## 2023 OUTLOOK

# This Too Shall Pass

COUNTERPOINT GLOBAL | COMMENTARY | December 31, 2022

As a team, we have never maintained a market outlook and believe that basing investment decisions on macro forecasts can be a futile exercise. However, we do consider how micro, and macroeconomics can impact the fundamentals and cost structures of our businesses.

**What We Are Seeing**

- Rising interest rates, inflation and geopolitical tensions have led to uncertainty and character-testing volatility, impacting business sentiment, and driving down share prices around the world.[1]
- Guidance-obsessed market participants have become increasingly fixated on short-term forecasts, losing sight of the underlying fundamentals and long-term growth potential for companies.
- As the Fed increases interest rates to tame inflation, we have seen the dollar strengthen year-to-date, impacting earnings power for companies that export products and services and have non-dollar-denominated sales.
- While these non-fundamental factors may be driving performance over the short-term, we continue to believe these headwinds are unlikely to materially impact the long-term cash generation and intrinsic value of the types of businesses we own.

**What We Are Doing**

- We maintain our belief that equities will be the best-performing asset class over the long term as they provide ownership in the creativity, ingenuity, and productivity of hundreds of thousands of talented workers. While money can be inflated, talent cannot.
- We do not spend a lot of time worrying about the ups and downs of the market or the forecasts of economists and pundits. Instead, we focus on the compounding potential and fundamentals of our portfolio companies.
- We continue to reassess the competitive advantages and qualitative characteristics of the businesses we own. Strength of customer value proposition, growth profile and earning power, track record of management team, direction and size of their moat, and short and long-term capital needs, remain primary concerns when evaluating companies.
- We are finding attractive opportunities within intellectual property-based and automation and productivity-enabling businesses, which can produce large dollar volume increases with minor additional capital investment.
- We continue to avoid commodity-related sectors given the capital-intensive nature of these businesses, unpredictable prices, and underappreciated liabilities.
- While a stronger dollar and higher energy prices have created a major headwind for companies in Europe, it has also created pockets of opportunity as we believe the share prices of some very attractive businesses have been penalized solely as the result of their location.

**What We Are Watching**

- While it is too early to tell if inflation has peaked in the US, we are observing lowering of input costs that should help improve our companies' margins.
- We continue to assess the longer-term implications of a higher cost of capital and its overall impact on the competitive landscape. With the days of easy money behind us (for now) we expect fewer market entrants

[1] It is important to note, however, that we are bottom-up, fundamentals driven investors and do not believe that share price volatility necessarily equates to risk.

and less competition, which should benefit companies that have already established valuable businesses and brands.

- Stock-based compensation plans have been a low-cost funding mechanism for emerging and innovative businesses. Given the recent drawdown, we are monitoring if companies will increase use of cash compensation and its subsequent impact on profitability and dilution.
- Our portfolio companies are increasingly focused on their cost structures and doing more with less, which should improve their free-cash-flow profitability. Will Price's Law—which states that 50% of contributions are done by the square root of the total number of contributors —hold true?

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**Manas Gautam**
Head of Global Endurance

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