

GLOBAL LONG-TERM UNCONSTRAINED

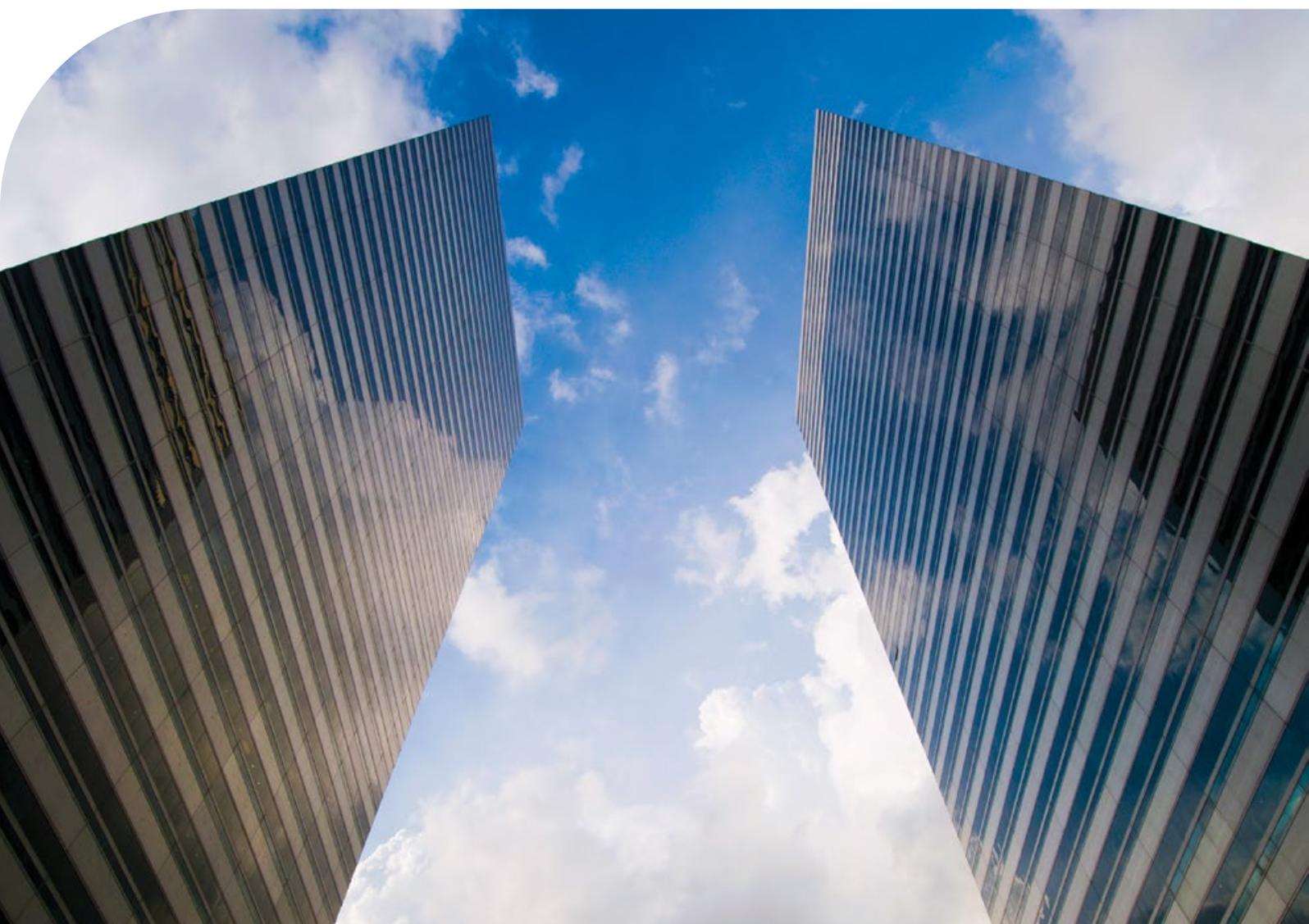


JULY 2024

For professional and wholesale investors only

THE FORMIDABLE TWO

A selective exposure towards the Magnificent Seven



We explore the Magnificent Seven stocks, and highlight why not all of them qualify as magnificent, when capturing their growth and/or returns profile, in conjunction with the valuation at which they are currently trading as at 18 May 2024.

We find that on a multi-dimensional assessment, based on a combination of growth profile, return on invested capital (ROIC) profile and price-to-earnings (P/E) ratio, some stocks within the Magnificent Seven do look attractive, whilst others do not have as appealing a profile for investors, and therefore are not all that magnificent.



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Not a homogeneous group: The Magnificent Seven have a different range of returns and growth profiles



Wide range of growth profiles: Ranging from +4% to +41% on a three year compound annual growth rate (CAGR) earnings growth basis¹



Broad range of ROIC profiles: From c.13% to c.58% based on consensus estimates for 2024¹



Wide range of P/E ratios: Trading on 21x to 56x currently, based on 12 months forward P/E ratio on consensus estimates¹



Valuation attraction: The stocks need to be assessed by capturing the different fundamentals and returns/growth profiles that each emanates



Three broad dimensions: We capture earnings growth, ROIC and PE ratios, to differentiate the stocks that look attractive, and those that look more appealing under these measures



Different industry dynamics and risks: Each stock will experience different ranges of risks related to competition, new entrants, customer power, pricing power, innovation, regulatory and disruption



Formidable two: Nvidia and Microsoft remain in our view the most attractive companies in the Magnificent Seven.

