fisher funds

Building Greater **Lifetime Savings**

An introduction to how we invest in the share market

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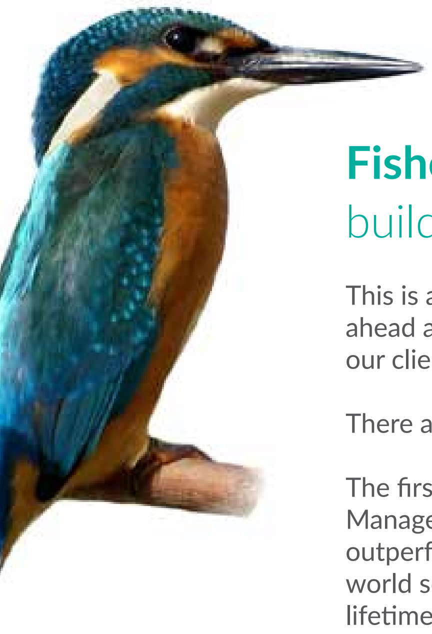


Fisher Funds exists for one reason. To help clients build **greater lifetime savings.**

This is a worthy goal. Greater lifetime savings means more choice, more confidence in the years ahead and more independence. In short, greater lifetime savings provide a better future for our clients.

There are two ways we help clients on their individual financial journeys.

The first is through **Smart Active Investment Management.** Smart Active Investment Management means that we manage money with the goal of generating long-term outperformance of the market. This involves handpicking the very best investments around the world so that clients can enjoy greater returns on their money. This ultimately delivers greater lifetime savings.

The second way that we can help clients is through sharing our knowledge. This is a broad statement and involves our advisors working with clients to develop a strategy to achieve their long-term financial goals. It also means being there to provide insight when markets are volatile and by shining a light on how markets work, including how we invest their savings.

Over the years markets have changed. Passive investing, where investors buy a share in every company in the market, has become increasingly common as has computer driven algorithmic trading. This means that, in the short-term, share prices are increasingly set by investors with no sense of the real value of what they are buying. In fact, in many cases, they don't even know what the companies even do!

We firmly believe this provides an opportunity for Smart Active Investment Management. By focussing on and understanding of long-term business strategy, we believe we can add significant value. But it needs to be done well.

It isn't easy. Investors wanting to outperform must be willing to follow an approach that other investors can't or won't. It means having a clear long-term approach in an increasingly short-term oriented market.

Thinking long-term is more than just a mindset. It involves building the right team, the right process and a supportive culture. We have been working on that for the past 21 years and are proud of what we have achieved, but we know that there is always more to learn.

This note shares some of what we have learnt with you. It focuses on how we invest in the share market. It is comprehensive, starting with our investment philosophy, then delving into how we identify opportunities, undertake individual company research and ultimately how we draw this together to build portfolios.

I hope you find it a useful insight into how we think.

Frank Jasper

Chief Investment Officer, Fisher Funds

What we believe

PRINCIPLES, INVESTMENT BELIEFS AND WHAT WE WON'T COMPROMISE ON

The bedrock of our investment process is a philosophy or set of beliefs that set out what we believe drives share prices, where best to look for investment opportunities and how we should organise ourselves to identify and profit from these opportunities.

The rest of our investment process flows from these beliefs.

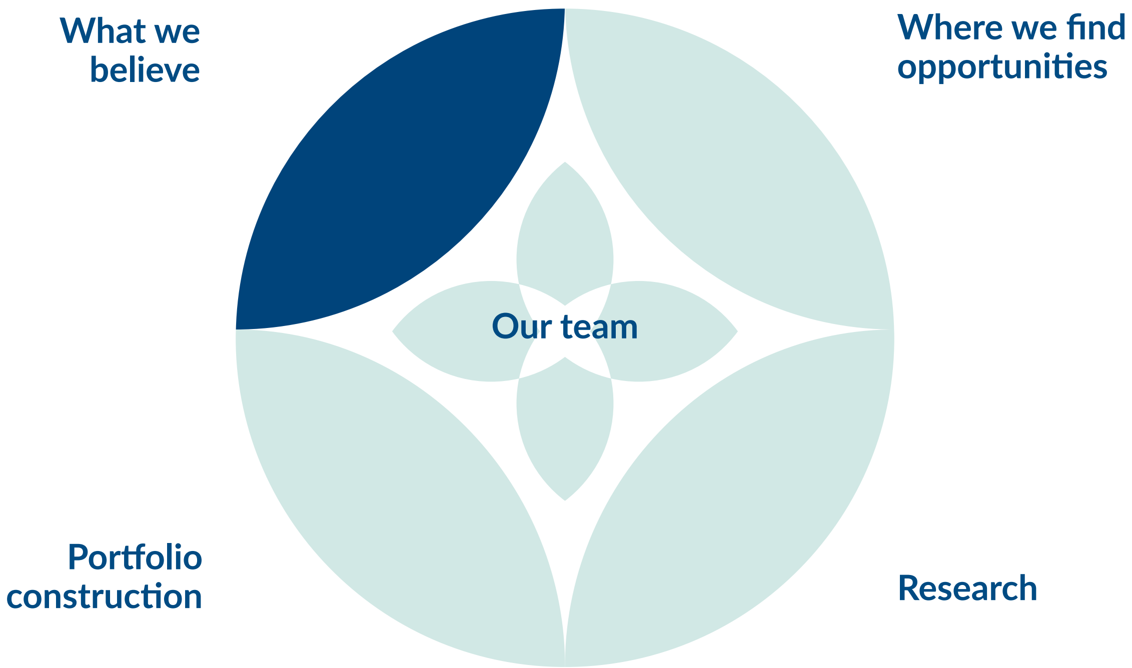


Figure 1- The investment process is governed by a set of principles that help identify where we find opportunities, how we research companies and build portfolios.

