Hello and welcome back to Conversations. Today we welcome Qiao Ma, lead portfolio manager for Munro Partners Global SMID Strategy, which has just clocked up its first year. Qiao will be speaking with GSFM CEO Damien McIntyre, and together, they'll discuss smaller mid-cap global equities, Munro's approach to this sector, and importantly how these strategies can add value to investor portfolios.

Before I hand over, I need to read this important notice.

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Damien and Qiao, it's over to you.

Damien McIntyre

Thank you Tracey, and welcome to Conversations, our podcast series. Today I'm with Qiao Ma from Munro. The point of the conversation series is to achieve two things. Firstly, you, the listeners, to get to know our partners better and for you to have a connection, greater connection with them as people, as well as investors.

And the second objective course is to give you a hidden gem that will either make an investment concept clearer to you or answer a lingering question that's been in your mind for some period of time. So yes, we want to bring you closer to our partners and at the same time, we want to try and provide you with insights that makes your job of conversing the clients about asset classes, investments, stocks, et cetera, a little bit easier. So with that, I'd like to welcome Qiao Ma, welcome.

Qiao Ma

Thank you. Thank you, Damien. Thank you Tracey. It's really good to be here with all of you. Thank you for listening.

Damien McIntyre

What I'd like to do is let's just start with you Qiao Ma, and let's talk about you growing up, where you were educated, and then let's step into how you found yourself in finance.

Qiao Ma

Yeah, sure. So I spent the first 16 years of my life in China. I was actually in China when the first stock exchange really opened on the ground and my dad took me to the local stock exchange and I was hooked. I still remember that moment. I walked in. There were a lot of men, a lot of smoking and there was a lot of digits and numbers showing up on the screen and I loved it. So growing up, stocks was always part of our family.

And then, I went to the United States for school when I was 16. I got a finance and economics degree from University of Virginia and University of Virginia has one of the top undergraduate commerce program in the US. And I was very, very fortunate that one of University of Virginia's graduates founded a huge hedge fund called Blue Ridge Capital, and he's one of the original Tiger Fund investors and his name is John Griffin.

He came down to UVA, gave a speech, and he donated a really big Bloomberg centre. So I really learned how to use Bloomberg and really learned stock investing in university. I started my career as an investment banker in the entity, formerly known as Lehman Brothers. I started off in New York. I had a short standing in Hong Kong, then I went back to business school at Harvard and coming out of business school, it was just really, really clear to me that I wanted to be a stock picker, I wanted to be an investor, and I had never done anything else ever since.

I worked at various US-based hedge funds for about a decade before I moved to Australia, and I continue to be a fund manager. So it really became this passion that started a really young age and continues, and I am pretty sure this is what I'm going to be doing until the day I die.

Damien McIntyre

I hope so too. So tell me about the firm you started working with in the US straight out of business school.

Qiao Ma

Yeah, so I joined a fund called Coatue. This is one of the tiger funds that the founder of Coatue used to work at the original Tiger Management, which was run by the world-famous Julian Robertson. Coatue was run very much the same way as a lot of the very classic tiger funds. Coatue was very focused on tech and consumer and very focused on growth. So the actual focus of Coatue is very similar to what we are doing today at Munro. And the philosophy is very, very deep research, very fundamental, very individual, stock driven. And one of the things that we were really instilled with as a very young analyst is we were obviously based in New York, and you invest with stocks globally. And it just doesn't matter if you invest with a very small Tokyo-based Japanese stock, you better know more about that stock than anyone else in the world.

The worst thing that could happen to an analyst and that any of the tiger funds is actually not when you lose money on the stock, it's when your portfolio manager realise that you missed an angle on research that you didn't know as much as the analysts of the other funds does. And it's not a good day for you when that happens. So it would just instilled in the very early on that you got to do deep research, you got to go visit companies, you got to know more about a company. It doesn't really matter where you are geographically based.

Damien McIntyre

Do you apply that across all of the sectors you invested?

Qiao Ma

Absolutely, and that's in a lot of ways the deep research ethos runs deep in Munro today. We got asked that a lot. We're based in Melbourne Australia. We love living in Melbourne Australia. The whole team sits here, but we invest with companies in all corners of the world. But that deep conviction that we can do really good deep, good work and deep work and we can get to know a whole lot about these companies. And I think for me personally, a lot of that conviction comes for the training of being a New York based investor but invest globally.

