RJ Management

Deep Dive Chat On Future Tech Trends With Stefano Rodella, AtonRâ Partners

Hi Stefano, could you give us some background on your firm AtonRâ and how does your equity selection methodology differ from other fund managers?

AtonRâ finds its roots in fundamental thematic equity research since 2004. The quest for new investment themes with high-growth potential is what has driven the company since its inception. Curiosity, passion, and thorough analysis are the main drivers.

The picking of the right theme comes first. We come up with new investment themes by continually searching and questioning ourselves on how world economies are to evolve in the future and on how specific technologies are to change and disrupt the world we live in, in addition to their addressable market opportunities and growth potential.

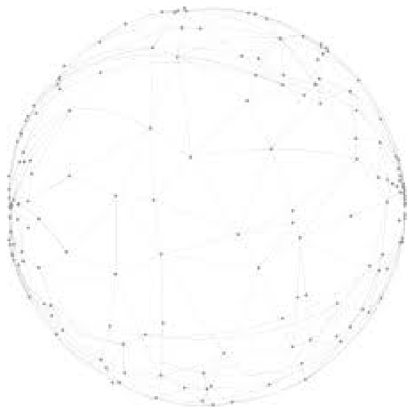
Only once this preliminary work is done, which is something we regularly do, we perform a detailed analysis of the whole investment ecosystem (including non-listed companies), and draw-up an investment universe which serves us as a guide for the investments we might do in any given theme. We believe that it is only through a complete understanding and most accurate picture of the whole investment ecosystem that we can better spot the most promising companies, which is precisely the main reason we are following the entire landscape rather than only focusing on specific (listed companies notably) investment opportunities.

I believe that knowledge is power but acquiring such knowledge requires tremendous efforts. We try to gain such understanding by focusing on the industrial landscape of any theme. We have an internal team of scientists and engineers in addition to a broad spectrum of contacts in the research, academic and industrial field, who are helping us better understand the fundamentals of any specific topic, besides regularly updating on the technological and product's landscape.

We always try to select those companies which are the ones that we consider as the "pick and shovels" of any theme and the companies with the best fundamentals. Such companies are not necessarily those with the best technological lead, but those who better forecast their industry landscape and execute flawlessly. It is not unusual to see that such companies are those with the highest barriers to entry and those maximizing shareholders' returns.

The concentration of the portfolios (15 to 35 investments) is thus a logical consequence of our fundamental research approach as we try, as much as we can, to have an investment portfolio made up of companies which are to perform the best from the growth in a given theme. The key is not to tame volatility at any cost but to have the best portfolio at any given time of the investment horizon that follows the investment cycles of the themes that we manage.

This bull market is already more than 10 years old, and equity markets seem quite mature. Given this, how do you envision the future growth opportunities of your investments?



Equities were a great place to be during the last ten years and still are in our view. Not all the sectors and companies performed the same, and technology led the gains with performances in excess of 500% during this timeframe. It will be even more so going forward as technology is taking over and disrupting almost every industry. One of the best examples is the shrinking lifespan of corporate longevity in indexes such as the S&P500. In term of valuations, stocks are not expensive at current levels (S&P500 trading at 17.2X forward PE's, well within historical averages) and when compared to bonds they are even much cheaper than what many ponder. When comparing a 10Y US Treasury bond yielding 2% vs. buying a stock at 17X PE, which is equal to having an earnings yield of 5.9% per year, we are very comfortable with current valuations. The different portfolios we manage carry a 1.5X to 1.8X PE / Growth (sure higher PE's but higher growth rates) which is at the low-end of the valuation band when compared to more mature companies.

If we compare private equity "buyout and growth funds," performances, where there's no liquidity, to returns in the "listed growth stocks" world, the investment case for listed growth equities is even more compelling. Over the last five years, the "listed growth stocks" performed on average 6% better (21% vs. 15%) vs. private equity.* We believe that as more and more money flows into the Private Equity space in addition to "passive" strategies, the valuation gap between the different approaches favors the "listed growth equity" world.

