

# The Value Of Stable Growth

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*Stable growth companies have always played a key role in our investments, because they typically offer an attractive risk/reward profile. So, where do we find stable growth? Actually, anywhere. Business models with stable growth are typically associated with food producers, drug companies, utilities, telecom operators etc. This is also correct, but we find companies with stable earnings in all sectors and geographies around the world. We look for companies that produce products or services that we as individuals or companies consume on a daily basis almost independent of the health of the global economy.*

## Population growth an underlying tailwind

An important factor supporting long-term investments is the growth of the global population, and the rise of the middle class, where people have sufficient disposable income to spend on consumer goods and services.

The Healthcare sector for instance is supported by the growing and ageing population being offered new and better treatments to the benefit of our health. It is very difficult for governments and payers to restrict patients' access to new and innovative treatments even though the treatments are often very expensive. From an investment perspective this secures a steady growth in demand and revenues for innovative pharmaceutical companies.

Stable growth companies with a strong business model and good management can make long-lasting investments. Consumer loyalty towards brands (e.g. within groceries) is very high and many of us use the same products and brands through a lifetime, which turns into predictable earnings for companies with consumer stable.

## The software industry has transformed

Some of the highest growth companies can be found within IT, and many investors painfully remember the burst of the IT bubble at the start of this century, and thus perceive the IT-sector as risky. Parts of the sector are definitely high growth with high risk, but part of the sector is changing. Over the past few years, a number of software companies have transformed from a license-model with large up-front payments to a subscription-model (examples are Microsoft, Adobe, SAP). This makes revenue much more stable and predictable, because the transformation is like going from selling one-day-tickets to selling memberships. In this process, some of the software companies have improved their competitiveness and gained a higher share of the overall IT-expenditure. As an investor, we look for the companies, who have managed to increase pricing in this transformation, as more predictable revenue with higher pricing makes good long-term investments.

## Electronic payment is the future

There is a global trend from cash to electronic payments, because it is more convenient and safer for the consumer and the merchant. Investing in companies gaining from the electronification of payments (Visa, Mastercard, PayPal etc.) gives a broad exposure towards global expenditure without the risk from fashion, season or likely changes in customer behavior. The payment companies have built a strong reputation and invested heavily in security and fraud protection to make the transaction process smooth and safe. Many traditional retail companies have been struggling with online competition, but this is just another tailwind for electronic payments. We still see a long runway for electronic payments globally, and the biggest brands look to be the winners.

## Pay your rent

Rental property is another area of stable and predictable earnings, as housing secures a fundamental need for individuals and companies. Furthermore, property investment often benefits from contractually inflation adjusted lease agreements, which secures a real return for long-term investors. We prefer to invest in property markets with either a natural supply constraint (Manhattan, Hong Kong etc.), or limited supply due to slow and restrictive administrative procedures to increase supply (Berlin). If limited supply is combined with a good long-term demand for property, which is often the case in cities with population growth, it will most likely put upward pressure on rents and thus make the foundation for a good investment.

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## Are you insured?

In most countries it is mandatory to have car insurance, and most homeowners want to secure their homes with insurance. Therefore, automobile and homeowners demand is much more stable than life insurance, which is more influenced by the economic cycle.

In America the number of cars is growing steadily, and the risk of an insurance company is spread across multiple insurance policies. This lowers the risk for large sudden losses, apart from situations with natural disasters, but even under these circumstances insurance companies are very fast to reclaim lost payments by raising premiums. This also lowers the risk for us as investor. The insurance market for cars and residential property is not a fast growth market, but several insurance companies in these areas are very cash generative.

## In banking look for low risk balance sheet

Banking is typically associated with cyclical earnings, as banks usually lose money on their loan portfolio, when the economy slows down. To minimise cyclicality, it is important to focus on banks with a low risk balance sheet. This can be done by looking at their historical loss ratios, the size of the corporate loan book, loan to value on mortgages etc. Banks with a strong balance sheet and exposure to structural growth areas are factors to look for when investing in banks and a way to limit risk.

First Republic Bank is an example of a mid-sized bank in the US that historically has had high loan growth (15-20 pct.) in combination with very low loan losses. One reason is that they focus exclusively on the wealthiest customers and cash rich companies in the highest growth areas (California, New York and Boston). These customers usually have a strong relationship with their advisor and are less price sensitive, which is always a positive in investing.

## Picking the best investments

At C WorldWide, we favor concentrated portfolios with a long-term investment horizon. It is imperative to find companies with strong business models and preferably companies that have a natural moat, which provide pricing power and keep competition at bay. We look for these companies in areas supported by structural growth rather than relying on the cyclical tide to drive revenues.

A broad exposure towards stable growth areas gives our portfolios robustness, when the unexpected slowdown hits the economy or the stock market.

If you wish to know more please go to [cworldwide.com](cworldwide.com).

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