“Our process is simple. Simple doesn’t mean easy, but it is simple.

Find a great company that can grow its earnings over years and years, buy it, let time do its magic and be patient.

That is the surest way to build long-term wealth in the share market.”

- FRANK JASPER

Seven core principles inform where we look for investment opportunities, how we research companies and how we build or construct portfolios.

1. We think like a business owner.

We don't buy pieces of paper looking to profit as we shuffle them back and forth with other investors as prices change.

Instead, we think like business owners buying part of a company expecting to own it for the long term.

THIS MEANS WE:

Take a long-term view

Thinking like a business owner rather than a share market trader means thinking about the long term. It means thinking about a company's competitive position, how its products or services resonate with customers, about how the company's strategy will play out and what new investments it will make. This is where we believe we can gain unique insights; developing a strong sense of which companies will be the winners and losers in the never-ending game of competition.

Aim to hold for the long term

Of course, if you have a long-term perspective then it makes sense to own a company for the long term, watching the opportunity you saw years ago being realised as its strategy plays out.

Build industry knowledge

The only way to pick the winners and losers in an industry is to develop deep domain knowledge, understanding how successful companies are differentiating themselves from the competition. Building this knowledge is a painstaking process that happens over years of talking to company management, industry experts, attending conferences and reading a lot.

Focus on the most important things

Information has become freely available, insightful analysis is just as rare as it always was. We focus our energy and attention on the things that drive long-term earnings and that improve a company's competitive position. It is easy to get caught up in the noise of the here and now. **We strive to avoid that.**

2. We won’t compromise on quality

There are many reasons we won’t compromise on quality when we invest your savings.

One of the most important is that quality companies typically perform better than the average company in challenging markets.

The reasons for this pass the common sense test. Quality businesses typically have less debt, tend to have profits less tied to the direction of the economy, are growing and have business models that are protected from competition. All of these attributes protect profits and are increasingly valuable in difficult times.

THIS MEANS WE:

Invest in companies with established competitive strengths

Over time competition saps the profits of the average company. That is something we seek to avoid. Instead we focus on companies that have clear competitive strengths that are able to withstand competition and enjoy profitable growth for years. This is often referred to as a company's economic moat, a phrase popularised by Warren Buffett. Ideally we want wide impenetrable, crocodile-infested moats around the businesses we invest in, and we want the businesses we own investing in those moats to make them even wider.

Seek resilient, proven business models

We don't take punts. We seek out proven business models that we can see working and that we believe can be scaled over time. Sometimes that success might be hidden behind marketing and other costs helping grow the business, but if the unit level economics are compelling and customers love the product or service we are interested.

Avoid companies with too much debt

To win the game you have to stay in the game. Too much debt and there is a risk the bank calls game over before the business has had the chance to execute its strategy. That's not for us.

Find the best operators in their field

We look to invest in the leaders in their industry. This does not always mean the biggest player, sometimes it can be a smaller competitor disrupting the status quo, but either way, our focus is on ensuring we are investing in tomorrow's winners.

3. We hunt out companies that create value

There are different ways to be successful as an investment manager.

Some investors seek to generate returns by buying average companies at cheap prices and hoping the market changes its view on value. We don't do that. We would rather buy outstanding companies that are able to create long-term value over time.

Like the tide lifting your boat, long-term value creation means the underlying worth of your investment increases over the years. Even if it takes a while for the share market to recognise this you can rest easy knowing the companies you own will be worth more over time and that the magic of compounding is working for you.

THIS MEANS WE PREFER COMPANIES THAT:

Grow organically

Not all growth is created equal. A company that is able to grow under its own steam selling goods and services highly prized by its customers is more valuable, in our view, than a company that builds scale by acquiring other firms. We prefer those companies doing it their own way.

Invest in a way that grows business value

Growth for growth's sake doesn't create value for shareholders. The only growth we care about is growth that makes a business worth more. This means we focus our energies on finding firms that can generate attractive returns on every new dollar they invest. Growth at the cost of value is good for management's ego but not good for shareholders' wallets.

4. Partnering with the right management teams is important

As Warren Buffet observes, "After ten years on the job, a CEO whose company annually retains earnings equal to 10% of net worth will have been responsible for the deployment of more than 60% of all the capital at work in the business."

As an investor we have a long-term focus. This means we are partnering with a company's management for a long time in order to give them a chance to drive superior returns. The choice of the right partner is of paramount importance.

THIS MEANS WE PREFER:

Management with skin in the game

The best way to align management with shareholders is to turn managers into owners. This creates a genuine partnership between shareholders and management which, if structured correctly, promotes long-term outcomes focussed on shareholder value. Everyone wins.

Leadership with integrity

Integrity is non-negotiable. The only management we will trust with your money are those people with exemplary levels of integrity who have shown themselves to be good stewards of capital. This includes not only how they conduct their personal and professional lives but whether they keep their promises and show appropriate treatment of their staff, the environment and society in general.

