



September 2019 | Market Perspective



## Finding Global Small-Cap Opportunities in Uncertain Markets

A larger opportunity set and a domestic focus help make global small caps attractive.

### GLOBAL SMALL CAP EQUITY

#### KEY TAKEAWAYS

- Continued trade disputes between the U.S. and China, deceleration in corporate earnings growth rates and concerns that central bank policy is becoming less effective in spurring economic growth have all helped increase global stock market volatility.
- While no clear resolution of these issues is in sight, we believe global markets will increasingly differentiate between stocks based on company fundamentals. Companies with less exposure to global macroeconomic trends and those with strong, company-specific growth drivers may be better positioned to weather these market pressures.
- Our investment process is designed to help us uncover attractive opportunities regardless of short-term market conditions. We focus on identifying inflection points and companies with improving fundamentals. Quantitative screening, collaboration, the free exchange of ideas and insights, meetings with thousands of companies, and rigorous fundamental analysis help us identify opportunities and exploit inherent market inefficiencies.

Investors have had to grow accustomed to heightened volatility in global equities. Ongoing trade conflicts between the U.S. and China, threats of a currency war, and decelerating corporate earnings growth have contributed to the instability. Many economists and market prognosticators believe the world's central bankers are running out of weapons to fuel economic growth after years of accommodative policies. Markets are reacting quickly and sharply to headlines, economic data or political posturing that may affect the macroeconomic environment. As a result, investors have become fearful of a global economic slowdown after an unprecedented period of expansion.



TREVOR GURWICH  
Senior Portfolio Manager



JIM SHORE  
Senior Client Portfolio Manager

### **MACROECONOMIC UNCERTAINTY IS DRIVING MARKET VOLATILITY**

There's no way to predict when the current trade war or currency battles will be resolved or whether they'll lead to a global slow-down or recession. However, we believe investors may be able to reduce the effects of these conditions through diversification into global small-cap stocks. An active global small-cap manager with a disciplined investment process can identify companies that may be positioned to succeed despite the uncertain macro-economic environment.

### **GLOBAL SMALL CAPS MAY BE BETTER POSITIONED IN DIFFICULT MARKETS**

Select small-cap companies may be better equipped to withstand the impacts of global macroeconomic uncertainty for several reasons. Smaller companies are usually more focused on their local and regional markets than large multinationals, and they are generally less exposed to the effects of changes to global trade and currency fluctuations. Additionally, the global small-cap universe contains a significantly larger number of companies than the large-cap universe; investors have more opportunities to find companies with attractive idiosyncratic strengths that may help position them to succeed in their home markets regardless of short-term economic trends. Taking a global approach can also help. If we see that one country or region is under pressure, we can consider alternatives more exposed to favorable conditions.

The prevalence of initial public offering (IPO) activity in the small-cap space may translate to attractive opportunities to invest in businesses early in their growth cycles. According to FactSet, approximately 90% of IPOs take place in the small-cap space. Newly listed small-cap companies are often run by founders and management teams that have been with the organization since its inception and may have been instrumental in launching the company's most innovative products and/or services. We think the attention of such highly incented and well-funded managers, with a vested stake in the firm's long-term success, may help small-cap companies navigate near-term volatility and uncertainty. Similar to IPOs, approximately 90% of all mergers and acquisitions occur in small caps and often result in small-cap companies taken out of the universe at a premium. (Source: FactSet. Data as of 6/30/2019.)

Our collaborative investment process is designed to help us take advantage of these conditions in the global small-cap space. The New York-based portfolio management team is supported by a group of dedicated small-cap analysts and benefits from the research of sector and emerging markets analysts and seven additional global and non-U.S. portfolio managers. This proximity promotes cooperation, collaboration and transparency via formal and ad hoc meetings and allows for a free exchange of insights and information that benefits the entire team.

### **OUR INVESTMENT PROCESS IS DESIGNED FOR ALL MARKETS**

We believe the American Century Investments philosophy and process is well-suited for uncovering opportunities in the global small-cap space. We focus on identifying companies in the early stages of a growth cycle, hoping to uncover attractive opportunities

with the potential for improving and sustainable earnings growth rates. We believe the market is slow to recognize positive inflection points in the earnings cycles of individual companies and slow to reward companies when the improvement in fundamentals is sustainable.