* source:
https://www.bain.com/contentassets/875a49e26e9c4775942ec5b86084dfoa/bain_report_private_equity_report_2019.pdf

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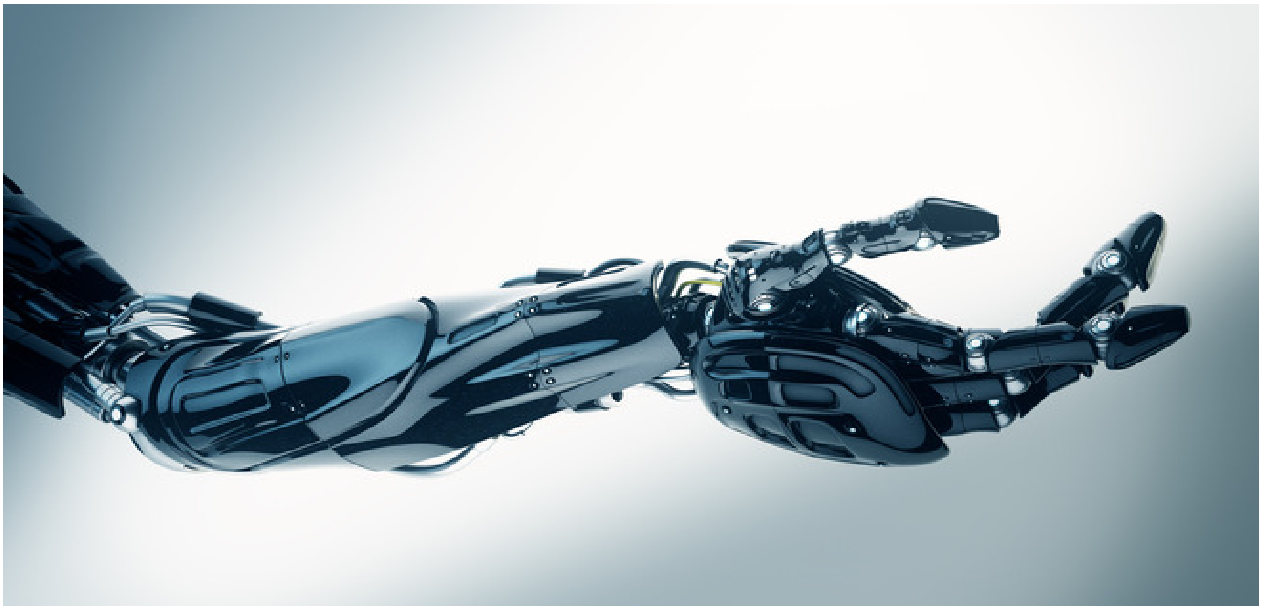
The Future Trends Certificate is currently built around 3 main themes chosen together with RJ Management: AI & Robotics, Bionics and Mobile Payments. What are the main arguments in favor of these sectors?

The increasing amount of data, coupled with the growing power of computing, is what makes Artificial Intelligence possible. We believe that we are only at the beginning of this investment cycle that is likely to carry on for the next several years. Artificial Intelligence is about automation and better efficiency. In a world where supply outstrips demand, every industry needs to be more efficient to remain competitive, and any task that could be automated will be so in the next few years. The value chain is moving up, and it is quite common-sense to us that those who do not embrace this technology are likely to disappear in the not too distant future. AI systems are very good at performing specific tasks, but when it comes to generalization, we're still far away from the day where we would see a machine behaving like humans. We believe that many businesses (and new companies and jobs) are going to emerge from this theme in the next few years, and we are closely following their developments. We notably believe that AI is to get out from the business world and to enter in force the "retail" world with applications based on edge computing, i.e. that would directly work on anyone smartphone device without having to transit through data centers, making them even more efficient.



Bionics is about the merger of electronics and biology. Nowadays, we see more and more products getting out of the clinical labs and coming into the market that all try to help and improve wellness and lifespan or the world population. As the market expands, costs are gradually declining, which in turn acts as a catalyst for their adoption. Social welfare is another significant catalyst for this kind of products and the main reason why more and more insurances across the world are reimbursing such expensive devices. It cost less to the social system having people who are healthy and reintegrate work rather than having the same people in need of assistance. The Bionics theme invests in companies spanning from medical robots to wearable medical devices to synthetic biology, which encompasses complex biologically-based functions that do not exist in nature, and many others.

Penetration rates in the Mobile Payments space are still low on a worldwide basis, and the authorities' push for a cashless society represents significant catalysts. The need for more efficient and cheaper transfer of money around the world (fees in the high single/ low double-digits figure) and the access of financial services from the unbanked of the world are also significant catalysts going forward. In the developed world, customer demand for seamless services such as Uber, the push towards real-time payments, and the growth of digital commerce are the main growth drivers. Here in Europe, there's an epic change taking place on September 14th, 2019. It will be the date in which the European Payment Services Directive (PSD2) comes into force. This law was designed to boost competition and give access to the fintech incumbents the traditional banks' customer data if the customers decide so.