Some stocks within the Magnificent Seven do look attractive, whilst others do not have as appealing a profile for investors, and therefore are not all that magnificent.

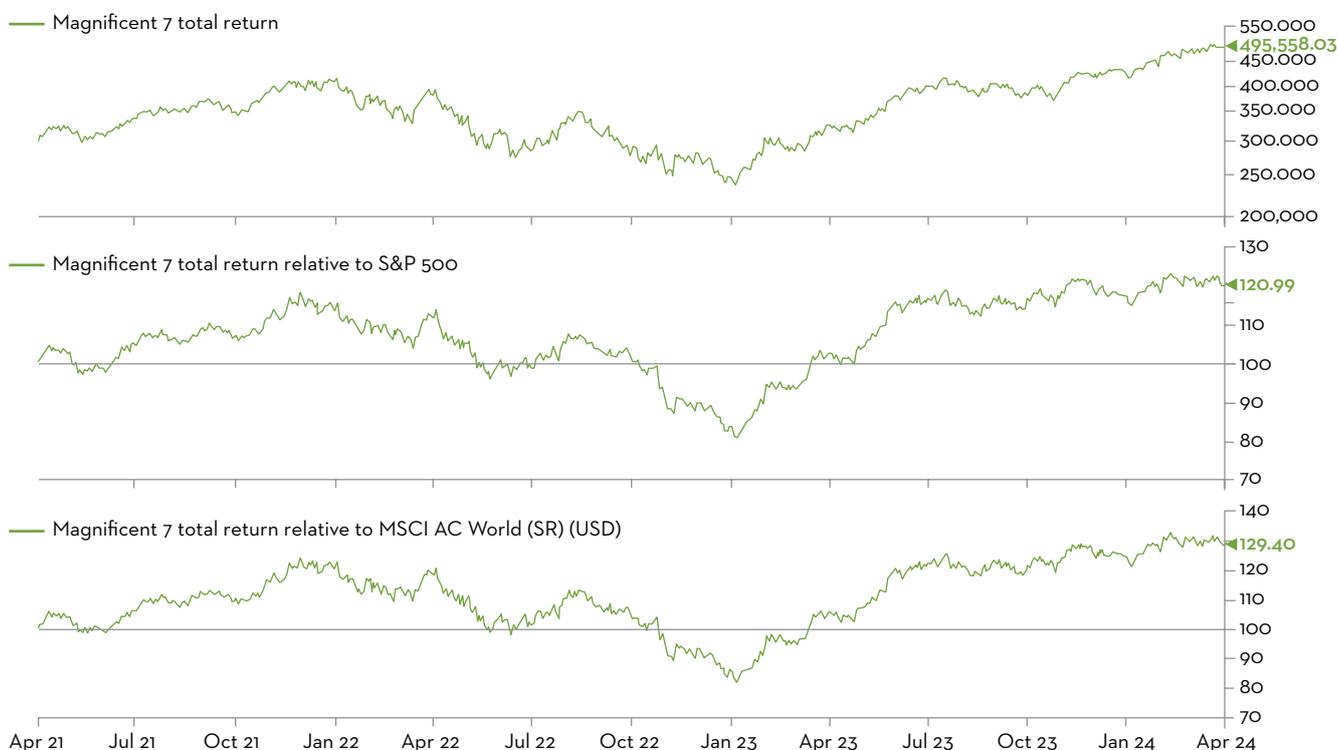
¹Source: FacstSet as at 18 May 2024.

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Strong outperformance

The Magnificent Seven stocks strongly outperformed, both the Standard and Poor's 500 (S&P 500) and the MSCI AC World in 2023. This has perhaps helped them earn the accolade of being magnificent stocks.

Magnificent 7 outperformance from 31 April 2021 to 31 April 2024



Source: FacstSet as at 18 May 2024.

However, the performance of stocks within the Magnificent Seven has been very disparate, and has so far in 2024 shown some divergence in share prices, as can be seen in the table below. The market seems to be starting to make a distinction between the different valuation and fundamentals of each stock.

	Total Return Relative to MSCI AC World (SR) (USD) from 30 April 2021 to 30 April 2024	Price Relative to MSCI AC World (SR) (USD) from 30 April 2021 to 30 April 2024
Apple	110.03	115.31
Meta	128.85	137.24
Nvidia	512.86	545.75
Tesla	62.15	66.26
Microsoft	140.70	146.14
Alphabet	114.24	121.80
Amazon	89.58	95.51

Source: FacstSet as at 18 May 2024.

The Sharpe Ratio (SR) is a measure used to evaluate the risk-adjusted performance of an investment.

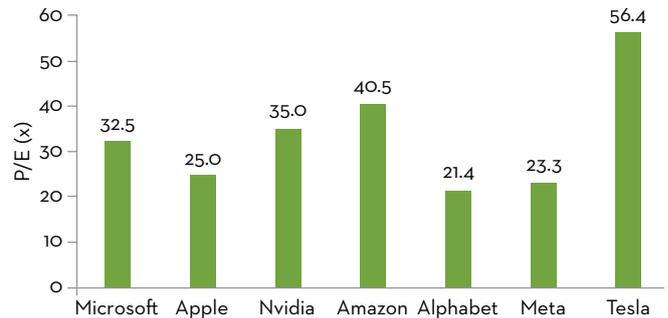
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Below, we explore various dimensions of differentiation amongst the Magnificent Seven, which could explain the reason for some of the divergence of fortunes amongst them.

