

How Innovation and Industry Disruption Creates Long-Term Value

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Narratives and themes regularly influence parts of the economy and financial markets. Occasionally, such themes become so dominant that, for a period, they disproportionately drive groups of stocks, both positively and negatively. Artificial Intelligence and GLP-1s, a groundbreaking class of obesity medications, have recently emerged as such thematic investments. However, investing with a short-term time horizon in nascent areas that will take years, if not decades, to fully develop, is a speculative pursuit.

Alternatively, long-term investing is about finding enduring opportunities that will be resilient through economic fluctuations, along with management teams and business models poised to adapt as the world evolves. While several Riverbridge holdings participate in and around today's headline-grabbing themes, our portfolios contain a diversified set of companies that are innovating and adding value to customers across a wider variety of end markets and evolving industries.

Consider the reshoring of manufacturing assets to the United States in a post-COVID world, or the ever-changing logistics landscape as companies navigate new supply sources. Manufacturing assets, distribution facilities, and technology investments are underway across industries to rework how raw materials come in, where manufactured goods are produced, and how goods are delivered to consumers. Companies like Fastenal and SPS Commerce help facilitate the physical and technological buildout of the new supply chain architecture necessary to compete in today's world. Re-shoring or supply chain headlines may more immediately impact construction and engineering companies, but in the coming years, we expect service-oriented companies like Fastenal and SPS will play a significant role as companies look to produce and transport their goods efficiently within the United States.

In Health Care, the transition from fee-for-service to value-based care is steadily reshaping how care is delivered and valued. Software and services provider Privia Health helps physician groups navigate increasingly intricate contractual and patient relationships, enabling their customers to focus on the quality patient care they were trained for, rather than administrative tasks. Similarly, UnitedHealth Group, as a leading employer of physicians, continues to expand its capabilities and services around patient engagement and care delivery.

Meanwhile, an example of unexpected disruption is playing out in residential real estate.

Selling homeowners just won a class action lawsuit against the National Association of Realtors and various large brokers. A court determined that real estate agents had essentially colluded to keep commission rates artificially high. As a result of the jury award and subsequent agreement to settle, companies exposed to the industry have been volatile.

The Riverbridge holding most exposed to this development is CoStar Group, a company we have owned since 2005. At that time, their business was focused only on commercial real estate information and analytics. Today, CoStar not only dominates commercial real estate, but they have evolved and consistently invested in new capabilities to become the largest player in multi-family rentals with Apartments.com. Plans are now underway to do the same in residential real estate with the recently re-launched Homes.com. When CoStar made the acquisition of Homes.com, the company did not know how the lawsuit would play out or how interest rate policy changes would impact existing home sales, but they saw an under-invested industry and the opportunity to deliver a new value proposition to key stakeholders. While CoStar is early in its roll-out of Homes.com, the company has consistently demonstrated a culture of adaptability and an ability to build value over time.

These examples are not to say that one theme is better than another, will last longer, or be more impactful. Change is constant, even in seemingly staid areas of the economy like supply chains and real estate. Occasionally, that change becomes a full-blown thematic trade that captures the attention of the investment world. More often, it hums along below the surface, attracting little attention but providing ample opportunities for value creation. If space allowed, we could identify innovation and new ideas impacting every area of the economy, from retail, to insurance, to human resources, to media.

As long-term investors, we focus on identifying the companies capable of benefiting from change: those that are responsive to customers and willing to pursue new opportunities that align with their capabilities. We believe this is a much more repeatable approach than attempting to identify market-moving trends, catch the waves before they crest, and jump off before they crash. As always, our focus in constructing the Riverbridge portfolios starts from the bottom up, looking to identify the management teams and business models likely to succeed in a dynamic world, no matter the theme of the day.

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