Damien McIntyre

Well, I mean it's often said an experienced analyst or an experienced portfolio manager, they know their sectors, they know their stocks, but they are such huge universes. How do you cover all of those universes to get the level of satisfaction that you're looking for?

Qiao Ma

There are a couple of angles to really think about that question. It's a really good one. So at Munro what we are looking for, and I joke about it and I say our entire process is designed like a heat-seeking missile looking for earnings growth. So what we are looking for is sustainable earnings growth over three to five years. And when you actually get down the nitty-gritty of it, you'll realise it's actually really hard to grow double-digit for three to five years. Very few businesses in the world can do that and there are stocks at Munro that we've held for 10 years. So that's even harder to grow year in and year out for a whole decade. And you don't get to do this unless there is really big structural tailwind behind your back.

So we call this areas of interest. So to your question, we actually don't brand ourselves as sector specialists. So at Munro we don't have an industrial analyst, we don't have a consumer analyst. We are also not organzing ourselves by region. So we don't have a Japan analyst, we don't have a China analyst. What we do specialise in is to truly understand these structural decade long growth tailwinds because we think that these tailwinds will carry a whole group of company to grow very fast for a long period of time. So we have roughly about 20 of these tailwinds, what we call areas of interest. And any particular point in time, seven or eight areas of interest will make up about 80 to 90% of the portfolio. So that's basically the whole book.

And what we do across the 12 of us is we go very, very deep to understand these tailwinds, why it happened, where is it happening, what does it really mean for multiple industries? Very often one tailwind, artificial intelligence is the perfect example, is one tailwind, but is actually touching many, many industries. So we then cast a net pretty wide to look for the beneficiaries really across different industries, but really being carried by these massive tailwinds. And that's really where we go deep. And then the second thing I would say about it is ... and some of the readers where the listeners might have followed our climate fund, our climate fund has an absolute cracker of a year more than 60% for the year. And you really ask, well why is this happening? Well, what's happening is when two tailwind collide, and this is actually the best thing. We love seeing two huge sectoral tailwinds carrying the same group of companies forward.

So for climate, this is the year where artificial intelligence and the need for power and the world's need to decarbonise. These two massive tailwinds collide, and they carry this group of companies just go kaboom. And they just become so entirely different companies within a very short period of time. So that's really how we think about the world. We find these tailwinds, we became experts in the areas of interest that we look at, then we find the best beneficiaries to really benefit from the tailwind. And then lastly, what I would say is every stock then make it into the portfolio on its own individual merits. So all the deep research, truly understanding the financials, the quality of a particular company, build a relationship with management team.

So then we really meld that bottoms-up work with our top-down understanding of areas of interest. And that's really how we end up getting pretty across to a lot of these stocks.

Damien McIntyre

You are a small and mid-cap specialist, is that a fair observation?

Qiao Ma

It's fair, but it's also not fair. It's fair because I'm the lead portfolio manager of the mono-global growth small mid-Cap fund. So yes, I'm across all the stocks that's in the portfolio. It's not fair in the sense that I also spend a good chunk of my time with mono-global growth, which is the all caps fund. So I do spend a lot of time looking at large cap companies and sort of to bring back to the earlier point. What we are specialists in is we deeply understand these structural tailwinds and we find the winners that's in the large cap space for our large cap fund because we have certain liquidity requirement, but then we find the small edgier companies that no one is looking at, but they're in the same areas of interest carried by the same growth tailwind.

Those become the components of the mono-global growth small mid-cap fund component. So yes, we have a small mid-cap fund that's doing very, very well. It's also having a very good year. But really, the lens, the research gets driven by the areas of interest by this very, very big picture, very big lens that look at the world. And this really differentiate this fund. And sometimes I say this is a small mid-cap fund, but it has the lens and the perspective and the vantage point of a big cap manager because these are not small companies. Yes, they are small in terms of market cap, but the areas that they play in the markets are huge. So these are small players. I often think about it, they're small boats but they have a big sail and they have this big tailwind behind them and that's why they're sailing really fast.

Damien McIntyre

Not every company is a fairy tale story. And let's just say that particularly in small to mid-caps. There are more imperfections to be aware of and to navigate every company is subject to a calamity, but the consequences, particularly when a small cap has had a big run, when things change, they become very volatile and tricky. With all your years of experience, what has it taught you about having one eye on the future and awareness of what could go wrong perhaps?