Treat your money as their own

Companies take the capital provided to them by shareholders and use it to invest in new business opportunities seeking to grow and to expand competitive strengths. Sometimes this capital is provided explicitly through new money raised on the market, sometimes it is capital retained in the business from past profits. Either way, the leaders we seek to partner with never lose sight of the fact that this is shareholders' money. They treasure it and only retain it if they can make it worth more. If not, they have the discipline to give it back to the shareholders.

5. We would rather pay a fair price for a great company than a cheap price for something average.

There is invariably a trade-off between the quality of a company and the price you pay.

While it's always our goal to buy a quality company for a bargain basement price this is not always possible. In the main we seek to pay a fair price for a quality business today knowing that over time quality pays off handsomely.

#5 : WE WOULD RATHER PAY A FAIR PRICE FOR A GREAT COMPANY THAN A CHEAP PRICE FOR SOMETHING AVERAGE.

THIS MEANS WE:

Think about the price of a company today versus its value over the long term

There is a well-known quote that says "price is what you pay, value is what you get." We couldn't agree more. We view value through a long-term lens focussing on the future profits that a firm will deliver, knowing that if we paid a sensible price today those higher profits will be well rewarded by a higher share price in future.

Don't get too hung up on the metrics other investors focus on

Many investors hang their hats on market measures of value like a price-to-earnings ratio. While simple and easily calculated, these kinds of measures are blunt tools that may miss the true value of a quality, growing business. We take a more nuanced perspective on value, focussing more on what the business might become than what it is today.

6. We will only invest in companies that act responsibly

Well managed companies think about more than just maximising today's profits.

These companies think about how their brand and reputation resonates with customers. They do the right thing. This involves being aware of the social and environmental impact of the business and ensuring that it has a well-balanced and appropriate governance framework in place.

This is where principles come into contact with how we manage money. We invest your money in companies that behave in a responsible way that is consistent with our principles and the principles of our clients.

In our view, as well as being the right thing to do, investing responsibly makes financial sense. Companies that take a long-term perspective and act in the best interests of all stakeholders – the community, the environment, customers, employees and shareholders - are more likely, in our view, to generate attractive long-term returns. A win-win situation.

#6 : WE WILL ONLY INVEST IN COMPANIES THAT ACT RESPONSIBLY

THIS MEANS WE:

Won't invest in industries that cause only harm

Some industries provide little value to the world and cause harm to their customers. We won't invest in these industries. This includes the tobacco industry, companies that manufacture weapons that cause indiscriminate or disproportionate harm including nuclear weapons and in companies that mine for thermal coal.

Take into account the conduct of companies and are prepared to say no

We review the conduct of companies that we invest in or could invest in. If these companies cross the line and engage in behaviour that compromises our principles of sound environmental, social or governance standards we will exclude that company as a possible investment.

7. We build focussed, resilient portfolios

As baseball catcher Yogi Berra famously said, "Predictions are difficult, especially about the future."

We know that we don't know everything about the future. That means we look to build portfolios that can perform well regardless of what gets thrown at us.

The list of things that could be is long; will inflation be higher or lower, what is the economy going to do, will the New Zealand dollar rise or fall? Portfolios need to be resilient regardless of how the world unfolds.

THIS MEANS WE:

Diversify appropriately

We seek to build all-weather portfolios that are sensibly diversified across a range of companies that will tend to perform differently at different times in the cycle.

Make sure our best ideas make a difference

While it's important to build a sensibly diversified portfolio we also want to get the best value from our investment insights. This means we are not afraid to focus portfolios on our very best ideas. We typically have investments in fewer companies than other asset managers.

CASE STUDY

MAINFREIGHT

Mainfreight has a moat?!

How can a company that competes in the brutally competitive global trucking market have an economic moat around its business?

Mainfreight has a very wide moat that is **getting wider.**

Culture is critical.

Many companies use "culture" as a buzzword. Mainfreight walks the culture talk more than any other company we have researched globally.

The truck owner-drivers are heavily invested in success. There is a weekly profit & loss statement on every branch office wall globally which drives accountability and encourages a healthy sense of competition. Every full time person gets a bonus based on their branch's profitability. This inspires everyone to think like a business owner. All of Mainfreight's people from the country head right down to the newest hire eat together in the canteen. Why is all of this important? It is important because it means Mainfreight's people care. They care about their work and they care about doing a good job for clients. And they care because Mainfreight cares about its people. This means that Mainfreight outshines its competitors with customer service, is able to charge a premium for its services, and is taking market share in every market in which it operates globally.

Longevity of management tenure and skin in the game is critical.

Bruce Plested started Mainfreight in 1978 with an old Bedford truck and $7,000.

41 years later he is still Chairman of the Board and the company is worth over $4 billion. Bruce owns $630m worth of stock. Don Braid has been the Managing Director for 16 years. Don owns $112m of stock. Tim Williams has been the CFO for 25 years and owns $9m of stock. John Hepworth, current President of Mainfreight USA, has been with Mainfreight for almost 30 years and owns $10m of stock. Longevity and skin in the game ensures the management team think like business owners rather than caretaker managers. It ensures excellent continuity of management.

Super long term lens is critical.

Mainfreight unashamedly talk about and takes a 100 year view.

This means that Mainfreight often eschews short-term profitability in order to set itself up for success in the very long term. Critics of Mainfreight questioned the rationale of them entering the Australian market. They questioned the rationale of buying into the US and into Europe. Those operations have all taken more than a decade to get to a level of service and culture that the company is happy with (and by the way, Don and his team are still not happy yet!). But the wisdom of those long-term decisions is now clear – sourcing multi-national clients from different jurisdictions and feeding them into the network to drive global network density and profitability.

