds, perhaps we should not be surprised by the challenged active management outcomes for this group. The superior performance to defensive reflects a combination of higher beta (albeit still below market) and factor exposure to other style cohorts.

High growth has outperformed over the past 12 months, while value (moderate and deep), moderate growth and defensive cohorts have underperformed. Essentially, investors needed to be as high growth as possible; valuation insensitive; and avoid defensives in such a strong market. However, core managers, at least those with a quantitative approach, have also delivered alpha as a product of relative value within sectors and by neutralising regional, sector and style tilts that have been such a headwind for most bottom-up driven managers (with the exception of high growth managers overweight US mega-cap tech).

**Table 2:** Frontier Global Equities Peer Set median alpha (June 2024)

Global equities median versus MSCI ACWI (June 2024)		
Frontier Peer Set	One-year (%)	Five-years (% p.a.)
Deep Value	-3.5	-0.9
Moderate Value	-6.1	-1.6
Moderate Growth	-0.9	0.6
High Growth	5.9	1.5
Core	4.1	2.1
Defensive	-7.3	-3.9

Source: eVestment, Frontier Advisors

## Defining quality

There is plenty of opinions on the true definition of ‘quality’ in active management and risk premia harvesting. This ranges from relatively simple factor definitions to more sophisticated and flexible forward-looking determinations, based on both quantitative and qualitative considerations. In academic terms, the quality factor has generally been an exceptional long-term outperformer and typically less cyclical than other factors proven to earn a persistent risk-adjusted return premium over the market. This is despite the questionable behavioural underpinnings of being compensated by a risk premium for holding quality stocks.

While we won’t go into the detail of defining quality, the different expressions of quality from our European manager engagements (both discretionary fundamental and quantitative) provide important learnings and input into how we differentiate our manager universe, and by extension the role these managers perform within the construct of multi-manager client equity portfolios.

But before we progress any further, it is important to note that Frontier does not define ‘quality’ as a separate peer set within our domestic, global or EM equity peer sets. Rather, quality is an attribute or factor represented to varying degrees across the spectrum of value, core and growth managers and overall equity portfolios. In this context, we recommend investors maintain a balanced portfolio with multiple exposures to robust factors (e.g. quality, value, size, momentum, low volatility) where practical. We also recommend these factor exposures are monitored via a risk model for awareness of relative positioning and rebalancing action taken when factor exposures move too far away from pre-defined tolerances.

## What makes a quality stock?

The MSCI ACWI Quality Index, which is based on its parent ACWI index, aims to capture the performance of quality growth stocks based on their exposure to three fundamental metrics – high return on equity (based on trailing 12-month earnings); low debt; and stable earnings growth (based on year-on-year earnings growth over the past five years). Some active managers (both fundamental and systematic) decry quality indices as overly simplistic in their narrow and backward definitions of quality. However, focussing on stable earnings, high returns, and low indebtedness aligns with the quantitative traits that most quality-focussed managers seek. They also consider qualitative and forward-looking factors related to management and business quality. Reasonable valuation is the other key consideration for most active, quality-focussed managers, at least relative to longer duration managers more dismissive of the relevance of short and medium-term valuation heuristics.

In any event, we observe the overweightings of the typical quality, moderate growth manager are diverging from the MSCI Quality Index, which notably today has a top ten that is very similar to the MSCI Growth and ACWI indices, including an even higher weight to Nvidia. Table 3 illustrates this high level of crossover the largest weights have within the MSCI ACWI and certain MSCI style factor indices.

**Table 3:** Top ten index weights (MSCI - June 2024)

MSCI quality	MCWI ACWI	MSCI Growth	MSCI Momentum
Nvidia (6.3%)	Microsoft (4.3%)	Microsoft (8.2%)	Nvidia (6.3%)
Apple (5.3%)	Apple (4.2%)	Apple (8.0%)	Amazon (5.1%)
Microsoft (5.1%)	Nvidia (4.2%)	Nvidia (8.0%)	Eli Lilly (4.5%)
Meta (4.9%)	Amazon (2.5%)	Amazon (4.7%)	Meta (4.5%)
TSMC (3.1%)	Meta (1.5%)	Meta (2.9%)	Broadcom (4.4%)
Eli Lilly (3.0%)	Alphabet A (1.5%)	Alphabet A (2.8%)	TSMC (4.3%)
Novo Nordisk (2.7%)	Alphabet C (1.3%)	Alphabet C (2.4%)	Alphabet A (2.6%)
Alphabet A (2.7%)	TSMC (1.0%)	TSMC (1.9%)	JP Morgan (2.6%)
ASML (2.3%)	Eli Lilly (1.0%)	Eli Lilly (1.9%)	Alphabet C (2.3%)
Alphabet C (2.3%)	Broadcom (1.0%)	Tesla (1.5%)	Novo Nordisk (2.3%)
<b>Total: 37.6%</b>	<b>Total: 22.3%</b>	<b>Total: 42.1%</b>	<b>Total: 38.9%</b>

