

EQUITY

Three Tenets for Investing in Innovation

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With global economic growth experiencing a slowdown this year, some investors may be concerned about valuations for the innovative companies that have been popular during the past decade. Against this backdrop, Franklin Equity Group's Matt Moberg explains why he thinks select companies have the potential to grow faster than the overall market in the next decade and beyond. He also shares his team's three guiding principles for investing in these companies.

As we move closer to 2020, we've received more questions from growth-minded investors about whether it's still a good time to invest in innovation. In many cases, these investors seem to doubt companies focused on shaking up the status quo can perform as well in the decade ahead as they have during this one.

It's an understandable concern considering that some of these companies have grown to be among the largest in the world, based on market capitalization. In many cases, these larger companies have become household names and are now the most widely covered by the media and equity analysts. As such, they tend to get critical attention for their valuations, particularly during periods of decelerating global growth.

Why We Think the Market Often Misprices Innovation

When we look across the global investment landscape, we see innovation accelerating at a faster pace than ever. We seek to invest in innovative companies with the vision to navigate the pace and scale of change and deliver sustainable growth.

We focus on companies with superior management, strong business models and exposure to secular tailwinds for growth. In our view, some are generational companies that have the potential to grow faster than global gross domestic product through 2030 and beyond.

Since 1968, we have developed and refined a process for investing in innovative companies. We follow three guiding tenets:

1. Innovation Drives Long-Term Wealth Creation

We see innovation as the main driving force behind value creation in the global economy. In our view, we are in the middle of a period of unprecedented innovation. New technologies, new processes and new modes of communication are changing the way we shop, communicate, travel, experience technology and live our lives.

Today's global economy reminds us of a period in the US economy in the late 1800s. Back then, the harnessing of electricity and the invention of the telegram, photography and the internal combustion engine spurred growth across industries.

These days, we believe we are living in a period of unprecedented innovation, sometimes referred to as the fourth industrial revolution. We are particularly excited about the growth prospects for five technologically enabled themes that are developing across the marketplace:

- Global e-commerce
- Genetic breakthroughs
- Intelligent machines
- New finance
- Exponential data

Of all these themes, we are most excited about the potential for genetic breakthroughs, or the sequencing of a gene. The cost of gene sequencing—or mapping DNA for diagnostic and curative purposes—has fallen rapidly in recent years. We are particularly interested in companies within the diagnostics, gene editing and gene silencing arenas that will likely benefit from this dynamic.

2. Investing in Innovation Requires Active Management

Despite the promising outlook for these five themes, we believe active management is needed to manage this environment more than ever before. These themes are evolving at different paces and are becoming investable at different times.

That's why we think active management can prove its worth—guiding investors to these platforms when they intersect well with a good investment. We look for select investments in industries where the penetration rates are low, the total addressable market is huge, and the prospects for monetization are readily visible.

Thanks to Franklin Templeton's Silicon Valley headquarters, we benefit from interacting with some of the world's leading innovators. Our team is constantly reaching out to thought leaders across industries, and meeting with trailblazing companies to understand cutting-edge technologies and ideas that could have transformative potential. In the past, we have demonstrated new technologies (surgical devices, 3D rendering software, driverless cars) that have helped us understand market developments.

At the same time, our analysts conduct fundamental stock research to develop a deep understanding of the companies in the sectors and industries they cover. They meet management, speak with customers, analyze the competitive environment and become intimately acquainted with the products or services offered.

3. Innovation Is Everywhere

Innovation today is pervasive. It stretches across all areas of the global economy. As growth investors, we seek to invest in innovation regardless of sector, market capitalization size or geography.

As we mentioned in a [previous article](#), standard industry classification tends to miscategorize innovation. For example, many innovative new companies are assigned to the technology sector initially. As these companies evolve and mature, they may move over to their proper classification.

We don't think it's prudent to limit our investment decisions and wait for those reclassifications to occur. We see these misclassifications as an opportunity to distinguish ourselves from the marketplace.

Tying It All Together

Disruption has always been a defining feature of capitalism—but its current speed, complexity, and global scope are unprecedented. A company's ability to innovate has become essential—not simply to grow, but often to survive amid intensifying competition. Leaders must be able to identify trends with the potential to transform their industries and respond with products and strategies to compete and win in new markets.

Looking beyond traditional growth metrics to spot companies with the vision and skill to thrive in this new environment has never been more critical. Growth driven by innovation and creative disruption can accelerate fast and can often be sustained over long periods of time.

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Franklin DynaTech Fund

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These and other risks are described more fully in the fund's [prospectus](#).

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