Qiao Ma

I mean you have to be really, really on the lookout. So think you are right, the small cap companies tend to be a bit more volatile, but the real risk actually doesn't lie with the volatility itself. The real risk lies with you'll have to rely much more on yourself to do the research because the small cap companies we look at, many of them might have one or two sort of a second-tier broker analysts look at it at best. There are just not a whole lot of publications and research sources in the public domain that we can leverage on. So you do have to do the hard yards, you got to go meet the companies, you got to go through a lot of the filings, you have to really sort of do the very fundamental work as investor yourself. Luckily, we enjoy that kind of work.

So that's been really good fun. But back to the risk side. So we run the small mid-cap fund with the same risk management system that Munro's has had over the past seven years. And it's a simple process, but the outcome is outstanding. So before I joined Munro, I sat down with the CIO and founder of Munro, Nick. And he said, well, in seven years of running Munro, we've never lost more than 100 basis points in one stock. And I just say, get out of here. There's just no way. I've worked my own share of fund managers to understand that that's just really hard to do for a concentrated growth fund regardless of market cap. If you think about how volatile, how much Google, Amazon, Apple could move, these are trillion-dollar companies and it's not uncommon for them to move 10% or 20% in a week.

So I said, how is that possible? And they said, "Well, we run this risk management process as a simple process." We looked at the stock as a review whenever it is down 20% either from the peak or from the cost. So we called it a trigger review. A stock will trigger if it's down more than 20%. And it is really an art and the science. So a trigger review is not a forced sale, so you don't get closed out automatically because your stock closes, but if your stock triggers, the entire team gets involved. We basically researched the stock with many, many fresh pairs of eyes and then, after a period of time we come together, and the stock gets pitched in front of everybody as if this were a new idea and then we take a vote. If you have one dissenting voice from the investment team, we sell the stock.

And that's our trigger process. If you did, the entire team unanimously agree that we will keep the stock for a certain period of time, we are very definitive about that period. It's never unlimited. It's usually a couple of weeks, a couple of months or to a particular catalyst. And then, if the stock doesn't untrigger, by then, we sort of do the trigger process again to really make sure we don't miss anything. So as a growth fund manager, big cap or small cap, the biggest risk we have is hopefully, we fell in love with our own thesis. We fell in love with the company, we fell in love with the management team, and next thing you know your stock is down 90% and you can't bring yourself to even sell it anymore.

So at 20% a growth investor is still in a very open mindset. We can still look at the mistake, we can still say, "Yes, you are right, we missed this part of the research. This turned out, not to be what I thought. Let's close out, let's reevaluate. We can always get back in." So that trigger process has really been ... really crucial and essential to Munro's investment process all along. And for the small mid-cap fund, we actually stick to it. There are investors that come to us and say, maybe you should have a longer leash, maybe you should have 30%. And we just end up deciding this is the same team, same process. And now, we've run the fund for almost 14 months. And I'm actually really pleased to say that the trigger process really works even for the small mid-cap fund.

What we aim to deliver to investors is if we are right because we invest with growth and small companies, we intend to make multiple times around money. But if you're wrong, we try not to lose more than 20% and we know we just rinse and repeat that process and really stick to it. We will deliver the return objective that we aim for of our investors, which is 11 to 13% annual return.

Damien McIntyre

So coming back to consistent right across the first, is this belief in structural growth and big tailwind and you are looking for companies that have leveraged that successfully. So let's take the tailwind industry aside. When you are looking at a company, what are the characteristics that leap off the page?

Qiao Ma

Yeah, so we actually have a six point test that we run with every single company we look at. And the first thing is customer perception. And this is a completely qualitative characteristics and is a really simple test, is when your name is mentioned to your customer, is there a little smile on his or her face? And it sounds no trivial and simple, but you know what? When we actually go back and we look at the best growth companies over the past 100 years, not a single one of them does not bring that smile to their customer's face for a very long period of time. Because without that, you don't grow. You don't get to beat your competitors, you don't get to grow your revenue and you don't get to grow profit.

So that is the first time that the first thing we debate at the boardroom of Munro, is the customer perception high? Does your customer love you? And by the way, we really aim to do the same for all of our clients. Hopefully, you have a little smile on your face when you think about Munro. The second thing we look for is control, which is another way of thinking of management. So we are unabashedly backers of founders. We love founders that still own the business, that still sweat in the business day in and day out. Damien, you're one of them. We know these hardworking founders and we really back them. We think that they were just no one that worked harder, no one that cared about the business more than the founders themselves.