There are two key controversies that the market is grappling with today.

The first is that Mainfreight is too expensive and the second is that it is too cyclical. We disagree with the market on both.

When Mainfreight listed in 1996, it was priced by the market at the bottom end of the proposed $0.95-$1.10 IPO price range because the market thought it looked expensive for a cyclical company.

In 2006 when the stock price raced above $5.00 and it was trading at a price to earnings multiple higher than the NZ stock market, investors thought it was too expensive. And today investors and analysts still think it looks too expensive. But the market is forgetting that a simple price to earnings multiple ignores the huge multi-billion dollar total addressable markets in the US and Europe which represent significant growth runway and enable decades of double-digit earnings growth ahead. At $40.00 today, Mainfreight delivered investors a return of 9,900% or 22% per annum since listing and it has rarely been accused of offering good value!

We agree with the market that Mainfreight is cyclical.

The global financial crisis reminded us of that.

But we disagree that it is too cyclical. The US freight market in which Mainfreight competes has been growing 3-5% per annum. Yet Mainfreight grows 3-4x faster than that as its superior service and culture allow it to take market share rapidly. Today the trucking market in the US has slowed sharply yet Mainfreight is reporting very full forward order books and cannot hire sales people fast enough to satisfy the huge opportunities it is presented with.

We get confidence in our differentiated views via deep dive proprietary research.

We travel extensively, we meet second and third line management regularly, we talk to Mainfreight's competitors, their suppliers and their customers. And most importantly, we take a leaf out of Mainfreight's book and think long term about our position. We think like business owners.

Where we find **opportunities**

OUR EDGE

Figure 1 **- The investment process is governed by a set of principles that help identify where we find opportunities, how we research companies and build portfolios.**

The competition for good investment ideas is intense with smart people and considerable computing power increasingly used in the search for market-beating insights. With so much effort being expended by other market participants we need to be clear where our edge lies. By edge we mean what is it that we can do or where is it that we can look that can enable us to systematically outsmart the competitors in the hunt for market outperformance?

When we are clear where our edge lies we then need to ensure that the types of opportunities we consider and the research approach to consider them is consistent with that edge. Identifying our edge is the first step in answering the question of where to look for fruitful investment opportunities.

John Huber of Saber Capital identifies "Three main inefficiencies that can be exploited in markets." These inefficiencies can be a source of edge:

1. Informational Advantage

Finding information that others don't have.

2. Analytical Advantage

This is the advantage that comes from thinking differently. In our case, we believe that the market, from time to time, does a poor job in judging the long-term outlook for a company and may miss the advantages that accrue with high-quality businesses with strong competitive positions. As John Huber points out, "The market is better at analysing short-term data points than it is when it comes to analysing long-term fundamentals."

3. Time Horizon Advantage

Opportunities can come about simply by being prepared to be more patient than the average investor. We adopt a long-term perspective when most investors are thinking about the next quarter or six months. This source of edge is about having patience and the willingness to invest when others are selling for short-term reasons.

In our view, information advantage is increasingly rare with any apparent edge likely to be either illegal or, in these days of lightning fast information flows, incredibly fleeting. Computers have become dominant in the speedy dissemination of "known or knowable information" into asset prices.

While computer algorithms have impacted strategies for short-term focussed investors, computers are still not good at making qualitative judgements about the long-term prospects of companies and industries. Humans have an edge if they focus on factors that drive long-term business value.

This is where we focus our energy. We believe we can develop, from time to time, analytical insights that will enable us to outperform markets. Similarly, we are patient and happy to buy good quality companies from short-term investors when they panic and wait for that quality to, once again, come to the fore.

Building an investment team and process to exploit these inefficiencies has profound implications for all aspects of managing your money.

It means we research and try to understand the things that will impact a business or industry years from now and that may not yet be fully appreciated by the market.

When hiring we focus on identifying patient, long-term focussed people – not people who obsess about the short-term and feel a need to react to every market development.

It means we build detailed knowledge of selected industries where we think there will be good long-term investment opportunities and we can develop an edge.

It means our incentive schemes reward the team for outperforming the market over the long-term – we don't reward mediocrity or short-term flash in the pan performance.

Building an investment team and process to exploit these inefficiencies has profound implications for all aspects of managing your money.

“The task is not to see what no one has seen, but to think what nobody has yet thought about that which everybody sees.”

- ERWIN SCHRÖDINGER

PHYSICIST

FINDING OPPORTUNITIES

The core tenets of our investment philosophy can be boiled down to a belief that through owning high-quality companies that can grow their earnings over time, we will generate attractive returns and outperform the market.

While this may be a simple statement the pursuit of this investment approach is anything but. It takes a long-term focus, which is increasingly hard in an increasingly short-term, flow driven market.

It takes clear thinking and the ability to apply a business-centric rather than a market-centric approach and it means having a clear focus on where the opportunities to add value are.

Over the years we have refined our search process identifying three broad opportunity types that fit with our investment philosophy. Our research process has been designed to exploit these opportunities.

