Market View
The importance of compounding

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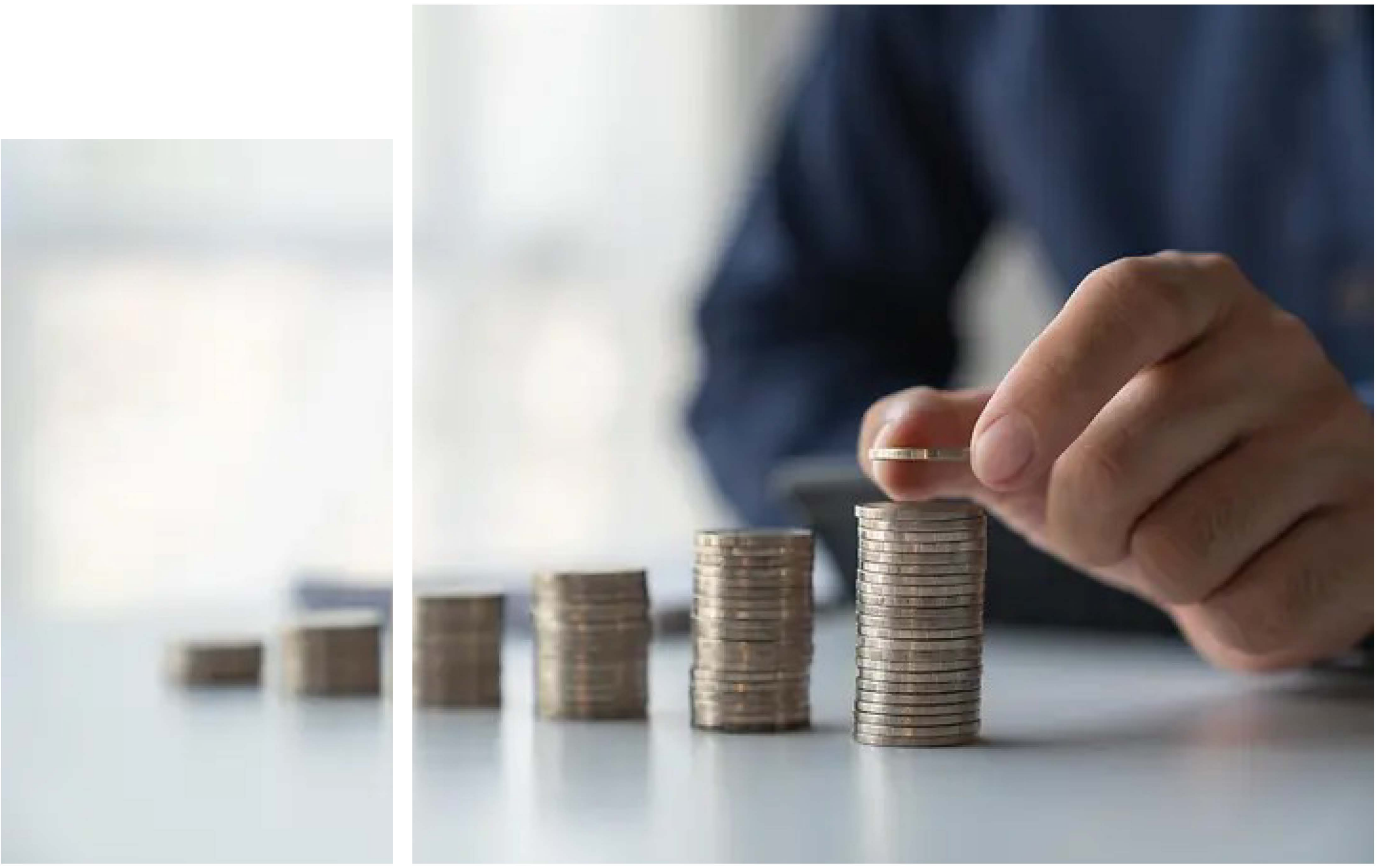