Valuation is within a broad range

Valuation appears to be in a broad range, pointing to varying levels of attraction. Taking the 12 month forward P/E, for simplicity, stocks in this group range from 21.4x to 56.4x P/E.

P/E 12 month forward

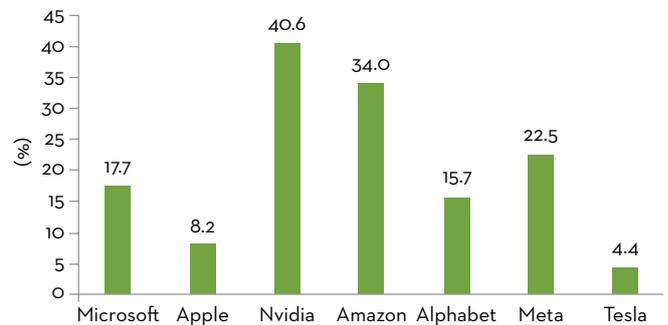


Source: FacstSet as at 18 May 2024.

Valuation alone is not enough - bring in the growth profile

Some of the valuation dispersion can be explained by the differing growth profiles. Bringing in the three years earnings growth CAGR into the equation, there remains a wide range of earnings growth profiles, ranging from c.+4% to c.+41%.

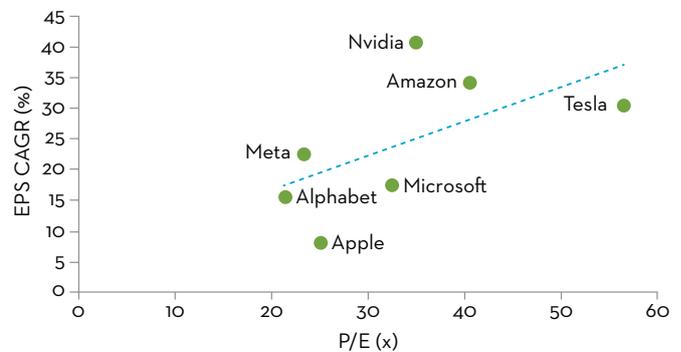
EPS 3 years CAGR



Source: FacstSet as at 18 May 2024.

Looking at P/E 12 month forward as the sole valuation approach for simplicity, and bringing in the three years CAGR earnings growth profile of each company, Nvidia appears as very cheap currently (PEG ratio of 0.9x). This is then followed by Meta (1.0x), Amazon (1.2x), and Alphabet (1.4x), whilst Tesla (12.8x) and Apple (3.0x) appear very expensive, both vs the Magnificent Seven peers, and the market (MSCI North America Index used in this instance). Additionally, their PEG ratios currently stand at 2.2x on consensus estimates, and at 3.5x using our top down earnings estimate of c.+6% (compared to consensus three years CAGR of +9%). PEG ratios tend to give a more reliable measure of attractiveness of a stock, as it captures its growth profile on a forward-looking basis, which is important, especially in the case of companies that are facing an accelerating or a sharply different growth profile from what they have been experiencing historically. There is evidence through various studies that companies with a lower PEG ratio tend to outperform those with a high PEG ratio.

P/E 12 months forward versus EPS 3 years CAGR



Source: FacstSet as at 18 May 2024.

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Valuation and earnings growth alone are not enough – bringing in returns profiles

PEG ratios are a better measure of relative valuation support, and are a useful way of showing comparison across a group of stocks. However, the measure misses the all-important dimension of the return profile for each company, which also vary significantly.

We focus on ROIC, as a reliable measure of returns profiles. We include Goodwill in our ROIC calculations, to capture the entire invested capital base, including acquisitions and goodwill paid. In the same way as with the P/E ratios and earnings growth profile, there is a wide range of ROIC profiles across the Magnificent Seven, ranging from c.13% ROIC for Tesla, to 58% ROIC for Nvidia, based on this year's consensus ROIC estimate. It is worth noting that our own ROIC estimates do differ given that our internal forecasts can differ significantly from consensus, and are significantly higher for Nvidia (c.166%) and Microsoft (c.32%)².

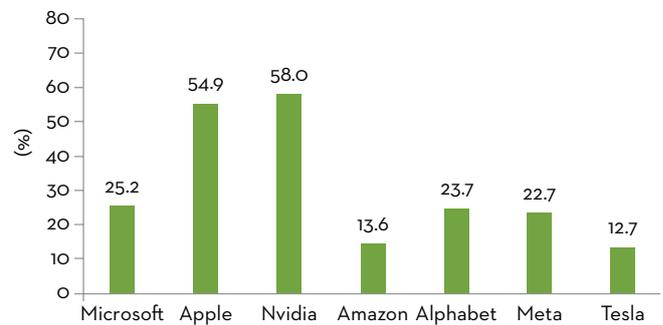
A combination of ROIC profile and P/E ratio (i.e. a PERoIC ratio) therefore highlights that Nvidia and Apple have a supportive P/E ratio, given the outsized ROIC profile that both companies emanate. Tesla and Amazon appear expensive on that basis, whilst Alphabet, Meta and Microsoft are middle-of-the-pack. Clearly, in the case of Apple appearing cheap on a PERoIC ratio, given the very high ROIC profile of Apple (c.59%), the ratio is not capturing the fact that Apple is challenged for growth, and has the lowest earnings growth profile of the Magnificent Seven. As detailed above, at +8% three years CAGR, vs an average of +18% for the Magnificent Seven group, based on an unweighted basis.

