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Forgo FOMO: Growth Investing for the Long Term

Disruptive Forces in Investing **July 19, 2022**

Anu Rajakumar: Growth stocks, which are essentially any share in a company that looks to be growing at an above-average growth rate, are a fundamental part of portfolio construction. However, during times of volatility, such as what we're seeing now, investors may be shifting their asset allocation to accommodate the ups and downs of markets globally. But does this thinking apply to growth stocks or not? My name is Anu Rajakumar, and joining me back on the show is Jason Tauber, Portfolio Manager for Equity Growth Strategies here at Neuberger Berman to shed light on what we're seeing in growth and where we believe the opportunities might be in this unprecedented market environment we're investing in. Jason, great to have you with us.

Jason Tauber: Great to be back. Thanks for having me.

Anu: So just to give our listeners a refresher, we had you on the show back in 2020 to discuss disruption back then. Now the market continues to be quite volatile and today we have inflation in the mix. So why don't we start by giving us an update as to what has changed since 2020 and what the current environment looks like across growth and any other disruptive investing markets?

Jason: Sure. So, obviously, a lot has changed since the last time we spoke, much of which your listeners are well aware. But quickly, at least from my perspective, during the pandemic, there were several companies in the tech and healthcare space that just flourished. I mean, they led us through the pandemic. Think of companies like Netflix, DocuSign, Moderna, even Etsy. These companies had massive positive earnings revisions. And a halo formed around all things innovation. And this drove a speculative investment bubble that we believe peaked out at about February 2021. And when you ask what is it that deflated it? First and perhaps most importantly, there was a huge supply response from the capital market. So tons of new issues. Think SPACs, IPOs, particularly of what we call story stocks, which I think of as growth companies in search of a business model.

The VC environment was very heady. The global unicorn count or the number of private companies valued over a billion dollars topped over 1,000. And then, of course, reopening caused some of this hypergrowth to reverse quickly. And so over the course of 2021 and into 2022, we saw some high-profile disappointments in companies like PayPal and Netflix, and DocuSign, some of those same companies that did so well during the pandemic. And that took a lot of air out of this innovation momentum.

And then of course today, or at least on a year-to-date basis, the market is seeing a lot more inflation, higher interest rates. And that's been painful for all stocks, but for high-growth stocks in particular. So this is an interesting time to revisit growth and disruption because the valuations are a lot lower, many are back to pre-pandemic levels or even lower, and they're likely to stay there for an extended period of time. It's really-- It's showtime for these secular growth companies. You know, put up or shut up.

But also, importantly, the competitive environment is broadly getting better because the funding environment is more difficult. And thankfully, from-from our perspective as fundamental investors, the markets aren't just irrationally driving up the valuations of any company with buzzwords like innovation, megatrend, and disruptive.

Anu: Great that is an excellent background. Thanks very much. Now given some of the comments that you said, you know, investors have been rotating away from growth and towards value for example. So maybe some people are starting to-to underweight growth given the-the current economic backdrop. Tell us why you think that maybe is not the right move right now. Why is that not the case? Talk-talk some of those investors off the ledge.

Jason: Well, I mean, taking a big step back, I think first when we think about why invest in growth and disruption? You know, every year we do this practice where we look at the top performers of the S&P 500 over the last 15 years. So this includes a full market cycle. It includes the global financial crisis. And we just did this on June 30th. So including this recent downturn. And 21 of those top 25 companies I would characterize as disruptive, so they were game-changing in one way or another.

And we don't think the next 15 years are really going to look much different. That list is not replete with steady eddies. It's really these companies that drive disruptive innovation that produce these outsize returns. Selecting them is obviously the challenge, but you want to be mindful, paying attention, and trying to catch them early. The other reason why it's important to look now is that, sure, a lot of the post-pandemic hangover stories had big negative estimate revisions, but there are many where earnings estimates haven't changed at all. And it's just the valuations have come down 40%, 50%. And so for that reason alone they're worth looking at.

And to your implied question about, well, can you own high valuation stocks in a risk-off environment? I think the market always sees the appeal of secular growth stories. And importantly, if a weaker economy, if a recession materializes which we think is more likely than not, that's likely to lead to lower interest rates and that's historically been a tailwind for growth stocks.

Anu: All right, terrific. And maybe some of your comments there that transitions nice into my next question, which is about risk tolerance, clearly something investors always consider regardless of the environment. So, Jason, tell me, how do you manage risk in what some could consider a risk-off environment or, you know, potentially going to recession? And especially for those who are generally risk-averse, how do you address this issue of risk tolerance when a market is particularly volatile as it is at the moment?