And then, the third and fourth one we're looking for is more quantitative growth metrics. So we're looking for revenue growth, at least double the GDP. Most likely you get to close to 10% revenue growth as a minimum to be a Munro stock. And we're looking for earnings per share faster than revenue growth. So it would definitely be double-digit earnings per share growth. And then lastly, we also look for really good ESG practices because in today's day and time, not having ESG is just ... there's no way you can be a great growth company over long term without good ESG practice. And finally, all this needs to be sustainable.

So we're looking for all these metrics that I talk about, but over at least a three to five year period because it's not a one-year cyclical recovery, we're really looking for the sustainability of earnings growth.

Damien McIntyre

And when these companies change gears, they get into a slipstream, they're moving fast, it's all great. What are you anticipating every time they've changed gears? Are the earnings lumpy or tell us about the earnings cycle. What are you generally expecting?

Qiao Ma

Yeah, I mean look, every company is a little bit different. So we are growth investor. So unsurprisingly we think about the world in a little bit of S-curve. So at the first half of the S-curve, the earnings are accelerating. And this is actually precisely why most of the people consistently ... Well, most of the investors in the market consistently mispriced growth companies because the human mind cannot really handle acceleration, compounded growth. And what I really mean by that is the human mind naturally assume, if you're growing 20% this year that you're growing 15, next year, you're growing 12 the year following, right? That's how every single sell side analyst model a growth company.

But when you actually go down and understand what's making these company's growth, they don't grow like that. They actually grow 20, 30, 50 and then they actually ... some of the growth companies keep at 50% for a few years and then, they slowly come down. So when you are in that growth tailwind, when you really understand which part of the S-curve is in, this is where the money is made, is instead of decelerating from 20 to 15, you're growing 20 to 30. And then imagine what that would do to your stock price. So that's sort of our bread and butter is to understand the trajectory of growth, the reasons of growth, and to really properly price the earnings growth and not just take the sell side consensus as a given.

Damien McIntyre

Munro set up their universe of company, areas of interest. So can you just very quickly define what an area of interest is. And then two, are there any areas of interest that are in front of you right now, that you think are particularly exciting?

Qiao Ma

Yeah, so there are about eight in front of us. Right now, that's really, really exciting. That's really sort of what make the portfolio home base is it's not really driven by just one areas of interest. Usually, we always have seven or eight of these growth drivers and we try to make them as uncorrelated as possible. But let me give you an example of areas of interest. So high performance compute is in areas of interest and most of the companies in hyper…

Damien McIntyre

Sorry. What does high-performance compute mean?

Qiao Ma

High-performance compute means that when compute goes very, very fast and very powerful, and this really goes into what's really driving artificial intelligence. So AI is doing some pretty amazing things globally right now. It's really touching every single industry that we could see, but at the core of it, is because now, we can do compute much faster than before. And that's how artificial intelligence works because it relies on many, many iterations. So that the simplest example is we are all wowed by Adobe's Firefly generating images of a cat. But for that to do it, for the program to do that, the program has seen billions of pictures of cat.

And then, it basically needs to work out, this is a cat, this is a dog, that's a rat, that's a cat, that's a dog. And then, after a few million times the program goes, "Aha, that's a cat." And then the program turn around and start regenerate images of cats. And that's why we see the outcome of that. So what we say high performance compute, we really refer to really the most direct contributor is the semiconductor industry because this industry enable the acceleration of the speed of compute. But why don't we just call it semiconductors? Why do we call it high-performance compute to your point, Damien, because high-performance compute is the actual tailwind. It's actually not semiconductors.

Today, it's semiconductors. It could actually be driven by entirely different components going forward, but to us, what's exciting is compute is gaining performance. Compute is getting faster, and the champion of that is NVIDIA. And NVIDIA basically make compute a thousand times faster for certain tasks over the past seven years. And the best, the old non-high-performance compute has ever achieved was roughly 100 times faster over 10 years. So we are talking about compute getting faster at an unprecedented speed. We basically have never seen that. And so Munro, we end up holding NVIDIA for a very long time. We continue to hold it as a core position, but we also find all these helping companies, all these we call NVIDIA's helpers.

