Goldman Sachs Exchanges: Great Investors

Large-cap investing with Jennison Associates' Kathleen McCarragher

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Date of recording: May 13 and June 4, 2024

Betsy Gorton: Welcome back to another episode of Goldman Sachs Exchanges - Great Investors. I'm Betsy Gorton, a partner in Goldman Sachs Asset Management and your host for today's episode.

Today I am delighted be speaking with Kathleen McCarragher, head of growth equity and a large-cap growth equity portfolio manager at Jennison Associates. Jennison is an investment firm that has focused on managing public equity and fixed income assets for institutional clients for 55 years. At Jennison, Kathleen oversees $111 billion in assets under management. Kathleen has been investing in large-cap growth stocks for over four decades and is known in the industry for turning in top decile performance. She and her team have also been early to invest in many of the largest stocks that are powering markets higher today.

We'll be talking with Kathleen about investing through multiple economic cycles, her perspectives on market concentration, and her advice on building and leading teams.

Kathleen, welcome to the program.

Kathleen McCarragher: Thank you, Betsy. It's good to be here.

Betsy Gorton: Great. Well, let's get into it. And for listeners who may be less familiar with Jennison, it's a firm that is highly regarded among institutional investors for, really, its decades-long track record of excellent performance in large-cap growth. But take me back to 1998 when you joined the company. What attracted you to Jennison at that time?

Kathleen McCarragher: Well, Jennison was very well-known in our industry. Quality firm. Strong results. Did great fundamental research. It had a really impressive client roster. And I knew it to have smart people and be very competitive, but a great place to work. So, I actually felt like I had sort of the inside scoop on what Jennison was from early in my career.

I was an analyst. And my favorite competitor counterpart was the analyst at Jennison. But despite all of these glowing characteristics and maybe surprisingly, I didn't really have an interest in talking to Jennison when they approached me. I had been building an institutional product and was leading a team. And we had really strong three- and five-year numbers, which gets you to the starting gates in this industry.

So, it was my mission to go after Jennison's book of business and that of the other established large-cap growth managers. So, I had what I thought would be a polite, 10-minute conversation with Sig Segalas, CIO and one of the firm founders. And about an hour and ten minutes into that conversation we hung up agreeing to meet shortly after that.

It was truly a meeting of the minds. And what appealed were Jennison's core principles of clients first, a belief that research matters, and a focus on creating long-term value for clients. Another thing is this business is only fun if you win. And I thought about the resources that Jennison brings to bear in doing the work and the talent in that team and the longevity of their client relationships, some 20 and 30 years, which is exceptional.

So, I crossed the street and never looked back.

Betsy Gorton: And you mentioned Sig Segalas who passed away last year at the age of 89. He's definitely one of the icons in growth investing. Anything beyond the tenets that you just mentioned that you really think contributed to his success?

Kathleen McCarragher: Oh yes. Sig was competitive. He needed to win. And he created a culture of performance. But he was also one of these people who truly believed that you're only as good as the people around you. So, he always had good people around him.

So, this team of truly distinct individuals, independent thinkers, and a culture of interdependence. His competitive instincts were focused externally, not internally.

Betsy Gorton: And was there one lesson, a particular experience of working with Sig that really stuck out to you over all those years?

Kathleen McCarragher: One thing that surprised me the most was the flexibility he displayed in his thinking. Here we are long-term investors looking at a fundamental strategic thesis for owning a stock. That doesn't necessarily change that often. But Sig would not get stuck in his thinking. So, he would continually be questioning and adapt to new information. His ability to change his mind was striking.

Betsy Gorton: And so, in 2003 as Sig was starting to think about his own succession, he named you to be head of the Jennison growth team. What do you think he saw in you at that time?

Kathleen McCarragher: I would say shared values around integrity and a complete commitment to driving performance for clients. Believing that if we did well for them, the rest would somehow fall into place.

It's a business where you go at risk of being wrong every day. And we need people to do their best work knowing that there are times they will be wrong, and very publicly so. And need to stand up the following day and do it again. So, a shared responsibility when things go wrong. And accolades for the idea generator when things go right.

