Investment Commentary

Staying the Course through the Summer Doldrums – Opportunities for Long-term Investors

We have seen a significant increase in global market volatility over the past few weeks, with all major global indices experiencing substantial declines followed by an equally rapid recovery. For example, the MSCI World Index fell by 8% in USD from mid-July to the 5th August, but subsequently has risen by over 7% and is now down 1.5% from its high point of 2024. Similarly, our World Stars Global Equity strategy has recovered sharply since the first week of August. This includes a 26% rise in our largest holding of *Nvidia* from the early August low point.

We think that the market correction was a significant overreaction and are not surprised that our portfolio has rebounded strongly in the last two weeks. It has been a 'normal' summer doldrums sell-off after almost 18 months of good performance. Remember the third quarter of last year? We are at a turning point, consumers are clearly getting squeezed by inflation and rates, incomes are growing but have not caught up, but they will, and the Fed has told us they are standing by to cut rates as soon as necessary.

There are several reasons behind the sell-off. Concerns over the spending power of consumers have dominated the headlines across the US, Europe and China, with low-end consumers hardest hit by cost-of-living pressures. The normalization of interest rates has successfully brought inflation under control, in part by cooling the labour market, with concerns about a recession in key markets such as the US coming back to the fore. As we have said before, in the fairy tale Goldilock's porridge is just right but in real life economic date is always too hot or too cold.

Geopolitical tensions in the Middle East are acting as a pressure point, as is the reversal of the highly profitable trade of borrowing in Japanese yen and investing in overseas stock markets. On a company level, we have seen a desire to lock in profits in stocks that have benefited from exceptionally strong returns.

Also, year-on-year comparisons for many companies are difficult. For example, in its Q2 results LVMH was lapping +17% total revenues and +21% in fashion & leather from Q2 2023. Not even the largest luxury company in the world can grow at that pace two years in a row. We have many other examples. Investors are very focused on earnings growth for this year and next, so a slowdown in growth, whether it is due to cyclical/consumer squeeze or technical/difficult comparisons, is something that many market participants find hard to handle.

We had been anticipating a level of profit-taking in the market but we believe the extent of the recent moves is unjustified and that the derating has gone too far.

The labour market may be cooling but it is doing so from exceptionally strong levels and remains healthy, again, especially in the US. Inflation is moderating and wages are increasing, so we expect the pressure on consumers to lessen and the price/wage equation to reverse. The risk of escalation in geopolitical tensions remains real, but conflicts for now remain highly localised.

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Profit-taking is ultimately a part of normal market ebbs and flows. What is key is the fundamentals and what it means for the earnings of the companies we invest in. If we look at the latter, the recent second-quarter results have broadly been supportive of our holdings.

Within industrials, the reshoring of critical industries, the refurbishment of ageing infrastructure, the transition to net zero and the push to automation in the face of labour shortages are driving a once-in-a-generation uptick in demand. In healthcare, we are finally seeing the easing of previous capacity constraints in hospitals and the normalisation of post-pandemic demand, with strong R&D pipelines coming back to the fore. Consumers are curbing spending, but demand for travel and luxury remains healthy, whilst post-pandemic inventory destocking in categories such as spirits is approaching its end.

Finally, within digital transformation, the opportunity around artificial intelligence has fuelled unprecedented investment spending by key players raising concerns about whether this trend is sustainable. We believe it is. Companies are being rewarded with tangible returns on investment, reinforcing our view that our portfolio is well-positioned in today's environment.

We continue to actively monitor and manage the risk profile of the strategy. We have reduced the position in Nvidia on three occasions over the past seven months (December 2023, February 2024 and May 2024), to manage our exposure. We also took profits in some of our industrial holdings where valuations had become elevated. We reinvested the proceeds in stocks where we believe the market has overreacted to short-term pressures and ignored long-term structural dynamics. This was the case for some of our consumer holdings, which we added to, for example.

The other thing not to forget is that the geopolitical/trade/sanctions risk that is being priced in assumes no positive surprises. What if the US elections lead to a clear and uncontested outcome; what if the wars in Ukraine or Gaza give way to negotiation and resolution; what if China decides to continue its pragmatic approach to relations with Taiwan and avoid open confrontation; what if Iran's government follows more moderate policies or the Revolutionary guard takes over from the clerics? We do not invest on that basis but we do have views, and not everything will continue to be bad or get worse.

We expect to experience continued market volatility in the coming weeks, as investors wait for the US Federal Reserve to cut interest rates, during the remainder of the Q2 earnings season and the summer doldrums.

Ultimately this volatility creates opportunities for long-term investors to step in and buy great quality companies, at great prices. As we wrote in the third quarter of last year, *caveat venditor* – seller beware.

World Stars Global Equity

Our World Stars Global Equity strategy consolidated its performance in July down 0.8% in US dollar terms but is still up 15.6% year to date, continuing to outperform the main global indices. You can find our latest factsheet here.

The majority of our holdings reported strong second-quarter 2024 earnings but some profit-taking was inevitable after several months of strong returns.

Performance was led by aerospace systems and engines company *RTX*, which was up 17%. The company delivered solid earnings, with strong momentum in its commercial aerospace and defence businesses, robust order trends, and its GTF engine recall programme being executed within the expected timescale and cost.