Opportunity	Description	Comments
Beat the Fade	**The market underestimates the period over which a business can generate healthy profits.** For most businesses, growth, margins and return on investment tend to diminish over time as the forces of competition bite. This gravitational pull doesn't apply to some rare businesses. These businesses are often mispriced.	A company in this category need not be delivering high growth to prove an attractive investment, but it needs to be able maintain or grow economic returns for longer than the market has baked into the current price. This places analytical emphasis on ensuring the breadth of the firm's economic moat to protect returns, and on understanding why and how our view on returns differs from that priced by the market.
Quality on Sale	**From time to time an otherwise high-quality company might have a disappointing earnings surprise or event that the market interprets as a permanent change in business fundamentals.** This may prove to be temporary and the market overreaction can create an opportunity.	A "quality on sale" opportunity typically results from a company either having a temporary negative earnings blip or where a company is for some reason generating profit results short of its true potential. In either case, if we can form the view that normal service will be restored there may be the opportunity to generate healthy returns as the market eventually looks past the near-term disappointment.

Opportunity	Description	Comments
Platform for Growth	The market may recognise that a company will "beat the fade" within in its existing core business but does not appreciate the extent to which the company can grow outside its core business or further leverage returns.	The "Platform for growth" is, in many ways, the most exciting investment opportunity. Unfortunately, not many businesses have this level of quality and growth potential. A platform for growth business not only generates strong economic returns for longer than the market expects but can also grow outside of its core. This drives further value creation. Some valuation creativity may be required to capture the true significance of the value creation platform that the company has developed and the possibility for it to deploy incremental (and potentially as yet unknown) amounts of capital over time. These investments require us to develop deep insights into how a company or industry may change over the longer term to create value not seen by other investors.

While it's important to know what we are looking for, it doesn't answer the question of exactly where to find it. Unfortunately, there is no formulaic and straightforward answer to this question.

We do know where the answer doesn't lie. The answer doesn't lie in spreadsheets nor does the most amazing investment opportunity very often come to you sitting at your desk reading share broker reports or gazing at your Bloomberg screen. Like almost everything worthwhile in life, it is invariably the result of hard work.

In this case the hard work means reading, a lot. It means reading the right things - trade journals, annual reports, newspapers, blogs and thoughts from other investors. It involves talking to a lot of people – other investors, industry players and experts, visiting companies and interviewing management teams. Most importantly it involves a never-ending curiosity, asking a lot of questions, looking at a lot of opportunities and rejecting most.

This is where a clear investment philosophy and a sense of what we are looking for pays off. We are able to quickly determine whether a potential investment is likely to be in the Fisher Funds ballpark. The ability to do this is important. With thousands and thousands of listed companies that we could invest in we have to be very choosy about where we invest our research time.

We are able to quickly determine whether a potential investment is likely to be in the Fisher Funds ballpark.

How we research companies

HOW WE RESEARCH COMPANIES

***Figure 1*- The investment process is governed by a set of principles that help identify where we find opportunities, how we research companies and build portfolios.**

Researching companies is the most time intensive step in building portfolios, and so is the focus of much of our day to day effort.

It may take months of detailed work and many meetings and phone calls with relevant stakeholders and a firm's management team to form a view on a prospective investment.

Our company research process, as all should be, is based firmly on the core tenets of our investment philosophy - a long-term focus aiming to identify quality businesses that have the opportunity to grow profits over the coming years.

There are six primary attributes of a business that we focus on in the research process.

Collectively we refer to these attributes as STEEPP, with each letter referring to a specific attribute - the Strength of a business, its Track record, its history of growing Earnings, the outlook for the firm's future Earnings, its People, including management and Board, and its Price or valuation.

These attributes provide a framework to organise our research process and to document our thinking on a company. As we discuss later, STEEPP also provides a ranking mechanism that is a key input into how we build portfolios.

Our research process evaluates every equity investment using our STEEPP research framework:

Six factors are considered:

S

Strength of the business

What is unique about this business? Does it have a moat?

T

Track record

How has the company executed in the past?

E

Earnings history

Has the company consistently generated strong earnings growth & high returns on capital in the past?

E

Earnings growth forecast

What future earnings growth & cash flow do we expect the company to generate?

P

People

Does the management team have a clear strategic vision? What's their track record like?

P

Price

What value is embedded in the current price? What value do we see?

Research is as much about perspiration as it is about inspiration.

“Starting [at a young age] he’s read everything that he could find about business. The subject that interests him, he’s read newspapers, biographies, trade press. He went over to his grandfather who was a grocer and he read the progressive grocer magazine, and he read articles on how to stock a meat department.

He’s gone to visit every company that he could find that was even slightly interesting to him, he went down to visit a barrel maker and spent hours talking about how to make barrels. He went to American Express, and he spent hours talking about that business, he went to GEICO and learned about the insurance business. He has stacks of reports on his desk from the companies he owns, pig stalls, jewellery, boat winches, everything you can imagine.

He reads hundreds of annual reports every year from companies that he doesn’t own yet, because he just wants to understand their businesses, and then when the opportunity arises, then he’s ready and he can make a decision. What he’s really done is he’s created this immense vertical filing cabinet in his brain of layers and layers and layers of files of information that he can draw back on now for more than 70 years’ worth of data.”

ALICE SCHROEDER

the author of Warren Buffett’s authorized biography.

As we research a company we focus our attention on each of these attributes:

Strength of the business

Arguably this is the most important question we consider. If a business doesn't have intrinsic strengths to its business model and some kind of moat protecting it from competition it is unlikely to be of interest.

Specific research questions we address when thinking about a company's strength include:

What is the source of a company's competitive advantage? Is it sustainable? Is the company a market leader? Does it have a dominant position? Has it generated attractive returns on capital? How does it compare to its competitors?
Is competition getting weaker or stronger? Does this company have a sound balance sheet and is it prudently managed?