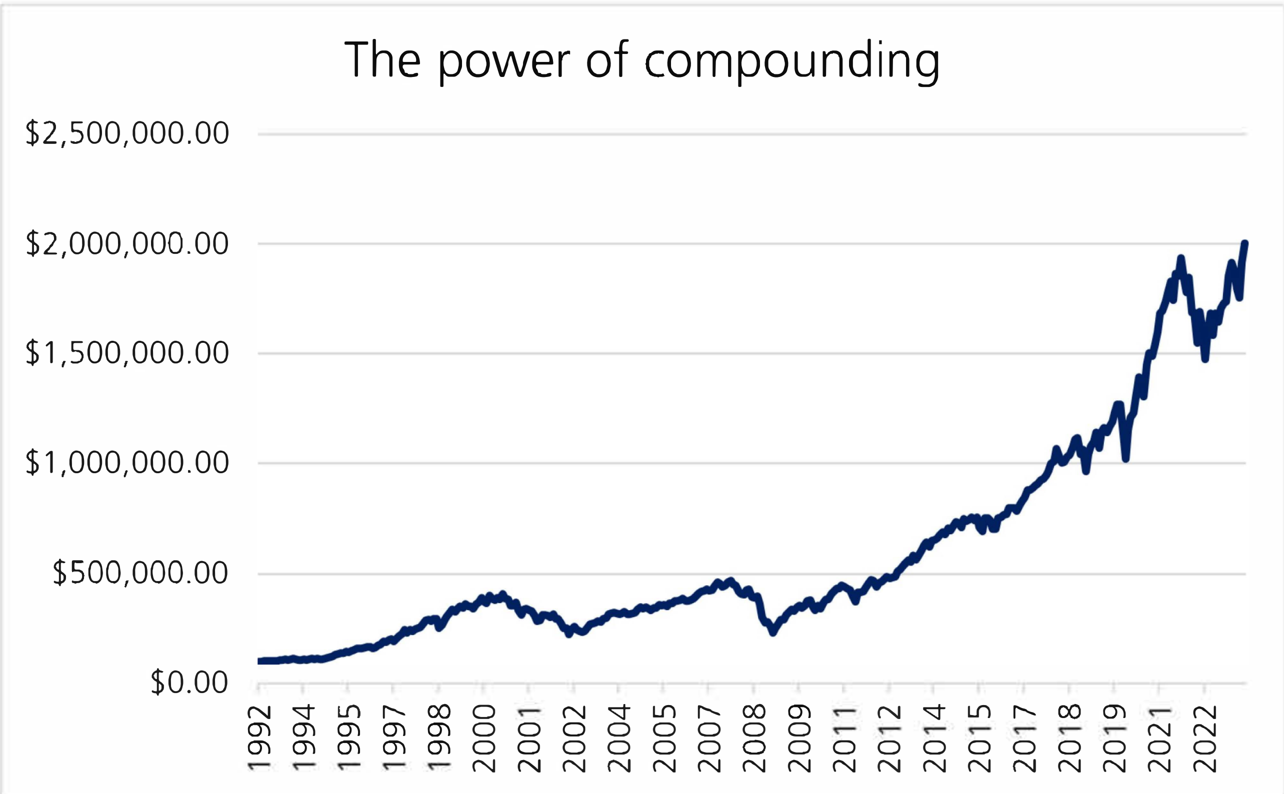
At a glance

- Compounding leads to exponential growth over time, as evidenced by the S&P 500's 1895% cumulative growth from 1993 to 2023.

- Recent gains in the S&P 500 were driven by a few tech stocks like Nvidia, but it is crucial to focus on companies with long-term compounding earnings.
- A disciplined approach, investing in high-quality companies with strong compounding potential, maximises long-term wealth growth.

Albert Einstein allegedly once described compounding as the eighth wonder of the world and one of the most powerful forces in the universe. Compounding – when your returns from the previous period are added onto the next period (and again and again) – is indeed a powerful force and a crucial part of long-term investing. While many can grasp the maths behind compounding, it is very hard to visualize over the long-term as the numbers become so large.

To benefit from compounding, investors must *remain* invested. If you invest £1,000 on day one and see a 10% annual return, in 12 months you will have £1,100 invested. If you experience the same 10% gain next year, your investments will be worth £1,210 at the end of year two. If you were prescient enough to have invested $100,000 in the S&P 500 at the beginning of 1993, you would have about $2 million at the end of 2023. This is a return on investment of 1895%, or 10.1% per year.



Source: Morningstar

This year, the S&P 500 continued to hit record highs, driven by a small number of technology-focused companies in the US benefiting from swirling euphoria over artificial intelligence (AI). The exponential growth these companies have experienced is remarkable—chipmaker Nvidia accounted for 35% of the S&P 500's total returns in the first half of the year. While it is not uncommon for a few stocks to dominate leadership in an index and make up a significant portion of an index's returns, Nvidia and Microsoft's impact on the S&P this year is extraordinary.

Although the focus this year has been on a few stocks, we advise investors to think more carefully about the importance of buying stocks with a proven track record of compounding earnings over time. The focus on a few large technology companies means these compounding stocks have actually become cheaper on a valuation basis. When equity market rallies broaden out to include other sectors and geographies, as opposed to just US mega technology companies, we could then see renewed interest for these quality compounders. Over time, this should drive their stock prices higher.

Conducting thorough research, being comfortable with occasionally missing out and avoiding over-diversification across every sub-sector or market are the cornerstones of our approach.

We minimise unnecessary trading and have adopted a long-term, disciplined approach, as we believe this will help provide the best risk-adjusted returns over the long-term.

Rather than simply investing in an index, we focus on a smaller number of high-quality companies with long-term compounding characteristics. This allows us to benefit from compounding and experience growth potential, as both the initial principal and accumulated interest - from the dividend or the company keeping its cashflows to re-invest at high internal rates of return - allow the investment to grow and increase wealth over time.

Investors should be aware that past performance is not an indication of future performance, the value of investments and the income derived from them may fluctuate and you may not receive back the amount you originally invested.