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The Local and Global Investment Climate

Charlie Aitken last spoke to us almost exactly a year ago just as the stockmarket was crashing in the wake of the realisation of the impact of covid-19 on global business and life. So, his return was very timely in providing a review of that extraordinary 12 months and an assessment of the investment climate both in Australia and globally.

After a period of lockdowns with unprecedented fiscal and monetary support, he described how a normalisation phase is starting to take shape with some confidence arising from the global roll out of highly efficacious vaccines now underway. This phase has seen increased confidence in the health situation, and emerging recovery in non-essential out-of-home economic activity, though at lower levels than pre-crisis.

The next phase is called the New Normal, where hopefully public health is well managed thanks to the vaccine, but many businesses and sectors may struggle while governments seek to wind back the massive support of the last 12 months. Investment questions arising include:

- What behaviours have changed permanently?
- What trends are reinforced/broken?
- What social or geopolitical changes lie ahead?
- What businesses will grow market share or benefit from changes (or both)?

Inflation is a risk that brings concern, especially as so many have flooded into the housing market where there would be massive problems if enough people have difficulty paying their mortgage obligations if interest rates rise significantly, though governments and central banks will strive to avoid severe problems overall. Inflation could be triggered by major infrastructure spending, tight job market, spending surges etc. For a business, there may be a risk of increases in nominal input costs, depending on its ability through pricing power to grow profits in real terms.

This has led AIM to seek to invest in businesses that exhibit a combination of pricing power, high returns on capital, low tangible reinvestment, robust cash generation and strong balance sheets. Many traditional businesses and industries may not have these characteristics.

On the other hand, some profitless companies' capitalisations have boomed, notably Tesla and Afterpay. All very well for an early investor, but the risk can be large for investors later in the cycle when rapid correction may be disastrous.

Instead it is considered more prudent to focus on a business's quality and resilience through attention to:

- Return on invested capital
- Cash flow

- Sensible capital structure
- Management track record (incl dealing with adversity), culture, integrity, vision, etc.

Examples of businesses were provided that met those criteria and have performed for the AIM fund even in the challenging market of 2020

He then helpfully and openly answered member's questions over a wide range of investment topics.