In the healthcare sector, pharmaceuticals manufacturer *Roche* reported strong earnings with the roll-off of Covid-19-related revenues largely gone, fuelling the stock up 15%. The market's focus is now on the company's efforts to accelerate its drug development process, with positive early clinical trial data on its obesity products, and further news on the company's pipeline expected in its upcoming R&D day in September.

Life sciences leader, *ThermoFisher*, was up 11%, having benefited from receding headwinds. The company has now lapped peak Covid-19 revenues and demand from biotech customers is improving as funding conditions have started to ease again, paving the way for a more normalised level of growth going forward. It has invested some $23 billion of Covid-19-related revenue windfall in targeted capex and M&A, reinforcing its industry-leading position and placing it well for further share gains. Finally, mobile tower operator, *American Tower* was up 13%, benefiting from the expectation of lower interest rates and following a strong set of quarterly results.

On the negative side, there was profit-taking in the digital transformation sector, with semiconductor manufacturer *ASML* particularly hard hit on the back of concerns over deepening geopolitical tensions between the US and China, and the potential that the US government could impose further restrictions on what products it can sell to China. However, the company continues to see strong orders, with a backlog of €38 billion at the end of the last quarter and with key customer TSMC, the Taiwan semiconductor company, set to receive their first advanced EUV lithography system later this year.

Google's parent company, *Alphabet* was down 6%, despite posting 14% revenue growth during the quarter, with strength across its search and cloud business, as the market doubted the scale of capital investment being made by the company to remain competitive. Although such spending in the self-driving car business, Waymo, has yet to prove itself, there is clear evidence that investments more broadly in AI are generating very satisfactory financial returns.

Multi-Asset Income

Our Multi Asset Income strategy saw a positive return of 0.6% during July (up 11.8% year to date). This was achieved despite a 1.5% decline in our equity portfolio (up 17.6% for the year) but with our fixed income securities up 2.1% for the month (up 9.1% for the year) and a significant contribution by our fund investments up 8.8% for the month (up 9.7% so far this year).

The earnings' release season was positive for our equity holdings with some anecdotal evidence that US consumers are starting to feel the pinch from higher prices and interest rates (e.g. *Booking* -6.2%). However, volatility increased around release dates and companies that missed targets suffered. A disappointing economic recovery in China dampened the mood in some sectors (*Estee Lauder* -6.4% and *Siemens Healthiners* -8%).

Our fixed-income investments delivered a strong performance (see Emerging Market Debt commentary) helped by lower US Treasury yields but mostly some idiosyncratic stories. We also have been highlighting the undervaluation of our investment trust opportunities and as mentioned previously, have sought to capitalise with some purchases. Performance was strong across the asset class but *Biopharma Credit* (up 10.1%) and *Greencoat* UK Wind (up 10.4%) were standouts for us.

We continue to expect volatility to increase from very low levels with some extra risk during the low-volume trading summer months. The most recent set of economic data from the US points towards a slowdown for the consumer and labour market. However, all in all, the US economy has remained solid and our holdings have provided constructive outlooks for the remainder of the year. Our portfolio is well-placed to keep generating healthy returns with low volatility, supported by strong cash generation.

Emerging Market Bonds

Our Emerging Market Bond strategy was up 1.2% for the month and 7.3% year-to-date, both in US dollar terms. The 'soft landing' narrative gained momentum as US economic data pointed towards a softening in growth and inflation, which has increased expectations the Fed will cut interest rates later this year. You can find our latest factsheet here.

Performance was driven by the decline in US Treasury yields and idiosyncratic credit news. *WOM* (Chile; Communication) and its creditors agreed on a reorganisation process to maximise the value of the company. This includes a potential asset sale with expressions of interest being received from both strategic and financial buyers.

Trans-Oil's (Moldova; Agri-commodities) operational update highlighted strong volume growth driven by a rebound in crop yields in the Central and Eastern European region. The company also continued to proactively manage its balance sheet. It renewed and upsized its pre-export facility with international banks and development finance institutions, underscoring confidence in the business model and prospects.

Finally, our Turkish corporates *Koc Holding* (Diversified), *Turkcell* (Communication), and *Sisecam* (Industrial) had their credit ratings upgraded. The action followed the recent upgrade of Turkey's government bond rating by Moody's, which was the first in over a decade. This was based on a shift in the direction of Turkey's macroeconomic stabilisation policies.

Focus has turned to the US elections with implications for economic growth, inflation and Fed interest rate policy. This will drive the trajectory of the US Treasury yield curve and could provide bouts of volatility. Meanwhile, key emerging market elections in South Africa, Mexico and India are behind us. Importantly, underlying credit fundamentals are robust and the default outlook is in check. Additional support comes from bond supply and investor positioning, which remain light.

Today, our Emerging Market Bond strategy offers a 10.5% per annum yield to maturity (in US dollar terms) with a relatively short duration of 3 years. This comprises a 7.5% per annum income yield which provides a degree of visibility on future returns as well as capital appreciation potential given the average bond price is 95 cents on the dollar.

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