Source: MSCI. Maroon: Magnificent seven stock. Orange: GLP-1 stock

A simple but important observation is that quality indices have become more skewed to mega cap tech because these companies have simply delivered consistent earnings growth and strong returns on capital with low leverage. However, they are still tech companies with more factor loading to momentum, which in theory increases the volatility of this quality exposure relative to the more stable compounders of yesteryear. Therefore, it is not surprising that many quality-focussed managers who prefer stable growers and reasonable valuations have struggled to keep pace with a market driven by higher growth names. Although for many investors, including some superannuation funds, the magnificent seven cohort of stocks are far from a one-way bet and represent a new breed of quality compounder, albeit higher growth and commensurately more expensive.

We're conscious that some quality-biased managers have struggled to keep pace with both quality indices and the broader asset class benchmark over an extended period. Additionally, many of the large tech companies have generated very consistent growth and returns over a horizon that extends well beyond the more recent AI driven boom. While most investors don't expect an explanation for the underperformance of quality when volatile commodity cyclicals are outperforming, it is a different story when debating the compounding attributes of a Microsoft, for example, and more specifically, the failure to identify this quality much earlier in the piece, at inherently cheaper valuations.

### European manager observations

Our performance discussion with European based global equities managers was a key starting point for gaining a different perspective on the underperformance of many quality growth managers. This included process learnings that further

informed our views around how managers are tackling the challenge of index concentration; elevated valuations; tech stock volatility (when targeting downside protection); and evolving approaches to earnings persistence.

We provide a snapshot of these process insights, with a more complete description included in the appendices. These manager observations included:

- How some managers define a quality compounder, including quants, is evolving.
- The market and 'quality' have been increasingly driven by a concentrated cohort of faster growing, expensive tech companies.
- Narrow markets and a focus on more stable/predictable rates of growth associated with traditional compounders is leading some moderate growth managers to look more value oriented.
- More flexible quality-core approaches have tended to do a better job navigating the rotational market conditions of recent years.
- One core manager is now prepared to hedge its exposure to the magnificent seven stocks (not previously held) by taking a market weight in certain stocks like Nvidia.
- A number of managers have been prepared to extend growth horizons within their valuation models, delaying fade rates but increasing forecasting risk.
- Some managers are more open to finding compounders in more cyclical domains than others, in some cases driven by thematic.



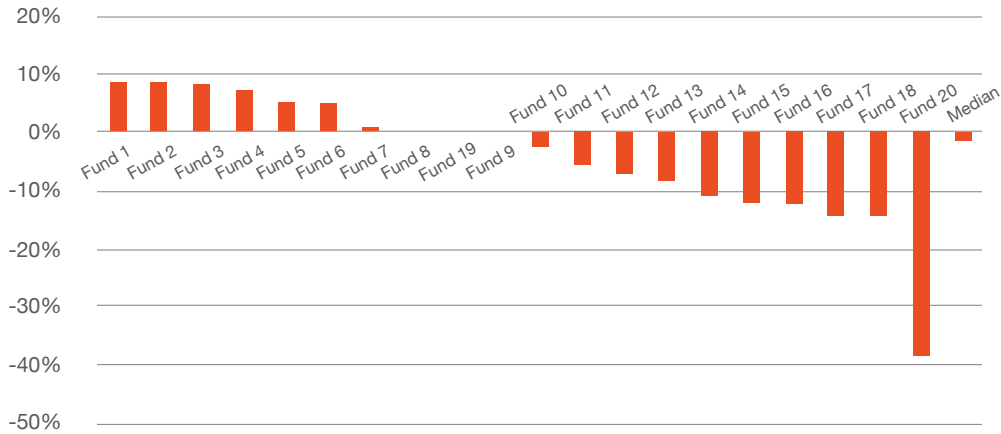
## Style and portfolio attributes of a quality-focussed manager

For the purposes of this exercise, we defined a cohort of managers focussed on ‘quality’ and made a comparison of their recent performance; downside capture/beta; common country, factor and sector tilts; and their positioning to the magnificent seven and the two major GLP-1 weight loss drugs. This is the same cohort of 20 managers referenced in the performance section.

### Active US exposure

The average active weight to the US is a 4% underweight (relative to the ACWI), which is a smaller underweight compared to other styles like value, which are much more underweight.