Track record

Track record is all about strategic and operational execution.

How has the company performed in the past? Has the company performed under the same management team? Has it grown organically or by acquisition? How did the company react during a downturn? Has is invested precious shareholder capital wisely?

We prefer to buy established companies that have executed well in the past.

Earnings history

While the past can be a hazy guide to the future, it is important to clearly understand a company's business and revenue model, looking in detail at past financial statements to gain insights that are relevant for the future.

How fast has the company been able to grow its earnings in the past? What are the fundamental drivers of this growth? How consistent has earnings growth been?

We prefer to buy companies that exhibit secular growth characteristics where they have proven their ability to provide a high or improving return on invested capital.

Earnings outlook

It is the path of a company's future profitability that drives its share price.

What is the company's earnings growth forecast over the medium and longer term? What is the probability of achieving the forecast?

This is an important area of differentiation in our process. We believe the market unduly focusses on short-term earnings. As long-term quality, growth investors, we think deeply about where the company's earnings could be over time.

People

People are important. Their vision, their skills and critically their integrity all play a role in creating a successful company.

Who are the management team and how long have they been in their roles? Who are the directors, what is their history with the company and what do they bring to the board? What is the depth of management in the organisation and is there a succession plan for the key executive roles? Do the management team own shares in the business and how are they rewarded? Has the board and management exhibited good corporate behaviour with respect to environmental, social and governance considerations? Do they have a long-term vision well aligned with shareholders?

The quality of the company management and its corporate governance is of paramount importance.

Price

How much of the future earnings growth is already reflected in the share price? Where does the current share price sit in relation to our worst to best case valuation range?

An investment will be more attractive when the market price currently reflects little of its upside potential.

As we research the opportunity we seek out the answers to these questions.

The process of finding these answers is organic, typically involving discussions with the company and with its competitors. In most cases, we identify independent experts within a company's industry and seek out their thoughts. We read. We think. It is an iterative and intensive process.

The formal output of the research process is our investment thesis. This written document outlines the reasons we like a company and how we see its competitive strengths driving earnings growth over the medium to long term. The investment thesis also includes scoring under each of the six factors considered under the STEEPP framework. We use this to help rank opportunities and it is one of the inputs into how we build portfolios.

Before we finally commit to making an investment in a company, the investment thesis is reviewed by our investment committee. This committee is chaired by the Chief Investment Officer and comprises the Senior Portfolio Managers and Chief Investment Strategist. Its role is to ask a lot of questions, probe into the research process that has been undertaken and to ensure that the investment opportunity has been considered from all angles.

“Our company research process, as all should be, is based firmly on the core tenets of our investment philosophy **- a long-term focus aiming to identify quality businesses that have the opportunity to grow profits over the coming years.”**

CASE STUDY

The war on cash and Mastercard's underappreciated growth potential

Mastercard's payment rails provide a competitive moat and uniquely position it for digital payment adoption.

The market has continually underappreciated Mastercard. We invested almost five years ago and wish we had moved sooner.

Despite being a large and well-known company, its share price has increased 60-fold since it listed on the stock exchange in 2006! A $10,000 investment would now be worth over $600,000. Not bad.

Mastercard is a great illustration of a business that has continually surprised investors due to its powerful business model and multi-decade growth runway.

Mastercard's network effect keeps competition at bay

Consumers expect to be able to pull out a credit card at a retailer, tap, and go.

Mastercard's network provides this capability. It makes in-store payments frictionless and online payments possible. Globally there are over 2 billion Mastercard branded cards in consumers' wallets - accepted at over 30 million merchants. This immense network creates a hurdle for would-be competitors and is now practically impossible to replicate.

This network effect creates a protective moat, keeps competition at bay, and gives Mastercard and Visa a payments duopoly. Mastercard is here to stay and its network is in pole position for digital payment growth.

Digital payment adoption provides a supportive tailwind

Mastercard's war on cash creates a long growth runway.

While Kiwis were early adopters of plastic cards, when you visit the US or Europe you may notice that many people still use cash. Small merchants don't always accept credit cards and contactless technology (tap and pay) isn't widely available in many countries. In fact, over 50% of global transactions are still made with cash.

Cash usage is declining and digital payments are on the rise. Contactless technology is being adopted and in London and New York you can just tap your credit card on the turnstiles to board a train. Mobile technology allows micro-merchants to accept credit cards, ecommerce can only be settled with digital payments, and your card is automatically charged when taking an Uber - when previously many taxi drivers only accepted cash. These advances are driving steady growth for Mastercard, and should do so for another 10 years.

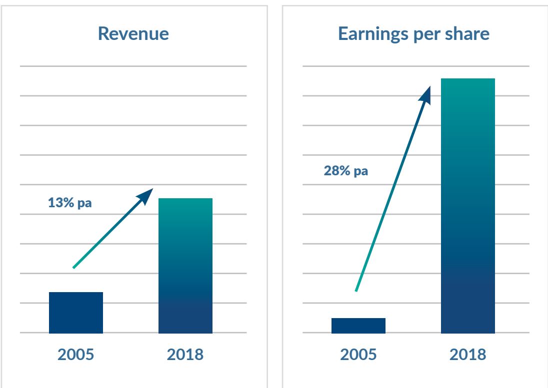
Mastercard had underappreciated earnings power

Mastercard's operating leverage, pricing power and new network uses have been underappreciated.

