From 1 September 2025, we will be known as amova Asset Management

Investing in Future Quality: unearthing diverse alpha sources

The Nikko Asset Management Global Equity team's investment philosophy is based on the belief that "Future Quality" companies will outperform over the longer term. When macroeconomic drivers are uncertain, diverse and unique alpha sources are even more essential.

By The Nikko AM Global Equity Team
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Our Global Equity team's approach is to identify "Future Quality" investments—companies that will attain and can sustain high returns on invested capital over the long term. This approach is supported by academic evidence that businesses with high and improving returns on invested capital provide superior compound performance over the long term. With higher interest rates restraining borrowing and consumption, and many mature economies entering a period of slower growth, this approach is especially relevant now. In this environment, companies capable of growing regardless of economic cycles become increasingly rare and valuable. These are precisely the "Future Quality" companies that we look for.

Identifying unique opportunities

The best investments start with companies we believe are truly unique, businesses that can thrive regardless of broader market concerns, whether it's geopolitics, interest rates, or currency fluctuations. These companies are rare, but when we find them, they tend to have independent catalysts that set them apart. Some catalysts stem from internal improvements, businesses refining their strategies, making acquisitions, or restructuring to drive higher returns. Others come from companies gaining market share in industries where overall growth may be modest, but their competitive position allows them to outperform.

A good example is **Netflix**. In 2022, its decision to launch a lower cost ad-supported tier and later to enforce paid subscriptions for previously unpaid users was a game changer. The move significantly boosted profitability, reinforcing its position as one of the few streaming platforms with a sustainable, profitable model. As competitors struggle with content quality, advertising overload, and declining market share, Netflix has strengthened its lead.

Other companies in the portfolio have similarly distinct drivers. **Oracle**, **Siemens Healthineers**, **Trip.com**, and **First Citizens** are among those with standout characteristics that make them compelling recent Future Quality investments. Finding them isn't easy, but when we do, they tend to be the ones that make a real difference to long-term returns.

Exploring future themes

While stock picking remains at the core of our approach, we often highlight broader themes that extend across multiple companies in the portfolio. These themes reflect long-term structural tailwinds, what we see as powerful forces shaping industries over time, which create sustained opportunities for growth. Identifying such trends helps us position the portfolio to benefit from fundamental shifts in the economy, technology, and consumer behaviour while staying true to our philosophy of investing in Future Quality businesses.

The long-term growth potential of global travel

Global travel remains a key investment theme, underpinned by long-term structural trends. One of the driving forces behind this is shifting spending priorities, particularly among younger generations who, unable to afford homeownership in many markets, prioritise experiences over material possessions. Travel is often the last thing they cut back on. More significantly, however, the real long-term driver of travel growth lies in emerging economies. Rising GDP per capita has historically been closely linked to increased outbound travel. We've seen this pattern play out before, Japanese tourists were once the dominant force, then came European and UK travellers, followed more recently by Americans. The trend is always the same: as people become wealthier and gain access to air travel, passports, and visas, they travel more.

China remains a prime example. While its outbound travel has been constrained in recent years, partly due to post-COVID factors and partly due to domestic economic policies, it is likely to resume its upward trajectory. Then there's India. With a population of 1.4 billion and per capita incomes still significantly lower than China's, it represents the next wave of global travellers. Even a relatively small proportion of the population reaching higher income levels will translate into a huge increase in international travel demand.

For us, the key is finding companies with strong business models that enable and benefit from this growth. **Booking.com** is a clear example as it continues to gain market share and deliver strong results. As mentioned, we own **Trip.com** in China, and also **Samsonite** and **Amadeus**, each with its own distinct strengths that meet our Future Quality threshold and, we believe, are well positioned to benefit from the long-term expansion of global travel. These are the kinds of businesses that fit our investment philosophy: companies with enduring tailwinds, strong competitive positions, and the ability, in our view, to sustain high returns well into the future.

AI and the race for infrastructure

Another significant theme is the race to build the infrastructure needed to support the surge in artificial intelligence (AI) investment. The immediate focus has been on ordering vast numbers of semiconductor chips from dominant suppliers like **Nvidia** and **Broadcom**, companies at the heart of AI-driven profitability. Beyond this, however, we're seeing the first and second-order effects of AI's rapid expansion. The sheer scale of AI compute is far beyond a few back-office servers; it requires vast data centres with immense processing power. Existing facilities are struggling to keep up due to power constraints and technical limitations, creating an urgent need for new data centres with significantly higher capacity.