**Chart 1:** Active US country exposure versus ACWI

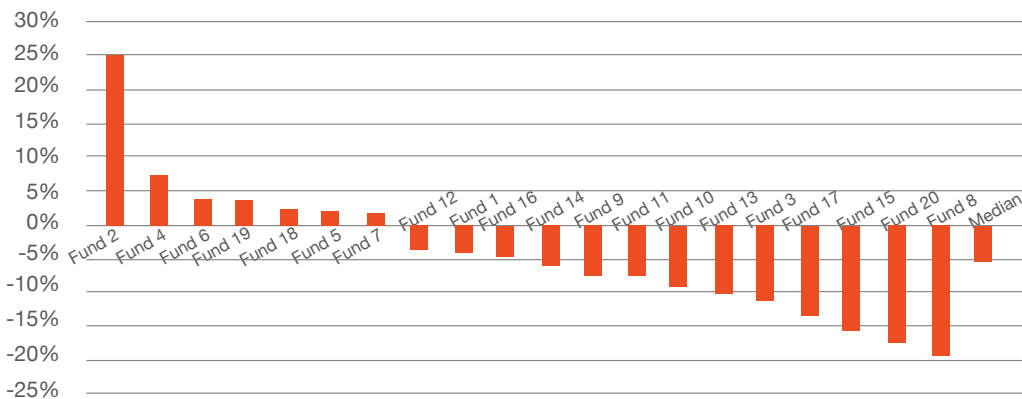


Source: eVestment, Frontier Advisors

### Active weight to the magnificent seven and GLP-1

We then examined the active exposure of each strategy to a combination of the magnificent seven and the two prominent GLP-1 weight loss stocks (Eli Lilly and Novo Nordisk), which have a combined index weight of 19.3%. This has since increased, driven primarily by Nvidia. At the end of March, the median strategy was about 5% underweight in these stocks. One strategy had no exposure, while another stood out by investing nearly 45% of its capital in this group of nine stocks, including a significant overweight in the two GLP-1 stocks.

**Chart 2:** Active weight to the magnificent seven and GLP-1 stocks

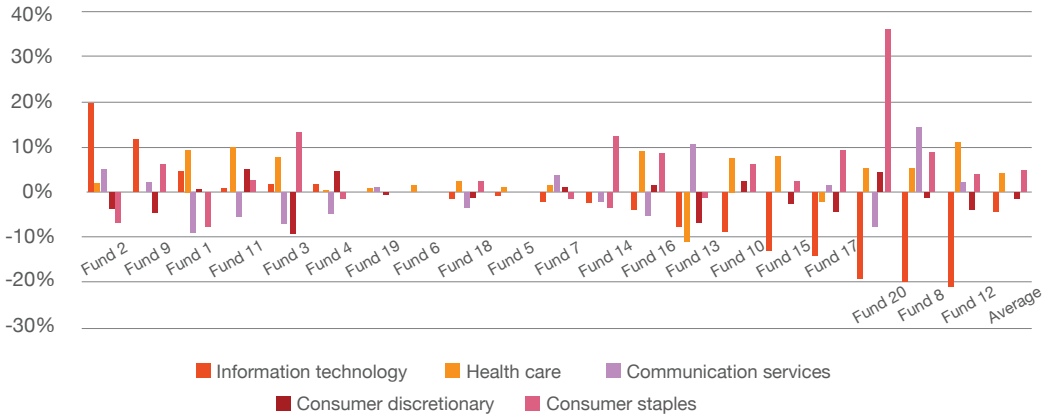




### Active sector exposures

We also analysed the active sector tilts (primarily bottom-up driven) for each strategy, with a focus on health care, IT, communication services, and the two consumer sectors, which tend to have significant exposures within the franchise strategies and some of the more traditional compounder strategies. The largest underweight was to IT (not unexpected), although this was similar in magnitude to the average overweight in the traditional quality stable sectors.