Jason: Yeah I mean from a high level on an individual stock basis, like, we just really look for companies where we feel like we have certainty into what this company's going to look like two, three, four, five years out from now regardless of the macro environment. Ideally, we want to have free cash flow estimates that are above consensus. And then when we look at our holdings from a portfolio perspective, we're looking very closely at factor risks. So it's, you know, it's very easy to understand what kind of sector over-weights or under-weights that you have, but it's also important to look at factors, especially in a volatile macro-environment because factors tend to whip around. And so we try to manage those very carefully.

Anu: And just out of curiosity, what are you seeing from a factor exposure perspective?

Jason: Well, I mean, for sure on a year-to-date basis, anything that is high growth has been under pressure. The market has been favoring companies with high dividend yield, companies with low valuations, just companies where, you know, skinny balance sheets where there's safety or some perception of safety,

Anu: Just out of curiosity, what you're seeing in different factor risk exposures, would you say that's a US phenomenon or you're seeing that globally as well?

Jason: Yeah, I mean, this has been a global phenomenon regardless of where companies are listed. There doesn't tend to be a huge arbitrage situation in the growth space, I wouldn't say. So-so this is definitely a global phenomenon, and it hasn't really mattered where the company's based.

Anu: Sure. Great. Now, at Neuberger Berman, engagement is a key aspect of the investment process. Do you have any examples of companies that you've been engaging with recently that have driven your conviction in growth? Any interesting stories that you can share?

Jason: Yeah. I mean, I think, Uber's a good example where we had a pretty frank conversation with the CEO after earnings. They've put out some earnings expectations for a few years out that are very robust and imply a very steep acceleration curve as they move to maturity, and I think we pressed them pretty aggressively. I was like, well, this business is relatively mature, why aren't we seeing that now? And I thought the answers that they provided were pretty clear and that helped with our conviction.

But importantly, we're seeing a lot of competition exit the market given this rationalization that's happening, including consolidation that Uber is doing itself. You know, companies like Caviar, Grubhub, Postmates, they've all kind of been absorbed. You're seeing, you know, layoffs in some of these courier-type businesses. You're definitely feeling in real time that pullback in the capital markets affecting companies directly. And so, you know, we've pressed them, and others have pressed their competitors to focus on profitability and that's happening.

I think you're seeing companies in the cloud space raise prices. In the software space, I think hiring got a little too aggressive, you're seeing pullbacks there. Things are moving really quickly in response to a rapid change in the funding environment. And ultimately I think that's going to be really positive for the survivors.

Anu: All right. Terrific. So as we wrap up here today, Jason, tell our listeners in your own words, why should they care about growth in this environment? And do you think there's another rally up the pike?

Jason: Yeah, so I think that it's more likely than not that we're going to return to the regime that we had pre-pandemic where pretty muted economic growth environment, where growth is going to be prized, and that the previous investment playbook will apply again. I think that it remains important to avoid investing on a fear of missing out basis. So make sure that you have visibility around what this business is going to look like, you know, three, four, five years from now. There's plenty of sub-industries like cannabis or plant-based meat that people just wanted exposure. They weren't thinking hard enough about, "Well, am I going to be able to make money here? Is the company going to be able to make money here?" You-you just can't invest that way.

And then finally, there's-there's a lot of great companies out there that have been unfairly punished, so they're interesting opportunities.

Anu: Terrific. Thank you very much. Well, we always have a bonus question at the end of every episode, Jason, and this one is no different. You know, you're an expert in finding disruptive companies and you mentioned being aware of, you know, the FOMO trends, the fear of missing out trends. So my question for you is in your personal life, would you describe yourself as a trendsetter or a trend follower, and why? [chuckles]

Jason: [laughs] Um, I would say that I am completely oblivious to trends-

Anu: [laughs]

Jason: -and-- A-a trend ignorer, is that-- does-does that count?

Anu: Uh, uh, yeah. Sure. That-that might be a thing. Yeah.

[laughter]

Jason: Beat to my own drum, I guess.

Anu: Perfect. Well, Jason, thank you very much. That's a good place to wrap. It's been a pleasure having you back on the show to discuss what some might consider to be a controversial view in today's market environment. But you've certainly left us with some concepts to think about as we continue to look for opportunities across the investment opportunity set. So thank you again for coming back on the show.

Jason: Thank you.

Anu: And to our listeners, if you've enjoyed this episode of *Disruptive Forces*, I encourage you to subscribe to the show via Apple Podcast, Google Podcast, or Spotify, or you can visit our website www.nb.com/disruptiveforces for previous episodes, as well as more information about our firm and offerings.

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