²Source Martin Currie as at 18 May 2024. Martin Currie's proprietary ROIC calculation are based on the firm's published financial information.

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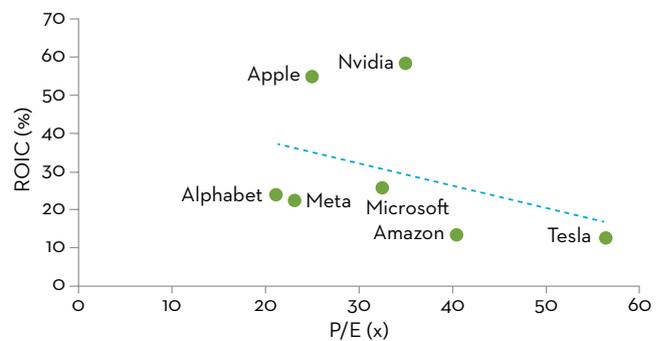
“ Nvidia appears as standout in terms of how low its PEGRoIC ratio is, and therefore how supportive its P/E ratio is given its growth and ROIC profiles. ”

ROIC FY1



Source: FacstSet as at 18 May 2024.

P/E 12 months forward versus ROIC FY1

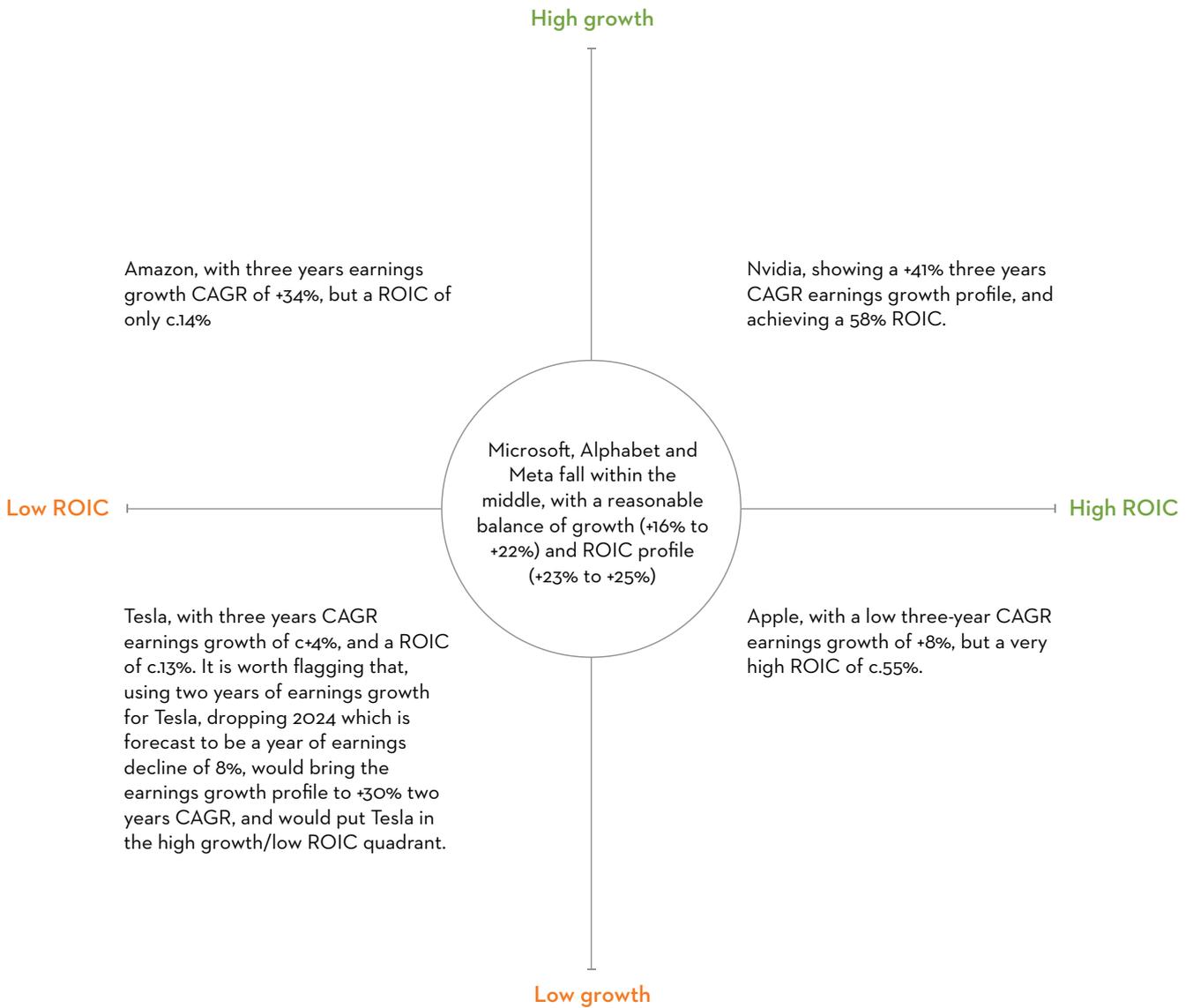


Source: FacstSet as at 18 May 2024.



