IMAP Independent Thought Podcast
Episode 20: Lessons from 30 years of Investing

Steve Hiscock of SG Hiscock discusses

- Why active management works. What is active and what is passive?
- The role of ETFs and their increasing popularity
- The rise of new methods of investing
- The role of financial advisors and asset consultants and how this has changed
- Have client needs changed?
- Residential property and the sharp rise in interest rates
- Property sector - is it the end of the office?

Moderated by David McDonald, CFA IMAP

IMAP Disclaimer (00:01):

This podcast series is not meant for retail investors, but instead is meant for financial advice and investment professionals. Please refer to IMAP's website **https://imap.asn.au** for more details.

David McDonald - IMAP (00:16):

Welcome to this podcast in the IMAP independent thought series. Today I'm joined by Steven Hiscock. Steve is the executive chairman of SG Hiscock, and we're going to talk about lessons that he has learned from 30 plus years of being in the investment field. Welcome, Steve.

Steve Hiscock - S G Hiscock (00:32):

Thank you, David

David McDonald - IMAP (00:34):

So maybe we can just start, Steve, we mentioned there that you've been doing this for 30 years or so. Would you like to just give us a sort of brief outline of what you've done in that time and what sort of things you've covered?

Steve Hiscock - S G Hiscock (00:48):

Sure. I've been doing it professionally for 36 years, but my whole investment journey really started with my father back when I was very young. He bought me some Woodside Petroleum shares back when they were about a dollar. As you know, well over $30 now. So it wasn't a bad

call but he really piqued my interest in investing and I've never lost that interest in why companies go up and down, why share prices go up and down.

And so my first exposure to the investment world was as a summer intern. I worked for Potter Warberg or Potter Partners back in those days. It's now called UBS.

David McDonald - IMAP (01:27):

Yes,

Steve Hiscock - S G Hiscock (01:27):

So that was back in the early eighties. And I was just working in the back office doing settlements for share trading. And I was lucky enough to be offered a role in London for six months with Potters and they sent me over there, which was just fantastic.

Unfortunately I had to come back. I came back to the State Bank of Victoria as a credit analyst and I was kind of disappointed coming back because London was such a great place.

But actually being a credit analyst, I reckon is a fantastic way to look at companies because you're taught the difference between cash flow and reported income. And that's something that's always stayed with me. Right. So it's cash flow that pays back debt. Income can be masked, it can be manipulated, it can include re-valuation uplifts and all sorts of things. So I went from State Bank Victoria to Wardley. Wardley is now HSBC Asset Management. So I went there in 1987 I joined, which was particularly good timing given the practice.

David McDonald - IMAP (02:33):

Yes indeed.

Steve Hiscock - S G Hiscock (02:34):

And that was a unbelievable lesson to see that a market can genuinely get wiped out, or 30% of it wiped out in one day. Has stayed with me for the rest of my life. And I loved HSBC. I was there for eight years and joined National Asset Management after that owned by the National Bank.

I was head of their Australian equity team, and later on ran the investment group as general manager, but then in 2001 the National Bank closed down National Asset Management and merged it into what's now MLC.

And so several of the senior people at National Asset Management started up SG Hiscock in 2001, and we've been there ever since. We started in 2001, we collectively scratched together a million dollars from the five of us to put into various investments. And, you know today we've got well over 4,000 investors, 15 investment products mandates institutional investors, and we've also got distribution relationships with some of the world's largest investors like Morgan Stanley, abrdn (Aberdeen), LaSalle and EAM Investors. So it's a completely different beast now.

David McDonald - IMAP (03:56):

That's great. Oh, it's good to hear businesses that have been around for that long. And I guess the thing is Steve, over that time, even the last 20 years or so, in your own business, it would be interesting to hear what sort of things you've learned in terms of: about cash flow, which is obviously important for looking at companies, but what things do you think work from an investment point of view or what should people not do or not look at what hasn't worked?

Steve Hiscock - S G Hiscock (04:26):

Yeah, well, great question David. I think there is a number of things over the years and they keep happening again, really, or you see people and including me make the same mistakes. But maybe I'll go through them. I've written down a few of these because I thought it might be worthwhile going through them in some sort of vague order.