Betsy Gorton: That's so fabulous. And to think Sig appointed you in 2003 and then you all were lucky enough to be able to work together for another 20 years. That's just so special. So, this is a sector that's dominated by large personalities. I've always found your style to be very thoughtful and insightful. When you speak, people really listen. How has that helped investing in this space?

Kathleen McCarragher: There certainly are big personalities and egos in our business. However, Jennison manages money for institutions. And so, we have never needed a big media presence or retail presence to promote ourselves. Our culture is one of teamwork, not an individual star system. So, we're really focused on just one thing, where our clients' success is our success. And that's all I care about.

Betsy Gorton: So, let's talk a little bit more about the investment approach, take a deeper dive there. You and your team have been early to identify and invest in some of the biggest names driving the market higher today. Describe the investment and research processes that help you make those calls, really, oftentimes before the rest of the market does?

Kathleen McCarragher: It starts with the significant experience of the team. We've got 25 years on average and 16 of those we Jennison. We take a very long-term perspective. We're looking to invest in companies that can create true economic value, that will grow revenues and cash flows at rates well above the market for multiple years.

And what we're looking for would be where innovation and duration can create structural growth that's not fully appreciated by the market. Sometimes this will come in the form of a high-quality company that is compounding growth at rates that over time adds really significant, incremental value. And sometimes it will come in companies that are earlier stage. Those that are creating products or markets that don't exist. Or they're changing the way business is currently being done or the way people move through their lives.

We also look for management teams with strategic vision and an ability to execute and an ability to lead through change. So, as a growth manager, we're kind of fortunate. We're always looking ahead. We're always learning. We learn from the past. But we also need to envision the future.

Betsy Gorton: And as one example, one company that you invested in quite early was NVIDIA. I think you've been invested since 2016. So, tell us the story around how and why you decided to invest when you did in that position?

Kathleen McCarragher: Very topical today of course with all things generative AI taking center stage. We've been following NVIDIA since it became public. And it began marketing GPUs initially in 1999. The purpose of those was to accelerate and improve 3D graphics. So, the primary market at that time was gaming and visualization applications.

In 2014, the company focused on becoming a specialized platform company with end-to-end capabilities. So, gaming was still their most important market. But this accelerated, high performance compute led to an emerging role in data centers.

When we bought the stock in 2016, it had just come off of a period in which gaming had been down. And a recovery was underway. And they were absolutely the world leader in gaming compute. However, we also saw them leading the next era of compute with GPUs where the data center business was doubling. So, gaming was recovering, and a new, important market was developing.

By 2018, demand for compute power was growing exponentially. And CPUs could no longer keep up. What NVIDIA offered was optimized across the stack. And it offered compelling cost and compute advantages. So, we have seen a massive shift in the way computing has done. And that is what has set up NVIDIA's place in all things AI today. That $5 billion revenue company that we bought in 2016 is annualizing revenues at greater than $100 billion today.

Betsy Gorton: Interesting. And how, in general, do you think about your holding period for positions? And has it evolved over time?

Kathleen McCarragher: It has evolved. We've typically had a three- to four-year holding period. But that's an average. And there have always been names that we've owned materially longer than that. But even that has been lengthening. Both because some names are being held even longer and because there are more names that can actually be held for longer where growth rates stay attractive.

So, some of these companies have scaled globally and they have meaningful market opportunities. At some point, maturation or the law of large numbers will set in and growth will slow. But right now, the competitive barriers and dominant industry positions allow them to continue to grow at really attractive rates.

But we know not all names will have this kind of holding period, so there are some where we intend to own them for shorter periods in that one or two, maybe three years. And then of course, there are those where we've been proven wrong. And they have a much shorter stay in the portfolios.

Betsy Gorton: Have you noticed any change in the speed at which you need to make decisions over the years?

Kathleen McCarragher: The market definitely reacts more quickly and more fully to the news than it used to. So, what it means for us is that we have a higher need to distinguish the noise from true news. And it requires us to be very crisp in our investment thesis because there's a lot of emotion in the move. And the valuation reaction, we can't let it swamp our understanding of the fundamental opportunity.

Betsy Gorton: You're also known as someone who's actively involved in the career progression of your team and really aims to diversify your investment approach and those driving it across generations. Can you describe how you do that and why you believe that's also a driver of success?

