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James Abela
portfolio manager
Fidelity Future
Leaders Fund

Delivering alpha through the cycles

Top line revenue is a strong indicator of success, but for one fund manager, profit and cashflow are more powerful markers when deciding where to invest.

Viability, sustainability and creditability are the long-term pillars of success for investors and are perhaps more relevant today than ever, according to Fidelity Future Leaders Fund portfolio manager James Abela[01].

To illustrate, Abela cites a popular quote, which doubles as the means by which he selects investments: 'Revenue is vanity. Profit is sanity. Cash is reality.'

"For investors in the Fidelity Future Leaders Fund, my strategy in the current market is to maintain a strategic tilt toward growth at a reasonable price and value. Later in 2019, scarcity premiums will likely see a move towards growth and sustainable yield," Abela explains.

The Fund comprises a diversified portfolio of 40-70 small-mid cap Australian companies. Abela is a rigorous bottom-up stock picker focused on finding attractively valued companies with strong competitive positioning and sound company management.

The portfolio aims to deliver more consistent returns through different market cycles to achieve returns in excess of the S&P/ASX 200 Mid Small Index over a suggested minimum investment period of five to seven years.

Conviction is driven by a high valuation discipline across the portfolio, Abela explains.

"I believe in holding companies with sustainable value yield, defensive positioning and sustainable quality. Concerns around the global slowdown have translated to a resolute move away from high risk momentum or companies that rely on equity or debt liquidity," he says.

It's a strategy that works too; the Fund was awarded the Morningstar 2019 Australian Fund Manager of the Year in the Domestic Equities Small Caps category* for the second year running.

In addition to Abela, the Fund is backed by about 400 investment professionals worldwide including 140 analysts; 10 in Sydney and 50 in the Asia Pacific region, working together for the benefit of the client.

The Fund is the product of Abela's 20 years as an investment professional, having over time developed a risk-controlled process he calls Quality, Momentum, Transition and Value (QMTV).

This unique approach to investing has secured very smooth outcomes for clients via great performance and strong risk/return outcomes, Abela explains.

The Fund has consistently outperformed its benchmark since its inception in 2013, achieving an average return of 14.53%.

QMTV, explained

QMTV is the means by which Abela selects companies for the Fund to invest in. It's a process that keeps him self-aware and aware of markets and risk, he says.

"It's about knowing why you're going to win and why you're going to lose; the positives and negatives of risk," Abela says.

Breaking it down, Abela explains the four quadrants. The first Quality quadrant he describes as the 'love' quadrant.

"Quality is a beautiful marriage or a wonderful niche, where you get competition, management complacency, higher capex and mean reversion," he explains.

Momentum is the nightclub which signifies the consensus trade or where the herd is, Abela says.

"Everyone is rushing into a particular sector or trend, but eventually that momentum fades. It's too busy; you've got peak sentiment, peak multiples and peak earnings and that's essentially the end of the momentum trade," he says.

The transition quadrant is the investing equivalent of no man's land.

"You get fallen angels from quality, the fading momentum from the nightclub and then no man's land which is where things are changing. It's not cool yet, it's not beautiful and it's not cold like it is in value; it's just warming up but you don't have consensus on your side," Abela explains.

Finally, value is the opposite of quality, he says.

"It's an environment of neglect. There's not a lot of popularity or love but there is a lot of opportunity there and if you can find those opportunities then you can make a lot of money," Abela says.

It's all part of what makes investing in small-mid caps so exciting for Abela, who likens the growth of companies in the sector to school children.

"They've got a great idea and a lot of potential and over the years they'll go from IPO to the top of small caps to a mid-cap, which is basically high school. From there you can tell whether they're going to be leaders in their field as they graduate," he says.

"That 12-year journey can be something like a Cochlear or CSL and, for an investor, that could be close to 100 times your money over that period."

Going forward

Having overseen the Fund for more than a decade, Abela says he's learned two key lessons about investing that guide him today.

The quote

It's about knowing why you're going to win and why you're going to lose; the positives and negatives of risk.

Watch the video on www.fsitv.com

Firstly, learn from your mistakes: "It's honestly how you learn, through failure. Once you've failed and learned from it, you've got a good chance of becoming successful."

Then it becomes about managing your temperament, ego, risk and enthusiasm, he says.

"And that applies for me as a portfolio manager but also for the companies I invest in. Do they manage the business well? Do they have integrity? Once they have that, the duration of success is much longer," he says.

Currently, the Fund is very balanced. There is a lot of quality but not a huge amount because valuation and quality is increasingly expensive and therefore probably not sustainable, Abela says.

There is also a low percentage of momentum stocks – or nightclub stocks – because "there's been a lot of momentum working in the world and now you're seeing a lot of it not working, like in fintech."

Instead, Abela is holding a lot of the transition and value components, like gold and REITs. "I call them boring businesses. They're on low valuations but very attractive, generating good cashflows and are actually quite low beta, sustainable businesses."

It's a funny time to be investing, he says, because there seems to be substantial fears of a repeat of the GFC, despite the data not supporting that theory.

The key things to keep in mind therefore are balance, valuation discipline and sustainability, he says.

"Liquidity is going down, the cost of capital is going up and access to debt is going down," Abela explains.

"Valuation and liquidity are the two things I'm thinking about the most at the moment, and the Fund is very balanced on that basis." **FS**

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