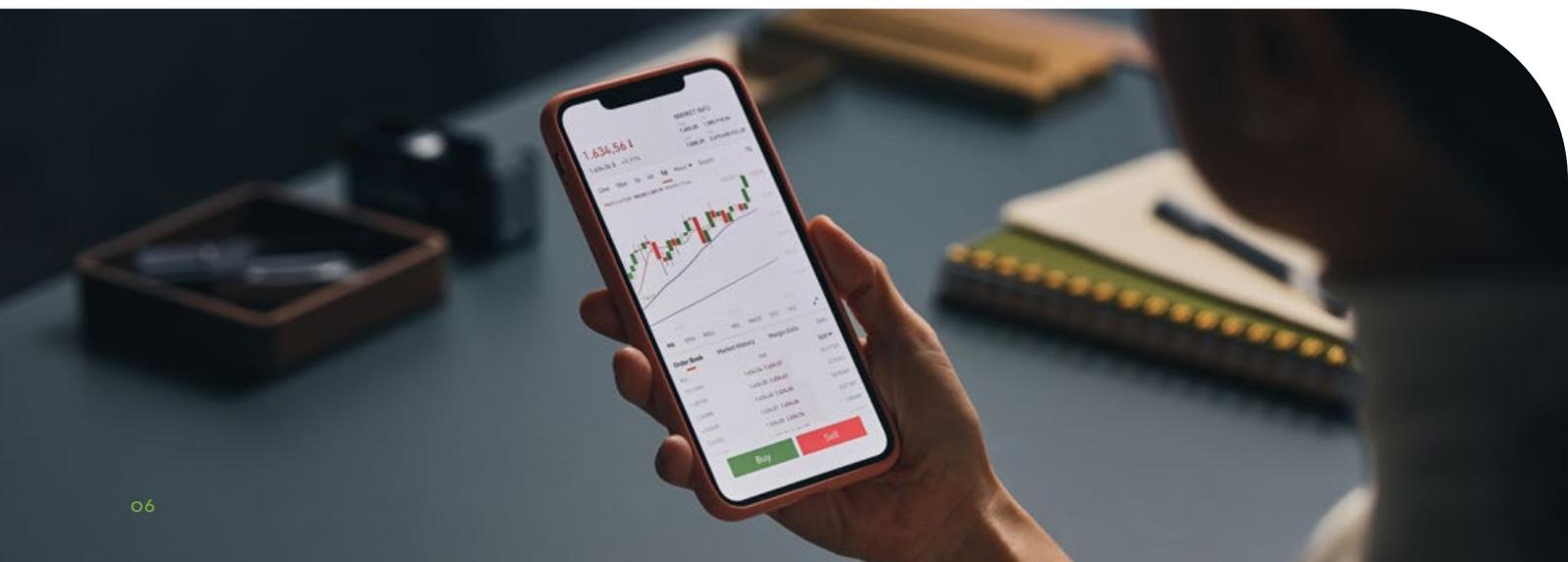
Quality growth dimension

When assessing the attraction of stocks, we use a range of valuation tools, but we also look at the growth and returns profiles that each company emanates. This is part of our company classification.



Source: FactSet as at 18 May 2024.

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Building an accurate picture

We are mindful that not only do the companies in that group trade on a wide range of P/E ratios, but they also emanate very different ranges of earnings growth and ROIC profiles. We believe that capturing all three dimensions of (i) P/E ratios, (ii) earnings growth three years CAGR and (iii) ROIC profiles is needed when assessing the relative attraction of each stock.

PEG ratio alone uses the two dimensions of P/E and earnings growth ratios. However, it does highlight that the market is inefficient and does not reward some companies for their outsized growth profile, such as Nvidia in particular, and seems to be generous with Apple's valuation, given its pedestrian growth profile.

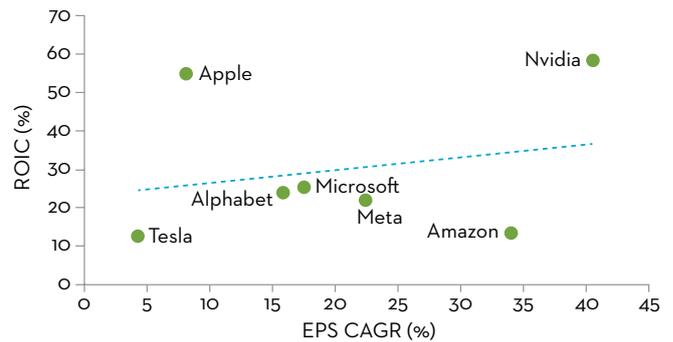
What we have labeled PERoIC ratio only uses the two dimensions of P/E and ROIC profile. It does, however, again highlight that the market is not efficient at rewarding companies with high ROIC profiles, such as Nvidia again.

Bringing the three dimensions, under a ratio of PEG ratio to ROIC profile, or PEGRoIC ratio, if we can be permitted that acronym, is perhaps a better way of capturing the P/E, earnings growth and ROIC profiles of each company. On that basis, Nvidia appears as standout in terms of how low its PEGRoIC ratio is, and therefore how supportive its P/E ratio is given its growth and ROIC profiles. On that measure, Tesla and Amazon appear expensive, whilst the other five companies in the Magnificent Seven are within a narrow cluster of 0.5x to 0.7x.