Our process seeks to exploit these persistent inefficiencies. We use our disciplined bottom-up analysis to attempt to isolate the most compelling companies. We also meet with more than 2,000 companies annually to understand how they operate, what their competitors and suppliers are doing, and how their strategies are faring. And, because global small caps are relatively under-covered by sell-side analysts, there's a higher probability that small-cap stocks may be mispriced by the market.

### **CASE STUDY: VARTA AG**

VARTA exemplifies how this process comes together to help us identify companies that may be poised to exhibit sustainable earnings acceleration. The firm has developed differentiated technology in rechargeable button-style microbatteries for hearing aids and wireless wearables (e.g., earbuds). VARTA isn't immune to global macroeconomic conditions, but we believe it may be better able to weather slowing global growth because its earnings growth is driven by stock-specific drivers. The company also benefits from longer-term secular growth trends, including a growing end-market user base and an expanding market share in wireless wearables. VARTA's hearing aid business also benefits from a high share of recurring revenues (it currently has approximately 50% market share), a consolidated market, and favorable demographics, such as ageing populations. (Source: FactSet and VARTA data. Data as of 6/30/2019.)

Following years of substantial investment in research and development and capacity expansion, we believe the company is well positioned, with superior battery technology in earbuds, one of the fastest-growing categories in consumer electronics. The potential for handset manufacturers to begin bundling the increasingly popular earbuds with their \$1,000+ smartphones to boost sales in a market approaching saturation, should also drive increased growth for the company. There's also potential upside from the next generation of Apple's AirPods, which may contain Varta batteries.

Partly due to the lack of analyst coverage of the stock, we believe the market isn't fully pricing in the sustainability of the organic growth in the earbuds business. Only a handful of sell-side analysts cover VARTA, resulting in a scarcity of information for investors. This is a common situation in global small-cap investing, but our bottom-up analysis and collaborative investment process has helped identify VARTA's growth potential in an inefficient market.

The team benefited from the insights of analysts and portfolio managers on our global growth and emerging markets equity teams whose coverage of Apple and Samsung informed our position. We also gained insights from American Century's ESG group, whose resources are integrated into our fundamental research process. The ESG team highlighted potential risks related to supply chain management practices and opportunities tied to the favorable aspects of the rechargeable, reusable battery business.

## American Century Investments®

OUR SOLE FOCUS IS INVESTMENT MANAGEMENT

**185** INVESTMENT PROFESSIONALS  
TOTAL as of 6/30/2019.



**19** YEARS OF EXPERIENCE  
AVERAGE as of 6/30/2019.

**1958**  
BUSINESS FOUNDED

### INVESTMENT CAPABILITIES

Global Growth Equity	Global Value Equity	Global Fixed Income	Disciplined Equity	Multi-Asset Strategies	Alternatives
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**\$168b**  
ASSETS UNDER MANAGEMENT  
as of 6/30/2019.

### TOP 10 HOLDINGS As of 6/30/2019

Rheinmetall AG	1.96	CareTrust REIT Inc	1.48
Kinsale Capital Group Inc	1.63	Kemper Corp	1.38
Hamilton Lane Inc	1.61	Badger Daylighting Ltd	1.30
Li Ning Co Ltd	1.51	Americold Realty Trust	1.29
R1 RCM Inc	1.50	frontdoor Inc	1.26

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### American Century Investments®

4500 Main Street Kansas City, MO 64111-7709	330 Madison Avenue 9th Floor New York, NY 10017	1665 Charleston Road Mountain View, CA 94043	2121 Rosecrans Avenue Suite 4345 El Segundo, CA 90245
Suite 3201 Champion Tower 3 Garden Road, Central Hong Kong	12 Henrietta Street 4th Floor London, WC2E 8LH	Governor Phillip Tower RM 3676 L36 1 Farrer Place Sydney, NSW 2000, Australia	Suite 4-101 Taunusanlage 8 60329 Frankfurt Germany



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