So we find all these companies that's directly in NVIDIA's ecosystem. So we're not stepping outside of the NVIDIA ecosystem. We said this is the winning ecosystem. We think this ecosystem is going to run away with 80% of the market and we want to find the helpers. We want to find the people that's winning alongside NVIDIA. And that's really how we end up finding about six to seven cluster of companies for the Munro global growth, all-caps fund. And in this research process, we just look literally not even that far from our own nose. And we saw all these very small edgy, fast-growing, incredibly unique companies staring at us in the face and they're all in the high-performance compute.

They're all enablers of NVIDIA and they're all small and no one is looking at them. So we just scooped them up and then we put it in the high-performance compute areas of interest for Munro global growth, small and mid-cap fund. So that's usually how we drive it.

Damien McIntyre

Well, there's an old war story and I think it's associated either you or the firm that you worked with in New York, took an iPhone and looked at the components internally and then, track two made them and invested in those. Is that true? Is that-

Qiao Ma

Yeah, it is true.

Damien McIntyre

It is. It's not a figment of my imagination.

Qiao Ma

It's not, although it's part of the urban legend at this point, but it did happen. And the gist of that and why I love repeating that story is the year was 2009 and it was actually quite obvious, and that was iPhone 4. It was pretty obvious that Apple was winning the race of smartphones, but Apple's stock has also gone up a lot. So there will be investors that I was working at a hedge fund in New York, and there will be investors that come to us and say, "Well, I missed Apple. I blink, I missed Apple. Who's the next Apple? Tell me who the next Apple is. Is it HTC? Is it Samsung? Because I'm going to then invest with the next Apple."

It's completely natural to ask that question, but now with the benefit of hindsight, that was the wrong question to ask because you know what guys, 20 years later there was never a next Apple. The next Apple was Apple. Apple end up running away with 80% of the market. Then, we go back and do the study of all the previous technology eras and we realize, hey, IBM ran away with 80% of all the profit made in mainframe. Intel and Microsoft ran away with 80% of all the profit made in PCs. Actually for technology that it just somehow, this is how the industry shake up is the winning ecosystem takes it all. So now we look at AI and you are right, so we did break a party iPhone, we end up buying all the components within the iPhone.

We end up shorting because it was a long/short fund. We shorted everything that was not in the Apple and that trade itself probably make more money over a decade than anything else that we come up with. And I just consider myself incredibly fortunate to be able to do this with NVIDIA because now, it is looking pretty obvious that NVIDIA is winning the race. It is not just years ahead of his competitor, it is running faster as well. So how do you catch up to someone that's ahead of you that's still running faster than you? So if you think NVIDIA, which we do believe that is going to run away with 80% of the profit made empowering AI, which is a far bigger era than smartphone or PC, the mainframe.

Then the really natural question is who's enabling NVIDIA instead of saying who's the next NVIDIA? So we found, yeah, there's roughly 10 companies that we identified as helpers of NVIDIA. It's a very dynamic space. So we also made some mistakes. There are companies we thought were helpers of NVIDIA turned out they were not so much and there were companies that we didn't realize were, turned out to be. So we continue to modify our own process and the portfolio holding the process as well, but yeah, that's how we come about.

Damien McIntyre

So technology and as we were just discussing, it's a market segment that is incredibly exciting. And as a market participant, you're very fortunate to have a front row seat on change, significant change and observe it financially as well as its impact on society. But tech aside, they're less exciting sectors that you look at with the same passion. Do you look at boring things and get excited as well?

Qiao Ma

The more boring the better and I'm saying this with tongue in cheek, but it really is true, and I said this because it comes a surprise to many people. So as much as we love high-performance, compute and technology, the top five holdings in Munro global growth, small, mid-cap fund today has one technology holding. The other four is non-tech. The top 10 has two. So eight out of my actual top 10 portfolio companies are not in technology at all. And where are they? Well, the interesting thing is a lot of these growth trends, and that's why we're not sector specialists, is when you take the lens and saying, well, who's really benefiting from the world digitizing? Who's benefiting from the world using AI?

We end up finding companies in some really surprising industries. So I give you a feel, we found companies that are in the security areas of interest. These are state and local ... So we found a company that sells tasers and body cameras to state and local police mostly in the United States. And because the taser company works so well with a body cam, in any kind of incident, if they taser is pulled, not only the body cam on that police officer turns on, the body camera in all his bodies, also turn on. So then you have a whole range of body cameras recording the same incident from different angles. And then, 10 months ago, the company used AI and say, "Well, if I'm already recording all this data and uploading it to the private cloud of the police department, why not run the AI program and just write the entire incident report?"