But the first thing is just because something looks cheap doesn't necessarily mean the price will move towards what you think…. It is cheap. I think that's really important. The fact that there is something looks cheap there might well be a reason. So do not get sucked into the fact that, oh, you know, that's looking really cheap. You've got to buy it quite often if a share price is down or the valuation of investment is very cheap, there's a reason for it.

Steve Hiscock - S G Hiscock (05:15):

So just be aware of that. So I think, you know, the first thing is over relying on valuation is dangerous. You've got to also incorporate qualitative factors into your research, and really the my whole theme I think throughout what I'm going to say is “do your research”.

You must own your own research, you must do it yourself, and you must make your own call. You've, I think another point to do is you've got to work out yourself what you want to do as an investor. So what I mean by that is you've got to have an investment style that is sympathetic to your own personality.

There's no point you being a long-term value investor if you are a trader at heart and if you like action the whole time.

So and there's many investment styles and we might talk about that later, but you've got to choose an investment style that suits your own personality, otherwise there'll be a mismatch and you'll make decisions at the wrong time. So that's something to think about it.

And a lot of people don't sit back and say, okay, am I a great investor? Am I a passive investor? Am I a long-term investor or a short-term investor at heart? You've got to work that out.

And the other thing as part of that is you've got to work out whether you are a short-term or a long-term investor. Some people love the thrill of trading. They're often the people, you know, they also like going to horse races and so forth.

David McDonald - IMAP (06:41):

<Laugh>

Steve Hiscock - S G Hiscock (06:42):

And I'm being sort of fairly tongue in cheek there, but share trading is something that is closer to betting because you're betting on short-term moves that are highly, highly unpredictable, whereas long-term investment investors tend to look at long-term themes that develop over time and they tend to work out more often if you like.

I think that, and on that… not everything works out the way you think it's going to work out.

You've got to accept as an investor that you will get investments wrong. That's really important. It's a fact of life as an investor that you'll get, you'll make mistakes.

But the idea from that is to learn from the mistakes. Make sure you haven't blown yourself up. So don't put all your eggs in one basket. Learn from your mistakes, get better over time and move on to the next one. And it is one I'm, I'm glad to say David, that because you and I are both advancing in age is that it is one of the areas that you do get better with years and, and age and experience.

And I sit on an investment committee with someone in their eighties and he is so smart and so wise and so great investor and it's just wonderful, and he's still learning and we're all still learning until we die in this area.

David McDonald - IMAP (08:04):

Yeah, I think that that's a good point, isn't it? I mean, you mentioned you started in ‘87, you know, both of us can actually have that experience, which not many people in markets do today. We've saw the tech bubble, we've seen the financial crisis there, as you say it certainly teaches you things,

Steve Hiscock - S G Hiscock (08:22):

That's right. You keep learning that. But, I think the one thing is people tend to sort of unfortunately make decisions at the wrong time, right?

So equity markets over the long term do rise. And that's something for investors keep in mind that you know, as we sit today and the market is around about 7,000 points in the Australian equity market. But obviously it's been higher than that, it's been lower than that. Pre the global financial crisis in 2008, it was roughly the same. But you know over time as company earnings increase, as the population increases, the equity markets do increase. So just remember that as an investor, but it's really important in a more tactical sense to look at interest rates and the direction of interest rates. It's not just the level of interest rates, it is the direction as well.

Steve Hiscock - S G Hiscock (09:11):

So that's something that is really worth paying attention to. And I've got to say this David, because please as investors be wary of overconfident market forecasters, <laugh>, they don't know any more than the rest of us. But because they sound particularly confident, they sound believable. The simple fact is that the equity markets, and all investment classes that get priced daily or frequently, they are unpredictable in the future. So if someone says the market's definitely going up or the stock's definitely going up, treat that with caution, please…..in case it is a disaster.

David McDonald - IMAP (09:53):

I remember early on that someone I worked with told me that this particular person was a really good economist and I asked why she thought that. And the answer was, well, he is on television a lot, <laugh> it doesn't necessarily correlate with the ability to forecast the economy.

Steve Hiscock - S G Hiscock (10:14):

No it doesn't. And yes I mean there's many funny jokes about economists, but we won't go there. I think it's that probably leads me to another point, which is don't invest based on a tip.

Don't invest based on a tip from a friend. Certainly not a forecaster. Particularly one on television.

You got to do your own research. You will get tips over time from friends, cab drivers, whoever avoid them all at least until you've done your own research, right? So do your own research thoroughly and own the decision that you are making.