**Chart 3: Active sector tilts**

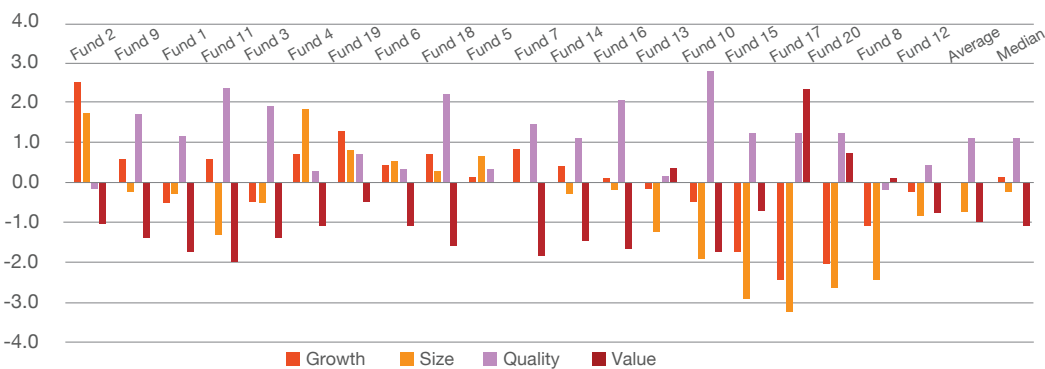


Source: eVestment, Frontier Advisors

### Factor tilts

We created composite value, growth, quality and size factor scores for each strategy. Looking at the median of these four factor exposures, there was a significant exposure to quality as expected but a similar underweight to value, which we expected to be more modest (larger if based on averages). Size was an underweight tilt as expected, while the median/average growth tilt was broadly in line with the index (slight premium). It is no surprise that the strong performers in recent years have a higher exposure to growth and size (as demonstrated by Funds 2 and 4 in Chart 4).

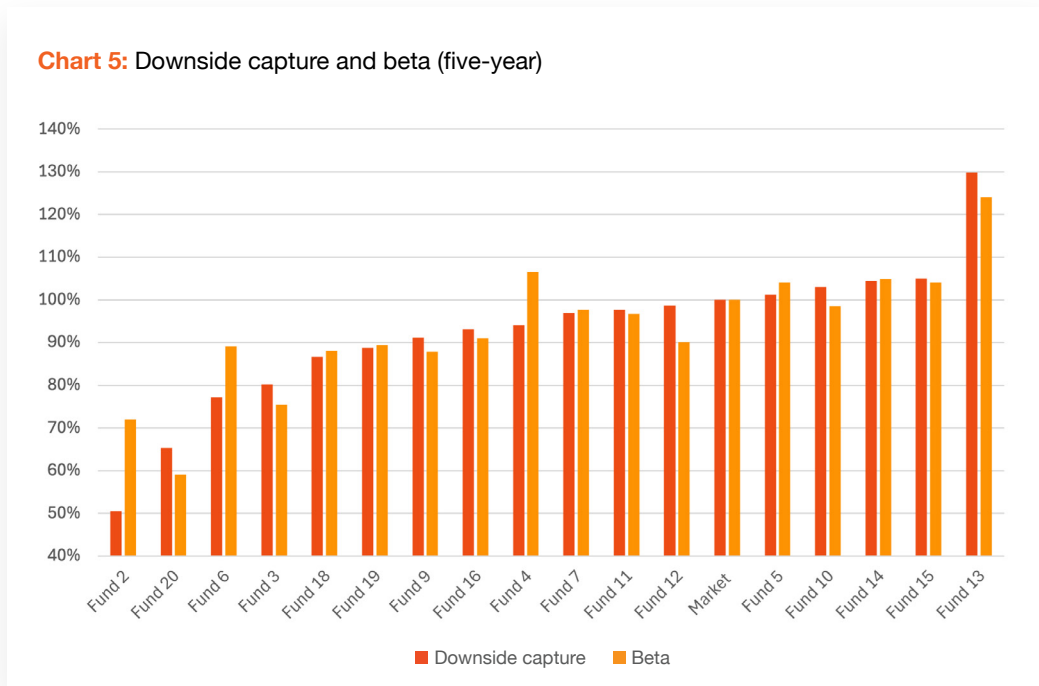
**Chart 4: Active factor tilts (+/-1 significant, +/-2 very significant)**



Source: Style Analytics, Frontier Advisors

### Downside capture and beta

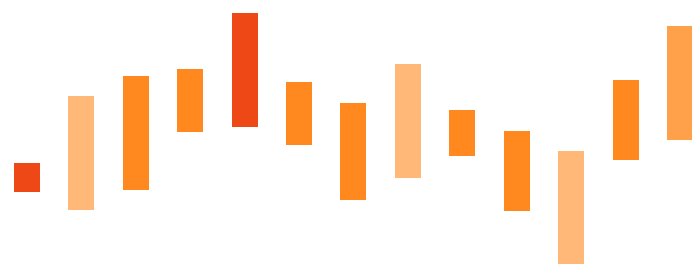
Finally, we looked at the downside capture and beta of the strategies, while acknowledging that a longer horizon would present a more robust analysis of these metrics than the five-year period illustrated in Chart 5. The higher tech exposure in general (although also a larger part of the index) arguably reduces downside capture expectations (in markets like 2022) outside of more unique drawdowns such as the environment associated with the onset of COVID-19 and pandemic shutdowns. However, all-else-equal, we would still expect capital preservation relative to the market for most of these strategies in a more typical recessionary downturn, subject to the level of beta, tech, cyclicals and momentum exposure.