It turns out an average policeman spent two hours on his desk, writing reports instead of patrolling the streets, this AI program called Draft One, end up saving an average policeman one hour a day, and that's an hour that he could use to go out and help people and maintain the safety of the citizens. So that's such a massive benefit. So we hold that company. We also found imaging equipment and imaging centres in the United States. Now they run an AI program in the scanning images they do for an AI mammogram reading, for example, an AI program can actually detect cancer 18 to 24 months earlier than what a human eye can. So imagine the benefit you are rendering to your patients.

So now, they're rolling out the digital service to a broader range of imaging centres. Now, they just strike a deal with the world's second largest imaging machine, which is GE Healthcare, to basically sell that software bundle with all the machines that GE has installed. So that's another incredible example, but this is an imaging centre business and this is completely non-tech, but the business itself is actually being held by AI a lot. So we probably have six or seven of these examples. Sometimes boring industries, but really going through some pretty incredible trends that we really like. And the last thing, which is really why we end up holding these companies is because these are winners and beneficiaries of AI and changes, but they are in boring industries, so no one looked at them.

So when we bought these industries, a lot of times we end up paying really boring, low, quite cheap valuation for these companies because no one is looking at them. And then, they started to grow earnings a lot faster. The business started to look very different. That Taser company went from essentially 100% hardware company to now, software being almost 40%. So it is almost borderline a software company and the market don't tend to wake up and give them the proper valuation until years after the transformation. So this is really also why we see the opportunity. So yeah, so eight out of my top 10, not even in tech.

Damien McIntyre

Now I want to ask you a question, a live question. How do you anticipate the Trump trade and the new era of US politics over the next four years? Trump is very pro-tariffs, pro-America. How do you see that playing out?

Qiao Ma

Yeah, I mean look, so far there have not been concrete policies being even proposed or pushed through. So I think it's probably a little premature. We don't really position our portfolio to benefit from Trump or to run away from potential Trump dangers in any way. We are bottom-up investors. We look at the company's earnings growth and our companies don't really need the government's help to grow their earnings. So far, obviously, it's been a volatile period. So far, there are some sectors that the market anointed as Trump winners. There are sectors in the market anointed as Trump losers and you start seeing these volatility. But for us, that's all short-term noise.

Ultimately, a stock price should follow a company's earnings, and if we are right with the earnings, then we should be roughly right with the stock price direction. That being said, I just went to Chicago for a really great industrial conference and America is definitely turning inwards. What I mean by that is tariff is only one aspect of it. There is a really big push within the American companies and also the American government policy to say, let's promote more manufacturing, more production on the soil of the United States using US labour, using US equipment sell back to US companies. So you do think for quite a lot of the industries, you do see a little bit more what I call internal circulation within the country.

But labour is really expensive in the US. So the next natural question is, well then, how do you reconcile the fact that you are just at a cost disadvantage when it comes to labour? And to us, this is something that we are researching actively. Frankly, we haven't quite figured out which companies is benefiting because a natural answer is actually AI and robotics within American manufacturing because that you could lower the price enough to be very competitive to international production. So we are really focused on this. We think it's really interesting to think about AI intersecting with the physical world, and that's one of the things we're excited about for 2025. So if I broadly think about AI, 2023 was really the year that AI sort of captured our attention and start to be built.

And 2024 is AI making its way into a lot of more tech-savvy industries and 2025, we actually think AI is going to get everywhere. It's pretty interesting to be an American industrial company at this point, because you have the internal circulation, you have the clients and customers turning inwards at you, and then you have this opportunity of building the modern manufacturing instead of building the old world manufacturing.

Damien McIntyre

Once upon a time United States held this view of the world, US was the centre of tech development and advancement. Where do you see that continuing?

Qiao Ma

I mean so far probably.

Damien McIntyre

They certainly have the capital. They've got all the capital to deploy. So in this sort of era of onshoring and protectionism, where do you see around the world other areas of tech excellence and tech development?

