Cutting out noise key for Gold Coast fundie

Monday fundie Lachlan Hughes believes in a long-term view.

William McInnes

Life is swell for Lachlan Hughes who says the Gold Coast is a great base from which to invest. PHOTO: JAMES BRICKWOOD

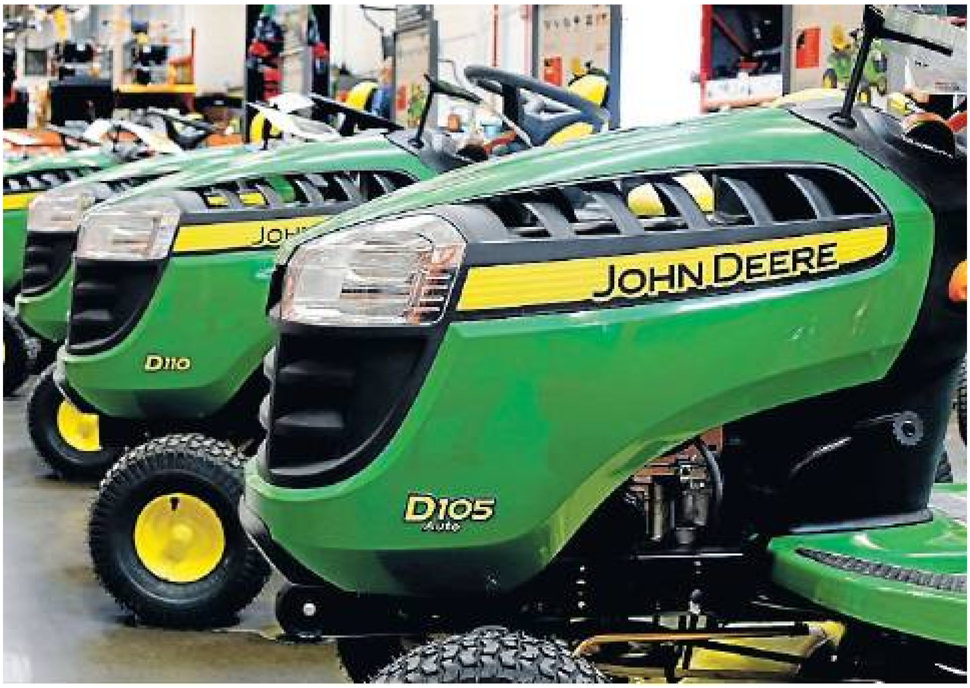
Running a fund focused on global large capitalisation stocks just minutes from the sandy shores of Surfers Paradise might not suit every investor, but Swell Asset Management founder Lachlan Hughes wouldn't have it any other way.

''Being away from the noise gives you objectivity and it makes it easy to apply your discipline,'' he says. ''Personally, it's just an easy place to invest.''

The firm's three-man investment team runs a highly concentrated global fund, holding just 15 companies with $30 million worth of funds under management.

A firm believer in doing in-house research, Hughes has found success in ignoring broker notes and doing his own due diligence on every company he invests in.

''You really have toblock out the noise and that's why I think doing your homework is key because otherwise you're relying on someone else to tell you how you should be feeling at that time. So it's good to have that independence.



Lachlan Hughes cites agricultural machinery manufacturer John Deere as one of his best long-term bets. PHOTO: AP

''We also won't meet with management in order to avoid the bias. Once you develop a good relationship with management, it can sometimes influence your judgment. We want to be super objective about management and the business. It's hard work but you've got to do all the work yourself.''

Hughes says he is willing to invest only in the best companies in the world and that means looking offshore, with almost all the company's funds invested in US-based businesses.

''We're really just trying to find the best companies wherever they are,'' he says. ''In Australia, there's a handful of companies that if they ever got to the right price they might find themselves in the portfolio. One day the banks might get interesting but the housing market is still something I'm not so sure about yet.

''But it just isn't as competitive a market as you find globally because the market is just a little bit more captive. It's really hard to put an Afterpay up against a PayPal.''

A believer in taking a 10-year view in every company he invests in, Hughes cites agricultural machinery manufacturer John Deere as one of his best long-term bets.