When taking into account the three dimensions of P/E, growth and ROIC profiles, one could conclude that the only Magnificent company is Nvidia. Additionally, we believe that Microsoft follows Nvidia in second place when looking at the same metrics, and therefore both companies, in our opinion, present themselves as the formidable two.

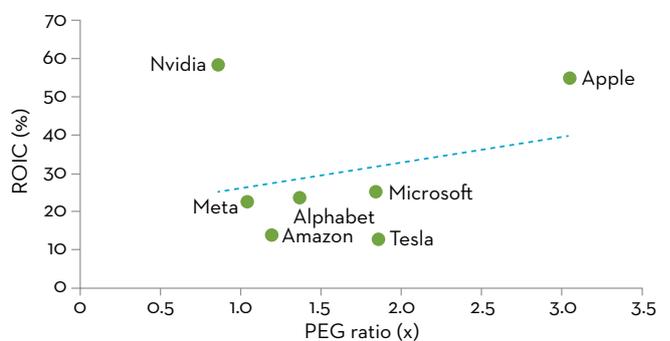
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EPS 3 years CAGR versus ROIC FY1



Source: FactSet as at 18 May 2024.

PEG ratio (PE/EPS 3 years CAGR) versus ROIC FY1



Source: FactSet as at 18 May 2024.



Other dimensions that differentiate the Magnificent Seven

There are of course other dimensions that are worth considering when assessing differences between the stocks, apart from varying fortunes on earnings growth and ROIC profiles, and various ranges of P/E ratios.

Whilst earnings growth and ROIC profiles capture prospects for each company, they do not necessarily capture some of the dimensions that we assess, when analysing stocks, linked to industry dynamics, and to some company specific risks in particular regulatory risks.

Below, we look at each stock in terms of industry risks, and zoom in on some of the company risks that are in focus from the market, notably the regulatory, innovation and disruption risks. Again, there is a broad range of outcomes across the different fundamental risk assessments we show, and therefore a potential different range of risk profiles that each company is bringing to investors, which needs to be taken into account in our view.

Industry risk assessments

The industry risks are the additional measures to assess when looking at how magnificent the Magnificent Seven truly are. Below, we compare each company across our industry risks framework, and highlight a few particularly important risks to consider.

Industry risks

	Microsoft	Apple	Nvidia	Amazon	Alphabet	Meta	Tesla
Competition	2	2	2	2	3	4	5
New entrant risk	2	2	3	2	2	3	4
Customer power	2	2	1	1	3	4	5
Supplier power	2	2	2	1	1	1	3
Disruption risk	1	2	3	2	3	4	4
Pricing power	3	3	1	3	2	3	4
Supply chain dependency	1	2	2	3	1	1	4

1 = Low Risk to 5 = High Risk

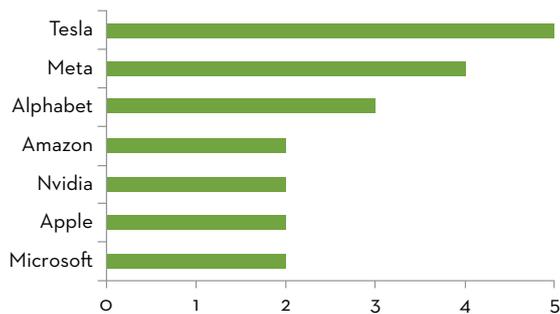
Source: Martin Currie as at 18 May 2024. Risk assessments are based on the Global Long-Term Unconstrained teams proprietary fundamental research.

Of particular focus is the competition risk and new entrant risk, as well as the disruption risk. The degree of competition risk that companies in the Magnificent Seven face differs widely, with companies like Tesla operating in the highly competitive autos industry, whilst companies like Alphabet being at the other end of the spectrum. Apple, in the consumer electronics space, has a constant high degree of competition risk, notably from the likes of leading Korean competitors. Apple and Alphabet also have some renewed and growing risks of competitive intensity from the rapid AI developments that we are seeing, which are related to the new entrant risk threat. We argue that Nvidia, being in a position of quasi-monopoly at the moment, is not facing much competition, but this is related to its technological leadership, and therefore its innovation potential.

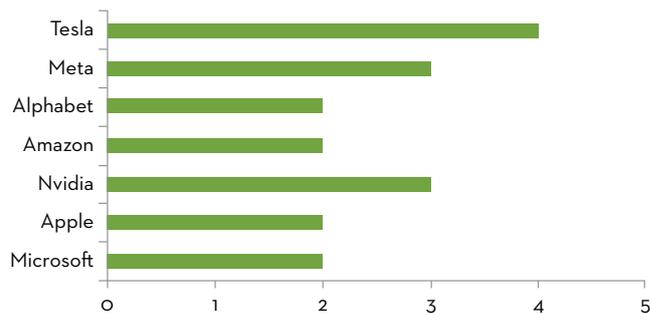
Whilst earnings growth and ROIC profiles capture prospects for each company, they do not necessarily capture some of the dimensions that we assess.

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Competition risk



New entrant risk



Source: Martin Currie as at 18 May 2024. Risk assessments are based on the Global Long-Term Unconstrained teams proprietary fundamental research.

