

Seeking Growth in Investments

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Chief Investment Office (CIO)

Moneta Bank

"Quality Growth Investing"

Introduction from our CIO about Growth investing:

Identifying high-quality stocks is essential for long-term wealth creation. A 2023 study by Bessembinder revealed that just 2% of US firms accounted for over 90% of wealth creation between 1926 and 2022. Historically, quality stocks (MSCI ACWI Quality) have outperformed global benchmarks (MSCI ACWI) by an annualized 9% during recessions since 1992, offering a potential shield for portfolio returns. A diversified mix of quality stocks across regions and sectors can help reduce volatility and enhance portfolio diversification.

Current investment trends emphasize technology leaders with strong balance sheets and dominant positions in the AI value chain, selective exposure to consumer brands with durable pricing power, and specific healthcare companies focused on weight loss and diabetes treatments. We also recommend high-quality energy transition companies involved in manufacturing, energy production, and infrastructure, as well as firms in transportation and electricity. Select quality stocks in Japan are also appealing.

Characteristics of Quality Stocks

Quality stocks are known for their strong fundamentals, including profitability, pricing power, and earnings consistency. These companies typically exhibit stable earnings growth, healthy free cash flow, and strong balance sheets. They are often industry leaders with established brand names and a history of superior returns on invested capital.

Identifying Quality Stocks

Does the company have a unique competitive edge? Quality companies usually possess a unique advantage—such as innovative products or strong brand loyalty—that insulates them from business cycle fluctuations.

Does the company grow earnings consistently? Quality firms' earnings tend to be less affected by market cycles, allowing them to achieve growth in various market environments.

Does the company generate free cash flow? Quality companies often generate free cash flow that can be reinvested, distributed as dividends, or used for stock buybacks to enhance stakeholder returns.

Does the company benefit from its investments? Quality businesses invest capital in ways that consistently generate high returns—measured as returns on invested capital (ROIC).

Does the company trade at a reasonable price? Quality companies often command higher valuations compared to peers, but typically within a fair range relative to their long-term growth prospects. These companies may fit within a "growth-at-a-reasonable-price" (GARP) strategy.

Historical Performance

Quality stocks have historically outperformed global indices by 9% annually during recessions, as evidenced by the performance of MSCI ACWI Quality compared to MSCI All Country World indices.

Sector Weightings according to our in-house research:

As of the end of August 2024, the MSCI ACWI Quality index's largest sector allocations include information technology (35%), healthcare (16%), communication services (11%), and

industrials (11%). As a result, implementing quality-focused strategies often involves a strong emphasis on these sectors.

Potential in Technology

Within the quality investment theme, we see strong potential in technology companies with solid balance sheets and the capacity to consolidate their leading positions within the AI value chain. Investors seeking to diversify their technology exposure should consider selective investments in consumer brands with durable pricing power and growing market share, as well as healthcare companies capitalizing on structural trends in weight loss and diabetes treatment.

Energy Transition

The global shift toward renewable energy, supported by advances in low-carbon technologies, is expected to remain a key long-term theme, regardless of cyclical growth trends. Companies aligned with global decarbonization efforts and technological innovations are likely to be less sensitive to broader economic cycles, potentially providing a hedge against market volatility. Rising energy demand, driven by AI and data center development, may boost profitability for energy and electricity suppliers that can quickly meet this growing need.

We favor quality growth stocks in this sector, including firms focused on manufacturing, energy production, energy infrastructure, and traditional energy companies. Other attractive investments include companies involved in transportation, electricity infrastructure, and energy storage.

Though election-related risks have negatively impacted investor perceptions of some renewable energy developers and suppliers in the US, we believe the risks—regardless of the election outcome—are less significant than what the market has priced in, creating potential for better performance in 2025.

Quality Stocks in Japan

While the US market boasts a higher-than-average share of quality stocks, we also see opportunities in quality stocks in Japan for investors seeking diversification in other developed markets. Japanese equity valuations currently appear attractive for long-term investors, with the TOPIX index trading at a price-to-earnings ratio of 13.5x—below the 13.7x average since 2010 and at a roughly 20% discount compared to developed market stocks. Beyond technology, we particularly favor Japanese banks.