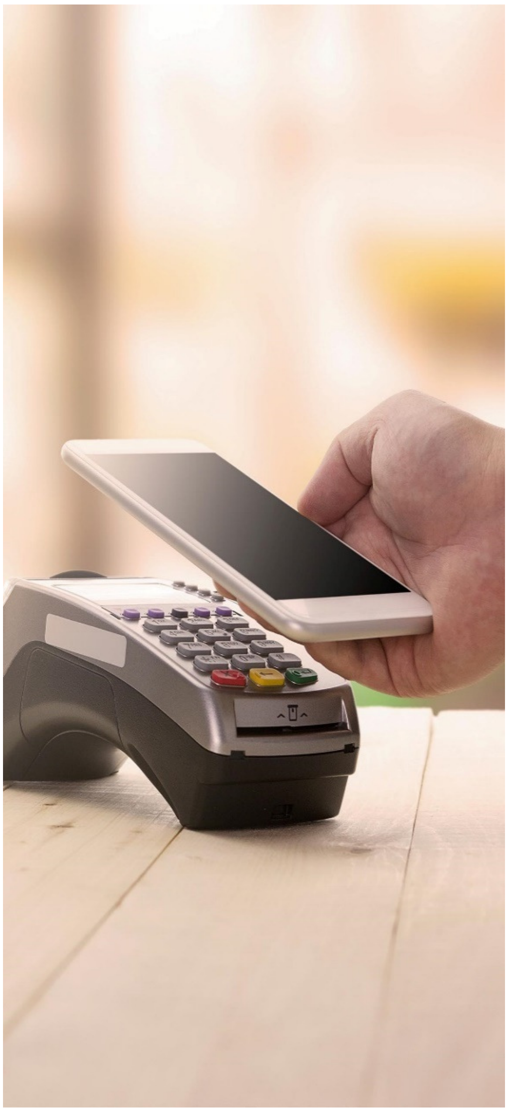
Picture: Elie Joory (left), Partner at RJ Management and Stefano Rodella (right),, Managing Partner at AtonRâ Partners

AtonRâ launched the Mobile Payments thematic in 2014. How have both the ecosystem and the growth drivers of this strategy evolved since?

We launched the Mobile Payment thematic in April 2014 with the firm conviction that the total addressable market was huge and offered an excellent growth potential for the years to come. We thought back then that the timing of the launch was just right because we had many catalysts all pointing in the same positive direction. Governments around the world were all pushing to have a cashless society; the millennials embraced peer-to-peer payment apps as speeds we rarely saw before; the possible entry of Apple into this market; the mandatory upgrade from credit card players such as MasterCard and Visa towards heightened security features such as chip & pin and many more.

With all those catalysts aligning, we saw a significant market opportunity for industrial players (the payment terminal vendors and the companies that were selling chips) that would have benefited from the upcoming Industrial Capex cycle. However, on a longer-term basis, it was quite clear to us from the beginning, that the real true winners would have been those companies that would have directly benefited from an increase in the volume of digital payments, thanks to the increased adoption of Mobile Payments.

More than five years after having launched the Mobile Payment theme, the same initial catalysts are playing out favorably but some others (blockchain – e.g., Libra, cashbacks, coupons, ...) are acting as additional drivers for the increased adoption of digital payments going forward.
We believe that the best days for this industry are ahead of us as the world's Mobile Payment penetration rates are still low (16% on average). If the Chinese market could serve as an example (in just five years, China shifted from a society where cash was king towards a cashless society), our initial statement might be even too conservative. Thanks to the data collected from digital payments transactions, which represents the primary fuel for Artificial Intelligence applications, companies such as Alibaba and Tencent were able to offer additional value-added services to their customers and have proven that they can disrupt legacy players on the one hand and the other hand expanding existing markets such as financial services.