New entrant risk is omnipresent in the autos industry, and therefore Tesla is having to face a significant degree of risk on that front as well. Meta has also been facing a significant degree of new entrant risk from the new social platforms that have been emerging rapidly both domestically and from China. Alphabet is now facing a rapidly growing risk from new entrants, as a result of the emergence of AI platforms challenging the Google search engine.

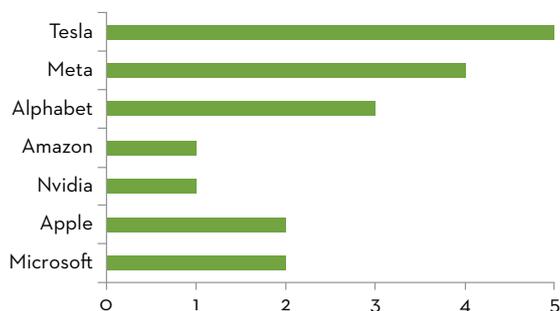
This is something that would have been difficult to consider only 18 months ago, yet one needs to now take into account that Google’s quasi-monopolistic position as a search engine could be challenged by AI, if Alphabet, its parent company, does not manage to remain competitive in the large-language-models (LLMs) field. If Alphabet’s dominant position as a search engine ends up being challenged by LLMs, we could be witnessing the textbook case of the innovator’s dilemma, as studied by the late Professor Clayton Christensen in the book bearing that very title (*The Innovator’s Dilemma*, by Clayton Christensen). Specifically, this is the risk of an established company failing to innovate to remain competitive, and missing new technological developments that end up challenging its established position.

Customer power is also worth zooming in on. Nvidia stands strong on that front, as a quasi-monopoly in the global processing unit (GPU) segment at the moment. One can argue that customer power risk is therefore low for Nvidia, as customers (hyperscalers and corporates notably), have limited alternative options. This therefore feeds into a stronger pricing power for Nvidia compared to other stocks in the Magnificent Seven group. The same holds at the moment for Alphabet, although this area of risk could potentially increase with the emergence of AI, as we explained above.

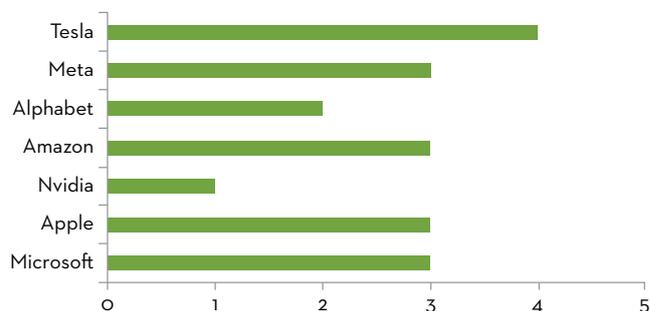
At the other end of the scale, customer power risk is high for Tesla given the competitive nature of the autos industry, and for companies like Meta and Apple. Apple has however demonstrated an ability to maintain strong pricing power, given the high degree of desirability of its products and services.

Microsoft, given its strong positioning in the corporate software space does not have as high a customer power risk. Similarly, Amazon, given its strong position in the e-commerce space, does have strong customer power, and therefore a low risk attached to that field.

Customer power



Pricing power



Source: Martin Currie as at 18 May 2024. Risk assessments are based on the Global Long-Term Unconstrained teams proprietary fundamental research.

Pricing power stems from a combination of competition risk, new entrant risk, and customer power, as we wrote in a report assessing pricing power through our strategies, back in 2023.

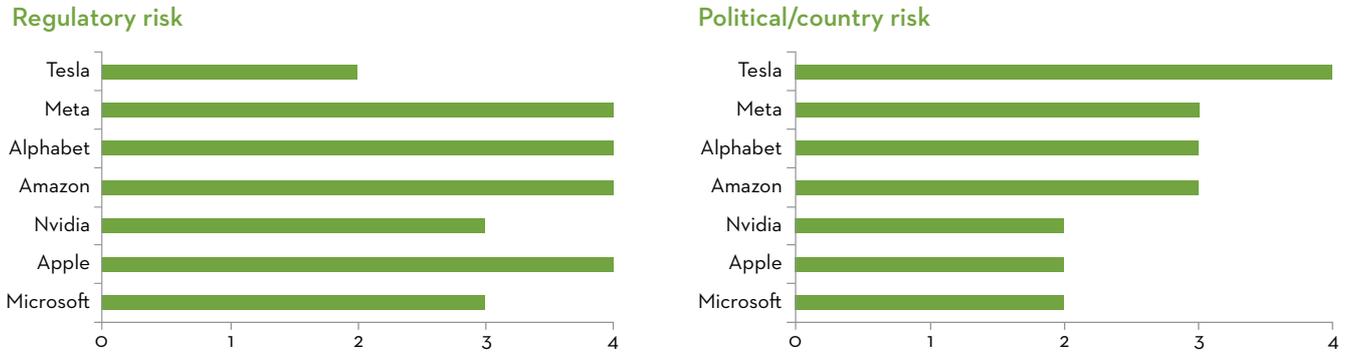
For the pricing power risk, the table above shows that we rate the pricing power risk as low for Nvidia, and is the stand-out in terms of having pricing power within the Magnificent Seven, whilst we estimate that Tesla has the highest pricing power risk.