''The [computer] chip business is one that I couldn't say intelligently where it's going to be in 10 years, so that's one I avoid,'' he says. ''Whereas I feel like I've know where John Deere will be in 10 years' time. They'll probably be making tractors and maybe adding tech to them with autonomous drive.''

His confidence in the company's long-term prospects led him to invest in Deere & Co at a time when the market was stagnant.

''There was a temporary setback,'' he says. ''There were a number of boom harvests so the prices the farmers were getting was very low, and consequently John Deere sold fewer tractors and the secondary market for tractors was full. People were worried people would be buying a second-hand instead of a new tractor.

''We knew that was going to resolve but I didn't know how long it would take. I knew it would happen within three years but it happened within six months.'' Since buying the company in June

2016, Hughes' investment has risen 86.4 per cent. In the three years before his investment, it had grown less than 2 per cent.

Hughes' desire to invest in highquality companies and take a longterm view came early on in his investing career.

Leaving a six-year career as a lawyer in the financial services industry, he moved into the funds management industry just weeks before the collapse of Lehman Brothers, joining Challenger's Smaller Companies Fund as an analyst in August 2008. ''Looking back, it was the best time to start your career because you got to see a really bad market and I think its shaped how I invest today,'' he says. ''Just seeing what can happen when things go wrong, it's what led us to invest in really highquality companies.''

He believes his background as a lawyer and experience during the global finance crisis has led him to be very risk averse and invest only in quality.

''When I look at a business I look at the risks first. If I can't get myself comfortable with all the risks then we move on and we move on quickly,'' he says. ''The biggest red flag is debt and we'll avoid companies with even moderate levels of debt. I just prefer companies to have a net cash balance – they're just safer.''

The Swell Global Fund advanced 8.02 per cent during the 2018 calendar year outperforming the MSCI World Index, which returned 1.26 per cent.

''Because we're focusing so much on the long term, the short term looks after itself,'' Hughes says. ''A good example of that in the last year was Facebook. We bought the last few per cent at $US125 and it's back to $US170 now. We know what the risks are, we were happy with them and really, if the share prices comes down and it's trading at a discount to our valuation we'll buy more.''

PayPal is another favourite of Hughes, who believes buying it early on, when the market was unsure of its future, was one of the best investment decisions he has made.

''When they were first spun out of eBay, there was a risk that Mastercard or Visa may get taken away as a funding source for PayPal, which would have been a real threat,'' he says.

''But Dan Schulman, the CEO, did a deal with Visa that changed the stakes. They went from 'frenemies' to strategic partners. That was the catalyst and when that changed, I lifted the weighting significantly. Since then, it's more than doubled so I feel like that's been a big win.

''We're trying to do what you're supposed to do, which is buy when they go down and sell when they go up, which is common sense, but people got scared at the wrong times. So we try to really focus on the long term because it makes all investment decisions easier.''

Hughes' strategy hasn't come without its pain, however, and in a highly concentrated portfolio the losses can hurt much more.

''The bad calls were IBM and Oracle where I feel I assessed management wrong,'' he said. ''Getting the call on management wrong is the one that really hurts. Fortunately we didn't lose money on IBM and we only lost a little bit on Oracle.''

He says IBM's question-answering computer system Watson promised more than it delivered and led him to overlook other issues within the business.

''The concept was great but implementing Watson was challenging,'' he says. ''I thought it might provide more growth than it's delivered today. Really having a good understanding of management and assessing whether their forecasts about a certain product are going to turn out as they say they're going to [is a really important lesson].

''I probably got overenthusiastic about Watson and that can lead you to overlook some other things.''

Despite the losses, Swell has made a 52 per cent return since its inception in 2014, with Hughes leading a team hired for their passion rather than their experience.

''I wanted to find guys who were super passionate about investing because I love investing. For me, it's not like a job,'' he says.

''I really wanted to hire from university. I wanted someone with no preconceptions about how how they should invest because I wanted people to come in knowing that we only buy the best companies, we focus on the long term and we make meaningful bets on those companies when we find the right one.''

Like any boutique fund manager, Hughes has entertained the idea of the fund joining a larger company but at the end of the day, he believes his independence is what gives him an edge.

''We've had some conversations with people. I'd never say never but we really love our independence and it really works for us.''

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Lachlan Hughes, Swell Asset Management