Qiao Ma

I actually think the development of AI probably put America pretty firmly back in driver's seat. And just because AI and NVIDIA and this high-performance computing, the design really go back to the United States. Obviously, the manufacturing of the actual silicon itself is still in Taiwan. 90% of the world's most advanced chips are still made in Taiwan today. So geopolitics definitely play a role of how the tech products will be made in the future. That's why you start to see a lot of government subsidies being give out to chip plans to being built onshore in the United States, in Japan, in Europe, really everywhere. But as of now, yeah, I think if the driver of tech development so far is artificial intelligence, then you do see the American companies having an advantage.

And that's also why this issue has really become a very sensitive one when it comes to geopolitics. NVIDIA is basically banned from selling any chips to China at this point. So this is definitely being used to Americans strategic advantage.

Damien McIntyre

So there'll be geographies that simply won't be able to catch up. China being one.

Qiao Ma

China is catching up really quickly. It's a long race because the semiconductor industry has been around since the 60s globally and is one of the most well-oiled, incredible supply chain that really has all these very specialised companies playing a critical part of it. So it's not about just replicating what NVIDIA does, China is actually rebuilding an entire ecosystem, but to what we could see, they're catching up fast. There are a lot of very, very smart engineers in China. I think that their breakthrough is already surprising the rest of the world. So I think the race is on.

Damien McIntyre

And in terms of everyone's concerned about Taiwan for obvious reasons that they are the epicentre of chip manufacturing and so forth. Where are TSMC in particular and others in the evolution of de-risking manufacturing from Taiwan?

Qiao Ma

They make some really good start. So the Arizona plant in the United States run by TSMC had a bit of a slow start now that they're roughly three years in, looks like they're actually catching up to the Taiwanese facility in terms of yield for chips and they will be supplying some of their American customers with chips made in Arizona. So I think they're making good progress, but this is just a very long-term project. I think it's going to take another 10 years at least for a truly meaningful portion of the chips being made outside of Taiwan.

Damien McIntyre

So okay, let's look at where we are today. We launched the fund 13 months ago, there or thereabouts. The fund has got off to a fantastic start. For those on the outside looking in who are saying or thinking it's up 50% in a year, I've missed the boat. What do you say to them?

Qiao Ma

I would say you definitely have not missed the boat that the boat was just getting started. Maybe let's just take a step back on why Munro Partners started this fund to start with. So we are growth investors. We've always looked at growth up and down the market cap, and we start noticing just these small companies being really cheap. So by cheap, I really mean two things. The first thing is any astute investor that just tracked the evaluation of the performance of the Russell or any type of small mid-cap index for the entire market, you will realise that this is the lowest relative valuation that a small mid-cap space had in 20 years.

So not since the dot com bubble had these stocks been this cheap relative to their big cap peers, but frankly that is interesting, but it's not that interesting to Munro because there were a lot of things in the small mid-cap index. Frankly, we will never invest in the cyclical, the highly levered, and we were just not interested in that kind of companies. But when we are looking at NVIDIA and we realise, well, there are parts of the NVIDIA supply chain right now is being offered to us in terms of shares of the stock being very cheap relative to the growth that we think they're going to have, that's really interesting to us.

When we start to see companies like Reddit, which is really having this fantastic social media business that we know really well because we've been looking at Facebook for so long. That's really interesting to us when we start looking at little software companies like App Loving that is also part of Facebook and Google's critical ecosystem, which is why we get to know them really well, being sold at 13 times earnings for a pure software business. That's really interesting. So we started this fund, knowing that the valuation on the absolute level, which is really low, these stocks are being very cheap. And the second thing that excites us even more is we know the earnings are about to really re-accelerate for these small companies.

So fast-forward a year, I would say the 50 something percent growth that we've had, vast majority of that was earnings growth. The reset of the valuation has not even started yet, because even today, the Russell and the small mid-cap index is still languishing. So the investor's attention is just starting to turn to the small mid-cap space, but it really hasn't come in a major way. So this is just good old earnings growth that's getting the returns of the fund. And when we look forward for 2025, I think this is going to be a really good year for the earnings growth for the small mid-cap fund. And then if we do get any kind of valuation reset that it just cream on top. And then the very, very last thing, which also has not started until probably now or a little bit later is M&A.

So M&A has been on ice since 2022. M&A is coming back in full force and a lot of these small mid-cap companies, because they're so cheap, they're actually just a natural acquisition target for any of the big cap company CFOs or even for PEs. So we do expect to see a lot of the deal activities happening again, and we haven't even factored any of that in our portfolio stocks. We sort of know which ones probably should be a decent acquisition target, but that's not in our model. That is not ... if it happens, that's just pure upside. That's not something we are factoring in or paying for at all.