Source: Style Analytics, Frontier Advisors

### Have things gone too far – recognising the value of quality-focused investing

For those investors expecting higher correlation of excess returns to quality factor indices/ETFs, cheaper implementation options may be a better fit. However, from our observations most actively managed quality growth strategies are building on more static, backward-looking measures of quality and stability, while integrating more forward-looking evaluations (as it relates to sustainable earnings growth) and importantly, valuation to reduce downside risk (some with more success than others). This multi-faceted approach to quality is not the domain of one type of active manager but evident across a range of fundamental, quantitative, concentrated, and diversified strategies. Nor is it as simple as distinguishing quality growth from quality value (or moderate value from moderate growth). Notwithstanding, there is certainly a spectrum of quality definitions across the European teams we met with, alongside the broader cohort of managers within Frontier’s universe of quality growth managers covered.



It would be easy to dismiss the value of quality growth strategies in the face of narrow market conditions more favourable to passive and higher growth styles owning the market's largest stocks. Beyond meeting their stated long-term alpha objectives, we also think it is important to recognise the broader attributes of these strategies (e.g. downside protection, style diversification) in the context of elevated market valuations.

This is particularly the case for those strategies with a strong dual focus on capital preservation (e.g. the franchise strategies) and the value of this contribution to an overall equities portfolio at key points in the cycle.

### 1999 or 1972

It is not uncommon to see comparisons made between the sky-high valuations of today's tech leaders and the speculative internet bubble of the late 90s. Market concentration was also a feature of this period, while there were also examples of fundamentally strong tech companies like Intel, Cisco, Dell and Microsoft. However, many of the other tech companies that dominated the index in the late 1990s were arguably far more speculative than today's winners, including the magnificent seven. For this reason, some suggest the so-called 'nifty fifty' period of the early 1970s more closely resembles today's environment in so far as great companies in many cases with strong earnings and profitability trading at elevated valuations.

The cautionary tale was that the starting valuations of this high-quality group of companies of the day in the early 70s led to disappointing relative returns over subsequent periods, including the recessionary environment of 73-74 despite strong

quality attributes. While business model disruption (quality impairment) was the ultimate driver of returns to the downside in some cases (e.g. Kodak), many of these quality companies had ultimately been bid-up excessively on the expectations of continued exceptional growth, which proved unsustainable in many cases (i.e. high valuations metrics did ultimately matter).

By definition, the 'nifty fifty' was a broader group than today's market darlings but also not a specific index or even necessarily an agreed group of 50 companies at any point in time. The ten stocks shown in Table 4 represents the ten largest stocks by market capitalisation at the end of 1972. This was compiled by Bridgeway Capital from an aggregation of two lists and includes some of the well-known examples of the day.

**Table 4: Nifty fifty top ten**

#### Nifty fifty top ten

IBM
Eastman Kodak Co.
General Electric Co.
Sear Roebuck & Co.
Xerox Corp.
Minnesota Mining & Manufacturing
Procter & Gamble Co.
Coca-Cola Co.
Avon Products Inc.
Johnson and Johnson

Source: Bridgeway Capital Management

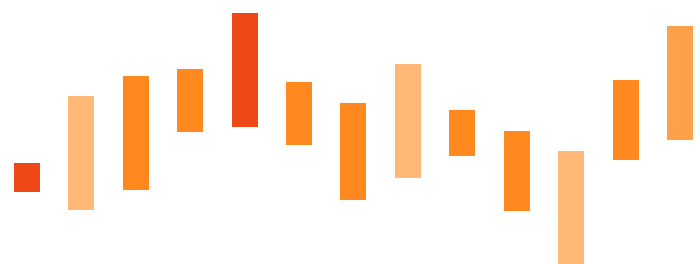


Comparison to either the internet bubble or the collapse of the nifty fifty may prove to be totally unfounded. Who's to say whether the magnificent seven or the weight loss stocks prove to be the ultimate long-term compounders and continue to justify their high near-term valuations. At this point, the reality is that many lagging strategies will likely require a meaningful reversion in the market's rising concentration to recoup underperformance (i.e. a broader market of winners), noting Nvidia accounted for approximately 25% of FY24's total market return.

### Key takeaways

It has been a challenging few years for the so-called quality-growth style, taking into account the outperformance of value cyclicals and a big de-rating of growth stock multiples in 2022 (where some quality growth managers were overexposed in hindsight), and the ensuing outperformance of the expensive magnificent seven and GLP-1 weight loss stocks. But what can we take away from the philosophical differences and variable style/allocation tilts, when it comes to dimensioning managers with a 'quality' focus? We think the underperformance of the broadly defined quality cohort in this paper is not altogether surprising when we consider the drivers of the market over the past five years and particularly since 2023, given the typical underweight exposure to the US mega-cap tech, along with value in 2022. These strategies have essentially been stuck in the middle, although the more flexible/rotational strategies have tended to buck the trend, primarily due to higher magnificent seven exposures and, in some cases, also value cyclicals at the right time.