The other thing that really gets people derailed is debt. Avoid debt as although a modest small amount of debt can make your investments tax efficient. I get that, but it should not be at a level where you are forced to make that the wrong decision at the wrong time of the market.

Steve Hiscock - S G Hiscock (11:13):

So there are a lot of geared share market funds back before the global financial crisis. And at the end of the day the funds that had debt in them were forced to sell as the market was falling and it ended up locking in all the losses.

So just avoid debt if you can in your investments. And we saw that last year, didn't we? You're in 2020, and actually late last year with the bond crash, anyone who had debt lost a lot of money.

There's probably a couple more things just on lessons, but first of all, reinvest if you can, that's really important because by reinvesting you're building on your capital and that capital will build on your reinvestment as well as your original capital. So I think that's, that's important.

Seeking quality financial advice is essential for most people.

Diversification is essential as well, just because you think you know exactly where BHP is going or CSL or Transurban. The simple fact is you don't know everything about that company and nor does the company because external factors will impact on the company that they haven't even thought about. As you know, things such as the Ukraine war can have a huge impact on the price of gas that wasn't predicted 12 months before.

David McDonald - IMAP (12:33):

True.

Steve Hiscock - S G Hiscock (12:34):

So it's important to diversify, to ensure that you don't get caught out… you will always get nasty surprises, but make sure those nasty surprises don't blow up your portfolio. \

And probably the final thing is active management. I think active management is really important where markets are super volatile. So if you are choosing an investment manager to place your investments with as opposed to doing it yourself, do consider active managers because they generally have a very good record when markets fall because what active managers generally do is avoid stocks that are excessively speculative stocks that might run in a Super Bowl market.

They tend to get blown up or get found out in a bear market. And that's generally where active management really comes into its fore. So there are a few things that sort of have struck me over the years though.

David McDonald - IMAP (13:28):

That's interesting. Your last point there, Stephen. I mean, one thing that's happened over the last 20 years, more so perhaps in the last five or six years is the growth of the index funds , market sector and market ETFs and the like. So I mean, you are still a general active investor obviously, and you believe that it does add value through the cycles.

Steve Hiscock - S G Hiscock (13:53):

Yes, definitely. Look, maybe I should start by defining active management, and passive management.

Active management is where an investor buys and sells companies or investments with the goal to outperform some sort of index. So it could be the ASX 300 index in the US S&P 500 or Dow Jones or whatever. So what an active manager or an active investor will do is they believe they can beat that index by having superior research, superior timing and so forth.

So in our investment team, we have 15 people who sit or stand at desks all day long researching companies. And their role is to find those unearthed gems, the angle that will help us beat the market. What that generally means is because you are looking at things through a lens of " would I want to own that company for a long period of time", you tend not to own the super speculative company.

Steve Hiscock - S G Hiscock (14:55):

So when the index is on fire as in going up 10% of every few months, we, we as active managers tend to underperform as a, as a group. But when, when the market falls, you tend to see that more of your capital is preserved.

The other side of it is passive management, right? … you mentioned indexing, so passive management or indexing is where a portfolio is built that tries to replicate the index. So the ASX 300 passive index fund will have 300 companies at exactly the same weights as they are in the index. And if you'll get exactly the same return less fees over a particular period. So that's good for people who don't like surprises or don't feel they've got sufficient skill to look at that. And that's absolutely legitimate.

Steve Hiscock - S G Hiscock (15:54):

And I genuinely do think there are places for both. Of course, as you mentioned, David, I'm a diehard active manager, <laugh>, I do believe there are sufficient opportunities in the markets around the world and in Australia that you can beat the index over time.

Interestingly moment though, as a group, active managers are not beating the index over the last couple of years.

And the reason for that is that first of all the turnaround in the bond market last year, the sorts of stocks that were running were clearly quite speculative and most active managers didn't own a lot of them. So that, that's one reason. And then what happened was that the bond market completely turned around and had the worst bond market move pretty much in the history of bond markets, particularly in the UK. And what you found there is most investors were not positioned for that. And so you saw different types of investments do well that most people weren't holding.

David McDonald - IMAP (16:57):

I was going to say you mentioned earlier about the direction of interest rates being important and I mean we're touching here on bond yields and so on, but can we just talk a little bit more maybe about the sort of influence of the macro? I mean, you've got your teams looking at companies and so on, but there's a lot of attention at the moment about inflation, with the RBA , US FED and everyone putting rates up.