This shift is benefiting a range of companies, particularly those tied to power infrastructure. In our portfolio, businesses like **Hitachi** and **Schneider Electric** are direct beneficiaries. Both are well-positioned in the broader electrification trend, which was already underway but is now being accelerated by AI's soaring energy demands. The world has underinvested in electricity generation and distribution for years, relying on spare capacity and low growth. That buffer has now been exhausted, creating an immediate need for expanded infrastructure, more transformers, more power distribution networks, and a new generation of data centres.

Scaling-up power infrastructure and building out new data centres is a multi-year process. For us, these kinds of companies fit perfectly within our investment philosophy, businesses with enduring tailwinds, strong fundamentals, and the ability to sustain growth and high returns over five years or longer.

The ongoing demand for healthcare

Healthcare has been a key overweight in our portfolio, driven by the belief that long-term spending in this sector will continue to rise. As societies age and become wealthier, particularly in markets like China, demand for healthcare is only increasing. The challenge, however, is affordability. Whether it's the NHS in the UK or the US system, the same pressures exist: people need healthcare, they expect access to it, and governments must find ways to deliver it

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efficiently. This is why we invest in companies that not only provide healthcare directly but also enable innovation to improve efficiency and quality. Businesses that help make healthcare more cost-effective, whether through better products, services, or technological advancements, are positioned for long-term growth.

The healthcare sector has faced some post-COVID headwinds, however. Many companies over-ordered equipment and supplies, fearing a prolonged crisis that didn't materialise. The result has been an extended inventory correction, which has made some typically steady-growth businesses feel more cyclical. Companies like **Danaher** and **Bio-Techne**, which supply critical tools for healthcare spending, have had a tougher time while waiting for demand to normalise.

That said, the fundamental need for healthcare investment hasn't changed. While political and economic uncertainty, particularly in the US, may prolong the recovery, the demand to replace equipment, replenish supplies, and improve healthcare systems is inevitable. This structural tailwind, combined with the gradual unwinding of post-COVID inventory issues, underpins our continued investment in this space. We remain positioned in a range of Future Quality healthcare companies that are well-placed to benefit from both the ongoing need for healthcare spending and the eventual recovery from recent industry disruptions.

Finding growth in a low-growth world: identifying market share gainers

In a low-growth world, particularly when macro drivers are so uncertain, finding diverse and unique alpha sources is key. Specifically, market share gainers, whose superior business models and innovation result in growth dominated by market share gains, can benefit from sustained growth tailwinds. Companies like **Meta** have successfully integrated AI into their business, refining algorithms to improve engagement and monetisation and drive improved market share. The rise of short-form video content has only strengthened this dynamic, making platforms like Instagram Reels even more addictive. As user engagement grows, advertising dollars follow, reinforcing the business model. Despite heavy AI-related capital expenditure, Meta continues to deliver high returns on capital and strong growth, exactly the kind of structural winner we look for.

Another example, though less obvious, is US general insurance. It's not an industry that typically excites investors, but that's precisely why it presents opportunities. The sector is dominated by slow-moving incumbents, creating space for more dynamic, tech-driven players to take market share. Companies that invest in better underwriting models, using data and AI to assess risk more accurately, can price more competitively, grow market share, and reinvest in further innovation. **Progressive** is a prime example. We've held it in the portfolio for a decade as it has consistently gained market share in motor and property insurance, delivering strong returns on equity*. Other mid-cap names, such as **Palomar** (specialising in earthquake insurance) and **Ryan Specialty** (focused on insurance broking), are also benefiting from industry inefficiencies, using their expertise to grow profitably.

Despite the common belief that active managers struggle to add alpha, the Future Quality strategy has proven a rare exception. At a time when economic cycles are weak and broad-based growth is hard to come by, individual company fundamentals matter more than ever. Ultimately, this has guided our investment strategy for the past decade, consistently generating strong returns for clients, with outperformance driven by stock selection rather than reliance on a single market trend or sector, proving that disciplined, high-conviction investing can deliver meaningful results.

If you have any questions on this report, please contact:

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**Bloomberg, The Progressive Corporation Annual Report 2014, 2024*

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