Perhaps the key takeaway here is that quality is broadly expressed (perhaps even more so than value and growth), which underscores the importance of dimensioning the specific quantitative and qualitative attributes of individual managers that emphasise 'quality' in their stock selection. For many managers, quality reveals itself overtime, although must be appropriately priced. For others, it is perhaps more in the eye of the beholder and/or more a forward-looking concept that can also be dependent on the prevailing market cycle. We are empathetic to both perspectives and for the most part think the variable definitions/implementations of quality growth have been true-to-label and within expectations given the prevailing environment.



# Final word

Our performance discussion with European based global equities managers was a key starting point for gaining a different perspective on the underperformance of many quality growth managers. A simple but important observation is that quality indices have become more skewed to high growth, mega cap tech (the so-called magnificent seven) which for the most part have delivered fundamentally. Therefore, it is not surprising that many quality-focussed managers leaning more traditionally into stable growers and reasonable valuations have struggled to keep pace with a market being driven by these less predictable names. On the other hand, for some investors (including super funds), the magnificent seven cohort of stocks are far from a one-way bet and represent a new breed of quality compounder, albeit higher growth and commensurately more expensive.

It's important to remember that most quality growth strategies tend to be more conservative in balancing valuation with quality and growth. However, this might not have been true for all strategies in 2022. Generally, quality-focussed strategies should deliver reliable capital preservation in most market drawdowns, but also the prospect of better forward-looking returns as a result of lower relative starting valuations. While many active managers, including many quality growth strategies, have struggled to deliver alpha in this environment of high valuations and increased market concentration, it seems the wrong time to capitulate on their role within a style-balanced, multi-manager equity portfolio. At the same

time, these strategies enjoyed remarkable tailwinds for much of the previous decade. Additionally, we think investors are right to question managers that focus too much on recent year headwinds in explaining longer-term underperformance. This is particularly the case where there has been a failure to identify long-term value creation in the face of an overly simple and/or dogmatic focus on the quantitative characteristics of a compounder. It isn't about being an early investor in Nvidia but there have been plenty of opportunities to identify some of the magnificent seven stocks earlier in the piece as durable compounders. Whether that is still the case on a forward-looking view at current valuations is a more difficult question.

Stay tuned for part two of our paper which focusses on geopolitical considerations from a European manager perspective.



## Want to learn more?

We hope this paper has generated ideas for your own portfolios. If you are interested in learning more, please reach out to your consultant or a member of the Equities Team.

# Appendix

The table below presents a snapshot of some key process insights from our European manager engagements (relating specifically to the discussion of quality growth). Each row represents a discussion with a specific manager.