Kathleen McCarragher: Well, we are on what I'd consider to be our third or maybe even fourth generation of investors. So, over the five decades we've been investing client assets, what we do is produce Jennison portfolios. And they're not the result of any one person.

If you look at the portfolios and the results, the return characteristics, you can't find the generational shifts in our team. And I think that's very important because when a client gives you this responsibility over the long term, we shouldn't be changing who we are and what we do.

Of course, the names in the portfolio will change. The portfolios themselves will change. But the role the portfolios play in our clients' mix of assets should be able to be consistent.

Betsy Gorton: All right, let's talk a little bit more about culture, particularly around the notion of high performing teams. How do you maintain it over time within the team?

Kathleen McCarragher: I never take culture for granted. I believe that Jennison has a strong and self-reinforcing culture. But it's much harder to build a culture than it is to unwind it. So, what does it take? I think a common purpose. I think acting with integrity and clarity. I also think, as I mentioned very early in this, that winning helps. And we win as a team.

So, when we think about developing and retaining talent, how do we create an environment which allows them to do their best work? And how does our process leverage that work into productive results for clients?

We value individual contribution within a very interdependent process. I think the people sitting around the table make each of us better at what we are doing. And that's a great environment in which to work.

Betsy Gorton: Okay. Let's pivot for a bit to the macro trends shaping investing today. Passive investing has obviously become increasingly popular, particularly in spaces like US large-cap growth. What does that mean for Jennison's business? When you speak to investors, what's the strongest case for active management in this asset class?

Kathleen McCarragher: Performance. If as an active manager we can outperform our benchmark, over time that outperformance compounds to a material number. When we see investors shifting from active to passive, it often follows a period of relative underperformance where a different risk profile may be applied as they're looking at that asset. And then we often see the shift back from passive into active when active outperforms. We like to think about it on a multiyear, multidecade basis where that compounding of the outperformance will truly matter.

Betsy Gorton: And when someone goes into your strategy, what time horizon do you think they need to have in mind?

Kathleen McCarragher: We think about investing in three-, five-, 10-year time horizon when we look at a stock. So, if a client can share that kind of a timeframe, that's productive. But we would really encourage even longer. Again, back to this idea of the power of compounding. The longer that persists, the more impact it has to those cumulative returns. And we do have clients that think that way. We have clients who've been with us 20, 30, 40, and some even 50 years.

Betsy Gorton: Great. Market concentration is getting brought up a lot in conversations lately. Of note is a concern that big tech is driving the majority of the market's gains. Does this concern you?

Kathleen McCarragher: There's no question that the talk around the M7 and before that the FANGMA and before that FANG has been around for a while. And it speaks to the business models that these large and very successful companies have built and the sustainability of those business models. So, as we were talking earlier, if companies go from strength to strength and can still drive outsized revenue growth, outsized returns looking forward, they can remain attractive holdings.

Now, this idea of concentration and benchmark, Russell 1000 growth benchmark is not diversified. We run diversified portfolios. And so, we are not going to have benchmark weights in the largest of those companies.

But the way we think about it is if we can find other companies, other stocks that will do as well or better than the large benchmark weights, Apple and Microsoft in particular, then if we own a large position but are "underweight" the bench, that's okay because we only have to do as well or better in the names that we are using instead. And that's a great portfolio position.

The other thing is mathematically, the largest seven contributed disproportionately to benchmark returns. We know that. It's been well documented. But there were another 150 names in Russell 1000 growth that outperformed last year. So, in theory you didn't even have to own any of them in order to outperform the benchmark. As an active manager, we have the luxury of picking and putting the assets where we think they will do best.

Betsy Gorton: So, AI gets brought up a lot with respect to big tech. How do you think it will change future growth opportunities, not only in technology, but really across other large-cap sectors as well?

Kathleen McCarragher: Well, clearly the immediate beneficiaries have been the NVIDIA and other "arms dealers" that are really benefiting from the investment in and the spending on all things AI. But beyond that, you know, if we look at technology, certainly enterprise software should benefit as AI unlocks new capabilities. Application software should benefit. Cybersecurity. Chip design companies. Sales and marketing or those in creative industries.