What are your thoughts on how that's impacting the market at the moment? or how important is that as something to focus on when you're looking at your investments?

Steve Hiscock - S G Hiscock (17:32):

Yeah, It's absolutely critical to have a view on interest rates.

The core of our investing thesis is that we believe the price of money in other words, interest rates determines the price of growth assets shares, property, everything. And so generally speaking, if interest rates are very high, the price of assets is lower because the cost of owning that asset is higher and the value of future income streams is lower.

So just because interest rates are high, it doesn't mean equities will fall. Because what also is important is to understand what's factored in already by the market, what the market is expecting. So there's two elements to it where interest rates are and what the market thinks they will do in the future and where they will actually go in the future.

Steve Hiscock - S G Hiscock (18:29):

They're the three moving parts.

One's easy where interest rates are working out what markets will do… what interest rates will do is harder, much, much harder. And you've also got to work out what the market is expecting.

So, if interest rates rise higher than markets expecting, (and this happened last year where bond rates rose much, much higher than most people are expecting), that was a surprise and the market fell a lot.

Yes. it's critical to have a view on interest rates. So for me you know, macro investors, you need to look at these things and you need (I can't remember who said this), but the old saying of if the facts change, you must change your mind. And that's absolutely critical in investing.

Yes when you get new information about interest rates or the macro or inflation or oil price or whatever, and they're different to what you are expecting, you've got to change your mind or you've got to be prepared to change your mind.

Don't stick your head in the sand, because you'll end up in trouble.

David McDonald - IMAP (19:36):

I think that's a quote from Keynes actually. <Laugh>. Right. It's a very good one. I guess if we want to be really controversial, we could say that you were saying how hard it is to predict where interest rates will go. It seems the RBA themselves have had trouble in the last couple of years trying to tell us where interest rates are going to go.

Steve Hiscock - S G Hiscock (19:54):

Oh, look, yes I know it. The statement by the Governor was quite surprising in even if he genuinely believed it, but the statement that interest rates were not going to change for an extended period of time is quite inflammatory for growth assets. And it was not a good thing in hindsight.

David McDonald - IMAP (20:19):

Just change topic a little bit, Steven. I mean, we've talked about what's happened in investment world in the last 20…30 years. How about the client side? How have found things changed there?

Have your client needs different now to what they were when you started your business, for instance?

Steve Hiscock - S G Hiscock (20:37):

Oh yes I mean when I started in funds management, nobody knew what funds management was. I mean, there was National Mutual and the big life funds, but it was basically all life funds.

I mean life funds really don't exist anymore, and the level of professionalism, education and literacy of investors has changed enormously. You know, with the abundance of new asset

classes, infrastructure, and long short funds, you know macro trading funds, these things didn't exist 30 years ago.

I think the other thing is that the relentless change of tax rates, and the complexity around that has seen a huge growth in demand for financial advisors right

Steve - S G Hiscock (21:30):

It’s increasingly important for most people, and I've said this before, but most people really need to have a financial advisor if they're going to have a proper financial plan because it's just too hard otherwise.

But, you know, even 30 years ago there were no such things as ETF exchange traded funds. There were no such things as index funds. You know, there's all sorts of ways to get an investment now. So yes a lot has changed over the last 30 years.

David McDonald - IMAP (22:01):

One thing we do hear more about from the super funds and from individuals these days is the focus on ESG, is that something you have to have now or is it part of your process?

Steve Hiscock - S G Hiscock (22:15):

Yes it's been part of our process since 2010. So we are a signatory of the Principles for Responsible Investment, which was set up 10…15 years ago.

It's a group of like-minded institutional investors who apply the six broad-based ESG principles across environmental, social, and governance. And the idea is that by applying these factors on behalf of your clients and other stakeholders, you will improve the share markets and the companies around the world, and for the benefit of obviously your investors, but also other stakeholders like the people who work in these companies.

And so it's embedded in most institutional managers these days, it is embedded in their investment process. And so it's essential to have as part of your process these days.

David McDonald - IMAP (23:21):

Seen in, I noticed lately we've seen in the US where some states particularly I guess oil producing regions of almost trying to ban, you know, their pension funds and the like from taking into account environmental factors and so on. But you think that's wrong? I mean, do you think it's actually, it's part of your research, part of your investment process, it impacts companies and so so on, it's not just a woke thing as they say.

