Ditching the rule book helps this fund manager succeed

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As a British-Kenyan-Indian who now calls Australia home, Monik Kotecha says life has taught him as much about successful investing as textbooks.

"We were in Uganda for a while, the last place was Nairobi, my dad was a doctor in the hospital there. Delivering babies. Back then they used to deliver lots of babies per day," Kotecha tells *The Australian Financial Review*.

Monik Kotecha is bullish on tech over the next five to 10 years. ***Peter Braig***

"You develop a broader perspective when you move around."

In the 1970s he moved to the UK and degrees in accounting and law followed. That led to a career in funds management that took him to Australia in 1994 and senior portfolio manager roles at Bankers Trust and Investors Mutual.

Since 2008 Kotecha has run his own global equities manager, Insync Investment Management, with co-founder Gary Wyatt.

Insync's fund offers two options for investors. Long-only, or a second strategy that uses downside protection via put options on benchmark indices.

The put option strategy costs 32 basis points more in annual fees at 1.3 per cent, but protection is offered if markets tumble on the back of, say, a conflict with Iran.

Performance has been strong, with the long-only Insync Global Quality Equity Portfolio delivering 21.5 per cent a per annum net of fees over the last three years. The put protected option returned 18.7 per cent, with the gap reflecting the historic cost of owning the options.

For the 12 months to the end of December, the long-only strategy has returned 37.2 per cent.

Adapt or lose

The fund uses a bottom-up selection process overlayed with a focus on megatrends. It has backed some big winners.

"Global disruption is a big part of what we do at Insync, we're not a disruptor fund, we're a broad-based global equities fund, but for us, disruption is everywhere," says Kotecha.

As an investor, the challenge is knowing where and how to invest in a fast-changing world. On one level this involves identifying megatrends that support new growth companies, he says, while on another it involves embracing the value tech companies are creating for tomorrow.

Basic valuation techniques he learned at university are not so relevant for him anymore.

"I've worked through different cycles over 29 years. In the 1990s price-to-earnings [PE] ratios were very low and you could buy stocks at a big discount to price to book and that was fantastic. I made a bomb doing it," he says.

"That worked well for old industrial companies when you had manufacturing plants, you had assembly plants, you could value them easily. Margin of safety and all that."

However, he says investors risk underperforming if they place too much emphasis on traditional ratios like price to book or EV/EBITDA (enterprise value to earnings before interest, tax, depreciation and amortisation) to derive valuations.

"In today's world where we're moving more towards R&D, more towards software, those tools are no longer a good guide to valuation. Because what's happened is we've seen the big growth in intangibles."

"It's brand, people, software, innovation, value. A lot of those items get expensed through the profit and loss account which makes the companies look expensive using short-term PE [price to earnings] ratios," he says.

The kind of companies he's talking about are software businesses that invest heavily in talent, research, sales, and marketing. This takes earnings lower and the PE higher on a one or two-year view, but Kotecha isn't worried.

"It's actually creating value for the future, that's what we're trying to find – the returns from those investments that they're making on innovation and growth."

"We still see a lot of good value, as we're measuring the profitability of those investments that they're making and working out what those cash flows are worth over time."

Big winners

As is fashionable with a number of fund managers, Kotecha says return on invested capital (ROIC) is the key metric Insync uses to identify investments. It sees a high ROIC as the calling card of a business likely to deliver strong profit growth into the future.

"We want very high levels right across the portfolio. The portfolio's average ROIC at the moment sits at about 50 per cent, which is about five times the market average," he says.

The fund's two largest holdings are Visa Inc and Walt Disney Corporation. Both of which are widely regarded as having strong track records of capital allocation and high levels of profitability.

"They [Disney] bought Lucas Films, the Star Wars franchise, they bought Pixar. So a great allocator of capital, great cash flow generation, and looking forward, they got 10 million people to subscribe to Disney + [the streaming service] in the first weekend," Kotecha says.

"That blew all the forecasts out the window and shows you the strength of their franchise."

The theme parks also possess qualities he looks for in businesses. Pricing power, growth, and the ability to cross-sell products across a widening network.

Digital megatrend

Kotecha is also bullish on Visa thanks to the growth of the digital economy as a megatrend, with the shift away from cash an obvious symptom. He gives India as an example of a large market where the cash economy is huge but that will shift to electronic over time.

"Plus online shopping will grow everywhere. The US market has to open up to tap and go payments. Anything that creates less friction for the customer we like".

Consultants Accenture and online accounting player Intuit are other holdings he nominates to win from the growth of the digital economy.

"Accenture is the leader globally in helping companies digitally transform."

"There's all this data sitting around people and businesses. So companies must digitally engage with the data and their customers. Make sure they've got the right data analytics to know what the customer's doing and make sure they engage with the customer. Make sure the whole thing is integrated."

Thinking ahead

According to Kotecha, investors perpetually underestimate the pace and durability of growth for companies benefiting from megatrends such as the digital economy.

"We've got a whole new type of company that has been built through the internet as its infrastructure. The cost of doing business has collapsed. They're not spending on hard assets, a lot of investments they're making are through intangibles."

"We're in a very forward-looking world, more than ever before. Things are moving very fast. A lot of stocks and sectors are very unstable today. This is why I think we're seeing a wide section of returns amongst fund managers".

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— Monik Kotecha

The dislike of looking backwards permeates his thinking on generating investment returns.

"People still say Europe looks cheap, or Asia looks cheap, and they don't try to understand what's underneath the surface. That's kind of an old-world approach to me," he says.

"Europe and Asia have consistently disappointed investors. So just owning a market that appears cheap on PEs doesn't make sense to us."

He thinks the world is changing so quickly that investment experience is more important than ever.

"I'd say to my son don't do CFA [Chartered Financial Analyst] until you're actually working or managing money. And then start thinking about how does it apply to the world we're moving to, not the world we came from."

He thinks only those that adapt will succeed.

"I'm actually really bullish the next 5 to 10 years. You have to be – look at what's going on – the changes are enormous, and it's going to have a big positive influence on what we do."

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