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Company Risk assessments

Company risks, in contrast to the industry risk assessment, focuses on the risks specific to the company itself rather than the wider industry it operates in. Of particular focus when assessing the Magnificent Seven are risks related to regulation. These notably comprise the risks related to increased regulatory scrutiny of the dominant market positions that some of these companies have established, as well as the risk of anti-competitive behaviour that could relate to that dominant market position.

Companies in the Magnificent Seven face varying degrees of regulatory risks, as can be seen in the chart below.



Source: Martin Currie as at 18 May 2024. Risk assessments are based on the Global Long-Term Unconstrained teams proprietary fundamental research.

We see Tesla as facing the lowest degree of regulatory risk, given the higher competitive intensity of the autos market, as explained in the previous section. We rate Nvidia and Microsoft at three for that field (i.e. neutral risk), whilst Apple, Amazon, Alphabet and Meta are rated four, which highlights the higher regulatory risk that these companies face.

In the case of Apple, the higher regulatory scrutiny relates to its abuse of dominant market position related to the way it controls the apps on its platform, and levies fees. In the case of Amazon, the increased regulatory risk relates to its dominant market platform, and therefore its position on its own marketplace, and its ability to favour products over others. For Alphabet, the quasi-monopolistic position of its Google search engine could put the company at increased regulatory scrutiny in terms of how its search engine is structured, and how it favours companies with dominant financial firepower to bring them at the top of the search listings.

Meta's regulatory risk stems from its dominant position as a social platform, and its perceived lack of investment in protecting its users' database and therefore safety, notably in the case of platforms used by younger cohorts.

These regulatory risks, and increased scrutiny, are difficult to quantify in terms of potential shareholder value impact, but they certainly bring an element of uncertainty when assessing the investment cases of these companies.

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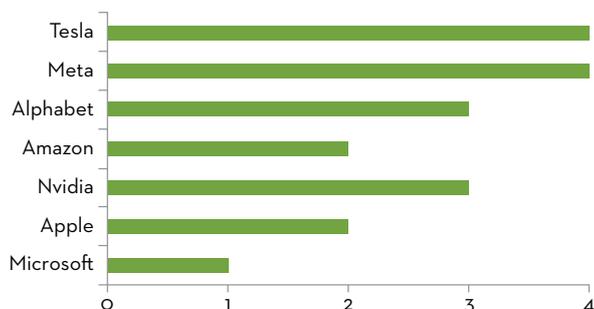


Disruption and innovation risk assessments

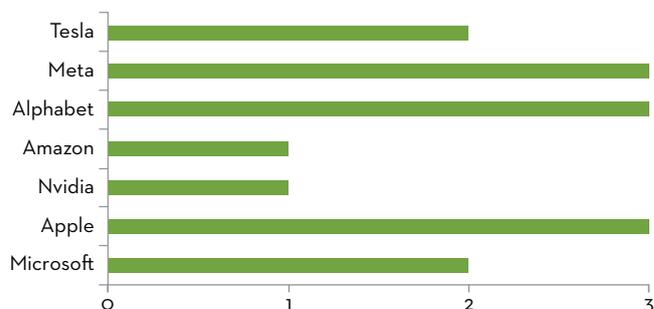
We assess the disruption and innovation risks for companies across various angles:

Firstly, the disruption risk related to the industry or industries in which each company operates. Secondly, we assess each company in terms of their ability to remain innovative, which permits it to have a higher potential to fend off disruption risk. Thirdly, we assess a company in terms of its ability to be a disruptor (i.e. its ability to disrupt established companies, or to disrupt its own market, and therefore remain innovative), or its ability to be a defender of its own established market position (i.e. its ability to fend off competition from new entrants and/or more innovative companies).

Disruption risk



Innovation risk



Source: Martin Currie as at 18 May 2024. Risk assessments are based on the Global Long-Term Unconstrained teams proprietary fundamental research.

Although not illustrated by the charts above, we rate disruptor/defender risk as low for the Magnificent Seven. This is due to the strong ability for the companies to defend their market positioning and/or to act as disruptors, given the financial firepower of many of these large companies. In the case of Nvidia and Amazon we rate as one. For Microsoft, Apple, Alphabet and Tesla, we rate as two and the lowest rated company on this field is Meta, which we rate at three.

Magnificent Seven need to be assessed on a case-by-case basis

All in all, whilst the Magnificent Seven might have tended to be seen as a homogenous group, we believe it is important to assess each company in that basket on an individual basis, given the varying industry dynamics that they all face, as well as the varying degree of disruption and innovation risks that they are exposed to. Each company also emanates different ranges of abilities to fend off disruptions that they are facing. Additionally, each company has varying degrees of regulatory risks, which also need to be assessed on a case-by-case basis. Finally, each of these companies have different ranges of growth and returns profiles, as well as different valuations, which therefore need to be taken into consideration when assessing relative attraction of each stock within that basket.

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- This strategy may hold a limited number of investments. If one of these investments falls in value this can have a greater impact on the strategy's value than if it held a larger number of investments.
- Smaller companies may be riskier and their shares may be less liquid than larger companies, meaning that their share price may be more volatile.
- Emerging markets or less developed countries may face more political, economic or structural challenges than developed countries. Accordingly, investment in emerging markets is generally characterised by higher levels of risk than investment in fully developed markets.

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