When you go beyond technology, we start to talk about productivity gains. And at this stage, the way we believe we will see them first is skill sets that can be enhanced rather than head count reductions. Over time, what we will find is as these technologies move into other industries, whether it's healthcare, whether it's education, whether it's oil and gas, we expect to see real foundational capabilities emerge out of utilizing this technology that will enhance growth rates, enhance productivity, enhance returns for those companies that can lever them the most.

Betsy Gorton: More broadly, how are you thinking about growth opportunities in this market?

Kathleen McCarragher: Well, we do still appreciate our positions in all things AI related. One of the big questions is, is this a bubble? We don't see it similar to the TMT '99/2000 scenario. Enterprises are spending on this. And they are beginning to see returns on that. No question as spending levels go up we'll have to monitor the profitability of those companies that are accelerating their spend and what we expect to see of it. But we believe that's useful.

Betsy Gorton: Very exciting times. Okay, finally we like to end these sessions with a lightning round. So, we're going to run through a couple of questions and just ask for a quick answer. What was your first investment?

Kathleen McCarragher: Oh goodness. Okay. Does a paper portfolio count? When I was in fifth grade I had a paper portfolio. We were allowed, my father ran this, we were allowed to have three stocks. And every Saturday morning we would get out our graph paper and pull out the newspaper, because in that era that is where you found your stock prices. And we would plot on the X and Y axis the movement of the price over time.

And my three stocks were Disney, Coca-Cola, and something called Fair Foods, which I don't think existed for much longer than my paper lasted. My father, I recall, quizzically looked at me and said, you know, "Fair Foods? Why did you pick that?" And I said, "I liked the name." And he continued to look quizzically at me. And that was my first lesson. Name is not one of the criteria you use in picking stocks.

In terms of actual stock, it was AT&T in the '70s before the breakup into the Bells.

Betsy Gorton: Okay, great. Well, you might have just given us the answer, but your biggest lesson outside of the name not mattering as an investor, knowing that sometimes these lessons can come from good investments. And others from more challenging investments.

Kathleen McCarragher: I would characterize it as a good house in a bad neighborhood is probably not a great investment.

Betsy Gorton: And what do you mean by that?

Kathleen McCarragher: In my experience, it has come when there's an industry in change. And the industry might have had very attractive characteristics, and something has come into play that's leading to new pressures that are going to change the growth opportunities for that industry.

Classically, what you will find is a really good company as an industry is going through change can hold on for longer than less well managed or less robust companies. And it would be easy to be fooled into the idea, well, this company can outrun the secular changes in the industry. Because they often do for a period of time.

But if that company cannot significantly adapt or change to the new, if the industry changes overarching, then even a really solid, well managed company is going to struggle as that industry changes.

Betsy Gorton: And how about your biggest mentor? You may have also already answered this for us as well.

Kathleen McCarragher: Sig. No doubt. His ability to take in new information, his flexibility, his commitment to building the people around him to be the best they could possibly be, and his pure focus on client returns. Incredible.

Betsy Gorton: And what's the best piece of investment advice you can give our listeners that you really wish someone had given you when you were starting out?

Kathleen McCarragher: Know what you know and what you can't possibly know. And try to lean into what you do know. And if something's running away from you on the upside and you don't know it and you don't understand it, that's okay. There are a lot of fish in the sea.

Betsy Gorton: Outside of the office, how do you like to spend your time?

Kathleen McCarragher: Oh, I love the outdoors. Hiking. Biking. Skiing. I've been involved philanthropically and involved in environmental organizations. I think we are at a point in this world where that's going to continue to be exceptionally important. I've also been involved in educational efforts, in particular with neurodiverse populations.

Betsy Gorton: And what are you most excited about in the world right now?

Kathleen McCarragher: I think technology is a positive. I think education and environment, the two I just cited, are long-term beneficiaries of what we learn as we go forward with this. And I just have an optimism about what will unfold.

Betsy Gorton: Kathleen, it was an absolute pleasure having you on the show. Thank you for joining us and sharing your perspectives.

Kathleen McCarragher: Thank you, Betsy.

Betsy Gorton: And thank you all for listening to this special episode of Goldman Sachs Exchanges - Great Investors. This podcast was recorded on May 13th, 2024.

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