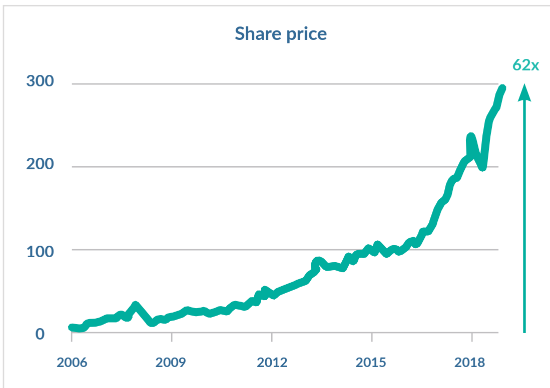
One of the beauties of the business is its cost base is largely fixed and expenses don't increase much with each additional transaction. This has seen net profit margins increase from 10% to 40% since listing. This operating leverage has been underappreciated and should drive strong earnings growth in the years ahead. Mastercard also has untapped pricing power due to the moat around its business and lack of competition.

The ability to leverage Mastercard's network in new ways provides optionality. Many businesses still pay their bills by cheque, but new tools can allow businesses to make corporate payments instantly over Mastercard's network. Uber drivers can have their cut of each fare paid out at the push of a button, rather than waiting for the weekly pay run. Insurers are also starting to pay out insurance claims instantly to customers' debit cards – rather than sending a cheque in the mail. These innovations are being demanded by businesses. With its payment infrastructure now well entrenched, Mastercard is in the right place at the right time to capitalise.

13% revenue growth leveraged to deliver 28% pa earning growth since IPO



Share price has multiplied 62x since IPO



How we **build portfolios**

HOW WE BUILD PORTFOLIOS

Figure 1 **- The investment process is governed by a set of principles that help identify where we find opportunities, how we research companies and build portfolios.**

Our philosophy, where we hunt for ideas and the research process are all designed to help us identify attractive investment opportunities.

There is one further element that is a crucial part of beating the market. That is portfolio construction; the way we build portfolios that not only reflect our best ideas but that are coherent and that we believe will offer attractive returns in a range of different economic and market environments.

Portfolio construction flows organically from the research process. When we have identified a company that scores highly across the six STEEPP attributes then, on the basis that it is more attractive than existing investments, we will look to include it in our portfolios.

This can't be done in isolation. We need to consider not only the attributes of the company we are looking to include but also how it relates to other investments in the portfolio.

This can be as much a creative process as it is scientific. It may involve balancing, sometimes competing, objectives:

Maximising return

First and foremost we seek to maximise portfolio returns, increasing the odds that we beat the market by a healthy margin over time. We believe that companies with the highest scores from our STEEPP research process are likely to exhibit the most attractive returns over the medium to long term. This means, all other things being equal, we want to include the highest scoring companies as the largest positions in portfolios.

Ensuring portfolios are resilient

A portfolio made up entirely of companies from only one industry or that are exposed to similar economic drivers would not be very resilient. We seek to build all-weather portfolios that are sensibly diversified across a range of companies that will tend to perform differently at different times in the cycle. This might mean including some companies that score lower in the STEEPP framework, but which bring some added traits that increases overall portfolio resilience.

We resolve these competing objectives by considering portfolio construction through a number of lenses.

At its most simple level we consider the industry mix of a portfolio to ensure we have an appropriate spread of capital invested across different industries. We wouldn't want a portfolio that was just invested in retailers or software companies!

As well as considering portfolio mix based on individual industries like technology or healthcare, we also look at portfolio mix based on a broader categorisation of defensive, economically sensitive or interest rate driven investments. Again the goal here is have to a sensible level of diversification between different types of companies, of course on the proviso that these investments individually rank highly through our STEEPP research process.

There is one further layer of diversification we build into portfolios.

This is diversifying between having exposure to different types of investment ideas. This ties in closely to the investment opportunities identified when we discussed our "edge" in the previous section.

The framework we use for this is highlighted below. This contrasts the business merits of the company (its quality, strength, management and earnings potential) against how attractive its current valuation is, measured by our Price score.

We would expect to have much of the portfolio's capital invested in the "Sweet Spot" quadrant.

However, our portfolios will also typically have exposure to both high-quality, large market, higher growth names (usually under the "platform for growth" type opportunity) as well as some more reasonably priced companies which often fall under the "quality on sale" idea type.

By building portfolios primarily from the bottom up, comprising our "favourite," highest STEEPP scoring companies, overlaid with a disciplined approach to portfolio construction, we believe we get the best of both worlds. This combines the creativity of identifying attractive companies to investment wrapped into portfolios that can perform well in a variety of different market and economic environments.

Selling

In an ideal world, we would never sell an investment.

We aim to hold for the long term with the view that a quality company that can compound earnings growth over many years will deliver strong shareholder returns. Of course, we don't always live in an ideal world. Making a good decision to sell an investment can be as important as making a good decision to buy. It is often a neglected element of the investment process.

There are three primary reasons why we might sell an investment:

1. The first, and in many ways most benign, reason to fully exit an investment in the portfolio is that we found something better to invest in. The STEEPP scoring process enables us to rank the prospective business and investment merits of companies. If a new idea is considered and found to be more attractive than an existing investment that may result in a weaker idea exiting the portfolio. This is a healthy outcome for the portfolio enabling us to ensure that investment ideas are fresh and that the portfolio at all times reflects our best thinking.

