Markets & Investing Podcast

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Topic: Large Cap Growth markets, with J.P. Morgan Asset Management

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Transcript

This is an auto-generated transcript that has been lightly edited for ease in reading.

Sean

Welcome to the Markets and Investing Podcast, featuring Equitable Investment Management's Chief Investment Officer Ken Kozlowski. I'm Sean Nicholason, director of relationship management. If you're familiar with this series, you know that Ken reaches out to some of the brightest people in the investment business to talk about the events and strategies that are behind today's market experience. Giri Devulapally, of J.P. Morgan Asset Management is Ken's guest in this edition, and I think you are really going to enjoy their conversation. Giri brings decades of experience to one of the most complex of equity markets—the large-cap growth sector. Let's listen in.

Ken

Hi. Ken Kozlowski here. At Equitable Investment Management, for over 25 years we've been fortunate to work with a wide range of investors all across Wall Street. Today, we will be talking with one of the newest in our lineup, Giri Devulapally. Giri is a portfolio manager in the U.S. equity group at J.P. Morgan Asset Management. He's a 20-year veteran of JPM who has been managing large-cap growth stock portfolios since 2003. Prior to joining the firm, he spent six years at a competitor firm where he developed expertise in equity analysis. Giri has some pretty impressive credentials in the academic department. He earned a B.S. in electrical engineering from the University of Illinois and an M.B.A. with a concentration in finance from the University of Chicago. He's also a CFA charter-holder. Today, we're going to talk about that corner of the equity market where investors tend to look for the biggest and fastest-growing companies—and sometimes the most expensive ones. In other words, large-cap growth stocks. So hi, Giri, and welcome to the podcast!

Giri

Good morning, Ken. Great to be with you.

Ken

Why don't we start out with a little more about your background and what makes your approach unique in a very crowded space - large-cap growth investing?

Giri

As you mentioned, I'm an engineer by educational training. I did software design and development for six years. But during that time, I developed a great passion for investing and that led me to go to business school. After that, I was covering technology stocks during the great boom of the late ‘90s and then the even bigger bust of the early 2000s. In 2003, I was recruited to join JPMorgan. As you mentioned, I've been on the large-cap growth strategy for 20 years and have been the lead portfolio manager for 18 years. I think one of the things that differentiates us is that we have a great focus on risk management. For us, there are three key risks in large-cap growth investing. The first risk is not to miss the truly outstanding stocks. The second risk is understanding the importance of mitigating the damage of underperforming stocks. We're engaged in a probabilistic endeavor, which means that we will be wrong on occasion. The key for us is managing the downside when we are in fact wrong. And then the third risk is that all active strategies have periods that are more favorable and other periods that are a bit more challenging for us. We recognize that holds for us as well and we want to really capitalize in the good times and then not give too much back in the challenging times. I think that's really the underlying philosophy that we have.

Ken

So what are the most important considerations for you as a growth manager?

Giri

When we look at individual stocks, it's easy to say you want to own the big winners and not get hurt too bad on the downside. So let me flesh that out a little bit. When we're looking at which stocks could be the really big winners of the next few years, what we've done is studied history. When we look at the really big winners of the past, there are three characteristics that they have. The first is these are companies that are going after large addressable markets or rapidly growing markets undergoing change; the change in the size of the opportunity creates the potential for long duration of outperformance by companies. The second thing we look for are companies that are doing something differentiated to separate themselves from the pack and create the potential for sustainable competitive advantage and durable market share gains. And then the third thing we look for are stocks that have good price momentum and the reason we look for price momentum is it's a way of embedding humility into the process. What I mean by that is we think that, in general, the market has wisdom. It's the collection of a lot of different viewpoints that results in the stock price and the stock price movements. And so, if we have a view, but the market is providing us contrary evidence, meaning if we like a stock and it's executing well, but the stock still can't go up or it actually underperforms, we'll use that as a signal to suggest that we're missing something, and we're going to reduce or potentially eliminate that stock. We'll be willing to come back to it at a later point when we think the market agrees with our viewpoint, but we don't want to engage in intellectual debates with the market. We think that humility, patience, and imagination combined with confidence in our approach are really important attributes to bring in managing the portfolio.

Ken

After a period in which investors scrambled for higher-quality stocks in 2022, it seems that many have jumped back on the growth bandwagon this year. Can you tell us what factors you think are attracting investors to a handful of large-cap growth stocks this year?

Giri

I think there are some commonalities and some idiosyncratic factors at play. Some of the commonalities are that several of these stocks, after having done well in 2020 or even 2021, really gave back a lot last year. And some, I'm thinking of stocks like Amazon and Meta, really started underperforming in 2020, so they had about two to three years of pronounced underperformance. And others maybe a little bit less so. Stocks like Microsoft and Apple maybe peaked in 2021 and then went down for a year and a half instead of two and a half years, and in the meantime they continued to grow their businesses. The other part I think revolves around

artificial intelligence. NVIDIA, one of the big winners of this year, is clearly a beneficiary of the tremendous upsurge in interest in artificial intelligence. But some of these other companies, like Microsoft, is also perceived to be a beneficiary of artificial intelligence. So I think it's a combination of some period of underperformance lasting anywhere between a year and a half, to three years that happened while the companies were growing, which made a better entry point in terms of relative valuation. Finally I think the crisis around the U.S. banking system that took place in March, or at least some of the concerns around what was happening in the banking system, also drew further interest into growth companies that were unaffected by some of those perturbations.