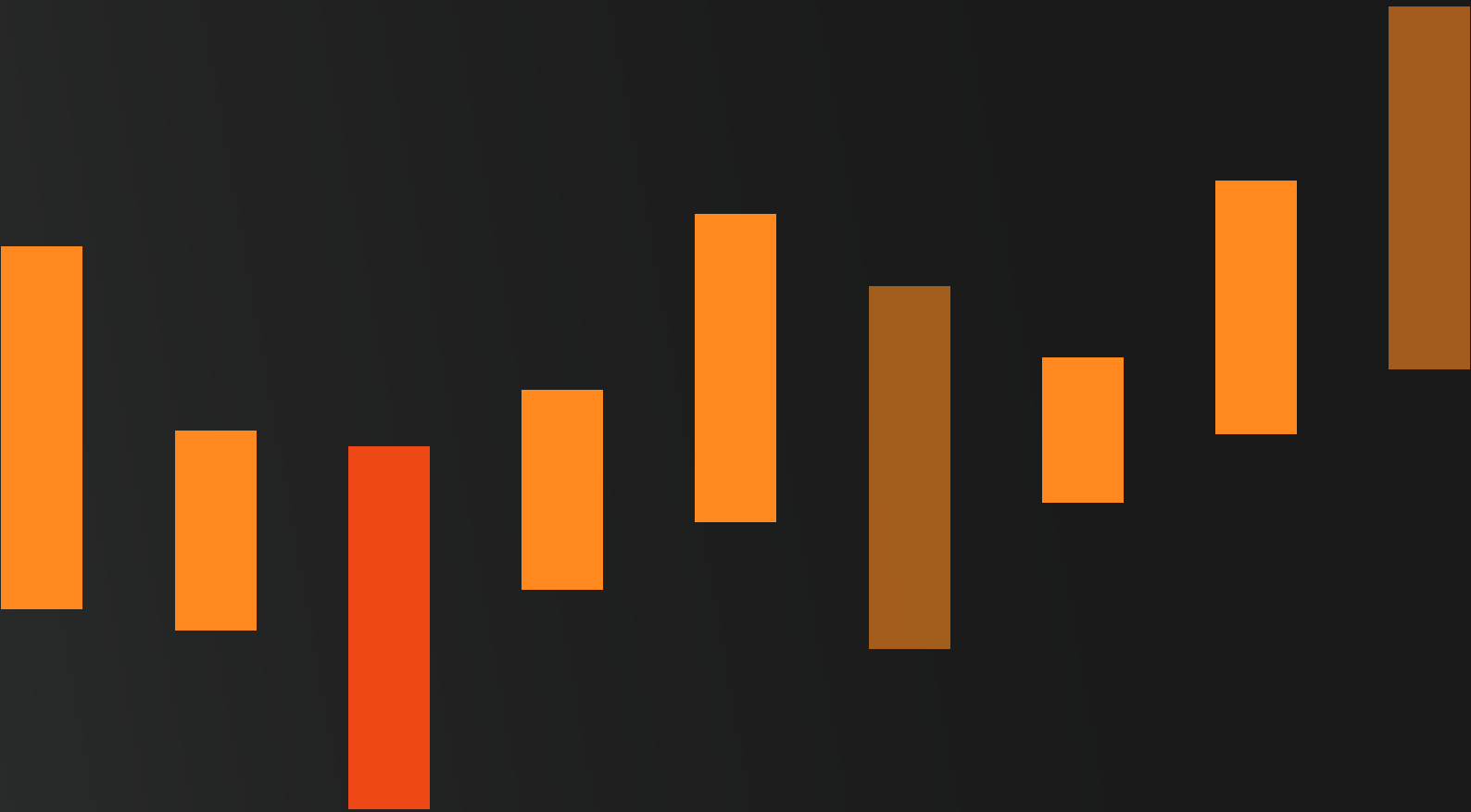
## European manager process observations

Quality approach	Observation	Process takeaway
ACWI fundamental - core	Recently took a position in Novo Nordisk. The catalyst was an analyst successfully challenging PMs on extending standardised fade rates for pharma companies (beyond horizon of typical patent cliffs). The analyst's view was that Novo was uniquely positioned with moat attributes to justify a longer growth runway. Interestingly, this was also extended to Microsoft (also the case with other managers), where the team has continued to evolve its view on the sustainability of the company's growth outlook – increasing confidence of the value creation occurring within both the cloud and now AI.	A number of managers have been prepared to extend growth horizons within their valuation models, delaying fade rates but increasing forecasting risk in the process. With the benefit of hindsight, the manager believes they have been too conservative/rigid in applying standardised fade rates within their valuation models – so are prepared to be more flexible than historically the case.
ACWI fundamental - core	As a core manager, PMs believe the outperformance of the magnificent seven has increased the importance of risk diversification post COVID-19 for a core manager. Where the manager believes the fundamentals of a magnificent seven company are strong, but the valuation upside does not meet its minimum requirements (or range of outcomes for projected earnings too wide), it is prepared to take an index-like exposure to minimise the active risk impact.	One core manager is now prepared to hedge its exposure to the magnificent seven stocks (not previously held) by taking a market weight in certain stocks like Nvidia. This is different to a fundamental manager taking an overweight position in a runaway stock like Nvidia based on revising its own upside target (as we observed in several cases) and/or purely for momentum reasons.
ACWI fundamental - core	Portfolio construction is diversified and tends to favour quality and value but with the objective of delivering consistent alpha, commensurate with the strategy's core objectives. The PM wants to concentrate the portfolio in premium quality stocks (has different quality tiers) but will flex these two factors depending on market conditions. The manager's more flexible approach to quality and valuation has contributed to a more consistent alpha profile in recent years, relative to some of its fundamental core peers. Higher valuation spreads and related volatility in recent years has created more opportunity for mispricing for the manager's process. Interestingly (like some other more flexible approaches to quality), the manager believes "defensives" have been completely overlooked	More flexible quality-core approaches have tended to do a better job navigating the rotational market conditions of recent years – and even thrived given more inter sector dispersion.