2. Valuation may be a reason to sell an entire position. This is the second, but more rarely used, reason to sell a portfolio investment. Given that our focus is on long-term, high-quality, growing businesses we would need to see evidence of extreme overvaluation before exiting. Great businesses have a habit of doing special things that make short-term modest overvaluation disappear very quickly, so caution is warranted. Valuation is more typically used in our weighting decisions rather than in our sell discipline.

3. The third reason to exit an investment is a fundamental change in our investment thesis, or our rationale for owning an investment in the first place. This may be as a result of fundamental shifts that undermine the company's competitive position. Or, we could discover new evidence which raises major questions on the quality of the business or its management. Or perhaps its opportunity to grow earnings that have diminished. In these cases we act quickly and sell the investment.

Our Team

Our Team

A well-defined investment process is central to delivering long-term investment success.

But it takes more than just a good process. It takes a team of smart, intellectually curious analysts who can each add a differing perspective. It takes a well-articulated, well-aligned culture committed to investment excellence. And it takes a commitment to learning, so the lessons from the past, both positive and negative, can be applied to the future. These "softer" factors are as important as the perfect process and are a key focus for us as we manage your money.

Over the years we have come to see a number of these factors as critical:

We are part of the process

Any student of physics will know Heisenberg's uncertainty principle. At the core of Heisenberg's thesis is that the act of observation, in his case watching a photon of light, influences the thing being observed. The act of observing inextricably links the observer to the observed. Researching a company can be like that.

Share market analysts like to think of themselves as cool, calm human calculators. Reality is different. We bring our biases, our sometimes flawed human brains and the sum total of our life experience, good and bad, to our analysis.

We acknowledge the reality of this in our process, seeking to understand any behavioural biases that are likely to influence our decision-making. It's why an intellectually diverse team is important and why we have a structured decision review process.

Humble, acknowledging what we can't know

We believe focussed, in-depth research can give us valuable insights on corporate strategy and help pick out those rare high-quality business that will be able to grow their earnings over the long term.

At the same time, we are humble enough to acknowledge those things that we can't know or where we don't believe we have sufficient "edge" to justify investing. What don't we know? We don't believe we have sufficient edge in forecasting the outlook for the economy, the level of GDP, or how interest changes might affect a company to make an investment solely on that basis. We focus on the micro not the macro. We also know some industries are so opaque and outside our understanding or competence that we just won't invest in them.

Focussed

We are focussed in where we spend our time and how we channel our energy. There are lots of industries and companies that we don't spend our time on because they are either hard to identify winners in, or they are outside our areas of expertise.

There are also investment strategies and approaches that others use that could be tempting to delve into from time to time. We also ignore these strategies. We believe that it is important to identify an approach that works and focus on getting better and better at that. When it comes to investing, it is better to be an expert in one domain than mediocre in five. We focus on honing our skills and building our edge over competitors.

Learning

While many of the principles underpinning our process are simple, implementing them skilfully is not. We strive to do it better and better every year. We do this by being deliberate in learning the lessons from our past. What has worked, what hasn't, what can we learn and what can we bake into the process for the future? Doing this takes intellectual honesty and hard work but is a critical part of getting the best out of the process and ourselves.

Our Team

Frank Jasper – *Chief Investment Officer*

Frank leads the Fisher Funds investment team. He has extensive industry experience and has worked in various analyst, research, portfolio management and strategy roles at ABN Amro Craigs, TOWER Asset Management & Mercer Investment Consulting over the last 25 years. He has been with Fisher Funds since 2005, initially building the Australian equity capability as well as helping oversee the growth of the firm to becoming one of New Zealand's leading investment managers.

Angela Quirk – *Head of Trading*

Angela has been at Fisher Funds since 2013 and is currently the Head of Trading where she is responsible for centralised dealing on behalf of the entire investment team. Angela was previously the Fixed Income Manager and she has in-depth knowledge of government and corporate bonds, interest rate swaps and cash management products. Angela is a CFA Charterholder and also has experience across other sectors, including NZ equities, commercial property and alternative assets.

Sam Dickie - *Senior Portfolio Manager — New Zealand Shares and Property & Infrastructure*

Sam leads both the New Zealand Shares and Property and Infrastructure teams. Sam joined Fisher Funds in March 2017 and is an experienced investment professional. He previously held senior investment roles at Moore Capital in Hong Kong and Bennelong Asset Management in London.

Robbie Urquhart *– Senior Portfolio Manager - Australian Shares*

Robbie is responsible for managing the Australian portfolio. Robbie has a long career in investment management, having worked as a portfolio manager and analyst since 2001 in both New Zealand and London where he held various roles with Trafalgar Copley, Copenhagen Capital and FNZC.

Ashley Gardyne *– Senior Portfolio Manager – International Shares*

Ashley leads the International Shares team and has been with Fisher Funds since 2013. Prior to Fisher Funds Ashley spent 10 years advising infrastructure and private equity funds on acquisitions and divestments. Ashley started his career with ABN AMRO in New Zealand before moving to the UK where he held a number of investment banking roles, including responsibility for the corporate finance group at RBS in London.

Thanks for being part of our journey.

Thank you for joining us as we strive for investment excellence. As investors, and for those of you who have read this out of curiosity, you are, in the broadest sense, part of our team.

If you have thoughts, feedback, ideas or insights we would love to hear them. This is our passion and we love talking and thinking about it!

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