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Compelling Growth Ahead

The past few months have been a white-knuckle experience for equity investors around the world. A rollercoaster ride of frenzied trading and sky-rocketing valuations has left some experts scratching their heads. However, others have seen the market's rise as a symptom of a larger, secular trend: the shift to a New EXceptional Technologies (NEXT) economy.

As analysts from New York to Tokyo were trying to make sense of the stock market's gyrations, Citywire met with Jennison Associates, PGIM's specialist in fundamental growth equity investing, to look at what to expect in the upcoming months, and in the longer term. Jennison's portfolio managers Thomas Davis and Sara Moreno sat down with Citywire's Richard Lander to examine the current investment landscape.

Their discussion covers the ongoing face-off between value and growth, disruptive innovation coming out of emerging markets and around the world, and the complexities of indices within developed and emerging economies.

The 'Recovery Trade': A Flash In The Pan Or An Enduring Opportunity?

Value stocks have been on a roll, fuelled by accelerating vaccination efforts and hopes for a return to relative normalcy in the foreseeable future. The question though, is will the recovery trade last?

Davis believes the dramatic rise of the 10-year US Treasury yield by more than 5% since the end of January[1] will have a major impact on 'how we value stocks, especially those with longer duration cashflows'.

He acknowledges that rising yields in the US have also triggered concerns that we may be entering an inflationary period, noting that 'stocks that did particularly well last year, namely growth stocks, have come under quite a bit of pressure.'

However, Davis is confident that 'these issues will normalise' over time, and that conditions should revert to favouring growth over value. He notes that 'we still have high unemployment rates around the world and a great deal of manufacturing capacity that has yet to come back online.' For these reasons, Davis does not foresee the type of sustained inflation that typically boosts cyclical, value-oriented industries.

Moreno agrees, suggesting that 'what we're seeing is a reversion back to the mean'. From her emerging markets perspective, the swing toward value stocks is the result of a 'rebasing' that is unlikely to be sustainable.

Moreno and Davis expect growth stocks to continue to be 'very solid', particularly given accelerating digitalisation. Moreno emphasises that 'throughout this period, the earnings trajectory of growth companies – especially for e-commerce, internet-related, digital names – has continued to surprise on the upside.' Both Moreno and Davis view the outlook as constructive for innovative, differentiated companies across developed and emerging markets.

Drivers Of The Next Big Growth Stories

So where will the next big growth stories come from? Moreno asserts that one of the most important developments globally is the shift to online consumption. She points out that there is substantial runway for growth ahead, noting that 'we're still in the early innings of the shift in emerging markets, and that Covid has accelerated things dramatically.' Moreno adds that groups of people who had been reluctant to shop online before, 'made the move because of social distancing and lockdowns.'

As a result, internet penetration rates are rising, especially in previously underserved regions. According to Moreno, rates for Latin America went from middle to high single-digits over the course of one year. She also sees enterprises actively working towards greater digitalisation, creating opportunity globally.

'Due to Covid, companies that were nibbling at the edges of their digitalisation journeys were forced to accelerate their efforts,' notes Moreno, who explains that enterprises are changing how they do business in order to better 'engage with customers, clients and internal stakeholders.'

The digitalisation trend extends to online payment systems as well. Moreno points out that 'by moving online, more people gain access to financial products and services, especially in emerging markets,' and that 'from a government policy point of view, you're allowing entire economies to leapfrog into the growth trajectory that more developed countries offer.'

Does that mean emerging economies are going to outpace their developed counterparts?

Not really, Davis says, highlighting that 'boundaries are meaningless in this more digitalised world...it's not so much developed versus emerging countries, but rather which businesses will win in the market.' He explains that in some cases emerging market companies will develop superior technologies that are adopted by the developed world, and at other times developed countries will lead the way.

Missing The Mark? A Closer Look At Today's Indices

The return profile of indices in both developed and emerging markets has increasingly shifted to the fastest growing companies. With these changes, do indices still offer a good representation of today's consumption trends? Moreno and Davis discuss the relevance of indices in both developed and emerging markets, and strike some cautionary notes.

Moreno warns that investors need to mindful of certain 'potholes' when using indices in emerging economies. Benchmark returns over the past decade have disappointed investors 'because the macro doesn't necessarily translate into attractive equity returns. Stock indices across emerging markets don't always reflect the underlying economies where they are located.'

Of particular concern, Moreno adds, is the heavy focus within the emerging markets index on 'old economy' sectors like financials, industrials, materials and energy. In her view, the most dynamic areas within emerging economies are in the secular growth industries that are dramatically underrepresented in emerging market indices.

She points out that '43% of the MSCI Emerging Markets Index appears to be in secular growth[2], but when you look under the hood, the top names don't include those companies just beginning their journeys' Moreno continues by emphasising that the index 'fails to accurately reflect the dynamism that emerging markets offer...so there is a lot of value in taking an active, benchmark-agnostic approach when investing in these economies.'

Davis sees a related picture in developed countries. These economies are tracked by a variety of indices, but the benchmarks include 'a wide swathe of companies, not all of which will be particularly strong players for any given reason and at any given time.' Like Moreno, Davis makes the case for a more concentrated investment approach that allows sidestepping older economy-type businesses.

'When it comes to generating returns for our clients, we find it far more powerful to largely disregard benchmarks,' Davis says, adding that passive investing provides exposure to winners but also to the big losers. Jennison's active approach aims to 'make sure we have as many of the winners as possible.'