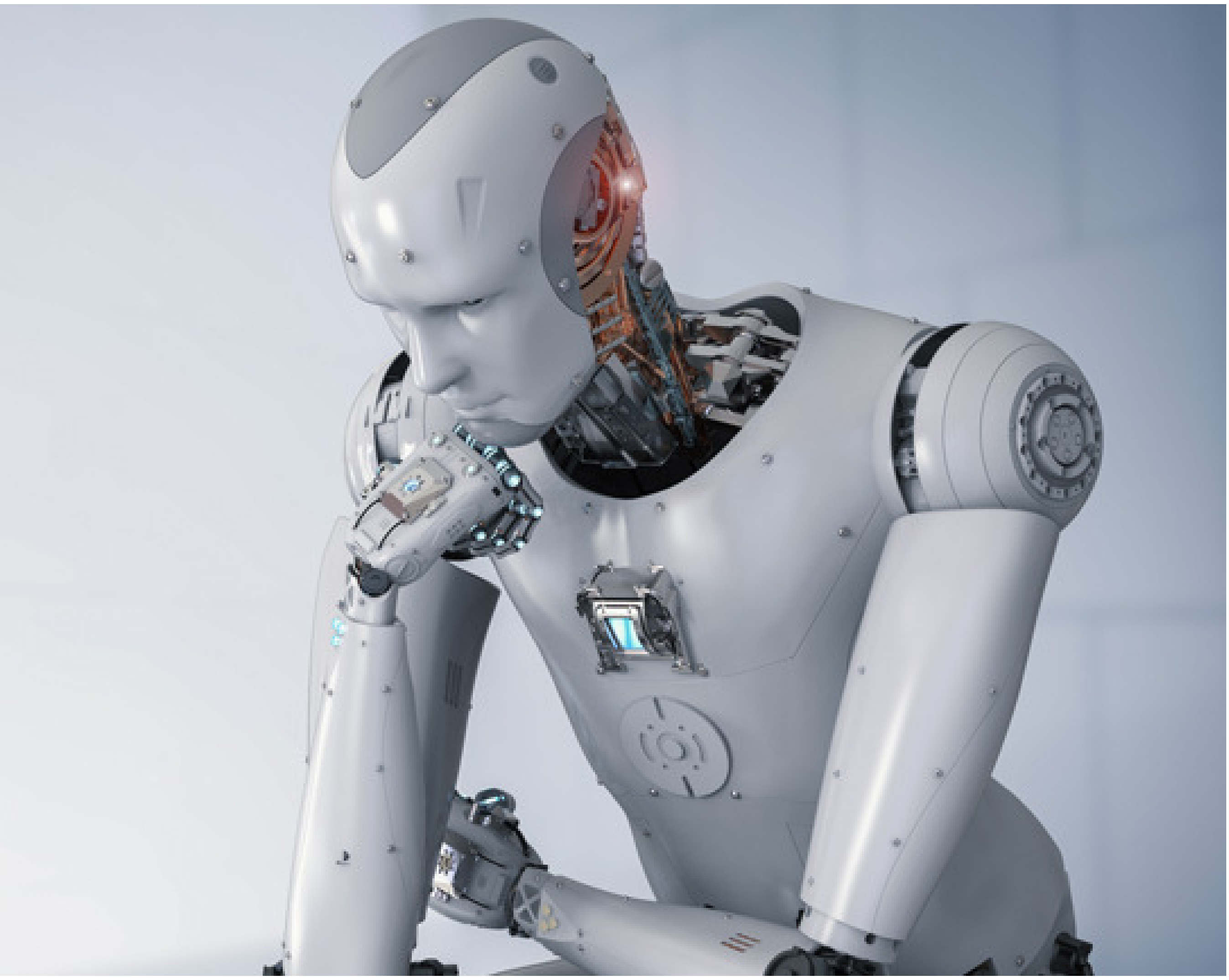
AtonRâ finds its roots in fundamental equity research. Despite a strong volatility, we noticed you hold some positions for several years (eg: Square – over 35% volatility). What are the key criterias to justify keeping a position for so long? How do you build your strategy around one thematic and keep optimizing your risk / return profile?

Our approach is definitively a fundamental one, but I would go a step further by saying that we are very close to a private equity approach. When we decide to launch an investment theme, we try to have the best mid-to-long term view and to have the most accurate forecast on the different cycles of the industry. When we decide on the portfolio's constituents and weightings allocation, we want to have the most significant exposure to those companies which we consider as core holdings (what we call the pick & shovels) and which are to benefit the most from the growth in a specific industry, sub-sector or any particular topic.

Unlike conventional wisdom, very often, there are only a few real players (oligopolies) which genuinely benefit from a specific industry's drivers. What we continuously try to do in all of the portfolios that we manage is to invest during the take-off or the growing phase and to exit when it matures. Such cycles are often longer than anyone thinks, and the aim is not to exit before we see the growth opportunities extinguish and not just because the stock price had risen. It explains why we tend to keep stocks for many years and do minimal turnover in our portfolios.

Higher volatility does not only mean higher risk but also higher expected returns. The perception by investors around volatility is not always well understood as they tend to look at only the negative side of it. For us, higher volatility means that there's an investment opportunity that is not fully appreciated by the market. What makes it a break is the knowledge and the understanding of the company's underlying business potential going forward.

Our most significant positions in any of the portfolios are the ones that carry the highest risk-adjusted upside potential such as Square. The remaining part of the portfolio is often made up of companies where the growth cycle is more advanced, which tend to bring down the overall portfolio's volatility. I believe that to have the best risk-adjusted returns portfolios one would need to navigate through the different cyclical phases of the theme (here is where we tend to trade), as the industrial players are different depending on the cycle.



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