	and are looking increasingly attractive relative to history and where we are in the interest rate cycle. As a result, the manager is leaning into traditional staples and utilities (which has lowered the portfolio beta). If correct, this should also benefit those quality-focused managers more focussed on traditional stable growers.	
<b>ACWI fundamental – quality growth</b>	The manager's more valuation sensitive approach to quality will typically steer it to more moderate, steady growers relative to faster growing, more expensive expressions. Performance hurt by higher weight to more traditional compounders in health care (not GLP-1 stocks), staples (Diageo, Unilever), luxury names, in addition to some underperforming industrial cyclicals.	The market and 'quality' have been increasingly driven by a concentrated cohort of faster growing, expensive tech companies - a major headwind for a more traditional quality growth approach focussed on steady growers or with greater sensitivity to valuation targets.
<b>ACWI fundamental – quality growth</b>	The manager has suffered underperformance like other moderate-growth peers, particularly in 2023 (although the manager's track record also now lags its benchmark over long-term periods). The manager finds the current environment particularly challenging (with most things too expensive from its perspective), so has been looking at opportunities with decent levels of growth and good quality at much cheaper starting multiples. However, most of the manager's new ideas appear more valuation driven (except for the recent purchase of Microsoft) on the view that the market has left behind quality companies not obviously exposed to AI tailwinds. The resulting portfolio is now at its historical cheapest but also lowest growth profile relative to the market.	Narrow markets and a focus on more stable/predictable rates of growth associated with traditional compounders is leading some moderate growth managers to look more value oriented. In some cases, portfolios characteristics are exhibiting historically low growth and valuation (relative to market).
<b>ACWI fundamental – quality growth/thematic</b>	The manager (via its thematic lens) is more open-minded than most quality growth managers about finding compounders in more cyclical areas. One key theme is the manager believes we are entering a more "tangible" decade due to underinvestment in physical infrastructure/outsourced manufacturing, which will enable a re-industrialisation of the west. Views the key winners of this theme to be industrial companies such as Siemens, which intersects with the broader themes of AI, reshoring, and transition to clean energy. The manager lamented current market concentration (few names doing disproportionately well), liking it to previous periods like the growth of the internet platform businesses but on steroids. The manager believes this concentration will end with broader opportunities for other compounders, including cyclicals. At same time, the manager admitted missing Nvidia was a big mistake.	Some managers are more open to finding compounders in more cyclical domains than others, in some cases driven by thematics – such as a rising opportunity for tangibles, which intersects with the broader themes of AI, reshoring and energy transition.

ACWI fundamental – quality value	With reference to Microsoft, this manager also believes it has been too conservative in fading its long-term forecast growth rates, which has seen a continual need to ‘lift and shift’ these valuation assumptions. This manager will pay-up for quality growth where visible, which has enabled it to capture more of the value creation in sectors like IT than some of its more classic value peers, along with some other conservative quality growth managers. Stock selection driven by quality screening and long-term valuation targets.	Some moderate value managers with a quality bias are longer duration in their modelling relative to their style peers - more focussed on the right price to pay for a given level of quality/sustainability (relative to near team P/E thresholds for example).
ACWI systematic - core	In contrast to most fundamental managers, this quality-biased quant has done a better job navigating the last two years – part of this has been risk management processes that limit the impact of the magnificent seven through greater portfolio breadth, along with higher within sector stock dispersion (has generally been a good period for quants). However, improved stock selection with the more stable cohort of companies has also been a contributing factor, with research undertaken into stable companies concluding that naive measures of stability no longer give a clear picture of business quality, as margins and moats slowly deteriorate. Essentially, companies that can grow revenues faster than industry average and above their cost of capital garner a justified premium and can beat the fade. This has led the manager to adjust its valuation parameters for companies with higher forward-looking quality and stability attributes.	How some managers define a quality compounder, including quants, is evolving. Systematic managers are scrutinising traditional quantitative definitions of a quality compounder, including more forward-looking attributes of resilience. At the same time, these managers are also conscious of ensuring too much momentum in models, so measures of quality must be backed by cash flows.
ACWI fundamental - franchise	The manager is not surprised by underperformance as they don’t expect to keep up in such strong market conditions (lower upside participation). The manager says they will continue to underperform (given valuation sensitivity) if markets continue to be driven by momentum and mega cap tech. They see the role of the strategy to protect the portfolio in downturns through both valuation discipline and quality focus. The magnificent seven stocks are generally trading below a 3% FCF yield relative to a portfolio on a 6% yield. The manager says the strategy will outperform when these factors unwind or in the event of a market downturn.	One franchise manager attributed its underperformance to its valuation discipline (rather than franchise quality underperforming).
ACWI fundamental - franchise	The manager attributes underperformance to quality/franchise stock underperformance (including the outperformance of IT, underperformance of healthcare) rather than relative valuation sensitivity.	Another franchise manager attributed its underperformance to franchise quality underperformance (rather than valuation sensitivity).





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