Steve Hiscock - S G Hiscock (23:49):

No, I mean, we're not woke investors. <Laugh>

look, it, it's a really, no, and, and certainly, I mean we, obviously there are, there are different views on this, but what we think is that you know, let's take property for example.

If you have two properties that are identical and they both, one has a very poor environmental footprint using old-fashioned globes and, and you know, poor quality chillers and you've got a, a brand spanking new building well completely refitted building, you will get higher rents in the second building, therefore with higher rents, you'll get a higher valuation and you'll benefit your investors.

So there is a pragmatic element to this where we think it actually helps investors in many ways.

But quite apart from that, if you have a mining company that has got a very poor record of environmental damage to the people surrounding say, some mine, that is just not right. It's not fair for them.

And so we do look at the social side quite a bit and the environmental side we just think it's the right thing to do. We're not work investors. There are a number of exclusions we have, but they're not necessarily what they are doing in the States at the moment.

David McDonald - IMAP (25:09):

Okay. And now you touched there on buildings and offices and so on, and I know properties are an area you've got a lot of experience in. Maybe that's something we can just touch on briefly at the end. There have been headlines in the financial press lately suggesting that office values are going to fall 20% because no one's going to the office anymore. What's your view on the office sector and post covid? Is it the end of the office or ???

Steve Hiscock - S G Hiscock (25:39):

Yes, I don't think so. I mean let me give you our policy, at the moment, we're three days a week in the office and, you know, you walk around the city today or yesterday or the day before it is packed. It is very high occupancy. Mondays are less so, but in our office, there's plenty of people in our office on a Monday, and Friday. Generally people are working from home. But I don't think it's the end of the office because at the end of the day, everyone is in the office on a Tuesday, Wednesday, Thursday. So there's not many ways to get around that.

And the simple fact with offices is that we've found that you are more productive. You are collegiate there, you share your ideas verbally rather than over Zoom. It's just a totally different way of doing things.

Steve Hiscock - S G Hiscock (26:29):

And there are undeniable distractions, an excellent coffee machine in our case and <laugh> in the office. But at the end of the day, I do think that it's easier to get into work mode in the office.

And going back to what you said about the fall in prices, I think you're right. There's no doubt that the price of office assets will fall. And the listed real estate sector, you know, Dexus and, and the GPT and so forth, they are already factoring that in. So if you buy the listed property trusts, you are buying them with prices that reflect the fact that they are investors expecting prices to call. That hasn't happened yet in the unlisted sector, in the syndicates or large unlisted funds. The valuations have not yet come down. So we're a little bit concerned about that side particularly when we see the REIT sector already factoring it in.

David McDonald - IMAP (27:29):

Yes Look, I can share your, your views about the collaboration and so on. And I know in my previous full-time role, like most fund managers and the like, you'd have a morning meeting, you can do that on Zoom. Sure. But it's the people that come up to you afterwards in the kitchen or the coffee machine and say, well, you said this, but you really think X or, you know, my client's asking about such and such, and you can't get that over Teams or Zoom really, can you?

Steve Hiscock - S G Hiscock (27:57):

No, I mean, look we use a system which actually isn't too bad. It's sort of it basically keeps you live on the system, so you've got your team around you on the screen if you want. Okay. So you can literally just live chat to them, but it's still not as good as sitting next to them or opposite them.

David McDonald - IMAP (28:19):

Well look, Steve, thank you so much. It's been great chatting to you.

And so it does just remain for me to thank Steve Hiscock for sharing lessons learned from his extensive experience in the investment industry with us. Thank you very much, Steve.

Steve Hiscock - S G Hiscock (28:34):

Thanks David. Have a good day

David McDonald - IMAP (28:36):

And a reminder of some upcoming IMAP events in May, we are going to be running a webinar series that'll look at what's been going on in financial markets so far this year, and particularly the outlook for the rest of the year.

So keep an eye on the IMAP website for details of that.

And also the IMAP Awards are about to open again. There is information on the website about that now, but do keep an eye out for the opening dates there and, and be sure to, to go in for those.

The difference this year, we are bringing back the ESG award we introduced last year, but we also bring in a new category for boutique licensees, which gives an opportunity perhaps to smaller outfits to take part in the awards process.

So do go to the IMAP website and find information on both of those. And thank you for joining us today.