Ken

Can you tell us how the interest rate environment impacts large-cap growth stocks if interest rates continue to climb? Is there a point at which investors start seeking the security of high quality, relatively cheaper stocks?

Giri

I don't know what the future is going to bring and so I don't want to make a prognostication. I'll make a couple of observations. When we talk about interest rates affecting high growth stocks, I think a lot of times the discussion is around the denominator in the DCF calculation. In other words, we're going to increase the denominator which would reduce the overall valuation of the company. That leaves the numerator constant, and it's not clear that the numerator ought to be constant in such a scenario, meaning that the numerator can grow faster than the rates on the bottom, and so it really comes down to which companies have pricing power? Which companies have products and services that will be in demand, such that if there is inflation, which would cause rates to be higher for long, they can offset the effects of inflation by raising prices. And the other thing I point out is a lot of high growth companies don't tend to have as much in wages as a proportion. They tend to have higher margins than other companies that are in more, let's say "old line" industries. And then the third observation is if we look at the mid-90s to the late-90s when growth stocks were doing really well, rates were actually higher than they are today. I think what some people are focused on is the recent rise, but they're not looking at the absolute levels. There have been periods historically when growth stocks have done very well at similar or even higher interest rate level. And so, while I'm not saying that we don't pay attention to that, we don't spend a lot of energy trying to forecast it. We're much more focused on which companies have a combination of what we look for: what's the fundamental setup and what's the market embedding in terms of expectations? And is there a disconnect that we can take advantage of and when we try and do that, we have to consider a whole host of factors, rates being one of them.

Ken

What kind of strategies can investors employ to remain diversified in a narrow market advance, such as we've seen lately? Can you remain prepared for the rally to broaden out? Without giving up too much in gains right now, is there any point to such a move?

Giri

Certainly what we're seeing is more concentration in the benchmark today than we've had historically. But the world of investing is dynamic. It's always posing different challenges and different landscapes that we as investors have to deal with. And so, while in some ways this is a particular challenge that we have to address, it also is a big opportunity. There will come a time when some of these mega cap stocks also stumble and fall out of favor, and that's going to be a huge alpha generation opportunity. The last thing I'd point out is, while companies like NVIDIA and Tesla are now considered part of this "Magnificent 7" when we bought NVIDIA back in 2016 at under $10 a share and Tesla in 2019 at under $30 a share, neither of those companies were considered one of the Magnificent 7. So in some ways the mega caps offer us greater opportunity to represent our fundamental insights, but we treat them very much the same way in terms of looking for disconnects between fundamentals and expectations. It's just that the position sizes are larger and so we may have some additional portfolio construction considerations that come into play.

Ken

And finally, I guess we can't talk about large-cap stocks today without mentioning artificial intelligence. Can you help us understand the AI landscape as you see it? Where is there potential for disruption?

Giri

I think basically everywhere we look probably has some potential for disruption. You know, maybe to take a step back, as I mentioned I was an engineer by educational background. I started my engineering education in the 1980s. There was talk about artificial intelligence back then, and so this is something that's been around for decades. It's just that the tools and the technology have evolved to a point where it can be operationalized in a significant manner today. And so, I think we are at the cusp of really exciting happenings related to AI. We think AI is going to create a huge demand for computing power and some of the technology enablers, the chip companies like NVIDIA and Broadcom and some of the cloud service providers like Amazon, Microsoft, and Google, will be beneficiaries. Basically, what we're looking for are the initial winners we think will be either the enablers, the computing centers or companies that have a rich proprietary data set that can really be mined for more information using the more powerful techniques of AI. Meta, the old Facebook, is an example, but there are a lot of software or business service companies that we think could be beneficial. Over time, we think that the power of AI has huge implications in healthcare and in drug discovery, but it's going to really

spread its tentacles into every sector and every industry and the companies that are able to take advantage of the power of AI and better mine their data to create business advantage, we think, will be the winners and those are going to be really exciting. And then the last pool of winners probably doesn't even exist right now as a public company, if we think of AI as a big platform chain similar to the Internet that happened 25 years ago. Some of the biggest winners of the Internet were not even part of the boom of the late 90s; Google and Facebook didn't exist as public companies, Amazon Web Services didn't exist back then, Netflix was shipping DVDs by mail. And so there are going to be huge winners that we don't even know about today because they don't exist. We're very open to identifying those winners as well in the years coming forward.

Ken

Giri, thanks so much for being with us today and sharing your insights and best of luck going forward. Thanks again.

Giri

Thanks, Ken. It was a pleasure to be with you. Have a great day.

Close

Hi. Sean Nicholason here again. Based on the fundamental, risk-sensitive process Giri describes—which places financial science at the center everything they do—you may find that this strategy could make an attractive addition to your investment plan. At Equitable, we are pleased to include JPMorgan's growth stock strategy in many of our variable insurance products. Check out the prospectus at equitable-funds.com, that's equitable hyphen funds.com and don't forget to look for our retail mutual funds at 1290funds.com.

We'll talk again soon!

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