Damien McIntyre

Yeah, yeah. I mean really, if you go back to the end of '21, so we got into '22, we came into a period where there was supply chain issues around the world, which sparked inflationary gene, well and truly got out of the bottle. Rates went up rapidly, M&A departed, and we were in this limbo for a period of two years.

Qiao Ma

Yeah, just from a stock picker's perspective, this is really what got us continue to be this excited is, I said it to my whole team. The only limit that we have is our time because everywhere we look in the areas of interest and the growth tailwind that we understand. So everywhere we look in the familiar industry that we already know, well, there are just bargains everywhere still for small mid-cap. So that's really what got us excited is when I look at my pipeline and look at all these companies that we could do work on could buy for this fund and still so cheap. That's really exciting.

Damien McIntyre

Now tell me, just for the last question, can we just talk through why should people own the asset class, tend to be fed a diet of large cap products. There are few small and mid-cap products available too invested in Australia, the universe is dozen or so. It's a small universe of managers. What are we missing? Why do we own the asset class?

Qiao Ma

I think you own the asset class, because you want to have a bit of a different diverse drivers of the portfolio. It's the investors, right? So if you think about the large cap portfolios globally, tend to start looking more and more similar, because the large cap winners are very concentrated. So when you think about the magnificent seven, they're all tech companies.

And when you look at, I just told you the small mid-cap companies, you can have really growth sources from a whole variety of industries top eight out of 10. Our portfolio names are not even in the tech industry at all. So they move differently. They're not nearly as correlated to the larger cap index, hence to most of the holdings that the investors would have from the large cap funds and they're growing really fast and these are the companies, they're still very undiscovered. I think the last aspect of it is ... which is why devaluation is still attractive, is the attention of the entire Wall Street has shifted with the large cap index to Magnificent Seven.

So I often joke about it and say, "Hey, when Microsoft reports earnings, 40 analysts will write a note analysing every single comma and period of that earnings release within 24 hours." When one of our companies report on the smaller side, they could be exceeding expectations by 20%, like a wild margin and maybe two analysts write a note about it a week after the earnings report if they get around to it. So just the undiscovered aspect of this is also, pretty exciting and just a bit different.

Damien McIntyre

Before I wind up though, in that scenario and working on the theory that capital always chases profit. It's such a focus on the Mag Seven and large cap generally, and this has been true for decades, this isn't a recent phenomenon. How does capital eventually find small cap stocks? How does it become obvious that I'm growing much faster than someone else?

Qiao Ma

The capital is already finding the small caps. We started this fund and we put together this portfolio of stocks and really, for the first couple of quarters we're sitting here, scratching our head and say, what are we missing here? They keep reporting just absolute cracker numbers and no one cares. The stock just wouldn't move. So in this earnings season, it is actually quite funny because as a stock picker, this never really happened to me in my career. 15 years covering stocks, I've never had stocks go up 40% in the day without it getting taken out in some kind of M&A deal.

In this earnings season, the Munro small mid-cap fund, we have four stocks that went up 40% in the day. And then, it sounded crazy and said, "Well, is it a bubble?" Well, it's not a bubble because these stocks should have gone up 10 to 15% and every time they report over the past three earnings, but they didn't because no one was looking. And then one day, capital, somehow to your point, meandered their way into their earnings, wake up, realise, "Wait a second, the growth is really impressive here," and they start having these outsized moves. So that's four out of the 35 companies we hold and we are fine. We're fine that not all of them go up the same way.

We think there is still a lot of these hidden heroes that we own today that really should have gone up more, but they didn't. But one day they will, because capital is efficient, investors are smart. They might be a little bit of a delay just because they've been very, very busy looking at Mag Seven. But I do think they will eventually find their way because you're right, the earnings are really strong, d the stock price should follow earnings.

Damien McIntyre

Well, Qiao, it's been a fascinating conversation. Thank you very much. Congratulations on a great start for the Munro global small and mid-cap fund. It's very exciting both for the firm and it's also a great product to bring here to the market in Australia. So thank you for your time and all the best of luck for the coming year.

Qiao Ma

Thank you so much for the kind word Damien and thank you for supporting and encouraging us along the way. We are excited.